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MSc IN ACCOUNTING AND FINANCE

FACTORS AFFECTING TAX COMPLIANCE BEHAVIOR OF SMALL TAX PAYERS: THE CASE OF NORTH WEST ADDIS ABABA BRANCH OFFICE

BY

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Table of Contents   Page no.

List of Tables

List of Figure

ABSTRACT

This study investigates the factors affecting tax compliance behavior among taxpayers. The research used a primary data collection approach with close-ended questionnaires and an explanatory research design, along with a quantitative research method. The data was analyzed using inferential statistics. The findings suggest a multifaceted approach is necessary to improve tax compliance. Tax knowledge emerged as the strongest factor, highlighting the need for investment in tax literacy initiatives. Educational workshops, online resources, and collaborations with educational institutions can equip taxpayers with the knowledge to understand their filing obligations and claim allowable deductions and credits. This can foster a culture of tax awareness from a young age. Perceived fairness and trust in the tax authority were also positively correlated with compliance. When taxpayers believe the tax system is fair and the tax authority is competent and operates with integrity, they are more likely to fulfill their obligations. Transparency in tax administration practices, including clear communication of tax codes and public disclosure of tax revenue allocation, is essential for building trust. The presence of fines and penalties was found to have a deterrent effect on non-compliance. However, it's important to balance deterrence with promoting trust and fairness. Overreliance on punitive measures can backfire, breeding resentment and distrust. The tax system should be designed in a way that compliance is the natural course of action, rather than something to be avoided out of fear of punishment. By investing in tax literacy, ensuring fairness and transparency, and implementing a balanced approach to enforcement, governments can empower taxpayers, reduce errors due to confusion, and ultimately, enhance tax compliance. The findings of this study provide valuable insights for policymakers and tax authorities to develop targeted strategies for improving tax compliance.

Keywords: Compliance Behavior, Tax Payers, Fairness, Knowledge, Penalties

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

The effective administration and enforcement of tax policies are essential for achieving revenue targets and ensuring a fair and equitable tax system (Taddese, 2014). Tax compliance is a critical aspect of any well-functioning tax system, as it ensures the collection of revenue necessary for government operations, public service delivery, and economic development (Bird, 2008). In Ethiopia, the tax system plays a vital role in financing various development initiatives and maintaining economic stability (Desta, 2017).

The Ministry of Revenues is the government body responsible for formulating and implementing tax policies, as well as managing tax collection and enforcement across the country (FDRE Ministry of Revenues, 2019). Within the Ministry, the North West Addis Ababa Small Tax Payers Branch Office focuses on tax compliance issues specifically related to small taxpayers. Small taxpayers constitute a significant portion of the taxpayer base and include individuals, microenterprises, and small businesses with relatively lower income or revenue levels (FDRE Ministry of Revenues, 2019).

Despite continuous efforts by the Ministry of Revenues to enhance tax compliance, there are persistent challenges in achieving full compliance among small taxpayers. Non-compliance can take various forms, such as underreporting income, evading taxes, or delaying tax payments. These behaviors not only lead to revenue shortfalls but also undermine the fairness and integrity of the tax system (Alm, McClelland, & Schulze, 1992). Understanding the factors that influence tax compliance behavior among small taxpayers is crucial for developing effective strategies to improve compliance rates and maximize revenue collection (James & Alley, 2002). By identifying the key drivers of compliance and addressing the underlying causes of non-compliance, tax authorities can design targeted interventions and implement policies that encourage voluntary tax compliance (James & Alley, 2002).

Therefore, this research aims to investigate the factors affecting tax compliance behavior within the specific context of the Ministry of Revenues North West Addis Ababa Small Tax

Payers Branch Office. By conducting a comprehensive analysis of these factors, the study intends to contribute to the existing body of knowledge on tax compliance and provide valuable insights for policymakers and tax authorities in Ethiopia (Melaku & Gebre, 2019).

1.2 Statement of the Problem

Despite continuous efforts by the Ministry of Revenues to enhance tax compliance among small taxpayers, there are persistent challenges in achieving full compliance within the North West Addis Ababa Small Tax Payers Branch Office. Non-compliance among small taxpayers can have significant implications for revenue collection and the overall effectiveness of the tax system (Alm, Jackson, & McKee, 1992).

One of the main problems is the presence of high levels of tax evasion and underreporting of income among small taxpayers. Studies have shown that small taxpayers are more likely to engage in non-compliant behaviors due to factors such as the perception of unfairness in the tax system, lack of trust in tax authorities, and limited knowledge of tax obligations (James & Alley, 2002; Torgler, 2004).

Furthermore, inadequate enforcement and monitoring mechanisms contribute to the problem of non-compliance among small taxpayers. Limited resources and capacity constraints within the North West Addis Ababa Small Tax Payers Branch Office may result in ineffective enforcement strategies, allowing non-compliant behaviors to persist (Melaku&Gebre, 2019).

The lack of tailored compliance assistance and taxpayer education programs specific to the needs of small taxpayers is another contributing factor. Small taxpayers may face challenges in understanding their tax obligations and may not have access to appropriate resources or guidance to fulfill their tax responsibilities (Sarfo, 2013).

Recent Ethiopian research sheds further light on the complexities of small taxpayer compliance. Ayalew (2023) found that limited access to professional accounting services due to financial constraints hinders compliance among small taxpayers in Addis Ababa. This highlights the need for targeted support programs that extend beyond basic tax education and equip small business owners with the practical tools needed to manage their finances and fulfill their tax obligations.

Furthermore, Assefa et al. (2018) emphasize the role of government expenditure in influencing compliance. When citizens perceive a direct link between tax revenue and improved public services, they are more likely to comply. This suggests that the North West Addis Ababa Small Tax Payers Branch Office could benefit from initiatives that address the unique challenges of small taxpayers and foster a sense of trust and reciprocity between taxpayers and the government. For instance, the branch office could collaborate with local businesses to conduct outreach programs that explain how tax revenue is allocated and used for public services that directly benefit their communities. Additionally, implementing transparent and efficient tax administration processes can further enhance perceptions of fairness and encourage voluntary compliance.

The repercussions of low tax compliance among small taxpayers are far-reaching. It leads to revenue shortfalls, hampers economic development, and undermines the fairness and integrity of the tax system. Therefore, it is imperative to understand the factors contributing to non-compliance among small taxpayers within the North West Addis Ababa Small Tax Payers Branch Office and devise effective strategies to address these issues (Bird, 2008; Desta, 2017). In light of these challenges, this research aims to identify the key factors influencing tax compliance behavior among small taxpayers and propose measures to enhance compliance within the specified branch office. By addressing the underlying causes of non-compliance, this study seeks to contribute to the improvement of tax compliance rates and revenue collection in the North West Addis Ababa Small Tax Payers Branch Office.

1.3 Research Questions

The research questions emphasis on the tax system and tax legislation of the Ministry of Revenues North West Addis Ababa Small Tax Payers Branch Office. The goal is to address whether the tax system and regulations of the authority contribute to non-compliance behavior. Furthermore, the study inspects the impact of continuous tax training provided by the tax authority on educating tax compliance behavior. The research also examines the positive or negative effects of fines and penalties on tax compliance behavior. Furthermore, it seeks to determine whether trust in and the power of the tax authority contribute to non-compliance behavior. The main research question is to identify the factors that affect the tax compliance behavior of taxpayers in Ethiopia. Specifically, the study aims to answer the following four main research questions:

1. How does the supposed fairness of the tax system affect tax compliance behavior?

2. How does tax knowledge and education affect tax compliance behavior?

3. How do fines and penalties disappoint compliance behavior?

4. How does the trust in and power of taxpayers add to compliance behavior?

1.4 Research Objectives

1.4.1 General Objective

The general objective of this study are to identify the factors influencing tax compliance behavior among small taxpayers in the North West Addis Ababa Small Tax Payers Branch Office and to recommend strategies for improving tax compliance in this framework.

1.4.2 Specific Objectives

This study addressed the following specific objectives which are draw from the general objective.

- Determine the impact of perceived fairness of the tax system on tax compliance levels.
- Examine the relationship between tax knowledge and tax compliance levels.
- Investigate the effect of fines and penalties on tax compliance levels.
- Evaluate the level of trust and perception of power towards the tax administration and its influence on tax compliance levels.

1.5 Research Hypotheses

This study empirically tested the following hypotheses,

- **H1:** Perceived fairness for tax system has a positive and significant effect on tax compliance behavior.
- **H2:** Tax knowledge has a positive and significant effect on tax compliance behavior.
- **H3:** Tax fines and penalties have a positive and significant effect on tax compliance behavior.
- **H4:** Trust and power of tax authority has a positive and significant effect on tax compliance behavior.

1.6 Significance of the study

The research titled holds significant importance in the field of tax compliance and has several implications for policymakers and tax authorities in Ethiopia. This study aims to investigate the factors influencing tax compliance behavior among small taxpayers within the specified branch office and contribute to the existing body of knowledge on this topic.

Understanding the factors that influence tax compliance behavior is crucial for developing effective strategies to improve compliance rates and maximize revenue collection (James & Alley, 2002). By identifying the key drivers of compliance and addressing the underlying causes of non-compliance, tax authorities can design targeted interventions and implement policies that encourage voluntary tax compliance (Bird, 2008).

Moreover, this research is particularly relevant within the context of the Ministry of Revenues North West Addis Ababa Small Tax Payers Branch Office. By conducting a comprehensive analysis of the factors affecting tax compliance behavior in this specific setting, the study aims to provide valuable insights for policymakers and tax authorities in Ethiopia (Melaku&Gebre, 2019).

The findings of this research can have practical implications for tax administration and enforcement. By evaluating the effectiveness of enforcement mechanisms and monitoring strategies, policymakers and tax authorities can identify areas for improvement and develop more efficient and targeted approaches (Alm, Jackson, & McKee, 1992).

Additionally, the research will assess the availability and effectiveness of taxpayer education and compliance assistance programs tailored to the needs of small taxpayers. By identifying the challenges faced by small taxpayers in understanding and fulfilling their tax obligations, policymakers can develop educational resources and support systems to enhance compliance levels (Sarfo, 2013).

Furthermore, the study aims to examine the impact of socio-demographic factors on tax compliance behavior among small taxpayers. By understanding how factors such as age, gender, education, and income levels influence compliance, policymakers can develop strategies that consider the unique characteristics and circumstances of different taxpayer groups (Torgler, 2004).

In conclusion, the research on Factors Affecting Tax Compliance Behavior of Small Tax Payers: The case of North West Addis Ababa Branch Office is of great significance. Its outcomes can inform evidence-based decision-making, policy formulation, and the development of targeted interventions to enhance tax compliance rates, revenue collection, and the fairness and integrity of the tax system in Ethiopia.

1.7 Scope of the study

The study on tax compliance behavior among small taxpayers in the North West Addis Ababa Small Tax Payers Branch Office embraces significant importance for various stakeholders. The findings of this research will contribute to policy and decision-making processes by providing valuable insights for policymakers and tax authorities, enabling the formulation of effective strategies to enhance compliance levels and increase revenue collection. Additionally, the study will aid in the development of targeted interventions and initiatives to promote tax compliance, reduce tax evasion, and underreporting of income. By understanding the challenges faced by small taxpayers and improving resource allocation, the study will benefit both tax authorities and small taxpayers themselves. Furthermore, the research addresses a specific research gap, providing context-specific insights and contributing to the existing knowledge on tax compliance.

1.8 Limitations of the study

The study on tax compliance behavior among small taxpayers in the North West Addis Ababa Small Tax Payers Branch Office has several limitations that should be considered. Firstly, the sample size and representativeness of participants may restrict the generalizability of findings, as the study may focus on a limited number of small taxpayers in a specific geographical area. Secondly, reliance on self-reported data may introduce biases and inaccuracies, as participants' responses may not fully reflect their actual behavior. Additionally, recall and social desirability biases could affect the accuracy of participants' responses. Moreover, the study's findings may have limited generalizability beyond the specific context of the North West Addis Ababa Small Tax Payers Branch Office due to unique regional characteristics. The cross-sectional design limits the establishment of causality and directionality, calling for longitudinal or experimental designs. Lastly, time and resource constraints may narrow the scope of data collection and analysis.

1.9 Definition of operational terms

In the study on tax compliance behavior among small taxpayers in the North West Addis Ababa Small Tax Payers Branch Office, several operational terms are defined for clarity.

