



**ST. MARY'S UNIVERSITY
SCHOOL OF GRADUATE STUDIES**

**THE EFFECT OF TAX KNOWLEDGE AND PENALTY ON TAX
COMPLIANCE THE CASE OF MINISTRY OF REVENUE WEST
ADDIS ABABA SMALL TAXPAYERS**

**BY
SENAIT ESTIFANOS**

**JUNE 2022
ADDIS ABABA, ETHIOPIA**

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**BY
SENAIT ESTIFANOS
(SGS/0553/2013)**

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DECLARATION

I, the undersigned, declare that this thesis is my original work; prepared under the guidance of Dereje Teklemariam (Associate Professor). All sources of materials used for the thesis have been duly acknowledged. I further confirm that the thesis has not been submitted either in part or in full to any other higher learning institution for the purpose of earning any degree.

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ENDORSEMENT

This thesis has been submitted to St. Mary's University School of Graduate Studies for examination with approval as a university advisor.

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ABSTRACT

This thesis aimed as to depict the effect of Tax Knowledge and Penalty on tax compliance at Ministry of Revenue West Addis Ababa small taxpayers branch office. To attain the objectives of this study explanatory research design was used. From the total population 11,815, by using convenience sampling technique, 400 participants were involved in this research. Data was collected through questionnaire from a sample of 400 taxpayers of Ministry of Revenue West Addis Ababa small taxpayers branch office. The data collected from the questionnaire were analyzed using statistical tools such as mean, standard deviation, correlation, and multiple regression analysis. The results of this study indicate that, general tax knowledge, legal tax knowledge, procedural tax knowledge, and tax penalty have positive and significant relationship to tax compliance. Additionally, the above-mentioned general tax knowledge, legal tax knowledge, procedural tax knowledge, and tax penalty significantly contribute 52% to tax compliance in Ministry of Revenue West Addis Ababa small taxpayers branch office. Based on the findings of the study, the researcher mentioned recommendations that the branch office should employ the best practices of general tax knowledge, legal tax knowledge, procedural tax knowledge, and tax penalty and should emphasizing more on doing extensive tax education and training schedules.

Keywords: General tax knowledge, Legal tax knowledge, Procedural tax knowledge, and Tax penalty

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Governments spend a lot of money to provide infrastructure and other social services to their citizens. They need significant funding to accomplish these tasks. Taxation is one of the most important and reliable sources of income for the government, especially in developing countries, and it contributes more than any other source of income. Taxes are one of the sources of financing for government sustainability, and most economies rely on them to meet spending needs. In this regard, a tax is imposed by the government on an individual's or an organization's income or profits to fund public expenditure to provide social services or facilitate infrastructure. However, many countries around the world, developed and developing, suffer from a high rate of noncompliance because taxpayers do not always comply with their tax obligations (Alkhatib et al.,2018; Alleyne & Harris,2017). Failure to provide the tax amounts due to taxpayers necessarily implies a financial gap in countries' budgets, as the amounts collected from taxes are usually spent in support of societal activities and infrastructure in the state, and the risk of non-compliance is that the amounts that are not committed to paying are relatively large, as specialized government economic reports around the world confirm that tax non-compliance costs the global public treasury(Majed, Amjad & Mohammad,2020).

Compliance with the tax law typically means true reporting of tax bases, correct computation of the tax liability, timely filing of returns, and timely payment of the amount due. Tax compliance can be described as the degree to which a taxpayer obliges to tax rules and regulations. James and Alley (2004) pointed out that tax compliance is the willingness of individuals and other taxable entities to act in accordance with tax law and administration without the application of enforcement activity. Academic scholars frequently do extensive research on tax compliance or non-compliance in the field of taxation in order to establish the relationship between economic and non-economic factors on tax compliance behavior. The problem of tax compliance is as old as taxes themselves. It is broadly assumed that tax non-compliance and tax evasion exist in every country (Palil, 2011). Both developed and developing countries face major challenges in seeking to ensure that their revenue agencies are efficient and effective in collecting as much of the legitimate tax revenues due from taxpayers as they possibly can (Loo, Evans and McKerchar, 2010). Many problems are observed

in the areas of the tax process. Ethiopia, like any other developing nations, faces considerable difficulties in producing revenues to the level needed for the advancement of its economic development. Hence, the country has been experiencing a consistent surplus of expenditure over revenue for a sufficiently long period of time Vadde, (2012). The level of tax compliance in developing countries can be affected by several factors, such as attitudes, penalties, income, education, knowledge, gender, age, corruption, high marginal tax rates, lack of access to information and accounting systems, a large informal sector, poor regulation, ambiguity in tax law, non-compliant culture, and ineffectiveness of tax administration. Furthermore, taxpayers are not always willing to fulfill their legal obligations and naturally want to reduce their tax liability through tax evasion or tax avoidance. This could result in incorrect tax returns and a loss of government revenue.

