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Legal Update

Tax Practice

New VAT Refund Directive No. 1132/2026

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Legal Update on the New VAT Refund Directive No. 1132/2026

Exercising the powers conferred upon it under Articles 48–51 of the Value Added Tax Proclamation No. 1341/2024(the "**VAT Proclamation**"), the Ministry of Revenue (the "**Tax Authority**") has issued VAT Refund Directive No. 1132/2026 (the "**New Directive**"). The New Directive repeals and replaces VAT Refund Directive No. 148/2018 (the "**Repealed Directive**"), thereby introducing a revised regulatory framework governing the administration of VAT refunds.

This legal update highlights the major changes brought by the New Directive.

1. Revised Rules on Refunds Relating to Zero-Rated Supplies

Under the Repealed Directive, a registered taxpayer was entitled to a refund where more than 25% of the value of taxable supplies in an accounting period consisted of zero-rated supplies and the supply is specified therein. The Tax Authority was required to process the refund within 45 days after submission of the VAT return.

Following the revised VAT Proclamation, the New Directive introduces two changes that align with similar amendments made in the VAT Proclamation.

- The threshold for qualifying zero-rated supplies has been increased from 25% to 50% of total taxable supplies; and
- The refund processing period has been reduced from 45 days to one calendar month, in line with the VAT Proclamation.

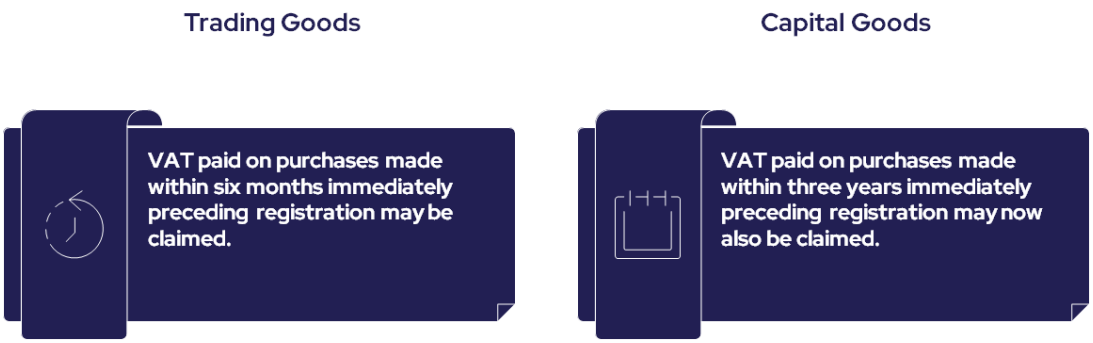
The New Directive further provides that refund requests must be submitted either within one year calculated from the relevant accounting period or from the date of filing the VAT return.

2. Two-Month Set-Off Rule for Withheld VAT Refunds

The New Directive provides a new requirement applicable to taxpayers to VAT withholding arrangements. Where taxpayers retain 50% of VAT or withhold reverse charged VAT and remit it directly to the tax authority, the amount indicated on the tax invoice or receipt issued to the taxpayer must first be credited against the tax paid or payable on the taxable supplies for two months. A refund is only triggered if an excess credit persists after the expiration of this two-month period. The tax authority is required to refund in 45 days. The Repealed Directive did not provide a two-months period requirement to credit the amounts related to withholding arrangements.

3. Expanded Recognition of Pre-Registration Input VAT

The New Directive expands the scope of recoverable pre-registration VAT. Under the Repealed Directive, VAT incurred prior to registration could generally be claimed only in relation to trading goods purchased within six months before registration. The New Directive broadens this entitlement by distinguishing between trading goods and capital goods:



The VAT paid in relation to capital goods and trading goods is required to be credited against the tax paid or collected on taxable supplies during the relevant accounting period, and where a credit balance remains, the excess becomes refundable. Refunds relating to pre-registration VAT are required to be processed within one month from submission of the refund request.

4. Operationalization of Input VAT Credits for registered persons with High Transaction Volume

According to Article 49(2) of the VAT Proclamation, a registered person is entitled to an immediate refund of unabsorbed input tax credits if two cumulative conditions are met:

- The annual value of the person's taxable supplies exceeds ETB 100,000,000.
- The excess credit arises from a creditable acquisition of capital goods.

