

# VAT and the FDRE Constitution: Is VAT Really an Undesignated Tax?

Gezachew Sileshi Chane\*

## Abstract

There has been a growing interest in the application of value added tax (VAT) on a global level. Yet the adaptability of VAT in federal systems has come to be a subject of discourse and experimentation in several countries. Ethiopia introduced VAT in 2002, and thereby, as federal state, faced issues of how best to design VAT in a federal set up. The introduction of VAT in Ethiopia was allegedly justified under the constitutional clause of “undesignated powers of taxation.” Though it was said to be undesignated tax power, practically speaking it has brought changes in the already existing distribution power of taxation by shifting part of states’ power of taxation over sales tax to the federal government. This article explores how VAT is adapted in the Ethiopian case both from practical and constitutional perspectives. It begins by reviewing the salient features of the constitutional provisions on tax allocation and description of the actual division of power of taxation between federal government and the states in Ethiopia, and then proceeds to the survey of the features of the VAT introduced in Ethiopia. The main focus is to explore the question of whether or not VAT was designated in the FDRE Constitution. In other words, it enquires into the issue of whether the introduction of VAT as undesignated tax power is in line with the

---

\* LLB (Addis Ababa University), LLM (Addis Ababa University), Assistant Professor, Bahir Dar University, School of Law.

constitution or not? After due analysis, the author concludes that the Ethiopian VAT legislation is not in congruity with the FDRE Constitution.

**Key Terms:** Value Added Tax, Sales Tax, Undesignated Tax

## Introduction

In a federal arrangement where two tiers of government operate side by side, responsibilities have to be properly shared and the power to raise the necessary financial power must also be divided. The assignment of revenue sources need to be carved out based on careful consideration. The interaction between taxation and federalism has assumed increasing importance.<sup>1</sup> This is especially true in regard to value added taxation (VAT), which is a relatively recent tax<sup>2</sup>.

It is noted that the spread of Value Added Tax (also called Goods and Services Tax – GST) has been the most important development in taxation over the last half-century; while the number of countries that adopted VAT was less than ten (10) until the late 1960s,<sup>3</sup> it has been adopted and implemented in over 160 countries in more recent times.<sup>4</sup> In spite of VAT's widespread adoption, there has been continuing contention about the

---

<sup>1</sup>See Bird, Richard M. and Gendron, Pierre –Pascal, VATs in Federal States: International Experience and Emerging Possibilities, March 2001, p.3-4, [herein after Bird & Gendron, VATs in Federal States]

<sup>2</sup> Organisation for Economic Co-Operation and Development(OECD)- Centre for Tax Policy and Administration, International VAT/GST Guidelines, February 2006, see preface, at at WWW <<http://www.oecd.org/tax/consumption/36177871.pdf>>, (accessed on 21 March 2015).

<sup>3</sup>Ibid.

<sup>4</sup> Visser, Amanda, OECD's Guidelines on Value-Added Tax Find Widespread Support, 05 MAY 2014 at WWW <<http://www.bdlive.co.za/business/2014/05/05/oecds-guidelines-on-value-added-tax-find-widespread-support>>, (accessed 07/07/2015).

implementation of VAT in a federal system.<sup>5</sup> The central question is whether VAT lends itself to proper execution at the state level in federations. Conventionally, VAT is considered a central tax<sup>6</sup> and this conception renders the regional states devoid of power over sales tax. In contrast, a renewed has arisen and growing interest among member states of federations as well as national governments for state participation in VAT.<sup>7</sup> In many federations, sales taxes (VAT or other alternative sales taxes) are the main source of revenue for states within their limited revenue power.<sup>8</sup> For instance, the sales tax accounts for more than 50 percent of total states' revenue in Brazil.<sup>9</sup> The view advancing sub national level/state level VAT goes on to say that while states exercise of taxing power over VAT has costs, these costs can be kept relatively modest and are plausibly offset by the advantages of local control.<sup>10</sup>

While the controversy continues in this way, recently Ethiopia has introduced VAT that has brought changes in the power of taxation. The main issue in this work is then how the VAT is adapted in Ethiopia from practical and legal points of view.

---

<sup>5</sup>Bird & Gendron, *Supra* note 1, p.2

<sup>6</sup>*Ibid.*

<sup>7</sup>*Ibid.*

<sup>8</sup>*Ibid.*, at 1.

<sup>9</sup>Ter-Minassian, Teresa, *Reform Priorities for Sub-national Revenues in Brazil*, Inter-American Development Bank, 2012, p.5.

<sup>10</sup>Bird & Gendron, *Supra* note 1, p.3.

## Overview of the Tax Power Configuration under the FDRE Constitution

The 1995 Constitution of Ethiopia created a federal structure Ethiopia,<sup>11</sup> departing from the long established unitary state tradition. The Constitution established two levels of governments-Federal Government and State Members- each vested with legislative, executive and judicial power of their own as a manifestation of their sovereignty.<sup>12</sup> The Constitution demarcates the powers and functions of both levels of government; enumerating the federal<sup>13</sup> and leaving the others to states accompanied by some lists.<sup>14</sup>

Then, what follows such allocation of responsibility is the question of the means to finance the respective responsibilities of different tiers of government. The way intergovernmental fiscal systems are organized varies from country to country.<sup>15</sup> There is no ideal assignment of taxes between central and lower levels of government. However, a set of ‘tax-assignment rules’ has been developed in the traditional fiscal federalism theory. These principles relate to the respective responsibilities of central and lower tiers of government in macroeconomic stabilization, income redistribution and resource allocation.<sup>16</sup> Moreover, the administrative capabilities of local governments in tax design (i.e., deciding on revenue bases and setting rates),

---

<sup>11</sup> Constitution of the Federal Democratic Republic of Ethiopia, 1995, Article 1, Proc.No.1/1995, Fed. Neg. Gaz., year1, No. 1, [herein after FDRE Constitution].

<sup>12</sup> Ibid, Article50 (1) & (2).

<sup>13</sup> Ibid, Article51.

<sup>14</sup> Ibid, Article52.

<sup>15</sup> Odd-Helge Fjeldstad, Intergovernmental fiscal relations in developing countries: A review of issues, Chr. Michelsen Institute Development Studies and Human Rights, CMI Working Papers, 2001, at WWW <<http://www.cmi.no/publications/file/871-intergovernmental-fiscal-relations-in-developing.pdf>>, (accessed 07/07/2015).

<sup>16</sup>Ibid.

and the issue of tax harmonization between jurisdictions is important when assigning taxing powers.<sup>17</sup>

The financial provisions of the FDRE Constitution have allocated revenue sources for the federal government and the states.<sup>18</sup> How the Constitution has dealt with perplexing task of assignment of taxes in federal systems is briefly addressed here. Under the FDRE Constitution, the scheme of tax power allocation displays important features: its fairly detailed provisions on revenue power division on designated taxes, and the manner it addresses the issue of future possible revenue sources (undesignated taxes) are the typical ones.

### *Tax Power Division of Designated Taxes in the FDRE Constitution*

The provisions under the FDRE Constitution embodying dispensation of revenue powers are divided in to four headings: the federal power of taxation,<sup>19</sup> state power of taxations,<sup>20</sup> concurrent power of taxation,<sup>21</sup> and undesignated power of taxation.<sup>22</sup> The constitution has gone to this extent providing detailed allocation of taxes differentiating the exclusive domain of each level of governments and also taxes that are concurrently given: As much as possible it endeavors to avoid ambiguity and possible conflicts that

---

<sup>17</sup> Ibid.