Among the major factors influencing taxpayers' compliance is the level of tax knowledge that enables the government to meet its ever-increasing tax obligations. Tax knowledge can be defined as the understanding or knowledge acquired by the taxpayer related to taxation. Tax understanding is the degree of knowledge and power of taxpayers to control and implement tax obligations. Tax knowledge is the ability to understand basic tax concepts applied within a country (Alkhatib & Abdul Jabbar, 2017). Understanding tax policies by taxpayers helps in accepting the tax system and increasing compliance. Taxpayers may not be able to comply if the taxpayer does not understand taxation. A study concluded that the technical and cognitive skill in filing tax returns is a factor affecting tax compliance. Another factor that may affect the taxpayer's compliance is the imposition of penalties on non-complaints. Tax sanctions are a guarantee of compliance with the provisions of the tax legislation that will be obeyed. A tax penalty is a punitive measure that the tax law imposes for the performance of an act that is proscribed, or for the failure to perform a required act such as failure to timely file return or filling wrong or undervalued returns, etc. Research by Erani & Meiliana, (2016) and (Siregar, 2017) shows that tax penalties in the form of fines affect taxpayers' compliance. If the imposition of tax penalties is executed regularly and in an orderly manner, tax penalties will increase the compliance of the corporate taxpayers themselves. Tax penalties in the form of fines have an important role in providing lessons for those who violate taxation rules and taxpayers will comply with taxes if the sanction is more inflicting financial loss. This study has examined the effect of tax knowledge and penalty toward tax compliance among small businessowners, specifically west Addis Ababa small taxpayers at the federal level.

1.2 Statement of the Problem

There has been a lot of attention paid to taxpayers' tax knowledge and compliance behavior. Taxpayers' knowledge of tax law is critical for tax authorities to improve the tax system and, as a result, encourage taxpayer compliance. As a result, obtaining knowledge and understanding of taxpayer attitudes and compliance behavior is an important issue for any government and revenue-collecting authority, particularly in a self-assessment environment. However, in developing countries, the study of taxpayers' tax knowledge is questionable, as they are more focused on studies that will increase their budgets in terms of huge revenue collection and enforcement efforts. Taxpayer compliance can be influenced by several factors, including the existence of government policies and programs, taxpayer awareness of tax payment, knowledge and understanding of tax regulations, tax sanctions, and tax services (Listyowati et al.,2018). It may also be affected by administrative systems, information and accounting systems, tax enforcement systems, tax audits, tax rates, education levels, and income levels. Taxpayer awareness of paying tax on time would affect the high and low levels of tax compliance (Lestari & Wicaksono,2017). Therefore, raising tax awareness means understanding the taxpayer's attitude or an individual taxpayer's understanding of the meaning, function, and purpose of tax compliance. Various studies have shown that tax awareness is very similar to a taxpayer's ability to understand and accept the tax laws and regulations. Tax knowledge shapes attitudes and, as such, influences the behavior of taxpayers' compliance behavior. Oktaviani, Kurnia, Sunarto and Udin (2020) argued that improving the tax knowledge of taxpayers will, logically, improve their level of compliance. However, taxpayers from developing countries commonly do not have adequate knowledge of tax systems and their related practices (Pertiwi, Iqbal & Baridwan,2020).

There are various ways to improve a taxpayer's tax knowledge, as well as tax knowledge elements. Tax knowledge can be divided into three categories: general tax knowledge, legal tax knowledge, and procedural tax knowledge (Bornman & Ramutumbu,2019). According to them general tax knowledge is concerned with the need to be fiscally aware; legal tax knowledge is concerned with the need to understand regulations, and procedural tax knowledge is concerned with understanding tax compliance procedures. Tax penalties are the enforcement of regulations in taxation that are imposed for the creation of tax compliance. Indicator variables used in this study were adopted from instruments adopted by (Oladipupo & Obazee,2016). The indicators include tax penalties that follow tax regulations, fines as the penalty compliance fulfills the principle of justice, penalties as

the sanction are imposed to create compliance taxpayers, and taxpayers who do not comply are subject to the applicable sanctions. Meiselman (2018) investigated the most efficient way to improve tax compliance through a communication campaign from the government. He found out that the inclusion of the threat of incurring a penalty in the communication message is the most effective measure to change taxpayers' behavior.

