



Addis Ababa University
College of Social Sciences
Faculty of Business & Economics
Master of Business Administration

Factors affecting tax collection and tax compliance in Ethiopia

The case of Addis Ababa Grade “A” tax payers

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Statement of Declaration

I, Tibebu Kifle Bereded, hereby declare that this thesis entitled “**Factors affecting effective tax collection and tax compliance in Ethiopia-The case of Grade “A” taxpayers**” submitted to the Department of Business Administration is my own original work and it has never been presented anywhere, All sources and materials used for this paper have been duly acknowledged and referenced

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Statement of Certification

This is to certify that the thesis entitled “**Factors affecting effective tax collection and tax compliance in Ethiopia-The case of Grade “A” taxpayers**” was carried out by Tibebu Kifle Bereded under the guidance and supervision of Yohannes Workaferahu (PhD), submitted in partial fulfillment for the degree of Master of Business Administration complies with the regulations of the University and meets the minimum requirement and standards with respect to originality and quality.

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Acronyms

A. A.	Addis Ababa
C	Corruption
EPRDF	Ethiopian People Revolutionary Democratic Front
ERCA	Ethiopian Revenue and Customs Authority
GDP	Gross Domestic Product
GNP	Gross National Product
HTC	High Tax Compliance
IMF	International Monetary Fund
GT	Government Trust
RL	Rule of Law
itc	international tax compact
MDG	Millennium Development Goal
ODA	Official Development Assistance
OECD	Organization for Economic Cooperation and Development
SPSS	Statistical Package for Social Sciences
SSA	Sub Sahara Africa
TA	Tax Avoidance
TE	Tax Evasion
TI	Tax Incentive
TPPS	Tax Proclamations, Policies and Strategies
UN	United Nations
UNDP	United Nations Development Program
USA	United States of America
VAT	Value Added Tax

ABSTRACT

This paper seeks to examine factors affecting tax compliance and revenue collection of Ethiopian government in an attempt of identifying some important areas of recommendation for policy makers and the tax authority. To do this, primary data obtained from the 302 random sample respondents by a way of questionnaire distributed applying convenience sampling and descriptive cross sectional survey research design method. Some gaps of this study are challenge of identifying all the possible factors, samples are drawn from one category tax payers and respondents are only from A.A. During the study, review of tax proclamations, monetary and financial sector policies, circulars, effects of tax incentives, tax exemptions and exploring or identifying factors, which lead to tax avoidance, tax evasions done. The data gathered from the questionnaires coded and entered into Statistical Package for Social Sciences (SPSS). Finally, the analysis is presented using tables, figures and graphs. Accordingly, the result of this study revealed that Government Trust (GT), Tax Evasion (TE) and Tax Avoidance (TA) to be the top three variables respectively which are affecting tax compliance. Secondly, behavior of the tax authority employees and behavior of the taxpayers plays its part. Quite a large number of tax payers said they pay taxes because of fear of penalties or where there is no opportunity to evade and/or hoping the government will use its revenue responsibly. Therefore, although some respondents say the existing tax system is workable, tax policies and strategies need to be regularly revisited and revised, Tax education need to be enhanced, Strict law enforcement on the offenders should be exercised and the tax collection base need to be widened.

KEY WORDS: Tax revenue, Compliance, Incentive, Tax Exemption, Tax Evasion, Tax avoidance, Authority, Proclamation, Policy, Primary Data, Government trust, Addis Ababa, Ethiopia

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Tax revenue has a paramount importance in almost all governments but majority of governments fall short in collecting enough tax to finance their public service delivery requirements. For example, according to OECD, (n.d.) the budget deficit for the OECD area as a whole probably peaked at around 7.5% of GDP in 2010. That's the equivalent of some US\$3.3 trillion. A decrease to around 6.1% of GDP is expected in 2011, which will still be high by historical standards. But while the need to restore public finances is a global challenge, the state of government balance sheets varies widely. Ethiopia, being one of the ancient nations, trade and the associated tax collection has been exercised for more than several thousand years although the level of its development and amount of tax collection is still among the young and minimum achiever countries and as any other developing country has rising economic and financial needs. The main source of revenue to meet these needs is coming from revenue collected from taxes. In terms of composition, income and profits tax, import duties and domestic indirect taxes jointly make up 99 percent of the revenue and the remaining one-percent coming from land use fees. Import duties and taxes have contributed sizable share over the years. However, despite the government's effort to strengthen mobilization of domestic revenues to finance the development strategy and reduce the savings-investment imbalance, in the last couple of decades, there was no single incident where the revenue generated by the government was able to sufficiently cover its expenditures.

During the emperor, in 1966, Emperor Haile Sellasie I by executive decree declared a new tax law. Though there was no constitutional distinction between bills subject to parliamentary legislation and those subject to executive declaration, parliamentary ratification has been, and continues to be, the basis for legitimizing and institutionalizing the political system(Peter, 1970). During that period the government dedicated about 36 percent of the annual budget to national defense and maintenance of internal order. Toward the end of the imperial period, the budgets of the various ministries increased steadily while tax yields stagnated. This has increased the necessity of tax reforms though the economy wasn't in a position to generate more revenues and create additional employment opportunities, as majority of the population were unemployed and living at subsistence level.

In 1976, in an attempt to revitalize the tax system, the socialist government took new measures, replacing existing taxes on agricultural income and rural land with a rural land-use fee and a new tax on income from agricultural activities. That measure partially alleviated the tax collection problem existed in the previous periods by delegating the responsibility for collecting fee and tax on

agriculture to peasant associations, which received a small percentage of revenues as administrative cost (Yohannes & Sisay, 2013). Whereas total revenue increased significantly, to about 24 percent of GDP in 1988/89, tax revenues remained stagnant at around 15 percent of GDP. In 1974/75, total revenue and tax revenue had been 13 and 11 percent of the GDP respectively (Yohannes & Sisay, 2013). In 1992/93, immediately after the new EPRDF government came to power, due to the economic shift from the command economy to market oriented economic system, significant reforms were made in the tax regime and in 2002 VAT was introduced and replaced the sales tax since 2003. For example, the marginal income tax rate was reduced to 35 percent and business profit tax to 30 percent (Haile & Rosa, 2016). Accordingly, the Federal Revenue has increased to Birr 6.7 billion in 2002/2003 from Birr 2.54 billion in 1993/94 as the result of which federal revenue as percentage of the GDP increased from 8.97% in 1993/94 to 11.87% in 2002/03. The increase in revenue mainly attributes to the modest increase in both direct and indirect taxes, mainly the foreign trade taxes. As well, National tax revenue as percentage of GDP has increased to 15.1% in 2002/03 from 10.9 in 1993/94 and declined to 13.4% in year 2014/15 (IMF country report no. 16/322). In comparison, according to OECD, (n.d.) Kenya's tax revenue as percentage of GDP in year 2002/03 was 17.5% and 18% in year 2014/15. Despite, the series of reforms and increase in revenue, the overall budget deficit of Ethiopia with and without grant has been increasing (Yohannes & Sisay, 2013). Tax compliance and non compliance studies do not exist at the same time. The existence of one is the non existence of the other. They are multi-disciplines in nature as well. However, tax compliance is, being aware of the existing state tax laws and requirements and observing all the requirements. Therefore, this study tries to identify major factors affecting tax compliance, assess them and intends to describe possible areas of attention for the policy formulators and tax collecting authorities.

1.2 Statement of the Problem

James, (2011) stated, "Being able to rely on domestic sources of funding in the form of taxes will allow African states to reduce their dependency on official development assistance to fund their development. According to UNCTAD (2016) low-income African countries collected 16.8% of their GDP from tax revenue, which is below the UN standard, 20% to achieve the millennium development goal (MDGs). Ethiopia is highly reliant on tax collection for all its government activities and noncompliance in this critical government activity could seriously threaten the existence of the government. In year 2015, Ethiopia's share of tax revenue stands at 83% of the total public revenue (UNDP Ethiopia, 2016). Ethiopia's tax to GDP ratio in 2010 was 12.2%. It was the lowest of its neighboring countries such as Kenya (17.7%) and Rwanda (14.1%) (Workineh,

n.d.). This exhibits Ethiopia still has difficulties in mobilizing enough resources for investment from domestic sources and tax mobilization is the lowest among most Sub Sahara African countries. The government is not able to generate enough revenue to cover its expenditures. Thus, identifying the factors that determine tax compliance behavior has been open for empirical investigation. Low tax to GDP ratio is a common feature of Ethiopian and most SSA countries. Tax evasion and tax avoidance are some of the consequences of not establishing a sound public finance system. Inappropriate tax law reforms, inefficient legislations, illiteracy, poverty, corruption and incompetence on the side of the government could be manifestations of the inadequacy. Tax revenue instability might result in public spending instability.

