

**Transformation of Sales Tax to VAT in Revenue Collection and Tax
Administration Problems in the Case of Ethiopian Revenue and
Customs Authority**

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1. Background of the Study

Governments use different policies to reduce and solve the problem of the country. The two such broader policies are monetary policy and fiscal policy. The latter focuses on the revenue and expenditures side of the government.

One of the bottom line instruments of fiscal policy is taxation. Taxation is a system of contributions levied by governments or other authorized body on Property, Corporation and people in order to fulfill the need of goods and service for the society.

According to Seigman (2004) tax is defined as, “a compulsory contribution from the person to the state to defray the expenses incurred in the common interest of all, without reference as special benefits conferred”. Tax can be used to redistribute income, goods which cannot be provided, by the private sector can but need to be provided by the government only if it has enough revenue. This revenue can be collected through taxation; hence, taxation is an important source of state revenue.

Developing countries like Ethiopia, among other things, need to have efficient and effective taxation system to facilitate the achievement of sustainable economic growth and development. Hence, The Ethiopian Revenues and Custom Authority (ERCA) has been instituted to assess and collect legally specified federal taxes which include domestic taxes, foreign trade taxes and profits from sales of lottery so as to enable the government to finance its developmental activities by assuring the enforcement and implementation of tax laws, regulations and directives.

The former Federal Inland Revenue Authority which was accountable to the Ministry of Revenue used to collect legally specified federal domestic Direct, Indirect and Non taxes. Its mission was to enable the taxpaying society to accomplish its duties and responsibilities on a self compliance basis and to collect adequate tax revenue through the help of ethical and skilled manpower and modern organization which provide efficient and honest service and tax payer education, thereby preventing tax fraud and evasion (ERCA annual report, 2000).

To this end, the Federal Democratic Republic of Ethiopia (FDRE) has introduced a tax reform program since early 2003 to modernize its taxation system. One of the major tax transformations is sales tax converted to Value Added Tax (VAT). This paper, therefore, assesses the impact of transformation of sale tax to Value Added Tax in Revenues Collection and Tax Administration in ERCA.

The former Federal Inland Revenue Authority was established as an autonomous public office in February 1997. The 1997 Proclamation No. 61/1997 provision the establishment of the Federal Inland Revenue Authority. Since 2009 Federal Inland Revenue Authority has been changed to Ethiopian Revenues and Custom Authority. The Authority is established to assess, collect and execute legally specified federal taxes of both domestic and foreign tax.

The sharing of revenue between the Federal and Regional Governments has been made in line with the prevailing Federal state structure. The collection of legally specified Federal tax revenues, which originate and are dispersed in all the regions, has to be properly executed. Therefore, it is necessary to establish Ethiopian Revenues and Custom Authority as an autonomous public office with the requisite powers and duties as well as an efficient working system. Currently, the Ethiopian Revenues and Custom Authority has its head office in Addis Ababa and seven branch offices in different regions.

Among ERCA's branch offices, the Large Taxpayers Office, VAT department, the Mekele and Jimma branches are established after the tax reform. The Large Tax Office

on the one hand and Mekele and Jimma branches and VAT department on the other have been providing tax collection service since June, 2003 and January, 2003 respectively. In addition to these, the Ethiopian Revenues and Custom Authority has been administrating the withholding tax scheme since January, 2003. In implementing this scheme the withholding taxes on payments are managed through the ERCA's tax collector offices (ERCA Annual Report, 2000).

2. Statement of the Problem

The Ethiopian Revenues and Customs Authority has implemented the tax reform program since 2003. The transformation of sale tax into Value Added Tax has been one of the broader issues reflected on the reform.

As it has been heard, the implementation of VAT has had a huge impact on the revenues generation, and at the same time, it has faced lots of problems during transformation, such as large number of TIN repetitions and lack of trained tax officers. The other problem was absence of such compiled research documents concerning the transformation of sales tax into VAT. Based on the above stated problems, this research will answer the following research questions.

3. Research Questions

The research questions of this study include:

1. What were the changes made during the transformation in tax law framework?
2. Did the transformation of sales tax into VAT have significant impacts on revenue collection?
3. What were the problems faced during transformation of sales tax into VAT with special focus to VAT implementation?
4. What were the causes and the impacts of the problems on the implementation?

4. Objectives of the Study

The general objective of the study is to assess the impact of transformation of sales tax into VAT in respect to revenues collection and administration. Having this general objective, the study has the following specific objectives

1. Analyze the changes made as a result of the transformation in light of tax law frame work,
2. Analyze whether the transformation of sales tax into VAT had a significant impact on revenue collection,
3. Identify the problems faced during the implementation of VAT,
4. Look for the causes for the problems on the implementation, and
5. Evaluate the impacts of the problems on the implementation.

5. Research Methodology

Descriptive research method was used. Tax officer which carry out the day to day activities in ERCA and the VAT registered companies are taken as a subject for this study. The study is based on sampling basis. The sample respondents are selected using non-probability sampling approach. From the non-probability sampling technique the researchers used judgmental/ purposive sampling technique in order to select tax officers and payers out of the total population.

