



**ADDIS ABABA UNIVERSITY**  
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**DEPARTMENT OF ACCOUNTING AND FINANCE**  
**(GRADUATE PROGRAM IN ACCOUNTING AND AUDITING)**

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**The effect of Tax Audit on Tax Compliance: In the case of  
Burayu City Administration Revenue Authority**

**A Project paper Submitted to the Department of Accounting and Finance in  
partial Fulfillment of the Requirements for the Degree of Masters of Science  
in Accounting and Auditing**

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**May, 2019 Addis Ababa, Ethiopia**

## Statement of Certification

This is to certify that **Gelete Tolina Negaro** has carried out a thesis on the topic entitled “effect of Tax Audit on tax compliance: In the case of Burayu City Administration Revenue Authority” under my supervision. In my opinion, this thesis is suitable for submission in partial fulfillment of the requirement for the award of the MSc Degree in Accounting and Auditing.

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## **Declaration**

I have carried out independently a thesis on “Effect of Tax Audit on Tax Compliance: In the case of Burayu City Administration Revenue Authority in partial fulfillment of the requirements of the MSc Degree in Accounting and Auditing with the constructive guidance and support of the research advisor. This thesis is my own work that has not been presented for any degree or diploma program in this and any other institution, and that all source of materials used for the thesis have been duly acknowledged.

**Gelete Tolina Negaro**

**Signature**\_\_\_\_\_

**May, 2019 Addis Ababa**

### **Approval of Board of Examiners**

As members of this thesis Approval Board of Examiners we certify that we have read the thesis prepared by Gelete Tolina Negaro, entitled "The effect Tax Audit on tax compliance: In the case of Burayu City Administration Revenue Authority" and submitted in partial fulfillment of the requirements for the MSc Degree in Accounting and Auditing complies with regulation of the university and meets the accepted standards with to originality and quality.

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**Abstract**

*The major objective of this study was to assess the effect of Tax Audit on Tax Compliance: In the case of Burayu City Administration Revenue Authority. The study employed quantitative research method where purposive sampling in the case study carried out. Survey was conducted with selected all tax auditors in Main Office and sub cities, quality controllers And Head managers of Main office and three sub cities Gefersa Burayu, Gefersa Nono and Burayu Keta working at Burayu City Administration Revenue Authority. Actual sample size achieved was all 16(sixteen) Tax Auditors in Main office and sub cities, 5(five) Quality controllers in Main office and 4(four) head managers of main office as well as sub cities. Results of the study reveal that regarding education, tax rate and probability of being audited do have an impact on the effect of tax audit on tax compliance. Regarding education, experience and capacity on tax audit function of Tax Auditors, the findings of this study indicated that, all of them were assigned to their current jobs through internal transfer, and by recommendation of Authorities of the City. Moreover, all of the Auditors did not attend any training programs related to their current job during the past years of their services at city. Yet, the results of this study revealed that, there is no a well-established strategies that make Tax Auditors competent and efficient on their job on continuous bases. With regard to probability of being audited, the study has revealed that educating the tax payers and conducting consultation session; Audits can assist to clarify the application of the law by every taxpayer and to identify improvements required in book keeping and thus may contribute to improved compliance by taxpayers in the future. Identify areas of the law that require clarification: Audits may bring to light areas of the tax law that are causing confusion and problems to large numbers of taxpayers and thus require further efforts by the revenue body to clarify the laws' requirements and/or to better educate taxpayers on what they must do to comply into the future. With regard to Tax rate the study reached in a conclusion that the Tax payers should evade tax if tax rates are too high. From this response it is clear that the tax rate is not based on the ability-to-pay principle or it is perceived to be unfair by taxpayers. Even though the principle says, tax should be based on the ability- to pay; the problem here is in determining this 'ability' for each taxpayer. the communication gap between the tax authority and taxpayers might have created this perception (i.e., the tax rates are too high) and it continues to be the issue as far as the understanding of the taxpayers regarding tax rates, assessment, calculation etc is low. Key recommendations of the study include: regard to Education; To make tax Audit staffs sufficiently experienced and capacity on tax audit functions, effective probability of being audited; to educating the tax payers and conducting consultation session and make effective tax rate through tax payers should evade tax if tax rates are too high and if the system is unfair.*

**Keywords: Tax Audit, Tax Auditor, Tax Compliance, Education, Tax Rate, Probability of being audited**

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## Acronyms

AA – Audit Amount

AAT – Amount After Audit

EBDSN – Ethiopian Business Development Services Network.

BCARA\_\_ Burayu City Administration Revenue Authority

RA \_\_\_\_ Revenue Authority

ABT – Amount before Audit

EC – Ethiopian calendar

ECC – Ethiopian Chamber of Commerce

ERCA – Ethiopian Revenue & Customs Authority

SPSS \_\_\_\_ Statistical package for social science

OECD \_\_ Office of Economic Cooperation and Development

RTA \_\_\_\_ Relevant Tax Authority

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## **CHAPTER ONE**

### **1.1 Introduction**

Governments formulate the means to generate revenue to undertake their obligations. Historically, this has been done through the levying of various forms of taxes. In pre-modern times, taxation was viewed as a direct exchange of bargain in which the taxing authorities on one hand, and the tax payer on the other hand, each expected to receive equal benefit in relation to what it gave out. Taxes were looked upon as the wages paid to government for its services, the chief among them being security. This concept became known as the ‘bargain theory’ (Danquah, 2007). The common view was that each one was to provide all his needs otherwise he paid the government authorities to do that for him.

As mentioned to (Brown et al, 2003) Today’s tax agencies typically lose some percentage of total revenues due to tax evasion and other types of noncompliance known as the “tax gap” The primary goal of a revenue body’s compliance activity is to improve the overall compliance with their tax laws, and in the process instill confidence in the community that the tax system and its administration are fair. Instances of failure to comply with the law are inevitable whether due to taxpayers’ ignorance, carelessness, recklessness and deliberate evasion, or weaknesses in administration. To the extent those failures occur, governments, and in turn the communities they represent, are denied the tax revenues they need to provide services to citizens (Forum on tax administration’s compliance, (2006)).

When tax audit is well conducted, taxpayers understand that their returns has been quickly and scientifically analyzed, voluntary compliance rates may rise which would help tax agencies avoid costs and further improve revenue collections (Brown et al, 2003). Tax audit on tax compliance system, a comprehensive, integrated solution designed to improve tax auditor productivity and increase tax revenues.

### **1.2 Back ground of the Study**

Burayu is one of the City in Oromia regional state; Oromia Special Zone Surrounding Finfine. According to Burayu investment office, Burayu is located in the road of Western part of the Oromia at a distance of 15 KM from Addis Ababa.

In Ethiopia, taxes are considered as a source for growth and development. The tax audit is a critical issue to the government. Tax revenues and other revenues are central to the current economic development agenda. They provide a stable flow of revenue to finance development priorities, such as strengthening physical infrastructure, and are interwoven with numerous other policy areas, from good governance and formalizing the Economy, to spurring growth (Pfister, 2009).

### **1.3 Statement of the Problem**

Taxes are the core revenue for the government and thus the concerned agency should ensure they are collected in the right way. The system must be checked to avoid evasion and wrong submissions. Clearly, a properly designed and administered taxation system is very important in generating revenue and increasing the tax base to the government of developed, developing, and transitional economies (Abinet Lulseged, 2016)

As mentioned by Bird (2008) noted, it is unquestionable to ensure that the revenue collected from tax should be raised in efficient and effective manner although it is difficult without fear or favor in countries that are politically delicate.

Though, the tax base of developing countries adversely affected by administration problems including poorly conceived tax policies and lack of certainty regarding future policy changes. In addition, tax administrations can also create problems for the tax payers as they impose onerous (difficult) reporting and record keeping requirements, perform excessive inspections and audits, fail to deal with their corrupt employees, and failure to provide transparency in the operations of tax administration (Baurer, 2005).

In Ethiopia, a tax policy is geared towards promoting investment, supporting industrial development; and broadening the tax base and decreasing the tax rate, at least maintaining the current reduced tax rates compared to most other countries, in view of financing the ever-growing needs of the government expenditure. Furthermore, the policy is designed towards discouraging certain production and consumption activities, which had /and will have bad effects on health, moral, economic and social settings of the community (ERCA 2010).

As stated in the paper of (Abinet Lulseged, 2016); in Ethiopia, taxation has been used for the purpose of raising governments revenue is as much as possible to meet the ever-expanding

public expenditure needs of the government. It is also a mechanism for reduction of inequalities in income distribution, promotion of capital investment and trade, encouraging and/or discouraging certain industries depending on how suitable for country's economic development program. Tax systems are usually elaborated without proper discussion with the business community. In addition, the business owners do not have easy access to clarification on information of the tax laws. The tax agencies rarely provide advising services. As a result, taxpayers misinterpret tax rules and regulations. Moreover, they lack awareness regarding the tax type to be imposed on their doings, purpose and operation of desk audit, goods and services exempted from tax, negative upshot of contraband trade, and reporting and filing requirements of the tax law.

If Tax auditors are not at the required level of operational capability to conduct tax audit and professional capability they get troubled in giving appropriate services to taxpayers. The incapability of tax auditor might be due to absence of using effective pre-audit plan and inadequate audit training as well as their lack of willingness as cited (Getaneh, 2011).

Currently few researches have been done in this area, of which most of them are not based in Ethiopia. Their main concern is to show, the positive relationship between Tax Audit and to that of Government revenue and Tax compliance. In addition the negative relation between Tax audit and tax evasion. In their analysis part they indicated that Tax Audit has increased Government revenue by Increasing Tax compliance and decreasing tax evasion and avoidance as well.

So, this study was intended to fill these gaps by establishing effect of tax audit on tax compliance in Burayu City Administration Revenue Authority (BCARA). Furthermore, the study will also show how Tax audit on tax Compliance affect the law of revenue collection of the government.

Therefore, Tax audit become a bridge that is believed to connect Taxpayers with the tax authority. And it could also fill the gap by taming tax auditors and teaching those that have Knowledge gap on the tax laws. Hence, existence of efficient and effective tax audit structure within a tax authority could guarantee optimum tax collection and increased societal awareness towards the existing tax laws. In order to meet this requirement, tax audit should be performed by highly skilled, knowledgeable and committed auditors.

These issues in relation to tax audit on tax compliance at the Burayu City Administration Revenue Authority together with the knowledge gap established in this area.

#### **1.4 Research Questions**

In line with the problems statements, the researcher developed four specific research questions. So, the main research questions have been:

1. How does an education effect on tax audit with tax compliance?
2. How does resource of Tax audit function effect on tax audit with tax compliance?
3. How the extent of tax rate to effect on tax audit with tax compliance?
4. How investigate the probability of being audited on the tax payer with tax laws?

#### **1.5 Objectives of the Study**

##### **1.5.1 General Objectives**

The main objective of the study is assessing the effect of tax audit on tax compliance in the Burayu City Administration Revenue Authority

##### **1.5.2 Specific objectives**

1. To assess an education in relation with tax audit on tax compliance effect in BCARA
2. To assess the resource of Tax audit function on tax compliance effect in BCARA
3. To show the extent of tax rate in relation to tax audit on tax compliance effect in BCARA.
4. To investigate the probability of being audited on the tax payer with tax compliance effect in BCARA.

#### **1.6 Research Hypothesis**

This focused on the hypothesis of as follow items:

In order to achieve the objective of the study the researcher developed four hypotheses by modifying from different scholars literature reviewed. The effects of tax audit on the tax compliance laws that affect compliances of tax. In this section, the researcher provides a brief theoretical discussion on effects Tax audit on tax compliance in the BCARA; in Ethiopia, Oromia and the hypothesis developed for the study as follows:

**Tax compliance** can be defined as the degree to which a taxpayer complies (or fails to comply) up of reporting compliance, procedural compliance and regulatory compliance and it is generally concerned with complying with the rule relating to lodging and payment of tax while technical

compliance is concerned with meeting up technical requirement of tax laws in up technical requirement of tax laws in computation of tax liability (Alabede al, 2011).

