

**ADDIS ABABA UNIVERSITY
SCHOOL OF GRADUATE STUDIES**

**A RESEASRCH PROJECT ON DETERMINANTS OF TAXPAYERS'
VOLUNTARY COMPLIANCE WITH TAXATION
The Case Study of Dire Dawa City**

**BY
Lemessa Tulu**



Submitted to the school of graduate studies, AAU, Faculty of Business and Economics, Department of Management in partial fulfillment of the requirements for the degree of Master's of Business Administration (MBA)

Advisor: Tilahun Teklu (PHD)



*August, 2007
Addis Ababa*

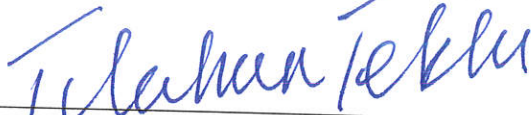
ADDIS ABABA UNIVERSITY
School of Graduate Studies

Determinants of Taxpayers' Voluntary Compliance with Taxation:
The Case Study of Dire Dawa City


By
Lemessa Tulu
Faculty of Business and Economics




Approved by Board of Examiners:



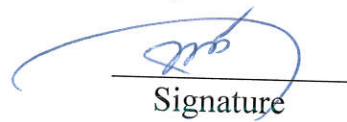
Advisor



Signature 10 Aug 2007



Examiner



Signature

Examiner

Signature

TABLE OF CONTENT

Title	Pages
Acknowledgement.....	i
List of Tables.....	ii
Abstract.....	iii
1. Introduction.....	1
1.1. Project Description.....	2
1.2. Statement of the Problem.....	2
1.3. Significance of the study.....	5
1.4. Objective of the Study.....	5
1.5. Research Design and Methods.....	6
1.5.1. Research Design.....	6
1.5.2. Sample of the Study.....	6
1.5.3. Data Collection Tools.....	8
1.5.4. Methods of Data Analysis.....	9
1.6. Limitations of the Study.....	9
2. Review of Literature.....	10
2.1. Introduction.....	11
2.2. Definition of Tax Compliance.....	12
2.3. Factors Determining Tax Compliance Behavior.....	14
2.3.1. Fairness/Equity.....	14
2.3.2. Organizational Strength of Tax Authority.....	16
2.3.3. Awareness.....	18
2.3.4. Culture.....	19
2.3.5. Honesty/loyalty of taxpayers.....	19
2.3.6. Lack of Ability to Pay.....	20
2.3.7. Social Factors.....	20
2.3.8. Attitude towards the Government.....	21

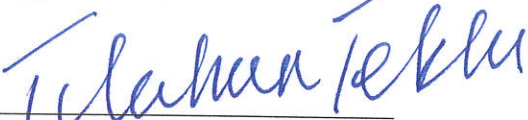
ADDIS ABABA UNIVERSITY
School of Graduate Studies

Determinants of Taxpayers' Voluntary Compliance with Taxation:
The Case Study of Dire Dawa City


By
Lemessa Tulu
Faculty of Business and Economics



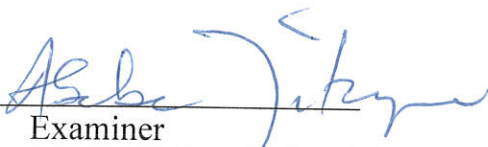
Approved by Board of Examiners:



Advisor



Signature 10 Aug 2007



Examiner



Signature

Examiner

Signature

TABLE OF CONTENT

Title	Pages
Acknowledgement.....	i
List of Tables.....	ii
Abstract.....	iii
1. Introduction.....	1
1.1. Project Description.....	2
1.2. Statement of the Problem.....	2
1.3. Significance of the study.....	5
1.4. Objective of the Study.....	5
1.5. Research Design and Methods.....	6
1.5.1. Research Design.....	6
1.5.2. Sample of the Study.....	6
1.5.3. Data Collection Tools.....	8
1.5.4. Methods of Data Analysis.....	9
1.6. Limitations of the Study.....	9
2. Review of Literature.....	10
2.1. Introduction.....	11
2.2. Definition of Tax Compliance.....	12
2.3. Factors Determining Tax Compliance Behavior.....	14
2.3.1. Fairness/Equity.....	14
2.3.2. Organizational Strength of Tax Authority.....	16
2.3.3. Awareness.....	18
2.3.4. Culture.....	19
2.3.5. Honesty/loyalty of taxpayers.....	19
2.3.6. Lack of Ability to Pay.....	20
2.3.7. Social Factors.....	20
2.3.8. Attitude towards the Government.....	21

2.4. Is non-compliance an intentional behavior?.....	21
2.5. Dimensions of Ensuring Compliance Behavior.....	21
2.5.1. The ‘carrot and stick’ approach.....	22
2.5.2. The responsible citizens’ approach.....	22
2.6. The Relevance of Understanding Tax Compliance.....	23
3. Data Analysis and Interpretation.....	26
3.1. Background of Taxation in Ethiopia.....	26
3.2. Profile of Dire Dawa City.....	28
3.3. Results and Interpretation.....	30
3.3.1. The sample kebeles.....	30
3.3.2. Taxpayers’ knowledge about taxation.....	31
3.3.3. Tax equity or fairness.....	33
3.3.4. Organizational Effectiveness of the Tax Authority.....	34
3.3.5. Taxpayers’ Attitude.....	36
3.3.6. Awareness.....	39
3.3.7. Honesty.....	40
3.3.8. Socio-cultural Factors.....	41
3.3.9. Political Factors.....	42
3.4. Possible measures to be undertaken.....	43
3.5. Content Analysis.....	45
4. Conclusion and Recommendation.....	48
4.1. Conclusion.....	48
4.2. Recommendation.....	52
Appendix 1: Questionnaire.....	59

Acknowledgement

I am indebted to Dr. Tilahun Teklu, my advisor, without whose wise and intellectual advice, guidance and directives this study would not have come to an end and would not become tangible.

My gratitude is also extended to the following have helped me in finalizing this study and data search; Dire Dawa City Administration, Zerihun Ashebir from Trade and Industry Bureau; Ketema Tessema Head of Finance and Economic Development Bureau; Asrat Chala Head of Tax Authority; Abiyu Teshome Head of Finance Office; Tibebe Eshetu Head of Planning and Policy Research Department all from Dire Dawa City Administratio.

Furthermore, I also owe special recognition to Ephrem Alemu Head of Addis Ababa City Revenue Agency, Wondimu Biratu Head of Oromiya Revenue Bureau and Dr. Daniel Tilahun who helped me materially and morally during my study.

Finally I would like to thank all my classmates for their support during my stay at the university.

List of Tables

Pages

1. The distribution of taxpayers in sample Kebeles.....	30
2. Distribution of business sectors included in the sample.....	31
3. Reasons why taxpayers pay taxes.....	32
4. The rank of tax evasion with respect to other crimes.....	32
5. Table that depicts overstatement/understatement of tax.....	33
6. Evaluation of the tax authority by respondents.....	35
7. Attitude of taxpayers on different issues.....	37
8. Reasons why people evade taxation.....	40
9. Response on honesty/ loyalty of taxpayers to tax system.....	40
10. Response on impact of socio-cultural factors.....	41
11. Responses on political factors.....	42
12. Taxpayers' response on measures to be undertaken to improve tax compliance.....	44

ABSTRACT

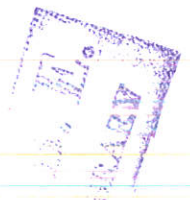
Improved tax compliance boosts the revenues available for supporting public services without increasing the current tax burden on compliant tax payers. There appears to be a trend in tax compliance policies with initiatives by a number of tax authorities to move towards a more taxpayer focused approach. A number of tax authorities have been moving towards a more sophisticated approach to tax compliance. Traditionally there seems to have been an assumption that tax compliance can be ensured with the help of legal enforcement and penalties.

These days this is ceasing to be the case, as the taxpayers are demanding more assistance and fair treatment from the tax authorities. Even there seems to have been a shift in attitudes towards treating the taxpayer less as a passive donor who simply has to be billed for taxes due and more as a customer sometimes requiring particular forms of assistance and support.

The voluntary compliance behavior of the taxpayers is determined by various factors and identifying these factors and treating them accordingly should be the central premises of any tax system in order to maintain voluntary compliance at satisfactory levels. This study was meant to identify the determinants of taxpayers' voluntary compliance in Dire Dawa city. Based on this fact the necessary data were collected using standard questionnaire and analyzed.

According to the response of the respondents, certain factors were found to be the determinants of taxpayers' voluntary compliance. These are, tax fairness and equity, organizational strength of the tax authority, awareness level of the taxpayers, socio-cultural factors, and provision of social services by the government.

Finally, based on the findings possible recommendations were given. These include, maintaining tax fairness and equity, building capacity of the tax authority, conducting extensive awareness creation programs, and providing social services to the general public.



1. Introduction

The amount of revenue collected alone could not explain the best tax administration. A poor quality of tax administration may also collect large amount of revenue from easy - to tax sectors such as wage earners, while unable to enforce taxes on business enterprises and professionals. Hence, measuring the effectiveness of the tax administration by the size of tax collected is unsophisticated judgment. Considering the size of the compliance gap is rather a much stronger criterion to the effectiveness of tax administration (FIRA, 2000).

In many under developed countries like Ethiopia, the low revenue yield of taxation can only be attributed to the fact that the tax provisions are not properly enforced, either on account of the inability of the administration to cope with them, or on account of straightforward corruption. But factors on the other side of the system get little attention, i.e. minor attention is given to the cultural background of tax payers, their awareness level, compliance behavior and its determinants when designing a given tax system. The tax system must be fair, both to promote the objective of an equitable distribution of income and to assure continued voluntary compliance by the taxpayer (Eckstein, 1979).

For voluntary system to work successfully, the people must be confident that the taxes are levied fairly and that everyone pays his share. If the feeling becomes widespread that the tax system is a collection of loopholes and evasions, if people see their equally prosperous neighbors paying substantially less or enjoying tax- free expense account living, taxpayer morale declines. Once this attitude prevailed in the public it is difficult to rectify it and costs the authorities a huge compliance and collection costs.

Hence, this study aims at identifying factors that affect the tax payer's voluntary compliance

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

1.1. Project Description

This project is intended to identify the determinants of the tax payers' voluntary compliance with tax law by taking the Dire Dawa city taxpayers in to account. The out put of this project is supposed to serve as input in designing the tax system both at the city and federal levels. More over, it may serve as a reference for further studies in the area.

1.2. Statement of the Problem

As stated by Scholz (1998; 137) in Fjeldstad (2004), without trust there is little basis for social co-operation and voluntary compliance with laws and regulations that could potentially benefit everyone. The temptation not to comply even if others do comply defines the free riding problem that is endemic in collective action situations in private as well as public institutions.

A topic which has interest from a variety of commentators is the issue of tax compliance. No tax system can function effectively without the co-operation of the great majority of tax payers, so the factors which affect compliance are important.

The definition of compliance is usually cast in terms of the degree to which tax payers comply with tax law. It has been said that the degree of non-compliance can be measured in terms of the 'tax gap'. This represents the difference between actual revenue and that which would be received if there were 100% compliance (James, 2000).



Voluntary compliance is a function of public attitude towards taxation and organizational strength (efficiency and effectiveness) of the tax authority. Public attitude towards taxation is also in turn affected by the social, cultural, and political factors as well as awareness about tax and fairness of the tax system.

