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Assessment of Business Income Tax Evasion in category A Taxpayers: In case of Ministry of Revenues Large Taxpayers Branch Office

By: Yechale Asresie

A Thesis submitted to the Department of Accounting and Finance in partial fulfillment of the Requirements for the Award of the degree of Master of Science in Accounting and Finance

**January, 2020
Addis Ababa, Ethiopia**

Declaration

I, the undersigned, declare that the research entitled “**Assessment of Business Income Tax Evasion in category A Taxpayers: In case of Ministry of Revenues Large Taxpayers Branch Office**” is my original work and is my own effort and study. It has been done by me independently except for the guidance and suggestion from my research advisor. It is presented here, in partial fulfillment of the Requirements for the degree of masters of science in Accounting and Finance.

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Abstract

Taxes are important sources of public revenue. Tax evasion is widely believed to be important factors limiting revenue office tax mobilization. In Ethiopia, tax evasion is pervasive features in tax collection process. The purpose of this study was assessing of business income tax evasion in category A taxpayers: In case of Ministry of Revenues Large Taxpayers Branch Office. Therefore, this study identified the current tax evasion practices in Ministry of Revenues large taxpayers branch office, examines the reasons and the methods of these tax evasions, and analyze methods to control or minimize tax evasion. In doing so, both qualitative and quantitative data that were obtained and the research design is descriptive. The target population was a total of 119 employees of Ministry of Revenues large taxpayers branch office whose work directly related with tax evasion. Among the total target population, 92 employees were selected by using random sampling method. Both primary and secondary data sources using collection tools such as interviews, questionnaires and different books & reports have been used. Descriptive method of data analysis was used to analyze and interpret the data using tools such as table, percentage, graphs and mean. The result shows that tax payers perception towards tax system is negative as they do not like paying tax, taxpayers of revenue office are engaging in different types of tax evasion which includes: overstate business expense and deductions, deduct personal expenses as business expenses, falsifying supporting documents, and didn't declare their tax liability honestly. These all are the indicators of tax evasion practices; the level of tax evasion is high and the government is losing a significant amount of revenue (Birr 8,732,139,709.07 on average per year) due to tax evasion, the tax office does not have adequate experienced tax auditors (only 22.77 % of the total staff) to conduct tax audit and to give appropriate services to tax payers. Therefore, the recommendation is that the most effective tool for making people more positive is to empower them with knowledge and changing taxpayers attitude through sustainable awareness creation program, the tax office should increase the number of auditors from time to time according to the size and the workload of the audit section, the tax office needs to enhance the level of voluntary compliance by providing effective and sufficient education and training service not only for the taxpayers but also its staff members regularly and the level of punishment should be stricter and the legal provisions for doing this should be clearly stated.

Key terms: Tax, Taxation and Tax Evasion

List of Tables

Table 3.1 Sample size selection.....	32
Table 4.1 Descriptive statistics on Perception of Tax Payers Towards the Tax System.....	37
Table 4.2 summary of perception of tax payers towards the tax system with the mean of its indicators.....	38
Table 4.3 Descriptive statistics on Tax Payers Income Reporting Trend	39
Table 4.4 Summary of Tax Payers Income Reporting Trend with the mean of its indicators.....	39
Table 4.5 Descriptive statistics On Level of Tax Evasion	40
Table 4.6 Summary of Level of Tax Evasion with the mean of its indicators	41
Table 4.7 Summary of The Amount of Tax Liability Before and After Audit	41
Table 4.8 Descriptive statistics on efficiency of the tax administration	43
Table 4.9 Summary of efficiency of the tax administration with the mean of its indicators.....	44
Table 4.10 Percentage of Tax Audit Section as per the Total Staff.....	44
Table 4.11 Tax Audit Coverage percentage.....	45

Lists of Figures

Figure 4.1 Respondents level of Education	34
Figure 4.2 Respondents level of work experience.....	35
Figure 4.3 Respondents current working process/section.....	35

Acronyms

EBDSN	Ethiopian Business Development Services Network
ECC	Ethiopian Chamber of Commerce
GDP	Gross Domestic Product
HMRC	Her Majesty's Revenue and Customs
HRM	Human Resource Management
IRS	Internal Revenue Service
TAP	Tax Administration Proclamation
TCMP	Tax Payers Compliance Measurement Program

Table of Contents

Declaration	A
Acknowledgments	i
Abstract	ii
List of Tables	iii
Lists of Figures	iii
Acronyms	iv
CHAPTER ONE	1
1. INTRODUCTION	1
1.1 Background of the study	1
1.2 Statement of the Problem	3
1.3. Research Question	4
1.4 Objectives of The study	4
1.4.1 General Objective of the study	4
1.4.2 Specific Objectives of the study	4
1.5 Significance of the Study	5
1.6 Scope of the Study	5
1.7 Limitation expected of the study	5
1.8 Organization of the Study	5
CHAPTER TWO	6
2. REVIEW OF RELATED LITERATURE	6
2.1 Theoretical and Conceptual Framework	6
2.1.1 Introduction	6
2.1.2 Definition and concept of tax	6
2.1.3 General framework	6
2.1.4 Classifications of Tax	7
2.1.5 Taxation in Ethiopia	7
2.1.6 Major Types of Taxes existing in Ethiopia	8
2.1.7 Tax Evasion	9
2.1.8 Tax Evasion Under Ethiopian Income Tax Laws	10
2.1.8.1 Evasion of Declaration	10

2.1.8.2 Evasion of Payment.....	13
2.1.9 Measuring Tax Evasion.....	14
2.1.9.1 Traditional Approaches.....	14
2.1.9.2 Modern Approaches.....	15
2.1.10 Indicators of Tax Evasion	15
2.1.11 Factors of Tax Evasion	16
2.1.12 Tax Evasion in Developing Countries.....	16
2.1.13 Consequences of Tax Evasion.....	17
2.1.14 Solutions for Reducing Tax Evasion	18
2.1.15 Tax Administration Efficiency.....	22
2.1.16 Theories Related to Tax Administration Efficiency	24
2.1.16.1 Goal-Setting Theory.....	24
2.1.16.2 Governance Theory.....	25
2.2 Empirical Literature review	25
2.3 Conclusion	27
CHAPTER THREE.....	30
RESEARCH DESIGN & METHODOLOGY.....	30
3.1 Research design.....	30
3.2 Data sources, types and methods of collection	30
3.3 Sample Design	31
3.3.1 Study Area and Target Population.....	31
3.3.2 Sampling Frame	31
3.3.3 Sampling Technique and Sample Size.....	31
3.4 Methods of Data Analysis and Interpretation.....	32
CHAPTER FOUR.....	33
DATA ANALYSIS, DISCUSSION AND PRESENTATION	33
4.1 Introduction.....	33
4.2 Response rate.....	33
4.3 Description of the Respondents	33
4.3.1 Description of the Respondents based on level of education.....	33
4.3.2 Distribution of respondents based on their working experience	34
4.3.3 Description of Respondents based on working process	35

4.4 Assessment of Business Income Tax evasion	36
4.4.1 Taxpayers perception of taxpayers towards the tax system.....	36
4.4.2 Tax payers' income reporting trend.....	38
4.4.3 Level of tax evasion	40
4.4.3.1 Primary data analysis on level of tax evasion	40
4.4.3.2 Analysis of secondary data on level of tax evasion	41
4.4.4 Efficiency of the tax administration	42
4.4.4.1 Primary Data Analysis	42
4.4.4.2 Secondary Data Analysis.....	44
CHAPTER FIVE	46
CONCLUSIONS AND RECOMMENDATIONS.....	46
5.1 Conclusions.....	46
5.2 Recommendations.....	47
Reference	49
Appendices.....	A
Appendices I: Questionnaires	A
Appendices II: Interviews.....	D
Appendices III(A): Number of Ministry of revenues large taxpayers branch office employees and taxpayers	H
Appendices III(B): Ministry of revenues large taxpayers branch office business income tax audit report.....	H
Appendices III(C): Ministry of revenues large taxpayers branch office tax audit coverage	H

CHAPTER ONE

1. INTRODUCTION

1.1 Background of the study

Tax evasion is a universal phenomenon. It takes place in all societies, all social classes, all professions, all industries, and all economic systems. Two thousand five hundred years ago, Plato was writing about it, and the aging Ducal Palace of Venice has a stone with a hole in it, through which people once informed the republic about tax evaders. The only surprise is how little attention this phenomenon has received, especially in the United States, until recent years. For example, there is no reference to it in the index to classic Individual Income Tax (Goode, 1964), nor The Theory of Public Finance in Richard (Musgrave, 1959), nor Federal Tax Policy in Joseph (Pechman, 1966). These authors either did not think that tax evasion was important or opted to ignore it.

In recent years, growing attention has been paid to tax evasion. In the United States, awareness may have started with the political problem of the rising fiscal deficit, which some began to argue could be solved by reducing the so-called tax gap, rather than by raising tax rates or cutting public spending (Shome, 2014).

Taxes are important sources of public revenue (Ethiopian Chamber of Commerce and Ethiopian Business Development Services Network (ECC & EBDSN), 2005). The main purpose of taxation is to generate sufficient revenue to finance public sector activities in a non-inflationary way (Zolt, 2003). The provision of public infrastructure and government services is a key factor for economic development. In many developing countries, a lack of public service provision slows down economic growth and undermines efforts to improve the living standard of the population. There are a number of reasons for the failure of many governments in developing countries to provide sufficient public services. A lack of tax revenue is one of them. In 2005, the average tax revenue to GDP ratio in the developed world was approximately 35%. In the developing countries, it was approximately 15%, and in the poorest of these countries, the group of low income countries, tax revenue was just 12% of GDP. This gap can partly be explained by the fact that demand for public services increases more than proportionally as income rises. But it also reflects weaknesses in the ability of developing countries to raise the revenue required for the provision of adequate public services (Riedel, 2009).

The first major change in Ethiopia's tax system was initiated in the post-Second World War period (1942-44), the years 1947-52 covering its second stage. These changes were generally discretionary, including amendments to property taxes (land and cattle). Broad-based taxes on goods and services were also introduced in the mid-1950s. Later in the decade and in the early 1960s, changes were also made in the rate and structure of taxes, especially on income. In the post-revolution period (1974-91), particularly during 1976-79, significant major changes on the rate and structure of all types of taxes were made. These involved widening the land tax base, introducing capital and surplus transfers from nationalized firms, as well as certain minor arrangements on other taxes (Wogene, 1994).

Leaving aside this brief description of the evolution of the tax system before the 1991/2 reform, the subsequent taxing system in Ethiopia can be divided into three broad categories: (i) taxes on income and profits, (ii) taxes on goods and services and (iii) taxes on international trade. Most of these taxes have been reformed and amended in the last decade following the general 1992 liberalization (or reform) policy. Some institutional reforms aimed at enhancing the government's capacity to raise tax revenue have also been made (Shimeles, 2005).

Tax evasion is widely believed to be important factors limiting revenue mobilization (Riedel, 2009). Tax evasion is the term so frequently referred to in economic and business relationships today that they constitute part of our conversational language and people in general use this term even without knowing its exact meaning.

In the context of the individual income tax, an actual frame work for nonwage earners may be described as follows. To declared personal income, adjustments should be made for those components of income that are included in the concept of income in the national accounts but are deductible for tax purposes. These include personal exemptions, deductions, investment allowances, and other deductible direct taxes that have been paid. The adjustments need to be made for individual tax brackets if the tax structure is progressive. The result of the exercise would be a series for gross taxable declared income (by income class). A comparison with gross taxable income from the national accounts would yield an estimate of undeclared nonwage income (Shome, 2014).

Thus, this study aims to assess the presence, cause, methods and the level of tax evasion towards category 'A' business income taxpayers in Ministry of Revenues Large Taxpayers Branch Office

and to recommend possible solutions used to control tax evasion based on data that have been collected from appropriate sources.

1.2 Statement of the Problem

In the light of recent commitments to increase official development assistance (ODA) to poorer countries, there has been renewed focus on identifying the most promising potential sources of new revenues which OECD country governments can allocate to development assistance. In this context, amid discussion of environmental taxes (including the airline tax backed by French President Jacques Chirac), global lotteries and the proposed International Financing Facility (IFF), the topic of tax evasion seems somewhat out of place. Arguably however it is both the most promising long term source of new funds for development, and also a politically attractive medium term option (Cobham, 2005).

Ethiopia, like most countries in Africa, has been making considerable efforts in recent years to restructure its tax system with a view to increase tax revenue as well as reduce distortions in the economy. The impact these reforms have had on the poor is of considerable importance to policymakers, given that the poor and the vulnerable constitute a significant majority of the population in Ethiopia. However, to analyze the distributional impact of its tax system is not so straightforward. There are several reasons for this. First, tax evasion is considered to be substantial in Ethiopia, leading to unintentional consequences on income distribution. Second, a substantial portion of tax revenue comes from commodity taxes whose effect on income distribution is essentially determined by household consumption patterns and the market structure (Shimeles,2005).

The legal background assigns the Ministry of Revenues as the only Authority to collect federal taxes and custom duties. The Authority has the objective of, among others, to collect timely and effectively tax revenues generated by the economy. And one of the Authority key goals is Identify strategies that may allow for combating tax evasion and promoting ethics and integrity within the tax administration. But as far as the fact indicates it does not perform as expected. Because the reason for the failure of many governments mainly in developing countries to provide sufficient public services is lack of tax revenue which is reduced mainly due to tax evasion. Tax evasion is a universal phenomenon. It takes place in all societies, all social classes, all professions, all industries, and all economic systems. It needs a great attention to reduce its impact on national revenues and subsequently diminishing of national development.