**H1: “There is no significant association education and tax compliance”**

**Education attainment:** is another important determinant of tax compliance. It usually relates to a taxpayer’s ability to comprehend and comply or not comply with tax laws. It is argued that education has two elements: the general degree of fiscal knowledge and the specific degree of knowledge regarding tax evasion opportunities. It is claimed that by enhancing the level of general fiscal knowledge, tax compliance can be improved as taxpayers will have more positive perceptions about taxation. Increased knowledge of tax evasion opportunities has a negative influence on tax compliance as it assists non-compliance. However, the vast majority of studies examining the impact of education on tax evasion use a taxpayer’s general education level as the approach to measure education (Jackson & Milliron, 1986).

**H2: “There are no significant association resources of tax audit function and tax compliance”**

Revenue bodies typically have at their disposal a finite level of resources to conduct the day to day business of revenue administration. Given the many tasks to be performed and the inevitable decisions that must be made on priorities, a process is required to determine how those resources are to be allocated. In some member countries, revenue bodies have relatively limited discretion as to how staff resources are to be spread across the various areas of work, while in others broad discretion is given to senior management on how resources are to be allocated. (Eugene, 2011)

Regardless of how the overall budget of resources for audit work is arrived at a key issue for the audit function is how those resources have been spread over the various segments of taxpayers. Determining how resources might best be allocated is a key element of a revenue body’s strategy for compliance improvement and is dealt with in the following section (1) Forum on Tax Administration’s Compliance Sub-group and (2) Tax Administrations in OECD and Selected Non-member Countries: Comparative Information Series (2006).

### **H3: “There is no significant association between tax rates and tax compliance.”**

Tax Rate is one of the economic factor affect to tax compliance decision. Therefore need to discuss, how tax rates influence taxpayers’ decision to comply with tax laws. Clotfelter (1983) claimed that “reducing tax rates is not the only policy that has the potential to discourage tax evasion” (p. 363) but the tax rate is an important factor in determining tax compliance behavior although the exact impact is still unclear and debatable (Kirchler, 2007:114) Raising marginal tax rates has been 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) .

### **H4: “There is no significant association between probability of being audited and Tax Compliance”.**

Tax audit is one of the most effective policies to protect the behavior of tax evasion. The level of tax audit can be determined by two elements: one is how many taxpayers are selected for audit and the second is how much intensive the audit is. The first element is easily measured by the number of audited taxpayers divided by the total number of taxpayers. However, the second element is so difficult to measure due to no published information about the process of tax audit. Tax audits, audit rates and prior audit experience have been ambiguously discussed in relation to tax compliance. Some studies claimed that audits have a positive impact on tax evasion (See Jackson and Jaouen, 1989; Shanmugam, 2003; Dubin, 2004). Butler (1993) also found that tax audits can change compliance behavior from negative to positive. These findings complement the Witte and Woodbury (1985) and the Beron, Tauchen and Witte (1988) studies. Witte and Woodbury in their study of small proprietors found that tax audits have a significant role in tax compliance. They did not empirically test individual taxpayers, thus left open room to conduct research in this area. While Butler (1993) and Witte and Woodbury (1985) found significant results, Beron et.al. (1988) found a contradictory result. They reported that audits did not significantly correlate with evasion for all groups they studied.

Bergman (1998) investigated 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.

## **1.7 Significance of the Study**

This research work can give feedback to tax payers and the tax authority regarding the significance, application and effect of tax audit on tax compliance. The study also contributes in evaluating the prevailing tax audit on tax compliance in making some adjustments on the existing tax auditors. Moreover, it can provide constructive feedback about the efficiency and effectiveness of the existing tax audit on tax compliance in Burayu city Administration Revenue Authority (BCARA). For those who are interested to make further study on the related issue it may be used as an indication.

This thesis is intended to provide immense benefit to tax administration and auditing in Oromia state and also seeks among other things to establish the extent to which tax administration and auditing can be improved. Again, knowing the positive extent to which tax administration and auditing has helped and the purpose of which tax auditing has been introduced to help in planning the country's economy. Mechanisms used in tax administration and auditing in Oromia gives clear methodologies that are of great importance to the research work.

## **1.8 Scope and limitation of the Study**

### **1.8.1 Scope of the Study**

This research work assesses the effect of tax audit on tax compliance in Burayu City Administration Revenue Authority (BCARA). While studying the tax audit on tax compliance effect, these study considerers only the practice and its application in the BCARA office and three sub cities: such as, Gefersa Burayu, Gefersa Nono and Burayu Keta, thus the scope was included.

However, since the general guidelines, application procedures and practice are the same throughout the country; it is supposed that this study can fairly reveal the tax audit on tax compliance in the revenue of the country.

### **1.8.2 limitation of the Study**

In spite of the researcher's efforts to gather the necessary information as objective as possible, the analysis of this study was based on the opinion of respondents, so the respondent may not cooperate well to fill and gave all the necessary data. This may in turn limit the ability to make broader generalization from the study suffered.

### **1.9 Organization of the Paper**

The project work is categorized into five main chapters. Chapter one focused on the introduction, background to the study, problem statement, objectives, significant of the study and Scope. Chapter Two is devoted to systematic review of existing literature. It provides evidence regarding the effect of tax audit on tax compliance. The Third Chapter deals with research methodology including population, sampling techniques, methods of data collection and the research instruments employed. Chapter Four is also made up of detailed analysis of data collected and presentation of information with the aid of quantitative and statistical models. Finally the Fifth Chapter covers conclusion, Discussion (findings) and recommendations.

## **CHAPTER TWO**

### **Literature Review**

#### **2.1 Theoretical Literature**

##### **2.1.1 Nature and Importance of Tax Audit**

As the study mentioned by the researcher Kircher (2008) defined as tax audit is an examination of an individual or organization's tax report by the relevant tax authorities in order to ascertain compliance with applicable tax laws and regulations of state. He further reported that tax audit is a process where the internal revenue service tries to confirm the numbers that you have put on your tax return. In line with this notion, a tax audit is an examination of whether a taxpayer has correctly reported its tax liability and fulfilled other obligations. Ola (2001) stated that the process of tax audit involves tax returns that are selected for audit using some selection criteria. Subsequently, the underlying books and records of the taxpayers are examined critically to relate them to the tax return filed.

So by definition; Tax audit is important because of its support to the government in collecting suitable tax revenue essential 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.

According to Badara (2012), tax audit objective includes to establish a viable and effective tax administration in order to deal with constantly changing economy, to put strategies in place in order to resolve tax dispute between the tax authority and the liable tax payers, to maintain a strong mechanism to deal with tax avoidance techniques which are available to various organizations, but are susceptible to tax abuse, to bring defaulting tax payers to the net of tax authorities, to prove the completeness, accuracy and timely filing of tax returns submitted by the tax payers.

As Biber (2010) noted, the role of an audit program in a modern tax administration must extend beyond merely verifying a taxpayer's reported obligations and detection of discrepancies

between a taxpayer's declaration and supporting documentation. Thus, tax audit results in increased tax revenue in two ways: (1) Directly through assessment of additional taxes; and (2) Indirectly by discouraging underreporting of liabilities by all taxpayers.

Additionally, Barreca and Ramachandran (2004) noted that the purpose of tax audit is to check the evasion of tax and ensure compliance in accordance with the laws and regulations.

Tax audits therefore provide the tax administration with important power across the community rather than only impacting on the taxpayer selected for audit and collecting the tax that should have been paid in the first place.

### **2.1.2 Basis for Taxation**

Governments have enumerable responsibilities. Some of these include economic infrastructure (roads, legal tender, enforcement of contracts, etc.), enforcement of law and public order, and protection of property, public works, social engineering, welfare and public services (including education systems, health care systems, pension for the elderly and public transportation, Energy, water and waste management systems are also common public utilities) and the operation of government itself.

Among the many sources; taxes consist of one prominent, prudent and feasible source of revenue for the government. Governments therefore tax the people in their country as they produce to earn income for themselves. Taxes form a high percentage of revenue to nations. Historically, the nobility were supported by taxes on the poor; modern social security systems are intended to support the poor, the disabled, or the retired by taxes on those who are still working.

### **2.1.3 Tax Audit**

A tax audit is an examination of whether a taxpayer has correctly reported its tax liability and fulfilled other obligations. It is often more detailed and extensive than other types of examination such as general desk checks, compliance visits or document matching programs (OECD 2006a).

Most tax payers report their tax liabilities more accurately if they believe that the tax administration has the capacity to detect any unreported liabilities and that heavy penalty may be applied when they are detected (Biber 2010).

The subsequent subsections discuss thoroughly about tax audit in a tax administration system that includes characteristics of effective audit program, types of tax audit to be performed, audit case selection methods, examination techniques to be applied for tax audit, and characteristics and required capabilities of effective tax auditors.

To the tax administration, tax audit refers to the examination of tax returns by concerned tax officials primarily with respect to checking as to timely arrival, inclusion of all required forms and attachments, and arithmetical accuracy. This may be called internal tax audit.

A tax audit is one of the most sensitive contacts between the taxpayer and a revenue body. Notwithstanding this, tax audits remain the only effective method for ascertaining additional facts or verifying provided information. (Eugene, 2011)

The tax audit function plays a critical role in the administration of tax laws in all countries. In addition to their primary role of detecting and deterring noncompliance, tax auditors are often required to interpret complex laws, carry out intensive examinations of taxpayers' books and records, while through their numerous interactions with taxpayers operating very much as the 'public face' of a revenue body. These factors, as well as the absolute size of the audit function in most revenues bodies, provide a strong case for all revenue bodies paying close attention to the overall management of the tax audit function. (Eugene, 2011)

For instance, according to Kamal Gupta & Ashok Arora, in India, the Income Tax Act, provides for compulsory audit of the accounts of certain income tax assesses (i.e. persons liable to pay income tax ) whose turn over exceed the specified limits. It was also practiced for some years in India but left after the 1997 E.C. election. The objective of such audit is to assist tax authorities in making the correct income tax assessment of the assessee concerned. The tax auditor has to specifically report on certain transactions which have an impact on the income tax liability of the assessee concerned and are, thus important to the tax authorities (Ahymed and Stern, 1991).

#### **2.1.4 Roles of the Taxpayer Audit Program**

The tax audit program of a revenue body performs a number of important roles that effectively carried out and can make a significant contribution to improved administration of the tax system. These roles are described briefly hereunder: as cited (Mesfin, 2008)

**Promote Voluntary Compliance:** The primary role of the audit program is to promote voluntary compliance by taxpayers with the tax laws. It seeks to achieve this by reminding taxpayers of the risks of noncompliance and by engendering confidence in the broader community that serious abuses of the tax law has been detected and appropriately penalized.

**Detect non-compliance at the individual taxpayer level:** By concentrating on major areas of risk (e.g. unreported cash income) and those individual taxpayers most likely to be evading their responsibilities, audits may bring to light significant understatements of tax liabilities, and additional tax revenue collections.

**Gather information on the ‘health’ of the tax system (including patterns of taxpayers’ compliance behavior):** The results of normal audit activity may provide information on the general well-being of the tax system. Audits conducted on a random basis can assist overall revenue administration by gathering critical information required to form judgments on overall levels of tax compliance, that over time can be used to identify trends in overall organizational effectiveness and to gather more precise information that can be used to inform decision-making on future compliance improvement strategies, to refine automated risk-based case selection processes, and even support changes to tax legislation.

**Gather intelligence:** Audits may bring to light information on evasion and avoidance schemes involving large numbers of taxpayers that can be used to increase major counter-abuse projects.

**Educate taxpayers:** Audits can assist clarify the application of the law for individual taxpayers and to identify improvements required to recordkeeping and thus may contribute to improved compliance by tax payers in the future.

**Identify areas of the law that require clarification:** Audits may bring to light areas of the tax law that are causing confusion and problems to large numbers of taxpayers and thus require further efforts by the revenue body to clarify the laws’ requirements and/or to better educate tax payers on what they must do to comply into the future. From this perspective alone, the audit program represents a sizeable strategic investment that dictates the need for sound management policies and practices, (Eugene, 2011).

