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**ADDIS ABABA UNIVERSITY
COLLEGE OF BUSINESS AND ECONOMICS
DEPARTMENT OF ACCOUNTING AND FINANCE**

**COMPLIANCE COST OF EMPLOYEMENT INCOME TAX PAYERS IN ADDIS
ABABA CITY ADMINISTRATION**

**A THESIS SUBMITTED TO THE SCHOOL OF GRADUATE STUDIES IN
PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE DEGREE OF
MASTER OF SCIENCE IN ACCOUNTING AND FINANCE**

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**June, 2016
Addis Ababa**

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APROVED BY BOARD OF EXAMINERS

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Acknowledgements

First and for most, I would like to thank the almighty God for His wisdom and patience that gave me during my work. Without the support of God, it was difficult to come to an end.

I am highly indebted to my advisor Dr. Laxmikantham P .for his valuable suggestions ,patience in repeatedly reading the draft manuscript of this study and for making constructive comments , suggestions and encouragements towards the accomplishment my thesis valuable comments this thesis would not have been finalized in its present structure.

I would like to thanks my family, without whose assistance from the beginning, the accomplishment of this paper would have been impossible. Thanks my family again

I would I like to express my heartfelt appreciation to my friends support , who support and initiate me to work hard from the beginning to the end of this study.

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List of Acrimonies

ETB: Ethiopian Birr

AEO: African Economic Outlook

FDRE: Federal Democratic Republic of Ethiopia

ERCA: Ethiopian Revenue and Custom Authority

NGO: Nongovernmental Organization

NBE: National Bank of Ethiopia

Abstract

The paper examines the tax compliance costs of employment income taxpayers in Addis Ababa. one research question and one hypothesis were investigated in this study: (RQ1) how much compliance costs of the individual income tax system borne directly by the taxpayers themselves, including both the time spent and pecuniary expenditures? (And (H1) the compliance costs of individual income tax are relatively low in terms of their costs per individual: especially costs of time and monetary costs. The survey was conducted to a total of 250 individual income tax payers and questionnaires were distributed to those individual taxpayers in the administrative city of Addis Ababa in Ethiopia. A total of 200 responses were received and used for the final data analysis. The findings from the survey provide pertinent and useful insights about the compliance costs of Addis Ababa individual taxpayers. The average values per tax payers were 157.78 ETB and the average times spent by tax payers for filing their tax return were 7.54hrs. In all, the study found that the compliance costs of individual taxpayers in Addis Ababa were relatively low in term of the total monetary value.

Keywords: compliance cost, income tax, Addis Ababa

CHAPTER ONE

1. Introduction

1.1 Background of the study

Taxation is one of the important elements in managing national income, especially in developed countries and has played an important role in civilized societies since their birth thousands years ago. Tax is defined as “a compulsory levy, imposed by government or other tax raising body, on income, expenditure, or capital assets, for which the taxpayer receives nothing specific in return (Lymer and Oats, 2009). The main objective of imposing certain taxes on the public is to generate revenues for the government for public expenditure (Singh, 1999). Nevertheless, there are other functions of taxes as suggested by Lymer and Oats (2009) including reducing inequalities through a policy of redistribution of income and wealth so that income gap between the rich and the poor is not as significant. 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; Fjeldstad, Herzenberg and Sjursen (2012).

Tax compliance costs are those costs incurred by taxpayers, or third parties such as businesses, in meeting the requirements laid upon them in complying with a given structure and level of tax” (Sandford et al., 1989: 10). Sandford (1995) defined compliance costs as “The costs incurred by the taxpayers in meeting the requirements imposed on them by the law and the revenue authorities, over and above the actual payment of tax and over and above any distortion costs inherent in the nature of the tax.” Therefore, in order to comply with tax regulations, taxpayers need to incur not only the amount of tax payable but also other costs such as the costs of acquiring sufficient knowledge to meet their legal requirements; compiling the necessary receipts, completing tax returns or payments to the preparer of tax returns, incidental costs of postage, telephone and travel, dealing with tax auditors, and resolving disputes with tax authorities.

Complying with regulations usually involves various costs for individuals, businesses and the voluntary sector: financial costs and compliance costs divided into substantive compliance costs

and administrative costs (SCM Network, 2005). Taxes impose many costs and these costs are the amount of money a person gives to the tax collector. Considering the Slemrod (2005) terms of the resource cost, taxation consists of compliance cost and enforcement cost. Compliance costs are the cost that is borne by individuals as a result of paying their income taxes. This includes record keeping learning about specific laws and forms, preparation and remittal time, and any monetary costs such as seeking assistance from a certified public accountant, tax lawyer, or tax preparer or buying computer programs or books. It is measure of the opportunity cost of complying with the tax code. However, Enforcement costs are the costs associated with the administrative operation of the Internal Revenue Service.

Taxation compliance costs have, in the last twenty-five years, been the subject of growing interest, especially in developed countries – on the part of both academics and governments. Still, research of that kind is very rare in the transition countries, mostly because it requires complicated investigation involving the collection of large amounts of data not available from published sources, but also because the problem Compliance costs can be divided and assessed at a business as well as at the individual level.

This paper focuses on personal income tax at the individual level – the compliance costs connected with filing personal income tax returns in 2007. Research concerned with filing personal income tax returns is common and relatively frequent in tax compliance costs, The researcher have decided to look solely at individuals (non-business units) filing personal income tax returns, that is, to exclude business units that pay personal income tax has been simply neglected.

1.2 Statement of the problem

Taxation in developing countries is a challenging topic and has attracted increasing attention in the last two decades. During this period, many problems observed like poor administration, failing to collect sufficient tax revenues, lack of government and economic stability (Vadde & Gundarapu, 2012). Taxation compliance costs are also the subject of growing interest and policy revamp in most developed countries for both academics and governments. However, in developing countries especially in Ethiopia, research on compliance costs was limited and not well established; mostly because it requires complicated investigation involving the

collection of large amounts of data not available from published sources; lack of interests by academicians; lack of cooperation with tax authorities; but also because the problem had been simply neglected (Das-Gupta and Chattopadhyay, 2002).

Study on individual taxation compliance costs conducted in the US begin with the work of Wicks (1966) was revealed that compliance activities claim an average of 32% of state and 11.5% of federal tax revenues. Those with the highest compliance costs were the self-employed and individuals engaged in professional, managerial and sales occupation. Slemrod and Sorum (1984) conducted a study of Minnesota households and estimated compliance costs as 5 - 7 percent of income tax revenue.

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 voluntary 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. 286/2002) 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. The Ethiopian Revenues and Customs Authority are responsible for overseeing the various changes and reforms and collecting taxes and customs duties among other things. However, lack of profit comes from inadequate enforcement and auditing. According to AEO 2010, the tax administration in Ethiopia lacks the institutional capacity to handle modern operational and enforcement practices to deliver efficient and quality service. Weak enforcement is a cause for concern since personal income tax compliance tends to be lower. In order to comply with the tax rule these tax payers were bears a number of costs, which is called compliance cost. The above discussed problems in the fiscal tax system of the Ethiopian along with the gap in the literature with respect to compliance costs of those individual income tax payers particularly in Addis Ababa call for extensive research.

1.3. Objectives of the Study

The overall objective of the study was to estimate compliance cost of individual tax payers Addis Ababa city Administration Sub-City in terms of time spend and monetary cost incurred.

1.4 Research question

Individual who employed are expected to pay income taxes (; As the same time there are hidden costs consist of time spent, fees paid, possible payment of tax advisers, and the work of unpaid assistants that the individual tax payer incurs in order to compliant with the tax laws. They constitute a part of the costs above and beyond the actual amount of tax paid that citizens have to bear in order to fulfill the requirements imposed by law and revenue services. Sometimes these costs are lower or higher than the amount of excess tax refunded. Therefore, for this study, the following research question is developed.

1. How much compliance costs of the individual income tax system borne directly by the taxpayers themselves, including both the time spent and pecuniary expenditures?

1.5. Hypotheses

The following hypotheses also developed to test these costs.

1. The compliance costs of individual income tax are relatively low - in terms of their costs per individual: especially costs of time and monetary costs.

1.5 Significance of the Study

The intent of this research is to estimate compliance cost of individual income tax payers Addis Ababa City Administration. The finding of this study will provide data on the amount of cost incurred by individual taxpayers in complying with tax regulations. The data on compliance costs of individual taxpayer compliance costs would also provide precious insights and inputs to the tax authority of Addis Ababa City Administration, for the formulation of tax policy and also would assist its mission to provide taxpayers with top quality service. This study also will help to understand the burdens placed on taxpayers by tax laws, tax system administration, and changes to those factors.

1.6. Scope and Limitation of the Study

The primary focus of the study is on compliance cost of individual income tax payers in Addis Ababa City Administration. In some exceptional cases, the income tax proclamation requires the employees to pay their tax by themselves. For instance an employee working for more than one employer and if employer is not legally obliged to act as withholding agent or an employee of an international organization having diplomatic immunity or working in embassies, missions and other consular establishments of a foreign government has the duty to declare and pay tax by her or himself within 30 days of the end of each calendar. The scope of this study is, therefore, selects only those individual income taxpayer which are employees of different embassies ,private and international organizations only by confined to estimate the compliance costs of the tax payers to get an insight into the scope and structure, as well as specific characteristics of personal income tax compliance costs regarding level of income in Addis Ababa city administration

1.7. Organization of the Research Report

The paper has five main chapters. The first chapter provides background of the study, statement of the problem objective of the study, significance of a study, scope& limitation of the study. The second chapter summarizes the related literature review and it described in a comparison of theoretical with empirical evidences. The methodology was also explained, including the sample, the questionnaire and the survey in the third section. The main part of the paper, section fourth was devoted to the results concerning the characteristics, structure and scope of the compliance costs (i.e. time and monetary cost only). The last section presents conclusions and recommendations regarding the relevant aspects of compliance cost.

