

**DETERMINANTS OF TAX COMPLIANCE OF MICRO AND
SMALL BUSINESS ENTERPRISE (MSE) CATEGORY “C”
TAXPAYERS, THE CASE OF SOUTHWEST SHOA ZONE,
ETHIOPIA**

**A THESIS SUBMITTED TO SCHOOL OF POSTGRADUATE STUDIES
OF WOLKITE UNIVERSITY IN PARTIAL FULFILLMENT OF THE
REQUIREMENTS FOR THE AWARD OF THE DEGREE OF MASTER OF
SCIENCE IN ACCOUNTING AND FINANCE (MSC)**

BY

GETAHUN AYANSA BIRAE

UNDER THE SUPERVISION OF;

DR. DERESSE MERSHA LAKEW (PH.D.)

AND

DR. ANBARASU (PHD)



**MSC PROGRAM, DEPARTMENT OF ACCOUNTING AND FINANCE,
COLLEGE OF BUSINESS AND ECONOMICS, WOLKITE UNIVERSITY,
WOLKITE, ETHIOPIA**

JANUARY, 2018


ABSTRACT

This study sought to identify the determinant of tax compliance in Ethiopia, specifically focusing on Micro and Small business enterprises operating in South west shoa zone. The researcher outlined a detailed literature review and identified the variables for this research to be tax rate, tax knowledge, tax compliance cost; attitude of Micro and small enterprises and tax system. The research employed both descriptive and explanatory research design. A sample size of 325 were used from a population of 1726 micro and small business enterprises category “C” taxpayers in south west shoa zone. Data was collected using questionnaires and structured interview. The collected data was consequently analyzed using Statistical Package for Social Scientist software (SPSS V.22) and the findings of the research presented using tables, various chart types and graphs. The results showed that tax rate, tax knowledge, tax compliance cost, attitude of SME’s and tax system significant determine tax compliance of taxpayers. Tax rate, Tax system and compliance cost predominantly affect tax compliance. With regard to cost of tax compliance, the study revealed that Micro and Small businesses incur different costs such as salary of accountants, fees to tax consultants, cost of stationeries, etc. that contributed for their non-compliance and estimation of Micro and Small Enterprises tax is another problem related tax system. However, the taxpayers do feel and strongly agree that the taxation system in Ethiopia is in great need of improvement. The study then recommended that the current tax law should be amended to incorporate provisions that grant special tax incentives to MSEs in order to improve voluntary tax compliance by MSE taxpayers. The study also recommended that the ERCA should disseminate information on tax rate and tax system more frequently in order to improve the levels of tax knowhow for voluntary tax compliance.

DECLARATION

I undersigned declare that this thesis is my original work and has not been presented for a degree in any other university, and all the ideas and views of other researchers, authors and scholars expressed in this research have been duly acknowledged.

Name: **Getahun Ayansa Birae**


Signature: 

Date: **18/01/2018**

This thesis has been submitted for defense with our approval as a university advisor

Main Advisor

Name: **Dr. Deresse Mersha (PhD)**

Signature: 

Date: **21/01/2018**

Co-Advisor

Name: **Dr. Anbarasu (PhD)**

Signature: 

Date: **21/01/2018**

CERTIFICATION

We certify that this thesis work titled “Determinants of tax compliance of Micro and small business enterprise category “C” taxpayers in south west shoa zone, Ethiopia” was undertaken and completed by Mr. Getahun Ayansa Birae and that the research work was supervised by us and submitted to the department of accounting and finance, school of Business and Economics, Wolkite University, Ethiopia

Approved by Board of Examiners

_____	_____	_____
External Examiner	Signature	Date
_____	_____	_____
Internal Examiner	Signature	Date

ACKNOWLEDGMENT

First and foremost, I am grateful to the Almighty God, the source of all fulfillments. I am deeply indebted to my advisor, Dr. Deresse Mersha (PhD) and my co-advisor Dr. Anbarasu (PhD) for their time and guidance in the preparation of my thesis.

I want to thank ERCA staffs, Micro and small business enterprises office in this thesis. Their enthusiasm to take part in the preparation of thesis highly contributed for the success of this thesis.

My sincere thanks are kept to all my friends and course mates, especially those supported me in the preparation of my thesis.

My warmest gratitude is of course reserved for my families who were giving me invaluable encouragement and support throughout my thesis. My wife Zinash T. and my sweet begat sons Rabira and Nimona, thank you for your love and moral support to complete my study. Finally, I am grateful to all who contributed to the accomplishment of this paper and whose works have been cited in this thesis. May the Almighty God Bless You!

Table of Contents

Abstract.....	i
Declaration.....	ii
Certificate.....	iii
Acknowledgment	iV
Table of Contents	V
List of Tables	Vii
List of Figures.....	X
Acronyms.....	Xii
CHAPTER ONE	
Introduction.....	1
1.1 Background of the study	1
1.2. Background of the organization.....	2
1.3 Statement of the problem	3
1.4. Objective of the Study	5
1.4.1 Main Objective.....	5
1.4.2 Specific Objectives	5
1.5.Research hypothesis.....	5
1.6. Significance of the study.....	6
1.7. Scope of the Study	6
1.8. Organization of the paper.....	7
CHAPTER TWO	
LITERATURE REVIEW	8
2. Introduction.....	8
2.1 Theoretical Review.....	8
2.1.1 Theoretical Approaches to the Evolutions of Micro and small Enterprises	8
2.1.2. Definition of Micro and Small Enterprises	10
2.1.3.Definition of Tax compliance	11
2.1.4. Determinants of tax Compliance	12
2.2. Empirical Literature	29
2.2.1. Review Empirical Literature	29

2.2.2. Conceptual Framework	33
CHAPTER THREE	
RESEARCH METHODOLOGY	34
3. Introduction	34
3.1 Research Design	34
3.2 source of Data and Data Collection Techniques	34
3.3 Target Population	35
3.4 Sample size and sampling methods.....	35
3.5 Methods of Data Analysis and presentation.....	36
3.6 Model Specification	36
CHAPTER FOUR	
DATA ANALYSIS, RESULTS AND DISCUSSION	
4.1. Respondent Background Information Discussion.....	40
4.2. Descriptive Statistics results	44
4.3. Correlation Analysis and Discussion	45
4.4. Multiple regression analysis.....	47
4.4.1 Results for test of classical linear regression model (CLRM) assumptions	48
4.4.2. Multiple regression output and its discussion	55
4.4.3. Testing of hypotheses	58
4.5. Discussion of interview and document review results	60
CHAPTER FIVE	
SUMMARY, CONCLUSION AND RECOMMENDATION	
5.1 Summary	62
5.2 Conclusions	63
5.3. Recommendations	64
5.4. Limitation of the Study.....	65
5.5. Future Research Implications	66
References.....	67
Appendices.....	73
Appendix 1. Questionnaire	73
Appendix 2. Structured Interview.....	77

<u>List of tables</u>	<u>Pages</u>
<i>Table 2.1. The 1997 (2005 E.C) Definition of Micro and Small Enterprises in Ethiopia</i>	13
<i>Table 2.2. The Revised Definition of Micro and Small Enterprises</i>	14
<i>Table 3.1. Total Numbers of MSE in the zone</i>	35
<i>Table 3.2. Proportional allocation of the sample sizes selected woredas level</i>	36
<i>Table 4.1. Age Bracket of the Respondents</i>	41
<i>Table 4.2. Kind of Business</i>	42
<i>Table 4.3. MSEs Duration of Existence</i>	43
<i>Table 4.4. Staff employed</i>	44
<i>Table 4.5. Descriptive statistics output of all variables</i>	45
<i>Table 4.6. Correlation matrix between variables</i>	47
<i>Table 4.7. Collinearity diagnostics using VIF</i>	53
<i>Table 4.8. Residuals Statistics</i>	55
<i>Table 4.9. Reliability analysis</i>	55
<i>Table 4.10. Model summary</i>	56
<i>Table 4.11. Anova</i>	56
<i>Table 4.12. coefficient of linear regression</i>	57
<u>List of Figures</u>	<u>Pages</u>
<i>Figure 4.1. Gender of the respondents</i>	40
<i>Figure 4.2. Highest Level of Educations of the Respondents</i>	41
<i>Figure 4.3. Legal form of the Business</i>	43
<i>Figure 4.4. Test for Heteroscedasticity</i>	49
<i>Figure 4.5. Rejection, non-rejection, and inconclusive regions for DW test</i>	50
<i>Figure 4.6. DW test result test of autocorrelation</i>	52
<i>Figure 4.7. Normality test</i>	54

List of Acronyms

ATP=Attitude of tax payers’

CTC=Cost of tax Compliance

ERCA=Ethiopia Revenue and Customs authority

IRS= Internal Revenue Service

MoUDH=Ministry of Urban Development and housing

MSEs=micro and small business enterprises

TC=Tax compliance

TPK= Tax payers’ knowledge

TR=Tax Rate

TS=Tax system

USD=United state Dollar

CHAPTER ONE

INTRODUCTION

1.1. BACKGROUND OF THE STUDY

Taxes and tax system are essential in nation building. They are required for state capacity building for meaningful economic development. The fundamental goal of any revenue authority is to collect taxes and duties payable according to the law. However, taxpayers are not always willing and ready to comply when it comes with the obligations imposed on them by law. 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. Kirchler (2007) define Tax compliance as the taxpayers' willingness to obey tax laws in order to attain economic development and goal. From a wider perspective, tax compliance requires a 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.

A key component of any tax system is the manner in which it is administered. No tax is better than its administration, so tax administration matters a lot. An essential objective of tax administration is to ensure the maximum possible compliance by taxpayers of all types with their tax obligations. Unfortunately, in many developing countries, tax administration is usually weak and characterized by extensive evasion, corruption and coercion. In many cases, overall tax compliance levels are low and large proportion of the informal sector of the economy escapes the tax net entirely (James S., and Nobes, C. 2004).

Tax compliance is a major problem for many tax authorities. It is not an easy task to persuade taxpayers to comply with tax requirements even as the tax laws are not always precise in some respects. Taxpayers are inherently disposed to reducing their tax liability either through tax evasion or tax avoidance. This may give rise to incorrect filling of their tax returns and loss of revenue to the government. An unduly complex regulatory system and tax regime enforcement makes tax compliance unduly burdensome and often has a distortion effect on the development of micro and small business enterprises (MSEs) as they are tempted to change in to forms that offer a lower tax burden or no tax burden at all and as such results in a tax system that imposes high expenses on the society. A poorly executed tax system also leads to low efficiency, high collection charges, and waste of time for taxpayers (Alm, at al., (2007).

The compliance costs of MSEs are higher than the larger businesses. This leads to limited capacity of developing countries to raise revenues for development purposes. A lot of factors affect the low level of tax compliance in developing countries, such as attitudes, penalty, education, knowledge (awareness), lack of availability of tax information, Tax system (no declaration of tax by MSE to ERCA but Estimation of tax system by ERCA), tax rate, compliance cost and the ineffectiveness of tax administration (proclamation 202/2009).

The objectives of this paper therefore are to identify the determinants of tax compliance of micro and small business enterprises taxpayers and find out the effects of tax knowledge and tax penalty over tax compliance.

1.2. BACKGROUND OF THE ORGANIZATION

The Ethiopian Revenues and Customs Authority (ERCA) is the body responsible for collecting revenue from Customs duties and Domestic taxes. In addition to raising revenue, it is responsible to protect the society from adverse effects of smuggling and contraband. It seizes and takes legal action on the people and vehicles involved in the act of smuggling, any tax evasion and avoidance while it facilitates the legitimate movement of goods and people across the border.

The Ethiopian Revenues and Customs Authority (ERCA) was established by the proclamation No .587/2008 on 14 July 2008, by the merger of the Ministry of Revenue, Ethiopian Customs Authority and the Federal Inland Revenue Authority for the purpose of enhancing the mobilization of government revenues, while providing effective tax and Customs administration and sustainability in revenue collection. The main objective of the establishment of ERCA was to streamline the public revenue generation function by bringing the relevant agencies under the umbrella of the central revenue collector body.

This structuring aimed at improving service delivering, facilitating trade, enforcing the tax and customs laws and thereby enhancing mobilization of Government revenue in sustainable manner. A study called "Business Process Re-engineering" had taken place before the merger of the foregoing administrations. The study was undertaken for a year and half beginning from November 2007 by teams of officials selected from within the administration.

The study has looked into the selected key business processes and has come across inefficient organizational structure and unnecessary complicated procedures that permitted in sufficient

service delivery. The study has also indicated that there was corruption within the administrations and that smuggling and tax evasion were serious problems. These problems have depressed the attempt of the foregoing administrations to be successful in achieving their objectives.

Documents for the import and export goods were processed through the former tax and customs administration and due to the inefficient procedures, these goods were subject to delay at exit or entry points of the former customs Authority. Owing to it, importers or exporters viewed the former customs procedure with disfavor or looks as an impediment for international trade. The former tax and customs administration also has long been criticized for lack of efficient and effective system to control tax evasion.

The administration had inefficient system to control taxpayers who fail to declare their actual income in order to reduce their tax bill and the federal government's revenue. The former administration was also far behind in protecting investors from adverse effects of contraband and illegal practices. In its proposal, the team has suggested merger of the foregoing three administrations. The study team believed that it would be better if the three administrations merged, forming a single powerful organization to increase modern and equitable tax and customs administration system, effective resource utilization and quick service delivery. Presently, the Authority is exercising the powers and duties that were granted to the Ministry of Revenue, the Federal Inland Revenue Authority and the Customs Authority by existing laws.

1.3. STATEMENT OF THE PROBLEM

The main source of revenue for public expenditure in Ethiopia is taxation. Tax plays an important role in the growth of any economy so tax evasion is harmful to the economy. Tax evasion hampers government revenue collection thus inefficiency in Government spending because it diminishes the capacity of the state to mobilize domestic revenues, resources that are needed for investments and also construction of infrastructure like roads, power, Education, water and other public infrastructures have favorable results on many facilities, business enterprises, industries and the general public. Government intervention in the supply of public goods is therefore inevitable and can only be done if the public pays taxes for the production and supply of such goods (ERCA, 2015.)

Tax compliance is currently a topical policy issue, especially in developing countries, as governments are seeking ways to improve efficiency in tax revenue collection to finance their budgets. MSEs are the majority business taxpayers in most developing countries and as such their compliance levels directly impact on government tax revenue collections. Since each country has its own approach to manage tax compliance levels and each has different tax laws and regulations, the factors influencing tax compliance behavior appear to vary among countries (Palil, 2011). Ethiopia, like any other developing countries, faces difficulty in raising revenue to the level required for the promotion of economic growth. Hence, the country experienced a consistent surplus of expenditure over revenue for sufficiently long period of time. (Shina, 2014). To address this problem, the government introduced a number of rules, systems and methods aiming tax collection as a major source of public revenue. However, this all efforts couldn't still bring the required result due to a number of reasons (ERCA, Customer Charter, 2015).

Non-compliance may take the lion share on the poor revenue performance. (ERCA, 2014) A number of taxpayers including MSE tax payers which are important source of revenue for Ethiopian government fail to fulfill income tax requirements and a number of them face prosecution for failing to pay taxes on time. (ERCA, 2014). Even if the government advocates voluntary compliance, the tax system in the country mainly stresses on legal enforcement as a remedy to ensure its proper functioning. (Proclamation, 286/2002).

This clearly shows that using traditional policies such as audits and fines (stick approach) may not work always and forever. Hence, there is a clear need for more empirical research on the factors that affect tax compliance, since a better understanding of these factors can yield strategies that improve compliance. However, 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 south west shoa zone, Ethiopia. It is therefore, the focus of this study is to identify determinants of Micro and small business enterprises taxpayer's compliance behavior with the tax system of Ethiopian Revenues and Customs Authority in south west shoa zone.

1.4. OBJECTIVE OF THE STUDY

1.4.1. General Objective

The general objective of the study is to identify the determinants of tax compliance of Micro and small business enterprises taxpayers in south west shoa zone.

1.4.2. Specific objectives

1. To assess the effect of tax rate on tax compliance of Micro and small Business enterprises.
2. To investigate the extent to which the cost of tax compliance determine tax compliance of Micro and small Business enterprises.
3. To determine how Micro and small Business Enterprises attitude about tax influence tax compliance.
4. To assess tax knowledge of small & micro business enterprise taxpayers as a factor of tax compliance
5. To assess how the tax estimation system in influence tax compliance among Micro and small Business Enterprises.

1.5. Research Hypotheses

These hypotheses are predictions about the outcome of the results. Therefore, in order to achieve the objective of the study, the following hypotheses are developed regarding the determinants of tax compliance of Micro and small business tax payers.

- **H1:** Tax payer's attitude is positively associated with *Tax compliance* of micro and small business tax payers in south west shoa zone.
- **H2:** Cost of tax compliance is positively associated with *Tax compliance* of micro and small business tax payers in south west shoa zone.
- **H3:** Tax Payers knowledge is positively associated with *Tax compliance* of micro and small business tax payers in south west shoa zone.
- **H4:** Tax rate is positively associated with *Tax compliance* of micro and small business tax payers in south west shoa zone.
- **H5:** Tax assessment system is positively associated with *Tax compliance* of micro and small business tax payers in south west shoa zone.

1.6. 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 focuses 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 will find the findings of this study important as it will act a reservoir of knowledge for further research.

1.7. SCOPE OF THE STUDY

This study is aimed at investigating factors affecting tax compliance behavior in Ethiopian context. The focused on Micro and small Business enterprises taxpayers selected from the study area.

There are many factors that affect tax compliance behavior; this study has investigated those factors which are likely to influence the tax non-compliance of Micro and small Business enterprises taxpayers in south west shoa zone, Ethiopia. These Micro and Small Business enterprises taxpayers selected because about more percent of the country's tax revenue originates

from them because the number of MSE in a country is more when we compare with other types of business. Therefore the study is limited to Micro and Small Business enterprises tax payers in south west shoa zone, Ethiopia. Determinants of Micro and small Business enterprises tax compliance, namely, tax compliance costs, attitude of tax payers, knowledge of tax payers, Tax system, and tax rate were analyzed.