If it is perceived that only those who are wealthy or dishonesty or both benefit from non-compliance, this might reduce 'tax morale' and the willingness of the rest of the population to comply. It has been noted by Wall Schutzky (1993) in James (2000) that, most of the attention in this area has been devoted to why some tax payers do not comply rather than why others do. But this study tries to focus on both sides i.e. why do tax payers comply and why do not comply.

Even though Ethiopian modern tax administration is not older than half a century, it has undergone several legal amendments during this time. But the improvement is not as big as its age as far as citizen's voluntary compliance is concerned. The tax system in the country mainly stresses on legal enforcement as a remedy to ensure its proper functioning. For example, the current income tax proclamation (no. 286/2002) has increased the amount of penalties and strengthened the means of enforcement while it states nothing about how to create and increase the awareness of the taxpayers. It gave the tax authorities the right to sell the property of evaders without going to courts in order to collect the outstanding tax liability.

Most of the reform efforts basically targeted institutional capacity building and putting enforcing legal frameworks in place while only insignificant effort, if any was deployed to

make the public aware of the benefits of paying tax to the nation. The taxpayers education program that is being carried on very occasionally, stresses more about teaching the contents of the tax laws and penalties rather than promoting citizens' sense of responsibility toward taxation and devising ways to reward compliant behavior. According to the information obtained from Dire Dawa City Tax Authority, only about 60% of the business communities which are subjected to tax are paying their tax obligation regardless of the existing powerful tax proclamation.

This clearly shows that relying solely on legal enforcement (stick approach) may not work always and forever. Rather, in addition to enforcement, the government must follow a participatory and holistic approach in addressing the issue of voluntary compliance. For the existence of efficient, effective, and sustainable tax system tax payers' voluntary compliance is second to nothing.

Understanding the factors that determine the compliance and non-compliance behavior of taxpayers with tax laws in Dire Dawa city/ Ethiopia is a key to further motivating and assisting the compliers and designing appropriate strategies to deal with non-compliers so that they can gradually develop the desired behavior of voluntary compliance.

Hence, this study tries to answer the following questions:

1. What are the variables that generally affect the taxpayer's voluntary compliance behavior?
2. What are the factors that encourage or force taxpayers to pay taxes?
3. What factors make the taxpayers evade or avoid tax or make them non-compliers?

- To explore the factors which make the taxpayers not to comply with tax law
- To provide the policy makers with some inputs in this aspect.
- To provide some useful contribution to the existing literature in this area.

1.5. Research Design and Methods

This section of the study shows details of the research design, the sampling method as well as the manner in which the data was collected and analyzed for this study.

1.5.1. Research Design

The research design used may vary from research to research. The type of research employed for the purpose of this canvass is descriptive in nature, because, the researcher has no control or effect on the variables of the study. It was intended only to describe the state of affairs of factors affecting the voluntary compliance of taxpayers as they exist currently there. Thus, the convenient design considered suitable for this study was case study (survey) of Dire Dawa city escorted by a survey of the theories and empirical studies related to the subject matter.

1.5.2. Sample of the study

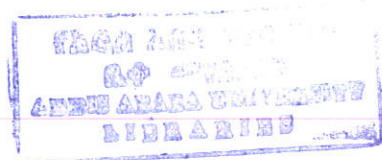
The population of the study is category 'C' tax payers of the city due to the fact that these tax payers are not required by law to declare their income or keep books of account, and considered as hard-to tax group.

According to the income tax regulation No.78/2002, category 'C' taxpayers are those whose annual turnover is up to or less than 100,000 Birr. A standard assessment method shall be used to determine the income tax liability of Category 'C' taxpayers. The standard

assessment shall be a fixed amount of tax determined in accordance with a Council of Ministers Regulations establishing a schedule of standard assessment amounts that reflect variations in the type of business, business size, and business location.

Three urban Kebeles were selected out of nine based on the density of taxpayers. That is, these kebeles are densely populated business areas so that they can represent the remaining others. This follows the concept of purposive sampling. Then proportional number of samples (tax payers) was allocated to main business sectors which can be considered as strata and samples were randomly drawn from each sector/strata. To sum, a combination of sampling techniques (stratified random sampling, and purposive sampling) were in use to select sample tax payers. This is to ensure that major business sectors within a population are adequately represented in the sample, and to improve efficiency by gaining greater control on the composition of the sample. The business sectors were selected based on the number of tax payers engaged in each sector or those commonly practiced businesses were taken into account.

The sampling technique might have its own draw back while inferring the findings based on the sample data to the whole population. To minimize this error appropriate sample size was taken and greater effort and caution was undertaken to make the samples as representative as possible. In addition to this, strict follow up and supervision was undertaken to make sure that the enumerators were actually collected data from the individuals they were supposed to collect.



1.5.3. Data Collection Tools

The data used in this study consists of both primary and secondary data. The primary data were collected through standard questionnaire. The demographics of the respondents were firstly established in the questionnaire. The questionnaire comprised of both closed and open ended questions. Closed ended questions are quicker and easier both for respondents and researcher. Most of the closed ended questions are designed on an ordinal level of measurement basis, and others are designed as ‘yes’ or ‘no’ questions, so that the variables can be ranked to measure the degree of their strength or the agreement or the disagreement of the respondents with the variables can be elicited. Adding open ended questions allows respondents to offer an answer that the researcher didn’t include in the questions. The replies of open-ended questions were analyzed by content under different categories.

Data investigators or enumerators were hired and undertaken the job after taking the necessary training. Individuals who have familiarity with the tax administration and who were also familiar with the taxpayers were selected for this job. These are people who work as agents for taxpayers in paying taxes and executing related tasks. The questionnaire was translated into Amharic by taking into consideration the fact that English is not the language of the respondents.

Secondary data were also collected from the city's tax authority data base or unpublished sources. This data includes number of category ‘C’ taxpayers in each Kebeles and their distribution with respect to business type/sector. While collecting and using these data for the study, more considerations were given to their time period, reliability, and relevance to the purpose of the study.

1.3. Significance of the Study

Taxes are fundamental to the existence of governments, for the tax revenues finance the bulk of services that governments provide including education, welfare, public safety, infrastructure, and basic public services. Improved tax compliance amplifies the revenues available for supporting public services without increasing the current tax burden on compliant tax payers.

Moreover, improved tax compliance bolsters citizen's satisfaction by increasing their faith in the system and promoting the perception that everyone pays its legal share. The impact of tax payer's attitude towards taxation is the major factor that determines the success of a tax system. Unless these voluntary compliance determinants are pointed out and addressed properly, it may be difficult to design an efficient and effective tax system that helps to narrow the existing compliance gap.

Hence, this study is significant in that it may help the policy makers of the city administration and at national level to make use of the outputs of the study in addressing the voluntary compliance problems. Moreover, it may give some highlights that would serve as a basis for further nationwide research and policy design in addressing the issue.

1.4. Objective of the Study

Since the effectiveness and efficiency of a given tax system is a function of tax payers' voluntary compliance, this particular study tries to elicit the factors that affect the tax payers' voluntary compliance behavior both positively and negatively.

The following are the specific objectives of the study.

- To identify the determinants of tax payers voluntary compliance.

1.5.4. Methods of Data Analysis

It is the most important component of this study. The responses of the respondents collected using the above methods were organized, analyzed, and interpreted in a sensible way. The analysis was based on descriptive statistics and STATA software was used to tabulate the data and present it in tables.

1.6. Limitations of the Study

The quality of the output of this study is contingent on the genuine responses from the respondents. But there was suspicion that the respondents may not give what is in their heart because they may suspect that they will face problems from the government. In addition, shortage of time and lack of sufficient fund may have its own impact on the qualities of the study output.

Hence, to overcome these bottlenecks:

- The respondents were assured that their responses are kept confidential.
- To overcome the time constraint, additional manpower support and other logistic assistance was requested from the city administration. More over, the researcher has exerted his at most effort to go according to the time table.
- To solve financial constraint, the city administration was asked for additional financial assistance and it become successful.

On the other hand, this study focused on part of category 'C' taxpayers only. Category 'A', category 'B' and some of category 'C' taxpayers were excluded. The study was only focused on three kebeles of the city. No detailed statistical analysis was performed due to the small number of respondents and lack of time and budget.

2. Review of Literature

2.1. Introduction

A tax is (Bhatia, 1976; James, 2000) a compulsory levy and those who are taxed have to pay the sums irrespective of any corresponding return of services or goods by the government. Government needs financial resources to act as a government and play a role that is expected from it by the public. So what the government gives it must first take away. The economic resources available to society are limited, and so an increase in government expenditure normally means a reduction in private spending. In this regard James (2000) states that taxation is one method of transferring resources from the private to the public sector. Other writers (Auld & Miller, 1984) describe the role of taxes as an instrument that stabilizes the economy, and reduces private demand so that resources can be released for public sector use.

Generally, governments levy taxes for multiple of purposes, but mainly to raise funds in order to cover public expenditures and on the other hand to properly allocate resources. Whatever its function and essence, tax is fundamentally important for the existence of a government and a nation. Hence, the taxes that governments levy have to be governed by certain principles.

In this literature review basic concepts about tax compliance, characteristics of good tax system, factors determining tax compliance such as attitude of tax payers, socio-cultural, political legal, administrative and ethical issues will be touched. The empirical work of various researchers and other reference materials are scanned to have basic conceptual framework of the subject matter.

2.2. Definition of Tax Compliance

The definitions of tax compliance frequently used in the literature might be considered to be too simplistic. As cited by James et al (2003), a more comprehensive definition has been developed by James and Alley (1999). The most common previous approach has been to conceptualize compliance in terms of the '*tax gap*.' This represents the difference between the actual revenue collected and the amount that would be collected if there were 100 per cent compliance, though there are some variations.

Similarly according to James (2000), tax compliance is expressed in terms of degree to which taxpayers comply with tax law, and the degree of non compliance is measured in terms of the tax gap, which is defined as (Andreoni et al, 1998 and Adams, 1921) the difference between the taxes that the law seeks to collect and those in fact collected. This gap happens by means of both tax avoidance and tax evasion. Similarly, compliance gap is also defined in (FIRA, 2000) as the break between the actual and the potential tax revenue and how that gap varies among the different sectors of the tax paying population.

Andreoni *et al.* (1998) include a time dimension to compliance, but are still mainly concerned with tax evasion as the central part of the tax gap definition. Regarding time dimension, James (2000) states that a tax payer might eventually pay his/her full liability but, if the payment is late, the taxpayer cannot be considered to have been compliant.

A more recent definition consists of three distinct types: payment compliance, filing compliance and reporting compliance. However, these basic concepts of the 'tax gap' of non-compliance seem to be far too simplistic for practical policy purposes. Successful tax

administration requires taxpayers to co-operate in the operation of a tax, rather than be forced to undertake every aspect of their obligations unwillingly. Tax law cannot cope with every eventuality and has to be supplemented with administrative procedures and decisions and, just as importantly, in order to work it has to have a reasonable degree of willing compliance on the part of the taxpayers themselves (James et al, 2003).

One issue is whether 'compliance' refers to voluntary or compulsory behavior. If taxpayers 'comply' only because of dire threats or harassment or both, this would not appear to be full compliance, even if 100 per cent of the tax was raised in line with the 'tax gap' concept of non-compliance. Instead, it might be argued that proper compliance means that taxpayers meet their tax obligations willingly, without the need for enquiries, obtrusive investigations, reminders or the threat or application of legal or administrative sanctions. A more appropriate definition could therefore include the degree of compliance with tax law and administration that can be achieved without the immediate threat or actual application of enforcement activity.

