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**WOLKITE UNIVERSITY
COLLEGE OF BUSINESS AND ECONOMICS
DEPARTMENT OF ACCOUNTING AND FINANCE**

**FACTORS AFFECTING TAX COMPLIANCE IN SMALL AND
MEDIUM ENTERPRISE IN WOLKITE TOWN**

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DECLARATION

I, the under assigned, hereby declare that this research paper entitled” **Factors Affecting Tax Compliance in Small and Medium Enterprise in Wolkite Town**” is my original work prepared under the guidance of Miss. Lakech E. (MSc). All sources of materials used for the research have been duly acknowledged.

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This paper has been submitted for examination with my appropriate approval as advisor.

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ACRONYMS

CTPA:	Center for Tax Policy and Administration
DRM:	Domestic Revalues Mobilization
EBDSN:	Ethiopian Business Development Service Network
ECC:	Ethiopia Champers Commerce
ERCA:	Ethiopia Revenue and Custom Authority
GDP:	Gross Domestic Product
IRS:	Intimae Revenue Service
MICS:	Medium Income Countries
OECD	Organization for Economic Corporation and Development
SMEs:	Small and Medium Enterprises
TIN	Tax payers Identification Number
TOT:	Turn Over Tax
USA:	United States of America
VAT:	Value Added Tax

ABSTRACT

This study investigated factors affecting tax compliance of small and medium enterprises in Wolkite town. This will greatly inform efforts to enhance tax compliance of small and medium enterprises in the town. The multiple regression model was estimated as analytical tools. The study is based on household-level data collected in 2020 from 134 randomly drawn micro and small enterprises working in Wolkite town. The multiple regression analysis indicated from among 7 explanatory variables 5 were significant in explaining the factors influencing tax compliance of small and medium enterprises in Wolkite town. These variables were age, education, tax rate, tax knowledge of the tax payers and tax compliance costs. Of these, education and tax knowledge of the respondents indicated positive influence, while age, tax rate, and tax compliance costs exerted negative impact. The result of the study suggests working on raising the knowledge and awareness of micro and small enterprises tax payers will improve their tax compliance behavior in Wolkite town.

CHAPTER ONE

INTRODUCTION

1.1 BACK GROUND OF THE STUDY

Now a day all developed and developing countries are depending on tax to assure their government revenue. It is a contract between citizen and state of countries concerned. Tax compliance is a degree to which tax payers are compliance or fail to comply with the tax rules and regulation of the countries and can be expressed by declaring income filling return over stating tax claim and paying tax in time manner (Cummings, 2009).

Similarly tax compliance is defined by many authorities as the ability and willingness of tax payers to compliance with the tax law which declare the correct income in each year and pay right amount of tax on time (IRS, Intimae Revenue Service, 2009). Marti (2010) defines tax compliance as fulfilling all tax obligations as specified tax law which declares the correct income in each year and regulation freely and completely.

As reports of CTPA (Center for Tax Policy and Administration, 2010) tax compliance generally include the following basic tax compliance obligation of the citizens and residence of particular country of business persons that must be administrated by all revenue body and their respective tax law are include register for tax, file tax liabilities. This compliance of taxpayers of basic obligation can checks in terms of weather such compliance achieved voluntarily or correct by enforcement of action carried by government revenue body.

Tax noncompliance is a failure of tax payers to meet tax obligations weather it is done intentionally (Jemez and Ally, 2009). Kirsches (2010) broadly classified tax noncompliance as failing to file tax return, under reporting of taxable income overstating of tax claim such as deduction and exemption and failing to timely payment of tax liabilities. Other terms used in the tax compliance and non-compliance context is tax evasion (tax avoidance) or unacceptable tax minimization arrangements. Tax noncompliance diminishes the mobilization of resources that government needs to invest in development programs, social and personal development like health, education, social security and infrastructure development (Cumming, 2010).

Noncompliance tax is a serious challenge in both developed and developing countries of tax authorities. Tax is the contract between citizens and government of one state. Tax compliance and administration is a mandatory for countries to avoid the external aid dependence and in turn make sustainable efforts towards poverty reduction. It shall be paid fairly and often it is called the revenue fairly distribute to citizen on behalf (European Parliament, 2018).

Small and medium business is a profit generating and expects to pay their duties to the government. The most important question is how much tax shall believe small and medium volatile establishment which needs special treatment. Putting their nature into consideration every little source at their disposal can make a world of difference; people need to pay tax based on the rational of horizontal and vertical equities. It is not always the case that tax systems are comprehensible and transparent for tax payers (ECC: Ethiopia Chambers Commerce and EBDSN: Ethiopian Business Development Service Network, 2010).

A number of Ethiopian small and medium business operators' choice to remain in the informal sectors. Considerable numbers of those who pay taxes only do because they are forced by Ethiopian Revenue and Custom Authority (Ethiopian development research institution, 2018). Previous study identify various variables as the major determinants of tax compliance. According to (OELID, 2008) for small and medium business tax compliance is associated with heavy cost due to various limitations they face particularly, unmaintained proper and sufficient records for management taxations purpose.

Taxpayers' behavior towards tax system has induced noticeable attention among several revenue authorities within the world particularly in developed countries. However, it is debatable on what has been done towards the study of taxpayers' behavior towards tax system in developing countries as they concentrate more on studies which might increase their budgets "bottom-line" in terms of enormous revenue assortment and social control efforts at the expense of studies on taxpayers' behavior which might build increase during this government income to be complete and social control efforts work (Marti, et al., 2010).

Following the increasing cases of tax disobedience, particularly non-payment and its consequences on the capability of a government to lift public revenue, large amount of attentions are paid to the difficulty of tax compliance globally by public policy makers and researchers for the past few decades. The compliance costs of MSEs are higher than

the larger business. This leads to limited capacity of developing countries in Ethiopia in general and in Wolkite town in particular to raise revenues for development purposes. In line with on top of realities, the aim of this study is to asses factors affecting tax compliance in small and medium enterprise in wolkite town, Gurage zone, Ethiopia.

1.2 STATEMENT OF THE PROBLEM

Tax compliance is a growing international concern for tax authorities and public policy makers as tax evasion seriously threatens the capacity of government to raise public revenue (Stephen B.2011).Tax is an import source of government revenue. The tax existence of collective consumption of goods and service insist on people tax lays to the government. The public good and service include road, electric power, municipal service and further public infrastructure has favorable results. Government intervention in the supply of public good is therefore the former and only done if public pay tax for production and supply of such goods (ERCA: Ethiopia Revenue and Custom Authority, 2018).

Tax compliance has subject matter of research in developed and developing countries. Each country has its own approaches to manage its compliance tax level and reach has different tax law and regulation. The factors influencing tax compliance behavior appears vary among countries (Pull, 2011). Currently government of developing countries collected less proportions of their GDP in tax revenue compared to developed countries. Their tax efforts induce revenue collection related to estimated revenue potential are also lower than those of organization for Economic Corporation and Development (OECD) countries. Many low income countries including sub-Sahara African countries report tax GDP ratio below 15 which is generally hard to the ministry of finance and economic development, 2018).

The government clearly stated that the effect will be geared towards promoting tax compliance, equipping tax collection institution and undergoing tax administration measure to further increase value mobilization at federal, regional and zonal level. However, the effort can bring the required result continued to lower revenue collection level for government is determined to economic development of the nation (Cob Harm, 2010).

Tax is that the main part of government revenue that may be accustomed to finance all the government expenditure to stabilize the economy. In Ethiopia, the government imposed

direct tax and indirect among others; as major and vital sources of public revenue for the promotion of its economic process. However, this imposition of tax could not still bring the desired result due to variety of reasons such among that the main reason is tax payers do not comply with their tax obligation (Tesfaye, 2015). Among different things, the challenges facing tax collectors are existence of taxpayers' culture to evade and avoid taxes, social disapproval among taxpayers against tax offences and taxpayers delay in tax declaration (Mpambara, Byiringiro and Donatille, 2013).

