

Compliance and Non Compliance Behavior of Business Profit Taxpayers' Towards the Tax System: A Case Study of Mekelle City, Ethiopia

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Abstract: In developing countries taxation is a challenging topic and has attracted increasing attention in the last two decades. Many problems observed like poor administration, failing to collect sufficient tax revenues, tax structures where tax horizontal and vertical equity considerations are not integrated, lack of government and economic stability. In many developing countries it is observed that there is low capacity of tax administration to monitor compliance among taxpayers. The voluntary compliance behavior of the tax payers is determined by various factors and identifying these factors and treating them accordingly should be the central premises of any tax system in order to maintain voluntary compliance with taxation in Mekelle City, Ethiopia. Based on this fact, a survey data for this study were collected based on questioners from a sample of Mekelle city business income tax payers by distributing the total sample purposely to three sub cities namely Kedamay weyane ,Hawelti and Adi-haki using proportional sampling technique. The scope of the study was limited to individual business income tax payers of the three sub- cities. Data were collected from 180 respondents and analyzed using descriptive statistics such as mean and standard deviation. The study was summarized and presented in tabular form representing proportions and percentages are used in analyzing the data collected. Based on the response of the respondents, certain factors were found to be the determinants of taxpayers' voluntary compliance. These are tax fairness and equity, organizational strength of the tax authority, awareness level of the taxpayers, socio-cultural factors, and attitude of taxpayers towards the government.

Keywords: Tax revenues, voluntary compliance, business profit tax payers and tax administration system etc.

INTRODUCTION

Taxation is one of the important elements in managing national income, especially in developed countries and has played an important role in civilized societies since their birth thousands years ago[1]. Tax is defined as 'a compulsory levy, imposed by government or other tax raising body, on income, expenditure, or capital assets, for which the taxpayer receives nothing specific in return' [1]. Adam Smith in his book '*The Wealth of Nations*' which was published in 1776 suggested that a tax system is based on certain basic principles, namely equity, certainty, convenience and efficiency.

Looking at the tax system in Ethiopia in the recent past indicates that until the year 1992, Ethiopia had a central tax system (in line with the principles of a command economic system) where all tax revenues belonged to the central government. The principal revenue organs were the Ethiopian Inland Revenue Authority and Regional Finance Ministry Offices. The Ethiopian Inland Revenue Authority had limited its tax administration duties to the capital city (Addis Ababa) [2] delegating the Regional Finance Ministry Offices to administer various types of taxes in their respective regions on its behalf. Later in the fiscal year 1992/93,

the Ethiopian government embarked on the path of a market oriented economy as opposed to a command economy for the preceding 17 years. This change coupled with the establishment of regional governments (with the enactment of Proclamation No. 7/1992) made the replacement of the central taxation system by federal taxation system inevitable.

In imperfect market where government plays various roles in the development and growth issues, the need to have adequate resources to achieve its goals efficiently is a prerequisite. Among the major sources of revenue, taxation is the predominant one. Optimum tax could be collected if and only if the government can propose appropriate tax policy.

In order for tax policies to be feasible, the prevalence of relevant institutions that enforce or implement the policy is unquestionable. Ethiopia also designed a tax policy which is believed to maximize the government's revenue with less adverse effect on the welfare of the society. Many finance offices have been established at regional and Woreda level all over the country to keep the efficiency of the tax policy at the highest possible position. Among the finance offices established at the regional level, Mekelle Finance and

Economic Development Office (MCFEDO) is one of them. It under takes the responsibilities of tax collection and assessment by its revenue department in such a way that it comes up with the formulated tax policy.

The MCFEDO has been performed many activities mainly in the areas of tax collection and assessment. However, there have been a substantial tax gaps in the city because the amount of revenue to be generated from these sources for its expenditure program me depends among other things, on the willingness of the individuals to comply with tax laws of a country. The failure to follow the tax provisions suggests that a taxpayer may be committing an act of noncompliance. Tax non-compliance occurs through failure to file tax return, misreporting income or misreporting allowable subtractions from taxable income or tax due [3].

Hence, the purpose of this research is to bring attitudes and these factors to light in relation to the business profit taxpayers and show how they affect tax compliance in Mekelle City, the attitudes of taxpayers varies considerably, that is, they exhibit varying levels of tax compliance. Some comply with the fullest extent required, irrespective of whether the tax authority is actively auditing them or not. But other taxpayers essentially play the audit lottery and either do not prepare contemporaneous documentation or prepare the absolute minimum with the hope of avoiding the imposition of penalties[4].