Because of this paramount importance to the existence of governments, tax compliance has been given a bigger emphasis by researchers in order to identify factors of noncompliance especially tax evasion, tax avoidance, corruption and its consequences on the capacity of government in raising public revenue. But most of the researches I examined have been done on developed countries. For eg. Such as (Norzilah, Anuar, Ahmed, & Azlin, 2016; Roy & Raffaella, 2015; Erica & Alex, 2018; Easson & Zolt, 2013; and Julian, 2019). . There are also researches done on tax compliance in Ethiopia. For example, Lemesa (2007), Workineh A. (n.d.), Baye, (2017).

As per the above researchers, all factors affecting tax compliance could not be identified at once, reviewed and concluded. Conclusions are only based on the factors identified and examined. This is because, factors affecting tax compliance are too many, vary from place to place and contextual. Therefore, the basic research question of this thesis is “What are the major factors affecting tax compliance in Ethiopia”

1.3 Objective of the study

The objective of the study is to describe factors affecting tax revenue & compliance in Ethiopia and to develop proposals to the policy formulators. Specifically:

- To examine the factors affecting tax revenue collection and compliance in Ethiopia.
- To assess tax collection and compliance practice.
- To develop possible recommendation to the policy formulators on how to address these tax collection and compliance problems.

1.4 Significance of the Study

Although, factors affecting tax compliance are mostly intricate and overall they are difficult to identify (because it involves human behavior), they have significant social and economic

consequences. The significance of this study is therefore to identify factors affecting the tax compliance and tax collection amount. The findings of this study/exercise can be used as an input to policy formulators, tax collecting authority and any other stakeholders who are interested in the findings. This study attempts to assess causes behind each factors so as to give a glimpse to the policy makers and where possible forward recommendations.

1.6 Scope and limitations of the study

The study aims to identify factors affecting tax compliance and tax collection in Ethiopia, the case of “Grade A” tax payers. However, the study was forced to be limited in Addis Ababa city taxpayers due to resource constraints. Some of the limitations of this study are: One, it considers only Category “A” taxpayers and two; it is focused only on Addis Ababa taxpayers. This clearly fails the representation of other taxpayers of other groups and other cities and regions. However, it is also believed “Group A” tax payers are the biggest contributors to the total tax collection and Addis Ababa is also the major city in contributing to the total tax revenue. Factors considered on this thesis for assessment are Government Trust (GT), Tax Incentive (TI), High Tax Compliance Cost (HTC), Tax Avoidance (TA), Rule of Law (RL), Tax Proclamations, Policies and Strategies (TPPS) and Corruption (C).

1.7 Definition of terms

Taxation is imposition of compulsory levies on individuals or entities by governments.

Tax compliance is the degree to which a taxpayer complies.

Tax evasion is an illegal activity in which a person or entity deliberately avoids paying a true tax liability.

Tax avoidance refers to the legal means adopted by taxpayers to reduce their tax bill

Corruption can be a challenge to define because it takes many forms, and perpetrators are skilled in developing new ways to be corrupt and cover their tracks. However, corruption may be defined as the abuse of power for private gain (Transparency International, n.d.).

Rule of law is a durable system of laws, institutions, and community commitment that delivers four universal principles: Accountability, just law, open government, accessible & impartial dispute resolution (worldjusticeproject.org, n.d.).

Compliance costs are the costs that taxpayers and others incur in meeting obligations imposed under tax legislation (Michael, 2000).

Tax incentive as an aspect of a country's tax code designed to incentivize or encourage a particular economic activity.

Tax holiday is a government incentive program that offers a tax reduction or elimination to businesses

1.8. Organization of the Study

This research paper consists five chapters. The first chapter includes background of the study, statement of the problem, research questions, objective of the study, significant of the study, scope of the study, and organization of the study. The second chapter covers the review of related literatures. The third chapter is all about research design and methodology of the study. Results and discussion are discussed under chapter four. The last chapter is about summary of major findings, conclusions and recommendations.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

Taxation is imposition of compulsory levies on individuals or entities by governments. Taxes are levied in almost every country of the world, primarily to raise revenue for government expenditures, although they serve other purposes as well. During the 19th century the prevalent idea was that taxes should serve mainly to finance the government. In earlier times, and again today, governments have utilized taxation for other than merely fiscal purposes. One useful way to view the purpose of taxation, attributable to American economist (Richard, 1989), is to distinguish between objectives of resource allocation, income redistribution, and economic stability (Fritz, Maria, Charles, 2019). Although taxation is compulsory, it also has a component of volunteering and consensus about the importance. However, this consensus or agreement will be breached because of the few factors discussed in this document and tax compliance becomes an issue. Tax compliance is the degree to which a taxpayer complies (or fails to comply) with the tax rules of his country, for example by declaring income, filing a return, and paying the tax due in a timely manner (USLegal.com, n.d.).

Tax compliance refers to fulfilling all tax obligations as specified by the law freely and completely (Atawodi & Ojeka, 2012). Higher compliance means more revenue can be collected and hence, more fund can be reserved to develop the countries and support the welfare of the society (Norzilah, Anuar, Ahmed, & Azlin, 2016).

Tax evasion in the contrary, is an illegal activity in which a person or entity deliberately avoids paying a true tax liability. Those caught evading taxes are generally subject to criminal charges and substantial penalties. Tax evasion applies to both the illegal nonpayment as well as the illegal underpayment of taxes. A person is not considered to be guilty of tax evasion unless the failure to pay is deemed intentional (Investopedia.com, n.d.). Tax incompliance like tax evasion, tax avoidance, corruption will severely affect the country's income (Roy & Raffaella, 2015). Decisions either to evade or not to evade taxes are heavily reliant on taxpayers' personal judgment (Mohani, 2001). The level of education, the tax system, financial constraints, lack of rule of law etc could exasperate tax evasion.

The rule of law is a durable system of laws, institutions, and community commitment that delivers four universal principles: Accountability, just law, open government, accessible & impartial dispute resolution (worldjusticeproject.org, n.d.). Rule of law is the mechanism, process, institution, practice, or norm that supports the equality of all citizens before the law, secures a non-arbitrary

form of government, and more generally prevents the arbitrary use of power. (Naomi, 2019). Where the rule of law is not respected, when there is a room for manipulation, law enforcement isn't to the standard etc... the probability of noncompliance is evident.

2.2 Historical literature review

Most developing countries lack the capacity to timely update their tax policies and to enforce the existing proclamations. Modern tax systems are also introduced in few of these developing countries and very recently. For example, Ethiopia introduced Value Added Tax (VAT) system in the year 2003 as replacement to sales tax. VAT is the principal source of revenue for the Ethiopian government. For instance, in the 2006-07 fiscal year, federal VAT revenue (on domestic transactions) accounted for about 41% of total federal revenues from domestic (EFIRA, 2007).

Literatures such as Kirchler (2007) classify the factors into five main categories, such as Economic factors (tax rates, tax compliance costs, perceptions of government spending etc...), Institutional factors (the role of the tax authority, simplicity of the tax returns and administration and probability of detection), Social factors (ethics and attitude, perceptions of equity and fairness, political affiliation and changes on current government policy, referent groups), Individual factors (personal financial constraints, awareness of offences and penalties) and Other factors (age, income, level, culture, education, gender).

Theory is formulated to explain, predict and make a phenomenon to be understood and a theoretical framework is the structure that supports a theory of research study. Different theories have been discussed in different times to show the factors affecting tax compliance.

