

# Challenges of Value Added Tax Administration: The Case of East Wollega Zone

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## ABSTRACT

Developed and developing countries of the world generate most of their government's revenues from taxes. Tax can be classified as direct tax and indirect taxes. Direct taxes are taxes, which suffered by tax payers and are one that cannot be shifted by the taxpayers to someone else, whereas indirect taxes are paid to tax collector by some others and can be shifted by other taxpayers. Value Added Tax is a types of indirect tax levied on consumption where value of goods and services increases as they charge in course of distribution and the end sales of consumers. In Ethiopia Value Added Tax Administration was introduced in January, 2003 primary to raise increasing Revenue, modernizing tax implementation. The study was particularly focused on challenges of Value Added Tax Administration regarding the Value Added Tax assessment, collection and implementation of Value Added Tax and to assess the main problems related to the Value Added Tax administration activities performance tax office, service delivery of tax office and voluntary compliance of tax payers in the case of East Wollega Zone. To achieve this objective, the researcher used types of research design and sample of Value Added Tax Registrants taxpayers and Tax officials of the Authority were selected using stratified random sampling method and judgmental sampling method respectively. The research used questionnaire and relevant documents to collect primary data and secondary data from sources of data. Charts, and figure and percentage by computer using (Statistical Package for Social Sciences) SPSS software to were used to analyzing the collected data. Value Added Tax is a tax system that has replaced the sales tax in Ethiopia and has applied a uniform rate of 15% on most consumption of goods and services. Value added Tax Administration in East Wollega Z one has faced different challenges. The main problems that encountered are the following such as: Lack of Awareness of Taxpayers, resistance against registrations for Value Added Tax by some traders, weak culture of taxpayers, poor Value Added Tax administration system. All these problems hinder the Administration of Value Added Tax of the Zone.

**Keywords:** Challenge, Value Added Tax, East Wollega, Ethiopia

## Introduction

The emergence and rapid spread of value added tax is among the most important tax development of the late 20<sup>th</sup> century. The concept of value added tax was generated in 1954 by a French economist Maurice Laurie who was joint director of the French tax authority. The theory is that the end consumer carries the burden of Value Added Tax, not the business, which is merely collecting the Value Added Tax on behalf of tax authority. Different scholars also define value added tax as a percentage tax on a value added applied at each stage of production. It is a type of indirect tax, nowadays found in more than 130 countries and has become the principal source of revenue for many countries (Kassu, 2011).

According to International Monetary Fund report in the year 2004, about 136 countries have made Value Added Tax part of their tax system, and from 53 member of countries of African Union 33 of them introduced Value Added Tax as their tax system (Wotku, 2008). In Ethiopia, according to IMF (2003), one of the focuses of the tax policy reforms is reforming indirect taxation. The main reform to indirect taxation was the introduction of Value Added Tax in January 2003. However, weak tax administration, particularly in developing and transitional economies is the principal impediment to the successful implementation of Value Added Tax. The same is true in Ethiopia (IMF, 2003). Value Added Tax is the principal source of revenue for the Ethiopian government. For instance, in the 2006–07 fiscal years, Federal Value Added Tax Revenue (on domestic transactions) accounted for about 41 percent of total federal revenues from domestic sources.

To sustain Value Added Tax's revenue role in the government's finance, it is important to ensure that the revenue generated by this tax is raised as efficiently as possible. However, researches reveal that in Ethiopia revenues raised by Value Added Tax are usually garnered at the expense of erosion in its salient features. This may be caused by factors including poor Value Added Tax administration and poor culture of paying tax of the tax payers i.e., the incapacity of tax authorities to implement the attributes of the tax in practice. A good tax

administration is essential in achieving government's policy objectives at large and fully implementing the design features of Value Added Tax (Yesegat W., 2008).

Ethiopian government has introduced Value Added Tax as part of the overall tax reform program. The tax reform program is preceded by establishment of a new Ministry of Revenue as a first step to improve tax collections and to combat fiscal fraud. Various activities have been conducted subsequent to this: the increase in the sales tax and the removal of import duty surcharge in 2000; a new legislation on presumptive taxation and a 5 percent withholding tax on imports became effective in February 2001; legislation was approved in March 2001 to introduce the TIN system to reinforce the collection powers of revenue agencies, and a tax reform implementation task force was established; a large taxpayer was made operational in July 2001; in October 2001, a draft Value Added Tax legislation was submitted to parliament and this is approved and implemented beginning January 1, 2003.

