



**St. MARY'S UNIVERSITY
SCHOOL OF GRADUATE STUDIES
MBA IN ACCOUNTING & FINANCE**

**THE PRACTICE AND CHALLENGES OF TAX ASSESSMENT OF CATAGORIES
“A” TAXPAYERS. A CASE OF AKAKI KALITY SUB CITY ADDIS ABABA CITY
ADMINISTRATION**

**BY
FITSUM ABERA**

**June, 2016
Addis Ababa**

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**A Thesis Submitted to the School of Graduate Studies of St. Mary’s University in partial
fulfillment of the requirements for the Degree of Master of Business Administration
(MBA) in Accounting and Finance.**

Advisor: Asst.Prof. Shoa Jemal

**June, 2016
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DECLARATION

I, Fitsum Abera declare that, this paper prepared for the partial fulfillment of the requirements for (MBA) in Accounting and Finance entitled “**The practice and Challenges of Tax Assessment of Categories “A” Taxpayers: A Case of Akaki Kality Sub city Addis Ababa Administration** ” is prepared with my own effort. I have made it independently with the close advice and guidance of my advisor.

Fitsum Abera

Signature_____

Date_____

CERTIFICATE

This is to certify that Ato Fitsum Abera has carried out this research work on the topic entitled **“The practice and Challenges of Tax Assessment of Categories “A” Taxpayers: A Case of Akaki Kality Sub city, Addis Ababa City Administration”** under my supervision. This work is original in nature and it is sufficient for submission for the partial fulfillment for the award of MBA in Accounting and Finance.

Shoa Jemal (Asst.Prof)

Signature_____

Date_____

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ABSTRACT

The prevalence of poverty in developing countries like Ethiopia demands improvising internal revenue generating projects particularly the tax administration to reduce dependence on foreign aid and borrowing. The goal of this study is to investigate tax assessment practice and challenges with regard to categories “A” taxpayers found in Akaki Kaliti Sub city. Descriptive survey was employed. Questionnaire and interview were used to collect data from 50 tax auditors and seven Revenue Authority officials respectively. The result of the study revealed that the information gathered witnessed that there exist inefficiency and insufficient number of tax assessment officers in the Akaki Kaliti sub city administration and extensively used comprehensive types of audit. Due to this the audit coverage of the revenue authority was too low, cases were selected based on associated risk but not used the standard risk identification criteria as of BPR. The Authority was not performed the audit work in predetermined time. Generally, the revenue authority was not performing tax audit according to the standards.

Key words: Audit effectiveness, Tax Assessment, Tax Audit, Taxation

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ACRONYMS

| | |
|---------------|--|
| ERCA | Ethiopia Revenue and Custom Authority |
| SMU | St. Mary's University |
| BoFED | Bureau of Finance and Economic Development |
| ECC | Ethiopian Chambers of Commerce |
| RAP | Repetitive Audit Procedure |
| SIGTAS | Standard Integrated Government Tax Administration System |
| FDRE | Federal Democratic Republic of Ethiopia |

ABBREVIATION

| | |
|-------------|--|
| OECD | Organization for Economic co-operation and development |
| BPR | Business Process Reengineering |
| GDP | Gross Domestic Product |
| NGO | Non-Governmental Organization |
| VAT | Value Added Tax |

Chapter One

Introduction

A tax (from latin taxare: to estimate, which in turn is from tangere: to touch) is be defined as “ a compulsory contribution payable by an economic unit to a government without expectation of direct and equivalent return from the government for the contribution made” (Bhatia, 2003).

Tax administration refers to the identification of tax liability based on the existing tax law, the assessment of this liability, and the collection, prosecution and penalties imposed on recalcitrant taxpayers. Tax administration, therefore, covers a wide area of study, encompassing aspects such as registration of taxpayers, assessments, returns processing, collection, and audits (Kangave, 2005).

Tax administration therefore, should aim at improving on laws regarding the registration, assessment, collection revenue, and exploiting fully taxation potential of a country (World Bank, 1991).

In most developing countries, like Ethiopia, the revenue generated by the government is quite less than the expenditures spent. This low revenue yield of taxation can only be attributed to the fact that tax provisions are not properly enforced either on account of the inability of administration or on account of straight forward collusion between the tax administration and taxpayers.

In Ethiopia, tax is administered at federal or central and regional levels. The constitution of Federal Democratic Republic of Ethiopia (FDRE) has separated the tax revenue to be collected by federal government, state or regional government and jointly by the federal and state government. The regional government of Ethiopia collects taxes and revenue from privately own enterprise and organs of regional governments (FDRE Constitution Article, 97). Where as, the central government revenue collection organs are responsible to collect revenue of federal and jointly revenues owned by both the central government and regional governments from different organization including those owned by federal government. (FDRE Constitution Article, 96). The sharing of revenue between the federal government and regional government take consideration like; ownership of source of revenue, the regional character of the source of

revenue, convenience of levying and collection of the tax or duty, population, distribution of wealth, standard of development of each region; and other factors that are basis for integrated and balanced economy. (FDRE Constitution Article, 98).

The tax assessment for those, who are required to maintain financial records, is done based on the records that taxpayers maintain; however, if they fail to maintain financial records, estimated assessment will be done. For the rest of taxpayers, who are not required to maintain financial records, it is based on the standard assessment method (Council of Ministers, 2002).

Specifically, the objective of the study is to identify the main challenges and practice of tax assessment relating to categories “A” taxpayers of Akaki kality sub city administration.

The remaining discussion in this chapter are organized to have nine sections which is the introduction of the study consists of background of the study, definition of key terms, statement of the problem, research questions, objectives of the study, and significance of the study, scope of the study, limitation of the study and organization of the paper.

1.1 Background of the Study

Laymer and Oat (2009) noted that taxation is one of the important elements in managing national income, especially in developed countries and has played an important role in civilized societies since their birth was thousands years ago. It becomes an issue of worldwide concern, from the time of its inception. This is due, in great part, to effects on the life of virtually every human being. Taxation has gained importance not only as a tool for raising revenue but also help to meet the administrative costs of governance, the provision of public services such as medical care, education, infrastructure, security and maintenance of law and order, but also as a tool available to planners, policy makers and implementers aiming to regulate the economy in order to bring about desired economic development (Dymond, 2008).

Developing countries are in difficult situation to provide these basic public goods and services from taxes due to weak tax collection and administration (Damme, 2008). Tax administration is a complex and dynamic responsibility. On a regular basis, leaders are faced with new issues, conflicting priorities, taxpayer compliance and emerging commitments (Thomson, 2008).

In Ethiopia, Ethiopian Revenue and Customs Authority (ERCA) is the authority dealing with

taxes at federal level and there are different tax administrators at each sub city, which Akaki Kality sub city is the one. ERCA focuses on those people and vehicles that may involve in the act of bringing into or taking out of goods, which customs duty and taxes are not paid and whose importation or exportation are prohibited by law. The authority conducts investigation, audit and prosecutes offenders. In the attempt to discharge its responsibility, the authority closely works with Federal Police, Standardization Authority, Ministry of Health and Immigration Service and with other stakeholders. Taxes levied by central and regional government consist of direct and indirect taxes. Direct taxes are taxes including employment income taxes, business income tax, and taxes on royalties and chance winnings while indirect taxes are mainly composed of value added tax (VAT), excise taxes, and custom duties. Hence, proper assessment is one of the factors that enable the government to achieve its goals and programs. Besides, it reduces the country's dependability on foreign loan and donations.

This study aims at promoting the taxpayers to enhance their attitude towards the reason why tax paid helps in the contribution of building the country economy.

The law has classified the business income tax payers on business profit on to three major categories with respect to their legal personality and annual turnover as category A, B and C. Category "A", category "B" and category "C" taxpayers are classified as follows (Council of Ministers 2002)

Category "A", which shall include the following persons and bodies:

- Any company incorporated under the laws of Ethiopia or in a foreign country, for example Private Limited Companies Share Companies and;
- Any other business having an annual turnover of Birr 500,000 (Five hundred thousand Birr) or more;

Category "B", unless already classified in category "A", any business having an annual turnover of over birr 100,000 (One hundred thousand Birr);

Category "C", unless already classified in Categories "A" and "B", whose annual turnover is estimated by the Tax Authority as being up to Birr 100,000 (One hundred thousand Birr) (Council of Ministers, 2002).

There are ten sub cities in Addis Ababa that are engaged in administering taxes from Category "A" and Category "B" taxpayers. The different Kebeles found in each sub city are dealing with taxes collected from Category "C" taxpayers. The study focus is on category "A" taxpayers that are found in Akaki Kality sub city. This category is required to maintain proper books of account and other necessary documents for tax purpose (Council of Ministers, 2002).

Therefore, the main purpose of this study is to examine the tax assessment problems in tax administration. This will equip the tax assessor with applicable knowledge of determining of compliance to the taxpayers.

