Examining the Tax Administration Law of Ethiopia in Light of the Tax Compliance Theories

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Abstract

The problem of tax non-compliance is a serious global phenomenon, especially in developing and least developed countries. In this regard, states design their tax administration laws and tax compliance rules in light of the two most dominant tax compliance theories: deterrence theory and behavioural theory of tax compliance. These theories are ideals or indexes of a good tax administration system. It is thus important to examine the base or policy of tax compliance rules of the tax administration laws of Ethiopia. This Article examines when and in what forms the tax administration law of Ethiopia is designed to embody the tax compliance theories. Doctrinal research method is used and the major findings show that –like many countries– the tax administration proclamation of Ethiopia is largely designed in consideration of the economic deterrence model to achieve taxpayers' compliance which depends on audit and penalties when tax is evaded. However, this approach is criticized due to its administrative inefficiency and its inability to build equitable tax system. Aside from tax penalties, tax administration policies and practice in Ethiopia should give much attention to changing individual taxpayers' attitudes toward the tax system. This requires improving its perceived fairness and equity, making government expenditure in the best interest of the taxpayers, improving procedural justice, tax education, establishing the culture of mutual respect between tax authorities and taxpayers, and making it easy to comply with the tax laws.

Key terms: Deterrence Theory · Ethiopia · Psychological Theory ·Tax Compliance

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1. Introduction

Citizens who are legally responsible to pay tax are expected to comply with their obligations under tax laws. Compliance theorists indicate how people and organizations respond to laws and other legal directives.[1] Allingham and Sandmo's (1972) work serves as the foundation for a large stream of tax evasion theoretical models that consider a variety of factors such as audit probability, social stigma, and information uncertainty, as well as economic decisions, including time allocation and high expenses that are used to conceal evaded taxes.[2] Since the theoretical analyses of Allingham and Sandmo (1972), a substantial literature has addressed ideas and arguments on the factors influencing tax compliance.[3]

Frequently used acronyms:

TAP	Tax Administration Proclamation
TIN	Tax Identification Number
ETB	Ethiopian Birr

[1] Jeff T. Casey and John T. Scholz, (1991), "Beyond Deterrence: Behavioral Decision Theory and Tax Compliance", *Law & Society Review*, Vol. 25, No. 4, p. 821.

[2] Michael G. Allingham and Agnar Sandmo, (1972), "Income Tax Evasion: A Theoretical Analysis", *Journal of Public Economics*, Vol. 1, North-Holland Publishing Company, pp. 323-338.

[3] Mark D. Phillips, (2011), *Reconsidering the Deterrence Paradigm of Tax Compliance*, Ph.D. dissertation for the Department of Economics at the University of Chicago, pp. 99-106.

These ideas relate to the application of Becker's (1968) economic theory of crime. According to this theory a rational, expected-utility-maximizing agent determines the amount of income to self-report to the government by contrasting his consumption when disobedience is or is not found.[4] The theory is known as the “deterrence” paradigm because it makes the assumption that taxpayers are “deterred” from paying their tax obligations only by the possibility of an audit, discovery, and penalty. The stylized taxpayer in the model behaves almost exactly like a gambler who decides how much to stake in accordance with the probabilities and pay-outs of the noncompliance bet.[5]

According to Larissa-Margareta Bătrăncea *et al,* tax compliance is influenced by behavioural problems that affect how public levies are raised, in addition to economic factors.[6] Governments have recently begun to pay more attention to the behavioural models of tax compliance. As a result, behavioural models based on sociological and psychological factors such attitudes, beliefs, norms, social features, or cultural background came into being.[7] The “slippery slope” framework is one of these models and serves as a remarkable illustration of how faith in authorities and their ability to enforce their will function as major determinants of compliance behaviour.[8] This model’s primary contribution is the way it separates compliance quality. Trust in authorities therefore promotes voluntary compliance, whereas the use of force by authorities promotes enforced compliance.[9] The framework, which analyses the dynamics of the relationship between taxpayers and tax authorities, promotes a “service and client” approach that can foster mutual trust and collaboration thereby bringing about increase in compliance levels.[10]

Ethiopia’s tax mobilization is lower than most African nations. As part of the federal tax reform agenda, the Tax Administration Proclamation No. 983/2016 (TAP), has been enacted by replacing dispersed tax administration rules in different tax laws. The Proclamation incorporates comprehensive legal provisions that deal with all forms of taxes. Remedies for non-

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[4] Ibid.

[5] Ibid.

[6] Larissa-Margareta Bătrâncea *et al*, (2012), “Tax Compliance Models: From Economic to Behavioral Approaches”, *Transylvanian Review of Administrative Sciences*, No. 36, pp. 13-26.

[7] Ibid.

[8] Erich Kirchler *et al* (2008), “Enforced versus Voluntary Tax Compliance: The “Slippery Slope” Framework*”, Journal of Economic Psychology,* Vol. 29(2), pp. 210-225.

[9] Ibid.

[10] Ibid.

compliance of tax obligations are among of the issues that are extensively addressed in the Proclamation. The Proclamation embodies civil, administrative and criminal liability or penalty if a taxpayer, tax official or any person abets or incites tax non-compliance. As prior research did not discuss the specifics of these tax non-compliance remedies included in the proclamation, the objective of this article is to evaluate and examine the theories of tax compliance under Ethiopia's Federal Tax Administration Proclamation No. 983/2016. The next section deals with general conceptual framework of tax obligation, non-compliance and remedies. The third section highlights economic deterrence and behavioral models. It also discusses the two competing theories on the subject of tax non-compliance. Sections four and five analyze these theories in the context of Ethiopia's tax administration law by using the provisions of the Tax Administration Proclamation.

2. The Concept of Taxpayer's Liability

Tax is a compulsory, unrequited payment to the government. It is unrequited in the sense that benefits provided by the government to taxpayers are not in proportion to the payments they make. Since there is no direct benefit, taxpayers may tend to be resistant to paying taxes. The resistance differs amongst taxpayers but is largely commensurate with the overall tax burden, and the quality of taxation, and the perception of government spending efficiency.[11]

When all taxpayers are compliant and pay their fair share of tax obligations, the level of public goods that the government provides to the public is at its best. Franzoni identifies four fundamental guidelines that a taxpayer should adhere to in order to comply with the law completely: Report the actual tax base to the tax authorities, calculate the tax liability accurately, timely file your tax return, and promptly pay any outstanding balances.[12] If a regulation is broken, the taxpayer is no longer in compliance.

The taxpayers' activities in relation to their resistance to pay tax they are expected to comply with is known as tax non-compliance.[13] Tax evasion and

[11] *See*, for example, Steven Klepper and Daniel Nagin (1989), "Tax Compliance and Perceptions of the Risks of Detection and Criminal Prosecution", *Law and Society Review*, Vol. 23(2), pp. 209-240.

[12] L.A. Franzoni (2000), "Tax Evasion and Tax Compliance", in Bouckaert, B. and De Geest, G., (eds.), *Encyclopaedia of Law and Economics*, vol. IV, Cheltenham: Edward Elgar Publishing, pp. 51-94.

[13] M. Wenzel (2002), "The Impact of Outcome Orientation and Justice Concerns on Tax Compliance", *Journal of Applied Psychology*, pp. 4-5.

tax avoidance are two behaviours that come to mind when discussing non-compliance. The legality of taxpayers' activities is used to draw a contrast between the two ideas. On the one hand, *tax avoidance* does not violate the law *pe se* because it presupposes the use of legal loopholes for the goal of lowering taxes through inventive accounting and therefore avoiding criminal activity.[14] The text of the law is followed, but not the spirit. *Tax evasion*, on the other hand, is prohibited because it involves intentionally breaching the law in order to reduce taxes, which constitutes a crime.[15] It also goes against both the letter and the spirit of the law.

