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**AN ASSESSMENT OF VALUE ADDED TAX ADMINISTRATION
IN ARADA SUB CITY**

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JUNE 2014

ADDIS ABABA

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

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, 2007:14), In Ethiopia, According to negarit gazeta the 15th year No. 6 (78/94:24)one of the focuses of the tax policy reforms was reforming indirect taxation (VAT). The main reform to indirect taxation was the introduction of a VAT in January, 2003 as a replacement to Sales Tax According to-2003 income tax proclamation 1. Compared with the replaced sales tax, the new VAT has the advantages of, 1) Taxes services in addition to production, 2) Grants zero rating to exports and 3) Gives exemption 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 collection 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. Tax operating costs are costs incurred by the private and public sectors while the tax system is in operation. Tax operating costs encompass both administrative and fulfillment costs signifying broadly the public and private sectors costs respectively. A high level of tax compliance costs may discourage voluntary compliance. On the other hand, very low tax administrative costs may imply that tax authorities are not equipped with the necessary human and physical resources which, in turn, may impact on the capability of tax administrations to carry out the responsibilities entrusted to them. The VAT administration is poor due to many factors, particularly incapacity of tax authorities to implement the attributes of the tax to practice. The same is true for Arada Sub City, Addis Ababa, where reports indicate that most of the VAT registrants are nil and credits filers Wollela (2008:1).

The Ethiopian revenue and customs authority (ERCA) is the body responsible for collecting revenue from custom duties and domestic taxes in addition to raising revenue; ERCA is responsible to protect the society from adverse effects of smuggling illegal objective of the Authority.

The Objective, Vision and Mission of ERCA are the Following

S To establish modern revenue assessment and collection and provide consumers with equitable efficiency and quality service.

S To cause tax payers voluntary discharge tax obligation and

S To collect timely and effectively tax revenues generated to the economy.

Vision

To be a leading fair and modern tax and customs administration in Africa by 2020 that will finance government expenditure through domestic tax revenue collection.

Mission

Ethiopian Revenue and Customs Authority will contribute to economy development and social welfare by developing a modern tax and customs administration that employees professional and highly skilled staff that promote voluntary compliance amongst *individual and business, and take swift action* against those who do not comply.

Values

Ethiopian Revenue and Customs Authority will understand its customers and their needs treat them with trust and respect and help them meet their obligations. We will set with integrity, transparency and professionalism, and enforce customs and tax related laws we will work closely with stakeholders and insure the participation of women.

Addis Ababa has 10 sub cities and each sub city is divided into ‘Woredas’, which are the smallest administrative units of the city. Arada Sub City, which is one of the sub cities found in the Eastern part of Addis Ababa. The sub city has 10 ‘Woredas’ under Ethiopian Revenue and customs Authority. 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. The Branch office is led by manager who reports to Head office. In general this branch office has 283 Employees, among them 187 are female and the rest are male.

1.2. Statement of the Problem

The Addis Ababa City collects taxes from individual taxpayers and belongings in its territory. However, the Proclamation No. 285/2002 authorized the Federal Inland Revenue Authority (FIRA) to administer the VAT. For simplicity, FIRA delegated regions and city administrations to collect the tax from their own taxpayers started from September 2004 (FIRA, 2004:103). In Addis Ababa due to VAT administration problems, the City Revenue Authority cannot collect the potential tax which the city can generate. For instance, among the ten sub cities the Arada Sub City Revenue Office quarterly Report (July -December 2013), shows among 4,411 VAT registrants those filled returns, on average, 400 of them are nil fillers. In addition to this, if we compare the gap between the amount of VAT collected and refund claimed in the same period, on average, in each month, 1317 registrants paid in cash, whereas 1650 registrants claimed for refund. Starting from January 2011, based on the agreement concluded between the Addis Ababa City Administration (AACAA) and the Ethiopian Revenue and Customs Authority (ERCA), the ERCA started to administer all taxes in Addis Ababa (ERCA, 2011).

The huge refund claim and the huge number of nil filler are some of the signs for low voluntary compliance of the VAT registrants, weak audit and enforcement performance of the tax office. This shows that the Arada Sub City Revenue Office, now called Arada Sub City Small Taxpayers Branch office is not effective in VAT administration so that it is unable to collect the potential tax from VAT registered individual taxpayers as well as unregistered potential taxpayers in the sub city. This is the problem that needed to be studied. Therefore, on the basis of theoretical and empirical framework the research assessed the effectiveness of the Arada Sub City Revenue Office in administering VAT to yield adequate revenue for the city treasury and to foster voluntary tax compliance. Unfortunately, there is no recorded study that has been conducted in the sub city to explore reasons behind under potential revenue collection and low voluntary compliance of VAT registrants.

1.3 Research Questions

The study attempted to answer the following research questions.

- > What are the trends of Arada Sub City Revenue Office is administering VAT in the last five years?
- > Have Arada Sub City Revenue Office been satisfactorily monitoring and auditing VAT registrants?
- > What are the major factors which hinder Arada Sub City Revenue Office to monitor and audit VAT registrants?

1.4. Objectives of the study

The general purpose of the study is to identify the major constraints against the successful administration of VAT in Arada Sub City Revenue Office, and there by it provides the basis for effective VAT administration. In doing so, the office can yield adequate revenue for the city in near future and enable to increase the number of voluntary taxpayers.

1.4.1. General Objective

The general objective of this study is to assess the effectiveness of the VAT administration at Arada Sub City Revenue Office with a view to improve revenue collection through voluntary compliance by taxpayers.

1.4.2. Specific Objectives

The following specific objectives are pursued.

- > To review the last five years VAT administrative activities of Arada Sub City Revenue Office.
- > To identify the monitoring and auditing of VAT registrant in Arada Sub City Revenue Office.
- > To list out the major factors that hinders Arada Sub City Revenue Office to monitor and audit VAT registrants.

1.5. Significance of the Study

The study helps:

- > To fulfill the requirement for student our researchers Bachelor Degree and up grading our research skill.
- > It helps us to have a practical experience for applying student researchers' research knowledge in the administration of VAT by the Sub City.
- > This paper can help for other researchers as reference for further studying related to VAT assessment in Arada sub city small tax payer branch office.

1.6. Delimitation/Scope of the Study

The study focused particularly in the case of Ethiopian Revenue and Customs Authority Arada Sub City Small Taxpayers Branch office. In terms of “VAT administration”, it only deals with administrative activities; taxpayers identification and registration, collection, audit and enforcement. The study not deals with assessing administrative organs (who administer the tax?) and assessing the mode of organization.

In examining the constraints in terms of administrative activities, the study only assessed the effectiveness of the sub city in administering the VAT.

1.7. Research Design and Methodology

1.7.1. Research Design

A research design is a conceptual structure that shows how all the major parts of the research project come together. According to Kothari (2004:31), research design is to provide for the blueprint for the collection, measurement and analysis of data. In this paper in order to get the target of the specified objective, the study uses a descriptive design method which considers both quantitative and qualitative studies.

1.7.2. Population and Sampling Technique

The research considers the tax officers which are devoted to the day to day activities in ERCA Arada sub city branch are selected as a population. Totally there are 3300 active VAT registrants as of October 2013 in the Arada Sub City. Regarding the tax officials, according to the employee registry of the Sub City there are 283 of which 80 of them are tax officers in the Sub City Revenue Office as of December 2013. Therefore, the population is 3300 VAT registrants and 80 tax officials. From the total population of the tax officers of 80, data is collected from 20, 18 employees for questionnaires and 2 coordinators for interview. From the total population of tax payers, data is collected from 150 who are engaged in various business areas in Arada sub city.