Tax evasion creates a great problem in generating tax revenue of the country since tax evasion is the cause of losing significant amount of revenue. As far as the researcher's knowledge is concerned, there is no recent published research that specifically investigates the presence, cause, method and level of income tax evasion in Ethiopia in general and in Ministry of Revenues Large Taxpayers Branch Office in particular. Hence, this researcher intends to assess business income tax evasion in category "A" taxpayers focusing on Ministry of Revenues Large Taxpayers Branch Office and to recommend possible solutions used to control tax evasion.

1.3. Research Question

The researcher believes that there is a gap on the area and the researcher tries to address and answer the following general guiding questions.

- What is the perception of income tax payers towards the tax system?
- Are the tax payers declaring (reporting) the true income generated from their business?
- How much is the degree of tax evasion in Ministry of Revenues large taxpayers branch office?
- How efficient is the tax revenue branch office (the tax audit process in particular) to control tax evasion?

1.4 Objectives of The study

1.4.1 General Objective of the study

The main objective of this study will be to assess the level of Tax Evasion in Ministry of Revenues Large Taxpayers Branch Office and to analyze the controlling mechanisms of tax evasion.

1.4.2 Specific Objectives of the study

The specific objectives of the study will be:

1. To assess the perception of income tax payers towards the tax system.
2. To examine whether the taxes payers declare (report) the true income generated from their business or to assess the presence of tax evasion.
3. To assess the degree of tax evasion in Ministry of Revenues large taxpayers branch office.
4. To examine the efficiency of Ministry of Revenues large taxpayers branch office (the tax audit process in particular) to control tax evasion.

1.5 Significance of the Study

The main outcome of this study has been the level of tax evasion and possible recommendations that can help to reduce tax evasion would have been forwarded. Thus, the findings of the study would have been offered policy makers on taxation an opportunity to further design and redesign policies that will use to reduce tax evasion and to promote better tax system and to increase tax revenue. This study would have been also provided for the researcher to get experience so as to do other researches as reference point in further research in the area of tax evasion.

1.6 Scope of the Study

Even if the study might result important solutions if it would be conducted in broad way, because of time and financial constraints the study will be limited on the assessment of the presence, cause, method and level tax evasion with an instrumentality of taxpayer's perception, their reporting trend with specific focus of category A taxpayers, efficiency of tax administration, and limited to the geographical territory of Ministry of Revenues large taxpayers branch office.

1.7 Limitation expected of the study

This study would have been limited to the category A taxpayers in Ministry of Revenues large taxpayers branch office and based on limited sample size. Therefore, it may not have a strong scientific justification and representativeness to generalize about the presence, cause, method and level of tax evasion. Despite the above expected limitations, the samples selected from respondents considered representative enough. It is believed that, the random samples help to make reasonable analysis and conclusion on assessing on the presence, cause, method and the level of tax evasion in Ministry of Revenues large taxpayers branch office. The other limitations in this study would have been include: carelessness/ unwillingness of respondents, lack of sufficient information from institution and shortage of available written documents as well as references and lack of experience in the study.

1.8 Organization of the Study

The study consists five chapters. Chapter one contains introductory part which, include background of the study, statement of the problem, Questions, objectives, significance, scope and limitations of the study. Chapter two of the study is the review of the related literature. Chapter three is about the methodology of the research, which describes the research design, sampling techniques, instruments of data collection, analysis and interpretation. Chapter four consists of data analysis, discussion and presentation, and the last chapter provides conclusion and recommendation.

CHAPTER TWO

2. REVIEW OF RELATED LITERATURE

2.1 Theoretical and Conceptual Framework

2.1.1 Introduction

Taxation is as old as history of early state formation. As tax remains essential source of public finance, states used to collect taxes for public funding. Apart from its extant condemnation by modern governments, one can strongly argue that tax evasion remains persistent challenge from the very inception of state. Nowadays, following the advancement of public finance the concept of tax evasion get emphasis by tax scholars. It is now condemned and categorized as anti-social behaviors as well as criminal act (www.abysinialaw.com, 2019).

2.1.2 Definition and concept of tax

Taxes are important sources of public revenue. The existence of collective consumption of goods and services necessitates putting some of our income into government hands. Such public goods like roads, power, municipal services, and other public infrastructures have favorable results on many families, business enterprises, industries and the general public. Public goods are normally supplied by public agencies due to their natures of non-rivalry and non-excludability. The nature of consumption of public goods is such that consumption by one does not reduce consumption for others. Besides, consumption of public goods by an agent does not exclude others from doing same. Such nature of public goods therefore makes them impossible for private suppliers to avail them at market prices like other commodities. Government intervention in the supply of public goods is therefore inevitable and can only be done if the public pays taxes for the production and supply of such goods (ECC & SBDSN, 2005).

2.1.3 General framework

Although there may be reasons, discussed later, for distinguishing among these categories of response to taxation, there is a common framework for analyzing these issues. Given the structure of the tax system and enforcement process, taxpayers are faced with opportunities to reduce their tax payments, or expected tax payments. There is a private cost to taking advantage of these opportunities, which may take the form of an altered consumption basket, an increasing

probability of detection of, and penalty for, evasion, and/or a real resource cost of effecting evasion or concealing evasion (Slemrod & Yitzhaki, 2002).

This private cost depends on policies of the government that include, but are not limited to, the setting of tax rates and bases. The parameters of the tax administration and enforcement policies also matter, but these policies themselves are usually costly.

The tax system establishes the relative prices among this broad set of taxpayer activities. In the standard model, it establishes the relative price of leisure and other goods, as well as the relative price among the set of goods. In a more general framework it also sets the price of "honesty", meaning the incentives to evade, and establishes the cost and reward to legally reducing taxes via avoidance activities. The dimensions of taxpayer response interact. For example, real behavior may alter the cost of evasion, thus changing the effective prices of real activities (Ibid).

2.1.4 Classifications of Tax

The usual broad classification of taxes into direct and indirect is followed. This classification relates to the method of payment and collection, rather than the purpose, since in practice taxes may have more than one purpose. Direct taxes are taxes levied on incomes, to which the persons concerned make direct payment to the Board of Internal Revenue or Local Authorities. These include income tax, taxes levied on total spending, company taxes, capital taxes where they apply, and local rates. Indirect taxes are those taxes levied on goods and services, so called because the Board of Customs and Excise does not usually collect them from the consumers directly but from importers, manufacturers and intermediaries. The duty paid by these people is reflected in the prices that consumers subsequently pay (Ogbonna, 1975).

2.1.5 Taxation in Ethiopia

In Ethiopia the year 1991 marked the end of the previous policy regime of hard control that had lasted for nearly two decades. This was the year when the seventeen-year old 'socialist' regime was toppled by the coalition of rebel forces, the Ethiopian Revolution Democratic Front (EPRDF), which formed the current government. Starting from 1992, the EPRDF has initiated a wide range of reforms that can be termed as liberalization. Reform of the tax system was among the range of liberalization policies that also extended, among others, to the exchange rate, interest rates, trade, domestic production and distribution (Shimeles, 2005).

After the 1992 liberalization, investment grew rapidly. But this increasing level of investment could not be financed by domestic resources alone. Savings declined sharply in 1990/1 (a period

of violent change in the government). Since then, there has been some recovery, only to decline further by the end of the 1990s. Public saving has shown quite a remarkable recovery in the 1990s. Thus, in this respect the government's fiscal policy seems promising. However, total domestic saving was far below the level of investment, and this resulted in a government deficit of about 10 per cent of GDP per annum in the last decade. The current government has registered modest achievement in terms of fiscal policy, chiefly through revenue generation, but this is being frustrated by the war with Eritrea and the natural disasters of the recent past (Geda, 2005). Despite the fact that people need to pay taxes based on rationales of vertical and horizontal equities, it is not always the case that tax systems are comprehensible and transparent for taxpayers especially for less literate business operators. Tax systems are usually not elaborated after proper consultation with the business community. The business owners complain that the tax assessment method is based on subjective estimation as a result of which they are frequently subjected to over-taxation. Since the business owners do not have simplified access to and clarification on information of the tax laws, they lack awareness on tax rules and regulations and this has an impact on the practicability of the regulations (ECC, 2005).

It is therefore worth clarifying the Ethiopian tax system and the rationales behind for the business owners through the relevant institutions that have access to and ability to understand this booklet. This booklet is the product of the common effort of the Ethiopian BDS Network (EBDSN) supported by the GTZ/MSE project and the Ethiopian Chamber of Commerce (ECC) supported by the partnership project between the German Chamber of skilled crafts and trades (HWK) from Rhein- Main financed by the German Federal Ministry of Economic Cooperation and Development (BMZ) through SEQUA. The main purpose of this booklet is thus to aware the business community the different types of taxes existing in Ethiopia and some of the purposes for which the tax revenues are utilized. For more detailed information on practical issues, we recommend to refer to a training manual, which the partnership project between the ECC and HWK has elaborated specially to assist category B and C taxpayers to avoid problems with the respective tax collecting authorities (ECC, 2005).

2.1.6 Major Types of Taxes existing in Ethiopia

According to (ECC & SBDSN, 2005), the major types of taxes in Ethiopia are:

Direct Taxes: includes Tax on Income from Employment / Personal Income Tax, Business Profit Tax, Tax on Income from Rental of Buildings, Tax on Interest Income on Deposits,

Dividend Income Tax, Tax on Income from Royalties, Tax on Income from Games of Chance, Tax on Gains of Transfer of Certain Investment Property, Tax on Income from Rental of Property, Rendering of Technical Services Outside Ethiopia, Agricultural Income Tax and Land Use Tax

Indirect Taxes: including Turnover Tax, Excise Tax, Value Added Tax (VAT), Custom duty and Stump duty

2.1.7 Tax Evasion

Tax evasion is the general term for efforts by individuals, firms, trusts and other entities to evade the payment of taxes by illegal means. Tax evasion usually entails taxpayers deliberately misrepresenting or concealing the true state of their affairs to the tax authorities to reduce their tax liability (Ibid). This definition purely indicates that tax evasion is legally as well as economically a crime. Because, the taxpayers violate the written tax law of a country. Tax evasion is deviation from what is to be found legal, fair and just. It is common in that it results in losses in the tax revenue.

Tax evasion is associated with breaking the law: it is a gap developed due to the taxpayers' real conduct departing from what has been promulgated as statutory fiscal law (Deak, 2004).

Tax Evasion may be defined as any action that results in the concealment of all or part of a person's legitimate or illegal economic activities from the tax authorities in order to escape or dodge the payment of tax. In short, it is an intentional and illegal avoidance of paying mandatory taxes to the Government (AlmJ. , 2012).

Tax evasion is not identical to the loss in the potential revenue that could be collected in the absence of tax evasion. If tax collection were more efficient, the tax- payers' conduct would not remain the same, and so the real economic circumstances for tax collection would also be different (Franzoni, 1996-2000). From the standpoint of law and economics at least, tax evasion is in fact a wedge between economic reality and the purely legal construction of statutory tax rates (Ibid). It is closely connected with the informal economy and associated crimes like fraud, false accounting, money laundering, bribery, etc.

Boll (2015) outlined two major distinctions in intentional tax evasion: 1) Evasion by commission and 2) evasion by omission.

Evasion by commission requires an action by the taxpayer, for example claiming deductions or rebates which mean that if a taxpayer is making a false claim, he will get a tax saving (a commission on top of his evading actions).

Conversely, evasion by omission is intentional and should be classified as seriously as evasion by commission. This kind of evasion requires taxpayers to do nothing in the tax return (i.e miss something out deliberately); for example, one would not report his casual income or any cash-based income.

2.1.8 Tax Evasion Under Ethiopian Income Tax Laws

The following issues are compiled from www.abbyssinialaw.com regarding tax evasion under Ethiopia tax law.

Ethiopian Income tax proc. no.286/94 was among the first laws that introduce the concept of tax evasions with its contemporary development. Section 9, art 96 of the proclamation comes with definition of the term. Accordingly, “A taxpayer who evades the declaration or payment of tax commits an offense and, in addition to the penalty for the understatement of income referred to in Article 86, may be prosecuted and, on conviction, be subject to imprisonment for a term of not less than five (5) years”

Pursuant to the above article tax evasion is regulated having two aspects. Those include: evasion of declaration(assessment) and evasion of payment

2.1.8.1 Evasion of Declaration

Unlike the case of value added and turn over tax where the epicenter of tax evasion discourse bases itself on whether we declare or pay the tax we collect on behalf of the government, under income tax law regime what can be evaded in the sense of evasion of declaration is tax payer’s income.

Proclamation no. 286/94 here after called the proclamation, though not peculiar to tax legislations, introduces evasion of declaration (assessment) in its newest sense to Ethiopian income tax law regime with the phrase “a taxpayer who evades the declaration...”. As majority of tax evasion cases fall under this category of evasion, tax professionals should be well versed with it. Other than the above phrase, the proclamation does not clearly define what evasion of

declaration mean. Hence, we have no option than being persuaded to discuss what evasion of declaration meant under developed tax jurisprudence.

In legal parlance evasion of declaration “Entails an attempt (actions) to prevent the government from calculating tax payers’ true tax liability”

The most common attempt to evade or defeat a tax is the affirmative act of filing a false return that omits income and/or claims deductions to which the taxpayer is not entitled. Consequently, such willful under reporting or overstating of costs constitutes an attempt to evade or defeat tax by evading the correct assessment of the tax.

To establish evasion of declaration the government (prosecutor) must prove that: The defendant committed an affirmative act to defeat or evade tax, there must be a material amount of tax due and owing and the defendant must act willfully.

The defendant committed an affirmative act to defeat or evade tax: Affirmative action is an action taken by the tax payers for the purpose of tax evasion. Taxpayer must undertake some action, that is, engage in an affirmative act for the purpose of attempting to evade or defeat the assessment of a tax. This might be in the form of Filing false tax return that omits income, or Claiming deductions to which the tax payer doesn’t have entitlement etc.

