

ST. MARY'S UNIVESITY  
FACULTY OF BUSINESS  
DEPARTMENT OF ACCOUNTING

AN ASSESSMENT ON THE VAT COLLECTION  
PROBLEM OF ERCA IN THE CASE OF  
MERCATO NO.1 TAX PAYERS OFFICE

By

Yemisrach Chane

Hayat Mohammed

Advisor: Yeserash Alemu

June, 2014

Addis Ababa, Ethiopia

ST. MARY'S UNIVESITY  
FACULTY OF BUSINESS  
DEPARTMENT OF ACCOUNTING

AN ASSESSMENT ON THE VAT COLLECTION  
PROBLEM OF ERCA IN THE CASE OF  
MERCATO NO.1 TAX PAYERS OFFICE

By

Yemisrach Chane

Hayat Mohammed

Advisor: Yesrash Alemu

June, 2014

Addis Ababa, Ethiopia

AN ASSESSMENT ON THE VAT COLLECTION  
PROBLEM OF ERCA IN THE CASE OF  
MERCATO NO.1 TAX PAYERS OFFICE

By

Yemisrach Chane

Hayat Mohammed

A paper submitted to St. Mary's University in Partial Fulfillment of the  
Requirements of the Bachelor of Art in Accounting

Advisor: Yeserash Alemu

June, 2014

Addis Ababa, Ethiopia

ST. MARY'S UNIVESITY  
FACULTY OF BUSINESS  
DEPARTMENT OF ACCOUNTING

AN ASSESSMENT ON THE VAT COLLECTION  
PROBLEM OF ERCA IN THE CASE OF  
MERCATO NO.1 TAX PAYERS OFFICE

By

Yemisrach Chane  
Hayat Mohamed

APPROVED BY BOARD OF EXAMINE

\_\_\_\_\_  
DEPARTMENT HEAD

\_\_\_\_\_  
SIGNATURE

\_\_\_\_\_  
DATE

Yeserash Almu  
ADVISOR

\_\_\_\_\_  
SIGNATURE

\_\_\_\_\_  
DATE

\_\_\_\_\_  
INTERNAL EXAMINER

\_\_\_\_\_  
SIGNATURE

\_\_\_\_\_  
DATE

\_\_\_\_\_  
EXTERNAL EXAMINER

\_\_\_\_\_  
SIGNATURE

\_\_\_\_\_  
DATE



## TABLE OF CONTENTS

	<b>PAGE</b>
Abstract.....	I
Acknowledgements.....	II
Table of Contents.....	III
List of Tables.....	VI
List of acronyms.....	VI
<b>CHAPTER</b>	
<b>I. INTRODUCTION .....</b>	<b>1</b>
1.1 Background of the Study .....	1
1.2 Statement of the Problem .....	2
1.3 Research Question .....	3
1.4 Objective of the Study .....	3
1.5 Significance of the Study .....	4
1.6 Delimitation of the Study .....	4
1.7 Research Design and Methodology.....	4
1.7.1 Research Design .....	5
1.7.2 Population and Sampling Technique .....	5
1.7.3 Types and Methods of Data collection .....	5
1.7.4 Data Analysis Method .....	6
1.8 Limitation of the Study .....	7
1.9 Organization of the Study .....	7
<b>II. REVIEW OF RELATED LITERATURE .....</b>	<b>8</b>
2.1 Theoretical Review .....	8
2.1.1 Definition of Concepts .....	8
2.1.1.1 Purpose of Taxation .....	10
2.1.1.2 Essential Characteristics of Taxation .....	11
2.1.1.3 Canon/Principle of Taxation.....	11
2.1.1.4 Some Other Canons/ Principles of Taxation .....	13

2.1.1.5 Nature of Taxes .....	14
2.1.1.6 Types of Taxes .....	15
2.1.1.7 Tax Assessment and Collection .....	15
2.1.1.8 Tax Administration Challenge .....	16
2.1.1.9 Tax Compliance Theory .....	18
2.1.2 VAT .....	19
2.1.2.1 Meaning and Definitions.....	19
2.1.2.2 Nature of VAT .....	20
2.1.2.3 Characteristics of Value Added Tax (VAT).....	20
2.1.2.4 Input and Output VAT .....	21
2.1.2.5 Advantage and Disadvantage of VAT .....	21
2.1.3 Business Income .....	23
2.1.3.1 Meaning and Definitions.....	23
2.1.3.2 Computation and Tax Rate of Business Income Tax .....	24
2.1.3.3 Categories of Tax Payers.....	27
2.1.3.4 Concepts of Income Tax Evasion.....	28
2.1.3.5 Possible Factors that Brings About Tax Evasion.....	28
2.2 Empirical Literature Review .....	29
<b>III. DATA ANALYSIS AND INTERPRETATION .....</b>	<b>32</b>
3.1 Background Information.....	32
3.2 characteristics of the study Population .....	32
3.3 Analysis of Findings of the Study.....	33
3.4 Responses from Taxpayers .....	34
Table 3.4.1. Gender and Age of Taxpayer's Respondents .....	35
Table 3.4.2. Occupational Status in the Company .....	36
Table 3.4.2.1. Academic Background of Owners.....	36
Table 3.4.3. Beneficiary from Tax .....	36
Table 3.4.4. Manner of Registration for VAT .....	37

Table 3.4.5. Number of customers and Income Level after Being Registered for VAT .....	37
Table 3.4.6. Enough Training and Awareness Creating Sessions .....	38
Table 3.4.7. Quality of Services Provided by the Tax Authority while Declaring Tax Duties or Requesting any Services .....	38
Table 3.4.8. Penalty and Interest Amount.....	39
Table 3.4.9. Fairness of ERCA's Tax Assessment .....	39
3.5 Responses from Tax Officials .....	39
Table 3.5.1 Gender and Age.....	39
Table 3.5.2. Educational Background of Taxpayers.....	40
Table 3.5.3 Taxpayers Understanding .....	40
Table 3.5.4 Timely Collection of Tax.....	41
Table 3.5.5 Taxpayers Feeling while Registered for VAT .....	41
Table 3.5.6 Increment of Number of Taxpayers.....	42
Table 3.5.7 Reason for the Increment of the Number of Taxpayers .....	42
Table 3.5.8 Ethics of Taxpayers.....	43
<b>IV. SUMMARY, CONCLUSION AND RECOMMENDATION .....</b>	<b>44</b>
4.1 Summary .....	44
4.2 Conclusion .....	46
4.3 Recommendations .....	47
Appendices.....	53



## **List of Tables**

Table 3.4.1. Gender and Age of Taxpayer's Respondents

Table 3.4.2. Occupational Status in the Company

Table 3.4.2.1. Academic Background of Business owners

Table 3.4.3. Beneficiary from Tax

Table 3.4.4. Manner Registration for

Table 3.4.5. Number of customers and Income Level after Being Registered for VAT

Table 3.4.6. Enough Training and Awareness Creating Sessions Given by ERCA

Table 3.4.7. Quality of Services Provided by the Tax Authority

Table 3.4.8. Penalty and Interest Amount

Table 3.4.9. Fairness of ERCA's Tax Assessment

Table 3.5.1 Gender and Age Taxpayers

Table 3.5.2. Educational Background of Taxpayers

Table 3.5.3 Taxpayers Understanding

Table 3.5.4 Timely Collection of Tax

Table 3.5.5 Taxpayers Feeling while Registered for VAT

Table 3.5.6 Increment of Number of Taxpayers

Table 3.5.7 Reason for the Increment of the Number of Taxpayers

Table 3.5.8 Ethics of Taxpayers

## **List of Acronyms**

- FIRA                      Federal Inland Revenue Authority
- ERCA                     Ethiopian Revenues and Customs Authority
- VAT                        Value Added Tax
- TIN                        Taxpayers Identification Number
- PLC                        Private Limited Company
- SIGTAS                  Standard Integrated Government Tax Administration System

# Acknowledgment

Above all thanks to our lord who has helped us to through all the period and accomplish our academic successful.

Our deepest gratitude goes to our advisor, Yeserash Alemu, for his continuous Support, encouragement and guidance during this research work as well as during the course work of this degree program.

we would like also to thank all Ethiopian revenue and customs authority Merkato No.1 Branch Staffs in general and that of Ato frew Shemles and Ato Taye Fekadu in particular, for their interest and contributions in reading and commenting our very infant draft and facilitating the data collection processes for this research.

Our family deserves our appreciation for their love and care, they coverlet us down in the hardship we had come through our studies.

## Abstract

The study was conducted to answer the research questions what procedures used by the branch for that amount of collection, that amount of collection, what is the level of awareness of tax payers and the way the branch administrative VAT. To answer the research question the study has done extensive literature review and follow a systematic research methodology to determine the sample size, the way data to be gathered and method of analysis the data obtained from survey.

Finally the research concludes that Majority of the ERCAs employees VAT and Tax payers well understand the importance of VAT towards the development of the country. From the research it can also be concluded that there is better level of awareness on the way VAT collection is implemented among employees, however the level of awareness by the VAT payers is less as compared to employees.

One of the main reason for this less awareness is Tax payers don't have consistent level of awareness and consistent sources of information about VAT implementation. Because of this and other reasons, the VAT collection practice within Merkato No.1 branch becomes inefficient and faces a lot of problem, the major problem in VAT collection are weak collection system and controlling mechanism of the center & lack of awareness among tax payers, improper way of disclosing their income and lack of manpower & experienced staff are some of the main challenges in VAT collection.

According to employee's response unable to attend a serious of awareness creation consultative meeting organized by Ethiopian revenue and customs authority (ERCA), knowledge and skill gap about VAT Administration, being careless and lack of attentions are some of the causes which results in less awareness.

The above problem in turn bring a lot of impacts on VAT payers; some of these are lack of confidence in implementing their business as a result of unclear and inconsistent system among Tax payer which open a chance for subjective way of treating Tax payers and effects the competition in the market.

