

**VALUE ADDED TAX PRACTICES AND PROBLEMS IN
FEDERAL INLAND REVENUE AUTHORITY OF ETHIOPIA**

GETU MINAYE



**A Thesis Submitted to the School of Graduate Studies of Addis
Ababa University in Partial fulfillment of the Requirements for
the Degree of Masters of Public Administration (MPA) in the
Department of Public Administration and Development
Management**

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AUTHORITY OF ETHIOPIA

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ACRONYMS

ECUA	Ethiopian Customs Authority
FIRA	Federal Inland Revenue Authority
GDP	Gross Domestic Product
IMF	International Money Fund
LAN	Local Area Network
LTO	Large Taxpayer's Office
MoFED	Ministry of Finance and Economic Development.
MoR	Ministry of Revenue
SIGTAS	Standard Integrated Government Tax Administration System.
TIN	Taxpayer's Identification Number
TOT	Turnover Tax
VAT	Value Added Tax

ABSTRACT

Most of the governments' revenue is generated from taxes. It can redistribute society's wealth by imposing the tax burden on one group in order to fund services for another. Taxes are classified into two: these are direct and indirect taxes. Direct taxes are directly related to the tax payers where as indirect taxes are paid by an individual through purchase of goods and services. Value Added Tax (VAT) is one of the indirect taxes. It is a tax on consumption levied wherever the value of goods and services increase as they change hands in course of production, distribution and final sale to the consumer. The value added at each stage of production is the difference between the sellers' cost for materials and the selling price. VAT is a key source of government revenue in most of the nations, so it is implemented in many developed as well as developing countries. The first proposal of VAT emerged in France in the 1920 and was recognized in 1948. Most of the developing countries of the world adopted this tax during 1980s and 1990s. Côte d'Ivoire is the first African country to introduce VAT in 1960.

VAT has become an indispensable component of tax reforms in developing countries. Ethiopia has also implemented this tax primarily to raise more revenue, modernizing its tax administration and encourage investment and trade. Ethiopia's tax reform program has introduced VAT since January, 2003. Tax reforms include changing policies to address insufficient revenue, to correct distortions that reduces economic welfare and growth, or measure to reduce inequalities. The tax reform has two components: Overhauling of the tax legislation and improving the tax administration.

VAT is a tax system that has replaced sales tax in Ethiopia and it has applied a uniform rate of 15% on most consumption goods and services. The replaced sales tax was collected only at the point of sales; as the result of this it has a double taxation (tax cascading effect) and had severe tax evasion problems. VAT, on the other hand, is applied on the value added at each stage of production, hence would solve the tax cascading and reduce its evasion with its modern administration system.

A threshold of half a million birr is a level above which registration for VAT is legally compulsory, but a category of taxpayers that fall below the threshold are registered for TOE. VAT is collected at all stages in the production and distribution process beginning with importers and producers raw materials and credits the final consumers. Unlike the former sales tax VAT is a broad based tax that is imposed at different levels of production and distribution. VAT is payable if there are supplies made in Ethiopia, made by a taxable person, made in the course or furtherance of a business and is not specifically exempted or zero rated.

The survey of the study indicates that VAT implementation in Ethiopia faced different challenges. Some of the challenges are: administration inefficiency, misunderstanding of the VAT laws by some business communities, resistance against registration of some traders, failure to maintaining books of accounts, understated financial statements, and non-issuance of invoices has been exercised by VAT registered person particularly on sales made on final consumer. Non-issuance of invoices is practiced in various forms: providing options to their customers to choose between sales with VAT and sales without VAT invoice, print and use identical VAT invoice one registered by the tax office and the other not registered. As the result of these constraints the implementation of VAT in Ethiopia could not be effectively implemented and achieve its objectives.

The study of the survey indicates that to alleviate these constraints the FIRA has taken some measures. These measures include: strengthen its tax administration functions by delegation of region/city administration, forced registration for non-compliance enterprises, door- to-door checking were made to identify those who should be registered but not yet registered for VAT, intensive awareness program have been conducted using mass media, seminars and workshops to disseminate information and to increase the awareness of the business community. Therefore the FIRA should continue to strengthen its administration capacity to curve the problems and achieve its objectives, and the business community should also obey the current VAT rules and regulations.

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Government must have funds or revenue to pay for different activities. It generates some revenue by charging fees for the services they provide, such as entrance fees at national parks or tolls for using a highway, however most government's revenue comes from taxes. Governments use tax revenues to pay soldiers and police, to build dams and roads, to operate schools and hospitals, to provide food to the poor and medical care to the society, and other purposes. Taxation is the most important source of revenues for modern governments. The remainder of government revenue comes from borrowing and from charging fees for services. Countries differ considerably in the amount of taxes they collect. In addition to using taxation to raise money, government may raise or lower taxes to achieve social and economy objectives, or to achieve political popularity with certain groups. Taxation can redistribute society's wealth by imposing a heavier tax burden on one group in order to fund services for another. Some economists consider taxation as an important tool for maintaining the stability of a country's economy.

Taxes are normally classified as direct and indirect. Direct taxes are levied on the income, profit, capital gain and wealth of persons and companies, the most well known direct tax being personal income tax. On the other hand, indirect taxes are levied on transactions, goods and service, not directly imposed on companies and individuals. Value Added Tax (VAT) is one of those indirect taxes. The value added at each stage of production is the difference between the seller's material costs and the selling price. In essence, a VAT is just a general

sales tax that is collected at multiple stages. VAT is a key source of government revenue in most of the nations. It was introduced in more developed countries of Europe and Latin America. The first proposal emerged in France in the 1920 and was recognized in 1948. The developing and transitional economies adopted the tax in the 1980s and 1990s. Côte d'Ivoire was the first African country to introduce VAT in 1960.

Since taxes are important sources of public revenue, the government of Ethiopia recognized the need to overhaul the tax legislation and to strengthen the administration capacities of the Federal Inland Revenue Authority (FIRA) and the Regional Tax Administrations. Consequently, the government devised the tax reform program as one of the key initiatives under its national capacity building program. The tax reform measures are designed to encourage local and direct foreign investment and to increase tax revenues through the establishment of a broader tax system and ensuring equity, fairness, consistency and honesty in the administration of the tax laws in the country.

Although the Revenue Sector Reform was thought to be commenced in May 1999, the government acknowledged that it had been burdened with delays during the first two years. During the restructuring of the Ethiopian government in 2001/2002, one of the changes included the upgrading of the Revenue Board to a Ministry of Revenue (MoR), which became responsible for directing, supervising, controlling, evaluating and coordinating the three revenue institutions: the Federal Inland Revenue Authority (FIRA), the Ethiopian Customs Authority (ECUA) and the National Lottery Administration; and for enhancing the revenue program. The Ministry made significant progress in

implementing the tax reform component of the program in a relatively short time.

Ethiopia's tax reform program has introduced VAT at the rate of 15% (fifteen percent) on January 1, 2003 to replace the sales tax proclamation that provides exemption for basic necessities and domestic transportation and zero rating to encourage exports and capital investments. Subsequent to the introduction of VAT, additional exemptions were extended to basic foods, agricultural fertilizers and to other products. Unlike the sales tax VAT provides relief of tax on all business inputs, including capital goods and business expenditures and will provide further business incentives by zero rating exports and the international transport of goods and passengers. Since domestically produced goods relieved of VAT, they will be more competitive within international markets.

In our VAT system a threshold of half a million birr is a level above which registration for VAT is legally compulsory. The tax payers below this threshold are mostly engaged in small business of distributions of goods and rendering of services. A category of taxpayers that fall below the threshold usually transact goods on which VAT is at least once paid. Moreover, turnover tax that serves as equalization scheme has been applied together with VAT.

The purpose of this thesis is to describe the practices of VAT in Ethiopia, identify and investigate the possible problems for the adoption, implementation and recommend solutions to help the successful achievement of VAT objectives.

1.2 Statement of the Problem

The VAT Proclamation No.285/2002 was issued on 4th July 2002 by the Council of People's Representatives to become into application as of first January 2003. The Proclamation has 13 sections and 66 articles. According to this proclamation taxpayers are those persons registered or required to be registered; persons carrying out taxable import of goods to Ethiopia. Most business transactions involve supplies of goods or services. VAT is payable if they are: supplies made in Ethiopia, made by a taxable person, made in the course or furtherness of a business and are not specifically exempted or zero-rated.

According to Article 22 of the VAT proclamation all persons registered for VAT are required to issue a VAT invoice to the person who receives the goods or services. There are cases where a receipt or simplified form of VAT invoices may be used depending on the value of transactions involved. Those unregistered do not have the right to issue a tax invoice.

VAT is a tax on the final consumption of certain goods and services. But it is collected at every stage of production and distribution. VAT is gathered by all entities providing taxable goods and services and imposed on sales to all purchases. A business firm calculates its VAT liability by the VAT rate. It is then permitted to offset its VAT liability by the amount of VAT paid for its purchases of goods and services. Without any induced production inefficiency or cascading, a multi-stage nature of VAT implies that two features are important to ensure that it is intended only a tax on consumption.

or cascading, a multi-stage nature of VAT implies that two features are important to ensure that it is intended only a tax on consumption. These features of VAT are: at each stage, net tax must be payable only on difference between sales and purchases, and no breaks in the VAT chain. Under VAT, output tax is charged at each stage of production irrespective of the use to which it is put to ensure that only final consumption is taxed. The tax on all goods and services subsequently used as inputs to production must, in effect be refunded to purchase of those inputs, a VAT with unrestricted crediting of this type, including of tax on investment goods purchase.

The introduction of a VAT can facilitate a substantial improvement in overall tax administration, and indeed adoption of the VAT is often seen as an opportunity for overall tax administration modernization. The introduction of the tax, however, has occasionally disrupted the functioning of an existing administration because of inadequate preparation and or ill- advised implantation divisions

The major activities in VAT administrations are identifying taxpayers; processing returns, controlling collections, making refunds, audit taxpayers and levying penalties. The other part of VAT administration is assessment on VAT execution. This includes identifying taxpayers and tax evaders as well as the registered and unregistered taxpayers among the business community. It follows that the concerned tax authorities would take legal measures against people who do not comply with the VAT law. For example, one those who conceal invoices, and engaged in illicit business transactions. It is not only the authorities who should be responsible in assessment of execution of VAT but the consumers themselves have a key role to play.

One of the major decisions that should be taken in preparation for the introduction of the VAT is a choice of organization and organizational changes to administer the VAT, staffing requirements and staff training. In some countries, customs organizations are assigned to administer the VAT. In others either they establish a separated organization due to their conviction that the modern nature of the tax would make it difficult to administer by the existing conventional and some what antiquate methods, or integrate it with the income tax administration taking into account, better planning and coordination of enforcement efforts and use of current tax audit expertise. In others, if the tax administration is organized by functional lines and a general sales tax was previously in force, a VAT unit shall replace the sales tax unit. In the Ethiopian case, as the FIRA was not only organized along functional lines, setting up a special VAT unit in FIRA was a necessary.

Along this line, there were efforts to design the organization structure and to determine the number of staff to be trained and deployed. Some have been taken from the ex-sales tax unit, some have gone from the tax reform program and the Ministry of Revenue and some have been newly recruited. At present the newly introduced Value Added Tax is administered by a newly established department located at the Mexico square and some branches in the country and by ~~the~~ Ethiopian Customs Authority.

VAT is collected by the FIRA, VAT department in Addis Ababa and its branches and at custom stations of the Ethiopian Customs Authority at importation of goods. When the VAT is not paid accordingly FIRA will only use

the powers for uncollected tax, FIRA may seize property to collect the tax due. The seized property could be sold at public auction.

Since the VAT is a tax that is levied on the consumer, it does not constitute a tax on business. In effect, a registered VAT taxpayer is charging and collecting funds that are being held in trust for the government before being remitted to the FIRA. However, the FIRA did experience the types of fraudulent activities that have been commonly encountered by many countries which have introduced VAT. Such fraudulent actions deny the country its revenue entitlements; create competitive inequalities in the business environment and work to the detriment of the honest business taxpayers. Even though intensive education program has been undergoing by the tax administration, there are various problems which restraint for the implementation of VAT in the country.

Therefore, this thesis aims at examining different problems associated with practices of VAT which affects on government revenue and tries to answer the following basic research questions:

- Do the business communities know the VAT rules and regulations properly?
- Do the business communities perform their business activities on the basis of the current VAT laws?
- Does the administration capacity of FIRA strong enough to control those noncompliance and delinquent taxpayers?
- Have the implementation of VAT in Ethiopia met its objectives properly and encourages for the growth of investment and export?

- What are the problems that hinder for the smooth implementation of VAT in Ethiopia?
- Does FIRA has taken some measures to alleviate the problems of those obstacles for the smooth implementation of VAT?

1.3 Objectives of the Study

This thesis attempts to examine and analyze the practices and problems of Value Added Tax of Ethiopia with its main issues of tax administration from its inception to present day. This gives some insight to policy makers giving closer attention towards tackling of the above mentioned problems by providing the appropriate solutions.

Specifically this thesis tries to address the following issues:

- To assess whether the tax payers do their work with the compliance of the current rules and regulations of the VAT.
- To assess whether the implementation of Value Added Tax has met its objectives of generating more government revenue, encouraging investment and export.
- To identify basic problems those hinder the implementation of Value Added Tax in Ethiopia.
- To provide alternative solutions to tackle identified problems and facilitate the implementation of Value Added Tax.

1.4 Significance of the Study

An effective and efficient collection of tax is important for the economic development of the country. Because if effective and efficient tax system is implemented, there is an increase of government revenue, which helps to fulfill the socio-economic needs of the society. The VAT Department of the FIRA did a very commendable job in introducing the new VAT proclamation on January 1, 2003 through the conduct of an extensive consultation process with the stockholders, comprehensive taxpayers' education and information program and an effective taxpayer's registration program.

This thesis, therefore, attempts to serve as:

- Would enable the reader to observe the economic importance of VAT.
- It may use to be added in the meager information that we have on the implementation of the Value Added Tax and its challenges.
- It provides the way for other researchers who want to make further investigation in the area of VAT and to conduct detailed researches on the issues.
- It helps to improve the knowledge of the reader on the new replaced VAT.
- Would enable the Federal Inland Revenue Authority to observe how the VAT developed is used as a measure of their success.
- It may serve as an additional source of reference.

1.5 Scope of the Study

This thesis deals with the analysis of Value Added Tax practices and problems in Federal Inland Revenue Authority of Ethiopia, which covers the period from its inception i.e., the introduction of VAT in Ethiopia (2003) to 2006/07. The data used for the analysis were gathered from various departments of the Ministry of Revenue and Federal Inland Revenue Authority. And also it assesses some VAT registered taxpayers in Addis Ababa city. The purpose of making general analysis is to show how the FIRA has practiced the Value Added Tax and the way to alleviate the problems at the time of implementation. Since it is difficult to cover the whole VAT registered taxpayers, due emphasis is given to some Addis Ababa VAT registered tax payers and employees of FIRA. The researcher believes that some of the Addis Ababa VAT payers and employees of the authority are representing most of the VAT payers and employees of FIRA.

1.6 Limitation of the Study

Adequate and reliable information is important to undertake any kind of survey. Precautions were taken in designing the questionnaires to avoid biases. Moreover, briefing was given about the purpose of the study, and explanation was given on some questions. However, unwillingness and carelessness from some respondents while filling the questionnaires were the shortcomings that were observed during data collection. The other constraint of the study were, since VAT is recently happened phenomena enough reference materials were

not found regarding VAT practices and problems in Federal Inland Revenue Authority. In addition to these there were time constraints in conducting of the study.

1.7 Research Design

A research design is the specification of methods and procedures of acquiring the information needed to structure or solve problem. Since to find sufficient and relevant information about the topic, the study is used a descriptive type of research. This is because it is important to portray an accurate profile of persons, events or situations.

1.8 Sample Design Procedure

A sample design is a define plan for obtaining a sample from a given population. It refers to the technique or the procedure the researcher would adopt in selecting items for the sample. It also lays down the number of items to be included in the sample i.e., the size of the sample. The sample size is governed by the total population from which the sample is drawn. The type of population for this thesis is employees of FIRA and VAT registered taxpayers.

Two types of sample design procedure were adopted for the survey. The first type is selection of sample of employees of FIRA while the second type is the selection of VAT registered taxpayers which includes Large Taxpayers Office (LTO) whose annual turnover is greater than or equal to 5 million Birr, Addis Ababa branch VAT registered taxpayers whose annual turnover is less than 5 million Birr and Sole Proprietors VAT registered taxpayers which includes the

individual VAT payers. LTO and Addis Ababa branch office VAT registered taxpayers include business organizations like share companies, partnerships, joint ventures etc. while the individual tax payers are under the Sole proprietorship.

The type of sampling to be used for the researcher is stratified sampling techniques, especially disproportionate stratified sampling for both Employees of FIRA and VAT registered tax Payers. Stratified sampling for employees was used on the basis of their occupation and level of education. The second stage, the selection of VAT payers from each sample tax payers, is also used stratified sampling, as LTO, Addis Ababa Branch tax payers and Sole Proprietor VAT payers. Stratified sampling for LTO, Addis Ababa Branch tax payers and Sole Proprietor VAT payers is applied on the basis of their income level.

Currently the total numbers of employees of FIRA in the three offices are 252. The employees are graduates of Accounting, Economics and the Management profession. Among these 80 (32%) employees are employed in LTO, 50 (20%) employees are employed in VAT Department and 122(48%) employees are employed in Addis Ababa Branch office. The size of the sample is 19(38%), 21(26%) and 23(19%) from VAT Department, LTO and Addis Ababa branch respectively. And the total number of VAT registered taxpayers in the three categories of VAT payers are 11, 276. Out of the total VAT payers, 514(14%) are LTO VAT payers, 6000(2%) VAT payers are Addis Ababa branch and 4762(2%) are Sole proprietors of VAT payers. For more detail see tables 1.1 and 1.2 accordingly.

Table 1.1: Disproportionate Stratified Sampling of Employees of FIRA

Stratum	Number of employees	Proportion of total	Sample size	Sampling fraction
Employees employed in VAT Department	50	0.2	19	38%
Employees employed in Large Tax Office	80	0.32	21	26%
Employees employed Addis Ababa main Branch	122	0.48	23	19%
Total	252	1.00	63	25%

Source: Planning and Statistics Department of FIRA, March, 2007

Table 1.2: Disproportionate Stratified Sampling of VAT Registered Taxpayers.

Stratum	Number of VAT payers	Proportion of total	Sample size	Sampling fraction
Large tax VAT payers	514	0.05	70	14%
Addis Ababa main Branch VAT payers	6000	0.53	95	2%
Sole proprietors VAT payers	4762	0.422	80	2%
Total	11,276	1.00	245	2.2%

Source: planning and statistics department, March, 2007.

1.9. Research Methodology

Evidence of facts, events and circumstances are obtained through data collection. The data are gathered from both primary and secondary sources.

Primary data provide a first hand account of the situation. So we can observe phenomena as it takes place. As the investigator collects the data, all precautions to ensure their reliability were taken. The primary data sources are employees of the FIRA, MoR and different VAT registered tax payers of public enterprises and private sectors such as large taxpayers, Addis Ababa branch taxpayers and Sole Proprietor taxpayers.

Questionnaires, especially structured questionnaires were designed and prepared to get information about VAT practices and problems in the country. Questionnaires were piloted for the purpose of revising and determining the specificity, relevance and clarity of the instruments to collect data that best fit for the analysis and to create favorable working conditions.

During the distribution and collection time of the questionnaires, briefings were given to respondents about the objectives of the survey and on some questions that needed explanation. This helped to collect a reasonable number of responses and to avoid possible biases. Moreover, face-to-face interviews were also conducted with different government officials and business communities. Through these interviews, different facts as well as opinions were obtained.

Secondary data are other sources of information. To gather the information it is necessary to review the existing published and unpublished materials and proclamations which are explained about the VAT, such as manuals, journals, magazines, company reports, guides and regulations, books, research and working papers with their findings. Data related to the Ethiopian VAT system was collected from FIRA (especially VAT department), Ministry of Revenue (MoR), Ministry of Finance and Economic Development (MoFED) and different statistical bulletins. Data about other countries was collected by browsing internet from different web-sites. These are the main sources of data for the purpose of this study.

1.10 Methods of Data Analysis

The Statistical methodology was adopted to analyze the collected data. The statistical analysis was conducted based on Percentages, Tables and Figures. In case of descriptive statistics, quantitative methods of data analysis were adopted.