Needless to mention, both prosecution office and courts must view the requirement of affirmative conduct broadly and all the means to do it. According to IRS, there are a lot of acts that constitute affirmative conduct as established by the Supreme Court of united states in the seminal case of Spies v. United States, 317 U.S. 492 (1943). Those nonexclusive lists of acts by the court that constitutes affirmative conduct includes “keeping a double set of books, making false entries of alterations, or false invoices or documents, destruction of books or records, concealment of assets or covering up sources of income, handling of one's affairs to avoid making the records usual in transactions of the kind, and any conduct, the likely effect of which would be to mislead or to conceal.”

Apart from the above discussion, the new tax administration proclamation no 983/2008 clearly regulate failure to file a tax declaration/return as tax evasion. The proclamation peculiarly comes

with the phrase “with intent to evade tax” which clearly depicts the duty of the government to unequivocally show the fraudulent intent of tax payer to evade tax with the shadow of failure to file tax return. In nutshell, the existence of affirmative act remains an essential element of Evasion of declaration under income tax law regime.

There must be a material amount of tax due and owing: In every jurisdiction where tax evasion is regulated as tax crime, the existence of a tax deficiency is a required element of evasion of declaration. Under IRC, even if a defendant intentionally failed to report income and took affirmative steps toward evasion, the suspect is convicted of tax evasion if and only if the government is capable to prove that additional tax was owed. The “no tax due defense” is often used by the suspect in developed tax regimes. Trial with an idea of convicting the tax payer, where there is no tax due and owing results in making criminal prosecution looking a lot like the civil tax case. Needless to mention, Ethiopian tax law is not an exception to the above lines of arguments. Therefore, to bring tax evasion charge Pursuant to art-96 of proc-286/94(the now art 125 Of TAP) the prosecutor is expected to be assured of the prevention of true tax liability (underpayment of true tax liability). This may possibly result from filing a false return that omits income or making statement which is false or misleading in material particular/that misleads in calculation of true tax liability. To clinch, prosecutors are expected to prove the existence of tax due and owing before filing the criminal charge at court of law.

Tax payers acted with willfulness or intent to defraud: Fraud is an essential element of tax evasion and tax evasion is in turn never conceived without fraud. A related concept in criminal tax prosecutions is “willful blindness.” If a defendant challenges willfulness on the grounds that he did not review his return prior to signing and filing, the government may introduce evidence to establish that the defendant acted with a conscious purpose to avoid knowledge of clearly false information reported on the return. In other words, a defendant may not avoid criminal liability by intentionally putting himself in a position where he does not have actual knowledge of the facts. Because a refusal to see what is clearly present is inconsistent with a good faith misunderstanding of the law, the government frequently requests willful blindness instructions in criminal tax trials. However, a willful blindness instruction should not be given without evidence that the defendant deliberately ignored relevant facts.

In nutshell, in first scenario of tax evasion charge (evasion of declaration) the prosecutor and the courts should show the following ingredients of the offence before court of law.

1. There should be certain affirmative act either in the form of filing false return or making misleading or false statement.
2. The affirmative act should result in underpayment of tax (tax deficiency should exist).
3. Existence of fraud/intent to defraud

2.1.8.2 Evasion of Payment

Unlike evasion of declaration, evasion of payment can't deal with income. It is all about evasion of income tax due and owing by the tax authority.

Under income tax law evasion of payment entails an action by the tax payers to evade payment of tax due and owed by the revenue authority. In this kind of evasion, the government must demonstrate the existence of a tax due and owing, i.e. existence of tax deficiency, to prove tax evasion.

Unlike the differences in tax regime, the legal philosophy underlying tax evasion coincides in evasion of payment. Under income tax law 286/94, value added tax proc 285/94, turn over tax proc 308/95 and the new tax administration proc 983/2008 evasion of payment appear fashioned the same.

To sue the tax payer for crime of evasion of payment the prosecutor is expected to show the following essential elements of evasion of payment to the court of law. These are: the existence of a tax due and owing, e., a tax deficiency, to prove tax evasion and there should be an affirmative act to evade or defeat payment of tax.

This Affirmative acts of evasion of payment almost always involve some form of concealment of money or assets with which the tax could be paid or the removal of assets from the reach of the authority. Affirmative acts of evasion of payment generally involve schemes to deal in currency, place assets in the names of others, transfer assets abroad or omit assets on a form to be filled by the authority. Those includes: concealment of money or assets with which the tax could be paid or the removal of assets with which the tax could be paid from the reach of the authority, tax

deficiency must be with intent to evade with intent to not to pay due and owing tax evade and conceal assets/property to be discussed by the authority (www.abysinnialaw.com).

2.1.9 Measuring Tax Evasion

There is no measure of the level of tax evasion. However, there are indicators to suggest that tax evasion is at an unacceptable level; more so for tax evasion than tax avoidance mainly because in the case of some small and medium companies, professionals, traders and other self-employed individuals there is the tendency to under report their income. Coupled with that, there is also a trend not to file tax returns. Though it must be stated that the majority of those filing tax returns, by and large fall, within the category of employees who believe that they have fulfilled their tax obligations since they come under the PAYE systems, it is also well established that persons in the informal sector for the most part are also less inclined to file tax returns. Overstating of expenses is another area of tax evasion that the Department has to cope with. Though this practice is quite prevalent it is not a major concern as there is always an adequate audit trail. A fundamental difficulty in analyzing tax evasion is the lack of reliable information on taxpayer compliance. After all, tax evasion is illegal, and individuals have strong incentives to conceal their cheating, given financial and other penalties that are imposed on individuals who are found cheating on their taxes. There have been many approaches to measurement, which is broadly classified as **Traditional** and **Modern Approaches** (AlmJ. , 2012).

2.1.9.1 Traditional Approaches

Among traditional approaches, the most accurate source of information on individual compliance is based on “direct” measurement of evasion via actual audits of individual returns. For example, from 1965 to 1988, the U.S. Internal Revenue Service (IRS) conducted detailed line-by-line audits of a stratified random sample of roughly 50,000 individual tax returns on a 3-year cycle via its Taxpayer Compliance Measurement Program (TCMP). These audits yielded an IRS estimate of the taxpayer’s “true” income, which when compared to actual reported items allowed the IRS to calculate measures of income tax evasion (e.g. the “tax gap”) (AlmJ. , 2012).

Another direct approach is based on survey evidence, in which individuals are asked about their evasion behavior. Still another direct approach uses tax amnesty data, in which declarations of income by amnesty participants are used as an exact measure of evasion (Ibid).

More “indirect” methods look for traces of evasion behavior that are left in various indicators that can be identified, so that evasion is not measured directly but rather indirectly via these measureable traces.

2.1.9.2 Modern Approaches

More recent approaches use a variety of novel methods. Some researchers have used measures of reported income from individual tax returns as a proxy for evasion, on the assumption that one’s total income must be divided between reported income and unreported (or evaded) income (e.g., Dubin, Graetz, and Wilde, 1990; Gruber and Saez, 2002). Other researchers have conducted controlled field experiments (Slemrod, Blumenthal, and Christian, 2001; Iyer, Reckers, and Sanders 2010; Kleven et al., 2010). Some have used consumption based (Pissardes and Weber, 1989) or tax deduction-based (Feldman and Slemrod, 2007) measures as an indicator of tax evasion. There are also examples of survey-based approaches in which particular occupations are examined to determine individual motivations to participate in the shadow economy (Lemieux, Fortin, and Frechette, 1994; DePaula & Scheinkman, 2010). All of these studies lack direct measures of evasion.

2.1.10 Indicators of Tax Evasion

Individual evasion of taxes may take different forms, facilitated by growing international financial globalization and ease of making transactions on the Inter- net. With little or no information reporting, individuals can purchase foreign investments directly (outside the United States), such as stocks and bonds, or put money in foreign bank accounts and not report the income (Gravelle, 2009).

There are several indicators that have often been used. One approach estimates evasion via some “gap” that can be estimated, such as the gap between income reported on tax returns and income in the national income accounts, between income and expenditures in the national income accounts, or between official and actual labor forces (Alm J., 2012).

It is also stated in Shome (1993) that tax evaders may not declare income; may underreport income, sales, or wealth; may over report deductible expenses; may smuggle goods or assets; or may undertake some other deception.

Tax revenue losses due to tax evasion can occur for a number of reasons. Existing estimates of these revenue losses distinguish between a domestic and an international component of tax evasion (Riedel, 2009).

The domestic component of tax evasion would include, for instance, non-declared or under-reported income from work or domestic business activities.

The international component of tax evasion includes practices like transfer price manipulation by multinational firms or the holding of financial assets in offshore bank accounts by private individuals with the purpose of concealing capital income.

Most economic analysis of taxation presumes that tax liability can be ascertained and collected costless. As a description of reality, this is patently untrue. For example, in the U.S. the Internal Revenue Service (henceforth IRS) estimates that about 17% of income tax liability is not paid; the figure for most other countries is probably higher. Furthermore, the resource cost of collecting what is paid can be large, in the U.S. probably about 10% of tax collections. The tax structures themselves are undoubtedly skewed by the realities of tax evasion, avoidance, and administrative costs (Slemrod&Yitzhaki, 2002).

The function of tax administration is to eliminate the discrepancy between what is observable and verifiable. Identifying irregularities is a key to combating tax evasion. Tax collection can be more efficient if the tax authority avails itself of the estimation of tax liability as an alternative to relying on books, of bargaining with the taxpayer in terms of tax rulings, or of the delegation of tax collection to private contractors by letting out of outstanding tax claims (Franzoni, 1996-2000).

2.1.11 Factors of Tax Evasion

Based on Kirchler (2007) the determinants of tax evasion could be divided into four main parts, namely

- 1) Economic factors (tax rates, tax audits and perceptions of government spending);
- 2) Institutional factors (the role of the tax authority, the complexity of the tax returns and their administration, and the probability of detection);
- 3) Social factors (ethics and attitude, perceptions of equity and fairness, political affiliation and changes in current government policies, referent groups); and
- 4) Individual factors (personal financial constraints, an awareness of the offences and penalties).

2.1.12 Tax Evasion in Developing Countries

Universally accepted definitions of tax evasion do not exist. Tax evasion is usually defined as a violation of the law (Slemrod & Yitzaki, 2002).

Quantitative estimates of the tax revenue lost due to tax avoidance and evasion face the difficulty that, due to the nature of these activities, they escape normal statistical registration and documentation. Attempts to estimate the amount of tax evasion therefore have to build on concepts which exploit correlations between observable and statistically documented variables and evasion. Estimates for developing countries face the additional challenge that the availability of economic data in general is much more restricted than in developed countries. These data problems may explain why there is very little reliable empirical evidence on tax evasion in developing countries. The existing studies mostly rely on highly restrictive assumptions and have to make use of data of mixed quality (Riedel, 2009).

Ascertaining the extent and characteristics of evasion immediately runs into many problems – conceptual and empirical. Sometimes the law itself is unclear, sometimes it is clear but not known to the taxpayer, sometimes the law is clear but the administration effectively ignores a particular transaction or activity. The importance of these factors certainly differs across situations (Slemrod&Yitzaki, 2002).

2.1.13 Consequences of Tax Evasion

The consequences of increasing tax evasion results in piling up of black income and wealth on a large scale are numerous and far reaching. Black money is playing havoc with the Indian economy and has far-reaching economic and social consequences. Since the concealed income goes to enhance the wealth, tax evaders carry on huge transactions in the black market, pile up stocks of goods and thus bring about artificial scarcity in the open market resulting in higher prices. Inflation affects adversely the standards of living of employees who then clam us for higher wages and resort to go slow policies, strikes, etc. to enforce their demands. This inevitably leads to strained employer-employee relations, loss of man-days and ultimately a decrease in national income (Jain, 1987).

Further, the large volume of black money which passes through different hands does not contribute to much national welfare. It diverts resources from productive uses and greatly helps in smuggling and encourages wasteful consumption expenditure (Ibid).

As discussed in Franzoni (1996-2000), tax evasion is in principle punishable, although in many cases it is almost impossible for the eventual public authority to verify what has been observed. Tax minimization is frequently the direct result of the use of tax incentives. It is then hard to say if the use of incentives can be substantiated in full compliance with the principles of tax law. The

economic analysis of law suggests that tax evasion should be examined from the viewpoint of how much economic decisions are efficient. In this context, tax evasion is harmful to the national economy because it ensures regression in taxation, as the poor have less chance to dodge tax.

Owing to evasion, the burden is heavier on the salaried class and honest taxpayers who feel frustrated as they have to pay more taxes because their fellow men in other professions are evading taxes. Thus, in the case of higher income group people, honesty becomes the first casualty and discourages work-effort or encourages evasion. Black money also destabilizes monetary policy. The social consequences of evasion are disastrous (Jain, 1987).

Black money has created in society two clear-cut groups: (i) the Haves, and (ii) the Have-nots. While the Haves are becoming richer day by day, the Have-nots are becoming poorer. This has created social unrest. Black money has encouraged the payment of huge dowries and extravagant expenditures at the time of marriage. The effect is badly felt by middle-income group people who, many a time, do not find suitable matches for their daughters as they cannot afford to pay good dowries (Jain, 1987).

2.1.14 Solutions for Reducing Tax Evasion

The problem of tax evasion has become the subject of parliamentary debates and newspaper articles (Al-Rai, 2006). Initially, the government reacted to the problem through arbitrary assessment methods (Kettaneh, 1998). This, however, only made the problem worse and led to a breakdown in the relationship between the public and the Income Tax Department.

This section of the paper suggests several methods to reduce the problem of tax evasion. These methods involve the following techniques;

Procedures to amend the Tax Law: The Government should adopt stricter procedures for the amendment of Income Tax Law. Presumably, these procedures will prevent the frequent changes which have needlessly complicated the current income tax regime.

