



**ST. MARRY UNIVERSITY COLLEGE  
SCHOOL OF GRADUATE STUDIES**

**PROBLEM OF VAT ADMINISTRATION: THE CASE OF ARADA SUB-  
CITY SMALL TAX PAYERS” BRANCH OFFICE OF ERCA**

**BY  
WUBETU GEZAHEGNE MARU  
ID SGS/0319/2007B**

**MAY, 2017  
ADDIS ABABA ETHIOPIA**

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**A THESIS SUBMITTED TO ST. MARRY UNIVERSITY COLLEGE  
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**ST. MARRY UNIVERSITY COLLEGE  
SCHOOL OF GRADUATE STUDIES  
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**APROVED BY BOARD OF EXAMINERS**

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Dean, School of Graduate

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Signature

\_\_\_\_\_  
Advisor

\_\_\_\_\_  
Signature

\_\_\_\_\_  
External Examiner

\_\_\_\_\_  
Signature

\_\_\_\_\_  
Internal Examiner

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Signature

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## **List of Acronyms and Abbreviation**

EEC	European Economic Community
ERCA	Ethiopian Revenue and Customs Authority
ETB	Ethiopian Birr
FSS	Forum for Social Studies
GDP	Growth Domestic Product
GST	Goods and Service Tax
IMF	International Monetary Fund
MOFED	Ministry of Finance and Economic Development
OECD	Organization for Economic Cooperation and Development
Proc. No.	Proclamation Number
RST	Retail Sales Tax
SAS	Self-Assessment System
SIGTAS	Standards Integrated Government Tax Administration System
SPSS	Statistical Package for Social Scientists
VAT	Value Added Tax

## ***Abstract***

*The study investigates and analyzes the Problems of VAT administration at the Arada Sub-City Small Taxpayers Branch Office of the ERCA. To achieve the objective of study, the researcher adopts descriptive method of research approach. The sample of VAT Registrants taxpayers and Tax officials of the Authority were selected using simple random method and judgmental sampling method respectively. The study used both quantitative and qualitative data. For the quantitative data, the questionnaire for taxpayers and tax officials and for qualitative data an in-depth interview with Process owner used. The collected data were analyzed using descriptive statistics .The result of this study showed that in the Arada Sub-city revenue authority the application of tax principle was not fair, the VAT payers at the sub-city didn't fully comply with the basis of the current VAT laws, lack of awareness, weak culture of taxpayers, tax evasion, unwillingness of consumers to buy goods and services with VAT, lack of good governance and poor tax enforcement. All these problem and weakness hinder the VAT administration at the Sub-City. The thesis suggests a series of measures which could be taken by the tax authority, to address the various problems identified in the study. These measures include establishing a media and transmit the tax related laws on a consistent basis, giving recognition to the honest traders and taking a legal action for non-compliant taxpayers, giving training and education , creating a continuous assessment mechanism by conducting continuous discussions about issues of VAT and self-assessment, preparing standard for each activities according to their office and then penalizing those tax officials who did not do according the standards set by the authority.*

# CHAPTER ONE

## INTRODUCTION

### 1.1 Background of the Study

Tax administration is important activity in tax collection because it is the source of revenue for government. A good Tax administration is essential in fully implementing the design feature of VAT and achieving government's policy objectives at large. This thesis deals with the Administration of value added tax (VAT), focusing on the Arada Sub-City in the capital city of Ethiopia, Addis Ababa. Ethiopia needs to increase its public revenues to reduce the high level of poverty in the population. One way of improving poverty is via generating higher revenues that will finance public expenditure. From the different sources of raising public revenue, taxation is one of a system of raising revenue by a government. It is the system of collecting money by government to finance government operations (Tesfaye, 2014). Also, it would help in reducing the country's debts. The proper amount of tax must be collected on a timely manner for successfully improving and maintaining stable economic growth in a nation. To do this, the enforcement power of the tax administration, including proper tax assessment and collection must be applied in a manner that fulfills the tax principles.

According to explanation given by Yesegat (2015) on the Addis Ababa-Forum for Social Studies (FSS), tax revenue performance in Birr value shows increasing trend overtime with indirect taxes accounting for the largest share of tax revenue. Moreover, the VAT and customs duties have major contribution to the total tax revenue, and as a result, tax revenues currently cover nearly 70 percent of the total government expenditures.

The VAT was introduced in various European countries as an alternative to turnover taxes. It was adopted on limited scale in France in 1954 and soon after it became popular among the members of the European Economic Community. So, in order to foster trade among its members, the Council of the European Economic Community (EEC) issued a directive on April 1, 1967 requiring all member countries to establish a VAT system by 1<sup>st</sup> January 1970. Owing to its multidimensional advantages it has been accepted by many states of the world with in short period of time, thus Ethiopia is not an exception country (Thuronyi, 1996).

In developing countries, adoption of VAT is often seen as the central element in a program of modernizing tax administration, developing the use of methods of self-assessment whose generalization is expected ultimately to ease administration and compliance in relation to other taxes too (Keen,2005). And also in most countries, the development of self-assessment is closely linked to the rise of the VAT. Indeed, the real question is not how to administer a VAT in a country without the capacity to administer self-assessment, but how to implement the basic principles of self-assessment in a country willing to introduce a VAT (Muñoz and Cho, 2003).

However, when we come to Ethiopia, the VAT system is still at its infant stage. Proclamation No. 285/2002, introduced the VAT by replacing the formerly known sales tax Proclamation as of January 2003. Compared with the replaced sales tax, the new VAT has the advantages of allowing little room for evasion, enhancing saving and investment, and generating adequate revenue for the government to cover necessary expenditures than the out dated sales tax (Mesfin and Bogale, 2009).

According to the World Bank, cited in Ayele (2013), the Ethiopian tax revenue to GDP ratio was only around 9.5% out of expected 13%, while sub-Saharan country has 16% of tax revenue to GDP ratio. As a result, it contributes for deficit problem in Ethiopia every year. But VAT is the principal source of revenue for the Ethiopian government (Dheressa,et al,2015). Since VAT is applied on the value added at each stage of production and distribution, it solves the tax cascading effect and reduces tax evasion with its modern administration system that sales tax cannot. For this reason, VAT has been more revenue productive than sales tax (Mesfin and Bogale, 2009).To sustain VAT's revenue role in the government's finance, it is important to ensure that the revenue generated by this tax is raised as efficiently as possible.

In order to make up sufficient revenue from VAT, it needs efficient and effective tax administration. However, in developing countries like Ethiopia, there would be several problems that hinder effective VAT collection and assessment (Yeseget, 2008). This study trial to investigate and analyze the current Problems of VAT administration activities regarding VAT assessment and collection processes at the Arada Sub-City Small Taxpayers Branch Office of the Ethiopian Revenues and Customs Authority (ERCA).

## **1.2 Statement of the problem**

Indirect taxes such as VAT, excise taxes, turnover taxes and foreign trade taxes play a major role in raising domestic revenue in Ethiopia. For instance, in the fiscal year 2004/05 total tax revenue was ETB 12,265 million out of which ETB 3,940 million was from direct taxation representing about 32 per cent of tax revenue leaving the remaining 68 per cent for indirect taxes mainly VAT and foreign trade taxes. So VAT is the principal source of revenue for the Ethiopian government (Yesegat, 2008).

Ebrill et al. (2002) stated that VAT is a good means to raise government revenue and they found that countries that have adopted VAT revenue from this source accounted on average 27 percent of the total tax revenue or 5 percent of the GDP. Moreover, 70 percent of the world's populations now live in countries with a VAT. This implies that it is a key source of government revenue in more than 126 nations.

Generating revenue from VAT in Ethiopia is frequently lower than expected. So, the government resolves to increase VAT revenue and to improve tax administration system on one side and taxpayer compliance on the other side. This creates problems on the business sectors. Some studies which have been undertaken in other places of the country (Markos,2010; Dheressa et al.2015; Bizualem,2015) have indicated that: lack of awareness by the side of the VAT payers while fulfilling their obligations, ineffectiveness and inefficiency of the Tax Authority, poor service delivery, total distrust between the Tax Administration and taxpayers, lack of simplified procedures, lack of the enforcement capacity of the Tax Administration, resistance against registrations for VAT by some traders and weak culture of taxpayers are some of the major problems in VAT Administration.

Unfortunately, there is no recorded study that has been conducted in the sub city to explore reason behind VAT administration regarding VAT assessment and collection. Therefore, in addition to examining the above already identified gaps, this study was designed to examine VAT administration regarding current problems of VAT assessment and collection process at the Arada sub-city small taxpayer's Branch office to recommend possible solutions to the problems that help the Tax Authority to incorporate measures that address these pitfalls while collecting tax.

### **1.3 Research Questions**

In addition to examining the above already identified gaps, the study also tried to answer the following questions:

- i. To what extent the principles of taxation are being applied in collecting VAT liability?
- ii. Do the registered taxpayers perform their work in compliance with current rule and regulations of the VAT?
- iii. What are the extents of the taxpayer's awareness towards VAT collection?
- iv. What are the problems facing the taxpayers?
- v. What are the problems facing the Arada Sub-City Small Taxpayers Branch Office of ERCA?

### **1.4 Objective of the Study**

#### **1.4.1 General objective**

The Main objective of this study is to assess the main problem relating to the VAT administration and VAT payers in case of Arada Sub City Revenue Office of ERCA and to recommend better ways and means for further improvement.

#### **1.4.2 Specific objectives**

The main problem mentioned above leads to address the following specific objectives.

- i. To determine whether the registered taxpayers do their work with the compliance of the current rules and regulations of the VAT;
- ii. To identify the principle of taxation applied in assessing VAT liability;
- iii. To evaluate the extent of awareness of tax payers towards VAT administration;
- iv. To assess the problems facing taxpayers; and
- v. To analyze the impacts of constraints on revenue collection, taxpayers compliance attitude and service delivery of the tax office.

### **1.5 Significance of the Study**

The contribution of this study may include the following: -It may help the branch to identify the problem area and take corrective action, in order to add knowledge to the existing practice of VAT administration systems. Furthermore, the finding of this study could be used as a base reference for further detail investigation in related areas of the topic.



## **1.6 Scope of the Study**

The scope of this study could be limited to Problem of VAT Administration at the Arada Sub-City Small Taxpayer Branch office.

## **1.7 Limitation of the Study**

These were the limitations encountered in the process of the study: - the unwillingness of some respondents to give reasonable reliable answers for the questions, time constraints and budget constraints in determine the sample size were some of the limitations that had an impact on the study. There was also unwillingness to take and fill the questions by some of taxpayers.

## **1.8 Organization of the Study**

The research has been organized as follows. The first chapter is introduction. Literature review on Problems of VAT Administration indicates in second chapter. The third chapter deals with methodology of the study. The fourth chapter presents results and interpretation of data while conclusions and recommendations are presented in chapter five.

## **CHAPTER TWO**

### **REVIEW OF RELATED LITERATURE**

#### **2.1 Introduction**

VAT is a general consumption tax assessed on the value added to goods and services. It is a broad based tax because it is charged in different stage of the production and distribution of goods and the provision of services. It is a consumption tax because it is borne ultimately by the final consumer. It is charged as a percentage of prices, which means that the actual tax burden is visible at each stage in the production and distribution chain. It is collected fractionally, via a system of deductions whereby taxable persons (i.e., VAT-registered businesses) can deduct from their VAT liability the amount of tax they have paid to other taxable persons on purchases for their business activities. This mechanism ensures that the tax is neutral regardless of how many transactions are involved (Herouy, 2004).

#### **2.2 Theoretical Review**

According to Carnahan (2015), state that well-functioning revenue system is a necessary condition for strong, sustained and inclusive economic development. And also a central element in supporting a strong citizen–state relationship that underpins effective, accountable and stable governments. So, greater focus on domestic revenue can build stronger citizen–state relations in order to contribute stronger economic and employment growth outcomes. The OECD ,cited in Carnahan (2015), also note that taxation can also improve governance by creating a shared interest in economic growth between the state and the private sector, and that the improvements in the state apparatus associated with improved revenue collection may encourage improvements elsewhere in the state apparatus.

Tax policy and tax administration are the means by which governments raise revenue to finance spending on public goods and services. Tax policy is the choice of tax instruments. Tax administration is the implementation of tax policy. Tax policy reforms focus on improving the efficiency and equity of the income tax system, modernizing tax administration by enhancing technical capacities, and reforming indirect taxation. The main reform to indirect taxation was the introduction of VAT in January 2003 primary to raise increasing revenue (Muñoz and Cho, 2003).

### **2.2.1 Types of VAT**

There are several bases for classifying VAT of particular importance are the extent of vertical coverage through production and distribution stages; the treatment of amounts paid for producers' goods, particularly durable capital equipment and the method used for calculating tax liability. Conceptually, there are two types of VATs: consumption and the income.

Under the consumption type VAT, the tax base is the value of goods and services sold or transferred for personal consumption. While the income type VAT, the tax base is determined as the net national income (Schenk and Oldman, 2007). As Capehart and Yakovlev (2007), stated that consumption-type VAT differs from income-type VAT with respect to the tax base. The key difference between the two is the tax treatment of capital investment. By excluding capital expenditures from its base, a consumption-type VAT taxes consumption but not investment, while an income-type VAT taxes both consumption and investment. Thus, an income-type VAT does not favor consumption over investment or vice versa.

