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St. Mary's University, Ethiopia

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Graduate Program

MBA in Accounting and Finance

**Problems of Tax Audit of Categories “A” tax payers:
(a case of manufacturing companies in Kirkos Sub
City)**

BY

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Problems of Tax Audit of Categories “A” tax payers: (a case of manufacturing companies in Kirkos Sub City)

A Thesis Submitted to the School of Graduate Studies of the St.Mary’s University in partial Fulfillment of the requirements for the Award of the MBA Degree in Accounting and Finance

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Statement of Certification

This is to certify that Melaku Dadi has carried out a thesis on the topic entitled “Problems of Tax Audit of Categories “A” tax payers: a case of manufacturing companies in Kirkos Sub City” under My Supervision. In My opinion, this thesis is suitable for submission in partial fulfillment of the requirement for the award of the MBA Degree in Accounting and Finance.

Advisor: Zenegawe Abiy (PhD)

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Examiner:

Signature: _____

Statement of declaration

I have carried out independently a thesis on “Problems of Tax Audit of Categories “A” tax payers: a case of manufacturing companies in Kirkos Sub City in partial fulfillment of the requirements of the MBA Degree in Accounting and Finance with constructive guidance and support of the research advisor.

This thesis is my own work that has been presented for any degree or diploma program in this and any other institution and that all source of materials used for the thesis have been duly acknowledged.

Melaku Dadi

June 2017

Addis Ababa

Abstract

This study examines Problems of Tax Audit of Categories “A” tax payers: a case of manufacturing companies in Kirkos Sub City”, and investigate key problems in tax audit operation regarding the appropriateness of tax audit type used, effectiveness, convince of audit case selection methods and audit examination types used, and the experience and capability of tax auditors and investigators.

The study adopts mixed methods approach in order to achieve the research objectives and to answer research questions, specifically , the techniques used in the study include survey with Manufacturing companies tax payers, tax auditors and investigators, open ended questioner and close ended questioner with tax officials and manufacturing companies tax payers.

With these research methods, the results of the study reveal that the tax payers’ confidence on tax auditor, investigator is unsatisfactory and tax audit program remains undeveloped with tax audit rule, law and instruction performed targeting aptly specific risks. The tax audit program is a toddler tool in improving voluntary compliance and increasing future revenue collection through educating and helping manufacturing companies’ tax payers to understand their tax obligations. The study also shows no fairness tax audit coverage, the absence of compliance risk-based tax audit performance, scarcity of tax auditor behavior, tax auditor professional competent. In the end, the study forward the possible measures to be taken by the manufacturing companies’ tax payers and ERCA to mitigate problem in tax audit.

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List of Abbreviation

CPTA – Certified Public Tax Accountant

GDP – Gross Domestic Product

GTP – Gross Total Product

FDRE – Federal Democratic Republic Ethiopia

MFG.CO. - Manufacturing Companies

ERCA – Ethiopia Revenue Custom Authority

EC – Ethiopia Calendar

GC- Gorgonian Calendar

IRS – Internal Revenue Service

GST – General Service Tax

VAT – Value Added Tax

CPA – Chartered Public Accountant

IFRS – International Financial Reporting Standard

IAS – International Accounting Standard

TRA – Tanzania Revenue Authority

CHAPTER ONE

1. INTRODUCTION

1.1. BACK GROUND OF THE STUDY

Taxes are important source of revenue. Public goods and services are normally subject to collective consumption, thus requiring that we put some of what we earn into government hands. Public goods are normally supplied by public agencies due to their natures of non-rivalry and non-excludability. The nature of consumption of public goods is such that consumption by one does not reduce consumption for others. Besides, consumption of public goods by an agent does not exclude other from doing same. Such nature of public goods therefore makes them impossible for private suppliers to avail them at market price like other commodities. Government intervention in the supply of public goods is, therefore, inevitable and can only be done if the public pays taxes for the production and supply of such goods (Tesfaye; 2005)

The original idea of a tax was that payment was not obligatory upon the subject, but consisted rather as a voluntary contribution toward the expenses of government, as appears from the medieval Latin term *donum*, and the English “benevolence” (BerNetel, 2006). This conception of the relation between the subject and government was gradually transformed; payment becoming more and more obligatory, until finally coercive taxation resulted. At the present time payment of taxes is obligatory in all civilized nations; where the rate or imposition is at all dependent upon the tax payer, the tax takes the form of a fee or payment for contractual services.

Nevertheless, the performance of tax revenue is relatively poor that an average of 20 percent of GDP during the 2006/07 to 2007/08 fiscal year, which is caused by lack of compliance mainly due to paucity of tax payers’ awareness and the weakness in tax law itself, ineffective tax audit in particular.

Today the role of the government has increased and government has collect more tax than ever to finance its operation. But governments are facing difficulty in collecting the tax they need for compliance is the willingness of tax payers to obey tax laws in order to obtain the economy equilibrium of a country (Andreoni, et al 1998).

Compliance with the tax law typically means true reporting of tax bases, correct computation of the tax liability, timely filing of returns and timely payment of the amount due.

Alm(1991) and Jackson and Millirion(1986) defined tax compliance as the reporting of all income and payment of all taxes by fulfilling the provisions of laws, regulations and court judgments. Tax non compliance is one of the problem many developing country face when it comes to tax administration.

Taxes are contributions from the national dividend; they must ultimately come out of the annual earnings of the nation. The private income of a nation is index of the capacity of the people to pay taxes, since it is the real source of public revenue. Labor and wealth employed productively by individuals create a fund which can be drawn upon; hence, as Adam smith urged, the importance of measures which remove restraints on production, which tend to stimulate the enterprise of people (George. 2005)

Tax evasion is a growing concern in today's economy. The expectation gap between financial auditing and tax auditing approach has been the subject of much debate. The new approach of tax auditing – the certified public tax accountant (CPTA) licensure, is seen as a necessary means to protect public interest and improve efficiency of the tax system. Previous studies in economics have largely focused on income tax evasion. However, not enough attention has been paid to the system of auditing with respect to financial and tax auditing to reduce tax fraud and evasion. Wonglimpiyarat (2010).

The tax auditing is a pragmatic approach to prevent, deter and detect fraudulent financial reporting and to detect cases of tax fraud.

Allingham and Sandmo (1972) tax non- compliance is a serious challenge slackening income tax administration and tax revenue performance in Ethiopia, as it does in some other countries. Like other developing countries, Ethiopia faces hurdles in rising revenue to the required level in order to scale up the development endeavors. Ethiopia has experienced an unswerving surplus expenditure over revenue for a sufficiently long period of time. To address this problem, the government introduced direct and indirect taxes to improve public revenue although prior statistical evidence proves that the contribution of income taxes to the government's total revenue remained consistently low.

The proper amount of tax must be collected on a timely manner for successfully improving and maintaining steady economic progress of a country. To do this tax audit may increase tax revenue in two ways: directly through assessment of additional tax, and indirectly by improving manufacturing companies' compliance with tax law and regulation (Barreca and Ramochandran 2004).

1.2. STATEMENT OF THE PROBLEM

As across the world the tax cost has gradually reduced and electronic systems has made tax compliance less burdensome. The rates of decrease have however slowed in recent year in particular we have seen a mixed picture for the total tax rate. While across the globe the average total tax rate has been fallen very slightly, it actually rose in more economies than it fell. We have also seen diametrically opposing in stances of tax reform with, for example, one economy introducing a tax which another economy has abolished or one economy increasing a tax rate which another has reduced. (Lopez-Claros; 2016)

In 2013/14 and 2014/15 tax revenue collected amount to birr 106 billion and birr 115.5 billion, respectively. Tax revenue collected in 2014/15 is higher than its planned target by about 47 percent, while it is higher than the performance in the preceding year by over 52 percent. The 2014/15 tax revenue is in fact double the amount collected in 2012/13, which was only 86 billion birr. The primary factors for the improvement in tax revenue are the deepening of effective administration of the tax system and the education and engagement the tax payers' community. The tax revenue as a percentage of GDP has been 16.92 in 2013/14 and 9.78 percent in 2014/15. These figures indicate that even though nominal tax revenue has been increasing rapidly, the growth rate is not commensurate with the rapid expansion of the size of the economy. The tax GDP ratio of Ethiopia is lower than the sub-Saharan Africa average of 17 percent of GDP. In order to attain the GTP target of 15-17 percent by 2015/16, it clearly requires strengthening, the tax administration system, further intensifying tax education and public engagement. (FDRE, Annual report; 2015/16 E.C).

The series of tariff and tax reform programs have helped to increase both federal government and national revenue. As per the reports of the Ethiopian revenue and custom authority, the federal revenue has increased to birr 106 billion in 2006/2007 from birr 86 billion in 2005/06. And also,

federal revenue has increase to birr 141.2 billion in 2007/2008 from birr 115.50 billion in 2006/2007 as the result of which federal revenue as percentage of the GDP increase from 15.14% in 2005/06 to 16.92% in 2006/07 and 18% in 2006/07 to 22% in 2007/08 respectively. (Finance and Economic minister report, 2016). Increase in both direct and indirect taxes, mainly the foreign trade taxes. As well, national tax revenue as percentage of GDP has increased to 16.92% in 2006/07 from 15.14% in 2005/06. Despite, the series of reforms and increase in revenue, the overall budget deficit with and without grant has been increasing. For example, the overall budget deficit without grants as percent of GDP has increased from -9.9% in 2005/06 to -10.5% in 2006/07.(Finance and economic minister report, 2016) shows GDP has increased from 19% in 2014/15G.C to 23% in 2015/16G.C. This shows that performance of revenue collection in Ethiopia has been 14% low compared to the rest of sub-Saharan African countries which is over 15% of the GDP.

Ethiopia has been double digit growth for over a decade. To do this, economic factor such as tax audit explore more detailed to address those problem for tax payers. The Ethiopia tax system may be described as loss agglomeration of proclamations, regulations, directives, rule etc. which despite their loose ends and rough edges, seem to fulfill the singular for which they are designed, namely raising revenue for the Ethiopia government (Jacques vanderlinde(1966).

John Henry Marryman(1985). “An operating set of legal institution, procedures and rule,” it is possible to qualify the rule of any sovereign state as a legal system, regardless of the degree of legal organization involved and the level of legal development in a given country.

Under inadequate tax administration includes in sufficient and ineffective audit program, the potential amount of tax revenue in developing and a transition country has not been collected in an efficient and equitable manner (Edmiston and Bird, 2004). It is unmoving under a number of challenges regarding to its operation and administration that are not yet resolved. Further, weak tax administration may make the tax system unfair in that honest tax payers would bear heavier and disproportional burden. It, in turn, may have also encouraged manufacturing companies' tax payers to work in the illegal economy.

As tax audit is one of the tools of revenue administration, this paper focus on its problems of tax audit of manufacturing companies' tax payers' problem and significance in Ethiopia taking Addis Ababa Kirkos sub city as a case.

1.3. BASIC RESEARCH QUESTIONS

1. What does late payment slacken in tax audit on the authority?
2. What does negligence suggest manufacturing companies in return tax collection audit on the authority?
3. Which type of evasion and avoidance explore on the manufacturing companies encourage tax audit on the authority?
4. What does fairness encourages manufacturing companies to increase tax collection audit compliance?
5. Which is efficient and effective tax audit done on the manufacturing companies increase tax collection return on the authority?
6. What does convenience tax payment could manufacturing companies address tax collection return on the authority?

1.4. OBJECTIVE OF THE STUDY

1.4.1. GENERAL OBJECTIVE

The main objective of the research is to assess Problems of Tax Audit of Categories “A” tax payers: a case of manufacturing companies in Kirkos Sub City .

1.4.2. SPECIFIC OBJECTIVE

- ✚ To assess of late payment program on tax audit.
- ✚ To assess of negligence role on tax audit.
- ✚ To assess of evasion and avoidance influence on tax audit.
- ✚ To assess of fairness tax system ascertain tax audit.
- ✚ To assess efficient and effective tax audit address tax collection goal

✚ To assess convenience tax systems encourage tax payers to collect tax by tax audit.

1.5. SIGNIFICANT OF THE STUDY

The primary use of this research study manufacturing companies found in Kirkos sub city for the managers and policy makers of those selected companies regarding decision on optimal level of tax audit problem, way of managing it and over all policies on tax audit problem . The study also contributes in assess the prevailing tax audit problem and in making some adjustment on the existing tax audit performance.

