eJournal of Tax Research (2008) vol. 6, no. 2, pp. 145-168

Value Added Tax Administration in Ethiopia: A Reflection of Problems

Wollela Abehodie Yesegat*

Abstract

This paper examines VAT administration in Ethiopia and identifies key problems including lack of sufficient number of skilled personnel and gaps in the administration in such areas as refunding, invoicing and filing requirements. The paper suggests that in Ethiopia attempting to implement what is legislated in the main areas (such as refunds) deserves the government's due attenti3(ten)i232.-1no-g.the decentralisation of its administration as a way forward for future research.

1. INTRODUCTION

Ethiopia introduced value added tax (VAT) in the year 2003 as a replacement to sales tax. VAT is the principal source of revenue for the Ethiopian government. For instance, in the 2006–07 fiscal year, federal VAT revenue (on domestic transactions) accounted for about 41 per cent of total federal revenues from domestic sources (EFIRA 2007). Further, since its introduction, VAT has been [illegible] 42(m)11.4(-a-5.2t ro) garnered at the expense of erosion in its salient features. This may be caused by factors including poor VAT administration, i.e., the incapacity of tax authorities to implement the attributes of the tax in practice. A good tax administration is essential in fully implementing the design features of VAT and achieving government's policy objectives at large.

This paper examines VAT administration in Ethiopia. The remainder of the paper is organised as follows. Section 2 presents a brief review of the literature on VAT

* The author is a PhD candidate in the Australian School of Taxation (Atax) at the University of New South Wales and a lecturer at the Addis Ababa University, Ethiopia. The author would like to thank Binh Tran-Nam and Margaret McKerchar for their invaluable comments and suggestions. The author would also like to thank Richard Krever, Michael Walpole, Fiona Martin and Kathryn James for their helpful comments when an earlier version of this paper was presented at the *20th Annual ATTA Conference* held in January 2008 at University of Tasmania, Hobart. Finally, the author wishes to thank an anonymous reviewer for constructive comments.

administration. Section 3 presents the methods adopted. Section 4 presents VAT administration practices in Ethiopia with respect to the main administrative tasks, administrative costs and the administrative organs (the issue of who should administer the tax). Finally, conclusions and limitations of the paper are presented in Section 5.

2. LITERATURE REVIEW

VAT administration pertains to how tax authorities discharge the responsibilities entrusted to them. According to Jantscher (1990) these responsibilities include a range of related activities such as taxpayer identification and registration, invoicing, filing and payment requirements,[1] control of filing and payments, refunds, audits and penalties.[2] Perhaps peripherally, VAT administration is also concerned with issues of who should administer the tax, what organisational setup to use and what resources are available.

There may be weaknesses in how VAT administrators perform their duties. Weaknesses in VAT administration, in turn, may adversely impact on the salient of filing and payments, refunds, audits and penalties. In addition, the costs of VAT administration were briefly examined in the case of Jantscher's (1990) study. The main conclusion of these studies is that VATs prevailing in developing countries were quite different from the broad based tax discussed in public finance literature and that administrative problems have a major contribution to this divergence.[3] Administrative problems, in turn, may be partly caused by administrative resources constraint.

VAT administrative costs can include costs incurred by tax authorities in performing member states as evidence.[4] They suggested different structures of sub-national VATs including dual and compensating VATs, which require a good administration[5] and information exchange among tax authorities. More specifically, Bird (2001) suggested that compensating VAT would be fairly feasible and potentially attractive in developing countries – at least in large countries in which states have major expenditure roles, the VAT is the major source of actual and potential revenue, and tax administration is not up to developed countries' standards. In general, however, according to Bird and Gendron (2005) in the context of developing and transitional countries a centralised VAT with some of the revenues shared with regional governments on a formula basis is the best approach to finance regional governments.

Following the assignment of VAT revenue, the question would be who should administer VAT? On this issue there are different possibilities, the extreme ones being central government only (centralised) or regional governments only (fully decentralised). Between these two extremes there may be different arrangements. There are arguments, at least conceptually, on the advantages and disadvantages of centralised and decentralised tax administration in terms of economies of scale and cost efficiency.Mikesell (2007) noted that innovation of new approaches and techniques are cited as advantages of decentralised administration while economies of scale and expertise are for a centralised administration. Martinez-Vazquez and

Surveys of taxpayers and tax practitioners (mainly accountants in the private practice) on VAT compliance costs in Ethiopia were conducted from mid November 2006 to July 6, 2007. These surveys were conducted using semi-structured questionnaires designed to elicit both quantitative and qualitative data on compliance costs and problems in the VAT system. Both surveys were conducted using face-to-face interview method.

