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**DETERMINANTS OF TAX COMPLIANCE ON SMALL AND MEDIUM ENTERPRISES
IN KIRKOS SUB CITY, ADDIS ABABA**

**A THESIS SUBMITTED TO THE DEPARTMENT OF ACCOUNTING AND FINANCE,
COLLEGE OF BUSINESS AND ECONOMICS, IN PARTIAL FULFILMENT OF
REQUIREMENT OF MASTERS OF SCIENCE (MSc) IN ACCOUNTING AND FINANCE**

BY: ASHEBR ADUGNA

ADVISOR: ALEM HAGOS (PhD)

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LETTER OF CERTIFICATIONS

This is to certify that Ashebr Adugna Amente has carried out this research project work under my supervision, on the topic of **Determinants of tax compliance in the case of Small and Medium Enterprises: In Addis Ababa city, Kirkos Sub city**". This work is original in its nature and it is suitable for Submission in partial fulfillment of the requirement for the award of Masters Degree in Accounting and Finance.

Approved by:

Internal Examiner:	Signature	Date
_____	_____	_____
External Examiner:	Signature	Date
_____	_____	_____
Advisor:	Signature	Date
_____	_____	_____

DECLARATION

I, Ashebr Adugna Amente, declare that the study entitled “**Determinants of tax compliance on Small and Medium Enterprises:** in the case of Addis Ababa city kirkos sub-city” is the result of my own effort in research undertaking. All information in this document has been obtained and presented in accordance with academic rules and ethical conduct. The study has not been submitted to any Degree or Diploma in any college or university. It is submitted in the partial fulfillment of the requirement of the award of Masters of Degree in Accounting and Finance. Lastly I have fully cited, acknowledged and referenced all material and results that are not original to this work.

Name: Ashebr Adugna Amente Signature _____ Date: _____

Abstract

The main objective of this study was to identify the determinants of tax compliance on small and medium enterprise taxpayers': the case of kirkos subity Addis Ababa. The specific objective includes examining, the effect of tax rate, knowledge of tax system, fairness of tax system, and trust in government on tax compliance. The research used explanatory research methods. The primary data was collected using Likert scale questionnaires distributed to the small and medium enterprise owners and employees in kirkos sub city taxpayers. Dependent variable (Tax compliance) was measured in terms of complied to tax law that is registered timely, collect taxes by a legal receipt, file the tax returns in the actual filing date, compute the tax liability as per the tax rate specified in the law, paid the right amount of tax within the time frame stipulated in the tax law and have adequate records to complete tax returns and associated tax documentation. The predictor or independent variables were tax rate, tax knowledge, fairness of tax system, probability of being audited, and trust in government. The target population was 8013 from SMEs registered taxpayers. The researcher utilized stratified random sampling for taxpayers and purposive sampling techniques to select the participants. A sample size of 381 has been drawn from the tax population in Addis Ababa kirkos sub city SMEs. The descriptive statistics was used to analyze the tax compliance and inferential analysis (multiple regression analysis) to determine the cause and effect relationship Independent variables on dependent variable and to test the hypothesis. According to the regression output the knowledge of tax system, fairness of tax system tax audit and trust in government affect the tax compliance significantly and positively. The remaining variable tax rate negatively related with tax compliance and their contribution was statistically insignificant. All these independent variables are making 67.2% of the contribution for tax compliance. The results of this study also provide specific insights and enable policymakers to gain a better understanding of key variables that are significantly linked to tax compliance and enable them to implement appropriate strategies to minimize potentially harmful factors, as well as improve tax collections for their government. Thus, these factors should be given due consideration to enhance taxpayers' compliance behavior and improve government's revenue collection.

Key words: Tax, tax compliance, tax audit, Small and medium enterprises

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Acronyms

AACGRA	Addis Ababa City government Revenue Authority
ANOVA	Analysis of Variance
CSA	Central Statistics Agency
FeMSEDA	Federal micro and small enterprise development Agency
FMS	Fairness of Tax System
GDP	Gross Domestic Product
KTS	Knowledge of tax system
MOR	Ministry of Revenue
OECD	Organization of Economic cooperation and Development
SMEs	Small and Medium Enterprises
SPSS	Statistical Package for Social Science
TA	Tax Audit
TC	Tax Compliance
TR	Tax Rate
TIG	Trust In Government
VAT	Value Added Tax

CHAPTER ONE

INTRODUCTION

1.1 Background of the study

The majority of multinational corporations have their origins in small and medium-sized businesses (SMEs). This indicates that the SMEs of today are the future of large companies, and that they must be nurtured to ensure their development. As a result, SMEs are widely regarded as the "seedbed" for indigenous entrepreneurship, generating a large number of small investments that would not have occurred otherwise (Aryeetey & Ahene, 2004). As a result, developing economies such as Ethiopia must continue to develop their private sector by creating an atmosphere that encourages the growth of SMEs, strengthening the factors that lead to business success, and addressing the issues that threaten the existence and advancement of small and medium enterprises (Chu, Kara, & Benzing, 2008), so that they can play the role that is required of them in economic transformation. Mobilization of domestic savings for investment, significant contribution to GDP, increased harnessing of local raw materials, job creation, and significant contribution to poverty reduction efforts through sustainable livelihoods and enhancement in staff income, technological growth, and export diversification are all examples of such roles (Smatrakalev, 2006). Furthermore, they have the advantage of reaching the farthest corners of the country unlike the large establishments.

Individual and business tax revenue is a significant source of revenue for the government, especially in an economy that is struggling to reduce budget deficits. Tax revenue is thus a major source of funds for development projects such as the provision of infrastructure such as good roads and reliable power and water supply, both of which help businesses – and thus the economy as a whole to flourish (Atawodi and Ojeka, 2012). Small businesses are important players in developing countries' economies, such as Ethiopia's, because they produce substantial jobs and output. Because of the importance of this sector to the country's economy, it's critical that tax administration policies are introduced to improve SME taxpayers' attitudes and compliance with paying taxes. MOR and AACRA administers different types of taxes under different laws and regulations such as income tax, value added tax, custom duties and excise

taxes, turn over tax among others and hence they are supposed to ensure taxpayers comply with the respective tax laws. It has been observed however, from previous taxation studies that several SMEs in developing economies are non tax compliant despite of major reforms, since they cannot easily be located by tax administration, yet they pay less tax than their reasonable tax.

Taxation has played an important role in civilized societies since their inception thousands of years ago, particularly for countries like Ethiopia, where taxation is the primary source of government revenue. Tax is characterized as a mandatory payment levied on income by the government or another taxing body in exchange for which the taxpayer receives no special benefit. Charges, tolls, and other levies, for example, are charged to access a particular service and are not exclusively tax payments. The significance of a country's tax system as a major revenue source is undeniable; these statistics show that tax collections are one of the most important sources of revenue for many governments around the world; however, maximizing tax collection while minimizing tax evasion by tax payers is difficult to achieve in practice.

According to Kircher (2008), a tax audit is the review of a person's or organization's tax return by the appropriate tax authorities to ensure conformity with state tax laws and regulations. He went on to say that a tax audit is a procedure in which the Internal Revenue Service verifies the figures you entered on your tax return. Ola (2001) stated that the process of tax audit involves tax returns that are selected for audit using some selection criteria. Thereafter, the underlying books and records of the taxpayers are examined critically to relate them to the tax return filed. Tax audit is important because it assist the government in collecting appropriate tax revenue necessary for budget, maintaining economic and financial order and stability, to ensure that satisfactory returns are submitted by the tax payers, to organize the degree of tax avoidance and tax evasion, to ensure strict compliance with tax laws by tax payers, to improve the degree of voluntary compliance by tax payers and to ensure that the amount due is collected and remitted to government. Ephrem(2016).

Tax administration basically consists of sets of rules and regulations guiding the tax authority to discharge its responsibilities in the implementation of the tax policy. The activities involved in the tax administration include: identifying and registering the taxpayer, invoicing, filing and payment requirements, control of filing and payments, refunds, audits and penalties. Tasks such as determining who would be administering the tax, what organizational setup to use and what

resources are available are peripherally fall under the responsibility of tax administration (Yesegat 2008, p. 146).

Ethiopia's tax system is mostly made up of direct and indirect taxes levied by both the national and provincial governments (Ethiopia Trade and Investment, 2015). Business profit taxes, personal income taxes, withholding taxes, rental taxes, and other taxes are the most common types of direct taxes. VAT, TOT, and Customs duty are the indirect taxes that apply.

According to income tax proclamation No. 286/2002, taxable business income would be determined per tax period on the basis of the profit and loss account or income statement. Accordingly, taxable business income of corporate businesses is taxed at a flat rate 30% and other business (unincorporated individual businesses and PLCs) taxpayers are taxed at a progressive rate between 10% to 35%. The standard rate of VAT is 15% of the value of every taxable transaction by a registered person and all imports of goods and services other than those exempted.

According to the tax law, business income taxpayers are divided into three groups based on their annual turnover: category A, B, and C. As a result, taxpayers with annual turnover of Birr 500,000 and above are classified as Category "A" taxpayers, whereas business income taxpayers with annual turnover of Birr 100,000 to Birr 500,000 are classified as Category "B" taxpayers and business profit taxpayers with annual turnover less than Birr 100,000 are under category "C" taxpayers. According to (ERCA, 2012), taxpayers are further classified in to large, medium, and small taxpayers at the Federal level and Regional level based on their annual turnover. Accordingly, large taxpayers are taxpayers those annual turnover is above Birr 15million, medium taxpayers are those annual turnover between Birr 1.5million and Birr 15million and small businesses are those annual turnover between Birr 100,000 and 1.5million.

There are nine regional states and two city administrations in Ethiopia. Addis Ababa city administration is chosen for this study as there are many small and medium business taxpayers found in Addis Ababa and convenience to the researcher. According to the Micro and Small Enterprises Development Strategy (2011) special attention is given to the following major sectors such as manufacturing, merchandizing trade & service giving. Hence, this study aims at identifying factors affect voluntary tax compliance of SMEs taxpayers. What factors motivate

SME taxpayers to comply with the tax system or what factors influence SME registered taxpayers' not to comply with system. The output of this study helps the tax authority to incorporate measures that address these pitfalls while designing a tax system or policy registered.

1.2 Statement of the problem

Taxes are a significant source of revenue for the government. The existence of common consumption of goods and services entails the government receiving a portion of our earnings. Roads, power, municipal services, and other public infrastructures have a positive impact on a variety of facilities, businesses, industries, and the general population. As a result, government participation in the provision of public goods is essential, and it can only be done if the public pays taxes to fund the creation and distribution of such commodities (ERCA, 2015.)

Small and medium businesses, being profit-generating businesses, are expected to pay their taxes. The crucial question is, though, how much tax should they levy? SMEs are high-risk businesses that require specific attention. Taking into account their nature and all of the resources at their disposal can make a huge difference. As a result, number Ethiopian SMEs prefer to remain in the informal sector since the cost of compliance is too expensive for them. And a sizable portion of those that pay do so only because they are forced to by the authorities. (Ephrem 2016)

In a vast number of developed and emerging countries, tax compliance has been a significant research topic. Because each country has its own strategy to managing tax compliance levels, as well as its own set of tax rules and regulations, the elements that influence tax compliance behavior appear to differ (Palil, 2011). Tax as a proportion of GDP is one metric used to estimate a country's tax mobilization (tax compliance). Developing countries' governments currently collect a lower proportion of their GDP in tax revenue than OECD countries' governments: 10-20% against 30-40%. Their tax effort indices, which compare revenue collections to predicted revenue potential, are similarly lower than those of OECD countries. Many low-income nations, notably those in Sub-Saharan Africa, have a tax-to-GDP ratio of less than 15, which is widely regarded as the level below which modern governments struggle to provide basic functions and services (European Parliament, 2014).

According to the Report of (African Economic Outlook, 2015), the average 2010/11 to 2015/16 Ethiopia Tax Revenue Ratio to GDP is about 12.08. Although tax revenue-to-GDP showed a slight improvement in 2013/14 that is 12.7 compared to 12.4 in 2012/2013, it still remains low compared to the tax revenue generating capacity of the economy and the financing requirements of the development programs as GTP1 target of tax to GDP was 15-17%. Similarly, it is well below the average performances of sub Saharan African Countries of about 20% (Kenya 23%, Mauritius 19% and Tanzania 17%).

The government clearly stated (Ministry of Finance and Economic Development, 2013) that efforts will be geared toward promoting tax compliance, by equipping tax collection institutions and undergoing tax administration measures to further increase revenue mobilization at the federal and regional levels and achieve the GTP1 target of 15-17 percent tax to GDP ratio by 2 years. However, despite this effort, the desired outcome was not achieved. Continued low revenue collection levels for a government are harmful to the country's economic development (Cobham, 2005). In Addis Ababa, a major section of the informal sector, particularly small and medium firms, has low tax compliance levels (ERCA report No. 74, 2015). This is a great loss of revenues to be used to finance public expenditures. It is for this reason that this study attempted to find out the determinants of tax compliance of small and medium enterprise taxpayers' in the case of kirkos sub city, Addis Ababa.

1.3 Objectives of the study

1.3.1 General objective

The general objective of the study will be identifying determinants of tax compliance among Small and Medium Enterprises in Addis Ababa city Administration kirkos sub city.

1.3.2 Specific objectives

The specific objectives of the study include:

- Determine the magnitude of tax compliance among the SMES operating in Addis Ababa kirkos sub city

- To analyze the relationship between the level of tax knowledge and tax compliance decisions of SMEs.
- To assess if tax rate and tax compliance have any relation ships
- To investigate how fairness of tax system affect the compliance level of SMEs
- To investigate how the tax audits perceptions of SME operators towards taxation affect their tax compliance decisions.
- To analyze how trust in government correlate with tax compliance behavior of SMEs.

1.4 Research questions

- What is the relationship between tax audit and tax compliance?
- Does the tax knowledge of the SMEs affect the tax compliance behavior of SMEs?
- What are the factors that motivate tax payers to pay tax?

1.5 Research Hypothesis

Taking into consideration, the nature and extent of the problems stated so far, and literatures to be discussed later, it is necessary to formulate the following hypotheses in the form of null Hypothesis:

H₁: There is Negative relationship between perception of tax rate and tax compliance.

Empirical studies imply that higher tax rates lead to less compliance, with under reported income-tax rate elasticity ranging from -0.5 to -3.0, according to Alm (1999, p. 753). From the compliance lottery perspective, this may be seen as higher tax rates increasing the rewards from cheating. Lowering marginal tax rates to prevent tax evasion, on the other hand, makes little sense. Tax rate should be designed based on efficiency and equity concerns (Sandmo, 2005). In conclusion, data demonstrates that tax rates have a mixed impact on tax compliance, i.e., lower tax rates do not always lead to higher compliance. Tax increases may have a beneficial or negative impact on evasion. Furthermore, raising tax rates does not always result in a reduction in compliance behavior (Allingham and Sandmo, 1972).

