DETERMINANT OF TAX EVATION (IN CASE OF WOLKITE TOWN)

RESEARCH PAPER SUBMMITTED TO DEPARTMENT OF ACCOUNTING AND FINANCE IN PARTIAL FULLFILMENT OF BACHELOR ARTS DEGREE IN ACCOUNTING AND FINANCE

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We Strive for Wisdom!

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Statement of declaration

I declare that the senior essay entitled: *determinants of tax evasion in case of wolkite town ,* hereby submitted by me in partial fulfillment of the requirements for the Degree of (Accounting and Finance) at the University Wolkite is my original work and has not been submitted for any degree in any other university. I have undertaken it independently with the advice of my advisor, Dr RAO In performing the essay I have used different sources and material which have been acknowledged.

Submitted by _____

Signature _____

Advisor _____

Signature _____

AKNOLEDGMENT

Above all, I am thankful to the almighty God for helping me accomplish my will. Secondly, I would like to extend my heartfelt gratitude to my research advisor Dr RAO) for his guidance, suggestions and constructive comments without which this thesis would have not been in this form.

I would like thank Wolkite University for the encouragement to complete BA degree requirement in accounting and finance especially college of business and economics.

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ABSTRACT

Tax administration in Ethiopia as in some other developing countries is characterized by low tax compliance level. From an economic point of view, legal considerations apart, tax evasion has negative effects, namely a reduction of revenue yields. The voluntary compliance behavior of the taxpayers is determined by various factors and identifying these factors and treating them accordingly should be the central duty of any tax system in order to maintain voluntary compliance at reasonable level.

The main objective of the study was to investigate the Determinant of tax evasion of tax payers at Wolkite branch office.to the objective of research around three research question were distributed to six respondents in wolkite town tax revenue and authority.

Descriptive research design was adopted in order to achieve the objective of the study. Descriptive statistics used to identify determinant factors that determining the tax evasion the case of tax payers in the study area. The research question were analyzed and interpreted by using descriptive statistics and finally conclusion and recommendation were made in basis of the interpreted result.

Key words: evasion, avoidance and tax compliance

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ACRONYMS

ERCA Ethiopian Revenue and Customs Authority

GDP Gross Domestic Product

MoFD Ministry of Finance and Economic Development

SPSS Statistical Package for Social Science

TCMP Taxpayer compliance Measurement program

CHAPTER ONE

Introduction

1.1. Background of the study

No government can announce a tax system and then rely on taxpayers' sense of duty to remit what is owed that is why some dutiful people will undoubtedly pay what they owe, while many others will not. Through time the amount of the dutiful people will shrink because of they see how they are being taken advantage of by the others. Therefore, paying taxes must be made a legal responsibility of citizens with penalties attendant on noncompliance. But even substantial tax evasion exists and always has though those penalties are practiced (slemord,2007).

Tax evasion and avoidance is a universal phenomenon that takes place in all societies and economic systems including both developed and developing countries (Chau and Leung, 2009). Tax Evasion includes acts in flouting of the law where by parsons pay a lesser amount of tax than they would otherwise be bound to pay by concealment of all or part of their legitimate or illegal economic activities from the tax authorities (Ian and veerinderjeet,1995). Tax avoidance on the other hand is used to describe acts in line with the law but not with in its sprits where by persons pay less tax than they would otherwise be bound to pay (Tracey, 2009). Thus, the failure to follow the tax provisions and regulations suggest that a taxpayer may be committing an act of noncompliance (Kirchler,2007).

Most authors trying to measure this shadow economy face the difficulty of how to define it. As Schneider and Buehn (2007) described One commonly used working definition is all currently unregistered economic activities that contribute to the officially calculated (or observed) Gross National Product. The shadow economy includes all market-based legal production of goods and services that are deliberately concealed from public authorities for the following reasons: - to avoid payment of income, value added or other taxes, to avoid payment of social security contributions, to avoid having to meet certain legal labor market standards, such as minimum wages, maximum working hours, safety standards, etc., and to avoid complying with certain administrative procedures, such as completing statistical questionnaires or other administrative forms. The average size of the shadow economy (as a percent of "official" GDP) in 2004/05 in 76 developing countries is 35.5%, in 19 Eastern and Central Asian countries 36.7% and in 25 high income countries 15.5%. An increased burden of taxation and social security contributions, combined with

labor market regulations are the driving forces of the shadow economy (Schneider and Buehn,2007).

1.2. Statement of the Problem

With serious economic consequences tax evasion and fiscal corruption have been a general and persistent problem throughout history. In general, tax evasion and corruption can have ambiguous effects on economic growth: tax evasion increases the amount of resources accumulated by entrepreneurs, but it also reduces the amount of public services supplied by the government, thus leading to negative consequences for economic growth (Roy and Raffaella, 2011). Due to the problem of tax avoidance and evasion is inherent in all tax systems tax compliance is growing international concerns for tax authorities and public policy makers as tax evasion seriously threatens the capacity of government to raise public revenue (Chau and Leung, 2009).

