

***FACTORS AFFECTING CATEGORY “C” TAXPAYERS’  
COMPLIANCE WITH TAXATION A CASE OF MIZAN-AMAN  
TWOON, SNNPRE***

***A Thesis Submitted To the School Graduate Studies of Jimma University in  
Partial Fulfillment of the Requirements for the Award of Masters of Science  
Degree in Accounting and Finance***

***BY: -***

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***JIMMA UNIVERSITY***

***COLLEGE OF BUSINESS AND ECONOMICS***

***MASTERS OF SCIENCE (MSc) PROGRAM***

***JUNE, 2017***

***JIMMA, ETHIOPIA***

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***UNDER THE GUIDANCE OF: -***

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***Board of the Examination Thesis***

We, the under signed members of the board of examiners red this thesis *Factors Affecting Category “C” Taxpayer’s Compliance with Taxation a case of Mizan-Aman Town, SNNPRE”* and evaluated the final open defense by *Muluken Tizazu*. We examined the candidate and then we certify that it is suitable submission for the reward of Master Degree in Accounting and Finance (MSc).

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## **Abstract**

*Understanding the factors affecting tax compliance has become an important topic for increasing public levies, especially since Tax is a compulsory contribution (levy) by an economic unit to a government without expectation of direct and equivalent return (quid pro quo) from the government for the contribution made (Bhatia, 1976). Government needs financial resources to act as a government and play a role that is expected from it by the public. According to the Federal Income Tax Proclamation No. 978/2008 taxpayers are categorized into three categories, namely category “A”, “B”, and “C” based on their volume of sales. Consequently, this thesis studies “Factors Affecting Category “C” Taxpayer’s Compliance with Taxation a Case of Mizan-Aman Town, SNNPRE”. The aim of this paper is therefore identifying factors affecting Category “C” Taxpayer’s Compliance with Taxation a Case of Mizan-Aman Town, SNNPRE. Based on the objectives of the paper and the availability of relevant information, this research paper was employed explanatory research approach so as the researcher has used it to identify factors affecting category “C” tax payers’ compliance with taxation in Mizan-Aman Town, SNNPRE. The main sources of data for the study are found from primary source; and this data was analyzed using explanatory qualitative method research approach, correlation and regression analysis. Seven independent variables that affect tax payer’s compliance with tax law were selected and analyzed. The study results from the survey conducted in Mizan- Aman Town using 54 respondents, indicate that Category “C” Taxpayer’s compliance was statistically influenced by six independent variables such as Fairness or Equity, Organizational strength of tax authority, Cultural factors such as Peer reporting and Ethical values, Social factors such as Social norms, Personal norms, Self-interest and Peer groups, Attitude of tax payers towards the government and Economic deterrence. Indeed focusing and exploring factors that determines and motivates citizens’ tax compliance to pay taxes in general and category C tax payers in particular could essential to raise domestic revenues from consenting citizens.*

**Key words:** *Compliance behavior, Tax payers, taxpayers’ compliance.*

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## **Abbreviation**

BoFED:	Bureau of Finance and Economic Development
CSA:	Carrot and Stick' Approach
DECB:	Dimensions of Ensuring Compliance Behavior
EFY:	Ethiopian Fiscal Year
ECRA:	Ethiopian Revenue and Customs Authority
FDRE:	Federal Democratic Republic Of Ethiopia
IAT:	Institutional Anomie Theory
IRS:	Internal Revenue Service IRS
MoFEC:	Ministry of Finance and Economics Cooperation
MATARBO:	Mizan-Aman Town Administration Revenue Authority Branch Office
RCA:	Responsible Citizens' Approach
RUTC:	Relevance of understanding Tax Compliance
SPSS:	Statistical Package for Social Science
SNNPRE:	South Nation, Nationalities, and People Region of Ethiopia
STATA:	Multipurpose Statistical Package
TPB:	Theory of Planned Behavior

### **Variable Abbreviation**

ATG:	Attitude of Tax Payers towards the Government
AWR:	Awareness Level of Tax Payers
B:	Coefficient for Xi
CFS:	Cultural Factors
ED:	Economic Deterrence
Ei:	Residual Term
FAS:	Fairness or Equity
H:	Research Hypotheses,
Ha:	Alternate Hypothesis
H0:	Null Hypothesis
OSTA:	Organizational Strength of Tax Authority
SFS:	Social Factors
TCOMP:	Tax Compliance

# CHAPTER ONE: INTRODUCTION

This chapter presents background of the study, statement of the problem, objectives of the study, significance of the study, scope and limitation of the study, and organization of the paper.

## 1.1. Background of the Study

Tax non-compliance is a serious challenge slackening income tax administration and tax revenue performance in Ethiopia, as it does in some other developing countries. Like other developing countries, Ethiopia faces hurdles in raising revenue to the required level in order to scale up the development endeavours. Ethiopia has experienced an unswerving surplus expenditure over revenue for a sufficiently long period of time. To address this problem, the government introduced direct and indirect taxes to improve public revenue although prior statistical evidence proves that the contribution of income taxes to the government's total revenue remained consistently low. It is obvious that taxes are important source of government revenue in both developing and developed countries. But the amount of revenue to be generated by a government from taxes for its expenditure program depends among other things, on the willingness of the taxpayers to comply with tax laws of a country (Eshag, 1983). Tax is a compulsory contribution (levy) by an economic unit to a government without expectation of direct and equivalent return (quid pro quo) from the government for the contribution made (Bhatia, 1976). Government needs financial resources to act as a government and play a role that is expected from it by the public. So what the government gives it must first take away. The economic resources available to society are limited, and so an increase in government expenditure normally means a reduction in private spending. In this regard James (2000) states that taxation is one method of transferring resources from the private to the public sector. Other writers (Auld & Miller, 1984) describe the role of taxes as an instrument that stabilizes the economy, and reduces private demand so that resources can be released for public sector use. Generally, governments levy taxes for multiple of purposes, but mainly to raise funds in order to cover public expenditures and on the other hand to properly allocate resources.

Tax compliance has been defined in various ways by various authors. For example, Kirchler (2007) stated that compliance might be voluntary or enforced compliance. Voluntary compliance is made possible by the trust and cooperation between tax authority and taxpayer and it is the willingness of the taxpayer on his own to comply with tax authority's directives and regulations. However, in the presence of distrust and lack of cooperation between authority and taxpayer, which creates tax hostile climate, authorities can enforce compliance through the threat and application of audit and fine. Alm (1991) and Jackson and Milliron (1986) defined tax compliance as the reporting of all incomes and payment of all taxes by fulfilling the provisions of laws, regulations and court judgments. Another definition of tax compliance is a person's act of filing their tax returns, declaring all taxable income accurately, and disbursing all payable taxes within the stipulated period without having to wait for follow-up actions from the authority (Singh, 2003).

Different stories and evidences point out that Emperor Zeria-Yakob started taxation in Ethiopia during the 15th century. Governments which came to power in Ethiopia at different periods have frequently revised and repealed the statutory bases for various types of taxes providing for tax bases and tax rates, time and mode payment, exemptions and offenses. However, there has been no document or materials produced which compiles tax proclamations issued at different periods.

The initial statutory bases for all the tax proclamations was the 1931 Constitution of Ethiopia which later revised and become Revised Constitution of Ethiopia. Because most of the products on which tax was levied (tax bases) were agricultural products, the type of taxation in traditional periods was unstructured and mostly in kind. Taxation in that period was varying highly from area to area and was often arbitrary, i.e. the amount to pay and the mode of payment depends on the will of the chief tax collector and the kind of resources available in the area.

According to the Constitution of Federal Democratic Republic of Ethiopia, revenue sources are assigned between Federal government and Regional states. Regional states can endorse their Income Tax Proclamation and Regulations based on the constitution in conformity with the Federal Income Tax Proclamation.

Taxpayers are classified into three categories according to their annual turnover they generate during a particular tax year. The Ethiopian income tax law classifies taxpayers into three categories. i.e., According to the Federal Income Tax Proclamation No. 978/2008 taxpayers are categorized into three categories, namely category “A”, “B”, and “C” based on their volume of sales. “Category A” Consists taxpayers with annual turnover Birr 1,000,000 or more as well as PLC and Share Companies regardless of their turnover. While “Category B” Taxpayers are taxpayers these have annual turnover between Birr 500,000 and Birr 1,000,000. The revised Income Tax Proclamation drafted and revised by the Ministry of Finance and Economics Cooperation (MoFEC) and Ethiopian Revenue and Customs Authority (ECRA).

### **Category ‘C’**

Category “C” is the third and the last category. Small businesses are the main types of businesses incorporated in this category. Taxpayers below Birr 500,000 annual turnover are classified under “Category C” taxpayers. That is, unless already classified in categories ‘A’ and ‘B’ include those taxpayers whose annual turnover is estimated by the Tax Authority with turnover between Birr 500,000 and Birr 1,000,000. On the other hand, standard assessment is used to determine the income tax liability of Category ‘C’ taxpayers. This type of assessment is a fixed amount of tax determined in accordance with the Council of Ministers Regulation established Schedules. 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 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.

Citizens’ inclination to cooperate with the state and its institutions in general and their willingness to pay taxes in particular, depend on a variety of variables. While economists stress the relevance of external variables such as tax rate, income and probability of audits and severity of fines, psychological research shows that internal variables are of similar importance: taxpayers’ knowledge of tax law, their attitudes towards the government and taxation, culture, personal norms, perceived social norms and fairness, as well as motivational tendencies to comply are determinants factors shaping tax behavior (Kirchler, 2007).

Empirical research on determinants of tax behavior has shown mixed evidence on the specific weight of economic variables: some studies found audits and fines to increase compliance; other studies have not found any or even opposite effects (Fischer, Wartick & Mark, 1992; Andreoni, Erard & Feinstein, 1998). The inconsistency of patterns of results suggests that economic and psychological determinants operate differently under different circumstances. Kirchler, Hölzl and Wahl (2008) developed a model suggesting that audits and fines are relevant under the condition of low trust in governmental institutions and tax authorities in particular, especially if the government has the power to exert audits effectively.

In a climate of mutual distrust, citizens can be forced to comply. On the other hand, if the climate is characterized by mutual trust, audits and fines would signal authoritarianism and distrust, and thus, rather than increasing compliance, be ineffective or even counterproductive. In a climate of mutual trust, citizens have positive representations of the tax systems and tax authorities and cooperate spontaneously. High subjective tax knowledge, favorable attitudes, personal and social norms of cooperation, as well as perceived fairness of the tax system are the basis of a motivational tendency to cooperate, of trust, and tax payers, compliance (Kirchler, 2007). Hence, Tax compliance is taxpayers' willingness to obey tax laws in order to obtain the economy equilibrium of a country (Andreoni, et al 1998).

The tax system must be fair, both to promote the objective of an equitable distribution of income and to assure continued voluntary compliance by the taxpayer (Eckstein, 1979). Successful tax administration requires tax payers to cooperate in the operation of a tax system rather than to be forced to carry out every aspect of their tax obligation. That is tax law cannot cope with every eventuality and therefore has to be supplemented with supporting provisions (James and Wallschutzky, 1995). Administrative procedures and decisions as well as appeal arrangements all have a part to play but the tax system cannot work properly without a reasonable degree of voluntary compliance on the part of taxpayers' themselves. The paper has, therefore, tried to assess factors that affect tax payer's compliance with taxation.

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

Without trust there is little basis for social co-operation and taxpayers' willingness to obey tax laws in order to obtain the economy equilibrium of a country and could potentially benefit everyone. A topic which has interest from a variety of commentators is the issue of tax compliance. No tax system can function effectively without the co-operation of the great majority of tax payers, so the factors which affect compliance are important. The definition of compliance is usually cast in terms of the degree to which tax payers comply with tax law. It has been said that the degree of non-compliance can be measured in terms of the 'tax gap'. This represents the difference between actual revenue and that which would be received if there were 100% compliance. Scholz (1998) and Fjeldstad (2009)

Public attitude towards taxation is also in turn affected by the social, cultural, and political factors as well as awareness about tax and fairness of the tax system. If it is perceived that only those who are wealthy or dishonesty or both benefit from non-compliance, this might reduce 'tax morale' and the willingness of the rest of the population to comply. Ethiopian modern tax administration is not older than half a century. It has undergone several legal amendments during this time. But the improvement is not as big as its age as far as citizen's tax compliance is concerned. The tax system in the country mainly stresses on legal enforcement as a remedy to ensure its proper functioning. For example, the Income Tax Proclamation (No. 978/2008 has increased the amount of penalties and strengthened the means of enforcement while it states nothing about how to create and increase the awareness of the taxpayers. It gave the tax authorities the right to sell the property of evaders without going to courts in order to collect the outstanding tax liability. Most of the reform efforts basically targeted institutional capacity building and putting enforcing legal frameworks in place while only insignificant effort, if any was deployed to make the public aware of the benefits of paying tax to the nation.

In a country like Ethiopia where the contribution of revenue to the overall economic development is believed to be very much significant, more local studies on the assessment of tax payers compliance with tax law is required so as to provide the policy makers and the implementers in the area with relevant information that can help them in designing the appropriate tax system.

This study is therefore; try to assess tax payers' compliance with tax law with a special reference to category "C" tax payers in Mizan-Aman Twon, SNNPRE. The rationale that motivates the researcher for focusing on this category of taxpayers is they are the most problematic category of taxpayers and considered as hard to tax group. (Head of Mizan- Aman Twon Administration Revenue Authority Branch office).

### **1.3. Research Questions**

The study has undertaken to address the following research questions:

- ❖ What are the factors that motivate taxpayers to pay taxes in general and category C tax payers in particular?
- ❖ What are the factors that generally affect taxpayer's compliance and category C tax payers in particular?
- ❖ Why category C tax payers become reluctant when it comes to paying tax?
- ❖ What strategy is appropriate and effective to increase category C tax payer's compliance?
- ❖ Why category C tax payers are considered as the most problematic category of taxpayers?

### **1.4. Objectives of the Study**

Therefore, having the aforementioned statement of problem in mind, the researcher has addressed the following research objectives:

#### **1.4.1. General Objective**

The main objective of the study is to examine factors affecting Category "C" Taxpayer's Compliance with Taxation a Case of Mizan-Aman Town, SNNPRE

#### **1.4.2. Specific Objectives**

In addition to the above general objective, the researcher has tried to achieve the following specific objectives through the research project.

- ❖ To explore factors that motivates category C tax payers to pay taxes ,
- ❖ To identify the determinant factors that affect category C tax payers' compliance with tax laws,
- ❖ To reduce the neglect of category C tax payers when it comes to paying tax, and
- ❖ To identify what strategy is appropriate and effective to increase category C tax payer's compliance.

## **1.5. Research Hypotheses (H)**

Given the availability of prior literature on the phenomenon of tax compliance and the need to examine the other critical “actors in the field” (Alm et al., 2011) which influence the individual’s compliance decision, particularly within the context of a developing country like Ethiopia, in line with the broad purpose statement the following directional hypotheses were formulated and examined in this study, and the hypothesis of the thesis is developed after supporting theoretical framework so as to achieve the objective of the study. The rationale for formulating directional hypothesis is in order to know the magnitudes (a cause-effect relationship) between the independent and dependent variables / taxpayer’s compliance establish.

