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School of Business and Public Administration
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A thesis submitted to the School of graduate studies in partial fulfillment of the requirements for the Degree of Master of Science in Accounting and Finance.

By
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Compliance cost of individual income tax payers in Addis Ababa

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Statement of Certification

This is to certify Addisu Mera has carried out his research work on the topic entitled "**Compliance cost of individual income tax payers in Addis Ababa**".

The work is original in nature and is suitable for submission for the reward of the Master`s Degree in Accounting and Finance.

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List of Acrimonies

ETB	Ethiopian Birr
AEO	African Economic Outlook
FDRE	Federal Democratic Republic of Ethiopia
ERCA	Ethiopian Revenue and Custom Authority
NGO	Nongovernmental Organization
GDP	Gross Domestic Product
NBE	National Bank of Ethiopia

Abstract

The paper examines the tax compliance costs of the individual taxpayers in Addis Ababa. One research question and one hypothesis were investigated in this study: (RQ) compliance costs of the individual income tax system borne directly by the taxpayers themselves, including both the time spent and pecuniary expenditures and (H) The compliance costs of individual income tax are relatively low - in terms of their costs per individual: especially costs of time and monetary costs. The survey was conducted to a total of 170 individual income tax payers and questionnaires were distributed to those individual taxpayers in the administrative city of Addis Ababa in Ethiopia. A total of 103 useable responses were received and used for the final data analysis. The findings from the survey provide pertinent and useful insights about the compliance costs of Addis Ababa individual taxpayers. The results of the study indicate that the highest time spend was on learning tax rules. The average values per tax payers were 168.83 ETB and the average times spent by tax payers for filing their tax return were 5.17hrs. In all, the study found that the compliance costs of individual taxpayers in Addis Ababa were relatively low in term of the total monetary value.

Keywords: compliance cost, income tax, Addis Ababa

CHAPTER ONE

1. INTRODUCTION

1.1 Background of the study

Taxes impose many costs and these costs are the amount of money a person gives to the tax collector. Since Adam Smith, economists have been concerned with the costs of taxation and have developed several different measurements of the economic costs (Smith, 1976). Smith pointed out that tax can change or alter behavior either intentionally or unintentionally. For example, a tax on cigarettes is for the purpose of reducing smoking. Likewise, tax incentives to attend school may lead to an increase in the demand for learning. However, there are other costs that are not intentional and these costs are known as the excess burden. The excess burden is a loss of welfare above and beyond the tax revenues collected.

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

Compliance costs are associated with taxation which is a primary result of the complexity in the tax system and complexity reduces the level of voluntary compliance either through avoidance or evasion. However, increases the difficulty in administering the tax law may reduce the perceived level of fairness in the Federal tax system (Wollela Abehodie, 2008).

Concern about the compliance costs of taxpayers, or costs incurred by taxpayers to comply with tax laws over and above taxes paid has gained prominence interactions of academicians, policy makers and the public in general (Das-Gupta and Chattopadhyay 2002).

The major reasons identified for the growth of interest in compliance costs include:

- 1) changes in technology (facilitating large-scale computer driven surveys),
- 2) growth of enterprise cultures involving the small business sector (where compliance costs are particularly onerous)
- 3) increasing complexity of tax systems.

Although various researchers defined compliance cost in different ways, these definitions shows the major components of taxpayer compliance costs include:

- 1) time costs (i.e. time spent either by taxpayers or third parties like employers in complying with the legal provisions)

- 2) monetary costs (costs incurred for record keeping, payment to professionals etc over and above the basic tax liability)
- 3) psychological Costs (costs associated with dissatisfaction, frustration etc.)

While all the components of compliance cost are important, the main purpose of the research was to get an insight into the scope and structure, as well as specific characteristics of personal income tax compliance costs regarding level of income on individual taxpayer compliance burden (i.e. the time and monetary costs incurred by individual taxpayers). Here psychological cost of the individual tax payers is excluded because of difficulty to measure. Remember Individual income tax payers in this research concerns in some exceptional cases, the income tax proclamation in Ethiopia requires the employees to pay their tax by themselves. For instance an employee working for more than one employer or an employee of an international organization having diplomatic immunity or working in embassies, missions and other consular establishments of a foreign government has the duty to declare and pay tax by her or himself within 30 days of the end of each calendar.

1.2 Statement of the problem

The 2010 ease of doing business index put Ethiopia as compared to the world, 47th in the ease of paying taxes and, when compared to other Sub-Saharan African countries, Ethiopia is ranked 8th in the ease of paying taxes (World Bank, 2010). There have been various reforms, regulations that aim to make things easier for the tax payer. The Ethiopian Revenues and Customs Authority are responsible for overseeing the various changes and reforms and collecting taxes and customs duties among other things. However, lack of profit comes from inadequate enforcement and auditing. According to AEO¹ 2010, the tax administration in Ethiopia lacks the institutional capacity to handle modern operational and enforcement practices to deliver efficient and quality service. Weak enforcement is a cause for concern since personal income tax compliance tends to be lower. In order to comply with the tax rule these tax payers were bares a number of costs, which is called compliance cost. Consequently, they appear to be continuously finding a loophole to depart from.

Taxation compliance costs are also the subject of growing interest and policy revamp in most developed countries for both academics and governments. However, in developing countries especially in Ethiopia, research on compliance costs was limited and not well established; mostly because it requires

¹ *The AEO 2010 is published jointly by the African Development Bank (ADB), the OECD Development Centre and the United Nations Economic Commission for Africa (UNECA), with financial support from the European Commission and the Committee of African, Caribbean and Pacific Group of States (ACP)*

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

All the above discussed problems in the fiscal tax system of the Ethiopian along with the gap in the literature (to be established in chapter 2) with respect to compliance costs of those individual income tax payers particularly in Addis Ababa call for extensive research.

1.3 Objectives

The extent of the compliance cost of individual income tax payers was not well understood and studies in this area have not been carried out in Addis Ababa. The overall purpose of this study is to examine the types of compliance costs incurred and the corresponding amount in terms of time spend and monetary cost of individual income tax payers in Addis Ababa. Therefore addressing this knowledge gap was the primary purpose of this study.

1.4 Significance of the study

The finding of this study will provide data on the amount of cost incurred by individual taxpayers in complying with tax regulations. The data on compliance costs of individual taxpayer compliance costs would also provide precious insights and inputs to the tax authority of Addis Ababa for the formulation of tax

policy and also would assist its mission to provide taxpayers with top quality service. This study also will help to understand the burdens placed on taxpayers by tax laws, tax system administration, and changes to those factors.

1.5 Scope and limitation of the study

The primary focus of the study was on compliance cost of individual tax payers in Addis Ababa. In some exceptional cases, the income tax proclamation requires the employees to pay their tax by themselves. For instance an employee working for more than one employer or an employee of an international organization having diplomatic immunity or working in embassies, missions and other consular establishments of a foreign government has the duty to declare and pay tax by her or himself within 30 days of the end of each calendar. The scope of this study is, therefore, selects only those individual income taxpayer which are employees of different embassies and international organizations only by confined to estimate the compliance costs of the tax payers to get an insight into the scope and structure, as well as specific characteristics of personal income tax compliance costs regarding level of income in Addis Ababa city administration.

1.6 Organization of the research report

The paper was organized as follows. The first section would begin with a very short explanation of the basic characteristics of personal income tax in Addis Ababa relevant for compliance costs. The second section would present literature

review and it described in a comparison of theoretical with empirical evidences. The methodology was also explained, including the sample, the questionnaire and the survey in the third section. The main part of the paper was, of course, devoted to the results concerning the characteristics, structure and scope of the compliance costs (i.e. time and monetary cost only) in the fourth section. The last section would be present conclusions and recommendations regarding the relevant aspects of compliance cost.

1.7 Research question and hypotheses

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

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

Therefore, each one of us has to do the math (alone or with the help of friends who are skilled in such matters, or perhaps with tax advisers) and decide whether getting involved in the procedure of claiming an income tax refund is worthwhile. The following hypotheses were also developed to test these costs.

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

CHAPTER TWO

2. REVIEW OF LITERATURE

Increasing complexity of the tax system is argued to have adverse impact on tax administration, compliance and compliance costs. According to Pope (1994), results of compliance costs studies revealed that greater emphasis should be given to conventional objectives of revenue maximization, equity and efficiency. Other related factors which raise the compliance costs identified are ambiguity of tax laws, frequent changes in the tax provisions, differential provisions for different components of the tax base (e.g. income from multiple sources) and complicated and time consuming administrative procedures.

Compliance costs also arise from poor rule -writing that provides a complex tax system, complicated bureaucratic procedures, lack of professionalism in the tax administration, and in the process of favoring certain taxpayer groups and activities (Das-Gupta and Chattopadhyay, 2002).

Therefore, the purpose of this chapter is to review the literature in the area of tax compliance costs. This review of the literature establishes the framework for the study and highlights the apparent strengths and weaknesses of the previous studies which help in identifying the gap in the literature and formulating the research questions for the study.

The review has three sections. Section 2.1 presents a review of the theory of tax compliance costs. This is followed by a review of the relevant empirical studies on tax compliance costs in section 2.2. Finally, conclusions on the literature review and knowledge gaps are presented in section 2.3.

2.1 Tax compliance costs: theory

Roth *et al.* (1989) defined tax compliance as compliance with reporting requirements, which means that the taxpayer files all required tax returns at the proper time and that the returns accurately report tax liability in accordance with the internal revenue code, regulations, and court decisions applicable at the time return is filed. Within this premise, tax non compliance may be thought of as the failure of taxpayers either intentionally or unintentionally to keep the required records, file accurate returns and pay the taxes due at the proper time and in line with the requirements laid down by the pertinent tax law, regulations, court decisions and administrative procedures.

Klun (2004a) describes researchers evaluating compliance costs in different countries have arrived at similar conclusions from their results: compliance costs are relatively high, especially for major taxes; they are also higher than administrative costs; they amount to as much as 10% of tax revenues; compliance costs are regressive and therefore create some undesirable distributive effects; high compliance costs diminish voluntary compliance; and compliance costs can

cause excess tax burden. So the researchers want to test these conclusions and can crosscheck whether the conclusions from prior research could be replicated for Addis Ababa.