1.2 Definition of Key Terms

Tax

Tax is a compulsory levy which a government imposes on its citizens to enable it to obtain the required revenue to finance its activities. (Adesola, 1998)

Tax assessment

An assessment of tax is a notice of tax liability computed on that taxpayer's annual income/profit. (Australian National Audit Office, 1984)

Category "A"

Any company incorporated under the laws of Ethiopia or in a foreign country, for example Private Limited Companies, Share Companies and Any other business having an annual turnover of Birr 500,000 (Five hundred thousand Birr) or more.

1.3 Statement of the Problem

A government finances its expenditure through the fund acquired from the service given by the government, tax, loan, and donation. From all sources of finance, tax is the major source; however, in most developing countries, it is a common phenomenon to notice serious problems

in developing adequate tax systems that permits a government to sufficiently finance its expenditures.

Along with the growth in the overall Ethiopian economy, it has been observed that there has been an increased government spending and deficit financing. In principle, government could use both domestic and external sources of finance that a country can tap to finance the deficit. The government collected significant amount of revenue including grants, which could not fully finance the total expenditure. Without grants, the deficit could have been also about significant. This makes the borrowing and grant element of government's total expenditure counts too much. Of the external grant that constitute part of government revenue, almost half comes in the form of grant in kind (earmarked) and the remaining comes in the form of untied cash (IMF, 2006).

Table 1.1 Summary of General Government Finance (In Billion of Birr)

| Items | 2004/05 | 2005/06 | 2006/07 | 2007/08 | 2008/09 | 2009/10 |
|--------------------------------------|---------|---------|---------|---------|---------|---------|
| Total Revenue Including Grants | 18.9 | 17.7 | 17.1 | 16.0 | 16.3 | 17.3 |
| Domestic Revenue | 14.6 | 14.8 | 12.7 | 12.0 | 12.0 | 14.0 |
| Tax Revenue | 11.6 | 10.8 | 10.1 | 9.6 | 8.6 | 11.3 |
| Non-tax Revenue | 3 | 4.1 | 2.6 | 2.4 | 3.3 | 2.8 |
| Grants | 4.3 | 2.8 | 4.4 | 4.0 | 4.3 | 3.2 |
| Total Expenditure | 23.5 | 22.4 | 20.7 | 18.9 | 17.2 | 18.6 |
| Recurrent Expenditure | 12.6 | 11.6 | 10.0 | 9.2 | 8.1 | 8.4 |
| o/w Defence | 2.7 | 2.3 | 1.7 | 1.4 | 1.2 | 1.0 |
| Capital Expenditure | 10.9 | 10.7 | 10.7 | 9.7 | 9.1 | 10.3 |
| Poverty Oriented expenditures | 13.2 | 13.4 | 13.0 | 12.1 | 10.8 | 12.4 |
| Expenditure Deficit including Grants | -4.4 | -4.7 | -3.6 | -2.9 | -0.9 | -1.3 |
| Deficit Financing | 4.2 | 4.7 | 3.6 | 2.9 | 0.9 | 1.3 |
| External net | 2.2 | 1.1 | 1.1 | 1.0 | 0.9 | 1.1 |
| Domestic net | 3.3 | 2.1 | 3.6 | 2.6 | -0.1 | 0.5 |

Source: Ministry of Finance and Economic Development

Furthermore, due to the great encouragement and conducive environment like investment opportunities created by the Ethiopian government, new firms are emerging surprisingly;

however, the amount of tax revenue for the government is not increasing proportionately even every so often a decreasing trends was observed. Accordingly, huge unfavorable variance is observed in the performance report. Consequently, huge amount of money that should have been paid is not really given to the government, which in turn can be used to meet the various objectives of a government.

Moreover, the prevalence such significant deficits demands the government to improve internal revenue generating activities to reduce dependence on foreign funding. In principle, government could use both domestic and external sources of finance that a country can tap to finance the deficit. Perhaps the most commonly used is to take corrective measures on the potential problems of tax administration at each tax office.

In order to raise adequate revenue to minimize revenue shortfall, ERCA and the different subcity are working together. The Akaki Kality sub city tax authority has mandate to look into tax assessment, periodic declarations, records and book of account to be maintained and submitted by taxpayers. The ERCA conducts pre-audit assessment by the time these documents are submitted so as to perform timely collection. Moreover, the tax assessment and controlling core process owner has been conducting general assessment the time when it conducts comprehensive audits of business organization according to the general plan of the sub city.

This low revenue yield of taxation can be attributed to the fact that tax provisions are not properly enforced either on account of the inability of administration to cope with them or on account of straight forward collusion between the tax administration and taxpayer.

Tax administration has to secure compliance with the laws by applying an array of registration and assessment procedures. A government can keep taxpayers from doing understating their taxable income by sufficient amount, lack of clear understanding about the tax system, hostility between the taxpayers and tax officials, don't comply with their tax obligation, and thus successfully avoid tax evasion depends on the nature of economy's actual tax base. Tax administration therefore, should aim at improving on laws regarding the registration, assessment and exploiting fully taxation potential of a country.

Therefore, identifying the problems on tax assessment at each office and taking corrective measures need attention since they have adverse effects on the overall of the government. Accordingly, this study tries to identify the challenges and practice on the tax assessment of Akaki Kaliti Sub city administration.

1.4 Research Questions

1. What are the challenges faced the tax assessment?
2. How the ERCA select tax assessment techniques?
3. What are the factors that hinder effective tax assessment?
4. What are the existing performances of tax assessment in the ERCA?

1.5 Objectives of the Study

1.5.1 The General Objective

The general objective of this study is the importance of identifying the effects of tax assessment problems on revenue generation.

1.5.2 Specific Objectives

The specific objectives of the study:

1. To examine the challenges and practice at the ERCA.
2. To determine the selection of techniques for assessment.
3. To investigate factors that hinder effective tax assessment program in the ERCA.
4. To evaluate the existing performance of tax assessment.

1.6 Significance of the Study

The study provides a better understanding to tax administration and how they relate to the taxpayer. In addition it benefits:

- 1.6.1 The higher tax officials- since it have looked at the tax system and suggested area that needs improvement and maintaining. .
- 1.6.2 ERCA understands the existing tax assessment performance, evaluating tax assessment practice to make a number of adjustments in the procedure and reinforces the weakness of tax assessment practice.

- 1.6.3 It helps the stake holders and taxpayers to have knowledge on tax assessment.
- 1.6.4 It is an initiation for those who are interested to conduct detailed and comprehensive study regarding tax assessment practice.

1.7 Scope of the Study

The research encompassed carrying out an examination or inquiry, especially on tax assessment process regarding profit tax; value added tax and rental income tax.

The study has conducted the ERCA annual report from 2005-2006 on Categories “A” taxpayers of Akaki Kaliti Sub city. For this study, all audit staffs and higher officials are under the study.

1.8 Limitation of the Study

Due to lack of sufficient information and documentation from the taxpayers & authorities, the study focused only on Akaki Kaliti Sub City of Categories of “A” Taxpayers.

1.9 Organization of the Study

The research is structured in five chapters. The first chapter consists of introduction, statement of the problem being focused, objectives of the study, research questions, significance of the study, scope and limitation of the study and organization of the thesis. The second chapter is concerned with the review of different researches and related literature dealing with the assessment of Tax Audit. Third chapter is presented methodologies used in conducting the study and description of the study area, research design, data sources, sample size and sampling procedures, data collection instruments, data collection procedures and methods of data analysis. Chapter four is the main part of the study results and discussion of statistical data are presented in this chapter. Finally, chapter recapitulates the study in terms of summary, conclusions and recommendations of the study.

Chapter Two

Review of Related Literature

This section presents a brief review of existing theoretical and empirical literature of tax administration.

2.1 Theoretical Review of Tax Administration

Tax administration refers to the identification of tax liability based on the existing tax law, the assessment of this liability, and the collection, prosecution and penalties imposed on recalcitrant taxpayers. Tax administration, therefore, covers a wide area of study, encompassing aspects such as registration of taxpayers, assessments, returns processing, collection, and audits (Kangave, 2005).

The low revenue yield of taxation can only be attributed to the fact that tax provisions are not properly enforced either on account of the inability of administration to cope with them or on account of straight forward collusion between the tax administration and taxpayers. Since taxes are an involuntary payment for government services, taxpayers have a strong incentive to minimize their tax liabilities either through avoidance (legal) or through evasion (illegal). Tax administration has to secure compliance with the laws by applying an array of registration, assessment and collection procedures. A government can keep taxpayers from doing these activities, and thus successfully avert tax evasion depends on the nature of economy's actual tax base. Tax administration therefore, should aim at improving on laws regarding the registration, assessment, collection revenue, and exploiting fully taxation potential of a country (World Bank, 1999).

