Evaluation of Ethiopian Tax Administration System: Emphasis on taxpayer Compliance

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Abstract

Voluntary compliance with tax laws of taxpayers is believed to be shaped by two major streams of factors: economic and social-psychological. Many countries of the world including Ethiopia try to emphasize the economic deterrence approach in which the belief is that taxpayers pay taxes only because they fear audit and the subsequent sanctions. The social-psychology approach to taxation, on the other hand, takes the position that taxpayers' (non)compliance decision is influenced by justice perception, how they value government expenditure, how they feel they are treated by the revenue authority, and so on. In this study we concisely went over the historical evolution of taxation in Ethiopia, assessed the culture of voluntary compliance, looked at how taxpayers perceive service delivery by the revenue authority, and evaluated the fairness perception of the Ethiopian tax system. Data for the study were gathered primarily through questionnaire distributed to 200 (162 usable ones returned) taxpayers and unstructured interview with selected officials from the revenue authority. Secondary sources such as journal articles, reports of the World Bank, IMF, and MoFED were also consulted. We used descriptive data analysis method. Both economic and social-psychological factors are found to influence taxpayers' (non)compliance decision in so far as those respondents' responses indicate.

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Historical Evolution of Tax in Ethiopia

Taxation had started in the world during the ancient Empires. The first known written record of taxes dates back to ancient Mesopotamia. Hammurabi produced some of the first written laws as far back as 1792 BC and tax law was a significant component of the legislation the Babylonian emperor carved into a six foot tall stone tablet (about.com, 20th century history).It is a fact that taxation regimes have evolved as successive government's devised new ways to fund government expenditure and manipulated their political landscape. Emperors, kings and feudal lords once levied tithes, taxes or duties to pay for wars or the upkeep of castles and palaces or other public projects.

The history of taxes reveals that their coercive nature is of comparatively recent development. The original idea of tax was that payment was not obligatory up on the subject, but considered rather voluntary contributions towards the expense of government, as had appeared in the Medieval Latin term "donum", and the English "benevolence". This conception of the relation between the subject and government was gradually transformed; payment of taxes becoming more and more obligatory, until finally coercive taxation resulted (Yonas and Sisay, 2009:27).

Ethiopia is one of the old aged countries; tax collection in Ethiopia is assumed to be as old as the time of Zerayakob—around 1414—and had been dealt with in a traditional way. But Emperor Tewodros formed the centralized state power in which the tax system had been made clearly visible and become mandatory even though the traditional way of collecting taxes had not changed much. Until the early twentieth century, taxes used to be paid mainly in kind-or labor services, rather than in cash while they were later substituted by fixed tithe on agricultural income tax (Eshetu, 1987) and (Girma-Selassie, 1978). In the case of Ethiopia fixed tithe on agricultural income was introduced during Minilik II.

During the Regime of Emperor Haile Selassie the tax system was totally changed resulting in modernized tax administration (Eshetu, 1987). Taxes were imposed on and collected from various sources such as income from employment, businesses, (personal and business tax proclamation 60/1944, 1944), rental of land and buildings, vocational occupation, agricultural income, interest, and exploitation of wood and forest used for lumbering purposes. Towards the end of the imperial period, the budgets of the various ministries increased steadily while tax yields stagnated. With the majority of the population living at a subsistence level, there was limited opportunity to increase taxes on personal or agricultural income. Consequently, the imperial government relied on indirect taxes (customs, excise, and sales) to generate revenues (CIA World Fact book, 1991).

During the Derg regime the only new events were widening the tax base, increasing the tax rate, and replacing taxes on agricultural income and rural land with a rural land-use fee to support war, to finance the ever growing government sector and the needs of the society (Rural Land Use Fee and Agricultural Activities Income Tax Proclamation No.77/76, 1976).The government partially alleviated the tax collection problem that existed during the imperial period by delegating the responsibility for collecting fees and tax on agriculture to peasant associations, which received a small percentage of revenues in the form of administrative costs. About 40 to 50 percent of the government's budget was dedicated to defense and government services (CIA World Fact book, 1991).

During the transition period, Proclamation No.33/92 was proclaimed with provision for the sharing of revenues between central and regional governments (1992). According to the proclamation, regional governments were entitled to tax and expenditure assignment powers in order to accomplish their duties and responsibilities with some modifications on the tax brackets and tax rates. New tax bases such as tax on mining activitiesand on capital gains were also introduced (Mining Income Tax Proclamation No.53/93, 1993) and payment of tax on gains from capital (Proclamation No.108/94, 1994) were proclaimed.

The current government, pursuant to the 1995 approval of the Ethiopian constitution, gave power to the federal and regional governments to levy and collect taxes. As a result, a number of changes have been made in the tax policy of the country as a result of the structural changes. Most significant changes were made in the tax laws bringing about reduction in the rate of income tax from 40% to 30% (Income Tax Proclamation No.286/02, 2002), equalization of tax rates for small and large scale mining activities (Amended Mining Proclamation No. 23/96, 1996), exemption of houses used for residence from paying capital gains tax. Because of a policy to encourage new investments, tax relief provisions were brought in (Investment Proclamation No.280/2002, 2002).