A revised income tax law has been approved and made operational. This revised law includes enhanced enforcement procedures and an improved penalty regime, with a view to increasing the efficiency of income tax collection, and ensuring the recovery of income tax arrears. Prior to the introduction of Value Added Tax, the Ethiopian government has initiated a number of processes. These include the design and computerization of the taxpayer registration process; the operational development of taxpayer services activities, return process and debit and audit activities; publicity campaign and taxpayer education. These measures are expected to improve the government's revenue position.

This paper examines Value Added Tax administration such as assessment and collection activities with respect to the main constraints at East Wollega Revenue Authority Office in the Value Added Tax implementation in terms of Value Added Tax administrative activities performance and service delivery of the tax office Authority and voluntary compliance of taxpayers.

So that many potential problem of Value Added Tax implementation of East wollega Zone Value Added Tax administration is poor due to many factors, such as: difference in culture Value Added Tax registrant, lack of self-registrant, lack of awareness among the potential tax payers about the importance of Value Added Tax and poor tax collection system still exists. The general objective of this study is to investigate the challenges of Value Added Tax Administration regarding the Value Added Tax assessment, collection and implementation of Value Added Tax and to assess the main problems related to the Value Added Tax administration activities performance tax office, service delivery of tax office and voluntary compliance of tax payers in the case of East Wollega Zone.

### **Research Design and Methodology**

This study was used descriptive types of research which used to identify and obtain information related to features of research problem. The basis for selecting this type of research method is that the study has no control on the variables, rather it describes the characteristic of the Eastern Wollega Revenue Authority Office Value Added Tax administrative activities and to answer the question what is the best way to administer the Value Added Tax in order to assess and collect the potential revenue from the Zone. This study was conducted in East Wollega Zone capital Town, Nekemte, which is located in western direction at 331 kilometers away from the capital city of Addis Ababa.

This study was conducted in East Wollega Zone Revenue Authority to investigate Problems associated with the administration of Value Added Tax. Hence, materials were useful to get full information and to collect raw data. Related to this the main sources of data used in collecting the data were both primary and secondary data sources. To investigate the primary sources, questionnaires were used as appropriate tools to gather relevant information for the problem under study. On the other hand, in the secondary data was collected from official documents of the organization and records about current Value Added Tax administration system and from Organization Authority Office and different statistical bulletins and websites has referred. Generally, secondary data have the following advantages for the study. The collection of these secondary data will save time and money it contains the most reliable quantitative data.

The total population of the tax payers is the registration list of Value added Tax registrants in East Wollega Zone totaling 631. Whereas, for the tax officials, employees of Revenue Authority office of the Zone

totaling 30 was the sampling frame. Hence, the total population of the study is equal to the sum of Value Added Tax registered in the Zone and tax officials of the Authority Office. This is equal to 661.

From the total population of the Value Added Tax registrant taxpayers and the Employees of the tax officials the researcher selected 60 respondents (50 and 11 respondents from both respectively), from the above respondents 42 of Value Added Tax registrant taxpayers were returned representing 84%, and from 11 questionnaires distributed to tax officials, all 11 respondents were returned representing 100 percent. For the selection of Value Added Tax registrant's taxpayers, simple random sampling techniques were used. The purpose of using this sampling method was each element of the respondents is equal chance and the sample can be independence, generalized and known population. For the selection of employees of the Authority Office, judgmental sampling method was used. The purpose of this sampling technique used here is to address experts in the area who are familiar with the work and based on knowledge and position their works.