As Carnahan (2015), describes indirect taxes or taxes on consumption are a core of the revenue base. In terms of a general tax on consumption, over 150 countries and all but one OECD country have some form of VAT. Because, VAT is consider to be the most economically efficient consumption tax then other tax.

### **2.2.2 Principal Components of VAT**

There are two principal components of VAT. These are Input VAT and Output VAT. Input VAT is the VAT payable by a taxable person on goods and services supplied to him and on goods which he imports for the purposes of a business carried on by him and for which registered for VAT. Viewing the concept from the other angle, it is the VAT payable on purchase of taxable supply including capital goods and operating and administrative expenditures. For a VAT registered person (taxable person) input VAT is not a component of the cost of purchase/import rather the registered person is entitled to take input VAT deduction against the VAT charge on sales or is recoverable from the Tax Authority. Hence, input VAT is a receivable for a registered person.

Output VAT is the VAT collectible by a taxable person at the time of sale of taxable goods and services (supply). It is the VAT chargeable on sales of taxable goods and services whenever a taxable person supplies taxable goods or services to other person. VAT must be included in the

price charged for those taxable goods or services. This is the output VAT for the supplier. Output VAT is not a component of the sales price rather it is a liability to the taxable person which is collected on behalf of the Tax Authority. The logic of VAT is that during a VAT accounting period, a VAT registered person pays VAT on its purchases, which is called input VAT; and the person charges VAT on its sales, which is called output VAT. At the end of the VAT accounting period, the difference between the amount of output tax and input tax represents either VAT payable to the tax Authority or VAT Refundable from the tax Authority (Tesfaye, 2014).

### **2.2.3 Implementation of VAT**

The standard way to implement VAT involves assuming a business owes some fraction on the price of the product minus all taxes previously paid on the good. The special feature of the modern value added tax is the mode of collection. So in order to do these first determine the VAT liability of a taxpayer by using the three alternative methods. These are credit (invoice) method, addition method, and sales subtraction method.

#### **i. Invoice Method**

Under the invoice method of collection, each seller charges VAT rate on his output and passes the buyer a special invoice that indicates the amount of tax charged. Buyers who are subject to VAT on their own sales (output tax), consider the tax on the purchase invoices as input tax and can deduct the sum from their own VAT liability. The difference between output tax and input tax is paid to the government (or a refund is claimed, in the case of negative liability). In other words, the credit method of collection should eliminate any cascading effects (Aruwa and Suleiman, 2008).

#### **ii. Addition Method**

Under addition method, a taxpayer calculates the value added by summing the value of the factors of production that it uses in the production of taxable goods and service. And also under the accounts based method, no such specific invoices are used. Instead, the tax is calculated on the value added, measured as a difference between revenues and allowable purchases. But this method not used at the national level (Schenk and Oldman 2007).

#### **iii. Sales Subtraction Method**

Under this method the VAT liability for each period is the product of the tax base multiplied by the VAT rate( Schenk and Oldman , 2007) .In general most countries today use the invoice method,

the only exception being Japan, which uses the subtraction method VAT (Keen and Smith,2007). According to Proclamation No. 285/2002 Article 21 Ethiopia uses the invoice method.

#### **2.2.4 VAT Rate**

The applicable rates to the tax base differ from country to country. Some developing countries have adopted VAT with a single rate and others with a multiple rate. The rate can be tax inclusive (rate applied to tax inclusive base) or tax exclusive (rate applied to tax exclusive base). In practice, few countries such as Brazil and Bolivia use tax inclusive while most countries such as Kenya, Senegal, adopt tax exclusive rate. Ethiopian VAT law follows a VAT exclusive approach where by the price indicates only the value of the good and the VAT will be imposed after that (Gebreegziabher, 2012).

The Ethiopian VAT rate is also single rate of 15% and tax exclusive (Proc. No. 285/2002). This rate is comparably less than other countries such as Kenya (16%), Colombia (45%), Argentina (27%), Uganda (17%) and Senegal (20%). On the other hand, zero rating is the mechanism under VAT system by which the tax can be completely removed from a particular product or services or from a particular transaction does not include on the tax base (Schenk and Oldman, 2007).

#### **2.2.5 VAT Administration**

As Jantscher (1990), noted that the basic tasks of tax administration consist of three distinct (though connected) activities, i.e. identification, assessment and collection. As Tait (1988), the introduction of VAT is usually the greatest change in tax system of a country and there is also a possibility to perform the reform of tax administration.

##### **i. Registration Procedure**

Under the VAT Proclamation, registration for VAT is categorized in to three. These are obligatory, voluntary and special business categories. Any person who carries on a taxable activity and at the end of any period of 12 calendar months has made, during that period, taxable transactions the total value of which exceeds 500,000 Birr or 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 the period will exceed 500,000 Birr, has the obligation to register for VAT. (Article 16(1) (a) and (b))

According to Article 17, a person who carries on taxable activity and is not required to be registered for VAT may voluntarily apply to the Tax Authority for such registration, if he regularly is

supplying or rendering at least 75% of his goods and services to registered persons. The third category of registration, special business categories that also have the following features: Those who are involved in export are advised to be registered voluntarily in order to get refund. This is practical through zero rate purchases that enable the person to ask credit on input tax. 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. (Proclamation No. 285/2002).

## **ii. Filling of Tax Return and Payment of VAT**

Every registered person is required to file a VAT return with the Authority for each accounting period, whether or not tax is payable in respect of that period; and to pay the tax for every accounting period by the deadline for filing the VAT return. The VAT return for every accounting period is filed no later than the last day of the calendar month following the accounting period. VAT on taxable imports is collected by the ERCA accordance with VAT as per the customs legislation of Ethiopia under the procedure contemplated for customs duty, (VAT Proclamation No.285/2002, Art.26).

## **iii. VAT Assessment Procedures**

The tax assessment for those, who are required to maintain financial records, is done based on the records that taxpayers maintain; however, if they fail to maintain financial records, estimated assessment will be done. For the rest of taxpayers, who are not required to maintain financial records, it is based on the standard assessment method (Council of Ministers, 2002). The self-assessment systems which are require tax payers to do calculation, payment, and reporting their own tax payable by themselves. However, VAT is essentially a self-assessed by taxpayer.

In the self-assessment taxation approach, taxpayers calculate their taxable income, file tax returns and pay their taxes due. This taxation system basically presupposes taxpayer's willingness to pay taxes, continue accurate bookkeeping behavior and calculate their taxable income based on objective data. Self-assessment is so important helps to improve effectiveness by focusing resources on taxpayer services, enforcement, reduce compliance costs and reduce corruption. But administrative assessment is not compatible with modern tax administration (Bodin, 2008).

The issue of self-assessment reemerged in the early 1990s, as transition economies moved toward VAT implementation with little experience of tax administration and little appreciation of what

would be required to administer an accounts-based tax (Ebrill, et al, 2002). Modern tax systems and their administration are built on the principle of “voluntary compliance,” meaning that taxpayers are expected to comply with their basic tax obligations with only limited intervention by revenue officials. In practice, voluntary compliance is achieved through a system of “self-assessment”. In most countries, the development of self – assessment is closely linked to the rise of the VAT. Indeed, the real question is not how to administer a VAT in a country without the capacity to administer self –assessment, but how to implement the basic principles of self–assessment in a country willing to introduce a VAT (Keen ,2005 ).

### **2.2.6 Principles of a Good Tax System**

According to Muñoz and Cho (2003), VAT is expected to enhance revenue, improve economic efficiency, promote exports, and foster growth. So the proper amount of tax must be collected on a timely manner for successfully improving and maintaining stable economic growth in a nation. To do this, the enforcement power of the tax administration, including proper tax assessment and collection must be applied in a manner that fulfills the tax principles.

A good tax system should be efficient in that it should be able to waste as little money and resources as possible. Efficiency can be measured against three standpoints: administrative costs, compliance costs and excess costs. These three relate to the cost of operation of the tax system, to its flexibility and certainty.

According to Tesfaye (2008), taxation has become a vital component of development effort of every country without a tax system that functions well governments cannot provide even the basic infrastructure and social services. Public infrastructures cannot be improved without an equitable and efficient means of mobilizing revenue. Many countries are beginning to see that a tax system has a role in providing a safety net for the poor. It is incentive measure to protect the environment a good tax system is essential if governments are to pursue growth, equity and environmental protection people will be more willing to pay.

As stated by Uremadu, 2000; Harvey, 1982; and Musgrave, 1987 cited in Uremadu and Ndulue (2011), a good tax system must be based on principles as thus explained. *Equity*: Treatment of similarly situated tax payers or that people should pay tax according to their abilities to pay. *Certainty*: It stipulates that the time of payment, the manner of payment and the amount to be paid should be clear to the taxpayer and to the taxing authorities. *Convenience*: This relates to mode of

payment and the timing. This principle stipulates that the time and manner of payments should be convenience to the taxpayer. As a matter of fact, a tax system should be simple, easily assessed, and understood and be collected at minimal costs. *Economy*: The total costs of collection should be small when compared with the tax yield or amount realized from tax. Hence, the compliance costs to the tax payers and the administrative costs to the government negatively affect national output of taxes collected. *Simplicity*: This is usually a good tax system should be very simple and not be complex. It should be simple and well understood by both the tax payers and tax administrators alike. It should as well be easily administered.

### **2.2.7 The VAT Compliance System**

According to Marti (2010) tax compliance is a complex term to define. Simply put, tax compliance refers to fulfilling all tax obligations as specified by the law freely and completely. VAT is collected by VAT registered traders on their supplies of goods and services. Each such trader, in the chain of supply from manufacturer to retailer, charges VAT on sales and is entitled to deduct from this amount the VAT paid on purchase. The effect of offsetting purchases against sales is to impose the tax at each stage of production on the added value. The final consumer, being unregistered for VAT, absorbs the VAT as part of the purchase price.

The VAT can play a key role in developing modern methods of tax administration, based on effectively monitored voluntary compliance (Ebrill, et al, 2002). Tax compliance could be defined as the ratio of official tax payment (actually collected) to tax due (the tax liability). Low compliance level may show administrative weakness or evasion. In the case of VAT, voluntary compliance is expressed as the ratio of VAT return filers plus VAT paid filers on time to the total VAT registrant. High voluntary compliance ratio implies that taxpayers are aware of the penalty system and believe in its inflexibility and immediate enforcement.

Non-compliance with VAT Proclamation failure to register for VAT as per VAT registration requirement, failure to issue a tax invoice, failure to maintain recorder such as original tax invoices received and a copy of tax invoices issued and failure to file timely return shall be liable to administrative penalties ranging from a fine 100 percent of the amount of tax payable and a fine of up to 50,000 Birr. In addition to administrative penalties tax offenders such as tax evasion, making false or misleading statement and failure to notify are all criminal offences under Ethiopian law. Accordingly, tax fraud - making false or misleading statements is punishable with a fine ranging from 1000 Birr to 100,000 Birr and an imprisonment ranging from 3 years to five years



where the making of false or misleading statement is made knowingly or recklessly such an offence is punishable by a fine of up to 200,000 Birr or an imprisonment of up to 15 years.

The VAT is a particularly complex and costly tax to comply with and administer, and is consequently ill-suited to developing countries. In general this will depend on the costs involved in its operation. These resource costs can be decomposed into the administrative costs incurred by the tax authorities and the compliance costs incurred by taxpayers. Given the potential role of the VAT as a catalyst for change both within the tax collection agencies (spearheading, for instance, the modern use of information technology and the development of audit methods) and among taxpayers (e.g., by stimulating a culture of record keeping), a VAT may involve substantial collection costs, especially at the beginning, but still be very successful (Keen, 2005).

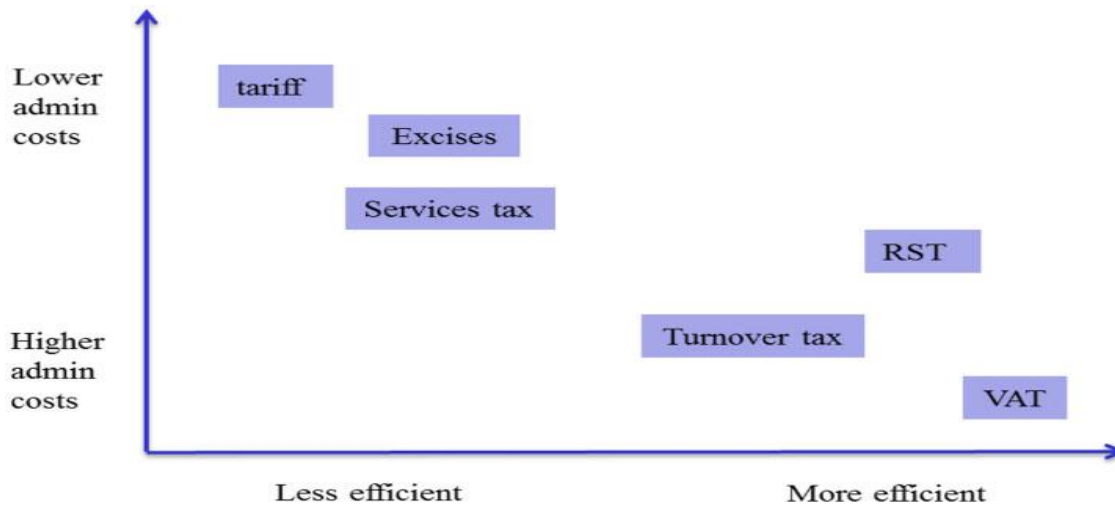
The growing concern of tax administrations throughout the world is on how to simplify the tax assessment system to encourage voluntary compliance, and many countries have adopted the self-assessment system as a solution (SAS). Thus, the recent trend in developing countries sees a shift from the official assessment system to a SAS (Sarker, 2003:2).