2.1.1 Legal Structure for Effective Tax Administration

The legal rules required for effective tax administration might be categorized under four broad headings:

- Rules for the establishment of an individual's tax liability;
- Rules establishing a system of appeals from the initial assessment of tax;
- Rules for the collection of taxes that have been established to be owing; and

- Rules relating to tax offences and their punishment. (Asian Development Bank, 2001)

The importance of a sound legal structure for effective tax administration and the importance of incorporating principles that will further tax compliance in the design of that legal structure. Since each stage of the administrative process is dependent upon the other, to achieve a significant improvement in the overall effectiveness of the tax administration each element of the legal structure needs to be designed for maximum effectiveness. In addition to the legal structure for tax administration, obviously, the organizational structure of the tax administration is also of crucial importance. According to the (Asian Development Bank, 2001), the range of issues that must be resolved, in this regard, include

- Agreement of autonomy from the executive branch
- Accountability to legislative assembly
- Relationship to the Ministry responsible for the tax legislation
- Type of organization structure in relation to taxes administered
- Decentralization
- Personnel policy
- Policies for internal audits
- Mission statement and strategic plan

2.1.2 Importance of Tax Administration

According to Asian Development Bank, 2001, tax administration dictates tax policy. Indeed, tax administration and compliance issues determine the broad evolution of tax systems. The shift in industrialized countries over a century ago from reliance on excise, customs and property taxes to corporate income and progressive income taxes can be explained, in large part, by the relative decline in the rural sector, the concentration of employment in large corporations and the growing literacy of the population. In recent years, the shift away from these taxes - corporate income and progressive individual income tax - and toward tax systems that rely more on broad-based consumption taxes such as the value-added tax, flatter rate structures, and the adoption of

“dual income taxes,” in which a progressive tax on labor income is accompanied with a low flat-rate tax on capital income, as adopted in certain Scandinavian countries, can be explained, in large part, by the forces of globalization and developments in financial innovation and the inability of tax administrators to develop technologies to cope with these forces and developments. In tax reforms there is a close correlation between successful tax policy and efficient tax administration. In other words, there is no good tax policy without efficient tax administration (Jenkins, 1994). Over the past century, changes in the size of governments themselves, and differences in the relative size of governments around the world, can be explained by changes and differences in the environment, resources and technologies available to the country’s tax administrators. Aside from the role of tax compliance and administrative issues on the evolution and general features of the tax system, there is no question that administrative considerations influence, and often impose decisive limits, on particular tax laws. Most obviously, the failure to tax all sources of economic power, such as the imputed rental value of homes or accruing capital gains, are often justified by reference to practical concerns of administer ability. It is futile to design a complex and sophisticated response to a tax policy problem if the rules to implement the regime cannot be administered. Ensuring that taxes are collected from those who owed them has always been an elusive challenge for tax departments. It has never been easy to collect taxes from lawyers who take cash for a Saturday office visit; waiters who receive most of their income as tips; landlords who collect rent in cash; small business people who skim part of their profits or hire people off the books; cash-only window cleaners, roofers and painters; or large corporations that contract out to sweatshops. It has been even more difficult to collect taxes from crack, cocaine dealers, smugglers, hit men and hit-women, and those who make their living defrauding and extorting their clients. The underground economy has always been diverse and even faster than these examples suggest. However, as if these traditional forms of tax evasion were not challenge enough, the combined effects of information technology and globalization is now alleged to allow those who have been able to hide in the shadow economy to evade paying their fair share of tax to disappear altogether. Many individuals are no longer tied to one national jurisdiction; those that are increasingly receive payments from work and investment abroad; anyone can have access to an over sea’s bank; anyone with access to a computer can transact business anywhere in the world; property is becoming increasingly intangible and consumption difficult to locate; and, capital is becoming

increasingly fungible and can be shifted relatively easily between jurisdictions. These and other developments are said to call into question governments' continued ability to levy taxes in a world in which companies, assets and people are infinitely mobile. Tax administrators face a formidable number of challenges in every country. In many developing countries tax administration reforms are needed simply to achieve macroeconomic stability. In countries with economies in transition there is a need to establish a tax administration that can respond to the demands of a growing market economy and the resulting increase in the number of taxpayers. Moreover, there is the need to establish the legitimacy of tax collection. In all countries tax administrators face the challenge of modernizing the tax administration so that it can operate effectively in an increasingly global economy. In spite of these challenges, several countries' recent experiences in improving the effectiveness of their tax administration have shown that fundamental reform is possible. In recent years, there has been a considerable amount of study on the steps that should be taken to improve tax administration and reform of fundamental importance to all reform efforts, to improve the effectiveness of tax administration significantly, the government must be politically committed to reform, the major obstacles to an effective tax administration have to be identified, and there has to be well-designed strategies for addressing them. As a preliminary step to developing a successful strategy for the reform of a revenue agency, the "Tax Policy and Administration Thematic Group" of the World Bank has developed a useful diagnostic framework for revenue administration. It includes a description of quantitative indicators and indicators of effectiveness and efficiency that might be used to get a general idea of the physical dimensions of the revenue administration and how effectively and efficiently it is currently performing its functions and where performance problems might be acute. It also provides a framework and checklist of questions relating to all aspects of revenue departments operations, environment, resources, history, organization and management functions and informal culture that can be used to assess its operations and diagnose its failings. A reform strategy to increase compliance requires a concerted, long-term, coordinated and comprehensive plan. It is vital that tax administrators ensure that every compliance policy instrument at their disposal is being used as effectively as possible. The uses of these instruments complement one another. (Asian Development Bank, 2001)

2.1.3 Tax Administration Challenges

The efficiency of a tax system is not determined only by appropriate legal regulation but also by the efficiency and integrity of the tax administration. In many countries, especially in developing countries, small amounts of collected public revenue can be explained by either incapability of the tax administration in realization of its duty, or with some degree of corruption. Regardless of how carefully tax laws have been made, they could not eliminate conflict between tax administration and tax payers. Tax administration with a skilled and responsible staff is almost the most important precondition for realization of "tax potential" of the state. It is generally known that tax laws and tax policy are as good as good is the tax administration (Kaldor, 1980).

Tax administrators face a formidable number of challenges in every country. In many developing countries tax administration reforms are needed simply to achieve macroeconomic stability. In countries with economies in transition there is a need to establish a tax administration that can respond to the demands of a growing market economy and the resulting increase in the number of taxpayers. Human resource is essential in tax administration. Trained personnel are what actually most developing countries lack and this forced them, for instance, to organize their activities under the existing tax administration structure. During the past decade, diverse developing countries have introduced radical reforms in their collection of taxes. In more than 15 countries, traditional tax departments have been granted the status of semiautonomous revenue authorities, which are designed with a number of autonomy-enhancing features, including self-financing mechanisms, boards of directors with high-ranking public and private sector representatives, and generic personnel systems (Polit and Hungler, 1999).

All transition countries had a very huge fall of GDP, which, with serious limitation of tax administration, resulted in an alarming revenue gap. Moreover, in all countries, revenues from taxes collected from big, mostly state firms, declined, and were not replaced with increased taxes collected from private, mostly small enterprise. This has created pressure to increase tax rates and introduce new, very often ad hoc taxes. These diversities, which are called "patches" in the tax system, are to a great extent a result of the inefficiency of the tax administration in collecting the existing taxes (Uremadu, 2000).

This situation would lead to a permanent need for new taxes, changes in the tax system and almost never-ending tax reforms. In transition countries income tax is gaining on importance. Taxpayers are not used to this form of taxation and when they are faced with it for the first time; they will obviously regard it as a burden. As Bird (2004) explained the citizens in these countries are not used to paying taxes at all. The tax administration and bodies which produce political decisions have to foresee the attempts to evade taxes and have to design a tax system that will not question the loyalty of its citizens.

Most developing countries continue to face serious problems in developing adequate and responsive tax systems (Bird and Jantscher, 1992). No matter what any country may want to do with its tax system, or what anyone might think it should do from one perspective or another (ethical, political, or developmental), what it does do is always constrained by what it can do. Economic structure, administrative capacity and political institutions all limit the range of tax policy options (IMF 2006).

Heavy tax distortions in transition economies come from various sources. First, base rates are often high. In transition economies with many fledgling small enterprises and weak tax administration, high tax rates are likely to encourage already widespread tax evasion and participation in informal economy. Second, many countries still rely heavily on payroll taxes to finance social expenditures. If payroll taxes are levied mainly on employers (as is the case in the great number of transitional economies) this can discourage entrepreneurial efforts, disincentive formal hiring and push economic activity underground. Third, and as World Bank estimations as the most important, the many exemptions and special tax rates in parts of the economy often coexist with higher tax rates on other activities, undermine revenue performance, complicate tax administration and distort revenue allocation. The key precondition for efficient tax administration is tax structure with minimizing distortions, strictly tax exemptions and elimination of the differences in tax treatment of particular parts of economy. This will mean extending the VAT to all but a few goods and services (notably export, which should be zero-rated, and banking and insurance services, where it may be difficult to determine the amount of value added to be taxed). (Mansfield, 1990)

2.1.4 Efficiency of Tax Administration

The key precondition for efficient tax administration is tax structure with minimizing distortions, strictly tax exemptions and elimination of the differences in tax treatment of particular parts of economy. This will mean extending the VAT to all but a few goods and services (notably export, which should be zero - rated, and banking and insurance services, where it may be difficult to determine the amount of value added to be taxed) (Hesse, 1993).