1.8. ORGANIZATION OF THE PAPER

This thesis is divided into five key sections. Chapter one provides a background on the introduction of taxation system in Ethiopia. It particularly highlights the tax compliance and tax reforms that have been undertaken in Ethiopia over the years. The Chapter further states the statement of the problem, research objectives and research questions that the study aims to answer. The significance of the study, scope and Limitation of the study and organization of the paper in the same chapter.

Chapter Two contains a review of the literature that outlines the various schools of thought that have been brought forward with regard to tax compliance behavior and the definitions of Micro and small business enterprises taxpayers, tax compliance theories and determinant of tax compliance. The variables of the study are discussed with reference to studies conducted by other researchers as well as published material on the same.

Chapter three outlines the research design and methodology to be used for purposes of completing the study. It also describes in details, the research design, target population, the sample, sampling procedure to be adopted as well as the data collection instruments, method of data analysis and presentation.

Chapter four contains data analysis, presentation and interpretation of the findings while chapter five provides a summary of findings, conclusions and recommendations. This is followed by references and appendices sections.

CHAPTER TWO

LITERATURE REVIEW

2.1. Introduction

This chapter outlined the various schools of thought revolving around tax compliance and Evasion and identified the various theories put across by various scholars in relation to tax compliance. For the research questions identified in Chapter One, the researcher highlighted the findings of different authors, on the factors influencing tax compliance among MSEs.

2.2. Theoretical Literature

This study borrowed heavily from existing research that is increasing. It was influenced by the following theories which have been put across by various scholars with regard to adoption of technology in society:

2.2.1 Theoretical Approaches to the Evolutions of Micro and Small Enterprises

Different approaches and theories were forwarded for the evolution of small enterprises at different times. There are two perspectives that are mentioned for the emergence of small enterprises. The first perspective view it as an outcome of improved opportunities for people (including the poor and disadvantaged) to participate in “ways that empower and nourish” them while the other perspective consider it as an indication of failure of an economy to provide jobs, forcing people to “take refuge in activities that provide only minimal subsistence support” (Liedholm & Mead, 1999). Similar to this view, Ozcan (1995) considers small firms as the function or outcome of underdevelopment that exists in developing countries. Moreover, classical and recent views on MSEs have also conflicting outlooks on the emergence and importance of the sector. Hence, the following sections present these different outlooks.

Classical Theories

Classical development theories describe small firms in connection with macro-economic structure and its development (Ozcan, 1995). It also attributes the development of small firms only to the new forms of the economic and technological diffusion brought by the capitalist economy. For instance, modernization theory views development as a process where primitive agriculture is gradually mechanized and small and low productivity is substituted by mechanized industrial enterprises with high productivity (Todaro, 1997). The theory assumes, in the course of rapid economic development, the economic share of MSEs declines while those of large and

modern enterprises dominate the economy. Production is concentrated in towns to exploit urban as a result economies of small enterprises are believed to disappear eventually. Similarly, the dependency theory views large scale industries, national and international corporations as the only means for changing the world economy (Pederson, 1989). The assumption in this theory is that corporation headquartered in the capital cities of developed countries, while their production units spread over the countries where there is cheap factors of production that enable them to achieve economies of scale as well as to be more profitable than small local firms.

Modern Theories

The modern theory gives attention to the roles of small firms in promoting local, regional and national development. In recent years when the economies of most industrialized countries have shown various sign of stagnation and structural decline, a variety of studies have been undertaken which demonstrate clearly that Micro and small sized firms may be regarded as generators of new growth, as primary source of technological change and via job creation, as one of the major factors in maintaining socio-economic stability (Rothwell and Zegvel cited by Giaoutzi,N.,&Storey, 1989). Today MSEs have become essential factors in the revival of production systems in industrial regions. Not only do they create new jobs, but they are also considered as major channels of innovation and technological change. They have certain characteristics which make them suitable for initiating changes in the production system. At the regional level, they contribute by their creativity and, especially, by their local foothold (Giaoutzi, Nijkamp&Storey, 1988).

Due to their small and perceived flexible nature MSEs are expected to be able to withstand adverse economic conditions and survive where many large businesses would collapse (Aryeetey & Ahene, 2004: p. 3). The flexible structure is also an advantage when it comes to adapting quickly to customers demands (Kayanula & Quartey, 2000: p.10). Flexibility refers to an ability to survive and an artesian capacity to respond to new design requirements and new market signals with fragmented and flexible use of labor in firms. In flexible theory it is argued that small firms, through network relations can compete and reach economies of scale through flexible specialization (ibid). Flexible specialization and networking, as are widely observed in particular regions of advanced countries have been crucial parts of innovation and survivals of small firms. According to Tambunan (2006), the flexible specialization on MSEs grows faster than large enterprises and is important source of invention, efficiency and innovation. They are

also capable of standing the competition with large enterprises. Hence, in the course of development, the economic share of MSEs increases.

2.2.2. Definition of Micro and Small Enterprises

Small business has often been seen as a narrowly defined development activity, with little or no connection to broader development priorities. However, this misrepresents the role this large and dynamic sector can play, and has the effect of limiting the potential contribution of micro and small enterprises to national development objectives (Simon W., 1999). Moreover there is no generally accepted definition for Micro and Small enterprises. The definitions given to MSEs vary from country to country and even within the same country. All use a range of terms to describe MSEs like for example, small businesses, small manufacturing enterprises, small firms, small enterprises, small scale industries, micro enterprises, the informal sector, cottage and handicrafts, tiny businesses, other income generating activities and the like (Wolday, 2002). The lack of consistent definition of MSEs lead to confusion to distinguish between one segment and another; and bring significant implications on the structure of interventions and promotional supports that could be provided to the sector.

- **Definitions: International and Ethiopian Experiences**

- ✓ **International Definitions of Micro and small Enterprise**

According to Ministry of urban Development and housing, (Micro and Small enterprise Development policy and strategy, Second Edition March 2012, edit April 2016, Addis Ababa, International definitions of micro and small enterprises use three basic criteria:

1. **Number of full time employed persons** (staff headcount),
2. **Total assets, net assets and paid up capital**, and
3. **Total annual sales turnover.**

These three criteria may be applied either jointly or separately.

In addition to these three basic criteria, some countries and international organizations also use the legal status of enterprises (legal entity) as a supplementary criterion. The most widely practiced approach is the use of the three basic criteria and, depending on the economic conditions of individual countries the weight to be attached to each criterion varies from country to country. In general, on the basis of the review of experiences of other countries, the following key points are identified:

1. Definitions of micro and small enterprises as well as the frameworks for support to be provided to such enterprises are used in all countries;
2. Each country's definition of small, micro and medium enterprises is tailored to its economic condition and overall level of development;
3. In most of the countries, the definitions of small, micro and medium enterprises are uniformly implemented by all institutions and have legal backing;
4. The principal criteria that are applied either separately or in combination to define small, micro and medium enterprises include the size of employment, total assets, net assets and paid up capital with annual sales turnover;
5. Some countries (e.g. China, U.S.A and South Africa) apply different definitions for different types of industry, such as for manufacturing, construction, transport, wholesale/retail trade and services;
6. Most countries follow uniform definitions for all micro and small enterprise sectors (European Union);
7. Some countries (e.g. India, the Philippines and Tanzania) use different definition for different sectors, including for micro enterprises;
8. Some countries (India and Japan) define the sector by classifying into manufacturing and services; and
9. Some countries (European Union).revise the definitions by taking into account the experience of other countries, price inflation and improvements in productivity.

✓ **Definition of MSEs in Ethiopia**

In Ethiopia, two different definitions of micro and small enterprises were adopted, namely:

- The definition used in the 1997 (2005E.C) micro and small enterprises development strategy; and
- The definition used by the Central Statistics Authority.

The Definition Provided in the 1997(2005 E.C) MSE Strategy

The formulation of the **1997 Micro and Small Enterprise Development Strategy** (2005E.C) took into account the experiences of South Africa and other countries. During that time, the use of a single criterion, namely paid up capital, was preferred as it was thought that there were difficulties in obtaining information on the numbers employed in MSEs as most of the

enterprises were operated by family members. As a result, the definition had the following limitations:

1. Given the fact that employment creation is one of the objectives of promoting MSEs, the absence of criteria related to employment creation in the definition meant that it was not possible to use it for comparing changes in employment creation. In addition, from the perspective of the international experience, it was difficult to estimate the amount of capital for the different categories of enterprises.
2. The use of paid up capital as a criteria in the existing definition does not take into account the realities on the ground. Since enterprises are established by paid up capital financed by own contributions and in most cases bank loans, the definition does not give a full picture of enterprises.
3. The existing definition, it being more than 13 years since it was first adopted, is found now to be incompatible with current realities. For instance, significant foreign exchange rate and inflation related changes have taken place since the definition was set. The paid up capital definition of MSEs, which was ETB 20,000 (about USD 2,300 in GC 2005), is incompatible with the current foreign exchange equivalent of about USD 925 (EUR 824). Similarly, the definition of small enterprises that was ETB 500,000 (USD 58,000) is about USD 23,800 (EUR 20,600) under the current exchange rate. Thus, the expected amount of paid up capital in foreign exchange equivalent thirteen years ago is 250% higher in GC 2005 than in GC 2012.
4. While the definition is based on paid up capital, the transition from micro to small and from small to medium were to be measured in terms of total assets.
5. Although small enterprises also include high-tech and consulting enterprises the definition did not include them; this needs to be reconsidered in view of the current significance of the sector. Thus, it becomes imperative to revise the existing definitions of MSEs, in light of the international experience as well as the significance of the sector in the country's current development endeavor.

Table 2.1. The 1997 (2005 E.C) Definition of Micro and Small Enterprises in Ethiopia

Sector	Paid up capital
Micro enterprise	≤ ETB 20,000 (USD 1,200)
Small enterprise	≤ ETB 500,000 (USD 30,000)

✓ **The Central Statistics Agency's Definition**

Government of Ethiopia's Central Statistics Agency definition of MSEs is based on the type of technology adopted and the size of manpower:

1. **Handicraft and cottage industries** in which a single person or family members perform their activities mainly by hand and using non-power driven machineries; and
2. **Small scale manufacturing enterprises** engaging less than 10 persons and using motor driven machinery.

The above mentioned definitions adopted by the Central Statistical Agency have the following limitations:

- Focus on the manufacturing sector (i.e., it does not refer to other sectors); and
- No use of the amount of capital as criteria.

The Central Statistics Agency definition is also different from the one adopted by MoUDH in the 1997 MSE Strategy. In the absence of a standard definition, the Central Statistics Agency did not collect data and conduct surveys of micro and small enterprises. The absence of a uniform definition also makes it difficult to conduct scientific studies to evaluate the impact of the existing strategy as well as the frameworks put in place to provide support to MSEs.

➤ **The Revised Definition of Micro and Small Enterprises**

After identifying the limitations of the existing definitions and reviewing international experience, the definition of MSEs is revised. A new set of definitions is provided that takes into consideration: the number of employed workers, total assets and two broad sectoral classifications (industry and service) as well as taking into account inflation and exchange rate related changes that might occur over the next five years.

➤ **The Revised Definition of Micro Enterprises**

Enterprises employing up to 5 persons including the enterprise owners and family members, with total assets of not more than ETB 100,000 (USD 4, 6303).

1. **For the industrial sector** (including manufacturing, construction and mining): Enterprises employing a maximum of five persons, including the enterprise owners and family members, with a total asset of not more than ETB 100,000 (USD 4,630); and
2. **For the service sector** (retail trade, transport, hotel, tourism, and information technology and maintenance services): Enterprises employing a maximum of five persons, including the

enterprise owners and family members, with a total asset of not more than ETB 50,000 (USD 2,310).

➤ **The Revised Definition of Small Enterprises**

1. **For the industrial sector** (manufacturing, construction and mining): This refers to enterprises employing 6-30 persons and with a total asset of from ETB 100,001 up to ETB 1,500,000 (USD 4,630 up to USD 69,500); and

2. **For the service sector** (retail trade, transport, hotel, tourism, and information technology and maintenance services): This refers to enterprises that are employing 6-30 persons, and with total asset of at least ETB 50,001 and up to ETB 500,000 (USD 2,310 up to USD 23,150).

Table 2:2. The Revised Definition of Micro and Small Enterprises

Level of enterprise	Sector	Head count staff	Total asset ETB	Total asset USD
Micro enterprise	Industry	≤ 5	≤ 100,000	≤ 4,630
	Service	≤5	≤50,000	≤ 2,310
Small enterprise	Industry	6- 30	101,000-1,5000,000	4,630 - 69,500
	Service	6-30	50,0001-500,000	2,310 - 23,150

In case of ambiguities regarding the use of total assets or the number of employment, total assets shall serve as the main criteria.

• **The Legal establishment of Micro and Small Enterprises**

1. It is imperative to ensure the legal status of MSEs so that they are eligible for enterprise development support services.

2. The legal status of the enterprises shall be defined based on their preference (registration) either as per the Commercial Law (Business Licensing and Registration Laws or as per the Cooperative Societies Proclamation).

3. The collection of countrywide data and information on MSEs shall be harmonized taking into account the new definitions adopted for micro and small enterprises and as per the procedures to be established by the Central Statistics Agency and in accordance with the standard categories of business licenses. (MoUDH. 2016, Addis Abebe).

2.2.3. Definition of Tax compliance

Tax compliance is defined as taxpayers' willingness and ability to comply with tax laws, declare the correct income, claim the correct deductions and pay all taxes on time. ((Bezamuche ,taken from Jackson and Milliron (1986) and Kirchler (2007), as cited in Mohad& Ahmed, 2011)),. Tax compliance has been defined in various ways by various authors. As stated by Kirchler (2007) compliance might be voluntary or enforced compliance. Voluntary compliance is made possible by the trust and cooperation between tax authority and taxpayer and it is the willingness of the taxpayer on his own to comply with tax authority's directives and regulations.

However, in the presence of distrust and lack of cooperation between authority and taxpayer, which creates tax hostile climate, authorities can enforce compliance through the threat and application of audit and fine. According to McBarnett (2003), cited in (Mohad,R. et al.,2011)compliance may take three forms, which include committed compliance, capitulative compliance and creative compliance. Committed compliance is the willingness to discharge tax obligations by taxpayer without complaining. While capitulative compliance is the reluctant in discharging of tax obligations by taxpayer and creative compliance (tax avoidance) refers to any act by taxpayer aimed at reducing taxes by redefining income and deductible expenditure within the confine of the law. As stated by Marti (2010) cited Felix N. (2015) tax compliance is a complex term to define. Simply put, tax compliance refers to fulfilling all tax obligations as specified by the law freely, willingly and completely. He also believes that high compliance costs can result in tax avoidance, tax fraud, and inhibit investment by way of diminishing competitiveness of the country in terms of taxation attractiveness.

2.2.4. Determinants of tax Compliance

Kirchler, (2007) provides a thorough description of the determinants of tax compliance, dividing them into three categories. He states there are social psychological determinants comprising attitudes, different types of norms, fairness perceptions, as well as motivational features relating to tax compliance, political determinants such as complexity of law and tax system, or fiscal policy, and economic determinants like the rational decision-making process and the effect of audits, fines, tax rates, income on tax behavior.

According to Jackson & Milliron(1986) cited in Desta(2010) they examined determinants or factors that have influenced tax compliance as discussed by various researchers. These factors are age, gender, education, income, occupation or status, peers' or other taxpayers' influence,

ethics, legal sanction, complexity, relationship with taxation authority (IRS), income sources, perceived fairness of the tax system, possibility of being audited and tax rate. For the research elaboration tax payer service, Tax audit, Tax compliance cost, Tax knowledge, perception of fairness/equity fines and penalties and strength of the organization were discussed under.

2.2.4.1. Tax Audit

According to Kricher (2008) cited in Badara (2012), tax audit is defined as the checking or examining of an individual or organizations' tax return and assess MSE enterprises by any concerned tax authorities so as to achieve the compliance with the proper tax laws, regulations, and directives of a country. In addition, he also defines it further that tax audit is a process whereby tax authorities give the confirmation to their stated tax returns whether these reports are prepared based on the consent of the tax laws or not.

In a similar fashion, OECD (2006) also defines tax audit as an examination of tax payer if the books of accounts are correctly reported and whether these reports correctly reflect the liability of the tax payer. Further, tax audit is primary activities of the tax authorities under the self assessment of MSE enterprise system in enhancing and encouraging voluntary compliance with the tax laws and regulations.

2.2.4.2. Tax Payer Service

Service quality provided to tax payers in tax department becomes our concern because it is related to society as service users (Nunung, 2015) The National Taxpayer Advocate believes quality taxpayer service is a fundamental taxpayer right, and Congress should fund taxpayer services at a level that enables the internal revenue service's to provide the quality service taxpayers need to comply with their tax obligations. Services to taxpayers include taxpayer registration, customer service, tax collection, taxpayer education on tax laws, providing tax related information, tax appeals and claims resolution, etc. Tax authorities need to provide timely and quality services to taxpayers by helping the taxpayers understand the tax laws and meet their tax responsibilities (IRS, 2010). By doing these, the tax authority can help the taxpayers to understand the tax laws, determine & report their tax liabilities and pay conveniently. These also can reduce the administrative costs of the tax authority and the compliance costs borne by taxpayers. The tax authority should also offer clear, understandable, and current tax information and make this information available to the taxpayers through various media and in written forms

that one can rely on to questions and requests for tax information (Asian Development Bank, 2001). According to Internal Revenue Service (IRS) of America, performance in tax administration can be measured using the following variables:

Behavioral outcomes: behavioral outcome measures evaluate taxpayer transactions with the tax administration to determine how effectively the tax administration is influencing taxpayers' behaviors, such as using web site, filling and paying electronically and generally fulfilling their tax obligations by meeting deadlines etc.

Quality measures: quality measures evaluate key characteristics of taxpayers' products and services, such as completeness, timeliness, consistency, and accuracy. Quality improvements can decrease the burden associated with erroneous information, and increase the public trust and confidence in the tax administration. Therefore, taxpayers should receive accurate information when asking tax related questions and when they seek and clarification on the tax laws and procedures and should be able to receive accurate responses from the tax officers.

