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## Challenges of Value Added Tax (VAT) Collection Performance: a Case Study of Hawassa City Revenue Authority (South Ethiopia)

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### Abstract

*This study investigates the challenges of Value Added Tax (VAT) collection performance in case of Hawassa City Revenue Authority. The study adopted a mixed research method approach to answer the research questions. A survey data was collected from 94 VAT registered businesses of which 78 were addressed through distribution of self-administered questionnaires and an in-depth interview was conducted with tax officials. The interview was conducted with three tax officials at different time to check the consistency of information. Beside to primary source secondary source of data collected from the annual report of Hawassa City Revenue Authority from the year 2008 up to 2013. Findings from mixed approach portrayed that both tax payer community and customers misunderstanding VAT in combination with administrative incapability challenging the effective collection of VAT in Hawassa city. Failure to issue invoices after selling and customers` lack of initiative to ask for receipts after shopping and getting services also increasing the prevalence of un-collectability of VAT in the city*

**Keywords:** Value added tax, collection performance, customer awareness, evasion, challenges

### 1. Introduction

Governments, all over the world have their stated number of public projects, such as social security protection and other services of public utilities like electricity, water supply, rail ways, heavy electrical, atomic energy, etc. In bible Jesus replied to Pharisees for their question “whether citizen should pay tax the government or not?” that “Render therefore unto Cæsar the things which are Cæsar's; and unto God the things that are God's (Mathew 22: 21, KJV). As Eric (2008) stated, common expenditure programs include health and welfare programs, defense spending, social security, and interest and repayment of principal on government debt. Under this view, the role of the tax system is to raise an amount of revenue that is tied to the level of government services. For those countries with significant sources of revenue other than taxes, government can fund operations with less reliance on current tax revenue.

Governments in low income countries have the difficult task of making wide-ranging decisions about public spending, taxation, and borrowing in aim of helping their countries maintain long-term debt sustainability, achieve higher economic growth, and ultimately reduce poverty. One of the challenging factors of implementing policies is raising public revenues which is difficult in a context of macroeconomic and growth instability, high debt ratios, weak tax administration, and large informal sectors (Eric, 2008). If VAT can be administered adequately, however, the conventional conclusion that it offers the best way for a country to make up revenue losses from trade liberalization. The critical point is that a country must have the capacity to administer VAT adequately. Other things being equal, the average economic cost of collecting revenue is less with VAT simply because the base of VAT is invariably broader than that of the taxes (tariffs, excises or other sales taxes) that it replaces. Even if increasing the rate of an existing VAT will neither necessarily increase revenues proportionately nor be costless, it is nonetheless often the economically most sensible way to expand revenue share in developing and transitional countries (Bird and Gendron, 2006).

In 2013, Ethiopia collected ETB 62.2billion tax revenue, which undermined by ETB 12.3billion compared to plan. Total VAT collection was ETB 25.23billion in the quarter, which shares 40.53% of total tax revenue in the country (The Reporter, 2013).The researchers` intention in this study is to assess the challenges of VAT collection performance a case of Hawassa city Revenue Authority Branch office.

#### 1.1. Statement of the Problem

Government performs many activities to fulfill social welfare in a given country. Common expenditure programs include health and welfare programs, defense spending, social security, and interest and repayment of principal on government debt (Eric, 2008). The major source of government income is tax in most economies, especially in developing countries like Ethiopia. Tax revenue is the principal domestic revenue for the Ethiopian government. Tax revenue is mainly generated by indirect taxes such as VAT, excise taxes and foreign trade taxes (Yesegat, 2009, p 26). To fulfill the public needs, governments in any country plan to collect tax revenues from the taxpaying community. The under developed countries are highly dependent on tax revenue; but it is not so easy to collect as planned.