- Tax compliance behavior refers to the actions and behaviors of small taxpayers in meeting their tax obligations (Andreoni, Erard, & Feinstein, 1998).
- Tax knowledge represents the level of understanding small taxpayers have regarding tax laws and regulations (Alm, Jackson, & McKee, 1993).
- Perceived fairness relates to the subjective evaluation of small taxpayers regarding the equity and fairness of the tax system (Kirchler, Hoelzl, & Wahl, 2008).
- Trust in tax authorities reflects the confidence and reliance small taxpayers have in the integrity and effectiveness of the tax administration (Braithwaite & Wenzel, 2008).
- Tax evasion and underreporting of income refer to intentional acts to evade or minimize tax liabilities (Pommerehne&Weck-Hannemann, 1996).

- The effectiveness of enforcement and monitoring mechanisms gauges the efficiency of measures implemented by tax authorities to detect and address non-compliance (Torgler, 2007).
- Taxpayer education and compliance assistance programs encompass initiatives and resources provided to help small taxpayers understand and adhere to their tax obligations (James & Alley, 2002).

1.10 Organization of the paper

The paper on tax compliance behavior among small taxpayers in the North West Addis Ababa Small Tax Payers Branch Office is organized as follows: The introduction provides the background and significance of the study, states the research objectives and questions, and gives an overview of the paper's organization. The literature review presents a comprehensive analysis of existing literature on tax compliance behavior, including relevant theories, concepts, and studies related to tax compliance among small taxpayers, and identifies research gaps. The methodology section outlines the research design, data collection methods, sampling strategy, ethical considerations, and data analysis techniques. Operational definitions are provided for key terms used in the study. The results section presents and analyzes the collected data, highlighting findings related to tax compliance behavior and factors influencing compliance. The discussion section interprets the results, compares them with existing literature, discusses implications for tax policy and administration, acknowledges study limitations, and suggests future research directions. The conclusion summarizes the main findings, contributions to the field, policy implications, and offers final remarks. The references section lists all cited sources, and appendices (if applicable) include additional supporting materials.

CHAPTER TWO

REVIEW OF RELATED LITERATURE

2.1 Theoretical Review

In the review of conceptual literature, this section provides an in-depth analysis of key concepts and definitions relevant to tax compliance behavior among small taxpayers, specifically focusing on the Ministry of Revenues North West Addis Ababa Small Tax Payers Branch Office.

2.1.1. Concept and Definitions of Tax-Compliance and Tax-Compliance Behavior

Different definitions and measures of tax compliance are explored, including both legal and ethical dimensions (Allingham&Sandmo, 1972; Alm et al., 1992). The section also examines the concept of tax morale, which refers to the intrinsic motivation and willingness of taxpayers to comply with their tax obligations (Torgler, 2002), within the context of the Ministry of Revenues North West Addis Ababa Small Tax Payers Branch Office. Factors such as societal norms, perceptions of fairness, and trust in the tax system are discussed as influences on tax morale (Kirchler, 2007; Roth et al., 2012), specifically focusing on their impact on the tax compliance behavior of small taxpayers within this branch office.

Furthermore, the section addresses the distinction between tax evasion and tax avoidance. Tax evasion involves illegal acts to intentionally evade taxes, while tax avoidance refers to legal strategies used to minimize tax liabilities (Slemrod&Yitzhaki, 2002). The ethical considerations and implications of both practices are examined, including their impact on tax compliance behavior (Braithwaite, 2003), within the context of the Ministry of Revenues North West Addis Ababa Small Tax Payers Branch Office.

To provide a theoretical framework for understanding tax compliance behavior, various conceptual models and theories are discussed. The deterrence theory posits that the fear of penalties and detection acts as a deterrent to non-compliance (Becker, 1968; Andreoni et al., 1998), and its relevance to the tax compliance behavior of small taxpayers within the Ministry of Revenues North West Addis Ababa Small Tax Payers Branch Office is explored. The theory of planned behavior suggests that attitudes, subjective norms, and perceived behavioral control influence an individual's intention to comply with tax obligations (Ajzen, 1991), and its applicability to the tax compliance behavior of small taxpayers in this specific branch office is examined. The slippery slope framework explores the idea that small acts of non-compliance can lead to larger-scale tax evasion (Kirchler et al., 2008), and its relevance within the context of small taxpayers in the mentioned branch office is discussed.

Additionally, the section explores the role of factors such as tax knowledge, perceived fairness, trust in tax authorities, social norms, and psychological factors in shaping tax compliance behavior. It examines how these factors interact and influence taxpayers' decisions to comply or engage in non-compliant behavior (Alm et al., 1993; Feld & Frey, 2002; Wenzel, 2002; Torgler& Schneider, 2007), specifically within the Ministry of Revenues North West Addis Ababa Small Tax Payers Branch Office.

Overall, the review of conceptual literature provides a comprehensive understanding of the key concepts, definitions, and theoretical frameworks that underpin the study of tax compliance behavior among small taxpayers within the Ministry of Revenues North West Addis Ababa Small Tax Payers Branch Office. It lays the groundwork for the subsequent sections of the literature review, empirical research, and hypotheses development.

2.1.2. Underpinning Theories

In order to explore the factors affecting tax compliance behavior among small taxpayers at the Ministry of Revenues North West Addis Ababa Small Tax Payers Branch Office, it is crucial to establish a strong theoretical foundation. Underpinning theories provide the necessary conceptual frameworks to understand and analyze the complexities of tax compliance behavior in this specific context.

Various theoretical perspectives can be applied to investigate tax compliance behavior. The deterrence theory, for example, posits that the fear of penalties and detection acts as a deterrent to non-compliance (Becker, 1968; Andreoni et al., 1998). This theory may help explain the influence of enforcement measures and the perception of detection on compliance behavior among small taxpayers in the mentioned branch office.

Another relevant theoretical framework is the theory of planned behavior, which suggests that attitudes, subjective norms, and perceived behavioral control influence an individual's intention to comply with tax obligations (Ajzen, 1991). By examining the attitudes, social norms, and perceived control of small taxpayers at the Ministry of Revenues North West Addis Ababa Small Tax Payers Branch Office, this theory can provide insights into their compliance behavior.

Furthermore, the slippery slope framework explores the idea that small acts of non-compliance can lead to larger-scale tax evasion (Kirchler et al., 2008). This framework may be applicable to understanding how initial non-compliance behaviors among small taxpayers in the branch office can escalate and potentially undermine overall tax compliance.

Additionally, factors such as tax knowledge, perceived fairness, trust in tax authorities, social norms, and psychological factors have been identified as influential in shaping tax compliance behavior (Alm et al., 1993; Feld & Frey, 2002; Wenzel, 2002; Torgler& Schneider, 2007). Examining these factors within the specific context of the Ministry of Revenues North West Addis Ababa Small Tax Payers Branch Office can provide valuable insights into the compliance behavior of small taxpayers in that setting.

By drawing on and integrating these underpinning theories, this research aims to develop a comprehensive understanding of the factors affecting tax compliance behavior among small taxpayers at the Ministry of Revenues North West Addis Ababa Small Tax Payers Branch Office. The theoretical frameworks will inform the research design, data collection, analysis, and interpretation of the study outcomes.

2.2. Determinants of Tax compliance behavior and hypotheses development

2.2.1. Perceived Fairness for Tax-System and Tax Compliance Behavior

Perceived fairness is a critical factor influencing tax compliance behavior. Taxpayers who believe the tax system is fair are more likely to willingly pay their taxes and comply with regulations. This fairness perception has multiple dimensions. Vertical fairness ensures that those with greater ability to pay contribute a larger share of their income towards taxes. Horizontal fairness guarantees equal treatment for taxpayers in similar economic situations. For instance, two individuals with the same taxable income should pay roughly the same amount in taxes. Additionally, procedural fairness focuses on the clarity and ease of navigating the tax code. A complex and cumbersome tax filing process can discourage compliance. Finally, distributive fairness emphasizes the efficient and effective use of collected taxes for public services. Taxpayers are more likely to comply if they believe their contributions are being used responsibly to fund essential services and infrastructure that benefit everyone (Feld & Frey, 2002).

When taxpayers perceive the system as unfair, they may feel less obligated to comply. This can occur for several reasons. A feeling of unfairness can arise if the tax burden is seen as unevenly distributed, with wealthier individuals or corporations exploiting loopholes to minimize their tax liability. For instance, a complex web of deductions and credits might allow corporations to shift profits to countries with lower tax rates, reducing their overall tax burden. This can be particularly irksome to ordinary taxpayers who feel they are shouldering a disproportionate share of the tax burden. Similarly, a lack of transparency in tax administration can erode trust and lead to non-compliance. If taxpayers are unsure how their tax contributions are being used, or if they suspect that there is corruption or inefficiency within the tax authority, they may be less willing to comply. Public perception of tax havens and wealthy individuals who utilize them to avoid paying their fair share of taxes can further exacerbate feelings of unfairness. Finally, feelings of unfairness can be compounded by a complex tax code or bureaucratic hurdles that make filing taxes difficult or time-consuming. If taxpayers perceive the tax filing process to be overly complex or burdensome, they may be more likely to make mistakes or simply avoid filing altogether (Torgler& Schneider, 2007).

Low tax compliance translates to a significant loss of revenue for governments. This shortfall hinders their ability to fund essential public services like education, healthcare, and infrastructure. Reduced tax revenue creates a vicious cycle. When governments lack sufficient funds, they may be forced to raise tax rates on compliant taxpayers. This can further erode trust and exacerbate perceptions of unfairness, leading to even lower compliance rates. Additionally, governments may be forced to cut spending on programs that citizens rely on, such as schools, hospitals, and roads. These cuts can have a negative impact on the overall quality of life for citizens and hinder economic growth. In extreme cases, governments with severe revenue shortfalls may be forced to borrow heavily, which can lead to national debt and economic instability (Kirchler, 2007).

To address these issues, governments can take a multi-pronged approach to enhance perceptions of tax fairness. Simplifying the tax code by reducing the number of deductions and credits can make the system easier to understand and comply with for all taxpayers. Additionally, increasing transparency in tax administration by publishing clear and concise information on how tax revenue is collected and spent can rebuild trust with the public. Governments can also establish citizen oversight committees to monitor tax collection and allocation processes. Furthermore, ensuring efficient use of collected funds by investing in public services and infrastructure that demonstrably benefit all citizens can help taxpayers see the value of their contributions. Finally, fostering tax literacy through education programs empowers taxpayers to understand their obligations and navigate the system effectively. Educating citizens about the importance of tax compliance and how tax revenue is used can cultivate a sense of civic responsibility and encourage voluntary compliance.

While fairness is crucial, it's not the only factor influencing tax compliance. Economic factors also play a significant role. The certainty of getting caught and the severity of penalties for non-compliance can strongly influence taxpayer behavior. For instance, if taxpayers perceive a low risk of detection or believe that penalties for tax evasion are minimal, they may be more likely to engage in non-compliant behavior. Conversely, a strong likelihood of getting caught and facing significant penalties can act as a deterrent and encourage compliance. In addition to economic factors, cultural norms and social pressure also influence tax compliance. In societies with a strong emphasis on civic duty and contributing to the collective good, individuals are more likely to comply with tax laws, even if they perceive the tax system as somewhat unfair. Conversely, in societies where tax evasion is seen as a common practice or there is a weak sense of civic responsibility, tax compliance rates may be lower (Ajzen, 1991).

H1: Perceived fairness for tax system has a positive and significant effect on tax compliance behavior.

2.2.2. Tax Knowledge and Tax Compliance Behavior

Tax knowledge plays a vital role in shaping tax compliance behavior. Individuals with a strong understanding of tax laws, deductions, and filing procedures are more likely to comply with regulations and pay their fair share. This knowledge empowers them to accurately calculate their tax liability, claim eligible deductions and credits, and navigate the filing process efficiently. Conversely, a lack of tax knowledge can lead to confusion, errors, and ultimately, non-compliance. Taxpayers who don't understand their obligations may unintentionally underpay or overpay taxes, or miss out on potential benefits that can reduce their tax burden. For instance, someone unaware of the deductions they can claim for childcare expenses or student loan payments could end up paying more in taxes than necessary. Additionally, a lack of knowledge about filing procedures can lead to missed deadlines or incorrectly filed forms, potentially resulting in penalties and delays (Feld & Frey, 2002).

Understanding tax regulations fosters a sense of confidence and control in taxpayers. When individuals comprehend the tax system, they are better equipped to make informed decisions about their finances and tax planning strategies. This knowledge empowers them to manage their tax liabilities effectively and avoid penalties associated with non-compliance. Additionally, tax knowledge equips individuals to identify and seek professional help when needed, ensuring they navigate the complexities of the tax code accurately. Furthermore, a strong understanding of tax regulations allows individuals to proactively plan for future tax obligations. For instance, knowing about tax implications of retirement savings plans or investment opportunities can help taxpayers make informed choices that minimize their tax burden throughout their lives. Tax knowledge can also empower individuals to participate in discussions about tax policy changes and advocate for a fair and efficient tax system that benefits everyone (Torgler& Schneider, 2007).