**H<sub>1</sub>:** Fairness does not affect Taxpayers Compliance.

Tax fairness is one of the variables that have attracted researchers to discover the extent the variable in fostering noncompliant behavior Wenzel (2007). Special interest is taken to relate the importance of tax fairness as a construct under attitudes and perceptions towards tax compliance.

**H<sub>2</sub>:** Tax Authorities Strength does not affect Taxpayers Compliance.

Bird and Oldman (1967), no tax will work effectively, unless its administrators maintain an aggressive attitude with respect to the correctness of the taxpayers’ actions.

**H<sub>3</sub>:** Tax payers’ awareness does not affect Taxpayers Compliance.

The effect of tax payers’ attitude on fairness as Anna, Che, and Kamala (2008), stated taxpayers’ perception on the tax system is important because fairness of the tax system will instill compliance among taxpayers. Attitudes about the tax system and perceptions of fairness are naturally influenced by what the public actually knows about it. A tax system that is complex, that is poorly understood by both tax administrators and taxpayers, that creates numerous opportunities for corrupt behavior, and that involves coercion in the collection of taxes from reluctant citizens provides a poor basis upon which to build trust between citizens and the government. Hence, due to complex tax system and weak data compile system are believed to affect the amount of tax to be collected (Anna, Che, and Kamala, 2008).

**H4:** Cultural factor does not affect Taxpayers Compliance.

“Culture” is considered to be a powerful environmental factor that affects the taxpayer’s compliance. Different social norms and ethical values will create different incentives for tax compliance. In fact, ethical values influenced by social norms may prohibit taxpayers from engaging in tax evasion (Blanthorne and Kaplan, 2008).

**H5:** A social factor does not affect Taxpayers Compliance.

An existing social bond between the society and this bond influences the members of the society in complying with the tax law. That is taxpayers may be influenced by their peer groups to comply or not to comply with the tax law. Peers are usually referred to taxpayers’ associates and include friends, relatives and colleagues (Jackson and Milliron, 1986). The peer influence is reflected in an individual’s expectations in relation to the approval or disapproval of that tax noncompliance behavior. Sanvely, 1990 also stated that compliance behavior and attitude towards the tax system is affected by the behavior of an individual’s reference group such as relatives, neighbors, and friends.

**H6:** Taxpayers’ attitude towards government does not affect Taxpayers Compliance.

Presence of government expenditures may motivate compliance (Alm, Jackson, and Mckee, 1992; Andreoni, et al., Cowell and Gordon, 1988). Individuals may pay tax because they value the goods provided by the government, recognizing that their payments are necessary both to help finance the goods and services and to get others to contribute. A tax payer therefore is seen as exchanging purchasing power in the market in return for the government services (Levi, 1998). 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 good is the tax administration (Kaldor, 1980).

**H7:** Economic deterrence does not affect Taxpayers Compliance.

The economic deterrence theory states that taxpayer's behavior is influenced by factors such as the tax rate determining the benefits of evasion, and the probability of detection and penalties for fraud which determine the costs (Allingham and Sandmo 1972; Becker 1968). Deterrence (the risk of detection and the punishments incurred) should positively influence taxpayer compliance (Slemrod, 2007).

## **1.6. Significance of the Study**

This study will have significance for various parties. More importantly it will be significant for managers and employees of Mizan-Aman Twon Administration Revenue Authority Branch office, current tax payers, policymakers and researchers.

At first glance, the study will be important for management bodies and employees of Mizan-Aman Twon Administration Revenue Authority Branch office by suggesting major factors those will influence their revenue collection decision and the most prominent strategy they have to care of as well. Moreover, it will also enable managers and employees to know how they have to treat such factors in order to increase compliances of tax payers to tax law thereby enabling to maximizing their revenue. Moreover, it will provide constructive feedback about the efficiency and effectiveness of the existing tax practice in Mizan-Aman Town Administration

Secondly, this study will be significant for current category C tax payers in Mizan-Aman Twon by providing feedback, knowledge and direction about tax payer's compliance with taxation

Thirdly, the results of this study can inform policymakers how the determinants influence tax compliance behaviour. The analysis focuses on tax compliance and its determinants and is therefore subject to an underlying assumption of tax payers' understanding of tax and other potentially relevant information. The results of this study also provide specific insights and allow policy makers to gain a better understanding of the key variables that are significantly associated with tax compliance and enable them to implement suitable strategies to minimize potentially

damaging factors, and should also allow them to improve their government's tax revenue collections.

Finally, this study will be used as a good reference, as indication, as a preliminary data, and as a stepping stone for other researchers in the future those will conduct their research in relation with factors affecting taxpayer's compliance in general and in case of category C taxpayers in particular.

### **1.7. Scope of the Study**

The study focus only examining the factors affecting tax payers' compliance with taxation with respect to category 'C' tax payers found in Mizan – Aman Twon, SNNPRE; because category 'C' tax payers are not required by law to declare their income or keep books of account, and considered as hard-to tax group. Category "A", "B" and some category "C" tax payer whose taxable income is objectively determined based on source documents or according to Income Tax Regulation No. *978/2008*, are beyond the scope of the study.

As it has been tried to point out in the scope of the study, the horizon of this study is confined merely on factors affecting tax payers' compliance with taxation with respect to category 'C' tax payers found in Mizan – Aman Twon, SNNPRE. The researcher believes that it would be much more comprehensible if it would have been conducted in country wide for taking numbers of tax payers' categories.

### **1.8. Limitation of the Study**

The researcher tries to accomplish the objective of the study successfully. However, this research has come across with some inherent limitations, which has possibly affected the outcome of the research under consideration. Due to the small sample size used for this study, results may not be generalized beyond the specific population from which the sample was drawn. Sampled respondents may not have answered all questions with candor, and therefore the results of this research based on the opinions of the sampled group might not accurately reflect the opinions of all members of the included population. This is more so because, people generally feel reluctant to divulge correct information about their incomes and tax positions (Coskun and Savasan, 2009). Furthermore, the capacity of the researcher, for instance, it has have difficulty and even

not that much possible to find a single specialized knowledge of performance, that is, tax evasion and tax avoidance, lacking of training and capacity building of tax payers by the tax authority. All these and other related constraints have, therefore, had negative influences on the research conducted smoothly and done accordingly on the scheduled period of time.

Therefore, in order to save the research finding from distortion of these all spare of influences/limitations, the researcher has been followed the following steps as exit – strategy during conducting the study:

- 1<sup>st</sup>. the researcher has finned, reviewed, and updated available related literatures,
- 2<sup>nd</sup>.the researcher has given training and building capacity to target representatives in collaboration with tax authority, and
- 3<sup>rd</sup>. deployed and utilized the resources as much as possible in a cost effective (use for its intended purpose).

## **1.9. Organization of the Paper**

This research report is organized in such a manner that the first chapter has presents Introduction. Particularly, Background of the Study, Statement of the Problem, Objectives of the Study Significance of the Study, Scope and Limitation of the Study, and Organization of the Paper. The second chapter presents the Literature Review. Chapter three presents Research Design and Methodology. Particularly, this session has shown Sources of Data and Data Collection Techniques, Target Population and Sampling Methods, and Method of Data Analysis and Presentation. The fourth chapter presents data presentation, discussion and interpretation the results of the different methods used. Specifically, the results of survey questionnaires were presented in this chapter. Finally, chapter 5 presents summary, conclusion, recommendations and future research direction.

# CHAPTER TWO

## 2. REVIEW OF RELATED LITERATURE

### 2.1. Theoretical Framework

This section deals about the theoretical framework supported by different authors regarding taxpayers' compliance with taxation. It is composed of definition of tax compliance, factors determining tax compliance behavior, and theories of tax compliance.

#### 2.1.1. Definition of Tax Compliance

The definition of tax compliance in its most simple form is usually cast in terms of the degree to which taxpayers comply with the tax law. However like many such concepts, the meaning of compliance can be seen almost as a continuum of definitions. This ranges from the narrow law enforcement approach, through wider economic definitions and on to even more comprehensive versions relating to taxpayer decisions to conform to the wider objectives of society as reflected in tax policy.

Taking the narrow end of the continuum first, one suggestion is that the degree of noncompliance may be measured in terms of the 'tax gap'. This represents the difference between the actual revenue collected and the amount that would be collected if there were 100 per cent compliance. Andreoni, Erard and Feinstein (1998) include a time dimension to compliance but are still mainly concerned with tax evasion as the central part of the tax gap definition. As they put it: 'A popular indication of the magnitude of evasion is the tax gap - the difference between the federal income taxes households actually owe, and what they report and pay voluntarily on a timely basis.' Regarding time dimension, James (2000) states that a tax payer might eventually pay his/her full liability but, if the payment is late, the taxpayer cannot be considered to have been compliant. A more recent definition of compliance by Brown & Mazur (2003) consists of three distinct types: payment compliance, filing compliance and reporting compliance.

However, these basic concepts of the ‘tax gap’ of non-compliance seem to be far too simplistic for practical policy purposes. Successful tax administration requires taxpayers to co-operate in the operation of a tax, rather than be forced to undertake every aspect of their obligations unwillingly.

The Internal Revenue Service (IRS, 1996) has two definitions - gross tax gap and the net tax gap. The gross tax gap is the amount of ‘true’ tax liability that is paid ‘voluntarily’ and on time and the net tax gap is this amount less tax paid late or collected by the Internal Revenue Service through enforcement activities. Both the gross and net tax gaps can be subdivided into the three main components. (Internal Revenue Service, 1996) - The non-filing gap, the under-reporting gap, and the underpayment gap. The underreporting gap is in turn made up of three elements – underreported income, overstated offsets and net arithmetical mistakes.

A major concern with such definitions is that they might be taken to indicate a certainty in the measurement of tax compliance that does not exist. Tax law is not always precise. Indeed, although legal definitions are often of the tax gap form, there are sometimes practical difficulties of interpretation. Bergman (1998) suggests that tax compliance ‘is what the state assumes is legally owed by taxpayers, but the state and taxpayers do not necessarily share the same interpretation’. The extent to which taxpayers dispute the meaning of the tax law can depend on a number of things, including their basic willingness to comply with a tax system. The basic concept of the ‘tax gap’ of non-compliance seems to be inadequate. The ‘tax gap’ definition and measure are far too simplistic for practical policy purposes since successful tax administration requires taxpayers to cooperate in the operation of a tax system rather than to be forced to carry out every aspect of their tax obligations. Tax law cannot cope with every eventuality (James and Wallschutzky, 1995) and therefore has to be supplemented with supporting provisions.

Administrative procedures and decisions as well as appeal arrangements all have a part to play but the tax system cannot work properly without a reasonable degree of willing compliance on the part of taxpayers themselves. There is the question whether ‘compliance’ refers to voluntary or compulsory behavior. If taxpayers ‘comply’ only because of dire threats or harassment or both, this would not appear to be proper compliance even if 100 per cent of the tax were raised in line with the ‘tax gap’ concept of noncompliance. Instead, it might be argued that successful tax

administration requires taxpayers to comply willingly, without the need for enquiries, obtrusive investigations, reminders or the threat or application of legal or administrative sanctions. A more appropriate definition could therefore include the degree of compliance with tax law and administration, which can be achieved without the actual application of enforcement activity. This 'voluntary' aspect appears in the definition supplied by Andreoni et al. (1998) which recognizes a basic difference in terms of compliance between tax paid without direct enforcement activity and tax paid as a result of it.

If taxes were considered to be intrusive or unfair, taxpayers might wish to reduce their tax liability by working less. Even though, this will have a cost to them that might be outweighed by a feeling of revenge. It is also possible that taxes might be used as an excuse to avoid unwanted overtime or other obligations. It is not known how powerful any spite effects might be but it is clearly possible that, apart from the direct costs of compliance themselves, difficulties in the willingness of taxpayers to comply might affect the revenue potential itself. The 'tax gap' definition of non-compliance might then have been partly satisfied because there is less to collect.

A fuller economic definition of compliance should also take into account other possible economic effects of the tax system and its enforcement. There has been some economic analysis of such possibilities, for example, by Cowell (1988) who considered the case where a worker can choose not just between working in the legal or illegal sectors but how much time to spend in work of any sort as opposed to leisure. It has also been specifically shown that uncertainty in tax audits could affect labor supply (Horowitz & Horowitz, 2000). It seems reasonable to conclude that tax administration could reduce potential tax revenue by discouraging taxable economic activity.

Paradoxically, therefore, a severe tax enforcement policy could even claim to have improved tax compliance by the narrow 'tax gap' definition because it would have reduced the amount there was to collect. Timing issues will also affect the value of the potential revenue available. A taxpayer might eventually pay his or her full liability but if it is paid late it cannot be considered to be full compliance or worth as much as tax liability paid on time or even before the due date. In economic terms, money in the future is worth less than the same nominal sum of money now.

If the Government does not receive tax payments on time it either increases the amount it has to raise elsewhere or reduces the revenue available for public expenditure. Although late payments of tax fit many of the 'tax gap' measures, they do not represent full compliance. As already indicated above, tax compliance may be seen in terms of tax avoidance and tax evasion. The two activities are usually distinguished in terms of legality, with avoidance referring to legal measures to reduce tax liability and evasion to illegal measures. James (2000) describes tax avoidance as the legal manipulation of an individual's affairs in order to reduce tax. Clearly tax evasion is a form of non-compliance.

However, if taxpayers go to inordinate lengths to reduce their liability, this could hardly be considered 'compliance' either. Such activities might include engaging in artificial transactions to avoid tax, searching out every possible legitimate deduction, using delaying tactics and appeals wherever this might reduce the flow of tax payments and so on. 'Tax exiles' even seem to prefer to emigrate rather than fulfill their obligations as citizens. Even if such activities are within the letter of the law, they are clearly not within the spirit of the law. Compliance might therefore be better defined in terms of complying with the spirit as well as the letter of the law. Many of the studies of compliance are concerned with intentional noncompliance.

There is, however, considerable scope for unintentional non-compliance. Full compliance may require positive actions on the part of the taxpayer to discharge his or her legal duties in full. It may be that taxpayers innocently fail to meet their tax obligations because they fail to complete their tax returns correctly or are unaware of, or misunderstand, various provisions of the tax system, or for similar reasons. Attempts by different tax authorities to improve tax administration in this respect have often found the problem of assisting taxpayers more difficult than might at first appear (James et. al., 1987 and James, Sawyer & Wallschutzky, 1998).

The tax avoidance/evasion issue may be important with respect to tax compliance for another reason. The two activities are defined the way they are with an implicit assumption that it is always possible to distinguish between the two. Of course, this is not always true. Since taxation is not always precise, Seldon (1979) in James et al (2003) has coined the term tax 'avoidion' to denote those areas of the tax system where the law is unclear. To the extent that there is such uncertainty in a tax system, it follows that tax compliance should follow the spirit of the law.