Tax revenue mobilization in Sub-Saharan Africa (SSA) is not only low compared to spending needs but also suffers from high instability. Indeed, instable revenues are costly because they might force the government to consequently cut public spending, leading to public spending instability (Ebeke and Ehrhart, 2010). Among other taxes, Value Added Tax (VAT) is the basic source of income. Ebeke and Ehrhart argued that VAT does indeed have a stabilizing effect on the tax revenue ratio. Countries which have adopted the VAT system enjoy much more stable tax revenue than other countries (Ebeke and Ehrhart, 2011). VAT is, therefore, less vulnerable to evasion than a retail sales tax, for which collection occurs during the final stage of production. However, Aizenman and Jinjarak (2008) emphasize that VAT collection efficiency remains largely dependent on the quality of enforcement and the efficiency of monitoring, both increasing with political stability and the ease and fluidity of political participation. Moreover, increased expenditure on the administration of VAT and more experience with VAT have been found to be significantly associated with increased compliance (Agha and Haughton, 1996). On the other hand, that VAT has actually reduced efficiency, for it clearly has potential weaknesses. The VAT has also proved vulnerable to high profile criminal attack: 'carousel fraud,' for example, which exploits arrangements for the taxation of intra-community trade within the European Union, has amounted to around 1.5 – 2.5 percent of net revenue, or more, in the United Kingdom (Keen and Lockwood, 2007).

VAT is the principal source of revenue for the Ethiopian government as the same to other VAT implementing countries. As Yesigat's (2008) study on administration problem indicate, VAT has a significant role in the revenue system of the Ethiopian government. To sustain VAT's revenue role in the government's finance, it is crucial to ensure that the revenue generated by this tax is raised as efficiently as possible (Yesegat, 2008, p17).

Currently, the Ethiopian government plan to collect large amount of revenue from tax; especially from VAT. Birr 19,993,636,370 is budgeted to be collected in the country as the whole, in the year 2013 (Federal Government of Ethiopia Revenue Budget, 2005 E.C). Though the government has planned to collect such amount of VAT from taxpaying community, which may not be easy to collect as budgeted. Some of the challenges identified by different researchers especially in developing countries are evasions and fraud (Keen and Lockwood, 2007), poor administration (Aizenman and Jinjarak, 2008), increase in administrative expenditure and compliance costs (Agha and Haughton, 1996; Yesegat, 2009), miss understanding of taxpaying community, poor technology management; especially Electronic Tax Register (ETR) (Taye, 2011). Empirical studies still revealing challenges related to consumers' awareness, taxpayers misunderstanding and evasion act, tax authority commitment and organizational inefficiency, unfair competition due to unregistered but fall in the domain of the criteria (Simon Tareke, Yibrah Hagos and Abiy Kassa, 2013; Habtamu Dheressa, K.K Reddy, and Debela Yadeta, 2015; Simon Tareke Abay, 2013). Therefore, the researcher believes that, these challenges may affect the effectiveness of the collection of VAT in the city of Hawassa as well.

### *1.2. Objective of the Study*

The general objective of this study is to assess the challenges of Value Added Tax (VAT) collection from the point of view of its budgeted and actual performance in Hawassa city.

### *1.3. Methodology*

A survey data collected from 94 VAT registered taxpayers (among total of 144 VAT registered business) in the city. In addition to primary data secondary data were collected from quarter/annual report (2008 to 2013), annual magazines and related reports. An interview with Hawassa city tax authority officers were addressed for identifying challenges they were facing while collecting VAT from organizational point of view.

### *1.4. Description of the Study Area*

Hawassa City is located on the main road between Addis Ababa and Moyale at a distance of 275 km south of Addis Ababa, Ethiopia. It is the capital City of the Southern Nations, Nationalities and Peoples Regional State (SNNPRS). Hawassa is not only the Capital City of SNNPR but is easily the largest urban center and also the political, economic and social nerve center of the Southern Ethiopia in total and the southern part of Oromiya region too. The Town location at Eastern shore of Lake Hawassa coupled with administrative center of the Southern Nations, Nationalities and Peoples (SNNP) Region, favored it as touristy center of the Rift Valley and terminal of travelers from various corners of the Country. The city of Hawassa is administratively divided in to 8 sub-City administration with 32 Kebele while data collected. These eight sub-cities are Hayek Dare, Menhariya, Tabor, Misrak, Bahile Adarash, Addis Ketema, Hawella Tula and Mehal Ketema sub cities.

### *1.5. Literature Review*

VAT administration pertains to how tax authorities discharge the responsibilities entrusted to them. According to Jantscher (1990) these responsibilities include a range of related activities such as taxpayer identification and registration, invoicing, filing and payment requirements, control of filing and payments, refunds, audits and penalties. In other point, VAT administration is also concerned with issues of who should administer the tax, what organizational setup to use and what resources are available (Yesigat, 2008). Value Added Tax (VAT) administration also has to secure compliance with the laws by applying an array of registration, assessment and collection procedures. A government can keep taxpayers from doing these activities, and thus successfully avoid tax evasion depends on the nature of economy's actual tax base. Tax administration therefore, should aim at improving on laws regarding the registration, assessment, collection revenue, and exploiting fully taxation potential of a country (World Bank, 1999).