As Hudson (2002) stated tax evasion is the source of a potentially serious loss of revenue to governments, resulting in the possible underfunding of public service and an 'unfair' burden on frank taxpayers. Thus, as Cob ham (2005) studied, who estimates that developing countries lose $ 285 billion per year due to tax evasion as far as the domestic shadow economy is concerned. This is why Chou and Leung (2009) stated that this concern is particularly severe for developing countries given the rapid growth of investment in their economies and their lack of adequate experience in dealing with this problem as Emerta (2010) stated Ethiopian taxation system is not an exception. By depriving national governments of vital revenue, tax evasion and avoidance can cause a fiscal deficit or aggravate an existing deficit; force government to decrease expenditure, increase tax rates or initiate new rates. Sometimes government is often tempted to borrow funds in order to bridge the tax 'gap'. In practice tax avoidance and evasion cannot be eliminated but can be minimized.

According to the data of MO FED (2010), tax to GDP ratio in Ethiopia is 9.7% which is one of the lowest in sub Saharan Africa. Studies have indicated that tax evasion and avoidance are one of the factors for this low tax revenue (Emerta,2010). As Addisu (2011) stated that the tax administration lacks the institutional capacity to handle modern operational and enforcement practices to deliver efficient and quality service. That is why Weak enforcement is a cause for concern since personal

income tax compliance tends to be lower. In order to comply with the tax rule these tax payers were bares a number of costs that is called compliance cost. Consequently, they appear to be continuously finding a loophole to depart from. A correct and complete return, failing which penalties and fines will be imposed, required to keep records of all transactions and report accordingly failing which penalties and fines will be imposed and finally make payments on the taxes due. However, there is still evidence that tax compliance is not at the expected target rate that justifies tax evasion and avoidance is practiced.

As Mansan (1988) stated the Common practices of tax evasion include: under-reporting of income, overstatement of expenses, non-recording of sales, and others. This also supported by Slemrod and Yitzhaki (2000) in which tax evasion refers to an illegal reduction of tax payments such as underreporting income or by stating higher deduction-rates. one justifies that there is tax evasion and avoidance in the branch office in which there are revenues collected through audit and assessments which is not declared or under reported by the tax payers for the consecutive years. Madeo, Schepanski, Uecker (1985) considers the judgement model of evasion behavior. This model includes economic oriented variables- level and source of income, penalties and structure of tax rate.

So the main purpose of this research is to investigate the Determinant of tax evasion Wolkite town Tax payer's branch office.

1.3. Research questions

Given the above situation of tax evasion in the tax branch office, this study is expected to give answers to the following specific questions;

1. Do noncompliance opportunities such as income level, and law abidance determine tax evasion?

2. Do tax system/structure such as probability of detection/caught and penalties determine tax evasion?

3. To what extent do moral attitudes and perception to tax evasion and local knowledge of evasion influence tax payers to evade tax?

1.4.1 General objective;

The general objective of this study is to investigate the Determinant of tax evasion of tax payers at Wolkite branch office.

1.4.2 Specific objectives;

In addition to the above general objective the study has the following specific objectives;

To identify if noncompliance opportunities such as income level and law abidance determine tax evasion in the branch office.

To investigate whether tax system/structure such as probability of detection/caught and penalties determine tax evasion in the branch office.

To examine to what extent do moral attitudes to tax evasion and local knowledge of evasion determines tax payers to evade tax in the branch office.

To identify the determination of demographic variables such as age, gender and education on tax evasion of tax payers in the study area.

1.5 Significance of the study

The study was expected to contribute some findings to the noncompliance situation of the branch office tax payers by examining the determinant of tax evasion in the study area. By identifying the determinant of tax evasion of tax payers focusing on the branch office the study helped to point out specific and efficient methods of limitation tax evasion that would maximized tax revenue in the branch office and create compliance tax payers and also given some highlights to the assessment he Ethiopian revenue and customs authority regarding what factors are affecting tax payers to evade and avoid tax in the branch office. In addition, this study was expected to serve as a reference material for further studies.

1.6 Scope of the study

The research was only cover Wolkite town Taxpayer's office report on tax evasion obtained from area. The study used qualitative and quantitative research methodology. Interaction effect of the independent variables was not considered in the study because this was beyond the purpose of the study. Private limited companies, share companies and cooperatives were included in the study while governmental organizations, joint venture and nongovernmental organizations were excluded due to the compliance nature of the companies. The research only covered the profit tax, value added tax, dividend and withholding tax collected by the branch office whereas personal income tax, turn over tax, custom duty and excise tax type were excluded from the study. The selection of this four tax type was on the basis of accessibility and adequacy of sample units and the ability to manage within the specified time period for the study work.