Tax compliance may be seen in terms of tax avoidance and tax evasion. The two activities are conventionally distinguished in terms of legality, with avoidance referring to legal measures to reduce tax liability and evasion to illegal measures. James (2000) describes tax avoidance as the legal manipulation of an individual's affairs in order to reduce tax. However, if taxpayers go to inordinate lengths to reduce their tax liability, this could hardly be considered 'compliance', even if it were within the letter of the law.

Since taxation is not always precise, Seldon (1979) in James et al (2003) has also coined the term 'tax avoision' to describe circumstances where the law might be unclear. However,

some commentators see non-compliance only as a problem of evasion, which does not seem to capture the full policy implications of the issue. Clearly tax evasion is an extreme form of non-compliance. However, if law-abiding taxpayers go to inordinate lengths to reduce their liability this could hardly be considered to be 'compliance' either. Such activities might include engaging in artificial transactions to avoid tax, searching out every possible legitimate deduction, using delaying tactics and appeals wherever this might reduce the flow of tax payments and so on. 'Tax exiles' even seem to prefer to emigrate, rather than fulfill their obligations as citizens - hardly an example of 'compliance.' Even if such activities are within the letter of the law, they are clearly not within the spirit of the law. Compliance might therefore be better defined in terms of complying with the spirit as well as the letter of the law

The 'tax gap' approach overlooks the possibility that some taxpayers pay more than their legal obligation. Not all taxpayers seek out every possible method of reducing their tax liability and an unknown number do not claim their full entitlement to allowable deductions.

A better definition of compliance might therefore include actions which are consistent with the spirit as well as the letter of the law. On the other hand a definition of non-compliance might be the failure of taxpayers to act in accordance with the statutory requirements or intentions of the tax law and administration without the application of enforcement activity.

In all the expressions compliance can be understood as acting in accordance with the law and non compliance is deviation from the law. *Based on the above expressions the definition of tax compliance can be shortly refined as the desire or willingness of the taxpayers to act*

in accordance with the tax law and the voluntary effort they exercise to pay their tax liability on timely basis.

2.3. Factors determining tax compliance behavior

The problem of tax compliance is as old as taxes themselves. Characterizing and explaining the observed patterns of tax non-compliance, and ultimately finding ways to reduce it, are of obvious importance to nations around the world (Andreoni et al, 1998).

The attitudes of the taxpayers (Bhatia, 1976) in this regard are influenced by a host of other factors like the political situation, natural calamities, economic situations, socio cultural and so on. Due and Friedlaender (1981) also state that a person's preference for a tax may be influenced if the tax- or an increase in it- is tied directly to the expenditures he strongly favors. Generally, attitudes toward choice of taxes and tax structures are greatly influenced by various criteria- often called principles- of taxation that have come to be widely accepted.

2.3.1. Fairness/Equity

As stated in Bhatia (1976), a good tax system, in order to achieve various objectives, chooses and adheres to certain principles which become its characteristics. A good tax system, therefore, is one which is designed on the basis of an appropriate set of principles, such as equality or fairness and certainty. Since fairness of a tax system is its corner stone a brief overview can be presented in the following paragraphs.

According to James (2000), the most obvious requirement of equity or fairness is to treat equal people in equal circumstances in an equal way. The problem here is in deciding who is equal to whom. Similarly, Due and Friedlaender (1981), also argue that what is fair or

equitable in taxation is inevitably a value judgment; no scientific specification of an equitable distribution pattern is possible, or people may be equal income wise while they may be unequal regarding their expenditure, wealth, total utility and so on. Such a pattern can be specified only on the basis of a consensus of attitudes of persons in the contemporary society. Lemessa (2005) also adds that a major responsibility is to ensure that all taxpayers dealt with by a given official are accorded similar treatment and that all officials dealing with a given taxpayer would accord the same treatment.

Similarly, Brooks (2001) states that fairness has always been widely regarded as the most important criteria in judging a tax system. The problem of unfairness is that a tax system allows taxes to be shifted from dishonest to honest taxpayers. The fairness of a tax system may also be perceived in different ways by the taxpayers and tax authorities. What is fair in the eye of the tax authorities may not have the same image in the mind of the taxpayers.

According to Bhatia (1976), the attitude of taxpayers is an important variable determining the contents of a good tax system. It may be assumed that each taxpayer would like to be exempted from tax paying, while he would not mind if others bear that burden. In any case, he would want his share to be within the general level of tax burden being borne by others. If this is not so, he will feel exploited.

Similarly, Due and Friedlaender (1981), argue that persons will oppose taxes that they feel strike them “unfairly” and allow others to escape a “reasonable” burden, and they will favor taxes they accept to concentrate on others, especially when “others” are non-humans such as corporations.

To sum, regardless of this inherent problem ensuring the fairness or equity of a tax system is second to nothing. To put it differently, it is essential that a good tax system should appear equitable to the tax payers.

2.3.2. Organizational Strength of Tax Authorities

According to Bird and Oldman (1967), no tax will work effectively, unless its administrators maintain an aggressive attitude with respect to the correctness of the taxpayers' actions. Some taxpayers will fail to file or make mistakes through ignorance or neglect; others will deliberately cheat. A passive attitude by the authorities towards these errors and falsifications will soon undermine the entire structure, since the diligent and honest taxpayers will almost in self-defense be forced to the level of the careless and dishonest. A tax administration which seeks compliance must protect those who comply or else compliance will not be forthcoming.

Bird and Oldman (1967) further state that the sure sign of ineffective tax administration is the presence of a very large delinquency in tax payments for it indicates the lack of taxpayer respect for the tax system. The taxpayer in effect is acting on his belief that the administrative machinery may bark, but that it has no bite. These writers argue that in large part the solution for the large delinquency lies in providing the bite. In this sense effective tax collection is a facet of the larger problem of providing adequate penalties, to which reference will later be made. In other words tax is evaded to the extent that tax authorities are perceived as weak by taxpayers.

A tax system doesn't function in a vacuum. Its relationship with at every turn are with the public, and since the combination of taxes reaches nearly every individual in one way or

another, the administration finds itself dealing with the nation as a whole. Hence, inevitably its operations and effectiveness are affected by the attitudes of the nation towards the tax system (Bird and Oldman, 1967).

But while tax administration is thus affected by these national attitudes (Bird and Oldman, 1967), it is equally true that the attitudes can in turn be affected by tax administration. Rational and efficient procedures, higher personnel standards, better management, improvement in relation with the public and in the daily contacts between tax official and taxpayer, can operate to increase the public respect for the tax administration. Moreover, once the tax administration has been placed on a sound basis, it is in a position to assert that compliance must be forthcoming. Such an assertion would hardly be tolerated or even taken seriously, as long as tax officials were themselves inefficient and corrupt. But if the administration has brought stability and honesty to its own operations, the self-respect thus achieved can form the foundation for its demand of respect and compliance from the taxpayer.

Lemessa (2005) states that tax systems that depend on ad hoc administrative procedures rapidly become discredited and endanger compliance. To encourage compliance it is equally important that tax authorities administer the law fairly. This implies both an absence of arbitrary or corrupt behavior on the part of the officials, and “normative standards” to ensure that the same laws are applied and administered in a standard fashion across the board.

A taxpayer (Peacock and Forte, 1981) will be more receptive to information on his obligation if, in his efforts to comply, he receives a reasonable degree of service from the

revenue administration. Poorly drafted forms, long waiting lines and even charges for acquiring them, bureaucratic hassle in processing the case, rudeness from the officials, cumbersome appeal procedures, and the like, can repel even the most loyal taxpayers.

On the other hand the ways in which revenue authorities interact with taxpayers and their own employees have an impact on public perception of the tax system and the degree of voluntary compliance. Taxpayers who are aware of their rights and expect, and in fact receive, a fair and efficient treatment are more willing to comply. Voluntary compliance is promoted not only by an awareness of rights and expectations of a fair and efficient treatment but also by clear, simple and “user friendly” administrative systems and procedures. Voluntary compliance is enhanced when it is easier for taxpayer to do so.

2.3.3. Awareness

James (2000) argues that the norm is usually to comply rather than not to comply. As already pointed out for a tax system to be effective the majority of the taxpayers have to comply. It follows that there may be greater gains in assisting basically compliant taxpayers to meet their fiscal obligations than in spending more resources in pursuing the minority of non-compliers. Many taxpayers might be willing to comply in full, but are unable to do so because they are not aware of, or do not understand, their full obligations. Even if such taxpayers understand their obligations, they may not know how to meet them or may be unable to do so for other reasons. On other side, other writers such as Smith and Kinsey (1987) argue that tax non compliance is an intentional behavior. In countries like Ethiopia where most of the business community have no access to information, lack of awareness cannot

simply be overlooked rather it can be assumed as a major determinant of tax compliance behavior.

2.3.4. Culture

According to Fjeldstad and Ranker (2003), increased efficiency of the tax administration, however, is not enough. Many observers conclude that a lack of tax paying 'culture' is the largest obstacle to building a firm long-term revenue base. The opposite may, however, also be the case: as long as the tax administration culture is perceived to be influenced by sectarianism, nepotism, and corruption, it is unlikely to contribute to the fostering of a more conducive tax paying culture.

Gaining a better understanding of why people do and do not accurately report and fully pay the taxes they owe is obviously interesting to policy makers (Smith and Kinsey, 1987). In Ethiopia where the system of government has evolved from feudal (where taxes were used by individuals in government) to current one, it is obvious that negative attitude towards tax has been developed in the society. In this sense it is difficult to conclude that there is a culture in the country that appreciates voluntary compliance.

2.3.5. Honesty of the taxpayers

It is pointed out by Adams (1921) that the success of income tax rests primarily upon the honesty of taxpayers. Some authors (Brooks, 2001) indicated that tax morality has declined over the past few decades and this is attributed to wasteful, inefficient, and even perverse governments. Adams further states that one of the factors that contribute to the dishonesty of the taxpayers is the complexity of the tax system, as it may lead to administrative failures. This can be viewed as it has relation with the tax culture of the society. Practically it is

difficult to obtain genuine information from taxpayers regarding their income. Hence, tax gap is created to the extent the taxpayers hide information regarding their business activity.

2.3.6. Lack of ability to pay

Some observers (Fjeldstad and Ranker, 2003) argue that in African countries like Namibia and South Africa, the non payment is due to poverty or inability to pay. This issue holds true in Ethiopia also where several small business operators (category 'c' taxpayers) are accumulating their annual tax obligations due to lack of ability to pay. Generally when taxpayers have no enough disposable income and they used to consume the return from sales, it is clear that tax evasion is inevitable and leads to tax arrears.

2.3.7. Social Factors

The issue of (non-) compliance is not only a question of state-society relationships but also a question of relationship between citizens and/ or groups of citizens within local communities. There is an existing social bond between the society and this bond influences the members of the society in complying with the tax law. That is taxpayers may be influenced by their peer groups to comply or not to comply with the tax law.

As cited by Slemrod (2000) and Levi (1998) in (Fjeldstad and Ranker, 2003), the dimension of trust that seem to affect compliance is trust in other citizens to pay their share of service charges. In particular, trust in other citizens to pay their share seems to be important. The larger the fraction of the local population that is observed not paying, the lower perceived risk of being prosecuted. This has impacts on the individual taxpayer's perception of the credibility and trustworthiness of the revenue administration.

