

**Assessment of Tax Administration focusing on Tax  
Assessment and Collection procedure in case of  
Nifas Silk Lafto Sub City Small Taxpayers  
Branch Office**

**A Research Project Submitted to Kidist Mariam University  
College in Partial Fulfillment of the Requirements for the Degree  
in Bachelor of Arts in Accounting**

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**Department of Accounting**

**May, 2013**

**Addis Ababa**

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## CHAPTER ONE

### 1. Introduction

#### *1.1 Background of Study*

It is commonly understood that every government seeks to raise revenue, mainly through taxation, in order to pay its expenditure on infrastructure development. The revenue of the Ethiopian government comes from different sources such as tax, public borrowing, sales of public assets, and transfer payments. The main purpose of generating revenue from these various sources is to finance government expenditure. These public expenditures are meant for public goods and services that are very essential for the development and wellbeing of the society. Among the various aforementioned sources of revenue, taxes are the primary and sustainable source of government revenue as can be observed from the table 1.

Table 1.1 summary of general government revenue by component (in million *Birr*)

Items	2005/06	2006/07	2007/2008	2008/09
Total Revenue	23261	29381	39704	54627
Domestic Revenue	19529	21797	29793	40174
Tax Revenue	14159	17354	23800	28998
Direct Tax	4461	5168	7015	9858
Indirect Tax	9698	12186	16785	19139
Non Tax Revenue	5371	4444	5993	11176
External Grant	3732	7583	9911	14454

Source: Ministry of Finance and Economic Development

In Ethiopia, the responsibility to collect revenue for the Federal Government rests with the Ethiopian Revenue and Custom Authority (hereafter cited as the ERCA). And there are different tax administrators at each sub city, which Nifas Silk Lafto sub city is the one. In addition to raising revenue, the authority is responsible to facilitate the legitimate movement of people and goods across the border. Simultaneously, the Authority focuses on those people and vehicles that may involve in the act of smuggling.

i.e. the act of bringing in to or taking out of the country goods on which customs duty and taxes are not paid and goods the importation or exportation of which are prohibited by law. The authority also conducts investigations, audit and prosecute offenders. Also closely works with the other border agencies the immigration service, the federal police, Ministry of Health etc.

There are a ten sub cities in Addis Ababa that are engaged in administering taxes from category “A” and category “B” tax payers. The different kebeles (at present called woredas) found in each sub city are dealing with taxes collected from Category “C” taxpayers.

On the basis of the above background, this study is initiated to examine the challenges in tax administration, tax collection procedures from taxpayers found in N/Lafto sub city.

## ***1.2 Statement of the Problem***

A government finances its expenditures through the fund acquired from the service given by the government, tax, loan and donation. From all sources of finance, tax is the major source; however, in most developing countries, it is a common phenomenon to notice serious problems in developing adequate tax systems that permits a government to sufficiently finance its expenditures.



Tax administration 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.

Therefore, identifying the problems on tax assessment and collection at each tax office and taking corrective measures need attention since they have adverse effects on the overall revenue of the government. And hence, this study tries to identify the problems on the tax assessment and collection procedures of the N/Lafo sub city revenue office.

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

#### **General Objective**

The overall objective of this study is to investigate tax assessment administration and collection problems found in N/Lafo sub city faced by both taxpayers and the authority.

#### **Specific Objective of the Study**

- ❖ to identify the main problems and their causes in tax assessment faced by the different parties i.e. taxpayers and tax administrators involved in the tax assessment.
- ❖ Identify the problems faced in the tax collection system and to comment on possible solutions.

## ***1.4 Methodology of the study***

The basic approach of the study will be used in the study is as follow both primary and secondary data are used in conducting the study.

### **1.4.1 Primary data**

First hand information is obtained after conducting face to face interviews that will be conducted with few government officials. Through these interviews relevant facts as well as opinions are obtained. Questionnaires were distributed to tax payers to get primary data.

### **1.4.2 Secondary Data**

The Secondary data include published materials such as books, Journals, magazines, internet and other documents specifically related to the topic.

## ***1.5 Significance of the Study***

The researcher hopes that this study will be important for the following reasons. In order to fulfill the socio-economic needs of the society, there must be effective and efficient collection of tax to increase government revenues so it could be efficient performance on tax if the taxpayers have enough knowledge about rules and regulation of the tax system. The findings of this study will contribute in enhancing the tax revenue of the selected sub city and the government at large by disclosing the core problems on the tax assessment and collection procedures so as to enabling them to put their effort to triumph over the observed problems.

## ***1.6 Scope of the Study***

Even though the ERCA accomplishes different governmental tasks the scope of this paper focuses on tax assessment and collection procedures regarding profit tax, value added tax and rental income tax who are obliged to pay to N/Lafto sub city in order to identify situations posing undesired influence on the tax revenue.

## ***1.7 Organization of the Study***

The paper is composed of four chapters;

**The first chapter/ introduction/ deals with the following topics**

- Historical background of the organization /ERCA/
- Statement of the problem
- Objective of the study
- Scope and limitation of the study
- Research methodology
- Organization of the study

**The second chapter deals with literature review of the topic. The third chapter discusses with the data analysis and interpretation part**

**The final chapter deals with conclusion and recommendation of the study.**

## **CHAPTER II**

### **2. Literature Review**

#### ***2.1 Introduction***

Taxes are important source of public revenue. The existence of collective consumption of goods and services necessitates putting some of our income into government hands. Such public goods like roads, power, municipal services, and other public infrastructures have favorable results on many families, business enterprises, industries and the general public. Public goods are normally supplied by public agencies due to their natures of non-rivalry and non-excludability.

The nature of consumption of public good in such that consumption by one does not reduce consumption for others. Besides, consumption of public by an agent does not exclude others from doing same. Such nature of public goods therefore makes them impossible for private suppliers to avail them at market prices like other commodities.

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.

Despite the fact that people need to pay taxes based on rationales of vertical and horizontal equities, it is not always the case that tax systems are comprehensible and transparent for tax payers especially for less literate business operators. Tax systems are usually not elaborated after proper consultation with the business community. The business owners complain that the tax assessment method is based on subjective estimation as a result of which they are frequently subjected to over-taxation. Since the business owners do not have simplified access to and clarification on information of the tax laws, they lack awareness on tax rules and regulations and this has an impact on the practicability of the regulations.