New tax system: The Government should put into place a new tax system. Among the new tax system's features are broad tax base and lower rates which could create a more stable economic environment. The law should impose a universal bookkeeping requirement instead of mandating account books in certain professions only such as traders. Other steps that could prove effective in preventing tax evasion include comprehensive withholding requirements for property and business income. The payment of tax owed on this type of income will not be the responsibility

of individual taxpayers. Rather, the amount of tax due will be calculated by the enterprise in which the taxpayer worked and that amount will be withheld from the taxpayer's wages.

The taxpayer regards a tax on consumption as the loss of a mere prospect, for the taxpayer pays no tax until the moment he makes a consumption choice. Taxes on income, however, are perceived as a loss of a vested right rather than the loss of a mere prospect (Feldman, 2002).

Taxpayers would probably perceive a broad-based consumption tax as more equitable than the current income-tax system. However, there are a host of factors policymakers must consider as they debate the merits of replacing the current income-tax system with a consumption tax. These factors include the type of consumption tax adopted, transition from the current system to the new system, how high the new tax rate should be in order to achieve revenue neutrality, and types of special goods or services to be exempted from the consumption tax (Zorow&McLure,1991). Further, adopting a consumption tax could involve additional administrative expenses.

Civil and criminal penalties: One method of tackling tax evasion is through penalties. Over the years, judges tended to adopt a passive approach toward tax evaders by imposing light sentences. Rarely jail sentences were imposed. The reason for this state of affair could be the fact that tax evasion is widespread. Now, judges should be more willing to impose jail sentences on tax evaders. Civil and criminal penalties should be increased and tax evasion should be upgraded from a misdemeanor to a felony (Al Shawabkeh, 2003). However, adoption of stringent penalties may have adverse effects by increasing tax non-compliance (Borck, 2004). Therefore, the government should strike the right balance regarding the correct type and size of remedies.

Tax compliance culture: The government should create tax compliance culture through education by creating for example pamphlets to familiarize school students with the notion of taxation and instill compliance. Moreover, the government can use newspapers, TV advertisements, and public meetings with taxpayers. The purpose of these activities is to develop among the general public a better understanding of the role of the income tax system and of the relationship between proper taxpaying and good citizenship.

Reforming the tax administration: Computerization plays an important role to improve service. Computers have replaced the previous filing cabinets in the Income Tax Department (Al-Zo'bi, 2006). Specific attention was also paid to redesigning the tax offices. In the past, income tax offices looked like shops rather than government offices. Tax officers sat together in

a large open space with many conversations going on simultaneously and the general noise level was high. Now, tax offices have been redesigned whereby there is an information clerk near the entrance, seats are provided for waiting taxpayers, and signs are available. However, reforming the tax administration goes beyond new lighting, decoration, and furniture. There must be continuous training for tax officers on how to provide rapid and courteous service.

Tax data collection and selectivity: The Tax Department should adopt scientific procedures in collecting data and selecting taxpayers for further audit. For example, tax assessors should audit prominent high-profile taxpayers rather than relatively small taxpayers who are not providing much revenue. This type of auditing could create a positive impact on the compliance attitudes and practices of taxpayers' in general. The Income Tax Department could set up a fraud hotline to report people who seemed to evade their tax obligations. Additionally, tax assessors should communicate more with taxpayers through letters or phones. This type of communication could help minimize the habit of Jordanian taxpayers who just drop in the tax offices without an appointment.

Public opinion of government: The negative perception of the government is not a phenomenon that can be easily changed. However, provisions against favoritism, improving enforcement, and further public participation in the tax assessment process would help restore taxpayers' faith in their government. The Income Tax Department, with the assistance of the Department of Statistics, could conduct public opinion surveys to measure taxpayers' attitudes. Public opinion of government could change as a result of a future rise in the real income per person.

Where tax evasion opportunities persist, HMRC aims to identify them as early as possible so that an effective response can quickly be put in place (HM RC, 2011). Current activities to enhance HMRC's detection capability are:

- improving the rules on disclosure of tax evasion schemes;
- bringing in the bank levy and Inheritance Tax on transfers into trusts;
- working with scheme promoters on a smooth introduction of the new requirement to provide lists of clients who have taken up evasion schemes
- improving coverage by developing new hallmarks
- monitoring compliance with the disclosure rules and challenging failure to comply, using litigation where necessary;

- monitoring and evaluating other sources of information, including using the relationship with large business and the wealthy to obtain an early insight into proposed transactions

The problem of tax evasion is very likely to increase as more and more people are becoming self-employed. This trend is fuelled by the closure of many small businesses who have succumbed to stiff competition as result of a liberalized trade regime. We see this trend continuing at least for the short term (Riedel, 2009).

We can perhaps look at some of the important factors that may lead to the creation and flourishing of the informal sector within national economies.

- a) The active encouragement by Governments of wayside vending and the reluctance on the part of Government to prosecute those unlicensed vendors.
- b) The non-registration of many activities carried on by self-employed persons.
- c) The culture of the society in which there is a tendency to avoid paying VAT and other taxes.
- d) The absence of employment opportunities and the lack of skills.
- e) The inability of Governments to create effective mechanisms that would draw persons in that sector into the tax net.
- f) Ever mindful that this sector has the potential to significantly increase the tax yield, this administration has undertaken the following recent initiatives to deal with the problem.
 - 1) Educating the public about their responsibilities to file and pay their income taxes.
 - 2) Our registration system has been upgraded to better identify and control delinquent taxpayers. Also with each upgrade of our computer system better methods are included to widen the net of known taxpayers.
 - 3) Strengthening of audit procedures which include an emphasis on third party information. As well as strengthening our relationship with Government Agencies that could provide similar information.

There is no doubt that institutionalized and effective exchange of information can play an important role in dealing with the problem of tax evasion. This may be facilitated with the increasing use of information technology and the creation of effective channels of communication internally between revenue collecting agencies and externally between countries. Exchange of information play an important role in assisting the country to increase revenue and at the same time helps to reduce audit cost. Without this information, there would be increase in

tax evasion because auditing and investigations would be that more lengthy and more difficult (AlmJ. , 2012).

Information technology can play a vital role in the fight against tax evasion in the following ways;

- 1) It provides the means whereby the identity of the taxpayer can be with accuracy which is critical and important.
- 2) It facilitates the retention, quick retrieval and updating of information garnered from past auditing and investigating of the taxpayer.
- 3) It allows for testing and analyses to be carried out on stored data that would allow investigators to arrive at a satisfactory conclusion;
- 4) Overall it reduces cost and saves on time. Without the use of information technology, it would indeed be more difficult to store information and to carry out analysis work on the information. Information technology therefore is a potent tool in the fight against tax evasion (Ibid).

2.1.15 Tax Administration Efficiency

According to Rahman (2009), tax administration efficiency is a primary determinant of effective revenue generation, implementation of tax policy and conducive environment for investment. Earlier, Erard (1994) argued that the main objective of any tax authority is to collect tax revenue for the government according to the established tax laws and enforce government tax policies that can increase tax compliance and restore taxpayers' confidence in the tax system as well as tax administration. This is a good quality of tax administration, include efficient in the process and ensure high compliance rate in implementing and administering the tax system and tax policies. Inefficient tax administration would not provide quality services to the taxpayers, and hence, there will be a high cost of running the system and problems for voluntary tax compliance. The OECD (2011) states that efficient tax administration would enhance tax compliance, reduce operational and compliance costs, and above all, increase revenue generation. In addition, they further opined that internal structure and design of tax administration would also determine the efficiency of the process together with resource allocation, motivation and autonomy of the tax authority. According to Alm and Duncan (2014), the efficiency of tax collection and tax administration is high in many OECD countries and low

in non-OECD nations because of variations in the tax system and tax policies that are designed to monitor the revenue authorities and increase tax revenue collection.

Several factors have been identified as the causes of tax administration inefficiency in developing countries. Ogbonna (2011) argued that lack of trained officials, lack of autonomy, poor record-keeping, lack of accountability and transparency, corruption and poor service quality are some of the factors that cause tax administration inefficiency in a country's tax system. Normally, tax administrations are faced with different issues related to tax collection due to some predominant characteristics in the economy and taxpayers' attitude toward taxation. Often, the tax administration's incapability results in inefficiency and ineffectiveness.

Gurama and Mansor (2015) stated that any modern and efficient tax administration needs to review its tax policies and tax administration style by incorporating new strategies and efficient tax processes through motivation, accountability and transparency of all of the administrative processes.

Joon and Kim (2011) added that the function of the tax administration could be enhanced by establishing effective tax policies, tax laws, autonomous administration, staff and taxpayer's motivation and strong commitment by the government.

A study sponsored by the United Nations (2000) on improving tax administration performance in African Sub-Saharan countries shows that to achieve tax administration efficiency; there is a need to have clear administrative strategies, accountability, transparency in decision-making, motivated tax officials and incentives for taxpayers. In addition, an adequate time framework and competent human resources that can handle the improvement process and deliver positive outcomes, are also vital. This discussion and identification from the UN and other studies highlighted above, clearly show the importance of an efficient tax administration and how efficiency is determined using the same factors.

Baurer (2005) studied tax administration in developing countries and concluded that external oversight and duty segregation, good internal control, robust code of conduct, transparency and accountability, are some of the strong factors that determine efficient tax administration in many emerging economies. Also, Shagari (2014) argued that autonomy of tax administration, motivation, transparency, trained personnel and ICT are strong determinants of tax administration efficiency. Furthermore, Muaen (2016) added that leadership style, motivation, ICT, autonomy and training are the determinants of tax administration efficiency in Libya.

Therefore, strong tax administration is characterized by the efficiency of processes and effectiveness of tax administration in coordinating all the resources under its disposal to earn a meaningful and fruitful outcome (Schlotterbeck, 2017).

The State Revenue Service (SRS) also contended that adequate regulatory framework, open and fair communication across all organizational levels, training of personnel and optimal allocation of resources, can enhance tax administration efficiency (Shagari, 2014). Therefore, to attain efficiency, the tax administration must have trained personnel, utilize its resources professionally and follow the tax laws, rules and regulations.

Ogbonna (2011) concluded that lack of tax administration efficiency in Nigeria is due to tax officials' and taxpayers' poor motivation, lack of transparency and accountability, weak fiscal autonomy, the complexity of tax laws and other related tax policies. Also, Olatunji et al. (2009) showed that the dishonesty of tax administration staff negatively affects tax administration efficiency. Hassan (2012) added that the lack of adequate staff, motivation and incentives and infrastructure could affect the tax administration's efficiency.

2.1.16 Theories Related to Tax Administration Efficiency

2.1.16.1 Goal-Setting Theory

Locke and Latham (1990), started studying the goal-setting theory in, the mid-1960s and continued to research on it for more than 30 years. Locke derived the idea of setting goals from Aristotle's form of ultimate causality. Aristotle speculated that purpose could cause work. Thus, Locke began to research the objectives which influence human activity.

Locke developed and refined his theory of goal-setting in the 1960s, and published his first paper on, "The Theory of Motivation" in 1968. In addition, Locke and Latham (1990), the goal-setting theory states that many conditions are particularly important for achieving a successful goal. These objectives include accepting and adhering to goals, the characteristics of goals, the difficulty of objectives and the reactions (O'Neil & Drillings, 1994). Locke and Latham (1990), studied the effects of goal-setting in the workplace. The results support Locke's findings that there is an inextricable link between goal-setting and workplace performance. In 1990, Locke and Latham published their core work, Theory of Setting Goals and Performing Tasks, while identifying five other characteristics of goal-setting success (clarity, challenge, commitment, feedback and complexity of tasks).

This concept was employed by (DeWalt) et al. (2009), where he found a direct relationship between those who achieved motivation and the set goals to generate additional goals or create additional challenging features to the present goals based on feedback. Also, another vital concept that the goal-setting theory lays much emphasis on is autonomy. Autonomy allows the tax administrators to act independently of any external influences that can jeopardize their activities.

The underlying assumption is that autonomy leads to a high degree of efficiency. Parker et al. (2009) observed that autonomy in the workplace enhances self-efficacy, which in turn, improves performance towards achieving the set goals of an organization. Based on the assertions mentioned above, the general vision and structure of the goal-setting theory are to motivate individuals and teams to do more and perform better.

2.1.16.2 Governance Theory

According to Stoker (2007), the emergence of governance theory from the early 1990s onwards has been one of the core developments in public administration. The governance theory starts by recognizing that public administrations stretch beyond multiple government institutions to those drawn from the community, voluntary and private sectors. Rakner and Gloppen (2003) looked at governance as the decision-making process and the process through which decisions are implemented. For tax administration to achieve efficiency and effectiveness or to implement the decisions appropriately, good governance plays a vital role.

The study of Stoker (1998), states that tax administration is considered as a formal government structure by which decisions are arrived at and implemented; therefore, in the absence of good governance mechanisms, tax administration decision-making may lead to corrupt practices. There are eight major characteristics of good governance: consensus-oriented, participatory, transparency, accountability, equitable and inclusive, responsible, effective and efficient and follow the rule of law (Aguilera & Cuervo-Cazurra, 2004; Stoker, 1998).

2.2 Empirical Literature review

The variety of tax evasion is truly remarkable, and taxpayers are always finding new ways to purposely reduce their tax burden. Many authors have reviewed these matters, including Sisson (1981) and Richupan (1987), and more recently Cowell (1990) and Webley and others (1991).

Notably, empirical findings are often confidential in nature, as they result from IMF technical assistance to a country or the work of a ministry of finance.

As implied in Slemrod and Yitzaki, (2002), it cannot adequately review here what is known about the extent and nature of tax evasion for all taxes in all countries at all times. Rather, in what follows we offer a few salient facts about the recent U.S. income tax, mostly gleaned from the TCMP data just discussed.

(1) With audit coverage hovering at about 1% and an extensive information reporting and matching program, evasion is estimated to be 17% of true tax liability.

(2) The extent of evasion varies widely across types of gross income and deductions; for example, the 1988 TCMP reports that the voluntary reporting percentage was 99.5% for wages and salaries, but only 41.4% for self-employment income. These percentages clearly correlate positively with the likelihood of income understatement being detected.