Tax knowledge also plays a significant role in fostering trust in the tax system. When taxpayers understand their rights and obligations under the tax code, they are more likely to perceive the system as fair and transparent. This understanding reduces the perception that the tax code is overly complex or designed to benefit a select few. Furthermore, knowledge empowers individuals to hold tax authorities accountable. Taxpayers who understand the proper procedures and have access to clear information are better equipped to identify and report potential errors or instances of unfair treatment. This fosters a sense of trust that the tax system is being administered effectively and efficiently (Kirchler, 2007).

The onus doesn't solely fall on taxpayers to acquire tax knowledge. Governments and tax authorities have a responsibility to make tax information accessible and understandable. This can be achieved through a multi-pronged approach. Public education campaigns can utilize various communication channels, such as traditional media, social media platforms, and community outreach programs, to deliver clear and concise messages about tax filing requirements, deductions, and credits. These campaigns should be tailored to reach diverse audiences with varying levels of tax literacy. Additionally, user-friendly online resources can provide a central hub for tax information, including downloadable forms, interactive tutorials, and FAQs. Tax authorities should also invest in creating a knowledgeable and accessible workforce to provide assistance to taxpayers. This can involve establishing toll-free helplines staffed by trained professionals who can answer taxpayer questions and guide them through the filing process. Finally, collaboration with educational institutions can integrate basic tax literacy concepts into school curriculums, fostering a culture of tax awareness from a young age (Webster & Watson, 2002).

Tax knowledge needs vary depending on individual circumstances. Business owners and those with complex financial situations, such as individuals with significant investments or rental properties, require a deeper understanding of tax regulations specific to their situations (Webster & Watson, 2002). This may involve knowledge of corporate tax structures, depreciation schedules, capital gains taxes, and various tax deductions and credits applicable to business operations or investment activities. Online resources and seminars specifically designed for business owners can provide valuable guidance on these topics.

Individuals with simpler tax profiles, such as salaried employees with limited deductions or investments, may benefit most from basic information on filing procedures, common deductions and credits they can claim, and user-friendly tax calculators. Tax authorities can develop tiered educational resources that cater to these varying levels of complexity. For instance, short online tutorials or info-graphics can explain basic tax filing procedures, while more comprehensive guides can delve deeper into specific deductions and credits. Interactive tax calculators can further empower these taxpayers by allowing them to estimate their tax liability and identify potential filing errors (Ajzen, 1991).

Investing in tax knowledge benefits both taxpayers and governments. Increased compliance leads to higher tax revenue for governments, enabling them to fund essential public services and infrastructure projects. For taxpayers, understanding the tax system empowers them to make informed financial decisions, avoid penalties, and potentially claim valuable tax benefits. By working together to bridge the knowledge gap, governments and taxpayers can create a more efficient and fair tax system for everyone (Webster & Watson, 2002).

H2: Tax knowledge has a positive and significant effect on tax compliance behavior.

2.2.3. Tax Fines and Penalties and Tax Compliance Behavior

Tax fines and penalties can act as a powerful deterrent to non-compliance, influencing tax compliance behavior in several ways. The threat of significant financial consequences for failing to meet tax obligations can discourage individuals and businesses from evading taxes or filing inaccurate returns. This deterrence effect is particularly strong when the likelihood of getting caught and the severity of penalties are perceived to be high. For instance, hefty fines coupled with potential criminal charges for deliberate tax evasion can significantly discourage such behavior. The fear of being audited and facing financial repercussions can incentivize taxpayers to maintain accurate records, file returns on time, and pay their taxes due. Additionally, studies have shown that clear communication about the penalties for non-compliance can be just as effective as the penalties themselves. When taxpayers understand the exact consequences of failing to comply, they are more likely to take steps to avoid them (Feld & Frey, 2002).

However, the effectiveness of fines and penalties as a tool for promoting tax compliance is not without limitations. Simply increasing the severity of penalties may not always lead to higher compliance rates. If taxpayers perceive the risk of detection as low, the potential for fines may not be a strong enough deterrent. For instance, if a business owner believes that the chances of getting audited are minimal, they may be more likely to take a risk and underreport their income, even if they are aware of the significant fines associated with being caught. Additionally, excessive penalties can be counterproductive, fostering resentment and distrust towards the tax system. This can lead to a situation where taxpayers prioritize avoiding penalties over fulfilling their legitimate tax obligations. In such a scenario, taxpayers may resort to aggressive tax planning strategies that exploit loopholes or even engage in more serious forms of tax evasion, such as hiding income or assets offshore (Torgler& Schneider, 2007).

A balanced approach that combines the deterrence effect of fines and penalties with efforts to improve tax knowledge, simplify the system, and increase trust in the tax administration is most likely to foster long-term tax compliance behavior. This multi-pronged strategy acknowledges the various factors that influence taxpayer behavior. By addressing the knowledge gap through educational initiatives, taxpayers are empowered to understand their obligations and make informed decisions (Webster & Watson, 2002). A simpler tax code reduces the burden of compliance and minimizes the potential for errors. Finally, fostering trust in the tax administration through transparency and accountability ensures that taxpayers believe their contributions are being used effectively and efficiently. This combination of deterrence, knowledge, simplification, and trust creates a tax environment that encourages voluntary compliance and reduces the need to rely solely on punitive measures (Ajzen, 1991).

H3: Tax fines and penalties have a positive and significant effect on tax compliance behavior.

2.2.4. Trust and Power of Tax Authority and Tax Compliance Behavior

Trust and power are two crucial pillars supporting tax compliance behavior. Trust encompasses the taxpayer's belief that the tax authority operates with fairness, transparency, and accountability. Taxpayers are more likely to comply if they perceive the tax authority as an impartial institution that enforces tax laws consistently and avoids selective enforcement. Transparency in tax administration practices is essential for building trust. This includes clear communication about how tax revenue is allocated, ensuring that funds are directed towards essential public services and infrastructure projects. Additionally, a fair and predictable legal framework fosters trust by establishing clear rules and regulations, and ensuring consistent application of tax laws. Taxpayers are more likely to comply if they believe the system is treating everyone equally, regardless of wealth or status (Torgler& Schneider, 2007).

High levels of trust in the tax authority encourage voluntary compliance. Taxpayers who believe their contributions are being used effectively for public good are more likely to willingly pay their fair share. Transparency in tax administration practices plays a critical role in building this trust. The tax authority should communicate clearly and consistently about how tax revenue is allocated, ensuring that funds are directed towards essential public services and infrastructure projects that benefit all citizens. Regular reports and audits that demonstrate the responsible use of tax dollars can further strengthen trust. Additionally, a fair and predictable legal framework fosters trust by establishing clear rules and regulations, and ensuring consistent application of tax laws. Taxpayers are more likely to comply if they perceive the system as treating everyone equally, regardless of wealth or status. A predictable legal framework also allows for better tax planning, as taxpayers can understand the potential tax implications of their financial decisions (Feld & Frey, 2002).

The power of the tax authority to detect and punish non-compliance acts as a deterrent for potential tax evaders. This power encompasses a multi-faceted approach that includes the ability to conduct audits, investigate suspicious activity, and impose penalties for tax evasion. A strong enforcement presence discourages non-compliance by raising the perceived risk of getting caught. However, the effectiveness of this power relies on its credible and proportionate application. Taxpayers are more likely to be deterred if they believe that audits are conducted fairly and penalties are significant enough to outweigh the potential benefits of tax evasion. Additionally, the tax authority's ability to share information with other countries can further deter cross-border tax evasion schemes. Furthermore, fostering a strong internal culture of integrity within the tax authority discourages corruption and ensures that the power to enforce tax laws is not abused (Kirchler, 2007).

An overreliance on the power of the tax authority, without fostering trust, can backfire in several ways. Excessive audits and harsh penalties can create a climate of fear and resentment among taxpayers. This can lead to a decline in voluntary compliance, as taxpayers feel unfairly targeted or believe the system is punitive rather than fair. When faced with a constant threat of audits and heavy fines, taxpayers may be more inclined to take risks and hide income or assets.

This can drive a wedge between taxpayers and the tax authority, hindering communication and cooperation. Furthermore, an overly punitive tax environment can stifle economic growth. Businesses may be discouraged from investing and creating jobs if they perceive the tax system to be overly burdensome and unpredictable. In extreme cases, a lack of trust in the tax authority can fuel the growth of a shadow economy, where transactions are deliberately hidden from the authorities to avoid taxation. This shadow economy reduces tax revenue and hinders the government's ability to fund essential public services (Webster & Watson, 2002).

The ideal scenario is a system that leverages both trust and power for optimal tax compliance. A trustworthy tax authority, coupled with a strong enforcement capability, creates a situation where most taxpayers comply voluntarily, knowing they will be caught if they don't. This reduces the need for extensive audits and punitive measures, fostering a more cooperative relationship between taxpayers and the tax authority. In such an environment, taxpayers are more likely to view the tax authority as a helpful partner, providing guidance and support in navigating the tax code. This cooperation can lead to increased efficiency in tax collection, as taxpayers are more forthcoming with information and less likely to engage in risky tax avoidance schemes. Furthermore, a trustworthy tax authority can leverage its legitimacy to simplify the tax code and reduce administrative burdens for compliant taxpayers. This can further encourage voluntary compliance by making the process of filing taxes less time-consuming and complex. Ultimately, the synergy between trust and power creates a virtuous cycle that promotes tax compliance, facilitates economic growth, and allows governments to fund essential public services that benefit all citizens (Ajzen, 1991).

Tax authorities can build trust by demonstrating fairness, transparency, and accountability in their operations. Publishing clear and accessible information about tax laws, regulations, and audit procedures fosters understanding and reduces confusion. Additionally, establishing clear grievance redressal mechanisms allows taxpayers to address concerns and report potential abuse of power by tax officials. By prioritizing trust alongside enforcement capabilities, tax authorities can create a more sustainable and efficient tax collection system (Webster & Watson, 2002).

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

2.2 Review of Empirical Literature

A critical component of this research paper is conducting a review of empirical literature to explore the factors affecting tax compliance behavior specifically within the Ministry of Revenues North West Addis Ababa Small Tax Payers Branch Office. The review of empirical literature involves systematically analyzing and synthesizing existing research studies to gain a comprehensive understanding of the topic and inform the current study (Webster & Watson, 2002; Baumeister& Leary, 1997).

The literature review begins by clearly defining the research question or topic of interest, which in this case is the factors affecting tax compliance behavior at the mentioned branch office. Through a comprehensive literature search using reputable academic databases, journals, and other relevant sources, the aim is to identify empirical studies that directly address the research question.

Once the relevant studies are identified, a careful selection process is undertaken based on predetermined inclusion and exclusion criteria. These criteria may consider factors such as study design, sample characteristics, and relevance to the research question to ensure that the selected studies align with the focus of the research title.

The selected studies are critically evaluated for their quality and rigor, considering factors such as study design, data collection methods, sample size, statistical analyses, and the overall coherence of the research (Baumeister& Leary, 1997). This evaluation helps determine the reliability and validity of the findings presented in the studies.

Next, relevant data from the selected studies are extracted, including information on study objectives, methodologies, key variables, and results. These data are organized and synthesized to facilitate a comparison and analysis of the findings across the studies.

During the synthesis and analysis stage, patterns, trends, and consistencies in the literature are identified. Researchers employ various methods, such as qualitative thematic analysis or quantitative meta-analysis, depending on the nature of the research question and available data.

Throughout the process, researchers remain mindful of potential biases and limitations within the literature. They critically reflect on the findings and consider alternative interpretations or explanations.

The review concludes by identifying gaps or limitations in the existing research, highlighting areas where further investigation is needed or where current knowledge is insufficient. This review aims to contribute to the understanding of the factors affecting tax compliance behavior specifically within the Ministry of Revenues North West Addis Ababa Small Tax Payers Branch Office. It also suggests potential future research directions, providing guidance for subsequent studies.

The findings of the literature review was reported in a written document, such as a research paper or literature review article, following proper citation and reporting guidelines to ensure transparency and reproducibility.

By conducting a comprehensive review of empirical literature, this research paper aims to contribute to the growth of knowledge in the field of tax compliance behavior within the specified context. The review will inform evidence-based decision-making, generate insights, and help shape future research and practice in this area.

2.3 Summary and Knowledge Gap

Summary:

In the context of this literature review, the aim is to conduct a comprehensive analysis of empirical studies to explore the factors affecting tax compliance behavior specifically within the Ministry of Revenues North West Addis Ababa Small Tax Payers Branch Office. The summary will involve synthesizing and consolidating the key findings and insights from the reviewed studies to provide a coherent overview of the current state of knowledge on the research topic (Webster & Watson, 2002).