The study is based on sampling basis. The sample respondents are selected by using non-probable sampling i.e. convenient sampling method for tax payers and simple random sampling method for the branch office employees.

From the total population of the VAT registered tax payers of the sub city and employees of the branch office, we selected about 170 (150 and 20 from both VAT registered tax payers and employees of the branch office respectively) samples using convenient sampling and simple random sampling techniques. We select this sampling method because it is more reliable, valid as well as each individual (respondents) has equal probability of being selected and the sample can be generalized to the larger population and they have experienced the centered observable fact.

1.7.3. Types of Data to be collected

The study uses both primary and secondary data. As primary data source the VAT registrant tax payers, the tax officials and managers in the Arada sub city office are preferred. VAT related documents were used as secondary data, to analyze the VAT collection trends.

1.7.4. Data Collection Tools

The primary data would be collected mainly through Self administered questionnaire and structured interview would be used to gather information from the sample population. Questionnaire and interview made with tax officers and tax payers. The questionnaire would be consisting both closed and opened questionnaire and the interview would holds predetermined

and structured questions. Those would be designed to address VAT administration problems and to assess tax payer's attitude. The questionnaire and interview would prepare to ERCA employees for tax payers only questionnaires. Secondary source of data will be obtained from published and unpublished documents; like tax proclamations directives and deferral documents issued by ERCA and other organizations. And also for further information source various data and websites are visited.

1.7.5. Data Analysis Method

It is easy to work and available, data processing and analysis procedures were undertaken by computer using Microsoft excel program. It helps to minimize errors that occur during data processing. In data processing categorizing variables was done manually. Describing data was processed and analyzed through listing the answers for a particular question.

1.8. Limitations of the study

Associated with restructuring of the Arada Sub City in March 2014, there was re shifting and training of tax officials. This created work overload on the remained tax officials and poor service delivery to taxpayers so that there was unwillingness from some respondents. To overcome the problem we had to wait for convenient time, however, all of the questionnaires were filled out on time

Time constraint and lack of willingness to participate on behalf of the taxpayers were some of the problem faced by the student researcher.

1.9. Organization of the Study

This paper organized in four chapters to give coherent flow of ideas to the basic findings. The first chapter explain about the general introduction of the research; the second chapter covers the review of related literature; third chapter shows the analyses of data collected by questionnaire and interview and also, from secondary sources. Finally, the last chapter brings the study to an end with findings, conclusions and recommendations respectively.

CHAPTER TWO

REVIEW OF RELATED LITERATURE

2.1. Tax Related Concepts

According to Gebrie (2008:16), tax system that includes the following two types of tax system in the world.

- > **Global Tax System:** is a tax system in which tax is computed on aggregate of all income and losses that the taxpayer derived from different sources in the world. The loss incurred in a certain business is offset by income on another business and tax is computed on the final balance.
- > **Schedule Tax System:** is a tax system in which tax is computed on separate schedule. The loss incurred in a certain business is not offset with income on another business and tax is computed on each type of schedule. Most countries including Ethiopia use schedule tax system.

2.2. Objectives of Taxation

Initially governments imposed taxes for three basic purposes: to cover the cost of administration, maintaining law and order in the country and for defense. But now government's expenditure pattern changed and gives service to public more than these three basic purposes and it restore social justice in the society by providing social services such as education, public health, employment, pension, housing, sanitation and other public services. Therefore, government need much amount of revenue than before. To generate more revenue a government imposes taxes of various types. As stated by Gebrie (2008:16) and Misrak (2008:6) objectives of taxation are:

- > **Raising revenue:** to render various economic and social activities, government needs large amount of revenue and to meet this government imposes various types of taxes
- > **Minimize income and wealth inequality:** to narrow the gap between the rich and the poor most government adopt progressive taxation system. In such system the higher income group pays more amount of tax, the middle income group pay low or lower amount of tax and lower income groups are exempted from tax. Then the tax collected

from the higher and the middle groups are used by the government to subsidize the lower income groups and unemployed.

- > **Ensuring economic stability/Stabilize Economy:** taxation affects the general level of consumption and production. Hence, it can be used as an effective tool for achieving economic stability. Governments use taxation to control inflation and deflation.
- > Governments use taxation to control inflation and deflation pressure during inflation period governments may increase the existing tax rates or impose additional taxes to reduce the abnormal (excess) demand. During deflation period governments may reduce the existing tax rates or remove certain taxes to increase demand and encourage business activities. Thus taxation has role in economic stabilization.
- > **To discourage the consumption of harmful products:** by imposing high heavy tax on harmful products that worsen peoples' health such as tobacco and alcoholic products , governments can reduce the consumption of such products for instance, in Ethiopia case tobacco products are subject to 20% - 75% excise tax. Alcoholic products are also subject to 50% - 100% excise tax imposing heavy taxes on such product. Increase their price and the majority of society may be discouraged to buy this products.
- > **To reduce regional imbalances:**
To reduce regional imbalances with in a country, governments may give tax exemption or recession to those investors who want to invest in relatively less /under developed regions for instance the Ethiopian government gives additional years tax exemption to those investors who are interested to invest in reality less developed region of the country such as Gambella, Somalia and Afar region.
- > **Capital accumulation:** Tax concession or tax rebates given for savings or investment in provident funds, life insurance, investment in shares and debentures lead to large amount of capital accumulation. This is essential for the promotion of industrial development.
- > **Creation of employment opportunities:** Governments might minimize unemployment in the country by giving tax concession or exemption to small entrepreneurs and labor-intensive industries.
- > **To promote private investment:**
Through the provision of tax exemption, tax recession (reduction) and tax holiday, governments promote private investment in their countries in Ethiopia the government

grants exemption on business profit tax and customs duty associated with investments on an approved manufacturing and agro industry from 2-8 years, depending up on the location in which the investments are under taken.

- > **To enhancement of standard of living:** By way of giving various tax concessions to certain essential goods such as medical equipments, governments may enhance standard of living of people.
- > **Encouragement of exports:** Governments enhance foreign exchange requirement through export oriented strategy. These provide a certain tax exemption for those exporters and encourage them with arranging a free trade zones and by making a bilateral and multilateral agreement.

2.3. Principles/canons of Taxation

According to Misrak (2008:23), the principles/Canons of taxation include the following points.

Principles of taxation refer to the appropriate criteria to be employed in developing (devising) and evaluating a good tax structure/system of a country. Tax authority must follow certain code of conduct in the form of principles of taxation while determining the type and amount of tax. Adam Smith, who was perhaps the first writer to attempt a general statement of the principle of taxation and most rather economists believe that a tax system should be based on the following principles of taxation to be the good tax system.

- > **Equity/Fairness principle:** states that similarly situated tax payers should be tax similarly. This principle takes two forms: horizontal equity and vertical equity. Horizontal equity states that tax payers in equal position or with equal ability to pay the same amount of tax. For instance, if two persons both have income of, say, Br. 2,000 each, then horizontal equity requires the two persons to pay the same amount of tax regardless of their position. On the other hand, vertical equity implies that tax payers with greater ability to pay more amount of tax. This in other words means tax payers in unlike circumstances should be treated differently. For instance, there is no ground to levy the same amount of Br. 2,000 and the other person earning Br. 3,000. This is the essence of vertical equity. The progressive tax rate structure is founded on the vertical equity. The progressive tax rate structure is founded on the vertical equity premise.