CHAPTER TWO

2. LITERATURE REVIEW

2.1. THE CONCEPT AND DEFINITION OF TAX COMPLIANCE COSTS

This section reviews previous literature in tax compliance cost. Specifically, first it provide the definition of tax compliance. Then reviews of theoretical and empirical literature on the determinants of tax compliance represented. This review of the literature establishes the framework for the study and highlights the apparent strengths and weaknesses of the previous studies which help in identifying the gap in the literature and formulating the research questions for the study.

2.2. Definition of Tax Compliance Costs

Tax compliance cost has been defined in various ways by various authors. 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. 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). DasGupta (2002) stated that compliance with tax laws involves true reporting of the tax base; correct computation of the tax liabilities; timely filling of tax returns and timely payment of the amount due as tax. Any behavior by the taxpayer contrary to the above constitutes noncompliance. According to McBarnett (2001), compliance may take three forms, which include committed compliance, capitulative compliance and creative compliance. Committed compliance is the willingness to discharge tax obligations by taxpayer without complaining. While capitulative compliance is the reluctant in discharging of tax obligations by taxpayer and creative compliance (tax avoidance) refers to any act by

taxpayer aimed at reducing taxes by redefining income and deductible expenditure within the confine of the law. However, according to Sandmo (2005) there is conceptual distinction between tax evasion and tax avoidance. The distinction between these two concepts hinges on the legality of taxpayer's actions. Sandmo(2005) distinguishes the two concepts from legal perspective. According to him tax evasion is carried out in violation of the law, therefore is illegal while tax avoidance is carried out within the legal framework of the tax law in order to reduce one's tax liability, therefore tax avoidance is legal. Since there have been many studies attempting to define tax compliance, Kirchler (2007) defined tax compliance as taxpayers' willingness to comply with tax laws, declare the correct income, claim the correct deductions and exemptions, and pay all taxes on time.

Tax noncompliance is the failure of taxpayer to meet tax obligations whether the act is done intentionally or unintentionally .Loo (2006)broadly classified noncompliance as failing to file a tax return; underreporting of taxable income; overstating tax claims such as deductions and exemptions and failing to make timely payment of tax liability. Therefore, for the purpose of this study, tax non-compliance is defined as failure to comply with tax laws and/or report incorrect income, the act of claiming incorrect deductions and exemptions and/or paying the incorrect amount of tax beyond the stipulated time frame.

Taxes impose many costs and these costs are the amount of money a person gives to the tax collector. Slemrod (2005) terms of the resource cost, taxation consists of compliance cost and enforcement cost. Compliance costs are the cost that is borne by individuals as a result of paying their income taxes. This includes learning about specific laws and forms, preparation and remittal time, and any monetary costs such as seeking assistance from a certified public accountant, tax lawyer, or tax preparer or buying computer programs or books. measure of the opportunity cost of complying with the code. However, Enforcement costs are the costs associated with the administrative operation of the Internal Revenue Service. While all the components of compliance cost are important, the main purpose of the research was to get an insight into the scope and structure, as well as specific characteristics of personal income tax compliance costs regarding level of income on individual taxpayer compliance burden (i.e. the time and monetary costs individual

taxpayers). Here psychological cost of the individual tax payers is excluded because of difficulty to measure.

Compliance costs are not only incurred by taxpayers but all the agents/parties involved in facilitating the transfer from the private sector to the government exchequer. For example, employers responsible for tax deduction at source and financial institutions entrusted with collecting taxes also incur compliance costs. Since cost of compliance is one of the many costs inflicted on society by a tax, there is a need to view tax compliance costs from a broader perspective than that implied in the definition above.

Overall costs of a tax system include –welfare costs, opportunity costs, psychic costs, social costs and soon.”To assess the total impact of taxes on society, –the total sacrifice imposed upon the populace –total collection costs, administrative and compliance costs should be looked into”. Slemrod and Yitzhaki (1996) identify compliance costs as one of the five component costs of taxation. The others are administrative costs, deadweight efficiency loss from taxation, the excess burden of tax evasion and avoidance costs. The general idea here is to consider situations with and without taxation. Taxes themselves are merely a transfer of purchasing power from the non-government sector to the government sector. The Slemrod-Yitzhaki classification seeks to capture all costs to society of affecting this transfer. This is equivalent, conceptually, to the aggregate welfare loss on account of the transfer while holding constant the utility from private as against public spending of tax revenues. The classification does not explicitly mention welfare loss due to equity violations from compliance requirements, though this is implicit.

The elements to be included in tax compliance costs are all costs incurred by the taxpayer to comply with the taxes, such as for labour, capital and intermediate inputs, expended either by the taxpayer or charged as fees by the tax experts. For individuals, these costs would include the financial and time costs of acquiring fiscal knowledge to meet their legal obligations; the costs in the form of time lost in filling up the tax returns, obtaining, filing and storing the data to facilitate the completion of returns. Other costs include travel and lodging costs to visit a tax adviser, or the revenue authorities, payments to professional advisers, incidental expenses of postage, telephone, etc. Sandford etal(1989).

2.3. Determinants of Tax Compliance Costs

From a tax policy perspective, it is important to look beyond the measurement of tax compliance costs and consider the factors that may determine their magnitude. In other words, what are the features of a tax or a tax system that potentially generate high compliance costs? A number of factors are considered by Shaw et al (2008: 20) in their work for the UK Mirrlees Review on administration and compliance costs. The main line of the argument made in that submission is that compliance costs tend to be lower where the tax is simple, i.e. Where the tax has one rate or few rates and where it has few borderlines and reliefs. They also note that when looking at the tax system as a whole, the use of common definitions and procedures across different taxes reduces compliance costs for the taxpayers by decreasing the number of calculations that need to be made. Kirchler (2007) and Loo (2006) divided these factors into five main parts, namely 1) economic factors (tax rates, tax audits and perceptions of government spending); 2) institutional factors (the role of the tax authority, simplicity of the tax returns and administration and probability of detection); 3) social factors (ethics and attitude, perceptions of equity and fairness, political affiliation and changes on current government policy, referent groups); 4) individual factors (personal financial constraints, awareness of offences and penalties) and 5) and other factors (age, income, level, culture, education, gender). The division into these categories is based on in which they approached tax compliance from an interdisciplinary perspective which represents a wider perspective of tax compliance cost determinants compared to other researchers.

In addition to the underlying complexity of the tax or tax system, the research also indicates that frequency of change can be a significant driver of tax compliance costs. As noted in a KPMGReport (2006: 6) “change creates both cost and uncertainty”. Frequent change in legislation, or the introduction of new legislation, can significantly impact upon the compliance burden, and it does not matter whether that change is as a result of the introduction of a relieving provision or the introduction of an integrity measure designed to protect the revenue base. In this sense, “an old tax is a good tax”. The notion is that change interferes with the smooth operation of the tax administrative machinery that facilitates the interactions that necessarily occur between taxpayer and revenue authority, which takes time to settle down to cope with change. Research by Evans (2003), which considered the major

drivers of the compliance costs of the capital gains tax for personal taxpayers in Australia and the UK, confirmed that “frequency of change” was considered to be one of the two most significant of the causes of the compliance burden – the other being complexity.

The literature also suggests that the nature of the tax itself may also be a driver of compliance costs. Compliance with specific taxes can have a significant impact on overall compliance costs for taxpayers. Taxes such as the VAT or GST in particular are often associated with high compliance costs because they are transaction based taxes that requires comprehensive record keeping and periodical reporting and remitting (Sandford et al, 1981). Hence one plausible explanation of the sharp increase in Australian small business compliance costs between 1995 and 2010 identified by Lignier and Evans (2012) may have been the introduction of the GST in 2000. In fact, in 2010, internal compliance time attributable to the GST was estimated at A\$11,111, representing more than half of total internal costs (Lignier and Evans, 2012: 640). Another important component of tax compliance costs is the cost of learning about new taxes or about tax changes. The 1995 Evans et al study reveals that nearly 26 per cent of business taxpayers sought external advice about changes in tax laws (Evans et al, 1997: 97). Meanwhile internal time spent annually by all categories of people on tax activities included 14.4 hours spent on learning about existing taxes and 9.36 hours spent on learning about tax changes (Evans et al, 1997: 100).

The processes and procedures used for calculating and remitting the tax may also be a driver of compliance costs. As a general rule, the higher the reliance on the taxpayer to calculate the tax, the higher are the compliance costs (and the lower administrative costs for the tax authorities) (Shaw et al, 2008: 21). The introduction of self-assessment regimes in Australia in the last few decades certainly had a large impact on the shift of the operating costs burden from the tax administration to taxpayers – so much so that there is now overwhelming evidence suggesting that compliance costs considerably exceed administration costs (Slemrod, 2009: 258). Evans (2008: 457) notes that taxpayer compliance costs are often a multiple of between two and six times administrative costs. The widespread introduction and use of withholding regimes (whereby the tax is remitted by someone other than the statutory bearer of the tax liability) has important compliance costs implication for businesses who must, as a result, keep a sophisticated record keeping system (Shaw et al, 2008: 24). For example, internal time spent on

record keeping in relation to employment withheld taxes and superannuation charges exceeded 25 hours per year according to a 1995 study (Evans et al, 1996: 101).

2.4.Income Tax in Ethiopia

The concept of income taxation was initially introduced in Ethiopia in the year 1944. The foundational principle of income tax in Ethiopia was laid by Emperor HaileSELLASIE when the emperor issued a decree requiring all peasants to pay one-tenth of their agricultural products to tax officials. Accordingly, tax officials would seasonally go to the land of the peasants and collect payment in accordance with the amount obtained from the land. The decree thus embodied the idea that each individual would be taxed according to the amount he/she earns. Though it was first related to agricultural income, it was modified on a number of occasions resulting in changes. One major change that was introduced was the idea of taxation on income from employment (Eshetu Chole, 1987). Income is defined in the laws of the legal system. According to the Income Tax Proclamation Number 286/2002, income is defined as “every sort of economic benefit including nonrecurring gains in cash or in kind, from whatever source derived and in whatever form paid credited or received”. Income subject to taxation under Ethiopian law derives from various sources. These sources are listed down in Article 6 of the Income Tax Proclamation as employment; business activity; entertainment, music and personal activities of a sports person; entrepreneurial activities of a non-resident through a permanent establishment in the country; movable property attributable to a permanent establishment in Ethiopia; immovable property and apparatuses thereof, livestock and inventory in agriculture and forestry; alienation of property; dividends of a resident company; profit shares paid by a resident registered partnership; interest; and license fees.