# Table of Content

	<b>Page</b>
ACKNOWLEDGMENTS.....	i
ABSTRACT .....	ii
TABLE OF CONTNTE.....	iv
LIST OF TABLES & LIST OF FIGURES.....	vi
CHAPTER ONE .....	1
1. Introduction.....	1
1.2. Background of the Organization.....	2
1.3. Statement of the problem.....	3
1.4. Research Questions.....	3
1.5. Objective of the study.....	4
1.6. Significant of the study.....	4
1.7. Scope and delimitation of the study.....	4
1.8. Research Design and Methodology.....	5
1.9. Organization of the paper.....	6
2. Review of related literature.....	7
2. 1 Theoretical Literature review.....	7
2.1.1. Definition of Tax.....	7
2.1.2. Definition of VAT.....	8
2.1.3. Ethiopian values Added Tax Administrative and collection .....	10
2.1.3.1. What is value added Tax as proclamation.....	10
2.1.3.3. Supplies and rates for VAT computation .....	13
2.1.3.4. Seizure of property to collect VAT .....	15
2.1.3.5. Filling to Tax return and payment of VAT.....	16
2.1.4. VAT refund.....	16
2.1.4.1. VAT Assessment .....	16

2.1.4.2. VAT investigation.....	17
2.1.5. Advantage and Disadvantage of VAT.....	17
2.1.5.1. Advantage of VAT.....	17
2.1.5.2. Disadvantage of VAT.....	18
2.1.6. The VAT exemption.....	19
2.1.7. The VAT system .....	20
2.1.8. Computation of VAT.....	20
2.1.9. VAT Administrative .....	21
2.1.10. Modernization VAT collection system.....	21
2.2. Empirical Literature review.....	22
<b>3. Data presentation and analysis.....</b>	<b>24</b>
3.1. Background of respondents.....	24
3.2. Analysis of responses to the questionnaire.....	26
3.2.1. Analysis of response from branch staff.....	26
3.2.2. Analysis of response from Tax payers .....	29
<b>4. Summary, Conclusion and Recommendations .....</b>	<b>34</b>
4.1 Summary.....	34
4.2 Conclusion.....	35
4.3. Recommendations.....	36

## List of Tables & Figures

Table 3.1. Background information of branch staff.....	24
Table 3.2. Background information of tax payers.....	25
Fig 3.1. Response on importance of VAT.....	26
Fig 3.2. Effectiveness of vat collection practice .....	27
Fig 3.3. Tax payers level of awareness.....	28
Fig 3.4. Response on importance of Tax.....	30
Fig 3.5. Response on level of awareness among Tax payers.....	30
Fig 3.6. Sources of information for awareness.....	31
Fig 3.7. Effectiveness of vat collection practice .....	32
Fig 3.8. The impact of inefficient VAT Collection practice.....	32

## Declaration

We, the understanding, declare that this paper is our original work and has not been presented for a degree in any other university and that all sources of materials used the paper have been duly acknowledged.

Name: Yemisrach Chane \_\_\_\_\_

Hayat Mohamed \_\_\_\_\_

Pace: Addis Ababa, Ethiopia

Date of submission June, 2014

Title of the paper:

“AN ASSESSMENT ON THE VAT COLLECTION PROBLEM OF ERCA IN THE CASE OF  
MERCATO NO.1 TAX PAYERS OFFICE”

This paper has been submitted for examination with our approval as university adviser

Name: Yeserash Alemu

Signature: \_\_\_\_\_

Date: \_\_\_\_\_





# **CHAPTER ONE**

## **INTRODUCTION**

### **1.1. Background of the Study**

Currently, one of the priorities of the Ethiopian government is to bring rapid and sustainable development in the country. The achievement of this rapid and sustainable development requires mainly sustained and dependable domestic revenue mobilization which otherwise be a dream to realize government vision depending only on external finance sources, which is subject to uncertainty. In order to realize domestic revenue mobilization objectives, the role of taxation is vital. The newly implemented overall tax reform program of Ethiopia consists of Direct and Indirect taxation scheme. Direct tax includes employment income tax, business income tax, rental income tax and other income tax. On the other hand, indirect tax includes VAT, excise tax, customs duty and sur-tax is the heads of indirect taxes in Ethiopia (Misrak, 2008:303).

Ethiopian government has introduced Value Added Tax (VAT) in 2003GC as a replacement to sales tax. Currently VAT is the principal source of revenue for the government. For example, in 2006-2007GC fiscal year, federal VAT revenue accounted for about 41 percent of total federal tax revenues from domestic sources (wollelaA, 2008). According to wollela, VAT has been more productive than sales tax since its introduction. To sustain VAT's revenue role in government's finance it is important to ensure that revenue collection through should be as effective as possible. However, in Ethiopia revenues generated through VAT is usually garnered at the expense of erosion in its salient features. This may be caused by factors including poor VAT administration, i.e., the incapability of tax authorities to implement the attributes of the tax in practice. A good tax administration is essential in fully implementing the design feature of VAT and achieving government's policy objectives at large (Wollela A, 2008).

VAT collection as the main part of VAT administration. It should be given a great concern for it. This is due to the fact that an overall VAT administration effectiveness of any tax collection office measured by its' capability to collect what it have to. ERCA currently collects at different level and collection center. Among these small scale tax payers office collect and administrate VAT at sub city level. Problems associated with the collection of VAT should be study to find possible solution that give us the overall picture of VAT administration .therefore ,This study will focus on VAT

collection problems of Addis Ketema Sub City small scale tax payers office merkato N.O 1 branch office and forward possible solution for it.

## **1.2. Background of the Organization**

The Ethiopian revenues and customs authority (ERCA) is the body responsible for collecting revenue from customs duties and domestic taxes. In addition to raising revenue, ERCA is responsible to protect the society from adverse effects of smuggling. It seizes and takes legal action on the people and vehicles involved in the act of smuggling while it facilitates the legitimate movement of goods and people across the border. The ERCA traces its origin to July 7, 2008 as a result of the merger of the ministry of revenues, the Ethiopian customs authority and the Federal Inland revenues into one giant organization. According to article 3 of the proclamation No. 587/2008, the authority is looked upon as “an autonomous Federal agency having its own legal personality”. The authority came into existence on 14 July 2008, by the merger of the ministry of revenue, Ethiopian customs authority and the federal Inland revenue authority who formerly were responsible to raise revenue for the Federal government and to prevent contraband. Reasons for the merge of the foregoing administrations into a single autonomous authority are varied and complex. Addis Ababa as the capital city of Ethiopia was established in 1986 Addis Ababa has 10 sub cities and each sub city is divided in to Woredas, which are the smallest administrative, unites of city Addis ketema sub city, which is one of the sub cities in central part of Addis Ababa and the branch which understudy. Until December 2010, Addis Ketema sub city revenue office was one of the offices in the Addis ketema sub city administration. According to ERCA (2011), due to the agreement concluded between the Addis Ababa city Administration and ERCA after December 2010 the Addis Ababa Revenue Authority and ERCA Have merged and four tax payer’s branch office emerged. Micro tax payers’ Branch include those taxpayers whose annual turnover is not greater than Br 100,000 and administrate in Woreda level, small tax payer’s branch include those tax payers whose annual turnover is greater than Br 1,000,000 and not more than one million Birr and minister at sub city level; medium tax payers Branch include tax payers whole annual turnover is greater than one million but not more than 15 million and administrate city level and large tax payers branch include tax payer whole annual turnover at Federal level. Therefore, Addis Ketema Sub City revenue called Addis Ketema Sub City small scale tax payers’ branch under ERCA only in

terms of administration and transfer the tax collected to the Addis Ababa city treasury including VAT.

### **1.3 Statement of the problem**

Value Added Tax (VAT) is a broad tax imposed on consumption of goods and services. It is collected at all stages in the production and distribution process. Ethiopian Revenue and Customs Authority (ERCA) has an authority to administer the VAT. It uses small scale branch offices as the main collection center of VAT and other types of taxes. The branch offices have a number of problems related with assessing, collecting and administering VAT that makes ERCA not to collect the potential tax which the authority can generate. Among the problems characterized in most small scale tax payers branch office related with VAT are huge refund, weak audit and enforcement of the tax office and low level of voluntary compliance.

Addis Ketema sub city small scale tax payers Merkato No. 1 branch office faced similar problems as other small scale branch of the city that makes it not effective in collecting the potential tax from registered tax payers as well as unregistered potential tax payers in the sub city. These problems were needed to be studied and solved to establish effective VAT collection process for the branch. Therefore this study assessed VAT collection system of the Merkato small scale taxpayers' branch office and identify the real causes of the branch is VAT related problems mentioned above, and it recommend some possible solution.

### **1.4 Research Questions**

This study has answered the following research questions

1. What procedure used by the branch (Merkato NO 1.Small scale tax payers office) for VAT assessment and collection?
2. How is the VAT payers' level of awareness about VAT and its compliance adequate?
3. How the branch is VAT administration is proper and efficient?

### **1.5. Objective of the Study**

#### **1.5.1. General Objective**

The general objective of this research was to assess VAT collection problem in the case of Merkato No 1 small scale tax payer's office and to recommend for some possible solution to minimize the problem.

### **1.5.2. Specific Objectives of the study**

To achieve above general objective, the following Specific objectives are formulated to be performed:-

- To assess effectiveness of VAT assessment mechanisms in Merkato No .1 branch office,
- To assess VAT payer's level of awareness and their compliances ,
- To evaluate the conformability of VAT collection mechanisms

### **1.6. Significance of the Study**

- Improve tax administration by identifying the gap
- Enhance the research skill of the students involved in the research
- To have a clear picture on how the VAT collection and assessment are taking place
- It could be used as major reference/secondary source for those who want to perform further study on the same subject matter.

### **1.7. Scope and delimitation of the Study**

Our study was encompassed to carrying out a detail examination, especially on the VAT collection problems of the merkato No. 1 small scale tax payers office on the basis VAT administration of aspect of ERCA . In order to describe the current status of the office and to make the scope manageable the study will use the most recent five years data from the fiscal year 2001EC up to 2005 EC.

### **1.8. Research Design and Methodology**

#### **1.8.1. Research Design**

The research was conducted in a descriptive and explanatory approach. The reason for using descriptive approach is to describe the current status of the branch office and for explaining reasons for existence of some facts by focusing on VAT collection problems. The study adopted mixed research design in order to achieve the stated research objective and to answer research questions. Specifically, the study used quantitative survey and qualitative in-depth interview and documentary analysis. The survey was conducted with employees of the branch office and

VAT payers while the in-depth interviews were conducted with the branch office staffs. In addition, documentary analysis was made referring annual reports of the branch office which relevant for the conduct of the study. To answers the research question we prepared a questionnaire and conducted an interview that enables us to get information about VAT collection practice and its effectiveness. The primary data obtained from the questionnaire and unstructured interview was analyzed and discussed. Finally the research concluded the findings of the study and forwarded the possible solution.