### **2.1.5 Government Audit Revenue**

The country papers bring out the dimensions of these two sources which in turn influence the areas of audit priority. These are tax and non-tax revenues. Government revenues are largely dependent on taxes legislated through various tax statutes. However, the spread of the two sources, viz. tax and non-tax revenues, varies from country to country. (Eugene, 2011)

According to (Mesfine, 2008) Since virtually all tax returns are accepted as filed without technical scrutiny when applying self-assessment principles, it is essential for the system to be supported by a reliable automated audit case selection system using risk-based screening techniques.

An audit on the other hand, is the conduct by audit staff for appropriate verification of selected tax payers declares tax liabilities. It may also include cross checks of tax payer's records with those of tax payer's suppliers or with other source of information such as the custom authorities or other government departments and agencies, (Eugene, 2011).

### **2.1.6 Key Audit Characteristics**

According to (Eugene, 2011), Compliance regimes operate within the unique legal, cultural and administrative background of individual member countries. Nevertheless, there are a number of common pre-requisite features and requirements that need to be in place to ensure a good level of effectiveness and efficiency from audit activities and to support continuous improvement.

They are:

- A comprehensive legal framework, including an appropriate regime of sanctions.
- Well-defined organizational and management processes, including a comprehensive performance measurement framework.
- Well-defined audit techniques and adequate support arrangements; and.
- Adequate human resource management and development programs.

### **2.1.7 Demands for Tax Audit**

Four conditions tend to create the demand for the independent performance of the audit or attest function. They are as follows: (Eugene, 2011)

- Conflict of interests between those who prepare accounting information reports and those who use them;
- Consequence of information to users while using them in decision-making;
- Complexity of subject matter and audit process; and
- Remoteness of users from subject matter and preparer.

When audit function is extended to tax, the above-mentioned four conditions are also required to be satisfied. Here, the preparer of income tax return and relevant information (the assessee) has the conflicting relationship in terms of financial interest with his counterpart user or evaluator of the return (the assessing officer). Because, manipulated information in the tax return may reduce the tax liability. (Eugene, 2011)

Second, use of the tax return, assume to be correct and complete, may have serious consequence on Government fiscal estimation and collection thereof. As a result, all the budgetary appropriations may stand for nothing but a baseless imagination.

Third, both financial accounting and tax accounting are recognized as a much complex discipline due to technicalities and their distinct characteristics of difficulties. Finally, between the preparer of the return and the information therein (by the assessee) and the assessing officer, there exists a wall of remoteness though the latter can call for any additional information from the former to be satisfied with the completeness and correctness of the information provided. But sometimes this may not be possible due to time and cost constraints and some other reasonable causes.

In this case, the tax authority can apply his best judgment, which may not be the expression of the reality and thus both the parties, the Government and the assessee may be affected by under- or over-charging of tax. Therefore, all the conditions creating the demand for audit with respect to tax can be found to be satisfied.

Besides, the Committee on Basic Auditing Concepts (COBAC) suggested that the subject matter of any extension of the audit function must have the following attributes:

The subject matter has to be susceptible to the deduction of evidential assertions. Such assertions have to be both quantifiable and verifiable;

There has to be an information system to record the actions, event or results thereof; preferably adequate internal controls have also to be in operation; and Consensus should exist on the established criteria against which the information prepared from the subject matter can be evaluated.

Each of the attributes stated above is essential. Two additional conditions are also needed. They are: auditor's competence and summarization of findings in a report.

Tax law requires the maintenance of an 'information system' adequate for recording the actions and events, and the law also serves as a criterion for evaluating the subject matter information. The International Federation of Accountants (IFAC) Ethics Committee, in the 'Code of Ethics for Professional Accountants' has defined 'professional service' as 'any service requiring accountancy or related skills performed by a professional accountant including accounting, auditing, taxation, management consulting and financial management services'.

Hence, an auditor must be competent first in accounting, inevitably in auditing, as well as thereafter in taxation. (Eugene, 2011)

Introduction of tax audit by qualified professional accountants is indeed the esteemed recognition of their specialized competence. The real benefit from compulsory tax audit, if legally enforced, is that the audit will ensure maintenance of proper books of accounts and other records. The growing accounting habit thus developed will enable creation of a transparency of the in the middle of grey area between assumed income and reported income.

### **2.1.8 Types of Tax Audits**

Audits can vary in their scope and the level of intensity to which they are conducted. For this reason, various terminologies have evolved to describe different types of audit activity (Mugume, 2006):

**Full audits** – The scope of a full audit is all-encompassing. It typically entails a comprehensive examination of all information relevant to the calculation of a taxpayer's tax liability for a given

period. The objective is to determine the correct tax liability for a tax return as a whole. In some countries full audits are carried out as part of random audit programs that are used to gather data on the extent, nature and specific features of tax compliance risks, for compliance research purposes and/or the development of computerized audit selection formulae. Given their broad scope, full audits are typically costly to undertake a substantial program of full audits will require considerable resources and reduce the rate coverage of taxpayers that could otherwise be achieved by a more varied mix of audit types.

**Limited scope audits** – Limited scope audits are confined to specific issues on the tax return and/or a particular tax scheme arrangement employed by the taxpayer. The objective is to examine key potential risk areas of noncompliance. These audits consume relatively fewer resources than full audits and allow for an increased coverage of the taxpayer population.

**Single issue audits** – Single issue audits are confined to one item of potential non-compliance that may be apparent from examination of a taxpayer's return. Given their narrow scope, single issue audits typically take less time to perform and can be used to review large numbers of taxpayers involved in similar schemes to conceal non-compliance.

In practice, the scope and nature of any audit activity undertaken for a particular taxpayer will depend on the available evidence pointing to the likely risks of noncompliance and a taxpayer's prior history. Extensive audit inquiries may also be justified simply because a taxpayer's financial and /or business activities are unusually complex.

**Periods under examination:** Audits can focus on one financial year or accounting period, or be extended to cover multiple fiscal periods. An audit can focus on specific parts of the taxpayer's activities (such as sales, goods in stock etc), specific incidents or transactions or activities (such as those carried out in a branch or subsidiary), or specific tax obligations. An audit can vary in its level of detail. Sometimes the taxpayer's affairs are examined in detail and in other situations, subject to the level of risk perceived, merely superficially (Bukanya, 1996).

### **2.1.9 The Efficiency and Effectiveness Tax Audit**

Audit effectiveness is measured by examining the amount of evidence selected for examination in relation to the total available evidence and an optimal level of evidence. Audit efficiency is then defined as audit effectiveness per unit of time by taking the audit effectiveness measure

divided by minutes spent on the task (Kangave, 2004). The key findings were that time pressure (manipulated by four levels of a time budget for the task) affected performance only at the extremes, with the highest time pressure group performing more efficiently than the auditors in the lowest time pressure group. Efficiency was also affected by audit program structure, with high structure (more detailed audit procedures listed) being associated with increased efficiency.

Apostolou et al. (1993) defined Audit efficiency as the ability to meet the budget and operationalize it as the percentage deviation between actual and budgeted hours. This research examined the effect of leader behavior on audit efficiency. Two leader behaviors; (1) Facilitating cooperation and teamwork and (2) Administering discipline; resulted in increased audit efficiency. On the other hand, showing consideration contributed to reduced audit efficiency (Apostolou et al., 1993).

In addition in an economic sense, the concept of efficiency is rooted in the ideas of minimization of inputs, absence of waste, and least cost production methods Auditing practitioners tend to define efficiency as accomplishing the audit task in less time thereby increasing profitability (McGrath and Hollingshead, 1993). The efficient and effective conduct of audit activities requires that a revenue body's audit and investigation staff have appropriate powers of access to information held by the taxpayer and other parties so that taxpayers liabilities reported in their returns can be properly verified or, in the absence of returns, be accurately established. There should also be an appropriate regime of sanctions to punish and deter non-compliance (Moyi and Muriithi, 2003).

For these reasons, revenue bodies require a set of powers and sanctions in the legal framework supporting the conduct of tax administration activities that includes the provision of adequate powers for obtaining information and an appropriate regime of sanctions covering the various offences that may arise (Cheeseman and Griffiths, 2005). In practice, this legal framework may be set out separately in the laws governing each tax administered or, preferably for ease of legislative maintenance, in a single comprehensive law on tax administration that provides a common set of provisions covering all taxes.

Collectibles is another factor for possible consideration. Some countries use collectability as a pre-contact consideration and other countries reported that it could become a factor during the

course of the audit if bankruptcy were imminent (Kangave, 2004). The collectability concept implies that a taxpayer's inability to pay a future proposed tax assessment would be sufficient basis for not conducting the audit.

### **2.1.10 Importance of Tax Audit in Fighting Corruption**

Simply define; corruption is the abuse of public power for personal gain or for the benefit of a group to which one owes loyalty. It occurs at the intersection of public and private sectors, when public office is abused by an official accepting, soliciting, or obtaining by threat a bribe. Klitgaard (1996) has developed a simple model to explain the dynamics of corruption:

Tax is one of the most exposed issues for corruption since it is carried out by the interaction of the tax payer and the tax auditor. (Eugene, 2011)

### **2.1.11 Criteria for a Good Tax Audit**

For the tax inspector to carry out a good audit exercise, the following conditions must be fulfilled.

1. The tax auditor must be familiar with the environment in which he works. It is a condition which is highly critical that the tax inspector must be properly schooled in the political, economic, social, cultural and religious environment of the taxpayer. A good knowledge of his environment will affect the decision made by him.
2. The tax officials should be motivated to carry out tax audit, he should be properly trained and have experience in his area. The tax inspector should not be carried away by corrupt practices that render the aim of the tax audit useless.
3. The tax audit should be properly supervised by those who are professional and when new tax inspectors are sent to carry out the audit, they should be monitored by older ones so as to make sure that the right thing is done.
4. Specialization should be encouraged. The cases should be grouped. This will allow the tax audit staff to become specialist in specific field.
5. The manner in which the audit is being carried out should be changed. The use of computer should replace the manual process as this will go a long way in facilitating the job and helping to preserve information for a long time. This will improve the efficiency of the exercise (Ogundele, 1999).

## **2.1.12 Tax Audit and Investigation**

According to (Mesfin, 2008), A number of issues are often mentioned when discussing matters relating to Tax Audit and Investigation. They are so persistent that they cannot just be ignored. A modest effort will hereby be made to address some of these contemporary issues related to Tax Audit and Investigation. Some of these are summarize below:

### **A. Responsibility for the result of Tax Audits**

The result of a tax audit is enforced by holding the employer responsible for any tax liability arising from the tax audit of the employees. In a situation where some affected staff (local and expatriates) might have left the country by the time of the audit there is always a debate as to who should be held responsible. This debate is quite unnecessary as the law is clear on who should be held responsible. Article`90 of the Personal Income Tax Proclamation (PITP) states Penalty for Failure to Withhold Tax can be'

- 1) A withholding agent who fails to withhold tax in accordance with this. Proclamation is personally liable to pay to the tax Authority the amount of tax which has not been withheld, the withholding agent is entitled to recover this amount from the payee.
- 2) The tax withholding liability imposed by this .Proclamation shall be treated as a tax liability for purposes of any Article providing taxpayers with the right to contest the amount of tax due or to recover tax paid. .
- 3) In addition to any amount for which a withholding agent is liable under Sub-Article (1), an agent who fails to withhold tax in accordance with this Proclamation shall be liable for a penalty of 1, 000 Birr for each instance of failure to withhold the proper amount. So uncollected tax from Income tax shall be recoverable as a debt due by the employer to the relevant authority”. Thus it is the duty of the appointed collection agent or an employer to fully account for what it had deducted, or ought to have deducted, on behalf of the relevant tax authority.

### **B. Focus on Revenue Generation**

It is often said that the customer is always right, this is however not the case in the relationship between the tax authority and the taxpayer. This is so because the major aim of tax audit and investigation is not to manage the taxpayer but a focus on generating revenue. (Ojo, 1996).