<sup>18</sup> FDRE Constitution, Supra note 11, Arts.96-98.

<sup>19</sup> FDRE Constitution, Supra note 11, Arts.96.

<sup>20</sup> Ibid, Article 97.

<sup>21</sup> Ibid, Article 98. N.B: The word “companies” under Article98 (2) is used to mean any business entity having its own legal personality including partnerships and companies. See the Amharic version.

<sup>22</sup> Ibid, Article 99.

may arise there from while this is not the case at least for some federal systems such as that of Canada<sup>23</sup> and Germany.<sup>24</sup>

By way of summary, the constitutional distribution of the taxation power among the federal government and the states is tabulated below.

Federal power of taxation (Art.96)	States' power of taxation (Art.97)	Concurrent power of taxation (Art. 98)
Custom duties, taxes and other charges on imports and exports	Income tax on employees of states and private enterprising	Profit, sales, excise, and personal income taxes on enterprise jointly owned by states and federal government.
Income tax on employees of federal government and	Land usufructuary right fees	Profits, and sales taxes (see the Amharic version of art. 98(2) on private

<sup>23</sup> For instance, it is provided in the Constitution of Canada that the provinces (states) are permitted to levy and collect direct taxes while the dominion (federal government) possesses unlimited power of taxation. It can raise revenue by any mode or system of taxations. Such broad and general provisions have a potential to create ambiguity and uncertainty as to the jurisdictional limitation of tax power. See Laskin, Bora, Canadian Constitutional Law: Cases, Text and Notes on Distribution of Legislative Power, 3<sup>rd</sup> ed., 1969, See Section91&92(see the appendix part).(herein after Laskin, Canadian Constitutional Law ).

<sup>24</sup>The German Constitution confers on the federal government and the Lander (state) concurrent power of legislation with respect to considerable types of taxes. This concurrent legislative power is non-coexistent in such a way that federal government may preempt the states from such fields of taxation where it feels that, with subjective appreciation; some conditions (such as where regulation by one state affects another) are met. In short, the states have power till the federal government tasks it over. Absent political goods faith and willingness, such disposition of revenue power could be a bone of contention. See The Constitution of the federal republic of Germany: essay on the basic rights and principles of the basic law (1989), Article72, p.288.

international organization		enterprises
Income, profit sales and excise taxes on federally owned enterprises	Income tax on private farmers and those incorporated in cooperative association	Dividends due to shareholders
Income and winnings of national lotteries and other games of chance	Profit and sales taxes on individual traders carrying out trade within their jurisdiction	Income tax from large scale mining and all petroleum and gas operations and royalties on such operations.
Income of air, rail and sea transport services	Income tax from transport service rendered on waters within their territory	
Income tax on houses and other properties federally owned and rent from same	Income from private houses and other properties within the states and rents from same	
Fees and charges relating to licenses issued and services rendered by organs of federal	Profit, sales, excise and personal income taxes on state owned	

government	enterprises	
Taxes on monopolies and federal stamp duties	Income tax royalty and land rentals on small scale operations fee and charges relating to license issued and services rendered by states organs	

*Table1. Taxes that are already allocated in the constitution per Articles 96, 97, and 98*

The lists of revenue sources are exclusive except those under concurrent power. In other words, those listed under Art.96 are only and solely exercisable by the federal government while those under Art.97 belong to the states only. Each level of government is expected to act within their own competence and one many not meddle with the other's taxing power. Given this quite comprehensive account on the division of revenue sources, the disputes that can possibly arise in relation to tax jurisdiction have been considerably reduced. However, specificity of the Constitution would hinder substantive tax reforms. It is now almost unavoidable that any serious tax reform at the national level must be preceded by a measure of constitutional amendment.<sup>25</sup> Another feature of the FDRE Constitutional dispensation of

<sup>25</sup> Taddese Lencho, Income Tax Assignment under the Ethiopian Constitution: ISSUES to Worry About, Mizan Law Review Vol. 4 No.1, March 2010, pp. 50-51.



tax power lies in the manner it addresses the issue of future possible revenue sources.

### *Undesignated Powers of Taxation under the FDRE Constitution*

Often federal constitutions allocate future revenue sources either to the federal government as in the Indian Constitution<sup>26</sup> or to the states as in the case of United States of America.<sup>27</sup> The FDRE Constitution framers refrained from advance disposition of taxes, and have opted for determination of revenue power on case by case basis. The Constitution has created a provision on undesignated taxes in which the House of Federation and House of Peoples' Representative, in joint session and by two third majority,<sup>28</sup> shall determine that the power over the new tax source in question. The houses may decide that the new tax source belongs either to the federal government alone or the states alone or else concurrently.

This scheme of designation of an undesignated tax power is even a departure<sup>29</sup> from the pattern of expenditure assignment under the Constitution. The mechanism could be viewed as a wise and far sighted arrangement. It provides the maximum flexibility in assigning new taxes by

---

<sup>26</sup> Basu, Draga Das, Commentary on the Constitution of India, 4<sup>th</sup> ed., Vol.4, 1963, p. 269,[herein after Basu, Commentary on the Constitution of India].

<sup>27</sup> Ibid.

<sup>28</sup> FDRE Constitution, Supra note 11, Article99.

<sup>29</sup> As per Arts.51 and 52 of the FDRE Constitution, the state possesses the residuary power and the power of the federal government is confined to those only expressly enumerated powers and functions. The logical deduction from such provisions gives the impression that residuary power of taxation is and should be vested to the states. However, Article 99 has done away with such inference.

weighing the attendant circumstances rather than rigid advance disposition. Taxes have not only revenue motives but also that they accomplish multitude of purposes. They are regulatory instrumentalities of a nation including redistribution and stabilization.<sup>30</sup> The nature of a tax as to its character (national/state) or its impact on economy and social welfare could not be ascertained in prophecy. Thus the mechanism of undesignated power affords the opportunity to evaluate each tax and dispose the power over there. Nevertheless, undesignated taxation creates uncertainty for both the federal government and the states. Moreover, such arrangement may also erode federalism either in favor of con-federal tendency or most probably towards unitary tendency since the states do not have direct access to control the decision making but the federal government that directly participates in the decision making through at least HPR. At any rate, the exercise of this power needs to be based on objective grounds. The revenue needs of the two levels of governments along with other factors must receive careful consideration by the houses.

Here are some taxes that have been allocated according to the joint decision of the two Houses.

**Taxes allocated as per Art.99 (taxes that were undesignated)<sup>31</sup>**

<sup>30</sup> Fjeldstad, Supra note 15, p.5.