Unquestionably, the higher the acceptance of taxes by the public, the easier the task for the tax administration to collect them. It would be too optimistic, however, to rely only on taxpayers' inner conviction that "paying taxes is the right thing to do." Legal coercion and sanctions are still necessary to enforce taxation. Obligations have to go hand in hand with sanctions.[16] Otherwise, they would become a classic *lege imperfecta*, an unimaginable approach in the public finance domain.[17]

Tax administration laws should establish clear standards and corresponding liability for all persons who may be involved in any non-compliance of taxpayers, agents of taxpayers or the tax authority, government officials, and other potential abusers of the country's interest in taxes.[18] The critical question, therefore, is not whether sanctions should be used but what they should look like. It is to be noted that a tax penalty should influence taxpayer behaviour –it should deter noncompliance and encourage future compliance. Second, it should be more painful than fulfilment of a given tax obligation, yet not repressive.[19]

[14] S. James & C. Alley (2002), "Tax Compliance, Self-Assessment and Tax Administration", *Journal of Finance and Management in Public Services*, Vol. 2, No. 2, pp. 27-42.

[15] *See*, for example, H. Elffers, R.H. Weigel and D.J. Hessing, (1987), "The Consequences of Different Strategies for Measuring Tax Evasion Behavior", *Journal of Economic Psychology*, Vol. 8, no. 3, pp. 311-337.

[16] A. Ripstein (2004), "Authority and Coercion", *Philosophy and Public Affairs*, 32(1), pp. 2-35.

[17] *See*, for example, T. Dębowska-Romanowska (2008), Za co karać podatnika, a za co powinno odpowiadać państwo w stosunku do działających w dobrej wierze podatników? Prawo i podatki.

[18] Id, pp.119-122.

[19] Artur Swistak (2015), "Tax penalties in SME tax compliance", *Financial Theory and Practice*, No.40, pp. 129-147.

The effect of tax penalties lies mainly in deterrence.[20] Taxpayers choose to comply with their tax obligations rather than pay more than the cost of the obligation or lose potential tax benefits (e.g., tax concessions). However, this is so only if they are aware of the consequences of non-compliance, find it unprofitable to cheat, and believe they may be detected. Tax liabilities also motivate taxpayers. This occurs where the liabilities are educative, in addition to which, the tax penalties should be fair and unavoidable. The certainty of being detected and punished is the prerequisite for taxpayer education.[21]

If tax penalties are perceived as fair by other taxpayers, they build up a sense of justice and reward to those who comply. At the same time, a clear message is sent out: "Paying taxes is a right thing to do," "taxpayers are honest: only those few who are non-compliant are punished." Such norms strongly motivate taxpayers, especially individual small businesses, to be compliant about their tax obligations.[22] Therefore, in any tax liability, there must be a reasonable financial outcome and impact –mostly to deter and motivate tax compliance. Tax penalties, unlike criminal penalties, should not aim at repression. [23]

Accordingly, policymakers and revenue authorities should first have to design a proper catalogue, forms, and limits for tax penalties. If there is some leeway for the revenue authority's discretion, the latter must select the appropriate penalty. Even if it is difficult to give a definitive answer to what a perfect penalty should be, some basic directives for effective penalties may be formulated. First, they have to be deterrent enough against any cost-benefit calculations on the taxpayer's side. Fulfilment of a tax obligation must be more advantageous for taxpayers than the option of being non-compliant.

Taxpayers have to respect the financial needs of the government and the predictability of its revenue streams. It is widely accepted that taxpayers may not use unpaid taxes as a source of revenue for financing their business activities. Interests on tax arrears are a primary instrument that prevents such situations and compensates the government for late payments. Moreover, tax

[20] *See,* for example, OECD (2010), "Understanding and Influencing Taxpayers' Compliance Behaviour", Information Note, Forum on Tax Administration: SME Compliance Subgroup, Paris: OECD.

[21] B. Frey & L. Feld (2002), "Deterrence and morale in taxation: An empirical analysis", Working paper, No. 760.

[22] B. Torgler (2007), *Tax compliance and tax morale: A theoretical and empirical Analysis*, Edward Elgar Publishing Limited.

[23] Swistak *supra* 19.

penalties such as fine and incremental increases in interest rates on tax arrears beyond the standard rate are additional means of safeguarding due payments.

Indeed, tax penalties make noncompliance unprofitable and painful. Meanwhile, assessment of understated taxes and payment of interest is a complementary measure because it is only restitution of what should have been paid and compensation for the loss of time value of money. Equally important is the need to note that penalties that are too harsh or destructive are counterproductive because excessive repression never works in all avenues including taxation.

3. Approaches of Tax Compliance: Theoretical Underpinning

Theoretical approaches to tax compliance are commonly divided into deterrence (or economic deterrence theory) and the wider behavioral or norm theory.[24] Main factors in tax compliance behavior includes: detection and punishment, overweighting of low probabilities, burden of taxation, government services, and social norms.[25]

3.1 The Deterrence theory model

Tax compliance has been studied in traditional public economics by heavily relying on deterrence as the most important compliance-increasing factor. The deterrence/ economic deterrence theory states that taxpayer behavior is influenced by factors determining the benefits and cost of evasion, such as the tax rate, the probability of detection, and penalties for fraud.[26] This implies that if detection is likely and penalties are severe, few people will evade taxes. In contrast, under low audit probabilities and low penalties, the expected return to evasion is high. The model then predicts substantial non-compliance.[27]

Although the model has been criticized for focusing exclusively on the coercive element at the expense of the consensual side of compliance,[28] there is some evidence to support the relevance of deterrence strategies to

[24] Frey & Feld *supra* 21, p. 7.

[25] James Alm (1996), Explaining Tax Compliance, in Susan Pozo (ed.), *Exploring the Underground Economy,* Upjohn Institute for Employment Research, pp.104-111.

[26] Allingham & Sandmo, *supra* 2.

[27] Ibid.

[28] A. Sandmo (2005), "The Theory of Tax Evasion: A Retrospective View", *National Tax Journal,* Vol. 58(4), 643-633.

addressing non-compliance.[29] For example, the fear of being detected and punished has in some contexts been found to be an effective strategy to induce truthful behavior.[30]

The deterrence theory is premised on dealing with the challenges of tax compliance in an attempt to seek an enforcement mechanism that can be complemented or substituted by the citizen's tax morality.[31] There is widespread evidence that tax evasion, or what is called illegal or intentional action aimed at reducing the responsibility to pay appropriate taxes is common place in almost all countries.[32]

The dominant deterrence/economic deterrence approach to the analysis of tax compliance follows the economics-of-crime methodology pioneered by Becker.[33] This approach was first applied to tax compliance by Allingham and Sandmo.[34] Becker's analysis is normative; his purpose is to determine optimal punishments by setting a wrongdoer's expected costs equal to the wrongdoer's expected benefits.[35] Becker models expected costs as a function of both the severity of the punishment potentially imposed on the wrongdoer and the probability of punishment. The purpose of his study is twofold. First, Becker attempts to evaluate the resources and punishments needed to enforce the law. In order to do that, he designs a measure of social loss resulting from crimes, and then identifies the outlays of resources and punishments that diminish the social loss.

Allingham and Sandmo's model is based on the following premise: filling in a tax return is a decision under uncertainty due to the lack of assurance concerning an audit performed by tax authorities and a bad repercussion in case of undeclared income. The aim of their study was to analyze taxpayers' propensity towards avoiding taxes by underreporting income and the degree

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[29] *See*, for example, M. McKerchar & C. Evans (2009), Sustaining Growth in Developing Economies through Improved Taxpayer Compliance: Challenges for Policy Makers and Revenue Authorities. *eJournal of TaxResearch,* Vol.7, 171-201.

[30] Ibid.

[31] *See*, D. Ortega & P. Sanguinetti (2013), "Deterrence and reciprocity effect on tax compliance, Experimental evidence from Venezuela", p.1.

[32] *See*, for example, James Alm (2013), "Expanding the Theory of Tax Compliance form Individual to Group Motivations", *Turlane Economic Working Paper Series*; L.P. Feld *et al* "Tax Evasion, Black Activities and Deterrence in Germany: An Institutional and Empirical Perspective", University of Warwick, p.1.

[33] Gary S. Becker, (1968), "Crime and Punishment: An Economic Approach", *Journal of Political Economy,* Vol. 76(2), pp.169-217.

[34] Allingham & Sandmo, *supra* 2.