### **2.1.13 Effect of tax audit on revenue collection**

Tax audit affects revenue collection in that it promotes voluntary compliance of taxpayers which increases revenue. It also determines the accuracy of returns so as to ensure the right taxes are submitted. With tax audit tax liability can be easily declared and matters that need adjustment are identified. It also helps in collecting tax interests and penalties which thereby increase revenue collection. Tax audit also helps to implement changes to eradicate evasion. Thus, tax audit is positively related to tax collection.

### **2.1.14 Theories on Tax Audit & Revenue Collection**

This part explains the theoretical contributions from various authors on tax audit and revenue collection. It also gives contribution of various research studies as carried out by various authors and then concludes on the general view of the various authors.

#### **2.1.14.1 Specific Theories**

Awe (2008) defines auditing as an independent examination of the books and accounts of an organization by a duly appointed person to enable that person give an opinion as to whether the accounts give a true and fair view and comply with relevant statutory guidelines. The American Accounting Association (1971) in its Statement of Basic Auditing Concepts in Hayes, Schilder, Daseen and Wallage (1999) described auditing as: a systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between these assertions and established criteria and communicating the results to interested users. Akinbuli (2010), Hayes et al (1999) reported that several theories of auditing were made to specify and determine the audit functions. Some of these theories include:

#### **2.1.14.2 The Policeman Theory**

This theory of auditing was formulated by Awe, (2008) on assumptions that once monitoring is done on the systems at unspecified times then that is like policeman.

#### **2.1.14.3 The Moderator of Claimants Theory**

This theory is stated by Frey, (2003) that it is important that all vital participants in an organization continue to contribute. In order to continue these contributions, it is important that each group believes it receives a fair share of the organizations income. This is based on the

assumption that when one gets a fair share then a fair share has been contributed. To the auditing theory then fairness is introduced.

#### **2.1.14.4 Agency Theory**

This theory is associated with conflicting interests of shareholders and management of organizations, suggesting that the less informed party will have to demand for information that monitors the behavior of better informed manager (Akinbuli, 2010). According to Hayes et al (1999), assumptions are made that agency theory can be used to explain the supply side of the audit market. The contribution of an audit to third parties is basically determined by the probability that the auditor will detect errors in the financial statements and the auditor's willingness to report these errors. Then independence is emphasizing in auditing.

#### **2.1.14.5 Classical Theory of Tax Compliance**

This theory of tax compliance initially formulated by Toggler, (1970) is also called the A-S models based on the deterrence theory. In the theory the taxpayer is assumed to maximize the expected utilities of the tax evasion gamble, balancing the benefits of successful tax cheating against the risky prospect of being caught and punished by tax authorities (Sandmo, 2005).

Alabede et al (2011) asserted that the deterrence theory depends largely on tax audit and penalty. They further stressed that this theory of tax compliance makes taxpayers to pay tax as a result of fear and sanctions. Trivedi and Shehata (2005) says that the deterrent theories suggest that taxpayers "play the audit lottery", that is they make calculations of the economic consequences of different compliant alternative. Verboon and Dijke (2007) stated that the essence of the deterrence model of tax compliance is to chiefly examine the interaction between probabilities of detection and sanction severity that should affect non-compliance.

Brook (2001) says that classical theory is only based on economic analysis but social and psychological variables are equally important in understanding the issue of noncompliance to tax. Some of the important studies about the effects of deterrence on compliance include Hasseldine (2000), Torgler (2002) and Kirchler (2007). Elffers (2000) and Braithwaith (2003) argued that if deterrence (that is the probability of detection and sanction severity) would be the most significant variable in explaining compliance, rational individuals in most societies of the world would be non-compliant because the levels of deterrence are low. The theory has

contributed to theory the fact that revenue authorities should seek audited statements or perform audits to ascertain compliance.

#### **2.1.14.6 Theory of Planned Behavior**

The theory of planned behavior states that the behavior of individuals within the society are under the influence of definite factors, originate from certain reasons and emerge in a planned way (Erten, 2002). It was assumed that the ability to perform a particular behavior depends on the fact that the individual has a purpose towards that behavior. Therefore, it was asserted that the factors that determine the purpose towards that behavior are attitude towards behavior, subjective norms and perceived behavioral control. Ajzen (2002) says that these factors are under the influence of behavioral beliefs, normative beliefs and control beliefs. It is also asserted that sociological and psychological factors have proved to be important in understanding the high levels of tax compliance. In such analyses, concepts such as trust in authorities perceived fairness of the system moral considerations and norms are added to theory and are used to promote better understanding of tax compliance.

#### **2.1.1.2 Tax Compliance**

The exact meaning of tax compliance has been defined in various ways. For example, Andreoni, Erard, and Feinstein (1998) claimed that tax compliance should be defined as taxpayers' willingness to obey tax laws in order to obtain the economy equilibrium of a country. Kirchler (2007) perceived a simpler definition in which tax compliance is defined as the most neutral term to describe taxpayers' willingness to pay their taxes. Compliance in pure administrative 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).

Taxpayers decision to tax compliance influenced by several factors. these factors may be economic factors such as tax rate probability of being audited, tax penalty; psychological factors such as norm, moral, attitude of taxpayers; social factors such as demographic factors ( Brook, 2001) and tax Administrative factors such as probability of detection, complexity of tax system, public service . Allingham and Sandmo (1972) were the first researchers to conduct empirical analysis into compliance behavior of taxpayers and they came up with a model which became known as A- S model. In the model, the compliance decision of taxpayers is considered to be

affected by income of the taxpayer, tax rate, probability of audit, and fine rate. Later, the new model introduced by (Alm, 1991; Jackson & Millron, 1986). Therefore, the authors underplayed the influence of psychological and social factors including the demographic characteristics on taxpayers' behavior.

#### **2.1.1.2.1 Tax audit relation to Education**

How education changes the behavior of an individual? The basic goal of most education programs is directed towards behavioral change. Being the case behavioral analytical theories of change and learning theories can best explain how education can change the behavior of an individual (Svetna and Taumo, 2007). Change theory is to predict behavior change, which assumes that when the problem relating to behavior exists; there should be modifiable factors that contribute to the problem. Some of the modifying factors are knowledge, attitudes, intentions, interpersonal support, organizational and environmental conditions. The theory assumes that education is fundamental, in bringing about change in the modifiable factors, and the tax payer education is expected to change this behavior. Education changes the behavior of an individual by affecting the way he or she makes decisions (Denis and Mehila, 2002). It has the significant positive impact on the behavior change of individual (Campbell, 2008).

There is a positive relationship between taxpayer education and voluntary tax compliance (Kassipillai, 2003). Taxpayer education will provide the necessary tax knowledge to comply with the tax matter and change the perceptions and attitudes towards tax-compliance by creating more positive attitudes. This was confirmed in a study carried out among the undergraduate students in the University of Malaysia. Using the questionnaires administered to the students, at the beginning of the semester, to test the compliance attitudes, before studying taxation subjects, and their responses were all recorded. At the end of the semester, another set of questionnaires, were administered to test the compliance attitudes, after acquiring the tax knowledge. The statistical findings confirmed the prevalence of the significant positive relationship between the level of taxpayer education and the level of the voluntary tax compliance. However there is need to conduct similar study currently, because the above study was conducted more than 5 years ago, using environment different from Tanzania's, and the sample selected for the study was university students, who were not really in business operations. Lin and Carrol (2000), conducted a study to determine how enhanced tax knowledge and tax attitudes, affects the

compliance behavior among the taxpayers in New Zealand. Analyzing the compliance behavior of the taxpayers after acquiring the tax knowledge did not have significant relationship with tax compliance behavior. There is need to carry out similar study in \Tanzanian environment, because the findings of the study were carried out in an environment most likely different from the Tanzanian in the year in 2000. Rasshid and Noor (2004), conducted a study to evaluate the influence of tax knowledge on the tax compliance behavior among the taxpayers in Malaysia. The objective of the study was to investigate the effect of the presence of tax knowledge and understanding, on the level of tax compliance behavior. Analyzing the data collected using questionnaires, to compare the compliance behavior of taxpayers with significant level of tax knowledge with those without tax knowledge. Statistical findings, confirmed that those with tax knowledge, had higher level of compliance than those without. The results indicated a significant relationship between the level of tax knowledge and the level of tax compliance. Nevertheless there is need to carry out similar study presently, because the environment, in which the study was carried out, is different, and the study only compared the behavior of those taxpayers with significant level of tax knowledge to those without tax knowledge. The study to be conducted need to establish and incorporate the relationship between the levels of tax compliance. Normala (2007), conducted a study to examine the influence of tax education, as a proactive approach to enhance the voluntary tax compliance, among the taxpayers, in Malaysia. There as a move from the official assessment of taxes, to self-assessment system, in 2004. Under the self-assessment system, tax payer has to his tax liability, pay taxes to revenue authority, later on the revenue authority conducts audit to establish the accuracy of the declarations in returns and payment. This system requires high voluntary tax compliance. Using questionnaires administered to the taxpayers and the tax officials, the respondents confirm the increase in the tax knowledge increase the level of voluntary tax compliance.

#### **2.1.1.2.2 Resources for the Tax Audit Function**

Revenue bodies typically have at their disposal a finite level of resources to conduct the day to day business of revenue administration. Given the many tasks to be performed and the inevitable decisions that must made on priorities, a process is required to determine how those resources are to be allocated. In some member countries, revenue bodies have relatively limited discretion as to how staff resources are to be spread across the various areas of work, while in others broad discretion is given to senior management on how resources are to be allocated. (Eugene,2011)

Regardless of how the overall budget of resources for audit work is arrived at a key issue for the audit function is how those resources have been spread over the various segments of taxpayers. Determining how resources might best be allocated is a key element of a revenue body's strategy for compliance improvement and is dealt with in the following section (1) Forum on Tax Administration's Compliance Sub-group and (2) Tax Administrations in OECD and Selected Non-member Countries: Comparative Information Series (2006).

#### **2.1.1.2.3 Tax Rate**

Tax Rate is one of the economic factor affect to tax compliance decision. Therefore need to discuss, how tax rates influence taxpayers' decision to comply with tax laws. Clotfelter (1983) claimed that "reducing tax rates is not the only policy that has the potential to discourage tax evasion" (p. 363) but the tax rate is an important factor in determining tax compliance behavior although the exact impact is still unclear and debatable (Kirchler, 2007:114) Raising marginal tax rates has been likely to encourage taxpayers to evade tax more (Whitte 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) .

#### **2.1.1.2.4 Probability of Being Audited**

Tax audit is one of the most effective policies to protect the behavior of tax evasion. The level of tax audit can be determined by two elements: one is how many taxpayers are selected for audit and the second is how much intensive the audit is. The first element is easily measured by the number of audited taxpayers divided by the total number of taxpayers. However, the second element is so difficult to measure due to no published information about the process of tax audit. Tax audits, audit rates and prior audit experience have been ambiguously discussed in relation to tax compliance. Some studies claimed that audits have a positive impact on tax evasion (See Jackson and Jaouen, 1989; Shanmugam, 2003; Dubin, 2004). Butler (1993) also found that tax audits can change compliance behavior from negative to positive. These findings complement the Witte and Woodbury (1985) and the Beron, Tauchen and Witte (1988) studies. Witte and Woodbury in their study of small proprietors found that tax audits have a significant role in tax compliance. They did not empirically test individual taxpayers, thus left open room to conduct research in this area. While Butler (1993) and Witte and Woodbury (1985) found significant

results, Beron et.al. (1988) found a contradictory result. They reported that audits did not significantly correlate with evasion for all groups they studied.

Bergman (1998) investigated 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.

## **2.2 Empirical Studies**

In this part the researcher tried to revise some researches which are done in different countries in the area of tax audit and has summarized as follows.