H₂: There is positive relationship between the level of tax knowledge and tax compliance decisions of SMEs.

According to the allegation of the responsible taxpayer, Hypothesis 2 is aimed toward involuntary tax compliance. Many taxpayers, in the opinion of the responsible taxpayer, lack sufficient knowledge of their tax obligations, tax processes, and requirements, and that such information would raise compliance. Because tax education is not included in Ethiopia's curriculum, it is logical to assume that certain taxpayers lack sufficient tax knowledge; therefore, tax knowledge is predicted to promote tax compliance in Ethiopia. According to Chandarasorn (2012), having a better understanding of taxes enhances tax compliance. Experts proposed using public relations and teaching citizens about their tax responsibilities and sense of citizenship, as well as making tax payment simple and educating tax personnel as techniques for enhancing tax compliance. Various studies have examined the impact of tax awareness on compliance behavior. The amount of education gained by taxpayers is an essential influence in their comprehension of taxation, particularly in terms of tax laws and regulations (Eriksen & Fallan, 1996). Previous research has shown that tax knowledge is closely linked to taxpayers' ability to comprehend tax laws and regulations, as well as their capacity to comply (Singh & Bhupalan, 2001).

H₃: There is positive relationship between fairness of tax system and tax compliance of SMEs.

Tax compliance decisions are also influenced by attitudes and views of the IRS (Shreffinn & Triest, 1992). Tax compliance decisions are influenced by three basic types of attitude and perception: 1) tax system and government administration procedural fairness, 2) government service excellence, 3) Social perceptions of tax evasion. In tax systems and government administration, procedural fairness is crucial because it provides taxpayers with justifications for paying their fair portion of taxes. Procedures fairness, according to Tyler (1997, p. 1), instilled in people a sense of need to follow group norms because they are legitimate and entitled to be obeyed. The social norms against tax evasion and trust in government are strengthened by ensuring that everyone is treated equally, fairly, and respectfully (Hanousek & Palda, 2004; Slemrod, 2003; Torgler, 2003). People assume that fair procedures will lead to fair distribution

because of procedural fairness in tax systems and government management (Thibaut & Walker, 1975).As a result, procedural fairness fosters good attitudes and impressions of tax systems and government administration, which aids in the promotion of taxpayer compliance. Attitudes and beliefs that affect trust in government include procedural fairness, responsive service, and social standards. Increased tax compliance is linked to higher government trust (Hanousek & Palda, 2004; Slemrod, 2003; Torgler, 2003).As a result, it is critical for the government to be procedurally fair, responsive, and uphold social standards in order to combat tax evasion.

H4: There is positive relationship Probability of being audit and tax compliance.

Tax audits are a hot topic in the field of tax compliance research. Scholars are interested in audit probability, audit productivity (percent of undeclared revenue discovered), and prior audit alerts. Higher audit rates are expected to promote compliance (Alm, 1999).If audit probability and productivity are higher, the expected loss of being caught will be larger, according to the compliance lottery view or expected utility theory.As a result, more income will be reported by taxpayers (Allingham & Sandmo, 1972).Witte and Woodbury (1985), Dubin and Wilde (1990), and surveys such as Kinsey (1992), Shreffinn and Triest (1992) all support this concept, reporting that compliance increases as audit rates get higher.

H5: There is a relationship between trust in government and tax compliance.

Hypothesis 5 is a different perspective on tax compliance (both the responsible taxpayer view and the behavioral models of tax evasion). Attitudes toward the current government, as well as perceptions of government administration, such as tax revenue administration quality and government corruption control. The perceptions of government administration in this survey reflect trust in government. People will pay more taxes if they have more faith in the government (Hanousek & Palda, 2004; Slemrod, 2003; Torgler, 2003). Richardson (2008) also claimed that the government's participation in influencing tax attitudes had a major positive impact. The author investigates the determinants of tax evasion in different countries including the USA, Argentina, Thailand, Canada, Chile, Kenya Nigeria and Brazil. Richardson also suggested that the government should increase their reputation and credibility in order to obtain trust from the

taxpayers. Therefore, it is expected that the perceptions of better government administration will result in increased tax compliance in Ethiopia

1.6 Significance of the Study

This study will help the AACGRA office improve its revenue-collection abilities by identifying factors that influence taxpayers' voluntary compliance. As a result, it's critical to generate some experimental proof for advance inquiries and utilize it as a stepping stone for other analysts so that they can think in similar ways in a few other areas.

Students, researchers, policy makers, scholars and academicians will find this study a useful guide in as far as further discussions or studies on the same are concerned. It will therefore form a basis of further research for individuals interested in the subject of tax compliance in Ethiopia and elsewhere.

Given the pervasiveness of tax compliance problems worldwide, it is hoped that a study that aims to investigate the determinants of tax compliance was of benefit to practitioners and policy makers. Management of firms that have adopted or those with the intention of adopting new systems of tax compliance will gain insights from such an effort highlighting relevant factors and relationships in the context of tax payments. More importantly, it will help to forge a good relationship between Government and tax payers in this case SMEs.

1.7 Scope of the Study

The study mainly focused on determinants of tax Compliance on SME in the case of kirkos sub city. However this study limited to examine only Five factors (tax rate, knowledge of tax system, perception on equity and fairness, tax audit, and trust in government) which will affect voluntary compliance of SMEs taxpayers'. Therefore the study couldn't address all determinants of tax compliance determination. This study also lasts only for the last ten years 2009/10 up to 2019/20. The scopes of this research also have a geographical limitation which is restricted to Addis Ababa specifically in kirkos sub city excluding the other sub cities.

1.8 Organization of the Study

The study will be organized in to five chapters. Chapter One introduces the study by discussing the introduction to the study, statement of the problem, purpose of the study and research

objectives, research questions, the scope of the study, and significance and limitations of the study. The next chapter shows related literatures relevant to understand the topic of the study deeply. The third chapter deals with the research methodology and the research design, which includes the data set used, methods adopted, the population & sample size, questionnaire design, data collection procedures applied research strategies the fourth chapter deals with data analysis, presentation and discussion the fifth chapter contains summary of the findings conclusion and recommendations

CHAPTER TWO

LITERATURE REVIEW

2. Introduction

This chapter reviews and summarizes a growing body of knowledge about tax compliance. As a result, the chapter presents theoretical and empirical data from publications on issues relevant to the research challenge. It starts with a theoretical overview, in which a number of ideas that explain individual tax behavior are thoroughly examined. These are the theories that will be investigated in this study to see if they may explain noncompliance. Following that, an empirical review of prior studies on the factors impacting tax compliance is presented and debated and the conceptual framework was the focus of this chapter.

2.1 Theoretical literature

2.1.1 The Concept and Definition of Tax Compliance

Tax compliance is a big issue for many tax authorities, and persuading taxpayers to comply with tax requirements, particularly when tax regulations are not always exact, is a difficult assignment James and Alley (2004). The term "tax compliance" has been defined in a number of ways. Tax compliance is defined by Marziana, Mohamad, Norkhazimah, and Mohmad (2010) as the extent to which a taxpayer conforms or fails to comply with their country's tax rules. According to Marti (2010), tax compliance entails freely and totally completing all legal tax duties. Tax compliance refers to a taxpayer's ability and willingness to follow tax regulations, declare correct incomes each year, and pay the correct amount of taxes on time. According to Andreoni, Erard, and Feinstein (1998), tax compliance should be defined as a taxpayer's desire to follow tax regulations in order to maintain a country's economic equilibrium. Tax compliance, according to Song and Yarbrough (1978), should be described as a taxpayer's ability and willingness to comply with tax rules, which are decided by ethics, legal environment, and other situational elements at a given time and place, due to the noteworthy aspect of the operation of the tax system in the United States, which is largely dependent on self-assessment and voluntary compliance. Tax compliance, according to Alm (1990) and Jackson and Milliron (1986), is defined as declaring all income and paying all taxes in accordance with the provisions of laws, regulations, and court judgments.

Compliance in administration terms, therefore, includes registering or informing tax authorities of status as a taxpayer, submitting a tax return every year (if required) and following the required payment time frames Ming Ling, Normala and Meera, (2005). The broader viewpoint, on the other hand, In order to complete tax returns and associated tax documentation, Singh, V., and Bhupalan, R. (2001) defined tax compliance as the degree of honesty, enough tax knowledge and capability to apply that knowledge, timeliness, accuracy, and adequate recordkeeping. Somasundram (2003, 2005) claimed since the total amount of tax payable is strongly dependent on tax compliance levels; this perspective illustrates the primary view of compliance becoming a key concern in a self-assessment, while it is likely that tax authorities will want to influence the areas taxpayers have control over determining to lessen the risks of non-compliant behavior they face otherwise e.g. through continuously conducting tax audits or a continuous assessment of different sorts and other means such as various compliance influencing activities including tax education.

Some authors have viewed tax compliance from a different viewpoint. For example, according to Brown and Mazur (2003), tax compliance is a multi-faceted measure that can be defined theoretically by categorizing three various types of compliance such as payment compliance, filing compliance, and reporting compliance into categories when examining tax compliance definitions. Andreoni et al. (1998) incorporated the desired outcome as a result of obedience to tax regulations to achieve an economic equilibrium, while Allingham and Sandmo (1972) enjoy tax savings or penalties, illustrating the broader view of tax compliance. Tax compliance, according to Singh (2003), is voluntary action taken without waiting for a response from the tax authority. Aside from this, Song and Yarbrough (1978) incorporated some compliance criteria in their definition, such as ethics, legal environment, and other situational considerations. Since many empirical studies have attempted to define tax compliance.

Alm (1990); Jackson and Milliron (1986); and Kirchler (2007) have characterized tax compliance as a taxpayer's willingness to comply with tax laws, declare the correct income, claim the correct deductions, relief, and refunds, and pay all taxes on time.

2.1.2 Taxation of SMEs

Fiscal policy is one of the most important aspects of macroeconomic policy, and its objectives have been examined in two ways: first, the core of fiscal policy, and second, monetary policy

consistency (Holban, 2007). In general, the choice of tax policy is based on the employment of one or both of two categories of instruments, the first of which is the use of special tax preferences and other incentives to help small businesses start up and grow. Reduced corporate income tax rates, specific tax exemptions, and relief for small enterprises are among the benefits. The primary goal of taxation is to raise income in an efficient manner, using measures that are tailored to each country's conditions and administrative capabilities. A well-designed tax system should be efficient in minimizing the distortionary influence on resource allocation and equitable in its impact on different groups in society in order to achieve the revenue purpose (Bolnick, 2004).

According to Slemrod, J. (2007), many of the challenges with the tax authorities are the result of poorly formulated tax policies and a lack of assurance surrounding future policy changes. It is critical that the country's condition be well examined before using any tax policy in order to have a fully functioning tax system. A tax policy's goal should be to reduce collection costs while limiting revenue loss, economic disruption, and the injustice and capriciousness of the tax burden. The tax policy for an economy like Ethiopia's must be flexible enough to encourage savings, boost investment, and reward social responsibility and research funding. To broaden the tax base, policymakers must never lose sight of the importance of investing in infrastructure, creating jobs and lowering unemployment, expanding the productive sectors of the economy, boosting exports, and considerably increasing government revenues. Hence, tax policies should aim at bringing all taxable adults into the tax net with a graduated rate that should ensure that the well-off pay their own share while the low income earners are given savings-enhancing incentives. Because a competent and efficient tax administration system is critical to every country's well-being, Baurer (2005) argues that the tax administration should ensure that all taxpayers complete their tax filing and payment obligations. The tax administration must strike a balance between its educational and aid functions and its enforcement functions. Two of the three basic tax theories, the Ability-to-Pay Principle and the Equal Distribution Principle, are consistent with the reason underpinning the entire tax system. These two values emphasize fairness and equality. While the Ability-to-Pay movement advocates for taxation based on an individual's ability to pay, the Equal Distribution Principle proposes that income, wealth, and transactions be taxed at a set rate; that is, persons who earn more and buy more should pay more taxes, but not at a higher rate (Gabay, Remotin, & Uy, n.d).

2.1.3 Tax Compliance and SMEs

Tax compliance, according to Marti (2010), is a difficult phrase to define. Simply speaking, tax compliance entails freely and totally performing all tax duties imposed by law. Regulatory constraints are disproportionately borne by small and medium-sized businesses around the world, according to research (Pope & Abdul-Jabbar, 2008). Because of their size and nature, tax compliance is a critical issue for SMEs, especially since most have limited resources and insufficient experience to comply with a wide range of regulations. He also argues that high compliance costs might lead to tax avoidance, tax fraud, and investment inhibition by lowering the country's tax competitiveness. Tax non-compliance can take various forms, including failure to file a tax return on time or not at all, understatement of income, overstatement of deductions, and failing to pay assessed taxes by the due date. (2006) (Kasipillai & Abdul Jabbar) Non-compliance can also entail failure to pay assessed taxes in particular situations. According to studies, the problem of tax avoidance is prevalent (Kasipillai & Abdul Jabbar, 2006). Furthermore, Fagbemi, Uadile, and Noah (2010) discovered that it is common in developing nations and that it obstructs growth, resulting in economic stagnation and other socio-economic issues. Tax rates, according to Chipeta (2002), are one of the causes of tax evasion. He explained that a higher tax rate increases the burden on taxpayers and reduces their disposable income, increasing the likelihood of tax evasion.

2.1.4 Tax Policy and Level of Voluntary Compliance among SMEs

Small taxpayers face discrimination under the ordinary tax system because compliance requirements, compliance costs, and tax rates are the same for small and large businesses. The profit margin of small businesses is increased by lowering compliance expenses and tax rates. Because the streamlined rules for small and medium firms reduce the size of the informal sector and the number of non-complying registered taxpayers, it also boosts tax revenue for the government (Vasak, 2008). Furthermore, SMEs are frequently forced to operate in an overburdening regulatory environment, which includes a countless of regulatory agencies, different taxes, difficult importation procedures, and heavy port costs, all of which place a significant strain on their operations. An overly complex regulatory structure and tax regime, or one that is opaque in its administration and enforcement, makes tax compliance unreasonably

expensive and often has a distortive effect on the development of SMEs, as they are encouraged to morph into forms that offer a reduced or no tax burden at all (Masato, 2009), resulting in a tax system that imposes large expenses on society. Low efficiency, expensive collection costs, waste of time for taxpayers and personnel, low quantities of gathered taxes, and diversion from optimal resource allocation are all consequences of a poorly implemented tax system (Farzbod, 2000). Existing empirical evidence clearly shows that these expenses disproportionately affect small and medium-sized firms: compliance costs for SMEs are higher than compliance costs for large enterprises when measured by sales or assets (Weichenrieder, 2007).