As Proclamation No 286/2002, 608/2008, Regulation No. 78/2002, Directive No. 21/2009, states individuals may receive various types of income such as wages or salary from employment, rent from letting houses or buildings, interest from lending/saving money, and profit from their trading activities or business (Abebe Hunachew, 2009). Accordingly these individuals are required to pay income tax. They are ordered to do so by income tax proclamations, regulation and directives. The law specifies how and when these individuals have to pay the required tax. This studies deals especially with the aspect of the law which applies to individuals who earn income from employment.

Therefore, individuals who obtain income from their employment are required by the law to pay tax. In line with internationally recognized best practice, employee's income tax liabilities are calculated and paid directly by their employer. As a result the government relies on employers to compute and withhold the tax to be paid by employees.

In order to discharge this responsibility properly, employers may need to know in advance what counts as income or shall be able to distinguish what kind of income is to be taxed or not (Abebe Hunachew, 2009). But there is exceptional cases, the income tax proclamation requires the employees to pay their tax by themselves. For instance an employee working for more than one employer or an employee of an international organization having diplomatic immunity or working in embassies, missions and other consular establishments of a foreign government has the duty to declare and pay tax by her or himself within 30 days of the end of each calendar (FDRE, 2002)

2.4. Empirical Studies on Tax Compliance Costs

Various researchers have defined the term compliance cost in different ways. They defined, identified and classified compliance costs and then present out own their definition and classification. The conventional definition of tax compliance cost by Sandford (1995) is: "Tax compliance costs are the costs incurred by the taxpayers in meeting the requirements laid on them by the tax law and the revenue authorities. They are costs over and above the actual payment of tax and over and above any distortion costs inherent in the nature of the tax."

Sandford et al. (1989) has emphasized the need for including the psychic costs comprising of stress and agony in dealing with one tax affairs, in particular for the poorer pensioners, widows and divorced and separated woman. But in this research it doesn't it comprise these costs. Given the discussion above, it will be clear that definition and classification of compliance costs is not a simple task. So tax compliance cost elements included, in principle, in this study are all costs incurred by taxpayers to comply with tax obligations excluding the cost of psychic cost and third parties (agents) because no agent organization here in our country Ethiopia who are responsible to collect taxes on behalves of the Authority. Tax compliance costs can be voluntary or mandatory, though both add to the social cost of the tax. Compliance activity also has benefits via better record keeping or cash flow benefits of

tax deductors. For individuals, these costs would include the financial and time costs of acquiring fiscal knowledge to meet their legal obligations; the costs in the form of time lost in filling up the tax returns, obtaining, filing and storing the data to facilitate the completion of returns.

It has also been emphasized by Sanford et al. (1989) as the need for including the psychic costs comprising of stress and agony in dealing with one's tax affairs, in particular for the poorer pensioners, widows and divorced and separated women. But in this research doesn't comprise these costs. From all the above discussion, it is clear that definition and classification of compliance costs is not a simple task.

Therefore tax compliance cost elements included, in this study are all costs incurred by taxpayers to comply with tax obligations excluding the cost of psychic cost and third parties (agents) because no agent organization here in our country Ethiopia who are responsible to collect taxes on behalf of the Authority. Tax compliance costs can be voluntary or mandatory, though both add to the social cost of the tax. Compliance activity also has benefits via better record keeping or cash flow benefits of tax deductor.

Andreoni, Erard, and Feinstein (1998) characterize and explain tax compliance costs as the output of interrelation among variables including perception of equity, efficiency and incidence (public finance views). Tax enforcement aspects like penalties and the probability of detection also relate to tax compliance cost while other labour market behavior factors including an individual's wages and tax bracket also contribute to tax compliance costs (Kirchler, 2007).

Study on individual taxation compliance costs conducted by Guyton et al. (2003) was revealed that compliance activities claim an average of 32% of state and 11.5% of federal tax revenues. Those with the highest compliance costs were the self-employed and individuals engaged in professional, managerial and sales occupation.

Singh (2003) described tax compliance as voluntary action – 'without having to wait for follow up actions from tax authority'. Apart from these, Song and Yarbrough (1978) included some factors of compliance in their definition i.e. 'determined by ethics, legal environment and other situational factors.

Slemrod and Sorum (1984) conducted a study of Minnesota households and estimated compliance costs as 5 - 7 percent of income tax revenue. Another study is repeated by Blumenthal and Slemrod (1992) point out that the average time spend on compliance activities has increase from 21.7 to 27.4 hours. Both studies indicated that on average, self-employed taxpayers spent nearly 3 times as much of their own time on tax compliance as other taxpayers and were twice as likely to use professional assistance to prepare their taxes.

Spicer and Lundstedt (1976) perceived degrees of tax compliance costs as ‘a special form of gambling’ (which, may involve likelihood of detection and penalties) (p. 295) which requires the tax authority to understand the factors underlying taxpayers’ decision to comply with tax laws (p. 295). Delgado and Diaz (1995) analyzed personal income-tax compliance costs in Spain using faceto- face interviews and found that compliance costs represented 3.3% of tax revenues. The results from a study in Sweden indicated even lower compliance costs. Allers (1994a) examined the compliance costs of personal income taxes and the wealth tax in the Netherlands using face-to-face interviews and drop-off questionnaires. Allers concluded that compliance costs for personal income taxes represented 1.4% of personal income tax revenues.

2.5. Summary and Gaps in the Literature of Tax Compliance cost

All the above evidences show that more researches were conducted in the developed countries; on the contrary research into compliance costs in developing countries is limited and not well established. There are reasons identified by scholars at different time regarding the limited researched conducted in developing country. Possible reasons include a lack of interest by scholars; no cooperation from tax authorities; surveys in developing countries are not common and constant changes in tax systems(Klun 2004). Ott and Bajo (2000) in their paper also presented the reasons or obstacles which include lack of experts; many experts overloaded by more pressing issues; no taxpayer associations and no civil initiatives. Most of the earlier research on individual income tax compliance costs conducted based on the data collected through mail surveys supplemented by follow up interviews which led to a relatively low response rate and non-response bias. Even though this method has the advantage of reaching a large geographical territory with low cost, it will most likely result in a low response rate. Having very low response rates it is difficult to establish the representativeness of the sample because those who responded to the survey may be or all

in all different from the population they were expected to represent. Further, any doubts a respondent might have cannot be clarified.

In Ethiopia, more specifically as per the knowledge of the researcher there is no single study on the compliance cost of individual income tax payers. All the above discussed problems in the fiscal tax system of the Ethiopian along with the gap in the literature with respect to compliance costs of those individual income tax payers particularly in Addis Ababa Sub-City call for extensive research.

CHAPTER THREE

3. RESEARCH METHODOLOGY

The previous chapter has indicated that the literature on compliance cost of individual tax payers. Especially from less developing countries' perspective, Ethiopia in particular, it has been shown that there is no comprehensive study that reviews and analyzes the compliance cost of individual tax payers.

This chapter discusses the research design and methodology used in the study, more specifically, nature of the data, sample and sampling techniques, method of data collection and analysis, and variable measurement. The chapter is arranged as follows. Section 3.1 presents the hypotheses and research questions for the study. This is followed by the research approach in section 3.2, and section 3.3 Sample design. Then presented in section 3.4. Data Collection Method and finally Data Analysis Techniques are presented in section.

3.1 Research question and hypotheses

An individual who have a job are required to pay income tax; but there are hidden costs that consist of time spent, fees paid, possible payment of tax advisers, and the work of unpaid assistants and other that the individual tax payer incurs in order to compliant with the tax laws. They constitute a part of the costs above and beyond the actual amount of tax paid that citizens have to bear in order to fulfill the requirements imposed by law and revenue services. Sometimes these costs are lower, but sometimes they are greater than the amount of excess tax refunded. So the researcher wants to develop research questions as:

Research Question: How much compliance costs of the individual income tax system borne directly by the taxpayers themselves, including both the time spent and pecuniary expenditures?

Therefore, each one of us has to do the math and decide whether getting involved in the procedure of claiming an income tax refund is worthwhile. The researchers also develop hypotheses to test these costs. The main hypothesis is;

Hypotheses1 : The compliance costs of personal income tax are relatively low - in terms of their costs per individual: especially costs of time and monetary costs.

3.2 Research Approaches

The three distinguishable research methods are quantitative, qualitative and mixed approaches. The quantitative research method relies on the collection of data based on numbers. The data were obtained by the means of survey questionnaires and then analyzed statistically. The quantitative research quantifies the results of people's words, actions and records – the meaning given to the words, behaviors and documents as interpreted through quantitative analysis or statistical analysis (Maykut and Morehouse, 1994). In this approach, numerical results are important because they are normally used to test hypotheses and draw conclusions from the phenomena.

The qualitative approach is another commonly recognized form of research method. Researchers especially in social sciences observed that quantitative methods were subjected to several limitations and were inadequate to explain and clarify the complexities of social phenomenon. Miles (1983) suggests that qualitative data is holistic, robust and real. It expresses a commitment to viewing events, action, norms, values, etc. from the perspective of the people who are being studied (Bryman, 1988) and thus, can produce valuable and more meaningful information (Denzin& Lincoln, 2000; 2005).