The following formula is used for the purpose of determining sample size of the Value Added Tax registrants.

$$n = \frac{(t^2)(p)(1-p)}{m^2}$$

Here that, n = required sample size, t = confidence level at 95% (standard value of 1.96 )  
 p =sample proportion, m =margin of error at 5% (standard value of 0.05)

$$\Rightarrow n = \frac{(1.96)(0.36)(1 - 0.36)}{(0.05^2)} = 50.$$

**Table 1.Used sampling method for Value Added Tax registrants**

No.	Types of respondents	Number of Value Added Tax registrants	Sample size	$N_1 = \frac{n(N_1)}{N}$
1	Value Added Tax Registrants	631		$N_1 = \frac{50(631)}{631} = 50$
2	Tax office	30		11
	Total	661		61

This study was conducted using both primary and secondary source of data to get information. The primary data obtained from two different population by stratified them based on basic features; such as: From Value Added Tax Registrants taxpayers Organization and From Tax Experts and administers by using deferent mechanisms, in order to obtain information from the above population that has been mentioned in the above sentence, the researcher used structure questionnaire to gather primary information. Questionnaire has been administered open ended and close ended types of questionnaires. Whereas, the secondary data obtained from East Wollega Zone Revenue Authority office. For collecting the data suitable techniques were used depending up on the nature of data. The primary data was collected by using closed and open- ended questioner to be distributed to a 50 respondents of VAT registrants and 11 Tax officials of East Wollega Zone Revenue Authority Office. The researcher took from a total of 30 employees target population by a system of judgmental sampling.

The data gathering tools were used questionnaire and certain written documents. This structured questionnaire was prepared for use in the survey based on literature review and objectives of the study. A 61 set of questionnaires distributed to the respondents 53 were Valid. To ensure all respondents can understand and answer the question in required manner the researcher was translated questionnaires from English to Afan Oromo languages. Having the goal this study in mind a data was processed by tabulating that identifying and classifying each answer which statistic by the researcher. The data analyzed and interpreted the finding by descriptive statistics method with table, charts, and figure and percentage by computer using (Statistical Package for Social Sciences) SPSS software. It is used to minimize errors that will occur during data processing and analysis by manual computations.

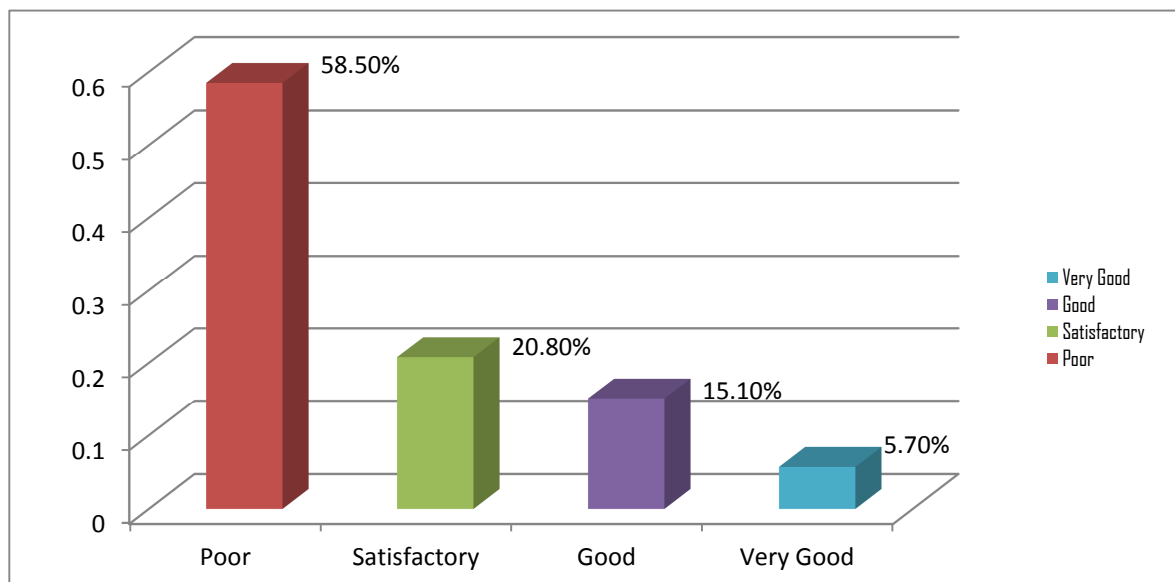
The used questionnaire was divided into three sections. Accordingly the first section focused on the demographic profile of respondents which include gender, age, formal education, marital status, business type, experiences of respondents on this business type, position and duration of tax officials of the authority. While the second section of questionnaire was given respondents to grasp their knowledge concerning with Value Added Tax administration. Whereas the third section of questionnaire asked respondents based on the Attitude related to Value Added Tax administration.

