

**ASSESSMENT OF VALUE-ADDED TAX ADMINISTRATION IN YIRGALEM TOWN  
REVENUE AUTHORITY**



**COLLEGE OF BUSINESS AND ECONOMICS**

**DEPARTMENT OF ACCOUNTING AND FINANCE**

**A RESEARCH PAPER SUBMITTED TO DEPARTMENT OF ACCOUNTING AND  
FINANCE IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE  
BACHELOR OF ARTS(BA) DEGREE IN ACCOUNTING AND FINANCE.**

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**APRIL,2025**

**WOLKITE, ETHIOPIA**

## **.ACKNOWLEDGEMENT**

First of all my deepest thanks goes to the almighty of God for let me to stay in life to this day and enables me to complete my academic life. I also would like to express my deepest gratitude to my advisor Mitku M (asst.prof.) for her enthusiastic support from the preparation until the final discussion of this paper with frequent follow up with receiving in detail, main body of the paper and forwarding constrictive suggestion. I would like to thank the all administrative staffs of revenue office authority in yirgalem town for giving me all the necessary data and information through filling the interviews. I also thank my family for giving me a lot of encouragement, support and love throughout my study to earn the first degree. I owe them a lot. Last but not least, I would like to extend gratitude to all my friends, colleagues and my beloved family who have supported and motivated me to come this far. My sincere thanks and appreciation goes to you all.

## **Abstract**

The development of accounting depends up on the nature of tax reform tax differ from other source of revenue in that they are compulsory levies are unrequited, that they are not paid in exchange for some specific things such as sales of public property most of European and artisan countries implemented VAT early and produced good results. In Ethiopian the implementation is too late. The study is designed to asses problems and suggestion VAT practice in yirgalem Town . The problem would identified from tax pars and tax administers side. For the purpose of this study, primary data would be used to collect through questionnaires. After the data collection the researcher analyzed and interpretation the data using percentages and table

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# CHAPTER ONE

## 1. INTRODUCTION

### 1.1 Background of the Study

Value Added Tax (VAT) as a tax on consumption on goods and services that is a shift away from the conventional sales taxes insofar as it taxes the net value added at all points of distribution and production instead of gross receipts. VAT was originally launched in France in 1954 and subsequently introduced into widespread use in Latin America, Asia, Africa, and the Pacific due to its efficiency in collecting revenues and its ability to remove the cascading impact of taxation. Unlike sales taxes, which are taxed at the final point of sale, VAT is taxed in stages at every step of the production chain so that only the value added by businesses is taxed. It is an open system that does not allow tax evasion and thus the preference of most governments who want to modernize their tax systems. The Ethiopian government had introduced VAT under a broader tax reform program for enhanced revenue mobilization as well as anti-fiscal fraud measures.

Before its launch, the government had set up a new Ministry of Revenue for the provision of smooth transition and effective administration of the taxation system. VAT was a better alternative to the existing sales tax as it is a tax on consumption, not on production, and thus encourages savings and investment. The reform followed consultation with both international and domestic experts and was informed by an international best practice standard of taxation. The VAT represented a revolutionary reform in the fiscal policy of Ethiopia, bringing it in line with international practice and closing loopholes in the erstwhile tax system. The most important aspect of VAT in Ethiopia is that it applies to businesses with turnover of 500,000 birr and above annually, a threshold designed to bring large businesses under coverage while maintaining the cost low for small businesses. A uniform rate of VAT at 15% was set which was competitively low compared to current rates in other developing countries.

In addition, businesses with turnover below the threshold level could also register for VAT voluntarily if 75% of their sales were to registered persons, a provision which tried to bring smaller firms into the tax net. Flexibility was designed to spur compliance at the same time reducing administrative costs to small business operators. The paper cites the case of VAT introduction in Ethiopia as having the ability to broaden the tax base, enhance revenue certainty,

and reduce over-dependence on revenue sources that have inherent volatility. VAT taxes expenditure instead of imposing taxes on profits or income, hence being less economically distortive in nature.

The system also has input tax credits provision, whereby firms can recover tax paid on inputs against their VAT liability to eliminate double taxation and enhance export competitiveness.

These reforms were approximated to provide a more business-friendly environment and stimulate investment, which would ignite economic growth in the long run. Nonetheless, the late introduction of VAT in Ethiopia relative to other nations posed challenges of public education and administrative preparedness. The majority of the businesses, particularly small and informal ones, were unaware of the new regime and thus offered resistance and evasion. The report emphasizes the need for taxpayer education and effective enforcement tools for successful implementation of VAT. Without effective support, the benefits of VAT in the form of increased revenue yield and fewer evasions can be offset by low compliance and inefficiency in administration. Background to the study gives justification for research on VAT administration in Yirgalem Town and challenges faced by taxpayers as well as by the tax authority. Through assessment of such challenges, the study aims at revealing areas of gaps in terms of awareness, enforcement, and infrastructure that do not support effective application of VAT. Implications are likely to offer directions towards feasible compliance, extending taxpayers' takeup, and the general taxation process in Ethiopia. This is within the larger perspective of the general objective of ensuring VAT achieves its potential as a secure and fair source of government revenues

## **1.2 Statement of the problem**

The problem statement identifies the issues in the implementation of VAT in Yirgalem Town, citing the differing views of taxpayers and tax authorities. As a multi-stage consumption tax, VAT is meant to be levied on the value added at each production and distribution stage, thereby apparently distributing the tax burden more equitably. But under actual operations, VAT is viewed by businesses as a factor that increases their prices, thereby making their products less competitive in the marketplace. This is why most businesses have opted not to register, hence weakening the effectiveness of the tax system and resulting in a disparity between policy intention and actual practice. The root problem from the taxpayers' point of view is the perception that VAT increases costs to final consumers, thereby diminishing demand for their goods and services.