Amendments in the laws were followed by other measures such as introduction of Taxpayer Identification Number (TIN), introduction of tax withholding system and replacement of sales tax by VAT, which has become the main source of revenue for the government. Also introduced were turnover tax, emphasis ontaxpayers' education, strong enforcement mechanisms, substantial reforms and amendments in the tax laws to keep pace with time and the changing economic environment. This has brought about increased efficiency and effectiveness in reducing fraud and smuggling though the problems are deep rooted and still persist. To be able to collect the revenue which the economy generates the revenue sector was restructured bringing together the former Federal Inland Revenue Authority (FIRA), Customs Authority, and Ministry of Revenue and forming the Ethiopian Revenue and Customs Authority (ERCA)based on Proclamation No. 587/2008. According to the 2011/12 annual report of ERCA, the government was able to collect Birr 70.75 billion revenue in 2011/12 budget year which covered more than 60% of the government budget in that fiscal year. This seems ideal and is promising but there needs to be continuous efforts to bring about tax compliance in the years to come, in order to fully finance the budget of the country with its own revenue by 2020.

Statement of the Problem

Taxation is a system of raising money to finance government. Empirical evidences, of course, reveal that taxation is not sufficient to meet all development financing needs. Yet, it is an imperatively crucial source of financing public expenditure and the other sources are merely alternatives to be resorted to. Quite evidently, external loans to and aids for developing nations from the western world are shrinking due primarily to the global financial crisis. The financial crisis in those developed nations nowadays, of course, is itself attributable to heavy dependence on external sources of financing government expenditure, the cases in point being USA, Greece, and Italy (Etienne, 2011).

However, revenue from taxation suffers from resistance on the part of the taxpayers to pay their taxes as they fall due. This resistance stands contrary to tax compliance—voluntary observance of or adherence to applicable taxation laws. Of course, noncompliance with tax laws is a result of both intentional tax evasion decisions and innocent mistakes committed by taxpayers owing especially to complexity of the tax laws.Taxation, which has to serve other important fiscal purposes in addition to generating revenue for public expenditure contributes only a slimmer share to public expenditure especially in developing countries. Consequently, the other purposes that taxation is meant to serve would also be beaten causing a vicious circle of problems to the public sector. Developing countries in general and Ethiopia in particular are currently being challenged by continuous fiscal deficits, huge debt service charges, and declining external assistance, all of which would seriously affect their development processes sooner or later.

Tax noncompliance is a challenge not only to government revenue but also to social welfare and allocative efficiency. This is so because when the rich are unwilling to pay their fair share of taxes the objective of using taxation as a redistributive tool would be defeated. By the same token, the idea of using taxation as an instrument for allocative efficiency[4] would suffer when taxpayers do not comply with the tax laws. It means that taxation would fail to serve its being a fiscal tool of the government as levy and collection do not match. More seriously, it would remain unfair if the rich continue to free ride the infrastructure built with the contribution of the poor.

[4] Government influences the allocation of scarce economic resources in a way they can generate maximum return to the nation. This can be achieved through tax incentives to encourage certain undertakings such as investments in remote regions and heavy taxes to discourage others such as concentration of investments in few regions.

As Murphy argues, it is assumed in an ideal world that all taxpayers would voluntarily pay their taxes and comply with all of their tax obligations willingly though in practice "… no one enjoys paying taxes, and at the end of each financial year some people's thoughts turn to how they can best arrange their affairs to pay as little taxes as possible" (Murphy, 2004).It is a common phenomenon, in Ethiopia also, that those that earn a significantly better amount of income do not pay taxes or pay an amount far less than their actual tax liabilities. Giant business houses are allegedly accused of keeping three books of accounts—one for their own business decisions (a genuine one), one for banks (with exaggerated assets and profits), and another for cheating the tax authority (with highly understated assets and profits)—and pay less than they would have otherwise paid. A study by Emerta (2010) shows that 36% of the Ethiopian economy is not captured by the official statistics and as a consequence, the amount of tax evasion from the informal sector reached 10% of the economy. With all possible improvements and best ever efforts, the country could raise only 11.4% of its GDP during the year 2010/11, and 12.3% in 2011/12, the least in the non-oil world implying persistent prevalence of very high tax resistance.

Though its need for funds is immense, Ethiopia is faced with a number of challenges in raising revenue from domestic taxes owing to: (i) the fact that the biggest population—nearly 85% of the workforce—is found in traditional agriculture or in small and informal enterprises which makes it difficult to impose taxes; (ii) massive tax evasion and avoidance practices contributing greatly to shrinkage of the country's taxable base; (iii) the limited capacity and alleged ethical problems of tax revenue collecting agencies both at the federal and local levels; (iv) poor quality of basic data—a significant number of traders operating unregistered businesses.

The consequences of failure to secure taxpayers' voluntary compliance are myriad. When taxpayers do not want to report their genuine income and pay their true tax liability to tax authorities it costs the nation in terms of (a) the administrative costs to bring about compliance, (b) loss of government revenue, (c) failure to attain such other objectives as income and/or wealth redistribution, efficiency in resource allocation, and use of taxation as a fiscal instrument in economic stabilization.