Factors affecting compliance

The fundamental goal of any revenue authority is to collect taxes and duties payable according to the law. However, when it comes to the obligations imposed on them by law, taxpayers are not always compliant. A compliant taxpayer is one who fulfills every aspect of their tax obligations including:

- ✓ registering with the revenue authority as required;
- ✓ filing the required returns on time;
- ✓ accurately reporting tax liability (in the required returns) in accordance with the prevailing legislation, rulings, return instructions and court decisions;
- ✓ paying any outstanding taxes as they fall due; and
- ✓ maintaining all records as required.

A non-compliant taxpayer is one who fails to satisfy any one or more of these aspects and poses a risk to revenue collection.

Tax noncompliance can be intentional (deliberate) or unintentional. Intentional noncompliance occurs when taxpayers consciously opt not to meet the requirements of the relevant tax regime. McKerchar (2002) cited in Wollela Abehodie (2008) explained deliberate noncompliance could include tax evasion,

which in turn would include all people or entities operating within the hidden economy, taxpayers that deliberately understate their income; over claim deductions, rebate or credits; take an aggressive stance in their tax affairs that cannot reasonably be supported; or do not keep the required records. In this case intentional noncompliance leads to under-compliance with the concomitant financial benefits (mainly reduction in tax liability) accruing to the noncompliant taxpayer.

Deliberate noncompliance may also aim at reducing, apart from the tax liability, the efficiency and compliance costs to taxpayers. In this case, deliberate noncompliance may be observed in a variety of ways including those arising from a taxpayer's intentional failure of claiming deductions, credits, hiding income involving complex treatment. These measures may result in overstatement or understatement of the tax liability. Further, these deliberate actions by taxpayers may be motivated by such factors as the difficulty of dealing with a complex tax system, and the amount of time and effort needed to comply with the requirements of the tax system (Wollela Abehodie, 2008).

On the other hand, unintentional noncompliance emerges when taxpayers fail to fulfill the requirements of any aspect of the tax system without any deliberate action. Unintentional noncompliance may result in either overstatement or understatement of the tax liability. Unintentional noncompliance is not

necessarily motivated by financial benefits to the noncompliant taxpayer. Unintentional understatement or overstatement of tax liability may arise because of, among others, lack of knowledge and failure to pay due care in the maintenance of book of accounts and the preparation of returns.

Further, there is a range of possible compliance outcomes driven by a variety of factors including demographic (including age, gender and level of education), personal (including attitudes, experiences, morale and financial circumstances) and aspects of the tax system itself (including tax rates, penalties, audit probabilities, enforcement strategies, complexity and costs of compliance). As many of these factors are not constant, it is to be expected that compliance behavior can change over time and a compliant taxpayer one year may be non-compliant the next.

From the perspective of the revenue authority, the ideal is to have all taxpayers fully compliant at all times. If this were the case, the tax gap (the difference between what a revenue authority theoretically should collect and what it actually does collect) would not exist. The ideal is obviously not attainable. But to be able to work towards this ideal, the revenue authority needs to be able to identify and understand the various types of compliance outcomes and then develop and apply appropriate strategies to modify (or reinforce) taxpayers' behavior accordingly. As the revenue authority normally has limited resources at

its disposal, it needs to be strategic if it is to be efficient and effective in managing its risks. This will require the authority to identify and priorities its risks, to tailor and target specific activities to each identified risk, and to allocate resources accordingly. This is commonly referred to as a risk management approach to compliance and is widely adopted in many jurisdictions, and in particular, where taxpayers are required to self-assess their tax liability.

Some Facts about Employment Income Tax in Ethiopia

Just like other countries in Ethiopia also anyone who derives income from employment and employment related activities is expected to pay Employment Income tax. Employment income tax is a kind of tax on earnings- money that individuals, receive in different ways from the employer. It is paid either on PAYE (Pay -As-You Earn) system or PAYG (Pay-As-You Go) system. PAYE (Pay -As-You-Earn) is a payroll deduction system in which tax is deducted from a person's income when paid by the employer. PAYG (pay-as-you-Go) is a system for businesses and individuals to pay installments of their expected tax liability on their income from employment, business or investment for the currents income year.

Every person having income from employment in any government or other private organization or non Governmental organization, such as Nongovernmental organization (NGOs), and if his/her is income from

employment includes any payments or gain in cash or in kind which he/she receives from employers is supposed to pay income tax (Jira Jebessa *et al.* 2005)

According to proclamation No 286/2002, 608/2008, Regulation No. 78/2002, Directive No. 21/2009, individuals may receive various types of income such as wages or salary from employment, rent from letting houses or buildings, interest from lending/saving money, and profit from their trading activities or business (Abebe Hunachew, 2009).

These individuals are required to pay income tax. They are ordered to do so by income tax proclamations, regulation and directives. The law specifies how and when these individuals have to pay the required tax. This studies deals especially with the aspect of the law which applies to individuals who earn income from employment. According to the law, individuals who obtain income from their employment are required to pay tax. In line with internationally recognized best practice, employee's income tax liabilities are calculated and paid directly by their employer. As a result the government relies on employers to compute and withhold the tax to be paid by employees. To discharge this responsibility properly, employers may need to know in advance what counts as income or shall be able to distinguish what kind of income is to be taxed or not (Abebe Hunachew, 2009).

However, in some exceptional cases, the income tax proclamation requires the employees to pay their tax by themselves. For instance an employee working for more than one employer or an employee of an international organization having diplomatic immunity or working in embassies, missions and other consular establishments of a foreign government has the duty to declare and pay tax by her or himself within 30 days of the end of each calendar (FDRE, 2002).

The government collects these kinds of tax from any individual employees, other than contractors, engaged whether on a permanent or temporary basis to perform services under the direction and control of the employer. Employment income includes any payment or gain in cash or in kind received from employment by the employee subject to certain exemptions. Employment income is one of the most well known forms of tax in Ethiopia. In 2008/9 fiscal year, employment income tax amounting to 1.017 billion birr was collected from payments made by employers to employees. This represents 4.31% of the total revenue collected by the Tax Authority in that fiscal year (NBE, 2008/9).

2.2 Empirical studies on tax compliance costs

Various researchers have defined the term compliance cost in different ways. A number of definitions have been given by Slemrod and Sorum (1984), Vaillancourt (1989), Sandford (1995), Das-gupta and Chattopadhyay (2002) and

Guyton *et al.* (2003). They defining, identifying and classifying compliance costs and then present out own their definition and classification.

The conventional definition of tax compliance cost by Sandford (1995) is:

“Tax compliance costs are the costs incurred by the taxpayers in meeting the requirements laid on them by the tax law and the revenue authorities. They are costs over and above the actual payment of tax and over and above any distortion costs inherent in the nature of the tax.”

Sandford *et al.* (1989) has emphasized the need for including the psychic costs comprising of stress and agony in dealing with one’s tax affairs, in particular for the poorer pensioners, widows and divorced and separated woman. But in this research it doesn’t comprise these costs. Given the discussion above, it will be clear that definition and classification of compliance costs is not a simple task.

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

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

The other costs include travel and lodging costs to visit a tax adviser, or the revenue authorities, payments to professional advisers, incidental expenses of postage, telephone, etc.

Researched findings on individual tax compliance costs of developed countries are well established. In the US, study on individual taxation compliance costs begin with the work of Wicks (1966) cited in Guyton *et al.* (2003) was revealed that compliance activities claim an average of 32% of state and 11.5% of federal tax revenues. Those with the highest compliance costs were the self-employed and individuals engaged in professional, managerial and sales occupation.

Slemrod and Sorum (1984) conducted a study of Minnesota households and estimated compliance costs as 5 - 7 percent of income tax revenue. Another study is repeated by Blumenthal and Slemrod (1992) point out that the average time spend on compliance activities has increase from 21.7 to 27.4 hours.

Both studies indicated that on average, self-employed taxpayers spent nearly 3 times as much of their own time on tax compliance as other taxpayers and were twice as likely to use professional assistance to prepare their taxes.

The most recent findings by Slemrod (2005) estimated that total compliance costs for individuals amounted to \$85 billion in 2004 representing 11.1% of personal income-tax revenues.

A series of studies by Sandford (1973), Sandford *et al* (1989) and Sandford (1995) in the UK found similar results as what is concluded in the US where compliance costs seemed to be borne more heavily by the self employed and the average compliance costs of low-income respondents, as a percentage of income, were greater than those of high-income people. The studies also found that compliance costs for the individual income tax to be 1.9% of revenues in 1973, 2.8% in 1989 and 2.21% in 1994. Studies on personal income tax in Australia found that the percentage of compliance costs becoming smaller through time. Pope *et al.* (1990) estimated compliance costs at 10.8% and Pope (1995) at 9.2%. For Canada, the studies found that the compliance cost as a percentage of tax revenue to be 2.53% and tax compliance costs were higher for the self employed.

The estimated compliance costs of individual taxpayers are found lower in studies done in several other developed countries. For example, Delgado and Diaz (1995) analyzed personal income-tax compliance costs in Spain using face-to-face interviews and found that compliance costs represented 3.3% of tax revenues. The results from a study in Sweden indicated even lower compliance costs. Allers (1994a) examined the compliance costs of personal income taxes and

the wealth tax in the Netherlands using face-to-face interviews and drop-off questionnaires. Allers concluded that compliance costs for personal income taxes represented 1.4% of personal income tax revenues.

Hite and Sawyer (1997), comparing compliance costs estimates is difficult due to differing tax systems and methodological differences. Anyway few attempts were made by researchers to arrive at comparable estimates.

2.3 Conclusion and knowledge gap

The review of the literature reveals the existence of many gaps of knowledge in respect of the estimation of tax operating costs and their relationship to compliance behavior of taxpayers. Having all the above evidences that indicates more researches were conducted in the developed countries; on the contrary research into compliance costs in developing countries is limited and not well established. Ott and Bajo (2000) in their paper presented the reasons or obstacles which include lack of experts; many experts overloaded by more pressing issues; no taxpayer associations and no civil initiatives. According to Klun (2004), possible reasons include a lack of interest by scholars; no cooperation from tax authorities; surveys in developing countries are not common and constant changes in tax systems.

Despite these obstacles, there are few outstanding researches done in this area. In 2004 personal income tax was conducted in Slovenia (Klun, 2004b), and a broad

based research into compliance costs was undertaken in Croatia (Blazic, 2004). These studies found that the compliance costs are relatively low, primarily because most taxpayers consider filing their tax declaration to be a simple procedure and consultancy costs are low.

