

# Innovations

## Challenges of Value Added Tax Administration: A case of Somali Regional State Revenue Authority, Jigjiga, Ethiopia

**Dr. Perways Alam**

Associate Professor

Department of Accounting and Finance

Jigjiga University, Jigjiga, Ethiopia

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### **Abstract**

*This study examines challenges of value added tax administration in Somali Regional State, Revenue Authority Jigjiga, Ethiopia. The study adopted a descriptive research design. The population of study comprised of 56 employees of Somali Regional State Revenue Authority, Jigjiga, Ethiopia. Out of 56 employees, 54 responded which was 96.43% response rate. The data was analyzed using data analysis tools like tables, percentages, frequencies, weighted mean and standard deviation and results presented based on the study objectives. The techniques used in the study include survey with tax officials. The results of the study reveal that the tax payers in Somali Regional State are not familiar with the Ethiopian VAT Laws and proclamations. Second important finding of the study is that the tax payers not are voluntarily registered in tax administration office. Another important finding is that tax payers are try to avoid VAT. On the basis of the findings, it is recommended that tax authorities in Somali Regional State should start a campaign to bring awareness about the Ethiopian VAT Laws and proclamations among the tax payers. Tax authorities should take necessary steps to encourage voluntarily registration in tax administration office. Tax authorities should make a proper mechanism/system to minimize the VAT avoidance by tax payers.*

**Key words:** 1.VAT administration, 2.VAT Laws and proclamations VAT registration, 3.Challenges and VAT liability

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## I. Introduction

Tax is the important avenue through which governments generate revenue needed for development projects and recurrent expenditure. Taxation is proposed to raise the necessary funds for public expenditure, to redistribute income, to stabilize the economy, to overcome externalities, to influence the allocation of resources, while at the same time should be supportive to the economic growth. (A Giddens,2013) Value added tax is an indirect tax imposed on domestic consumption of goods and services as well as on imported goods. It can be considered as the most important tax innovation of the second half of the twentieth century. VAT is primarily collected by business firms or individuals at all phases of production and distribution beginning with importers and producers of raw materials and ending with retailers. In line with this awareness, VAT is implemented in many developed as well as developing countries. (Hailemariam, 2011).

VAT 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. Since VAT is applied on the value added at each stage of production and distributions, it solves the tax cascading effect and reduces tax evasion with its modern administration system that sales tax cannot. VAT is payable if there are supplies made in Ethiopia, made by a taxable person, made in the course of making of another business and is not specifically exempted or zero rated.

### 1.1 Statement of Problem

Over the last few decades, a general consensus regarding the indirect tax reform in developing countries has emerged. A reduction in the trade tax with a compensating or revenue-enhancing increase in value-added tax (VAT) has been the center-piece of such a reform, and it has been implemented in a large number of developing countries under the structural adjustment and stabilization policy conditionality of the IMF and the World Bank.

Now-a-days developing countries generate substantial amount of their revenue from income tax & customs duties on import & export and it is clear that these traditional revenue sources are not sufficient sources of revenue for a nation's economic & social development, so reforming the tax system and formulating adequate tax policy towards the advancement of tax administration system is a necessary phenomenon. Upon this Ethiopia has implemented value added tax in 2003 that has replaced the sales tax under the proclamation 285/94 says that "the current sales tax does not allow collection of the tax on the added value created wherever a sales transaction is conducted; whereas, the value added tax decreases the damage that may be caused by attempts to avoid and evade the tax and helps to ascertain the profit obtained by the taxpayers; whereas, the tax increases saving and investment as it is a consumption tax and does not tax capital; whereas, replacement of the current sales tax by value added tax enhances economic growth and improves the ratio relationship between Gross Domestic Product and Government Revenue".