- > **Certainty Principle:** states that taxes should not be arbitrary and based on relationship rather it should be based on statutory bases. Therefore, taxes not to be arbitrary and not to be based on relationship, a tax law should specify,
 - How the amount of tax that due is determined,
 - How tax is to be paid (the method of payment), and
 - When the tax is to be paid (period of payment).

A certain tax ensures a stable source of government tax revenue through tax planning.

- > **Simplicity principle:** states that as complex tax system may result in error (due to failure to understand the tax laws), tax evasion (violation of tax laws) and disrespect for the system, tax laws should be simple and clear to understand by the tax payers and they should not be confronted with accounting, administrative or other difficulties.
- > **Convenience Principle:** also called convenient for payment principle, states that taxes should be due at a time and in a manner which is most likely convenient for tax payers. In other words, the period of tax payers (not in such a manner). For, instance, the government of Ethiopia collects employment income tax from tax payers (employees) at source, i.e., when they receive salaries from their employers. Similarly, the best time for the collection of land tax should be the time for the collection of land tax should be the time of harvest.
- > **Efficiency/economy of collection principle:** states that the costs to collect taxes should be kept as minimum as possible for both the government and tax payers. Governments incur administrative costs such as for hiring tax collectors to gather tax revenues, data entry clerks to process tax returns, auditors to respect questionable returns, lawyers to handle disputes, and accountants to track the flow of money. Tax payers also incur cost of taxation to comply with the tax system such as costs to workers (accountants, tax lawyers and tax preparers),s for record keeping, and non-compliance appeal. Therefore, efficiency theory implies that government administrative costs and tax payers cost of taxation should be as low as possible.

- > **Neutrality principle:** states that a tax system should be free from bias. A tax system to be free from bias,
 - Incomes of tax payers from different sources should be taxed without;
 - The decisions of tax payers to undertake transactions should not significantly be affected by the tax system;
 - The tax system should not create any inflationary or deflationary effects in the economy (or taxation should not create distortion on economy), and
 - The government should not collect too much tax just to finance its operations or should not collect too little tax just to favor tax payers.

- > **Economic growth/Buoyancy Principle:** states that a tax system should not impede or reduce the productive capacity of an economy by overtaxing. For instance, a tax system should not significantly affect international competitiveness, investment, and production like labor supply. Viewing the concept from the other angle, a tax system should be in line with the economic growth policy of a country and should have an inherent tendency against the economy goals and policies of the government. Economic growth principle highly reflects the theory of neutrality.

- > **Transparency and Visibility Principle:** This implies that tax payers should know that a tax exists why tax exists, and how tax is imposed on them. When tax payers are aware of a tax and the change in their liabilities that result from specific transaction or events, they can compute the true cost of the transaction and identify who ultimately pays the tax. In addition, it is the responsibility of the government to let perform its essential services, and one means to acquire those resources is through the collection of tax revenue.

- > **Appropriate government revenue Principle:** implies that taxes should be predictable by government, meaning, a tax system should enable a government to predict (determine) how much tax revenues will likely be collected and when so as to undertake its budgeting and appropriation process accurately.

- > **Minimum Tax gap Principle:** A tax system should be structured to minimize tax gap/non-compliance. Tax gap exists if the actual tax owed (tax imposed) is not the same as the tax voluntarily paid by tax payers. Mathematically, it is expressed as follows:

$$\text{Tax Gap} = \text{Tax actually owed (Imposed)} - \text{Tax voluntarily paid}$$

(Or)

$$\text{Tax Gap} = \text{Tax that should have been paid} - \text{Tax already paid}$$

Tax gap may occur due to,

- i) Intentional errors such as overstatement of expenses, understatement of taxable revenues, omission of taxable transactions, not declaring total taxable revenues, etc.
- ii) Unintentional error such as mathematical mistakes, failure to understand tax laws (rules and regulation), error in tax assessment, etc.

In order to avoid or at least minimize tax gap, a tax system should be certain, simple, neutral and transparent; clear penalties (refund) should be set in the tax laws if tax gap exists.

2.3.1 Other principles/Canons of Taxation

In addition to the aforementioned ideal principles of taxation, the following principles of taxation have also been developed by various gnomists

- > **Elasticity/Fiscal adequacy principle:** a tax system should be able to yield enough revenue for the government and at the same time should not discourage productivity in the short as well as in the long run.
- > **Diversity/Variety Principle:** state that a government should not depend on only too low tax sources and also a tax system should not consist of too many tax sources. It is risky for a government to depend up on too few sources of public revenue since such a system is bound to breed a lot of uncertainty and the treasury. Too much multiplicity of taxes also should be avoided since it leads to unnecessary burden on the society in the form of additional administrative expenses. It also isolates the principle of economy of collection.

- > **Co-ordination Principle:** says that if taxes are levied by both the federal and regional governments, there should be co-ordination between those authority as to what type of taxes are imposed and collected by the federal (central) government, by regional (state) governments and by both the federal and regional governments.

- > **Expediency Principle:** in accordance with this canon, tax should be based on certain well founded principles so that it may need no justification from the side of the government, and tax payers should have no doubt about its desirability. In other words, taxes should be levied after considering all favorable and unfavorable factors from different angles such as economical, political and social factors.

- > **Equality of benefit/Equality Principle:** According to this principle, every tax payer should contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; this is, in proportion to the revenue, which they respectively enjoy under the protection of the government. In other words, this principles state that the burden of taxation should fall on the people according to the benefit received by them form the government. Viewing it from the other angle, the principle implies the desirability of imposing taxes on the individual according to the benefit which they enjoy from the government action. The principle naturally proclaims the justice of “do not take more than you give.”

2.4. Classification of Taxes

Governments impose many types of taxes. In most developed countries individuals pay income taxes when they earn money, consumption taxes when they own a home or land, and in some cases estate taxes when they die. In general, in terms of the relationship between the nature of taxes and the reason for payment, taxes classified as direct tax and indirect tax (Gebrie, 2008:18).

2.4.1. Direct Tax

According to Dalton, Direct taxes are those which are paid entirely by those persons on whom they are imposed. Direct taxes are those taxes which can't be shifted to others (Gebrie, 2008:28).

Direct tax may be through of as a tax an individual or business and direct taxes as taxes on transaction involving goods and services. Under this classification approach direct tax include

taxes on personal and company income as well as a payroll taxes, social security taxes and property and wealth.

The direct taxes include:

- > Employment income tax,
- > Business income tax,
- > Rental income tax, and
- > Taxes on other incomes include:
 - S Tax on income from rental of property
 - S Tax on dividend income
 - S Tax on income from games of chance
 - S Tax on interest income on deposit
 - S Tax on income on royalty
 - S Tax on gain on transfer of certain investment property/ capital gain
 - S Tax on income from rendering of technical service
 - S Agricultural income tax, and
 - S Land use tax

2.4.1.1. Merits of Direct Taxes:

According to Gebrie (2008:29) the following are merits of direct taxes.

- 1. Equitable:** direct taxes such as income tax are equitable because it is based on the principle of progression.
- 2. Certainty:** Direct axes satisfy the canon of certainty. The taxpayer is certain as to how much he/she is expected to pay, and similarly the tax collector is certain how much it receive.
- 3. Reduce inequalities:** Direct taxes are progressive in nature and therefore, rich people are subject to higher rates of taxation, while poor people are exempted from direct tax obligation.
- 4. Elasticity:** Elasticity in direct taxes implies that the government collects more revenues simply by raising the rate of taxation.