(3) Evasion (as measured by underreported income, not tax liability), rises with income but at a less than proportionate rate. Christian (1994) reports that in 1988, taxpayers with (auditor adjusted) incomes over \$100,000 on average reported 96.6 percent of their true incomes to the IRS, compared to just 85.9 percent for those with incomes under \$25,000.

(4) Within any group defined by income, age, or other demographic category, there are some who evade, some who do not, and even some who overstate tax liability. For example, of middle income (auditor-adjusted income between \$50,000 and \$100,000) taxpayers in 1988, 60% understated tax, 26% reported correctly, and 14% overstated tax (Christian, 1994).

According to Riedel (2009), as existing tax gap estimates for developing countries focus on macro indicator approaches, a possible starting point to improve the information on tax gaps in the developing world would be to use macro methods based on the identification of discrepancies in national accounting data. But in the long run, an appropriate quantification of the tax gap in the developing countries requires research based on micro approaches, in particular methods which rely on tax audit information collected by the national tax authorities. Firstly, this would deliver relatively reliable tax gap estimates. Secondly, it would allow calculating individual components of the tax gap according to tax payer groups (e.g. corporations versus individuals, different income classes and sectors of activities) and the type of income which is evaded (e.g. income earned from international and national transactions). The latter provides important and valuable guidance for reforms of the tax administration and the tax system in a developing country.

Most of the international tax reduction of individuals reflects evasion, and this amount has been estimated at \$40-70 billion a year.

As stated in (Gravelle, 2009), major countries, such as the United States (including three states, Delaware, Nevada, and Wyoming), the United Kingdom, the Netherlands, Denmark Hungary, Iceland, Israel, Portugal, and Canada have been charged with having tax haven characteristics. A number of smaller countries or areas in countries, such as Campione d'Italia, an Italian town located within Switzerland, have also been characterized as tax havens.

After detail investigation is made by Cobham (2005) the estimation of overall tax revenue losses due to tax evasion developing countries and showed that tax revenue losses due to corporate profit shifting out of developing countries is 50 billion US-Dollars per year.

Altshuler and Grubert (2006) and van Dijk, Wyzig, and Murphy (2007) describe the Netherlands as a corporate tax haven, as it allows firms to reduce taxes on dividends and capital gains from subsidiaries and has many treaties that reduce taxes. O'Brien (2006) reports that Bono and the U2 band moved their music publishing company from Ireland to the Netherlands after Ireland changed its tax treatment of music royalties.

(Haile, 2011) assessed Tax Evasion and Avoidance in Mobilizing Tax Revenue by using descriptive way of research. The result shows that the government is losing a significant amount of revenue due to tax evasion. Only from taxpayers who are audited and assessed there are a huge amount of money (birr 87,359,749) that had not collected yet. The existence of other unaudited taxpayers and informal sectors, who have not audited yet, makes the government a loser in generating more revenue in the tax center. In addition to the revenue losses, the existence of tax evaders in trade markets are also making the legal taxpayers a loser and creating a negative impact on legal taxpayers to change their behavior from compliance to noncompliance and the study recommend the necessary measures for creating compliance include: creating optimal legitimates and enforcement practices to deter the effect of tax evasion; educating, following and handling taxpayers; and identifying, investigating and prosecuting of tax evaders.

2.3 Conclusion

The empirical analysis of tax evasion obviously requires some measure of compliance. As emphasized earlier, such measures are difficult to find and subject to much criticism. However, these limitations have not prevented researchers from attempting to estimate the determinants of evasion, whatever the source of data. This literature is large and growing, and I can only

highlight some important studies. For example, most empirical evidence has found that a higher tax rate generally leads to less compliance, with an estimated underreported income-tax rate elasticity of 0.5 to 3.0 (Clotfelter, 1983); Crane and Nourzad, 1992). Various empirical studies also have found a significant, though diminishing, deterrent effect of higher audit rates, with an estimated reported income audit rate elasticity ranging from 0.1 to 0.2; that is, an increase in audit rates of 10 percent increases reported income by 1 to 2 percent (Witte and Woodbury, 1985; Dubin et al, 1990). However, the increase in compliance appears to be nonlinear, which suggests that there are limits to how much government can increase compliance by increasing the probability of detection. Audits also seem to have a “spillover effect”, or an increase in compliance independent of revenues generated directly from the audits and penalties themselves (Dubin,2007). There is substantial evidence that a tax amnesty generates relatively small amounts of additional tax revenues, and seems to have relatively small effects on post-amnesty compliance (Fisher et al, 1989). Similarly, there is strong evidence that audit rates are endogenous, that there are revenue gains from strategic audit selection, and that information sharing across governments could increase compliance (Feinstein, 1991; Alm et al, 1993; Johannesen, 2010).

It should be emphasized, again, that this empirical work needs to be treated cautiously.

The main difficulty in all empirical work here is the absence of reliable information on individual reporting behavior. This information is hard to come by for any country. Also, the information that is available seldom allows the identification of the independent effects of, say, audit rates or fine rates on compliance, given the inevitable commingling of cause-and-effect.

These difficulties have not stopped researchers. However, there are obvious problems with the data and with the identification strategy that make much of this empirical work somewhat suspect.

(Torgler, 2007) and (Alm J. &, 2007) also reported that many other factors have been investigated, such as audit “productivity”, withholding systems, audit selection methods, complexity and uncertainty, taxpayer services, social institutions, collective decision rules, notions of “fairness” and “inequity”, and tax amnesties.

Based on these gaps in the literature together with the problems stated in section 1.2 the following grand research question is established. **How much is the level of Business Income Tax Evasion in category A Taxpayers?** Thus this thesis was conducted with a title “An

Assessment of Business Income Tax Evasion in category A Taxpayers in Ministry of Revenues large taxpayers branch office focusing on variables including the perception of income tax payers towards the tax system, tax payers reporting trend, the degree of tax evasion and the effectiveness and efficiency the tax revenue office (the tax audit section in particular) to control tax evasion.

CHAPTER THREE

RESEARCH DESIGN & METHODOLOGY

This chapter discussed about research design and specific research methods that was applied for the study along with proper justification for the selection of appropriate research methods.

3.1 Research design

The study was designed as a descriptive research that was used primarily to discuss and interpret data gathered from Primary and secondary data with qualitative and quantitative data analysis approaches.

3.2 Data sources, types and methods of collection

Primary and secondary data related to the taxpayer's perception towards the tax system, the reporting trend of taxpayer's income and tax liability, the level of tax evasion, efficiency of tax administration in Ministry of Revenues Large Taxpayers Branch Office and possible controlling mechanism of tax evasion were collected from Ministry of Revenues Large Taxpayers Branch office.

In this study, both qualitative and quantitative data were used. The data were obtained from primary and secondary sources. The reason of using qualitative and quantitative data types gathered from primary and secondary data sources is to increase validity and reliability of the research result.

The basic tools/instruments during primary data collection system was Survey Questionnaires and semi-structured interviews. The survey questionnaire was used to gather information about opinions and attitudes on the perception of tax payers towards the tax system, the reporting trend of taxpayers income and tax liability, the level of tax evasion, efficiency of tax administration and possible controlling mechanism of tax evasion of the tax officials working in Ministry of Revenues Large taxpayers branch office. The interviews were used as capturing the perspectives of the manager, officials and taxpayers of the revenue office about the above issues. The questionnaires were prepared with open-ended and closed-ended questions for the collection of qualitative and quantitative data from the respondents. The open-ended questions assumed to make the respondents free to reveal existing problems and their possible causes, whereas the closed-ended questions were supposed to be used for the purpose of making respondents to express their level of agreement on the variables and existence of tax evasion. The secondary data sources of data such as financial report finding of tax payers /before and after audit/, tax

audit coverage and human resource department annual report were used for the study to assess the level of tax evasion and the efficiency and effectiveness of the branch office.

3.3 Sample Design

While developing a sampling design for this study, the researcher gave attention to the following point: The populations or universe, sample frame, sampling technique and sample size.

3.3.1 Study Area and Target Population

The study was conducted in ministry of revenues large taxpayers branch office. The target population of this study was 119 employees of Ministry of Revenues large taxpayers branch office.

3.3.2 Sampling Frame

The researcher collected financial reports prepared before tax audit and after the audit from the tax office, identified tax officials that are working related with tax audit, fraud investigation and risk and compliance analysts who have knowledge about the tax payers' activities and their jobs are directly related to taxpayers' evasion. They have independent information about the issue in tax payers found in Ministry of Revenues large taxpayers branch office.

3.3.3 Sampling Technique and Sample Size

In addition to time, money and data constraints that had played an important role in selecting of the sample size, it is very important to determine a sample size by considering the practical situation. On the one hand selecting the sample size of the category A tax payers and employee of the tax office, the most important section for this study were tax audit process, tax fraud investigation process and risk and compliance strategy process. Therefore, to determine the sample size the researcher used the Slovene's formula as follows:

$n = \frac{N}{1 + N(e)^2}$, Where "n" is sample size, "N" is number of population, "E" is 0.05 which is an allowance of random error (sampling error). $n = \frac{119}{1 + 119(0.05)^2}$. $n=92$

The sample size as indicated as is 92. Therefore, the number of respondents were distributed in proportion to the working process as shown by table 3.1 and selected randomly from each class of work.

Table 3.1: Sample Size Selection

Working Processes/sections	Population No.	Sample selected	In %
Tax audit process	87	68	78
Tax fraud investigation process	24	18	75
risk and compliance strategy process	8	6	75
Total	119	92	76 %

Source: Ministry of revenues large taxpayers branch office HRM Dep't June, 2011 E.C report

Moreover, from the total number of category A taxpayers 15 out of 785 tax payers were selected randomly for interview. Since the branch office knows about the taxpayer and representative information was collected from the branch office tax administration officials, interviewing only 15 taxpayer is sufficient along with the data collected from the branch office tax administration officials and secondary data.

3.4 Methods of Data Analysis and Interpretation

In order to make it manageable, first the data were classified on the basis of their similar characteristics, editing, coding and tabulation process were done prior to analysis of the raw data. Then, MS excel software were used for data entry, checking, validation and data analysis.

The data collected through survey questionnaires, semi-structured interviews on tax payers' declaration and income report, tax liability report, the situation of tax evasion and possible controlling mechanisms as well as secondary data that were gathered on the above criteria through reading different literatures, manuals, proclamations and regulations, and reports had been analyzed quantitatively and qualitatively.

The quantitative data were analyzed through descriptive statistics such as percentages, graphs and tabular representations. Whereas the qualitative data were analyzed by reading, understanding and interpreting the raw data gathered from the respondents in to word.

CHAPTER FOUR

DATA ANALYSIS, DISCUSSION AND PRESENTATION

4.1 Introduction

This part of the research discusses about the findings based on the information gathered from the questionnaires, secondary data and interviewees by the researcher. The primary objective of this paper is to assess the presence and the level of Tax Evasion in Ministry of Revenues Large Taxpayers Branch Office and to analyze the controlling mechanisms of tax evasion.

Considering the above general objective, the questionnaires and interviews have been designed to assess the perception of income tax payers towards the tax system, to measure income declaration and reporting trend of taxpayers, to assess the trend of tax payers' tax liability report, to examine the presence and the level of tax evasion and to assess possible mechanisms of controlling tax evasion.

4.2 Response rate

In order to undertake this study, a total of 92 questionnaires were distributed to Ministry of Revenues Large Taxpayers Branch Office Tax administration officials and among the total questionnaires 81 (88%) were completed and returned. Moreover, all the fifteen semi-structured interviews were conducted with the category A tax payers of Ministry of Revenues Large Taxpayers Branch Office. Both the survey questionnaires and the interviews are attached at the end of the thesis as Appendices. Therefore, the collected data is representative of the sample and can be used to make conclusions. Based on the data obtained from the respondents, the following analyses and interpretations have been made.

4.3 Description of the Respondents

This section provides a general background about the respondents who participated in answering the questionnaires of the study. During data collection the basic characteristics like level of educational, work experience and Working Processes/sections in which they work were collected.

4.3.1 Description of the Respondents based on level of education

The description of respondents according to their level of education is analyzed by the following figure.

