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Factors affecting tax compliance behavior of Merkato
Number 2 Medium Taxpayers Branch office.

BY

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Determinants of Tax compliance:

Evidence from Addis Ababa City Administration Revenue
Bureau Merkato Number 2 Medium Taxpayers Branch

BY

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DECLARATION

This thesis was written by myself, the undersigned, and was supervised by Misraku Molla (Ph.D.). The thesis has properly acknowledged all sources of information used in it. I further affirm that the thesis has not been submitted, in whole or in part, to any other institution of higher education with the intention of obtaining a degree.

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ENDORSEMENT

This thesis has been submitted to St. Mary's University College, School of Graduate Studies for examination with my approval as a university advisor.



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APPROVED BY BOARD OF EXAMINERS

We, the undersigned certify that we have and here by recommendation to the Saint Mary's university to accept the thesis submitted by Shimelis Dessalegn entitled "Determinants of Tax compliance: Evidence From Addis Ababa City Administration Revenue Bureau Merkato Number 2 Medium Taxpayers Branch" for the fulfillment of the requirement for the award of a Master's degree in Business Administration.

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ACRONYMS

AACARB	Addis Ababa City Administration Revenue Bureau
OECD	Organization for Economic Cooperation and Development
BMS	Block Management System
IMF	International Monetary Fund
ADB	Asian Development Bank
VAT	Value Added Tax
ATAF	African Tax Administration Forum
SAS	Self-Assessment System
GDP	Gross Domestic Product

ABSTRACT

Like most developing countries, Ethiopia has mainly relied on loans and foreign aid to fund its development efforts. The tax percentage of GDP has consistently been low because of low tax compliance. This study "examines the factors of Tax compliance behavior of Merkato number two medium tax payers in Addis Ababa City Administration Revenue Bureau-". 302 respondents' replies to closed-ended questionnaires were used as the study's primary source of data. The study employs descriptive and explanatory research designs along with quantitative research approach. Generally, the research signifies that the factors which make taxpayers not discharge their tax duties with their own self-assessment and right amount. The research implies that the researcher's selected factors; perceived fairness of tax system, tax knowledge and education, fine and penalty and power and trust of the tax authority. The taxpayers have impact on the tax compliance level. The tax bureau strongly advised the local administration tax bureau to carry out a variety of initiatives in order to build a strong and trustworthy relationship with the taxpayers. For the taxpayers to have a clear understanding of how taxes are used by the government, the tax bureau should assume and give ongoing education. Additionally, strict enforcement of fines and penalties is necessary to discourage tax avoidance. The tax bureau has not sufficiently increased familiarity with its laws and regulations. When creating the tax code, tax policy, and tax decrees, it is important to consider the level of knowledge, income, and perception of the taxpayers.

Keywords: Addis Ababa, Fines and penalties, Perceived fairness, Tax compliance, Tax Knowledge.

CHAPTER ONE

1. INTRODUCTION

1.1. BACK GROUND OF THE STUDY

Taxation is one of the important elements in managing national income. However, as most of the developing countries, Ethiopia has been highly depending on external aid and loan for funding its expansion events. The money is needed to pay for crucial socially necessary programs (like health care and education), services (like public safety and utilities), and infrastructure (like building roads and protecting the environment) (Muzainah & zekariah 2016).

According to Thomas Wendy Eicher (2002), taxes are a key source of income for governments in both wealthy and poor countries in order to pay for the delivery of necessary infrastructure and social services. However, a taxpayer, who fails to comply with their tax duties, whether on purpose or accidentally, is said to be in tax noncompliance. This may occur as a result of neglecting to file tax returns, reporting taxable income incorrectly, or claiming deductions from taxable income or taxes owed that are legitimate (such as exemptions, deductions, or tax credits) but were reported incorrectly. (Kirchler, 2007).

As a result, tax administration should put methods and mechanisms in place to ensure that there is a non-compliance with the law (Organization for economic cooperation and development, OECD, 2004). Rich and developing countries alike are concerned with boosting marginal tax rates, maintaining current compliance rates, and reaching high levels of voluntary tax compliance. This is thus because taxes are always levied with the intention of raising money for government spending and the provision of public goods and services, regardless of the type of economy.

The tax authority will put in place a comprehensive framework for compliance in order to be able to collect the money that the economy produces. The high level of non-compliance that exists in the Merkato business district must be urgently addressed in the meanwhile. Merkato is one of the highly exposed areas for tax evasion and avoidance due to large number of traders.. According to International Monetary Fund report (2011), tax compliance in Ethiopia is estimated to be 25%. The 75% non-compliant population is in breach of its responsibilities for the reasons

like failure to register properly and not being in the tax net, failure to file returns and/or to pay and Failure to pay the appropriate amount of tax liability.

Even though the IMF study's findings were published more than ten years ago, the noncompliance issue has not been resolved. Since it substantially jeopardizes governments' ability to produce necessary public income, tax non-compliance is a growing source of concern for Ethiopian tax officials and public policy makers. Hence, when planning to perform this study, the researcher took this issue into consideration. The goal of this study is to assess the factors that influence tax compliance at the Addis Ababa City Administration Revenue Bureau Merkato Number 2 Medium Taxpayers Branch Office.

1.2. STATEMENT OF THE PROBLEM

The Addis Ababa City Administration Revenue Bureau (AACARB) oversees the administration of the laws under its authority in a way that is customer-focused, equitable, and forward-thinking. The Bureau strives to increase client voluntary compliance, lessen the administrative load on compliant participants, improve service, and make sure that all taxpayers fulfill their legal tax duties.

The contribution of the Addis Ababa city administration Revenue Bureau (AACARB) to the city's government expenses is growing over time and will become increasingly important. The administration has stated that it believes voluntary compliance is not currently at the level expected or desired and is aware of the need to strike a balance between facilitation and control.

Comprehensive strategy has been put in place by the Addis Ababa city administration Revenue Bureau (AACARB) to promote voluntary compliance in various crucial areas in merkato.

Due to the significant number of traders in Merkato, one of the regions that are most vulnerable to tax evasion, the Revenue Bureau has established a broad-based framework for tax compliance as a major priority. Gezahegn, (2018).

A 2011 report from the International Monetary Fund estimates that 25% of taxes are paid in Ethiopia. This rate is expected to be higher in Addis Ababa city administration Revenue Bureau, particularly in merkato branch. The 75% non-compliant population is in breach of its responsibilities for the reasons like failure to register properly and not being in the tax net, failure

to file returns and/or to pay and failure to pay the appropriate amount of tax liability. Despite the fact that the results of the IMF study were released more than ten years ago (2011), the noncompliance problem has not been remedied.

Tax non-compliance is becoming a bigger source of worry for Ethiopian tax Professionals and public policy makers since it seriously jeopardizes governments' capacity to generate sufficient public revenues. Therefore, this study intends to assess the tax compliance of Addis Ababa city administration Revenue Bureau (AACARB) specifically merkato No.2/Medium Taxpayers Branch Office.

Previous researches by many academics revealed that the mentioned tax administration issues had a negative impact on tax collection, tax payer satisfaction, tax burden on a small number of taxpayers, and the consequences of violating citizens' rights. The branch office's records for 2013 E.C show that a large number of people were outside the tax system and in default of a variety of tax obligations. For instance, more than 2800 tax payers failed to appear at the branch office to pay the 2013 E.C annual profit tax, 345 tax payers were fined for failing to provide invoices for goods sold, and 394 illegal traders were forced by the branch office to obtain a trade license.

According to the report's statistics, Merkato has a significant difficulty with tax compliance. Tax evasion and avoidance are openly performed in the area, as may be seen. Most research focuses on the social and behavioral factors that influence tax payer compliance, but most studies don't pay enough attention to how these factors are impacted by issues with tax administration.

Tax compliance is a complicated issue that can be influenced by a variety of factors, but the effectiveness of tax administration (fairness, complexity, tax payer awareness, and authority service) should be evaluated in this regard.

1.3. RESEARCH QUESTIONS

Based on the problem highlighted in the previous section, this study mainly answer the following research question by taking first hand empirical data from Addis Ababa City Administration Revenue Bureau (AACARB) Merkato No.2 Branch Office.

- 1) How is perceived fairness for tax system affecting tax compliance?
- 2) How is tax knowledge and education influencing tax compliance?
- 3) How are fines and penalties deterring compliance?
- 4) How is trust and power of taxpayers contributing compliance?

1.4. OBJECTIVES OF THE STUDY

1.4.1 GENERAL OBJECTIVE

The general objective of this study is to examine factors affecting tax compliance in Merkato No.2 Medium Taxpayers Branch office.

1.4.2. SPECIFIC OBJECTIVES

Specifically, this study addressed the following research objectives.

- 1) To investigate the effect of perceived fairness of tax system on tax compliance.
- 2) To examine the effect of tax knowledge on tax compliance.
- 3) To determine the effect of fines and penalties on tax compliance.
- 4) To evaluate the trust and power of tax administration on tax compliance.

1.5. Research Hypotheses

This study empirically tested the following four hypotheses.

- H1: Perceived fairness of the tax system positively and significantly affect tax compliance.
- H2: Tax knowledge of taxpayers positively and significantly affect their tax compliance level.

- H3: The amount of fines and penalties positively and significantly affect tax compliance.
- H4: Trust and power of tax administration positively and significantly influence tax compliance.

1.6. SIGNIFICANCE OF THE STUDY

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

1.7. SCOPE OF THE STUDY

This studies' geographic scope was limited to the Merkato region. Also, the conceptual focus of the research was to identify the branch office tax compliance of Merkato No. 2/Medium Taxpayers.