Compliance with tax laws is believed to be attributable to both economic factors such as frequency of audit, sanction size, marginal tax rate, income, and opportunity to avoid or evade taxes; and a range psychological factors such as complexity of tax laws, attitudes towards paying taxes, personal norms, social norms, distributive justice, procedural justice, retributive justice, and taxpayer services (Alm, Kirchler, and Muehlbacher, 2012). Accordingly, it is worth assessing which of these two streams of factors matters much in terms of influencing taxpayers' compliance behavior in Ethiopiato this end the paper aims at finding answers to the following g questions:

- Whatis the culture of voluntary compliance with taxation in Ethiopia?
- What is the fairness perception of taxpayer about the Ethiopian tax system?
- How the status of taxpayers' service by Ethiopian revenue and customs authority impact voluntary compliance?

Tax Compliance: Theoretical Framework

Compliance with the tax laws typically means: (i) true reporting of the tax base, (ii) correct computation of the liability, (iii) timely filing of the return, and (iv) timely payment of the amounts due. The bulk of tax evasion involves the first point and most evaders either do not declare their liability at all, or declare it only in part (Luigi, Alberto, and Franzoni, 1999, p. 4).As noted by Trivedi et al. (2005), there are two prominent classes of tax compliance theories—economics-based theories which emphasize incentives and social psychology-based theories which emphasize attitudes. Economic theory of compliance, pioneered by Allingham and Sandmo (1972) based on Becker's theory of Economics of Crime (Becker, 1968), contends that taxpayers "play the audit lottery", i.e., they make calculations of the economic consequences of different compliance alternatives (such as whether or not to evade tax), the probabilities of detection and the consequences thereto, and then choose the alternative which maximizes their expected after-tax return. This assumption underlies the deterrence theory approach—a taxpayer is likely to break the law unless anticipated legal penalties exceed the additional earnings that could be made by evading tax.

The economic model of tax compliance is valid at least partly on the ground that audit and penalties curb or threaten noncompliance behavior of some selfish taxpayers. It is also possible to assume that this argument is more acceptable in societies where the vast majority of taxpayers feel that the government does not take care of them. McKerchar and Evans (2009) in their review of the economic model also argue that economic deterrence models in general are based on the theory that behaviour, in a wide range of contexts including tax evasion, is responsive to punishment or sanctions. They, however, criticize the model arguing that it tends to have a narrow theoretical view of behaviour, reducing its dimensions to numerical measures and assigned probabilities from which outcomes can be predicted using calculus.

The second class of theories assumes that social psychological factors—including moral, attitudinal, and ethical concerns—are also important to taxpayers, though the deterrence efforts surely play some role and so taxpayers may comply where the risk of audit is low or even zero. Of course, some taxpayers' behaviour may follow the economic theory while others may follow the social psychological theory, and mixtures are also possible (Trivedi et al. 2005:4). The social psychology based theory asserts that there is a wide array of factors that shape the attitude of taxpayers. Frey and Feld (2002) note that tax compliance decision is influenced by a psychological tax contract between citizens and tax authorities. The way the taxpayers are treated affects their tax morale, and therefore their willingness to pay taxes.

Unlike the economic based model which treats tax morale as a residual element, the social psychology based models treat tax morale as an endogenous variable, which is based largely on how the taxpayers view the fairness situation of the tax system, whether government spends tax revenues in the most efficient manner and on provision of socially valuable goods and services, and more importantly, the legitimacy of the government itself (see Feld and Frey, 2007; and Torgler, 2003). Legitimacy of an authority refers to the belief that the authority is appropriate, proper, and just (Tyler and Blader, 2005).

The significance of whether economic or social psychological theories matter more is of critical concern as they differ in where a tax authority should invest its limited resources. Economic theories generally call for increased audits and penalties as the solution to compliance problems. These solutions, of course, are costlier than those proposed by the social psychological theories.Trivedi et al. (2005) argue that the policy recommendations of social psychological theories vary across theories, but these theories generally lead to policy recommendations which give much attention to changing individual taxpayers' attitudes toward the tax system by improving its perceived fairness and equity, making government expenditure in the best interest of the taxpayers, improving procedural justice, establishing the culture of mutual respect between tax authorities and taxpayers, and making it easy to comply with the tax laws through such measures as increased telephone assistance, and shorter line-ups in tax offices.

Kircler, et al. (2008) categorize the relationships between tax authorities and taxpayers into: (i) antagonistic whereby tax authorities should vigilantly follow up the taxpayers in a very costly manner, requiring enforced compliance; and (ii) cooperative or synergistic whereby taxpayers perceive the tax authorities as mediators of mutually beneficial contributions to a collective, resulting in voluntary compliance. In multi-ethnic societies like Ethiopia, taxpayers are even more sensitive to fairness/justice in taxation. Justice has three main components: Distributive justice, procedural justice, and retributive justice.