### **2.3 Empirical Review**

The study conducted by Bird (2005), reveals VAT as the ‘money machine’ tax which necessarily adopted by both developed and developing countries that allow the government to collect sufficient amount of revenue. Hence, the majority of economists as well as experts of political scientists think that VAT is the best preferable general consumption tax recently available that enhances economic growth.

According to Carnahan (2015), tax reform looks to balance economic, compliance and administrative cost when raising adequate revenue. Different consumption taxes have significantly different economic impacts and administrative costs. Figure 2.1 presents a simple schema to highlight the tradeoff between different ways to tax consumption. The VAT, RST and turnover tax are generally applied to broader bases than tariffs excises or service taxes, so they will be more economically efficient. Within this first group, a VAT is considered to be the most economically efficient consumption tax.

**Figure 2.1: Tradeoff between Administration and Efficiency costs – taxing consumption**



Source: Asia & the Pacific Policy Studies, 2015

However, the VAT is more difficult to administer because it applies to more taxpayers. Even in its simplest form, it is more complex to administer, because intermediate producers need to get credit for the tax they pay. These complexities are multiplied when there are multiple rates or some products are ‘zero-rated’, while others are exempt.

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

In Ethiopia revenues raised by VAT are usually gathered at the expense of erosion in its main features. So, this is due to VAT administration problems particularly for key VAT administrative functions like VAT assessment and collection. In order to make up sufficient revenue from VAT it needs efficient and effective tax administration. However, developing countries like Ethiopia, there would be several challenges that hinder effective VAT collection and assessment (Yesegat, 2008).

### **2.3.1 Application of Tax Principles during VAT Collection**

According to Makedonskiy (2005), the ability of the tax system to adequately perform its functions is to a large extent determined by its correspondence to the economic environment along with certain principles and requirements. Specifically, tax burden should be fairly distributed among all

the economic entities depending on their taxable capacity. For example the role of VAT within broader strategies will have for alleviating poverty and achieving fairness (Keen, 2005). However, the implementation of this principle is hampered by the informal (unregistered) economic activity and active tax evasion by a significant part of the taxpayers.

### **2.3.2 Compliance of the Taxpayer**

According to Shahroodi (2010), stated that for a tax system to be efficient, the tax policy needs to be designed such that the tax rates are appropriate and rational, the exemptions are lower in amount, the tax collection organization are more efficient, the tax burden of the indigent people should be lighter and the fight against corruption and tax evasion should be much more intense. Pro-business Tax regimes and enforcement should be simple, consistent and predictable should to lower compliance and administrative costs, and hence reduce uncertainty faced by taxpayers as well as improve the levels of voluntary compliance (Kasipillai, 2005).

Even though VAT is less vulnerable than other form of taxations, like any other tax, it is vulnerable to evasion and fraud (Keen and Smith, 2007). It is widely accepted that the goal of an efficient tax administration is to foster voluntary tax compliance using all possible methods including penalties. Penalizing tax evaders or going after delinquent taxpayers are not in themselves the object of tax administration, although it would serve to encourage voluntary compliance if the taxpayers believe that the tax administration can effectively detect and punish noncompliance.

It is difficult to get an accurate picture; it is clear from the few studies that, VAT evasion is widespread and involves significant revenue losses, though the extent varies considerably across countries (Webley et al., 2002:1). For instance, a study on VAT Compliance in the United Kingdom identifies four forms of noncompliance:-

- I. Engage in taxable transactions without having registered with the tax authority
- II. Fail to file their tax return by the statutory filling deadlines
- III. Underreporting their tax liability or illicit claim of tax refunds, or
- IV. Underpay the amount of taxes due (tax arrears).

These forms of noncompliance give rise to tax gap representing forgone government revenue and unfair competitive advantage to noncompliant businesses. According to Tompson and Green

(1988), one of the shortfalls in VAT administration is lack of registering those who should be registered.

According to Atawodi and Ojeka (2012), various opinions exist about the best ways to improve tax compliance. Given the chance, a lot of businesses will not pay taxes unless there is a motivation to do so. Some believe that the best way is to increase incentives others believe the best way is to increase penalties. Tax compliance theories can be broadly classified into two. They are; economics based theories and psychology based theories.

Economic based theories are also known as deterrence theory and they place emphasis on incentives. The theory suggests that taxpayers are amoral utility maximizers. They are influenced by economic motives such as profit maximization and probability of detection. As such they analyze alternative compliance paths for instance whether or not to evade tax, the likelihood of being detected and the resulting effect and then select the alternative that maximizes their expected after tax returns after adjusting for risk. Therefore according to the theory, in order to improve compliance, audits and penalties for non-compliance should be increased.

Psychology theories on the other hand posit that taxpayers are influenced to comply with their tax obligations by psychological factors. They focus on the taxpayers' morals and ethics. The theories suggest that a taxpayer may comply even when the probability of detection is low. As opposed to the economic theories that emphasize increased audits and penalties as solutions to compliance issues, psychology theories lay emphasis on changing individual attitudes towards tax systems.

As Ebrill et.al (2002), the introduction of a VAT can facilitate substantial improvements in overall tax administration, particularly the establishment of more integrated tax administration organizations and the development of modern procedures based on voluntary compliance. But there have been some significant weaknesses in the VAT's implementation in developing and transition countries. Some of these are the difficulty of implementing workable self-assessment systems, under which taxpayers declare and pay taxes on the basis of their own calculations, subject to the possibility of later audit by the tax Authorities.

According to Keen (2005), a review of experience in 31 developing countries found that VAT administration is based on the concept of self-assessment in 26 of them. But further analysis of the data indicated that there has been less progress than would appear. Under a system of voluntary

compliance (meaning that taxpayers comply with their basic tax obligations without the intervention of a tax official) taxpayers self-assess: that is, they calculate and pay their own tax liabilities. They must complete their returns and submit them with their payments to the tax administration. One way to appreciate why self-assessment is important to an effective VAT administration is to consider the impact of not having self-assessment.

### **2.3.3 Awareness of Taxpayers**

According to Dekan (2003), the tax assessment sometimes can be unclear to the tax payers. Regarding to the complexity of tax assessment system (not simple and clear) may result in unintentional non-compliance if taxpayers have problems with filling the tax form. Furthermore, such noncompliance differs from other crimes. Because, it can be conclude that the errors occurred unintentionally due to the misinterpretation of the rules. Results from a survey shown that only 55% of the taxpayers were certain, that they had neither overstated a deduction nor understated taxable income on their return. Thus, by enhancing complexity, it is difficult to distinguish honest from dishonest taxpayers. By this virtue, tax examiners in the tax administration will have greater problems to identify a case of noncompliance and comparing whether the violation was deliberate or unintentional. And this can be increased tax collection costs.

Besides, the Kwabena (2011), findings on the knowledge of tax systems revealed that most self-employed are not knowledgeable of the tax system in Ghana. To affirm this internal revenue service organizes educational programmers, for the self-employed category of the taxpayers and find out the possible impact on revenue mobilization from the informal sector. The analyses on education the research shown that, only 27 out of 189 respondents representing 14.3% have received some tax education while the remaining 85.7% have never received any form of income tax education.

According to Hastuti (2014), self-assessment system requires taxpayers to calculate, pay, and report their own tax payable. Having full understanding of this kind of obligation helps the government indeed to have complied taxpayers. The complied taxpayers pay tax with the right amount with the right procedure. This is good since government revenue will be earned. For the potential taxpayers, it is also good to be informed with his kind of obligation. Tax is something unquestionable for every citizen, their awareness of taxation will be important in pursuing tax compliance.

Asamenew (2012), found that the major causes are there exist inefficiency and insufficient number of tax assessment and collection officers, most taxpayers lack sufficient knowledge of tax assessment and collection Procedures. Thus, most of taxpayers do not know why they are paying taxes; what types of taxes are expected from them; and the applicable rules and regulations. Due to this he recommend that negligence, delay in tax payment and evasion are taken by taxpayers as solution to escape from payment of taxes.

According to Hagos (2011) and lemessa (2007), awareness creation by the authority on taxpayers were rated about 87.8% and 74% of the respondents responded that below enough and poor and this shows that the awareness creation activities of the tax authority were ineffective and inefficient in according to awareness creation. Therefore, they established that the awareness creation problem was a series and the root cause of all problems relating to the tax collection and assessment. Due to this, the authority may not achieve the expected future voluntary compliance in the absence of services along with the taxpayer's lack of tax awareness. Without educating taxpayers and creating tax awareness, making power visible to the community might detect the deliberate evasions and frauds but not be a solution to create a compliant taxpayer those does not comply unknowingly (Mihret, 2011).

Markos (2010), found that different problems were observed, the main one is being attitudinal problem of the tax payers and implementation capacity of the government employees. As a result, the data show that there are many business men and companies that should be registered for VAT but are not. As a result, the branch office is losing millions of birr per year. And he recommended changing the attitude of the taxpayers and building the implementation capacity of the employees.

#### **2.3.4 Problems of Taxpayers and Tax authority**

Dheressa et.al, (2015), the study was particularly focused on challenges of VAT Administration regarding the assessment, collection and implementation of VAT .Their survey result showed that, most of the business entities have not comply with the laws and regulations of VAT and they committed illegal activities by preparing fake invoices and they remitted the tax income for themselves rather than to pay the government. Concerning the side of the Authority, it is incapable to identify and control business enterprises that are noncompliance with the laws and regulations of VAT. They recommended in their study that the Authority should strengthen its follow-up, appraise the performance of existing, recruit qualified new employees, strengthen its controlling

mechanisms, improve its administrative systems and prepare programs to provide intensive education to the society about the benefits, rules and regulations of taxes specifically VAT.

Bizualem (2015), indicated that the major challenges delay ERCA from generating what was initially planned are: lack of sufficient number of skilled personnel, limited staff capacity, non-responsiveness by the management, limited awareness creation, problems related with invoicing, unfair competition, and control centered management tendency. And he recommended that the need to strengthen the administration capacity in general and the VAT collection system in particular as efficiently as possible.

According to Jebessa (2005), many business owners do not keep their books properly, which invited to general estimations, which are often arbitrary. So training is necessary on the one hand and on the other hand, national standards for bookkeeping, which would be respected in all taxation offices nationwide, need to be defined and introduced.

To summarize, the empirical findings found that the determinants of the VAT administration problems were limited awareness creation, lack of equity and fairness of the tax system, ineffectiveness and inefficiency of the Tax Authority, poor service delivery, problems related with invoicing, total distrust between the tax administration and taxpayers and lack of simplified procedures .

## **CHAPTER THREE**

### **METHODOLOGY OF THE RESEARCH**

### **3 RESEARCH METHODOLOGY**

#### **3.1 Research Approach**

According to Punch (2006) the more general question covers both quantitative and qualitative approach. In order to benefit from the advantage of quantitative and qualitative approach, the mixed method approach was used for this study. In mixed method approach study begins with a broad survey in order to generalize results to a population.

#### **3.2 Research Method**

In this study, the type of research was descriptive. The rationale for selecting this type of research method was that the study has no control on the variables, rather it describes the characteristics of the Arada Sub-City VAT administration regarding assessment and collection 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.

According to Kumar (2011), many methods could be used to gather the required information. The study gather data through quantitative survey and qualitative interview with tax officials and taxpayers of arada Sub-City Small Tax Branch Office.

##### **3.2.1 Research Techniques**

Leedy and Ormond (2005), state that survey research involves acquiring information about one or more group of people perhaps about their characteristics, opinions, attitudes, or previous experiences-by asking them questions and tabulating their answers. Creswell (2009), also states that the purpose of survey research is to generalize from the sample to the population in order to be able to make inferences about some characteristic, attitude or behavior of the population. Survey design was selected for this research because of budget and time constraint (economical advantage of the design).

The survey method was conducted using a questionnaire for both tax officials and VAT registered taxpayers. The interviews were made for those most related process owners in administration. The questionnaire prepared in English language for the tax officials and it was classified into two sections. The first part of the questionnaires were designed to collect participants' profile (background information), whereas, the second part of the questionnaire focus on VAT related



issues that addresses the research questions. In addition, the study used Arada Sub-City Small Taxpayers office's report, documentary review, and brochures in relation to VAT administration.

### **3.3 Target Population**

A population is a group of items that a sample was drawn from. The target population that defined as suitable for this study was employees of tax officials and VAT registered taxpayers at Arada Sub-City Small Taxpayers Branch Office to collect different information on the problems of VAT administration.

### **3.4 Types and Sources of Data**

The study was a descriptive type of research whereby both primary and secondary data used. The reason for using such type was due to simplicity and the nature of the topic selected. The primary data was collected from two sources; from the taxpayers and tax officials. The primary data from the tax payers collected through questionnaire and the data collected from the tax officials through questionnaire and interview. On the other hand in the secondary data collection section the data collected from the Arada Sub-City Small Taxpayer Branch Office document materials, different publications as well as reports on the VAT assessment and collection, Ministry of Finance and Economic Development (MoFED), different statistical bulletins and websites were referred.