Ability to pay tax theory

Ability-to-pay tax theory refers to the taxing of tax progressively and it maintains that tax should be charged according to the capability of a taxpayer. (Neil, 1958) assert that the ability-to-pay tax theory is the taxing of tax progressively. This methodology does encourage and increase tax burden on businesses and individuals. This approach argues that for businesses and individuals having high income should pay more tax according to their level of income as compared to low earners investors and individuals. On the contrary, although this approach does create uniformity with the different classes of society, it could discourage individuals and businesses from working hard to get additional income beyond certain level. This theory earns the government a lot of revenue because people with high revenue pay higher taxes. Absence of this theory the government will have a flat rate where it will be forced to set a lower rate so as to accommodate everyone. However, in conclusion, this

theory is important because it identifies the level of ability in paying tax and places an increased tax burden to individuals, partnerships, corporations, trusts and certain estates with high incomes.

Gordon Li Theory

Gordon and Wei Li developed a theory of tax enforcement based on Chinese experience in 1990s. During that time, the government of China had difficulty in collecting reasonable tax from small and medium sized businesses in that almost the entire taxes collected came from larger sized businesses. The model came to explain the reason behind the failure of the government of China from collecting tax from small and medium sized firms (Gordon & Li, 2009). Majority of firms entirely rely on use of cash transaction, which create the room for tax evasion hence narrowing of tax base. (Gordon & Li, 2009) assert that businesses can have tax been administered if they make use of the finance sector. The theory however continues to argue that the large sized businesses will value more regarding the use of finance sector because of the expected benefits (Gordon & Li, 2009). The Gordon-Li theory is important in the study research in that it helps to identify the factors affecting tax revenue collection since tax is enforced onto the taxpayers.

For tax compliance and increase in the tax collection amount depends not only on structural factors but also social and natural factors. Literatures suggest various determinants of tax revenue such as the level of economic development, fiscal deficits and debt, trade openness, share of aid in GNP, population density, share of agriculture in GDP, and share of manufacturing in GDP, inflation level, compliance level, foreign direct investment, weather condition, revenue outsourcing, ineffective implementation of bylaws and other. However, in this study very few factors such as GT, TE, TA, HTC, LRL and TPPS have been considered for examination.

2.3 Empirical Literatures Review

Because of its paramount importance to the existence of governments, tax compliance has been given a bigger emphasis by researchers in order to identify factors of noncompliance especially tax evasion, tax avoidance, corruption and its consequences on the capacity of government in raising public revenue. But most of these researches have been done on developed countries such as (Norzilah, Anuar, Ahmed, & Azlin, 2016; Roy & Raffaella, 2015; Erica & Alex, 2018; Easson & Zolt, 2013; and Julian, 2019).

Norzilah, Anuar, Ahmed, & Azlin, (2016) says, “Higher compliance means more revenue can be collected and hence, more fund can be reserved to develop the countries and support the welfare of the society”. Although this is true, it is argued that compliance doesn’t guarantee collecting of more

revenue. Roy & Raffaella, (2015) considers tax noncompliance like tax evasion which will severely affect the country's income. Tax evasion applies to both the illegal nonpayment as well as the illegal underpayment of taxes. A person is not considered to be guilty of tax evasion unless the failure to pay is deemed intentional (Investopedia.com, n.d.). This point is argued by raising a point "how intention of an individual could certainly be determined?" A tax holiday is a government incentive program that offers a tax reduction or elimination to businesses. Tax holidays are often used to reduce sales taxes by local governments, but they are also commonly used by governments in developing countries to help stimulate foreign investment (Julian, 2019).

However, recent researches suggest that tax holiday is not fulfilling the objectives (Julian, 2019) advises African countries to abandon tax holidays for investors.

He says, "Many countries in Africa have offered tax exemptions, tax holidays that never worked. Tax holidays do not really matter a lot. They are just a loss...the loss of tax incentives is more than the gain. It is not tax incentives that matter most for investors to do business in Africa.

There are also researches done on tax compliance in Ethiopia. For example, Lemesa (2007), Workineh A. (n.d.), Baye, (2017) and UNDP Ethiopia, (2016).

Lemessa (2005), says when compliance is not achieved on a voluntary basis, revenue authorities must identify and address the risk associated with non-compliance by developing strategies targeted at those risks.

(Workineh, n.d.). Findings concluded;

- 1.1 Real GDP Per capita income is expected to be positively correlated with tax share as it is expected to be a good indicator of the overall level of economic development and sophistication of the economic structure. A higher per capita income reflects a higher level of development that implies a higher capacity to pay taxes as well as a greater capacity to levy and collect taxes (Chelliah, 1971). It is measured as the ratio of RGDP to total population.
- 1.2 Certain sectors of the economy are easier to tax than others; i.e., the agriculture sector may be hard to tax, especially in developing countries where the lion's share of the economy is dominated by this sector; it is not politically feasible to tax this sector. Many countries are unwilling to tax this sector since it is subsistent (Stotsky & Wolde Mariam, 1997). Also, this sector is highly informal and costly to assess. In addition, the tax rate is lower on the sector and taxable items do not generate surplus production. Hence, negative relationship is anticipated between agricultural share and tax revenue.

- 1.3 This variable helps to show the effects of industrialization on revenue generation; particularly it is intended to capture the effect of industrial growth on the tax revenue generation of Ethiopia. Increase in the growth of industrial sector will increase direct tax through corporate income tax, indirect taxes through sales tax, and excise duty on domestic products. Hence, the researcher expected positive sign of this variable. It is measured as the ratio of industrial value added to GDP.
- 1.4 Inflation is a sustained rise in the general price level of goods and services in an economy. It is the proxy for macroeconomic stability of a country. The most commonly used measure of inflation is consumer price index; it reduces the purchasing power of a society and erodes the taxpaying capacity of taxpayers. Unlikely; taxpayers on average, respond to the inflation-induced tax increase by instituting their own non legislated tax cut through evasion (i.e. The increased level and proportion of income underreported). Taxpayers will engage in an informal or underground economic activity. As a result, inflation is expected to affect tax revenue negatively.
- 1.5 Foreign aid is used to capture the effect of dependence on foreign assistance on domestic revenue mobilization (i.e. through tax). According to (Chaudhry, & Munir, 2010) a country, which depends on revenue from natural resources, that does not come through the political effort of persuading their citizens to pay taxes, may be less likely to develop effective and democratic institutions. According to (Workineh, n.d.) increase in foreign aid inflow make government of developing countries to relax their effort towards mobilizing internal sources, the effect of foreign aid on tax revenue is expected to be negative. It is measured as official development assistance (ODA) share of GDP. This is because ODA is the most popular measure of foreign aid (Joweria, 2003).
- 1.6 Education is by far the most important element for successful collection of tax revenue. Because, the documentation of the economy is essential for an effective tax system. Documentation comes from a literate tax base. Literacy is more than being able to keep records on books. It includes knowledge and usage of information technology. Taxes yield less revenue in less literate economies (Imran & Farzan, 2010). The fact that more educated peoples are expected to have the knowledge of tax, education is expected to have positive effect on tax revenue.

Baye, (2017) in his thesis for MBA, concludes that the increasing revenue from tax in Ethiopia is directly related to the rate of inflation, foreign direct investment, disposal income, exchange rate and with the unemployment rate. The results of the regressions considering tax revenue as dependent

variable and considering five independent variables called rate of inflation, FDI, rate of unemployment, exchange rate and level of disposable income.

The explanatory power of the tax revenue in terms of 0.975 which shows, that there is a linear relationship between tax revenue and inflation of rate, foreign direct investment, level of disposable income, unemployment rate and exchange rate with all these factors affect for 97.5% differences in total tax revenue per year. The remaining 2.5 % could be due to other factors not included in this study. The standard error of estimation 3713.337 is a bit high which can be due to multiple data sources.

UNDP Ethiopia, (2016). Working paper, says “The result shows that in the Ethiopian case sectorial composition of the economy, trade openness and macroeconomic stability are the major determinants of the level of tax to GDP ratio. The dummy variable that captures tax reform was not significant enough though the effect is positive as expected. The impact of per-capita GDP was also found to be insignificant but bears the expected sign.

The model explained 76 percent of the variation in tax revenue as indicated by the adjusted R². As is the case in other developing countries, the dominance of the agriculture sector is negatively related to the level of tax revenue mobilization. The impact of trade openness is significant and positive as Ethiopia collects around one-third of its tax revenue from imports.