Distributive justice calls for a socially just allocation of goods and services in a society. In other words, it is about the fair, just or equitable distribution of benefits and burdens. These benefits and burdens cover all dimensions of social life and comprise income, economic wealth, political power, taxation, work obligations, education, shelter, healthcare, military service, community involvement and religious activities.

Procedural justice concerns the fairness and the transparency of the processes by which decisions are made, and may be contrasted with distributive justice (fairness in the distribution of rights or resources), and retributive justice (fairness in the punishment of wrong-doings). Hearing all parties before a decision is made is one step which would be considered appropriate to be taken in order that a process may then be characterized as procedurally fair. Some theories of procedural justice hold that fair procedure leads to equitable outcomes, even if the requirements of distributive or restorative justice are not met. It has been suggested that this is the outcome of the higher quality interpersonal interactions often found in the procedural justice process, which has shown to be stronger in affecting the perception of fairness during conflict resolution. Leventhal (1980) identifies six criteria against which fairness of procedures may be evaluated. These are consistency, bias suppression, accuracy, correctability, representativeness and ethicality.

Retributivejustice isa theoryofjustice thatconsiders punishment proportionate to wrongdoing to be the best response to crime. When an offender breaks the law, s/he thereby forfeits or suspends her/his right to something of equal value, and justice requires that this forfeit be enacted. This is sometimes taken to mean that justice involves seeking revenge on behalf of the aggrieved party, or society as a whole.

Research Methodology

We used a descriptive research design in which we employed primary and secondary data to achieve the research objectives and provide answers to the research questions. Primary data were collected through interview and questionnaire. We conducted unstructured interview with selected stakeholders from the tax authority. From the tax authority we have had discussions with the relevant directors of directorates such as the audit and investigation directorate, the intelligence directorate, and the customer service directorate. We also distributed 200 questionnaires to non-randomly selected taxpayers of which only 162 filled and returned responses usable for analysis. Variables constructed (i.e. in question form) to assess the compliance issues, service delivery and fairness perception of taxpayers were measured on five scale likrert measurement: very strongly agree (5), strongly agree (4), agree (3), slightly agree (2) and disagree (1). This follows *Diamantopoulos and Winklehholefer (2001)* who suggested the use of averaging if multivariate factors are used for measurement of a variable. Using this approach, we treated the questions as formative indicators of compliance, service delivery and fairness perception of taxpayers' and average those to create observed variable. We also consulted relevant secondary documents from different sources including the World Bank country reports, the IMF reports, the periodic reports of the Ethiopian Revenue and Customs Authority and the Ministry of Finance and Economic Development.

Results and discussions

All Category "A" taxpayers whose annual turnover is more than birr 500,000 are expected to declare their VAT monthly in a scheduled manner as: nil-filers, starting from first date of the next month up to 10th date of the month; credit filers, from 1st date up to 20th and payment filers from 1st up to 30th date. Even though the time schedule is not supported by the tax proclamation, the schedule enables taxpayers to declare based on their current-prevailing status and reduce the time they spend in declaring their statements. On the other hand, the schedule enables the tax authority to get adequate time for verifying the statement of credit filers and nil filers if they declare in advance. Category B taxpayers are expected to declare and pay turnover taxes every three months, while category C taxpayers are supposed to pay turnover tax within a month from the end of each fiscal year.According to Income tax Proclamation N0 286/2002, category "A" taxpayers are supposed to declare and settle their tax liability within four months from the end of the fiscal year. Category "B" taxpayers are expected to declare and pay their tax liability within two months from the end of each fiscal year. Category "C" taxpayers are expected to pay their taxes within a month from the end of each fiscal year.

Table-1: SPSS Results of Responses to Compliance Related Questions

	N	Minimum	Maximum	Mean	Std. Deviation	Variance
The reason for noncompliance of taxpayers is the government do not use the revenue for public use	124	1.00	5.00	2.9032	1.35202	1.828
Noncompliance of taxpayers is because the tax authority does not give fast service	120	1.00	5.00	2.2667	1.25513	1.575
Level of understanding on the tax laws	129	1.00	5.00	2.0388	1.29544	1.678
The tax authority presumes the taxpayers generally as evaders	105	1.00	5.00	2.7524	1.59796	2.553
The level of audit frequency is low, so I have the possibility of not to be caught	102	1.00	5.00	3.3333	1.29991	1.690
There is no capable auditor that can detect evasion (no one can find out the exact problem)	102	1.00	5.00	3.2647	1.29681	1.682
Since most taxpayers do not pay their taxes properly, their neighbors want to follow them	106	1.00	5.00	2.6509	1.40775	1.982
There is ethical problem with the tax auditors and other tax officials so it is possible to negotiate on tax minimization	101	1.00	5.00	2.9901	1.35274	1.830
The tax authority is not willing to receive any opinion from taxpayers	105	1.00	5.00	2.7714	1.49523	2.236

Source: authors' computation from questionnaire

It is evident from Table 1 that most taxpayers that filled the questionnaire for this study (with mean value of 2.9032 out of 5) perceive that the Ethiopian government is spending tax money on valuable goods and services. In tax compliance literature, there are evidences that claim taxpayers may decide not to comply with their tax obligations when they perceive tax money as being wasted. As this study shows, however, it is not because the taxpayers perceive government expenditure of tax money as being spent on non-valuable goods and services that they do not voluntarily comply.