2.2 Tax Compliance Theories

There are many different viewpoints on how to increase tax compliance. If given the opportunity, many businesses will refuse to pay taxes unless there is a compelling reason to do so. Some believe that increasing incentives is the greatest solution (Feld & Frey, 2007); others say that increasing punishments is the best solution. The following tax compliance theories are thought to be appropriate for this research: optimal tax theory, economic deterrence, fiscal exchange and political accountability. The theories are to some extent interrelated and some represent an evolution of others.

2.2.1 Optimal tax theory

The theory's core premise is that a government wants to raise a specific amount of money through taxation. Furthermore, taxes influence economic choices, and the topic at hand is how to establish taxes so that the distortions that do occur are minimized (Bordignon et al., 1997). In this context, a clear balance must be made between the ideal levels of taxes charged to SMEs, as high taxes may result in defaults, preventing the national government and county governments from meeting their revenue collection targets.

Furthermore, Emanuele (2012) notes that optimum tax theory is made up of numerous models that focus on different aspects of a tax system. The set of models aims to create equilibrium in the collection of a set of taxes by the government in order to obtain a specific amount of income. These models were created in response to the elimination of the lump-sum method in tax administration, as well as the necessity for equality and the maximizing of social welfare, which

is the primary purpose of policymakers. These models are designed to meet the requirements of a fair tax system, which include equity, transparency, efficiency, stability, flexibility, and affordability (Emanuele, 2012). Equity aspects bring out the role of taxation in transferring wealth from the rich to the poor thus achieving fairness in the economy.

Therefore an optimal tax system is one where taxes are chosen by the government to maximize the welfare of the society given the amount of revenue to collect while minimizing the excess tax burden. This approach is more relevant for informing the study because, while the government seeks to increase revenue collection through MOR, it should avoid raising taxes to levels that will be burdensome for tax payers such as SMEs. In other words, raising taxes does not guarantee that county governments will make more money. It may be a way for tax avoidance.

2.2.2 Economic deterrence theory

The economic deterrence concept states that factors such as the tax rate, which determines the advantages of evasion, and the probability of detection and penalties for fraud, which define the costs, impact taxpayer behavior (Allingham and Sandmo, 1972; Becker, 1968). Few people will avoid taxes if they are likely to be discovered and the penalties are harsh.

On the contrary, under low audit probabilities and low penalties, the estimated return to evasion is high. The model then predicts substantial non-compliance. Although the approach has been criticized for focusing solely on coercive compliance at the expense of consensual compliance (Sandmo, 2005), there is some evidence to show the importance of deterrent methods in dealing with non-compliance (McKerchar and Evans, 2009). For example, in some situations, the fear of being caught, or the likelihood of being discovered, has been demonstrated to be an effective method for inducing truthful behavior. Tax administrations have frequently used the theoretical ideas of economic deterrence when establishing enforcement techniques that focus primarily on penalties and the fear of being caught.

2.2.3 Fiscal exchange theory

According to the fiscal exchange hypothesis, government spending can incentivize individuals to comply, and governments can promote compliance by delivering commodities that citizens want in a more efficient and accessible way (Cowell and Gordon, 1988; Levi, 1988; Tilly, 1992;

Moore, 2004). Alm et al. (1992) noted that compliance increases with (perceptions of) the availability of public goods and services. As a result, taxpayers' primary concern is what they receive directly in exchange for their tax payments in the form of public services (quid pro quo). Taxation and the provision of public goods and services are viewed as a contractual relationship between taxpayers and the government in this approach (Moore, 2004). Individuals may pay taxes because they value the government's goods and services, understanding that their contributions are required both to help finance the goods and services and to encourage others to contribute (Fjeldstad and Semboja, 2001). Positive rewards may improve the likelihood of taxpayers complying freely and without direct compulsion. Although most taxpayers are unable to determine the exact worth of what they receive from the government in exchange for taxes paid, it may be argued that they have a broad impression and attitude about their own and others' terms of trade with the government (Richupan, 1987). It's logical to believe that taxpayers' conduct is influenced by their pleasure or dissatisfaction with their government's terms of trade. Thus, if the tax system is thought to be unfair, tax evasion may be viewed as an attempt by taxpayers to change their terms of trade with the government, at least in part. The fiscal exchange hypothesis has garnered a lot of attention and is theoretically well-established. However, empirical data supporting the idea is equivocal (D'Arcy 2011).

2.2.4 Political legitimacy theory

Finally, tax compliance is influenced by individuals' trust in their government, according to the political legitimacy theory (Tayler 2006; Kirchler et al., 2008; FauvelleAymar, 1999). Legitimacy can be defined as the belief or faith that the authorities, institutions, and social arrangements are acceptable, legitimate, and just, and that they work for the collective benefit. How political legitimacy and civic affiliation are fostered has been studied by political scientists. (Persson, 2008) claims that African countries that prioritized national identity over ethnic identity when they gained independence have fared better than those that let ethnicity become the primary source of political division.

2.3 Factors Determining Tax Compliance Behavior

Many research on tax compliance look into the factors that influence compliance. The majority of studies concentrate on tax enforcement, such as tax audits and fines, which are the most

important aspects of the traditional strategy. Alternative elements such as positive incentives, tax amnesties, attitudes and opinions about tax systems, tax rates, actual income levels, and demographic features are investigated by the others. All of these research aim to uncover the factors that influence tax compliance in order to improve tax administration and increase tax compliance. However, no thorough investigation of these determinants has been conducted in Ethiopia.

Several factors that have influenced tax compliance have been discussed by various scholars, according to Jackson and Milliron (1986). These characteristics include, among others, age, gender, education, and income. According to Chan et al. (2000), persons with a higher education level are more likely to have a greater level of moral development and higher levels of compliance attitudes, and hence will comply more. Assuring that taxpayers have a specific level of credentials, skill, and confidence to execute their tax responsibilities is one way to enhance voluntary compliance (Mohani, 2001). In contrast, a recent study by Richardson (2008), reported in Mohd (2010), found that education and compliance have a negative relationship. Regarding gender Hasseldine and Hite (2003) found that female taxpayers were more compliant than males. Mohamad Ali et. al. (2007) and Palil (2010) also reported that females were more compliant in their study. In contrast, Richardson (2006) suggested that gender has no significant impact on compliance across a study of 45 countries.

According to Jackson and Milliron (1986), there are fourteen primary elements that have influenced tax compliance. Age, gender, education, income, occupation or status, peer or other taxpayer influence, ethics, legal sanction, complexity, relationship with the Internal Revenue Service (IRS), income sources, perceived fairness of the tax system, possibility of being audited, and tax rate are all aspects to consider. Various scholars have identified demography, income, compliance cost, and tax agents as factors that influence tax compliance, as well as moral or ethical concerns (Mohani, 2003). (Singh, 2003, Kasipillai et al., 2003).

2.3.1 Tax Rates

Empirical studies imply that higher tax rates lead to less compliance, with underreported income-tax rate elasticity ranging from -0.5 to -3.0, according to Alm (1999, p. 753). From the compliance lottery perspective, this may be seen as higher tax rates increasing the rewards from

cheating. Although, it does not make much sense to lower marginal tax rates in order to reduce tax evasion. Tax rate should be designed based on efficiency and equity concerns (Sandmo, 2005). According to James, Brian, and Jonathan (1998), theoretical models show that as income grows, tax evasion should climb across the board. Although there are exceptions where tax evasion decreases as income rises, the regressive bias of tax evasion is the overall rule. Theoretical models, on the other hand, produce no unambiguous predictions about the effects of tax rates on compliance.

Due to the inclusion of both, income and substitution effects, additional assumptions concerning the form of penalties, income distribution, and preference shape are frequently required to find any comparative statics. "Reducing tax rates is not the only policy that has the ability to discourage tax evasion," according to Clotfelter (1983), but the tax rate is a significant component in determining tax compliance behavior, despite the fact that the exact impact is still unclear and controversial. Kirchler, (2007). Clotfelter also suggests that there was a strong link between tax rates and evasion, owing to the fact that tax rates are employed as a tool for policy aims in particular. Raising marginal tax rates will be likely to encourage taxpayers to evade tax more (Witte and Woodbury, 1985; Ali, Cecil and Knoblett, 2001; Torgler, 2007) while lowering tax rates does not necessarily increase tax compliance (Trivedi, Shehata, and Mestelmen, 2004; Kirchler, 2007). This ambiguity and competing problem (for example, lowering the tax rate to boost compliance) has piqued the interest of tax scholars who are looking for more specific proof of the impact of tax rates on evasion. Previously, Allingham and Sandmo (1972) used statistical modeling to try to identify a link between actual income, tax rates, penalty and investigation, and tax evasion. Other economic models of rational compliance decisions, on the other hand, believe that tax rates have a mixed effect on compliance or anticipate that raising tax rates will enhance compliance (Kirchler, Hoelzl, and Wahl, 2008). Various research, in contrast to Allingham and Sandmo, concluded that increasing tax rates encouraged noncompliance or showed mixed results (Pommerehne and Wech-Hannemann, 1996; Park and Hyun, 2003). When trust is low, a high tax rate may be regarded as unjust treatment of taxpayers, but when trust is high, the same level of tax rate may be regarded as community contribution (Kirchler et. al. 2008). In conclusion, data demonstrates that tax rates have a mixed impact on tax compliance, i.e., lower tax rates do not always lead to higher compliance. Tax increases may have a beneficial or

negative impact on evasion. Furthermore, raising tax rates does not always result in a reduction in compliance behavior (Allingham and Sandmo, 1972).

2.3.2 Awareness level of Taxpayers and tax knowledge

According to James (2000), the norm is to conform rather than not comply. As previously stated, the majority of taxpayers must comply in order for a tax system to be effective. As a result, enabling mostly compliant taxpayers to achieve their fiscal duties may yield larger benefits than devoting additional resources to pursue the minority of non-complaints. Many taxpayers may be eager to comply completely, but they are unable to do so because they are unaware of or do not comprehend their full responsibilities. Even though such taxpayers are aware of their obligations, they may be unable to meet them due to a variety of factors. On other side, other writers such as Smith and Kinsey (1987) argue that tax noncompliance is an intentional behavior. On the other hand, some authors, such as Smith and Kinsey (1987), contend that tax evasion is a deliberate act.

Various studies have examined the impact of tax awareness on compliance behavior. The amount of education gained by taxpayers is an essential influence in their comprehension of taxation, particularly in terms of tax laws and regulations (Eriksen & Fallan, 1996). Previous research has shown that tax knowledge is closely linked to taxpayers' ability to comprehend tax laws and regulations, as well as their capacity to comply (Singh & Bhupalan, 2001).

2.3.3 Fairness/Equity of tax system

The most evident need of equity or fairness, according to James (2000), is to treat equal persons in equal circumstances equally. The issue is determining who is equal to whom. Similarly, Due and Friedlaender (1981) argue that determining what is fair or equitable in taxation is unavoidably a value judgment; no scientific specification of an equitable distribution pattern is feasible, and people may have equal income but differ in expenditure, wealth, overall utility, and so on. Only a consensus of attitudes among people in current society can be used to define such a pattern.

2.3.4 Tax Audits

Tax audits are a hot topic in the field of tax compliance research. Scholars are interested in audit probability, audit productivity (percent of undeclared revenue discovered), and prior audit alerts. Higher audit rates are expected to promote compliance (Alm, 1999). If audit probability and

productivity are higher, the expected loss of being caught will be larger, according to the compliance lottery view or anticipated utility theory. As a result, more income will be reported by taxpayers (Allingham & Sandmo, 1972). Studies using TCMP data, such as Witte and Woodbury (1985), Dubin and Wilde (1990), and surveys, such as Kinsey (1992), Shreffinn and Triest (1992), confirm this concept, noting that when audit rates rise, compliance rises as well. The results of experimental approaches are similar to those of Alm (1999, p. 756), with estimated reported income-audit rate elasticity ranging from 0.1-0.2. Alm and McKee (2006) come up with very interesting findings. They assess individual compliance replies using an experimental manner to provide insight into audit probability and productivity. The amount of unreported money revealed by audits is referred to as audit productivity. According to the findings, notifying people that they will be audited boosted compliance for those who know they will be audited, but decreased compliance for those who will not be audited. The overall compliance actually falls with advance notification of audits. The results are interesting in the sense that telling taxpayers exactly what will happen to their reports might not always give a positive outcome. Alm, Jackson, and McKee (2009) recently used laboratory experiments to investigate the influence of different methods of information dissemination (formal information from the tax authorities and informal communication among taxpayers) on audit frequency and outcomes compliance. Pre-announcement of audit rates and stressing the previous period audit frequency in yearly enforcement effort reports are two essential tactics that tax authorities can use to increase compliance. Another finding is that informal communication will only be effective if audit rates are publicly announced.

2.3.5 Taxpayers Attitude towards the Government

Compliance may be aided by the presence of government expenditures (Alm, Jackson, and Mckee, 1992; Andreoni, et al., 1998, Cowell and Gordon, 1988). Individuals may pay taxes because they value the goods and services offered by the government, and they understand that their contributions are required both to help finance the goods and services and to encourage others to contribute. As a result, a tax payer is viewed as exchanging purchasing power in the market in exchange for government services (Levi, 1988). Positive advantages may enhance the likelihood of tax payers complying voluntarily rather than through force. Without a tangible advantage, cooperation is less likely. Although most tax payers are unable to determine the exact

worth of what they receive from the government in exchange for taxes paid, it may be argued that they have general impressions and attitudes about their own and others' terms of trade with the government.

2.4 Empirical literature

Tax compliance has been the subject of a number of theoretical and empirical researches. These research yield contradictory results when it comes to the association between tax compliance and tax rates, tax audit, fairness of tax system, knowledge of tax system and trust in government. Alm and McKee (2006) use experimental methods to analyze individual compliance reactions to a "certain" chance of audit, concluding that if an individual knows he will be audited, his compliance rate rises, whereas his rate lowers if he knows he will not be audited. Slemrod, Blumenthal, and Christian (2001) analyzed randomly selected taxpayers after informing them that their returns would be "closely inspected." They discovered evidence of taxpayers' behavior changing in response to an increased likelihood of audit; however the reactions were not uniform across different groups of taxpayers. Mittone (2006) studied whether early audit experience in a taxpayer's "tax life" is more successful than later audits in increasing compliance. Although the effectiveness of audits and fines cannot be totally established, Kastlunger and Pitters' (2009) analysis of experimental research reveals that early audits in a taxpayer's "tax life" have a favorable impact on compliance. High tax rates and complex filing procedures are the most important causes influencing SMEs' non-compliance, according to Atawodi & Ojeka (2012), who aimed to uncover factors that affect tax compliance among SMEs in North Nigeria. Other issues, such as double taxation and a lack of sufficient education, were found to have a minor impact on tax compliance among the SMEs examined.

