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ASSESSING THE GAPS AND PROBLEMS THAT EXIST BETWEEN THE BUSINESS COMMUNITY AND TAX AUTHORITIES OF DIRE DAWA ADMINISTRATION

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ABSTRACT

The study was conducted to assess the challenges faced by the business community of Dire Dawa City, in relation to taxation. Although, data were collected from various sources, the tax payers' survey and focus group discussions were the main sources of data for the study. In this regard, a total of 183 tax payers have participated in the study as a source of information. In addition, key informants from Dire Dawa Chamber of Commerce and Sectoral Association (DDCCSA), Tax and Revenue Authority (TRA) and Federal Custom and Inland Revenue Authority (FCIRA) were interviewed to support and checkup the reliability of the data collected using survey method. Descriptive statistics such as mean, standard deviation, percentages, frequency, charts, and graphs were used to summarize the study findings and present the results. Moreover, the Kruskal Wallis chi square test was also implemented in testing the statistical significance of mean differences, with respect to some variables, between category "C" and categories "A" and "B" tax payers. Generally, findings of the study revealed that most of the taxpayers, especially those in the category "C", have been facing various problems related to the taxation system. Despite the business community's positive attitude towards the general concept of taxation, most of the surveyed tax payers stated that what they are paying is beyond their ability to pay and that they neither have trust in the employees of the authority nor in the overall tax estimation, assessment and collection procedures. In light of these facts, the study concluded that the tax authority of the city administration is not being effective or is being reluctant in making the tax procedures objective, transparent and understandable to taxpayers. Thus, it is recommended that the responsible tax authorities should revise their working system and promote transparency, so that trust of tax payers on the tax system will gradually develop.

1. INTRODUCTION

1.1. BACKGROUND OF THE STUDY

Taxes are important sources of public revenue. Public goods such as roads, power, municipal services, and other public infrastructures are normally supplied by public agencies due to their natures of non-rivalry and non-excludability (Joseph, 2008). Government intervention in the supply of public goods is therefore inevitable and can only be done if the public pays taxes for the production and supply of such goods (Fjeldstad, 2004).

According to the current federal income tax proclamation no.286/2002 taxpayers are categorized into three categories, namely category "A", "B", and "C" based on their volume of sales and form of business. Category "A" includes any company incorporated under the tax law of Ethiopia or in or a foreign country and other entities having annual turnover of Birr 500,000 and more. Category 'B' includes those enterprises having annual turnover of more than Birr 100,000 and less than Birr 500,000. These categories of taxpayers must submit profit and loss statement at the end of the year. The law requires all entries in the records and accounts to be supported by appropriate vouchers (Council of Ministers Regulation no. 78/2002: Article 18, Sub Article 2).

Category 'C' unless already classified in categories 'A' and 'B' include those taxpayers whose annual turnover is estimated by the Tax Authority at Birr 100,000 or less. Unlike the case for category "A" and "B" tax payers, the income tax liability of Category 'C' taxpayers is determined using standard assessment. This type of assessment is a fixed amount of tax determined in accordance with the Council of Ministers Regulation established Schedules. In this regard, this category of taxpayers is the most problematic category of taxpayers and it is considered as hard to tax group. This is due to the fact that these taxpayers pay taxes at fixed rate on the income estimated by the income tax authority rather than declaring their income by themselves. Their daily income is estimated by assessment committee and the taxpayers have little room to address their view so that frequent friction is observed in this area (Lemessa, 2007). According to DDCCSA, 2011, the currently prevailing condition of taxation, in Dire Dawa City, has been causing wide spread complain over unfairness and overstated tax by the majority of traders especially by the tax payers of category "C". The same source also indicated that, Tax payers of category A and B are not also free of such complaints which are related to accounting procedure and validity of receipts and business related expenses.

1.2. PURPOSE AND OBJECTIVES OF THE STUDY

The general purpose of the study is to assess, in an objective way, the current problems and gaps that exist between the business community and the public sectors of Dire Dawa Administration, in relation to taxation. Being initiated and funded by the DDCCSA, which is a non-governmental Organization working to safeguard the overall rights and benefits of the business community, the study primarily intends to scientifically identify and prioritize basic problems of the business community and seek out sustainable solutions.