Moreover, it will provide constructive feedback about the efficiency and effectiveness of the existing tax audit problem in A.A particularly Kirkos sub city tax authority and manufacturing companies.

Accordingly, the study also identifies contextual factors that augment or inhibit tax audit performance and draw some conclusions: this would assist the manufacturing companies to understand those identified tax auditor rule, tax law, and instruction affecting the operation of manufacturing industries.

Finally, for those who are interested to make further study on the related issue may be used as indication.

1.6. SCOPE OF THE STUDY

This research study for problems of tax Audit of Manufacturing Companies Categories “A” tax payers. Such as, late payment, negligence and evasion on Ethiopia Revenue and Custom Authority (ERCA), on the case of Kirkos Sub city. While studying the tax audit problem, the present study, considers only the tax audit problem and its application in Kirkos sub city tax authority and manufacturing companies, so that the scope somehow limited.

1.7. LIMITATION OF THE STUDY

The study assessed the tax audit problem manufacturing companies with specially reference A.A Kirkos sub city. In particular problems of tax audit of manufacturing companies categories “A” tax payers will be considers in the study. However, since the general guideline, application procedure and assessment are throughout the A.A tax authorities and manufacturing companies,

it is supposed that the paper can fairly reveal the tax audit problem and its significance in increase the revenue of the city.

Of course it may have some limitation with conclusion to take it as city wide. The reasons it that, there are some resources and time which are not cover all A.A tax authorities and manufacturing companies.

1.8. ORGANIZATION OF THE PAPER

Chapter one of the study the detailed view of the study and organization background, statement of problem, basic research question, objective of the study, significance of the study, scope of the study, and limitation of the study. The next chapter brought for us the review of related literature and studies.

The 3rd chapter is about methodology, the 4th chapter is about analysis of the study and the 5th chapter is about the conclusion and recommendation on the findings.

CHAPTER TWO

2. Literature Review

2.1. Theoretical

Kricher (2008), Tax audit be defined as “an examination of an individual or organization’s tax report by the relevant tax authorities in order to ascertain compliance with applicable tax laws and regulations of state”. He further said that tax audit is a process where the internal revenue service tries to confirm the numbers that you have put on your tax returns.

The tax compliance can be defined as “an ability of a tax liable body submit accurate , complete and satisfactory returns in conformity with tax laws and regulations of the state to the authority for the purpose of tax assessment” (Kircher 2008).

Frank (2010) concludes that the designed tax authorities audit policy can have important effects on production decision firm. The nature of such effects depends on whether firms compete or collude. Accordingly, an appropriate designed audit policy may not only achieve greater compliance and higher net revenue for a given output and resources spend on audit but may also have other effects that would be normally considered desirable in a wider economic context. By a smart design of audit policy, the authorities can create information externalities that partially offset the information advantages of industry insider. Since decision in the product market is in the light of the eventual outcome of the net after tax expected profits, the audit policy can create a linkage to output decisions.

Yongzhi(2005) concluded that this study does find a positive relationship between the audit and the voluntary competence. The finding suggests that the audit productivity may be under estimated in many studies in the literature. It remained us that when considering the productivity of the audit work. Besides the direct audit collection, for this reason, the finding may provide tax professionals and tax authorities with incentives to strengthen the audit power and to better structure their audit organization to generate more revenue for the state.

Erard(1994) mentioned some reason for tax audit which include, among other: to assist the government in collecting appropriate tax revenue necessary for budget, maintaining economic and financial order and stability, to ensure that satisfactory return are submitted by the tax

payers, to improve the degree of voluntary compliance by tax payers and to ensure that the amount due is collected and remitted to government.

James(1993) identified a priority list of tax audit mission as follows: to establish a viable and effective tax administration in order to deal with constantly changing economy, to put strategies in place in order to resolve tax dispute between the tax authority and liable tax payers, to maintain a strong mechanism to deal with tax avoidance techniques which are available to various organizations, but are susceptible to tax abuse, to bring defaulting tax payers to the net of tax authorities, to prove the completeness, accuracy and timely filing tax returns submitted by the tax payers.

Early compliance studies examine tax payers' report decision using a decision theory framework, in which the tax agency's audit probability is assumed to be fixed. Tax payers either know their tax liabilities with certainty (Allingham and Sandmo, 1972; Yitzhaki, 1974) or are uncertain about them (Alm, 1988; Beck and Jung, 1989a; Scotchmer and Slemrod, 1989). These models, however, ignore the interrelationships between flexible action choices of the internal revenue service (IRS) and non compliance, as pointed out by Gratez et al. (1986).

In tax compliance, tax payers' first report to the IRS, and agency can act strategically by conditioning its audit policy on tax payers reports. Gratez et al. (1986), Reinganum and Wilde (1986; 1988), and Beck and Jung(1989b) generalize the fixed audit probability model by adopting a game-theoretic approach that allows reporting and auditing to interact each other. Sansing (1993) extends this line of research by examining the role of cost less but imperfect pre-audit information on reporting and auditing strategies.

The above model assumes that the IRS' audit finalizes tax liabilities and that there is no interaction between the tax payer and the IRS after an audit. This approach is suitable for a setting where tax payer uncertainty originates from complex but unambiguous tax rules. In such an environment, an audit, if done without errors, would produce a result that competent professionals can agree upon. Even when the IRS makes errors in (initial) audits, these errors are assumed to be either undetected (Reinganum and Wilde, 1986; Feinstein, 1991) or corrected by IRS subsequently (Rhoades, 1997).

Tax payers' uncertainty due to ambiguous tax rules, however, may lead to disagreements about tax liabilities even among competent experts. The tax payer in this setting may challenge results of the IRS audit in court if expected tax savings exceed related costs. Subsequent research introduces the possibility of the tax litigation and examines the interaction between tax litigation and tax reporting. Lee(1990) investigates why the IRS may limit the scope of an individual rulings program that can reduce disputes between the IRS and tax payers.

Jung(1995) develops a models in which a tax agency, after an audit, can accurately estimate the probability of prevailing in court. Tax payers in his study, however, cannot rely on experts to discover and evaluate the probability used by the agency. Instead tax payers try to infer if from the tax agency's post-audit settlement offer.

2.1.1. Prospects of tax collection

Effective and efficient utilization of the collected revenue from taxes will allowed the government to provide adequate infrastructure that may boost and improved the life quality of its citizen. Therefore, beyond any reasonable doubt with proceed from taxes, a nation or society will gain prosperity and their standard of living would be up graded. A prominent economist of 17th century Adam Smith (1776) posits the following as prospect of good tax collection:

- Tax administration and collection should be efficient and supported to safeguard required tax collection via creating awareness and enlightenment campaign on the important of paying tax, training and re-training of tax personnel and computerization of tax process.
- Forceful action particularly should be deployed to table the leak of revenue especially on minor goods or services and as well as unpacked items.
- Government on various level should ensure sufficient and effective policies regarding tariff was put in place to enable the domestic firms have ability to compete with their counter foreign trade accordingly.
- Fair tax administration must be ensured and maintained in accordance to the principles taxation and sources of tax income through enacting new and amending existing tax laws.
- General Service tax (GST or VAT value added tax) is one of the indirect types of tax that yield government with revenue. With that, there is need for government to put more effort in strengthening and widening the scope of the tax base by bringing closer the

administration of GST or VAT to the tax payers. This will be achieved through establishing new office and relevant collection point that would facilitate the process.

2.1.2. Characteristics of good tax system.

A good tax system is expected to be rational, fair, unbiased and even non-discriminatory in nature and practice. Therefore, a fair system should contained good qualities and attributes that distinguish it from bias and lack of credibility.

- **Neutral:** A tax system that is said to be neutral is expected to be free from any bias through economic activities and hence not excessively castigate effort in support of leisure. This may also include tax income set for saving and even investment more deeply than earnings used for consumption. (Smith; 1776).
- **Visibility:** tax payers are always after to see the impact of their taxes to encourage them continue paying. A reasonable number among the populace are not clearly informed and aware that running public affairs by government costs money, therefore, government need monies from taxes to cut across the needs. Precautionary measures should be taking while spending collected proceeds from taxes to match its cost and benefit. (Smith; 1776).
- **Fairness:** this is simply refers to equity and fairness in tax system. Every citizen is expected to pay tax according to his earnings unless otherwise stated. It is frequently identified as the wealthy individuals pay higher share of their income in taxes due to high earnings than the poor people who earn lower. However, sometimes certain amounts of income are exempted from tax and even individuals shelter the destitute citizens. (Smith; 1776).
- **Simplicity:** A good tax system have to be simple so that government would easily administered and enforced, and also, less costly from the government side and tax payers as well. The eradication of several payers of tax also would provide a simpler tax system that should be ample and relaxed to enforce, comply to and administered. (Smith: 1776)
- **Convenience:** A convenient tax system would allow both the tax payers and tax collectors to easily exercise their function effectively. A good tax system that is very

convenient would minimize the cost of administering the collection and hence encourage compliance which in the long run cut off the level of tax evasion. Moreover, convenient tax system would also reduce time taken to collect the due taxes and facilitate the process as a whole. (Ricardo, 1998).

- **Administrative Efficiency:** the method of imposing and collecting taxes essentially is administrative effective, efficient, economical and transparent without any ambiguity or distortion. Failure to administer in an efficient manner would course the collection and enforcement of taxes to be more expensive. This may sabotage the aims of having convenient process of any good and effective tax system. It is unwise administration to spend even half of the taxes on collection and administration process talk less of beyond the half of total taxes. (Nhekairo, 2014).
- **Productive:** productive tax system is the system that would provide adequate revenue to the government. Meanwhile tax payment contains the discharge of money by the tax payers; where some of them (tax payers) have assumed various approaches in evading taxes. Therefore, a productive tax system should always look into the loopholes of the tax laws and block them to prevent leakage and improved the revenue due to the government. (Smith; 1776).

2.1.3. Tax Audit Approach

The extent of tax auditing is as important as the extent of financial auditing in public finance since accounting and tax laws are intertwined. However, the scope of tax auditing tends to have a narrower functional focus of obtaining compliance with existing laws and revenue code (Compare to the broader scope of financial auditing focusing on the compliance examination of the accounting act, the companies act and a number of tax laws).

Tax compliance review includes the examination of activities relating to the preparation of tax payers' tax returns and financial statements information documenting the taxpayer's filing position and the tax calculation (Cuccia, 1994; Mata and Call, 2010).

The possibility of non-compliance with tax law and loss of tax revenue are issues of critical interest to tax policy makers and enforcement agencies. Previous literature shows that most tax

payers tend to evade taxes in the absence of audit and fines for evasion (Allingham and Sandamo, 1972; Chung, 1976; Dawes, 1980; Messick and Brewer, 1983; Shinivason, 1973).

Tax evasion refers to an illegal reduction of tax payment; for instance by underreporting income or by stating higher deduction rates (Cowell, 1992; Slemrod and Yitzhaki, 2002; Slemrod, 2007).

Firms can evade taxation either by misreporting sales or profit, or by making false declaration about input use (Cremer and Gahvari, 1993, 1995, Virmaini, 1989; Yamada, 1990).

Tax evasion is particularly severe in developing and transition economies (Schneider and Enste, 2000; Hashimzade et al., 2010).

Tax evasion is considered an illegal act and therefore the government of many countries attempt to invest a tool-tax auditing-to lessen its impacts to the economy (decreasing revenue and increasing deficits of the country) (Cremer and Gahvari; 1995; Kim, 2008; Kastlunger et al., 2009).

2.1.4. Tax Audit and Investigation

➤ Tax Audit

Tax audit just like financial audit involves the gathering of information and processing it for determining the level of compliance of an organization with tax laws of the territory. For a successful audit, it is necessary that the auditor organizes his work in such a way that the assignment is accomplished completely and efficiently. More importantly however, a professional tax auditor or investigator must possess sound accounting and taxation knowledge, he must be sharp in interpreting the tax laws, tactical and must be alert and open minded with good communication skills. These are necessary personal prerequisite for any tax auditor or investigator to be successful for tax audit assignments. A tax as we already know is charge imposed by governmental authority upon property, individual or organization to raise money for public purpose. An audit on the other hand can be seen as the examination of the records underlying a financial statement as will enable the auditor to report authoritatively, whether in his opinion, the statement gives a true and fair view (Izedonmi 2000, Okoye, 2006).