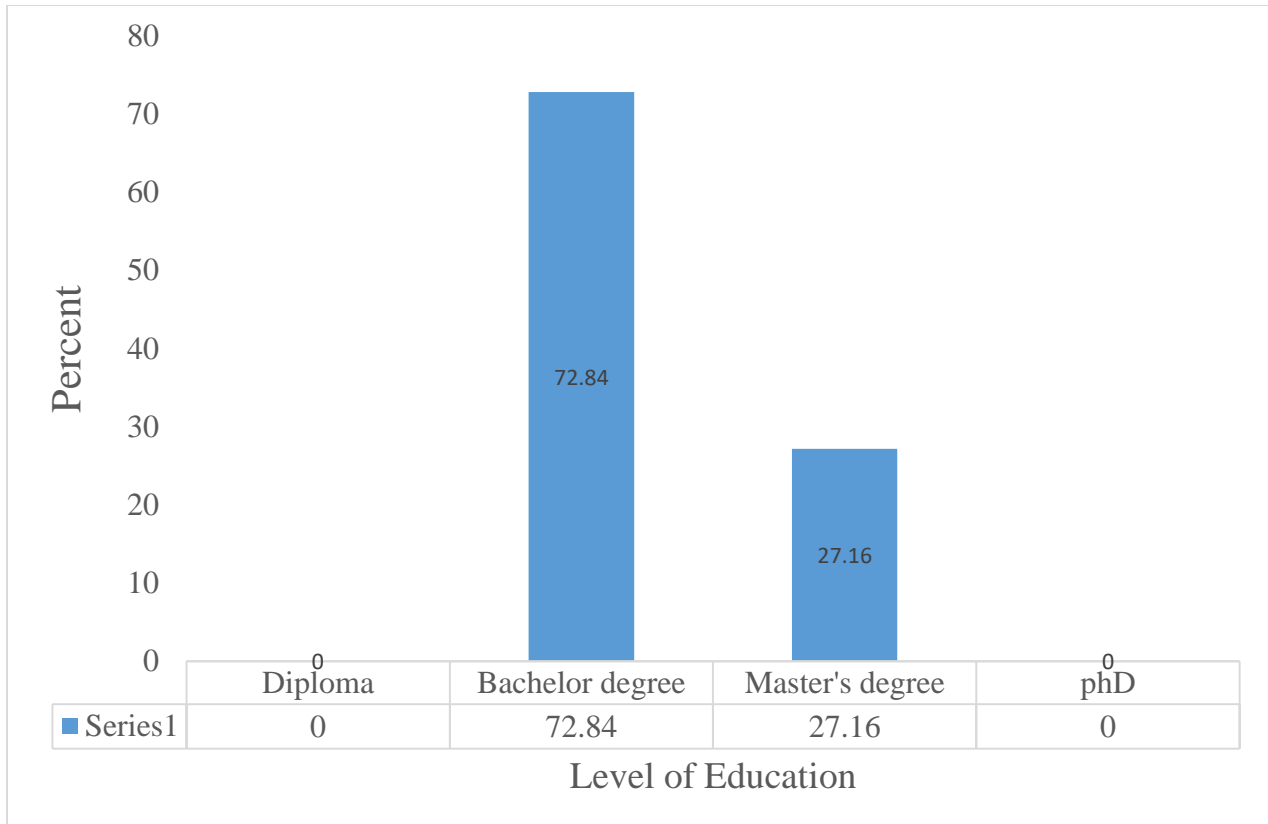


Figure 4.1 Respondents level of education

Source: own survey result, 2019

Figure 4.1 indicated that the respondents are bachelor degree and master’s degree holders, among which majority of the respondents 72.84% are Bachelor degree and the remaining 27.16% are master’s degree.

4.3.2 Distribution of respondents based on their working experience

As depicted by figure 4.2 more than half of the total respondents (61.73%) have more than 4 years of working experience (51.85% >4-10 and 9.88% more than 10 years’ experience) which is followed by those having 1-4 years of experience (35.8%). However, the remaining respondents have less than a year of experience (2.47%).

The description of respondents according to their work experience is analyzed by the following figure.

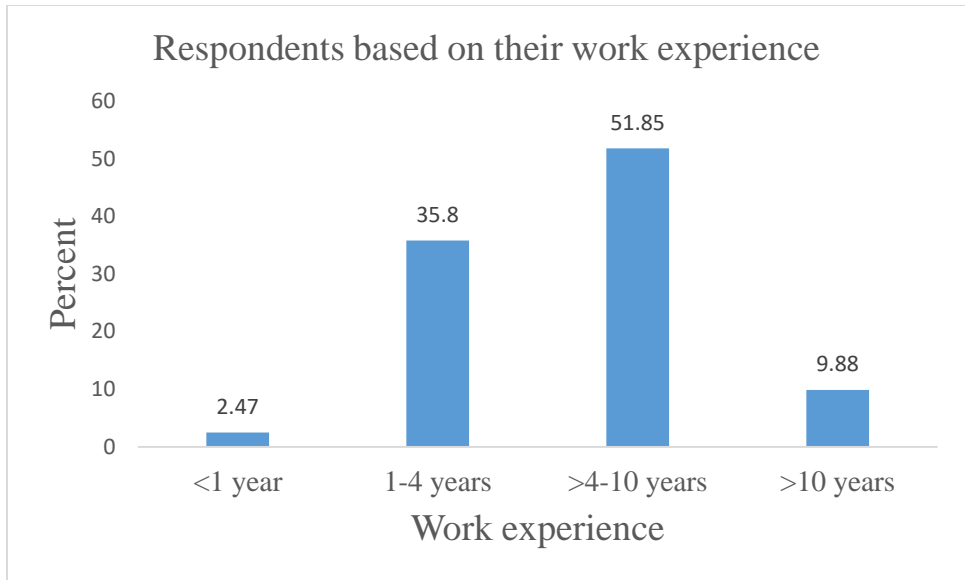


Figure 4.2 Respondents level of Experience

Source: own survey result, 2019

4.3.3 Description of Respondents based on working process

The description of respondents according to their current working process/section is analyzed by the following figure

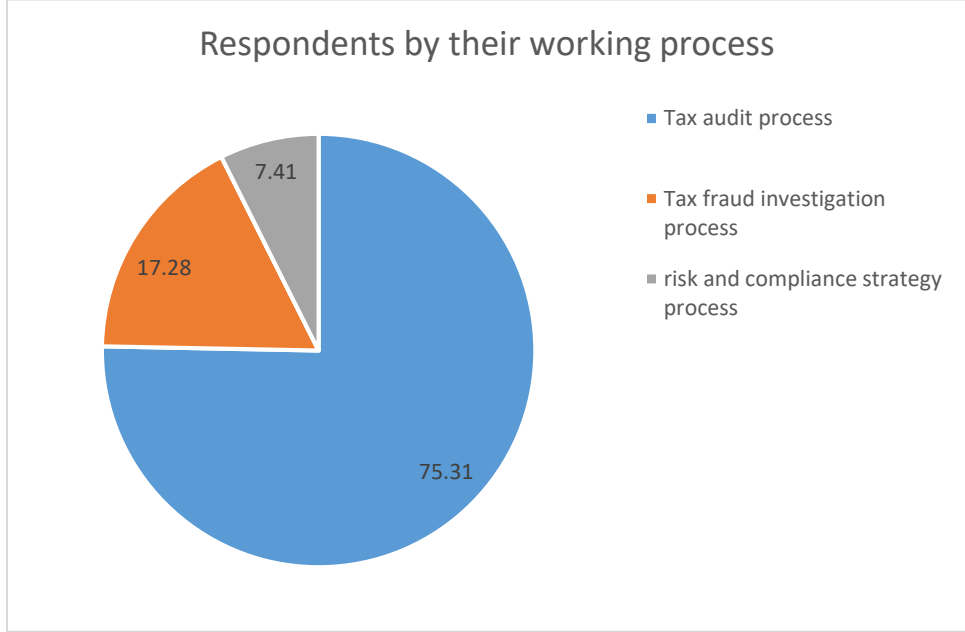


Figure 4.3 Respondents current working process/ section

Source: own survey result, 2019

Regarding to the working process of the respondent, figure 4.3 showed that majority of respondents (75.31%) are tax audit process officials followed by Tax fraud investigation process

officials (17.28), while the remaining 7.41% respondents are risk and compliance strategy process officials.

Procter (2000) stated that demographic data are needed to obtain basic information about the respondents. For this study the demographic information is concerned about level of education, working process and work experience. According to the survey result, respondents in the organization are Bachelor degree and master's degree graduates. This indicates the respondents are well educated. In addition, most of them have more than 4 years' experiences. Having experienced officials helps the organization have quality audit and investigation result. Since every jobs are required certain professional skills, knowing the educational status of the respondents are important thing to decide whether the appropriate persons are employed in the organization or not. Likewise, the persons who have work experience performed the tasks given for him/her than the person who have not as such much experience. Moreover, knowing the working process of the organization help to get the appropriate respondents, who have more awareness about the issues raised in the study. Generally, even though knowing the work experience, working process and educational status is not explicitly expressed in the objective of the study, knowledge about this information are important to decide how well the respondents are representative for the result of the study.

In general, the result implies that most of the Ministry of Revenues large taxpayers branch office administration tax officials are well educated and experienced.

4.4 Assessment of Business Income Tax evasion

4.4.1 Taxpayers perception of taxpayers towards the tax system

To assess taxpayers' perception towards the tax systems, five indicator questions were forwarded to respondents and the findings has been discussed as follows.

As indicated in table 4.1 out of the total respondents 3.7% and 37.04% were strongly agree and agree respectively as the present tax system benefits the rich and is unfair to the ordinary working people. Comparative with this out of the total respondents 34.57% and 7.41% disagree and strongly disagree with this issue, while the remaining 17.28% of respondents are neutral.

Table 4.1 **Descriptive statistics on perception of taxpayers towards the tax system**

Roll No.	Statement and its indicators	Strongly agree (5)		Agree (4)		Neutral (3)		Disagree (2)		Strongly disagree(1)	
		No	%	No	%	No	%	No	%	No	%
1. Perception of taxpayers towards the tax system											
1.1	The present tax system benefits the rich and is unfair to the ordinary working people.	3	3.70	30	37.04	14	17.28	28	34.57	6	7.41
1.2	They pay less tax if they know that they would not be penalized.	7	8.64	42	51.85	9	11.11	19	23.46	4	4.94
1.3	They think that government wastes a lot of money collected from tax.	9	11.11	35	43.21	20	24.69	14	17.28	3	3.70
1.4	They feel that tax cheating is common nowadays.	11	13.58	39	48.15	13	16.05	16	19.75	2	2.47
1.5	They don't like paying tax.	9	11.11	43	53.09	15	18.52	11	13.58	3	3.70

Source: own survey result, 2019

As indicated in table 4.1 out of the total respondents 3.7% and 37.04% were strongly agree and agree respectively as the present tax system benefits the rich and is unfair to the ordinary working people. Comparative with this out of the total respondents 34.57% and 7.41% disagree and strongly disagree with this issue, while the remaining 17.28% of respondents are neutral.

Majority of the respondents, which is 60.49% (8.64% strongly agreed and 51.85% agreed) indicated that tax payers pay less tax if they know that they would not be penalized. Whereas 23.46% and 4.94% of the respondents were disagree and strongly disagree respectively with the issue, while the remaining 11.11% of the respondents were neutral.

Regarding the waste of money collected from tax by the government, table 4.1 showed that majority of the respondents (54.32%) agree (11.11% strongly agree and 43.21% agree) as the tax payers think that government wastes a lot of money collected from tax. Whereas 17.28% and 3.7% of the respondents were disagree and strongly disagree respectively with this issue, while the remaining 24.69% were neutral.

Table 4.1 also depicted that there is a feeling by tax payers that tax cheating is common nowadays as most of the respondents that is 13.58% strongly agree and 48.15% agree with this issue. Whereas 19.75% and 2.47% of the respondents were disagree and strongly disagree respectively, while the remaining 16.05% were neutral.

Table 4.1 also reveals that tax payers don't like paying tax as most of the respondents (11.11% and 53.09% strongly agree and agree respectively) reflect this. Whereas 13.58% and 3.7%

disagree and strongly disagree respectively with this issue, while 18.52% of the respondents were neutral.

Table 4.2 summary of perception of taxpayers towards the tax system with the mean of the indicators

Statement	Strongly agree (5)		Agree (4)		Neutral (3)		Disagree (2)		Strongly disagree(1)	
	No	%	No	%	No	%	No	%	No	%
Perception of taxpayers towards the tax system	7.8	9.63	37.8	46.67	14.2	17.53	17.6	21.73	3.6	4.44

Source: summary of table 4.1

Generally, the result revealed that more than half of the respondents (9.63% and 46.67% strongly agree and agree) assured that there is not good perception of tax payers towards the current tax system. This indicated that taxpayers pay less tax if they know that they would not be penalized, tax payers think that government wastes a lot of money collected from tax, tax payers feel that tax cheating is common nowadays and tax payers don't like paying tax. All these ideas indicate that the tax payers have negative perception towards the current tax system.

4.4.2 Tax payers' income reporting trend

In this regard data were collected from respondents and the results were showed and discussed as follows.

As revealed by table 4.3 majority of the respondents strongly agree and agree (23.46% and 76.9% respectively) that there is none declaration and under reporting of income. Whereas, 12.35% of the respondents were disagree with this issue, while 13.58% were neutral.

Regarding the reporting trend of business expenses, table 4.3 indicated that majority of the respondents 90.12% (23.46% strongly agreed and 66.67% agreed) implied that tax payers overstating business expenses and deduction and 4.94% disagree with this while the remaining 4.94% were neutral.

As table 4.3 showed among the total respondents, 13.58% strongly agree and 51.85% agree that tax payers are lying to tax auditors even when audited and 7.41% and 3.70% of the respondents disagree and strongly disagree respectively on the issue. While the remaining 23.46% were neutral with this.

Respondents' opinion regarding the morality of taxpayer's when reporting tax liability, table 4.3 depicted that 11.11% strongly agree and 30.86% agree as the society has the tendency of assuming minimizing tax liability is morally right. Whereas, 22.22% disagree while the remaining 35.80% of the respondents were neutral on the issue.

Table 4.3 also showed that majority of the respondents (53.09%) strongly agree and agree (7.41% and 45.68% respectively) that taxpayers Maintain multiple set of books of accounts. Whereas,9.88% disagree while the remaining 37.04% of the respondents were neutral on the issue.

Table 4.3 also revealed that 6.17% and 45.68% of respondents strongly agree and agree respectively as Most tax payers declare their liability dishonestly with underreporting. Whereas, 17.28% of the respondents disagree with the issue while the remaining 30.86% were neutral.