2.3.8. Attitude towards the Government

Attitudes towards the government (Levi, 1988) may affect the taxpayer's normative commitment to comply with law. Similarly, Due and Friedlaender (1981), also argue that, attitudes toward the general level of taxation and tax increases are dependent, of course, on attitudes about the desirability of governmental programs and on attitudes toward the government itself. On the other hand, (Fjeldstad, 2004) citizens' willingness to pay taxes voluntarily rests on the local government's capacity to provide services and its demonstrated readiness to secure the compliance of the otherwise non-compliant.

2.4. Is non compliance an intentional behavior?

Most theories of tax compliance, as well as empirical works (Smith and Kinsey, 1987) have until recently been premised on the assumption that tax under reporting is an intentional behavior. Behavior that is unintentional has either been ignored or set aside in a footnote or can be safely ignored as random noise. However, as noted earlier, the evidence is accumulating that unintentional noncompliance is neither small nor inconsequential. Nor it is necessarily random in nature. As far as Ethiopia's practice is concerned tax non compliance is not only an intentional behavior it is also attributed to lack of ability to pay, lack of awareness and weak institutional capacity of the revenue administrations and other factors.

2.5. Dimensions of Ensuring Compliance Behavior

Edmund Burke in (Long and Swingen, 1991) states 'the revenue of the state is the state'. Put another way, without the legal authority to collect taxes and the compliance of the citizenry to these laws, government is a sham. It is this fact that taxes are profoundly essential to the

existence of all successful states- that makes the age-old question of why people pay or fail to pay their taxes of central interest.

Clearly much depends (James, 2000) on the motives of taxpayers. This is a complex area and different commentators have offered different analyses. The two main approaches are to concentrate on the probability of detection and on penalties for non-compliance (the ‘carrot and stick’ approach) or activities designed to promote voluntary compliance (the ‘responsible citizen’ approach).

2.5.1. The ‘carrot and stick’ approach

According to James (2000), the carrot and stick approach is based on a relatively narrow interrelationship of economic rationality. According to this approach, totally amoral individuals maximize their utility by maximizing their income and wealth. They will evade tax if they consider that by doing so they can expect to increase their spending power. Non-compliance can therefore be explained by factors such as the level of tax rates, the probability of being caught evading, the penalties imposed and the degree of risk aversion.

2.5.2. The responsible citizens’ approach

Regarding the responsible citizens approach James (2000) extends his discussion that, looking outside economics; other academic disciplines have suggested factors which might be important in influencing taxpayers’ behavior. Sociology has offered a number of variables such as social support, social influence, attitudes and certain background characteristics such as age, gender, race and culture. Psychology reinforces this approach and has even created its own branch of ‘fiscal psychology’. The contribution from

psychology includes the indication that attitudes towards the state, the revenue authorities are as important factors as perceptions of equity.

If psychological and sociological factors are important then a major drawback of the carrot and stick approach becomes apparent. While such an approach might be considered by some as suitable for donkeys, human beings might not respond so positively. The result might be a reduction in voluntary compliance. For instance, Strumpel (1969) and Schmolders (1970) as cited in James (2000) reported that the German tax system was very rigid in its assessment procedures, which led to an effective but expensive and confrontational system. The result was a high degree of alienation and resistance among taxpayers.

The conclusion would seem to be that a successful compliance policy should take account of a much wider range of motivations than simply rewards and punishments (James, 2000). The tax system (Eckstein, 1979) must also be fair, both to promote the objective of an equitable distribution of income and to assure continued voluntary compliance by taxpayers.

2.6. The Relevance of Understanding Tax Compliance

According to James et al (2003), a number of tax authorities have been moving towards a more sophisticated approach to tax compliance. Traditionally there seems to have been an assumption that with a basic level of assistance for taxpayers, together with an enforcement program, tax compliance could be expected to be maintained at satisfactory levels. However there seems to have been a shift in attitudes towards treating the taxpayer less as a passive donor who simply has to be billed for taxes due and more as a customer sometimes requiring particular forms of assistance and support.

According to Lemessa (2005), when compliance is not achieved on a voluntary basis, revenue authorities must identify and address the risk associated with non-compliance by developing strategies targeted at those risks. Voluntary compliance is maximized when revenue authorities are aware of major developments and trends in the business and legislative enforcement, and are responsive to their implications on tax administration and compliance.

The choice (Smith and Kinsey, 1987) between compliance and non compliance may only be a matter of opportunity, convenience, or even interpretation of the law. Legal validity, economic and social purpose, distributive justification, and revenue yield may all be defeated if a tax is not levied and collected well. No matter what the justifications advanced, a tax fails to the extent that it is avoided or evaded (Shultz and Harriss, 1949).

Taxation is an inevitable phenomenon in any economy or nation as far as services and other roles are expected from governments. Even though the history of taxation is as old as that of states or governments, still there are gaps in every nation, particularly underdeveloped countries like Ethiopia as far as voluntary compliance is concerned.

Taxes are considered by many citizens as necessary evils that cannot be avoided under normal conditions. Hence, the issue of voluntary compliance is a central idea when dealing with efficiency and effectiveness of a tax system. From the above review of literature several writers have discussed about factors that affect voluntary compliance behavior and how it is related with various socio-cultural, political legal and administrative aspects.

Legal enforcement (i.e. penalties and sanctions) are all exist in the tax laws of every nation in varying degrees. But still are gaps in tax compliance regardless of these laws. This clearly shows that tax compliance can not be ensured only through enforcement or stick approach. Even though the existence of enforcement and penalties cannot be undermined when dealing with tax compliance, focusing on positive side i.e. encouraging voluntary compliance is by far rewarding as far as long lasting and consistent advantage is concerned. Hence, the understanding of tax compliance that is why people tend to comply and why they tempt to evade, gives a clear road map to the solution of this very classical problem.



3. Data Analysis and Interpretation

3.1. Back ground of Taxation in Ethiopia

Though the history of taxation in Ethiopia has a relationship with the government structures of the country, there exist hardly any reliable documentary evidences to justify the relation of emergence of government and taxation, when exactly taxation was introduced. Different stories and evidences point out that Emperor Zeria-Yakob started taxation in Ethiopia during the 15th century. Governments which came to power in Ethiopia at different periods have frequently revised and repealed the statutory bases for various types of taxes providing for tax bases and tax rates, time and mode payment, exemptions and offenses. However, there has been no document or materials produced which compiles tax proclamations issued at different periods. The initial statutory bases for all the tax proclamations was the 1931 Constitution of Ethiopia which later revised and become Revised Constitution of Ethiopia.

Because most of the products on which tax was levied (tax bases) were agricultural products, the type of taxation in traditional periods was unstructured and mostly in kind. Taxation in that period was varying highly from area to area and was often arbitrary, i.e. the amount to pay and the mode of payment depends on the will of the chief tax collector and the kind of resources available in the area.

According to the Constitution of Federal Democratic Republic of Ethiopia, revenue sources are assigned between Federal government and Regional states. Regional states can endorse their income tax proclamation and regulations based on the constitution in conformity with the federal income tax proclamation. According to the current federal income tax proclamation no.286/2002 taxpayers are categorized into three categories, namely category

“A”, “B”, and “C” based on their volume of sales and form of business. Subsequently, the Tax Authority will determine whether the taxpayer shall continue in the same category or should be shifted from one category to the other.

Category “A” includes any company incorporated under the tax law of Ethiopia or in or a foreign country and other entities having annual turnover of Birr 500,000 and more. Those who are categorized under “A” have to maintain all records and accounts which will enable them to submit a balance sheet and profit and loss account disclosing the gross profit, general and administrative expenses, depreciation, and provisions and reserves together with supporting vouchers (Council of Ministers Regulation no. 78/2002: Article 18, Sub Article 2).

Category ‘B’ includes those enterprises having annual turnover of more than Birr 100,000 and less than Birr 500,000. This category of taxpayers must submit profit and loss statement at the end of the year. The law requires all entries in the records and accounts to be supported by appropriate vouchers (Council of Ministers Regulation no. 78/2002: Article 18, Sub Article 2).

Category ‘C’ unless already classified in categories ‘A’ and ‘B’ include those taxpayers whose annual turnover is estimated by the Tax Authority at Birr 100,000 or less. On the other hand, standard assessment is used to determine the income tax liability of Category ‘C’ taxpayers. This type of assessment is a fixed amount of tax determined in accordance with the Council of Ministers Regulation established Schedules. This category of taxpayers is the most problematic category of taxpayers and it is considered as hard to tax group. This is due to the fact that these taxpayers pay taxes at fixed rate on the income estimated by the income

tax authority rather than declaring their income by themselves. Their daily income is estimated by assessment committee and the taxpayers have little room to address their view so that frequent friction is observed in this area.

3.2. Profile of Dire Dawa City

Dire Dawa City Administration is located in the eastern part of Ethiopia. It occupies a total area of 1288.02km² with a total population estimated to be 412,333 according to Dire Dawa Administration Statistical abstract. The city is the, second largest city of the country and 505km far from Addis Ababa. The administration is divided into 25 rural kebeles and 9 urban kebeles. Regarding its boundary it shares borderline with East Hararghe zone of Oromiya region and Shinle zone of Somali region.

Ethnically, the population of Dire Dawa is composed of different ethnic groups; the major ones are Oromo, Amhara, Somali, Gurage, Harari and Tigre. Climatically, the region is hot and dry. The average annual temperature of the region is 31.5⁰C and the annual average rainfall is 640mm. Dire Dawa town is strategically located between Addis Ababa and Djibouti and serves as a transit and terminal both for import and export. The city has accessibility to various infrastructural facilities such as international airport, railway and road transport. In addition to these, there are well organized electric power supply, digital telephone connection, and broad band Internet service, well- equipped custom and transit service etc.

The city administration is directly accountable to the Federal Government and it is administered by a mayor who has council of cabinet members (the executive body). Currently the mandate of tax administration is given to the Tax Authority of the city

administration which is accountable to Finance and Economic Development Bureau. The authority was established by proclamation as an independent agency with the mandate of city's revenue administration. The authority has a manager and there are five divisions and a legal service which are directly accountable to the manager. The organizational structure of the authority is depicted in the following diagram.