Timeliness measures: used to evaluate how quickly tax authority services to the taxpayers can be delivered. The timely execution of activities by the tax authority can help taxpayers avoid unnecessary burdens resulting from long wait times (such as fees, penalties, and opportunity costs due to delayed services).

One of the external factors on tax compliance is the approach patterns of tax administration towards taxpayer. According to Mutlu&Taşçı (2013) cited in Helhel, (2014) found that customer oriented tax administration fosters voluntary tax compliance of citizens. While agricultural income tax payers have been found to be affected by the customer oriented approach of tax administration at the highest level in terms of voluntary compliance, the commercial income tax payers have been affected to a lesser extent.

An important trend in tax administration policies in recent years is the recognition that the traditional "enforcement" paradigm of tax administration, in which taxpayers are viewed and treated as potential criminals and the emphasis is exclusively on repression of illegal behavior through frequent audits and stiff penalties, is incomplete. A revised "service" paradigm recognizes the role of enforcement, but also emphasizes the role of the tax administration as a facilitator and a provider of services to taxpayer-citizens (Alm and Martinez-Vazquez, 2003).

Taxpayer service plays a critical role in maximizing voluntary compliance by providing taxpayers with the information and assistance they need to enable them to meet their tax

obligations. Taxpayer services curb compliance costs by providing programs that enable taxpayers to fulfill their obligations more easily, thereby minimizing the need for the tax administration to expend more costly resources to enforce compliance. With effective public information, forms, and services, and by convincing non-compliant taxpayers that they can comply with relative ease, taxpayer services can also encourage and help accomplish greater voluntary compliance.

The USAID report (2013) categorized the tax payer service strategy into three broad themes: These are; **Tax simplification:** Most tax administrations agree that simplified policies and procedures greatly facilitate voluntary compliance. Without institutional simplification enabling taxpayers to fulfill their responsibilities more effectively, even the most comprehensive services offered to taxpayers will not be effective; **Taxpayer assistance:** Taxpayer assistance means providing taxpayers with information to prepare tax returns and to resolve issues of filing, as well as questions and adjustments that may arise after the tax returns have been submitted to the tax administration. These areas of assistance have also been referred to as the pre-filing, filing, and post-filing stages of assistance; and **Facilitation of tax collection and enforcement:** The ultimate goal of the tax administration is to collect the proper amount of taxes due to the government. Therefore, providing the mechanism to facilitate the payment of taxes – especially for business taxpayers who are required to regularly remit multiple tax payments for different taxes – is an essential enabling tool to encourage voluntary compliance. Call center operations supported by modern telephone technology are becoming an increasingly significant element in service delivery.

2.2.4.3. Tax Knowledge

As stated by Lewis, (1978) cited in Hofman et.al (2008) people not only have difficulties to understand tax law, they also show poor knowledge about tax rates and basic concepts of taxation. Studies on knowledge and evaluation have addressed people's understanding and acceptance of tax phenomena as well as relevant associations towards taxation held by different groups of taxpayers. While from the perspective of the community, tax avoidance, tax evasion, and tax flight all have similar negative consequences, people evaluate these phenomena differently.

Palil (2012), states that in addition to tax education, knowledge about tax laws also plays a major role in determining taxpayers' compliance behavior. Therefore a step ahead, for example continuous education programmes and effective monitoring mechanisms must be taken into account by tax authorities to ascertain that taxpayers have a good and reasonable knowledge and understanding of tax matters. On the contrary, awareness and attitude of the taxpayer himself is more important since the effectiveness of tax education depends on the readiness, acceptance and honesty of taxpayers.

Knowledge of tax is the process of changing the attitudes and code of conduct of taxpayers or group of taxpayers in an effort to inform human beings through the efforts of teaching and training. Increasing knowledge of tax regulation/ law among tax payers through formal and non-formal education will have a positive impact on taxpayer awareness to pay taxes. Knowledge of tax regulations in the new tax system is through a self-assessment MSE enterprise system. In this system, taxpayers are trusted to calculate, estimate, and determine the payable amount of income tax and report it to the Tax service Office or extension service office and tax consultant office, or can also be delivered through the post office, tax corner, mobile tax office and certain places for annual notification letters (drop box) after the tax year ends (Nurlis.,2015). The Taxpayers Advocate Service is an independent organization within the IRS and was introduced to assist taxpayers who are experiencing economic hardship, who are seeking help in resolving tax problems that have not been resolved through normal channels, or who believe that an IRS system or procedure is not working as it should (IRS, 2009). (Misu, 2011) divide the tax information into two components: one is the tax statistics, and the second is the tax return information for each taxpayer. There are so many types of information in tax statistics. One of the most important statistics for the purpose of increasing the level of tax compliance is the exact amounts of tax evasion .The other information is given by the tax return information for each taxpayer. There are some exceptional countries, like Finland and Norway, which release the tax return information for each taxpayer to the public. However, in most developed economies, the tax return information for each taxpayer is strictly prohibited to release to the public for the protection of private information. The statistics about tax evasion has been released to the public for most developed countries. This information disclosure might be not only for taxpayers' rights to know, but also for inducing more tax compliance. Furthermore, some private information for the richest group of individuals and corporations has been released to the public under the legal

basis. Tax education can constitute any informal or formal programme organized by the tax authority or independent agencies by which to facilitate taxpayers in completing tax returns correctly and also to cultivate awareness of their responsibilities in respect of the tax system. Various programmes in the US, including the Public Information Programme, were introduced to educate school children, small business owners and other self-employed individuals. Through workshops or in-depth tax courses, instructors provided training on filing tax returns, starting a business, recordkeeping, preparing business and personal tax returns, self-employment tax issues, and employment taxes (IRS, 2009).

The Taxpayers Advocate Service is an independent organization within the IRS and was introduced to assist taxpayers who are experiencing economic hardship, who are seeking help in resolving tax problems that have not been resolved through normal channels, or who believe that an IRS system or procedure is not working as it should (IRS, 2009). Knowledge about taxation, the benefits of taxation and the dangers of non-compliance remain a key impediment to tax compliance in many countries (Among.et.al, 2013). James (2000) argues that the norm is usually to comply rather than not to comply. As already pointed out for a tax system to be effective the majority of the taxpayers have to comply. It follows that there may be greater gains in assisting basically compliant taxpayers to meet their fiscal obligations than in spending more resources in pursuing the minority of non-compliers. Many taxpayers might be willing to comply in full, but are unable to do so because they are not aware of, or do not understand, their full obligations.

As stated in (Eric at al, (2015), in local government, revenue collection can be improved through sensitization of tax payers as means of shaping their attitudes and ensure compliance of tax payers. Local revenue collection has to comply with certain general principles of raising revenue and how these principles should be fair, convenient and certain. The collection and administration of revenue must be economical to the collectors and administrators. Greater education is directly linked to a likelihood of compliance. Educated taxpayers may be aware of non compliance 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 (Chan at al. (2000). Chan *at al.* also suggested that those 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.

From the literatures we can understand that taxation knowledge is necessary to increase public awareness especially in areas concerning taxation laws, the role of tax in national development, and especially to explain how and where the money collected is spent by the government .More importantly, it is necessary that current and future taxpayers are exposed to the roles that they could play in developing the country. This exposure could be given through seminars, dialogue sessions, or collaboration with the Ministry of Education to introduce the subject of Taxation at secondary schools.

2.2.4.4. Fairness and Equity

Perceived fairness of the tax system is an important factor that is likely to affect individuals' tax compliance decisions. Equity theory helps explain how individuals make fairness judgments. Equity theory suggests that individuals continuously evaluate their inputs and the outputs they receive (Walster et, al. 1978). If individuals perceive that outputs do not properly align with inputs, they experience distress. The distress could be related to either an underpayment inequity or an overpayment inequity. Underpayment receives. This theory is often used in organizational research to examine the influence compensation has on employees' behavior. In an organization this occurs when an individual believes he is not paid enough for the work he does. Perceptions of distributive fairness have been shown to affect tax compliance (Wenzel, 2003 and Kirchler, 2007). People who experience their tax burden to be higher than others tend to be less compliant with tax laws. Likewise, the more people believe that the government takes good care of their paid taxes and spends it carefully; the more compliant they tend to be. Equity theory, organizational justice research, and social exchange theory all agree that perceptions of fairness can have a significant influence on individuals' decisions (Deconinck, 2010). For instance, in an organization an employee's perceptions of fairness can have a significant influence on behaviors, such as organizational citizenship behaviors (Masterson et al. 2000).

Equity or fairness can be perceived via horizontal and vertical equity. Horizontal equity states people with the same income or wealth brackets should pay the same amount of taxes while vertical equity says, taxes paid increase with the amount of the tax base. The driving principle

behind vertical equity is the notion that those who are more able to pay taxes should contribute more than those who are not. As Spicer and Becker (1980) if a specific group perceives that their tax liability is higher than other groups, then tax evasion might occur among the group members. An individual tax payer also can be affected by other groups. Example if he feels that his tax burden is higher than other people within the same income group, his tax compliance probably decreases more widely at group levels; taxpayers want a fair treatment of their group relative to other income groups. In other words if the tax payer perceives the tax system is equitable and fair the level of his compliance will increase and become compliant.

Fairness and trust are perceived by many researchers to be important drivers for compliance. As cited in a report of OECD (2011) Valerie Braithwaite points out the importance of mutual trust and cooperation between the taxpayers and their tax authority in order to achieve voluntary compliance (Braithwaite, 2008). Kirchler and Hoelzl (2006) argue that fair treatment of taxpayers and trustworthiness of tax authorities will enhance voluntary compliance, Murphy (2004) shows in a study of accused tax avoiders that there is a correlation between fair and correct treatment of the taxpayer and trust in the revenue body. Trust is in turn correlated to the willingness to comply. If regulators are seen to be acting fairly, people will trust the motives of that authority, and will defer to their decisions voluntarily. Fairness and trust are thus interlinked and the one cannot exist without the other.

According to D. Jimenez (2013) studies suggest that procedural fairness influences the acceptance of decisions made by the tax authority and builds trust in the tax authority among private taxpayers (Braithwaite, 2003; Murphy, 2004). Procedural fairness is important for tax authorities, since by enacting fair procedures authorities support their legitimacy and trust (Tyler, 1997; 2006). Kirchler, Niemirowski and Wearing (2006) found that perceived supportiveness of advice by tax officers was associated with self-reported compliance and studies by Pommerehne and Frey (1992) and Torgler (2005) show that if taxpayers have a say in political decisions with regard to financial issues tax morale is stronger, as cited in (OECD, 2011). According to James (2000), the most obvious requirement of equity or fairness is to treat equal people in equal circumstances in an equal way. The problem here is in deciding who is equal to whom. Similarly, Due and Friedlander (1981), as cited in (Solomon, 2014), also argue that what is fair or

equitable in taxation is inevitably a value judgment; no scientific specification of an equitable distribution pattern is possible, or people may be equal income wise while they may be unequal regarding their expenditure, wealth, total utility and so on. Such a pattern can be specified only on the basis of a consensus of attitudes of persons in the contemporary society.

According to Brooks (2001) cited in Solomon, (2014), states that fairness has always been widely regarded as the most important criteria in judging a tax system. The problem of unfairness is that a tax system allows taxes to be shifted from dishonest to honest taxpayers. The fairness of a tax system may also be perceived in different ways by the taxpayers and tax authorities. What is fair in the eye of the tax authorities may not have the same image in the mind of the taxpayers.

“The implementation of the tax systems based on either progressive tax structure or flat tax rate structure however, most of the individual taxes are progressive tax structures. i.e., that is vertical in terms of providing equity does not meet. According to Valerie Braithwaite (2008) the important message from this research is that authorities develop trust and build their legitimacy, not through giving people the outcomes they want, which is often impossible, but rather through observing their right to a fair hearing and respectful treatment.” Studies show that the perception of procedural fairness is linked both to the acceptance of a specific decision and to the inclination to comply with laws and rules more generally (Tyler 2001”).

2.2.4.5. Fines and Penalties

As stated Gruber and Saez (2002) cited in (Micheal et al., 1996) it is a fact that if many persons are given the chance they may not pay taxes unless there is a motivation to do so. Tax experts have a perception that the best way is to increase tax incentives while others believe the best way is to increase tax penalties. Stopping non compliance requires applying penalties effectively. The most appropriate strategy is to combine various measures so as to maximize their effects on tax compliance as it were, in order to move the country from a low level of tax compliance to a higher level.

According to (Kirchler at al.(2008) cited in Misu, (2011)In an antagonistic climate, fines can be a part of the game of “cops and robbers”; in a synergistic climate, they can be perceived as an adequate retribution for behavior that harms the community. Fines are therefore connected to

trust and power. Fines that are too low could be perceived as indicator that the authorities are weak and unable to control the wrongdoers, undermining trust among honest taxpayers. Fines that are inappropriate because a taxpayer involuntarily made a mistake resulting from ambiguous tax laws, or fines that are exorbitantly high, would undermine the perception of retributive justice and induce tax evaders to try even harder to regain their “losses” incurred by those fines. The most extreme penalties will have no effect, if it is common knowledge that audits virtually do not occur. The increasing tax avoidance and tax resistance due to an increase of fines puts into question how fines should be assessed to be effective. On the one hand fines should be high enough to decrease the expected value of tax evasion and to assure its deterrent effect on tax payers. On the other hand, if fines are too high, the tax system would be perceived as unjust and unfair and taxpayers would use any possibility to legally avoid taxes (Kirchler at al.(2007).

As stated by Hyun (2005) the structure of penalty system may be different in the countries: can be various types of penalty rate by the different tax subjects or different structure of penalty rates by the types of taxpayer. So, penalty rates have been separately applied by the different tax subjects like the individual income tax, capital income tax, value added tax etc. Furthermore, the penalty rates for each tax subject are differentiated by the different types of evasion, like non-filing, timely filing but under-reporting, no bookkeeping of invoices, receipts etc. Or, the penalty rates are differently applied to the types of taxpayers, depending upon their evaded behaviors. If some taxpayers had the intentional evasions, the penalty rate is much higher than that of unintentional evasions.

The increasing tax avoidance and tax resistance due to an increase of fines puts into question how fines should be assessed to be effective. On the one hand, fines should be high enough to decrease the expected value of tax evasion and to assure its deterrent effect on taxpayers. On the other hand, if fines are too high, the tax system would be perceived as unjust and unfair and taxpayers would use any possibility to legally avoid their taxes. In most countries, fines are relative to the evaded tax. However, depending on the income of the accused such a system might yield too low fines to have deterrent effects. An alternative would be to adjust the fine to the income of taxpayers (Kirchler at al.(2007). A possible explanation for this is that very few taxpayers will be likely to be involved with tax audits, and so penalties and fines take on a critical behaviour-influencing role in helping to improve tax compliance. Fines and penalty rates

may substitute each other due to their multiplicative linkages as long as neither of them is set to zero (Kirchler et al.(2007).

Various arguments arise regarding the impact of fines and penalties on tax compliance to explain this lack of a clear impact relationship. For example, fines that are too low could be perceived as an indicator that the authorities are weak and unable to control non-compliant taxpayers, thereby undermining trust among honest taxpayers and leading to a lack of encouragement to comply with tax law. Furthermore, fines that are inappropriate because a taxpayer has made a mistake resulting from vague or overly complex tax laws would weaken the perception of retributive justice and encourage tax evaders to try harder to regain their losses incurred by those fines.

2.2.4.6. Strength of the organization

For many aspects of tax compliance, there is a debate in literature as to how the effective operation of the tax system by the tax authorities influences taxpayers' compliance behavior. The role of the tax authority in minimizing the tax gap and increasing voluntary compliance is clearly very important. According to Hasseldine and Li (1999) cited in Tadesse E.(2014) illustrated tax compliance is placing the government and the tax authority as the main party that need to be continuously efficient in administering the tax system in order to curtail tax evasion. Besides, the study of Richardson (2008) also suggested that the role of a government has a significant positive impact on determining attitudes toward tax. On the other hand the ways in which revenue authorities interact with taxpayers and their own employees have an impact on public perception of the tax system and the degree of voluntary compliance. Taxpayers who are aware of their rights and expect, and in fact receive, a fair and efficient treatment are more willing to comply. Voluntary compliance is promoted not only by an awareness of rights and expectations of a fair and efficient treatment but also by clear, simple and "user friendly" administrative systems and procedures. Voluntary compliance is enhanced when it is easier for taxpayer to do so.

According to OECD, (2011) The perception of fairness depends thus to a great extent on how the citizens perceive the authority's actions. A taxpayer may perceive an authority as just and fair even if it has made a decision that goes against him, if the authority acted in a good manner. This leads in turn to fewer complaints about the authority's decisions. What is important is not, therefore, whether the outcome is positive or negative, but whether it is fair (Wenzel, 2004). If an authority treats an individual courteously, it shows respect for the individual and helps increase the perception of fairness (Murphy(2003).

Rational and efficient procedures, higher personnel standards, better management, improvement in relation with the public and in the daily contacts between tax official and taxpayer, can operate to increase the public respect for the tax administration. Moreover, once the tax administration has been placed on a sound basis, it is in a position to assert that compliance must be forthcoming. Such an assertion would hardly be tolerated or even taken seriously, as long as tax officials were themselves inefficient and corrupt. But if the administration has brought stability and honesty to its own operations, the self-respect thus achieved can form the foundation for its demand of respect and compliance from the tax payer.

2.2.4.7. Tax payers' Attitude and Behavior

Taxpayers' willingness to pay taxes differs widely across the world. It cannot be viewed as simply depending on the tax burden. Rather, empirical research indicates that taxpayers throughout the world pay more taxes than can be explained by even the highest feasible levels of auditing, penalties and risk aversion (Alm et al.(2007). These high levels of tax compliance result from the tax morale of society that fosters self-enforcement of tax compliance. Tax morale, attitude and behavior is, however, not easy to establish. Especially countries without a deep-rooted 'culture' and habit of paying taxes find it difficult to establish tax morale. This willingness to pay" of the taxpayer is influenced by the following factors: In general, citizens expect some kind of service or benefit in return for the taxes paid. If the government fails to provide basic public goods and services or provides them insufficiently, citizens may not be willing to pay taxes and tax evasion and avoidance will be the consequence (Brautigam et al.(2008). Some studies suggest that high tax rates foster evasion. The intuition is that high tax rates increase the tax burden and, hence, lower the disposable income of the taxpayer (Chipeta, (2002). However, the level of the tax rate may not be the only factor influencing people's decision about paying taxes. In fact, the structure of the overall tax system has an impact as well. If, for example, the tax rate on corporate profits is relatively low, but individuals are facing a high tax rate on their personal income, they may perceive their personal tax burden as unfair and choose to declare only a part of their income. Similarly, large companies can often more easily take advantage of tax loopholes, thereby contributing to the perceived unfairness of the system. Tax rates and the overall structure of the tax system, therefore, have a significant effect on the disposition to evade and avoid taxes.