1.4. Objective of the study

1.7 Organization of the paper

This study was organized in five chapters each incorporated topics and subtopics. Chapter one provided the necessary background of the study. It stated the problem, raised the research questions. It also described the objectives, scope, and significance of the study. Chapter two stated the foundation of the study. It reviewed that the existing literature on assessment of tax evasion related issues to extract useful and relevant information and concepts. It also formed the theoretical basis and constructs an empirical framework drawn from the theoretical concepts. Chapter three deals with research area description, methodology such as research strategy, sample size and sampling techniques. It also described the tools for sources of data, data type and data analysis techniques. The fourth chapter stated about the data presentation and analysis by using tables and charts and the last chapter stated about the conclusion and recommendation the study finding

Chapter two

RELATED LITERATURE REVIEWS

2.1. Theoretical literature

Understanding taxpayer behavior is crucial for policy makers to develop strategies to overcome problems of noncompliance among individual taxpayers' and prevent evasion. Two most commonly known models are the Becker (1986) and Fisher (1992) which have contributed to taxation literature in understanding taxpayer behavior. Chan, Troutman and O'Bryan (2000) have incorporated important constructs namely demographics, noncompliance opportunity, attitudes and perceptions and the tax structure / system, in the Fisher (1992) model.

Many other researchers described that tax compliance is operationally considered as complying with tax laws in the act of true reporting of the tax base, correct computation of the tax liabilities, timely filing of tax returns and timely payment of the amount due as tax (Chatopadhyay and DasGupta, 2002; Franzoni, 2000: cited in Alabede et al., 2011). Any behavior by the taxpayer contrary to the foregoing statement is noncompliant. Noncompliance with tax laws comes in different forms. It may be intentional noncompliance in which the taxpayer deliberately undermines the tax rules and regulations in order to have personal gains. The second is in the form of unintentional noncompliance that may be as result of ignorance, oversight or mistake in applying tax laws. Any noncompliance act committed by taxpayer that results to non-declaration / underreporting/ of taxable income leading to non-payment or underpayment of tax is regarded as tax evasion (Alabed et al., 2011).

Tax structure is a major determinant of tax compliance behavior. Thus, the factors that determine the effectiveness of the tax system/structure of any country includes such as probability of detection, penalty, tax rate and complexity of tax system (Fischer et al., 1992). Taxpayers committing noncompliant act may be detected through the process of tax audit and investigation.

That is why the primary aim of tax audit is to detect taxpayers not complying with the submission of income tax returns and the payment of income tax (Jackson and Milron, 1986).

Researchers (e.g., Jackson and Milliron, 1986; Hanno and Violette, 1996) have studied the influence of demographic variables such as age and gender on behavior of taxpayers. Vogel (1974), Fallan (1999), and Christen, Weihrich, and Gerbing (1994) also explored other variables on noncompliance opportunities such as level of income, occupations status and education levels.

Furthermore, an individual's attitude towards the tax system may predict his tax compliance behavior. Theoretically, Ajzen (1991) claimed that attitude is an indication of behavior. Attitude towards an event, object, function or person may be favorable or unfavorable. Kirchler, Hoelzl and Wahl (2008) stated that a taxpayer with a favorable attitude towards tax evasion is expected to be less compliant and equally a taxpayer who has an unfavorable attitude is likely to be more compliant.

Taxpayers may also choose to evade taxes and pay tax on their declared income. When enforcement becomes stricter, voters have two ways to react: by changing evasion and by changing the tax rate. For given tax rate, taxpayers would evade less. However, the equilibrium tax rate will change as well. If richer individuals evade particularly large amounts, stricter enforcement puts a larger burden on them. Hence, lower income voters may prefer higher taxes since the tax system becomes more progressive. In this case, while stricter enforcement in itself reduces evasion but the effects of the increased tax rate (and transfer) may offset this effect, since higher taxes and transfers would make evasion more attractive (Borck, 2004).

Despite the many studies as discussed above, much work remains to be done if we would like to develop fully understanding of this intrinsically complex subject and the means of promoting tax compliance. Many researchers such as Alabede et al. (2011), Fischer (1992) and Chau and Leung (2009) suggested that extant literature on the compliance including both analytical and empirical studies mainly focused on individual noncompliance. There is little or no research on corporate tax noncompliance. Greater attention should be paid to the complex corporate noncompliance.

2.2. Determinants of tax evasion

The general framework to be adopted for the literature review of Determinants of tax evasion is the one given by Orviska and Hudson (2002) as depicted below. The Determinants are generally

classified as Tax noncompliance opportunities such as income level, opportunities of reward or cost and law abidance determine tax evasion, tax system/structure such probability of detection or audit and penalties determine tax evasion, moral attitudes to tax evasion and local knowledge of evasion influence tax payers to be non-compliance or to evade tax and demographic variables such as age, gender, marital status and education and point out the influence on tax evasion of tax payers in the study area.

2.2.1. Demographic variable

The relationship between demographic variables and tax compliance has long been of interest (Tittle, 1980). Three major personal characteristics for which there is evidence of a relationship are age, gender and education (Jackson and Milliron, 1986). The Fischer model suggests that demographic variables indirectly affect taxpayer compliance by their impacts on noncompliance opportunities and attitudes and perceptions (Chau and Leung, 2009).

a) Age

A common demographic variable is the taxpayers' age. A positive link between age and taxpayer compliance is reported (Jackson and Miliron, 1986). Noncompliance is significantly less common and of lower magnitude among householders in which either the head or the head's spouse is over age 65 (Andreoni et al., 1998: cited in chau and leung, 2009). In general, young taxpayers are more willing to take risks and are less sensitive to sanctions (chau and leung, 2009).