Therefore this study was conducted by the combined quantitative and qualitative approach of research. By means of employing this combined approach, the researcher obtained the advantages of both quantitative and qualitative approaches and overcome their limitations. This section introduces the fundamental elements of a research approaches. The three common approaches to conducting research are quantitative, qualitative, and mixed methods. Researchers typically selected the quantitative approach to respond to research questions requiring numerical data, the qualitative approach for research questions requiring textural data, and the mixed methods approach for research questions requiring both numerical and textural data (Williams, C. 2007).

The goal for researchers using the mixed methods approach is to draw from the strengths and minimize the weaknesses of the quantitative and qualitative research approaches (Williams, 2007). To sum up, quantitative and qualitative research methods investigate and explore the different claims to knowledge and both methods are designed to address a specific type of

research question. While the quantitative method provides an objective measure of reality, the qualitative method allows the researcher to explore and better understand the complexity of a phenomenon. This paper presented a clear statement of what constitutes quantitative and qualitative research designs and summarized techniques used to conduct studies for both research approaches. This paper also presented statements of what constitutes the mixed methods approach when conducting research. Although each approach seeks to validate sensory knowledge as truth, neither is absolute in its form.

3.3 Sample design

The sample size will depend on the type of research and what the researcher wants to do with results. Choosing an appropriate sample size is crucial to having a study that will provide statistically significant results. Research needs to be cost effective, so it is best to use as small a sample as possible to reduce time and cost. However, if using a sample size that is too small, the results will not be statistically valid. In quantitative research, statistical methods can be used to choose the size of sample required for a given level of accuracy and the ability to generalize. In the year 2014/15, 29,749 individuals are employed in different private organizations, international organizations and embassies in Addis Ababa city administration (CSA, 2015) and all these individuals are registered in ERCA to pay employment income tax. From this study population, the researcher listed 200 (0.67228% of the total population, which is above most similar surveys in the world: for example, Klun, 2004 = 0.022%, Diaz and Delgado, 1995 = 0.026%, Pope, 1995 = 0.008%), registered individual income tax payers, which are employees of different private organizations, international organizations and embassies in ten sub-cities of Addis Ababa as sample frame. Considering the concentration of embassies and international organizations of each sub-city, this sample frame again congregates among six districts of Addis Ababa sub-city (Arada, Kirkos, Addis Ketema, Kofe, Yeka and Gulele sub-city) by purposive sampling method and from each sub-city individual income tax payers were randomly selected as sample by using simple random method of sample selection.

3.4. Data Collection Method

This study intends to identify compliance cost of individual income tax payers in Gulele, Arada, Kirkos, kolife, yeka and Addis ketama sub city. Survey questionnaire, adopted from Slemrod and Sorum (1984) and Das-Gupta and Chattopadhyay (2002), was used as the main data-gathering instrument for this study. They were designed to collect both qualitative and quantitative data on compliance costs towards individual income tax payers in Addis Ababa. The taxpayer survey instrument was prepared in English languages because participants are professionals. The questionnaire was divided into two main sections: a profile and the survey proper. The profile contains socio-demographic characteristics of the respondents such as age, gender, marital status and occupation. The survey proper explored the perceptions of on personality questionnaire, particularly on cost of filing

Individual income tax returns. The questionnaire proper section also contains questions that identify the estimated costs that the individual income tax payers was incurred in connection with the time they spent and some related monetary costs they exposed. The questions were also structure some Likert format. In this survey type, six choices are provided for some question or statement. The choices represent the degree of agreement each respondent has on the given question. The Likert-scale survey was enabled the respondents to answer the survey easily.

3.5. Data Analysis Techniques

In order to investigate the compliance cost of individual income tax payers the responses obtained from the above mentioned data gathering instruments will be tabulated, interpreted and analyzed by SPSS statistical package, using descriptive statistics. The interpretation, analysis and discussion will be based on the results obtained and literature guide. The frequency and cross tabulation of responses of the compliance cost of the individual income tax payer evaluation scores will be presented.

CHAPTER FOUR

4. RESULTS AND DISCUSSION

As stated in section 3.1 in chapter 3 the overarching research question of this study was „How much compliance costs of the individual income tax system borne directly by the taxpayers themselves, including both the time spent and pecuniary expenditures?, in this context, the objectives of this study, as presented previously, are in view of lack of data on compliance costs that are incurred by individual taxpayers in Addis Ababa, this study aims to examine the types of compliance costs incurred and the corresponding amount in terms of time spend and monetary cost incurred. These broad objectives were stated as hypotheses in chapter 3.

As Table 4.1b shows the frequencies related to the characteristics of the sample taxpayers Higher percentages (58.5%) of respondents were male while 41.5% were female of the total 200 respondents. The individuals participated in the survey were at their taxable working age as 62.5% with age between 18 and 30 years old. The age ranging from 31 to 45 represent the prime working age of working individuals where 31.5% of respondents fall within this categories. Whereas 46 - 55 years of age group represent the upper management or business owner with a higher degree of income stability with 6% of respondents falls within this bracket. Therefore, it makes this study looking into the main contributor towards the tax authority's revenues. In relation to the researchers analysis with the respondents age, level of income shows the same pattern. Almost 53.5% earn between 5,001 and 10,000 ETB while 21.5% earn 2,001 to 5,000ETB. 19%,3% and 2%of respondents fall under income ranges of10, 001-15,000,15,001-20,000 and1,001-2,000 respectively. However the educational attainment was generally average among respondent with just 15.5% some college/technical school, 81.5% possessing a graduate degree and 3% with master, PhD and other professional certificates

Table 4.1a Tax payers survey respondents by Age

Age	18-30	31-45	46-55	>55	Total
Frequency	125	63	12	0	200
Percent	62.5	31.5	6	0	100

Source: tax payers survey

Table 4.1b Tax payers survey respondents by Sex

Sex	Male	Female	Total
Frequency	117	83	200
Percent	58.5	41.5	100

Source: tax payers survey

Table 4.1c Tax payers survey respondents by monthly income

Monthly income (ETB)	1	2	3	4	5	6	7	Total
Frequency	0	4	43	107	40	6	0	200
Percent		2	21.5	53.5	20	3	0	100

Note: Legend: **1**=< 1,000; **2**=1,001-2,000; **3**=2,001-5,000; **4**=5,001-10,000; **5**=10,001-15,000; **6**=15,001-20,000; **7**=>20,000 in ETB.(Source: tax payers survey)

Table 4.1d Tax payers survey respondents by level of education

Education level	1	2	3	4	Total
Frequency	0	31	163	6	200
Percent	0	15.5	81.5	3	100

Note: Legend: 1= Higher secondary; 2= some college/technical school; 3=

Degree; 4= Post graduate/PhD, professional Qualification (Source: tax payer's survey).

Regarding to the responses to the researcher's question about attitudes to tax filing, Of those surveyed, only 11% said they "very much" enjoyed preparing and filing their income tax returns and 50.% said they enjoyed the process; 17.5% replied that they neither enjoyed nor disliked it. On the other hand, 21.5% of those surveyed said they disliked the process and 0% said they disliked it "very much". (See Appendix3)

The researchers have also address that most of the respondents either use help from somebody without payment or do the assessment themselves. In relation to the result 85 respondents were no got help and 115 were get helps from somebody. The reason that only 57.5 % of the respondents got help were might be due to the fact Some of the respondent did their own tax filing while the other getting assistances from their friends, families and even in the tax department.

Table 4.2 did you receive help from somebody without payment?

Respondents Answer	Frequency	Percent
No	115	57.5
Yes	85	42.5
Total	200	100

Source: tax payers survey

The study also showed that the respondents constituting 79.10% of that get help did not pay for assistant or and the rest which is 20.9% of the same group did pay for those who give them help. A large percentage of taxpayers still prepared their own tax returns.

Table 4.3 did you pay for tax return filling assistance?

Respondents Answer	Frequency	Percent
No	91	79.10
Yes	24	20.9
Total	115	100

Source: tax payers survey

Monetary costs

Compliance costs were evaluated for personal income taxpayers only; the costs of self-employed taxpayers, of employers (who are responsible for advance payments of tax) and for planning tax liabilities were excluded, as were psychological costs. These limitations were considered when the data are analyzed. The evaluated compliance costs include the cost

of time spent filing a tax declaration properly (learning tax rule, record keeping, looking tax table, actual preparation of their statements and tax advisors), consultancy costs and other expenses (forms, postage, copying, Phone call etc.), and each of which is indicated in Table 4.4 Evaluating time spent on filing tax declarations depends on how ,time spent is determined. Different studies in different time and different countries calculated the value of time in relation to spare time, work time or overtime at work.

Almost all studies have used the values stated by taxpayers in questionnaires but with different modifications: Pope (1995) used stated values but the extreme high and low values were removed; Allers (1994b) made two evaluations, one with stated values and the other using GDP to value an hour. WollelaAbehodie(2008) considers the estimation of tax compliance costs tends to be very sensitive to the method of valuation of time adopted. Market salary or wage rates could be used as a valuation basis for employees' time or as a check on the value of time provided by survey respondents. In Ethiopia, nevertheless, market salary or wage rates appear to be unavailable thereby impeding the possibility of checking the reasonableness of valuations provided by respondents. Accordingly, times spent by taxpayers in this study, were evaluated with the values that the taxpayers stated in questionnaires. Since the tax payers survey question raises a question like

–Do you pay someone for assistance with your 2014/2015 income tax return? All of them were said no. Even though the tax payers did not pay for professional tax assistance, they still have had some expenses in preparing their tax returns such as, buying self-help tax guides, making phone calls, traveling, or postage costs.