VAT replaced the current sales tax on manufactured and imported goods and services on January 1, 2003 in Ethiopia. The responsibility for the correct allocation and timely payment of VAT rests on the taxpayers 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 retailers. Cascading of tax (i.e. tax on tax) is avoided by providing level. Unlike the sales tax system, whereby relief is granted only to raw materials used directly in the production of goods, under a VAT, relief is granted for tax paid on capital goods, distribution and administration inputs. Sales of exported goods are not subject to the VAT (Worku, 2006). VAT is a tax on consumer expenditure. It is collected on business transactions and imports. In Ethiopia VAT is collected from those VAT registered tax payers whose turnover is the threshold of ETB 500,000 and above per year. It is applied at uniform rate of 15% on all goods and services, except zero rated exports. It provides tax exemptions for goods and services such as transportation, education, medical and other services and goods such as Kerosene, flour, etc....the special feature of the modern VAT is mode of collection (I bid).

The design of VAT also includes concessions to small scale business to register to collect VAT. The registration threshold is at the turnover value of Birr 500,000. However, an equalization of tax scheme is being worked out to ensure equity considerations for all level of the tax payers when a business that is registered for VAT supplies (or sales) goods or services: VAT is included on the selling price (but shown separately) and collected by the business. The VAT on these supplies is called output tax. When a business that is registered for tax purchases, goods or services the VAT paid on these supplies received is called input tax (Worku, 2008).

The evidence for developed countries suggests that the VAT is less costly than the income tax, but the more relevant question is whether it is more or less costly than alternative forms of sales tax, and, in particular, than the taxes that it replaced. Making such a comparison for six Francophone and six Anglophone African countries, it becomes clear that the predecessors to the VAT were far from simple to collect. In West Africa, the VAT generally replaced turnover taxes of the kind prevalent in France before the adoption of the VAT there. In East Africa, it generally replaced a manufacturer level sales tax on the old Commonwealth model. There were many similarities among the earlier regimes: numerous and sometimes narrowly differentiated rates (including luxury excises); many specific exemptions, an exemption for retail trade and, in some cases, differential treatment of domestic sales and imports (ITD, 2005). As World Bank report on tax revenue in percentage of GDP in Ethiopia in the year 2008, 2009 and 2010 was 7.4, 6.6 and 9.8 respectively (<http://data.worldbank.org/indicator/GC.Tax.ToTL.GD.Zs>). This shows that, Ethiopia generating more revenue from tax from its total GDP. Ethiopia introduced value added tax (VAT) in the year 2003 as a replacement to sales tax. VAT is the principal source of revenue for the Ethiopian government. For instance, in the 2006-07 fiscal years, federal VAT revenue (on domestic transactions) accounted for about 41 per cent of total federal revenues from domestic sources (EFIRA 2007). Further, since its introduction, VAT has been more revenue productive than sales tax (Teferra 2004) and (Yesigat, 2008).

## 1.6. Result and Discussion

### 1.6.1. VAT Registrants' Perception about VAT

In this section researcher discusses the VAT registrants' attitude that how they think about registering for VAT. The researcher raised some questions like whether registering for VAT is important or not and whether they think that registering for VAT leads to losing their potential customers' or not. Misunderstanding of VAT by the taxpaying community is one of the hindering factors in collection of VAT according to (Taye, 2011).

		Frequency	Percent	Valid Percent	Cumulative %
Valid	Yes (beneficiary)	43	55.1	55.1	55.1
	No (not beneficiary)	35	44.9	44.9	100.0
	Total	78	100.0	100.0	

*Table 1: Respondents' perception on benefit of registering for VAT  
Source: VAT payers' survey and own computation using SPSS*

Respondents were asked, whether they believe that beneficiary from registering for VAT? As respondents shows, 44.9% of respondents believed that they are not beneficiary being registered for VAT and the remaining 55.1% of respondents think that they are beneficiary being registered for VAT. Though most of VAT registrants believe that they are beneficiary of registering for VAT like participating for government bids and getting refunds and credit at the time of nil, still some of registrants perceived that they are not benefited from being registering for VAT. As data revealed from open ended question for the reason how they are not beneficiary from registration for VAT, most of respondents raised similar kind of reasons. Some of the reasons given in survey through open ended question were as follows:

- Complaining as there is no faire competition among businesses because of existence of some unregistered businesses for VAT.
- Retailers face challenges to get invoices from whole sellers especially importers and exporters and sometimes they are forced to take under-invoice for purchases.