<sup>31</sup> የኢትዮጵያ ፍዴራላዊ ዲሞክራሲያዊ ሪፑብሊክ የፌዴሬሽን ምክር ቤት፣ የፌዴሬሽን ድምጽ፣ ቅጽ 02፣ ቁጥር 01፣ ሚያዚያ 1998፣ገጽ 18 ይመልከቱ (ከዚህ በኋላ የኢትዮጵያ ፍዴራላዊ ዲሞክራሲያዊ ሪፑብሊክ የፌዴሬሽን ምክር ቤት፣ የፌዴሬሽን)።(Translation -The Federal Democratic Republic of Ethiopia, Voice of the Federation (Magazine), Issue 02, No.01., April 2006, p.18)[herein after, Voice of the Federation (Magazine)]

Taxes allocated to Federal Government	Taxes allocated to states
<ul style="list-style-type: none"> <li>• Income tax on interest from money deposit in bank.</li> <li>• Value added tax?</li> </ul>	<ul style="list-style-type: none"> <li>• Royalty from patent on individuals,</li> <li>• excise tax on individuals (traders),</li> </ul>

*Table 2. Taxes allocated as per Art.99 (taxes that were undesignated)*

Excise tax on private enterprise and royalty from patent on private enterprises are disposed as concurrent power of taxation.<sup>32</sup> The assignment of these taxes follows the constitutional trend that confers revenues from private enterprise concurrently.<sup>33</sup> Income tax on interest income from bank deposits (of money) is allocated to the Federal Government.<sup>34</sup> On the other hand, three taxes; patent royalty tax on individuals, excise tax from individual traders and state stamp duty go to the taxation power of states.<sup>35</sup> Excise tax and royalty on individuals also follow the constitutional disposition that designates individuals as states tax subjects. This disposition based the constitutional

---

<sup>32</sup> Ibid.

<sup>33</sup> FDRE Constitution, Supra note 11, Article 98(2).

<sup>34</sup> Voice of the Federation (Magazine), Supra note 25. The regulation of bank deposits might have substantial implication on macroeconomic management. This consideration appears to have influenced this designation.

<sup>35</sup> Ibid.

trend would not be bad but strict adherence may not be advisable as the constitutional trend tends to be skewed to the center.<sup>36</sup>

The other tax disposed by virtue of Art.99 is value added tax. The two Houses conceived value added tax as undesignated tax. With that assumption, it has been decided that both the power of levying and collecting value added tax resides with the federal government<sup>37</sup> provided that the revenue collected by the federal government from regional sales tax payers would be refunded back to the states.<sup>38</sup> Whether VAT is really undesignated or not will be analyzed later.

### *Overview of Current VAT System in Ethiopia.*

VAT may be defined as a tax assessed at each step in the production of a commodity, based on the value added at each step by the difference between the commodity's production cost and its selling price.<sup>39</sup> VAT belongs to the family of sales tax<sup>40</sup> (for details see section 2.1 below). It is an indirect tax.

<sup>36</sup> Gizachew Silesh, The Problem of Value Added Taxation in Federal Systems, the Option Taken in Ethiopia and the Constitutional Issue Related to It, unpublished LL.B thesis, Addis Ababa University, 2006, p.32, [herein after Gizachew, The Problem of Value Added Taxation in Federal Systems].

<sup>37</sup> የኢትዮጵያ ፌዴራላዊ ዲሞክራሲያዊ ሪፐብሊክ ሁለተኛው የህዝብ ተወካዥና የፌዴሬሽን ምክር ቤቶች ሁለተኛ ዓመት የስራ ዘመን 2ኛ የጋራ ስብሰባ ቃለ ጉባዔ፣ ሚያዚያ 3/1994 ዓ.ም፣ አዲስ አበባ፣ገጽ 2-6 )(የተጨማሪ እሴት ታክስ የፌደራል መንግስት እንድሆን የተወሰነበት)። (Translation-the Federal Democratic Republic of Ethiopia, Minute of the Second Joint Session of the House of Federation and the House of Peoples' Representatives, the second year(of the parliaments') working season, April 2002 ( the joint session in which VAT is decided to be within the exclusive power of taxation of the Federal Government), [herein after Minute of Joint Session of the Houses].

<sup>38</sup> Ibid, p.2 & 5.

<sup>39</sup> Garner, Bryan A.(ed.), Black's Law Dictionary, 7<sup>th</sup> ed., West Group, St. Paul, Minn., 1999(1<sup>st</sup> published 1891), p.1472[herein after Black's Law Dictionary].

<sup>40</sup> FDRE Constitution, Supra note 11, Article99.

As an indirect tax, the incidence finally falls on consumers.<sup>41</sup> To this effect, it operates through “tax credit mechanism” enabling firms to offset the tax they have paid on the input purchases of goods and services against the tax they charge on their sales of goods and service.

Though there is an increasing preference<sup>42</sup> for VAT to other alternative sales taxes, federalism and VAT constitutes an uneasy compromise due to cross border adjustment of input tax credit.<sup>43</sup> In a federal setting, the alternatives for state participation in VAT are:<sup>44</sup> (1) national VAT-uniform across the country with revenue sharing arrangement; (2) state VAT-levied and collected either with the origin or destination principle; or (3) joint national- state VAT with a national VAT uniformly imposed across the nation and the states set their own rates. Each of these alternatives has unique pros and cons.<sup>45</sup>

In the Ethiopian federal system, a national level VAT is chosen among the alternatives.<sup>46</sup> The VAT proclamation provides that the VAT is applied at a

---

<sup>41</sup> Black’s Law Dictionary, Supra note 35.

<sup>42</sup> Visser, Supra note 4; Organisation for Economic Co-Operation and Development (OECD), Supra note 2.

<sup>43</sup> Keen, Michael, VIVAT, CVAT, and All That: New Forms of Value –Added Tax for Federal Systems, IMF Working paper (wp/00/83), 2002, p.3.

<sup>44</sup> ...Options for VAT in the Indian Context, at WWW <[http://www.nipfp.org.in/media/pdf/books/BK\\_39/Chapters/6.%20Options%20For%20Vat%20In%20The%20Indian%20Context.pdf](http://www.nipfp.org.in/media/pdf/books/BK_39/Chapters/6.%20Options%20For%20Vat%20In%20The%20Indian%20Context.pdf)>, pp. 47-56.

<sup>45</sup> Ibid, the first one affords significant advantages both economic and administrative owing to its simplicity while at the same time it involves cost that are both economic and political. The second option affords the maximum autonomy to states to determine the tax base as well as the rate but would markedly increase administrative and compliance costs. The last one allows states to set their desired rate while uniform base is maintained across the country. But still administration and compliance costs are high.

<sup>46</sup> Minute of Joint Session of the Houses, Supra note 31.

uniform rate of 15% on all goods and services except zero rated ones and exemptions<sup>47</sup>. The federal government has assumed all the powers of (levying and collection) with respect to VAT, and the states have lost control over the tax bases and on tax rates. Neither the FDRE constitution nor any subsidiary legislation requires such complete uniformity. Of course, harmonized and standardized tax base is legally required via the financial administration proclamation<sup>48</sup> but still with the involvement and assent of the states and the federal government. There is, however, no such requirement with regard to tax rates.

Federal Inland Revenue Authority<sup>49</sup> (later reorganized as Ethiopian Revenue and Customs Authority, hereafter Authority) has the power of administering VAT throughout the country; leaving the states without any legally recognized role with respect to administration of VAT as well. It seems that the Ethiopian scenario is more centralized even as compared to some countries, like Germany, that are alleged to have offered “only a very minimal level of sub-national revenue autonomy.”<sup>50</sup>

---

<sup>47</sup> Value Added Tax Proclamation, 2002, Article 7(1), Proc. No. 285, Fed. Neg. Gaz., Year 8, No. 33, [herein after Value Added Tax Proclamation, Proc. No. 285/2002].

<sup>48</sup> Federal Government of Ethiopia Financial Administration Proclamation, 2009, Article 64 (1), Proc. No. 648, Fed. Neg. Gaz., Year 15, No. 56, [herein after Financial Administration Proclamation, Proc. No. 648/2009].

<sup>49</sup> Value Added Tax Proclamation, Supra note 47, Article 30.