Even if improving voluntary tax payer compliance is one of the most important, to the best of the researchers' knowledge the factors influencing tax compliance is not well understood and studies have not been carried out especially on micro and small Business enterprises tax payers in our study area in Ethiopia in general and Wolkite town in particular. Therefore to fill this gap, this study was undertaken to examine factors affecting tax compliance of small and medium business tax payers in Wolkite town administration.

1.3 RESEARCH HYPOTHESIS

In order to identify factors that influence tax compliance the following major hypotheses are taken into consideration.

1. Being age, gender and education level of tax payers have positive and significant effect on tax compliance
2. Tax compliance cost has a negative and significant impact on tax compliance of small and medium enterprise .
3. Tax knowledge and awareness has a negative and significant effect on tax compliance
4. High tax rate has a negative and significant impact on the level of tax compliance among small and medium enterprise tax payers
5. Tax audit has a positive and significant effect on tax compliance of small and medium enterprise tax payers

1.4 OBJECTIVE OF THE STUDY

1.4.1 GENERAL OBJECTIVE

The general objective of the study is to assess factors affecting tax compliance among small and medium enterprise in Wolkite town, SNNE, Ethiopia.

1.4.2 SPECIFIC OBJECTIVES

The specific objectives of the study were:

- ❖ To investigate the effect of demographic factors such as gender, age and education level on tax compliance of small and medium enterprise
- ❖ To examine the effect of tax compliance cost of small and medium enterprise tax payers on tax compliance.
- ❖ To examine the effect of awareness of small and medium enterprise on tax compliance
- ❖ To see the effect of tax rates on tax compliance among small and medium enterprise tax payers.
- ❖ To examine the effect of audit productivity on tax compliance of small and medium enterprise tax payers.

1.5 SIGNIFICANCE OF THE STUDY

Study about taxation is significant because taxation is believed to be central to economic, social and political development. According to several authors a strong tax system can play three important roles in national development: revenue generation (Keen, 2012), lessen inequality (Cobham, 2005) and promote good governance (Odd-Helge & Rakner, 2009). Research on understanding factors explaining Micro and small business enterprises taxpayers' compliance is appropriate and timely. Many developing countries are now re-focusing on taxation to reduce over-dependency on aid or one source of revenue for development.

This study focused on investigating the determinants of tax compliance of Micro and small business enterprises. It is anticipated that the results of this study will provide concepts and grounds on which to develop a framework. The knowledge accruing from this study could benefit the Government of Ethiopia and its revenue collection body Ethiopia Revenue and Customs authority in its effort to design suitable tax policies for MSEs. This study has provided concepts which to develop a framework to explore tax compliance behavior among MSEs. The research will be useful to the business community and organization's management teams for purposes of knowing the tax compliance environmental factors and how the conditions can be improved or dealt with.

Finally, the research will be of interest to scholars and researchers who may require developing and/or advancing their knowledge in the field of tax compliance and

administration. Researchers found the findings of this study are important as it will act a reservoir of knowledge for further research.

1.6 SCOPE OF THE STUDY

This study focused only on small and medium level tax payers. The scope of this study is also focused on the factors affecting Tax Compliance among Small and Medium Enterprise in terms of structure of tax system such as perception on equity or fairness of tax system, tax knowledge and awareness of offenses, tax rate and tax audit educational level of tax payers and the role of tax authority in Wolkite town administration. Therefore this study couldn't address all determinants of tax Compliance dimensions.

1.7 LIMITATION OF THE STUDY

Due to large number of tax payers the study was not cover all individual tax payers. Therefore the researcher is obligated to take sample in order to draw inferences. Taking samples by its nature have its own limitation. Another limitation is shortage of time and finance of the student researcher to conduct the tax compliance behavior of all taxpayers in the study area. COVID-19 also affected the researcher to collect all necessary data from respondents. Similarly the study was limited to wolkite town on small and medium enterprise taxpayers.

1.8 ORGANIZATION OF THE PAPER

This research paper is compiled as follows: Chapter one contains back ground of the study, statement of the problem, research hypothesis, objectives of the study, significances of the study, scope of the study and organization of the paper. Chapter two is the literature review, definition of small and medium enterprise tax compliance. Chapter three contains research methodologies and design, source of data, data collection method, population, sample size and sampling techniques. The fourth chapter deals with data analysis and presentation. The fifth chapter contains conclusion and recommendations of the study.

CHAPTER TWO

LITERATURE REVIEW

This chapter represents review of related literature concerning the definition of small and medium business profit tax payers and their tax compliance; theories about tax are presented in the literature review part.

2.1 THEORETICAL LITERATURE REVIEW

2.1.1 THE CONCEPT AND DEFINITION OF TAX COMPLIANCE

Tax compliance is a major problem for many tax authorities and it is not an easy task to persuade taxpayers to comply with tax requirements even though tax laws are not always precise (James and Alley, 2004). The meaning of tax compliance has been defined in various ways. Marziana, and Mohmad (2010), define tax compliance as the degree to which a taxpayer complies or fails to comply with the tax rules of their country. According to Marti (2010), tax compliance is fulfilling all tax obligations as specified by the law freely and completely. Tax compliance is the ability and willingness of taxpayers to comply with tax laws, declare the correct incomes in each year and pay the right amount of taxes on time. Andreoni, Erard, and Feinstein (1998) claimed that tax compliance should be defined as taxpayers' willingness to obey tax laws in order to obtain the economic equilibrium of a country.

Song and Yarbrough (1978) suggested that due to the remarkable aspect of the operation of the tax system in the United States and that it is largely based on self-assessment and voluntary compliance, tax compliance should be defined as taxpayers ability and willingness to comply with tax laws which are determined by ethics, legal environment and other situational factors at a particular time and place. Compliance in administration terms, therefore, includes registering or informing tax authorities of status as a taxpayer, submitting a tax return every year if required and following the required payment time frames (Ming Ling, Normala and Meera, 2005).

In contrast, the wider perspective (Singh, V and Bhupalan . R, 2001) defined tax compliance in a pure administration term the degree of honesty, adequate tax knowledge and capability to use this knowledge, timeliness, accuracy, and adequate records in order to complete the tax returns and associated tax documentation.

2.1.2 GENERAL DEFINITION OF SMALL AND MEDIUM ENTERPRISE PROFIT TAX PAYERS

Many authors and organization have to define what actually small and medium enterprises are. Various definitions have been put forward and all are based on variables such as number of employees, turn over level, total net asset and capital base. For example South Africa is defined as any business with below 200 employees, annual turnover of less than five million, capital asset of less than two million and with owner who are directly involved management of businesses (Nelson, 2014).

In the USA small and medium enterprise is defined as an entity that is independently owned and operated and which does not dominate in its field operation (His Richet etal, 2004). The Australia tax office want further to separate small and medium enterprise from micro enterprise and large firms by using the annual revenue baseless than two million is categorized as microenterprise and above 250 million is large enterprise.

Different academic discipline has similarly endeavor to define SME using different fundamental variables and characteristics. However, most of this definition has been depends on size, measured in term of annual sale revenue, total asset figure and average number of permanent employees (Q.Jelson, 2014).The classification of business into small and medium scale depends on number of variables such as level of employment, turn over, capital investment, production, capacity level of technology and subsector. Accordingly, the following scale indicates classifications of enterprise in the Ethiopian context.

2.1. 3 GENERAL REVIEW OF SMALL AND MEDIUM ENTERPRISE TAX PAYERS

Most large company has their roots in small and medium enterprise suggested that future large corporations are the small and medium business of today that must be raise to enter their growth. Therefore, developing economies like Ethiopia needs to further development of its private sector by creating an environment favorable to the growth of small and medium business, strengthening the factors that lead business success and address the problem treating the existence and advancement of small and medium business enterprise. It is well known that the revenue generated from the taxation of individual and businesses are an important stream of income for government.

Tax revenue is source of funds for development projects such provision of infrastructure like road, stable power supply, water supply etc. All of these are combined to create an enabling

environment for business and intern the economy at large growth. In most Organization for Economic Corporation and Development (OECD) countries, small and medium enterprise represent over 95% of enterprise and generate over 50% of private sector employment (European commission, 2008). Small and medium sized enterprise plays the central role in a European economy. They are a major source of entrepreneurial skills, innovation and employment.