Studies on the influence of tax knowledge and penalties on taxpayers' compliance have yielded different results. A study by Arvian and Djani (2018), Nurkhinet al. (2018) and Nurkin (2018) found that taxpayers' awareness and tax knowledge have a positive effect on taxpayer compliance. However, the results of this study contradict the findings of Famami and Norsain (2019); as they pointed out that the taxpayers' awareness had no significant effect on tax compliance. Studies on the effect of penalties on taxpayers' compliance behavior found that the findings of (Arvian & Djani,2018) showed penalties had a significant effect on taxpayers' compliance, while findings by Rahmawati and Julian, (2018) and Famami and Norsain (2018) reported that tax penalties do not affect taxpayer compliance.

In Ethiopia, there are a few studies regarding the effects of tax knowledge and penalties on tax compliance, but they are not exhaustively done and remain open for detailed research. The research was done by Zelalem (2011) on "The Influence of Tax Education on Tax Compliance Attitude" using a quantitative research approach that concludes that the level of tax compliance is influenced by tax education. The research was done by Amina, (2013) on "Determinants of Tax Compliance: The Case of Jimma Town" using Pearson's correlation matrix and a Logistic Regression Model was used to identify the main factors that determine tax compliance, and her results show that tax rate, probability of detection, penalty rate, reference group, and tax knowledge are the determinants of tax compliance. And also, the research done by Tilahun, (2016) on 'Determinants of Tax Compliance Behavior in Ethiopian: The Case of Bahir Dar City by using one-way ANOVA, two samples, and one sample T-test, this study examined the determinants of tax compliance behavior in Ethiopia, particularly in the Bahir Dar city administration, and the results revealed that tax knowledge and penalty are among the determinants of tax compliance and significantly affect tax compliance behavior. In the study by Messay (2019) on Tax Assessment and Collection Problems in the Addis Ababa sub-city, the findings indicated that most taxpayers lack tax knowledge of assessment and collection methods, rules, and regulations.

Ethiopian taxpayers showed varying levels of tax knowledge. As for the researcher's knowledge, it was not fully covered as the issue of taxpayers' tax knowledge is a major one that should be thoroughly researched. Currently, the Ethiopian government is not collecting enough taxes, and citizens are not complying. The relationship between tax knowledge and tax compliance, as well as penalties and compliance, are not well explained and understood due to a lack of research in this area. So, the researcher is attempting to fill the gap. In the current study, "knowledge" refers to taxpayers' level of awareness and understanding of or sensitivity to tax legislation. This factor is measured through three elements: 1) general tax knowledge, which includes an understanding of why taxes are paid and the tax morality component; 2) legal tax knowledge, which includes the ability to apply legal tax knowledge to taxpayers specific situation and comply accurately; and 3) procedural tax knowledge, which includes interacting with tax authorities such as submitting forms, paying the amount due, dealing with queries, and keeping the necessary tax records. The study aims to investigate the effect of the three tax knowledge elements towards tax compliance as well as the effect of tax penalties towards compliance decisions, focusing on federal west Addis Ababa small taxpayers. To generalize the gap, the relationship among the three tax knowledge elements has not discussed as correlated variables especially in Ethiopia. And also, no studies have been conducted to determine the magnitude to which the three tax knowledge elements affect the tax compliance using quantitative research approach.

1.3 Research questions

The main research questions of the study are as follows:

1. What is the effect of general tax knowledge on taxpayers' compliance decisions?
2. How much is the effect of legal tax knowledge on taxpayers' compliance decisions?
3. How much is the effect of procedural tax knowledge on taxpayers' compliance decisions?
4. What is the effect of the tax penalty on taxpayers' compliance decisions?

1.4 Objectives of the Study

1.4.1 General Objectives

The main objective of the study is to examine the effect of tax knowledge and the tax penalty on tax compliance on selected taxpayers of the West Addis Ababa Small Taxpayers Branch Office.

1.4.2. Specific objectives

- ✓ To examine the effect of general tax knowledge on compliance of taxpayers
- ✓ To examine the effect of legal tax knowledge on compliance of taxpayers
- ✓ To examine the effect of procedural tax knowledge on compliance of taxpayers and
- ✓ To examine the effect of tax penalties towards tax compliance of West Addis Ababa Small Taxpayers Branch Office

1.5 Research Hypothesis

Hypothesis 1: General tax Knowledge has a positive significance effect on tax compliance

Hypothesis 2: Legal tax knowledge has a positive significance effect on tax compliance

Hypothesis 3: Procedural tax knowledge has a positive significance effect on tax compliance