An average value of 2.2667 in the above Table implies that taxpayers' noncompliance with tax laws can be explained by the poor or sluggish taxpayer services provided by the revenue authority. This is evidenced by the 34.2% and 33.3% of the respondents strongly agreeing and agreeing respectively when asked as whether their noncompliance is attributable to the poor quality of taxpayer services by the revenue authority. We could confirm this through an interview with the director of customer services directorate of Revenues and Customs Authority. The director stated that taxpayers spend much time in queues though they may be served within some specified range of time in offices. The fact that taxpayers' waiting time is not of much care to the authority is evidenced by non-consideration by the authority of the queuing (waiting) time when it set standard service time.

As can be seen from Table 1 above, majority of the respondents to our questionnaire believe that their level of understanding of the tax laws is low with mean value of 2.0388. 33.8% of the respondents believe that their level of understanding of the tax laws is low while 24.3% of them believe that their understanding is very low. However, 33.8% and 8.1% of the respondents believe that their understanding of tax laws is good and very good respectively. The low level of taxpayers' understanding of tax laws can be attributable either to ineffective awareness creation efforts through taxpayer education, or complexity of the tax laws. Slightly above average value of 2.7524 in the table above indicates that the taxpayers believe that the tax authority has a prejudice that taxpayers are generally evaders. This can be substantiated by 32.4% and 21% of the respondents strongly agreeing and agreeing with the idea that "taxpayers are perceived by the revenue authority as evaders". This implies absence of mutual trust and good relationship between taxpayer population and the revenue authority. The director of audit services directorate argued, however, that the authority trusts the taxpayers' declaration of tax liabilities as the system itself is based on self-assessment of taxpayers. This implies lack of mutual understanding of taxpayers and tax officials regarding how the officials perceive the taxpayers. The discrepancy might also be due to variations in what is believed by top level tax officials to prevail and what the operational level officials actually do in dealing with taxpayers.

Average values of 3.3333 and 3.2647 for probability of being audited and capability of tax auditors to detect tax fraud respectively signify that taxpayers perceive the probability of being audited and detected for tax fraud is very high. 34.3% and 20.6% of the respondents disagree and strongly disagree when asked whether their noncompliance with tax laws is attributable to low probability of being audited. In a similar fashion, 28.4% and 20.6% of the respondents respectively disagree and strongly disagree with the fact that their tax noncompliance is explained by incapability of tax auditors to detect tax frauds.

One can deduce from the above argument that even the existing level of compliance itself is due to enforced compliance rather than a voluntary one. This result is confirmed by the interview held with the director of the audit services directorate of the Revenue and Customs Authority. According to the interview, almost all audited firms were identified to be non-compliers as the audit and investigation results usually lead to findings of tax evasion. We also came to know that the Revenue and Customs Authority uses risk based model of tax audit in which focus is on size and nature of taxable entity. This model however is subject to judgments of people as the audit feature of the SIGTAS program is not being used by the authority.

The slightly above average value of 2.6509 indicates that tax noncompliance is influenced by the prevalence of other non-compliers. This result can be supported by 27.4% and 27.4% of the respondents strongly agreeing and agreeing respectively with the idea that their tax noncompliance is because of the prevalence of other non-compliers they know. Studies elsewhere also concur with the idea that taxpayers' voluntary compliance decision is highly dependent on their belief that all other citizens are contributing their fair share of taxes.

An average value of 2.9901in the table above indicates that majority of the respondents believe there is ethical problem with tax auditors and other officials and it is possible for them to negotiate for tax liability minimization. We have verified this result through interview with the director of the audit services directorate of the Revenue and Customs Authority. There has been recorded evidence of tax auditors penalized and fired from the authority because of violation of the ethical standards and human resource policies of the authority.An average value of 2.7714 in Table 1 above means that the revenue authority is not willing to entertain any opinion from taxpayers regarding tax related decisions. This can also be evidenced by 25.7% and 27.6% of the respondents strongly agreeing and agreeing respectively with the idea that the revenue authority is not willing to take account of any opinion from taxpayers in their decisions regarding taxes. From the focus group discussion we understood that tax officials also believe that they are vested with the power to enforce the tax laws, rules and regulations and do not have to consult the taxpayers for decisions they have to pass regarding taxes. Although this is the belief, there have been discussions and forums by the tax authority with taxpayers on various matters related to tax issues. Whether those forums were effective in terms of entertaining genuine taxpayers' concerns has to be studied in the future.

Taxpayers who have refund claims of income tax or VAT are expected to submit a CPO to the cashiers of the respective branches of Revenues and Customs Authority before the deadline. But the question is whether there are enough employees that can serve the taxpayers. In principle, when the number of taxpayers increases the number of employees of the tax authority should increase. Even though there are efforts by the tax authority to enhance its revenue collection, still the efforts could not bring significant change that can convince the taxpayers.