2.1.4 THEORIES OF TAX COMPLIANCE

Various opinions exist about ways to improve tax compliance. Given the chance a lot of the business will not pay taxes unless there is a motivation to do so some believed that the best way is to increase encouragement (Field Frey, 2007). Other believes the best way is to increase penalties. The following tax compliance theories are considered suitable for this study.

- Economic based theories
- Non-economic or psychological based theories

2.1.4.1 ECONOMIC BASED THEORIES

Economic factors such as tax and perception of government spending in relation to tax compliance referred to action which is associated with the cost and benefit of performing the action and suggest that tax payers are moral utility maximizes. They are influenced by economic motive such as profit maximization and probity of detection as such they analysis alternative compliance paths for instance whether or not to evade tax.

The likelihood of being detected and resulting effects and then select the alternative that maximize their expected after tax return after adjusting for risk (Trivedi and Shehata, 2005).They will attempt to minimize their tax liability, for instance by intentionally under reporting their income and will enjoys tax saving if they were not detected by the tax authority (Sandmo,1972).

Similarly, the economic deterrence theories state that tax behavior influenced by factor such as tax rate determine the benefit of evasion and the probability detection and penalty while determined the cost (Andmo, 1972).Concerning perception of government spending in relation to tax compliance, logically tax payers are sensitive to what government spend their money on(lalil,2010). According to (palil) tax payers will tend to avoid taxif they perceive that government spent tax money wisely. In addition to that (Roberts et al,1994)also suggests

that if the government is wisely spending national revenue, for example basic facility like, education, health, safety and public transaction, it is likely that voluntary tax compliance will increase.

2.1.4.2 NON ECONOMIC OR PSYCHOLOGICAL BASED THEORIES

Psychological based theories on the other hand put forward that tax payers are influenced to comply with tax obligation by psychological factors. They focus on tax payer's moral and ethics. The theory suggests that tax payer comply even the probability of detection is low as opposed to economic theories that emphasize on factors such as increased audit and penalty as solution to compliance issues, Psychology theories by emphasis on changing individual attitude toward tax system (Ahn and Torgler,2012).

There are many non-economic factors to affect the level of tax compliance. These non-economic factors include the willingness to pay for public provision, public education, tax knowledge and information, attitude toward tax, personal and social norms and perceived fairness of tax system.

Tax compliance is proposed to be studied based on a psychological tax contract representing public interaction between tax payers and the government in establishing a fair and reciprocal exchange (Field Frey,2007).The existence and survival of this contract is an apparent in a number of circumstances in prior studies. For instance, if taxes paid and service provided by government are regarded as equitable, tax payers may be fulfill with the tax laws and this has significant positive effect on tax Compliance(Ibid).

2.1.5 TAX COMPLIANCE BY SMALL AND MEDIUM ENTERPRISE PROFIT TAX PAYERS

The fundamental purpose of taxation is to raise revenue effectively through measure that suit each countries circumstances and administrative capacity. Fulfilling the revenue function a well-designed tax system will be efficient in minimizing the misrepresentation impact on resource allocation and equitable in its impact on different groups in society (Ojochoguw and Stephen, 2012).An effective and efficient tax administration system is integral to any countries wellbeing (Baurer, 2005) believes that the tax administration must provide an even playing field for businesses by ensuring that all tax payers meet their tax filling and paying requirements.

The tax administration must balance its educational and assistance role with its enforcement role. According to (Marti, 2010) tax compliance is a complex term to define. Simply tax compliance refers to fulfilling all tax obligations as specified by the tax law freely and completely. It has been found that regulatory burdens fall disproportionately on small and medium enterprises intentionally (pope and Abdul Jobber, 2008). Their size and nature makes the issue of tax compliance one of particular importance especially since most small and medium have access to limited resources and inadequate expertise to comply with diverse and complicated regulation.

Tax noncompliance maybe in one of many forms, it could either be a failure to submit tax return within the specific period or no submission under the statements of income over statement of detections, failure to pay assessed tax by due date (Hanefahetal,2002). In some cases noncompliance may mean a complete failure to pay taxes. Furthermore, (Fagbemi and Noah, 2010) found that it is prevalent in developing countries and it hinders development there by leading to economic decline and other socioeconomic problem.

Ojochoguw and Stephen, 2012 identified tax rates and complex filling procedures as the major causes for compliance. They pointed out that a higher tax rate increases taxpayers' burden and reduces their disposable income. Therefore, the probability of avoidance taxes is higher. Different variables are core determinants of tax compliance of small and medium enterprises namely tax rates, tax audits, perception of government spending, role of tax authority, simple city of tax return and administration, probability of detection, awareness on offenses and penalty and personal financial constraints (Yong and Hooper, 2011).

In Ethiopia, all small and medium enterprises are required to be formal, probably licensed and subject to paying taxes as per the tax proclamation of the country. Tax payers who receive income from trade are required by law to register for tax (have their TIN Tax payers Identification Number) keep and maintain sufficient records for tax purposes, carry out tax assessments, pay taxes as due and carry out other tax related duties like withholding and paying employment income tax on behalf of their employees.

All small and medium business is required to use cash register machine. Most business operators of small and medium tax payers are subject to indirect taxes like VAT, TOT and are required to comply with all applicable provision under the respective tax status. For instance, small and medium businesses whose annual taxable transaction is less than birr

500,000 are required to pay turn over to equalize and famines in commercial relation and intake complete the coverage of tax system so as to increase government revenue from taxation (ERCA,2015).

Compliance by small and medium businesses to the different tax regulation require same level of tax knowledge in order for them to be able to interpret the provisions of different tax status. Without this knowledge small and medium business acquires internal and external costs as they seek to be compliant with the tax laws and regulations.

2.1. 6 DETERMINANTS OF TAX COMPLIANCE

Jackson and Milliron (1986) listed several factors that have influenced tax compliance as discussed by various researchers. These factors include:

2.1.6.1 DEMOGRAPHIC CHARACTERISTICS

Age, gender, income, level of education is tax compliance determinants from demographic perspective variables used in tax compliance research. Researchers have long studied demographic factors such as age; however, the findings from different studies remain inconclusive. For example, Tittle (1980), Warneryd and Walerud (1982) posit a negative association - older people are less compliant. In contrast, Clotfelter (1983), Dubin and Wilde (1992) argued that age was positively related to compliance. However, there have been a significant number of studies that have found no relationship (Spicer and Becker, 1980).

Mason and Calvin, 1984 reported younger people likely to admit underreporting of taxable income than the older people. In the study using taxpayers in the US and Hong Kong, Chan, Troutman, and O'Bryan, (2000) found that the decision to comply with tax rules is driven by the age of the respondents. The result suggests that older taxpayers are more tax compliant than the young taxpayers

The association between gender and tax compliance has received some attention in prior literature however, findings vary across studies. Some studies found that males are more compliant but others found the other way around. Although the agreement among the findings is still in discussion, the need to explore this more fully is still relevant especially in a SAS, in order to help tax administrators to plan and determine the framework of their tax

audits and help target tax education programmers effectively differences in the toward risk-taking. Studies had indicated

2.1.6.2 SOCIAL FACTORS THEORIES (FAIRNESS / EQUITY OF TAX SYSTEM)

The theory suggests that taxpayers are compliance behavior is influenced by fairness of the tax system and effects of referrals. Fairness of the tax system is a concept of having equitable tax system. Fairness of the tax system is believed by the taxpayers and tax authority as one of the significant determinants of compliance decision (Amina and Saniya 2015). Warneryd and Walerud (1982) suggest that perceived inequity in the tax system does not contribute to tax evasion, but it is used to rationalize non-compliant behavior.

When we come to see effects of referrals: Individual taxpayers do not live alone in this world and they have to interact with others in their daily life. Thus influence of one person on another in their compliance is an important part of their continuous existence in society. Perception of peers not to comply with the tax laws resulted in the taxpayers' non-compliance action (Hai T 2011).