Hypothesis 4: Tax penalty has a positive significance effect on tax compliance

1.6 Significance of the Study

The results of this study are significant for several reasons. First, the study will reveal taxpayers' perceptions regarding general, legal, and procedural tax knowledge in Addis Ababa specifically west Addis Ababa small taxpayers and learn whether such perceptions affect their compliance behavior. Second, Ethiopian policymakers understand the important segment of tax knowledge and complexity of the system so that appropriate improvements can be made to ensure high compliance in the future. Third, this paper will contribute information on tax knowledge and tax complexity may provide the basis to develop tax knowledge and tax complexity measures. Forth it gives feedback to taxpayers and the tax authority regarding the significance, application, and effect of different levels of tax knowledge and tax sanctions on tax compliance. The study also contributes to evaluating the taxpayer's tax awareness and understanding of taxation as well as their perception of tax penalties. It also indicates the revenue office that in which knowledge level lack of education and training should be concentrate. And it shows in the future curriculum in which area of tax knowledge should be included. Finally, this research paper is open for those who are interested to make a further study on the related issues.

1.7 Delimitation/Scope of the Study

At the federal level, there are five taxpayer offices in Addis Ababa: Large Taxpayers Office, Medium Taxpayers Office, West Addis Ababa Small Taxpayers Branch Office, Eastern Addis Ababa Small Taxpayers Branch Office, and North-West Addis Ababa Small Taxpayers Branch Office. The current study only addresses taxpayers in Ministry of Revenue West Addis Ababa small taxpayers' branch office which is Debre Zeit Road near to Global Hotel. And also, however there are several factors that influence the tax compliance of taxpayers this research focused only on variables limited to tax knowledge and tax penalty; focusing on west Addis Ababa small taxpayers branch and expected to provide an insight into the level of tax knowledge of taxpayers, penalty, and compliance.

1.8 Limitation of the study

Regardless of the researcher's efforts to gather the necessary information as objectively as possible, the analysis of this study has been based on the opinion of respondents. This may in turn limit the ability to make a broader generalization from the study has been endured. In addition, due to the time and budget to study focused on the effect of tax knowledge and the tax penalty on taxpayers' compliance in the Ministry of Revenue west Addis Ababa small taxpayers branch office.

1.9 Organization of the Paper

The study was categorized into five main chapters. Chapter one focused on the introduction, background to the study, statement of the problem, general and specific objectives, the significance, scope, and limitations of the study, ethical consideration, and organization of this paper. Chapter two is a literature review. It provides theoretical and empirical overviews regarding the effect of tax knowledge and penalty on improving tax compliance as well as the conceptual framework of the study. Chapter three deals with research methodology including a description of the study organization, research approach and design, data type and source, target population and sample, sampling techniques, methods of data collection, and the research instruments employed. Chapter four is with detailed analysis of data collection and presentation of information with the aid of quantitative and qualitative statistical models. Finally, the fifth chapter covers the conclusion, discussion, and recommendation.

CHAPTER TWO

REVIEW OF RELATED LITERATURE

2.1 Theoretical Review

2.1.1 Theories of Tax Compliance

There are two broad schools of thought regarding taxpayer compliance, which emerge from the literature. The beginning is the studies based around the theory of economics and the second is the studies based on theories of psychology and sociology (Cuccia,1994).

2.1.1.1 Economic Based Theories

They are as well-known as deterrence theory, and they lay emphasis on incentives. The hypothesis indicates that taxpayers are amoral utility maximizers. They are determined by economic motives such as profit maximization and probability of detection. As such, they analyze alternative compliance paths, for instance, whether or not evade tax, the likelihood of being detected and the resulting repercussions and then select the alternative that maximizes their expected what after tax returns and after adjusting for risk (Trivedi and Shehata, 2005). Granting to the theory, in lodge to improve compliance, audits and penalties for non-conformity should be increased. Economic deterrence factors also include enforcement activities such as tax audits, penalties and probability of detection, and tax rate.

2.1.1.2 Socio-Psychology Theories

Psychological theories, on the other hand, posit that taxpayers are influenced to comply with their tax obligations by psychological factors. They concentrate on the taxpayers' morals and moral philosophy. The theories suggest that a taxpayer may comply even when the probability of detection is low. As opposed to the economic theories that emphasize increased audits and penalties as solutions to compliance issues, socio-psychological theories lay emphasis on changing individual attitudes towards tax systems. The socio-psychological factors include tax knowledge, demographic variables (Gender, Age, income etc.), perception of tax fairness and tax law complexity etc. (Loo, Evans and McKerchar, 2010). Jackson and Milliron (1986, pp. 65) listed 14 main factors that affect 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, income sources, perceived fairness of

the tax system, possibility of being audited and tax rate. Other elements such as penalties, audit, and tax rates are also listed as factors having great influence on tax compliance behaviors (Mohani, 2001). Finally, from the above mentioned two major theories of tax compliance, depending on the level of relevance and applicability, the researcher is intended to use both the economic basic and social psychology theory of tax compliance as a basic for this study. This is due to the fact that using both theories help to identify the major factors that affect tax compliance so as to increase compliance level and enhance revenue of town.