The specific objectives of the study are

- To identify tax payers' problems related to the overall taxation system, tax assessment, collection and service delivery of tax authorities and
- To provide important information as to how to narrow the gaps and work for the better of the business community and the government

2. METHODS

2.1. DATA SOURCE AND SAMPLING

Both primary and secondary data were collected to attain the research's objectives. The data collected had qualitative and quantitative nature. In collecting the primary data, survey method, key informants interview as well as Focus Group Discussions (FGDs) were employed. Tax payers were sampled from stratified sectors and market places which included exporters; importers; Construction, Garage and Taylor's associations; and small traders operating in the four main market areas of Dire Dawa City: (1) Taywan, Roose tera and Hafetessa (2) Kefira, Megala and Alaibed (3) Gendekore and (4) Sabean Market areas. For methodological simplicity, tax payers were first re-grouped/stratified into two groups: Group 1 (Category "C" tax payers) and Group 2 (Category 'A' and 'B' Tax payers). Then, a proportional random sampling method was employed to select 165 tax payers from the first Group and 18 tax payers from the second, leaving a total of 183 tax payers participating in the study as survey respondents or FGD participants. On the other hand, key informants from Dire Dawa Chamber of Commerce and Sectoral Association (DDCCSA); Tax and Revenue Authority of Dire Dawa (DDTRA) and Federal Custom and Inland Revenue Authority (FCIRA) were interviewed by the study team. The use of different respondents was to triangulate the data and obtain full information from the study subjects. Secondary data of both published and unpublished documents, pertinent to the research objectives, were also collected and reviewed to supplement the primary data.

2.2. METHOD OF DATA ANALYSIS

Descriptive statistics such as mean, percentage, frequency, chart and graph were used to process the collected data. Moreover, an inferential statistics called the kruskal wallis chi square test was implemented in testing the statistical significance of mean differences, with respect to important variables, between the two groups of sampled tax payers. Triangulation Method was also employed to support and check-up the reliability of the data obtained from various subjects. STATA 11 Computing Software was used to carry out data analysis.

3. FINDINGS OF THE STUDY

Findings of the study focuses on some selected variables related to taxation and tax payers in the City Administration. These include: taxpayers' knowledge and awareness about taxation, problems related to tax assessment, organizational effectiveness of tax authorities and other relevant issues.

3.1. TAXPAYERS' KNOWLEDGE ABOUT TAXATION

The following table shows the responses of survey respondents regarding the reasons of why they are paying taxes.

Table 1: Reasons why taxpayers pay taxes

Reasons	Tax payer's Category		Chi-square test	
	Category 'A' and 'B' (%)	Category 'C' (%)	χ^2	p-value
To avoid disturbances	0.00	52.56	6.505	0.0108
In the anticipation of public services	79.17	30.77		
It is an obligation towards the government	20.83	16.67		
Total	100	100		

In response to this question, majority of the respondents (79.17% from categories 'A' and 'B' and 30.77% from category 'C') have said that they pay taxes in the anticipation of public services from the government. However, 52.56% of the sample respondents from category 'C' said that they pay taxes to avoid disturbances while 16.67% said, "it is an obligation to the government". On the other hand, 20.83% of the respondents from categories 'A' and 'B' said that they pay taxes because it's an obligation while none of the respondents from this group said "to avoid disturbances". Generally, the results indicate that there is a positive understanding as to why the tax payers are paying taxes. Comparing the outcomes between the two groups, the results show that Category "A" and "B" Tax payers have got a better understanding towards paying taxes, which is also confirmed by the statistically significant mean difference, in the responses of the two groups at 1% probability level (Table 1). When respondents were asked whether the tax they are paying is based on their ability-to pay or not, 70.41% of category 'C' tax payers responded that the tax is not fair and not based on their ability-to pay while only 29.49% of the respondents from this category believed that what they are paying is fair and equitable (Table 2).

Table 2: Tax Fairness by category of tax payers

Is your tax liability overstated or understated?	Tax payer's Category		Chi-square test	
	Category 'A' and 'B'	Category 'C'	χ^2	p value
	Per cent	Per cent		
Understated	0.00	0.00	7.150	0.0021
Overstated	0.00	70.41		
Fair	100.00	29.49		
Total	100	100		

Conversely, the results also show that 100% of the sampled, category 'A' and 'B' tax payers, perceive what they are paying is fair. The chi-square value of 7.150, with a p-value of 0.0021 also shows that there is a statistically significant difference in the perception of fairness of tax between the two groups of tax payers at 1 % level of significance.

3.2. TAX ASSESSMENT

Category 'C' tax payers, the main targets of this study, are those who pay their taxes on the basis of tax assessment by estimation. To this effect, they were asked whether they have faced any problems when their tax is assessed using standard tax assessment scheme.