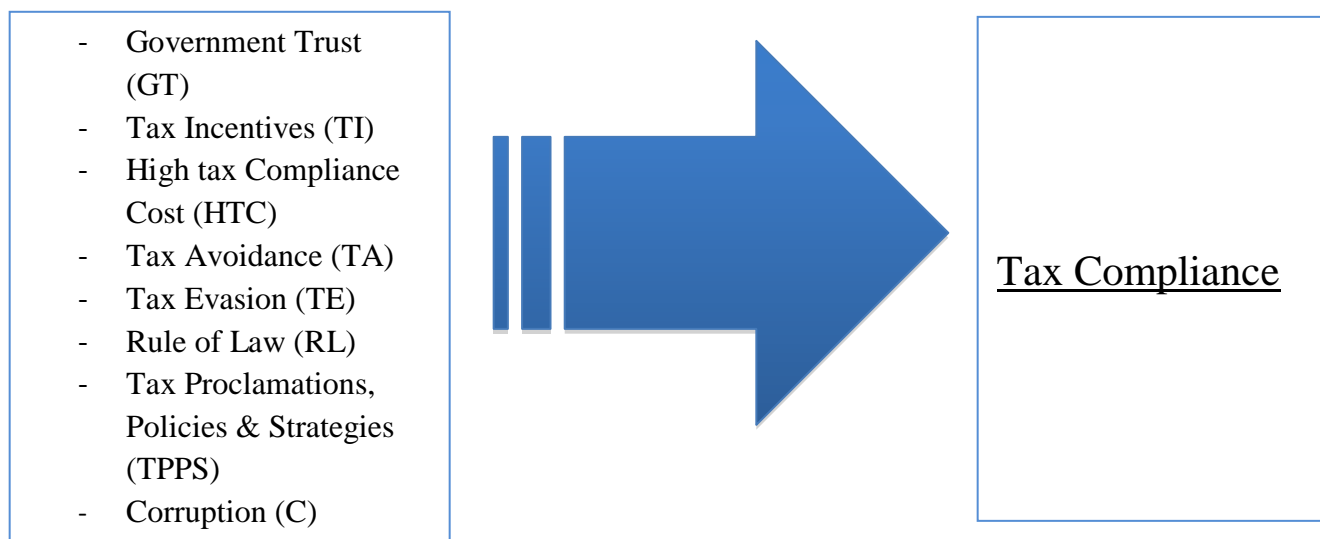
The impact of the change in per capita income, it is not statistically significant as opposed to the theory and empirical evidences from other countries. This indicates that there is a reasonable share of the economy that is not taxed. So far, the growth registered in the economy has not resulted in commensurate taxation. The fact that services contributes to the economic growth, while at the same time it is the sector hoarding majority of the informal sector, which are out of the current taxing spectrum, could be one reason. Macroeconomic stability as measured by inflation is found to have significant negative impact as expected”.

Accordingly, the following conceptual framework is developed by analyzing the independent variables considered in the above empirical review and the distinct cultural characteristics and history of tax collection in Ethiopia.

Figure 2.1: Conceptual Frame Work

Independent Variables

Dependent Variable



Basis: Eschborn, December 2010, itc (International tax compact) and own observation

Table 2.2: Operationalization of Variables

Variable	Dimensions	Definition
<i>Government Trust (GT)</i>	<i>Government delivery in infrastructure, transparency & accountability in fund utilization</i>	<i>The level of trust that the tax payer has to fulfill its responsibility willingly</i>
<i>Tax Incentives (TI)</i>	<i>To what extent the incentive applied and its outcome with regard to stimulating the economy</i>	<i>An aspect of a country's tax code designed to incentivize or encourage a particular economic activity</i>
<i>High Compliance Cost (HCC)</i>	<i>Cost-Benefit analysis whether the compliance cost is worth taking</i>	<i>Cost on the tax payer in relation with complying to the tax authority requirements</i>
<i>Tax Evasion (TE)</i>	<i>Illegal nonpayment as well as illegal underpayment of taxes</i>	<i>An act of a person or an entity deliberately avoids paying a true tax liability</i>

<i>Tax Avoidance (TA)</i>	<i>Investing in tax-free municipal bonds, use of illegal methods to avoid paying proper taxes, use of legal means to lower the obligations of a taxpayer</i>	<i>The legal means adopted by taxpayers to reduce their tax bill</i>
<i>Rule of Law (RL)</i>	<i>Haphazard implementation of the law, inconsistency, incomplete and partial</i>	<i>Where there is no durable system of laws, institutions, and community commitment that delivers four universal principles: Accountability, just law, open government, accessible & impartial dispute resolution</i>
<i>Tax Proclamations, policies & Strategies (TPPS)</i>	<i>Maximizing on the weakness of the proclamations, policies and strategies. Abuse of power in relation with implementation</i>	<i>Appropriateness level of tax proclamations, policies and strategies</i>
<i>Corruption (C)</i>		<i>Corruption is abuse of entrusted power for private gain which manifests dishonesty & greed aiming to acquire illicit benefit (Transparency International, n.d.)</i>

2.1.3 Summary of the literature

We can see that these three studies as a sample and many more others reach in different conclusions based on their study perspectives. Different models have been used to study the factors affecting tax compliance and collection. However, existing empirical literatures fail to give a definite answer and there is no study that has isolated and identified single or a combination of factors affecting compliance and tax collection in Ethiopia. Social, Economic, cultural, political, and religious and other factors could affect the compliance level and differ from time to time. This shows the importance of further and continuous studies and it is not be expected to arrive in a consensus at least in the short run.

2.1.4 Basis for the Hypotheses

Hypothesis

H1 = Tax knowledge is positively correlated with tax compliance.

H2 = Perception of government spending is positively correlated with tax compliance.

Perception of government spending is negatively correlated with tax compliance

H3 = Citizens resistance to tax payment is negatively correlated with tax compliance

H4 = Simplicity of tax system is positively correlated with tax compliance:

H5 = Government inefficiencies and bad policies are the reason for low tax collection.

H6 = Education level of tax payers positively correlated with tax compliance

H7 = Penalty is positively correlated with tax compliance

H8 = Perception of unfairness from tax authority negatively correlated with tax compliance

H9 = Behavior of tax authority employees negatively correlated with tax compliance

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter presents the methodology used to conduct this study. Research design, method, sampling technique, target population, data collection, instruments and procedures, the method of data analysis that is employed, research quality and ethical considerations are explained.

3.2 Study Approach.

Quantitative approach is used to gather information. This approach gave a correct and useful data, which is used to analyze the causes of noncompliance and low tax collection. The data was based on precise measurements and the final report is statistical report with correlations, comparisons of means and statistical significance of the findings.

3.3 Research Design

According to Kothari, (2004) a research design informs decisions concerning a research study and arrangement of conditions for collection and analysis of data so as to combine relevance to the research.

A research design informs decisions concerning a research study and arrangement of conditions for collection and analysis of data so as to combine relevance to the research purpose with the economy. A descriptive cross sectional survey research design is best used to conduct this study, which involves acquiring information by asking respondent's questions and tabulating the answers they give. Explanatory approach were also be used since the research design has intended to be flexible to allow the consideration of many different aspects of the problem.

3.4 Population of the Study

All the items under consideration in any field of inquiry constitute a universe or population.

Therefore, population for this study constitutes Ethiopian taxpayers of category "A" and representative sample was selected from. Category "A" taxpayer are a company or any other person having an annual gross income of Birr 1,000,000 or more as well as PLC and Share Companies regardless of their turnover but relatively few in number.

3.5 Sample size and sampling techniques.

In the formation of a sample, simple random sampling and convenience sampling (Ilker, Sulaiman & Rukayya, 2016) method is used which is a type of non-probability or nonrandom sampling where members of the target population that meet certain practical criteria, such as easy accessibility,

geographical proximity, availability at a given time where reaching all respondents is impossible and sample need to be drawn.

Using a total population under study of 1240 grade “A” taxpayers with an error limit of 5%, a sample size of 302 is considered reasonable. This is because the target population’s nature of homogeneity. The taxpayers are segmented as small, medium and large based on the total annual revenue.

