

ADDIS ABABA UNIVERSITY
COLLEGE OF BUSINESS AND ECONOMICS

VALUE ADDED TAX REVENUE PERFORMANCE AND
ADMINISTRATION PROBLEMS IN CASE OF ERCA IN GONDAR

BY
BIRHAN MESFIN

ADVISOR
VENKATI PONNALA (**PhD**)

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BY
BIRHAN MESFIN WODAJIE

APPROVED BY THE BOARD OF EXAMINERS:

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|---------------|-------------------|--------------------|
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| _____ DATE | _____ EXAMINER | _____ SIGNATURE |
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DECLARED BY

BIRHAN MESFIN WODAJIE _____ FEBRUARY, 2014

STUDENT

SIGNATURE

DATE

CONFIRMATION BY ADVISOR

VENKATI PONNALA (**PhD**) _____ FEBRUARY, 2014

ADVISOR

SIGNATURE

DATE

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ABSTRACT

Every government needs dependable and sustainable domestic revenue so as to run its function. In North Gondar, where substantial proportion of government revenue has been collected from tax. However, in practice, VAT revenue performance in North Gondar was not geared with VAT theoretical feature. This is due to VAT administration problems particularly for key VAT administrative functions. Survey had been conducted to gather information about taxpayers and tax officials' attitude towards VAT administration problems in case of ERCA in Gondar branch. Self-administered semi-structured interviews and questionnaires were distributed for ten tax officials and fifty VAT registered taxpayers respectively. Further, secondary data was collected to measure the VAT revenue performance of the authority. The study tries to investigate and analyze VAT administration problems in case of ERCA in Gondar branch and it tries to assess VAT effectiveness in generating more government revenue (VAT revenue performance in the authority). For this study Surveying method through semi- structured questionnaire and semi- structure self administered questionnaire is used to investigate the research questions mentioned in chapter one. Besides, the study used percentages, mean and standard deviation statistical tools to strengthen and to make the study more systematic. In general, to analyze the data, statistical package for social science (SPSS) soft ware version 16 was employed. The result part presents response rate for tax official and taxpayers survey, VAT administration tasks on key administration function, strength of VAT administration, VAT rate and market competition. Finally, this section presented VAT revenue performance of the authority and identifies VAT administration problems. VAT is the major source of government revenue in most developing countries. Thus, VAT has a significant role in the revenue system of government of Ethiopia. To sustain its role for the generation of revenue, it is important to ensure that the revenue generated by VAT system should be efficient as possible. In the survey opinions were forwarded by the respondents. For instance, strengthening administration capacity by skilled manpower and the required materials to encourage honest traders by rewarding them and giving incentives and taxpayers should obey for the rules and should also cooperate with the authorities' operational activities.

LIST OF ACRONYM ABBREVIATION

| | |
|-------|--|
| AU | African Union |
| DTE | Developing and Transitional Economies |
| EC | European Community |
| ERCA | Ethiopian Revenue and Custom Authority |
| EU | European Union |
| GDP | Gross Domestic Product |
| GNP | Gross National Product |
| IMF | International Monetary Fund |
| LDCs | Low Developing Countries |
| MoFED | Ministry of Finance and Economic Development |
| MoR | Ministry of Revenue |
| OECD | Organization of Economic cooperation and Development |
| TOT | Turnover Tax |
| VAT | Value Added Tax |

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Chapter One: Introduction

The major aim of most governments in developing countries is to stimulate and guide their economic and social development. These governments continue to reach out for the goal of government promoted and directed development. As Wawire (2011) cited in Kaldor (1964:253) pointed out the importance of government revenue in accelerating economic development. Whatever the prevailing ideology or political situation of a particular country, it must steadily expand a host of non-revenue yielding services such as education, health, infrastructure, and social security. As Wawire (2011) cited in Toye (1978:1) asserted that the link between taxation and economic development is a link between a universal desire and a form of government action that is believed to be a means to that end. As Wawire (2011) cited in Wildford (1978a: 83) asserted that one of the most important policy upon which most economists agree is that emerging nations must increasingly mobilize their own internal resources to provide economic growth. The most important instrument by which resources are marshaled is through the implementation of an effective tax policy (Wawire, 2011).

In most developing countries, tax administration was in a poor state (Bird and Bahl 2008 cited in Radian 1980). Tax bases were grossly under-assessed, collection rates were low, and penalties existed more in law than in fact. In some countries, tax evasion was seen to be more a badge of honor than a crime. In addition, low tax morale combined with inadequate and unwilling enforcement to produce an adverse tax culture. Further, Staff was underpaid and under-skilled, recordkeeping was manual, modern procedures for assessment and collections were not in place, and tax systems were often so complex that they made a bad situation worse (Bird and Bahl ,2008). Faced with such realities, some countries (and advisors) opted to concentrate on improving tax administration, others attempted to devise tax systems that could work with bad tax administration and still others continued to ignore the interdependence of tax policy and tax administration (Bird and Bahl ,2008).

Although tax administration has come a long way in many developing countries over the last three decades (Bird and Bahl 2008 cited in Bird and Zolt 2007), there is still much to be done. For example, most developing countries have adopted a modern value added tax (VAT). However, there are many ways in which VATs can and should be improved in most developing and transitional countries, in part by ensuring that VAT design is more in tune

with the real capabilities of VAT administration and in part by providing a better defense against the common tendency to narrow the VAT tax base by expanding exemptions and zero-rating as the years go by (Bird and Bahl 2008 cited in Edmiston and Bird 2006). Nonetheless, there is no question that the VAT is now properly considered central to a good tax system in most countries.

The Ethiopian government has replaced the former sales tax so as to broaden the tax base and make the tax administration more efficient. In line with this the Federal Democratic Republic of Ethiopia (FDRE) has adopted VAT into its tax system on January 1, 2003 by replacing the former sales tax system. Therefore multi stage sales tax which is imposed at more than one level of production and distribution has replaced sales tax for reasons of administration and simplicity (Hailu, 2004).

According to Hailu (2004) VAT is a tax levied on consumption goods and services. Moreover it is a modified sales tax based on the net value added at each stage of production or services rather than on gross receipts. The VAT system is believed to encourage savings, exports and capital accumulations as it is levied on goods and services meant for consumption. Apart from this the VAT is charged on taxpayers that meet the threshold of Ethiopian Birr (ETB) 500,000 and above in annual turnover and the tax is charged at 15% rate on transactions subject to VAT.

VAT is the major source of revenue for the government of Ethiopia since its introduction. But, in practice, its potential performance to GDP is not geared with VAT theoretical feature. This is due to VAT administration problems particularly for key VAT administrative functions. Therefore, the objective of this paper is to assess VAT revenue performance and administration problems particularly for key VAT administrative functions in case of ERCA in Gondar. This chapter presents background of the study. The remaining discussions are organized in seven sections. Section 1.1 presents statement of the problem. Section 1.2 presents objectives of the study. Section 1.3 presents methods adopted. Section 1.4 presents significance of the study. Section 1.5 presents limitation of the study. Section 1.6 presents scope of the study. Finally, organization of the project is presented in section 1.7.

1.1 Statement of the problem

According to Tesfaye (2008) the Ethiopian government declared VAT tax laws to all domestic and foreign enterprises since July 2002 so as to increase its revenue and to reduce its dependency on foreign debt. So that both direct and indirect taxes are levied on customers and business enterprises. The indirect taxes are mainly Value added tax; turn over tax and other consumption taxes. Among the indirect taxes, VAT has the widest scope and has become the major sources of tax revenue for the government.

As Ebrill and Keen(2001) stated VAT is a good means to raise government revenue and they found that in countries that have adopted VAT, revenue from this source accounted on average 27 percent of the total tax revenue or 5 percent of the GDP. Moreover, 70 percent of the world's populations now live in countries with a VAT. This implies that it is a key source of government revenue in more than 126 nations. However, government determination to increase VAT revenue and to improve tax administration system on one side and taxpayer compliance on the other side pose problems in the business sectors (Tesfaye, 2004).

Bird (2005) noted the underlying problem for VAT performance does not, as a rule, lie in poor tax design. Rather, it usually reflects on the existence of fundamental gaps in the institutional requirements for good VAT administration and the real fiscal institutions in place in a country.

As Hailu (2004) stated the efficiency of VAT administration highly depends on the behavior of taxpayers and tax compliance. Like most developing countries, in Ethiopia most people are reluctant to pay VAT. However, an efficient VAT administration is an administration which could minimize tax evasion in the economy. The introduction of VAT in Ethiopia has helped tax administration to use computerized system apart from the built-in checking system of VAT.

A VAT is a critical revenue stream for industrialized countries. Among non-U.S. OECD members in 2009, the VAT raised 6.4 percent of GDP in revenue and accounted for 19.2 percent of revenue raised at all levels of government. As with any tax, revenue from a VAT depends on the rate structure and the base. The standard VAT rate, the rate charged on most goods and services, has remained relatively steady in recent years in non-U.S. OECD countries. In 2012, it ranged from a low of 5 percent in Japan to a high of 27 percent in Hungary. The average rate was 18.7 percent (Gale and Harris, 2012).

1.2 Objectives of the study

The general objective of the study is to assess VAT revenue performance and administration problems in case of ERCA in Gondar. The study has the following specific objectives.

- To investigate VAT administration problems pertaining to VAT registered tax payers as a result of VAT law enforcement by the tax authority (Particularly VAT registration, invoice, file, payment, audit and penalty); in Gondar;
- To assess the attitudes of taxpayers towards VAT rate and market competition between VAT registered and non VAT registered business enterprises;
- To examine the strength of Ethiopian revenue and custom authority in Gondar branch and regional tax office in Gondar to control noncompliant taxpayers (in view of skilled and competent employees, simplification of tax procedure based on attitude of respondents, sufficient resource availability); and
- To assess VAT revenue performance of the Ethiopian government using efficiency ratio.

1.3 Research Methods Adopted

To assess the VAT administration problems and revenue performance for taxpayers in ERCA in Gondar, the study used mixed method approach. Specifically, the study was gather data through self administered semi-structured questionnaire with tax officials. Besides, a survey of taxpayers was used and the survey will be conducted using semi-structured questionnaires which were designed to elicit both quantitative and qualitative data on problems in the VAT system.

1.3.1 Research design

A research design is the arrangement of conditions for collection and analysis of data in a manner that aims to combine relevance to the research purpose with economy procedure. In fact the research design is the conceptual structure with in which research is conducted; it constitutes the blue print for the collection, measurement and analysis of data.

1.3.2 Data type, source and method of collection

Data, which is raw information, is the essential and core element of any type of studies. So that the more valuable and actual data will be used to produce more reliable and dependable information for this particular study. In order to achieve the objective of the study basically both primary and secondary data was used. The primary data was obtained using survey of

Self administered semi-structured questionnaires with selected samples of 50 tax payers by using questionnaire and semi-structured questionnaires were distributed to ten tax officials. Moreover documentary analysis using data held by the tax authorities, Ministry of Revenue, the Ministry of Finance and Economic Development was used. Finally different web sites were visited.

1.3.3 Methods of data analysis

The term analysis refers to the computation of certain measures along with searching for patterns of relationship that exist among data groups. For this particular study time series analysis or trend analysis was used.

1.3.4 Sampling technique

A sampling design is a definite plan for obtaining a sample from a given population it refers to the technique or the procedure the researcher was adopt in selecting item for the sample. For this particular study judgment sampling method was used. Due to shortage of time and resource constrain the sample size for the survey will be 50 taxpayers and 10 tax officials. Self administered semi-structured questionnaires were distributed for 50 VAT registered taxpayers. In addition, semi-structured questionnaires were distributed to ten tax officials.

1.4 Significance of the study

The purpose of the study will be to identify the problems which will face at the administration of VAT and improving the VAT administration system to increase revenue performance of VAT to the gross domestic product. Moreover, the study will be important to investigate problems on taxpayers so as to increase revenue performance. It is also expected that the project paper will give guideline to the concerned tax authorities as regard how they properly address the VAT system and at the same time to monitor and to ensure the system of VAT administration effectively and efficiently to achieve the objectives.

Further, the study will help the tax authorities to identify their problems and inefficiencies and to make corrective action to improve revenue performance to Gross domestic product. Finally, it is believed that the study will add something to the existing literature and it will serve as a reference for those who will conduct further study.

1.5 Limitation of the study

Adequate and reliable information is important to undertake any kind of survey. And hence precaution was 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 tax officials while giving documents was the shortcomings that were encountered. Finally, the problems which will face in this study are time shortage and difficulty of getting documents in the tax office.

1.6 Scope of the study

Though the source of government revenue is obtained from both direct and indirect taxes, the study focus on VAT which was one of the recently implemented indirect tax. The study focuses on VAT, because it was difficult to investigate all indirect taxes which are vast and cumbersome to make a analysis. Due to shortage of time and resource the study only gives emphasis on VAT revenue performance and its administration problems, particularly for key administrative tasks, in case of ERCA in Gondar.

1.7 Organization of the project

The paper is organized in 5 chapters. Chapter 1 presents introduction. Chapter 2 presents literature review. Chapter 3 presents research design and methodology. Chapter 4 presents results and analysis. Finally, conclusions and recommendations are presented in chapter 5.

Chapter Two: Literature review

The previous chapter presented about the background of the study, statement of the problem, objectives of the study, methods adopted, significance of the study, limitations of the study, scope of the study and organization of the project. And hence, as explained in chapter one in the statement of the problem section, the major problems of VAT is its administration, particularly for key administrative tasks, and improving VAT revenue performance. Therefore, this chapter presents literature review. Accordingly, section 2.1 presents the theoretical aspects of VAT administration and revenue performance. Section 2.2 reviews the empirical evidence on VAT administration and revenue performance. Lastly, section 2.3 presents conclusion.

2.1 Theoretical aspect of VAT administration and revenue performance

Different authors who wrote about the tax have defined VAT, which is also known as goods and services tax (GST) or consumption tax, in different ways. According to Shop (1969), VAT may be defined as a consumption/expenditure tax charged on the value added to goods and services by importers, manufacturers and traders at each stages of the production and distribution process.

According to Hyman (1996), VAT is a general tax on consumption levied on the value added to intermediate products by businesses at each stage of production. VAT is not a tax on the total value of the goods and services being sold, but it is only on the value added to it by the last seller. The seller, therefore, is not liable to pay a tax on its gross value, but on its net value (the gross value minus the value of inputs) (Bhatia, 2003).

According to Ebrill and Keen (2001) VAT was first introduced in France in 1948, where it was initially applied up to the manufacturing stage and gave credit for tax on capital goods. By 1969 only eight nations adopted VAT. Out of the eight nations Cote d'Ivoire is the first country in Africa to introduce VAT. Since 1979 the VAT spread rapidly in the industrialized as well as in the developing countries. This makes VAT the first tax system, which spread quickly within a short time after its introduction. As of 2003, among 190 countries of the world about 126 (66%) of them have made VAT part of their tax system. From the 53 member countries of the Africa Union (AU) about 31 (59%) of them have introduced VAT (Tesfaye, 2004).

Tait (1991) noted the usual VAT is a general sales tax on all goods and services. It is levied at each stage of production and consumption so that it is equivalent to a tax on all final household consumption. It has become the most popular sales tax in the world. It was adopted by the European Community (EC) in 1968, and has since spread to more than 100 countries. The only major economy that does not use some form of the VAT is the United States.

As Bird and Gendron (2005) noted the principal reasons for the VAT's incredibly rapid spread and success are twofold. The first was undoubtedly the early adoption of VAT in the EU and the perceived success of both the EU and its VAT. The second has been the key role played by IMF in spreading the word to developing countries.

The demonstrated success of VAT in the EU showed that VAT worked. The consistent support and advocacy of this form of taxation by the IMF in a variety of countries, first in Latin America, and then around the world, first introduced the idea of VAT and then facilitated its adoption by countries with much less developed economic and administrative structures. At the same time, for various reasons of their own, all the non-EU countries of the OECD—other than the U.S. have also, one by one, introduced VAT of their own in recent years—New Zealand in 1986, Japan in 1989, Canada in 1991, and, most recently, Australia in 2000 (Bird and Gendron, 2005).

Following its success in Europe, the VAT has been implemented in numerous Low Developing Countries under “the structural adjustment and stabilization policy conditionalities of the IMF and World Bank” (Bird and Gendron 2007 cited in Lauren et al, 2008, page 9).

As Kerver (2008) mentioned VAT has emerged in Africa as a result of coercion from Institutional financial organizations (IMF), difficulties in collecting sufficient revenue, and also international changes to tariff regimes. In the context of the discussions so far, the subsequent review shows VAT administration and VAT revenue performance in an orderly manner.

2.1.1 VAT Administration

As Bird (2004) noted that the basic tasks of tax administration consist of three distinct (though connected) activities, i.e. identification, assessment and collection. Further, Bird and Gendron (2005) noted tax administration consists of several related but separable processes—registration, filing, payment, audit, and enforcement. In accordance with Tait (1988) the introduction of VAT is usually the greatest change in tax system of a country and there is also a possibility to perform the reform of tax administration.

It would be better for countries in transition to adopt simple taxes - with a broad base and low rates - to give the tax administration the chance to adjust to the new system. Although the needs of organizational and technical aid can be easily obtained from foreign experts, a successful reform of tax administration is necessary "critical mass" of domestic experts that can be better acquainted with the domestic conditions and situation (Tanzi and Zee, 2001).

According to Bird and Jantscher (1992), a very important precondition for effective work of tax administration is canceling all additional duties out of the process of taxation. Besides, in some countries in transition, tax administration also performs many analyses and realizations of forecasting, which are in completely inconsistent with its duties in countries with ground economies. Furthermore, the tax administration was responsible for the distribution of means between governing bodies on various levels.

As Bird (2004 10(3) p. 135) noted in a very real sense, "tax administration *is* tax policy". Maximizing revenue for a given administrative outlay is only one dimension of the task of tax administration. Revenue outcomes may not always be the most appropriate basis for assessing administrative performance. How revenue is raised, i.e. the effect of revenue generation effort on equity, the political fortunes of the government, and the level of economic welfare, may be equally (or more) important as how much revenue is raised.

As Grandcolas (2008) noted VAT performance in Africa may depend on significant variations to the conventional view of VAT practice, and that the main objective of a tax administration should be to improve voluntary compliance. Grandcolas (2008) also suggests that the level of VAT compliance is particularly influenced by the design of the VAT and the quality of the tax administration; and discusses that the lack of skilled tax administrators poses a struggle for developing countries, including those in Africa. Grandcolas (2008)

suggests that the overall performance of the VAT systems in Africa depends on three main factors: “The capacity of policymakers to take into consideration the structural weaknesses of the tax administration; commitment to apply the designed penalty system; and development of a client-oriented tax administration and an effective audit Program. Grandcolas (2008) discusses in great detail strategies to modernize the tax administration, such as simplifying filing and payment processes and streamlining refund procedures.

According to Bird (2008) reaping revenues from tax rate changes (whether up or down) requires effective tax administration. Raising revenues through base expansion requires even better administration. New taxpayers must be identified and brought into the tax net and new collection techniques developed. Such changes take time to implement. The best tax policy in the world is worth little if it cannot be implemented effectively (Bird, 2008). What can be done to a considerable extent inevitably determines what is done. One cannot assume that whatever policy designers can think of can be implemented or that any administrative problems encountered can be easily and quickly remedied. How a tax system is administered affects its yield, its incidence, and its efficiency. Administration that is unfair and capricious may bring the tax system into disrepute and weaken the legitimacy of state actions (Bird, 2008).