[35] Gray *supra* 33 pp.170, 176.

in which taxpayers display this type of economic behavior.[36] Allingham and Sandmo's model of tax evasion assesses the individual's decision of filling in a tax return under the uncertainty of being audited in a static framework.

Given an exogenously established income, a constant income tax rate and a constant audit probability, the taxpayer is confronted with two alternatives: to declare or to understate his real income. If the taxpayer chooses to declare less than his real income, he is uncertain about his final outcome due to the probability of being audited and fined for non-compliance. Allingham and Sandmo stress that the taxpayer will evade taxes if the expected utility from evasion exceeds the expected utility from full compliance. As this model sets the penalty rate proportional to the undeclared income, the results reported are rather ambiguous.[37]

In the attempt to clarify the mathematics behind Allingham and Sandmo's model, Yaniv offers a comprehensive explanation for the reason why the results reported by the classical tax evasion model are considered ambiguous.[38] Based on graphical representations of the tax compliance demand curve, the author shows that the substitution effect generated by the increase in the income tax rate is annulled by the income effect. According to Yaniv's conclusions, the demand curve of tax compliance can serve as a tool for predicting taxpayer's behavior when other parameters change (*i.e.*, audit probability, penalty rate). Using his graphical representations, it can easily be observed that a rise in enforcement strategies deters tax evasion, and this result is in line both with empirical studies and theoretical grounds concerning the economics of crime.[39]

However, the Allingham and Sandmo model has been extensively criticized. Besides the inconsistent results generated by the application of the penalty to the undeclared income, another notable weakness is that it assumes audit probability to be constant.[40] This assumption is not in tandem with economic realities. For example, the audit probability in the US depends on the amount of income reported. In Romania, tax authorities establish audit probabilities during a process which comprises risk analysis aiming to identify

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[36] Bătrâncea, *et al*., supra 6.

[37] Ibid.

[38] G. Yaniv, (2009), "The Tax Compliance Demand Curve: A Diagrammatical Approach to Income Tax Evasion", *Journal of Economic Literature*, Vol.40 (2), pp. 213-224.

[39] Gray *supra* 33, pp.169-217.

[40] J. Andreoni *et al* (1998), "Tax Compliance", *Journal of Economic Literature*, Vol.36 (2), pp. 818-860.

the economic areas subject to a high probability of tax evasion (*i.e.*, excisable commodities, intracommunity trade, production and distribution of agricultural commodities).[41]

The shortcomings of the Allingham & Sandmo model of tax evasion (1972) were addressed two years later by Yitzhaki (in 1974), who suggested that the penalty should be set on the evaded taxes rather than on the undeclared income.[42] According to this view, the substitution effect is consequently eliminated and the increase in compliance will solely relate to the income effect. Thereafter, almost all papers on tax evasion adopted Yitzhaki's recommendation, incorporating also other economic variables (*i.e.*, labor supply, expenses for concealing tax evasion, repetition of reported decisions).

The economic models of tax compliance have been subject to harsh criticism. The first reason for this criticism was that they assumed taxpayers to be fully rational utility maximizers whose behavior is construed as a reaction to different financial benefits and losses. The second reason was that the predictions of the economic models were invalidated by a bevy of empirical studies. [43]

Unlike the general conclusion of these analyses that most people engage in tax evasion, empirical studies suggest that many people are honest taxpayers,[44] or there are some people who never evade paying taxes even when the risk is sufficiently low and susceptible to cheating behavior.[45] Economic models predict far too much tax evasion than actually exists. According to Alm and Torgler, 'the puzzle of tax compliance is not why there is so much cheating. Instead, the real puzzle is why there is so little cheating.[46]

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[41] Ibid.

[42] S. Yitzhaki (1974), "Income Tax Evasion: A Theoretical Analysis', *Journal of Public Economics*, 3(2), pp. 201-202.

[43] *See,* for example, P. Dean *et al* (1980), "Taxpayers' Attitudes to Income Tax Evasion: An Empirical Study", *British Tax Review*, Vol.1, p. 44.

[44] *See* T.M. Porcano (1988), "Correlates of Tax Evasion", *Journal of Economic Psychology*, Vol.9 (1), pp. 47-68; Gordon, J.P.F. (1989), "Individual Morality and Reputation Costs as Deterrence to Tax Evasion", *European Economic Review*, 33(4), pp. 797-805.

[45] *See*, for example, J.C. Baldry (1986), "Evasion Is Not a Gamble: A Report on Two Experiments", *Economics Letters*, Vol. 22(4), pp.333-335.

[46] *See* James Alm & B. Torgler (2011), "Do Ethics Matter? Tax Compliance and Morality", *Journal of Business Ethics*, Vol. 101(4), p. 635; J. Alm *et al* (1992), "Why Do People Pay Taxes? *Journal of Public Economics* Vol.48, p. 22.

3.2. Behavioural Theory of Tax Compliance

The limitations of deterrence approaches such as huge administrative costs[47] like auditing cost and its lesser support to build equitable tax system[48] have paved the way for the development of behavioral or socio-psychological theory of tax compliance. In this model, built on the grounds of socio-psychological determinants, taxpayers are seen no longer as selfish utility maximizers but as human beings motivated to pay taxes on the basis of different attitudes, norms, beliefs, perceptions, feelings, social characteristics, including cultural background, age, gender, religion and other factors.[49]

One such behavioral model of tax compliance is the '*slippery slope*', which encompasses these socio-psychological determinants and bases on trust in authorities and power of authorities as main predictors of compliance behavior.[50] A 'service and client' climate between tax authorities and taxpayers is meant to foster trust in authorities and stimulate taxpaying behavior. Alternatively, a *'cops and robbers'* climate breads distrust and resistance, giving birth to cheating behavior. In the light of these realities, a huge merit of the 'slippery slope' framework is that it promotes a more 'service and client' approach of tax authorities towards taxpayers.

In his study, Kirchler suggests the shift from a perspective of compliance enforced by authorities' power ("cops and robbers approach") to voluntary compliance driven by trust in authorities ("service and client approach").[51] He shapes this suggestion by a slippery slope model according to which deterrence and trust as two equally valid ways of achieving compliance could dynamically interact with each other.

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47 J. Andreoni et al, *supra* 40.

48 *See*, for example, Wayan Parsa (2021), "Tax Equity Principles in Online Taxation Systems", International Journal of Business, Economics and Law, Vol. 24, Issue 2; Also *see*, Douglas H. Eldridge (1964), "*Equity, Administration and Compliance, and Intergovernmental Fiscal Aspects*", Princeton University Press, pp. 141-215.

49 *See*, for example, G. Schmölders (1960), *Das Irrationale in der öffentlichen Finanzwirtschaft*, Frankurt am Main: Suhrkamp; M. Fishbein & I. Ajzen (1975), "*Belief, Attitude, Intention and Behavior: An Introduction to Theory and Research*", Reading: Addison-Wesley; *See* R.F. Meier & W.T. Johnson, (1977), "Deterrence as Social Control: The Legal and Extra-legal Production of Conformity", *American Sociological Review*, vol.42(2), pp.292-304;

50 Kirchler *et al*, supra 8.

51 Erich Kirchler (2007), "*The Economic Psychology of Tax Behaviour*", Cambridge University Press, p.188.

The relationship between taxpayers and tax authorities can be modeled as an implicit or relational contract[52] which also involves strong emotional ties and loyalties.[53] The psychological tax contract is influenced by government policy and procedure, tax authorities' behavior and state institutions.[54] Posner studies the role of social norms in tax compliance.[55] According to his analysis, good governance and fair procedures lead to higher tax compliance by taxpayers. The government can shape tax morale by following these behavioral norms in order to signal citizens that they can reply to such a treatment by themselves trusting in government.[56]

The second view relates tax morale (intrinsic willingness to pay tax) with behavioral tax compliance. Tax morale would thus imply an intrinsic motivation to comply with the tax laws. It is when a person's act of filing their tax returns, declaring all taxable income accurately, and disbursing all payable taxes within the stipulated period without having to wait for follow-up actions from the authority. Tax morale may be affected by (1) the fiscal exchange where taxpayers get public services for the tax prices they pay, (2) the political procedures that lead to this exchange and (3) the personal relationship between the taxpayers and the tax administrators. For instance, when the auditors detect incorrectly reported income in the tax declaration, they can immediately have suspicious intent to cheat, and impose legal sanctions. Alternatively, the auditors may give the taxpayers the benefit of the doubt and inquire into the reasons for the mistake.

