

Study of the vat system in ethiopia finance essay



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Government collects revenue from different types of sources to invest for public services like education, health, road and infrastructure distributes equally to the public. This revenue will be the one in which it levies from different income is called a tax.

A tax is a blood vessel of a country for development, most of developed countries their tax harmonies are very attractive and strong, the people are well known about the tax what and why you are pay, if you are not pay you accept like you didn't accomplished your duty even your right. How ever in most Sahara counties like Ethiopia the people do not well understand about the necessity of the tax what and why you are pay, that's why the fraudulent and smugglers would be many and high developing country.

Hence the problem of tax collection and assessment in Ethiopia is the gap between the taxpayers willingness to pay tax is as a major with different implementation and other problems by the tax collectors. In general in Ethiopia, where the awareness of taxpayers, the culture of paying taxes and the capacity of tax administrators appear poor.

The tax system should be balance the economic activity and expected the people on the ability to pay a tax in proportion to their level of income.

From the broad concepts of taxation the tax should be divided in to two major groups.

These are direct and indirect tax, from these indirect tax the one in which highly

Comprehensive that includes producers, wholesalers and retailers is the value added

Tax (VAT).

The value added tax (VAT) is a new tax system introduced in Ethiopia since 2003 as a

Replacement to sales tax. This tax collects from domestic transaction and importation of

goods. Where this tax is replaced the sales tax the assumption was the sales tax does not collect on added value, the value added tax minimizes the damage that may be caused by attempts to avoid and evade the tax and helps to ascertain the profit obtained by the tax payers and the tax initiates saving and investment because the tax is levied on consumable goods and services and does not tax capital and enhance economic growth and improves the ratio relationship between gross domestic product and government revenue. And has a proclamation, cites as a proclamation No. 285/2002.

This paper will state the current main issues of VAT administration like organizational structure, staffing and training, Tax Payers Identification and Automation, invoicing and book keeping Requirements, controlling of filing and payment, Audit of VAT, Refunds management, penalties and cost of administration and compliances with its strength and weakness in Ethiopia's as follows

2. OBJECTIVE OF THE STUDY

How it works the Administration and compliance of VAT system in Ethiopia with its positive and negative during implementation of the current system and explains what compliance risks there are and why and how the risks occur over all those problems will be discussed and further the solutions shall be recommended in the report of study.

3. METHODOLOGY OF THE STUDY

The study is gathered from different secondary data of annual reports and from assessment of different researches of administration of VAT system In Ethiopia by different Authors.

4. SCOPE OF THE STUDY

The study is limited on the current of VAT administration in Ethiopian and compliance risks

With its strength and weakness in which applies will be generalized.

5. DEFINITIONS A value added tax is a modern tax system and broad based . It replaces the sales tax, have two rates 15% and 0% with exemptions of the tax. The threshold is based on the annual sales of goods and services above 500, 000 Ethiopia birr. Have two types of registration that is obligatory and voluntary registration, the voluntary registrants are registered when 75% their sales are supplied for VAT registered. The reports are monthly which provides in the declaration format whether it credit or nil.

Any taxpayers who are not registered for VAT automatically payable to turn over tax (TOT). The exemption in VAT also applies in TOT.

6 . ANALYSIS (MAIN BODY)

Value added tax in Ethiopia introduced in the year 2003 cited as proclamation No. 285/2002 which replaces the sales tax with the assumptions mentioned in the introduction part. The current Ethiopia Revenue and Customs Authority (ERCA) was Federal Inland Revenue Authority (FIRA) before 2008. During the period of FIRA the VAT was introduced and implemented in our country and still exercises after merging of FIRA and Customs Authority.

The administration of VAT includes organizational structure, staffing and training, Tax Payers Identification and Automation, invoicing and book keeping Requirements, controlling of filing and payment, Audit of VAT, Refunds management, penalties and cost of administration all these activities are pertinent to how they apply and affect the government revenue and strategy properly will be described as follows:

6.1 Organizational structure, staffing and training

Ethiopia Revenue Authority should be taken an organizational structure for VAT to be implemented through the branches of the Authority and the staff recruited and trained during the preparation of the VAT introduced. Hence due to the complication of the system in the Ethiopia case a special VAT unit in FIRA was set up.

Along this line, there were efforts to design the organization structure and to determine the number of staff to be trained and deployed. Some have been taken from the ex-sales tax unit, some have gone from the tax reform program and the Ministry of Revenue and some have been newly recruited.

At present, the newly introduced Value Added Tax is administered by a newly established department located at the Mexico square and some branches in the country and by the Ethiopian Revenue and customs Authority. The new department in ERCA is answerable to the General Manager. The staffs are graduates of accounting, economics and the management profession.

The organo-gram and staff assignment is depicted in the following diagram.