The data for most of the earlier research on individual income tax compliance costs conducted in the other country were collected through mail surveys supplemented by follow up interviews which led to a relatively low response rate and non-response bias. This method has the advantage of reaching a large geographical territory with low cost. However, this method is likely to result in a low response rate.

On the demerits of mail surveys, Sekaran (1992) indicated that response rates were typically not as high as might be desired, and indeed sometimes, they were very low. With very low response rates it is difficult to establish the representativeness of the sample because those who responded to the survey may be (totally) different from the population they were intended to represent. Further, any doubts a respondent might have cannot be clarified.

More specifically, in the case of Ethiopia, to the knowledge of the researcher there is no single study on the compliance cost of individual income tax payers. The magnitude and nature of individual income tax payer's compliance cost along with areas in the design and administration of the tax at large are not known.

CHAPTER THREE

3 RESEARCH METHODOLOGY

The purpose of this chapter is to present the research questions and hypotheses, the underlying principles of research methodology and the choice of the appropriate research method for the thesis. The chapter is arranged as follows. Section 3.1 presents the hypotheses and research questions for the study. This is followed by the research approach in section 3.2, and section 3.3 presents the quantitative aspect adopted for this study. Then, the qualitative aspect also presented in section 3.4. Finally, the linkage between research questions and hypotheses, and items in the specific method of inquiry are presented in section 3.5.

3.1 Research question and hypotheses

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

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

Therefore, each one of us has to do the math (alone or with the help of friends who are skilled in such matters, or perhaps with tax advisers) and decide whether getting involved in the procedure of claiming an income tax refund is worthwhile. The researchers also develop hypotheses to test these costs. The main hypothesis was;

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

3.2 Research Approaches

This study was conducted by the combined quantitative and qualitative approach of research. By means of employing this combined approach, the researcher was able to obtain the advantages of both quantitative and qualitative approaches and overcome their limitations.

This section introduces the fundamental elements of a research approaches. The three common approaches to conducting research are quantitative, qualitative, and mixed methods. Researchers typically select the quantitative approach to respond to research questions requiring numerical data, the qualitative approach

for research questions requiring textual data, and the mixed methods approach for research questions requiring both numerical and textual data (Williams, C. 2007).

3.2.1 Quantitative research approach

Quantitative data collection methods are centred on the quantification of relationships between variables. Quantitative data-gathering instruments establish relationship between measured variables. When these methods are used, the researcher is usually detached from the study and the final output is context free. Measurement, numerical data and statistics are the main substance of quantitative instruments. With these instruments, an explicit description of data collection and analysis of procedures are necessary. An approach that is primarily deductive reasoning, it prefers the least complicated explanation and gives a statement of statistical probability. The quantitative approach is more on the detailed description of a phenomenon. It basically gives a generalization of the gathered data with tentative synthesized interpretations.

Well designed and implemented quantitative research has the advantage making generalizations to a wider population from the sample. To enhance the generalization of findings, quantitative research approach follow standardized procedures in sample selection, instrument design, implementation and analysis.

Standardization in turn enhances the reliability of findings and alleviates the impact of investigator and subjects biases.

Quantitative approach is useful as it helps the researcher to prevent bias in gathering and presenting research data. Quantitative data collection procedures create epistemological postulations that reality is objective and unitary, which can only be realized by means of transcending individual perspective. This phenomenon in turn should be discussed or explained by means of data analysis gathered through objective forms of measurement. The quantitative data gathering methods are useful especially when a study needs to measure the cause and effect relationships evident between pre-selected and discrete variables. The purpose of the quantitative approach is to avoid subjectivity by means of collecting and exploring information which describes the experience being studied.

A quantitative research approach employs strategies of inquiry such as experiments and surveys, collects information using preset standardized instruments, and uses statistical methods in describing patterns of behavior and generalizing from sample to populations. A survey research is one of the ways to gather data in the social sciences. In line with this, a survey design provides a quantitative or numeric description of trends, attitudes, or opinions of a population by studying a sample data with the intention of statistically

generalizing to the population under investigation (Creswell, 2003). In other words, subjectivity of judgment, which is not needed in a thesis discussion, can be avoided through quantitative methods. Thus, conclusions, discussion and experimentation involved in the process are more objective. Variables, both dependent and independent, that are needed in the study are clearly and precisely specified in a quantitative study. In addition, quantitative method enables longitudinal measures of subsequent performance of the respondents.

Despite these advantages, quantitative research design has a number of limitations: lack flexibility in design, standardization can cause bias or hinder exploitation of new ideas, and lack interpretive and exploratory examination of a research problem (Creswell, 2003).

3.2.2 Qualitative research approach

Contrary to the quantitative method, qualitative approach generates verbal information rather than numerical values (Creswell, 2003). Instead of using statistical analysis, the qualitative approach utilizes content or holistic analysis; to explain and comprehend the research findings, inductive and not deductive reasoning is used. The main point of the quantitative research method is that measurement is valid, reliable and can be generalized with its clear anticipation of cause and effect (Cassell & Symon, 1994). Being particularistic and deductive in nature, quantitative method is dependent on the formulation of a research hypothesis and confirming them empirically using a specific data set (Cowton,

1998). The scientific hypothesis of a quantitative method holds no value. This means that the researcher's personal thoughts, subjective preferences and biases are not applicable to this type of research method.

The researcher opted to integrate the qualitative approach in this study due to its significant advantages. The use of qualitative data gathering method is advantageous as they are more open to changes and refinement of research ideas as the study progresses; this implies that qualitative data gathering tools are highly flexible. Moreover, no manipulation of the research setting is necessary with this method; rather than employ various research controls such as in experimental approaches, the qualitative data gathering methods are only centred on understanding the occurring phenomena in their naturally occurring states. Aside from these advantages, researchers use qualitative data-gathering tools as some previous researchers believe that qualitative data are particularly attractive as they provide rich and well-grounded descriptions and explanations as well as unforeseen findings for new theory construction. One of the notable strengths of the qualitative instruments is that they evoke a more realistic feeling of the research setting which cannot be obtained from statistical analysis and numerical data utilized through quantitative means. These data collection methods allow flexibility in conducting data gathering, research analysis and interpretation of gathered information. In addition, qualitative method allows the presentation of the phenomenon being investigated in a more holistic view.

In spite of the above advantage, qualitative research design has its own limitations: lack of standardized rules reduces the objectivity of the findings, the personal view and stand of the researcher may induce bias in the interpretation of the data, and the findings cannot be statistically generalized for a broader population under investigation (Creswell, 2003).

3.2.3 Mixed methods approach

As explained above discussion, both quantitative and qualitative research approaches have limitations. According to Sale *et al.* (2002) the advantage of a quantitative research approach may be limitations for a qualitative approach and vice versa.

Mixed research design, which is supposed to alleviate the limitations of quantitative and qualitative approaches, bases on pragmatic knowledge claims. Pragmatists contend that knowledge claims arise out of actions, situations, and consequences rather than antecedent conditions. There is a concern with applications and solutions to problems. Instead of methods being important, the problem is most important, and researchers use all (mixed method studies) approaches to understand the problems (Creswell, 2003).

Sale *et al.* (2002) illustrated that it has often been observed very accurately that no single research methodology is intrinsically better than any other methodology, many authors calling for a combination of research methods in order to improve

the quality of research. Researchers incorporate methods of collecting or analyzing data not only numerical data, which is customary for the quantitative research, but also narrative data, which is the norm for qualitative research in order to address the research question(s) defined for a particular research study.

The goal for researchers using the mixed methods approach is to draw from the strengths and minimize the weaknesses of the quantitative and qualitative research approaches (Williams, 2007). To sum up, quantitative and qualitative research methods investigate and explore the different claims to knowledge and both methods are designed to address a specific type of research question. While the quantitative method provides an objective measure of reality, the qualitative method allows the researcher to explore and better understand the complexity of a phenomenon. This paper presented a clear statement of what constitutes quantitative and qualitative research designs and summarized techniques used to conduct studies for both research approaches. This paper also presented statements of what constitutes the mixed methods approach when conducting research. Although each approach seeks to validate sensory knowledge as truth, neither is absolute in its form.

3.3 Research method: quantitative aspect

The quantitative aspect of the research method intends to elicit data needed to generalize about the magnitude and nature of individual income tax payers'

compliance costs in Addis Ababa. Specifically, the current study employed a survey design administered through using semi-structured questionnaires. The following discussion presents respectively the survey (semi-structured questionnaires).

The data for most of the earlier research on tax compliance costs conducted in the other country were collected through mail surveys supplemented by follow up interviews. This method has the advantage of reaching a large geographical territory with low cost.

However, this method is likely to result in a low response rate. For example Sapiei and Abdullah, (2008), five hundreds questionnaires were distributed to individual taxpayers in the region of Klang Valley in Malaysia. A total of 144 useable questionnaires were obtained and used for the final analysis representing a response rate of almost 29%. On the demerits of mail surveys, Sekaran (1992) indicated that response rates were typically not as high as might be desired, and indeed sometimes, they were very low. With very low response rates it is difficult to establish the representativeness of the sample because those who responded to the survey may be (totally) different from the population they were intended to represent. Further, any doubts a respondent might have cannot be clarified.

Sample design

In the case of sample design, as the literature on survey method reveals, how well a sample represents a population depends on the sample frame, the sample size and the specific procedures of selecting potential respondents (Wollela Abehodie, 2008).

The sample size will depend on the type of research and what the researcher wants to do with results. Choosing an appropriate sample size is crucial to having a study that will provide statistically significant results. Research needs to be cost effective, so it is best to use as small a sample as possible to reduce time and cost. However, if using a sample size that is too small, the results will not be statistically valid. In quantitative research, statistical methods can be used to choose the size of sample required for a given level of accuracy and the ability to make generalizations.