Many businesses, especially small businesses, do not sign up for VAT in order to charge lower prices and avoid administrative expenses. Non-compliance results in an uneven playing field, in which registered businesses are unfairly competed with by unregistered businesses. Complexity in VAT computation as well as bookkeeping obligations also dissuades participation, particularly on the part of businesses with weak accounting competencies. These are due to insufficient knowledge about the long-run benefits of VAT, such as input tax credits and formalization advantages. Alternatively, tax authorities face significant hurdles in enforcing VAT compliance due to weak monitoring systems and inconsistent application of the regulations.

The revenue authority is unable to identify and penalize non-compliant firms, leading to enormous tax evasion and revenue loss.

In addition, the absence of coordination between taxpayers and tax administrators heightens mutual suspicion, as both parties hold each other responsible for the failure in the system. For example, taxpayers blame administrators for discretionary enforcement, whereas administrators accuse businesses of intentional non-compliance. Such a confrontational relationship undermines efficient application of VAT and restricts its potential in contributing to national development. The underlying problem therefore is the discrepancy between the theoretical design of VAT and its practical application. While the tax is theoretically efficient and equitable, its success depends on the co-operative comprehension and adherence of taxpayers and administrators. Solutions to these issues require targeted interventions, such as taxpayer education campaigns, simplified compliance procedures, and more effective enforcement.

By filling this gap, Yirgalem Town can enhance VAT uptake, increase revenue collection, and provide a more level playing field for all concerned.

### **1.3 Research Questions**

The study was attempt to seek answer for the following question.

1. Why business people perform activity with out being registration to VAT?
2. Does all tax payers have awareness regard to VAT?
3. What are the major weakness of tax administration?

4. What are the major factor that affect business people not registered VAT?

## **1.4 Objectives of the study**

### **1.4.1 General objectives**

To identify the major problem related to value added tax and its practice inyirgalem town

### **1.4.2 Specific objectives**

- To assess attitude of the tax payers to wards the tax policy
- To assess the awareness of tax administration toward tax policy
- To identify the major factors that affect business people to unregister to VAT
- To assess effect of VAT on accounting and record

## **1.5 Significance of the study**

The output of the study would useful for private and Government organization. The purpose of the study this research would significant be cause it was the major problems and solution of VAT practice.

By clearly under standing the main problems of VAT practice and to strength the relation with tax payers and tax administer and to avoid the compliance. By doing this it initiates the VAT payers to pay the VAT timely and properly. Value added tax will enhances saving and investment, as it is a consumption.

## **1.6 Scope of the study**

Major and particular emphases were given to Yirgalem town revenue agency, which is located in the south of Addis Ababa sidama Region state. Since the value added tax implication too vast and difficult to cover all of the area. The scope of the study on the value Added tax practice and its problem.

## **1.7 Organization of the paper**

The organizational of the study were cover five chapter one consist is:- Background of the study, statement of the problem, objective of the study, significance of the study scope of the study, organizational of the study and limitation of the study. The second chapter contain literature review .The third chapter methodology. The fourth chapter data analysis and interpretation and the final chapter five focused on summary, conclusion and recommendation.

## **1.8 Limitation**

**The major limitation were:-**

- Lack of awareness among the respondent about the tax system.
- Lack of sufficient secondary data.
- Most of the tax payers lack willingness to fill the questionnaires.

## CHAPTER TWO

### 2. Literature Review

#### 2.1 Definition

The introduction of value added tax (VAT) is probably the most important tax development in the world. VAT had been introduced for the first time almost 50 years ago, and its application remained confined to a handful of countries until the late 1900's, (Bhatian, 1996; P 145)

Value added tax (VAT) is a tax which is imposed on value which Traders add to their purchase of raw materials, goods and services. It is perhaps best described as the taxation of value added. The purchase of raw material, goods and services that are made by a trader for the purpose of his business are known as "input," with the ultimate sales to the third party customer made by the trader described as output. VAT liability is calculated on the difference between a trader's input tax (VAT that it pays on the acquisition of the raw material, goods and services required for the purpose of its business). And the output tax that it charges on making supplies of goods and services to its own customer, (Jonathan Ivanson, 2002, P. 180).

VAT is imposed by the government at each stage in the production of goods and services. The tax is paid by every company that handles a product during its transformation from raw materials to finished goods. The amount of the tax is determined by the amount of the value that a company adds to the materials and services it buys from other firms, (World Book, 2001, P., 267).