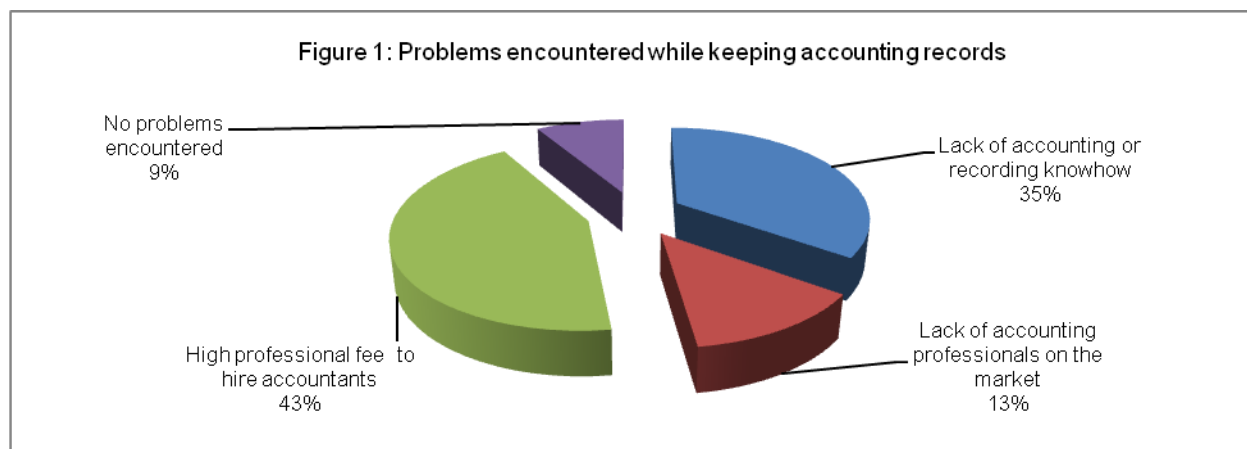
Table 3: Problems of tax assessment based on estimation

Problems	Agree (%)	Disagree (%)
Method of assessment is a simple guess or subjective	85.71	14.29
Inflated daily/annual income in tax estimation	97.14	2.86
No fair tax among similar businesses in same proximity	97.14	2.86
No trust of tax payer's statement of volume of daily sales	100.00	0.00

As can be seen in the above table, all of the respondents (100 %) have agreed that the tax authority has no trust on the tax payers' statement of daily sales volume and all most, all of them (97.14%) believed that there is no fair taxation among similar businesses in the same area and that their daily/annual income are inflated in the process of estimation. Similarly, 85.71% of the respondents believe that the method of assessment is based on a simple guess and that it is subjective. Results from the focus group discussions held among category 'C' tax payers suggests that the procedures of the standard assessment and computations are not objectively understood by most of the category "C" taxpayers and that the tax authority is reluctant in making these procedures objective, transparent, and understandable to taxpayers. To put it differently, the majority of taxpayers do not exactly know how to determine or calculate their tax obligation by themselves. Furthermore, some of the participants expressed their fear and concern about the effects of the prevailing inflation, which is making their daily nominal sales inflated and eventually overstate the tax without them, gaining real profit from executed sales.

Key informants from the DDCCSA have also asserted that the actual practice of tax assessment by Tax and Revenue Authority is very hard to tolerate and practically very difficult to fulfil mainly by the tax payers of category 'C'. In their

defence, key informants from the tax authority have firmly stated that category 'C' tax payers have never been honest to the tax assessment officers. They also added that most of the business communities are not even willing to declare their daily sales when they are told to do so. Category 'A' and 'B' tax payers, who are legally obliged to keep accounting record, were also asked whether they are facing problems while keeping records. In their responses, only 8.70% of them said that they faced no problems while the majority of them (43.48 %) said that high professional fee for accountants is their major problem in keeping records.



As can be seen on the figure above, the next larger portion of respondents (34.78 %), said that the lack of accounting and recording knowhow is their major problem while 13.48% of them have put the lack of accounting professionals and firms in the market as their major problem in this area. Concerning the problems faced by these tax payers while submitting accounting books, the survey findings indicate that 57.14% of the respondents have encountered unjustifiable and deliberate rejection of expenditure receipts while 28.57% of them said they are fed up by the unnecessary frequent call by the authority to defend and explain issues related to the accounting books. However, it is also shown that 14.29% of the respondents have not faced any problems while submitting accounting books to the authority.