1.8. LIMITATION OF THE STUDY

The drawback is the absence of current and pertinent literature produced in the unique environment of Ethiopia.

1.9. ORGANIZATION OF THE PAPER

The research comprises five chapters. The first chapter deals with an introduction part which consists background of the study, statement of the problem, objectives of the study, research questions, scope of the study, significance of the Study and limitation of the study. The second chapter deals with a review of related literature. The third chapter contains research methodology, whereas the fourth chapter presents the analysis and discussions of the study and Chapter five holds conclusion and recommendation.

CHAPTER TWO

2. LITERATURE REVIEW

2.1. THEORETICAL LITERATURE REVIEW

This chapter covers review of literatures related to the study. The first section of the chapter covers theoretical literature review while empirical literature review and conceptual framework are dealt in the second and third sections of the chapter respectively. This review of the literature establishes the framework for the study and formulating the research questions for the study.

2.1.1. THE DEFINITION AND CONCEPT OF TAX COMPLIANCE

This section reviews previous literature in tax compliance. Specifically, first it provides the definition of tax compliance, then reviews of theoretical and empirical literature on tax compliance. This review of the literature establishes the framework for the study and formulating the research questions for the study.

2.1.2. DEFINITION OF TAX COMPLIANCE

The exact meaning of tax compliance has been defined in various ways. For example, According to Brown and Mazur (2003) Cited in Mutai, M. K. (2013) tax compliance is multi-faceted measure and theoretically, it can be defined by considering three distinct types of compliance such as

- ✚ Payment compliance,
- ✚ Filing compliance, and
- ✚ Reporting compliance.

Kirchler, E. (2007). Perceived a simpler definition in which tax compliance is defined as the most neutral term to describe taxpayers' willingness to pay their taxes. Gezahegn, (2018). In considering definitions of compliance, it is convenient to divide compliance into two key categories. These categories are

- ✚ administrative compliance and
- ✚ technical compliance where the administrative compliance refers to complying with administrative rules of lodging and paying otherwise referred to as reporting compliance,

procedural compliance or regulatory compliance and the technical compliance refer to complying with technical requirements of the tax laws in calculating taxes or provisions of the tax laws in paying the share of the tax (OECD, 2004).

2.1.3. TAX NON-COMPLIANCE

As tax evasion severely hinder governments' ability to collect the necessary tax revenue, tax authorities and public policy makers are growingly concerned about it on a global scale. In less developed countries, the problem is particularly serious. Tax non-compliance is defined as failure to obey with tax laws and/or declare understate revenue, the act of asking for unfitting expense, relief and refunds and/or paying the incorrect amount of tax beyond the stipulated time frame. And, noncompliance is also perceived as the failure of a taxpayer to report the actual income, claim exaggerate deductions and rebates and remit the small amount of tax payable to the tax authority on time (Kirchler, 2007).

Taxpayers vary in terms of the opportunities available to them in overstating expenses and understating incomes (Chau and Leung, 2009). Superior tax denial chance usually result from self-employment and income sources not subject to withholding taxes. Taxes can be classified into two main types: direct and indirect taxes.

Direct taxes mean the burden (incidence) of tax is borne entirely by the entity that pays it, and cannot be passed on to another entity; for example, corporation tax and individual income tax. Indirect taxes are typically the charges that are levied on goods and services (consumptions) for example VAT (Value Added Tax), sales tax, and excise tax and stamp duties. Indirect taxes are not levied on individuals, but on goods and services. Customers indirectly pay this tax in the form of higher prices.

For example, it can be said that while purchasing goods from a retail shop, the retail VAT is actually paid by the customer. The retailer eventually passes this tax to the respective authority. The indirect tax actually raises the price of the goods and the customer's purchase by paying more for that product. Unlike indirect tax, direct taxes are based on 'ability to pay' principle but (by being very obvious to the taxpayer) they sometimes work as a disincentive to work harder and earn more because that would mean paying more tax. Individuals do not like paying taxes, and they take a variety of actions to reduce their tax liabilities. Some of these actions can be

classified as tax avoidance, which is the legal reduction in tax liabilities by practices that take the full advantage of the tax code, such as income splitting and postponement of taxes for example through contribution to a Home Ownership Savings Plan. The other classification of actions is tax evasion which consists of illegal and intentional actions taken by individuals to reduce their legally due tax obligations (Mansor, 2005).

Individuals and firms can evade taxes by underreporting incomes, sales, or wealth, by overstating deductions or by failing to file appropriate tax returns. In every jurisdiction, tax authorities are empowered to collect revenue from taxpayers. Although there are a number of taxpayers who have reported their income and paid their tax liabilities properly, there are a few taxpayers who have not done so. The issue of tax compliance is extremely important both to those concerned with the key role the increased tax yields can play in restoring macroeconomic balance and those concerned with tax policy and its effects on the economy in general (Mansor, 2005).

The level of tax collection though important is an unsophisticated measure of the effectiveness of tax administration .A more accurate measure is the level of compliance. Facilitating compliance involves such elements as improving services to taxpayers by providing clear instructions, easy to fill forms and assisting and educating them on their duties and obligations.

Monitoring compliance requires establishing and maintaining current accounts of taxpayers and management information systems covering both ultimate taxpayers and third party agents such as banks involved in the tax system as well as appropriate and prompt procedures to detect and follow up on non-filers, nil filers and delayed payments. Deterring noncompliance requires establishing both a reasonable risk of detection as well as applying penalties effectively. The ideal approach is to combine these measures so as to maximize their effect on compliance as it were, to move a country from a “low compliance to a high compliance environment”(Masinde and Makau 2010).

2.1.4. CATEGORIES OF TAXPAYERS OBLIGATION

According to OECD (2004), the broad categories of taxpayer obligation are:

1. Registration in the system;
2. Timely filing or lodgment of requisite taxation information;
3. Reporting of complete and accurate information (incorporating good record keeping);
4. Payment of taxation obligations on time.

If a taxpayer fails to meet any of the above obligations then they may be considered noncompliant. As noted in OECD (2004), the main reasons for noncompliant behavior can be categorized as:

- 1) Equity: the perceived fairness of a taxation system is important, with taxpayers' behavior influenced by two perceptions: the first one is that the system treats them unfairly compared to others, and that the government is doing too little with the income it collects.
- 2) Opportunity for non-compliance: several studies report this as the most important explanatory factor for noncompliant behavior. However, it is unclear whether those who are pre-disposed to noncompliance seek work where there are further opportunities.
- 3) Individual differences: those who do not observe tend to be male, younger, and egotistical and have positive attitudes towards tax evasion and negative attitudes towards taxation authorities. There is some evidence to suggest that education about the taxation system has a straight impact on reducing the propensity to evade.
- 4) Social norms: If a person believes that incompliance is widespread they are much more likely not to comply themselves. Studies indicate that it is effective in reducing noncompliant behavior to ensure that taxpayers have an accurate understanding of the compliance behavior of others.
- 5) Dissatisfaction with revenue authorities: There is a positive correlation between belief by taxpayers that the revenue authority is inefficient and the likelihood of their noncompliance. However, it is unclear just how potent this is compared to other factors.

2.2. ORGANIZATIONAL BACK GROUND

The Addis Ababa city administration Revenue Bureau is one of the government institution and an Autonomous revenue Agency having its own legal personality , Merkato no,2 medium taxpayers Branch Office are one of among 16 (sixteen) branches of Addis Ababa city administration Revenue Bureau found in Addis Ketema sub city. There are 11 small revenue taxpayers branch offices, four medium, one large tax payers branch office amongst the 16 branch offices the two branch offices namely, Merkato Number one and number two medium branch offices, On top of this, the business area divided in to six tax centers or blocks borrowing names of the area in which they are located and Each branch administers three tax centers. Now the branch offices are administered by Addis Ababa city administration revenue Bureau. From January/2013 up to January/2018 the tax administration and collection was taken over by Ethiopia Revenues and Customs Authority (ERCA) at that time. But, until January/2018 for effective and efficient collection of taxes it is taken over by Addis Ababa City Administration Revenue Bureau. The AACARB has the powers and duties of establishing and implementing modern revenues assessment and collection systems; providing efficient, equitable and quality service within the sector; properly enforcing incentives of tax exemptions given to investors and ensuring that such incentives are used for the intended purposes.

In addition, AACARB has the responsibility of collecting and analyzing information necessary for it and the assessment and determination of taxes; compiling statistical data on criminal offences relating to the sector, and disseminating the information to others respected sectors.

2.3. DETERMINANTS OF COMPLIANCE

2.3.1. ECONOMIC FACTORS OF TAX COMPLIANCE

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

taxpayers are reluctant to lose their hard-earned money by “gambling” with tax authorities (Kirchler2007).

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

Tax audit is one of the most effective policies to protect the behavior of tax evasion. The level of tax audit can be determined by two elements: one is how many taxpayers are selected for audit and the second is how much concentrated the audit is. The first element is easily measured by the number of audited taxpayers divided by the total number of taxpayers. However, these elements are so difficult to measure due to no published information about the process of tax audit. It is commonly measured by the first element to indicate the level of tax audit for practical comparison (Hyun, 2005).

2.3.2. NON ECONOMIC FACTORS FOR COMPLIANCE

Many studies have been conducted to take these non-economic elements into account in order to understand tax compliance behavior within the context of economic analysis (Alm, Sanchez and DeJuan, 1995). The willingness to pay for public services, public education, tax morale, tax information, etc., is some of these non-economic elements.