Table 4.3 Descriptive statistics on tax payers' income reporting trend

Roll No.	Statement and its indicators	Strongly agree (5)		Agree (4)		Neutral (3)		Disagree (2)		Strongly disagree(1)	
		No	%	No	%	No	%	No	%	No	%
2. Tax payers' income reporting trend											
2.1	Not declare (report) some income	5	6.17	55	67.90	11	13.58	10	12.35		
2.2	Overstating business expenses (deduction)	19	23.46	54	66.67	4	4.94	4	4.94		
2.3	Lying to tax auditors even when audited	11	13.58	42	51.85	19	23.46	6	7.41	3	3.70
2.4	The society has the tendency of assuming minimizing tax liability is morally right nowadays	9	11.11	25	30.86	29	35.80	18	22.22		
2.5	Maintenance of multiple set of books of accounts	6	7.41	37	45.68	30	37.04	8	9.88		
2.6	Most payment fillers declare their liability dishonestly with underreporting	5	6.17	37	45.68	25	30.86	14	17.28		

Source: own survey result, 2019

Table 4.4 summary of tax payers' income reporting trend with the mean of the indicators

Statement	Strongly agree (5)		Agree (4)		Neutral (3)		Disagree(2)		Strongly disagree(1)	
	No	%	No	%	No	%	No	%	No	%
Tax payers' income reporting trend	9.17	11.32	41.67	51.44	19.67	24.28	10	12.35	0.5	0.62

Source: summary of table 4.3

In generally, the result revealed that more than half of the respondents (11.32% and 51.44% strongly agree and agree respectively) assured that tax payers haven't a trend of reporting the exact tax due expected from them. In other word, the data collected from respondents based on questionnaire using different questions implied that tax payers not declare and reporting some income, lying to tax auditors even when audited, overstate business expense and deductions, maintain multiple set of books of accounts and didn't declare their tax liability honestly. These all are indicators of tax evasion practices.

4.4.3 Level of tax evasion

Regarding to level of tax evasion, data were collected from both primary and secondary sources and discussed in the following manner.

4.4.3.1 Primary data analysis on level of tax evasion

Table 4.5 Descriptive statistics on level of tax evasion

Roll No.	Statement and its indicators	Strongly agree (5)		Agree (4)		Neutral (3)		Disagree (2)		Strongly disagree(1)	
		No	%	No	%	No	%	No	%	No	%
3. Level of tax evasion											
3.1	Falsifying supporting documents	9	11.11	57	70.37	13	16.05	2	2.47		
3.2	Securing contracts under non-existent persons	4	4.94	41	50.62	29	35.80	6	7.41	1	1.23
4.3	Deduction of personal expense as business expense	8	9.88	54	66.67	8	9.88	9	11.11	2	2.47
4.4	Omission to report several income from irregular sources	4		62		11		4			

Source: own survey result, 2019

As table 4.5 revealed about the delivery of supporting documents, among the total of respondents 11.11% strongly agree and 70.37% agree with supporting documents are falsifying by tax payers and among the remaining respondents only 2.47% disagree with the issue while 16.05% neutral.

Regarding contract taken by tax payers, table 4.5 showed 4.49% of the respondents strongly agree and 50.62% agree that they are securing contract under doomy names/non-existing persons/. Among the remaining respondents, 7.41% disagree and 1.23% strongly disagree while 35.8% neutral with the issue.

Table 4.5 also depicted that most of the tax payers (9.88% strongly agree and 66.67% agree) deducted personal expenses as a business expense. Whereas, 2.47% strongly disagree and 11.11% disagree with this issue and the remaining 9.88% were neutral.

The table (table 4.5) also indicated that the majority of respondents (81.48%) replied that there is omission to report several incomes from sources by tax payers. Whereas, 4.94% of respondents disagree with this issue, while the remaining 13.58% respondents were neutral.

Table 4.6 summary of level of tax evasion with the mean of the indicators

Statement	Strongly agree (5)		Agree (4)		Neutral (3)		Disagree(2)		Strongly disagree(1)	
	No	%	No	%	No	%	No	%	No	%
Level of tax evasion	6.25	7.72	53.5	66.05	15.25	18.83	5.25	6.48	0.75	0.93

Source: summary of table 4.5

As table 4.6 revealed, 7.72% and 66.05% of respondents strongly agree and agree respectively as there is high level of tax evasion with different indicators in the Branch Office.

4.4.3.2 Analysis of secondary data on level of tax evasion

According to Biber (2010), tax audit results in increased tax revenue in two ways: (1) directly through assessment of additional taxes; and (2) indirectly by discouraging underreporting of liabilities by all taxpayers. Further, Barreca and Ramachandran (2004) noted that the purpose of tax audit is to check the evasion of tax and ensure compliance in accordance with the laws and regulations.

Table 4.7 summary of the amount of tax liability before and after audit

Year(E.C)	Income tax /in ETB/			Unpaid tax (tax evasion) in%
	Before audit	Audit finding	After audit	
2009	1,792,729,903.85	589,262,094.43	2,381,991,998.28	25%*
2010	5,393,616,558.83	5,286,549,406.54	10,680,165,965.37	49%
2011	48,840,065,068.79	20,320,607,626.23	69,160,672,695.02	29%
Total	56,026,411,531.47	26,196,419,127.20	82,222,830,658.67	32%
Average	18,675,470,510.49	8,732,139,709.07	27,407,610,219.56	32%

Source: Ministry of Revenues large taxpayers branch office annual report for the year 2009-2011 E.C

25%*=589,262,094.43/2,381,991.28

The assessment based on the report taken from Ministry of Revenues large taxpayers branch office represented that the amount of tax evaded by tax payers in each year is much more.

As shown by table 4.7, the total amount of tax that should be reported from the audited companies in the year 2009 were birr 2,381,991,998.28. A tax liability of birr 1,792,729,903.85 (75%) has been reported by those companies. Thus, 589,262,094.43(25%) was considered as tax evasion in that year.

Similarly, birr 5,286,549,406.54 (49%) and 20,320,607,626.23 (29%) tax have been found by the investigation of tax auditors that was not reported by the audited companies in year 2010, 2011 respectively. On average, about birr 8,732,139,709.07 (32%) have been evaded by tax payers per year.

In general, the result found from the analysis of both primary and secondary data have been approved that the level of tax evasion in Ministry of Revenues large taxpayers branch office is high. Table 4.7 also implied that there is no significant decreasing trend of the rate of tax evasion from year to year.

The summary of assessment result shows that revenue office is losing a total amount of birr 26,196,419,127.20 from the three years audited (i.e. birr 8,732,139,709.07 on average per year). This amount of tax liability is only on the registered taxpayers of the revenue office. The prevalence of informal sectors in Ethiopia estimates by (Schneider, 2007) suggest that in 2004-05, Ethiopia's shadow economy accounted for 42 percent of GDP. This indicates that the government is losing a significant amount of money from both formal and informal sector because of tax evasion.

Moreover, the interviews with taxpayers show the taxpayers technology based documents such as cash register papers are fictitious and the dominance of tax evasion has a great effect on the market structure. Particularly, the existence of tax evaders in trade areas are making the legal taxpayers out of market. Consequently, tax evasion is creating an effect of making the market unbalance.

4.4.4 Efficiency of the tax administration

In related to efficiency of tax administration data were collected from both primary and secondary sources and discussed in the following manner.

4.4.4.1 Primary Data Analysis

As presented on table 4.8, majority of the respondents 11.11% and 46.91% strongly disagree and disagree respectively with sufficient experienced and highly motivated personnel for tax assessment and tax collection. However, 16.05% and 2.47% of the respondents agree and

strongly agree respectively with this issue, while the remaining 23.46% of the respondents are neutral.

Regarding to sufficiency of audit experts, table 4.8 indicated that the number of auditor's experts is not enough to accommodate all registered taxpayers efficiently (as implied by the majority of respondents i.e. 60.49%). Whereas, 4.94% and 17.28% strongly agree and agree respectively with this issue while the remaining 17.28% were neutral.

Table 4.8 Descriptive statistics on efficiency of the tax administration

Roll No.	Statement and its indicators	Strongly agree (5)		Agree (4)		Neutral (3)		Disagree(2)		Strongly disagree(1)	
		No	%	No	%	No	%	No	%	No	%
4. Efficiency of the tax administration											
4.1	There are sufficient experienced and highly motivated personnel for tax assessment and tax collection.	2	2.47	13	16.05	19	23.46	38	46.91	9	11.11
4.2	The number of auditor's experts is enough to accommodate all registered taxpayers efficiently.	4	4.94	14	17.28	14	17.28	41	50.62	8	9.88
4.3	The tax administration perform a continuous assessment and training to improve the capability or competency of staff resources, auditors and investigators in particular	2	2.47	23	28.40	10	12.35	40	49.38	6	7.41
4.4	An availability of the database of all taxable individuals by the revenue authority provides to minimize an opportunity for people to evade tax.	4	4.94	22	27.16	11	13.58	35	43.21	9	11.11
4.5	The procedures for tax assessment and tax collection are easy.	4	4.94	13	16.05	14	17.28	46	56.79	4	4.94
4.6	There is an appropriate penalty when someone is caught cheating by small amount	6	7.41	13	16.05	19	23.46	41	50.62	2	2.47

Source: own survey result, 2019

Table 4.8 also indicated that the tax administration does not perform continuous assessment to improve the capability or competency of staff resources, auditors and investigators (as majority of the respondents 56.79% (49.38% disagree and 7.41% strongly disagree) disagree on this issue. Whereas, 32.1% opposed this idea while the remaining 12.35% were neutral.

In addition, an assessment was also made on the availability of the database of all taxable individuals by the revenue authority and the provision to minimize an opportunity for people to evade tax. The result, as stated in table 4.8, showed that majority of the respondents i.e. 54.32% (11.11% strongly disagree and 43.21% disagree) disagreed with the availability of database that can provide minimizing an opportunity for tax evasion. The remaining 4.49%, 27.16% and 13.58% strongly agree, agree and neutral with this idea respectively.

In respect to the procedures of tax assessment and collection, the result shows (table 4.8) that the procedures are not easy as replied by most of the respondents i.e. 61.73% (56.79% disagree and 4.94% strongly disagree with its easiness). Whereas, among the total respondents, 4.49% strongly agreed and 16.05% agreed while the remaining 17.28% were neutral with this.

An assessment was also made towards the appropriateness of penalty. The result as depicted on table 4.8 assured that there is no appropriate penalty when someone is caught cheating. It is supported by most of the respondents 53.09% (50.62% disagree and 2.47% strongly disagree). Among the total respondents, 7.41% strongly agreed and 16.05% agreed while the remaining 23.46% were neutral with this.

Table 4.9 summary of efficiency of the tax administration with the mean of the indicators

Statement	Strongly agree (5)		Agree (4)		Neutral (3)		Disagree(2)		Strongly disagree(1)	
	No	%	No	%	No	%	No	%	No	%
Efficiency of the tax administration	3.67	4.53	16.33	20.16	14.5	17.9	40.17	49.59	6.33	7.82

Source: summary of table 4.8

Generally, the result indicates that more than half of the respondents agreed as tax administration is inefficient.

4.4.4.2 Secondary Data Analysis

Tax auditor's percentage from the total staff

The international standards as to the total staff assigned to audit should be close to 40 percent of the total staff of the tax administrations (Biber, 2010). Further, audit capacities of field offices are determined by calculating the number of returns that can be audited. The calculation made using estimates of the number of returns each tax auditor can reasonably be expected to complete during a given audit period. However, as shown by table 4.10, in Ministry of Revenues large taxpayers branch office the reality regarding the percentage of audit department to total number of staff indicates only 22.77%.

Table 4.10: Percentage of tax audit section as per the total staff

Total number of staff in ministry of revenues large tax payers branch office	Total number of audit section employees	Percentage (audit section/total no of staff)
382	87	22.77

Source: Ministry of Revenues large taxpayers branch office HRM dep't annual report (2011 E.C)

In general, the revenue office does not have adequate tax auditors to conduct tax audit and to give appropriate services to tax payers. Some of the reasons (based on their reply from interview questions) are less emphasis is given for continuous upgrading the capability and knowledge of staff resources. There is also higher staff turnover in the tax authority, tax audit section in particular.

Tax audit coverage

The audit coverage result was assessed from the secondary data collected from Ministry of Revenues large taxpayers branch office as presented by table 4.11 as follows.

Table 4.11: Tax Audit coverage percentage

Year (E.C)	Number of cases(companies or individuals)selected to audit	Number of cases (companies or individuals) audited	Audited Percentage
2009	156	42	27%
2010	156	122	78%
2011	272	144	53%
Total	584	308	53%
Average	194.67	102.67	53%

Source: Ministry of Revenues large taxpayers branch office annual report for the year 2009-2011 E.C

As indicated by table 4.11, from the total of number 156 tax payers/ entities selected for audit only 42 (27%) were audited on the year 2009 E.C. Moreover, 78%, and 53% of the total auditable tax payers (entities) were auditing through the years 2010 and 2011 E.C. respectively. On average only 53% is the audit coverage of the revenue office.

The implication is that the overall tax audit coverage rate is low. In addition, although the audit coverage of year 2010 E.C is good compared with the year 2009 E.C, there is no consistent improvement towards audit coverage.

In general, there are factors that lead tax payer's tax evasion practices. Some of these are: the system of tax administration in the branch office is inefficient, the non-availability of the database of all taxable individuals by the revenue office provides an opportunity for people to evade tax, there is shortage of experienced and highly motivated personnel for tax assessment and tax collection, the procedures for tax assessment and tax collection are ambiguous and there is an inappropriate penalty when someone is caught cheating.

CHAPTER FIVE

CONCLUSIONS AND RECOMMENDATIONS

The previous chapter presented the findings and analysis of the study about the Assessment of Business Income Tax Evasion in category 'A' Taxpayers: the case of Ministry of Revenues large taxpayers branch office. This chapter provides the conclusions and recommendations in line with the findings of the study. The chapter is structured in two sections. The first section deals with conclusions whereas the second section presents some recommendations suggested as a solution to problems that have been identified in the study.

5.1 Conclusions

Based on the presentation, analysis and interpretation of data, this part of the study puts the general conclusions about the perception of taxpayers towards the tax system, income declaration (reporting) trend of taxpayers, the trend of tax payers' tax liability report, the level of tax evasion and the possible mechanisms of controlling tax evasion based on the results of the study.

Taxpayers perception towards the tax system is negative/bad, as they think that government wastes a lot of money collected from tax, taxpayers does tax evasion and tax cheating is common now a day and they don't like paying tax.