### **3.5 Sampling Design**

In order to select the appropriate representative of the total population and to make the research findings more relevant and accurate, the sample design well structured. So, the researcher designed the sample as follows.

#### **3.5.1 Sampling Technique**

Depending on the nature of the respondents, the study was used two sampling design methods: the simple random sampling and the purposive method. According to Kumar (2011), simple random sampling is the most commonly used method of selecting a probability sample, whereby, each element in the population is given an equal and independent chance of selection. Whereas, in the purposive sampling the primary consideration is our judgment as to who can provide the best information to achieve the objectives of our study.

#### **3.5.2 Sampling Frame**

The sampling frame for VAT registrant taxpayers was the registration list of taxpayers in the arada Sub-City that consists of 3,792 VAT payers currently. Beside that the number of tax officials in the

sub-city have 87. Whereas for the tax officials, employee registration list of the Sub-City Small Tax Payers Branch Office were used.

Therefore, the simple random sampling technique was used for the taxpayers and the purposive sampling method was used to select proper officials from whom relevant information gathered. From the total population of the VAT registrant taxpayers of the Arada Sub-City, the sample size was determined. The selection of individual taxpayers was done by simple random sampling. On the other hand, the tax auditor, tax assessors and collectors selected to gather proper and relevant information. For this case, purposive (nonrandom) sampling technique was used on their responsibility.

### 3.5.3 Sample Size Determination

Kumar (2011), when the population under study  $N \geq 10,000$ , suggests the following formula to select the sample size:

$$n = \frac{z^2pq}{d^2}$$

Where p = the proportion in the target population estimated to have characteristics being measured.

$$q = 1-p$$

d = the level of statistical significance set (marginal of error)

n = the desired sample size

z = the standard normal variation at the required confidence level (z-statistics)

In this study, the proportion of a target population with an incidence rate of 0.50(50%) taken, since there was no previous research study conducts in VAT administration regarding assessment and collection activities at the Arada Sub-City. The z statistics is 1.75(92%), and the acceptance of error 0.08 and then the sample size was determined as follows:

$$n = z^2pq/d^2, n = [1.75]^2 * [0.50 * 0.50] / [0.08 * 0.08] = 120, \text{ since } N < 10,000$$

When the population estimated  $N < 10,000$  the following formula should be used to calculate the sample size  $f_n = n / (1 + n) / N$

Where:  $f_n$  = the desired sample size

n = the sample size when the population  $> 10,000$  which is equal to 120.

N = the estimated population size

So, as the estimated population of VAT taxpayers at Arada Sub-City Small Taxpayers Branch Office is 3,792 and the sample size become:  $fn = 120 / (1+120) / 3,792 = 116$ .

For the tax officials since they were selected purposively according to their responsibility 4 from tax audit, 6 from tax assessment and collection employee's and 2 process owners from 87 employees of Arada Sub-City Branch Office would be selected.

### **3.6 Data Collection Methods**

Primary data was collected through questionnaire which includes closed and open ended questions for the tax payers as well as officials. The questions prepared for the tax payers included close ended; that are four alternatives, three alternatives and with two alternatives. On the other hand, some questions designed open and this type of question was prepared to gather information freely which was not covered by the close ended questions. The interview questions were designed for the former process owner of the sub-city office, and this would be designed to gather information from the respective bodies and to strengthen the data. An in-depth interview would be conducted on face-to-face basis.

### **3.7 Data Presentation and Analysis**

The main target of data analysis is to summarize the collected data and organize them in order to draw appropriate conclusion from the findings. In the data analysis involves three major steps. The first step is cleaning and organizing the data for analysis (Data Preparation). Since the type of research study was descriptive and data gathering tools were questionnaires and interviews data collected from survey questionnaires were carefully coded and checked for consistency and entered into Statistical Package for Social Scientists (SPSS). The next step is describing the data (Descriptive Statistics). The statistical analysis was conducted based on Percentages, Tables and Figures by applying Excel programs. It provides simple summaries about the sample and the measures. The last steps would be to try to generalize from the sample data what the population looks like or how the population looks like. The quantitative data would be analyzed and interpreted using percentages. The qualitative data analysis would be expressed in terms of attitudes, opinion and observation. The results of all analysis were presented in tabular forms.

## CHAPTER FOUR

### DATA PRESENTATION, ANALYSIS AND DISCUSSION

#### 4.1 Response Rate Analysis

**Table 4.1: Summary of Response Rate of the Respondents**

No	Respondents	Number of Questionnaires distributed	Interview Question	Response rate in number	Response rate in percent
1	Taxpayers	116	-	116	100
2	Tax assessment and collection officials	6	-	6	100
3	Tax auditors	4		4	100
4	Process owners		2	2	100
<b>Total</b>		<b>126</b>	<b>2</b>	<b>128</b>	<b>100</b>

Source: Survey Results, 2017

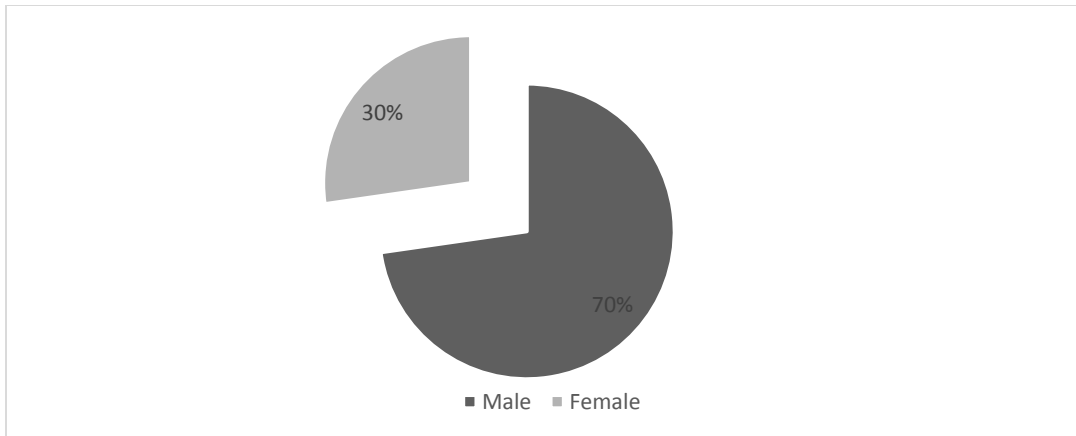
As shown in the above table, the survey result indicates that from the total 116 questionnaires distributed to taxpayers at the Arada Sub-City Small Taxpayer's Branch Office, all the respondents responded and returned the questioner. And 6 questionnaires were distributed to tax assessment and collection and 4 questionnaires were distributed to Tax auditor of employees in the Sub-City all the respondents responded and returned the questionnaires. In addition to the questionnaires, interviews were held with 2 process owners of Arada Sub-City Branch Office. Therefore, the collected data is sufficient and has a capacity to address the 012345objectives of the study.

#### 4.2 Characteristics or Profile Data

##### 4.2.1 Characteristics of Tax Officials

The response of tax officials was also as important as the response of taxpayers in identifying the problem of VAT Administration at the Arada Sub-City Small Taxpayer's Branch Office .In this survey the researcher conducted an interview for 2 of the tax process owner and took a questionnaire for the remaining 10 tax official.

**Figure 4.1: Gender of Tax Officials Respondents**



Source: Survey Result, 2017

As indicated in the above figure 70 percent were male and the remaining 30 percent were female. This indicates that Arada Sub-City Revenue Authority recruit more male than female.

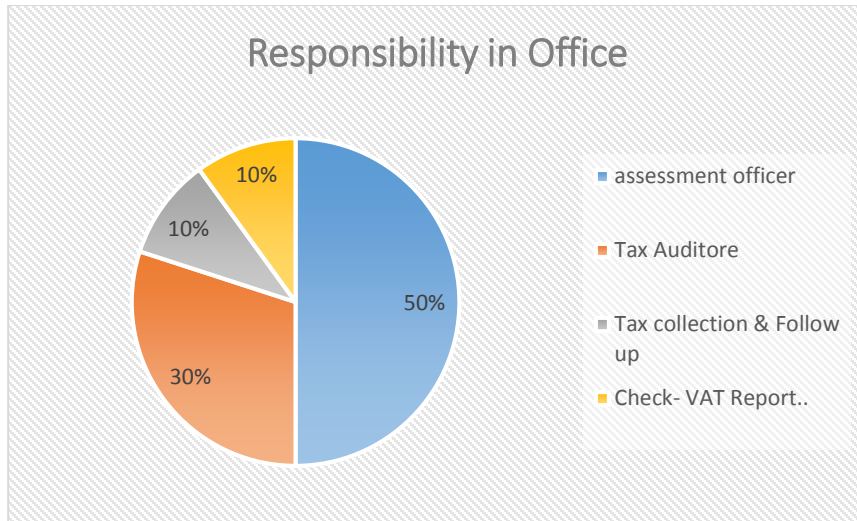
**Table 4.2: Level of Education of Tax Officials**

Level of education	No of Respondents	Percentage
Below 12 <sup>th</sup> grade	-	
10 <sup>th</sup> complete	-	
12 <sup>th</sup> complete	-	
Certificate	-	
Diploma	-	
First Degree	10	100
Master Degree	-	-
PHD	-	-
Total	10	100

Source: Survey Result, 2017

Educational levels and responsibility for the tax official are also the most important variables that can affect the performance the sub-city. In line with these, attempts have been made to assess the educational level and the responsibility of the respondents. As shown in the table above all tax officials' respondents had the first degree level of education. This implies that, the majority of the respondents have a good level of educational qualification that is BA or BSc degree.

**Figure 4.2: The Responsibility of Tax Officials**



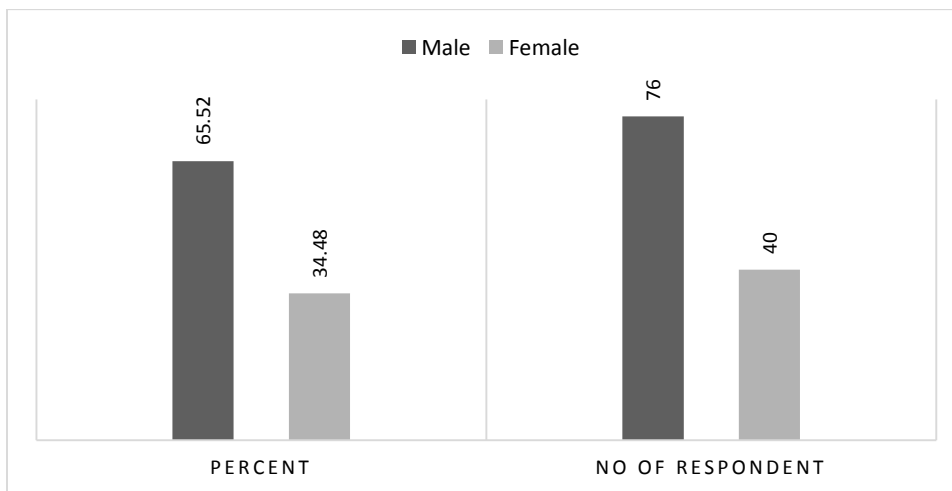
Source: Survey Result, 2017

As shown in the above figure, the highest percentages of respondents were responsible for tax assessment and collection which were accounted 50 percent. This implies that the tax officials' respondents have an idea about the VAT Administration.

**4.2.2 Characteristics of Taxpayers**

Taxpayers were the main witnesses to explain the problem of VAT administration activities of the authority. The survey result in this section shows the gender, type of business and level of education of taxpayers.

**Figure 4.3.: Genders of Taxpayers Respondents**



Source: Survey result, 2017

The above figure shows that from the total respondents, 65.52 percent of the respondents were accounted by the male taxpayers while the remaining 34.48 percent of the respondents were accounted by the female taxpayers. So that this implies that the majority of the taxpayers were dominated by male. This leads to the level of involvement in the business has a significant difference between male and female taxpayer.

**Table 4.3: Respondents 'Business Sector**

<b>Type of business</b>	<b>Frequency</b>	<b>Percent</b>
Import and export	10	8.62
Manufacturer	27	23.28
Wholesalers and retailers	20	17.24
Service providers	46	39.66
No response	13	11.21
Total	116	100

Source: Survey result, 2017

The survey was made by grouping the taxpayers in four business sectors. As shown in the table above from 116 taxpayers around 8.62 percent of the respondents were importers and exporters, 23.28 percent were manufacturer, 17.24 percent were wholesalers and retailers, and 39.66 percent were service provider. This implies that majority of VAT payer are Service providers.

**Table 4.4: Level of Education of Taxpayers Respondents**

<b>Level of Education</b>	<b>No of Respondents</b>	<b>Percentage</b>
No formal education	-	-
Below 10th grade	6	5.17
10th complete	28	24.14
12th complete	14	12.07
Certificate	10	8.62
Diploma	20	17.24
First degree	36	31.03
No response	2	1.7
Total	116	100

Source: Survey result, 2017

Education is the base to know and perform day to day activities. In running business education has a significant benefit to identify and use their rights and to fulfill their obligation. As shown in the table from the total taxpayer's respondents there is no any taxpayers whose level of education falls in the No formal education category. 6 respondents were less than grade 10 which represent 5.17 percent, 28 taxpayers respondents were grade 10 complete which represent 24.14 percent, 14 taxpayers respondents were grade 12 complete which represent 12.07 percent and 10 taxpayers respondents were certificate which represent 8.62 percent. 20 and 36 taxpayer's respondents were Diploma and first degree which represent 17.24 and 31.03 percent of the total taxpayer's respondents respectively. While the remaining 1.7 percent of the taxpayers was not answered the question. This shows that the respondents are qualified enough to easily understand and respond the questionnaire correctly.