According to Gebrie (2008:29) the following are demerits of direct taxes.

- 1. Inconvenience:** Tax payers should submit the statement of total income along with the source of income from which it is derived. Thus, it is additional task to tax payers.
- 2. Evasion:** Direct taxes are certain and taxpayers know the rate of tax they have to pay, therefore, awareness of tax liability tempts the taxpayers to evade tax. It is a fact that people in higher income groups do not reveal their full income.
- 3. Arbitrary:** Direct taxes are found to be arbitrary because there is no logical or scientific principle to determine the degree of progression in determining tax brackets. Tax rates are determined on opinion of tax authority. They are likely to underestimate or overestimate taxable capacity of taxpayers.

2.4.2. Indirect Tax

Indirect tax is a tax in which the burden may not necessarily be swallowed by assesses, which means indirect taxes can be shifted on to other person. Generally the tax incidence of indirect tax is on ultimate consumer; however, sometimes seller might absorb such indirect tax to be competitive in market. This action reduces its profit. Indirect taxes are taxes that are lived up on commodities before they reach the customer who ultimately pay the tax as a part of the market price of commodity. Indirect taxes included domestic taxes such as excise tax and taxes on international trade, such as import duties and export taxes (Gebrie, 2008:28).

Indirect taxes as explained by Misrak (2008:20) are classified as follows:

- > Value added tax (VAT).
- > Turnover tax
- > Excises tax.
- > Custom duties.
- > Sur-tax.

Note:- Stump duty is neither direct nor indirect tax in Ethiopia (Misrak, 2008:20)

According to Gebrie (2008:29) the following are merits of indirect taxes.

1. **Convenient:** Indirect taxes are convenient to pay. They are paid in small amounts instead of in one lump sum so that the burden of these taxes is not felt very much by the taxpayer.
2. **No Evasion:** Indirect taxes are generally difficult to be evaded, as they are included in the price of a commodity. One can avoid an indirect tax only if he/she decides into purchase such commodity.
3. **Elastic:** Government may increase revenue if the tax is imposing on commodities that are elastic.
4. **Broad coverage:** In indirect tax every member of the community can be taxed so that everyone may contribute something to finance public utilities.
5. **It can be progressive:** Indirect taxes can be made progressive by imposing heavy taxes on luxuries and exemptions of those commonly consumed products.

2.4.2.2. Demerits of Indirect Tax

According to Gebrie (2008:29) the following are demerits of indirect taxes.

1. **Regressive:** In direct taxes are regressive in nature, as they fall more heavily upon the poor than the rich.
2. **Administrative cost:** The administrative cost of indirect tax is generally heavy as they have to be collected from large number of people in small amounts. The government hires number of inspectors to check records of sellers.
3. **Discourage saving:** Indirect tax discourage savings because they are included in the price of a commodity and people have to spend more on essential commodities.
4. **Uncertainty:** It is uncertain because the tax authority cannot certainly estimate the total yield from different taxes.
5. **Creation of inflation:** prices of taxed goods keep on rising without any reduction in the purchasing power in the economy, thus indirect tax may create inflation.

2.5. Meaning of Value Added Tax (VAT)

Different authors who wrote about the tax have defined Value Added Tax (VAT), which is also known as Goods and Service Tax (GST) or consumption of Tax, in the following different ways and from different sources.

- o VAT: is may be defined as a consumption/expenditure tax charged on the value added goods and services by importers, manufacturers and traders at each stage of the production and distribution process (Misrak, 2008:303).
- o VAT: is work on the assumption that value is added at every stage, and taxes should be levied on amounts of value added (Encarta, 2009).
- o VAT: is tax on the consumer expenditure, It is collected on business transaction, Imports and acquisition, Despite its name the VAT is not general intended to become consumption. Its essence is that it is charged at all stage of production, but with the provisions of some mechanisms enabling firms to offset the tax they have paid on purchase of goods and services against the tax they charge on their sales of goods and services (Erbil, 2001:1).
- o VAT: is the tax on the value added on goods in the process of production and distribution (Sundharam and Andley, 2003:195).
- o VAT: is an indirect tax levied on domestic consumption of goods and services and imported goods (MOR working paper).
- o VAT: Is a tax on consumption lived whenever the value of goods and services increased as they change hands in the course of production, distribution and final sale to the consumer (Encarta 2009).

2.6. History of VAT

Emergence and rapid spread of VAT is one among the most important tax developments of the latter twentieth century. VAT was invented in 1954 by French economist Maurice Laurie who was joint director of the French Tax Authority. France was the first country to introduce VAT effective from April 10, 1954. By 1969, only eight nations had adopted VAT, out of this Cote-Devour was the first country in Africa to introduce VAT in 1960. Since 1979, VAT has been adopted as the main form of an indirect tax by many countries around in different parts of the world. According to International Monetary Fund (IMF) report (2004) more than 4 billion 70%,

of the world's population now live in countries with VAT and VAT raises about \$18 trillion in tax revenue , roughly one-quarter of all government revenue. Nowadays among 190 countries of the world over 136 of (72%) of them have made VAT part of their tax system; and from 53 members of countries of Africa Union, 33(60%) of them have introduced VAT (Misrak, 2008:310).

2.7. VAT in Ethiopia

The federal democratic of Ethiopia (FDRE) has adopted VAT in to its tax system in 2003. It has been introduced on January 1, 2003, replacing the former sales tax system. The VAT proclamation no.285/2002 (VAT law) has been ratified by the house of peoples' Representatives six months before VAT implementation (July, 2002). This VAT proclamation has thirteen sections (13) and (66) articles. In December, 2002 the VAT regulation no. 79/2002 has also been issued by the council of Ministers pursuant to the value added tax proclamation for the implementation and regulation of VAT. (Misrak, 2008:319)

2.7.1. Objective of VAT in Ethiopia

According to Misrak (2008:320) the following are merits of direct taxes.

- ◆ To collect tax on the added value whenever a sales transaction is conducted
- ◆ To minimize the damage that may be caused by attempts to avoid and evade the tax and to ascertain the profit obtained by the tax payer.
- ◆ To enhance saving and investment as it is a consumption tax and does not capital.
- ◆ To enhance economic growth and improve the ratio relationship between Growth Domestic Product and Growth Revenue.

According to the newly implemented VAT law, supply of goods and rendition of services in Ethiopia are subjected to VAT at standard rate of 15% except those exempted and zero-rated supplies determined by the VAT law. The standard rate, 15% is applied only to imports and domestically manufactured goods. Unlike the sales tax, VAT provides th relief of tax in all inputs (taxable supply) including capital goods, operating and administrative expenditures. The relief of the tax and zero-rating also encourages investment and exports.

The VAT system that Ethiopia has implemented also gives exemption to basics and necessities such as education, medical service, electricity, water, kerosene, basic foods, transportation

service, fertilizer, books and printed materials, the supply of goods and services in the form of humanitarian aid etc.