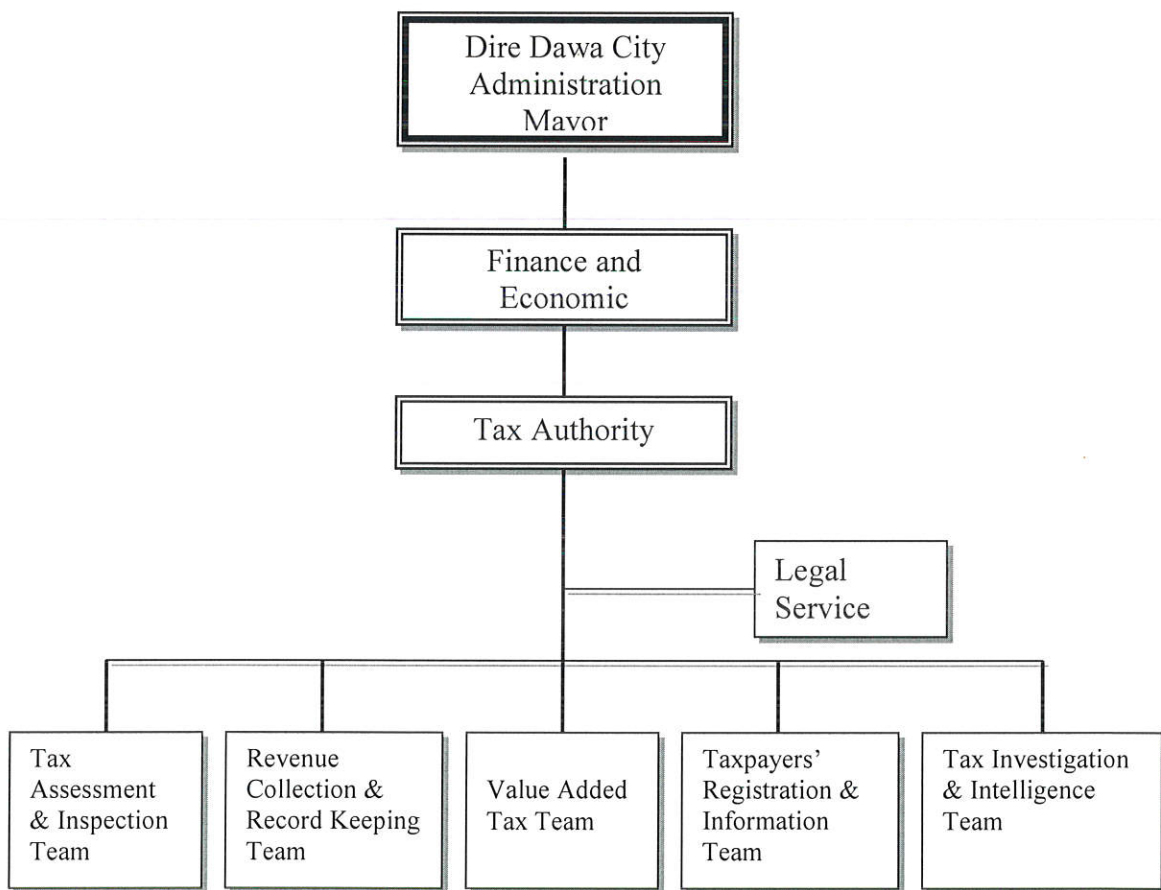


Figure1: organizational structure of Dire Dawa City Administration Tax Authority

3.3. Results and Interpretation

3.3.1. The sample kebeles

Three urban kebeles out of nine were selected based on the density of category ‘C’ taxpayers. Some business sectors such as importers, exporters, transport and others whose taxable income is objectively determined based on source documents or according to their capacity (Income Tax Regulation No. 78/2002), were not included in the sampling frame. Only the relevant population of taxpayers was considered for this study.

The following table shows the sampling frame of the study.

Table 1: the distribution of taxpayers in sample Kebeles

Ser. No.	Kebeles	Population	Sample	Percentage
1	Kezira(03)	410	28	6.83
2	Megala(06)	665	46	6.92
3	Taiwan(07)	751	52	6.92
Total		1826	127	6.96

The survey covered 127 sample taxpayers from 1826 target taxpayers. The sample constitutes around 7% of the target population. Questionnaires were distributed to these 127 taxpayers and only 103 taxpayers responded. This shows approximately 81% response rate. An analysis of the non-responses shows it doesn’t materially bias the sample.

Based on this survey the profile of the respondents looks the following.

- 80% of the respondents were men and 20% women,
- 21% of the respondents were single, 77% married, and 2% were divorced,
- 25% of the respondents have tertiary, 65% secondary, 7% primary education, while 4% have adult education.

- 19% of the respondents were less than 30 years, 67% between 30-45 years, and 14% 50 years and above.

According to Income Tax Regulation No. 78/2002, there are 69 categories of business sectors and for the purpose of this study only the major ones were surveyed and their distribution is presented in the table below.

Table 2: distribution of business sectors included in the sample

Ser. No.	Business Sector	Frequency	Percentage
1	Retail shops	13	12.62
2	Fabrics & Threads	12	11.65
3	Hotel	11	10.68
4	Electronics	9	8.74
5	Spare parts	7	6.80
6	Tailoring	7	6.80
7	Stationary	6	5.83
8	Garage	6	5.83
9	Construction material	5	4.85
10	Health care services	5	4.85
11	Cereal & Pulses Trade	4	3.88
12	Shoe trade	4	3.88
13	Barber& beauty salon	4	3.88
14	Household utensils	4	3.88
15	Music& video shop	3	2.91
16	Wood work	3	2.91
	Total	103	100.00

3.3.2. Taxpayers' knowledge about taxation

Regarding this aspect 99% of the respondents responded that they knew why they pay taxes. On the other hand the following table shows the response of the respondents regarding their reason of paying taxes.

Table 3: reasons why taxpayers pay taxes

Ser. No	Questions	Percentage
1	To avoid disturbances	5
2	In the anticipation of public services	31
3	There is no opportunity to evade	6
4	It is an obligation towards the government	58
	Total	100

From the above table when people asked why they pay taxes, 58% of the respondents said that they pay taxes because it is an obligation to the government or state and in the anticipation of public services from the government (31%). This indicates there is a positive understanding as to why people pay taxes and if successive works are done probably better results can be registered. On the other hand, some of them (6%) said that they have no opportunity to evade, and the remaining 5% of the respondents said that they pay taxes to avoid disturbances. Particularly with respect to those 5% who said they pay taxes to avoid disturbances, the response indicates that the revenue collection regime is not considered by majority of taxpayers (at least 95%) to be harsh and unpleasant. In other words, only 5% of the respondents think that way. The response of the other 6% who said there is no opportunity to evade indicates they have the intention not to pay if they have the opportunity to do so or their compliance behavior is questionable.

Table 4: the rank of tax evasion with respect to other crimes

Type of crimes	Percentage
Kidnapping	18
Drunken driving	6
Tax evasion/ fraud	33
Stealing some one's cell phone	4
Bribery	35

On the other hand, taxpayers understand that tax evasion is a crime and as it can be observed from the table above, 38% of the respondents ranked bribery as the most serious crime and 33% of the respondents said tax evasion is a serious crime while the remaining respondents chosen stealing, kidnapping, and drunken driving. From this response one can understand that taxpayers perceive tax evasion as a crime, even though it is ranked second, and this indicates that there is an attention towards taxation. But the problem here is there is poor compliance even though tax evasion is considered as crime by the taxpayers. Perceiving tax evasion as crime is a normal and desired behavior that has to prevail in the society to build a positive attitude to wards taxation and to discourage the problem of non-compliance.

3.3.3. Tax equity or fairness

When people asked whether the tax they are paying is based on their ability-to pay or not, 71% of them responded that the tax is not fair and not based on their ability-to pay.

Table 5: table that depicts overstatement/understatement of tax

Questions	Percentage
Is your tax liability overstated or understated?	
Overstated	71
Understated	8
Normal	21

According to the above table, from those respondents who have said the tax they are paying is not based on their ability- to pay, only 29% said that the tax they paid is fair and equitable or even understated whereas the majority (71%) of those who said the tax they pay is not fair responded that it is overstated. On other question in support of this issue, the respondents were asked to rank the major problems in the tax system and they responded accordingly. From the list of five most probable options the majority of the respondents (60%) felt that

the tax rates are too high, 17% said tax revenues are not spent on public services, and also 15% said taxpayers are not willing to pay. 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. This can be either really true or human beings are benefit maximizers so that it may be difficult to please taxpayers. Even though the principle says the tax should be based on the ability- to-pay, the problem here is in determining this ‘ability’ for each taxpayer. Actually the tax rate may not be as such high but the communication gap between the tax authority and taxpayers might have created this perception and it continues to be the issue as far as the understanding of the taxpayers regarding tax rates, assessment, calculation etc is low.

On the other hand, significant number of respondents (17%) said that tax revenues are not spent on public services. Theoretically tax revenue is used to finance services provided by the government. This might be practically true, but the public must be made aware of these social services which are being financed by the taxpayers’ money. As long there is a gap in communicating these facts to the public the above attitude problem will not be changed. The other issue which was raised as a problem thirdly is that taxpayers are not willing to pay taxes (15%). This problem is the central problem as far as tax compliance is concerned and it is related with variety of factors.

3.3.4. Organizational Effectiveness of the Tax Authority

The respondents evaluated the Tax Authority with respect to certain parameters. The following table shows their response to these questions in percentages.

Table 6: evaluation of the tax authority by respondents

Parameters	Excellent	Good	Fair	Poor
Service delivery	15%	25%	38%	23%
Tax collection efficiency	9%	26%	35%	29%
Law enforcement	12%	17%	43%	28%
Awareness creation	6%	14%	23%	59%

From the table it is observed that the respondents rated service delivery by the tax authority as excellent (15%), good (25%), fair (38%), and poor (23%). Regarding tax collection efficiency, they responded excellent (9%), good (26%), fair (35%), and poor (29%). Similarly, they rated the authority with respect to law enforcement activity as an excellent (12%), good (17%), fair (43%) and poor (28%). On the other hand, concerning awareness creation, they said excellent (6%), good (14%), fair (23%) and poor (59%).

From the table it is palpable that the majority of the respondents rated the tax authority from excellent to fair except for awareness creation where 59% of them said poor. In all the parameters most of the respondents rated the authority's effort as fair and below that. This clearly shows the tax authority is not effective and not providing satisfying service for taxpayers. On the other hand, the effort of the authority in creating awareness was rated poor (59%). This can be cited as the root cause for all the problems as far as voluntary compliance is concerned.

On other question 83% of the respondents said that the tax authority and the city administration are jointly responsible for poor tax compliance and only 6% of the respondents said taxpayers are responsible. This can be directly related to the authority's strength and effectiveness in providing services, information, and creating awareness. The

respondents additionally commented on this issue and they reasoned out that both the tax authority and the city government didn't play their role well in improving the tax administration, creating awareness, providing social services, and other information regarding taxes and other activities of the city government.

Hence the poor effort of both the tax authority and the city government in these area can be cited as the major factor that has contributed to the underlying problem and so that both are responsible for poor tax compliance. On the other hand, even though the above comment given by the respondents cannot be undermined, the fact that people always externalize certain problems and make others responsible for the problem, might be taken into consideration while analyzing this response.

3.3.5. Taxpayers' Attitude

Attitude of taxpayers toward taxation and its administration is the other key factor that has to be considered and analyzed duly. Accordingly, the respondents were asked for various questions to know their attitude and their response is summarized in the following table.

Table 7: attitude of taxpayers on different issues

Ser. No.	Question	Yes	No
1	Do you have trust in the employees of Tax Authority?	73%	27%
2	Do you have trust in the tax system, assessment, and collection procedures?	42%	58%
3	If there is no penalty or legal enforcement, is there a possibility that you may not pay a tax?	43%	57%
4	Do you feel guilty if you are evading a tax, provided that you remain unnoticed?	90%	10%
5	Have you paid your current tax obligation?	85%	15%
		Agree	Disagree
6	The tax law should be respected	90%	10%
7	Paying tax is unfair	9%	91%
8	Taxpayers evade taxation if possible	39%	61%
9	The severity of sanctions and penalties ensure tax compliance	41%	59%
10	Tax amnesty encourages noncompliance/ evasion	52%	48%

From the above table it can be observed that majority (73%) of the respondents have trust in the employees of tax authority. On the other hand, only 42% of the respondents said that they have trust in the tax assessment, collection, and overall tax system while the remaining majority (58%) said they have no trust. From this it can be understood that the taxpayers have trust in the employees but not in the assessment and collection or other procedures. This shows the taxpayers do not know about the internal procedures of the tax authority i.e. how it assesses and collects taxes or sufficient information was not communicated to taxpayers. The fact that the authority's procedures are obscure from the taxpayers, it is inevitable that loss of confidence on the authority and its procedures will be created in the taxpayers. In other words, the tax system might be considered so complex and time consuming that taxpayers felt they did not have enough knowledge to feel secure about the accuracy of their records and returns despite their best intentions.

