

The Effects of COVID-19 on Tax Administration in Ethiopia

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Abstract

The role of effective tax administration is vital to safeguard healthy business environment and promote economic growth. Ethiopian tax administration practice has shown improvement for the last five years, though it has started to be challenged due to COVID-19 outbreak. The aim of this study is to examine the effect of the pandemic on tax administration in Ethiopia. The researchers have made desk review using data gathered from websites, published articles, reports, and press conference release. The study result showed that before the pandemic, the country's tax administration has shown good progress in the past few years. If the pandemic is to stay for a long time, it has the probable effect of affecting over all public finance structure and well-being of the economy. To minimize these negative probable effects of the pandemic, the government should take appropriate measures such as improving cash-flow for business organizations and re-assess its medium- to longer-term fiscal strategies.

Key words: COVID-19, Tax Administration, Probable Effect

1. INTRODUCTION

Pandemics are epidemics (occurrence of disease beyond normal threshold) which can affect at least several countries on more than one continent. A noticeable characteristic of such risk is that it combines a low probability of occurring with high, potentially catastrophic, global impact. The most severe of the four flu pandemics in the last 100 years, the 1918 pandemic, killed 50 million-100 million people in a global population of less than 2 billion. In such a severe case, economic losses could amount to 4.8 percent of global GDP, or more than \$3 trillion (World Bank 2008). A moderate flu pandemic could have an impact of about half this amount; weak pandemics such as the 2009 H1N1 flu pandemic have economic impacts of less than 0.5 percent of GDP (Jonas, 2013).

The major reason for expansion of this pandemic is the growing international movement of goods, services, and people. Local and national public health authorities are increasingly tasked with coordinating internationally, but this is often a challenge. Globalization has outstripped the capacities of public health systems in many countries. Not only there is a booming trade in livestock and its products, but human mobility is dramatically greater than a hundred years ago as more people than ever travel domestically and internationally. More people visit countries and regions with poor public health systems (developing countries) and travel between these countries and high-income countries that have far stronger governance of veterinary and human public health (Jonas, 2013). Hence, COVID-19 is one of the pandemic that touched every corner of continents across the globe.

COVID-19 pandemic brought the third and greatest economic, financial and social shock of the 21st Century after Global Financial Crisis of 2008 (OECD, 2020). This shock brought a lot of problems including: termination in production and aborting supply chains across the world and a steep drop in consumption together with a collapse in confidence and result for business operation risk on business community, financial institutions and public finance. Particularly, the impact has many fold consequence on developing nations as compared to advanced economies. It overwhelmingly changed the manner in which individuals engage in work activities and go about their daily lives. The global supply chains are expected to experience significant disruptions, including through reductions in trade volumes, decline in foreign direct investment, lower consumer goods demand, a reduction in commodity prices, in loan collection, government tax revenue and general economic decline.

The pandemic has huge negative impact on business operation that will result for today's economic turmoil potentially more severe than we witnessed during the global financial crisis. The COVID-19 pandemic is a different kind of shock. Never before have modern economies shut down at the drop of a top. From day to day, many workers lost their jobs and paychecks. Restaurants, hotels, and airplanes all shrunk and consumers and businesses now face steep losses in income and potentially widespread bankruptcies as a result. These have great adverse implication for effective tax administration.

Effective tax administration ensures high compliance by taxpayers and efficient administrative costs relative to revenue collected. However, this administration is challenged by the pandemic.

This challenge has the tendency to increase due to quick rising number of COVID-19 cases around the world, with major adverse effects on health, mortality and economy. To fight the outbreak and the spread of the virus, countries are imposing unprecedented measures such as restrictions on the free movement of people and goods, and are shutting down large parts of the economy. The result is that economic activity has fallen sharply in many countries and increased global uncertainty has further eroded confidence and tax revenue collection.