If the taxpayer in question did not intend to cheat but simply made a mistake, he or she will most likely be offended by the disrespectful treatment of the tax authority. The feeling of being controlled in a negative way, and being suspected of tax cheating, tends to crowd out the intrinsic motivation to act as an honorable taxpayer and, as a consequence, tax morale will fall. In contrast, when the auditor makes an effort to locate the reason for the error, the taxpayer will appreciate this respectful treatment and tax morale is upheld.

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[52] *See*, for example, George A. Akerlof (1982) "Labor Contracts as Partial Gift Exchange", *Quarterly Journal of Economics, Vol.* 84, pp. 488-500.

[53] O. E. Williamson (1985), "*The Economic Institutions of Capitalism"*, New York: Free Press; Feld and Frey, *supra* 21, p.7; *See*, Denise M. Rousseau & Judi McLean Parks (1993), "The Contracts of Individuals and Organizations", *Research in Organizational Behaviour,* Vol. 15, pp. 1-43.

[54] Lars P. Feld and Bruno S. Frey (2007), "Tax Evasion, Tax Amnesties and the Psychological Tax Contract", *Andrew Young School of Policy Studies*, p. 5

[55] E. A. Posner (2000), "Law and social norms: The Case of Tax Compliance", *Virginia Law Review,* Vol.86, pp.1781–1820; Feld and Frey*, supra* 21*,* pp. 23-24.

[56] Feld and Frey, *supra* 21, p. 24.

For instance, the experience in Switzerland shows the relationship between the respectful treatment of Swiss citizens by the tax authority and the strongly developed citizens' participation rights.[57] Tax authorities in more direct democratic cantons more frequently appear to give taxpayers the benefit of a doubt.[58]

It is to be noted that although deterrence contributes to tax compliance, it may at the same time adversely affect tax compliance because the intrinsic motivation to pay taxes can be crowded out by the state's intervention into individuals' privacy.[59] Thus, enhancing bonds between taxpayers and the state shape individual tax morale thereby positively affecting tax compliance.[60]

In settings where tax compliance incentives are weak, there are incentives to free ride and selfish individuals may opt not to pay or to evade taxes because of the 'probability' of not being detected and the low size of the fines.[61] Therefore, incentives are needed to enforce taxation. That is providing a reward for filing their tax returns, declaring all taxable income accurately, and disbursing all payable taxes within the stipulated period without having to wait for follow-up actions from the authority. However, care needs to be given to avoid the crowding effect of reward.[62] For example, giving monetary rewards may undermine intrinsic motivation or willingness to conform to tax laws.[63] But, this depends on the individual's perception of external interventions as intrusive or supportive depending on how self-determination and self-esteem are affected.[64] In this regard, a reward tends to be perceived

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[57] Lars P. Feld & Bruno S. Frey (2002), "Trust breeds trust: How taxpayers are treated", *Economics of Governance* Vol. 3, 87–99.

[58] Ibid.

[59] *See*, Bruno S. Frey (1997), "*Not Just for the Money: An Economic Theory of Personal Motivation"*, Cheltenham: Edward Elgar; Bruno S. Frey (1997), "A Constitution for Knaves Crowds out Civic Virtues", *Economic Journal,* Vol.107, pp.1043–1053.

[60] Feld and Frey, *supra* 57, p.1-5; *See* also, Ramona-Anca Nichita, *et-al*, *Tax Compliance Models: From Economic to Behavioural Approaches*, p.21.

[61] Feld and Frey, *supra* 57*,* pp.*4-6.*

[62] *See*, for example, M. Levi (1988), "*Of Rule and Revenue",* University of California Press.

[63] Feld and Frey*, supra* 57, p. 6.

[64] E.L., Deci, & R.M .Ryan, (1985), "*Intrinsic Motivation and Self-Determination in Human Behaviour"*, New York: Plenum Press; *See* E.L .Deci & R. Flaste (1995), "*Why We Do What We Do: The Dynamics of Personal Autonomy*", New York: Putnam.

as a sign of acknowledgment, and it is preferable to give rewards in non-monetary form.[65]

Furthermore, the norms model maintains that a substantial number of taxpayers comply with their tax obligations through adherence to social or personal norms.[66] The argument here is not that a taxpayer complies with her tax obligations because she fears formal sanctions potentially imposed by the government; rather, she complies because she follows social norms, and she wants to avoid informal sanctions potentially imposed by other taxpayers.[67] The model points in particular to social norms of reciprocal cooperation and trust as drivers of tax compliance.[68]

For example, taxpayers may comply by being induced or in the course of reciprocating the compliance of other taxpayers.[69] This argument similarly applies to personal norms. A taxpayer who values integrity, honesty, and the benefits of citizenship may feel guilt, shame, or similar emotions if she does not meet her tax obligations.[70] These personal norms may depend on whether she regards her tax obligations as legitimate. That, in turn, may depend on whether she sees legal actors, such as government tax officials, satisfying basic concerns of procedural justice such as "neutrality, lack of bias, honesty, efforts to be fair, politeness, and respect for citizens' rights."[71]

4. The Place of Behavioural Tax Compliance Theory under Ethiopia's Tax Administration Proclamation

A comprehensive tax administration law, i.e. tax administration Proclamation No. 976/2016, has been enacted in 2016. Its preamble states the Proclamation's rationale which includes the creation of an effective, efficient, and measurable tax administration system.[72] As discussed above, the

[65] Lars Feld and Bruno Frey (2005), "Tax Compliance as the Result of a Psychological Tax Contract: The Role of Incentives and Responsive Regulation", *Centre for Tax System Integrity, Research School of Social Sciences*, pp.11-12.

[66] Marjorie E. Kornhauser (2007), *"A Tax Morale Approach to Compliance: Recommendations for the IRS"*, *FLA. TAX REV*., Vol. 8, pp. 599, 612–617.

[67] Ibid; *See*, for example, Joel Slemrod (2007), "Cheating Ourselves: The Economics of Tax Evasion", *Journal of Economic Perspective*, Vol. 21, p.39.

[68] Feld & Frey, *supra* 57.

[69] Michael Doran (2009), "Tax Penalties and Tax Compliance", Harvard Journal on Legislation, Vol. 46, pp. 111, pp.131-132.

[70] Id.

[71] Id.

[72] Ethiopia Federal Tax Administration Proclamation No. 983/2016, Preamble [hereinafter TAP).

behavioural approach of tax compliance indicates factors that could contribute to tax compliance apart from tax penalties. These factors include good governance and fair procedures by the government that create a system which shapes the emergence of trust between citizens and between the state and citizens thereby resulting in higher tax compliance by taxpayers.[73] This creates an environment which nurtures the commitment of citizens to follow their civic duty.

Second, there is the need to simultaneously use both respectful treatment as well as incentives.[74] Third, tax morale or psychological contract is a function of the fiscal exchange where taxpayers get public services for the tax they pay.[75] Fourth, taxpayers are seen no longer as selfish utility maximisers but as human beings motivated to pay taxes on the basis of different attitudes, norms, beliefs, perceptions, feelings, social characteristics, and cultural background.[76] An implicit psychological contract between the government and taxpayers creates a 'service and client' climate between them which foster trust in authorities and influence taxpaying behaviour.

This section evaluates the inclusion of behavioural tax compliance approach under Ethiopia's tax administration law. Provisions of the Proclamation, *inter alia*, deal with obligations imposed on tax officers and improving service delivery, self-declaration or self-assessment declarations, tax incentive, crediting and refund of paid taxes. These are stipulated under various provisions of the Proclamation such as Articles 5-8, 21-29, 135, 49-51 respectively. These provisions show the place of behavioural tax compliance theory under the tax administration proclamations of Ethiopia in one way or another.