It would therefore seem that compliance is a much wider issue than simply the gap between actual revenue and some concept of 100 per cent of revenue collected. In all the expressions, compliance can be understood as acting in accordance with the law and non-compliance is deviation from the law. Based on the above expressions the definition of tax compliance can be shortly refined as the desire or willingness of the taxpayers to act in accordance with the tax law and the voluntary effort they exercise to pay their tax liability on timely basis.

### **2.1.2. Factors Determining Tax Compliance Behavior**

Jackson and Milliron (1986) listed fourteen main factors that have influenced tax compliance as discussed by various researchers. These factors are age, gender, education, income, occupation or status, peers' or other taxpayers' influence, ethics, legal sanction, complexity, relationship with taxation authority (IRS), income sources, perceived fairness of the tax system, possibility of being audited and tax rate. Various researchers have listed factors that influenced tax compliance such as demographic, income, compliance cost, and tax agents (Mohani, 2003), in addition to moral or ethical factors (Singh, 2003; Kasipillai et al., 2003).

Other researchers (Sour, 2002; Keller, 1997; Trivedi, 1997) listed enforcement element factors (such as penalty, audit, and tax rates) as having a great influence on tax compliance behaviors. Tax compliance behaviors of a taxpayer usually differ from the compliance behaviors estimated in economics models. Taxpayers are greatly influenced by other taxpayers. Besides, the rate and quality of audit will also influence tax compliance behaviors of a taxpayer (Trivedi, 1997).

Due and Friedlaender (1981) also state that a person's preference for a tax may be influenced if the tax- or an increase in it- is tied directly to the expenditures he strongly favors. Generally, attitudes toward choice of taxes and tax structures are greatly influenced by various criteria- often called principles- of taxation that have come to be widely accepted.

A comprehensive review of determinants of tax payers' compliance with taxation such as cultural background of tax payers, their awareness level, fairness/equity, tax payers' attitude towards government, socio-political factors, organizational strength of tax authority, will be touched. The empirical work of various researchers and other reference materials are scanned to have basic conceptual framework of the subject matter.

### **2.1.2.1. Fairness/Equity**

As stated in Bhatia (1976), a good tax system, in order to achieve various objectives, chooses and adheres to certain principles which become its characteristics. A good tax system, therefore, is one which is designed on the basis of an appropriate set of principles, such as equality or fairness and certainty. Since fairness of a tax system is its corner stone a brief overview can be presented in the following paragraphs.

Whether an outcome is perceived to be fair will often influence behavior. Experiments have shown that people prefer an option in which they receive no reward to an option in which they are rewarded but are perceived as unfair. They are rejecting an outcome that would make them better off (Braithwaite 2009). Often trust and legitimacy are linked to fairness, as the perceived fairness of an outcome will be contingent upon them.

According to James (2003), the most obvious requirement of equity or fairness is to treat equal people in equal circumstances in an equal way. The problem here is in deciding who is equal to whom. Similarly, Due and Friedlaender (1981), also argue that what is fair or equitable in taxation is inevitably a value judgment; no scientific specification of an equitable distribution pattern is possible, or people may be equal income wise while they may be unequal regarding their expenditure, wealth, total utility and so on. Such a pattern can be specified only on the basis of a consensus of attitudes of persons in the contemporary society.

Lemessa (2005) also adds that a major responsibility is to ensure that all taxpayers dealt with by a given official are accorded similar treatment and that all officials dealing with a given taxpayer would accord the same treatment. Similarly, Brooks (2011) states that fairness has always been widely regarded as the most important criteria in judging a tax system.

The problem of unfairness is that a tax system allows taxes to be shifted from dishonest to honest taxpayers. The fairness of a tax system may also be perceived in different ways by the taxpayers and tax authorities. What is fair in the eye of the tax authorities may not have the same image in the mind of the taxpayers.

According to Bhatia (1976), the attitude of taxpayers is an important variable determining the contents of a good tax system. It may be assumed that each taxpayer would like to be exempted from taxpaying, while he would not mind if others bear that burden. In any case, he would want his share to be within the general level of tax burden being borne by others. If this is not so, he will feel exploited. Similarly, Due and Friedlaender (1981), argue that persons will oppose taxes that they feel strike them “unfairly” and allow others to escape a “reasonable” burden, and they will favor taxes they accept to concentrate on others, especially when “others” are non-humans such as corporations. To sum, regardless of this inherent problem ensuring the fairness or equity of a tax system is second to nothing. To put it differently, it is essential that a good tax system should appear equitable to the tax payers.

#### **2.1.2.2. Organizational Strength of Tax Authorities**

According to Bird and Oldman (1967), no tax will work effectively, unless its administrators maintain an aggressive attitude with respect to the correctness of the taxpayers’ actions. Some taxpayers will fail to file or make mistakes through ignorance or neglect; others will deliberately cheat. A passive attitude by the authorities towards these errors and falsifications will soon undermine the entire structure, since the diligent and honest taxpayers will almost in self-defense be forced to the level of the careless and dishonest. A tax administration which seeks compliance must protect those who comply or else compliance will not be forthcoming. Most commentators, policy makers, and tax administrators agree that tax compliance would be greatly facilitated by the existence of a simplified tax structure.

Indeed, without institutional simplification that enables tax payers to fulfill their responsibilities more effectively, even the most elaborate service offered to tax payers by the tax administration would be lost in a sea of confusion, waste, and widespread disrespect of the law (Bahl, 1989; Jenkins, 1992). A simpler tax structure will make it easier for tax payers to assess their tax liability and thus comply more fully with tax laws. Bird and Oldman (1967) further state that the sure sign of ineffective tax administration is the presence of a very large delinquency in tax payments for it indicates the lack of taxpayer respect for the tax system. The taxpayer in effect is acting on his belief that the administrative machinery may bark, but that it has no bite.

These writers argue that in large part the solution for the large delinquency lies in providing the bite. In this sense effective tax collection is a facet of the larger problem of providing adequate penalties, to which reference will later be made. In other words tax is evaded to the extent that tax authorities are perceived as weak by taxpayers. A tax system doesn't function in a vacuum. Its relationship with at every turn are with the public, and since the combination of taxes reaches nearly every individual in one way or another, the administration finds itself dealing with the nation as a whole. Hence, inevitably its operations and effectiveness are affected by the attitudes of the nation towards the tax system (Bird and Oldman, 1967). But while tax administration is thus affected by these national attitudes (Bird and Oldman, 1967); it is equally true that the attitudes can in turn be affected by tax administration.

Rational and efficient procedures, higher personnel standards, better management, improvement in relation with the public and in the daily contacts between tax official and taxpayer, can operate to increase the public respect for the tax administration. Moreover, once the tax administration has been placed on a sound basis, it is in a position to assert that compliance must be forthcoming. Such an assertion would hardly be tolerated or even taken seriously, as long as tax officials were themselves inefficient and corrupt. But if the administration has brought stability and honesty to its own operations, the self-respect thus achieved can form the foundation for its demand of respect and compliance from the tax payer.

Lemessa (2005) states that tax systems that depend on ad hoc administrative procedures rapidly become discredited and endanger compliance. To encourage compliance it is equally important that tax authorities administer the law fairly. This implies both an absence of arbitrary or corrupt behavior on the part of the officials, and "normative standards" to ensure that the same laws are applied and administered in a standard fashion across the board. A taxpayer (Brooks. N. 2011) will be more receptive to information on his obligation if, in his efforts to comply, he receives a reasonable degree of service from the revenue administration. Poorly drafted forms, long waiting lines and even charges for acquiring them, bureaucratic hassle in processing the case, rudeness from the officials, cumbersome appeal procedures, and the like, can repel even the most loyal taxpayers.

On the other hand the ways in which revenue authorities interact with taxpayers and their own employees have an impact on public perception of the tax system and the degree of voluntary compliance. Taxpayers who are aware of their rights and expect, and in fact receive, a fair and efficient treatment are more willing to comply. Voluntary compliance is promoted not only by an awareness of rights and expectations of a fair and efficient treatment but also by clear, simple and “user friendly” administrative systems and procedures. Voluntary compliance is enhanced when it is easier for taxpayer to do so.

### **2.1.2.3. Awareness level of Taxpayers**

James (2000) argues that the norm is usually to comply rather than not to comply. As already pointed out for a tax system to be effective the majority of the taxpayers have to comply. It follows that there may be greater gains in assisting basically compliant taxpayers to meet their fiscal obligations than in spending more resources in pursuing the minority of non-compliers. Many taxpayers might be willing to comply in full, but are unable to do so because they are not aware of, or do not understand, their full obligations. Even if such tax payers understand their obligations, they may not know how to meet them or may be unable to do so for other reasons. On other side, other writers such as Smith and Kinsey (1987) argue that tax non-compliance is an intentional behavior. In countries like Ethiopia where most of the business community have no access to information, lack of awareness cannot simply be overlooked rather it can be assumed as a major determinant of tax compliance behavior.

### **2.1.2.4. Cultural Factors**

Culture is considered to be a powerful environmental factor that affects the taxpayer’s compliance. Different social norms and ethical values will create different incentives for tax compliance. In fact, ethical values influenced by social norms may prohibit taxpayers from engaging in tax evasion (Blanthorne and Kaplan, 2008). The cultural framework most widely used is that of Hofstede (1980).

Based on an attitude survey of about 116,000 employees, Hofstede identifies four underlying societal values; individualism, power distance, uncertainty avoidance and masculinity. Cultural research has found significant differences between the US and Chinese citizens (Hofstede, 1991).

Chan et al. (2000) suggests that the cultural dimension affecting tax compliance is collectivism and individualism. In Hofstede's model, individualism and collectivism refer to the degree of interdependence a society maintains among individuals (Hofstede, 1991).

The cultural dimension of individualism relates to the degree of integration a society maintains among its members. A high individualism culture is signified by people focusing on themselves rather than on the group to which they belong. Under this perspective, an individual is seen as separable from and independent of a group affiliation. People in such low individualism culture as Chinese citizens, they tend to be collectivists who are expected to follow and subscribe to the values of their in-groups in order to gain peer acceptance and social status (Hofstede, 1991). In contrast, a high individualism culture such as US citizens is signified by people focusing on themselves rather than on the group to which they belong. Under this perspective, they view themselves as distinct entities and place great value on individual rights.

These cultural differences may have a direct impact on ethical values and moral development and ultimately affecting tax compliance decisions. The study conducted by Chan et al. (2000) indicates that culture of the taxpayers has an impact on taxpayer compliance efforts. There is reason to believe that societal reasons may account for the way taxpayers behave. While tax evasion may be considered wrong and immoral in some societies, it may be regarded as socially tolerable in other Schwartz et al. (2004)

In countries with a tradition of high compliance with tax law; few tax payers would attempt tax evasion strategies. However, empirical evidence seems to suggest that tax payer compliance with the law is influenced by their perception about whether or not other tax payers are complying

(Van den Doel, 1979; Laver, 1981; Lewis, 1982), especially when they feel that the taxes they pay are intended for worthy purposes Oldman, (1965). In Ethiopia where the system of government has evolved from feudal (where taxes were used by individuals in government) to current one, it is obvious that negative attitude towards tax has been developed in the society. In this sense it is difficult to conclude that there is a culture in the country that appreciates voluntary compliance.

#### **2.1.2.5. Social Factors**

The issue of (non-) compliance is not only a question of state-society relationships but also a question of relationship between citizens and/ or groups of citizens within local communities. There is an existing social bond between the society and this bond influences the members of the society in complying with the tax law. That is taxpayers may be influenced by their peer groups to comply or not to comply with the tax law. Peers are usually referred to taxpayers' associates and include friends, relatives and colleagues (Jackson and Milliron, 1986). The peer influence is reflected in an individual's expectations in relation to the approval or disapproval of that tax noncompliance behavior. Sanvely, 1990 also stated that compliance behavior and attitude towards the tax system is affected by the behavior of an individual's reference group such as relatives, neighbors, and friends. Thus if a tax payer knows many people in groups important to him who evade taxes, his commitment to comply will be weaker. On the other hand, social relationship may also help deter individuals from engaging in evasion for fear of social sanctions imposed once discovered and revealed publicly (Grasmick and Green, 1980; Grasmick and Scott, 1982).

The survey conducted by Mason et al. (1984) finds that people committing tax noncompliance are more likely to discuss tax matters with their peers. The study conducted by Chan et al. (2000) also reveals that taxpayers may still commit noncompliance so long as this noncompliance is consistent with in-group expectations and norms. As cited by Slemrod (2000) and Levi (1998) in (Fjeldstad and Ranker, 2003), the dimension of trust that seem to affect compliance is trust in other citizens to pay their share of service charges. In particular, trust in other citizens to pay their share seems to be important. The larger the fraction of the local population that is observed not paying, the lower perceived risk of being prosecuted. This has impacts on the individual taxpayer's perception of the credibility and trustworthiness of the revenue administration.

#### **2.1.2.6. Taxpayers Attitude towards the Government**

The presence of government expenditures may motivate compliance (Alm, Jackson, and Mckee, 1992; Andreoni, et al., Cowell and Gordon, 1988). Individuals may pay tax because they value the goods provided by the government, recognizing that their payments are necessary both to help finance the goods and services and to get others to contribute.

A tax payer therefore is seen as exchanging purchasing power in the market in return for the government services (Levi, 1998). Positive benefits may increase the probability that tax payers will comply with taxation even without direct coercion. Without a material benefit, compliance becomes less assured. Although most tax payers cannot assess the exact value of what they receive from the government in return for taxes paid, it can be argued that they have general impressions and attitudes concerning their own and other's terms of trade with the government Richupan (1997). It is then reasonable to assume that a tax payers' behavior is affected by his satisfaction or lack of satisfaction with his terms of trade with the government. Thus, if the system of taxes is perceived to be unjust, tax evasion may, at least partly, be considered as an attempt by the tax payer to adjust his terms of trade with the government.

Wahlund (1992) also stated that tax compliance is related to political affiliation that is people favoring parties with social democratic values tend to comply more than people voting for liberal parties. Similarly, Due and Friedlaender (1981), also argue that, attitudes toward the general level of taxation and tax increases are dependent, of course, on attitudes about the desirability of governmental programs and on attitudes toward the government itself . On the other hand, (Fjeldstad, 2004) citizens' willingness to pay taxes voluntarily rests on the local government's capacity to provide services and its demonstrated readiness to secure the compliance of the otherwise non-compliant.

### **2.1.3. Is Non Compliance an Intentional Behavior?**

Most theories of tax compliance, as well as empirical works (Smith and Kinsey, 1987) have until recently been premised on the assumption that tax under reporting is an intentional behavior. Behavior that is unintentional has either been ignored or set aside in a footnote or can be safely ignored as random noise.

However, as noted earlier, the evidence is accumulating that unintentional noncompliance is neither small nor inconsequential. Nor it is necessarily random in nature. As far as Ethiopia's practice is concerned tax noncompliance is not only an intentional behavior it is also attributed to lack of ability to pay, lack of awareness and weak institutional capacity of the revenue administrations and other factors.