Therefore, this research will help in reducing the level of attitudinal difference among business profit taxpayers' in Mekelle city by making them understand the objective of taxation and help comply with the tax laws and regulations. Moreover, it is primarily undertaken to identify the factors that determines the behavior of business profit tax payers with the tax system .The study can also contribute to the Mekelle city revenue development office (MCRDO) by increasing the amount of tax collectability for undertaking developmental activities.

The History of Ethiopian Taxation

There is no clear and tangible evidence as to when taxation in Ethiopia had begun although it has a relationship with the government structures of the country. There exist hardly any reliable documentary evidences to justify the relation of emergence of government and taxation and when exactly taxation was introduced. So many stories and evidences point out that Emperor Zeria-Yakob started taxation in Ethiopia during the 15th century. Governments which came to power in Ethiopia at different periods have frequently revised and repealed

the statutory bases for various types of taxes providing for tax bases and tax rates, time and mode of payment, exemptions and offenses. However, there has been no document or materials produced which compiles tax proclamations issued at different periods. The initial statutory bases for all the tax proclamations was the 1931 Constitution of Ethiopia which later revised and become Revised Constitution of Ethiopia [5].

Because most of the products on which tax was levied (tax bases) were agricultural products, the type of taxation in traditional periods was unstructured and mostly in kind. Taxation in that period was varying highly from area to area and was often arbitrary, i.e. the amount to pay and the mode of payment depends on the will of the chief tax collector and the kind of resources available in the area[5].

The first major change in the Ethiopian tax system was initiated in the post Second World War period between 1942 and 1944, the years 1947 to 1952 covering its second stage. These changes were generally discretionary, including amendments to property taxes (land and cattle). Broad based taxes on goods and services were also introduced in the mid 1950s. Latter in the decade and in the early 1960s, changes were also made in the rate and structure of taxes, especially on income. In the post revolution period (1974-1991), particularly during 1976-1979, significant major changes on the rate and structure of all types of taxes were made. These involved widening the land tax base, introducing capital and surplus transfers from nationalized firms, as well as certain minor arrangements on other taxes[6].

In Ethiopia the year 1991 marked the end of the previous policy regime of hard control that had lasted for nearly two decades. This was the year when the seventeen year old socialist regime was toppled by the coalition of rebel forces and the current government that is, Ethiopian Revolution Democratic Front (EPRDF) was formed. Starting from the year 1992, the EPRDF government has initiated a wide range of reforms that can be termed as liberalization. Reform of the tax system was among the range of liberalization policies that also extended, among others, to the exchange rate, interest rates, trade, domestic production and distribution[6].

Business Profit Tax

This is the tax imposed on the taxable business income / net profit realized from entrepreneurial activity. Taxable business income would be determined per tax period on the basis of the profit and loss account or income statement, which shall be drawn in compliance with the generally accepted accounting standards. Corporate businesses are required to pay

30% flat rate of business income tax. For unincorporated or individual businesses the business income tax ranges from 10% - 35%. Unincorporated or individual businesses are taxed in accordance with the following table below.

Table -1: Computation of tax on business profit taxpayers

Taxable income (net profit per year)	Tax rate in (%)	Deduction in Birr
0-1800	Exempted	-
1801-7800	10%	180
2801-16800	15%	570
16801-28200	20%	1410
28201-42600	25%	2520
42601-60000	30%	4950
over60000	35%	7950

Source: (FDRE proclamation number 286, 2002)[8].

Objective of the Study

The main objective of the study is to identify the factors that influence Business Profit tax payer's compliance with the tax administration system in Mekelle city.

Significance of the Study

Taxes are fundamentals to the existence and give government power to allocate resources; to enable government to provide/support social development; to stabilize the economy; to constitute and define the market place; and to encourage optimal economic growth. Improved tax system improves the revenues available for supporting public service without increasing the current tax burden on compliant tax payers. Moreover, improved tax system bolsters citizen's satisfaction by increasing their faith in the system and promoting the perception that everyone pays its legal share. Understanding to the factors which determine business profit tax payers compliance with the tax administration system is the major factor that contributes to the success of the overall tax system unless these factors are pointed out and addressed properly, it may be difficult to design a sufficient and effective tax system that helps to narrow the existing compliance gap.