### **1.8.2. Population and Sampling Technique**

Employees, managers and VAT payers of small scale tax payer's branch office are the target population of the study. As it is impossible to collect from the whole population because the numbers are not manageable so, the required data will be collected from the sample respondent of employees and VAT payers.

From all employees of the branch office 15 respondents was taken as a sample size. The study has taken a sample of 15 respondents as a sample size for their research purpose out of all tax payers within the branch VAT payers. Simple random sampling will be used to select a sample from the employees of the branch office and convenient sampling to select a sample from VAT payers as the main sampling techniques. Simple random sampling will be used as the main technique because to give the respondent equal chance being selected and convenient samplings because it helps the researcher easily reach the sample respondents.

### **1.8.3. Sources of Data Collection**

Both primary and secondary data were used for this research. Primary data was collected from managers' interview and questionnaire distributed to employees of the branch office and VAT payers. Secondary data was collected from the organization documents, relevant literature and other printed materials.

### **1.8.4. Method of Data Collection**

The researchers will employ the survey method as a main data collection tool in this study because it is the main type of data gathering in descriptive research explanatory research.

Therefore, the survey method questionnaire and in-depth interview will be expected to supply the required data for this research. Questionnaires have been distributed to the sample

employees and VAT payers of the branch office. The questionnaire developed for customers has been translated to Amharic to avoid language barriers.

#### **1.8.5. Data Analysis Method**

The data through questioner and interview was categorized and analyzed based on the response of the sample respondents. Collected data was tabulated to summarize the respond of employees and VAT payers and analyzed using word statements, descriptive statistics and graphs. Descriptive statistics was be used because it is appropriate to analyze quantitative data frequency count and percentage.

#### **1.9. Organization of the Paper**

This research paper has been organized in to four chapters.

- The first chapter was contain the introduction part to give general overview of the study;
- The second chapter was contain the review of the related literature which gave a theoretical and empirical knowledge by using related literatures;
- The third chapter was gives an emphasis and show the data presentation, interpretation and analysis from the respondent through data analysis and methods that will be used in the study; and
- The fourth chapter was containing the summary conclusions and recommendations based on the finding of the study.

## CHAPTER TWO

### 2. REVIEW OF RELATED LITERATURE

This section presents a brief review of existing theoretical and empirical literature of Value Added Tax (VAT) Collection. At the end of the review, an attempt is made to summarize the major drawbacks of the existing empirical studies and to identify the knowledge gap to be filled in by further investigation.

#### 2.1. Theoretical Literature Review

##### 2.1.1. Definition of Tax,

Tax is a compulsory contribution or unrequited payment by the people to the government for which there is no direct return to taxpayers. A tax is a generalized exaction which may be levied on one or more criteria upon individuals, groups of individuals, or other legal entities (Bhatia, 2002). Taxation is a system of raising money to finance government. All governments require payments of money –taxes- from people. Without taxes to fund its activities, government could not exist.

Throughout history, people have debated the amount and kinds of taxes that a government should impose, as well as how it should distribute the burden of those taxes across society. Unpopular taxes have caused public protests, riots, and even revolutions. In political campaigns, candidates' views on taxation may partly determine their popularity with voters.

The Ethiopia tax system classifies taxes into two major categories as direct and indirect taxes. In indirect tax both incident and tax impact lies on the taxpayers. It is mostly known by four schedules as schedule A-income from employment, schedule B- income from rental of building, schedule C-income from business profit and schedule D-other income.

Income from employment excluded the first Birr 150 per month of taxable employment income and its minimum and maximum rate is 10% and 35% respectively. Income from rental of building excluded the first birr 1,800 per year of rental income from taxable income. The minimum range of income tax is 10% and the maximum is 35%. Income from business profit depends on whether the taxpayer is incorporated or unincorporated. For unincorporated entity the first birr 1,800 per year of business profit income is excluded from taxable income. The minimum range of income tax is 10% and the maximum is 35%. The tax rate for incorporated ones is 30%. Schedule D (commonly known as other income) includes income from royalties,

income paid for services rendered outside of Ethiopia, income from games of chance, dividends, income from casual rental of property, interest income, gains on transfer of certain investment property and income from agricultural activities. It executed the rate by applying proclamation set by House of People Representatives, Regulation set by council of Ministers and Directives set by tax Authority.

Unlike direct taxes, indirect taxes are not directly paid by individuals and enterprises from income derived. Indirect taxes collected from customers. Indirect taxes are levied on locally produced and imported goods and services rendered. In Ethiopia, the government has given due attention to indirect taxes. The main reason for the shift in emphasis is that about 75% of the Federal Government revenue is collected from indirect tax. Indirect taxes include Value Added Tax (VAT), Turnover Tax (TOT), Excise Tax, Stump Duty and Custom Duty. VAT obliged to those who register as VAT payers and their taxable annual turnover is above Birr 500,000 the standard VAT rate is 15%, while exported goods are treated as zero rate. TOT is payable on domestically produced and sold goods; including on services rendered by a person not registered for VAT and whose annual turnover is below 500,000 Birr. 2% and 10% are rates for goods services respectively even if there are specific goods and services exempted from TOT. Tax imposed on limited number of imported and/ or locally produced goods refers to excise tax. It is imposed on luxury goods and basic goods, whose demand is inelastic. The computation of excise tax is based on cost of production and Cost, Insurance and Freight (CFI) value for locally produced and imported goods respectively. But, the rate differs accordingly the type of goods. The two duties stump and customs are among the types of indirect taxes. Stump duty is chargeable on instrument with stump duty in respect of any amount expressed in any currency, other than Birr. However, custom duty paid when goods imported in to the country based on the criteria specified by law on tradable goods for individual or organization service (ERCA Statistical Bulletin, VOL 11, 2011).

### **2.1.2 Definition of VAT**

Value Added Tax (VAT) a tax on consumption levied whenever the value of goods and services increases as they change hands in the course of production, distribution, and final sales to the consumer. For example, a manufacturer pays a VAT on the materials it buys to make a product, a wholesaler pays one on the price it pays a manufacturer for a good, and a retailer pays one on



the price it pays a wholesaler. Price paid by consumers also includes VATs, reflecting the cost of providing goods and services for sale. VAT work on the assumption that value is added at every stage, and taxes should be levied on amounts of value added. This distinguished VATs from sales taxes, which are based simply on the retail price of goods. (“Value-Added Tax” Encarta 2009)

In this system the seller pays the government a percentage of the value added to goods or services at each stage of production. The value added at each stage of production is the difference between the seller’s costs for materials and the selling price. In essence, a VAT is just a general sales tax that is collected at multiple stages. VAT is belongs to the family of sales taxes and a tax not on the total value of the goods being sold, but only on the value added to it by the last seller (Bhatia, 1994:152-153).

According to Rosen (1988), Value Added Tax (VAT) is a percentage tax on a value Added applied at each stage of production. It is a type of indirect tax, nowadays found in More than 130 countries and has become the principal source of revenue for many Countries (Keen and Lockwood, 2007). In Ethiopia, according to IMF (2003), one of the Focuses of the tax policy reforms is reforming indirect taxation. The main reform to Indirect taxation was the introduction of VAT in January 2003. However, weak tax Administration, particularly in developing and transitional economies is the principal Impediment to the successful implementation of VAT. The same is true in Ethiopia as well in Addis Ababa (Yesigat, 2008). In Addis Ababa, according to BoFED (2009), lack of capital expenditure for public investment has hindered sustained economic Development. Therefore improving tax administration, particularly VAT administration helps the Addis Ababa city to improve its revenue through voluntary compliance. Almost unknown in 1960, VAT is now found in more than 130 countries, raises around 20% of the world’s tax revenue (Keen and Lockwood, 2007). According to Ulbrich (2003) it was a surprisingly popular revenue tool in South America, Asia and Africa.

In Ethiopia, one of the focuses of the tax area is indirect tax The main reform to indirect taxation was the introduction of a VAT in January, 2003 as a replacement to Sales Tax. Compared with the replaced sales tax, the new VAT have the advantages, (1) taxes services in addition to production, (2) grants zero rating to exports and (3) gives exemptions to fewer basic products.

In order to make up sufficient revenue from VAT it needs efficient and effective tax administration. However, developing countries like Ethiopia, where there is a large number of informal sector, low tax moral, rampant evasion, and total distrust between tax administration and taxpayers may not make the tax successful. One of the reasons is lack of simplified procedures. In VAT administration, there should be a concern for small businesses because as compared to the burden of VAT administration on large businesses, the cost of administering VAT is proportionally high for small businesses.

To that effect, many countries adopt simplified procedures for small and medium businesses like, allowing accounting for VAT on a cash basis rather than accrual basis and filling within reasonable accounting period, however this is not the case in Ethiopia.

According to Yesegat (2008) the VAT administration is poor due to many factors, particularly incapacity of tax authorities to implement the attributes of the tax to practice.

### **2.1.3 Ethiopian Values Added Tax Administration and collection**

#### **2.1.3.1. What is Value Added Tax AS per proclamation?**

As the student researcher tried to mention earlier that VAT replaces the sales tax on manufactured and imported goods and services in Ethiopia January 2003 (FDRE VAT Proclamation No. 285/2002). According to this proclamation, VAT in Ethiopia is payable if they are: supplies made in Ethiopia, made by a taxable person, made in the course of furtherance of a business, are not specifically exempted or zero rated. Supplies, which are made in Ethiopian, not exempt known as taxable supplies.

As it was also tried to mention earlier that, VAT is an indirect tax type, which is imposed on consumption or spending. VAT is collected from sales of the value added of goods and services, starting form importers and producers ending with consumers through the conditions of whole selling and retailing.

VAT applied on the value added meaning a producer for example provides final product to sell, performs different activities like spending direct and indirect costs and administrative cost except VAT and prepaid income tax. Doing that, value is created. This value is liable to tax, (FDRE VAT Proclamation No. 285/2002).

VAT is imposed only on the value created up on production and distribution but not on the cumulative return. Therefore, it avoids tax cascading burden using this method. This tax follows the procedures of refunding or credit input tax that is paid on purchasing inputs for production

of goods or provision of services. Again, it is paid for the sales of output. It is based on invoice in order that it reconciles the input tax against output tax.

Thus, record processing is mandatory to balance them. Therefore, modern accounting method of business system is being practical as the result of VAT introduction, (Misrak Tesfaye, Msc, 2008).