According to Djawadi and Fahr (2013), tax compliance is higher in tax systems with limited authority when complete openness on public spending is provided and taxpayers have the ability to choose how their taxes are spent. This shows that tax knowledge and budget spending have an impact on tax compliance. Merima, Odd-Helge, and Ingrid (2013) discovered that perceptions of the difficulty of dodging taxes, contentment with public service supply, payments to non-state actors, perceptions of ethnic groups being treated unfairly, and tax knowledge all influenced tax compliance behavior among residents in Kenya, Tanzania, Uganda, and South Africa.

Allingham and Sandmo (1972) claimed that taxpayers will always declare their income correctly if the probability of detection is high. Probability of detection plays a significant role in reporting behavior as taxpayers will declare everything if they perceive that they will be one of the auditees in that particular year (Riahi-Belkaoui, 2004; Richardson, 2008). Slemrod, Blumenthal, and Christian (1998) look into the relationship between the likelihood of being audited and the reactions of taxpayers. The experiment found that taxpayers' evasion behavior varied depending on their income level, and that the likelihood of being audited played a significant impact in influencing their evasion behavior. Slemrod et al., on the other hand, did not specify whether the link was favorable or negative (1988). Andreoni et al. (1998) observed that earlier audit experience and ongoing contact (relation) with the tax authorities influenced and increased taxpayer compliance. In contrast, Young (1994) and Slemrod et al. (2001) found that compliance behavior was adversely connected with the likelihood of being audited again.

Bergman (1998) cited in Palil and Mustapha (2011) investigates tax compliance behavior in Argentina using two approaches; (1) the measures to enhance commercial taxpayers and (2) extensive campaigns and audits which will increase the probability of detection among individual taxpayers. The results suggested that as the number of audits and the probability of detection increased, taxpayers are encouraged to comply with tax laws and accurately report their income. This suggests that unintentional evasion may occur rather than intentional evasion. He also claimed that the lack of audits and investigations implemented by tax authorities in the 1980s in Argentina had driven taxpayers to behave 'recklessly'. Moreover, as taxpayers were aware that they would not be detected due to lack of investigations, they incorporated more complex tax evasion strategies and less traceable documentations so that they could pay less tax. Findings by Bergman are consistent with the theoretical proposition that the fear of detection influences the level of compliance behavior, suggesting that the evaders take precautionary measures when the perceived risk of detection is high.

Previous research has found a direct and positive link between educational attainment and tax compliance (Jackson and Miliron 1986). According to Chan, Troutman, and O'Bryan (2000), education level is directly related to the chance of compliance. Although educated taxpayers are aware of non-compliance alternatives, their possible better comprehension of the tax system and higher level of moral development encourage a more favorable taxpayer attitude and greater

compliance (Ephrem, 2016). Small and medium firms must be able to understand and comply with administrative and regulatory requirements in addition to lowering compliance expenses. One alternative course of action is to improve the tax awareness of small and medium-sized business owners (Bernadette et. al., 2012). Small and medium-sized business owners must not only self-report and pay income taxes, but also account for a variety of business taxes such as property taxes, payroll taxes, and sales taxes like VAT and TOT (Christen et. al, 2001). To comprehend the rules and pay the proper taxes, they require extensive tax understanding of the many compliance procedures and obligations. The level of tax knowledge a person possesses has a significant impact on their tax-paying behavior. Less educated taxpayers are less exposed to and informed on key tax compliance information, making them more vulnerable to tax evasion (Andreoni J.Errard, 1998). The intricacy of tax information might be difficult to interpret for certain taxpayers, particularly small firms. If taxpayers have trouble completing out tax returns, this intricacy may lead to accidental tax non-compliance. Tax regulations are frequently too complex for laypeople to understand (Kirchler, 2007), which many small business owners are. Acquiring tax expertise is time-consuming (e.g., becoming informed, keeping records, filling out forms), and so on. As a result, small business owners seek the assistance of tax professionals to assist them with a portion of the tax filing process (Coolidge, 2009).

High tax rates and complex filing procedures are the most important causes influencing SMEs' non-compliance, according to Atawodi & Ojeka (2012), who aimed to uncover factors that affect tax compliance among SMEs in North Nigeria. Other issues, such as double taxation and a lack of sufficient education, were found to have a minor impact on tax compliance among the SMEs examined. This is a significant study that elucidates the aspects that contribute to noncompliance but not compliance. As a result, in the current study, it may be necessary to conduct an analysis that distinguishes between the two groups of taxpayers.

Amina and Saniya (2014) conducted a study on tax compliance and its determinants in the Jimma zone of Ethiopia, with the goal of determining the determinants of tax compliance for Jimma zone category "A" taxpayers. The study attempted to investigate the key drivers of tax compliance by delivering 384 questionnaires to category "A" taxpayers. The findings shows that age, sex, penalty, audit, simplicity, fairness and government perception were found to affect tax compliance. The goal of Tilahun & Yidersal's study, Determinants of Tax Compliance Behavior

in Ethiopia: The Case of Bahir Dar City Taxpayers was to uncover factors that influence tax compliance behavior. The data was collected using a structured questionnaire and the researcher utilized one-way ANOVA, two samples, and one sample T-test. The result reveals Perceptions of government expenditure, justice and justice of the tax system, fines, personal financial constraints, changes in existing government policies, and referral group (friends, relatives, etc.) were all found to have a substantial impact on tax compliance behavior.

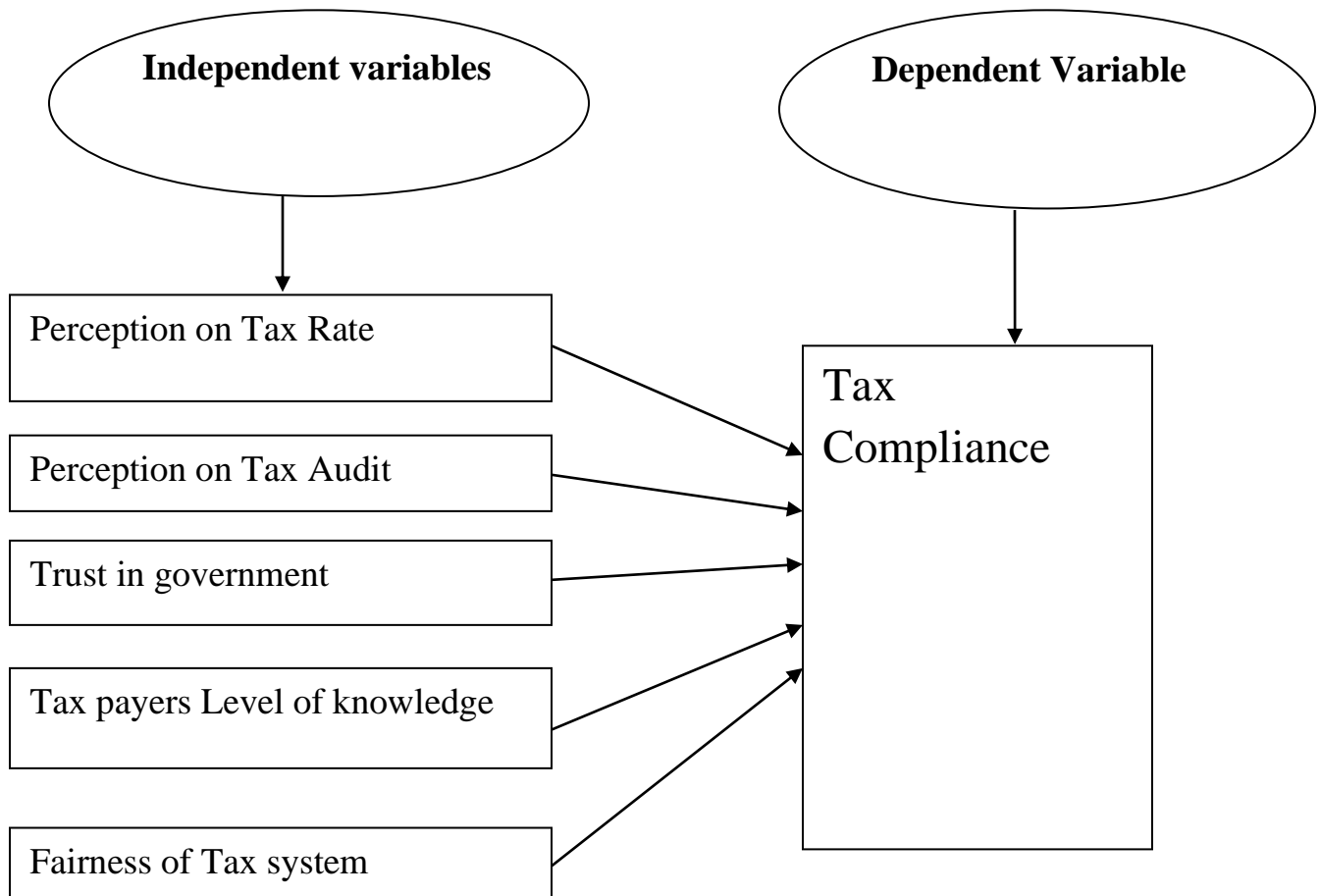
2.5 Research Gap

As much as possible different literature's have been researched and examined under the heading of empirical literature review. The literature review yielded a variety of results in terms of tax compliance. The majority of study on tax compliance attitudes was undertaken in western countries. Therefore, the researcher is looking at determinants of tax compliance on Small and medium enterprises there seem to be a disagreement in the findings. Some variables are Significant in one study also insignificant in another study. And also from the previous empirical research found that the determinants of tax compliance have been found to differ between countries. This means there is no universal findings are highlighted by researchers pertaining to genuine tax compliance determinants among countries sharing similar tax systems, and cultures. In addition, most prior studies regarding tax compliance issues tried to examine the factors affecting compliance improvement and fraud detection. However, to the knowledge of the researcher, it is possible to conclude that although there have been a number of studies on tax compliance related issues both in developed and developing countries, Ethiopia in particular, there are no studies that exhaustively examine factors affecting tax compliance. Most of studies focused on all or some types of tax compliance, not all forms of taxation contribute the same to Government revenues. This research focused determinants of tax compliance on Small and medium enterprises taxpayers and, the reason for choosing SMEs are small and medium size enterprises have become popular in the world especially since 1960s. Schumacher (2003) denotes the superiorities of SMEs as such: SMEs have a competitive structure, SMEs are more efficient, SMEs keep up with the new demands and new technology easier, SMEs are more enduring to the economic crisis, SMEs have a more successful role in increasing employment and arranging income. Furthermore, the reason for the emphasis on tax compliance is tax generates a large portion of government revenue. Based on the gaps in the literature indicated

above, as well as the problems listed in section 1.3, the purpose of this study is to fill the gap on the determinants of tax compliance for small and medium tax payers in the Kirkos sub city.

2.6 Conceptual Framework

From the above reviewed theoretical and empirical literatures the conceptual framework were formulated as follows:



Source: Musau (2015) and modified by researcher

CHAPTER THREE

RESEARCH METHODOLOGY

Introduction

This chapter presents the methodology of the study that clearly depicts a description of research type and approach, research design, sources of data, determining the instrument selected for data gathering, survey procedure used in the study, determination of the sample size, sampling procedure, model specification, variable measurements, and analysis of data that has been used in this study.

3.1 Research Approach

The blueprint for achieving research objectives and answering research questions is the research design. In other words, it's a master plan that lays out the processes and procedures for gathering and analyzing the data that's needed. Furthermore, it must verify that the data gathered is relevant to the topic at hand (Adams, Khan, Raeside and White 2007).

In every research, it is critical to determine the best research strategy for achieving the researcher's goal. Qualitative, quantitative, and mixed techniques approaches are all possible. Using a main data source, this study used a quantitative research approach.

According to Van der Merwe (1996), quantitative research is a method of evaluating theories, establishing facts, revealing correlations between variables, and estimating results. Quantitative approach involves tactics of inquiry such as experimentation to describe patterns of behavior and generalize findings from samples to the population of interest. In quantitative research, the researcher is considered external to the actual research, unlike in qualitative research, where he or she is regarded as a great research instrument because of his or her active participation in the research process. Results are expected to be repeatable, regardless of who conducts the research (Abdulsemed 2018). Quantitative research provides precise, numerical data and since it is so deeply rooted in numbers and statistics, it has the capability to successfully interpret data into simply quantifiable charts and graphs. Overall, the quantitative method allowed the researcher to use a series of techniques that yield data that is projectable to a higher population (Abdu 2019).

The design of this study is explanatory in order to answer the problem statement and accomplish the research objectives. Cause-and-effect relationships are attempted using explanatory designs. The basic goal of explanatory research is to figure out how events happen and which factors may impact specific outcomes (Dawson, 2006). Explanatory studies are distinguished by research hypotheses that define the nature and direction of the relationships between or among the variables being investigated. The information for this study was gathered from primary sources.

In order to obtain primary data, a survey method is used. A survey is an explanatory research approach for gathering data at a certain point in time with the goal of characterizing the nature of current conditions. As a result, using a survey design in the study is beneficial in terms of representing a larger population, providing descriptive, inferential, and explanatory data, and gathering data that would not be available via archive records. Questionnaire was distributed to different sectors of small and medium business profit taxpayers found in Kirkos sub city. The questionnaires were consisted of properly constructed close ended questions. The subsequent sub sections deal with sample design and sampling technique.

3.2 Sources of Data

Data collection was done through both primary and secondary resources. The study used primary data to collect first hand by the researcher on the areas of interest using structured questionnaires. The merit of primary data is that it is direct information, uncontaminated by being transmitted through another source. The demerits of primary data are that sometimes the person who is on the field sees only part of the action. The primary data was collected through a survey by a structured questionnaire. Secondary data refers to data which is collected by someone who is someone other than the user. Secondary data saves time in enhancing primary data, provides a larger database (usually) than what would be possible to collect on one's own, however there are disadvantages to the fact that the researcher cannot personally check the data so its reliability may be questioned. In addition to the survey questionnaire, secondary data was collected through office documents such that notifications, circulars, newspaper archives, minutes of meetings, consultancy reports, journals, articles, books, organizational reports and magazines. Thus, the primary data sources were collected from SMEs Tax payers who are in Kirkos Sub city.

3.3 Data Collection Tools

Both primary and secondary data were used to obtain the necessary information about the research. In the domain of tax compliance level of SMEs, many researchers have used survey instruments to collect the data. Among them are (Abdulsemed, 2018) who worked on tax compliance determinants of VAT registered SMEs. All these researchers applied survey questionnaires to collect the data which is an efficient way for collecting data for specific variables of interest (Hussey and Hussey, 1997; Bove and Hede, 2001). The goal of the survey, according to Verschuren and Doorewaard (1999), is to find out what a specific group of people believe, feel, or do. Because it is a simple and inexpensive technique for collecting data, a survey questionnaire can be used to involve a large number of people in the research. Thus, this study applied a survey questionnaire to collect primary data. Items in the survey questionnaire were measured using a five-point Likert Scale, with 1 representing “strongly disagree” and 5 representing “strongly agree”. According to Oppenheim (1992), the Likert scale was used in the survey partly because of its high reliability and partly because it allows respondents to give a wider variety of replies.