2.1.2 Overview of various tax laws of Ethiopia.

Ethiopian tax law is emanated from three sources: legislative, administrative, and judicial sources. The major sources of Ethiopian tax laws are legislative sources. Several laws have been adopted by the legislature of the country to deal with the different types of taxes in the country and their administration. The Ethiopian Taxation system has two major categories: direct and indirect taxes.

I. Direct Taxes

These are one types of taxes a company or individual pays directly to the government. Under the income tax proclamation, No. 979/2016 taxpayers are categorized A, B, or C according to their income levels. Category A taxpayer: A body or any other person having an annual gross income of ETB 1,000,000 or more. Category B taxpayer: A person, other than a body, having an annual gross income of ETB 500,000 or more, but less than ETB 1,000,000. Category C taxpayer: A person, other than a body, having an annual gross income of less than ETB 500,000.

The proclamation provides for the taxation of income by the following schedules: 1)

Schedule A, income from employment.

2) Schedule B, income from the rental of buildings.

3) Schedule C, income from the business.

4) Schedule D, other income.

5) Schedule E, exempt income.

II. Indirect Tax

Indirect tax is a kind of tax that the taxpayers collect from the customers on behalf of the government and not from their own income. The taxpayer adds selling price on the goods or services she/he provides so that the customers may pay taxes indirectly. The main types of indirect taxes are VAT, customs duty, excise tax, and turnover tax

III. Obligations of Taxpayers

Any taxpayer obliged: a) to pay her/his tax on time, b) have registered account, c) notify his income timely, d) if the taxpayer is an employer he should withhold the appropriate amount of tax from the employees and pay to the tax authority, e) every taxpayer, when asked by the tax authority, must give information, f) to submit records and documents, and g) if necessary to show the stock record for the authority when asked.

IV. Penalties

There are two forms of penalties that entail if the person does not comply with his obligation of tax payment. 1) Administrative penalty which includes the sell or seizure of taxpayer's property and pays the tax e.g., the penalty for understatement of tax and penalty for overdue payment, Penalty for failure to keep proper records. 2) Criminal penalties include imprisonment and fine.

2.1.3. Tax Knowledge

Tax knowledge can be indicated by knowledge of tax regulations, how to calculate tax payable and how to fill out notification forms and letters. Understanding tax laws is a way for taxpayers to know taxation and apply that knowledge to paying taxes. Taxpayers lack confidence in their ability to correctly calculate the tax owed, forcing them to hire experts to prepare and submit the tax return According to Edward and Ambrose (2017). They concluded that the technical and cognitive skill in filing tax returns is a factor affecting tax compliance. If taxpayers know and understand their obligations as taxpayers in advance, they will be obliged to enforce their rights and fulfill their responsibilities as taxpayers. Different scholars defined and interpreted "Tax knowledge" in various ways. These interpretations include general awareness of taxation; understanding tax procedures and responsibilities; and a better understanding of tax laws and regulations (Marina& Pusheletso,2019). Tax knowledge can be divided into three categories: general tax knowledge, legal tax knowledge, and procedural tax knowledge (Bornman & Ramutumbu,2019).

2.1.3.1 General tax knowledge

General tax knowledge relates to having fiscal awareness (Bornman & Ramutumbu,2019). Kamil (2015) proposes that awareness includes recognition of taxpayers' attitude towards a willingness to pay taxes. Bornman and Ramutumbu (2019) describe tax morality as an element of tax awareness, where tax morality refers to an intrinsic willingness to pay taxes. Wilson, Abraham, and Mason (2014) observe that "awareness" is a pre-condition to being literate. Tax awareness is thus an essential element of the tax knowledge required to behave in a tax-compliant manner. Hastuti

(2014) confirms that tax is inevitable for most people, and therefore tax awareness is the basis of tax compliance. He suggests that tax awareness is the ability of taxpayers to take responsibility for their tax calculations, payments, and reporting. Tax awareness includes knowing when you are liable for tax and understanding how your decision to be compliant or not will influence your financial position.