2.2.4.8. Tax Compliance Costs

There are many definitions of tax compliance costs and most of them are similar. Tax compliance costs can be defined as all the costs borne by businesses and individuals for complying with tax regulation, excluding the costs of the taxes themselves. As tax system implementation is largely concerned with information processing, the bulk of costs of tax compliance are caused by information obligations, for instance, record keeping, filing in tax returns with data etc (OECD, 2004) The term ‘corporate tax compliance costs’ refers to the value of resources expended by corporate taxpayers in complying with tax regulations. (Tran-Nam B and Glover J, 2002) Some of the theoretical literature has suggested tax compliance costs as a possible determinant of tax compliance behavior. (Slemrod J., 1985) (Slemrod J. B., 2001) defined tax compliance costs as costs incurred by taxpayers in meeting the requirements laid on them by the tax law and the revenue authorities. These are costs over and above the actual payment of tax and over and above any distortion costs inherent in the nature of the tax. These costs would disappear if the tax was abolished. He segregated compliance costs of corporate taxpayers into main components, specifically: (1) internal costs; (2) external costs and (3) psychological costs.

The internal costs component comprises of time costs of employing internal staff such as tax manager, accountant, account clerks and programmers to handle the company’s tax affairs. Incidental tax compliance costs are other expenses incurred in the completion of tax activities such as the costs of postage, travelling and stationeries. The external costs component includes payments made to tax professionals from outside a company and any incidental costs incurred in relation to the tax work. These payments include the financial costs of professional fees paid to tax agents, accountants, legal advisers and any other external consultants in relation to the corporate income tax (CIT).

Tax practitioners provide services and information and might be “guardians against unequivocal breaches of legal code and, on the other hand, exploiters of legally ambiguous features of tax code to the advantage of taxpayers” (Beck, 1994). There are many reasons why taxpayers choose to use a tax agent. These reasons range from taxpayer wanting to file an accurate return, not having the knowledge to complete a complex return, wanting to minimize the tax they are required to pay, or simply not having enough time to complete their own return. Whatever the

reason, taxpayer demand for tax agents increased substantially over the past few decades. The tax agents do have the knowledge and expertise to exploit the gray areas of tax laws, a number of studies have examined whether professionally prepared returns are more non-compliant in nature than self prepared returns. For example, (Erard, 1993) found that paid tax preparer exhibited greater non-compliance. Thus the potential loss of tax revenue due to non-compliant reporting poses a serious problem for the tax authorities. The question of who instigates this non-compliant reporting, whether the tax agent or taxpayer, is therefore, an important one. To this end, (Klepper, 1991) suggest that tax agents can be both exploiters and enforcers of the law. When a tax agent is faced with an ambiguous situation, they tend to be exploiters of the law, in that they encourage tax avoidance.

2.2.4.9. Tax Rate

Kircher (2007), 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 (Clotfelter (1983) and (Slemrod J. (1998), also found that the marginal tax rate has a significant effect on underreporting. In a previous attempt by (Allingham(1972) to find a relationship between actual income, tax rates, penalty and investigation and tax evasion using the statistical modeling, they concluded that taxpayers may choose either to fully report income or report less, regardless of tax rates. Tax rates appeared to be insignificant in determining tax evasion.

In contrast with (Allingham(1972), various studies found that raising marginal tax rates will be likely to encourage taxpayers to evade tax more (Torgler(2007) while lowering tax rates does not necessarily increase tax compliance (Kircher(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. Laboratory experiments with varying tax rates frequently found that tax rate increases leading to higher tax evasion (Alm J. G., 1992). Other economic models of rational compliance decisions however, perceived that tax rates have a mixed impact on tax compliance or predict that increasing tax rates will increase compliance behavior (Kirchler(2008). Since the impact of tax rates was debatable (positive, negative or no impact on evasion), (Kirchler(2008) and (McKerchar (2009) suggested that the degree of trust between taxpayers and the government has

a major role in ascertaining the impact of tax rates on compliance. When trust is low, a high tax rate could be perceived as an unfair treatment of taxpayers and when trust is high, the same level of tax rate could be interpreted as contribution to the community, which in turn again profits each individual.

2.2.4.10. Tax system

One of the essential things affecting governments' ability in tax collection is the existence of proper tax laws and their correct performance. Having tax laws which are consistent and stable in enactment and performance will make the tax system to be less complex and can encourage tax compliance (Reza at al (2011) E. (2014). Cited by **Amina Ahmed and SaniyaKedir (2015)**, According to Richardson (2006) simplicity is the most important determinant of tax compliance in his study. Tax system should be as simple as possible for the reason that taxpayers come from various background, with different level of education, income level, different culture and different tax knowledge. In helping taxpayers to complete the tax returns accurately, the tax authority should have come up with a simple, but sufficient, tax return. The information required in the return must be at minimum level and be readily available from taxpayers' business and personal records (Mohd. and Ahmad, 2011). It is importance to have a simple tax return and system .Although the word 'simple' carries multiple interpretations, at least the majority of taxpayers require that the tax return should be as simple as possible. The tax authority may assume its tax return is simple and easy to complete but it may not be from the taxpayers' point of view. Therefore, it is good practice, before the final version is delivered to taxpayers, to ensure that 'pilot' tests have taken place first so that the tax return is really as simple and easy as it can be. (Silvani, 1992)

2.2. Empirical Literature

2.2.1. A review of empirical studies

Taxpayer's attitude on compliance 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). Study made on 'Evaluating taxpayers' attitude and its influence on tax compliance decisions in Tamale, Ghana' (Abubakari& Christopher, 2013) can be summarized as follows:

The above study focused on individual self-employed/petty traders and individuals engaged in micro and small scale enterprises. After analyzing the survey responses from questions administered to operators of micro and small enterprises, in Ghana, the results indicated that individuals are highly concerned with the amount of taxes they pay. The rates of income taxes in Ghana are generally perceived to be high. Furthermore, the burden of taxes paid affects the attitudes of individuals and this informs how they evaluate the tax system and consequently their compliance decisions. 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.

Another study made on ‘Factors that influence rental taxpayers’ compliance with the tax system’ an empirical study of Mekelle City, Ethiopia, (Suresh & Sriniva, 2012) identified tax compliance issues as follows: The researchers used structured questionnaires to collect data from a respondents of 140. And the responses were analyzed using SPSS software to summarize the findings of the study. Accordingly, the major problems of rental tax compliance in Mekelle City, Ethiopia were found to be intentional tax avoidance (presence of dishonest taxpayers), that means some rental taxpayers intentionally understate their taxable income, and also there are some who entirely do not report their taxable income to the concerned body. Consequently, this result is affecting the attitudes and tax compliance of genuine taxpayers towards the tax system. In addition to this, lack of knowledge of the tax system, especially how the taxable income is calculated and low awareness creation by the Revenue and Tax Authority by Mekelle City to taxpayers were found to be the major factors for tax compliance issues.

Similarly, a study by Ojochogwu & Stephen (June 2012) 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.

Study made by Nelson Maseko (2014) on ‘Determinants of tax compliance by micro and small enterprises’ in Zimbabwe can be summarized as follows: The main objectives of the study were to investigate how the unique business conditions of micro and small enterprises, the perceptions of micro and small operators towards taxation, levels of tax knowledge and compliance costs affect tax compliance of micro and small enterprise taxpayers. To achieve these objectives, the researcher stated research propositions: the current tax system in Zimbabwe does not cater for the special business needs of micro and small enterprises and that strong correlation do exist among tax knowledge, compliance costs, and tax compliance. The study adopted a chiefly qualitative research design. Methodological triangulation was employed, utilizing the interview method and questionnaire survey to collect primary data from small and medium enterprises in Harare. Interview responses were analyzed through summative content analysis and questionnaire responses were analyzed using SPSS software (V.16.0). The results indicated that micro and small enterprises face different business conditions from large companies which cause them to bear high tax compliance burdens. The results also indicated that the perceptions of micro and small enterprise operators about tax fairness, tax service quality and government spending priorities greatly affect their tax compliance decisions. Tax knowledge was discovered to have no correlation with tax registration compliance but weak negative correlations with filing compliance.

In addition to that, the 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 behaviour. 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.

Finally, the study on “assessing the gaps and problems that exist between the business community and Tax Authorities of Dire Dawa Administration (Yohannes&Zerihun, 2013) found various factors related to taxation system. The study was conducted to assess the challenges the business community of Dire Dawa City, in relation to taxation. Data were collected from various sources such as taxpayers’ survey and focus group discussions. A total of 183 taxpayers, key informants from Tax and Revenue Authority and Federal Customs and Inland Revenue Authority have participated in the study. Descriptive statistics such as mean, standard deviation, percentages, frequency, charts and frequency, etc. were used to summarize the study findings and present the results. The findings of the study revealed that most of the taxpayers, especially those in the category “C” have been facing various problems such as they are paying beyond their ability to pay and that they have no trust in the employees of the Tax Authority and the overall tax assessment of MSE, estimation and collection procedures. They pointed out the following major problems creating the existing gap between the taxpayers and the Dire Dawa Tax Administration. These are overexertion as a result of overestimation, lack of fairness in similar businesses, poor tax laws enforcement, poor communication and understanding between taxpayers and the Tax Authority and weakness in tax collection and unsatisfactory service delivery of the Tax Authority. Thus, they recommended that the Tax Authority should revise its working system and promote transparency, so that trust of taxpayers on the tax system will develop.

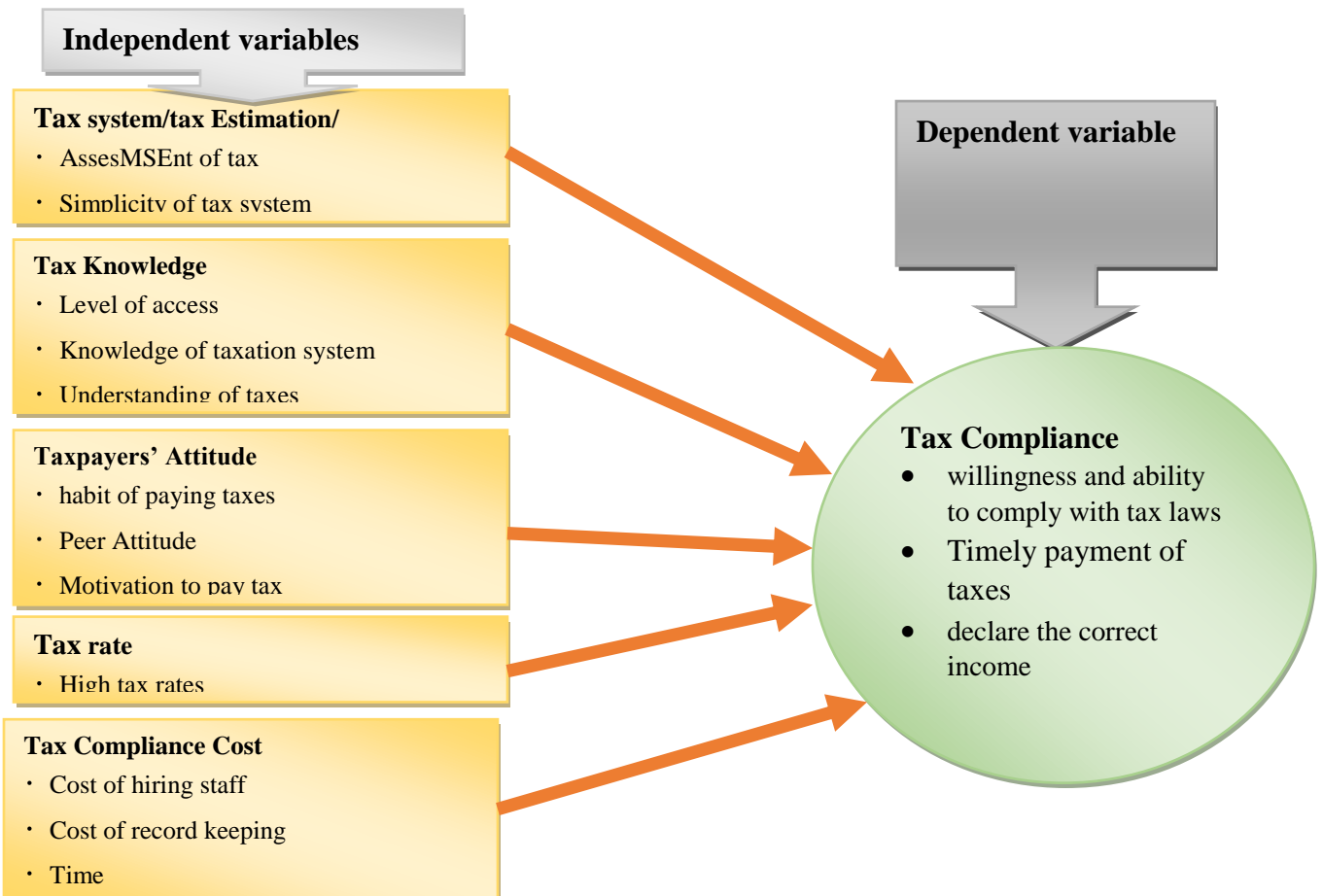
Reviews of past studies on tax compliance of Micro and small enterprises indicate mixed but interesting findings. For instance, while study made by Nelson Maseko, on ‘Determinants of tax compliance by micro and small enterprises’ in Zimbabwe that tax compliance of micro and small enterprises are affected by different situations from those of larger corporations which make them to bear high tax burden. Similarly, various studies were made on tax compliance issues, in developing countries especially, Nigeria, Kenya and Ghana.

2.2.2. Literature Gap

This study is needed for three reasons. **Firstly**, In Ethiopia there were few researches made on tax compliance in general, there is no study on such issues specifically on tax compliance of Micro and small business enterprises taxpayers in Ethiopia, particularly in South west shoa zone. **Secondly**, it will pave the way forward for the government, policy makers, and researchers to understand the different determinant of tax compliance of Micro and small business enterprises. **Finally**, this study advances the knowledge of how MSE tax system (Tax estimation), Tax payers knowledge, Compliance Cost, Tax rate and tax payers attitude influence the tax compliance of MSEs. This encourages the researcher to assess and identify the determinants of tax compliance of micro and small business enterprises taxpayers in the study area.

2.2.3. Conceptual Framework

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



CHAPTER THREE RESEARCH METHODOLOGY

Introduction

This chapter presents research design, population of the study, sample size and sampling techniques, sources of data, research instruments and procedures of data collection and methods of data analysis.

3.1 Research Design

The research design of this study would be 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 level “C” tax payers.

3.2. Sources of Data & Data Collection Techniques

The researcher collected the data from primary sources.

3.2.1 Primary data sources

The primary data were collected through questionnaire and structured interview. The questionnaire consisted close-ended and open-ended questions to understand Micro and small business enterprises opinions about the determinant tax compliance. Along with some of the closed ended questions are five score Likert scales to provide respondents a wider range of alternative with end points where “5” the level of agreements are represented by 1 to5.

1=strongly agree, 2=agree, 3=Neutral, 4=disagree and 5=strongly disagree. The primary data sources were collected from Micro and small business enterprises of South west shoa zone and from tax department of Ethiopia revenue and customs authority staffs.

3.3. Target Population

The population of the study consisted of all the Micro and small business Enterprises level “C” tax payers in south west shoa zone. South west zone consists of 11 woredas. Those eleven woredas are;

Table 3.1.Total Number of MSEs all woreda level.

S.No	Woreda	Number of MSE
1	Woliso	571
2	Wanchi	453
3	Ameya	318
4	Dawo	237
5	Sodo Dach	174
6	Bacho	303
7	Sadan Sodo	197
8	Tole	183
9	Ilu	384
10	Kersa	209
11	Goro	232
TOTAL		3,261

From these 11 woredas four woredas were as convenience taken into account the number of total Level C Micro and Small Business Enterprises tax payers they have. Those are; Woliso Woreda, Wonchi Woreda, Ilu Woreda and Ameya Woreda. The reasons for selecting only four woredas were the time and budget constraint to cover all woredas in the zone because the researcher is self sponsored.

3.4. Sample size and sampling Methods

From the selected woredas 1726 MSE category C tax payers were identified, which serve as a target population by using random sampling method. The sample size would be determined according to Yamane (1967:886). The formula the researcher would select and obtained from Yamane (1967:886) for sample determination is presented below. The sample size for the survey questionnaire is determined from tax payers and this is because of the fact that, the issue of compliance is better related to tax payers. However, tax authority staffs are also included not in the survey but to share their opinions through interview in the factors that influence business tax payer compliance.

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

n=Sample

N=Population size

e=an error

$$\text{Then the sample} = \frac{1726}{1 + 1726(0.05^2)} = 325$$

N. B. Here the error is assumed to be 5 percent

The researcher used a sampling size determination formula developed by (Yamane, 1967:886). Therefore, the researcher has taken 325 samples of Micro and Small business Enterprises from the branch and 5 tax department office staffs.

The method of proportional allocation under which the sizes of the samples from the different woredas /strata/ are kept proportional to the sizes of the strata. That is, if P_i represents the proportion of population included in stratum i , and n represents the total sample size, the number of elements selected from stratum i is $n \cdot P_i$. Therefore, a sample of size $n = 325$ to be drawn from a population of size $N = 1726$ which is divided into four strata of size Woliso woreda=571, Wonchi woreda=453, Ilu woreda=384 and Ameya woreda = 318 Micro and small business enterprises. Adopting proportional allocation, the sample sizes as under for the different woreda level:

Table 3.2. Proportional allocation of the sample sizes selected woredas level.