**INPUT TAX:** The VAT charged on creditors for VAT charged on business purchases and recollect on sales .not only the VAT on the purchases of raw materials or on goods purchased for resale, but also the VAT on things like, office equipment of the business, commercial vehicles used in the business for the carriage of goods, the telephone bill for the business, and payments for services in connection with the business,

Accountants, Lawyers fee's. It does not include VAT paid on goods or services for someone else's business or VAT on private purchases, such as furnishings for the home of the proprietor. VAT charged in these circumstances is not considered as input tax, (FDRE VAT Proclamation No. 285/2002).

Input tax are credited, however there are cases of purchasing which cannot be allowed as credit passenger automobiles, the repair and maintenance of passenger automobiles unless the business is dealing in or hiring such automobiles entertainment. Credit for input tax needs supporting documents original copy of a tax invoice, or certified customs import declaration-warehousing entry to substantiate a claim for input tax credit. (FDRE VAT Proclamation No. 285/2002)

**Output Tax:** The VAT charged on customers. It is only the taxable person who charges VAT in the course of effecting supplies. It is applied on taxable supplies. The rate, which is used for calculating for VAT on output, is standard rate. In Ethiopian case, standard rate is 15%, as the proclamation stated, (FDRE VAT Proclamation No. 285/2002).

**Taxable supplies:** According to VAT proclamation, VAT is chargeable on all taxable supplies. The sales of goods or service in the businesses for which are tax paid on them are taxable supplies. It is possible to supply goods and service in the reference of VAT, if supplier has right to make such activities.

**Rate of VAT:** There are two rates of VAT, which are standard rate and zero rates 15% and 0% respectively. Tax rates are applied to tax base to determine a taxpayer's liability, (Willis, Eugene et.al, 2007).

Gifts: The proclamation also stated that VAT is accounted on any gift of goods or services from the business based on the fair market value of the goods or services at the time the supply is made. Cascading of the tax, tax on tax, is avoided by providing credit the tax paid at the preceding level. Unlike the current sales tax system, where by relief is granted only to raw materials used directly in the production of goods, under a VAT, relief is granted for tax paid on capital goods, distribution and administration inputs. Sales of exported are not subjected to the VAT, (FDRE VAT Proclamation No. 285/2002).

Benefit: VAT removing the tax content, on input, from exported goods makes the goods more competitive in international markets, domestically produced will be more competitive with imported goods. In addition, relief from tax on capital goods will encourage investment; potential investors consider VAT legislation as one of the factors in making favorable investment decisions. VAT is less easily evaded, and the minimizing of tax avoidance supports the maintenance of equality and fairness in the application of tax legislation, (Misrak Tesfaye, Msc, 2008). VAT reduces unfair burden, has not been placed on the lower burden like the sale and transfer or lease or immovable property the rendering of medical services, the rendering of educational services, the supply of electricity and water and post office and the provision of public transport permits and license fees. VAT includes concessions to small-scale business to lessen the administrative burden, such as relief from the requirement to register, to collect VAT, (FDRE VAT Proclamation No. 285/2002).

### **2.1.3.2. Registration for VAT**

Registration for VAT is categorized in to three. These are obligatory, voluntary and special business categories. The first category obligatory registration is made for any person conducting a commercial enterprise or intending to conduct a commercial enterprise may apply to be registered for VAT. However if the taxable turnover of the enterprise, that is gross income for 12 calendar months exceeds or is likely to exceed birr 500,000 in Ethiopia, the person conducting the enterprise must register for VAT, (proclamation No 285/2002 Article 8). sole proprietor, company, partnership, trust, incorporate persons, unincorporated body, club or association. Authority determine whether a person obligatory registrant if it makes (Ethiopia VAT proclamation No.285/2005 Art. 16) birr 500,000 taxable turn over within 12 months of a year. If one reasonably expects that during 12 months the total value of taxable supplies excluding tax is likely to exceed birr 500,000, in Ethiopia, then the person needs to be registered

for VAT. A registrant, the turnover on an ongoing basis, makes calculation of VAT. Two periods need to be considered the past 12 calendar months and the next 12 calendar months on a month-by-month basis. There is the need to estimate at the end of each trading calendar month the total value of taxable goods and services supplied by all the business for the past 12 months. Where the total exceeds Birr 500,000, in Ethiopia, then there is the requirement to register for VAT. The second category of registration is voluntary registration the total of twelve months business transaction turnover may not necessarily be birr 500,000 in Ethiopia case, however, if customers of a registrant are at least 75 % for supplies provided, a person is allowed to be registered voluntarily. Things to be recognized in voluntary registration are those who are involved in export advised to be registered voluntarily in order to get refund. This is practical through zero rated purchases that enable the person to ask credit on input tax. Otherwise, the person voluntarily registered, there may be the loss of customers who are VAT registrants that need invoice from their provider in order to claim input tax Credit. Therefore, voluntary registration here is compulsorily required. Revenue Authority needs prerequisites like: Permanent residential; proper accounting records; Bank account and; the one who obeys tax law and that must have capacity to do what the Authority requires. 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.

### **2.1.3.3 Supplies and Rates for VAT Computation**

For VAT administration purposes in Ethiopia, the rates are computing in the following ways:

#### **a). Taxable Supplies**

VAT is collected from taxable supplies, which are imported or sold domestically Transactions on which the tax is paid up on are where supplies: Made in the territory and produced or provided by VAT registrants that are not exempted or zero-rated. Aid or exchanging similar supplies from the business are liable to VAT. These values of derived from market price. In case the value increases, tax should be adjusted in the form of aid or exchanging, (Abebe Worku, 2008),

## **b) VAT on Import**

According to VAT proclamation of Ethiopia, all goods imported in to country are liable to VAT, except zero-rated goods and exempt goods. The imported goods regardless of the goods are private or for business purposes, and whether or not the importer is registered for VAT.

The VAT for importation is paid at the point of clearing the goods in the customs division of ERCA of Ethiopian case.

VAT is paid that is due. However, VAT and TIN number should be provided on customs import entry and declared if the goods imported are for the given business. If they are imported for taxable business purpose, credit is claimed for the tax paid on the VAT tax return. The value on which the VAT will have to be paid at importation is in accordance with the VAT law as the CIF (cost, Insurance and Freight) duty plus the customs duty plus the cost of any service supplied incidental to the delivery of the goods. The customs division will give the basis of value for VAT purposes, as proclamation stated. Import credits are claimed for the VAT paid on imports are applicable if, client is VAT registrant, the import must be for the business and not for private use, the copy of the customs bill must of entry certified by customs as to the amount VAT paid. This amount must entered in appropriate box on the VAT return and claim it as a credit. A copy of customs bill of entry must be retained.

Service business conduct to give service in the country and registered for VAT then pays VAT. If the service supplied by foreign who is not registered for VAT in Ethiopia, then Ethiopia registrant must be accounted for VAT of service received from abroad. (Misrak Tesfaye, Msc, 2008).

## **c). Zero rated Supplies**

Supplies of zero-rate goods or services are business transaction, which VAT is chargeable as 0% (Zero rate). Supplies are taxable although no VAT is charged and the value of these supplies forms part of the taxable turnover for registration purpose. Input tax could be claimed in full, tax paid on purchases, credit related to zero rated supplies.

The supplies of export of goods or services treated by zero-rate. Goods are treated as exported from Ethiopia if the goods are delivered to or made available at all address outside Ethiopia as evidenced by documentary proof from customs acceptable by the concerned official of ERCA. Services are treated as exported of the services are supplies for use or consumption outside Ethiopia as evidenced by documentary proof from customs by concerned official of ERCA.

The rendering or supply of transaction or other services directly connected with international transport of goods or passengers, as well as the supply of lubricants and other consumable technical supplies taken on board for consumption during international flights. International transport of goods or passengers occur where the goods or passengers are transported by road, rail, water, transportation from a place outside

Ethiopia or another place outside Ethiopia where the transport or port of the transport is across the territory of Ethiopia, or outside to a place of Ethiopia, the Ethiopia to outside. In addition, supply of gold to the National Bank of Ethiopia from abroad. (Misrak Tesfaye, Msc, 2008).

#### **d). VAT on Exports**

Exports are subjected to VAT at zero rates. VAT has no to be charged for the goods and service would be exported, however, credit or input tax is claimed upon those supplies purchased to produce the exports.

The one who is making taxable supplies even if it a nil rate and law requires that it will be registered if the turnover exceeds the registration limits. Secondly if will be entitled to refund of VAT from the authority if it exports, goods or services, and it will therefore be its interest to register regardless of the level of turnover, to be able to claim VAT refunds, (Proclamation No. 285/2002).

#### **e). Exempt Supplies**

Supplies of exempt goods and services are business transactions on which VAT is not chargeable at either the standard or zero-rate. Exempt supplies are not taxable supplies

#### **2.1.3.4. Seizure of Property to Collect VAT**

A person who has liability to pay VAT imposed by the law has to pay properly. However, this may not be implemented as per expected. During this Authority is lawful to collect the tax by seizing property equivalent to tax and administrative cost of managing seizure of property, as per the proclamation.

Seizure extends only to property possessed and an obligation existing at the time the seizure is made. Whenever the seizure properties are sold, the procedure to be followed is with public auction or any other approved method by Authority after ten days of the seizure. However, for perishable goods the authority decides appropriate time to sell.

The person, whose property to the seized should be notified before 30 days of seizure. However, if the Authority makes a finding that the collection of the tax is in jeopardy, it does not necessarily to keep 30 days period.

### **2.1.3.5 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, (FDRE VAT Proclamation No.285/2002, Art.26).

### **2.1.4 VAT Refund**

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

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

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

#### **2.1.4.1. VAT Assessment**

After review by the Authority, it appears that a person has understood his tax obligation. The Authority issues an additional assessment within 5 years after the end of the accounting period concerned; and in the case of fraud or willful negligence, notwithstanding any limitation in any other law, assessment make at any time. If the Authority makes an additional assessment within 30 days of the notice and demand, the person assessed does not pay the additional assessment or



appeal the assessment as provided in VAT proclamation, the person is in default, (Proclamation No.285/2002, Art.29).

#### **2.1.4.2.. VAT Investigation**

Authority gets to mitigate VAT evasion through investigation activities. This is done through qualified professionals in different disciplines. These help to investigate various tax offences easily because most activities are identified through diverse expertise capacity. Tax evasions mainly made by high taxpayers who are involved with VAT, such activities are due to deep understanding of corruption seeking and supported by well experienced and skilled workers capable to fraud the system.

