

## Implementation of VAT in Ethiopia: Critical Assessment of the Practice in Jigjiga Town

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### Abstract

Value Added Tax (VAT) has been introduced in Ethiopia in 2002, the administration of which is exclusively the Federal Government's through the Ethiopian Customs and Revenue Authority (ERCA). However, since 2004, based on its power to delegate fully or partially the administration of VAT and other revenue collection activities, ERCA has been delegating its power to regional revenue collecting organs, including, Jigjiga Town Revenue Bureau. Yet, even if the Bureau has been delegated with this power there are various challenges in the implementation and enforcement of VAT, among others, shortage of adequate and qualified personnel and relevant equipments affecting registration process, how VAT operates, how VAT payment is filled, invoicing, claiming VAT credit, record keeping, VAT filing and return process etc.; lack of awareness with regard to taxpayers implicating on screening and identifying taxpayers; inefficiency of controlling and monitoring mechanism. The research, therefore, identified such problems affecting effective implementation of VAT in Jigjiga town and after careful analysis of the problem forwarded recommendations that could, not only be useful for the Bureau in Jigjiga, but also other delegated agencies with similar powers.

**Keywords:** Value Added Tax, Implementation of VAT in Ethiopia, Implementation Challenges, Jigjiga Town

### Introduction

Value Added Tax (herein after VAT) is a general consumption tax assessed on the value added to goods and services. It is a *consumption tax* for it is borne ultimately by the final consumer. VAT is relatively new sales tax type introduced around 1960s – i.e., at the global level.<sup>1</sup> Though VAT was rarely known fifty years ago, now it is adopted and implemented in different parts of the world, particularly in sub-Saharan African countries with developing economies.<sup>2</sup> Underlying this is the high revenue potential of VAT and its tendency to improve the overall tax system.<sup>3</sup> Ethiopia has introduced VAT in to its tax system replacing hitherto sales tax in 2002 which came into force as of January, 2003 with the objective of enhancing economic growth; and enhancing saving and investment.<sup>4</sup>

As far as administration of VAT in Ethiopia is concerned, the Federal Government is given the exclusive authority to levy and collect VAT on taxable transactions throughout the country.<sup>5</sup> Ethiopian Revenues and Customs Authority is given the power to administer and collect VAT. However, where circumstances so demand - particularly, in the interest of effectiveness and efficiency, the authority is given the power to delegate, fully or partially, its powers to revenue collective agencies of regional states.<sup>6</sup>

It is in accordance with this scheme that the Ethiopian Somali Regional State Revenue Authority is delegated by the Federal Government to administer VAT within the jurisdiction of the State. Consequently, the Bureau embarked in the enforcement of VAT, particularly within the capital city of the region, i.e., Jigjiga and other parts of the region. The task began since 2003 E.C (2010) and administered by Jigjiga Town Revenue Bureau.

As it has been stated before, VAT is introduced in Ethiopia for its advantage of maximizing the revenue government collects out of tax. Partly this is attributed to the salient features of VAT that make it different from other taxes such as, identification and registration of the taxable persons, filling and payments, VAT invoicing, refunding, auditing and penalties for non-compliance. This makes VAT less vulnerable to evasion and fraud compared. However, unless well implemented; non-compliance, evasion, tax avoidance and fraud will ensue affecting the entire tax system, the revenue generated, disturb smooth market operation and entail unnecessary administrative costs. Failure to register, failure to file tax return, underreporting tax liability, illicit claim of

<sup>1</sup> Keen M. and Lockwood B., “*The Value Added Tax: Its Causes and consequences*”, 2007, [Available at: [http://www2.warwick.ac.uk/fac/soc/economics/research/papers/twerp\\_8\\_01.pdf](http://www2.warwick.ac.uk/fac/soc/economics/research/papers/twerp_8_01.pdf)], Last Accessed on 15 December 2014, p.3

<sup>2</sup> Ibid

<sup>3</sup> Alan S. and Oliver O., “*Value Added Tax: A Comparative Approach*”, 2007, p.16.

<sup>4</sup> Proclamation No.285/2002, “Value Added Tax Proclamation” (herein after the VAT Proclamation), Federal Negarit Gazeta, 8<sup>th</sup> Year No.33, para.3

<sup>5</sup> Article 30 of VAT Proclamation empowers the Ethiopian Revenue and Customs Authority to monitor the implementation and enforcement of the Proclamation and of Regulations issued in respect to VAT.

<sup>6</sup> Article 6 (13) of Proclamation No. 587/2008; “Ethiopian Revenues and Customs Authority Establishment Proclamation, Federal Negarit Gazeta, 14<sup>th</sup> Year No.44.

refunds and issuing improper invoices are among the major challenges. These challenges arise from different root causes; related with the tax authority, tax payers and the consumers.