General Manager

ERCA

Tax Payers registration and Education Division (7)

VAT DEPARTMENT Head (5)

VAT Administration

(2)

Revenue Collection and Enforcement

Assessment and Audit Division

Revenue Accounts and Consolidation

Diagram 1:- Organo- gram of the VAT Department

By: – Arega Hailu Teffera June/2004

Even though, the VAT is computerized, considering the current and future challenges, the VAT department requires additional personnel in all areas- taxpayer education and service, accounting and collection, enforcement and audit. Efforts currently underway within the Ministry and ERCA to strengthen the VAT administration, to improve service delivery, training of staff should <https://assignbuster.com/study-of-the-vat-system-in-ethiopia-finance-essay/>

continue to address the shortfall encountered. Specially, the administration should focus in strengthening its audit and enforcement wings.

6. 2 Tax Payers Identification and Automation

Taxpayer Identification Number (TIN) and VAT SIGTAS were implemented during 2000-2003. These systems have been operational by the FIRA and regional states and city administrations revenue authorities through country-wide network

As earlier described the system introduced during Federal In land Revenue Authority where it is Ethiopian Revenue and Customs Authority (ERCA). The system is an important for efficient and effective tax and customs administration. Any taxpayer has only one identification number; this will be used for VAT purpose, for with holding tax, for property tax e. t. c. In our country case taxpayers couldn't used different identification number. Except

The trade license number issued by Ministry of Trade and Industry

Automation of VAT administration commenced with a simple software developed by a local IT firm. In an attempt to deploy better software that integrates the different functions and processes of VAT administration, the government entered an agreement with a Canadian firm known as CRC-SOGEMA in April 2003. The software development project, VAT SIGTAS, was finalized and made operational at the VAT Department during February 2004. Later on, the new software rolled out to the regional branches of the ERCA. It was also made operational in four regional states and two city administration revenue authorities following the delegation of VAT administration.

Large taxpayers, started applying VAT SIGTAS in October 2005 upon the decision of the tax authority to administer all taxes of large taxpayers under one office. Previously the large taxpayers used to settle their VAT obligations at the VAT Department.

The proper implementation of SIGTAS all taxes would help realize the following anticipated benefits of the project:

increased revenues and enhanced control,

better service to taxpayers,

standardize practices throughout operational departments,

reduction of non-value adding activities,

real-time management (reminders, remittances, etc.), and

Integrated management of all taxes (especially for audit).

The regional and city administration tax offices are also using the new system for their VAT operations with the previous VAT functionalities provided unchanged. Efforts are underway to deploy SIGTAS all taxes, with certain modifications, in all regional states and city administrations. The CRC-SOGEMA has already conducted requirements study.

6. 3 invoicing and book keeping Requirements

Is a very important for issuance of invoices during transaction of VAT system these invoices are printed by registered printing press after getting approval

from ERCA. The invoices are separately printed for taxable and exempted transactions.

In addition to the printing of invoice recording are mandatory for every VAT registered and required separate of taxable invoice and exempted. The VAT proclamation stipulates that VAT registrants should keep records of account for at least 10 years.

However, due to lack of tax administrators' follow-up and control, lack of awareness among the society and the prevalence of poverty. these rules are not applied perfectly as to the law required many problems faced with getting invoices, using duplicated invoices, lack of consistency in using invoice, most business holds two books ; one for tax Authority and for Banks . usually the understated income holds book for tax Authority and the over stated book would be for Banks, Do not use invoices approved by the Authority, dealing with buyer to issue the lower price in the invoice , also issue fraudulent invoices using invented VAT numbers of their own and collect VAT for their own e. t. c. These will be paralyzing the function of revenue as a whole. In order to solve this problem of invoicing the ERCA gets the expiriance from Latine America to be used the electronical cash registered at retailer on a net work with the SIGTAS.

6. 4 controlling of filing and payment

According to proclamation No. 285, Article 26/1, every registerd person is required to file VAT return with ERCA for each accounting period and to pay the tax for accounting period by the deadline for filling the VAT return.

Article 26/2 , the VAT return for every accounting period shall be filled no

later than the last day of the calendar month following the accounting period, where as VAT on taxable imports is collected at Customs and made by C. P. O automatically. The VAT liability is computed based on the invoice credit method in that the registered person will remit the difference between VAT received and VAT paid during transactions conducted during the accounting period.

ERCA made a controlling and filing of VAT using computerized system to administer VAT properly 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. The 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,

6. 5, Audit of VAT

Auditing is a basic measuring of for effective tax collection, Audit of VAT in our country was very complicated before the introduction of computerized the tax system, due to different fraudulent of using invoice as mentioned in the above invoicing and book keeping requirements. However, the audit case

by the audit selection committee. The selection criteria include; credit declaration, nil VAT declaration, non – filers, unusual VAT filing and information obtained from third parties and customs declaracion. Based on the above selected criteria would be subject to audit. Most of VAT registrant provides monthly report as credit or nil. This is the effect of tax evasion by the taxpayers. All these problems affect the potential of revenue this would be due to lack of taxpayers awareness, human resources auditor in particular, the number of VAT registrant compare to auditors or the employees in tax authority is very low they cannot cover by the actual current employees in the ERCA.