2.8. Nature of VAT

According to Misrak (2008:305) VAT is characterized by the following features:

- VAT is a “*genera tax or comprehensive*” that applies, in principle, to all commercial activities involving the production and distribution of goods the provision of services.
- VAT is a “*consumption tax*” because it is levied on sales of goods and the provision of services rather than on income, wealth (capital) or saving.
- VAT is a “*broad based tax*” since the government collects such tax from all sectors, that is, from import, manufacturing, wholesalers and rental sectors.
- VAT is “a percentage of prices” which means, the actual tax burden is visible at each stage in the production and distribution chain.
- VAT is collected “fractionally” because each time the item changes hands in the process of production and distribution; the VAT is assessed on the incremental value.
- VAT is “neutral” because regardless of how many transactions are involved, VAT registered supplier can deduct from their VAT liability the amount of tax they have paid to the person on purchases for their business activities.
- VAT is an “indirect tax” because VAT is paid to a tax authority by the seller of the goods, who is the taxable person, but it is actually paid by the buyer to the seller as part of the price.

2.9. Types of VAT

According to Misrak (2008:309) In modern taxation world there are four types of VAT, namely, consumption, production, income, and wage VAT

- > Consumption VAT. In this type of VAT, the Firm is allowed to deduct from the gross value of its product not only the non-capital inputs purchased from other firms but also the capital equipment purchased. Thus, in consumption type VAT, tax base is the difference between gross value and total value of inputs purchased (capital and non-capital).

- > Production VAT. In the production type VAT, the value of the inputs purchased by the firm from other firms is not deducted in full. Only the value of non-capital purchase is deducted. Furthermore, no depreciation is permitted on the purchase of capital goods even in subsequent years. Thus, the tax base in production type VAT is equal to gross value of non-capital goods purchased.
 - > Income VAT. According to income type VAT, the firm is allowed to deduct the depreciation on the capital goods (during the year) apart from the full value of its non-capital purchases. Here, firms cannot deduct the entire value of the capital goods purchased during the year but they can deduct the respective amount of depreciation attributable to that year.
- A) Wage VAT. In wage type VAT, the firm is able to deduct the net earnings from its capital in order arrive at the tax base. It is unlike to be used for taxation by any government.

2.9. VAT Administration

Regarding the main issues of VAT administration, the Common Wealth Association of Tax Administration (2006:176) listed, “identifying taxpayers, processing returns, controlling collections, making refunds, auditing taxpayers, and leaving penalties are the main tasks that must be performed by the organization in charge of the VAT.” According to Gendron (2005:191 and Grandcolas (2005:191) cited in Wollela (2008,182), the key VAT administrative activities are; registration, collection, audit and enforcement.VAT administration is concerned not only with administrative activities but also about administrative organs (who should administer the tax) and their mode of organization (Wollela, 2008:183). According to (Wollela, 2008:109) the actual expenditures incurred in respect of VAT administration in Ethiopia are identified (provided the required information is available). However, where information on which department each expenditure item actually relates to is unavailable, cost: staff or cost: yield ratios would be employed.

The VAT replaced the current sales tax on manufactured and imported goods and services on January 1, 2003. The responsibility for the correct calculation and timely payment of VAT rests on the tax payers himself. The VAT is a broad based tax on the consumption of goods and services. It is collected at all stages in the production and distribution process beginning with the importers and produced of raw materials and ending with the retailers. Cascading of the tax (i.e. tax on tax) is avoided by providing for a credit of the tax paid at the preceding level. Unlike the sales tax system, whereby 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 goods are not subjected to the VAT. Removing the VAT content (on inputs) from exported goods makes the goods more competitive in international markets (Gebrie: 2008:190).

VAT is consumer expenditure. It is collected on business transactions and imports. Most business transactions and involves supplies of goods services and VAT is payable if they are

- > Supplies made in Ethiopia.**
- > Made by the taxable person.**
- > Made in the course or furtherance of a business.**
- > Are not specifically exempted or zero-rated.**

Supplies are outside the scope of the tax if they are

- > Made by someone who is not taxable person or**
- > Not made in the course or furtherance of a business.**

Course or furtherance- the way a tax able person has to carry out its activity to develop, advance and progress the taxable activity. It refers to the normal and expected events or processes to develop the taxable activity. Anything done in correction with the commencement or termination of a taxable activity is treated as carried out in the course or furtherance of that taxable activity.

2.10. Advantage of VAT

According to Misrak (2008:306) the following are some of the main advantages of VAT

S It avoids cascading effect of a tax (Tax on Tax)

The same commodity does not get taxed again and again, thus there is no cascading effect. Putting the concept in simple terms, in VAT system each input is taxed only once. However, this is not a condition in sales and excise taxes.

S It is a more comprehensive and equitable tax system

Even though the ultimate burden of VAT falls on the final consumer, VAT is collected by the government from all sectors. Therefore, it is a more comprehensive and equitable tax system. On the contrary, sales tax is a normally levied one stage of the whole marketing.

S It reduces the possibility of tax evasion

In each stage, every transaction is made using VAT invoice approved by the tax authority. In addition each VAT registered person (supplier) has to maintain appropriate records on their sales and purchase transaction.

S It has less tax burden

Under VAT system, the tax is collected in small fragments at different stages of production and sales. Hence, the VAT payers feel the burden of the tax less.

S It is neutral

Regardless of the number of stages of production and distribution, VAT is collected in each stage. There for, VAT is expected to be perfectly neutral in the allocation of resources in the form of production and commercialization.

S It improves productivity

In VAT system, a firm has to pay tax even though it runs into loss. The firm cannot claim any exemption for loss because it pays taxes on the value produced and not on profits. So, firms will always try to improve their performance and reduce the cost of production. As a result, the overall productivity of the country will be improved.

S It promotes capital investment and saving

VAT is a consumption tax since one pays VAT on its expenditure and has the option to save so as not to be taxed. Furthermore, relief from tax on capital goods may encourage investment. Potential investors also consider tax legislation as one of the factors in making investment decision.

S It enhances exports

Exports of goods and services in most countries that implement VAT are liable to VAT at zero-rate. This may make exports internationally competitive and, thus, encourages exports.

2.11. Disadvantages of VAT

According to Misrak (2008:308) the following are some of the disadvantages of VAT
VAT is not just bundle of advantages. It is also seriously criticized for the following:

S It is regressive in nature

A straightforward single rate VAT with few exemptions would tax lower income groups (the poor) more heavily than the higher income groups (the rich). It is, thus, incongruent with the basic principle of taxation which states that a person should be taxed according to his ability-to-pay. This makes VAT regressive tax system.

S It require advanced economic structure

The proper implementation of VAT system requires organized and advanced financial and economic structure as it is complicated system. VAT system also requires proper record keeping of invoices at each stage of production and sale by both the seller and buyer.

S It puts additional burden to tax authority

In VAT system, the manufacturers, wholesalers and retailers have to fulfill various legal formalities in the form of maintaining various records, accounts, books, etc. The verification of those formalities puts additional burden to the tax enforcing authorities.

S It is uneconomical

VAT system involves high cost of administration, assessment, verification, collection, etc. Hence, it is highly uneconomical.

S it has ream loopholes for tax evasion

Although VAT system requires proper record keeping of invoices at each stage of production and distribution by both the buyer and seller, it has ream loopholes for tax evasion. This may include the following:

- > Taxpayers could over report sales of zero rated goods;
- > Taxpayers could use invoices they received for personal purchase to claim tax credit;
- > It enables buyers and sellers to strike secret deals with regards the issuance of receipts;
- > It could lead to the formation of forged companies' receipts to claim tax credit on input VAT, etc.

Data Presentation, Analysis and Interpretation

This chapter presents and discusses the results obtained from the questionnaires distributed. It explains the response rate, general characteristic of the respondents, and findings of the study about the effectiveness of the Arada Sub-City Revenue Office and the main constraints that deter the smooth administration of VAT on the basis of the objectives of the study.