The TAP requires a tax officer to be honest and fair in the exercise of any power, or performance of any duty or function under a tax law.[77] They also have a duty to treat each taxpayer with courtesy and respect.[78] The TAP also requires the tax officer to avoid any exercise of power and function under the tax law in situations that will involve conflict of interest.[79] For instance, potential threat to conflict of interest is created when the taxpayer has or had

[73] Kirchler, *et-al, supra* 8.
[74] Feld and Frey, *supra* 57, pp. 4-6; Levi, *supra* 62.
[75] Doran, *supra* 69, 72.
[76] Schmölders; Fishbein and Ajzen; Meier and Johnson, *supra* 49; Marjorie, *supra* 66; Joel Slemrod, *supra* 67; Feld and Frey, *supra* 57.
[77] TAP, Article 6 (2).
[78] Id.
[79] Id, Article 6 (3).

a personal, family, business, professional, employment, or financial relationship with the tax officer.[80] This provision of the TAP seems to have adopted the approach that good governance and fair procedures will lead to higher tax compliance by taxpayers because fair procedure of tax collection and the personal relationship between the taxpayer and tax officer determine the tax morale of taxpayer's.[81] The requirement of treating taxpayers with courtesy and respect and the duty of tax officers to be honest and fair in enforcing the tax law builds the taxpayer's tax compliance moral standards and strengthens trust and loyalty between a taxpayer and the government.

In this regard, some empirical studies show that attitude of taxpayers towards tax, perceived role of government expenditure, perception of corruption and satisfaction with the tax administration were found to have a statistically significant impact on taxpayers' compliance attitude.[82] Perception of taxpayers regarding government spending is also an identified factor which triggers the government to provide comparable and sufficient social services for the society such as education, health, safety and public transportation from the tax collected in addition to fighting corruption.[83]

There is also another provision that seems to aim at creating bondage of trust between the tax authority and a taxpayer. The taxpayer has the duty to tax declaration, and the declaration should be signed by the taxpayer's tax representative or licensed tax agent verifying that the taxpayer knows the contents of the declaration and assuring that the declaration including any attached material is complete and accurate.[84] The Authority has also a right not be bound by a tax declaration or information provided by, or on behalf of, a taxpayer and the Authority may determine a taxpayer's tax liability based on any reliable and verifiable sources of information available to the Authority.[85]

Another instrument that can create trust between the taxpayer and the government is allowing taxpayer's self-assessment. In relation to this, the TAP provides that a taxpayer's self-assessment "in the approved form for a

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[80] Id.
[81] Feld and Frey, *supra* 57, p.5.
[82] Wollela A. Yesegat & O-H Fjeldstad (2013) *Taxpayers' views of business taxation in Ethiopia: Preliminary results from in-depth interviews*, a paper presented at ICTD's annual meeting held 10-12 December 2013, Lome, Togo. *See* also, Wollela A. Yesegat & Odd-Helge Fjeldstad (2016), Business people's views of paying taxes in Ethiopia, p.17;
[83] Id.
[84] TAP, Article 21.
[85] Id. Article 21 (5).

tax period shall be treated, for all purposes of th[e] Proclamation, as having made an assessment of the amount of tax payable (including a nil amount) for the tax period to which the declaration relates being that amount as set out in the declaration." [86] This implies the motive in TAP to establish trust and cooperation between the taxpayer and the government.

According to the literature, voluntary compliance is made possible by enhancing the trust and cooperation between the tax Authority and taxpayers and it envisages the willingness of the taxpayer on his or her own to comply with tax laws.[87] This includes a person's act of filing their tax returns, declaring all taxable income accurately, and disbursing all payable taxes within the stipulated period without having to wait for follow-up actions from the authority.[88] But this does not preclude the government's power to examine the accuracy of the taxpayer's tax declaration or tax assessment. The law enables the tax authority to trace the information given by a taxpayer by using any reliable and verifiable sources of information available to the Authority.[89]

In addition to trust, the behavioural tax compliance model uses sanctions in the form of social or informal sanction to be imposed by another taxpayer to enhance taxpayers' compliance.[90] Practice shows the perception of others' compliance behaviour was found to have a significant impact on compliance attitude, where taxpayers may still commit non-compliance so long as this non-compliance is consistent with in-group expectations and norms.[91] A taxpayer who values integrity, honesty, and the benefits of citizenship may feel guilt, shame, or similar emotions if they do not meet their tax obligations.

In this scenario the government's duty is to cultivate trust among taxpayers that their compliance will not be exploited by other taxpayers. This may include publicizing the fact that most taxpayers comply with their tax obligations and not publicizing criminal tax prosecutions. However, the tax laws of Ethiopia do not entertain such kind of incentive to enhance the

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[86] Id, Article 25.

[87] Tilahun Aemiro Tehulu and Yidersal Dagnaw Dinberu (2014), "Determinants of Tax Compliance Behavior in Ethiopia: The Case of Bahir Dar City Taxpayers," *Journal of Economics and Sustainable Development*, Vol. 5, No. 15.

[88] *See*, for example, Nichita Ramona-Anca and Batrancea Larissa-Margareta, (2012), 'The Implications of Tax Morale On Tax Compliance Behavior' *Annals of Faculty of Economics,* 2012, Vol. 1, issue 1, pp. 739-744

[89] TAP, Article 21(4), 25-28.

[90] Doran, *supra* 69, pp.131-132.

[91] G. Chau & P. Leung (2009), 'A critical review of Fischer tax compliance model. A research synthesis', *Journal of Accounting and Taxation* 1(2): 34-40.

behavioural norm of tax compliance. It rather stipulates that "[t]he Authority may from time to time publish a list of the names of persons convicted by final decisions of court of law of an offence under a tax law on its website and through other mass media."[92] This provision focuses on deterrence and it fails to consider the negative effect –of sole focus on such publicity–in building tax morale in society.

More subtly, external intervention such as provision of reward to taxpayers incentivizes their tax compliance. The TAP obliges the tax authority to give reward to a taxpayer for exemplary discharge of his tax obligations".[93] The purpose of this provision is to incentivize and promote the tax compliance norm (behaviour) of the general taxpayer. An award of this kind is explicitly exempted from income tax duty in Ethiopia.[94] The cumulative reading of Article 135 of the Tax Administration Proclamation No. 983/2016 and Article 65 (1(h) of the Federal Income Tax Proclamation No. 979/2016 shows tax exemption to a taxpayer in the form of an award for his exemplary discharge of tax obligation exempted. Hence, exemplary discharge of tax compliance has dual benefits; that is acquiring income in the form of reward from the tax Authority and this income is not taxable. In reality, however, what we can witness from the media shows certification awards for taxpayer who pays his tax without delay. That can incentivize taxpayer's behaviour towards executing their duty of paying tax. Some empirical studies show that tax compliance was positively affected, among others, by the rewarding scheme to loyal taxpayers.[95]

Another illustrative scenario that shows the voluntary compliance driven by trust in authorities by "service and client" approach than "cops and robbers approach" under the TAP is the system of crediting and refund of overpaid tax, and release from tax duty wholly or partly.[96] Credit for tax payments or refund of overpaid tax creates trust on the part of the taxpayer and it guarantees the taxpayer that their tax payment in excess of tax liability will be refunded or credited. This aligns with the "service and client" approach. In addition, relief of the taxpayer from duty of tax payment in cases of serious

[92] TAP, Article 133

[93] TAP, Article 135.

[94] Ethiopia Federal Income Tax Proclamation, No.979/2016, (2016), Article 65(1(h)), (hereinafter, Proc.No.979/2016).

[95] Abdu Mohammed Assfaw and Wondimu Sebhat, "Analysis of Tax Compliance and Its Determinants: Evidence from Kaffa, Bench Maji and Sheka Zones Category B Taxpayers, SNNPR, Ethiopia", *Journal of Accounting, Finance and Auditing Studies*, (2019), p. 58.