Considering studies conducted so far were on analysis of the contribution of VAT for economic development & Social Spending (Dakito,2011) , the impact of electronic tax register on VAT

(Yelemtesfa ,2011),the implementation of VAT and its related problems in Ethiopia as case of ERCA , The implementation of VAT in Ethiopia in general and in Addis Ababa city government administration particularly (Sewagegne,2006) so these studies seem to emphasis VAT from the economic development contribution , automation impact perspectives, administration of VAT at regional level and also legal enforcement of VAT implementation. However, these studies didn't specifically consider problems & solutions of VAT administration at regional levels.

Therefore, this study will expect to shed light on identifying and assessing the challenges of VAT administration on Somali Regional Revenue Authority, Jigjiga, Ethiopia.

### **1.2. Research Questions**

Through the course of this research, it intends to provide answer to the following research questions:

- What are the main Challenges of VAT administrations?
- What are the possible measures to tackle with these challenges?

### **1.3. Objective of the Study**

The research objectives of this research are:

- To identify the main challenges of VAT administration.
- To propose recommendations to tackle the challenges

## **II Review of Related Literature**

VAT administration challenges adversely impact on the salient features of the tax and governments policy objectives as a whole. In this regard, Tanzi and Pellechio (1995) (cited in Mikesell, 2007) noted that poor tax administration would change the manner in which taxation affects government's policy objectives, namely economic stabilization, resource allocation and redistribution of income. Challenges rise from the following facts- taxpayer identification, invoicing, filing and payment process, control of filing and payments, refunds, audits and penalties are challenges. In developing countries, the poor performance of taxes is likely is to be due to weak tax administration (that is, the incapacity of the administration to implement the tax in practice). This is perhaps caused by such factors as resource constraint and designing the tax independently from the administration. According to Dheressa, K.K Reddy, and Yadeta (2015) Value Added Tax administration, there are many challenges have, 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, Tax laws enforcement problems, are the challenges which affect the collecting sufficient revenue in terms of Tax collected from Value Added Tax.

**Tuan Minh Le (2003)** on his finding expresses that there is interlink between the VAT performance of a country and its level of development, the revenue gains from VAT are likely to

be higher an economy with higher level per capital income ,lower share of agriculture ,and higher level of literacy VAT proves to be an efficient tool for revenue collection.

**Chanchal (2005)** on his finding argues that Indian sub national VAT would enable the regional governments to deal with the expenditure responsibilities shifted to them after 1991.

**IP and Mintz (1992)** in their sub national VAT mode recommended deal that federal government should turn over all sales taxes to the provinces to reduce the administrative & compliance costs of taxation and give more revenue dissections to province and hence make more responsible for financing more of their own spending on health or education under this.

**Ainul Islam and Murimuzzam (2011)** found that VAT has made a substantial contribution to the public revenue and particularly in later period of review also evident is the declining contribution of income tax & customs duties there for the total contribution of VAT to total revenue has raised from 24% in 1991-92 to 38% in 2006-07 therefore developing countries such Bangladesh are usually expected to have delete rate 15% to 16% to support their development needs.

**Hailemariam Mamo (2011)** concluded that VAT administration is weak because there less motivated employees of the authority due to less remuneration , lack of sufficient number of ethical , trained and skilled employees , accelerated rotation of employees in the authority and firing of senior officials , absence of strong enforcement activities and also the mere difficulty that the authority faces to distinguish between honest and disobedient traders , provision of less quality service by the authority and lastly absence of strong controlling system against the frauds and evasion performed by some non compliant enterprises , therefore the above mentioned result of his study pose that the VAT administration of the authority to be not so strong enough to bring those non registered enterprises to be registered and to control illegal activities of VAT payers and this becomes a bottleneck for achieving the desired objectives.

**Bizualem (2015)** identified key challenges related to VAT with the title of the thesis practices and challenges of Value Added Tax implementation in Ethiopia post January 2003 assessment. His findings were lack of sufficient number of skilled personnel, limited staff capacity, non-responsiveness by the management, limited awareness creation, problems related with invoicing, unfair competition, and control centered management tendency were the main challenges.