2.1.3.2 Legal tax knowledge.

Most citizens do not understand much about tax laws and why the tax system is structured and administered (Oladipupo&Obazee,2016). Knowing and understanding the legal aspects of taxation is often very tedious. Fjeldstad and Heggstad, (2012) argue that even the simplest law is often open to interpretation, both tax authorities and taxpayers interpret the rule in their favor. Tax laws are often too complex to understand by many small business owners. According to an Austrian study, small business owners have less tax knowledge than business students (Kirchler et al., 2012). Tax experts recognize the complexity of taxation, which makes compliance difficult especially for many small businesses (Oladipupo & Obazee, 2016). Therefore, it can be understood from the above that the knowledge of tax law involves a broad understanding of the legal term in complex tax law. Tallaha et al. (2014) point out that the ability to use an electronic tool to submit a tax return does not necessarily mean that the returns are complete or filed correctly

2.1.3.3. Procedural tax knowledge.

Appropriate knowledge of the procedural aspects of tax law is required in many countries, especially in self-assessment systems. Taxpayers need to be in touch with the tax authority to know how to comply with tax filing, prepare supporting documents, and pay their taxes on time (Oladipupo & Obazee,2016). Tallaha et al. (2014) support the question of whether procedural tax knowledge can be distinguished and can exist separately from legal tax knowledge. Taxpayers have found that the desire to use e-filing is not based on their (legal) tax knowledge and have realized that e-filing can be managed by most people with procedural knowledge. Tallaha et al. (2014) also agreed, being able to use e-filing does not mean that taxpayers have properly submitted tax returns. Bornman and Ramutumbu (2019) maintain that taxpayers need to be aware of tax processes and their responsibility to adhere to tax laws. Therefore, taxpayers still need a certain level of legal tax knowledge to ensure that they are tax compliant.

2.1.3.4. Tax Penalty

A tax penalty is an action in the form of punishment given to people who break the rules. Rules or

laws are signs for someone to do something about what should be done and what should not be done. Penalties are needed so that regulations or laws are not violated. Tax penalties are guarantees that the provisions of tax legislation (tax norms) will be obeyed, in other words, tax penalties are a means of preventing taxpayers from violating tax norms (Mardiasmo,2016). There are two types of tax penalties: administrative penalties consisting of fines, interest, and criminal penalties(offenses) consisting of criminal fines, and imprisonment. With tax penalties, it is expected that taxpayers can carry out their obligations properly. So that with tax penalties there is hope that will increase compliance in paying taxes by taxpayers (Mardiasmo,2016). Penalties are made to keep taxpayers from violating the tax law. The penalty is a guarantee that the tax provisions of taxation legislation (taxation norms) will be followed/obeyed.

2.1.3.5 Tax Compliance

Tax compliance has been described in different ways by different authors. Voluntary compliance can only be achieved through trust and cooperation between the tax authority and the taxpayer, and the taxpayer's own desire to comply with the tax authority's rules and regulations. The ability of taxpayers to make tax payments can be viewed as a behavioral requirement. Augustine (2020) divides these principles into two: personal and social norms. Personal expectations indicate a combination of different factors correlated with individual values that have driven taxpayers' positive attitudes toward tax administrators. Social norms influence tax behavior where the majority of people are tax compliant, resulting in a lower tendency to evade taxes, but where the rate of evasion is high in the country, there will also be a high inclination to non-compliance. However, in the event of mistrust and lack of cooperation between the authority and the taxpayer, the authorities may enforce compliance by threatening and application of audits and fines. Fredrick and Peter (2019) concluded that tax compliance is the degree to which taxpayers' tax conduct, including tax estimation and timely manners, is already acceptable to the tax laws of the country. Therefore, government-anticipated tax compliance is not enforcement imposed by the government, but voluntary tax compliance.

2.2. Empirical Review

2.2.1 Tax Knowledge

Tax knowledge for taxpayers can significantly affect taxpayers' understanding of a fair tax system. The higher quality of knowledge creates a sense of fulfilling obligation through the existence of a

