



**FACTORS AFFECTING TAX COMPLIANCE BEHAVIOR OF
ADDIS ABABA NUMBER TWO MEDIUM TAXPAYERS
BRANCH OFFICE, IN ADDIS ABABA, ETHIOPIA**

BY: HABTAMU LASHETEW

**SUBMITTED TO AAU, COLLEGE OF BUSINESS AND
ECONOMICS, DEPARTMENT OF ACCOUNTING AND
FINANCE IN PARTIAL FULFILMENT OF THE
REQUIREMENTS FOR THE DEGREE OF MASTERS OF
SCIENCE IN ACCOUNTING AND FINANCE (MSC)**

JANUARY 31, 2019

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**SUPERVISOR
ABEBAW KASSIE (PHD)**

JANUARY 31, 2019

ADDIS ABABA

DECLARATION

I declare that:

- I. This Study is based on a study undertaken by me, Habtamu Lashetew Wondale of the department of Accounting and finance, school of Business And Economics, Addis Ababa University, Ethiopia
- II. The research work is based on my desire to investigate the factors that affect tax compliance in Ethiopia particularly Addis Ababa medium taxpayers
- III. This research work is my original work and to the best of my knowledge, it has not been submitted elsewhere for academic achievement (any degree or diploma)
- IV. The ideas and views of other researchers, authors and scholars expressed in the work are duly acknowledged.

Declared by:

Name_____

Sign_____

Date_____

Confirmed by:

Name_____

Sign_____

Date_____

CERTIFICATION

We certify that this research work titled “Factors affecting tax compliance behavior of Addis Ababa medium taxpayers in Addis Ababa Ethiopia” was undertaken and finalized by Mr. Habtamu Lashetew Wondle and that the research work was supervised by us and submitted to the department of accounting and finance, school of Business And Economics, Addis Ababa University, Ethiopia

Approved by:

Advisor

Internal Examiner

External Examiner

Signature

Signature

Signature

DEDICATION

This work is dedicated to the almighty God, the source of all good things, for making this work a reality. I do not forget my lovely family's and friend's contribution with all regards for the success of this paper.

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I would like to thank the almighty God that gives me his mercy and persistence help during my study and for blessing me with good people, who are genuinely committed to my progress. Besides, I would like also thanks my thesis advisor, Dr. Abebaw Kassie for is such a wonderful councils. Without his wise and knowledgeable advices, this paper would not become noticeable. I am also greatly admire his humbleness and commitment for his advisee with fabulous tactic. I sincerely say thank you Sir. Your commitment towards my success as an academic is highly appreciated.

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ABSTRACT

Taxation is one of the important elements in managing national income. However, as most of the developing countries, Ethiopia has been highly depending on external aid and loan for funding its expansion events. The tax involvement to GDP remained consistently low and is relatively reduction due to low tax compliance. The main objective of this paper is to insight the influence of some possible factors that affect the compliance behavior of Addis Ababa medium tax payers in Addis Ababa. The data required for this research was collected from primary sources which were collected directly from taxpayers through researcher-administered questionnaire .In addition, the research employed quantitative research design. A sample size of 303 was drawn from the tax population in Addis Ababa medium taxpayers branch office. Generally, the research signifies that the factors which make taxpayers not discharge their tax duties with their own self-assessment and right amount. The research implies that the researcher's selected factors; perceived fairness of tax system, tax knowledge and education, fine and penalty and power and trust of the tax authority the taxpayers are have impact on the tax compliance level. The city tax authority has to do a lot tasks to build strong and trustful relationship between the tax authority and the taxpayers. The tax authority should supposed provide continuous education for the taxpayers for creating clear awareness the use tax for the citizens. Besides, there should be rigid enforcement of fines and penalties to deter tax evasion. The tax authority has not provided sufficient awareness with its directives and laws. The tax system, tax policy and tax proclamations should extract by considering the taxpayers' knowledge level, income level and perception.

CHAPTER ONE

INTRODUCTION

1.1 BACKGROUND TO THE STUDY

Taxation is a branch of public law. As important sources of public revenue, taxes are very important part of the daily functioning of a government. Taxes are important sources of public revenue. Public goods and services are normally subject to collective consumption, thus requiring that we put some of what we earn into government hands. Any government's priority is the generation of revenue money by means of which it can procure such services and goods necessary for the performance of its functions. (Ethiopian Chamber of Commerce and Ethiopian Business Development Services network, 2005).

A number of authors have tried to define the term 'tax'; however, it is hard to say that these attempts at coming up with a definition for the term have been successful mainly owing to the fact that too great precision is attempted in a single sentence. The best way to understand the term is to state the fundamental idea of a tax and afterwards to note its leading characteristics. Accordingly, in general terms, tax can be defined as a contribution from individuals out of their private property for the maintenance and defense of government, so that it may perform its functions and the ends of the state be realized. According to (Bhatia, 1996) "tax is a financial charge or other levy imposed on an individual or a legal entity by government.

It is vested in the legislature by the general grant of the legislative power whether specially enumerated in the constitution among the powers to be exercised by it or not. Coming particularly to the case of Ethiopia, the Constitution of the Federal Democratic Republic of Ethiopia, while enumerating the powers and duties of the Federal Government in Article 51 clearly states that the levying of taxes and the collection of duties on revenue sources is among the duties of the government. In addition to this, Article 52 goes on and enumerates the powers and functions of state governments, amongst which is the levying and collection of taxes and duties on revenue

sources reserved to the States. When taxes are levied; the citizen is liable for their payment at the time and in the manner required and provided by the law authorizing their assessment and collection (FDRE Constitution).

A key component of any tax system is the manner in which it is administered. No tax is better than its administration, so tax administration matters a lot. An essential objective of tax administration is to ensure the maximum possible compliance by taxpayers of all types with their tax obligations. Tax compliance as filing all required tax returns at the proper time and that returns accurately report tax liability in accordance with the tax law applicable at the time the return is filed. Tax compliance as filing all required tax returns at the proper time and that returns accurately report tax liability in accordance with the tax law applicable at the time the return is filed (Olaoye, Agbaje Ajewole, 2017)

The scope of tax compliance includes, reporting income and paying all taxes in accordance with the applicable laws, regulations, and court decision. Tax compliance typically means, true reporting of the tax base, correct computation of the liability (accuracy), timely filing of the return, and timely payment of the amounts due (timeliness). Another definition of tax compliance is a person's act of filling the income tax form, declaring all taxable income accurately, and disbursing all payable taxes within the stipulated period without having to wait for follow-up actions from the authority. To execute the tax compliance the best methods the tax self-assessment methods. SAS makes the tax systems more convenience, convince and economy. It is the most essential for avoiding unnecessary tax collection cost. (Manchilot,2018)

Many countries have accepted the self-assessment system (SAS) in order to simplify the tax assessment system and encourage voluntary compliance. As tax non-compliance affects revenue collection and the ability of the government to achieve its fiscal and social goals, the Ethiopian government, through its revenue collection agency (Ethiopian revenue and custom authority) clearly stated that efforts will be geared towards promoting voluntary compliance (ERCA, annual report, 2012).In Ethiopia, SAS was recently introduced in 2005. Self-assessment was adopted to address the low level of tax compliance under official (Direct) assessment system (Kasipillai & Jabbar, 2003).

The researcher motivated with tax because it is multi-disciplinary specially economics, law and accounting. The researcher have educational background with the above three disciplines. The objectives of this paper therefore are to assess the degree of compliance of the relevant tax laws by taxpayers and find out the effects of tax knowledge, tax penalty, and perceived fairness for tax system and effects of trust and power over tax compliance. The rest of the paper is divided into four parts. The first section discuss about introduction, second section talks about a review of literature and section three is elaborating how the methodology used to collect and analyze the data. Section four presents the results and discuss the findings from the software analysis. The last section disclose conclusion and recommendation based on the results.

1.2. PROBLEM STATEMENT

The problem of noncompliance is more serious in developing countries particularly in Sub-Saharan African countries (Cobham, 2005). Ethiopia is presently reliant on more on external economic resources (aids and loans) to fund their development activities. Hence, the country practiced a consistent excess of expenditure over revenue for adequately long period of time. Tax noncompliance is a growing concern for Ethiopia tax authorities and public policy makers since it seriously threatens the capacity of governments to raise required public revenue. So, the government introduced a number of rules, systems and methods aiming tax collection as a major source of public revenue. However, this all efforts couldn't still bring the required result due to a number of reasons (ERCA,2015).

The main reason of this low revenue collection performance is due to tax noncompliance and due to poor tax administration (IMF, 2015).One of the main problems in implementing self-assessment system (SAS) is achieving acceptable levels of voluntary compliance (Palil , 2010). This may happen due to factors such as lack of familiarity with the self-assessment system, poor tax

authority administration, lack of awareness creation about tax provisions, regulations, directives and general limited knowledge of tax issues.

Due to these reasons, tax compliance has been given a serious attentions by researchers because of increasing noncompliance especially tax evasion and its consequences on the capacity of government in raising public revenue. Ethiopian government fail to fulfill income tax requirements and a number of them face prosecution for failing to pay taxes on time. (ERCA, 2014). Even if the government advocates voluntary compliance, the tax system in the country mainly stresses on legal enforcement as a remedy to ensure its proper functioning. (Proclamation, 286/2002). According to the information obtained from large tax payer's office, number of non-filers, null-declarants and amount of tax collected from enforcement activity showed continual increment. (ERCA, 2014).

It is obviously shows that using old policies such as controls and forfeits may not work continuously and persistently. Hence, there is a clear need for more empirical research on the factors that affect tax compliance, since a better understanding of these factors can yield strategies that improve compliance. However, to the best of the researchers' knowledge the factors influencing tax compliance studies have not been carried out especially on Addis Ababa Medium taxpayers in Ethiopia;

The former researchers focused on the large taxpayers which have sufficient and effective knowledge regarding with tax compliance and also they have good understanding for identifying their duties and rights which legislated under tax laws, regulation and directives.(ERCA,2018). Second, large taxpayers have hired well trained and professional accountant. The accountant has great impact on the tax compliance matter. Beside, most of the large taxpayers companies made agreement with independent external auditor. Lastly, the former research has given emphasis on the behavior of the taxpayers. But, there are tax authority behavior that makes the taxpayers to be non-tax compliant. The researcher has considered these issues as the limitations of the previous studies. It is therefore, the focus of this study is to identify factors affecting Addis Ababa Medium taxpayer's compliance behavior with respect to direct and indirect tax reporting requirements in Ethiopia.(Akalu,2016)

1.3 RESEARCH QUESTIONS

These research questions are concentrated on the tax system and tax legislation of Addis Ababa revenues authority . The research questions tried to address that the authorities tax system and tax regulation contribute for the behavior non-tax compliance. Moreover, the tax authority providing continues tax training to tax payers. So, the research questions have tried to assess does this training contributes for improvement of tax compliance behavior. It also tried to address the positive or negative impact of fines and penalties on the tax compliance behaviors. Moreover, it attempts to check whether trust and power of tax authority contributes for non-compliance behavior

The core research question is what factor affect tax compliance behavior of taxpayers in Ethiopia. Precisely, this study has tried to answer the following four major research questions.

- ✓ How is perceived fairness for tax system affecting tax compliance behavior?
- ✓ How is tax knowledge and education influcing tax compliance behavior?
- ✓ How is fines and penalties detering compliance behavior?
- ✓ How is trust and power of tax payers contributing compliance behavior?

1.4 OBJECTIVES OF THE STUDY

1.4.1 GENERAL OBJECTIVE

To examine the factors affecting tax compliance in Addis Ababa tax system.

1.4.2 SPECIFIC OBJECTIVES

- i. To determine perceived fairness for tax system on tax compliance level
- ii. To examine the effect taxknowledge on tax compliance level
- iii. To assess the effect of fines and penalties in tax compliance level
- iv. To evaluate the trust and power of tax administration compliance level

1.5 SIGNIFICANCE OF THE STUDY

This study help to tax stakeholders like tax authority, taxpayers, accountants and auditors, tax policy makers, tax law legislator and other tax research makers. This research help the tax authority to know the outlook the taxpayers, knowledge level of the taxpayers and the drawback of their organization. All the taxpayers will have the chance to know the use tax compliance and the use of tax for their daily life. Both accountant and auditors will be beneficiary from the study with creating awares for their employers. The tax law legislator and tax research makers will have one more additional reference for their research. Since it helps them to understand various challenges faced by taxpayers towards voluntary compliance and help them advice their clients accordingly. The study is prominence to the community since it will high point various encounters faced by the taxpayers towards compliance and the possible resolutions to these complications. To other researchers the survey is a basis for further research, more so, when seeking to research on enhancing revenue collection through other systems that either supplement or substitute self-assessment system.