S.No	Name of selected woreda (strata)	Population size (p)	Proportion to the size of the strata ($P_i = p/N$)	Proportional allocation of the sample sizes ($i = n \cdot p_i$)
1	Wolisoworeda	571	571/1726	325 (571/1726)= 108
2	Wonchiworeda	453	453/1726	325 (453/1726) = 85
3	Ilu Woreda	384	384/1726	325 (384/1726) = 72
4	AmeyaWoreda	318	318/1726	325 (318/1726) = 60
	Total	1726		325

Accordingly, the researcher used both probability and non probability methods of sampling. Among the probability sampling methods, the researcher employed the simple random sampling using random lottery method. The non probability sampling methods would help in the case of selecting tax authority for an interview purpose only. Here, it is logical and practically impossible to collect data from significant number of staffs through interviews. Therefore, the purpose of the researcher in getting the accurate data is the initiative factor in selecting the interviewee. It is therefore the judgmental or purposive method of sampling that was employed in the study. Accordingly, the researcher interviewed a total of 5 tax staffs from tax departments of the study area.

3.5. Method of Data Analysis & Presentation

After the necessary data collected from the primary and secondary sources, then, these data would be grouped, coded and tabulated. Data presented using tables, various chart types and graphs. All these data presenting techniques implemented based on the nature of the data. The researcher employed descriptive method of data analysis and multiple regression analysis using SPSS version 22 together with excel spreadsheets

3.5.1. Conceptual Model

$$Y = f(x_1, x_2, x_3, x_4, x_5)$$

$$\text{i.e } TC = \beta_0 + \beta_1 TPK + \beta_2 TS + \beta_3 TR + \beta_4 TPA + \beta_5 CTC + \varepsilon$$

(1)

Where y is the tax compliance level; and Xs are the independent variables i.e.

X1 – Knowledge of tax payers about tax laws and rules

X2- Tax estimation by tax authority that affect tax compliance of micro and small enterprise

X3-Tax rate

X4- tax payers` attitude -this is the willingness of the taxpayer to be tax complaint

X5- Low compliance cost- penalty of taxpayers for not to pay tax.

n- Is the total number of variables in the study

3.5.2. Measures of dependent and independent variables

➤ Dependent variable

Tax Compliance:- This variable would be measured by part II items (eleven Questions). The majority of these items dealt with the tax compliance.

➤ Independent variables

It would be noted that the data for the five independent variables would be collected from the Micro and small business enterprise tax payers. Therefore, the independent variables represent the opinion of the tax payers regarding these concepts.

Tax payers` attitude:- This variable would be measured by Part III items (five questions). The majority of these items deal with the tax payer`s attitude to pay tax.

compliance cost:- This variable would be measured by part IV items (five questions). The majority of these items deal with penalty of taxpayers for not to pay tax.

Knowledge of tax payers:-This variable would be measured by part V items (Eight question). The majority of these items deal with the tax payer's awareness about tax laws and rules.

Tax rate:-This variable would be measured by part VI items (three Questions). The majority of these items deal with the tax rate.

Tax estimation by tax authority/tax system/:-This variable was measured by Part VII items (two questions). The majority of these items deal with the tax estimation by revenue and customs authority office.

Analytical Model

The analytical model for this study is as explained below;

$$Y = \beta_0 + \beta_{ij}X_{ij} + \epsilon$$

Where

Y -dependent variable- value of the firm

β_0 -is the constant (y intercept)

X_{ij} -measure of independent variable i for company j

B_{ij} -regression coefficient i for variable j

ϵ -the stochastic error term

In relation to the objectives of the study the researcher will uses multiple regression analysis:

$$T_0 = \beta_0 + \beta_1x_1 + \beta_2x_2 + \beta_3x_3 + \beta_4x_4 + \beta_5x_5 + \epsilon$$

(2)

Where T_0 : Tax compliance by Micro and Small Enterprises.

β_0 is the intercept; and reflects the constant of the equation.

β_1 is the sensitive coefficient of each independent variable ($i=1,2,3,4,5$).

ϵ is the error term.

The study will use the T-test to analysis the relationship of the factors that affect tax compliance of Micro and small Business Enterprises in south west shoa zone. These tests will be conducted at 95% level of confidence ($\alpha=0.05$).

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This chapter covers various sections. These include response rate in relation to gender, age bracket of the respondents, and category of representative and highest level of educations of the respondents. The chapter also covers the determinants of tax compliance, Descriptive output, regression analysis and summary of statistics.

4.2. Response Rate

A total of 325 questionnaires were distributed to MSE level C taxpayers of which 315 returned filled completely and properly. This made the return rate around 96% while 4% of the respondents did not respond to the questionnaires. After the data were collected, checked for errors and completeness, it was analyzed using descriptive research techniques and multiple regression analysis.

4.3. Background information of respondents

4.3.1 Gender

Figure 4.1 below best illustrates that; the researcher sought to find out the gender of the persons filling the questionnaire.

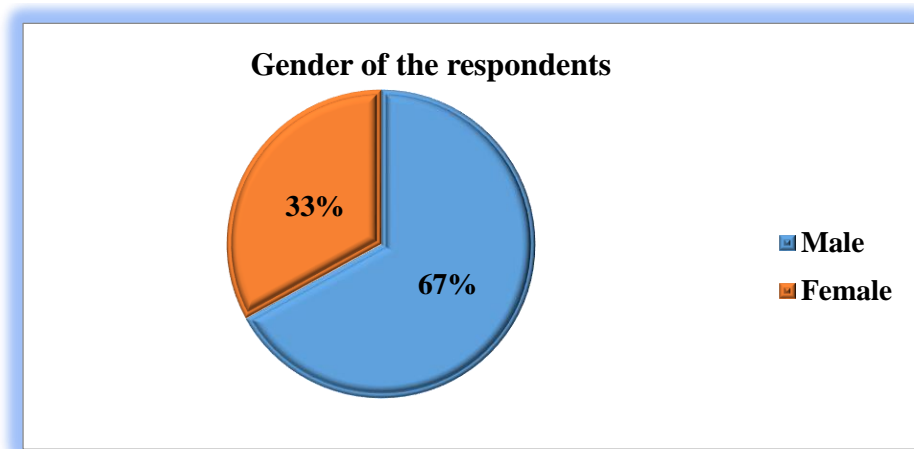


Figure 4:1. Gender of the respondents, Source: Research Findings

Figure 4.1.shows the gender of the respondents. The findings indicate that majority of the respondents 211 who filled the questionnaires were male representing 67% as opposed to 104 or 33% of them being female.

4.3.2 Age Bracket of the Respondents

The researcher was interested in establishing the age bracket of the respondents.

Table 4.1 Age Bracket of the Respondents

Age Bracket	Frequency	Percentage
19-24 years	65	20.6
25-29 years	108	34.3
30-34 years	92	29.2
35-39 years	27	8.6
40-44 years	15	4.8
45 years and above	8	2.5
TOTAL	315	100

Source: Research Findings

Table 4.1 shows the age groups of the respondents. The study found out that majority of the respondents was in the age bracket of 25-29 years at 34.3% followed by those in the age bracket of 30-34 years with 29.2%. The study findings indicate that 20% of the respondents were in the age bracket of 19-24 years, 8.6% were in the age bracket of between 35 -39 years and 7.3% were in the bracket of 40 years and above.

4.3.3. Highest Level of Educations of the Respondents

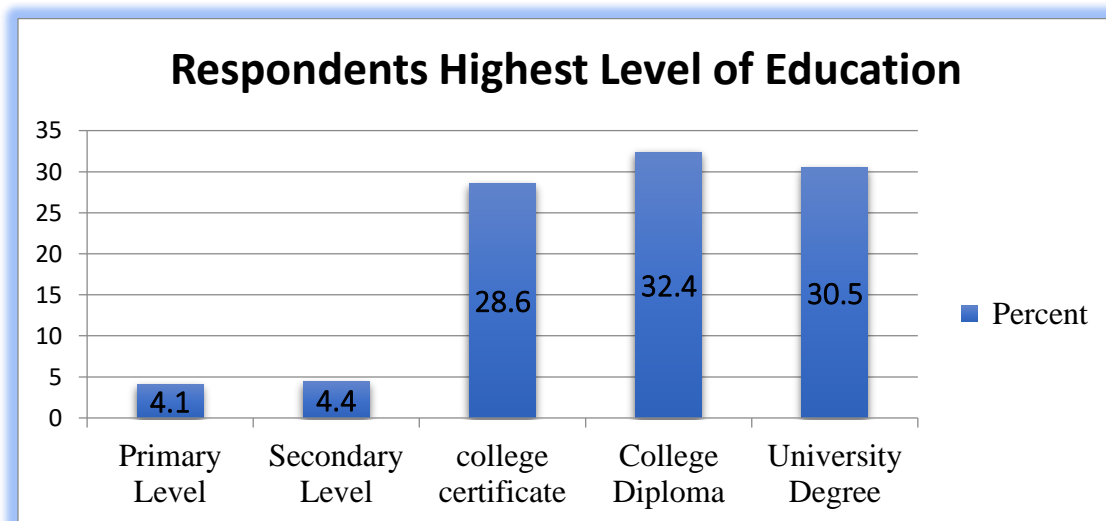


Figure 4.2 Highest Level of Educations of the Respondents, Source: Research Findings

Figure 4.2 shows the age groups of the respondents, the study wanted to find out the highest level of education among the respondents. The findings indicate that 102 of the respondents were college diploma holders, 96 were university degree holders, 90 were college certificate holders in addition 14 were secondary school level holders while 13 of the respondents were primary school level holders.

4.3.4. Kind of Business

According to Income Tax Regulation No. 78/2002, there are different types of businesses in Ethiopia. The types of business sectors are summarized into five major categories for the consumption of this thesis.

Table 4.2. Kind of Business

Kind of Business	Frequency	Percentage
Trade	94	29.8
Service	143	45.4
Manufacturing	9	2.9
Agriculture	6	1.9
Construction	63	20.0
TOTAL	315	100

Source: Research Findings

Table 4.2.Above wanted to find out the kind of business that the respondents were carrying out. From the study findings most of the businesses 45.4% were in the Service, 29.8% were in the Trade industry, 20% of the respondents were in the construction industry, 2.9 % were in the Manufacturing industry and 1.9% were in the agriculture industry.

4.3.5. MSEs Duration of Existence

The researcher sought to establish the duration in which the MSEs which respondents had been existence. Table 4.3 below summarizes the duration of existence of the MSEs.

Table 4.3 MSEs Duration of Existence,

Duration	Frequency	Percentage
0-3 years	129	41.0
4 years-8 years	167	53.0
9 years- 15 years	10	3.2
above 15 years	9	2.9
TOTAL	315	100

Source: Research Findings

The findings indicate that most 53% of the MSEs had been in operation for a period of above 4-8 years, 41% of the MSEs had been in operation for a period of 0-3 years, these were followed by those which had been in operation for a period of between 9-15 years representing 3.2%. The study findings indicate that 2.9% of the responding MSEs had been in operation for a period between above 15 years. Table 4.3 below illustrates these facts further.

4.3.6. Registration status of MSEs

The researcher sought to find out the registration status of the MSEs. The findings indicate that all of the respondents indicated that the businesses had formally been registered by the registrar.

4.3.7. Legal form of the business

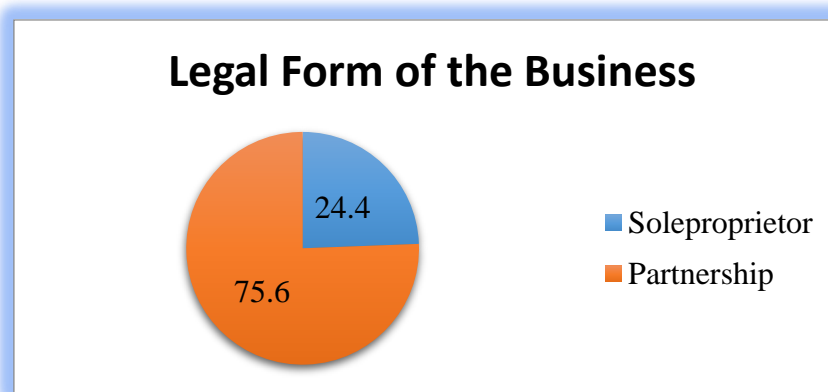


Figure 4.3. Legal form of the Business, Source: Research Findings

Figure 4.3 above summarizes the legal forms of the MSEs. The study wanted to establish the legal form of the business. From the study findings most of the respondents stated that 24.4% of

the MSEs were sole proprietor and 75.6% of them were partnership and no limited company in MSE selected as respondents.

4.3.8. The number of staff Employed in the business

The study sought to find out the number of staff employed in the organizations including the owner of the business. Table 4.4 below illustrated the number of staff employed.

Table 4.4: Staff employed

Number	Frequency	Percentage
1-5	138	43.8
6-10	168	53.3
11-20	3	1.0
21-30	3	1.0
31-40	3	1.0
TOTAL	315	100

Source: Research Findings

Table 4.4. Shows that majority 53.3% of MSEs which responded had 6-10 staff employed in their organizations followed by organizations with 1-5 employees representing 43.8%. The findings indicated that 1% of the respondents had 11-20 employees, 1% had 21-30 employees whereas 1% of the MSEs organization had 31-40 employee.

4.6. Descriptive Statistics results

The descriptive statistics (such as mean of distribution and standard deviation of the distribution) were employed to investigate and present an overview of both dependent variable (Tax Compliance) and independent variables (Compliance cost, Attitude of tax payers, MSE Knowledge of the tax payers, Tax rate and MSE Tax System) used in the study. Table 4.5. shows the descriptive statistics output summary of all variables.

Table 4.5. Shows the descriptive statistical results of corresponding 315 total observations of each variable in the study. It also describes the overall nature of variables employed in the study and their interpretation is presented as follows.

Table 4.5: *Descriptive statistics output of all variables,*

Descriptive Statistics						
		Observation	Minimum	Maximum	Mean	Std. Deviation
Dependent Variable	TC	315	7.00	23.00	14.3365	3.53343
Independent Variable	ATP	315	7.00	21.00	15.5175	2.76042
	CTC	315	5.00	19.00	12.0254	2.91809
	TPK	315	12.00	21.00	16.7556	2.25604
	TR	315	8.00	17.00	12.2381	2.69296
	TS	315	5.00	21.00	13.4476	3.15516

Source: Output of SPSS 22

1. According to Best, (1977), standard deviation of the score from 1-1.80 is lowest, from 1.81-2.61 is lower, from 2.62-3.41 is average/moderate, from 3.42-4.21 is good/high, and 4.22-5 is considered very good.
2. Besides, the decision rules used in the analysis was average mean less than 3 was considered as low, average mean equal to 3 was considered as medium and average mean greater than 3 was considered as high . (Best and khan1995).

The mean distribution of the dependent variable (TC) of the study is 14.3365 which is greater than 3 and standard deviation statistics for TC is 3.53343, which is greater than 1. It shows that as per the Micro and small business enterprise perception tax compliance in ERCA is greater than its moderate level.

The mean distribution of attitude of tax compliance was 15.5175 which are greater than 3 and the standard deviation of attitude of tax compliance 2.76042 which is greater than 1, indicates that there is attitude of tax compliance affect tax compliance in MSE tax payers.

Cost of Tax compliance is determined by the penalty due to not paying tax, cost stationeries, cost of cash register machine, cost of hiring staff and cost of tax consultant. The mean value of Cost of tax compliance was 12.0254, which is greater than 3. This implies that MSE perception on cost of tax compliance in MSE tax payers in its planning up to working paper preparation, the tax

compliance is affected by cost tax compliance. The variation of cost tax compliance measured by standard deviation was 2.91809 which is greater than 1 of its moderate score, it can be understood that the MSE tax payers have highest cost of tax compliance.

The mean value of Tax payer's knowledge of tax rules was 16.7556 which is greater than its moderate value of 3. The standard deviation of organizational independence was 2.25604 which indicate the MSE tax payers have less average deviation of 2.25604 from the mean value. Its implication is that MSE tax payers do not have awareness of tax rules.

The mean value of Tax rate was 12.2381 which is more than its moderate level 3 and its standard deviation was also 2.69296 it is more than its average. So its implication is MSE tax rate determine tax compliance.

The average mean value of tax system/ tax estimation/ of MSE tax payer's was rated as 13.4476 which is more than 3 and its standard deviation was 3.15516 which is also more than its moderate level. So the MSE tax system influences tax compliance.

4.7. Correlation Analysis and Discussion

Correlation analysis is a statistical tool which is used to measure the strength or degree of linear association between two variables. The correlation coefficient, which always lays between -1 and +1, was used to measure the strength and magnitude or degree of linear association between two variables. A correlation coefficient of +1 shows a strong and positive linear relationship between two variables. On the contrary, a correlation coefficient of -1 indicates a strong and negative linear association between two series. A correlation coefficient of 0 shows that there no linear relationship between two variables.

The correlation table below shows that the independent variables have a positive and negative significant relationship with the dependent variable. The result of correlation analysis is discussed in detail as follows:

Table 4.6: Correlation matrix between variables

	TC	ATP	CTC	TPK	TR	TS
TC	1					
ATP	.121*	1				
CTC	.170**	.881**	1			
TPK	.102	.883**	.786**	1		
TR	.130*	.801**	.874**	.881**	1	
TS	.424**	.591**	.595**	.682**	.730**	1

*. Correlation is significant at the 0.05 level (2-tailed).

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

The coefficient of correlation between attitude of tax payers and tax compliance was 0.121. It shows that there is weak and positive relationship between them. The relationship is significant at 0.05 level of significance. This implies that attitude of tax payers' during tax payment have weak or low effect on tax compliance. Another variable employed in the study was cost of tax compliance. The coefficient of correlation between tax compliance and cost of tax compliance is 0.170, which indicates that there is positive correlation between TC and CTC and the relationship, is significant at 0.05 level of significance. The relationship between tax compliance and cost of tax compliance is higher than the relationship between tax compliance and attitude of tax payers'. This implies that if the cost tax compliance (cost of stationary, cost of tax consultant, the penalty due to not to paying tax, cost of cash register, cost of hiring staff) were improved in the process its compliance will be affected significantly.