Table 4.4 Income, Age and Level of education with total expenditures

Number of Respondents	44	43	107	6		
Income(ETB	1001-2000	2001-5000	5001-10000	10001-15000	15001-20000	>20000
Monetary cost (ETB	10540	10235	3430	7350		
Number of Respondents	125	63	12			
Age	18-30	31-45	46-55			
Monetary cost (ETB)	16021	10365	5169			
Number of Respondents	31	163	6			
Level of Education	Some College	Degree	Post graduate/Ph D			
Monetary cost (ETB	15521	5689	10345			

Source: tax payers survey

Times spent by taxpayers for the purpose of learning tax rules; keeping record; looking tax tables; time spent for actual preparation and assistant for the tax advisors were evaluated here with the values that the taxpayers stated in questionnaires as stated previously. The total hours the tax payers spent for the above five conditions were 1508.25hr ; and the total expenses that the tax payers were incurred was 31,555ETB (Total monetary costs such as buying self-help tax guides, making phone calls, traveling or postage costs)(see Appendix 2 and 4). The average value per tax payer on tax compliance was 157.76 ETB. On average, taxpayers

spent 1.65hrs for learning tax rules; 1.32hrs for keeping record; 1.57hrs for looking tax tables; .89hrs for actual preparation and 2.11 hrsassistant from tax advisors. Thus, in total, 7.54 hours were spent, on average. Time taken for advice for income tax purposes is the highest time spends of 422hours in the first class of each variable, means that different class of income level, different category of age groups and in the different level of education, have dedicate more time in the year of assessment 2014/15 next to tax advisors. The explanation to the result might be because with based on the findings of a study called “Business Process Reengineering” radical change -that alters the fundamental nature of the Ethiopian Tax and Customs Administration system has recently taken place. The change has involved the introduction of new tax and customs laws and regulations in the federal taxation system, taxpayers become aware that they need to know what the new reengineering process have an impact on the tax laws. The least time spend is on activities associated with keeping records. Taxpayers become not aware that they need to keep record in order for them to claim all the deductions available. In all, the total time spend are 1508.25hr and the mean time spend for individual taxpayer is 7.54 hours.

Table4.5 indicated that the details relationship between compliance cost and income. One feature of this table is the large amount of time spent by the lowest income group. One conceivable explanation for this finding is that these individual tax payers had a commitment of large amount of time itself contributed to a low value for taxable income, since they were a low income group relative to the other class, so they devote more time to save the income tax liability.

Table 4.5 Tax payers survey respondent cross tabulation of monetary cost and time by income of the individuals

Number of Respondents	44	43	107	6			
Income(ETB)	1001-2000	2001-5000	5001-10000	10001-15000	15001-20000	> 20000	
Own time							Total
Tax rule	78	107	100	45			330
Keeping records	83	94	54	33.75			264.75
Tax table	161	98.5	26	29			314.5
Preparation	80	73	9	15			177
Tax advisors	103	178	64	77			422
Total	505	550.5	253	199.75			
Monetary Expenditure	10540	10235	3430	7350			

Source: tax payers survey

The overall distribution of own time spent with respect to income is no pattern. This relationship is more unusual when the value of time is considered, because the total time valuation per hour was highest for the lowest income class, and lowest for the top income class. Note that the value of time for the lowest income class is almost similar to the value of time in the 5,000 to 10,000 ETB range and greater than the value in the 10,000 to >20,000 ETB income groups. The allocation of time spent among the various categories is relatively constant among income

groups, learning tax rules and tax advisors are relatively more important for 1,000 to 10,000 ETB income groups. The fraction of individuals who looks tax tables generally increase with income, starting from about 82.5% for the lowest two classes (for the first two class), about 17.5% for the middle income groups (for the next two class), up to 0 % for those households earning more than 15,000 ETB of income (for the last two class). Except for the last two classes, the average amount spent by those who do use assistance falls as well.

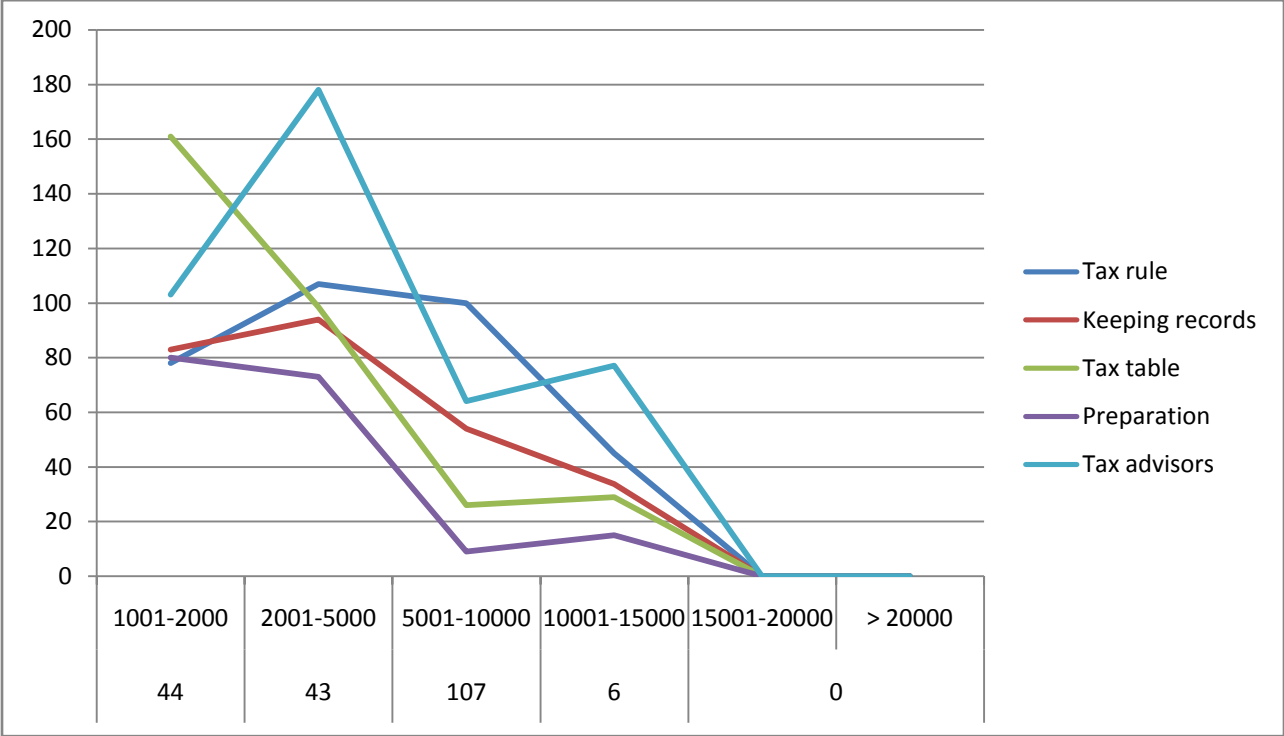


Figure 4.1 indicates the corresponding value of time and income

Source: tax payers survey

The total monetary cost of compliance has a v-shaped relationship with income. For households with below 5,000 ETB incomes, the average monetary cost were 10387.5 ETB. Measured as a percentage of income, the cost for the this group is (65.83%) which is significantly higher than for any of the other groups

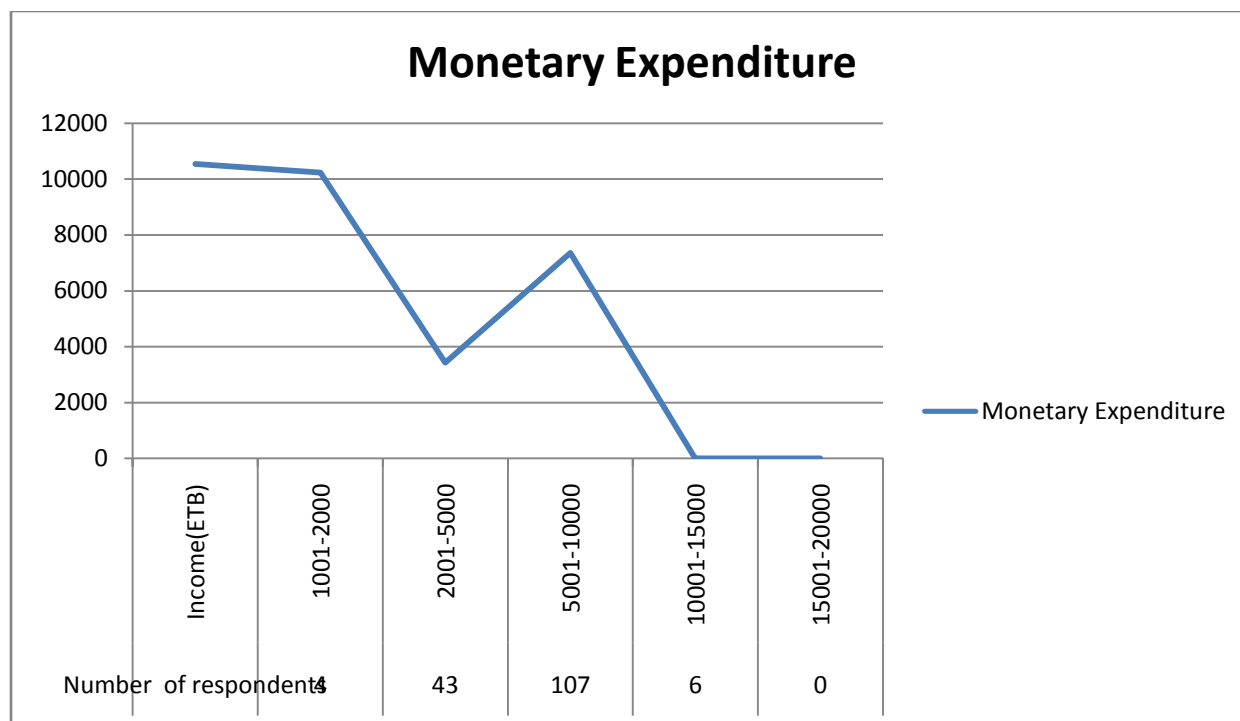


Figure 4.2 monetary cost and income

Source: tax payers survey

Table 6 was explained data on the relationship between compliance cost and educational attainment. This table indicates the less educated taxpayer tends to spend more time on his tax affairs and is more likely to need professional tax advice. In the middle educational attainment group, over 46.9% of individuals need for assistance, compared to less than 33.9% for college graduates and less than 19.2% for those with a post graduate level education. However, Measured as a percentage of level of education, the cost for the middle group is significantly lower (18%) than for any of the other two groups (some college 49.2% and post graduate and PhD 32.8%). Here we can understand the cost of middle class educational attainments (degree), were incurred less cost than the other two classes because the time they devote in learning tax rules and needs to help the tax advisors were more relative to others and also because no payment for the tax advisors at all rather they are voluntarily assist them. So they can Straight forwardly minimize their costs.