national tax system. Hence tax knowledge can change people's behavior to comply with tax laws. A study in South Africa by Bornman and Ramutumbu (2019) discovered that small business owners have high tax morale (or internal motivation to pay taxes) but their biggest challenge is a lack of knowledge about their tax issues. Olsen (2015) and Onu and Oats (2015) suggest that most taxpayers are willing to comply and more concerned about how to do it. Therefore, providing additional tax knowledge to taxpayers can help prevent tax evasion and promote voluntary tax compliance in the self-assessment system. In contrast, poor tax knowledge increases the risk of tax evasion associated with negative attitudes toward taxation. A study was done by Kofi et.al (2019) in Ghana, using ANOVA, and regression analyses revealed that knowledge of tax significantly affects tax compliance, although the level of tax knowledge varies essentially among respondents. Similarly, the study made in Nigeria using the same method shows that the corporate taxpayer's perception of fairness has a significant effect on taxpayers' willingness to pay taxes and tax knowledge significantly influenced tax compliance. In various studies tax knowledge is a key factor in the perception of tax-compliant behavior. The results of those studies show that the influence of tax knowledge on tax compliance has either a significant effect or insignificance effect or no correlation at all. For example, research conducted by Oladipupo and Obazee (2016) found that tax knowledge has a positive and significant effect on tax compliance. but the results of this study contradicted the findings of Famami and Norsain (2019) and Nurgroho and Raharjo (2016) they indicated that knowledge of tax had no significant effect on taxpayer compliance. Research by Arvian and Djani (2018) and Nurkhin, et al. (2018) found that tax knowledge had a positive effect on taxpayer compliance in paying taxes while Andinata (2015) observed that knowledge of tax regulations has no significant effect on taxpayer compliance in fulfilling tax obligations.

Palil (2010) studied on Tax Knowledge and Tax Compliance Determinants in Self-Assessment System in Malaysia for the degree of Doctor of Philosophy in the University of Birmingham. The results suggested that tax knowledge has a significant effect on tax compliance even though the level of tax knowledge varies significantly among respondents. The results also indicate that tax compliance is influenced specifically by probability of being audited, perceptions of government spending, penalties, personal financial constraints, and the influence of referent groups. Loo, Evans, and McKerchar (2010) studied on Challenges in Understanding Compliance Behavior of Taxpayers in Malaysia, they found that tax knowledge is a key influence on their compliance behavior.

Agbadi (2011) study on Determinants of Tax Compliance Theory and Empirical Analysis of Tax Compliance in Ghana Accra town, he found that Simplicity of tax returns and administration has positive and significant relationship with compliance. The results also indicate that tax education also has a positive and significant relation with compliance.

Lemmesa (2007) revealed Determinants of Taxpayers' Voluntary Compliance towards Taxation in Dire Dawa City, he found that the tax being levied is not fair and equitable and may reduce the motivation and the voluntary compliance behavior of current taxpayers. The study also warned that it could deter potential taxpayers from joining the tax system voluntarily. The study undertaken by Kiflu (2013) on Challenges of Business Income Tax Audit with respect to Revenue enhancement in Ethiopia: The Case of the Mekelle City Revenue Office in the Tigray Region shows that increase the chance of being audited by the tax office increase the level of compliance. Taxpayer's attitudes towered tax compliance in developed and developing countries a critical review of the literature evidence from Au Land University of technology (2017), the finding suggest that in order to improve the willingness of taxpayers to comply with tax laws the authorities should monitor fairness and the result also suggest developing countries have low level of tax knowledge. Manchilot (2018) determinant of tax compliance in the case of Gondar city, Ethiopia, shows that simplicity of the tax system, probability of detection and organizational strength of the tax authority were found to be the significance determinants of tax compliance in Gondar city.

In Ethiopia, empirical studies revealed the effects of tax knowledge and penalties on tax compliance, but they are not exhaustively done and remain open for detailed research. The research was done by Zelalem (2011) on "The Influence of Tax Education on Tax Compliance Attitude" using a quantitative research approach that concludes that the level of tax compliance is influenced by tax education. The research was done by Amina (2013) on "Determinants of Tax Compliance: The Case of Jimma Town" using Pearson's correlation matrix and a Logistic Regression Model was used to identify the main factors that determine tax compliance, and her results show that tax rate, probability of detection, penalty rate, reference group, and tax knowledge are the determinants of tax compliance. And also, the research done by Tilahun (2016) on 'Determinants of Tax Compliance Behavior in Ethiopian: The Case of Bahir Dar City by using one-way ANOVA, two samples, and one sample T-test, this study examined the determinants of tax compliance behavior in Ethiopia, particularly in the Bahir Dar city administration, and the results revealed that tax knowledge and penalty are among the determinants of tax compliance and significantly affect tax

compliance behavior. In the study by Messay (2019) on Tax Assessment and Collection Problems in the Addis Ababa sub-city, the findings indicated that most taxpayers lack tax knowledge of assessment and collection methods, rules, and regulations., Therefore, the hypothesis proposed in this study is that tax knowledge has a significant effect on tax compliance.