In the year 2009/10, 25,287 individuals are employed in foreign embassies and international organizations in Addis Ababa city administration (CSA, 2010) and all these individuals are registered in ERCA to pay employment income tax. From this study population, the researcher listed 170 (0.67228% of the total population, which is above most similar surveys in the world: for example, Klun, 2004 = 0.022%, Diaz and Delgado, 1995 = 0.026%, Pope, 1995 = 0.008%), registered individual income tax payers, which are employees of only

international organizations and embassy's in ten sub city of Addis Ababa as sample frame. considering the concentration of embassy's and international organizations of each sub city, this sample frame again congregate among five districts of Addis Ababa sub city (Bole, Nifas silk lafto, kirkos, yeka and Gulele) by purposive sampling method and from each sub city individual income tax payers was randomly selected as sample by using simple random method of sample selection.

The survey instruments

Survey questionnaire, adopted from Slemrod and Sorum (1984) and Das-Gupta and Chattopadhyay (2002), was used as the main data-gathering instrument for this study. They were designed to collect both qualitative and quantitative data on compliance costs towards individual income tax payers in Addis Ababa.

The taxpayer survey instrument was prepared in English languages because participants are professionals.

The questionnaire was divided into two main sections: a profile and the survey proper. The profile contains socio-demographic characteristics of the respondents such as age, gender, marital status and occupation. The survey proper explored the perceptions of on personality questionnaire, particularly on cost of filing individual income tax returns. The questionnaire proper section also contains questions that identify the estimated costs that the individual income tax payers

was incurred in connection with the time they spent and some related monetary costs they exposed. The questions were also structure some Likert format. In this survey type, six choices are provided for some question or statement. The choices represent the degree of agreement each respondent has on the given question.

The likert-scale survey was enabled the respondents to answer the survey easily. In addition, this research instrument allowed the research to carry out the quantitative approach effectively with the use of statistics for data interpretation. In order to test the validity of the questionnaire used for the study, the researcher tested the questionnaire to seventeen (10% of the sample) respondents. These respondents as well as their answers were not part of the actual study process and were only used for testing purposes. After the questions have been answered, the researcher asked the respondents for any suggestions or any necessary corrections to ensure further improvement and validity of the instrument. The researcher revised the survey questionnaire based on the suggestion of the respondents. The researcher then excluded irrelevant questions and changed vague or difficult terminologies into simpler ones in order to ensure comprehension.

Ethical Considerations

As this study required the participation of human respondents, specifically human resource professionals, certain ethical issues were addressed. The

consideration of these ethical issues was necessary for the purpose of ensuring the privacy as well as the safety of the participants. In order to secure the consent of the selected participants, the researcher relayed all important details of the study, including its aim and purpose. By explaining these important details, the respondents were able to understand the importance of their role in the completion of the study. With this, the participants were not forced to participate in the research. The confidentiality of the participants was also ensured by not disclosing their names or personal information in the research. Only relevant details that helped in answering the research questions were included.

Data Analysis Techniques

In order to investigate the compliance cost of individual income tax payer's the responses obtained from the above mentioned data gathering instruments was tabulated, interpreted and analyzed by SPSS statistical package, using descriptive statistics. The interpretation, analysis and discussion were based on the results obtained and literature guide. The frequency and cross tabulation of responses of the compliance cost of the individual income tax payer evaluation scores are presented. A one way ANOVA was used to assess the relationship between the compliance cost and the classification variable.

3.4 Research method: qualitative aspect

The qualitative aspect seeks information about the difficulties that taxpayers face when they comply with the tax system and also tries to identify areas in the income tax system, specifically, in the income tax legislation and administrative procedures that have contributed to the level of compliance costs and the performance of the income tax system at large. Qualitative data collection methods could be observations, interviews, documentary studies, and studies of audiovisual materials. Qualitative method with any of the methods of inquiry and data collection procedures can be integrated with quantitative method at different stages of the research process. The integration can occur at the time of data collection, analysis or interpretation.

It has been stated that this study intends to identify compliance cost of individual income tax payers in Addis Ababa. To this end, in addition to the integration of the quantitative and qualitative aspects of the design through use of both open-ended and closed-ended questions in the surveys, the qualitative aspect of the research will be use documentary analysis.

Documentary analysis

Documentary analysis covers a wide variety of sources, including official statistics, photographs, texts and visual data. Bloyce (2004), has argued that 'when engaged in socio-historical analysis documentary analysis can be a useful

research tool' (Documents such as newspapers, books, magazines and government minutes can be read and preserved so that they are available for analysis by the social researcher (Bryman, 2004). Documentary analysis has its own strengths and weaknesses. The literature on documentary study identifies strengths including convenience, low cost and replication. Weaknesses include the lack of representativeness (documents are not necessarily representative of their kind and thus do not allow generalizations), personal bias (documents may be biased since they represent the view of their authors) and reliability (the reliability of some documents is questionable).

The extent of their relevance depends, however, on the adequacy of the document chosen for the phenomena being investigated. With reference to the research topic under scrutiny here, the relevant secondary data have been collected from various periodical reports of the financial reports of the tax authority; manuals of the tax authority and using the internet will try to find more information about the tax authority, and tax proclamation analysis will be deemed the most appropriate.

3.5 Relationship between research questions/ hypotheses and the research design

This chapter has presented the various research questions/hypotheses and the methods appropriate to address them. Table 3.1 sets out how each research

question/hypothesis is addressed by the appropriate item in the survey (semi-structured questionnaire) and documentary study. In conclusion, based on the overarching research problem stated in the preceding chapter, one primary research question and one primary hypothesis have been developed. With respect to methodology, the principles of qualitative, quantitative and mixed methods research approaches have been shown. Based on the underlying principles of research methods and the research problem mixed methods approach has been chosen as appropriate to this research because this method can draw from the strengths and minimize the weaknesses of the quantitative and qualitative research approaches. More specifically, to address the various research questions, survey design and documentary analysis were shown to be the appropriate methods of inquiry for this research. The next chapter presents the results of each of these methods of inquiry.

Table 3.1 Relationship between research questions/hypotheses and research instruments

	Research questions/Hypotheses	Items in the survey and documentary Analysis
<i>RQ</i>	How much compliance costs of the individual income tax system borne directly by the taxpayers themselves, including both the time spent and pecuniary expenditures?	Tax payer's survey questions 8, 9, 11,12, 13,14,15, 16, 17, and 18
<i>H1</i>	The compliance costs of individual income tax are relatively low - in terms of their costs per individual: especially costs of time and monetary costs.	Tax payer's survey questions 8, 9, 11,12, 13,14,15, 16, 17, and 18

CHAPTER FOUR

4 RESULTS AND DISCUSSION

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

As indicated in Table 2, the frequencies related to the characteristics of the sample taxpayers. Higher percentages (68.9%) of respondents were male while 31.1% were female of the total 103 respondents. The individuals participated in the survey were at their taxable working age as 95.1% with age between 18 and 45 years old. The age ranging from 18 to 30 represent the prime working age of working individuals where 49.5% of respondents fall within this categories. Whereas 46 - 55 years of age group represent the upper management or business owner with a higher degree of income stability with 4.9% of respondents falls within this bracket. Therefore, it makes this study looking into the main contributor towards the tax authority's revenues. In relation to the researcher's

analysis with the respondent's age, level of income shows the same pattern. Almost 29.1% earn between 5, 000 and 10,000 ETB while 27.2% earn 1, 000 to 5,000ETB. However the educational attainment was generally average among respondent with just 29.1% some college/technical school, 54.4% possessing a graduate degree and 16.5% with master, PhD and other professional certificates.

Table 4.1a Tax payers survey respondents by Age

Age	18-30	31-45	46-55	>55	Total
Frequency	51	47	5	0	103
Percent	49.5	45.6	4.9	0	100.0

Source: tax payers survey

Table 4.1b Tax payers survey respondents by Sex

Sex	Male	Female	Total
Frequency	71	32	103
Percent	68.9	31.1	100.0

Source: tax payers survey

Table 4.1c Tax payers survey respondents by monthly income

Monthly income (ETB)	A	B	C	D	E	F	G	Total
Frequency	0	28	28	30	5	6	6	103
Percent	0	27.2	27.2	29.1	4.9	5.8	5.8	100.0

Note: Legend: A=< 1,000; B=1,001-2,000; C=2,001-5,000; D=5,001-10,000; E=10,001-15,000; F=15,001-20,000; G=>20,000 in ETB.

Table 4.1d Tax payers survey respondents by level of education

Education level	A	B	C	D	Total
Frequency	0	30	56	17	103
Percent		29.1	54.4	16.5	100.0

Note: Legend: A= Higher secondary; B= some college/technical school; C= Degree; D= Post graduate/PhD, professional Qualification.

Judging by the responses to the researcher's question about attitudes to tax filing, this may not be significant. Of those surveyed, only 10.7% said they "very much" enjoyed preparing and filing their income tax returns and 50.5% said they enjoyed the process; 17.5% replied that they neither enjoyed nor disliked it. On the other hand, 21.3% of those surveyed said they disliked the process and 0% said they disliked it "very much". (See Appendix 3)

The researchers have also address that most of the respondents either use help from some body without payment or do the assessment themselves. In relation

to the result 31 respondents were no help at all and 72 were get helps from their relatives. The reason might be due to the fact that only 69.9% of the respondents were getting assistances from their friends, families and even in the tax department. Some of the respondent did their own tax filing.

Table 4.2 did you receive help from somebody without payment?

Respondents Answer	Frequency	Percent
Yes	72	69.9
No	31	30.1
Total	103	100.0

Source: tax payers survey

The study is also raveled that most of the respondents either pay for assistant or not, 89 respondents were get assistance from different individuals but no payment at all and 14 respondents were keep silence. A large percentage of taxpayers still prepared their own tax returns.

Table 4.3 did you pay for assistance?

Respondents Answer	Frequency	Percent
No	89	86.4
Missing item	14	13.6
Total	103	100.0

Source: tax payers survey

Monetary costs

Compliance costs were evaluated for personal income taxpayers only; the costs of self-employed taxpayers, of employers (who are responsible for advance payments of tax) and for planning tax liabilities were excluded, as were psychological costs. These limitations were considered when the data are analyzed. The evaluated compliance costs include the cost of time spent filing a tax declaration properly (learning tax rule, record keeping, looking tax table, actual preparation of their statements and tax advisors), consultancy costs and other expenses (forms, postage, copying, Phone call etc.), and each of which is indicated in Table 4. Evaluating time spent on filing tax declarations depends on how 'time spent' is determined. Different studies in different time and different countries calculated the value of time in relation to spare time, work time or overtime at work.