The coefficient of correlation between tax compliance and tax payers' knowledge is 0.102. This figure reveals that there is a weak and positive relationship between tax compliance and tax payers' knowledge in MSE tax payers. The relationship is significant at 0.05 level of significance. This implies that the organizations independence from giving awareness about tax laws and rules have a low impact on tax compliance.

Tax compliance is positively correlated to tax rate with correlation coefficient of 0.130. The relationship is strong and significant at 0.05 level of significance. This implies that any change in tax rate positively and significantly affects its tax compliance in ERCA.

The coefficient of correlation between tax compliance and tax system is 0.424. It shows that there is strong and positive relationship between them. The relationship is significant at 0.05 level of significance. This implies that any improvement on tax system to the Tax compliance have a positive significant impact on tax compliance in ERCA.

4.8. Multiple regression analysis

The study employed multiple regression models in the form of ordinary least square (OLS) and used a cross-sectional data from MSE tax payers'. The researcher undertook the diagnostic tests for the assumption of classical linear regression model (CLRM) before directly going to the multiple linear regression models.

4.8.1 Results for test of classical linear regression model (CLRM) assumptions

Diagnostic test is made to make sure that the classical linear regression model assumption violated or not. In this study an attempt is made to test Heteroscedastic, Autocorrelation, normality and Multi-collinearity the result of which are presented and discussed as follows.

✚ Test for no heteroscedasticity (homoscedasticity) $\{var(u_i) = \sigma^2 < \infty\}$

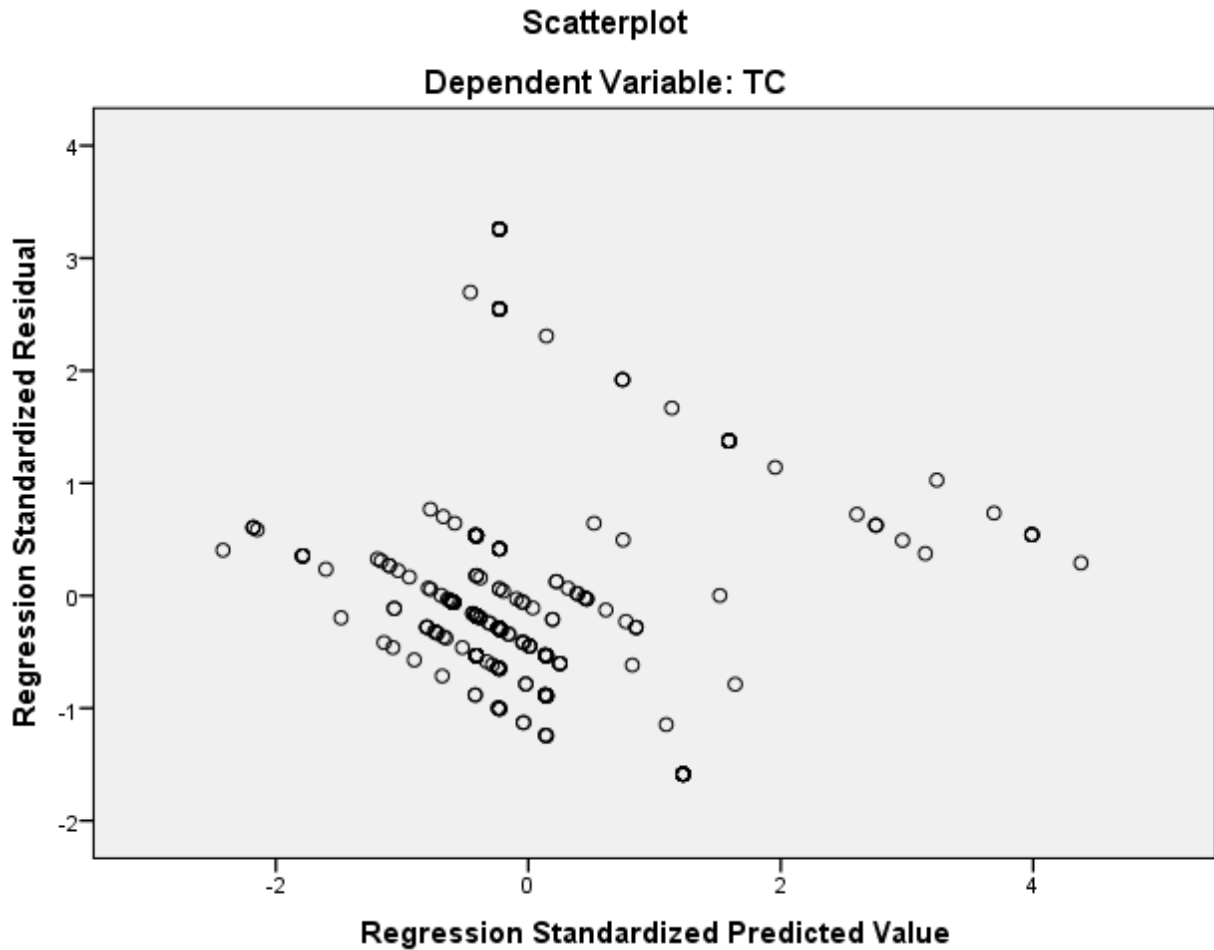
One of the important assumptions of the classical linear regression model is Heteroscedasticity. As noted by Brooks (2008) Heteroscedasticity assumption states that the disturbances u_i appearing in the population regression function are homoscedasticity; that is, they all have the same variance. The variance of each disturbance term u_i , conditional on the chosen values of the explanatory variables, is some constant number equal to σ^2 . This is the assumption of Heteroscedasticity, or equal (homo) spread (scedasticity), that is, equal variance (Gujarati, 2004).

If the error term u_i do not have constant variance it is said to be there is Heteroscedasticity problem. Heteroscedasticity makes your parameter estimates no longer BLUE they are still unbiased, but no longer have a minimum variance. Unfortunately, SPSS does not have built in procedure to test for heteroscedasticity. The test can be done by writing some codes.

Despite not having built in procedure to test for heteroscedasticity, we can plot standardized residuals (ZRESID) against the standardized predicted values (ZPRED). If there is no heteroscedasticity, the plot should look random. If you see a pattern, such as a funnel shape or a

curve, this indicates heteroscedasticity. A curve shape, in particular, could indicate some non-linearity in the relation that you failed to take into account. To avoid heteroscedasticity, we can check again by removing one independent variable and try again.

Figure 4.4:-Test for heteroscedasticity



Source: Output of SPSS 22

As we can see in the plot the residuals have a random pattern, which signifies that there is no sign of heteroscedasticity.

➤ ***Test for assumption of no autocorrelation $\{cov(u_i, u_j) = 0 \text{ for } i \neq j\}$***

The diagnostic test for CLRM assumption of no autocorrelation was tested by this study. According to Gujarati, (2004) the assumption of no autocorrelation between the disturbances assumes that given any two X values, X_i and X_j ($i \neq j$), the correlation between any two u_i and

$u_j(i \neq j)$, is zero. According to Chris Brooks (2008) it is assumed that the errors are uncorrelated with one another. If the errors are not uncorrelated with one another, it would be stated that they are ‘auto correlated’ or that they are ‘serially correlated’. This assumption was tested by Durbin Watson (DW) test of autocorrelation. Durbin--Watson (DW) is a test for first order autocorrelation -- i.e. it tests for a relationship between an error and its immediate previous value. One way to motivate the test and to interpret the test statistic would be in the context of a regression of the time t error on its previous value

$$u_t = \rho u_{t-1} + v_t$$

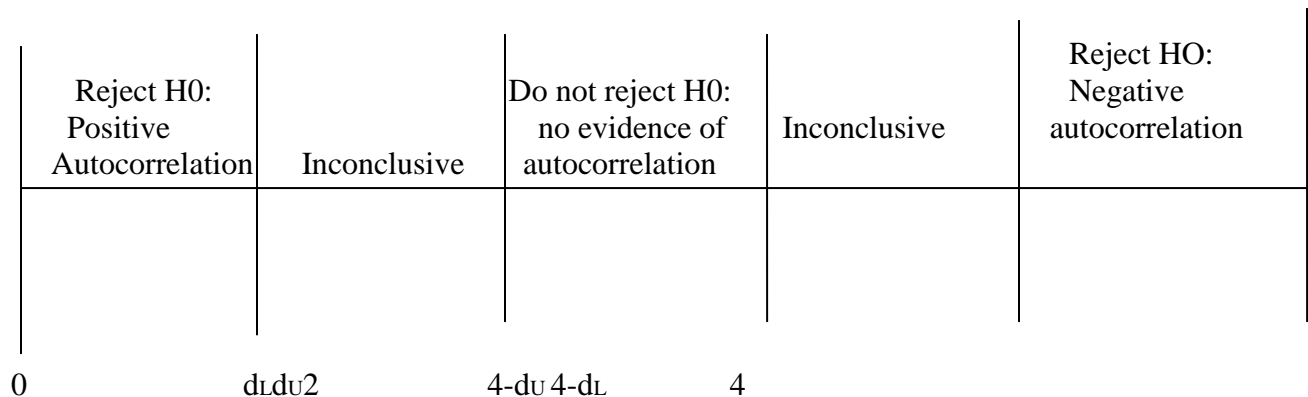
Where $v_t \sim N(0, \sigma^2 v)$ and ρ is the coefficient of autocorrelation. The DW test statistic has as its null and alternative hypotheses. Under the null hypothesis, the errors at time $t - 1$ and t are independent of one another (the errors at time $t - 1$ and t are uncorrelated), and the alternative hypothesis says the errors at time $t - 1$ and t are independent (the errors at time $t - 1$ and t are serially correlated). Therefore

$$H_0 : \rho = 0 \text{ (no autocorrelation)}$$

$$H_1 : \rho \neq 0 \text{ (autocorrelation)}$$

DW has 2 critical values: an upper critical value (d_U) and a lower critical value (d_L), and there is also an intermediate region where the null hypothesis of no autocorrelation can neither be rejected nor not rejected! The rejection, non-rejection, and inconclusive regions are shown on the number line in figure 5.

Figure 4.5:-Rejection, non-rejection, and inconclusive regions for DW test

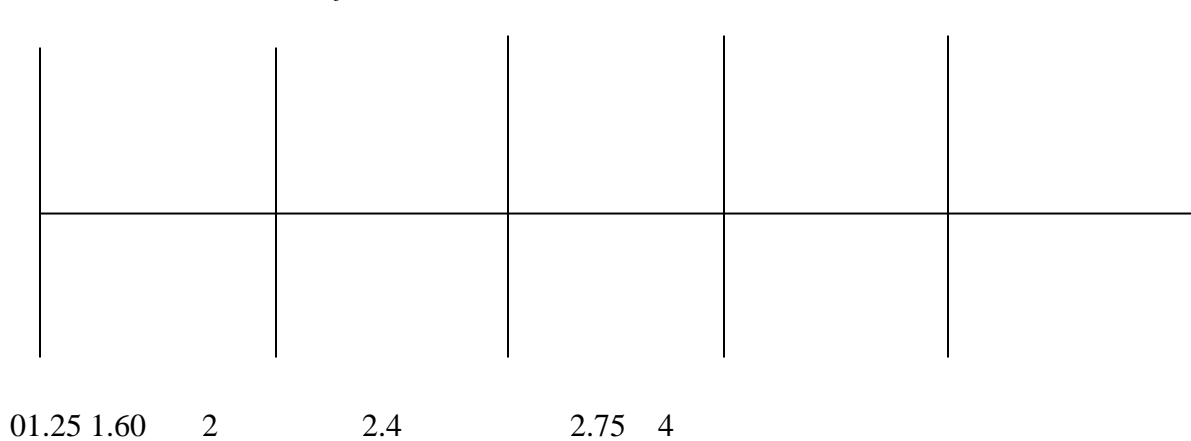


According to Brooks (2008) the following is the decision rule to reject and not to reject the null hypothesis

- Null hypothesis is rejected and the existence of positive autocorrelation presumed if DW is less than the lower critical value d_L ; the null hypothesis is also rejected and the existence of negative autocorrelation presumed if DW is greater than 4 minus the lower critical value d_L ;
- The null hypothesis is not rejected and no significant residual autocorrelation is presumed if DW is between the upper critical value d_U and 4 minus the upper critical value d_U .
- The null hypothesis is neither rejected or fails to be rejected if DW is between lower critical value d_L and the upper critical value d_U or if DW is in between 4 minus the upper critical value d_U and 4 minus the lower critical value d_L .

The DW test table value of d_L , d_U , $4-d_U$ and $4-d_L$ at N 315, and K 3 for this study is presented graphically below.

Figure 4.6:-DW test result test of autocorrelation



	Durbin-Watson
Result	2.423

Source: Output of spss 22

The DW test statistic value for the model was 2.423 for a total observation of 315 responders with 5 regressors. Thus the decision values for the test are $d_L = 1.25$, $d_U = 1.6$, $4-d_U = 2.4$ and $4-d_L = 2.75$.

The DW test statistics for the model is 2.423 which is clearly in between the inconclusive area.

So, the null hypothesis of no autocorrelation is within the inconclusive region. Therefore, there is no evidence of autocorrelation in the study.

➤ *Test for absence of multi-collinearity assumption*

The other CLRM assumption tested in this study was the absence of multi collinearity assumption. According to Brooks (2008) the absence of multi collinearity assumption says that the explanatory variables are not correlated with one another. If there is no relationship between the explanatory variables, they would be said to be orthogonal to one another. If the explanatory variables were orthogonal to one another, adding or removing a variable from a regression equation would not cause the values of the coefficients on the other variables to change. A small degree of association between explanatory variables will almost always occur but will not cause too much loss of precision. However, a problem occurs when the explanatory variables are very highly correlated with each other, and this problem is known as multicollinearity. Perfect multicollinearity occurs when there is an exact relationship between two or more variables. In this case, it is not possible to estimate all of the coefficients in the model. Perfect multicollinearity will usually be observed only when the same explanatory variable is inadvertently used twice in a regression.

According to Gujarati, (2004) multicollinearity refers to the existence of more than one exact linear relationship, and according to the author, the assumption of no multicollinearity says that there are no perfect linear relationships among the explanatory variables. In this study the researcher has checked for the independent variables are not correlated with one another. The following hypotheses were tested in the study for assumption of no multicollinearity.

Ho: there is multicollinearity among independent variables.

H₁: there is no multicollinearity among independent variables.

Different acceptable levels of degree of relationships between the independent variables have been suggested by different literatures. According to Cooper and Schendler (2009) the correlation coefficient between independent variable up to 0.8 may not cause series multicollinearity problem therefore, coefficient of correlation less than 0.8 is acceptable. According to Hair et al (2006), the correlation coefficient between independent variable should not exceed 0.9 which means coefficient of correlation less than 0.9 is acceptable.

In addition, we can also use another method, a Collinearity diagnostics using SPSS one of which is the variance inflating factor (VIF). The VIF indicates whether a predictor has strong linear relationship with the other predictor(s). Although there are no hard and fast rules about what value of the VIF should be a cause for concern, Field (2000) suggests that value of 10 is good value at which to worry. Field (2000), suggest that if the average VIF is greater than 10, then multicollinearity may be biasing the regression model. Related to the VIF is the tolerance statistics, which is a reciprocal of VIF (1/VIF). Such values below 0.2 are worthy of concern. Considering the regression model for this study correlation matrix of more of the predictor variables value of less than 10 that is good and the tolerance statistics values are all below 1 as such no multicollinearity is observed in this model.

Table-4.7. Collinearity diagnostics using VIF

Model	Unstandardized Coefficients		Standardized Coefficients			Collinearity Statistics	
	B	Std. Error	Beta	t	Sig.	Tolerance	VIF
1 (Constant)	6.127	.523		11.720	.000		
CTC	.396	.100	.394	3.954	.000	.230	4.353
TPK	-.219	.103	-.216	-2.114	.035	.219	4.569
TR	-.603	.145	-.579	-4.159	.000	.118	8.492
TS	.761	.071	.760	10.682	.000	.451	2.215

a. Dependent Variable: TC , Source: Output of SPSS 22

➤ **Test of normality assumption { $ut \sim N(0, \sigma^2)$ }**

The last diagnostic test for CLRM assumption of normality assumption was tested by this study.

The assumption says that disturbances are normally distributed. Frequency distributions come in many different shapes and sizes. It is quite important, therefore, to have some general descriptions for common types of distributions. In an ideal world our data would be distributed symmetrically around the center of all scores. As such, if we drew a vertical line through the center of the distribution then it should look the same on both sides. This is known as a normal distribution and is characterized by the bell-shaped curve. This shape basically implies that the majority of scores lie around the center of the distribution (so the largest bars on the histogram are all around the central value).