Most studies focus on just one or a few non-economic components for a thorough examination because it is not always possible to include all non-economic factors in analyses of tax compliance behavior. Despite the fact that we are aware that non-economic factors have a significant role in determining the extent of tax compliance.

The release of tax information might be one important determinant for tax compliance, as it gives taxpayers an exact figure about tax evasion. There are three tax subjects under this public notification system, which are individual income tax, corporate income tax and inheritance tax (Hyun, 2005).

Attitudes represent the positive and negative evaluations that an individual holds of objects .It is assumed that attitudes encourage individuals to act according to them. Thus, a taxpayer with positive attitudes toward tax evasion is expected to be less compliant than a taxpayer with negative attitudes. Attitudes towards tax evasion are often found to be quite positive (Kirchler et al., 2008).

On the one hand, favorable attitudes will contribute to trust in authorities and consequently will enhance voluntary tax compliance. On the other hand, attitudes towards the authorities will be relevant for the interpretation of the use of power as benevolent or malicious. Tax attitudes in general also depend on the perceived use of the money collected and therefore are connected to knowledge (Kirchler et al., 2008).

Personal, social and national norms. Besides attitudes, norms are important factor of tax compliance. Behavioral intentions are determined also by subjective norms (Ajzen, 1991). Norms are behavioral standard son three different levels: the individual level, the social level and the national level (Kirchler et al., 2008). On the individual level, norms define internalized standards on how to behave. Individual norms are related to moral reasoning, authoritarianism and Machiavellianism, egoism, norm dependency and values. A norm where all citizens are perceived as contributing their fair share would certainly help to increase trust in the authorities (Kirchler et al., 2008).

2.4. SERVICE COMMITMENTS OF TAX ADMINISTRATION

Tax administration should provide impartial and professional well-mannered service and must keep private and confidential information regarding the individual taxpayers. It should also offer clear, reasonable and current tax information and will make this information available to tax payer through various media and provide timely, accurate written information that one can rely on to questions and requests for tax information (ADB, 2001).

Education and information programs on specific tax issues should be arranged with taxpayers to enhance the awareness and taxpayers should be allowed to voluntarily disclose their tax situation without incurring a penalty or being prosecuted for tax violations under certain conditions (ADB, 2001).

2.5. CORE AND SUPPORT FUNCTIONS OF TAX ADMINISTRATION

According to URESPOND (2013), the core or basic functions that a modern tax administration performs in its direct operations are:

- 1) Taxpayer registration: the collection, recording, and maintenance of basic identifying tax payer information in the tax administration's master database that permits the administration to understand its tax payer base and to plan accordingly;
- 2) Taxpayer services: the information, forms, publications, and tax education that the tax administration provides tax payers to help them comply with their tax obligations, to demonstrate that they are considered valued customers of the tax administration, and to reduce the need for extensive enforcement, given limited resources;
- 3) Processing of tax declaration filings and tax payments: the processes and forms designed by the tax administration for taxpayers to file their tax return and pay their tax liabilities on specified dates, and the processes used by the tax administration to receive, document, review, correct if necessary, and archive the tax returns;
- 4) Taxpayer audits: the processes used by the tax administrations to monitor compliance, by selecting filed tax returns to audit income, expenses, and supporting information reported by the taxpayer and to make additional assessments which require collection action;
- 5) Taxpayer objections: the processes offered to tax payers to first dispute proposed additional tax assessments in forums within the tax administrations field offices;
- 6) Taxpayer appeals: the formal processes available to tax payers under the law to protest projected additional tax assessments or other actions by the tax administration at forums away from the direct authority of the tax administration's compliance offices, including judicial reviews and hearings;
- 7) Collection of tax arrears: it is opposed to tax payment the business processes used by the tax administration to collect taxes which are due, assessed, not paid by the due date under the law, including use of enforcement measures, such as liens, levies, and seizure and sale of taxpayers' property; and
- 8) Tax-fraud investigations: the processes used to investigate financial transactions declared by taxpayers on their tax returns in cases in which the tax administration has a reasonable cause to expect that the taxpayer has committed tax fraud. Tax-fraud investigations also

involve cases of tax evasion, when taxpayers subject to tax do not register, file, and pay their taxes.

2.6. TAXPAYERS SEGMENTATION

According to the African Tax Administration Forum (2017), there are several types of tax administration issues because taxpayers are not all the same. The main criteria that nations utilize to divide up taxpayers are:

- 1) Turnover, where taxpayers are classified as large, medium or small according to the size of their turnover.
- 2) Tax payment, where they are classified as large, medium or small according to the amount of tax collected from them.
- 3) Nature of business, i.e. the economic sectors in which a taxpayer operates. Those that operate in the financial sector, like banks and insurance companies are generally considered as large taxpayers.

2.7. BLOCK MANAGEMENT SYSTEM

A taxpayer outreach scheme, which physically identifies and maps taxpayers and breaks them down into manageable blocks tax administrators then visit them in person to educate and encourage compliance. Proper implementation of BMS prevents the under-declaration of sales and profits, the non-issuance of invoices, false refunds and offset claims. It also helps revenue authorities track down untraceable taxpayers and reduce the size of the large informal sector (African Tax Administration Forum, 2017).

2.8. EMPIRICAL LITERATURE

This section of the research covers the findings of different researchers about the determinants of tax compliance empirical evidence on determinants of tax Compliance around the Globe. Several empirical studies have been undertaken to assess and understand the compliance behaviors or determinants of tax compliance across different countries. The compliance behavior of taxpayers and scholars especially in-developed countries has concluded that economic, social, psychological and cultural factors influence tax compliance.

According to Clotfelter's (2008) an important early study of the empirical relationships among income, the marginal tax rate, and evasion, reports elasticity's for the after-tax income, and marginal tax rate variables for each of a separate audit classes. Coefficients on both the after-tax income and marginal tax rate variables are positive and significant.

Witte and Woodbury (1985) found that tax audit could change compliance behavior from negative to positive. Witte and Woodbury in their study of small proprietors found that tax audits have a significant role in tax compliance.

According to a study by Richardson (2008), the role of the government significantly influences how people feel about paying taxes. In this study, the causes of tax evasion were attempted to be identified in the USA, the UK, Argentina, Thailand, Canada, Chile, and Brazil, among other nations. Richardson added that in order to win the trust of the public, the government should improve its standing and credibility. Abdulsemed, (2019).

Although previous studies could not provide conclusive results on the measurable impact of the efficiency of the government on compliance, however, researchers from different countries have discussed this issue and some authors have described how the role of government in inducing tax compliance is important and relevant in self-assessment systems (Richardson, 2008; Hasseldine and

Orviska and Hudson (2002) and Trivedi, Shehata, and Mestelmen (2004) found a significant (but weak) relationship between tax evasion and ethics. The evidence clearly shows various attitudes towards taxation, such as tax ethics and the fairness of the tax system and that these have an influence on the inclination towards tax evasion (Jackson and Milliron, 1986). It is consequently important to get more details about how these attitudes are influenced. Roth et. al. (1989) identified two primary factors in taxpayer compliance, namely financial self-interest and moral commitment.

Individuals comply with tax laws because it is in their own financial interests to minimize their tax bill, but also because of their perceived moral obligation to obey tax laws. Roth et. al. (1989) validates that there was a consistently positive relationship between moral commitment and compliance behavior. Roth et. al. (1989) finding seems to theorize that ethics have a positive effect on compliance behavior, more than financial self-interest. Ajzen (1988) claimed that the best predictor of a person's behavior is ethics, but argued that this link can be disrupted by the passage of

time, unforeseen events or new information. In addition, low involvement behaviors are likely to be based on few, weakly held or possibly unstable views.

As suggested by previous studies Kirchler et. al., (2008); Orviska and Hudson (2002); Jackson and Milliron (1986)), attitudes and ethics remain important in determining evasion behavior. Based on Ajzen (1991) the theory of reasoned action or the intention to evade will encourage a taxpayer to behave negatively toward taxation and thus attempt to under-report income. On the other hand, attitudes towards the tax authority are also important as tax attitudes and ethics generally depend on the perceived use of the money collected by the government (Kirchler et. al., 2008).

In Ethiopia, different researches have been made on tax. Tilahun & Yidersal (2014) on the title Determinants of Tax Compliance Behavior in Ethiopia: The Case of Bahir Dar City Taxpayers with the objective to identify factors that determine tax compliance behavior. The researcher used one-way ANOVA, two samples and one sample T-test, the data were collected using structured questionnaire. The results revealed that perception on government spending; perception on equity and fairness of the tax system; penalties; personal financial constraint; changes on current government policies; and referral group (friends, relatives etc.) are factors that significantly affect tax compliance behavior.

A study made by Amina & Saniya (2014) on tax compliance and its determinant the case of Jimma zone, Ethiopia, with the aim of investigating the determinants of tax compliance for the case of Jimma zone category „A“ taxpayers. By distributing 384 questionnaires to category A sample taxpayers, the study tried to explore the main determinants of tax compliance.

The findings shows that age, sex, penalty, audit, simplicity, fairness and government perception were found to affect tax compliance. In general it is recommended that AACARB has to work on educating the young generation about the tax system and the benefit it has to the society as a whole, try to make the whole tax system as fair as possible with regard to the benefit received from paying tax and the tax burden of paying it, to expand and make more regular and consistent auditing still putting in mind the cost associated with it, work on bringing a good reputation in providing public service and making the tax system simple in general and the law, the forms, the filling, the paying and appeal system in particular in order to increase the tax compliance in one hand and the tax revenue in general.

