



**INDIRA GANDHI NATIONAL OPEN UNIVERSITY**  
**School of Management Studies**

The Challenges of VAT Administration in Ethiopia:  
The Case of Bole Sub City Small Tax Payers Branch Office of  
Ethiopian Revenue and Customs Authority (ERCA)

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### **CERTEFICATE OF ORIGINALITY**

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## LIST OF ACRONYMS/ABRIVATIONS

ASYCUDA - Automated System for Customs Data

Both Respondents – Tax Payer and Employee Respondents

Branch Office - Bole Sub City, Small Tax Payers Branch Office of ERCA

CPO - Certified Payment Order

Employee - workers of the Branch office

ERCA - Ethiopian Revenue and Customs Authority

ETB - Ethiopian Birr (the unit of currency used in Ethiopia)

FDRE - Federal Democratic Republic Of Ethiopia

FIRA - Federal Inland Revenue Authority

GERD - Grand Ethiopian Renaissance Dam

GST - Goods and Services Tax

Kw - kilowatt

SIGTAS - Standard Integrated Government Tax Administration System

TIN - Taxpayer Identification Number

VAT - Value Added Tax

## **ABSTRACT**

*VAT being one of the indirect taxes is levied on consumption, where the value of goods and services increases as they change hands in the course of production, distribution and final sales to consumer is considered to be governments' main source of revenue in more than 160 countries in the world. Ethiopia has implemented Value Added Tax in January, 2003. VAT in Ethiopia is applied at a uniform rate of 15% on most consumption of goods and services, except those are zero rated and exempted by law. Bole Sub City Small Tax Payers' Branch Office of the Ethiopian Customs and Revenue Authority (ERCA), who takes the responsibility of administrating VAT in its territory is facing with substantial challenges. This study has focused particularly on identifying and assessing these challenges. To achieve this objective, the researcher used questionnaires, interviews and relevant documents to collect data from the data sources. Graphs, tables and Percentages were used in analyzing the collected data. The findings of the study reveal that the main challenges of VAT administration are: misunderstanding of the public in general and business community in particular regarding the VAT laws, resistance against registrations for VAT by some traders, administration inefficiency from ERCA (the branch office) and non-issuance of invoices or issuance of illegal invoices exercised by some registered business enterprises. Based on these findings, the study recommends that the authority (the branch office) should familiarize the taxpayers with the VAT laws and its benefits, retain sufficient and skilled manpower, processing of returns, controlling collections, making refunds on time, auditing taxpayers on a planned and risk based program, recognizing genuine taxpayers and levying penalties on those violating the VAT laws. The business communities should also obey to the VAT laws and start to work in cooperation with ERCA (the branch office) in fighting against those violating VAT laws.*

## CHAPTER ONE

### 1.1 INTRODUCTION

Taxes are a portion of private wealth, exacted from individuals by the State for the purpose of meeting the expenditure essential to carrying out the functions of government. It becomes the principal means of raising revenue for public purposes. A tax is a compulsory contribution of persons toward the needs of government. Taxes are levied for the benefit of government as a whole, not for the advantage of individuals or of a particular class.

Commonly, taxes are classified into direct and indirect and this classification owes to the relationship between the nature of the taxes and the reason for payment of the taxes. A direct tax is a tax which the taxpayer is not able to pass the burden to someone else. Accordingly, direct taxes are paid entirely by those persons on whom they are imposed. On the other hand, an indirect tax is a tax whereby the taxpayer's burden to pay the tax can easily be passed on to another person. Based on the abovementioned classification, Value Added Tax is one of the indirect taxes.

Ethiopia is one of the developing and fast growing countries in the world. The country is in the transformation process. Basic infrastructures such as highways, Airports, Universities, Hospitals, etc are under construction. Dams for power supply and irrigation are also being constructed. In the process of such heavy construction and development, huge amount of capital is required.

The Grand Ethiopian Renaissance Dam (GERD) expected to produce about 6,000 kilowatt (kw) is estimated to cost more than ETB 80 billion. The dam will be the largest hydroelectric power plant in Africa when completed, as well as the 8th largest in the world, Wikipedia, the free encyclopedia ([en.wikipedia.org/wiki/Grand\\_Ethiopian\\_Renaissance\\_Dam](https://en.wikipedia.org/wiki/Grand_Ethiopian_Renaissance_Dam)). This urges to facilitate the collection of taxes (the potential sources of government revenue) among which is VAT. Therefore, in order to generate expected revenue, VAT in Ethiopia requires fair and effective administration.

Addis Ababa, the capital city of Ethiopia and Africa as well, where more tax payers are concentrated is expected to contribute considerable amount of capital by collecting tax (VAT being one of the contributors). Hence, to assess the challenges of VAT administration in Addis Ababa, taking Bole Sub-City as a sample is found to be very important.

## **1.2 Background of the Study**

Value added tax (VAT) is an indirect tax, which is imposed on goods and services at each stage of production, starting from raw materials to final product. VAT is levied on the value additions at different stages of production. VAT is intended to tax every stage of sale where some value is added to raw materials, but taxpayers will receive credit for tax already paid on procurement stages.

According to Kathryn James (2011), though the origins of the VAT have never been decisively settled, VAT was first introduced at a national level in France in 1954. But, its original coverage was limited, and France did not move to a full VAT that reached the broader retail sector until 1968. The first full VAT in Europe was enacted in Denmark in 1967. VAT adoption progressed in two major phases. The first occurred mostly in Western Europe and Latin America during the 1960s and 1970s. The rise of the VAT in Western Europe was accelerated by a series of EEC directives requiring member states to adopt a harmonized VAT upon entry to the European Union. The second phase of VAT adoption occurred from the late 1980s with the introduction of VAT in some high-profile industrialized countries outside the EU, such as Australia, Canada, Japan, and Switzerland. This phase also witnessed the massive expansion of VAT in transitional and developing economies, most notably in Africa and Asia, Kathryn James (2011).

VAT has been the most important development in taxation and over the last half-century; it becomes a widely accepted indirect tax system across the globe.

According to the Royal Malaysian, Customs Department (Jan. 24, 2014) (cited in [gst.customs.gov.my/en/gst/Pages/gst\\_ci.aspx](http://gst.customs.gov.my/en/gst/Pages/gst_ci.aspx)), 160 countries of the world have implemented VAT/GST.

There is a growing recognition among developing countries of the crucial role of VAT revenue as an instrument of economic development. VAT revenues are increasingly accounting for significant proportion of government revenue to finance the required level of public expenditure both at federal state and local government levels. VAT as a consumption tax has been embraced by many countries worldwide. Because it is a consumption tax, it is relatively easy to administer and difficult to evade. No matter how many transactions the goods went through, the tax is always a fixed percentage of the final price.

VAT is a self-assessment tax that is paid when returns are being rendered. In-built in the new tax system is the refund or credit mechanism which eliminates the cascading effect that is a feature of the retail sales tax. The input- output tax mechanism in VAT also makes it self-policing. In essence, it is the output tax less input tax that constitutes the VAT payable.

It is the equivalent of the VAT paid by the final consumer of the product that will be collected by the government. VAT, also known as goods and services tax (Behan & Jenkins, 2005) proves to be beneficial for the government. Through implementation of this tax system, government can raise revenue. VAT is different from sales tax in various aspects. While sales tax is to be paid on the total value of the goods and services, VAT is levied on every exchange of the product, so that consumers do not have to carry the total cost of tax. However, VAT is generally not applied on export goods to avoid double taxation on the final product. In fact, if VAT is charged on export goods, the tax amount is usually refunded to the tax payer. Value added tax can also be recovered. The individual consumers cannot recover VAT on purchases made by them. However, businesses can recover VAT on the services and materials, which are bought by them in order to continue the supply of the products and services.

In Ethiopia, VAT was implemented effective January 1st, 2003 (Proclamation No. 285/2002) replacing sales tax. VAT in Ethiopia is a multi-stage tax levied at each stage of the value addition chain, with a provision to allow input tax credit on tax paid at an earlier stage, which can be appropriated against the VAT liability on subsequent sales.

According to the Value Added Tax Proclamation (Proclamation No 285/2002) registration for VAT in Ethiopia is both Obligatory and Voluntary. Under the obligatory registration, a person (natural person or legal person), who carries taxable activity is required to file an application for VAT registration with the authority if; a) at the end of any period of 12 calendar months the person made, during that period, taxable transactions the total value of which exceeded ETB 500,000, or b) at the beginning of any period of 12 calendar months there are reasonable grounds to expect that the total value of taxable transactions to be made by the person during that period will exceed ETB 500,000. Under the voluntary registration, a person who carried on taxable activity and is not required to be registered for VAT may voluntarily apply to the authority for such registration, if he/she/it regularly is supplying or rendering at least 75% of his/her/its goods and/or services to registered persons. The VAT rate in Ethiopia is 15% for products and services other than those are zero rated and exempted goods and services. The VAT is expected to enhance revenue, improve economic efficiency, promote exports, and foster growth.

Thus, this study is particularly interested in assessing challenges of VAT administration in Addis Ababa, taking Bole Sub-City Small Tax Payers Branch Office as a sample.

### **1.3 Statement of the Problem**

The Federal Democratic Republic of Ethiopian (FDRE), under Proclamation No 285/2002, has authorized the Federal Inland Revenue Authority (FIRA) or as amended under proclamation No 609/2008 Ethiopian Revenue and Customs Authority (ERCA), to administer the VAT. ERCA, in order to perform the responsibility of administrating VAT and other taxes executed to it, has opened many branches in the country, Bolie Sub City Small Tax Payers Branch Office being one of these Branches. Hence, the branch office is expected to administer the tax (VAT) payers fairly and efficiently. Every Data related to the tax payers is expected to be available in the Branch office. Practically, the Branch office doesn't have organized data regarding the number of registrants for VAT. Even there is no data that show how many tax payers have filed VAT as Payable, Credit or Nill every month. In the Branch Office, there is always crowded of people

(tax payers), making long queue, who are waiting for filing their tax. The tax payers always complain for the long time they spent waiting for accommodation by the employees of the branch office. On the other hand, the employees as well as the higher officials of the Branch Office complain for the work load they have. Even sometimes, they are not willing to respond for question/s raised by tax payers. This shows that the Bole Sub City Small Tax Payers' Branch Office of the Ethiopian Revenue and Customs Authority (ERCA) is unable to execute the responsibility (to fairly and efficiently administer the collection of VAT) entrusted to it. This may result understatement of VAT collection from the registered individual taxpayers as well as unregistered potential taxpayers in the sub city. According to Wollela Abehodie Yesegat (2008), VAT has a significant role in the revenue system of the Ethiopian Government and to sustain VAT's revenue role in the governments finance, it is crucial to ensure that the revenue generated by this tax is raised as efficiently as possible. Nevertheless, in Ethiopia revenues generated by VAT are usually garnered at the expense of a compromise in its salient features which is usually caused by factors including weaknesses in the administration, that is, the incapacity of the administration to put the attributes of VAT in practice (Wollela Abehodie Yesegat, 2008).

This is the problem that needed to be studied. Therefore, on the basis of theoretical and empirical framework, the research will assess the Challenges of VAT Administration in Bole Sub City Small Tax Payers Branch Office of the Ethiopian Revenue and Customs Authority (ERCA) in administering VAT to the potential VAT and to foster voluntary tax compliance.

Unfortunately, there is no recorded study that has been conducted in the sub city to explore reasons behind the poor VAT Administration that may result under potential revenue collection and low voluntary compliance of VAT registrants. Hence, this study is conducted to fill the gap.

#### **1.4 Research Questions**

The study attempts to answer the following research questions.

1. What are the existing Value Added Tax (VAT) administrative activities and how are implemented at Branch Office?

2. What are the main challenges of VAT administration in terms of Service delivery of the tax office and Voluntary compliance of taxpayers at the Branch Office?
3. What is the impact of the challenges on attitude and compliance of taxpayers, service delivery of the Branch Office and tax collection?

## **1.5 Objectives of the study**

### **1.5.1 General Objective**

The general objective of this research is to assess the effectiveness of VAT administration at Bole Sub City Small Tax Payers Branch Office of the Ethiopian Revenue and Customs Authority (ERCA), with a view to improve revenue collection through voluntary compliance by taxpayers.

### **1.5.2 Specific Objectives**

The specific objectives that emanate from the above general objective are:

1. To review the existing Value Added Tax (VAT) administrative activities and its implementation at Branch Office.
2. To examine the main challenges of VAT administration in terms of Service delivery of the Branch Office and Voluntary compliance of taxpayers at the Branch Office.
3. To analyze the impacts of the challenges on attitude and compliance of taxpayers, service delivery of the Branch Office and tax collection.

## **1.6 Significance of the study**

The study will help in identifying the existing challenges of the successful VAT administration of the Branch Office. By identifying the major challenges, the findings of the study are expected to indicate the strategic intervention areas that might improve the administration of VAT by the Branch Office and other concerned bodies.

Thus; the research will help the Branch Office to improve VAT administrative activities so that to increase voluntary taxpayers which may help collect the potential tax (VAT) in the sub city. It will also help taxpayers to get fair and efficient administration from the Branch office. The sum



of the above mentioned benefits will help the government to collect more VAT from the sub city. The researcher will be benefited in fulfilling his master's degree; upgrading his research skill and mental satisfaction for the benefits this study may contribute. The study can also serve as springboard to investigate uncovered areas and to use it as a secondary data in due course of further research.

### **1.7 Scope of the study**

The study has focused particularly on the challenges of VAT Administration in Bole Sub City Small Tax Payers Branch Office of Ethiopian Revenue and Customs Authority. Basically, the study has analyzed VAT administrative activities for the period of recent three years.

The researcher is fulltime employee of a private owned company and is self financed for the research the result of which is constraint of time and finance to be used. Hence, the reason why this study was limited to one Branch Office only is that it could be too costly in terms of time and money to include (cover) other Branch Offices. As mentioned above, the study was limited for three years activity only and the reason was that, it is only three years since the Branch Office had taken over the responsibility of administration and collection of VAT from the previously "Bole Sub City Revenue Office".

### **1.8 Research Methodology**

This section shows details of the research design, the sampling method as well as the source and manner in which the data was collected and analyzed for the study.

