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# Perceptions of VAT Compliance in Ethiopia

Summary of ATAP Working Paper 11 by Worku Tamrie Atnafu, Gebregziabhere Gebretsadik Kalayou and Assefa Gezae Huluf

## What is VAT compliance?

Tax is a major source of government revenue. Many countries prioritise mobilising domestic resources to finance government spending. However, many factors influence the revenue generated by taxation, including the population's level of compliance with tax expectations. A country's ability to raise funds from tax depends on the level of tax compliance. Tax compliance refers to complex attitudinal issues towards all types of tax.

This paper explores attitudes to compliance with value added tax (VAT) among those registered for VAT in Addis Ababa, Ethiopia. There is a high possibility of non-compliance with VAT for several reasons. These include how often tax returns have to be completed, numerous calculations that have to be done along with evidence that need to be produced, and complications in the system of refunds and exemption.

There is also an opportunity for fraud, as the VAT system relies on proper processing and compliance by multiple vendors in a supply or purchasing chain, supported by paperwork from each stage. VAT is different from other taxes in ways that might matter for tax compliance attitudes. One of these is that the taxpayer is not necessarily an individual, but acting within a business. Another is the high visibility of other businesses' behaviour through the need for them to produce VAT invoices or receipts. In this sense companies can be tax-compliant in two ways – in producing or issuing the required invoices, and then filing their tax return and paying tax owed. The objective of our research was to assess perceptions of VAT compliance in Ethiopia, with a specific focus on the different activities of VAT invoicing and filing of VAT returns.

The study used a mixed research approach with both quantitative and qualitative elements with different audiences and research participants. The quantitative aspect of the study consisted of a survey of VAT-registered taxpayers at three branch offices of the Ethiopian Revenues and Customs Authority (ERCA) in Addis Ababa – the Large Taxpayers Office, and the East and West Medium Taxpayers Offices. We randomly selected a sample of 1,060 VAT registrants out of the total of 23,114 registrants in the three branch offices. We used a structured survey instrument that asked questions about respondents' characteristics, their perceptions of VAT filing and invoicing compliance, their perceptions on a number of issues identified in other studies to be linked to more tax-compliant attitudes, and the challenges people saw in successfully complying with VAT requirements. The questionnaire largely used five point Likert scales to identify attitudes and opinions of varying strength. The qualitative component of the study used one-on-one interviews and focus group discussions. These were supplemented with documentary review of various ERCA reports and relevant laws.

## Theories and models

There are many different models and theories used to explain the different factors that shape the perception and attitude of taxpayers towards paying taxes in general, and VAT in particular.

In relation to VAT, one of the factors suggested as lowering compliance is the administrative burden on taxpayers, and technical complexity of completing an accurate and regular tax return.

These theories about taxpayers balancing the relative costs of paying or not paying taxes owed can be characterised as *economic deterrence*

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theories. Fiscal exchange theory states that compliance will be higher if the taxpayer believes and trusts that the government is providing sufficient goods and services for the 'price' of their taxes.

Several scholars have suggested approaching the issue of what drives tax compliance from more social, cultural and psychological perspectives. The *comparative treatment* theory suggests that if taxpayers believe the government treats them fairly, tax compliance will increase. Willingness to comply might increase if there are severe social sanctions against non-compliant taxpayers, as taxpayers value their relationship with others. Reviewing the theoretical and empirical literature on this topic, we conclude that many existing theories could be applicable to VAT compliance.

## Findings and implications

We found evidence to support a number of existing theories on factors that are associated with more tax-compliant attitudes in other countries, and with other types of taxation. We have also gained new insight into factors that are particularly important for VAT compliance.

The results of data obtained from different sources and analysis of factors identified from the literature review revealed a number of key findings. Overall, we consider that we have found *evidence of low tax compliance attitudes* in relation to VAT. Whilst a majority of our survey respondents felt that avoiding VAT payment was wrong and punishable to some degree, a significant proportion disagreed. Moreover, we found a view that dishonest filing was relatively common, and that there is a high prevalence of false VAT invoices. A significant number of our respondents felt that VAT registrants would only comply with VAT requirements if they feared enforcement action by ERCA.

We also discovered a perception that a sizeable proportion of the business population is willing to comply with VAT requirements, but do not do so for various reasons. This suggests to us that action by ERCA may be able to increase tax compliance. We found that many of our respondents and colleagues working in the tax authority agreed that processes for filing tax returns and complying with VAT laws in this respect were over-complicated and not easy to comply with. These 'costs of compliance' factors may be reducing compliance if those

that should pay VAT are weighing these against the possibility of being sanctioned for non-payment, and also potentially negatively affecting perceptions of ERCA's performance.

We found a widespread perception that it is difficult to get VAT invoices from suppliers, and that customers do not request VAT invoices. This does not encourage taxpayers to issue VAT invoices, making filing more complex and influencing their perception of compliance levels and social demand for compliance. As VAT is collected at each stage of value addition, the proper issuance of invoices is required at all stages. Our findings identified that manufacturers and importers are not properly issuing VAT invoices for their wholesale or retail customers. This may cause wholesalers or retailers not to issue VAT invoices, and to perceive tax compliance as low.

We found that a significant number of our VAT registrants did not believe that VAT income was used by the government to provide public goods. We also found that holding the view that ERCA treats taxpayers without discrimination was associated with perceptions of higher compliance. ERCA may want to consider how its fair treatment of different groups of taxpayers might be emphasised in its communications and public profile.

We suggest that ERCA needs to develop and implement a better compliance management policy and strategy, which allows tracking and investigation of taxpayers' compliance history. Such a strategy could help encourage taxpayers and the general public towards greater tax compliance. ERCA may want to focus public awareness-raising around VAT compliance. ERCA could consider how to emphasise fair treatment of different groups of taxpayers in its communications and public profile. We suggest there is potential for ERCA to modernise core VAT processes, including filing and invoicing, so that they are more cost-effective. Digitalisation through an e-filing system should be fully applied across branches.

This study has allowed in-depth research into factors underlying VAT tax compliance among businesses in Addis Ababa. It has identified a number of key issues to address, and ways in which ERCA can intervene to alleviate these issues. Potentially this could lead to more local revenue being generated from VAT in Ethiopia.

## Further reading

**Citation:** Tamrie Atnafu, W; Gebretsadik Kalayou, G; Gezae Huluf, G. and Anderson, C. (2019) *Perceptions of Value Added Tax Filing and Invoicing Compliance in Ethiopia: The Case of Three Federal Branch Offices in Addis Ababa*, ATAP Working Paper 11, Brighton, IDS

## Credits

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