### Result and Discussion

The field survey result indicates that from 50 questionnaires distributed to Value Added Tax registrants taxpayers in East Wollega Zone, 42 were returned representing 84%, and from 11 questionnaires distributed to tax officials in the East Wollega Zone Revenue Authority Office all 11 respondents were returned representing 100 percent. From the total sample of 50 and 11 from Value Added Tax registered taxpayers and employees of East Wollega Revenue Authority Office respectively, 42 (84%) responses were gathered from VAT registered taxpayers and 11 (100%) from employees of East Wollega Revenue Authority Office.

One of the very important to evaluate the effectiveness of the office in Value Added Tax administration and also to understand the thought of taxpayers towards Value Added Tax is the response of tax officials of the Zone. The result of the study shows that 36.4% of the respondent's position or tax officials were composed of auditors, and also 36.4% of respondents from Tax collectors, 18.2% from Audit and assessments position, and 9.1% from Process Owners /Team leaders. The researchers asked the Value Added Tax registered taxpayers how they did get information to know Value Added Tax, 45.2% of the respondents obtained much information about Value Added Tax from the media followed by those who attend Radio; About 40.5% of the respondents obtained information about Value Added Tax from Television. About 9.5% of the respondents obtained information about Value Added Tax from Training and 4.8% from friends. This indicates that knowledge of Value Added Tax has widely used of public mass media. From the Figure below 1, 5.7 percent of the respondents revealed that there is very good Value Added Tax implementation in East Wollega Zone, 58.5 percent of them are responded there is poor Value Added Tax implementation, 20.8 percent of them are answered as Value Added Tax implementation of the Zone is satisfactory and the rest of 15.1 percent of the respondents there is Good Value Added Tax implementation in the Zone. Majority of the respondents agree on that the implementation of VAT in East Wollega Zone is Poor.

Figure 1: How do you evaluate Implementation of VAT in East Wollega Zone?

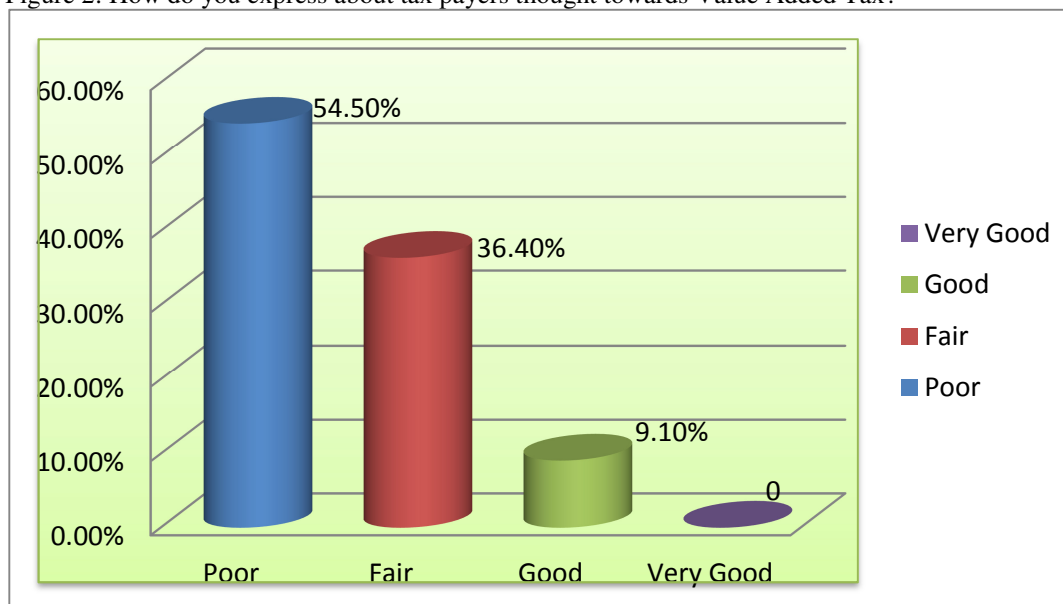


Sources: Primary data 2014

The respondents answer for the question how the office overcome that the problem related to clarity and loyalty of Value Added Tax registrants. Majority of the respondents (81.8 percent) respondents of tax officials said that, there are many Value Added Tax collectors those are not sell goods and service with tax invoice. Because, they have no knowledge (skill) for why they collect that from the Value Added Tax payers. Also according to the respondent idea majority of Value Added Tax Registrants have no accountants from their