Table 4: Problems encountered while submitting book of account

Problems	Per cent
Unjustifiable and deliberate rejection of expenditure receipts	57.14
Unnecessary frequent call by the authority to defend and explain issues related to the accounting book	28.57
No problems encountered	14.29

Likewise, in the focus group discussion held among category 'A' and 'B' tax payers, the majority of the participants said that the authority rejects their statement of expenses for no good reasons.

Furthermore, most of the participants were aggressively complaining about the follow up system of the authority in terms of VAT implementation. They said that the tax authority employees seriously oversee the compliance of some businesses while turning blind eyes to many others who are breaching tax laws by making their sales without VAT. In

response to this issue, key informants from both the tax authority and Federal Custom and Inland Revenue authority have admitted that they are facing shortcomings in enforcing vat laws, due to lack of qualified and competent manpower working in the area of intelligence. However, they highlighted that it should primarily be the responsibility of the tax payers themselves to report those law breaching business owners to the respective authorities. They also stated that their respective authorities have a system of rewarding people who report such business owners.

3.3. ORGANIZATIONAL EFFECTIVENESS OF THE TAX AUTHORITY

Survey respondents evaluated the Tax Authority with respect to certain parameters. The following table shows their response to these questions in percentages by category.

Table 5: Organizational effectiveness of the tax authority

Parameters	Excellent (%)		Good (%)		Poor (%)		Very Poor (%)		Chi-square test	
	Cat. 'A' & 'B'	Cat. 'C'	Cat. 'A' & 'B'	Cat. 'C'	Cat. 'A' & 'B'	Cat. 'C'	Cat. 'A' & 'B'	Cat. 'C'	χ^2	p value
Service delivery	51.01	5.51	48.97	39.74	0	32.05	0	22.7	15.022	0.000
Tax collection effectiveness	51.01	2.56	48.97	25.9	0	32.05	0	39.5	23.105	0.000
Awareness creation	33.39	12.32	16.67	9.42	8.33	33.33	41.61	44.9	2.7	0.101

The parameter, service delivery, which refers to the ability of the authority in handling customers, was rated by category 'C' respondents as excellent (5.51%), good (39.74%), poor (32.05%), and very poor (22.69%) while category 'A' and 'B' respondents rated service delivery as excellent (51.01%) and good (48.97%). The chi square test indicates that there is a significant mean difference in service delivery between the two groups of tax payers at 1% level of significance. Regarding tax collection effectiveness, which refers to the ability of the Authority in establishing trustworthy tax system, law enforcement and fairness of the taxing system, category 'C' respondents rated excellent (2.56%), good (25.90%), poor (32.05%), and very poor (39.50%) while the same responses as in the service delivery parameter, was obtained from category 'A' and 'B' respondents with the mean differences still significant between the two groups at 1% level of significance. These results clearly indicate that the tax authority is not relatively being effective in providing satisfactory service for category 'C' taxpayers. Concerning efforts being made by tax authority to promote tax awareness, category 'C' respondents said excellent (12.82%), good (9.42%), poor (33.32%) and very poor (44.87%) while category 'A' and 'B' respondents said excellent (33.33%), good (16.67%), poor (8.33%) and very poor (41.61%). The chi square test indicates that the mean difference in awareness creation between the two groups is statistically insignificant between the two groups ($p=0.101$). Focus group discussion participants from category "C" also raised the issue of service delivery, effort of awareness creation by the authority. They were bitterly complaining about the lack of concerted and consistent efforts from the authority in the area of awareness creation and below standard service delivery.

Contrary to this, category A and B focus group discussion participants were positively evaluating the improvements of tax authority in these areas but underscored that the tax authority have to work hard to maintain the on-going improvements. From the key informants' interview made with representatives from tax authority, the study found out that there is a substantial capacity gap in the Dire Dawa Tax and Revenue Authority. According to the informants, inappropriate organizational structure of the authority coupled with the prevalence of high management staff turnover

are the key sources of their incompetency. For instance, one of the informants added, there are only four officers in the authority to provide customer service for around 16, 000 tax payers in the city. The informants also emphasized that, with their limited capacity, they are working as good as they can, although the prevailing situation has made their efforts worthless.