Almost all studies have used the values stated by taxpayers in questionnaires but with different modifications: Pope (1995) used stated values but the extreme high and low values were removed; Allers (1994b) made two evaluations, one with stated values and the other using GDP to value an hour. Wollela Abehodie (2008) considers the estimation of tax compliance costs tends to be very sensitive to the method of valuation of time adopted. Market salary or wage rates could be used as a valuation basis for employees' time or as a check on the value of time provided by survey respondents. In Ethiopia, nevertheless, market salary or

wage rates appear to be unavailable thereby impeding the possibility of checking the reasonableness of valuations provided by respondents.

Accordingly, times spent by taxpayers in this study, were evaluated with the values that the taxpayers stated in questionnaires. Since the tax payers survey question raises a question like

“Do you pay someone for assistance with your 2009/10 income tax return?”

All of them were said no. Even though the tax payers did not pay for professional tax assistance, they still have had some expenses in preparing their tax returns such as, buying self-help tax guides, making phone calls, traveling, or postage costs (See Appendix 2).

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

Number of respondents	28	28	30	5	6	6
Income (ETB)	1001-2000	2001-5000	5001-10000	10001-15000	15001-20000	>20000
Monetary cost (ETB)	3,510	5,560	2,080	740	3,000	3,000
Number of respondents	51	47	5	-	-	-
Age	18-30	31-45	46-55	-	-	-
Monetary cost (ETB)	10,770	6,120	500	-	-	-
Number of respondents	30	56	17	-	-	-
Level of education	Some college	Degree	Post graduate/PhD	-	-	-
Monetary cost (ETB)	7,040	3,610	7,010	-	-	-

Source: tax payers survey

Times spent by taxpayers for the purpose of learning tax rules; keeping record; looking tax tables; time spent for actual preparation and assistant for the tax advisors were evaluated here with the values that the taxpayers stated in questionnaires as stated previously. The total hours the tax payers spent for the above five conditions were 532.25; and the total expenses that the tax payers were incurred was 17,390 ETB (Total monetary costs such as buying self-help tax guides, making phone calls, traveling or postage costs)(see Appendix 2 and 4). The average value per tax payer on tax compliance was 168.83 ETB.

On average, taxpayers spent 1.39 hrs for learning tax rules; 0.72 hrs for keeping record; 0.88 hrs for looking tax tables; 0.90 hrs for actual preparation and 1.72 hrs assistant from tax advisors. Thus, in total, 5.17 hours were spent, on average.

Learning tax rule for income tax purposes is the highest time spends of 143.5 hours in the first class of each variable, means that different class of income level, different category of age groups and in the different level of education, have dedicate more time in the year of assessment 2009/10 next to tax advisors. The explanation to the result might be because with based on the findings of a study called "Business Process Reengineering" radical change -that alters the fundamental nature of the Ethiopian Tax and Customs Administration system has recently taken place. The change has involved the introduction of new tax and customs laws and regulations in the federal taxation system, taxpayers

become aware that they need to know what the new reengineering process have an impact on the tax laws. The least time spend is on activities associated with keeping records. Taxpayers become not aware that they need to keep record in order for them to claim all the deductions available. In all, the total time spend are 532.25 and the mean time spend for individual taxpayer is 5.17 hours. The full result is shown in Table 5. Nearly 1/4th of the time spent on filing was devoted to learning tax rules and actual preparation of the return accounting for about 1/7th of total time.

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

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

Number of respondents	28	28	30	5	6	6	
Income (ETB)	1001-2000	2001-5000	5001-10000	10001-15000	15001-20000	> 20000	
Own time							Total
Tax rule	37.5	41.5	42.5	4.5	10	7.5	143.5
Keeping records	19.5	25	21.75	1	4.5	2.5	74.5
Tax table	26.75	24.25	21.75	2.5	7	8	90.25
Preparation	23.25	28.75	24	3.5	7	7.25	93
Tax advisors	32	40	35.5	4.5	11	7.5	131
Total	139	159.5	145.5	16	39.5	32.75	
Monetary Expenditure	3,510	5,560	2,080	740	3,000	3,000	

Source: tax payers survey

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

greater than the value in the 10,000 to >20,000 ETB income groups. The allocation of time spent among the various categories is relatively constant among income groups, learning tax rules and tax advisors are relatively more important for 1,000 to 10,000 ETB income groups. The fraction of individuals who look at tax tables generally decrease with income, starting from about 56.5% for the lowest two classes (for the first two classes), about 26.9% for the middle income groups (for the next two classes), up to 16.6% for those households earning more than 15,000 ETB of income (for the last two classes). Except for the lowest middle two classes, the average amount spent by those who do use assistance rises as well.

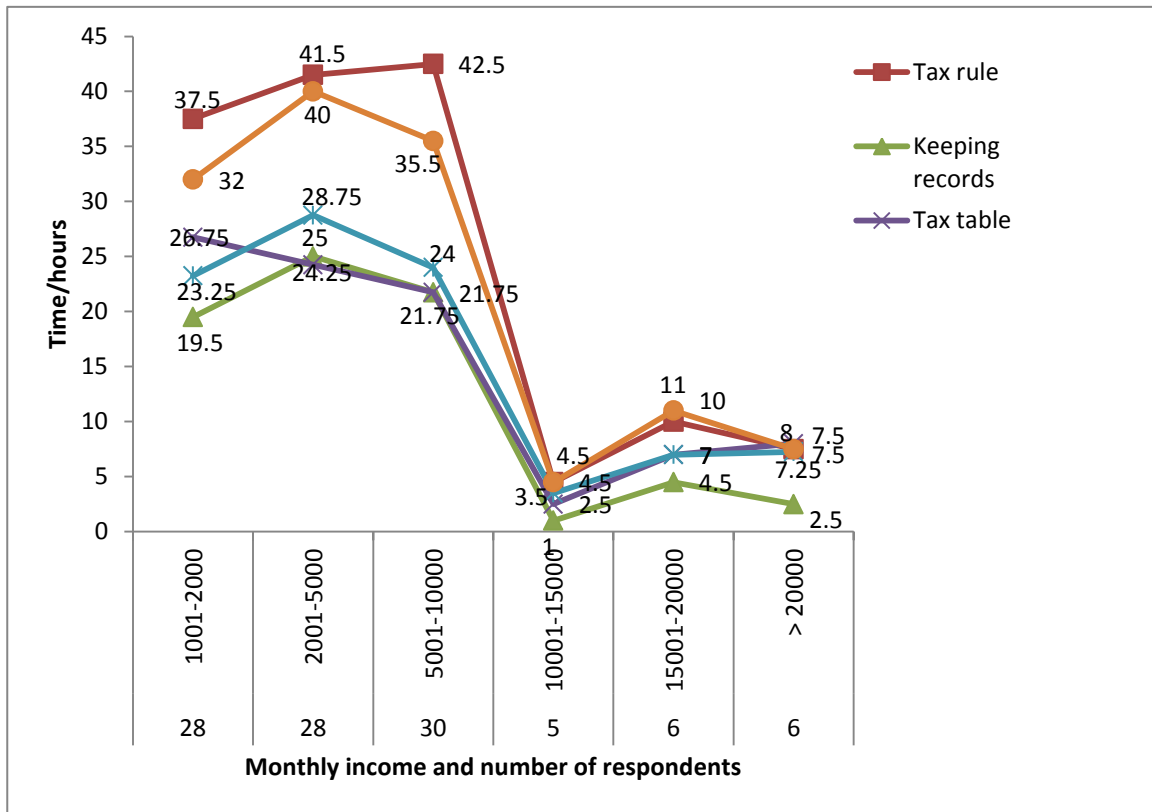


Figure 4.1 indicates the corresponding value of time and income

Source: tax payers survey

The total monetary cost of compliance has a U-shaped relationship with income. For households with over 20,000 ETB incomes, the average monetary cost were 3,000 ETB. Measured as a percentage of income, the cost for the highest group is (32.45%) which is significantly higher than for any of the other groups.

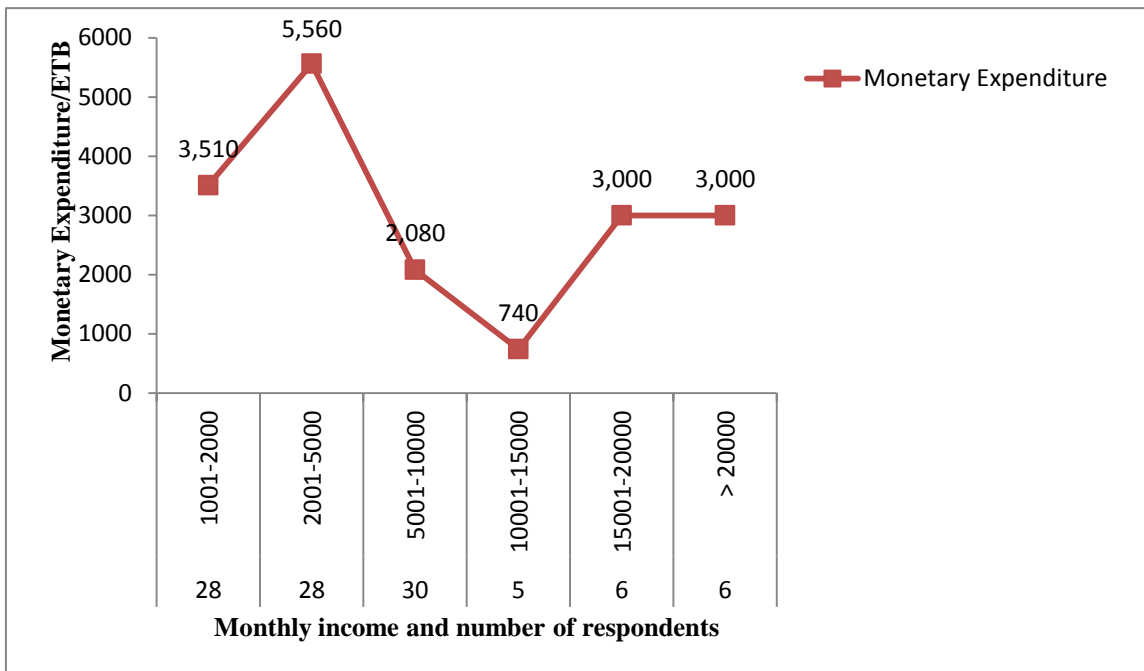


Figure 4.2 monetary cost and income

Source: tax payers survey

Table 6 was explained data on the relationship between compliance cost and educational attainment. This table indicates the less educated taxpayer tends to spend more time on his tax affairs and is more likely to need professional tax advice. In the middle educational attainment group, over 55.7% of individuals need for assistance, compared to less than 30% for college graduates and less than 20% for those with a post graduate level education. However, Measured as

a percentage of level of education, the cost for the middle group is significantly lower (20.76%) than for any of the other two groups (some college 40.48% and post graduate and PhD 38.76%). Here we can understand the cost of middle class educational attainments (degree), were incurred less cost than the other two classes because the time they devote in learning tax rules and needs to help the tax advisors were more relative to others and also because no payment for the tax advisors at all rather they are voluntarily assist them. So they can straightforwardly minimize their costs.