business. Due to this they fear using of invoice; this indicates that Value Added Tax collector's taxpayers have lack of awareness. The mechanism that tax officials using to bring to legal Value Added Tax collection by try to educating them, By door to door inspection and auditing, by using monitoring and supervising those Value Added Tax collectors which they use sell goods and service without tax invoice and manipulate cash tape machine to providing guidance and penalty law. 1 respondent revealed his idea as in the year of 2012/13 seven of Value Added Tax registrants are provided penalty because of not using cash tape machine.

Figure 2: How do you express about tax payers thought towards Value Added Tax?



Sources: secondary data 2014

## Conclusion

The general conclusion drawn from the study with particular and the research questionnaire included the following. So that now a day's Laws and procedures of Value Added Tax collection and audit manuals are prepared and bring in to use in East Wollega Zone Revenue Authority Office. Depending up on the above idea, East Wollega Zone Revenue Authority would perform many activities to improve services delivery and the potential of revenue on Value Added Tax administration the Authority try to strongly use of computerized tax and customs system (Standard Integrated Governmental Tax Administration System and Taxpayer Identification Number).

Based on the results of the findings, in Value Added Tax administration there are many challenges have and Value Added Tax was successfully introduced in East Wollega Zone due to adequate preparations. In general East Wollega Zone Revenue Authority still faced under the following challenges in administration of Value Added Tax. Such challenges include: Resistance against Value Added Tax registration, Low level of tax awareness, weak audit and enforcement capacity of the tax authority, sell goods and service without tax invoice Value Added Tax collectors, Tax laws enforcement problems, are the challenges which affect the collecting sufficient revenue in terms of Tax collected from Value Added Tax of East Wollega Zone. Based on the results of the findings, the main problem of Value Added Tax implementation practice in East Wollega Zone are: lack of tax payers awareness, Lack of selling goods and services without tax invoice or lack of use proper Value Added Tax invoices, weak culture of taxpayers, and lack of fairness, lack of experience of Value Added Tax registrants, weak follow-ups and controlling mechanisms against those unregistered and registered Value Added Tax payers. The major mechanism which the authority office supervising and monitoring is those whether unregistered and registered of Value Added Tax taxpayers was door to door inspection. This Method is one of the most authority office mechanisms of monitoring and supervising locking the Value Added Tax registered and try to search unregistered to registering for Value Added Tax.

The other finding is that the factors that hinder the taxpayers not to be registered voluntarily to collect Value Added Tax are due to fear of competition from unregistered similar firms and due to weak Value Added

Tax administration. From the result show Value Added Tax assessment and collection; the collection performance of Value Added Tax, in the last of five years (2008/9 to 2012/13) East Wollega Revenue Authority Office has performed more than 100% of its plan this is also one of the prospects of Value Added Tax administration of the Zone. But this does not mean it is effective because, as it is discussed here under, many potential taxpayers are not registered for Value Added Tax rather the Zone was planning under its potential.

The findings of the analyses suggested that from the idea of respondents, the following are the strength of Value Added Tax administration of East Wollega Zone Revenue Authority according to the given possibility. Which is open and clarity of human resources Tax officials, preparation of Simple Value Added Tax registration procedure, preparation of Facilities from tax office for their customers. According to the responses of the respondents depend up on the given possibility the following are the weakness of the Authority office. They include: Lack of strong and follow up for non complaints, lack of human resources specially Value Added Tax auditors, lack of taxpayers awareness, In some lack of fairness, lack of Imposing penalty, lack of education and assistance for taxpayers , lack of qualification of tax office, fair and square appeal system, fair taxation mechanism, and good awareness creation for Value Added Tax collectors and conducted comprehensive trainings on the Value Added Tax law, regulation, directives and administration techniques for tax officers are also poor.

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