According to Kefela (2009), the real tax system facing people and businesses in most developing countries is not how the tax law is designed but rather the outcome from how that system is actually put into practice and very importantly how the tax administration and its role impacts the tax reform. As Tanzi (1991) cited in Kefela (2009) has pointed out tax administration has a crucial role in determining the real (or effective) tax system, as opposed to the statutory tax system.

There is a growing conviction among tax policy specialists in developing countries that "a policy change without administrative change is nothing. Bird (1989) cited in Kefela (2009) and that it is critical to ensure that "changes in tax policy are compatible with administrative capacity" World Bank (1991) cited in Kefela (2009). Only very few developing countries have managed to establish their tax systems in such a way as to achieve an appropriate level of revenue and to keep tax-generated misallocations within tight bounds. In most other countries, neither has it been possible to ensure the financing of public expenditure nor have the tax systems operated in conformity with economic policy objectives (Kefela, 2009).

According to Santos (2002) an argument often used against the introduction of VAT is the weakness of the tax administration. This is a valid concern. VAT performance would be poor under a weak administration. However, if a tax administration is weak, its strengthening is a priority regardless of what taxes the country has in place.

During the process of deciding whether to introduce a VAT, the tax administration's weakness should be a concern, but not an overriding factor. If such weaknesses are a real problem, they will have to be tackled under any scenario. Since preparation for VAT introduction takes approximately two years; this time could and should be used to strengthen tax administration. In fact, some countries have used the VAT introduction to set up a new, more modern tax administration. With the correct perspective and commitment, this process can naturally lead to a strengthening of the tax administration (Santos, 2002).

According to Bird (2003) unfortunately, tax administration is a difficult task even at the best of time and in the best of places, and conditions in few developing countries match these specifications. Moreover, it is inherently country-specific and surprisingly hard to quantify in terms of both outputs and inputs. Accordingly, The "best" tax administration is not simply that collects the most revenues; tax administration depends on private and public actions (and reactions), various environmental factors, substantive and procedural tax law and the outcome of a given administrative effort. All this makes tax administration a complex matter.

In a very real sense, "tax administration is tax policy" (Jantscher 1990 cited in Kefela 2009 p. 99). Maximizing revenue for a given administrative outlay is only one dimension of the task of tax administration. Revenue outcomes may not always be the most appropriate basis for assessing administrative performance. How the revenue is raised - the effect of revenue-generation effort on equity, the political fortunes of the government, and the level of economic welfare - may be equally or more important in some contexts. Similarly, private as well as public costs of tax administration must be taken into account and due attention given to the extent to which revenue is attributable to "enforcement" (the active intervention of the administration) rather than "compliance" (the relatively passive role of the administration as the recipient of revenues generated by other features of the system). Assessing the relation between administrative effort and revenue outcome is thus not a simple task (Jantscher 1990 cited in Kefela 2009).

The major activities in VAT administration are identifying taxpayers, processing returns, controlling collections, making refunds, auditing taxpayers and levying penalties (Purhoit,

2000). On the part of administration, preparation of a single master file, based on unique tax identification number (TIN) is crucial and this ensures that each taxpayer's account contains all the relevant tax and payment data for that taxpayer alone. On account of requirements of VAT, the even functioning of VAT would depend upon taxpayers keeping careful and complete records (Purhoit, 2000). To minimize the likely amount of high compliance costs, however, sellers are expected to maintain sufficient details to have information on the following aspects. These are particulars of invoices giving details of tax on sales and credit on purchases, detail of accounts giving information of all purchases and sales and interaction between invoices, purchases and sales account with the tax return form (Purhoit, 2000).

VAT execution is also part of VAT administration. This includes identifying tax payers 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. It is not only the authorities should be responsible in assessment of execution of VAT but the consumers themselves have a key role to play (Purhoit, 2000).

As Tanzi and Pellechio (1995) cited in Ott (1998) noted the main tasks of VAT administration involve: (1) information and instruction to taxpayers, (2) registration, organizing and processing tax returns (input of data, processing declarations and payments), (3) coercive collection (closely connected with registration, accounting and return processing), (4) control and supervision (discovering lacking and insufficient tax returns and controls of books and papers in tax administration offices or business activities and books of taxpayers, while routine check-ups had already been done in the registration, accounting and return processing department), (5) legal services and complaints (taking cases to court, defending tax administration in court, explaining procedures which are or are not in accordance with the law).

According to Andic (1994) cited in Ott (1998) transition countries most definitely need changes in VAT administration, and its adjustment to modern accounting, control, assessment, collection, coercive collection, compliant procedures and the growing number of individual taxpayers.

VAT is administered and managed by the IRS, a federal agency responsible for the administration of federal taxes with power to do such things as may be deemed necessary and expedient for the assessment and collection of the tax due. At the planning stage, some

reservations were expressed about the competence and desirability of the FIRS to effectively administer VAT. The Federal Government rejected the recommendation that a fully independent and self-sustaining Commission should be established to administer (Sanni, 2012).

The VAT has compliance advantages over a retail sales tax, which is intended to collect all revenue at the point of sale from a business to a household. Since revenue collection for the VAT is spread across stages of production, with producers receiving a credit against taxes paid as an incentive for compliance, the VAT in practice is less likely to be evaded (Gale and Harris, 2011).

The VAT is in theory a tax on consumption, but in practice, calculating the amount of VAT due is as complex as calculating the amount of income tax due, as Strachan (1981), a tax administrator in the UK, notes when describing the administration of the UK's VAT. To see how administrative and compliance costs arise, one needs to understand some of the details regarding the way a VAT is administered. (Gale and Harris, 2011)

2.1.2 VAT Revenue Performance

Traditionally, the effectiveness of VAT in raising revenue is measured by the ratio of VAT revenue to GDP. Countries with similar standard of VAT rate can have significant different ratio of VAT revenue to GDP. More generally, the efficiency ratio as defined by (Ebrill and Keen, 2001) as the ratio of VAT revenues to GDP divided by the standard VAT rate. It has been mostly used as a general indicator of the performance of VAT (Ebrill and Keen, 2001).

Another method of measuring the effectiveness of VAT is C-efficiency ratio. C-efficiency ratio as defined by Ebrill and Keen (2001) is the ratio of the share of VAT revenue in private consumption (rather than GDP) to the standard VAT rate. A uniform tax on all consumption has a C-efficiency ratio of 100 percent. Thus, it shows that all goods and services are covered by the tax and also there is high literacy or awareness from the taxpayer side. Any deviation from a single tax rate on private consumption will be depicted by a higher or lower value of C-efficiency ratio. The C-efficiency is more informative than the efficiency ratio as it is based on private consumption.

According to Tait (1988) VAT is designed to raise large amounts of revenue (typically 5 to 10% of gross domestic product) without creating economic distortions. In practice, many countries, because of political pressures to use the tax system to correct social inequities and

because of their inability to tax certain sectors use exemptions and multiple rates that erode the neutrality of the VAT.

As Bird and Zolt (2003) stated tax systems exist primarily to raise revenue to fund government operations. Lack of sufficient revenue often results in large budget deficits. Except when short-term fiscal stimulus may be considered appropriate for macroeconomic reasons, deficits generally have undesirable macroeconomic consequences such as crowding out private investment and increasing inflation. Preventing deficits requires good control over both the expenditure and revenue sides of government. The legislated budget must be structured each year to operate strictly within estimates of likely revenue receipts. While this may seem obvious, even these initial conditions for good tax and budgetary policy are not satisfied in a number of countries.

As Menck (1992) cited in Kefela (2009) noted the average taxation ratio of developed countries as a proportion of GDP lay between 29 and 32%, whereas the corresponding range for developing countries in the medium-income category was from 17 to 22%. The average taxation ratio in the poorest countries lies between 13 and 16%. The problem is a vast gap exists between the tax payments required by law and those actually surrendered to the state. The taxation authorities – often inadequately staffed, institutionally weak and lacking in political support - are not in a position to collect the amounts outstanding.

In developing and transitional economies in which revenue constraints generally bite, fulfilling this laundry list is usually too much to expect. Unsurprisingly, few countries have managed to do it all. One result is that many problems have been encountered in implementing VAT in most DTE—ranging from flaws in tax design (e.g. in appropriate thresholds) to failures in implementation (weak registration procedures, poorly functioning refund systems, insufficient audit, etc.) (Bird and Gendron, 2005).

According to Tanzi and Zee (2001) the ideal level of tax revenue; determining the optimal tax level is conceptually equivalent to determining the optimal level of government spending. Unfortunately, the vast literature on optimal tax theory provides little practical guidance on how to integrate the optimal level of tax revenue with the optimal level of government expenditure.

Nevertheless, an alternative, statistically based approach to assessing whether the overall tax level in a developing country is appropriate consists of comparing the tax level in a specific country to the average tax burden of a representative group of both developing and industrial

countries, taking into account some of these countries' similarities and dissimilarities. This comparison indicates only whether the country's tax level, relative to other countries and taking into account various characteristics, is above or below the average. This statistical approach has no theoretical basis and does not indicate the "optimal" tax level for any country. The most recent data show that the tax level in major industrialized countries (members of the Organization for Economic Cooperation and Development or OECD) is about double the tax level in a representative sample of developing countries (38 percent of GDP compared with 18 percent) (Tanzi and Zee, 2001).

VAT is not always the 'money machine' that it has sometimes been called. The effects on revenue of introducing VAT in particular contexts remain a matter open to interpretation and question (Bird, 2005). This conclusion has recently been underlined by some who have questioned the capability of VAT to replace revenues from trade liberalization, especially in lower-income DTE (Rajaraman 2004 cited in Bird 2005).

If a VAT can be administered adequately, it offers the best way for a country to make up revenue losses from trade liberalization. Thus, it seems convincingly, for more developed than for less developed countries in which trade taxes are generally more important and alternative tax bases less accessible (Bird and Gendron, 2005).

Similarly, VAT is the most economically desirable and administratively effective way in which to collect a given share of national income through a general consumption tax also holds provided, again, that the capacity exists to administer VAT adequately (Bird and Gendron, 2005). When a country introduces VAT, whether to replace another form of general sales tax or as a new tax, there need not necessarily be an aggregate increase in revenues (either from consumption taxes or in general). All else equal, however, the economic cost of collecting revenues will decline simply because the base is broader, thus making society better off. Similarly, as with any tax, although increasing the rate of an existing VAT will neither necessarily increase revenues proportionately nor be costless, it may still be the economically most sensible way to expand revenue share in DTE, if that is the policy goal (Bird and Gendron, 2005).

VAT is one of the main sources of government revenue in all EU member states. Across the EU as a whole, VAT brought in €783.7 billion of revenue in 2009, 6.6% of the EU's GDP and 17.3% of all taxes raised. In the current fiscal context, a key attraction of the VAT is its ability to generate significant amounts of revenue. Among non-U.S. OECD members in 2006,

the VAT raised almost 7 percent of GDP in revenue and accounted for almost 19 percent of revenue raised at all levels of government. As with any other tax, revenue from a VAT depends on the rate structure and the base. The standard VAT rate, the rate charged on most goods and services, has remained relatively steady in recent years in non-U.S. OECD countries. In 2007 the standard rate ranged from a low of 5 percent in Japan to a high of 25 percent in Denmark, Iceland, Norway, and Sweden. The average rate was 18 percent (Holcombe 2010 cited in OECD 2008).

While the primary motivation at the moment for considering a VAT is its revenue-raising potential, in the past supporters have promoted the VAT as a possible substitute for the federal income tax, either abolishing the income tax altogether and substituting a VAT, or lowering income tax rates and substituting VAT revenues in a revenue-neutral tax reform. Along these lines it is interesting to examine the effect of introducing the VAT into the EU, because most member nations said that they were going to adopt a VAT to redesign their tax structures to comply with the EU regulations, but were going to undertake their reforms in a revenue-neutral manner. In fact, as Holcombe and Mills (1994) report, throughout the EU, tax revenues ratcheted up substantially when the VAT was introduced. The evidence is all the more clear because the

VAT introduction was staggered, as EU countries introduced it from 1967 to 1973. Statistical analysis shows a clear ratcheting up in the level of revenue, followed by an increase in the growth rate of revenue, after the introduction of the VAT (. Holcombe, 2010)

2.2 Empirical Evidence of VAT Administration and Revenue Performance

2.2.1 VAT Administration

Experience around the world demonstrates that the single most important ingredient required for effective tax administration is clear recognition at high political levels for task importance and willingness to support good administrative practices. Few developing countries have been able to leap this initial hurdle frequently, urged by international agencies or simply desperate to get more revenues. Moreover, countries have from time to time launched frantic efforts to corral defaulters or to rope in new victims without hurting politically powerful interests and without providing the time, resources and consistent long-term political support needed to do the job. Such efforts are doomed to failure. And hence, collecting taxes

efficiently and effectively without fear or favor is especially difficult in countries that are politically fragile (Bird and Zolt 2007 cited in Bird 2008).

According to Ebrill et al (2001) cited in Grandcolas (2005) with few exceptions, modern tax administrations require taxpayers to self-assess their tax liabilities. They do not examine the details of tax returns when filed but use special selection techniques to identify appropriate cases for audit (including desk audits and field audits) at a later time. Such a system, based on voluntary compliance provides a more effective allocation of the scarce resources of a tax department for audit and enforcement work.

As Bird and Zolt (2003) noted the failure to develop good tax administration and good tax policy together has been a particular problem in some transitional countries. In Russia, for example, serious problems existed with both the structure of the VAT and the lack of administrative experience and capacity. A simple example is that under the initial VAT legislation, no tax liability was due when loans were made from one business to another. Thus, a buyer would claim to have made a loan that was never repaid (and was in fact payment for goods) to a supplier and no tax was due. The result was a significant loss of revenue. A more capable administration would have foiled this simple evasion technique, but better legislation was also needed.

As Bird and Zolt (2003) stated even if policies are good, the way in which they are administered can yield very different outcomes than those intended. Administration that is seen as unfair and capricious may bring the tax system as a whole into disrepute. The initial failure of transitional countries to develop their tax administrations when introducing new tax structures resulted in very uneven tax imposition, lower than anticipated revenue, and widespread tax evasion.

As Grandcolas (2005) noted a result of the policy and administration measures taken, Gabon found that: – compliance was high: 800 VAT taxpayers have been registered using a registration threshold of USD 1 million or more. Since the implementation of VAT, all receipts and notices have been issued electronically, and 80% of returns are filed on time and 87% upon receipt of the first reminder. Moreover, as Grandcolas (2005) indicated the introduction of VAT in Mauritius saw: – outstanding levels of compliance: At the end of May 1999 (nine months after its introduction), the level of voluntary compliance was close to 99.5%. At the end of May 1999, only 38 monthly returns were missing (0.48%) compared with 7,825 VAT monthly returns receivable since October 1998. With regard to the recent

VAT implementation experience in developing and transition economies, Bird (2005) showed that developing and transitional countries encounter various problems in the introduction process, caused by, for instance, the lack of self-assessment based tax return practices, the difficulties in establishing efficient VAT administration and control systems, a large share of shadow economy and tax fraud.

The VAT is easier to enforce, and its administrative structure is widely regarded as superior to that of the retail sales tax. Although it would be new to the United States, the VAT is in place in about 150 countries worldwide and in every OECD country other than the United States. Experience suggests that the VAT can raise substantial revenue and is administrable and minimally harmful to economic growth. It also has potential advantages: A properly designed VAT might help the states deal with their own fiscal problems, and a preannounced, phased-in VAT could accelerate the pace of economic recovery (Gale and Harris, 2011).

A broad-based VAT would cost less to administer than the current income tax. For example, in the United Kingdom the administrative costs of the VAT were less than half of those of the income tax, measured as a share of revenue. Similarly, the New Zealand revenue department was required to intervene in just 3 percent of VAT returns, compared with 25 percent of income tax returns (Gale and Harris 2011 cited in GAO 2008).

As Tanzi and Zee (2001) stated while VAT has been adopted in most developing countries, it frequently suffers from being incomplete in one aspect or another. Many important sectors, most notably services and the wholesale and retail sector, have been left out of 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 these features allow a substantial degree of cascading (increasing the tax burden for the final user), they reduce the benefits from introducing the VAT in the first place. Rectifying such limitations in the VAT design and administration should be given priority in developing countries.

As Tait (1988) cited in Bird and Gendron (2005) noted developing and transition economies are generally advised that a preparatory period of between 18 and 24 months is necessary to set up a VAT (This advice seems both reasonable and to some extent accords with experience). As Tait (1988) cited in Bird and Gendron (2005) mentioned certainly, some countries that have tried to do it in less time have paid a substantial price for their haste and had to spend a lot of resources subsequently in getting it right. On the other hand, in other

cases too long a preparation period may prove dangerous in the sense that the window of opportunity open to introduce major tax changes may be open only for a very short time. Countries that adopt a VAT must sometimes for better or worse thus take what may be called the ‘big bang’ approach. Of course, when this has happened the experience has seldom worked out well, which is no doubt experts so often emphasize the desirability of following the ‘normal’ time schedule mentioned above.

Nonetheless, another lesson suggested by experience in many DTE is that even two years may vastly underestimate the nature and time scale of the task in many countries. Two years is not nearly long enough to have a good (or even an acceptable) VAT system up and running well. Ten years or at least five is perhaps closer to reality. Many DTE cannot be, as it were, simply ‘given’ a good VAT administration. Instead, they need to ‘grow’ it themselves, a process that may sometimes take a long time (Bird and Gendron, 2005).

2.2.1.1 VAT Registration

As Bird and Gendron (2005) noted as a rule, a small number of VAT registrants, sometimes less than a few dozen, account for 80 percent, 90 percent or even more of VAT collections in DTE. In Egypt, for example, 10% of registrants account for over 90% of GST collections. In Jamaica, the largest 100 taxpayers accounted for two-thirds of domestic GST collections. What has proved much more troublesome in VATs around the world is the question of how best to deal with the ‘minnows’ of the system—small taxpayers. That issue is where to set the threshold – the point at which firms must register as VAT taxpayers. The usual ‘first stage’ advice with respect to thresholds was, on the whole, that this entry point to the VAT system should be set as low as possible in order to widen the tax base, thus ensuring that all potentially taxable transactions were caught in the fiscal net. However, as experience with the difficulties of imposing general sales taxes in fragmented economies with large informal sectors has accumulated, a ‘second stage’ recommendation that is increasingly being heard is that the threshold should be set considerably higher. A level of something like US\$100,000 is probably more or less what current ‘conventional wisdom’ would suggest (Bird and Gendron, 2005).

Developed countries with good tax administrations may be found at both ends of this spectrum, from countries like Sweden with thresholds of zero—all in!—to Singapore (US\$700,000) at the other extreme. Similar variety may be found in other regions. In the

Middle East, for example, thresholds range from EUR18, 000 in Morocco and Pakistan to a high of EUR100, 000 in Lebanon (Bird and Gendron, 2005).

2.2.1.2 VAT Filing and Payment

According to Bird and Gendron (2005) registrants are normally required to file returns on a monthly basis if their annual taxable sales exceed some specified limit, with smaller taxpayers filing bi-monthly, quarterly, or even annually. There seems to be little empirical study of the relative costs and benefits of such different filing periods, but the practice is almost universal. Returns generally have to be filed within a month (or less) of the end of the relevant taxable period. Some countries have different types of returns for different taxpayers, especially when some file on a ‘simplified’ or ‘quick’ basis and some are subject to special high-rate excise (or VAT) rates. As Bird and Gendron (2005) mentioned in Jamaica, for example, there is a general return used by all registered taxpayers who do not use the quick method, another for the quick-method taxpayers.