1.11 Organization of the Paper

This thesis is attempted to discuss the Value Added Tax practices and problems in Federal Inland Revenue Authority of Ethiopia. Accordingly, the thesis is organized in the following manner: After making Introduction in Chapter One, a Review of Literature is made on general overview of VAT in Chapter Two. The task of Chapter Three is discussion on VAT Development in Ethiopia including , Tax reform, introduction of VAT, Ethiopian VAT Law, Constraints of VAT implementation and Organization of VAT administration. Chapter Four is Analysis and Interpretations on Practices and Problems of VAT and Chapter Five Conclusion and Recommendations.

CHAPTER TWO

LITERATUR REVIEW

2.1 Terminologies used in the Thesis

In discussion of VAT, it is important to familiarize the reader with terms related to taxation so as to have a good understanding of the whole concept behind VAT and its implementation. The definition is concerned on: Tax, Sales Tax, Turnover Tax and Value Added Tax.

Tax: -Tax is defined as an amount of money levied by a government on its citizens and used to run the financial activities of the government. A tax is an unrequited payment by individuals or businesses to a government without Quid Pro Quo. This means tax is an involuntary payment without any expectation of direct return in benefit. In the private sector you get what you pay for. But in public sector with regard to tax you don't get what you pay for. In short there is no direct relationship between the tax payment and the benefit to be received by the taxpayers.

Sales Tax: - Taxation imposed on the sale of goods or services. The tax is computed as a Percentage of the total sales price. Sales tax may be imposed either on the purchaser or on the seller; in the former case they are charged on each transaction and in the latter they are collected as a percentage of the gross receipts during a given period

Turnover Tax (TOT): - The turnover tax derives its name from the fact that the tax applies to the sales of a good every time turnover from one firm to another (Auld and Miller, 1984). The turnover tax would be payable on goods sold and services rendered by persons not registered for Value Added Tax. The base computation of the turnover tax is the gross receipts in respect of goods supplied or services rendered. A person who sells of goods and services has the obligation to collect the turnover tax from the buyer and transfer it to the Tax Authority. Hence the seller is principally accountable for the payment of the tax.

Value Added Tax (VAT):- VAT is a tax levied on the increase in value of commodity that has been created by the taxpayer's stage of the production or distribution cycle. The VAT can be thought of as a retail sales tax that is collected in stages, instead of all at once from the final consumer. The tax is collected by all entities providing taxable goods and services and is imposed on sales to all purchasers. A business calculates its VAT liability by taking the total value of its taxable sales and multiplying by the VAT rate. The business is then permitted to offset its VAT liability by the amount of VAT paid for its purchases of goods and services (Byrd et al (1996/97)).

Preset and Barr (1979) also defined, Value Added Tax can in principle approximate to a tax in income or in consumption depending on the precise computation of value added. They also explained difference from a retail sales tax is in the method of collection. First, by its very nature a value added tax is a multi-stage tax, being collected at all the different stages in the production process and not just of the final stage, as with a retail sales tax. Secondly, tax liability is computed by the tax from tax method. Liability from any transaction is based on output tax minus input tax.

2.2 Historical Development and Spread of VAT

In this section attempts are made to present variants of the theoretical frameworks upon which the empirical investigation of VAT. The Value Added Tax (VAT) is a tax imposed upon the value that the activities of a business firm add to the goods and services it purchases from other firms that is upon the excess of sales during a period over the amount paid for goods and services acquired from other business firms during that period.

Value Added Tax, first introduced less than 50 years ago, remained confined to a handful of countries until the late 1960s. Today, it is a key source of government revenue in more than 120 nations. About 70 percent of the world's populations now live in countries with a VAT (Liam Ebrill et al, 2001). It is introduced in more developed countries of Europe and Latin America. The first proposal emerged in France in the 1920s and was recognized in 1948. . The success of the French levy and the realization that the existing cascade multiple-stage taxes were incompatible with the European Common Market led the fiscal and financial committee of the European Economic Community to recommend in 1962 that all member countries shift to the value-added form. This was approved by the European Economic Commission (EEC) council of Ministers and gradually implemented. Denmark adopted VAT in 1967, Federal Republic of Germany in 1968 and Italy in 1973, Ireland 1972 and the United Kingdom 1973 imposed this tax as the sources of revenue.

John F. Due (1976) also states that, the modern trend toward VAT began in 1954 with modification in the French production tax, following the work of Maurice

Laure and the application of the name, value – added tax; to the reform levy. The change involved two elements: the extension of the tax through wholesales distribution (not until 1968 through the retail level), and the exclusion from tax of capital equipment on a current basis, instead of materials and parts alone.

The developing and transition economies adopted the tax in the 1980s and 1990s. In Africa, the countries that were formerly French colonies have followed the French precedent in moving to a levy designated as a VAT. Cote de'Ivoire is the first country in Africa to introduce VAT in 1960. Morocco 1961, Senegal 1966, and in North Africa now use the tax. In Latin America, the tax was adopted for the states of Brazil 1967; Uruguay established the tax in 1968, Ecuador in 1970, Bolivia in 1973, and Argentina in 1975. There has been substantial discussion in Asian countries, including Singapore and Malaysia; the Republic of Vietnam imposed the VAT in the summer of 1973. This makes VAT the first tax system, which spread quickly with in a short time after its introduction. (For details see annex 3).

Value Added Tax has also become an indispensable component of tax reform in developing countries. It is the most important tax innovation of the second half of the twentieth century. In line with this perception, an increasing a number of developing countries have converted their sales tax to Value Added Tax (VAT). The continuing introduction and evolution of general sales taxes especially of the value added tax has been the outstanding feature in development taxation in recent years (Goode, 1984).

While there are many variations on the structure of the VAT and how it is implemented, there is wide agreement on some core issues. First, the consensus

favors ensuring that the final base of the tax is consumption. Such a VAT, which requires that tax on capital goods be credited, does not distort the prices that producers face in buying and selling from one another and accordingly has the desirable feature of preserving production efficiency (so that the tax does not move the economy off its production possibility frontier). Given that it is levied at each stage of production ensuring that the VAT bears only on consumption also requires both full crediting of the tax paid on inputs and the absence of breaks in the VAT chain.

The key features of the VAT are that it is a broad-based tax levied at multiple stages of production, with crucially –taxes on inputs credited against taxes on output. That is, while sellers are required to charge the tax on all their sales, they can also claim a credit for taxes that they have been charged on their inputs. The advantage of this is that revenue is secured by being collected throughout the process of production (unlike a retail sales tax) but without distorting production decision as a turnover tax does.

The VAT was initially developed to meet rising revenue requirements that couldn't easily be met by existing turnover taxes, the cascading nature of which could seriously distort economic decisions. As mentioned earlier, adoption of VAT which came first in France began slowly. However, the pace of adoption subsequently accelerated. The 1990s witnessed a particularly spectacular increase in the taken –up of the VAT, with its adoption by almost all of the transition (reflecting the need to replace their traditional sources of revenue), by a large number of developing countries, notably in sub-Saharan Africa and the Pacific (where the adoption of VAT has been given additional impetus by long-run

revenue implications of trade reform), and by the small island economies (Tax Dialogue Conference on the VAT, 2005).

2.3 Issues on the VAT

VAT is a system whose base is sales. Any item originating from the producer and transferred to the wholesaler to the retailer and finally to the customer picks additional value at each step which would be taken whenever transaction takes place. VAT has interested many scholars beginning from its inception in the 1940s. VAT has been conceived as a system that can increase government revenue with minimal economic distortion. The main issues surrounding VAT have centered around this somewhat general belief and have tried to discuss the points on types of VAT, principles of VAT, computation of VAT liability and exemption and zero rate.

2.3.1 Types of VAT

There are several bases for classifying value-added taxes of particular importance are the extent of vertical coverage through production and distribution stages; the treatment of amounts paid for producers' goods, particularly durable capital equipment and the method used for calculating tax liability. Conceptually, there are two types of VATs (Rob Capehart, 1999): consumption VAT and the income VAT.

Consumption VAT: - The tax base of a consumption type VAT is the value of goods and services sold or transferred for personal consumption. For example, in consumption, credit-subtraction VAT, a taxpayer typically claims an input credit for VAT paid on purchases of capital goods, as well as on inventory and intermediate goods and services used in his business. A consumption VAT is

calculating by adding together the amount of a firm spends on consumption, interest, dividends and expended capital during the year (Alan and Oliver, 2001).

Bhatia (2003) also states about the types of VAT, if a firm is allowed to deduct the entire credit when the capital equipment is purchased, the system is termed as consumption VAT. Thus the tax actually applies only to purchase for personal household use, with all purchases for use in production by taxpaying firm being excluded from tax. Thus the term consumption type is used the tax is limited to purchase to personal consumption purpose.

A purchase of an investment good is treated like any other material input. Its full value is subtracted from sales in the consumption, despite the fact that it is durable. This is referred to as a consumption type of VAT because the tax base excludes investment and involves only consumption (Harvey S. Rosen, 1995).

Income VAT: - A second type of VAT is income type, it is one that does not permit deduction of the purchase price of durable capital goods in the period of purchase but instead allows the deduction of an annual depreciation charge arising from such purchases (that is if the firm is allowed to deduct the credit as the equipment depreciates over time, the system is termed as income VAT). Each period, firms may deduct only the amount by which investment goods depreciate. The tax base is thus total income net of depreciation, which is why this is characterized as a net income type VAT. Expended capital consists of the amount depreciation a firm has during the year since, by definition, the life of an asset extends over several years and depreciation represents the amount of that asset used during any particular year.

There is a conventional belief that taxing income entails higher welfare (efficiency) cost than taxing consumption (Tanzi, 2002). According to proponents of this idea, the reason for this is that income tax which contains elements of both a labor tax and a capital tax, reduces the taxpayer's ability to save. The argument is that increasing income taxes should not be considered available option in the grounds of both policy (because of their revenue yield is less certain and less timely than that from consumption tax changes). On equity grounds, on the other hand, taxing consumption has traditionally been thought to be inherently more regressive (that is harder on the poor than the rich) than taxing income. Data from industrial and developing countries have consistently remained more than double the ratio in developing countries) that is compared with developing countries industrial countries achieve proportionally time as much reduce from income tax than from consumption tax).

2.3.2 Principles of VAT

According to Alan Schenk and Oliver (2001), there are two types of the principles of VAT. These are origin principle and destination principles. Two understand more let's explain each in details as shown below:

Origin Principle: - A VAT is said to use the origin principle when it taxes values that added domestically to all goods, including goods that are subsequently exported, but does not tax value that has been added abroad and is embodied in goods that are imported and sold domestically. (Goods are taxed where they are produced, and services are taxed where they are rendered). Under the origin principle, therefore, exports are taxable and imports are exempted. This regime is compatible with the income VAT.

Destination principle: - In a VAT that defines its tax jurisdictional reach on the destination principle; the tax is imposed where the goods and services are delivered for personal consumption. In this case, therefore, exports are exempted and imports are taxable. The destination principle is well suited to the consumption VAT. The destination principle is used by central governments in most occasions. It is argued that the preference for the destination principle may be due to the general preference for the consumption VAT and a mercantilist inclination to emphasize economic activity (employment) more than consumption. The choice between the destination and origin principles will influence the choice of the method for computing the amount of tax due.

2.3.3 Computation of VAT Liability

Riswold (2003) stipulated that, the VAT system has to also choose between two methods of computation for determining VAT liability. These methods of computation are either the invoice credit method or subtraction method:

Invoice credit method: - VAT is charged and paid on invoice, thus the producer will remit the difference between VAT received and VAT paid. Taxpayers then are allowed to deduct the tax paid on intermediate purchases from their sale in determining their tax liability. This is called the invoice method because payment of the tax merely requires firms to maintain invoice on sales and purchases for each tax payment period (usually monthly or quarterly). Tax liability is determined simply by applying the fixed rate of taxation to total sales invoices and deducting the amount of VAT paid previously on intermediate purchases as indicated on purchases invoices (David N.Hyman, 1991). Under the invoice

method, all transactions are taxed at a fixed proportional rate, regardless of where they are final or intermediate transactions.

Using the following formula we can compute the tax liability:

$$\begin{aligned}\text{Tax liability} &= \text{Tax payable on Sales} - \text{Tax paid on intermediate purchase} \\ &= [(t) (\text{Total sales} - ((t) (\text{purchases})))] \\ &= (t) (\text{Total sales} - \text{Total intermediate purchase}) \\ &= (t) (\text{Value Added})\end{aligned}$$

Where t is the rate of taxation

Firms that make capital purchases are allowed an additional tax credit for taxes paid on capital goods. So the tax liability of a firm that makes capital purchase in a given tax period would be computed as:

$$\begin{aligned}\text{Tax liability} &= [(t) (\text{Total sales} - \text{Total intermediate purchase})] - [(t) (\text{capital purchase})] \\ &= (t) (\text{Total sales} - \text{Total purchases} - \text{Capital purchases}) \\ &= [(t) (\text{Value added} - \text{investment})]\end{aligned}$$

Subtraction method: - Under the subtraction method, the firm calculates its value added by subtracting from total receipts the cost of produced goods purchased during the period. The tax rate is applied to the figure. The subtraction method uses company accounts to determine VAT liability by subtracting taxable receipts less taxable purchases to obtain total value added. In other words, the subtraction method of computing a firm's VAT calls simply for subtraction of total purchases from the sales of the firm in question and the balance, the value added by this firm, is then subject to the VAT rate. To understand more see the following Table.

Table 2.1 Assessment of VAT Liability under the Subtraction Method.

No	Transaction A	Sales Value Birr B	Birr Value added C	Value added Tax 15% D	Invoice Price (Birr) E	Remittance to tax Authority Birr	Assess the VAT
1	Importer imported	200	200	30	230	30	D1- D0=30
2	Importer Sold goods to wholesaler	300	100	45	345	15	D2- D1=15
3	Wholesaler sold goods to Retailer	400	100	60	460	15	D3- D2=15
4	Retailer sold goods to final consumer	500	100	75	575	15	D4- D3=15

Source: FIRA a Bi-annul Magazine published by the public relation service, 2004.

- The table illustrates that the tax paid on each purchase is deducted from the tax collected from sale, and the net tax is remitted to the tax Authority with out any cascading (compute tax on tax).
- The nature of VAT, with its credit facility, never hinders the flow of factors of production and in effect, it a voids uneven rise in prices of goods and services (Price fluctuation). Besides, it induces to prevail stabilized market condition.
- The table illustrates the deduction of tax paid on direct inputs, whereas it is important to bear in mind that the tax paid on capital goods and administrative expense would be offset as well. Although it indicates that the final consumer bears the cumulative tax effect, and the consumer enjoy prices made free from cascading. The business firm responsible to collect the tax at all levels begins with providing invoices.

Moreover, the value-added based of VAT is an ascertained conceptually by subtracting the purchase cost of taxable goods from its selling price. That is, each firm would pay a tax on the increase in value of an economic good for which productive or distributive activities are responsible.

The invoice credit method is preferred and is used through out the sub-Saharan Africa (Riswold, 2003). Further, it is widely accepted that the transactions based invoice credit methods provides several advantages such as the ability to deal with different rates and minimizing tax evasion by providing an audit trail (that is it greatly facilitates cross-audit). For example, firm A indicated on its tax

return that it has paid \$10,000 in VAT on purchases from supplying B. when 'B' own VAT return is audited, a check will be made to see if B has actually reported and paid the \$10,000 on its sales to firm A (less credits).

Moreover, the tax credit method greatly facilitated the handling of exemptions and rate differentiation. The other methods would require the firm to segregate its purchases of materials on the basis of their use in producing exempt or taxable goods. With the tax credit method, the amount to deduct is indicated by the taxes shown on the purchase invoice provided that tax paid on purchases to produced exempt or zero rated goods is deductible (John F.Due, 1976).

2.3.4 Exemption and Zero-Rating

Exemption: - As the name indicates exemption means that no VAT is charged on the supply and no credit can be taken for VAT paid on purchases used to make the supply. If particular enterprises are exempted, the tax applies to their purchases and they received no credit for or refund of this tax since they are not taxpayers (John F.Due, 1976). Exemption of an entire firm an all its sales are allowed to usually because the firm is below a certain size and in order to facilitate administration or compliance.

One line of argument against exemption is that it complicates administration, erode the tax base and distort input-choice decisions and hence they have to be kept to a minimum. According to proponents of this argument where exemptions have been almost entirely eliminated (as in Chile), the VAT has been much easier to administer and therefore quite successful. Exemptions, according to these proponents, require additional record keeping segregating taxable from

exempts. Sales and in practice the destination between what is exempt to improve the distributional impact of the tax a potentially reasonable trade off while others might be exempted for administrative or political reasons. This is exactly why developing countries exempt particular commodities as they are influenced more distributional objectives than administrative concerns.

Zero-Rating:- zero rating means the supply is charged with a VAT at zero percent but credit can be taken for VAT paid on purchases used to make the supply. Zero rating may be applied to classes of sales such as exports or sales to government agencies, correspondingly reducing the tax payable by the seller or, where his sales are predominantly zero rated, entitling him to a credit or refund the aim of zero rating on the other hand is to lift the entire VAT, including that already collected at earlier stages from a particular goods or services. This is accomplished by allowing full credit for the tax shown on the invoices for purchases of the goods in question or of inputs into it. It is argued that exemption should be granted where the law maker would rather not free the firm, but feel compelled to do so owing to administrative and compliance difficulties while zero-rating is to be given when the purpose is to lift the VAT completely from a goods or services, for social or economic ends.

Zero-rating is often said to be unsuitable for developing countries just because it may require tax refunds. This is quit a weak argument since tax refunds are important in establishing fairness for tax authorities in these countries (Bekure, 2004).

Administrative issues are more important under zero-rating. Since zero-rating increases the number of VAT refunds, most developing countries astutely have limited it to exports. In addition, tax administrations in such countries are poorly

equipped to handle refunds of any kind, and adding to the number of refunds would divert administrative resources from enforcement of the VAT (Gills et al, 1990).

2. 5 Impact of VAT on Revenue

VAT is increasingly being used through out the world, including many African countries to raise government revenue with less administration and economic costs than other broadly based taxes. It is believed to be a good means to raise government revenue even when relatively poorly administered. Ebrill and Keen (2001) also strengthen the above idea empirically. They found that in the countries have adopted VAT, revenue from this source accounted on average 27 percent of the total tax revenue or 5% of the GDP. And about 70% of the world's populations now live in countries with a VAT. This implies that it is a key source of government revenue in more than 126 nations.

Sales tax is collected without any threshold on the annual transaction. On the other hand VAT is collected on all sales of commodities at every stage of production and distribution with threshold on the annual turnover. VAT tax payers have an incentive to demand VAT invoices from suppliers because they are needed to claim the VAT credit create a paper trail that may induced business to comply more fully with the law. Most taxable transactions will appear on two tax returns (that is the buyer's and the seller's) so that tax authorities will have two opportunities to detect evasion. Further, because sellers provide the tax administration a record of their purchases by claiming input credits, tax administrations are more able to estimate what sales and therefore VAT due should be and thereby can detect evasion more easily in a VAT than in a retail

sales tax. Under the VAT the amounts of tax liability at risk in most transactions is only a fraction of the total tax assessed on the sales of the good or service to a consumer. This is because the VAT is collected in smaller pieces at each stage of production, while the entire retail sales tax is collected on a final consumer sale. The lower effective tax rate on each transaction may reduce the intensive to evade the VAT. It is argued that VAT avoids cost-cascading effect. A conventional sales tax leads to compounding of the tax liability, while VAT does not. (Bhatia, 2003).

In order to compare VAT revenue with that of sales revenue, the turnover tax should be added on VAT since sales tax was replaced by VAT and turnover tax.

Table 2.2 Revenue Performance of VAT in Selected African Countries

Countries	Date of VAT introduced	VAT standard Rate%	VAT Revenue (% of tax) revenue	Percent of GDP
Benin	1991	18	41.6	5.6
Algeria	1992	17	31	3.1
Egypt	1991	15	17.9	2.7
Tunisia	1988	18	25.3	6.5
Senegal	1980	20	37.1	6.2
Tanzania	1998	20	32.3	3.2
Uganda	1996	17	33.6	3.4
Zambia	1995	17.5	29.8	5.8
Kenya	1990	18.0	25.9	5.5
Mauritius	1998	10	17.4	3.0
Madagascar	1994	20	39.3	4.3
Ethiopia	2003	15	42.4	5.7

Source: Ebril and Keen (2001), computed from own source

As can be seen from Table 2.2, VAT is a major source of revenue in most African countries. The share of VAT in total tax revenue ranges from 17.4 percent in Mauritius to 42.4 percent in Ethiopia. The average for 31 African countries (24.3 percent) is lower than the world average (27 percent). In Ethiopia the share of VAT in total revenue, which is 42.4 percent is the largest as compared to the sampled countries. The VAT to the GDP ratio ranges from 2.7 percent in Egypt to 6.5 percent in Tunisia with the average of 4.6 percent. Similarly many sub-Saharan African countries have also experienced an increase in revenue from VAT. The revenue performance of VAT as measured by the ratio of VAT to GDP in Ethiopia which is 5.7 % is much higher than the African average (4.6%) and stood the fourth among the twelve African countries under consideration. This implies that VAT in Ethiopia is showing a good revenue performance.