Adesina (2005) defined an audit as the examination of accounting documents and of supporting evidence for the purpose of reaching an opinion concerning their propriety. It is an examination intended to serve as a basis for an expression of opinion regarding the fairness, consistency, conformity with accepted accounting principles of statement prepared by a corporation or other entity for submission to the public or to other interested parties. Tax audit is therefore a means of ensuring compliance with the tax laws. The primary purpose of tax audit is to maintain the confidence in the integrity of the self-assessment system. It helps to improve voluntary compliance by detecting and bring to book those who do not pay the correct amount of tax.

One of the cardinal principles governing the tax audit program is that each line of grade or business should received at least a nominal amount of audit attention. The selection of times for audit is management decision and criteria used vary from time to time (Ola, 1999).

➤ **Desk (or Office) Audit**

This is one which the whole activity of the audit takes place within the confines of the office of the tax officials. In this situation the tax official may simply request the tax payers to provide some additional documents to his office to enable him clear some issues in the returns submitted.

In this type of audit, no official notice is given to the tax payers of the impending desk audit exercise. He only gets to know when letters are written to him requesting for certain documents or explanations. The essence is to ensure some level of compliance with tax laws, rules and regulations as well as performing the administrative checks on returns submitted (Ebril et.al.2001).

➤ **Field Audit**

By the nature and scope of their work, regular assessing officers can only carrying out limited desk audit through examination of accounts and returns. It is in a bid to check this handicap as well as to improve on tax compliance that tax authorities carry out field audit exercise on tax payers by physically conducting the exercise in the office of the taxpayer. The tax payers are however formally notified of the arrival of the auditor prior to the commencement of the audit and the requirements of the auditors in terms of documents to be audited will also be requested for in advance. Field audit involves physical verification of documentary evidence and materials

at the premises of tax payers so as to confirm the facts and figures of the tax returns filed by corporate tax payers. The scope or depth of verification depends on the outcome of the desk audit work carried out by the tax auditor as well as the risk factors of the audit exercise. Special attention will normally be paid to those items likely to have high tax yield potentials. The tax audit is normally carried out through the back duty audit (Grandcolas; 2005).

➤ **Back Duty Audit**

1. Failure to disclose or include in full any income or earning in the return made available to the tax office.
2. Doubtful claims of capital allowance in respect of current or previous year.
3. Reduction in the profit in the returns files in tax office.
4. What the tax charged or assessed is less than what it ought to be.

The institution of back duty audit on a tax payer can either be a routine or as a result of the above reason. It is an exercise by the relevant tax authority to ensure that the amount due to the government is duly collected.(Ariswodola, 2000).

Tax audit refers to the practice of monitoring and enforcing the social contract between public and government (Pent land and Carlile, 1996). Tax audit is the extension of the normal audit process that gives true and fair view on the financial statement (Sen and Bala, 2002).

2.1.5. The Relationship between Tax Audit and compliance

Prior studies have recognized the tax audit as a medium to enhance tax compliance and to deter tax evasion. By using cross sectional data from 1977 to 1985, Dubin and Wilde (1990) approved that tax rate and audit rate have significantly deterrence effects on non compliance, according to Beck,Davis,and Jung(1991), tax compliance improved when penalty rate and probability audited increase, but no tax rate effect on tax compliance, Kamdar(1997) in his study using time series analysis found that tax audit rate has a positive and significant relation with compliance.

Collins and Plumlee (1991), on the other hand, studied the effect of tax schemes on reported income. Tax schemes comprise random selection, cutoff and conditional schemes. If cut off and conditional schemes were used, non compliance which encompasses under reporting of income

will go down as compared to random method. It indirectly suggests that tax audit can reduce under reported income notwithstanding the schemes used.

2.1.6. External Tax Audit

External tax audit refers to the process of business income tax returns attested by other party than the tax authority such as Chartered public accountants (CPAs) or tax agents (Lin, 2000). This definition is premised on similar concept as out sourcing since it involves a third party external to the organization. Lee (2001) defined out sourcing as the process of turning over part or all of an organization's functions to external service provider(s). The process is done to acquire economic, technological, and strategically advantages. Schneider jans and Zuckweiler(2004) explained out sourcing as a reallocation of service from one location to another . outsourcing can also be referred as a services requiring contract with external party(Sanders,Locke,Moors,and Autry,2007) to provide products or services that could also be provide internally(Carey,Sbramaniam and Karin,2006) that can give mutual benefits to the organization and the out sourced company(Jumah and Wood,1999). Hence, we can conclude that External Tax Audit is an out sourcing process in which the tax audit service performed by external auditor and benefits in land revenue Board and the tax payers.

2.1.7. Tax audit and Tax compliance

Tax audit have been variously discussed in relation to tax compliance. According to Palil and Mustapha(2011), some studies claimed that audits have a positive impact on tax evasion(Jakson and Jaouen, 1989; Shanmugam,2003; Dubin,2004). These findings suggest that it self assessment systems, tax audits can play an important role and their central role to increase voluntary compliance. Palil and Mustapha (2011) argued audits rates and the thoroughness of the audits could encourage tax payers to be more prudent in completing their tax returns, report all income and claim the correct deductions to ascertain their tax liability. In contrast, tax payers who have never been audited might be tempted to under report their actual income and claim false deductions.

2.1.8. Perceptions of Government spending and Tax Compliance

Palil and Mustapha(2011) observe that studies on the relationship between the specifics of actual government spending and tax compliance, particularly on tax evasion, are very limited. They acknowledge that tax payers, and especially these who high amounts of tax, will be sensitive to what the government spends their money on.

Lewis(1982) cited in Halil and Mustapha(2011) suggests that attitudes should be examined for the degree to which myths and misperceptions are replaced by knowledge, a change in attitudes towards taxations will occur even if, the tax payer's basic ideology and values remain unchanged and the tax law is unchanged. He also claimed that misperception probably plays a major role shaping fairness evaluations. Corroborating the view of Lewis (1982), Roberts, hits and Bradley (1994) also suggest that attitude to one's own tax evasion (tax ethics), and attitude to other people's tax evasion are important.

2.1.9. Probability of Detection and Tax compliance

Slemrod, Bluementhas and Christian (1998) investigated the relationship between the probability of being audited and tax payers' responses. The experiment indicated that tax payers' behavior varied with respect to level of income and the probability of being audited played a significant role in determining tax payers' evasion behavior.

2.1.10. Financial Auditing Approach

There is a growing realization for many countries to adopt international accounting standard (IASs) and international financial reporting standard (IFRSs) as these standard would make financial statement comparable and prevent financial instability (Dumontier and Raffournier,1998; Meall,2004).

The financial auditing is an audit of the financial reporting process comprising the annual financial statements, the company's internal controls over the process, and all related financial information (Carmichael, 2003).

The financial auditing approach can be seen as a standard surveillance-compliance system to achieve transparency of accounts (Wade, 2007).

2.2. Empirical

Mmari(2016) provides a theoretical analysis of the factors on failure to achieve full potentiality on tax revenue collection in Tanzania- a case study of the Tanzania revenue Authority located in Temeke Region. The study intended to identify the main resources of revenue available in Tanzania, investigate the major problems/obstacles hinders performance of revenue collection process and suggest the alternative means and strategies of the increasing the revenue base and revenue yield at TRA. The study reveals that TRA is facing complaints and hindrances in collecting taxes due to tax evasion, tax avoidance, and tax complexities another challenge facing TRA today is misuse of tax exemptions extended to business communities and excessively used by tax officials on the other hand tax officials faces difficulties such as administering all tax laws by failure to accessing, collecting and accounting of the tax revenues, monitor, oversee and coordinate all tax activities, promote voluntary compliance, take effective step to counter act frauds and tax evasions. The finding of this study provides initial directions in determining the factors that leads to ineffective tax collections by TRA.

Asamenew(2011) provided by Ethiopia researcher for fulfillment of MA Graduation and the prevalence of poverty in developing countries like Ethiopia demands improving internal revenue generating projects particularly the tax administration to reduce dependence on foreign aid and borrowing. The goal of this study is to investigate tax assessment and collection problems and the causes with regard to Category “A” tax payers found in yeka sub city. The finding the information gathered witnessed that there exist inefficiency and insufficient number of tax assessment and collection officers in the yeka sub city finance and economic development Bureau. Moreover, most tax payers lack sufficient knowledge of tax assessment and collection procedures. Thus, most of taxpayers do not know why they are paying taxes; what types of taxes are expected from them; and the applicable rules and regulation.

Nwaolisa(2015) was conducted in gombe Nigera. Thus, tax administration is a body responsible for implementing and governing the tax law and other tax related matter. They are held responsible for assessing, collecting and administering tax process. The problem identified include poor staffing, lack of facilities, poor record keeping and poor working conditions, poor remuneration and lack of motivational incentives are among the issues leads to low tax generation.

Berhane (2011) the title the law of corporate taxation in Ethiopia, thus, the taxation of business organization generally falls into two basic models-“corporate taxation and “partnership” taxation. Corporate taxation typically imposes a tax on the income of certain types of business organization and also taxes the profits distributed to the holders of the ownership interests. The partnership taxation model, on the other hand, taxes the income derived by the organization directly to the owners whether or not distributed. The paper assesses the treatment of corporate taxation in the Ethiopia tax law and argues that the corporate tax issues are not properly addressed in a manner that attracts corporate business investment.

Temtime (2014) focuses on examining the view of tax payers toward the taxpayer’s services, tax policy, tax administrative mechanism, and tax law enforcement. The findings of this study shows that business tax payers are not satisfied with the existing tax systems. The ways tax authority provides tax information to tax payers, tax collection and tax refund, administration capability to solving tax payers’ problem and the area of tax audit procedures are found to be major dissatisfied areas. Moreover, the finding revealed that the tax system is so complex and unfair, discretionary treatment by officers and existent of lack of monitoring in the tax authority.

Getaneh (2011) the title tax audit practices in Ethiopia. The study focus on examines tax audit practice in Ethiopia (the case of federal government), and investigate key problems in tax audit operation regarding the appropriateness of audit type used, audit rate, aptness of audit case selection methods and audit examination techniques used, and the experience and capability of audit staff resources. With these research methods, the results of the study reveals that tax audit program remains undeveloped with slight range of tax audit activities performed targeting aptly specific risks. The tax audit program is a toddler tool in improving voluntary compliance and increasing future revenue performance through educating and helping tax payers to understand their tax obligations. The study also shows low audit coverage, the absence of compliance risk-based audit case selection strategy, scarcity of audit resources, tax auditor in particular, and absence of proficient and experienced tax auditors.

Atsbeha (2011) the title Factors that influence Business income tax payers compliance (A case study in large tax payer Branch office). The study finding showed that probability of being audited, providing quality service, tax knowledge, perception of fairness and equality, fines and

penalties and organizational strength are basic considerations by taxpayers in their compliance-one-compliance decision.

Anyaduba (2016) the title impact of tax audit on tax compliance in Nigeria. The study finding showed that there exists a positive relationship between tax audit and tax compliance. The result also revealed that the probability of being audited, perception on government spending, penalties and enforcement, the joint effect of tax audit and penalties have a tendency to significantly influence tax compliance in Nigeria.

Msefin (2008) the title Tax Audit Practice and its significance in increasing revenue in Ethiopia the case of Addis Ababa city administration. The study finding showed that all countries need to collect taxes for several reasons, such as to finance developmental activities, to meet their day – to – day expense related to maintenance of a free and fair society, to control the economy through fiscal measures, and to a certain extent, to change the economic behavior of people. The result also reveals that the real challenge for nations is to ensure that tax payers are treated with fairness, justice, and equity, while national governments emphasize their authority as taxing authorities.

2.3. Summary and Knowledge gap

Problem of tax audit of manufacturing companies is a current issue for both developing and developed countries. These are not sufficient theory regarding tax audit problem manufacturing companies. In the theoretical review, to the knowledge of the researcher, there is no standard as to the percentage of the audit methodologies to be conducted in a given tax authority and manufacturing companies. In addition, there is no adequate literature regarding the appropriate audit examination activity to be used for checking the accuracy of tax returns in line with the level of economy, efficient and effective tax pay, developing countries in particular.