6. 6 Refunds Management

The VAT proclamation No. 285/2002 Article 27/1 stated that at least 25% of the value of a a registered person’s taxable transaction for the accounting period is taxed at zero rate, the ERCA shall refund the amount of the VAT applied as a credit in excess of the amount of VAT charged for the accounting period within two months after the registered person files an application for refund, accompanied by documentary proof of payment of the excess amount. The second Article 27/2 relates to unused excess credit. For non-zero rated transactions, the amount of VAT applied as a credit in excess of the amount charged for the accounting period is to be carried forward to the next five accounting periods and credit against payments for these periods. The registered person can claim refund if it has still unused excess credit at the end of the five month period. Refund claims are subject to checks and audit by the tax authority. In view of promoting export supplies,

the tax authority effects VAT refund for exporters in 15 days after checking and verifying the documents presented to it.

6. 7. Penalties

Taxpayers that are not compliant to the VAT law are subject to administrative criminal penalties. According to the VAT proclamation, articles 45-47 administrative penalties are imposed while persons are not registered for VAT where registration is required, when any registered person issued incorrect tax invoices, where invoices are issued without being registered, where there is underpayment and late filing of returns. Administrative fines range from a fine 100 percent of the amount of tax payable and a fine of up to 50, 000 Birr.

According to articles 48-59 criminal offences are liable to prosecution. A tax offence is a violation of the criminal law of the country and thus is subject to criminal charge and prosecution. Tax evasion, obstruction of tax administration, failure to notify changes in business address and business line, unauthorized VAT collection, improper tax debit and credit notes, aiding or abetting, offence by entities, offence by tax officers, offence by receivers are liable on conviction to monetary fine of Birr 1000- 200, 000 and imprisonment of not less than 1 year to not more than 15 years depending on the gravity of the offence.

6. 8. Cost of Administration

In the case of Ethiopia the cost of VAT administration must be proportional with professional standards of like developing countries. The researches indicate in most developing countries cost of administration estimates the

range between 1 & 2% of collection. Actually low collection may not reflect efficiency but rather indicate unused of resources may occurred.

In our country the administration costs are: salaries and wages and top-ups to staff deployed to VAT department, the cost of fixed assets and consumables including telephones, faxes, internet, electricity and power, fuel and lubricants etc.... Since customs collects duties and taxes in a single administrative document, i. e. the customs declaration, it is very difficult to apportion the cost of administration for VAT all these costs are the total consumable of ERCA's administration cost for VAT (the above costs are only for VAT actually expend).

Therefore when take 2003 & 2004 FIRA & Customs report the total cost of administration for VAT was 9, 718, 848 birr and total collection of VAT during the year would be 5, 234, 730, 000 birr, so total administration cost was 0.00186 this is under the standard from the point of professional standards sited. (I think this information is too late, but it can see or indicate the current performance, how ever now a day there are a lot changes to use resources effectively like the deployment of automation, recruitment of employees by allocate more budget how ever, it is not researched, but still it has a limitation)

(Source: FIRA and Customs- Administration and Finance, Budget for 2003/2004 fiscal year.)

Tax Payers Compliance

From any taxpayer that expected they must comply with the laws and regulations of tax and customs duty. How ever as an employee of tax and

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customs authority the real situation of the taxpayers behavior is not what we are expected them. They are not complying with the tax and customs law. For instance with the fulfillment of the VAT registration requirement, timely reporting with the actual transaction they did, using authorized VAT collection, making true financial statement for tax purpose, providing the correct VAT invoice for any client e. t. c. consider the above issues; most of our taxpayers are not compliance. This would be faced in daily activity during tax and customs assessment and collection. Even there is a positive improvement to comply with law in changing the taxpayers' attitude through different way of awareness creation.

Strength on VAT administration

When ever the VAT administration in Ethiopia has a problem, but there are positive actions are taken off by the Authority to facilitate the tax and customs servies with strong enforcement for non compliance taxpayers.

Basically the Authority pursued the reform program in order to achieve the main objectives that are tax policy and administration reform, and customs reform and modernization. From the reforms the tax policy and administration reform have a result during the implementation would be :

income tax law that was in force for more than 40 years was replaced in July 2002;

VAT was introduced on January 1, 2003 to replace sales tax.

Turnover tax was introduced on January 1, 2003 to apply to those taxpayers whose annual turnover is below VAT threshold.

Excise tax was rationalized to more accurately reflect the current market situation.