## **2.1.4. Dimensions of Ensuring Compliance Behavior (DECB)**

Edmund Burke in (Long and Swingen, 1991) states ‘the revenue of the state is the state’. Put another way, without the legal authority to collect taxes and the compliance of the citizenry to these laws, government is a sham. It is this fact that taxes are profoundly essential to the existence of all successful states- that makes the age-old question of why people pay or fail to pay their taxes of central interest. Clearly much depends (James, 2000) on the motives of taxpayers. This is a complex area and different commentators have offered different analyses. The two main approaches are to concentrate on the probability of detection and on penalties for non-compliance (the ‘carrot and stick’ approach) or activities designed to motivate tax payers to pay tax (the ‘responsible citizen’ approach).

### **2.1.4.1. The ‘Carrot and Stick’ Approach (CSA)**

According to James (2000), the carrot and stick approach is based on a relatively narrow interrelationship of economic rationality. According to this approach, totally moral individuals maximize their utility by maximizing their income and wealth. They will evade tax if they consider that by doing so they can expect to increase their spending power. Non-compliance can therefore be explained by factors such as the level of tax rates, the probability of being caught evading, the penalties imposed and the degree of risk aversion.

### **2.1.4.2. The Responsible Citizens’ Approach (RCA)**

Regarding the responsible citizens approach James (2000) extends his discussion that, looking outside economics; other academic disciplines have suggested factors which might be important in influencing taxpayers’ behavior.

Sociology has offered a number of variables such as social support, social influence, attitudes and certain background characteristics such as age, gender, race and culture. Psychology reinforces this approach and has even created its own branch of ‘fiscal psychology’. The contribution from psychology includes the indication that attitudes towards the state, the revenue authorities are as important factors as perceptions of equity.

If psychological and sociological factors are important then a major drawback of the carrot and stick approach becomes apparent. While such an approach might be considered by some as suitable for donkeys, human beings might not respond so positively. The result might be a reduction in voluntary compliance. For instance, as cited in James (2000) reported that the German tax system was very rigid in its assessment procedures, which led to an effective but expensive and confrontational system. The result was a high degree of alienation and resistance among taxpayers. The conclusion would seem to be that a successful compliance policy should take account of a much wider range of motivations than simply rewards and punishments (James, 2000) and stated in (Eckstein, 1979) tax system must also be fair, both to promote the objective of an equitable distribution of income and to assure continued voluntary compliance by taxpayers.

### **2.1.5. The Relevance of Understanding Tax Compliance (RUTC)**

According to James et al (2003), a number of tax authorities have been moving towards a more sophisticated approach to tax compliance. Traditionally there seems to have been an assumption that with a basic level of assistance for taxpayers, together with an enforcement program, tax compliance could be expected to be maintained at satisfactory levels.

However there seems to have been a shift in attitudes towards treating the taxpayer less as a passive donor who simply has to be billed for taxes due and more as a customer sometimes requiring particular forms of assistance and support. According to Lemessa (2005), when compliance is not achieved on a voluntary basis, revenue authorities must identify and address the risk associated with non-compliance by developing strategies targeted at those risks. Voluntary compliance is maximized when revenue authorities are aware of major developments and trends in the business and legislative enforcement, and are responsive to their implications on tax administration and compliance.

The choice (Smith and Kinsey, 1987) between compliance and non-compliance may only be a matter of opportunity, convenience, or even interpretation of the law. Legal validity, economic and social purpose, distributive justification, and revenue yield may all be defeated if a tax is not levied and collected well. No matter what the justifications advanced, a tax fails to the extent that it is avoided or evaded (Shultz and Harriss, 1949).

Taxation is an inevitable phenomenon in any economy or nation as far as services and other roles are expected from governments. Even though the history of taxation is as old as that of states or governments, still there are gaps in every nation, particularly underdeveloped countries like Ethiopia as far as voluntary compliance is concerned. Taxes are considered by many citizens as necessary evils that cannot be avoided under normal conditions. Hence, the issue of voluntary compliance is a central idea when dealing with efficiency and effectiveness of a tax system. From the above review of literature several writers have discussed about factors that affect voluntary compliance behavior and how it is related with various socio-cultural, political legal and administrative aspects.

Legal enforcement (i.e. penalties and sanctions) are all exist in the tax laws of every nation in varying degrees. But still are gaps in tax compliance regardless of these laws. This clearly shows that tax compliance cannot be ensured only through enforcement or stick approach. Even though the existence of enforcement and penalties cannot be undermined when dealing with tax compliance, focusing on positive side i.e. encouraging voluntary compliance is by far rewarding as far as long lasting and consistent advantage is concerned. Hence, the understanding of tax compliance that is why people tend to comply and why they tempt to evade, gives a clear road map to the solution of this very classical problem in varying degrees. But still are gaps in tax compliance regardless of these laws. This clearly shows that tax compliance cannot be ensured only through enforcement or stick approach. Even though the existence of enforcement and penalties cannot be undermined when dealing with tax compliance, focusing on positive side i.e. encouraging tax payers' compliance is by far rewarding as far as long lasting and consistent advantage is concerned. Hence, the understanding of tax compliance that is why people tend to comply and why they tempt to evade, gives a clear road map to the solution of this very classical problem.

## 2.1.6. Theories of Tax Compliance (TTC)

Our review of the 18 papers suggests that several theories of behavior, borrowed from economics and the psychological sciences, can be useful in classifying the variables in this analysis. These include:

- Allingham and Sandmo (1972) Model,
- Institutional Anomie Theory, and
- The Theory of Planned Behavior.

### 2.1.6.1. Allingham and Sandmo (1972) Model

In 1968 Nobel laureate Becker theorized the economics of crime on the basis of which Allingham and Sandmo (1972) produced an economic model of tax compliance. The model was seminal for it was followed by a large number of contributions to the literature which extended the original model in a number of directions. In the model, the taxpayer is assumed to have an income  $I$  and must choose the amount to declare to the tax agency (Alm, Jackson and McKee, 1992). Declared income  $D$  is taxed at the rate  $t$ ; undeclared income is not taxed, but the taxpayer will face a probability of detection  $p$  at which point a fine  $f$  will be imposed for cheating.

The taxpayer has the choice between two strategies: (1) He may declare his true income or (2) he may declare less than his true income. If he chooses the latter strategy his payoff will depend on whether or not he is investigated by the tax authorities. If he is not, he is clearly better off than under strategy one. If he is investigated, he is worse off as the audit may lead to penalties. Thus the taxpayer chooses  $D$  to maximize the expected utility of the evasion gamble. This framework suggests that declared income depends upon  $I$ ,  $p$ ,  $f$  and  $t$ :  $D = f(I, P, f, t)$ . This model shows that declared income  $D$  varies directly with income, the probability of detection (audit rate) and the penalty (fine rate), but inversely with the tax rate. There are however other factors that affect compliance decision; while government “taketh away, it also giveth back” (Alm, Jackson and McKee, 1992) and this surely exerts influence on compliance or evasion. The declared income  $D$  may be modified to reflect individual’s receipt of Government expenditures  $G$  as follows:  $D = f(I, p, f, t, G)$ . Thus compliance is also directly related to individual’s perceived benefits from public good funded by their tax payments.

### **2.1.6.2. Institutional Anomie Theory (IAT)**

Anomie is a sociological theory that holds that individuals make decisions based on socialized values, which separately may be contradictory but together, balances each other out, producing behavior considered “normal” by society. When one holds an imbalanced set of values, decisions made on that set may produce deviant behavior, such as everyday crime (Itashiki, 2011). Specifically, the most recent rendition of anomie theory, institutional anomie theory (Messner & Rosenfeld, 2001) appears readily adaptable for examining the relationship between cultural values and tax evasion behaviors (Riahi-Belkaoui & Picur, 2000). Institutional Anomie Theory highlights four theoretically derived sets of national cultural dimensions likely to promote or suppress tax evasion. They include individualism, achievement orientation, assertiveness and humane orientation.

Individualistic cultural values set the stage for behaviors that emphasize the pursuit of firm self-interest, largely neglecting concern for ethical consequences. According to IAT, individualistic cultural values encourage firm’s decision makers to choose goal achievement beyond concerns for the ethical or legal means to achieve goals (Bame-Aldred, Cullen, Martin & Parboteeah, 2011). Thus, in such societies, firms more willingly deviate from accepted norms and evade taxes. On the contrary, collectivist cultures favor allegiance to the greater collective rooted in the notion that societal members are interdependent (Triandis, 1995) and, as such, should deter individual gains at the expense of the collective. This suggests that individualistic cultural values should inflate temptations for firms to evade taxes.

### **2.1.6.3. Theory of Planned Behavior**

The Theory of Planned Behavior was proposed by Ajzen (1985) as an extension of the Theory of Reasoned Action, which had been proposed a decade earlier, by (Fishbein & Ajzen, 1975). According to the Theory of Reasoned Action, people are more likely to do a behavior if they evaluate the suggested behavior as having positive results (attitude) and if they think their significant others want them to perform the behavior (subjective norm). A high correlation of attitudes and subjective norms to behavior has been confirmed in many studies (Sheppard, Hartwick, & Warshaw, 1988).

However, the same authors have raised a counterargument against the high relationship between attitude, subjective norms and behavior. They argued that because of circumstantial limitations, attitude and subjective norms do not always lead to behavior. To improve on the predictive power of the Theory of Reasoned Action Ajzen added a new component "perceived behavioral control" to help account for behaviors that arise where an individual's control over the behavior is incomplete. By this, he extended the Theory of Reasoned Action to include the role of non-volition in predicting behavior. The extended version is called the Theory of Planned Behavior.

## 2.2. Empirical Evidence

This section highlights a number of previous studies and deals with the empirical framework supported by different researchers regarding the tax payer's compliance with taxation.

(Merima Ali, Odd-Helge Fjeldstad, Ingrid Hoem Sjørusen, and Chr. Michelsen, 2011-2012.)

Explore factors that determine citizens' tax compliance behavior in Kenya, Tanzania, Uganda and South Africa using attitude and perception data from the new round 5 of Afro barometer surveys. The survey includes a series of theoretically rooted questions about citizens' views about taxation. A main challenge was to find an accurate proxy for taxpayer compliance since individual's reporting of own compliance is likely to be over-reported. Thus we used an indirectly phrased question on respondent's opinion about other people's action of whether not paying taxes is wrong or not. Results from the logit regression provide robust results for two determinants of tax compliance. We find that individuals are more likely to express tax compliant attitude if they perceive that enforcement makes evasion more difficult in South Africa and Kenya. This is in line with the prescription of the standard economic theory of deterrence. The analysis also finds evidence that those who are more satisfied with public service provision are more likely to support the government's right to tax in all the four countries, supporting certain elements of the fiscal exchange theory. However, the link between tax compliance attitude and public service provision depends on the specific service in question and differs between countries. While access to infrastructure such as roads and electricity encourage tax compliant attitude in Kenya, respondents in Tanzania and Uganda refer to education and health services as key to their tax compliance. In South Africa, government provision of issuing identity cards and police services are more likely to support tax compliant attitude.

A key finding of the study that applies to all the selected countries is that payment to non-state actors such as criminal gangs for protection reduces tax compliant attitude. Previous research suggests that the way the state treats individuals or groups relative to their fellow citizens is an important factor in determining taxpayer compliance attitude (D'Arcy 2011). We have tested this hypothesis by examining how citizens' perceive their ethnic group is treated by the government compared to other groups. Only in South Africa and Tanzania this seems to matter for tax compliant attitude.

The study finds no strong evidence that political legitimacy, e.g. trust in government policy and institutions, impacts on taxpayers' compliance attitude. These findings are robust for a different econometric estimation, where we include all the responses of individuals regarding other people's action about tax in an ordered logit regression.

The study provides us with some directions for further research. For an improved understanding of tax compliance attitude and behavior in Africa, there is a need for a more thorough examination of the concept of fairness in fiscal exchange, i.e., the contractual relationship between taxpayers and the government. In this context it is also relevant to analyze if – and when – user charges are to be preferred instead of general taxes to finance public services.

Critical factors in this respect are citizens' perceptions about the role of the state, how the tax law is administrated, perceptions about enforcement, government trustworthiness, and impacts of payments to non-state actors may have on tax compliance. Furthermore, there is a need for research focusing on fairness in tax collection and comparative treatments of taxpayers. Can, and under what conditions, compliance be established in African countries without an extensive and costly enforcement apparatus? This question is important because it is likely that governments, seeking power on the basis of popular consent, face restrictions in their use of coercion in tax collection. Thus, the challenge for taxation in Africa is to raise domestic revenues from consenting citizens.

(Wenzel, M, 2011) Tax compliance has been studied in economics by analyzing the individual decision of a representative person between paying taxes and evading taxes. In the research of tax compliance have been done many empirical studies that emphasized the impact of a wide variety of potential determinants of compliance with individual income/profit tax filing and reporting obligations. The most important determinants identified are: economic factors as the level of income, audit probabilities, tax audit, tax rate, tax benefits, penalties, fines and other non-economic factors as attitudes toward taxes, personal, social and national norms, perceived fairness etc.

Measuring compliance behavior would seem to be simple, but the problem is to find a measure which allows the researcher to directly study how compliance is changed with a change in an underlying tax-related parameter, such as the audit rate.

Thus, directly asking addressed to the participants about their own past involvement in tax evasion is not sufficient. What is needed is a compliance indicator which can be repeatedly measured with changes in policy parameters. One possibility is to ask hypothetically about tax evasion behavior (possibly with a case situation to describe the context in detail) and how it would differ if a specific change occurred.

The study of tax compliance is related to avoided tax as a measure of reporting compliance because several of the potential determinants of voluntary compliance (e.g., marginal tax rates, filing thresholds, marital status and allowable child exemptions) also have a direct role in the calculation of tax from gross income, making it difficult to separate their impact on compliance (Plumley, 2002). The findings of many studies suggest that taxpayers' attitudes towards the tax system and the way taxpayers feel treated by a tax authority are important in explaining taxpayer non-compliance. Related to the tax system itself, there is specific evidence to suggest that perceptions of unfair tax burdens can affect taxpayers' views about paying tax and can go on to affect their compliance decisions.

Tax fairness seems to involve at least two different dimensions (Jackson and Milliron, 1986): the first relates to the benefits one receives for the tax given; the second dimension involves the perceived equity of the taxpayer's burden in reference to that of other individuals. This second dimension relates to taxpayers' perceptions of the vertical equity of the tax system. If a taxpayer were to feel that they pay more than their fair share of tax when comparing themselves to wealthy taxpayers, they are more likely to see paying tax as a burden than a taxpayer not concerned about these issues.

### **2.3. Conclusion and Knowledge Gaps**

There is evidence from the literature reviewed that although tax compliance has been the subject of considerable empirical research, however, no homogeneity in the determinants of tax compliance has been achieved. There are too many and different explanatory factors that have been proposed in the literature as determinants of tax compliance. The problem with this situation is that when undertaking an empirical study one would be faced with choosing a set of predictor variables from what is a very large set of candidate predictors.

It is therefore recommended that future research need to develop a meaningful set of few predictors that yield accurate predictions. The second conclusion and related to the one above is that some studies on tax compliance proceed without a theoretical framework to help guide the selection of independent factors. In some of the studies that use some theory, the theories are not comprehensive. For example the Allingham and Sandmo Model focus on economic factors. While the Institutional Anomie Theory focuses on cultural factors.