All payments, including those on estimated assessments, should be accompanied by returns (Jantscher and Silvani 1991 cited in Bird and Gendron 2005). If payments are made without an associated return, either taxpayers have to indicate to which assessments the payments apply or some ‘stacking rule’ (e.g. delinquent principal first, then penalties, interest, and surcharges) has to be applied. If a nonverpayment is made with a return for a particular period, a similar ‘stacking’ rule may be used after the current tax due is paid. Alternatively, if a taxpayer overpays, he may receive either a credit (to be carried forward against future liabilities) or a refund. Even if government pays interest on such refunds (as it should), most such taxpayers will probably request refunds. Of course, if tax due is not paid or paid only in part, appropriate penalties and interest need to be promptly assessed, and enforced (Bird and Gendron, 2005).

As Jantscher and Silvani (1991) cited in Bird and Gendron (2005) noted in some countries—but by no means have all—taxed payments may be made to recognized financial institutions such as banks, to the revenue department itself, or to both. Those that do not already make use of financial institutions to both collect payments and do an initial processing of simple returns (those accompanied by full payment) should definitely explore this possibility further. On the whole, as a matter of good policy it seems best to keep the

function of actually collecting and processing money out of the hands of revenue officials who should be more concerned with ensuring that the right people pay the right amounts than with spending their evenings in adding up the day's proceeds.

According to Santos (2002) VAT is a transaction-based tax, and consequently should be reported and controlled as often as possible. Many countries require monthly filing and payment. However, this could result in a large number of returns and payments, which the administration could be unable to administer. Thus, some administrations have decided in favor of monthly returns and payment for the largest taxpayers and quarterly returns and payment for other taxpayers. Longer filing and payment periods, while reducing the number of returns and payments to process, make administration more complicated. Control of compliance with filing and payment requirements and information crosschecking are more difficult to implement where longer filing and payment periods are in place. Longer filing and payment periods also affect revenue.

2.2.1.3. VAT Invoice

According to Santos (2002) invoices are a critical component of VAT. The correct use of invoices must be enforced by tax administrations. Tax practitioners often say that an invoice is like a check issued against the Treasury. So, all precautions should be taken to ensure that they are adequately used. Tax administrations have to decide on the contents of the VAT invoice. Usually, invoice information should include: the taxpayer identification number of both the seller and the purchaser; the name and address of the seller; the name of the purchaser; the date the invoice is issued; the invoice number, a description of the goods, indicating a unit and total selling price; the amount of VAT resulting from that transaction; the total amount of the invoice, including the VAT payable, the date the invoice was printed, and the serial number of invoices printed in that batch. Special provisions should be made for taxpayers who use computer systems to print their own invoices.

As Jantscher (1990) cited in Yesegat (2008) noted unlike developed countries most developing countries require some form of invoicing for all transactions subject to VAT including sales to final consumers. In Ethiopia the VAT legislation states mainly two things. Firstly, the weaver of traders that have transactions with total consideration not exceeding ETB 10 from the requirement to issue invoices and secondly, simplification of the VAT invoice (it pertains to the format and the amount of information to be contained in the invoice).

2.2.1.4 VAT Audit

As Bird and Gendron (2005) noted perhaps the safest statement that can be made about VAT administration in any D T E i s t hat auditing procedures should be modernized and strengthened. Audit is the core of any tax system, especially of essentially self-assessed taxes like VAT. In most countries, the data exist to begin to design sound audit design policies for those already in the tax net. In principle, such audits should be done both randomly and on a more selective basis taking into account the ‘risk profile’ of different types of taxpayers. For example, since VAT is applied in effect to the difference between sales and purchases (or the ‘gross margin’ as it is often called with respect to retailers), a critical factor is the reported mark-up coefficient—supplies as a ratio of inputs. When this ratio is equal to or less than 1, a taxpayer is in effect reporting that his sales are less than his purchases, thus claiming that his ‘gross profit margin’ (value-added, under another name) on such sales is negative. While those taxpayers with persistently very low mark-ups (less than 0.5, for example) may sometimes have such reasonable explanations as substantial export sales on the whole (Bird and Gendron, 2005).

As Silvani (1992) cited in Bird and Gendron (2005) notes: “Experience has shown that taxpayers who report a low mark-up (under 1.10, for instance) have a strong likelihood of turning out to be tax evaders.” Firms in particular lines of industry that report markedly lower ‘mark-ups’ than their competitors would seem to bear close and automatic examination by tax auditors. Table 2.1 illustrates, for example, the situation in this respect in Jamaica with respect to the 81% of VAT taxpayers for which mark-ups could be calculated about 13% of these taxpayers reported mark-ups less than 1. Although this proportion does not appear to be particularly high in comparative terms, the potential problems in this respect are by no means confined to small firms, since over 100 of the largest firms (those in the top decile) also reported mark-ups of less than 1, a result that appears to warrant further investigation.

Table 2.1 Mark-ups reported on VAT Returns

| Mark-up Range (in percent) | Number of Firms |
|-----------------------------------|------------------------|
| <50 | 722 |
| 50-75 | 555 |
| 75-100 | 1,220 |
| 100-110 | 1,157 |
| 110-120 | 1,032 |
| 120-130 | 1,761 |
| 130-140 | 665 |
| 140-150 | 512 |
| 150-160 | 442 |
| 160-170 | 413 |
| 170-180 | 297 |
| 180-190 | 270 |
| 190-200 | 282 |
| | |
| 200-210 | 219 |
| >210 | 5,455 |
| Total | 13,902 |

Source: (Edmiston and Bird 2004 cited in Bird and Gendron 2005)

The critical point is that cases for an audit (which may involve up to 30% of the revenue authority's professional and administrative staff) should not be selected on a random basis. Rather, audit selection should be based on unbiased risk assessment using automation and statistically determined parameters (McKerchar and Evans, 2009).

As Allingham and Sandmo (1972) cited in Das-Gupta (1996) stated auditing is an activity which leads to the discovery of (all or part of) under-reporting of the tax base of the audited taxpayer by the tax authority. An important implicit assumption, which may be termed the independent audit assumption, is that auditing of one taxpayer does not systematically throw up information which can be used to detect evasion by other taxpayers. In practice, this assumption may be justified in many situations. However, in important modern contexts, such as in the enforcement of the value added tax (VAT), the assumption is unrealistic. The underlying transactions structure of value addition implies that auditing of one taxpayer throws up important information on other taxpayers. This information gain arises essentially from matching the receipts (for example from sales) with the expenditures (for example on purchases) of different taxpayers.

2.2.1.5 VAT penalty

As Bird and Gendron(2005) noted if someone is caught cheating on VAT, the tax administration must first act quickly to stop the practice, then impose civil penalties (including e.g. intercepting income flows to delinquent taxpayers, seizing assets, and perhaps temporary business closures of the sort that have proved effective in some Latin American countries) as appropriate, and, finally, and only in especially serious cases proceed to the lengthy and difficult level of criminal prosecution. A simpler way to build credibility for a penalty system without going to the extreme of launching a criminal case may sometimes simply be to publicize the administration of penalties, including the names of the people or organizations penalized, through the media

According to Grandcolas (2005) to take appropriate action against defaulters Compliance covers three aspects of VAT collection ensuring that (i) the VAT return is submitted promptly, (ii) the tax is paid on time and (iii) the correct net tax is declared on the returns. Obviously, failure to take action to enforce submission of returns and payment of tax undermines the credibility of the tax. This, in turn, could result in increased non-compliance. A “gentle enforcement approach” in the early stage of the tax should be avoided. Indeed, non-filers need to be dealt with firmly and immediately. The main objective of a tax administration, when self-assessed procedures are the rule, is not to collect the maximum amount of tax, but firstly to improve the level of voluntary compliance. The maintenance of proper records is vital for the effective administration of VAT. Consequently, substantial penalties should be imposed on a taxpayer who fails to comply with this obligation. The maximum penalty depends on the degree of capability of the taxpayer in relation to the particular failure. Further, a taxpayer who fails to maintain proper records but wishes to challenge a taxation assessment may not be able to satisfy the burden of proving that the assessment is excessive. Obviously, the penalty system should be designed to help increase the level of compliance. However, a strong commitment, from the highest levels to the tax officials, is needed to implement this strategy (Grandcolas, 2005).

2.2.2 VAT Revenue Performance

VAT is increasingly being used throughout the world, including many African countries to raise government revenue with less administrative 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 that have adopted VAT, revenue from this source accounted on average 27 percent of the total tax revenue or 5 percent of the GDP. And about 70 percent of the world population now lives in countries with a VAT. This implies that it is a key source of government revenue in more than 126 nations. To see whether the newly implemented VAT is effective or not in raising government revenue, it is important to compare VAT revenue performance with the replaced sales tax. 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 with threshold on the annual turnover. So, in order to compare VAT revenue with that of sales tax 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 VAT introduced | VAT standard rate percentage | VAT Revenue | |
|------------|---------------------|------------------------------|---------------------------|-------------------|
| | | | Percentage of tax revenue | Percentage 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 | 25.9 | 5.5 |
| Mauritius | 1998 | 10 | 17.4 | 3 |
| Madagascar | 1994 | 20 | 39.3 | 4.3 |

Source: - Ebrill and Keen (2001)

As can be seen from table 2.1, 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. The average for 31 African countries (24.3%) is lower than the world average (27%). In Ethiopia, the share of VAT in total revenue, which is 42.4%, is the largest as compared to the sampled countries. The VAT to the GDP ratio ranges from 2.7% in Egypt to 6.5% in Tunisia with an average of 4.6%. 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.

Table 2.3 Revenue performance of VAT by region

| Indicators | Sub-Saharan Africa | Asia and Pacific | American | Europe Norway Switzerland | Central Europe and BRO | North Africa and Middle East | Small Island | Ethiopia | Average |
|------------------|--------------------|------------------|----------|---------------------------|------------------------|------------------------------|--------------|----------|---------|
| Efficiency ratio | 27 | 35 | 37 | 38 | 36 | 37 | 48 | 14 | 30 |
| C- efficiency | 38 | 58 | 57 | 64 | 62 | 57 | 83 | 19 | 55 |

Source: (Ebrill et al 2001 cited in Tesfaye 2004)

As Tesfaye (2004) stated even if VAT has a short span of time since its implementation, the efficiency ratio of the Ethiopian VAT for the year 2003/04 is calculated to be 14%, which excludes VAT on import. This efficiency ratio, indicated in table 2.2, is lower than the average efficiency ratio in sub-Saharan African countries (27%), excludes VAT on import. The efficiency ratio of 14% implies that a 1-point increase in the standard rate is associated with a 0.14 point increase in the share of VAT revenue to GDP. A low ratio, in particular, could be taken as evidence of revenue loss (erosion) either by exemptions and reduced rates within the tax law or by imperfect enforcement (Ebrill and Keen, 2001).

As Grandcolas (2005) noted VAT performance has been particularly strong in small island countries with populations under one million. One possible reason for this strong performance is that these countries have open economies with a heavy reliance on international trade, and most of their VAT is collected at customs.

Table 2.4 Performance of VAT in Island countries

| Country | % of VAT in total tax revenues | % of VAT in GDP | C-efficiency |
|--------------|--------------------------------|-----------------|--------------|
| PNG | 19 | 4.5 | 68 |
| Jamaica | 35.8 | 8.8 | 83.5 |
| Trinidad | 23.6 | 4.3 | 46.8 |
| Mauritius | 26.3 | 5.6 | --- |
| Fiji | 27.6 | 6.2 | 84.1 |
| Cyprus | 18.9 | 5 | 100.1 |
| Malta | 23.4 | 6.5 | 67 |
| Iceland | 30.5 | 9.4 | 64.8 |
| Barbados | 32.5 | 9.5 | 101.2 |
| Vanuatu | 23.3 | 5.4 | ---- |
| Samoa | 40 | 10.7 | ----- |
| Cook Islands | 49 | 13 | ----- |

Source: (Grandcolas, 2005)

According to Grandcolas (2005) table 2.3 shows that VAT is a major source of revenue wherever it has been adopted. The share of VAT in total tax revenue ranges from 19% in PNG to 49% in the Cook Islands. Indeed, the average for the five PICs (i.e. 32%) is higher than the world average of 27% and also higher than that for small islands (i.e. less than 1 million of people; 29%). The VAT collected compared to the GDP, which is the efficiency ratio, ranges from 4.5% in PNG to 13% in the Cook Islands and averages at 7.9%. The thresholds (minimum of annual turnover to be VAT registered taxpayer) vary from USD 8,000 in Fiji to USD 65,000 in Vanuatu.

As Grandcolas (2005) noted VAT was a revenue generator for Gabon: during the first year of implementation (i.e. April 1995 to March 1996), VAT revenue had been 45% greater than the revenue from the taxes it had replaced. In 1995, for the first six months of its implementation, VAT accounted for about 32% of the total non-oil revenue and 5.5% of the non-oil GDP; and— tax reform and statistics: In Gabon, most of the fiscal data is now available from computer analyses provided by the tax, customs and treasury departments on a regular and reliable basis. Besides, as Grandcolas (2005) noted in Mauritius high levels of revenue collected: For the first fiscal year after its introduction, the VAT collected was 53% higher than the amount collected from the sales tax and hotel tax during the same period for the previous. For fiscal year 1999-2000, the VAT collected was estimated at 5.6% of the GDP.

As Bird (2005, 11) noted cautiously concluded that “there is some evidence that the presence of a VAT has been associated with a higher ratio of general government revenue and grants to GDP.” This study went on to note that this relationship seems stronger the higher GDP per capita and the lower the share of agriculture in GDP, though the latter relation may simply reflect the common exclusion of most agricultural activity from VAT. Perhaps the most important point noted in Bird (2005) was the extreme variation across countries in the revenue performance of VAT, reflecting a very wide range of factors including differences in tax design, differences in economic environment, and different characteristics (e.g. literacy) in different economies. Definitive answers with respect to VAT’s revenue impact are, it seems, considerably more difficult to come by than the simple assertions that characterize political debate everywhere.

In order to illustrate some of the foregoing points, consider briefly the revenue dimension of VAT in Ukraine (Bird, 2005). In Ukraine, as in many DTE, VAT has become the workhorse of the revenue system. In 2001, for example, almost half (47%) of state budget revenues came from VAT, which accounted for 5.1% of GDP. VAT is the largest, most important, tax in Ukraine. The design and implementation of VAT is thus a critical determinant of the performance of the entire fiscal system (Bird, 2005).

According to Bird and Gendron (2005) recently, attempts have therefore been made to develop more comparable measures such as those labeled ‘productivity’ and ‘efficiency’ in table ----, which compares VAT performance in the Western Hemisphere. While it is not easy to interpret these measures, they may broadly be understood as follows. VAT productivity’ is the ratio of VAT revenues to GDP divided by the ‘standard’ rate of the VAT. In other words, this figure shows what percent of GDP each percentage point of the standard VAT rate collects. On average, for the countries included in table ----, one percentage point of VAT collects 0.36% of GDP, with the range being between a low of 0.10% for Brazil’s (very limited) national VAT and a high of 0.62% in Nicaragua. By this criterion, the VAT in, say, Jamaica looks very good indeed. However, this measure may be quite misleading in an important sense since in principle VAT usually taxes consumption, not production, and GDP measures production, not consumption.

Table 2.5 VAT Revenue Performance in the Western Hemisphere

| Country | Current rate | VAT as % revenues | VAT as % GDP | VAT productivity | VAT efficiency |
|---------------------|--------------|-------------------|--------------|------------------|----------------|
| Argentina | 21 | 30.9 | 3.9 | 0.19 | 0.27 |
| Barbados | 15 | - | - | - | - |
| Bolivia | 14.9 | 37.1 | 5.4 | 0.36 | 0.47 |
| Brazil* | 20.5 | 9.9 | 2 | 0.1 | 0.16 |
| Canada* | 7 | 13.4 | 2.7 | 0.38 | 0.67 |
| Chile | 19 | 44.4 | 8 | 0.42 | 0.64 |
| Colombia | 16 | 42.3 | 4.5 | 0.28 | 0.44 |
| Costa Rica | 13 | 25.2 | 4.6 | 0.35 | 0.53 |
| Dominican Republic | 12 | - | - | - | 0.31 |
| Ecuador | 12 | - | - | - | 0.42 |
| El Salvador | 13 | 52.8 | 5.6 | 0.43 | 0.5 |
| Guatemala | 12 | 45.8 | 4.5 | 0.38 | 0.45 |
| Haiti | 10 | - | - | - | - |
| Honduras | 12 | - | - | - | 0.55 |
| Jamaica | 15 | 36.5 | 9.2 | 0.61 | 0.93 |
| Mexico | 15 | 26.5 | 3.3 | 0.22 | 0.33 |
| Nicaragua | 15 | 32.5 | 9.3 | 0.62 | 0.7 |
| Panama | 5 | - | - | - | 0.52 |
| Paraguay | 10 | 43.2 | 4.4 | 0.44 | 0.54 |
| Peru | 18 | 45.9 | 6.4 | 0.36 | 0.5 |
| Suriname | 10 | - | - | - | - |
| Trinidad and Tobago | 15 | - | - | - | - |
| Uruguay | 23 | 30.2 | 7.8 | 0.34 | 0.46 |
| Venezuela | 16 | 35.3 | 4.7 | 0.29 | 0.43 |
| Average | 14.1 | 34.5 | 5.4 | 0.36 | 0.49 |

Source: (Bird and Gendron 2005 cited in Edmiston and Bird 2004)

As Bird and Gendron (2005) noted the measure shown in table 2.4 as ‘VAT efficiency’ sometimes called ‘C-efficiency’—has come to be used as a more reliable indicator of comparative VAT performance. This figure is calculated as the ratio of VAT revenues as a percentage of (usually private) consumption divided by the standard rate, so it has a unit value for a uniform tax on all consumption. The actual ratios shown in the table, however, range from a low of 0.16 for Brazil’s very narrow-based national VAT to a startling high of 0.93 for the VAT (General Consumption Tax, or GCT) in Jamaica. Jamaica’s performance as measured by this indicator thus again appears to be well above average.

As Bickley (2006) estimated that each percentage point of a VAT with only a few exclusions could generate net revenue equivalent to 0.4% of gross domestic product (GDP). For calendar year 2005, U.S. gross domestic product was \$12.5 trillion. For calendar year 2005, each 1.0% rate for a VAT could have raised net revenue of approximately \$50 billion with a broad base. The VAT high revenue yield at a low tax rate not only makes it possible source revenue for tax reform but also has generated concerns among some that VAT revenues may finance a larger public sector (Bickley, 2006).

According to Wawire (2011) cited in Adari (1997) study focused on the introduction of value added tax (VAT) in Kenya that replaced sales tax in 1990. The study analyzed the structure, administration and performance of VAT. The estimated buoyancy and elasticity coefficients were less than unity implying a low response of revenue from VAT to changes in GDP. This suggested the presence of laxity and deficiencies in VAT administration. However, the estimation of buoyancy and elasticity coefficients were done in total disregard of the time series properties and without taking care of unusual observations in the data. Therefore, the results were not reliable for planning purposes.