### **2.1.1 What is tax?**

Tax is a financial charge or other levy imposed on an individual or a legal entity by a state or a functional equivalent of a state. Taxes could also be imposed by a sub national entity. Taxes consist of direct tax or indirect tax, and may be paid in money. A tax may be defined as a “pecuniary burden laid upon individuals or property to support the government payment exacted by legislative authority”. “A tax” is not a voluntary payment or donation, but an enforced contribution, exacted pursuant to legislative authority” and is “any contribution imposed by government whether under the name of toll, tribute, duty, custom, excise, subsidy, aid supply, or other name.

In modern capitalist taxation systems, taxes are levied in money, but in-kind and in-come's taxation is characteristic of traditional or pre-capitalist states and their functional equivalents. The method of taxation and the government expenditure of taxes raised are often highly debated in politics and the government expenditure of taxes raised is often highly debated in politics and economics. Tax collection is performed by a government agency such as Revenue Canada, the International

Revenue Service (IRS) in the United States, or Her Majesty's Revenue and Customs (HMRC) in UK. When taxes are not fully paid, civil penalties (such as fines or forfeiture) or criminal penalties (such as incarceration) may be imposed on the non-paying entity or individual. (<http://en.Wikipedia.Org/wiki/tax>)

The low revenue yield of taxation can only be attributed to the fact that tax provisions are not properly enforced either on account of the inability of administration to cope with them or on account of straight forward collusion between the tax administration and taxpayers.

Since taxes are an involuntary payment for government services, taxpayers have a strong incentive to minimize their tax liabilities either through avoidance (legal) or through evasion (illegal). Tax administration 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).

### **2.1.2 Tax Administration Challenges**

The efficiency of a tax system is not determined only by appropriate legal regulation but also by the efficiency and integrity of the tax administration. In many countries, especially in developing countries, small amounts of collected public revenue can be explained by either incapability of the tax administration in realization of its duty, or with some degree of corruption. Regardless of how carefully tax laws have been made, they could not eliminate conflict between tax administration and tax payers. Tax administration with a skilled and responsible staff is almost the most important precondition for realization of "tax potential" of the state. It is generally known that tax laws and tax policy are as good as the tax administration (Kaldor, 1980).

Tax administrators face a formidable number of challenges in every country. In many developing countries tax administration reforms are needed simply to achieve macroeconomic stability. In countries with economies in transition there is a need to establish a tax administration that can respond to the demands of a growing market economy and the resulting increase in the number of taxpayers.

Human resource is essential in tax administration. Trained personnel are what actually most developing countries lack and this forced them, for instance, to organize their activities under the existing tax administration structure.

### **2.1.3 Efficiency of tax administration**

The key precondition for efficient tax administration is tax structure with minimizing distortions, strictly tax exemptions and elimination of the differences in tax treatment of particular parts of economy. This will mean extending the VAT to all but a few goods and services (notably export, which should be zero-rated, and banking and insurance services, where it may be difficult to determine the amount of value added to taxed) (Hesse, 1993).

Badly conceived or unnecessarily complicated tax structure greatly complicates the operating function of the tax administration, while simple and transparent tax structure could affect it in the opposite way. So, the increase of efficiency of the tax administration could be attributed mainly to the simplification of the tax system. Tax administration cannot change legislation as a means for improvement of tax structure, but could propose necessary changes in laws that can improve tax structure and/or could aid in application of the law (Mansfield, 1990).

#### **2.1.4 Improve tax administration**

In reform of tax administration the importance of tax structure is clearly reflected, because tax administration and tax structure are interconnected and they have to be improved simultaneously in the tax reforms (The World Bank, 1991).

Reaping revenues from tax rate changes (whether up or down) requires effective tax administration. Raising revenues through base expansion requires even better administration. New taxpayers must be identified and brought into the tax net and new collection techniques developed. Such changes take time to implement. The best tax policy in the world is worth little if it cannot be implemented effectively. What can be done to a considerable extent inevitably determines what is done. One cannot assume that whatever policy designers can think up can be implemented or that any administrative problems encountered can be easily and quickly remedied. How a tax system is administered affects its yield, its incidence, and its efficiency.

The tax administration should provide impartial and professional courteous service and must keep private and confidential information regarding the individual taxpayers. It should also offer clear, understandable and current tax information and will make this information available to tax payer through various media and provide timely, accurate written information that one can rely on to questions and requests for tax information (Asian Development Bank, 2001).

Education and information programs on specific tax issues should be arranged with taxpayers to enhance their awareness and taxpayers should be allowed to voluntarily disclose their tax situation without incurring a penalty or being prosecuted for tax violations under certain conditions (Asian Development Bank, 2001)

### **2.1.5 Tax assessment**

A tax assessor is responsible for preparing and maintaining the assessment roll, the tax roll and collecting the tax levies in accordance with the quality standards.

The core service responsibilities include:

- Preparing annual market value assessments for all properties
- Preparing the business assessment valuations for all business premises
- Maintaining accurate property information and ownership on all realty accounts
- Maintaining accurate business information and ownership on all business accounts
- Defending assessments before municipal and provincial assessment tribunals
- Responding to inquiries and requests for information related to assessment and taxation
- Producing and mailing annual assessment and tax notices to tax payers
- Reporting assessment rolls and meeting annual audits

### **2.1.6 Procedures for tax collection**

It is expected that people's tax payments should be in line with their income and they are required to pay a tax in proportion to their level of income. On the other part of the tax collectors, collection of tax should be time conscious and convenient and the cost of collecting the taxes should not be high to discourage business. Alternatively, this means that the ideal tax system in developing countries should raise essential revenue without excessive government borrowing and should do so without discouraging economic activity and without deviating too much from tax system in other countries (Tanzi, 2001). The procedures undertaken by tax authority to ensure compliance are discussed as follows.



### **2.1.6.1 Identification and registration of taxpayers**

Tax Identification Number (TIN) is used to identify taxpayers. Every taxpayer has a unique TIN, which he/she is supposed to use in all his or her correspondence with the tax authority, and no taxpayer should have more than one TIN. In countries like Uganda, they issue TIN free of charge upon the taxpayer completing a TIN application form (Kangave, 2005).

### **2.1.6.2 Filing returns**

Taxpayers are required to file returns within specified months of the end of their tax accounting year. The return should be filed in quadruplicate and should contain all the particulars of the taxpayer. All documents respecting taxation should be presented to the tax authority office where the taxpayer has their file.