#### **1.8.1 Research Design**

In this study, the type of research was descriptive. The rational for selecting this type of research was that the study was not have any control on the variables, rather it described the characteristic of the Branch Office VAT administrative activities and to answer the question what was the best way to administer the VAT in order to collect the potential revenue from the sub city.

## **1.8.2 Data Sources**

### **1.8.2.1 Primary Data sources**

The primary data sources were the VAT registrant taxpayers, the tax officials, and managers in Branch Office. Therefore, open and closed ended questionnaires and interview were prepared for the three target groups, (VAT registrants, Management and Experts) of the Branch Office.

### **1.8.2.2 Secondary Data sources**

Among the secondary data that was used to examine the VAT administration, relevant documents such as the VAT registrants (from ERCA's Head Office), the organizational structure, employees list, Performance Reports etc from the Branch Office was collected.

## **1.8.3 Sample Design and Technique**

The sampling frame for VAT registrant taxpayers was the registration list of tax payers in Branch Office that consists of 5,966 VAT payers collected from the Head office of ERCA at time of field survey. Whereas the sampling frames for the tax officials and officers of the Branch office was the employee registration list of the Branch Office.

In this research probability and non probability sampling techniques was used. From probability sampling technique, simple random sampling technique was used to select the representative sample from the tax payers where as the samples for the tax officials and officers were determined using purposive sampling technique of non-probability sampling method. This is because the need to address experts in the area who are familiar with the tax (VAT) administrative activity.

In this regard, interviews with the respective officials and officers of the Branch Office those are responsible for the tax administration in the sub-city was held.

## **1.9 Limitations of the study**

It is obvious that adequate and reliable information is important to undertake any kind of survey. However, the unwillingness and unavailability of managers, coupled with the unavailability of secondary data in the branch office were the major limitations of this study. To overcome these

limitations, the researcher had contacted the lower level managers and has gone to the head office to collect the required data.

Besides, lack of sufficient fund and time constraint were intended, however to overcome the problem of time data collectors were employed and the researcher has exerted his at most effort to manage it. Regarding the fund constraint, the researcher managed by spending from his personal saving.

Finally, though there were some limitations as stated above, the research is finalized successfully.

### **1.10 Structure of the Thesis**

The thesis has four chapters. Chapter one deals with the important introductory issues that include, Background of the study, Statement of the problem, Objective of the study, basic Research questions, Significance of the study, Scope of the study, Methodology of the study and Definitions for basic abbreviations, terminologies and phrases. At the end of the chapter, the overall structure of the thesis is indicated.

Chapter two deals with literature review on the areas of VAT administration. Chapter three focuses on data presentation, analysis, and discussion based on the information that was obtained by secondary data, questionnaire and interview.

Then, the thesis is concluded by chapter four in which the main findings are summarized, conclusions is drawn, and suggestions and recommendations regarding shortcomings and other issues that need remedies are issued.

## **CHAPTER TWO**

### **2 LITERATURE REVIEW ON VALUE ADDED TAX ADMINISTRATION**

#### **2.1 Introduction**

This chapter presents the theoretical discourses as well as the empirical facts about VAT administration conducted by different scholars. Therefore, the chapter is structured as follows; General Overview on Tax (showing the Direct and Indirect taxes), Value Added Tax (explaining its concept and history), and the administration aspects of VAT. Under the administration aspects, the importance of VAT administration and its organization, the administration process (showing the basic principles of VAT administration) and the administrative tasks are stated. The administrative tasks again include, the identification and registration of tax payers, the filing and payment of VAT returns, controlling of the filing and payment of VAT returns, VAT invoicing, Auditing, penalty and VAT refund are discussed.

#### **2.2 General overview on Tax**

Taxes are important sources of public revenue. The existence of collective consumption of goods and services necessitates putting some of our income into government hands. Such public goods like roads, power, municipal services, and other public infrastructures have favorable results on many families, business enterprises, industries and the general public. Public goods are normally supplied by public agencies due to their natures of non-rivalry and non-excludability. The nature of consumption of public goods is such that consumption by one does not reduce consumption for others. Besides, consumption of public goods by an agent does not exclude others from doing same. Such nature of public goods therefore makes them impossible for private suppliers to avail them at market prices like other commodities. Government intervention in the supply of public goods is therefore inevitable and can only be done if the public pays taxes for the production and supply of such goods.

Basically, there are two main categories of Taxes known as Direct and Indirect taxes. Direct taxes are taxes which suffered by tax payer, where as indirect taxes are paid to tax collector by some others. Accordingly, the major categories of taxes in Ethiopia are stated hereunder.

### **2.2.1 Direct Taxes**

Direct taxes are taxes imposed on direct income of any individual or company. Majority of these taxes have progressive rates generating income tax progressively while others have fixed (flat) rate generating income tax proportionally. Direct taxes include taxes on: Employment Income, Building Rent Income, Business Profit, Interest Income on Deposits, Dividend Income, Royalties Income, Income of Games of Chance, Gains from Transfer of Certain Investment Property, Rental of Property Income, and Income from Rendering of Technical Services outside Ethiopia. (Taxation in Ethiopia, 2005).

### **2.2.2 Indirect Taxes**

Indirect taxes are taxes imposed by government and collected by taxpayers assigned by law from consumers for the transaction of goods or service they get from market. These taxes are; Turnover Tax, Value Added Tax, Excise Tax, Customs duty, and Stamp Duty (Taxation in Ethiopia, 2005).

## **2.3 Value Added Tax (VAT)**

### **2.3.1 Concept of VAT**

Value added tax is not only a simple taxation system, but also is the most common model used in the world today. So, before anything else, we should know the meaning of Value Added and Value Added Tax. From economic point of view, the value added is the difference between the worth of outputs and inputs. But in compilation of the law, it is defined according to the accounting standards and by relaying on invoice method. By considering the above point, the Value Added is defined as the difference between the value of the goods and services supplied and value of the goods and services bought by a person in a specific period of time.

By considering the above definition, the Value Added Tax is a kind of multiphase tax, which is calculated and collected according to a percentage of value added of the goods and services produced and supplied in the process of production and distribution cycle,

[www.investopedia.com/terms/v/valueaddedtax.asp](http://www.investopedia.com/terms/v/valueaddedtax.asp).

Value added tax (VAT) is an indirect tax, which is imposed on goods and services at each stage of production, starting from raw materials to final product. VAT is levied on the value additions at different stages of production and distribution.

The general mechanism under which VAT is collected by Governments can be briefly stated as follows.

Taxable persons charge output VAT, using applicable rates, on the sale of taxable supplies on the invoices they issue to their customers. At the same time Taxable persons pay input VAT to their suppliers via the corresponding purchase invoices. Taxable persons prepare VAT returns showing total output VAT from which the total input VAT is deducted. The excess of the output VAT over the input VAT for a given accounting period (monthly in the case of Ethiopia) is payable within thirty days after the end of the accounting period.

If input VAT is higher than output VAT then the difference is carried forward and set off against future output VAT. As a general principle excess input VAT can be refunded after a certain accounting periods.

### **2.3.2 History of VAT**

According to Kathryn James (2011), though the origins of the VAT have never been decisively settled, VAT was first introduced at a national level in France in 1954, Kathryn James (2011).

The French economist, Maurice Laure, the joint director of the French tax authority, the Director General Des impost, initiated the concept of VAT, which came into effect on April 10, 1954 and it was considered to be one of the major sources of state finance, (Encyclopedia of Management. 2009). But, its original coverage was limited to large businesses only. According to Kathryn

James (2011), France did not move to a full VAT that reached the broader retail sector until 1968. With the passage of time VAT was employed for all business sectors of the country. The first full VAT in Europe was enacted in Denmark in 1967. VAT adoption progressed in two major phases. The first occurred mostly in Western Europe and Latin America during the 1960s and 1970s. The rise of the VAT in Western Europe was accelerated by a series of EEC directives requiring member states to adopt a harmonized VAT upon entry to the European Union. The second phase of VAT adoption occurred from the late 1980s with the introduction of VAT in some high-profile industrialized countries outside the EU, such as Australia, Canada, Japan, and Switzerland. This phase also witnessed the massive expansion of VAT in transitional and developing economies, most notably in Africa and Asia, Kathryn James (2011).

VAT has been the most important development in taxation and over the last half-century; it becomes a widely accepted indirect tax system across the globe.

According to the Royal Malaysian Customs Department (Jan. 24, 2014) (cited in [gst.customs.gov.my/en/gst/Pages/gst\\_ci.aspx](http://gst.customs.gov.my/en/gst/Pages/gst_ci.aspx)), 160 countries of the world have implemented VAT/GST.

Ethiopia having introduced VAT, in place of sales tax, effective Jan 01, 2003 is one of the 160 countries.

## **2.4 VAT Administration**

### **2.4.1 Importance of VAT Administration**

VAT is important tax imposed on all transactions that show additional value on each stage of either production or distribution of goods or services. The tax is collected on the value, which is added during each stage of transaction. Thus it has broad revenue bases as the result of this its revenue generating capacity is high. This tax system encourages self assessment that helps taxpayers to assess VAT themselves. It promotes the trend of using accounting records principle. Because of this, it reduces administrative cost of tax collection as well as evasion. Since the tax

bases the records and collected on transaction it gets, the administration is achieving the main objective that is voluntary compliance.

VAT refunds for taxes paid on charges of production, distribution and administrative activities encourages investment and saving by crediting capital input tax. Stimulates foreign trades because it is applied zero rate on export productions and services in order to get them efficient competent in the world market. It attracts foreign investments, as it is accepted modern tax type by many countries in the world, (Misrak Tesfaye, Msc, 2008).

#### **2.4.2 Organization of Vat Administration**

As indicated by the Indian Government Department of Revenue (report on international best practice in VAT administration), Execution of a good tax payer strategy relies heavily on the organization designed to facilitate it. A successful VAT administration requires both an effective field delivery function and excellent guidance and oversight from headquarters. The two levels of administration (field and headquarters) have quite different functions and responsibilities. The field offices being responsible for assessing and collecting tax liabilities, while headquarter is fundamentally a design and oversight body, Indian Government Department of revenue, (2006).

It is also stated on the International Tax Dialogue, the value added tax experiences and Issues (March, 2005) that the introduction of VAT can facilitate a substantial improvement in overall tax administration, and indeed adoption of the VAT is often seen as an opportunity for overall tax administration modernization; however, it has occasionally disrupted the functioning of an existing administration because of inadequate preparations and/or ill-advised implementation decisions and there is one important decision concerning where to place VAT administration within the overall tax administration and suggests three possibilities;

1. Administration of the VAT by the department responsible for domestic tax operations (including personal and corporate income taxes, and, in several countries, social contributions);
2. Administration by a separate VAT department; or



### 3. Administration by the customs department.

In the case of Ethiopia, VAT is administered by the Ethiopian Revenue and Customs Authority (ERCA). The authority has got various Directorates at the Head Quarter and Branches in different parts of the country. The Finance Bureaus of Regional States of the country are also authorized to administer VAT in their territory. In fact, there is a specific VAT Directorate at the Head Quarter which is responsible for the administration of VAT. However, the branches including Bole Sub City Small Tax Payers' Branch Office lack to have separate VAT section

## **2.5 VAT Administration Process**

### **2.5.1 Basic Principles Governing VAT Administration**

Modern tax administrations operate on the principles of Voluntary compliance and self-assessment. Voluntary compliance is to mean that taxpayers are expected to comply with their basic tax obligations with only limited intervention by revenue officials whereas self assessment is to mean taxpayers, with reasonable access to advice from the tax administration, calculate their own tax liabilities; complete their tax returns; submit returns and payments to the tax administration; and are then subject to risk of audit. As a country that introduced modern taxation system, Ethiopia's VAT administration system allows to follow the abovementioned principles.

#### **2.5.1.1 Voluntary compliance**

The promotion of voluntary compliance is the primary objective of revenue authorities. In order to achieve high levels of voluntary compliance, taxpayers and their representatives must have a good standard of services, which help them determine their obligations under the laws and to complete the steps required to acquit those obligations.

Like any other revenue authorities, ERCA has several tax laws and regulations upon which it operates with a spectrum of needed compliance instruments. The preferred option of ERCA is adopting an administrative approach that encourages voluntary compliance with in a co-operative and participative regulatory environment. Although this approach can be viewed as the

strength of the VAT administration in Ethiopia, the practical observation is far apart from this wish.

It is relevant to mention here that voluntary compliance is promoted by an awareness of rights and expectations of a fair and efficient treatment and the existence of clear, simple and “user-friendly” administrative system and procedures. In other words, voluntary compliance is enhanced when it is easier for taxpayer to do so. However, due to the low coverage and poor performance of these matters and some other cultural and administrative problems, voluntary compliance is hardly attained objective in Ethiopia ([ukessays.com](http://www.ukessays.com/essays/finance/assessing-the-vat-administration-in-ethiopia-finance-essay.php), Assessing the VAT Administration in Ethiopia).

<http://www.ukessays.com/essays/finance/assessing-the-vat-administration-in-ethiopia-finance-essay.php>).

#### 2.5.1.2 Self Assessment

Self-assessment requires more than simply permitting the taxpayer to make the tax calculations and pay the amount calculated without notification from the tax administration. The concept is based on the understanding that taxpayers are, because of the information known only to them, best placed to assess their tax liabilities and that the tax authorities’ efforts are best directed to identifying those taxpayers most likely to understate their tax liabilities, and focusing their scarce resources on the greatest areas of risk, (International Tax Dialogue, the value added tax experiences and Issues (March, 2005)).

As indicated by the Indian Government Department of Revenue, “report on international best practice in VAT administration”, the modern tax management relies heavily upon risk-assessment tools to determine which taxpayers' matters must be examined very closely, not merely at the audit level, but at all stages of the tax process, from registration to collection. In order for such a self-assessment system to be effective, the apparent freedom granted to

taxpayers must be backed up with a supportive legislative framework and a comprehensive and integrated set of administrative processes, (Indian Government Department of revenue, 2006).

When we look at the Ethiopian situation in light of this view; VAT is self assessed tax and this can be viewed as its strength that, one of the important features of modern tax administrations is the provision for self assessment. The responsibility for the correct calculation and timely payment of VAT rests on the taxpayer himself. In fact there are varieties of circumstances in which the authority may issue an additional assessment such as in the case, where a person fails to furnish a return as required by law, and if the authority is not satisfied for any reason of perceived risks. However, there was no formal compliance risk management policy and strategy until June 2010. It is in June 2010 that ERCA has endorsed compliance risk management policy and strategy which is expected to bring a significant improvement on the compliance management efforts of the authority.