1.6. SCOPE AND LIMITATION OF THE STUDY

There are many factors that affect tax compliance behavior; this study has been to study those factors which are likely to affect the tax non-compliance of Addis Ababa medium taxpayers in Addis Ababa. Therefore the study is limited to Addis Ababa number 2 medium taxpayers branch office. These Addis Ababa medium taxpayers selected because about most of the city's tax revenue generate from them. Factors affecting tax compliance behavior, namely, fines and penalties, tax knowledge and education, effects of trust and power of tax authority and perceived fairness of tax system were analyzed. The limitation of this study, however, is due to the small sample size used for this study as compare with the number of taxpayers available in the branch. Another limitation is shortage of time and finance of the researcher to conduct the tax compliance behavior of all the taxpayers in the branch. Results based on such opinions might not accurately reflect the opinions of all members of the included population.

1.7. ORGANIZATION OF THE PAPER

This paper is organized as follows: The first chapter of this paper discuss about the background of study, problem of the statement, objective, significant of the study and research questions. The next chapter analyses prior literatures investigative compliance, its describing factors from the viewpoint of different professionals and Ethiopian taxation history. Following the pertinent literature, there is a discussion of research methodology including population, sampling techniques, methods of data collection and the research instruments employ. After a discussion of methods procedures and techniques follow, the survey findings are analyzed and summarized. The last chapter covers conclusion and recommendations.

CHAPTER TWO

REVIEW OF RELATED LITERATURE

2.1 INTRODUCTION

This chapter reviews earlier study and literature in tax compliance. Specifically, the chapter begins with a general discussion on Ethiopian tax system development and the current tendency, followed by tax compliance concepts and finally, a review of prior literature on possible factors affecting tax compliance and Conceptual Framework.

2.2 TAXATION SYSTEM IN ETHIOPIA

Tax has been defined by different ruling classes and experts in various methods. Conceptually, tax can be defined or seen as a compulsory transfer of resources from the private to the public sector (Uremadu, 2000). Taxes are compulsory transfers of resources to the government from the rest of the economy. Tax as liability on account of tax payers as contribution in some quantum measure to the fund available for use by the government in providing necessary infrastructure for her citizens (Loo, 2004). Taxes are compulsory levy by the tax subject (government) through her designated agent on the tax subject (the tax payers). And another study by tax is defined as ‘a compulsory levy, imposed by government or other tax raising body, on income, expenditure, or capital assets, for which the taxpayer receives expenditure, or capital assets, for which the taxpayer receives nothing specific in return’ (Lymer and Oats, 2009).

Toward the end of the imperial period, the budgets of the various ministries increased progressively while tax yields deteriorated. With a majority of the population living at a sustenance level, there was limited opportunity to increase taxes on personal or agricultural income. Consequently, the imperial government relied on indirect taxes (customs, excise, and sales) to generate revenues. For instance, in the early 1970s taxes on foreign trade accounted for close to two fifths of the tax revenues and about one-third of all government revenues, excluding foreign grants. At the same time, direct taxes accounted for less than one-third of tax revenues. (Yohannes and Sisay, 2013)

The revolutionary government changed the tax structure in 1976, replacing taxes on agricultural income and rural land with a rural land-use fee and a new tax on income from agricultural activities. The government partially lessened the tax collection problem that existed during the imperial period by delegating the responsibility for collecting the fee and tax on agriculture to peasant associations, which received a small percentage of revenues as payment (Gebrie, 2008). That percentage declined after 1979, although it remained relatively higher than the figure for the pre-revolutionary period. (Yohannes and Sisay,2013)

Since 1992/93, the Government of Ethiopia has made a major economic policy shift from Central Planning to market oriented economic system. In line with this change, a series of tariff and tax reform measures have been taken. The reasons to these were: outdated tariff and tax laws; weak customs and tax administration; failure of the tariff and tax regime to attract investment, to facilitate trade and to generate adequate revenue to cover current and capital expenditure, and hence finance development and poverty reducing projects. (Yohannes and Sisay,2013)

2.3 THE HIERARCHY OF LAWS

It is used to describe the structure of power relationship with varying amount of power and authority. It is believed that laws derive their validity from the authority that respective makers possess. Thus, the superior and subordinate kind of relationship exists between the laws. Therefore, hierarchy of laws is a chain of subordination between laws. Hierarchy of laws is a system in which all the laws of a certain country are put at various levels or ranks according to their order of importance. The order of importance of laws is very much related to the order of importance of state organs that make laws (Degol and Kedir, 2013).

In other words, hierarchy of laws is the reflection of, a coordinated aggregate of persons among whom power relationships hold so as to establish an order of superiors and subordinates the highest law in Ethiopia is the Constitution (Proclamation No.1/1995) which was adopted by the highest legislative body (parliament) and signed by the head of state in 1995. It states the constitution is the supreme law of the land. Any law, customary practice or a decision of an organ of state or a public official that contravenes this Constitution shall be of no effect. Proclamations come below the

Constitution in the hierarchy. They are acts of parliament, discussed and voted on in the HPR and signed by the president of Ethiopia. International treaties that have been ratified by Ethiopia similar status to proclamations because they are also enacted by the HPR. The other group of law (derivative legislation) that are issued at the federal level include regulations and directives. The Council of Minister and each ministry issue these legislation. In this case, the Council of Ministers derives its power to make the regulations from the supreme legislator i.e. the House of Peoples' Representatives through the primary legislation. Consequently, the position of the regulations and directives on the ladder of hierarchy is below the proclamations and decrees (FDRE Constitution, 1995).

However, in so far as the regulations are passed by the Council of Ministers, they are higher in hierarchy than the directives passed by each ministry. Regulations are the next level. They are issued by the Council of Ministers to supplement a proclamation. Regulations have detailed descriptions of the provisions of the respective proclamation. Directives are the lowest level in the Ethiopian legislation hierarchy. They describe how regulations should be implemented and are usually developed by a ministry or a department within a ministry (Degol and Kedir, 2013).

2.4 MAJOR TYPES OF TAXES IN ETHIOPIA

The major types of taxes that exist in Ethiopia, their meaning, rates and conditions, as provided by the Federal Inland Revenue Authority, are presented as follows:

2.4.1 Value Added Tax (VAT)

Black's law dictionary on its part provides that "*VAT is a tax assessed at each step in the production of a commodity based on a value added at each step by the difference between the commodities production cost and its selling price*". This is a sales tax based on the increase in value or price of product at each stage in its manufacture and distribution. The cost of the tax is added to the final price and is eventually paid by the consumer. The concept of VAT was propounded first by American experts by 1920's. But at that time, Americans failed to implement it. The modern concept of VAT was truly introduced in France (1954). It is from France that other countries took lessons about VAT and introduced in their legal systems. Ethiopia is not an exception. According to some scholars, in 2003, VAT was exercised, it had been adopted and in more than 123 states of the world.

In Ethiopia, VAT was introduced since January 1, 2003 designed to replace the out dated sales tax, which has served for more than four decades, which was collected at manufacturing level. VAT is taken as dispensable component of tax reforms in developing countries such as Ethiopia by considering it a miracle tax to replace direct and indirect taxes entirely. In other areas of taxation, where VAT is not regularly governing, turnover tax is introduced. The introduction of VAT under Ethiopian tax system, borrowed from foreign systems, clearly signifies an advancement in the area of taxation (ERCA, 2003). Currently, since Ethiopia adopted federal structure the former tax law cannot be properly used and implemented in the presence of federal and state government for both have say on tax laws and enforcements thereof (Gebrie, 2008). All in all, Ethiopia adopted VAT proclamation No 285/2002 applied and practiced from January, 1, 2003 onwards. Good tax administration such as VAT is challenging in all countries especially, developing ones. The rate and impose of VAT: The rate of VAT is 15% of the value for every taxable transaction by a registered person, all imported goods other than an exempt import and an import of services; The export of taxable goods or services to the extent provided in regulations for zero tax rate (Desalegn, 2014)

2.4.2. Excise Tax

Excise tax is one variety of sales tax like VAT and turn over tax but unlike turn over tax and VAT, It is applicable not on all kinds of goods rather on selected goods. It is imposed on luxury goods and basic goods which are demand inelastic. It is also applicable on goods which are hazardous to health and societal problems. But advalorem is calculated out from the value of the good. Excise tax in Ethiopia is introduced for many reasons. (Yohannes and Sisay, 2013).

Firstly, it helps to improve government revenue by imposing excise tax payable on selected goods. When tax is imposed on certain items that were not subject to tax, the effect is usually increment of government's revenue to facilitate different projects a head. Secondly, tax shall be imposed on luxury goods and basic goods which are demand inelastic. Thus, the excise tax has positive impact on the reduction of consumptions of goods hazardous to health and cause social problems (Gebrie, 2008).

The attachment at the schedule indicates that the goods or products are related to luxury goods, goods dangerous to health and that cause serious problems to the society, ranging from perfumes to

tobacco and tobacco products (ERCA,2008). The excise tax is imposed on goods imported or produced locally in accordance with the schedule attached with the proclamation proc. No. 307/2002. The rate specified above is uniformly applied for goods produced locally and imported from abroad, what matters is the type of product (ERCA,2008).

2.4.3 Turnover Tax

It is applicable in Ethiopia tax law. Unlike VAT, where the threshold to identify persons subject to it is 1,000,000 birr, turn over tax is applicable for those whose annual transaction is below this amount save voluntary registration for VAT (Yohannes and Sisay,2013). The base to compute turn over tax is the goods receipts in respect of goods supplied or service rendered (Art 5). Thus, the person who sells goods and services has the obligation to collect the turnover tax from the buyer and transfer collected tax authority. Two kinds of rates: 2% on goods sold locally and for services rendered locally again in two rates: 2% for contractors, grain mills, tractors and combine-harvesters and 10% on others. Rate of turnover tax is 2% on goods sold locally and 10% on others; as provided by the 'Excise Tax Proclamation No. 307/2002' (ERCA,2008).

2.4.4 Income Tax

The concept of income taxation was initially introduced in Ethiopia in the year 1944. The foundational principle of income tax in Ethiopia was laid by Emperor Haileselassie in 1882, when the emperor issued a decree requiring all peasants to pay one-tenth of their agricultural products to tax officials (Gebrie, 2008). The arrangement of income taxation of that period provided a modern structural and legal framework for the collection and levying of income taxation. Income taxation under this arrangement was classified into four schedules based on the sources of the income (Eshtu, 1987).

The first schedule, Schedule A, provided for taxation of income from employment; the second schedule, Schedule B, provided for taxation of income from rent of land and buildings used for purposes other than agricultural purposes; the third schedule, Schedule C, provided for taxation of income from business, professional and vocational occupations, the exploitation of woods and forests

for lumbering purposes and from interest; finally, the fourth schedule, Schedule D, provided for taxation of income from agricultural activities. By basing on these schedules, income was charged progressively. Employers were required to declare the incomes of employees and employees of more than one organization/institution were required to declare the total amount of their income from their employments (Gebrie, 2008). As far as the history of the laws governing income taxation in Ethiopia go, it is said to have started with the Personal and Business Tax Proclamation No. 60/1944 which provided for income taxation in modern form as opposed to the traditional forms of taxation of earlier times. This proclamation was replaced by the Proclamation No. 107 of 1949, which was replaced seven years later by the Income Tax Decree No. 19 of 1956. Then after, Income Tax Proclamation No. 173/1961 was enacted followed by Proclamation No. 255/1967. (Gebrie 2008)

During the Dergue period, Proclamation No. 77/1976 and Proclamation No. 152/1978 were adopted as amendments to Proclamations No. 173/1961 and 255/1967. These two amendments changed the income tax structure levied on agricultural activities; and thus introduced rural land use fee and tax on income from agricultural activity (which had been exempted from taxation by the Income Tax Proclamation No. 255/1967). Furthermore, Special Decree No. 18/1990 was passed thereby changing the rate of taxation on business income (Yohannes and Sisay,2013). During the transitional period of Ethiopia, Proclamation No. 30/1992 was adopted thus amending the previous laws on personal income taxation. This proclamation was further amended by the Income Tax Amendment Proclamation No. 107/1994, which, among other things, amended the tax on income from business and other profits. The currently operating laws with regard to income taxation in Ethiopia are the Income Tax Proclamation No. 286/2002 and the Income Tax Regulation No. 78/2002. (Eshetu, 1987)

2.5 TAX NON-COMPLIANCE

Tax non compliance is a growing international concern for tax authorities and public policy makers since it seriously threatens the capacity of governments to raise required public revenue. The problem is more serious in developing countries. Tax non-compliance is defined as failure to obey with tax laws and/or declare understated revenue, the act of asking for unfitting expense, relief and refunds and/or paying the incorrect amount of tax beyond the stipulated time frame. And, noncompliance is also perceived as the failure of a taxpayer to report the actual income, claim

exaggerate deductions and rebates and remit the small amount of tax payable to the tax authority on time (Kirchler, 2007).