Badly conceived or unnecessarily complicated tax structure greatly complicates the operating function of the tax administration, while simple and transparent tax structure could affect it in the opposite way. So, the increase of efficiency of the tax administration could be attributed mainly to the simplification of the tax system. Tax administration cannot change legislation as a means for improvement of tax structure, but could propose necessary changes in laws that can improve tax structure and / or could aid in application of the law (Mansfield, 1990).

Effective tax administration in a market economy is based on voluntary compliance by a large number of decentralized taxpayers. Most transition economies have only recently started to address compliance issues and build up a modern tax administration with better overall revenue performance. A first step is restructuring how the work is organized. In transitional countries, tax administration can be organized respecting the functional principle (collecting, recording, auditing, and enforcement) according to the type of taxpayers; the type of taxes; and type of enterprises in economy. Tax administration should develop around activities (such as recording or auditing), as in Hungary, rather than according to the type of tax and taxpayers. More generally, tax payment needs to be assessed, collected and recorded more efficiently. Current procedures are rarely up to the job of dealing with a growing number of taxpayers, many of which particularly private businesses and service enterprises are tricky to tax at best. The government might start by assigning an identification number to all taxpayers, focusing its efforts on large taxpayers who generate the bulk of revenue, and withholding wage tax at the source. This, however, does not mean that results of successful monitoring of large taxpayers can be excused for neglecting medium and small taxpayers. This can lead to the decrease of their compliance, resulting with lower total revenue. Next should be improved auditing and follow-up actions against those who fail to file returns or make payment. Latvia, for example, has issued regulations for an improved taxpayers' register: every taxpayer must register with the State

Revenue Service; financial institutions will not be allowed to open accounts for any business or individuals without a taxpayer code (Hesse, 1993).

Most transitional economies are in the midst of a comprehensive reform of their government (that include the tax administration) and tailor them to the changing needs of a market environment. In that task they can use the experiences from West European countries and from countries that have recently realized tax reforms as a stepping stone to further development and/or as a challenge and incentive for reaching a higher level of efficiency and success (Mulligan and Oats, 2009). The reform of tax administration in these countries is a part of a complete transformation of public administration, so there are no reasons to be too optimistic about the speed of change and about expected results (Hesse, 1993).

2.1.5 Improve Tax Administration

In reform of tax administration the importance of tax structure is clearly reflected, because tax administration and tax structure are interconnected and they have to be improved simultaneously in the tax reforms (The World Bank, 1991).

Reaping revenues from tax rate changes (whether up or down) requires effective tax administration. Raising revenues through base expansion requires even better administration. New taxpayers must be identified and brought into the tax net and new collection techniques developed. Such changes take time to implement. The best tax policy in the world is worth little if it cannot be implemented effectively. What can be done to a considerable extent inevitably determines what is done. One cannot assume that whatever policy designers can think up can be implemented or that any administrative problems encountered can be easily and quickly remedied. How a tax system is administered affects its yield, its incidence, and its efficiency. Administration that is unfair and capricious may bring the tax system into disrepute and weaken the legitimacy of state actions. (Gorman, 2001)

Good tax administration is a difficult task even at the best of times and in the best of places (Edmiston and Bird, 2004). Conditions in few developing countries match these specifications. How revenue is raised the effect of revenue-generation effort on social capital, equity, the political fortunes of the government, and the level of economic welfare may be more important from many perspectives than how much revenue is raised. The private costs of tax compliance as

well as the public costs of tax administration must be taken into account. Assessing the relation between administrative effort and revenue outcome is by no means simple: it is important, for example to distinguish the extent to which revenue is attributable to the active intervention of the administration rather than its relatively passive role as the recipient of revenues generated by other features of the system. Improving administrative efforts and outcomes is not impossible but it is neither easy nor quick. (Thomson, 2008)

2.1.6 Service Commitments of Tax Administration

The tax administration should provide impartial and professional courteous service and must keep private and confidential information regarding the individual taxpayers. It should also offer clear, understandable and current tax information and will make this information available to tax payer through various media and provide timely, accurate written information that one can rely on to questions and requests for tax information. Education and information programs on specific tax issues should be arranged with taxpayers to enhance their awareness and taxpayers should be allowed to voluntarily disclose their tax situation without incurring a penalty or being prosecuted for tax violations under certain conditions (Asian Development Bank, 2001).

2.1.7 Tax Assessment

A tax assessor is responsible for preparing and maintaining the assessment roll, the tax roll and collecting the tax levies in accordance with the quality standards. (Gorman, 2001). The core service responsibilities include:

- preparing annual market value assessments for all properties
- preparing the business assessment valuations for all business premises
- maintaining accurate property information and ownership on all realty accounts
- maintaining accurate business information and ownership on all business accounts
- defending assessments before municipal and provincial assessment tribunals
- responding to inquiries and requests for information related to assessment and taxation

- Producing and mailing annual assessment and tax notices to tax payers
- reporting assessment rolls and meeting annual audits

Tax administration authorities, throughout the world, are responsible for the assessment, collection and enforcement of the tax laws or statues for their government. As the government's principle revenue collecting agency, the performance and efficiency of Revenue Authority has direct and immediate impact on the economy. Ethiopian Revenue and Customs Authority give the authority in year 2011/12 for Akaki Kality Sub city Revenue Authority to collect revenue from category A and B taxpayers and assess as well as audit the mentioned taxpayers. Before 2011/12 category tax revenue was collected.

Due to less experience Akaki Kality Sub city Revenue Authority, it faces different problems in administering taxes. The reasons are lack of awareness by taxpayers, inefficient tax audit, result in low audit coverage, tax policy and complexity of law, legal and economic environment, and availability of administrative inputs, skilled man power and tax evasion. The Revenue Authority only focus category 'A' for Audit and not consider other categories. As described in the above, this study discusses and analyzes Tax Assessment Problems in Akaki Kality Sub City Revenue Authority.

2.2 Empirical Literature Review

Kangave (2005) discussed tax administration in Uganda's context. It then discussed Uganda's tax structure, the problems faced in administering taxes, and it gave possible solutions to the problems the author identified in his research. The author, in his research, identified corruption, tax evasion, and inadequate resources for tax administration poor quality of audits and inadequate support for tax administration as problems or challenges of tax administration that have weakened the ability to achieve desired revenue targets.

James (1999) examined issues affecting the formulation of tax policy through the development of actual proposals by tax policy-makers. This was done taking account of the possibility that too narrow an approach to this process can produce misleading conclusions and that proposals for tax reform may be inappropriate when the wider context of the tax system as a whole and the environment in which it has to operate are considered. Two issues were used to illustrate the situation – tax compliance and tax simplification. The paper concluded that in developing tax policy it is important to ensure that the wider context is taken into account and it also outlines a practical approach to achieve this aim.

Jenkins (1991) emphasized that the tax system can never work better than its tax administration, but even the best tax administration would certainly fail to turn a bad tax system into a well-operating one. The researcher also warned that many ambitious tax reforms failed because of the inefficient tax administration. Without the permanent reorganization of the tax administration and almost daily improvements in methods of its management, it is impossible to expect that tax reforms could be realized successfully.

The removal of exemptions, loopholes, and concessions can simplify administration and reduce evasion. Taking a systematic view of the tax system, rationalization, simplification, and the removal of anomalies should have the effect of reducing the administrative costs of identification, assessment, auditing and enforcement. The administrative simplicity of "tax handles", however, while influencing tax policy, should not be allowed to dictate it. Concentrating on just a few handles can lead to highly distortion structures (Burgess and Stern, 1993).

Sahota (1961) undertook a study on the tax performance of the tax system of India for the period 1948-1958 using the proportional adjustment method and found that the tax system was inelastic even though the country had a highly progressive income tax at that time. The reason was due to a defective tax structure and rate schedule, wide spread tax invasion and income distribution in favor of the "non-income tax payers group" or in favor of the low-income brackets within the tax-paying group.

Sahota (1931), on his part, studied the performance of the Indian tax system for the period 1948-58. This study used the proportional adjustment method to estimate elasticity of the system.

Results of the study showed that the Indian tax system was inelastic, the causes of which were found to be a defective tax structure and wide spread tax evasion.

Kussi (1994) tried to show the effect of tax reforms of 1983 on the revenue productivity of the tax system in Ghana. To this end, two separate regressions for the pre-reform period (1970-82) and the reform period (1983-1993) were fitted for some major tax types. It was found out that there was a progress of both buoyancy and elasticity for personal income tax, company income tax, sales tax and import tax. The study attributed the improvements to growth in GDP and general improvement of the tax administration.

The following part will be discussing the empirical review specific to Ethiopia related to tax administration in the country. There were studies on tax components and tax systems for different periods in different regimes in Ethiopia.

Wogene (1983) tried to examine the contribution of taxation. He argued that taxation and tax system was used as a tool for establishing the material basis of socialism. He estimated the buoyancy and built-in elasticity of the total tax revenue and examined the difference between the two measures to reflect the impact of the tax reforms on tax revenue for the period 1975-1981. He used the constant rate structure method to separate the revenue impact of discretionary tax measure. His result indicated that the tax reforms have significantly contributed to increasing tax revenue in the country.