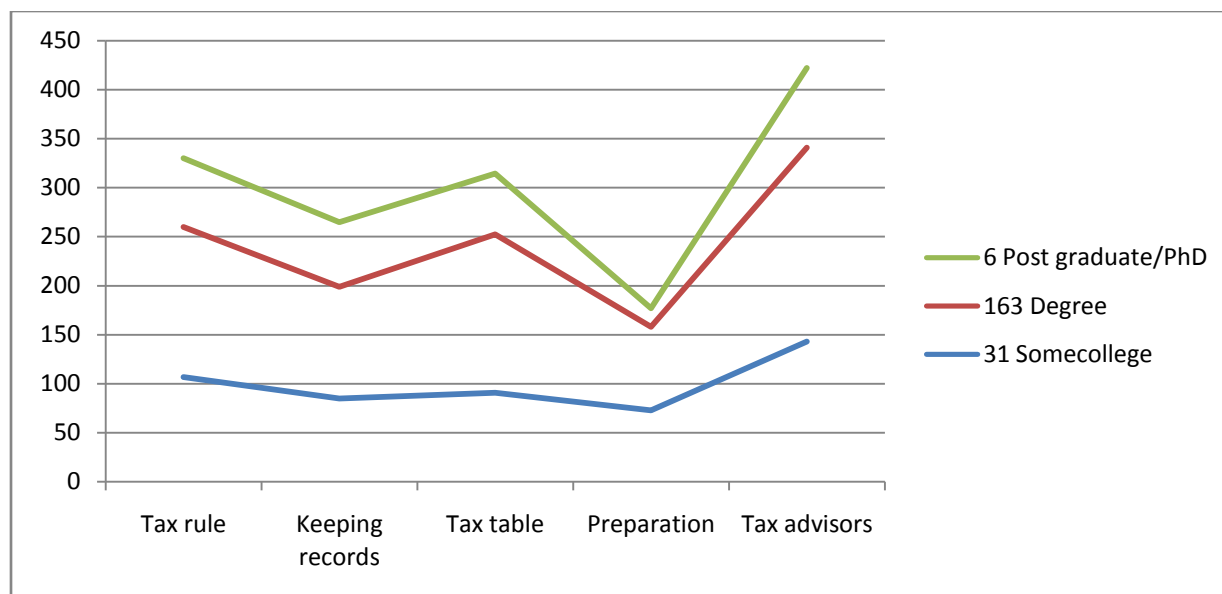


Figure 4.3 components of time and educational attainments

Source: tax payers survey

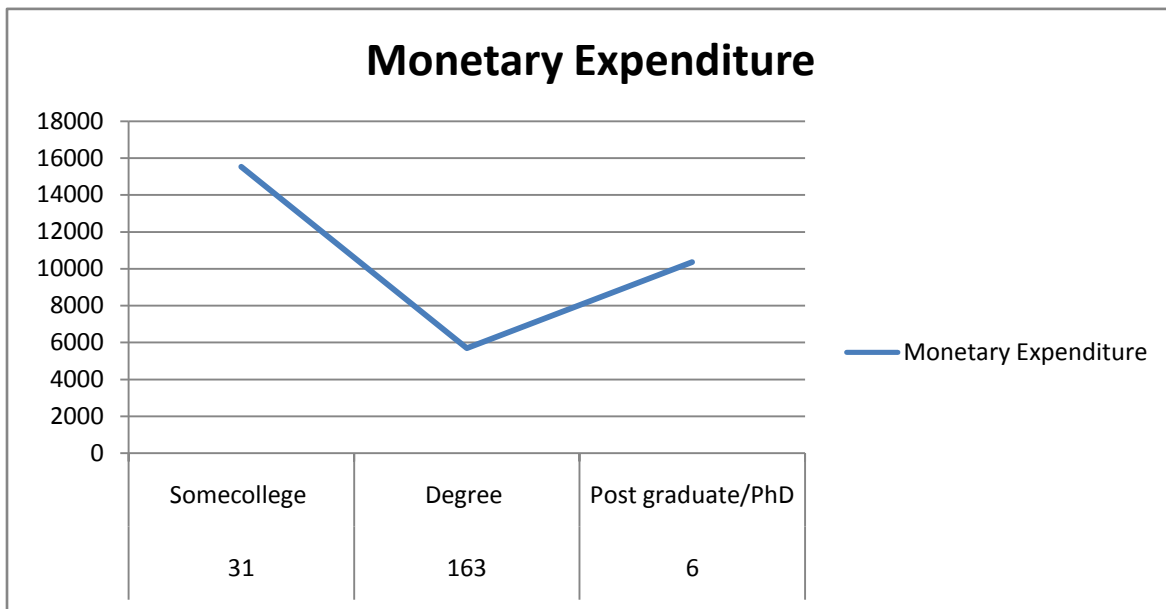
Table 4.6 Tax payers survey respondent cross tabulation of monetary cost and time by level of education of the individuals

Number respondents of	31	163	6	
Level of Education	Some college	Degree	Post graduate/PhD	Total
Tax rule	107	153	70	330
Keeping records	85	114	65.75	264.75
Tax table	91	161.5	62	314.5
Preparation	73	85	19	177
Tax advisors	143	198	81	422
Total	499	711.5	297.75	
Monetary Expenditure	15521	5689	10345	31555

Source: survey result

The total monetary costs of compliance generally decrease with Middle class educational attainment, due to the increasing number of hours spent for all the variables and almost equal to the first and the last educational attainments.

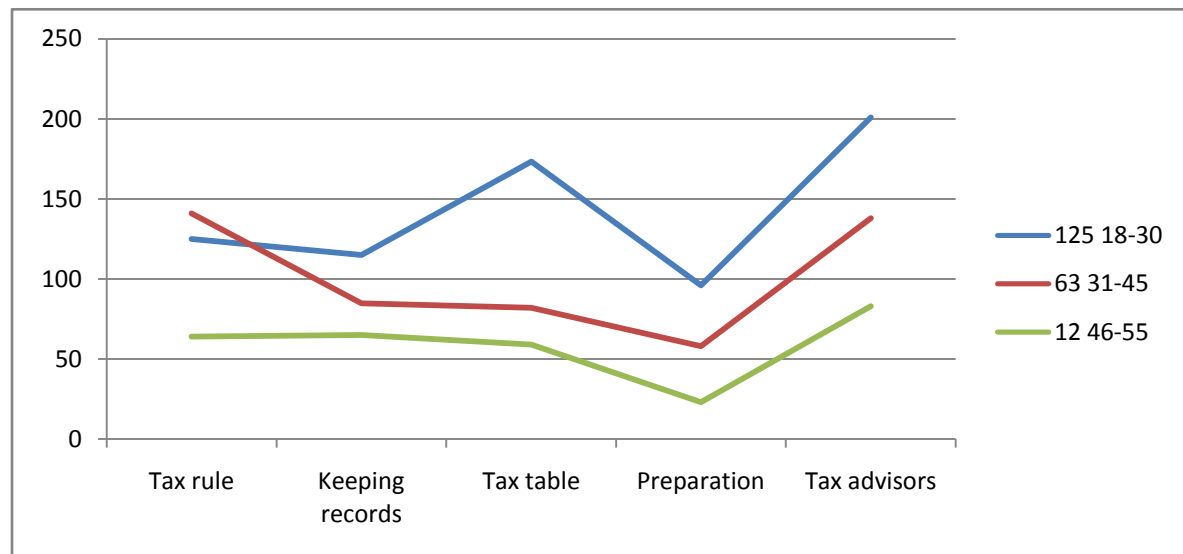
Figure 4.4 Monetary expenditure and educational attainment



Source: tax payers survey

Table 7 indicates the relationship between compliance cost and the age of the person in the household most familiar with the tax return. Total time spent on compliance first falls then rise with age, but the reverse is true for compliance cost. This is also true for its major component, record-keeping, learning tax rule; looking tax table. In contrast, the fraction of households that needs professional tax assistance is higher for the older groups (46-55), 6.91hrs (83/12 = 6.91) than for the two younger groups (18-30 and 31-45), 2.19hrs (201/125 = 1.6) and 2.19hrs (138/63 = 2.19) respectively. Whether this represents an unwillingness to hassle with tax matters on the part of older taxpayers or more complicated tax returns is impossible to say without further analysis.