Study by Yesigat (2008) in Ethiopia reported that, the dominance of VAT unregistered businesses, resulted in uneven market competition and a loss of market share and profitability by registered businesses. From the survey responses, this is also shown as one of the main hindering situations for effective collection of government revenue in Hawassa.

		Frequency	Percent	Valid %	Cumulative %
Valid	Yes (loses)	55	70.5	70.5	70.5
	No (not lose)	23	29.5	29.5	100.0
	Total	78	100.0	100.0	

Table 2: VAT Registrants` perception of losing customers  
 Source: VAT payers` survey and own computation using SPSS

The researcher asked close ended question that, whether the taxpaying community perceive that registering for VAT allows them to lose their potential customers or not. 70.5% of respondents perceived that they are losing their potential customers while the remaining 29.5% of respondents believe that they are not, because of registering for VAT. From this one can conclude that more than half of VAT paying community (i.e. 70.5%) believe that they are losing potential customers and the researcher asked an open-ended question to know the reason that how they are losing their potential customers. Respondents` response shows customers believes that 15% of VAT rate inclusive price is high and for these customers are searching for unregistered businesses` goods and services and this also leads to unfair competition among businesses. This implies businesses, which registered for VAT, prefer to made sales without issuing invoices in order to not losing their potential customers. Therefore, this attitude of taxpaying community and customers` skipping attitude can lead to losing huge amount of tax revenue to the government as well.

1.6.2. Customers` Awareness about VAT

In this section the researcher wants to know how the end payers of VAT i.e. consumers, perceive about VAT and how far are they aware of it.

		Frequency	Percent	Valid Percent	Cumulative %
Valid	Yes (Refuses)	23	29.5	29.5	29.5
	No (not refuses)	55	70.5	70.5	100.0
	Total	78	100.0	100.0	

Table 3: Customer refusal to accept Receipt  
 Source: VAT payers` survey and own computation using SPSS

VAT registered community were asked if they see any customer, who refused to accept the receipt after issued for goods sold or the service rendered. 70.50% of respondents never experienced such situation while 29.50% of respondents faced it. From this one can conclude that, though most of customers accept receipt after shopping, still there are many customers` who refuse to accept receipt (careless to take receipts). The researcher asked open ended question to respondents to know why customers refuse to accept the receipt. Among many other reasons respondents site, it was; lack of awareness, carelessness, lack of trends of accepting receipts, and even some of customers feel that they are not directly beneficiary from paying tax. Businesses are obliged to post a notice for their customers at a prominent place that states "Do Not Pay Unless Receipt Issued". However as per the interview with tax officers reveal, customers` sometimes ignore to act accordingly. In addition, salesmen at shop and waiters in some hotels and cafeteria, waiting until they are asked for receipts. Such intentional delay in service pushes their customers to pay without receiving invoices. Surprisingly it shows that, some of customers even fail to understand the meaning of tax that says; "tax is a compulsory charge imposed by the Government without any expectation of direct return in benefit" (Parameswaran, 2005, p 55).