## **2.6 VAT Administration Tasks**

### **2.6.1 Tax Payers' Identification and Registration for VAT**

According to the Indian Government Department of revenue, (2006), identification of potential but unregistered dealers is usually done in a two-fold manner:

1. Audit of registered taxpayers: The first approach is to audit registered taxpayers in order to detect their unregistered suppliers or customers. If VAT is in place, this may be done by checking that purchases invoices on which VAT credits are claimed and sales invoices show a valid TIN; detection of an invalid TIN may lead to the detection of unregistered taxpayers.
2. Locality inspections: The second approach involves searches or inspections in which a group of officials go door-to-door within a particular geographical area, checking that all persons or establishments engaged in taxable business activity in that area are properly registered.

In the case of Ethiopia, as indicated by Teklu Kasa (2011), the most used technique for identification unregistered taxpayers for VAT is door-to-door inspection.

VAT requires a dynamic approach to new taxpayer registration and the key requirements of the registration system are:

- On commencement of the VAT to ensure that all existing businesses with turnover above the threshold are registered automatically
- To ensure that new businesses operating above the threshold are identified quickly by the VAT office the most effective administrations have put in place systems to ensure automatic registration where a new business is registered with an organization such as the companies office, business registration department etc.
- Identify potential false registrations which are likely to be a precursor to attempted VAT fraud.

Efforts should be made to keep the registration process user friendly like having a single page registration form and doing away with all the unnecessary information requirements.

The registration process will generally include functions such as: the automated allocation of a taxpayer identification number, issue of a VAT certificate, issue of initial blank return and will also trigger a taxpayer service advisory contact, Indian Government Department of revenue, (2006).

The Indian Government Department of revenue, (2006), has also stated that one of the common problems faced by VAT administrations is the over-registration of taxpayers with only a small percentage of the registered taxpayers actually filing returns and paying taxes. This makes it more difficult to identify and monitor taxpayers who contribute significant amount of revenue and creates an unproductive workload for the tax administration. This makes it essential to set a reasonable registration threshold keeping in view the administrative capacity of the department.

In Ethiopia, registration for VAT is categorized in to three. These are obligatory, voluntary and special business categories. The threshold for obligatory registration is the annual taxable turnover that exceeds Ethiopian Birr 500,000. The primary intention to limit the registration threshold was consideration to administrative feasibility. However with this threshold limit even,

the registration performance tends to be unsatisfactory. Under the category of voluntary registration, a person who carried on taxable activity and is not subject to mandatory registration may voluntarily apply to the authority for such registration, if he regularly supplies at least 75% of his taxable goods and services to VAT registered person, FDRE VAT Proclamation No.285/2002.

The third category of registration, special business categories are defined as forced registrants regardless of the threshold. Such forced special business category registrants are: Gold, Electronics, Importers, Shoe factories, Level ten and above constructors, Computers and their accessories, Leather and leather products, Plastic and plastic products. This is done in order to get fair market competition between the special business categories. If registration by special business categories not implemented, market competition difference would be seen among registrants and non-registrants within them.

In line with the threshold limit for obligatory registration, the government set turnover tax as equalizing factor to enhance fairness in commercial relations and make complete the coverage of the tax system at the same time reaching those tax payers below the threshold value. However due to the low enforcement capacity and some other reasons it tends to be less performed and viewed by registered taxpayers as ill addressed area. For example the Ethiopian Chamber of Commerce and Sectoral Association in its release on National Business Agenda stated the following:

“A VAT registrant has to charge consumers an indirect tax of 15% of the value of goods or services sold. A non registrant, however, pays a turnover tax (TOT) of 2% on goods sold and 2-10% on services rendered. Given these rates VAT registrants could not compete in the market. More over the tax Authority has limited capacity to enforce compliance. Knowing the authority’s limitations, many business enterprises who are required to register for VAT do not comply. This situation has created a distorted market, where those registered for VAT are subjected to unfair competition” (Ethiopian Chamber of Commerce & Sectoral Association 2007-2008 pp8) As we

can understand from these statements, their argument refers to the wider gap between the VAT rate of 15% and the 2% rate for turn over tax which led to market distortion (unfair competition) together with the limited administrative capacity of the authority to enforce and facilitate the proper management of the turnover tax and the registration to VAT.

According to the FDRE Proclamation No 285/2002, cancellation of VAT registration is allowed. A registered person is to apply to have his registration for VAT canceled if he has ceased to make taxable transactions. A registered person may apply to have his registration for VAT canceled at any time after a period of three years of the date of his most recent registration for VAT if the registered person's total taxable transactions in the period of 12 months then beginning reasonably are expected to be not more than 500,000 Birr.

The cancellation of VAT registration takes effect at the time the registered person ceased to make taxable transactions or, if the registered person has not ceased to do so, at the end of the accounting period during which the person applies to the Authority for cancellation of VAT registration. If a person's registration for VAT is canceled, the Authority is required to remove the person's name and all other details from the VAT register and the person is required to return the issued certificate of registration, (FDRE Proclamation No 285/2002).

The procedure for cancellation of VAT registration is clearly stated under FDRE Regulation No 79/2002 as follows. A registered person must apply for cancellation of registration within 30 days of the date the person ceases to make taxable transactions. The application for cancellation shall be in writing, shall state the date upon which the person ceased to make taxable transactions, and shall state whether or not that person intends to make taxable transactions within 12 months from that date.

The Authority shall approve an application for the cancellation of registration unless the Authority has reasonable grounds to believe that the person will make taxable transactions at any time within 12 months from the date of cessation.

While the cancellation of registration generally takes effect on the date of cessation, if the Authority is satisfied that the registered person did not make taxable transactions from the date the registration took effect, the Authority can cancel the registration retroactive to that effective date,

When registration is cancelled, the registered person may be deemed to have sold the goods on hand in a taxable transaction.

Any obligation or liability under the Proclamation, including the furnishing of returns, of any person in respect of anything done by that person while the person was a registered person, is not affected by cancellation of the person's registration, (FDRE Regulation No 79/2002 as follows).

### **2.6.2 VAT Filing and Payment**

VAT filing practices differ among countries. According to a Jantscher (1990) as cited by Welella A.Y. (2008), in some developing countries, (like Argentina, Mexico, Peru...), taxpayers effect provisional payments monthly and file returns annually; while most developing countries require monthly filing and payment of VAT and do not require taxpayers to furnish a yearly return. In the case of Ethiopia, the VAT accounting period is one month and taxpayers are required to file VAT returns accompanied by the appropriate payments on monthly basis and there is no year-end reconciliation requirement. Though the VAT legislation in Ethiopia allows taxpayers a 30-day period within which to file returns and make payments, in practice, there are three VAT reporting periods depending on whether a taxpayer is reporting a nil (no activity), credit (input VAT exceeds output VAT) or payment (output VAT exceeds input VAT). The reporting time from the end of the accounting period is 10 days for nil filers, 20 days for credit filers and 30 days for payment filers.

Tax payers complain regarding the above mentioned reporting periods, especially the 20-day period for credit filers is very short. This is a problem especially for taxpayers conducting

business at several locations for the reason that gathering documents from different offices takes time.

Return filing could be done by going to the premises of the tax authority in person, through the post office or electronically. In Ethiopia, taxpayers file VAT returns by going to the tax office in person. This is a problem for taxpayers that reside in remote areas (where the ERCA does not have branch offices) and are forced to go to the capital city, Addis Ababa, or nearby cities where the tax authority has a branch office. In addition, in terms of the method of payment, in Ethiopia taxpayers with VAT liability greater than ETB 1,000 may be required to effect payments with bank Certified Payment Orders (CPOs). In fact, the use of CPOs is, to avoid the problem of insufficient fund balance that might arise from accepting taxpayers' cheques. Nevertheless, such a practice imposes a cost on taxpayers in the form of out of pocket payment (CPO preparation fees charged by banks) and time costs.

Generally, the above mentioned practices pertaining to reduced VAT reporting periods, the return filing process and the method of effecting payments are increasing taxpayers' compliance costs, especially on small businesses.

### **2.6.3 Control of VAT Filing and Payment**

In administering VAT, the Ethiopian tax authority uses computer programs, namely:

Standard Integrated Government Tax Administration System (SIGTAS) and Automated System for Customs Data Management (ASYCUDA), W.A. Yesegat, (2008). The computer programs are used to maintain taxpayer register and process VAT returns. Detection of non-filers seems to be carried out mainly manually. The tax authority tries to identify non-filers in collaboration with the Ministry of Trade and Industry. In Ethiopia every trader is required to renew business license annually with the pertinent offices under the Ministry of Trade and Industry or regional governments. To renew business licenses, traders are required to produce evidence from tax authorities that all taxes have been paid. The tax authorities on their part, before providing the evidence to taxpayers, check if there are delinquent taxes (including VAT).



Besides to the annual license renewal, traders are also required to submit tax clearance every six months when they need to participate in any tender. As Jantscher (1990) noted that most developing countries detect non-filers manually after a long delay putting the collection of the delinquent tax at risk, the above practices pertaining to controlling VAT filing and payment delay the collection of the tax and jeopardize the government's revenue.

#### **2.6.4 VAT Invoicing**

Jantscher (1990), cited by Welella.A.Ysgat, (2008), noted that unlike developed countries most developing countries require some form of invoicing for all transactions subject to VAT including sales to final consumers. In Ethiopia, the VAT proclamation under article No '22' sub article '6' and '7' states two things. Firstly, in the case of a registered person's supply of goods or rendering of services at retail to purchasers who are not VAT registered persons, a receipt or simplified form of VAT invoice may be used instead of a VAT invoice. Secondly, waive a registered person's obligation to issue a receipt or tax invoice for cash sales if the total consideration for the entire supply does not exceed 10 birr. To facilitate the implementation of these provisions the then Minister of Revenue (which later combined with the then Federal Inland Revenue Authority (FIRA) to form the current Ethiopian Revenue and Customs Authority (ERCA)) has been empowered to issue directives under VAT proclamation No 285/2002 article No '22' sub article '6' and '7'. According to the proclamation, the VAT legislation empowered the Ministry of Revenue to issue the relevant directives, FDRE Proclamation No 285/2002. However, the pertinent directives had not yet been issued. Consequently, all registered traders (including those who have transactions with total consideration not exceeding ETB 10) are effectively required to issue the standard VAT invoice. According to Welella.A.Ysgat,(2008), problems raised by tax payers include the difficulty of getting invoices on purchases and details of customers for the preparation of sales invoices, the problem of supplying without invoices (by giving the option of buying with or without invoices to customers) and using duplicated invoices. The optional issuance of VAT invoices in some sectors reveals that invoices are being used as a

negotiation tool between customers and VAT registered businesses. That is, full VAT is chargeable if a customer needs invoices. Such a practice can jeopardise the use of invoices as a revenue safeguarding tool, lack of consistency in using invoices and also emphasized the need to design a strategy that can encourage customers, including government institutions, to ask for VAT invoices. Welella.A.Ysgat, (2008), added that there appear to be various factors contributing to the invoicing problems mentioned above. The factors include lack of tax administrators' follow-up and control, lack of awareness among the society and the prevalence of poverty.

#### **2.6.5 VAT Auditing**

The only real solution to the evasion problem is a good tax administration and, especially, a strong VAT audit program that needs, among other things, an appropriate audit case selection method, Edmiston and Bird 2004, cited in Welella A. Yesgat (2008). Jantscher 1990, cited in Welella A. Yesgat (2008) also noted that cross checking purchases and sales data by various taxpayers would provide an effective tool for selecting VAT taxpayers for audit and hence improve audit results. From the above statements, it can be said that tax audit is one of the most important tools of treating compliance risk by tax administrators. However, it is also considered to be one of the capacity challenges to many administrations. The Indian Government Revenue Department study indicated that it has generally been observed that audit is most often the weakest component of VAT administration, early in the implementation phase. This is because a completely new law is introduced, and both the department's staff and the dealers are inexperienced with it" (Indian government department of revenue 2006, pp 61).

For audit to be efficient and effective, it should be supplemented by sound risk management /selectivity practices. The lack of sound risk management practice is one of the most contributing factors for the insignificant impact of audit on VAT compliance efforts.

In respect of VAT audit in Ethiopia, the selection criteria include: credit declaration, nil VAT declaration, non-filers, unusual VAT filing patterns, and information obtained from third parties.

Cases selected based on the above criteria would be subjected to audit, Welella A. Yesgat (2008).

However lacking confidence to make decisions and willingness to help taxpayers, tax administrators are not qualified enough and also not capable of handling cases quickly, particularly at the time of audit. The tax administrators also fail to give consistent information on the same VAT issues.

In general, the quality of auditors (VAT administrators at large) that appears to be poor coupled with their relatively small number is affecting the effectiveness of the audit program. This is, in turn, likely to impact on the revenue that could be generated through effective audit programs and on the use of effective audits as tools of deterring noncompliance.

#### **2.6.6 Penalties**

From examination of the practices pertaining to VAT penalties, Jantscher 1990 cited in Welella A. Yesgat (2008), noted that in most developing countries the stricter penalties in VAT laws are usually not applied, thus penalties have little deterrent effects. The Ethiopian VAT proclamation /legislation clearly states that taxpayers that fail to comply with the requirements of VAT are chargeable with penalties ranging from financial to imprisonment. It sets out the rights and obligations of the tax officers as well as the tax payers. There are clearly stated provisions about the powers and penalties available to the tax authorities including the administrative settlement of tax offences and other related issues. In order to implement the above stated laws, the tax authority started enforcing the penalty provisions (including the stricter ones) of the VAT legislation to some extent. For instance, a tax payer who failed to file, regardless of his filing (nil, Credit or payment) is penalized ETB 2,000.00 for each accounting period. The current trend differentiate between violations leading to customer education or warning and deliberate non-compliance leading to penalties i.e. those who are willing to be compliant but don't understand (making mistakes) are tackled through simplification of procedures, guidance and taxpayer

education and those who deliberately violate are treated through ranges of appropriate enforcement actions and penalties.