A study by Teshome (1979) also tried to see tax elasticity in Ethiopia. The author used built-in elasticity method to examine the revenue effectiveness of the Ethiopia's coffee export taxes. His empirical finding shows that revenue elasticity with respect to change in volume and value of exports is unity i.e. the revenue was price inelastic. He thus concluded that the present coffee tax formula requires constant revisions of tax laws whenever significant changes in the price and /or volume of coffee exports occur.

Teame (1985); studied the overall productivity of the tax system for the period 1968-83 and found out that the system had a buoyancy greater than unity but an elasticity which is less than one from which the conclusion was that the tax system was unstable and inflexible. This study employed the CRS and DV techniques of estimating tax elasticity.

Generally, one can see that the empirical studies undertaken thus far for developing countries, particularly for Ethiopia, bothered little or no to see the potential challenges faced by taxpayers and the tax authorities in administering different tax activities such as tax assessment. The performance of the tax administration has a bearing on the capacity to raise revenue for a country since it includes primarily the assessment activities. Therefore, this research is not only identifying the problems of the Akaki Kality sub city tax administration and tax payers, but also the cause of these problems. Because the researcher believes that identifying the root cause of the problems is the best ground to provide appropriate solutions.

CHAPTER THREE

Research Design and Methodology

This chapter, briefly discusses the research design, source of data, instrument of data collection, population and sampling procedure, methods of data analysis and finally ethical consideration

3.1 Research Design

The study used a descriptive study design with internal comparison. The research design incorporates both quantitative and qualitative research methods so as to know those actions to understand the reasons behind the perceived attitudes and feelings of the respondents. Bickman and Rog (1998) suggest that descriptive studies can answer questions such as “what is” or “what was.” It also identifies the knowledge gap that previous writers bothered little or no to see the potential challenges face in the tax authorities in carrying out tax activities such as tax assessment. Due to this, the researcher conducted this study on the area of tax administration in Addis Ababa city administration taking Akaki Kaliti sub city as a case.

3.2. Sources of Data

The data used in this study consists of both primary and secondary data. The primary data were collected through questionnaire and interview. The questionnaire comprise of both closed and respondents and researcher. Most of the closed ended questions have been designed on an ordinal level of measurement basis, and others also design as multiple choice.

Secondary data is also collect from the Authority annual report from 2005-2006 E.C. In addition to annual report, tax declarations were used. While collecting and using these data for the study, more considerations were given to their time period, reliability, and relevance to the purpose of the study.

3.3 Population and Sampling Procedure

The study population includes all ERCA Audit division staff or tax auditors including tax officers of Akaki Kaliti Sub City. Since the number of staff is not large, the study used census approach.

Inclusion Criteria

- ❖ Being a staff of Audit division of Akaki Kality Sub City

Exclusion Criteria

- ❖ Those who are still in probation period (less than 45 days of employment)
- ❖ Those who are on leave (e.g. Sick leave, maternal leave,...) during the data collection

Data collection procedure includes structured questionnaire for population group; semi-structured questionnaire for the key informant interviews. A pre-test has been conducted on 5 randomly selected tax Audit staff of another Sub city so as to make sure that the questionnaire is clear and understandable coupled with to avoid related information. Those respondents of the study population have been notified by division heads and the questionnaire has been submitted by respective personnel or by the researcher as appropriate. In both cases, the researcher provides technical supervision during the data collection. Furthermore, the researcher has conducted the semi structured questionnaire for the key informant interview guide.

3.4 Methods of Data Analysis

Data analysis has done by SPSS. Quantitative data findings were triangulated with the qualitative data findings and secondary data findings. Field questionnaires have been collected as soon as data collection completed. The researcher was reviewing the completeness as well as anonymous of the data. Data entry template has designed by using SPSS. Each filled questionnaire that checked for its completeness, anonymity and missing values will be coded and double entered using SPSS software. Data cleaning also has done after saving the master database on a separate file.

3.5 Ethical Consideration:

The researcher has collected a formal letter from SMU to be handover to Akaki Kality Sub city ERCA office. The researcher prepares a well-structured questionnaire for tax assessors/audit. As a self-administered questionnaire, the introduction of the questionnaire states the objective and purpose of the research. Respondents have been ensured that the information they provide will be kept confidential; for such reason, name or any specific issue which can expose the identity of the respondent has not recorded. There has been also a statement indicating that the respondent is engaged on voluntary bases where to the respondent have the right not to answer any of the questions which they don't want to answer.

CHAPTER FOUR

DATA ANALYSIS AND RESULT

This chapter presents two parts which are demographic characteristics of the respondent and the descriptive analysis of the practices and challenges of ERCA under study.

4.1 Demographic characteristics

In the first part of the analysis, the demographic characteristics of the respondent, they are required to provide their bio-data. The bio-data question include gender, age distribution, marital status, educational background, current position and year of experiences in organization under the study, Accordingly, the analysis below reveals the bio-data of the respondent with the help of frequency and percentage table

Table .1 Demographic Information of Respondent

| | | Frequency | Percent |
|-----------|--------------------|-----------|------------|
| Gender | Male | 29 | 58 |
| | Female | 21 | 42 |
| | Total | 50 | 100 |
| Age Group | Less than 30 years | 37 | 74 |
| | 31-40 | 13 | 26 |
| | 41-50 | 0 | 0 |
| | Above 50 | 0 | 0 |
| | Total | 50 | 100 |

Source: Own survey, 2016

Table 1 show that majority of respondents (74 per cent) were categorized under less than the age of 30 years and (26 percent) were categorized under less than the age of 31-40 years. Out of the

total respondents, 58 per cent were males and 42 per cent were females. This indicates that Akaki Kality Sub city Revenue Authority recruit more male than female.

Table 2 Socio- economic status of respondents

| S.N | Item | | Frequency | Percentage |
|-----|----------------------------|---------------------|-----------|------------|
| 1 | Educational back ground | BA/BSC | 49 | 98 |
| | | MA/Msc | 1 | 2 |
| 2 | Field of Study | Accounting &Finance | 38 | 76 |
| | | Economics | 6 | 12 |
| | | Management | 6 | 12 |
| 3 | Work experience as Auditor | Less than 2 years | 19 | 38 |
| | | 2-4 years | 20 | 40 |
| | | 4-6 years | 11 | 22 |

Source: Own survey, 2016

Educational levels, field of study and work experience of the tax auditors in general are the most important variables that can affect the performance of tax audit as well as tax administration system. Besides the attempts have been made to assess the educational level of the respondents, Field of study and work experience. Generally, the respondent's socio-economic status is presented in Table 2. In regarding field of study, majority of the respondents are specialized in accounting and finance which accounts for 38 percent of the total sample. The remaining 24 percent were specialized in management and Economics. As indicated in item four of Table 2, 38

percent of the respondents have service year ranging from 0 - 2 year, while 40 percent of the respondent have service years of 2-4 years and 22 percent of the respondents have service years of 4-6 Years. This shows that the respondents have mixed experience for the current position. As it is discussed on the above, the majority of the respondents have a good level of educational qualification that is BA or BSc degree and MA/Msc degree which enables the respondents to have idea of the tax audit. Moreover, majority of the respondents studied the field related to business which enables them to understand the implementation of taxes and related issues.

4.2 Descriptive Analysis of Data

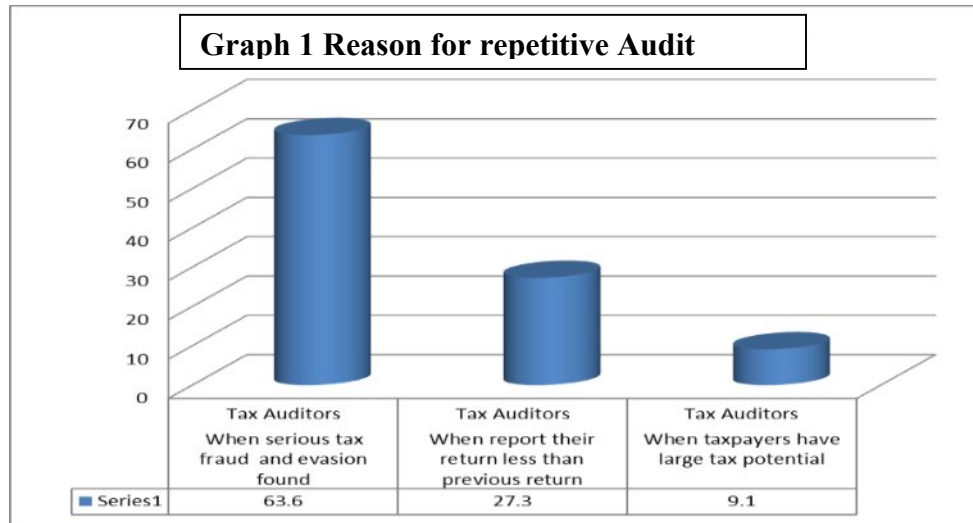
Table 3 Repetitive Tax Audit performed

| S.N | Statement | Respondents | | Frequency | Percentage |
|-----|--|------------------------|-----------|-----------|------------|
| 1 | Tax auditors repetitively audit the same taxpayer in consecutive period? | Tax Auditors/Assessors | Always | 6 | 12 |
| | | | Sometimes | 15 | 30 |
| | | | Rarely | 20 | 40 |
| | | | Never | 9 | 18 |

Source: Own survey, 2016

Regarding audit frequency as shown in Table 3, out of 50 respondents 20 (40 percent) stated that rarely similar tax payers are selected for audit in a consecutive years, (30 percent) of respondents stated that sometimes similar tax payers are selected for audit in a consecutive years, (18 percent) of the respondents stated that tax payers who audited previously were not selected for the next audit, the remaining (12 percent) respondents stated that there is a possibility to audit similar tax payers in consecutive years. This implies that taxpayers are selected for audit for consecutive audit period. This results in wastage of time.