CHAPTER THREE

VAT DEVELOPMENT IN ETHIOPIA

VAT is a tax on consumer's expenditure. It is collected on business transactions and imports. Most business transactions involve supplies of goods or services. VAT is payable if they are: Supplies made in Ethiopia, made by a taxable person, made in the course or furtherance of a business and are not specifically exempted or zero-rated. Supplies which are made in Ethiopia which are not exempt are called taxable supplies. A taxable person can be an individual, firm, company as long as such a person is required to be registered for VAT. Supplies are outside the scope of the tax if they are: made by someone who is not a taxable person or not made in the course or furtherance of business (Basic VAT Guide, 2002).

Weak tax administration stems from a number of interesting factors such as: overly complex and outdated tax laws and procedures, weak or outdated operating and management information systems, poorly trained staff, low remuneration packages for civil servants, bureaucratic civil service procedures, poor infrastructure and equipment and corruption and political interference in tax administration. Due to the existence of these problems, the government of Ethiopia introduced the tax reform program.

3.1 Tax Reform

Tax reform include changing policies to address insufficient revenue, to correct distortions that reduce economic welfare and growth, or measure to reduce inequalities. The tax reform program in Ethiopia has two components:

overhauling of the tax legislation and improving the tax administration. The reform aims at establishing a sustainable domestic revenue base, encouraging trade and investment, ensure fairness, equity and transparency in the administration of the tax laws.

As Demirew Getachew (2004) stated, faced with severe macroeconomic imbalances such as fallings, worsening balance of payments, mounting debts and declining economic growth, the country undertook various policy measures since 1992/93 following a major economic shift from central planning to market oriented system. In the fiscal front, the aim is to expand the tax base and allow government expenditure to grow moderately so that the level of budget deficit could be reduced to a reasonable level. Prior to the tax reform, the government noticed different signals indicating the need to overhaul the tax system. The major ones are:-complex and outdated tax law, weak tax administration, failure of the tax system to generate adequate revenues for government expenditure and the like.

The Ethiopian government has introduced VAT as a part of the overall tax reform program. The tax reform program is preceded by establishment of a new Ministry of Revenue as a first step to improve tax collections and to combat fiscal fraud. Various activities have been conducted subsequent to this: the increase in the sales tax and the removal of import duty surcharge in 2000; a new legislation on presumptive taxation and a 5 percent withholding tax on imports became effective in February 2001; legislation was approved in March 2002 to introduce the TIN system to reinforce the collection powers of revenue agencies, and a tax reform implementation task force was established; a large taxpayer was made operational in July 2001; in October 2001; a draft VAT

legislation was submitted to parliament and this is approved and implemented beginning January 1, 2003. A revised income tax law has been approved and made operational. This revised law includes enhanced enforcement procedures and an improved penalty regime, with a view to increasing the efficiency of income tax collection, and ensuring the recovery of income tax arrears.

Prior to the introduction of VAT, the Ethiopian government has initiated a number of processes (Africa Development Bank, 2003). These include the design and computerization of the taxpayer registration process; the operational development of taxpayers services activities and debit and audit activities; publicity campaign and taxpayer education. These measures are expected to improve the government's revenue position.

Tax policy reforms focus on improving the efficiency and equity of the income tax system, modernizing tax administration by enhancing technical capacities and reforming indirect taxation. The main reform to indirect taxation, hence, was the introduction of a VAT which is made operational beginning January 1, 2003 as said earlier.

The tax system reform project aims to create a tax system that is more supportive of private sector development, improving revenue collection and ensuring equity and fairness of the tax system. The tax reform that has been initiated will lay the foundations for strengthened revenue base (Munoz and Cho, 2003).

3.2 VAT Introduction

The newly introduced VAT is one of the components designed by foreign and local experts to improve the tax collection and administration system is invoice based, and thus required a complete revamp of the way business was conducted in this country. VAT is introduced in Ethiopia with the following main objectives: to minimize the damage caused by attempts to avoid and trade the tax and as certain the profit obtained by tax payables, to enhance economic growth and import the ratio relationship between domestic production and government revenue and to enhance saving and investment as it essentially a consumption tax and it does not tax capital.

VAT is becoming the ministry of the revenue in most of the country. It introduced in many countries and the trend of its introduction is also increasing rapidly. Consistent to the world trend, as the researcher mentioned earlier Ethiopia introduced VAT in January 2003, replacing the sales tax. The VAT has applied a uniform rate of 15% on most consumption goods and services with the exception of exports and exempted goods and services. The scope of exempted goods and services differs from that of the sales tax. Under the VAT, the main exempted items are sales of used dwellings, financial services, medical and educational services, electricity, kerosene, water and transportation.

(For more understanding see annex 4).

Eligible business enterprises for VAT registration are those which have annual turnover of Birr 500,000 and above. For those business enterprises whose annual turnover of taxable goods is less than the VAT registration threshold. an

equalizing turnover tax is introduced at the rate of 2% for goods and 10% for services. VAT registered business enterprises are eligible to claim input tax while non-registered are not given this opportunity. That is why the equalizing rate of turnover tax appears (Demirew Getachew, 2004).

The merits of VAT as compared with the replaced sales tax are:-

- VAT is broad based tax, which enables to raise more government revenue. This is because of the following reasons:
 - The rate is uniform and the scope of exemption is limited under VAT,
 - VAT is applied at each stage of production and distribution i.e. wherever additional value is created the tax is applied;
- VAT encourage export and investment since this activities are zero rated and exempted respectively;
- VAT is confined on consumption of goods and services so that it avoids the distorting effects of tax cascading that arises from the taxation of business inputs;
- Evasion is minimized under VAT system due to a built in checking system. The system demands each VAT registered enterprise to report its sales and purchase. One cannot hide its sales, as the sale of one is the purchase of other. The purchaser has incentive to reveal purchases so that he can get credit on input tax.
- With a move toward globalization and regional integration (which the government has to join the trend), with the implication on loss of revenue from foreign trade, VAT is expected to take a lead as a source of revenue

by minimizing the number of exempted and zero rating goods and services and by broadening the base.

- Replacement of the current sales tax by the value added tax enhances economic growth and improve the ratio relationship between government revenue and gross domestic product.

Same line of argument can be proposed in introducing VAT i.e. the deficiency in sales tax. The sales tax base in Ethiopia was narrow because it was limited to imports, manufactured goods and a few selected services (Munoz and Cho, 2003). Because credit was given only for taxes paid on raw materials, the tax had a cascading effect, distorted efficient resource allocation, and thus likely impeded economic growth. Hence, in comparison to the sales tax, the new VAT taxes services in addition to production grants zero-rating to exports and gives exemptions to fewer basic product

As mentioned above in the good practice of tax reform in developing countries, Ethiopia introduce broad-based tax i.e. VAT in January 2003 with uniform rate on all goods and services having threshold of Birr 500,000 for registration. The scope of exemption is also limited as compared to sales tax.

3.3 Salient Points of Ethiopian VAT Law

The VAT Proclamation No 285/2002 was issued on 4th July 2002 by the council of representatives which has rescinded and replaced the sales tax. It has come into force as of January 1st, 2003 is a consumption tax. The proclamation has 13 sections and 66 articles. It is levied and paid as a value added tax at a rate of 15 percent of the value of every taxable transaction by a registered person, every

import of goods, other than an exempt import and an import service rendered in Ethiopia for a person registered in Ethiopia for VAT or any resident legal person by a non resident person who is not registered for VAT in Ethiopia (Article 7(1)-(c) and Article 23 (1) and (2)). A taxable transaction is supply of goods or a rendition of services in Ethiopia in the course or furtherance a taxable activities other than an exempt supply (Article 7(3). whereas a taxable activity is any activity, which is carried on continuously, or regularly by any person in Ethiopia, or partly in Ethiopia, whether or not for a pecuniary profit that involves, in whole or in part, the supply of goods or services to another person for consideration (Article 6 (1) and (2)).

The VAT Law contains two VAT rates; one is the standard 15 percent rate and the other is zero-rated. The taxable transaction such as the export of goods and services are charged with a tax at rate of zero percent. A person who deals in zero rate supply can register for VAT and can, therefore, recover all his input tax; consequently, the goods or services he supplies are completely free of VAT

Tax-exempt goods and services are supplies in which VAT, both the standard rate and zero- rate tax, are not paid on so a person who deals only in exempt supplies cannot registered and so cannot recover any input tax charged to him. Under the VAT Law, the following are exempt from VAT the sale of used dwelling or the lease of a dwelling, the reversing of financial service, the supply or import of national or foreign currency, the rendering of religious services, the import or supply or import of national or foreign currency, the rendering of religious services, the import or supply of drugs. educational services, the supply of goods and rendering of services in the form of humanitarian aid, the supply of electricity, kerosene, water, goods imported by governmental organization,

institution and projects exempted from duties, post office supplies, printed books and other printed materials, the import of goods to the extent provided under schedule 11 of the customs tariff regulation, the supply of goods by work shops for the disabled, food items like bread, injera, milk, agricultural inputs.

Note that the exempted categories such as health, education basic utilities such as electricity, kerosene and water and mass or public transportation have a common feature in that they are designed and intended to benefit the public at large and encourage and enhance the economy and to protect social and public interest. Generally speaking the exemptions have been granted for economic administrative or social reasons.

The registration for VAT is both obligatory and voluntary under the obligatory registration; a person who carries on taxable activity and is not registered is required to file an application for registration if his annually transaction exceeds Br 500,000 (US \$ 58,100). Those people who are required to registered are also expected to fill be registered for VAT. Voluntarily registration, a person not required to be registered for VAT may voluntarily apply to the authority for such registration, if they regularly supply or render at least 75 percent of goods and services for registered persons. A registered person may conduct taxable activities in different branches or division, in such cases, the registered person must be registered only in the name of the registered person at its main address. (i.e. divisional registration).

According to Article 22 (1) (2) of the VAT proclamation all persons registered for VAT required to issue a VAT invoice to the person who receives the goods or services. There are cases where a receipt or simplified form of VAT invoice

may be used depending on the value of transportation and type of transaction involved. Those unregistered do not have the right to issue a tax invoice.

VAT is collected by the Federal Inland Revenue Authority, VAT department in Addis Ababa and the branches and at customs stations of the Ethiopian customs Authority at importation of goods. When VAT is not returned accordingly, the Federal Inland Revenue Authority may seize property to collect the tax due. The seizure shall extend only to property possessed and obligation existing at the time the seizure is made. The seized property could be sold at public auction or in any other manner depending on the nature of the goods to sell to cover or given over to it for any cause what so ever. Nevertheless, portion of the proceeds in excess of the liabilities shall be returned to the owner. In this process, FIRA will only use the powers uncollected tax. No other agency of the government may require the property seized to be transferred of attachment and seizure as a last resort. The tax payer will be afforded every opportunity to make payment arrangements before the enforcement action is taken.

Some of the violations of the proclamation are administrative and there are administrative penalties and interest, applicable to failure to file, failure to pay, failure to maintain the required books and records and the like. The rest of the violations of this law are tax offences hence shall be charged, prosecuted and appeared in accordance with the Ethiopian criminal law. Tax evasion making false and misleading statements, obstruction of administration, failure to notify changes in addresses and line of business-unauthorized VAT collection, aiding or abetting, offences by entities, offences by receives, imported tax debit and tax credit subject to prosecution and on conviction subject to monetary fine and imprisonment from not less than 1 to not more than 15 years. Any tax officer or

former taxation officer employed in carrying out the provision of this proclamation who commits offences is subject to monetary fine and imprisonment of not less than 10 years and more than 20 years.

Except for problems of tax compliance delay of computerization and some weakness in the administrative set up of VAT Department, the implementation has been smooth. The Ministry of Revenue and FIRA have done a good job and avoided most of the problems encountered by other countries, for example Ghana in 1995 (World Bank, 2001). Since strong and clear political management was crucial for the implementation of the VAT, extensive consultation with stakeholders, comprehensive taxpayer education and information programs have been conducted.

3.4 Constraints of VAT Implementation in Ethiopia

Ethiopia shares developing countries problems in their effort to establish efficient tax systems in general (Tanzi, 2001). Firstly, most workers in these countries are typically employed in agriculture or small informal enterprises and this means the possibility of regular or fixed wages is rare as they receive cash payments (i.e. off the books) that further mean difficulty to calculate the base for an income tax. Related to this, as most of the workers do not made transactions in large stores, the role is played by income taxes and customer taxes is limited and little possibility for the government to achieve a high tax levels. Secondly, it is difficult to create an efficient tax administration without a well-trained staff, when money is lacking to pay good wages to tax officials and to computerize the operation (or even to provide efficient telephone and mail services) and when taxpayers have limited ability to keep accounts. Thirdly, because of the informal

structure of the economy in many developing countries and because of the financial limitations, statistical and tax offices have difficulty in generating reliable statistics. This lack of data prevents policymakers from assessing the potential impact of major changes in the tax system. As a result, marginal changes are often preferred over major structural changes, even when the latter are clearly preferable. This perpetuates inefficient tax structure. Finally, income tends to be unevenly distributed in developing countries. Although raising high revenues in this situation ideally calls for the rich to be taxed more heavily than the poor, the economic and political power of rich taxpayers often allows them to prevent fiscal reforms that would increase their tax burdens. This explains in part why many developing countries have not fully exploited personal income and property taxes and why their tax systems rarely achieve satisfactory progressivity (in other words where the rich pay proportionately more taxes).

Alternatively, it can be said that the whole tax system in Ethiopia is faced with such problems as unsatisfactory level of record keeping and administration inefficiency, lack of sufficiently educated (informed tax payers), there is high cost of tax compliance, extensive evasion, over-zealous and corrupt tax officials and extremely narrow tax base-in many of the countries, 20-30 large business account for two-third of a country's tax revenue.

It is obvious that the introduction of any new tax scheme will invariably met with reservations and mixed reactions from the general public in any country, irrespective of the country's socio-economic status or its level of development. Because VAT is a new and sophisticated tax that differs significantly from the classical tax schemes with which the people were familiar, various misconceptions regarding its impact, its application, and its benefit to the

national economy are normal in the initial phase of its application. Several well-meaning but insufficiently informed individuals, or otherwise people with ulterior motives, have misled the public into thinking that its impact is cumulative and claimed that its effect on consumer spending would go far beyond even the 15 percent flat rate that the tax imposes.

While VAT has been adopted in most developing countries, it frequently suffers from being incomplete in one aspect or another (Riswold, 2003), many important sectors, most notably services and the wholesale and retail sector have left out the VAT net, or the credit mechanism is excessively restrictive (that is there are denials or delays in providing proper credits for VAT on inputs), especially when it comes to capital goods.

As Munoz and Cho (2003) also stated that, VAT is progressive when we analyze total expenditure at the national level. However, because it has fewer exemptions and only one rate, the VAT is less progressive than the sales tax it replaced. Most of the exempt goods and services are disproportionately consumed by the relatively well to do, so the exemptions cannot be justified on equity grounds. The other problem commonly observed is that some of the tax payers refuse to honor their debit obligations to the VAT service while others submit their VAT returns without payments. There also deliberate submission of nil returns, non-issuance of VAT invoices and entertainment provides and lotto operators refuse to use the VAT coupons.

3.5 VAT Audit and Refund

The difference between the amount of output tax and input tax is the VAT payable to the FIRA. VAT Payable is the VAT to be paid to the FIRA/VAT by a taxable person. If the VAT on sales is greater than the VAT on Purchases, then the trader pays to FIRA on sales in excess of the VAT on purchases. It is arrived at by the formula;

(that is, Output Tax minus Input Tax = VAT payable/VAT). When Input Tax exceeds output tax, a taxpayer may be allowed to carry the credit forward and a refund made after 5 months if input taxes still exceed output tax (i.e. Input Tax minus Output Tax =VAT Refundable/Credit). If the VAT on sales is less than the VAT on Purchases, then the FIRA refunds or grants an offset to the trader equal to the excess of VAT on purchases over VAT on sales.

As John F. Due (1976) stated, in many countries, especially developing and in transition, audit performance is reported to be a particularly poor aspect of VAT administration. The evidence is that several of some developing countries like Ethiopia which adopted the VAT in the late 10- 15 years do not yet have effective audit programs. And, for those that do have some elements of such a program, it is often dominated by pre-refund verification. There is also the tendency for these countries to try to offset weak audit by adopting complex procedures, such as increasing filing requirements and massive cross-checking of audit. These compound administrative difficulties and add to compliance costs.

Without effective audit, VAT compliance deteriorates and the credibility of tax administration suffers strengthening audit is thus a key challenge, particularly in developing countries. Therefore the nature of VAT audit includes: Most tax administration experts agree that, an effective VAT audit program should provide for a 25-30 percent coverage of tax payers each year, VAT audits need to be closely coordination with audit of other tax liabilities (especially income tax), The development of an effective VAT audit program significantly helps to improve income tax compliance and The effective audit programs used to avoid VAT specific fraud includes the use of fake invoices to abuse the credit system, the misreporting of domestic sales as exports to be benefit from zero-rating.

Hence the VAT auditor should establish that the taxpayer is accounting for VAT correctly with respect to transactions that are taxable at 15 percent transactions, input tax credits in addition to verifying that the claim for refund is supported by the appropriate documentation and VAT paid on inputs. An effective refund mechanism is essential to preserve the VAT as tax on consumption and to avoid distorting the allocation of resources. However, countries have the legal and administrative framework, and the administration of VAT refunds is a persistent problem. The problem emanates from a widespread of abuse and fraud in filing credits and refunds by taxpayers and exporters and also the reluctance of officials to give tax refunds.

In Ethiopian case, according to Article 27/1 of the VAT proclamation 285/2002, if at least 25 percent of the value of registered person's taxable transaction for the accounting period is taxed at zero rate, the Federal Inland Authority shall refund the amount of VAT applied as a credit in excess of the amount of VAT charged for the accounting period with in two months after the registered person

files an application for refund, accompanied by documentary proof of payment of the excess amounts.

Also, Article 27/2 stipulates that in case of other registered person, the amount of VAT applied as a credit in excess 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. A pre-refund audit should be undertaken for a first re-fund claim. Refund audit should focus only on the period covered by the claim: The types of tests that VAT auditor conducts in verifying taxpayer's compliance are: classifying operations as taxable or tax exempt, charging VAT at 15% on the sales of goods and services, calculated on the total charge made including charges for delivery, services, training and the like, maintaining the required evidence to support the zero-rating of exports, in accordance with VAT regulations 34 to 38 inclusive, Adhering to the VAT invoicing provisions.

CHAPTER FOUR

DATA PRESENTATION AND INTERPRETATION ON PRACTICES AND PROBLEMS OF VAT

4.1 Introduction

As explained earlier in the methodology part of this thesis, the nature of this research project is that descriptive type which included the survey and fact-finding inquires with regard to practices and problems of VAT. Quantitative analysis techniques are used to analysis the collected data. This is because the range from creating simple tables or diagrams that showing the frequency of occurrences, through establishing statistical relationships between variables to simple statistical modeling. So the analysis of the data presented by percentages, tables and figures

The study analyzed the selected large VAT Registered Taxpayers, Addis Ababa branch VAT registered taxpayer and Sole proprietor VAT registered tax payers and also the selected employees of FIRA. So the analysis is concerned on the practical application of VAT and the challenges faced on the practices of VAT and provide appropriate solutions for the constraints.

The survey was conducted by the distribution of Questionnaires to VAT register taxpayers (LTO, A.A branch office, and Sole Proprietorship) and Employees of FIRA. Close and open-ended Questionnaires were prepared for both respondents on the basis of a simplified lists of yes or no and detailed information requirements along with any kind of comment given by the requirements. The instrument was given by Amharic for VAT registered

taxpayers and English for employees of FIRA as almost all of the respondent are capable of comprehending the selected language barriers and hence to avoid language barriers and minimizing responses bias due to misunderstanding. Data collection was carried out by the researcher and enumerators (trained by the investigator). And also interviews were conducted for some VAT registered taxpayers and officials of the authority.