**Gweru, Zimbabwe (2017)** indicated that effectiveness of VAT administration is affected through its factors that are the registration of VAT taxpayers, processing of VAT returns, and collection of VAT arrears, penalties and interest, VAT refunds, VAT rates, VAT audits. The respondents also noted that the effectiveness of VAT administration of revenue collection is negatively affected due to the current economic hardships.

**Birhanu Sissay (2018)**, The findings from this research provide evidence that on average direct tax revenue contributes 23.13%, indirect tax revenue contributes 25.77% and customs taxes and duties contribute 50.95 to total tax revenue. VAT contributes above 40% to total tax revenue which was collected at customs and inland tax authorities and Excise tax contribution to tax

revenue on average was 24% which was collected at customs and inland tax authorities. In line with primary data analyses of this study it is found that tax payers and professionals have huge problems on the clarity of the Ethiopian value added tax (VAT) and excise tax proclamations, regulation and directives, lack of control and follow by the tax authority most of businesses are affected by those who are not registered for VAT, computation VAT on consignment transaction, advance payments and promotional goods delivered to customer considered by the taxpayers is not fair.

The researcher believes that, as these and related challenges affect contribution of indirect tax to tax revenue collection of Ethiopian revenue and customs authority large tax payers branch office. Therefore, there is considerable need for conducting research on the area which this study purports to do. The main gap researcher identified related to the title is that previous researchers more focus were on challenges of VAT administration in Ethiopia as a whole and this research focused on challenges of VAT administration in Somali Regional State (SRS).

### **III. Research Design and Methodology**

#### **3.1 Description of the Study Area**

The study area of this study is Somali Regional State, Ethiopia. Jigjiga is the capital of Somali Regional State (SRS), The office of Somali Regional State Revenue Authority is located in Jigjiga.

#### **3.2. Research Design**

This research used Descriptive research design. Structured questionnaires were used to collect data from the target population.

#### **3.3. Target Population**

The target population of this study was 56 the employees of Somali Regional State Revenue Authority, Jigjiga. These employees are directly involved in VAT collection and administering department and census method used to collect data.

#### **3.4 Source of Data Collection**

The sources of data of this research are based on primary and secondary data. The primary data has contained questionnaire that was be given to the employee of Somali Regional State Revenue Authority, Jigjiga. and unstructured interviews with higher officials.

The secondary data sources of this study were gathered from the books, library documentations annual reports of the authority, international publications related to the subject matter.

#### **3.5. Data Analysis Method**

This study has used descriptive statistics like tables, percentiles, frequencies, weighted mean and standard deviation to analyze the data and interpretation of the result.

#### IV. Results and Discussion

This section of the study has been prepared on the basis of data obtained through data collection instruments which include questionnaire. The researcher has distributed 56 questionnaires among those 54 questionnaires were correctly managed and returned back but the remaining 2 questionnaires did not return. The response rate was 96.43%. Researcher used Likert scale where 1=Strongly Disagree (SDA); 2=Disagree (DA); 3=Undecided (UN); 4=Agree (A); 5=Strongly Agree (SA)

#### 4.Challenges of Value Added Tax Administration

**Table 4. Challenges of Value Added Tax Administration in Somali Regional State (SRS)**

Statement	Response	Descriptive statistics		
		F (%)	Mean	SD
Tax payers in Somali Regional State are familiar with the Ethiopian VAT Laws and proclamations.	Strongly disagree	10(18.5%)	2.703	1.369
	Disagree	23(42.6%)		
	Undecided	2(3.7%)		
	Agree	11(20.4%)		
	Strongly agree	8(14.8%)		
	Total	54(100%)		
It is true that the non-VAT registered taxpayers are more benefited than registered one.	Strongly disagree	8(14.8%)	3.240	1.373
	Disagree	12(22.2%)		
	Undecided	3(5.5%)		
	Agree	21(38.9%)		
	Strongly agree	10 (18.5%)		
	Total	54(100%)		
It is believed that the tax payers are voluntarily registered in tax administration office.	Strongly disagree	15(27.8%)	2.5	1.397
	Disagree	21(38.9%)		
	Undecided	1(1.8%)		
	Agree	10(18.5%)		
	Strongly agree	7(13%)		
	Total	54(100%)		
It is believed that VAT declaration process is easy and effective.	Strongly disagree	15(27.8%)		
	Disagree	22(40.7%)		