Reasons for Repetitive Audit



Source: Own Survey, 2016

Regarding the reason for repetitive audit, 63.6 percent of respondents were replied that when serious tax fraud and evasion found, the taxpayers is selected for audit for a consecutive audit period. As it is clearly indicated in the above graph, 27.3 percent of Tax Auditors replied that taxpayers were selected for repetitive audit, when report their return less than previous return, Only a small portion of respondents tax auditors (9.1 percent) replied that repetitive tax audit is found when taxpayers have large tax potentials. Graph 1 and Table 4, inferred that repetitive audit on individual taxpayers were found. This situation might have effect on compliance behavior of taxpayers and Tax audit effectiveness.

Table 4 Taxpayers cooperation to give information for tax auditors and assessor

| S.N | Statement | | Tax Auditors | |
|-----|---|----------|--------------|------------|
| | | | Frequency | Percentage |
| 1 | Are taxpayers cooperating to provide enough information for tax auditors? | Agree | 26 | 52 |
| | | Disagree | 24 | 48 |

Source: Own survey, 2016

Regarding taxpayer’s cooperation to give enough information for tax auditors and assessors, Table 4 shows that 48 percent of respondents of tax auditors were not cooperative to give sufficient information to tax auditors and tax assessor. And the remaining respondents replied that taxpayers were cooperating with tax auditors and tax assessors. 52 percent of respondents tax auditors replied that taxpayers were cooperate to give information for tax assessor and tax auditors. Generally, the cooperation of taxpayers with tax auditors as well as tax assessor is good but they were not fully cooperating for the effective tax administration system. They were not given enough information for tax authority.

Table 5- Methods of getting information regarding taxpayers

| S. N | Statement | Tax Auditors | |
|---------|--|--------------|------------|
| | | Frequency | Percentage |
| 1 | Reviewing the previous case history of taxpayers | 20 | 40 |
| 2 | Using information from third party such as financial institution | 13 | 26 |
| 3 | Using business sector profile | 17 | 34 |
| | Total | 50 | 100 |

Source: Own Survey, 2016

According to Table 5, Tax auditors and investigators get information from different sources. Majority of respondents have agreed that Tax Auditors get information from third party, by reviewing previous case history of taxpayers and taxpayer’s business profile. Table 5 showed that 26 percent of respondents of tax auditors reported as tax auditors were getting information from third party like financial institution and other agency. 34 percent of respondents as tax auditors replied that tax auditors get necessary information of taxpayers from business sector profile. Generally, tax auditors get information from third party rather than other means of receiving information regarding taxpayers business.

Table 6 - Tax Auditors access for information

| S. N | Statement | Percentage | | | | |
|---------|---|------------|-------|---------|----------|------------|
| | | S/Agree | Agree | Neutral | Disagree | S/disagree |
| 1 | Tax auditors and investigators have good access of information held by the taxpayers and others | 8 | 54 | 14 | 20 | 4 |

Source: Own survey, 2016

Table 6 deals with tax auditor access to get information held by taxpayers and others. 8 percent of the respondents strongly agreed on access of information. Whereas, 54 percent of respondents agreed replied that tax auditors and investigators have good access to information held by taxpayers and other, the remaining disagreed. It implies that there is no limitation of information on access of taxpayers and others data.

4.2.1 Challenges

Table 7 Challenges of Tax Assessment

| Statement | N | Mean | Std. Deviation |
|--|----|--------|----------------|
| Taxpayers understate their income deliberately | 50 | 4.0400 | 0.75485 |
| Tax auditor usually performs the audit work repetitively | 50 | 3.5600 | 0.86094 |
| Taxpayers insist tax assessors to report inequitable statement | 50 | 3.4200 | 0.99160 |
| Tax administration has enough audit staff to perform onsite on all taxpayers | 50 | 2.3600 | 1.35164 |

Source: Own survey, 2016

According to the above table 7, taxpayers understate their income deliberately regarded as the highest score value 4.04 mean. Table 7 Shows 3.56 value of mean scored of the respondents that tax auditors perform audit work repetitively. Table 7.3 indicates that 3.42 value of mean scored of the respondents that taxpayers insist tax assessor to report understatement. Table 7 2.36 value of mean scored of respondents indicates that ERCA haven't got enough audit staff to perform

onsite audit on all taxpayers. Generally, table 7 depicted except line 4 the remaining variable is acceptable and it implies that taxpayers report understated income deliberately and insisting the assessor/auditors to report inequitable audit notice was the problem of tax assessment. Due to lack of large number of audit staff, there were high possibility of auditing similar company performed repetitive audit work which helps the taxpayer to negotiate with assessors for their interest were also the challenges.

4.2.2 Case Selection

Table 8 Case selection Techniques

| Statement | N | Mean | Std. Deviation |
|--|----|--------|----------------|
| Selection conducted based on taxpayer's cooperation to provide essential information necessary for performing the audit. | 50 | 3.1400 | 1.06924 |
| Taxpayers are selected based on their associated compliance risk | 50 | 3.9600 | 0.96806 |
| Selection carried out based on taxpayers high tax potential | 50 | 1.8400 | 0.50950 |
| Series evasion and fraud are criteria's for the selection | 50 | 3.8200 | 1.10083 |
| Taxpayers to be audited was selected through data mining | 50 | 2.3000 | 0.70711 |

Source: Own survey, 2016

Regarding Case selection criteria, 3.14 value of mean scored of the respondents replied that taxpayers have been selected for audit based on their cooperation. Item 2 on Table 8 has regarded as the highest score value of 3.96 mean of the respondents of tax auditors replied that, taxpayers have been selected based on their associated compliance risk (compliance risk indicators) for audit purpose. Item three on Table 8 shows 1.84 value of mean scored which is unacceptable variable those taxpayers' select for tax audit were not based on taxpayer's tax potential and it indicates that high tax potential of taxpayers was not a base for case selection. Item four of Table 8 elicits that case selection is based on serious evasion and fraud. 3.82 value of mean scored of the survey result shows that case selection was based on the commitment of serious evasion and fraud. The respondents of tax auditors' responses, taxpayers select for audit

when they commit serious fraud and evasion. Item 5 of Table 8 shows that, the respondents view in relation to case selection through data mining techniques is 2.30 value of mean scored. Accordingly, from table 8 the score of line 1, 2, and 4 are acceptable variables while line 3 and 5 are unacceptable variable thus, indicates that taxpayers selected for audit is not based on data mining techniques. The survey result shows that case selected for audit was not based on data mining techniques. Generally, table 8 depicted that tax auditors selects cases based on associated risk, and commitment of tax fraud and evasion.

As the interview result, Akaki Kality Sub City Revenue Authority conduct tax audit is based on service and associated risk. Service audit is un- planned audit which performed by auditors based on the interest of taxpayers. If taxpayers want to shut down their business or change sector they have to inform to Revenue Authority so that Authority assign auditors to perform the audit work.

4.2.3 Effectiveness of Tax Audit

Audit effectiveness is dependent on auditor’s capability and efficiency to perform audit activities in well-organized manner, tax auditors resources allocated for audit and the revenue authority tax administration system. The other factors that affect the effectiveness of audit work are the link between intelligent information and tax audit. For the effective and efficient tax audit not only the skill and qualification of tax auditor’s but also adequate number of tax auditors, materials and equipment necessary for audit have greater impact.