Figure 4.7:- Normality test

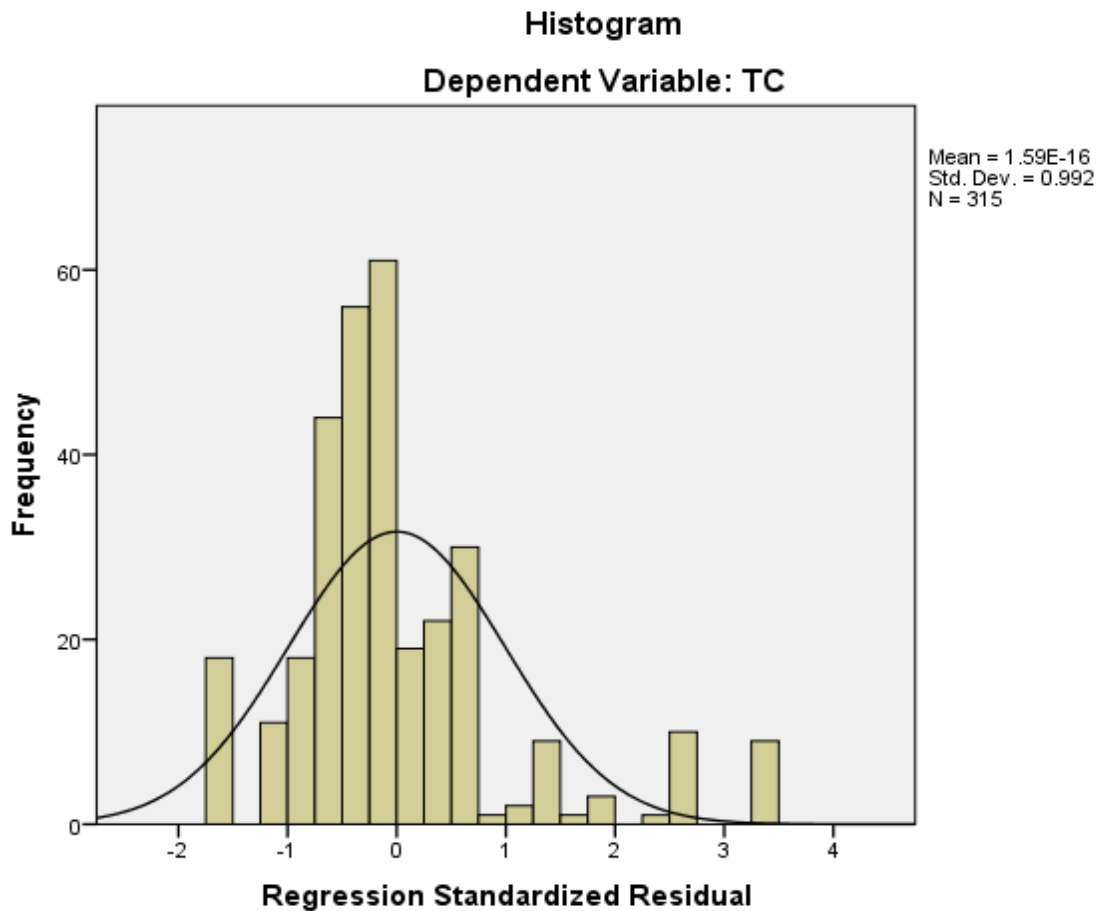


Table 4.8. Residuals Statistics

Residuals Statistics ^a					
	Minimum	Maximum	Mean	Std. Deviation	N
Predicted Value	4.8598	17.1811	9.2444	1.81277	315
Std. Predicted Value	-2.419	4.378	.000	1.000	315
Residual	-4.46606	9.17209	.00000	2.79235	315
Std. Residual	-1.587	3.258	.000	.992	315

a. Dependent Variable: TC

Table 4.9:-Reliability analysis

Variables	No. Of items	cronbach's alpha
TC	5	0.699
TPK	5	0.706
TS	5	0.704
TPA	5	0.703
TR	5	0.674
CTC	5	0.695

Source: Output of SPSS 22

From the above table 4.9, it is seen that the reliability value was estimated to be a 0.674 - 0.706 between the scale. If the above calculated reliability values are compared with the standard value alpha of 0.5 advocated by Cronbach's, then it can be safely assumed that the scales used by the research are reliable for data analysis.

4.8.2. Multiple regression output and its discussion

In this study, multiple regression analysis was carried out to get the predictive value of the variables considered. This was basically made to determine the linear combination of the constructs.

Regression of tax compliance (TC) on Tax payers' knowledge (TPK), Tax system (TS), Tax rate (TR), tax payers' attitude (ATP) and Cost of tax compliance (CTC).

The econometrics model employed in this study was the following

$$TC = \beta_0 + \beta_1 (TPK) + \beta_2 (TS) + \beta_3 (TR) + \beta_4 (TPA) + \beta_5 (CTC) + \varepsilon$$

Table 4.10:-Model summary

Model Summary^b

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.545 ^a	.296	.285	2.81485

a. Predictors: (Constant), TS, ATP, TR, CTC, TPK

b. Dependent Variable: TC

Table 4.11:- Anova

ANOVA ^a					
Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	1031.845	5	206.369	26.045	.000 ^b
Residual	2448.332	309	7.923		
Total	3480.178	314			

a. Dependent Variable: TC
b. Predictors: (Constant), TS, ATP, CTC, TPK, TR

Source: Output of SPSS 22

Table 4.12:-coefficient of linear regression

Model	Unstandardized Coefficients		Standardized Coefficients		
	B	Std. Error	Beta	t	Sig.
1 (Constant)	6.190	.524		11.811	.000
ATP	-.208	.153	-.208	-1.361	.174
CTC	.546	.149	.544	3.665	.000
TPK	-.063	.154	-.062	-.409	.683
TR	-.710	.165	-.682	-4.310	.000
TS	.765	.071	.764	10.743	.000

a. Dependent Variable: TC

Source: Output of SPSS 22

After running this equation using SPSS 22, the regression model was as follows.

$$TC = 6.190 - 0.208ATP + 0.546 CTC - 0.063 TPK - 0.710 TR + 0.765 TS$$

The regression model output was presented in table-4.10; it shows the coefficients, standard errors, t-values, and p-values for explanatory variables. The model in table-4.10, summary shows R-squared, Adjusted R-squared and standard error of the estimates.

The ANOVA result table shows F-statistics and probability (F-statistics) for the regression. The R-squared and Adjusted R-squared statistic of the model were 54.5% and 29.6% respectively. The explanatory power of independent variables such as attitude of tax payers, cost of tax compliance, tax payers knowledge, tax rate and tax system/tax estimation/ on the change in dependent variable (tax compliance) was 54.5%. The result of Adjusted R-squared shows that change on dependent variable (TC) was explained 29.6% by the independent variables employed in the study. Therefore, 70.4% of change on dependent variable (TC) was explained by other factors which are not included in the model. The null hypothesis of F-statistic (the overall test of significance) which says the Adjusted R-squared is equal to zero was rejected at 1% significance

level. F-value of 0.0000 shows strong statistical significance which enhanced the reliability and validity of the model.

Table 4.12, shows that Cost of Tax compliance and Tax system had positive coefficients. The positive coefficient indicates that there was direct relationship between those variables and TC. The variables, cost of tax compliance, tax system and tax rate are significant at 1% and 5% significance level. Whereas Attitude of tax payers and tax payer's knowledge had a statistical value more than 1%, 5% or 10% significance level, which means Attitude of tax payers and tax payer's knowledge had negative coefficients with no significant impact on tax compliance of MSE tax payers. The negative coefficient indicates that there was an inverse relationship between Attitude of tax payers and tax payer's knowledge with TC.

4.4.3. Testing of hypotheses

The hypotheses testing based on regression model output is discussed below:

H₀: There is no positive and significant relationship between *Tax compliance* and *attitude of tax payers* of micro and small business tax payers in south west shoa zone.

From the table 4.12, it can be observed that attitude of tax payers has -0.208beta coefficient, which shows that if attitude of tax payers is increased by 100%, tax compliance will be decreased by 20.8% by controlling other factors constant. Since the beta coefficient of attitude of tax payers has a negative sign, attitude of tax payers has a negative impact on tax compliance of MSE tax payers in south west shoa zone. Attitude of tax payers is not statistically significant at 5 percent significant level because the p-value of attitude of tax payers was 0.174 which is higher than 5%. This implies attitude of tax payers did not have significant effect on tax compliance of MSE tax payers. The null hypothesis is accepted. This result is consistence with (Trivedi & Shehata, 2005).

H₀: There is no positive and significant relationship between Cost of tax compliance and tax compliance of Micro and small tax payers in south west shoa zone.

As it is shown from table 4.12, cost of tax compliance has 0.546 beta coefficients, which shows that if cost of tax compliance is increased by 100%, tax compliance will be decreased by 54.6%

by controlling other factors constant. Since the beta coefficient of *cost of tax compliance* has a large magnitude of positive sign, tax compliance has a strong positive impact on *tax compliance of MSE tax payers*. *Cost of Tax compliance* is statistically significant at 1 percent significance level because the p-value of *Cost of tax compliance* was 0.000 which is less than 1%. Therefore, the null hypothesis was rejected in the study because *cost of tax compliance* has a positive significant impact on tax compliance. These result has been consistence with (Yeseget et. al. (2012), (Okeka, 2012),(Yong & Hooper, 2011).

H0: There is no positive and significant relationship between *tax payers' knowledge* and *tax compliance* of MSE tax payers in South West Shoa Zone.

As shown from table 4.12, Tax payers' knowledge has -0.063 beta coefficients, which shows that an increase in the *tax payers' knowledge* 100% will increase tax compliance by 6.3% by controlling other factors constant. Since the beta coefficient of *tax payers' knowledge* has a negative sign, it has a negative impact on tax compliance of MSE tax payers. *Tax payers' knowledge* is statistically insignificant at 5 percent significant level because the p-value of *tax payers' knowledge* was 0.683 which is greater than 5%. Therefore, the null hypothesis was not rejected in the study because according to the finding of the study, *tax payers' knowledge* has a negative significant impact on tax compliance. Therefore, *tax payers' knowledge* has a more contribution for the raise of tax compliance of MSE tax payers. This is consistence with the study of (Shailinder S., 2015), (Bernadette et. al., 2012),(Hanefah et al, 2002) and (Yohannes & Zerihun, 2013).

H0: There is no positive and significant relationship between *tax rate* and *tax compliance* of MSE tax payers in South West Shoa Zone.

Tax rate has beta coefficient of -0.710 which indicates that if *tax rate* is increased by 100%, the tax compliance will be decreased by 71.3% by controlling other factors constant. Since the coefficient has a negative sign, *tax rate* has a negative impact on tax compliance of MSE tax payers. However, the p-value of the variable was 0.000 and this indicates that the impact of variable on tax compliance was statistically significant at 1% significance level because the p-value of the variable was less than 1% significance level. Therefore, the null hypothesis was

rejected in the study because according to the finding of the study, *tax rate* has negative significant impact on tax compliance. These result is consistence with (Ojochogwu & Stephen (2012).

H0: There is no positive and significant relationship between *tax system* and *Tax compliance* of MSE tax payers in South West Shoa Zone.

As shown from table 4.12, tax system has beta coefficient of 0.765, which shows that an increase in the tax system at 100% will decrease the tax compliance by 76.5% by controlling other factors constant. The positive sign of beta coefficient of *tax system* variable has indicated that tax system has a positive impact on tax compliance of MSE tax payers. *Tax system* is statistically significant at 1 percent significant level because the p-value of *tax system* was 0.000 which is less than 1%. Therefore, the null hypothesis was rejected in the study because according to the finding of the study, *tax rate* has positive significant impact on tax compliance. These result is consistence with (Yohannes & Zerihun, 2013)

4.5. Discussion of interview

This section presents the discussion of data from interview and review of relevant documents. Structured interview with ERCA office tax collection process owner and staff workers of the function was conducted. It includes all variables those are; attitude of tax payers, tax rate, tax system, cost of tax compliance and tax payers knowledge.

The process owner and ERCA staff workers highlight on the interview of cost of tax compliance the purpose of penalty is to teach the taxpayer to comply for the tax laws and to truly & timely pay its obligation. But on the ground tax payers are knowingly and unknowingly hiding their income from the tax base, this leads the authority to request additional interest and penalty from the tax base and to make risk assessment on its taxpayers yearly and make the appropriate supervision for the periods specified.

The interview result showed that in ERCA the managements support to the tax collection process owner was not as it intended .as the interviewees explained one issue is resources like laptops is

not given to the tax process owner rather to its staff workers this makes the process owner to depend on the staff worker's resource during the tax collection.

The final issue raised in relation to management support management of ERCA was busy on other administrative issues and it cannot give due attention to the tax process owner department.

The interview and the document review results revealed that after the new tax collection system manual/ tax estimation manual is check for proper approval by its process owner next to staff workers approval at the time of collection. And the taxpayers have legal right to go in to appeal with in 10 day. If they are not satisfied by appeal committee's decision they can go until court. These activities enable better communication with taxpayers and ERCA office and help to ensure tax compliance.

The other issue was in relation to directives, circulars and explanations. Interviewee's argued that explanations requested are not replayed duly from the office; this makes some decision to lack concrete legal background. On the one hand also there are some regulations that needs amendment or further explanation which makes the MSE tax collection complex as interviews conclusion these laws makes the taxpayers and the ERCA office not to come into common understanding .as an example income tax bracket of MSE tax payers (income tax Proclamation 202/2009 of MSE).

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter covers various sections including the summary of the study, the conclusion and the limitations of the study. The chapter will also cover recommendations for further research as well as implications for policy and practice.

5.2. Summary of the Study

The purpose of the study was to identify the determinants of tax compliance of Micro and small business enterprises taxpayers using descriptive method of data analysis and multiple regression analysis using SPSS version 22 together with excel spreadsheets.

The research instruments were survey questionnaires developed with lottery method, interview with ERCA office of the tax compliance process. Before questioners were sent to respondents they were tested for reliability. A total of 325 copies of questionnaire were distributed to tax auditors and however 315 copies were found to be returned and used for analysis. Since each construct was affected by other constructs, regression analysis was conducted by the models, using tax compliance as dependent variables, this was basically done to get the best linear combinations of the constructs as well as to get predictive value of individual predictors for testing the hypotheses proposed.

The results of the study enable us to summarize that Attitude of tax payers, Tax payer's knowledge, cost of tax compliance, tax rate and tax system as a linear combination significantly influence tax compliance. However, as individual predictors: attitude of tax payers and tax payer's knowledge are not significant enough to influence tax compliance.

Tax system in comparison to Tax rate and cost of tax compliance is greater influence on tax compliance. The results of study demonstrated that perceived adequacy or inadequacy of tax system, tax rate and cost of tax compliance, extends noticeable influence on perception of tax

compliance. The influence of tax system on tax compliance may be attributed to the tax rate and cost of tax compliance.

There is no statistical significance negative relationship between attitude of tax payers and tax compliance. Besides, the results showed that there is no statistical significance positive relationship among tax payers knowledge and tax compliance. Findings of the research indicated that majority of the respondents replied that, most taxpayers may not have awareness of the tax system, cost tax compliance and the tax rate without knowledge of sufficient tax laws and regulations, according to this perception, ERCA office penalize taxpayers instead of educating them, low level encourage honest taxpayers, and also deliberately some taxpayers do not support the tax office during the collection. It can be summarizes that most taxpayers are noncompliance as result they impeded the tax compliance.

1.4. Conclusion

The primary objective of this study was to identify the determinant of tax compliance of MSE tax payers in south west shoa zone, Ethiopia. Based on objective of the study analysis of data and discussion of findings, the following are major conclusions of this study.

Four potential determinants of tax compliance were examined in this study, namely tax compliance cost, tax payers' attitude, tax rate, tax system and tax payers Knowledge.

The results revealed that Tax compliance Cost, Tax Rate and tax System consistently influence the tax compliance of MSE tax payers'. Nonetheless, Tax payers' knowledge, tax payers' attitude have an insignificant relationship with tax compliance of MSE taxpayers. Tax Compliance cost, tax system and tax rate are significant determinants of tax compliance micro and small business enterprises tax payers'.

Most of the respondents' from the taxpayers and interviewers from ERCA staffs believed the existence of the stated problems. The problems will be solved by regular training of the taxpayers on the tax rules and procedures especially, on changing proclamation and guidelines and making them available to the taxpayers timely.

The Ethiopian Revenues and Customs Authority of the branch should encourage the Micro and Small business enterprises taxpayers to use the web sites related to tax information, to improve

their bookkeeping and filing of documents related to their businesses and they should be engaged on forums on how to reduce costs associated with the tax compliance. Similarly, the government should be transparent and wisely use the tax collected from the public and communicate with the taxpayers about tax programs to promote the benefits of paying taxes.

Finally, the Government should work towards building confidence and trust between the taxpayers and its tax officers so that any tax related problems can be solved smoothly. ERCA needs to give on job training especially for new staffs on the usage of the tax systems and customer handling. There is a need of improving network problems and office layout to deliver quality and timely services to the Micro and Small business enterprises taxpayers.

1.5.Recommendations of the study

Based on the findings of this study, the researcher came up with several recommendations to encourage tax compliance among MSEs. These include;

- Tax proclamation, guidelines and any changes therein should be available to micro and small business profit taxpayers' timely and necessary tax training about tax rate and tax system should be given consistently and frequently by using different medias such as TV, Radio, different publications, Magazines and training activities by ERCA. So that it will enhance awareness of taxpayers, minimize gaps of tax compliance problems and it will also enhance timely payment of the tax by micro and small business profit taxpayers.
- Since the presence of those who do not pay taxes negatively affect the taxpayers behavior towards tax compliance, ERCA should strengthen the tax enforcement team so as to monitor informal suppliers transacting without using legal receipts and to include all micro and small business in to the tax system. The frequency and coverage of supervision should be increased to ensure uniform application of tax rules and procedures and to ensure fair tax system among similar businesses.
- 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.

- With regards to tax system of MSE, the study findings confirmed that most of the micro and small business enterprises taxpayers in south west shoa zone, Ethiopia are encouraged to pay taxes when they are satisfied with the public services. This factor can be exploited to improve tax compliance of micro and small businesses. Therefore, the government should use the taxpayers' money wisely and in a transparent manner and communicate with the taxpayers about tax programs to promote the benefits of paying taxes to improve tax compliance.
- 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.
- Tax authority should step up to their duty of promoting awareness. The awareness should not be about laws and penalties alone but also on needs and justifications for tax. In addition, taxpayers are entitled to have up-to-date information on the operation of the tax system and the way in which their tax is assessed and tax rate. All the information provided to taxpayers should reflect the complexity of the situation, thereby enabling them to understand better their tax affairs. The authorities may use a variety of means to fulfill this obligation.

5.5. Limitation of the Study

The limitation of this study is,

- Due to the respondents required much explanation to fill survey questionnaires and that took much time, money and energy of the researcher.
- Most of the respondents of Micro and small business enterprises taxpayers are service providers and retail traders and do not have enough time to respond to the questionnaires.

These all required additional time to encourage and frequently visit most of the businesses even during weekends and out of the normal working hours.

5.6. Suggestions for further research

This study proposes the following areas for further research:

1. Factors affecting tax compliance among Micro and small business taxpayers in other zone and regions of Ethiopia.
2. Impact of tax audit on tax compliance of Micro and Small business Enterprises tax payers.