Decisions to comply or not are sometimes influenced by family members and friends (Ajzen and Fishbein, 1980). A Behavioral research by (Puspitasari and Meiranto, 2014) states that peer groups have a strong impact on behavior, preferences and personal values of the individual person .However, (Green, 2000) found that there is no significant correlation between taxpayer non-compliance and knowing non-compliant peers.

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

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

Related to distributive justice, comparisons are made on the individual, the group, and the societal level. On the individual level, taxpayers are concerned about the fairness of their outcomes, and they want to be treated relative to their merits, efforts and needs. If an individual's tax burden is heavier than that of comparable other individuals, tax compliance is likely to decrease. On the group level, taxpayers are concerned about the fairness of outcomes of the group and want a fair treatment of their group relative to other income groups (Spicer and Lundstedt, 197).

2.1.6.3 INSTITUTIONAL FACTORS (EFFECTS OF TRUST AND POWER OF TAX AUTHORITY)

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

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

While reasonable authority can be seen as a helpful assessment of authorities, power that is associated with positive attitudes towards tax authorities, strong power describes tax

authorities' abilities to notice tax crimes and to carry out severe penalty. As long as power of authorities is supposed as legitimate, it is not necessarily regarded as negative but instead is perceived as having positive effects on citizens trust (Lavoie, 2008). Legitimacy of authorities' actions is deeply connected with procedural fairness (Tyler 1990a, 1990b).

For example, in Switzerland, if taxpayers are called to participate in decision-making processes through referenda, authorities power is likely to be perceived as legitimate and actions against evasion serve the maintenance of law and order (Bohnet and Frey, 1994). In contrast, if citizens have no speech, authorities power may be perceived as coercive, and actions to control citizens are likely to be judged as "cops fighting robbers." Therefore, the prevailing tax climate influences the perception of changes in power.

For many aspects of tax compliance, there is a debate in the literature as to how the effective operation of the tax system by the tax authorities influences taxpayers' compliance behavior as researchers from different countries have been unable to achieve agreement about this issue, which appear to differ from country to country. Therefore, different countries have proposed and developed a different solution to the relationship between taxpayer compliance and their operation of the tax system. The role of the tax authority in minimizing the tax gap and increasing voluntary compliance is clearly very important.

Hasseldine and Li (1999) illustrated this, placing the government and the tax authority as the main party that needs to be continuously efficient in administering the tax system in order to minimize tax evasion. The government plays a central role in designing the tax systems itself, and the specific enforcement and collection mechanisms (Hasseldine and Li, 1999). Furthermore, Roth and Witte (1989) suggested that in order to increase compliance, maximize tax revenue and be respected by taxpayers, a government must first have an economical tax system, which is practicable; they must discourage tax evasion and not induce dishonesty; they must avoid the tendency to dry up the source of the tax and should avoid frustrating and raising political difficulties; they should also have a good relationship with the international tax regime.

2.1.6.4 TAX KNOWLEDGE AND EDUCATION

In addition to reducing the compliance costs, small and medium business have to understand and cope with the administrative and legal requirements. One possible route of

action is to increase small and medium business owners' level of knowledge (Bernadette et.al, 2018). Small and medium business owners not only self-reports and pay their income taxes but need to take account of various types of business taxes such as property taxes, payroll taxes and sales taxes such as Value Added Tax (VAT) and Total Over Turn (TOT) (Christen et al,2004).

The required substantial tax knowledge about the different compliance measurement and requirements in order to understand the role and pay appropriate taxes . The degree of tax knowledge is an important factor on the behavior of taxpayers. Less educated tax payers are less expected to tax compliance information and less informed about relevant tax compliance information to tax evasion (Adreois Enad, 1998).

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

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

High awareness by the society would encourage people to fulfill their obligations to register as taxpayer reporting and paying taxes properly are forms of national and civic responsibility. Most citizens do not have much understanding of what tax laws mean and why the tax system is structured and administered as it is states that tax knowledge reveal that there is a relationship with taxpayers' ability to understand the laws and regulation of taxation and their ability to comply. Tax knowledge is necessary to increase public awareness especially in

areas concerning taxation laws, the role of tax in national development and especially to explain how and where the money collected is spent by the government (Mohd, 2010).

The influence of knowledge on compliance behaviors has been assessed in various researches. Knowledge as one of the factors in compliance is related to the taxpayers' ability to understand taxation laws and their willingness to comply. The aspect of knowledge that relates to compliance is the general understanding about taxation regulations and information pertaining to the opportunity to evade tax (Kasipillai, Norhani and Noor, 2003). Taxpayers will readily accept any new system introduced like self-assessment system, if they have plenty of knowledge to understand the system.

Thus, education programs organized by the tax authority or other public education institutions are needed to enhance taxpayers' ability to understand self-assessment System and to increase their confidence in fulfilling their responsibilities as taxpayers (Mohani, 2001). Greater education is directly linked to a likelihood of compliance. Educated taxpayers may be aware of noncompliance opportunities, but their potentially better understanding of the tax system and their higher level of moral development promotes a more favorable taxpayer attitude and therefore greater compliance (Chanet.al.2000).

2.1.6.5 TAX RATES

James, Brian and Jonathan (1998) claimed that the theoretical models indicate that, as income rises, tax evasion should increase over most ranges. Although there are special cases in which cheating declines with income, the regressive bias of tax evasion is the general prediction. By contrast, theoretical models generate no clear predictions on the effects of tax rates on compliance. The presence of both income and substitution effects complicates the analysis and special assumptions about the form of penalties, distribution of income and shape of preferences are often required to identify any comparative statics.

Clotfelter (1983) claimed that "reducing tax rates is not the only policy that has the potential to discourage tax evasion" but the tax rate is an important factor in determining tax compliance behavior although the exact impact is still unclear and debatable Kirchler, (2007). Clotfelter also suggests that there was a significant relationship between tax rates and evasion due to tax rates being used as an instrument that can be manipulated for policy goals in particular. Raising marginal tax rates will be likely to encourage taxpayers to evade tax more

(Witte and Woodbury, 1985; Ali, Cecil and Knoblett, 2001; Torgler, 2007) while lowering tax rates does not necessarily increase tax compliance (Trivedi, Shehata, and Mestelmen, 2004; Kirchler, 2007) This uncertainty and conflicting issue (for example reducing tax rate to increase compliance) has attracted the attention of tax researchers aiming to come up with more certain and concrete evidence of the impact of tax rates on evasion. Allingham and Sandmo (1972) previously attempted to find a relationship between actual income, tax rates, penalty and investigation and tax evasion using statistical modeling.

2.1.6.6 TAX AUDITS

Studies claimed that tax audits have a positive impact on tax evasion (Dubin, 2007). These findings suggest that in self-assessment systems, tax audits can play an important role and their central role is to increase voluntary compliance. Audit rates and the carefulness of the audits could encourage taxpayers to be more cautious in completing their tax returns, report all income and claim the correct deductions to ascertain their tax liability. In contrast, taxpayers who have never been audited might be attracted to under-report their actual income and claim false deductions.

2.1.7 TAX COMPLIANCE COSTS

Tax compliance costs include three major components. Namely monetary costs ,time costs and psychological costs to the tax payers (Sandford, 1989). Monetary costs include tax professional (tax agents and accountants) and expenses related to taxation guides, books, communication and other incidental costs. Time costs are carried by the tax payer, mainly on record keeping for the purpose of completing the tax return and preparing tax details for tax professionals as well as time spent on dealing with the tax liability. Psychological costs comprise costs such as anxiety of handing complex tax matters.

2.1.8 ATTITUDE TOWARDS TAXES

Attitude towards taxes: represent the positive and negative evaluations that an individual hold of objects. It is assumed that attitude encourages individuals to act according to them. The tax payers with positive attitude towards tax evasion are expected to be less compliant than a tax payer with negative attitudes. Attitude towards tax evasion are often found to be quite positive (Richler and Hoelzl, 2000).

