



**St. MARY'S UNIVERSITY
SCHOOL OF GRADUATE STUDIES
MBA IN ACCOUNTING & FINANCE**

**The Impact of Tax Audit on the Tax compliance: The Case of Selected
Category “A” Taxpayers in Bole Sub City, Addis Ababa City
Administration**

**A THESIS SUBMITTED TO THE SCHOOL OF GRADUATE STUDIES OF St. MARY'S
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ACCOUNTING AND FINANCE**

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DECLARATION

I, Ephrem Bedada, declare that, this paper prepared for the partial fulfillment of the requirements for (MBA) in Accounting and Finance entitled **“The Impact of Tax Audit on Tax Compliance: The Case of Selected Category “A” Taxpayers in Bole Sub City, Addis Ababa City Administration”** is prepared with my own effort. I have made it independently with the close advice and guidance of my advisor.

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Date _____

CERTIFICATE

This is to certify that Ato Ephrem Bedada has carried out this research work on the topic entitled **“The Impact of Tax Audit on Tax Compliance: The Case of Selected Category “A” Taxpayers in Bole Sub City, Addis Ababa City Administration”** under my supervision. This work is original in nature and it is sufficient for submission for the partial fulfillment for the award of MBA in Accounting and Finance.

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ABSTRACT

The main issue faced by all tax authorities is that it has never been easy to persuade all taxpayers to comply with the regulations of a tax system. Business sector is one of the fastest growing sectors of the economy in Ethiopia. The study specifically sought the effect of tax audit, fines and penalties and tax education and knowledge on tax compliance in Bole sub city, Addis Ababa administration. Data was collected using structured questionnaire, both primary and secondary data were used. Descriptive statistical tools and correlation and multiple regressions analysis were used in analyzing the data collected. The study findings showed that probability of tax audit; tax knowledge and education have positive effect on level of tax compliance. Similarly, fines/penalties have positive effect on level of tax compliances. The study provides some preliminary evidence that probability of tax audit, imposing fines/penalties and provision of tax knowledge and education will improve tax compliance. There should be stiff enforcement of fines and penalties to deter tax evasion. Additionally, tax authorities should simplify processes involved in filling of returns and payment of taxes.

Key words: *Tax audit, Tax compliance, Tax education*

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ACRONYMS & ABBREVIATIONS

ERCA	Ethiopia Revenue and Customs Authority
GDP	Gross Domestic product
GTP	Growth and transformation plan
OECD	Organization for Economic Co-operation and Development
PENALTY	Penalties and Enforcement
SMU	St. Mary's University
TAX KNOW	Tax Knowledge and Education
TAXAUDIT	Probability of being audited
TAXCOMP	Tax Compliance

CHAPTER ONE

1. INTRODUCTION

1.1 Background of the Study

All over the world, governments undertake huge public expenditure on behalf of their citizens for the provision of basic amenities and other social services. To meet up with these responsibilities, governments thus require substantial amount of funds. Among the various sources from which governments can generate income, taxes are the most important and most reliable; contributing much more than any other source. A tax therefore, is a compulsory levy imposed by the government on the income, profit or wealth of an individual, family, community, corporate or unincorporated bodies etc for purposes of financing public expenditures. Taxation is the inherent power of the state, exercised through the legislature, to impose financial burdens upon subjects within its jurisdiction for the purpose of raising revenues to carry out the legitimate duties of government. One major problem inhibiting effective tax administration in emerging economies is tax evasion, i.e., deliberate refusal to pay tax. To combat this ugly phenomenon, various countries of the world have introduced tax audit into their tax system.

According to Kircher (2008) tax audit is the examination of an individual or organization's tax report by the relevant tax authorities in order to ascertain compliance with applicable tax laws and regulations of state. He further reported that tax audit is a process where the internal revenue service tries to confirm the numbers that you have put on your tax return. Ola (2001) stated that the process of tax audit involves tax returns that are selected for audit using some selection criteria. Thereafter, the underlying books and records of the taxpayers are examined critically to relate them to the tax return filed. Tax audit is important because it assist the government in collecting appropriate tax revenue necessary for budget, maintaining economic and financial order and stability, to ensure that satisfactory returns are submitted by the tax payers, to organize the degree of tax avoidance and tax evasion, to ensure strict compliance with tax laws by tax payers, to improve the degree of voluntary compliance by tax payers and to ensure that the amount due is collected and remitted to government.

The government of Ethiopia has several options to finance its public expenditures and pursue its fiscal policy. These options include imposing of taxes on businesses and persons, and non-tax revenues such as service fees, money prints, loans (both domestic and foreign institutions), property and investment income, privatization of public enterprises, and domestic and foreign grants. Among others, tax along with customs collections is an important source of revenue for government. The proper amount of tax must be collected on a timely manner for successfully improving and maintaining steady economic progress of a nation. To do this, the enforcement powers of the tax administration, including tax audit, must be applied judiciously and in an evenhanded fashion (Baurer, 2005). A tax audit is an examination of whether a taxpayer has correctly reported its tax liability and fulfilled other obligations. It is often more detailed and extensive than other types of examination such as general desk checks, compliance visits or document matching programs (OECD, 2006a). As Biber (2010) noted, the role of an audit program in a modern tax administration must extend beyond merely verifying a taxpayers reported obligations and detection of discrepancies between a taxpayer's declaration and supporting documentation. Tax audit may increase tax revenue in two ways: directly through assessment of additional taxes, and indirectly by improving taxpayer compliance with the tax laws and regulations (Barreca and Ramachandran, 2004). Therefore, the purpose of this study is to identify or assess the effect of tax audit on tax compliance with reference to Category "A" taxpayers in Bole sub city of Addis Ababa city Administration.

1.2 Statement of the Problem

Taxation in developing countries is a challenging topic and has attracted increasing attention to the researchers. Many problems observed like poor tax administration, failing to collect sufficient tax revenues. In many developing countries it is observed that there is low capacity of tax administration to monitor compliance among taxpayers and the potential amount of tax revenue has not been collected in an efficient and equitable manner (Edmiston and Bird, 2004).

In many developing countries it is observed that there is low capacity of tax administration to monitor compliance among taxpayers (Tanzi, 2000). Ethiopia, like any other developing countries, faces difficulty in raising revenue to the level required for the promotion of economic growth. Hence, the country has been experienced a consistent surplus of expenditure over

revenue for sufficiently long period of time. To address this problem, the government introduced the imposition of tax (direct and indirect), among others; as major and important sources of public revenue.

However, this imposition of tax couldn't still bring the required result due to a number of reasons such as lack of clear understanding about the tax system by the taxpayers, taxpayers don't comply with their tax obligation, hostility between the taxpayers and tax officials, negative attitude of taxpayer towards the tax system, understating their taxable income by significant amount For these reasons, the actual amount of tax couldn't be collected properly (Tadele, 2010).

During the past three years, on average birr 83.9 billion was collected from taxation every year. In 2012/13 a total of birr 107 billion was collected in tax revenues. This was 32 percent higher compared to its target. Compared to the tax receipts in 2011/12, it has increased by 24.8 percent. Tax revenue as a percentage of GDP was 11.7 percent in 2010/11 and 11.6 percent in 2011/12. The tax to GDP ratio has further increased to 12.5 percent in 2012/13. Even though, nominal tax revenue has been increasing rapidly, the growth rate was not proportionate to the rapid expansion of the size of the economy. In order to attain the GTP target of 15-17 percent of tax to GDP ratio by 2014/15, it is required to strengthen the tax collection and administration systems, expand public education and participation, strengthen enforcement and build the capacity of the taxation institutions (MOFED 2014).

Therefore it is very important to study factors that affect tax compliance of the country in order to increase government revenue and assure economic stability. In a country like Ethiopia where the contribution of revenue to the overall economic development is believed to be very much significant, more local studies on the assessment of tax payers voluntary compliance with tax law is required so as to provide the policy makers and the implementers in the area with relevant information that can help them in designing the appropriate tax system.

1.3 Objectives of the Study

1.3.1 General Objective

The main objective of this study is to examine the impact of tax audit on tax compliance in Ethiopia.

1.3.2 Specific Objectives

The study assumes the following specific objectives, i.e., to:

- 1 To identify factors that motivates tax payers to pay taxes.
- 2 To examine the association between tax knowledge and tax compliance behavior.
- 3 To examine the relation between probability of tax audit and tax compliance behavior
- 4 To examine the association between tax penalties and tax compliance behavior

1.4 Basic Research Questions

- What is the relationship between tax audit and tax compliance?
- What are the factors that motivate taxpayers to pay taxes?
- To analyze ERCA have adequate tax audit resources, tax audit staff in particular?

Research Hypotheses

The following hypotheses have been tested:

H₀₁: Probability of audit has no significant effect on tax compliance

H₀₂: Fines and Penalties have no significant impact on tax compliance

H₀₂: Tax knowledge and education have no significant effect on tax compliance

1.5 Significance of the Study

The primary use of this research is to the ERCA. The authority might be able to see its level and performance of tax audit activities, and learn some lessons and build some corrective measures for the weaknesses based on recommendations to be forwarded. Hence, this study will have a significance to provide relevant information to policy makers and other concerned bodies in

addressing tax voluntary compliance problems. Besides, the study is believed to prompt the importance for undertaking further research on the area as the tax payer's voluntary compliance.

1.6 Scope of the Study

The study analyses the impact of Tax Audit on Tax compliance with respect to category 'A' tax payers found in AA City Administration Bole sub city excluding other sub cities and other category (B and C) tax payers.

1.7 Limitation of the Study

Tax compliance is affected by various factors. Due to lack of sufficient information and documentation from the tax payers and authority, the study is mainly limited to the impact of Tax Audit on Tax compliance with taxation considering only some variables. Probability of tax audit, Penalty and Tax knowledge. Therefore, based on the above limitations some of variables are used in the model that are expected to affect taxpayers' voluntary compliance behavior.