VAT is a tax on consumption; the more you buy the more tax you pay. It is also a neutral tax on businesses in that it does not represent a real cost to anyone but the end consumer. Everybody pays tax to the Government whenever they purchase goods or services. This tax is collected for the government by the supplier of those goods and services. VAT revenue has become a significant source of government revenue in Nigeria. Therefore, the primary objective of fiscal policy is to raise more revenue through value added tax. The tax authorities have been guided by the need to design equitable and efficient VAT system capable of complementing government expenditure and, thus, reduce recourse to public borrowing (Nayeem, 2012).

VAT rate in Nigeria has been determined in a way that minimizes disincentive effects on economic activities. The effects of low tax effort in Nigerian have been strengthened by the value added tax system. This, in turn, has addressed part of the worries of Kaldor (1963) who asked "will underdeveloped countries learn to tax?" Bird, Vazques and Torgler (2007) noted that the underlying assumption of Kaldor's question is that a country [or state] wishing to develop needs to collect in taxes an amount greater than the 10-15 percent found in many developed countries. To meet the global aspiration of attaining the Millennium Development

Goals (MDGs) come 2015, these countries must spend more on economic and social infrastructures, which can only be achieved through improvement in tax efforts to realize the required level of public expenditure (Nayeem,2012 cited in Golit 2008).

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2.3 Conclusion

There are many studies on VAT administration problems and revenue performance in developing countries; however, in Gondar there are no studies which examine the aforementioned issues. Therefore, no one can know which VAT administration problems affect the feature of VAT and the viability of VAT performance on GDP. And hence, the objective of this paper is to identify the key administrative problems of VAT and its revenue performance for GDP of ERCA in Ethiopia. Since it is difficult to calculate the efficiency ratio for Gondar, only VAT to tax ratio was calculated.

Chapter Three: Research Methodology

The previous chapter presented the literature review where the various studies dealing with VAT administrative problems and revenue performance were examined and knowledge gap was identified. This chapter tries to discuss about four main issues. Section 3.1 presents the research objectives indicated in chapter one. Section 3.2 discusses about the philosophy of the research approaches. Section 3.3 presents the research methods adopted in this study. Finally, a concluding remark about the chapter is presented in section 3.4.

3.1 Research objectives

As shown in chapter one the broad objective of this study is to assess VAT revenue performance and administration problems in case of federal and regional taxpayers in Gondar city. Based on this broad objective the study developed the following specific objectives: - To investigate VAT administration problems pertaining to VAT registered tax payers as a result of VAT law enforcement by the tax authority (Particularly VAT registration, invoicing, filing, payment, auditing and penalty) and possible solutions for smooth operation of VAT in ERCA and regional tax authority in Gondar.

- To assess taxpayers' attitudes towards VAT rate and market competition between VAT registered and non VAT registered business enterprises.
- To determine the strength of ERCA and regional tax authority in Gondar to control non compliant tax payers (in view of skilled and competent employees, simplification of tax procedure, sufficient resource availability).
- To assess VAT revenue performance in Ethiopia using efficiency ratio.

3.2 Philosophy of research approaches

According to Hair (2000) the heart of any research design is the method and the technique actually used to collect the required data. In recent years the methods available for collecting data has been generally classified into three broad categories: qualitative, quantitative and mixed research methods.

3.2.1 Qualitative Research approach

According to Hair (2000) qualitative research tends to focus on the collection of detailed amount of primary data from relatively small samples of subjects by asking questions or observing behavior. One of the main objectives of qualitative research is to gain preliminary insights into decision problems and opportunities. As Ortinau (1999) noted on the surface qualitative research methods incorporate some scientific elements but normally lack of critical elements of true reliability. In this research method interviewing techniques plays an important role to collect qualitative data. The major advantages of this method include:

- Economical and timely data collection;
- Richness of the data; and
- Preliminary insights into building models and scale measurement Ortinau (1999).

On the other hand the disadvantages of the qualitative research method are mentioned as follows:

- Lack of generalize ability;
- Inability to distinguish small differences;
- Lack of reliability and validity; and
- Difficulty of finding well-trained investigators, interviewers and observers Ortinau (1999).

3.2.2 Quantitative Research Method

According to Harold (1958) quantitative research is commonly associated with surveys or experiments and is still considered the main stay of the research industry for collecting data. Quantitative research places heavy emphasis on using formalized standard questions and pre-determined response options in questionnaires or surveys administered to large number of respondents. Normally in quantitative research, the information research problems and opportunities are specific and well defined, and the decision maker and the researcher have

agreed on what the precise information needs are. AS Harold (1958) noted the main goal of quantitative research is to provide specific facts decision makers can use to:

- Make accurate predictions about relationship between market factors and behaviors;
- Gain meaningful insights into those relationships; and
- Verify or validate the existing relationships.

The major advantages of quantitative research methods are the following:

- Ability to accommodate large sample sizes; increases generalizability of results;
- Ability to distinguish small differences;
- Ease of administering and recording questions and answers;
- Capabilities of using advanced statistical analysis; and
- Abilities of tapping into factors and relationships not directly measurable Harold (1958).

On the other hand the disadvantages of quantitative research methods are listed as follows:

- Difficulty of developing accurate survey instruments (questionnaire design);
- Limits to the in-depth detail of data structures;
- Lack of control over timeliness, and potentially low response rates;
- Difficulties in determining whether respondents are responding truthfully; and
- Misinterpretation of data results and inappropriate use of data analysis procedure Harold (1958).

3.2.3 Mixed Research Method

As Sheth (1971) stated triangulation is the term used to describe the combination of several qualitative methods or combining qualitative with quantitative methods. This method is invented because of the controversy between qualitative and quantitative methods. Possibly because of their origin, qualitative methods do not enjoy the unqualified endorsement of upper management. Many senior managers maintain qualitative data are too subjective and susceptible to human error and bias in data collection and interpretation. They believe such

research provides an unstable foundation for expensive and critical business decisions. The fact that results cannot be generalized from qualitative study to a large population is considered a fundamental weakness. Increasingly however, managers are returning to these techniques as quantitative techniques falls short of providing the insights needed to make those ever-more expertise business decisions. Because of the aforementioned reasons qualitative studies may be combined with quantitative ones to increase the perceived quality of the research especially when quantitative study follows a qualitative one and provide validation for the qualitative findings. This method is advantageous that qualitative research compensates for the weakness of quantitative research and vice versa.

3.3 Methods Adopted

Though the above research approaches are available for a researcher, mixed research method was appropriate for this particular study. Because the research problems identified earlier in this chapter needs both quantitative data and qualitative data. And hence, descriptive survey type of research was used for the study. The advantage of this method was that the topic could be examined in-depth, albeit gathering information from a much more limited sample of subjects than would have been possible with a much more questionnaire (Girma, 2010).

Further surveys on taxpayers were used for this study. And hence, the survey was conducted by using self administered semi-structured questionnaire. For the purpose of data gathering, both open ended and close ended questions were included in the questionnaires. Open ended survey was adopted in this study since it captures holistic components of the image constructs and it is inclined that free structure of the questionnaire encourages respondents to unleash opinions freely (Girma, 2010). Moreover, close ended questionnaires were used to gather information from respondents. Questionnaires were designed and prepared to get information about the study. During the distribution and collection time of the questionnaires, briefing was given to taxpayers about the objectives of the survey and on some questions that need explanation. This helped to collect reasonable number of responses and to avoid possible biases. Further, Questionnaires were prepared and conducted from November 25-December 10 2013. In connection with this, self administered semi-structured questionnaire adopted for tax officials of E RCA branch and regional tax office in Gondar. And accordingly, semi-structured questionnaire was distributed to tax officials.

Apart from the primary data collected, Documentary analyses of financial records were used from MoFED, ERCA in Gondar branch and regional tax office in Gondar. Since it is difficult to calculate GDP for Gondar, Ethiopian GDP is used to determine the efficiency ratio.

In this study, due to time constraint, purposive sampling method was used. According to Roscoe (1975), the appropriate sample sizes for most research to be greater than 30 and less than 500. Taking in to consideration this guideline, the sample size decided to be 50 VAT registered taxpayers in Gondar. Further, judgment purposive sampling method was adopted because of the relative advantage of time and money inherent in this method of sampling.

Finally, self administered semi-structured questionnaire was distributed with a sample of 10 tax officials in ERCA in Gondar branch and tax officers working at the regional tax office in Gondar city.

3.3.1 Data Analysis Methods

In the qualitative part of the study, after the data has been collected and processed manually, descriptive technique was adopted for analysis of the data. Besides, the qualitative part used percentages, mean and standard deviation statistical tools to strengthen and to make the study more systematic. In general, to analyze the data, statistical package for social science (SPSS) software version 16 was employed.

Analysis procedures can vary widely in sophistication and complexity, from simple frequency distribution (percentage) to sample statistics measures (e.g. mode, median, mean, range, standard deviation and standard error). But for this study the data for five years (i.e. 2008/09-2012/13) was used. And hence percentages, mean and standard deviation were used for this study. The data presentation methods for this particular study were text, tables.

3.4 The link between the research objectives and the different data sources and Conclusions

As a concluding remark for this chapter, surveying method through semi-structured questionnaire and semi-structured self-administered questionnaire is used to investigate the research questions mentioned in chapter one. Moreover, the philosophy of the research methods has been discussed and the appropriate research method is selected for the given research questions based on its relative advantage. A part to this data analysis method is discussed. Finally sampling technique, sample size, and sampling unit is also explained. Finally, the relationships between research question, the research method employed and the question number; which indicated in the questionnaire and semi structured interview can be shown in the following table.

Table3.1 Relationship between specific objectives, and the different data sources

| Specific objectives | Data collection methods with question numbers | | Respondents |
|--|---|--|---------------|
| To investigate VAT administration problems pertaining on VAT registered taxpayers as a result of VAT law enforcement by the tax authority (Particularly VAT registration, invoicing, filing, payment, auditing and penalty) and possible solutions for smooth operation of VAT in ERCA | Data collection methods | Semi-structured questionnaire with tax officials | Tax officials |
| | Question numbers | 7,8,9,10,11,12,13,14,17,18,19,20,21,22 | |
| | Data collection methods | Semi-structured questionnaire with taxpayers | Taxpayers |
| | Question numbers | 6,7,8,9,10,11,12,13, 14, 18,19,20,21,22,23,24 | |
| To describe the attitudes of taxpayers towards VAT rate and market competition between VAT registered and non VAT registered business enterprises | Data collection methods | Semi-structured questionnaire with tax officials | Tax officials |
| | Question numbers | 23,24 | |
| | Data collection methods | Semi-structured questionnaire with taxpayers | Taxpayers |
| | Question numbers | 25,26,27 | |
| To examine the strength of Ethiopian revenue and custom authority in Gondar branch and regional tax office in Gondar to control noncompliant taxpayers (in view of skilled and competent employees, simplification of tax procedure based on attitude of respondents, sufficient resource availability | Data collection methods | Semi-structured questionnaire with tax officials | Tax officials |
| | Question numbers | 25,26,27,28,29,30 | |
| | Data collection methods | Semi-structured questionnaire with taxpayers | Taxpayers |
| | Question numbers | 28,29,30,31 | |

Chapter Four: Results and analysis

As explained earlier in methodology part of this project paper, the nature of the research project is that descriptive which includes the survey and fact finding inquires with regard to practices and problems of VAT administration and VAT revenue performance in case of ERCA and regional tax authority in Gondar. Quantitative analysis for both qualitative and quantitative data techniques were used to analyze the collected data. This is because the range from creating simple tables or diagrams which shows frequency of occurrences through establishing statistical relationships between variables by using simple statistical modeling. Accordingly, for this particular study, analysis of data presented by using percentages, tables and figures.

The study examined the outcomes of surveys with selected VAT registered tax payers in Gondar branch and also selected tax officials in ERCA in Gondar. So the analysis is concerned with the practical application of VAT and the challenges faced in its practice and provide appropriate solutions for the constraints. The chapter is organized into two parts. The first part presents the results while the second part shows the analysis of data obtained from the different sources.

4.1 Results

The study conducted survey of VAT registered federal and regional taxpayers residing in Gondar town. It also conducted survey with tax officials working at the ERCA Gondar Branch and regional tax office in Gondar. Further, the study used structured documentary analysis of financial records held by the ERCA Gondar branch, regional tax office in Gondar and MoFED. Further, the next sub sections present the results of these different data sources. This part presents response rate for tax official and taxpayers survey, VAT administration tasks on key administration function, strength of VAT administration, VAT rate and market competition. Finally, this section presented VAT revenue performance of the authority and identifies VAT administration problems.

In the survey, questionnaires were distributed in the period December – January 2013 to fifty VAT registered taxpayers, but out of which responses were collected from 48 taxpayers (96%). On the other hand self administered semi-structured questionnaires were distributed to ten tax officials and all responses were collected.

4.1.1 Background of Respondents

In the survey the background information of both of tax officials and taxpayers were examined. The survey results of tax officials' age category and establishment of business by taxpayers' are shown in tables 4.1 and 4.2 respectively.

Table 4.1 Age category of tax officials

| Age | Frequency | Percentages |
|----------|-----------|-------------|
| 20-30 | 1 | 20 |
| 31-40 | 5 | 50 |
| 41-50 | 3 | 30 |
| Above 50 | 1 | 10 |
| Total | 10 | 100 |

Source: Survey of tax officials

As indicated in the table 4.1 most tax officials were in age category of 31-40 (50%) and about 10% of respondents were in the age category of above 50 years. Therefore, the survey outcome indicated that most of the respondents were young and productive age category which accounted about 60% of tax officials belong to age category of 20-40 years.

In the taxpayers' survey, VAT registered tax payers were also asked about the establishment of their business and the summary of results are shown in table 4.2.

Table 4.2 Establishment of business by VAT registered tax payers

| Years of business started | Federal VAT payers | | Regional VAT payers | |
|---------------------------|--------------------|------------|---------------------|------------|
| | Frequency | Percentage | Frequency | Percentage |
| 2011/12-present | 10 | 27.03 | 2 | 18.18 |
| 2007/08-2011/12 | 14 | 37.84 | 4 | 36.36 |
| 2003/04-2007/08 | 8 | 21.62 | 3 | 27.27 |
| Before 2003/04 | 5 | 13.51 | 2 | 18.18 |

| | | | | |
|-------|----|-----|----|-----|
| Total | 37 | 100 | 11 | 100 |
|-------|----|-----|----|-----|

Source: Survey of taxpayers

As indicated in table 4.2, most of the respondents have started their business in the year 2007/08-2011 onwards. i.e. 37.84% federal VAT payers and 36.36% regional VAT payers. Whereas a few respondents have started their business in the year before 2003/04 which were 13.51% federal and 18.18% regional VAT payers. In line with this, table 4.2 indicated, the number of business enterprises increased in the years under consideration i.e. 13.51% to 37.84% for federal VAT payers and 18.18% to 36.36% for regional VAT payers.

The summary results of gender patterns of the tax officials and business enterprise registered for VAT were shown in table 4.3 and 4.4 respectively.

Table 4.3 Gender patterns of tax officials

| Gender | Frequency | Percentage |
|--------|-----------|------------|
| Male | 6 | 60 |
| Female | 4 | 40 |
| Total | 10 | 100 |

Source: Survey of tax officials

As shown in table 4.3 most of the respondents were male 60 percent, but only 40 percent of the respondents were female.

In the survey, business enterprises were also asked about years for which they have registered for VAT and their responses were summarized in table 4.4.

Table 4.4 Business enterprises registration year for VAT

| Years of registration for VAT | Federal VAT payers | | Regional VAT payers | |
|-------------------------------|--------------------|------------|---------------------|------------|
| | Frequency | Percentage | Frequency | Percentage |
| 2003/04- 2005/06 | 3 | 8.12 | 1 | 9.09 |
| 2005/06-2007/08 | 7 | 18.92 | 1 | 9.09 |
| 2007/08-2009/10 | 12 | 32.43 | 4 | 36.36 |
| 2010 on wards | 15 | 40.54 | 5 | 45.45 |
| Total | 37 | 100 | 11 | 100 |

Source: Survey of taxpayers

As indicated in table 4.4, the number of VAT registered enterprises increased from year to year, for instance, in the year 2003/04-2005/06 VAT registered federal taxpayers have accounted only 8.12% whereas in the year 2010 onwards they accounted about 40.54%. Besides, the number of regional VAT payers were increased in the period 2003/04-2005/06 (9.09%) to 2010 onwards (45.45%). This increment was relatively due to taxpayers' educational campaign and awareness towards VAT laws and regulations.

In the survey tax officials were also asked about the level of education and taxpayers were also asked about average annual turnover of their business and hence their responses were summarized in the form of table 4.5 and 4.6.

Table 4.5 Level of education of tax officials

| Level of education | Frequency | Percentage |
|--------------------|-----------|------------|
| Diploma | - | - |
| Bachelor Degree | 8 | 80 |
| Masters or above | 2 | 20 |
| Total | 10 | 100 |

Source: Survey of tax officials

As indicated in table 4.5 the level of education of most tax officials belong to Bachelor Degree 80% and a few of them belong to masters or above 20%. Therefore, the authority should encourage those tax officials who want to pursue for masters or above in order to increase the number of tax officials having qualifications of masters or above.

In the survey respondents were asked about their average annual turn-over of their business enterprises and their responses were summarized in table 4.6

Table 4.6 Average annual turn-over of VAT registered business enterprises:

| Average annual turnover (Birr) | Federal VAT payers | | Regional VAT payers | |
|--------------------------------|--------------------|------------|---------------------|------------|
| | Frequency | Percentage | Frequency | Percentage |
| < 100,000 | 15 | 40.54 | 7 | 63.64 |
| 100,001-500,000 | 13 | 35.4 | 4 | 36.36 |
| 500,001-1,000,000 | 6 | 16.22 | - | - |
| 1,000,001-10,000,000 | 2 | 5.4 | - | - |
| 10,000,001 or more | 1 | 2.7 | - | - |
| Total | 37 | 100 | 11 | 100 |

Source: Survey of taxpayers

As indicated in table 4.6, the highest level of average annual turnover for VAT registered federal taxpayers was birr less than 100,000 which accounted 40.54% and the lowest one was birr 10,000,001 or more that accounted only 2.7%. In addition, the highest level of average annual turnover for VAT registered regional taxpayers was birr less than 100,000 which accounted 63.64% and the lowest one was birr 100,000-500,000 which accounted 36.36%.

Examination of the survey response revealed respondents department, position and their experience in table 4.

Table 4.7 Tax officials Department, Position and Experience

| Items | Description | Frequency | Percentage |
|------------|------------------------|-----------|------------|
| Department | Assessment & Follow-up | 2 | 20 |
| | Auditing & Inspection | 3 | 30 |
| | Collection & Reporting | 3 | 30 |
| | Others | 2 | 20 |
| | Total | 10 | 100 |
| Position | Auditor | 3 | 30 |
| | Assessor | 2 | 20 |
| | Collector | 3 | 30 |
| | Follow-up & Reporter | 1 | 10 |
| | Others | 1 | 10 |
| | Total | 10 | 100 |
| Experience | < 5 years | 6 | 60 |
| | 5-10 years | 3 | 30 |
| | 10-15 years | 1 | 10 |
| | Total | 10 | 100 |

Source: Survey of tax officials

As shown table 4.7 about 50% percent of respondents belong to Department of Auditing, Inspection, Assessment and Follow-up. Further, 30% of the respondents belong to Department of Collection and Reporting. In connection with this, about 20% of respondents are belonging to "Others" category like Tax Intelligent Department. Besides, table 4.7 shows the position and experience of respondents within each department. From position point of view, collectors and auditors account the highest percentage of respondents 30% each and the lowest belongs to follow-up & reporter which account 10%. On the other hand, the survey outcome of respondents revealed experienced tax officials account only 10% of the respondents. But respondents that have less experience account 60% of the respondents. This indicates the authority lacks experienced tax officials in handling VAT administration issues and this resulted in poor tax enforcement.