Taxpayers vary in terms of the opportunities available to them in overstating expenses and understating incomes (Chau and Leung, 2009). Superior tax denial chance usually result from self-employment and income sources not subject to withholding taxes. Taxes can be classified into two main types: direct and indirect taxes. Direct taxes mean the burden (incidence) of tax is borne entirely by the entity that pays it, and cannot be passed on to another entity; for example, corporation tax and individual income tax. Indirect taxes are typically the charges that are levied on goods and services (consumptions) for example VAT (Value Added Tax), sales tax, and excise tax and stamp duties. Indirect taxes are not levied on individuals, but on goods and services. Customers indirectly pay this tax in the form of higher prices.

For example, it can be said that while purchasing goods from a retail shop, the retail VAT is actually paid by the customer. The retailer eventually passes this tax to the respective authority. The indirect tax actually raises the price of the goods and the customer's purchase by paying more for that product. Unlike indirect tax, direct taxes are based on 'ability to pay' principle but (by being very obvious to the taxpayer) they sometimes work as a disincentive to work harder and earn more because that would mean paying more tax. Individuals do not like paying taxes, and they take a variety of actions to reduce their tax liabilities. Some of these actions can be classified as tax avoidance, which is the legal reduction in tax liabilities by practices that take the full advantage of the tax code, such as income splitting and postponement of taxes for example through contribution to a Home Ownership Savings Plan. The other classification of actions is tax evasion which consists of illegal and intentional actions taken by individuals to reduce their legally due tax obligations (Mansor, 2005).

Individuals and firms can evade taxes by underreporting incomes, sales, or wealth, by overstating deductions or by failing to file appropriate tax returns. In every jurisdiction, tax authorities are empowered to collect revenue from taxpayers. Although there are a number of taxpayers who have reported their income and paid their tax liabilities properly, there are a few taxpayers who have not done so. The issue of tax compliance is extremely important both to those concerned with the key

role the increased tax yields can play in restoring macroeconomic balance and those concerned with tax policy and its effects on the economy in general (Mansor, 2005).

The level of tax collection though important is an unsophisticated measure of the effectiveness of tax administration. A more accurate measure is the level of compliance. Facilitating compliance involves such elements as improving services to taxpayers by providing clear instructions, easy to fill forms and assisting and educating them on their duties and obligations. Monitoring compliance requires establishing and maintaining current accounts of taxpayers and management information systems covering both ultimate taxpayers and third party agents such as banks involved in the tax system as well as appropriate and prompt procedures to detect and follow up on non-filers, nil filers and delayed payments. Deterring noncompliance requires establishing both a reasonable risk of detection as well as applying penalties effectively. The ideal approach is to combine these measures so as to maximize their effect on compliance as it were, to move a country from a “low compliance to a high compliance environment”(Masinde and Makau 2010).

2.6 TAX COMPLIANCE

Tax compliance is a major problem for many tax authorities and it is not easy task to persuade taxpayers to comply with tax requirements even though ‘tax laws are not always precise’ (James and Alley, 2004). The definition of tax compliance in its most simple form is usually cast in terms of the degree to which taxpayers comply with the tax law (James,1999). However, like many such concepts, the meaning of compliance can be seen as a continuum of definitions. One suggestion is that the degree of non-compliance may be measured in terms of the ‘tax gap’. Tax gap represents the difference between the actual revenue collected and the amount that would be collected.

Tax compliance is also bigger when the individuals perceive some benefits from a public good funded by the tax payments while changes in fine rates appear to have little effect on tax compliance behavior (Almetal., 1992). The taxpayers’ outlook on tax compliance may be affected by many factors, which eventually influence taxpayer’s behavior. Those factors which affect tax compliance and/or non-compliance behavior are not the same from one country to another and also from one individual to another (Kirchler, 2007).

It therefore appears that there are additional tax policy instruments beyond the standard prescription of enforcement actions that government can enact to achieve its desired degree of compliance with the tax laws. In fact, some of these standard instruments- greater penalties- may be largely ineffective in increasing tax compliance. In short, government should pursue arrangement of approaches in its efforts to promote compliance (Alm, 1992). Thus, the payment of fines and penalties appear for overdue taxes. Thus, there arises the need to allow audit by tax collectors if deemed necessary, especially if they suspect that there is some kind of some tax non-compliance.

The behavior of tax compliance has been long explained by the policies oriented to punishment, like tax audit and penalty rate (Alm, McClelland, Schulze, 1992). However, the theoretical approach could not completely explain the behavior of tax compliance. There have been many studies to explain the behavior of tax compliance in a more realistic situation. They have been focused on the factor affecting of tax compliance, respectively one economic and non-economic factors. Non-economic factors, which had been neglected by economists, have been introduced to explain the tax compliance by using the economic framework (Smith and Stalans, 1991). They have tried to include many non-economic factors which are, for example, the willingness to pay for public provision, public education, tax morale etc. (Hyun, 2005).

2.7 FACTORS AFFECTING OF TAX COMPLIANCE

Tax compliance has affected by different factors. The previous research done in Arba Minch University by Wondwossen Jerche and Niway Adimasu and in Addis Ababa University by Ketema Derar helped the researcher to identify economical or non-economical factors. Both the researches have been doing deeply and attain their research objective properly. Beside, the research is done in Ethiopian. The researcher extracted variables from both types of tax compliance factors which can exist the habitual interactions among both the taxpayers and tax authorities. The variables which discussed in this research analyze the impact of tax authority's system, power, procedures and activities that makes the tax payers to be non-tax compliance.

2.7.1 ECONOMIC FACTORS OF TAX COMPLIANCE

A number of factors have been considered important for explaining tax compliance: the level of actual income, tax rate, tax benefits, tax audit, audit probabilities, fines and penalties. The level of actual income. Spicer and Lundstedt (1976) point out that self. A different aspect of the income source, if income was earned by hard worker an effort less job-has been studied in experiments by (Kirchler, Muehlbacher, Hölzl and Webley). Participants were less compliant when they reported income earned by low effort than when they reported hard-earned income. It seems that taxpayers are reluctant to lose their hard-earned money by “gambling” with tax authorities (Kirchler 2007).

Tax rate: economic models of rational compliance decisions provide either mixed predictions of the effect of the marginal *tax rate* on compliance, or predict that increased tax rates would increase compliance (Allingham and Sandmo, 1972). The tax rate had no effect on evasion and under reporting (Kirchler, 2008). When trust is high, the same level of tax rate would be interpreted as contribution to the community, which in turn again profits each individual. In the first case, the tax rate would be interpreted as the wielding of power by some tax offices and in the second case, as a joint agreement within the community (Kirchler, 2008). If tax rates are described as abstract concept or in concrete terms by giving hypothetical examples. Knowledge about effects could help authorities in promoting changes in tax policy such as tax rate increases without undermining taxpayers’ compliance (Kirchler, 2007).

Tax benefits of various forms of taxation of legal entities / individuals: - we can consider as a factor influencing tax compliance, the tax benefits of various forms of taxation of legal entities individuals, as their form of constitution. Thus, entrepreneurs have done the migration from one form of organization to another, which offers tax advantages for purposes of paying lower taxes. As an example, we present the case of limited liability companies and individual enterprises (Nicoleta, 2011).

Tax audit is one of the most effective policies to protect the behavior of tax evasion. The level of tax audit can be determined by two elements: one is how many taxpayers are selected for audit and the second is how much concentrated the audit is. The first element is easily measured by the number of audited taxpayers divided by the total number of taxpayers. However, these element is so difficult to

measure due to no published information about the process of tax audit. It is commonly measured by the first element to indicate the level of tax audit for practical comparison (Hyun, 2005).

2.7.2 NON-ECONOMIC FACTORS FOR COMPLIANCE

There are many non-economic factor to affect the level of tax compliance. Many researches have been done to include these non-economic factors to explain the behavior of tax compliance under the framework of economic analysis (Alm, Sanchez and DeJuan, 1995). These non-economic factors include the willingness to pay for public provision, public education, tax morale, tax information etc. As there are some limitations to include all non-economic factors for the analysis of behavior of tax compliance, most studies pay attention on just one or several factors for rigorous analysis. Even though we understand that non-economic factors are the important determinants for the level of tax compliance.

The release of tax information might be one important determinant for tax compliance, as it gives taxpayers an exact figure about tax evasion. However, there is few empirical evidence whether or not the release of tax information has an effect on the level of tax compliance. There are three tax subjects under this public notification system, which are individual income tax, corporate income tax and inheritance tax (Hyun, 2005).

Attitudes toward taxes. Attitudes represent the positive and negative evaluations that an individual holds of objects. It is assumed that attitudes encourage individuals to act according to them. Thus, a taxpayer with positive attitudes toward tax evasion is expected to be less compliant than a taxpayer with negative attitudes. Attitudes towards tax evasion are often found to be quite positive (Kirchler et al., 2008). On the one hand, favorable attitudes will contribute to trust in authorities and consequently will enhance voluntary tax compliance. On the other hand, attitudes towards the authorities will be relevant for the interpretation of the use of power as benevolent or malicious. Tax attitudes in general also depend on the perceived use of the money collected and therefore are connected to knowledge (Kirchler et al., 2008).

Personal, social and national norms. Besides attitudes, norms are important factor of tax compliance. Behavioral intentions are determined also by subjective norms (Ajzen, 1991). Norms are

behavioral standard on three different levels: the individual level, the social level and the national level (Kirchler et al., 2008). On the *individual level*, norms define internalized standards on how to behave. Individual norms are related to moral reasoning, authoritarianism and Machiavellianism, egoism, norm dependency and values. A norm where all citizens are perceived as contributing their fair share would certainly help to increase trust in the authorities (Kirchler et al., 2008).

2.8 FINES AND PENALTIES

Most of countries law empower their tax authority to take any measures on the taxpayers who participate in tax evasion or any illegal activities. The tax authority has a right to accuse both the tax payers and tax office who has not discharge his duties. Failure of taxpayers to comply with the procedures provisions of the tax laws shall result in imposition of interest, civil or administrative penalties and criminal offence penalty. In general, the tax authority can levy fine or penalty on the tax offenders according the degree of the offence. The tax authority has the duty to monitor and supervise tax payers, hence administrative penalties are inherent consequences on tax players that fail to comply with tax obligations under direct or indirect taxes. The failures to comply are related to administrative penalties and criminal offences (Fischer, 1992).

Fines and penalty rates may substitute each other due to their multiplicative linkages as long as neither of them is set to zero (Kirchler 2007). Higher fines simply make evading taxes more hazardous for taxpayers and should deter them from evasion. Empirically, the deterrent effect of fines could not always be supported. The observed effects were weaker than expected and some studies even suggest that an increase of penalties can have undesirable effect and result in more tax avoidance (Kirchler, 2007). Alm (1992) supports the evidence that fines do affect tax compliance though the impact was virtually zero. (Friedland, 1978) compliance was strongly affected by the amount of fines than by audit probabilities. Some of the findings suggest that a policy based on deterrence is effective only in combination with frequent Audits (Kirchler et al., 2007).