3.4 Population and Sampling Design of the Study

3.4.1 The population of the study

A population can be defined as including all people or items with the characteristic one wish to understand in a specific study. The target populations were 8013 registered SMEs taxpayers, consisting of 3097 small (annual turnover between half million and five million) & 4916 medium (annual turnover between five million and forty million) level tax payers found in Kirkos Sub city (AACGR, 2020). And these populations are characterized based on their operating different types of activities namely 1331 on manufacturing, 2937 trade, 1590 construction, 1963 service and the rest 192 on urban agriculture.

3.4.2 Sampling Design of the study

According to Cooper, D., and Schindler, P. (2008), sample design is a part of the study strategy that outlines how samples will be chosen for observation. The design lays out the steps for selecting the study's sample. The term "sampling design" refers to a road map that acts as the foundation for selecting a survey sample and outlines the basic plan and methods for doing so

(Cooper, D., and Schindler, P., 2008). A sample frame, a sample procedure, and a sample size are all part of the sampling design.

3.4.2.1 The sampling frame of the study

A sampling frame is a list of population elements from which a sample is taken (Saunders, et al, 2012). Sampling frame in this study consisted of a number of elements in the general population from which the researcher selected subjects to represent the general population of SMEs tax payers in Kirkos sub city. In this study, the sampling frame consisted of 8013 tax payers who are in different types businesses. Therefore, SMEs tax payers in Kirkos sub city were incorporated as a sampling frame. The researcher acquired the list of tax payers from Kirkos sub city administration and small and micro enterprise agency. And it is depicted in table 3.1 below.

Table 1 the sampling frame of each tax payers

Number	Business activity or types	Number of tax payers
		total
1	Manufacturing	1331
2	Trade	2937
3	Construction	1590
4	Service	1963
5	Urban Agriculture	192
Total		8013

Source: AACGRA, (2020)

3.4.2.2 Sampling technique of the study

A probability sampling method is often preferable to a non-probability sampling method in survey research because "the resulting sample is expected to give a representative cross section of the entire population" (Denscombe, 2002). Due to limited resources of time, money, and population size, the sampling methodology is the process of selecting different possibilities to enable researchers to reduce the capacity of data that has to be collected by examining a sample rather than the complete group. If the population from which a sample is to be drawn does not represent a homogeneous group, then stratified sampling technique is applied so as to gain a

representative sample. In this technique, the population is stratified into a number of non overlapping subpopulations or strata and sample items are selected from each stratum. If the items selected from each stratum is based on simple random sampling the entire procedure, first stratification and then simple random sampling, is known as stratified random sampling (Kothari, 2004). In this research, probability sampling technique used particularly from probability sampling technique, stratified sampling was used to stratify the total list of accessible population of 8013 into 5 strata as based on the type of their businesses. Then, the random sampling technique particularly lottery method was used to select the representative sample from each stratum because the environment is similar and the researcher can get a homogeneous activities from all activities of the tax payers.

3.4.2.3 Sample size determination of the study

The sample size refers to the portion of the population from which the researcher intends to make generalizations about the total population. According to Sekaran and Bougie (2013), it is practically impossible to be flawless in surveys, therefore errors will always exist; nevertheless, the level of error in data collecting, which is commonly referred to as the margin of error, must be reduced. Researchers mostly work with a plus or minus 3-5% of the true value of the population characteristic. Therefore, for this study, the researcher was adopted the 95% level of certainty to produce results among variables that are significantly different and it broadened the range of possible data and formed a better picture for analysis. The researcher implemented a statistical instrument formula to determine the sample size and if it was representative of the target population. Yamane's mathematical formula was used (1997).

The sample size was determined by the simplified Yamane formula below;

$$n = \frac{N}{1 + N(e)^2}$$

Where; n = is the sample size,

N = is the study of population, and

e = is the level of precision.

Sample size is then determined by: $n = \frac{N}{1 + Ne^2}$

$$n = \frac{8013}{1 + 8013(.05)^2} = 381$$

Applying a 5% error margin, the sample size of tax payers for the study are 381 members of the target population. Therefore, the study's sample size of 381 is fair enough to represent the target population of the study area. Using the above statistical formula, the sample size of the study has determined as follows:

Table 2 Sample size determination using simple stratified random sampling

Tax payers	Number of tax payer	Sample from tax payers
Manufacturing	1331	61
Trade	2937	140
Service	1963	96
Construction	1590	75
Urban Agriculture	192	9
Total	8013	381

Source: AACGRA and own computation (2021)

3.5 Measurement of variables

In this research, independent and dependent variables were used to measure the determinants of tax compliance of small and medium enterprises. There is one dependent variable, tax compliance, and five independent variables tax rate, tax audit, tax payer's knowledge, perception of tax payers and trust in government served as independent variables. The variables chosen based on theoretical and empirical evidence they are relevant to tax compliance.

3.5.1 Measurement of independent variables

The determinants of tax compliance were the independent variables which include tax rate, tax audit, tax payer's knowledge, fairness of tax system and trust in government.

Tax rates

A tax rate is a percentage rate that is applied to a tax base to determine the amount of tax owed (2014, Misrak). Six separate questions were asked to assess the impact of tax rates, and the responses were rated using a Likert scale.

Tax audit

Taxpayers may be more cautious in completing their tax returns, reporting all income, and claiming the necessary deductions to determine their tax due if audit rates and the thoroughness of audits are high. Taxpayers, who have never been audited, on the other hand, may be inclined to underreport their income and claim bogus deductions. Six separate questions were asked to assess the impact of tax audits on tax compliance, and the responses were rated using a Likert scale.

Knowledge of tax system

Under this one level of access to information, knowledge of taxation system, attitude towards tax compliance procedures effect on tax compliance are measured. Five separate questions were asked to assess the impact of knowledge of tax system on tax compliance, and the responses were rated using a Likert scale.

Fairness of tax system

Tax fairness is a concept which stipulates that a government's tax system should be equitable to all citizens. Five separate questions were asked to assess the impact of fairness of tax system on tax compliance, and the responses were rated using a Likert scale.

Trust in government

In order to measure political legitimacy, a range of variables to capture political legitimacy such as trust in tax officials, trust in tax officials, overall level of satisfaction with politicians and individual's perception about their country's level of democracy were used. Trust in tax officials was measured as a rank response for the extent of trust that individuals have in tax officials. The variable ranged from 1= "strongly disagree" to 5= "strongly agree". Overall satisfaction with politicians was captured as a rank response on individual's opinion whether they are satisfied or

not. The responses ranged from 1= “strongly disagree” to 5= “strongly agree”. Based on these responses, factor analysis was made in order to have an indicator for individual’s satisfaction with politicians. Democracy was captured as a rank response on individual’s opinion on how much of a democracy their country is. Four separate questions were asked to assess the impact of trust in government on tax compliance, and the responses were rated using a Likert scale.

3.5.2 Measurement of dependent variable

The dependent variable was tax compliance by SMEs which was affected by its determinants. Tax compliance is the degree to which a taxpayer complies (or fails to comply) with the tax rules in Ethiopia, for example by declaring income, filing a return, and paying the tax due in a timely manner. In this study, SMEs were required to pay taxes such that increased taxes and timely payment of taxes was the outcome of tax compliance.

Tax compliance

Six hypothetical questions were used to assess tax compliance in this study. It is based on Palil (2010) and Troutman (1993), with certain changes to fit the needs of our country. The use of hypothetical questions can improve the accuracy of results and reduce respondents' dishonesty when filling out surveys (Troutman, 1993). The respondents were asked to score each hypothetical question on a Likert Scale of 1 to 5 on whether they would take the same action as a taxpayer if they were in the same circumstance. The items that made up the scale include one, Tax rate second Tax knowledge third fairness of tax system fourth probability of being audited; and finally trust in government.

Table 3 Summary of the measurement of various variables and the expected effect of each main variable

Variable	Measurement	Expected outcome/sign
Dependent Variable		
Tax Compliance	Registered for relevant taxes such as income tax, withholding tax, VAT, and filing returns	
Independent Variable		
Tax rates	The level of tax rate if it affect tax compliance or not	+
Tax audit	Detection or fear of getting caught and penalties increases tax payment.	+
Fairness of tax system	government's tax system should be equitable to all citizens	+
Knowledge of tax system	Level of access to information, knowledge of taxation system, attitude towards tax compliance procedures.	+
Trust in government	Trust in tax officials and authorities	+

3.6 Data Analysis

According to Sarantokos (1998), data analysis allows the researcher to organize the information gathered during the study in order to appraise and evaluate the findings and come to a valid, reasonable, and appropriate conclusion. In the business research domain, the statistical package for social sciences (SPSS version 25) has been applied widely to infer results. Recently many researchers in social sciences studies have applied this package and found relationships of

predictor variables (Cinite *et al.*, 2009; Park and Kim, 2009, Abdulsemed, 2018). In this study, data was analyzed by applying SPSS (statistical package for social science). Through this package a number of statistical tests including descriptive statistics and correlations test were analyzed from the data of the study. To describe the demographic characteristics of the sample and general results, various descriptive statistics such as frequencies, means, and standard deviations will be used. While for alpha reliability, Pearson's correlations and exploratory factor analysis package will also applied to infer results. This technique is widely used to assess the relationship of predictor variables (Cinite *et al.*, 2009; Elias, 2009).

3.7 Model specification

Pearson correlation and multiple linear regression models were used in the analysis. Multiple regressions, according to Coakes and Steed (2007), are an extension of bivariate correlation. According to them, regression produces an equation that provides the best prediction of a dependent variable from a set of independent variables. When independent variables are correlated with one another and with the dependent variable, regression analysis is applied.

The regression model that was used to test is as follows:

$$Y = \alpha_0 + \beta_1 TR + \beta_2 KTS + \beta_3 FTS + \beta_4 TA + \beta_5 TIG + \sum$$

Where; Y = Tax compliance

α_0 = constant

$\beta_1, \beta_2, \beta_3, \beta_4$ and β_5 = Coefficient indicating rate of change of tax compliances as the Probability of tax rate, knowledge of tax system, fairness of tax system, probability of being audit and trust in government changes respectively.

TR = tax rate

KTS = knowledge of tax system

FTS = fairness of tax system

TA= tax audit

TIG= trust in government

\sum = Error term

3.8 Validity and Reliability

Patton (2002), states that validity and reliability are two factors which any researcher should be concerned about while designing a study, analyzing results and judging the quality of the study.

3.8.1 Validity

Validity, according to Healy & Perry (2000), evaluates if the research genuinely measures what it was designed to assess or how accurate the study results are. It calculates how well the data collected in the study accurately reflect a specific variable or construct in the investigation (Mugenda, 2008). According to Saunders et al., (2009), it is necessary to assess the validity and reliability of an instrument prior to its final delivery in any research.

Table 4 validity test of tax compliance

Variables	Pearson two tailed test
Perception on Tax Rate	.980
Perception on Tax Audit	.957
Tax payers Level of knowledge	.997
Tax payers' attitude	.988
Trust in government	.981

Source: own research computation, (2021)

3.8.2 Reliability

According to Healy and Perry (2000), dependability is defined as the degree to which results are consistent throughout time and accurately represent the overall population under study. Cronbach's alpha was employed as a measure of internal consistency and reliability. Cronbach's Alpha is a reliability coefficient that indicates how well items in a set are positively correlated to one another. It measures the inter correlations among test items, with a measure of 1 being higher in terms of internal consistency and reliability and 0.7 to 0.9 being acceptable (Revelle & McDonald, 2006).

Table 5 reliability test

Variables	Cronbach's Alpha	No. of Items
Perception on Tax Rate	.973	6
Perception on Tax Audit	.969	5
Tax payers level of knowledge	.955	5
Tax payers' attitude	.979	6
Trust in government	.967	4

Source: own research computation, (2021)

3.9 Ethical Consideration

When it comes to research involving human participants, ethical considerations are crucial. According to Neuman (1995), the researcher's job is to safeguard, advice, and supervise people's interests. Informed consent, privacy and confidentiality, and accuracy are among the minimum standards listed by Christians (2000). In this research, all ethical requirements were followed throughout all phases of the research. According to Saunders, 2009, ethics is the norms or standards of behavior that guide moral choices about our behavior and our relationships with others. Participants and respondents were given full information on the purpose and objectives of the study in order for them to make informed decisions as to whether to partake or not. Moreover, all information concerning the identity and personality of respondents were treated with utmost confidentiality. Additionally, all information gathered was used for the sole purpose of this research study.

CHAPTER FOUR

DATA PRESENTATION AND ANALYSIS

4.1 Introduction

This chapter presents the analysis of data and findings of the research in accordance to the research objective and hypothesis focusing on demographic results to show the general characteristics of the respondents, descriptive statistics of the response to describe the basic features of the data, and correlations and regression analysis to investigate the relationship of the independent variables which includes tax rate, tax audit, tax payer's knowledge, perception of tax payers and trust in government on the dependent variable tax compliance. In order to analyses the research results, SPSS is a computer program used for statistical analysis. Descriptive measures of each questions response results are presented in the following sections.

4.2 Respondents profile and response rate

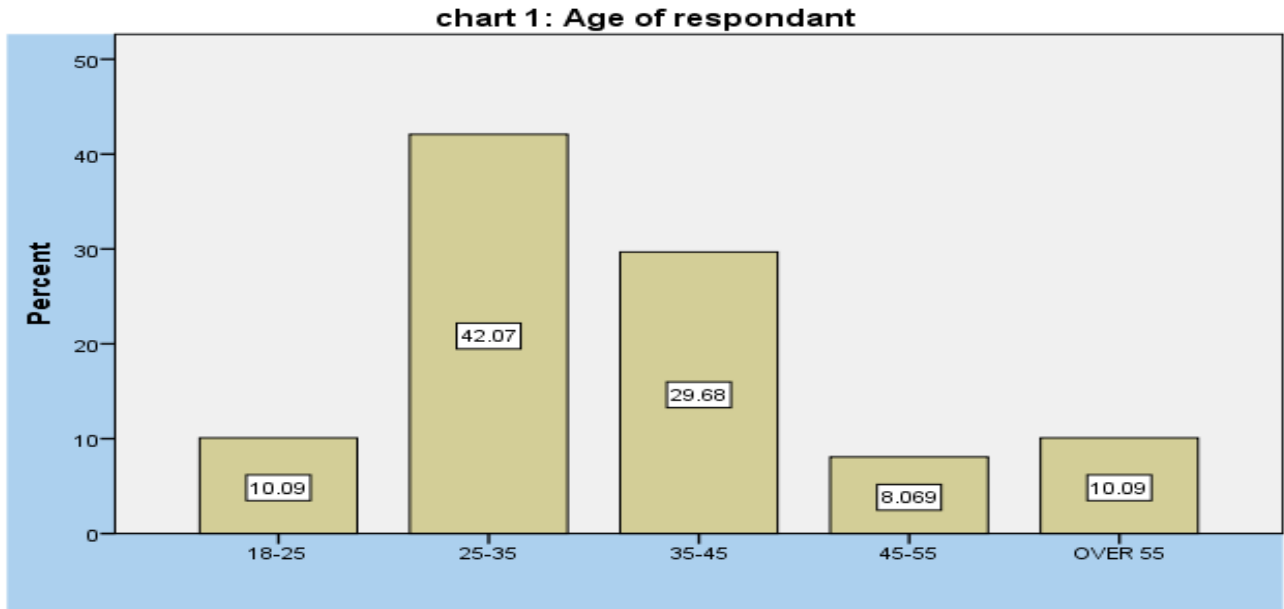
The Table below depicted the demographic characteristics of respondents in terms of Gender, Age, Educational Level, main business activities, forms of businesses and position of respondents in their company.