National implementation of the TIN network through the installation of communication equipment at FIRA, and City and Regional administrations sites. And taxpayers were registered for TIN.

The replacement of the estimated assessment method with the more standard assessment method in order to achieve equity and administrative efficiency in connection with presumptive taxation.

Tax collection and audit manuals prepared and put in use.

Large Taxpayers Office and VAT Department established.

Operational departments are automated as part of the modernization of the FIRA. TIN system interface with the Ethiopian Customs Authority is operational.(before merging the two Authority)

Using this in mind the strength way of FIRA, currently ERCA would be perform many activities to improve services delivery and the potential of revenue on VAT administration. Thus are;

The reform introduced during FIRA would take as a base to perform effectively and introduced BPR.

Make extensive consultation with stake holders, comprehensive taxpayer's education program and aggressive advertisement campaign.

strongly used of computerized tax and customs system (SIGTAS, TIN, ASYCUDA ++)

Create positive attitude for the tax collector with good payments.

Conducted comprehensive trainings on the VAT law, regulation, directives and administration techniques for tax officers drawn from different area of the country.

Create strong enforcement unit on VAT

7. Measures were taken to enforce registration: for non compliant

8 Administrative and criminal cases are strongly followed-up

9. Strongly applied deterrent provisions: penalties and prosecution e. t. c, thus would be

Taken to improve performance of VAT administration.

9. Basic Weakness

1. Lack of strong and follow up for non complaints

2. Lack of human resources specially VAT auditors

3. Lack of taxpayers awareness.

4. In some lack of ethics .

Although VAT was successfully introduced in Ethiopia due to adequate preparations, different challenges have been faced in implementation as I

have stated in VAT administration. In general ERCA faced the following challenges in VAT administration still-

Resistance against VAT registration,

Failure to register due to the prevalence of large informal sector,

Low level of tax awareness,

Suppression of taxable sales,

Failure to issue invoices during transaction,

Negotiate with customers during transaction to account VAT or not,

Print and use of identical invoices, one registered by the FIRA and the other not,

Issuance of fictitious invoices among related persons without actual transaction to overstate input VAT and claim refund,

Prevalence of significant number of constant credit filers, nil-filers and non-filers,

Non-remittance of VAT collected,

Prevalence of missing traders,

poor audit and enforcement capacity of the tax authority, and

Mal-practices in the administration aspect.

Recommendations

From the above study I recommended as following:

Recruit quality and quantity of human resource to be deployed and Training and development for staffs who will join and who have already joined.

All liable businesses registered for VAT in all sectors of the economy must be registered and it needs strong and practical monitoring and controlling system. that fall within the threshold should be identified and an action to be compliant..

Must be apply frequent audit system , donot delay the auditing.

Due to lack of auditor, the auditors must selective based on the size of the business with return of tax from these.

Make consistent tax educations for taxpayers in each tax Authority to create awareness.

Create ethical tax servants e. t. c

All the basic challenges that mentioned must be change and improve with substantial monitoring and controlling effort.

Conclusions

Ethiopian Government committed to improve the tax harmony in each stage of the tax authority by allocating resources with the efforts of ERCA. The effort which applied is the introduction of tax reform in Ethiopia. The Government introduced the VAT since 2003, mainly to broaden the tax base, and to compensate for revenue loss as a result of duty reduction at customs, <https://assignbuster.com/study-of-the-vat-system-in-ethiopia-finance-essay/>

to reduce distortions by other indirect taxes, and to encourage trade and investment.

With the challenges that already stated, the performance of tax from VAT would be increase. For the increasing of VAT collection the introduction of IT has great role. The implementation of SIGTAS increases revenue collection, Real-time Management of Non-compliers, Facilitation of Assessments and Reassessments, Prompt Calculation of Penalty and Interest, Provision of Better Service to Taxpayers, these are facilitated the collection of VAT progressively.

Appreciating the role of IT in VAT administration, during FIRA decided to automate the administration of all taxes in an integrated manner. Thus, the functionalities of VAT SIGTAS were extended to embrace the other taxes and ERCA would be catch-up the system and implemented successfully. SIGTAS all taxes was tested at the Large Taxpayers Office in August 2006. Currently, all tax centers of the FIRA are using SIGTAS all taxes software.

The application of SIGTAS has been instrumental in improving the efficiency and effectiveness of the tax administration. And Extensive consultation with stakeholders, comprehensive taxpayer education programmed, aggressive advertisement campaign and an intense registration drive did help the tax authority.

Over all the experience of Ethiopia in automating tax administration, including VAT, shows that success in IT implementation is mainly dependent upon: aggressive implementation as per schedule, strict control over procedural issues, active action in case of peculiarities, monitoring and

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feedback, continuous manpower development, timely provision of hardware and supporting services, and proactive and genuine participation of every member of the tax authority.