Thus, given the significance of the revenue for the national economy, to the revenue of the Ethiopian Somali Regional State, and ultimately the role of VAT system to ensure smooth, uniform and competitive business environment throughout the country in general and in the region particularly, this research investigated the root causes and challenges in the implementation of VAT in Jigjiga town. The research explored the problems; identified the root causes and consequences of the challenges; and formulated the solutions thereof.

### Research Design

The study employed a mixed approach with an emphasis given to qualitative research method supplemented with quantitative method. Quantitative method is used to capture variables which are quantifiable such as, registration, declaration, payments, and using cash register machines and/or issuance of valid invoice.

### Sampling and Sample Size

As of February, 2015 there were 454 registered tax payers within Jigjiga Town; disaggregated by sectors such as, Electronics shops constitute (55), hotels and grocery (113), building materials (83), furniture (43), stationeries (16), spare parts (20) and others such as, whole sales, metal works, constructions, enterprises, consultants, photo services, etc count (124). To select participants, the technique opted for is probability sampling that assures equal chance of participation among the study population. Accordingly, based on statistical method<sup>1</sup>, 113 questionnaires were distributed to VAT registered tax payers in Jigjiga Town (disaggregated proportionately by business sectors).

### Data Collection Methods

The study has implemented both primary data and secondary data. As part of primary data source questionnaires and key informant interviews were used. Furthermore, content analysis of the National VAT Proclamation, VAT Regulation and Directives issued by the Ethiopian Revenue and Customs Authority is made. Information regarding registered VAT payers, invoicing and collection and enforcement level were secondary sources.

### Objective of the Research

Focusing on the issue of enforcement of VAT in Jigjiga Town, the general objective of this study is to examine the challenges in the implementation of VAT in the study area.

Under this general objective, the specific objectives are:

- ❖ Finding out particular problems under the regional tax authority which are restraining the effective and efficient enforcement of VAT within Jigjiga town;
- ❖ Looking in to the factors behind the reluctance and non-compliance of the tax payers; and
- ❖ Pointing out the effects of administrative challenges and non-compliance on the tax system generally, and specifically on the revenue to be collected and administrative costs for non-compliance.

### VAT administration in Ethiopia and Implementation Challenges in Jigjiga Town

This section presents the general overview of VAT administration in Ethiopia, particularly focusing on the legal frameworks along with the findings of the study on the implementation practice and the major challenges and limitations impacting upon the administration of VAT in Jigjiga Town.

#### a. Taxpayers Identification and Registration

According to VAT Proclamation, there are at least three categories of persons who are defined as taxpayers.<sup>2</sup> These are:

- A registered person, including a person who is not yet registered but who is required to be registered;

<sup>1</sup> According to Bartlett et al. (1995) set formula to determine the sample size of the total number of target population which is assumed to be less than 10,000 considering the level of acceptable error at 5%, the sample size is determined by using the formula: If  $N < 10,000$ , then the sample size is calculated as the formula  $n = \frac{fn}{(1 + \frac{n}{N})}$  where  $N$  = Target population and  $n$  = Desired sample size. Desired sample size  $n$  is again calculated based on the formula  $n = \frac{z^2pq}{d^2}$  where  $z$  = Confidence level= 95 % (standard value is 1.96),  $p$  = Estimated characteristics of study population (0.5),  $q$  = 1- $p$  and  $d$  = level of significance test or margin of error=5% (standard value is 0.05)

<sup>2</sup> Article 3 (1) of VAT Proclamation ; and Teklu Kassu, "Challenges of Tax Administration in Arada Sub-City of Addis Ababa City Administration", 2011, MA Thesis, Addis Ababa University School of Graduate Studies, (unpublished), p.14.

- A person who carries out taxable imports of goods to Ethiopia, with respect to such imports; and
- A non-resident person who performs services without registration for VAT in Ethiopia for any VAT registered person in Ethiopia or any other resident legal person.<sup>1</sup>

Unlike the second and third categories where VAT will be collected at customs centers or by importer of service in Ethiopia, there are technical and legal requirements for the first category – registered tax payers. Generally, there are three types of registration of tax payers: obligatory registration<sup>2</sup>, voluntary registration<sup>3</sup> and registration of special business categories.<sup>4</sup> All this process works smoothly if the tax payers, tax authorities and customers are acquainted with the legal frameworks and the tax authority is furnished with sufficient skilled man power and facilities.

Coming to the practice in Jijjiga, Though VAT needs adequate preparation in terms of both human resource and materially, i.e., computerizing and using latest technological systems of controlling and auditing VAT process, personal observation of the researchers, data gathered from taxpayers and interview with tax officials clearly indicated that, the Jijjiga Town Revenue Bureau which is in charge of administering VAT in the Town is short of adequate personnel and relevant equipments.