As can be seen from the Table 2, regarding VAT declaration and payment based on the standard time in the operational manual the mean value of 4.03 reveals that VAT payers are not served as per standard set. This is supplemented by 56% and 16.4% of the respondents strongly disagreeing and disagreeing respectively about the services being rendered within the standard time. Another question forwarded to the respondents was regarding the declaration and payment of income tax which is paid on annual basis even though it may differ based on their categories. The mean value of 4.0410 in Table 2 means that income taxpayers are not served as per standard time. This can be substantiated by 54% and 16.4% of respondents strongly disagreeing and disagreeing respectively with their being served within the standard time which is almost the same as that of VAT payers. Some of the reasons the respondents forwarded as detrimental to meeting the standard time are system failure, dishonest response of officers, inconsistent rendition of services, and disproportionate number of employees with services rendered. As a result, the taxpayers are waiting in a queue for longer period.Clearance procedure is one of the activities that is expected to be handled by the customer service department and needs a prompt response after checking the documents that assure that taxpayer does not have any tax liability. To do so the tax authority mainly verifies the documents in the assessment section of the department if the clearance is to be used only for renewal of license. To assess taxpayers' satisfaction with the clearance services, the researchers included questions in the questionnaire distributed to the respondents.

As you can see from Table 2 the mean value of 4.13 does mean that the taxpayers do not get clearance within the standard time. This can also be substantiated by 53% and 13% of the respondents strongly disagreeing and disagreeing respectively with the idea that services are rendered within the standard time. Some of the respondents are highly aggrieved and stated that most of the time they get their clearance after a day. As per the researchers' observation and informal interviews conducted with some taxpayers in some branches, the submission of financial statement is one precondition for getting clearance. When taxpayers come to the office to collect their clearance the officers urge them to bring another financial statement as finding the originally submitted statement will take long time. This is due seriously to extreme shortage of employees in the branches.

Compliance and service delivery aspect of repayment administration is one part of the broader compliance and service areas. Tax repayments entail attention to the taxpayers (OECD, 2011). With regard to this, the revenue bodies of different countries are faced by both compliance and service challenges. In this case expectation of timely service is more sensitive for ongoing challenge in balancing taxpayers' expectation of good levels of service with responsibility for preventing and dealing with fraudulent and erroneous repayment of claims (ibid). As can be seen from Table 2, the mean value of 3.3 means that refund payments are not effected as per taxpayers' expectations. This is supported by 38.7 % of them highly dissatisfied, 3.2% dissatisfied, 25.8% neutral, 15.1% satisfied and 17.2% highly satisfied. Even though the dissatisfaction level is a little bit higher than the satisfaction level, the 17.2% high satisfaction is attributable to improvement as a result of the Business Process Reengineering. In light of the national and international complaints regarding refunds, the 17.2% high satisfaction level cannot be undermined. But it needs further identification of problems to improve the service delivery.

Table -3 SPSS Results of Response Related to Fairness in Service Efficiency

	N	Minimum	Maximum	Mean	Std. Deviation	Variance
Does the tax administration fairly treat the taxpayers?	145	1.00	2.00	1.5931	.49296	.243
Do you think the service provided is good?	138	1.00	2.00	1.5290	.50098	.251

Source: authors' computation from questionnaire

The mean value of 1.593 in Table 3 above reveals that the respondents perceive the prevalence of partiality in the treatment of taxpayers. This is evidenced by the 59.3% of the respondents answering the question: "Does the tax administration fairly treat the taxpayers?" as no. From the same table, it can be understood that taxpayers perceive the overall taxpayers' service is not fairly good. This fact can be supported by the 52.9% of the respondents viewing the taxpayers' service as not good.

Ethiopian Tax Administration System in Light of Best Standards

The most effective tax administration systems around the world are characterized by a tax gap of 10% or lower. The tax gap, which is defined as the difference between the taxes actually paid and the taxes which should be paid according to the existing laws and statutes, includes taxes not paid due to tax evasion, tax arrears (taxes declared but not paid), the shortfall in taxes due to taxpayers' misunderstanding of the tax laws, and any other form of non-compliance. According to Carloss Cilvani and Katherine Baer (1997), the ideally effective tax system is characterized by the following attributes:

- *Good system of self-assessment based on taxpayers' understanding of the tax system and their tax liabilities;*
- *Good taxpayer treatment by tax authorities; as partners for development*
- *Systems and procedures in all areas of tax administration are well-defined and used effectively by tax personnel;*
- *The organization is well structured, managed, and financed;*
- *Taxpayer services are available to a high proportion of the taxpaying population;*

- *Sanctions are adequate and systematically applied;*
- *Audit activities are properly planned and targeted;*
- *Computer technology effectively supports the tax administration's operations and is continuously updated;*
- *Tax administration staffs are professional and held to a high standard of behavior.*