Figure 4.5 Components of time spent and Age of tax payers



Source: tax payers survey

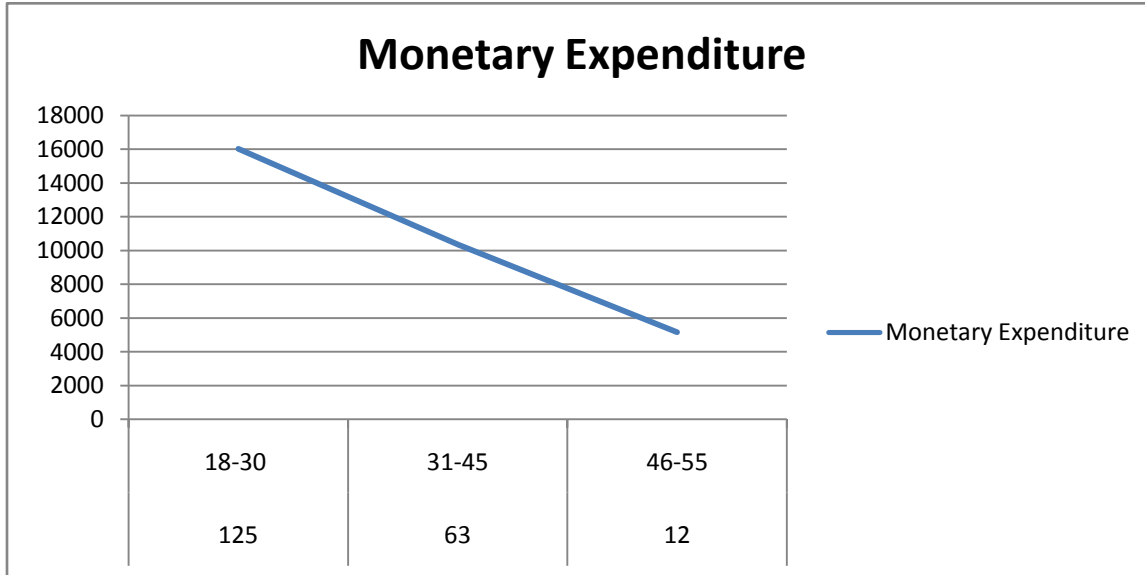
The total monetary cost of compliance also strictly falls as age increases. The average compliance cost of each individual tax payers were sustain ETB 211.18 from the table 3, ETB 430.75 ($5169/12=430.75$), ETB 164.52($10365/63=164.52$), and ETB 128.16($16021/125=128.16$) from each age group respectively.

Table 4.7 Tax payers survey respondent cross tabulation of monetary cost and time by Age of the individuals

Number of respondents	125	63	12	
Age	18-30	31-45	46-55	Total
Tax rule	125	141	64	330
Keeping records	115	84.75	65	264.75
Tax table	173.5	82	59	314.5
Preparation	96	58	23	177
Tax advisors	201	138	83	422
Total	710.5	503.75	294	
Monetary Expenditure	16021	10365	5169	31555

Source: tax payers survey

Figure 4.6 monetary cost and Age of tax payers



Source: tax payers survey

The correlations between compliance costs and income, level of Education and Age were also assessed and are explained in Table 8. There is a negative statistically significant relationship between the way of filling in the tax return in record keeping and age (Pearson correlation, $p=0.001$). But there is no a significant relationship to other variables,(learning tax rules; looking tax tables; preparation and helping from tax assistances). Here in record keeping the tax payers are not devote much time to keep their records because their attitudes and know how are increase and they also have increase their commitment to pay their tax liability as age increases.

There is no such significant relationship between level of education and learning tax rules (Pearson correlation, $p=0.162$) as well as no statistically significant relationship with keeping records. There is also a positive statistically significant relationship concerning the level of education (Pearson correlation, $p<0.01$) with looking a tax tables and actual preparation but a negative statistically significant relationship with helping from tax advisors. As the education level rises, the percentage of individual income tax payers who fill in on their own rises too (and, vice versa, the percentage of the taxpayers using external help falls). This is in accordance with the results of similar researches (Diaz & Delgado, 1995).There is also a

relationship between income and compliance time. There is a positive statically significant relationship between income of the individual income tax payers and learning tax rules, looking, tax tables, keeping records and actual preparation of their statements (Pearson correlation, $p < 0.01$), but a negative statistical significant at 5% confidence relationship with helping from tax assistances (Pearson correlation, $p = 0.024$).

In general, the income and level of education was found to have a strong influence on compliance time, but age was not correlated with compliance time except in record keeping. Taxpayers who stated that they find tax compliance complicated had higher compliance costs, as did taxpayers who monitor their inflow of income and distribute income to reduce their tax liability.

To sum up, results in respect of compliance costs of individual income tax payers depicted the following findings. The average values per tax payers were 157.78 ETB and the average times spent by tax payers for filing their tax return were 7.54hrs. The largest component of compliance time (422 hours) is the time spent for learning from advisor which is on average 28% and the least component of compliance time (12%) is the time preparation records.

Despite the fact that international comparisons of compliance costs could not be made because of several obstacles like different methodologies, different response rate, evaluation of time, assessment of tax and tax rates, the study also make comparisons with other similar prior studies such as the study conducted by Diaz and Delgado, 1995 = 6.8hrs, Pope, 1995 = 7.8hrs, Slemrod and Sorum, 1984 = 21.7hrs, and Blumenthal an Slemrod, 1992 = 27.4hrs, time spent by tax payers for personal income tax on average in Addis Ababa are relatively low. The main reason for this is the low consultancy costs. Almost all of the surveyed tax payers were no payment for tax advisors. If they sought help, they turned to friends and family and did not pay for it.

Documentary analysis

As stated in chapter 3, apart from the survey, this study employed documentary study. Documents including the income tax legislation or proclamation and other official documents (both published and unpublished) held by the tax authorities and other

government institutions were examined. Besides, the documentary analysis aimed at obtaining estimates of percentage of costs incurred and time spent by each individual income tax payers. Some clue of the estimates of percentage of costs incurred and times spent in connection with income tax administration by the individual income tax payers were obtained from all the selected tax offices which were specified in chapter 3 above in Addis Ababa. The numbers of Individuals who are required to pay their income tax liability within the specified date were decrease from year to year. The reason behind to this is that their fear of such kinds of costs. Since they are voluntarily registered without enforcing by any government body, at the beginning they registered more but unfortunately after a certain period of time they dispose themselves too. As chapter one stated, weak enforcement is a cause for concern since personal income tax compliance tends to be lower. And also these individuals are required to pay income tax. They are ordered to do so by income tax proclamations, regulation and directives.

According to the law, individuals who obtain income from their employment are required to pay tax. In line with internationally recognized best practice, employee's income tax liabilities are calculated and paid directly by their employer. As a result the government relies on employers to compute and withhold the tax to be paid by employees. But in this study these individuals were forced to pay their income tax liability by themselves. The employers were not responsible to calculate and paid to the tax authority. They were not act as an agent; rather they pay the gross amount. These individuals were voluntary disclose their income and goes to the nearer tax office and therefore, they exposed compliance cost easily. Therefore, the authority should design a strong tax audit policy and strategy to deliver the aspiration of helping customers to pay the right tax at the right time and with the minimal administrative and compliance cost to both ERCA and customers alike

CHAPTER FIVE

5. CONCLUSION AND RECOMMENDATIONS

Under this chapter conclusion for the whole thesis and highlight future research directions was made. Accordingly, the first part presents an overview of the thesis and its major findings. The second section discusses the implications to the Ethiopian government and the tax authorities in particular, and to taxpayers. Finally, the limitations of the thesis and future research directions are presented in section three.

5.1 Conclusion

Compliance costs of taxation are also known as a hidden cost of taxation or the excess burden of taxation. The awareness or initiatives to reduce the cost must come from the taxpayers themselves. However, in Addis Ababa little is known on taxation compliance costs and no research has been conducted on individual tax compliance costs.

Data was obtained from taxpayer surveys and documents held by tax authorities and other institutions were employed to address this research question and hypotheses. On average, respondents to this survey spent 7.54 hours of their own time on tax filing, which had a resource cost of 157.78 ETB. Thus, the average total cost amounted to 157.78 ETB per individual income tax payers. The results also provide evidence that unlike the practice in most developed countries, the majority of taxpayers in Addis Ababa do not use tax advisors.

5.2 Recommendations

- Ethiopian Revenue and Customs authority must improve the tax system by different kinds of mechanisms to enhance and facilitate the tax collection mechanisms. For example give workshops for taxpayers' and tax practitioners' education and communication training. The training focused on developing taxpayer education understanding, communication skills and customer service delivery techniques and the training also focused on developing the various skills essential for improving voluntary tax compliance through better education and communication. Communication with

taxpayers is an art which must be performed with skills acquired from training to identify areas that they would like to enhance and improve the way they interact and deal with certain matters with taxpayer and also to build effective working relationship.

- The authority better to design a strong tax audit policy and strategy to deliver the aspiration of helping customers to pay the right tax at the right time and with the minimal administrative and compliance cost to both ERCA and customers.

5.3. Research limitations and future research directions

The results of the study, however, are limited in the following ways.

- This study covers only a small number of taxpayers. Hence, the findings of the study might limit their general .
- It is has also limited regarding methods of estimating the cost of times spent by each individual income tax payers. Specifically, estimating the time spends was calculated based on the questionnaires the tax payers were stated rather than using stated value, wage rate or others methods. These methods do not result in exact measure of tax compliance costs.

These limitations lead to possible future research directions. There are a number of issues which deserve further research. The studies focused on compliance cost of individual income tax payers in Addis Ababa. The relevance of the findings in connection with other types of taxes in the context of Ethiopia remains unknown. So, examining the compliance costs of the various types of taxes in Ethiopia deserves more attention.

Therefore considering these and other limitations the study recommends for further researchers as

- Future research may be conducted to explore further on the problem that are faced by taxpayers in complying with tax legislation, practical action to reduce compliance costs and also to include psychological costs of individual taxpayers compliance costs.

- The survey method (questionnaires) used to measure compliance costs in this studies were one Saied, only the tax payers, not include the tax officials. Consequently considering those officials make the findings of the study more accurate and general.

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APPENDIX

Appendix 2 shows the total cost of the tax payers in preparing their tax return in respect of the buying self-help tax guides, making phone calls, traveling, or postage costs.