1.8 Operational Definition of Terms

Tax Compliance: This refers to adherence to the administrative rules of lodging and paying taxes on time. This includes compliance with the reporting requirements, procedural rules and regulations. This entails filing tax returns on time, reporting all the income and claiming the right deductions and where taxes are due making tax payments on time (Mohd *et al.*, .2011).

Tax Rates: Tax rates refer to the rate at which a business or person is taxed on income. It also refers to the rate of tax on goods and services (Alm et al., 1992).

Tax Audits: This is an exercise undertaken by tax authorities to determine if a taxpayer paid the correct amount of tax (Kircher, 2008).

Fines and Penalties: A fine or penalty is money paid usually to a government authority, as a punishment for a crime or other offence (Alm et al., 1992).

Tax incentives: A tax incentive is an aspect of the tax code designed to incentivize, or encourage, a certain type of behavior (Mittone,2006).

Tax avoidance: Refers to the legal reduction in tax liabilities by practices that take the full advantage of the tax code, such as income splitting and postponement of taxes for example through contribution to a Home Ownership Savings Plan (Bergman ,1998).

Tax evasion: Refers to illegal and intentional actions taken by individuals to reduce their legally due tax obligations. Individuals and firms can evade taxes by underreporting incomes, sales, or wealth, by overstating deductions or by failing to file appropriate tax returns (Bergman,1998).

1.9 Organization of the Research

This paper is divided into five chapters that covered Introduction, Literature Review, Research Methodology, Research Results, and Conclusion and Recommendation. The outlines of the five chapters are as below.

Chapter 1: Introduction

This chapter provides an overview of the study. It contains general introduction to the issues with which the study is concerned, problem statement, objectives and research questions, hypotheses, significance of the study, scope and limitations, organization of the study and Operational definition of terms.

Chapter 2: Literature Review

This chapter assesses previous literature and studies relevant to the fields and related topics. A literature review also provides a rationale for the proposed study by placing it next to the previous studies.

Chapter 3: Research Methodology

This chapter describes and explains the research methodology used in the study. Key topics of this chapter include description of the study area along with the research methodology employed, research instrument, sampling design, data collection procedures, and data analysis techniques.

Chapter 4: Results and Discussions

This chapter describes overall findings. It summarizes the statistics of respondents' demographics, respondents' response on adequate tax audit resources, respondents' response on motivational factors, result of statistical analysis, and discussion of the research results.

Chapter 5: Conclusions and Recommendations

And finally, the last chapter presents the conclusions drawn from the findings, the recommendations forwarded and directions for future researches.

CHAPTER TWO

The purpose of this chapter is to review the literature in the area of the impact of tax audit on tax compliance behavior. The review has three major sections. Section 2.1 presents a review of the theoretical aspects related to the study. This is followed by the empirical literature review in section 2.2. Section 2.3 present summery of the literature review and knowledge gaps.

2.1. Theoretical Framework

2.1.1. Concept and Nature of Taxation

Taxation is seen as a burden which every citizen must bear to sustain his or her government because the government has certain functions to perform for the benefits of those it governs. A précised definition of taxation by Farayola (1987) is that taxation is one of the sources of income for government, such income as used to finance or run public utilities and perform other social responsibilities. Ochiogu (1994) defines tax as a levy imposed by the government against the income, profit or wealth of the individuals and corporate organizations. According to Adams (2001) taxation is the most important source of revenue for modern governments, typically accounting for ninety percent or more of their income. Taxation is seen by Aguolu (2004), as a compulsory levy by the government through its agencies on the income, consumption and capital of its subjects. These levies are made on personal income, such as salaries, business profits, interests, dividends, discounts and royalties. It is also levied against company's profits, capital gains and capital transfer. Whereas, Ojo (2008) stresses that, taxation is a concept and the science of imposing tax on citizens. According to him, tax is itself a compulsory levy which is required to be paid by every citizen. It is generally considered as a civic duty. The imposition of taxation is expected to yield income which should be utilized in the provision of amenities, both social and security and creates conditions for the economic well-being of the society.

Okon (1997) states that income tax can be regarded as a tool of fiscal policy used by government all over the world to influence positively or negatively particular type of economic activities in order to achieve desired objectives. The primary economic goals of developing countries are to increase the rate of economic growth and hence per capita income, which leads to a higher standard of living. Progressive tax rate can be employed to achieve equitable distribution of

resources. Government can also increase or decrease the rates of tax, increase or decrease the rate of capital allowances (given in lieu of depreciation) to encourage or discourage certain industries (e.g. in the area of agriculture, manufacturing or construction) or may give tax holidays to pioneer companies.

Income tax therefore can be used as an agent of social change if employed as a creative force in economic planning and development.

2.1.2. Objectives of Taxation

Although the tax structure in the various developing countries differs widely, the objectives of taxation in these countries are virtually the same. Unfortunately, however, the objectives of the tax system and the relationship between these objectives are hardly clearly stated (Cutt, 1969). This does not only makes tax administration difficult but also give room for tax evasion with the attendant effects on economic development. Cutt (1969) therefore, states that a brief discussion on the objectives of taxation as outlined below would be a gainful exercise.

(A) Rising of Revenue:

The classical function of a tax system is the raising of the revenue required to meet government expenditure. This income is required to meet the expenditure which are either the provision of goods and services which members of the public cannot provide such as defense, law and order to the provision of goods and services which the federal and state governments feel are better provided by itself such as health services and education.

(B) Wealth Redistribution:

In modern times, great emphasis has come to be placed on the objective of redistribution of wealth. This has two quite distinct forms. The first is the doctrine that taxation should be based on ability to pay and is summarized by the saying that “the greatest burdens should be borne by the broadest backs.” The second form presupposes that the present distribution is unjust and concludes that this should therefore be undone. This second principle sees confiscation as a legitimate objective of taxation.

(C) Economic Price Stability:

It has been said that the most fundamental reason a government has for taxing its citizens is to provide a reasonable degree of price stability within the nation (Summerfield, et al., 1980). Most spending by the public and private sectors without taxes generates high demand, which is inflationary. In such a situation, the basic function of taxation is to reduce private expenditure in order to allow government to spend without causing inflation. Thus, taxation is basically a deflationary measure. On the other hand, when aggregate demand is lower than the deserved level, government has two options which are to increase government spending with increasing taxes or to reduce taxes while leaving government spending stable.

(D) Economic Growth and Development

The overall control or management of the economy rests on the central government and taxation plays an important role in this direction. In addition to maintaining reasonable price stability, governments are determined to promote the near-full employment of all the resources of the country (including human resources i.e., labor) and ensure a satisfactory rate of economic growth. Economic growth and development programs are geared towards raising the standard of living of the masses of a country through the improvement of their economic and social conditions. Taxation in one way discourages, postpones or reduces consumption and encourages saving for private investments. This is only possible when the basic necessities of life including security, law and order, education and communication are provided by government, hence, the national development plans of developing countries are considered to be important. This objective will be of great assistance to Nigeria where there is mass unemployment of labor force and economic resources.

According to Soyode and Kajola (2006) the responsibilities or objectives of government using taxation are as follows:-

(a) Revenue Generation:

The primary objective of a modern tax system is generation of revenue to help the government to finance ever-increasing public sector expenditure.

(b) Provision of Merit Goods:

An important objective of tax system is the promotion of social, economic and good governance through provision of merit goods. Examples of merit goods are health and education. These must not be left entirely to private hands though, private participation should be encouraged. Private enterprises will push the cost of providing education and health services beyond the reach of common people if left entirely in their hands.

(c) Provision of Public Goods:

Revenue generated from tax can be used to provide commonly consumed goods and services for which an individual cannot be levied the cost of the goods or a service consumed is one of the functions of government. Examples of public goods include:-

- (i) Internal security through maintenance of law and order by police and other security agencies.
- (ii) External security through defense against external aggression by Army, Navy and Air forces, and (iii) Provision of street lights and roads.

(d) Discouraging Consumption of Demerit Goods:

Tax can be used to discourage consumption of demerit or harmful goods like alcohol and cigarette. This is done to reduce external costs to the society. These external costs include health risks and pollution.

(e) Redistribution of Income and Wealth:

Tax system is a means of ensuring the redistribution of income and wealth in order to reduce poverty and promote social welfare. For example, taxation can be used as economic regulator for promotion of economic stability and sustainable growth through fiscal policy. Government also has responsibility for fighting inflation, unemployment and creating a sound infrastructure for business. A tax system is one of the means of achieving this.

(f) Harmonization of Economic Objective:

Harmonization of diverse trade or economic objectives of different countries is one of the modern objectives of tax systems. For example, tax system can be used to achieve the

philosophy of the single market in ECOWAS or Africa so as to provide for the free movement of goods/services capital and people between members states.

2.1.3 Meaning of Tax Audit

A tax audit is an examination of whether a taxpayer has correctly reported its tax liability and fulfilled other obligations. It is often more detailed and extensive than other types of examination such as general desk checks, compliance visits or document matching programs (OECD, 2006). Most taxpayer's report their tax liabilities more accurately if they believe that the tax administration has the capacity to detect any unreported liabilities and that heavy penalty may be applied when they are detected.

2.1.4 Types of Tax Audit

There are different types of Tax Audit which are implemented in different countries. Biber (2010) noted that, there are different tax audit program. These are desk audit or verification, field audit, registration check, advisory audit, record keeping audit, refund audit, issue-oriented audit, comprehensive or full audit and fraud investigation.

(a) Desk Audit or Verification

Desk audit usually carried out annually and primarily based on: (1) a review of income tax and VAT returns, or basic ratios comparing with previous periods or other taxpayers in similar industries, and (2) the crosschecking of information included in the taxpayer files. It involves basic checks conducted at the tax office when the auditor is confident that all necessary information can be ascertained through in-office examination. Information technology (IT) systems should provide strong support for these verifications (Ebrill, 2010).