	Undecided	4(7.4%)	2.388	1.311
	Agree	7(13%)		
	Strongly agree	6(11.1%)		
	Total	54(100%)		
The revenue authority organized with Competent and skilled manpower.	Strongly disagree	9(16.7%)	2.629	1.221
	Disagree	23(42.6%)		
	Undecided	5(9.3%)		
	Agree	13(24%)		
	Strongly disagree	4(7.4%)		
	Total	54(100%)		
Tax official gives sufficient information where ever asked.	Strongly disagree	9(16.7%)	3.277	1.432
	Disagree	11(20.4%)		
	Undecided	2(3.7%)		
	Agree	20(37.0%)		
	Strongly agree	12(22.2%)		
	Total	54(100%)		
Tax payers are accurately determining its VAT liability.	Strongly disagree	16(29.6%)	2.277	1.223
	Disagree	22(40.7%)		
	Undecided	5(9.3%)		
	Agree	7(13%)		
	Strongly agree	4(7.4%)		
	Total	54(100%)		
It is believed that the tax payers are pays actual VAT assessed.	Strongly disagree	15(27.8%)	2.425	1.327
	Disagree	21(38.9%)		
	Undecided	4(7.4%)		
	Agree	8(14.8%)		
	Strongly agree	6(11.1%)		
	Total	54(100%)		
It is believed that the tax payers are always	Strongly disagree	17(31.5%)		

pay VAT on time.	Disagree	22(40.7%)	2.296	1.285
	Undecided	1(1.8%)		
	Agree	10(18.5%)		
	Strongly agree	4(7.4%)		
	Total	54(100%)		
It is assumed that the tax payers are attempted to avoid VAT.	Strongly disagree	5(9.3%)	3.648	1.321
	Disagree	9(16.7%)		
	Undecided	3(5.5%)		
	Agree	20(37%)		
	Strongly agree	17(31.5%)		
	Total	54(100%)		

**Source:** Field Survey, 2022

Table 4 illustrates about the challenges of VAT administration in Somali Regional State. First statement was that Tax payers in Somali Regional State are familiar with the Ethiopian VAT Laws and proclamations. Regarding to familiarity of tax payers with the Ethiopian VAT Laws and proclamations, 23(42.6%) of the respondents disagreed that tax payers in Somali Regional State are familiar with the Ethiopian VAT Laws and proclamations while 11(20.4%) of the respondents reported agreement to the statement. The mean is 2.703 which were less than Likert scale mean (3). The calculated mean was concentrated far from the standard deviation 1.369. From the above result it is assumed that tax payers in Somali Regional State are not familiar with the Ethiopian VAT Laws and proclamations.

The second statement was that the non-VAT registered taxpayers are more benefited than registered one. Regarding to this issue, 21(38.9%) of the respondents agreed to the issue while 12(22.2%) of the respondents reported their disagreement that non-VAT registered taxpayers are more benefited than registered one. Moreover, the calculated mean 3.240 is more than Likert scale mean (3). The calculated mean also concentrated far from the standard deviation 1.373. This implies that non-VAT registered taxpayers are more benefited than registered one.

The third statement was that the tax payers are voluntarily registered in tax administration office. Regarding to this issue, 21(38.9%) of the respondents disagreed to the issue while 10(18.5%) of the respondents reported their agreement that the tax payers are voluntarily registered in tax administration office. Moreover, the calculated mean 2.5 is less than Likert scale mean (3). The calculated mean also concentrated far from the standard deviation 1.397. This implies that the tax payers not are voluntarily registered in tax administration office

The fourth statement was that VAT declaration process is easy and effective. Regarding to this issue, 22(40.7%) of the respondents disagreed to the issue while 7(13%) of the respondents reported their agreement that VAT declaration process is easy and effective. Moreover, the calculated mean 2.388 is less than Likert scale mean (3). The calculated mean also concentrated far from the standard deviation 1.311. This implies that VAT declaration process is not easy and effective.