Hence, the findings of this study will contribute in enhancing the tax revenue of Mekelle City and the government at large by uncovering the core problems on the factors which influence Business profit tax payers compliance with the system so as to enabling them to put their effort to triumph over the observed problems. Thus, the government will be able to adopt a comprehensive strategy, and minimize the observed problems to increase tax revenue. Similar approach can be replicated in identifying the problems related to similar tax payers in other cities. Besides, it may be also

used as an input for other interested researchers for conducting further study.

Scope of the Study

The study could have covered to the factors that affect to all tax payers like rental income tax payers, employment income tax payers, dividend income tax payers, agricultural income tax payers, land use tax payers, interest income tax payers, turnover tax payers, value added tax payers, custom duty payers, and other taxpayers. However, due to time and financial constraints among other factors this Study is limited only to Mekelle city business profit tax payers, who are only natural persons currently found at Mekelle city.

RESEARCH DESIGN

The research design to be used is different from one research to another depending on the nature of the study under consideration. Because this research is on the determinant factors and compliance of business profit taxpayers' with the tax system, it is a qualitative research in nature and the researcher has no control over the variables of the study. As a result of this, the researcher only describes those factors that influence business profit taxpayers' compliance with tax system which currently exist. Therefore, the suitable research design used for this study was case study (survey) of Mekelle city supported by a survey of the theories and empirical studies related to the subject matter.

Sampling Design

The total population of this research is the individual business profit tax payers of Mekelle city. Out of the total tax payers in Mekelle city, three administrative areas (Kebeles) from a total of seven kebeles were selected by taking in to account their densities or availabilities. These kebeles are with highly densely populated tax payers which is representative of the entire population. Since this research is a qualitative type of research, purposive sampling technique was used which helps to acquire an in-depth data about the research.

There is no fixed rule for the determination of sample size in qualitative types of research. The size of the sample depends on what you try to find out and from what different informants or perspectives you try to find out[7]. Therefore, taking in to account the previous research studies and judgments, on trend analysis, the researcher had drawn 200 sample sizes out of 13659 total populations which constitute 7933 from Kedamay weyane 4811 from Hawelti and remaining 915 from Adi haki. The study is confident to the above general business profit tax payers in the capital city of Tigray regional state Mekelle. That is because they are large enough and hence will make the

conclusions and recommendations that the study will come up with more valid and representative. Hence after the list of all these payers is taken from the office with the available time and cost 1.5 percent of the total population has been selected as sample respondents. Thus in total 200 tax payers were selected on systematic random sampling bases using proportional number of samples (taxpayers) from the selected three kebeles.

The details of the general business profit taxpayers of each of the selected local administrative areas (Kebeles) corresponding to the sample size is given in the table below.

Table - 2: Total population and sample size of each administrative area

Kebeles	Population	proportion	Per cent
Kedamai	7933	0.58	116
Hawelti	4811	0.35	70
Adihaki	915	0.07	14
Total	13659	1.00	200

Source: (Mekelle city revenue development office report, 2012)[4].

Data Sources and Collection Instruments

The data used in this study consists of both primary and secondary data. The primary data were collected through standard questionnaire. The demographics of the respondents were firstly established in the questionnaire. The questionnaire comprised of both closed and open ended questions. Closed ended questions are quicker and easier both for respondents and researcher. Most of the closed ended questions are designed on a Likert type scale from 1- 'strongly disagree' to 5- 'strongly agree'. In addition to these open ended questions allows respondents to offer an answer that the researcher didn't include in the questions. The replies of open-ended questions were analyzed by content under different categories.

Data investigators or enumerators were hired and undertaken the job after taking the necessary orientation. Individuals who have familiarity with the tax administration and who were also familiar with the taxpayers were selected for this job.. The questionnaire was translated into Tigrigna language by taking into consideration the fact that English is not the language of the respondents.

Secondary data were also collected from the city's tax authority data base and unpublished sources. This data includes number of taxpayers in each Kebeles and their distribution with respect to their category. While collecting and using these data for the study, more considerations were given to their time period, reliability, and relevance to the purpose of the study.