[96] TAP, Articles 49-51.

hardship is another context that advances the "service and client approach". That is when the Minister of Finance and Economic Cooperation believes payment of the full amount of tax owed by a taxpayer will cause serious hardship to the taxpayer due to natural cause, or supervening calamity or disaster, or in cases of personal hardship not attributable to the negligence or any failure on the part of the taxpayer. Under such circumstances, the Minister may release the taxpayer wholly or in part from payment of the tax due and any late payment interest payable in respect of the tax due.[97]

Although amounts to the causes will invite interpretation, this provision of the TAP can be an example that fits to the psychological tax compliance theory which is in tandem with service-client relationship between taxpayer and the government. Similarly, owing to the death of a taxpayer, the payment of the full amount of tax owed by the deceased taxpayer will cause serious hardship to the dependents of the deceased taxpayer, and the Minister may release the executor of the estate of a deceased taxpayer wholly or in part from payment of the tax due and any late payment interest that is payable in respect of the tax due.[98]

The duty of confidentiality under the TAP is also another normative ground to establish trust on Authorities.[99] Any tax officer shall maintain the secrecy of all documents and information received in official capacity except the listed exceptions. In spite of these positive indications, however, the empirical reality shows the existence of high tax rates or burden and complicated procedures which are found to be the biggest disadvantages of registering for taxes by both formal and informal businesses.[100]

5. The Place of Deterrence Based Tax Compliance Theory under Ethiopia's Tax Administration Proclamation

Deterrence model of tax non-compliance prevention measures rely heavily on the existence of continuous auditing in the tax compliance culture of taxpayers, as well as providing a coercive punishment that can deter them and enable them to comply as stated in the tax laws. Countries that use the deterrence model frequently try to challenge taxpayers' tax evasion behaviours by stipulating different punishments in their tax laws. Regardless

[97] TAP, Article 51.
[98] Id.
[99] TAP, Article 8.
[100] Tax Compliance Cost Burden And Tax Perceptions Survey In Ethiopia, WB, (2016), p. 42.

of its various forms and structures, this punishment must be greater than any potential financial gain the taxpayer would stand to gain from his deviance.

In the modern tax regime of Ethiopia, the economic deterrence approach has an important place before the tax administration arrangements.[101] In the 1940s, the imperial regime worked hard to modernize the tax system, and some of the country's annual budget was based on taxes collected from direct sources (personal and agricultural income) and primarily from indirect tax bases.[102] Because taxation has no equal counter-benefit arrangement on the taxpayers' side, it is common to see when tax administrators are challenged by taxpayer noncompliance. New developments in the area of taxation are showing the regulators' interest in gradually changing this non-compliance environment and creating a society that considers paying taxes as a good culture.

In the current tax regulatory arrangements as well, the deterrence approach is continuing with its role in increasing taxpayer compliance. In addition to the normative approach, the deterrence economic theory is used as a last resort in the current regulatory arrangement to enforce taxpayer duties. As mentioned in Section 4 above, various legal provisions in the Ethiopian tax legal regime give encourage the voluntary engagement of the taxpayers with the compliance of their duties to pay tax. The economic deterrence instruments are designed to be used only if the normative standards or voluntary engagement instruments fail to achieve the necessary level of taxpayer compliance.

According to the texts of the Ethiopian Tax Administration Proclamation No. 983/2016, a taxpayer who is disobedient with tax duties before the law may face criminal, civil, and/or administrative liabilities. The tax dispute settlement arrangements and the enforcement machinery are also in place for the proper implementation of these liabilities in non-compliance with tax obligations. These liability frameworks in the tax law aim at enhancing the taxpayer's compliance in fear of punishments and administrative measures that may include fine, imprisonment, closure of trading centres, and other related sanctions discussed below.

5.1. Criminal Liabilities

Criminal punishment is among the deterrence aspects of the taxpayers' compliance enhancement strategies in Ethiopia. One of the primary purposes

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[101] Ibid.

[102] Taddese Lencho (2010), "The Ethiopian Tax System: Excesses and Gaps", *Michigan State International Law Review*, Vol. 20:2, pp. 327-380

of criminal punishment is to create a deterrence environment for individuals who may engage in criminal activities. Criminal punishments discourage criminal activities when they are designed to exceed the benefits from irregularities. The Ethiopian Criminal Code incorporates criminal punishments.[103] This has also been recognized by the criminal policy of Ethiopia.[104] Article 3 of the Criminal Code recognizes special laws, including the tax laws, and the applicability of the general principles of the Criminal Code in these circumstances.

Unlike the 2002 tax reform activities, which bestowed each tax law with the authority to specify the tax offenses in their perspectives, the Tax Administration Proclamation No. 986/2016 incorporates most of the tax offenses within a single comprehensive legal framework.[105] In addition to administrative actions that may be taken against a taxpayer who disobeys his obligations outlined in the tax laws, the Proclamation recognizes both commissions and omissions that bear criminal penalties.[106] The punishment may range from a fine to the loss of personal liberty. The rationale behind those criminal punishments resulting from tax non-compliance is related to the enhancement of taxpayers' compliance behaviour in the performance of their obligations under the tax laws. The Proclamation states various forms of tax offenses and their respective punishments as highlighted below by using some examples.

Tax Identification Number (TIN) is issued to taxpayers to deter individuals who may take part in non-issuance or issuance of more than one TIN and using another person's TIN. The Proclamation recognizes all these activities as a tax offense. Following this, a person who acts against these prohibitions will face punishments of Ethiopian Birr (ETB) 20,000 and up to three years of simple imprisonment.[107] Taxable income declarations, reports, and other information that could be provided to the tax collection authority by each taxpayer must be free from falsified and misleading statements. Providing falsified and/or misleading information is a tax offense under the Tax Administration Proclamation punishable up to ETB 100,000 and 15 years of rigorous punishment.[108]

[103] The FDRE Criminal Code, Proclamation No.414/2004, Article 1.
[104] The FDRE Justice Policy, 2011.
[105] TAP.
[106] Id Article 100 and 116.
[107] Id Article 117.
[108] Id Article 118.

Taxpayers have the right under the law to reclaim excesses in tax payments. The excess may result from either an error in reporting taxable income or other circumstances. This is meant to protect taxpayers from undue payment of tax that may arise from errors in the tax collection process. It is, however, to be noted that fraudulently requesting exceeds without a claimable right is a tax offense under the Tax Administration Proclamation. The Proclamation imposes fine of ETB 50,000 and three to seven years of imprisonment. This punishment shall not relieve the taxpayer from repaying illegally taken refund. These punishments are designed to discourage or deter taxpayers from unlawful claims exceeding refunds.[109]

Only those taxpayers registered for Value Added Tax (based on the VAT Proclamation) are allowed to collect VAT from the final consumers of goods and services. VAT-registered individuals are responsible for withholding taxes from their customers or clients on behalf of the Tax Authority. Both the collection of VAT without registering for VAT and failure to uphold their responsibility while being a taxpayer registered for VAT are tax offenses. To deter or discourage registered or unregistered taxpayers' involvement in offenses in relation to VAT, the Proclamation imposes punishments up to ETB 200,000 and up to 7 years of rigorous imprisonment.[110]

The Stamp Duty Proclamation and its amendments require the document authentication and registration authorities to charge stamp duty before putting the authentication signature and stamp on the document. The document holders are also required to pay the amount. If there are irregularities with the obligations specified in the stamp duty Proclamation, the criminal liability framework ranges from 25,000 up to 50,000 ETB and three up to seven years of rigorous imprisonment. The stamp document seller has also responsibilities that are articulated in the Proclamation. Failure to act accordingly may cause the liability to pay up to 25,000 ETB and imprisonment of up to three years. [111]

Failure to comply with the responsibility to issue a tax invoice, the duty to use sales register machines, obstructing tax administration activities of the tax authority, obstruction of the tax appeal commission, aiding and abetting non-compliance with tax laws, and other specific activities are mentioned in the Tax Administration Proclamation as grounds for a tax-related offense that may entail criminal liability punishable with fine and imprisonment. [112]

[109] Id Article 121.
[110] Id Article122.
[111] Id Article 123.
[112] Id, Article 117.

According to Article 125 of the Tax Administration Proclamation, tax evasion practice-related offenses refer to activities that involve the concealment of income, failure to file a tax declaration, or failure to pay tax by the due date with the intention of evading tax duties. Taxpayers who violate these prohibitions entail punishments up to 200,000 ETB and up to 5 years imprisonment.