Tax payers' attitude may be influenced by many factors which eventually influence tax payers' behavior (Am Brecht, 1998). These factors which influence tax compliance behavior

are many and are different from one country to another and from one individual to another. They include tax payers perception towards tax system and revenue authority, peer attitude, tax payers understanding of the tax laws, motivation such as rewards and penalties, cost of compliance, equity of the tax system and demographic factors such as sex, age and size of income.

2.2. EMPIRICAL LITERATURE

2.2.1. A REVIEW OF EMPIRICAL STUDIES

Taxpayer's compliance to tax system may be influenced by many factors, which eventually influence taxpayer's behavior. Those factors that influence tax compliance and /or non-compliance behavior are different from one country to another and also from one individual to another (Kirchler, 2007). Below the researcher reviewed empirical studies conducted in other countries and Ethiopia.

Abubakari & Christopher, 2013 conducted study on 'Evaluating taxpayers' attitude and its influence on tax compliance decisions in Tamale, Ghana. According to this study, other important factors contributing for tax non-compliance of individuals were found to be the perception level of benefits derived from the provision of public goods and services particularly physical infrastructure, problems of understanding the tax laws, and levels of accountability and transparency in governance are matters that tax payers have less regard for their tax compliance issues.

Ojochogwu & Stephen (June 2012) also conducted study on 'Factors that affect tax compliance among micro and small enterprises' in Northern Central Nigeria revealed some of the issues of tax compliance. Data for this research was collected from primary sources using survey method (questionnaire and personal interview with 150 respondents of micro and small enterprises). The sample was obtained using a combination of non-probability (judgmental) and probability (random) sampling methods. Data analysis was made by using Microsoft Office excel 2007 using the one sample-size z-test. Thus according to this study, it was found that high tax rates and complex filing procedures are the most crucial factors causing non-compliance of micro and small enterprises. Other factors like multiple taxation and lack of proper enlightenment affect tax compliance among micro and small enterprise taxpayers to a lesser extent.

Other study made by Tilahun & Yadersal (2014) on “determinants of tax compliance behavior in Ethiopia: The case of Bahir Dar City taxpayers can be summarized as follows: The study used quantitative methods research approach to study the determinants of tax compliance. The study also employed survey methods of data collection using questionnaires. The data collected from 201 usable questionnaires was analyzed using T-test and one-way ANOVA. The results revealed that perception of government spending, perception of equity and fairness of the tax system, penalties, personal financial constraint, changes on current government policies and referral group (friends, relatives, etc.) are factors that significantly affect tax compliance behavior of taxpayers. However gender and probability of being audited have no significant impact on tax compliance behavior. The findings also showed that older people will comply less if there is no equity and fairness in the tax system and any changes in government policy on fuel prices, electricity and water rates are not favorable.

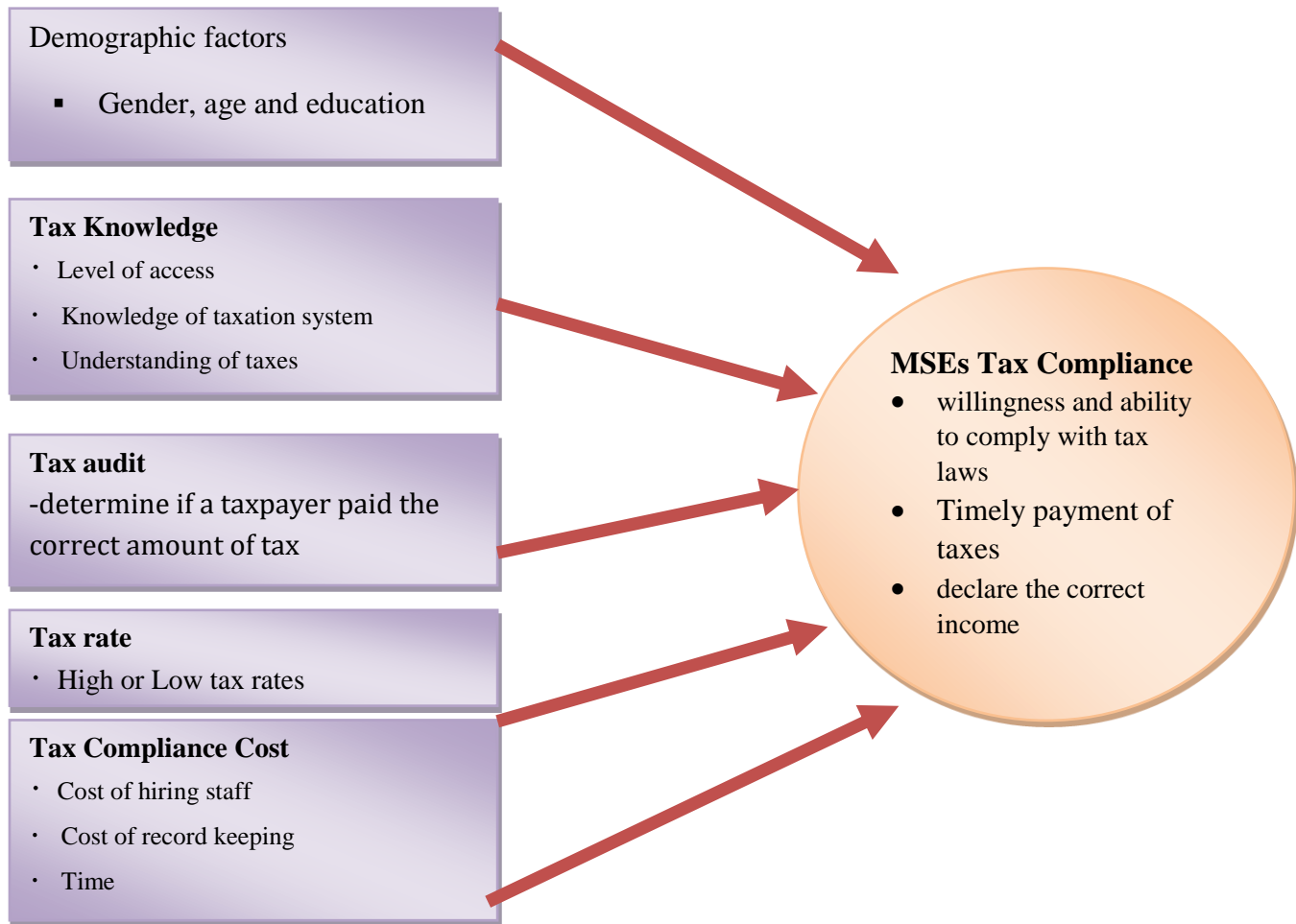
A study made by Amina and Saniya (2014) on tax compliance and its determinant the case of Jimma zone, Ethiopia, with the aim of investigating the determinants of tax compliance for the case of Jimma zone category ‘A’ taxpayers. The study tried to explore the main determinants of tax compliance. The findings shows that age, sex, penalty, audit, simplicity, fairness and government perception were found to affect tax compliance.

2.2.2 CONCEPTUAL FRAMEWORK

The study assumed that the determinants under discussion have a direct influence on tax compliance among SMEs in Ethiopia. The relationship between the dependent and the independent variables is illustrated in the conceptual framework presented in figure 1.

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CHAPTER THREE

METHODOLOGY OF THE STUDY

3.1 RESEARCH DESIGN

It is known that research designing is the blueprint (design) for fulfilling research objectives and answering research question in other words, it is a master plan specify the methods and procedures for collecting and analysing the needed information. It ensures that the study would be relevant to the problem and that it used economical procedures. This study employs both descriptive and explanatory research. Because the selected research problem allows the researcher to use both method. Its main goal is to describe the determinant of tax compliance of Micro and Small Business enterprises in Wolkite town.

3.2 TARGET POPULATION, SAMPLING TECHNIQUES, DATA SOURCE AND TYPE

3.2.1 TARGET POPULATION

For this study the target population is formally registered Micro and small business Enterprises in the Wolkite Town Administration Trade and Industry Development Bureau. According to Town Administration Trade and Industry Development Bureau by the year 2009 there are 358 micro and small enterprises which includes constructions the total population 94, manufactures the total population 73 trade the total population 88, services the total population 83 and agriculture the total population 20 enterprises in the town.