(b) Field Audit

According to OECD (2006), field audit is types of audit focuses on detailed examination of taxpayers' books and records to determine whether the correct amounts were reported on the tax returns. The auditor may also obtain information from other sources such as banks, creditors and suppliers, to confirm items on returns. The audit is conducted at taxpayers' place of business,

home, or at the office of their accountant, attorney, or other person who may represent them. The auditor tries to select the place that is most appropriate under the circumstances and most convenient for them.

(c) Registration Check

Registration check is a form of unannounced visits to taxpayer's premises for new enterprises (mainly small and medium sized) to detect businesses operating outside the tax system and a quick check on businesses to establish that they are correctly registered. It should not take more than half a day (OECD, 2006) According to Ebrill (2001) in this visit, the tax officer ensures that the taxpayer: (1) has a basic understanding of their obligations; (2) keeps appropriate records (book keeping review should be mandatory in case of voluntary compliance when the turnover of the taxpayer is below the registration threshold); and (3) issues proper invoices when required by law.

(d) Advisory Audits

It involves the auditors visit to newly established businesses. They advise them regarding tax types, filing of returns, payment of amounts due, record keeping to be maintained, refund claims, risk of audit and sanctions of noncompliance. These visits are very appropriate when introducing new tax laws.

(e) Record Keeping Audit

It is unannounced visits to the taxpayers' business premises to check whether the appropriate records are kept and VAT invoices are issued. The visit points out the obligations of the taxpayer regarding the keeping of records and followed up with penalties if the taxpayer continues to disregard record keeping requirements (OECD, 2006).

(f) Refund Audit

Refund audit should focus only on the period covered by the claim. A pre-refund audit should be undertaken to verify the taxpayer's entitlement to a refund prior to processing a first refund claim particularly for new registrants. It is also carried out where the refund claim varies significantly from established patterns and trends. Audits of further claims should be carried out selectively Grandcolas (2005).

(g) Issue-oriented Audit

According to Grandcolas (2005), issue oriented audit focus on a single tax type and covers no more than one or two reporting periods. It should be directed at verifying items for which errors have been detected in the returns (atypical ratios, gross revenues, comparison of gross sales to imports). Single-issue audits are confined to one item of potential noncompliance that may be apparent from examination of a taxpayer's return. Given their narrow scope, single issue audits typically take less time to conduct and can be used to review large numbers of taxpayers involved in similar schemes to conceal non-compliance (OECD, 2006).

(h) Comprehensive or full Audit

Ebrill (20011) defined comprehensive audit as comprehensive examination of all information relevant to the calculation of a taxpayer's tax liability for a given period. This audit may cover all tax obligations over a number of tax periods, or extended to several years up to the limit provided for in the law. All cases where serious underreporting or evasion has been detected under any of other audits should be forwarded to a unit responsible for undertaking comprehensive audits of all tax liabilities. The objective is to determine the correct tax liability for a tax return as a whole. As this audit is usually time consuming and costly to undertake, it should only be applied to those taxpayers if there is an indication of under reporting that may impact across taxes. It requires considerable resources and reduces the rate coverage of taxpayers that could otherwise be achieved by a more varied mix of audit types.

(i) Fraud Investigation

Fraud investigation is a type of tax audit that investigates criminal which arises from where the most serious cases of noncompliance. It helps to detect fraud, evasion, and criminal activity Krelve (2005). Fraud investigation requires special skill including meeting evidentiary requirements, seizure of evidences or records, testimony from key witnesses and preparing briefs for courts. Hence, it should be undertaken in accordance with criminal procedure laws. OECD (2004a) stated that, Revenue authorities should maintain a dedicated organizational unit responsible for the handling of serious cases of tax fraud or evasion. According to OECD (2006) the types of tax audit are categorized in different based on the scope and its intensity of the audit performed.

2.1.5 The Roles of the Taxpayer Audit Program

The tax audit program of a revenue body performs a number of important roles that effectively carried out and can make a significant contribution to improved administration of the tax system.

These roles are described briefly hereunder:

- **Promote voluntary compliance:** The primary role of the audit program is to promote voluntary compliance by taxpayers with the tax laws. It seeks to achieve this by reminding taxpayers of the risks of noncompliance and by engendering confidence in the broader community that serious abuses of the tax law will be detected and appropriately penalized.
- **Detect non-compliance at the individual taxpayer level:** By concentrating on major areas of risk (e.g. unreported cash income) and those individual taxpayers most likely to be evading their responsibilities, audits may bring to light significant understatements of tax liabilities, and additional tax revenue collections. Gather information on the ‘health’ of the tax system (including patterns of taxpayers’ compliance behavior): The results of normal audit activity may provide information on the general well-being of the tax system. Audits conducted on a random basis can assist overall revenue administration by gathering critical information required to form judgments on overall levels of tax compliance, that over time can be used to identify trends in overall organizational effectiveness and to gather more precise information that can be used to inform decision-making on future compliance improvement strategies, to refine automated risk-based case selection processes, and even support changes to tax legislation.
- **Gather intelligence:** Audits may bring to light information on evasion and avoidance schemes involving large numbers of taxpayers that can be used to increase major counter-abuse projects.
- **Educate taxpayers:** Audits can assist clarify the application of the law for individual taxpayers and to identify improvements required to recordkeeping and thus may contribute to improved compliance by taxpayers in the future.

- **Identify areas of the law that require clarification:** Audits may bring to light areas of the tax law that are causing confusion and problems to large numbers of taxpayers and thus require further efforts by the revenue body to clarify the laws' requirements and/or to better educate taxpayers on what they must do to comply into the future.

Given the broad range of roles to be performed a revenue body's audit program typically entails the largest allocation of a revenue body's total staff resources. From this perspective alone, the audit program represents a sizeable strategic investment that dictates the need for sound management policies and practices.

2.1.6 Government Revenues Scope and Extent

According to OECD (2006), government revenues are sourced from various tax and nontax receipts. The country papers bring out the dimensions of these two sources which in turn influence the areas of audit priority. These are tax and non-tax revenues. Government revenues are largely dependent on taxes legislated through various tax statutes. However, the spread of the two sources, tax and non-tax revenues, varies from country to country.

The scope of audit activities varies across countries, in part as a result of the system of assessment in place. There are two generally accepted systems of tax assessment applied worldwide (administrative assessment and self-assessment) in around half of OECD countries, administrative assessment is employed to varying degrees in the administration of personal income tax and corporate profits/income tax. All countries administer VAT under self-assessment principles.

Assessment systems operate on the principle that all tax returns should be subject to a degree of technical scrutiny before a formal assessment is sent to the taxpayer. In practice, however, much of the scrutiny previously undertaken by technical staff has been replaced in many countries by the use of automated screening techniques to identify returns requiring scrutiny before a formal assessment is issued. To the extent that there is some level of scrutiny carried out by technical officers, it ranges in practice from a very cursory examination of some tax returns to a more in-depth examination where further inquiries may be made with taxpayers (sometimes by correspondence) before a formal assessment is issued. Even countries that operate administrative

assessment regimes complement these arrangements with a formal program of post-assessment audits. However, in practice such programs tend to be conducted on a smaller scale than is the case in countries only applying self-assessment principles.

In countries where self-assessment principles are applied, returns are typically accepted as filed in the first instance (with the exception of returns containing mathematical errors or clearly erroneous deductions) and, for income tax, a formal assessment/ notice confirming/advising the tax liability is sent to the taxpayer before any inquiry. A sample of returns is selected for post-assessment audit, generally applying computer-based risk selection techniques and/or manual screening processes. Large scale matching programs may also be mounted on a post –assessment basis for the major categories of income (i.e. wages, interest, and dividends).

Since virtually all tax returns are accepted as filed without technical scrutiny when applying self-assessment principles, it is essential for the system to be supported by a reliable automated audit case selection system using risk-based screening techniques. Typically, such systems are developed using risk-based criteria derived from analyses of completed audit cases and are regularly updated to take account of the results of audit activities and to reflect important changes in the behavioral patterns of taxpayers. Examples of risk identification models and approaches are described in the companion note ‘Audit Case Selection. As systems of administrative assessment and self-assessment have evolved over time in many countries there is something of a fine-line in practice between their features and relative efficacy (OECD, 2006).

According to the Ethiopian Federal Inland Revenue Authority’s tax assessment and audit manual (2006), an assessment is basically an initial review by tax official of the tax declarations and information provided by tax payer and a verification of the mathematical and technical accuracy of the declared tax liability shortly after the submission of the declaration. The initial review also includes the application of various risk criteria to determine possible tax underpayments and the subsequent selection for tax audit. An audit on the other hand, is the conduct by audit staff for appropriate verification of selected tax payers declared tax liabilities. This can include a review of tax payer’s systems, books of account and other related information. It may also include cross checks of tax payer’s records with those of tax payer’s suppliers or with other source of

information such as the custom authorities or other government departments and agencies.

2.1.7 Resources for the Tax Audit Function

Revenue bodies typically have at their disposal a finite level of resources to conduct the day to day business of revenue administration. Given the many tasks to be performed and the inevitable decisions that must be made on priorities, a process is required to determine how those resources are to be allocated.

Regardless of how the overall budget of resources for audit work is arrived at, a key issue for the audit function is how those resources will be spread over the various segments of taxpayers. Determining how resources might best be allocated is a key element of a revenue body's strategy for compliance improvement and is dealt with in the following section

2.1.8 Definition of Tax Compliance.

The exact meaning of tax compliance has been defined in various ways. For example, Andreoni, Erard, and Feinstein (1998) claimed that tax compliance should be defined as taxpayers' willingness to obey tax laws in order to obtain the economy equilibrium of a country. Kirchler (2007) perceived a simpler definition in which tax compliance is defined as the most neutral term to describe taxpayers' willingness to pay their taxes. A wider definition of tax compliance, defined in 1978 by Song and Yarbrough suggested that due to the remarkable aspect of the operation of the tax system in the United States and that it is largely based on self-assessment and voluntary compliance, tax compliance should be defined as taxpayers' ability and willingness to comply with tax laws which are determined by ethics, legal environment and other situational factors at a particular time and place. Similarly, tax compliance is also defined by several tax authorities as the ability and willingness of taxpayers to comply with tax laws, declare the correct income in each year and pay the right amount of taxes on time (IRS, 2009; ATO, 2009; IRB, 2009).