For instance, according to Abdisalan Ahmed, senior tax auditor in Jijjiga Town Revenue Bureau and Jijusuf Tahir Abdi – tax officer in the same bureau<sup>5</sup> (herein after the ‘tax officials’), though the bureau has strong relation with the Federal Revenue and Customs Authority which used to organize experience sharing forums and training, still it is difficult to take that the bureau has adequate expertise in the area. Their allegation is also backed by the survey response from taxpayers. Accordingly, 52.8 percent of VAT registered taxpayers responded that the bureau and the tax officials therein are not skilled enough regarding the administration and enforcement of VAT. This calls for action from both the bureau and the federal government.

Besides, and beyond, the expertise level of taxation personnel, the business persons knowhow on the overall nature of VAT, more particularly on registration process, how VAT operates, how VAT payment is filled, invoicing, claiming VAT credit, record keeping, etc, is of utmost importance for smooth, efficient and effective implementation of VAT in the study area. Unfortunately, pragmatic evidences on the ground reveal that no such awareness creating trainings or education programs are designed and implemented so far for tax payers in the study area.<sup>6</sup>

According to the survey made, more than half of the registrants (i.e., 55%) have no sufficient information on how VAT operates before they get registered. It means that the tax authorities are less concerned about awareness creation or for education; and the matter seems to be left for the taxpayers themselves. This obviously is series challenge for implementation.

One area where the problem of resource and expertise constraint on the side of tax authority, and lack of awareness with regard to taxpayers is manifest is in connection with screening and identifying taxpayers. As it has been said before, the VAT Proclamation set minimum threshold level 500,000 Birr of transaction made or reasonably expected to be made. However, owing to lack of awareness, business persons usually understate the value of transactions or conceal merchandize to evade registration for unreasonable fear that it will put them in extra-burden ultimately affecting their turnover.<sup>7</sup> Despite the fact that such a trend will make identification and registration difficult, will affect market competition of registered person vis-à-vis non-registered ones.

However, the Federal Revenue and Customs office has issued directive that is meant to ease the

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<sup>1</sup> VAT Proclamation, Article 3 (1) (c)

<sup>2</sup> Obligatory registration is made for any person conducting a commercial enterprise or intending to conduct a commercial enterprise if the taxable turnover of the enterprise, i.e., gross income for 12 calendar months exceeds or is likely to exceed birr 500,000. See Art.16 of VAT Proclamation.

<sup>3</sup> See Art.17 of VAT Proclamation. Voluntary registration refers to persons regularly supplying or render at least 75% of goods or services to registered persons. This category is devised by the law for couple of reasons: first, it entitles the voluntarily registered person to get tax credit for the input transaction made with VAT and to this end, the person will be motivated to collect VAT; and secondly, persons who regularly undertake their business with VAT registered persons will lose customers unless it issue VAT invoice which help the customer to claim for refund latter.

<sup>4</sup> See VAT Proclamation Articles 16 and 17. Special business categories involves the registration of certain business undertakings that are required to register not based on the requirement of minimum threshold but based on the nature of business activities they undertake. A directive issued by the Ethiopian Revenue and Customs Authority set at least three criteria which help to identify the sectors which are likely to fall under the third category. There are:

- a. Trade sectors which conduct highly priced taxable activities;
- b. Trade sectors which conduct highly demanded taxable activities; and
- c. Trade sectors which require high initial capital and which have high production turnover.

<sup>5</sup> All interviews were made with the tax officials on February 11, 2015

<sup>6</sup> Interview with Abdisalan Ahmed, Senior Tax Officer at Jijjiga Town Revenue Bureau

<sup>7</sup> Interview with Jijusuf Tahir Abdi – tax officer in Jijjiga Town Revenue Bureau

registration and regulate the possible unfair market competition between registered and unregistered persons. According to the directive, where business persons understate their annual turnover or conceal merchandize to avoid registration, there is no tangible evidence to get such persons registered. Thus, in such circumstances, the way out is to consider the nature of business of the person and if it falls under the categories listed as ‘selective trade sector registration’, the tax officials can register them regardless of the amount of annual turnover.<sup>1</sup>

When we look at the facts on the ground in Jigjiga Town, based on the above formula the tax authority managed to register almost all persons who have engaged in electronics trading – as this sector falls under the few selective trade sector registration. However, when it comes to collection and control, still there are challenges as explored below. In respect to other businesses, such as hotels and groceries, spare parts, building materials, furniture, etc. still the problem of competitiveness between non-registered and registered persist.