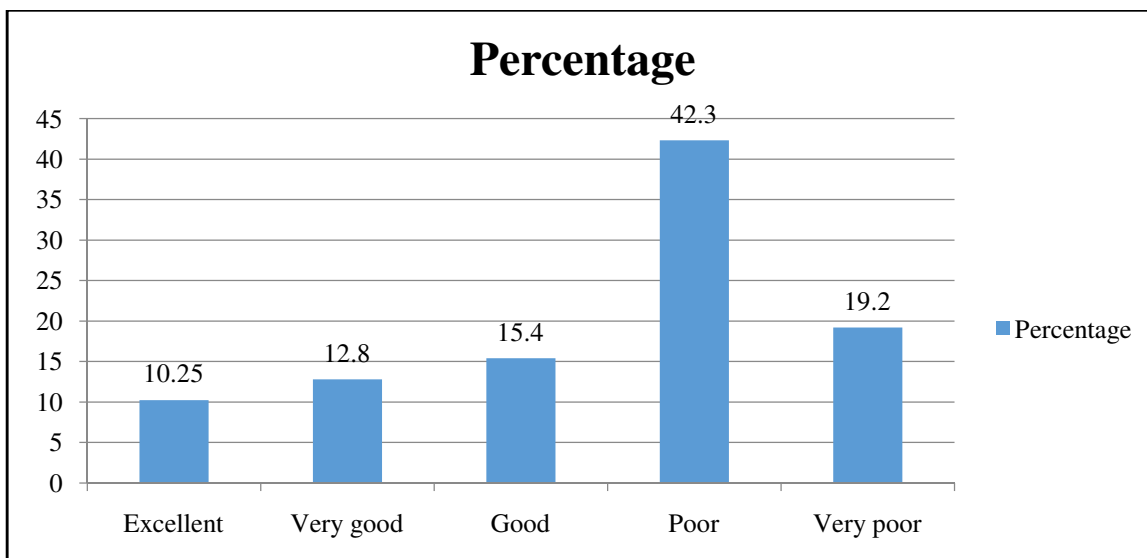


Figure 1: Customers` attitude to receive VAT Invoice

The researcher asked taxpaying community as to how they evaluate their customers` attitude of asking for invoice and receiving after shopping. The result shows, 10.3% of respondents replied that customers` have excellent, 12.8% very good, 15.4% good, 42.3% poor and 19.2% very poor, attitude in asking for invoices after shopping. This implies that, even though around 38.5% of customers` have a positive attitude and experience to ask and receive invoices the remaining 61.5% of customers need to improve their attitude of asking and receiving invoices after shopping. Data gathered from interview reveals, VAT registered businesses are hindering customers` invoice receiving attitudes by intentionally delaying to issue invoice in advance to receive payments. This is because some VAT registered sellers` waits until they have been asked for invoices. According to proclamation No- 609/2008, this is violation of tax law because business organizations should issue sales register invoices or use authorized sequential printed receipts for every sale they make in advance to receive money. (Tesfaye,2011) stated that, under the invoice method of collection, each seller charges VAT rate on his output and passes the buyer a special invoice that indicates the amount of tax charged.

Yesigat (2008) stated, these problems include the difficulty of getting invoices on purchases and details of customers for the preparation of sales invoices, the problem of supplying without invoices (by giving the option of buying with or without invoices to customers) and using duplicated invoices. The optional issuance of VAT invoices in some sectors reveal that invoices are being used as a negotiation tool between customers and VAT registered businesses. That is, full VAT is chargeable if a customer needs invoices. In the study, it clearly showed the collection challenges by stating, such a practice can jeopardize the use of invoices as a revenue safeguarding tool. There are various factors that are firing the invoicing related problems. These factors include lack of tax administrators` follow-up and control, lack of awareness among the society and the prevalence of poverty and inflation on consumption goods and consumer`s dissatisfaction in government services. Some of these factors can be tone downed through, enhancing tax education and follow-up programs, increasing administrative costs are worthwhile to consider.

### 1.7. Analysis of Collection Performance and Challenges

In this section researcher discusses results of data collected from secondary sources namely annual plan and performance reports, and annual magazine. According to annual plan and performance report from Hawassa City Revenue Authority, the total planed revenues, both taxes and other revenues and performance for five years were as follows:

Year	Plan (ETB)	Actual (ETB)
2008	36,952,000	40,969,882.12
2009	47,200,000	54,110,722.68
2010	130,900,000	116,506,691.82
2011	166,861,411	184,786,944.91
2012	294,160,000	250,009,204.42
2013*	357,615,798.28	388,418,190.91

Table 4: Total Revenue Collection (2008 to 2013)

Source: Annual plan and performance report (2008 to 2013) and own computation  
2013\* shows the third quarter report of the budget year

Except in the year 2010 and 2012 the revenue collection performance of the organization is increasing from year to year when compared to its budgeted plan. As data revealed from written documents, the reason for the reduction of revenue collection in the year 2010 was due to tax evasion activities like some non-governmental organizations failure to report employee`s income tax and corruption activities of some internal employees, using government revenue for their own benefit where as in the year 2012 is due to its transition of VAT registrants from manual recording to cash register machine as obliged by the regional government. In relation to this the identification of different category tax payers for assessment purpose opened a gap in the collection.