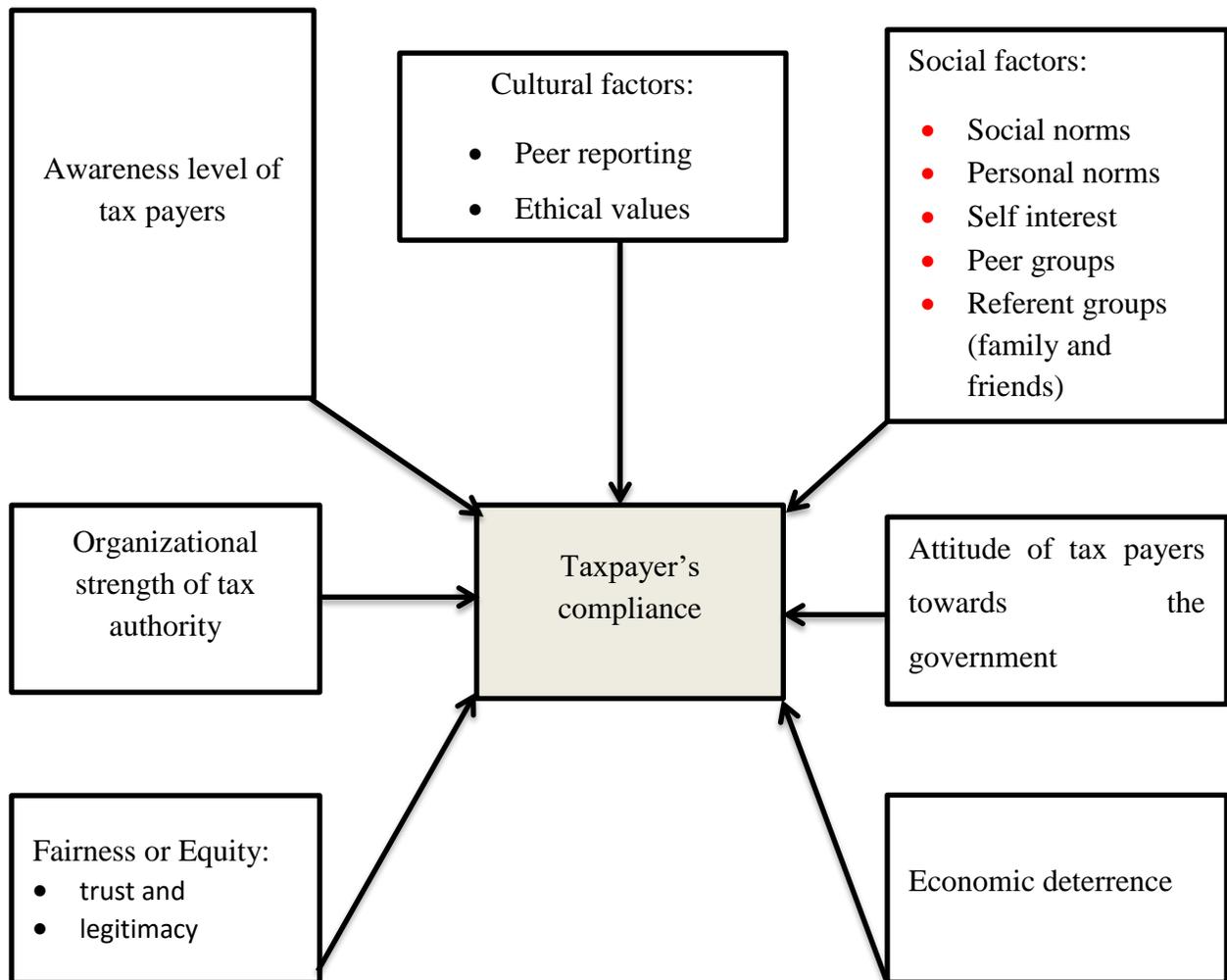
Only the Theory of Planned behavior embraces a wider spectrum of variables involving attitudes, social norms and behavioral control. Nevertheless the literature suggests that tax compliance research has made a big step forward in recent years by adopting the more comprehensive TPB. This development has significantly strengthened the theoretical foundation of research on tax compliance. Now, researchers would be able to build their studies upon some fairly comprehensive theoretical foundation.

Despite this positive progress in theory development, the tax compliance literature is still plagued by several problems. The TPB is a general theory, not specifically developed for tax compliance behaviour and hence it may fail to capture behavioural factors that are unique to tax compliance. In fact it is a requirement by the TPB that investigators should interview a sample of the group under investigation to determine the salient attitudes, identify significant others and subjective control factors that are relevant to the study group or research issue in question. (Edward E. Marandu, 2014)

So far various researchers tried to examine on this particular topic. However, there is a gap in the literature due to the absence of studies, specifically in Mizan-Aman Town, SNNPRE context. In order to fill the identified gap knowledge concerning the tax payers' compliance with taxation, the researcher try to undertake the study to replicate knowledge by using mixed methods of study and provide additional information by considering of the missed components tax compliance not studied together with the topic by the previous researcher so as to increase the level of understanding about the tax payers' compliance with taxation here in Bench Maji Zone by focusing category "C" tax payers which is found in SNNPRE specifically Mizan Aman Town.

## 2.4. Conceptual Framework

Conceptual framework as depicted in the below figure 1. Demonstrate a potential link between independent variables with the dependent variable. In other word, it indicates the cause and effect relationship between selected factors affecting category “C” tax payers’ compliance with taxation and Category “C” tax payers’ compliance with taxation in Mizan-Aman Town, SNNPRE.



Source: Researcher Own Designed Based On His Literature Review, 2017

## 2.5. Variable Measurement

In this study tax compliance was measured using seven hypothetical questions. It was based on Palil (2010), Troutman (1993) and Chan et al (2000) with some modification to suit our country's context. The use of hypothetical questions can increase reliability of results and minimizes respondents' dishonesty when answering the questionnaire (Troutman, 1993). The respondents were asked to rate each hypothetical question whether as a taxpayer they would undertake the same action if they faced the same situation using 'Strongly disagree to 'strongly agree, using a Likert Scale of 1 to 5 respectively. The items that made up the scale include 1) Questions related to Taxpayers' General Knowledge about Taxation; 2) Questions related to Motivational Factors 3) Perception on equity and fairness of the tax system; 4) Questions related to cultural Factors; 5) Questions related to social Factors 6) Questions related to Tax Payers Compliance (Dependent Variable); and 6) Questions Related to Economic Deterrence.

Other items include demographic variables such as gender and age. These variables were independent variables so that an association between these demographic variables and tax compliance could be examined. In prior studies, demographic variables like gender, age, education level and income level also appear to potentially have their own influence on tax compliance and hence the need to test in the Ethiopian context since study results differ from country to country. Age will be divided into five groups: Less than thirty, 30 to 39, 40 to 49, 50 to 59 and 60 years or more.

Taxpayers compliance influenced by factors like Fairness or Equity, Organizational strength of tax authority, Awareness level of tax payers, Cultural factors, Social factors, Attitude of tax payers towards the government, and Economic deterrenc, factors. Let us represent Taxpayers compliance by TCOMP. TCOMP is the dependent variable that will be explained by seven explanatory denoted by xi variables.

$$TCOMP_i = \alpha_0 + \beta_1 FAS_i + \beta_2 OSTA_i + \beta_3 AWR_i + \beta_4 CFS_i + \beta_5 SFS_i + \beta_6 ATG_i + \beta_7 ED_i + \varepsilon_i$$

<b>Study variables</b>			
<b>Variable</b>	<b>Description</b>	<b>Unit</b>	<b>Source</b>
<b>TCOMP</b>	Taxpayers compliance	Continuous	Research Survey
<b>FAS</b>	Fairness or Equity	Continuous	Research Survey
<b>OSTA</b>	Organizational strength of tax authority	Continuous	Research Survey
<b>AWR</b>	Awareness level of tax payers	Continuous	Research Survey
<b>CFS</b>	Cultural factors	Continuous	Research Survey
<b>SFS</b>	Social factors	Continuous	Research Survey
<b>ATG</b>	Attitude of tax payers towards the government	Continuous	Research Survey
<b>ED</b>	Economic deterrence	Continuous	Research Survey

**Table 1: Description of Study variables**

Taxpayers' attitude towards taxation is crucial for any tax system's success toward compliance. Perceptions of taxpayers' compliance are influenced by the many variables such as education, age, gender, norms, self interest, complexity, fairness, audit rate, tax rate, peer reporting and tax administration. These variables can provide critical judgments to develop methods to increase compliance. Referent groups such as family members and friends in tax compliance is limited although Ajzen and Fishbein (1980) (in their Theory of Reasoned Action (TRA) and Theory of Planned Behaviour (TPB) theorised that referent groups play a significant role in determining people's intentions and behaviour.

**Table 2. Determinants and Statements measuring the Determinant Factors**

Serial number	Determinants	Number of Questions
1	Fairness or Equity	Question No: 2,3,4,6,8,9,10,11,13, and 14
2	Organizational Strength of Tax Authorities	Question No: 7,12,15, and 16
3	Awareness Level of Tax Payers	Question No: 1,17,18
4	Cultural Factors	Question No: 5,19,20,21 and 25
5	Social Factors	Question No: 22, 24,
6	Attitude towards the Government	Question No: 23,26,27,28 and 29
7	Economic deterrence	Question No. 37-39

Table 2 shows the different determinant factors and the number of the questions as stated in the questionnaire.

**Table 3: Items to Measure Tax Payers' Compliance (the Dependent Variable)**

Item No.	Questions
TCOMP 1	Tax payers should evade tax if tax rates are too high
TCOMP 2	Tax payers should evade tax if the tax system is unfair.
TCOMP 3	Tax payers should evade tax if a large portion of the money collected from tax is wasted.
TCOMP 4	Tax payers should evade tax if the probability of getting caught is low.
TCOMP 5	Evading tax due to lack of ability to pay should not be considered as crime/problem.
TCOMP 6	Tax payers should evade tax if everyone is doing it.
TCOMP 7	Generally, Tax evasion should not be considered as a crime.

Table 3. shows questions on the dependent variable which is the tax compliance with seven items, also with 5 - point Likert type-scale from 1 – “Strongly Disagree” to 5 - “Strongly Agree” as stated in the questionnaire.

## **2.6. Ethical Considerations**

Ethics are norms or standards of behavior guiding moral choices about our behavior and relationships with others, therefore in research; ethical considerations aim to ensure that no individual suffers adverse consequences or is harmed (Leedy & Ormrod, 2013). The basic ethical principles of autonomy, beneficence and justice (Marshall & Rossman, 2011) was incorporated in this study by means of maintaining confidentiality of information and of respondents.



# CHAPTER THREE

## 3. RESEARCH DESIGN AND METHODOLOGY

The previous chapter reviewed both theoretical and empirical studies, and it tried to give a brief conclusion and excavate the gap in the existing knowledge. While this chapter has given full details to show how the research activity was carried out; and highlights the methodology of the study and comprises study design, sampling design, data source and collection, data analyzing method. Since this section is the main and the most important part of the research proposal, the researcher splits it into sub – section in order to make the report transparent and clear to the readers as well as to the reviewing committee.

### 3.1. Research Design

As described by Creswell (2009), there are three common approaches to conduct a research project in the area of business and social sciences research namely; quantitative, qualitative, and mixed research approaches.

This research has been designed to answer the question, to attain the general and specific objective of the research, and to get valid findings. Based on the objectives of the paper and the availability of relevant information, this research paper was employed explanatory qualitative method research approach. The rationale for using Qualitative research approach is Qualitative research is “an inquiry process of understanding” where the researcher develops a complex, holistic picture, analyzes words, reports detailed views of informants, and conducts the study in a natural setting (Creswell, 2009). In this approach, the researcher makes knowledge claims based on the constructivist (Creswell 2009) perspectives. This has advantage of design results mainly from its flexibility to follow unexpected ideas during research and to explore processes effectively. However, knowledge produced may not be generalized to other people or other settings By using such research approach the researcher enabled to establish a cause-effect relationship between the independent and dependent variables of the study, testing hypothesis and generalized about factors affecting category “C” tax payers’ compliance with taxation in Mizan-Aman Town, SNNPRE.

Nevertheless, the survey response was collected from only 54 survey respondents due to their workload as well as negligence. As Yesegat (2008) stated, the response rate of 71.8 per cent was reasonably good in consideration of the difficulty to collect data in poor developing countries, Ethiopia in particular. For this study, the response rate was 84.375 percent ( $= \frac{54}{64} * 100$ ), and it is rationally fine.

### **3.2. Data Source and Collection Methods**

The main sources of data for the study are found from primary source. The primary data were collected through questionnaire adopted from other researcher Aemiro (2014). The questionnaire has comprised of both closed and open ended questions. The popularity of the closed-ended questions provided less effort by respondents to complete the questionnaire and it was easy for analysis. Most of the closed ended questions were designed on a Likert type-scale with a 5- point scale from 1 – “Strongly Disagree” to 5 “Strongly Agree”. Adding open ended questions has allowed respondents to offer an answer that the researcher did not include in the questions.

### **3.3. Target Population and Method of Sampling**

According to the federal Income Tax Proclamation No.978/2008 taxpayers are categorized into three categories, namely category “A”, “B”, and “C” based on their volume of sales. Category “C” is the third and the last category. The target population of the study has category 'C' tax payers of Mizan-Aman town from which the desired data / information has been collected; and they were 965 in number as of July, 2016. (Mizan-Aman Town Administration Revenue Authority Branch Office).

To analyze the data and draw a conclusion, the respondents were selected with probability sampling design. As all we know, there are different methods of probability sampling. Among this, simple random sampling is the most basic selection method in which each element of the population has equal or nonzero chance of being selected. It is the best way of ensuring that sample is unbiased (Thiétart et al. 2001). Hence, simple random probability sampling is appropriate, and the researcher used lottery method to select the survey respondents.

Furthermore, justification to the choose of this probability sampling technique is it is cost effective, comparatively easier way of sampling, less time consuming, and involve lesser degree of human judgment which makes the overall process free from over biasness. (Thiétart et al.2001).

### 3.4. Sample and Sample Size

A population is a large pool of cases of elements from which the researcher draws a sample and results generalized from the drawn sample (Leedy & Ormrod, 2013). According to (Mizan-Aman Town Administration Revenue Authority Branch Office), the total number of category 'C' tax payers in the town as of July, 2016 was 965. With this in mind, to select a sample of 64 category C tax payers the researcher has used 64 respondents as a representative of a population by using the following finite population sample formula at Confidence level of 95%. Then, a total of 64 questionnaires were distributed to Category C taxpayers of which 54 returned filled completely and properly. This made the return rate around 84.375% ( $\frac{54}{64} * 100$ ).