### **2.2.1 Corruption And Tax Audit**

Burcu Gediz Oral and Ferhan Sayın, (2015), Aiming to determine the relationship between corruption and tax auditing during the period of 1985-2011 in Turkey, the study determines the relationship between the variables using the Vector Autoregressive (VAR) Analysis. The results from VAR Granger Causality Test indicate that audit rate variable has an impact on the corruption index and also corruption index variable on the share of the tax revenues in the general budget revenues. The Variance Decomposition Analysis results used in order to determine the most effective of the variable on those in the model show that corruption variable acts as an exogenous variable in the short-term. In other words, corruption is not affected by other variables in the short term. Changes in index of corruption are largely due to the corruption itself and audit rate in the long term. However, results of Impulse-Response Analysis to show whether the effective variable could be used as an effective policy instrument indicate that variable likely to be in audit rate could be positively effective for the mid-term while it could decrease in the long run. In other words, the tax audit reduces corruption in the long term.

### **2.2.2 Tax Audit and Voluntary Compliance**

Niu (2010) in his study found, a positive association between the audit and the voluntary compliance. The finding suggests that the audit productivity may be under estimate in many studies in the literature. It reminds us that when considering the productivity of the audit work. Besides the direct audit collections, we should also take the audit impact on the voluntary compliance into consideration. For this reason, the finding may provide tax professionals and tax

authorities with incentives to strengthen the audit power and to better structure their audit Organization to Generate More Revenue for the State.

### **2.2.3 Tax Audit and Tax Compliance**

According to, Badara, M.S. (2012) Questionnaire distributed to forty-eight (48) respondents using descriptive statistics. The result shows that the Relevant Tax Authority (RTA) employed tax audit towards achieving target revenue, that tax audit reduce the problems of tax evasion, that tax payers do not usually cooperated with tax audit personnel during the exercise. There are several theoretical and empirical studies on tax audit and tax compliance. These studies provide mix reactions on the relationship between tax audit and tax compliance.

### **2.2.4 Experimental Methods**

J.Alm and McKee, (2006) investigates the application of experimental methods to examine the individual compliance responses to a “certain” probability of audit, and conclude that the compliance rate rises if an individual knows he has been audited and the rate falls if he knows he will not be audited.

Slemrod et al, (2001) examines randomly selected taxpayers and inform them that their filling has been “closely examined” and found evidence of taxpayers’ behavior changes in response to an increased probability of audit, although the responses are not uniform among different groups of taxpayers.

Mittone (2006) investigates that early experience of audits in taxpayers’ “tax life” is a more effective way to increase compliance than later audits. Also Kastlunger et al, (2009) study of experimental research also suggests that, although the effectiveness of audits and fines cannot be completely confirmed, early audits in taxpayers’ “tax life” have a positive impact on compliance.

According to Kleven et al (2010), 40,000 individual tax filers using experimental design and randomization test and SKAT’s Business object Database with ordinary least square. Their research found that tax evasion rate is small for income subject to third party reporting, but substantial for self-reported income; marginal tax rates have a positive impact on tax evasion, but that this effect is small; prior audits substantially increase self-reported income and threat of audit letters also have a significant effects on self-reported income, and the size of this effect depends positively on audit probability expressed in the letter. Hyun (2005) Japan & Korea using

world value survey dataset and descriptive statistics and multiple regressions for analysis. Japan has the higher level of tax culture than that of Korea; and the legal system is relatively more important factor to determine the level of tax culture which eventually affects the level of compliance.

### **2.2.5 Tax Audit and Investigations**

Adediran S. A., Alade S. O and Oshode,(2013) , examines the impact of tax audit and investigations on revenue generation in Nigeria. The aim is to determine if tax audit and investigations can actually increase the revenue base of the government and if it can also stamp out the incidence of tax evasion. Data were collected through the primary sources from four hundred and ten respondents who are staff of the Federal Inland Revenue Service and Edo State Board of Internal Revenue. Hypotheses formulated were tested with Pearson Correlation Coefficient using SPSS output data. The findings are that Tax audit and investigations can increase the revenue base of the government and can also stamp out the incidents of tax evasion in the country. It is recommend that assessment of Tax audit shall be carried out more often and as thorough as possible to accomplish its task of increasing the revenue base and stamping out tax evasion in the country.

### **2.2.6 Education and voluntary tax compliance**

There is a positive relationship between taxpayer education and voluntary tax compliance (Kassipillai, 2003). Taxpayer education will provide the necessary tax knowledge to comply with the tax matter and change the perceptions and attitudes towards tax-compliance by creating more positive attitudes. This was confirmed in a study carried out among the undergraduate students in the University of Malaysia. Using the questionnaires administered to the students, at the beginning of the semester, to test the compliance attitudes, before studying taxation subjects, and their responses were all recorded. At the end of the semester, another set of questionnaires, were administered to test the compliance attitudes, after acquiring the tax knowledge. The statistical findings confirmed the prevalence of the significant positive relationship between the level of taxpayer education and the level of the voluntary tax compliance.

### **2.2.7 Tax rate in relation to compliance**

Tax rate is an important factor in determining tax compliance behavior although the exact impact is still unclear and debatable (Kirchler, 2007). According to Clotfelter (1983) revealed that reducing tax rates is not the only policy that has the potential to discourage tax evasion.

### **2.3 Researchable Gaps from the Theoretical and Empirical Review**

To conclude up, the overall argument above on the Tax audit is a current issue for both developing and developed countries. In the theoretical review, to the knowledge of the researcher, there is no standard as to the percentage of audit methodologies to be conducted in a given tax authority. In addition, there is no adequate literature regarding the appropriate audit examination techniques to be used for checking the accuracy of tax returns in line with the level of economy and technological advancement. The empirical studies that have been reviewed in the preceding section (focused on the different audit strategies that affect tax compliance behavior, income tax in particular, and the use of sampling tax audit strategy for improving the tax audit coverage. In addition, most prior studies regarding tax audit issues tried to examine the possible audit strategies including the use of audit information for the purpose of compliance improvement and fraud detection, and the impact of component reporting requirements on taxpayer incentives to misstate the tax liability.

However, as far as the knowledge of the researcher is concerned, it is possible to conclude that although there is some studies on tax audit related issues both in developed and developing countries, Ethiopia in particular, the studies did not explore assessment in tax audit thoroughly though some is say about the praactices. Most of those studies has make a little effort to address on issues related to praactices of tax audit, and major issues that focus on competences of tax auditors has not well elaborate. Based on these gaps in the literature together with the problems stated in this literature, and in order to attain: How the effect of tax audit on tax compliance in Burayu City Administration with respect to: education used; resources of the tax audit function; tax rate and probability of being audited of tax audit.

### **2.4 The Conceptual Framework of the Study**

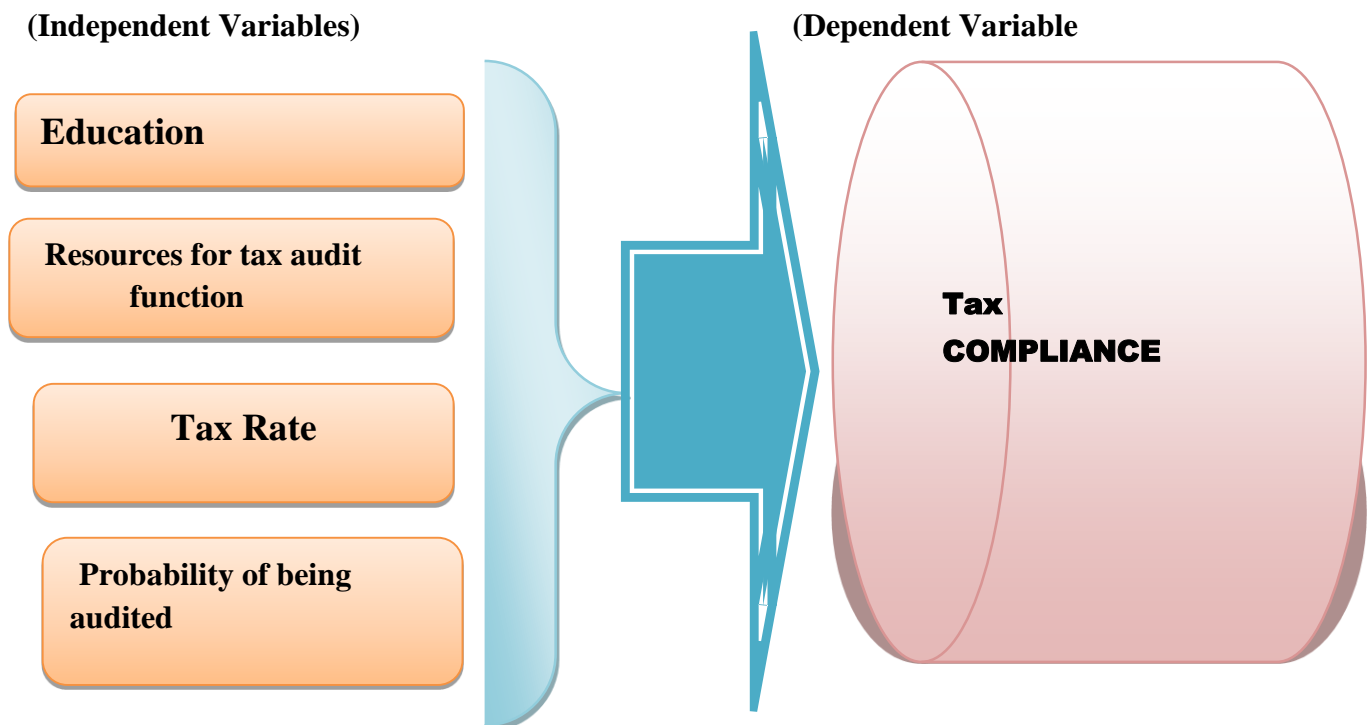
The major objective of this panel study is to investigate the effects of tax audit on tax compliance in BCARA. The study concerned to assess effects of tax audit on tax compliance that tax auditors consider in their law applications for BCARA. Specifically, the study assess whether the

tax compliance is influenced by education, resources for tax audit function, tax rate and probability being audited the revenue authority in the country. The framework is usually used to explain the relationship between the independent variables and the dependent variables of the study. **Major Components of Tax Audit selected are the following:**

- Education
- Resources for the tax audit function
- Tax rate
- Probability of being audited

In this study, basically the practices of tax audit are considered as the major variable under investigation. It begins investigating how the tax audit on tax compliance is practiced in Burayu City Administration Revenue Authority with respect to: Tax audit education used; resources of tax audit function; tax rate and probability of being audited of tax audit.

**Figure 2.1 The conceptual frame work of Research Hypotheses and Variables**



**Source:** Modified from extensive review of the related literature by researcher

## **CHAPTER THREE**

### **3 Research Design and Methodology**

#### **3.1 Research Design**

In order to identify the effect of tax Audit on tax compliance, case study, experimental or longitudinal design are not suitable but cross-sectional design capable to do so. A cross-sectional design is employed for a data collected and analyzed more than one case at a single time. The pattern of association is then examined by using the collected quantitative or quantifiable data. Therefore, this feature is relevant to this study. Because, the data in this study has not been collected in stages but carried out in a single time period and finally there is a relative large sample size in the study.

#### **3.2 Research Approach**

There are two types of research approaches such as deduction and the induction approach. The study used deduction approach because the conceptual framework is built based on the previous studies. A deduction approach adopts current theories and concepts to justify research relationships. Deductive approach is searching for an explanation of the causal relationships between variables by collecting data in most cases using a quantitative method. It also helps in generalizing from the chosen sample to the whole population.

#### **3.3 Research Method**

There are three common approaches to conduct a research thesis in the area of business and social sciences namely; quantitative, qualitative, and mixed research approaches. Quantitative method is an objective and systematic process in which pieces of numerical data are used to obtain information about the world and which are analyzed by using mathematical methods. It is also used to test a theory by identifying the variables based on the previous studies, examining the research relationships and obtaining the findings. It can generalize research findings when the study collects data from a random sample which represents its population and it has sufficient sample size. Quantitative method can also achieve greater objectivity and more accurate results if we comparing with the other methods. It depends on a few variables and it follows many tools in order to test the validity and reliability of the data. Therefore, in

order to achieve the objectives of this study and thereby to give answer for its problems, quantitative research approach was used by the researcher.