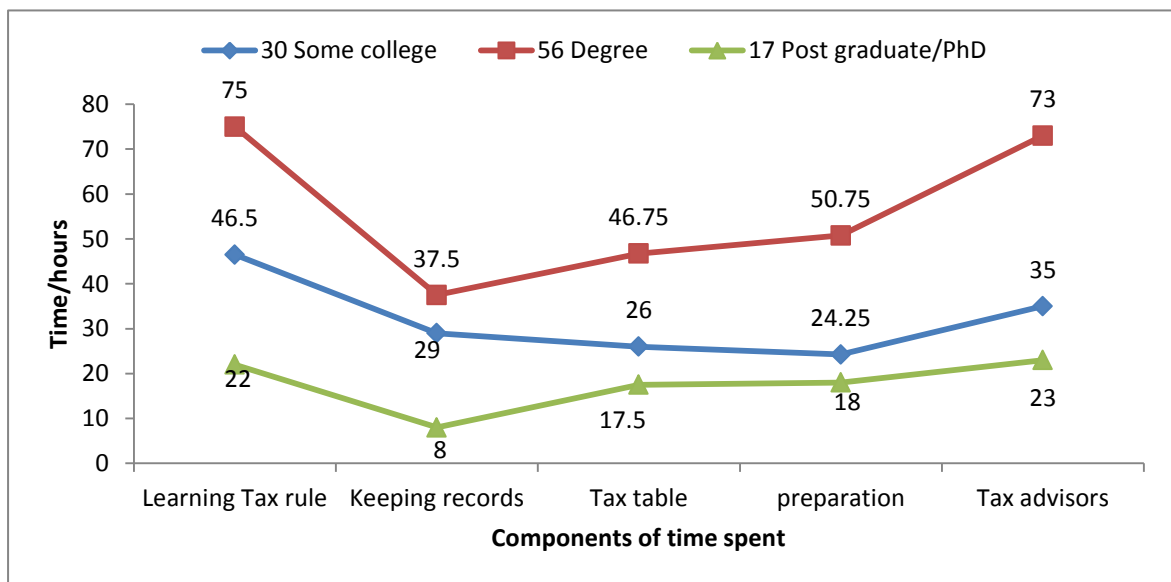


Figure 4.3 components of time and educational attainments

Source: tax payers survey

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

Number of respondents	30	56	17	
Level of education	Some college	Degree	Post graduate/PhD	Total
Learning tax rule	46.5	75	22	143.5
Keeping records	29	37.5	8	74.5
Tax table Preparation	26	46.75	17.5	90.25
Tax advisors	35	73	23	131
Total	160.75	283	88.5	
Monetary expenditure	7,040	3,610	6,740	17,390

Source: survey result

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

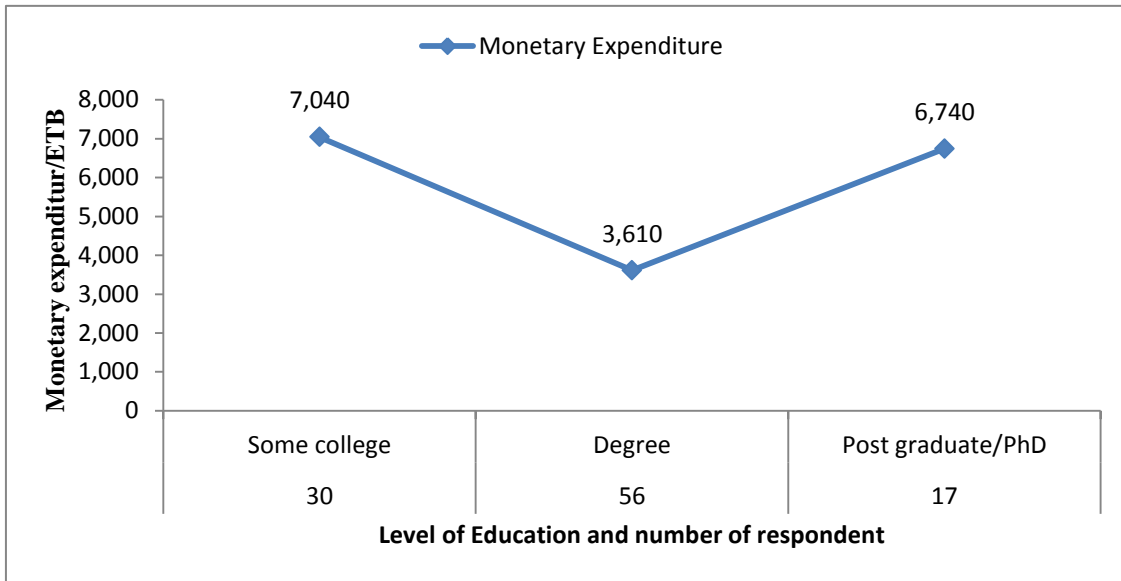


Figure 4.4 Monetary expenditure and educational attainment

Source: tax payers survey

Table 7 indicates the relationship between compliance cost and the age of the person in the household most familiar with the tax return. Total time spent on compliance first falls then rise with age, but the reverse is true for compliance cost. This is also true for its major component, record-keeping, learning tax rule; looking tax table. In contrast, the fraction of households that needs professional tax assistance is higher for the older groups (46-55), 1.3 hrs ($6.5/5 = 1.3$) than for the two younger groups (18-30 and 31-45), 1.28 hrs ($65.5/51 = 1.28$) and 1.16 hrs ($59/47 = 1.26$) respectively. Whether this represents an unwillingness to hassle with tax matters on the part of older taxpayers or more complicated tax returns is impossible to say without further analysis. In any event, the ratio of expenditures

on professional tax assistance to hours of own time spent rises monotonically from 1.28 hrs for the youngest group to 1.3 hrs for the oldest group.

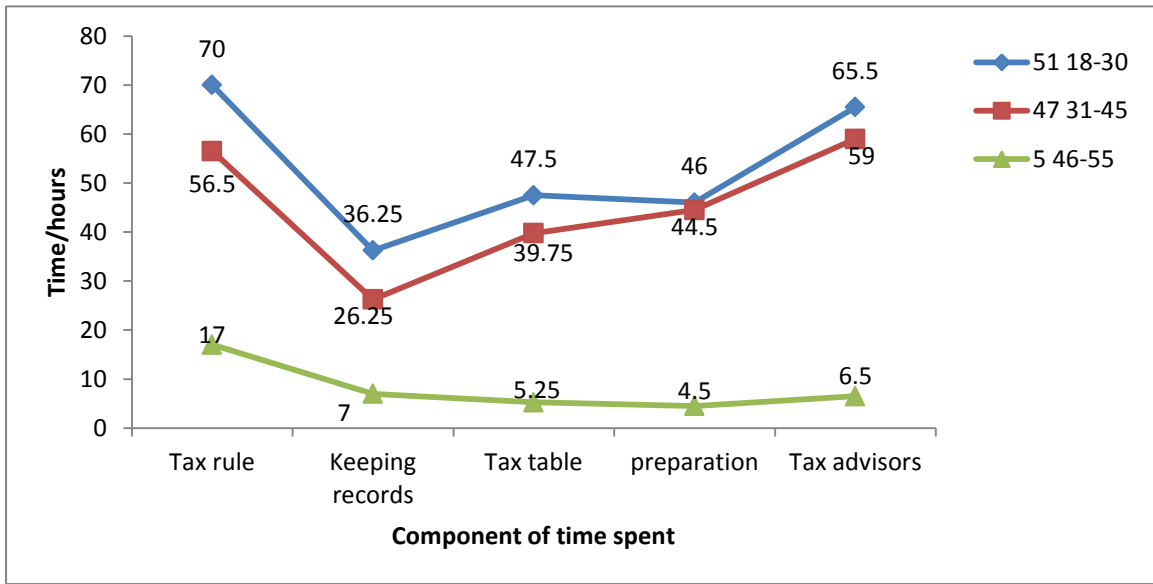


Figure 4.5 Components of time spent and Age of tax payers

Source: tax payers survey

The total monetary cost of compliance also strictly falls as age increases. The average compliance cost of each individual tax payers were sustain ETB 211.18 from the table 3, $(10,770/51=211.18)$, ETB 130.21 $(6,120/47=130.21)$, and ETB 100 $(500/5=100)$ from each age group respectively.