In 1954, France became the first nation to adopt the value added tax. Today, this tax is growing in popularity, and about 40 nations use it. It is not used by the United States on the federal level. But most of the other large industrial nations use it, (World Book, 2001, P., 257). Value added tax belongs to the family of sales taxes. It is helpful to distinguish between different forms of sales tax and note the place of VAT in them. A general sales tax is a tax on sales transactions but it is applied at only one stage of business activity right from the manufacturer to retail. Usually it is collected either at the wholesale level or a retail level. The trader is allotted sales tax numbers and a trader possessing such a number can purchase goods without paying the sales tax. The similarity of sales goods to the next buyer is that if the next buyer also happens to possess a sales tax number with the authorities (Bhatian, 2002, P., 146).

Depending on the tax base on which the value added tax is computed, value added tax can be classified in three consumption types: VAT, gross domestic product VAT and income style VAT. Under consumption, while the tax base of a gross domestic product VAT is goods and

service included in gross domestic product, which includes personal consumption capital goods, government purchases and net export under the income style VAT, the tax bases is determined as the net national income. Despite of their type of VAT, consumption type VAT is used in most nations, (Hyman, 2002, P., 2002).

VAT is a tax not on total value of the good being sold, But only on the value added to it by the last seller. The seller, therefore, is liable to pay a tax not on its gross value, but net value that is the gross value minus the value of inputs, (Bhatia,2002,146).

To determin the VAT liability of a tax payer one of the three alternative methods can be used under addition method, a tax payer calculates the value added by summing the value of the factors of production that uses in the production of taxable goods and services. Under the credit method (and also called invoice method however, the tax payers computers his/her tax liability from the VAT show in the invoice he/she receives on his/her issues on his/her taxable sale. invoice keep track of which credit firms are allowed. Firms subtract the VAT paid on the purchases (the credit) since it represents the tax liability in the previous stage of the production. The tax are therefore collected only on value added at each stages of production (Hyman, 2002, P., 702).

Theoretically the tax liability in the case of VAT and in the case of sales tax at the retail level shaulturn out to be the same. This is because the total retail price is nothing but the value added to be the raw material at different stages of production and trade. In case of VAT, the same value of created value is taxed in stages. The usual practice is to estimate the tax liability of the last seller on the bases of gross value of the produce and give him credit for the tax paid by the earlier seller. It must be noted that were the assumption is that final sale value aatetail represents the actual value added at different stages and that market fraction and other imperfection are not distorting the whole picture (Bhatian, 2002, P., 147).

## **2.2 Forms of VAT**

Like a sales tax, VAT can also be classified to have deferent forms, exemption and rates. In these connection, there are two important varieties of VAT, Viz- the consumption variety. The difference between these two varieties emerges from the treatment of capital depreciation. If firms allowed to deduct the entire credit as the equipment is purchase, the system is termed as a consumption VAT. If the firms is allowed to deduct the credit as the equipment is depreciates over the time the system is termed as an income VAT, (Bhatian, 2002, P., 148).

The second variety of consumption VAT in these case the firm in question is allowed to deduct from the gross value of the product not only the non capital purchased from other firms, but also the capital equipment so purchased. In the absence of foreign trade the aggregate base of this tax for the economy as whole becomes wage (w) plu profit (p) plus depreciation minus invest ment (I) there for, the aggregate tax base becomes GNP- I that is consumption in the economy (Bhatian, 2002, P., 149).

The third variety the one where the firm is able to deduct the net earnings from its capital in order to arrange tax base since earnings from its capital in order to tax base earnings from capital amount to profit plus interest. There balance left to be taxed equivalent to wages.

The fourth variety is where the firms is allowed to deduct the full valve of its non capital purchased from other firms and depreciation on the capital purchase from other firm for the country as the whole the aggregate tax base net notional product (NNP). This is called the income type value added tax, (Bhatia, 2002, P., 149).

### **2.3 Arguments toward VAT adoption**

There are several argument for or against the adoption of VAT in Ethiopia base on its strong and weak points (Hussein, 2003) some arguments are advanced for the adoption of VAT first, VAT has broad based, so it would provide with Higher and constant source of revenue for the government second, VAT promotes saving and investment. In consumption type VAT, the investment and saving are excluded for the tax base capital formation is promoted. Third, VAT would reduce tax evasion. The tax (VAT) system requires that tax invoice must be issued in transaction and that tax payers would keep invoice in order to benefit from tax deduction. Fourth VAT promotes or enhances export, because the input tax is allowed or refundable. Currently the tax payers claim on the tax administer and the tax administer also claims against them finally, it alloids cascading unlike excise or sale tax under the VAT system, each input is only taxed only (HYMAN, 2002, P160).

In contrast some arrangements are also for warded a gains the adoption of value added tax.

The first and main argument is that VAT is a regressive taxation. A reason should be taxed only according to his/her ability to pay, but it is incongruent with this principle because poor person pay higher percentage of their income for the level of consumption the have (Hussein, 2003).

A Number of country has however exempted basic necessities particularly food items from VAT in order to compensate for its regressive effect. In addition, the system of record keeping was

not ready to operate the VAT system. Therefore, the business and trader need time to develop the record keeping capacity at the applicable VAT rate on the difference between sales and allowable purchases according to proclamation no 285/2002 Art 21 Ethiopia uses the invoice method in practice, few countries such as Brazil and Bolivia use tax inclusive while most countries such as Kenya, Senegal, adopt tax exclusive rate the Ethiopia VAT rate 15% also single rated 15% and tax exclusive, (proc No 285/2002).

VAT 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. (Federal NegarotGazeta, 2002).