The reason for using this formula is to obtain results on time; and it helps the researcher to train and supervise the number of enumerator well in the process of data collection.

$$n = \frac{Z * p * q * N}{e^2}$$

Source: (Given by Jaro, 1989)

$$n = \frac{1.96 * 0.5 * 0.5 * 965}{(2.71828)^2} = 64$$

Where: N= Population size,      n =sample size,      p=proportion of success,

Z = Confidence level,      e = 2.718,      q=proportion of failure

### 3.5. Survey Area

According to Bench Maji Zone investment office, Mizan- Aman city which is the capital city of Bench Maji Zone is located in southern part of Ethiopia, Southern Nations, Nationalities and Peoples Regional State, in Bench Maji Zone at a distance of 565 km from Addis Ababa. It is situated at an average altitude of 1500 meters above sea level and Mount Garnance is the roof of the city even for Bench Maji Zone. Mizan-Aman city is divided in to Five (5) Kebeles.

### 3.6. Method of Data Analysis

After data processing: editing, coding, classification and tabulation of collected data so that they are amenable to analysis. For the purpose of obtaining related information about the subject matter, the data was analyzed using descriptive statistics, and multiple linear regression analysis. A correlation matrix was also used to examine the relationship between the dependent variable and explanatory variables. A multiple linear regression model and t-static was used to determine the relative importance of each independent variable in influencing taxpayer's compliance. The multiple linear regressions model was run, and thus OLS was conducted using SPSS20 and STATA 12 econometric software package, to test the casual relationship between the independent variable and its impact on the dependent variable. In order to found answers to the specific objective one as stated in chapter one, descriptive statistical tools such as tables, percentages, averages, and so on were employed.

### 3.7. Model Specification

$$TCOMP_i = \alpha_0 + \beta_1 FAS_i + \beta_2 OSTA_i + \beta_3 AWR_i + \beta_4 CFS_i + \beta_5 SFS_i + \beta_6 ATG_i + \beta_7 ED_i + \varepsilon_i$$

Source: Adapted from Richardson, 2006

Richardson had used the above model to identify the direct association between the five dimensions of tax fairness and the tax compliance but the current study has modified the model to identify the direct association between the seven factors affecting tax compliance in Mizan-Aman Town, SNNPRE.

**Abbreviations of the terms in the regression model are as follows:**

**FAS** - Fairness or Equity

**OSTA** - Organizational strength of tax authority

**AWR** - Awareness level of tax payers

**CFS** - Cultural factors

**SFS** - Social factors

**ATG** - Attitude of tax payers towards the government

**ED** - Economic deterrence

**TCOMP** - Taxpayers compliance

$\epsilon_i$  - Residual term

$\beta$  - Coefficient for X

### **3.8. Method of Presentation and Interpretation**

After the process of data analysis has completed, the analyzed data was organized, summarized and then presented by the means of tabulation and graphs. After presenting the results in the form of table, graphs as well as percentage, the researcher has interpreted them by adding and assigning meaning to the result by making connections and comparisons and exploring causes and consequences in order to increase their understandability.

# CHAPTER FOUR

## 4. RESULTS & DISCUSSIONS

### Introduction

This chapter presents the results and findings of the study based on the research objectives. The Results are presented in the form of summary tables. Regression and Correlation analysis are used to analyses the data to answer the research objective.

### 4.1. Descriptive Statistics

**Table .4. Frequency Table for the Personal Characteristics of the Respondents**

Sex		Frequency	Percent	Valid percent	Cumulative percent
Valid	Male	29	53.7	53.7	53.7
	Female	25	46.3	46.3	100
	Total	54	100	100	
Age		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Less than thirty	25	46.3	46.3	46.3
	30 to 39	19	35.2	35.2	81.5
	40 to 49	10	18.5	18.5	100.0
	Total	54	100.0	100.0	
Educational Status:		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Illiterate	10	18.5	18.5	18.5
	General secondary school or less	15	27.8	27.8	46.3
	TVET certificate	20	37.0	37.0	83.3
	Diploma	5	9.3	9.3	92.6

	Degree	4	7.4	7.4	100.0
	Total	54	100.0	100.0	
	<b>Year of Experience</b>	Frequency	Percent	Valid Percent	Cumulative Percent
<b>Valid</b>	for one year	9	16.7	16.7	16.7
	for two year	13	24.1	24.1	40.7
	three years	16	29.6	29.6	70.4
	four and above	16	29.6	29.6	100.0
	Total	54	100.0	100.0	

Source: researcher, field survey outcomes (2017), SPSS Output.

Out of the total respondents, 53.7 per cent were males and 46.3 per cent were females. Thus, most category C tax payers in Mizan –Aman town were Males in their gender/sex. This high ratio of males reflects the structure of income earners in the study area. That is in most husbands and single males are responsible for the earning of income and providing money for wives to purchase goods and services in the study area.

As it is shown in the table above, the majority of respondents (46.3 valid per cent) were under the age category of less than 30 years. This implies the majority of the tax payers' fall in the working age group. This shows that the young people who fall in the working age group are engaged in different business types or sectors in Mizan –Aman town.

Regarding educational status, 37 valid per cent of respondents had TVET certificate, 27.8 valid per cent of respondents were General secondary school or less, 18.5 valid per cent of respondents were Illiterate, 9.3 valid per cent attended diploma, and 7.4 valid per cent of respondents had degree holders. Furthermore, regarding tax payers " Year of Experience, 29.6 Valid per cent of survey respondents showed that for three, four and above years they are engaged in business and known as a tax payer. As the year of experience increase, compliance for tax law also increases in the same direction.

**Table .5 Distribution of Business Sectors included in the Sample**

Business sectors	Frequency	
Barberry and Beauty Salon	6	10%
Hotel, Bar and Restaurant	4	7.4%
Juice and Coffee house	2	3.7%
Cafeteria and Snack bar	9	17%
Business center, Tele center and Stationery	6	10%
Pharmacy and Health cares	3	5.5%
Super market, Cosmetics and Retail shops	4	7.4%
Cereals and Pulses trade	5	9.25%
Electronics and house utensils	4	7.4%
Fruit and Vegetables	3	5.5%
Music and Video center	2	3.7% %
Garage and Spare parts	2	5.5%
Wood work, Metal work and Glass work	4	7.4%
Total	54	100

Source: (Mizan-Aman Town Administration Revenue Authority Branch Office, 2017).

#### **4.1.2. Descriptive Statistics of the Variables included in the Regression Model.**

The table below summarizes the descriptive statistics of the variables included in the regression model such as; dependent and independent variables. The dependent variable is Taxpayers compliance explained by independent variables such as: Fairness or Equity, Organizational strength of tax authority, Awareness level of tax payers, Cultural factors, Social factors , Attitude of tax payers towards the government, and Economic deterrence.

**Table .6. Descriptive Statistics of the Variables included in the Regression Model**

**Summarize**

Variables	OBS	Mean	Std.Dev.
TOMP	54	3.886243	0.5059367
FAS	54	3.657407	0.4819778
AWR	54	2.158642	1.064974
OSTA	54	3.534512	0.5332347
CFS	54	3.894444	0.7077513
SFS	54	4.212963	0.6486696
ATG	54	3.47037	0.7570124
ED	54	3.759259	0.8020327

Source: researcher, field survey outcomes (2017), STATA Output

As stated in the above table 6, it was found that the mean tax compliance of category C tax payers in the sample was 3.886 percent, meaning on average those sample categories C tax payers of Mizan-Aman Town administration Revenue Authority Branch were compliance to tax law. Whereas the dispersion among the sample measured with standard deviation was 0.5 percent. In table 6 above, it is also stated that during the study period, sample of category C tax payers in Mizan-Aman Town, SNNPRE “ was on average 3.65 percent, 2.15 percent, 3.5 percent, 3.89 percent, 4.2 percent, 3.4 percent, and 3.75 percent influenced by independent variables such as Fairness or Equity, Organizational strength of tax authority, Awareness level of tax payers, Cultural factors, Social factors, Attitude of tax payers towards the government and economic deterrence. The dispersion for a sample, were, 0.48 percent, 1 percent , 0.5 percent, 0.7 percent, 0.65 percent, 0.75 percent, and 0.8 percent.

**4.2. Test Results for the Classical Linear Regression Model Assumptions**

In this study as mentioned in chapter three diagnostic tests were carried out to ensure that the data fits the basic assumptions of classical linear regression model. Consequently, the results for model misspecification tests are presented as follows:

#### 4.2.1. Test for Average Value of the Error Term is Zero ( $E(u_t) = 0$ ) assumption

The first assumption required is that the average value of the errors is zero. In fact, if a constant term is included in the regression equation, this assumption will never be violated. Therefore, since the constant term (i.e.  $\alpha$ ) was included in the regression equation, the average value of the error term in this study is expected to be zero.

#### 4.2.2. Test for Homoscedasticity Assumption ( $\text{Var}(u_t) = \sigma^2$ )

In this study as shown below both the F-statistic and Chi-Square versions of the test statistic gave the same conclusion that there is no evidence for the presence of heteroscedasticity, since the p-values were in excess of 0.05. The third version of the test statistic, Scaled explained  $SS^*$ , which as the name suggests is based on a normalized version of the explained sum of squares from the auxiliary regression, also gave the same conclusion that there is no evidence for the presence of heteroscedasticity problem, since the p-value was considerably in excess of 0.05.

#### **Breusch-Pagan / Cook-Weisberg test for heteroskedasticity**

Ho: Constant variance

Variables: fitted values of  $\text{tomp}$

chi2(1) = 1.82

Prob > chi2 = 0.1769

Source: researcher, field survey outcomes (2017), STATA Output

#### 4.2.3. Test for Normality Assumption

The statistical methods are based on various assumptions that uphold the methods. One of them is the normality assumption. It is often required to check the normality in many data analyses, although normality is implicitly or conveniently assumed in reality. If the assumption is violated, interpretations and inferences based on the models are not reliable, if not valid (Oscar Torres-Reyna, 2003). The assumptions given above can be more compactly stated as  $U_i \sim N(0, \delta^2)$ . The normality tests for this study as shown in the coefficient of kurtosis was close to 0.0566, and the Bera-Jarque statistic had a P-value of 0.06 implying that the data were consistent with a normal distribution assumption since the value of p is greater than 0.05.

**Regression: testing for normality.**

		Skewness/Kurtosis tests for Normality			
Variable	Obs	Pr(Skewness)	Pr(Kurtosis)	----- adj chi2(2)	----- joint Prob>chi2
e	54	0.131	0.0566	5.63	0.0600

Source: researcher, field survey outcomes (2017), STATA Output

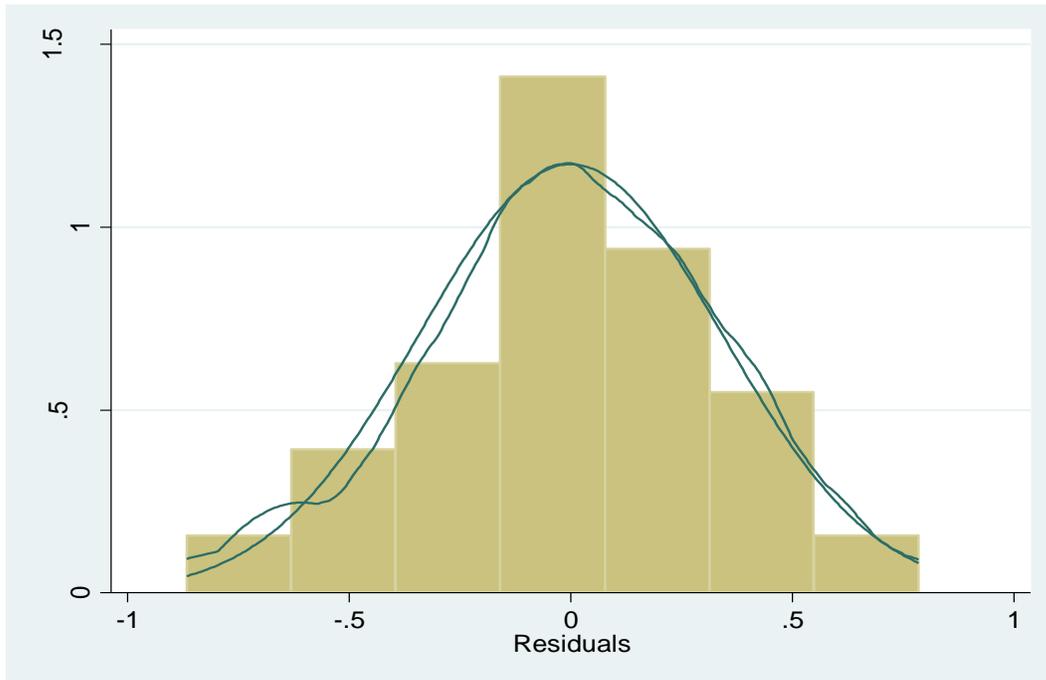


Figure 2 Normal Distribution/pattern for the Residual

Here residuals seem to follow a normal distribution/ Pattern. Implying that, there is no a problem of omitted variables, model specification, linearity, functional forms.

NB: In practice normality does not represent much of a problem when dealing with really big samples.

**4.2.4. Test for Absence of Series Multicollinearity Assumption**

This assumption is concerned with the relationship exist between explanatory variables. If an independent variable is an exact linear combination of the other independent variables, then we say the model suffers from perfect Collinearity, and it cannot be estimated by OLS (Brooks 2011).

Multicollinearity condition exists where there is high, but not perfect, correlation between two or more explanatory variables Hausman, J.A. (1978). When there is multicollinearity, the amount of information about the effect of explanatory variables on dependent variables decreases.

As a result, many of the explanatory variables could be judged as not related to the dependent variables when in fact they are. This assumption does allow the independent variables to be correlated; they just cannot be perfectly correlated. If we did not allow for any correlation among the independent variables, then multiple regressions would not be very useful for econometric analysis.

How much correlation causes multicollinearity however, is not clearly defined. While Hair et al (2006) argue that correlation coefficient below 0.9 may not cause serious multicollinearity problem. Malhotra (2007) stated that multicollinearity problem exists when the correlation coefficient among variables is greater than 0.75. Kennedy (2008) suggests that any correlation coefficient above 0.7 could cause a serious multicollinearity problem leading to inefficient estimation and less reliable results.

This indicates that there is no consistent argument on the level of correlation that causes multicollinearity. According to Gujarati (2004), the standard statistical method for testing data for multicollinearity is analyzing the explanatory variables correlation coefficients (CC); condition index (CI) and variance inflation factor (VIF). Therefore, in this study correlation matrix for seven of the independent variables shown below in the table had been estimated. The results in the following correlation matrix show that the highest correlation of 0.4549 which is between Organizational strength of tax authority/OSTA and Attitude of tax payers towards the government/ATG. Since there is no correlation above 0.7, 0.75 and 0.9 according to Kennedy (2008), Malhotra (2007) and Hair et al (2006) respectively, the researcher can conclude in this study that there is no problem of multicollinearity.

## VIF result

Variable	VIF	1/VIF
Ed	1.84	0.544175
Fas	1.66	0.603615
Osta	1.55	0.644036
Cfs	1.27	0.785555
Sfs	1.23	0.814115
Atg	1.20	0.830597
Awr	1.20	0.831318
Mean VIF	1.42	

Since the table above showed that variable inflation factor (vif) results were less than 10, there is no problem of multicollinearity.