#### **2.6.7 VAT Refund**

Grandcolas, 2005 and Jantscher, 1990 cited in Welella A. Yesgat (2008) noted that managing VAT refunds is one of the challenges of VAT administrations in developing countries. In managing refunds and combating refund frauds, different countries use schemes including denial of refund claims (except to exporters), carrying forward of refund claims, demanding a third party certification of the claim, demanding guarantee, requiring taxpayers to have separate VAT bank accounts, zero rating of supplies to exporters and remission of input VAT on certain goods (mainly capital goods). Some of these schemes are not only to combat refund frauds, but are also intended to reduce the strain on business cash-flows.

Looking closely at the practices concerning VAT refunds in developing countries shows that all developing countries give refunds to exporters and some require other VAT taxpayers to carry forward their excess credits indefinitely (Jantscher 1990, cited in Welella A. Yesgat (2008)).

For the purpose of refunds, the Ethiopian VAT legislation categorizes taxpayers into two groups: zero rated businesses (mainly exporters) and other (non-exporting) businesses.

According to the FDRE VAT proclamation, VAT refund is practical if at least 25 percent of the value of a registered person's taxable transactions for the accounting period is taxed at a zero rate. The Authority refunds the amount of VAT applied as a credit in excess of the amount of VAT charged for the accounting period within a period of two months after the registered person files an application for refund, accompanied by documentary proof of payment of the excess amounts.

In the case of non exporter registered persons, mainly importers the amount of VAT applied as a credit in excess of the amount of VAT charged for the accounting period is to be carried forward to the next five accounting periods and credited against payments for these periods, and any unused excess remaining after the end of this five-month period is refunded by the Authority

within a period of two months after the registered person files an application for refund, accompanied by documentary proof of payment of the excess amounts.

If a registered person is entitled to a refund is not paid by the Authority that is satisfied with in two months whichever is applicable, the Authority pays the person entitled to the refund, interest set items, for export at 25% over and above the highest commercial lending interest rate that prevailed during the preceding quarter, (proclamation No.285/2002, Art. 27).

In Ethiopia, in addition to the zero rate export items, voucher system is used for coffee exports. Coffee exporters can use vouchers as VAT payments to suppliers of coffee for export. The main purpose of the voucher system is to reduce the number of refund requests.

## **CHAPTER THREE**

### **3 DATA PRESENTATION AND INTERPRETATIONS**

#### **3.1 Introduction**

The nature of this research is descriptive type that incorporates fact finding inquiries and surveys with regard to the Value Added Tax Administration and its related challenges. As it is stated in chapter one of this research, the objective of this research is to assess the effectiveness of VAT administration at Bole Sub City Small Tax Payers Branch Office of the Ethiopian Revenue and Customs Authority (ERCA), with a view to improve revenue collection through voluntary compliance by taxpayers.

This may give some possible insights to tax administrators to give closer attention towards tackling the challenges raised in association with the VAT administrations by providing appropriate suggestions. Quantitative analysis techniques are used to analyze the collected data. Thus the analysis of the data is accessible by means of percentages, tables and figures with simple mathematical calculations.

Data was collected through questionnaire from the selected employees and VAT registered taxpayers, in Bole Sub-City Small Tax Payers Branch Office.

The questionnaire has three sections. Section “A” begins with personal data of the respondents such as age group, sex, and educational level. Work experience of the employees of the Branch Office and the time for how long the tax payers have been registered for VAT are also included in section “A”. Section “B” of the questionnaire contains issues related to the tax office which includes human Resource related, policy related issues, Awareness of the public and the business society towards the policies and Vat administrative issues are included where as section “C” holds taxpayers related issues.

Close and open ended interviews were also conducted with selected employees. In order to keep the balance of conclusions and recommendation that are drawn from the findings generated from

the collected data, the same questionnaires were distributed to both the employees and tax payers in the branch office.

The questionnaires were distributed to a total number of 380 samples (350 from VAT registered taxpayers and 30 from employees of the Branch Office).

Hence, the data is analyzed and interpreted in this chapter from which conclusions and recommendations are drawn and presented in chapter four of this research.

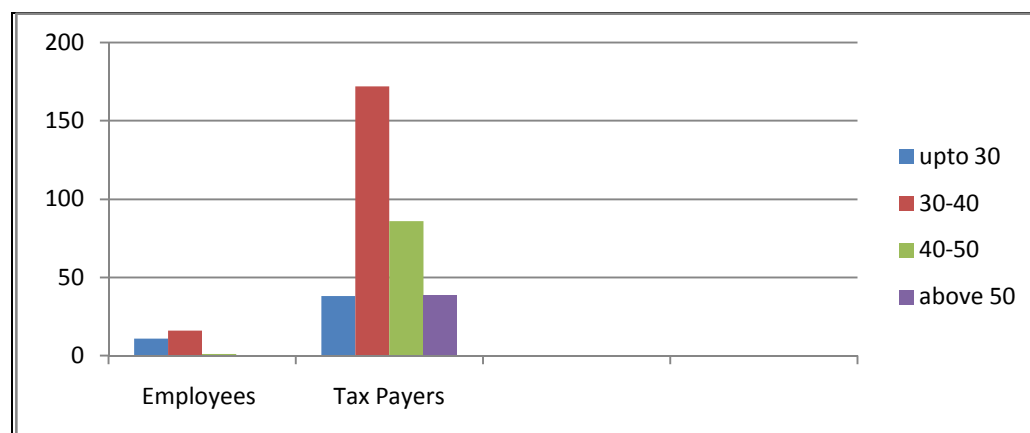
Among the 385 questionnaires, 363 (95.5%) responses were gathered (i.e. 335 (95.7%) from VAT registered taxpayers and 28 (93.3%) from employees of the Branch Office).

The details of the respondents and their responses are revealed and interpreted in the following parts of this chapter.

### 3.2 Respondents' Personal Data

VAT registrant taxpayers are the main witnesses to explain the VAT administrative activities of the branch office. The survey result in this section reveals the gender, level of education, and their experience as VAT registrant. In the same manner, the employees of the branch office were also requested to reveal their age group, sex, educational level and their work experience in ERCA. The result of the personal data of both the tax payers and employees of the branch office is stated hereunder.

Figure 3-1 Age Group of both Respondents



Source: Field Survey Result 2014

The age group of both the respondents is analyzed in the above table and the result is presented here. The age group of the employees in years is 11 (39%) up to 30, 16 (57%) 30-40, and 1 (4%) 40-50 years. On the same manner the age group of the tax payer respondents in years is found as 38 (11%) up to 30, 172 (51%) 30-40, 86(26%) 40-50 and 39 (12%) 40-50 years

Following the age group, both respondents (employees of the branch office and VAT registered tax payers) were requested to tick on the box of their respective gender and the result is stated in the following manner.

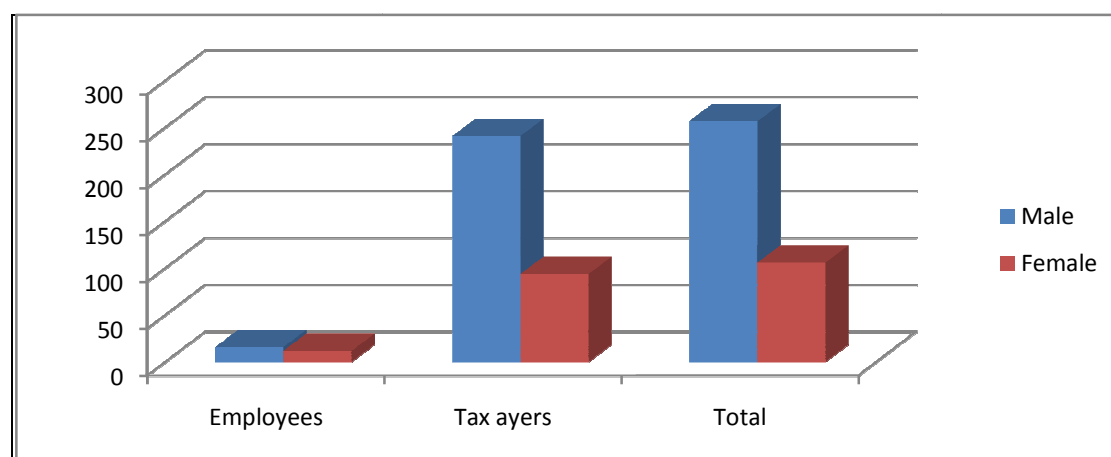
**Table 3-1** Gender of both Respondents

Respondents	Male		Female		Total	
From Employees of the Branch office	16	57%	12	43%	28	100%
From Tax Payers	241	72%	94	28%	335	100%
Total	257	71%	106	29%	363	100%

Source: Field Survey Result 2014

As indicated in the above table, 16 (57 percent) of the employee respondents and 241(72 percent) of VAT registrant taxpayer respondents are male while 12 (43percent) of the employee respondents and 94(28 percent) of VAT registrant taxpayer respondents are female. This can be seen graphically as follows.

**Figure 3-2** Gender of both Respondents



Source: Field Survey Result 2014



Out of the 28 employee respondents, 16 are male and 12 are female. From the 335 tax payer respondents, 241 are male while the remaining 94 are female. Over all, out of the total 363 respondents, 257 are male and 106 are female.

After the age group and gender, the survey regarding the educational level of both the respondents was made and the result of the survey is stated in the following table.

**Table 3-2** Respondents' Level of Education

Respondents	Grade 12 and below		Diploma		First Degree		Masters and above	
Employees of the Branch Office	0		2	7%	26	93%	0	
Tax Payers	28	8%	127	38%	180	54%		
Total	28	8%	129	35%	206	57%	0	

Source: Field Survey Result 2014

As it is shown in above table, 93% of the employee respondents are first degree holders and 7% are diploma holders. When we see to the respondents from the tax payers, 57% are first Degree holders and 35% are Diploma holders while the remaining 8% are 12<sup>th</sup> grade and below. From the above data, we can see that there is no literacy problem from both respondents to understand the tax laws and comply accordingly.

In addition to the survey made on the above mentioned personal data, survey on work experience (in ERCA) of the employees of the branch office and the period for which the tax payer respondents have been registered for VAT was also made. The following result was found from the survey.

**Table 3-3** Employee Respondents' Work Experience, in ERCA

Details	Years of Service				
	Below 1 year	1-2 years	2-3 years	Above 3 years	
Number of Employees	16	7	3	2	28
Percentage	57%	25%	11%	7%	100%

Source: Field Survey Result 2014

From the above table we can see that 57% of the employees have worked with ERCA for less than one year and 25 % of them for less than two years while 11% and 7% of them have served for 2 to 3 and above 3 years respectively. The survey result obtained from the sample of employee respondents shows that the employees of the branch office are not experienced enough to serve the tax payers to the expected level.

When we see the survey result for the period of the VAT registered tax payers have been registered, the result shows the following.

**Table 3-4** Tax Payers Experience in Paying Tax

Details	Years of Service				Total
	Below 1 year	1-2 years	2-3 years	Above 3 years	
Number of Tax Payers	39	32	143	121	335
Percentage	12%	9%	43%	36%	100%

Source: Field Survey Result 2014

From the above table we can see that about 79% of the respondents have been paying VAT for more than two years and it is only 21% of them that have been paying VAT for less than two years. This data may help to have confidence on their response to the questionnaires.

### 3.3 Human resource

This can be seen in terms of Organization Structure, Quality and Quantity of Human Resource.

#### 3.3.1 Organization Structure of the Branch office

Organizational structure is the formal system of task and reporting relationships that controls, coordinates, and motivates employees so that they cooperate to achieve an organization's goals. An organizational structure is mainly hierarchical concept of subordination of entities that collaborate and contribute to serve one common aim.

An organization can be structured in many different ways and styles depending on its objective.

The structure of an organization determines the modes in which it operates and performs.

Organizational structure allows the expressed allocation of responsibilities for different functions and processes such as branch, department, workgroup and individual.

An effective organizational structure shall facilitate working relationships between

Various entities in the organization and may improve the working efficiency within the organizational units. International norms dictate to organize tax administrations on function line for optimal performance. In Bole Sub city Small Tax Payers' Branch Office of ERCA, is organized based on tax administration function to be carried out for all types of tax payers such as tax assessment and collection, audit and investigation, customer service etc rather than based on type of tax. As it is stated earlier, ERCA has separate VAT department at head office level but, this type of structure is not applied in the branch office.

The respondents were asked whether they believe that the organization structure of the branch office is appropriate for service delivery to the tax payers and the result is presented below.

**Table 3-5** Respondents' Opinion on the Organization Structure

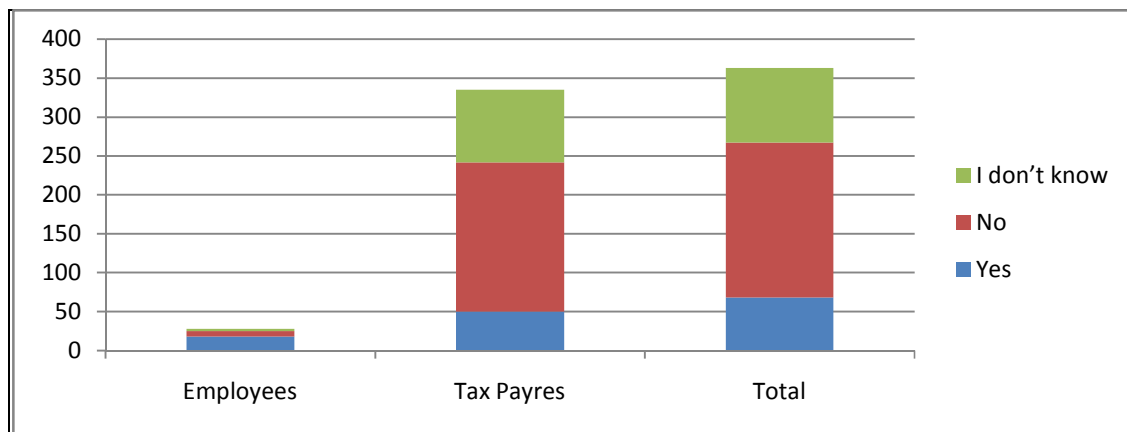
Respondents	Yes		No		I don't know	
Employees of the B/O	18	64%	7	25%	3	11%
Tax Payers	50	15%	192	53%	93	26%
Total	68	19%	199	55%	96	26%

Source: Field Survey Result 2014

As can be seen from the above table 64% of the employee respondents said it is appropriate and 25% of the said not appropriate while the remaining 11% know nothing. From the taxpayer respondents, 19% said it is appropriate and 53% said not appropriate while 26% know nothing. When we see to the overall respondents, 19% appropriate, 55% not appropriate and 26% know nothing. Hence though the majority of the employee respondents said appropriate, the majority of the taxpayer respondents said the Organization Structure is not appropriate.