The empirical studies that have been reviewed in the preceding section focused on the different audit strategies that affect tax compliance behavior, income tax in particular and use of sampling tax audit strategy for improving the tax audit benefit. In addition, most prior studies regarding tax audit issues tried to examine the possible audit strategies including the use of audit service for the purpose of compliance improvement and fraud detection, and the impact of component reporting requirements on tax payers' incentives to misstate the tax liability.

However, to the knowledge of the researcher, it is possible to conclude that although there have been a number of studies on tax audit related issue both in developed and developing countries, Ethiopia in particular, there are no studies that exhaustively examine the tax audit problem manufacturing companies. In Ethiopia particularly in the case studies of kirkos sub city. In Ethiopia, the three exceptions regarding tax audit issues are the study by Gebeyehu(2011), Mihrety(2011) and Teklu(2011) which have been reviewed in the preceding section.

Even these studies did not asses exhaustively all the tax audit activities in Ethiopia. The study by Gebeyehu (2011) was specific to income tax in Addis Ababa city administration, and mainly focused on the way of increasing government revenue. The study by Mihret (2011) was specific to tax audit in Ethiopia (the case of federal government and investigate key problems in tax audit operation regarding the appropriateness of audit type used, audit rate and aptness of audit. And the study by Teklu (2011) was specific to the probability of being audited, providing quality service, tax knowledge, Perception of fairness and equality in large tax payer branch office.

Based on these gap in the literature together with the problem stated in section 1.2. The following grand research question is established.

“How is the tax audit problem manufacturing company in Ethiopia particularly case study of Addis Ababa kirkos sub city revenue and custom authority and the selected manufacturing companies’ categories “A” tax payers found in Addis Ababa in respect of the type of tax performed and its suitability, problems, case selection method used, audit techniques applied, the frequency or rate of audit performed, and the interest and qualities of tax auditors and tax payers its operation?”

CHAPTER THREE

3. RESERCH METHODOLOGY

3.1. Introduction

This chapter has been focused on research design and methodology that can be used to undertake the research. These are; research approach and techniques, sample design, sample size and sample techniques, data source and collection methods, procedure of data collection, questionnaire, ethical consideration and conclusion.

3.2. Research Design

Both quantitative and qualitative case study approach were used in this work. The tax audit problem manufacturing companies in the kirkos sub city of Addis Ababa served as a case in the study. The study employed the case study approach since it involved as in-depth probe into the services provided by a sub unit of a manufacturing companies. Additionally, case study provides more realistic responses than a purely statistical survey. The design of the study is to identify the role of tax auditing in terms of extent, efficiency and effectiveness of tax auditing in maximizing the generation of revenue. To achieve these objectives the study focused on obtaining quantitative and qualitative data to facilitate a conclusion about the practice of tax audit and its effect on the revenue generated in the kirkos sub city revenue and custom authority.

3.3. Research Approach

The research would use mixed research approaches. This study would be based on descriptive analysis and the methodology would be combined quantitative of data and qualitative method for those quantitative data via questionnaire.

3.3.1. Quantitative research approaches

Quantitative research is grounded in the post- positivism knowledge claim that primarily reflects the scientific method of the natural sciences. This paradigm adopted a deductive approach to the research process. The researcher gathers data from the real world setting and then analysis the

data statically to support or reject the ideas (Blanchi and Durrhein, 1999). Researchers who adopt a more deductive approach use theory to guide the design of the study and interpretation of the results. In line with this, the overall objective of quantitative research is to test or verify a theory, rather than to develop one. Therefore, the theory offers a conceptual framework for the entire study, and it serves as an organizing model for the entire data collection procedure (Welman and Kruger, 2001).

Fire Stone (1987) stated that quantitative data are those which can be sorted, classified, measured in a strictly objective ways. They are also capable of being accurately described by a set of rules or formulae which then make their definition (if not always their interpretation) unambiguous and independent of individual judgments. Quantitative researchers put their emphasis on procedures, methodologies and statistics. As a result, it relies on statistical techniques aided by computational algorithms and software packages for analysis the problem under study.

Quantitative research is one in which the investigator primarily uses positivist claims for developing knowledge and its strategies of inquires are associated with experimental and survey research methods. Creswell (2009) mentioned that experimental research seeks to determine if assessed by providing a specific treatment to one group and withholding it from another and then determining how both groups scored on an outcome. Whereas, survey research provide quantitative or numerical descriptive of research trends attitude or opinion of a population by studying sample of population. Using questioner for data collection, with intent of generalize from the sample to the population.

3.3.2. Qualitative research approaches

Qualitative approach is centered on the interpretive social science paradigm. Qualitative methodology of investigation tend to be based on recognition of the importance of the subjective, experimental 'life-world' of human beings (Blanchi and Durrhein, 1999).

Shaw (2006) describe the qualitative research seeks to come to terms with meaning than frequency because they discover or uncover issues in order to generate ideas. This paradigm therefore focuses on context and capture ways in which people interpret events, experiences and relationship.

Easterbyet et al. (1991) mentioned that the task of the qualitative methodologist as to capture what people say and do as a product of how they interpret the complexity of their world, and to understand events from the view points of the participants. Creswell(2009) pinpointed that qualitative approach is one in which the inquirer often makes knowledge claims based primarily on constructivist perspectives (i.e. the multiple meaning of individual experiences meanings socially and historically constructed, with an intent of developing a theory or pattern) or advocacy/ participatory perspectives (i.e. political, issue-orientated, collaborative, or change oriented) or both. Qualitative research uses data collection method open ended questioners and finally the finding is conveyed subjectively through description using words rather than numbers. This means, in qualitative research the main emphasis is on descriptive and inductive discovery of evolving theory that may arise after data is collected.

3.4. Research Techniques

Relevant data and information for the research have been collected through the use of instruments such as questionnaire and records.

3.5. Sample Design

The sampling design would deals with the method of selecting items from a target population (tax payers and employees) to be engaged for the given study. Sample design comprises the following procedures such as, population or universe, sample unit, sample technique and sample size.

3.5.1. Population or universe

The population is the aggregate or collection of units about which the survey would be conducted. We have a target population, the group of units about which information is wanted, and a survey population, the units that we are able to survey. The target population is also known as the scope of the survey, the population that the survey is aimed at; the survey population is also called the coverage, the population the survey actually covers. Ideally the survey population should correspond exactly with the target population; however, the two populations may not match, so the conclusions based on survey data only apply to the survey population.

The target populations of this study were manufacturing companies and ten sub city revenue and custom authority found in Addis Ababa which are: Kirkos sub city revenue and custom authority, Ledeta sub city revenue and custom authority, East and West region revenue and custom authority, south and North region revenue and custom authority, Nifasilk sub city revenue and custom authority , Addis Ketema revenue and custom authority, kolfa and keraneo sub city revenue and custom authority, Golila sub city revenue and custom authority, Bole subcity revenue and custom authority and akaki and kality sub city revenue and custom authority. From these listed authority only kirkos sub city revenue and custom authority employees (tax auditors, investigator and assessor) selected.

The target populations of this study will be the employee of Ethiopia revenue and custom authority kirkos sub city and tax payers of manufacturing companies, there are 27 employee and 194 manufacturing companies' tax payers will be used as a population of this study.

3.5.2. Sample units

The sample units of analysis will be Employees and Taxpayers of the Authority.

3.6. Sampling size and Sampling

The target population of the study will be Ethiopia revenue and custom authority in Addis Abeba Such as, Bole sub city, ledeta Sub city, kolfe and keranio sub city, gulali sub city, east and west region, South and north region, Nefasilk sub city, Addis Ketema sub city, akaki and kality sub city and kirkos sub city. From those kirkos sub city will be selected by using purposive sampling techniques, the reason to select my working place and more respondent are expected to provide reliable and confidential data on the Tax audit problem Manufacturing companies catagories "A" tax payers. Besides, selected kirkos sub city tax payers and Employees would help the researcher to get more knowledge and enable to get. How tax audit problem manufacturing companies of the authority tax payers.

After selected the Sample companies, the next task will be determining the sample size of the population of the authority the sample size determination formula that is developed by taro Yamane (1967).

- The target population of the studies 27 from Ethiopia revenue custom authority employee. i.e.,

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

Where n is the Sample size

N is the population size and

e is the level of precision error =(5%)

$$n = 25$$

- The target population of the studies 194 from manufacturing companies found in A.A sub city i.e.

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

Where n is the Sample size

N is the population size and

e is the level of precision error =(0.187%)

$$n = 194 / (1 + 194(0.187)^2)$$

$$n = 25$$

Therefore, the sample size will be 50. Based on the above formula, 25 samples will be taken from tax payers and 25 sample sizes will be taken from Employees of the sub city of the authority.

Simple random sampling technique would be used to give each and every tax payers and employee of the selected sub city. This is because in simple random sampling technique each member of the population will have equal chance of being selected.

3.7. Data Source, Collection procedure and Questioners

To achieve the objective of the research, primary data source will be used which can be collected through questionnaires (both open ended and close ended) and distributed to the tax payers and employees of the authority. The variable will be attitudinal and measured using Likert Scale with five response categories (Strongly disagree, disagree, neutral, agree and strongly agree).

The research would request permission of the authority managers of Ethiopia revenue and custom authority in kirkos sub city and after the permission, questionnaires would be distribute to the respondent. The questionnaire would have closed ended and open ended questionnaire, collect of the responses would be start after a week from the date of administration and would continue for a month.

The questionnaires would have parts, Tax auditing problem Manufacturing companies (TAP) by using the five point Likert response scale.

3.8. Data analysis and interpretation

SPSS soft ware for version 20.0 has been employed to give descriptive analysis on the data. In the case of quantitative data, the analysis will use descriptive statistical tools (table, percentage, frequency, means, and standard deviation).

3.9. Ethical Considerations

When questionnaires are distributed the researcher would inform respondent on the introduction part of the paper about the title and objective of the study. Besides, to develop respondents confidence they would be informed that their responses would be kept confidentially and the information uses only for academic purpose.

To avoid misunderstanding and problem related with questionnaires in acquiring information from the respondent the researcher would design the questionnaires in clearly and understandable manner.

3.10. Summary

Both revenue and custom authority including Ethiopia revenue and custom authority are working a very high competition and gaining comparative advantage is becoming the day to day activities of the authority by providing fair, simplicity, visibility and convenience advantage so as to collect and maintained taxation. Due to the big importance of fair tax system which could yield higher revenue and tax collection at large, it is vital to conduct a research on problems of tax auditing of categories “A” Manufacturing companies’ tax payers. In this case study would be undertaken. The research is going to be designed using descriptive research design, purposive sampling and simple random sampling technique and primary data sources. To collect data questionnaires would be prepared and distributed to tax payers and employees of the authority. The data would be presented, analyzed, and interpreted in frequencies and percentages by using table and figures.

CHAPTER FOUR

Analysis and Results

The former chapter presented the research methodology and the rational for undertaking for the research using quantitative approach surveys of primary analysis such as questioner.

This and the next chapter presented respectively the analysis and results of the findings on the problems of tax audit of categories “A” tax payers in the case of manufacturing companies in Kirkos sub city. The approach adopted is first to present the outcome as of the different methods independent in the chapter. The results obtained under different methods are jointly analyzed in the subsequent chapter to address each research questions. Therefore, the chapter is organized as follows. Sections 4.1 and 4.2 present the outcomes of the study and finally Summary are presented in section 4.3.

4.1. Survey results

The sample size for the survey was 25 tax payers and 25 authority employees so that 50 questionnaires were distributed. Nevertheless, the survey response was collected from 40 respondents due to their work load as well as negligence. The main purpose of this study is investigate the Problem of Tax Audit of Categories “A” tax payers: a case of manufacturing companies in Kirkos Sub City. The primary data sources to this end are the surveys of questioners’ analysis of manufacturing companies particularly tax payers and authority employees. Using manufacturing companies and the authority employees’ respondent questioners the subsequent discussion presents the results obtained using various statistical tools. Specifically, section 4.1.1. Presented results the summary descriptive statistical of the study followed by the test results for the assumptions of Frequencies, Basic statistical procedures, tables and interpreting the finding and inferential statistical such as descriptive statistical and interpretation the finding in section 4.1.2. In section 4.1.3 Presents summary of significance of the statistics and interpreted by using qualitative approach presented.