Time/hr	Frequency	Result	Percent	valid percent	Cumulative Percent
100	35	3500	17.5	17.5	17.5
145	8	1160	4	4	21.5
130	19	2470	9.5	9.5	31
300	2	600	1	1	32
350	14	4900	7	7	39
500	6	3000	3	3	42
450	2	900	1	1	43
160	5	800	2.5	2.5	45.5
80	5	400	2.5	2.5	48
25	9	225	4.5	4.5	52.5
50	35	1750	17.5	17.5	70
200	17	3400	8.5	8.5	78.5
650	1	650	0.5	0.5	79
120	7	840	3.5	3.5	82.5
60	9	540	4.5	4.5	87
70	7	490	3.5	3.5	90.5
45	3	135	1.5	1.5	92
75	1	75	0.5	0.5	92.5
180	8	1440	4	4	96.5
700	6	4200	3	3	99.5
80	1	80	0.5	0.5	100
Total	200	31555	100	100	

Appendix 3 indicates attitude towards the preparation and filing of the tax payers income tax returns

	Frequency	Percent	Valid percent	Cumulative percent
I very much enjoy it	22	11	11	11
I enjoy it	100	50	61	61
I neither enjoy nor dislike it	35	17.5	78.5	78.5
I dislike it	43	21.5	100	100
I dislike it very much	0	0	100	
Total	200	100		

Appendix 4 indicates the total time the tax payers spent for the purpose of filling and preparing their tax return

Time/hr	Frequency	Result*	Percent	valid percent	Cumulative Percent
0	33	0	16.5	16.5	16.5
0.5	26	13	13	13	29.5
0.75	19	14.25	9.5	9.5	39
1	49	49	24.5	24.5	63.5
1.5	26	39	13	13	76.5
2	12	24	6	6	82.5
3	10	30	5	5	87.5
3.5	14	49	7	7	94.5
8.75	11	96.25	5.5	5.5	100
Total	200	314.5	100	100	

*** Result=ETB*frequency**

Appendix 4a Time spent on learning tax rules

Time/hr	Frequency	Result	Percent	valid percent	CumulativePercent
0	15	0	7.5	7.5	7.5
0.5	45	22.5	22.5	22.5	30
1	21	21	10.5	10.5	40.5
2	16	32	8	8	48.5
2.5	34	85	17	17	65.5
3	27	81	13.5	13.5	79
4	17	68	8.5	8.5	87.5
4.5	25	112.5	12.5	12.5	100
Total	200	422	100	100	

Appendix 4b Time spent for keeping records

Time/hr	Frequency	Result	Percent	valid percent	Cumulative Percent
0.5	67	33.5	33.5	33.5	33.5
0.75	29	21.75	14.5	14.5	48
1	51	51	25.5	25.5	73.5
1.5	12	18	6	6	79.5
2	5	10	2.5	2.5	82
3	22	66	11	11	93
4	2	8	1	1	94
4.5	7	31.5	3.5	3.5	97.5
5	5	25	2.5	2.5	100
Total	200	264.75	100	100	

Appendix 4c Time spent for looking tax tables

Time/hr	Frequency	Result	Percent	valid percent	Cumulative Percent
0	33	0	16.5	16.5	16.5
0.5	26	13	13	13	29.5
0.75	19	14.25	9.5	9.5	39
1	49	49	24.5	24.5	63.5
1.5	26	39	13	13	76.5
2	12	24	6	6	82.5
3	10	30	5	5	87.5
3.5	14	49	7	7	94.5
8.75	11	96.25	5.5	5.5	100
Total	200	314.5	100	100	

Appendix 4d Time spent for actual preparation

Time/hr	Frequency	Result	Percent	valid percent	Cumulative Percent
0	50	0	25	25	25
0.25	52	13	26	26	51
0.5	31	15.5	15.5	15.5	66.5
1	17	17	8.5	8.5	75
1.5	12	18	6	6	81
2	8	16	4	4	85
3	15	45	7.5	7.5	92.5
3.5	15	52.5	7.5	7.5	100
Total	200	177	100	100	

Appendix 4 e Time spent for helping from tax advisors

Time/hr	Frequency	Result	Percent	valid percent	Cumulative Percent
0	15	0	7.5	7.5	7.5
0.5	45	22.5	22.5	22.5	30
1	21	21	10.5	10.5	40.5
2	16	32	8	8	48.5
2.5	34	85	17	17	65.5
3	27	81	13.5	13.5	79
4	17	68	8.5	8.5	87.5
4.5	25	112.5	12.5	12.5	100
Total	200	422	100	100	

ADDIS ABABA UNIVERSITY

COLLEGE OF BUSINESS AND ECONOMICS

DEPARTMENT OF ACCOUNTING AND FINANCE

This questionnaire is designed to explore the extent of uses of information contained compliance cost of individual income tax payers in Addis Ababa City. The researcher is a post graduate student of Addis Ababa University, college of business and economics in the Department of Accounting and finance. All of us expect not to have to face aggravate while interacting with Government departments. Especially when meeting your tax obligations, you would like to have simple tax laws and procedures and freedom from harassment.

Unfortunately, as things are, it takes a long time to comply with tax laws and one also has to bear substantial monetary costs. These costs do not give any additional benefits. You are one of 200 randomly selected taxpayers for this survey. The enclosed questionnaire will give the information, which only you can provide, of your time and money costs in paying income tax. This information is anonymous and strictly confidential – you need not disclose your identity. The information will be used only for the study and will not be given to any other organization, government department or person. I realize your time is valuable and appreciate your concern for tax reforms. Your responses are vital to the outcome of the study and you are kindly requested to completely and objectively answer all questions.

Thank you in advance for your indispensable cooperation to spare your time and energy to complete this questionnaire.

LET US WORK TOGETHER FOR A BETTER TAX SYSTEM IN ETHIOPIA.

Yours sincerely, -----

Survey of costs of filing individual income tax returns

Personal characteristics:

1. I am Female Male

2.1. Age 18-30 31-45
46-55 Over 55

2.2. Marital status: single married
widowed divorced

3. Level of education completed: No education

Higher secondary Some college or technical school
Degree Post graduate/PhD, professional qualification

4. Do you file a 201/15 federal and/or state income tax return?

Yes No

IF YES, GO TO QUESTION 6. IF NO, GO TO THE NEXT QUESTION (5)

5. Why do you not file a 2014/15 income tax return?

My income was too small to file a return I was not employed in 2014/15

Others (explain).....

BECAUSE YOU DID NOT FILE A 2014/15 TAX RETURN YOU ARE FINISHED WITH THIS QUESTIONNAIRE.

THIS SECTION IS FOR THOSE PEOPLE WHO DID FILE A 2014/15 TAX RETURN.

6. Did you itemize your personal deductions such as interest expenses, medical expenses, taxes, contribution, etc. for your 2014/15 tax return?

Yes

No

7. Check the income bracket which describes your 2014/15 total income. (If you filed a joint return, please include your spouse's income.)

Under Br1, 000

Br 10,001 — Br 15,000

Br 1,000 — Br2, 000

Br 15,001 — Br 20,000

Br 2,001 — Br 5,000

over Br 20,000

Br 5,001 — Br 10,000

8. Can you increase your income by choosing to work more hours?

Yes

No

If yes, how much pay before taxes do you receive for working an additional hour?
Br.....

If no, how much per hour would you want to be paid if you could work extra hours?
Br.....

9. The time you spent on your 2014/15 income tax returns can be divided into several areas such as learning tax rules, keeping records, preparing tax returns, and meeting with tax advisors.

Please estimate how much time you spent on the various areas listed below. (Mark only the lines that apply to you.)

Time spent learning about tax rules (perhaps by reading magazine or newspaper articles, tax guides, or attending tax seminars.) -----hours

Time spent keeping receipts or records for your income taxes. -----hours

Time spent looking up tax tables for your deductions and tax liability. -----hours

Time spent in actual preparation of your tax returns. -----hours

Time spent supplying a tax advisor with your income tax information.-----hours

How many hours total did you spend on your income tax affairs? -----hours

10. What is your attitude towards the preparation and filing of your income tax returns?

Underline it

I very much enjoy it I enjoy it I neither enjoy nor dislike it I dislike it

I dislike it very much

11. Have you ever chosen not to undertake some type of business activity (such as buying or selling real estate) because of the hassle or expense of complying with the tax laws?

Yes

No

12. Did you have someone help you with your 2014/15 income tax returns but did not pay them for their assistance?

Yes

No

If yes, approximately how much time, did that person spend helping you? -----hours

13. Did you pay someone for assistance with your 2014/15 income tax returns?

Yes

No

IF YES, GO TO QUESTION 16. IF NO, PLEASE CONTINUE WITH THE NEXT QUESTION (#14).

THIS SECTION IS FOR THOSE PEOPLE WHO DID NOT PAY FOR TAX ASSISTANCE WITH THEIR 2014/15 INCOME TAX RETURNS.

14. Even though you did not pay for professional tax assistance, you may still have had some expenses in preparing your tax returns (such as buying self—help tax guides, making phone calls, traveling, or postage Costs). Please estimate these costs for filing your 2014/15 income tax returns. Br-----

15. If you could have avoided all the time and effort of gathering tax information and preparing your 2014/15 tax returns, how much would you have been willing to pay? (Assume the amount of income tax paid would not have changed.)

Br-----

IF YOU DID NOT PAY FOR TAX ASSISTANCE, YOU ARE FINISHED WITH THIS QUESTIONNAIRE. THANK YOU FOR YOUR HELP.

16. What amount in fees did you pay to any of the following for help in filing your 2014/15 federal and/or state tax returns? (Please give amounts to the nearest Birr.)

Accountant or Accounting Firm Br.....

Tax Preparers or Firms Br.....

Other (describe) Br.....

17. In preparing your 2014/15 tax returns you may have had other costs besides the fees paid to tax advisors such as travel expenses, phone calls, postage, or written materials. Please estimate these additional Costs. Br.....

18. If you could have avoided all the time and effort on your 2014/15 income tax returns, how much more would you have been willing to pay above and beyond what you already paid for tax assistance? (Assume the amount of income tax paid would not have changed.)

DECLARATION

I am Tewodros Mengistu, hereby declare that the Research project entitled –Compliance cost of employment income tax payers in Addis Ababa City Administration submitted by me for the award of the Degree of Master of Accounting and Finance in Addis Ababa university, is original work and it has not been presented for the award of any other Degree, Diploma, Fellowship or other similar titles of any university or institution.

By:

Tewodros Mengistu

Signature _____

Date _____