b) Gender

Early research (Tittle, 1980: cited in Jackson and Milliron, 1986) testing the tax compliance level of males versus females reports that females are more likely to tax compliance. Traditionally, females have been identified with conforming roles, moral restraints and more conservative life pattern (Jackson and Milliron, 1986). All these attributes may promote higher tax compliance. Experimental study conducted by Baldry (1987) Also finds that females tend to tax compliance by more than males do. Jackson and Jaouen (1989) also revealed a significant gender difference by treatment group from a pool of potential jurors. However, the study by Houston and Tran (2001) indicates a higher proportion of tax evasion committed by women than men.

c) Education

Education, as a demographic variable relates to the taxpayers' ability to comprehend and comply or not comply with the tax laws (Jackson and Milliron, 1986). Two aspects of education have been distinguished: "the general degree of fiscal knowledge and the degree of knowledge involving evasion opportunities". This knowledge is considered to be important for attitudes towards tax compliance (chau and leung, 2009). Chan et al. (2000) also reveal that higher education is directly linked to an increased likelihood of tax compliance.

2.2.2. Non-compliance opportunity

In the Fischer model, noncompliance opportunity can affect taxpayer compliance directly through income level, income source and occupation and indirectly through attitudes and perceptions (chau and leung, 2009).

a) Income

According to Andreoni et al. (1998) most of the theoretical models indicate that as income increases, tax compliance should decrease. Studies have proved this assertion (Chau and Leung, 2009; Ritsema and Thomas, 2003). Houston and Tran (2001) also reveal the respondents in the lower income group tend to have a lower proportion of tax compliance by under-reporting income and by over-claiming expenses than their counterparts in the higher income group.

b) Law abidance

Tyler (1990) argues that citizens may comply with the law because they view the legal authority as having a legitimate right to dictate their behavior. He specifically distinguishes between this and an 'internalized obligation' derived from people's desire to behave in a way consistent with their own sense of 'personal morality'. This latter concept appears closely related to civic duty. Tyler briefly mentions tax evasion as an area where these concepts may be relevant. However, he goes into more detail when discussing illegal use of drugs, where he argues that law abidance, personal morality (equivalent, as we have said, to civic duty), the fear of punishment and the fear of friends' disapproval are the major Determinants of behavior.

According to legal positivists, laws are norms or rules determining how a person ought to conduct themselves in the community (MacCormick, 1991). This normative view of law sees advantages

to individuals in obeying laws, although it does leave the door open to moral objections to such obedience. It also recognizes that not everybody in society will be bound by the desire of the majority, and hence, sanctions must be employed against the minority of law breakers. For the majority, however, a tendency to obey the law must be a significant factor in determining their view on whether to comply with any law including those in the domain of public law such as tax compliance (Marta, and John, 2002).

c) Penalty

Doran (2009) stated that tax penalties remain important for the following reasons. For the norm model assumes that certain taxpayers will not comply with tax obligations and those taxpayers must be deterred by the threat of legal sanctions and, for, taxpayers who complied must be assured that noncompliant taxpayers will be sanctioned. Similarly, Chau and Leung (2009) argued that tax penalty is an important factor affecting tax evasion and that the idea is that the fear of penalty will prohibit the noncompliance tendency.

d) Costs and benefits of tax evasion

As Torgler and Schneider (2005) assumed that taxpayers are rational economic evaders who likely would assess the costs or benefits of evasion. They would attempt to minimize their tax liability, for instance, by intentionally under reporting their income and would enjoy tax savings if they were not detected by the tax authorities. But they would be willing to pay more, adding a penalty, if they were caught.

2.2.3. Attitudes and perception

The Fischer suggests two major considerations for altering taxpayers' attitudes and perceptions to tax compliance are the fairness of the tax system and peer influence (Chau and Leung, 2009). Thus, individual evaluates an event or object positively or negatively and positive and negative evaluation is the main dominant characteristic of an individual's attitude (Alabede et al, 2011). This also supported by Kirchler et al. (2008) who suggested that taxpayer who has favorable attitude towards tax evasion is expected to be less compliant and equally taxpayer with unfavorable attitude is likely to be more compliant.

With regard to distributive justice, comparisons are made on the basis of individuals, groups and societal level and at individual level; taxpayers will be interested in the fairness of his tax burden, if it is perceived to be too high compare to other individuals' tax burden, his rate of compliance is likely to decrease. At the group level, the taxpayers are interested on the fairness of treating their groups compare to other groups, when a group perceived that it is not fairly treated in respect to tax burden in relation to other groups that may lead tax noncompliance in the group (Alabede et al, 2011).

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

2.2.4. Tax system/structure

It is widely acknowledged that the extent of tax compliance in many developing countries has been decreasing through time. The underdeveloped tax system/structure is one of the major causes for this decreasing trend. In the Fischer Model, the effectiveness of tax system is affected by complexity of tax system, penalties and tax rates and probability of detection or caught (Chau and Leung, 2009).

a) Probability of detection and penalties

The other 'direct' factors impacting on tax evasion are the opportunities for evasion, which determine the costs and the potential gains. In the empirical study that follows, the opportunities for and costs of tax evasion, the probability of being caught and any fine, are all constant across individuals. Socio-economic variables impact on the fear of moral censure and will proxy this variable in the empirical analysis (Mart, and John, 2002). In general, higher audit probabilities and strict penalties encourage tax compliance. Probability of detection refers to the likelihood that the tax authorities may discover an individual's noncompliance and seek to remedy the evasion (Chau and Leung, 2009).