4.1.1.1 Results for analysis of descriptive statistics

The descriptive statistics are presented for 50 total observations of manufacturing companies and the Ethiopia revenue and custom authority employees found in Addis Ababa city administration on kirkos sub city for the 50 respondent 25 from the manufacturing companies and 25 from the authority employees. For both independent variable value of mean, percentage, frequency and standard deviation are presented on the table 4.1 Descriptive statistics of sample manufacturing companies and the authority employees.

Under the sub section the study presented two different results of the test of descriptive statistical procedures frequency statistics such as categorical and continues data.

4.1.1.2 Presentation and analysis of data

This segment is dedicated for the presentation and analysis of data collected for the study. The analysis is based on the data collected from the field of the study according to the response given by the respondents. The opinion of the manufacturing companies and the authority employee for the compliment, confirm or contradict the one given by the tax payers and ERCA employees.

4.1.1.3 Characteristics of the respondent.

This segment provides information on the back grounds of the respondent in the study. The personal characteristics of the respondents considered are sex, age, the marital status and education level with manufacturing companies and the authority employees in the case of kirkos sub city in Addis Ababa.

4.1.1.4 Back ground of the respondent.

The majority of respondent (90 percent) were under the age category of less than 46 years. Out of the total respondent 90 percent were males and 10 percent were female. Regarding educational level, 100 percent of respondents were BA degree holder. The respondent studied Accounting (63 percent), Finance (25 percent), management (5 percent), and economics (2 percent). The rest 5 percent of respondent studied other field. Regarding occupation, 95 percent of respondent were finance division, 5 percent of respondent were management division.

4.1.1.4 Manufacturing Companies' respondent analysis by frequency.

Table 4.1.1 Back Ground information of Respondent

| Variable | | Count | Percent |
|----------------------------|--------------------|-------|---------|
| N= 20 | | | |
| Gender | Male | 18 | 90 |
| | Female | 2 | 10 |
| Age | Less than 29 years | 2 | 10 |
| | 30-45 years | 14 | 70 |
| | 46-60 years | 4 | 20 |
| Highest level of education | Bsc/BA | 20 | 100 |
| | Other | 0 | 0 |

4.1.1 Frequency Analysis

Table 4.1.2 Summary of benefit getting from ERCA for tax audited the record or book of account Mfg.Co. Respondent*

| ERCA Program Tax audited on Mfg.Co. | Responses | | Percent of case |
|--|-----------|---------|-----------------|
| | Frequency | Percent | |
| Timely Collect | 3 | 13 | 15 |
| Check Fairness | 10 | 43.5 | 50 |
| Take Convince tax pay | 1 | 4.3 | 5 |
| Consider Efficient &Effective tax pay | 9 | 39.1 | 45 |
| Total | 23 | 100 | 115 |

Source: From Manufacturing Companies questioner respondent

*Multiple Answers were possible

Regarding the manufacturing companies' tax audit done by tax auditor and investigators, 50 percent of respondent conducted that for check fairness of their book of account. Tax payers also conducted by tax auditor that consider efficient and effective tax pay (45 percent of respondent), followed to ensure timely collect (15 percent of respondent). Tax payers also conducted by tax auditor that take convince pay (5 percent of respondent) (Table 4.1.2).

Table 4.1.3. Summary as of Audited/ investigated/ by tax audit their book of Mfg.Co.

| Tax audited by ERCA on the record of Mfg.co. | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|-----------|---------|---------------|--------------------|
| Yes | 13 | 65 | 65 | 65 |
| No | 7 | 35 | 35 | 100 |
| Total | 20 | 100 | 100 | |

Source: From Manufacturing Companies questioner respondent

***Figures are add up**

Regarding the tax audited (investigated) by tax auditor their book of account, 65 percent of respondents have audited within a predetermine time frame (Table 4.1.3). The 35 percent survey respondent have not audited with in a predetermine time frame (i.e. five years tax rule or final tax audit) and stated that of bring the complexity of audit cases and the size of the manufacturing companies tax payers.

Table 4.1.4 Summary of character of frequently tax audit of their book of record Mfg.Co.

| ERCA base of Tax audited on Mfg.Co. | Frequency | Percent | Valid Percent | Cumulative Percent |
|-------------------------------------|-----------|---------|---------------|--------------------|
| Yearly base | 5 | 25 | 25 | 25 |
| Official notified | 2 | 10 | 10 | 35 |
| When Requested | 9 | 45 | 45 | 80 |
| Routine/usually | 1 | 5 | 5 | 85 |
| Other | 3 | 15 | 15 | 100 |
| Total | 20 | 100 | 100 | |

Source: From Manufacturing Companies questioner respondent

***Figures are add up**

The survey results showed that ERCA exhaustively conducts tax audit (45 percent of respondent) audited (investigated) their book of account in accordance with the authority requested time schedule. Followed by audited (investigated) their book of account in accordance with yearly base (25 percent of respondent). ERCA also conducted tax audit in accordance with five-year base (15 percent), official notified (10 percent), routine or usually (5 percent) respectively (Table 4.1.4).

Table 4.1.5. Summary of the tax audit done on their record of account of Mfg.co. have benefited.

| ERCA Tax audited on Mfg.Co. benefited on the base of rule, instruction of the Authority | Frequency | Percent | Valid Percent | Cumulative Percent |
|--|-----------|---------|---------------|--------------------|
| Yes | 17 | 85 | 85 | 85 |
| No | 3 | 15 | 15 | 100 |
| Total | 20 | 100 | 100 | |

Source: From Manufacturing Companies questioner respondent

***Figures are add up**

Regarding the tax audited (investigated) by tax auditor their record or book keeping effectively benefited, 85 percent of respondents have tax audit program performed accordance with convince and effective tax estimation and assessment (Table 4.1.5). The 15 percent survey respondents stated that tax estimation and assessment through third party information is unexpected way.

Table 4.1.6 Summary of tax audit done on their record of account Mfg.Co. for investigated tax liability records .

| Tax audit performance by ERCA on Mfg.co. Base of rule, procedure of the Co. | Frequency | Percent | Valid Percent | Cumulative Percent |
|--|-----------|---------|---------------|--------------------|
| Strongly agree | 7 | 35 | 35 | 35 |
| agree | 9 | 45 | 45 | 80 |
| Neutral | 4 | 20 | 20 | 100 |
| Disagree | 0 | 0 | 0 | |
| Strongly disagree | 0 | 0 | 0 | |
| Total | 20 | 100 | 100 | |

Source: From Manufacturing Companies questioner respondent

***Figures are add up**

Regarding the auditor done tax audit with manufacturing companies' tax payers, 80 percent of respondent showed that tax auditor for investigation tax liability conduct with the tax authority

rule and procedure for their tax liability. However, 20 percent of respondent replied that tax auditors have not conduct with rule and procedure of ERCA (Table 4.1.6)

Table 4.1.7 Summary of tax audit done by ERCA give proper tax solution.

| ERCA Tax audit program on Mfg.Co. give proper solution on tax liability investigation. | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|-----------|---------|---------------|--------------------|
| Yes | 15 | 75 | 75 | 75 |
| No | 5 | 25 | 25 | 100 |
| Total | 20 | 100 | 100 | |

Source: From Manufacturing Companies questioner respondent

***Figures are add up**

Regarding tax liability investigation, 75 percent of survey respondent replied that there is conducted with manufacturing companies knowledge or practice for give proper solution for their tax liability program performed (Table 4.1.7). The 25 percent survey respondent further stated that tax liability investigator and intelligent team handles serious knowledge or practice for proper tax solution is disproportional way.

Table 4.1.8 Summary of tax audit and investigation on their Mfg. Co. getting effective or efficient tax revenue on their tax liabilities.

| ERCA Tax audit performance on Mfg.Co. getting efficient tax revenue on them tax liabilities. | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|-----------|---------|---------------|--------------------|
| Yes | 13 | 65 | 65 | 65 |
| No | 7 | 35 | 35 | 100 |
| Total | 20 | 100 | 100 | |

Source: From Manufacturing Companies questioner respondent

***Figures are add up**

Regarding tax revenue collection, 65 percent of survey respondent replied that there is an effective, efficient tax revenue collection, for their tax liability record or investigation (Table 4.1.8). However, 35 percent survey respondent replied tax audit getting effective, efficient tax revenue through investigation their tax liability is unsatisfactory.

Table 4.1.9 Summary of when tax audit done on their Mfg.Co. have satisfactory information about ERCA rule and procedure.

| ERCA non-compliance investigation on Mfg.Co. have get information for rule, instruction. | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|-----------|---------|---------------|--------------------|
| Yes | 15 | 75 | 75 | 75 |
| No | 5 | 25 | 25 | 100 |
| Total | 20 | 100 | 100 | |

Source: From Manufacturing Companies questioner respondent

***Figures are add up**

Regarding non-compliance investigation, 75 percent of survey respondents replied that there is have satisfactory information from responsible unit, tax investigator team, for tax investigation of their tax liability rule and procedure (Table 4.1.9). The 25 percent survey respondents further stated that tax investigator and intelligent team handle their rules and procedures are un satisfactory way.

Table 4.1.10 Summary of does it suitable for the tax declaration and payment time schedules of ERCA with their Mfg.Co. Payment time schedule.

| ERCA Tax audit time schedule suitable with Mfg. Co. payment time schedule. | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|-----------|---------|---------------|--------------------|
| Yes | 18 | 90 | 90 | 90 |
| No | 2 | 10 | 10 | 100 |
| Total | 20 | 100 | 100 | |

Source: From Manufacturing Companies questioner respondent

The survey results showed that ERCA exhaustively conducted tax audit, 90 percent respondents replied that there is a tax declaration and payment schedule consider their serious payment time schedule (Table 4.1.10). However, 10 percent of survey respondent further stated that payment tax schedule is conducted using five year or final tax audit and tax payer rule and procedure is disproportional.

4.1.2 Data Analysis by descriptive analysis

The previous section presented the frequency analysis of the information and the outcome of the survey result for manufacturing companies. The next part focuses on the analysis of the outcome of survey along with outcome of the descriptive analysis with manufacturing companies.

4.1.2 Descriptive Analysis

Table 4.1.11 Summary of descriptive analysis between the benefit getting from tax audit and Audited / investigated/ by tax audit their book of Mfg.Co.

| Percent | | | | | | | | | |
|---|----------------|----------------|-----------------------|--|-----|----|-------|------|---------|
| | Timely collect | Check Fairness | take Convince Tax pay | Consider Efficient & Effective tax pay | Yes | No | Total | Mean | Std.dev |
| - benefit getting when tax audit done | 15 | 40 | 5 | 40 | 0 | 0 | 100 | 2.7 | 1.17429 |
| - tax audited by tax auditor book of record | | | | | 65 | 35 | 100 | 1.35 | 0.48936 |

Source: From manufacturing companies' questioner respondent

As of 40 percent of survey respondents replied with a mean of 2.7 ± 1.17429 , ERCA tax audit program performed for the base of check fairness as per tax authority rule and procedures. Followed by consider efficient and effective tax pay (15 percent of respondent). ERCA also conduct on the base of timely collect (40 percent) and take convince tax pay with a mean of 2.7 ± 1.17429 as responded 5 percent of respondent (Table 4.1.11). As 65 percent of survey respondents replied, tax auditors and investigator team have audited on the predetermine time frame with a mean of 1.35 ± 0.48936 (Table 4.1.11). although, 35 percent survey respondents further stated that tax investigation and intelligence team handle serious tax audited time frame is Undetermined way.

Table 4.1.12 Summary of descriptive analysis between frequently taxes audits their book of account and tax audit done on their Mfg.Co. have benefited.

| Percent | | | | | | | | | | |
|--|-------------|-------------------|----------------|------------------|-------|-----|----|-------|-------|-----------|
| | Yearly base | Official notified | when requested | Routine /usually | other | Yes | No | Total | mean | Std. Dev. |
| - Frequency of tax audit for them Mfg.co. taxpayer | 25 | 10 | 45 | 5 | 15 | 0 | 0 | 100 | 2.750 | 1.33278 |
| - benefited tax audited performance regarding tax payer record and book of account | | | | | | 85 | 15 | 100 | 1.150 | 0.36633 |

Source: From the manufacturing companies' questioner respondent

The survey results showed that the ERCA tax audit conducted exhaustively for as per their requested procedure and rule (45 percent of respondent) followed tax audit conducted on the base of yearly time frame (25 percent of respondent) . ERCA also conducted their record or

book of account on the base of official notified (10 percent of respondent) the remaining on the base of routine or usually time frame(5 percent) and as of the base five year ERCA rule and time frame (15 percent of respondent) with a mean of 2.75 ± 1.33278 (Table 4.1.12). Tax payers believe that there is benefited tax auditor and investigation team conducted their record or book of account by the ERCA tax law and rules for prevent misrepresentation and other non compliance activity during an audit as responded by 85 percent of respondents with a mean of 1.15 ± 0.36633 (Table 4.1.12). ERCA has no enough audit performance for tax audited of their record or book of account with a mean of 1.15 ± 0.36633 as responded by 15 percent of respondents (Table 4.1.16).