2.8.1 FINES

Fines that are inappropriate because a taxpayer involuntarily made a mistake resulting from ambiguous tax laws, or fines that are exorbitantly high, would undermine the perception of retributive justice and induce tax evader's to try even harder to regain their "losses" incurred by those fines (Kirchler et al., 2008). In an experimental survey study by Muehlbacher, Hölzl and Kirchler income-adjusted fines had more impact on the sentenced taxpayer's intention to commit the same offense again than fines which were solely adjusted to severity of evasion fact (Kirchler, 2007).

In the current framework, it would be argued that the interpretation of fines matters. In an antagonistic climate, fines can be a part of the game of "cops and robbers"; in a synergistic climate, they can be perceived as an adequate retribution for behavior that harms the community. Fines are therefore connected to trust and power. Fines that are too low could be perceived as indicator that the authorities are weak and unable to control the wrong doers, undermining trust among honest taxpayers.

Fines that are in appropriate because a taxpayer involuntarily made a mistake resulting from ambiguous tax laws, or fines that are exorbitantly high, would undermine the perception of retributive justice and induce tax evaders to try even harder to regain their "losses" incurred by those fines (Kirchler et al., 2008). The increasing tax avoidance and tax resistance due to an increase of fines puts into question how fines should be assessed to be effective. On the one hand, fines should be high enough to decrease the expected value of tax evasion and to assure its deterrent effect on taxpayers. On the other hand, if fines are too high, the tax system would be perceived as unjust and unfair and taxpayers would use any possibility to legally avoid their taxes.

In most countries, fines are relative to the evaded tax. However, depending on the income of the accused such a system might yield too low fines to have deterrent effects. An alternative would be to adjust the fine to the income of taxpayers. In an experimental survey study by Muehlbacher, Hölzl and Kirchler income-adjusted fines had more impact on the sentenced taxpayer's intention to commit the same offense again than fines which were solely adjusted to severity of evasion fact (Kirchler et al., 2007).

2.8.2 PENALTY

The structure of penalty system may be different in the countries: can be various types of penalty rate by the different tax subjects or different structure of penalty rates by the types of taxpayer. So, penalty rates have been separately applied by the different tax subjects like the individual income tax, capital income tax, value added tax etc. Furthermore, the penalty rates for each tax subject are differentiated by the different types of evasion, like non-filing, timely filing but under-reporting, no book keeping of invoices, receipts etc. Or, the penalty rates are differently applied to the types of taxpayers, depending upon their evaded behaviors.

If some taxpayers had the intentional evasions, the penalty rate is much higher than that of unintentional evasions (Hyun, 2005). As two kinds of evaded behavior are most common in analyze of tax compliance and are timely filing but under reporting, and non-filing. If the countries have the same system that tax authority prosecutes some intentional and malicious tax evaders for criminal responsibility, after tax audit. This system might play an important role in increasing the level of penalty rates or the behavior of tax evasion. The number of prosecuted cases by tax authority might be an important indicator to compare an additional penalty rate between countries.

2.9 TAX KNOWLEDGE AND EDUCATION

Tax knowledge is the level of consciousness or understanding of the taxpayers to tax legislation. It refers to the processes, by which taxpayers become aware of tax legislation and other tax-related information. Taxation knowledge is necessary to increase municipal alertness especially in areas regarding taxation laws, the role of tax in national advance, and especially to enlighten how and where the money composed is spent by the government (Mohd, 2010). Attitude towards tax compliance can be enhanced through the enrichment of taxation knowledge.

When a taxpayer has a positive attitude towards tax, this will reduce his or her inclination to evade tax payment (Eriksen & Fallan, 1996). Self-assessment system (SAS) requires taxpayers to understand all the laws and regulations that govern taxation. This is necessary because taxpayers will have to calculate themselves the amount of tax they need to pay and make the payment (Kasipillai, 2003). One of the fundamental ways to increase public awareness is for taxpayers to have knowledge about taxation.

High awareness by the society would encourage people to fulfill their obligations to register as taxpayer reporting and paying taxes properly are forms of national and civic responsibility. Most citizens do not have much understanding of what tax laws mean and why the tax system is structured and administered as it is states that tax knowledge reveal that there is a relationship with taxpayers' ability to understand the laws and regulation of taxation and their ability to comply. Taxation knowledge is necessary to increase public awareness especially in areas concerning taxation laws, the role of tax in national development, and especially to explain how and where the money collected is spent by the government (Mohd, 2010).

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The influence of knowledge on compliance behaviors has been assessed in various researches. Knowledge as one of the factors in compliance is related to the taxpayers' ability to understand taxation laws, and their willingness to comply. The aspect of knowledge that relates to compliance is the general understanding about taxation regulations and information pertaining to the opportunity to evade tax (Kasipillai, Norhani, and Noor, 2003). Taxpayers will readily accept any new system introduced, like he SAS, if they have ample knowledge to understand the system. Thus, education programs organized by the ax authority or other public education institutions are needed to enhance taxpayers' ability to understand Self-assessment system and to increase their confidence in fulfilling their responsibilities as taxpayers (Mohani, 2001).Greater education is directly linked to a likelihood of compliance.

Educated taxpayers may be aware of noncompliance opportunities, but their potentially better understanding of the tax system and their higher level of moral development promotes a more favorable taxpayer attitude and therefore greater compliance (Chanet.al.2000). One of the measures

to increase voluntary compliance is by assuring that taxpayers have a certain level of qualifications, ability and confidence to exercise their tax responsibility (Mohani,2001).Taxpayers who have attended tax course would be expected to have better tax knowledge and tax compliance attitude in a comparison with taxpayers who have never attended a tax course (Mohd,2010).(Hite and Hasseldine (2001) highlighted that tax authority need to emphasize teaching tax courses because of impact of education on compliance.

Under the direct assessment, it is assumed that individual taxpayers might not possess the sufficient knowledge to compute their tax payable but in SAS, tax knowledge is vital as an insufficient level of tax knowledge may result in inaccurate tax returns and therefore computation of tax liability (Eriksen & Fallan, 1996). (Loo and McKerchar (2010) argue that lack of appropriate tax knowledge may lead to unintentional noncompliance behavior. In Ethiopia, affecting factors of voluntary tax compliance behavior in self-assessment system are not well understood. Therefore, this study tries to investigate the affecting factor of tax compliance in SAS in Ethiopia particularly by taking evidence from one of selected revenue authority in Addis Ababa, Ethiopia.

The output of this study may help to understand the reason why taxpayers are not willing to be compliant for their tax obligation and take corrective measures in order to enhance domestic revenue mobilization through tax payer's voluntary compliance and sustain Ethiopia's recent growth.

2.10 EFFECTS OF TRUST AND POWER OF TAX AUTHORITY

Trust and power not only determine the amount of tax payments but are also interrelated in so far as a change of one factor can affect the second parameter (Kirchler2007;Kirchler, Hoelzl,and Wahl 2008).If we convert the government strategies, fines for illegal tax actions are enhanced. On the one hand, honest taxpayers could detect this amendment in influence as a sign that untrue taxpayers will be penalized with respectable cause.

Accordingly, their belief in powers that be will grow than d initiate arising of tax payments. The significant tax situation is more synergistic than the previous. On the other hand, taxpayers may observe this change as an increase in severity and as a signal of mistrust. As trusties inherently joint in nature, taxpayers might lose confidence in authorities accordingly, and a descending tax payments might result. The current dominant tax climate will be observed as more contrasting. In the first setup the improved power is supposed as fair and thus as valid, where as in the second scenario, the increase in power is skilled a sun fair and therefore as forced. It is necessary, then, to distinguish between legitimate power and coercive power (Turner 2005).

While reasonable authority can be seen as a helpful assessment of authorities' power that is associated with positive attitudes towards tax authorities, strong power describes tax authorities' abilities to notice tax crimes and to carry out severe penalty. As long as power of authorities is supposed as legitimate, it is not necessarily regarded as negative but instead is perceived as having positive effects on citizens' trust (Lavoie 2008). Legitimacy of authorities' actions is deeply connected with procedural fairness (Tyler 1990a, 1990b).

For example, in Switzerland, if taxpayers are called to participate indecision-making processes through referenda, authorities' power is likely to be perceived as legitimate, and actions against evasion serve the maintenance of law and order (Bohnet and Frey1994).In contrast, if citizens have no speech, authorities' power may be perceived as coercive, and actions to control citizens are likely to be judged as "cops fighting robbers." Therefore, the prevailing tax climate influences the perception of changes in power.

In a synergistic climate, increased power is perceived as legitimate, whereas the same increase is perceived as coercive antagonistic climate. Accordingly, Sheffrin and Triest (1992) found that taxpayers' attitudes towards authorities and social norms shape the effect of increased audit probabilities on tax compliance. Falk and Kosfeld (2004) found that being controlled and thus feeling distrusted reduces trust and consequently cooperation.

An opposing effect is possible, however, as governments lacking real power are scarcely trusted by citizens .In this case, them is sing implementation of lying tax payers could undermine a synergistic environment and honest taxpayers could start to disbelief the authorities. Subsequently,

authorities need to exert power in an appropriate way in order to be judged as acting fairly and serving the community by enforcing cooperation from evading taxpayers (Lavoie 2008). (Richardson2008) found that trust and legal enforcement strategies were connected with lower tax evasion in different countries .In such a situation, a robust synergistic climate is perceived, by the authorities and by the taxpayers, which could lead to tax payments at the highest stage.

2.11 PERCEIVED FAIRNESS OF TAX SYSTEM.

Policy makers have long been concerned with taxpayers' perceptions of the fairness of the federal tax system. The importance of public perception has been the motivation for numerous studies that attempted to measure the level of perceived fairness and identify the determinants of the public's perception of taxes. Tax system is type of official governmental system connected to governmental policy created to administer, collect, integrate, improve, change and manage methodically tax law and tax legislation. It is using accurate, defined, effective, transparent, just and evidence based on different tax rates tax compliance and related issues. A fair, transparent, accurate and effective tax system is vital for a government to administer, collect, change and manage tax within a country or state (MCHarmonious,2016)

Perceived fairness of tax system is referring to tax system fairness concerns (Taylor,2003).A conceptual framework for fairness considerations suggests differentiating three areas of fairness, as in social psychology: distributive justice, which refers to the exchange of resources, both benefits and cost; procedural justice, which refers to the process of resource distribution; and retributive justice, which refers to the perceived appropriateness of sanctions in the case of norm-breaking (Kirchleret ,2008).

Related to *distributive justice*, comparisons are made on the individual, the group, and the societal level. On the individual level, taxpayers are concerned about the fairness of their outcomes, and they want to be treated relative to their merits, efforts and needs. If an individual's tax burden is heavier than that of comparable other individuals, tax compliance is likely to decrease. On the group level, taxpayers are concerned about the fairness of outcomes of the group and want a fair treatment of their group relative to other (income) groups (Spicer and Lundstedt, 1976).

If a specific group perceives its tax burden as heavier than that of another group, tax non-compliance is likely to increase within this group (Juan, Lasheras and Mayo, 1994). On the societal level, taxpayers are concerned about the fairness of the outcomes of the whole nation. If the tax system is perceived as unfair, tax non-compliance is likely to increase (Cowell, 1992), whereas a system experienced as fair might increase trust and consequently increase voluntary tax compliance.

Related to *procedural justice*, the components essential for perceived fairness are neutrality of the procedure, trustworthiness of the tax authorities and polite, dignified, and respectful treatment (Tyler and Lind, 1992). Evaluations again are made on the individual, group and societal level. On the individual level, tax payers consider the treatment by the tax authorities, information provided, costs regarding compliance and administration, and the dynamics of allocation of revenues. It is argued that increased information related to tax law and explanations for changes can increase fairness perceptions of tax system (Carnes and Cuccia, 1996; Wartick, 1994).

Perceived procedural justice on the individual level and a culture of interaction are important for building up trust (Job, Stout and Smith, 2007). On the group and societal level, taxpayers consider the neutrality of tax officers regarding subgroups, such as vocational groups or income groups. If tax authorities and officers treat tax payers equally, in a respectful and responsible way, trust in the government and thus voluntary tax compliance is likely to increase on the individual, group and societal level.