This can be presented graphically as follows.

**Figure 3-3** Respondents' Opinion on the Organization Structure



Source: Field Survey Result 2014

In addition to the presentation of respondents, it was also observed from the open ended interview that the organization structure lacks career development. It doesn't give chance the employees at the lower status to be promoted upward. This leads to high employees' turnover.

### 3.3.2 Quantity and quality of Human Resource

Human resource is the most valuable asset of any organization. It is the most contributor to the realization of an organization's objectives. The objective of human resource management is to help an organization meet its strategic goals by attracting, and maintaining employees and also to manage them effectively. An organization's human resource function may possess selection and recruitment policies, disciplinary procedures, reward/recognition policies, human resource plan, or learning and development policies. Activities also include managing employee benefits and

compensation, employee records and personnel policies. Bole Sub City Small Tax Payers' Branch Office has a manpower administrative unit in the approved organizational structure of current tax administration which is directly responsible to the Manager of the Branch Office. It has the responsibility of organizing employee data, training, controlling and other related activities. In order to achieve its objectives, the Branch Office has to have stable, skilled, and sufficient number of manpower. The respondents were asked to confirm whether there exists stable, skilled and sufficient number of man power. Regarding this, four questions were raised and the questions together with their respective answers from the respondents are presented as follows.

The first question was "How do you evaluate employees' turnover in the Branch Office?" The response from both respondents is stated here under.

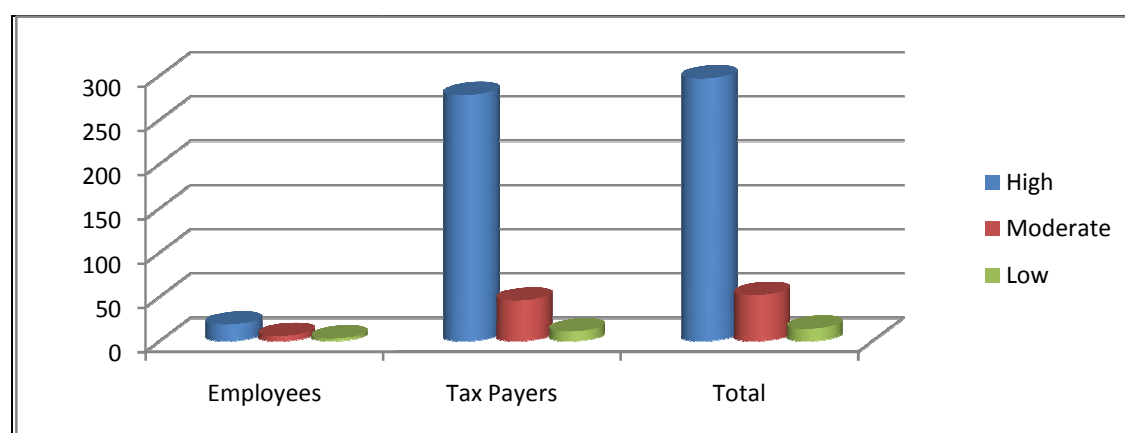
**Table 3-6** Respondents opinion on Employees' Turn Over

Respondents	High		Moderate		Low	
	Count	Percentage	Count	Percentage	Count	Percentage
Employees from B/O	19	68%	6	21%	3	11%
Tax Payers	278	83%	46	14%	11	3%
Total	297	82%	52	14%	14	4%

Source: Field Survey Result 2014

This is graphically represented as follows.

**Figure 3-4** Respondents opinion on Employees' Turn Over



Source: Field Survey Result 2014

As can be seen from the above data, 68% of employees' respondents said that there is high employees' turnover while 21% and 11% of them said that the employees' turnover is moderate and low respectively. On the other hand 83% of the tax payer respondents said that there is high employees' turnover while the rest 14% and 3% have said moderate and low respectively. When we see the overall respond, 82%, 14% and 4% have said high, moderate and low respectively.

Besides the above data, it was also revealed during the interview that the employees' turnover in the branch office is very high. The interview was conducted with selected employees of the branch office. During the interview, the interviewee has mentioned some of the reasons for the high employees' turnover as follows. As mentioned earlier, the organization structure does not allow upward promotion for the lower level employees. Besides to this the existing employees' benefit is not satisfactory. Hence the main reasons for the high employees' turnover are unsatisfactory employees' benefit and no hope for future carrier development (having organization structure that doesn't allow upward promotion).

It is obvious that employees' turnover can affect VAT administration. The respondents were asked the question "to what extent does the employees' turnover affect VAT administration in the branch office?" The response of the respondents is shown in the following table.

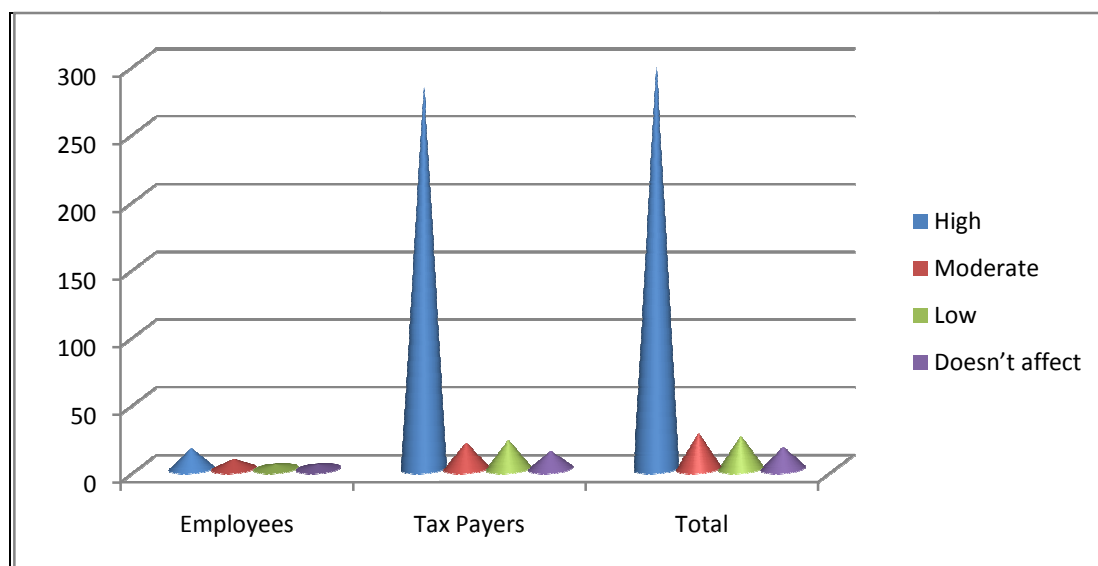
**Table 3-7** Respondents opinion on the effect of Employees' Turn over on VAT Administration

Respondents	High		Moderate		Low		Doesn't Affect	
Employees	15	54%	7	25%	3	11%	3	11%
Tax Payers	282	84%	19	6%	21	6%	13	4%
Total	297	82%	26	7%	24	7%	16	4%

Source: Field Survey Result 2014

The graphical presentation can be seen as follows

**Figure 3-5** Respondents opinion on the effect of Employees’ Turn over on VAT Administration



Source: Field Survey Result 2014

Hence from the above data, we can understand that the employees’ turnover highly affects the VAT Administration in the branch office.

Another question regarding the number of employees in the branch office was raised. The question was “Do you believe that there is sufficient number of employees in the Branch office?” The response for this question is presented in following table in terms of number and percentage of respondents.

**Table 3-8** Respondents Opinion Regarding the Number of Employees in the Branch Office

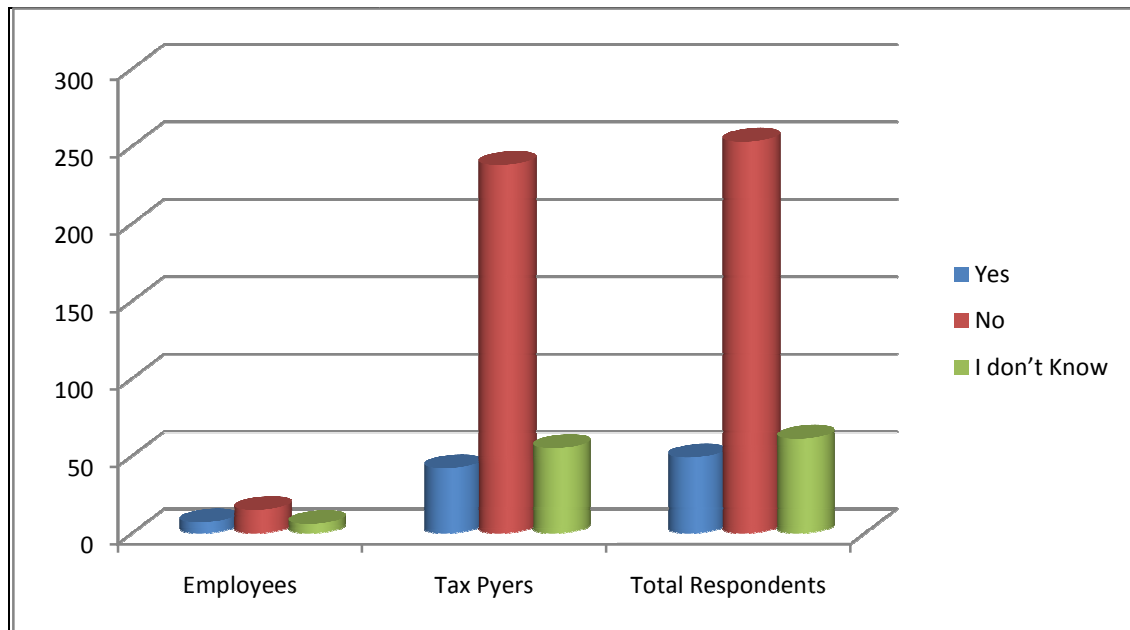
Respondents	Yes		No		I don't know	
	Count	Percentage	Count	Percentage	Count	Percentage
Employees	11	39%	16	57%	1	4%
Tax Payers	40	12%	261	78%	34	10%
Total	50	14%	277	76%	36	10%

Source: Field Survey Result 2014

From the above data, one can say that the number of employees is not sufficient to service the tax payers to the expected level.

The last question regarding Human Resource was “Do you believe that there are skilled employees in the branch Office?” and the response of the respondents is presented graphically as follows.

**Figure 3-6** Respondents Opinion on Skilled Manpower



Source: Field Survey Result 2014

From the above chart, we can see that the employees are not skilled enough to the expected level to provide the required service to the tax payers. As it is observed during the interview session, the reason for the unavailability of skilled employees is high employees' turn over. Employees are recruited directly from universities and are directly assigned to job without sufficient job training. After they acquire some skill, they left the office and then similar recruitment continues leaving the office to lack skilled employees.

### **3.4 Policy Related Issues**

According to the FDRE proclamation number 285/2002, a person whose annual turnover is ETB500,000 and above are compulsory to register for VAT. The threshold for VAT registration has been put in place for administrative purpose. VAT registered tax payers and the employees of the branch office were asked to forward their opinion whether the existing threshold is high, moderate or low for VAT registration. Out of 335 taxpayer respondents, 230(69%) replied that the threshold is high, 85(25%) of them replied that it is moderate and 20(6%) replied as low. As



can be understood from the responses provided by the taxpayers, the majority, 142(54%) said that the current threshold level (500,000 birr) is high and hence allows most business communities whose return is below the threshold but actively participating in the market competition to stay unregistered.

The employees of the branch office were also asked the same question. Out of the 28 employee respondents, 6(21%) respondents replied that the current threshold level is high, 21(75%) respondents replied that the threshold level is moderate, and 1(4%) respondents replied as low. As mentioned above the survey result shows that most of the respondents have replied that the threshold is high.

All the respondents were also asked about the mechanism used by the branch office to identify tax payers those are not registered for VAT while they are eligible to be registered. The question was raised whether the branch office uses door to door inspection, checking invoice of registered tax payers or any other method. Accordingly, the respondents have given their answers as follows.

Out of the 28 employee respondents, 18 (64%) relied “door to door inspection” and 5 (18%) replied “checking invoice of registered tax payers” while the remaining 5 (18%) did not say anything. In a similar way, 223 (67%) of the tax payer respondents replied that the branch office uses door to door inspection and 104 (31%) of them replied “checking invoice of registered tax payers” while the remaining 8 (2%) did not say anything. According to the reply of the above mentioned respondents, the office mostly uses door-to-door inspection to register unregistered taxpayers for VAT. Actually, this is thought to be expensive mechanism.

A question regarding the clarity, transparency and accessibility of the tax laws (Proclamation, Regulation and Directives) was also raised to the respondents. The response from the respondents is stated below.

**Table 3-9** Respondents Opinion on the Clarity, Transparence and Accessibility of the Tax Laws

Respondents	Excellent		Good		Fair		Poor	
Employees from Branch Office	15	54%	6	21%	4	14%	3	11%
Tax Payers	25	7%	51	15%	103	31%	156	47%
Total	40	11%	57	16%	107	29%	159	44%

Source: Field Survey Result 2014

The above table shows that most of the respondents gave their response as “fair” and “poor”. Although 54% and 21% of the employee respondents have said “Excellent” and “good” respectively, 31% and 47% of the tax payer respondents have said “fair” and “poor” respectively. In general, 29% and 44% (73%) of the respondents have said “fair” and “poor” respectively. This shows that the tax laws lack clarity, transparence and accessibility.

### **3.5 Awareness Related Issues**

In Ethiopia, the VAT laws are FDRE Proclamation Number 285/2002 and FDRE Regulation Number 79/2002 issued in July 2002 and implemented Effective Jan 01, 2003. Following these laws, various directives have been issued. In order to attain the intended objective of implementing VAT, the public in general and tax payers in particular have to be familiar with, aware of and clear about the above mentioned laws. Above all the employees of the tax office who are expected to implement these laws are also expected to have deep knowledge about these tax laws. With this point of view the survey was carried by asking both the VAT registered taxpayers and employees of the branch office whether they believe that ERCA has made sufficient explanations to the public regarding VAT rules and regulations. The question says “do you believe that ERCA has made sufficient explanations to the public regarding VAT?”