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

Number of respondents	51	47	5	
Age	18-30	31-45	46-55	Total
Tax rule	70	56.5	17	143.5
Keeping records	36.25	26.25	7	74.5
Tax table	47.5	39.75	5.25	90.25
Preparation	46	44.5	4.5	93
Tax advisors	65.5	59	6.5	131
Total	266	226	37.25	
Monetary expenditure	10,770	6,120	500	

Source: tax payers survey

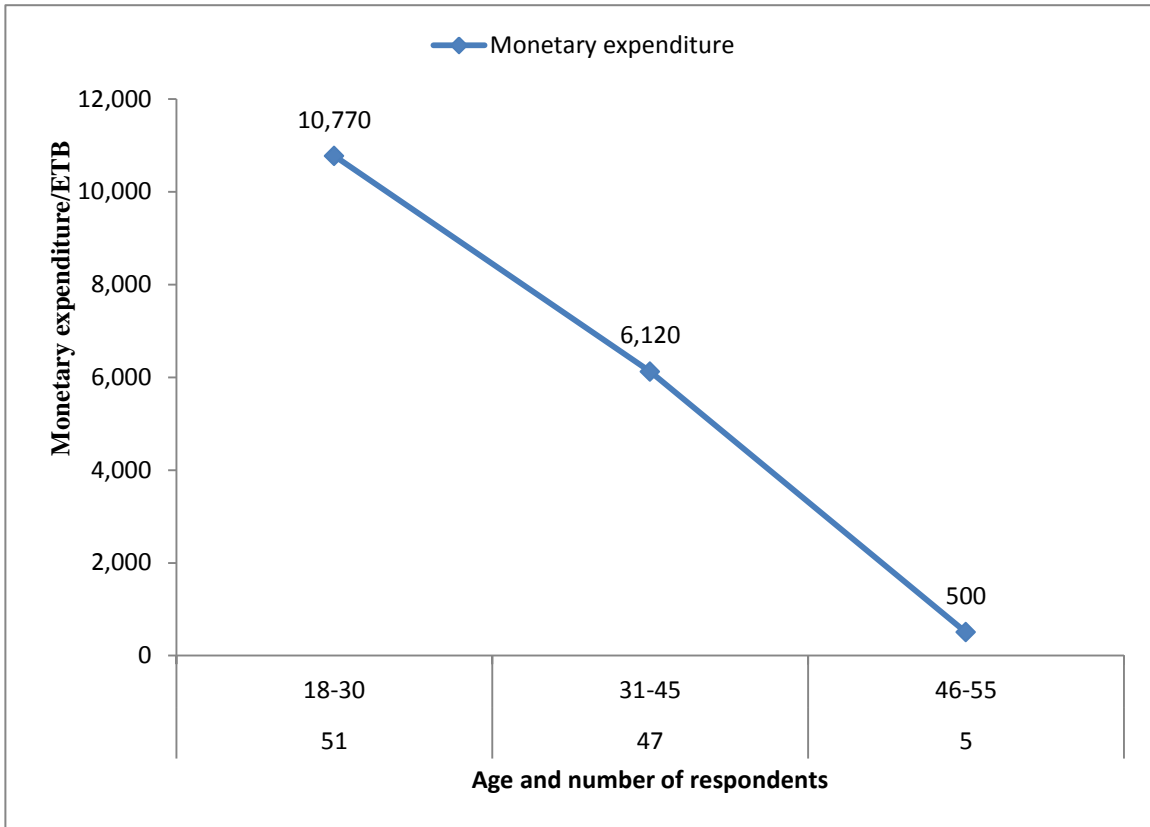


Figure 4.6 monetary cost and Age of tax payers

Source: tax payers survey

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

and know how are increase and they also have increase their commitment to pay their tax liability as age increases.

There is no such significant relationship between level of education and learning tax rules (Pearson correlation, $p=0.162$) as well as no statistically significant relationship with keeping records.

There is also a positive statistically significant relationship concerning the level of education (Pearson correlation, $p<0.01$) with looking a tax tables and actual preparation but a negative statistically significant relationship with helping from tax advisors. As the education level rises, the percentage of individual income tax payers who fill in on their own rises too (and, vice versa, the percentage of the taxpayers using external help falls). This is in accordance with the results of similar researches (Diaz & Delgado, 1995).

Table 4.8 the correlation matrix of variables

	Age	Level of education	Income	Learning tax rule	Keeping records	Looking tax tables	Preparation	Tax advisors
Age	1	.454** (.000)	.394** (.000)	.019 (.846)	-.344** (.001)	-.173 (.081)	-.033 (.740)	-.183 (.065)
Level of education		1	.807** (.000)	.139 (.162)	.052 (.608)	.319** (.001)	.616** (.000)	-.279** (.004)
Income			1	.313** (.001)	.241* (.017)	.488** (.000)	.776** (.000)	-.223* (.024)

Note: The numbers presented are the Pearson correlation and a two-tailed significance test** (in parentheses).
 Source: correlation matrix table

As also understand from the above table, there is also a relationship between income and compliance time. There is a positive statically significant relationship between income of the individual income tax payers and learning tax rules, looking, tax tables, keeping records and actual preparation of their statements (Pearson correlation, $p < 0.01$), but a negative statistical significant at 5% confidence relationship with helping from tax assistances (Pearson correlation, $p = 0.024$). Some correlations between attitude variables are also shown in the correlation matrix in Appendix 5.

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

To sum up, results in respect of compliance costs of individual income tax payers depicted the following findings. The average values per tax payers were 168.83 ETB and the average times spent by tax payers for filing their tax return were 5.17hrs.

Despite the fact that international comparisons of compliance costs could not be made because of several obstacles like different methodologies, different response rate, evaluation of time, assessment of tax and tax rates, the study also make comparisons with other similar prior studies such as the study conducted by Diaz and Delgado, 1995 = 6.8hrs, Pope, 1995 = 7.8hrs, Slemrod and Sorum, 1984 = 21.7hrs, and Blumenthal and

Slemrod, 1992 = 27.4hrs, time spent by tax payers for personal income tax on average in Addis Ababa are relatively low. The main reason for this is the low consultancy costs. Almost all of the surveyed tax payers were no payment for tax advisors. If they sought help, they turned to friends and family and did not pay for it.

Compliance costs for the 2009/10 fiscal year were found to be 4,269,329.4 million ETB. As a share of total tax revenues and GDP² these costs were in the range of approximately 0.98 % and 0.11% respectively. The largest component of compliance time (143.5 hours) is the time spent for learning tax rules, which is on average 27% and the least component of compliance time (14%) is the time spent for keeping records.

Documentary analysis

As stated in chapter 3, apart from the survey, this study employed documentary study. Documents including the income tax legislation or proclamation and other official documents (both published and unpublished) held by the tax authorities and other government institutions were examined. Besides, the documentary analysis aimed at obtaining estimates of percentage of costs incurred and time spent by each individual income tax payers. Some clue of the estimates of percentage of costs incurred and times spent in connection with income tax administration by the individual income tax payers were obtained from all the selected tax offices which were specified in chapter 3 above

² In the fiscal year 2009/10, GDP at current market price reached 383.4 billion Birr, The Ethiopian Revenues and Customs Authority (ERCA) reported collecting 43.315 billion Br from tax revenue (from direct and indirect tax) in the 2009/10 fiscal year(NBE, 2010).

in Addis Ababa. The numbers of Individuals who are required to pay their income tax liability within the specified date were decrease from year to year. The reason behind to this is that their fear of such kinds of costs. Since they are voluntarily registered without enforcing by any government body, at the beginning they registered more but unfortunately after a certain period of time they dispose themselves too. As chapter one stated, weak enforcement is a cause for concern since personal income tax compliance tends to be lower. And also these individuals are required to pay income tax. They are ordered to do so by income tax proclamations, regulation and directives. According to the law, individuals who obtain income from their employment are required to pay tax. In line with internationally recognized best practice, employee's income tax liabilities are calculated and paid directly by their employer. As a result the government relies on employers to compute and withhold the tax to be paid by employees. But in this study these individuals were forced to pay their income tax liability by themselves. The employers were not responsible to calculate and paid to the tax authority. They were not act as an agent; rather they pay the gross amount. These individuals were voluntary disclose their income and goes to the nearer tax office and therefore, they exposed compliance cost easily. Therefore, the authority should designed a strong tax audit policy and strategy to deliver the aspiration of helping customers to pay the right tax at the right time and with the minimal administrative and compliance cost to both ERCA and customers alike.

CHAPTER FIVE

5 CONCLUSION AND RECOMMENDATIONS

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

5.1 Conclusion

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

Data was obtained from taxpayer surveys and documents held by tax authorities and other institutions were employed to address this research question and hypotheses. On average, respondents to this survey spent 5.17 hours of their own time on tax filing, which had a resource cost of 168.8 ETB. Thus, the average total cost amounted to 168.8 ETB per individual income tax payers.

Considering the total estimated of 25,287 taxpayers in Addis Ababa in 2009/10, it yields aggregate estimates of 130,733.79 hours and a total compliance cost of 4,269,329.4 ETB.

This cost is approximately 0.98 % of total tax revenues and 0.11% of total GDP of the country as a whole for the year of assessment. The results also provide evidence that unlike the practice in most developed countries, the majority of taxpayers in Addis Ababa do not use tax advisors.

5.2 Recommendations

- So the authority improves the tax system by different kinds of mechanisms to enhance and facilitate the tax collection mechanisms. For example give workshops for taxpayers' and tax practitioners' education and communication training. The training focused on developing taxpayer education understanding, communication skills and customer service delivery techniques and the training also focused on developing the various skills essential for improving voluntary tax compliance through better education and communication. Communication with taxpayers is an art which must be performed with skills acquired from training to identify areas that they would like to enhance and improve the way they interact and deal with certain matters with taxpayer and also to build effective working relationship.
- The authority better to design a strong tax audit policy and strategy to deliver the aspiration of helping customers to pay the right tax at the right time and with the minimal administrative and compliance cost to both ERCA and customers alike.

5.3. Research limitations and future research directions

The results of the study, however, are limited in several ways. First, this study covers only a small number of taxpayers. Hence, the findings of the study might limit their generalisability. Second, associated with methods of estimating the cost of times spent by each individual income tax payers. Specifically, estimating the time spends was calculated based on the questionnaires the tax payers were stated rather than using stated value, wage rate or others methods. These methods do not result in exact measure of tax compliance costs.

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

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

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

- The researcher also recommends a study to be conducted, which will evaluate the above concepts in the other excluded tax payers (e.g. an employee working for more than one employer) to improve on the revenue collection so as to build our developing economy.
- The survey method (questionnaires) used to measure compliance costs in this studies were one Saied, only the tax payers, not include the tax officials. Consequently considering those officials make the findings of the study more accurate and general.

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Appendices

Appendix 1 tax payers survey instrument

April, 2011

Dear Taxpayer,

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

Unfortunately, as things are, it takes a long time to comply with tax laws and one also has to bear substantial monetary costs. These costs do not give any additional benefits. You are one of 170 randomly selected taxpayers for this survey. The enclosed questionnaire will give the information, which only you can provide, of your time and money costs in paying income tax. This information is anonymous and strictly confidential – you need not disclose your identity. The information will be used only for the study and will not be given to any other organization, government department or person. I realize your time is valuable and appreciate your concern for tax reforms.

Your responses are vital to the outcome of the study and you are kindly requested to completely and objectively answer all questions.