From the survey responses, category of taxpayers and area of occupation for VAT registered business enterprises has shown in table 4.8.

Table 4.8 area of occupation and category for VAT registered taxpayers:

| Area of occupation | Federal VAT payers | | Regional VAT payers | | VAT registered taxpayers | Frequency | Percentage |
|----------------------|--------------------|------------|---------------------|------------|--------------------------|-----------|------------|
| | Frequency | Percentage | Frequency | Percentage | Federal VAT payers | 37 | 77.08 |
| Manufacturing | 11 | 29.73 | 2 | 18.18 | Regional VAT payers | 11 | 22.92 |
| Construction | 3 | 8.11 | 2 | 18.18 | Total | 48 | 100 |
| Agriculture | 5 | 13.51 | 1 | 9.09 | - | - | - |
| Trade | 12 | 32.43 | 3 | 27.27 | - | - | - |
| Professional Service | 6 | 16.22 | 3 | 27.27 | - | - | - |
| | 37 | 100 | 11 | 100 | - | - | - |

Source: Survey of taxpayers

As shown in table 4.8, In terms of area of occupation the share of federal VAT payers for trade 32.43% accounted the highest percentage and construction 8.11% was the lowest percentage of responses. Moreover, table 4.8 indicated that regional VAT payers accounted 27.27% of trade and professional service each in terms of area of occupation which was the highest one and. Finally, as table 4.8 indicated, 77.08%% of the taxpayers were federal VAT payers where as 22.92% of the taxpayers were regional taxpayers.

Furthermore, the study tried to look at VAT registration and the outcome of the survey reveals in table 4.9.

Table 4.9 Reasons for non-registration by VAT registered taxpayers:

| Items | Federal VAT payers | | Regional VAT payers | |
|---|--------------------|------------|---------------------|------------|
| | Frequency | Percentage | Frequency | Percentage |
| weak administration of authority to force them | 18 | 48.64 | 7 | 63.64 |
| lack of information by the authority about unregistered taxpayers | 6 | 16.23 | - | - |
| Business enterprise want to monopolize the market with least price | 4 | 10.81 | - | - |
| Some traders fear of VAT registration for not loosing their customers | 9 | 24.32 | 4 | 36.36 |
| Total | 37 | 100 | 11 | 100 |

Source: Survey of taxpayers

As table 4.9 showed, 48.64% of federal taxpayers noted weak administration of authority to force taxpayers as reasons for non-registration by taxpayers. Nonetheless, 10.81% of federal taxpayers stated business enterprises want to monopolize the market as reasons for non-registration by taxpayers. In addition, 63.64% of regional taxpayers stated weak administration of authority to force taxpayers as reasons for non-registration by taxpayers whereas 36.36% of them noted business enterprises want to monopolize the market as reasons for non-registration by taxpayers.

In the survey both tax payers were asked about approaches that ERCA follows in increasing the awareness of tax payers about the VAT registration process in order to reduce involuntary VAT registration on some traders. Therefore, the outcome of the survey was summarized in table 4.10.

Table 4.10 possible solutions to reduce involuntary VAT registration on some traders

| Items | Federal VAT payers | | Regional VAT payers | |
|--|--------------------|------------|---------------------|------------|
| | Frequency | Percentage | Frequency | Percentage |
| The tax authority should create awareness taxpayers | 16 | 43.24 | 6 | 54.54 |
| The tax authority should improve quality of service providing for taxpayers | 13 | 35.13 | 3 | 27.27 |
| Makes tax laws understandable, communicate changes very well | 5 | 13.51 | 2 | 18.18 |
| Business enterprises which are eligible but not registered for VAT should obey for VAT rules and regulations | 3 | 8.12 | - | - |
| Total | 37 | 100 | 11 | 100 |

Source: Survey of taxpayers

As indicated in table 4.10, about 43.24% of federal taxpayers revealed the solution to reduce involuntary VAT registration was creating taxpayers awareness by the authority. But, about 35.13% of federal taxpayers stated that improving quality of service as a major solution for the problem. Further, 13.51% of federal taxpayers noted that making tax laws understandable, communicating changes very well as a solution to reduce involuntary VAT registration. Lastly, 8.12% of federal taxpayers indicated that business enterprises should obey VAT rules and regulations as a solution for the problems identified. Moreover, 54.54% of regional taxpayers indicated the solution to reduce involuntary VAT registration was creating taxpayers awareness by the authority and 27.27% of them stated improving quality of service as a major solution for the problem. Finally, 18.18% of regional taxpayers pointed out making tax laws understandable, communicating changes very well as a solution to reduce involuntary VAT registration

4.1.2 VAT Invoice

In the survey taxpayers were asked about the reasons for some traders not to maintain records of their business operations in accordance with the laws and regulations of VAT. The responses of tax payers were summarized in 4.11.

Table 4.11 Reasons for Traders not to maintain Records of their Business Operation

| Description | Federal VAT payers | | Regional VAT payers | |
|--|--------------------|------------|---------------------|------------|
| | Frequency | Percentage | Frequency | Percentage |
| Absence of professional and qualified employees for business enterprises | 13 | 35.14 | 6 | 54.54 |
| The authority doesn't create awareness about books and records maintained for VAT purpose for tax payers | 3 | 8.10 | 2 | 18.18 |
| Tax payers lack knowledge about books and records maintained for VAT purpose | 15 | 40.54 | 3 | 27.27 |
| Lack of knowledge of owner of the business | 6 | 16.21 | - | - |
| Total | 37 | 100 | 11 | 100 |

Source: Survey of taxpayers

As table 4.11 indicated, 35.14% of federal taxpayers noted absence of professional and qualified employees for business enterprises as reasons for traders not to maintain records of their business operation. However, 8.1% of them stated both the authority doesn't create awareness about books and records maintained for VAT purpose for taxpayers. But, 40.54% of them indicated lack of knowledge of taxpayers about books and records maintained for VAT purpose as reasons for traders not to maintain records of their business operation. Finally, 16.21% of them stated lack of knowledge of owner of the business as reasons for traders not to maintain records of their business operation. Besides, 54.54% of regional taxpayers stated absence of professional and qualified employees for business enterprises as reasons for traders not to maintain records of their business operation. Lastly, 27.27% and 18.18% of regional taxpayers noted taxpayers lack knowledge about books and records maintained for VAT purpose as reasons for traders not to maintain records of their business operation and the authority doesn't create awareness about books and records maintained for VAT purpose for tax payers as reasons for traders not to maintain records of their business operation respectively.

In the survey the tax payers were also asked the reasons for some VAT registered business enterprises collect the tax with illegal invoices. Therefore, they replied in table 4.1

Table 4.12 Reasons for Illegal Invoices Practices by VAT Registrants

| Descriptions | Federal VAT payers | | Regional VAT payers | |
|---|--------------------|------------|---------------------|------------|
| | Frequency | Percentage | Frequency | Percentage |
| They unable to compete with unregistered taxpayers | 7 | 8.91 | 2 | 18.18 |
| Customers are interested to buy goods or services from non registered enterprise to get lower price | 15 | 40.54 | 6 | 54.54 |
| Insufficient human power of the authority to control such activities. | 5 | 13.51 | 3 | 27.27 |
| Competency of similar organizations | 3 | 8.1 | - | - |
| To retain government tax for themselves illegally | 6 | 16.21 | - | - |
| Lack of knowledge | 1 | 2.7 | - | - |
| Total | 37 | 100 | 11 | 100 |

Source: Survey of taxpayers

As table 4.12 showed, 40.54% of federal taxpayers stated customers are interested to buy goods or services from non registered enterprise to get lower price as reasons for illegal invoices practices by VAT registrants. However, 16.21% of federal taxpayers noted taxpayers are unable to compete with unregistered taxpayers as reasons for illegal invoices practices by VAT registrants. Additionally, 16.7% of federal taxpayers stated to retain government tax for themselves as reasons for illegal invoices practices by VAT registrants. Further, 54.54% of regional taxpayers stated customers are interested to buy goods or services from non registered enterprise to get lower price as reasons for illegal invoices practices by VAT registrants. But, 27.27% of regional taxpayers noted insufficient human power of the authority to control activities as reasons for illegal invoices practices by VAT registrants. Finally, 18.18% of regional taxpayers pointed out taxpayers are unable to complete with unregistered taxpayers as reasons for illegal invoices practices by VAT registrants.

4.1.3 VAT filing and payment

In the survey taxpayers were asked about reporting period for VAT filing and payment and their responses were summarized in table 4.13.

Table 4.13 The reporting period for VAT filling and payment is short

| Items | | Strongly disagree | Disagree | Don't know | Agree | Strongly agree | Total | Mean | Standard deviation |
|---------------------|------------|-------------------|----------|------------|-------|----------------|-------|------|--------------------|
| Federal VAT payers | Frequency | 3 | 4 | 7 | 15 | 8 | 37 | 2.4 | 4.17 |
| | Percentage | 8.12 | 10.81 | 18.92 | 40.54 | 21.62 | 100 | - | - |
| Regional VAT payers | Frequency | 1 | 1 | 3 | 4 | 2 | 11 | 2.55 | 1.56 |
| | Percentage | 9.09 | 9.09 | 27.27 | 36.36 | 18.18 | 100 | - | - |

Source: Survey of taxpayers

As table 4.13 indicated, 40.54% and 21.62% of federal taxpayers agreed and strongly agreed respectively for the statement the reporting period for VAT filling and payment is short. However, 10.81% and 8.12% of them disagreed and strongly disagreed respectively for the statement the reporting period for VAT filling and payment is short. Besides, 27.27% and 18.18% of regional taxpayers agreed and strongly agreed respectively for the statement the reporting period for VAT filling and payment is short. Nonetheless, 18.18% of them disagreed and strongly disagreed for the statement the reporting period for VAT filling and payment is short.

The survey outcome of taxpayers for filing and method of effecting payment was summarized in table 4.14.

Table 4.14: Taxpayers filing tax return and method of effecting payment to the tax authority

| Items | Federal VAT payers | | Regional VAT payers | | Items | Federal VAT payers | | Regional VAT payers | |
|---|--------------------|------------|---------------------|------------|--------|--------------------|------------|---------------------|------------|
| | Frequency | Percentage | Frequency | Percentage | | Frequency | Percentage | Frequency | Percentage |
| By appearing at tax authority in person | 25 | 67.57 | 9 | 81.82 | Cash | 27 | 72.97 | 8 | 72.73 |
| By sending through post office | 12 | 32.43 | 2 | 18.18 | Checks | 10 | 27.03 | 3 | 27.27 |
| Total | 37 | 100 | 11 | 100 | - | 37 | 100 | 11 | 100 |

Source: Survey of taxpayers

As table 4.14 showed, most federal taxpayers i.e. about 67.57% of taxpayers filing tax return and method of effecting payment to the tax authority by appearing at tax authority in person. However, only 32.43% of them filing tax return and method of effecting payment to the tax authority by sending through post office. Further, 81.82% and 18.18% of regional taxpayers noted filing tax return and method of effecting payment to the tax authority by appearing at tax authority in person and by sending through post office respectively. In connection to this, in table 4.14, 72.97% and 27.03% of federal taxpayers indicated cash and checks as a method of payment to the tax authority respectively. In addition, 72.73% and 27.27% of regional taxpayers noted cash and checks as a method of payment to the tax authority respectively.

4.1.4 VAT Audit

In the survey both taxpayers and tax officials were asked about VAT auditing related question and forwarded their attitude in table 4.15.

Table 4.15 VAT auditing on taxpayers

| Items | Respondents | Responses | Strongly disagree | Disagree | Don't know | Agree | Strongly disagree | Total | Mean | Standard deviation |
|---|--------------------|------------|-------------------|----------|------------|-------|-------------------|-------|------|--------------------|
| The existing auditors, inspectors and prosecutors lack necessary skill and experience to detect and handle tax offenses by tax payers | Federal taxpayer | Frequency | 1 | 3 | 4 | 19 | 10 | 37 | 2.08 | 4.2 |
| | | Percentage | 2.7 | 8.12 | 10.81 | 51.35 | 27.03 | 100 | - | - |
| | Regional taxpayers | Frequency | - | 1 | 1 | 7 | 2 | 11 | 2.09 | 2.67 |
| | | Percentage | - | 9.09 | 9.09 | 63.64 | 18.18 | 100 | - | - |
| | Tax officials | Frequency | 0 | 7 | 0 | 1 | 2 | 10 | 3.2 | 3.88 |
| | | Percentage | 0 | 70 | 0 | 10 | 20 | 100 | - | - |
| The criteria for selection of tax payers for audit and auditing procedure lack clarity and transparency | Federal taxpayers | Frequency | 3 | 4 | 5 | 18 | 7 | 37 | 2.41 | 3.82 |
| | | Percentage | 8.12 | 10.81 | 13.51 | 48.65 | 18.92 | 100 | - | - |
| | Regional taxpayers | Frequency | - | 3 | 2 | 6 | - | 11 | 2.73 | 2.49 |
| | | Percentage | - | 27.27 | 18.18 | 54.55 | - | 100 | - | - |
| | Tax officials | Frequency | 2 | 5 | 1 | 2 | 0 | 10 | 3.7 | 2.5 |
| | | Percentage | 20 | 50 | 10 | 20 | 0 | 100 | - | - |
| The existing audit criteria are not sound enough to identify tax payers that are engaged | Federal taxpayer | Frequency | 3 | 3 | 7 | 14 | 10 | 37 | 2.32 | 3.3 |
| | | Percentage | 8.12 | 8.12 | 18.92 | 37.84 | 27.03 | 100 | - | - |
| | Regional taxpayers | Frequency | 1 | 2 | 2 | 3 | 3 | 11 | 2.55 | 1.16 |
| | | Percentage | 9.09 | 18.18 | 18.18 | 27.27 | 27.27 | 100 | - | - |
| | Tax officials | Frequency | 1 | 4 | 2 | 2 | 1 | 10 | 3.2 | 1.97 |
| | | Percentage | 10 | 40 | 20 | 20 | 10 | 100 | - | - |

Source: Survey of tax officials and taxpayers

As table 4.15 indicated, 48.65% of federal taxpayers' agreed and 18.92% of them strongly agreed that the criteria for selection of taxpayers for audit and auditing procedure lack clarity and transparency. Further, the mean value of taxpayers' responses 3.59 was higher than the average value of ratings 3. But, 20% of tax officials strongly disagreed and 50% disagreed about the lack of clarity and transparency in the criteria for selection of taxpayers for audit and auditing procedure. Moreover the mean value of tax officials' responses 2.8 was lower than the average of response ratings 3. Besides, in the survey responses of taxpayers 51.35% agreed and 27.03% strongly disagreed that the existing auditors, inspectors, prosecutors and other staff members lack the necessary skill and experience to detect and handle tax offenses by taxpayers. In line with this, 37.84% and 27.03% of federal taxpayers agreed and strongly agreed respectively for the statement the existing audit criteria are not sound enough to identify tax payers that are engaged. Moreover, table 4.15 indicated 63.64% and 18.18% of regional taxpayers agreed and strongly agreed about the lack of clarity and transparency in the criteria for selection of taxpayers for audit and auditing procedure. But, only 9.09% of them disagreed for same statement. Further, in table 4.15 54.55% and 27.27% of regional taxpayers agreed and disagreed for the statement the criteria for selection of tax payers for audit and auditing procedure lack clarity and transparency. Lastly, 54.54% of them agreed

and strongly agreed for the statement the existing audit criteria are not sound enough to identify tax payers that are engaged. On the other hand, 18.18% and 9.09% of the regional taxpayers disagreed and strongly disagreed for the statement the existing audit criteria are not sound enough to identify tax payers that are engaged.

4.1.5 VAT Penalty

Examination of survey responses of taxpayers with regard to penalty for understatement, a late payment and/or other offenses revealed to VAT registered business enterprises are shown in table 4.16.

Table 4.16 Taxpayers penalty for understatement and late payment

| Description | Federal taxpayers | | Regional taxpayers | | Tax Officials | |
|--------------------------------------|-------------------|------------|--------------------|------------|---------------|------------|
| | Frequency | Percentage | Frequency | Percentage | Frequency | Percentage |
| 10% of understatement | 4 | 10.81 | 2 | 18.18 | 1 | 10 |
| 50% of understatement | 6 | 16.22 | 1 | 9.09 | 1 | 10 |
| Imprisonment | 4 | 10.81 | 2 | 18.18 | 2 | 20 |
| Fines of both money and imprisonment | 10 | 27.03 | 6 | 54.55 | 5 | 50 |
| I don't know | 3 | 8.11 | - | - | 1 | 10 |
| Total | 37 | 100 | 11 | 100 | 10 | 100 |

Source: Taxpayers survey

As indicated in table 4.16, 27.03% of federal taxpayers and 50% of tax officials stated that both fines of money and imprisonment as a penalty for understatement and late payment for taxpayers. Besides, table 4.16 revealed 10.81% of federal taxpayers and 20% of tax officials stated imprisonment as a penalty for understatement and late payment for taxpayers. Besides, in table 4.16, 54.55% and 18.18% of regional taxpayers noted fines of both money and imprisonment and 10% understatement respectively for taxpayers' penalty for understatement and late payment. However, 9.09% and 18.18% of them stated 50% of understatement and imprisonment for taxpayers' penalty for understatement and late payment. Furthermore, survey outcomes of taxpayers and tax officials in relation to VAT penalty were summarized in table 4.17 as follows.