### **3.4 Research Strategies**

Research strategies help researchers to provide data that can answer the research questions or achieve the research objectives. There are many types of research strategies, depending on the types of data that the researcher wants to collect and analyze, such as experiment, survey, case study, action research and grounded theory. However, this study employed survey strategy because the data collected from as such kinds of strategy can be used to suggest a possible explanation of the relationship between the study variables. Furthermore, the survey is the most relevant to the study which follows deduction approach and quantitative method.

### **3.5 Data Sources and Collection Method**

#### **3.5.1 Sources of Data**

Sources of data for this study were primary and secondary data sources. These are primary data were obtained through survey questionnaire and secondary data were obtained from various books, articles and research journal that helps that the researcher to have more insights about effect of tax audit on tax compliance at the study area.

It constitutes a blue print for the collection, measurement, and analysis of data. The research design in this study was descriptive research design. Descriptive studies are non-experimental researches that describe the characteristics of a particular individual, or of a group. It deals with the relationship between variables and development of generalizations and use of theories that have universal validity. It also involves events that have already taken place and may be related to present conditions (Kothari, 2004).

#### **3.5.2 Data Collection Technique**

From the strategies of inquiry associated with quantitative methods, survey method was adopted in this study. It enables the researcher to test objective theories in the real world by constructing the cause and effect relationship between variables and promote the replication of research. In this study, this approach allowed the researcher to identify the effect of tax audit on tax compliance in Burayu City Administration Revenue Authority.

A questionnaire was considered as a key tool in collecting data and it is the most widely used tool in social research such as this study. It contains standardized questions whereby all respondents may understand these questions in the same way. Therefore, it is more suitable for descriptive or explanatory research and is inappropriate to exploratory research which requires many closed-ended questions. Hence, this study collected data using a questionnaire because the present study is an explanatory research. Data from the concerned study areas were collected using self-administered questionnaires which were hand-delivered and hand-collected.

### **3.5.3 Research Instruments**

The study incorporates both the secondary and primary data sources. The secondary data collected from the books, journals, articles, etc. that helps the researcher to have more insights about the effect of tax audit on tax compliance at the study area. The primary data collected from Tax auditors, Quality controllers, and head managers of main office and sub cities using structured questionnaires which are obtained by adoption from Tesfaye Bekele (2018) and Dasta Kasa (2010). Each questions starting from section three to section five has specific number of items which was presented in a Likert type-scale with a 5- point scale from 1 – “Strongly Disagree” to 5 - “Strongly Agree”

## **3.6 Subject of the Study**

### **3.6.1 Source of Study Population**

The source of population was the Tax Auditors, quality controllers and managers of main office and three sub cities of Burayu City Administration Revenue Authority.

### **3.6.2 Target Population**

The target population who participated in this research was: the current total number of 16 tax auditors, 5 Quality controllers; 4 head managers totally 25, workers in Burayu City Administration Revenue Authority.

### **3.6.3 Study Units**

The workers who were selected in the given positions from the Burayu City Administration Revenue Authority that full file the inclusion criteria.

### 3.6.4 Sampling

The respondents were purposively selecting the study unit because they are responsible for strategic decisions at tax audit at high level and to contribute to the quality of tax audit, and to review the report at its standards.

### 3.6.5 . Sampling Frame

The sampling frame of this study was list of Tax auditors, quality controllers and managers of main office and sub cities in BCARA.

### 3.6.6. Sample Size Determination

The sample population is from the current total number of Tax auditors, quality controllers; and Head managers in Burayu City Administration Revenue Authority main office and sub cities. The selected respondent of the population are as follows:

**Table3.1: The sample size selected distributed and collected populations**

s/n	Name of selected Authority	Revenue	Selected population from each	Total distributed	Collected
1	BCARA, Main office		<ul style="list-style-type: none"> <li>• Head manager</li> <li>• Auditors</li> <li>• Quality controllers</li> </ul>	1x1 5x1 5x1	1 4 4
2	BCARA, Gefersa Burayu sub city		<ul style="list-style-type: none"> <li>• Head manager</li> <li>• Auditors</li> </ul>	1x1 3x1 -	1 3 -
3	BCARA, Gefersa Nono sub City		<ul style="list-style-type: none"> <li>• Head manager</li> <li>• Auditors</li> </ul>	1x1 5x1	1 4
4	BCARA Authority, Burayu Keta Sub City		<ul style="list-style-type: none"> <li>• Head manager</li> <li>• Auditors</li> </ul>	1x1 3x1	1 3
<b>Total population</b>				25	22

NB: BCARA\_ Burayu City Administration Revenue Authority

As shown in table 3.1 above, based on the identified population number, was applied to identify the level taking into consideration their responsibility to control and manage the organization and risk area relative to revenue generations.

Finally, from the identified Revenue Authority (RA) and select Tax audit staff members and quality controller Departments as well as managers of the main and sub city offices was selected using by purposive sampling of their function weights for all tax audit staff and quality controllers; so managers at identified process. Therefore, from the distributed questionnaires 22 were collected rating to 88% respondents were tested.

### 3.7 Methods of Data analysis

After the data was collected, the following activities on data processing have been carried out. The raw data was converted into suitable form for analysis and interpretation. This was achieved through sequences of activities including editing, coding, entry, and tabulation. The objectives were to check the completeness, internal consistency and appropriateness of the answers to each of the questions. Finally, an analysis progress was developed using Statistical Package for Social Science (SPSS).

Mean standard deviation and non-parametric tests was used to analysis and find out the results. Moreover, the descriptive method of data analysis was important to analysis the demography of the sample in population at the study area in terms of age, educational background, work experience etc. of the respondents and overall population as well as the descriptive methods of statistical analysis like percentage, measures of central tendency and measures of dispersion were used to analysis the data.

### 3.8 Dependent variable

**Tax compliance:** The exact meaning of tax compliance has been defined in various ways. For example, Andreoni, Erard, and Feinstein (1998) claimed that tax compliance should be defined as taxpayers' willingness to obey tax laws in order to obtain the economy equilibrium of a country. Kirchler (2007) perceived a simpler definition in which tax compliance is defined as the most neutral term to describe taxpayers' willingness to pay their taxes. Compliance in pure administrative 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).

### 3.9 Independent Variables

There were various numbers of explanatory variables so far identified and have strong bond with the effect of tax audit on tax compliance in the study area. For the purpose of detail investigation and measurability the four explanatory variables are identified and discussed below.

**Education:** The basic goal of most education programs is directed towards behavioural change. Being the case behavioral analytical theories of change and learning theories can best explain how education can change the behavior of an individual (Svetna and Taumo, 2007).

Change theory is to predict behavior change, which assumes that when the problem relating to behavior exists; there should be modifiable factors that contribute to the problem. Some of the modifying factors are knowledge, attitudes, intentions, interpersonal support, organizational and environmental conditions. The theory assumes that education is fundamental, in bringing about change in the modifiable factors, and the tax payer education is expected to change this behaviour. Education changes the behavior of an individual by affecting the way he or she makes decisions (Denis and Mehila, 2002). It has the significant positive impact on the behaviour change of individual (Campbell, 2008). There is a positive relationship between taxpayer education and voluntary tax compliance (Kassipillai, 2003). Taxpayer education will provide the necessary tax knowledge to comply with the tax matter and change the perceptions and attitudes towards tax-compliance by creating more positive attitudes. This was confirmed in a study carried out among the undergraduate students in the University of Malaysia. Using the questionnaires administered to the students, at the beginning of the semester, to test the compliance attitudes, before studying taxation subjects, and their responses were all recorded. At the end of the semester, another set of questionnaires, were administered to test the compliance attitudes, after acquiring the tax knowledge. The statistical findings confirmed the prevalence of the significant positive relationship between the level of taxpayer education and the level of the voluntary tax compliance. However there is need to conduct similar study currently, because the above study was conducted more than 5 years ago, using environment different from Tanzania's, and the sample selected for the study was university students, who were not really in business operations. Lin and Carrol (2000), conducted a study to determine how enhanced tax knowledge and tax attitudes, affects the compliance behavior among the taxpayers in New Zealand. Analyzing the compliance behavior of the taxpayers after acquiring the tax knowledge did not have significant relationship with tax compliance behavior. There is need to carry out similar study in \Tanzanian environment, because the findings of the study were carried out in an environment most likely different from the Tanzanian in the year in 2000. Rasshid and Noor (2004), conducted a study to evaluate the influence of tax knowledge on the tax compliance behavior among the taxpayers in Malaysia. The objective of the study was to investigate the effect of the presence of tax knowledge and understanding, on the level of tax compliance behavior. Analyzing the data collected using questionnaires, to compare the compliance behavior of taxpayers with significant level of tax knowledge with those without

tax knowledge. Statistical findings, confirmed that those with tax knowledge, had higher level of compliance than those without. The results indicated a significant relationship between the level of tax knowledge and the level of tax compliance. Nevertheless there is need to carry out similar study presently, because the environment, in which the study was carried out, is different, and the study only compared the behavior of those taxpayers with significant level of tax knowledge to those without tax knowledge. The study to be conducted need to establish and incorporate the relationship between the level of tax compliance. Normala (2007), conducted a study to examine the influence of tax education, as a proactive approach to enhance the voluntary tax compliance, among the taxpayers, in Malaysia. There as a move from the official assessment of taxes, to self-assessment system, in 2004. Under the self-assessment system, tax payer has to his tax liability, pay taxes to revenue authority, later on the revenue authority conducts audit to establish the accuracy of the declarations in returns and payment. This system requires high voluntary tax compliance. Using questionnaires administered to the taxpayers and the tax officials, the respondents confirm the increase in the tax knowledge increase the level of voluntary tax compliance.

**Resources for the Tax Audit Function:** Revenue bodies typically have at their disposal a finite level of resources to conduct the day to day business of revenue administration. Given the many tasks to be performed and the inevitable decisions that must made on priorities, a process is required to determine how those resources are to be allocated. In some member countries, revenue bodies have relatively limited discretion as to how staff resources are to be spread across the various areas of work, while in others broad discretion is given to senior management on how resources are to be allocated. (Eugene,2011) Regardless of how the overall budget of resources for audit work is arrived at a key issue for the audit function is how those resources has been spread over the various segments of taxpayers. Determining how resources might best be allocated is a key element of a revenue body's strategy for compliance improvement and is dealt with in the following section (1) Forum on Tax Administration's Compliance Sub-group and (2) Tax Administrations in OECD and Selected Non-member Countries: Comparative Information Series (2006).

**Tax Rate** Tax Rate is one of the economic factor affect to tax compliance decision. Therefore need to discuss, how tax rates influence taxpayers' decision to comply with tax laws. Clotfelter (1983) claimed that "reducing tax rates is not the only policy that has the potential to discourage

tax evasion” (p. 363) but the tax rate is an important factor in determining tax compliance behavior although the exact impact is still unclear and debatable (Kirchler, 2007:114) Raising marginal tax rates has been likely to encourage taxpayers to evade tax more (Whitte 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)

**Probability of Being Audited;** Tax audit is one of the most effective policies to protect the behavior of tax evasion. The level of tax audit can be determined by two elements: one is how many taxpayers are selected for audit and the second is how much intensive the audit is. The first element is easily measured by the number of audited taxpayers divided by the total number of taxpayers. However, the second element is so difficult to measure due to no published information about the process of tax audit. Tax audits, audit rates and prior audit experience have been ambiguously discussed in relation to tax compliance. Some studies claimed that audits have a positive impact on tax evasion (See Jackson and Jaouen, 1989; Shanmugam, 2003; Dubin, 2004). Butler (1993) also found that tax audits can change compliance behavior from negative to positive. These findings complement the Witte and Woodbury (1985) and the Beron, Tauchen and Witte (1988) studies. Witte and Woodbury in their study of small proprietors found that tax audits have a significant role in tax compliance. They did not empirically test individual taxpayers, thus left open room to conduct research in this area. While Butler (1993) and Witte and Woodbury (1985) found significant results, Beron et.al. (1988) found a contradictory result. They reported that audits did not significantly correlate with evasion for all groups they studied.