The samp2x.8(-8(Ad)-8n)8.7(od)88.7(od)8Tc0.0865 T9t2maach-6.3(a6.7(y)-15)88.7(or.15 TD-0.0t5.8(2x.x)

businesses for transactions valued ETB 100,000 and above. In general, according to discussion with tax officials, these schemes were designed to help the administration in bringing taxpayers (that were required to register but did not do so) into the VAT net. At March 2008, there were about 32,840 taxpayers registered for VAT (EFIRA 2008).

Examination of survey responses revealed several problems related to taxpayers registration. For example, 13 per cent of (taxpayer survey) and 62 per cent of (tax practitioner survey) respondents indicated the prevalence of VAT unregistered businesses and urged the government's due attention. 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 ETB 500,000 as the major causes of the prevailing competition problem.

VAT filing and payment

VAT filing practices differ among countries. As Jantscher (1990) noted, in some developing countries[16] taxpayers effect provisional payments monthly and file returns annually; while most developing countries require monthly filing and payment of VAT and do not require taxpayers to furnish a yearly return. In the case of Ethiopia, taxpayers are required to file VAT returns accompanied by the appropriate payments on monthly basis and there is no year-end reconciliation requirement. Further, the VAT legislation allows taxpayers a 30-day period within which to file returns and make payments. Nevertheless, in practice, according to the outcomes of interviews with tax officials, there are three VAT reporting periods depending on whether a taxpayer is a nil, credit or payment filer.[17] The reporting time from the end of the accounting period is 10 days for nil filers, 20 days for credit filers and 30 days for payment filers. According to tax officials, taxpayers that fail to meet the reduced deadlines would not be fined as long as they report within 30 days from the end of the accounting period. However, such taxpayers would be given verbal warning that if they do not keep the reduced reporting periods, penalty would be applied.

Concerning the reporting periods, 15.5 per cent of taxpayer survey respondents indicated that the reporting period, especially the 20-day period for credit filers, is very short. This is a problem especially for taxpayers conducting business at several locations since gathering documents from different offices takes time. Further, according to survey respondents, the shortness of the reporting period puts substantial pr4(ts Tc94.9 2tyv.8(1)6.espo6.8(ral[taxps, (m)t)-6.4(hs)t(peri(y)0.4(prps, sru.6(o)6.)0s)-)re are -1.15h)0.4(

person. This is a problem for taxpayers[18] that reside in remote areas (where the EFIRA does not have branch offices) and are forced to go to the capital city, Addis Ababa, or nearby cities where the tax authority has a branch office. In addition, in terms of the method of payment, in Ethiopia taxpayers with VAT liability greater than ETB 1,000 may be required to effect payments with bank certified payment orders (CPOs). The use of CPOs is, in fact, to mitigate the problem of insufficient fund balance that might arise from accepting taxpayers' cheques. Nevertheless, such a practice imposes a cost on taxpayers in the form of out of pocket payment (CPO preparation fees charged by banks) and time costs.

Generally, the above mentioned practices pertaining to reduced VAT reporting periods,[19] the method of effecting payments and the return filing process are likely to be translated into increasing taxpayers' compliance costs, especially on small businesses.[20] It is therefore worthwhile to strengthen the administration capacity of the tax authorities and reduce the burden on taxpayers (because this may, in turn, have an impact on their compliance decisions).

Control of filing and payment

In administering VAT in Ethiopia tax authorities use computer programs, namely: Standard Integrated Government Tax Administration System (SIGTAS) and Automated System for Customs Data Management (ASYCUDA). The computer programs are used to maintain taxpayer register and process VAT returns. Detection of non-filers seems to be carried out mainly manually. As the outcomes of the in-depth interviews with tax officials showed, the tax authority tries to identify non-filers in collaboration with the Ministry of Trade and Industry. In Ethiopia every trader is required to renew business license annually with the pertinent offices under the Ministry of Trade and Industry or regional governments. To renew business licenses, traders are required to produce evidence from tax authorities that all taxes have been paid. The tax authorities on their part, before providing the evidence to taxpayers, check if there are delinquent taxes (including VAT).