The New Directive provides the implementation for this entitlement. Under Article 2(16), these entities are defined as "*Registered Persons with High Transaction Volume*". Article 4(5) mandates that once a refund application is submitted in respect of deductible capital goods, the Tax Authority must pay the refund within one month from the date of submission.

The provision allowing refund of input VAT incurred in relation to Projects with high investment cost which was defined under the Repealed Directive as "*a project established for provision of goods or services that would take more than three years before it starts to provide the goods or services and for which a cost of at least USD 100,000,000 is allocated*". This provision allowed investors to get VAT refund even before commissioning. The New Directive entirely removed this VAT refund framework for Projects with high investment cost.

5. New rule on Mixed-Supply Input VAT Thresholds

The New Directive introduces a new framework governing input VAT attributable to purchases used partly for taxable supplies and partly for exempt supplies. The Repealed Directive recognized only two ratios and denied refunds where the taxable-use ratio fell below 0.90. The New Directive adopts an express three-tier system based on the division of taxable supplies made during the accounting period by the total value of supplies:

Taxable Use Ratio	VAT Treatment	Refund Outcome
≥ 95%	Input VAT is treated as fully attributable to taxable supplies.	100% of input VAT refundable through the VAT carry-forward/refund mechanism.
> 5% and < 95%	Input VAT must be apportioned based on the taxable use ratio.	Partial refund permitted, limited to the proportion attributable to taxable activities.
≤ 5%	Input VAT is treated as predominantly related to exempt activities.	No refund available. Input VAT is non-recoverable.

6. Removal of Provisions Granting Refund Rights for Certain Areas

The New Directive has removed the provisions under the Repealed Directive that established the framework for the refund of input VAT incurred in relation to the following activities:

- Projects involving high capital investment costs;
- Mining and petroleum exploration activities that did not result in a successful discovery;
- The construction of condominium housing projects and projects undertaken by the Defense Foundation; and
- Leasing of capital goods by persons licensed by the National Bank of Ethiopia.

7. Refund Mechanism Following Audit and Investigation Decisions

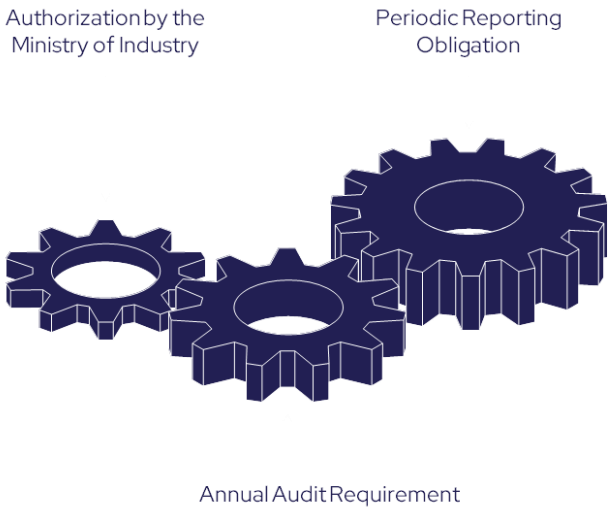
The preamble of the New Directive acknowledges the necessity of *responding to refund requests arising from refund decisions issued by various work units.* Accordingly, per Article 8 of the New Directive the Tax Authority is mandated to process refund requests arising from decisions issued by *tax audits, investigation audits, service audits, and other work units*. This provision establishes the two-tier timeline:

- *Filing Deadline*: The taxpayer must submit the formal refund request within six (6) months from the date the audit or investigation decision was received.
- *Processing Deadline*: The Tax Authority must issue the refund within forty-five (45) days from the date of the request.

8. Expedited Refund for Exporters

As under the Repealed Directive, the New Directive retains an accelerated VAT refund regime for qualifying exporters under Article 2(22) and Article 10. However, the New Directive establishes a more detailed framework governing the administration and oversight of the accelerated refund process.