The questionnaires were distributed to types of group which are VAT registered taxpayers and tax officials in Arada sub-city. One hundred fifty questionnaires were distributed to VAT registered taxpayers but only 121 responded. 18 questionnaires were also distributed to officials and all have given their response.

Table: 3.1A Respondents Background Information

No	Items	Options	Tax payers		Officials	
			No.	Percentage	No.	Percentage
1	Sex	Male	90	74.4	7	39
		Female	31	25.6	11	61
		Total	121	100	18	100
2	Educational Status	Below 10 th /12 th grade	19	15.7	-	-
		10 th /12 th grade complete	32	26.4	-	-
		Certificate/Diploma	51	42.2	6	33.3
		First degree	17	14	10	55.6
		2 nd degree and above	2	1.7	2	11.1
		Total	121	100	18	100
3	Work experience	Below 2 years	53	43.8	8	44.4
		2-4 years	38	31.4	7	38.9
		Above 4 years	30	24.8	3	16.7
		Total	121	100	18	100

As indicated in item 1 of Table 3.1A of which 90(74.4%) were male while 31(25.6%) were female. In the same item were tax official, while 7(39%) are males 11(61%) female officials. This shows while more number of male tax payers in contrary more in number with regard to officials.

As indicated in item 2 of Table 3.1A shows that, in terms of level of education, 19(15.7%) were below grade 10th or 12th; 32(26.4%) high school complete; 51(42.2%) were Certificate/Diploma, 17(14%) were first degree and; 2(1.7%) were second degree and above respectively. This shows 85% of our respondent don't have first degree and it can be articulated that it has its own impact on tax and the business activity itself because education help to maximize the awareness of business person on tax and facilitating the business activity, ethics and codes. On the other hand, the result raises what are the causes of the reason behind for the educated labor are not involved in the business sector doesn't require a higher education to start a business in Ethiopia. While looking at the level of education for tax officials, grade 12 & below no one, 6(33.3%) certificate/diploma; 10(55.6%) first degrees; 2(11.1%) second degree. This shows that there is still a need to train and educate the tax officials at a minimum level of first degree level.

As indicated in item 3 of Table 3.1A shows that 53(43.8%) of our tax payers respondents had two years experience in the business sector while in the business sector while 38(31.4%) had 2-4 years experience and 30(24.8%) had above 4 years experience. While tax officials 8(44%) had below 2 years experience, 7(38.9%) had 2 to 4 years and 3(16.7%) had above 4 years work experience. This figures shows that majority of the respondents had short work experience which can a have a significant effect on the effective delivery of the service they provide to customers, diminishes customer willingness to pay tax time on time which creates redundancy and there can also be a barrier for transfer of skills and knowledge from the more experienced officers. During the interview with the supervisor of the tax payer's officials, she has indicated that they recruit a new staff every two a years.

No	Items	Options	Tax payers		Officials	
			No.	Percentage	No.	Percentage
1	Types of Business	Services	51	42.2		
		Manufacturing	43	35.5		
		Merchandising	27	22.3		
		Total	121	100		
2	Position	tax assessment and collection officers			9	50
		Data analysis officer			7	33.3
		tax intelligence			2	16.7
		Total			18	100
3	At this month you fill	Nil	45	37.2		
		Credit	42	34.7		
		Payment	34	28.1		
		Total	121	100		

Source: Field Survey Result 2013/14

As indicated in Item 1 of table 3.1B shows that 51(42.2%) are engaged in service sector while 43(36%) are in manufacturing and the rest 27(22%) work in the merchandising business sector. The figures are a clear indicative that majority of the tax payers are engaged in the service sector as the location of the sub-city is in the middle of Addis Ababa there is a clear possibility for there to be less manufacturing industries in Arada sub city. The result in over all show a positive indication as the service sector and the manufacture sectors are identified by the growth and transformation plan of the country as the main engine for development.

As indicated in Item 2 of table 3.1B during the sample selection regarding tax official 9(50%) were had a position of tax assessment and collection officers and 7(33.3%) were data analysis and officers and the rest 2(16.7%) are in the position of tax intelligence. Hence, the sample size is good fit for the analysis of the study as they can identify and indicate the constraints and explain the tax administration system in the Arada sub-city.

As indicated in Item 3 of table 3.1B out of the 121 vat registered tax payers, 45 (37%) are null filler while 42(35%) are credit filler while only 34(28%) are payment fillers. This is a clear indicative that real productive business companies are only 72% while the rest are registered VAT tax payers with future business prospects. This implies that the sub-city doesn't monitoring the taxpayers accordingly.

Table 3.2 Systems to Register Unregistered Taxpayers for VAT

Item	Options	Officials	
		No.	Percentage
System to register unregistered tax payer	Door to door	10	55.6
	Checking purchase invoices	5	27.8
	Any other	3	16.6
	Total	18	100

As indicated table 3.2, 10(55.6%) of register unregistered tax payer by investigating door to door; 5(27.8%) were Checking purchase invoices; 3(16.6%) were any other. This indicates that the most efficient way according to tax officials is the door to door method owing its efficiency to its inclusive and through method.

Table 3.3 Report Indicate the Number of nil filler and Its Impact

No.	Items	Options	Officials	
			No.	Percentage
1	Lack of effective control is the cause for huge number of nil fillers?	Strongly agree	5	27.8
		Agree	4	22.2
		Neutral	3	16.7
		Disagree	4	22.2
		Strongly disagree	2	11.1
		Total	18	100
2	Impact of huge nil filler on your service delivery?	Create work overload	8	44.5
		Takes time so that unable to control the potential taxpayers	10	55.6
		Total	18	100

As indicated in item 1 of table 3.3, by tax officer of which 5(27.8%) would strongly agree, 4(22.2%) stated that they Agree with the statement, 3(16.7%) were Neutral, with 4(22.2%) Disagreeing and 2(11.1%) Strongly disagree. Examination of survey responses of the tax officials revealed that 27% and 22% of the respondents strongly and moderately agreed respectively that one of the reasons for the huge number of nil filers in the Sub-City is lack of effective control.

As indicated in Item 2 of table 3.3, 8(44.5%) believe it creates work overload and 10(55.6%) believe it takes time so that unable to control the potential taxpayers. This shows the impact of huge nil filer destructs the controlling system.

Table 3.4 The Feelings of Tax payers towards VAT

Item	Options	Tax payers	
		No.	Percentage
Tax payers thought towards VAT	Very high	2	11.1
	High	2	11.1
	Moderate	4	22.2
	Low	6	33.3
	Very low	4	22.2
	TOTAL	18	100

As indicated table 3.4, 6(33.3%) were very high 4(22.2%) were high 4(22.2%) were moderate 2(11.1%) were low and 2(11.1%) were very high of VAT officer respondents. The result show that the tax payers thought towards VAT is low.