The response of most VAT payers, i.e., 83 percent, represents the perception of taxpayers that there are competitive businesses that are not registered for vat for different reasons put forth by the respondents. Among others, the high minimum threshold set by the law accompanied by poor evaluation trend of tax officials contributed for non-registration; and this has serious impact on the commitment of taxpayers in discharging their obligation. According to interview with the town’s tax officials, the problem is partially attributable to lack of awareness of the officials regarding the different legal means of mitigating the problem.

The problem, however, is not one that is insurmountable. At least, the Jigjiga Town Revenue Bureau can make use of different awareness creation mechanisms on the merit of VAT and change the perception of those who conceive that VAT has negative impact in terms of down turning their transaction reducing the number of customers. Utmost, the Authority can improve its monitoring and control mechanism and audit the performance of unregistered persons’ transaction constantly. Based on such information, the authority may use its discretionary power under the VAT Proclamation to obligatorily register a person who has not applied for VAT registration but which the authority reasonably expects that the person shall register for VAT.<sup>2</sup>

#### **b. Filling of VAT Return and Payment**

According to the VAT Proclamation, every registered person is required to file a VAT return with the tax authority for each accounting period<sup>3</sup>, whether or not tax is payable in respect of that period, and to pay the tax for every accounting period by the deadline for filing the VAT return, i.e., no later than the last day of the calendar month following the accounting period.<sup>4</sup> Thus, the VAT Proclamation allows taxpayers a 30-day period within which to file returns and make payments.

Nevertheless, in practice, there are three VAT reporting periods depending on whether a taxpayer is a nil, credit or payment filer. The reporting time from the end of the month 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.<sup>5</sup>

Though the legislation has devised at least three means through which taxpayers may file their monthly return, so far, the Jigjiga Town Revenue Bureau use only one of the options, i.e., filing return by appearing in person.<sup>6</sup> However, such method of filing return has its own drawbacks, i.e., since every taxpayer has to discharge its obligation in time, they are forced to go to the authority which has drawbacks in terms of skilled man power and technological facilities. As a result, customers are forced to wait for prolonged time until their turn; which kills the time and resources of both the authority and taxpayers. According to the survey made, 87 percent of taxpayers responded that they wary of services awaiting them in the Town’s revenue bureau. According to the interview made with the bureau tax officials as well, the bureau recognizes the problem and is trying its best to speed up the service delivery.<sup>7</sup>

Given the insufficient technological facilities at the disposal of the town tax authority, it is infeasible at this juncture to recommend the use of electronic filing system. Such system is not also well established at the national level. But, the bureau may think of it in the future. However, there is no constraint which the researchers

<sup>1</sup> See Article 3 and 4 of Ethiopian Revenue and Customs Authority, Directive No. 25/2009

<sup>2</sup> Article 16 (1) (a) cum Article 18 (6) of the VAT Proclamation gives the message that the tax authority may obligatorily register a person for VAT and issue VAT certificate if there are reasonable ground to expect that the taxable transaction to be made by the person who is not registered will exceed the minimum threshold.

<sup>3</sup> According to Article 2 (1) of VAT Proclamation, ‘Accounting Period’ refers to a calendar month (according to the Ethiopian calendar), the month of Nehase and Pagumen are aggregated and treated as one calendar month.

<sup>4</sup> Id, Article 26 (1) and (2)

<sup>5</sup> Bisrat Alemayehu., “*An Examination of the Link between Tax Administration and Value Added Tax Compliance in Ethiopia*”, Master Thesis, Addis Ababa University School of Graduate Studies, unpublished, 2010, p.31

<sup>6</sup> Interview with Jigjiga Town Revenue Bureau tax officials

<sup>7</sup> Ibid

observe and which limit the bureau from making use of third party agents which have experience in doing such activities such as banks or other commission agents.<sup>1</sup> These institutions have relatively better positioned to undertake tax collection activities effectively and efficiently. Then based on the CPO taxpayers produce, the authority undertakes other controlling and auditing tasks. Thus, by making use of this the authority will focus on other activities and ease the burden on the authority, simultaneously minimizing taxpayers' compliance costs and avoiding inconveniences especially during the deadline for filing VAT returns.