The law with regard to VAT requires the person to pay value added tax is a registered person who is registered or required to be registered a person who is registered is taxable as soon as registration for VAT takes place but a person who fails to adhere to registration requirement is considered to be taxable beginning from the start to the accounting period following the period the obligation for the registration arose, (Proc, No 285/2002).

## **2.4 Computation of VAT**

In modern taxation there are four types of value added taxation system there are:

- a. Gross product value added tax.
- b. Income type value added tax.
- c. Capital exemption type value added tax
- d. Consumption type value added tax (Gebrie, 2008, p. 188).

## **2.5 VAT Administration in Ethiopia**

The VAT replaced the current sales tax on manufactured and imported goods and services on January 1, 2003. The responsibility for the correct calculation and timely payment of VAT rests on the tax payer himself. The VAT is a broad based tax on the consumption of goods and services it is collected at all stages in the production and distribution process beginning with the importers and producers of raw materials and ending with the retailers cascading of the tax (i.e. tax on tax) is avoided by providing for a credit for the tax paid only to raw materials used directly in the production of goods under a VAT. Relief is granted for goods that are not subject to the VAT. Removing that tax content (on inputs) from exported goods makes the goods more competitive in international markets.

VAT is a customer expenditure it is collected on business transaction and important most business transactions involve of goods and services and VAT is payable if they are:

- Supplies made in Ethiopia
- Made by a taxable person
- Made in the course of furtherance of a business
- Are not specifically exempted or zero-rated supplies are outside the scope of the tax if they are
- Made by someone who is not a taxable person or
- Not made in the course or furtherance of business

Course or furtherance the way a taxable person has to carry out its activity to develop advance and progress the taxable activity. It refers to the normal and expected events or processes to develop the taxable activity. Anything done in connection with the commencement or termination of a taxable activity is treated as carried out in the course or furtherance of that taxable activity (Gebrie, 2008, p.191).

## **2.6 VAT Refund**

VAT registered person shall get refund if at least 25% of the value of a registered person in a single transaction of substantially all of the asset of a taxable activity provide a notice in writing signed by the transferee is finished with 21 days after the supply taken place is taxed at a zero rate the authority shall refund the amount of VAT applied as a credit in excess of the amount of VAT charged for the accounting period within a period of two months after the registered person files an application for refund accompanied by documentary proof of payment of the excess amounts.

In the case of other registered persons the amount of VAT charged for the accounting period is to be carried forward the next five accounting period is to be carried forward to the next five accounting periods and credited against payment for these period and any unused excess remaining after the end of this five month period shall be refunded by the authority with a period of two months after the registered person files an application for refund accompanied by documentary proof of payment of the excess amounts. Where the tax authority satisfied for refund application in over paid tax the tax authority shall.

- First apply the amount of the excess in reduction of any tax levy interest of penalty payable by the person under the customs proclamation the income tax proclamation and excise tax proclamation.
- The repay any amount remaining to the person amount to be refunded is more than 50 by.

When registered person is entitled to refund and the tax authority is satisfied but does not pay the refund within specified date the authority shall pay the person the refund plus interest set at 25% over and above the highest commercial lending interest rate that prevailed during the preceding quarter (Gebrie, 2008, p. 119).

## **2.7 Registration**

In Ethiopia, registration for VAT is categorized into two. It discussed as follow:

### **An Obligatory registration**

Any person conducting a commercial enterprise or intending to conduct a commercial enterprise may apply to be registered for VAT. However if the taxable turnover of the enterprise which is gross income for 12 calendar months exceeds or is likely to exceed birr 500.000 the person conducting the enterprise must register for VAT. Turn registration is compulsory (Gebrie, 2008, p. 201).

The term any person for purposes of VAT registration includes

- Sole profiteer
- Company
- Partnership
- Estate of deceased
- Trust
- Incorporated body or unincorporated body
- Club or association

A commercial enterprise refers to any business of whatever nature and includes:

- Ordinary business e.g. shop contractors manufacture wholesalers etc.
- Trades and professions e.g. Builders, Engineers, Accountants lawyers etc.
- Activities of non-profit making bodies e.g. societies, associations, sporting club, etc.

The turn is calculated on an ongoing basis two periods need to be considered the past 12 calendar months and the next 12 calendar month-by month basis. There is the need to estimate at the end

each trading calendar month the total value of taxable goods and services supplies by all the business for the past 12 months where the total exceeds birr 500.000 then there is the real nutriment to register for VAT.

### **2.7.1 Voluntary Registration**

A person who carried on taxable activity and is not required to be registered for VAT max voluntarily apply to the authority for such registration if he/she regularly is supplying or rendering least 75% of his goods and services to registered persons.

### **2.7.2 Benefits of voluntary registered**

Input VAT can be recovered if a person registered it will therefore be beneficial to voluntarily register where the person makes mainly zero rated supplies. In such a case input VAT will be recovered and on VAT will be charged on zero rated out puts (Gebrie, 2008, p.203).

### **2.7.3 Registration procedure**

Application for compulsory as well as voluntary registration must be made on application form called “application for VAT registration” on application for sale and the authority is required to register the person in the VAT register and issue a certificate of registration within 30 days of the registration containing details of.