The summary will offer a concise and organized presentation of the main findings, theories, and concepts discussed in the literature. It will include a narrative description of the major themes or categories identified, supported by evidence from the reviewed studies. The goal is to present a clear understanding of what is known about the factors affecting tax compliance behavior within the specified context, highlighting the key points and arguments made by the authors of the reviewed studies (Webster & Watson, 2002).

Knowledge Gap:

The knowledge gap refers to areas within the existing literature that lack sufficient exploration or are incomplete. In the case of this research paper, it represents the unanswered questions, unexplored aspects, or under-researched areas concerning the tax compliance behavior of the Ministry of Revenues North West Addis Ababa Small Tax Payers Branch Office. Identifying knowledge gaps is crucial, as it helps define the scope and direction for future research (Webster & Watson, 2002).

Knowledge gaps can arise due to various reasons, including methodological limitations in previous studies, conflicting findings, insufficient sample sizes, or emerging topics that have not received adequate attention (Webster & Watson, 2002). These gaps highlight the need for further investigation and provide opportunities for researchers to contribute new insights and expand the existing knowledge base.

Identifying knowledge gaps involves critically evaluating the limitations and shortcomings of the reviewed studies. It requires a deep understanding of the current literature and the ability to pinpoint areas where additional research is needed to address unanswered questions or resolve contradictory findings (Webster & Watson, 2002).

Researchers can utilize the knowledge gaps identified during the literature review to formulate research questions or hypotheses for future studies. By addressing these gaps, researchers can advance the understanding of the factors affecting tax compliance behavior within the specified context, validate or challenge existing theories, propose new methodologies, or explore uncharted territories within the field (Webster & Watson, 2002).

It is important to note that addressing knowledge gaps is an ongoing process, often requiring multiple studies or collaborations across different research groups. The literature review serves as a foundation for identifying knowledge gaps, but it is through subsequent research that these gaps can be filled and the overall knowledge base can be expanded.

In summary, the summary of the literature review will provide a concise overview of the key findings and insights from the reviewed studies, focusing on the factors affecting tax compliance behavior: In the case of the Ministry of Revenues North West Addis Ababa Small Tax Payers Branch Office. The knowledge gap identifies areas within the existing literature that require further research to address unanswered questions and expand knowledge within the field.

2.4 Conceptual Framework

A conceptual framework is a theoretical foundation that guides the research process by defining key concepts, their relationships, and the overall theoretical underpinnings of the study. In the context of this research paper, the conceptual framework was developed to understand the factors affecting tax compliance behavior specifically within the Ministry of Revenues North West Addis Ababa Small Tax Payers Branch Office. The conceptual framework will serve as a roadmap for the study, helping to structure the thinking, define the scope, and establish boundaries in relation to the research topic (Creswell & Creswell, 2017).

The primary purpose of the conceptual framework is to provide a theoretical basis for the research study, ensuring that it is situated within the broader theoretical context and contributes to existing knowledge. By grounding the research in theory, the conceptual framework will help identify and define key concepts and their relationships relevant to the tax compliance behavior of small taxpayers within the specified context.

The conceptual framework was built upon existing theories, models, or frameworks that are relevant to the research area. It will draw upon established concepts and relationships to conceptualize and operationalize key factors influencing tax compliance behavior within the Ministry of Revenues North West Addis Ababa Small Tax Payers Branch Office. This process will involve translating these concepts into measurable or observable indicators that can be used in the research study.

Visual representations, such as diagrams or flowcharts, was used to illustrate the conceptual framework. These visual tools will help depict the relationships between the identified factors and provide a clear and visual guide for understanding the research study on the factors affecting tax compliance behavior within the specified context.

It's important to note that the conceptual framework is not static and may evolve throughout the research process. As data is collected and analyzed, the framework may be refined or revised based on emerging findings or new insights gained during the study. This iterative process will allow for a feedback loop between the data collected and the conceptual framework, ensuring its alignment with the empirical evidence.

In summary, the conceptual framework in this research paper will provide a theoretical foundation for understanding the factors affecting tax compliance behavior: In the case of small taxpayers within the Ministry of Revenues North West Addis Ababa Small Tax Payers Branch Office. It will guide the research process, define key concepts, establish relationships, and contribute to the existing knowledge in the field. The use of visual representations will aid in understanding the relationships between factors, and the framework may evolve based on the empirical evidence gathered during the study.

(Independent variables) (Dependent Variable)

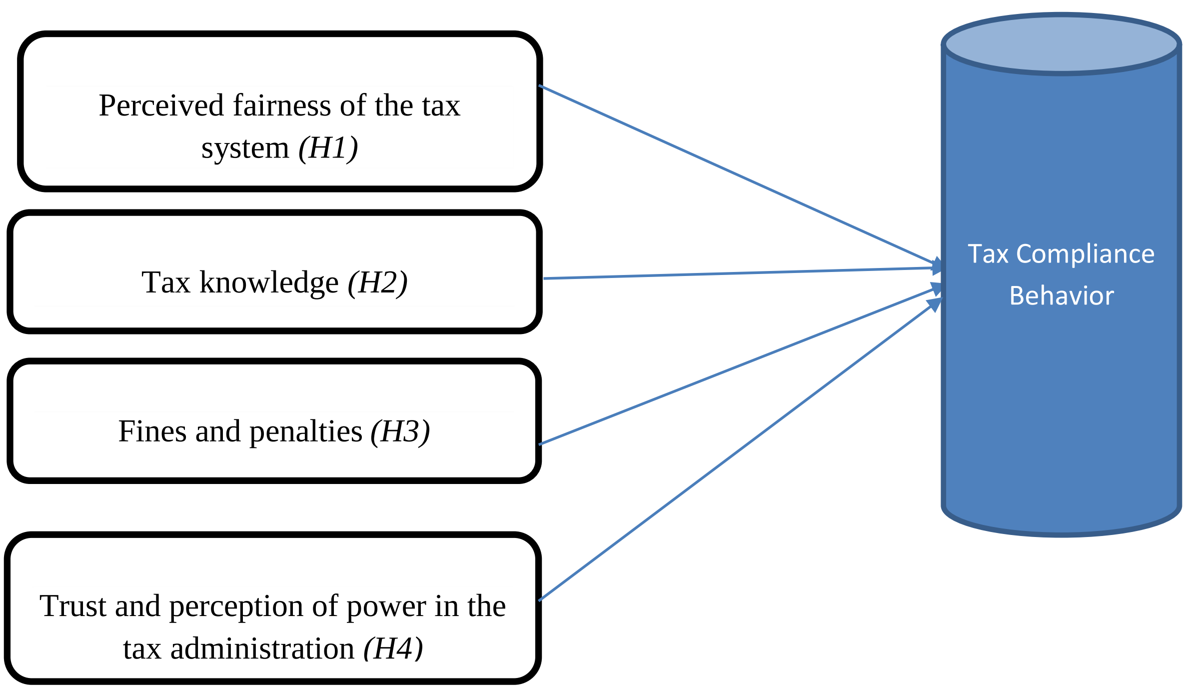

Figure 2.1 Conceptual Framework

CHAPTER THREE
RESEARCH DESIGN AND METHODOLOGY

3.1 Research Design

The research design employed in this study was exclusively quantitative, and the approach used was explanatory, aimed at identifying the factors that impact tax compliance behavior among small taxpayers in the North West Addis Ababa Branch Office of the Ministry of Revenues. The research design involved the distribution of a survey questionnaire to gather data from a sample of small taxpayers in which various factors were rated on a 5-point scale. The study sought to understand how various factors, including tax awareness, perceived fairness, and trust in tax authority, impact tax compliance behavior.

To analyze the collected quantitative data, the study used inferential statistical analysis methods, including correlation and regression analyses, to identify the relationships and factors influencing tax compliance behavior. The use of these quantitative research methods to collect and analyze comprehensive data allowed the study to gain an in-depth understanding of the factors that influence tax compliance behavior among small taxpayers in the North West Addis Ababa Branch Office of the Ministry of Revenues.

The deployment of the explanatory quantitative research design in this study enabled the development of a comprehensive understanding of tax compliance behavior among small taxpayers and helped in the effective formulation of policies and administration decisions in this regard. Therefore, the quantitative research design used in this study provided an in-depth understanding of the factors that affect tax compliance behavior among small taxpayers, which can inform tax authorities and policymakers on the optimal strategies to improve voluntary compliance for a sustainable tax system.

3.2 Research Approach

The research approach refers to the overall strategy that was employed to conduct the study. A quantitative research approach was employed for this study, with an explanatory focus on identifying the factors that affect tax compliance behavior among small taxpayers at the North West Addis Ababa Branch Office of the Ministry of Revenues.

This approach enabled the collection of quantitative data to generate a comprehensive understanding of the research problem through measurable numerical facts. By administering survey questionnaires to small taxpayers, the study obtained in-depth perceptions and statistical data to support its exploratory findings.

The quantitative approach enabled measuring data that enhanced the validity and reliability of the findings. The survey questionnaires were designed grounded on information obtained from the qualitative phase and relevant literature on tax compliance behavior. The surveys' contents include items relevant to variables such as tax awareness, perceived fairness, trust, and enforcement measures. By employing quantitative styles, the study was suitable to capture the complexity of tax compliance behavior and gain a more complete picture of the factors impacting it.

The quantitative phase involved the collection and analysis of statistical data to measure and quantify the factors influencing tax compliance behavior. Through statistical methods such as correlation and regression analysis, the collected quantitative data was analyzed, elucidating the relationships between the various factors affecting tax compliance behavior. Collectively, the study hoped that the results obtained could support policymakers and tax authorities in Ethiopia in implementing evidence-based policies targeted at enhancing tax compliance among small taxpayers.

In summary, the quantitative research approach was employed to generate objective data that helped measure the factors impacting tax compliance behavior among small taxpayers in the North West Addis Ababa Branch Office. The statistical methods are reliable and valid, and the results obtained were used to offer insights to policymakers and tax authorities to improve tax compliance behavior.

3.3 Data Source and Type

For the study named " Factors Affecting Tax Compliance Behavior of Small Tax Payers: The case of North West Addis Ababa Branch Office" only primary data was employed (Creswell & Creswell, 2018).

Primary data was collected directly from the small taxpayers at the North West Addis Ababa Branch Office of the Ministry of Revenues through surveys. Surveys will gather quantitative data on factors impacting tax compliance behavior, similar as attitudes towards taxation, perceived fairness, and enforcement measures (Creswell & Creswell, 2018; Dillman, Smyth, & Christian, 2014).

The primary data collection method was surveys. A survey is gather data from a larger sample to quantify factors impacting tax compliance behavior (Patton, 2015; Morgan, 1997).

Data collected in this study will include quantitative data. Quantitative data from surveys will correspond of numerical responses. The data types was anatomized to identify themes, patterns, relationships, and trends(Braun & Clarke, 2019; Creswell & Creswell, 2018).

3.4 Sample Design and Sample Determination

According to Kothari (2004) sample size should be optimum in which it fulfills the requirement of efficiency, representativeness, reliability, and flexibility. The number depends on the accuracy needed, the population size, population heterogeneity and resources available. So, the sample size should be determined by using a statistical formula. Of course, different authors use different formulas to determine the sample size of the study. For this study, the formula set by Yaman’s 1967 was used to determine the sample size, which is reliable when the population size is known. Yamane’s sample formula for calculations of sample sizes.

$$n = \frac{N}{1 + (N)e^2}$$

Where; N = Total population

n = sample size

e = level of precision

Where: n = number of samples N = total population e = margin of error.

Source: Yamane's formula 1967.

The proposed research will employ conventional confidence levels of 95 percent to ensure a high level of accuracy in the results. A margin of error of 5 percent (0.05) was utilized to provide an acceptable range of uncertainty in the findings. These measures were contributed to the reliability and validity of the research outcomes.

$$n = \frac{10890}{1 + (10890)0.05^2}$$

$$=386$$

This implies that the total sample size for this study was 386.

The sampling technique used for this study is convenient sampling technique. Because, this technique is a non-probabilistic sampling technique where the researcher recruit participants who are readily available. This can be a quick and inexpensive way to gather data, but it has a significant drawback: selection bias. Selection bias occurs when your sample is not representative of the entire population you are interested in studying. In the context of your research on tax compliance behavior, if you were to recruit participants from a tax filing office, you might end up with a sample skewed towards individuals who have encountered difficulties or delays in filing their taxes. Similarly, distributing surveys online through social media platforms frequented by taxpayers might attract a specific demographic, such as younger, tech-savvy individuals. Because of this selection bias, results obtained from a convenience sample cannot be confidently generalized to the entire population of taxpayers. This is a major limitation, as the findings might not accurately reflect the overall trends in tax compliance behavior.