As discussed above the empirical study on determinants of tax compliance around the world shows that different variables have been taken into account to investigate what determine tax compliance of different taxpayers. According to the results of the various study tax compliance has been influenced specifically by probability of being audited, perceptions of government spending, penalties, personal financial constraints, Ethics and attitude toward tax compliance.

2.9. SUMMARY AND KNOWLEDGE GAP

The former studies indicate various researchers on similarly area of studies presented are that the justification part of those studies address that findings are still debatable among different researcher. Hence, we looking at factor affecting tax compliance behaviors there seem to be a disagreement in the findings.

Some variables are Significant in one study also insignificant in another study. And from the previous empirical research found that the factors affecting of tax compliance have been found to differ between countries. This means there is no universal findings are highlighted by researchers pertaining to genuine tax compliance determinants among countries sharing similar tax systems, and cultures.

The case of Ethiopia is a good example for this situation. Therefore, this research is to fill the research gap that were not addressed by any one of the earlier studies, specifically problems associated with tax payers and revenue authority in Addis Ababa and also this study initiation is needed to fill the literature gap regarding the factors of tax compliance behavior and contribute to the body of knowledge.

2.10. CONCEPTUAL FRAMEWORK AND HYPOTHESES DEVELOPMENT

2.10.1. CONCEPTUAL FRAMEWORK

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

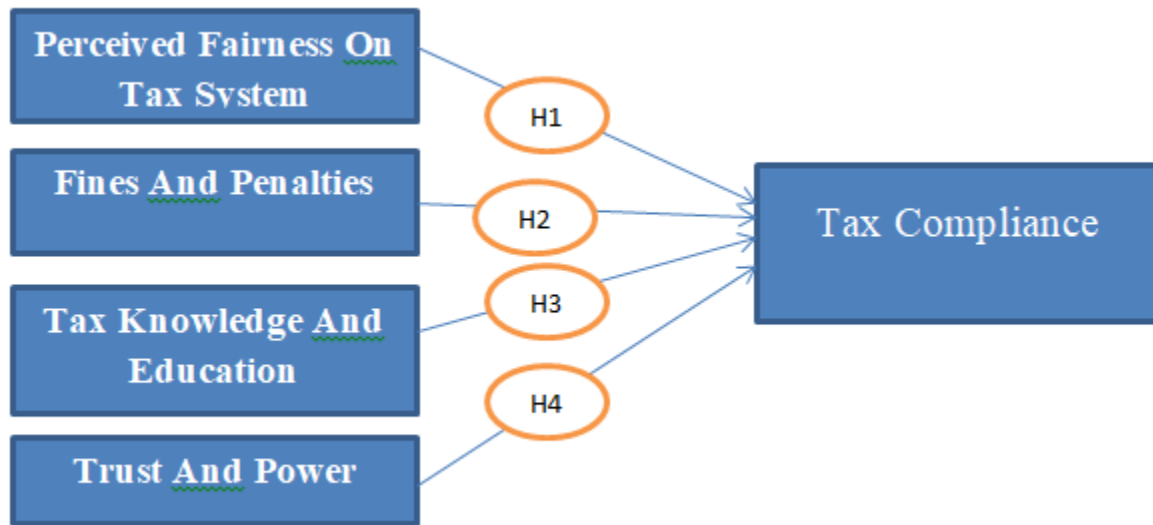


Fig 2.1. Conceptual framework (self-developed)

2.10.2. Hypothesis Development

The process of developing hypotheses is ultimately experience-based. New knowledge is contrasted to prior knowledge in this experience-based reasoning. This internal knowledge base is updated with new information. An analyst soon creates a set of internal spatial norms.

Researchers can use hypotheses to both identify relationships between variables and forecast relationships based on theoretical principles and/or empirical data. The creation of a hypothesis necessitates a thorough comprehension of the research question and a thorough analysis of the body of prior research. (<https://opentext.wsu.edu>)

2.11. PERCEIVED FAIRNESS OF TAX SYSTEM AND TAX COMPLIANCE

The importance of public perception has been the motivation for numerous studies that attempted to measure the level of perceived fairness and identify the determinants of the public's perception of taxes. Tax system is type of official governmental system connected to governmental policy created to administer, collect, integrate, improve, change and manage methodically tax law and tax legislation. It is using accurate, defined, effective, transparent, just and evidence based on

different tax rates tax compliance and related issues. A fair, transparent, accurate and effective tax system is vital for a government to administer, collect, change and manage tax within a country or state (MCHarmonious, 2016).

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

Related to distributive justice, comparisons are made on the individual, the group, and the societal level. On the individual level, taxpayers are concerned about the fairness of their outcomes, and they want to be treated relative to their merits, efforts and needs. If an individual's tax burden is heavier than that of comparable other individuals, tax compliance is likely to decrease. On the group level, taxpayers are concerned about the fairness of outcomes of the group and want a fair treatment of their group relative to other (income) groups (Spicer and Lundstedt, (2008).

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

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

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

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

In the current framework, perceived fairness is connected to the trust dimension because a just treatment of taxpayers (i.e., distributive and procedural fairness) helps to build and maintain trust. Retributive justice is connected to the power dimension, because it depends also on detecting and fining wrong doers. In turn, an inconsiderate exertion of power that is perceived as intrusive can reduce trust. In conclusion, some of the major factors discussed on tax compliance would gain from considering them within the “slippery slope” framework and its interaction of the power and trust dimension (Kirchler et al., 2008.). Therefore, the first hypothesis developed as follow.

- H1: Perceived fairness of the tax system positively and significantly affect tax compliance.

2.12. FINES AND PENALTIES OF TAX COMPLIANCE

Most of countries laws empower their tax authority to take any measures on the taxpayers who participate in tax evasion or any illegal activities. The tax authority has a right to accuse both the taxpayers and tax office that has not discharge his duties. Failure of taxpayers to comply with the procedures provisions of the tax laws shall result in imposition of interest, civil or administrative penalties and criminal offence penalty. In general, the tax authority can levy fine or penalty on the tax offenders according the degree of the offence. The tax authority has the duty to monitor

and supervise tax payers, hence administrative penalties are inherent consequences on taxpayers that fail to comply with tax obligations under direct or indirect taxes. The failures to comply are related to administrative penalties and criminal offences (Fischer, 1992).

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

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

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

Fines that are in appropriate because a taxpayer involuntarily made a mistake resulting from ambiguous tax laws, or fines that are exorbitantly high, would undermine the perception of retributive justice and induce tax evaders to try even harder to regain their "losses" incurred by those fines (Kirchler et al., 2008).The increasing tax avoidance and tax resistance due to an

increase of fines puts into question how fines should be assessed to be effective. On the one hand, fines should be high enough to decrease the expected value of tax evasion and to assure its deterrent effect on taxpayers. On the other hand, if fines are too high, the tax system would be perceived as unjust and unfair and taxpayers would use any possibility to legally avoid their taxes.

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

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

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

- H2: The amount of fines and penalties positively and significantly affect tax compliance.

2.13. TAX KNOWLEDGE AND EDUCATION AND TAX COMPLIANCE

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

Self-assessment system (SAS) requires taxpayers to understand all the laws and regulations that govern taxation. This is necessary because taxpayers will have to calculate themselves the amount of tax they need to pay and make the payment (Kasipillai, 2003). One of the fundamental ways to increase public awareness is for taxpayers to have knowledge about taxation.

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

Attitude towards tax compliance can be improved through the enhancement of taxation knowledge. When a taxpayer has a positive attitude towards tax, this will reduce his or her inclination to evade tax payment. Self-assessment system (SAS) requires taxpayers to understand all the laws and regulations that govern taxation. This is necessary because taxpayers will have to calculate themselves the amount of tax they need to pay and make the payment (Kasipillai, 2003).

The influence of knowledge on compliance behaviors has been assessed in various researches. Knowledge as one of the factors in compliance is related to the taxpayers' ability to understand taxation laws, and their willingness to comply. The aspect of knowledge that relates to compliance is the general understanding about taxation regulations and information pertaining to

the opportunity to evade tax (Kasipillai, Norhani, and Noor, 2003). Taxpayers will readily accept any new system introduced, like the SAS, if they have ample knowledge to understand the system. Thus, education programs organized by the tax authority or other public education institutions are needed to enhance taxpayers' ability to understand Self-assessment system and to increase their confidence in fulfilling their responsibilities as taxpayers (Mohani, 2001). Greater education is directly linked to a likelihood of compliance.

Educated taxpayers may be aware of noncompliance opportunities, but their potentially better understanding of the tax system and their higher level of moral development promotes a more favorable taxpayer attitude and therefore greater compliance (Chanet.al.2000). One of the measures to increase voluntary compliance is by assuring that taxpayers have a certain level of qualifications, ability and confidence to exercise their tax responsibility (Mohani, 2001). Taxpayers who have attended tax course would be expected to have better tax knowledge and tax compliance attitude in a comparison with taxpayers who have never attended a tax course (Mohd, 2010). Highlighted that tax authority need to emphasize teaching tax courses because of impact of education on compliance.

Under the direct assessment, it is assumed that individual taxpayers might not possess the sufficient knowledge to compute their tax payable but in SAS, tax knowledge is vital as an insufficient level of tax knowledge may result in inaccurate tax returns and therefore computations of tax liability argue that lack of appropriate tax knowledge may lead to unintentional noncompliance behavior. In Ethiopia, affecting factors of voluntary tax compliance behavior in self-assessment system are not well understood. Therefore, the output of this study may help to understand the reason why taxpayers are not willing to be compliant for their tax obligation and take corrective measures in order to enhance domestic revenue mobilization through taxpayer's voluntary compliance and sustain Ethiopia's recent growth. Hence, the hypothesis formulated as follow.