<sup>50</sup> Perry, Victoria J., International Experience in Implementing VATs in Federal Jurisdictions: A Summary Fiscal Affairs Department International Monetary Fund, June 2009, at WWW <<http://www.citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.169.139&rep=rep1&type=pdf>> , (consulted 21 March 2015) , p.5, [herein after Perry, International Experience in Implementing VATs in Federal Jurisdictions].

For instance, Germany has delegated the administration of the VAT to the lander (states) albeit the criticism for inefficiency and duplication of efforts. The task of administering the VAT on behalf of both levels of government falls to the Lander. However, the Lander can

In administering VAT, the Authority has been operating through branch offices in regions.<sup>51</sup> But as the number of VAT registrants has increased, there has come an adjustment in which the states have gained delegated power to administer VAT in their jurisdiction beginning September 2005.<sup>52</sup> Since then, new VAT registrants are retained with regions while those who had already been under the administration of the Authority remain with it.<sup>53</sup> The states administer and retain the revenue from these new VAT registrants. This new adjustment affords some control over VAT for the states. It enables better supervision and enforcement. The issue of whether the Federal Government has this power to be delegator in relation to VAT is a point awaiting exploration.

Another remaining issue pertains to revenue sharing arrangement. In a federation where national VAT is preferred, the manner in which the revenue from that is shared should also be designed. Some states, for instance Canada, rely on consumption statistics in apportioning the revenue VAT from

---

choose only the form and operation of their tax administrations--they cannot alter the structure, base or rates of the VAT itself (or of the other taxes). Thus, The Landers collect and remit the revenue to the center for sharing the revenue there from.

<sup>51</sup> የኢትዮጵያ ፋዴራላዊ ዲሞክራሲያዊ ሪፐብሊክ የገቢዎች ሚኒስቴር፣ ከክልል ግብር ከፋዮች የሚሰበሰቡ የተጨማሪ እሴት ታክስ (VAT)፤ የቅድመ ክፍያ ታክስ(Withholding)፤ እና የጋራ ገቢዎች ለክልሎች ፈሰስ ስለሚደረግበት አሰራር የወጣ መመሪያ፣መስከረም 28፣1996 ይመልከቱ።(Translation-The Federal Democratic Republic of Ethiopia, Ministry of Revenue, Directive Issued on How to Refund VAT Collected from Regional States, withholding taxes, and Revenue from Concurrent Revenue Sources, September 28, 1996 E.C), [herein after, , Ministry of Revenue, Directive(1996 E.C). Also see Minute of Joint Session of the Houses, Supra note 32.

<sup>52</sup> Gizachew, the problem of value added taxation in federal systems, Supra note 36, p.59.

<sup>53</sup> Ibid.

the Harmonized Sales tax among the Maritime Provinces.<sup>54</sup> In Australia, the revenue from Goods and Services Tax/GST/VAT is distributed according to the grant formula from the common wealth to the state; a formula unrelated to the distribution of the base of the tax<sup>55</sup> while VAT revenues in Germany are split based upon redistributive equalization formulas.<sup>56</sup>

The revenue sharing scheme in the Ethiopian system is relatively straightforward. As discussed above, the revenue sources are assigned in three categories not by type of tax, but by the nature of taxpayer.<sup>57</sup> The sharing of VAT revenue follows this pattern. The Customs and Revenue Authority and its branch offices shall keep records showing the name of taxpayer and to which state or to federal government the taxpayer belongs.<sup>58</sup> The branches will segregate the taxes paid to each state and the Federal Government, and then they shall send to the Authority.<sup>59</sup> The Authority categorizes the VATs paid according to taxpayers, to each state and Federal

---

<sup>54</sup> Mclure, Charles E., *Coordinating State Sales Taxes with a Federal VAT: Opportunities, Risks and Challenges*, at WWW <[http://www.aaxadminorg/tta/FFS\\_Symposium/mulure.pdf](http://www.aaxadminorg/tta/FFS_Symposium/mulure.pdf)> (consulted 21 March 2015).

<sup>55</sup> Perry, *International Experience in Implementing VATs in Federal Jurisdictions*, Supra note 50. It is determined neither by the location of consumption nor of the production of goods and services, but rather by means of a formula determined from the estimated overall revenue capacity of each state, and, importantly, also based upon their expenditure needs.

<sup>56</sup> Ibid, p.3. VAT revenues are not split between each Lander and the federal government based upon the location of tax collection, consumer consumption, or production of taxable goods and services, but rather based upon redistributive equalization formulas. It is used to address equity concerns so as to diminish horizontal fiscal disparity.

<sup>57</sup> The Federal Government has the power to levy and collect sales taxes on imports and federally owned enterprises. States are empowered to levy and collect sales taxes on individual traders (unincorporated businesses) within their territory and on state owned enterprises. Both the Federal and State Governments possess concurrent power to levy and collect sales tax on jointly owned enterprises and private enterprises. See table 1 above. [refer to specific articles of the constitution]

<sup>58</sup> Ministry of Revenue Directive (1996 E.C), Supra note 51.

<sup>59</sup> Ibid, Article5.1.



Government; it then aggregates; and it will be sent to the entitled states, deducting administrative expenses,<sup>60</sup> within twenty days after the end of each month, accompanied by a letter informing the details.<sup>61</sup>

Likewise, the VAT from joint sources is distributed in a similar manner. The branch offices and the Authority record the name and address of the enterprise and aggregates the revenues accordingly.<sup>62</sup> The revenue will be shared among the Federal Government and the state in which the enterprise is incorporated if it is a private enterprise; or between the state and the federal government that are joint owners if it is from jointly owned enterprises.<sup>63</sup> The formula provided by the House of Federation for sharing joint sources will be applied.<sup>64</sup> The formula may change from time to time. But as an example, the 2006 formula provided by the House of Federation for sharing joint sources provides that with respect to sales tax (VAT) 70% will be to the Federal Government while the rest (30%) goes to the state concerned.<sup>65</sup>

---

<sup>60</sup> Five percent (5%) from the revenue of each state shall be retained by the authority for the purpose of refund to taxpayers; the 5% retention in excess of refund to taxpayers will be sent to the states within three month; the bank commission for the here and there of the revenue and other costs will be charged on the states, *Ibid*, Article4.1.

<sup>61</sup> *Ibid*, Article5.2

<sup>62</sup> *Ibid*, Article12

<sup>63</sup> *Ibid*, Article13. Although the term concurrent implies action in conjunction, the Federal governmental has in practice taken exclusive legislative and administrative power on these revenues.

<sup>64</sup> See *Voice of the Federation (Magazine)*, *Supra* note 31, p. 18.

<sup>65</sup> *Ibid*, Equity concerns arise from the current revenue sharing arrangement. First, the VAT introduced is origin based VAT. Input taxes paid in the state of origin are not channeled to the destination state. By its nature VAT is a consumption tax. It implies that the state of consumption is entitled for the tax on consumptions in its jurisdiction. In Ethiopian case the

Having said this much about the current VAT in practices, taken as an option to the problem of which level of government should take the power over VAT, now let us consider whether the option taken, national level VAT, is in line with the Constitution or not.

### **The VAT and the FDRE Constitution: Is VAT Really an Undesignated Tax?**

We have seen that VAT and some other taxes have been introduced as new sources of revenue by the decision of the two federal Houses. Taxes to be introduced in such manner should necessarily be new taxes that have not been given either to the Federal Government or to the States or concurrently. But is VAT really a new tax? Or does the Constitution embrace VAT in its tax provisions?