On the sample of 308 (245 and 63 VAT registered tax payers and employees of FIRA respectively). 276(90%) responses were gathered (that is 217(89%) from VAT registered taxpayers and 59(94%) from employees of FIRA). Out of 217 respondents VAT registered indicates that Large VAT taxpayers, Addis Ababa branch VAT registered taxpayers and Sole Proprietor VAT payers, are account 26(12%), 108 (50%) and (38%) respectively.

As explained earlier in the methodology part of this thesis large taxpayers, includes the taxpayers of share companies, partnerships, joint ventures etc. whose annual turnover is equal or greater than 5 million Birr, where as Addis Ababa branch VAT tax payers includes share companies, partnerships, Joint Ventures and the like but there annual turnover is less than 5 million Birr, however both exclude sole proprietorship taxpayers.

In terms of employees of FIRA out of 59 the share of respondents are as follows: Employees of VAT department (Sole proprietor ship) 17(29 %). employees of large taxpayers 19(32%) and employees of Addis Ababa branch VAT registered taxpayers 23(39%). See table 4.1 below for details. .

Table 4. 1, VAT Registered Taxpayers and Employees of FIRA Respondents.

Types of VAT payers	Numb of Respondents	Percent	Employees of FIRA	Number of Respondents	Percent
Large VAT Registered Taxpayers	26	12%	Employees of VAT Department	17	29%
Sole proprietor VAT Registered Taxpayers	83	38%	Employees of Large Taxpayers Office(LTO)	19	32%
Addis Ababa Branch VAT Registered Taxpayers	108	50%	Addis Ababa Branch VAT payers office	23	39%
Total	217	100%		59	100%

Sources: computed from survey data, 2007

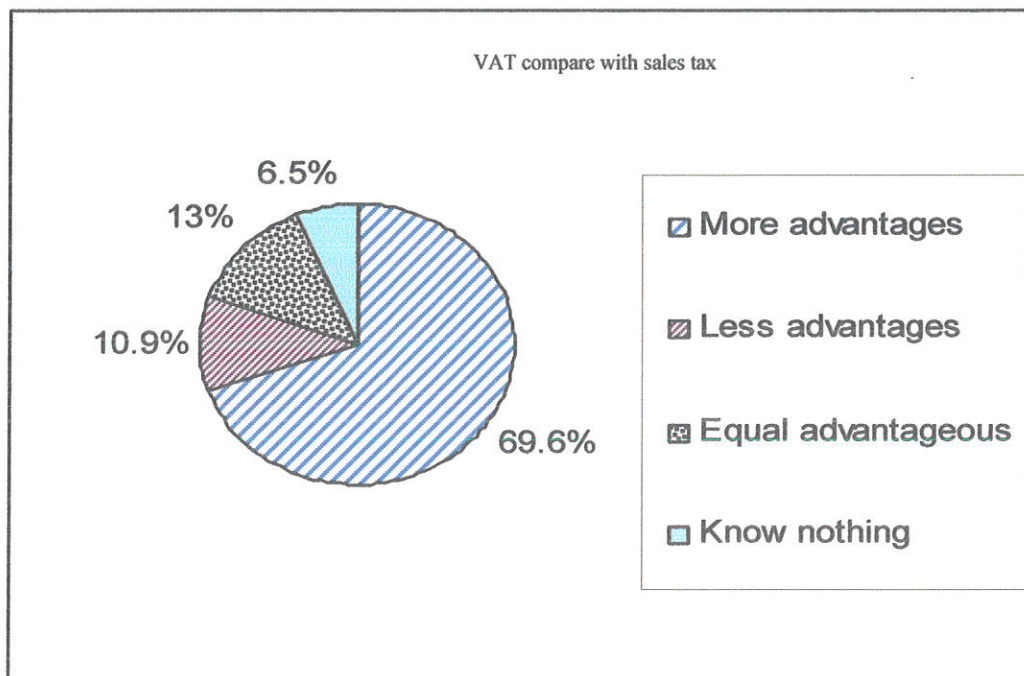
4.2 Benefits of VAT Compare to the Sales Tax

VAT is broad based tax, which enables to raise more government revenue. This is because VAT is applied of each stage of production and distribution that is whenever additional value is created the tax is applied. But the bases of sales tax are narrower because it was limited to imports, manufactured goods and a few selected services.

In the survey, the VAT registered enterprises were asked about their opinion whether VAT is more advantageous than the replaced sales tax or not. Out of 217 VAT registered tax payers, 152(69.6%) answered it is more advantageous

than the sales tax, 24(10.9%) answered it is less advantageous, 28(13%) of them responded it is equal advantageous with sales tax and the rest of 13(6.5%) knows nothing. For more understanding see the following figure.

Figure 1, VAT and Sales Tax.



Source: computed survey data, 2007

The above figure shows that most of the respondents 152(69.9%) replied that VAT is more advantageous than the sales tax this is because it is a refundable tax when input tax exceeds out put tax in addition to this it is not affect the business community rather the tax collected from the consumer. But the rest 13(6.5%) replied know nothing about the benefits of VAT from the sales tax, incase of this the FIRA should provide intensive education to them and they should understand clearly about the merits of VAT.

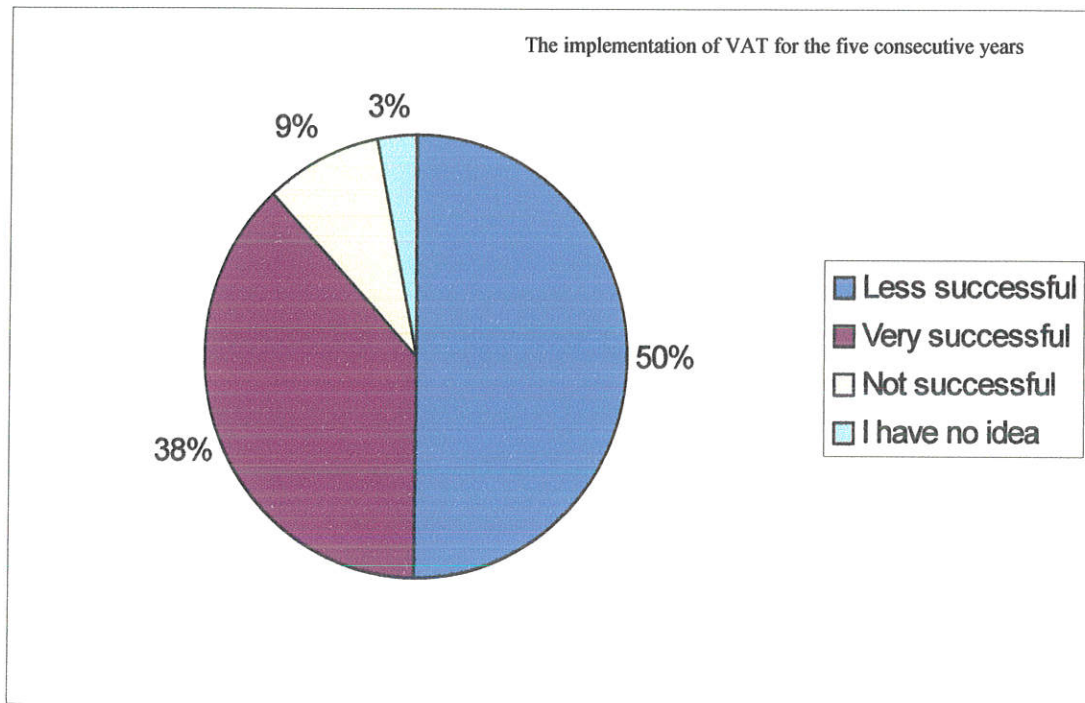
The survey was also conducted on employees of FIRA asked about whether VAT more important than sales tax or not. Out of 59 respondents, 51(87.1%) responded VAT is more advantageous than the replaced sales tax, 6(9.7%) answered it is less important than sales tax and 2(3.2%) responded no difference between the VAT and the sales tax. As we can understand from the above responses, most of the respondents replied that VAT is more useful than the replaced sales tax.

VAT registered tax payers and employees of FIRA were also asked why they thought the VAT more advantageous than the sales tax. Their reasons are summarized as follows:

- VAT provides more revenue for the economic development of the country than the sales tax this is because it is a broad based tax system and it has less exempted goods or services than the replaced sells tax.
- It is fundable tax system,
- It reduces the evasion of tax. This happens because the tax is divided into parts and there fore the incentive to evade tax by only one firm is reduced.
- It avoids cascading; Cascading occurs when a tax on inputs is not refundable and charged again on output.

As we have seen from the above points described by both respondents, VAT is more important than the sales tax this is because as the survey result indicates since VAT is a broad based type of tax system it increases the revenue of the government, encourages both investment and export and it avoids cascading. The employees of FIRA were asked about whether the implementation of VAT successfully in the consecutive five years or not. Out of 59 respondents, 22(38%) responded the implementation of VAT is very successful, 30(50%)

replied that the VAT implementation is less successfully, 5(9%) answered not successful and the rest 2(3%) replied no idea. For detail see the following figure Figure 2, Implementation of VAT



Source: computed survey data, 2007

As to have seen from the above figure 30(50%) of the respondents, replied that the implementation of VAT in the five consecutive years is not much successful, this is because of various constraints such as inefficient tax administration, less awareness of the business communities on the VAT rules and regulations and the like. The survey was also asked the respondents about why the implementation of VAT for the consecutive five years is less successful. They put their reasons as follow:

- The VAT administration of FIRA is weak, due to insufficient number of employees in the authority.

- The way and method of fraudulent activities on VAT is increasing by taxpayers. For example, applicable to failure to file, failure to pay, failure to maintain the required books and records and so on. So the authority should not control these non compliance enterprises and take appropriate action on them due to inefficient tax administration .Hence noncompliance business communities are remitted the collected tax for themselves rather than the government,
- Some business communities are misunderstand about the tax laws and its application, and
- The attitude of most business community towards tax is negative.

Therefore due to different constraints such as the weaknesses of tax administration, less awareness of the business communities towards the tax, the existence of the noncompliance of the business communities the implementation of VAT in Ethiopia is not much successful and it couldn't achieve its objectives properly.

4.3 VAT Rules and Regulations

As discussed briefly in chapter three the VAT proclamation was introduced in Ethiopia January 1st, 2003. It has 13 sections and 66 articles. According to this proclamation VAT is payable and would be levied at the rate of 15 percent if they are: supplies made in Ethiopia, made by a taxable person, made in the course or furtherance of a business and are not specifically exempted or zero rated.

The survey was carried out by asking the VAT registered tax payers about whether you are familiar with the proclamation of VAT rules and regulations or not. The survey result shows, 141(65%) of 217 replied that they know little the rules and regulations of VAT, 41(19%) responded know much the rules and regulations of VAT and 35(16%) replied know nothing about the proclamations of VAT rules and regulations. For details see the following table.

Table 4.2 VAT Rules and Regulations.

Question survey	Items				Total
Do you know the proclamation of VAT rules and regulations properly?	Yes	Yes but not much	Nothing know	None	217(100%)
	41(19%)	141(65%)	35(16%)	0(%)	

Source: computed survey data, 2007

As we have seen from the above table 4.2, 141(65%) of the VAT registrants taxpayers replied that they have not yet sufficient knowledge about the rules and regulations of VAT and 35(16%) of them replied nothing to know about the proclamation of VAT rules and regulations. Therefore due to the presence of unawareness business communities about VAT laws are the bottle necks of the implementations of VAT in the country properly. So the FIRA should work more on the area of awareness creation about the concept of VAT rules and regulations. In order to know the causes about these constraints the survey was

also conducted by asking them about why not yet you know the rules and regulations of VAT properly. They summarized their reasons as follow:

- The authority doesn't create conducive atmosphere in order to teach about the VAT rules and regulations,
- There is no any access (means) to get the documents which are explained about the rules and regulations of VAT like brochures, Pam plates and other necessary materials,
- The FIRA makes not enough preparation to aware the tax payer to learn and it isn't also explained it well to the tax payers,

Therefore the FIRA should do more in order to create awareness about the VAT concepts, rules and regulations to the taxpayers.

The survey was also made by asking the employees of FIRA about whether the authority had made sufficient clarification to the public about the concept of VAT or not. Out of 59 respondents, 18(31%) responded yes, 34(57%) replied that yes but not much 5(9%) answered no and the rest 2(3%) know nothing. For more detail see the following table.

Table 4.3 The Concept of VAT.

Question survey	Items				Total
	Yes	Yes, but not much	No	Know nothing	
Do you believe that FIRA has made sufficient clarifications to the public about the concept of VAT?	18(31%)	34(57%)	5(9%)	2(3%)	59(100%)

Source: computed survey data, 2007

As we have seen from the above table, 34(57%) of the respondents replied that the FIRA has not given much information about the concepts and laws of VAT to the business communities. This is because the number of employees in the FIRA is too small compare to the VAT registered taxpayers, so it couldn't provide sufficient information about the laws of VAT to the community.

In order to create more knowledgeable societies about the concepts and uses of tax the authority should provide continuous clarification about the laws of VAT. In order to know the causes of the unawareness of the business communities about the VAT laws clearly the survey was conducted by asking officials about

why the FIRA has given less clarification about the concept and laws to the society. They put their reasons as the following manner:

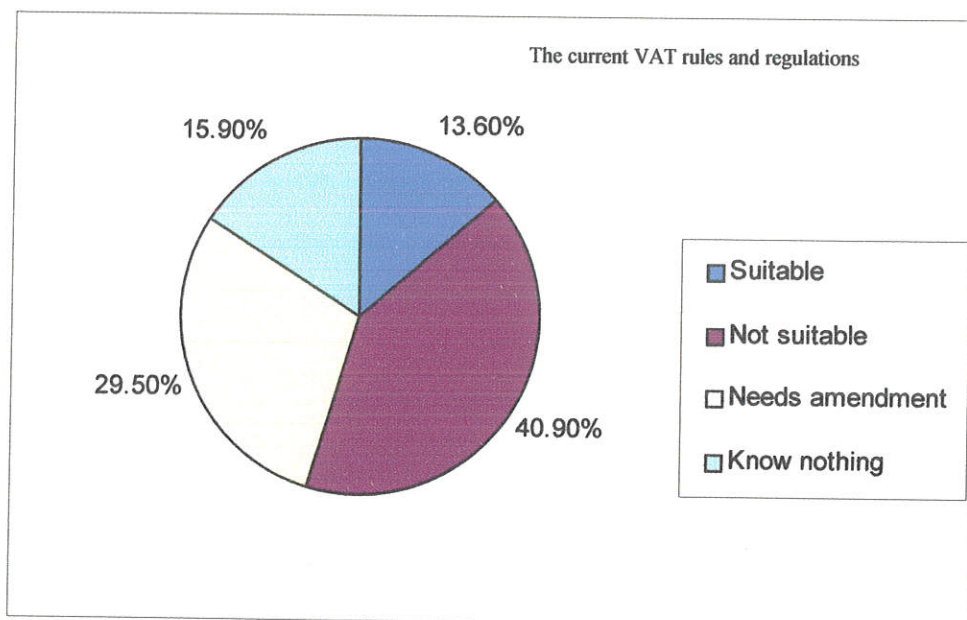
- Due to the presence of small number of employees in the authority the FIRA couldn't provide sufficient clarification about it,
- Some tax payers are not willing to learn at the scheduled prepared by the authority because they prefer to run their business and had to give less attention to the program,
- Some of them are forced registrants and have no sufficient knowledge about the rules and regulations of VAT. Therefore they are not willing to know or learn,
- Some tax payers have negative image about the tax so they have no interest to know about VAT rules and regulations,
- Some tax payers are illiterate so they didn't know the concept of VAT, and
- There is a gap between taxpayers and the authority; this is because most of the time tax payers performed their duties by their representative agents. So there is no direct communication between them.

As to understand from the above explanations given by both the officials of the FIRA and the VAT registered taxpayers, there are some constraints which are obstacle to perform their duties properly. So to curve these constraints, the authority should give high emphasis for teaching of the tax payers intensively about the concepts of VAT rules and regulations. The authority should also create conducive conditions for the taxpayers to get the necessary materials which explain about the VAT rules and explanations. Such materials are like brochures, pan plates and other supportive documents. The tax payers should also give special attention and acquire sufficient knowledge about the rules and

regulations of VAT and they should also obey the proclamation of the VAT rules and regulations.

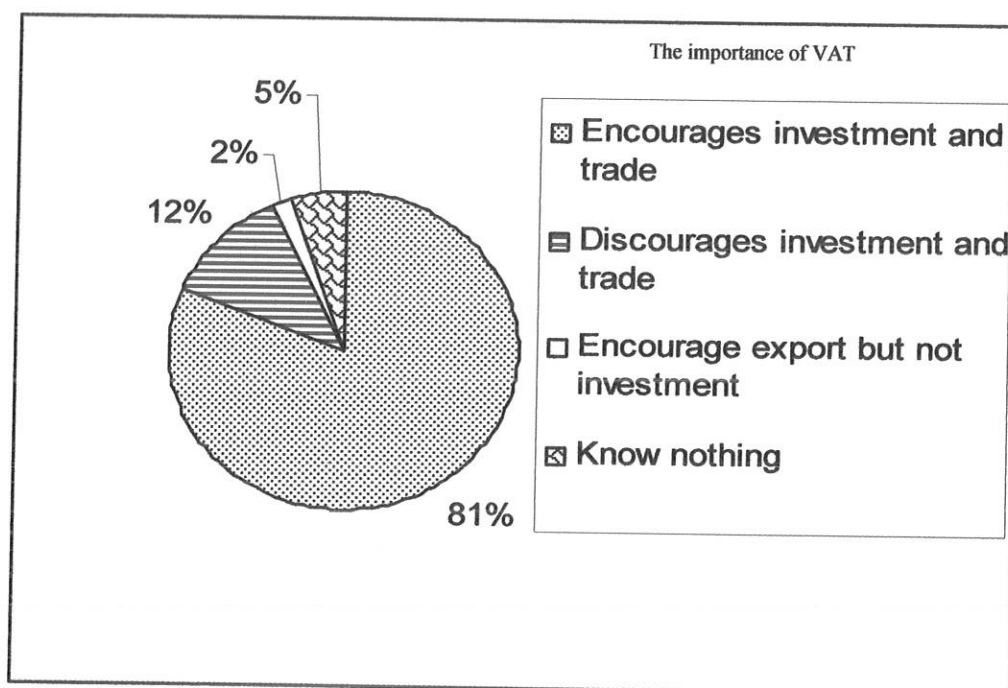
During the survey the VAT registered tax payers were also asked whether the current rules and regulations of VAT are suitable or not. Out of 217 respondents, 30(13.6%) responded the current VAT rules and regulations are suitable, 88(40.9%) of them replied the VAT rules and regulations currently applied is not suitable, 65(29.5%) responded some VAT rules and regulations should be amended and 34(15.9%) of them replied know nothing. For detail see the following figure 3.

Figure 3, Rules and Regulations of VAT



Source: computed survey data, 2007

Figure. 4. Importance of VAT



Source: computed survey data, 2007

As to understand from the above figure 4, 176(81%) of the respondents know properly about the importance of VAT for encourage investment and export. This is because VAT encourages both investment and export by zero rating the input tax. 26(12%) answered VAT discourage for the development of investment and export. This is because poor administration of the authority to control tax evasion. Even though most of the respondents were given a positive respond, the FIRA should strengthen its capacity of administration and provide a continuous education to the VAT registrant tax payers about the VAT rules and concepts. Since the newly tax system (VAT) is important to encourage both investment and export of the country.

As the above figure indicates that 88(40.9%) of the respondents responded that the current VAT rules and regulations are not suitable for the business communities, and 34(15.9%) replied know nothing about the current VAT rules and regulations, so the FIRA should teach them about the concept of VAT laws and regulations properly. In order to properly implement and achieve its objectives the FIRA should set up suitable VAT rules and regulations with consideration of the business societies.

4.4 The Impact of VAT on Investment and Export

The newly introduced VAT is one of the components designed by foreign and local experts to improve the tax collection and administration system is invoiced based. Thus required a complete revamp of the way business is conducted in this country. This new tax system is to encourage investment and export because these activities are zero credited.