In order to better understand the probable effect of COVID-19 and to provide suggestions that help to mitigate its negative effect on tax administration in Ethiopia, the authors have made desk review on the tax administration performance prior to the pandemic and measures taken by the government, pandemic's probable effects. The main objective of the study is to examine the effect of COVID-19 on Tax administration in Ethiopia. Specifically, the study:

1. examines the tax administration performance prior to COVID-19
2. identifies the major tax administration measures taken by the government
3. explores the probable effect of COVID 19 on tax administration

1. MATERIALS AND METHODS

This study used exploratory and descriptive research design in order to assess the probable effect of COVID-19 on tax administration in Ethiopia. The main purpose of exploratory study is that of formulating a problem for more precise investigation or of developing the working hypotheses from an operational point of view. The major emphasis in such studies is on the discovery of ideas and insights. As such, the research design appropriate for such studies must be flexible enough to provide opportunity for considering different aspects of the problem under study. Whereas, in descriptive research, the researcher can only assess what has happened or what is happening (Kothari, 2004). The study has adopted qualitative research approach. According to Hoepfl (1997), qualitative research method can be used to gain new perspectives on issues few or little is already known, or to gain more information that may be difficult to convey quantitatively.

The study used secondary source of data. Secondary data were obtained from document review of various reports and research results focusing on tax administration. These were gathered from websites, newspapers, published articles, government reports (NBE) and press conference release. The authors were unable to collect primary data due to movement restriction as a result of the pandemic. Content analysis was used to conduct the analysis and interpretation in this study.

2. RESULTS AND DISCUSSION

2.1. Tax Administration before COVID-19 in Ethiopia

Ethiopian Fiscal policy continued to focus on increasing tax revenue by strengthening tax administration and enforcement while covering a greater proportion of government expenditures from domestic resources. These government expenditures have largely been geared towards supporting capital expenditure and enhancing pro-poor social spending programs and safety nets. Even though, there is an improvement on the performance of tax administration as domestic revenue record shown a 15.5 percent annual growth while general government expenditure showed a 16.6percent increment resulting in a budget deficit equivalent to 2.5 percent of GDP

which was lower than the 3 percent of GDP target set in the GTP II plan and as well there is increasing trend on total tax revenue collection for the last five years (2015 to 2019) (NBE, 2019).

2.2. Major Response in Tax Administration amid COVID- 19

The pandemic COVID- 19 has resulted businesses to break around the globe. Different countries are looking to adjust their income, consumption and corporate tax systems to respond to worst scenarios. The frameworks that have been in place for decades to collect and remit tax payments are in many cases, the fastest way for governments to get relief to their citizens at a time when every passing day creates more economic disorder. This is true in Ethiopia, though there is difference on the magnitude of the problem.

Ethiopian government has taken different measures related to tax administration. Among these, the government of Ethiopia has issued different international cooperation call for international communities to fill its public financing gaps. Government's proposal is not limited to the country, rather for the continent too. This call has obtained swift response from international organization, such IMF with grant of \$411million, World Bank \$82.5 million, Bill Gate and Jackma foundation support, extending interest payment period for previously borrowed public debt from international funding institutions and getting medical equipment for fighting against COVID 19. In addition to these, the ministry of Revenue has taken different measures of precautionary for its employees and tax payers to maintain physical distance and keep personal hygiene.

Other mitigation measures taken by Ethiopian government were accelerated processing of VAT refunds to help in the cash flow of the private sector to enable them better manage the effects of COVID-19 on their businesses and tax exemption on importation of products related to curbing the coronavirus outbreak (KPMG 2020).

Furthermore government action towards removing penalties and tax liabilities with the purpose of subsidizing companies not to reduce employee is appreciable decision. On April 16, 2012 EC Council of ministers has decided to give mercy which is limited to the following time frame; from 2008 to 2011 EC, if their account is closed, they will be free from tax liability. For tax liability before 2007, their main tax, penalty and interest have got mercy. Whereas those, who have tax liability and that pays 25 percent of their tax liability can be free from interest. Besides, for those who will pay their entire tax liability, they will get 10 percent tax liability deduction.

2.3. The Probable Effect of COVID-19 on Ethiopian Tax Administration

According to OECD (2020) estimates stated by General Angel Gurría, shows that the lockdown will directly affect sectors amounting to up to one third of GDP in the major economies. For each month of containment, there will be a loss of 2 % in annual GDP growth. The tourism sector alone faces an output decrease as high as 70%. This business closures has the probability of reducing by 15% or more in the level of output throughout advanced economies and major emerging-market economies. In the middle level economies, output would decline by 25%.