REFERENCES

- Abubakari Abdul-Razak & Christopher Jwayire Adafula (2013). Evaluating taxpayers' attitudes and its influence on tax compliance decisions in Tamale, Ghana.
- Allingham, M. G., & Sandmo, A. (1972). Income tax evasion: A theoretical analysis. *Journal of Public Economics* 1(3-4): 323-38.
- Alm, et al., (2007), Tax morale and tax evasion in Latin America, Andrew Young school of policy studies.
- Alm, J., Jackson, B., & Mckee, M. (1992). Estimating the determinants of taxpayer compliance with experimental data. *National Tax Journal*, 45(1), 107-114.
- Alm, J., & Vazquez T. (2003). Institutions, paradigms, and tax evasion in developing and transition countries. In public finance in Developing and transition countries; Cheltenham, UK and Northampton. Retrieved from http://scholarworks.gsu.edu/cgi/viewcontent.cgi?article=1041&context=econ_facpub accessed on August 10, 2015
- Amina, A., & Saniya, K. (2015). Tax Compliance and its determinant the case of Jimma zone, Ethiopia annual conferences on the Ethiopian Economy.
- Aryeetey, E., & Ahene, A. (2004). Changing regulatory environment for small medium size enterprises and their performance in Ghana. CRC Working Paper No. 30594, Centre on Regulation and Competition (CRC).
- Badara, M. S., & Saidin, S. Z. (2012). Impact of the effective internal control system on the internal audit
- Best, J.W. & Khan, J.V. (1995). *Research in Education* (7th Edition). Prentice Hall pressboard, New York.
- Beza, M. (2011). Determinants of tax payer's voluntary compliance with taxation in east Gojjam Ethiopia. *International journal*, 03 (issn-255-1555).
- Braithwaite, V. (2008). Perception of who's not paying their fair share. *Australian journal of social Science issues*, 38, 335-362.

- Chan, C., Troutman, C.T., and O.Bryan, D. (2000). An expanded model of taxpayer compliance: empirical evidence from United State and Hong Kong. *Journal of international accounting, Auditing and taxation*, 9(2), 82-103.
- Chipeta, C. (2002). *The Second Economy and Tax Yield in Malawi*, Research Paper
- Chris, B. (2008). *Introductory econometrics for finance*, (2nd ed.) Published in the United States of America by Cambridge University Press, New York.
- Clotfelter, C. T. (1983). Tax evasion and tax rates: An analysis of individual returns. *The Review of Economics and Statistics* 65(3): 363-73.
- Cobham, A. (2005). Tax evasion, tax avoidance and development finance, QEH Working Paper Series, No. 129.
- D.Jimenez, p. (2013). Tax compliance in asocial setting :the influence of norms ,perception of fairness, and trust in government tax payer compliance. Retrieved from http://digital.library.unt.edu/ark:/67531/metadc283805/m2/1/high_res_d/dissertation.pdf. accessed on September 3,2015
- DeConinck, J. (2010). The effect of organizational justice, perceived organizational support, and perceived supervisor support on marketing employees' level of trust. *Journal of Business Research* 63: 1349-1355.
- Desta,w.k.,(2010). Assess MSE enterprise of tax payers' voluntary compliance with taxation:. Retrieved from <http://opendocs.ids.ac.uk> accessed on August 26,2015
- Due, J.F. &Friedlaender, A.F. (1981). *Government Finance: Economics of the Public Sector* 7thed. Illinois, USA: effectiveness at local government level. *Journal of Social and Development Sciences*, 4(1), 16-23.
- Eric M,Mafabi,J., and Olutayo, K. Osunsan,Samuel Pule,Dr. NalelaKizito, (2015). Tax Education And Revenue Collection As A Perception Of Tax Payers In Northern Division MbaleMunicipality,Uganda. *Researchjournali's Journal of Finance*, Vol.3(2).pp2348-0963.

- Federal NegaritGazeta of the Federal Democratic Republic of Ethiopia.(2002). income tax proclamation number 286/2002.
- Fedral Federal NegaritGazeta of the Federal Democratic Republic of Ethiopia.(2008). Establishment of Ethiopian revenue and customs authority proclamation number 587/2008.
- Hasseldine, J.,& Li, Z. (1999). More tax evasion research required in new millennium. *Crime, Law and Social Change* 31(1): 91-104.
- Jackson. B. R. &Milliron, V. C. (1986). Tax compliance research: Findings, problems, and prospects. *Journal of Accounting Literature* 5: 12565.
- James, S., and Nobes, C. (2000). *The Economic of Taxation*, 7th ed. London: Prentice Hall.
Retrived from <https://business-school.exeter.ac.uk/.../0208.pdf> accessed on August 2,2015
- Kayanula,Dalisto; Quartey,Peter, (2000). The Policy Environment for Promoting Small and Medium sized Enterprises in Ghana and Malawi. In: Eva M.,(ed), *Challenges and Constraints of MSME. A case of GRATIS Foundation’s Clients In the food processing and metal sector.*
- Keen, Michael, and Mario Mansour, (2010). “Revenue Mobilisation in Sub-Saharan Africa: Challenges from Globalisation I – Trade Reform,” *Development Policy Review*, Vol. 28 (September), pp. 553–71.
- Kirchler,E.(2007).The economic psychology of tax behavior. Cambridge: Cambridge University press.
Retrieved from <https://www.cesifo-group.de/.../C48A..accessed on August 2,2015>.
- Lewis, E. B. (1978). A gene complex controlling segmentation in *Drosophila*. *Nature* 276:565-570.
- Liedholm, Carl, and D. Mead.(1999). *Small Enterprises and Economic Development: The Dynamic Role of Micro and Small Enterprises*. London: Routledge.
- Marti, L. O. (2010). Taxpayers’ attitudes and tax compliance behaviour in Kenya.*African Journal of Business & Management*, 1,112-122.
- McBarnet, D. (2001). When compliance is not the solution but the problem: From changes in law to changes to attitude. Working Paper No. 18. Canberra: Australian National University, Centre for Tax System Integrity.

- McKerchar, M., & Evans, C. (2009). Sustaining growth in developing economies through improved taxpayer compliance: Challenges for policy makers and revenue authorities. *Journal of Tax Research* 7(2): 171-201.
- McPherson, Michael A. (1996). "Growth of Micro and Small Enterprises in Southern Africa." *Journal of Development Economics* 48(21):31-54.
- Michael, T., and Willy, M. (2015). Factors that influence compliance with tax laws among micro and small enterprises in Kenya. *International journal of scientific and research publictaios*, Vol.5 (6) pp, 12864-12872
- Mohad, R., and Ahmed, M. (2011). Factors affecting compliance behavior in self assessMSE enterprises system. *African journal of Business management* Vol.5 (33) pp. 12864-12872
- MoUDH (2016), Micro and Small enterprise Development policy and strategy, Second Edition March 2012, edit April 2016, Addis Ababa. Public Relations and Developmental Communication Secretariat, Ministry of Urban Development and Housing.
- Murphy, K. (2003). An examination of taxpayers' attitudes towards the Australian tax system: Findings from a survey of tax scheme investors, Center for Tax System Integrity, Working paper No. 46, November 2004, Research School of Social Sciences, Canberra: Australia National University.
- Nelson Maseko (2014) .The impact of personal tax knowledge and compliance costs on tax compliance behavior of SMEs in Zimbabwe: *Journal of Accounting and Business Management* Vol. 2(3), 26 – 37.
- Nurlis (2015). The Effect of Taxpayer Awareness, Knowledge, Tax Penalties and Tax Authorities Services on the Tax Compliance: Survey on the Individual Taxpayer at Jabodetabek & Bandung,
- Ozcan, G. B. (1995). " Small Business Network and Local Ties in Turkey". *Entrepreneurship and Regional Development*, 7,265-282.
- Palil, M.N., and Mustapha, A.F, (2011). The evolution and concept of tax compliance in Asia and Europe, *Australian Journal of Basic and Applied Sciences*, vol. 5(11), pp557-563.
- Palil, M. (2012). Tax knowledge and tax compliance determinants in self assessMSE enterprises system in Malaysia. Birmingham: PHD Thesis University of Birmingham. Retrieved from <http://etheses.bham.ac.uk/> - accessed on September 2, 2015

- Pederson, P.O (1989) The Role of Small Enterprises and Small Towns in developing and developed countries. CDR Project paper 89.1 Copenhagen: Centre for Development Research.
- Richardson, G. (2006). Determinants of tax evasion: A cross country investigation. *Journal of International Accounting, Auditing and Taxation* 15(2): 150-169.
- Roth, J. A., Scholz, J. T. & Witte, A. D. (1989). *Taxpayer Compliance: An Agenda for Research*. Philadelphia: University of Pennsylvania Press.
- Silvani, C. (1992). Tax payers' Attitudes and Tax compliance Behavior in Kenya. *African Journal of Business & Management (AJBUMA)* Vol. 1 (2010), 11pages
<http://www.aibuma.org/journal/index>. Accessed on August 12, 2015
- Simon W. (1999) creating an Enabling Environment for MSE Development in Thailand Project ILO/UNDP.
- Slemrod, J., Blumenthal, M. & Christian, C. (1998). The determinants of income tax compliance: Evidence from a control experiment in Minnesota. National Bureau of Economic Research Working Paper no. W6575.
- Spicer, M. W. & Becker, L. M. (1980). Fiscal inequity and tax evasion: An experimental approach. *National Tax Journal* 33(2): 171-175.
- Storey D.J., Giaoutzi, M., and Nijkamp, P. (eds). (1988). *Small and medium size enterprises and regional development*, London, Routledge.
- Suresh, V., and Srinivas G. (2012). Factors that influence rental tax payers' compliance with tax system: An empirical study of Mekele city, Ethiopia. *International refereed research journal- vol,-III (4(2))*. www.researchers world.com
- Tadesse, G., and Goitom, A. (2014). Factors influencing taxpayers' compliance with the tax system: An empirical study in Mekele city, Ethiopia. *Journal of tax research*, vol. 12 no.2, pp.433-452.
- Tambunan, T. (2006) *Micro Small and Medium Enterprises: Economic Growth and Poverty: A gender Analysis*. Report Prepared for Gender Equality Unit, Indonesia.
- Tilahun, A., and Yidersal, D. (2014). Determinants of tax compliance behavior in Ethiopia. The case of Bahir Dar City taxpayers. *Journal of economics and sustainable development*, Vol.5, pp. 2222-2855

- Todaro, M.P. (1997). *Economic Development*. Harlow: Addison Wesley Longman
- Torgler, B. (2007). *Tax Compliance and Tax Morale: A Theoretical and Empirical Analysis*. Cheltenham: Edward Elgar.
- USAID`S (2013).Leadership in Public financial management detailed guidelines for improved tax administration in Latin America and Caribbean. REtrived from <https://www.usaid.g/> accessed on August 5, 2015
- USAID`S (2013).Leadership in Public financial management detailed guidelines for improved tax administration in Latin America and Caribbean. RE trived from <https://www.USAID.g/> accessed on August 5,2015
- Vadde, D.S. (2014). Compliance and non compliance behavior of business profit tax payers' towards the tax system: A case study of Mekelle City, Ethiopia. *Scholar's journal of economics, business and management*.Vol.1(10):pp.525-531
- Walster, E.,G. Walster., & E. Berscheid. (1978). *Equity: Theory and Research*. Boston, MA:AllynandBacon,Inc.Retrievedfromhttp://mario.gsia.cmu.edu/micro_2007/readings/Greenbe_g_Equity_Workplace.pdf.accessed on August 12,2015
- Wenzel, M. (2003).Tax compliance and the psychology of justice.Taxing Democracy and the issue of tax avoidance and tax evasion. Retrieved from accessed on September 5, 2015
- Wenzel.M.(2004). An analysis of norm processes in tax compliance. *Journal of economic psychology*, Vol.25, pp.213-228.
- Wolday, A. (1997). *Small Scale Enterprise Development in Ethiopia* proceeding of the six annual conferences on the Ethiopian Economy.

APPENDICES

WOLKITE UNIVERSITY
MSc IN ACCOUNTING AND FINANCE
RESEARCH QUESTIONNAIRE

APPENDIX 1: RESEARCH QUESTIONNAIRE

The aim of this questionnaire is to gather information needed for the research report that will be Produced under the title “**Determinants of tax compliance of Micro and Small Business Enterprises Level “C” tax payers: The case of south west shoa zone revenue and customs authority, Ethiopia.**” The information you provide is believed to have a great value for the success of this research. The information you provide will be used for academic purpose and strictly kept confidential. In case you want to contact the student researcher, Getahun Ayansa can be reached at 0913733579 mobile number.

Kindly requesting you to give genuine response to all the questions hereunder, I am grateful to your cooperation.

General Instructions:

- I. Please provide your responses by marking a tick (√) in the relevant boxes.
- II. Do not write your name on the questionnaire.

Thank you for your cooperation!!!

Part I. General Information

Background information of respondents

1. Location of the enterprise within the woreda.....
2. Gender of the person filling the questionnaire. (Please tick the appropriate)
Male female
3. Age bracket of the owner
 - a) 19 years – 24 years
 - b) 30 years – 34 years
 - c) 40 years – 44 years
 - d) 25 years – 29 years
 - e) 35 years – 39 years
 - f) 45 years and above
4. What is your highest level of education?
 - a) Primary level
 - b) Secondary level
 - c) College Certificate
 - d) College Diploma
 - e) University Degree
5. Kind of business
Trade Service Manufacturing Agriculture Construction
6. For how long has the Micro and Small Enterprise been in existence? (Please tick the appropriate)
 - a) 0 – 3 years
 - b) 4 years - 8 years
 - c) 9 years – 15 years
 - d) Above 15 years
7. Has the business been formally registered by the Registrar? (Please tick the appropriate)
 - a) Yes
 - b) No
8. What is the legal form of the business?
 - a) Sole Proprietor
 - b) Partnership
 - c) Limited Company
9. What is the number of staff employed in this organization including the owner of this business?
 - a) 1- 5
 - b) 6 – 10
 - c) 11- 20
 - d) 21 – 30
 - e) 31 - 40

Part II:-Questions related to Tax compliance

S.N	Possible measures	1 Strongly agree	2 Agree	3 Neutral	4 Disagree	5 Strongly disagree
1	Can you believe Tax compliance improves the revenue of the government					
2	Is the amount payable in terms of taxes by micro and small business enterprises influences tax					
3	Micro and small tax payer's office has an effective motivation scheme to the compliance taxpayers.					
4	There is a good work relationship between the taxpayers and tax department office.					
5	Would you agree every tax payers pays on ability to pay?					

Part III: -Attitude of taxpayers towards tax as a factor influencing tax compliance, I wish to comply with the tax laws for the following reasons

S.N	Possible measures	1 Strongly agree	2 Agree	3 Neutral	4 Disagree e	5 Strongly disagree
1	I would fill guilty if excluded some of my income when completing my tax return					
2	By paying right amount of income tax, I believe that I am contributing for the economic growth of the country					
3	Serious enforcement and penalty may apply by Ethiopia Revenue and Customs authority if I do not comply					
4	There is fair tax among similar businesses in same proximity					
5	My friends and all similar traders pay their taxes faithfully					

Part IV:Cost of tax compliance as a factor affecting tax compliance of taxpayers

Please state your opinion to the statements listed in the following table using the given scales: I wish not to comply with the tax laws for the following reasons

S.No	Statements	1 Strongly agree	2 Agree	3 Neutral	4 Disagre e	5 Strongly disagree
1	The penalty due to not paying tax is lower than my tax saving					
2	Cost of stationeries, computer, etc. is high					
3	Cost of cash register machine and its operation is high					
4	Cost of hiring staff such as accountant & sales man is high					
5	Most of the time I hire external services (tax consultant) to file tax returns and I pay additional costs					

Part V: Business enterprises taxpayers’ knowledge of tax rules as a factor of tax compliance: For each question below please tick one using the given scales, I wish to comply with the tax laws for the following reasons

S. N	Possible measures	1 Strongly agree	2 Agree	3 Neutral	4 Disagree	5 Strongly disagree
1	I know how to determine my taxable income					
2	I clearly know deductible and nondeductible expenses to determine my taxable income					
3	I know schedule “C” income tax rates					
4	I am certain about the period and where to pay my tax liability					
5	I can easily get the necessary tax information & updates					

Part VI:-Tax rate as a factor of tax compliance: For each question below please tick one using the given scales,

S. N	Possible measures	1 Strongly agree	2 Agree	3 Neutral	4 Disagree	5 Strongly disagree
1	Do you think the Ethiopian tax rates for Micro and Small Enterprise are high?					
2	The Ethiopian revenue and customs authority tax rate and procedure increase the noncompliance of Micro and Small business enterprises tax payer.					
3	Do you think the existing tax rate is influence tax compliance					
4	The tax rates are very high and I can't afford to pay the amount					
5	Is there a need to improve the Ethiopian MSE tax rate					

Part VII:-MSE level "C" Tax system /Tax estimation as a factor of tax compliance,

S.N	Possible measures	1 Strongly agree	2 Agree	3 Neutra l	4 Disagre e	5 Strongly disagree
1	Are there strategies that can improve the tax compliance by Micro and Small Enterprise in Ethiopia?					
2	The existing tax system is promoting voluntary compliance that builds public confidence.					
3	Is there a need to improve the Ethiopian tax system of Micro and Small Enterprise that is estimation of tax?					
4	In Revenue and customs authority office of the branch, transparent estimation procedure are made based on facts.					
5	The existing MSE tax system has impact on tax compliance					

APPENDIX 2: STRUCTURED INTERVIEW

1. Do you believe that the number of employees working in the organization is sufficient for the effective service?
2. Do you believe the service rendered by your organization is fast and clear?
3. Do you agree the attitude of the staff towards the tax payers is affect compliance?
4. Would you agree for compliance the best way is to increase tax incentives rather than tax penalties?
5. Would you agree every tax payers pays on ability to pay?
6. As you are staff of the authority what is the tax payers' compliant level lookalikes.
7. The branch tax authority office timely discloses information to tax payers.
8. What factors do you think affect tax compliance among MSEs in Ethiopia?
9. The branch tax authority office timely giving training/awareness on tax law to tax payers.
10. Please give your opinion of how these factors can be addressed.

Thank you very much for your cooperation!!!