### **2.1.6.3 Returns processing**

Upon receiving a taxpayer's return, the tax authority officers examine the accuracy of the return by determining whether the return is properly completed, whether tax has been properly computed, and whether there are any penalty payments to be made by the taxpayer. The officer then allocates an assessment number to the return and issues the taxpayer with a Bank Payment Advice Form, stating the tax payable.

### **2.1.6.4 Payment of taxes**

Taxes are due on the due date of the submission of the self-assessment returns. Tax should be paid to an authorized bank, using the Bank Payment Advice Form.

### **2.1.6.5 Audit and examination**

The role of tax audits and examinations is to check the accuracy of the information that taxpayers provide to tax authorities. The audits range from simple field and desk audits to comprehensive audits.

### **2.1.6.6 Collection and enforcement**

When the taxpayer has not made payment on the due date, and does not object to the tax assessed, tax authority can enforce payment in a number of ways. The Commissioner may bring a suit against the taxpayer or request a person owing or holding money for the taxpayer to pay the money on a specified date or institute distress proceedings against the taxpayer's moveable property. In a wider context, the issue of enforcement includes offences committed by the taxpayer, and the penalties for these offences.

### ***2.2 Overview of the history of Tax Administration in Ethiopia***

There were studies on tax components and tax systems for different periods in different regimes in Ethiopia. Wogene (1983) tried to examine the contribution of taxation. He argued that taxation and system was used as a tool for establishing the material basis of socialism. He estimated the buoyancy and built-in elasticity of the total tax revenue and examined the difference between the two measures to reflect the impact of the tax reforms on tax revenue for the period 1975-1981. He used the constant rate structure method to separate the revenue impact of discretionary tax measure. His result indicated that the tax reforms have significantly contributed to increasing tax revenue in the country.

A study by Teshome (1979) also tried to see tax elasticity in Ethiopia. The author used built-in elasticity method to examine the revenue effectiveness of the Ethiopia's coffee export taxes. His empirical finding shows that revenue elasticity with respect to change in volume and value of exports is unity i.e. the revenue was price inelastic. He thus concluded that the present coffee tax formula requires constant revisions of tax laws whenever significant changes in the price and/or volume of coffee exports occur.

The study by Wegene (1983) showed that for the period 1975-81 tax reforms had enabled an increase in tax collection. This study employed the constant rate of adjustment method to estimate elasticity of the tax system. Likewise, the study by Eshetu compared tax productivity in the pre revolution, post revolution periods of

Ethiopia, and found out that there was certain improvement in tax collection of the government in post revolution Ethiopia.

The study by Teshome, (1979) showed that coffee export tax in Ethiopia was inelastic while study of agricultural tax share in capital formation by Kifle showed that tax collected from this category was very small.

Teame (1985); studied the overall productivity of the tax system for the period 1968-83 and found out that the system had a buoyancy greater than unity but an elasticity which is than one from which the conclusion was that the tax system was unstable and inflexible. This study employed the CRS and DV techniques of estimating tax elasticity.

Zelalem (1999) studied the productivity of the Ethiopian tax system for the period 1961-1998. He estimated the buoyancy and elasticity of the overall and major individual tax categories by using the method of division index. The results of this study showed that the Ethiopian system was inefficient for most of the coefficients were found to be less than one. The explanation given for the low productivity of the tax system was that the system suffered from the problems of weak administration and extensive tax evasion.

## ***2.3 Tax administration***

### **2.3.1 Tax administration organization**

An organizational issue that has received recent attention is the creation of semi-autonomous revenue agencies. Tax administration Autonomy and revenue boards. These appear to have worked well been created- with mixed success- in several developed and developing countries to in increasing to increasing administration efficiency and effectiveness. The same objective forms the background to efforts to improve the cooperation between tax and customs organizations, which can like in Denmark and Canada, result in the complete merger of tax and customs. Even when the revenue administration is not set up as an autonomous agency its relationship to the Ministry of Finance needs to be determined. While in some countries it is part of

the ministry, other countries prefer a separate structure for tax and customs administration. Another issue in some countries has been the creation of a separate Tax Policy, partly following the example of Guardia di Finanza in Italy. In the internal structure of the organization, an issue of key importance is the organizational model, which can be based on tax administration functions, on type of taxes, or on type of taxpayers. In practice, although all tax administrations choose one model as the basic model, to a certain extent mix different organizational approaches. Typical example of such a mix is the creation of a Large Taxpayer Unit in tax administrations organized along functional lines. The second principal issue is the regional structure of the organization, the determination of the number, role and responsibilities of regional and local offices, and their supervision through the headquarters of the organization. An issue which has created serious problems in a number of countries is the interference of local governments in the work of regional and local tax offices in cases where these offices are responsible for the collection of national and local taxes though determinants of their success-and their failure in some cases-have not been systematically explored. Finally,

Internal Accounting conventions for tax administration, though a part of the broader area of government accounting, are important as they affect the accuracy with which administrative costs are determined and allocated to different administrative units, and also for measured effectiveness, for example through conventions for recognizing tax collection arrears.

### **2.3.2 Tax administration management and functions**

The main functions of a tax administration, in dealing with taxpayers, aside from actual tax collection or sanctioning non-compliance, largely involve gathering or processing information. The first information related function is Identification of taxpayers followed by their Registration as taxpayers and, for most major taxes, the assignment of assigning taxpayer identification numbers. Other information function include, at the preliminary stage collection of information from third party sources including, importantly, tax withholders, accessing asset ownership information (such as cadastral records), engaging in tax payer education and providing taxpayer services

to keep their compliance burden low. Verification of the correctness of tax payment starts with return filing control followed by assessment of tax liability of the taxpayer. Among the major types of assessment activities are Valuation and Tax Audit the latter activity typically being the most important function of tax administrations from the perspective of resource use. In some countries a substantial part of valuation and Tax Audit the latter activity typically being the most important function of tax administrations from the perspective of resource use. To establish tax evasion or to facilitate identification of non-filers Investigation and inspection are also necessary. If prima facie non-compliance is established, then penalties and prosecution of tax offenders may be required. Actual Tax collection is divided into two functions, mechanical collection of taxes from those who pay voluntarily on time and collection of delinquent taxes. In some countries a substantial part of the capacity of tax administration is absorbed by the execution of non-tax related functions, such as the collection of user charges and fees for other government agencies. Those kinds of responsibilities should be critically reviewed to allow the tax administration to concentrate on its main function. In several countries, Amnesties are declared for different reasons. Amnesties, of course, must be administered and not just enacted. The final function of tax administrations covered here, again largely information related and becoming increasingly important, is International tax cooperation with other administrations