Table 6 Gender

Measurement		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Female	152	43.8	43.8	43.8
	Male	195	56.2	56.2	100.0
	Total	347	100.0	100.0	

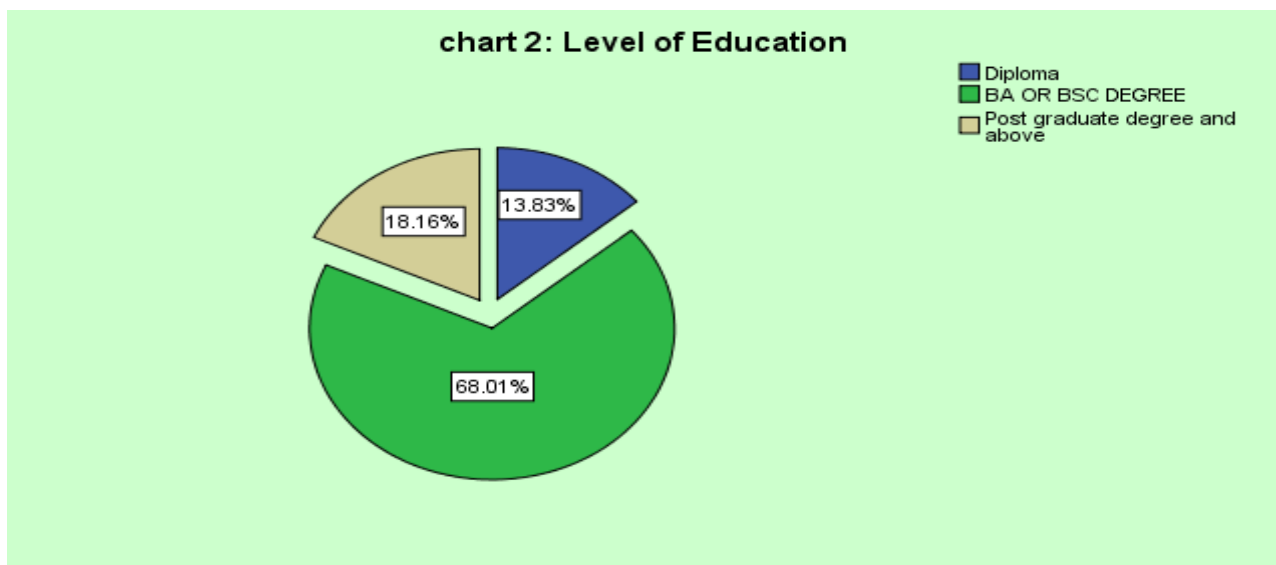
Source: From own computations, 2021

As stated in data, majority of the respondents were male 195(56.2%) as compared with 152(43.8%) of remaining respondents being females.



Source: From own computations, 2021

Regarding the age category of the respondents, the data illustrated that, majority of respondents were in the category of 25-35 years old representing the highest percentages among respondents with (42%) whereas (29.68%) were in the age bracket of 35-45 years, (10%) were between 18-25 the same number of respondents from the age over 55 years and (10%) of respondents were between 45-55 years old.



Source: From own computations, 2021

This indicates that most respondents are in the working age group of the population which may have implication to the firm that it has a lot of young people who may continue to do business with the organization for a long time if they are satisfied with the firm. With regard to the educational qualification and work experience of respondents, the highest percentage 239(68.1%) was taken by holders of bachelor's degree while the remaining 63(17.9%), Master's Degree and above 49(14%) were attained College diploma.

Table 7 main business activity

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Manufacturing	57	16.4	16.4	16.4
	Construction	119	34.3	34.3	50.7
	Trade	98	28.2	28.2	79.0
	Service	55	15.9	15.9	94.8
	Urban agriculture	18	5.2	5.2	100.0
	Total	347	100.0	100.0	

Source: From own computations, 2021

From above table 2 result regarding the main business activity enterprise which is majority 34.3% of them are involving in constructions, other 28.2% of them were involving trade, similarly, other 16.4% of them are involving in manufacturing.

4.3. Descriptive statistics

4.3.1 The level of Tax rate

Table 8 descriptive statistics analyzing the level of tax rate

statement	Strongly disagree	Disagree	Neutral	Agree	Strongly Disagree	Mean	St. dev.	Grand mean
Tax rate have no impact on tax compliance	211 60.8%	101 28.9%	15 4.5%	7 2%	13 3.7%	1.6138	.74928	2.1864
Tax rate cause to Reduce compliance	64 18.4%	30 8.6%	17 4.9%	172 49.6%	64 18.4%	2.8876	1.01523	
The current Tax rate is not fair	63 18.2%	7 2%	30 8.6%	146 42.1%	101 29.1%	2.3602	1.00859	
Reducing tax rate encourage taxpayer's voluntary compliance	64 18.4%	22 6.3%	14 4%	139 40.1%	108 31.1%	2.7406	1.39431	
Raising the rate of tax will encourage taxpayers' voluntary compliance.	144 41.5%	160 46.1%	22 6.3%	7 2%	14 4%	1.8790	.71910	
The current personal income tax rates are high	56 16.1%	14 4%	23 6.6%	131 37.8%	123 35.4%	1.6369	.69733	

Source: own computation 2021

As we see from the above table majority of them 60.8% of them were strongly disagreed that tax rate have no effect on tax Compliance, while 28.8% of the respondents disagree 4.6% of the respondents are uncertain about this impact and the rest 2% and 3.7 % of them agree and

strongly agree respectively regarding the tax rate on tax compliance. The other question was reducing the tax rate encourage tax payers voluntary compliance majority of the respondents agree with these idea as we see from the answers 31.1% and 40.1% strongly agree and agree with reducing tax rate while the rest 18.4% and 6.3% disagree and strongly disagree that the reduction of tax rate cannot increase tax compliance. In general when we see the respondents answers regarding the tax rate on tax compliance it highly affect the tax compliance of SMEs.

4.3.2. Knowledge of tax

Table 9 descriptive statistics analyzing the level of tax knowledge

statement	Strongly disagree	Disagree	Neutral	Agree	Strongly agree	Mean	St. dev.	Grand mean
I feel that taxpayers have enough knowledge on tax compliance	137 39.5%	14 4%	0	132 38%	64 18.4%	1.6369	.69733	2.5112
The authority given training on the Ethiopian tax law and its procedure to taxpayer to build tax compliance knowledge	138 39.8%	16 4.6%	28 8.1%	108 31.1%	57 16.4%	2.6484	1.09796	
I am able to interpret taxation laws when computing taxes	118 34%	122 35.2%	14 4%	44 12.7%	49 14.1%	1.6369	.69733	
I feel that every taxpayer has knowledge an obligation to fill a tax return form and calculate his own tax liability	122 35.2%	56 16.1%	8 2.3%	138 39.8%	23 6.6%	3.4726	.72624	

I believe that tax authority awareness creation program helps to known of tax law and tax comply when you get a service	117 33.7%	147 40.8%	10 3%	14 4%	64 18.4%	3.1614	.97507	
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Source: own computation 2021

One of the questions that asked by the tax consultants concerning tax compliance was about the tax knowledge of the small and medium businesses found in kirkos sub City Administration.

Majority of the respondents generally explained that it is difficult to say the owners of small and medium businesses have tax knowledge as most of them do not have taxation background. The tax consultants explained that lack of tax knowledge can be the main reason why small and medium businesses seek their services. Even if small and medium businesses have accountants on regular or retention based, they mainly seek the services of the tax consultants to make sure that they are within the tax laws and procedures.

Another problem that makes small and medium businesses to seek the services of tax consultants is the frequent changes of directives and guidelines by MOR and not giving training on this tax laws and procedures to tax payers to build tax compliance knowledge concerning taxes that are not made public or not provided to professionals or tax consultants.

Majority of the respondents cannot interpret taxation laws or misinterpret it when computing their taxes as we see from the respondents 34% and 35.2% of them strongly disagreed and disagreed when questioned about if they can interpret tax laws when computing taxes while the rest 14.1% and 12.7% of them strongly agrees and agrees to the answer.

4.3.3. Tax Fairness

Table 10 descriptive statistics analyzing the level of fairness of tax system

statements	Mean	Std. Deviation	N
I feel while the tax burden imposed upon Small and medium business firms is fair	3.8732	.57001	347
I believe that a fair tax system would inspire tax compliance of taxpayer	2.8156	1.25412	347
Every SMEs business pays fair tax under the current income tax system	2.8876	1.01523	347
I believe that the tax system is fair and encourages business taxpayers' to properly pay their tax compliance	2.3602	1.00859	347
Do you agree there is fair tax among similar businesses in same proximity?	1.8790	.71910	347
Grand Mean = 2.7631		.64407	347

Source: own computation, 2021

From above table 4.5, result regarding to Descriptive statistics analyzing Tax Fairness ability-to-pay principle is found in moderate level rationalized indicted in mean difference of 2.7631 as a surrogate for taxation according to benefits received depicted in standard deviations of 0.64407, the most prominent conceptions of this approach found ignore Tax Fairness ability any connection to public expenditures altogether, treating the collection of taxes as 'a common disaster' as though the money once collected were thrown into the SME's conclusion, therefore, these considerations suggest that a proportionate consumption Tax Fairness ability above a basic exemption might be the most appropriate way to implement a scheme of fair taxation for the collection of revenues to finance publicly provided goods and services that cannot reasonably be financed according to the benefit principle of tax fairness.

In practice, such a tax could be implemented in the form of a personal expenditure tax under which revenues are included and savings deducted, but is more easily collected through abroad-based VAT combined with a universal or targeted transfer payment designed to offset the tax on a minimum amount of tax (ERC, 2020).

4.3.4. Probability of Tax audit

Table 11 descriptive statistics analyzing the probability of being audited

statement	Strongly disagree	Disagree	Neutral	Agree	Strongly agree	Mean	St. dev.	Grand mean
Tax Audit have no effect on Tax compliance	144 41.5%	97 28%	22 6.3%	77 22.2%	7 2%	2.3602	1.0085 9	2.4837
The probabilities of being detected by the tax authority for not declaring the exact tax is low	35 10.1%	36 10.4%	31 8.9%	117 33.7%	128 36.9%	2.1297	.99007	
The probability of being audited by the tax authority are very low as a result I can under report and over claim the tax	63 18.2%	42 12.1%	19 5%	101 29%	122 35.8%	1.8790	.71910	
I believe that tax audits can play an important role to increase voluntary compliance	71 20.5%	30 8.6%	14 2%	89 25.6%	143 41.2%	2.8646	1.2797 2	
Taxpayers who have never been audited before cause for malicious report	65 18.7%	30 8.6%	22 6.3%	144 41.5%	86 24.8	2.8156	1.2541 2	

Current's penalties are too low to make people obey tax laws even if they get through Audit	87 25.1%	29 8.4%		114 32.9%	117 33.7%	2.8530	1.3250 6	
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Source: own computation, 2021

From the above table 4.6 Tax audit have no effect on tax compliance most of the respondents disagree and strongly disagree with average of 28% and 41.5% respectively while the rest 6.3% and 2% strongly agree the remaining average score 22.2% respondents were neither agree nor disagree. The probability of being detected by the tax authority for not declaring the exact tax is low are strongly agree and agree with percent 36.9% and 33.7% while strongly disagree and disagree with percent of 10.4% and 10.1% respectively, the remaining 8.9% respondents were neither agree nor disagree. The probability of being audited by the tax authority are very low as a result I can under report and over claim are agree and strongly agree with average of 30.3% and disagree with average of 64.8% and the remaining average score 5% respondents were neither agree nor disagree. I believe that tax audits cannot be play an important role to increase voluntary compliance are strongly agree and agree with average of 41.2% and 25.6% respectively, while strongly disagree and disagree with average of 20.5% and 8.6% and the remaining average score 4% respondents were neither agree nor disagree. Regarding Taxpayers who have never been audited before cause for malicious report majority of the respondents agree and strongly agree with average of 41.5% and 24.8 respectively the rest 18.7% strongly disagree while 8.6% of the respondents disagree and the remaining average score 6.3% respondents were neither agree nor disagree.

The study shows that more taxpayers do not audited regularly so, they do not paid right amount and/or timely. This implies that taxpayers comply with taxation for the reason that they fear may caught by tax audit. Thus the tax authority should be focused on audit to increase the revenue.

4.3.5. Trust in government

Table 12 descriptive statistics analyzing the taxpayers trust in Government

statement	Strongly disagree	Disagree	Neutral	Agree	Strongly agree	Mean	St. dev.	Grand mean
As trust in tax officials increases tax compliance increase	2.5%	4.2%	5.8%	79.2%	8.3%	2.7061	1.24001	2.5476
Integrity of tax officials and government officers	1.7%	2.5%	8.3%	69.2%	18.3%	2.6427	1.18235	
Overall level of satisfaction with politicians affects tax compliance	4.2%	2%	9.7%	73.3%	10.8%	1.8386	.97210	
perception about their country's level of democracy	3.3%	5%	3%	83.3%	5.3%	3.0029	1.18395	

Source: own computation, 2021

The degree to which citizens trust their government influences tax compliance, which in turn influences political legitimacy. The respondents were asked to rate their agreement with the statements below that motivate them to be tax compliant (1 = Strongly Disagree). 2 = Disagree; 3 = Agree; 4 = Disagree 3 = Uncertain 4 = Strongly Agree, 5 = Agree).

Table 4.7 indicates the variables that inspire tax payers to be tax compliant, with 83.3 percent and 79.2 percent agreeing with the assertions regarding their country's level of democracy and trust in tax officials, respectively. Overall satisfaction with politicians and the honesty of tax authorities and government employees came in second and third, respectively, with 73.3 percent and 69.2 percent agreeing.