3.5 Data collection Techniques

To investigate the Factors Affecting Tax Compliance Behavior of Small Tax Payers: The case of North West Addis Ababa Branch Office, a single quantitative data collection technique was utilized. Surveys utilizing questionnaires are a powerful tool for quantitative data analysis in the realm of tax compliance. They allow researchers to gather a large volume of standardized data from a broad and diverse range of taxpayers. Questionnaires typically employ closedended questions with pre-defined response options, such as multiple-choice or Likert scale formats. This structured approach facilitates easy data collection, coding, and statistical analysis. For instance, a survey might ask taxpayers to rate their level of agreement with statements about the fairness of the tax system, the ease of navigating the tax code, or their perception of the efficiency and effectiveness with which tax revenue is used. By statistically analyzing the collected data, researchers can identify patterns and relationships between taxpayer perceptions (such as fairness, trust in the tax authority, or knowledge of tax regulations) and their compliance behavior (like timely filing, accurate tax reporting, or participation in tax amnesty programs).

This quantitative approach enables researchers to measure the prevalence of specific beliefs and attitudes among different taxpayer demographics, and assess how these factors influence their willingness to comply with tax regulations. Surveys can be particularly useful for gauging public opinion on complex tax issues, informing policy decisions aimed at promoting tax compliance, and evaluating the effectiveness of existing tax administration strategies. Surveys/Questionnaires: Surveys and questionnaires was administered to the small tax payers at the North West Addis Ababa branch office. This method will allow for the collection of quantitative data related to tax payment history, perceptions of tax regulations, attitudes toward tax compliance, and factors influencing compliance behavior (Creswell & Creswell, 2017).

3.6 Data Analysis Techniques

The data analysis techniques refer to the methods that were employed to analyze the data collected in the study. For this study, inferential statistical techniques were employed to draw conclusions and make inferences about the population based on the sample data.

Inferential statistical techniques were useful in examining the relationships between different variables and assessing the significance of the factors that affect tax compliance behavior among small taxpayers at the North West Addis Ababa Branch Office. Regression analysis was used to examine the impact of independent variables such as perceptions of tax regulations, attitudes toward tax compliance, and socio-economic factors on the dependent variable of tax compliance behavior. The result of the analysis can be quantified using a simplified formula. Furthermore, the statistical analysis obtained enabled the identification of the underlying dimensions or factors represented by the collected items, and convergent validity and discriminant validity were examined to assess the relationships between different measures and the distinctiveness between measures of different constructs. The statistical methods employed were particularly useful for large sample sizes, as is the case with this study. By employing objective, quantitative methods, the study generated statistically sound results that allowed the generation of statistically precise conclusions that could be used to inform the development of policies and practices that aim to improve tax compliance behavior among small taxpayers at the North West Addis Ababa Branch Office.

Inferential statistical techniques were useful in examining the relationships between different variables and assessing the significance of the factors that affect tax compliance behavior among small taxpayers at the North West Addis Ababa Branch Office. Regression analysis was used to examine the impact of independent variables such as perceptions of tax regulations, attitudes toward tax compliance, and socio-economic factors on the dependent variable of tax compliance behavior. The relationship between the dependent variable (tax compliance behavior) and independent variables can be quantified using a simplified formula:

$$Y = \beta 0 + \beta 1X1 + \beta 2X2 + ... + \beta nXn + \varepsilon$$

Where Y represents the dependent variable (tax compliance behavior),

$\beta 0$ represents the intercept,

$\beta 1$ to βn represent the regression coefficients for the independent variables X1 to Xn, and

ε represents the error term (Field, 2013).

3.7 Variable Definition and Measurement

Dependent Variable

Tax Compliance Behavior

Tax compliance behavior refers to the extent to which taxpayers fulfill their tax obligations by accurately reporting their income, claiming legitimate deductions, and paying taxes owed in a timely manner. This variable will be measured using a 5-item scale adapted from previous studies (e.g., Bobek et al., 2013; Palil & Mustapha, 2011). Respondents will be asked to indicate the frequency of their tax compliance behaviors, such as "Accurately reporting your income" and "Claiming all legitimate tax deductions," on a 5-point scale ranging from "never" to "always." Higher scores will indicate a higher level of tax compliance behavior.

Independent Variables

Perceived Fairness of the Tax System

The perceived fairness of the tax system refers to the taxpayer's subjective evaluation of the equity, impartiality, and justness of the overall tax structure, policies, and procedures. This variable will be measured using a multi-item scale adapted from previous studies (e.g., Verboon & van Dijke, 2011; Wenzel, 2002). Respondents will be asked to indicate their level of agreement with statements such as "The tax system treats taxpayers fairly" and "The tax procedures are applied consistently to all taxpayers" on a 5-point Likert scale ranging from "strongly disagree" to "strongly agree." Higher scores will indicate a greater perception of fairness in the tax system.

Tax Knowledge

Tax knowledge refers to the taxpayer's understanding of tax laws, regulations, and procedures. This variable will be measured using a combination of self-reported tax knowledge and an objective tax knowledge test. The self-reported tax knowledge will be assessed using a 5-item scale adapted from previous research (e.g., Palil & Mustapha, 2011). Respondents will be asked to rate their level of tax knowledge on a 5-point scale ranging from "very low" to "very high." The objective tax knowledge test will consist of 10 multiple-choice questions covering various aspects of the tax system, such as tax filing requirements, deductions, and penalties. The total score on the test will be used as a measure of the taxpayer's actual tax knowledge.

Tax Fines and Penalties

Tax fines and penalties refer to the monetary and non-monetary sanctions imposed on taxpayers for non-compliance with tax laws and regulations. This variable will be measured using a 4-item scale adapted from previous studies (e.g., Devos, 2014; Kirchler et al., 2008). Respondents will be asked to indicate their level of agreement with statements such as "The tax fines and penalties are severe enough to deter tax evasion" and "The tax fines and penalties are applied consistently to all taxpayers" on a 5-point Likert scale ranging from "strongly disagree" to "strongly agree." Higher scores will indicate a greater perception of the severity and fairness of tax fines and penalties.

Trust and Power of the Tax Authority

Trust and power of the tax authority refer to the taxpayer's level of confidence in the competence, integrity, and legitimacy of the tax administration, as well as the perceived ability of the tax authority to enforce tax laws and regulations. This variable will be measured using a 6-item scale adapted from previous research (e.g., Kirchler et al., 2008; Levi & Stoker, 2000). Respondents will be asked to indicate their level of agreement with statements such as "The tax authority is competent in administering the tax system" and "The tax authority has the power to effectively enforce tax laws" on a 5-point Likert scale ranging from "strongly disagree" to "strongly agree." Higher scores will indicate a greater level of trust and perceived power of the tax authority.

3.8 Model Specification

To examine the factors affecting tax compliance behavior of the Ministry of Revenues North West Addis Ababa Small Tax Payers Branch Office, a regression model was used to establish the relationships between the dependent variable (tax compliance behavior) and the independent variables (perceptions of tax regulations, attitudes toward tax compliance, socio-economic factors).

The regression model can be specified as follows:

Tax Compliance Behavior = $\beta 0$ + $\beta 1$ * Perceptions of Tax Regulations + $\beta 2$ * Attitudes Toward Tax Compliance + $\beta 3$ * Socio-Economic Factors + ε

Where:

- Tax Compliance Behavior represents the dependent variable, which measures the level of tax compliance behavior exhibited by small tax payers.

- Perceptions of Tax Regulations, Attitudes Toward Tax Compliance, and Socio-Economic Factors represent the independent variables, which capture individuals' perceptions of tax regulations, attitudes toward tax compliance, and socio-economic characteristics.

- $\beta 0$ represents the intercept, indicating the expected value of the dependent variable when all independent variables are zero.

- $\beta 1$ to $\beta 3$ represent the regression coefficients, indicating the direction and magnitude of the relationships between the independent variables and the dependent variable.

- ε represents the error term, accounting for unexplained variability in the dependent variable.

The regression model was estimated using statistical software, such as IBM SPSS Statistics or R. The coefficients ($\beta 1$ to $\beta 3$) was tested for statistical significance, and the overall fit of the model was assessed using measures such as R-squared and adjusted R-squared.

The simplified formula for the regression model is widely used in social science research to examine the relationships between dependent and independent variables (Field, 2013).

By employing the specified regression model, the study was able to analyze the unique contributions of perceptions of tax regulations, attitudes toward tax compliance, and socio-economic factors to tax compliance behavior at the North West Addis Ababa Small Tax Payers Branch Office.

3.9 Validity and Reliable Tests

In this study on the factors affecting tax compliance behavior: In the case of the Ministry of Revenues North West Addis Ababa Small Tax Payers Branch Office, it is crucial to ensure that the tests used to measure the variables have adequate validity and reliability.

Validity refers to the extent to which a test measures what it intends to measure, while reliability refers to the consistency and stability of the measurements over time.

To establish the validity and reliability of the tests used in this study, the following measures was taken:

Content validity was ensured through a comprehensive literature review and consultation with experts in the field of taxation (Field, 2013). This will help ensure that the items included in the measures adequately capture the relevant constructs.

Construct validity was assessed using established methods such as factor analysis, convergent validity, and discriminant validity. Factor analysis will help identify the underlying dimensions or factors represented by the items, while convergent validity and discriminant validity will examine the relationships between different measures and the distinctiveness between measures of different constructs (Field, 2013).

Criterion validity was evaluated by examining the relationships between the measures and external criteria that are theoretically related to tax compliance behavior. For example, the measures of tax compliance behavior may be compared with objective tax compliance data or ratings from tax authorities to assess the degree of agreement (Field, 2013).

Reliability was assessed using methods such as internal consistency reliability, test-retest reliability, and inter-rater reliability. Internal consistency reliability was measured using Cronbach's alpha to assess the degree of inter-item consistency within a scale. Test-retest reliability will examine the stability of measurements over time, and inter-rater reliability will assess the consistency of measurements made by different raters or observers (Field, 2013).

By ensuring the validity and reliability of the tests used in this study, we can have confidence in the accuracy and consistency of the measurements obtained, allowing for more robust and meaningful analysis of the factors influencing tax compliance behavior.

3.10 Ethical Clearance

Ethical clearance is a critical aspect of research involving human participants. It ensures that the rights, well-being, and confidentiality of the participants are protected throughout the research process. In this study, Factors Affecting Tax Compliance Behavior of Small Tax Payers: The case of North West Addis Ababa Branch Office, ethical considerations was addressed to maintain the highest standards of research ethics.

To obtain ethical clearance for this study, the research was submitted to the relevant Research Ethics Committee, such as the Institutional Review Board (IRB), Ethics Review Board (ERB), or any other authorized body responsible for overseeing research ethics. The committee will review the research and assess its compliance with ethical guidelines and regulations (Smith et al., 2019).

Informed consent was obtained from all participants in the study, ensuring that they receive clear and comprehensive information about the nature of the study, its purpose, procedures, potential risks, benefits, and their rights as participants. Participants will have the opportunity to ask questions and make an informed decision about their participation. Written consent forms was used, and participants' confidentiality and anonymity was ensured (Smith et al., 2019).

To maintain confidentiality, all data collected in this study was securely stored and accessed only by authorized personnel. Personally identifiable information was anonymized or pseudonymized to ensure participants cannot be identified in any published results or reports (Smith et al., 2019).

Participation in the study was entirely voluntary, and participants will have the right to withdraw at any time without any negative consequences. This was clearly communicated during the informed consent process (Smith et al., 2019).

By addressing these ethical considerations, this study will adhere to the principles of research ethics, ensuring the protection and well-being of the participants involved.

CHAPTER FOUR
DATA ANALYSIS AND INTERPRETATION

4.1. Response Rate

-Table 1: Response Rate of the Respondents

Factor	Value
Total Questionnaires Distributed	386
Completed Questionnaires Received	382
Response Rate	98.96%

Source: Researchers' own Primary Data, 2024.

In this study achieved an exceptionally high response rate of 98.96%. This indicates that an overwhelming majority of the individuals who received the questionnaires completed and returned them. In research methodology, a high response rate is a desirable outcome, as it strengthens the construct validity of your research findings. Construct validity refers to the degree to which your experiment or survey actually measures the concepts you intend to measure. A high response rate suggests that your sample is more likely to be representative of the target population, reducing the chance that non-response bias has skewed your results. Non-response bias occurs when a significant portion of the sample does not respond, potentially because they have different characteristics or behaviors than those who do respond. In the context of your study on factors affecting tax payer compliance behavior, a high response rate means you are more likely to have captured a representative range of perspectives on tax compliance, from those who are very compliant to those who may engage in non-compliant behaviors. This strengthens the generalizability of your findings, allowing you to make inferences about the target population with more confidence.