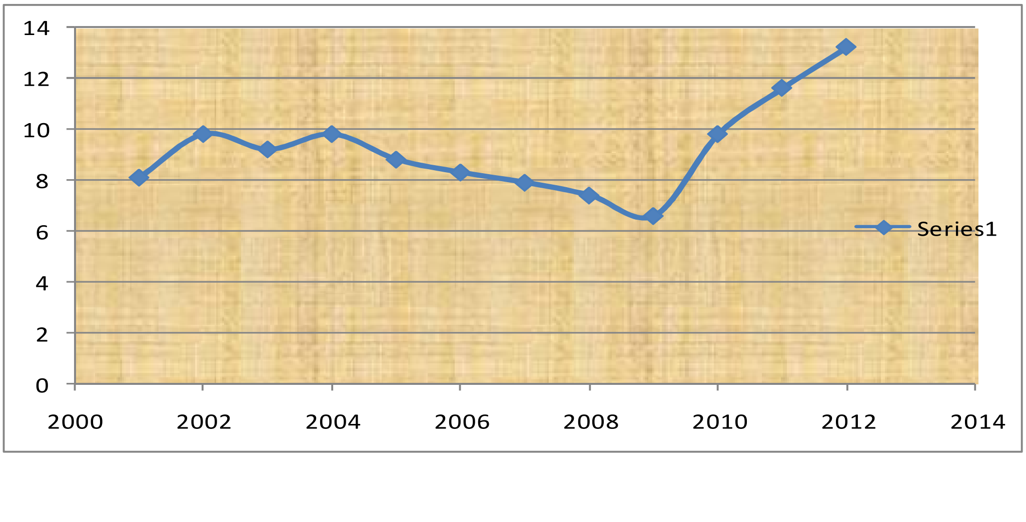
In Ethiopia, the size of tax gap has never been studied in the history of the nation and tax potential of the country is obscure. However, the condition of the tax administration of the country can be discussed in light of the attributes of best tax administration standards. Self-assessment and voluntary compliance is poor in Ethiopian tax administration system leading to focus on legal enforcement as a mechanism to collect tax revenues. A survey conducted by the IMF in 2011 indicates that value added tax compliance rate is about 25%. Since the introduction of the comprehensive tax reform in 1999 the tax administration authority has been providing taxpayer education with the use of different media such as pamphlets, television program, radio broadcasting and since recently direct forum for periodic dialogue with the taxpayers. The fact that these measures improved the understanding of taxpayers cannot be neglected even though the expected level of voluntary compliance is yet to come.

The tax authority has been under continuous institutional and administrative reform to improve taxpayer service and enhance voluntary compliance. The major administrative reform measure was the reorganization of the revenue sector into the Ethiopian Revenue and Customs Authority. This restructuring has brought about improvement in operational programme, systems and procedures. The Ethiopian Revenue and Customs Authority's administrative system is structured as a hybrid of the function base, the taxpayer size base and the customer orientation base. This lead to the following as reform measures: the establishment of additional branch offices; training and recruitment of qualified personnel, introduction of performance and accountability measures and setting up a taxpayer education programme. The tax authority has been upgrading its computer system, introducing sales register machine for online tracking, implementing the use of a tax identification number for the enforcement, verification and processing of VAT refund claims. In 2012 large size taxpayers were offered online tax return filling service which is the first of its kind in the history of Ethiopian tax administration. But such service is yet to address the majority of taxpayers. The poor quality of human resource in the tax administration system has been one of the noticeable challenges in the tax administration system. The tax authority has more than 70% of its staff with bachelor's degree or lower. But the international best practice standard shows that more than 70% of the personnel hold masters degree or above in relevant fields to tax administration.

The tax audit and investigation in practice in Ethiopian tax and customs revenue authority is based on the risk based model of tax audit. That is, tax audit and investigation focuses on areas and sectors with huge potential of revenue loss because of tax evasion and avoidance. Any tax fraud identified leads to sanctions and penalties as per the legal provisions of the country. To this end, there was no record of a taxpayer arrested without alleged and/or proved non-compliance to tax laws of the country. Detected noncompliance to the governing tax laws has lead to criminal as well as civil suits against those who failed to comply with the legal requirements in place. While doing so the tax authority have been respecting the rights of the tax payers stipulated in the tax laws and other laws of Ethiopia.

Ecumenically speaking, the Ethiopian tax administration system in practice is far from achieving the indicators of the most effective tax administration system though the progressive development cannot be denied. With the comprehensive tax reform introduced since 1999 there has been radical shift in terms service, taxpayer education and compliance enhancing activities such as audit and investigation which are essential to enhance tax revenues. The government is committed to expanding its domestic revenue mobilization efforts to ensure fiscal sustainability. Since 2009 it continued to implement measures aimed at improving tax administration and enforcement. Tax revenues increased by 37% in 2010/11, compared with the previous year. However, the domestic revenue to GDP ratio increased only marginally from 11.2% in 2009/10 to 11.3% in 2010/11 because of a 34% increase in nominal GDP. Domestic revenues as a share of GDP increased to 13.2% in 2012. Ethiopian economy has been growing continuously since 2004 and Ethiopia has been receiving complementary reports from the World Bank and International Monetary Fund for its economic growth records. In absolute terms both the gross domestic product and the tax revenue have been growing. However, the tax to GDP ratio has begun to rise significantly only recently (i.e. since 2009) after implementation of the business process reengineering in the tax administration authority accompanied by strong legal enforcement measures. Figure-1 below summarizes the trend in Tax to GDP Ratio Performance in Ethiopia in recent periods.