The Constitution has attempted to provide exclusive and distinctive division of power of taxation, as noted earlier. Nevertheless, this does not afford a complete guarantee that possible dispute would not arise. Indeed, disputes

---

state of production takes the input taxes paid on its products. The states are at different levels of development. Some may be net exporters while others are net importers. The difference in input taxes paid in state of origin might not be marginal. The net exporters, which are relatively at higher level of development, would collect VATs more than its consumers consume while the net importers, the least developed ones, lose revenues from their consumers. This by itself could contribute to the divergence of level of development. While some countries use VAT to redress equity problems, the Ethiopian contributes to the disparity. The other equity concern arises from the formula for distribution of VAT revenue from joint sources. Only the state of incorporation and the Federal Government are entitled to the revenue. However, it is true that corporations have the potential to aggregate huge revenues from different jurisdictions particularly if they operate in more than one jurisdiction through branches. Such huge revenue (in this case VAT) should have been distributed to all states though the special interest of the state of incorporation needs to be considered.

appear to be inevitable in federations. In this regard, Laskin, writing on Canadian Constitutional Law stated:

*No amount of care in phrasing the division of power in a federal scheme will prevent difficulty when division comes to be applied to the variety and complexity of social relationships. The different aspects of life in a society are not insulated from one another in such a way as to make possible a mechanical application of the division of powers.*<sup>66</sup>

It is logically and practically visible that attempts to exercise the powers allotted by constitutions frequently raise questions as to its meaning in relation to particular circumstances. It might be difficult for the federal government to make laws with a view to achieve national objectives without affecting, in some way, one or other subjects which the states were given exclusive powers.<sup>67</sup> Conversely, laws made by the states under the heads of jurisdiction given to them as exclusive power might frequently have direct implication, in some unexpected way, upon the enumerated powers and function exclusively vested to federal government.<sup>68</sup>

Thus, in a variety of circumstances, the problem of what amounts to an invasion of the field of one by the other would raise difficult questions of interpretation. The replacement of the preexisting manufacturer's tax<sup>69</sup> by

---

<sup>66</sup> Laskin, Supra note 23, p.4.

<sup>67</sup> Ibid.

<sup>68</sup> Ibid.

<sup>69</sup> See The 'Sales and Excise Tax Proclamation', 1993, Proc.No.68/1993, Neg.Gaz., Year 2, No.61.

VAT has led the issue of constitutionality of the VAT legal bases in Ethiopian federal system. The issue could be reframed as: could VAT be subject to new allocation under Article 99 as undesignated power of taxation? The Houses have decided that VAT is undesignated tax. The power to levy and collect VAT is now vested to the Federal Government by the decision of the Houses.<sup>70</sup> Whether VAT is one of the alternative forms of sales tax that could be subsumed under the constitutional phrase “[s]ales tax” as provided in Arts. 96, 97 and 98 or is it *nova species* (new) one necessitating new allocation under Art.99 remains questionable.

During the joint session of the two Houses to allocate VAT, most of the members of the Houses held that VAT is a new tax.<sup>71</sup> For them, the Constitutional allocation of sales tax in to federal and state power of taxation could not be interpreted to include VAT because of its unique features.<sup>72</sup> On the other hand, there were few members of the Houses who questioned as to whether VAT is a new tax.<sup>73</sup> The majority had been heedless to voices calling for consideration of the constitutional and other legal implications of VAT and finally VAT was assigned to the Federal Government by unanimous consent of members of the Houses.<sup>74</sup>

The Constitutional division of power with respect to sales tax provides that the Federal Government has the power to levy and collect sales taxes on

---

<sup>70</sup> Minute of Joint Session of the Houses, *Supra* note 37.

<sup>71</sup> *Ibid.*

<sup>72</sup> *Ibid.*

<sup>73</sup> *Ibid.*

<sup>74</sup> *Ibid.*, p.6.

imports and on federally owned enterprises.<sup>75</sup> States are empowered to levy and collect sales taxes on individual traders (unincorporated businesses) within their territory and on state owned enterprises.<sup>76</sup> The Federal and state governments are concurrently empowered to levy and collect sales taxes on jointly owned enterprises and private enterprises (incorporated businesses in the form of business organization).<sup>77</sup> The Constitution provides this dichotomy of authority over sales taxes. But what sort of sales tax does the Constitution purport to mean remains questionable. The question then is one of constitutional interpretation. Constitutional supremacy necessarily assumes that a superior rule is what the constitution says it is. How, then, can an objective meaning of constitutional provision be ascertained?

This scenario leads to academic discourse on constitutional interpretation. In legal parlance, there are different approaches to constitutional interpretation<sup>78</sup>

---

<sup>75</sup> FDRE Constitution, Supra note 11, Article96 (1) & (3). In relation to import and export, it simply reads taxes; which should include sales tax.

<sup>76</sup> Ibid, Article97 (4) & (7).

<sup>77</sup> Ibid, Article98. For clarity, see the Amharic version.

<sup>78</sup> For instance, Rober C. Post has identified three distinct theories of interpretation that compete for control of the

Constitution. He stated that “in one corner is a form of interpretation that strives to implement the Constitution through the articulation of explicit doctrinal rules. In a second corner is a form of interpretation that attempts to construe the Constitution to reflect the original intent of its Framers. In yet a third corner is a form of interpretation that reads the Constitution in a manner designed to express the deepest contemporary purposes of the people. Each of these three theories is immediately recognizable and familiar to those who practice constitutional adjudication. See Post, Robert C., "Theories of Constitutional Interpretation" (1990). Faculty Scholarship Series. Paper 209, at WWW

<[http://www.digitalcommons.law.yale.edu/fss\\_papers/209](http://www.digitalcommons.law.yale.edu/fss_papers/209)> , p.15, [ herein after, Post, Robert C., Theories of Constitutional Interpretation]; Ducat, Graig R., Constitutional Interpretation, 6<sup>th</sup> ed., 1996, p.66

but two tools of interpretation<sup>79</sup>-the “plain meaning” rule and the “intention of the framers”- seem to be the general modes of interpretation. The former embodies the notion that the words of the constitution are to be taken at face value and are to be given their ordinarily accepted meaning while the latter requires fidelity to what those who wrote the constitution intended its provision to mean.<sup>80</sup> The writer will now analyze the place of VAT in the FDRE Constitution from these approaches and from the perspective of the effect of the allocation of VAT as undesignated tax. Attempts shall be made to elucidate what the term “sales tax” mean in the Ethiopian Constitution.

***VAT as a Species of Sales Tax: In Search of the Plain Meaning of VAT within the FDRE Constitution.***

What does “sales tax” ordinarily convey? We may resort to taxation literatures in search of how sales tax is normally understood. To begin with, Bernard P. Herber, in his book entitled *Modern Public Finance*, describes sales taxes as “in *rem* taxes imposed on a market transaction base. They are impersonal and use only a particular market transaction as its base”.<sup>81</sup> He further provides a number of species under the generic term of “sales tax”. He divided sales tax into single stage sales taxes and multistage sales taxes.<sup>82</sup> The former embraces manufacturer’s tax, whole sales tax, and retail sales tax. Multistage sales tax includes turnover tax and VAT. The same classification is

---

<sup>79</sup> Ibid.

<sup>80</sup> Ibid.