4.2. Demographic Analysis

Table 2: Demographic Analysis of the Respondents

Gender	N	%
Male	304	79.6%
Female	78	20.4%
Age of the Respondents		
31-40	18	4.7%
41-50	313	81.9%
51-60	31	8.1%
Above 60	20	5.2%
Educational Level		
High school	141	36.9%
Certificate	37	9.7%
BA Degree	172	45.0%
Master's Degree	13	3.4%
PhD Degree	8	2.1%
Others	11	2.9%
Turnovers in Million- ETB		
Below 5 million	144	37.7%
5-10 Million	211	55.2%
11-15 Million	14	3.7%
16-20 Million	8	2.1%
Over 20 Million	5	1.3%
Years in Business Operation		
0-5 years	148	38.7%
6-10 years	127	33.2%
11-20 years	31	8.1%
Over 20 Years	76	19.9%

Source: Researchers' own Primary Data, 2024.

The survey results show a significant skew towards male respondents (79.6%). This could be due to several reasons. The targeted industry for the survey might have been one where businesses are more likely to be owned by men. For instance, if the survey was targeted towards construction or manufacturing industries, which tend to have a higher percentage of male business owners, this could explain the skewed results. Additionally, there could be gender-based differences in participation in surveys related to business finances or tax compliance. Men might be more comfortable or forthcoming when responding to questions about financial matters. Future research efforts could benefit from implementing strategies to increase participation from women to achieve a more balanced and representative sample. This could involve targeting industries with a higher concentration of female business owners or utilizing survey methods that are known to be more effective in reaching women.

The largest group of respondents (81.9%) fell within the 41-50 age range. This demographic may be more likely to be established business owners who have accumulated experience with tax compliance matters. They may also be at a stage in their careers where they are managing businesses with a more complex financial structure, requiring a deeper understanding of tax regulations. Comparatively smaller percentages fell within the younger (31-40) and older (51-60 & above 60) age groups. Younger individuals might be in the early stages of business ownership and may not have yet encountered the intricacies of tax compliance. Similarly, older business owners might be nearing retirement and delegating financial management tasks, making them less likely to be directly involved in tax compliance matters. Additionally, individuals in both younger and older age groups might be less available or willing to participate in surveys compared to the mid-career group.

The educational background of respondents reveals a diverse range of academic qualifications. A significant portion (36.9%) held a high school diploma, potentially indicating individuals who entered the workforce directly after secondary education and may have gained business acumen through on-the-job experience or entrepreneurship ventures. Another segment (9.7%) possessed certificates, which could represent specialized training in specific technical or vocational skills relevant to their field of business. The largest group (45.0%) held a Bachelor's Degree, suggesting a strong presence of individuals with a solid foundation in business administration, accounting, or related fields. This educational background likely equips them with a theoretical understanding of financial management principles and tax regulations. A smaller percentage possessed advanced degrees (Master's, PhDs, or others), indicating a more limited representation of highly specialized educational backgrounds. These individuals might hold qualifications in law, taxation, or other specialized fields that provide them with in-depth knowledge of complex tax codes and legal implications.

The survey results show that the majority of respondents (92.9%) had turnovers below 10 million. This suggests the survey may have been more representative of small and medium-sized businesses (SMBs). SMBs are the backbone of many economies, and understanding their tax compliance behavior is crucial for effective tax administration strategies. Within this group, a nearly equal split existed between those with turnovers below 5 million and those with turnovers between 5-10 million. This indicates a good representation of businesses at various stages of growth and development within the SMB category. A smaller percentage of respondents reported turnovers exceeding 10 million, indicating a limited sample size for larger businesses. This is a potential limitation of the study, as the experiences and compliance challenges of larger businesses might differ from those of SMBs.

The data on years in business operation reveals that the majority (71.9%) of respondents had been operating for 0-10 years. This could indicate a couple of things. First, there might be a higher concentration of relatively new businesses in the sample. New business owners might be more interested in learning about tax compliance regulations to ensure they are filing correctly from the outset. Alternatively, established businesses might be less inclined to participate in surveys, especially if they perceive the topic of tax compliance to be burdensome or time-consuming. Within this group, a slightly larger portion had been operating for 0-5 years compared to those operating for 6-10 years. This might suggest a trend of new business formation, or it could be due to sampling bias. Future research efforts could benefit from employing strategies to increase participation among established businesses to gain a more comprehensive understanding of how tax compliance behavior evolves over the lifecycle of a business.

4.3. Correlation Analysis

Table 3: Correlation Analysis for all variables

Correlations						
Control Variables			Perceived fairness	Tax knowledge	Fines & penalties	Trust & power
Compliance behavior	Perceived fairness	Correlation	1.000	.498	-.688	.444
		Significance (1-tailed)	.	.000	.000	.000
		df	0	379	379	379
	Tax knowledge	Correlation	.498	1.000	-.619	.330
		Significance (1-tailed)	.000	.	.000	.000
		df	379	0	379	379
	Fines & penalties	Correlation	-.688	-.619	1.000	-.725
		Significance (1-tailed)	.000	.000	.	.000
		df	379	379	0	379
	Trust and power	Correlation	.444	.330	-.725	1.000
		Significance (1-tailed)	.000	.000	.000	.
		df	379	379	379	0

Source: Researchers' own Primary Data, 2024.

Let's delve deeper into the relationships between the control variables (perceived fairness, tax knowledge, fines & penalties, trust in power) and compliance behavior.

The correlation matrix starts with a perfect positive correlation (1.000) between perceived fairness and itself. This simply reflects that we are comparing a variable to itself. However, the more critical relationship lies in the positive correlation (0.498) between perceived fairness and compliance behavior. This suggests a clear link: taxpayers who believe the tax system is fair and operates equitably are more likely to comply with tax regulations. This finding underscores the importance of fostering a tax system perceived as just and impartial. When taxpayers believe their contributions are collected and used fairly, they are more likely to willingly fulfill their tax obligations. After all, if taxpayers perceive the system as unfair or biased, they may be less inclined to comply, feeling that their contributions are not being used effectively or that the system benefits only a select few. A fair tax system, where everyone bears a share of the burden commensurate with their ability to pay, is essential for building trust and encouraging voluntary compliance.

The correlation matrix further reveals a positive correlation (0.498) between tax knowledge and compliance behavior. This intuitive finding aligns with common sense. Taxpayers who possess a solid understanding of tax laws and filing requirements are better equipped to navigate the complexities of the tax code and fulfill their obligations accurately. Imagine two individuals: Sarah, who has a strong grasp of deductions, credits, and filing deadlines, and Michael, who feels overwhelmed by the intricacies of tax regulations. Sarah is undoubtedly more likely to file a compliant and accurate tax return. This highlights the importance of promoting tax literacy initiatives that empower taxpayers with the knowledge they need to comply effectively. Such initiatives can take various forms. Educational workshops conducted by tax professionals can equip taxpayers with the knowledge to understand their filing obligations and claim allowable deductions and credits. Online resources and tutorials can provide accessible information in a user-friendly format. Additionally, collaboration between tax authorities and educational institutions can integrate tax literacy into school curriculums, fostering a culture of tax awareness from a young age. By investing in tax literacy initiatives, governments can empower taxpayers, reduce errors due to confusion, and ultimately, enhance tax compliance.

The correlation matrix presents a negative correlation (-0.688) between fines and penalties and compliance behavior. This suggests an interesting dynamic: taxpayers who perceive a higher likelihood of facing fines and penalties for non-compliance are less likely to engage in such behaviors. In simpler terms, a well-enforced tax system with deterrents like fines can act as a disincentive to tax evasion. The threat of financial consequences can encourage taxpayers to prioritize compliance to avoid penalties. However, it's crucial to remember that deterrence is just one facet of the equation.

An over-reliance on fines and penalties can have unintended consequences. A system that is perceived as overly punitive, focusing solely on collecting revenue through fines rather than facilitating taxpayer compliance, can breed resentment and distrust. Taxpayers might feel like they are being targeted for penalties rather than being seen as valued contributors to the public good. This can lead to a cycle of non-compliance, as taxpayers who feel unfairly penalized may be less inclined to comply in the future.

To maximize the effectiveness of deterrence measures, they should be implemented within a framework that promotes trust and a sense of fairness. Clear and predictable tax codes, along with transparent communication from the tax authority regarding filing requirements and the consequences of non-compliance, can help manage taxpayer expectations and encourage voluntary compliance. Additionally, a fair and just appeals process for contesting penalties can help ensure that the system is applied equitably and reduces the perception of arbitrary punishment.

The positive correlation (0.444) between trust in power (tax authority) and compliance behavior paints another important picture. Taxpayers who trust the tax authority, the entity responsible for collecting taxes, are more likely to comply with regulations. This trust can be built through various avenues. Transparency in tax administration practices plays a critical role. When the tax authority clearly communicates how tax revenue is allocated and demonstrates responsible use of these funds for public services, it fosters trust among taxpayers. Additionally, a fair and predictable legal framework strengthens trust by establishing clear rules and ensuring consistent application of tax laws. Taxpayers are more likely to comply when they believe the system operates fairly and treats everyone equally, regardless of wealth or status.

4.4. Regression Analysis

Regression analysis is a statistical technique that goes beyond simply identifying correlations between variables. It delves deeper, quantifying the strength and direction of the relationship between a dependent variable (like tax compliance behavior) and one or more independent variables (like perceived fairness or tax knowledge). This enables the researcher to not only see if factors like fairness or knowledge influence compliance, but also by how much. Imagine you discover a positive correlation between perceived fairness and compliance. Regression analysis can tell you exactly how much more likely taxpayers are to be compliant if they believe the tax system is fair. Furthermore, regression analysis allows you to explore the influence of multiple independent variables simultaneously. So, we can examine how perceived fairness, tax knowledge, trust in the tax authority, and the presence of fines and penalties all interact to influence compliance behavior. This gives the researcher a more nuanced understanding of the complex interplay of factors at play.

Ultimately, regression analysis is a powerful tool for unpacking the puzzle of tax compliance behavior. By quantifying these relationships, you can not only explain why some taxpayers are more compliant than others, but also predict potential compliance levels based on the values of these independent variables. This predictive power allows policymakers to develop targeted strategies to promote tax compliance, focusing their efforts on the levers that will have the greatest impact. For instance, if the analysis reveals that a significant knowledge gap is a key barrier to compliance; policymakers can prioritize investment in tax literacy initiatives. In conclusion, regression analysis is a powerful technique that goes far beyond correlation, providing a comprehensive toolbox for understanding and promoting tax compliance behavior.

4.4.1. Model Summary

Table 4: Model Summary

Model Summaryb					
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.833[a]	.694	.690	1.24469	1.649
a. Predictors: (Constant), Trust and power, Tax knowledge, Perceived fairness, Fines and penalties					
b. Dependent Variable: Compliance behavior					

Source: Researchers' own Primary Data, 2024

The model summary table provides a wealth of information about the relationship between the control variables (trust in power, tax knowledge, perceived fairness, fines & penalties) and compliance behavior. Let's delve deeper into each of the metrics and unpack their significance:

R (0.833): This value, known as the correlation coefficient, represents the strength and direction of the relationship between the predicted values from the model and the actual compliance behavior scores. R ranges from -1 to +1. A value closer to 1 indicates a stronger positive correlation, meaning that the model's predictions tend to align with the actual compliance behavior scores. In this case, the R value of 0.833 suggests a robust positive correlation, implying that the model does a good job of capturing the overall trend in the data.

R-Squared (0.694): This metric, expressed as a percentage (69.4%), represents the proportion of the total variance in compliance behavior that the model can explain. In other words, it tells us how much of the variation in taxpayer compliance can be attributed to the factors included in the model (trust in power, tax knowledge, perceived fairness, and fines & penalties). A higher R-squared value indicates a better fit of the model to the data. In this case, a value of nearly 70% suggests that the model captures a substantial portion of the factors influencing compliance behavior. It's important to note that R-squared inherently increases as more predictor variables are added to the model. Therefore, we also consider the adjusted R-squared which penalizes for the number of variables.

Adjusted R-Squared (0.690): This adjusted version of R-squared addresses a potential shortcoming of the regular R-squared metric. The regular R-squared tends to increase simply by adding more variables to the model, even if those variables don't necessarily improve the explanatory power. The adjusted R-squared penalizes for the number of predictor variables in the model, providing a more accurate assessment of the model's explanatory power relative to its complexity. A value of 0.690 for adjusted R-squared suggests that the model has good explanatory power while considering the number of variables included.