## **CHAPTER THREE**

### **3 Data Presentation and analysis**

#### ***Historical Background of ERCA***

According to Article 3 of the proclamation No. 587/2008 the Authority is looked upon as “an autonomous Federal Agency having its own legal personality” The Authority came into existence 14 July 2008, by the merger of the Ministry of Revenue, Ethiopian Customs Authority and the Federal Inland Revenue Authority who formerly were responsible to raise revenue for the federal government and to prevent contraband. Reasons for the merge of the forgoing administrations into a single autonomous authority are varied and complex. Some of those reasons include:

1. To provide the basis for modern tax and customs administrations.
2. To cut through the red tape or avoid unnecessary and redundant procedures that results delay and are considered cost-inefficient etc.
3. To be much more effective and efficient in keeping and utilizing information, promoting law and order, resource utilization and service delivery.
4. To transform the efficiency of the revenue sector to a high level.
5. Long process of study called Business Process Reengineering had taken place before any steps were taken to effect the merger of the foregoing administration. The study was undertaken for a year and half beginning from November 2007 by teams of officials’ selected from within the administration.

## ➤ **Power and Duties of ERCA**

The Authority has the following powers and duties to:-

1. Establish and implement modern revenue assessment and collection system;
2. Provide, based on rules of transparency and accountability, efficient, equitable and quality service within the sector; properly enforce incentives of tax exemptions given to investors and ensure that such incentives are used for the intended purposes;
3. Implement awareness creation programs to promote in the discharge of their tax obligations;
4. Carry out valuation of goods from the purpose of tax assessment and collect the taxes;
5. Conduct study and research activities with greater emphasis to improve the enforcement of customs and tax laws, regulations and directives and the collection of other revenues; and base on result of the study and research initiate laws and policies and implement the same up and approval.

## ➤ **VAT Reinforcement and Collection of ERCA**

Ethiopia VAT is a tax system of federal administration by Ethiopia Revenue and Custom Authority /ERCA/. VAT is levied on all goods and services produced in or imported into the country other than those exempt apply.

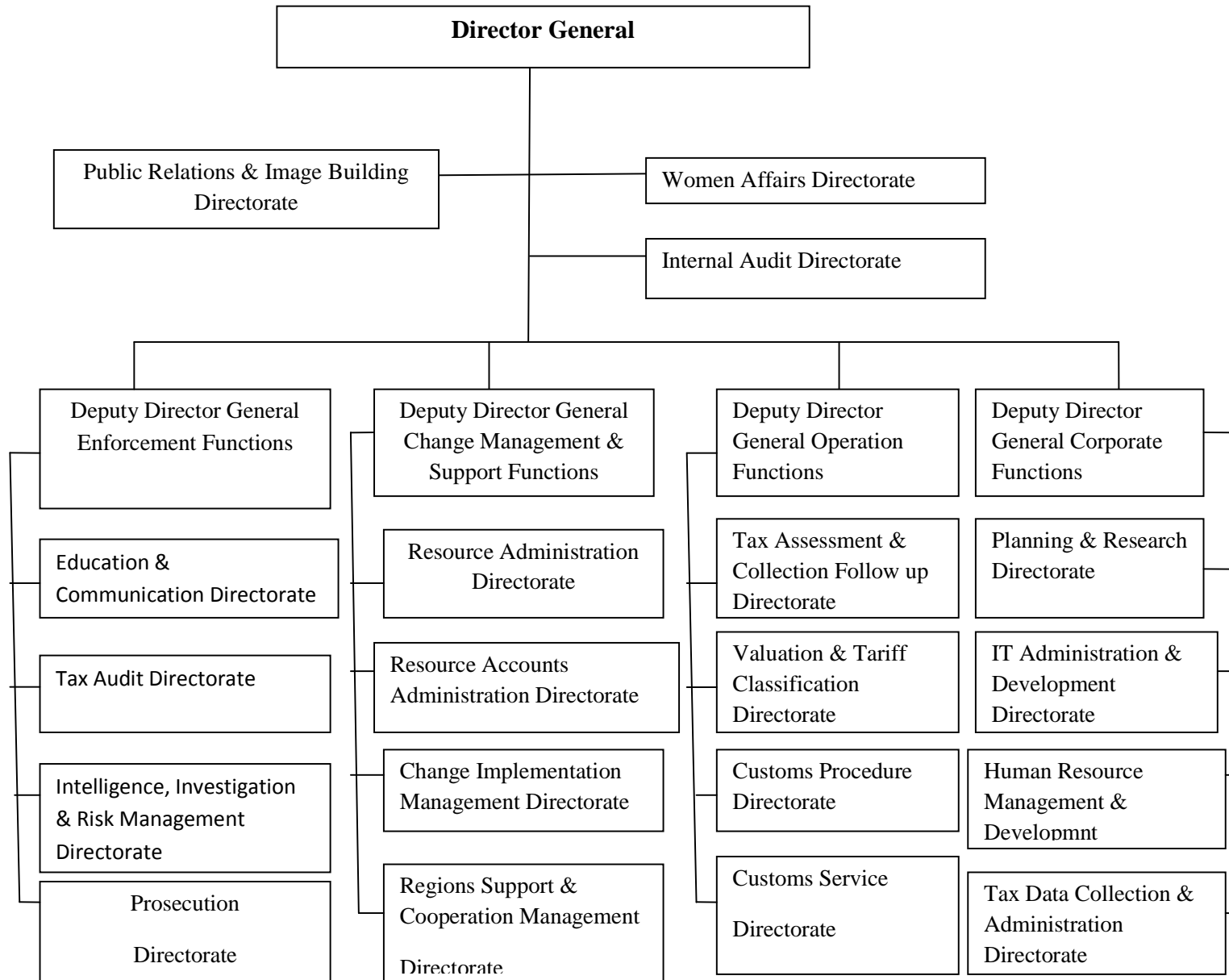
## ➤ **Organizational Structure of ERCA**

The Authority has its headquarters in Addis Ababa. The Authority is led by a director General who reports to the Prime Minister and is assisted by four Deputy Director Generals. The Authority is divided into four sectors and each sector is managed by a Deputy Director General.