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

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

Where n is the sample size

N is the population

e is error limit (0.05 on the basis of 95% confidence level)

$$n = \frac{1240}{\{(1+1240(0.05)^2)\}}$$

$$n = \frac{1240}{\{(1+1240(0.05)^2)\}}$$

$$n = 302$$

4.1

$$n = 302$$

3.6 Data Analysis and Presentation Method

After the data was collected from various groups of taxpayers, it is edited, organized and analyzed using SPSS. Statistical tools such as descriptive statistics used to describe the phenomenon that exist at the time of the study in the form of frequency distribution, mean calculation and graphical representation; regression analysis was done to test the hypothesis and correlation analysis was done to establish the nature and degree of relationships between dependent variable and independent variables.

According to Sellywati, & Mohd, (2015) multiple linear regression analysis is used to test hypothesis 1 with model $y = \beta_0 + \beta_1\chi_1 + \epsilon$ in the representation of y = Tax collection and compliance, χ_1 = Tax incentives, χ_2 = High tax compliance cost, χ_3 = Tax Evasion, χ_4 = Tax Avoidance, χ_5 = Rule of law, χ_6 = Tax proclamations, policies and strategies, χ_7 = Corruption ϵ = error. Multiple regression analysis

is used to test hypothesis 1, 2 ...5 and 6 based on the following model:

$$y = \beta_0 + \beta_1\chi_1 + \beta_2\chi_2 + \beta_3\chi_3 + \beta_4\chi_4 + \beta_5\chi_5 + \beta_6\chi_6 + \beta_7\chi_7 + \varepsilon$$

y = Tax collection and compliance

χ_1 = Tax incentives

χ_2 = High tax compliance cost

χ_3 = Tax Evasion

χ_4 = Tax Avoidance

χ_5 = Rule of law

χ_6 = Tax proclamations, policies and strategies

χ_7 = Corruption

ε = Error

3.7 Questionnaire

Questionnaire, which consist relevant points, are developed, incorporated in a form and attached. Targeted taxpayers given maximum assurances of the confidentiality with regard to their responses, codes were used to replace names and respondents were advised to read carefully and understand before attempting to respond.

3.8 Reliability and Validity Issues

Meeting the assumptions of regression analysis was the necessary step to confirm that the obtained data truly represented the sample and that researcher has obtained the best results (Hair et al., 1998). Therefore, in these study three-assumption tests for regression analysis used. Which were discussed for the individual variables such as Multi-co linearity, linearity and Normality test. Cronbach's Alpha result of the instruments are also checked and verified. Accordingly, values obtained from the tolerance and variance inflation factors (VIF) shows there is no multicollinearity symptoms, condition for linearity and normality test are met.

3.9 Ethical Considerations

Ethical issues are considered in the study: surprisingly, most of the informants I contacted were hesitant to accept my questionnaire due to confidentiality and some other reasons which I am not aware of but managed to get their consent (by informing the aim of the study, including the importance of the data and assuring the confidentiality) and by informing them that there is no single place which mention names and all of the information in this study will solely be used for the academic purpose only.

CHAPTER FOUR

RESULTS AND DISCUSSIONS

In this chapter, the result obtained from the questionnaire survey are presented and analyzed. First demographic characteristics of the respondents are presented. It follows with a summary of respondent's reply on various variables presented to them. Then it follows with description of the data gathered, discussed and analyzed the findings carefully. This is in order to assess the effect of various independent variables with the dependent variable and findings have been organized in accordance with the study objectives.

Therefore, this chapter presents the results and findings of the research. The chapter mainly includes data results from the statistical tests conducted on the gathered primary data. The research main emphasis was to examine factors affecting effective tax collection and tax compliance in Ethiopia in the case of Grade "A" tax payers. Descriptive analysis and inferential analysis of the study are presented respectively. Three hundred two questionnaires were distributed to the respondents and out of these questionnaires; two hundred eighty three questionnaires were collected that accounts 93.7% response rate. Accordingly, the analysis of this study is based on the number of questionnaires collected. Here the statistical program used for the analysis and presentation of data in this study is the Statistical Package for the Social Sciences (SPSS) version 20. First the reliability of the questionnaires was presented below.

4.1 Reliability of the Questionnaire

Table 4.1 Reliability results

Sub scales	Number of items	Cronbach's Alpha
Government Trust (GT)	5	.725
Tax Incentives (TI)	4	.706
High tax Compliance Cost (HTC)	5	.842
Tax Avoidance (TA)	3	.796
Tax Evasion (TE)	4	.886
Rule of Law (RL)	7	.860
Tax Proclamations, Policies & Strategies (TPPS)	4	.765
Tax compliance (TC)	4	.759
Entire scale	36	.930

The above table depicts Cronbach's coefficient alpha was calculated for each field of the questionnaire and the entire questionnaire. The values of Cronbach's Alpha showed that all of the results are more than acceptable, which fall in the range between 0.7 and 0.95. The resulting range is considered high as the result ensures the reliability of each field of the questionnaire. More over Cronbach's Alpha for the entire questionnaire shows the value of .930, which falls in an excellent range, and it indicates reliability of the entire questionnaire. Therefore, based on the test, the results for the items are reliable and acceptable.

4.2. Demographic Characteristics of Respondents

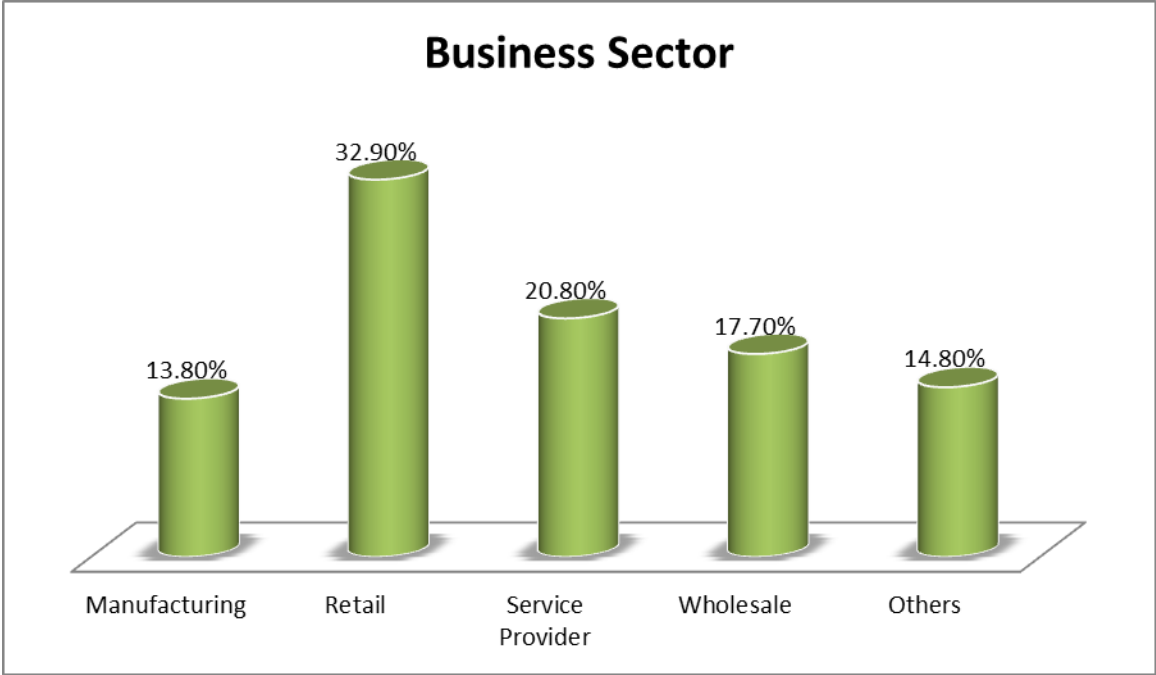
Table 4.2 Demographic Characteristics of Respondents

Characteristics		Frequency	Percentage
Gender	male	181	64.0%
	female	102	36.0%
Age	18 - 30 years	26	9.2%
	31 - 40 years	187	66.1%
	41 - 50 years	63	22.3%
	51 - 60 years	6	2.1%
	above 60 years	1	0.4%
Educational Status	Not completed primary school	6	2.1%
	Primary School	22	7.8%
	Secondary School	176	62.2%
	University/College and above	79	27.9%
Business Sector	Manufacturing	39	13.8%
	Retail	93	32.9%
	Service Provider	59	20.8%
	Wholesale	50	17.7%
	Others	42	14.8%
Total		283	100%

Based on table 4.2, regarding the sex of respondents, the majority of them 181(64.0%) were males while the remaining 102(36.0%) were female respondents. Regarding the age of respondents, the majority of the respondents 187(66.1%) fall in the age range 25–40 years.