VAT evasion offence can be treated with criminal penalty. The ordinal court treats the offence made by taxpayers through the prosecuting. Such activities are processing with layers of the Authority. Offenders of tax evasion penalized in money as well by imprisonment as per the criminal law states. Their names with offence they commit also publicized through mass media. Exposing such offenders pertains to aware others keep the tax law as stated to be implemented. Therefore, the Authority focuses investigations of VAT evasions in order to reduce corruption in this sector. Ethiopia is treating such problem with VAT proclamation.

### **2.1.5. Advantages and Disadvantages of VAT**

#### **2.1.5.1. Advantages of VAT**

As started Bhatia, 1994:148-150, the following are advantage of VAT.

1. VAT is a major source of revenue.
2. Domestically produced goods will be more competitive with imported goods.
3. Relief from tax on capital good will encourage investment.
4. Literacy is noticeably higher in countries that adapted and VAT reduce tax distortions, encourage investment by allowing input credits, broadens the tax base and ultimately raised the revenue potential.
5. Lesser tax evasion. Firstly this happens because the tax is divided into parts and therefore the incentive to evade tax by any firm is reduced. Secondly, it is in the interest of a firm to account for the taxes paid by earlier firms through which the inputs have come otherwise, this firm pays that tax itself. It may firms, therefore understates its output, it will be caught by

the disclosure of the firm buying inputs from it. This type of cross-auditing enables the authorities to plug the tax leakage.

6. VAT is conducive to efficiency since a firm is not exempted from its tax liability even if it runs into a loss. It pays a tax not on its profits but on the value produced. It, therefore, tries to improve its performance and reduce the cost of production
7. Some goods should enjoy a tax exemption (zero tax rate) while the remaining ones need not be subjected to uniform tax rate so multiple (including zero) rates are now commonly found in VAT systems. A multiple tax rate variety can also easily accommodate credit system (that is, deducting tax liabilities of a firm by the amount of taxes paid by other firms on its purchases).

#### **2.1.5.2. Disadvantages of VAT**

VAT, however, is not just a bundle of advantages. Rather it has serious limitations especially for under developed countries because of which it has not yet become popular. As stated By Bhatia, 1994:155-158, the following are disadvantages of VAT.

1. VAT is a complicated system and needs honest and efficient government machinery to do the cross checking and link up various production activities and the resulting tax liability of each firm. It is, therefore, necessary that the country adopting it should also be sufficiently advanced in its financial and economic structure and the firm should be in the habit of keeping proper accounts.
2. VAT system depends a lot up on the cooperation of the tax-payers each firm itself calculates its tax liability to begin with and also finds out the taxes paid by the earlier firms. Once however, the sellers realize that the administrative machinery of government is not equipped to do all the necessary cross-checking, they will resort to the creation of false purchase invoices showing taxes paid by others, to the extent this happens, tax evasion becomes a major possibility and common practice.
3. Unless the rates of VAT are extraordinarily high, the state would end up with smaller tax revenue as against the collection from sales tax.
4. Even if the taxpayers are fully honest, this system of taxation forces them to maintain elaborate and costly accounts. This becomes uneconomical especially for the smaller firms.

5. Critics of VAT doubt that it induces efficiency. They claim that is shortage economically like ours speculative hoarding non-competitive price rise and similar practices are quite common. In a seller's market, producers and sellers have no incentive of their quality and high prices.
6. VAT requires a highly efficient administration and Competitive market.

### **2.1.6. The VAT Exemption**

The following type of supplies of good or rendering of service are exempted :-(Misrak, 2008:375).

- Insurance and banking operation
- (<http://www.conseco.ru/eng/abc/tax/small/vat3.htm>) the seller or transfer of used dwelling or the lease of a dwelling
- The rendering of financial service
- The supply or import national or foreign currency (except for that used numismatic purpose) and of securities
- The import of gold to be transferred to national bank of Ethiopia
- The rendering of religious organization or church related service
- The import or supply of prescription drugs specified in directive issued by the minister of health and rendering of medical service
- The supply of electric city, resource and water
- Good imported by the government organization, situation or projected exemption from duties and other import tax to be extent provided by law or by agreement
- Supply by post office authorized under the Ethiopian Postal Service proclamation, other than service rendered for free or commission
- Some R&D operation.
- Sale of companies employed disabled
- Gratuitous aid
- Transfer of participatory share in limited liability companies.

### **2.1.7. The VAT System**

#### **How does VAT work?**

The VAT due on a taxable sale is a percentage of the sales price but from this the taxable person (VAT registered person) is entitled to deduct all the tax already paid at the preceding stage. Therefore, double taxation is avoided and tax is paid only on the value added (incremental value) at each stage of production and distribution. As the final price of a supply to consumer is the sum of value added at each stage of the production and distribution chain, the final VAT paid by the consumer is also made up of the sum of the VAT paid at each stage. (Misrak, 2008:316)

When the vendor is applied with goods or services by another vendor, VAT will be levied by the supplier of those good or services the VAT on those goods or services received, is the Input tax of the vendor who received those goods and services. When the vendor in turn supplies goods or services to other persons (or vendors) VAT must be included in the output tax of the vendor.

Output tax minus Input tax = VAT payable  
When input tax exceeds output tax, a taxpayer may be allowed to carry the credit forward and a refund made after 5 months if inputs tax still exceeds output tax.

Input tax minus Output tax = VAT refundable/credited

### **2.1.8. Computation of VAT**

#### **2.1.8.1. Calculation of Net VAT Liability/Payable to FIRA**

Though value added (VAT base) is often thought as the difference between a firm's sales and its purchases, VAT liability on sales may be calculated by three different methods; by subtraction, credit or addition. (Misrak, 2008:372)

##### **a) Subtraction Method**

Under this method, a taxpayer calculates its VAT liability by subtracting its cost of purchases from other firms from its sales and applying the tax rate to the difference. With a consumption VAT, the deduction for purchases would include any capital equipment brought during the period. (ibid)

### **b) Credit/Invoice Method**

Under the credit method, a firm's tax liability is determined by allowing the firm to subtract VAT paid on purchases from VAT due on its sales. The amount of deductible tax paid on purchases would include the full amount of tax paid on any capital equipment purchase in the case of a consumption type VAT.(ibid)

### **c) Addition Method**

Though value added is equal to the difference between a firm's sales and its purchases, it is also equal to the payments for the labor and capital that generate the value added. Under the addition method, a taxpayer's VAT liability is calculated by adding together the components of value added such as various production factors like wage, rent, interest etc and profit (markup) and then applying the tax rate to that sum.

## **2.1.9. VAT Administration**

Administration of value added tax does not require firm to calculate value added. The most common means of administering the tax is the invoice method developed in France and used in European Union nation to collect the tax. Under the invoice method, all transaction are taxed at fixed proportion rate regardless of whether they are final or intermediate transaction tax payer then are allowed to deduct the terming their tax liability. This is called the invoice method because payment of the merely required firm to maintain invoice on sales and purchased for each tax payment period (usually monthly or quarterly). Tax liability is simply by applying the fixed rate of taxation to total sales invoice and then deducting the amount of VAT paid previously on intermediate purchased invoice. (Misrak, 2008:228)

## **2.1.10. Modernizing VAT Collection System**

Modernizing tax system mainly consists of computerizing the tax collection system using well trained human power and drafting proper tax rules and regulations that enhance tax administration effectiveness. As it has been mentioned reputedly, tax collection is not functioning properly without an effective and efficient tax administration. To that end, a well designed computer system is an important tool of tax administration. Naturally computerization is useful to improve efficiency and reduce cost in the current information technology age, computers and their wide spread application allow tax collectors to provide efficient, timely and

accurate services. A computers application is equally important to save tax payers time and promote tax equity (Semegn, 2002).

In administering VAT in Ethiopia tax authorities use computer programs, namely: Standard Integrated Government Tax Administration System (SIGTAS) and Automated System for Customs Data Management (ASYCUDA). The computer programs are used to maintain taxpayer register and process VAT returns. Detection of non-filers seems to be carried out mainly manually. In addition, tax authorities endeavor to follow-up non-filers identified by the computer programs. However, because of shortage of manpower, such follow-ups are usually carried out once in a 3 to 6 month period. The above practices pertaining to controlling VAT filing and payment delay the collection of the tax and jeopardize the government's revenue. Hence, suggested that to ameliorate the potential impact of non-filers on the revenue performance of the tax, strengthening the administration capacity of the tax authorities, and effectively using the computer programs coupled with timely follow-up of non-filing taxpayers are worthwhile to consider (Wollela Abehodie, 2008).

## **2.2. Empirical Literature Review**

A study made by Wollela Abehodie (2008) examines VAT administration in Ethiopia and identifies key problems including lack of sufficient number of skilled personnel and gaps in the administration in such areas as refunding, invoicing and filing requirements. The paper suggests that in Ethiopia attempting to implement what is legislated in the main areas (such as refunds) deserves the government's due attention. The study also emphasizes the need to strengthen the administration capacity in general and the tax audit program in particular.

Furthermore, the paper assesses the assignment of VAT revenue to regional governments and the decentralization of its administration. This paper examined how VAT administrators in Ethiopia perform their duties and how the effective taxation requirements differ from the legislation (focusing on the key administration tasks).

In addition, the outcomes showed a paucity of tax awareness among the society and strong education programs as well as lack of trust between taxpayers and administrators as major challenges to the VAT system in the country. The gaps and problems identified in the study were partly because of under staffing of the tax authority. This, in turn, is attributable to limited tax administration resources. It is hence suggested that the government would better look at the

possibility of making sufficient resources available for the administration of VAT. However, considering the role of VAT administration in the overall financial system of the Ethiopian government, allocating reasonably sufficient resources is worthwhile to consider. Generally, one can see that empirical studies undertaken by the above researcher do not account for specific areas of the tax administration and specific areas of tax payers. So that this Study focuses on VAT collection problems of VAT payers particularly small scale tax payers.