Both primary and secondary data were collected. Primary data was collected from taxpayers as well as tax officials, and secondary data was collected from those materials that are related with the research topic. Primary data was obtained by distributing questionnaires and conducting interview with tax officers and tax payers. Secondary data had been obtained from published materials and the Internets.

This study uses descriptive statistics for the analysis of the data. Thus, percentage and average of different tax categories are used to compute and see the share of Domestic Taxes in the total revenue collection and to indicate the growth of Domestic Tax after implementation of VAT.

6. Summary of Findings, Conclusions and Recommendations

6.1 Summary of Findings

Government revenue is increasing from year to year by changing the tax law from sale tax to VAT, and VAT is becoming the major source of government revenue. The following table shows distribution of government taxes and revenues.

Table 1: Share of Direct, Indirect and Non-tax Revenue from Total Tax Revenue

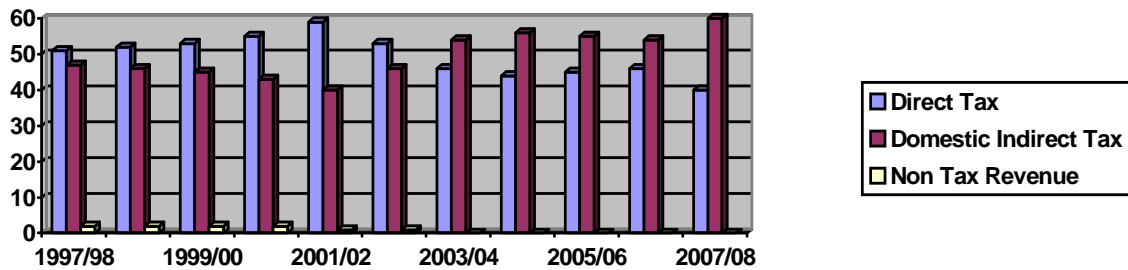
Description	Years										
	1997/98 1990	1998/9 1991	1999/00 1992	2000/0 1 1993	2001/02 1994	2002/03 1995	2003/0 4 1996	2004/05 1997	2005/06 1998	2006/07 1999	2007/0 8 2000
Direct Tax	51	52	53	55	59	53	46	44	45	46	40
Domestic Indirect Tax	47	46	45	43	40	46	54	56	55	54	60
Non Tax Revenue	2	2	2	2	1	1	0	0	0	0	0
Total Tax	1	1	1	1	1	1	1	1	1	1	1

Table 1 indicates that domestic indirect tax covers an average of 46% and 60% of the total revenue before and after the tax reform respectively. Here we can clearly see that after the tax reform, indirect tax is the major contributor of government revenue compared as with the direct tax because the direct tax is reduced from 53% to 40% before and after the tax reform.

The figure below gives an idea about the share of Direct, Indirect and Non-tax Revenue from Total Tax Revenue before and after the tax reform. After the tax reform the revenue

collection performance shows an increment throughout the year; especially the indirect tax collection shows growth from year to year.

Figure 1: Share of Direct, Indirect and Non-tax Revenue from Total Tax Revenue



Performance of Indirect Tax

Indirect tax is a tax, in which the burden may not necessarily be swallowed by assessing, which mean indirect taxes can be shifted on to other persons. Generally, the tax incidences of indirect tax are on ultimate consumer; however, sometimes seller might absorb such indirect tax to be competitive in the market. Example of Indirect Taxes are; Customs Duty, Excise Tax, Sales Tax, Value Added Tax, Stamp Duty. Here, we may see only VAT.

Table 2: Performance of Indirect Taxes (In million)

Description	Year									
	1998/99 1991	1999/00 1992	2000/01 1993	2001/02 1994	2002/03 1995	2003/04 1996	2004/05 1997	2005/06 1998	2006/07 1999	2007/08 2000
VAT	-	-	-	-	372.26	1220.70	1542.80	1819.85	2390.31	3243.37
Excise Tax	417.20	431.89	312.40	343.76	362.32	413.90	466.60	577.32	603.37	834.49
Turn Over Tax					40.42	132.60	82.43	51.95	57.86	36.88
Sales Tax	527.60	684.02	764.82	860.24	579.14	-	-	-	-	-
Stamp Sales and Duties	54.86	51.92	58.02	45.12	52.31	53.11	75.18	84.22	104.08	109.47
Total Indirect Tax	999.88	1167.83	1135.24	1249.12	1406.45	1820.31	2167.01	2533.34	3155.63	4224.21