4.3.6. Tax Compliance

Table 13 Descriptive statistics analyzing Tax Compliance

Item Statistics	Mean	Std.	N
I registered in the concerned tax Authority as VAT taxpayer	2.6484	1.09796	347
I've only collected VAT from customers by issuing proper legal receipt	3.4726	.72624	347
I file the VAT tax returns in the actual filing date on time	3.1614	.97507	347
I accurately compute the tax liability as per the tax rate specified in the law	3.8732	.57001	347
I paid the right amount of tax within the time frame stipulated in the tax law	2.1297	.99007	347
I have adequate records in order to complete tax returns and associated tax documentations	2.6427	1.18235	347
Grand Mean = 2.9880		1.04196	347

Source: From researcher Owen survey data, 2021.

From above table 4, result regarding to Descriptive statistics analyzing Tax compliance as taxpayer obedience in carrying out the tax provisions that have been required and implemented based on established tax laws found in intermediate level progressed in mean difference of 2.9880 seen as less likely voluntary behavior of taxpayers in terms of reporting all other income received by SMEs in Addis Ababa. According to MOR (2020), tax compliance is found lower the availability of taxpayers to fulfill their tax obligations following applicable regulations without any actions such as inspection, investigation, warning or threat and the application of sanctions in punishment or administrative fines.

4.4. Analysis measure

According to sign (2009) stated that impact analysis can be seen as the out-sourcing rig and trust worth of the data to be able to present study reliability and study impact analysis result to continuing final output of the research. Hence, research goes over by analyzing and measure reliability of data adequacy and impact analysis measure using Kemeo -Bartist test.

4.4.1. Reliability Test

A reliability analyses was conducted to each variable of the instrument. The reliability of the measures was examined through the calculation of Cronbach's alpha coefficients. For scale acceptability, Hair et al. (1998) suggested that Cronbach's alpha coefficient of construct is 0.6. If each domain obtains the value 0.6, it means that, the items in each domain are understood by most of the respondents. On the other hand, if the findings are far from the expected value of 0.6, this might be caused by respondents' different perception toward each item of the domain.

Table 14 Reliability Test measures indicator

Variable	Number of items	Cronbach Alpha α
Tax rate	6	0.973
Knowledge of tax system	5	0.969
Fairness of tax system	5	0.955
Tax audit	6	0.979
Trust in government	4	0.967
Tax Compliance	6	0.970

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

Source: From researcher Owen survey data, 2021.

The Cronbach's alpha values are reported as follow. Aspect of Tax rate yield Cronbach's alpha =0.699, Knowledge of tax system yields in Cronbach's alpha = .846, the Cronbach's alpha for Fairness of tax system was at 0.778, Cronbach's alpha for Tax audit was at 0.979, Cronbach alpha for Trust in government yields =0.699 which is higher.

Aspect of Cronbach's alpha the Tax Compliance is 0.970 which is highly unvarying. The Cronbach's alpha values for all the variables considered are greater than 0.6 and this indicates the items in each of the domains are well understood by the respondents. The items have measured what they were designed to measure.

4.4.2. Assumption of multicollinearity

Table 15 assumption of multicollinearity

Coefficients ^a		Collinearity Statistics	
Model		Tolerance	VIF
1	Tax rate	.372	2.689
	Knowledge of tax system	.289	3.461
	Fairness of tax system	.376	1.480
	probability of Tax	.333	2.312
	Trust in government	.218	1.223

a. Dependent Variable: Tax Compliance practice

Source: own computation

In the above table 4.10, it shows whether there is multicollinearity or not from Tolerance & VIF result. The Tolerance result is above 0.1 & VIF result is below 10 the indicated result in the table fulfills the standard of multicollinearity. Based on the Coefficients Output - collinearity Statistics, obtained VIF value of 2.689, 3.461, 1.480, 2.312 and 1.223, and tolerance of greater than 0.1 for all variables meaning that the VIF value obtained is between 1 and 10, it can be concluded that there are no multicollinearity symptoms.

4.5. Pearson's Correlations between Constructs

According to (shukran, 2003), the relationship is expressed by value within the range -1.00 to +1.00 as Pearson product moment indicates. Pearson correlation is +1 in the case of a perfect increasing (positive) linear relationship (correlation), -1 and 1 in all other case indicating the degree of linear dependency between variables. To determine Relationship between determinant of tax compliance and overall voluntary compliance (Y), Pearson correlation computed. As to the magnitude of the correlation scores is concerned, the following points can be supposed.

Table 16 Pearson's correlation matrix between variables

Correlations		TC	TR	KTS	FTS	TA	TIG
TC	Pearson Correlation	1					
	Sig. (2-tailed)						
	N	347					
TR	Pearson Correlation	-.673**	1				
	Sig. (2-tailed)	.000					
	N	347	347				
KTS	Pearson Correlation	.785**	.589**	1			
	Sig. (2-tailed)	.000	.000				
	N	347	347	347			
FTS	Pearson Correlation	.698**	.629**	.494**	1		
	Sig. (2-tailed)	.000	.000	.000			
	N	347	347	347	347		
TA	Pearson Correlation	.744**	.537**	.619**	.589**	1	
	Sig. (2-tailed)	.000	.000	.000	.000		
	N	347	347	347	347	347	
TIG	Pearson Correlation	.697**	.582**	.713**	.607**	.635**	1
	Sig. (2-tailed)	.000	.000	.000	.000	.000	
	N	347	347	347	347	347	347

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

Source: own computation

The Pearson Correlation Analyses were employed among variables. Table 4.12 shows the correlation analyses among all constructs for determinant of tax compliance. The result reveals that there is significant negative correlations between Tax rate and Tax compliance of SMEs in Addis Ababa ($r = -0.673, p < 0.01$), the result reveals that there are significant positive correlations between Knowledge of tax system and Tax compliance of SMEs in Addis Ababa ($r = 0.785, p < 0.01$). In other hand, there is a positive correlation between Fairness of tax system and Tax compliance of SMEs in Addis Ababa ($r = 0.698, p < 0.01$). Other, correlation coefficient demonstrates that there is a positive relationship between Probability of Tax audit and Tax compliance of SMEs in Addis Ababa score ($r = 0.744, p < 0.01$), which shows high strength of SMEs in Addis Ababa tax compliance. This means that the more Probability of Tax audit is in the SME's will lead to better Tax compliance of SMEs in Addis Ababa.

According to According to Hutcheson, (2011) and Daniel (2014), When Pearson's r is close to #1, this means that there is a strong relationship between your two variables. This means that changes in one variable are strongly correlated with changes in the second variable which is not meant that have multicollinearity problem. In our example, the highest Pearson's r is 0.785 which is interpreted as; -knowledge of tax system correlated with Tax compliance of SMEs in Addis Ababa was found first highest number by ($r = 0.785, p < 0.01$). In other hand when Pearson's (r) is close to (0), this means that there is a weak relationship between our two independent and dependent variables. This means that changes in one variable are not correlated with changes in the second variable. If our Pearson's r were 0.01, it could conclude that our variables were not strongly correlated. But our outputs as can be evidenced from the correlation matrix above table 4.12, there is a negative and positive significant relationship in between the variables and that all correlation coefficients are significant at 1% level of significance.

4.6. Multiple linersRegression Analysis on Determinates of Tax compliance

Multiple liner regression analysis was employed on constructive statistical techniquethat can be used to analyze the association between a single dependent and severalindependent variables. One of the vital considerations in multipleregression is the sample size of the data.

4.6.1 Regression analysis (independent variables as predictors to dependent variable)

Table 17 model summary b

Model Summary^b

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.737 ^a	.672	.619	.32803

a. Predictors: (Constant), Trust in government, Knowledge of tax system , Tax audit , Fairness of tax system , Tax rate

b. Dependent Variable: tax Compliance

Source: own computation, 2021

In this study, a multiple regression analysis was conducted to test relationship among variables i.e., dependent and independent variables. The analysis was done to establish how the specific determinates of tax compliance by SMEs in kirkos sub city. From table 4.13, The result shows that the R-square with a value of 0.672 implies that about 67.2% of the changes in tax compliance could only be explained by repressors namely; Tax rate (TR), Knowledge of tax system (KTS), Fairness of tax system (FTS),probability of being tax audited (TA), and Trust in government (TIG) while about 32.8% of the changes in tax compliance (TC) could be explained by other factors not included in the model.

4.6.2 Analysis of Variance

Table 18 ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	1761.401	5	352.080	2942.909	.000 ^b
	Residual	40.831	341	.120		
	Total	1765.232	346			

a. Dependent Variable: tax Compliance

b. Predictors: (Constant), Trust in government, Knowledge of tax system , Tax audit , Fairness of tax system , Tax rate

Source: own computation

From Above table 4.14 regarding to Coefficient of determination explains the extent to which changes in the dependent variable can be explained by the change in the independent variables or the percentage of variation in the dependent variable (Organizational performance a) that is explained by all the five independent variables. The F-ratio found in the ANOVA table 14 measures the probability of chance departure from a straight line. The significance value is 0.00 which is less than 0.05 thus the model is statistically significance in predicting how; -Trust in government, Knowledge of tax system, probability of Tax audit, Fairness of tax system, Tax rate show significance change the determinations of tax compliance by SMEs in kirkos sub city. The F critical at 5% level of significance was 0.00. Since F calculated is greater than the F critical (value = 2942.909), this shows that the overall model was significant.

4.6.3 Coefficients Model

Table 19 coefficients

		Coefficients ^a				
		Unstandardized Coefficients		Standardized Coefficients		
Model		B	Std. Error	Beta	t	Sig.
1	(Constant)	-.896	.178		-5.031	.000
	Tax rate	-.177	.078	-.084	-2.264	.024
	Knowledge of tax system	.148	.014	.095	10.430	.000
	Fairness of tax system	.943	.024	.673	38.780	.000
	Tax audit	.513	.038	.203	13.510	.000
	Trust in government	.217	.070	.119	3.112	.002

a. Dependent Variable: tax Compliance
Source: own computation

The coefficients table sought to identify which predictors are significant contributors to the 67.2% of explained variance in Y (i.e., R²=.67.2) and which have the significant ones help strongly to explain Y intercept established regression equation was:

$$Y = -0.896\beta_0 - 0.084\beta_1 + 0.095\beta_2 + 0.673\beta_3 + 0.203\beta_4 + 0.119\beta_5 + \dots + \Sigma$$

The regression equation above has established that holding all influence indicator variable (Trust in government, Knowledge of tax system, probability of Tax audit, Fairness of tax system, Tax

rate) but, constant show to organizational performance determined by negative 89.6% shows coefficient probability of indications starts from the scratch.

From above Table 4.15 shows that the values of the coefficient independent variables can be retained in the model. In other word, these variables can explain the change in tax compliance which is independent variables are found to be very significant and supportive to the hypotheses of regression analysis Trust in government, Knowledge of tax system, probability of Tax audit, Fairness of tax system, Tax rate are statistically significant and it does support the hypotheses.

4.6.4 The Summary of Hypotheses Results

Table 20 summary of hypothesis

Hypothesis	Results	Reason
H1: There is Negative relationship between tax payers' tax rate and tax compliance of SMEs.	Accepted	B= -.084, P<.05
H2: There is positive relationship between perception of Knowledge of tax system and tax compliance.	Accepted	B=.095, P<0.05
H3: There is positive relationship Fairness of tax system and tax compliance.	Accepted	B=.673, P<0.05
H4: There is positive relationship between the level of Probability of Tax being Audit and tax compliance decisions of SMEs.	Accepted	B=.203, P<0.05
H5: There is a positive relationship between trust in government and tax compliance.	Accepted	B=.119, P<0.05

Table 4.16 also indicates that, the hypotheses **H1**, is accepted at the 5 % level of significance (p - value is less than 0.05) but negative result been found on coefficient which has inverse relationship between tax payers' tax rate and tax compliance of SMEs. Research has shown that determinates tax compliance by SMEs in *kirkos* sub city was found is created tax awareness can be increased by understanding the taxpayers of taxation regulations and taxation laws that include taxation procedures that will help taxpayers to know how to fulfill their tax obligations.

Awareness of taxpayers of the importance of fulfilling their tax obligations to contribute to Fairness of tax system that is important in the development of the nation and state is fundamental

in increasing taxpayer compliance. But, Knowledge of tax system is found none reasonable and comparatively low to another variable.

4.7. Discussions

Regressions result shows in determinates of tax compliance by SMEs in Kirkos sub city which several studies examine the effect of **tax rate** on tax compliance found negatively at likely coefficient of ($\beta = -0.084$) in significance of ($P = 0.024$). The studies found that the high tax rate causes 8.4% growing of the tax non compliance SMEs in Kirkos sub city. By implication, the perception by taxpayers that pay high tax rate is that they can outweigh their overpayment through tax evasion. It is supported by Spicer & Becker (1980) found that taxpayers who are aware that their tax rate is higher than average tax rate paid by other have higher records of tax evasion.

By implication, the perception by taxpayers that pay high tax rate is that they can outweigh their overpayment through tax evasion. Similarly, it was also found that taxpayers' underreporting behavior is positively correlated with high tax rate (Clotfelter, 2013). Moreover, though majority of literature showed that the high tax rate is positively related to tax evasion and negatively related to tax compliance, other studies found either no relationship or in fact even positive relationship between tax rate and tax compliance. Thus, in a recent study in one of the African countries, the findings show that tax rate do not have any positive or negative effect on tax compliance (Modugu, Eragbhe, & Izedonmi, 2012).

Findings of some prior research has indicated that in **knowledge of tax** issues by taxpayers tend to comply less as compared with direct assessment indicted in ($\beta = 0.095$) at 5% significance level. This could happen due to unintentional non-compliance especially in the early years of the introduction due to factors such as lack of familiarity with the new system, or general limited knowledge of tax issues where such knowledge was less 9.5% required and has to be obtained somehow.

These include the fact that it is a complex multi-racial and multi-faith country, enabling us to contribute new evidence to the tax compliance literature where previous studies evidenced that knowledge of tax system have a significant impact on Tax compliance Chandarasorn (2012), Within this time frame, it may be arguable that many taxpayers were not as fully aware of their full responsibilities in completing the tax returns compared to the previous system. For those

taxpayers who were not fully aware of the changes in the system, they potentially treated the tax return as usual (as in Formal System).

It is expected that within this study's time frame (five years after SMEs was implemented), the taxpayers' knowledge and awareness of tax laws will have significantly increased compared to Loo's research findings and could be reasonably considered to have reached a stable plateau of development of SMEs specific knowledge making this a suitable point to extend current research in Addis Ababa, Ethiopia SMEs tax compliance.