## CHAPTER THREE

### 3. Data Presentation and Analysis

This chapter presents primary information collected from respondent in Merkato No. 1 branch tax office from both tax payers and the officers. As it was stated in chapter one, a random sampling method was used to determine the sample size. Based on this random sampling method 15 tax payers and 15 tax office staffs were participated in the study. The data obtained from these respondents were presented, analyzed and interpreted as follows;

#### 3.1. Background of Respondents

**Table 3.1. Background information of respondent from tax office of the branch**

No	Description		No.	Percent	Total
1	Position /responsibility	Officer	5	35.72	14
		Assistant officer	2	14.43	
		Audit officer	1	7.15	
		Finance officer	3	21.43	
		Tax officer	3	21.23	
2	Educational background	Diploma	3	21.43	14
		First Degree	11	78.57	
		Sec. Degree	0	0	
3	Work experience	0-5 years	7	50	14
		6-10 years	4	28.57	
		11-15 years	0	0	
		>15 years	3	21.43%	

**Source: Primary data**

**Table 3.1,** depicts the respondent background of sampled respondents from Tax payers office in Merkato Number 1 Branch. As it can be seen from Table 4.1 the respondent has position ranging from Tax Payers Team leader to cashier. Regarding their educational background, 3 (21.43%) of the respondent are diploma holder and 11(78.57%) have first degree. According to their Table 4.1 50% of the respondent have 0-5 Years' Experience, 28.57% have 6-10 years and 21.43% of them have



more than 15 years' experience. This indicates the research respondent has sufficient educational background and working experience which makes the information obtained from these respondents to have a better quality.

**Table 3.2 Background information of respondent from Tax payers.**

No	Description		No.	Percent	Total
1	Type of trade participant are involved	Stationary	2	14.43	14
		Retailer	6	42.68	
		Importer	3	21.23	
		Whole sale	2	14.43	
		Electronics	1	7.15	
2	Experience	0-5 years	8	57.14%	14
		6-10 years	4	28.57%	
		11-15 years	0	0%	
		>15 years	2	14.29%	

**Source: Primary data**

**Table 3.2**, depicts the respondent background of sampled respondents from Tax payers in Merkato Branch. As it can be seen from Table 4.2 these respondents are involved stationary, retailing, Importer, whole sale, electronics and kitchen appliance. .

Regarding their experience in Trade, 57.14% of the respondent stay in business for 0-5 years', 28.57% of them stay in business 6-10 years and 21.43% of them and 14.29% of the Tax pay have more than 15 years' experience in the business. As it can be seen from the above table the tax payers are involved on various type of trade and more than 57% of them have 0-5% experience in the business.

### **3.2 Analysis of Respondent Responses for question Related with VAT collection practice**

To achieve the objective of the research primary data was collected through questionnaire from employees of Ethiopian Revenue and Customs Authority at Merkato Branch and Tax Payers

under this branch. Accordingly a questionnaire was distributed to 15 staff members of the branch and 15 Tax payers within the branch. The questionnaire was aimed to assess the VAT Collection practice in this branch. Respondent had been given both open-ended and close ended questions. The results obtained from both respondents are summarized as follows;

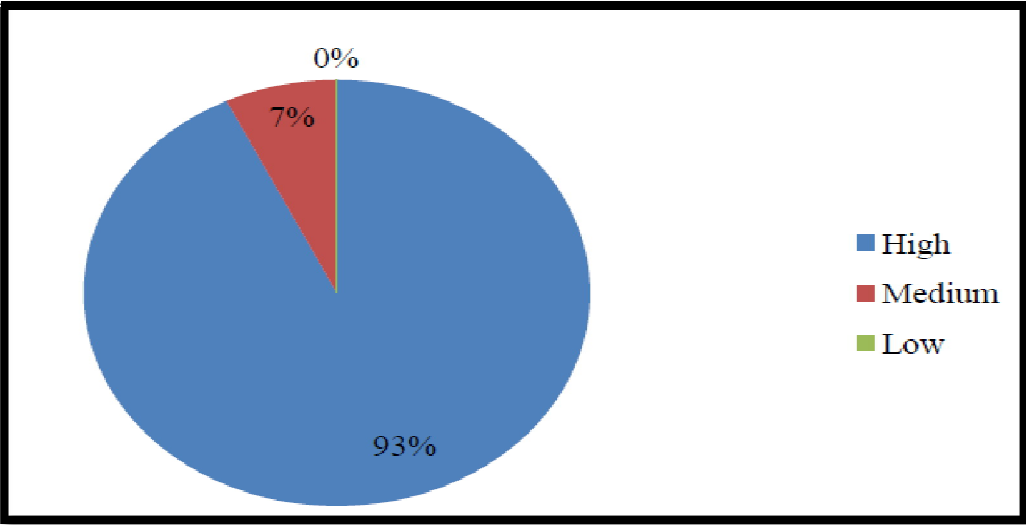
**3.2.1 Analysis of Response from Branch Staff**

To achieve the research objective the following questions were forwarded to employees of Ethiopian Revenue and Customs Authority under Merkato No 1 Branch.

**1. The Importance of VAT to the development of the Nation/Country**

The first question forwarded to employees of the Revenue and Customs Authority employees at Merkato No. 1 Branch were contribution of VAT towards the development of the country. As it is indicated on Fig4.3 majority of the respondent close to 93% believe that contribution of VAT to the nation is high and the remaining 7% respond that its contribution is medium. From this we can realize that employees are aware about the importance of VAT towards nation’s development.

**Fig 3.1.Response on Importance of VAT**



**3.2.1 Analysis of Response from Branch Staff**

To achieve the research objective the following questions were forwarded to employees of Ethiopian Revenue and Customs Authority under Merkato No 1 Branch.

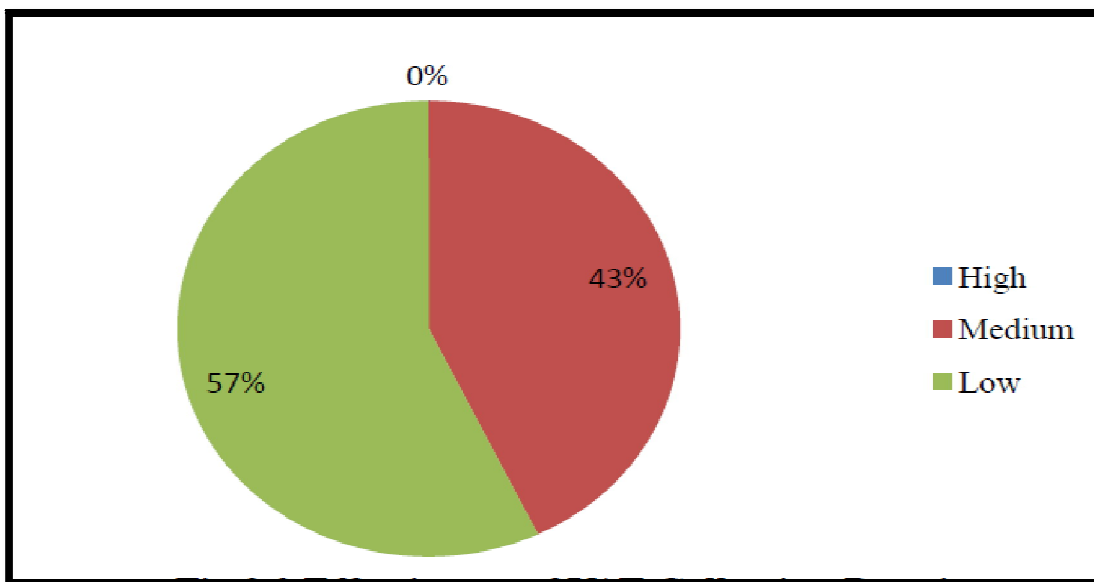
### 1. The Importance of VAT to the development of the Nation/Country

The first question forwarded to employees of the Revenue and Customs Authority employees at Merkato No. 1 Branch were contribution of VAT towards the development of the country. As it is indicated on Fig4.3 majority of the respondent close to 93% believe that contribution of VAT to the nation is high and the remaining 7% respond that its contribution is medium. From this we can realize that employees are aware about the importance of VAT towards nation's development.

### 2. The effectiveness of VAT Collection Practice in the country

Following the importance of VAT the second question forwarded to respondent under the branch was the effectiveness of the VAT collection processes. The response in this regard reveals that, the effectiveness of the collection processes is very poor, in terms of figure, 57% of the respondent believe that the collection processes/Mechanism is less effective and the remaining 43% think that it is medium.

**Fig3.2. Effectiveness of VAT collection Practice**



### 3. Problems Encountered in VAT Collection Processes

Majority of the respondent agreed that, the major problem in VAT Collection are weak collection system and controlling mechanism of the center & lack of awareness among tax

payers, improper disclosing their income and Lack of manpower & Experience in the Tax collection center are the main challenges in VAT collection.

**4. Possible Solution to solve problems encountered**

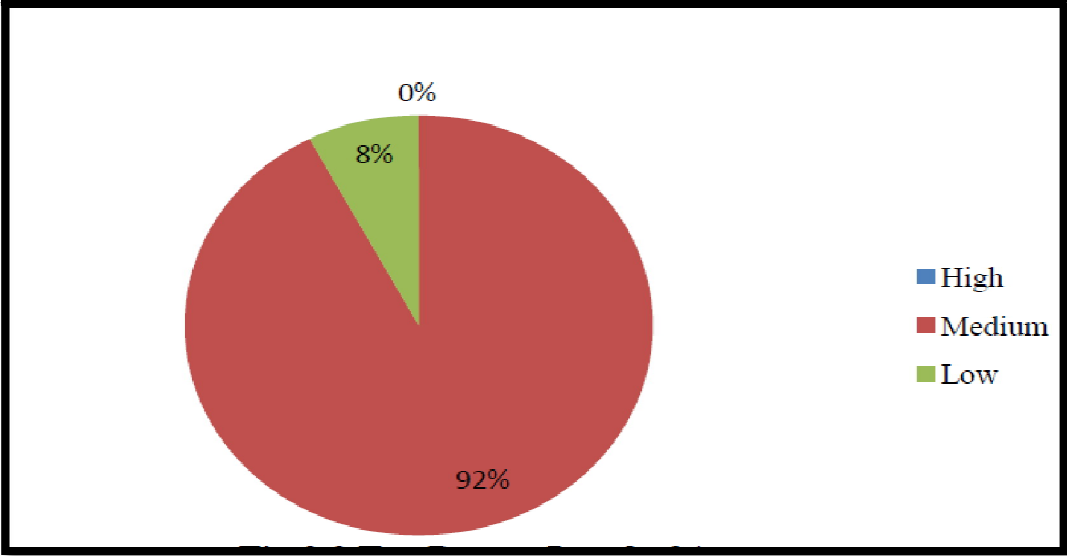
To overcome the above problems respondent suggested the following solution;

- ✓Conduct a research to identify the main bottlenecks and provide appropriate solution in accordance to the finding of the research
- ✓Improving knowledge and skills of tax collection staffs through extensive trainings and strengthening the institutional capacity
- ✓Improving tax payers knowledge and awareness of Tax payers with training and the consequences of unable to perform their duties
- ✓Improving the organizational setup of the Ethiopian revenue and customs authority
- ✓Establishing strong controlling mechanism that enables the authority to implement the collection processes as effectively as possible
- ✓Increasing manpower

**5. Tax payers level of awareness towards the importance VAT**

Response on tax payer’s level of awareness indicated that, majority (92.31%) of the respondent has medium level of awareness. This indicated that a lot has to be done to improve the situation since this one of the key factor that affects the effectiveness of VAT collection (Fig 3.3)

**Fig 3.3 Tax Payers Level of Awareness**



## **6. Causes for less awareness towards VAT (if any)**

According to employee's responses unable to attend a serious of consultative meeting organized by Ethiopian Revenue and Customs Authority (ERCA) to create awareness on the importance of VAT and its implementation, knowledge and skill gap about VAT Administration, being careless and lack of attentions are some of the root causes which results in less awareness.