Based on their education status, more than half of the respondents 176(62.2%) were in secondary school.

Regarding the business sector, as presented in the following chart, of these participant tax payers, were retail 93(32.9%), service providers 59 (20.8%), and wholesale 50 (17.7%) were the largest sectors.



In this part of the thesis, descriptive statistics in the form of mean and standard deviation were presented to illustrate the level of agreement of the respondents with their implications. The responses of the respondents for the variables indicated below were measured on five point Likert scale with: 1= strongly disagree, 2= disagree, 3 = neutral, 4= agree and 5= strongly agree. However, while making interpretation of the results of mean the scales were reassigned as follows to make the interpretation easy and clear.

This formula is adapted from (Vichea, 2005), with 5 point scales, the interval for breaking the range in measuring each variable id is calculated by $5-1/5= 0.8$. It means items with scores fall between the ranges of: 4.20 – 5.00 are considered as strongly agreed; 3.40 – 4.19 as agreed; 2.60 – 3.39 as Neutral; 1.80 – 2.59 as disagree and 1.00 – 1.79 strongly disagree.

Data from questionnaires were processed by SPSS program in terms of frequency, mean, and standard deviation (Descriptive statistics).

Regarding Government Trust (GT), the following items are used. The results obtained are presented below.

Table 4.3 Government Trust (GT)

Items	Mean	Standard Deviation
I pay taxes because I believe it is my citizenship responsibility.	2.4876	1.69135
I pay taxes to avoid penalties	3.6714	1.46403
I pay taxes because there is no opportunity to evade	3.5583	1.55261
I pay taxes because I believe the government will use its revenue responsibly	3.5795	1.39014
The tax authority tax collection system is workable	3.7385	1.25852
Grand Mean	3.40706	1.47133

The grand mean of the above table about the presence of government trust of tax payers fall in the agreement range (mean 3.40706 and standard deviation 1.47133). However, individual items such as paying taxes to avoid penalties (mean 3.6704 and SD 1.46403), whether taxpayers pay their taxes because they believe the government will use its revenue responsibly (mean 3.5795 and SD 1.39014), and whether the tax authority tax collection system is workable (mean 3.7385 and SD 1.25852) fall in the agreement range (the percentage and frequency of the responses are presented in the appendix part of this paper for all items).

This result shows that grade “A” taxpayers pay their taxes in order to avoid penalties, as well as they believe that the government will use its revenue responsibly. Additionally, this study also revealed that the majority of these respondents believe the existing tax authority tax collection system is workable but needs subsequent review and updates.

4.4 Tax Incentives (TI)

Table 4.4 Tax Incentives (TI)

Items	Mean	Standard Deviation
The tax incentive system is relevant	3.6572	1.30704
The tax incentive legislation is effective and transparent	4.0247	1.09937
The tax incentive system affect the tax collection amount	3.6290	1.28279
The absence of tax incentive system can result in low tax collection	3.6325	1.37838
Grand Mean	3.73585	1.266895

As reviewed in the literature, tax incentives contribute largely for the tax compliance of tax payers. This study also found, as presented in the above table, higher presence of tax incentives based on the perception and response of grade “A” taxpayers. With a grand mean of 3.73 and standard deviation 1.26, these items fall in the agreement range.

The result found that the tax incentive system is relevant, the tax incentive legislation is effective and transparent, the tax incentive system affect the tax collection amount, and the absence of tax incentive system can result in low tax collection.

The above results imply that there is a tax incentive for grade “A” taxpayers based on effective and transparent tax incentive legislation, which will increase the volume of tax collection in the country.

4.5 High tax Compliance Cost (HTC)

Table 4.5 High tax Compliance Cost (HTC)

Items	Mean	Standard Deviation
Using cash register machine is costly.	3.5124	1.14345
Issue receipts and maintaining the system is worth keeping.	3.5760	1.40808
maintaining books of accounts are important	3.7420	1.25784
Accounting cost for maintaining records is big.	3.6254	1.32662
Tax education is necessary for tax compliance	3.9258	1.28472
Grand Mean	3.67632	1.284142

The above descriptive statistics show that the items related to High tax Compliance Cost (HTC) fall in the agreement range with a grand mean of 3.67 and standard deviation of 1.28 this result implies that the presence of High tax Compliance Cost (HTC) in the studied area of grade A tax payers.

This high tax compliance cost includes; purchase of expensive cash register machine, system reporting and handling of receipts during power interruptions, and maintaining accounting book of records.

4.6 Tax Avoidance (TA)

Table 4.6 Tax Avoidance (TA)

Items	Mean	Standard Deviation
The tax system is open for manipulation /tax avoidance.	3.6325	1.44617
High Tax rates deters compliance	3.8763	1.41255
Lack of trust to the authorities lead to tax avoidance	3.6466	1.46188
Grand Mean	3.718466667	1.4402

Based on the above table the response fall in the agreement rage (grand mean 3.72 and SD 1.44) for items of tax avoidance, which implies that the tax system which is open for manipulation, high tax rate, and lack of trust of tax authorities lead to tax avoidance.

4.7 Tax Evasion (TE)

Table 4.7 Tax Evasion (TE)

Items	Mean	Standard Deviation
Tax authority employees are the reason for tax evasion.	3.9046	1.35848
Government need to take strong measure on tax evaders	3.7809	1.34799
Tax payer's behavior is the reason for tax evasion.	3.6042	1.40626
Level of education is a reason for TAX evasion.	3.7279	1.43419
Grand Mean	3.7544	1.38673

Regarding Tax Evasion (TE), the above items showed that the causes of tax evasion include; Tax authority employees, government weak measure against tax evaders, tax payers' behavior, and level of education.

4.8 Rule of Law (RL)

In order to measure the rule and its relation with taxpaying behavior of respondents the following questions were asked and the result in the upcoming table obtained.

Table 4.8 Rule of Law (RL)

Items	Mean	Standard Deviation
If the government is accountable to its citizens, I will be happy to pay taxes	3.947	1.29676
Trust of the government officials affects compliance	4.0274	1.39382
Gov't transparency & provision of improved public services will lead to increased tax collection.	3.7046	1.40215
Enforce tax compliance in fair and just manner.	3.9324	1.30892
Ease of the bureaucracy to make payments	3.9324	1.22433
Focused taxpayer education and sensitization.	3.726	1.32544
Prosecute tax evaders and publicize the cases.	3.8185	1.37548
Grand mean	3.8697	1.33241

Based on the above results, with grand mean 3.86 and standard deviation 1.33, rule of law items fall in the agreement range. This result implies that when the government is accountable to its citizens, trust of the government officials, Gov't transparency and provision of improved public services enforcement of tax compliance in fair and just manner, Ease of the bureaucracy, and prosecute tax evaders and publicize the cases found to increase tax compliance.

4.9 Tax Proclamations, Policies & Strategies (TPPS)

In relation to tax proclamations, policies and strategies, the following results are obtained.

Table 4.9 Tax Proclamations, Policies & Strategies (TPPS)

Item	Mean	Standard Deviation
Tax policies give room for tax evasion.	3.9324	1.12077
Simplify the tax payment procedures.	4.0356	1.18569
Tax reforms are necessary.	3.6784	1.07805
Understanding of the TPPS determines the tax compliance	3.6784	1.02091
Grand mean	3.881575	1.101355

Based on the above table tax proclamations, policies and strategies (TPPS) with a grand mean score of 3.88 and standard deviation 1.10 falls in the agreement range. Which implies the inherent quality of the tax policy, nature of payment system, tax reform, and awareness about tax policies and strategies has been found to affect tax compliance.

4.10 Tax compliance (TC)

Table 4.11 Tax compliance (TC)

Items	Mean	Standard Deviation
I have never been late in paying my taxes	3.6784	1.46076
During the past years, I always reported my business transactions honestly	4.0459	1.27497
I have never been accused of any tax related crimes	3.0919	1.60629
I always behave based on the tax law of the country	3.3604	1.64730
Grand Mean	3.54415	1.49733

Regarding the dependent variable of this study, tax compliance, the above table clearly showed that there is high tax compliance in the study area with a grand mean 3.54 and standard deviation 1.49.