In addition, tax authorities endeavour to follow-up non-filers identified by the computer programs. However, because of shortage of manpower, such follow-ups are usually carried out once in a 3 to 6 month period. The above practices pertaining to controlling VAT filing and payment delay the collection of the tax and jeopardise the government's revenue.[21] It is, hence, suggested that to ameliorate the potential impact of non-filers on the revenue performance of the tax, strengthening the administration capacity of the tax authorities, and effectively using the computer programs coupled with timely follow-up of non-filing taxpayers are worthwhile to consider.

[18] This includes Federal or joint taxpayers who file their returns with the EFIRA including its branch offices.

[19] The segregation of the reporting period is likely to impose psychological burden on taxpayers in addition to out of pocket and time costs. The psychological burden may be due to the verbal warnings of tax administrators on late filers. Psychological burden may also arise because of the pressure on employees that the shortness of the 20 day period causes.

[20] For discussion on compliance costs and their regressivity see Sandford (1995), Evans et al. (1997) and Evans (2003).

[21] Jantscher (1990) noted that most developing countries detect non-filers manually after a long delay putting the collection of the delinquent tax at risk.

VAT invoicing

Jantscher (1990) noted that unlike developed countries most developing countries require some form of invoicing for all transactions subject to VAT including sales to final consumers. n Ethiopia, the VAT legislation states mainly two things. Firstly, the waiver 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.[22] To facilitate the implementation of these provisions, the VAT legislation empowered the Ministry of Revenue to issue the relevant directives. However, as the interviews with tax officials showed, until June 2007 the pertinent directives had not been issued. Consequently, all registered traders (including those who have transactions with total consideration not exceeding ETB 10) were effectively required to issue the standard VAT invoice.[23]

Examination of survey responses in this regard showed that about 10.4 per cent of taxpayer survey respondents raise several problems. These problems include the 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 negotiation tool[24] between customers and VAT regist

voucher system[38] for coffee exporters. According to interviews with tax officials the first cash refund to non-exporting businesses was made in February 2007. In addition, tax officials revealed that refund claimants in the non-exporting business category are mainly importers that claim have excess VAT credits which are not being used by carrying forward to the next five accounting periods (months). This was believed to be because at the time of import taxpayers pay VAT based on customs valuation, which is usually more than the price that taxpayers claim they sell their products. In this situation, in the opinion of the tax officials, giving refunds to taxpayers would have its own impact on the revenue position of the government. Further, the tax authority is not in a position (in terms of capacity) to administer the refund claims of these taxpayers.

In connection with customs valuation, 37.9 per cent of tax practitioner survey respondents showed that the valuations are unreasonably high. According to these survey respondents, the high customs valuation usually leads taxpayers, including genuine traders, to report excess VAT credits for a very long time. This in turn results in rejection of taxpayers' accounting records by the tax authorities and determination of taxes due[39] using the customs valuation as a basis. This practice is resulting in higher effective taxation and is also against the generally accepted accounting principles legislated to be followed in taxation in Ethiopia.

As a whole, instead of totally refusing taxpayers' refund requests, it is reasonable to re-examine the customs valuations periodically and endeavour to check selectively the sales invoices of traders with the invoices held by, at least, government institutions. In addition, strengthening the administration capacity of tax authorities and attempting to make refunds on genuine requests deserve the government's due attention.

Further, in connection with refunds, it is important assessing the practices in treating VAT on capital goods. In the Ethiopian VAT system, capital goods are treated in the same way as other merchandise items. Such a custom affects mainly taxpayers that are required to carry forward credit claims including those on capital goods to future periods. This procedure, apart from tying up investors' money for a very long time, is likely to constrain business cash-flows and impact negatively on investment. This coupled with the escalating inflationary[40] trend in Ethiopia evidences the effective taxation of capital goods against the hallmark of a consumption type VAT.[41] In light of the above, making a distinction between goods and devising a strategy by which the VAT on capital goods could be immediately refunded deserve the government's attention.