The response of both respondents (Employees and Tax Payers) for this question is show in the following table.

Table 3-10 Respondents Opinion on the Awareness of the Public to VAT Laws

Respondents	Yes		To some extent		No		I don't Know	
Employees	6	21%	15	53%	5	18%	2	7%
Tax Payers	25	7%	233	70%	65	19%	12	4%
Total	31	9%	248	68%	70	19%	14	4%

Source: Field Survey Result 2014

From the side of employee respondents 21%, 53%, 18% and 7% gave their response by saying “yes”, “to some extent”, “no” and “I don’t know” respectively. On the same manner, from the taxpayer respondents 9%, 68%, 19% and 4% have said “yes”, “to some extent”, “no” and “I don’t know” respectively. When we look at the overall respondents, 68% have said “to some extent” while 19% and 4% have said “no” and “I don’t know” respectively. This shows that ERCA has not made sufficient explanation to the public regarding the concept of Vat and the benefits that can be generated from implementing it.

Regarding the awareness related issues, a question whether the tax payers are familiar with the existing VAT laws was also raised. The question was raised to both the respondents their response is shown below.

Table 3-11 Respondents Opinion on the Awareness of the Tax Payers to VAT Laws

Respondents	Yes		To some extent		No		I don't Know	
Employees	4	14%	5	18%	16	57%	3	11%
Tax Payers	20	6%	254	76%	61	18%	0	0%
Total	24	7%	259	71%	77	21%	3	1%

Source: Field Survey Result 2014

Here, ERCA’s effort to educate tax payers regarding VAT is not to the expected level. Because, it is only 14% Of the employee respondents and 6% of the tax payer respondents (7% of the total respondents) have said “yes”. Besides to this 18% of the employee respondents and 76% of the tax payer respondents (71% of the total respondents) have said “to some extent”. Lastly, 57% of

the employee respondents and 18% of the tax payer respondents (21% of the total respondents) have said “no” and only 3% of the employee respondents (1% of the total respondents) have said “I don’t know”.

From the result of the survey, we can see that the tax payers are not aware enough to comply with the tax laws and to follow the basic principles of VAT administration i.e, voluntary compliance and self assessment.

### **3.6 Administration Issues**

Under this issue, the responses of the respondents to the questions related with designing and implementing proper administration system, audit Practice, the overall capacity of the branch office to administer VAT, major problems of VAT collection in the branch office and the strength of the branch office with respect of some specific parameters (fair and timely service to tax payers, simple filing and payment procedure, and fair & efficient refund system) are presented and interpreted.

The first question raised to the respondents was to give their opinion whether the capacity of the branch office is strong enough to administer VAT, by saying “Yes” “no” or “I don’t know” and their response is shown in the following table.

#### **3.6.1 Designing and implementing of Proper Administration System**

In order to achieve its objective, any organization requires proper administrative system. On the same token, VAT administration requires designing and implementing administrative system suitable to its operation. In order to assure whether the branch office has designed and implemented proper administrative system, a question was raised to the respondents. The question says “Do you believe that Proper VAT administration system is designed and implemented in the branch office?” and the expected response was either “yes”, “no” or “I don’t know”.

Table 3-12 Respondents opinion on the Designing and implementing of Proper Administration System

Respondents	Yes		No		I don't know	
	Count	Percentage	Count	Percentage	Count	Percentage
Employees	5	18%	19	68%	4	14%
Tax Payers	27	8%	301	90%	7	2%
Total	32	9%	320	88%	11	3%

Source: Field Survey Result 2014

The result of the survey on the above table shows that there is no proper administrative system. Hence without properly designed and implemented system, the objective of introducing VAT cannot be achieved to the expected level.

### 3.6.2 Audit Practice

The only real solution to the tax evasion problem is good tax administration and, especially, strong VAT audit program that needs, among other things, an appropriate audit case selection method. Modern tax management relies heavily upon risk-assessment tools to determine which taxpayers' matters must be examined very closely, not merely at the audit level, but at all stages of the tax process, from registration to collection. In order to perform the audit activities skilled manpower is found to be crucial. Accordingly, a question whether they have confidence in the Audit of the branch office was raised in the questionnaire to the respondents and they have provided their opinion as follows, by saying either “yes”, “no” or “I don't know”.

Table 3-13 Respondents opinion on Audit Practice in the Branch office

Respondents	Yes		No		I don't know	
	Count	Percentage	Count	Percentage	Count	Percentage
Employees	10	36%	15	53%	3	11%
Tax Payers	72	21%	227	68 %	36	11%
Total	82	23%	242	66%	39	11%

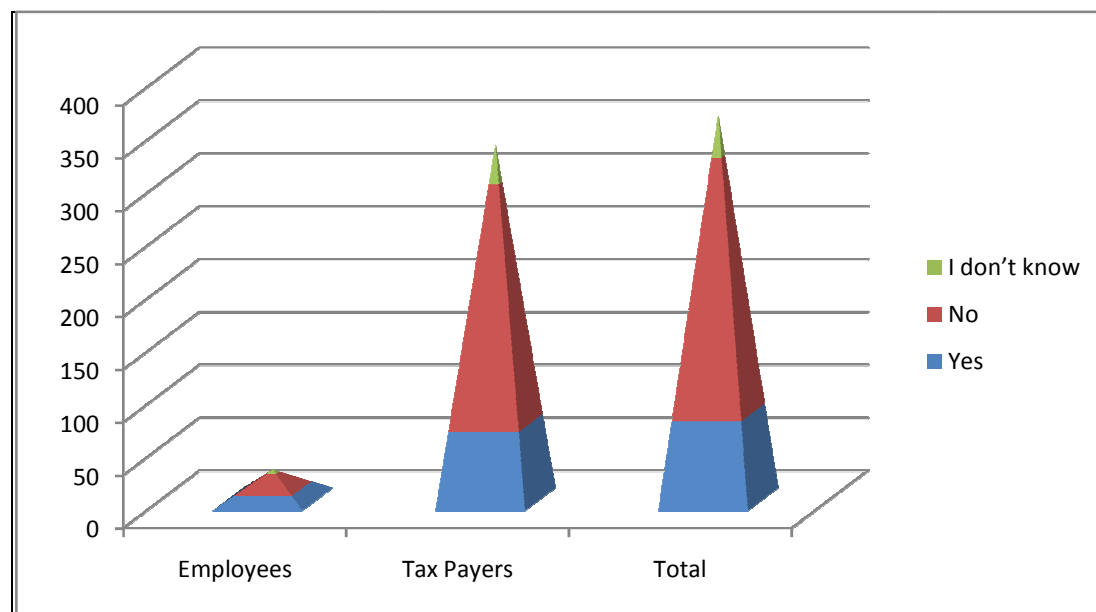
Source: Field Survey Result 2014

The above result shows that both the respondents have no confidence on the audit of the branch office. Besides to the respondents' opinion, it was also observed from the interview that there is no planned audit in the branch office. According to the interviewees, there is no planned and risk

based audit. It is only when the tax payers come to the tax of for filing their VAT that audit assessment is made.

The survey result can also be seen graphically as follows.

Figure 3-7 Respondents opinion on Audit Practice in the Branch office



Source: Field Survey Result 2014

The respondents were also requested to forward their reason for not having confidence on the audit. The possible alternatives (Luck of Planned Audit system, Incompetence of Auditors, Corruption, and attitude of auditors toward tax payers) were provided to the respondents to choose among and open space was provided to state their own reason. Accordingly, the response is summarized as follows.

**Table 3-14** Respondents' reasons for not having confidence on the Audit Practice of the Branch Office

Respondents	Lack of Planned Audit System		Incompetence of Auditors		Corruption		Auditors towards Tax payers	
	Count	Percentage	Count	Percentage	Count	Percentage	Count	Percentage
Employees	14	50%	9	32%	2	7%	3	11%
Tax Payers	153	46%	131	39 %	42	12%	9	3%
Total	167	46%	140	39%	44	12%	12	3%

Source: Field Survey Result 2014

From the above table it can be said that the main problem in the audit process is lack of planned audit system coupled with incompetency of auditors.

### **3.6.3 Major Problems of VAT Collection**

Except the value of goods and services exempted by the VAT proclamation, all imported materials, locally produced items and services rendered are taxed at the rate of 15%. Export of goods and services, international transport of goods and passengers, gold supplied to National Bank of Ethiopia, transfer of organization on movement are some of the zero rate taxed goods and services

VAT is considered as a credit invoice method because it is a tax system in which issuance of invoice serves as a cornerstone for the tax collection process.

Collection in terms of taxpayers is the activity of filing and payment returns whereas in terms of tax collectors, it is checking the returns, collect the money and/or paying the refund.

In order to check whether there exist collection problems, a question having five alternatives was provided to the respondents.

The question was: “What are the major problems of VAT collection in Bole Sub City? (Tick all that apply)”

- Monthly returns for small firms is costly
- There are many filing requirements
- Laws and procedures not clear and simple
- Monthly massive cross checking takes long time
- Tax collectors (officers) are not skilled enough

Among these alternatives, one or more can be selected as problem/s for VAT collection. Among the employee respondents, more than 65% have said that all are problems and they have included their own reason saying that tax payers do not come on time for filing. Almost all the tax payers

come for filing on the last dates of the accounting period making crowded and unable the tax collectors give their service properly. On the same manner, 146 have said all are problems and 167 said that laws and procedures not clear and simple while other 22 respondents have said that there are many filing requirements.

### 3.6.4 Strength of the Branch Office with respect to some Parameters

Under this issue, the employees and the tax payers were requested to forward their opinion regarding the strength of the branch office in terms of fair and timely service to taxpayers, Simple filing and payment procedure and Application of Appropriate Penalties.

The response of the respondents from the employees and from the tax payers are separately presented here under.

**Table 3-15** Employee Respondents’ Opinion on the Strength of the Branch Office.

Parameters	Excellent		Good		Faire		Poor	
Fair and Timely Service to taxpayers	9	32%	13	46%	5	18%	1	4%
Simple filing and payment procedure			14	50%	10	36%	4	14%
Application of Appropriate penalties	7	25%	15	54%			6	21%
Faire and efficient VAT refund system	6	21%	17	54%	2	7%	3	11%

Source: Field Survey Result 2014

On the same way the response of the tax payer respondents is shown below.

**Table 3-16** Opinion of Tax Payer Respondents on the Strength of the Branch Office.

Parameters	Excellent		Good		Faire		Poor	
Fair and Timely Service to taxpayers	10	3%	61	18%	84	25%	180	50%
Simple filing and payment procedure	11	3%	80	24%	110	33%	134	40%
Application of Appropriate penalties	35	10%	69	21%	71	21%	160	48%
Faire and efficient VAT refund system	17	10%	43	13%	76	23%	199	59%

Source: Field Survey Result 2014

Now based on the above data, we can compare the responses of both the respondents and evaluate the result. Thus, when we see to the responses regarding the Fair and Timely Service to



taxpayers 32% and 46% of the employee respondents have said Excellent and good respectively while 18% and 4% of them have said fair and poor respectively. On the other hand, 7% and 15% of the tax payer respondents have said Excellent and good respectively while 31% and 47% of them have said fair and poor respectively. Although majority ( $54\%+21\%=75\%$ ) of the employee respondents have said Excellent and good the majority ( $31\%+47\%=78\%$ ) of the tax payers have shown their dissatisfaction with parameter by saying fair and poor. Unless it is witnessed by the service receiving body, it cannot be said that there is Fair and Timely Service to taxpayers.

The remaining parameters (Simple filing and payment procedure, Application of Appropriate penalties) can also be interpreted in the same manner while Faire and efficient VAT refund system is seen differently as follows.

VAT refund is any credit made in excess of payment in the transaction of taxable supplies. In the case of Ethiopian context, if input tax is greater than output tax, credit or refund may be claimed on a supply with zero rate or standard rate in the tax period.

According to the FDRE VAT proclamation, VAT refund is practical if at least 25 percent of the value of a registered person's taxable transactions for the accounting period is taxed at a zero rate. The Authority refunds the amount of VAT applied as a credit in excess of the amount of VAT charged for the accounting period within a period of two months after the registered person files an application for refund, accompanied by documentary proof of payment of the excess amounts.

In the case of non exporter registered persons, mainly importers the amount of VAT applied as a credit in excess of the amount of VAT charged for the accounting period is to be carried forward to the next five accounting periods and credited against payments for these periods, and any unused excess remaining after the end of this five-month period is refunded by the Authority within a period of two months after the registered person files an application for refund, accompanied by documentary proof of payment of the excess amounts.

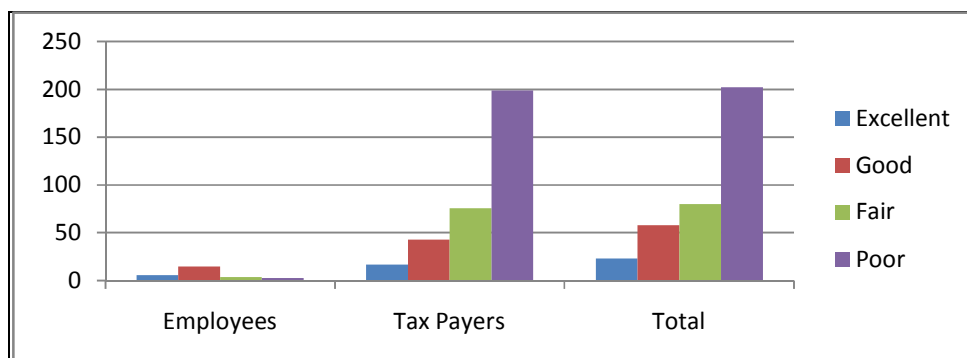
In order to prove whether the Branch Office is strong in implementing fair and efficient Vat refund system as per the requirements by the proclamation, the respondents were asked to provide their opinion on the strength of the branch office in regard to this parameter. The question was raised to both the respondents (the employees of the branch office and VAT registered tax payers).

Accordingly, 59% of VAT registered tax payers said poor and 22% of them said fair while 13% and 7% of them have said good and excellent respectively. On the other hand, the opinion of the respondents from the employees of the branch office was 11% poor, 14% fair, 54% good, and 21% excellent. Over all, the opinion of the total respondents is 56% poor, 22% fair, 16% good and 6% excellent. From this opinion, it can be said that refund treatment practice in the branch office is found to be weak. Interest payment is part of refund. If a registered person who is entitled to a refund is not paid by the Authority within the specified period of time, the person is entitled to be paid interest. The interest is set, for export, at 25% over and above the highest commercial lending interest rate that prevailed during the preceding quarter.