- The full name and other relevant details of the registered person
- The date of issuance of the certificate
- The data from which the registration takes effect and
- The registered person’s tax payer identification number

If registration is disallowed FTRA will have to notify the applicator and the reasons for the refusal. The tax authority many deny the application for voluntary registration if the person:

- Has no fixed place of residence or business
- Does not keep proper accenting records
- Has no bank account
- Has previously been registered for VAT purposes but failed to perform his duties under the VAT law (Gebrie, 2008, p.203).

### **2.8 Time of application**

A person who carries on taxable activity and is not registered is required to file an application for VAT registration it shall fill an application for registration on later than the last day of the month after the end of the period if:

1. At the end of any period of 12 calendar months the person made during that period, taxable transactions with a total value exceeding 500,000.00 birr or the last day of the month of the period if taxable transactions with a total value exceeding 500,000.00 birr.
2. At the beginning of any period of 12 calendar months when there is reasonable around to expect that the total value of taxable transactions to be made by the person during that period will exceed 500.000 birr (Gebrie, 2008, p. 203).

### **2.8.1 Time of registration**

Registration takes place on one of the following dates depending up on which date comes first.

- In case of obligatory registration on the first day of the accounting period following the month in which the obligation to apply for registration arose.
- In case of voluntary registration on the first day of the accounting period following the month in which the person applied for registration or
- On the date selected by the registered person on his application for a registration person who conducts taxable activity in a branch or division shall be registered only in the name of the registered person to register one or more of its branches or divisions as separate registered person. The tax authority allow when its satisfied on such case that divisions or branches maintains and independent accounting system and can be identified by the nature of its activities or location (Gebrie, 2008, p. 204).

### **2.8.2 Cancellation of registration**

VAT registered person can apply for cancellation of registration

- If tax payer ceased to make taxable transactions.
- At any time after a period of 3 years of the date of his most recent registration for VAT if the registration persons total taxable transactions in the period of 12 months then beginning reasonable are expected to be not more than 500,000.00 birr.

The cancellation of VAT registration takes effect

- At the time the registration person ceased to make taxable translation for example, if one close down or sell his business. However, if one has more than one business and is not closing down or selling them all he may not be able to cancel it will depend on the level of taxable turn of remaining businesses.

- If the registered person has not ceased to do so at the end of the accounting period during which the person applies to the authority for cancellation of VAT registration.

When registered of VAT is cancelled, the authority is required to remove the person's name and all other details from the VAT register and the person is required to return back the issued certificate of registration. VAT registered person cannot charge VAT or issue tax invoices for any supplies made and cannot claim a refund of VAT incurred on any goods or services purchased from the date of the registration is cancelled (Gebrie, 2008, p. 209).

## **2.9 Advantage and disadvantage of VAT**

### Advantage of VAT

The following are some of the advantages of VAT

- a. It avoids cascading effect of tax (tax on tax)

VAT works on the principle of that when the raw material passes through various manufacturing stages and manufactured products through various distribution stages, tax should be levied on the incremental value at each stage and not on the gross sale price. This insures that some commodity does not get taxed again and again, and thus there is no cascading effect. Putting the concept in simple terms, in VAT system, each input is taxed only once (Misrak, 2008, p. 310).

- b. It is a major comprehensive and equitable tax system

Even though the ultimate burden of VAT falls on the final customer, VAT is collected by the government from all sectors that is from import manufacturing, wholesale and retail sectors. Therefore, it is a more comprehensive and equitable tax system. On the contrary, sales tax is normally levied at one stage of wholesaling (Misrak, 2008, p. 310).

- c. It reduces the possibility of tax evasion

In the case of VAT the taxes are divided into several parts depending on the number of stages of production and sales. In each stage every transaction is made using a VAT invoice approved by tax authority. In addition each VAT registered person (supplier) has to maintain appropriate records on their sale and purchase transactions. Those obligations make tax evasion difficult (Misrak, 2008, p. 310).

It has less tax burden

Under VAT system, the tax is collected in small fragments at different stages of production and sale. Hence, the VAT payers feel the burden of the less (Misrak, 2008, p. 310).

d. It is neutral

Regardless of the number of stages of production and distribution, VAT is collected in each stage, therefore; VAT is expected to be perfectly neutral in the location of resources in the form of production and commercialization (Misrak, 2008, p. 310).

e. It improves productivity

In VAT system, a firm has to pay tax even though it goes into loss. The firm cannot claim any exception for loss because it pays taxes on the value produced and not on profits. So, firms will always try to improve their performance and reduce the cost of production. As a result, the overall productivity of the country will be improved (Misrak, 2008, p. 310).

f. It promotes capital investment and saving

VAT is a consumption tax since one pays VAT on its expenditure and has the option to forego so as not to be taxed. Furthermore, relief from tax on capital goods may encourage investment. Potential investors also consider tax legislation as one of the factors in making investment decisions (Misrak, 2008, p. 311).

g. It enhances exports

Exports of goods and services in most countries that implement VAT are liable to VAT. At zero rates this may make exports internationally competitive and thus encourage exports (Misrak 2008, p. 311).

### Disadvantage of VAT

The following are some of the main disadvantages of VAT

a. It is regressive in nature

A straightforward single rate VAT with few exemptions would tax lower income groups (the poor) more heavily than the higher income groups (the rich). It is thus incongruent with the basic.