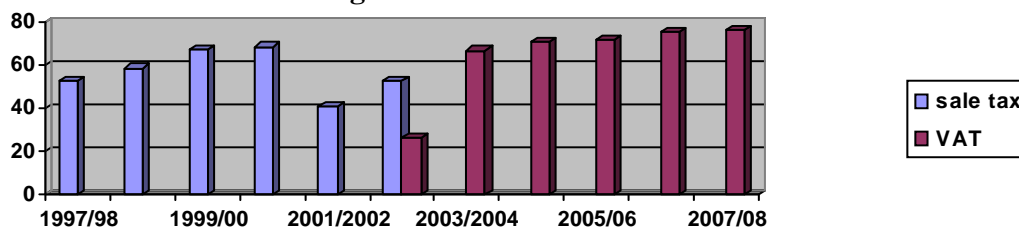
When we observe the performance of domestic indirect tax from table 2, it covers the lowest part of the total taxes revenue up to the tax reform (1995 EFY). After the tax reform (1995 EFY) it shows an improvement and covers the largest part i.e.1406.45 to 4224.21 before and after the tax reform. The reasons for the improvement for the performance of domestic indirect taxes could be the introduction of Value Added Tax (VAT), and the introduction of Turn Over Tax (TOT).

Table 3: Share of Sales Tax and VAT

Descriptions	Years										
	1998/99 1991	1999/00 1992	2000/01 1993	2001/02 1994	2002/03 1995	2003/04 1996	2004/05 1997	2005/06 1998	2006/07 1999	2007/08 2000	Average
Sale tax	52.76	58.57	67.37	68.86	41.17	-	-	-	-	-	57.84
VAT	-	-	-	-	26.46	67.06	71.19	71.83	75.74	76.78	64.4.

Table 3 indicates the performance of all Indirect Taxes, when we observe the performance of sales tax; it covers on the average 57.84%. This indicates sales tax cover more than half of the Indirect Taxes Revenue up to the tax reform (1995 EFY). After the tax reform (1995 EFY) when sales tax were converted to VAT, it shows an improvement and covers the largest part on the average 64.4% implying that VAT is the major contributor of government revenue compared with sales tax.

Figure 2: Share of Sales Tax and VAT



Accordingly to Fig 2, VAT collection increased steadily, and showed a trend in growth from 372.26 million in 1995 EFY to Birr 3243.37 million in 2000 EFY (table). It now contributes about 15.57% of the total domestic tax revenue of the ERCA, implying that VAT has become the major contributor of the government revenue.

6.2 Conclusions

As per the analysis of the study, the transformation of sales tax to VAT system was associated with increased government revenue and simplified tax administrative procedures. It covers more portion of ERCA domestic indirect tax revenue implying that VAT has become the major contributor of the government revenue. In line with the responses of VAT registered companies and tax officials, the following conclusions were drawn.

- The majority of taxpayers claimed they faced different problems. To begin with, the timing of transformation of sale tax to VAT was not clear for a number of large tax payers. It was well addressed and they were not trained to comply with the law.
- Almost half of the respondents did not get sufficient time for declaration of VAT and do not get sufficient cooperation at the time of payment. Those who fail to meet the due date have severe and un-proportional penalty.
- Most respondents encountered working capital deficiency due to non-refunding VAT inputs. Large numbers of respondents do not get direct refund on the return of VAT in put. At the time of damage, the authority doesn't give due consideration for the damage. Almost half of the respondents had not been asked for an audit by ERCA.
- VAT registrations have effect on competitiveness, Non-registrant companies have negative impact on competition as observed in the analysis from 15%-75% reduction on customers.
- From the data collected, it can be concluded that almost all of the respondents have seen change in the accounting records as the result of the change introduced by the authority from sales tax to VAT. On the other hand VAT payers suggested several points concerning improvement of VAT assessment by the authority.

- To begin with, the authorities do not register all the concerned parties liable for VAT. Some VAT employees do not have the appropriate training. Some taxpayers complain that the authorities do not set up clear directions.
- On the other hand, however, most, if not all, officials claim that the implementation of VAT is at the right time. Media coverage is enough to create awareness. Inversely, the tax officials responded that department officials, staffs have adequate knowledge concerning VAT. The number and educational qualification of employees are adequate and sufficient.
- Large number of tax officials responded that the VAT reinforcement capacity of the law is appropriate by using different methods, such as auditing, assigning and approving.
- According to the findings there are positive indications that government revenue dramatically increases through changes in the tax law and that the number of VAT registrants increased from year to year. VAT refund service by the organization has been organized and facilitated as a means of forwarding into their future.
- Yet tax officials faced problems during VAT assessments and a problem in collection has been observed. Most tax payers do not have complete financial documents and most VAT payers are not honest. Large number of TIN repetition and lack of trained officials on the SIGTAS system are some of the drawbacks observed.

6.3 Recommendations

Based on the empirical analysis and drawn conclusion, it is appropriate to indicate the recommendation.

- ERCA should be equipped with efficiency in all aspects and respond positively to the questions and demands of the taxpayers. Well-educated and rich experience personnel is vital for ERCA.

- All Information should be duly passed to the taxpayers. Changing the attitude of the taxpayers is also equally important.
- Protection of VAT payers from unduly system, VAT unregistered companies, VAT refund and maladministration is very important. And the time and penalty given to the tax payers should improve.
- Rotation of staff may have negative effect. The replaced staff should be knowledgeable and ought to have the necessary work experience and the required educational qualification.

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