Audit rates and the thoroughness of the audits could encourage taxpayers to be more careful in completing their tax returns, declare all income and claim the correct deductions to ascertain their

tax liability. In the other hand, taxpayers who have never been audited might be tempted to under report their actual income and claim false deductions (Palil and Mustapha, 2011).

Another important factor affecting tax compliance is the relationship between tax compliance and the strictness of sanctions. The issue is that fear of penalties prohibits tax noncompliance behavior. Establishing an effective system to penalize tax evaders is an important measure to encourage tax compliance. Taxpayers will be more seem to comply if noncompliance may result in strict penalties (Chau and Leung 2009). This also supported According to the theoretical work conducted by Allingham and Sandmo (1972), tax compliance can be increased by increasing the penalties levied on tax evasions which are already discovered. To be effective, penalties must be applied speedily and forcefully.

2.3. How to Measure Tax Evasion

The Taxpayer compliance Measurement program data consist of line–by–line information about what the taxpayer reported and what the examiner concluded was correct. The primary purpose of the TCMP was to improve the process for selecting returns for operational audits. Rather than to estimate the tax gap Measuring a behavior that individuals attempt to hide is inherently one of the more challenging problems faced by social scientists. Social

Scientists therefore rely on both direct and indirect approaches for measuring what is commonly referred to as the ‘‘Underground economy.’’ Joel Slemrod (2007).

Andreoni, Erard, Feinstein(1998, p.836) claim that the most reliable information about noncompliance is based on actual tax return information that has been thoroughly examined by auditors as part of the IRS Taxpayer Compliance Measurement program (TCMP) which attempts to measure ‘’ unreported income’’ and the national ‘tax gap’’.

Another direct approach is based on survey evidence, in which individuals are asked about their evasion behavior. Still another direct approach uses tax amnesty data, in which declarations of income by amnesty participants are used as an exact measure of evasion. More “indirect” methods look for traces of evasion behavior that are left in various indicators that can be identified, so that

evasion is not measured directly but rather indirectly via these measureable traces. There are several indicators that have often been used. One approach

Another indirect approach looks for traces of evasion in transactions financed by currency, on the assumption that the "true" level of economic activity can be estimated via a Fisherian relationship between money and its velocity. The gap between this predicted level of economic activity and the official national accounts level gives a measure of the so-called "shadow economy", which can then use as a proxy for the amount of tax evasion.

A related and more commonly used method is the currency demand approach, which estimates the demand for currency as a function of conventional factors (e.g., income, interest rates) and also as a function of factors that are assumed to motivate individuals to engage in evasion activities (e.g., the direct and indirect tax burden, government regulation, the complexity of the tax system). Any

"excess" in currency demand, or the amount unexplained by the explanatory variables, is then attributed to the shadow economy and, by extension, the amount of tax evasion.

2.4. Empirical Literature

Empirical work has also focused on the link between tax evasion and socio-economic characteristics. There is evidence that evasion declines with age, and is more common among men and in households in which the head is married (Clotfelter, 1983; Feinstein, 1991). There is also evidence from the USA that evasion varies between occupations, with car dealers, stores and restaurants evading the most (understating taxes by 39%) while those in finance, insurance and agriculture the lowest evaders (Andreoni et al., 1998).

The empirical analysis of the deterrent effects of audit probability and fines or penalties is complicated by the potential endogeneity of both of these variables, which necessitates the use of simultaneous equation techniques that integrate social norms within a model of tax evasion (Hudson, 2002).

Tax evasion is examined in East Asian economies, where some economies have a severe tax evasion problem and others do not as summers and Heston (1991) indicate that East Asian tigers have performed equally well and extraordinarily better than all other areas in the past two decades.

These above stylized facts seem to indicate that policies leading to more severe tax evasion do not necessarily hurt economic growth in East Asia (Chen, 2003).

Tax evasion concern is particularly severe for developing countries given the rapid growth of investment in their economies and their lack of adequate experience in dealing with this problem. In China, the tax evasion by multinationals resulted in revenue loss amounted to US$ 3.88 billion each year. In Hong Kong, the Inland Revenue department reported that about US $ 1.15 billion was collected from 2003 - 07 back tax and penalties (Chau and Leung, 2009).

Schneider (2007) provides estimates of the shadow economy as a percent of gross domestic product (GDP) for 145 countries over different times. The average size of this metric ranged from 16.1% for Organization for Economic Cooperation and Development countries to 40.1% for developing and in transition countries.

Tax evasion is both personally sensitive and potentially incriminating, self-reports are vulnerable to substantial underreporting (Baumeister, 1982). Moreover, the dividing line between illegal tax evasion and legal tax avoidance is blurry. Under u.s. law, tax evasion refers to a case in which a person, through commission of fraud, unlawfully pays less tax than the law mandates. Tax evasion is a criminal offense under federal and state statutes, subjecting a person convicted to a prison sentence a fine, or both.