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

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

Yours sincerely,

Addisu Mera

7. Check the income bracket which describes your 2009/10 total income.

(If you filed a joint return, please include your spouse's income.)

Under Br1, 000	<input type="checkbox"/>	Br 10,001 — Br 15,000	<input type="checkbox"/>
Br 1,000 — Br2, 000	<input type="checkbox"/>	Br 15,001 — Br 20,000	<input type="checkbox"/>
Br 2,001 — Br 5,000	<input type="checkbox"/>	over Br 20,000	<input type="checkbox"/>
Br 5,001 — Br 10,000	<input type="checkbox"/>		

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

Yes

No

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

Br.....

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

Br.....

9. The time you spent on your 2009/10 income tax returns can be divided into several areas such as learning tax rules, keeping records, preparing tax returns, and meeting with tax advisors.

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

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

-----hours

Time spent keeping receipts or records for your income taxes.

-----hours

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

-----hours

Time spent in actual preparation of your tax returns.

-----hours

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

-----hours

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

-----hours

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

√

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

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

Yes No

12. Did you have someone help you with your 2009/10 income tax returns but did not pay them for their assistance? Yes No

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

-----hours

13. Did you pay someone for assistance with your 2009/10 income tax returns?

Yes No

IF YES, GO TO QUESTION 16.

IF NO, PLEASE CONTINUE WITH THE NEXT QUESTION (#14).

THIS SECTION IS FOR THOSE PEOPLE WHO DID NOT PAY FOR TAX ASSISTANCE WITH THEIR 2009/10 INCOME TAX RETURNS.

14. Even though you did not pay for professional tax assistance, you may still have had some expenses in preparing your tax returns (such as buying self—help tax guides, making phone calls, traveling, or postage Costs). Please estimate these costs for filing your 2009/10 income tax returns.

Br-----

15. If you could have avoided all the time and effort of gathering tax information and preparing your 2009/10 tax returns, how much would you have been willing to pay? (Assume the amount of income tax paid would not have changed.)

Br-----

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

16. What amount in fees did you pay to any of the following for help in filing your 2009/10 federal and/or state tax returns? (Please give amounts to the nearest Birr.)

Accountant or Accounting Firm Br.....

Tax Preparers or Firms Br.....

Other (describe) Br.....

17. In preparing your 2009/10 tax returns you may have had other costs besides the fees paid to tax advisors such as travel expenses, phone calls, postage, or written materials. Please estimate these additional Costs.

Br.....

18. If you could have avoided all the time and effort on your 2009/10 income tax returns, how much more would you have been willing to pay above and beyond what you already paid for tax assistance? (Assume the amount of income tax paid would not have changed.)

Br.....

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

ETB	Frequency	Results*	Percent	Percent	Cumulative Percent
100	10	1000	9.7	9.7	9.7
120	1	120	1.0	1.0	10.7
140	2	280	1.9	1.9	12.6
150	5	750	4.9	4.9	17.5
160	1	160	1.0	1.0	18.4
20	4	80	3.9	3.9	22.3
25	6	150	5.8	5.8	28.2
30	16	480	15.5	15.5	43.7
350	6	2100	5.8	5.8	49.5
45	6	270	5.8	5.8	55.3
50	9	450	8.7	8.7	64.1
500	12	6000	11.7	11.7	75.7
60	10	600	9.7	9.7	85.4
700	6	4200	5.8	5.8	91.3
80	6	480	5.8	5.8	97.1
90	3	270	2.9	2.9	100.0
Total	103	17390	100.0	100.0	

* Result=ETB*frequency

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

	Frequency	Percent	Valid percent	Cumulative percent
I very much enjoy it	11	10.7	10.7	10.7
I enjoy it	52	50.5	50.5	61.2
I neither enjoy nor dislike it	18	17.5	17.5	28.1
I dislike it	22	21.3	21.3	100
I dislike it very much	-	-	100	-
Total	103	100		

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

Time/hours	Frequencies	Results	Percent	Valid Percent	Cumulative Percent
1.5	7	10.5	6.8	6.8	6.8
1.75	2	3.5	1.9	1.9	8.7
12	2	24	1.9	1.9	10.7
14	4	56	3.9	3.9	14.6
16.5	2	33	1.9	1.9	16.5
2.25	3	6.75	2.9	2.9	19.4
2.5	6	15	5.8	5.8	25.2
3	9	27	8.7	8.7	34.0
3.5	9	31.5	8.7	8.7	42.7
3.75	2	7.5	1.9	1.9	44.7
4	9	36	8.7	8.7	53.4
4.5	10	45	9.7	9.7	63.1
5	10	50	9.7	9.7	72.8
5.5	4	22	3.9	3.9	76.7
5.75	2	11.5	1.9	1.9	78.6
6	6	36	5.8	5.8	84.5
6.5	6	39	5.8	5.8	90.3
7	2	14	1.9	1.9	92.2
7.5	4	30	3.9	3.9	96.1
8	2	16	1.9	1.9	98.1
9	2	18	1.9	1.9	100.0
Total	103	532.25	100.0	100.0	

Appendix 4a Time spent on learning tax rules

Time/hours	Frequency	Results	Percent	Valid Percent	Cumulative Percent
0	5	0	4.9	4.9	4.9
0.5	21	10.5	20.4	20.4	25.2
1	43	43	41.7	41.7	67.0
1.5	8	12	7.8	7.8	74.8
10	2	20	1.9	1.9	76.7
2	18	36	17.5	17.5	94.2
2.5	4	10	3.9	3.9	98.1
6	2	12	1.9	1.9	100.0
Total	103	143.5	100.0	100.0	

Appendix 4b Time spent for keeping records

Time/hours	Frequency	Results	Percent	Valid Percent	Cumulative Percent
0	35	0	34.0	34.0	34.0
0.25	2	0.5	1.9	1.9	35.9
0.5	36	18	35.0	35.0	70.9
1	14	14	13.6	13.6	84.5
1.5	4	6	3.9	3.9	88.3
2	6	12	5.8	5.8	94.2
3	2	6	1.9	1.9	96.1
4	2	8	1.9	1.9	98.1
5	2	10	1.9	1.9	100.0
Total	103	74.5	100.0	100.0	

Appendix 4c Time spent for looking tax tables

Time/hours	Frequency	Results	Percent	Valid Percent	Cumulative Percent
0	8	0	7.8	7.8	7.8
0.25	5	1.25	4.9	4.9	12.6
0.5	47	23.5	45.6	45.6	58.3
1	18	18	17.5	17.5	75.7
1.5	15	22.5	14.6	14.6	90.3
2	4	8	3.9	3.9	94.2
2.5	2	5	1.9	1.9	96.1
3	4	12	3.9	3.9	100.0
Total	103	90.25	100.0	100.0	

Appendix 4d Time spent for actual preparation

Time/hours	Frequency	Results	Percent	Valid Percent	Cumulative Percent
0	3	0	2.9	2.9	2.9
0.25	6	1.5	5.8	5.8	8.7
0.5	39	19.5	37.9	37.9	46.6
1	41	41	39.8	39.8	86.4
1.5	6	9	5.8	5.8	92.2
2	4	8	3.9	3.9	96.1
3	2	6	1.9	1.9	98.1
4	2	8	1.9	1.9	100.0
Total	103	93	100.0	100.0	

Appendix 4 e Time spent for helping from tax advisors

Time/hours	Frequency	Results	Percent	Valid Percent	Cumulative Percent
0	8	0	7.8	7.8	7.8
0.5	18	9	17.5	17.5	25.2
1	41	41	39.8	39.8	65.0
1.5	8	12	7.8	7.8	72.8
2	18	36	17.5	17.5	90.3
2.5	2	5	1.9	1.9	92.2
3	4	12	3.9	3.9	96.1
4	4	16	3.9	3.9	100.0
Total	103	131	100.0	100.0	

Appendix 5 correlation of the stated variables

Correlations

		age	level of education of the respondant	income level	time spent on learning tax rules	keeping records	taxtable	preparation	taxadvisor
age	Pearson Correlation	1	.454**	.394**	.019	-.344**	-.173	-.033	-.183
	Sig. (2-tailed)		.000	.000	.846	.001	.081	.740	.065
	N	103	103	103	103	98	103	103	103
level of education of the respondant	Pearson Correlation	.454**	1	.807**	.139	-.052	.319**	.616**	-.279**
	Sig. (2-tailed)	.000		.000	.162	.608	.001	.000	.004
	N	103	103	103	103	98	103	103	103
income level	Pearson Correlation	.394**	.807**	1	.313**	.241*	.488**	.776**	-.223*
	Sig. (2-tailed)	.000	.000		.001	.017	.000	.000	.024
	N	103	103	103	103	98	103	103	103
time spent on learning tax rules	Pearson Correlation	.019	.139	.313**	1	.548**	.261**	.441**	-.138
	Sig. (2-tailed)	.846	.162	.001		.000	.008	.000	.165
	N	103	103	103	103	98	103	103	103
keeping records	Pearson Correlation	-.344**	-.052	.241*	.548**	1	.569**	.448**	-.152
	Sig. (2-tailed)	.001	.608	.017	.000		.000	.000	.136
	N	98	98	98	98	98	98	98	98
taxtable	Pearson Correlation	-.173	.319**	.488**	.261**	.569**	1	.789**	-.100
	Sig. (2-tailed)	.081	.001	.000	.008	.000		.000	.316
	N	103	103	103	103	98	103	103	103
preparation	Pearson Correlation	-.033	.616**	.776**	.441**	.448**	.789**	1	-.052
	Sig. (2-tailed)	.740	.000	.000	.000	.000	.000		.600
	N	103	103	103	103	98	103	103	103
taxadvisor	Pearson Correlation	-.183	-.279**	-.223*	-.138	-.152	-.100	-.052	1
	Sig. (2-tailed)	.065	.004	.024	.165	.136	.316	.600	
	N	103	103	103	103	98	103	103	103

** . Correlation is significant at the 0.01 level (2-tailed).

* . Correlation is significant at the 0.05 level (2-tailed).

Statement of Declaration

I, the undersigned, declare that this thesis is my original work, has not been presented for a degree in any other university and that all sources of materials used for the thesis have been dully acknowledged.

Declared by:

Name: Addisu Mera

Signature: _____

Date: _____