Table 4.1.13. Summary of descriptive analysis tax audit done on their record of account Mfg.Co. and tax audit investigation on their Mfg.Co. getting effective tax revenue.

| percent | | | | | | | | | | |
|---|----------------|-------|---------|----------|-------------------|-----|----|-------|-------|-----------|
| | Strongly agree | Agree | Neutral | Disagree | Strongly disagree | yes | No | total | mean | Std. Dev. |
| - ERCA tax audit performance for investigate tax liability records | 35 | 45 | 20 | 0 | 0 | 0 | 0 | 100 | 1.850 | 0.745 |
| -tax audit program obtained effective tax revenue tax payer tax liability | | | | | | 65 | 35 | 100 | 1.350 | 0.489 |

Source: From the manufacturing companies' questioner respondent

Regarding tax payers compliance for tax audit performance on their tax liability records in the tax law for clarification and amendment, as of 80 percent of respondent replied and believes that the program, rule and procedure were done with a mean of 1.85 ± 0.745 (Table 4.1.13). tax payers awareness regarding ERCA tax audit program, tax law and procedure for tax revenue

obtained effectively or efficiently, 65 percent of survey respondent showed that have obtained effective tax revenue on their tax liability with a mean of 1.35 ± 0.489 (Table 4.1.1).

4.1.3. Open ended questioner according problems of tax audit of manufacturing companies

The opened ended question with manufacturing companies regarding problems of tax audit of manufacturing companies performance regarding ERCA tax audit program accordingly investigate the book of them refuse because they have product raw material and should be exported or sale locally bring foreign currency for the product of their manufacture, as of investigated in this case should be done not fairness compare with the other manufacturing companies, and other manufacturing companies replied regarding currently investigated the book of them accordingly product type this bring for them huge product for tax not easy to provide and the tax authority not time consider for this tax facilitation(i.e. for desk audit or field audit) ,where as regarding investigated tax audit for the book of them not done frequently i.e. every five year for final tax audit without supported by external auditor for correctness the fairness and the authority not accepted our done for more than five year and these result fairness done by ERCA not measurement.

As of open ended questioner regarding tax audit done on the record of book of account think that benefited or not and the respondent think only benefited for given only assurance but not tax revenue for tax authority, and other of them do not have qualified tax audit rule and procedure for tax audit done comparison from other manufacturing companies, and other of them were tax audit done on their manufacturing companies based on general principle as well as the country's law and regulation by doing so the benefit only but will not control evasion and avoidance by tax audit because improved their performance and practice for implemented.

As of manufacturing companies think tax audit done on their company's did not benefited manufacturing companies because of excise tax payment due to production and have problem on selling its product and also in short of cash the tax authority will not allow to consider such tax audit problem.

Furthermore, regarding tax audit investigated getting effective and efficient tax revenue , and the respondent of manufacturing companies did not believe effective and efficient tax revenue because:-

- i) The proclamation is biased and full of prejudice; the tax payer is conceived to evade and avoid tax deliberately.
- ii) The tax auditors are not competent in profession and lack of the ethics the profession requires.
- iii) The auditing system and procedure does not give an opportunity for future improvement and a lesson from past problems.
- iv) As a result, there is no trust between the ERCA auditors and the tax payer; the letter considers the former as a fault finding body while the former consider the latter as a tax evasion and criminal.
- v) The practice of auditing and implementation of the outcome there of in the face of law are not consistent across all tax payers.

As of other manufacturing companies respondent regarding tax audit getting effective and efficient tax revenue did not think because it is not done on timely manner. Because of this the penalty and interest will be right. Moreover, think it lack of fairness regarding the necessary of the tax base.

Furthermore, regarding tax audit getting effective and efficient tax revenue, of them were not because they do not properly investigate, they simply use estimation to benefit ERCA and themselves, on the other hand the company cannot pay the tax the ERCA will blocked our account and property, if this happen the company, the employees and government itself will be affected. And other of them did not getting effective and efficient tax revenue because the tax collection law and rule are not effective as our country compare with other developed country as want to collect tax revenue.

4.2. The ERCA employees (Tax auditor, Tax Investigator and assessor) respondent by Frequency and Descriptive statistics

4.2.1. Back ground of the respondent.

The majority of respondent (100 percent) were under the age category of less than 46 years. Out of the total respondent 65 percent were males and 35 percent were female. Regarding educational level, 100 percent of respondents were BA degree holder. The respondent studied accounting (65 percent), Finance (35 percent). Regarding occupation, 30 percent of respondent were tax auditors, 50 percent tax investigators, 20 percent tax assessors.

4.2. ERCA employees (Tax auditor, investigator and assessor) respondent analysis by frequency.

Table 4.2.1 Back Ground information of Respondent

| Variable | | Count | Percent |
|----------------------------|--------------------|-------|---------|
| N= 20 | | | |
| Gender | Male | 13 | 65 |
| | Female | 7 | 35 |
| Age | Less than 29 years | 4 | 20 |
| | 30-45 years | 16 | 80 |
| | 46-60 years | 0 | 20 |
| Highest level of education | Bsc/BA | 20 | 100 |
| | Other | 0 | 0 |

4.2.1. Frequency Analysis

Table 4.2.1 Summary of tax audit done on Mfg.Co. Give training*.

| Training is given to ERCA employee | Responses | | Percent of Cases |
|------------------------------------|-----------|---------|------------------|
| | Frequency | Percent | |
| Yes | 7 | 31.8 | 35 |
| No | 2 | 9.1 | 10 |
| Neutral | 3 | 13.6 | 15 |
| Sometimes | 10 | 45.5 | 50 |
| Total | 22 | 100 | 110 |

Source: From ERCA employees' questioner respondent

***Multiple Answers were possible.**

Regarding the auditor done tax audit with manufacturing companies' tax payers, 35 percent of respondent give training regarding tax law and rule before engage in tax audit activity in different audit period. Similarly, 50 percent of respondent replied positively answers for this assertion (Table 4.2.1).

Table 4.2.2 Summary of the primary purpose of tax audit performed in the ERCA*

| Purpose of Tax audit performed in the ERCA | Responses | | Percent of Cases |
|--|-----------|---------|------------------|
| | Frequency | Percent | |
| To check the Evasion of tax | 11 | 23.9 | 55 |
| To ensure Compliance in accordance with tax law | 17 | 37 | 85 |
| For assessment and collection Additional revenue | 11 | 23.9 | 55 |
| Educate tax payer | 7 | 15.2 | 35 |
| Total | 46 | 100 | 230 |

Source: From ERCA employees' questioner respondent

***Multiple Answers were possible**

As 85 percent of survey respondents showed, tax audit is performed to ensure compliance in accordance with tax law. The tax audit is also conducted to assess and collect additional tax revenue, check tax evasion or fraud, and educate tax payers as responded by 55 percent, 55 percent and 35 percent of respondents respectively (Table 4.2.2)

Table 4.2.3 Summary of the main activities that tax auditor. Investigator and assessors expected to perform tax audit on Mfg.Co.*

| Activity that tax auditor to perform on Mfg.Co. | Responses | | Percent of Cases |
|--|-----------|---------|------------------|
| | Frequency | Percent | |
| Investigate fraud and avoidance | 14 | 41.2 | 70 |
| To investigate non-compliance behavior of tax payer | 11 | 32.4 | 55 |
| Detect on the health of the tax system problem information | 6 | 17.6 | 30 |
| Interpreting complex tax rule & regulation for tax payers | 3 | 8.8 | 15 |
| Total | 34 | 100 | 170 |

Source: From ERCA employees' questioner respondent

***Multiple Answers were possible**

The survey result also showed that the main activities of tax auditors and investigators in ERCA is investigate Fraud and avoidance of manufacturing companies tax payers(70 percent of respondents), investigate non compliance behavior of the tax payer(55 percent of respondents), detect on the health of the tax system problem information(30 percent of respondent) (Table 4.2.3)

Table 4.2.4 Summary of the ERCA can gather information regarding Mfg.Co.

| ERCA can gather information regarding the Mfg.co tax audit program non-compliance behavior | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|-----------|---------|---------------|--------------------|
| Strongly agree | 4 | 20 | 20 | 20 |
| Agree | 6 | 30 | 30 | 50 |
| Neutral | 9 | 45 | 45 | 95 |
| Strongly disagree | 1 | 5 | 5 | 100 |
| Total | 20 | 100 | 100 | |

Source: From ERCA employees' questioner respondent

Regarding ERCA capable gather information through tax audit program, 50 percent of survey respondent replied regarding manufacturing companies' compliance behavior and collection weakness in the tax law for clarification and amendment (Table 4.2.4)

Table 4.2.5 Summary of tax registered Mfg.Co. can easily understand rule and procedure .

| ERCA tax registered on Mfg.Co. can easily understand rule and procedure. | Frequency | Percent | Valid Percent | Cumulative Percent |
|---|-----------|---------|---------------|--------------------|
| Strongly agree | 4 | 20 | 20 | 20 |
| agree | 3 | 65 | 65 | 85 |
| Neutral | 2 | 10 | 10 | 95 |
| Disagree | 1 | 5 | 5 | 100 |
| Total | 20 | 100 | 100 | |

Source: From ERCA employees' questioner respondent

***Figures are add up**

Regarding manufacturing companies' tax payers' tax awareness, 85 percent of survey respondents showed that tax payers have awareness, and do easily understand tax rules, forms and instructions and information provided by ERCA (Table 4.2.5).

Table 4.2.6 Summary of in Mfg.Co. believes that tax audit done there is good chance of being seized in their under report and non-compliance activity.

| ERCA tax audit done on Mfg.Co. Is good chance of being seized underreporting. | Frequency | Percent | Valid Percent | Cumulative Percent |
|--|-----------|---------|---------------|--------------------|
| Strongly agree | 3 | 15 | 15 | 15 |
| Agree | 4 | 20 | 20 | 35 |
| Neutral | 9 | 45 | 45 | 80 |
| disagree | 3 | 15 | 15 | 95 |
| Strongly disagree | 1 | 5 | 5 | 100 |
| Total | 20 | 100 | 100 | |

Source: From ERCA employees' questioner respondent

***Figures are add up**

Regarding the ERCA tax auditors and investigator believe that there is a good chance of being seized in their under reporting and other non compliance activities during an audit as respondent 35 percent replied (Table 4.2.6)

Table 4.2.7 Summary of tax audit program performed by the ERCA non-compliance tax payers to comply.

| Tax audit performed by the ERCA non-compliance tax payers to comply during an audit | Frequency | Percent | Valid Percent | Cumulative Percent |
|--|-----------|---------|---------------|--------------------|
| Strongly agree | 6 | 30 | 30 | 30 |
| Agree | 5 | 25 | 25 | 55 |
| Neutral | 3 | 15 | 15 | 70 |
| Disagree | 6 | 30 | 30 | 100 |
| Total | 20 | 100 | 100 | |

Source: From ERCA employees' questioner respondent

The majority of respondents (55 percent) also stated that manufacturing companies tax payers make its power visible to the community and do not comply with the tax audit program performed by the ERCA (Table 4.2.7) .

Table 4.2.8 Summary of the ERCA participating tax audit in Mfg.Co.*

| ERCA base of participating on Mfg.Co. | Responses | | Percent of Cases |
|---------------------------------------|-----------|---------|------------------|
| | Frequency | Percent | |
| Check late payment | 5 | 21.7 | 25 |
| Check fairness | 2 | 8.7 | 10 |
| Check negligence | 1 | 4.3 | 5 |
| Check evasion& Avoidance | 15 | 65.2 | 75 |
| Total | 23 | 100 | 115 |

Source: From ERCA employees' questioner respondent

***Multiple Answers were possible.**

The survey results showed that ERCA tax audit exclusively conducted on manufacturing companies tax payers for check evasion and avoidance(75 percent of respondent) followed by check late payment (25 percent of respondent) . ERCA also conduct check fairness (10 percent) and check negligence (5 percent) (Table 4.2.8).