Principles of taxation which states that tax should be levied according to one's ability to pay. This makes VAT a regressive tax system.

In order to compensate for its regressive effect a number of countries have exempted basic goods particularly food items from VAT (Misrak, 2008, p.311).

b. It requires advanced economic structure

The proper implementation of VAT system required organization and advanced financial and economic structure as it complicated system. VAT system also requires proper record keeping of invoice at each stage of production and sale by both the seller and buyer. Hence, it becomes, difficult to implement the system in all types of economy (Misrak, 2008, p. 312).

c. It put additional burden to tax authority

In VAT system, the manufactures whole sellers and retailers have to fulfill various legal formalities in the form of manufactures various records, accounts, books, etc. the verification of those formalities put additional burden to the enforcing authorities (Misrak, 2008, p. 312).

d. It is uneconomical

VAT system involves high of administration, assessment, verification collection, etc. hence; it is highly uneconomical (Misrak, 2008, p. 312).

e. It has reams loopholes for tax evasion

Although VAT system requires proper record keeping of invoices at each stage of production and distribution by both the buyer and seller, it has ream loopholes for tax evasion. This may include the following:

- Tax payers could over report sales of zero rated goods.
- Tax payers could use invoices they received for personal purchase to claim tax credits.
- It enables buyers and sellers to strike secret deals with regards the issuance of receipts.
- It could lead to the formulation of forged ponies' recipients to claim tax credit on input VAT, etc (Misrak, 2008, p. 312).

## **CHAPTER THREE**

### **3. Research methodology**

#### **3.1 Source of data**

Primary sources would be used for the main source of information for the study. Because primary sources are more relevant and trust full for me and for most of researchers. Some information for study would be collected by researcher, using primary source of data collection through questionnaires. The study would be conducted by distributing questionnaires to the Yirgalem town revenue authority employees and tax payer. The primary data for this study is the response of employee, tax payers that the researcher would obtain on his research study using its data collection tools.

#### **3.2 Sample size**

The number of the questionnaires for the organization would depend up on the number of the employee and VAT registered merchant of the yirgalem town. The total number of VAT registered in yirgalem town is 930. From that the researcher used the sample size 100 of the tax payers that registered to VAT.

#### **3.3 Sample method**

The researcher collected sample from tax administration authority and tax payers of yirgalem town by using random sampling. The reason for taking random sampling is gives every business in the population (930) an equal chance of being selected. This minimizes selection bias ensuring that the sample reflects the true characteristics of all VAT-registered businesses (manufacturing, trade, service). Since the sample is randomly drawn, the results can be statistically generalized to the entire population of VAT-registered businesses in Yirgalem Town. This is crucial for policy recommendations, as tax authorities need reliable data to improve VAT compliance.

#### **3.4 Method of data collection**

Primary data collection was used to gather the data. This was done through the distribution of questionnaires to both the tax administration authority and the taxpayers of the town. To obtain the required information, the researcher selected data collectors and provided them with orientation on the method of data collection, as well as an explanation of the purpose of each item.

### **3.5 Method of data analysis and interpretation**

After data have been collected the process of analysis would begun. Data processing to make the raw data suitable for further analysis. Editing, coding and classification would be made the descriptive analysis methods of data analyzing technique of both tabulation and percentage would be used. Finally the responsible explanation of the relation would be identified and the final tax of interpretation would accomplished after considering all the relevant factor.

## CHAPTER FOUR

### 4. Data analysis and interpretation

#### 4.1 Over view

In this section the overall, result of the data collected were analyzed and discussed. In order to make easy and understand able interpretation and interference were made by comparing types as business (Manufacturing, Trade and service) with their attitude to ward VAT system.

it is important first to see the difference characteristics of the sample population. The variables include types of business. Their registration time, problem associated with value added tax in yirgalem Town. Out of 100 the total sample size there were only 82 or 82% respondent filled questionnaire correctly the rest respondent were not willingness to filled.

#### 4.2 Personal background of the respondent

##### 4.2.1 Demo graphic structure of the sample

Table 4.1 Syndication of demographic structure

S. No	Description business type	Respondent in number	Respondent in percentage
1	Manufacture	20	24.39
2	Trade	40	48.78
3	Service	22	26.83
	Total	82	100

Source of primary data 2017 E. C

From the above data (table) trade activity contribute 40(48.78%) service activity contains 22(26.83%) and manufacturing enterprise contain 20(24.39%) of the targeted population individually. Grossly seen from the business type trade activity covers 40(48.78) of the total population. This is due to the fact that VAT is major applicable to it in the town and affect trading activity relatively.

Manufacture enterprise covers 20(24.39) out of the total targeted population which compare to other types of business it contributes the smallest. This is due to number of manufacturing enterprise in the town rather than trade and service. But in the real way value added tax was applicable more on manufacturing enterprise. Because value added tax is multistage tax which is

imposed at more than one well of production as the above table show the service activities is more applicable next to trade activities.