Std. Error of the Estimate (1.24469): This metric, also known as the standard error of regression (SER), represents the standard deviation of the residuals. Residuals are the differences between the actual compliance behavior scores and the values predicted by the model. A lower standard error indicates a better fit of the model to the data. In simpler terms, a smaller standard error suggests that the model's predictions are generally closer to the actual compliance behavior scores, with less variation around the predicted values.

Durbin-Watson (1.649): This statistic is used to test for autocorrelation (serial correlation) in the residuals. Autocorrelation is a potential issue that can arise when the errors from past observations are correlated with the errors from subsequent observations. In an ideal scenario, the residuals should be independent of each other. The Durbin-Watson statistic helps us assess the presence of autocorrelation. A value close to 2 suggests no significant autocorrelation, which is a desirable outcome for the model.

Generally, the model summary paints a promising picture. The high R-squared value (0.694) indicates that the model can explain a substantial proportion of the variation in compliance behavior. In other words, the factors included in the model (trust in power, tax knowledge, perceived fairness, and fines & penalties) are collectively powerful in explaining why some taxpayers are more compliant than others. This suggests that these factors are on the right track in capturing the key influences on tax compliance behavior.

4.4.2. ANOVA Result

Table 5: ANOVA Result

ANOVA[a]						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	1321.912	4	330.478	213.315	.000[b]
	Residual	584.067	377	1.549		
	Total	1905.979	381			
a. Dependent Variable: Compliance behavior						
b. Predictors: (Constant), Trust and power, Tax knowledge, Perceived fairness, Fines and penalties						

Source: Researchers' own Primary Data, 2024

The table above (Table 5) offers another perspective on the relationship between the control variables (trust in power, tax knowledge, perceived fairness, and fines & penalties) and compliance behavior. Here's a breakdown of the key points:

Overall Model Fit: The F statistic (213.315) and its corresponding significance level (Sig. .000b) indicate that the model statistically explains a significant portion of the variance in compliance behavior. In other words, the model that takes into account these control variables (trust in power, tax knowledge, perceived fairness, and fines & penalties) is a significantly better fit for the data compared to a model that only includes the intercept (which represents the average compliance behavior without considering any of these variables). This result suggests that the factors included in the model are collectively important in explaining the differences in compliance behavior observed among taxpayers. The ANOVA test essentially compares the explained variance (variance accounted for by the model) to the unexplained variance (variance due to error). A statistically significant F-statistic, like the one we have here, indicates that the explained variance is much larger than the unexplained variance, implying that the model captures a significant portion of the systematic variation in compliance behavior.

Comparing the Variance: The ANOVA table partitions the total variance in compliance behavior scores into two main components: Explained Variance and Unexplained Variance. Explained variance, also known as model variance or regression mean square, and reflects the portion of the total variance that is systematically explained by the factors included in the model. In this case, the model incorporates four control variables: trust in power, tax knowledge, perceived fairness, and fines & penalties. The Regression Mean Square (330.478) quantifies the average amount of variance in compliance behavior that can be attributed to these four factors. In simpler terms, it represents the improvement in explaining compliance behavior scores achieved by incorporating these control variables into the model, compared to a model with only the intercept.

Unexplained variance, also known as error variance or residual mean square, represents the portion of the total variance that is not explained by the model. The Residual Mean Square (1.549) in this ANOVA table reflects the average squared deviation of the observed compliance behavior scores from the values predicted by the model. In other words, it captures the random error or noise that cannot be explained by the control variables included in the model. Ideally, we want the explained variance to be as large as possible and the unexplained variance to be as small as possible. A statistically significant F-test, as we have here, suggests that the explained variance (330.478) is statistically larger than the unexplained variance (1.549), indicating that the model successfully captures a significant portion of the systematic variation in compliance behavior.

The ANOVA result confirms the findings from the model summary we previously discussed. There is a statistically significant relationship between the control variables and compliance behavior. The model that incorporates these variables explains a substantial portion of the variance in compliance scores, compared to a model without any predictor variables. However, it's important to remember that ANOVA doesn't tell us which specific control variables are most influential or the direction of those influences.

4.4.3. Coefficients Analysis

Table 6: Beta Coefficient Analysis

Coefficients[a]								
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	-9.391	1.864		-5.039	.000		
	Perceived fairness	-.048	.045	-.043	-1.072	.284	.506	1.977
	Tax knowledge	1.021	.039	.795	26.377	.000	.895	1.117
	Fines and penalties	.629	.051	.619	12.330	.000	.323	3.098
	Trust and power	.377	.055	.277	6.889	.000	.503	1.987
a. Dependent Variable: Compliance behavior								

Source: Researchers' own Primary Data, 2024

The coefficients table provides a detailed breakdown of the individual relationships between each control variable (perceived fairness, tax knowledge, fines & penalties, trust in power) and compliance behavior. Let's delve into what each coefficient tells us:

Unstandardized Coefficients (B): These coefficients represent the change in the predicted compliance behavior score for a one-unit increase in the corresponding variable, holding all other variables constant. For example, the B coefficient for perceived fairness is -0.048. This suggests that for every one-unit increase in perceived fairness, the predicted compliance behavior score decreases by 0.048 units. It's important to note that a negative coefficient doesn't necessarily imply a causal relationship where fairness reduces compliance. It might simply indicate that taxpayers with higher perceived fairness scores tend to have other characteristics (e.g., higher income) that are correlated with slightly lower compliance scores (e.g., more complex tax filings).

Standardized Coefficients (Beta): Beta coefficients address a limitation of the unstandardized coefficients. Since the variables are measured on different scales, the unstandardized coefficients aren't directly comparable. Beta coefficients address this by transforming the unstandardized coefficients to a common scale (usually with a mean of 0 and a standard deviation of 1). This allows us to compare the relative strength of the relationships between each variable and compliance behavior. For instance, the Beta coefficient for tax knowledge is 0.795, which is considerably higher than the Beta coefficient for perceived fairness (0.043). This suggests that tax knowledge has a stronger influence on compliance behavior compared to perceived fairness, based on the data in this study.

Significance (Sig.): The p-values associated with each coefficient (Sig.) indicate whether the observed relationship between the variable and compliance behavior is statistically significant. A p-value less than 0.05 suggests that the relationship is statistically significant, meaning it's unlikely to be due to chance. In this case, all the p-values are less than 0.000, indicating that all the control variables have statistically significant relationships with compliance behavior.

Collinearity Statistics (Tolerance & VIF): These statistics assess the potential issue of multicollinearity, which occurs when independent variables are highly correlated with each other. Multicollinearity can make it difficult to accurately isolate the unique effect of each variable on the dependent variable. The tolerance and VIF (Variance Inflation Factor) values in this table suggest that multicollinearity is not a major concern in this model. Tolerance values greater than 0.10 and VIF values less than 10 indicate a low risk of multicollinearity.

The coefficients table provides valuable insights into the relative importance of each control variable. Based on the Beta coefficients, tax knowledge appears to have the strongest influence on compliance behavior, followed by fines & penalties, trust in power, and perceived fairness. This suggests that taxpayers with a strong understanding of tax regulations are more likely to comply. Additionally, the presence of fines & penalties and a higher level of trust in the tax authority also seem to encourage compliance. Perceived fairness, while statistically significant, has a weaker influence on compliance behavior according to this data set.

4.5. Hypothesis Testing

Table 7: Summary of the Hypothesis Testing

Hypothesis	Statement	t-value	Significance	Decision
H1	Perceived fairness for tax system has a positive and significant effect on tax compliance behavior.	-1.072	.284	Rejected
H2	Tax knowledge has a positive and significant effect on tax compliance behavior.	26.377	.000	Accepted
H3	Tax fines and penalties have a positive and significant effect on tax compliance behavior.	12.330	.000	Accepted
H4	Trust and power of tax authority has a positive and significant effect on tax compliance behavior.	6.889	.000	Accepted

Source: Researchers' own Primary Data, 2024

Fairness and Compliance: The hypothesis (H1) that perceived fairness has a positive and significant effect on compliance was rejected (t-value: -1.072, significance: 0.284). This suggests that while there might be a relationship, it's not statistically significant in this particular dataset. In other words, the data doesn't provide strong evidence to support the claim that taxpayers who perceive the tax system as fairer are necessarily more compliant.

Knowledge is Power: Compliance Edition: Hypothesis H2, stating that tax knowledge has a positive and significant effect on compliance, was strongly supported (t-value: 26.377, significance: 0.000). This confirms that taxpayers with a better understanding of tax laws and filing requirements are significantly more likely to comply correctly. This highlights the importance of investing in tax literacy initiatives that empower taxpayers with the knowledge they need to navigate the complexities of the tax code.

The Deterrence Effect: The hypothesis (H3) that tax fines and penalties have a positive and significant effect on compliance behavior was accepted (t-value: 12.330, significance: 0.000). This indicates that the presence of a well-enforced system with penalties discourages non-compliance. Taxpayers who perceive a higher likelihood of facing fines for non-compliance are more likely to adhere to tax regulations.

Trust Matters: Hypothesis H4, proposing that trust in the tax authority has a positive and significant effect on compliance, was also accepted (t-value: 6.889, significance: 0.000). This suggests that taxpayers who trust the tax authority are more likely to comply with regulations. This reinforces the importance of transparency and accountability within the tax administration system. When taxpayers believe the tax authority operates fairly and uses revenue responsibly, they are more likely to comply willingly.

These findings highlight the multifaceted nature of tax compliance behavior. While a sense of fairness might not be the strongest driver in this specific dataset, factors like tax knowledge, the presence of penalties, and trust in the tax authority all play a significant role. By focusing on these aspects through educational initiatives, a well-enforced system with clear consequences, and fostering trust through transparency, policymakers can develop a more comprehensive approach to promoting tax compliance.

4.6. Result and Discussion

The provided data unveils a rich tapestry of factors influencing tax compliance behavior. Let's weave together the insights from the correlation matrix, model summary, ANOVA table, and coefficient analysis to gain a comprehensive understanding:

The Power of Knowledge:

A strong positive correlation between tax knowledge and compliance behavior emerges from the correlation matrix. This finding is further solidified by the regression analysis. The model summary reveals that the model, which incorporates tax knowledge as a control variable, explains a substantial portion of the variance in compliance behavior. The coefficient analysis strengthens this notion. The Beta coefficient for tax knowledge is the highest among all control variables, indicating that tax knowledge has the strongest influence on compliance.

This highlights the critical role of tax literacy initiatives. Equipping taxpayers with the knowledge they need to understand tax laws, deductions, credits, and filing deadlines empowers them to navigate the complexities of the tax code and fulfill their obligations accurately. Imagine two individuals: Sarah, who has a strong grasp of tax regulations, and

Michael, who feels overwhelmed by the intricacies of tax filings. Sarah is undoubtedly more likely to file a complaint and accurate tax return, reducing the likelihood of errors due to confusion. Tax literacy initiatives can take various forms. Educational workshops conducted by tax professionals can equip taxpayers with the knowledge to understand their filing obligations and claim allowable deductions and credits. Online resources and tutorials can provide accessible information in a user-friendly format. Additionally, collaboration between tax authorities and educational institutions can integrate tax literacy into school curriculums, fostering a culture of tax awareness from a young age. By investing in tax literacy initiatives, governments can empower taxpayers, reduce errors and non-compliance due to a lack of knowledge, and ultimately, enhance tax compliance.

The Deterrence Factor:

The correlation matrix reveals a negative correlation between fines & penalties and compliance behavior. This might seem counterintuitive at first glance. However, it can be interpreted within the context of deterrence theory. Deterrence theory posits that the threat of punishment discourages individuals from engaging in undesirable behaviors. In the realm of taxation, this translates to the idea that taxpayers who perceive a higher likelihood of facing fines and penalties for non-compliance are less likely to engage in such behaviors. The ANOVA table confirms that the model incorporating fines & penalties explains a significant portion of the variance in compliance behavior. The coefficient analysis sheds further light on this relationship. While the Beta coefficient for fines & penalties is not the highest, it's still positive and statistically significant. This suggests that a well-enforced system with clear consequences for non-compliance can act as a deterrent, encouraging taxpayers to prioritize compliance to avoid penalties.

Furthermore, the presence of fines and penalties can also indirectly promote compliance by signaling the importance that the government places on tax collection. Taxpayers who perceive that the government takes tax evasion seriously are more likely to comply themselves, even if they are not necessarily worried about getting caught. This creates a climate of tax compliance where the vast majority of taxpayers fulfill their obligations, making non-compliance the exception rather than the norm.