The fifth statement was that the revenue authority organized with competent and skilled manpower. Regarding to this issue, 23(42.6%) of the respondents disagreed to the issue while 13(24%) of the respondents reported their agreement that the revenue authority organized with competent and skilled manpower. Moreover, the calculated mean 2.629 which is less than Likert scale mean (3). The calculated mean also concentrated far from the standard deviation 1.221. This implies that the revenue authority is not organized with competent and skilled manpower.

The sixth statement was that tax official gives sufficient information where ever asked. 20(37.0%) of the respondents agreed that tax official gives sufficient information where ever asked while 11(20.4%) of the respondents reported disagreement to the statement. The mean is 3.277 which is more than Likert scale mean (3). The calculated mean was concentrated far from the standard deviation 1.432. From the above result it can be said that tax official gives sufficient information where ever asked.

The seventh statement was that tax payers are accurately determining its VAT liability. 22(40.7%) of the respondents disagreed that tax payers are accurately determining its VAT liability while 7(13%) of the respondents reported agreement to the statement. The mean is 2.277 which is less than Likert scale mean (3). The calculated mean was concentrated far from the standard deviation 1.223. From the above result it is possible to say that tax payers are not accurately determining its VAT liability.

The eighth statement was that the tax payers are pays actual VAT assessed. 21(38.9%) of the respondents disagreed that the tax payers are pays actual VAT assessed while 8(14.8%) of the respondents reported agreement to the statement. The mean is 2.425 which were less than Likert scale mean (3). The calculated mean was concentrated far from the standard deviation 1.327. From the above analysis it is possible to conclude that tax payers are not pays actual VAT assessed.

The ninth statement was that the tax payers are always pay VAT on time. 22(40.7%) of the respondents disagreed to the statement while 10(18.5%) of the respondents reported agreement to the statement. The mean is 2.296 which were less than Likert scale mean (3). The calculated mean was concentrated far from the standard deviation 1.285. From the above analysis it is possible to say that tax payers are not always pay VAT on time.

The last statement was that the tax payers are attempted to avoid VAT. 20(37%) of the respondents agreed to the statement while 9(16.7%) of the respondents reported disagreement to the statement. The mean is 3.648 which were more than Likert scale mean (3). The calculated mean was concentrated far from the standard deviation 1.321. From the above analysis it can be said that tax payers are attempted to avoid VAT

## V. Conclusion

The main objectives of this research have been to find out challenges of Somali Regional State Revenue Authority, Jigjiga, Ethiopia. Survey technique was employed to find out the challenges of VAT administration Somali Regional State, Revenue Authority, Jigjiga, Ethiopia. Based on the presentation and analysis of the data obtained, the main findings and recommendations are summarized below.

- ✓ Tax payers in Somali Regional State are not familiar with the Ethiopian VAT Laws and proclamations.
- ✓ The tax payers not are voluntarily registered in tax administration office
- ✓ The revenue authority is not organized with competent and skilled manpower.
- ✓ Tax payers are not accurately determining its VAT liability.
- ✓ Tax payers are attempted to avoid VAT

Based on the above-mentioned findings, the following are the recommendations;

- ✓ Tax authorities in Somali Regional State should start a campaign to bring awareness about the Ethiopian VAT Laws and proclamations among the tax payers.
- ✓ Tax authorities should take necessary steps to encourage voluntarily registration in tax administration office
- ✓ The revenue authorities should appoint competent and skilled manpower to collect and process VAT.
- ✓ Tax authorities should make a proper mechanism to calculate exact VAT liability.
- ✓ Tax authorities should make a proper mechanism/system to minimize the VAT avoidance by tax payers.

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***Email: [perwaysl@rediffmail.com](mailto:perwaysl@rediffmail.com)***