Table 4.2 Relationship between types of business and their registration time

Registration time									
Types of business	During implementation		Month after implementation		One year after implementation		Currently		
	No	(%)	No	%	No	(%)	No	%	No
Manufacturing	4	18.18	6	27.27	4	18.18	8	36.36	22
Trade	7	22.58	10	32.25	4	12.90	10	32.25	31
Service	7	24.14	6	20.67	8	27.58	8	27.58	29
Total	18	21.95	22	26.83	16	19.51	26	35.70	82

Source of primary data 2017E.C

Table 4.2 Show during implementation types of business registration for value added tax were 18 in number. Out of the total manufacturing enterprise contain 4(18.18%) and service activity in the town more registration during the implication than manufacturing and trade activities.

Six month implementation the manufacturing enterprise contain 6(27.27%) trade covers 10(32.25%) service contain 6(20.67%) trade contain the largest registered during six month which compared to those types of business one year after implementation the manufacturing enterprise registered to VAT contain 4(18.18%) trade contain 4(12.90%) and service contain 8(27.58%) during this period service activities the largest registered to VAT.

current 8(36.36%) manufacturing enterprise 10(32.25%) trade activities 8(27.58%) service activities registered during this period among these types of business type manufacturing enterprise contain the largest registered to VAT as seen from above table that from the period of the registered period of registered time currently the types of business make good participation for the registration to VAT. this is due to the types of business get awareness and knowledge some extent than before about value added tax. When compared the registration types of business with unregistered to VAT the unregistered one is more than registered one this is due to the fact that the factor not unregistered for VAT in time are the following reason.

- Lack of awareness about tax system
- Lack of hard and fast we to force them
- Aiming to get huge profit without paying the appropriate tax

Additionally, inland revenue authority were not registered all types of business whose annually sale is  $\geq 500,000$  this is one of the problem of tax administration.

Table 4.3 Attitude of respondent toward the impact of VAT on customer

Business type	Number	Percent (%)
Manufacturing	18	21.96
Trade	38	46.34
Service	26	31.70
Total	82	100

Source of primary data 2017 E. C

From the above table trade contain 18(46.34%) service activities contain 26(35.7%) and manufacturing 26(31.96%) of the target population individually which compared those types of business the trade and service activities most respondents said that VAT has on impact on consumer.

This is due to the reason that they think when compare the commodity which requested for VAT and commodity that of not registered for VAT the commodity registered VAT in crease the price of commodity and the commodity not registered for VAT is not increase the price. This bring shift of customer from high price commodity to which is low price the number of customer decrease due to the fact that customer were not understand the advantage of the tax system registered.

Most of the employee of registered companies could not identify tax able and nontaxable items due to this so cheques and receipts receipt become avoid. in addition to this companies will collect VAT on free good and not collection VAT payable. This will shift customers to other as fail to collect the government revenue incase of shifting customers they will go to unregistered company to purchased items at fewer price.

Table 4.4 The attitude of respondent towards the threshold annual sales  $\geq$  50000 Good range.

Types of business	Threshold $\geq$ 500.000 birr range is good				
	Yes		No		
	No	%	No	%	Total
Manufacturing	18	61.53	10	38.46	26
Trade	16	47.36	10	26.31	38
Service	10	35.57	18	64.28	28
Total	44	53.65	38	46.39	82

Source of primary data 2017 E.C

Table 4.4 shows that 16(61.53%) of manufacturing enterprise replied that the threshold of annual sales  $>$  500,000 birr good range and 20% of manufacturing replied that the threshold is not good range in addition to that 18(47.36%) of trade activities respondent replied that the threshold of annual sale of 500,000 birr is good range and (32.74%) of the trade replied the threshold is not good range finally 10(35.37%) service activities the threshold is not good range.

From above table we conclude that 16(61.53%) manufacturing and (47.37%) of grade activities respondent said that the threshold is a good range because most of them are profitable and they apply the rule and regulation of inland revenue authorizes. In contrast to this most service activities and some manufacturing trade activities respondent said more than birr 500,000 sales is not good range. This due to tax payers will paid not on their willingness but only to obey the policy. It also clear that most business people will refuse the policy in different medias. If the threshold amount is decrease more business types will registered for VAT.

Replied that VAT not create impact on sales was from the manufacturing enterprise. This due to they assumes that VAT is a multi stage tax. This means VAT is paid at every stage of sales on the problems identification part of the questionnaire the following problems identified by the respondents. These are

- VAT increases the price of commodity.
- Lack of knowledge and awareness regarding to VAT
- In availability of skilled man power.
- Lack of hard and fast rule, notable to implementation of the settled tax rules and regulations.
- Most customer shift from the registered VAT to unregistered VAT.

Table 4.5 Attitude of respondent towards the tax rate 15%

Business types	15% tax rate is better				Total
	Yes		No		
	No	%	No	%	
Manufacturing	11	52.23	10	47.65	21
Trade	18	50.00	18	50	36
Service	9	36.00	16	64.00	25
Total	38	46.34	44	53.36	82

Source of primary data 2017 E.C

Table 4.5 shows that 11(52.23%) of manufacturing enterprise said 15% tax rate is better and (47.37%) of them said that the tax rate is not better and 50% grade activities said that the tax rate is better and the rest of 50% trade activities said that tax rate is not better. In addition to that 32(46.34%) of service enterprise respondents that the tax rate is better and (45.76%) service enterprise respondent tax rate is not better.

From the above table except manufacturing enterprise the most types of business respondent said the tax rate is not better. This is due to the reason that tax rate paid from the customer who purchase the good and service but most of customer do not think that as they pay 15% the tax rate to government rather that they consider as the price of the commodity in crease this causes decrease demand of commodity and shift of customer from VAT registered to unregistered one.