### 4.2.5. Correlation Matrix of Dependent and Independent Variables

In statistic, correlation, (often measured as a correlation coefficient), indicates the strength and direction of a linear relationship between two random variables. In general it refers to the departure of two variables from independence. A number of different coefficients are used for different situations as mentioned by Coakes and Steed (2007). Here in this section the associations of independent variables with the dependent variable of Category “C” tax payer’s compliance as well as the independent variables themselves were analyzed and discussed by using a correlation matrix. As described by Brooks (2008), correlation measures the extent of linear relationship between two or more variables.

If two variables are correlated, it doesn't mean that one variable affects the other and vice versa, rather it means that they are being treated completely in the same manner. Similarly speaking, once we are sure for a linear association between the two variables and on average their movements are related to an extent which is given by the correlation coefficient. A correlation coefficient of two variables ranges between -1 and +1. A correlation coefficient of negative one implies that a perfect negative linear relationship between the two variables while positive one indicates a perfect positive linear association. On the other extreme, a correlation coefficient of zero indicates that the absence of any linear relationship between two variables. Table 4.5 below presents a correlation matrix which shows the degree of linear relationship between the dependent and independent variables of the study.

**Table .7. Correlation Matrix of Dependent and Independent Variables**

	TOMP	FAS	OSTA	AWR	CFS	SFS	ATG	ED
TOMP	1.0000							
FAS	0.3212	1.0000						
OSTA	0.2687	0.4280	1.0000					
AWR	0.1301	0.1738	-0.0916	1.0000				
CFS	0.1637	0.2567	0.3705	-0.1565	1.0000			
SFS	0.1820	-0.3167	0.0275	0.2105	0.0546	1.0000		
ATG	-0.0520	0.0932	0.1341	-0.1591	0.2106	-0.1563	1.0000	
ED	0.0973	0.3563	0.4549	0.0825	0.3252	-0.0568	0.2493	1.0000

Source: researcher, field survey outcomes (2017), STATA Output

**Note that:** The above correlation matrix described the strength of a linear relationship between two variables

### 4.3. Results of the Regression Analysis

According to Coakes and Steed (2007), multiple regressions are an extension of bivariate correlation. They state that the result of regression is an equation that represents the best prediction of a dependent variable from several independent variables.

Regression analysis is used when independent variables are correlated with one another and with the dependent variable, to predict the values of a dependent variable based on the value of at least one independent variable, and to explain the impacts of changes in an independent variable on the dependent variable. Under the following regression outputs the beta coefficient may be negative or positive; beta indicates that each variable's level of influence on the dependent variable. P-value indicates at what percentage or precession level of each variable is significant. R<sup>2</sup> values indicate the explanatory power of the model and in this study adjusted R<sup>2</sup> value which takes into account the loss of degrees of freedom associated with adding extra variables were inferred to see the explanatory powers of the models.

$$TCOMP_i = \alpha_0 + \beta_1 FAS_i + \beta_2 OSTA_i + \beta_3 AWR_i + \beta_4 CFS_i + \beta_5 SFS_i + \beta_6 ATG_i + \beta_7 ED_i + \varepsilon_i$$

**Table .8. Regression Result.**

Total observations: 54

reg tomp fas awr osta cfs sfs atg ed							
Source	SS	df	MS	Number of obs		=	54
				F( 7, 46)		=	7.95
Model	7.42631311	7	1.06090187	Prob > F		=	0.0000
Residual	6.14019987	46	.133482606	R-squared		=	0.5474
				Adj R-squared		=	0.4785
Total	13.566513	53	.255971943	Root MSE		=	.36535
	tomp	Coef.	Std. Err.	t	P>t	[95% Conf.	Interval]
	fas	.3520791	.1340193	2.63	0.012	.0823122	.6218461
	awr	.0152	.0520858	0.29	0.772	-.0896434	.1200433
	osta	.1764442	.0739985	2.38	0.021	.027493	.3253953
	cfs	.3356899	.0800028	4.20	0.000	.1746525	.4967272
	sfs	.2643144	.0857449	3.08	0.003	.0917189	.4369098
	atg	.2146016	.0987758	2.17	0.035	.0157763	.4134269
	ed	.1684599	.0849865	-1.98	0.053	-.3395288	.002609
	_cons	-.3488373	.6802144	-0.51	0.611	-1.718038	1.020363

Source: researcher, field survey outcomes (2017), STATA Output

From above table, the R-squared statistics and the adjusted-R squared statistics of the model was 55 % and 48 % respectively. The result indicates that the changes in the independent variables explain 55 % of the changes in the dependent variable i.e. the regression line give a good fit to the observed data, since this line explains 55% of the total variation in tax compliance values around their mean. The remaining 45% of changes was explained by other factors which are not included in the model i.e. uncounted by the regression line and is attributed to factors included in the disturbance term. Thus these variables collectively, are good explanatory variables of taxpayer's compliance in the Town. F value of 0.000 indicates strong statistical significance, which enhanced the reliability and validity of the model.

Based on the results shown in the above table, six independent variables had statistically significant impact on taxpayer's compliance. Fairness or Equity, Organizational strength of tax authority, Cultural factors, Social factors, Attitude of tax payers towards the government and Economic deterrence were significant at five percent significance level since the p-value for the variables were 0.012, 0.021, 0.000, 0.003, 0.035 and 0.05 respectively . On the other hand awareness level of tax payers has insignificant impact on taxpayer's compliance since the p-value for the variables was greater than five percent significant level .

Besides, the above table also shows that the coefficient of Economic deterrence(ed) against taxpayer's compliance was negative as far as the coefficients for this variable is negative 0.169. This indicates that there was an inverse relationship between the aforementioned independent variables and taxpayer's compliance. Thus the increase of this variable will lead to a decrease in taxpayer's compliance. This implies that under low audit probabilities and low penalties, the expected return to evasion is high. On the other hand, variables like Fairness or Equity, Organizational strength of tax authority, Cultural factors, Social factors, and Attitude of tax payers towards the government have a positive relationship with taxpayer's compliance as far as their coefficients were positive. This revealed that there were a direct relationship between the above five independent variables and taxpayer's compliance. In general as per the regression results provided in the above table among the seven explanatory variables used in this study six of them were significant.

## Regression Model

$$TCOMP_i = \alpha_0 + \beta_1 FAS_i + \beta_2 OSTA_i + \beta_3 AWR_i + \beta_4 CFS_i + \beta_5 SFS_i + \beta_6 ATG_i + \beta_7 ED_i + \varepsilon_i$$

Source: Richardson (2006)

$$TCOMP_i = 0.35 + 0.352FAS_i + 0.152AWR_i + 0.176OSTA_i + 0.335CFS_i + 0.264SFS_i + 0.214ATG_i + 0.348ED_i + \varepsilon_i$$

Regression analysis showed that the models were fit and the results were supporting the hypothesis.

### 4.3.1. Summary for the Hypotheses Testing

The following table summarizes the results of hypotheses testing:

Table: 9. Summary of Hypotheses Testing Results

Alternative Hypotheses	Taxpayer's compliance(TCOMP)	
	The detected coefficient sign	Decision
<b>H1:</b> Fairness does affect Tax Compliance.	+	Accepted
<b>H2:</b> Tax Authorities Strength does affect Tax Compliance.	+	Accepted
<b>H3:</b> Awareness does affect Tax Compliance.	+	Rejected
<b>H4:</b> Culture does affect Tax Compliance.	+	Accepted

<b>H5:</b> A social factor does affect Tax Compliance.	+	Accepted
<b>H6:</b> Taxpayers' attitude towards government does affect Tax Compliance.	+	Accepted
<b>H7:</b> Economic deterrence does affect Tax Compliance.	+	Accepted

Fairness or Equity, Organizational strength of tax authority, Awareness, Cultural factors, Social factors, and Attitude towards the government was found significantly influencing tax payers compliance with tax law in the study area. That is they are found to be determinant factors affecting tax payers compliance in the study area and it answered the second research question (what are the variables that generally affect tax payers' compliance with taxation). Among the independent variables, a Cultural factor has been found to be the most important determinant factor to tax compliance and explained standardized coefficients ( $\beta$ ) of 0.335. It follows by Social factors ( $\beta = 0.264$ ) and Fairness or Equity ( $\beta = 0.35$ ).

#### 4.4. Analysis of Results

This section of the chapter discusses the analysis of the results. The analysis is based on the theoretical framework and the data collected through the data collection instruments. The data are analyzed in light of the specific research question and hypotheses stated.

Hence, the analysis focuses mainly on the results of the regression analysis for the selected factors that have an impact on taxpayer's compliance.

These selected factors are Fairness or Equity, Organizational strength of tax authority, Awareness level of tax payers, Cultural factors, Social factors, Attitude of tax payers towards the government, and Economic deterrence.

#### **4.4.1. Fairness or Equity**

Tax fairness is one of the variables that have attracted researchers to discover the extent the variable in fostering noncompliant behavior Wenzel (2007). Special interest is taken to relate the importance of tax fairness as a construct under attitudes and perceptions towards tax compliance. The positive coefficient of this ratio which was in line with the prior expectation and theory for that matter indicated the existence of a tandem relationship between taxpayer's compliance and Fairness or Equity. In addition the coefficient of the variable was statistically significant at five percent significant level. This implies that an increase in the Fairness or Equity of the tax system, certainly lead to increase in taxpayer's compliance. The finding was in consistent to the results of Weldegiorgis (2010). Therefore one can conclude as the Fairness or Equity of tax system was a key driver taxpayer's compliance in Mizan Aman town.

#### **4.4.2. Organizational Strength of Tax Authority**

The impact of organizational strength of tax authority is positive and statically significant impact on taxpayer's compliance. The coefficient of organizational strength of tax authority was positive as expected, it was statistically significant at five percent significance level ( $p\text{-value}=0.021$ ), insinuating that its influence is significant on taxpayer's compliance Mizan-Aman Town. Moreover, the significant parameter indicates that the organizational strength of tax authority/structure does affect the Zon's taxpayer's compliance. Thus the hypothesis that states there is a positive significant relationship between organizational strength of tax authority and taxpayer's compliance should be accepted. So the output of the regression analysis are in agreement in relation to the direction of the effect of organizational strength of tax authority as far as both of them proves the existence of positive or tandem relationship between organizational strength of tax authority and taxpayer's compliance. Supported by Bird and Oldman (1967), no tax will work effectively, unless its administrators maintain an aggressive attitude with respect to the correctness of the taxpayers' actions.

#### **4.4.3. Awareness Level of Tax Payers**

One would expect that the impact of awareness level of tax payers is positive and significant. However, even if the coefficient of awareness level of tax payers was positive as expected, it was not statistically significant even at 10% significance level (p-value= 0.772), insinuating that its influence is negligible.

Moreover, the insignificant parameter indicates that the awareness level of tax payers Strength does not affect taxpayer's compliance. Thus the hypothesis that states there is a significant relationship between awareness level of tax payers Strength and taxpayer's compliance may be rejected or data did not support the hypothesis.

#### **4.4.4. Cultural Factors**

The impact of Cultural factors is positive and statistically strong/significant impact on taxpayer's compliance. The coefficient of Cultural factors was positive as expected, it was statistically significant at five percent significance level (p-value= 0.000), insinuating that its influence is significant on taxpayer's compliance in Mizan-Aman Town. Moreover, the significant parameter indicates that the Cultural factor does affect category C taxpayer's compliance in Mizan-Aman Town. Thus the hypothesis that states there is a positive significant relationship between Cultural factors and taxpayer's compliance should be accepted. So the output of the regression analysis are in agreement in relation to the direction of the effect of Cultural factors as far as both of them proves the existence of positive or tandem relationship between Cultural factors and taxpayer's compliance. Supported by, "Culture" is considered to be a powerful environmental factor that affects the taxpayer's compliance. Different social norms and ethical values will create different incentives for tax compliance. In fact, ethical values influenced by social norms may prohibit taxpayers from engaging in tax evasion (Blanthorne and Kaplan, 2008).

#### **4.4.5. Social Factors**

Also the impact of Social factors such as how and where the customers fits in to the society, the norm of the groups they belong to, age, gender, ethnicity, educational level, personal relationship is positive and statistically strong/significant impact on taxpayer's compliance as cultural factor too. The coefficient of Social factors was positive as expected, it was statistically significant at five percent significance level ( $p\text{-value} = 0.003$ ), give to understand that its influence is significant on category C taxpayer's compliance in Mizan-Aman Town. Thus the hypothesis that states there is a positive significant relationship between Social factors and taxpayer's compliance should be accepted. So the output of the regression analysis are in agreement in relation to the direction of the effect of Social factors as far as both of them proves the existence of positive or tandem relationship between Social factors and taxpayer's compliance. This result is in line with literature an existing social bond between the society and this bond influences the members of the society in complying with the tax law. That is taxpayers may be influenced by their peer groups to comply or not to comply with the tax law. Peers are usually referred to taxpayers' associates and include friends, relatives and colleagues (Jackson and Milliron, 1986). The peer influence is reflected in an individual's expectations in relation to the approval or disapproval of that tax noncompliance behavior. Sanvely, 1990 also stated that compliance behavior and attitude towards the tax system is affected by the behavior of an individual's reference group such as relatives, neighbors, and friends.

Thus if a tax payer knows many people in groups important to him who evade taxes, his commitment to comply will be weaker. On the other hand, social relationship may also help deter individuals from engaging in evasion for fear of social sanctions imposed once discovered and revealed publicly (Grasmick and Green, 1980; Grasmick and Scott, 1982).

#### **The Impact of Norms on Behavior**

A key factor in tax compliance is a widespread desire to "do the right thing". Taxpayers seek to comply because they believe it the right thing to do, not because of fear of punishment if they do not comply (Wenzel, 2005). The desire of a taxpayer to comply is strongly linked to behavioral norms, both the personal norms and beliefs of the individual taxpayer and the social norms that prevail in society at large.

Personal norms are the result of a combination of factors inherent to the individual. These guide a taxpayer's posture to the tax administration (OECD, 2010) but are difficult to influence. Tax administrations can try to send messages that stress the importance of compliance to educate taxpayers and build up positive personal norms. Engagement by tax administrations with young people (early working age or younger) can influence their personal norms and this benefits tax compliance in the long-term. There is evidence from diverse areas (not just tax related) that people seek to conform to social norms and that the behavior of others strongly influences an individual's choices (OECD, 2010). This influence is important though in many cases people do not consciously realize it. This effect can be heightened when the relationship to the social grouping is stronger or closer (peers or neighbors may exert greater influence than those more distant to the individual). Social norms influence taxpayer behavior. If there is a perception that tax evasion is limited and the majority of the people are compliant, this makes people less willing to evade taxes themselves. Often people tend to believe that non-compliance is more prevalent than it is in practice so correcting misperceptions regarding the scale of evasion is also a positive way to reinforce compliance.