Thus, National accounts cover only limited economic activities in their premise since complete coverage is challenging as there are a wide range of economic activities in reality. Some of these activities are deliberately concealed by businesses to avoid taxes while others are missed because survey frames exclude small businesses or very new ones. Hence some will remain actually unrecorded (Emrta, 2010)

Tax audits, audit rates and prior audit experience have been ambiguously discussed in relation to tax compliance. Some studies declared that audits have a positive impact on tax evasion (Jackson and Jaouen, 1989; Shanmugam, 2003; Dubin, 2004: cited in Palil and Mustapha, 2011). These findings suggest that in self-Determinants systems, tax audits can play an important role and their central role is to increase voluntary compliance.

CHAPTER THREE

RESEARCH DESIGN AND METHODOLOGY

3. INTRODUCTION

This chapter over view the methodology the study adopted in the research .It included the research design used to assess about the research and detail methodology showing the logical framework that discuses research designed ,sampling designed and research method was presented .To achieve the objective of this research the appropriate method was adopted and method that have been used to collect the data and the method employed to run the data analysis and interpretation as discussed under this chapter.

3.1. Research design

The researcher used descriptive type of research with the rationale of describing the prevailing problems in relation to tax evasion, This was also preferred to explain the roles of Tax Administration office and, as well as, towards combating tax evasion problems. The research also adopted qualitative and quantitative research approaches. Qualitative approach was used to explain and discuss respondents' and interviews' opinions with regards to the tax collection status, tax evasion problems in small taxpayers of Wolkite town. From the quantitative approach the study uses self-administered survey. Thus, descriptive research design used to conduct this research

3.2 Sources and type of data

The data for this study used to collect from both primary and secondary sources. Primary data have been collected through structured questionnaire survey in which respondents of the questionnaire were tax payers of the branch office and interview from the tax office employee.

3.3 TARGET POPULATION

Why the researcher would have used. Thus, the researcher believed that the analysis which have given based on whole the whole population. The total number of respondents in wolkite town was six in tax revenue and authority employed. The researcher believed that all employees were important to collect data from the tax authority.

3.4 data collection method

In this study, the unit of analysis was made at company level; whereas, the unit of data collection was the manager of the company or owners. To collect primary data, the researcher would have used a structured questionnaire for taxpayers who were payed the already specified tax type to the branch office supported by extensive document analysis and unstructured interview of the operational employee of the branch office for the sake of triangulation. The data collection activity preceding with the distribution of questionnaires via personal contact us in the enumerators and direct contact/face to face by using enumerators/ data collectors/ have been used as data collection instrument. The secondary data was collected from the branch office reports via direct contacts of the concerned bodies.

3.5 Data processing and analysing

The collected data was processed, analyzed and interpreted to report the result of researcher finding of the selected company. The data analysis begun by editing and classifying the collected data in more meaningful and relevant information to the study by attached documents (if any)

as it was appropriate in conducting the study. Data editing means the process of examining collected data identify errors and omissions. As to data classification, the gathered data were arranging and grouped in to similar categories and generalize the data in order to facilitate the study. The interpreted data was summarized and concluded in to meaningful way that can be understand by any concerned body. The researcher used percentage distribution for the categorical data which were obtained from the questionnaire and interview. Taxpayers were unit of analysis and the mangers or owners of every organization which are element of the sample size were unit of observation for the research. Finally, narrative sentences have been used to present the study report and where necessary descriptive way of data analyzed by comparing actual finding with theory in conducting the study.

CHAPTER FOUR

DATA ANALYSIS AND PRESENTATION

4. INTRODUCTION

This chapter presents the data; analysis and interpretation made on the data of the research entitled determinant of tax evasion in wolkite town" The primary data collected through questionnaires unstructured questionnaires distributed to six employees. The data collected was then presented and analyzed using descriptive techniques endeavored in tables

4.1. Background Information of respondents

From the total 6 questionnaires distributed to employees and office manager of Revenue Authority in wolkite town, all questionnaires are returned by the respondents.

Table 4.1: Respondent's personal information

	Description	**Frequency**	**Percentage**
Sex	A, Male	4	67%
	B, Female	2	33%
	Total	6	100%
Level of education	Diploma	0	0%
	Degree	5	83.3%
	Master's Degree	1	16.7%
	Total	6	100%
Field of Study	Accounting	4	67%

	Management	1	16.5%
	Economics	1	16.5%
	Total	6	100%
Current Position	Process owner	0	0%
	Auditor	5	83%
	Team leader	1	17%
	Total	6	100%
How long have you been (Work experience)	<2 years	1	16.67%
	2-5 years	3	50%
	>5 years	2	33.33%
	Total	6	100%

Tabe 4.1 shows that According to tax authority most of the respondent educational level are master's degree and there is no respondent less than first degree Around 83%and 16.67% of masters science .the employee were taken their course in accounting around 67%, n management around 16.55 and in economics around 16.5% and their current position in tax authority company was that0% owner, around 83% auditor and 17 % were team leader in the company. The employees had an experience of 2 years and less was that around16.67%, employees that had experiences between 2-5 years was that50% and the remaining respondents were equipped with greater than five years' experience around 33%.