Item	Options	Officials	
		No.	Percentage
Express Number of voluntary VAT payers	Very high	1	5.6
	High	2	11.1
	Moderate	3	16.7
	Low	5	27.8
	Very low	7	38.9
	Total	18	100

As indicated table 3.5, In terms of voluntary compliance of VAT registrant taxpayers in Arada Sub City, the survey results show that it is poor. 1(5.6%) were very high 2(11.1%) were high 3(16.7%) were moderate 5(27.8%) were low 7(38.9%) were very low of VAT registered taxpayer respondents revealed that many tax payers are not willing to be registered for VAT. According to the outcomes of interviews with managers, voluntarily compliance of the taxpayers in the sub-city is not good due to three reasons. First, taxpayers' thought towards VAT is one of the reasons. That means, there are taxpayers who think VAT increases the price of goods and services they sell so that they lose their customers. Others think if they sale goods and services with VAT invoices at the end of the year the tax office know their annual turnover and forced to pay more amount of income tax than what they have paid before. However, there are taxpayers who do not voluntary comply due to lack of awareness. Second, lack of uniform registration of similar businesses within the same area and "equal" businesses activities. Third, lack of effective control and enforcement were the main reasons

No.	Items	Options	Tax payers	
			No.	Percentage
1	Major problems of VAT collection	Monthly returns for small firms is costly		16.5
		There are many filing requirements		19
		Laws and procedures not clear and simple		30.6
		Monthly massive cross checking takes long time		22.3
		Tax collectors are not skilled enough		11.6
		Total		100
2	Non registration of other taxpayers for VAT have a negative impact in your company	Yes	82	67.8
		No	39	32.2
		Total	121	100

As indicated in item 1 table 3.6, The major problem of VAT collection regarding to tax payers 16.5% were monthly returns for declaration is costly for small firms; 19% There are many filing requirements; 30.6% laws and procedures not clear and simple; 22.3% monthly massive cross checking takes long time; 11.6% Tax collectors are not skilled enough. This shows that majority of the problem of VAT collection is raised by Laws and procedures not being clear and simple. In the interview the managers have indicated that it's true that the law could be perceived as hard to follow but the sub city have been working and will continue working on shaping the procedures to be time efficient and easy to follow.

As indicated in item 2 table 3.6, the presence of potential taxpayers unregistered for VAT; 82(67.8%) of VAT registrant taxpayer respondents think un registrants have a negative impact on their company and rest 39(32.2%) responded no to the question. There's a general consensus amongst the taxpayers that the unregistered have a negative impact on legal businesses. In addition, this shows the office cannot collect the potential tax from the sub city.

Item	Options	Tax payers	
		No.	Percentage
Strength of Arada Sub City Revenue Office	Education and assistance program for taxpayers	27	22.3
	Qualified human resource	25	20.6
	Honest human resource	44	36.6
	Office facility	25	20.6
	Total	121	100

As indicated table 3.7, the strength of Arada Sub-city revenue office based on tax payers opinions ; 27(22.3%) responded the sub-city adequate and assist the tax payer; 25(20.6%) of the human resource staffs are qualified; 44(36.6%) were Honest human resource staff; and 25(20.6%) for the office facility. This indicates honest human resource has supported the well being of the revenue office. The managers have agreed with the result of our research and expressed their concern in the effectiveness of VAT administration and blamed the lack of job specific training and high turnover rate in the workforce. They have also credited the problems to lack of budget and the country's salary scale.

Item	Options	Tax payers	
		No.	Percentage
If there is no penalty, is there a possibility that you may not be registered for VAT?	Yes	31	25.6
	No	90	74.4
	Total	121	100

As indicated table 3.8, According to the survey responses of VAT registrant taxpayers, if there is no penalty 90(74.4%) of the respondents revealed they may not be registered for VAT, while 31(25.6%) may still register. Greater part of the tax payers expressed they were not willing to register for VAT; this may be due to lack of awareness in the public.

Table 3.9 Express the Number of Taxpayers who are not registered for VAT

No.	Items	Options	Tax payers	
			No.	Percentage
1	Express the amount of taxpayers who are not registered for VAT	High	60	49.6
		Moderate	40	33
		Low	21	17.4
		Total	121	100
2	If your answer is high, which of the following could be the reason?	Poor VAT administrative system	25	41.7
		Due to problems from their suppliers	19	31.7
		Due to fear of competition from unregistered similar businesses	16	26.6
		Total	60	100

As indicated in item 1 of table 3.9, the number of taxpayers who are not registered for VAT based on the view of tax payers 60(49.6%) were high; 40(33%) were moderate and 21(17.4%) were low; this shows there are still many potential taxpayers who did not registered for VAT.

As indicated in item 2 table 3.9, 25(41.7%) were Poor VAT administrative system; 19(31.7%) were Due to problems from their suppliers and 16(26.6%) were fear of competition from unregistered similar businesses. As survey responses indicated, one of the problems in taxpayer registration is lack of uniformity; still there are many potential taxpayers who did not register for VAT.

Table 3.10 VAT Auditing and Enforcement Effectiveness

No.	Items	Option	Tax payers		Officer	
			No.	Percentage	No.	Percentage
1	Do you have confidence in the assessment and auditing evaluation of the Sub City?	Yes	51	42.1		
		No	70	57.9		
		Total	121	100		
2	If your answer is no for the above question describe your reason	Incompetency of auditors	40	78.4		
		Corruption	11	22.6		
		Total	51	100		
3	Do you agree your office is effective in auditing and enforcement of VAT	Strongly agree			1	6.66%
		Agree			5	27.7%
		Neutral			7	38.8%
		Disagree			5	27.7%
		Strongly disagree			-	-
		Total			18	100

As indicated in item 1 table 3.10, response of tax payers 70(57.9%) do not have confidence on the Arada Sub-City Revenue Office VAT assessment and auditing practice. the rest 51(42.1%) believe that the sub city's Revenue Office VAT assessment and auditing practice is trustworthy. This shows that the sub city has below par VAT assessment and auditing practices. And as described by the coordinator the sub city performance is better than previous years by cooperating with customers and by upgrading the staff, they have a plan to make the assessment and audit simple and satisfactory to their customers.

As indicated in item 2 table 3.10, according to the above unsatisfactory VAT registrant taxpayer respondents 55(78.4%) were Incompetency of auditors; 15(22.6%) were Corruption. This shows that the majority have agreed that tax officials are not skilled enough to assess and audit, this could have a detrimental effect on the VAT system. The managers have expressed their concern in the lack of job specific training and high turnover rate in the workforce.

As indicated in item 3 table 3.10, According to officer Effective in auditing and enforcement of VAT, 1(6.66%) strongly agree; 5(27.7%) Agree; 7(38.9%) were Neutral and 5(27.7%) have expressed their disagreement; the belief of even the tax officials in the system is debatable with only 34% of them believing in the system wholeheartedly.

Table 3.11 Honesty and Loyalty of VAT Registrants

Item	Options	Tax payers		Officials	
		No.	Percentage	No.	Percentage
In terms of honesty and loyalty of VAT registrants	VAT registrants sell goods and services without tax invoice	33	27.3	6	33.3
	VAT registrants manipulate Cash Register Machine	49	40.5	10	55.6
	VAT registrants provide fake invoices to secure more input tax	39	32.2	2	11.1
	Total	121	100	18	100

As indicated in table 3.11, VAT registrant taxpayers respondents' In terms of honesty and loyalty of VAT registrants, 33(27.3%) of the total respondents revealed many VAT registrants sell goods and services without tax invoices. In addition to this, 49(40.5%) of the respondents revealed some taxpayers manipulate cash register machines and 39(32.2%) VAT registrants provide fake invoices to secure more input tax.

The same question was provided for tax officials of the office and the respondents' response In terms of. Honesty and loyalty of VAT registrants, 6(33.3%) of the total respondents revealed many VAT registrants sell goods and services without tax invoices. In addition to this, 10(55.6%) of the respondents revealed some taxpayers manipulate cash register machines and 2(11.1%) VAT registrants provide fake invoices to secure more input tax. As indicated it's believed the majority of the taxpayers manipulate the cash register machine to their benefit which results in inaccurate and inconsistent VAT collection.