Bergman (1998) investigated 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.

## CHAPTER FOUR

### 4. Data Analysis and Interpretation

The questionnaire which was prepared with Likert scale style distributed to 25 respondent of various department who has a position of Head managers, tax auditors and quality controller's workers.

#### 4.1. Demographic Characteristics of Respondent

As the table below depict that 11(50%) of the respondents were male while the remaining 11(50%) of the respondents were also female. From the above information we deduced that the respondents were male is equal female.

**Table 4. 1:** Sex of Respondent

Item	Sex category	Frequency	Percent
	Male	11	50.00
	Female	11	50.00
<b>Total</b>		<b>22</b>	<b>100</b>

Source: field survey

The survey result elaborated that 4(18.20%) of respondents age were laid in the category of equal or less than 30, then follow 15(68.20%) of respondents were at the age 31-40 and the left 3(13.60%) were 41-50. This implies that the majority of respondents were at their matured age group.

**Table 4.2:** Age (in year) of respondents

Item	Age Category	Frequency	Percent
	Less or equal to 30	4	18.20
	31-40	15	68.20
	41-50	3	13.60
<b>Total</b>			<b>100</b>

Source: Field Survey

Relatively the researcher gathered the information about the participants' educational background. As a result, 17(77.30%) of the participants have got their Bachelor degree,

5(22.70) of the participant have got their master’s degree. From this we can conclude that the majority of the participants of the study have got their Bachelor degree.

**Table 4.3 Educational back ground of Respondents**

<b>Item</b>	<b>Field of the study</b>	<b>Frequency</b>	<b>Percent</b>
Level of education	Bachelor Degree	17	77.30
	Master’s Degree	5	22.70
<b>Total</b>		<b>22</b>	<b>100</b>

Source: Field survey

The result indicated below revealed that the majority of the participants, 9(40.90%), have got a work experience of 11 to 15 years of age. Contrarily, few the participants, 2 (9.10%), worked above 15 years of age, 4(18.20%) Worked at 1 to 5 years of age, The reset 7(31.80%) participants have got the experience of 5 to 10 years. Thus, it is possible to conclude that the majority of respondents were having good medium work experience to give relevant information for this study variable.

**Table 4.4: work experience of respondents**

<b>Item</b>	<b>Years</b>	<b>Frequency</b>	<b>Percent</b>
Work Experience	1-5	4	18.20
	5-10	7	31.80
	11-15	9	40.90
	More than 15 years	2	9.10
<b>Total</b>		<b>22</b>	<b>100</b>

Source: Field survey

#### **4.2. Tax Audit relation to Education**

Under this topic, there are 5 hypothetical statements designed to test tax audit relation to education. From a result shown in the table below, primarily, the researcher interested to test whether Understanding and knowledge of tax related rules and regulation is applied or not. .But the result also recognized that tax audit has Understanding and knowledge of tax related rules and regulation the average Likert scaled value of that specific variable, 2.45 (SD±0.800), is less than mean value, 3. In that regard the calculated statistical significance value supposed to not

escalating, i.e., the probability of insignificance rises up. So, we reject the null hypothesis stated in the above result.

The second hypothetical statement which was included in the study was that the Experience and capacity on Tax audit functions is sufficient or not. Thus, probabilistic value is 0.059 which is greater than the usual statistical threshold value 0.05. From this it is possible to conclude that the Experience and capacity on Tax audit functions is average Likert scaled value of that specific variable, 4.00 (SD±0.926), is greater than mean value, 3. In that regard the calculated statistical significance value supposed to escalating, i.e., the probability of insignificance rises up. So, we accept the null hypothesis stated in the above result.

The third hypothetical statement which was included in the questionnaires was that Attitude towards Tax payers or not. The average Likert scaled value of that specific variable, 2.14 (SD±0.990), is less than mean value, 3. In that regard the calculated statistical significance value supposed to not escalating, i.e., the probability of insignificance rises up. So, we reject the null hypothesis stated in the above result.

The fourth hypothetical statement designed to describe Team-work and working in collaboration among themselves or not. Consequently, the average Likert scaled value of that specific variable, 2.18 (SD±1.053), is less than mean value, 3. In that regard the calculated statistical significance value supposed to not escalating, i.e., the probability of insignificance rises up. So, we reject the null hypothesis stated in the above result.

The fifth hypothetical statement which was included under the below table describe the Effort made to improve their knowledge and skills, i.e., it hypothesized that whether Effort made to improve their knowledge and skills or not. As a result, the average Likert scaled value of that specific variable, 2.36 (SD±1.136), is less than mean value, 3. In that regard the calculated statistical significance value supposed to not escalating, i.e., the probability of insignificance rises up. So, we reject the null hypothesis stated in the above result.

This result is in agreement with the study done by (Kassipillai, 2003) which examine There is a positive relationship between taxpayer education and voluntary tax compliance. Taxpayer education will provide the necessary tax knowledge to comply with the tax matter and change the perceptions and attitudes towards tax-compliance by creating more positive attitudes. This was confirmed in a study carried out among the undergraduate students in the University of Malaysia. Using the questionnaires administered to the students, at the beginning of the semester, to test the compliance attitudes, before studying taxation subjects, and their responses were all recorded. At the end of the semester, another set of questionnaires, were administered to test the compliance attitudes, after acquiring the tax knowledge. The statistical findings confirmed the prevalence of the significant positive relationship between the level of taxpayer education and the level of the voluntary tax compliance. Similarly, Niu (2010) in his study found, a positive association between the audit and the voluntary compliance. The finding suggests that the audit productivity may be under estimate in many studies in the literature. It reminds us that when considering the productivity of the audit work. Besides the direct audit collections, we should also take the audit impact on the voluntary compliance into consideration. For this reason, the finding may provide tax professionals and tax authorities with incentives to strengthen the audit power and to better structure their audit Organization to Generate More Revenue for the State.

**Table 4.5: Tax audit relation to Education**

No	Hypothetical Statement	Mean	SD	Chi-Square	Degree of freedom	Asyp.sig (P-value)
1	Understanding and knowledge of tax related rules and regulation	2.45	.800	9.273a	2	.026*
2	Experience and capacity on Tax audit functions	4.00	.926	7.455a	3	.059*
3	Attitude towards Tax payers	2.14	.990	6.000a	3	.112*
4	Team-work and working in collaboration among themselves.	2.18	1.053	2.000a	3	.572*
5	Effort made to improve their knowledge and skills	2.36	1.136	8.000b	4	.092*

\* Significant with 0.05 level of significant, Source: Field survey

### 4.3 Resources for the tax audit function

**Table 4.6** illustrate about the resources for the tax audit function. To identify the significant factor, the researcher was hypothesized different hypotheses. The first hypothesis stated that whether the there were well organized structure and suitable office for tax audit function or not. As a result, the average Likert scaled value of that specific variable, 2.23 ( $SD\pm 0.685$ ), is less than mean value, 3. In that regard the calculated statistical significance value supposed to not escalating, i.e., the probability of insignificance decline. So, we reject the null hypothesis stated in the above result.

The second result also indicated that Tax audit has enough human resources to perform audits on all tax payers. Because, under the considered statistical significance valve, 0.005, the threshold value 0.05 is lesser. So, we reject the null hypotheses which stated that tax audit has enough human resources to perform audits on all tax payers.

The result also recognized that tax audit has enough human resources to perform audits on all tax payers with sufficient, reliable and relevant reports about the work they perform and recommendations made. Since, the average Likert scaled value of that specific variable, 2.18 ( $SD\pm .853$ ), is less than median value, so, we reject the null hypothesis stated in the above result.

The study reached in a conclusion that the required budget for tax audit was sufficiently allotted every year. Because, the mean Likert scaled value of that specific variable (2.45) is of the median reference point with a minimum standard deprivation (1.101). In that regard the chi-square statistical significance value (.545) escalating up. So, we are supposed to reject the null hypothesis which stated that the required budget for tax audit was sufficiently allotted every year is reasonable.

Similarly, the study result identified that Computers and appropriate digital technology required for tax audit are assessed at this office of the authority. Because, the calculated chi-square value is a (8.909); so, the p- value enforced to decline (0.031). In that reason, the usual statistical rejection value (0.05) comes to higher than that of the p-value. So, we rejected the hypothesis which stated that Computers and appropriate digital technology required for tax audit are assessed at this office of the authority

**Table 4.6: Resources for the tax audit function**

No	Hypothetical Statement	Mean	Standard deviation	Chi-Square	Degree of freedom	Asyp.sig (P-value)
1	There were well organized structure and suitable office for tax audit function	2.23	.685	4.455c	2	.108*
2	Tax audit has enough human resources to perform audits on all tax payers	2.30	.974	15.043d	4	0.005*
3	There are enough material and equipment required for tax audit	2.18	.853	6.364	3	.095*
4	Required budget for tax audit was sufficiently allotted every year	2.45	1.101	.545a	3	.909*
5	Computers and appropriate digital technology required for tax audit are assessed at this office of the authority	2.32	.839	8.909	3	.031*

*\*Statistical significance test value – 0.05*

### **4.3. Probability of being audited**

As the below table indicate, the first hypothetical statement is “Strengthening legal enforcement and penalties.” So, the average Likert scaled value of that specific variable, 2.18 (SD±0.907), is less than mean value, 3. In that regard the calculated statistical significance value supposed to not escalating, i.e., the probability of insignificance decline. So, we reject the null hypothesis stated in the above result.

The result identified that improving relationship with the public. Against 0.05 level of confidence and 0.036 calculated significance value.

The analytical result revealed that Educating the tax payers and conducting consultation session or not; we have enough evidence that the tax auditors do not undertake continuous educating the tax payers and conducting consultation session. Because, the mean Likert scaled value of that specific variable (3.95) is higher than that of the median reference point with a minimum standard derivation (.999). In that regard the chi-square statistical significance value (7.455) escalating up. So, we are supposed to accept the null hypothesis which stated that the Educating the tax payers and conducting consultation session.

The next hypothetical statement which is included under this study is “Providing necessary information to tax payers regarding the provision of services and utilization of tax revenues.” So, the average Likert scaled value of that specific variable, 2.27 (SD±0.827), is less than mean value, 3. In that regard the calculated statistical significance value supposed to not escalating, i.e., the probability of insignificance decline. So, we reject the null hypothesis stated in the above result.

This implies that providing necessary information to tax payers regarding the provision of services and utilization of tax revenues. The researcher also wants to check whether Reducing tax rates and making the collection procedures simple and transparent or not. As a result, t the average Likert scaled value of that specific variable, 2.36 (SD±0.902), is less than mean value, 3. In that regard the calculated statistical significance value supposed to not escalating, i.e., the probability of insignificance decline. So, we reject the null hypothesis stated in the above result.

**Table 4.7: probability of being audited**

No	Hypothetical Statement	Mean	SD	Chi-Square	Degree of freedom	Asyp.sig (P-value)
1	Strengthening legal enforcement and penalties	2.18	.907	5.273a	3	.153*
2	Improving relationship with the public	2.36	.902	9.273a	3	.026*
3	Educating the tax payers and conducting consultation session	3.95	.999	7.455a	3	.059*
4	Providing necessary information to tax payers regarding the provision of services and utilization of tax revenues	2.27	.827	7.455a	3	.059*
5	Reducing tax rates and making the collection procedures simple and transparent	2.36	.902	4.909a	3	.179*

\*Statistical significance test value – 0.05

#### 4.4. Tax rate

**Table 4.8** deals about tax rate. There are five hypothetical statement designed to assess the tax rate.

The study reached in a conclusion that the Tax payers should evade tax if tax rates are too high. Because, the calculated chi-square statistical tests value is a bit higher (10.727) with a 3 degree of freedom; the average Likert scaled value of that specific variable, 4.09 (SD±0.811),

is greater than mean value, 3. In that regard the calculated statistical significance value supposed to escalating, i.e., the probability of insignificance rises up. So, we accept the null hypothesis stated in the above result.