Table 4.2.9 Summary of the reason behind for tax audit done on Mfg.Co. *

| ERCA Tax audit done main reason done on Mfg.Co. | Responses | | Percent of Cases |
|---|-----------|---------|------------------|
| | Frequency | Percent | |
| Manufacturing companies have higher compliance risk | 16 | 72.7 | 80 |
| Manufacturing companies have large tax collection risk | 5 | 22.7 | 25 |
| Manufacturing companies have no effective record or book keeping. | 1 | 4.5 | 5 |
| Total | 22 | 100 | 110 |

Source: From ERCA employees' questioner respondent

***Multiple Answers were possible.**

The main reasons for selection of the above categories and sector of the tax payers are there is higher compliance risk and large tax collection risk as responded by 80 percent and 25 percent of survey respondents respectively (Table 4.2.9).

Table 4.2.10 Summary of tax audit is usually performed by the ERCA on Mfg.Co.*

| Type of tax audit done by ERCA on Mfg.Co. | Responses | | Percent of Cases |
|---|-----------|---------|------------------|
| | Frequency | Percent | |
| Desk(office) audit | 5 | 13.9 | 25 |
| Field audit | 8 | 22.2 | 40 |
| Comprehensive audit | 17 | 47.2 | 85 |
| Issue audit | 2 | 5.6 | 10 |
| Advisor audit | 1 | 2.8 | 5 |
| Registration check | 1 | 2.8 | 5 |
| Refund audit | 1 | 2.8 | 5 |
| Fraud investigation | 1 | 2.8 | 5 |
| Total | 36 | 100 | 180 |

Source: From ERCA employees' questioner respondent

***Multiple Answers were Possible**

The survey results showed that ERCA exhaustively conducts comprehensive audit (85 percent of respondent) followed by field audit (40 percent of respondent). ERCA also conduct desk audit (25 percent), issue audit (10 percent), advisor audit, registration check, refund audit and Fraud investigation respectively (5 percent) (Table 4.2.10). The survey respondents further stated that comprehensive audit is conducted using five-year tax payer information to check whether tax payers filed out paid the appropriate tax return in line with the tax law and accounting principle.

4.2.2. Data Analysis with descriptive Analysis

The previous section presented the frequency analysis of the information and the outcome of the survey result for ERCA employees (tax auditors, tax investigators and assessor). The next part

focuses on the analysis of the outcomes of survey along with outcome of the descriptive analysis with ERCA employees.

4.2.2. Descriptive Analysis

Table 4.2.11 Summary of the ERCA can gather information regarding the Mfg.Co. about tax audit problem compliance behavior and collection weakness in tax law through tax audit and tax registered Mfg.Co. can easily understand and be aware of the rule, forms and instruction or information.

| | Percent | | | | | | Total | mean | Std. Dev. |
|---|----------------|-------|---------|----------|-------------------|-----|-------|--------|-----------|
| | Strongly agree | agree | Neutral | disagree | Strongly disagree | | | | |
| - ERCA can gather information regarding compliance & collection weakness in tax law through tax audit program | 20 | 30 | 45 | 0 | 5 | 100 | 2.400 | 0.9947 | |
| - Tax registered awareness ,regarding rule, form & instruction | 20 | 65 | 10 | 5 | 0 | 100 | 2.000 | 0.7254 | |

Source: From ERCA employees' questioner respondent

As of 50 percent of survey respondents replied with a mean of 2.4 ± 0.9947 , ERCA is capable to gather information through tax audit program regarding tax payers' compliance behavior and area of weakness in tax law for clarification and amendment (Table 4.2.11). Further, tax payers' tax awareness, 5 percent of survey respondents showed that tax payers lack of awareness, and do not easily understand tax rules, forms, and instruction or information provided by the ERCA with a mean of 2.0 ± 0.7254 .

Table 4.2.12 Summary of ERCA Employees'. believes that tax audit done there is a good chance of being seized in their under reporting and other non compliance activities an audit and tax audit program performed by the ERCA makes power visible to the Mfg.Co. and encourages non compliance tax payers to comply.

| Percent | | | | | | | | |
|--|----------------|-------|---------|----------|-------------------|-------|-------|-----------|
| | Strongly agree | agree | neutral | disagree | Strongly disagree | Total | mean | Std. Dev. |
| - good chance of being seized in under report & non compliance activity by tax audit | 15 | 20 | 45 | 15 | 5 | 100 | 2.75 | 1.0699 |
| - ERCA make power visible non compliance taxpayer to comply | 30 | 25 | 15 | 30 | 0 | 100 | 2.450 | 1.2343 |

Source: From ERCA employees' questioner respondent

Out of the total respondents, 35 percent of respondents with a mean of 2.75 ± 1.0699 believe that there is a good chance of being seized in their underreporting and other non compliance activity during an audit (Table 4.2.12). The majority of respondents, 55 percent of respondents with a mean of 2.45 ± 1.2343 stated that tax audit program performed by ERCA makes its power visible to the community, and encourage non compliant tax payer to comply (Table 4.2.12).

Table 4.2.13 Summary of the reason behind for tax audit done on Mfg.Co. tax payers and type of tax audit is usually performed by the ERCA on Mfg.Co.

| | Percent | | | | | | | | | | |
|---|-----------------|-----------------|---------------------|------------|-------------|---------------------|-------------|--------|-------|------|-----------|
| | Compliance risk | Collection risk | No effective record | Desk Audit | Field audit | Comprehensive audit | Issue audit | others | total | mean | Std. Dev. |
| -reason behind for tax audit by ERCA on tax payer | 75 | 20 | 5 | 0 | 0 | 0 | 0 | 0 | 100 | 1.30 | 0.571 |
| -type of tax performed by ERCA | | | | 15 | 20 | 55 | 5 | 5 | 100 | 2.75 | 1.292 |

Source: From ERCA employees' questioner respondent

Regarding tax payers reason tax audit, 75 percent ,20 percent and 5 percent respectively survey respondent showed that manufacturing companies have higher compliance risk, manufacturing companies have large tax collection risk and manufacturing companies have no effective record or book keeping provided by ERCA with a mean of 1.30 ± 0.571 . Further, out of the total respondents, 55 percent of respondents by comprehensive audit , followed by field audit 20 percent of respondent, ERCA also conduct desk audit 15 percent, issue audit, advisor audit, registration check, refund audit and Freud investigation respectively 5 percent respondent with a mean of 2.75 ± 1.292 stated that tax audit program performed by ERCA make its compliance to the tax law, rule and procedure (Table 4.2.13).

4.2.3. Open ended questioner according problems of tax audit ERCA employees.

The open ended questioner with tax official showed that regarding for good acceptance by manufacturing companies tax payers for they examine the book of account. As a result, tax audits performed reveals the loopholes of the law and fails to consider and help them to adjust existing situation, further stated there may be different interest of conflicts between the two parties (the tax payers and tax auditors). Consequently, the ERCA tried good acceptance but no trust on the ERCA employees, and ERCA tried to create tax awareness through perform their audit activities according to the expecting tax law, regulation and directive, and some respondent replied with ERCA employee to check tax payers book are not correct amount because the cost is very high, due to these to cooperate with our tax audit performance lack of compliance.

Regarding tax payers' awareness for providing essential information about tax audit performing testified that most of Mfg.Co. tax payers lack of awareness, because some tax payers may not sufficient knowledge about tax. In addition, not provide the necessary document on time, and further stated they are not confidence to third party and other institution about their organization information. Some ERCA employees' compliant the rest of respondent, they cooperate with our tax audit performance to provide information when their companies become audited by bring the necessary document for the auditors need.

Further, the open –ended questioner about comply your tax audit done regarding tax system of them of book account and most of the time, while the auditors are engaged in the audit activity faced the tax payers are:-

- I) Poor in maintaining book or records. i.e. in proper or incomplete book of records.
- II) Illegal receipts which are not permitted by the tax authority.

The questioner respondent further stated comply our tax audit done depends on the quality of the audit, and sometimes tax payers are not agree tax auditors assessment, because lack of awareness about tax systems. i.e. tax law and regulation.

Regarding were audited the book of account and found tax liabilities owed to cooperate for ERCA tax system, the questioner responded showed that based on the amount paid will help the government and on other side some tax payers to comply our tax system. Consequently, it

depends most of the time and most of tax payers showed don't want to cooperate the tax authority, because they have negative attitude about the tax authority, as the result it must asks by the law and regulation.

Besides, the open-ended questioner with tax officials showed that what the main reason the Mfg.Co. tax audited their book of account, and replied most of the time based on cost recording, difficult to understand the input and output relationship, they do not have proper book of account, the suppliers of the input providers have not legal receipt(factor).

4.3. Summary

The chapter has presented the analysis and result of the study along with the presentation of questioners in three sections. In the first section research analysis with presented to connect them with frequency analysis with result interpretation of the study. The second section has presented research analysis with descriptive analysis and the outcome presented in the interpretation section. The third section has the outcome of the qualitative research methods adopted in the study separately. Specifically, the results of surveys with Mfg.Co. Tax payers, tax auditors and investigators, are open ended and close ended questioners with tax payers and tax officials were presented. The results obtained through these two instrument were employed to investigate the problems of tax audit of Categories "A" tax payers a case of manufacturing companies in Kirkos Sub city, the tax audit problem including tax collection audit, role of ERCA in alleviating tax audit problem, tax evasion, late payment and negligence. The findings of data collection methods were consistent with the exception of slight different between the Mfg.Co. and tax official results regarding audit case selection methods used. In the result of all methods were combined by pooling them together and analyzed concurrently in order to address the research objective and questions. The analysis was made in line with the literature presented in chapter two and tax law with economic reality in Ethiopia.

CHAPTER FIVE

CONCLUSION AND RECOMMENDATION

The previous chapter presented the analysis and results of the study. This chapter provides the conclusion and recommendation in line with the finding of the study. The chapter is structured in two sections. The first section deals with conclusions where as the second section presents some recommendation suggested as a solution to problem that have been identified in the study.

5.1. CONCLUSIONS

Taxes are important source of revenue. Public goods and services are normally subject to collective consumption, thus requiring that we put some of what we earn into government hands. Today the role of the government has increased and government has collect more tax than ever to finance its operation. But government are facing difficulty in collecting the tax they need for compliance is that willingness of tax payers to obey tax laws to obtain the economy equilibrium of a country.

Thus the study examine the problem of tax audit of categories' "A" tax payers (the case of manufacturing companies in kirkos sub city). The study was conducted to investigate the tax audit problem, and to identify the main problem of the tax audit performed that affect tax revenue collection and tax payers' voluntary compliance in Ethiopian tax system. The study adopted both quantitative and qualitative approaches. Specifically, the techniques used in the include survey with manufacturing companies tax payers and tax auditors and investigators, closed ended questioner and open ended questioner with manufacturing companies tax payers, tax officials, and tax investigators.

Further, currently many countries have placed importance on the public concern over issues of tax evasion and tax fraud in economic activities. The government aims to use tax auditing to prevent and suppress tax evasion which would adversely affect the economy. Policy makers may alleviate the problem of tax evasion and shrinks in tax revenue by imposing stringent tax auditing procedures and implementing polices that would raise the expected cost of tax evasion relative to benefits either by increasing tax audit on manufacturing companies to increase tax

revenue to benefit the country economy to benefit consistent between tax payers and the population.

Nevertheless, the performance of tax revenue is relatively poor on average. The federal revenue has increased to birr 141.2 billion in 2007/2008 from birr 115.50 billion in 2006/2007 as a result of which federal revenue as percentage of the GDP increase from 18% in 2006/07 to 22% in 2007/08 fiscal year, Which is caused by lack of voluntary compliance mainly due to paucity of tax payers' awareness and weakness in the tax auditor behavior itself, lack of professional tax audit program in particular.

Further, manufacturing companies tax payers and ERCA employees are selected for audit based on risk criteria, and selected tax audit cases are expected to be performed the tax audit problem on the selected if there is an indication of tax evasion and fraud and when they report less tax return than previous periods. As a result, investigate of incorrect assurance the audit payment of compare with previous consumption and increase the risk of audit the book of account for compliant tax payers. Furthermore, the proclamation is biased and full of prejudice. The audit system and procedure does not give an opportunity for future improvement.