Moreover, withholding agent tax evasion activity is stipulated in the Tax Administration Proclamation as a tax offense and a withholding agent who is responsible by law to withhold taxes from the taxpayers must act in line with the stipulation in the tax laws. Where the withholding agent acts contrary to these obligations, the Tax Administration Proclamation imposes imprisonment from three to five years. The Tax Administration Proclamation also publicizes the names of taxpayers convicted of a tax-related offenses as a deterrence mechanism for taxpayer noncompliance.

The stipulations on tax-related offenses under the Tax Administration Proclamation (highlighted above) presuppose criminal punishment objectives, i.e., prevention, deterrence, and rehabilitation. In addition to rehabilitating a taxpayer from his/her tax non-compliance behaviour, the criminal punishments in the Proclamation aim at preventing tax law violations and deterring taxpayers from engaging in tax non-compliance behaviour. Over time, this economic deterrence strategy is meant to achieve the behavioural/normative theory expectation while also correcting individuals for non-compliance behaviour. This also relates to the role of law in social change and social control.

5.2 Civil Liabilities

Civil liabilities are liabilities that could be imposed to recover monetary loss. This monetary loss may result from either the violation of contractual or extra-contractual and legally prescribed obligations. Violation of the legal obligation in relation to tax duties may also result in civil liabilities. It can be imposed on the taxpayer either individually or in addition to other forms of liabilities, such as administrative and criminal liabilities. Civil liabilities are one aspect of those measures that are designed by Ethiopian law to support the taxpayers' compliance behaviour.

In tandem with criminal liabilities, civil responsibilities are part and parcel of economic deterrence-based tax duty enforcement instruments. A rational taxpayer would expect to conduct a cost-benefit analysis before engaging in tax evasion activities. Cost-benefit analysis will be made between the amount that may be received from the tax evasion practice and the resulting penalty that may ensue. For this reason, tax laws may follow a stringent approach in the specification of penalties.

The Ethiopian Tax Administration Proclamation identifies various types of civil liabilities that could be imposed on the taxpayer individually or in addition to other types of liabilities.[113] Payment of money intended to recover costs, payments due to civil fraud, and failure to pay penalty are the major tax-related civil liabilities identified in the Proclamation. In addition to paying a sum equal to the unpaid amount of the tax, any taxpayer should cover all costs incurred by the tax administration authority because of his/her non-compliance activities.[114]

When non-compliance behaviour results from fraudulent activity, the taxpayer and any individual who may render support in fraudulent activities shall be jointly and severally liable in relation to the unpaid amount due to fraud.[115] Furthermore, taxpayers who fail to make payment by the due date shall pay late payment interest as a penalty, and the interest "shall be the highest commercial lending interest rate that prevailed in Ethiopia during the quarter immediately before the commencement of the period specified in [Article 37, sub-article (1)] increased by 15%."[116] The interest will be calculated for all months starting from the due date of the payment. But it cannot exceed the actual sum of the tax expected to be paid by the taxpayer. When the taxpayer is liable for penalty and late payment interest in addition to tax liability and makes a payment that is less than the total amount of tax plus penalty plus interest due, the payment shall be distributed in the following order: first for payment of tax liability, second for payment of interest due, and lastly, the remaining balance to cover payment of penalty.[117]

The only defense of the taxpayer in relation to the civil liabilities specified in the Proclamation is a reasonable cause for delinquency.[118] Non-compliance because of factors beyond the taxpayer's control and making a reasonable effort to comply with the law are among the reasonable causes that may be invoked by the taxpayer.

5.3 Administrative Liabilities

The Tax Administration Proclamation provides administrative liabilities as supportive measures to discourage the taxpayers' non-compliance behaviour.

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[113] TAP, Article 100.
[114] Id Article 30-31.
[115] Id Article .48.
[116] Id Article 37.
[117] Id Article 34.
[118] Id Article 47.

The administrative liabilities include two types of penalties, namely the so-called "fixed amount penalty" and "percentage-based penalty." These penalties are economic deterrence theory-based instruments for the enhancement of taxpayers' compliance behavior, with or without other forms of liabilities. The Proclamation recognizes approximately fourteen types of taxpayer errors that may result in administrative liabilities.

It includes failure to comply with the registration or cancellation of registration requirements, which may entail an additional 25% of the payable tax. If the taxpayer does not have a recognized payable tax, the payment shall be 1000 ETB per month.[119] A taxpayer who fails to maintain any document as required under a tax law shall be liable for a penalty of 20% of the tax payable by the taxpayer under the tax law for the tax period, to which the failure relates. If no tax is payable by the taxpayer for the tax period the penalty shall be 20,000 ETB for each tax year that the taxpayer fails to maintain documents for the purposes of the income taxes; or 2,000 ETB for each tax period that the taxpayer fails to maintain documents for the purposes of any other tax.[120]

A taxpayer who fails to state TIN on a tax invoice, tax debit or credit note, tax declaration, or any other document as required under a tax law shall be liable for a penalty of ETB 3,000 for each failure. This amount will be ETB 10,000 when the taxpayer provides their TIN for use by another person; or uses the TIN of another person.[121] Late filing or failure to make a declaration of tax liability by the due date can also result in a penalty of 5% to 25% of the unpaid tax being assessed to the taxpayer.[122]

Late payment can also entail penalties of 5% of the unpaid tax that remains unpaid at the expiration of one month or part thereof after the due date; and an additional 2% of the amount of the unpaid tax for each month or part of a month thereafter to the extent that the tax remains unpaid.[123] A person who fails to withhold tax or, having withheld tax, fails to pay the tax to the Authority, as required under the Federal Income Tax Proclamation, shall be liable for a penalty of 10% of the tax to be withheld or actually withheld but not transferred to the Authority. Where the taxpayer is the body, in addition to the penalty imposed on the body, the manager of the body, the chief

[119] Id Article 101.
[120] Id Article 102
[121] Id Article 103
[122] Id Article 104
[123] Id Article 105

accountant, or any other officer of the body responsible for ensuring the withholding and payment of withholding tax shall be liable for a penalty of ETB 2,000 each.[124]

In the case of Art. 92 of the Income Tax Proclamation, both the supplier and purchaser shall be liable for a penalty of ETB 20,000 each. A person, who, with the intention of avoiding withholding tax under Article 92 of the Federal Income Tax Proclamation, refused to supply goods or services to a person who is obliged to withhold tax under that Article shall be liable for a penalty of ETB 10,000. Failure of the taxpayer to apply for registration in relation to VAT can result in penalties ranging from ETB 2,000 to ETB 50,000 as a specified amount, as well as 100% of the value-added amount of taxable transitions beginning from the day expected to apply for registration up to the date of application for this effect.[125]

Failure to apply for VAT registration and issuance of an incorrect invoice are specified in the Tax Administration Proclamation as grounds for taxpayer's liability in relation to value added tax.[126] If a taxpayer who is required to issue a tax invoice fails to do so, they will be fined ETB 50,000 for each transaction to which the failure to issue a tax invoice relates. A taxpayer who understates his/her liability may be required to pay up to 40% of the shortfall.[127] But no penalty shall be imposed under this Article if the tax shortfall arose as a result of a self-assessment taxpayer taking a reasonably arguable position on the application of a tax law on which the Ministry has not issued a ruling prior to the taxpayer filing their self-assessment declaration. In cases of tax avoidance, the taxpayer would be liable to pay double the amount that would have been avoided if the tax authority had not applied anti-tax avoidance measures.[128]

The taxpayer who fails to comply with the electronic tax system without adequate reason is also liable to pay ETB 50,000 as a penalty.[129] Tax agents who fail to comply with their responsibilities under the law are liable to pay a penalty of ETB 10,000. A taxpayer who fails to comply with the responsibility of using a tax registration machine would also be liable to pay penalties ranging from ETB 10,000 up to ETB 100,000 in different circumstances. The Proclamation further recognizes miscellaneous penalty in relation to the

[124] Id Article 106
[125] Ibid.
[126] Id Article 107.
[127] Id Article 109.
[128] Id Article 110.
[129] Id Article 111.

taxpayer penalty for failing to notify any change as required by law, failing to give any information requested by the tax authority, failing to provide details of transactions with related persons, failing to file a copy of the memorandum of association, articles of association, statute, partnership agreement, or other document relating to the formation or registration of the business, or any amendment to such a document.[130]

Procedurally, the tax authority should follow all requirements that are clearly stipulated under Article 115 of the Tax Administration Proclamation in the task of making an assessment of the taxpayer's administrative liabilities. Primarily, the Authority shall serve a person liable for an administrative penalty with notice of the penalty assessed. When the same act or omission may involve administrative penalties in relation to more than one tax, the penalties shall be aggregated after being assessed separately for each tax. A person liable for an administrative penalty may apply in writing to the authority for waiver of the penalty payable, and such application shall include the reasons for the requested remission. The Authority may, upon application or on its own motion, waive, in whole or in part, an administrative penalty imposed on a person in accordance with a directive issued by the Authority. The authority shall maintain a public record of each administrative penalty waived and report it to the ministry on a quarterly basis.