The survey was conducted on VAT registered enterprises to know their opinion by asking them about VAT is importance for the growth of investment and export or not. Out of 217 respondents, 176(81%) responded VAT is important for the growth of investment and export, 26(12%) answered VAT discourage for the development of investment and export, 4(2%) responded VAT is encourage export but not investment and 11(5%) of them nothing to know about its impact on investment and export. For details see the following figure.

The survey was also conducted by asking the employees of FIRA to discover their attitude about the impact of VAT on investment and export. Out of 59 respondents, 37(63%) responded VAT encourages investment and export, 5(9%) answered VAT discourage investment and export and 17(28%) of them responded it encourages export but not investment. For more detail see the following table.

Table 4.4 Implementation of VAT.

Question survey	Items			Total
The current implementation of VAT in Ethiopia	Encourage investment and export	Discourage investment and export	Encourage export but not investment	
	37(63%)	5(9%)	17(28%)	

Source: computed survey data, 2007

The above table indicates that 37 of 63% of the respondents replied VAT encourages both investment and export since the activities are zero rated and 17(28%) of the respondents replied VAT is encouraged export but not investment, so the survey was also conducted by asking them why VAT encourages export but not investment. They summarized their reasons as follow: Because of the fact that the country's per capita income is one of the lowest in

the world, the purchasing power of the Ethiopian people is very weak. This lack of effective demand has in turn, been discouraging investment particularly investment in the production for the local market. Imposing a taxation system that further weakness the people's purchasing power could this make the system inimical to economic growth. And it those who live in absolute poverty who will be hurt the most, in the light of the regressive character of VAT.

4.5 Problems Of VAT Implementation

A poorly administer VAT raises less revenue than possible and can change the very nature of the tax resulting in unintended economic distortions. As it has been observed in many developing countries at the initial stage, VAT implementation faced different problems. This has been the case with Ethiopia as well.

The survey was conducted by asking of the employees of FIRA about do you know that the problems that hinder for the VAT implementation of VAT in Ethiopia. Out of 59 respondents, 50(85%) responded yes there are problems which are obstacle for the implementation of VAT, 7(12%) replied no, 2(3%) responded no idea. For detail see the following table.

Table 4.5 Problems of VAT implementation.

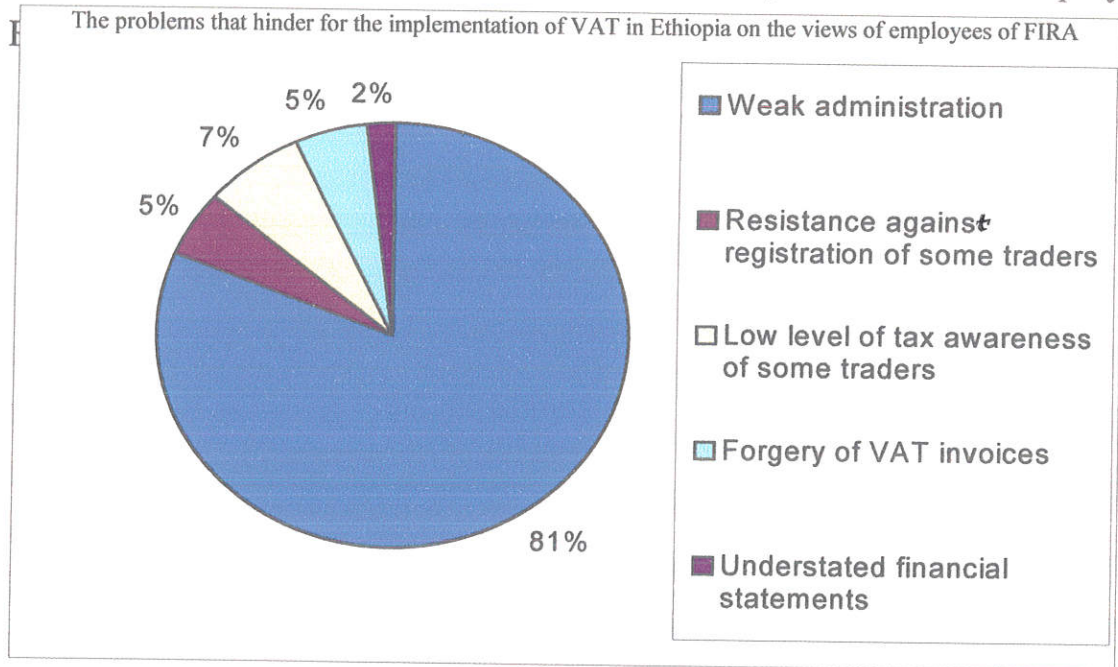
Question survey	Items			Total
	Yes	No	No idea	
Do you know the problems that hinder for the implementation of VAT in Ethiopia?	50(85%)	7(12%)	2(3%)	59(100%)

Source: computed survey data, 2007

As to observe from the above table, 50(85%) of the respondents replied that there are problems that hinder the implementation of VAT. By considering this

the survey were also conducted to ask them what are the problems that hinder for the smooth implementation of VAT?, Out of 59 respondents, 48(81%) responded that the serious problem is inefficient administration due to less number of employees, 3(5%) replied the serious problem is the resistance of some VAT payers against registration for VAT, 1(2%) responded due to understated financial statement, 4(7%) answered low level of tax awareness for some business communities and 3(5%) responded forgery of VAT invoices is the serious problems for VAT implementation. For more detail see the following figure5.

Figure 5, Problems of VAT Implementation by the Views of Employees of FIRA



Source: computed survey data, 2007

As we have seen from the above figure5, 48(81%) of the respondents replied that one of the serious problems of VAT implementation is inefficient tax administration this is due to insufficient number of employees in FIRA. To alleviate this and other problems explained above the FIRA should recruit more qualified employees and strengthen its tax administrative capacity.

Following a brief discussion was made together with the officials of the authority on each identified problems mentioned above.

1. Weak Tax Administration

Weak administration from the tax collector side is one of the serious problems for the implementation of VAT. As the above figure 7, shows 48 respondents 48(81%) ranked this problem as the first serious problem. VAT with the advantage of modernizing the tax administration, needs strong and trained staff supported by the necessary equipment. However in the country, where VAT registrants are increasing surprisingly from what has been planned, trained manpower and the necessary materials are not provided in accordance with the rising number of registrants. So, if necessary materials and staff are not fulfilled, VAT in Ethiopia should not continue in achieving the objectives it is designed for.

2. Resistance against Registration for VAT

Any person dealing in taxable supplies and whose taxable annual turnover is above registration threshold is required to register for VAT. A trade who fails to register while liable to do so, he shall be legally required to account for VAT beginning with time he came to be liable for registration including financial penalty. However, most of the traders eligible for registration do not appear to the tax authority to take registration certificates. The survey result indicates that 3(5%) of the respondents rank this problem another serious problem.

3. Understated Financial Statement

Mostly traders who maintain books of account usually declare turnover much less than the registration threshold level. According to the survey study most business holds two books one for the tax authority and another for banks. Usually the financial statement produced to the tax authority are highly understated and to banks overstated. Hence, give a wrong tax. This, of course, requires an intensive audit work in order to adjust the actual income for registration. This is one of the areas where resistance traders use as a means against registration for not to come into the VAT network.

4. Low Level of Tax Awareness

Resistance against registration for VAT is attributable to the trader's limited awareness towards the tax legislation. Most of the tax paying community is not aware of the fact that the tax is collected from the customer and the opportunity to have credit for taxes paid on purchase. This is because most of the traders do not attend tax awareness program by the tax authority. An extensive education or program to make the tax community on VAT operation is yet of primary action to be carried out regularly by the tax authority. The survey result shows that 4(7%) of the respondents ranked this problem as the first serious problem.

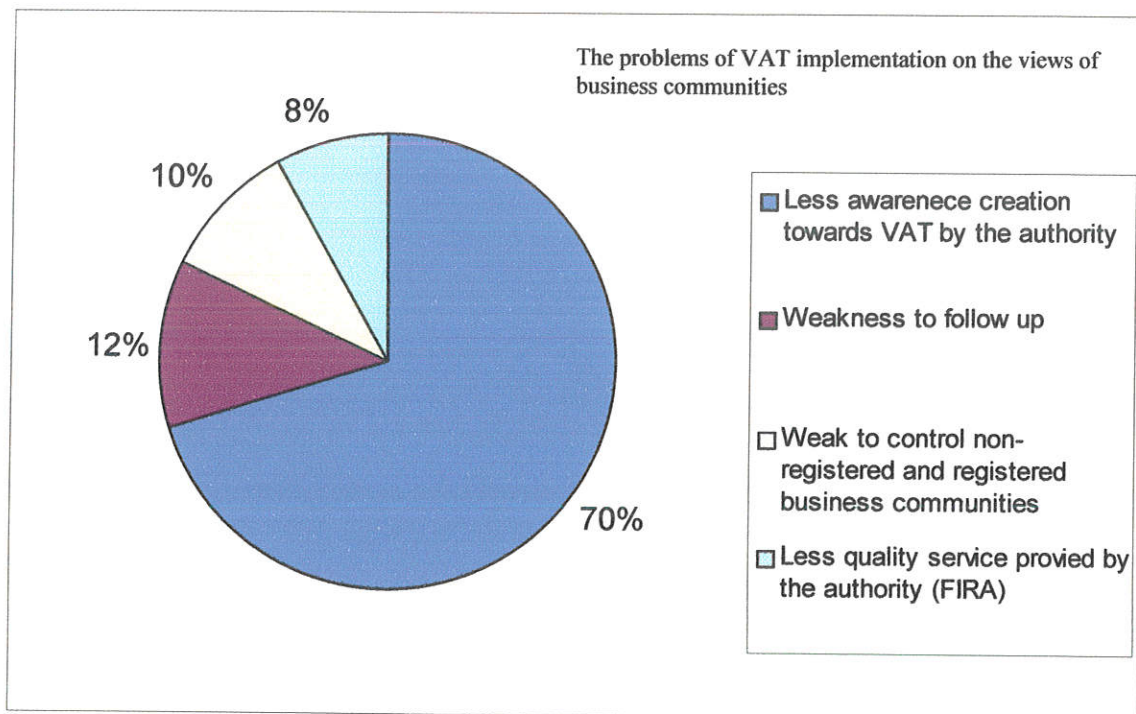
5. Forgery of VAT Invoices

In particular credit and refund request are directly the outputs of real VAT invoices. However, forgery of invoice is likely to occur for credit and refund request such a fraud shown is carefully examined by means of special controlling device. The new division in charge of control of invoice productions

and utilization has commenced to run the function. According to the survey results on figure 7, 3(5%) officials of the authority identified this is one of the serious problems for the development government's revenue.

The same issues were also raised to ask the business communities in order to know their views about the problems of VAT implementation. Out of 217 respondents, 152(70%) responded the serious problem is less awareness on the VAT issues, 22(10%) replied weak to control the non-registered and registered enterprises by the authority, 17(8%) answered less quality service provided by the authority and 26(12%) responded weakness to follow up to identify compliance and noncompliance business communities. For details see the following figure.

Figure 6, Constraints of VAT Implementation by the Views of Business Communities.



Source: computed survey data, 2007

The above figure shows 151(70%) of the respondents replied that less awareness creation towards the community on VAT by the authority is the serious problem for the implementation of VAT and 26(12%) of the respondents replied that weakness to follow-up of the noncompliance business communities is the second serious problems of VAT implementation. Therefore the authority should make create awareness about VAT rules and regulations to the business communities by giving extensive education programs and also strength it's controlling mechanisms to control for non compliant tax payers.

In order to generalize and understand the opinions of both business communities and the officials of FIRA about the practical situation of the implementation of VAT and the problems encountered interviews were conducted on both parties. Therefore as May 2007, the information gotten from the officials of the FIRA and the business communities by interviewed, the problems are categorized on both sides as mentioned below accordingly.

4.6 The Causes of Problems for VAT Implementation

4.6.1 On the Views of Business Communities

During the interviews, the VAT registered tax payers were asked about what you think the main causes of the problems encountered during VAT implementation. They put their reasons in the following manner:

- Lack of understanding for the rules and laws of the proclamations of VAT.
- The authority should not be taken proper action for the evasion of VAT by non-compliances.
- The society (customers) has not the habit of asking the proper invoices for their purchasing of goods/services.
- Weak system of auditing performance to identify the non-compliance business communities.

As the survey result indicates that lack of awareness in most business communities about VAT proclamations and in efficient administration of the FIRA are the first and the second main causes of the creation of the current problems that obstacle for the smooth implementation of VAT. So the authority should provide intensive education and create awareness towards the business communities about the VAT laws, but also the FIRA should strengthen its administration capacity by skilled manpower as well as the required materials, which are important for the facilities of administration. Moreover, the authority should take prompt actions for those non compliance tax payers. It should also encourage the honest traders like rewards them and give other priority

advantages. The business community should also obey the existing rules of VAT and they should also cooperate with the authorities operational activities.

4.6.2. On the Views of Employees of FIRA

In order to get more information from the sides of the officials of the authority the researcher interviewed them by asking them about what are the root causes of the problems of the VAT implementation. They identified the causes of the problems as follows:

- Insufficient skilled manpower as well as the required materials which are provide for the facilitation of effective administration of VAT,
- Weakness of the institute to enforce for non compliance business communities,
- Lack of adequate budget for the administration activities of VAT,
- Low level of knowledge of the tax payers about VAT rules and regulations (unawareness about the benefit of the VAT). Some of the business communities are illiterate, less clarity of the VAT rules and regulations on the business communities and some of them are illiterate.
- Voluntary compliance of the tax payers registered for VAT is very low
- Negative attitude of the societies towards the tax and most of them shouldn't understand the reason to pay tax.

The survey was also made on employees of the authority by asking whether the FIRA has taken some measures to alleviate the existing problems or not. Out of 59 respondents, 41(69%) responded that yes the authority has taken some measures to alleviate the problems of VAT implementation, 13(22%) replied no

and the rest 5(9%) responded no idea. For more information see the following table 4.6.

Table 4.6 Measures have been taken by FIRA to alleviate the Problems of VAT Implementation.

Question survey	Items			Total
Does FIRA have taken some measures to alleviate the problems that obstacle for the implementation of VAT?	Yes	No	I have no Idea	
	41(69%)	13(22%)	5(9%)	

Source: computed survey data, 2007

As indicated from the above table, 41(69%) of the employees said that the authority has taken some measures to alleviate the existing problems. For example, to recruit additional employs and use Standard Integrated Government Tax Administration System (SIGTAS), which uses to facilitate the tax administration effectively but the efforts were not much effective to control for the noncompliance enterprises. In connection to this the survey was conducted by asking the officials of the authority on what are the alternative solutions have taken by FIRA to alleviate the above mentioned problems. They put their answers as follow:

- To teach the tax payers on the registration time about VAT rules and regulations,
- To upgrade the tax officials skills,
- To recruiting new employees and give continuous training the existing once,
- Delegation of authorities to regional government and city administration,
- Take a forced registration for those business enterprises are above the threshold,
- Take legal measures for non compliance enterprises,
- Using a computer system which is cover standard Integrated Tax Administration System (SIGTAS) which helps to facilitate the VAT administration activities, and
- Transmitted information by media (TV, Radio, etc) and distribute Pam plates and brochures about the issues of tax to the business community.

The surveys were also conducted by asking the business communities to understand their suggestions by asking them about what are the alternative solutions to alleviate the current problems of the implementation of VAT. They put their responses as follows:

- The tax payers and the authority should conduct continuous discussion about the issues of VAT,
- The FIRA should teach the business community about the concept of VAT intensively (it should participate the business communities for different seminars about the issues of tax, especially VAT),-
- To provide quality services the FIRA should increase the number of qualified employees,
- Establish free from corruption management system,

- The FIRA should take prompt measures for noncompliance business communities, and
- The FIRA should increase its follow-up of the enterprise and it should investigate the compliance and non-compliance business enterprises. So the authority should encourage and reward the honest traders and it should take a legal action for non-compliance business enterprises.

Moreover, in order to know the practical situation of VAT implementation and to discover the constraints faced during its activities the survey was conducted on both the VAT registered taxpayers and the employees of FIRA by asking them various types of questions and interviews. The issues which are assessed and discussed are: VAT registration process, threshold of VAT, VAT revenue collection, VAT administration, VAT audit, VAT refund, issues of invoices, maintaining books of accounting keeping and market competition. So let's discuss each of them in detail as follows.

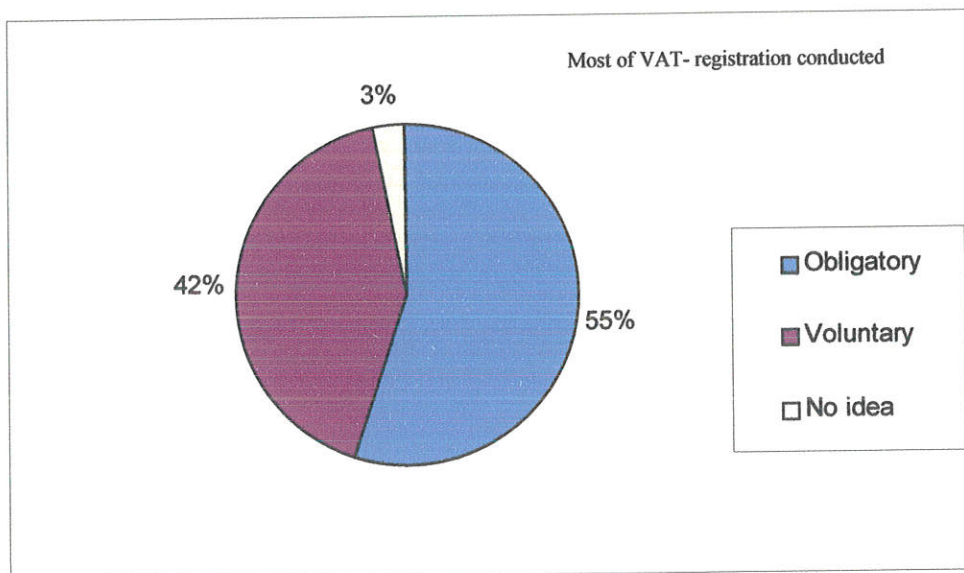
4.7 VAT Registration

According to the VAT proclamation No. 285/2002 of Article 16 and 17. person who runs an enterprise or activity where the value of his taxable transaction Birr 500,000 and above in any period of 12 months immediately preceding his application to the tax authority or whose turn over in respect to taxable transactions is expected to exceed the threshold in the following 12 months is liable to register for VAT.

In order to grasp some information from the opinions of employees of FIRA, about the registration process the survey was conducted by asking the

are registered obligatory, 25(42%) replied the registration process of the VAT payers are voluntary and the rest 2(3%) answered nothing to know about the registration process.

Figure 7, Obligatory and Voluntary of VAT Registration.



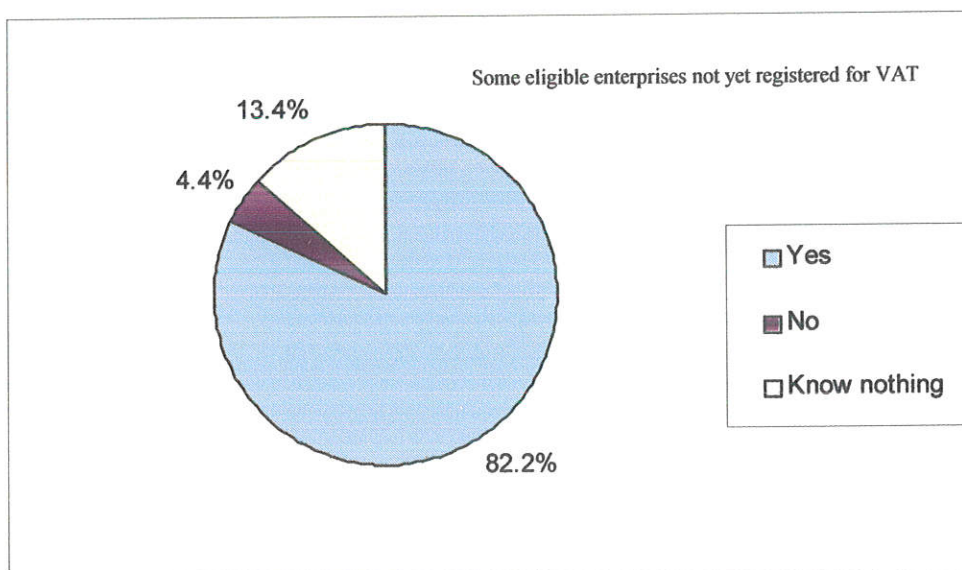
Source: computed survey data, 2007

As to have seen the above figure 7, most of the tax payers 32(55%) are registered for VAT obligatory. According to them the reasons are lack of knowledge (awareness) about the registration of VAT (lack of information how, when to register). Therefore the FIRA should work more in order to provide the required knowledge about VAT rules and regulations to business communities, and so the business communities should also ready to learn and obey the proclamations of the VAT laws.