4.11 Descriptive summary of Variables

The following table depicts the descriptive summary of variables of this study based on their minimum, maximum, sum, mean and standard deviation.

Table 4.11 Descriptive summary

Descriptive Statistics

	N	Minimu m	Maximu m	Sum	Mean		Std. Deviation
	Statistic	Statistic	Statistic	Statistic	Statistic	Std. Error	Statistic
GT	283	1.00	5.00	964.20	3.4071	.06065	1.02034
TI	283	1.00	5.00	1057.25	3.7359	.05507	.92650
HTC	283	1.00	5.00	1040.40	3.6763	.05983	1.00656
TA	283	1.00	5.00	1052.33	3.7185	.07217	1.21411
TE	283	1.00	5.00	1062.50	3.7544	.07118	1.19738
RL	283	1.00	5.00	1088.39	3.8733	.05854	.98127
TPPS	283	1.00	5.00	1091.50	3.8843	.05039	.84461
TC	283	1.00	5.00	100.00	3.5442	.07002	1.17799

Based on the above summary, Tax Incentives (TI), Tax Evasion (TE) Tax Proclamations, Policies & Strategies (TPPS) were the big three variables based on their mean, respectively. This result shows that although all the factors reviewed are significantly important for tax compliance, emphasis need to be given to tax proclamations, policies, strategies and to rule of law in general.

4.12 Correlational and Regression analysis

Correlation refers to synonym for association or the relationship between variables. It measures the degree to which two sets of data are related. Higher correlation value indicates stronger relationship between both sets of data. In this section Pearson's Product Moment Correlation Coefficient, and multiple regression analysis was computed. With the help of these statistical tools, conclusions are drawn with regard to the sample and decisions are made with respect to the research questions.

4.12.1. Pearson's Product Moment Correlation Coefficient

Pearson's Product Moment Correlation Coefficient was used to determine the relationship between the independent variables with tax compliance of grade "A" tax payers.

Table 4.12 Correlational Matrix Correlations

Variables		TC	GT	TI	HTC	TA	TE	LRL	ITPPS
TC	Pearson Correlation	1							
	Sig. (2-tailed)								
	N	283							
GT	Pearson Correlation	.569**	1						
	Sig. (2-tailed)	.000							
	N	283	283						
TI	Pearson Correlation	.424**	.553**	1					
	Sig. (2-tailed)	.000	.000						
	N	283	283	283					
HTC	Pearson Correlation	.530**	.730**	.683**	1				
	Sig. (2-tailed)	.000	.000	.000					
	N	283	283	283	283				
TA	Pearson Correlation	.341**	.276**	.246**	.360**	1			
	Sig. (2-tailed)	.000	.000	.000	.000				
	N	283	283	283	283	283			
TE	Pearson Correlation	.580**	.654**	.604**	.796**	.300**	1		
	Sig. (2-tailed)	.000	.000	.000	.000	.000			
	N	283	283	283	283	283	283		
RL	Pearson Correlation	.128**	.137**	.251**	.342**	.163**	.355**	1	
	Sig. (2-tailed)	.000	.000	.000	.000	.000	.000		
	N	283	283	283	283	283	283	283	
TPPS	Pearson Correlation	.276**	.325**	.373**	.436**	.138**	.421**	.425**	1
	Sig. (2-tailed)	.000	.000	.000	.000	.000	.000	.000	
	N	283	283	283	283	283	283	283	283

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

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

Based on the above correlational matrix, there is positive and significant relationship between, the independent variables (GT, TI, HTC, TA, TE, RL, and TPPS) and dependent variable (tax compliance of grade "A" tax payers (P <0.01).

4.12.2. Multiple Regression Analysis

Before the analysis of multiple regressions, different assumptions of regression analysis were conducted. They are necessary to confirm that the obtained data truly represented the sample and that researcher has obtained the best results (Hair et al., 1998). Three assumptions for regression analysis used in this study were discussed for the individual variables: multicollinearity, linearity and Normality.

A. Multicollinearity Test

		Collinearity Statistics	
Model		Tolerance	VIF
1	GT	.429	2.331
	TI	.508	1.969
	HTC	.233	4.301
	TA	.867	1.154
	TE	.336	2.979
	RL	.742	1.347
	TPPS	.708	1.413

a. Dependent Variable: TC

According to the coefficients outputs of collinearity statistics, obtained Tolerance and Variance Inflation Factors (VIF) values showed that the obtained values are 1 to 10, it can be concluded that there is no multicollinearity symptoms.

B. Linearity Test

The linearity of the relationship between the dependent and independent variable represented the degree to which the change in the dependent variable is associated with the independent variable. In a simple sense, linear models predict values falling in a straight line by having a constant unit change of the dependent variable for a constant unit change of the independent variable (Hair et al., 1996).

Therefore, the scatter plots of standardized residuals versus the fitted values for the regression models were visually inspected. So that the dots at the P-P Plot are closer to the diagonal line, indicating that assumption of normality is met (the plots are shown in the appendix).

C. The Assumption of Normality

A check for normality of the error term is conducted by a visual examination of the normal probability plots of the residuals. The normality probability plots were plotted to assess normality. The P-P plots were approximately a straight line instead of a curve. Accordingly, the residuals were deemed to have a reasonably normal distribution, as suggested by Hair et al. (1996). The result showed that the assumption of normality has been met.

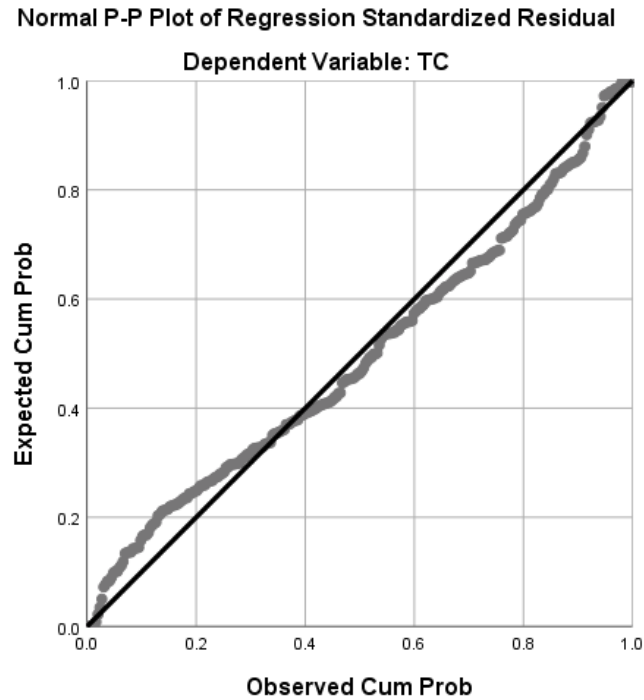


Fig 4.1 Normal P-P plot

4.13 Multiple Regression Model

Table 4.13 Model summary of regression result

Model Summary ^b				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.651 ^a	.424	.410	.90434

a. Predictors: (Constant), ITPPS, TA, GT, LRL, TI, TE, HTC

b. Dependent Variable: TC

ANOVA ^a						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	164.624	7	23.518	28.756	.000 ^b
	Residual	223.266	273	.818		
	Total	387.890	280			

a. Dependent Variable: TC

b. Predictors: (Constant), ITPPS, TA, GT, LRL, TI, TE, HTC

From above correlation between the independent variables and tax compliance with R square and adjusted value .424 which is interpreted as 42.4% of variance in tax compliance is explained by the predictor variables, while the remaining of variation in tax compliance can be attributed to other variables which are not considered in this study.

The F-statistic of 28.756 at 1 and 273 degrees of freedom is statistically significant at 99% confidence level; which implies the variation in tax compliance that is explained by other independent variables expressed by R square is statistically significant.

Table 4.14 Multiple Regression Coefficients

Model		Unstandardized Coefficients		Standardized	t	Sig.
		B	Std. Error	Coefficients Beta		
1	(Constant)	.592	.332		1.787	.075
	GT	.350	.081	.304	4.340	.000
	TI	.052	.083	.041	.630	.529
	HTC	-.074	.111	-.063	-.663	.508
	TA	.161	.048	.166	3.367	.001
	TE	.357	.078	.362	4.573	.000
	RL	-.094	.064	-.078	-1.463	.145
	TPPS	.066	.076	.047	.867	.387

a. Dependent Variable: TC

Based on the above coefficient table, the GT, TA, and TE were found to be significant predictors of tax compliance (p value <0.05).