- H3: Tax knowledge of taxpayers positively and significantly affect their tax compliance level.

2.14. TRUST AND POWER AND TAX COMPLIANCE

Trust and power not only determine the amount of tax payments but are also interrelated in so far as a change of one factor can affect the second parameter (Kirchler 2007; Kirchler, Hoelzl, and Wahl 2008). If we convert the government strategies, fines for illegal tax actions are enhanced. On the one hand, honest taxpayers could detect this amendment in influence as a sign that untrue taxpayers will be penalized with respectable cause.

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

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

In a synergistic climate, increased power is perceived as legitimate, whereas the same increase is perceived as coercive antagonistic climate. Accordingly, Falk and Kosfeld (2004) found that taxpayers' attitudes towards authorities and social norms shape the effect of increased audit probabilities on tax compliance. Falk and Kosfeld (2004) found that being controlled and thus feeling distrusted reduces trust and consequently cooperation. An opposing effect is possible, however, as governments lacking real power are scarcely trusted by citizens. In this case, them is sing implementation of lying tax payers could undermine a synergistic environment and honest taxpayers could start to disbelief the authorities. Subsequently, authorities need to exert power in an appropriate way in order to be judged as acting fairly and serving the community by enforcing

cooperation from evading taxpayers (Lavoie 2008). (Richardson2008) found that trust and legal enforcement strategies were connected with lower tax evasion in different countries .In such a situation, a robust synergistic climate is perceived, by the authorities and by the taxpayers, which could lead to tax payments at the highest stage. Therefore the final hypothesis postulated as follow.

- H4: Trust and power of tax administration positively and significantly influence tax compliance

CHAPTER THREE

RESEARCH METHODOLOGY

Chapter three presents the methodological issues that are going to conduct this research, and offers an explanation for each stage. It involves the general research design, population of study, Sample size and sampling technique, Sources of data, methods of data analysis, model specification, Variable definition and measurements, validity and reliability and presentation.

3.1 Research Design

Both a descriptive and an explanatory research strategy were used in this study. While the primary goal of descriptive research is to describe the current situation, explanatory research designs are used to examine the relationships between variables (Kothari, 2004).

The research Provide your descriptive findings first, and then use inferential statistics to illustrate how the four independent factors and the dependent variable, tax compliance, are related.

The researcher employed a mixed study design to characterize the variables in order to meet the specified research objectives and provide insight into the issues at hand. The study uses both qualitative and quantitative research approach. The use of qualitative methods in research aids in the interpretation of the findings and the description of respondent-related factors.

Data is presented more effectively in tabular form and as numerical value with the use of a quantitative approach. In order to describe the tax compliance of Merkato NO.2/med/Taxpayers Branch office.

3.2 POPULATION OF THE STUDY

The medium taxpayers in Addis Ababa municipal Administration revenue Bureau Merkato number two branch office would be the target demographic for this study. When compared to large taxpayers, middle taxpayers have less experience in tax compliance. Small taxpayers do not practice tax compliance with bookkeeping.

The tax amount determined by the tax authority's declaration period. For the reasons listed above, the researcher favors medium taxpayers. Hence, the population estimate of around 7,000 would be appropriate. Since the law requires medium taxpayers to report their income or maintain books of account, the focus is on how these taxpayers are experiencing the self-assessment system (SAS) fully.

3.3. SAMPLE SIZE AND SAMPLING TECHNIQUE

There are high numbers of taxpayers in Addis Ababa City Administration revenue Bureau Merkato number 2. Medium Taxpayer's Branch Office. For this reasons, both purposive and convenience sampling systems employed for collecting data from taxpayers. The researcher purposively selected by taking into account risk level taxpayers which assigned by tax Branch based on not paying the proper amount of tax, not paying on time and declaring taxes during last days.

Then the researcher selected only 1240 taxpayers as population from the existed taxpayers in the branch based on the branch tax authority taxpayer's risk assessment department. This department assigns taxpayer's risk level with high, medium and low by considering their continuously behaviors and habitual actions. The higher the degree indicates that there is a problem of tax compliance.

According to the records on March, 2022 of the Addis Ababa city Admiration revenue Bureau Merkato no 2 medium taxpayers branch office risk assessment department , there are around 1240 high degree risk taxpayer's in this branch convenience sampling technique used in order to randomly select higher risk tax payers. Simplified formula to calculate sample sizes (Wooldridge, 2012).

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

$$n= \frac{N}{1+ Ne^2}$$

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

$$n = 1240/1+1240 (0.05*0.05) = 302$$

3.4. Source and tool of data collection

Both primary and secondary sources were used in the process of collecting data. Primary sources include such instruments as questionnaires. Secondary sources include documents analysis such as annual reports, research papers, journals, books, online resources and other relevant materials used to the study.

3.4.1 Questionnaire

Questionnaires were prepared based on the tax compliance, which indicate in different literatures. The questionnaires were prepared to see the performance of the paper. All questions are closed ended questions and in the first part, questions like the age, gender, marital states, educational background, years of experience in the business area.

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

3.5. METHODS OF DATA ANALYSIS

The analysis methods of this study was fully based on the information extracted from survey data collected using questionnaire. In order to address the objective of the study both a qualitative and quantitative methods were applied. After the necessary data collected from the primary and secondary sources, then, these data were presented using frequency tables, and percentages. Response collected through questionnaires from respondents was quantitatively analyzed and the result summarized and presented using various simple statistical tools including inferential statistics was employed to focus strictly on regression just to analyze which and how much the hypothesized repressors was related to determinant of level of tax compliance. The multiple regression technique was used to identify the determining factors of level of tax compliance. Below is the detailed model for specifying the model which is an important step in this research.

3.6. Model specification

Given economic theory and existing literature, the study used the level of tax compliance (dependent variable) and the factors that are considered as independent variables. The functional form of the regression equation is presented as:

Therefore, the general model:

Regression model: $Y = \alpha + \beta_1 (X_1) + \beta_2 (X_2) + \beta_3 (X_3) + \beta_4 (X_4) + \beta_5 (X_5) + + e$

X1: level of tax compliance, X2: fairness of tax system X3: Fines and penalty of tax compliance X4, Tax knowledge and education, X5: Trust and power of tax authority.

β_0 = the intercept term- constant which would be equal to the mean if all slope coefficients are 0.

β_1 , β_2 , β_3 , and β_4 are the coefficients associated with each independent (on the First, Second, Third and Fourth predictor) variable which measures the change in the mean value of Y, per unit change in their respective independent variables.

e= error term, for calculation purpose.

F-Test for the overall significance of the model also had undertaken to test if there was a linear relationship between all of the independent variables and the dependent variable. From the ANOVA output if the p value is less than 0.05, concluded that there is evidence that at least one independent variable affects the dependent variable.

3.7. Variable definition and measurements

Level of Tax compliance:- defined as tax compliance involves being aware of and observing the state, federal, and international tax laws and requirements set forth by government officials and other taxing authorities Girma, (2009). Tax compliance refers to taxpayers' decision to comply with tax laws and regulations by paying tax timely and accurately. These variables were focused on those taxpayers who have made any complaints to the office of the tax authority. The variable is qualitative in nature and measured by likert scale.

Fairness in tax: - to measure fairness in taxes are benefits received and ability to pay. According to the benefits received principle, those who receive or benefit from public services should pay for them. tax fairness perceptions when taxpayers are better educated and with a capacity to deal with complex tax laws. On the contrary however, highly educated taxpayers also have the capacity to exploit loopholes in tax laws to reduce their tax liabilities (lawan & Salisu, 2017, Engida & Baisa, 2014).

H1: Fairness in tax factor has a significant and positive effect on the level of tax compliance

Fines and penalty: - Tax penalties and fairness determine the standards of conduct that the law imposes on taxpayers to distinguish compliant taxpayers from non-compliant taxpayers. The idea of tax compliance in self-assessment system can consist only in the taxpayer making her best efforts to assess and report her correct tax liabilities (Doran, 2009).

H2: Penalty and fairness has a significant and positive effects on the level of tax compliance

Tax Knowledge: Explained as the taxpayer understanding toward the tax laws and regulations. It is the ability of the taxpayer to fully understand the tax law and compute his / her tax liability. It is an essential element in a voluntary compliance tax system (Ahmad Farhan et al, 2020, Saad, 2014).

H3: Tax knowledge has a significant and positive effect on the level of tax compliance

Trust and power tax authority: the results showed that as the taxpayers has more trust on the authorities; they do their role (filing compliance, reporting compliance and payment compliance) better. These results are in line with other researches (Mas'ud et al., 2014; Gobena & Van Dijke, 2015) identifying trust as the main component for explaining voluntary tax compliance. In general, the positive effect of trust on honest tax reporting as reported in the literature was confirmed (Bergman, 2002; Torgler, 2003; Murphy, 2004;Torgler & Schneider, 2005).

H4: Trust and power tax authority has a significant and positive effect on the level of tax compliance.