The other challenge is one related with the method the authority use to assessment and collect VAT in the town. Nationally, the system put in place and most often used is the Standard Integrated Government Tax Administration System (SGTAS) and Automated System for Customs Data Management (ASYCUDA).<sup>2</sup> The Standard Integrated Government Tax Administration System (SIGTAS) is an integrated information system that enables governments to automate the administration of taxes and licenses. SIGTAS is able to manage every facet of the tax management process including:

- ❖ Taxpayer registration;
- ❖ Handling of tax declaration forms;
- ❖ Assessments (including payments and withholdings);
- ❖ Collections case management and objection case management;
- ❖ Cashing, penalties and calculation of interest and penalties;
- ❖ Audit (case tracking and follow-up).<sup>3</sup>

The software also provides for documentation management, objections (appeals) and payment agreements handling. In addition, SIGTAS offers the possibility of developing interfaces to share data with external systems such as customs, government financial software or other government divisions. SIGTAS can operate in three languages simultaneously, which makes it possible for tax agents to perform operations in the language of their choice and facilitate correspondence with taxpayers.<sup>4</sup>

Unfortunately, owing to the inadequate technological facilities at the disposal of Jigjiga Town Revenue Bureau and lack of skilled man power, the system and software of VAT administration are not yet put in practice. Rather, the authority has been using manual system of data recording and management which is obviously ineffective in any measure and worst when accompanied by lack of skilled man power. Manual system will also pave the way for corruption and malpractice in assessment, calculation and refund of VAT. Thus, to make the tax assessment, collection and data management process effective, efficient and impersonal and thereby restrain possible malpractices and unethical practice from both the taxpayers and tax officials it is important to adopt and implement the computer programs and software.

As the VAT legislations of Ethiopia clearly put, every taxpayer is entitle to get refund in case the VAT return the taxpayer made is less than the input VAT paid, provided that the input is used or to be used for the purpose of taxable transaction which is not exempt. In other words, in all cases where taxable transaction is made with zero, standard or the exceptional 150 percent rate set by the law, the registrant can claim for refund and the tax authority is obliged to refund within the conditions set by the law.<sup>5</sup>

Accordingly, the law provides different circumstances where refund will be implemented and the manner of refund. These are;

- ❖ If at least 25 percent of the value of a registered person's taxable transactions for the accounting period is taxed at a zero rate, the authority shall refund the amount of VAT credit for the accounting period within a period of two months after application for refund;
- ❖ In other cases, the amount of VAT applied as a credit for the accounting period is to be carried forward to the next five accounting periods and credited against payments for these periods; and any unused credit remaining after five months period shall be refunded by the authority within a period of two months after application for refund;
- ❖ In any case the authority is obliged to refund any amount remaining if the amount to be refunded is more than 50 birr. If the amount eligible for refund is 50 Birr or less, this amount can be carried forward and credited against tax due in the subsequent accounting period; and
- ❖ No tax credit is allowed unless a tax invoice, or debit or tax credit note, in relation to the supply has been provided and furnished to the authority by the claimant<sup>6</sup>

<sup>1</sup>Article 26(1) of VAT Proclamation cum Article 2(12) of the VAT Amendment Proclamation No.609/2008

<sup>2</sup> Bisrat Alemayehu, cited above at note 20, p.36 and Tadesse Lenco, as cited under Meseret Kalayu, "Administrative Challenges on the Implementation of Value Added Tax (VAT): in Mekelle, Tigray", LLM Thesis, Mekelle University, College of Law and Governance, Department of Law, (unpublished), p.53

<sup>3</sup> Hailemriam Mamo, "Implementation of Value Added Tax and its Related Problems in Ethiopia" (The Case of ERCA), MA Thesis, Addis Ababa University School Of Business And Public Administration MB Program, (Unpublished), 2011, p.36

<sup>4</sup> Ibid

<sup>5</sup> Article 21 of VAT Proclamation

<sup>6</sup> Id, Article 27

If the authority does not pay the refund in a timely manner as provided above, it will be required to pay interest at the rate of 25% from the date on which the refund was due until the date on which the payment of the refund is made.<sup>1</sup>

The above being the legal procedure for VAT refund, the practice on the ground in the study area however shows that it is below average compared with the applicable law. While one of the tax officials interviewed replied that, there is no refund which the authority has effected so far and held that the office has no such a system<sup>2</sup>, the other opined that the authority refer the claimants to the region's finance office and do not directly refund.<sup>3</sup> This indicates two things. On the one hand, it means that the tax officials and taxpayers are not aware of or informed about the system. In addition, referring claimants to the region's finance office means that the very tax officials lack adequate know how on how the credit system work; and as a result send the claimants to authority which is not implied in the legislation.

The finding of the research shows that among the taxpayers, only 9 percent replied that they know about the very concept of VAT refund; affirming the assertion above that there is little knowledge on the party of taxpayers regarding the matter. Among these while 70 percent confirmed that there is no VAT refund system in Jigjiga Town Tax and Revenue Bureau, 20 replied that they are not sure about it. Both data confirm that the overall refunding practice in the bureau whether in practice or not is below expectation.