Both the director General and the Deputies are appointed by the Prime Minister. The Authority, at the headquarters level, has 19 business processes and two directorates. According to the Council of Ministers Regulation No. 155/2008, the technical term, “business processes” is defined as a class or some class of work flow in which a serious and succeeding group of activates are performed step by step by a case worker or a case team in a single cycle of performance to bring about a result from the external or internal inputs and formation utilized in the general course of performance of the Authority. Each business process and directorate is led by a director.



**Fig 3.1 Organizational Structure of the Ethiopian Revenue & Customs Authority**



There are a total of 11,076 tax payers in N/Lafto sub city Revenue office. The targeted respondents in the N/Lafto sub city Revenue office were 36 tax assessment and collection officers, 22 customer service officer, 20 auditors, 5 investigators, and 10 law officers 20 under resource administration core process, 41 tax data administration core processes and different process owners in different core processes and a manger. Participants were asked general questions, and the researcher explored their responses to identify and define tax officers' perceptions, opinions and feelings about the tax assessment and collection and identified the problems and challenges regarding the tax administering process.

### ***3.2 Background information***

The tax administration in Ethiopia is divided on two levels as Federal and Regional. At the lowest level are a number of woredas in different regions. The tasks of woredas are assessment and collection of taxes and other liabilities of Category "C". the others are the different sub cities that are in charge of tax assessment, collection and control of veracity of the tax bases declared by category "A" and "B" taxpayers in their jurisdiction. At the Federal level ERCA is in charge of collecting revenues, both tax and none tax, from different organizations owned by federal government and from customs duties.

The study focus here is N/Lafto sub city tax payers residing in the sub city. In the sub city, tax assessment and collections are carried out according to income tax regulation No.78/2002 article 18 and value added tax proclamation No.285/2002.

TIN system is registering mechanism in which each taxpayer is given a single identification number to be used in administering the taxes (Income tax proclamation no. 286/2002, article 43). The TIN system encompasses personal and business profiles of taxpayers including full name, address, business information and related information of the taxpayer. The TIN system has the advantages of facilitating proper use of various systems and enhancing the financial recording system of the business communities.

The main expected taxes in the sub city are:-

- Business profit Tax
- Value Added Tax
- Rental Income Tax
- Employment Income Tax from their employee

### **3.2.1 N/Lafto Sub City Small Taxpayers Branch office**

N/Lafto sub city revenue office is the tax authority, which is delegated to assess and collect both direct and indirect taxes from Category "A" and Category "B" taxpayers performing different types of business activities in 12 woredas found in N/Lafto sub city. The office is found around Goffa camp south part of Addis Ababa.

In the statutory authority of the N/Lafto sub-city, the tax assessment, collection and controlling core process office performs assessment of taxes and collection based on income tax proclamation No 286/2002 and Addis Ababa city government charter proclamation No 311/2003, which are delegated powers to sub-city and woredas for the purpose of efficient provision of various social goods and services.

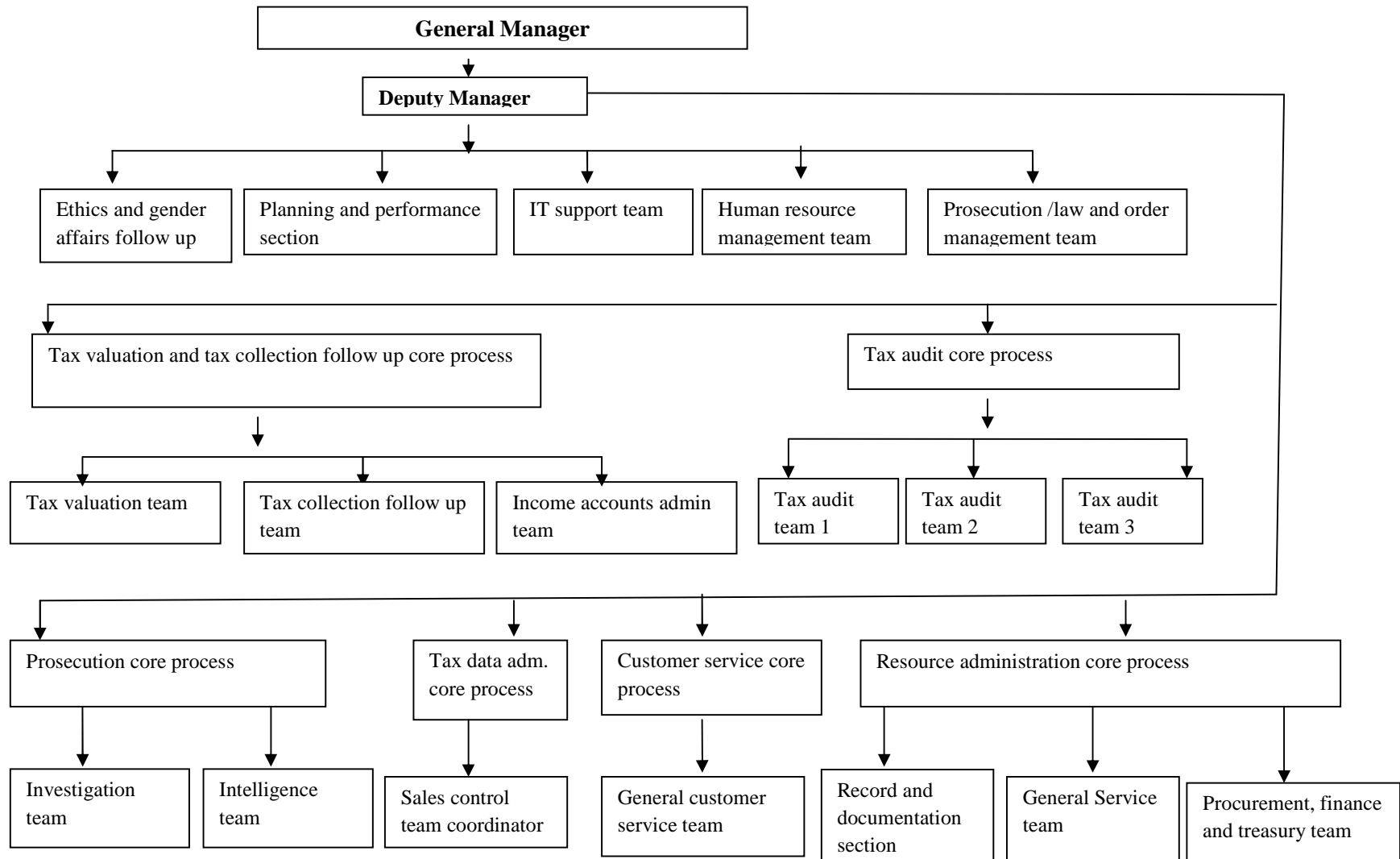
N/Lafto revenue office has an objective to establish modern revenue assessment and collection system, and provide equitable, efficient and quality service to tax payers, who are considered customers, and cause taxpayers voluntary discharge their obligation by enforcing the applicable tax laws.