As a result, lack of trust between tax payers and tax auditors for the possibility of collecting evade tax return. There is a sight range of tax audit activities performed and the practice of auditing and implementation of the outcome there of in the face of law are not consistent across tax payers.

Further, the audit program performed in ERCA could detect non compliance behavior of manufacturing companies tax payers, and used as a compliance enforcement tool to collect from categories' "A" tax payers this performance not fairness and suspected of committing tax avoidance and the tax auditors and tax investigators report is incorrect, fraud executed for tax paid.

Nevertheless, the performance of tax revenue is relatively poor that an average of 20 percent of GDP during the 2006/07 to 2007/08 fiscal year, which is caused by lack of compliance mainly due to paucity of tax payers' awareness and the weakness in tax law itself, ineffective tax audit in particular.

A well- structured tax audit program is vital to achieve revenue objectives that ensure the fiscal health of the country, and sustain the health of the tax system by reducing tax gap through voluntary compliance improvement and additional tax collections.

Further, the audit program performed in ERCA could detect noncompliance behavior of Mfg.Co. tax payers, and used as a compliance enforcement tool to collect unpaid or evaded tax return and to ensure the deterrent effect. Through audit, ERCA utilizes its enforcement power in addressing tax revenue in arrears and evasion challenges, and makes its power visible to the Mfg.Co. to encourage non-compliance tax payers to comply.

To check the accuracy of tax returns, various type of information might be reviewed namely tax return, financial statements, accounting records, and other source documents. The accuracy of Mfg.Co. tax payers' tax liability is determined mainly through analytical review of financial statements and returns. However, the application of investigation approach is problem, and it might be difficult to determine what Mfg.Co. Tax payers have accumulated but not documented or recorded in their books of accounts and financial reports.

5.2. RECOMMENDATIONS

This section provides some recommendation that are suggested as a solution to mitigate the tax audit problem on manufacturing companies for tax program so that to improve voluntary compliance and to meet the revenue needs of the ERCA. Therefore, the researcher has tried to provide briefly the following recommendations:

- To increase tax audit for effective revenue collection compliance having biased for proclamation and prejudice for consistency with other tax payers, the ERCA should adopt a wide range of audit methodologies rather than use simple tax system. The issue tax audit should be widely applied to increase tax revenue collection law and rules, and to be done strictly with timely, conveniently and effectively work together with tax payers. In addition, they must focus to the ERCA tax compliance through improving service to tax payers to create fair and smooth tax system with high compliant tax payers.
- Tax auditors and tax investigator lack of competent in profession and the ethics, therefore, ERCA should give emphasis and assign adequate tax auditors and investigator, and it is better to conduct such tax audit problem.
- ERCA should give emphasis for all level of manufacturing companies' tax payers segment to improve future manufacturing companies' tax payers' voluntary compliance that May future tax revenue, and to be capable lesson from past problem and opportunity in the tax system and its administration. Manufacturing companies of tax payers should feel that their underreporting and other non compliance activities have improvement to tax system procedure of being proper tax audit.
- ERCA should done on trust between tax auditors, or investigators with tax payers' consideration of the complexity of the tax audit cases. The authority should implementation the outcome of tax payers on timely manner for detect noncompliance and achieve the require tax revenue.
- To avoid corruption on the case of not collected on timely and highly collect of penalty and interest with manufacturing company tax payers, ERCA should consider the inherent factors in a specific economic quality before conducting audit in consecutive audit problem on the same tax payers that have been audited and tax amount owed found with them in the previous period but show less tax return in the current period. In addition, the authority should give

attention and preclude tax auditors from auditing the same tax payers in different audit periods to alleviate the risk of corruption.

- The authority should make right and correct tax collection estimation and provide accessible tax auditor and tax investigators, and should fully utilize it for risk assessment purpose. There must be also a specified time range within which the manufacturing companies tax payers are expected to present their report or information, to enforce especially non volunteer tax payers, and to get the necessary information as required for audit activities.
- To increase the tax audit on Mfg.Co. and tax audit compliance having inadequate awareness tax payers, the ERCA should adopt a wide range of tax audit knowledge rather than use of usual tax audit performance. The comprehensive audit should be widely applied to increase the audit coverage, and education type audit that are not yet in place should be implemented to improve Mfg.Co. tax payers' awareness and voluntary compliance.
- To avoid unnecessary exaggerating cost activity, to keep proper (legal) document and proper book and minimize compliant tax payers' burden, ERCA should consider the inherent factors in a specific sector and economic conditions before conducting tax audit in consecutive audit periods on the Mfg.Co. tax payers that have been audited and no tax liability owed found with them in the previous period but show less tax return in the current period.

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Appendix I- questioner with Manufacturing Companies Taxpayers'



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St. Mary's University, Ethiopia

ST. MERRY UNIVERSITY

SCHOOL OF GRADUATE STUDIES

❖ General Instruction for manufacturing companies

The purpose of this study is to investigate the role of Ethiopia revenue and custom authority (ERCA) in alleviating the problem of tax payers by tax evasion, late payment and negligence. This questionnaire is aimed at collecting information from the tax payers and authority employees regarding the tax audit problem on manufacturing companies. In addition, information regarding their cost and benefit towards the tax collection activities by the ERCA is collected. The ultimate objective of collecting the information is purely for the academic purpose. The output of the study entirely depends on the accuracy of the information. So, you are kindly requested to fill this questionnaire accurately and truly. Moreover, all of your responses to any of the question will be treated with highest confidentiality and no report of the study will ever expose your identity. I am here by asking for a little of your time.

Put 'X' for the multiple choice questions and state your opinion briefly for the short answer questions.

I) Background information

1) Age **1** 15 -29 **2** 30 – 45 **3** 46 – 60

2) Sex Male **1** Female **2**

3) Education Level

Never been to School 1 Vocational School 4
 Elementary School 2 College/University 5
 High School 3 Other 6

4) Marital Status

Married 1 Widowed 3
 Divorced 2 Other 4

II) **General information**

5) What does the benefit getting when tax audit done from Ethiopia revenue and custom Authority (ERCA)? (Multiple Answer Possible)

Timely collect 1 take Convenience tax pay 3
 Check Fairness 2 consider Efficient and effective tax pay 4

6) Are you audited (investigated) by tax auditing your book of Manufacturing Companies?

Yes 1 No 2

7) If Your Answer for question 6 is Yes, Why? Please explain?

8) How frequently tax Audit of your book of account of factory/industry?

Yearly base 1 when requested 3
 Official notified 2 Routine/usually 4

Other-----

9) Do you think that tax audit done on your manufacturing companies have benefited with regarding your effective record or book keeping?

Yes **1** No **2**

10) If your Answer for question 9 is No, why? Please explain?

11) Tax Audit done on your manufacturing companies for investigate tax liability records by the respecting body of ERCA is necessary?

Strongly agree **1** agree **2**

Neutral **3** disagree **4** strongly disagree **5**

12) Do you think tax audit investigation on your manufacturing companies getting effective /efficient tax revenue regarding your tax liability?

Yes **1** No **2**

13) If your answer for question 12 is No, why? Please explain?

14) Tax audit done by Ethiopia revenue and custom authority (ERCA) give proper tax solution and keep of your manufacturing company's knowledge or practice?

Yes **1** No **2**

15) If your answer for questions 14 No, why? Please explain?

16) When tax audit done on your manufacturing companies by tax auditor and investigator you have satisfactory information about ERCA rules and procedures?

Yes **1** No **2**

17) If your answer for question 16 No, why? Please explain?

18) Does it suitable for the tax declaration and payment time schedule done by respective body of ERCA consider your manufacturing company payment time schedule?

Yes **1** No **2**

19) If your answer yes or No? Please explain?

20) When tax audit done on your manufacturing company's what ERCA rules are? Please explain?

21) Do your manufacturing company's tax liability done by tax auditor give your opinion about non-compliance behavior of tax auditors?

22) When your record or book keeping account with tax audit done by ERCA give your compliant about the performance?

Thank you for your Time

Appendix II-questioner with ERCA employees (Tax auditor, investigator & assessor).



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St. Mary's University, Ethiopia

ST. MERRY UNIVERSITY

SCHOOL OF GRADUATE STUDIES

❖ **General Instruction for ERCA Employees**

The purpose of this study is to investigate the role of Ethiopia revenue and custom authority (ERCA) in alleviating the problem of tax payers by tax evasion, late payment and negligence. This questionnaire is aimed at collecting information from the tax payers and authority employees regarding the tax audit problem on manufacturing companies. In addition, information regarding their cost and benefit towards the tax collection activities by the ERCA is collected. The ultimate objective of collecting the information is purely for the academic purpose. The output of the study entirely depends on the accuracy of the information. So, you are kindly requested to fill this questionnaire accurately and truly. Moreover, all of your responses to any of the question will be treated with highest confidentiality and no report of the study will ever expose your identity. I am here by asking for a little of your time.

Put 'X' for the multiple choice questions and state your opinion briefly for the short answer questions.

Part I Closed ended questioner

1) Age **1** 15 -29 **2** 30 – 45 **3** 46 – 60

2) Sex Male **1** Female **2**

3) Education Level

- Never been to School 1 Vocational School 4
Elementary School 2 College/University 5
High School 3 Other 6

4) Marital Status

- Married 1 Widowed 3
Divorced 2 Other 4

5) Does ERCA tax audit done on manufacturing companies give training regarding tax law and rules before engage in tax audit activities?

- Yes 1 Usually 3 Neutral 4 Sometimes 5
No 2

6) What is the primary purpose of tax audit performed in the ERCA (Multiple answers are possible)?

- To check the evasion of tax 1
To ensure compliance in accordance with tax law 2
For assessment and collection of additional revenue 3
To educate tax payers 4 other 5

7) What are the main activities that tax auditors, investigators and assessors expected to perform tax audit on manufacturing companies?

- To investigate fraud and avoidance 1
To investigate non compliance behavior of tax payer 2
Detect on the health of the tax system problem information 3
Interpreting complex tax rules and regulation for tax payers 4

8) When the ERCA can gather information regarding the manufacturing companies about tax audit problem compliance behavior and collection weakness in tax law through tax audit program performed necessary?

Strongly agree **1** Agree **2** Neutral **3** Disagree **4**
Strongly disagree **5**

9) When Tax registered manufacturing companies can easily understand and be aware of the rule, forms and instructions or information provided by the ERCA necessary.

Strongly agree **1** Disagree **2** agree **3** Neutral **4**
Strongly disagree **5**

10) When manufacturing companies believes that tax audit done there is a good chance of being seized in their under reporting and other non compliance activities during an audit.

Strongly agree **1** agree **2** Neutral **3** Disagree **4**
Strongly disagree **5**

11) Tax audit program performed by the ERCA makes power visible to the manufacturing companies and encourages non compliance tax payers to comply.

Strongly agree **1** agree **2** Neutral **3** disagree **4**
Strongly disagree **5**

12) In which the ERCA usually participating tax audit performance in manufacturing companies tax payers?

Check late payment **1** check Fairness **2** check negligence **3**
Check evasion and avoidance **4** check simple case tax **5**

13) What is the reason behind for tax audit done on manufacturing companies' tax payers usually done?

Manufacturing companies have higher compliance risk **1**

Manufacturing companies have large tax collection risk 2

Manufacturing companies have no effective record or book keeping 3

Manufacturing companies difficult about tax to tax payers 4

14) What type of tax audit is usually performed by the ERCA on manufacturing companies?

Desk (office) audit 1 Field audit 2

Comprehensive audit 3 issue audit 4

Advisory audit 5 Registration check 6

Refund audit 7 Fraud investigation 8

Part II Open ended Questioners

15) Tax auditors, investigators and assessors have good acceptance by manufacturing companies tax payers for they examine the book of account? Please explain?

16) When tax audit done on manufacturing companies cooperate for providing essential information to your tax audit performing? Please explain?

17) Manufacturing companies tax payers comply your tax audit done regarding for investigated tax system of them were of book of account? Please explain?

18) Do manufacturing companies that were audited the book of account and found tax liabilities owed that tax audited cooperate for your tax system? Please explain?

19) What are the main reasons for manufacturing companies' tax audit problem for their book of account? Please explain?

Thank you for your Time