Table 4.17 VAT penalty on taxpayers

| Items | Respondents | Responses | Strongly disagree | Disagree | Don't know | Agree | Strongly disagree | Total | Mean | Standard deviation |
|---|--------------------|------------|-------------------|----------|------------|-------|-------------------|-------|------|--------------------|
| In Ethiopia, enforcement of penalty is very weak and lack consistency | Federal taxpayer | Frequency | 1 | 3 | 4 | 17 | 12 | 37 | 2.03 | 3.92 |
| | | Percentage | 2.7 | 8.11 | 10.81 | 45.95 | 32.43 | 100 | - | - |
| | Regional taxpayers | Frequency | 1 | 1 | 2 | 5 | 2 | 11 | 2.45 | 1.73 |
| | | Percentage | 9.09 | 9.09 | 18.81 | 45.45 | 18.18 | 100 | - | - |
| | Tax officials | Frequency | 2 | 1 | 1 | 5 | 1 | 10 | 2.8 | 1.97 |
| | | Percentage | 20 | 10 | 10 | 50 | 10 | 100 | - | - |
| The extent of penalties on tax payers are not that much high | Federal taxpayers | Frequency | 2 | 9 | 5 | 15 | 6 | 37 | 2.62 | 3.68 |
| | | Percentage | 5.41 | 24.32 | 13.51 | 40.54 | 16.23 | 100 | - | - |
| | Regional taxpayers | Frequency | 2 | 1 | 2 | 3 | 3 | 11 | 2.64 | 1.13 |
| | | Percentage | 18.18 | 9.09 | 18.18 | 27.27 | 27.27 | 100 | - | - |
| | Tax officials | Frequency | 1 | 2 | 1 | 4 | 2 | 10 | 2.6 | 1.62 |
| | | Percentage | 10 | 20 | 10 | 40 | 20 | 100 | - | - |
| There is lack of clarity and transparency in imposing the penalty on tax payers | Federal taxpayer | Frequency | 1 | 4 | 6 | 15 | 11 | 37 | 2.16 | 3.27 |
| | | Percentage | 2.7 | 10.81 | 16.23 | 40.54 | 29.73 | 100 | - | - |
| | Regional taxpayers | Frequency | 1 | 1 | 2 | 4 | 3 | 11 | 2.18 | 1.23 |
| | | Percentage | 9.09 | 9.09 | 18.18 | 36.36 | 27.27 | 100 | - | - |
| | Tax officials | Frequency | 1 | 1 | 1 | 5 | 2 | 10 | 2.4 | 1.93 |
| | | Percentage | 10 | 10 | 10 | 50 | 20 | 100 | - | - |

Source: Survey of tax officials and taxpayers

As table 4.17 indicated, 45.95% and 32.43% of federal taxpayers agreed and strongly disagreed respectively for the statement in Ethiopia, enforcement of penalty is very weak and lack consistency. However, 8.11% and 2.7% of them disagreed and strongly disagreed respectively for the statement weak and lack consistency for enforcement of penalty. On the other hand, 50% and 10% of tax officials agreed and strongly agreed respectively for the same statement mentioned above. Besides, 10% and 20% of tax officials disagreed and strongly disagreed respectively for this statement. Apart from this table 4.17 showed that 40.54% and 16.23% of federal taxpayers agreed and strongly agreed respectively for the statement the extent of penalties on tax payers are not that much high. Nonetheless, 24.32% and 5.41% of federal taxpayers disagreed and strongly disagreed for same statement. Besides, 40% and 20% of tax officials agreed and strongly agreed respectively for the statement the extent of penalty on taxpayers are not that much high. But, 20% and 10% of tax officials disagreed and strongly disagreed for the above mentioned statement. Lastly, table 4.17 indicated 40.54% and 29.73% of federal taxpayers agreed and strongly agreed respectively for the statement there is lack of clarity and transparency in imposing the penalty on taxpayers. However, 50% and 20% of tax officials agreed and strongly agreed respectively for the statement there is lack of clarity and transparency in imposing the penalty on

taxpayers. On the other hand, each 10% of tax officials disagreed and strongly disagreed for same statement. Moreover, in table 4.17, 45.45% and 18.18% of regional taxpayers agreed and strongly agreed respectively for the statement in Ethiopia, enforcement of penalty is very weak and lack consistency. But, only 18.18% of them disagreed and strongly disagreed for same statement. In addition, 54.54% of the regional taxpayers agreed and strongly agreed respectively for the statement the extent of penalties on tax payers are not that much high. However, 9.09% and 18.18% of them disagreed and strongly disagreed respectively for the statement the extent of penalties on tax payers are not that much high. Further, 36.36% and 27.27% of regional taxpayers agreed and strongly agreed respectively for there is lack of clarity and transparency in imposing the penalty on tax payers. Nevertheless, only 18.18% of them disagreed and strongly disagreed for same statement.

4.1.6 Strength of VAT Administration

Table 4.18 and 4.19 shows the survey responses of taxpayers and tax officials with regard to the strength of VAT administration for the authority.

Table 4.18 Strength of tax authority to control noncompliant taxpayers in view of taxpayers

| Items | Responses | | Strongly disagree | Disagree | Don't know | Agree | Strongly disagree | Total | Mean | Standard deviation |
|---|--------------------|------------|-------------------|----------|------------|-------|-------------------|-------|------|--------------------|
| Tax officials (administrators) are not qualified enough, lack necessary skills and are not in a position to provide adequate information up on tax payers request. | Federal taxpayers | Frequency | 2 | 9 | 1 | 13 | 12 | 37 | 2.35 | 3.69 |
| | | Percentage | 5.41 | 24.32 | 2.7 | 35.14 | 32.43 | 100 | - | - |
| | Regional taxpayers | Frequency | 1 | 2 | 1 | 5 | 2 | 11 | 2.55 | 1.73 |
| | | Percentage | 9.09 | 18.18 | 9.09 | 45.45 | 18.18 | 100 | - | - |
| Tax administration tend to take very long time in handling tax audit and inspection | Federal taxpayers | Frequency | 1 | 2 | 5 | 21 | 8 | 37 | 2.11 | 4.59 |
| | | Percentage | 2.7 | 5.41 | 13.51 | 56.76 | 21.62 | 100 | - | - |
| | Regional taxpayers | Frequency | 1 | 2 | 1 | 4 | 3 | 11 | 2.45 | 1.44 |
| | | Percentage | 9.09 | 18.18 | 9.09 | 36.36 | 27.27 | 100 | - | - |
| Tax officials lack politeness and confidence in decisions | Federal taxpayers | Frequency | 3 | 10 | 3 | 14 | 7 | 37 | 2.92 | 3.54 |
| | | Percentage | 8.11 | 27.03 | 8.11 | 37.84 | 18.92 | 100 | - | - |
| | Regional taxpayers | Frequency | 1 | 2 | 1 | 5 | 2 | 11 | 2.55 | 1.73 |
| | | Percentage | 9.09 | 18.18 | 9.09 | 45.45 | 18.18 | 100 | - | - |
| VAT tax enforcement, tax auditing and inspections are slightly weak and there is high probability of being undetected of a business in engaged in an act of evasion | Federal taxpayers | Frequency | 3 | 5 | 3 | 16 | 10 | 37 | 2.32 | 2.55 |
| | | Percentage | 8.11 | 13.51 | 8.11 | 43.24 | 27.03 | 100 | - | - |
| | Regional taxpayers | Frequency | 2 | 2 | 1 | 4 | 2 | 11 | 2.73 | 1.26 |
| | | Percentage | 18.18 | 18.18 | 9.09 | 36.36 | 18.18 | 100 | - | - |

Source: survey of taxpayers

Table 4.18 indicated 35.14% and 32.43% of federal taxpayers agreed and strongly agreed respectively for the statement tax officials are not qualified enough, lack necessary skills and are not in a position to provide a dequate information up on taxpayers' request. However, 24.32% and 5.41% of federal taxpayers disagree and strongly disagree respectively for same statement mentioned above. Moreover, table 4.18 indicated that 56.76% and 21.62% of federal taxpayers agreed and strongly agreed that tax administration tends to take very long time in handling tax audit and inspection. But, 5.41% and 2.7% of federal taxpayers

disagreed strongly disagreed for the statement that tax administration tends to take very long time in handling tax audit and inspection. Besides, table 4.18 revealed that 37.84% and 18.92% of federal taxpayers agreed and strongly agreed respectively the tax officials lack politeness and confidence in decisions. However, 27.03% and 8.11% of them disagreed and strongly disagreed respectively for the statement tax officials lack politeness and confidence in decisions. Finally, table 4.18 indicated that 43.24% and 27.03% of federal taxpayers agreed and strongly agreed respectively that VAT enforcement, auditing and inspections are slightly weak and there is high probability of being undetected of business in engaged in act of evasion. On the other hand, 13.51% and 8.11% of federal taxpayers disagreed and strongly disagreed for the statement VAT enforcement, auditing and inspections are slightly weak and there is high probability of being undetected of business in engaged in act of evasion. Further, in table 4.18, 45.45% and 18.18% of regional taxpayers agreed and strongly agreed respectively for the statement tax officials are not qualified enough, lack necessary skills and are not in a position to provide adequate information upon taxpayers' request. But, 18.18% and 9.09% of them disagreed and strongly disagreed respectively for same statement. In addition, 36.36% and 27.27% of the regional taxpayers' agreed and strongly agreed for the statement tax administration tends to take very long time in handling tax audit and inspection. However, 18.18% and 9.09% of them disagreed and strongly disagreed for the statement tax administration tends to take very long time in handling tax audit and inspection. Table 4.18 also indicated that 45.45% and 18.18% of regional taxpayers agreed and strongly agreed respectively the tax officials lack politeness and confidence in decisions. Nevertheless, 18.18% and 9.09% of them disagreed and strongly disagreed for same statement. Finally, 36.36% and 18.18% of regional taxpayers agreed and strongly agreed respectively that VAT enforcement, auditing and inspections are slightly weak and there is high probability of being undetected of business in engaged in act of evasion. However, 36.36% of them disagreed and strongly disagreed for the statement VAT enforcement, auditing and inspections are slightly weak and there is high probability of being undetected of business in engaged in act of evasion.

Table 4.19 Strength of tax authority to control noncompliant taxpayers in view of tax officials

| Item code | Responses | Strongly disagree | Disagree | Don't know | Agree | Strongly agree | Total | Mean | Standard deviation |
|---|------------|-------------------|----------|------------|-------|----------------|-------|------|--------------------|
| All tax officials and other staff members are competent enough to handle the duties assigned them | Frequency | 0 | 2 | 1 | 5 | 2 | 10 | 3.7 | 2.61 |
| | Percentage | 0 | 20 | 10 | 50 | 20 | 100 | - | - |
| There is in general shortage of resources and infrastructural facilities to enhance tax law enforcement | Frequency | 0 | 2 | 1 | 6 | 1 | 10 | 3.6 | 3.09 |
| | Percentage | 0 | 20 | 10 | 60 | 10 | 100 | - | - |
| The organization provides appropriate incentives and awards to the best performing tax officials especially those who have done the best in deterring non compliance. | Frequency | 1 | 2 | 0 | 3 | 4 | 10 | 3.7 | 2.38 |
| | Percentage | 10 | 20 | 0 | 30 | 40 | 100 | - | - |
| Training provided to employees and career development plan at different levels and in different departments is sufficient in promoting the capacity of tax officials. | Frequency | 4 | 2 | 0 | 3 | 1 | 10 | 2.5 | 1.84 |
| | Percentage | 40 | 20 | 0 | 30 | 10 | 100 | - | - |

Source: Survey of tax officials

As table 4.19 showed 50% and 20% of tax officials agreed and strongly agreed respectively that tax officials and other staff members are competent enough to handle the duties assigned them. But, 20% of tax officials disagreed for the statement tax officials and other staff members are competent enough to handle the duties assigned them. Further, 60% and 10% of tax officials' agreed and strongly agreed respectively that there is in general shortage of resources and infrastructural facilities to enhance tax law enforcements. Nonetheless, 20% of tax officials disagreed that that there is in general shortage of resources and infrastructural facilities to enhance tax law enforcements. Moreover, about 30% and 40% of tax officials agreed and strongly agreed respectively that the authority provides appropriate incentives and awards to the best performing tax officials especially those who have done the best in deterring non compliance. However, 20% and 10% of tax officials disagreed and strongly disagreed that the authority provides appropriate incentives and awards to the best performing tax officials especially those who have done the best in deterring non compliance. Finally, table 4.19 indicated that 30% and 10% of tax officials agreed and strongly disagreed respectively that the trainings provided to employees and career development at different levels and in different departments are sufficient in promoting the capacity of tax officials. However, about 20% and 40% of tax officials' disagreed and strongly disagreed that the trainings provided to employees and career development at different levels and in different departments are sufficient in promoting the capacity of tax officials.

4.1.7 VAT Rate and Market Competition

Survey results of taxpayers and tax officials on VAT rate and market competition were summarized in table 4.20 below.

Table 4.20 VAT rate and market competition

| Items | Respondents | Responses | Strongly disagree | Disagree | Don't know | Agree | Strongly disagree | Total | Mean | Standard deviation |
|--|--------------------|------------|-------------------|----------|------------|-------|-------------------|-------|------|--------------------|
| The level of the VAT rate is high and has made goods and services expensive and results in non-compliance of taxpayers | Federal taxpayer | Frequency | 1 | 5 | 1 | 17 | 13 | 37 | 2.03 | 4.07 |
| | | Percentage | 2.7 | 13.51 | 2.7 | 45.95 | 35.14 | 100 | - | - |
| | Regional taxpayers | Frequency | 1 | 2 | 1 | 4 | 3 | 11 | 2.45 | 1.44 |
| | | Percentage | 9.09 | 18.18 | 9.09 | 36.36 | 27.27 | 100 | - | - |
| | Tax officials | Frequency | 1 | 2 | 0 | 5 | 2 | 10 | 2.5 | 4.38 |
| | | Percentage | 10 | 20 | 0 | 50 | 20 | 100 | - | - |
| The existence of unregistered taxpayers is creating unfair competition and making registered taxpayers lose their market share and profitability | Federal taxpayers | Frequency | 1 | 2 | 5 | 15 | 14 | 37 | 1.95 | 3.74 |
| | | Percentage | 2.7 | 5.41 | 13.51 | 40.54 | 37.84 | 100 | - | - |
| | Regional taxpayers | Frequency | 1 | 1 | 2 | 4 | 3 | 11 | 2.27 | 1.31 |
| | | Percentage | 9.09 | 9.09 | 18.18 | 36.36 | 27.27 | 100 | - | - |
| | Tax officials | Frequency | 1 | 2 | 1 | 4 | 2 | 10 | 2.6 | 1.62 |
| | | Percentage | 10 | 20 | 10 | 40 | 20 | 100 | - | - |
| It should be worthwhile to consider the possibility of reducing the threshold | Federal taxpayer | Frequency | 2 | 4 | 3 | 18 | 10 | 37 | 2.19 | 3.95 |
| | | Percentage | 5.41 | 10.81 | 8.11 | 48.65 | 27.03 | 100 | - | - |
| | Regional taxpayers | Frequency | 1 | 1 | 2 | 4 | 3 | 11 | 2.36 | 1.44 |
| | | Percentage | 9.09 | 9.09 | 18.18 | 36.36 | 27.27 | 100 | - | - |
| | Tax officials | Frequency | 1 | 2 | 0 | 3 | 4 | 10 | 2.3 | 1.69 |
| | | Percentage | 10 | 20 | 0 | 30 | 40 | 100 | - | - |

Source: Survey of tax officials and taxpayers

As table 4.20 indicated that 50% and 20% of tax officials respectively agreed and strongly agreed that the level of VAT rate is high and have made goods and services expensive and resulted in non-compliance of taxpayers which indicates administrative weakness or tax evasion. Moreover, 45.95% and 35.14% of federal taxpayers agreed and strongly agreed that the level of VAT rate is high and have made goods and services expensive and resulted in non-compliance of taxpayers which indicates administrative weakness or tax evasion. Further, about 40% and 20% of tax officials', 40.54% and 37.84% of federal taxpayers' agreed and strongly agreed that the existence of unregistered taxpayers is creating unfair competition and making registered taxpayers lose their market share and profitability. Finally, 30% and 40% of tax officials, 48.65% and 27.03% of federal taxpayers agreed and

strongly agreed respectively that it should be worthwhile to consider the possibility of reducing the threshold. Similarly, in table 4.20, 36.36% and 27.27% of regional taxpayers agreed and strongly agreed respectively that the level of VAT rate is high and have made goods and services expensive and resulted in non-compliance of taxpayers. Nevertheless, 18.18% and 9.09% of them disagreed and strongly disagreed for same statement. Further, 27.27% and 36.36% of regional taxpayers agreed and strongly agreed that the existence of unregistered taxpayers is creating unfair competition and making registered taxpayers lose their market share and profitability. Lastly, 36.36% and 27.27% of regional taxpayers agreed and strongly agreed respectively that it should be worthwhile to consider the possibility of reducing the threshold. Nonetheless, 18.18% of them disagreed and strongly disagreed for the statement it should be worthwhile to consider the possibility of reducing the threshold.

4.1.8 VAT Revenue Performances

4.1.8.1 VAT revenue as a percentage of total tax revenue

For an analysis purpose, VAT collection with its respective total tax revenue collection (2008/09-2012/13) for ERCA Gondar branch showed in table 4.21.

Table 4.21 VAT revenue to tax revenue ratio of Gondar (2008/09-2012/13)

| Items | Years | | | | |
|--|------------|--------------|--------------|--------------|--------------|
| | 2008/2009 | 2009/10 | 2010/11 | 2011/12 | 2012/13 |
| VAT revenue for federal revenue authority | 1,379,848 | 1,466,370.5 | 1,558,751.8 | 1,651,133 | 2,084,454 |
| Tax revenue for federal revenue authority | 15,760,900 | 13,889,100 | 86,000,600 | 110,339,000 | 125,822,600 |
| Percentage of VAT revenue to tax revenue federal revenue authority | 8.75% | 10.56% | 18.12% | 14.96% | 16.57% |
| VAT revenue for regional tax office | 517,998.47 | 569,700.26 | 436,310 | 1,830,957 | 1,955,423.78 |
| Tax revenue for regional tax office | 968,174.55 | 1,753,597.50 | 1,412,139.64 | 1,942,935.66 | 2,059,827.78 |
| Percentage of VAT revenue to tax revenue for regional tax office | 53.5% | 32.4% | 30.9% | 94.24% | 94.93% |

Source: ERCA Gondar branch and regional tax office in Gondar

As table 4.21 showed that the share of VAT in total tax revenue ranges from 8.75% in the year 2005/06 to 18.12% in 2007/08. Indeed, the average for the five years was 13.79%. However, from the year 2007/08 onwards the share of VAT to tax revenue was higher than the average value of the five years. For example, the share of VAT in total tax

revenue in 2007/08 (18.12%) was higher than the average value (13.79%). In short the share of VAT to tax revenue was highest in the year 2007/08 and lowest in the year 2005/06. Moreover, the share of VAT in total tax revenue for regional tax office ranges 30.9% in the year 2007/08 to 94.93% in 2009/10.

4.1.8.2 Efficiency ratio

The efficiency ratio of VAT for ERCA in Gondar branch for the year's 2008/09-2012/13 indicated in table 4.22.

Table 4.22 efficiency ratio of VAT in Ethiopia (in Millions)

| Item | Years | | | | |
|---------------------------------|----------|----------|----------|-----------|-----------|
| | 2008/09 | 2009/10 | 2010/11 | 2011/12 | 2012/13 |
| VAT Revenue | 7,346.34 | 10,419.9 | 15,272.4 | 19,235.43 | 24,236.64 |
| Gross domestic product | 351,187 | 456,543 | 511,200 | 569,476.8 | 627,753.6 |
| Standard VAT rate (in percent) | 0.15 | 0.15 | 0.15 | 0.15 | 0.15 |
| VAT efficiency ratio in percent | 13.95% | 15.21% | 19.92% | 22.52% | 25.74% |

Source: ERCA and MoFED

Table 4.22 indicated the VAT collected compared to GDP, which is the efficiency ratio, ranges from 13.95% in 2008/09 to 25.74% in 2012/13. Further, as table 4.22 indicated the share of VAT to GDP was increasing in the period considered.

4.1.8.2.2 C-Efficiency ratio

Table 4.23 showed the c-efficiency ratio of VAT for the period 2008/09-2012/13.

Table 4.23 C-efficiency ratio of VAT of Ethiopia (in Millions)

| Items | Years | | | | |
|----------------------------------|------------|----------|-----------|------------|------------|
| | 2008/09 | 2009/10 | 2010/11 | 2011/12 | 2012/13 |
| VAT revenue | 7,346.34 | 10,419.9 | 15,272.4 | 19,235.43 | 24,236.64 |
| Private consumption for Ethiopia | 237,763.33 | 393,540 | 424,807.2 | 458,558.61 | 495,014.02 |
| Standard VAT (In %) | 0.15 | 0.15 | 0.15 | 0.15 | 0.15 |
| C-efficiency ratio | 20.6% | 17.64% | 23.97% | 27.97% | 32.64% |

Source: ERCA and MOFED

As table 4.23 indicated the c-efficiency ratio ranges from 17.64% in the year 2009/10 to 32.64% in the year 2012/13. And hence, the share of VAT to private consumption was highest in 2012/13(32.64%) and lowest in the year 2009/10(17.64%).