### 4.3 Findings of the Study

#### 4.3.1 The Tax officer's respondents

##### 4.3.1.1 The Compliance of the Taxpayer with the Current Rules and Regulations

##### i. Taxpayers Experience in Declaring and Depositing VAT Liability

**Table 4.5: Taxpayers experience in Declaring and Depositing VAT liability**

<b>Item</b>	<b>Variable or description</b>	<b>Response</b>	<b>Frequency</b>	<b>Percentage</b>
1	Taxpayers experience in VAT declaring and depositing (tax official respondents)	Good	2	20
		Fair	5	50
		Not good	2	20
		Worse	1	10
		<b>Total</b>	<b>10</b>	<b>100</b>

Source: Survey data, 2017

As per the summarized data in the table above 20 percent of the respondents responded that the taxpayers have a good experience in VAT declaring and depositing, 50 percent of the respondents responded that the taxpayers have a reasonable experience in VAT declaring and depositing, 20 percent of the respondents responded that the taxpayers have a bad experience in VAT declaring and depositing and the remaining 10 percent of the respondents responded that the taxpayers have worse experience in VAT declaring and depositing. From the above analysis, most of the respondents responded that the taxpayers were not experience in paying and declaring VAT



regularly. Therefore, the above analysis of finding detect that in the Arada Sub-City revenue authority the VAT payers still have a gap to fully comply on the current VAT laws.

According to the proclamation every registered person is required to file a VAT return with the authority for each accounting period, whether or not tax is payable in respect of that period; and to pay the tax for every accounting period by the deadline for filing the VAT return. The VAT payers declares their tax payments monthly, they bring their own Self-assessment report of VAT payment. So, this survey was conducted to see whether the VAT payers were experiencing in declaring and depositing VAT liability as stated in VAT proclamation or not.

### ii. All Eligible Business Traders Get Registered as VAT Payers

**Table 4.6: All Eligible Business Traders get registered as VAT Payer**

Item	Variable or description	Response	Frequency	Percentage
1	All eligible business traders get registered as VAT payer	Yes	0	0
		No	10	100
		Total	10	100

Source: Survey data, 2017

The survey data taken from the Sub-City tax officials showed that 100 percent of the respondents responded that all eligible business traders not get registered as VAT payers. Based on the extension question raised for the tax officials, they proposed that lack of transparency ,accountability of tax payers, intention of hiding their business and being profitable illegally (Unlawfully) are the main reason not to be registered as eligible business traders. The respondents mentioned that there are many business traders not yet registered, this indicates the Sub-City revenue authority is not very much effective in the tax law enforcements.

### iii. The Number of Voluntary VAT payers

**Table 4.7: Number of Voluntary VAT payers**

Item	Variable or description	Response	Frequency	Percentage
1	The number of voluntary VAT payers in your Sub-City	High	0	0
		Moderate	8	80
		Low	0	0
		Very low	2	20
		<b>Total</b>	<b>10</b>	<b>100</b>

Source: Survey data 2017

To know the number of voluntary VAT payers at the Sub-City, the survey data taken from the tax officials. As shown in the above table 80 percent of respondents responded that the number of voluntary VAT payers is “Moderate”, and 20 percent of respondent responded that “Very Low”. This implies that the voluntary VAT payers at the Sub-City are on average.

The responses through interview taken from the tax official are support that the numbers of voluntary VAT payer were very few and on the contrary the majority of tax payers are enforced. Generally, the analysis of the finding indicated that the authority is not strong enough in awareness creation to the tax payers, to control noncompliance tax payers.

#### **iv. Business peoples who do not Maintain Proper Record Keeping of operations**

**Table 4.8: Business People who do not maintain Proper Record Keeping of Operations**

<b>Item</b>	<b>Variable or description</b>	<b>Response</b>	<b>Frequency</b>	<b>Percent</b>
2	Do you know that all register tax payers maintain proper recording (Tax officials response)	Yes	3	30
		No	5	50
		No response	2	20
		<b>Total</b>	<b>10</b>	<b>100</b>

Source: Survey data, 2017

The above table shows that (N=5, 50%) revealed that some traders do not maintain proper record keeping of their business operations due to many reason. Some of the reasons stated by these respondents were the culture that they have in financial record keeping, fear of government, lack of confidence, cheating of the tax authority, lack of awareness and trained professionals to maintain their financial operations. The remaining 30 percent of the respondents declared that they maintain proper record keeping. This implies that at the Arada Sub-City revenue authority the taxpayers do not properly maintain records of their transactions in accordance with the VAT law. Therefore, the tax authority is not doing to the maximum of their capacity in order to create awareness and to control for those VAT payers who do not maintain proper record keeping.

The tax assessment for those, who are required to maintain financial records, is done based on the records that taxpayers maintain; however, if they fail to maintain financial records, estimated assessment will be done. For the rest of taxpayers, who are not required to maintain financial records, it is based on the standard assessment method (Council of Ministers, 2002). The self-assessment systems which are require tax payers to do calculation, payment, and reporting their

own tax payable by themselves. VAT is essentially a self-assessed by taxpayer. The VAT payers have the responsibility to maintain proper recording system, so that they can have the required information as needed. Otherwise, it is very difficult to properly manage the operations of the business, i.e. their incomes and expenses of the business. Besides, failure to maintain records of the business transactions is considered as non-compliance with VAT proclamation, which is against the current VAT law.

#### 4.3.1.2 Awareness of Taxpayers towards VAT Collection

**Table: 4.9: Awareness of Respondents towards VAT Proclamation**

Item	Variable or description	Response	Frequency	Percentage
1	Are the registered tax payers well aware of the VAT proclamation? (tax official respondents)	High	0	0
		Low	3	30
		Average	2	20
		Very low	5	50
		<b>Total</b>	10	100

Source: Survey data 2017

The above table shows that taxpayers awareness about VAT. Out of ten taxes official respondents 30 percent reported the awareness about VAT is “low”, 20 percent reported average. The remaining 50 percent reported there awareness about VAT is very low. From this we can understand that the awareness of taxpayers about VAT is on low. The analysis of finding indicted that taxpayer’s awareness about VAT were on low. So, Arada Sub-City revenue authority is not doing in order to create awareness about VAT.

Awareness creation for the taxpayers is one way of increasing compliance level of the taxpayers. It is used for taxpayers to know how to ask their rights and perform their obligation. This is done through taxpayers’ education on the tax laws and regulations.

According to Hastuti (2014), self-assessment system requires taxpayers to calculate, pay, and report their own tax payable. Having full understanding of this kind of obligation helps the government indeed to have complied taxpayers. The complied taxpayers pay tax with the right amount with the right procedure. This is good since government revenue will be earned. For the potential taxpayers, it is also good to be informed with his kind of obligation. Tax is something

unquestionable for every citizen, their awareness of taxation will be important in pursuing tax compliance.

**Table 4.10: Training concerning Self-Assessment**

Item	Variable or description	Response	Frequency	Percentage
1	Training concerning self-assessment for taxpayers	Yes	3	30
		No	7	70
		<b>Total</b>	10	100.0

Source: Survey data, 2017

From the table above 30 percent of the tax officials respondents were responded that there was training given by the tax authority for the taxpayers. 70 percent of the respondents were responded that there was no training prepared and given by the tax authority to the taxpayers within a year.

From the interview session with the process owners at the authority about the training prepared and given to the VAT payers, they responded that even if the tax authority prepared a training session for the VAT payers, but the majority of the VAT payers didn't attend the training themselves instead they send their representative. So, the Sub-city revenue authority must develop the taxpayers' skills and knowledge through different means.

#### 4.3.1.3 Problems of the Tax Authority

**Table 4.11: Problems faced by the Tax authority**

Item	Variables/ description	Responses	Frequency	Percentage
1	Do you think that, there is tax evasion?	Yes	8	80
		No	2	20
		Total	10	100
2	If your answer for the above question is 'Yes' what do you think the reason for tax evasion?	low awareness of tax payers about VAT	7	70
		Inefficient tax administration	2	20
		Discrimination by tax authority	1	10

Source: Survey data, 2017

From the survey result above 80 percent tax officials were replied that at the Arada Sub-City revenue authority was tax evasion by the tax payers. The remaining 20 percent of the tax officials

responded that there was no tax evasion. When the tax officials responded the reasons for tax evasion at Arada Sub-City revenue authority 70 percent were responded that low awareness of tax payers about VAT was the major reason for tax evasion by the taxpayers. 20 percent and again 10 percent of the respondents were responded that the reason for the tax evasion was inefficient tax administration and discrimination by tax authority respectively.

From the above analysis the majority of the VAT payers in the sub city responded that most of the VAT payers involved in the evasion of the tax by using illegal invoice. Tax evasion is the main Problem faced by the tax authority in the Sub-City.

Tax evasion is an illegal act of reducing the tax liability by the taxpayers by breaking the tax laws and regulations. According to the Proclamation, failure to register for VAT as per VAT registration requirement, failure to issue a tax invoice, failure to maintain recorder such as original tax invoices received and a copy of tax invoices issued and failure to file timely return shall be liable to administrative penalties ranging from a fine 100 percent of the amount of tax payable and a fine of up to 50,000 Birr. In addition to administrative penalties tax offenders such as tax evasion, making false or misleading statement and failure to notify are all criminal offences under Ethiopian law.

**Table 4.12: The Capacity of Tax Authority to Control VAT payers**

Item	Variables/ description	Responses	Frequency	Percentage
1	Do you think that tax administrations are strong enough to control non-registered?	Yes	2	20
		No	8	80
		I have no idea	0	
		Total	10	100
2	Do you think that tax administrations are strong enough to control illegal activities of VAT payers?	Yes	0	
		No	10	100
		I have no idea	0	
		Total	10	100

Source: Survey data, 2017

A good VAT administration capacity is critical in reducing gaps between the effective taxation and what it is supposed to be in the proclamation. In general, a good VAT administration capacity is

important to achieve the policy objectives of a government. The survey was conducted by asking the tax officials whether the tax administration strong enough to control none registered and illegal activities of VAT payers. Among the 10 tax official’s respondents, 20 percent replied as yes that the VAT administration capacity is strong to control none registered & illegal activities, 80 and 100 percent replied that it is not strong respectively.

From the above analysis, majority of tax official respondents replied that the Sub-City did not strong enough to control none registered & illegal VAT payers. So, not strong enough to control non registered and illegal VAT payers are weakness faced by tax authority in the Sub-City.

Since the government’s main source of revenue is collected from taxpayers, the system using to collect this money needs to be effective and efficient in administrative mechanisms. Having this in mind the authorities’ employee respondents were asked whether the VAT administration mechanism followed by the authority is effective and efficient or not.

**Table 4.13: the VAT Administration Mechanism**

Item	Variables/ description	Responses	Frequency	Percentage
1	Do you think that the VAT Administration mechanism is effective and efficient?	Yes	1	10
		No	4	40
		Little	4	40
		No response	1	10
		Total	10	100

Source: Survey data, 2017

The above table shows that 10 percent of tax official respondents responded the VAT administration mechanism currently followed by the authority are effective and efficient, 40 percent responded that the administration mechanisms are not effective and efficient and 40 percent responded that the administration mechanisms requires additional efforts to be effective although it shows a little progress.

The main reasons that the respondents put are associated with the inconveniency of the Standards Integrated Government Tax Administration System(SIGTAS) that the authority is using to decide and collect the tax, weak performance and inefficiency of the employees and lack of consciousness of the taxpayers about the responsibilities that they do have in relation to taxpaying. Therefore the

authority has to pay a considerable attention to improve its tax administration, follow-up and enforcement systems.

## 4.3.2 Taxpayers respondents

### 4.3.2.1 Application of Tax Principles during VAT collection

**Table 4.14: Application of Tax Principles during VAT Collection**

The table below summarizes the responses concerning the findings of the application of tax principles during VAT collection at the Arada Sub-City Small Taxpayer’s Branch Office.

Variable or description	Response	Frequency	Percentage
Do you know why you are paying tax?	Yes	112	96.55
	No	4	3.45
	Total	116	100
Do you know when you pay your VAT liability?	Yes	104	89.65
	No	10	8.62
	No response	2	1.72
	Total	116	100
Do you know where you pay your VAT liability?	Yes	107	92.24
	No	7	6.03
	No response	2	1.72
	Total	116	100

Source: Survey result, 2017

As indicated in the above tables 96.55 percent of the taxpayer’s respondents know why they pay tax but 3.45 percent of the respondents did not know why they pay tax. This implies that most of the respondents have knowledge about the reason why they pay tax.

According to tax principles taxpayers should know when and where they pay tax. As shown in the above table 89.65 and 92.24 percent of the Taxpayers respondents know the time and place of payment respectively. This implies that majority of VAT payers in the Sub-City knows when and where they pay tax.