Taxpayers of the revenue office are engaging in different types of tax evasion which includes: overstate business expense and deductions, deduct personal expenses as business expenses, maintain multiple set of books of accounts, have the tendency of assuming minimizing tax liability is morally right, tax payers technology based documents Like Cash Registers papers are Fictitious and didn't declare their tax liability honestly. These all are indicators of tax evasion practices.

The government is losing a significant amount of revenue due to tax evasion. Only from taxpayers who are audited and assessed there are a huge amount of money (birr 8,732,139,709.07 on average per year) a government lost in tax evasion. The existence of other unaudited taxpayers, who have not audited yet, makes the government a loser in generating more revenue in the tax center. In addition to the revenue losses, the existence of tax evaders in trade markets are also making the legal taxpayers a loser and creating a negative impact on legal taxpayers to change their behavior from compliance to noncompliance.

Regarding audit staff, less emphasis is given for continuous upgrading the capability and knowledge of staff resources. The tax office fails to retain proficient and well-trained auditors. As a result, the tax office does not have adequate experienced tax auditors (only 22.77% of the total staff) to conduct tax audit and to give appropriate services to tax payers.

The system of tax administration in the revenue office is inefficient, the non-availability of integrated and coordinated database of all taxable individuals by the revenue office provides an opportunity for people to evade tax, there is shortage of experienced and highly motivated personnel for tax assessment and tax collection, the procedures for tax assessment and tax collection are ambiguous and there is an inappropriate penalty when someone is caught cheating. These are among the factors that lead tax payer's tax evasion practices.

Although not sufficient and satisfactory, some of the effective methods of creating compliance include: informing of taxpayers about the interpretation of paying taxes; informing the penalty of being noncompliant to the tax system; showing the follow up of the tax office rewarding those who give information about noncompliant, making sure that names of those who have been fined or jailed for tax evasion appear in newspaper, offer encouragement to those whose tax returns are accurate and sent in on time.

5.2 Recommendations

Based on the conclusions of this paper, the researcher recommends the following points:

- One of the areas to stress while dealing with the issue of perception of taxpayers towards the tax system is the development of persuasive communications between the tax authorities and taxpayers. The most effective tool for making people more positive is to empower them with knowledge and changing taxpayer's attitude through sustainable awareness creation programs. Awareness creation should go beyond simply giving tax education to taxpayers it should extended to having consultative sessions. There should be more preventative education for the public and increased awareness of tax responsibilities in schools starting from lower grades and in different medias. Students should be educated early in their career about tax responsibilities. All of these promote a view for tax system fair at the same time to inculcate in citizens a sense of responsibility toward taxes.
- The tax office should increase the number of auditors from time to time according to the size and the workload of the audit section. In addition to this, providing continuous theoretical and practical training for audit staff members are highly required.

- To increase the audit coverage and voluntary compliance, the tax office should have adequate staff resources and adopt a wide range of audit methodologies. The spot (issue)audit should be widely applied to increase the audit coverage, and educate taxpayers whenever the get opportunity to improve taxpayers' awareness and voluntary compliance. Moreover, the tax department should adopt scientific procedures in collecting data and selecting taxpayers for further audit and perform risk based tax audit.
- Increasing awareness of taxpayers on their rights and obligations should be made in continuous way. This creates the opportunity of mutual understanding and honest relationship between taxpayers and the tax office.
- The tax office needs to enhance the level of voluntary compliance by providing effective and sufficient education and training service not only for the taxpayers but also its staff members regularly.
- The level of punishment should be stricter and the legal provisions for doing this should be clearly stated.
- Revenue office audit section should make detailed investigate of tax payers technology based documents Like Cash Registers Papers.
- The revenue office should work in collaboration with other government offices such as trade minister and develop integrated technology based tax system. Because the taxpayers pass through ministry of trade before become taxpayer of the branch office collaboration and integrated technology based tax system is important to minimize tax evasion.

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Appendices

Appendices I: Questionnaires



SEEK WISDOM, ELEVATE YOUR INTELLECT AND SERVE HUMANITY!



A. Questionnaire prepared for Ministry of Revenues Large Taxpayers Branch Office Tax administration officials

**Addis Ababa University
College of Business and Economics
Department of Accounting and Finance**

Dear Respondents,

This questionnaire is prepared to collect data for research work in partial fulfillment of MSc Degree in Accounting and Finance on the **title Assessment of Business Income Tax Evasion in category A Taxpayers: In case of Ministry of Revenues Large Taxpayers Branch Office.** This questionnaire is aimed at collecting information about tax evasion in Ministry of Revenues Large Taxpayers Branch Office. The ultimate purpose of this information is to know and assess the cause, extent and level of tax evasion in the Branch Office and to forward possible recommendation. The output of the study depends on truth information collected from you. Therefore, your honest and genuine participation by responding to the questions is highly expected and appreciated.

The researcher assures you that all information obtained through this questionnaire should be used for academic purpose only and will be kept and stored with the highest order of confidentiality. For any question regarding this questionnaire please contact me through +251-926-839-333

Thank you in advance for your kind cooperation in filling and returning back

***Please, Put a tick mark (✓) on the box answer you choose.**

Section 1: Personal Background

1.1 Educational level 1. Diploma 3. Master's degree PhD
 2. Bachelor degree 4. Others specify -----

1.2 what is your Working Processes/sections in the organization -----

1.3 Experience in related to your present position 1. < 1 year 2. 1 – 4 years

3. >4 – 10 years 4. > 10 years

Section 2: Information about tax evasion

Roll No.	Statement	Strongly agree (5)	Agree (4)	Neutral (3)	Disagree (2)	Strongly disagree (1)
1. Perception of taxpayers towards the tax system						
1.1	The present tax system benefits the rich and is unfair to the ordinary working people.					
1.2	They pay less tax if they know that they would not be penalized.					
1.3	They think that government wastes a lot of money collected from tax.					
1.4	They feel that tax cheating is common nowadays.					
1.5	They don't like paying tax.					
2. Tax payers' income reporting trend						
2.1	Not declare and reporting some income					
2.2	Overstating business expenses and deduction					
2.3	Lying to tax auditors even when audited					
2.4	The society has the tendency of assuming minimizing tax liability is morally right nowadays					
2.5	Maintenance of multiple set of books of accounts					
2.6	Most payment fillers declare their liability dishonestly with underreporting					
3. Level of tax evasion						
3.1	Falsifying supporting documents					
3.2	Securing contracts under doomy names/non-existent persons/					
3.3	Deduction of personal expense as business expense					
3.4	Omission to report several income from irregular sources					
4. Efficiency of the tax administration						
4.1	There are sufficient experienced and					

	highly motivated personnel for tax assessment and tax collection					
4.2	The number of auditor's experts is enough to accommodate all registered taxpayers efficiently.					
4.3	The tax administration perform a continuous assessment and training to improve the capability or competency of staff resources, auditors and investigators in particular					
4.4	An availability of integrated and coordinated database of all taxable individuals by the revenue authority provides to minimize an opportunity for people to evade tax.					
4.5	The procedures for tax assessment and tax collection are easy.					
4.6	There is an appropriate penalty when someone is caught cheating by small amount.					

1. Express your ideas about the Perception of taxpayers towards the tax system in general. --

2. What looks like the tax payers' income reporting trend?-----

3. How to express the level of tax evasion? Please express your idea with proper justification?-----

4. How to express the Efficiency of the tax administration?-----

Thank you again for your cooperation

Appendices II: Interviews

B. Interview questions prepared for higher level tax administration officials

1. Do you think that the business tax system is clear and understandable for taxpayers? Yes
No

If your response is “NO” for question 1, please indicate the improvements needed to make business tax system clear and understandable for taxpayers?.....

.....
.....
.....

2. How do you evaluate the perception of income taxpayers towards tax?

.....
.....
.....

3. How do you evaluate the norm and honesty of the taxpayers of Ministry of Revenues Large Taxpayers Office in declaring the true tax liability?

.....
.....
.....

4. Do you believe that there is tax evasion in Ministry of Revenues Large Taxpayers Office?

1. Yes 2. No

5. If your response is “Yes” for question 4, how can you express the level of tax evasion in Ministry of Revenues Large Taxpayers Office?

.....
.....

6. If your response is “Yes” for question 4, what are the reasons for tax evasion?

.....
.....

7. If your response is “Yes” for question 4, what are the methods/ways of tax evasion?

.....
.....
.....

8. If your response is “Yes” for question 4, how much do you believe about the capacity of the tax administration in minimizing tax evasion in the current situation?

.....
.....
.....

9. Do you believe that the tax administration laws and procedures are easy for understanding and application by the taxpayers? 1. Yes 2. No

10. If your response is “No” for question 9, what laws and regulations need improvement to make easy and understandable for tax payers?

.....
.....
.....

11. What is your opinion about the capacity and techniques of the tax administration in identifying and penalizing tax payers involving in tax evasion activities?

.....
.....
.....

12. What are the possible solutions used to reduce tax evasion?

.....
.....
.....
.....

ሐ. በገቢዎች ሚኒስቴር ከፍተኛ ግብር ከፋዮች ቅርንጫፍ ጽ/ቤት ለደረጃ U የንግድ ትርፍ ግብር ከፋዮች የቀረበ ቃለ- መጠይቅ

1. የግብርና ታክስ አስተዳደር ስርአቱ ግብር ለመሰብሰብ ለግብር ከፋዮች አሰራሩን ቀላል፤ ግልጽ እንዲሆን ምን መደረግ አለበት ይላሉ? -----

2. በእርሶዎ አስተሳሰብ የግብርና ታክስ አስተዳደር ግብር የአሰባሰብ ሂደት ሲስተሙ ፍትሃዊ ነዉ ብለዉ ያስባሉ? አዎ አይደለም

ከላይ በጥያቄ ቁጥር 2 መልስዎ አይደለም ከሆነ ምን ማሻሻያ ቢደረግ ይመክራሉ?

3. በዚህ ወቅት በጽ/ቤቱ የግብር መሰወር በስፋት አለ? አዎ አይደለም

አዎ ካሉ በምንስ ደረጃ?-----

የስፋቱ መጠንስ? -----

በየትኛዉ የንግድ ዘርፍ አይነቶች -----

የግብር መሰወሪያ መንገዶች ምን ምን ናቸው?-----

የግብር ስወራን ለመከላከል ምን የመፍትሄ ሀሳብ ያቀርባሉ/ምን መደረግ አለበት ይላሉ?-----

4. የግብር አስተዳደር ስርአቱ ግብርን የሚያጭበረብሩ አጥፊዎችን ይዞ የማስቀጣት ብቃቱ ምን ያህል ነዉ? -----

5. የግብር አስተዳደር ስርዓቱና ግብር ከፋይ ትክክለኛውን ግብር ለመክፈል ምን ያህል ተቀራርቦዉ እየሰሩ ነዉ? -----

6. የግብር አስተዳደር ስርዓቱ ግብር የሚሰጡትን ለህግ በማቅረብ የሚከተላቸዉ መንገዶችን እንዴት ይመለከቱታል? -----

7. ግብር አስተዳደር ስርዓቱ የግብር ስወራን በመከላከል የሚጠቀሙዉን ዘመናዊ ቴክኖሎጂ አጠቃቀምን ደረጃ እንዴት ይገመግሙታል?-----

8. ብዙን ጊዜ የግብር ኪሳራ የሚያሳዉቁ ግብር ከፋዮችን ከፍትሃዊ ግብር መርህ አንጻር ሲታይ የግብር አስተዳደሩ ምን ማድረግ አለበት ይላሉ?-----

9. በማህበረሰቡ ውስጥ ትክክለኛን ግብር አሳዉቆ በመክፈል በኩል ያለዉ ልምድ እንዴት ይገልጹታል?--

10. እርስዎን ጨምሮ ብዙ ግብር ከፋዮች ግብር ያለምንም መደበቅና ማሳነስ ግብር በታማኝነት ይከፍላሉ ብለዉ ያስባሉ? በምን ምክንያት?-----

11. ለግብርና ታክስ መሰዎርና መደበቅ አንዱና ትልቁ ምክንያት የግብር ማስከፈያዉ የትርፍ ምጣኔ /ህዳግ/ማደግ ነዉ ይላሉ?-----

12. በከተማዉ የግብር ስዎራ የሚካሄደዉ በግብር ከፋዮች ብቻ ነዉ? ሌሎች ተባባሪ አካላት የሉም? አዎ ከሆነ መገለጫዎቹስ-----

አይደለም ከሆነ ሌሎች ተባባሪ አካላትስ እነማን ናቸዉ ?-----

Appendices III(A): Number of Ministry of revenues large taxpayers branch office employees and taxpayers

Category of information	Their number
Tax audit process employees	87
Tax fraud investigation process employees	24
risk and compliance strategy process employees	8
Ministry of revenue large taxpayers branch office total employees	382
Taxpayers	785

Source: Ministry of revenues large taxpayers branch office June, 2011 E.C annual report

Appendices III(B): Ministry of revenues large taxpayers branch office business income tax audit report

Budget Year(E.C)	Income tax /in ETB/			Unpaid tax in percent
	Taxpayers report	Audit finding	After audit	
2009	1,792,729,903.85	589,262,094.43	2,381,991,998.28	25%
2010	5,393,616,558.83	5,286,549,406.54	10,680,165,965.37	49%
2011	48,840,065,068.79	20,320,607,626.23	69,160,672,695.02	29%

Source: Ministry of Revenues large taxpayers branch office annual report for the year 2009-2011 E.C

Appendices III(C): Ministry of revenues large taxpayers branch office tax audit coverage

Budget Year	Number of cases(companies or individuals)selected to audit	Number of cases (companies or individuals) audited	Audited Percentage
2009	156	42	27%
2010	156	122	78%
2011	272	144	53%

Source: Ministry of Revenues large taxpayers branch office annual report for the year 2009-2011 E.C