3.2.2 SAMPLING TECHNIQUES AND SIZE

There are 358 micro and small enterprises registered at Wolkite which are considered to be sample of this study. Since the total population is not large it was possible to collect data from all population but due to shortage of time, finance constraint and COVID-19 the researcher collected data from 145 micro and small enterprises found in Wolkite town. To represent all the population the researcher randomly selected sample from all micro and small enterprises in the town.

Finally structured and pretested questionnaire was prepared and administered to the sample micro and small enterprises to collect data. The data was collected via face to face (in-person)

interview. According to Kwak et al. (2007), a face-to-face interview is a preferred technique compared to other techniques, especially in the developing countries, because it provides the greatest scope for detailed questions and answers.

3.2.3 DATA SOURCE AND TYPE

For this specific study primary and secondary sources of data were used. Primary data was collected by survey method through face to face interview using questionnaires. As such a variety of qualitative and quantitative data were obtained for descriptive and inferential analysis of micro and small business enterprise tax compliance behavior. Secondary data source was collected from literatures, reports of revenue office of Wolkite town, etc.

3.4 METHOD OF DATA ANALYSIS

After the necessary data were collected from the primary and secondary sources, then, these data were grouped, coded and tabulated. Data were presented using tables. All these data were presented and implemented based on the nature of the data. The researcher employed both descriptive and econometrics method of data analysis and multiple regression analysis using STATA version 12. Using descriptive statistics, the researcher compared different categories of sample units with respect to the desired characteristics. Hence, in this study, descriptive statistics such as mean, standard deviation, and percentages were used to see the relationships between explanatory variables of small and medium business tax payers' tax compliance in Wolkite town. A multiple regression model was used to know the correlation between the dependent and independent variables of the study.

3.5 MODEL SPECIFICATION

In this study a multiple regression model was used to know the correlation between the dependent and independent variables of the study. Hence, the Multiple regression model is specified as follows:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \dots + \beta_n X_n + u_i$$

Where, Y is dependent variable which is tax compliance of micro and small enterprise.

β_0 is constant parameter

$\beta_1, \beta_2, \dots, \beta_n$ are coefficients of independent variables

X_1, X_2, \dots, X_n are independent variables

u_i is the error term

Based on the above general equation, the following model was established to estimate the parameters for the study.

$$TCOMP = \beta_0 + \beta_1 GENDER + \beta_2 AGE + \beta_3 EDUC + \beta_4 TKNW + \beta_5 TRATE + \beta_6 TCC + \beta_7 TAUDIT + u_i$$

Where: TCOMP: Tax Payers Compliance

AGE, GENDER, EDUC: is Age, Gender, and education level of respondents respectively

TRATE: Tax rate

TKNW: Tax knowledge (awareness) of the respondents

TCC: Tax compliance cost

TAUDIT: Tax audit

β_0 : Constant (Y intercept)

u_i Error term

$\beta_1, \beta_2, \beta_3, \beta_4, \beta_5, \beta_6$ and β_7 : Coefficients of the independent variables

3.6 VARIABLES DESCRIPTION MEASUREMENT AND EXPECTED RESULT

➤ **Dependent Variable**

- **Tax compliance level of micro and small enterprise:** is the dependant variable of this study. Tax compliance is defined as taxpayers' willingness to comply with tax laws, declare the correct income, claim the correct deductions, relief and returns and pay all taxes on time (Kasipillai and Jabbar, 2006). This variable is measured on five point Likert scale with: 1= strongly disagree, 2= disagree, 3 = neutral, 4= agree and 5= strongly agree.

➤ **Independent Variables:** For this study the data for the following seven independent variables were collected from the Micro and small business enterprise tax payers.

- **Age:** Age is considered as a factor affecting the level of micro and small enterprise tax payers' compliance behaviour.

- **Gender:** It is considered one of the important demographic factors when studying the determinants of micro and small enterprise tax compliance level of tax payers. This variable is coded 1 if respondent is male, 0 if the respondent is female
- **Education:** Education is also another issue that has to be dealt while examining the factors affecting tax compliance behaviour of tax payers. It is described as the respondent's level of education.
- **Tax knowledge (awareness) of the respondents:** Tax knowledge (awareness) is one of the important factors influencing tax compliance. This variable is related to the taxpayers' ability to understand taxation laws, and their willingness to comply. Through taxpayer education, the taxpayer is aware of the rights, obligations and the procedures of paying taxes as well as the consequences of non-compliance (Machogu & Amayi, 2013). This variable is measured on five point Likert scale.
- **Tax rate:** - This variable was measured by part VI items (three Questions). The majority of these items deal with the tax rate.
- **Tax compliance cost:** - This variable was measured by five likert scale (five questions). The majority of these items deal with penalty of taxpayers for not to pay tax.
- **Tax audit:** Is another important variable which effect tax compliance of micro and small enterprise tax payers.

The expected effect of key explanatory variables on dependent variable tax compliance is given by the following table.

Table 1: Expected effect of independent variables on dependent variable

Dependent variable	Description	Unit	Expected correlation between dependent and Independent Variables
Y= TCOMP, Tax compliance level of micro and small enterprise	willingness and ability to comply with tax laws	Measured by five likert scale	
Independent variables	Description	Unit	Expected correlation between dependent and Independent Variables
X1 = Age	Age of the respondents	Number	+ve
X2 = Gender	Gender of the respondent	1 if a household head is male, 0 otherwise	-ve/+ve
X3 = EDUC, Educational level	Respondents educational level	Years of education of the respondents directly taken as a number	+ve
X4 = TKNW, Tax knowledge (awareness) of the respondents	taxpayers' ability to understand taxation laws, and their willingness to comply	Measured by five Likert scale	-ve
X5 = Trate, Tax rate	Tax rate set by revenue authority	Measured by five Likert scale	-ve
X6 = TCC , Tax compliance cost	Cost of hiring staff, cost of record keeping, Time	Five Likert scale	-ve
X7 = Taudit, Tax audit	Determine if a taxpayer paid the correct amount of tax	Five Likert scale	+ve

3.7. DIAGNOSTIC TESTS

Before making the analysis of the result, it is important to judge the efficiency of the model using some diagnostic tests. In particular, inferences based on OLS results can be valid depending on whether the classical linear regression assumptions hold.

MULTICOLLINEARITY TEST

According to Thomas Andren (2007), Multicollinearity refers to how the explanatory variables are linearly correlated. If there is Multicollinearity problem in our model, it is really very difficult to conclude how the explanatory variables affect the dependent variable. It also

makes the estimated regression coefficients to have the wrong signs, smaller t-ratios, high standard errors and that might lead to wrong conclusions.

There are two alternative ways to detect Multicollinearity problem. **Variance Inflation Factor (VIF)**: Measures how the variance of an estimator is inflated by the presence of Multicollinearity problem. $VIF = 1 / (1 - r_{xy}^2)$, where r_{xy} is the coefficient of correlation between two explanatory variables of x and y. VIF is between one and infinite. If VIF is one, there is no Multicollinearity which means that the explanatory variables are independent. If VIF is infinite, there is perfect Multicollinearity which means that it is impossible to determine the independent impact of the explanatory variables on the dependent variable. As a rule of thumb, it is indicated by a VIF greater than 10. **Tolerance Margin (1/VIF)**: in which, as a rule of thumb, the presence of Multicollinearity is indicated by the tolerance margin ($= 1/VIF$) less than 0.1 or 10%.

Heteroscedasticity Test

It is the test of the variance of U_i whether to have a constant variance or not. If the error term doesn't have a constant variance, there is Heteroscedasticity problem. It makes estimated parameters consistent but inefficient (Thomas Andren, 2007).

Test of Overall Significance of the Model

The overall significance of the model has been tested by the F-test, by applying a rule of thumb as if F-calculated value is greater than 4, and then the explanatory variables included in the model were jointly significant and explain the dependent variable. The P-value can also be useful. The goodness of fit of the model will be measured by the coefficient of determination (R^2) and adjusted R^2 which show the percentage of the explained variation of the dependent variable (Gujarati, 2003).