The employees were around 67% male and 33% were females as table showed.

Table 4.2 non-compliance opportunities of tax payers

RESEARCH QUESTION	**Number of respondents under each weight**	**Weighted average (mean)**
	Weight	

	5	4	3	2	1	
1. Your annual income is Increasing	2	3	1			2
1. Do you think your annual income is Higher lower	2	1	2	1 -	-	2
1. I Have you penalized by the office due to Under reporting income 1 late tax payment	-	-	1	4	1	2
I believe tax law should be strengthen	-	-	3	2	1	2
the government spends a reasonable amount on welfare	-	2	1	2	1	2
there are a number of government services, facilities and infrastructures for which i am thankful	2	2		-	2	2
by paying right amount of tax I believe that other people especially the poor will get the benefit			2		4	2
I pay about the same amount of taxes as others making the same income	5				1	2

Table 4.2 tax compliance

The above table showed that the employee respond towards question raised that the annual income increasing with in average 2 of the respondents that is around 33.3% of the data indicated that agreed to annual income is increasing and the annual income higher in the year on average 33.3% believed that the annual income was higher. Result of the table showed around the 66.67% were dis agreed. The employees believed that the company was not punished in ta authority was decide about the implementation of the tax law to avoid the evasion around 50 % so the employees were not sure that the organization was punished or not.

The researcher also observed that the government spend on average that 2 of the employees believed that government spend were dis agreed. That means around five respondents were dis agreed. This implied that government were not volunteer in expenditure. The infrastructure were satisfactory enough. That means almost all except one employees in tax evasion activities were not determined to avoidance. Around 66.7% believed infrastructure, services and facilities affects tax evasion but to the reality. The right amount of tax were not paid to the government were dis agreed that means around 66.67% were dis agreed and the employees we not paid the same amount of tax as a result around 66.7% were dis agreed implied that the tax payers were not paid that creates avoidance of tax evasion .

Table 4.3; tax attitude and perceptions of tax payers

Descriptive Statistics						
Research question	**Number of respondents under each weight**					**Weighted average (mean)**
	weight					
	5	**4**	**3**	**2**	**1**	
To evade tax is favorable	6	-	-	-	-	2
The tax system is unfair	2	3	1			2
The tax I pay is based on my ability to pay	5	-	-	1	-	2
my tax burden is as similar as others	-	2	2	-	2	2

According to the questionnaire observed the all employees were dis agreed that tax was not favorable to evade tax that means 100% were strongly disagreed. And also

the payment were not on the ability to pay. This implies tax payment that doesn't consider ability to pay expos for tax avoidance .at the same time tax burden were not equally distributed. This implied that the should be distributed equally in order to a avoid tax evasion, if so the tax payers were not paying tax voluntarily because of UN fair distribution between tax payers. The wolkite town tax revenue and authority were not able to distribute equally

Table4.4 ; the tax system in wolkite revenue and customs branch office, 2014

Descriptive Statistics						
QUESION	**Number of respondents under each weight**					**Weighted average (mean) and**
	weight					
	5	**4**	**3**	**2**	**1**	
Tax system/ structure is too complex	-	-	1	3	2	2
Penalties and sanctions are too severe	-	-	1	-	4	2

Probability of being detected by the tax office for not declaring the exact income is too high	-	-	-	5	1	2
There are probability of under reporting income that comply with the tax law	1	-	5	-	-	2
The tax office is tolerable to your tax offences	1	4	1`			2
Probability of being audited is too low	3			1	2	2

The table 4.4

above showed that the the first question raised were that the tax system or structure were not complex rather than the tax evasion may occurred in the presence of not related with complexity of tax structure . The penalties and sanctions were strongly dis agreed and also the probability of tax income reporting on the comply of tax law were not un- decided with the tax evasion. The tax office were not tolerable to tax offences. This implies that the tax offices were not able to determine the tax evasion activities of the auditors in wolkite town tax revenue and tax authority. And also the probability of tax to be to low were not important to a avoid the activity of the tax re venue and authority of the organization. That means around 33.3 % of the employees were not able to determine the tax evasion I the tax venue and authority of the organization in wolkite town..

Chapter five

Conclusion and Recommendation

The earlier chapter presented the results and discussion, whereas this chapter deals with the conclusions and recommendations based on the findings of the study. Accordingly, this chapter is organized into two sub-sections. Section 5.1 presents the conclusions and section 5.2 presents the recommendations in line with findings of the study.

5.1 Conclusion

This study was aimed at investigating a sample of taxpayers' factors that determine tax evasion of tax payers in Wolkite town Taxpayer's. The demographic variable such as age, marital status, gender and educational back ground were found insignificant to determine tax evasion of tax payers though the majority of the taxpayers were found male, married, aged young and educated.

As the majority of the taxpayers agreed with minimizing tax liability enjoy tax savings, cost of complying with tax law is too high, underreporting costs too high if detected and to hide tax liability costs too high, cost to evade tax/noncompliance opportunity/ was found significant to determine tax evasion of tax payers.