## **7. Possible solution to improve the level of Awareness on the importance VAT**

Almost all respondent agreed that ERCA has to provide extensive trainings to improve the level of awareness of tax payers and the consequence of unable to perform their duties in various means of communication that are accessible to customers instead of waiting them to come to the authority to attend meetings .

## **8. General Remark on VAT Implementation**

Realizing the importance of VAT, the Ethiopian Revenue and Customs Authority has to improve the level of awareness of both its employee and tax payers to improve the efficiency of VAT collection system and establish strong controlling mechanism that enables those who doesn't fulfill their duties to be punished and that encourages proper tax payers of VAT collection system and establish strong controlling mechanism that enables those who doesn't fulfill their duties to be punished and that encourages proper tax payers.

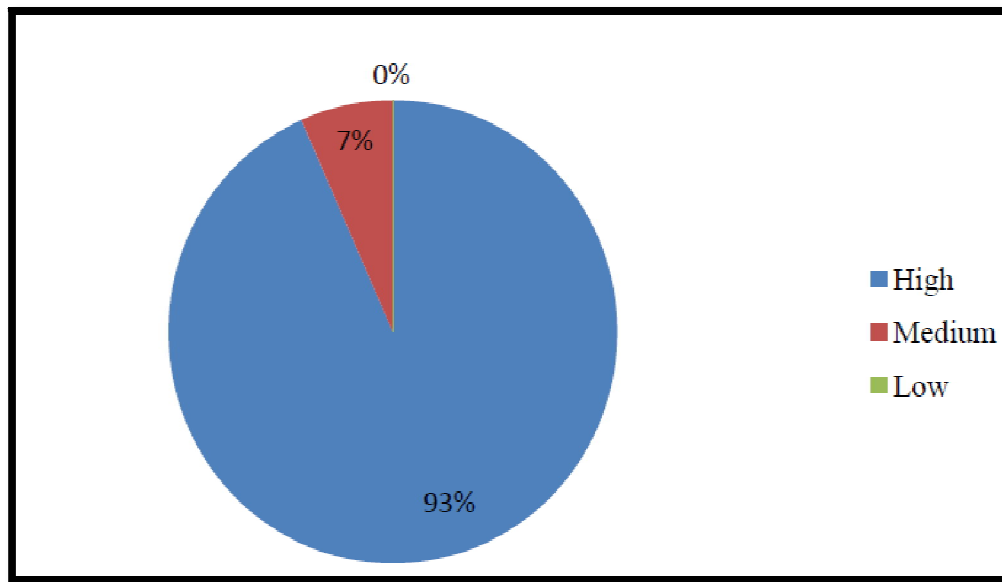
### **3.2.2 Analysis of Respondent Response from Tax payers**

In order to get balanced information data was also collected from tax payers in Merkato No. 1 Branch. Accordingly a questionnaire was distributed to 15 tax payers with in the Branch and the information obtained from 14 respondents were summarized as follows;

#### **1. The Importance of VAT to the development of the Nation/Country**

As it can be shown from the following figure (Fig 3.4), more than 93% of the tax payers believed that VAT is very important for the development of the country. This indicates that there is a common view about the importance of VAT among Tax payers and Tax collectors which is a very good opportunity to improve the situation.

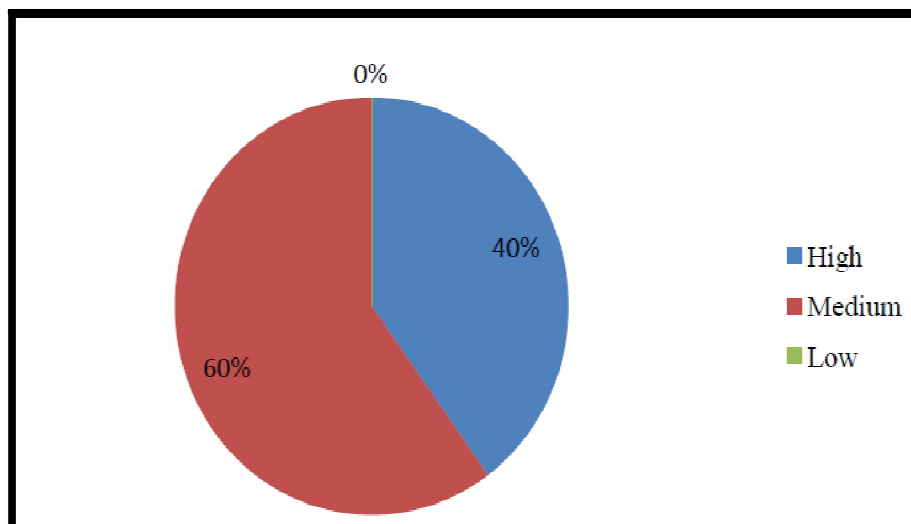
**Fig 3.4 response on importance of tax**



## **2. Tax payer's level of awareness towards VAT**

Even though there is a good understanding on the importance of tax to the development of the country among tax payers, the level of awareness on the implementation of VAT is not that level. As it can be observed from fig, 3.5, Majority of the respondent (60%) has medium level of awareness which makes the tax collection processes to be less effective.

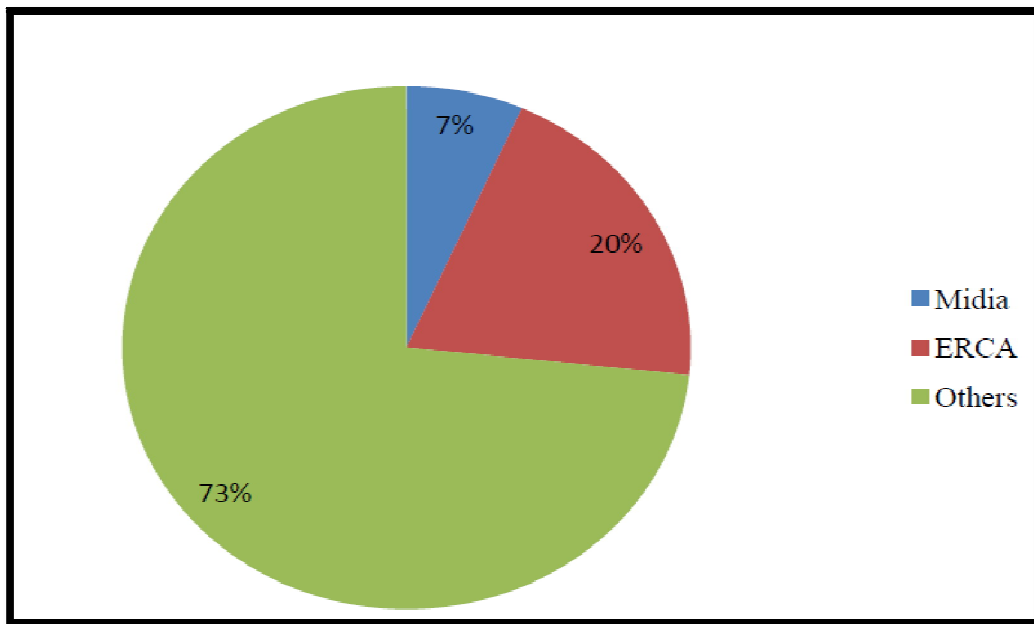
**Fig 3.5 Response on Level of Awareness among Tax Payers**



### 3. Source of Information for Awareness on VAT

Fig. 3.6 shows that majority of the Tax payers don't get information in formal ways from Media and the Ethiopian Revenue and customs authority (ERCA) instead they get information from others sources such as from colleagues in their own way. In this case, Tax payers may not get appropriate and consistent information from the informal sources and this may have negatively affected the implementation VAT.

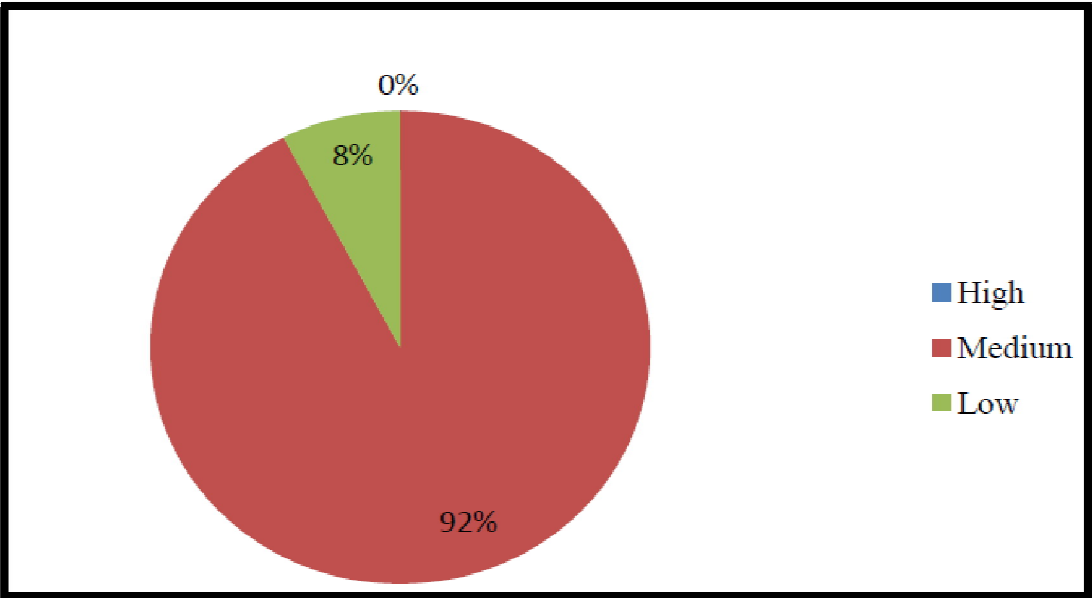
**Fig 3.6. Sources of information for awareness**



### 4. The effectiveness of VAT Collection Practice in the country

The response from majority (92%) of Tax Payers on effectiveness of VAT collection practice reveals that, the effectiveness of the current VAT collection practice is medium and low (8%). This indicates that there is some gap in the way the VAT collection implemented.