Table 9 Audit effectiveness

| Statement | N | Mean | Std. Deviation |
|---|----|--------|----------------|
| Education and experience on tax assessment affect tax administration effectiveness | 50 | 4.1400 | 1.06924 |
| Use of taxpayers segmentation for investigation | 50 | 1.9800 | 0.71400 |
| Assessment performed based on manual/standards | 50 | 2.2600 | 1.17473 |
| Effectiveness of tax assessment measured by volume of the investigate performed | 50 | 3.5000 | 1.07381 |
| Continuous and sufficient trainings given for tax auditors | 50 | 2.2800 | 1.35586 |
| Applying of standard risk identification criteria to identify highly risky business for audit | 50 | 2.0400 | 1.00934 |

Source: Own survey .2016

According to the above table, of respondents regarded as a highest scored of mean value 4.14 on education and experience on tax assessment affects tax administration effectiveness which is qualified assessors have a great impact on effectiveness of tax administration. Item 2 table 9 shows that scored 1.98 of mean value of the respondents regard as they were not used for their investigation segmentation. Item 4 tables 9 as shown in the table above, the effectiveness of tax assessment were measured by the volume of investigated performed. Majority of the respondents reported that the volume of investigated performed was indicator for assessment effectiveness and scored of mean value of 3.5 which is regarded as acceptable variable that the assessment effectiveness was measured by the volume of investigation performed. Table 9 of item 5 depicted that views of tax auditors regarding the ERCA did not provides continuous and sufficient training for tax auditors to increase their efficiency. With a scored value of 2.28 of tax auditors regarded on the issues that tax authority provides continuous and sufficient training to Auditors. The interview result also supports the responses given by tax auditors. As the responses of the interviewer's revenue authority recruit less/no experience audit staff and provide only 15 days training before the auditors enter in to the audit work and give examination for the attendants of the training for assessing the efficiency of the auditors but not provide continuous and efficient training to upgrade less experienced staff. ERCA plan to provide training for auditors only once a year. To maintain standards of auditing it is essential that revenue authority are give both initial training (classroom and on-the-job instruction) to bring auditors up to the required level and continued training so that their skills are kept up to date and relevant.

2.04 mean value of the respondents rated on unacceptable for the questions that tax auditors were not used standard risk identification criteria for effective tax audit and sample selection for tax audit. These shows that auditors were not use standard risk identification criteria. The revenue authority has fourteen point risk identification criteria on the Business Process Reengineering (BPR) manual but the auditors were not using the standard criteria due to complexity of the criteria.

According to BPR manual, the time to complete a single audit was 15 days. Due to complexity of taxpayers' business transaction and the size of the taxpayer's Akaki Kality Sub City Revenue Authority were not use the standard time to complete the audit. As the result of the survey, tax auditors not start and complete the audit work as of BPR standard.

4.2.4 Performance of Tax Audit

Table 10 Performance of Tax Audit

| Statement | N | Mean | Std. Deviation |
|--|----|--------|----------------|
| The primary purpose of tax auditing performed in tax administrations is to ensure compliance in accordance with tax law. | 50 | 4.2000 | 0.80812 |
| The audit work to be started and completed within a predetermined timeframe. | 50 | 2.2800 | 0.90441 |
| Tax administration has enough audit staff resources to perform onsite audits on all taxpayers. | 50 | 1.8400 | 0.97646 |
| Observing, discussing and reviewing documents of taxpayer's are conducted to check the accuracy of tax. | 50 | 4.1200 | 0.89534 |

Source: Own survey .2016

According to table 10 item one, the primary purpose of Tax Audit is to ensure compliance behavior of taxpayers. Score of 4.2 mean of the respondents of tax auditors were regarded as acceptable that tax audit performed in the city revenue authority is to ensure compliance behaviors of the taxpayers. According to the response of the Taxpayers, revenue authority performed tax audit was not for ensuring compliance behavior of taxpayers. 2.28 value of mean scored of the respondents have rated as unacceptable on that the audit work was not started and completed within predetermined time frame. This implies that the ERCA has no standard time for complex and simple cases. According to the above table, 1.84 value of mean scored value of respondents indicate that ERCA has no enough audit staff to perform onsite audit on all taxpayers. Table For the effective and efficient tax audit not only the skill and qualification of tax auditor's but also adequate number of tax auditors, materials and equipment necessary for audit have greater impact. With the highest value of mean 4.12 score rated as acceptable variable of respondents of tax auditors replied that observing, discussing and reviewing documents of taxpayers were the means for checking the accuracy and physical checks of businesses' current operation including transactions, assets and other aspects

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECCOMENDATIONS

The last chapter of the study summarizes and concludes the major findings that emerged from the analysis of qualitative and quantitative data collected for the study. Finally, based on the summary and conclusion, the researcher recommends.

5.2 Summary of Findings

Depending on the review of related literature as well as analysis and interpretation of the data, the findings are summarized and presented as follows:

- Appropriate audit selection is a key to the effectiveness of tax audit program. Akaki Kality Sub city select taxpayers for audit based on associated risk. Akaki Kality Sub city select cases based on deviation from previous period's profit (underreporting income) and they think that it is an indicator for evasion.
- The other things to be considered for audit were grouping Taxpayers. Taxpayers have different characteristics and present different risks to revenue Authority. Segmentation based on industry type or turnover is vital to improve revenue collection of the sub city as well as to improve audit performance. However, Akaki Kality Sub city was not implemented this segmentation approach.
- The effectiveness and efficiency of Audit work was affected by staff qualification, experience and resources for audit. Auditors have the ability to interpret rules and laws, analyses the compliance behavior of taxpayers, investigative and advisory skill. The survey and the interview result revealed that Akaki Kality Sub city recruit qualified but less experienced audit staffs.
- The number of auditors in Akaki Kality Sub city was very less compared to the business .Similarly the revenue authority has no enough resource and equipment like computer and suitable office to conduct audit work. The tax officials, auditors in particular, also fail to keep properly taxpayers data that have been already submitted by taxpayers, and they unnecessarily request taxpayers to submit the report yet again.

- According to BPR tax audit timeframe, Akaki Kality Sub city has a rule that requires an individual audit case to be started and completed within 15 days period regardless of the complexity of the cases and the size of the taxpayers to be audited. In general, as per the level of the researcher understanding and the finding what he has got in the previous chapters the researcher conclude that the allocation of equal period for both complex and simple cases might result operational inefficiency including decrease in audit quality and coverage although there is no standard timeframe for both complex and simple cases.
- The standard time frame on the BPR manual was not sufficient to perform and conclude complex cases. Individual Auditors might not properly detect noncompliance due to time scarcity and the required audit quality might not be achieved
- The primary purpose of tax audit performed in Akaki Kality Sub Town Revenue Authority was to assess and additional revenue for the Government. According to Table 12 tax audit was for assessing taxpayers and need additional revenue for the Government. Tax audits allow tax auditors to educate taxpayers on the application of tax laws, to identify improvements required for record-keeping and to identify areas of tax laws that taxpayers need clarification .Tax audits is not allow tax auditors to educate taxpayers on the application of tax laws. Taxpayers’ awareness creation is unquestionable to increase voluntary compliance and to mitigate compliance risks. Consequently, Akaki Kality Sub city tried to create tax awareness through electronic media, printed materials. However, taxpayer awareness creation through such mechanisms might depend on the literacy level of the target taxpayers and the accessibility of such materials to the public within a given tax jurisdiction. The respondents further stated that taxpayers need compliance education to understand the benefits of being compliant and the consequence of not being compliant.
- The primary purpose of tax audit performed in Akaki Kality Sub city Revenue Authority was to assess additional revenue for the Government. Tax audits allow tax auditors to educate taxpayers on the application of tax laws, to identify improvements required for record-keeping and to identify areas of tax laws that taxpayers need clarification. The respondents further stated that taxpayers need compliance education to understand the benefits of being compliant and the consequence of not being compliant.

- In addition, there is a communication gap between Akaki Kality Sub city and taxpayers, which leads taxpayers to mistrust.
- However, the application of investigation approach is not as such in Akaki Kality Sub City Revenue Authority. The accuracy of taxpayer's tax liability is determined mainly through analytical review of financial statements and returns. Thus, Akaki Kality Sub city may not be able to determine how much wealth the taxpayers have accumulated but not documented or recorded in their books of accounts and financial reports without the conduct of appropriate investigation. It may not be also possible to ERCA to establish the completeness, accuracy, credibility, and validity of taxpayers' declarations, disclosures and other financial arrangement.

5.3 Conclusion

These study findings provide direct evidence that challenges of tax assessment is a contributory factor in tax compliance, and an indication of its magnitude effect. From the study findings there is enough proof to conclude that effectiveness of tax audit is associated with high levels of tax system.

The study also provides some preliminary evidence that tax audit performed, and effectiveness of tax audit and risk identification criteria for case selection play a vital role in improving tax assessment. Specifically, for a tax system with fair selection techniques, tax assessment is likely to improve.

Finally, the study concludes that effective tax audit has a significant effect on tax assessment. It is therefore prudent for the tax system to enhance performance of tax audit on how to file tax returns and the importance of assessment.

5.4 Recommendations

In light of the aforementioned conclusions of the study, the researcher wishes to make the following recommendations to minimize the challenges of Akaki Kality Sub City Administration Revenue Authority tax assessment so that to improve voluntary compliance and to meet the revenue needs of the government.