The probability of detection was found to determine tax evasion of tax payers as possibility of being penalized for tax payers those who believe the probability of detection is high for tax evasion decreases by 33.3 % as compare to their counterpart. This clearly indicates that the capacity of the tax office to investigate tax evasions can discourage to hide tax liabilities.

The study found that the public attitude towards taxation is poor but the majority respondents believed that loyalty of taxpayers to the tax law is fair. However, attitude was found insignificant to determine tax evasion. Therefore, the attitude and perception of tax payers towards tax evasion cannot influence them if they are to evade tax.

As the majority of tax payers believe that audit effectiveness of the branch office was poor, tax system is too complex and the availability of probability of underreporting income that comply

with tax law. This is a clear indication of that tax payers in the branch office are less sensitive to audit effectiveness.

5.2 Recommendations

The branch office needs to implement strong tax assessment and has to have satisfactory audit coverage to deliver the aspiration of helping customers to pay the right tax at the right time and with the minimal administrative and compliance cost to both the tax office and customers. Therefore, high probability of detection and its effectiveness could encourage tax compliance and prohibit tax evasions.

In order to create an efficient tax administration, the tax office needs to strengthen itself by educating and training its employees, by computerizing and system support its operations, and devoting additional resources. Training should include customer service training and cross functional training for employees. As a result they can come up with a satisfactory understanding of the entire tax administration system.

One set of responses is to improve the tax administration to facilitate detection and successful prosecution of certain classes of tax evasion. Another possible response is to strengthen the penalties and implement severely on tax evasion that are detected. Furthermore, there should not be any benefits that possibly the tax payer can enjoy because of their ability to evade tax liabilities, instead higher costs should be put in place for detected tax evasions. Thus, tax compliance of taxpayers would be improved sustainably and effectively.

Generally, in order to increase tax compliance, governments must adopt a comprehensive strategy, beginning with the writing of the tax laws in easy and understandable terms to enforce. In the light of changing social and economic conditions, the tax office must take a sustainable comprehensive look at their tax administration in order to assess how they can increase compliance and minimize the problems existing in the tax noncompliance.

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APPENDIXES I

RESEARCH QUESTIONNAIRE

Questionnaire on "determinant of tax evasion case of Wolkite town tax payer's revenue.

WOLKITE UNIVERSITY

Dear valued respondent this questionnaire is prepared by a student of requirement in accounting and finances in Wolkite University. The purpose of this questionnaire is to find out the Determinants of tax evasion and avoidance of tax payers in Wolkite town tax payers revenue and

customs branch office. Your response will be kept strictly confidential and it will be used for this research purpose only.

The questionnaire should be filled by either business owners or business managers.

In all cases where answer options are available please tick (x) in your response box.

It would be greatly appreciated if you could answer all questions.

Thank you for your cooperation!!!!

Part 1- Participant information and business profile

1. Sex; male [ ] 1 female [ ] 2

2. Age_____ (in year):

3. Marital status ;

Single [ ] 1 married [ ] 2 divorced [ ] 3 widowed 4 [ ]

4. Educational level_____(year of schooling)

5. Type of Business entity you are running now_____ **6.** Type of Tax you pay?

Income tax [ ] 1 dividend [ ] 2

Value add tax [ ] 3 with bolding tax [ ] 4

7. Your status/position in the business company _____

8. Your work experience in the same business _____(in years)

9. Have you penalized by the tax office?

Yes [ ] 1 No [ ] 2

Part 2- Non-compliance Opportunity

1. Your annual income is

Increasing [ ] 1 decreasing [ ] 2

2. Do you think your annual income is

Higher ☐ 1 lower ☐ 2

3. Have you penalized by the office due to

Under reporting income ☐ 1 late tax payment ☐ 2

Over claiming of deductions ☐ 3 not at all ☐ 4

4. Give your response for the following questions according the instruction given below.

Part 4- tax system / structure

Strongly agree= 5; Agree =4; undecided = 3; Disagree = 2; strongl Disagree

Questions	Tick x mark in your response			
	5	4	3	2
I pay tax because of fear of punishments				
I believe tax law should be respected				
I believe tax law should be strengthen				
I believe that the tax office has the capability to investigate all income reported to the office				
The government spends a reasonable amount on welfare				
There are a number of government services, facilities and infrastructure for which I am very thankful				
By paying right amount of tax, I believe that other people especially the poor will get the benefit				
I pay about the same amount of taxes as others making the same income				

1. How often you have been audited by the tax office? _____Times per year

2. Tax audit effectiveness of the office is

Excellent ☐ 1 Good ☐ 2 pair ☐ 3 poor ☐ 4

3. Give your response for the following questions according the instruction given below.

Strongly agree=5; Agree=4; undecided =3; Disagree= 4; strongly disagree =1

Questions		Tick x mark in your response				
		5	4	3	2	1
Probability of detection and penalties	Tax system/ structure is too complex					
	Penalties and sanctions are too severe					
	Probability of being detected by the tax office for not declaring the exact income is too high					
	There are probability of under reporting income that comply with the tax law					
	The tax office is tolerable to your tax offences					