3.8. Validity and Reliability of Data

As reported by Hair et al. (2007) found that reliability implies the extent to which some variable or set of variables is consistent in what it is designed to measure. Reliability analysis to measure the consistency of a questionnaire. The validity and reliability of the measures must be assessed before using the data collection tool (Hair et al., 2003). Validity is about whether an instrument can measure accurately, while reliability refers to the consistency of the measurement. There are various methods of reliability testing; Cronbach's alpha is considered appropriate for this study. Cronbach's Alpha is the most common measure of reliability. To ensure the reliability of the measurement scales, Cronbach's alpha was used in the calculation. Where a higher value above 0.6 indicated the variables were reliable, while values above 0.9 were considered the most reliable, but anything below 0.6 was considered inconsistent with the reliability scales as per George & Mallery (2003)

3.9. ETHICAL CONSIDERATION

Regarding ethical consideration, an attempt was made to ensure all respondents to keep their identity and responses as confidential in order for all the information to be given in full confidence. The questionnaires were distributed based on willingness of each respondent. In addition, the purpose of the questionnaire was clearly indicated beforehand within questions. To ensure anonymity they were not required to write their names on the questionnaires. This ensures that the respondents are anonymous.

CHAPTER FOUR

DATA ANALYSIS, PRESENTATION AND DISCUSSION

4.1 INTRODUCTION

Based on the established objectives and hypotheses that were presented in chapter one, this chapter presents the study's findings. The conceptual model outlined in chapter two is estimated as well as the studies variables are analyzed. A description and analysis of the data are given in the first two sections. Following that, a discussion of model estimation and result analysis takes place. Finally, some final thoughts have been prepared. An explanation of the dependent and independent variables is included in the data description, as well as a discussion of the data's sources. Computed analysis of the data was done, and tables with the results were shown. Additionally, hypotheses are tested; based on the p values, the study will either accept or reject the hypotheses.

4.2. RESPONDENTS DEMOGRAPHIC INFORMATION

Demographic information describes the characteristics of the sample size's components: As a result, the researcher must determine the general information about the respondents, which serves as the foundation for the analyses.

Table 4.1 Demographic Information and year of experience

		Frequency	Percent
Gender	Male	181	60
	Female	121	39.9
	Total	302	100
Age	20-30	79	26.1
	31-40	60	19.9
	41-50	71	23.5
	51-60	91	30.1
	Above60	1	0.3
	Total	302	100
Highest Academic Qualification	High school	88	29.1
	Certificate/Diploma	70	23.1
	Degree/Professional	121	40

	MSC	18	6.0
	Ph.D.	2	0.7
	OTHER	3	0.99
	Total	302	100
years in experience	Range	Frequency	Percent
	0-5	118	39
	6-10	115	38
	11-20	34	11.2
	Over 20	35	11.6
	Total	302	100

The respondents' gender was looked at using demographic factor one. To determine whether the respondents were male or female, the researcher needed to know this information. Among the respondents, sixty percent (60%) were men and thirty-nine and nine percent (39.9%) were women. Males participate in the tax system at a higher rate than females, according to gender research. Nevertheless, men still make up the majority of women participating in outside activities that are not related to the home. The demographic component shows the respondents' age ranges: 26.1% are between the ages of 20 and 30; 19.9 % are between the ages of 31 and 40; and 23.5 % are between the ages of 41 and 50. 30.1% of respondents are between the ages of 51 and 60, while 3% are over the age of 60. This outcome shows that the majority of taxpayers are typically older than 40. This indicates that the majority of taxpayers are at an appropriate age to rationalize and assess how taxes affect the economies of their countries. As a result, the majority of respondents are taxpayers who are able to work at the appropriate level.

The demographic component looks at the respondents' academic backgrounds. The data is required in order to help the researcher determine if the respondents are educated or illiterate. Table 4.1 following statistically displays information regarding the respondents' academic backgrounds. It represents the respondents' scholastic backgrounds. Twenty-nine point one and four percent (29.1%) of the population holds a high school education . twenty-three and one percent (23.1%) hold a certificate or diploma, forty percent (40%) have a degree or professional designation, and six percent (6%) have a master's degree, zero point seven percent (0.7%) have a doctorate, and zero point nine percent (0.9%) have other education. Other education mean, having technical school education. The results show that most respondents in the study area have a good education level. How well-educated a taxpayer is has a big impact on how well-informed

they are about taxes and how they affect the economy. The degree of education possessed by the person may affect how well taxes are filed.

According to research findings about year of experience of the respondents are, the majority of they have been in business for between 0 and 5 years (39%), followed by businesses that have been around for between 6 and 10 years (38.0%), and those that have been around for more than 20 years (11.6%). This shows that the sample businesses have sufficient expertise handling tax-related problems. This suggests that a corporation with extensive business expertise should have a thorough understanding of tax compliance and its regulations. This also shows that the organization has a lot of experience and growing sales every year. As a result, compliance was lower for businesses with higher yearly sales turnover. This is because the frequent and vast volume of business conducted by larger companies can occasionally become unmanageable.

Additionally, it is revealed that intentional falsification is carried out with the aim of reducing tax liability.

4.3. TAX CHARACTERISTICS

Respondents were questioned about tax-related characteristics. Respondents demonstrate having taken a formal tax course offered by a government agency or other organization. 53.5% of people (or 53%) had not attended the authority training. However, 46.7% (46.7%) of those who have taken a taxation course. Only forty-five point nine percent (45.9%) of respondents have ever had an audit, while the majority of respondents, 54.1%, have never had one. Regarding with the authority training indicates that customer service has not carried out its responsibilities. Lack of training suggests that taxpayers are unaware of the importance of tax compliance in a reliable and pertinent manner. The majority of taxpayers have reportedly dealt with auditing processes, according to the authority auditing response. This procedure signifies that the taxpayers knows their tax compliance level.

4.2 Tax characteristics

	Item	Frequency	Percent
Authority training	yes	141	46.7
	No	161	53.5
	Total	302	100
Authority auditing	yes	138	45.7
	No	164	54.3
	Total	302	100

4.4. DESCRIPTIVE RESULTS

4.4.1. TAX COMPLIANCE LEVEL

In the selected sample of respondents, less than half only filed their tax returns on time, according to Table 4.4 (mean: 1.98). However, they paid the correct amount of taxes for their branch (mean=2.27) as opposed to returning on time. In comparison to returning on time, paying on time (mean=2.05) is likewise preferable. The aggregate mean for tax compliance is generally (2.17), meaning that more than half of the respondents are willing to fulfill their tax obligations. In contrast, it claims that 50% of taxpayers do not care to pay their taxes in a timely manner or in the appropriate amount. Taxes are the primary source of income for underdeveloped nations like Ethiopia (Eshtu, 1987). Therefore, the researcher's conclusion that there is a problem with tax compliance among taxpayers is supported by the fact that over half of the respondents do not carry out their responsibilities. In order to achieve the aforementioned results of compliance, it is also necessary to construct and maintain current accounts for taxpayers, as well as management information systems that cover all final taxpayers using the tax system. There could be a variety of causes for the branch office's tax compliance issues with the chosen Merkato medium taxpayer's branch office. The functions of taxes are not sufficiently and deeply understood by the taxpayers. Most people are still unaware that the tax they paid would provide them with services. They failed to take into account the infrastructure they needed for daily activities, the ongoing tranquility around their homes and places of employment, or the relationship between their political ideologies and their obligations. In addition, the aforementioned results of compliance requires establishing and maintaining current accounts of taxpayers, management information systems covering the final taxpayers participating in the tax system, as well as appropriate and

prompt procedures. There could be different possible reasons for the problem of tax compliance in the selected Merkato medium taxpayer's branch office. The taxpayers have not sufficient and deep understanding about the functions of tax. Most taxpayers have not recognized yet the tax which they paid would give them service as services. They do not considered their sustainably peace around their resident and working place, the infrastructure they used for their daily activities, they related their duties with their political ideology. Taxpayers typically have a negative attitude toward taxes, are unaware of their obligations and requirements, and have received insufficient education regarding the criminal nature of taxes and their effects.

In their conclusions, scholars who have studied tax compliance, such as (Akalu, 2016), (Goitom and Taddesse, 2014), (Joseph, 2003), and (Rawling, 2003), have found that there is a lower degree of compliance.

Table 4.3. Tax Compliance level and taxpayers' responsibility

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

4.4.2. PERCEIVED FAIRNESS TAX SYSTEM

Respondents indicate on censuses that they are unsure about how readily they comprehend the tax system when it comes to results on perceived fairness of the tax system (mean=1.71). Additionally, respondents questioned the tax authority's fair impartiality (mean: 1.83). Additionally, respondents are quite skeptical about how fair the tax rate is (1.93). The taxpayers' image of the tax system has been negatively impacted by the circular that was shifted from the higher level tax authority officers to the branch division. (1.95). additionally, they had doubts about their chances of being discovered by the taxpayers' perceived stress from the unfairness of the tax system (mean: 1.84). For tax-related matters, the tax proclamation serves as the law. All rules, guidelines, and circulars must be taken directly from the proclamation. As a result, the taxpayers' view of the announcement regarding an equitable tax system is negative (mean=1.91).

Regarding the importance of a perceived fair system, the taxpayers were dissatisfied with the efforts made by the tax authority to motivate them. The average taxpayer's opinion of the tax authority and the tax system is negative (mean=1.90), while the average taxpayer's perception of the fairness of the tax system is lower (mean=1.85). This shows that taxpayers do not have a favorable opinion of the tax system. As a result, they can decide to support tax avoidance and evasion.