In the above table we can generalize most of tax payers respondent said that tax rate is not better. But for manufacturing enterprise there respondent most of them the tax take is better. This is due to value added tax is a multistage tax which is imposed at more than one level of production and distribution and manufacturing enterprise have more than one level of production.

Table 4.6 The attitude toward the respondent get enough information regarding to VAT.

Types of business	Get enough information regarding to VAT				
	Yes		No		
	No	%	No	%	Total
Manufacturing	16	61.53	10	38.46	26
Trade	18	56.25	14	43.75	32
Service	10	41.66	14	58.33	24
Total	44	53.65	38	46.34	82

Source of primary data 2017 E.C

The above table show that 16(65.53%) of manufacturing enterprise respondent said that get enough information regarding to VAT and (34.47%) respondent said that they didn't get enough information regarding to VAT In other case 18(56.25%) trade activity respondent said that they get information regarding to VAT Finally 10(41.66%) service activity respondent get enough information regarding to VAT.

From the above table the researcher conclude that most of manufacturing activity get enough information from the above business activity.

## CHAPTER FIVE

### 5. Summary conclusion of findings and recommendations

#### 5.1 Summary and conclusion

- As per the study result most of eligible and potential business the town should have not registered for VAT which affects the legitimate business in the competitive markets.
- Due to unfair price competition in the market most of the value added tax (VAT) registered business. Replies that they lost their customers.
- Yirgalem town revenue authority has well strangled to increase the level of awareness of VAT payers. Even though it marginalized the ultimate consumers who are affected economically with VAT.
- Most of VAT payers in yirgalem town revenue authority were not satisfied with facilities given by the administration.
- The yirgalem revenue authority are weak in applying rules and regulation related to VAT. Due to this the numbers of complaints have increased from time to time.
- The in land revenue authority is not control both the registered and unregistered business it had not enough controlling system. This will result in decreasing Government tax revenue in land authority.

#### 5.2 Recommendations

- yirgalem town revenue authority advised to great awareness among the business organizations and society about the benefit of value added tax (VAT) so as to bring potential business in to the value added tax (VAT).
- Basket which informs avoid the complaints related to unfair price completion.
- The revenue authority of yirgalem town should also give emphasis for the ultimate consumer because they help the in the effectiveness of the value added tax (VAT) application simply by asking VAT receipts from registered.
- Business while they transact with them.
- Sale of employee would feed the code of the item, immediately the VAT amount and total with display.
- Rules and regulation should be implemented effectively and some fast and horde rules should be acted. It this is the case business peoples not initiated to perform illegal activity.

- This rules may include shout downing the business, legal punishment (prison and money punishment) taking trade licenses etc.

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**APPENDIX 1**  
**WOLKITE UNIVERSITY**  
**COLLEGE OF BUSINESS AND ECONOMICS**  
**DEPARTMENT OF ACCOUNTING AND FINANCE**

This questionnaire is prepared by wolkite University college of business and economics accounting department prospective graduates so as to provide them with further assistance in conducting a research on the practice and challenge of compliance audit in the case of western center government office of auditors general which is the partial requirement for the fulfillment of BA degree in accounting honest and truthful answers must be given, as participants identify is keep confidential. There is no need to write your name.

**Part I**

**For tax payers**

1.Types of business

1.1 Public          Private

1.2 Manufacture          Service          Trade          Others

2. How long do you stay in these business activity in years

0-5          5-10          10-15          15-20          more than 20

3. When did you register for VAT?

During implementation          3 months after implementation

6 months after implementation          current

4. Is the threshold (> 500,000 is good range?

Yes          No

If no what should be

5. Is the tax rate (15)? High          Medium          Low

6. Do you think registration for VAT have advantages?

Yes          No

7. Are all facilities to collect VAT is fulfilled?

Yes          No

## APPENDIX 2

### UNIVERSITY WOLKITE

#### COLLEGE OF BUSINESS AND ECONOMICS DEPARTMENT OF ACCOUNTING

##### For VAT Administer employee

This questionnaire is prepared by Wolkite University college of business and economics accounting department prospective graduates so as to provide them with further assistance in conducting a research on the practice and challenge of compliance audit in the case of western center government office of auditors general which is the partical requirement for the fulfillment of BA degree in accounting honest and truthful answers must be given, as participants identify is keep confidential. There is no need to write your name.

1. Education status  
 12 Completed certificate Degree      Diploma  
Master degree      Other
2. In which department, division you are working?  
Finance      Marketing      Purchase      Other
3. Do you think VAT is better than sales tax?  
Yes      No
4. All the expected VAT eligible companies registered?  
Yes      No
5. Are all facilities to collect VAT is full filled?  
Yes      No
6. Which facility should be added?  

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7. Which the threshold of annual sales do you prefer?  
➤ 500000      >200000      > Other
8. Is that tax rate?  
High      Medium      Low
9. Do you think registration for VAT is advantage?

Strong agree Agree Disagree I don't know

1. Implementation VAT is good

for the development of business and country

2. Registration of VAT is easiest

3. Before implementation of VAT create awareness among payers

4. VAT will increase price of commodity

5. The time given to pay VAT is enough

6. It is negative impaction customer.