The respondents were also asked whether absence of penalty or legal enforcement have impact on their compliance with the tax law and 57% of them said there is no possibility of not paying tax even though there is no legal enforcement. This response is consistent with the previous response on why taxpayers pay taxes and majority of them responded it is an obligation towards the government or state. In this regard, if this is the assumption by the taxpayers as to why they pay taxes, so it is normal to say taxes will be paid whether legal enforcement is present or absent. But this should not have to lead to the conclusion that legal backup is unnecessary or worthless. The remaining 47% responded there is a possibility of not paying tax if penalty or legal enforcement is not in place. Even if these respondents are not the majority to reverse the finding it has be considered cautiously that this figure (47%) by it self is significant amount and it shows there is a huge gap in voluntary compliance.

From the same table, there is another question asked to know whether the respondents feel guilty when they fail to pay taxes provided that they remain unnoticed and accordingly they responded that 90% of them said they feel guilty whatever the case and this is an indication about the taxpayers' attitude that they believe paying tax is a citizenry obligation which creates a sense of guilt in them when not accomplished.

Analysis continues on the same table and respondents were asked whether they agree or disagree with a number of statements that deal with general issues related to tax. From the table it is shown that 90% of the respondents agreed that tax law should be respected, and it is also indicated that the majority of the respondents (90%) did not feel it is unfair to pay tax. On the other hand, respondents are against the statement 'taxpayers evade if possible' (61%), and they also do not agree that severity of sanctions and penalties ensure tax

compliance (59%). This should not be misinterpreted as if taxpayers do not want the presence of penalty or legal enforcement, but it simply means penalty or legal enforcement is not the only way out to ensure tax compliance. Regarding tax amnesty 52% of the respondents said that it does not encourage tax non-compliance or evasion. The remaining 48% said tax amnesty rather encourages tax non-compliance or evasion. In my opinion, this idea is also acceptable because giving tax amnesty for evaders strongly discourages compliant taxpayers and they also tempt to evade or become reluctant. They feel that their compliance behavior has not given credit by the authority; instead they think that the authorities are rewarding tax evaders for their mal conduct.

3.3.6. Awareness

With respect to awareness about 62% of the respondents said they have attended taxpayers' education session less than once in a year, 32% attended twice in a year and 6% said three times a year from different sources. Similarly, a question was forwarded to know how the respondents estimate the size of taxpayers who are not paying tax and 43% said many, 32% said significant, 17% said few and only 3% said none. From this response it is clear that there are sizable amount of individuals who have the capacity to pay tax but not paying. In other words, this shows there is high tax evasion or tax gap. The respondents were asked for possible reasons on the above problem and it is depicted in the following table.

Table 8: reasons why people evade taxation

Reasons	Percentage
Lack of awareness	50
Lack of ability to pay	32
Intentional	4
Negligence	13
Poor and tiresome collection procedure	1

According to this table, the respondents reasoned out lack of awareness as the major reason (50%), lack of ability to pay (32%), negligence (13%) and only 4% of them said it is intentional behavior. The response on lack of awareness found to be consistent with the response obtained in assessing the tax authority's organizational strength. The factor that found in the previous question to be the major weakness of the tax authority here is mentioned as a leading reason for tax evasion.

3.3.7. Honesty

The respondents were also asked to know how far they are loyal to the tax system. Hence their responses were summarized in the table below.

Table 9: response on honesty/ loyalty of taxpayers to tax system

How loyalty/ honesty of taxpayers to the tax system is evaluated by the taxpayers	Percentage
Excellent	7
Good	36
Fair	29
Poor	28

According to the response of the respondents with respect to this issue 7% said the loyalty of the taxpayers is excellent, 36% said it is good, 29% said fair, and 28% of them said it is poor. Generally, this response indicates a more or less encouraging result. On the other side,

the loyalty of the taxpayers is still under question mark even though the ratio does not take the major share. Hence, it calls for further action from tax authorities.

3.3.8. Socio-cultural Factors

From the literature review part is mentioned that taxpayers' compliance behavior can be affected by socio-cultural factors. Hence, the respondents were asked to know whether these factors really have an impact on tax compliance. Their responses were presented in the table below.

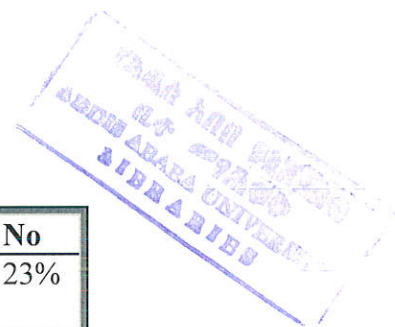


Table 10: response on impact of socio-cultural factors

Question	Yes	No
Does the noncompliance of the other taxpayers have a negative impact on your own compliance behavior?	77%	23%
Do you think that social and cultural factors have an impact on tax compliance behavior?	55%	45%

According to the table above, majority of the respondents (77%) said that the non-compliance of other taxpayers have a negative impact on their compliance behavior. Similarly 55% of them also responded that social and cultural factors have an impact on tax compliance behavior. This may follow the fact that the society is from various ethnic, religious, and social backgrounds and the tax system of the country has also its own historical background. Since there is strong social bond between members of the same group in society, tax compliance behavior of an individual can be affected either positively or negatively by other members of the group. If there are tax compliant and influential individuals in social group or society, there is a possibility that other members follow them and affected by these individuals. Similarly when the influential individuals are tax non-compliant and against the tax law, there is a higher tendency for the followers or members to

be influenced by these individual. Hence, the socio-cultural factors can have a direct or indirect relationship with the tax compliance behavior of taxpayers.

3.3.9. Political Factors

In this study political factors are assumed to be among the factors that determine taxpayers' compliance with the tax law. Based on this assumption respondents were provided with a question and their responses were summarized in the table below.

Table 11: responses on political factors

Question	Yes	No	
Are you concerned about the future of Dire Dawa city?	91%	9%	
Does the political system have an impact on your as well as other taxpayers' attitude towards the tax system?	28%	72%	
Do you think that you are getting comparable social services from the government for the government for the tax you have paid?	45%	55%	
	Agree	Disagree	
Tax is used by the government for meaningless purposes and it doesn't provide enough information about how it utilizes the taxpayers' money	73%	27%	
	Support	Oppose	No opinion
How do you about the current city administration	58%	22%	20%

According to the responses of the respondents from the table above, majority of the respondents have concern about the future of the city (91%). This indicates that as long as they are concerned about the future prospect of the city they can be willing to contribute to the development of the city through taxation. In other words, if taxpayers are taught and convinced that their money will be reinvested on the provision of various services in the city from which they benefit; there is no reason why they are unwilling to contribute their share. This can be supplemented by an other fact that 55% of the respondents said they are not

getting comparable social services from the government in return of what they have paid as a tax.

In conjunction with the above idea, majority of the respondents (73%) said that tax is used by the government for meaningless purposes and it doesn't provide enough information about how it utilizes the taxpayers' money. From the same table it is visible that 72% of the respondents said that the political system have no impact on their as well as other taxpayers' attitude towards the tax system. That is they may consider paying tax as a citizenry obligation rather than a gift to the political party in power. In other words paying tax continues to be an obligation as a citizen regardless of the political ideology of the government in power. This may not be the case always because public attitude towards taxation can be adversely affected when government is highly corrupted and misappropriate the taxpayers' money.

Even though the respondents think that they are not getting comparable social services from the government and the tax revenue is used for meaningless purposes, still majority of the respondents (58%) support the city government. Generally this shows that there is a favorable ground as far as taxpayers' attitude towards the political system or the city government is concerned or it can be generalized that the respondents see taxation and government in different eye.

3.4. Possible Measures to be undertaken

The respondents were also asked for some possible measures that has to be undertaken in order to improve tax compliance behavior of the public. Their response is presented in the table below.

Table 12: taxpayers’ response on measures to be undertaken to improve tax compliance

Possible measures	Response	
	Agree	Disagree
Strengthening legal enforcement and penalties	56%	44%
Improving relation ship with the public	95%	5%
Educating the taxpayers and conducting consultation sessions	98%	2%
Providing necessary information to taxpayers regarding the provision of services and utilization of tax revenues	98%	2%
Reducing tax rates and making the collection procedures simple and transparent	99%	1%

From the above table it is clearly visible that 56% of the respondents agree with strengthening legal enforcement and penalties to ensure compliance. This opinion seems contradictory with the response in Table 7 previous paragraphs where 59% of the respondents indicated severity of sanctions and penalties does not ensure tax compliance. What they tend to say in the above table is, strengthening legal enforcement and penalty can be considered as a complementary with other measures rather than merely relying on it. On the other hand, even though the majority of the respondents support the measure, a significant size (44%) of taxpayers do have a reservation that strengthening legal enforcement and penalties by itself can ensure voluntary tax compliance behavior. These people rather have the belief that focusing on educating taxpayers or encouraging the responsible citizens’ approach has to be the axis of the reform.

Regarding the other measures almost all (i.e. from 95%-99%) respondents strongly agree with them. It is evident from the table that the majority of the respondents felt that the income tax rates should be reduced (99%). This is consistent with response obtained from the respondents under the issue of tax fairness or equity, where the respondents strongly

indicated that the tax they are paying is not fair or based on their ability- to-pay. To put it in nutshell, currently the taxpayers are not satisfied with existing tax system so that they strongly supported the measures proposed in the study.

3.5. Content analysis of open-ended questions

The respondents were also given opportunities to indicate their comments on some open-ended questions and to give general comment on the overall tax system. Accordingly they issued several comments and mainly regarding problems and measures that has to be undertaken. These comments were categorized and listed as below:

- The tax system lacks fairness or equity.
- So many business operators were not accommodated by the tax system and there is high prevalence of illegal trade.
- No sufficient tax education/ lack of awareness, and poor communication between the tax authority and taxpayers.
- No adequate provision of social services.
- Weakness in tax collection and enforcement.
- Absence of transparency in the overall tax system.

The additional comments forwarded by the taxpayers were generally summarized under the above six points. The respondents also stated the possible actions that have to be undertaken in order to bring about improvement in the tax system and ultimately ensure voluntary tax compliance. Based on the detail comments given by the respondents, the above points were briefly explained below.

- Several respondents firmly commented that the tax system lacks fairness and equity. They further elaborated their comment that individuals having equal income are not paying equal tax and this highly affects the taxpayers' motivation to be compliant and remaining compliant. In other words, as long as the tax system lacks horizontal equity (individuals with equal income pay equal tax) it is difficult to change taxpayers' attitude in order to bring about voluntary compliance.

- The other point strongly raised by the respondents is that there are several individuals who are doing business but not paying tax or not known as taxpayers. Similarly there are so many individuals who are engaged in illegal (contraband) trades and according to the views of the respondents, all these abnormal acts are hampering their business activities and as a result unfair competition has prevailed in the city. The respondents have said that the city administration as well as the tax authority has done little to curb these acts so as to reduce tax evasion. The respondents generally commented that these problems have created distortion in their market and affected their attitude towards taxation negatively.

- The other comment given by the respondents is that the tax authority does not provide sufficient education to taxpayers to boost awareness. According to the respondents the root cause of all the problems in the overall tax system is lack of awareness which is attributed to poor tax education practice and absence of consultation sessions between taxpayers and the authority. That is, there is no culture of communication and consultation between both parties and this is what resulted in the existence of a gap.