Regarding the practice of the branch office, the finding from the respondents declared that refunding system is inefficient.

The response of the respondents regarding the strength of the branch office in terms of the VAT Refunding system is shown hereunder.

Figure 3-8 Respondents’ opinion on VAT refund



Source: Field Survey, Result 2014

In order to make it more visible the data is presented in the following table.

Table 3-17 Respondents' opinion on VAT refund

Respondents	Excellent		Good		Fair		Poor	
Employees	6	21%	15%	54	4%	7	3%	11
Tax Payers	17	5%	43%	15	76%	23	199%	59
Total	23	6%	58%	16	80%	22	202%	56

Source: Field Survey, Result 2014

### 3.6.5 Overall Capacity of the Branch Office to Administer VAT

The employee as well as taxpayer respondents were asked whether they believe that the capacity of the branch office with regard to VAT administration is strong enough. Their response to the question is shown in the following table

Table 3-18 Respondents Opinion on Overall Capacity of the Branch Office

Respondents	Yes		No		I don't know	
Employees	8	28%	15	53%	5	19%
Tax Payers	31	9%	251	75%	53	16%
Total	39	11%	266	73%	58	16%

Source: Field Survey Result 2014

As 53% of the employee respondents, 75% of the tax payer respondents and 73% of the total respondents have said "no", it can be said that the branch office is not strong enough to administer VAT.

### 3.7 Tax Payer Related Issues

Under this issue, the existence of eligible for VAT registration but unregistered tax payers, the impact of such tax payers on the compliance behavior of the VAT registered tax payers, the beneficiary from the market competition due to the existence of VAT, the attitude of taxpayers towards VAT, the honesty and loyalty of the VAT registrants and the satisfaction tax payers with the service they get from the branch office are surveyed.

- a) Non VAT Registered Tax Payers

The VAT legislation of Ethiopia revealed that businesses undertaking taxable activities in Ethiopia with an annual turnover of ETB 500,000 and more are required to file an application for VAT registration. In addition to this, the authority has devised two types of forced registration schemes. First, compelling all businesses in a specific sector regardless of the level of their annual turnover based on some criteria. For instance, importers, gold smiths, shoe factories, contractors above grade 10 are some of them. The second scheme was by estimating the daily income (sales) of taxpayers to calculate their annual turnover in door to door inspection by tax officials. Having this in mind, a survey was made whether there are unregistered tax payers while they are eligible for VAT registration. The survey was made by asking the respondents “Do you believe that there are potential tax payers who are eligible for VAT registration but not yet registered?” with alternative responses of either “Yes”, “No” or “I don’t know”

Table 3-19 Respondents Opinion on Eligible Unregistered Tax Payers

Respondents	Yes		No		I don’t know	
	Count	Percentage	Count	Percentage	Count	Percentage
Employees	13	46%	9	32%	6	21%
Tax Payers	224	67%	35	10%	76	23%
Total	237	65%	44	12%	82	23%

Source: Field Survey Result 2014

The summary of the survey result indicates that there are potential tax payers not registered for VAT. This is evidenced by the response of 46% of Employee respondents, 67% of tax payer respondents and 65% of the overall respondents.

The respondents were further asked to forward their estimate of the non VAT registered tax payers and the survey report shows that the number of such tax payers is large; evidenced by that 57% of the total respondents have said large, 29% medium and 13% said small. This can be seen in the following table.

Table 3-20 20 Respondents' opinion on the number of Eligible Unregistered Tax Payers

Respondents	Yes		No		I don't know	
	Count	Percentage	Count	Percentage	Count	Percentage
Employees	13	46%	9	32%	6	21%
Tax Payers	195	58%	97	29%	43	13%
Total	208	57%	106	29%	49	13%

Source: Field Survey Result 2014

The respondents were also requested to forward the reason they think is for not registered the tax payers for VAT. The question was forwarded with different alternatives and says “what do you think the reason why they are not yet registered? (Tick all that apply)

- Luck of awareness regarding VAT
- They intentionally want to hide themselves
- Due to fear of competition from unregistered similar businesses

Among the total respondents, 69% have said “Luck of awareness regarding VAT”, 5% said “They intentionally want to hide themselves” and 26 said “Due to fear of competition from unregistered similar businesses”. From this, although all are possible reasons, Luck of awareness regarding VAT and fear of competition from unregistered similar businesses are the major reasons that need attention of the branch office in particular and ERCA in general.

In relation of the above question, the respondents were asked if they believe that the compliance behavior of the VAT registered tax payers is influenced by those who are not registered. The response for this question is stated in the following table.

Table 3-21 Respondents' Opinion on the Impact of Non VAT registered on the VAT Registered Tax Payers

Respondents	Yes		No		I don't know	
	Count	Percentage	Count	Percentage	Count	Percentage
Employees	16	57%	7	25%	5	18%
Tax Payers	239	71%	60	18%	36	11%
Total	255	70%	67	18%	41	11%

Source: Field Survey Result 2014

According to the above survey result, it can be said that the compliance behavior of the VAT registered tax payers is influenced by those who are not registered. This is evidenced by the response of 57%, 71% and 70 of the employee respondents, tax payer respondents and total respondents respectively.

**b) Benefits from Market Competition**

Both the taxpayer and employee respondents were further asked whom they think is benefited from the market competition between VAT registered and non VAT registered businesses. Out of the 335 taxpayer respondents, 85(23%) respondents replied that businesses that are registered for VAT are more benefitted from the market competition, 231(64%) respondents replied that non VAT registered enterprises are more benefitted and 23(6%) said equally benefited while 24(7%) said that they have no idea. From the result of the survey most respondents, 231(64%) replied that enterprises that are not registered for VAT are taking the advantages of the market competition and this discourages the VAT registered business and aggravates the market distortion. The reason why the non VAT registered businesses are more benefited from the market competition was justified by the respondents as follows.

Purchasing of goods and services with VAT requires consumers to pay additional cost than without VAT. Hence, consumers prefer to purchase goods and services from those entities that are not VAT registered. Therefore, businesses that are not registered for VAT are more benefited than those registered ones.

**c) Honesty and Loyalty of VAT Registrants**

In order to implement the basic principles of VAT administration (Voluntary Compliance and Self Assessment), tax payers have to be honest and loyal to the tax laws. To ascertain whether the VAT registrants in the branch office are honest and loyal, the respondents were asked to

forward their opinion on the honesty and loyalty of tax payer's, in terms of some specific parameters. The question had the following content and parameters.

“In terms of honesty and loyalty of VAT registrants, how do you express the following? (Tick all that apply)”

List of possible Considerations	Many	Few	Non
VAT registrants sell goods and services without tax invoice			
VAT registrants manipulate Cash Register Machine			
VAT registrants provide fake invoices to secure more input tax			

**Table 3-22 Opinion of Employee Respondent's on Honesty and Loyalty of VAT registered tax payers**

List of possible Considerations	Many		Few		Non	
VAT registrants sell goods and services without tax invoice	18	64%	7	25%	3	11%
VAT registrants manipulate Cash Register Machine	15	54%	9	32%	4	14%
VAT registrants provide fake invoices to secure more input tax	11	39%	12	43%	5	18%

Source: Field Survey Result 2014

**Table 3-23 Opinion of Tax Payer Respondent's on Honesty and Loyalty of VAT registered tax payers**

List of possible Considerations	Many		Few		Non	
VAT registrants sell goods and services without tax invoice	182	55%	137	44%	6	1%
VAT registrants manipulate Cash Register Machine	110	34%	198	57%	27	8%
VAT registrants provide fake invoices to secure more input tax	56	18%	215	63%	64	19%

Source: Field Survey Result 2014

Table 3-24 Opinion of Total Respondent’s on Honesty and Loyalty of VAT registered tax payers

List of possible Considerations	Many		Few		Non	
	Count	Percentage	Count	Percentage	Count	Percentage
VAT registrants sell goods and services without tax invoice	200	55%	144	40%	9	2%
VAT registrants manipulate Cash Register Machine	125	34%	207	57%	31	8%
VAT registrants provide fake invoices to secure more input tax	67	18%	227	63%	69	19%

Source: Field Survey Result 2014

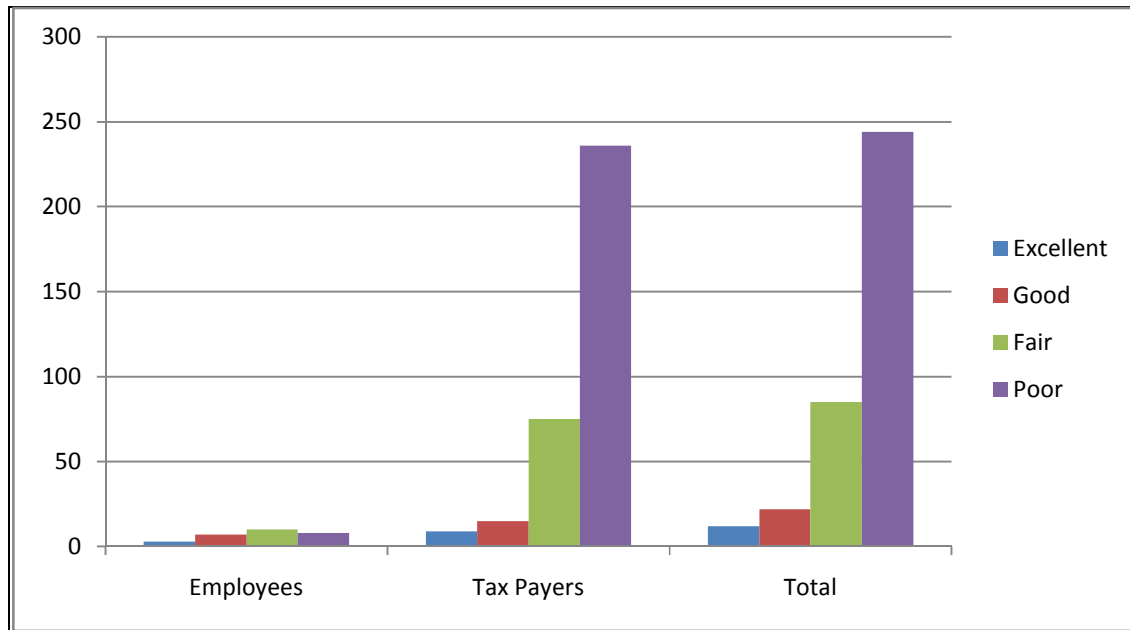
In terms of honesty and loyalty of VAT registrants, 55% of the total respondents revealed many VAT registrants sell goods and services without tax invoices. In addition to this, 57% and 63% of the respondents revealed few taxpayers manipulate cash register machines and few VAT registrants provide fake invoices to secure more input tax respectively. Hence all the parameters are risk areas that need close attention of the branch office.

**d) Tax Payers’ satisfaction with Tax Collectors’ Service**

Customer satisfaction is one of the key performance factors of an organization. Hence, the respondents were asked to forward their opinion towards tax payers’ satisfaction with the service they get from the branch office. “How do you evaluate the satisfaction of tax payers with the service they get from the branch office?” The respondents’ reply to this question reveals that 3%, 6%, 23%, and 67% of the respondents say Excellent, Good, Fair and Poor respectively. From this survey result it is clear that the tax payers’ satisfaction is poor. This can clearly be seen in the following graph.



**Figure 3-9** Respondents opinion on Tax Payers' satisfaction



Source: Field Survey Result 2014

The data analysis and interpretation is finalized here and the conclusion and recommendation continues in the next chapter.

## CHAPTER FOUR

### 4 CONCLUSION AND RECOMMENDATIONS

#### 4.1 Introduction

This chapter holds conclusions that are drawn from the findings of the study, which were presented, discussed and interpreted in chapter three. In chapter three, challenges of VAT administration and their impacts were identified. Bole Sub City Small Tax Payers' Branch Office is influenced by these challenges. Hence, Recommendations that are thought to be possible solutions for these challenges are forwarded in this chapter.

#### 4.2 Conclusion

As shown in the following table, VAT collection performance of Bole Sub City Small Tax Payers' Branch office in the recent three years (2011/12 to 2013/14) has been more than 100% of the plans.

**Table 4-1 Three Years' VAT collection Plan and Actual Performance of the Branch Office**

Fiscal Year	Plan	Actual	Percentage of Performance	Remarks
2011/12	244,660,000.00	265,445,508.05	108.50%	
2012/13	344,480,000.00	395,100,336.09	114.69%	
2013/14	308,947,214.10	309,852,779.11	100.29%	
Total	898,087,214.10	970,398,623.25	108.05%	9 months' Performance

Source: Extracted from the Annual Reports of The Branch Office for the years 2011/12-2013/14.

However, this does not mean that it has been planning based on the actual economic activity of the Sub City. This is proved by this study that many potential taxpayers who are eligible to be registered for VAT did not do so. Extracted from the

As it is identified in chapter three, not only the existence of potential tax payers who are not registered for VAT, but there are also other challenges of VAT administration.

According to this research, the identified challenges can be categorized as challenges from the tax office and Challenges from the tax payers.

The challenges related to the tax office can be seen as Human Resource (HR) related, policy related issues, Awareness of the public and the business society towards the policies and Vat administrative issues. From the tax payers side, the existence of eligible for VAT registration but unregistered tax payers, the impact of such tax payers on the compliance behavior of the VAT registered tax payers, the beneficiary from the market competition due to the existence of VAT, the attitude of taxpayers towards VAT, and the honesty and loyalty of the VAT registrants are surveyed and related challenges are identified.

These challenges are concluded here under.

#### **4.2.1 The Tax office (ERCA and/ or the Branch Office) Related Challenges**

As it is indicated in chapter three of this research, the challenges of VAT administration in the branch office start from the organizational structure. The organization structure of the branch office lacks career development. It doesn't give chance to the employees at the lower status to be promoted upward. The employees are not motivated with the existing employee benefits and future career developments. Because of the above mentioned reasons, there exists high employees' turnover leading to insufficient number of employees and unskilled man power. Besides to the findings from all respondents, the work experience of the employee respondents in section "A" of the questionnaire clearly shows that the employees are not skilled enough. For more clarity, 57% of the employees have worked with ERCA for less than one year and 25 % of them for less than two years while 11% and 7% of them have served for 2 to 3 and above 3 years respectively.