In addition to the concerns discussed thus far, about 25.4 per cent of taxpayer survey respondents noted that frequent changes in the administrative procedures, directives

federal government. Accordingly, until September 2004, VAT was being administered by the federal government's revenue organs (the EFIRA and ECA). However, since September 2004, the EFIRA has delegated[42] to regional governments the administration of VAT for sole traders residing in their respective jurisdictions revealing the trend in decentralising the VAT administration. As indicated in the literature review, it is crucial to assess the decentralisation of VAT administration within the framework of the whole fiscal system. Consequently, before proceeding to the decentralisation of the administration, the following discussion briefly examines the assignment of VAT revenues in Ethiopia.

Proclamation No. 33/1992 and the Constitution of the Federal Democratic Republic of Ethiopia identify revenues belonging to the federal and regional governments and those jointly shared by both. In addition, on the assignment of revenues, Article 99 of the Constitution stipulates that the power of imposing and collecting taxes, which are not identified and given to a particular level of government to be determined by at least a two-thirds majority vote in a common meeting of the councils of federation and the representatives of peoples and nationalities.

Of particular importance for this discussion is the assignment of sales taxes. Sales taxes from organisations owned by the federal government and regional governments are stipulated to belong to the federal government and regional governments respectively. Sales taxes on imports belong to the federal government. Sales taxes from sole traders are entirely given to regional governments whilst sales taxes from private companies are legislated to be shared between the federal and regional governments. In the case of VAT revenue, the outcomes of interviews with tax officials revealed that neither Article 99 of the Constitution was applied nor did any written document on the assignment of VAT revenue exist. Instead, the assignment of sales taxes seems to have dictated, to some extent, that of VAT. Accordingly, while VAT revenue from sole traders is for regional governments, the VAT revenue from other sources is given either entirely to the federal government or jointly shared with regional governments.[43] This reveals that in Ethiopia VAT revenue is decentralised. The decentralisation is against the approach considered to be the best, in the literature, in financing regional governments, i.e., assigning VAT to central government and adopting some revenue sharing scheme with regional governments.

The decentralisation of VAT revenue, in Ethiopia, may result in distortions[44] including a revenue gain in one jurisdiction at a loss in another. To illustrate such a problem assume two sole traders (A and B) and two regional governments (1 and 2). Sole trader "A" resides in region 1 while "B" is in region 2. Sole trader "A" supplies goods subject to VAT to "B" (who is an exporter). Sole trader "A" files VAT return with

---

[42] The transfer of the admin-9.1(A()-677ref(er o)[8(n)-Tm03 Tc0 20558 T 0.5(d r)6.2(o9.3(er10.5(meme)-14.2n)10.50.5)10.50.5)

when the horizontal flow of information between different agencies is difficult (Bird 2005)**.**

In general, the decentralisation of VAT revenue and its administration in Ethiopia is likely to impact on the proper functioning of the VAT system, and achieve the government's policy objectives at large. So, considering the practical difficulties of administering VAT at regional governments' level and the distortions of VAT revenue decentralisation (revenue import among different regional governments), it is worthwhile for the government to reassess the assignment of VAT revenue and the decentralisation of its administration.

4. CONCLUSIONS AND LIMITATIONS

VAT has a significant role in the revenue system of the Ethiopian government. To sustain VAT's revenue role in the government's finance, it is crucial to ensure that the revenue generated by this tax is raised as efficiently as possible. Nevertheless, in Ethiopia revenues generated by VAT are usually garnered at the expense of a compromise in its salient features. This is usually caused by factors including weaknesses in the admin7(e)-3(ne(at)-7.3( )5.8(the ramaht7(e)-31 TD0.00ie)5.8(reg(co)-6.9(mp98388Tw[,)-

It is hence suggested that the government would better look at the possibility of making sufficient resources available for the administration of VAT. Of course, this would be a challenge for countries like Ethiopia where resources appear to be limited. However, considering the role of VAT administration in the overall financial system of the Ethiopian government, allocating reasonably sufficient resources is worthwhile to consider.