Due to the aforementioned factors many economies has the probability to fall into recession, if they are not working well to continue fighting the pandemic. This will in return brings negative

effect on tax revenue assessment, collection, enforcement and litigation. The difficulty of this public finance management leads to disabling the public health financing. As a result, if the government has no other source of finance for administering its basic expenditures, it will exacerbate the pandemic effect on the general wellbeing of the society.

In developing economies, without further debt accumulation and support from the global community, mobilizing government revenue targets will remain very challenging in general and specifically for Ethiopia. Ethiopian tax collection performance of the last 9 months is not satisfactory per its collection plan (www.fanabc.com). This gap will further exacerbate due to the decrease in investment activities. According to recent United Nations Conference on Trade and Development report (2020), global FDI is anticipated to be cut between 5% and 15% in 2020. In February 2020, the global completion rate of cross-border acquisitions fell below USD10 billion, from normal monthly values of around USD50 billion, which has severe implications on international trade and in return government revenue too not only for Ethiopia, but Africa as a whole, and especially countries that have outlined their medium-term growth strategies to be supported by large inflows of FDI.

Growth in Sub-Saharan Africa has been significantly affected by the ongoing coronavirus outbreak and is forecasted to fall sharply from 2.4% in 2019 to -2.1 to -5.1% in 2020, the first recession in the region over the past 25 years, according to the latest Africa's Pulse, the World Bank's twice-yearly economic update for the region (Ghanem, 2020).

COVID-19 will cost the region between \$37 billion and \$79 billion in output losses for 2020 due to a combination of effects. These include trade and value chain disruption, which affects commodity exporters and countries with strong value chain participation; reduced foreign financing flows from remittances, tourism, foreign direct investment, foreign aid, combined with capital flight; and through direct effects on health systems, and disruptions caused by containment measures and the public response (Ghanem, 2020).

Hence, if the pandemic is not controlled within a short period of time, it has the probable effect on disconcerting the overall tax administration performance in terms of tax assessment, collection, enforcement and litigations.

- i. Tax assessment;** if the challenges go to worst scenario, the government tax assessment will be challenged more because the normal operation of different economic sector will be interrupted and as a result makes a challenging task for the authority on tax assessment.
- ii. Tax collection;** the failure to conduct tax assessment has spillover effect on the subsequent tax administration functions. Because the failure to assess effectively, leads to distortion and ultimately may lead to waiver of different tax. This will result in decrease in government tax collection performance.
- iii. Tax law enforcement;** since tax authority is not in a position to conduct effective tax assessment and collection, it becomes difficult to enforce different tax laws enacted by the legislative body.
- iv. Tax litigation;** if the scenario goes with worst case due to failure to enforce the existing laws, the litigation process will not be fruitful. Even, for the betterment and

sustainability of firms existing firms and not reduce their employees, their previous litigation might be aborted in addition to current government action taken as a mercy up to 2008EC. As a result, it will lead to reduction in government tax revenue.

3. CONCLUSIONS AND RECOMMENDATIONS

The study was conducted with the aim of examining the tax administration performance prior to COVID-19, measures taken to reduce impact of COVID-19 and exploring the probable effect of COVID 19. To attain the stated objective, the researchers have used both exploratory and descriptive research design. Government has a key role in ensuring a vigorous business environment and promoting economic growth through effective tax administration. Tax administration should be effective, ensuring high compliance by taxpayers, efficient administrative costs and enhance revenue collected. Hence, government has to focus on the following tax measures. Improving cash-flow for businesses, re-assessing its medium- to longer-term fiscal strategies to achieve a balance between fiscal stimulus and fiscal consolidation, adapting to a new reality that unfortunately is still largely unknown. In addition, it is better if the government looks at the following suggestions to reduce the probable effect of COVID-19 on socio economic in general and tax administration in particular:

In connection to personal income tax, it is better to waive or defer employer and self-employed social security contributions as well as payroll related taxes by organizations. This will help for badly hit sectors and those affected by a shutdown to benefit from the waiver of payroll related taxes and social security contributions, paid by the employer or the self-employed, to immediately reduce labor costs. In order to reward people for working extra hours in potentially dangerous conditions, governments could provide tax concessions (e.g. exempting overtime income from taxation) or could incentivize retired workers to temporarily re-enter the workforce by ensuring that their pension entitlements are not affected. Particularly, this tax reduction and insurance coverage has to be provided for workers in health and other emergency-related sectors.