The principal changes introduced by the New Directive are as follows:



1. Authorization by the Ministry of Industry: Eligibility for the accelerated refund regime is not available to all exporters. The New Directive limits eligibility to direct and indirect manufacturing exporters that have been specifically selected and authorized by the Ministry of Industry. While the accelerated refund mechanism itself has been retained from the Repealed Directive, the requirement for prior authorization by the Ministry of Industry is a new addition.

2. Annual Audit Requirement: the New Directive requires taxpayers benefiting from the accelerated refund regime to submit, at least once annually, documents and information evidencing that the goods have been exported and relating to the commercial activity of the taxpayer for audit purposes. Where the audit reveals that a taxpayer has received a refund to which it was not entitled, the improperly refunded amount will be subject to recovery by the tax authority.

3. Periodic Reporting Obligation: The New Directive introduces a reporting obligation requiring the tax authority to submit semi-annual implementation reports on the operation of the accelerated refund regime to both the Ministry of Industry and the Ministry of Finance. No equivalent reporting requirement existed under the Repealed Directive.

9. Enhanced Compliance Requirements for Special Rights Organizations

Diplomatic missions, consular offices, international organizations, foreign governments, and entities benefiting from VAT privileges under international agreements continue to obtain relief through the refund mechanism rather than through direct exemption at source.
The legal basis for this treatment is found in Article 51 of the VAT Proclamation, which authorizes the Tax Authority to grant VAT refunds to diplomatic missions, consular offices, international organizations, and foreign governments.
The New Directive introduces more stringent procedural requirements and notable limitations on the refund process, including:

- Minimum Refund Threshold: No refund will be granted where the VAT amount indicated on a single invoice is less than ETB 100.

- Shortened Filing Deadline: Refund applications must be submitted within one month from the date stated on the supporting invoice or receipt. The Tax Authority may extend this period for up to six months where the applicant provides compelling and adequately documented justification. Claims submitted after the applicable deadline will be rejected. Under the Repealed Directive, refund claims could be submitted within a period of up to one year.

10. Refund Suspension for Failure to File VAT Returns

The New Directive expressly authorizes the tax authority to withhold payment of VAT refunds where a taxpayer has failed to file VAT returns for one or more accounting periods. Refund payment remains blocked until all outstanding filing obligations are fully undertaken. This new rule operationalizes the similar rule provided under Article 17 of the Council of Ministers Value Added Tax Regulation No 570/2025 (the "VAT Regulation").

11. Mandatory Stamping of Processed Invoices

The New Directive introduces a new anti-fraud safeguard requiring all invoices submitted in support of a VAT refund claim to be officially marked after processing.
Invoices must be stamped as:

- "Refunded";
- "Rejected"; or
- "Held".

Where an invoice is marked as "Held," the taxpayer may subsequently provide acceptable supporting documentation to address the underlying issue. In such cases:

- the invoice may be reconsidered; and
- the taxpayer retains the original submission date and filing position.

12. Restriction on Refunds for Large Cash Transactions

The New Directive renders any cash transaction exceeding ETB 50,000 categorically ineligible for VAT refund, thereby leveraging the tax framework to enforce broader financial transparency and bank-intermediated traceability. This provision is aligned with the restrictions introduced under the Federal Income Tax Proclamation No. 1395/2025.

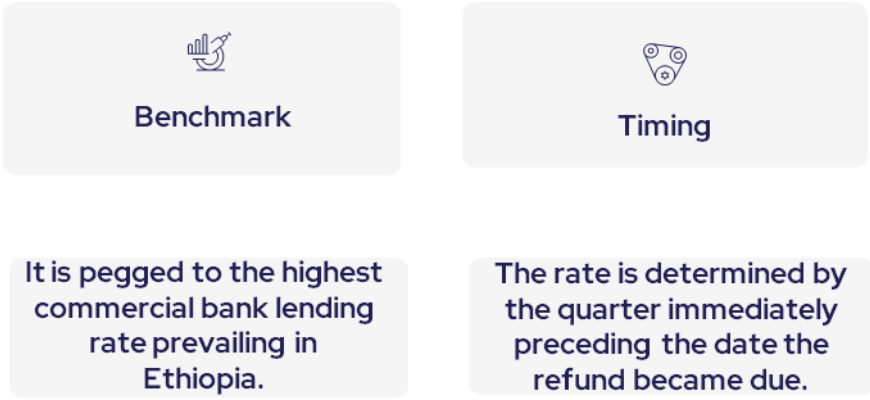
13. Establishment of a VAT Refund Reserve Fund