Accordingly, the following regression equation is constructed based on the above results.

$$TC = .592 + .350 GT + .161 TA + .357 TE - .094 RL$$

CHAPTER FIVE

CONCLUSION AND RECOMMENDATIONS

5.1. Conclusions

The study has been done with the aim verifying relevant factors, which could materially affect the tax compliance, and tax collection, why taxpayers could be resistant to tax payments, review them and proposes possible areas of recommendations on. Which factors are unaddressed, where more emphasis to be given etc... To achieve this, primary data was collected using a questionnaire and analyzed using descriptive statistical tools such as mean, standard deviation, tables, graphs and regression models. Among the several possible factors, seven factors as independent variable are examined.

5.2 Summary of the findings

The finding show that there is positive and significant relationship between, the independent variables (GT, TI, HTC, TA, TE, RL, and TPPS) and dependent variable (tax compliance of grade “A” tax payers ($P < 0.01$)). 42.4% of variance in tax compliance is explained by the predictor variables (GT, TI, HTC, TA, TE, RL, and TPPS) while the remaining of variation in tax compliance can be attributed to other variables which are not considered in this study.

According to the majority respondents, they pay taxes in order to avoid penalties not because they believe it is their citizenship responsibility, as well as in anticipation that government will use its revenue responsibly in due course. With regard to the tax system in place, respondents believe the existing tax collection system is workable but requires frequent review and revision in order to address new emerging issues because efficient policies, strategies and regulations have been found to be important for tax compliance. Intrinsic quality of the tax policy, nature of payment system, tax reform, and awareness about tax policies and strategies has been found to affect tax compliance.

Concerning tax incentives, the study has found that a tax incentive for grade “A” tax payer’s lacks transparency and to be effective, it requires the presence of effective and transparent tax incentive legislation. Tax compliance cost which is for maintaining accounting records, purchase and maintenance of required machine and other costs to be material. The result of the study also indicated that the existing tax system is open for manipulation, tax rates are high, and government trust leads to tax avoidance. According to this study, other causes of tax evasion include; behavior of

some tax authority employees, taxpayers' behavior, level of education and government weak measure against tax evaders.

According to the respondents, presence of rule of law such as when the government is accountable to its citizens, transparency and provision of improved public services, enforcement of tax compliance in fair and just manner, ease of the bureaucracy, and prosecution of tax evaders and publicizing the cases found to increase trust of the government and tax compliance.

5.2. Recommendations

Based on the findings and conclusions of the study, the researcher forwards the following recommendations.

- ❖ Tax authorities should work towards creating a voluntary tax compliance through improving tax knowledge of the taxpayers and changing taxpayers' attitude by introducing successive tax education programs. Therefore, awareness creation programs should be provided consistently to tax payers in order to increase citizens' tax compliance attitude.
- ❖ Government need to be fair and transparent about the collection and utilization of the revenue collected. Public services need to be fairly provided so as to retain the trust and voluntary tax paying.
- ❖ The tax system in Ethiopia should treat equal people in equal circumstances in an equal way to ensure rule of law. Taxpayers will be discouraged to voluntarily payment when they know others are not paying as required or not paying at all. Therefore, the question of fairness or equity is not only dealing with current taxpayers but also with concerned people outside the tax system because ensuring fairness means encouraging and protecting honest and loyal citizens by ensuring fair competition among business community, tax assessment, collection, and by taking into account the ability to pay principle.
- ❖ The government should make the tax law and procedures simple, understandable and easy to ensure transparence in the tax administration, increase revenue and diminish noncompliance of tax. Frequent revisiting and revisions are required to address emerging issues.
- ❖ While working towards voluntary tax compliance, government needs to give emphasis on how to expand the tax base. There are several people who are outside the tax system just because they aren't approached and/or avoiding tax paying using several tactics.

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Appendix 1: RESEARCH QUESTIONNAIRE FOR TAX PAYERS

The purpose of this questionnaire is to find out determinants of tax collection amount and compliance among direct taxes taxpayers in Ethiopia. It is purely for academic exercise. You are therefore kindly requested to provide honest and dispassionate information/answers.

Information provided would be treated very confidential.

SECTION A: SOCIO-ECONOMIC CHARACTERISTICS

Demographic characteristics

1. Gender:

- a) Male ()
- b) Female ()

2. Age:

- a) 18-30 years ()
- b) 31-40 years ()
- c) 41-50 years ()
- d) 51-60 years ()
- e) 61 and above ()

3. Level of education:

- a) Not completed Primary School ()
- b) Primary School ()
- c) Secondary School ()
- d) University/College and above ()

4. How long have you been registered as a taxpayer?

- a) 0-5 years ()
- b) 6-10 years ()
- c) 11-15 years ()
- d) 16 and above ()

5. In which business sector are you categorized?

- a) Manufacturing ()
- b) Retail ()
- c) Service Provider ()
- d) Wholesale ()
- e) Others ()

SECTION B: GENERAL QUESTIONS: REASONS FOR NON-VOLUNTARY TAX COMPLIANCE, FACTORS AFFECTING TAX COMPLIANCE ATTITUDE, INDIVIDUAL CHARACTERISTICS & EDUCATION and WAYS ON HOW TO IMPROVE VOLUNTARY TAX COMPLIANCE

For the following questions please put “ ✓ ” mark on the alternatives that expresses your point of view better. Where:

- Strongly disagree (SD),
- Disagree (D),
- Undecided (U),
- Agree (A), or
- Strongly agree (SA)

1. Government Trust (GT)

No	Statements	SD	D	U	A	SA
1	I pay taxes because I believe it is my citizenship responsibility and in anticipation of adequate public services.					
2	I pay taxes to avoid penalties					
3	I pay taxes because there is no opportunity to evade					
4	I pay taxes because I believe the government will use its revenue responsibly					
5	The tax authority tax collection system is reliable					

2. Tax Incentives (TI)

No	Statements	SD	D	U	A	SA
1	The tax incentive system is relevant					
2	The tax incentive legislation is effective and transparent					
3	The tax incentive system affect the tax collection amount					
4	The absence of tax incentive system can result in low tax collection					

3. High tax Compliance Cost (HTC)

No	Statements	SD	D	U	A	SA
1	Using cash register machine is costly.					
2	Issue receipts and maintaining the system is worth keeping.					
3	maintaining books of accounts are important					
4	Accounting cost for maintaining records is big.					
5	Tax education is necessary for tax compliance					

4. Tax Avoidance (TA)

No	Statements	SD	D	U	A	SA
1	The tax system is open for manipulation /tax avoidance.					
2	High Tax rates deters compliance					
3	Trust to the authorities lead to tax avoidance					

5. Tax Evasion (TE)

No	Statements	SD	D	U	A	SA
1	Tax authority employees are the reason for tax evasion.					
2	Government need to take strong measure on tax evaders					
3	Tax payer's behavior is the reason for tax evasion.					
4	Level of education is a reason for TAX evasion.					

6. Rule of Law (RL)

No	Statements	SD	D	U	A	SA
1	If the government is accountable to its citizens, I will be happy to pay taxes					
2	Trust of the government officials affects compliance					
3	Gov't transparency & provision of improved public services will lead to increased tax collection.					
4	Enforce tax compliance in fair and just manner.					
5	Ease of the bureaucracy to make payments					
6	Focused taxpayer education and sensitization.					
7	Prosecute tax evaders and publicize the cases.					

7 Tax Proclamations, Policies & Strategies (TPPS)

No	Statements	SD	D	U	A	SA
1	Tax policies give room for tax evasion.					
2	Simplify the tax payment procedures.					
3	Tax reforms are necessary.					
4	Understanding of the TPPS determines the tax compliance					

8. Tax compliance (TC)

No	Statements	SD	D	U	A	SA
1	I have never been late in paying my taxes					
2	During the past years, I always reported my business transactions honestly					
3	I have never been accused of any tax related crimes					
4	I always behave based on the tax law of the country					

Thank you for your time and cooperation.

Appendix II Scatter plot matrix