According to Muñoz and Cho (2003), VAT is expected to enhance revenue, improve economic efficiency, promote exports, and foster growth. So the proper amount of tax must be collected on

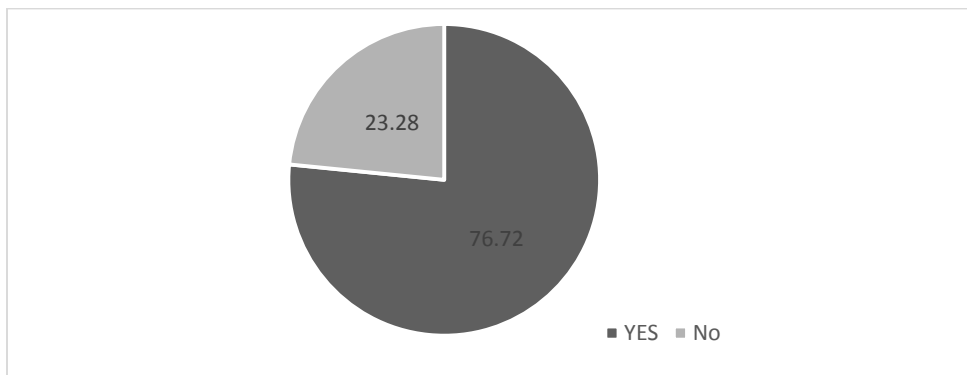
a timely manner for successfully improving and maintaining stable economic growth in a nation. To do this, the enforcement power of the tax administration that fulfills the tax principles.

Principles of taxation are basic concepts by which a government is meant to be guided in designing and implementing an equitable taxation regime. According to Tesfaye (2014), taxation has become a vital component of development effort of every country without a tax system that functions well governments cannot provide even the basic infrastructure and social services. A good tax system can be judged from its principles such as fairness, elasticity, certainty, convenience, awareness, economy, productivity and diversity.

According to Makedonskiy (2005), the ability of the tax system to adequately perform its functions is to a large extent determined by its correspondence to the economic environment along with certain principles and requirements. Specifically, tax burden should be fairly distributed among all the economic entities depending on their taxable capacity. For example the role of VAT within broader strategies will have for alleviating poverty and achieving fairness (Keen, 2005). However, the implementation of this principle is hampered by the informal (unregistered) economic activity and active tax evasion by a significant part of the taxpayers.

According to different writers, the tax paid should be according to ability to pay and it must be fair and equitable, because tax is not only used to raise revenue to the government but also used for income distribution among the rich and the poor. When there is a difference in the tax burden on individuals in similar circumstances, taxpayers may withdraw from the exchange relationship by evading taxes in order to offset or reduce the disparity.

**Figure 4.4: Convenience of Tax Payment**

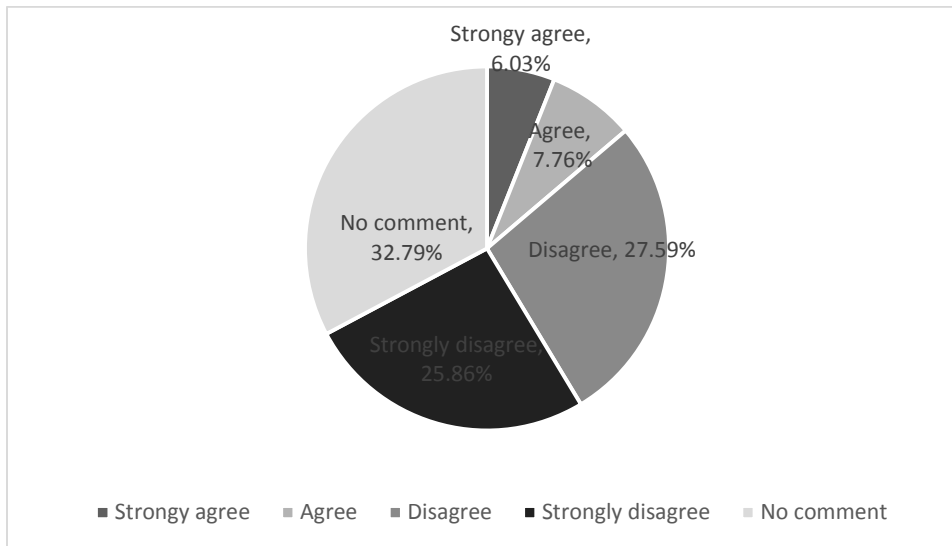


Source: Survey result, 2017



As per the taxation principle, the time and the manner of payment for the taxpayers should be convenient. In relation to convenience of tax payment the above figure shows that from the total respondents 76.72 percent of the respondents found convenient. While the remaining 23.28 percent of the respondents found not convenient.

**Figure 4.5: The Fairness of Tax Authority**



Source: Survey Result, 2017

The above figure shows that the feeling of the tax payers towards the fairness of the tax payment within the tax payers. This response is important in identifying the application of tax principle during VAT collection at the Arada Sub-City Small Taxpayer’s Branch Office. In relation to fairness of tax payment the above Figure shows that from total respondents only few taxpayers (N=16, 13.79%) strongly agree and agree, a great number of taxpayers (N=38, 32.79%) have no comment, and most taxpayers (N=62, 53.45%) strongly disagree and disagree that those of similar income are taxed similarly. As per the above analysis the majority of the respondents responded that the fairness of tax principle was violated. This implies that there is a problem of fairness at the Arada Sub-City tax authority. This is a very critical problem that needs to be addressed. Unless this inequity is properly addressed, great dissatisfaction is likely to be aroused among the majority of reliable taxpayers. It also affects the Arada Sub-City revenue and also, more of them will incline to become less compliance and join the rank of evaders.

To sum up, the analysis of the finding indicated that the application of tax principles during VAT collection by Arada Sub-City taxpayers authority was convenient .The taxpayers well know why

they pay tax and they are aware of the time and place of payment. But the authority was not fair. As proved by this study, 53.45 percent of the taxpayers' respondents were justified that the application of tax principles by the tax authority did not according to taxpayer's income. So, there is a difference in the tax burden on individuals in similar circumstances, and then the taxpayers may withdraw from the exchange relationship by evading taxes in order to offset or reduce the disparity and hinder the revenue mobilization to the Sub-City.

#### **4.3.2.2 The Compliance of the Taxpayer with the Current Rules and Regulations**

According to Marti (2010), tax compliance is a complex term to define. Simply put, tax compliance refers to fulfilling all tax obligations as specified by the law freely and completely. Similarly, tax compliance is also defined by several tax authorities as the ability and willingness of taxpayers to comply with tax laws, declare the correct income in each month and pays the right amount of taxes on time.

VAT is collected by VAT registered traders on their supplies of goods and services. Each such trader, in the chain of supply from manufacturer to retailer, charges VAT on sales and is entitled to deduct from this amount the VAT paid on purchase. The effect of offsetting purchases against sales is to impose the tax at each stage of production on the added value. The final consumer, being unregistered for VAT, absorbs the VAT as part of the purchase price.

According to Webley et al. (2002), a study on VAT Compliance in the United Kingdom identifies four forms of noncompliance:-Engage in taxable transactions without having registered with the tax authority, Fail to file their tax return by the statutory filling deadlines, under reporting their tax liability or illicit claim of tax refunds, or under pay the amount of taxes due (tax arrears).

These forms of noncompliance give rise to tax gap representing forgone government revenue and unfair competitive advantage to noncompliant businesses. Similar to the above finding this survey was conducted to see whether the VAT payers in the Sub-City perform their activity with comply the rule and regulation.

## I. Business Traders Practice of Issuing VAT Receipts to All Buyers

**Table 4.15: Traders Practice of Issuing VAT Receipts to All Buyers**

Item	Variable or description	Response	Frequency	Percentage
1	Traders practice of issuing VAT receipts to all buyers without fail	Yes	101	87.07
		Not at all	4	3.45
		Some times	4	3.45
		No response	7	6.03
		<b>Total</b>	<b>116</b>	<b>100</b>

Source: Survey result, 2017

As per the VAT proclamation business traders are expected to issue VAT receipts to all buyers without fail. This is actually, an indication how the business community well understood the VAT proclamation to put into practice. In this regard, the response for the question in the above table shows that from the total respondent's 87.07 percent confirmed that they are issuing VAT receipts without fail to all buyers. However, 3.45 percent of respondents responded that they did not issue a VAT receipt at all, while the remaining 3.45 percent issue a VAT receipt occasionally. This implies that the taxpayers have a good practice of issuing VAT receipts to all buyers.

## II. Taxpayers Experience in Declaring and Depositing VAT Liability

**Table 4.16: Taxpayers experience in Declaring and Depositing VAT liability**

Item	Variable or description	Response	Frequency	Percentage
1	Taxpayers experience in VAT declaring and depositing (taxpayers respondents)	Poor	10	8.62
		Good	57	49.14
		Very good	19	16.38
		Excellent	30	25.86
		<b>Total</b>	<b>116</b>	<b>100</b>

Source: Survey data, 2017

According to the above table from 116 respondents a few respondents (N=10, 8.62%) responded that they have a poor experience in VAT declaring and depositing, a great number of respondents (N=57, 49.14%) responded that they have a good experience in VAT declaring and depositing, some of the respondents (N=19, 16.38%) responded that they have a Very good experience in VAT declaring and depositing and the remaining respondents (N=30, 25.86%) responded that they have an excellent experience in VAT declaring and depositing. Based on this, majority of

the respondents have an average experience in declaring and depositing VAT liability. This shows that most of the tax payers at the Arada Sub-City revenue authority were not declared their VAT liability based on the VAT rule and regulation. From the above analysis, most of the respondents responded that the taxpayers were not experience in paying and declaring VAT regularly. Therefore, the above analysis of finding detect that in the Arada Sub-City revenue authority the VAT payers still have a gap to fully comply on the current VAT laws.

### III. Business peoples who do not Maintain Proper Record Keeping of operations

**Table 4.17: Business People who do not Maintain Proper Record Keeping of Operations**

Item	Variable or description	Response	Frequency	Percent
1	Do you know that some business people do not properly maintain records of their transactions in accordance with the VAT law (Taxpayer response)	Yes	46	39.66
		No	27	23.28
		I have no information	37	31.90
		No response	6	5.17
		<b>Total</b>	<b>116</b>	<b>100</b>

Source: Survey data, 2017

The above table shows that 39.66 percent of taxpayer’s respondents replied that some taxpayers do not properly maintain records their transaction in accordance with the VAT law, due to different reasons as they indicated in their comments. Some of the comments were: some tax payers deliberately manipulated when they issued the VAT invoices, lack of control of the authority, tax authority do not follow the procedure for all taxpayers, lack of know-how and awareness about the benefit to maintain accounting records and other reasons. 23.28 percent of the respondents said they don’t know and the remaining 31.9 percent of the respondents declared that they don’t have information. This implies that at the Arada Sub-City revenue authority the taxpayers do not properly maintain records of their transactions in accordance with the VAT law. Therefore, the tax authority is not doing to the maximum of their capacity in order to create awareness and to control for those VAT payers who do not maintain proper record keeping.

### 4.3.2.3 Awareness of Taxpayers towards VAT Collection

**Table: 4.18: Awareness of Respondents towards VAT Proclamation**

Item	Variable or description	Response	Frequency	Percentage
1	Do you feel that you have adequate knowledge of VAT?(taxpayers respondents)	Very good	4	3.44
		Good	43	37
		Average	20	17.24
		Poor	45	38.79
		No response	4	3.44
		<b>Total</b>		116

Source: Survey data 2017

As observed from the above tables out of 116 taxpayer's respondents 3.44 percent reported their awareness about VAT is very good, 37 Percent reported well, 17.24 percent reported their awareness about VAT is somehow average and 38.79 percent respondents responded their awareness level as poor. But four taxpayers do not give their response. This implies that majority of the respondents do not have adequate knowledge of VAT. So, Arada Sub-City revenue authority is not doing in order to create awareness about VAT.

Some studies which have been undertaken in other places of the country (Hagos, 2011; lemessa, 2007; Mihret, 2011) have indicated that the awareness creation problem was a series and the root cause of all problems relating to the tax Administration.

Due to this, the authority may not achieve the expected future voluntary compliance in the absence of services along with the taxpayer's lack of tax awareness. Without educating taxpayers and creating tax awareness, making power visible to the community might detect the deliberate evasions and frauds but not be a solution to create a compliant taxpayer those does not comply unknowingly.

According to Dekan (2003), the tax assessment sometimes can be unclear to the tax payers. Regarding to the complexity of tax assessment system (not simple and clear) may result in unintentional non-compliance if taxpayers have problems with filling the tax form. Furthermore, such noncompliance differs from other crimes. Because, it can be conclude that the errors occurred unintentionally due to the misinterpretation of the rules.