Tax Payers compliance and non compliance

Compliance of Business taxpayers' towards the tax system is one of the important factors to be considered in analyzing this research. Tax compliance can be defined as the degree to which a taxpayer complies (or fails to comply) with the tax rules of his country. Business taxpayers' compliance may be influenced by many factors, which eventually influence their behavior .Some of those factors are amount of tax rate, fairness of the tax system or tax laws, the probability of getting caught ,socio-cultural ,political impact. Accordingly, respondents were also asked to indicate their extent of agreement or disagreement with questions related to tax payers compliance and non compliance status. A five point liker scale was used to measure their degree of agreement or disagreement, i.e. strongly agree = (5), agree = (4), neutral = (3), disagree = (2) and strongly disagree = (1). The results from the respondents were summarized in table 3.14 as shown below:

Table - 3: Tax payers compliance and non compliance behavior

No	Statements	Mean	Std. deviation
1	Tax payers should evade tax if tax rates are too high	3.9778	0.14782
2	Tax payers should evade tax if the tax system is unfair	3.9889	0.10511
3	Tax payers should evade tax if a large portion of the money collected from tax is waste.	3.9944	0.07454
4	Tax payers should evade tax if the probability of getting caught is low	1.9778	0.14782
5	Evading tax due to lack of ability to pay should not be considered as crime/problem	1.9889	0.18274
6	Tax payers should evade tax if everyone is doing it	3..6222	0.31633
7	Generally, tax evasion should not be considered as crime	2.0611	0.36866

Source: Authors' field survey, 2013

The above table, indicates that most of the respondents disagreed with the statements, with mean value of approximately 2 and standard deviation of insignificant value, that tax payers should evade tax if the probability of getting caught is low, evading tax due to lack of ability to pay should not be considered as crime/problem, tax payers should evade tax if everyone is doing it and in general tax evasion should not be considered as crime. Therefore this indicates that majority of the respondents have positive understanding on evading tax is considered as a crime and they pay taxes because they are morally committed. From this response it is clear that most of the taxpayers are rational enough in evaluating the cost of tax evasion to the government if successive works are done by the government probably better results can be achieved.

However, as it is depicted in the above table, respondents were agreed, with mean value of

approximately 4 and standard deviation of insignificant, with the statements that tax payers should evade tax if tax rates are too high, if tax system is unfair and if a large portion of the money collected from tax is waste. As it is clear the tax payer's behavior is highly affected by his/her level of satisfaction or dissatisfaction with government. thus if the tax system is perceived to be unjust, tax evasion may at least partly, be considered as an attempt by the tax payer to adjust his terms of trade with the government furthermore attitudes towards the general level of taxation and tax incremental are dependent, of course on the desirability of government programmers and on attitude towards the government itself therefore from the above analysis it is clear that most of respondents are very sensitive towards tax rate, tax system and on what purpose dose the government is spent the amount collected .

Table - 4: Factors that influence Business tax payers' compliance with tax system

No	Statements	Mean	Std. deviation
1	Imposing the same tax rate to all taxpayers	2.0111	0.2111
2	Fairness of tax imposition	1.9889	0.1491
3	Higher tax imposition for higher income	2.0500	0.3851
4	Perception of tax fairness	4.9944	0.0745
5	Tax payers trust in the tax system, assessment, and collection procedures	2.9944	0.1670
6	Service delivery system of the tax authority	2.0167	0.2236
7	the impact of tax authority enforcement actions	4.9778	0.2102
8	If no penalty tax payers may not pay	3.8389	0.3687
9	Fell guilty if remains unnoticed	1.9222	0.2686
10	The awareness level of tax payers	3.8944	0.3081
11	Cultural impact	4.6603	0.1051
12	The impact of cultural differences	3.9778	0.1478
13	Social impact	3.7167	0.8605
14	The impact of taxpayers to one another	3.9778	0.1478
15	Level of group expectation	3.8833	0.3388
16	The influence of important group on tax payers	3.8556	0.5192
17	The impact of good political system	4.9944	0.7454
18	Getting comparable social service	4.0056	0.7450
19	Level of satisfaction with the terms of trade with the government	2.9889	0.1051
20	Government program and government it self	4.0167	0.1284
21	Government investment	2.0167	0.1663

Source: Author, field survey, 2013

According to the above table, most respondents disagreed, with mean value of approximately 2 and standard deviation of

insignificant value with the statements that Imposing the same tax rate to all taxpayers, Fairness of tax imposition, Higher tax imposition for higher income,