The survey was also conducted by asking the VAT registered enterprises whether eligible business entities whose annual turnover more than the threshold

have not yet registered or not. Out of 217 respondents, 178(82.2%) responded yes there are some business enterprises whose annual turnover are more than the threshold but not registered, 10(4.4%) replied there are no any business entities registered yet for VAT and 29(13.4%) responded about the existences of non-registrant enterprises but capable to registered. For details see the following figure 8.

Figure 8, VAT Registration and Eligible Business Enterprises.



Source: computed survey data, 2007

The above figure shows that most of the respondents 178(82.2%) assured that there is some business enterprises whose annual turnover are 500,000 birr and above have not yet registered for VAT. By considering of this issue the survey was also conducted by asking them why some taxpayers have not yet registered for VAT?, they provide their reasons in the following summarized manner:

- Some business entities think that the authority have no power to force them to be registered for VAT because of the existence of insufficient manpower,
- The authority has not access to get sufficient information for those tax payers capable to register but not yet to registered for VAT,
- They want to monopolize the market with least price,
- Some traders fear register for VAT they assume to loose their customers due to the price differences between VAT registered and non-VAT registered business entities, this is because most of the time customers believe that the cost of goods inclusive with VAT is higher than the VAT exclusive one, and

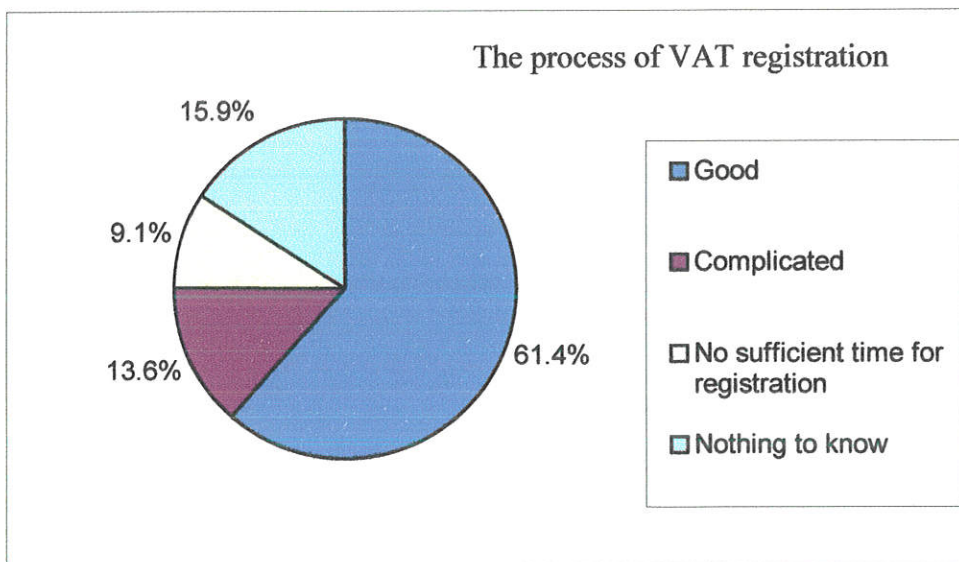
In order to reduce the obligatory registrants and promote voluntary tax compliance, the FIRA should engaged in continues education for the tax payer education programs, which aimed at educating and sensitizing the business community on various VAT issues. It also improve the quality of services to provide for tax payers and forced to register for those business enterprises are not yet registered for VAT but there annual turnover is above the threshold. So on the side of the business community they should obey the VAT rules and regulations and so they should register for the VAT according to the registration process of the VAT without any enforcement action

As May 2007, the researcher received the information from interviewees from different concerned parties of the officials of FIRA as well as the business communities' view the practical situation of VAT registration mostly conducted involuntary. So as it was mentioned above the FIRA should work more and strengthen its administration techniques and the business community should

respect and apply practically the VAT rules and regulations and so they should fully accept it. By doing co-coordinately between the tax payers and the authority jointly solve the current problems by discussion so by doing these the authority should minimize and eradicate the problems. So both the authority and the tax payer become benefited from the development of the country by collecting of more revenue from the society.

The survey was also conducted on the business community by asking about whether the process of VAT registration good or not. Out of 217 respondents, 133(61.4%) responded the process of registration of VAT is good, 30(13.6%) answered the VAT registration process is complicated, 20(9.1%) replied there is no sufficient time in VAT registration process and 34(15.9%) responded no idea about the VAT registration process. For more detail see the following figure.

Figure 9, VAT Registration Process.



Source: computed survey data, 2007

Though most we are observed from the above figure most of the respondents 133(61.4%) answered in a positive way (that is more than half respondents said the process of VAT registration is good), the tax administration needs further intensify its tax education program. As indicated the above figure 30(13.6%) taxpayers responded that the process of VAT registration is complicated. In case of this the survey was conducted by asking them about why the process of VAT registration is complicated. They put their reasons as follow:

- The registration process demands additional and cumbersome accounting procedure,
- There were no active way of registration process(time taking the process of registration),

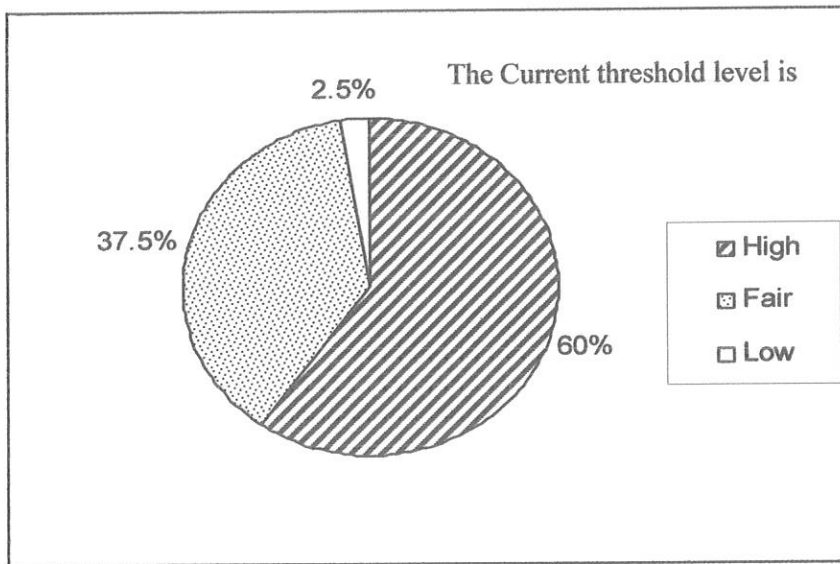
To curve these constraints the authority should improve the quality of services to provide for the business communities and promote and reward those honest and compliance of voluntary registrants. Besides this the authority should take a prompt action of those operate their business operations without obeying of the rules of the VAT.

4.8 Threshold of VAT

For administrative purpose a threshold has been put in place for VAT registration. In Ethiopian case, the VAT proclamation, the enterprises whose annual turnover is half a million (500,000) birr and above compulsory to register for VAT.

VAT registered tax payers were asked about their opinion whether the existing threshold fair or not for VAT registration. Among 217 respondents 81(37.5%) answered it is fair, while 131(60%) of them answered it is high there reasons were to include the other business community the current threshold level of VAT should be lowered (improved) and the rest of 5(2.5%) responded that it is low. See figure 10 for more detail.

Figure 10, Current Threshold Level of VAT.



Source: computed survey data, 2007

As we understand from the above figure, 131(60%) of the respondents (the tax payers) are responded that the current threshold level (500, 000 birr) is high. Due to this most business communities below the threshold but actively participate in the market competition remain unregistered. Therefore the current threshold level should be amended by considering of increasing the number of trained employees.

The survey was also conducted by asking for the employees of FIRA to understand their suggestions about whether the threshold fair or not. Among the 59 respondents, 28(47%) answered fair, 24(41%) responded high and the rest 7(12%) responded the current threshold level of VAT is low. For details see the following table.

Table: 4.7. Threshold Level of VAT

Question survey	Items				Total
	Fair	High	Low	No idea	
How do you suggest about the current threshold level of VAT in the country	28(47%)	24(41%)	7(12%)	0(0%)	59(100%)

Source: computed survey data, 2007

As we have seen from the above table, 28(47%) and 7(12%) of the respondents said that the current threshold level of VAT is high and low respectively. But the problem of this due to the presence of insufficient human resources the FIRA incapable to administer effectively if the threshold is lowered below the current level. The survey was conducted by asking both of the respondents (VAT registrants and employees of FIRA) why you said the current threshold level is high. According to them the reasons are summarized in the following manner.

- To include the other business enterprises in the tax net the current threshold level should be lowered,

- The other opinion said: to increase more number of VAT registrant taxpayer business community the current threshold should be improved. But the main problem of this stage is the smaller the threshold more costly will be to administer. Experiences indicates that setting too low threshold caused failure of VAT in some countries like Ghana in 1995 (\$20,000) and Uganda. Currently, the main problem is that as the number of VAT registrants increases it becomes above the capacity of the VAT department to administer it. Now in FIRA, the number of VAT registrants' tax payers and employees of the authority are not proportional.

Therefore during implementation on relatively high threshold could be set up to have an optimum number of tax payers that fixes the existing capacity of the tax administration. Even though the current threshold level is administration capacity of FIRA is not sufficient enough to administer the existing large number of VAT registered tax payers by a few number of employees the authority should have recruit more qualified and professional employees.

4.9. VAT Revenue Collections

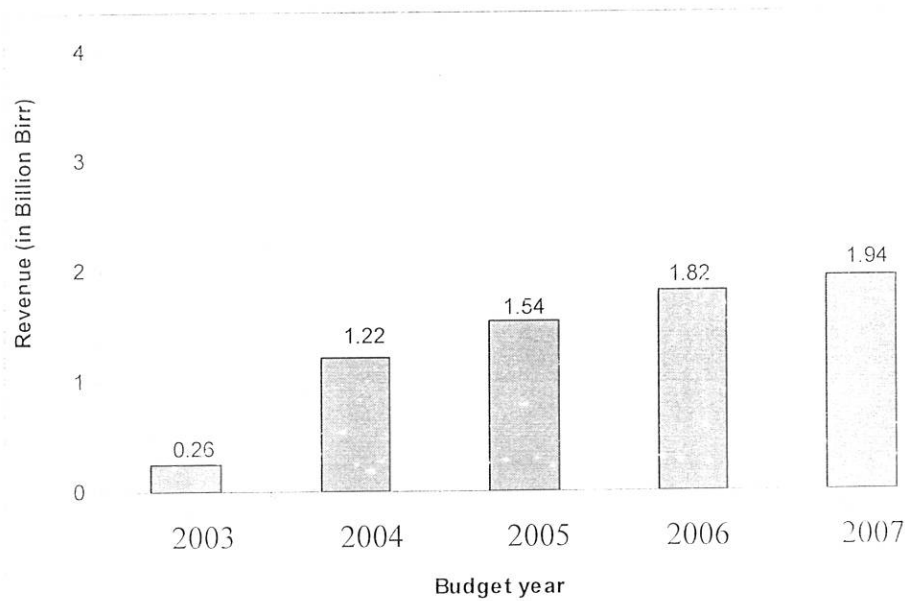
Except the value of goods and services exempted by VAT proclamation all imported materials, locally produced items and services rendered are taxed at 15%. Export of goods and services, international transport of goods and passengers, gold supplied to National bank of Ethiopia, transfer of organization on movement are zero rate taxed goods and services. All VAT exemptions are listed in the proclamation of article 8 and regulations from 19-23. Included in

this list is purchase of goods and services for economic, social and institution of the country's development are exempted.

As per the power given to Ministry of Finance and Economic Development of Ethiopia (MoFED) some items like bread, milk and milk products, agricultural inputs like fertilizer and pesticides and other related are exempted from VAT.

The following graph shows the revenues annual collections of VAT from five consecutive years (2003-2007).

Graph 1



Source: FIRA, Audit department, March 2007

As we can infer from graph 1 VAT collection shows progress in the consecutive five years. So the introduction of VAT in Ethiopia enhances the development of the economy. Even though the VAT contributes for the development of the revenue the authority should work more to collect more revenue from the business societies.

The survey was conducted by asking the officials of the FIRA about whether some traders did not declare the tax they collected as per the law or not. Among 59 respondents, 54(91%) responded that yes there are some traders did not declare the tax they collected as per the law, 4(6%) replied that no, 1(3%) answered know nothing. For detail see the following table.

Table 4.8 Tax Collection and Declaration as Per the VAT Laws

Question survey	Items			Total
	Yes	No	Know nothing	
Do you know that some traders did not declare the tax they collected as per the law?	54(91%)	4(6%)	1(3%)	59(100%)

Source: computed survey data, 2007

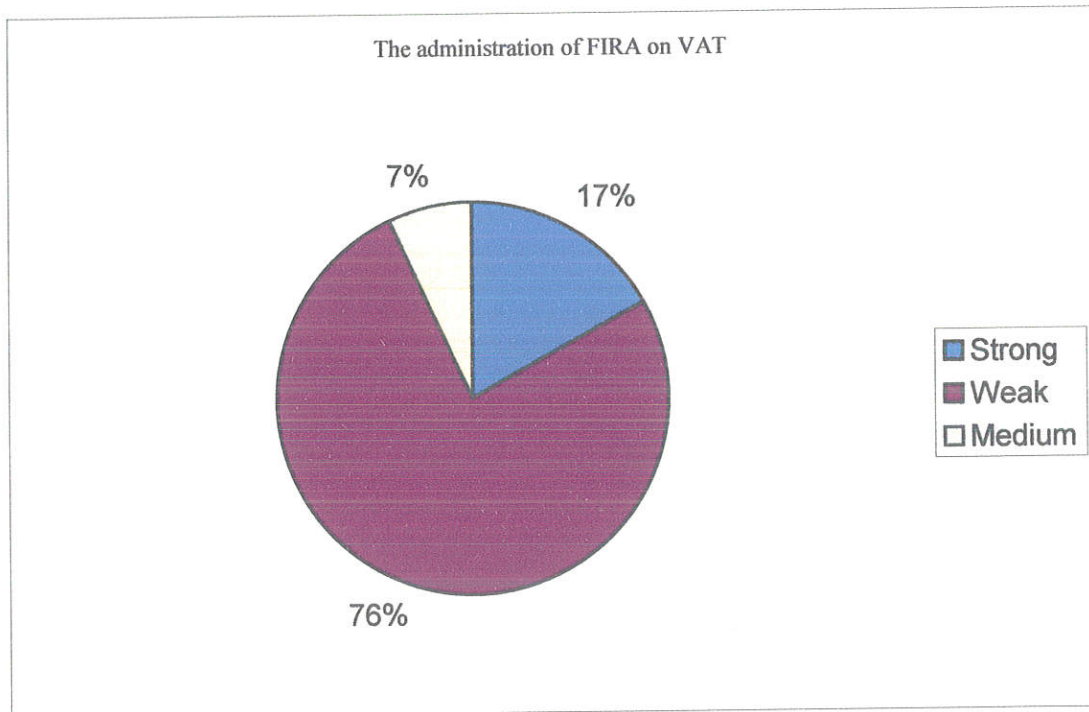
As we have seen the above table replied that 54(91%) of the businesses communities are collected the tax and they are not declare it as the current VAT laws. In case of this the authority should strength it's follow-up, administrative capacity and also intensify education program about the tax to the business communities. Besides these the societies should also accept and obey the existing VAT rules and regulations

4.10 Effectiveness of VAT Administration

Any tax administration review must rely more on accumulated experience with what works and what does not. The main tasks that must be performed by any department in charge of VAT are: identification and registration of tax payers, processing returns, controlling collections, making refunds, auditing taxpayers, investigation for tax frauds and evasion or levying penalties. In order to administer these tasks, the department in charge has to be well organized and conduct publicity tax payer's education and information during the led-in-time.

The survey was conducted by asking of the officials of the authority about whether the capacity of VAT administration of FIRA strong or weak. Out of 59 respondents, 45(76%) responded the VAT administration of FIRA is weak, 10(17%) replied that it is strong and 4(7%) responded it is medium. For details see the following figure.

Figure 11, VAT Administration of FIRA.



Source: computed survey data, 2007

As we observe from the above figure 13, 45(76%) of the officials of the authority replied the administration capacity of FIRA is weak, so the survey was also conducted by asking them about why the VAT administration of FIRA is weak. They identified the reasons summarized as the following manner:

- There is less number of trained and skilled employees /insufficient number of human resources,
- The FIRA is incapable to control the whole registered and non-registered enterprises this is because extremely small number of employees compare with the large number of tax payers (that is unproportional relationships between them),

- Limited resources (insufficient budget) ,
- Weak enforcement activities regarding to human, material and legal aspects, and
- Less motivation of some employees due to less remuneration.

Therefore non-strengthened tax administration is the main problem in tracing those non registered and delinquent taxpayers. To minimize and eliminate these constraints that hinder for the implementation of VAT the authority should strengthen its administrative capacity in both material as well as human resources.

The VAT registered enterprises was also asked whether the VAT administrative capacity of FIRA strong enough or not. Out of 217 respondents, 34(16%) responded the VAT administration of FIRA is strong, 152(70%) replied weak, and 20(9%) answered the administration of FIRA on VAT is medium and 11(5%) responded know nothing. For details see the following table.

Table 4.9 Tax Administration Capacity of FIRA

Question survey	Items				Total
	Yes	No	Medium	No idea	
Do you believe that the administration capacity of FIRA are strong enough to control non registered and illegal activities of the tax payers?	34(16%)	152 (70%)	20 (9%)	11(5%)	217(100%)

Source: computed survey data, 2007

As we can see from the above table 4.9, 152(70%) of respondents replied that the administration capacity of FIRA is weak. The survey was also conducted on the respondents to identify their reasons by asking them why the tax administration capacity of FIRA is weak.

They put their reasons as follow:

- Due to insufficient number of employees in FIRA, it couldn't control the non-registered enterprises whose annual turnover is half a million and above. This leads to unbalance market competition between VAT-registered and non-VAT registered enterprises,
- Lack of service facilitation. This is due to insufficient human power,
- FIRA could not identify the honest traders and non compliance once, and
- FIRA couldn't control the frauds performed by some non compliance traders. For example some enterprises use their trading activities with fictitious invoice and remit the collected tax for themselves.

As to understand from the investigation results the VAT administration of FIRA is not strong enough to administer effectively, especially in the areas like making refunds promptly, auditing activities and controlling evasion of VAT; providing quality services to the tax payers is poor. So the authority should work strongly to alleviate the existing bottle necks for its implementation.

Interview was conducted with the officials of FIRA on the issues of VAT audit and refund as explained for the following discussion

4.11 VAT Refund

Since VAT promotes investment and foreign trades, payments made on purchase are refunded if inputs exceeds outputs and for business having zero bases. Up to March 2007, 73.5 million have been paid for exports and other businesses which are 0.6% of the total VAT collection made up to now. However, compare to returns exceeding 40% in Europe and some African countries. For example Botswana (20%) our country refund rate is almost nil and needs to be worked more.

The reasons are:

- Refund claim is based on the evidences of the tax payers only, and
- Of the total tax payers who are reporting credits, 30% have not yet filled return applications. Therefore returns claims can be increased with the development of audit engagement.

Up to now only 75 tax payers have received refunds and refund process took an average of four months which is believed to long compare to 26 days of other countries.

Challenges facing VAT refund:-

- under-reporting of sales,
- exaggerate refund claims through the inflation of input claims,
- false export claims which can lead to unrealistic input tax,
- fictitious claims for goods not exported, and
- No clear-out refund plan by VAT administrator to follow.

Hence to curve these constraints the FIRA should follow the clear and out-put plan for the refund program by strengthen its administration capacity, by fulfilling both human resources and logistics.

4.12 VAT Audit

Audit of VAT uses to control evasions such as under reporting of sales, abuse of the credit mechanism by using falsified invoices, fraudulent refund claims. So in the absence of self compliance and self assessment audit engagement is very important. However, as per FIRA recorded up to now only 1124 registered tax payers, 1% of the registered tax payers were audited. This shows FIRA has no sufficient auditors and qualified staff on this area. This could be a very dangerous as it moved invite the tax payers not to be compliant due to the weakness of the tax audit.