Related to *retributive justice*, unreasonable and intrusive audits and unfair penalties lead to negative attitudes toward the tax office and taxes in general (Spicer and Lundstedt, 1976; Wenzel and Thielmann, 2006). Thus, unfavorable retributive justice perceptions could lead to increased distrust and consequently to increased tax non-compliance. Although justice research has not always yielded consistent evidence for the impact of justice perceptions on tax compliance, perceived justice might increase voluntary tax compliance.

In the current framework, perceived fairness is connected to the trust dimension because a just treatment of taxpayers (i.e., distributive and procedural fairness) helps to build and maintain trust. Retributive justice is connected to the power dimension, because it depends also on detecting and

fining wrong doers. In turn, an inconsiderate exertion of power that is perceived as intrusive can reduce trust. In conclusion, some of the major factors discussed on tax compliance would gain from considering them within the “slipperslope” framework and its interaction of the power and trust dimension (Kirchler et al., 2008.)

2.12 RESEARCH HYPHOTHESIS

The following hypotheses based on the literature discussed in chapter two. The test would be presented as hull hypothesis;

HO1: perceived fairness for tax system has no significant effect on tax compliance level

HO2: Tax knowledge have no significant effect on tax compliance level

HO3: Fines and Penalties have no significant effect on tax compliance level

HO4: Trust and power of tax administration has no significant effect on tax compliance level

2.13 RESEARCH GAP

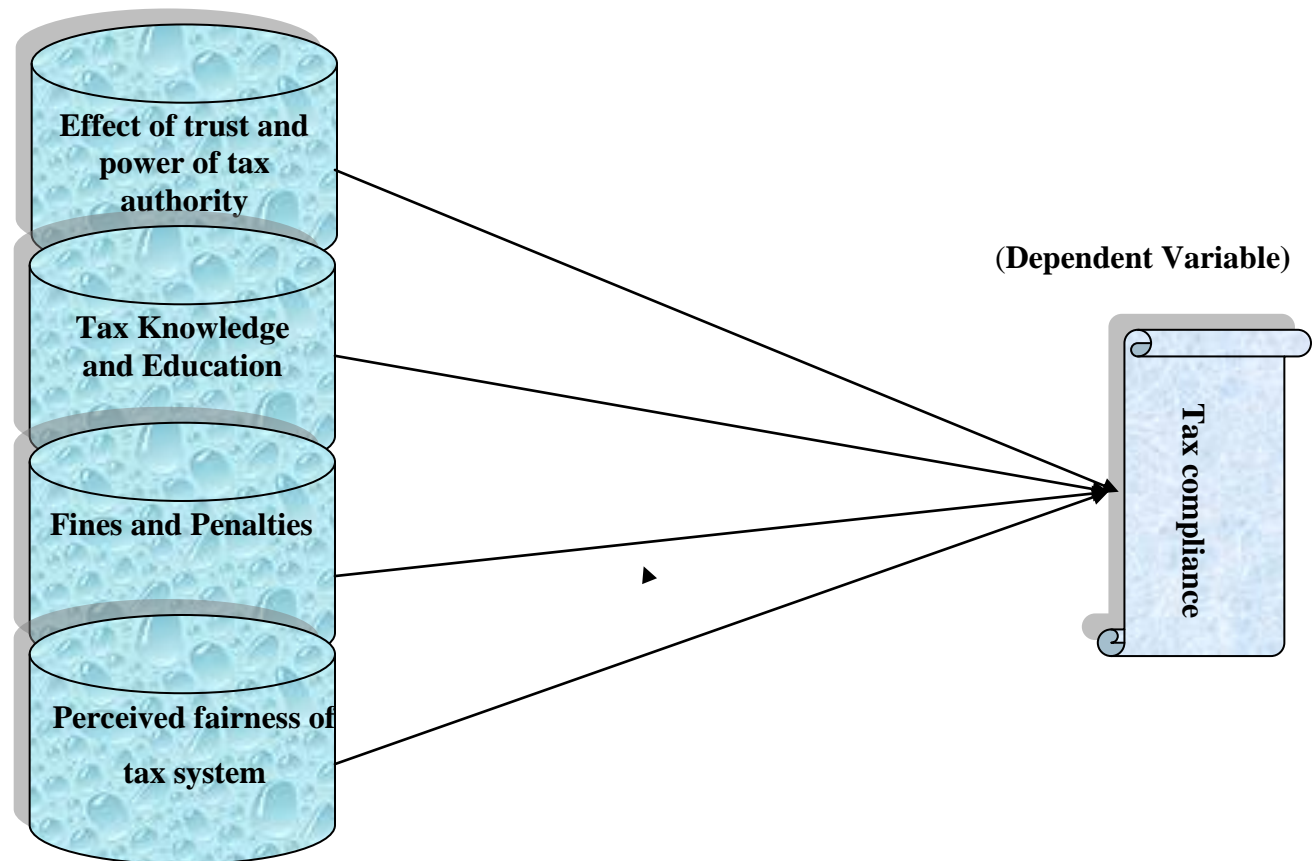
The former studies indicates various researchers on similarly area of studies presented are that the justification part of those studies address that findings are still debatable among different researcher. Hence, we looking at factor affecting tax compliance behaviors there seem to be a disagreement in the findings. Some variables are Significant in one study also insignificant in another study. And also from the previous empirical research found that the factors affecting of tax compliance have been found to differ between countries. This means there is no universal findings are highlighted by researchers pertaining to genuine tax compliance determinants among countries sharing similar tax systems, and cultures. The case of Ethiopia is a good example for this situation. Therefore, this research is to fill the research gap that were not addressed by any one of the earlier studies, specifically problems associated with tax payers and revenue authority in Addis Ababa and also this study initiation is needed to fill the literature gap regarding the factors of tax compliance behavior and contribute to the body of knowledge.

2.14 CONCEPTUAL FRAMEWORK

This study conceptualizes that the tax compliance could be affected by fines and penalties, tax knowledge and education, effects of trust and power of tax authority and perceived fairness of tax system. The purpose of this study is therefore to test the nature and the strength of these relationships. This study tests the conceptual framework presented in the following Figure.

Figure 2.1 Conceptual Framework

(Independent variables)



Source: (Rawlings, 2013)

CHAPTER THREE

RESEARCH METHODOLOGY

Chapter three presents the methodological issues used in conducting this research, and offers an explanation for each stage taken. It involves the general research design, population of study, Sample size and sampling technique, Sources of data, research instrument and methods of data analysis and presentation.

3.1 RESEARCH DESIGN

A research design is a plan, structure and strategy considered in order to obtain answers to research questions and control variables. It helps to control the experimental, extraneous and error variables of a particular research problem being investigated (Creswell, 2005). This study employed quantitative research design that would enable the researcher to collect data about the selected factors and presented in form of numerical values. Quantitative research design is used to analyze fairly the taxpayers response that have numerical format can be analyzed in a quantifiable way using statistical methods. Such a design is a systematic empirical inquiry in which the researcher does not have direct control of independent variables because they cannot be manipulated (Creswell, 2005).

3.2 POPULATION OF STUDY

The marked population for this research would be medium tax payers in Addis Ababa city government revenue authority number two branch office, Ethiopia. As we compare medium taxpayers with the large taxpayers, the medium taxpayers have low experience with tax compliance, unorganized accountancy and management system, and they do not have independent auditing and attestation service. On the other hand, most small taxpayers are treated with the

presumptive methods. They the small tax payers are not exercising the tax compliance with keeping book of account.

The tax assigned by the tax authority with their declaration period. So, the researcher prefer medium tax payers for the previous reasons. The population of medium taxpayers a sat July 7/2017 totaled around 8000. Therefore, the population size of nearly 8,000 would be applicable. The focus in medium taxpayers is that taxpayers in this branch are considering as they are fully experiencing in self-assessment system (SAS) because the law do require them to declare their income or keep books of account.

3.3. SAMPLE SIZE AND SAMPLING TECHNIQUE

There are high number of taxpayers in Addis Ababa government revenue authority medium taxpayer's number 2 branch office. For this reasons, both purposive and convenience sampling systems employed for collecting data from tax payers. The researcher purposively selected by taking into account risk level taxpayers which assigned by tax authority based on not paying the proper amount of tax, not paying on time and declaring taxes during last days. Then the researcher selected only 1250 taxpayers as population from the existed taxpayers in the branch based on the branch tax authority taxpayer's risk assessment department. This department assigns taxpayer's risk level with high, medium and lower by considering their continuously behaviors and habitual actions which the taxpayers . The higher the degree indicate that there is a problem of tax compliance. According to the records on July, 2018 of the Addis Ababa city Admiration revenue authorithy no 2 medium taxpayers branch office risk assessment department , there are around 1250 high degree risk task payers in this branch convenience sampling technique u s e d in order to randomly select higher risk tax payers. Simplified formula to calculate sample sizes (Wooldridge, 2012).

$$n=N/(1+Ne^2)$$

Where, n = sample size, N=population size, e=0.05 is the level of precision. This formula was used to calculate the sample sizes for the study as follows:

$$n = 1250/1+1250(0.05*0.05) = 303$$

3.4. SOURCES OF DATA

Primary data gathering is crucial for this study. Secondary sources may the researcher use if it is necessary for the research. The researcher had interest in primary data about characteristics, attitude/opinion/interest, awareness/knowledge, intentions, motivation and behavior of the taxpayers. Thus the essential data for this research gathered mainly from primary sources with self-administered questionnaire. (Noor, 2014)

The data collection included information on taxpayers, tax compliance in this selected branch, biographical information of the respondents, proxy variables representing, perceived fairness tax system, tax knowledge and education, fines and penalties and trust and power of tax payers. These variables are selected by the researcher because the tax authority activities could have impact on the non-tax compliance behavior of the tax payers. Moreover, the data which collected from tax payers may indicate their perception towards the tax authority. Other tax compliance related issues and concepts gathered from secondary data sources. From relevant legislation enacted in connection with the topic, tax journals, as well as articles published in the media.

3.5. RESEARCH INSTRUMENTS

During planning the research instrument, the pervious existed tools on tax compliance behavior is considered first (Noor Sharoja Sapiei, 2014). The questions prepared by considering the specific characteristics of the Ethiopian tax system, concentrate on factors that considered relevant to this study of Addis Ababa medium taxpayers. The questionnaire comprised of five parts, refer to as part I to V. The first part (part I) contained questions about the perceived fairness for tax system. Part II generally produce information on respondents' tax knowledge and education and Part III required information on fines and penalties levy on taxpayers. While part IV prepared on the trust and power of taxpayers on the tax administration. The last part, which is part V focused on financial and demographic characteristics of companies.

Validity of the Research Instrument: According to Paton (2002), validity is the quality attributed to a proposition or a measure of the degree to which they conform to established knowledge or truth. The content validity of the instrument was determined in two ways. First, the researcher discussed the items in the instrument (questionnaire) with supervisors, lecturers and colleagues from the School of Business. Since the determination of content validity is judgmental, all these people helped to refine the definition of the topic of concern, the items to be scaled and the scales to be used. Secondly, content validity of the instrument was determined through piloting, where responses of the subjects were checked against the research objectives.

Reliability of the Research Instrument: According to Mugenda (1999), the reliability of an instrument is the measure of the degree to which a research instrument yields consistent results or data after repeated trials. Reliability of the test items in the questionnaire was tested by calculating a Cronbach's alpha during piloting. The Cronbach's alpha value was found to be above the threshold of 0.7 hence reliable.

3.6. METHODS OF DATA ANALYSIS

The questionnaire distributed to the respondent like business owners, tax managers, accountants, professional auditors and tax agents to measure their view about each provided compliance factor. Questionnaires received from respondents for completeness with repeat calls being made for incomplete questionnaires to maintain the number of respondents. Classification and coding was then done and data entered into SPSS version 20. Data summarized using descriptive statistics and various inferential statistics was used to infer population characteristics from the sample. The descriptive interpretation use the mean as a base and inferential interpretation used the p value, the coefficients β of the independent variables, and necessary regression analysis.