Hence, high employees' turnover, unskilled and insufficient number of employees, highly affecting the VAT administration, is found to be one of the main challenges.

In relation to the policy issues, a threshold for VAT registration has been put in place for administrative purpose. The current threshold level (500,000 birr) is high and hence allows most business enterprises, whose return is below the threshold but actively participating in the market competition, to stay unregistered.

This leads to unfair market competition by giving chance the consumers to buy goods and service without VAT. This can also lead the registered VAT payers to unlawful acts like giving alternatives to their customers to sell goods and services with or without VAT, to collect VAT illegally and retain it for their own consumption. Therefore the existing threshold, being high is found to be one of the challenges.

The tax payers' identification and registration is one of the VAT laws implementation activities. The branch office uses door to door inspection method to identify eligible but unregistered tax payers. This method is too costly to reach all unregistered tax payers and is one challenge to the VAT administration. According to the respondents, the tax laws are not clear, transparent and accessible to the tax payers and even to the employees of the branch office. The effect of this is seen in that when one tax payer requests clarity for on e case to different tax officers, he gets different answers for the same question.

The public in general and the tax payers in particular are not aware of the VAT laws. This shows that the effort of the tax authority (ERCA) towards awareness creation is weak. ERCA has not made sufficient explanation to the public regarding the concept of VAT and the benefits that can be generated from implementing it. Because of this, the public is not playing its role in implementation of VAT laws by asking receipts for the goods and service purchased. On the other hand, the tax payers are not aware enough to comply with the tax laws and to follow the basic principles of VAT administration i.e, self assessment and voluntary compliance.

Lack of properly designed and implemented administrative system is also one of the challenges of VAT administration in the branch office. Hence without properly designed and implemented system, the objective of introducing VAT cannot be achieved to the expected level.

Although it is believed that strong audit program is one of the best solutions for tax evasion, there is no planned and risk based audit practice in the branch office. It is only when the tax payers come to the tax office for filing their VAT that audit assessment is made. Besides to the lack of planned and risk based audit, the low competence of the auditors is also another challenge.

The branch office is also weak in terms of Fair and Timely Service to taxpayers, Simple filing and payment procedure and Application of Appropriate penalties.

The branch office is also weak in terms of refunding system. Refund to tax payers is too much delayed, if not denied. This practice discourages the tax payers and sometimes leads them to illegal acts to the contrary of the tax law. Regarding the practice of the branch office, the finding from the respondents declared that refunding system is inefficient.

In general, having all the above mentioned problems and challenges, the branch office is not strong enough to administer VAT to the expected level.

#### **4.2.2 Tax Payers' Related Issues**

Under this issue, the challenges regarding the existence of eligible for VAT registration but unregistered tax payers, the impact of such tax payers on the compliance behavior of the VAT registered tax payers, the beneficiary from the market competition due to the existence of VAT, the attitude of taxpayers towards VAT, the honesty and loyalty of the VAT registrants and the satisfaction of tax payers with the service they get from the branch office are analyzed and interpreted.

Accordingly, the study has indicated that there is huge number of eligible for VAT registration but not yet registered and this negatively affects the compliance behavior of the VAT registered tax payers. Among others, lack of awareness regarding VAT and fear of competition from unregistered similar businesses are the major reasons for the existence of such tax payers. The unregistered businesses have upper hand in the market. Consumers pay less cost for the goods and services they buy from the unregistered businesses than from the registered ones. Hence, they prefer to pay less cost. Through this practice, the non VAT registered businesses are more benefited than those registered ones. This leads the VAT registered ones to give their customers the chance of buying with or without VAT. This is another challenge that leads to the violation of the VAT laws.

The loyalty and honesty of the tax payers was surveyed in terms of some parameters and the result showed that some VAT registrants sell goods and services without tax invoice, some VAT registrants manipulate Cash and others provide fake invoices to secure more input tax. Hence the honesty and loyalty of some VAT registered tax payers is questioned.

Finally, the tax payer's satisfaction with the service they get from the branch office was surveyed and the result shows that they are not satisfied.

Based on the above conclusion of the findings, corresponding recommendation is provided in the following part of this chapter.

### **4.3 Recommendations**

The major recommendations that come out from the survey result go towards ERCA and/or the branch office, and the public at large and the business community in particular.

#### **4.3.1 The Tax office (ERCA and/ or the Branch Office) Related Recommendations**

To reduce the undesirable consequences that may undermine the whole VAT administration system, the organizational structure and human resource should be adjusted in order to cope up with the increasing number of VAT registrants. Particularly, manpower requirement should be

given special attention since the business community is in advance in searching for shortcomings of the tax administration. The result of the survey shows that there is large number of non-VAT taxpayers. To tackle these challenges investigation and enforcement work should be strengthened and measures on those taxpayers who are constantly failing to comply with the tax rules and regulations should be taken.

A threshold for VAT registration has been put in place for administrative purpose. The current threshold level (500,000 birr) is high and hence allows most business communities whose return is below the threshold but actively participating in the market competition to stay unregistered. Therefore the current threshold level should be adjusted into more rational level by considering the increasing number of entities engaging in different businesses and should be minimized to incorporate at least those business enterprises that are actively participating in the market competition and balance the revenue generated from the tax. This can be carried out by hiring more qualified and professional employees, designing and implementing proper administration system and reducing the threshold to the lower level.

There is a strong believe that well-informed taxpayer society can be considered as an important asset for the tax authority. Therefore, the authority should conduct a consistent awareness creation programs to update the business community and the society at large about the concepts, rules and regulations, advantages and uses of the Value Added Tax. This can be carried out by intensively educating the public using mass-medias like television, radio, news papers, creating accessible websites, distribution of brochures, preparations of different seminars and workshops on a regular basis to increase awareness.

In general the administration of Value Added Tax in Ethiopia (in the branch office) has faced various challenges such as tax evasion and fraud, false invoices prepared by enterprises, increased number of enterprises that collect VAT for their selves, selling products by offering

invoices of VAT inclusive and VAT exclusive, resistance from the business community against registration for VAT and making a business transaction reports under threshold level after it has launched. However, to sustain the VAT system as a good means to raise government revenue, the Ethiopian Revenue and Customs Authority (the branch office) should take actions such as: train the taxpayers about the rules and regulations of VAT continuously, recruiting new employees and give continuous training for the existing once, and it should also increase its follow-up and investigation to control noncompliance enterprises, as well as effectively and efficiently performing the tasks of identification of VAT taxpayers, processing of returns, controlling collections, making refunds, implementing risk based and planned auditing practice, and levying appropriate penalties to tackle the challenges it has encountered.

#### **4.3.2 The Recommendations Forwarded to the Taxpayers and the Public**

In addition to the tasks performed by the tax authority, the business communities should also obey to the VAT laws. develop the culture of taxpaying through modern thinking, pay attentions towards the government's effort to collect and fund the long run projects carrying out all through the country, understand that the government's main source of income to fund the social and public affairs is the wealth collected and accumulated from taxes mainly VAT, consider paying tax as a means of directly or indirectly putting one's own contribution on changing the life of each citizen and they perform their activities according to the VAT laws as well as start to work in cooperation with the authority in fighting against those enterprises that are violating the rules and regulations of VAT.

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## **Annex 1- Questionnaires**

Questionnaire for tax officials and Employees, and Tax Payers in Bole Sub City Small Tax Payers' Branch Office of ERCA on the title "Challenges of Value Added Tax administration in Bole Sub City Small Tax Payers' Branch Office of ERCA".

Dear respondents;

This study is conducted in partial fulfillment of the requirements for the Masters of Business Administration (MBA). I am carrying out a study on the Challenges of Value Added Tax Administration in Bole Sub City Small VAT Registered Tax Payers' Branch Office of ERCA. The purpose of this questionnaire is to obtain your perceptions and views regarding the existing Value Added Tax administrative activities of the Branch Office and its main challenges against effective tax administration. This study will help the Branch Office to identify its problems and improve its VAT administration.

The information you are expected to provide will enable me to critically analyze the subject matter.

Therefore, please forward your possible answers for all the questions provided here under.

### **Confidentiality:**

I hereby assure you that all information obtained through this questionnaire shall be used for academic purposes only and will be handled and stored with the highest order of confidentiality.

Please do not write your name anywhere on the questionnaire.

I thank you very much in advance for your cooperation.

### **Section A: Personal data**

1. Age group (in years): up to 30     30-40     40-50     50 and above
  
2. Sex: Male        Female

3. Level of education: below grade 12  Certificate  Diploma  Bachelor Degree   
Masters and above

4. Years of Service in ERCA \_\_\_\_\_ (For Tax Officials and Employees)

Below One Year  One to Two Years  Two to Three Years  Above Three Years

5. For how long have you been paying VAT? (For Tax Payer Respondents)

Below one year  One to Three years  Three to Seven years  Above Seven years

## Section B: Questions Related to the Tax Office

### I. Human Resource Related Issues

1. Do you believe that the organizational structure of the branch is appropriate to deliver services to the tax payers?

Yes  No  I have no idea

2. How do you evaluate employees turn over in Bole Sub City Small Tax Payers' Branch Office?

High  Moderate  Low

3. To what extent does employees' turn over affect VAT Administration in Bole Sub City Small Tax Payers' Branch Office?

High  Moderate  Low  Doesn't affect

4. Do you believe that there is sufficient number of employees in the branch office?

Yes  No  I have no idea

5. Do you believe that there are skilled employees in the branch office?

Yes  No  I don't know

## II. Policy related Issues

1. What is your opinion about the threshold (average annual turnover) of ETB 500,000 as a minimum requirement for VAT registration?

High  Moderate  Low

2. What Mechanism does the Branch Office use to identify non VAT registered tax payers?

Door to door inspection

Checking Invoices of Registered Tax Payers

If there is any other mechanism, please mention here \_\_\_\_\_  
\_\_\_\_\_.

3. How do you evaluate the tax laws, (Proclamations, Regulations and Directives), in terms of Clarity, Transparency and Accessibility?

Excellent  Good  Fair  Poor

## III. Awareness Creation Issues

1. Do you believe that Ethiopian Revenue and Customs Authority (ERCA) had made sufficient explanation to the public regarding VAT?

Yes  to some extent  No

2. Do you think that all the tax payers are familiar with VAT proclamations regulations and directives? Yes  to some extent  No

## IV. Administration Related Issues

1. Do you think that proper administrative system is designed and implemented?

Yes  No  I don't know

2. Do you have confidence in the VAT assessment and audit of Bole Sub City Small Tax Payers' Branch Office?

Yes  No  I don't know

3. If your answer For question number '3' above is 'No', tick the reason(s) of your choice

(Tick all that Apply)

Incompetency of auditors

Corruption

Auditors' attitude towards tax payers

If you have any other reason, please mention it here \_\_\_\_\_  
\_\_\_\_\_.

4. What are the major problems of VAT collection in Bole Sub City? (Tick all that apply)

Monthly returns for small firms is costly

There are many filing requirements

Laws and procedures not clear and simple

Monthly massive cross checking takes long time

Tax collectors (officers) are not skilled enough

If you have any other reason, please mention it here \_\_\_\_\_

5. How do you evaluate the strength of the Branch Office with respect to the following parameters?

Parameters	Excellent	Good	Faire	Poor
Clear, Transparent and Accessible tax laws				
Fair and Timely Service to taxpayers				
Simple filing and payment procedure				
Application of Appropriate penalties				
Faire and efficient VAT refund system				

6. How do you evaluate the VAT administration system in terms of fair and efficient VAT refund system?

Excellent  Good  Fair  Poor

7. Do you believe that the capacity of the Branch Office with regard to the VAT administration is strong enough?

Yes  No  I don't know

### Section C: Questions Related to Taxpayers

1. Do you believe that there are potential tax payers who are eligible for VAT registration but not yet registered?

Yes  No  I have no idea

2. If your answer to question number '1' above is yes, how do you express the number of such taxpayers?

Large  Medium  Small

3. If your answer for question number '1' above is 'yes' what do you think the reason why they are not yet registered? (Circle all that apply)

Lack of awareness regarding VAT

They intentionally want to hide themselves

Due to fear of competition from unregistered similar businesses

4. Who do you think is benefitted from the market competition due to the existence of VAT?

VAT Registered  Non-registered  Equally Benefitted  I don't know

5. Do you believe that the compliance behavior of VAT registered tax payers is negatively influenced by those who are not registered?

Yes  No  I don't know



6. In terms of honesty and loyalty of VAT registrants, how do you express the following? (Tick all that apply)

List of possible Considerations	Many	Insignificant	Few	Non
VAT registrants sell goods and services without tax invoice				
VAT registrants manipulate Cash Register Machine				
VAT registrants provide fake invoices to secure more input tax				

If you have any, mention it here \_\_\_\_\_

7. What do you think about taxpayers thought towards VAT?

Excellent  Good  Faire  Poor

8. How do you evaluate the satisfaction of tax payers with the service they get from the branch office?

Excellent  Good  Faire  Poor

9. Give your general comment on the overall VAT administration of Bole Sub-City Small Tax Payers Branch Office. \_\_\_\_\_

Thank you again

## **Annex 2 - Interview Guide**

### **Queries on general issues to be answered by the heads of Bole Sub City Small Taxpayers' Branch Office of ERCA.**

- 1) How do you evaluate the trends of Bole Sub City Small Tax Payers Branch Office in administering VAT in the last three years?
- 2) What are the main challenges in administering VAT in your Branch Office in terms of;  
Registration \_\_\_\_\_  
  
Collection \_\_\_\_\_  
  
Auditing \_\_\_\_\_  
  
Refund \_\_\_\_\_  
  
Enforcement \_\_\_\_\_
- 3) How do you express the voluntary compliance of taxpayers in your Branch Office and if any effort or plan to improve it?
- 4) Do you the existing tax laws and procedures are simplified, Transparent and accessible particularly for small businesses?
- 5) Do you think that the office outlay and organizational structure is suitable for your service delivery?
- 6) Do you believe that your branch office has sufficient, qualified and experienced manpower?
- 7) Finally, please, generalize the degree of effectiveness of the Branch Office in VAT administration.

Thank you very much