Service delivery system of the tax authority, tax payers fell guilty when they remain unnoticed, Government investment. In addition to the above analysis taxpayers evaluation towards the tax authority with respect to service delivery, tax collection efficiency and their knowledge on tax related issue is low this demonstrates that the tax collection efficiency of the tax authority is relatively low and inefficient as compared to other services. Hence, the tax authority's capacity of delivering service to the public is not yet sufficient enough. Therefore government should increase the level of service delivery system so that taxpayers can be motivated to comply. To this end respondents were also asked and being disagreed to the statement that the large portion of taxes collected is used for meaningless purpose by government this shows that the image of government by the business tax payers is positive and it is also important to facilitate taxpayers behavior compliance. This means that if the government is perceived to be develop meal tax payers are encouraged to pay their expectations.

Most respondents were also indifferent, with mean value of approximately 3 and standard deviation of insignificant value, with the statements that tax payers trust in the tax system, assessment, and collection procedures, level of satisfaction on terms of trade with the government, this means that when respondents were asked about their trust on the tax system, assessment and collection procedures majority of the population were in between on the transparency and understandability of the tax laws, they were not clear enough about the tax assessment and collection procedures. It is clearly understood that effective business tax assessment and collection is a means to facilitate the well functioning of the economy of the country in general and the city in particular. However, it has been observed that in Mekelle city there is a substantial tax gap between the tax that supposed to be collectable and that is actually being collected. This is due to the assessment and collection problem It can also be understood that respondents had neither disagreed nor agrees when they were asked about tax payer's behavior affected by level of satisfaction or lack of satisfaction with terms of trade with the government this means that the above two factors can facilitate either tax compliance or tax non compliance.

Respondents also agreed, with mean value of approximately 4 and insignificant standard deviation, that if no penalty tax payers may not pay, the awareness level of tax payers, the impact of cultural differences, social impact, the impact of taxpayers to one another, level of group expectation, the influence of important group on tax payers, getting comparable

social service, This may follow the fact that the society is from various ethnic, religious, and social backgrounds and the tax system of the country has also its own historical background. Since there is strong social bond between members of the same group in society, tax compliance behavior of an individual can be affected either positively or negatively by other members of the group. If there are tax compliant and influential individuals in social group or society, there is a possibility that other members follow them and affected by these individuals. Similarly when the influential individuals are tax non-compliant and against the tax law, there is a higher tendency for the followers or members to be influenced by these individual. Hence, the socio-cultural factors can have a direct or indirect relationship with the tax compliance behavior of taxpayers.

Most respondents also strongly agreed, with mean value of approximately 5 and insignificant value of standard deviation towards the perception of tax fairness, the impact of tax authority enforcement actions, cultural impact, and the impact of good political system facilitate the business tax payers compliance .from the above statements compliance of taxpayers can increase once they perceive that if government has a good tax system and cultural influence is also played a vital role in facilitating taxpayers compliance towards the tax administration system. Therefore the image of government by the business tax payers is very important. In addition to that most of the population are strongly agreed with a good political system has positive impact on tax payers attitude towards the tax system This means that if the government is perceived to be a developmental, then It will have positive impact on tax pares compliance with the tax legislation and vice versa.

CONCLUSION

Regarding the tax compliance and noncompliance status and in relation to providing information which are relevant to compliance requirements to enable and facilitate the determination of level of tax compliance, it was found that most of the respondents were disagreed with statements that Imposing the same tax rate to all taxpayers, Fairness of tax imposition, Higher tax imposition for higher income, Service delivery system of the tax authority, Fell guilty if when remains unnoticed, Cultural impact, Government investment, indifferent, with statements that tax payers trust in the tax system, assessment, and collection procedures, level of satisfaction on terms of trade with the government, Respondents also agreed, that if no penalty tax payers may not pay, the awareness level of tax payers, the impact of cultural differences, social impact, the impact of taxpayers to

one another, level of group expectation, the influence of important group on tax payers, getting comparable social service are among the different factors which have a direct impact on tax payer compliance behavior. Most respondents also strongly agreed, towards the perception of tax fairness, the impact of tax authority enforcement actions, cultural impact, and the impact of good political system facilitate the business tax payers' compliance.

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