<sup>81</sup> Herber, Berdinand P., *Modern Public Finance*, 5<sup>th</sup> ed., 1996, p.99, [herein after Herber, *Modern Public Finance*].

<sup>82</sup> Ibid.

adopted by John F. Due in his article entitled “alternative forms of sales taxation in developing country.”<sup>83</sup>

In like manner, there is ample literature defining VAT as a species of sales tax. H.L. Bhatia, in his book entitled *Public Finance*, begins discussion of VAT by defining it as follows: “VAT belongs to the family of sales taxes.”<sup>84</sup> “Therefore,” he goes on to say, “it would be helpful if we briefly distinguish between different forms of sales taxes and note the place of VAT in them.”<sup>85</sup> He maintained the above classification of sales tax. Bhatia’s definition of VAT is also maintained by many others who have written in the field of taxation.<sup>86</sup>

However, it does not mean that someone scanning the literature would not face any confusing characterization of “sales tax” and VAT in the literatures. Herber, cited above, gives sales tax a much broader view to embrace even excise taxes.<sup>87</sup> The same understanding is upheld in some other books.<sup>88</sup> But it is clear that even such understanding of sales tax as inclusive of excise tax has the effect of broadening the scope of sales tax rather than narrowing down its reaches. It gives broader understanding without excluding VAT from the class of sales tax but still it denies the term sales tax exact meaning. Also,

---

<sup>83</sup> Due, John F., *Alternative Forms of Sales Taxation for a Developing Country*, in *Reading on Taxation in Developing Countries*, 3<sup>rd</sup> ed., 1975, p.309.

<sup>84</sup> Bhatia, H.L., *Public Finance*, 23<sup>rd</sup> ed., 2002, p.152, [herein after, Bhatia, *Public Finance*].

<sup>85</sup> *Ibid*.

<sup>86</sup> Brashares, Eidith, et al, *The distributional Aspects of Federal Value Added Tax*, *National Tax Journal*, Vol., No.2, 1988, p.156.

<sup>87</sup> Herber, *Modern Public Finance*, *Supra* note 81, p.244.

<sup>88</sup> *American jurisprudence*, Vol. 47, 1943, p.195.

Bhatia, after defining VAT as a tax belonging to the family of sales tax, stated on the same page that “the basic difference between VAT and sales tax is that the tax liability under VAT is split up into stages.”<sup>89</sup> He added that “like a sales tax, VAT can also be designed to have different forms...”<sup>90</sup>. Such phraseology gives the impression that sales tax and VAT belongs to different category of taxes instead of VAT being part of sales tax. It sounds a far stretched understanding of sales tax and VAT as mutually exclusive. These misleading descriptions often arise in writings whereby authors having specific type of sales tax in mind deal with sales tax *vis-à-vis* VAT.<sup>91</sup>

On the whole, in spite of the rare confusing description and use of the terms VAT and “sales tax”, in essence, either VAT or any of the alternatives in sales tax refer to a consumption tax imposed on a person that carries a taxable transaction. The tax liability of a taxpayer arises from sale. The balance of the argument is in favor of the position that VAT is one form of sales tax.

This conception was asserted<sup>92</sup> during the Indian tax reform toward VAT in place of what the Indian Constitution calls “tax on the sale or purchase of

---

<sup>89</sup> Bhatia, Public Finance, Supra note 84, p. 153.

<sup>90</sup> Ibid.

<sup>91</sup> It seems that this author is arguing not based on the general conceptualization of sales tax but sticking on the sales tax that was in place in India by the time for call for reform. The Indian Sales Taxes were levied either at the 1st point /manufacturer’s sales tax/ or the last point of sale or purchase/retailer’s tax/. See Verma, L.C., Training Schedule with Material on VAT, Haryana Institute of Public Administration, Hipa Complex-76, Sector-18, Gurgaon, June-2002,p.10,at [http://www.persmin.gov.in/otraining/UNDPPProject/undp\\_modules/vat%20module.PDF](http://www.persmin.gov.in/otraining/UNDPPProject/undp_modules/vat%20module.PDF) (consulted 24 March 2015).

<sup>92</sup> Ibid, p. 39. It was stated that“VAT is nothing but a form of sales tax only and is charged at each stage of sale on the value added to goods.”



goods”.<sup>93</sup> In practice, the State’s Sales Tax Acts levied either at the 1st point (manufacturer’s tax) or the last point of sale or purchase (retail sales tax) in the State.<sup>94</sup> At the time of transition from these sales taxes to the state level VAT, it was held that “VAT is nothing but a form of sales tax only and is charged at each stage of sale on the value added to goods”<sup>95</sup>; sales tax is a state subject and the introduction of VAT could have been within the states own competence but VAT’s inter-jurisdictional implication compels resort to request the president’s blessing as he is empowered to supervise check posts and transit passes pertaining to cross border trade.<sup>96</sup> In other words, this writer is saying that VAT is sales tax and it is for a different reason (the inter-jurisdictional implication of VAT) that the regional states (in India) resort to the president for replacement of pre-existing sales tax with VAT.

This conceptual exploration may be concluded by citing what Richard A. Musgrave and Peggy B. Musgrave stated in their joint work “...the VAT is not a genuinely new form of taxation but merely a sales tax administration in a different form.”<sup>97</sup>

---

<sup>93</sup> The Indian Constitution authorizes the States to levy tax “on the sale or purchase of goods other than ...where such sale or purchase takes place in the course of inter-State-trade or commerce.” See Constitution of India, adopted in 1949, 1949, see Entry No.54 of List II of the Seventh Schedule of the Constitution of India as per Article 246(3) of the Constitution of India.

<sup>94</sup> Verma, *Supra* note 91.

<sup>95</sup> *Ibid.*

<sup>96</sup> *Ibid.*

<sup>97</sup> Musgrave, Richard A. & Musgrave, Peggy B., *Public Finance in Theory and Practice*, 4<sup>th</sup> ed., McGraw Hill Book Company, 1989, p.339.

From this conceptual understanding it is clear that sales tax is broader than VAT and embraces VAT. We may then arrive at the conclusion that the term “sales tax” in the FDRE Constitution includes VAT and as such VAT is a species of the designated sales tax in the Constitution. As the states are allocated with sales tax power in the Constitution, it follows that they are given power over VAT; constitution that vests the genus may not be interpreted to deny the species. It is the discretion and mutual consensus of the states and the Federal Government that matter as to which of the alternatives are to be taken (manufacturer’s tax, whole sales tax, retail sales tax, turnover tax or value added tax). And the mere fact that the Constitution does not mention VAT but the term sales tax would not make VAT undesignated tax. We could say that the Constitution has allocated sales taxes whichever form is preferred including VAT. Indeed, constitutional provisions are general by their nature. The details and form of sales tax among the alternatives is a matter to be determined by other laws. It could be said that the preexisting manufacturer’s tax that was replaced by VAT was opted only as a matter of alternative among others, and thus VAT is a designated tax like the manufacturer sales tax. Therefore, the argument that VAT is already allocated in the Constitution could be said to be a well founded one.

But others may rely on constitutional interpretation based on the intention of the framers of the constitution and pose the question can we reasonable say that the framers of the constitution had VAT in mind?