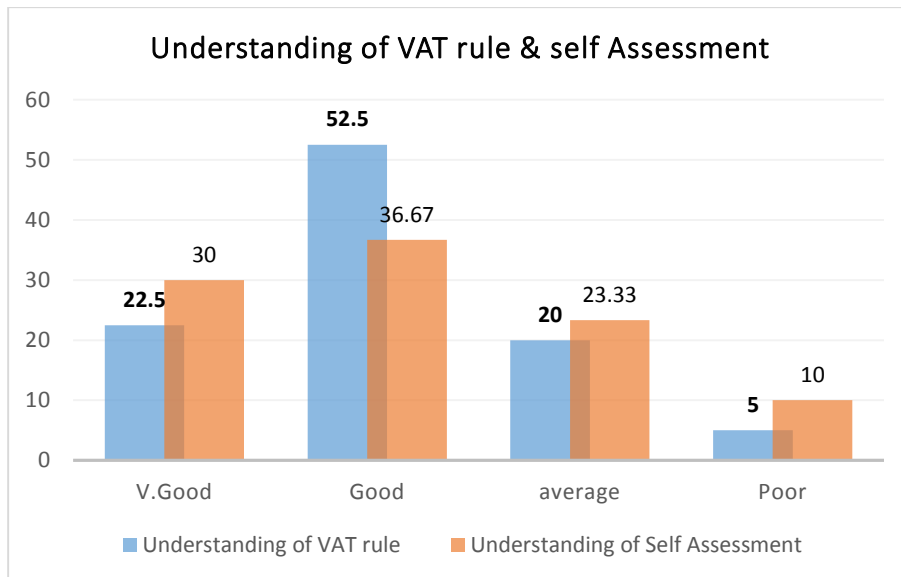
**Table 4.19: Trials made by the branch office to enhance awareness**

Item	Variable or description	Response	Frequency	Percentage
1	Did you get any education about VAT by tax Officers?	Yes	40	34.48
		No	70	60.34
		No response	6	5.17
		<b>Total</b>	<b>116</b>	<b>100</b>
2	Did you get any education about Self-assessment by tax Officers?	Yes	30	25.86
		No	74	63.79
		No response	12	10.34
		<b>Total</b>	<b>116</b>	<b>100</b>

Source: Survey data, 2017

As observed from the above table 60.34 and 63.79 percent of the taxpayer’s respondents were responded that they did not have any education by the tax authority on VAT and self-assessment respectively. 34.48 And 25.86 percent of the taxpayer’s respondents responded that they got education about VAT and self-assessment by tax authority respectively.

**Figure 4.6: Understanding of VAT rule and self-assessment**



Source: Survey data, 2017

The above figure shows that the taxpayers those who were responded they got education about VAT rule and self-assessment by tax authority were responded for the extension question that when they responded on how well they understand the given education on the VAT rule and its self-assessment. 22.5 And 30 percent responded that they understand very well. 52.5 And 36.67 percent were responded they understood well, 20 and 23.33 percent of the respondents were responded

they understood on average. 5 And 10 percent they did not understand at all about VAT rule and self-assessment. So, majority of the respondents responded that the education given by the Sub-City revenue authority is not enough.

One of the methods of the capacity building was giving training to taxpayers. Enhancing the awareness of the tax payers is a task that needs to be performed by every citizen. By giving training the tax authority must increase the compliance level of the taxpayers.

#### 4.3.2.4 Problems of the Taxpayers and the Tax Authority

As per the report circulated by Arada Sub-City revenue authority, the revenue collected during the period of 2011-2015 G.C amounted to ETB 2.07 billion which was smaller than the balance stated as budgeted revenue of ETB 2.60 billion during the specified period. Since the Sub-City actual revenue collection performance is below the budgeted performance, this indicates that, Arada Sub-City revenue authority did not perform as per the planned. Beside the above report the survey were conducted for both taxpayers and tax official in order to investigate the challenge faced by tax payers and tax official. The problem faced by taxpayers and tax authority is shown in the below tables.

#### I. Problems of the Taxpayers

**Table 4.20: Problems faced by the Taxpayers**

Item	Variable or Description	Response	Frequency	Percentage
1	Is there any problem you face while paying tax?	Yes	56	48.27
		No	50	43.10
		No response	10	8.62
		<b>Total</b>	116	100
2	If your answer is “yes” which is /are the problem(s) you face during paying your VAT liability?	Absence of tax collector	7	10
		Complicated tax procedure	24	34.29
		Discrimination in tax authority	6	8.57
		Insufficient treatment	19	27.14
		Delay in giving solution for appeal	14	20

Source: Survey data, 2017

Taxpayers are the main sources of revenue for the government. So, the government must create favorable conditions and environments to the tax payers. But sometimes the reverse would happen

from the tax authority. As indicated in the table above 48.27 percent of the taxpayer’s respondents responded that there were problems they face from the tax authority. 43.10 percent of the taxpayer’s respondents were reported there was no problem they face from the tax authority.

Those taxpayers’ respondents who were responded that they face the problem from tax authority were responded for the extension question that 10 percent of them were responded that there was an absence of tax collector. 34.29 percent of the respondents were responded that the procedure is complicated for them and this made the taxpayers to hide themselves from legally paying their tax liability. 8.57 percent of the respondents were responded that there was discrimination between the taxpayers by the tax authority.27.14 percent of the respondents were responded that there was an inefficient treatment by the tax officials when the taxpayers need different services from the tax authority and 20 percent of the respondents was responded the authority did not give solution for the appeal from the taxpayers and there was delay in giving response.

**Table 4.21: Service Delivery of Tax Officials**

<b>Item</b>	<b>Variables/ description</b>	<b>Responses</b>	<b>Frequency</b>	<b>Percentage</b>
1	Do you think that the tax officials are transparent in service delivery?	Yes	28	24.14
		No	35	30.17
		Partially	40	34.48
		No response	13	11.21
		<b>Total</b>	116	100

Source: Survey data, 2017

As indicated in the above table 24.14 percent of the tax payers respondents were responded that the tax officials were deliver service in a transparent manner. But 30.17 percent of the respondents were responded that the tax officials were not transparent in service delivery. The remaining 34.48 percent were partially transparent in service delivery. So, majority of the taxpayer respondents were replied that the tax officials at Arada Sub-city revenue authority are partially transparent in service delivery.

Generally, as the taxpayers are the main sources of the government revenue, the tax authority should create simple, transparent and favorable conditions for taxpayers in paying their VAT liability. But from the above field survey analysis the greater numbers of the taxpayers respondents



were responded that they face different problems from the tax authority. The main problems faced by the VAT payers were insufficient treatment, complicated tax procedure and delay in giving solution for their appeal .The other problem for the taxpayers was transparency; transparency is one way of increasing public trust on the organization whether public or private. As shown in the analysis above at Arada Sub-City revenue authority the tax officials were not transparent in service delivery. So, to make these the Arada Sub-City revenue authority should give training for tax officials

## II. Problems of the Tax Authority

**Table 4.22: Problems faced by the Tax authority**

Item	Variables/ description	Responses	Frequency	Percentage
1	Do you know that some VAT registered business people collect the tax with illegal invoice? (Tax payers respondents)	Yes	89	76.72
		No	10	8.62
		No response	17	14.66
		Total	116	100

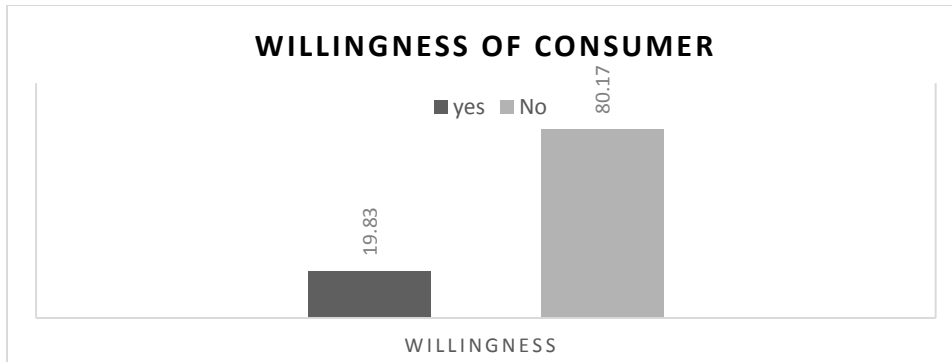
Source: Survey data, 2017

In order to check the reliability of data the same question raise for taxpayers. As indicated in the above table 76.72 percent of the VAT registered respondents replied that they know some VAT registered business people collect the tax with illegal invoice. The remaining 8.62 percent of the respondents replied no.

Collecting of VAT with illegal invoice by a business organization is the practice made to evade government income. This is out of the essence of the proclamation and problem in the collection of VAT. This kind of practice is considered as tax evasion, which is criminal offence under Ethiopian law that is subject for punishment.

From the above analysis the majority of the VAT payers in the sub city responded that most of the VAT payers involved in the evasion of the tax by using illegal invoice. Tax evasion is the main problem faced by the tax authority in the Sub-City.

**Figure 4.7: Consumers Willing to Transact with a Proper VAT Receipt**



Source: Survey data, 2017

The willingness of the consumers to transact with a proper VAT receipt is the key factor in the VAT assessment and collection activities. The purpose of awareness creation to the general public is to have such consumers, who play an important role in the collection of the VAT. Having this in mind taxpayers respondents asked whether the customers willing to transact with a proper VAT receipt. The above figure shows that 19.83 percent respondents responded that the consumers willing to transact with a proper VAT receipt. But 80.17 percent of taxpayers noted that the consumers not willing to transact with proper VAT receipt. This implies that in the sub city the consumers prefer to transact without proper VAT receipts. Not all consumers but some consumers are not willing to transact with a proper VAT receipt because they need to hide the tax. Most of the time consumers prefer to transact without receipt so as to get cheaper price at least reduced by VAT amount. Willingness of the consumers to transact without VAT receipt are the challenge for VAT Administration in the Sub-City .Therefore the authority should due attention for such problem to improve its VAT collection.

Generally, tax evasions are an illegal act of reducing the tax liability by the taxpayers by breaking the tax laws and regulations. From the analysis above 80 percent of the respondents indicate that the tax evasion by the taxpayers at Arada Sub-City. The respondents responded the reasons for tax evasion were low awareness of the taxpayers, insufficient tax administration and discrimination by tax authority.

The VAT registered respondents also indicate that in the Sub-City majority of taxpayers collecting VAT by using illegal invoice. Collecting of VAT with illegal invoice by a business organization is the practice made to evade government income .So; Sub-City revenue authority should solve these causes or reasons in order to reduce tax evasion.

The other problems the capacity of tax administration to control non registered and illegal activities of VAT payers. From the analysis above majority of tax officials respondents said the administration capacity is not strong to bring those non registered business to be registered and to control illegal activities of VAT payers. A good VAT administration capacity is important to achieve the policy objectives of a government.

From the interview with tax officials, about the main problems in collecting VAT the respondents said that weak culture of taxpayers, inefficiency to control noncompliance, existence of VAT payers issuing illegal invoice, failing of some taxpayers to notify the collection of VAT to the tax officer, frequent change of taxpayers address without acknowledgement of the office and not balance the number of tax official and VAT payers in the Sub-City.

For both respondents were also given opportunity to indicate their comments on open ended questions asked in the questioner. Accordingly, they give comments and mainly on problems and measures that have to be undertaking to reduce the problems. The tax payers' respondents said that, the overall problems of VAT assessment and collection were insufficient treatment by the tax official, lack of awareness, delay in giving response for appeal and lack of control of non-compliance.

The taxpayer's respondents also commented on measures to be undertaken by the tax authority to reduce the problems. Such measures are as follows: create awareness for both tax official and taxpayers, giving training for existing taxpayers to fill their gaps, creating a good work environment, strong follow up for non-compliance, monitor and evaluate the tax official and respect every taxpayer as customer.

On the other hand, the same issue from tax official respondents commented that the main problems VAT administration at Arada Sub-City revenue authority were majority of VAT payers comes to settle their tax liability at the end of tax period, lack of skilled manpower and low voluntary compliance of taxpayers in the Sub-City. The tax official also commented on measures to be undertaken. Such as develop good governance, establish effective enforcement mechanisms and create awareness. So, the Arada Sub-City revenue authority should work to solve the problem by improving the Tax administration system, creating awareness and strengthen the enforcement system equally to all.

## CHAPTER FIVE

### CONCLUSIONS AND RECOMMENDATIONS

#### 5.1. Conclusions

The conclusion drawn based on major findings is discussed as follows. The studies cover four main parts.

The first part describes about the application of tax principle during VAT collection. In relation to the application of the tax principle during VAT Administration, the study proved that the time and the manner of tax liability payment for the tax payers in the Sub-City were convenient. The taxpayers well know why they pay tax and they are aware of the time and place of payment. With regard to the principles of fairness or equality within the taxpayers, the Sub-City didn't apply the tax principles fully, since the taxpayers in the same category didn't treated in the same manner by the tax authority within the Sub-City.

According to Makedonskiy (2005), the ability of the tax system to adequately perform its functions is to a large extent determined by its correspondence to the economic environment along with certain principles and requirements. Specifically, tax burden should be fairly distributed among all the economic entities depending on their taxable capacity. Based on the result obtained from the analysis and interpretation, the following conclusion is drawn: The application of tax principles during VAT Administration at Arada Sub-City revenue authority was not fair. So, application of tax principle by tax authority not based on taxpayer income is one of the weaknesses.

The second part describes about the performance of business activities on the basis of the current rule and regulation of VAT. In relation to these, the study proved the VAT payers at Sub-City have a good practice of issuing VAT receipts to all buyers. The majority of the VAT payers at the Sub-City didn't have good experience in paying and declaring VAT. In addition to this some eligible tax payers were reluctant to register for VAT.

According to Tompson and Green (1988), one of the shortfalls in VAT administration is lack of registering those who should be registered. When analyzing the finding with regard to this issue the number of voluntary taxpayers at the Sub-City was on average. Beside this the taxpayers were not properly maintain records of their transaction in accordance with the VAT law .From the

above result of analysis and interpretation, the following conclusion is drawn: the performance of business activities at the Sub-City were not comply with the rule of VAT.