SIRM (Standard Integrated Revenue Management) and SIGTAS (Standard Integrated Government Tax Administration System) software are applicable for regular tax assessment and collection.

### **3.2.2 The structure and profile of N/Lafto sub city Revenue Authority**

The organizational structure is designed on the basis of different activities to be performed rather than depending on the different tax types.

Fig.3.2.2 organization structure of N/Lafto sub city small taxpayers branch office



Source: N/Lafto sub city small tax payers branch office statistics section.

According to the business process reengineering, tax assessment and collection officer is accountable and responsible for the data or documents presented by a self- assessed taxpayer and collect the assessed amount properly.

Taxpayer's registration and information officers are responsible for registration of taxpayers based on the regulation of licensing by receiving necessary information, and then passing the documents to documentation section.

Tax assessment auditors receive records of the required books and supporting documents of taxpayers to verify according to business income tax regulation for purpose of taxation. After statements are verified, a copy will be given to taxpayer and also send to documentation section, which is based on by the approval of income tax assessment, collection and controlling core process owner.

Income tax intelligence investigation and income tax law accomplisher and controlling process officers are responsible to check whether taxpayers are performing in compliance with the applicable rules and regulations and to take legal action on the bases of proclamation no 311/2003 on those who receive tax assessment notification and refused to pay their liability.

In general, the newly conducted business process reengineering changed the previous structure by empowering individuals based on their duties and responsibilities. So Revenue Authority previously is called Revenue Agency is directly accountable to Addis Ababa city Administration executive body. At present N/Lafto sub-city small taxpayers branch office is accountable to Ethiopian Revenue Customs Authority.

The researcher tries to examine the existing profit tax, rental income tax and value added tax assessment and collection systems followed by N/Lafto sub-city.

### **3.2.3 Profit tax administration**

If a taxpayer has submitted a declaration of income within the time and manner as prescribed in the proclamation, the N/Lafto sub city revenue office has five years to amend the assessment. The five years assessment period runs from the due date of the

declaration. In case where the taxpayer has not declared his/her income or has submitted a fraudulent declaration, assessment is made by the Tax Authority.

Every assessment notification should contain the following elements: gross income and deductions applicable; taxable income; rates applicable or percentage; taxes paid and due; and any penalty or interest; taxpayer's name, address, and TIN; and brief explanation of the assessment and a statement of the taxpayers' rights.

### **3.2.4 Value Added Tax (VAT) administration**

The introduction of VAT was part of the overall tax reform program in Ethiopia.

Proclamation No.285/2002/

The design of the VAT legislation is intended to achieve the expected revenue projections, support capital investment and development, simplify its administration for the tax authority and the business community, and combined with the recent reductions in the income tax rates, minimize the tax burden for the lower income population.

The International Monetary Fund (IMF) provided excellent technical assistance through the assignment of an experienced and competent legal expert who drafted the legislation, regulation and explanatory notes. In addition, the expert participates in the key seminars with the various stakeholders and made comprehensive presentations on the concepts, benefits and impacts of the VAT.

According to the VAT proclamation cited, supply of goods and rendering of services are subject to standard 15% tax rate except those exempted and zero-rated by the tax law. The standard rate is the same as the repealed sales tax, which applied only to imports and domestically manufactured goods. Unlike the sales tax, the VAT provides for the relief of tax on all business inputs including capital goods, operating and administrative expenditures, and will further encourage investment by the zero rating of exports and the international transport of goods and passengers. VAT exemption has been extended to the basic necessities such as Education, Medical services, Electricity and Water, Kerosene,

Basic foods, Transportation Service, the sale of a used dwelling or the lease of dwelling, the supply of goods and rendering of services in the form of humanitarian aid, etc.

The VAT registration threshold is based on annual turnover of taxable goods and services of Eth. Birr 500,000 (USD 59,000) on the premise that taxpayers with this turnover level of business activity will maintain the required books and records as a normal business practice and will be able to cope with the VAT requirements. The law also allows voluntary registration for those who regularly supply or render a least 75% of their goods and services to registered persons. This implies existence of both obligatory and voluntary registration for VAT.

Once the registration takes place and the registered person is issued VAT registration certificate, the registrant is obliged to fulfill and requirements stipulated by the tax law. This includes issue VAT invoice for all taxable transactions, file vat declaration within the tax period (every calendar month) and pay tax due.

The law provides strengthened enforcement powers to the tax authority to the extent of seizing property of the liable taxpayers. This is in line with international practices, which will improve taxpayer compliance and support the goal of equity, fairness and consistency in the administration of the tax laws.

Failure to comply with the provisions of VAT obligations stipulated is subjected to administrative penalties and criminal offences. Administrative penalties and interest are applicable to failure to file, failure to pay, failure to maintain books and records etc. violations of the VAT law are tax offences, and hence, shall be charged, prosecuted, and appealed in accordance with the Ethiopian criminal procedure law. Tax evasion, making false or misleading statements, obstruction of administration, failure to notify changes in addresses and line of business, un authorized VAT collection aiding or abetting, offences by entities, offences by receivers, improper tax and debit tax credit notes are subject to prosecution, and on conviction be subject to monetary fine and imprisonment.

Any tax officer or former taxation officer employed in carrying out the provisions of the VAT proclamation who commit offences is subject to monetary fine imprisonment.



### **3.2.5 Rental Income Tax Administration**

Tax on income from rental of buildings is the tax imposed on the income from rental of buildings. If the taxpayer leased furnished quarters, the amounts received attributable to the lease of furniture and equipment would be included in the income and taxed.

The owner of a building who allows a lessee to sub-lease is liable for the payment of the tax for which the sub-leaser is liable, in the event the sub-lessor fails to pay; when the construction of a rental building is completed or when the building is renewed, the owner and the builder are required to notify the administration of the woreda in which the building is situated about such completion and name, address, and tax identification number of the person or persons subject to tax on income from rental of buildings; the woreda administration has the obligation to communicate the information obtained to the appropriate tax authority.