Numerous empirical findings from academic research have been made about the efficacy of deterrence-based tools in Ethiopia. Desta Kassa believes that there appears to have been a historical presumption that penalties and punishments are the only effective ways to ensure tax compliance. However, in the modern world, taxpayers' compliance can be ensured through a straightforward combination of support and fair treatment while dealing with the tax authorities. He also stated that governments ought to emphasize non-coercive methods. He places the normative component of taxpayers' compliance devices ahead of deterrent tools.[131]

According to Wollela Yesegat, there is a considerable and positive correlation between the likelihood of deterrence-based measures, such as audits, fines, and penalties, and the decision to comply with VAT reporting requirements. He shows that the quantity, kind, and prominence of economic

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[130] Id., Article 112-114.

[131] Desta Kassa Weldegiorgis (2010), *Assessment Of Taxpayers' Voluntary Compliance With Taxation: A Case Of Mekelle City*, Tigray, Ethiopia, MSc Thesis, Mekele University.

deterrence tools for tax compliance are closely correlated with the taxpayer's compliance attitude. [132]

Ali *et al.* provide evidence of a favorable relationship between compliance behavior and the likelihood of deterrence-based measures like audits, fines, and penalties.[133] Tilahun Aemiro Tehulu regarded the penalty as a determinant factor in Ethiopian taxpayer compliance. However, because deterrence approaches are expensive, he directs efforts toward voluntary aspects rather than deterrence approaches.[134] Tilahun did not deny the role of deterrence in increasing taxpayer compliance, but he suggests more focus on voluntary approaches for cost reasons.

According to Dejene Mamo *et al.*, the perception of equity and level of income are the major determinants of tax evasion, followed by fines and penalties and gender perceptions of equity and fairness (low tax evasion).[135] Regarding the rate of fines and penalties, the positive association indicates that when the rate of fines and penalties increases, a high rate of fines will result in low levels of tax evasion. There is a statistically significant association between fines and penalties and tax evasion.[136] These empirical studies highlight the importance of economic deterrent strategies in Ethiopia's tax system although they are expensive, less effective than the voluntary strategy, and call for strong enforcement mechanisms.

The discussion in this section general shows that the Ethiopian tax administration law incorporates the economic deterrence approach as an instrument of increasing the taxpayer’s compliance behavior. It embodies three forms of liabilities, and each liability may be used by the tax system either individually or jointly, based on the specific provisions of the Tax Administration's Proclamation.

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[132] Wollela Yesegat (2009), *Value added tax in Ethiopia: A study of operating costs and compliance*, PhD thesis submitted to the University of New South Wales, Australia

[133] Merima Ali, O-H Fjeldstad & I. Sjursen, (2014), “To pay or not to pay?” Citizens' tax attitudes in Kenya, Tanzania, Uganda, and South Africa”, *World Development* 64: 828-42.

[134] Tehulu and Dinberu, *supra* 87.

[135] Dejene Mamo *et al* (2014), “Evaluation of Ethiopian Tax Administration System: Emphasis on Taxpayer Compliance”, *JBAS*, Vol. 6(2), pp. 46-76.

[136] Ibid.

6. Conclusion

Voluntary compliance of taxpayers with tax laws is believed to be shaped by two major streams of factors: economic and socio-psychological. Many countries including Ethiopia try to emphasize the economic deterrence approach based on the belief is that taxpayers pay taxes only because they fear audit and the subsequent sanctions. The social-psychology approach to taxation, on the other hand, takes the position that taxpayers' non-compliance decision is influenced by various factors such as justice perception, how they value government expenditure, how they feel they are treated by the revenue authority, conformity to social group or social norms, trust between taxpayer and the government, and easy procedure to comply with tax laws.

The deterrence theory, on the other hand, is based on the premise that taxpayers' are economically rational and will evade taxes by failing to self-declare or declaring lesser amount. In this model, tax evasion can therefore be mitigated if expected fines are sufficiently high to deter taxpayers from cheating and there exists a high probability of audit and detection. The sum of revenue obtained from taxation of declared income, detected income evaded, and the fines, less the administrative costs to conduct auditing of taxpayers, is used to provide a certain amount of public goods. That means economic deterrence model can have lower possibility to achieve administrative efficiency and equitable tax system. The limitations of deterrence approaches have paved the way for the development of behavioural models of tax compliance.

In the behavioural or socio-psychological determinants, taxpayers are seen no longer as selfish utility maximizers but as human beings motivated to pay taxes on the basis of different attitudes, norms, beliefs, perceptions, feelings, social characteristics, cultural background like age, gender, race, religion etc. The relationship between taxpayers and tax authorities can be modelled as an implicit or relational contract which also involves strong emotional ties and loyalties. It relies on mutual trust, tax morale, social norm, and other forms. This model is more efficient and helpful to build equitable tax system. This model the tax Authority may take positive measure or treats the taxpayers to systematically build the latter's tax morale which in turn affects the costs of raising taxes.

The government of Ethiopia has issued a harmonized Tax Administration Proclamation to create an effective, efficient, and measurable tax administration system in the country as explicitly provided in its preamble. The close reading of the law shows that it has contained both of the economic deterrence and behavioural tax compliance strengthening mechanisms though the degree is different. For instance, the law embodies behavioural approach in the form of levying an obligation and responsibility on a tax officer to be honest and fair in the exercise of any power or performance of any duty or function under a tax law. They also have a duty to treat each taxpayer with courtesy and respect and to keep secrecy of taxpayers' information. It gives taxpayers' opportunity to do self-assessment and self-declaration. Through these provisions embrace the behavioural or socio-psychological theory of tax compliance, most of its provisions focus on deterrence against taxpayer's non-compliance, tax audit and consequent penalties based on the economic deterrence approach. The law contains the economic deterrence approach in the form setting probability of audit and penalties which includes civil, criminal and administrative penalties. It also provides deterrence instruments in the form of civil, criminal and administrative liabilities.

Thus, the tax administration law of Ethiopia –in many aspects– depends much on the economic deterrence approach. However, in view of efficiency and equity, the Ethiopian tax law regime should give emphasis to the behavioural theory of tax compliance at least at par with the deterrence theory. Therefore, the tax authorities at different levels of the country have to build trust in the tax system, avoid high tax rates, and build simple tax declaration or assessments and collection procedures in the mind of citizen as a whole and specifically to taxpayers. The government should work towards behavioural developments that nurture the creation of loyal and honest taxpayers who feel guilty if they evade tax though they could not be noticed by the tax authorities. Accountability and transparency of government and tax education and awareness creation of taxpayers deserve utmost attention.

In sum, the significance of whether economic or social-psychological theories matter more is of critical concern, based on which a tax authority should invest its limited resources. Economic theories generally call for increased audits and penalties as the solution to compliance problems. These solutions, of course, are costlier than those proposed by the social-psychological theories. The socio-psychological theories generally lead to policy recommendations which give much attention to changing individual taxpayers' attitudes toward the tax system by improving its perceived fairness and equity, making government expenditure in the best interest of the taxpayers, improving procedural justice, establishing the culture of mutual respect between tax authorities and taxpayers, and making it easy to comply with the tax laws through such measures as increased telephone assistance, and shorter line-ups in tax offices. ■

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