3.4. Access to Tax Education/Training

Results from the key informants' interview made with representatives from both the Tax Authority and the Federal Custom and Inland Revenue Authority suggest that their respective offices have been doing their level best in building the capacities of the business community using various ways. For instance, the informant from the Dire Dawa Tax Authority said that a series of awareness creation trainings were provided to the business community at each of the 9 urban kebeles in the last fiscal year. The informant also added that the Authority broadcasts tax awareness creation programs in three languages (Amharic, Oromiffa and Somaligna) using the available local Medias (FM Dire and Dire TV). By the same token way, the key informant from the Federal Custom and Inland Revenue Authority has expressed that various efforts were made by the authority to build the capacity of the business community, through provision of trainings, distributing reading materials such as brochures and booklets, construction of billboards and broadcasting messages in four languages (Amharic, Oromiffa, Tigrigna and Somaligna) using the local medias. For instance, the informant added, in the last year, six awareness creation discussion sessions were conducted with tax payers selected from the various sectors by category. Despite, both of the respondents from the Tax Authority and Custom and Inland Revenue, they confessed that the efforts made so far are not enough and that more should be done to bring sustainable behavioural change among the business community. However, they admit that the efforts made so far are not enough and that more should be done to bring sustainable change. But still, some positive results has been observed, especially, the late coming habit of tax payers was seen decreasing from year to year. This issue was also a major area of concern in the focus group discussion held among tax payers of all categories. The majority of participants in each category highly stressed that the tax authority has not provided sufficient tax education to taxpayers to boost awareness. Furthermore, some of the category 'C' tax payers said that they were often called for trainings but the authority uses the opportunity to intimidate/threaten the tax payers, by referring to penalties as the sole weapon to make people comply with tax laws, rather than using tax education as a tool to bring more people into the tax network.

4. SUMMARY AND CONCLUSION

The major concern of this study in identifying the gaps and problems that exist between the Dire Dawa business community and the tax authority, is believed to provide important information as to how to narrow the gaps and work for the better of the business community and the government in the study area. Although the majority of tax payers interviewed and reached through a focus group discussions, did not feel it is unfair to pay tax; almost all of the study sample representatives have elicited certain problems and suggested potential measures to be undertaken by the tax authority to curb off the gaps and ensure fairness and equity. Generally, results show that most of the taxpayers, especially those in the category 'C', do not exactly know how the tax is assessed or calculated and the procedures in the tax assessment and computations are not objectively understood by most of the taxpayers. In light of this fact, it can be concluded that the tax authority of the city administration is not being effective in designing and implementing sustainable system to make this procedures objective, transparent, and understandable to taxpayers. To summarize, most of the problems identified by the study, rest on the category "C" tax payers, though, category A and B are not also free of complaints. All in all, the following six issues are pointed out as major problems creating the existing gap between the private and public sector in Dire Dawa Administration.

- Over taxation as result of over estimation of daily/annual income
- Nontransparent, non-participatory standard assessment by the authority for category "C"
- Lack of fairness or equity of taxation among similar businesses of category "C"
- Poor tax laws enforcement especially for VAT and large number of tax defaulters.
- Poor communication and understanding between the tax authority and taxpayers.
- Weakness in tax collection and unsatisfactory service delivery of tax authority

5. RECOMMENDATIONS

It is clear that a reform strategy to deal with such a problem requires a concerted, long-term, coordinated and comprehensive plan. However, possible recommendations and policy implications are forwarded based on the findings of the study. These include:

- The tax authorities should revise their system not only to ensure that equal taxes are levied on individuals who have equal income but also to make sure that each taxpayer is paying according to his/her ability to pay;
- The authority must also actively involve taxpayers or their representatives while estimating the daily sales or revenue of taxpayers so that trust of tax payers on the tax system will develop gradually.
- The tax authority needs to strengthen itself by recruiting qualified manpower , educating and training its employees, computerizing its operations and devoting additional resources. ‘
- The city Administration and DDCCSA should design a mechanism to bring more accounting professionals into the business of private auditing, so as to reduce the high professional fees of certified accountants that the tax payers are being charged.
- Human resource administration of TRA should be revised in order to enhance the overall organizational effectiveness of the authority
- Creation of sustainable system through which tax payers will be well informed as to how their money is being utilized.
- Awareness creation should not only be giving tax education to taxpayers but should also participate Influential groups in the society (elderly, religious leaders, prominent personalities).

Finally, it is recommended that a joint effort should be made by the tax payers and all concerned bodies of the Government to bring about a spirit of team work, so that sustainable growth and development will be ensured in the nearest future.

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