Alm (1991) and Jackson and Milliron (1986) defined tax compliance as the reporting of all incomes and payment of all taxes by fulfilling the provisions of laws, regulations and court judgments. Another definition of tax compliance is a person's act of filing their tax returns, declaring all taxable income accurately, and disbursing all payable taxes within the stipulated

period without having to wait for follow-up actions from the authority (Singh, 2003). Furthermore, tax compliance has also been segregated into two perspectives, namely compliance in terms of administration and compliance in terms of completing (accuracy) the tax returns (Chow, 2004; Harris, 1989). Compliance in pure administrative terms therefore includes registering or informing tax authorities of status as a taxpayer, submitting a tax return every year (if required) and following the required payment time frames (Ming Ling, Normala and Meera, 2005). In contrast, the wider perspective of tax compliance requires a degree of honesty, adequate tax knowledge and capability to use this knowledge, timeliness, accuracy, and adequate records in order to complete the tax returns and associated tax documentation (Singh and Bhupalan, 2001). In line with Singh and Bhupalan, Somasundram (2003, 2005a and 2005b) claimed that the wider perspective of compliance becomes a major issue in a self-assessment system since the total amount tax payable is highly dependent on the levels of tax compliance this perspective reveals, although it is inevitable that tax authorities will seek to 'influence' the areas taxpayers have influence over determining to reduce the risks of non-compliant behavior.

2.1.9 Factors Determining Tax Compliance Behavior

Jackson and Milliron (1986) listed fourteen main factors that have influenced tax compliance as discussed by various researchers. These factors are age, gender, education, income, occupation or status, peers' or other taxpayers' influence, ethics, legal sanction, complexity, relationship with taxation authority (IRS), income sources, perceived fairness of the tax system, possibility of being audited and tax rate. Various researchers have listed factors that influenced tax compliance such as demographic, income, compliance cost, and tax agents (Mohani, 2003), in addition to moral or ethical factors (Singh, 2003; Kasipillai et al., 2003).

(a) Fairness/Equity

According to James (2000), the most obvious requirement of equity or fairness is to treat equal people in equal circumstances in an equal way. The problem here is in deciding who is equal to whom. Similarly, Due and Friedlaender (1981), also argue that what is fair or equitable in taxation is inevitably a value judgment; no scientific specification of an equitable distribution pattern is possible, or people may be equal income wise while they may be unequal regarding

their expenditure, wealth, total utility and so on. Such a pattern can be specified only on the basis of a consensus of attitudes of persons in the contemporary society.

(b) Organizational Strength of Tax Authorities

According to Bird and Oldman (1967), no tax will work effectively, unless its administrators maintain an aggressive attitude with respect to the correctness of the taxpayers' actions. Some taxpayers will fail to file or make mistakes through ignorance or neglect; others will deliberately cheat. A passive attitude by the authorities towards these errors and falsifications will soon undermine the entire structure, since the diligent and honest taxpayers will almost in self-defense be forced to the level of the careless and dishonest. A tax administration which seeks compliance must protect those who comply or else compliance will not be forthcoming. Most commentators, policy makers, and tax administrators agree that voluntary compliance would be greatly facilitated by the existence of a simplified tax structure.

(c) Awareness level of Taxpayers

James (2000) argues that the norm is usually to comply rather than not to comply. As already pointed out for a tax system to be effective the majority of the taxpayers have to comply. It follows that there may be greater gains in assisting basically compliant taxpayers to meet their fiscal obligations than in spending more resources in pursuing the minority of non-compliers. Many taxpayers might be willing to comply in full, but are unable to do so because they are not aware of, or do not understand, their full obligations. Even if such tax payers understand their obligations, they may not know how to meet them or may be unable to do so for other reasons. On other side, other writers such as Smith and Kinsey (1987) argue that tax noncompliance is an intentional behavior.

(d) Taxpayers Attitude towards the Government

The presence of government expenditures may motivate compliance (Alm, Jackson, and Mckee, 1992; Andreoni, et al., 1998, Cowell and Gordon, 1988). Individuals may pay tax because they value the goods provided by the government, recognizing that their payments are necessary both

to help finance the goods and services and to get others to contribute. A tax payer therefore is seen as exchanging purchasing power in the market in return for the government services (Levi, 1988). Positive benefits may increase the probability that tax payers will comply voluntarily, without direct coercion. Without a material benefit, compliance becomes less assured. Although most tax payers cannot assess the exact value of what they receive from the government in return for taxes paid, it can be argued that they have general impressions and attitudes concerning their own and other' terms of trade with the government.

(e) Cultural Factors

Culture is considered to be a powerful environmental factor that affects the taxpayer's compliance. Different social norms and ethical values will create different incentives for tax compliance.

The cultural dimension of individualism relates to the degree of integration a society maintains among its members. A high individualism culture is signified by people focusing on themselves rather than on the group to which they belong. Under this perspective, an individual is seen as separable from and independent of a group affiliation. People in such low individualism culture as Chinese citizens, they tend to be collectivists who are expected to follow and subscribe to the values of their in-groups in order to gain peer acceptance and social status (Hofstede, 1991). In contrast, a high individualism culture such as US citizens is signified by people focusing on themselves rather than on the group to which they belong. Under this perspective, they view themselves as distinct entities and place great value on individual rights. These cultural differences may have a direct impact on ethical values and moral development and ultimately affecting tax compliance decisions.

(f) Social Factors

The issue of (non-) compliance is not only a question of state-society relationships but also a question of relationship between citizens and/ or groups of citizens within local communities.

There is an existing social bond between the society and this bond influences the members of the society in complying with the tax law. That is taxpayers may be influenced by their peer groups to comply or not to comply with the tax law. Peers are usually referred to taxpayers' associates and include friends, relatives and colleagues (Jackson and Milliron, 1986). The peer influence is reflected in an individual's expectations in relation to the approval or disapproval of that tax noncompliance behavior.

2.2 Prior Empirical Reviews

There are several theoretical and empirical studies on tax audit and tax compliance. These studies provide mixed reactions on the relationship between tax audit and tax compliance. Alm and McKee (2006) investigates the application of experimental methods to examine the individual compliance responses to a "certain" probability of audit, and conclude that the compliance rate rises if an individual knows he will be audited and the rate falls if he knows he will not be audited. Slemrod, Blumenthal, and Christian (2001) examines randomly selected taxpayers and inform them that their filling will be "closely examined" and found evidence of taxpayers' behavior changes in response to an increased probability of audit, although the responses are not uniform among different groups of taxpayers. Mittone (2006) investigated that early experience of audits in taxpayers' "tax life" is a more effective way to increase compliance than later audits. Also Kastlunger and Pitters (2009) study of experimental research also suggests that, although the effectiveness of audits and fines cannot be completely confirmed, early audits in taxpayers' "tax life" have a positive impact on compliance.

2.2.1 Probability of Detection and Tax Compliance

Allingham and Sandmo (1972) claimed that taxpayers will always declare their income correctly if the probability of detection is high. Probability of detection plays a significant role in reporting behavior as taxpayers will declare everything if they perceive that they will be one of the auditees in that particular year (Riahi-Belkaoui, 2004; Richardson, 2008). Slemrod, Blumenthal and Christian (1998) investigate the relationship between the probability of being audited and the taxpayers' responses. The experiment indicated that taxpayers' behavior varied with respect to level of income and the probability of being audited played a significant role in determining

taxpayers' evasion behavior. However, the direction of the relationship (positive or negative) was not clearly stated by Slemrod et al. (1988). Their result was also supported by Andreoni *et al.* (1998) who found that prior audit experience and continuous contact (relation) with the tax authority influenced and increase compliance among taxpayers. Conversely, Young (1994) and Slemrod et al. (2001) observed that probability of being audited again was negatively correlated with compliance behavior.

Bergman (1998) cited in Palil and Mustapha (2011) investigates tax compliance behavior in Argentina using two approaches; (1) the measures to enhance commercial taxpayers and (2) extensive campaigns and audits which will increase the probability of detection among individual taxpayers. The results suggested that as the number of audits and the probability of detection increased, taxpayers are encouraged to comply with tax laws and accurately report their income. This suggests that unintentional evasion may occur rather than intentional evasion. He also claimed that the lack of audits and investigations implemented by tax authorities in the 1980s in Argentina had driven taxpayers to behave 'recklessly'. Moreover, as taxpayers were aware that they would not be detected due to lack of investigations, they incorporated more complex tax evasion strategies and less traceable documentations so that they could pay less tax. Findings by Bergman are consistent with the theoretical proposition that the fear of detection influences the level of compliance behavior, suggesting that the evaders take precautionary measures when the perceived risk of detection is high.

2.2.2 Awareness of Offences and Penalties and Tax Compliance

According to Palil and Mustapha (2011), a theoretical economic model introduced by Allingham and Sandmo (1972) has clearly indicated that penalties as well as audit probability have an impact on tax compliance. The higher the penalty and the potential audit probability the greater the discouragement for potential tax evasion. However, the more complex models like principal agent theory and game theory suggest that penalties and audit probability are difficult to portray in compliance models as the results are determined endogenously with tax cheating (Andreoni *et al.*, 1998). They suggested that to overcome the endogeneity it is necessary to control the enforcement environment artificially by using laboratory experiment methods. This has been evidenced by Beck, Davis and Jung (1991) and Becker, Buchner and Sleeking (1987) through their experiments in which they found that penalty rates affect tax compliance in accordance with

the theory. However, an experimental approach does limit the environment to a narrow perspective compared to the real world. Bryman and Bell (2003) suggested that an experimental approach is only suitable for a study that can be addressed with a high degree of experimental arrangement and control. Nevertheless, an experimental approach for a tax compliance study might show a smaller effect or influence than for direct observation (Alm, Jackson and McKee, 1992). In addition, Marrelli (1984), Wang and Conant (1988), Gordon (1990), Marrelli and Martina (1988) found that penalty rates have a negative association with evasion. In contrast however, Virmani (1989) indicated results the other way around, in which penalty rates had a positive association with evasion, meaning that higher rates did indeed encourage people to cheat.