Table 3.12 Tax Payers Opinion about the Threshold, 500,000 Birr

Item	Options	Tax payer	
		No.	Percentage
What is your opinion about the threshold, 500,000 Birr?	Very high	42	34.7
	High	30	24.8
	Moderate	27	22.3
	Low	15	12.4
	Very low	7	5.8
	Total	121	100

As indicated in table 3.12, 42(34.7%) were very high 30(24.8%) were high, 27(22.3%) were moderate, 15(12.4%) were low 7(5.8%) were very low. The data shown in table 3.12 is to be expected considering the data was collected from merchants whose ambitions are mainly to lower tax and maximize profit. The VAT legislation of Ethiopia revealed that businesses undertaking taxable activities in Ethiopia with an annual turnover of ETB 500,000 and more required filing an application for VAT registration. In addition to this, according to the discussion with the managers, to bring those required to register but did not do so in to the VAT net, the authority devised two types of forced registration schemes. First, compelling all

businesses in a specific sector regardless of the level of their annual turnover based on some criteria. For instance, importers, gold smiths, shoe factories, contractors above grade 10 are some of them. The second scheme was by estimating the daily income (sales) of taxpayers to calculate their annual turnover in door to door inspection by tax officials.

The coordinators of the Arada sub city have described the trends of the Office in administering VAT in the last five years as follows: The number of VAT registrant have been rising along with the revenue of the sub city in the last five years, in addition VAT collection procedure has been improving in structure and human resource management.

CHAPTER FOUR

SUMMARY, CONCLUSION AND RECOMMENDATIONS

4.1. SUMMARY

This study has been assessed an assessment of value added tax administration in arada sub city to achieve objective, related literature were reviewed, 150 questionnaires distributed to VAT registrant taxpayers in Arada Sub City, 121 were returned representing 80.6 percent, and from 18 questionnaires distributed to tax officials in the sub city, all were returned representing 100 percent. In addition, interviews were held with two managers of the sub city.

Based on data presentation, analysis and interpretation of the data we have summarized it as follows

- > Arada sub-city's higher managements has expressed to us that the sub city's revenue has been progressively increasing after the introduction of the VAT collection law.
 - > Arada sub-city registered taxpayers and VAT registrants have been increasing in quantity year after year, with an estimated increase of 10% expected for the coming fiscal year.
 - > According to higher managements of the Arada sub city, VAT collection procedure has been improving with quick, clear and easy to follow procedures being introduced to the system.
 - > Concerning to the effectiveness of the authority in collecting VAT, 12(66%) of them agree that it's not effective and the sub city hasn't been strongly monitoring.
 - > The most effective method of monitoring the VAT collection system has been door to door, this is shown by 10(55.6%) of Tax officers preferring it to other methods.
 - > Its common belief among the taxpayers that the amount of registered VAT taxpayers is low in number, this idea is shared by 60(49.5%) of them. Who believe that Arada sub city is not strongly monitoring its subjects.
 - > There's doubt in the effectiveness of the office amongst the tax officials with 5(28%) of them disagreeing and 7(39%) of them having a neutral opinion about it.
 - > The public opinion about VAT is vastly negative, with 67(55.5%) of them having a negative outlook. This has been a major hindrance to the system.
- ^A Lack of consistency and problems in the lawmaking body are hindering the monitoring and audit of VAT registrants.

4.2. CONCLUSIONS

Based on summary of the finding we have concluded as follows

- > The sub city's revenue has increased progressively after the introduction of the VAT collection law.
- > VAT collection law has been effective in accomplishing its objective of increasing Tax registrants as well as tax payers.
- > Most of tax payer did not declare honestly their tax liabilities, because they are using under invoice system, they are selling without invoice and some taxpayers manipulate cash register machines.
- > Despite the fact that door to door inspection being preferred, the office have found it harder to practice it mainly due to shortage of manpower to inspect door to door and to deliver tax notices to tax payers on time.
- > The low level of interest in registering for VAT is an indication of lack of awareness of the public in that sector.
- > The VAT collection of the authority has not been fully achieved due to inefficient administration.
- > The authority has not been providing continuous and effective training to its employees, which has contributed to high levels of unprofessionalism.

4.3. RECOMMENDATIONS

- > Arada sub city small tax payer's branch office should create awareness in the form of workshop or distributing magazines which is prepared on the importance of VAT collection to the improvement of public goods in general to the business people who are involved in VAT collection.
- > During our research complaints about skilled manpower was a common denominator amongst the taxpayers, so that management body of the office should recruit skilled manpower in the area especially who are assigned in tax auditing.
- > The management of the sub city should prepare or design a reward for those business people in sub city who are performing highest VAT collection during the fiscal year. The reward can be certificate or lump sum amount of money.
- > The management body of the sub city should work on awareness creation to the general public on the importance of VAT payment for the economic development of their area. This can be done by distributing informative brochures and posters in relation to the issue.
- > Since the threshold set by the law does not give equitable ground for each business, the sub city has stretch to make it equitable.
- > Tax payers should try to solve their problems with arada sub city through discussion and agreement.
- > Imitate consumer to request VAT invoice through awareness programs.

Section B. Questions related to the tax office

5. In registration process followed for unregistered taxpayers for VAT before, what system do you follow?

Door to door inspection

Checking purchase invoices of registered taxpayers

If any other, (specify here) _____

6. Reports indicate huge number of nil filler in your sub-city. Some say it is due to lack of effective control.

Strongly Agree

Disagree

Agree

Strongly Disagree

Neutral

7. What is the impact of huge nil fillers on your service delivery? (you can choose more than one option)

Create work overload

Takes time so that unable to control the potential taxpayers

If any other, mention it here_

8. How do you evaluate the strength of your office with respect to the following parameters?

Excellent Very Good Good Faire Poor Very Poor

Simple and stable tax laws

Good service to taxpayers

Simple filing and payment procedu^A |

Appropriate penalties

Fair and efficient appeals system

9. Do you agree your office is effective in auditing and enforcement of VAT?

Strongly Agree

Disagree

Agree

Strongly Disagree

Neutral

Section "C" Questions related to taxpayers

10. How do you express the number of voluntary VAT payers in your Sub City?

Very high

High

Moderate

Low

Very low

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

Excellent

Good

Fair

Poor

Very poor

12. In terms of honesty and loyalty of VAT registrants, how do you guess the following?

	Many	Few	None
VAT registrants sell goods and services without tax invoice			
VAT registrants manipulate Cash Register Machine			
VAT registrants provide fake invoices to secure more input tax			

15. Give your general comment on the overall VAT administration of the Arada Sub City_____

Thank you

Interview Guide

(Queries on general issues to be answered by the heads of Arada Sub City Revenue Office and Arada Sub City Small Taxpayers' Branch of ERCA)

1. How do you evaluate the trends of Arada Sub City Revenue Office in administering VAT in the last five years?
2. What are the main constraints in administering VAT in your sub city in terms of; registration, collection, auditing, refund and enforcement activities?
3. How do you express the voluntary compliance of taxpayers in your sub city and if any effort or plan to improve it?
4. Do you have simplified laws and procedures particularly for small businesses?
5. What about your service delivery in terms of; office facilities, qualified and honest human resource, sufficient man power and so on?
6. Finally, please, generalize the degree of effectiveness of the Sub City in VAT administration.

Thank you very much



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