Similarly, the study result identified that the Tax payers should evade tax if the tax system is unfair. Because, the average Likert scaled value of that specific variable, 4.1364 (SD±0.63960), is greater than mean value, 3. In that regard the calculated statistical significance value supposed to escalating, i.e., the probability of insignificance rises up. So, we accept the null hypothesis stated in the above result. The Tax payers should evade tax if the tax system is unfair.

The hypothetical statement which was included under the below table described that tax payers should evade tax if a large portion of the money collected from tax is wasted. As a result, the calculated significant value is 0.006 which is less than the usual statistical rejection threshold value 0.05. This implies that the tax audit obtains sufficient to Tax payers should evade tax if a large portion of the money collected from tax is not wasted.

The next hypothetical statement which was included under this study is either Tax payers should evade tax if the probability of getting caught is low or not; under 0.05 level of significance consideration. Thus, the result significant value is 0.022 that, of course, tax payers should not evade tax if the probability of getting caught is low.

The next hypothetical statement which is included under this study is “Evading tax due to lack of ability to pay should not be considered as crime or problem” So, the calculated the statistical significance values 0.042 which was less than the usual statistical significance rejection value 0.05. This implies that there is no evading tax due to lack of ability to pay should not be considered as crime or problem.

This result is in agreement with the study done by (Kirchler, 2007). Tax rate is an important factor in determining tax compliance behavior although the exact impact is still unclear and debatable According to Clotfelter (1983) revealed that reducing tax rates is not the only policy that has the potential to discourage tax evasion.

**Table 4.8: Tax rate**

No	Hypothetical Statement	Mean	Standard deviation	Chi-Square	Degree of freedom	Asyp.sig (P-value)
1	Tax payers should evade tax if tax rates are too high	4.09	.811	10.727	3	.013*
2	Tax payers should evade tax if the tax system is un fair	4.136 4	.63960	7.182	2	.028*
3	Tax payers should evade tax if a large portion of the money collected from tax is wasted	2.227 3	.75162	12.545	3	.006*
4	Tax payers should evade tax if the probability of getting caught is low	2.318 2	.77989	9.636	3	.022*
5	Evading tax due to lack of ability to pay should not be considered as crime or problem	1.954 5	.84387	8.182	3	.042*

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\*Statistical significance test value – 0.05

## **CHAPTER FIVE**

### **5. Conclusions and Recommendation**

#### **5.1 Conclusion**

The purpose of this study was to identify the effect of Tax Audit on Tax Compliance in the case of Burayu City Administration Revenue Authority. Purposive sample selection technique is employed and collected data for the following concerned bodies such as: Tax Auditors, Quality controllers of main office and head managers of sub cities, as well as Main office Of BCARA. The questionnaire has two sections. Section **1** was deals about the personal profiles and section **2** was about Tax Audit on tax compliance context.

Regarding education , experience and capacity on tax audit function of Tax Auditors, the findings of this study indicated that, majority of them were assigned to their current jobs through internal transfer, and by recommendation of Authorities of the City. Moreover, majority of the Auditors did not attend any training programs related to their current job during the past years of their services at city. Yet, the results of this study revealed that, there is no a well-established strategies that make Tax Auditors competent and efficient on their job on continuous bases.

The result indicated lack of experience and capacity of the tax auditor's tax audit department may cause the delay in auditing work. Even if the experience of the workers is a bit high, most of the participants engaged indirect stream subjects. With all these fact, it can be assumed that the effect of tax audit on tax compliance in a given Authority have relatively still need improvement. The Authority had faced a problem in having enough experienced employee (particularly Tax Auditors).From these we deduced that the Authorities still tied by grate experience and capacity of Tax auditor's problem.

With regard to the availability of resources for the tax audit function, the responses obtained from questionnaire indicated that, the Authority was arranged and organized tax audit function using appropriate digital technology required for tax audit at City Administration level. Moreover, respondents were rated highest scores regarding the availability of enough materials

and equipment's required for tax audit programs at BCARA. Overall, the results of this study clearly indicated that, there is no problem in resources for the tax audit function.

With regard to probability of being audited, the study has revealed that educating the tax payers and conducting consultation session; Educating taxpayers: Audits can assist to clarify the application of the law by every taxpayer and to identify improvements required in book keeping and thus may contribute to improved compliance by taxpayers in the future. Identify areas of the law that require clarification: Audits may bring to light areas of the tax law that are causing confusion and problems to large numbers of taxpayers and thus require further efforts by the revenue body to clarify the laws' requirements and/or to better educate taxpayers on what they must do to comply into the future. Given the broad range of roles to be performed a revenue body's audit program typically entails the largest allocation of a revenue body's total staff resources. From this perspective alone, the audit program represents a sizeable strategic investment that dictates the need for sound management policies and practices.

Since some tax payers are not educated and they don't understand the purpose of paying tax, they are not committed to pay tax rather they tried to avoid. So, tax audit will teach such tax payers about the purpose of paying tax and helps to develop their bad taxpaying experience and helps them to be a good tax payer in the future. (Help to apply modern tax collection system through educational process.)

With regard to the study reached in a conclusion that the Tax payers should evade tax if tax rates are too high. Because, the calculated chi-square statistical tests value is a bit higher (10.727) with a 3 degree of freedom; due to a large average beyond the reference median value with a minimum standard deviation. In that regard we are supposing to accept the null hypothesis which stated that Tax payers should evade tax if tax rates are too high.

From this response it is clear that the tax rate is not based on the ability-to-pay principle or it is perceived to be unfair by taxpayers. Even though the principle says, tax should be based on the ability- to pay; the problem here is in determining this 'ability' for each taxpayer. the communication gap between the tax authority and taxpayers might have created this perception (i.e., the tax rates are too high) and it continues to be the issue as far as the understanding of the taxpayers regarding tax rates, assessment, calculation etc is low.

This problem is the central problem as far as tax compliance is concerned and it is related with variety of factors.

The study also indicated that almost all of the respondents do not feel paying tax is unfair but they suggest the amount that they pay has to be fair and based on their ability to pay. In addition to this, majority of the respondents agreed that every tax payer has a moral obligation to respect the tax law

## 5.2. Recommendation

Based on the above finding (conclusion) the following recommendation was made.

- ❖ The BCARA, other concerned government body and stake holders should work to the education, experience and capacity on tax audit functions internal Audit. To make tax Audit staffs sufficiently experienced and capacity on tax audit functions.

**Education:** According to the finding of this study, non-experienced and lack of capacity on tax audit function among Tax Auditors of the office have been affecting efficiently performing duties and responsibilities to be accomplished by them at Burayu City Administration Revenue Authority. Moreover, majority of them were assigned to their current jobs through internal transfer, and by recommendation of Authorities of the Region. So, Burayu City Administration Revenue Authority have to work to assign those individuals competent and qualified on Tax Auditor job positions is highly recommended.

- ❖ The BCARA, other concerned government body and other stakeholders should work to effective probability of being audited to educating the tax payers and conducting consultation session.

**Educating tax payers:** Awareness rising should be provided to the tax payers by the BCARA in order to create awareness about their rights and obligations so as to build and develop a better partnership with them and also to create citizens who have better understanding of taxation which will engender honest and voluntary compliance.

- ❖ The BCARA, other concerned government body and other stakeholders should work to make effective tax rate through tax payers should evade tax if tax rates are too high and if the system is unfair.

In addition to this, efficient service delivery to taxpayers is a key factor against which the strength of the authority is judged. Taxpayers tend to evade to the extent they feel that the authority is weak and unable to enforce the law. This directly hampers the compliance behavior of compliers and motivates non compliers to continue evading and if the system is unfair. Hence, to create an efficient tax administration, the tax authority needs to strengthen itself by educating and training its employees, by computerizing its operations and by devoting additional resources. Training should include customer service training and cross functional training for employees so that they can have an understanding of the entire system of tax administration.

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## Annex 1: Research Questionnaire



*College of Business and Economics*

*Department of Accounting and Finance*

*Program of Accounting and Auditing Questionnaire*

### **Dear Participants**

The title of this thesis is “**The effect of Tax Audit on tax compliance**” in the case of Burayu City Administration Revenue Authority. The name of the researcher is **Gelete Tolina** who is currently studying an MSc in Accounting and Auditing student in Addis Ababa University.

The aim of this thesis is to assess the effect of Tax Audit on Tax compliance: In the case of Burayu City Administration Revenue Authority. This questionnaire is prepared to supplement the data obtained from respondents as sources for the paper.

This survey questionnaire is being distributed to get relevant information from randomly selected respondents and participation is totally voluntary. The investigator respectfully requests your kind cooperation in answering the whole question as frankly as possible and your response will be recorded anonymously and strict confidentiality will be maintained. For further information, please contact using the following address:

Tel. (mobile): +251 912073044; E-mail: [geletetolina@gmail.com](mailto:geletetolina@gmail.com)

**N.B** please give your answer on the space provided & put tick a mark in the box corresponding to your response.

## Personal Information

### Section 1 : Background information of the Respondents

- 1. Gender:** 1. Male ( ) 2. Female ( )  
**2. Age:** 1. Less than or equal to 30 years ( ) 2. 31-40 years ( ) 3. 41-50 years ( ) 4. Above 50 years ( )

### 3. Educational Background:

Qualification	Responses	Remarks
Certificate		
Diploma		
Bachelor's Degree		
Master's Degree		
Others (specify)		

### 4. Your Work Experiences

Duration	Responses	Remarks
1-5 years		
6-10 years		
11-15 years		
Above 15 years		
Others (specify)		

### 5. Current Position:

1. Tax Auditor   
2. Manager   
3. Quality controller   
4. Others (Please specify) \_\_\_\_\_

## Section 2: About Tax Audit on tax compliance context

### 1. Tax audit relation to Education

Ser No	Description	Strongly agree	Agree	Neutral	Disagree	Strongly disagree
1	Understanding and Knowledge of Tax related rules					

	and regulation					
2	Experience and capacity on Tax audit functions					
3	Attitude towards Tax payers					
4	Team-work and working in collaboration among themselves					
5	Effort made to improve their knowledge and skills					

Hint: used likert scale 5- Strongly agree 4-Agree - 3- Neutral 2-Disagree 1-Strongly Disagree

## 2. Resources for the tax audit function

Ser No	Description	Strongly agree	Agree	Neutral	Disagree	Strongly disagree
1	There were well organized structure and suitable office for Tax audit functions					
2	Tax audit has enough human resources to perform audits on all taxpayers					
3	There are enough material and equipment required for tax audit					
4	Required budget for Tax audit was sufficiently allotted every year					
5	Computers and appropriate digital technology required for tax audit are accessed at this office of the Authority					

Hint: used likert scale 5- Strongly agree 4-Agree - 3- Neutral 2-Disagree 1-Strongly Disagree

## 3. Probability of being audited

Ser No	Description	Strongly agree	Agree	Neutral	Disagree	Strongly disagree
1	Strengthening legal enforcement and penalties					
2	Improving relationship with the public					
3	Educating the taxpayers and conducting consultation sessions					
4	Providing necessary information to taxpayers regarding the provision of services and utilization of tax revenues					

5	Reducing tax rates and making the collection procedures simple and transparent					
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Hint: used likert scale 5- Strongly agree 4-Agree - 3- Neutral 2-Disagree 1-Strongly Disagree

#### 4. Tax Rate

Se r No	Description	Stron gly agree	Ag ree	Ne utr al	Dis agre e	Stron gly dis agree
1	Tax payers should evade tax if tax rates are too high					
2	Tax payers should evade tax if the tax system is unfair					
3	Tax payers should evade tax if a large portion of the money collected from tax is wasted.					
4	Tax payers should evade tax if the probability of getting caught is low					
5	Evading tax due to lack of ability to pay should not be considered as crime/problem					

Hint: used likert scale 5- Strongly agree 4-Agree - 3- Neutral 2-Disagree 1-Strongly Disagree

**Thank you for your devotion of time to respond this questionnaire!**