4.1.9 Problems in VAT Administration

In the survey both tax officials and taxpayers were asked about VAT administration problems and their responses were summarized table 4.24.

Table 4.24 Problems in VAT Administration

| Description | Federal taxpayers | | Regional taxpayers | | Tax Officials | |
|---|-------------------|------------|--------------------|------------|---------------|------------|
| | Frequency | Percentage | Frequency | Percentage | Frequency | Percentage |
| VAT tax payers are less competition in the market than non VAT tax payers | 9 | 24.32 | 3 | 27.27 | 3 | 30 |
| Consumers are not willing to buy goods and services with VAT | 16 | 43.24 | 4 | 36.36 | 2 | 20 |
| Poor tax enforcement capacity of the authority | 5 | 13.51 | 2 | 18.18 | 1 | 10 |
| Use of fraudulent invoices and non issuance of invoices | 7 | 18.92 | 2 | 18.18 | 4 | 40 |
| Total | 36 | 100 | 11 | 100 | 10 | 100 |

Source: Survey of taxpayers

As table 4.24 indicated, 43.24% of federal taxpayers stated that consumers are not willing to buy goods and services with VAT as the major problem in VAT administration. However, 13.51% of taxpayers noted that poor tax enforcement capacity of the authority as problem in VAT administration. Moreover, table 4.24 revealed that 40% of tax officials stated that the use of fraudulent invoices and non issuance of invoice as the major problem in VAT administration. But, 10% of tax officials noted that poor tax enforcement capacity of the authority as problem in VAT administration. Besides, 36.36% and 27.27% of regional taxpayers noted Consumers are not willing to buy goods and services with VAT and VAT tax payers are less competitive in the market than non VAT tax payers respectively as problems in VAT administration. Finally, 36.36% of them stated poor tax enforcement capacity of the authority and Use of fraudulent invoices and non issuance of invoices respectively as problems in VAT administration.

4.2 Analysis

Examination of survey responses of federal and regional taxpayers revealed several problems related to taxpayer registration. For example, 48.64 % of federal taxpayers' and 63.64% of regional taxpayers surveys indicated the prevalence VAT unregistered businesses due to weak administration of the authority to force them and this urged the government's due attention. Further, about 24.32% of federal taxpayers and 36.36% of regional taxpayers stated that some traders fear of VAT registration for not losing their customers as a problem for taxpayer registration. The dominance of VAT unregistered businesses, according to survey respondents, resulted in uneven market competition and a loss of market share and profitability by registered businesses. Survey respondents identified weaknesses in the tax administration and exclusion of businesses with annual turnover less than birr 500,000 as the major causes of the prevailing competition problem.

As table 4.11 revealed the major reasons for some traders not to maintain records of their business operations in accordance with the laws and regulations of VAT was lack of knowledge of taxpayers about record keeping for VAT purpose and the absence of professional and qualified employees for business enterprises which accounted 40.54% and 35.14% respectively. Further, 54.54% of regional taxpayers noted absence of professional and qualified employees for business enterprises as the major reasons for some traders not to maintain records of their business operations in accordance with the laws and regulations of VAT. However, 18.18% and 27.27% of them stated both the authority doesn't create awareness about books and records maintained for VAT purpose and taxpayers lack of knowledge of taxpayers about record keeping for VAT purpose respectively as the major reasons for some traders not to maintain records of their business operations in accordance with the laws and regulations of VAT.

As indicated in table 4.12, the taxpayers' responses revealed the major reasons for the use of illegal invoice by the traders were the competition problem with unregistered taxpayers (18.91%) and the interest of customers to buy goods or services from unregistered enterprises to get discount (40.54%). Besides, 54.54% and 27.27% of regional taxpayers pointed out the interest of customers to buy goods or services from unregistered enterprises to get discount and insufficient human power of the authority as the major reasons for the use of illegal invoice by the traders. And hence, this reduced the amount of revenue collected by the tax authority and open a room for corruption.

Countries have to decide how to control printing, issuing and the use of invoices. False or altered invoices are one of the concerns in VAT administration. Several countries have dealt with it through the introduction of strict invoicing regulations. Many of them require the taxpayers to obtain tax administration authorization before printing invoices. Some countries have introduced systems to register the printers that print invoices and require them to inform tax authorities the taxpayer identification number and range of the invoice numbers printed (Bird and Gendron, 2005).

According to Yesegat (2008), the problems in VAT invoices were difficulty of getting invoices on purchases and details of customers for the preparation of sales invoices, the problem of supplying without invoices (by giving the option of buying with or without invoices to customers) and using duplicated invoices. The optional issuance of VAT invoices in some sectors reveals that invoices are being used as a negotiated tool between customers and VAT registered businesses Yesegat (2008). That is, full VAT is chargeable if the customer needs invoices. Such a practice can jeopardize the use of invoices as a revenue safeguarding tool. In addition, tax officials' survey respondents indicated the lack of consistency in using invoices and also emphasizes the need to design a strategy that can encourage customer, including government institutions to ask for VAT invoices. Generally, there appear to be various factors contributing to the invoicing problems mentioned above. These factors include lack of tax administrators follow-up and control, lack of awareness among the society and the prevalence of poverty.

Concerning the reporting periods for VAT filing and payment for taxpayers, 40.54% of federal taxpayers' and 36.36% of regional taxpayers agreed and 21.62% of federal taxpayers and 18.18% of regional taxpayers strongly agreed for the statement that stated the reporting period is short. Further the mean value of federal taxpayers which was 2.4 and the mean value of regional taxpayers i.e. 2.55 supported the statement the reporting period is short, because the means were less than the average value of ratings (3). This is resulted a problem especially for taxpayers conducting business at several locations since gathering documents from different offices takes time. Further, the shortness of the reporting period creates substantial pressure on employees and disrupts the normal operation of business.

As indicated in table 4.14, 67.57% of federal taxpayers and 81.82% of regional taxpayers, noted that return filing could be done by going to tax offices in person. This is a problem for taxpayers that reside in remote areas (where the ERCA and regional tax office do not have branch offices) and are forced to go to the nearby town where the tax authority has a branch

office banks). Further, according to the results of the survey, about 72.97 of federal and 72.73 of regional taxpayers stated that the frequently used method of effecting payment to the tax authority is using cash.

Taxpayers should file their return and make their payments around the 15th of the month following the month/quarter when the relevant transactions took place as per Caribbean region Legislation. In the Caribbean region return and payment form (unique form) should be simple. It should contain the taxpayer name and identification number, the tax period (month/year) the amount of domestic purchases, imports, domestic sales and exports. Also, the VAT paid on imports and domestic purchases and the VAT charged on domestic sales Santos (2002).

When a supplier is supplied with taxable goods and services by another supplier, the supplier of those goods and services receives the input VAT to the supplier who received those goods or services to other person (customers) VAT shall be included in the price charged for those goods and services and the output VAT to the supplier. At the end of the VAT accounting period, if output VAT exceeds input VAT, the difference is the amount of VAT payable to the tax authority. On the other hand if input VAT exceeds output tax, the supplier may be allowed to carry the credit forward and a refund is made after five months if input VAT still exceeds output VAT. All these information are shown in a form called VAT return or declaration.

VAT return is a form filled by a VAT registered person and filed with the tax authority, ERCA, at the end each VAT accounting period showing if there is VAT payable or refundable. According to administrative procedures of VAT proclamation, every registered person is required to file the VAT return with the tax authority for each accounting period whether or not tax is payable in respect of that period, not later than the last day of the calendar month following the VAT accounting period as stated in VAT proclamation no 285/2002.

Examination of the survey responses for tax officials revealed that the audit selection criteria by the audit committee. The selection criteria include credit declaration, nil VAT declaration, non-filers, unusual VAT filing patterns and information obtained from third parties in the ERCA. Cases selected based on the above mentioned criteria are subjected to audit. Moreover, in the survey responses 48.65% of federal taxpayers' 54.55% of regional taxpayers' agreed and 18.92% of federal taxpayers strongly agreed that the criteria for

selection of taxpayers for audit and auditing procedure lack clarity and transparency. Further, the mean values of federal taxpayers' (2.41) and regional taxpayers (2.73) were lower than the average value of ratings (3) and thus, indicated lack of clarity and transparency in the criteria for selection of taxpayers for audit and auditing procedure. But, 20% of tax officials strongly disagreed and 50% disagreed about the lack of clarity and transparency in the criteria for selection of taxpayers for audit and auditing procedure. Moreover the mean value of tax officials' responses (3.7) which was higher than the average of response ratings (3) indicated that there was clarity and transparency in the criteria for selection of taxpayers for audit and auditing procedure. . Further, in the survey responses of federal taxpayers 51.35% agreed and 27.03% strongly disagreed that the existing auditors, inspectors, prosecutors and other staff members lack the necessary skill and experience to detect and handle tax offences by taxpayers. In addition, 63.64% and 18.18% of regional taxpayers agreed and strongly agreed for same statement. And hence, this resulted weak tax administration which intern affects the amount of revenue collected by the authority. This was also supported by the means of 2.08 for federal and 2.09 for regional taxpayers which were lower than average of response rating (3). This is due to low level of literacy, low and fragmented economy and poor taxpaying culture. However, 70% of tax officials disagreed about the existing auditors, inspectors, prosecutors and other staff members lack the necessary skill and experience to detect and handle tax offences by taxpayers. In addition the mean value of tax officials response was greater than the average of response ratings (3.2>3). Moreover, in the survey of federal taxpayers, 37.84% and 27.03% of federal taxpayers agreed and strongly agreed that the audit rate and number of audit staff members are not sufficient for detecting and handling VAT avoided and evaded taxpayers and their mean value which was 2.32 was lower than the average rating (3). Further, 54.54% of regional taxpayers agreed and strongly agreed about the existing auditors, inspectors, prosecutors and other staff members lack the necessary skill and experience to detect and handle tax offences by taxpayers and their mean value which was 2.55 was lower than the average rating (3). But, about 10% and 40% of tax officials disagreed strongly disagreed that the audit rate and number of audit staff members are not sufficient for detecting and handling VAT avoided and evaded taxpayers

Perhaps the safest statement that can be made about VAT administration in any DTE is that auditing procedures should be modernized and strengthened (Bird and Gendron, 2005).

According to McKerchar and Evan (2009) Audit and investigation can take many different forms, ranging from low profile queries resulting in no further action through to full scale

investigation resulting in prosecution for fraud. Too much auditing implies inefficiency and harassment, whereas too little calls into question the enforcement efforts of the tax administration.

As Edmiston and Bird (2004), cited in Yesegat (2008), noted the only real solution to the evasion problem is a good tax administration and, especially, a strong VAT audit program needs among other things an appropriate audit cases selection method (Jantscher, 1990) as cited in Yesegat (2008), stated that the cross checking purchases and sales data by various taxpayers would provide an effective tool for selecting VAT tax payers for audit and hence improve audit result.

In examination of the survey responses with regard to taxpayers and tax officials in relation to VAT penalty, 78.38% of federal taxpayers and 63.63% of regional taxpayers and 60% of tax officials indicated that penalty on taxpayers was weak and lack consistency. The mean values of federal taxpayers (2.03), for regional taxpayers 2.45 and tax officials (2.8) were also below average value of response ratings and thus, showed that penalty on taxpayers was weak and lack consistency.

Further, about 56.77% of federal taxpayers, 54.54% of regional taxpayers and 60% of tax officials noted that the extent of penalties on tax payers were not that much high. The mean values, 2.62 for federal taxpayers, 2.64 for regional taxpayers and 2.6 for tax officials which are below average value of response ratings have also inferred that the extent of penalties on taxpayers were not that much high. Moreover, in the survey responses, 70.27% of federal taxpayers, 54.54% regional taxpayers and 70% of tax officials indicated that the lack of transparency and clarity in imposing the penalty on taxpayers by the authority. In addition, the mean values of federal taxpayers (2.16), regional taxpayers (2.18) and tax officials (2.4) were still below average and thus, revealed that the lack of transparency and clarity in imposing the penalty on taxpayers by the authority.

Generally, respondents of both survey revealed the importance of enhancing voluntary compliance and focusing on taxpayers' education about tax rather than punishment for defaults. Otherwise the strict penalty may have negative impact on the attitude of taxpayers beyond its deterrence effect. Moreover, the lack of consistency and transparency in administration imposing the penalty may open a room for corruption.

If someone is caught cheating on VAT, the tax administration must first act quickly to stop the practice, then impose civil penalties (including e. g. intercepting income flows to

delinquent taxpayers, seizing assets, and perhaps temporary business closures of the sort that have proved effective in some Latin American countries) as appropriate, and, finally, and only in especially serious cases proceed to the always lengthy and difficult level of criminal prosecution (Bird and Gendron, 2005).

It is by no means clear that the public support needed to improve the administration of VAT really exists in many DTE. For example, the relatively few large formal-sector firms who currently account for most of the revenues—while of course supportive of measures to extend the weight of the tax to their relatively ‘untaxed’ competitors in the informal sector—are understandably likely to react adversely to any measures tightening up the system as it applies to them. (Bird and Gendron, 2005).

According to Ranker (2003), effective VAT administration can be achieved by applying the following:

- ❖ Identify VAT liabilities based on existing tax legislation
- ❖ Assess VAT to determine if the VAT actually collected are smaller or larger than VAT liabilities
- ❖ Collects, prosecutes and penalizes activities that impose sanction on VAT evaders and ensures that the VAT penalties due from taxpayers are actually collected.

In examination of the survey responses both the tax officials and taxpayers were asked their level of attitude towards tax officials’ (administrators’) qualification, necessary skill and their position for providing adequate information upon taxpayers’ request. Therefore, 70% of tax officials pointed out that tax officials and other staff members are competent enough to handle the duties assigned them. However, 67.28% of federal taxpayers, 63.63% of regional taxpayer noted that tax officials are not qualified enough, lack necessary skills and are not in a position to provide adequate information upon taxpayers’ request. The mean values of tax officials (3.7), federal taxpayers (2.35) and regional taxpayers (2.55) have also assured the above ideas.

As a result the authority is found weak in VAT administration which in turn leads to a loss of government revenue granted from VAT. Moreover, the survey responses indicated that 78.38% of federal taxpayers, 63.63% of regional taxpayers indicated that tax administration tends to take very long time in handling tax audit and inspection.

In addition, the concerns discussed so far, about 37.84% and 18.92% of federal taxpayers, 45.45% and 18.18% of regional taxpayers agreed and strongly agreed respectively that the tax officials lack politeness and confidence in decisions which in turn leads for widening the gap between taxpayers and tax officials and resulted in inability to solve cases immediately. Further, 60% and 10% of officials' agreed and strongly agreed that there is in general shortage of resources and infrastructural facilities to enhance tax law enforcements. In addition, examination of the survey respondents' responses indicated that 43.24% and 27.03% of federal taxpayers, 36.36% and 18.18% of regional taxpayers agreed and strongly agreed respectively that VAT enforcement, auditing and inspections are slightly weak and there is high probability of being undetected of business in engaged in act of evasion.

Moreover, about 30% and 40% of tax officials agreed and strongly agreed that the authority provides appropriate incentives and awards to the best performing tax officials especially those who have done the best in deterring non compliance. However, most of the respondents expressed that they consider the recently introduced relatively high amount of salary increment as a good compensation to their best performance. In addition, about 20% and 40% of tax officials' disagreed and strongly disagreed that the trainings provided to employees and career development at different levels and in different departments are sufficient in promoting the capacity of tax officials.

In Ethiopian case, according to Tesfaye (2004), some business enterprises are complaining about the rate difference between turnover taxes, 2%, and VAT rate 15%, though it is known that turnover tax is an equalizing rate with VAT. It is true that a 2% turnover tax is an equalizing rate for VAT assuming VAT registrants have the advantages of getting credit for input tax. But, if two enterprises procure their inputs from non-VAT registrants and sale adding different tax rate of VAT and turnover tax, then the two enterprises are not equal footing in the market and hence a 2% turnover tax cannot be an equalizing rate for VAT.

In the survey of responses, 50% and 20% of tax officials, 45.95% and 35.14% of federal taxpayers and 36.36% and 27.27% of regional taxpayers agreed and strongly agreed respectively that the level of VAT rate is high and have made goods and services expensive and resulted in non-compliance of taxpayers which indicates administrative weakness or tax evasion. Accordingly, the existence of unregistered taxpayers is creating unfair competition and making registered taxpayers lose their market share and profitability.

In Ethiopia, VAT is also implemented primarily to raise government revenue since it is abroad based tax. Therefore, the data for five years were used to analyze VAT revenue performance in ERCA in Gondar branch and regional tax office. In line with this connection this section tries to reveal about the trend in revenue collection for the period under consideration (i.e. 2005/06-2009/10). For analysis purpose only VAT to tax ratio for Gondar was used as it is difficult to calculate efficiency ratio and c-efficiency ratio. And hence, efficiency ratio and c-efficiency ratio for Ethiopia is calculated. And compared with other countries efficiency and c- efficiency ratios (Sub-Saharan African countries standard)

As the indicated in table 4.24 above, the major problems in VAT administration were consumers are not willing to buy goods and services with VAT based on federal taxpayers response that accounted (43.24%), but (30%) of tax officials noted that the use of fraudulent invoices and non issuance of invoices as the most serious problem for VAT administration. Moreover, 36.36% of regional taxpayers pointed out customers are not willing to buy goods and services with VAT as the serious problem in VAT administration. Therefore, the authority should due attention for such problems to improve its VAT administration functions.

In conclusion, the analysis so far attempted to show the major findings of this study in relation to the revenue performance of VAT, and administrative problems pertaining to the operation of VAT in Gondar city. The next chapter presents conclusions and recommendations.

Chapter Five: Conclusion and recommendation

This chapter tries to show the conclusions and recommendations. The chapter is organized into two sections. Section 5.1 presents conclusions and section 5.2 presents recommendations.

5.1 Conclusions

VAT is the major source of government revenue in most developing countries. Thus, VAT has a significant role in the revenue system of government of Ethiopia. To sustain its role for the generation of revenue, it is important to ensure that the revenue generated by VAT system should be efficient as possible. However, revenue generated by this tax system is not good as expected due to weakness in the tax administration.

A good tax administration is vital in improving VAT revenue performance by minimizing the cost of collection and through increasing the amount of revenue to be collected for the tax authority, ERCA Gondar branch and regional tax office in Gondar.

Concerning the aforementioned issues, this project paper examined VAT revenue performance in case of ERCA in Gondar branch regional tax office in Gondar. Besides, it tries to identify VAT administration problems, particularly in key administrative tasks, faced by the authority. Further, the project paper describes about the strength of the authority to control non-compliant taxpayers and it also examined taxpayers' and tax officials' attitude on VAT rate in market competition. Finally, the project paper identified VAT administration problems and possible solutions encountered by the authority.

The findings of the analyses suggested that VAT revenue performance in Ethiopia is low as compared to the Sub-Saharan African countries VAT revenue performance and its potentiality of generating revenue. Additionally, the result of the study indicates the prevalence of weak VAT administration in the authority as a result of insufficient resources, skilled and competent manpower.