Year (E.C)	Plan (ETB)	Actual (ETB)
2008	33,841,000.00	38,029,943.10
2009	43,424,000.00	51,144,657.21
2010	84,396,000.00	82,909,445.92
2011	107,825,500.00	130,959,607.98
2012	209,686,500.00	188,795,233.37
2013*	299,728,919.25	307,314,348.22

Table 5: Total Tax Revenues

Source: Annual plan and performance report (2008 to 2013) and own computation

The collection of tax revenue is growing from year to year in Hawassa city. In other word, this shows that the main source of revenue is tax as compared to other revenue sources in the city. The collection performance of the authority is in positive side except in the year 2010 and 2012. The reason for the less performance of collection especially in the year 2012 is, because of transition from the manual system to the computerized system and the regional government gave full responsibility of VAT collection to the Hawassa City Revenue Authority. And in this year the authority was being busy in providing different trainings to employees and payers and identifying and enforcing the tax law on tax paying community under its` control. Data shows in the annual performance report of the authority shows that, direct tax collection was 83.87% of its plan to collect, which means the remaining 16.13% were not collected.

Year (E.C)	Plan (ETB)	Actual (ETB)
2008	4,320,000.00	6,941,469.23
2009	8,700,000.00	11,940,181.04
2010	18,000,000.00	24,288,830.13
2011	44,603,500.00	57,261,694.19
2012	63,652,500.00	69,561,676.30
2013*	122,112,022.90	186,019,111.25

Table 6: VAT Revenue Collection Performance

Source: Annual plan and performance report (2000 E.C – 2004 E.C) and own computation

VAT revenue is increasing from year to year. VAT revenue especially after the year 2011 is increasing dramatically compared to the previous year's collection. As interview showed, this is because of implementation of sales register machine in the region starting from October, 2011 at the regional level and in the year 2012 the Regional Revenue Authority transferred full authority of VAT collection to Hawassa City Revenue Authority and introduced new software called SIGTAS (Software Integrated Government Tax Administration System). In other word, especially after the year 2010 there is a significant change of collection improvement because of the government attention like hiring new university graduate students and implementation of new technology.

## 2. Conclusion

- The collection performance of VAT in terms of its budget to collect shows good performance. However, the budget level needs improvement compared to the potential of VAT revenue that can be exploited. As per the Economic Association investigation the Hawassa city has much tax revenue potential to be exploited. The introduction of sales register machine and Standard Integrated Government Tax Administration Software (SIGTAS), positively contributed for collection of VAT. This effectiveness is witnessed after the year 2010. Tax collection performances significantly improved in government tax revenue.

- Unregistered businesses for VAT, leading to unfair competitions among businesses in addition to being barrier for effective collection of VAT. Administrative incapability allowed such opportunity for illegal businesses without charging compulsory taxes. The absence of clear tax assessment procedure and criteria in combination with lack of sufficient committed employees, open a chance for businesses to left unregistered.

- Disobeying to issue invoice by businesses is breaking down the smooth flow of VAT system is identified as chained problem going from wholesaler to retailers. Such disobedient revealed in the form of negotiating with customers to sell "with invoice or without", under invoicing and intentional delay in delivering service. Since invoices are the root document to tax audit and even to collect business profit tax at the end of the financial year. The under invoicing allows businesses to understate their annual sales, in which they are trying to evade the tax burden.

- Customers' non-awareness of tax especially about VAT is clearly seen in their experience of not asking for /receiving/ invoices after shopping and getting services. Their carelessness to read and act according to written notice like "Do not pay unless invoice issued!" and other information is exposed to VAT evasion. Smooth customers' cooperation has a great role in increasing government revenue. However, customers' cooperation is highly affected by current market condition and perception of customers' on services rendered by government in different sectors. Absence of good governance in civil service offices and inflation on consumption goods and services leads customers' to be reluctant for cooperation in governments' effort to increase tax revenue.

- Administrative limitations in resource allocation, awareness creation, providing trainings and feedbacks, controlling and follow up to combat VAT evaders and employees' corruption involvement is observed as some of the key internal factors among others hindering tax collection. Employees rent seeking (corruption) arises due to their close connection with business people.

- The audit work of the authority is very insignificant compared to its total number of VAT registrants in the city. Regarding tax audit, the number of auditors is very low compared to total number of registrants. It also affected the quality of audit work. VAT auditing work limited because of its criteria to select businesses for audit such as: nil filers, credit-fillers and information from third parties and intelligence workers'. But the nature of evasion does not depend on such cases only. It can be concluded that though the business is payment filer yet it can commit evasion.

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