Omitted Variable (Model Specification) Test

In this test, using Ramsey reset test, whether the model has omitted variable or not will be performed. The decision of this is, if p-value is higher means that there is no omitted variable (specification problem), otherwise the model has omitted variable (specification problem) (Thomas Andren, 2007).

CHAPTER FOUR

RESULTS AND DISCUSSION

This chapter focuses on the important findings and results obtained from the sample survey of sample respondents. The first section presents the descriptive statistics followed by econometric analysis.

4.1 DESCRIPTIVE STATISTICS RESULTS

A total of one hundred forty five (145) questionnaires were organized and distributed to micro and small enterprises taxpayers of which one hundred thirty four (134 questionnaires) were filled and returned back properly. This has made the return rate around ninety two point four (92.4%).

Demographic characteristics of the respondents such as age, sex and academic qualification were given in table 4.1 below and illustrated in the following manner.

Table 2: Demographic characteristics of the respondents

Variables	Category	Frequency	Percentage
Gender	Male	93	69.41
	Female	41	30.59
	Total	134	100
Age	20-30	43	32.1
	31-40	57	42.54
	41-50	24	17.91
	51-60	10	7.46
	Total	134	100
Academic Qualification	Primary school	14	10.44
	High school	31	23.13
	Certificate/level/diploma	53	39.55
	Degree	26	19.4
	MA	8	5.97
	Total	134	100

Source, Own Survey, 2020 G.C

Based on table 2 above, the research finding indicates as demographic factor was examined the gender of the respondents. This information was necessary to enable the researcher to obtain information on whether the respondents were either male or female. Sixty nine point four percent (69.41%) of the respondents were male whereas thirty point five nine percent (30.59%) were female. The gender finding indicates that males take more parts on the tax system than females. Still the portion of females on the outside activities other than household is dominated by males.

From table 2 above, demographic factor also displays the age brackets of respondents. That is, thirty two point one percent (32.1%) of the respondents were between (20-30) years of age, forty two point five percent (42.5 %) were between (31-40) years old, seventeen point ninety (17.91 %) were in the range of (41-50) years old. Respondents between (51-60) years are seven point forty six percent (7.46 %). This result indicate that most of taxpayers are generally above thirty (30) years old. This means that most of the taxpayers age lies on the right time for efficient and considered the effect of the tax on countries economy. So, most of the respondents are taxpayers that are available on the right working stage.

In addition to this, the academic qualifications of the respondents were also analyzed. The information was necessary to assist the researcher to identify whether the respondents are educated or uneducated. As shown in table above ten point four percent (10.44%) have completed primary school. Twenty three point thirteen percent (23.13%) have completed high school, thirty nine point fifty nine percent (39.55%) have level/diploma; nineteen point four percent (19.4%) have a degree profession and five point nine percent (5.97%) have Masters of Science (MSC).The finding indicates that majority of respondents in are fairly educated.

Education was also another issue that has to be dealt while examining the factors affecting tax compliance behavior of tax payers. Tax payers' education status has significant effect on understanding the obligatory duties of tax payers and the effect of tax on economy (Chan et al, 2000). This shows that tax payers with a higher education level are more likely to have a higher level of moral development and higher level attitudes toward compliance and thus will tend to comply more. One of the measures to increase voluntary compliance is by assuring that taxpayers have a certain level of qualifications, ability and confidence to exercise their tax responsibility (Mohani, 2001).

4.2 ECONOMETRIC ANALYSIS

Finding the factors that determine micro and small enterprises tax payers' level of tax compliance goes beyond the descriptive analysis and requires employing econometric model. Multiple regression analysis helps us to identify factors which influence micro and small enterprises tax payers' level of tax compliance behavior. Before analyzing multiple regressions result the researcher checked diagnostic tests such as Multicollinearity problem test, Heteroscedasticity test, and omitted variable test and Overall significance model. In particular, inferences based on multiple regression results can be valid depending on whether the classical linear regression assumptions hold.

4.2.1 DIAGNOSTIC TESTS

4.2.1.1. MULTICOLLINEARITY PROBLEM TEST

From different possible detection of Multicollinearity two methods were used in this model in order to check Multicollinearity. Variance inflation factor and correlation coefficient were used here.

VIF: After developing variance inflation factor, Multicollinearity will be serious problem if VIP is grater or equal to 10 or if tolerance margin is less than 10%. In this study, the model is free from Multicollinearity since the maximum VIF is 1.29 which is less than 10 and tolerance margin $1/VIF$ is greater than 10%.

4.2.1.2. HETROSKEDASTICITY

For this model, Breusch pagan test was used to test the existence of hetroscedasticity. If calculated chi-square exceeds critical value of chi-square at chosen level of significance, one can reject the null hypothesis of homoscedasticity, otherwise one doesn't reject. Moreover, in this study calculated chi-square (0.4024) is less than that of critical value of chi-square (0.70). Thus, the null hypothesis that sets constant variance has not been rejected.

4.2.1.3. OMITTED VARIABLE TEST

From the omitted variable test, as the result shows as F-calculated value (10.73) is greater than critical F-value (0.000) and it tells us that the null hypothesis that there is no omitted variable will be no longer holds true. Thus the model has the problem of omitted variable or functional form misspecification.

4.2.1.4. OVERALL SIGNIFICANCE MODEL

The overall significance of the model is verified by the rule of thumb for calculated F-value. Since the rule of thumb shows that calculated F-value (24.46) is greater than 4, the F-test verified that the model overall is significant. The other important way for the overall significance test is the p-value. The smaller the p-value (0.0000) in the model is, the higher the probability to reject (drop) the null hypothesis which states that all variables are insignificant to the model. That is, $B_0 = B_1 = \dots = B_{16} = 0$. Thus, rejecting this statement implies that the model overall is significant.

The goodness of fit of the model is measured by the coefficient of determination (R-squared). As the regression result shows, the coefficient of determination is 0.5654 which implies that about 56.54% of the variation in the dependent variable (Tax compliance) is explained by the explanatory variables included in the model. And the remaining 43.46% of the variation in tax compliance is explained by other variables that aren't included in the model or included in the disturbance term.

4.2.2 MULTIPLE REGRESSION RESULTS

Below table regresses the response variables, the factors affecting micro and small enterprise tax payers' level of tax compliance in Wolkite town. The result shows most of the explanatory variables in the model have the signs that is consistent to the researcher's prior expectations. It is also shown that most of the variables are statistically significant at less 1% and 5% confidence level.

Table 3: Multiple regression results

TCOMP	Coefficient	Std. error	t-value	P-value
AGE	-0.45**	0.261	-1.82	0.041
GENDER	0.071	0.631	0.12	0.610
EDUC	0.226**	0.391	1.45	0.029
TRATE	-0.312***	0.432	-1.34	0.067
TKNW	0.810*	0.291	2.71	0.000
TCC	-0.670*	0.314	-2.29	0.002
TAUDIT	0.047	0.570	0.18	0.317
Constant	6.28	4.34	1.21	0.028

Number of observation = 134
F(5, 127) = 102.47
Prob > F = 0.0000
R-squared = 0.8520
Adj R-squared = 0.8437

Source: own survey, 2020

Note: *, ** and *** indicate that the coefficients are statistically significant at 1%, 5%, and 10% level

Interpretation of significant Variables from the multiple regression output

Age: As expected the result of the regression analysis revealed age was found to have a negative relationship with micro and small enterprises tax payers' tax compliance and is statistically significant at a 5% level of significance. This show holding the other variables constant, a one year increase in age of the respondents will lead to 0.45 decreases in tax compliance of micro and small businesses. Tadesse and Goitom (2014) on their study also found a negative association implying that older taxpayers were less compliant.

Education: As expected, education level plays an important role in enhancing compliance level of tax payers. It has positive and significant effect on tax compliance behaviour at less than 5% level of significance. This indicates holding other variables constant, a one year increase in education of micro and small enterprises will lead to 0.226 increases in tax compliance of micro and small businesses. This finding is consistent with the finding of

Adimassu and Jerene (2016) who stated that tax compliance is positively related with education level of tax payers.