Table 4.4. Perceived fairness tax system

	Mean	Std. Deviation	Maxi.	Mini.
Tax system is easy to understood	1.71	1.463	0.092	-1.553
Tax system is fair and neutral	1.83	1.474	0.024	-1.537
The tax rate is fair	1.93	1.462	-0.084	-1.514
Tax system is circular	1.95	1.484	-0.032	-1.459
Tax system cause stress	1.84	1.460	0.048	-1.490
Tax proclamation are clearly and easily available	1.91	1.439	-0.061	-1.475
Tax system is at vital level	1.85	1.502	0.061	-1.430
I clearly understand the tax system	1.90	0.996	0.368	-0.505

4.4.3. TAXPAYERS TAX KNOWLEDGE AND EDUCATION

The interviewees were also questioned about their knowledge and education of taxes. According to the results of the data collection, respondents should be aware of how to inform the tax authority of the actual tax due (mean=1.77). Additionally, the respondents feel confident in their ability to maintain financial records and documentation for the revenue authorities (mean=1.85). Additionally, tax payers are aware that they must pay tax within the allotted time frame starting from the date of issuance (mean: 2.00); additionally, respondents appear to comprehend whether income should be included or excluded in calculating taxable income (mean: 2.07). Taxpayers have not received enough tax-related education from the tax authority or continued it (mean=2.02). In addition, tax authorities' instruction aids in taxpayers' accurate bookkeeping. Furthermore, safeguard them against tax, interest, and penalties that may result from bad luck

(mean: 1.76). In general, tax knowledge and education have a significant impact on the tax activity to follow the duties of taxpayers. (Mean=1.82). The outcome suggests that, in terms of tax knowledge and education, the respondent did not give the tax authorities enough consideration or awareness at the appropriate moment. The mean falls short of the average.

Table 4.5. Tax knowledge and Education

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

4.4.4. FINES AND PENALTIES

About the findings regarding fines and penalties, respondents agreed that the penalty rates are reasonable and can be paid without raising an objection (mean=2.00). Taxpayers believe that the penalty is smaller than their tax (mean=2.13), and serious enforcement and penalty by authority make them more conscious to declare all my duties on time and property (mean=2.13). The fine and penalty enforcement appears to be very poor (mean=1.84). Taxpayers typically experience a strong impact from the fines and penalty system on their tax compliance (Mean = 2.10) and support fine and penalty has a considerable impact on tax compliance (Mean = 2.09). This means that a taxpayer will incur a fine and a penalty if they don't pay their taxes on time or in full. The mean is already about average. The taxpayers have problems with the fines and penalties. This encourages the researcher to think about the fine and punishment as separate variables, which is more appealing.

Table 4.6. Fines and Penalties

Item	Mean	Std. Deviation	Maxi.	Mini.
The penalty rates are affordable and can pay the Penalty without any complain.	2.00	1.397	-0.154	-1.320
The enforcement seems very poor	1.84	1.472	0.059	-1.461
I believe that the penalty is lower than my tax	2.13	1.392	-0.099	-1.254
Serious enforcement and penalty by authority makes me more conscious to declare all my duties on time	2.13	1.378	-0.133	-1.171
I support fine and penalty has great impact on tax compliance	2.09	1.434	-0.135	-1.333
Over all	2.10	1.173	-0.064	-0.961

4.4.5. TRUST AND POWER OF TAX AUTHORITY

The results of the study on power and trust reveal that respondents had little faith in the ability of the government to exercise its powers as required by law (mean: 1.88). The tax authority's power, as it is currently exercised, is not well received by taxpayers. (Mean=2.12). A mean of 1.99 indicates that there is not much confidence between taxpayers and the tax office. The tax authority officials use their powers to seek bribes or other forms of inducement (mean: 1.91). The tax authority does exercise its authority and take actions that may have an impact on the taxpayer's business (mean: 1.80). The trust and power of the tax authorities generally have an impact on making the taxpayers more honest and accountable to their tax obligations. (Mean =2.01). This suggests that the taxpayers have serious reservations about the tax authority's behavior as a government agency and the authority it wields. Because of this, the research takes authority and trust into account as independent factors.

Table 4.7. Trust and power tax authority

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

4.5. CORRELATION STATISTICS

The results regarding this were summarized and presented in table 4.9. Pearson Correlations results in table 4.8 showed that tax perceived fairness for tax system was positively and significantly correlated to tax compliance level ($r=0.483, p<0.05$). Thus perceived fairness tax system had 48.3% positive significance relationship with tax compliance level. Tax knowledge and education was the second component to be positively related with tax compliance level ($r=0.493, p<0.05$) an indication that tax knowledge and education had 49% significant positive significance relationship with tax compliance. tax fines and penalties rate for tax evasion was significantly associated with tax compliance level as shown by ($r=.488, p<0.05$) implying that perceived opportunity for tax evasion had a 48.8% positive relationship with tax compliance level. Finally, trust and power of tax authority ($r=.388, p<0.05$). Therefore, trust and power had 38.8% positive significance relationship with tax compliance.

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

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

Table 4.8. Correlation Statistics

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

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

4.6. STASTICAL TEST ANALYSIS

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

Table 4.9. Normality test One-Sample Kolmogorov-Smirnov Test

	perceived fairness understand	tax knowledge and Education	penalty & fines rate	trust and power
N	302	302	302	302
Mean	1.90	1.82	2.10	2.01
Normal Parameters ^{a,b} Std. Deviation	.996	1.250	1.173	1.147
Most Extreme Absolute	.212	.162	.190	.186
Differences Positive	.212	.162	.173	.167
Negative	-.145	-.149	-.190	-.186
Kolmogorov-Smirnov Z	8.694	.600	9.314	8.231
Asymp. Sig. (2-tailed)	.480	.740	.125	.270

a. Test distribution is Normal.

b. Calculated from data.

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

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

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

Table 4.10 Multicollinearity Coefficients

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

Multicollinearity test done to avoid habits in the decision making process regarding the partial effect on independent variables on the dependent variable. Good regression model should not happen correlation between the independent variables or not happen multicollinearity. Test Multicollinearity as a basis the VIF value of multicollinearity test results Using SPSS. Making Process in Multicollinearity Test 1. If the VIF value lies between 1-10, then there is no multicollinearity 2. If the VIF <1 or > 10, Then there is multicollinearity Based on the coefficients output collinearity statistics obtained VIF of Perceived fairness understand is 1.719, the tax knowledge announce of VIF is 1.723, The Penalty and Fines rate of VIF is 1.434 and The VIF of Trust and Powerful is 1.286. All the VIF value obtained is between 1to10. It can be concluded that there is not multicollinearity symptoms.

HETEROSKEDASTICITY TEST

Breusch-Pagan and Koenker test statistics and sig-values:-This is the basis of the Breusch–Pagan test. It is a chi-squared test: the test statistic is distributed $n\chi^2$ with k degrees of freedom. If the test statistic has a p-value below an appropriate threshold (e.g. $p < 0.05$) then the null hypothesis of homoscedasticity is rejected and heteroskedasticity assumed.

Table 4.11. Breusch-Pagan and Koenker test

	LM	Sig
BP	28.944	.000
Koenker	32.267	.000

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

The existence of heteroscedasticity is a major concern in regression analysis and the analysis of variance, as it invalidates statistical tests of significance that assume that the modelling errors all have the same variance..

4.7. REGRESSION RESULT

In the research, the amount of tax compliance was predicted using a linear regression model. The prediction was made based on how four separate factors perceived fairness of the tax system, tax knowledge and education, tax fines and penalties, and trust in and control over the tax system would have an impact on the outcome. As a result, the study produced a model summary. The ANOVAs for the effect sizes and the regression model are shown in tables 4.12 and 4.13, respectively. The results showed that was 0.608, which meant that the model predicted more than 60% of the change in the independent variable. This Relationship was significant considering the coefficient of determination value of 0.370. The model was adequate in this case as indicated by the Durbin-Watson statistic value of 2.286 which is in the range of 2 to 3.

Table 4.12. Model summary

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

Table 4.13's ANOVA model demonstrated that the regression model was also suitable. The residual mean sum of squares was demonstrated to contribute to a regression model with an

effect size of above 4. The F-ratio for the four components was 43.767. With a p-value of 0.000, this was significant and showed the regression model's effect size.

Table 4.13: ANOVA Model

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

Dependent Variable: Tax compliance level

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

4.14. Coefficients model

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

Predictors: (Constant), trust and powerful, penalty & fines rate, perceived fairness understand, tax Knowledge announces.

For Merkato number two medium taxpayers, the predictor variables (F=43.767, p<0.05) explained 38.2% of the variation in their non-compliance behavior. The four independent variables perceived fairness of tax systems, tax knowledge and education, penalties and fines, and faith in and control over the tax authority were discovered to be important contributors to tax non-compliance behavior.

The predictors included the belief that tax systems are fair ($t=2.828$, $p<0.05$), tax knowledge education ($t=3.486$, $p<0.05$), penalties and fines ($t=4.550$, $p<0.05$), and trust and authority in the tax authority ($t=2.844$, $p<0.05$).

The regression results in table 4.14. Show that each of the predicted parameters in relation to the independent factors were significant; $\beta_1=0.151$ ($p\text{-value}=0.004$ which is less than $\alpha=0.05$) which implies that we reject the null hypothesis stating that there is no significant relationship between trust and power of tax authority and tax compliance level. This indicates that for each unit increase in the negative effect of trust and power of tax authority, there is 0.151 units decrease on tax compliance level. Furthermore, the effect of trust and power was stated by the t-test value= 2.940 which implies that the standard error associated with the parameter is less than the effect of the parameter.