In connection to tax payer's service, since the nature of the pandemic appeals for physical distancing, Ministry of revenue should follow different strategies while they deal with tax filling, adjusting tax return, payment requirements, advance payment schemes, and refunds to taxpayers. This can be done by setting different shifts and providing additional time for dealing with tax affairs that will enhance taxpayer services and implementing clear communication strategies.

In relation to VAT administration, it is better to postpone payments of VAT, customs or excise duties for essential items imported, particularly on food, medicine, capital goods which is assumed to be relevant for helping and controlling the pandemic campaign with great careful administration of system or policy abuse. Furthermore, if there are better finance options, it is better to make it free till the pandemic is under control. To limit fraud risks or system abuse, it is better to speed up refunds of excess input VAT or simplifying procedures for claiming relief from VAT on bad debts.

In connection to business profit tax, adjusting the required advance payments of business income taxes on the basis of a revised expected tax liability that more closely approximates the taxpayer's likely final tax liability, taking into account the expected effect on business turnover

is recommended. In addition, waiving taxes that are levied on a tax base that does not vary with the immediate economic cycle, e.g. recurrent property taxes or business turnover taxes is suggested.

In addition to domestic revenue collection, assessment and enforcement, Ethiopian government has to look forward on its customs work for mitigating the effects of the COVID-19 Pandemic. In connection to facilitating Cross-border Movement of Relief and Essential Supplies, the ministry should: Coordinate and cooperate with other government agencies with the objective of speeding up the clearance of relief goods. Prioritize the clearance of relief consignments on the basis of a list of essential items. Clear relief consignments as a matter of priority, provide for the lodging of a simplified Goods declaration or of a provisional or incomplete Goods declaration, provide for pre-arrival processing of the Goods declaration and release of the goods upon arrival, apply risk management and perform inspections on relief goods only if deemed high risk. Ensure inspections by other government agencies and inspections by Customs are coordinated and, if possible, carried out at the same time. Advocate for or support the waiving or suspension of import duties and taxes for relief items.

In relation to Supporting the Economy and Sustaining Supply Chain Continuity; introduce tax relief measures, such as extending payment of duties, payment of duties in instalments, and duty drawback. Waive penalties for delays that are due to late arrival of commercial documents from exporting countries. Introduce facilitative measures with regard to the requirements to submit original documents or to stamp certain documents. Set up crisis teams to ensure the overall performance of Customs tasks. Take measures to guarantee personnel availability in the long term. Operate a 24/7 Customs clearance system. Create a Helpdesk to resolve issues faced by importers/ exporters. Apply risk management to keep physical inspections to the necessary minimum and speed up Customs clearance. Optimum use of non-intrusive inspection equipment. Designate priority lanes for freight transport and introduce measures to guarantee the supply chain continuity. Facilitate the continuation of transport by road, including for goods in transit, in cases where the driver of the means of transports has COVID-19 symptoms.

In connection to Protecting Staff and the society; provide personal protection equipment to staff, such as masks, gloves, sanitizers, etc, Apply physical distancing measures. Encourage the use of electronic services in conducting business with Customs. Ensure appropriate integration in the preparedness and response mechanisms of Customs administrations with health and safety responsibilities. Make COVID-19 related information available on official web-site and social media accounts. In this regard Ethiopian MOR and Custom authority has lagged behind, because they will not update their website timely. Share advance passenger information (API) with sanitary control authorities. Measure certain indicators and provide statistical data to the government to inform decisions in the response to the disaster. Intercept the trafficking of counterfeited medical supplies. Expand the tax-free import for the purposes of disinfectants production.

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