Besides, the survey responses of both taxpayers and tax officials indicate that the VAT rate is high and made goods and services expensive and results in non-compliance of taxpayers. In

line with this, the survey outcome shows the existence of market competition between registrants and non-registrants which leads to lose market share and profitability.

In addition, the survey respondents indicate that the tax authorities lack the necessary strength in handling tax administrative tasks. Hence, it is suggested that the authority should look at the possibility of making sufficient resources available for the administration of VAT and it could also upgrade the skill and competency of tax officials in order to handle tax related offences in a better way.

Furthermore, the survey of analysis stated that the major problems of VAT administration such as, weak tax administration, competition between registrants and non-registrants, unwillingness of consumers to buy goods and services with VAT, poor tax enforcement capacity of the authorities.

Finally, in the survey respondents suggested the possible solutions for VAT administration problems and hence the possible solutions were intensive awareness creations for taxpayers giving training for existing ones, to make forced registration for potential taxpayers and take legal measures on non-taxpayers.

5.2 Recommendations

In the survey opinions were forwarded by the respondents. For instance, strengthening administration capacity by skilled manpower and the required materials to encourage honest traders by rewarding them and giving incentives and taxpayers should obey for the rules and should also cooperate with the authorities' operational activities.

It is also observed that from the data collected different opinions have been forwarded. To sustain the VAT system as a good means to raise government revenue, the authorities should have to take the following measures:

- ✓ It is suggested that there are many non-VAT taxpayers. Therefore, actions should be taken to narrow the gap by conducting intensified awareness creations programs and enforcement.
- ✓ Since VAT registrants have increased from year to year, the designed organizational structure and human resources should be adjusted accordingly to cope up with the increased number of VAT registrants. Otherwise, it may bring undesirable consequences to the VAT administration. In particular, manpower requirement should

be given special attention since the taxpayers are ahead of time in searching for shortcoming of tax administration.

- ✓ It is believed that the existing threshold should come down to as low as possible to allow all taxpayers to compete with equal ground. Here the taxpayers seem to be short sighted; they only look at from one direction. However, ERCA and regional tax office should teach the pros and cons of reducing the VAT threshold.
- ✓ The tax authority and taxpayers should conduct continuous discussions about issues of VAT.
- ✓ The ERCA and regional tax office should teach the business community about the concept of VAT intensively.
- ✓ To provide quality services the ERCA and regional tax office should increase the number of qualified employees.
- ✓ ERCA and regional tax office should take prompt measures for non-compliance taxpayers and should increase its follow-up, investigate the compliance and non-compliance taxpayers so that the authority should encourage and reward the honest traders and should take a legal action for non-compliance taxpayers.

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Appendix 1 Survey Instruments

Addis Ababa University

School of Business and Public Administration

Department of Accounting and Finance

MSc Program

Semi-Structured interview questions for tax officials

This project is entitled VAT revenue performance and administration problems in case of ERCA in Gondar. The investigator is Birhanu Mesfin who is currently an Msc (in Accounting and Finance) student at Addis Ababa University.

The aim of this project is to assess VAT revenue performance and administration problems in case of ERCA in Gondar. To supplement the data obtained from Ethiopian revenue and custom authority in Gondar town, the investigator seeks to gather relevant information from a sample of ten tax officials (auditors, prosecutors, inspectors and others) by means of face to face interview using semi structured questionnaire.

Participation in this project is completely voluntary, the interviews results will be recorded anonymously and strict confidentiality will be maintained. Individual responses will not be identified in the investigator's Msc thesis.

For further information please contact Birhanu Mesfin by the following address.

Tel.: 0911 82 33 75

E-mail: mesfin.birr@yahoo.co

Instructions

- Put x mark in a box for all questions provided in each table.
- Brief explanation is needed for open ended questions.
- Semi structured interview has five parts

Part one background

| | |
|-------------|----------------------------|
| 1. Your age | |
| 20-30 | <input type="checkbox"/> 1 |
| 31-40 | <input type="checkbox"/> 2 |
| 41-50 | <input type="checkbox"/> 3 |
| Above 50 | <input type="checkbox"/> 4 |

| | |
|-----------|----------------------------|
| 2. Gender | |
| Male | <input type="checkbox"/> 1 |
| Female | <input type="checkbox"/> 2 |

| | |
|--|----------------------------|
| 3. What is your highest level of education | |
| Below Diploma | <input type="checkbox"/> 1 |
| Diploma | <input type="checkbox"/> 2 |

| | |
|------------------|----------------------------|
| Bachelor Degree | <input type="checkbox"/> 3 |
| Masters or above | <input type="checkbox"/> 4 |

| | |
|-----------------------------|----------------------------|
| 4. Name of your department | |
| Assessment and follow-up | <input type="checkbox"/> 1 |
| Auditing and inspection | <input type="checkbox"/> 2 |
| Collection and reporting | <input type="checkbox"/> 3 |
| Other, please specify _____ | |

| | |
|---|----------------------------|
| 5. Your status or position in the organization? | |
| Auditor | <input type="checkbox"/> 1 |
| Assessor | <input type="checkbox"/> 2 |
| Collector | <input type="checkbox"/> 3 |
| Follow-up and reporter | <input type="checkbox"/> 4 |
| Other, specify _____ | <input type="checkbox"/> 5 |

| | |
|--|----------------------------|
| 6. How long have you been working in the organization? | |
| less than five years | <input type="checkbox"/> 1 |
| Five to ten years | <input type="checkbox"/> 2 |
| Ten to fifteen years | <input type="checkbox"/> 3 |
| More than fifteen years | <input type="checkbox"/> 4 |

Part Two

VAT registration and identification for tax payers

| | |
|---|----------------------------|
| 7. Are there tax payers that are required to register for VAT but did not do so? | |
| Yes | <input type="checkbox"/> 1 |
| No | <input type="checkbox"/> 2 |
| <p>If yes, please explain why this is happening?</p> <p>-----</p> <p>-----</p> <p>-----</p> | |

| |
|--|
| <p>8. What are the approaches that the ERCA follows in increasing the awareness of tax payers about the VAT registration process?</p> <p>-----</p> |
|--|

-----.

Part Three

VAT Invoice, file, payment, audit and penalty for taxpayers

9. What are the reasons for some traders not to maintain records of their business operations in accordance with the laws and regulations of VAT?

10. Do you think that the reporting period for VAT filling and payment is enough for tax payers? -----

11. Would you specify any problems and complications issues or issues of VAT invoicing, filing and payment by the tax authority that needs improvement?

-----.

12. What are the criteria used by the authority for selection of tax is payers for audit and audit procedure?

-----.

| | |
|--|----------------------------|
| 13. Do you think the enforcement of penalty is strong, clear and consistent in ERCA in Gondar? | |
| Yes | <input type="checkbox"/> 1 |
| No | <input type="checkbox"/> 2 |
| If yes, please specify your reason? ----- ----- | |

| |
|---|
| 14. Would you suggest any measures that should be taken to mitigate the problems related to imposing and enforcement of penalties on VAT tax payers? ----- ----- ----- |
|---|

Part Four

VAT, related problems and possible solutions

| | |
|---|----------------------------|
| 15. What are the problems that hinder smooth administration of VAT? | |
| VAT tax payers are less competitive in the market than non VAT tax payers | <input type="checkbox"/> 1 |
| Consumers are not willing to buy goods and services with VAT | <input type="checkbox"/> 2 |
| Poor tax enforcement capacity of the authority | <input type="checkbox"/> 3 |
| Use of fraudulent invoices and non issuance of invoices | <input type="checkbox"/> 4 |
| Other, please specify | <input type="checkbox"/> 5 |

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

Part Five

Attitude questions about VAT revenue performance and administration problems

| Item | Strongly Disagree (1) | Disagree (2) | Do not know (3) | Agree (4) | Strongly Agree (5) |
|---|--------------------------|-----------------|--------------------|--------------|-----------------------|
| I.VAT Invoice, file, payment, audit and penalty | | | | | |
| 17.VAT registered business enterprise collect tax with illegal invoice | | | | | |
| 18. Existing auditors, inspectors and prosecutors have the necessary skill and experience to detect and handle tax offences by taxpayers. | | | | | |
| 19. The existing audit rate and number of audit staff are sufficient for detecting VAT avoided taxpayers. | | | | | |
| 20. The existing extent of penalties on taxpayers are low | | | | | |

| | | | | | |
|--|--|--|--|--|--|
| 21. There is clarity and transparency in imposing the penalty on tax payers by the authority. | | | | | |
| 22. The penalties imposed on taxpayers are unfair. | | | | | |
| II. Taxpayers attitude on VAT rate and market competition | | | | | |
| 23. The level of VAT rate is high and has made goods and services expensive and results in non compliance of taxpayers. | | | | | |
| 24. The existence of unregistered taxpayers is creating unfair competition and making registered taxpayers' lose their market share and profitability. | | | | | |
| III. Strength of the tax authority to control non complaint tax payers and achieving its objective | | | | | |
| 25. All tax officials and other staff members are competent enough to handle the duties assigned them. | | | | | |

| | | | | | |
|---|--|--|--|--|--|
| 26. There is in general a shortage of resources and infrastructural facilities to enhance tax law enforcement. | | | | | |
| 27. The organization provides appropriate incentives and awards to the best performing tax officials specially those who have done the best in deterring non compliance. | | | | | |
| 28. Training provided to employees and career development plan at different levels and in different departments is sufficient in promoting the capacity of tax officials. | | | | | |

| |
|---|
| 30. Any further information |
| <p>-----</p> <p>-----</p> <p>-----.</p> |

Addis Ababa University

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MSc Program

Questionnaire for VAT registered tax payers.

This project is entitled VAT revenue performance and administration problems in case of ERCA in Gondar. The investigator is Birhanu Mesfin who is currently an Msc (in Accounting and Finance) student at Addis Ababa University.

The aim of this project is to assess VAT revenue performance and administration problems in case of ERCA in Gondar. To supplement the data obtained from Ethiopian revenue and custom authority in Gondar town, the investigator seeks to gather relevant information from a sample of fifty taxpayers by means of semi self administered structured questionnaire.

Participation in this project is completely voluntary, the questionnaire results will be recorded anonymously and strict confidentiality will be maintained. Individual responses will not be identified in the investigator's Msc project paper.

For further information please contact Birhanu Mesfin by the following address.

Tel.: 0911 82 33 75

E-mail: mesfin.birr@yahoo.com

Instructions

- Put x mark in a box for all questions provided in each table.
- Brief explanation is needed for open ended questions.
- The questionnaire has six parts

Part one back Ground

| | |
|---------------------------------|----------------------------|
| 1. When did you start business? | |
| 2006/07-present | <input type="checkbox"/> 1 |
| 2003/04-2005/06 | <input type="checkbox"/> 2 |
| 2000/01-2002/03 | <input type="checkbox"/> 3 |
| Before 2000/01 | <input type="checkbox"/> 4 |

| | |
|---|----------------------------|
| 2. When was your business first registered for VAT? | |
| 2003/04-2004/05 | <input type="checkbox"/> 1 |
| 2005/06-2006/07 | <input type="checkbox"/> 2 |
| 2007/08-2008/09 | <input type="checkbox"/> 3 |
| 2008/09 on wards | <input type="checkbox"/> 4 |

| | |
|--|----------------------------|
| 3. What is your main business activity? | |
| Manufacturing | <input type="checkbox"/> 1 |
| Construction, real estate and mining and quarrying | <input type="checkbox"/> 2 |
| Agriculture, hunting and forestry | <input type="checkbox"/> 3 |
| Trade | <input type="checkbox"/> 4 |
| Professional service | <input type="checkbox"/> 5 |
| Other, please specify | <input type="checkbox"/> 6 |

| | |
|--|----------------------------|
| 4. Your business is? | |
| A sole proprietorship (individual ownership) | <input type="checkbox"/> 1 |
| A cooperative | <input type="checkbox"/> 2 |
| A partnership | <input type="checkbox"/> 3 |
| A private limited company | <input type="checkbox"/> 4 |
| A share company | <input type="checkbox"/> 5 |
| A state owned | <input type="checkbox"/> 6 |
| Other, please specify | <input type="checkbox"/> 7 |

| | |
|--|----------------------------|
| 5. Please indicate roughly the average annual turnover of your business? | |
| Birr. 100,000 or less | <input type="checkbox"/> 1 |
| Birr. 100,001 - Birr. 500,000 | <input type="checkbox"/> 2 |
| Birr. 500,001 - Birr. 1000,000 | <input type="checkbox"/> 3 |
| Birr. 1000,001 - Birr. 10,000,000 | <input type="checkbox"/> 4 |
| Birr. 10,000,01 or more | <input type="checkbox"/> 5 |

Part Two

VAT registration and identification and its impact on tax payers

| | |
|--|----------------------------|
| 6. Why some eligible business enterprises whose annual turnover more than the threshold have not yet registered for VAT. | |
| Weak administration of the authority to force them for registration. | <input type="checkbox"/> 1 |

| | |
|--|----------------------------|
| Lack of formation for the authority about unregistered tax payers. | <input type="checkbox"/> 2 |
| Business enterprises want to monopolize the market with least price | <input type="checkbox"/> 3 |
| Some trades fear VAT registration for not loosing their customers. | <input type="checkbox"/> 4 |
| Other, please specify ----- ----- | |
| 7 What are the possible solutions to reduce involuntary VAT registration on some traders? | |
| The tax authority should create awareness to tax payers | <input type="checkbox"/> 1 |
| The tax authority should improves quality of service providing for tax payers | <input type="checkbox"/> 2 |
| Makes tax laws understandable, and communicate changes very well | <input type="checkbox"/> 3 |
| Business enterprises who are eligible but not registered for VAT should obey for VAT rules and regulations | <input type="checkbox"/> 4 |
| Others, please specify ----- ----- | <input type="checkbox"/> 5 |

Part Three

VAT invoicing, filling and payment for tax payers

| | |
|---|----------------------------|
| 8 Why some VAT registered business enterprises collect the tax with illegal invoices? | |
| They unable to complete with unregistered tax payers | <input type="checkbox"/> 1 |
| Customers are interested to buy goods or services from non registered enterprise to get lower price | <input type="checkbox"/> 2 |

| | |
|--|----------------------------|
| Insufficient manpower of the authority to control such activities. | <input type="checkbox"/> 3 |
| The Competition problem with other organizations | <input type="checkbox"/> 4 |
| To retain government tax for themselves illegally | <input type="checkbox"/> 5 |
| Lack of knowledge | <input type="checkbox"/> 6 |
| Others, please specify ----- ----- | |

| | |
|---|----------------------------|
| 9. What are the reasons for some traders not to maintain records of their business operations in accordance with the laws and regulations of VAT? | |
| Absence of professional and qualified employees for business enterprises | <input type="checkbox"/> 1 |
| The authority doesn't create awareness about books and records maintained for VAT purpose for tax payers | <input type="checkbox"/> 2 |
| Tax payers lack knowledge about books and records maintained for VAT purpose | <input type="checkbox"/> 3 |
| Lack of knowledge of the owner of the business | <input type="checkbox"/> 4 |
| others, please specify_----- | |

| | |
|--|----------------------------|
| 10. How does your organization file a timely tax return and how does it pay tax? | |
| By appearing at tax authority in person | <input type="checkbox"/> 1 |
| By sending through post office | <input type="checkbox"/> 2 |
| By sending through mail | <input type="checkbox"/> 3 |
| Through electronic media like internet | <input type="checkbox"/> 4 |
| Others, please specify | <input type="checkbox"/> 5 |

| | |
|----------------|--|
| ----- ----- | |
|----------------|--|

| | |
|---|----------------------------|
| 11. The method of effecting payment to the tax authority is done by using | |
| Cash | <input type="checkbox"/> 1 |
| Cheque | <input type="checkbox"/> 2 |
| Bank certified payment order | <input type="checkbox"/> 3 |
| Others, please specify ----- ----- | <input type="checkbox"/> 4 |

| |
|--|
| 12. Would you specify any problems and complications on issues of VAT invoice, VAT filing and payment by the tax authority that needs improvement ----- ----- ----- |
|--|

Part Four

VAT auditing and penalties for tax payers

| | |
|--|----------------------------|
| 13 Most frequently observed Penalty for understatement /late payment and other offences related to business profit tax (multiple answer is possible) | |
| 10% of understatement | <input type="checkbox"/> 1 |

| | |
|--|----------------------------|
| 50% of understatement | <input type="checkbox"/> 2 |
| Imprisonment | <input type="checkbox"/> 3 |
| Fines of both money and imprisonment | <input type="checkbox"/> 4 |
| I don't know | <input type="checkbox"/> 5 |
| Other please specify ----- ----- | |
| 14. If you want to suggest any measures that should be taken to mitigate the problems (if any) related to imposing and enforcement of penalties, please state them below | |

| | |
|---|----------------------------|
| 15. What are the problems that hinder the smooth implementation of VAT? | |
| VAT tax payers are less competition in the market than non VAT tax payers | <input type="checkbox"/> 1 |
| Consumers are not willing to buy goods and services with VAT | <input type="checkbox"/> 2 |
| Poor tax enforcement capacity of the authority | <input type="checkbox"/> 3 |
| Use of fraudulent invoices and non issuance of invoices | <input type="checkbox"/> 4 |
| Other please specify | <input type="checkbox"/> 5 |

| |
|---|
| 16. What are the alternative solutions to alleviate the identified problems? ----- ----- |
|---|

Part Six

Attitude questions on VAT revenue performance and administration problems for tax payers

| Item | Strongly Disagree (1) | Disagree (2) | Do not know (3) | Agree (4) | Strongly Agree (5) |
|---|--------------------------|-----------------|--------------------|--------------|-----------------------|
| I. VAT invoice, file, audit and penalty on taxpayers | | | | | |
| 18. The reporting period for VAT filling and payment is short | | | | | |
| 19. The existing auditors, inspectors and prosecutors lack necessary skill and experience to detect and handle tax offenses by tax payers | | | | | |
| 20. The criteria for selection of tax payers for audit and auditing procedure lack clarity and | | | | | |
| 21. The existing audit criteria are not sound enough to identify tax payers that are engaged | | | | | |
| 22. In Ethiopia, enforcement of penalty is very weak and lack consistency | | | | | |
| 23. The extent of penalties on tax payers are not | | | | | |
| 24. There is lack of clarity and transparency in imposing the penalty on tax payers | | | | | |
| II. Tax payer's attitude towards VAT rate and market competition | | | | | |
| 25. The level of the VAT rate is high and has made goods and services expensive and results | | | | | |

| | | | | | |
|---|--|--|--|--|--|
| in non compliance of tax payers | | | | | |
| 26.The existence of unregistered tax payers is creating unfair competition and making registered tax payers loss their market share and profitability | | | | | |
| 27.It should be worthwhile to consider the possibility of reducing the thresh hold | | | | | |
| III. Strength of tax authority to control noncompliant tax payers | | | | | |
| 28. Tax officials (administrators) are not qualified enough, lack necessary skills and are not in a position to provide adequate information upon tax payers request. | | | | | |
| 29.Tax administration tend to take very long time in handling tax audit and inspection | | | | | |
| 30.Tax officials lack politeness and confidence in decisions | | | | | |
| 31.VAT tax enforcement, tax auditing and inspections are slightly weak and there is high probability of being undetected of a business engaged in an act of evasion | | | | | |

32.If you have any other comments related to VAT in Ethiopia please mention them here