- On the other hand the respondents indicated that there is no sufficient provision of social services by the government. According to their comment, the taxpayers need various social services from the government in return of what they have paid as a tax. If there is no provision of sufficient services, the willingness and motivation of the taxpayers to pay their tax obligation in full and on timely basis may be affected, i.e. the taxpayers perceive that their money is being misappropriated or used for meaningless purposes.

- The respondents also commented that the tax authority is not effective with respect to tax collection and enforcement. They further explain that there are several taxpayers who are not included in the tax bracket and large amount of uncollected tax exists as an arrear. Moreover, the tax authority exercises little effort in enforcing the tax law. This could be as result of the authority's lack of capacity.

- Finally the respondents indicated that there is no transparency in the tax system. That is, the taxpayers have no access to information and they do not know how the tax is assessed or calculated. In other words, the procedures in tax assessment and computations are not objectively understood by taxpayers or the tax authority is reluctant in making this procedures objective, transparent, and understandable to taxpayers. To put it differently, most of the taxpayers do not know how to determine or calculate their tax obligation by themselves.

4. Conclusion and Recommendations

4.1. Conclusion

There appears to be a substantial tax gap between the tax that is theoretically assumed to be collectable from economically active individuals in the city and the tax that is actually being collected. One of the main reasons for the tax gap is non-compliance of taxpayers and potential taxpayers, with the tax legislation. One of the causes for non-compliance has been demonstrated to be the attitudes and perceptions of people. Dire Dawa is a city that comprises a diverse collection of cultures, languages, beliefs and backgrounds. It is obvious that these different population groups may have differing perceptions of taxation resulting from their cultural backgrounds or social histories. These perceptions may, in turn, influence their attitudes towards tax compliance.

Against this background, it is of utmost importance to determine taxpayers' perceptions towards taxation in order not only to influence government policy regarding taxation and protecting the city's tax base but also to enable government to market itself and its services more effectively to the general public. This study was aimed at investigating a sample of taxpayers' attitude and factors that determine their compliance with the tax law in Dire Dawa city.

The study indicated that although the majority of the respondents did not feel it is unfair to pay tax, all of the respondents have elicited certain factors that affect taxpayers' voluntary compliance and measures to be undertaken by the tax authority to ensure voluntary compliance. These factors which influence the taxpayers' voluntary compliance behavior can be concluded in the paragraphs that follow.

- ❖ From this study it is concluded that the tax rate undoubtedly is a lot higher than what most taxpayers would like it to be. Most of the respondents feel that people should pay taxes according to their ability; in other words they feel that they do not pay about the same amount of tax as others in similar situations. Generally as long as the tax being levied is not fair and equitable it may reduce the motivation and voluntary compliance behavior of current taxpayers and also deter potential taxpayers from joining the tax system voluntarily.

- ❖ Awareness is a corner stone as far as voluntary compliance is concerned. The survey data has shown that majority of the taxpayers know why they pay taxes but they have no detail knowledge about taxation. On the other hand, in this study lack of awareness was cited as the major and leading reason for tax evasion and the respondents strongly agreed and commented that great effort has to be employed in this area.

- ❖ Tax authority is the responsible body for assessing and collecting the city's tax revenue. The amount of revenue collected is directly dependent on the efficiency and effectiveness of the authority. In light of this fact the survey result showed the tax authority of the city administration is not efficient and effective in various aspects such as improving the tax assessment and collection procedures, creating awareness, enforcing the tax law, providing services, and information regarding tax. It can be concluded that, so long as this is the fact it is not easy to bring about voluntary compliance and narrow the tax gap.

- ❖ The respondents additionally commented on this issue and they reasoned out that both the tax authority and the city government didn't play their role well. Majority of the taxpayers believe that tax law should be respected and do not feel paying tax is unfair. Similarly most of the respondents have trust in the employees of the authority but not in tax estimation, assessment and collection procedures. From this it can be concluded that this problem has emanated from lack of awareness and problem of transparency in the activities of the authority. Still majority of the respondents said that they feel guilty if they do not pay tax and believe that their compliance is not contingent on the presence of penalty, and even agree that severity of sanctions and penalties do not ensure voluntary compliance. To conclude, the survey result shows there is a positive attitude towards taxation and the existing problems are down to lack of awareness and absence of transparency.

- ❖ Even though the survey results show the honesty and loyalty of taxpayers is above average, still some respondents have reservation on the issue. The factor is also contingent on other factors mentioned in the foregoing paragraphs and on how the government utilizes taxpayers' money.

- ❖ The survey data also revealed that socio-cultural factors have an impact on the tax compliance behavior of individuals. Especially with respect to social factors, the result indicates social relationships and influences can affect attitude of taxpayers towards taxation positively as well as negatively. Influential individuals such as elderly, religious leaders, community leaders or certain social group leaders will play a great role in influencing the attitude of other individuals.

- ❖ It was discussed in the literature review part that the political attitude of the society has an impact on their compliance behavior. Hence, political factor was considered as a determinant factor of taxpayers' voluntary compliance. But the results of this survey showed that the political system has no impact on the taxpayers' attitude towards taxation. Even though the taxpayers feel that they are not getting comparable social services from the city and the tax revenue is being used for meaningless purposes, majority of them have sympathy to towards the city administration. To sum, in this particular study it is found that the impact of political system on the taxpayers' attitude towards taxation is not determinant.

To put in nut shell, the survey indicated factors that determine taxpayers' voluntary compliance behavior. These are:

- equity and fairness of the tax system
- level of awareness of taxpayers
- effectiveness and efficiency of tax authority and
- socio-cultural factors

Other factors such as taxpayers' attitude and honesty/loyalty are found to be the result of lack of awareness or others while political factor has found to have little impact on taxpayers' attitude towards taxation. Hence, it is advisable to capitalize on these factors to bolster taxpayers' voluntary compliance.

4.2. Recommendations

Any strategy to prevent tax evasion should begin with a theory of why people cheat on their taxes. Economists approach the question of why people to comply with the tax laws begin by constructing a theory based upon the assumption about human behavior that underlies all of economics, namely, individuals generally act rationally in evaluating the cost and benefits of any chosen activity. According to Allingham and Sandmo (1972), based on Becker's (1968) economic theory of crime, the extent of deterrence, as the product of the probability of being detected and the size of fine being imposed, determines the amount of income tax evaded.

On the other hand, psychologists tend to assume that individuals are moral beings with ideas and values of their own and that commands and their own impulses filter through and are affected by this moral screen. They would note that variables such as the probability of detection, size of fines and so on are mediated through individual attitudes and perceptions.

According to Brooks (2001) sociologists also tend see the cause of variation in human behavior in the structure of the social system. It is reasonable to assume that human behavior (Fjeldstad, 2004) in the area of whether or not to pay taxes is influenced by social interactions much in the same way as other forms of behavior. Compliance behavior and attitudes towards the tax system may thus be affected by the behavior of an individual's reference group such as relatives, neighbors, friends and political associates. Thus they explain people's actions by examining the forces that impinge on the positions that they occupy within the system. Social scientists from almost every discipline have turned their attention to tax evasion as social phenomena.

Edlund (2003) summarizes that those who have carefully studied the public's attitudes, perceptions, and knowledge of taxes and tax policy have generally found that citizens are indeed remarkably misinformed and/ or confused. In similar vein Lewis (1982) claims that most people do not regard fiscal policy as an important issue and concludes that 'the general public is fiscally ignorant'.

In general theories of tax compliance are organized around the above three premises, namely, economic theories, psychological theories, and sociological theories. Assessing all these theories help to know why people comply with the tax law from which an interested tax administration could deduce a comprehensive compliance strategy. In other words, the determinant factors of tax compliance behavior emanate from these theories in one way or the other so that the theories always serve as a baseline in understanding tax compliance behavior.

There is no magic or quick solution to increasing tax compliance. A reform strategy to increase compliance requires a concerted, long-term, coordinated and comprehensive plan. It is vital that tax administrators ensure that every compliance policy instrument at their disposal is being used as effective as possible.

Based on the study conducted using survey method factors that determine taxpayers' voluntary compliance were identified and possible recommendations will be forwarded so that it may help the tax authority and other policy makers to approach the issue accordingly. Multiple approaches are needed to reduce the tax gap. No single approach is likely to fully

and cost-effectively address noncompliance, since; it has multiple causes and spans different types of taxes and taxpayers.

Generally, understanding better these factors, and their interrelationships, that impact on taxpayer behavior can help to develop targeted strategies which impact on the non-compliant without adversely affecting compliant taxpayers.

- ❖ The most obvious requirement for fairness or equity is to treat equal people in equal circumstances in an equal way. If there is a reason for not discriminating between equals, then this suggests that there should be discrimination between those who are not equal. Maintaining tax equity and fairness is not achieved only through levying equal taxes on individuals who have equal income but also each taxpayer should pay according to his ability- to pay. In addition, bringing non taxpayers to tax system has to be considered as a measure of ensuring tax equity. In other words, it is unfair to say that the tax system is equitable as long as several capable traders are not paying tax. Taxpayers will be discouraged to the extent that the tax is believed to be unfair and inequitable or so many others are not paying. Hence, the question of fairness or equity is not only about dealing with current taxpayers but also concerned with people out side the tax system. Ensuring equity means encouraging and protecting honest and loyal taxpayers by adopting fair competition. This can be achieved by incorporating in to the tax system all those who are eligible. The authority must also involve the taxpayers or their representatives while estimating the daily sales or revenue of taxpayers to address the question of fairness and equity. Generally, the

authority has to try its level best in ensuring tax fairness and equity so that voluntary compliance behavior can be developed.

- ❖ An effective compliance program requires that tax administration has sufficient powers that enable it to enforce compliance effectively. Voluntary compliance is promoted not only by an awareness of rights and expectations of a fair and efficient treatment, but also by clear, simple and user friendly administrative systems and procedures. Tax systems that depend on ad hoc administrative procedures rapidly become discredited and endanger compliance. To encourage compliance it is equally important that tax authority administers the law fairly.

The tax authority needs to be strong enough in order to implement the tax law effectively and efficiently. Functions such as tax assessment, collection, awareness creation, providing information, and enforcement has to performed effectively and efficiently, so that it will be perceived as strong and powerful by the taxpayers. 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.

Hence, to create an efficient tax administration, the tax authority needs to strengthen it self by educating and training its employees, by computerizing its operations, devoting additional resources. Training should include customer service training and

cross functional training for employees so they have an understanding of the entire system of tax administration. In addition to this, the authority should make the tax law and procedures simple, understandable, and transparent. Voluntary compliance is enhanced when vibrant and efficient tax authority exists.

- ❖ One of the areas to stress on while dealing with the issue of voluntary compliance is the development of persuasive communications between the tax authorities and taxpayers. The most effective tool for making people more positive is to empower them with knowledge. It is submitted that there is no better tool for government to positively influence the taxpayers than to provide them with knowledge on how taxpayers' money is utilized. Any resistance or inability by government to communicate this most important area, will lead to possible speculation and resistance. Taxpayers' attitude toward taxation is changed only through sustainable awareness creation programs.

Awareness creation should go beyond simply giving tax education to taxpayers. It should be extended to having consultative sessions with elderly, religious leaders, prominent personalities in the society or other influential individuals. This can help to influence the whole society through these influential persons who have acceptance in their respective groups.

There should be more preventative education for the public and increased awareness of tax responsibilities in schools. Students should be educated early in their career about tax responsibilities. All of these promote a positive view to voluntary compliance. This is to inculcate in citizens a sense of responsibility toward taxes.

There is a need for citizens to understand and accept their responsibilities of compliance. There is also a need to publicize the tax burden carried by compliers versus the burden that would be carried if everyone complied.