#### **4.4.6. Attitude of Tax Payers towards the Government**

The impact of attitude of tax payers towards the government is positive and significant impact on taxpayer's compliance. The coefficient of attitude of tax payers towards the government was positive as expected, it was statistically significant at five percent significance level ( $p\text{-value}=0.035$ ), implying that its influence is significant on taxpayer's compliance in Bench Maji zone. Moreover, the significant parameter indicates that the attitude of tax payers towards the government does affect category C taxpayer's compliance. Thus the hypothesis that states there is a positive significant relationship between attitude of tax payers towards the government and taxpayer's compliance should be accepted. So the output of the regression analysis are in agreement in relation to the direction of the effect of attitude of tax payers towards the government as far as both of them proves the existence of positive or tandem relationship between attitude of tax payers towards the government and taxpayer's compliance of Mizan-Aman Town. The result is in line with the literature, presence of government expenditures may motivate compliance (Alm, Jackson, and Mckee, 1992; Andreoni, et al., Cowell and Gordon, 1988).

Individuals may pay tax because they value the goods provided by the government, recognizing that their payments are necessary both to help finance the goods and services and to get others to contribute. A tax payer therefore is seen as exchanging purchasing power in the market in return for the government services (Levi, 1998).

#### **4.4.7. Economic Deterrence**

The economic deterrence theory states that taxpayer's behavior is influenced by factors such as the tax rate determining the benefits of evasion, and the probability of detection and penalties for fraud which determine the costs (Allingham and Sandmo 1972; Becker 1968). Deterrence (the risk of detection and the punishments incurred) should positively influence taxpayer compliance (Slemrod, 2007). The impact of Economic deterrence on taxpayer's compliance is negative and statistically significant impact on taxpayer's compliance. The coefficient of Economic deterrence was negative as expected, it was statistically significant at five percent significance level (p-value= 0.05), that mean its influence is significant on the taxpayer's compliance in Mizan-Aman Town specifically, category C tax payer's compliance.

#### **4.5. Content Analysis of Open-Ended Questions**

The respondents were also given the opportunity to give their general comment on the overall tax system. Accordingly, they issued several comments regarding the problems and measures that have to be undertaken. These additional comments forwarded by the tax payers are generally listed below:

- Encouragement rather than coercion: Means that the government should not use Carrot and Stick' Approach/ strategy. But it is better to use Responsible Citizens' Strategy.
- The tax system lacks fairness or equity
- Many business operators are not accommodated by the tax system and there is high prevalence of illegal trade
- Less effort to create awareness, and poor communication between tax authority and tax payers
- No enough adequate provision of social services
- Absence of transparency in the overall tax system



# CHAPTER FIVE

## 5. CONCLUSIONS AND RECOMMENDATIONS

It is generally agreed that a strong and healthy taxation system is a prerequisite for Sustainable economic growth of a given country; today, tax has become a part and parcel of all economic activities of human beings. Every man, willingly or unwillingly, pays an amount of money in the form of tax on the products he uses basically. Besides, he pays tax on his income, wealth, etc. In order to survive negative shocks and maintain a good economic stability, it is important to identify the major determinant factors that mostly influence taxpayer's compliance with taxation. The study also used an appropriate econometric methodology for the estimation of variables coefficient. The following sections discussed about the final concluding remarks of the study and possible recommendations.

### 5.1. Conclusions

- As indicated in table 4.6. Of regression results, the independent variables such as fairness or equity, organizational strength of tax authority, awareness level of tax payers, cultural factors, social factors, attitude of tax payers towards the government, and economic deterrence are able to explain a taxpayer's compliance with taxation (R- square of 55 % and A-R- square of 48 % respectively). For that matter, the study specified an empirical framework to assess the effect.
- A cross-sectional data was collected from fifty four sampled category "C" taxpayer's.
- The collected Data was analysis by using descriptive statistics, correlation and regression analysis.
- The study also used an appropriate econometric methodology for the estimation of variables coefficient.
- Before performing OLS regression the models were tested for the classical linear regression model assumptions.
- Seven factors affecting taxpayer's compliance with taxation were chosen and analyzed.

- On the other hand, this study found that cultural factor is the main significant factor which determines taxpayer's compliance with taxation in Mizan-Aman Town; supported by Culture is considered to be a powerful environmental factor that affects the taxpayer's compliance. Different social norms and ethical values will create different incentives for tax compliance. In fact, ethical values influenced by social norms may prohibit taxpayers from engaging in tax evasion (Blanthorne and Kaplan, 2008) theoretical results.
- Social factors, fairness or equity, organizational strength of tax authority and attitude of tax payers towards the government are also the major and significant factors these determines taxpayer's compliance with taxation; This finding is consistent with previous theoretical results of (Jackson and Milliron, 1986), ( Sanvely, 1990), and (James , 2000) theoretical results. This implicated that taxpayer's compliance with taxation in Mizan –Aman town has significantly influenced by cultural factor, Social factors, fairness or equity, organizational strength of tax authority and attitude of tax payers towards the government.
- Responsible Citizens' Strategy (encouragement rather than coercion) is appropriate and effective Strategy to increase category C tax payer's compliance in Mizan- Aman town. While such an approach might be considered by some as suitable for human beings might respond so positively. The result might be an increment of tax payer's compliance even for voluntary compliance. James (2000)
- Because of not enough comparable social services offered by government for the tax they pay, category C tax payers in Mizan-Aman town becomes reluctant when it comes to paying tax in the right amount, time, and place.
- According to Head of Mizan- Aman Twon Administration Revenue Authority Branch office, Category C tax payers are considered as the most problematic category of taxpayers in Mizan-Aman town pay taxes at fixed rate on the income estimated by the tax authority rather than declaring their income by themselves.

## 5.2. Recommendations

Based on the findings obtained from the results, the following feasible recommendations were made:

- Indeed focusing and exploring factors that determines and motivates citizens' tax compliance to pay taxes in general and category C tax payers in particular could essential to raise domestic revenues from consenting citizens.
- The following measures should be undertaken by the tax authority to motivate category "C" Tax payers to pay tax.
  - Improving relationship with the public
  - Educating the taxpayers and conducting consultation sessions
  - Providing necessary information to taxpayers regarding the provision of services and utilization of tax revenues
  - Reducing tax rates and making the collection procedures simple and transparent
- Strengthen systems of taxpayer information and support, including a comprehensive support web site and information publications made available at all tax offices.
- Encouragement rather than coercion. The overwhelming majority of taxpayers, whilst not being enthusiastic about paying tax, recognize that it is their civic duty to do so. The tax administration system should take this as its starting point and concentrate primarily on helping people to get their tax affairs right rather than threatening them if they get them wrong.
- To reduce the reluctance of category C tax payers when they comes to paying tax in the right amount, time, and place, the government should offer comparable social services for the tax they pay; indeed reduce the attempt of tax evasion strategies. Because, in societies with a tradition (culture) of high compliance with tax law, few tax payers would attempt tax evasion system.
- Category C tax payers are considered as the most problematic category of taxpayers due to the fact that these taxpayers pay taxes at fixed rate on the income estimated by the 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. Therefore, it is advisable giving them specialty treatment, monitoring and evaluating them to address their view.

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## ***APPENDIX***

### ***Taxpayers Survey Instrument/ Questionnaire (English version)***



**Jimma University**

**College of Business and Economics**

**Department of Accounting and Finance**

**MSc in Accounting and Finance Program**

The aim of this questionnaire is to assess information needed for the research report to be produced under the title “Factors Affecting Category “C” Tax Payers’ Compliance with Taxation: A Case of Mizan-Aman Town, SNNPRE” The information you provide is believed to have a great value for the success of this research. The information you provide is to be used for academic purpose and will be strictly kept confidential. Besides to its academic purpose, the study is entirely devoted to assess category “C” tax payers’ compliance with tax law. Muluken Tizazu Dirkentete is doing the research under the guidance of Jimma University. Kindly requesting you to give genuine response to all the questions hereunder, really I am grateful to your cooperation. Additionally you are not required to write your name, addresses by any way.

**General Instructions:**

Please read each statement and indicate your level of agreement by taking the most relevant answer from the options provided. If you make an error, cross it out and indicate your actual response. Your elaboration will add tremendous value to the findings of this study. Hence, if you need more space to express your opinions use the back of each page in this questionnaire.

**Section I: Background information of respondents**

**Age :( in years)**

- A. Less than thirty
- B. 30 to 39
- C. 40 to 49
- D. 50 to 59
- E. 60 years or more

**Gender:**

- A. Male
- B. Female

**Educational Status:**

- A. Illiterate
- B. General secondary school or less
- C. TVET certificate
- D. Diploma
- E. Degree

If other specify \_\_\_\_\_

For how many years you are in this business? \_\_\_\_\_

For how many years you are known as tax payer? \_\_\_\_\_

**Section II: Questions Related to Taxpayers' General Knowledge about Taxation**

A. Why do you pay taxes?

- A. To avoid disturbances (penalties, sanctions,)
- B. in the anticipation of public services
- C. There is no opportunity to evade.
- D. It is an obligation towards the government.
- E. Don't know.

State if any

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5. Considering your ability to pay, how do you think the amount of tax liability you have paid?

- A. Overstated
- B. Understated
- C. Normal

Possible measures	Strongly disagree	Moderately disagree	Neither agree nor disagree	Moderately agree	Strongly agree
6. It is unfair to pay tax					
7. The tax laws should be respected.					

8. Which of the following is the most serious crime? (Rank them 1-4)

- A. Drunken driving
- B. Stealing some ones mobile
- C. Tax evasion
- D. Hi-jacking

State if any; \_\_\_\_\_

9. What are the major problems in tax system/ collection?

- A. Tax revenues are not spent on public services
- B. Tax rates are too high.
- C. There are dishonest tax collectors.
- D. Several tax items are levied at the same time.
- E. Taxpayers are not willing to pay taxes

State if any; \_\_\_\_\_

**Section III: Questions related to Motivational Factors**

10. Which of the following measures should the tax authority undertake to motivate category “C” Tax payers to pay tax?

<b>Possible measures</b>	<b>Strongly disagree</b>	<b>Moderately disagree</b>	<b>Neither agree nor disagree</b>	<b>Moderately agree</b>	<b>Strongly agree</b>
Strengthening legal enforcement and penalties					
Improving relationship with the public					
Educating the taxpayers and conducting consultation sessions					
Providing necessary information to taxpayers regarding the provision of services and utilization of tax revenues					
Reducing tax rates and making the collection procedures simple and transparent					

**Section IV: Questions related to different Determinant Factors**

<b>Possible measures</b>	<b>Strongly disagree</b>	<b>Moderately disagree</b>	<b>Neither agree nor disagree</b>	<b>Moderately agree</b>	<b>Strongly agree</b>
<b>11.</b> In general, would you agree that the business income tax burden imposed upon category “C” tax payers is fair?					
<b>12.</b> Personally, would you agree that the business income tax burden imposed upon you is fair?					
<b>13.</b> Would you agree that tax payers with higher business incomes pay tax at higher rates than tax payers with lower business incomes?					
<b>14.</b> As tax payers’ perceptions of tax fairness increases, the level of tax compliance will also increase.					
<b>15.</b> How do you evaluate the strength of the tax					

authority with respect to the following Parameters?					
<b>Possible measures</b>	<b>Excellent</b>	<b>Good</b>	<b>Neither nor</b>	<b>Poor</b>	<b>Extremely Poor</b>
Service delivery					
Tax collection efficiency					
Law enforcement					
Awareness creation					
<b>Possible measures</b>	<b>Strongly disagree</b>	<b>Moderately disagree</b>	<b>Neither agree nor disagree</b>	<b>Moderately agree</b>	<b>Strongly agree</b>
<b>16.</b> Tax payers have trust in the tax system, assessment, and collection procedures					
<b>17.</b> Do you agree that the tax assessors' committee is unbiased in determining your income tax liability?					
<b>18.</b> Tax payers who perceive the tax authorities' enforcement actions to be ineffective are less Compliant.					

<p><b>19.</b> If there is no penalty or legal enforcement there is a possibility that tax payers may not pay tax.</p>					
<p><b>20.</b> Tax payers feel guilty if they are evading tax provided that they remain unnoticed</p>					
<p><b>21.</b> Tax payers who possess an awareness of the penalties for non-compliance are more compliant than those who do not possess such awareness.</p>					
<p><b>22.</b> As the culture of paying tax in a society is high, the level of tax compliance is also high</p>					
<p><b>23.</b> Do you agree that cultural differences have a direct impact on ethical values and moral development and ultimately affect tax compliance decisions?</p>					
<p><b>24.</b> In societies with a tradition (culture) of high compliance with tax law, few tax payers would attempt tax evasion strategies.</p>					
<p><b>22.</b> The noncompliance of other taxpayers</p>					

has a negative impact on compliant tax payers' Behavior					
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23. What do you think about the public attitude toward taxation, including you?

- A. Excellent
- B. Good
- C. Neither nor
- D. Poor
- E. Extremely poor

Possible measures	Strongly disagree	Moderately disagree	Neither agree nor disagree	Moderately agree	Strongly agree
24. Do you agree that tax payers including you may commit non-compliance as long as your noncompliance is consistent with in-group expectations and norms?					
25. As tax payers knows many people in group important to them are evading taxes, their commitment to comply will be weaker.					
26. Would you agree that a good political system has positive impact on tax payers' attitude towards the tax system?					
27. Do you agree that					

people are getting comparable social services from the government for the tax they pay?					
28. Do you agree that tax payers' behavior including you is affected by your satisfaction or lack of satisfaction with your terms of trade with the government?					

29. Do you agree that tax payer's attitude including you towards the general level of taxation and tax compliance is dependent on attitudes about the desirability of the government programs and the government itself?

- A. Strongly disagree
- B. Moderately disagree
- C. Neither disagree nor agree
- D. Moderately agree
- E. Strongly agree

**Questions Related to Economic Deterrence (Independent Variables)**

37. Tax rate determining benefits of evasion should influence tax payers compliance

- A. Strongly disagree
- B. Moderately disagree
- C. Neither disagree nor agree
- D. Moderately agree
- E. Strongly agree

38. Probabilities of detection of tax evasion should influence tax payer's compliance

- A. Strongly disagree
- B. Moderately disagree

- C. Neither disagree nor agree
- D. Moderately agree
- E. Strongly agree

39. Penalties for fraud which determine the costs are high, few people will evade taxes.

- A. Strongly disagree
- B. Moderately disagree
- C. Neither disagree nor agree
- D. Moderately agree
- E. Strongly agree

**Section V: Questions related to Tax Payers Compliance (Dependent Variable)**

Ser. no.	Questions	Strongly disagree	Moderately disagree	Neither agree nor disagree	Moderately agree	Strongly agree
40.	Tax payers should evade tax if tax rates are too high					
41.	Tax payers should evade tax if the tax system is unfair					
42.	Tax payers should evade tax if a large portion of the money collected from tax is wasted.					
43.	Tax payers should evade tax if the probability of getting caught is low					

44.	Evading tax due to lack of ability to pay should not be considered as crime/problem					
45.	Tax payers should evade tax if everyone is doing it.					
46.	Generally, Tax evasion should not be considered as a crime					

State if any; \_\_\_\_\_

47. Write/state and give your general recommendation/ comment on which strategy is appropriate and effective to increase category C tax payer’s compliance.

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48. Why category C tax payers becomes reluctant when they comes to paying tax in the right amount, time, and place?

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49. Why category C tax payers are considered as the most problematic category of taxpayers?

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