A research model used to examine the level of tax compliance using the four independent variables in:-tax knowledge and education, fines and penalties, trust and power of the tax authority

and perceived fairness for tax system. In addition, the β coefficients for each independent variable generate from the model was subject to a different tests, in order to test each of the hypotheses under study. So, Y (tax compliance) is the dependent variables which has influenced by the dependent variables like X1, X2, X3 AND X4. $Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \epsilon$ (Wooldridge, 2012) the researcher has taken the multiple regression model from

Where; Y -Tax compliance
 α -Constant

$\beta_1, \beta_2, \beta_3$ and β_4 -Coefficient indicating rate of change of tax compliances as perceived fairness for tax system, tax knowledge and education, fines and penalties and trust and power of taxpayer's changes. X1-perceived fairness for tax system, X2 -taxknowledgeand education, X3-tax fines and penalties, X4-trust and power of taxpayers and ϵ -Error term. This is the methods to check the error term/ residual/ how the value of each sample far from the predicted value.($\epsilon = Y_i - \hat{Y}$). On the graph the expected value was drawing on the graph. All the above statistical tests analyzed using the Statistical Package for Social Sciences (SPSS), version 20.

CHAPTER FOUR

DATA ANALYSIS, PRESENTATION AND DISCUSSION

4.1 INTRODUCTION

This chapter presents results of the study based on the formulated objectives and hypotheses as presented in chapter one. The chapter analyzes the variables involved in the study and estimate the conceptual model described in chapter two. In the first two sections data description and analysis is presented. The model estimation and the analysis of the results are then discussed. Lastly concluding remarks are prepared. Data description includes a discussion on the sources of data and explanations of the dependent and the independent variables. Data composed was quantitatively analyzed and presented in tables. Hypotheses are also tested with the study accepting or failing to accept them depending on the p values.

4.2 DEMOGRAPHIC INFORMATION

Demographic information's how the characteristics of the components in the sample size is: As such the researcher required to establish the general information of the respondents, which forms the basis under which the analyses are done.

Table 4.1 Demographic Information

		Frequency	Percent
Gender	Male	182	60.1
	Female	121	39.1
	Total	303	100
Age bracket	20-30	79	22.1
	30-40	60	39.6
	40-50	71	5.9
	50-60	92	30.4
	Above60	1	0.3
	Total	303	100
Highest Academic Qualification	High school	86	28.4
	Certificate/Diploma	67	22.1
	Degree/Professional	120	39.6
	MSC	18	5.9
	PHD	2	0.2
	OTHER	2	0.2
	Total	303	100

Demographic factor one examined the gender of the respondents. This information was necessary to enable the researcher to obtain information on whether the respondents were either male or female. Sixty point one percent (60.1%) of the respondents were male whereas Thirty nine point nine (39.9%) were female. The gender finding indicate that males takes more parts on the tax system than females. Still the portion of females on the outside activities other than household is dominated by males.

Demographic factor displays the age brackets of respondents, (26.1%) of the respondents are between 20-30years of age, (19.8%) are between 30-40years, (23.4%) are in the 40-50 age bracket. Respondents between 50-60 years are (30.4%) and those above 60 years of age are three percent (3%).This result demonstrates that most of the taxpayers generally above 40 years. This signifies that most of the taxpayers age lies on the right time for rationalized and analyzed the

effect of the tax on countries' economy. So, most of the respondents are taxpayers that are available on the right working stage.

Demographic factor examines the academic credentials of the respondents. The information is necessary to assist the researcher to recognize whether the respondents are educated or illiterate. Information on the academic qualifications of the respondents is statistically shown in table 4.1 below. It reflects the academic qualifications of the respondents. Twenty eight point four (28.4%) have a completed high school certificate, Twenty two point one percent (22.1%) hold a Certificate/diploma; Thirty nine point six percent (39.6%) have a Degree/Professional, and five point nine percent (5.9%) have a MSC, two percent (2.0%) have PHD, two percent (2.0%) other educated .

The finding indicates that majority of respondents in the study area are fairly educated. Taxpayer's education status has significant effect on understanding the obligatory dustiness of tax and the effect tax on the economy. The taxpayer's education level could have impact on the tax compliance.

4.3 INFORMATION ABOUT TAX COMPLIANCE LEVEL

Research results on information about tax compliance level that majority of the respondents have been in experience for between 0-5years (38.9%) followed by those that have been in operation for 11-20 years (11.2%), 6-10years (38.0%) and experience that have been in operation for over 20 years (11.9%). This signifies that the sample companies had adequate experience in dealing with tax related issues.

This implies the company with high business experience is expected to have high knowledge and exposure towards the tax compliance and its requirements. This also indicates that company which has high experience and also has yearly increased annual sales. So, business is expected non-compliance was greater for companies with a higher annual sales turnover. This is due to the fact that larger company's frequent and huge amount of transaction sometimes become unmanageable. It is also identified that deliberate misrepresentation is done for the intent of minimizing tax liability.

Table 4.2 Information about tax compliance level year of experience

	Range	Frequency	Percent
Years in experience	0-5	118	38.9
	6-10	115	38.0
	11-20	34	11.2
	Over 20	36	11.9
	Total	303	100

4.4 TAX CHARACTERISTICS

Tax characteristics were requested from respondents. Respondents establish to have appeared formal taxation course organized by authority or any other institution. Fifty three point five percent (53.5%) has not taken the authority training. But, forty six point five percent (46.5%) who have attended any taxation course. In relation to being audited, majority of respondents fifty four point one (54.1%) have never been audited while only forty five point nine percent (45.9%) have been audited.

Regarding with the authority training signifies that the customer's service department has not executed its duties. Insufficient training indicates that the taxpayers has not got reliable and relevant awareness about necessitate of the tax compliance. The authority auditing response indicated that most of the taxpayers have experienced the auditing procedures. This procedure signifies that the taxpayers knows their tax compliance level.

4.3 Tax characteristics

		Frequency	Percent
Authority training	Yes	141	46.5
	No	162	53.55
	Total	303	100
Authority auditing	Yes	139	45.9
	No	164	54.1
	Total	303	100

4.5 TAX COMPLIANCE LEVEL

Table 4.4 shows that below half of the respondents from the selected sample only declared their tax returns on time (mean=1.98). But, they paid the right amount of taxes (mean=2.27) for their branch as compare with retuning on time. And also paying on time (mean=2.05) is better as comparing with the returning on time. Generally, tax compliance level has an aggregate mean=(2.17) which indicates that more than half of the respondents are willing to execute their tax duties. In other hand, it state that 50% of the taxpayers are not interested to pays their tax in proper procedures and amount. Tax is the main source of the developing country income like Ethiopia (Eshtu, 1987). So, almost half the respondents who are not execute their duties leads the researcher to conclude that there is a difficulty tax compliance problem of taxpayers. Besides, the above outcomes checks compliance, requires founding and conserving current accounts of taxpayers and management information systems covering ultimate taxpayers involved in the tax system as well as appropriate and prompt procedures.

There could be different possible reasons for the problem of tax compliance in the selected Addis Ababa medium taxpayer's branch office. The taxpayers have not sufficient and deep understanding about the functions of tax. Most taxpayers have not recognized yet the tax which they paid would give them service as services. They do not considered their sustainably peace around their resident and working place, the infrastructure they used for their daily activities, they related their duties with their political ideology. Generally, the taxpayers would have improper perception towards tax, lack of knowledge about mandatory and obligatory nature of tax, inadequate education about the criminality nature and its consequences of tax. The researchers like (Akalu, 2016) ,(Goitom and Taddesse, 2014), (Joseph,2003), (Rawling, 2003) who have done research related with the tax compliance has concluded that there is lower level of compliance level in their conclusion.

Table 4.4: Tax Compliance level

	Mean	Std. Deviation	Skewness	Kurtosis
Tax compliance taxpayer tax returns on time	1.98	1.451	-0.044	-1.434
Tax compliance taxpayer correctly report	2.27	1.425	-0.134	-1.269
Tax compliance pay on time	2.05	1.475	-0.110	-1.431
Tax compliance level	2.17	1.247	-0.254	-1.061

4.6 PERCEIVED FAIRNESS TAX SYSTEM

Concerning results on perceived fairness tax system, respondents reach on censuses that they are not certain regarding with easily understanding the tax system (mean=1.71). And also, respondents had doubt regarding with fair neutrality of the tax authority (mean=1.83). In addition to this, respondents has great doubt on the fairness of the tax rate (1.93). The circular which transferred from the higher level tax authority officers to the branch division has negative impact on tax system perception of the taxpayers. (1.95).

And they were uncertain on the probabilities of being detected by the taxpayers perceived fairness tax system stress (mean=1.84). The tax proclamation is rule of law for the tax matters. All, the regulation, directive and circulars should extract from the proclamation. So, the taxpayers have not positive perception regarding with fairness tax system proclamation (mean=1.91). Regarding with perceived fairness system vital, the taxpayers did not satisfied with the tax authority activities that tries to make the taxpayers energetic.(Mean=1.85), generally perceived fairness tax system has lower mean that indicate the taxpayers has negative outlook for the tax authority and the tax systems (mean=1.90) .This signifies that the taxpayers have not positive view towards the tax system. This may lead them to stand on the side of the tax evasion and tax avoidance.

Table 4.5 Perceived fairness tax system

	Mean	Std. Deviation	Skewness	Kurtosis
perceived fairness tax system easy understood	1.71	1.463	0.092	-1.553
Perceived fairness tax system fair neutrality	1.83	1.474	0.024	-1.537
Perceived fairness tax system fair tax rate	1.93	1.462	-0.084	-1.514
Perceived fairness tax system circular	1.95	1.484	-0.032	-1.459
Perceived fairness tax system stress	1.84	1.460	0.048	-1.490
Perceived fairness tax system proclamation	1.91	1.439	-0.061	-1.475
Perceived fairness tax system vital level	1.85	1.502	0.061	-1.430
Perceived fairness understand tax system	1.90	0.996	0.368	-0.505

4.7 TAX KNOWLEDGE AND EDUCATION

Further, tax knowledge and education was inquired from the respondents. From the gathered data results, respondents are supposed to know how to announce actual tax to tax authority (mean=1.77). Also, respondents are certain on how to keep records /documents pertaining to income and expenditure for revenue authority (mean=1.85). And also, tax payers understand that they should pay tax according to prescribed period from the date of issue (mean=2.00), Further respondents seem to know which income should be included or excluded in determining the taxable income (mean=2.07). Taxpayers have not taken sufficient and continues tax related education from the tax authority (mean=2.02). Beside, tax authority's education help the taxpayers to keep their books properly. And, protect them from tax, interest and penalty that can occur lack of knowledge (mean=1.76). Generally tax knowledge and education have great impact on the tax activity to obey taxpayers' duties. (Mean=1.82). Regarding tax knowledge and education the result implies that the respondent has not given sufficient thought and awareness by the tax authority on the right time. The mean is below the average

Table 4.6 Tax knowledge and Education

	Mean	Std. Deviation	Skewness	Kurtosis
I know how to announce all income	1.77	1.469	0.084	-1.488
I know how to keep records/documents	1.85	1.501	-0.011	-1.555
I understand that I should pay taxes due within the prescribed period	2.00	1.489	-0.097	-1.481
I know which income should be included or excluded determining the taxable income	2.07	1.487	-0.120	-1.474
I know sufficient and continues tax	2.02	1.469	0.092	-1.458
tax knowledge authority education for keep book protect from tax penalty	1.76	1.477	0.226	-1.420
Tax knowledge and Education	1.82	1.250	0.088	-1.01

4.8 FINES AND PENALTIES

Regarding with the findings of fines and penalty respondents agreed figure in the penalty rates are affordable and can pay the penalty without any complain (mean=2.00). The fine and penalty enforcement seems very poor (mean=1.84), tax payers believe that the penalty is lower than my tax (mean=2.13) and serious enforcement and penalty by authority make them more conscious to declare all my duties on time and property (mean=2.13). The taxpayers support fine and penalty has great impact on tax compliance (Mean =2.09), Generally fines and penalty system have great impact on the tax compliance of the taxpayers (Mean=2.10).

This mean signifies that fine and penalty makes the taxpayers to be non compliance their taxes on the right time and amount. The mean already around average. The taxpayers has problem with regarding the fines and penalties. This leads the researcher to be more interesting for including fine and panlty as independent variable.