- ❖ Akaki Kality Sub city must adopt different ranges of audit types to increase the audit coverage and voluntary compliance having inadequate staff resources; the Akaki Kality Sub city should adopt a wide range of audit methodologies rather than use of full comprehensive audit because to address risk and audit quality. The spot (issue) audit should be widely applied to increase the audit coverage, and education type audits that are not yet in place should be implemented to improve taxpayers' awareness and voluntary compliance. In addition, Akaki Kality Sub city should give emphasis and assign adequate resources for investigation audit.
- ❖ The Akaki Kality Sub city should design pre audit procedure to select highly risky business. In addition to pre-auditing the authority should use data mining, case review and full risk-based audit selection strategy that rewards taxpayer compliance with a light touch approach and openly demonstrates that valuable taxpayer resource is being deployed against the non-compliant.
- ❖ The Authority should use standard risk identification criteria to give priority for highly risky businesses and to encourage compliance taxpayers by minimizing taxpayers' compliance cost.
- ❖ Akaki Kality Sub city should give emphasis for taxpayer segments to improve future overall taxpayers' voluntary compliance that may affect future tax revenue, and to be capable to sustain confidence in the tax system and its administrations. And also perform audit work including other category of taxpayers. Focusing only on category A taxpayer leads to tax evasion. Underreporting and other noncompliance activities have a good chance of being detected due to high probability of being audited.
- ❖ The Revenue Authority should perform audit activity in cooperation with the intelligence information. And should use Audit manual for better efficiency.
- ❖ Akaki Kality Sub city should revise the stated 15 days audit period with the consideration of the complexity of the cases and the size of the taxpayers to be audited. The authority

should dispense more time for complex cases and audit of large taxpayers to properly detect noncompliance and achieve the required audit quality.

- ❖ Taxpayers have lack of awareness regarding tax rules, regulation directives and procedures and directives. This is due to level of awareness is dependent on taxpayers educational background and exposure. To increase the awareness level Akaki Kality Sub city should give great attention to educate communities as well as taxpayers through different techniques like mass-media, preparing broacher and using different structures (School,church, and kebele 1 to 5 approach). In addition to this the revenue authority provides house to house education and discussion by considering the type and size of taxpayers.
- ❖ Akaki Kality Sub city should sufficiently use an investigative approach to check the accuracy of tax returns to establish what have not been recorded in the accounting system. It should use an investigatory approach to establish the completeness, accuracy, timeliness, credibility and validity of taxpayers' declarations, disclosures, and other financial arrangements.
- ❖ To make effective audit the Akaki Kality Sub city audit should increase number and capability of audit staffs through appropriate need assessment and employees and identified gap. Auditors should have been taken continuous training so that their skills are kept up-to-date and relevant. Further, the authority should supply sufficient computers and other necessary audit resources for auditors.
- ❖ The authority should use appropriate short cut techniques to increase the audit quality and coverage.

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Appendix A
St. Mary's University
School of Graduate Studies (SGS)
Masters of Business Administration (MBA) in Accounting and Finance

Data Gathering Questionnaire

Annexes:

Annex I: Tax Auditors and Assessors Survey Instrument

Questionnaire to be filled by Tax Auditors/Assessors

This questionnaire is designed to meet the objective of research titled “The practice and Challenges of Tax Assessment of Category “A” Taxpayers of Akaki Kaliti Sub City, Ethiopian Revenue and Customs Authority”. I feel that your contribution which means information obtained from you is essential for success of this research. Thus, I appreciate your cooperation to give me your time for the success of this research thesis. I assure you that the information to be shared by you will be used only for academic purpose and kept confidential. Your open and genuine response is highly appreciated

The questionnaire has two parts: Part -I is about your personal information. Part-II is the overall questions about the tax assessment problems. Please read each item carefully and give your honest response to each item.

Thank you for your cooperation!

Fitsum Abera

Part-I Demographic Variables of the Respondent

Put a “√” mark in one of the choices provided for each possible option.

1. Gender:

1. Male 2. Female

2. Age:

1. Less than 30 year's 3. 41-50 years
2. 31-40 years 4. Above 51 years

3. Education:

1. Certificate 3. BSc/BA
2. Diploma 4. MSc/MA and above

4. Field of study:

1. Accounting & finance 3. Management
2. Economics 4. Others, please specify _____

5. Current job occupation:

1. Tax auditor 3. Tax audit coordinator 5. Tax audit director
2. Tax investigator 4. Tax assessor 6. Others, please specify _____

6. Did you have any audit experience before you joined the ERCA?

1. Yes 2. No

7. If your answer in question #6 is yes, how long did you work as an auditor?

1. Less than 2 years 4. 6-10 years 5. Above 10 years
2. 2-4 years 3. 4-6 Years

8. How long did you work with your current job occupation in the ERCA?

1. Less than 2 years 3. 4-6 year's 5. Above 10 years
2. 2-4 years 4. 6-10 years

Part - II Question Regarding Tax Assessment

1. Tax auditors repetitively audit the same tax payer in consecutive period?

1. Always 2. Sometimes 3. Rarely 4. Never

2. If your answer for Q 9 is always, what is the condition those taxpayers may be audited?

1. When taxpayers reported tax less than previous period
2. When serious tax fraud case is found
3. When taxpayers have large tax potential
4. Other please specify-----

3. What are the main activities that tax auditors, investigators and assessors expected to perform during an audit period (multiple answers are possible)?

1. Detecting noncompliance behavior of individual taxpayer
2. Gather information on the health of the tax system including compliance behavior
3. Educating taxpayer's
4. Interpreting complex tax rules and regulations for taxpayers

4. How often tax audit is supported by intelligence input?

1. Always 2. Sometimes 3. Rarely 4. Never

5. How tax auditors and investigators can get the required information?

1. By reviewing the previous case histories of taxpayers
2. Using information from third parties such as financial institutions
3. Using business sector profile

4. Others, please specify _____

6. Taxpayers cooperate to give information for tax auditor/Assessor?

1. Agree 2. Disagree

Put a “√” mark in one of the columns provided for each possible indicator. Use the scales:

Strongly agree (5), Agree (4), Neutral (3), Disagree (2), strongly disagree (1)

| | Statement | Strongly Agree | Agree | Neutral | disagree | Strongly Disagree |
|----------|---|-----------------------|--------------|----------------|-----------------|--------------------------|
| | Questions Regarding Challenges of Tax Assessment | | | | | |
| 1 | Taxpayers understate their income deliberately | | | | | |
| 2 | Tax auditor or investigator usually performs the audit work repetitively | | | | | |
| 3 | Taxpayers insist tax assessors to report inequitable statement | | | | | |
| 4 | Tax administration has enough audit staff resources to perform onsite audits on all taxpayers | | | | | |

| | Statement | Strongly Agree | Agree | Neutral | disagree | Strongly Disagree |
|---|---|-----------------------|--------------|----------------|-----------------|--------------------------|
| | Questions Regarding selecting techniques | | | | | |
| 5 | Selection is based on taxpayer's cooperation to give essential information necessary for performing an audit. | | | | | |
| 6 | Taxpayers are selected based on their associated compliance risk | | | | | |
| 7 | Selection is based on taxpayers high tax potential | | | | | |
| 8 | Series evasion and fraud are basis for selection | | | | | |
| 9 | Taxpayers to be audited was selected through data mining | | | | | |

| | Statement | Strongly Agree | Agree | Neutral | disagree | Strongly Disagree |
|----|--|-----------------------|--------------|----------------|-----------------|--------------------------|
| | Questions Regarding effectiveness of tax assessment program | | | | | |
| 10 | Education and experience on tax assessment affect tax administration effectiveness | | | | | |
| 11 | Use taxpayers segmentation for investigation | | | | | |
| 12 | Assessment is performed based on manual/standards | | | | | |
| 13 | Effectiveness of tax assessment is measured by volume of the investigate performed | | | | | |
| 14 | Continuous and sufficient trainings for tax auditors | | | | | |

| | | | | | | |
|-----------|--|--|--|--|--|--|
| 15 | Apply standard risk identification criteria for identify highly risky business for audit | | | | | |
|-----------|--|--|--|--|--|--|

| | Statement | Strongly Agree | Agree | Neutral | disagree | Strongly Disagree |
|-----------|---|-----------------------|--------------|----------------|-----------------|--------------------------|
| | Questions regarding the Performance of Tax Audit | | | | | |
| 16 | The primary purpose of tax audit performed in tax administrations is to ensure compliance in accordance with tax law. | | | | | |
| 17 | The audit work to be started and completed within a predetermined timeframe. | | | | | |
| 18 | Tax administration has enough audit staff resources to perform onsite audits on all taxpayers. | | | | | |
| 19 | Observing, discussing and reviewing documents of taxpayer's are conducted to check the accuracy of tax. | | | | | |

1. What are the challenges of tax administration? What do you suggest for the improvement of Tax administration and tax assessment program? _____

Thank you for your time and kind contribution.

Appendix II - Tax officials in-depth interview instrument

1. Is there any Audit manual to perform tax assessment Activities?
2. What is the primary purpose of conducting an assessment? Does Akaki Kality subcity Revenue Authority provide awareness creation for taxpayers? How?
3. Does Akaki Kality subcity Revenue Authority use appropriate short cut techniques and Tax payer segmentation?
4. How audit cases are selected? What are the bases considered for selecting the audit case?
5. How the decision to audit or investigate a certain taxpayer is conducted? What inference or criteria considered for such decision?
6. How Akaki Kality subcity Revenue Authority recruit Auditors/Assessors?
7. How and by what criteria audit cases are assigned to auditors/assessors?
8. Is there anybody to evaluate tax audit performance? Who and How?
9. Could you tell me about the auditor's capability to clarify unclear rules and regulation, willingness to advise taxpayers and decision giving procedure of tax auditors?