Moreover, this paper examined the decentralisation of VAT administration following the assignment of VAT revenue to regional governments. As discussed previously, the Ethiopian government has assigned VAT revenue to regional governments without clearly envisaging the distortions which, until recently, have impeded many developed and developing countries from decentralising the tax. Following the assignment of VAT revenue, the administration has been partly delegated to regional governments. Both the decentralisation of VAT revenue and the administration do not appear to be with thorough consideration of the distortions, the inherent administrative difficulty of the tax and weaknesses in the tax administrations, especially, at regional governments' level. In this regard, it is suggested that before the tax has further consequences in the form of revenue losses and undesirable inter-governmental relationships it is worth to reassess the decentralisation. That is, the assignment of VAT revenue and the decentralisation of its administration ought to be re-examined in light of the design features of the tax, the constitutional inter-governmental fiscal relationships, the experiences in other developing countries and the capacity of the country in implementing sub-national VATs. This issue,

REFERENCES

Bird, R.M. 2005, 'Value added taxes in developing and transitional countries: Lessons and questions', *ITP Paper No. 0505*, International Tax Program, Rotman School of Management, University of Toronto, available at <http://www.rotman.utoronto.ca/iib/ITP0505.pdf>, accessed November 2007.

Bird, R.M. 2004, 'Administrative dimensions of tax reform', *Asia–Pacific Tax Bulletin*, 10(3): 134–150.

Bird, R M. 2001, 'Sub-national revenues: Realities and prospects', *Fiscal Policy Training Program*, Andrew Young School of Policy Studies July 23–August 3, available at <http://www1.worldbank.org/wbiep/decentralization/Courses/Atlanta%207.23.01/bird2000.pdf>, accessed November 2007.

Bird R.M. 1989, 'The administrative dimension of tax reform in developing countries' in M. Gillis (ed.) *Tax Reform in Developing Countries*, Duke University Press, Durham, North Carolina, pp. 315–346.

Bird, R.M. and P–P Gendron 2005, 'VAT revisited: A new look at the value added tax in developing and transitional countries', paper presented at the *USAID Workshop for Practitioner on Tax*, 4 May.

Bird, R. M and P–P Gendron 1998, 'Dual VATs and cross-border trade: Two problems, one solution?', *Journal of International Tax and Public Finance* 5(3): 429–442.

CIA 2007, *World Fact Book Ethiopia* (last updated 18 October 18 2007), available at <https://www.cia.gov/library/publications/the-world-factbook/geos/et.html#Econ>, accessed October 2007.

Council of Ministers – Federal Democratic Republic of Ethiopia 2002, 'Value Added Tax Regulation, Council of Ministers Regulation No. 79/2002', *Federal Negarit Gazeta*, Addis Ababa, Ethiopia.

Edmiston, K.D. and R.M. Bird 2004, 'Taxing consumption in Jamaica: the GCT and SCT', *IPT Paper No 0414*, International Tax Program, Rotman School of Management, University of Toronto, available at <http://www.rotman.utoronto.ca/iib/ITP0414.pdf>, accessed October 2007.

Ethiopian Delegates 2006, 'Value added tax in Ethiopia', Speech at the *9th Value Added Tax Administration in Africa* (VADA) *Forum*, Zimbabwe.

EFIRA 2008, 'Federal Inland Revenue Authority (FIRA) collected more than ETB 5.9 billion in the last nine months', *EFIRA News*, available at <http://www.mor.gov.et/firaweb/fira%20collection%202000.htm>, accessed October 2008.

Yesegat, W A (2008) 'Estimating VAT administrative costs in Ethiopia', Paper presented at the 8th *International Conference on Tax Administration*, Atax, Sydney, 27 –28 March.

Appendix 1

Summary of response[redacted]yer survey respondents to the question "What aspects of the legislation and administrative procedures are problematic for you to [redacted]th the VAT system?"

Summary of response[redacted]	**Count**	**Per cent**
The reporting periods [redacted]for nil filers and 20 days for credit filers are very short. The 20 day period for credit filers is problematic especially[redacted]ers conducting business at several locations as it takes a lot of time until documents are collected from differe[redacted]. There is also delay in getting customs declarations. So trying to report within 20 days sometimes leaves out s[redacted] from being reported in the appropriate period.	[redacted]	

Appendix 2

Summary of responses of tax practitioner survey respondents to the question "Do you have any comments on the VAT system in Ethiopia?"

Summary of responses	Count	Per cent