Table 4.7 Fines and Penalties

	Mean	Std. Deviation	Skewness	Kurtosis
The penalty rates are affordable and can pay the tax on time	2.00	1.397	-0.154	-1.320
The enforcement seems very poor	1.84	1.472	0.059	-1.461
I believe that the penalty is lower than my tax	2.13	1.392	-0.099	-1.254
Serious enforcement and penalty by authority make me more conscious to declare all my duties on time	2.13	1.378	-0.133	-1.171
I support fine and penalty has great impact on tax compliance	2.09	1.434	-0.135	-1.333
Fines and Penalties	2.10	1.173	-0.064	-0.961

4.9 TRUST AND POWER OF TAX AUTHORITY

The findings on trust and power shows that respondents have great doubt in the authority use its power as the law prescribed (mean=1.88).Taxpayers have negative response towards the power of the tax authority which it exercise. (Mean=2.12).The taxpayers and the tax authority have not that much trust each other (mean=1.99).The tax authority officers practice their power for seeking any inducement or bribery (mean=1.91).The tax authority action does exercise and take actions which can affect taxpayer's business (mean=1.80).Generally trust and power of the tax authority has effect to make the taxpayers be more honesty and accountable to their tax duties. (Mean =2.01). This implies that the taxpayers have great doubt concerning the trustee behavior of the tax authority like government organ and the power they exercise. That is why the research considering trust in authority and as the independent variables in this research.

Table 4.8 Trust and power tax authority

	Mean	Std. Deviation	Skewness	Kurtosis
Authority use its power as the law prescribed	1.88	1.375	0.009	-1.279
Taxpayers have positive response towards the power of the tax authority	2.12	1.428	-0.176	-1.290
the taxpayers and the tax authority have great trust each other	1.99	1.380	-0.112	.279
the tax authority officers use their power for seeking an inducement or bribery	1.91	1.444	0.023	-1.391
I trust that tax collector does not exercise and take actions which affect my business	1.80	1.393	0.070	-1.340
Trust and power of tax authority	2.01	1.147	0.073	0.279

4.10 CORRELATION STATISTICS

The results regarding this were summarized and presented in table 4.9. Pearson Correlations results in table 4.9 showed that tax perceived fairness for tax system was positively and significantly correlated to tax compliance level ($r=0.483, p<0.05$). Thus perceived fairness tax system had 48.3% positive significance relationship with tax compliance level. Tax knowledge and education was the second component to be positively related with tax compliance level ($r=0.493, p<0.05$) an indication that tax knowledge and education had 49% significant positive significance relationship with tax compliance. tax fines and penalties rate for tax evasion was significantly associated with tax compliance level as shown by ($r=.488, p<0.05$) implying that perceived opportunity for tax evasion had a 48.8% positive relationship with tax compliance level. Finally, trust and power of tax authority ($r=.388, p<0.05$). Therefore, trust and power had 38.8% positive significance relationship with tax compliance.

As the above result indicates all the independent variables which selected in this study has positive relationship with the tax compliance. The p value also indicates the perceived fairness tax system, tax knowledge and education, tax fines and penalties and trust and power of tax authority has affected the willingness of the taxpayers to pay their right and real tax on time by their own. So, the result of the collected data shows the researcher that the research should be done. The independent variables significantly affect the dependent variables.

The correlation indicates that the positive increament in the independent variables have positive effect on the the tax compliance level. The taxpayers would show positive response towards their tax duties when they have strong believe on the fairness tax system of the country. Continuous training and creating awareness also have positive impact on avoiding not tax compliance behavior of the taxpayers. And also, they give them sufficient understanding about the taxes which they paid for their better tomorrow. The fine and penalty also have impact on the deterrence on non-tax compliance. Strong enforcement of the rules would make the taxpayers more sensitive to declare their tax with on time and right amount. Moreover, the tax authority should exercise the power as the law prescribed only. The tax authority should supposed to build great trust in the heart of the taxpayers.

Table 4.9 Correlation Statistics

	Tax compliance level	Perceived fairness Tax system	Tax Knowledge and education	Tax fines and penalties	Trust and power of tax authority
Tax Compliance level	1				
Perceived fairness tax system Understand	.483**	1			
Tax Knowledge and tax system	.493**	.580**	1		
Tax fines and penalties	.488**	.485**	.489**	1	
Trust and power of tax authority	.388**	.418**	.415**	.300**	1

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

. 4.11 STASTICAL TEST ANALYSIS

Before discussing regression result the researcher should assessments of the four assumptions fundamental the regression analysis, namely, normality, linearity, homoscedasticity and multicollinearity. Tax compliance $Y = 0.216 + 0.076 \text{ perceived fairness} + 0.061 \text{ tax knowledge and education} + 0.059 \text{ penalty and fines} + 0.058 \text{ trust and powerful} + \epsilon$. The regression equation indicates that the scatterplot show almost the straight line. So, it can be conclude that there is a linear relationship between the independent variables.

Table 4.10 Normality test One-Sample Kolmogorov-Smirnov Test

		perceived fairness understand	tax knowledge and Education	penalty & fines rate	trust and powerful
N		303	303	303	303
Normal Parameters ^{a,b}	Mean	1.90	1.82	2.10	2.01
	Std. Deviation	.996	1.250	1.173	1.147
Most Extreme Differences	Absolute	.212	.162	.190	.186
	Positive	.212	.162	.173	.167
	Negative	-.145	-.149	-.190	-.186
Kolmogorov-Smirnov Z		8.694	.600	9.314	8.231
Asymp. Sig. (2-tailed)		.480	.740	.125	.270

a. Test distribution is Normal.

b. Calculated from data.

Normality test is intended to determine the distribution of the data in the variable that will be used in the research. If the data is good and decent used in the study in normally distrusted data. To know the research data is normally distributed or not, can be done with the Kolmogorov-Smirnov test using SPSS. Decision- making process in the normality test with this test

1. If the value Asymp.Sig>0.05, then the data is normally distributed research
2. If the value Asymp Sig<0.05, then the research is not normally distributed

Based on the output of one- sample Kolmogorov-Smirnov test, the variable Asymp.Sig perceived fairness understand of 0.480, tax knowledge and Education of 0.740, penalty & fines rate of 0.125 and trust and powerful of 0.270 are all is great than 0.05. It can be concluded that the data of all the independent variables are normally distributed.

Table 4.11 Multicollinearity Coefficients

Model	Collinearity Statistics	
	Tolerance	VIF
(Constant)		
perceived fairness understand	.582	1.719
tax knowledge announce	.580	1.723
penalty & fines rate	.697	1.434
trust and powerful	.778	1.286

Multicollinearity test done to avoid habits in the decision making process regarding the partial effect on independent variables on the dependent variable. Good regression model should not happen correlation between the independent variables or not happen multicollinearity. Test Multicollinearity as a basis the VIF value of multicollinearity test results Using SPSS. Making Process in Multicollinearity Test

1. If the VIF value lies between 1-10, then there is no multicollinearity
2. If the VIF <1 or > 10, Then there is multicollinearity

Based on the coefficients output collinearity statistics obtained VIF of Perceived fairness understand is 1.719, the tax knowledge announce of VIF is 1.723, The Penalty and Fines rate of VIF is 1.434 and The VIF of Trust and Powerful is 1.286. All the VIF value obtained is between 1to10. It can be concluded that there is not multicollinearity symptoms

HETEROSKEDASTICITY TEST

Breusch-Pagan and Koenker test statistics and sig-values

Table 4.12 Breusch-Pagan and Koenker test

	LM	Sig
BP	28.944	.000
Koenker	32.267	.000

Null hypothesis: heteroskedasticity not present (homoskedasticity), if sig-value less than 0.05, reject the null hypothesis, Note: Breusch-Pagan test is a large sample test and assumes the residuals to be normally distributed

4.12 REGRESSION RESULT

A linear regression model was used to predict tax compliance level in the study. The prediction was carried out basing on the effect of the four independent factors: Perceived fairness tax system, Tax Knowledge and education, tax fines and penalties and Trust and power of tax authority. In addition, the coefficients for each independent variable generated from the model was subjected to at-test, in order to test each of the hypotheses under study. The study thus came up with a model summary, the ANOVAs for the effect sizes and the regression model as presented in table 4.14, 4.15 and 4.16 From table 4.14, the findings indicated that the model correlation coefficient was 0.608 which indicated that the model predicted over 60% of the change in the independent variable. This Relationship was significant considering the coefficient of determination value of 0.370. The model was adequate in this case as indicated by the Durbin-Watson statistic value of 2.286 which is in the range of 2 to 3.

Table 4.13 Model summary

R	R Square	Adjusted Square	Std. Error of the Estimate	Durbin-Watson
0.608	0.370	0.362	0.996	2.286

- A) Predictors: (Constant) perceived fairness tax system, trust and power of tax authority, Tax knowledge and education, tax fines and penalties
- B) Dependent Variable: Tax compliance level

Table 4.14 Residuals Statistics

	Minimum	Maximum	Mean	Std. Deviation	N
Predicted Value	.84	3.75	2.17	.759	303
Residual	-2.711	2.977	.000	.990	303
Std. Predicted Value	-1.752	2.095	.000	1.000	303
Std. Residual	-2.721	2.987	.000	.993	303

a. Dependent Variable: tax compliance level

The ANOVA model in table 4.15 showed that the regression model was also adequate. The effect size of the regression model was shown to be over 4 that contributed by the residual mean sum of squares. The F-ratio was 43.767 for the four factors. This represented the effect size of the regression model and was significant with a p-value of 0.000.

Table 4.15: ANOVA Model

	Sum of Squares	Df	Mean Square	F	Sig.
Regression	173.840	4	43.46	43.767	0.000
Residual	295.91	298	0.993		
Total	469.749	302			

Dependent Variable: Tax compliance level

Predictors: (Constant) perceived fairness tax system, trust and power of tax authority, Tax knowledge and education and tax fines and penalties

4.16 Coefficients model

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	.685	.216		3.168	.002
perceived fairness understand	.215	.076	.172	2.828	.004
tax knowledge announce	.213	.061	.213	3.486	.001
penalty & fines rate	.269	.059	.253	4.550	.000
trust and powerful	.165	.058	.151	2.844	.004

Predictors: (Constant), trust and powerful, penalty & fines rate, perceived fairness understand, tax knowledge announce

The predictor variables explained 38.2% of the variability in the non-compliance behavior of Addis Ababa medium taxpayers ($F=43.767$, $p<0.05$). The four independent variables were perceived fairness of tax systems, tax knowledge and educations, penalty and fines and trust and power of the tax authority found to be significant factors of tax non-compliance behavior. The predictors perceived fairness of tax systems ($t=2.828$, $p<0.05$), tax knowledge educations ($t=3.486$, $p<0.05$), penalty and fines ($t=4.550$, $p<0.05$) and trust and power of the tax authority ($t=2.844$, $p<0.05$).

The regression results in table 4.17 show that each of the predicted parameters in relation to the independent factors were significant; $\beta_1=0.151$ ($p\text{-value}=0.004$ which is less than $\alpha=0.05$) which implies that we reject the null hypothesis stating that there is no significant relationship between trust and power of tax authority and tax compliance level. This indicates that for each unit increase in the negative effect of trust and power of tax authority, there is 0.151 units decrease on tax compliance level. Furthermore, the effect of trust and power was stated by the t-test value=2.940 which implies that the standard error associated with the parameter is less than the effect of the parameter.

The table also shows that $\beta_2=0.269$ (p-value=0.000 which is less than $\alpha=0.05$) which indicates that we reject the null hypothesis stating that there is no significant relationship between tax penalties and fineness rate and tax compliance level. This implies that for each unit increase in penalty and fineness rate. There is up to 0.269 unit increase in tax compliance level. Also the effect of penalty and fineness is shown by the t-test value of 4.550 which implies that the effect of exceeds that of the error by over 4 times.

The value of $\beta_3=0.213$ (p-value=0.001 which is less than $\alpha=0.05$) which implies that the Null hypothesis stating that there is no significant relationship between tax knowledge and education and tax compliance level. This indicates that for each unit increase in tax fines and penalties, there is up to 0.213 units increase in tax compliance level. The effect of tax fines and penalties is stated by the t-test value=3.486 indicate that the effect of tax penalties and fines is over 3 times that of the error associated with it.