Tax on Income from Rental of Property is tax on income derived from casual rental of property (including any land, building, or moveable asset) not related to a business activity. This type of income is subject to tax at a flat rate of 15% of the annual gross income.

### ***3.3 Analysis of Questioners and Interview***

In this chapter the information gathered about tax assessment and collection problems of taxpayers residing in N/Lafto sub city through the use of interview and questionnaire are presented and analyzed.

#### **3.3.1 Number of Respondent**

10 questionnaires were prepared and distributed to the tax payers and some questions were asked to respective tax collectors and workers. Out of 10 questionnaires distributed to tax payers randomly 7 of them returned back and 3 were not returned. Therefore the analysis is based on returned questionnaires i.e. 70% of the distributed questionnaires. Almost all of the interview questions are replayed by the representative of N/Lafto revenue office tax

officers. To make easier for understanding to the respondent taxpayers the questions were prepared in Amharic and the sample is attached as annex “A” at the end of this paper.

### 3.3.2 Analyses of the Questioners

Table 3.3.2 Tax payer's responses on tax assessment and collection problems

No	Item	Respondent	
		Number	Percent
1	Response of questionnaires		
	a) responded	7	70%
	b) non responded	3	30%
2	Respondents service satisfaction		
	a) satisfied	2	29%
	b) unsatisfied	5	71%
3	Survey response regarding the fulfillment of required documents		
	a) fulfill required documents	4	57%
	b) sometimes fulfill documents	2	29%
	c) No opinion	1	14%
4	Respondents' tax knowledge		
	a) Sufficient knowledge	2	29%
	b) Not much knowledge	4	57%
	c) No opinion	1	14%

5	Usage of cash register machine		
	a) Use cash register machine	4	57%
	b) Do not use cash register machine	3	43%
6	Level of training regarding the use of cash register machine		
	a) Got adequate training	2	33%
	b) Did not get adequate training	4	67%
7	Faced problems when using cash register machine		
	a) Yes	5	83%
	b) No	1	17%
8	Did you get quick and adequate support from the tax authority		
	a) Yes	1	17%
	b) Sometimes	3	50%
	c) No	2	33%

Source: compiled from the questionnaire

From the questionnaires distributed in the above table number 1, 70% of them returned the questionnaires, while the remaining 30% did not.

When the respondents were asked about service satisfaction in N/Lafto revenue office in table no.2, majority of the respondents, 71% replied that they are not satisfied with the service provided by the tax offices. Only 29% were satisfied.

The survey also assessed regarding the fulfillment of required documents, in table no.3. The result was 57% of the respondents fulfilled the required document when they went to the tax office. While 29% of them replied, they sometimes fulfill the required document; where as 14%, of them did not give their opinion.

The respondents were also asked regarding their tax knowledge and procedures in table no.4, 29% replied as having sufficient knowledge about tax procedures, while majority of them, i.e. 57% do not have much knowledge, and 14% did not give their opinion.

Additional when the respondents were asked about the usage of cash register machine on table number 5, 57% of them replied that they use cash register machine, while 43% do not use cash register machine.

Moreover when the respondents were asked about the level of training regarding the use of cash register machine on table number 6; 33% replied that they have acquired the necessary dose of knowledge about how to operate the machine. Whereas majority of the respondents, 67% did not get adequate training as to how to operate the machine.

When the respondents were asked on question no. 7, regarding any problem they face when using register machine, majority of them, 83% face problems when using cash register machine, while 17% did not face any trouble with the machine.

The respondent's were asked about the assistance they got from the tax authority on question 8 from the above table. 17% replied they got quick and adequate support from the tax authority when they face problems. While 50% replied that they sometimes got support and the rest (33%) replied that they did not get quick and adequate support.

### **3.3.3 Data analysis**

This section focuses on the analysis of the outcome of survey in association with in-depth interview with tax officers and tax payers.

According to the information given from the interview of N/Lafto revenue tax officers, the office does not have the required man power and state the following two points as a main reason.

These constraints are both internal and external to the office

1. Internal constraints: generally the main internal problems lie as lack of vision of the work force, ethics and lack of skilled manpower. Especially, one of the major problems is that the tax worker in the sub city did not fulfill the spirit of service giving duties and responsibilities and this has its own impact on the service delivery system by the tax office. Apart from this some tax office workers leaving aside their duties and responsibilities made a wrong relationship with some taxpayers and tried to fulfill their personal interest. And also the low level of technological application to collect taxes and not making proper check of the validity of financial statement presented by tax payers due to not having well organized and properly trained tax audit department.
2. It is difficult to create an efficient tax administration without a well trained staff, when money is lacking to good wages to tax officials and to computerize the operation.
3. External constraints include low level of tax awareness by tax payers, not maintaining proper accounting records and taxpayers try to use various techniques which enable them to pay lesser amount of tax (like failure to issue invoice during transaction, suspension of sales, forger of VAT invoice).

Based on the information gathered from the interview with tax officers and from literature review the following analysis is made for Profit tax, VAT and Rental income tax assessment and collection problems.

Table: 3.3.3 shows the amount of money collected by tax payers in N/ Lafto sub city small tax payers branch office

Year	Collected amount of money in Birr
2009/2010	126,814,884.58
2010/2011	172,761,161.07
2011/2012	194,606,388.21

Source: N/Lafto Sub city small taxpayers branch office

Note: Summary of different tax income for the sub city for three consecutive years are attached as annex at the end of this paper.

The total number of taxpayers when this data was collected as of March 2013 in N/Lafto revenue office is reaching 11,076. However, there are very few employees as compared to the increasing number of tax payers from time to time. There are 36 tax assessment and collection officers, 20 tax auditors, 11 employees under prosecution section, 41 tax data administration and cash registration, 22 employees under customer service core process and 20 employees under Resource administration Core process. Especially under customer service core process the generalized customer service section which includes about 22 senior and junior officers are very few in number in comparison with the very large number of customers as a result there is always overcrowding and dissatisfaction of tax payers.

Due to increased investment opportunities, and awareness creation programs held in the sub city, the amount of tax collected shows rising as seen in the above table.

From the interview the other problem pointed out was that there are still some taxpayers though it is decreasing nowadays with different TIN numbers for different business activities. More over, the prevalence of firms performing business without being registered or having TIN created duplication and falsification of address and reduce the tax revenue of the government.