This shows the Sub-City didn't collect the expected amount of revenue from the taxpayers. Since there were eligible taxpayers who didn't register as taxpayers at the Sub-City, this creates problem of distrust between the registered taxpayers and the tax authority.

Based on the result of findings the VAT payers at the Sub-City didn't fully comply with the basis of the current VAT laws. These were the major problems of VAT Administration at the Arada Sub-City revenue authority.

The third part describes about the extent of taxpayers awareness towards VAT assessment and collection. In relation to these, the study proved that majority of taxpayers at the Arada Sub-City revenue authority didn't have adequate knowledge of VAT and self-assessment. As though the taxpayers responded that they didn't take any training about the VAT and self-assessment, the Process owners at the authority responded the authority has been prepared training on VAT and self-assessment to the concerned bodies but the majority of the taxpayers didn't attend the training.

Based on the above analysis and interpretation, the following conclusions are drawn: taxpayers have lack of awareness regarding VAT and self-assessment. Therefore, the low level of awareness about VAT and self-assessment by the taxpayers were the problems at the Arada Sub-City revenue authority.

The fourth part describes about the problems of taxpayers and tax authority. In relation to these the study proved that the majority of the taxpayers at the Sub-City justified that they have faced problems such as insufficient treatment and weak customer handling by the tax officials, complicated tax procedure , delay in giving solution for their appeal and the tax officials lack transparency in service delivery.

Besides the problem faced by the taxpayers, the tax authority faced the following problems. Majority of the respondents indicate that the taxpayers at the Sub-City were evading taxes by collecting taxes with fake invoices. The respondents responded the reasons for tax evasion were low awareness of the taxpayers and insufficient tax administration. Therefore, tax evasion and

weak culture of tax payers (VAT payers comes to settle their tax liability at the end of tax period) are the problem faced by tax authority.

The other problems are the unwillingness of consumers to buy goods and services with VAT, the administration capacity is not strong to bring those non registered business to be registered, to control illegal activities of VAT payers, and the VAT assessment and collection mechanisms are not effective and efficient. Furthermore, the survey of analysis stated that lack of good governance, poor tax enforcement and Lack of tax awareness.

Finally, in the survey taxpayer's respondents suggested that the possible solutions for VAT administration were intensive awareness creations for the unregistered eligible taxpayers and for tax official and giving training for existing taxpayers to fill their gaps, creating a good work environment, respect every taxpayer as customer, take legal measures on non-taxpayers and establish effective enforcement mechanisms, monitor and evaluate the tax official. So, the Arada Sub-City revenue authority should work to solve the problem by improving the Tax administration system, creating awareness and strengthen the enforcement system equally to all.

## 5.2. Recommendations

The following recommendations are suggested to minimize or to solve the problems of VAT Administration at Arada Sub-City Revenue Authority. To sustain the VAT system as a good means to raise government revenue, the authorities should have to take the following measures.

- ❖ A good tax system can be judged from its principles such as fairness, elasticity, certainty, convenience, awareness, economy, productivity and diversity. Though the role VAT with in broader strategies is to alleviate poverty and achieving fairness, the collection of VAT liability in Arada Sub-City didn't based on to all taxpayers' income. This indicates that the fairness of tax principle was violated since the taxpayers with in the same category do not treated in the same manner by the tax authority within the Sub-City. This is a very critical problem that needs to be addressed. Unless this inequity is properly addressed, great dissatisfaction is likely to be aroused among the majority of reliable taxpayers. Furthermore, more of them will incline to become less compliance and join the rank of evaders and also affects the Arada Sub-City revenue collection.
- ❖ The researcher proposes the following action to be taken by the tax authority to fill the loop hole. The authority should establish a media and transmit the tax related laws, proclamations and regulation on a consistent basis to attract the eligible unregistered taxpayers in the tax scope. Beside this giving recognition to the registered and eligible taxpayers who pay their tax on a regular and ethical manner on the contrary the tax authority should differentiate eligible but unregistered tax payers and prepare the tax awareness training to attract them to the tax scope and take the legal action to the non-compliant tax payers.
- ❖ In order to increase taxpayer's compliance the researcher proposes the following action to be taken by the tax authority to treat the taxpayers as a king. There are a number of mechanisms to appear this. For instance, examine the compliant and noncompliant taxpayers so that the authority should encourage and reward the honest traders and should take a legal action for non-compliant taxpayers and concerning VAT report and payment, the tax authority should prepare regular and consistent practical demonstration on how to prepare and fill a VAT declaration form and self-assessment for the taxpayers.

- ❖ To create common and better understanding on the concept of VAT and self-assessment, the authority should arrange training to the VAT payers and tax authority employees. Beside this authority should prepare a workshop to the taxpayers on how to organize their financial report and how can them work hand in hand with the tax authority.
- ❖ The Arada Sub-City revenue authority must develop the taxpayers' skills and knowledge through different means. With respect to providing tax awareness training is the duty and responsibility of the tax authority to conduct series training to the VAT payers. Beside this authority should create a continuous assessment mechanism by conducting continuous discussions about issues of VAT and self-assessment.
- ❖ Taxation is the main sources of revenue for the government. So, the tax authority should create simple, transparent and favorable conditions for taxpayers in paying their VAT liability. But sometimes the reverse would happen from the tax authority. Therefore, Sub-city revenue authority should solve the problems faced by VAT payers like complicated procedure, insufficient treatment and weak customer handling, delay in giving solution for appeal and the tax officials lack transparency in service delivery. These problems are highly discouraging taxpayers and reduce their compliance level.
- ❖ The tax authority should prepare standard for each activities according to their office and give short and long- term training to its employees to reduce the problem. After doing this penalizing those tax officials who did not do according the standards set by the authority. In addition, creating awareness for taxpayers on the standards set by the authority. Beside this the taxpayer's service can be enhanced by the introduction of online reporting and through the bank payment mechanisms.

In performing these duties the organization faces different problems. Arada Sub-City revenue authority is also facing different problem like tax evasion, weak culture of taxpayers, unwillingness of consumers to buy goods and services with VAT, the administration capacity is not strong to bring those non registered business to be registered, to control illegal activities of VAT payers.



- ❖ To achieve or meet its objectives or aims the problems should be solved. To tackle the problems were doing awareness creation for the taxpayers. When the taxpayers are aware of the laws and regulations of the VAT the number of tax evaders were reduced to the minimum or least. After doing this the tax authority should increase its follow-up and enforcement work should be strengthened and measures on those taxpayers who are constantly failing the tax rules and regulations.
- ❖ As a research, this thesis is not without limitation. The major limitations in this thesis are the time and financial resource scarcity, getting relevant data from the concerned stakeholders', and the researcher's skill. Beside this the study focuses only on the VAT Administration regarding assessment and collection at Arada Sub-City small Taxpayers Branch Office. Hence, the scope needs to be widened to cover the rest of the Sub-City. To this end it is believed that this thesis has made a significant contribution to the relevant body of knowledge and used as starting point for further study.

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## **Annex No.1**

**St. MARRY UNIVERSITY**  
**SCHOOL OF GRADUATE STUDIES**  
**Department of MBA in Accounting & Finance**

Questionnaire for VAT Registered in Arada Sub-City Small Taxpayers Branch Office on the VAT Administration activities

Dear respondents

This study is conducted in partial fulfillment of the requirements for the MA Degree in accounting and finance. I am carrying out a study on the problem of VAT administration in Arada Sub-City Small Taxpayers Branch Office .The purpose of this questionnaire is to obtain your perceptions and views regarding the Assessments of VAT administration in Arada Sub-City Small Taxpayers Branch Office. This study will help to identify its problems and means for further improvement. The information you will give enable me to critically analyze the subject matter. Therefore, please answer all questions.

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.

Wubetu Gezahegne

Tel. 0927441696

Email: wubetu10@gmail.com

Instruction:- put (√)mark in the box of your choice.

Part I: Personal information of Taxpayers.

1. Gender Male  Female

2. Types of business \_\_\_\_\_

3. Level of education

No formal education  10<sup>th</sup> complete  12<sup>th</sup> complete

Below 10<sup>th</sup> grade  certificate  Diploma  Degree

Part II: Questions

1. Do you know why you are paying tax? Yes  No

2. Do you know when you pay your VAT liability?

Yes  No

3. Do you know where you pay your VAT liability?

Yes  No

4. Is the time of tax payment is convenient for you? Yes  No

5. Are those of similar incomes taxed similarly?

Strongly agree  Agree  No comment  Disagree  strongly disagree

6. Are you issuing VAT receipts to all buyers without fail?

Yes  not at all  some times

If you answer is either “not at all” or “sometimes”, please indicate your rationales.

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7. What is your experience in declaring and depositing VAT liability to the government account every month?

Poor  Good  Very good  Excellent

If you answer is either “Good” or “Poor”, please indicate your rationales.

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8. Do you know that some business people do not properly maintain records of their transactions in accordance with the VAT law?

Yes  No  I have no information

If your answer to question no 8 is “yes”, please indicate the causes for poor recording? -----  
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9. By now, do you feel that you have adequate knowledge of VAT?

Good  Very good  Average  Poor

10. Did you get any education about VAT by tax Officers?

Yes  No

---

11. If your answer is ‘Yes’ how well did you understand about VAT?

Very good  Average  Good  I didn’t understand

12. Did you get any education about self assessment by tax Officers?

Yes  No

13. If your answer is ‘Yes’ how well did you understand about self assessment?

Excellent  Very Good  Good  I didn’t understand

14. Is there any problem you face while paying tax?

Yes  No

15. If your answer is “yes” which is /are the problem(s) you face during paying your VAT liability? (You can choose more than one)

- a. Absence of tax collector
- b. Complicated tax procedure
- c. Discrimination in tax authority
- d. Inefficient treatment
- e. Delay in giving solution for appeal

If any other \_\_\_\_\_

16. Do you think that the tax officials are transparent in service delivery?

Yes  No  Partially

17. Do you know that some VAT registered business people collect the tax with illegal invoice?

Yes

No

18. Are consumers willing to transact with a proper VAT receipt?

Ye s

No

If your answer is “No” what do you think is their reason?-----

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19.What is your overall challenges in relation to VAT assessment and collection in Sub-Cities?--

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20. What possible solution do you suggest?

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## **Annex No.2**

**St. MARRY UNIVERSITY**  
**SCHOOL OF GRADUATE STUDIES**  
**Department of MBA in Accounting & Finance**

Questionnaires of tax official's in Arada Sub-City Small Taxpayers Branch Office on the VAT Administration activities.

Dear respondents

This study is conducted in partial fulfillment of the requirements for the MA Degree in accounting and finance. I am carrying out a study on the problem of VAT administration in Arada Sub-City Small Taxpayers Branch Office .The purpose of this questionnaire is to obtain your perceptions and views regarding the Assessments of VAT administration in Arada Sub-City Small Taxpayers Branch Office. This study will help to identify its problems and means for further improvement. The information you will give enable me to critically analyze the subject matter. Therefore, please answer all questions.

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.

Wubetu Gezahegne

Tel. 0927441696

Email: wubetu10@gmail.com



Yes  No

7. Do you think that, there is tax evasion?

Yes  No

8. If your answer for question number 10 is 'Yes' what do you think the reason for tax evasion?  
(You can choose more than one)

low awareness of tax payers about VAT

Insufficient tax administration

Discrimination by tax authority

If any other reason \_\_\_\_\_

9. Do you think that tax administrations are strong enough to control non-registered?

Yes  No  I have no idea

10. Do you think that tax administrations are strong enough to control illegal activities of VAT payers?

Yes  No  I have no idea

11. Do you think that the VAT assessment and collection mechanism is effective and efficient?

Yes  No  little

If your answer for question no. 11 is "no" or "little" what do you think of the reasons?

-----  
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12. What are overall constraints you face in assessing and collecting of VAT?

-----  
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13. What possible solution do you suggest?

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Thank you!!

### **Annex No.3**

#### **Interview Guide**

Queries on general issues to be answered by Arada Sub-City Small Taxpayers Branch of office of ERCA for the process owners

1. How do you express the voluntary compliance of taxpayers in your Sub-City?
2. What main obstacles have you encountered in collecting VAT liability?
3. How often do you give training on VAT for both taxpayers and tax officials?
4. How often do you give training on self-assessment for both taxpayers and tax officials?
- 5 Finally, please, generalize the main challenges in administering VAT in your sub city in terms of assessment and collection activities?

Thank you very much!!

## **DECLARATION**

I, the undersigned, declare that this thesis is my original work, prepared under the guidance of Asmamaw Getie (Asst. Prof.). All sources of materials used for the thesis have been fully acknowledged. I further confirm that the thesis has not been submitted either in part or in full to any other higher learning institution for the purpose of earning any degree. It is offered for the partial fulfillment of the degree of MBA in Accounting and Finance.

-----  
**Candidate's Name**

**St. Mary's University College, Addis Ababa**

-----  
**Signature**

**May, 2017**

## **ENDORSEMENT**

This Thesis has been submitted to St. Mary's University College, School of Graduate Studies for Examination with my Approval as a university advisor.

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Advisor

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Signature

**St. Mary's University College, Addis Ababa**

**May, 2017**