The researchers do not hold that there should necessarily be taxpayers who applied for or were refunded VAT credit. As VAT credit and refund is possible only when there is excess VAT paid as evidenced by all relevant documents, it is possible that there would be no taxpayer who qualify for refund. But, VAT credit system has further relevance beyond refunding. Among others, it motivates taxpayers to track record purchases and sales and maintains relevant records. These documents in turn are essential in assessing VAT payable by the claimant as well as may be used to cross-check VAT liability of others who issued invoices to the refund claimant – it is one auditing and controlling mechanism. Thus, creating awareness and putting in place the system helps the tax authority in different aspects.

### c. VAT Invoice

Regarding invoicing, the VAT legislations of Ethiopia require tax payers to issue invoice except for a transaction of less than 10 Birr.<sup>4</sup> This is because the legislations adopted credit invoice method of VAT calculation in which issuance of invoice is mandatory for a person registered for VAT, but a person who is not registered for VAT does not have the right to issue tax invoice.<sup>5</sup> Therefore VAT registered enterprises perform their business transactions using an invoice. Hence the tax administration would not be expected to estimate the total sale or purchase made for levying the tax rather the invoice would depict the taxable sales and the buyer claims on what he has paid on his input.<sup>6</sup>

But, the assertion above works when VAT payers voluntarily comply with the law and undertake every taxable transaction in accordance with what has been provided by the law. Certainly, effectiveness of tax administration is also measured significantly on the basis of the level of voluntary compliance of taxpayers; unless, it either depicts the ineffectiveness of the tax administrator and/or the low level of awareness of taxpayers and the general community of the tax system.

In the context of invoicing, the VAT legislation defines specifically what activities amount to incorrect invoicing and if the taxpayers intentionally fail to live up to their invoice obligation, they will be subjected to the penalty set thereby. As it has been stated under chapter two, incorrect VAT invoicing includes using receipts not authorized by the tax authority, increasing or decreasing figures with the intention to increase or decrease the actual purchase, using receipts with identical serial numbers, use of copies of receipts. In addition to incorrect invoicing, failure to use VAT invoices at all is an offence.<sup>7</sup> Not only that, if the taxpayer is under obligation to use tax register machine, it has to put a conspicuous notice that reads “*Do not pay if a receipt is not issued*”.<sup>8</sup>

One of the major challenges with taxpayers in Jigjiga Town in relation with VAT invoice is that though it is common to see every where the text “*Do not pay if a receipt is not issued*”, practically transactions are held without invoice. In an interview with the town's tax officials, they admit the existence of the problem and held that the bureau uses its own surveillance system, most often sending investigators to the business vicinity, and

<sup>1</sup> Id, Article 27 (6) and Article 15 of Council of Ministers Regulations No.79/2002, Council of Ministers Value Added Tax Regulations, Federal Negarit Gazeta, 9<sup>th</sup> Year, No.19

<sup>2</sup> Interview with Abdiselan Ahmed, Senior Tax Official in Jigjiga Tax and Revenue Bureau

<sup>3</sup> Interview with Yusuf Tahir, Tax Official in Jigjiga Tax and Revenue Bureau

<sup>4</sup> Article 22 (7) of VAT Proclamation

<sup>5</sup> Id, Article 22 (1)

<sup>6</sup> Hailemriam Mamo, “*Implementation of Value Added Tax and its Related Problems in Ethiopia*” (The Case of ERCA), MA Thesis, Addis Ababa University School Of Business And Public Administration MB Program, (Unpublished), 2011, p.58

<sup>7</sup> Articles 2 (19) and of VAT Amendment Proclamation No.609/2008

<sup>8</sup> Id, Article 18

trying to control transactions without VAT. According to the officials, if the goods sold without VAT are discovered, they will be seized and, administrative and criminal measures will be taken. Despite the alleged measures, there is rampant practice of not issuing VAT invoice during transactions. This means that the tax collected by taxpayers is not paid to the tax authority and the normal tax operation will be compromised, including the refund system.

The other challenge observed (while conducting survey in relation with the electronic trade) is that, during transactions, buyers are given the option whether they opt for transaction with VAT or not; and if they choose the latter, VAT will not be collected and receipt will not be issued. Most often, the taxpayers covertly agree with the purchaser and if the latter consents, the transaction will be effected without VAT. Then, based on their agreement, the good will be taken out of the package, put in old plastic bag and the customer will leave the shop pretending that possession of something else. If this is not possible, for the good is not manageable to easily unpack and hold, another system is utilized. In such cases, either the buyer will take the goods quickly by Bajaj or other cars; or the good will be delivered from the store of the taxpayer locate elsewhere. In the latter case, the good is loaded on a car as if is being transported to the shop or display room; but, they are basically transported to the place of delivery by the agents of the taxpayers.