Since previous studies indicate that penalty rates impact upon tax compliance behavior, the awareness of offences was presumed to have a significant influence as well. If the taxpayers are aware of the offences they are committing when evading tax and the consequences of being non-compliant taxpayers, they might reduce their tendency to evade tax. On the other hand, if they are not aware of the implications of being dishonest in terms of the offence they are likely to be charged with if caught, they might be more inclined to cheat because they presume that they will not be detected and could save money. Thus, educating taxpayers and keeping them well informed with the sentences of being an evader may be important, as a prevention measure is better than cure (imposition of a penalty)

2.2.3 Tax Education

Previous literature supports the direct, positive relationship between educational level and taxpayer compliance (Jackson and Miliron 1986). Chan, Troutman, and O'Bryan (2000) also postulate that education level is directly linked to a likelihood of compliance. Educated taxpayers may be aware of non-compliance opportunities, but their potentially better understanding of the tax system and higher level of moral development promote a more favorable taxpayer attitude and greater compliance.

2.2.4 Tax Audit and Tax Compliance

Tax audits have been discussed in relation to tax compliance. Numerous studies such as Palil and Mustapha (2011), Jackson and Jaouen (1989); Shanmugam (2003) and Dubin (2004) reported

that tax audits have a positive impact on tax evasion. These findings suggest that in self-assessment systems, tax audits can play an important role and their central role is to increase voluntary compliance. Palil and Mustapha (2011) argued audits rates and the thoroughness of the audits could encourage taxpayers to be more prudent in completing their tax returns, report all income and claim the correct deductions to ascertain their tax liability. In contrast, taxpayers who have never been audited might be tempted to under report their actual income and claim false deductions.

Butler (1993) cited in Palil and Mustapha (2011), also found that tax audits can change compliance behavior from negative to positive. These findings complement the Witte and Woodbury (1985) and the Beron, Tauchen and Witte (1988) studies. Witte and Woodbury in their study of small proprietors found that tax audits have a significant role in tax compliance. They did not empirically test individual taxpayers, thus left open room to conduct research in this area. While Butler (1993) and Witte and Woodbury (1985) found significant results, Beron et al. (1988) found a contradictory result. They reported that audits did not significantly correlate with evasion for all groups they studied. Audits were found to be more effective in inducing taxpayers to over claim deductions rather than encouraging them to correctly report actual income (Beron et al., 1988).

From another point of view, Evans, Carlon and Massey (2005) studied the tax compliance of small and medium size enterprises (SME) in Australia. Their objective was to examine the relationship between record keeping practices of SMEs and the potential exposure to tax compliance problems. The study hypothesized that low tax compliance among SMEs might better encourage the tax authority to increase audits and investigations. This study involved 129 small business owners, 130 tax practitioners and Australian Tax Office (ATO) auditors. Using mail surveys, this study found that audit history, including frequency, audit outcome and the type of audit of small business owners has a significant indirect impact on tax compliance (in terms of record keeping). The result also evidenced that the primary objective of the small business owners doing their record keeping is tax compliance related rather than part of their management of their business. Thus, as the audits investigations increase, many SMEs will make more of an effort at proper record keeping.

From the foregoing, it is observed that previous studies have evidenced that tax audits play an important role in increasing voluntary compliance. Audits rates and the thoroughness of the audits could potentially encourage taxpayers to be more prudent in completing their tax returns.

2.3 Summary of literature review and knowledge gap

Tax compliance has been an important subject of research in a large number of developed and a number of developing countries. Since each country has its own approach to managing tax compliance levels and each has different tax laws and regulations, the factors impacting tax compliance behavior appear to vary among countries.

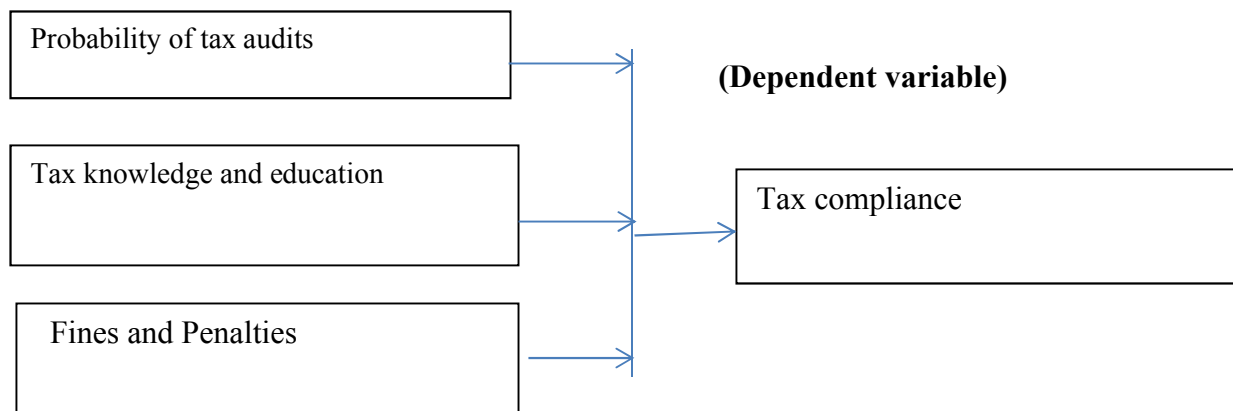
In the theoretical review, to the knowledge of the researcher, there is no standard as to the percentage of audit methodologies to be conducted in a given tax authority. In addition, there is no adequate literature regarding the appropriate audit examination techniques to be used for checking the accuracy of tax returns in line with the level of economy and technological advancement, developing countries in particular. The empirical studies that have been reviewed focused on factors affecting tax compliance behavior, Probability of tax audit particular, penalty and tax education and tax knowledge on improving the tax compliance. In addition, most prior studies regarding tax compliance issues tried to examine the factors affecting compliance improvement and fraud detection. However, to the knowledge of the researcher, it is possible to conclude that although there have been a number of studies on tax audit related issues both in developed and developing countries, Ethiopia in particular, there are no studies that exhaustively examine factors affecting tax compliance. In Ethiopia, exceptions regarding tax audit on tax compliance by Desta kasa (2010). Even these studies did not assess exhaustively the impact of tax audit activities in Ethiopia. The study by Desta kasa (2010) was mainly focused factors affecting voluntary tax compliance. These studies did not comprehensively examine issues regarding tax audit and its effect on tax revenue growth and compliance improvement by considering issues such as probability of tax audit, fines and penalty, tax fraud investigations, educational level and experience of tax payers in Ethiopia. Based on these gaps in the literature together with the problems stated in section 1.2, the following research question is established. “What is the relationship between tax audit and tax compliance in Ethiopia” With this end, the

next chapter discusses the research design and specific research methods that are applied for the study along with proper justification for the selection of appropriate research method

2.4 Conceptual Model

This study conceptualizes that the tax compliance could be affected probability of tax audit, tax knowledge and education, fines and penalties. study is therefore to test the nature and the strength of these relationships. Conceptual model presented in Figure 2.1

(Independent variables)



Source: *Researcher (2016)*

Figure 2.1: Conceptual model

CHAPTER THREE

3. RESEARCH DESIGN & METHODOLOGY

Research methods are the techniques used to collect data. In this study, the researcher adopted mixed methods approach; there are different tools available to the researcher to collect the required data including questionnaires, interview, and document analysis. For this study, the researcher applied quantitative and qualitative and are discussed in the following sub-sections

3.1 Research Design

The research design incorporates both quantitative and qualitative research methods so as to know “how often” or “how many” questions as well as the “why” for those actions to understand the reasons behind the perceived attitudes and feelings of the respondents. A case study was conducted at Bole Sub City Category ‘A’ taxpayers. Therefore, this study used descriptive research to examine the effect of tax audit on tax compliance of selected category ‘A’ taxpayers in Bole sub city of Addis Ababa city Administration. For this research, to utilize the strengths and overcome the weaknesses of qualitative and quantitative approaches, a mixed research method was employed.

3.2 Study Population

The study population includes all ERCA Audit division staff or tax auditors including tax officers of Bole Sub City.

Population under this research comprises ERCA Bole sub city audit officers who are 50 audit officers. Since the number of staff is not large, the study was census approach. The researcher administered 50 questionnaires out of which 47 questionnaire were completed and returned.

Inclusion Criteria:

- ❖ Being a staff of Audit division of Bole Sub City

Exclusion Criteria:

- ❖ Those who are still in probation period (less than 45 days of employment)
- ❖ Those who are on leave (e.g. Sick leave, maternal leave,...) during the data collection

3.3 Sources and Tools/instruments of Data Collection

A structured questionnaire was administered to the population group. Due to the fact that knowledge and perception of Tax officers is related to group dynamics, interaction, group values and norms as well as internal and external factors that positively or negatively affect their performance on tax compliance. On the other hand, in order to understand the views, trends and challenges of the management, a semi-structured key informant interview was conducted with officials of the Bureau. Tape recorder was used during the Key informant interview to capture all discussions with prior knowledge of discussion participants and the respective interviewee. In addition, secondary data from journals, literatures as well as official reports of ERCA was used during analysis.