Regression result shows SMEs perceptions of **a fair tax administration system** have garnered found 67.3% growing interest as a decisive ingredient that can install compliance behavior among tax payers which is indicted in 5% significance level. The relationship between perceived fairness of the tax system and individuals' compliance behavior remains clear as evinced by the inconsistencies reported in past studies. Importantly, given the differences in tax systems, laws, sample selections, and methods used in prior studies, fairness in various countries is difficult to ascertain.

To answer the call for urgent research to explore how tax fairness perceptions influence taxpayers' decision to comply with tax regulations in Kirkos sub city in Addis Ababa Ethiopia, the present study empirically examines the relationship between tax fairness (as a multidimensional construct) and compliance behavior among Ethiopian taxpayers by adapting five developed dimensions of fairness, namely, general fairness, preferred tax rate structure, exchange with the government (i.e., benefits received from the government), special provisions, and self-interest found significantly accepted (MOR,2020).

As stated by regression coefficient that **probability of tax audit** have significant effect on tax Compliance is in agreement with the hypothesis since probability of tax audit has coefficient estimate ($\beta_1 = 0.203$, $p \text{ value} = 0.002$), probability of being audited has a positive effect on tax compliance, thus the higher the potential audit probability found probability of 20.3% encouragement for potential tax compliance behavior of tax payers are in agreement with (Allingham & Sandmo, 1972), claimed that taxpayers will always declare their income correctly if the probability of audit is high. Probability of audit plays a significant role in reporting behavior as taxpayers will declare everything if they perceive that they will be one of the auditees in that particular year.

In regression result coefficient indicated that **the taxpayer's trust in government** will have a positive 11.9% significance influence on the level of taxpayer confidence in the government at 5% significance level. This will have a positive influence on the level of tax compliance by SMEs in Kirkos sub city of Addis Ababa, Ethiopia.

Research conducted by Ephrem (2016), shows that trust in government increases perceptions of fairness of taxpayers and consequently affects tax compliance positively. In this case trust is formed before justice, then taxpayers evaluate whether the system is fair or not through the trust they have in the government. In other words, the taxpayer will assume that the application of the system carried out by the government is fair if the taxpayer puts trust in the government. Other studies prove that perceptions of fair government practices by taxpayers will increase taxpayer trust; perceptions of fairness correlate with trust in government (Hanousek&Palda, 2004). Similarly, Richardson (2008) also suggested that the role of government has a significant positive impact on determining attitudes toward tax. The author investigates the determinants of tax evasion in different countries including the USA, Argentina, Thailand, Canada, Chile, Kenya, Nigeria and Brazil. Richardson also suggested that the government should increase their reputation and credibility in order to obtain trust from the taxpayers. Therefore, it is expected that the perceptions of better government administration will result in increased tax compliance in Ethiopia.

CHAPTER FIVE

CONCLUSION AND RECOMMENDATION

5.1. Conclusion

The general objective of the study is to determine the factors influencing tax compliance among Small and Medium Enterprises in Addis Ababa city Administration kirkos sub city. The result regarding to Descriptive statistics analyzing Tax compliance as taxpayer obedience in carrying out the tax provisions that have been required and implemented based on established tax laws found in intermediate level progressed in mean difference of 2.9880 seen as less likely voluntary behavior of taxpayers in terms of reporting all other income received by SMEs in Addis Ababa.

Regressions result shows in determinates of tax compliance by SMEs in kirkos sub city studies found that the high tax rate causes 8.4% growing of the tax noncompliance SMEs in kirkos sub city. By implication, the perception by taxpayers that pay high tax rate is that they can outweigh their overpayment through tax evasion.

In other hand, Findings of some prior research has indicated that in knowledge of tax issues by taxpayers tend to comply less as compared with direct assessment indicted in due to unintentional non-compliance especially in the early years of the introduction due to factors such as lack of familiarity with the new system, or general limited knowledge of tax issues where such knowledge was less 9.5% required and has to be obtained somehow. Similarly, Regression result shows SMEs perceptions of a fair tax administration system have garnered found 67.3% growing interest as a decisive ingredient that can install compliance behavior among taxpayers.

Moreover, the tax Compliance SMEs is in agreement with the hypothesis since probability of tax audit has coefficient estimate probability of being audited has a positive effect on tax compliance, thus the higher the potential audit probability found probability of 20.3% encouragement for potential tax compliance behavior of tax payers are in agreement. Finally, the regression coefficient result indicated that the taxpayer's perception of tax justice will have a positive 11.9% significance influence on the level of taxpayer confidence in the government that will have a positive influence on the level of tax compliance by SMEs in kirkos sub city of Addis Ababa, Ethiopia.

5.2. Recommendations

- Increased audit rates that aim to shorten the time between audits will enhance compliance since taxpayers will be afraid of being audited and fined. Audits should be expanded to cover a larger area, with the option of performing joint income tax and VAT audits using current audit techniques. These initiatives are expected to increase tax collection, information exchange, and time savings for both the authority and the taxpayers. Because audits will be more productive and informative, the criteria for selecting files for audits should be based on information provided in returns rather than random or subjective selection.
- An effective compliance program requires tax administration to have sufficient powers that enable it to enforce compliance effectively. To encourage compliance, it is important that tax authority administers the law fairly. The tax authority needs to be strong enough in order to implement the tax law effectively and efficiently. Functions such as tax assessment, collection, awareness creation, providing information, and enforcement has to performed effectively and efficiently, so that it will be perceived as strong and powerful by the taxpayers.
- Small and medium business profit taxpayers should have access to tax directives, guidelines, and any changes thereto. Tax education and training should be provided regularly and frequently through various media such as television, radio, various publications, magazines, and training events. Taxpayers should be encouraged to use MOR's websites as well. As a result, it will increase taxpayer knowledge, reduce gaps in tax compliance, and improve the timely submission of tax returns by small and medium business profit taxpayers.
- More recently, however, it was suggested that due to inconclusive findings on the effect of tax rate on tax compliance, government should continue to explore such revision of tax rate due to negative perceptions by SMEs.

- Consider decreasing tax rates in order to increase collections. This is consistent with optimum tax theory, which states that lower tax rates make evading taxes less appealing than high rates.
- Based on the results of this study it can be suggested especially to the government to continue to increase public trust by improving the quality of tax services, developing payment systems for easier tax payments, and improving regulations on applicable tax rates which will ultimately affect the increase in tax compliance.
- Equal treatment of taxpayers under equal circumstances is the most obvious condition for fairness or equality. In some circumstances, tax equality and fairness are achieved not just through horizontal fairness, but also through concerns such as vertical equity and personal fairness. As a result, the issue of fairness or equity affects people both inside and outside the tax system, because ensuring fairness means encouraging and protecting society's honest and loyal citizens by ensuring fair competition among business communities, particularly in terms of registration, tax assessment, collection, and payment capacity. . The authority can also include taxpayers or their members in addressing the problem of justice and equality when calculating the regular transactions or tax of taxpayers.

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Appendices I

**ADDIS ABABA UNIVERSITY
FACULTY OF BUSINESS AND ECONOMICS**

DEPARTMENT OF ACCOUNTING AND FINANCE

QUESTIONNAIRE TO BE FILLED SMEs TAX PAYERS IN KIRKOS SUBCITY

Dear Respondents,

The purpose of this study in general and this questionnaire in particular is to study “The Determinants of tax compliance among Small and Medium tax payers” as a requirement for the partial fulfillment MSc. degree in Accounting and Finance. The outcomes of this study will help policy makers and tax authorities, Particularly Ministry of Revenue and Customs Commission with a deeper understanding of the compliance behavior of their clients” (i.e., taxpayers) and to identify strategies that help in fostering the level of voluntary compliance. This research has been intended only for academic purposes authorized by Addis Ababa University Faculty of Business and Economics School of Graduate Studies. Thus, your ideas and comments kept confidential.

I would like to thank you for your participation in responding the questionnaire. Your frank response and valuable support in responding to the questions raised is of vital important to the success of the study. Hence, I request you to fill the questionnaire carefully and at your own best knowledge in all regard.

Please do not put your name or other identifiable information anywhere in this survey. Your response will be anonymous. All responses will be compiled together and analyzed as a group. The responses will be used only for academic and public interests and will never be used against the respondents in any circumstances.

If you would like additional information concerning this study before or after it is completed, please feel free to contact us by phone or email.

+251909677411/+251921192657

Email- ashebradugna@gmail.com

Thank you very much again for sacrificing your valuable time.

Section I: Respondent's Background
PART A: Demographics

1. Gender? Male Female

2. How old are you?

a. 18-25 b. 25-35 c. 35-45 d. 45-55 e. Over 55

3. What is your position in the company a. Owner b. Manager
c. Employees d. other

If your answer is Employee, please tell us your position

4. How long have you been in operation or worked for your company in years?

Less than 2 2-4 5-7 8-10 Over 10

5. Level of Education

a. Primary School c. Certificate/diploma graduate degree & above

b. High School Graduate d. BA/BSc degree

6. What is your main business activity?

a. Manufacturing c. Trade e. Service

b. Construction d. Urban Agriculture

7. Please indicate the legal form of your business.

a. Sole proprietorship c. Private limited company

b. Partnership d. Share company

e. Other if other please specify-----

8. What is the size of business in terms of employees?

a. 0-5 b. 6-10 c. 11-15 d. over 15

9. Please indicate, how long your company has been in business?

a. Less than 1 year c. 6-10 years

b. 1-5 years d. More than 10 years

How strongly do you AGREE or DESAGREE with the following statements? Please tick (✓) in the box that matches your opinion the best.

Tax rate – tax rate affects tax compliance of business taxpayers. Please indicate to what extent you agree with each of the following statements:

No.	Statements	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
10	Tax rate have no effect on tax Compliance					
11	Tax rate cause to Reduce compliance					
12	The current Tax rate is not fair					
13	Reducing tax rate might encourage taxpayers voluntary compliance					
14	Raising the rate of tax will encourage taxpayers' voluntary compliance.					
15	The current personal income tax rates are high					

Knowledge of tax system – tax knowledge affects tax compliance of business taxpayers. Please indicate to what extent you agree with each of the following statements:

No.	Statements	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
16	I feel that taxpayers have enough knowledge on tax compliance					
17	The authority given training on the Ethiopian tax law and its procedure to taxpayer to build tax compliance knowledge					
18	I am able to interpret taxation laws when computing taxes					
19	I feel that every taxpayer have knowledge an obligation to fill a tax return form and calculate his own tax liability					
20	I believe that tax authority awareness creation program helps to known of tax law and tax comply when you get a service					

Fairness of tax system – tax fairness affects tax compliance of business taxpayers. Please indicate to what extent you agree with each of the following statements:

No.	Statements	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
21	I feel while the tax burden imposed upon large business firms is fair					
22	I believe that a fair tax system would inspire tax compliance of taxpayer					
23	Every large business pays fair tax under the current income tax system					
24	I believe that the tax system is fair and encourages business taxpayers' to properly pay their tax compliance					
25	Do you agree there is fair tax among similar businesses in same proximity?					

Tax audit – tax audit affects tax compliance of business taxpayers. Please indicate to what extent you agree with each of the following statements:

No.	Statements	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
26	Tax Audit have no effect on Tax compliance					
27	The probabilities of being detected by the tax authority for not declaring the exact tax is low					
28	The probability of being audited by the tax authority are very low as a result I can under report and over claim the tax					
29	I believe that tax audits can play an important role to increase voluntary compliance					
30	Taxpayers who have never been audited before cause for malicious report					
31	Currents penalties are too low to make people obey tax laws even if they get through Audit					

Trust in government-Please indicate your level of acceptance with the following statements that motivate you to be tax compliant

No.	Statements	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
32	Trust in tax officials					
33	Integrity of tax officials and government officers					
34	Overall level of satisfaction with politicians affects tax compliance					
35	Your perception about their country's level of democracy					

Tax compliance – Please indicate to what extent you agree with each of the following statements:

No.	Statements	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
36	I registered in the concerned tax Authority as taxpayer on time					
37	I've only collected VAT from customers by issuing proper legal receipt					
38	I file the tax returns in the actual filing date on time					
39	I accurately compute the tax liability as per the tax rate specified in the law					
40	I paid the right amount of tax within the time frame stipulated in the tax law					
41	I have adequate records in order to complete tax returns and associated tax documentations					

42. If you have any comment or suggestion, please specify about factors affecting tax compliance of taxpayers.....

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

43. Please state your possible solutions about how to improve taxpayer's tax compliance

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Appendices II

Variable	Number of items	Cronbach Alpha α
Tax rate	6	0.973
Knowledge of tax system	5	0.969
Fairness of tax system	5	0.955
Tax audit	6	0.979
Trust in government	4	0.967
Tax Compliance	6	0.970

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

		TC	TR	KTS	FTS	TA	TIG
TC	Pearson Correlation	1	-.673**	.785**	.698**	.744**	.697**
	Sig. (2-tailed)		.000	.000	.000	.000	.000
	N	347	347	347	347	347	347
TR	Pearson Correlation	-.673**	1	.589**	.629**	.537**	.582**
	Sig. (2-tailed)	.000		.000	.000	.000	.000
	N	347	347	347	347	347	347
KTS	Pearson Correlation	.785**	.589**	1	.494**	.619**	.713**
	Sig. (2-tailed)	.000	.000		.000	.000	.000
	N	347	347	347	347	347	347
FTS	Pearson Correlation	.698**	.629**	.494**	1	.589**	.607**
	Sig. (2-tailed)	.000	.000	.000		.000	.000
	N	347	347	347	347	347	347
TA	Pearson Correlation	.744**	.537**	.619**	.589**	1	.635**
	Sig. (2-tailed)	.000	.000	.000	.000		.000
	N	347	347	347	347	347	347
TIG	Pearson Correlation	.697**	.582**	.713**	.607**	.635**	1
	Sig. (2-tailed)	.000	.000	.000	.000	.000	
	N	347	347	347	347	347	347

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

Model Summary^b

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.737 ^a	.672	.619	.32803

a. Predictors: (Constant), Trust in government, Knowledge of tax system , Tax audit , Fairness of tax system , Tax rate

b. Dependent Variable: tax Compliance

ANOVA^a

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	1761.401	5	352.080	2942.909	.000 ^b
	Residual	40.831	341	.120		
	Total	1765.232	346			

a. Dependent Variable: tax Compliance

b. Predictors: (Constant), Trust in government, Knowledge of tax system , Tax audit , Fairness of tax system , Tax rate

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-.896	.178		-5.031	.000
	Tax rate	-.177	.078	-.084	-2.264	.024
	Knowledge of tax system	.148	.014	.095	10.430	.000
	Fairness of tax system	.943	.024	.673	38.780	.000
	Tax audit	.513	.038	.203	13.510	.000
	Trust in government	.217	.070	.119	3.112	.002

a. Dependent Variable: tax Compliance