The New Directive introduces a VAT Refund Reserve Fund, requiring the segregation of 10% of monthly VAT collections into a dedicated reserve account. This measure appears intended to address longstanding liquidity constraints that have hindered the timely processing of VAT refunds and to ensure the prompt settlement of legitimate refund claims. The Directive further provides that amounts held in the reserve fund may be utilized to finance refunds of business profit tax where such refunds are authorized under applicable law.
The legal basis for this provision appears to be Article 18 of the VAT Regulation, which provides that the percentage of VAT collections to be retained by the tax authority for refund purposes shall be determined by a directive issued by the Ministry of Finance. Clearly, Article 18 expressly delegates the authority to determine the applicable percentage to the Ministry of Finance.

In light of this delegation, a question arises as to whether the Ministry of Revenues has the legal authority to prescribe, through the New Directive, that 10% of monthly VAT collections be allocated to the refund reserve fund. Since the power to determine the percentage of the reserve is expressly vested in the Ministry of Finance, it may be argued that the Ministry of Revenues has acted *ultra vires* by unilaterally fixing the reserve at 10% in the absence of a corresponding directive or authorization from the Ministry of Finance.

14. Interest on Delayed Refund Payments

The substantive right to interest is established by Article 50 of the VAT Proclamation and is procedurally operationalized by Article 14 of the New Directive.
According to the Directive's Article 14(2) and Article 50(2) of the Proclamation, the interest rate is not fixed.



Additional Procedural Requirement Introduced by the Directive: A significant procedural requirement introduced by the New Directive concerns the procedure for claiming interest on delayed refunds. The Directive appears to require the taxpayer to submit evidence of a court judgment establishing entitlement to the refund before interest can be paid.
This requirement raises both legal and practical concerns. Article 50 of the VAT Proclamation provides for the payment of interest on delayed VAT refunds and does not make that entitlement conditional on obtaining a court judgment. It may therefore be argued that the New Directive introduces a substantive limitation not contemplated by the Proclamation, thereby restricting a statutory right established by primary legislation.
The requirement is also difficult to reconcile with Ethiopia's tax dispute resolution framework, which generally requires disputes to proceed through administrative review and appeal mechanisms before reaching the courts. By conditioning the payment of interest on a court judgment, the New Directive effectively alters the ordinary dispute resolution process for this issue.
From a practical perspective, the requirement risks rendering Article 50 ineffective. Whether interest is payable on a delayed refund can ordinarily be determined by the tax authority itself

from its own records, without the need for a court action. Requiring taxpayers to obtain a court judgment imposes additional cost and delay, which may discourage taxpayers from pursuing relatively small interest claims and thereby undermine the statutory protection intended by the Proclamation.

Accordingly, there is a credible argument that the New Directive's requirement for a prior court judgment or similar adjudicative decision is inconsistent with both the text and purpose of Article 50 of the VAT Proclamation and may exceed the authority delegated to the Ministry of Revenues.

Conclusion

The New Directive significantly revises Ethiopia's VAT refund framework by introducing new eligibility criteria, compliance requirements, refund procedures, and processing timelines. While several changes are intended to facilitate refunds, others impose additional procedural obligations and restrictions on taxpayers. Certain provisions, particularly those relating to the VAT Refund Reserve Fund and interest on delayed refunds, may also raise questions regarding their consistency with the VAT Proclamation and VAT Regulation. Taxpayers should review their VAT compliance and refund practices to ensure timely access to available refund entitlements.

Disclaimer: This information is intended as a general overview and discussion of the subjects dealt with. The information provided here was based on New VAT Refund Directive No. 1132/2026 and is final and accurate as of the day it was posted; however, the law may have changed since that date. This information is not intended to be, and should not be used, as, a substitute for taking legal advice in any specific situation. Mehrteab & Getu Advocates LLP is not responsible for any actions taken or not taken based on this information. Please refer to the full terms and conditions on our website.

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