Based on the survey result, the tax officials were asked whether they are aware of such practices and what measure are taken or in order. The officials gave the same response provided above, that they use secrete agents and investigators who will monitor and control the illegal activities. However, despite the fact that such agents and investigators work is not regular, the tax authority has not assessed to what extent it managed to break the practice and maintain order. The practice on the ground reveals, however, that the practice is intensified than lessening. One can easily appreciate these observing taxpayers to deal with every customer on the matter. It indicates that the taxpayers noticed the inefficiency of the controlling and monitoring mechanism set by the authority.

In electronics trading as well as other sectors incorrect invoicing is common. Most often incorrect invoicing is done by means of: increasing or decreasing the figures on the invoice to conceal the actual purchase or sales amount; or issuing invoice for part only of the transaction and the remaining made without invoice; or using copies of receipts or computer generated receipts not authorized by the authority. Though the taxpayers deny any such practice, in a question raised to customers, out of 25 respondents, 18 (72%) replied 'Yes' – that there are traders in the market that collect VAT using incorrect invoices. While 2 (8%) replied that there are no such traders, the remaining 5 (20%) responded that they are not aware of such practice.

According to literatures, such practice is attributable to manifold reasons. Among these are:

- ❖ Absence or inadequate follow-up and control by the tax authority of issuing incorrect VAT invoice, using computer generated or printed invoices which are not authorized by the tax authority;
- ❖ The existence of other competitive but unregistered enterprises in the market;
- ❖ The desire of registered taxpayers to attract customers so as to compete with unregistered enterprises or illegally out compete registered taxpayers that issue correct VAT invoice; and
- ❖ Lack of awareness of the taxpayers and customers about the benefits, purpose and norms of tax invoice.<sup>1</sup>

Therefore, the Jiggiga Town's Revenue Bureau needs to further strengthen its follow-up and controlling mechanisms by deploying sufficient and skilled expertise, and making the investigation and follow-up regular and well informed. In addition, it has to devise mechanisms to equip the taxpayers and the general society on the purpose and benefits of VAT invoice to the taxpayers as well as to the society at large. Besides, strictly enforcing administrative and criminal penalties as set under the law will be instructive and deter others from similar practices.

#### **d. Challenges Related with Collection and Enforcement**

Basically, implementation and enforcement of VAT involves different activities such as investigating statements, records, books of account, vouchers, stocks or other documents and items which are either submitted by any person or at the person's place of business or practice.<sup>2</sup> In addition, the activity includes investigating taxpayers, employees or other persons who has access to or custody of any information, records or books of account, etc. Working in collaboration with other government bodies, institutions, and departments at federal or regional level is also defined as implementation and enforcement practice according to the VAT legislations. Finally, implementation involves enforcing the administrative and criminal penalties on those non-complying taxpayers. It is important to note at this point that, though penalty is one aspect of controlling the proper observance by taxpayers of their obligations, it is not one which is preferable always and in all circumstances. Rather, it has to

<sup>1</sup> Hailemriam Mamo, cited above at note 34, p.59

<sup>2</sup> Article 30 of VAT Proclamation

come to fore only after other measures of ensuring compliance are employed; more particularly, after enhancing the awareness creation.

According to the VAT Proclamation, a person who fails to file a timely return is liable to pay for penalty. In this respect, concerning the controlling of taxpayers who fail to file return on time, the Jigjiga Town Revenue Bureau tax official, the bureau used to control such persons when they come before the office to renew their license with the Ethiopian Somali Regional State Trade and Industry Office. According to the relevant trade licensing legislation, every trader whether VAT registered or not has to clear any tax obligation before applying for license renewal. It is at this moment that the Office will send defaulting VAT payers to the Town's Revenue Bureau to clear their VAT obligation.

However, according to the VAT Proclamation, every VAT payer is required to file VAT return and effect payment within thirty days following the accounting period, and such person will be subjected to administrative penalty. Thus, defaulting payment for prolonged period not only subjects taxpayers to extra-penalty calculated on monthly basis, it will also compromise the amount of payment to be collected monthly, as such prolonged period create fertile grounds for evasion and malpractices on the taxpayers and tax officials, respectively. Thus, the Bureau is required to design other appropriate and consistent means of auditing non-filers, informing their default and take fair measures (i.e., informed measures).

For instance, according to the VAT Proclamation, one means of enforcing default payment is seizure of any property belonging to such person.<sup>1</sup> Accordingly, after indentifying the registered taxpayer in default, the bureau will give due notice to file return and payment within due time, then the bureau will resort to seizure. A good practice which Jigjiga Town Revenue Bureau used to do against defaulting taxpayers is sealing the business until discharging VAT obligation or until the problem revealed is rectified. This is in fact prominent in facilitating and improving compliance, and creating awareness on taxpayers about the possible consequence of defaulting.