### ***Intention of the Framers of the Constitution***

Evidence of extraneous facts existing at the date of the constitutional drafting may in some cases help to throw light on the intention of the framers of the constitution though not conclusive. In searching for the intention of the framers of the FDRE Constitution, this researcher consulted the minutes of the Constitutional Assembly. But minute of the Constitutional Assembly does not have anything to say on what the phrase “sales tax” was intended to imply.<sup>98</sup> It does not provide indications as to whether the provision on “sales tax” implies manufactures sales tax, whole sales tax, retail sales tax, turnover tax or VAT.

Pondering on the intention of the drafters of the constitution, during the joint session of the federal houses to introduce VAT, it had been argued that had the framers were to mean sales tax to include VAT, they would have explicitly provided for it<sup>99</sup> and held that VAT was not depicted at that time. But is it because the predecessor manufacturer’s sales tax and the current turnover taxes are mentioned in the Constitution that we have these taxes without the issue of designation? Not at all; we infer these taxes from the generic “sales tax” provision. For instance, would a shift from manufacturer’s sales tax to retail sales tax or whole sales tax raise the issue of undesignated tax? It is unlikely.

---

<sup>98</sup> See Minute of the discussion on draft of the Ethiopian Constitution, Volume 5&6, November 1994. The author has revisited the Minute of the Constitutional Assembly. While lots of debates are documented on several of the draft provisions of the constitution including on the issue of royalty tax, no word uttered on the issue of sales tax.

<sup>99</sup> Minute of the joint session of the Houses, *Supra* note 37, p.6.

The FDRE Constitution does not prescribe sales tax to mean only manufacturer's tax or turnover tax or any of the alternatives observed in literature and in practice. Some unique technicalities in the administration of VAT might make it a bit unusual as compared to other sales taxes. In particular, interstate jurisdictional implication of VAT and input crediting scheme of VAT are notable peculiarities of VAT. The empowerment of states over VAT might result in market disintegration owing to the need for interstate border tax adjustment and the difference in rate set by each state.<sup>100</sup> A state may be required to provide credit for goods imported from other states at a higher rate than its own to which states are less likely to submit.

The unique aspect of VAT that requires input tax crediting may be radical and unexpected change for Ethiopia. The implementation of tax credit clearance system could be administratively costly and complex and even it might have been unknown to the framers. It has never been considered as alternative in our tax history; Ethiopian tax history, as can be gathered from proclamation No. 68/1993 and its predecessors,<sup>101</sup> reveals that previous taxes were manufacturer's tax and turnover tax or some other taxes. Applying the sales "tax clause" to VAT that might not have been imagined by the constitutional framers might appear to be odd.

Yet the stated peculiarities of VAT do not bring about conceptual fallacy; VAT is a sales tax in as much as it remains a tax based on sales of goods and services .i.e. the tax base is sale just like other alternative sales taxes. The

---

<sup>100</sup> Keen, Michael, VIVAT, CVAT, and All That: New Forms of Value –Added Tax for Federal Systems, IMF Working paper (wp/00/83), 2002, p.3.

<sup>101</sup> See The Sales and Excise Tax Proclamation, *Supra* note 69; see also Proclamation No. 205/1963.

credit system in VAT accomplishes the same goal that retail sales tax accomplishes through taxing only the final value of transaction transferred to the consumer so that there would not be cascading of tax.<sup>102</sup> Moreover, as any of sales taxes, VAT is a consumption tax measured as a percentage of sales price less purchase price. VAT's unusual features come into view only in relation to administrative technicalities which the constitutional framers need not be astute. If a VAT taxing the same value of goods as retail sales tax but by way of credit is held novel, retail sales tax that taxes the same base should also be held new.

Hence it is tenable to argue that the constitutional phrase "sales tax" in the Ethiopian Constitution should be interpreted broadly to include VAT. Most of all, it is a well-known principle that constitutions should be interpreted broadly. The general provisions of constitutions should be interpreted in such a manner as to accommodate new development. In this respect Justice Marshal once stated that "[i]t is a constitution that we are expounding."<sup>103</sup> Marshal propounds expansive interpretation of constitutions to accommodate circumstances born through time rather than mechanical application of provisions in constitutions. The FDRE Constitution has depicted tax on sales transaction, which is what VAT also does. Hence, the exclusion of VAT from sales tax category is not defensible.

---

<sup>102</sup> Due, *Alternative Forms of Taxation for a Developing Country*, *Supra* note 83, p.318.

<sup>103</sup> Ducat, *Constitutional Interpretation*, *Supra* note 78, p.130

Beyond that should we destroy the power of states over sales tax that have been intentionally given so as to provide the Federal Government with a probably an unanticipated power?

***Power over VAT and Power over Sales Tax: Destroying the Express Power of States to Legislate on Sales Tax?***

In this third approach of exploring whether VAT is really undesignated or not, we will see what VAT has brought in relation to the “sales tax” that was in effect. What power the states have with respect to VAT and what power had they had in relation to with the previous sales taxes which were replaced by VAT?

The VAT proclamation (proc .No. 285/2002) pronounces, in its preamble, the replacement of the existing sales tax by VAT. At the same time, this legislation provides that, again in its preamble, “in accordance with Art.55 (1) and (11) of the Constitution it is hereby proclaimed as follows”-proclaims VAT. It is true that subsidiary legislations must draw ultimate justification in the constitution at least for prima facie validity. The question here pertains to the issue of how far justified is the proclamation’s justification under Art. 55 (11)? Is it merely a symbolic frame of reference or constitutionally tenable?

Art 55(11) states that the House of peoples’ Representatives shall levy taxes and duties on revenue sources reserved to the Federal Government. Then, is VAT a revenue source reserved to the Federal Government? The validity of VAT being Federal revenue source is derived from the decision of the

Houses. The decision itself must cope with constitutional scrutiny for the VAT legislation to be constitutional.

The Houses generously conceded that VAT is constitutionally undesignated and at the same time and inescapably admitted that it replaces the existing sales tax.<sup>104</sup> Fortunately or unfortunately voices that called for consideration of constitutional implication of this replacement were ignored. The VAT legislation proclaimed on the basis of the decision of the Houses does not explicitly repeal state sales tax laws, if any. Nor does it explicitly require that the state parliaments should abdicate their power to impose and collect sales tax. It simply states the existing sales tax is replaced by VAT and Proclamation No.68/1993 is repealed.<sup>105</sup> It does not specify whether the replaced sales tax is that of federal or both federal and state sales taxes. In this case, given that this is a federal legislation, one would normally interpret it to mean only the previous Federal sales tax is replaced.

However, the proclamation by necessary implication has attempted to throw away states from their constitutionally asserted power of taxation. The minute of the Federal Houses decision, from which the VAT legislation draws its legitimacy, indicates that the parliamentary committee had come up with proposal stating “the constitutional provisions dealing with sales tax shall be read as VAT then after”.<sup>106</sup> The decision was adopted having that in mind. It

---

<sup>104</sup> Minute of the Joint Session of the Houses, Supra note 37, p.4.

<sup>105</sup> Value Added Tax Proclamation, Supra note 47, Article65.

<sup>106</sup> Minute of the Joint Session of the Houses, Supra note 37, p.4. One member had called for clarification on this issue and argued that as it stands the proposal amounts to amending the constitution without adhering to the amendments process but the other members simply

is clear that the Houses were abolishing an existing sales tax and replacing it by a “new” tax as long as they tagged VAT as a novel one. It implies that state sales tax laws are repealed and state parliament is bound to abdicate its power over sales tax as long as the decision of the Federal Houses vested power over VAT totally to the Federal Government.