The findings also showed that β_4 was 0.215 (p-value=0.004 which is less than $\alpha=0.05$) which Implies that we reject the null hypothesis that states that there is no significant relationship between perceived fairness tax system and tax compliance levels. This implies that there is up to 2.828 unit decrease in tax compliance for each unit increase in perceived opportunity for tax.

4.13 DISCUSSION OF THE FINDINGS

As stated by **Hypothesis1** that tax authority trust and power has no significant effect on tax compliance level, research findings how in consistency with the hypothesis hence ,Trust and power had affection to tax compliance level (coefficient estimate ($\beta_1 =0.165$, pvalue=0.004). High trust and power has been found to diminish the competitiveness of the country in terms of taxation attractiveness thus tax authorities are interested in making the tax legislations simpler in order to avoid this situation. Finding also showed that it had affect the tax compliance. The previous study also shared the result carried out in this study. The studies are; (wahl, kastlunger and kircheler, 2010) and (Munyentuali Gadi, 2004).

Hypothesis 2 states that penalty and fines rate has no significant effect on tax compliance. Research findings are not in agreement with the hypothesis coefficient estimates 0.269,

value=0.000). A high level of penalty and fines rate contribute immensely to tax compliance. From the finding, Companies which penalized high fines or penalty, they have not willingness to pay their tax duties by their own. Regarding fines and penalty, the previous study also supported this study finding like (Joseph, 1980); (Akalu, 2016) and (Rawling, 2013).

Hypothesis 3 states that tax knowledge and education have no significant effect on tax compliance. Research findings are not in agreement with the hypothesis since fines and penalties has coefficient estimate ($\beta_3=0.213$, p value=0.001), hence hypothesis 3 does not hold. Higher fines simply reduce the cases of tax knowledge and education thus encouraging tax compliance level. . This findings supported by previous studies of; (Joseph, 2003) and (Akalu, 2016), which evidenced that tax knowledge could have a positive effects on tax compliance. However some other study by (Goitom and Taddesse, 2014) indicate that education and tax knowledge has not impact on tax compliance

Hypothesis 4 states that perceived fairness tax system has no significant effect on tax compliance. Research findings show inconsistency with the hypothesis; hence perceived opportunity for perceived fairness tax system was correlated to tax compliance, (coefficient estimates $\beta_4=0.215$, p value=0.004 The finding indicate that the fairness perception on the tax system could have significant on the self-assessment declaration by the tax payers. There were other researches which supported the finding of this study such as (Mukasa, 2010) and (Munyentuali Gadi, 2004).

CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSION AND RECCOMENDATIONS

5.1 INTRODUCTION

The general objective of this study is to analyze the factors affecting tax compliance level .The target population consists of selected tax payers with regard to their risk level in Addis Ababa medium taxpayer's number two branch office during the study period.

5.2 SUMMARY OF FINDINGS

Findings on gender indicated that there are more male than females among the respondents showing that more men than female are involving on business in Addis ababa medium taxpayer branch and tax activities It was also affirmed that majority of the respondents were between the age bracket of 50-60 years and it was also brought to light that majority of respondents were fairly educated ,those with a diploma contributing the highest percentage followed by those with an undergraduate degree affirming that there were moderate levels of literacy among the respondents .

Research findings on information about Tax compliance level that majority of the respondents have been in experience for between 0-5 years. Respondents found to have attended formal taxation course organized by authority or any other institution fifty six point two percent (53.5%) against events three point eight percent (46.5%) who have never attended any taxation course. In relation to being audited, majority of respondents tax payer event fifty four point one (54.1%) have never been audited while forty five point nine percent (45.9%) have been audited.

The study found that compliance levels among tax compliance level of tax payer is low. There for need for tax authorities and the government to come up with strategies to effectively monitor this

category of taxpayers with a view of enhancing compliance levels. The study also found out that most of the respondents under reported their income and over claimed deductions.

A determination of the effect of trust and power of authority on tax compliance level revealed a strong positive correlation meaning that trust and power of authority has a significant effect on the level of tax compliance. This means that higher trust and power of authority will reduce tax compliance levels. The study also examined the effect of tax knowledge announce on tax compliance level .The findings show a strong positive relationship between the two implying that enhanced knowledge on taxation will in turn enhance tax compliance level.

An assessment of the effect of fines and penalties on tax compliance levels revealed that there is a significant positive relationship between them. This implies that an effective use and enforcement of fines and penalties on tax offenders will enhance levels of tax compliance. The study having evaluated the effect of perceived opportunity for tax payer on compliance level concluded that there is a positive relationship between the two implying that a perceived fairness understands will lead to lower levels of tax compliance level.

5.3 CONCLUSION

These study findings provide direct evidence that tax compliance cost is a contributory factor in tax compliance, and an indication of its magnitude effect. From the study findings there is enough proof to conclude that trust and power of the tax authority is associated with high levels of tax compliance. The study also provides some preliminary evidence that fines and penalties play a vital role in improving tax compliance. Specifically, for a tax system with fair tax rates of fines and penalties, tax compliance is likely to improve.

The study results also inferred that perceived fairness tax system has a significant effect on tax compliance. This is because through opportunity, induced opportunity to cheat increased non-compliance regardless of whether the participants actually intended to be non-compliant or not. Finally, the study concludes that tax knowledge and education has a significant effect on tax compliance. It is therefore prudent for the tax system to enhance education on how to file tax returns and the importance of paying tax.

5.4 RECOMMENDATIONS

From this paper finding, it was deduced that trust and power of authority has a deep effect on tax compliance. The findings suggest tax systems with low trust and power of authority are most likely to be complied with. Therefore, more trust and proper use of power makes the taxpayers be more confident to obey their duties. This may not encourage taxpayers to evade tax. The study finds strong upkeep for the argument that fines and penalties influence highly on tax compliance, Thus there should be reasonable levels of fines and taxes to implement. This way, taxpayers been courage to comply since they will keep precise records for taxation purposes in order to escape from fines and penalties.

Also, tax knowledge and education has a significant effect on tax compliance. Thus the tax system should not only provide a clear and simple guide line on how to fill tax returns but also enhance taxpayer education services to enable the taxpayers understand their rights and obligations as taxpayers. This way tax compliance levels will increase.

Finally, perceived fairness tax system has a significant effect on tax compliance, therefore the tax system should target individuals at all levels of income to pay taxes that may discourage tax evasion. Tax systems should also ensure that all the taxpayers should express their citizenship and love to their country by paying their taxes. Specifically, Countries like Ethiopian which based on their budget on the tax collected from their citizen, tax compliance is the mandatory issue for proving what the citizen is looking for from their government.

5.5 FURTHER RESEARCH RECOMMENDATIONS

In future, researchers should work on this study to arrive whole over the country .A study on the self- assessment system can also be carried out to determinates effectiveness on enhancing tax compliance levels. Further the study should also put into consideration the influence of economic conditions on tax compliance.

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Appendix 1: Questionnaire

Addis Ababa University

School of Business and Economics

Department of Accounting & Finance

Dear Respondents,

This research is entitled **“Factors that affect Tax Compliance in Addis Ababa city Administration Revenue Authority Addis Ababa Number 2 Medium Taxpayers Branch Office”** and conducted in partial fulfilment of the requirements for the master’s degree in Accounting & Finance at Addis Ababa University. Its main objective is to identify and understand the factors of tax compliance in Addis Ababa medium taxpayers in Ethiopia. The research is held on be carried out on your responses and other relevant data that could support it.

The concern of this questionnaire is to attain your observations and opinions regarding various aspects of taxation. The answers of the research will be give in to the concerned government bodies so that they can make use of the recommendations made. Hence, the response you will provide assist me to censoriously analyze why medium taxpayers obey and/or why not they obey with reporting preconditions.

Your collaboration to reply is so important to this research because it represents a number of others who are not included in the sample. Your response is purely for academic purpose. In order to achieve this research, you are kindly request to answer every question; your kind cooperation is highly appreciated.

I thank you very much in advance for your cooperation

Researcher's Name: HABTAMU LASHETEW

Position: MSC student at AUU

Phone number 09 11 80 72 85/ 09 11 22 60 35

SECTION A: BACKGROUND INFORMATION OF THE RESPONDENTS

1. Gender: Male ☐
Female ☐

2. What is your age bracket?

AGE BRACKET	TICK APPROPRIATELY
20-30	
30-40	
40-50	
50-60	
Above 60	

3. What is your highest level of education?

Level of Education	Tick Appropriately
High School Certificate	
Certificate/Diploma	
Degree/Professional	
Masters	
PHD	
Other(Specify)	

PART V: BACKGROUND INFORMATION OF THE BUSINESS.

1. What is the name of your business?

(Optional).....

2. How many properties do you own/manage?

.....

3. How long have you been in the business?

YEARS	TICK
0-5	
6-10	
11-20	
OVER 21	

4. What is your annual turnover?

TURNOVER	TICK APPROPRIATELY
BELOW 5 MILLION	
5-10 MILLION	
11-15 MILLION	
16-20 MILLION	
OVER 21 MILLION	

5. Have you attended/passed any formal taxation course/training organized by Addis Ababa tax authority

Yes ☐ No ☐

6. Have you ever been audited by Addis Ababa tax authority

Yes ☐ No ☐

6a) If Yes, how many times?.....

7. Have you ever been penalized by the Addis Ababa tax authority due to the following conditions?

	Yes	No
Not filing a tax return		
Late filing of tax return		

8. Have you ever engaged in the following?

	Yes	No
Under reporting income		
Over claiming deductions		

SECTION C: TAX COMPLIANCE LEVEL

Tick Appropriately.	Strongly disagree (1) Disagree (2) Not Certain (3) Agree (4) Strongly agree (5)				
	1	2	3	4	5
The business files its tax returns on					
The business pays the right amount of taxes on time					

PART I: PERCEIVED FAIRNESS FOR TAX SYSTEM

Tick Appropriately.	Strongly disagree (1) Disagree (2) Not Certain (3) Agree (4) Strongly agree (5)				
Personally, I agree that the Ethiopian tax system is easy to understand and consider the taxpayers.	1	2	3	4	5
there is fair neutrality of the procedure, trustworthiness of the tax authorities and polite, honorable, and respectful treatment in tax authority					
comparisons are made on the individual, the group, and the societal level among taxpayers					
A 'fair' tax rate which consider all the taxpayers ability are implemented in the Ethiopia tax system					
The tax proclamation ,regulations and directives are keeping their hierarchy and never collide each other					
The tax authority circular does not affect the fairness of the tax system					
The tax compliance requirement may have produced stress and anxiety to taxpayers. It may have psychological impact causes by the tax system.					

PART II: TAX KNOWLEDGE AND EDUCATION

Tick Appropriately.	Strongly disagree (1) Disagree (2) Not Certain (3) Agree (4) Strongly agree (5)				
	1	2	3	4	5
I know how to announce all income received from all bases to the tax authority					
I know how to keep records/documents relating to income and expenses for a period that should be declare					
I understand that I should pay taxes due within the prescribed period from the date of issue of the Notice of Assessment or within the stipulated period					
I know which income should be included or excluded in determining the taxable income					
I have got sufficient and continues tax related education from the tax authority					
The tax authority education help me to keep my books properly and protect me from an tax, interest and penalty that can occurs because for lack of knowledge					

PART III: FINES AND PENALTIES

Tick Appropriately.	Strongly disagree (1) Disagree (2) Not Certain (3) Agree (4) Strongly agree (5)				
	1	2	3	4	5
The penalty rates are affordable and I can pay the penalty without any complain					
The enforcement seems very poor					
I believe that the penalty is lower Than my tax saving due to not complying with tax laws					
Serious enforcement and penalty by the tax authority makes me more conscious to					
I support fine and penalty has great impact on the tax compliance					

PART IV: THE TRUST AND POWER OF TAX AUTHORITY

Tick Appropriately.	Strongly disagree (1) Disagree (2) Not Certain (3) Agree (4) Strongly agree				
The tax authority use its power as the law prescribed					
Most of taxpayers have positive response towards the power of the tax authority					
The taxpayers and the tax authority have great trust each other					
the tax authority officers use their power for seeking any inducement or bribery					
I believe that the tax collector does not exercise and take actions which affect my business.					