In addition to the structured questionnaire, semi-structured key informant interview was also held with selected officials in Bole sub city revenue office. Key informant interview is used because of its flexibility. Moreover, it allowed depth to be achieved by providing the opportunity on the part of the interviewer to probe and expand interviewee's responses. This atmosphere enabled the researcher to clarify points and raise fresh questions so as to gain a deeper understanding (Patton, 2002).

3.4 Procedures of Data Collection

Data collection procedure includes structured questionnaire for quantitative data collection method; semi-structured questionnaire for the key informant interviews. A pre-test was conducted on 10 randomly selected tax Audit staff of another Sub city so as to make sure that the questionnaire is clear and understandable coupled with to avoid information contamination.

Those respondents of the study population were notified by division heads and the questionnaire was submitted by respective personnel or by the researcher as appropriate. In both cases, the researcher provided technical supervision during the data collection. Furthermore, the researcher conducted the semi structured questionnaire for the Key Informant Interview guide.

3.5 Methods of Data Analysis

Data analysis was done by SPSS window version 20. Dependent Variable which in this case is Tax compliance was analyzed against independent variables such as tax knowledge, probability of being audited and tax penalties. Quantitative data findings will be triangulated with the qualitative data findings and secondary data findings. .

Questionnaires received from respondents and interview schedules were checked for completeness with repeat calls being made for incomplete questionnaires to maintain the number of respondents. Categorization and coding was then done and data entered into SPSS for windows version 20 for analysis. Spearman Correlation and Multiple regressions analysis were also conducted. Finally, the results from SPSS Software were expressed using various descriptive statistical techniques like frequencies, percentages, means, etc.; and presented using tables and figures.

3.6 Description of Study Variables & Model Specification

❖ Dependent variable

Tax Compliance

❖ Independent variables

Probability of tax audits, tax knowledge and education, fine and tax penalties

3.6.1 Variable Measurement

In this study tax compliance was measured using three hypothetical questions. It is based on Palil (2010) and Troutman (1993) with some modification to suit our country's context. The use of

hypothetical questions can increase reliability of results and minimizes respondents' dishonesty when answering the questionnaire (Troutman, 1993). The respondents were asked to rate each hypothetical question whether as a taxpayer they would undertake the same action if they faced the same situation using 'strongly disagree' to 'strongly agree', using a Likert Scale of 1 to 5 respectively. The items that made up the scale include 1) probability of being audited; 2) tax penalties and 3) Tax knowledge.

3.6.2 Model Specifications

Analysis was done using Spearman correlation and multiple linear regression models. According to Coakes and Steed (2007), multiple regressions is an extension of bivariate correlation. They stated that the result of regression is an equation that represents the best prediction of a dependent variable from several independent variables. Regression analysis is used when independent variables are correlated with one another and with the dependent variable. The regression model used to test is shown below:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \epsilon$$

Where; Y = Tax compliance

A = Constant

β_1 , β_2 , and β_3 = Coefficient indicating rate of change of tax compliances as

Probability of tax audit, fines and penalties and tax knowledge
and education changes

X_1 = Probability of tax audit

X_2 = tax fines and penalties

X_3 = tax knowledge and education

ϵ = Error term

All the above statistical tests were analyzed using the Statistical Package for Social Sciences (SPSS), version 20. All tests were two-tailed. Significant levels were measured at 95% confidence level with significant differences recorded at $p < 0.05$.

3.7 Ethical Consideration

The researcher collected a formal letter from SMU to be handover to the Bole Sub city ERCA office. After the acceptance of the office, staff members were informed through appropriate department heads. As a self-administered questionnaire, the introduction of the questionnaire states the objective and purpose of the research. Respondents were be ensured that the information they provide will be kept confidential; for such reason, name or any specific issue which can expose the identity of the respondent were not be recorded. There were also statements indicating that the respondent is engaged on voluntary bases where to the respondent have the right not to answer any of the questions which they don't want to answer.

CHAPTER FOUR

4. ANALYSIS AND RESULTS

4.1 Introduction

This chapter deals with four sections. First section contains a summarized description of the personal characteristics of the respondents. The second section shows Audit resources include audit staffs, materials and equipment needed for facilitating audit work. The third section shows respondents' responses on motivational factors. The fourth section shows the association between tax penalty, probability of Audit and tax knowledge in various aspects (independent variables) and tax compliance. Analysis of measures, testing of hypothesis and summary of Regression analysis are examined under fifth section of the chapter

4.2 Demographic Information

Demographic information shows the characteristics of the elements in the sample size: As such the researcher sought to establish the general information of the respondents, which forms the basis under which the interpretations are made. Demographic factor 1 analyzed the gender of the respondents. This information was necessary to enable the researcher to obtain information on whether the respondents were either male or female. Accordingly, 31 (66%) of the respondents were male whereas 16 (44%) of them were female.

Demographic factor 2 shows the age groups of respondents, 27 (57.4%) of the respondents were below 30 years of age, whereas 20 (42.6%) of them were between 31-40 years of age. This result illustrates that most of the tax auditors in Bole sub city were generally young (below 30) years.

Table.4 1 Demographic Characteristics of Tax Auditors

		Frequency	Percent
Gender	Male	31	66
	Female	16	34
	Total	47	100
Age Group	Less than 30 years	27	57.4
	31-40	20	42.6
	41-50	0	0
	Above 50	0	0
	Total	47	100

Source: SPSS Output from Survey Data, 2016

4.3 Socio-economic status of respondents (Tax Auditors)

Educational levels, field of study and work experience of the tax auditors in general are the most important variables that can affect the performance of tax audit as well as tax administration system. In line with these attempts have been made to assess the educational level of the respondents, Field of study and work experience. Generally the respondent's socio-economic status is presented in Table 4.2.

Table 4.2 Socio- economic status of respondents

S.N.	Item		Frequency	Percentage
1	Educational back ground	BA/BSC	46	97.9
		MA/Msc	1	2.1
2	Field of Study	Accounting & Finance	41	87.2
		Economics	1	2.1
		Management	5	10.7
3	Work experience as Auditor	Less than 2 years	8	17
		2-4 years	21	44.7
		4-6 years	18	38.3

Source: SPSS Output from Survey Data, 2016

With regard to field of study, majority of the respondents were specializing in Accounting and Finance which accounts for 87.2% of the total respondents. The remaining 10.7 % and 2.1 % of the respondents were specializing in Business Management and Economics respectively. As indicated in Table 4.2, 17 % of the respondent Tax Auditors have service year of less than 2 years, 44.7% of the respondents have service years of 2-4 years and 38.3% of the respondents have service years of 4-6 years. This shows that above 83% of Bole sub City Revenue Authority's Tax Auditors have more than 2 years of work experience, as tax auditor. As it is discussed in the above paragraphs, the majority of the respondents have a good level of educational qualification that is BA or BSc degree and MSc Degree which enables the respondents to have idea of the Tax Audit. Moreover, majority of the respondents studied the field related to business which enables them to understand the implementation of taxes and related issues.

4.4 Audit Resources

Table 4.3: Responses on Audit Resources

Possible Measures	Percentage				
	Strongly agree	Agree	Neutral	Disagree	Strongly disagree
Tax administration has enough audit staff resources to perform onsite audits on all taxpayers	2.1	17	27.7	48.9	4.3
Enough material and equipment for audit program	2.1	17	29.8	47	4.1
Qualified audit staff /well experienced staffs are available	0	4.3	29.8	61.6	4.3
Well organized structure and suitable office	2.1	2.1	27.7	61.7	6.4

Source: SPSS Output from Survey Data, 2016

According to the above table, more than 48.9 % of respondents indicated that ERCA has not enough audit staff to perform onsite audit on all taxpayers. Table 4.3 indicates that only small

portion of the respondents 17 % were agreed that the authority has enough staff s to conduct on site audit. For the effective and efficient tax audit not only the skill and qualification of tax auditors but also adequate number of tax auditors, materials and equipment necessary for audit have greater impact. The same Table shows that ERCA has no enough materials and equipment to facilitate audit program. 61.7 % of the respondents were confirmed that the Authority have no well experienced audit staffs to perform audit activities.

4.5 Motivational Factors

As it is shown below in Table 4.4, the respondents were in favor of the responsible citizens’ approach such as educating tax payers, improving relationship with public, providing necessary information about the utilization of the revenue collected, and making the collection system simple and transparent as motivational factors. More details of the results are depicted in table 4.4 below.

Table 4.4: Responses on Motivational Factors

Possible Measures	Percentage				
	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
Strengthening legal enforcement and penalties	8.5	27.7	19.1	36.2	8.5
Improving relationship with the public.	19.1	70.2	10.6	0	0
Educating the taxpayers and conducting consultation sessions	17	78.7	0	4.3	0
Reducing tax rates and making the collection procedures simple and transparent	42.6	25.5	23.4	2.1	6.4

Source: SPSS Output from Survey Data, 2016

Table 4.4 shows a significant size, 36.2% of tax auditors disagrees that strengthening legal enforcement and penalties by itself can't ensure voluntary tax compliance behavior. These people rather have the belief that encouraging the responsible citizens' approach has to be the axis of the motivational factor. Regarding the other measures almost all of the respondents agreed with the possible measures proposed in the study. It is evident from the table that the majority of the respondents felt that improving relationship with the public (70.2%) respondents agrees and making the collection procedures simple and transparent (42.6%) could motivate them to pay their fair share of taxes voluntarily. Similarly, conducting different consultation session and educating tax payers (78.7 percent) is another possible measure which is strongly proposed by the respondents as other motivational factors in the study .