The implicit exclusion was practically explicated. So far, the states have accepted<sup>107</sup> the federal VAT though it deprives<sup>107</sup> them discretionary control over the tax base as well as on the rate of the tax. Of course, the states had no role at the stage of VAT introduction; they were informed that a decision for national VAT was made after the Houses decision.<sup>108</sup> The federal legislation impliedly informed the states that they are ousted from the sphere of sales tax to the extent that their tax payers fall within the VAT threshold.<sup>109</sup>

Overall, the Houses’ decision is meant to budge the existing state sales tax power to the Federal Government. To do so would amount to constitutional

---

ridiculed the the question and replied that what matters is whether it should be to the federal or to the states. (Author’s translation of the minute).

<sup>107</sup> Gizachew, Supra note 36, p.78. After VAT was introduced, the states were consulted and they agreed to the national VAT.

<sup>108</sup> Minute of the Joint Session of the Houses, Supra note 37, p.5. Indeed, the Houses decided power over VAT after the VAT was drafted and was about to be promulgated, just as justifying background to the proclamation.

<sup>109</sup> Value Added Tax Proclamation, Supra note 47, Article 16. Obligatory Registration

1) A person who carries on taxable activity and is not registered is required to file an application for VAT registration with the Authority if -

(a) at the end of any period of 12 calendar months the person made, during that period, taxable transactions the total value of which exceeded 500,000 Birr; or

(b) at the beginning of any period of 12 calendar months there are reasonable grounds to expect that the total value of taxable transactions to be made by the person during that period will exceed 500,000 Birr.

2) The Minister of Finance and Economic Development may by directive increase or decrease the threshold provided for under Sub-Article 1. Even as regards turnover taxpayers the states power over sales tax is limited to power of administration only since the legislative power over there should be assumed by the Federal Government for the sake of uniformity.



amendment. Constitutional amendment, however, goes far beyond the consensus of the two Houses. The decision of the Houses cannot cope with constitutional scrutiny since the two Houses could not appropriate the power of States and assign same to the Federal Government. If that is the case, the VAT proclamation does not have constitutionally valid legal base. In a dual system, we cannot expect to find either government legislating for the other.<sup>110</sup> The federal parliament cannot repeal the states' sales tax laws, if any. It cannot repeal or suspend a law which it has no power to enact. It cannot legislate for states whether or not the states have failed to enact laws in their exclusive powers of taxation.

The decision of the Houses and the legislation there from are unlikely to be in congruity with the Constitution should the case be lodged for constitutional interpretation.<sup>111</sup> It is not undesignated power that the Houses designate. Whether we call it VAT or else, VAT in effect is the same as the previous sales tax. It replaces the manufacture's sales tax over which the states used to have their own share of power thereby ending states power over sales tax.

Should it be desired to shift power of "sales tax" from states and replace it with national VAT for any justifiable reason, the procedure should have proceeded according the amendment clause in Art. 104 and 105 of the

---

<sup>110</sup> Sawyer, Geoffrey, Cases on the Constitution of the Common Wealth of Australia, 1964, p.84.

<sup>111</sup> The FDRE Constitution bestows the power to interpret the Constitution to the House of Federation assisted by the Council of Constitutional inquiry. See FDRE Constitution, Supra note 11, Article 62 (1)&(2).

Constitution, and no other alternative seem to be legally tenable.<sup>112</sup> Whether the States would have conceded to it or not is another issue. The enthusiasts for VAT, nonetheless, did not want to follow that route.

### **Concluding Remarks**

The decision of the Houses and the legislation based on them are, at least in the opinion of the writer, unconstitutional. The power to decide as to the

---

<sup>112</sup> Delegation was suggested as a solution to get out of the constitutional hurdle during the introduction of VAT in Ethiopia. It was suggested that the states should delegate their power over sales tax to the federal Government. (see *Supra* note 23). But would such option have been viable in the eyes of the Constitution requires some inquiry. The FDRE Constitution provides for unlimited delegation from Federal government to the states whenever appropriate unless the nature of the power by itself is non delegable. (see Article 28&50(9)). The fundamental question then is whether there can be upward delegation and if so to what extent. The Constitution is not clear on this issue. It could be urged, however, that delegation from state to Federal Government is constitutionally impossible in as far as legislative power is concerned. In the first place, the very idea of upward delegation may militate self governance and self reliance of states. It may be a defeat to the rational of federalism. Secondly, It could be reasonably argued that a constitution that expressly provides for downward delegation could have done same as regards upward delegation had it been to mean that upward delegation is permitted. More important than other arguments, the minute of the Constitutional Assembly communicates the intention unequivocally. It provides, after hot debate on the issue, delegation will be only downward so as to assure and encourage state self-governance. See Minute of the discussion on draft of the Ethiopian constitution volume 5, November 1994, p 5.

On the contrary, doubt might arise when one looks at Article 94(2) of the Constitution . It reads "...unless otherwise agreed upon, the financial expenditures required for the carrying out of any delegated function by a state shall be borne by the delegating party." Here it appears that even the states may to delegate. But even if that is the case, what can be delegated is restricted as the languages of the provisions speak. Delegation under Article 50(9) (downward delegation) pronounces "powers and functions" while Article 94(2) reads "functions". The Constitution makes distinction as to the scope of delegation. The latter delegation is bare administrative function. Although the scope of functions may be hard to precisely demarcate, it is made obvious that states cannot delegate at least their legislative power as the minute clarifies. The ultimate conclusion is that, absent constitutional amendment, upward delegation is not possible and any attempt to delegate state legislative power would not bear fruit. The suggestion that states could delegate their power to the Federal Government for the introduction of national VAT would not have been viable and any future attempt will not be viable.

issue of constitutionality rests with the House of Federation. It will be a judge on an issue which itself has taken part in the decision in another capacity. The verdict would be challenging to the House. But to hold the decision and legislations constitutional would obviously be against the commitment of the framers that provide the states with legislative as well as administrative power over sales tax. In so far as the decision of the Houses entrusting the power over VAT to the Federal Government and legislations there from can hardly pass the test of constitutionality, future challenges are feasible from taxpayers and states.

From the taxpayers' perspective, no persons or property is subject to taxation absent valid laws to that effect. A tax payer may defend a proceeding against him pointing to the non-applicability/invalidity of the tax law. Mere submission by citizen when power is exercised illegally is not a bar to contest future proceeding. Thus in relation to VAT, taxpayers may raise as a defense in court proceeding by challenging<sup>113</sup> the validity of the federal tax legislations on VAT on state subjects of sales tax (individual traders).

From the perspective of regional states, notwithstanding the current practice, they may begin to challenge the continuation of national level VAT that denies discretion in setting tax base and tax rates in designing state sales tax. The states council can at any time come up with its own valid sales tax

---

<sup>113</sup> Of course, the challenge has already started. In 2006, some allegedly VAT payers in Tigray were prosecuted for VAT evasion. The defendants challenged the legality and applicability of the Federal VAT laws on them as they are subject of state sales tax. See Gizachew, *Supra* note 36, p.77, (but no information on the final outcome of the decision as it was pending).

should it want to make use of its constitutional power. This may be a reality when the states become strong and self-assertive through time and experience. The present harmony may also be attributed to the fact that the Federal and state governments are from same party. These good old days might wither away in the future.

No matter what the current practice or any agreement, if any, a state legislature could not bind itself not to legislate upon a particular subject matter constitutionally vested to it. All this tells us that only constitutional amendment is safe exit, if at all centralized VAT is indispensable.