One of the challenges that the office faces is the chronic corruption as the interviewee explained. Undesired communication b/n some taxpayers with some auditors, some tax assessment, tax collection and follow up officers and also with daily income estimators are areas that are prone to corruption. However, there is problem of identifying corrupted tax officers since they are doing it under ground with great care and secrete. When some suspected officers leave or resign from the work they are found out to be accountants for some taxpayers.

One basic problem is that most taxpayers and their employees lack sufficient education to understand the laws and regulations of taxation that affects the income tax administration.

More over some taxpayers purposefully submit nil returns and also prepare a financial statement showing low profit for the sake of paying reduced corporate profit tax and even there is also no willingness to submit complete financial documents for audit.

Proclamation No. 286/200 article 21 and 26 of value added tax and regulation of the tax No. 78/2002 article 11, every taxpayer who has registered is obliged to declare and pay tax. Therefore regarding VAT, some tax collectors, even some of the management of the core process lacks the necessary knowledge to administer collection of VAT.

Tax payers use to complain about a complex procedure when they went to the tax office to pay their taxes. More over, tax payers often complain about the use of cash register machine b/c they did not get sufficient training how to operate it and also it is expensive. In an effort to conquer unreasonable tax assessment and also to establish fair and modern tax administration nationwide, the Ethiopian Revenues and Customs Authority (ERCA) has pushed forward with the implementation and use of sales register machines. Since its commencement- to-date, 55,866 taxpayers have been using 62,549 sales register machines across the country. A great share of these (46,947) taxpayers are using 52,796 machines in the capital and the rest are share out by Tigray, Amhara, Oromia, South, Somale, Harari Regional States and Dire Dawa City Administration, according to the monthly report of Tax Data Directorate of ERCA. Finally from the sold out of 67,631



machines, 62,549 have been ready and put in place so far, according to November report. Some taxpayers did not give invoice to beneficiaries to hide their income.

In the case of rental income tax, the major problem observed was that there is no complete list of registered rental income taxpayers; this may be due to few numbers of employees in the sub city. More over the registered rental tax payers bring a false document which do not show the exact amount of rent by reducing the amount of money and that will affect the revenue of the government.

According to the information gathered from the interview some tax payers when their estimated tax revenue is high they close and return their license and in turn again they evade and open their license through their relatives and continue the same business to get more profit until the coming year by so doing they affect what the government ought to gain, but when the office proves that they are continuing the same business they are obliged to pay that same amount.

Some of the identified problems on tax assessment and collection procedures in the sub city are as follows:-

- Poor or lack of clear understanding about tax proclamations, regulations and government policies by tax payers and few employees to apply it, this has lead that the tax workers lack confidence and are unable to decide by their own; on the other hand it is believed to be a means of avoiding accountability even by some process owners and in turn this leads to a delay for the decision process and it is one big complain raised by the business community.
- Shortage of dedicated or committed tax officers and also very frequent employee turnover, this leads to over burden on some motivated officers.
- Tax payers are not willing to give clear information.
- Electric power failure.

- System failure from ETC (network interruption which consumes the time of customers and also the tax officers are unable to perform their task timely.)
- Lack of organized computer system even shortage of printers, etc
- The tax office is not wide enough to accommodate the large number of tax payers
- Lack of sustainable educative promotion by the government though there is seldom awareness trainings.
- Poor management system, which can not confidentially consult tax payers and lead tax officers due to insufficient awareness of rules and regulation of the tax system of the country.
- Poor handling of organized data system for referring targeted plans and performance achieved for each fiscal year.

## **CHAPTER FOUR**

### **CONCLUSION AND RECOMMENDATION**

The main conclusions and recommendations are drawn from the analysis of the data.

#### ***4.1 Conclusion***

From gathered in formations through interview and from questionnaires I made the N/ Lafto sub city small taxpayers branch office encounter administrative and operational problems to assist the taxpayers. Due to inefficient and insufficient number of tax assessment and collection officers in the sub city including weak management one can conclude that, the amount of tax revenue that should be collected is not registered.

One-to- five team evaluation conducted every day at present should strengthen the team spirit, relationship and should improve weak sides among workers.

It was observed that the sub city administration especially ERCA should find a solution as to why a large number of employees resign work which results in over burden on remaining few tax officers.

Category “C” tax payer’s income and tax liability who were not required to maintain books and records is assessed/ estimated by tax workers. This system relied heavily on the judgment of the tax officers, which creates inconsistencies in the treatment of the taxpayers and creates a loophole for corruption; but the sub city administration tries to solve this problem by sending officers in groups and is also the income is revised each year.

Survey also showed that, most tax payers do not know the rules and regulations of different types of taxes they pay. Due to this, negligence, delay in tax payment and evasion are taken by tax payers as solution to escape from payment of taxes. More over

taxpayers do not record their book timely and do not submit their book of records timely for assessment.

#### **4.2 Recommendation**

To minimize the tax administration problem in N/Lafto sub city one can forward the following suggestions:-

- ERCA has to staff adequately in terms of qualifications and number of the employees. It also needs to give continuous training to its employees to improve their capacity.
- Further work must be done by the tax office, to identify tax payers that bring under invoicing, that sale with out invoice, and unusual credit declaration and also should identify those that are not registered so far.
- At present ERCA has started to use ICT using internet for tax payers to declare their income, however to apply this system in the sub cities tax office, frequent interruption of net work system that challenges the tax administration must be improved.
- Problems related to cash register machine facing tax payers should be solved by tax officers themselves to facilitate the activity of each customer.
- The office should increase tax payer's educational programs to increase tax awareness by tax payers. Tax payers should know that payment of tax by them will benefit the country's development and will be used for provision of social benefits to the public as a whole. As a result, they will be benefited directly or indirectly.

In general, the tax reform program will continue to contribute to the capacity enhancement of the country through maximization of revenue, attainment of macro economic stability, and creating conducive environment for private sector development to promote economic

growth and also combat corruption. Last but not least, to minimize the problems in the N/Lafo sub city revenue office and to improve tax administration, tax assessment and also procedures amending or revising past mistakes and should conduct continuous discussion with taxpayers and promote tax payers to give genuine feed back as to how to improve or increase our country's economy.

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## Annex A: Questionnaires

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**Annex B Summary of Income of N/Lafto Sub City Small Taxpayers Branch Office from 2009/2010 – 2011/2012 and partly for 2012/2013 up to April 18/2013**