In order to alleviate these problems the FIRA should increase the number of well trained human resources i.e. auditors establish on effective audit selection system based on the risk levels, used fully computerized system.

4.13 Issue Invoices

VAT is a tax system in which invoice service serve as a corner stone for the tax collection process. That is why VAT is considered as a credit invoice method. According to VAT proclamation No. 285/2002 Article 22/1 stipulates that a person registered for VAT is required to issue a VAT invoice for a taxable transaction, but a person who is not registered for VAT does not have the right to issue a tax invoice.

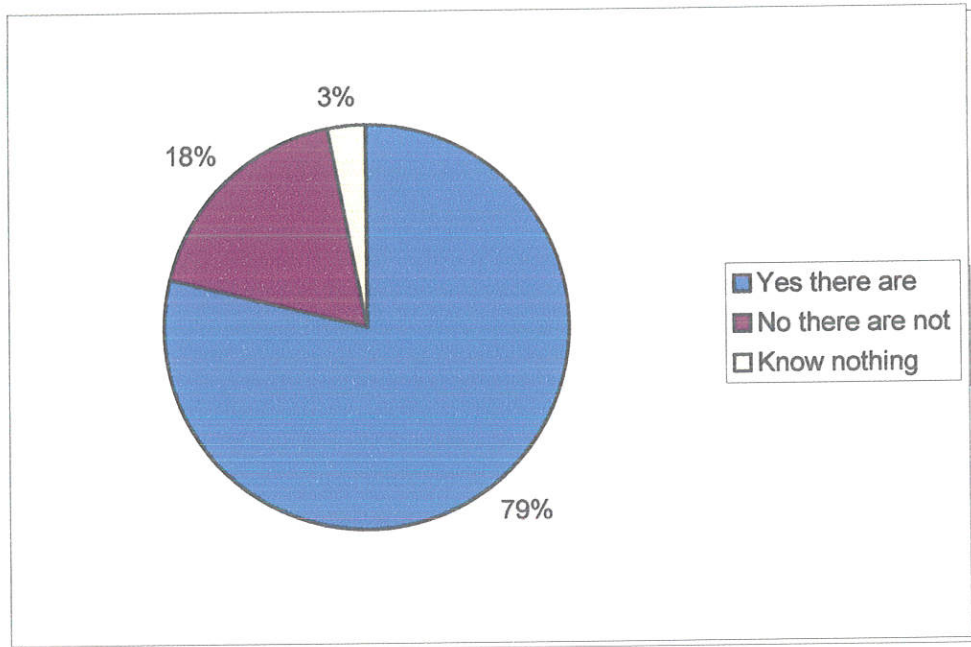
Therefore VAT registered enterprises move their transaction using an invoice. Hence the tax administration would not be expected to estimate the total sale or purchase made for levying the tax rather the invoice would depict the taxable sales and the buyer claims on what he has paid on his input.

But in practice it is not applied this proclamation in some business entities as the researcher got information from the interviewees. This is because several number of VAT registrant do not issue VAT invoice properly during transactions. This discloses two things.

- The tax collected by the taxpayer is not paid to the tax authority
- The normal tax operation system becomes jeopardized as the buyers could have no evidence for off setting the tax paid the course of business activities.

In the survey, employees of FIRA were asked, are there some VAT registered taxpayers conducted their business operations with out invoice. Out of 59 respondents 47(79%) responds that yes there are some traders collect the tax with illegal invoice, and 11(18%) of them argued to the contrary and the rest 1(3%) responded that they know nothing about it.

Figure 12; VAT Registered Taxpayers and the Collection of Tax.



Source: computed survey data, 2007

The above figure shows that, 47(79%) responded that there is some VAT registered taxpayers collecting the tax with illegal invoice. Therefore the tax administration needs further intensify its tax education program and strengthen its controlling mechanism to control some business communities to collect the tax with illegal invoices such as fictitious invoices.

The survey was also conducted by asking the VAT registered tax payers to grasp the information about the existence of VAT collection with illegal invoices by some enterprises. Out of 217 respondents, 109(50%) responded yes there are, 4(2%) no there are not and 104(48%) responded know nothing. For more detail see the following table.

Table 4.10 Collection of Tax by VAT Registered Enterprises.

Question survey	Items				Total
	Yes	No	No idea	None	
Do you know that some VAT register business enterprises have collected the tax with illegal invoices?	109(50%)	4(2%)	104 (48%)	0 (0%)	217(100%)

Source: computed survey data, 2007

As indicated from the above table 4.10, most of the respondents 109(50%) replied that there are some business communities collected the tax with illegal invoices. To control this illegal activities the authority should strengthen its controlling activities and the business communities should also perform their activities with VAT laws.

In order to know the causes of the problems the surveys were also conducted by asking them why some business communities sell their goods by using illegal invoices. They summarized and put their reasons as the following manner:-

- VAT registered and non-registered enterprises couldn't compete of the same area of their business activities. The non-VAT registered enterprises sell their goods and services to the customers by the lower prices than VAT registered business enterprises of the same goods & services. So

VAT registered enterprises are forced to use illegal invoices in order to attract the customers.

- Most of the customers are interest to buy goods or services from non-VAT registered enterprises in order to get lower prices,
- The authority does not have enough man power to control over all tax payers,
- Competency of similar organizations,
- Retain government tax for themselves illegally, and
- Lack of knowledge.

Due to these reasons as explained above most of the business communities perform their trading activities and collecting the tax by illegal invoices and they make fraud activities intentionally.

Moreover some traders suppress sales and use all supplies of goods to be carried out with out invoices. This is to minimize the actual sales amount which results in evasion of the tax collected and finally declare least amount of tax to the authority.

The survey was also conducted by asking of the employees of FIRA about are there some traders collected the tax without invoice. Out of 59 respondents. 45(79%) responded yes there are some traders conducted there operation without legal invoices, 10(18%) replied no, 2(3%) know nothing. For detail see the following table.

Table 4.11 Sales of Goods and Invoice

Question survey	Items				Total
	Yes	No	Know nothing	None	
Do you know that some traders suppress sales and urge all supplies of goods to be carried out without invoice?	45(79%)	10(18%)	2(3%)	0 (%)	59(%)

Source: computed survey data, 2007

As the investigation result indicates that 45(79%) respondents, replied that most of the traders are collected the tax without invoice, so the tax authority should have discovered sellers that do not use invoice designed and prescribed by the FIRA and even if they did, have been found dealing with buyers to offer them lower price if they do not request for a VAT invoice and issue invoice at a higher prices if VAT invoice is requested other business also issue fraudulent invoices using invented VAT number of their own and collect VAT for their own.

Therefore, as the researcher observed the practical activities of the enterprise on the bases of the survey most of business entities have not comply with the laws of regulations of VAT and they committed illegal activities on falsify invoice and they remitted the tax income for themselves rather than to pay the government. And when we see on the side of the authority, it is incapable to

identify and control that business enterprises in compliance with the laws of regulations of the VAT laws. This is due to insufficient manpower.

In order to solve these problems the tax authority should recruit more qualified employees to perform its duty correctly and to control and investigate the unlawful activities of some traders. VAT registrant is legally obliged to issue a VAT sales invoice but which is not prescribed by law and at the time avoids the tax element or collect their own use the help of the public and investigation schemes of the tax authority, such traders could be detected and forced to come before law by the tax authority. In addition to solve these problems the FIRA could decide in the type of electronic car registers to be used by retailers in a network with the SIGTAS.

4.14 Maintaining Books of Account keeping

Every person carrying on a business as well as every person who is required to pay or collect taxes must keep adequate books and records. Such records must be maintained at the tax payer's place of business or at the individual's residence. Adequate records retention can become a cumbersome and costly process, some limitations must be available.

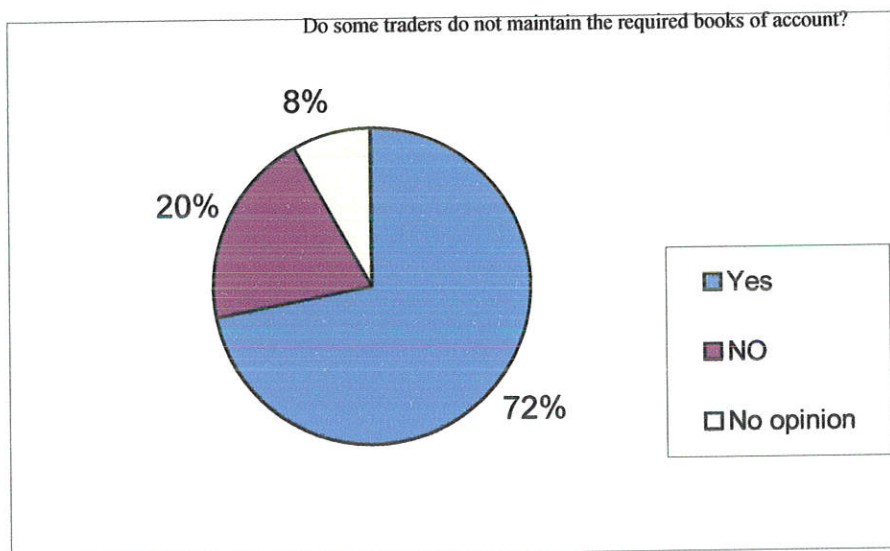
In the Ethiopian case, the commercial code of 1960, of Ethiopia Article 63/1 states that any person or business organization carrying out trade shall keep such books accounts as are required in accordance with business practices and regulations, having regards to the nature and importance of the trade carried on. Also Article 37 of VAT proclamation No 285/2002 requires VAT registrants to keep records of accounts for at least 10 years in Ethiopia: original tax invoices

received by the person, a copy of all tax invoices issued by the person, customs declaration relating to imports and exports by the person, accounting records; and any other records as may be prescribed by the ministry of revenue by directive.

The FIRA does have the legislated authority to estimate the amount of taxes owing by a tax payer under certain circumstances, such as the failure of the tax payer to remain the required books and records or to accurately declare income. However, while the FIRA is required to exercise judgment and reasonableness in determining the estimated taxes owing, the onus is on the taxpayer to disprove the assessment review by the FIRA.

The employee of FIRA were asked about their opinion about the record keeping cited in the VAT proclamation by asking the questions do you know that some business enterprises do not properly maintain records of their business operations in accordance with the laws and regulations of VAT. Among the 59 respondents, 42(72%) said yes, 12(20%) said no and 5(8%) responded no opinion. For more detail see the following figure 13 as describe below.

Figure 13, Maintaining the Required Books of Account.



Source: computed survey data, 2007

As the survey result shows in the above figure 42(72%) respondents, explained that most of the tax payers are not maintain the required books of account for their business operations. Therefore, the FIRA should work hard to minimize and dissolve this problem by conducting intensive education programs and identify the noncompliance business communities.

During the survey the VAT registered taxpayers also asked whether some traders do not maintain their record systems of the business operations in accordance with business practices and regulations. Out of 217 respondents, 158(73%) responded yes there are some trades do not maintain proper records of

books of accounts, 13(6%) replied no and 46(21%) responded know nothing. For more detail see table 4.12.

Table 4.12. Maintaining the Proper Books of Account for Business Enterprises

Question survey	Items				Total
	Yes	No	I have no idea	None	
Do you know some business enterprises do not properly maintain the records of their business operations according with the laws of VAT?	158(73%)	13(6%)	46(21%)	0(0%)	217(100%)

Source: computed survey data, 2007

The above table shows 158(73%) of the taxpayers responded that there are some traders who are not maintain the proper books of account for their business activities. So the business communities should obey the current VAT rules and regulations and so they should maintain the correct books of accounts.

In connection to this the surveys were also conducted by asking both the respondents about why some enterprises fail to maintain the correct recording

systems of accounting on the bases of VAT rules. So the respondents put their reasons as follows:

- Most of the business enterprises especially private enterprises and others do not hire professional and qualified employee. So they have done their books of accounts of their business operations by unqualified employee.
- The authority does not create awareness about what books and records maintain for the VAT purpose for tax payers properly,
- Some of them have not enough knowledge about what books and records are maintained for VAT purpose, and,
- The owner of some business enterprises is not educated; hence they couldn't understand the tax laws and its application as the result of these have made a mistake of handling a true book of account.

As the survey result shows that most of the business enterprises are not maintain the proper recording system of their business operation activities.

As it was observed from the audit report of VAT department of FIRA shows the practice of holding books and accounts has a mixed picture in this course. State owned enterprises, some private share companies and limited companies hold the true accounts. But according to the recent investigation report and the information gathered from different parts of interviewees the concerned parties most business enterprises, especially sole proprietor enterprises do not properly maintain the books of their business activities and hold two books are for the tax authority and another for banks. Usually, the financial statements produced to tax authority are highly understated and to banks overstated. Hence, give a wrong picture of the business be it on VAT returns and income taxes.

In order to curb these problems the authority should strengthen its controlling capacity on the noncompliance taxpayers. Such as:

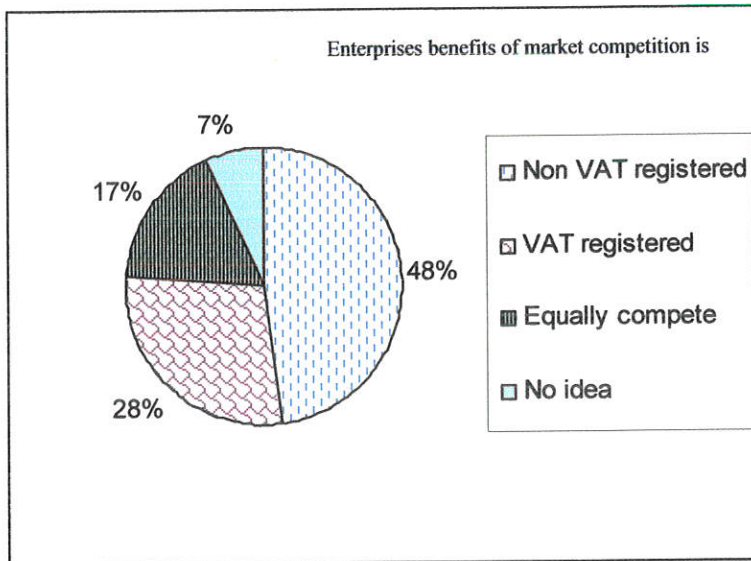
- To provide regular teaching about the rules and regulations of VAT,
- To conduct spot and comprehensive auditing in order to identify which enterprises perform a problem and check whether enterprises fulfill the required recording system or not

So the survey proved that the authority is not capable enough for administering efficiently and controlling these types of malpractices properly. Hence it should recruit additional qualified manpower to administer effectively and also it should provide regular teaching to the business community about maintaining the correct recording systems of books of accounts for their business operations.

4.15. Market Competition

To understand the attitudes of the VAT registered enterprises asked them about the benefits of market competition between VAT registered and non-registered enterprises. Out of 217 enterprises, 104(48%) responded non VAT registered enterprises more advantageous, 61(28%) answered VAT registered enterprises benefited more, 37(17%) said they benefited both equally and the rest 2(7 %) they haven't any idea. See the following figure 14 for more detail.

Figure 14, Impact of VAT on Market Competition.



Source: computed survey data, 2007

As indicated from the above figure most respondents 104(48%) gave their responses in market competition mostly benefited non-VAT registered enterprises and so this leads discourage the compliance business communities

and aggravated market distortion. To alleviate this imbalance the authority should strengthen its administration capacity for controlling of some noncompliance business communities. And few of them 2(7%) responded no idea about the market competitions of VAT, so the authority should teach them about the concepts of VAT laws.

In connection with this, the survey was conducted by asking the VAT registered enterprises about why they thought the non-registered enterprises advantageous more from the market competition. Out of 217 respondents explained their reasons in the following way:

- Goods/services inclusive with VAT higher price than exclusive of VAT 157(73%)
- Customers are not usually the habit of has to pay tax 20(9%)
- Low purchasing power of most of the community 20(9%)
- Insufficient tax administration and evasion 20(9%)

As we observed from the respondents suggestions there is unequal (unbalance) market competition between VAT registered and non-VAT registered enterprises. In order to protect this problem (market distortion) the authority should strengthen its administrative capacity. The FIRA should also control those who are not yet register for VAT but capable to register and some tax payers should perform their activities with the compliance of VAT laws, but also intensive education would be given to the enterprises about the advantageous of VAT for the economic development of the country and the main sources of revenue for the government. The business enterprises should also ready learn and acquire sufficient knowledge about VAT proclamations of laws and they should compliance with the rules and regulations of it.

In order to know the intension of the business communities about the customers purchasing habit of goods/services and how to influence the VAT registered enterprises a survey was also conducted by asked the VAT registered enterprises whether the customers mostly buy goods/services from VAT registered or non-VAT registered enterprises. Out of 217 respondents, 35(16%) responded customers buy goods/services from VAT registered enterprises, 147(68%) replied most of the customers buy goods and services from non-VAT registered business enterprises and the rest 35(16%) answered they buy equally both in VAT registered and non-registered enterprises. See table 4.13 for detail.

Table 4.13 VAT and Non VAT Registered Enterprises and the Purchasing habit of the Customers

Question survey	Items				Total
	VAT Registered enterprises	Non- VAT Registered enterprises	Equally in both enterprises	None	
Which business enterprises are mostly the customers to buy goods (services)?	33 (16%)	47 (68%)	33(16%)	0(0%)	217(100%)

Source: computed survey data, 2007

The above table shows that 47 of 68% of the respondents were replied that most of the customers buy goods/services from non VAT registered enterprises. By considering this the survey was also conducted by asking the VAT registered business communities about why most of the customers buy goods/services mostly from non-VAT registered enterprises than VAT registered enterprises. They explained their reasons as like these: Due to the variation of the price between VAT registered and non-VAT registered enterprises that is the price of

goods/services is high with VAT inclusive goods /services than VAT exclusive goods / services. Because of the price difference the customers are attracting to buy the lower price of the goods from non-VAT registered enterprises. as the result of this, VAT registered enterprises couldn't compete with the non VAT registered enterprises. To alleviate this problem the FIRA should strength its capacity in controlling and forced the enterprises to register for VAT when the annual turnover income is more than a half million Birr. So if both enterprises registered for VAT according to their annual income the customers would be equally purchase goods and services in both enterprises and so the VAT registered enterprises shouldn't affect by the price differences.

In order to summarize the findings of the survey, interviews were conducted, about the problems of VAT implementation related with the authority and VAT registered taxpayers. Moreover, discussions were made between them about the alternative solutions to alleviate the current problems of VAT implementation in the country. The brief discussion is explained as follows:

Even though Ethiopian had a chance to learn from other countries for those implemented the tax in prior times, VAT implementation faced different problems. Such problems are classified into two categories these are problems related to: the business communities and VAT administration offices.

Problems related to VAT registered taxpayers are: misunderstanding the VAT laws and its applications, printing and using duplicate VAT invoices, collection of VAT and failing to notify to the tax office, registration for only one business while actually running many business, making a business under threshold. evading VAT to be paid by understating output and deducting input paid on

exempted items, not capable of maintaining appropriate book of account and records for VAT and suppress sales and urge all supplies of goods to be carried out without invoices

Problems related to VAT Administration office are: problems of understaffing and weak auditing, intelligence, insufficient skilled manpower, weakness of enforcement technology related to taxpayers information, weakness of follow-up on those who are not filling VAT reports and who are not paying regularly, weakness of efficient services to be provided by tax offices; weak to control some taxpayers registered but doesn't use proper VAT invoices, weakness in tax collection system and audit techniques and programs, weakness to control those who are expected to be registered but not yet registered.

Therefore to tackle these constraints remedial measures have to be taken as immediately as possible. The public at large and the government have to reach to a consensus to have a common national vision of development and work together to increase the tax views of the country which finally is to finance social and economic development and poverty reducing projects by a new tax culture which actually demands compliance from the sides of all tax payers and organizational strength and efficiency from the sides of the tax administration. Therefore FIRA has enacted serious of measures to manage the adverse situation. The following are some of the measures adopted.