Concerning awareness about the ramification of non-compliance with timely payment, 89 percent of taxpayers who are surveyed for this study informed that they lack the knowhow and appropriate information on the advantages and corollary repercussion of defaulting. The remaining 11 percent replied that they learnt the effects from the measures taken by the bureau. Still, given the insignificant percent the latter constitute, the bureau is expected to work more on awareness creation and education.

As it has been said time and again, though penalty is one aspect of VAT ensuring compliance with VAT, it is not recommended to strictly pursue such route. Among others, considering the recent introduction of the system, freshness of the taxpayers to such system, lack of adequate resource to implement the tax flawlessly and challenges related with consumers' penalty will not be taken as the right path to ensure compliance. Nevertheless, during interview with the town's tax officials, they responded that the authority used to resort to administrative penalties and criminal prosecution in cases of non-compliance. Instead of focusing on education, awareness creation and capacity building, resorting to penalties will have negative implications on the attitude of taxpayers than playing deterring role.<sup>2</sup>

Finally, according to the VAT Proclamation, there are Tax Review Committee and Tax Appeal Commission established at the federal level to examine and decide on complaints of taxpayers over assessment, VAT refund claims, penalties, interests, etc done by the tax authority or upon appeal, respectively. These organs are however sit at the federal level, and will not timely respond to the questions of taxpayers regionally. Rather, the respective regional tax authorities are expected to put in place appropriate organ that respond to and give appropriate administrative decision on the complaints and questions of taxpayers. But, as observed during field survey and confirmed by the town's tax officials there is no distinct organ set up to do such activity; rather personnel's and officials respond to questions as a case may be. Despite the implication of the problem on access to justice of taxpayers, un-institutionalization of compliant handling will open the floodgate for evasion and malpractice. Thus, the town revenue bureau has to consider the problem and set the appropriate grievance handling organ in consultation with the Ethiopian Revenue and Customs Authority.

## Conclusion

Consequent to the challenge above, Jigjiga Town Revenue Bureau is short of managing and improving business persons knowhow on the overall nature of VAT, more particularly on registration process, how VAT operates, how VAT payment is filled, invoicing, claiming VAT credit, record keeping, etc. Survey result revealed that no awareness creating trainings or education programs are designed and implemented to build the capacity of business persons or VAT registered persons. A taxpayer who is less aware about the system will hardly be committed and discharge his responsibilities as expected.

One area where the problem of resource and expertise constraint on the side of tax authority, and lack of

<sup>1</sup> Id, Article 31

<sup>2</sup> Bisrat Alemayehu, cited above at note 20, p.37



awareness with regard to taxpayers is manifest is in connection with screening and identifying taxpayers. In this respect, business persons' trend to understate the value of annual transaction or concealing merchandise during inspection accompanied by complexity of normative standards in the area is affecting the implementation process and compromising market competition of registered person vis-à-vis non-registered ones.

Even after registration, the fact that the bureau is short of expertise and technological facilities is affecting the VAT filing and return process. Particularly, the practice of filing monthly return and payment appearing in person has forced customers to wait for prolonged time until their turn; which kills the time and resources of both the authority and taxpayers. Manual VAT assessment and collection system, and manual data recording and management system the bureau use is further bottleneck in the effectiveness and efficiency of the bureau.

Regarding VAT credit and refund system, the study found out that the tax officials and taxpayers are not aware of or informed about the system. In addition, referring VAT credit and refund claimants to the region's finance office affirm tax officials lack of adequate know how on how the credit system work; and as a result send the claimants to authority which is not implied in the legislation.

Challenges are also witnessed in respect to VAT invoicing. One of the major challenges with taxpayers in Jigjiga Town in relation with VAT invoice is that though it is common to see every where the text "*Do not pay if a receipt is not issued*", practically transactions are held without invoice. Though the Bureau has been implementing its own surveillance and investigation system which is dependent more on surveilling by personnel, given the complexity of incorrect invoicing or failure to issue invoice, the challenge is far from over. Rather, it is intensified and diversifying than lessening. It indicates that the taxpayers noticed the inefficiency of the controlling and monitoring mechanism set by the authority.

Finally, concerning the controlling of taxpayers, who fail to file return on time, incorrect invoicing, VAT evasion and other illegal activities, though the practice of temporarily sealing business centers until the resolution of the problem by Jigjiga Town Revenue Bureau is prominent in facilitating and improving compliance, and creating awareness on taxpayers about the possible consequence of defaulting, still the fact that the Bureau waits until license renewal season to identify defaulters is not procedural. It will also compromise the amount of payment to be collected monthly, as such prolonged period create fertile grounds for evasion and malpractices on the taxpayers and tax officials, respectively.

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