4.6 Tax compliance

Findings on tax compliance reveal that If the tax authority has limited capability to investigate all income reported to them, so people have an opportunity to not report their exact income regarded as the highest score value (mean 3.77), followed by the amount of taxable amount and profit is declared by the taxpayer so, it is not wrong to omit or understate the taxable income and the profits declared (mean 3.64), and If one is paid in cash for a job and then not reporting it in the tax return is regarded as the lowest score value (mean=3.62)

Table 4.5: Responses on Tax Compliance

	Mean	Std. Deviation	Min.	Max.
Since the amount of taxable amount and profit is declared by the taxpayer so, it is not wrong to omit or understate the taxable income and the profits declared	3.64	.845	2	5
If one is paid in cash for a job and then not reporting it in the tax return	3.62	.822	1	5
If the tax authority has limited capability to investigate all income reported to them, so people have an opportunity to not report their exact income	3.77	.666	1.298	1.298
Tax Compliance	3.68	0.78	1.67	5

Source: SPSS Output from Survey Data,2016

4.7 Probability of tax audit

Findings on probability of tax audit reveal that tax auditors, investigators and assessors expected to perform during an audit period is detecting noncompliance behavior of individual taxpayer regarded as the highest score value (mean 4.00), followed by tax audit improves the level of compliance (mean 3.89), and high probability of audit solves the problems of tax evasion, avoidance and other irregularities is regarded as the lowest score value (mean=3.85).

Table 4.6: Responses on Probability of tax audit

	Mean	Std. Deviation	Min.	Max.
Tax audit improves the level of compliance	3.89	.521	3	5
Tax auditors, investigators and assessors expected to perform during an audit period is detecting noncompliance behavior of individual taxpayer	4.00	.511	3	5
High probability of audit solves the problems of tax evasion, avoidance and other irregularities.	3.85	.955	2.298	1.298
Probability of tax audit	3.91	0.66	2.67	5

Source: SPSS Output from Survey Data, 2016

4.8 Fines and Penalties

Findings on Fines and Penalties reveal the prospect of tough penalties deter people from evading tax regarded as the lowest score value (mean=3.00), Tax payers who possess an awareness of penalties for noncompliance are more compliant than those who do not possess such awareness regarded as the highest score value (mean 3.77), followed by If there is no penalty or legal enforcement there is a possibility that tax payers may not pay tax (mean 3.72)

Table 4.7: Responses on Fines and Penalties

	Mean	Std. Deviation	Min.	Max.
The prospect of tough penalties would deter people from evading tax	3.00	.885	2	5
Tax payers who possess an awareness of penalties for noncompliance are more compliant than those who do not possess such awareness	3.77	.666	2	5
If there is no penalty or legal enforcement there is a possibility that tax payers may not pay tax	3.72	.772	2.298	1.298
Fines and Penalties	3.50	0.77	2	5

Source: SPSS Output from Survey Data, 2016

4.9 Tax Knowledge and Education

Findings on tax knowledge and education reveal that teaching tax evaders to deal effectively with their taxes would reduce future offences regarded as the highest score value (mean 4.43), followed by the awareness of tax audit makes the tax payers to render a satisfactory returns(mean 4.13), tax evasion could be best handled though informing & encouraging tax payers to comply voluntarily (mean 4.06) and Tax audit performed in tax administrations is to educate taxpayers is regarded as the lowest score value (mean=3.83)

Table 4.8: Responses on Tax Knowledge and Education

	Mean	Std. Deviation	Min.	Max.
Teaching tax evaders to deal effectively with their taxes would reduce future offences	4.43	1.098	1	5
Tax evasion could be best handled though informing & encouraging tax payers to comply voluntarily	4.06	.639	3	5
The awareness of tax audit makes the tax payers to render a satisfactory returns	4.13	.494	3	5
Tax audit performed in tax administrations is to educate taxpayers.	3.83	.601	2.298	1.298
Tax Knowledge and Education	4.11	0.71	2.25	5

Source: SPSS Output from Survey Data, 2016

4.10. Analysis of Measures

4.10.1. Reliability Test

The Cronbach's coefficient alpha was tested. Table 4.10 reports the alpha scores for all the variables. As proposed by Nunnally (1967 & 1978), The Cronbach's alpha coefficient was within the acceptable level of reliability of 0.70 for scale acceptability.

Table 4.9: Cronbach's Alpha for Determinant Factors and Tax compliance

Reliability Statistics	
Cronbach's Alpha	N of Items
.796	12

Source: SPSS Output from Survey Data, 2016

4.11 Correlation Statistic

Correlation statistics is a method of assessing the relationship between variables/factors. To be precise, it measures the extent of association between the ordering of two random variables. Thus, the study analyzed the relationships that are inherent among the independent and dependent variables as well as among the independent variables/ factors. The results regarding this were summarized and presented in table 4.9 below.

Spearman Correlations results in table 4.9 showed that tax fines and penalties was positively and significantly correlated to tax compliance ($r=0.604$, $\rho<0.05$). Thus tax penalty had 60.4% positive relationship with tax compliance. Probability of tax audit was the second component to be positively related with tax compliance ($r = 0.299$, $\rho<0.05$) an indication that tax audits had 29.9% significant positive relationship with tax compliance.

Finally, tax knowledge was significantly & positively correlated to tax compliance ($r=0.316$, $p<0.05$). Therefore, tax compliance cost had 31.6% positive relationship with tax compliance.

Table 4.10 Correlation Statistics

	TAXCOMP	TAXAUDIT	PENALTY	TAXKNOW
Correlation Coefficient	1.000	.299*	.604**	.316*
TAXCOMP Sig. (2-tailed)	.	.041	.000	.030
N	47	47	47	47
Correlation Coefficient	.299*	1.000	-.059	.118
TAXAUDIT Sig. (2-tailed)	.041	.	.693	.429
N	47	47	47	47
Correlation Coefficient	.604**	-.059	1.000	.175
PENALTY Sig. (2-tailed)	.000	.693	.	.239
N	47	47	47	47
Correlation Coefficient	.316*	.118	.175	1.000
TAXKNOW Sig. (2-tailed)	.030	.429	.239	.
N	47	47	47	47

Source: SPSS Output from Survey Data, 2016

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

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

4.12 Results of Regression Analysis

A Multiple linear regression model was used to predict tax compliance in the study. The prediction was carried out basing on the effect of the three independent factors: probability of tax audit, tax fines and penalties and tax knowledge and education. In addition, the β coefficients for each independent variable generated from the model was subjected to a t-test, in order to test each of the hypotheses under study. The study thus came up with a

model summary, the ANOVA and the regression model as presented in tables 4.10, 4.7 and 4.8.

From table 4.10, The result shows that the R-square with a value of 0.628 implies that about 62.8% of the changes in tax compliance could only be explained by repressors namely; probability of being tax audited (TAXAUDIT), penalties and enforcement (PENALTY) and tax knowledge and education (TAXKNOW) while about 37.2% of the changes in tax compliance (TAXCOMP) could be explained by other factors not included in the model.

Table 4.10: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.792 ^a	.628	.602	.42061

a. Predictors: (Constant), TAXKNOW, TAXAUDIT, PENALTY

The ANOVA model in table 4.11 showed that the regression model was also adequate. The effect size of the regression model was shown to be over 24 that contributed by the residual mean sum of squares. The F-ratio was 24.152. This represented the effect size of the regression model and was significant with a p-value of 0.000.

Table 4.11: ANOVA Model

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	12.818	3	4.273	24.152	.000 ^b
	Residual	7.607	43	.177		
	Total	20.426	46			

a. Dependent Variable: TAXCOMP

b. Predictors: (Constant), TAXKNOW, TAXAUDIT, PENALTY

4.13 Coefficients Model

The regression results in table 4.12 show that each of the predicted parameters in relation to the

independent factors were significant; $\beta_1 = .303$ (p-value = 0.002 which is less than $\alpha = 0.05$) which implies that we reject the null hypothesis stating that there is no significant relationship between probability of tax audit and tax compliance. This indicates that for each unit increase in probability of tax audit, there is 0.303 units increase in tax compliance.

The table also shows that $\beta_2 = 0.664$ (p-value = 0.000 which is less than $\alpha = 0.05$) which indicates that we reject the null hypothesis stating that there is no significant relationship between tax fines and penalties and tax compliance. This implies that for each unit increase in tax fines and penalties, there is up to 0.664 unit increase in tax compliance.

The value of $\beta_3 = 0.204$ (p-value = .037 which is less than $\alpha = 0.05$) which implies that we reject the null hypothesis stating that there is no significant relationship between tax knowledge and education and tax compliance. This indicates that for each unit increase in tax fines and penalties, there is up to 0.204 units increase in tax compliance.

Table 4.12: Coefficient Model

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	-2.270	.905		-2.508	.016
1 TAXAUDIT	.436	.134	.303	3.258	.002
PENALTY	.809	.115	.664	7.008	.000
TAXKNOW	.365	.170	.204	2.150	.037

a. Dependent Variable: TAXCOMP

4.14 Discussion of the Findings

As stated by **Hypothesis 1** that probability of tax audit have no significant effect on tax compliance. Research findings are not in agreement with the hypothesis since probability of tax

audit has coefficient estimate ($\beta_1 = 0.303$, p value =0.002), audit probability have positive effect on tax compliance, thus the higher the potential audit probability the greater discouragement for potential tax evasion. Therefore, the hypothesis that audit probability has no significant impact on tax compliance behavior of tax payers has been rejected, this in agreement with Allingham and Sandmo (1972) claimed that taxpayers will always declare their income correctly if the probability of audit is high. Probability of audit plays a significant role in reporting behavior as taxpayers will declare everything if they perceive that they will be one of the auditees in that particular year

Hypothesis 2 states that tax fines and penalties have no significant effect on tax compliance. Research findings are not in agreement with the hypothesis since fines and penalties has coefficient estimate ($\beta_2 = 0.664$, p value =0.000), hence hypothesis 2 does not hold. Higher fines simply reduce the cases of tax evasion thus encouraging tax compliance, this in agreement with According to Palil and Mustapha (2011), a theoretical economic model introduced by Allingham and Sandmo (1972) has clearly indicated that penalties as well as audit probability have an impact on tax compliance. The higher the penalty and the potential audit probability the greater the discouragement for potential tax evasion.