- Education campaign:- VAT, being the tax system that follow self assessment scheme, education campaign has been conducted intensively prior to take action on the defaulters.
- Tax audit:- conducts tax audit and investigation on suspected VAT fraudsters and initiates legal action;

- Strength tax administration:- to strength tax administration functions delegate region / city administration, revenue collecting organs to administer VAT;
- Forced Registration:- this is one of the measures of enforcement carried out based on collected tax-relevant information of transaction of goods and services of business organization that enabled registration of involuntary;
- Survey of Business Premises:- this is a door-to-door visit of tax payer's establishment to observe the business activity as to whether the business entity is liable to registration or not;
- Investigation of Movement of Taxable goods:- this is an examination of taxable goods going out across the main gate points of the city Addis Ababa. The goods were checked whether VAT invoice were issued or not. The action supported all of to have invoice issued transaction.
- To present illegally suspected before Law: - a number of tax payers strongly violate VAT laws and regulation i.e. after collecting the tax from the public they never file tax return, never issue VAT sales invoice or make negotiation in the amount of the tax. These actions are absolutely against the laws of the tax. Besides, they jeopardize the tax system as a whole. Thus such a group of taxpayers is coming before court, so as this is to pursue them to hold the legal direction and ensure justice among all taxpayers.

One such measure was conducted by FIRA with a view to change negative attitude against threshold. In consequence, VAT could lie on a good foundation FIRA will, still proceeds with various legal measure of enforcement to avoid adverse condition associated with threshold i.e. to enforce those that abuse the thresholds not to comply with VAT laws and to develop more tax awareness program so that the taxpayers voluntary comply with the tax legislation.

CHAPTER FIVE

CONCLUSION AND RECOMMENDATIONS

5.1 Conclusion

VAT is the most important tax innovation of the second half of the twentieth century. In line with this perception, an increasing number of developing countries have converted their sales tax to VAT. Following this the government of Ethiopia has introduced VAT on January 1, 2003 to replace the sales tax. The replaced sales tax was collected only at the point of sales; at the result of this it had double taxation and had severe tax evasion problem. VAT on the other hand is applied on the value added at each stage of production and distribution.

The VAT has applied a uniform rate of 15% on most consumption goods and services with the exception of exports and exempted goods and services. The registration of VAT has conducted in both obligatory and voluntary. Under the obligatory registration person who carries on taxable activity and is not registered is required to file an application for registration if his annual transaction exceeds Br 500,000. VAT registered business enterprises are eligible to claim input tax while non-registered are not given this opportunity. For those business enterprises whose annual turnover of taxable goods is less than the

VAT registration threshold, on equalizing turnover tax is introduced of the rate of 2% for goods and 10% for service.

After the implementation of VAT in Ethiopia VAT collection has shown an increasing trend in the government revenue as compared to the replaced sales tax. This is because VAT is a broad based tax, which enables to raise more government revenue, the rate is uniform and the scope of exemption is limited under VAT and it is applied at each stage of production and distribution i.e. whenever additional value is added is created the tax is applied.

VAT in Ethiopia could be helpful in simplifying and modernizing the tax administration with its invoice based characteristics and its requirement for the registrants to hold a systematic book of accounting. Economically, VAT does encourage investment by providing a refund for a tax paid on inputs and encourage export by zero rating export items. Under, VAT output tax is charged at each stage of production irrespective of the use to which it is put to ensure that only final consumption is taxed.

Since VAT is a new and sophisticated tax that differs significantly from the classical tax schemes with which the people were familiar, various misconceptions regarding its impact, its application, and its benefit to the national economy are normal in the initial phase of its application. According to the results of the survey during the implementation of VAT different problems were encountered, the major ones are: administration inefficiency to control noncompliance taxpayers, lack of sufficiently educated tax payers, some enterprises were reluctant to register for VAT, some registrants of VAT were printing and using duplicate VAT invoices, mostly the consumers were not

willing to buy goods with VAT included goods/ services, certain enterprises were preference to pay tax without maintaining books of account (unsatisfactory level of record keeping), FIRA is weak to control some taxpayers registered but doesn't use proper VAT invoices, It is unable the tax collection system and audit technique, some taxpayers are failing to notify the collection of VAT to the tax offices, and many important sectors, most notably services and the wholesale and retail sectors have left out of the VAT net.

The other problems commonly observed is that some of the tax payers refuse to honor their debit obligations to the VAT service while others submit their VAT returns without payments. There also deliberate submission of nil returns and non-issuance of VAT invoices. The main causes of these problems were not only from the tax laws and proclamations but also mainly from the fact that these is still lack of awareness and deliberate resistance not to comply with the VAT laws, insufficient skilled manpower as well as the required materials, lack of adequate budget for the administration activities of VAT, negative attitudes of some business societies towards VAT and weak system of auditing performance. Hence the whole tax system in Ethiopia is faced with such problems as there is high cost of tax compliance, extensive evasion overzealous and corrupt tax. As the result of these constraints the implementation of VAT in Ethiopia could not meet its objectives properly.

The major activities in VAT administrations are identifying tax payers; processing returns, controlling collections, making refunds, audit taxpayers and levying penalties. The other part of VAT administration is assessment on VAT execution, this includes identifying taxpayers and tax evades as well as the registered and unregistered taxpayers among the business communities. But due

to insufficient manpower in the FIRA could not perform its activity properly, so some taxpayers couldn't obey the existing VAT rules and regulations. By considering this the authority should take legal measures against people who do not comply with the VAT laws. As the survey result shows that some of the measures have taken by the authority to curve the above problems are: Intensive taxpayers education campaign was conducted, implementation seminars, taxpayers advisory services (tax audit), media release, forced registration, strength tax administration, and investigation of movement of taxable goods.

The increases in VAT registrants tend to grow more, as there potential registrants eligible for VAT through out the nation. This growing trend of registrants and tax administration function cannot be properly administered with limited employees and branch offices of FIRA. Considering this situation FIRA has delegated regional/city administration revenue collection organs to administer taxpayers with their respective jurisdiction. Delegation of VAT administration is important for, it reduce mal-practices exercised against the tax system such as reluctance to register, failure to file their return, non-issuance of VAT invoices, it helps in maintaining uniformity of VAT system a among regions, it enhances service delivery, it increases the number of VAT payers as region /city revenue offices have more access to the transactions of the traders with their vicinity, there by increase tax revenue and it enhances tax administration skills of regions tax officers through transfer of knowledge and application of information communication technology.

To curve the above constraints which are obstacles for the implementations of VAT in the county, the public at large and the government have to reach common national vision of development and work together to increase the tax

view of the country which finally is to finance social and economic development and poverty reducing projects by introducing a new tax culture which actually demands compliance from the sides of all taxpayers and organizational strength and efficiency from the side of the tax administration. The FIRA has also enacted serious measures to manage the adverse situations. Such as education campaign, strength tax administration functions, forced registration for that annual turnover of the business is over the threshold, survey of business premises, and increases the controlling system for those tax payer who are strongly violate VAT laws and regulations.

5.2 Recommendations

The major recommendations that come out from the survey result are:

- For the successful implementation of VAT, Federal Inland Revenue Authority should make the public to aware and build its administration capacity on both human and material resources to perform its duties and responsibilities effectively and efficiently. It should also recruit more qualified employees for controlling of non compliance VAT payers. Training and development for staffs who will join and who have already joined should also be taken care of. The tax payers should also perform their duties only in accordance with the current VAT laws.

- In order to create educated and trained business community FIRA should always provide advice and training for the business communities about the rules and regulations of VAT by mass media intensively like Television, Radio and Newspapers. This is with the conviction that an educated taxpayer society is an important asset for the tax authority.

- The primary objective of VAT implementation in Ethiopia is to raise government revenue, to encourage investment by providing a refund for a tax paid on inputs and encourage export by zero rating export items. But the result of the survey indicates that VAT could not be effectively implemented and meets its objectives properly. This is because most taxpayers are not compliance with the current VAT laws and inefficient tax administration to control non compliance taxpayers. Therefore to avoid these constraints and achieve the desired objectives FIRA should strengthen its tax administration capacity by delegated regional/city administration revenue collection organs to administer taxpayers with their respective jurisdiction and also the tax payers should comply with current VAT rules and regulations
- Organizational strength of tax administration is an important tool to effectively perform what has to be performed by a standard VAT office. Hence, the organizational setup of the VAT offices and branches should be revisited effectively and efficiently perform the tasks of identification of VAT taxpayers, processing of returns, controlling collections, making refunds, auditing taxpayers and levying penalties.
- Efforts currently underway within FIRA to strength the VAT administration, to improve services delivery, training of staff should continue to address the shortfall encountered. Specially, the administration should focus in strengthen its audit and enforcement wings.

- FIRA should strengthen the intelligence and investigation departments by skilled personnel and also it should conduct an advisory visit on the tax payer's premises to check how tax payers are applying it. This helps to reduce problems of implementation. So it has to take measures on those tax payers who are constantly failing to comply with the tax rules and regulations.
- The organizational and human resource should be adjusted in order to cope up with the increased number of VAT registrants. This will greatly help to reduce the undesirable consequences that may undermine the whole reform program. Particularly, manpower requirement should be given special attention since the business community is in advance in searching for short comings of the tax administration. As the result of the survey observed that the non-tax payers are very large in number and most registrants as VAT payer claim credit. To tackle this problem inspection and enforcement work should be strengthened.
- VAT in Ethiopia has faced various problems such as tax evasion and fraud after it has launched. Enterprises started to prepare their own false invoice, some enterprises collected VAT for themselves, some are sold their product as two kinds of VAT inclusive and VAT exclusive, some are resistance against registration for VAT, some are understated financial statement and some are making a business under threshold. However, to sustain the -VAT -system as a good -means to raise government revenue, the government should take the following measures to tackle these problems such as: train the taxpayers about the rules and regulations of VAT continuously, recruiting new employees

and give continues training for the existing once, delegate the tax authority to regional and city administration and it should also increase its follow-up and investigation to control non compliance enterprises. The business communities should also obey the current VAT rules and regulations and they perform their activities according to the current VAT laws.

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ANNEXES

Annex 1, Questionnaires for the Employees of FIRA.

ADDIS ABABA UNIVERSITY

SCHOOL OF GRADUATE STUDY

FACULTY OF BUSINESS AND ECONOMICS

**DEPARTMENT OF PUBLIC ADMINISTRATION AND
DEVELOPMENT MANAGEMENT.**

Dear Participants

You are being asked to participate in a survey that intends to assess Value Added Tax Practices and Problems in Ethiopia especially in Federal Inland Revenue Authority. The purposes of the study are to: describe the practices of VAT in Ethiopia, identify the inductive factors and investigate the possible problems for the adoption and implementation and recommend solutions to help the program implemented successfully.

I respectfully request your kind cooperation in answering the question that follows a clearly and frankly as possible and your response will be highly confidential.

Thank you in advance for your kind cooperation.

Section I: Classification/ Identification questions

Answer by putting a thick mark (√) in one of the blank spaces corresponding to each item.

1. Age group (in years): 20-30____, 30-40____, 40-50____, 50+
2. Sex: Male____, Female____
3. Level of education: Below 12 grade____ Certificate____, Diploma____
Bachelor Degree,____ Masters and Above____
4. Name of department_____
5. Your status/ position in the working area_____
6. Year of experience in the specific office/ area_____

Section II: Survey Questions (SQ)

Select an appropriate answer from the given alternatives and circle it. For other questions please provide responses in your own words.

- 1 The introduction of VAT in Ethiopia is:
A. Very much necessary C. Not necessary
B. Less necessary D. I have no idea
2. Are you familiar with VAT proclamations and regulations?
A, Yes B, No C, Little D, I have no idea

If your answer is " B, " in question number 2, please explain the reason:

3. The current implementation of VAT is:

- A. Encouraging investment and Trade
- B. Discouraging trade and investment
- C. Encouraging investment but not trade
- D. I have no idea

4. Do you know the problems that hinder the implementation of VAT?

- A. Yes
- B. No

If your answer is "A," please list down the reasons:

5. Are there some measures taken by the FIRA to alleviate the problems?

- A. Yes
- B. No
- C. I have no idea

If your answer is A, please list down:

6. The threshold of VAT (Birr 500,000) is:-

- A. Fair
- B. Not fair
- C. I haven't opinion

7. Do you know that some registered business enterprises have collected the tax with illegal invoice and retain the tax for themselves?

- A. Yes B. No

If your answer is "Yes," in question number 7, please describe the reasons:

8. Do you know that some traders did not declare the tax they collected as per the law?

- A. Yes B. No

9. In consecutive five years (2003-2007) the implementation of VAT is:

- A. Very successful C. Not successful
B. Less successful D. I have no idea

If your answer is "C," please describe the reasons briefly:

10. To compare VAT from the replaced sales tax is:

- A. More advantageous B. Less advantageous
C. No difference D. None

11. Do you think the Federal Inland Revenue Authority (FIRA) had made sufficient clarifications to the public about the concept of VAT?

- A. Yes B. Little C. No

If "No," what do you think the reasons are?

12. Do you think that all VAT payers are well known about the laws and regulations of VAT?

- A. Yes B. No

If your answer is "No", Please explain the reasons::

13. The implementation of VAT is:

- A. Successful and achieve its objective C. Less Successful
B. Not successful and achieve its objective D. No idea

14. Most of VAT payers registered:

- A, Obligatory B, Voluntary

If your answer is "A," what are the reasons do you think?

15. Do you know that some eligible business entities have not yet registered for VAT?

- A. Yes B. No C. I don't know

If your answer is "Yes," please explain the reasons

16. Do you know that, some traders do not maintain the proper recording systems of their business operation in accordance with business practices and regulations?

- A. Yes B. No

If "Yes," what are the reasons, please explain:

17. Do you know that some customers did not willing to buy goods with VAT?

- A. Yes B. No C. I don't know

If your answer is "Yes," please explain the reasons:

18. Do you think that there are enough/ adequate and well educated, trained and skilled employees/human resources/ in the Authority (VAT department)

A. Yes B. No

19. Do you think that the tax administrations are strong enough in controlling of the illegal activities of some VAT payers?

A. Yes B. No

If your answer is "No," please list down the reasons:

20. Whom do you think has benefited from the market competition between registered and non-registered enterprises?

A. Registered B. Non-registered C. Both

21. What do you think most enterprises are evading tax-payment?

22. Any further suggestion:

Annex 2. Questionnaires for VAT Registered Taxpayers

ADDIS ABABA UNIVERSITY

FACULTY OF BUSINESS AND ECONOMICS

DEPARTMENT OF PUBLIC ADMINISTRATION AND

DEVELOPMENT MANAGEMENT.

Dear Participants

You are being asked to participate in a survey that intends to assess Value Added Tax Practices and Problems in Ethiopia especially in Federal Inland Revenue Authority. The purposes of the study are to: describe the practices of VAT in Ethiopia, identify the inductive factors and investigate the possible problems for the adoption and implementation and recommend solutions to help the program implemented successfully.

I respectfully request your kind cooperation in answering the question that follows a clearly and frankly as possible and your response will be highly confidential.

Thank you in advance for your kind cooperation.

Section I: Classification/ Identification questions

Please answer the following questions correctly.

1. Sex: Male _____, Female _____
2. Age group (in years): 20-30 _____, 30-40 _____, 40-50 _____, 50+
3. Level of education: Below 12 grade _____ Certificate _____, Diploma _____
Bachelor Degree, _____ Masters and Above _____

Section II: Survey Questions (SQ)

Select an appropriate answer from the given alternatives and circle it. For other questions please provide responses in your own words.

1. Do you know the concept of VAT?
A. Very much B. Much C. little D. no idea
2. Do you think that the Authority (FIRA) had made sufficient clarifications to the public about the concept (meaning) of VAT?
A. Yes B. No C. Nothing
3. Do you think that the current implementation of VAT contribute for raising government revenue?
A. Yes B. No
4. De you believe that the introduction of VAT is important in Ethiopia?
A. Yes B. No

5. Does VAT is more advantageous than the replaced sales tax?

- A. Yes B. No C. I don't know

If your answer is No, please describe the reasons:

6. Do you believe that the implementation of VAT is successful?

- A. Yes B. No

7. Do you know the Ethiopian VAT Laws properly?

- A. Yes B. No C. Little

8. How do you see the process of VAT registration looks like?

- A. Good C. Not easy
B. No sufficient time for registration D. No intensive awareness

9. Do you think that the tax administrations are strong enough to control non-registered and illegal activities of VAT payers?

- A. Yes B. Little C. No

10. Do you know that some VAT registered business enterprises have collected the tax with illegal invoices?

- A. Yes B. No C. I don't know

11. Do you know that some eligible business entities have not yet registered for VAT?

Yes

No

If your answer is "Yes," please explain the reasons briefly:

12. Do you know that some traders do not properly maintain records of their business operations in accordance with the laws and regulations of VAT?

A. Yes

B. No

C. I don't know

If your answer is "Yes," please list down the reasons:

13. Do you know that some customers did not willing to buy goods with VAT?

A. Yes

B. No

C. I don't know

If your answer is "Yes," please describe the reasons:

14. Do you think that the number of non- taxpayers exceeds taxpayers in the country?

A. Yes

B. No

C. I don't know

15. Do you think that the threshold level (500,000 birr) in the VAT proclamation is fair?

A. Yes

B. No

If "No," please explain the reasons:

16. Whom do you think has benefited from the market competition between VAT registered and non-registered?

A. Registered

B. Non- registered

If your answer in Question number 16 is "A", why do you think that?

If your answer is "B," please list down the reasons:

17. Do you believe that the implementation of VAT has met its objectives?

A. Yes

B. No

18. Do you believe that VAT is important for the development of investment and international trade?

A. Yes

B. No

19. Do you know that some business men suppress sales and urge all supplies of goods to be carried out without invoice?

A. Yes

B. No

20. What are you suppose are the major problems that hinders the smooth implementation of VAT?

21. What are the alternative solutions to alleviate the identified problems?

22. Any further information.

Annex 3

VAT in Selected Countries

No.	countries	Date of VAT Introduced	Standard Rate	Other Rates
1	France	1948 Jan.	19.6	2.1;5.5
2	Cote deivoir	1960 Jan	20	11.1
3	Brazil	1967 Jan	20.5	22
4	Germany	1968 Jan	16	7
5	Italy	1973 Jan.	20	4; 10
6	Austria	1973 Jan.	20	10; 16
7	United Kingdom	1973 Apr	17.5	5
8	Bolivia	1973 Oct	14.9	-
9	Colombia	1975 Jan	16	7; 10; 20; 35
10	Israel	1976 Jan	17	9
11	Senegal	1980 Mar	17	7
12	Japan	1989 Apr	5	-
13	Russia	1992 Jan	18	10
14	Singapore	1994 Apr	5	-
15	Rwanda	2001 Jan	18	-
16	Australia	2000 Jan	10	-
17	Gambia	2003 Jan	10	15
18	Ethiopia	2003 Jan	15	-
19	Zimbabwe	2004 Jan	15	-

Source: International Bureau of Fiscal Documentation (IBFD, 2004) and corporate Taxes 2003 – 2004, world wide summaries.

Annex 4

Sales Tax and Value Added Tax Rate Comparison

Sales Tax		Value Added Tax (VAT)
Goods	Services	
15% of rate applied on the values of all goods and services other than specified below.		15 percent tax rate applied on the value of all goods and services other than specified below:
5% on the following: a, live animals, meat, fish b, fresh milk, cream, eggs, honey and cereals. c, vegetables, fruits, and nuts d, coffee and spices e, pharmaceutical products f, hides and skins g, books and newspapers h, cotton I, sales of food in hotels and restaurants	15 percent on the following: a, telecommunications b, garage, laundry c, photography d, auditing, engineering e, consultation f, cinema, g, commission agents h, barber/ beauty salon I, tourism J, hire of goods	Exemptions: a, sales/ transfer of used dwelling /lease b, financial services c, religious services d, medical services and goods e, educational/ child care services f, humanitarian goods and services g, electricity, kerosene and water h, post service supplies i, transportation j, printed books k, permits and license fees l, import of gold, currency m, fertilizer n, bread, injera, milk
2 Birr/ kg on locally sold chat	5 percent on the following: a, work contracts b, financial services	Zero Rate on export goods/services
Exempted items: a, bread , injera b, fertilizer c, aviation fuel/ kerosene d, railway/ marine transport e, equipment for national defense	Exemptions: a, water b, electricity c, medical services d, educational services	

Sources: Proclamation No. 228/2001 and 285/2002

DECLARATION

I, the undersigned, declare that this thesis is my original work, has not been presented for a degree in any university and that all sources of the materials used in this thesis have been duly acknowledged.

Name:-Getu Minaye

Signature



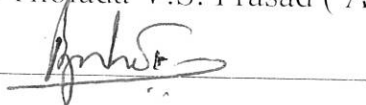
Date

26/07/07

This thesis has been submitted for examination with my approval as a University advisor.

Name of Advisor:- Dr. Tholada V.S. Prasad (Associate Professor)

Signature



Date of approval

26/07/07