Hence, awareness creation must remain the tax system's central premise in building voluntary compliance so that robust revenue productivity will be ensured simultaneously.

- ❖ Tax resistance is likely to continue (and increase) if service provision does not improve, necessitating costly and coercive methods of tax enforcement that may undermine the legitimacy of the government. Improvement in service delivery for the majority of citizens is therefore a necessary condition to improve tax compliance. The existence of positive benefits in the form of public services, security, etc. may therefore increase the probability that taxpayers will comply voluntarily, without direct coercion.

Hence, the city government has to provide social services to the public and it has to inform the taxpayers that these services are provided by their money. This is to convince the taxpayer that they are getting their money back and this in turn enhances voluntary compliance and increases the trust of the taxpayers on the government.

Tax compliance will be developed only with the voluntary participation of the society. Merely relying on stick approach has no far reaching outcome. Hence, the government and the tax authority have to capitalize on responsible citizens' approach in their effort of

bringing about voluntary compliance. Tax evasion and non-compliance is inevitable in every society or nation. Therefore, it is worthwhile to recommend that the above approach has to be backed by legal enforcement and the efforts must complement each other.

Bibliography

- Adams, T.S. (1921). Fundamental problems of Federal Income Taxation. *Quarterly Journal of Economics* 35(4), 527-557.
- Allingham, M.G. and Sandmo, A.(1972). Income Tax Evasion: A Theoretical Analysis. *Journal of Public Economics* 1.
- Andreoni, J. and et al (1998). Tax Compliance. *Journal of Economic Literature*, Vol. 36, No.2. American Economic Association.
- Bhatia, H.L.(1976). *Public Finance, 19th edition*. New Delhi, India: Vikas Publishing House Pvt Ltd.
- Bird, R. M. and Oldman, O. (1967).*Readings on Taxation in Developing Countries*, Revised. edition. Baltimore, USA: The John Hopkins Press.
- Brooks, N. (2001). *Key Issues in Income Tax: Challenges of tax administration and compliance*. Asian Development Bank Tax Conference.
- Due,J.F. and Friedlaender, A.F. (1981). *Government Finance: economics of the Public Sector 7th ed*. Illinois, USA: Richard D. IRWIN, INC.
- Eckstein, Otto. (1979). *Public Finance 4th edition*. Englewood Cliffs, USA: Prentice-Hall, INC.
- Edlund, J. (2003). Attitude towards Taxation: Ignorant and Incoherent? *Scandinavian Political Studies*, Vol.26, No.2. Nordic Political Science Association.
- Federal Inland Revenue Authority (2000). Components of Tax Administration. *Tax*, Vol.1, no 3, FIRA, Addis Ababa.
- Fjeldstad, O. (2004). *To Pay or Not to Pay? Citizens' Views on taxation in local authorities in Tanzania*. Working paper, Bergen, Norway: Chr.Michelsen Institute.
- Fjeldstad,O. and Ranker, L. (2003). *Taxation and Tax Reforms in Developing Countries: Illustration from sub-Saharan Africa*. Bergen, Norway: Chr.Michelsen Institute.
- James, S. and Nobes, C. (2000). *The Economics of Taxation: Principles, Policy and Practice 7th edition*. Prentice-Hall.
- James, S. et al (2003). *Tax Compliance Policy: An International Comparison and New Evidence on Normative Appeals and Auditing*: Unpublished manuscript.

- Lemessa, B. (2005). *Federal Income Tax Administration in Ethiopia: The Case of Employment and Business Income Taxes*, Unpublished Msc. Thesis, AAU.
- Levi, M. (1988). *Of Rule and Revenue*. Los Angeles, USA: University of California Press.
- Lewis, A. (1982). *The Psychology of Taxation*. Oxford: Martin Robertson.
- Long, S.B. and Swingen, J.A. (1991). Taxpayer Compliance: Setting New Agenda for Research. *Law and Society Review*, Vol. 25, No.3,PP. 637-684. Law and Society Association.
- Negarit Gazette, (2002).*Income tax proclamation 286/2002*, FDRE: Addis Ababa, BSPE.
- _____ (2002). *Income Tax Regulation 78/2002*, FDRE: Addis Ababa, BSPE.
- Peacock, A. and Forte, F. (1981). *The Political Economy of Taxation*. New York, USA: St. Martin's Press.
- Shultz and Harriss (1949). *American Public Finance 4th edition*. New York, USA: Prentice- Hall, INC.
- Smith, K.W. and Kinsey, K.A. (1987). Understanding Tax Paying Behavior: A conceptual framework with implications for research. *Law and Society Review*, Vol. 21, No.4. Law and Society Association.
- Song, Y. and Yarbrough, T. E. (1978). Tax Ethics and Taxpayer Attitudes: A survey. *Public Administration Review*, Vol.38, No.5,pp.442-452. American Society for Public Administration.
- Statistical Abstract (2006), Dire Dawa Policy Study and Planning Department.

**Questionnaire on Determinants of Taxpayers' Voluntary Compliance
with the Taxation**

Dear Respondents,

This study is conducted in partial fulfillment of the requirements for the master's degree in business administration at Addis Ababa University. Its main objective is to identify the determinant factors of taxpayers' voluntary compliance with the taxation. The research is going to be carried out on your responses and other relevant data that could support it.

The purpose of this questionnaire is to obtain your perceptions and views regarding various aspects of taxation. It forms a major part of the research and the information you will give enable me to critically analyze why taxpayers comply and/or why not they comply with the tax law. Your cooperation to respond is very important to this study because it represents thousands of others who are not included in the sample.

Please answer every question. The questionnaire seeks basic factual information and you can tick the option that you choose or write your answer on the blank space provided. Space is provided at the end of the questionnaire for you to add further comments or explanations. I would promise that all information you provide would be strictly confidential.

I thank you very much in advance for your cooperation.

Data collector's name: _____

Researcher's Name: Lemessa Tulu

Position: MBA student at AUU

Telephone: 0911-77-26-87

1. Personal Data

Age _____

Sex: Male Female

Ethnicity _____ Religion _____

Marital Status: Single Married Divorced

Family size _____

Level of education _____

Type of business _____

For how many years you were in business? _____

For how many years you are known as tax payer? _____

2. Questions to be answered by taxpayers. (Put “√” in the box of your choice.)

I. Questions related to taxpayers’ general knowledge about taxation

1. Do you know why you pay taxes?

Yes No

2. Why do you pay taxes (check all that apply)?

- To avoid disturbances (penalties, sanctions,) []
- In the anticipation of public services []
- There is no opportunity to evade. []
- It is an obligation towards the government. []
- Don’t know. []

State if any, _____

_____.

3. Do you think that the tax you are paying is fair and based on your ability to pay? If your answer is no, go to the next question.

Yes []

No []

4. Is your tax liability understated or overstated?

Overstated []

Understated []

5. The tax laws should be respected.

Strongly Agree []

Moderately agree []

Moderately disagree []

Strongly disagree []

6. Which of the following is the most serious crime? (rank them 1-6)

Kidnapping []

Drunken driving []

Hit and run []

Tax fraud/evasion []

Stealing someone's mobile []

Bribery []

7. How often you are attending education sessions about taxation?

Three times per year []

Twice a year []

Once a year []

Not at all []

II. Questions related to the tax authority

8. How do you evaluate the strength of the tax authority with respect to the following parameters?

	<u>Excellent</u>	<u>Good</u>	<u>Fair</u>	<u>Poor</u>
Service delivery	[]	[]	[]	[]
Tax collection efficiency	[]	[]	[]	[]
Law enforcement	[]	[]	[]	[]
Awareness creation	[]	[]	[]	[]

9. What are the major problems in tax system/ collection (thick all that apply)?

Tax revenues are not spent on public services. []

Tax rates are too high. []

There are dishonest tax collectors. []

Several tax items are levied at the same time. []

Taxpayers are not willing to pay taxes. []

If you have any, mention it here _____

10. Do you have trust in the employees of Revenue Agency?

Yes [] No opinion []

No []

11. Do you have trust in the tax system, assessment, and collection procedures?

Yes [] No []

12. The non compliance of taxpayers can put the credibility and trustworthiness of the revenue administration under question mark.

Strongly Agree []

Moderately agree []

Moderately disagree []

Strongly disagree []

III. Questions related to taxpayers' attitude towards taxation

13. If there is no penalty or legal enforcement, is there a possibility that you may not pay a tax?

Yes [] No []

14. Do you feel guilty if you are evading tax, provided that you remain unnoticed?

Yes [] No []

15. Have you paid your current tax obligation? If your answer is no, go to the next question.

Yes [] No []

16. What could be your reason for not paying your tax obligation (check all that applies)?

- It is unfair/ beyond my ability.
- I face no problem by doing so.
- I have no sufficient disposable income
- Since the payment period already passed, now I afraid of the penalty
- Expecting amnesty or write off

If you have other reasons you can mention them here _____

17. How do you guess the size of taxpayers who are not willing to pay taxes?

- Many
- Insignificant
- Few
- None

18. Why these taxpayers are not willing to pay taxes (check all that apply)?

- Lack of awareness
- Lack of ability to pay
- Intentional
- Negligence
- Poor and tiresome collection system

If any, mention here _____

19. Does the non compliance of other taxpayers have a negative impact on your own compliance behavior?

- Yes
- No

Ser. no	Question	Excellent	Good	Fair	Poor
20	What do you think about the public attitude towards taxation, including you?				
21	How do you evaluate the honesty and loyalty of the taxpayers to the tax system?				

Ser. no	Question	Strongly Agree	Moderately agree	Moderately disagree	Strongly disagree
22	Paying tax is unfair				
23	Taxpayers evade taxation if possible				
24	The severity of sanctions and penalties ensure tax compliance.				
25	Tax amnesty encourages non compliance/ evasion.				

26. Who is to blame for the poor tax compliance (check all that applies)?

Tax authority

City government

Taxpayers

License and permit authorities

Why? _____

_____.

IV. Questions related to taxpayers' socio-cultural and political situations

27. Do you think that social and cultural factors have an impact on tax compliance?

Yes [] No []

If your answer is yes, state how it affects _____

28. Are you concerned about the future of Dire Dawa city?

Yes [] No []

29. How do you feel about the current city administration?

Strongly oppose []

Mildly oppose []

Mildly Support []

Strongly support []

No opinion []

30. Does the political system have an impact on your as well as other taxpayers' attitudes toward the tax system?

Yes [] No []

31. Do you think that you are getting comparable social services from the government for the tax you have paid?

Yes [] No []

32. Tax is used by the government for meaningless purposes and that the government doesn't provide enough information about how it utilizes the taxpayer's money.

Strongly Agree []

Moderately agree []

Moderately disagree []

Strongly disagree []

33. Which of the following measures should the government undertake on order to improve tax compliance behavior of the citizens?

Possible measures	Strongly agree	Moderately agree	Moderately disagree	Strongly disagree
Strengthening legal enforcement and penalties				
Improving relation ship with the public				
Educating the taxpayers and conducting consultation sessions				
Providing necessary information to taxpayers regarding the provision of services and utilization of tax revenues				
Reducing tax rates and making the collection procedures simple and transparent				

Add if you have additional comment _____

 _____.

34. Give your general comment on the overall attitude of the public towards taxation and how positive attitude towards taxation can be developed.

Thank You!!!

Declaration

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

Declared by:


Name Lemessa Tuleu

Sign 

Date 08/08/07

Confirmed by Advisor

Name Telahun Tsekh

Sign 

Date 10 Aug 2007