Hypothesis 3 states that tax knowledge and education has no significant effect on tax compliance. Research findings are not in agreement with the hypothesis since tax knowledge and education has coefficient estimate ($B_3 = 0.204$, p value =0.037). A high level of tax knowledge and education contributes immensely to tax compliance This in agreement with studies by (Mohd, 2010) asserts that tax knowledge is necessary to increase public awareness on taxation rules and the role of taxation in national development. Once individuals have the knowledge pertaining the importance of taxation, they will be influenced to comply without any enforcements or pressure on them.

CHAPTER FIVE

5. SUMMARY OF FINDINGS, CONCLUSIONS AND RECCOMENDATIONS

5.1 Introduction

The general objective of this study is to analyze The Impact of Tax Audit on the Tax compliance in Bole Sub City, Addis Ababa City Administration. The target population consists of all tax auditors bole sub city; According to Bole Sub City, Addis Ababa City Administration records, there are around 50 tax auditors. The study also made interpretation on the hypothesis that probability of tax audit, tax knowledge and education, fines and penalties have no significant effect on tax compliance level.

5.2 Summary of Findings

Findings on gender revealed that there are more male than females among the respondents indicating that more men than female are tax auditors. It was also affirmed that majority of the respondents were less than 30 years. It was also brought to light that majority of respondents were fairly educated, those with a undergraduate degree contributing the highest percentage levels of literacy among the respondents.

A determination of the effect of probability of tax audit on tax compliance revealed a strong positive correlation meaning that probability of tax audit has a significant positive effect on the level of tax compliance. This means that higher probability of tax audit will increase tax compliance levels.

The study also examined the effect of tax knowledge and education on tax compliance level. Accordingly, the findings show that there is a strong positive relationship between the two

implying that enhanced knowledge on taxation will in turn enhance tax compliance.

An assessment of the effect of fines and penalties on tax compliance levels also revealed that there is a significant positive relationship between them. This implies that an effective use and enforcement of fines and penalties on tax offenders will enhance levels of tax compliance.

5.3 Conclusions

These study findings provide direct evidence that probability of tax audit is a contributory factor in tax compliance, and an indication of its magnitude effect. From the study findings there is enough proof to conclude that probability of tax audit is associated with high levels of tax compliance.

The study also provides some preliminary evidence that fines and penalties play a vital role in improving tax compliance. Specifically, for a tax system with fair tax rates of fines and penalties, tax compliance is likely to improve.

Finally, the study concludes that tax knowledge and education has a significant effect on tax compliance. It is therefore prudent for the tax system to enhance education on how to file tax returns and the importance of paying tax.

5.4 Recommendations

- ✓ An effective compliance program requires tax administration to have sufficient powers that enable it to enforce compliance effectively. To encourage compliance it is important that tax authority administers the law fairly. The tax authority needs to be strong enough in order to implement the tax law effectively and efficiently. Functions such as tax assessment, collection, awareness creation, providing information, and enforcement has to performed effectively and efficiently, so that it will be perceived as strong and powerful by the taxpayers.

In addition to this, efficient service delivery to taxpayers is a key factor against which the strength of the authority is judged. Taxpayers tend to evade to the extent they feel that the authority is weak and unable to enforce the law. This directly motivates non compliers to

continue evading. Hence, to create an efficient tax administration, the tax authority needs to strengthen itself by educating and training its employees, by computerizing its operations and by devoting additional resources.

- ✓ There should be more preventative education for the public and increased awareness of tax responsibilities. Tax payers should be educated early in their career about tax responsibilities. Only through tax education concepts of taxation and tax knowledge can be communicated. Furthermore, taxpayers need more information about their tax obligations and their role in promoting the growth of the economy of the country and the well-being of its citizens. The tax education can be a tool to motivate voluntary compliance by taxpayers. In the context of reaching to the society at large, the tax authority can use the electronic media such as radio, television, etc as a means to educate taxpayers and change their perceptions about taxation. All of these promote a positive view to voluntary compliance. This is to teach in citizens a sense of responsibility toward taxes.

5.5 Direction for Future Research

As identified by Jackson and Milliron (1986) there are fourteen main factors that affect tax payers' voluntary compliance behavior but the current study has used only three variables out of the fourteen variables to check whether these variables affects tax compliance of tax payers in the study area or not. The result from the study shows that these are the factors affecting voluntary compliance of tax payers in Bole Sub City, Addis Ababa City Administration.

So, interested researchers can extend the same topic by incorporating more variables in to the model that are expected to affect taxpayers' voluntary compliance behavior.

Another possible research would be to change the sample population to category "A" and Category "B" taxpayers by increasing the sample size and then make a comparative study between taxpayers with book of accounts and taxpayers who have no book of accounts; to find out if there are any significant difference between these groups of taxpayers' attitude towards taxation

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Appendices

Appendix I: Tax auditors and investigators survey instrument

St. Mary's University
School of Graduate Studies
MBA in Accounting and Finance

Questionnaire to be filled by Tax Auditors

This questionnaire is designed to meet the objective of research titled “The impact of tax audit on tax compliance: The case of category A tax payers in Bole sub city, Addis Ababa City Administration” Therefore; the data from this questionnaire will help the researcher to obtain reliable and valid information. Your open and genuine response is highly appreciated.

The questionnaire has two parts: Part -I is about your personal information. Part-II is the overall questions about the impact of tax audit on tax revenue. Please read each item carefully and give your honest response to each item.

Thank you for your cooperation!

Ephrem Bedada

Part –I: Background Information

Please provide your responses by marking a tick (√) in the relevant boxes.

1. Gender:

1. Male 2. Female

2. Age:

1. Less than 30 years 3. 41-50 years

2. 31-40 years 4. Above 50 years

3. Education:

1. Certificate

3. BSc/BA

2. Diploma

4. MSc/MA and above

4. Field of study:

1. Accounting & finance

3. Management

2. Economics

4. Others, please specify _____

5. Current job occupation:

1. Tax auditor

4. Tax assessor

2. Tax investigator

5. Tax audit director

3. Tax audit coordinator

6. Others, please specify _____

6. Did you have any audit experience before you joined the ERCA?

1. Yes

2. No

7. If your answer in question #6 is yes, how long did you work as an auditor?

1. Less than 2 years

4. 6-10 years

2. 2-4 years

5. Above 10 years

3. 4-6 years

8. How long did you work with your current job occupation in the ERCA?

1. Less than 2 years

4. 6-10 years

2. 2-4 years

5. Above 10 years

3. 4-6 years

9. Does ERCA provide training, tutor and/or exam regarding tax law and tax audit issues soon you employed before you engage in tax audit activities?

1. Yes

4. Sometimes

2. Usually

5. No

3. Neutral

10. Does ERCA perform a continuous assessment to improve the capability or competency of staff resources, auditors and investigators in particular, after you occupied the current position and engaged in the tax audit and related activities?

1. Yes

3. Sometimes

2. Usually

4. No

5. Neutral

Put a “√” mark in one of the columns provided for each possible indicator. Use the scales: Strongly agree (5), Agree (4), Neutral (3), Disagree (2), strongly disagree (1)

S.N	Questions regarding Tax compliance	Strongly agree	Agree	Neutral	Disagree	Strongly disagree
11	Since the amount of taxable amount and profit is declared by the taxpayer so, it is not wrong to omit or understate the taxable income and the profits declared.					
12	If one is paid in cash for a job and then not reporting it in the tax return					
13	If the tax authority has limited capability to investigate all income reported to them, so people have an opportunity to not report their exact income.					
	Questions regarding to motivate Tax payers to pay tax					
14	Strengthening legal enforcement and penalties					
15	Improving relationship with the public.					
16	Educating the taxpayers and conducting consultation sessions					

17	Reducing tax rates and making the collection procedures simple and transparent					
	Questions regarding tax penalties					
18	The prospect of tough penalties would deter people from evading tax					
19	Tax payers who possess an awareness of the penalties for non compliance are more compliant than those who do not possess such awareness					
20	If there is no penalty or legal enforcement there is a possibility that tax payers may not pay tax					
	Questions regarding tax Education					
21	Teaching tax evaders to deal effectively with their taxes would reduce future offences					
22	Tax evasion could be best handled though informing & encouraging tax payers to comply voluntarily					
23	The awareness of tax audit makes the tax payers to render a satisfactory returns					
24	Tax audit performed in tax administrations is to educate taxpayers.					
	Questions regarding probability of being audited					
25	Tax audit improves the level of compliance					
26	Tax auditors, investigators and assessors expected to perform during an audit period is					

	detecting noncompliance behavior of individual taxpayer.					
27	High probability of audit solves the problems of tax evasion, avoidance and other irregularities					
	Questions regarding tax audit resources					
28	Tax administration has enough audit staff resources to perform onsite audits on all taxpayers					
29	Enough material and equipment for audit program					
30	Qualified audit staff /well experienced staffs are available					
31	Well organized structure and suitable office					
	Questions regarding frequency of tax audit					
32	Every businesses audited once a year					
33	Every businesses audited once within two years					
34	Tax auditor or investigator usually performs the audit work repetitively					
35	Taxpayers that were audited in the previous audit period and found no tax liability during an audit is not selected for the next audit					

Thank you for your cooperation

Appendix II - Tax official's in-depth interview instrument

1. What is the primary purpose of conducting an audit?
2. Could you tell me the level of taxpayer's tax awareness and compliance behavior for Ethiopian tax system? If they are not aware, what ERCA plans to do regarding awareness creation and compliance improvement?
3. Do you believe that ERCA has currently collecting the potential amount of tax revenue? If yes, how is it achieved? If not, could you tell me the reason behind, and on what audit cases should ERCA concentrate in its audit work?
4. Which category of taxpayers and sectors are usually selected for tax audit? What would be the reason behind this selection?
5. How audit cases are selected? What are the bases considered for selecting the audit case?