Tax rate: In line with researcher expectations, the result of the regression analysis revealed that the tax rate is found to be statistically negative and significant at less than 10% level of confidence. This indicates keeping other variables constant, a one percent increase in tax rate will lead to 31.2 percent (31.2%) increases in tax compliance of micro and small businesses. This is confirmed with the finding of Abdulsalam Mas'ud (2014) that states there is significant negative correlation between tax rate and tax compliance in Africa.

Tax knowledge of the respondents: The results of the study indicated that the variable under consideration is positively related and significant at a less than one percent with micro and small enterprise tax payers. Holding other things constant, a one percent increase in tax knowledge of micro and small enterprise tax payers will lead to 31.5% increase in tax compliance also. This finding is supported by the finding of Adimassu and Jerene (2016), who identified that high tax knowledge would increase voluntary tax compliance.

Tax compliance cost: The regression analysis result of this variable is found to be statistically negative and significant with tax compliance of micro and small enterprise tax payers at the 1% level of confidence. This means keeping other variables zero, a 1% increase in tax compliance cost will lead to 67% decrease in tax compliance of micro and small businesses taxpayers.

CHAPTER FIVE

CONCLUSION AND RECOMMENDATIONS

5.1 CONCLUSION

This study investigated factors affecting tax compliance in Small and Medium Enterprise in Wolkite Town. This study was undertaken with the objectives of identifying factors affecting tax compliance among small and medium enterprise in Wolkite town, SNNE, Ethiopia. A simple random sampling technique was used to select sample micro and small enterprise tax payers in the town. There are 358 micro and small enterprises registered at Wolkite which are considered to be sample of this study. Since the total population is not large it was possible to collect data from all population but due to time, finance constraint and COVID-19 the researcher collected data from 145 micro and small enterprises found in Wolkite town. To fairly represent all the population the researcher randomly selected sample from all micro and small enterprises. Descriptive statistics, multiple regression models were analyzed to see the relationships between explanatory variables and the micro and small enterprise tax compliance level.

Descriptive statistics of the study showed that more than 50% (69.41%) of respondents is male, while the rest (30.59%) are female. The study also showed that most respondents' (42.54 %) age is between 31-40 years old. 39.55% of the respondents have Certificate/level/diploma education qualification.

The multiple regression analysis results of the study indicated that among the 7 hypothesized explanatory variables included in the model, 5 were found to have a significant influence on the micro and small enterprise tax compliance. In this regard, the results confirmed that variables like age, education, tax rate, tax compliance cost and tax knowledge were key factors affecting the micro and small enterprise tax compliance. Particularly from education and tax knowledge indicated positive influence, while age, tax rate and tax compliance cost indicated a negative influence. Unfortunately gender and tax audit is in significant in affecting tax compliance of micro and small enterprise.

5.2 RECOMMENDATIONS

Based on the findings of this study, the researcher draws several recommendations to encourage tax compliance among SMEs in Wolkite town.

These include; To enhance tax knowledge and awareness of tax payers tax proclamation, guidelines and any changes related to tax system should announced to micro and small business taxpayers' timely through training, discussion, promotional material, magazines if possible using medias like TV, Radio , etc by revenue office of the town. This will also encourage micro and small business profit taxpayers' to pay their tax on time.

Since the tax rate negatively affect the micro and small businesses taxpayers' behavior towards tax compliance, ERCA should revise tax rate which is fair and acceptable for all micro and small enterprises. Giving training on how tax rate is determined and the advantage of paying tax should also important.

The primary responsibility of tax authority is to ensure compliance with tax system. At the same time, they should ensure that the tax system is simple, transparent and minimize compliance cost. Thus, the authority should aim to simplify and clarify the tax policy to motivate taxpayers to pay taxes. Especially, while changing the tax law (system), consultations should be held with the MSE business taxpayers.

The study findings confirmed that tax compliance cost negatively affect tax compliance of the micro and small business enterprises taxpayers in Wolkite town, Ethiopia. To reduce this problem ERCA should modernize tax system of the country. For example facilitating tax payers to pay their tax online will reduce time and physiological cost of the tax payers. Giving training on how the tax payers handle the book record by themselves will also reduce the cost of hiring staffs and finally encourage tax compliance of tax payers.

Tax compliance can be developed only with the voluntary participation of the society. Merely relying on stick approach has no far reaching outcome. Hence, the tax authority have to cause taxpayers voluntarily discharge their tax obligations as much as possible. Tax authority should come up with new techniques of enforcing tax compliance such as tax amnesty and strong supervision /guidance/, after careful analysis of its consequences rather than setting up heavy penalties which discourage taxpayers from being complaints.

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**APENDIX
QUESTIONNAIRE**

**WOLKITE UNIVERSITY
COLLEGE OF BUSINESS AND ECONOMICS
DEPARTMENT OF ACCOUNTING AND FINANCE**

Dear Respondents:

This research is entitled factors that affect tax compliance among small and medium enterprises tax payers of Wolkite town and conducted in partial fulfillment of the requirements of Bachelor of Art (BA) degree in Accounting and Finance at Wolkite University. The research is held on be carried out on your responses and other relevant data that could support it.

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

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

SECTION A: BACKGROUND INFORMATION OF THE RESPONDENTS

(1) Gender: Male Female

(2)What is your age bracket?	
Age bracket	tick appropriately
18-20	
21-30	
31-40	
41-50	
51-60	
Above 60	

(3)What is your highest level of education	
Level of Education	tick appropriately
Below grade 12	
Grade 12 completed	
Certificate/Diploma	
BA /BSC Degree	
Masters	
PHD	

PART I: SOCIAL FACTORS OF TAX COMPLIANCE (PERCEIVED FAIRNESS/EQUETY OF THE TAX SYSTEM)

Please choose for each of the given statements using the following scales by placing tick

(/) mark:

Tick Appropriately	Strongly disagree (1) Disagree(2) Not Certain (3) Agree (4) Strongly agree (5)				
	1	2	3	4	5
Personally, I agree that the Ethiopian tax system is easy, understand and consider the taxpayers.					
Comparisons are made on the individual, the group and the societal level among taxpayers					
The tax compliance requirement may have produced stress and anxiety to taxpayers. It may have psychological impact causes by the tax system.					

PART II: THE ROLE OF TAX AUTHORITY/GOVERNMENT

Tick Appropriately	Strongly disagree (1) Disagree (2) Not Certain (3) Agree (4) Strongly agree (5)				
	1	2	3	4	5
The tax authority collects the required amount of tax as planned and expected					
The tax authority officers use their power for seeking any inducement or bribery					
The tax authority uses power as the law prescribed					
Most of taxpayers have positive response towards the power of the tax authority					

PART III: TAX KNOWLEDGE AND EDUCATION

Tick Appropriately	Strongly disagree (1) Disagree (2) Not Certain (3) Agree (4) Strongly agree (5)				
	1	2	3	4	5
I have got sufficient and continues tax related education from Wolkite tax authority					
I understand that I should pay taxes due within the prescribed period from the date of issue of the Notice of Assessment or within the stipulated period					
I know how to keep documents relating to income and expenses for a period that should be declare					

PART IV: ABOUT TAX RATE

Measurement	Strongly disagree (1) Disagree (2) Not Certain (3) Agree (4) Strongly agree (5)				
	1	2	3	4	5
Reducing the tax rate might encourage taxpayer voluntary compliance					
Raising the tax rate will encourage taxpayers' voluntary compliance.					
A fair tax rate which consider all the taxpayers ability are implemented in the Wolkite, Ethiopia tax system					

PART V: TAX AUDIT ISSUES

Measurement	Strongly disagree (1) Disagree (2) Not Certain (3) Agree (4) Strongly agree (5)				
	1	2	3	4	5
I believe that tax audits can play an important role to increase voluntary tax compliance					
The probability of being audited by the tax authority are very low as a result I can under report and over claim the tax compliance					
Taxpayers who have never been audited before cause for hateful report					