Figure1-Recent Periods Tax to GDP Ratio Performance in Ethiopia


14
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2002
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2010
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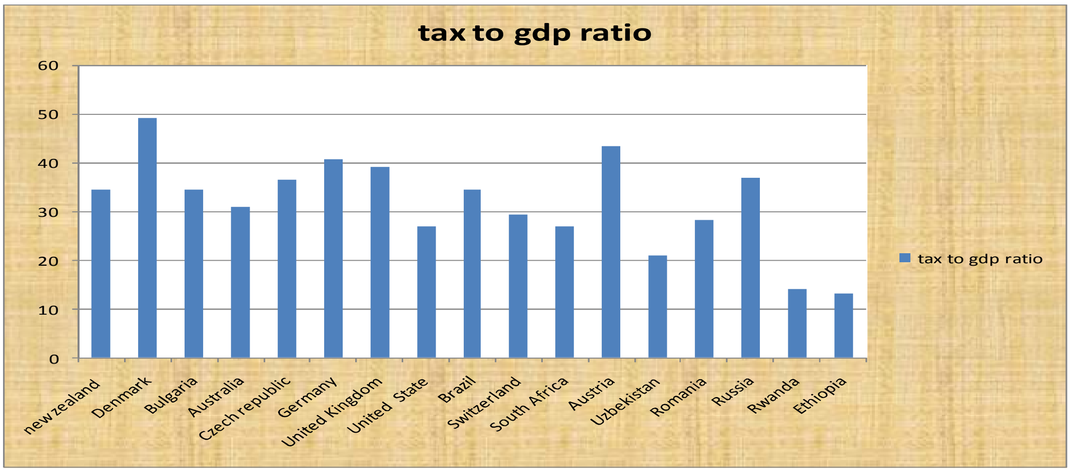
2014
Series1

International Status of Tax to GDP ratio of Ethiopia

The international comparisons of the Ethiopian tax revenue to its GDP ratio revealed that it is among the lowest in the world. In 2012 the tax to GDP ratio of Ethiopia is reported to be 13.2% by the ministry of finance and economic development to be a record which is far below the average of sub Saharan economies of about 19%. The fact presented in figure -2 below shows that the tax to GDP ratio of Ethiopia is the lowest not only in comparison with developed economies but also with the former socialist blocks of the Eastern European Countries. Although figure-1 indicates that the tax to GDP ratio has been increasing the international comparison leads us to argue that significant improvement is mandatory in Ethiopian tax administration system. Strategies and operational actions that target the possible causes of low tax to GDP ratio should be pursued by the tax authority. The possible reasons behind low tax to GDP ratio include: tax avoidance, tax evasion, failure to tax the informal sector, failure to control misuse of tax incentives for investment. Figure-2 below indicates the tax to GDP ratio of Ethiopia at international level.

Figure-2- tax to GDP ratio of Ethiopia at international level



Conclusions

In this paper we explored how taxpayers view the tax administration system in terms of securing voluntary taxpayers' compliance, taxpayers' understanding of the tax system, the taxpayers' services provided by the revenue authority, and the fairness perception of the taxpayers. We consulted relevant documents to supplement the results of analyses of primary data gathered through questionnaire distributed to non-randomly selected taxpayer respondents, informal interviews with some taxpayers, and researchers' personal observations. Based on these analyses, the following conclusions are drawn:

- Tax to GDP ratio is improving, though still among the lowest in the world.
- Tax revenue performance is improving from year to year.
- Taxpayers' compliance that prevails currently, according to the perception of the respondents, is due to enforcement, not voluntary.
- The level of understanding of tax laws by the taxpayers is low.
- The respondent taxpayers believe that the revenue authorities' treatment of taxpayers is partial.
- The respondents perceive the taxpayers' services as inadequate.

Recommendations

Based on the findings, we recommend the following steps to be taken:

Effort has to be directed towards enhancing voluntary compliance as enforced compliance is costly. To this end, improvement of taxpayer services, enhancing taxpayers understanding of the tax system through tax payer education programme and improving tax audit quality so that taxpayers would feel they might be caught and sanctioned if they commit evasions or frauds are the ways forward. Enhancing technological control mechanisms is also essential. This means the tax authority should invest on the use of technology to easily track taxable transactions online.

It would be good to work on simplification of the tax laws and taxpayers' education using various media. We recommend intensive use of the traditional media such as television broadcasting, radio broadcasting, and periodic consultative discussions with taxpayers, informal social institutions such as idir and, iqubi as well as religious institutions. In addition to these, schools could be used to develop the attitude of the future generation of the nation regarding taxation.

There is a need to check how impartial the treatment of taxpayers by different departments is and to try to maintain impartiality as it plays a great role in securing voluntary compliance. The authority should study the impartiality and ethical integrity of its officer using psychometric analysis questionnaires. Proactive role could be exercised by testing the potential applicants for their impartiality and ethical integrity through the same mechanism during the employment process. There needs to be concern for retention of experienced tax officials and employees without prejudice to the authority's human resource policy.

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