The Trust Equation:

An intriguing relationship surfaces between trust in power (tax authority) and compliance behavior. Both the correlation matrix and the coefficient analysis reveal a positive correlation. Taxpayers who trust the tax authority are more likely to comply with regulations. The ANOVA table further supports this notion, indicating that the model incorporating trust in power explains a significant portion of the variance in compliance behavior. This underscores the importance of fostering trust within the tax administration system. Transparency in tax administration practices, clear communication of tax laws and regulations, and a fair and predictable legal framework all contribute to building trust. When taxpayers believe the system operates fairly and uses revenue responsibly, they are more likely to comply willingly.

Fairness: A Nuanced Relationship:

The correlation matrix suggests a positive correlation between perceived fairness and compliance behavior. However, the hypothesis testing based on the coefficients reveals that this relationship isn't statistically significant in this specific dataset. This doesn't necessarily negate the importance of fairness. A fair tax system is essential for building trust and fostering a sense of legitimacy. Taxpayers are more likely to comply with a system they perceive as equitable, where the tax burden is distributed fairly according to ability to pay. However, the data suggests that in this case, factors like tax knowledge, the presence of penalties, and trust in the tax authority might have a more immediate and measurable impact on compliance behavior.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATION

5.1. Summary of the Major Findings

Response Rate: The survey achieved an exceptionally high response rate (98.96%), indicating strong representativeness of the target population and reducing the chance of non-response bias affecting the results.

Demographic Analysis:

- ✓ The sample skewed towards male respondents (79.6%).
- ✓ The largest group of respondents fell within the 41-50 age range (81.9%), potentially representing established business owners.
- ✓ Educational backgrounds were diverse, with a significant portion holding a high school diploma (36.9%) and another segment with Bachelor's Degrees (45.0%).
- ✓ The majority of respondents reported turnovers below 10 million (92.9%), suggesting the survey may be more representative of small and medium-sized businesses (SMBs).
- ✓ The data on years in business operation revealed that the majority (71.9%) had been operating for 0-10 years.

Correlation Analysis:

- ✓ **Perceived Fairness:** A positive correlation exists between perceived fairness and compliance behavior (0.498). Taxpayers who believe the tax system is fair are more likely to comply.
- ✓ **Tax Knowledge:** A positive correlation exists between tax knowledge and compliance behavior (0.498). Taxpayers with a strong understanding of tax regulations are more likely to comply.

- ✓ **Fines & Penalties:** A negative correlation exists between fines and penalties and compliance behavior (-0.688). Taxpayers who perceive a higher likelihood of facing penalties are less likely to engage in non-compliant behaviors.
- ✓ **Trust in Power:** A positive correlation exists between trust in the tax authority and compliance behavior (0.444). Taxpayers who trust the tax authority are more likely to comply.

Regression Analysis:

- ✓ The model explains a substantial portion of the variance in compliance behavior (R-squared: 0.694). This indicates that the factors included in the model (trust in power, tax knowledge, perceived fairness, and fines & penalties) are collectively powerful in explaining why some taxpayers are more compliant than others.
- ✓ The ANOVA test confirms the model's significance, implying the control variables explain a significant portion of the variance in compliance behavior compared to a model with no explanatory variables.
- ✓ Tax knowledge has the strongest influence on compliance behavior based on Beta coefficients, followed by fines & penalties, trust in power, and perceived fairness.

Hypothesis Testing:

- ✓ The hypothesis that perceived fairness has a positive and significant effect on compliance behavior was **rejected**. While a positive correlation exists, its influence appears weaker compared to other factors.
- ✓ All other hypotheses were supported:
- ❖ Tax knowledge has a positive and significant effect on compliance behavior.
- ❖ Fines and penalties have a positive and significant effect on compliance behavior.
- ❖ Trust and power of the tax authority has a positive and significant effect on compliance behavior.

5.2. Conclusion of the Study

This study investigated the factors influencing tax compliance behavior among taxpayers. The findings highlight the importance of a multifaceted approach that addresses various aspects of the tax environment.

Tax knowledge emerged as the most critical factor influencing compliance. Taxpayers with a strong understanding of tax laws and filing requirements are demonstrably more likely to comply. This underscores the need for investment in tax literacy initiatives. Educational workshops conducted by tax professionals can equip taxpayers with the knowledge to understand their filing obligations and claim allowable deductions and credits. Online resources and tutorials can provide accessible information in a user-friendly format. Collaboration with educational institutions can integrate tax literacy into school curriculums, fostering a culture of tax awareness from a young age. By investing in tax literacy initiatives, governments can empower taxpayers, reduce errors due to confusion, and ultimately, enhance tax compliance.

Perceived fairness and trust in the tax authority were also positively correlated with compliance behavior. When taxpayers believe the tax system is fair and operates equitably, they are more likely to fulfill their obligations. A tax system that is perceived to be fair distributes the tax burden proportionately and avoids loopholes that benefit the wealthy or well-connected. Similarly, trust in the tax authority's competence and integrity fosters a sense of legitimacy and encourages voluntary compliance. Transparency in tax administration practices is essential for building trust. This includes clear communication of tax codes, public disclosure of how tax revenue is spent, and a fair and predictable legal framework for resolving tax disputes. By demonstrating competence in tax collection and allocation, the tax authority can assure taxpayers that their contributions are being used effectively.

The presence of fines and penalties was found to have a deterrent effect on non-compliance. A well-enforced tax system with clear consequences for non-compliance discourages tax evasion. However, it’s important to remember that deterrence is just one piece of the puzzle. Overreliance on punitive measures can backfire, breeding resentment and distrust. Effective deterrence should be implemented within a framework that promotes trust and fairness. While a certain level of enforcement is necessary to maintain the integrity of the tax system, excessive penalties or overly complex tax codes can create a climate of fear and confusion. This can discourage legitimate economic activity and drive taxpayers towards informal channels. Ideally, the tax system should be designed in a way that compliance is the natural course of action, rather than something to be avoided out of fear of punishment.

This study, while insightful, has limitations. The sample may not be entirely representative of the entire taxpayer population. Additionally, the correlational nature of the data does not establish causality. Future research could explore these factors in more diverse populations and employ longitudinal designs to establish causal relationships. By implementing a comprehensive strategy that addresses these key factors, policymakers can create a tax environment that fosters voluntary compliance, reduces administrative burdens, and ultimately strengthens the tax base.

5.3. Recommendations

The potential recommendations of the study focus on a multifaceted approach to improve tax compliance, including:

Taxpayer Education and Literacy Initiatives:

- ✓ Develop educational workshops delivered by tax professionals.
- ✓ Create online resources and tutorials with user-friendly interfaces.
- ✓ Collaborate with educational institutions to integrate tax literacy into school curriculums.

Enhancing Trust and Fairness in the Tax System:

- ✓ Ensure the tax system distributes the tax burden fairly.
- ✓ Increase transparency in tax administration practices.
- ✓ Publicly disclose how tax revenue is spent.
- ✓ Establish a fair and predictable legal framework for tax disputes.

Effective Deterrence with a Balanced Approach:

- ✓ Implement proportionate penalties based on the severity of the offense.
- ✓ Combine enforcement with educational programs.
- ✓ Simplify tax codes and provide clear guidance.
- ✓ Establish alternative dispute resolution mechanisms for tax issues.

These recommendations aim to empower taxpayers with knowledge, build trust in the system, and encourage voluntary compliance through a balanced approach to deterrence.

Recommendation for Future Researchers

- ✓ This study highlights the importance of tax knowledge for compliance. Future research can explore how advancements in technology like automation, big data analysis affect tax compliance behavior.
- ✓ The study emphasizes the role of deterrence like fines and penalties but acknowledges the importance of a balanced approach. Future research can delve deeper into behavioral economics factors and explore how "pushes" and other non-punitive interventions can influence taxpayer behavior.
- ✓ The rise of the gig economy and the sharing economy presents new challenges for tax collection. Future research can explore effective ways to integrate these new models into the tax system while maintaining compliance.

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Appendix 1

Appendix 1: Questionnaire

St. Mary's University
School of Graduate Studies
Department of Accounting and Finance

Dear Respondents,

I am conducting a research project titled " Factors Affecting Tax Compliance Behavior of Small Tax Payers: The case of North West Addis Ababa Branch Office" as part of the requirements for my master's degree in Accounting & Finance at St. Mary's University. The main objective of this study is to identify and understand the factors that influence tax compliance at the Small Tax Payers Branch Office of the Ministry of Revenues in North West Addis Ababa.

Your participation in this research is crucial as it will be based on your responses and other relevant data to gain insights into tax compliance behavior. The information you provide will be used to critically analyze why small taxpayers comply or fail to comply with reporting requirements. The research findings and recommendations will be shared with the concerned government bodies to aid in decision-making and improve compliance measures.

Please note that your responses are strictly for academic purposes and will be treated with the utmost confidentiality. Your cooperation in answering all the questions is highly appreciated, as it will contribute to a comprehensive understanding of tax compliance behavior in the specific context of the Small Tax Payers Branch Office.

Thank you in advance for your valuable cooperation!!

Researcher's Name: Serkalem Hailu
Position: MBA in Accounting and Finance student at St. Mary's University
Phone number: 0911 16 45 22

SECTION A: BACKGROUND INFORMATION OF THE RESPONDENTS

1. Gender: Male ☐ Female ☐

2. In which age range do you fall?

AGE BRACKET	TICK APPROPRIATELY
20-30	
31-40	
41-50	
51-60	
Above 60	

3. What is the highest level of education you have completed?

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

4. What is your annual turnover?

TURNOVER (Birr)	TICK APPROPRIATELY
BELOW 5 million	
5-10 million	
11-15 million	
16-20 million	
OVER 20 million	

5. Have you participated in or completed any formal tax-related courses or training offered by the Ministry of Revenues?

Yes ☐ No ☐

SECTION B: BACKGROUND INFORMATION OF THE BUSINESS.

1. How long have you been in the business?

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

SECTION C: TAX COMPLIANCE LEVEL

Tick Appropriately.	Strongly disagree (1), Disagree (2), Not Certain (3), Agree(4), Strongly agree (5)				
	1	2	3	4	5
The business pays the correct amount of taxes on time.					
The business submits its tax returns within the designated timeframe					

PART I: PERCEIVED FAIRNESS FOR TAX SYSTEM

Tick Appropriately.	Strongly disagree (1), Disagree(2), Not Certain (3), Agree (4),Strongly agree (5)				
	1	2	3	4	5
The requirements for tax compliance may cause stress and anxiety for taxpayers, leading to psychological impact.					
The tax system in Ethiopia ensures fairness by making comparisons among individual taxpayers, groups, and society as a whole.					
The tax authority follows fair procedures, and its officials are trustworthy, polite, honorable, and respectful.					
The Ethiopian tax system implements a fair tax rate that considers the ability of all taxpayers.					
The tax laws, regulations, and directives in Ethiopia maintain their hierarchical structure and do not contradict each other.					
Tax authority circulars do not compromise the fairness of the tax system.					
Personally, I believe that the Ethiopian tax system is easy to comprehend and takes taxpayers' circumstances into consideration					

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PART II: TAX KNOWLEDGE AND EDUCATION

Tick Appropriately.	Strongly disagree (1), Disagree (2), Not Certain (3), Agree (4), Strongly agree (5)				
	1	2	3	4	5
The tax authority's educational assistance helps me maintain proper bookkeeping and protects me from potential taxes, interest, and penalties that may arise due to a lack of knowledge.					
I am knowledgeable about which income should be included or excluded when determining taxable income.					
I understand that I should promptly pay taxes due from the date of issuance of the Notice of Assessment or within the prescribed period					
I am aware of the procedures for maintaining records and documents related to income and expenses for the required period.					
I have received adequate and ongoing tax-related education from the tax authority.					
I possess knowledge on how to report all income received from various sources to the tax authority.					

PART III: FINES AND PENALTIES

Tick Appropriately.	Strongly disagree (1), Disagree (2), Not Certain (3), Agree (4), Strongly agree (5)				
	1	2	3	4	5
I support fines and penalties as they have a significant impact on tax compliance.					
I believe that the penalty is lower than the tax savings I would achieve by not complying.					
The enforcement of penalties seems very poor					
Serious enforcement and penalties by the tax authority make me more conscious about tax compliance.					
The penalty rates are affordable, and I can pay the penalty without any complaints.					

PART IV: THE TRUST AND POWER OF TAX AUTHORITY

Tick Appropriately.	Strongly disagree (1), Disagree (2), Not Certain (3), Agree (4), Strongly agree (5)				
	1	2	3	4	5
I believe that the tax collector does not take actions that negatively affect my business.					
Do tax authority officers use their power to seek bribes or engage in corrupt practices?					
There is great trust between taxpayers and the tax authority.					
Most taxpayers have a positive response towards the power of the tax authority.					
The tax authority uses its power as prescribed by law.					