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

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

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

4.8. DISCUSSION OF THE FINDINGS

According to Hypothesis 1, the perceived fairness of a system has little effect on tax compliance. Therefore, perceived likelihood of a thought to be fair tax system was associated with tax compliance (coefficient estimates $4=0.215$, p value= 0.004), contradicting the assumption. The findings indicate that how tax payers self-report their income may be influenced by their perceptions of the fairness of the tax system. There were further research that supported the conclusions of this one, such as (Mukasa, 2010) and (Munyentuali Gadi, 2004).

Hypothesis 2 claims that the amount of penalties and fines has no appreciable impact on tax compliance. The hypothesis coefficient estimates (0.269 , value= 0.000) do not match the research findings. A high rate of penalties and fines has a significant impact on tax compliance. The conclusion is that businesses who have been subjected to severe fines or penalties are unwilling to fulfill their tax obligations on their own. In terms of fines and penalties, the earlier research, such as that by Joseph (1980), Akalu (2016), and (Rawling, 2013).

According to **Hypothesis3**, tax compliance is not much impacted by tax knowledge or education. Since fines and penalties have a coefficient estimate of $3=0.213$ and a p value of 0.001 , the research findings do not support hypothesis 3, and this conclusion is supported by the data. Higher penalties just discourage people from learning about taxes and educating them selves, which boosts the degree of tax compliance. These results are backed by earlier research from (Joseph, 2003) and (Akalu, 2016), which showed that tax compliance could benefit from having a better understanding of taxes. However, according to a different study (Goitom and Taddesse, 2014), knowledge of taxes and education do not affect tax compliance.

According to Hypothesis 4, which states that trust and power in the tax authority have no appreciable impact on the level of tax compliance, research results showed that trust and power did, in fact, have an impact on tax compliance level (coefficient estimate ($1 =0.165$, p value= 0.004)). The tax authorities are interested in simplifying the tax laws in order to avoid a situation where there is a high level of trust and power that reduces the competitiveness of the nation in terms of taxation attractiveness. Additionally, research indicated that it had an impact on tax compliance. The previous study also shared the result carried out in this study. The studies are; (wahl, kastlunger and kircheler, 2010) and (Munyentuali Gadi, 2004).

CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSION AND RECCOMENDATIONS

5.1 INTRODUCTION

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

5.2 SUMMARY OF FINDINGS

According to the results of the gender study, there were more males than women among the respondents, indicating that more men tax payers than women are employed in branch offices.

The majority of respondents were also found to be between the ages of 50 and 60, and it was revealed that most of them were fairly educated, with those with a diploma making up the highest percentage and those with an undergraduate degree confirming that the respondents had moderate levels of literacy.

Most of the participants in the study on tax compliance levels have work experience ranging from 0 to 5 years. A formal tax course that was sponsored by a government agency or other institution was taken by 56.2% of respondents, compared to 46.5% of those who had never taken a tax course.

The majority of tax payer event respondents 54.1% have never had their accounts audited, compared to 45.9% who have and the remaining 45.1% have never had their accounts examined. According to the survey, there is low tax payer compliance overall. Therefore, in order to effectively monitor this group of taxpayers and increase compliance levels, the government and tax authorities need to develop tactics.

The study found that the majority of respondents overstated their deductions while underreporting their income. When the effects of trust and authority were looked at, it was discovered that there was a strong positive correlation, showing that trust and authority have a

major impact on the degree of tax compliance. When trust and authority levels increase, tax compliance rates will therefore increase. The study also examined the relationship between tax compliance levels and tax knowledge, and the findings show a strong positive association between the two, indicating that greater tax knowledge will also result in greater levels of tax compliance.

An analysis of the impact of fines and penalties on tax compliance levels found a strong positive correlation between them. This suggests that increasing levels of tax compliance will be accomplished by using fines and penalties against tax offenders effectively and enforcing them.

5.3 CONCLUSION

The results of this study give clear proof that the cost of tax compliance contributes to tax compliance and give an idea of the size of this influence. The study's results provide sufficient evidence to draw the conclusion that high levels of tax compliance are correlated with the authority and trust of the taxing authority. The study offers some preliminary evidence that fines and penalties are essential for enhancing tax compliance.

The study's findings also suggested that tax compliance is significantly impacted by how fair people consider the tax system to be. This is due to the fact that opportunities to cheat regardless of whether participants had the intention to do so or not increased non-compliance.

The study's final finding is that tax education and knowledge significantly influence tax compliance. As a result, it makes sense for the tax system to increase awareness of the value of paying taxes and how to file tax returns.

5.4. RECOMMENDATIONS

- ❖ According to the findings of this study, trust and the ability to command respect have a significant impact on tax compliance. The results indicate that tax laws with weak authority and low trust are more likely to be followed. Because of this, the taxpayers are more likely to obey their obligations when there is greater confidence and proper use of power. The likelihood of tax evasion may not be increased by this.

- ❖ Based on the study there is solid support for the claim that penalties and fines have a significant impact on tax compliance. As a result, there should be fair thresholds for enacting penalties and taxes.
- ❖ Taxpayers will have the confidence to abide by the law since they will maintain accurate records for taxation in order to avoid fines and penalties. Moreover, tax education and understanding play a big role in tax compliance. In order to help taxpayers understand their rights and responsibilities as taxpayers, the tax system should increase taxpayer education programs in addition to providing clear and straightforward instructions on how to complete tax forms.
- ❖ The tax system should target people at all income levels to collect taxes in order to deter tax evasion because perceived fairness has a big impact on tax compliance.
- ❖ All taxpayers should be able to show their loyalty to and affection for their nation by paying their taxes, according to tax systems.
- ❖ Tax compliance is a prerequisite for demonstrating what the public expects from their government in countries like Ethiopia where the budget is built on taxes collected from citizens.

5.5 FURTHER RESEARCH RECOMMENDATIONS

Future research should focus on expanding this study to include the entire nation. It is also possible to do research on the self-assessment system to determine whether it increases tax compliance rates. The study should also take into account how the state of the economy affects tax compliance.

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Appendix 1

Dear Respondents,

This research is entitled “Factors that affect Tax Compliance in Addis Ababa city Administration Revenue Bureau Merkato Number 2 Medium Taxpayers Branch Office” and Conducted in partial fulfillment of the requirements for the master’s degree in Business Administration at Saint Marry University under Dr. Misraku Molla supervision. Its main Objective is to identify and understand the factors of tax compliance in Merkato medium Taxpayers Branch Office. The research is carried out on your responses and other relevant Data that could support it. The concern of this questionnaire is to attain your observations and Opinions regarding various aspects of taxation. Your response will be used for academic purpose only. In order to achieve this research, you are kindly request to answer every question; your kind cooperation is highly appreciated.

I thank you very much in advance for your cooperation

Shimelis Desalegn

0911480562

Part I: Respondents General information

Please answer by putting a thick (✓) in box give for corresponding item.

1. Age group (in year): 20-30 31-40 41-50 more than 50 years

2. Sex: Male Female

3. Level of education: Below 12 grade certificate Diploma

Bachelor degree masters and above

4. Type of the business/unit: _____

5. Your status/position in the unit/business: _____

6. Year of experience in the specific office/units: _____

7. The number of years since your business start operation _____

8. Your business annual turnover (in birr):

Below 5 Million 5-10 million 11-15 million

16-20 million above 21 million

Part II: Tax compliance related questions

1. Have you attended any formal taxation course/training organized by Addis Ababa tax authority or any other tax authority?

Yes No

2. Have your business ever been audited by Merkato Branch Office?

Yes No

3. If 'Yes' how many times your business audited by the tax office? _____

4. Have your business ever been penalized by merkato No.2 Branch office?

Yes No

5. If 'Yes' what was the reason for penalty? (You can check more than one times)

- A. Because of not filing a tax return
- B. Because late filing of a tax return
- C. Under reporting income
- D. Over claiming deductions
- E. Other

6. Please rate your company **LEVEL OF TAX COMPLIANCE**

Tax compliance level indicators	Strongly disagree (1)	Disagree (2)	Not Certain (3)	Agree (4)	Strongly agree (5)
My company files its tax returns on Time					
My company pays tax liabilities on Time					

7. Please state your perception about the **FAIRNESS FOR TAX SYSTEM**

FAIRNESS FOR TAX SYSTEM	Strongly disagree (1)	Disagree (2)	Not Certain (3)	Agree (4)	Strongly agree (5)
Personally, I agree that the Ethiopian tax system is easy understood and consider the taxpayers.					
There is fair neutrality of the procedure, trustworthiness of the tax authorities and polite, honorable, and respectful treatment in tax authority					

Comparisons are made on the individual, the group, and the societal level among taxpayers					
A „fair“ tax rate which consider all the taxpayers ability are implemented in the Ethiopia tax system					
The tax proclamation ,regulations and directives are keeping their hierarchy and never collide each other					
The tax authority circular does not affect the fairness of the tax system					
The tax compliance requirement may have produced stress and anxiety to taxpayers. It may have psychological impact causes by the tax system					

8. Please express your level of **TAX KNOWLEDGE AND EDUCATION**

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

9. Please express your perception about tax **FINES AND PENALTIES**

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

10. Please rank your understanding about the **TRUST AND POWER OF TAX AUTHORITY**

TRUST AND POWER OF TAX AUTHORITY	Strongly disagree (1)	Disagree (2)	Not Certain (3)	Agree (4)	Strongly agree (5)
The tax authority use its power as the law prescribed					
Most of taxpayers have positive response towards the power of the tax authority					
The taxpayers and the tax authority have great trust each other					
the tax authority officers use their power for seeking any inducement or bribery					
I believe that the tax collector does not exercise and take actions, which affect my business.					

Thank You!

Appendix 2 : Map of Tax blocks/centers at Merkato Business Area