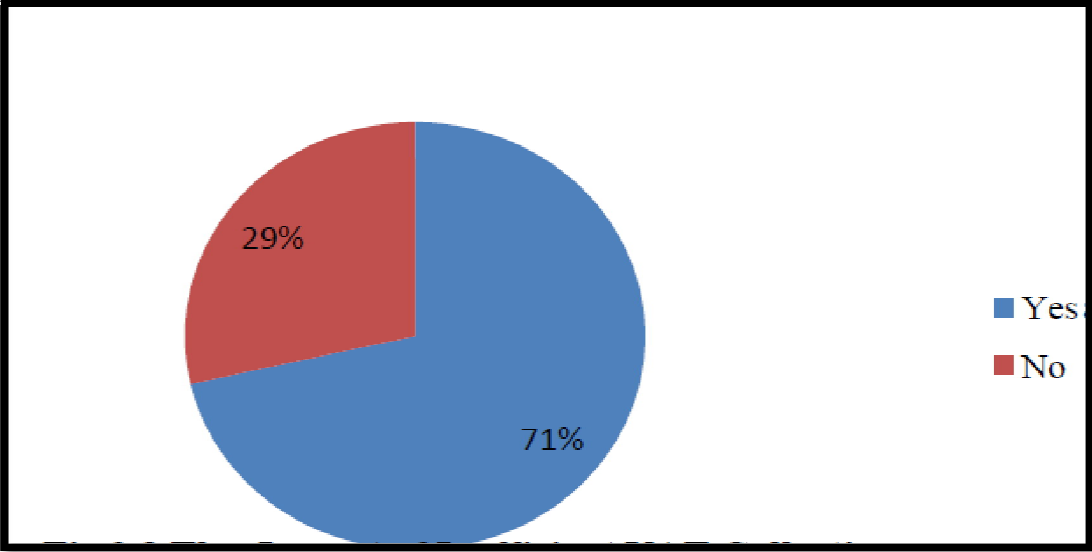
**Fig 3.7 Effective of VAT collection practice**



**5. The Impacts of Inefficient VAT Collection Practice on your Business**

Following the assessment of effectiveness of the current VAT collection practice Tax Payers were requested whether the current inefficient VAT collection system affect their business or not. Accordingly, 71% of the respondent responds the system has negatively affected their business (Fig 3.10)

**Fig 3.8 The impact of Inefficient VAT collection Practice**





## **6. If there are negative consequences, what are their impacts?**

The impacts of inefficient VAT Collection forwarded by respondent as follows.

- The tax payers are not confident in implementing their business since the procedure is not clear and consistent for all tax payers.
- Due to the inconsistent procedure, the VAT collection practice becomes subjective and affects the competition.

## **7. What are the possible solutions to resolve problems associated to VAT collection Practice?**

To improve the VAT collection procedures and efficiency, respondent suggested;

- The authority should establish a consistent procedure/system that can treat all tax payers in the same way to develop confidence among all tax payers.
- Creating awareness to the public through various means to improve the VAT implementation procedure

## **8. General Remark on VAT Implementation**

Understanding importance of VAT ERCA has to improve the level of awareness of both its staff and tax payers to improve the efficiency of tax payers and establish strong controlling mechanism that enables those who doesn't perform their duties to be punished.

### **3.2.3 Analysis of Respondent interview from tax office**

Since our first research question was not boldly addressed in the questionnaire survey at beginning we interviewed some tax office staffs to assesses the VAT collection procedure of the tax office. Accordingly the VAT collection procedure of Merkato No1 small tax payer's office is based on schedule in three different categories which include schedule A, B and C. Schedule A consists of tax payers more than 500,000ETB and the way to determine the tax to be paid decided by the tax office. Tax payers in this range should settle their tax between Hamle 1-Tikemt 30 each physical year. Schedule is on the other hand including in the range of 100,000-500,000ETB and it has to be settled between Hamle 1 - Nehasie 30 of each year based on financial stamen and audit report. The last category which is schedule C encompasses tax payers below 100,000 ETB and it should be settled Hamle 1-30.

## **CHAPTER FOUR**

### **SUMMARY, CONCLUSIONS AND RECOMMENDATIONS**

The previous chapter presented the result and analysis of the study. This chapter provides the summary, conclusions and recommendations in line with the findings of the study. The chapter is structured in to two sections. The first section deals with the conclusion whereas the second presents some recommendation suggested as a solution to problem which is identified in the study.

#### **4.1 SUMMARY**

The study was conducted to answer the research question what procedures used by the branch to collect VAT, what is the level of awareness of tax payers and tax officer and the how the branch administrative VAT. To answer the research question the study has done extensive literature review structured based on the objective of the study which is followed by a systematic research methodology to determine the sample size, the way data to be collected and the method of analysis to be used to analyze the data through questionnaire survey and structured interview with the branch office.

Accordingly the research identified that both ERCA employees and Tax payers has better understand on the importance of VAT towards the development of the country. From the research it can also be concluded that there is better level of awareness on the way VAT collection is implemented among employees, however the level of awareness by the VAT payers is less as compared to employees. Besides this unable to get consistent information and the difference they employees and tax payers understand the level of implementation of VAT within the branch office are some of the reasons for low level of awareness. Because of this and other reasons identified in the study, the VAT collection practice within Merkato No.1 branch has a lot of problem, the major problem in VAT collection are inefficient collection VAT system, poor controlling mechanism in implementing the VAT collection processes of the center & lack of awareness among tax payers, improper way of disclosing their income and lack of manpower & experienced staff are some of the main challenges in VAT collection process in the branch.

According to employee's response unable to attend a serious of awareness creation consultative meeting organized by Ethiopian revenue and customs authority (ERCA), knowledge and skill gap about VAT Administration process, being careless and lack of attentions are some of the causes which results in less awareness.

The above problem in turn bring a lot of impacts on VAT payers; some of the these are lack of confidence in implementing their business as a result of unclear and inconsistent system among Tax payer which results in subjective way of treating Tax payers and affects competition among tax payers in undertaking their business, this in turn results affects the end users or the public at large since there will not be fare completion among various tax payers.

In order to minimize these problems respondent recommends ERCA to device a mechanism to improve the level of awareness and identify/study the root causes of the problem in order to bring a tangible solution.

## **4.2 CONCLUSION**

Analyzing the data obtained from employees through questionnaire survey, the research concluded the following:

Majority of the ERCAs employees and VAT Tax payers well understand the importance of VAT towards the development of the country. From the research it can also be concluded that there is better level of awareness on the way VAT collection is implemented among employees, however the level of awareness by the VAT payers is less as compared to employees.

One of the main reason for this less awareness is Tax payers don't have consistent level of awareness and inconsistent sources of information about VAT implementation. Because of this and other reasons, the VAT collection practice within Merkato No.1 Branch becomes in efficient and faces a lot of problem, the major problem in VAT Collection are weak collection system and controlling mechanism of the center & lack of awareness among tax payers, improper way of disclosing their income and Lack of manpower & experienced staffs are some of the main challenges in VAT collection.

According to employee's responses unable to attend a serious of awareness creation consultative meeting organized by Ethiopian Revenue and Customs Authority (ERCA), knowledge and skill gap about VAT Administration, being careless and lack of attentions are some of the root causes which results in less awareness. The above problems in turn bring a lot

of impacts on VAT payers; some of these are lack of confident in implementing their business as a result of unclear and inconsistent system among tax payers which open a chance for subjective way of treating Tax Payers and affects the competition in the market.

### **4.3 RECOMMENDATIONS**

In line with the findings and conclusions made the researchers gives the following possible recommendation forwarded as being important to the tax payers office of Merkato No.1 branch office for taking corrective action on the observed problems.

- ERCA has to device a means that improve the level of awareness of Tax Payers about the implementation of VAT, apply a consistent procedure among all tax payers and ensure proper controlling mechanism.
- ERCA shall also consider an option of hiring more experienced staffs to narrow the knowledge and skill gap of employees who are responsible in VAT assessment and collection processes.
- To identify the root causes of the main problems in Tax collection Processes, ERCA has to conduct a research provide appropriate solution in accordance to the finding of the research

# Reference

Bhatin, H.L.(1994). Public Finance (18<sup>th</sup> Revised Edition). New Delhi: Viskas Publishing House PVT Ltd.

Council of ministers, 2002, value added tax proclamation no 79/2002, Negarit Gazetta, FDRE.

Council of ministers, 2002, value added tax proclamation no 285/2002, Negarit Gazetta, FDRE.

Warnest and Young (1995) VAT and sales Taxes World Wide: A guide to practice and proclamation is 61 Countries, John will and Sons, England Ebrill L, Keen M, Bodin J, and Summers V, (2001) The Modern VAT, IMF, Washington.

ERCA (2010) revenue performance reports during 2007-2010) (Unpublished

Encarta (2009), “Value Added Tax”

IMF (2003) Social impacts of a tax Reform: The Case of Ethiopia, Working Paper, and WP/03/232: Washington.

MOR (2004) Ministry of Revenue Working Paper, Implementation of VAT in Ethiopia, Addis Ababa

Addis Ababa City Gov.

Misrak Tesfay (2008) Ethiopia Tax Accounting Theory and Practice ( 1<sup>st</sup> Edition) Addis Ababa, Ethiopia

Representatives, value Added Tax proclamation No 285/2002, Birhanina Selam Printing press, Addis Ababa

Rosen H, S, (2011) Challenges of VAT administration in Arada Sub city of Addis Ababa city administration



# ANNEX

## Questioner