2.2.2 Tax Penalty

Tax penalties if associated with the precept of legitimacy can't be separated from taxation laws and imposing regulations. Taxpayers who intentionally do not fulfill their tax responsibilities will be penalized. Tax sanctions are ensuring that the requirements of tax policies (tax norms) will be obeyed (Mardiasmo,2016: 60). Penalties end up an assurance that taxpayers will no longer forget to fulfill their duties as taxpayers, with penalties that furnish a deterrent effect, taxpayer compliance will make increase. The search outcomes of Gunarso (2016), Ngadiman, and Huslin (2015) stated that tax penalties had a highly significant influence on taxpayer compliance. This is supported by the results of Arvian and Djeni (2018), Gunarso (2016), and Kamil (2015) found that tax penalties had a significant effect on taxpayer compliance in paying taxes. Sheikh Obid (2014) discusses the effect of tax penalties on taxpayers' compliance and the finding suggests that penalty rate, as well as audit detection rate, does have a significant influence on tax evasion. Mohd, Yusof, Lai & Yap, (2014) finds the relationship between tax penalties rate and tax non-compliance is insignificant. On the other hand, the study carried out Mohdali, Isa and Yusoff (2014) appear at the effect of the threat of punishment on tax compliance and non-compliance attitudes in Malaysia recommend that the threat of punishment has influenced taxpayers to emerge as less compliant which would maybe point out their rebellious act toward the authorities. Therefore, the literature review above indicated that the study of the effect of tax knowledge and penalties on tax compliance is mostly conducted in developed countries, except for a few developing countries. In Ethiopia, studies regarding tax knowledge have been made related to the determinants of tax compliance and in these studies tax, knowledge and penalty are described amongst the determinants of taxpayers' compliance behavior. As the researcher's knowledge, no study has been conducted to determine the magnitude to which general tax knowledge, legal tax knowledge, and procedural tax knowledge affect tax compliance. Realizing this gap, the researcher determined to conduct this study.

2.3. The Conceptual Framework of the Study

The effect of General tax knowledge towards compliance

General tax knowledge is similar to subjective tax knowledge or ordinary people's understanding of taxation. Several studies have found that different groups of people have different cognitive representations and attitudes toward taxes. People's recognition of taxes as contributing to the public budget is one aspect that is understood to be a distinct representation of taxes. These tax knowledge programs typically begin with a focus on knowledge areas such as understanding why we pay tax, the relationship between taxes and spending by the government and the benefits of taxation to the community, the fairness of taxation (who pays tax, how we pay tax – including choice of the tax base and rate structure), tax morality, and good financial habits. According to the literature, "general tax knowledge" refers to tax awareness, which includes understanding the goals of governmental fiscal strategies, the "why" of paying taxes, and the tax morality component, as well as understanding the effect of taxation on one's own finances (Bornama & Ramutumbu, 2019). Various research indicates that higher levels of general tax knowledge are positively associated with higher tax compliance. Based on the description above, the hypothesis is formulated as follows:

H1: General tax knowledge has a positive significant effect on taxpayers' compliance.

The effect of Legal tax knowledge on compliance

Most citizens have little understanding of what tax laws mean or why the tax system is structured and administered in the way that it is (Oladipupo & Obazee, 2016). It can be difficult to become familiar with and understand the legal aspects of taxation. Tax laws are frequently too complex for the average person to comprehend. As a result, taxpayers may avoid even attempting to understand tax terminologies, effectively distancing themselves from the tax system. The situation becomes particularly difficult because tax laws are frequently changed and are more complex and ambiguous than general laws. According to an Austrian study, small business owners' tax knowledge was lower than that of business students (Kirchler et al., 2012). Tax professionals also acknowledge that the complexities of taxation make compliance particularly difficult for many small businesses (Oladipupo & Obazee, 2016). As a result of the above, it is reasonable to conclude that legal tax knowledge includes a broad understanding of legal terminologies in complex tax legislation. It could also be argued that legal tax knowledge includes the ability to apply specific rules and legislation to accurately determine your tax liability. Knowledge of society's tax laws through

awareness will positively affect the taxpayer's consciousness to pay taxes (Lestari & Wicaksono, 2017). According to several studies, there is a relationship between taxpayers' ability to understand and apply tax laws and legislation and their ability to comply. Based on the description above, the hypothesis is formulated as follows:

H2: Legal tax knowledge has a significant positive effect on taxpayers' compliance.

The effect of Procedural tax knowledge on compliance

Many countries, particularly those with a self-assessment system, require an appropriate level of knowledge about the procedural aspects of tax laws. Taxpayers must be aware of the processes and responsibilities associated with being tax compliant because they must interact with the tax authorities to submit tax forms on time, produce supporting documents, and make timely tax payments (Obazee & Oladipupo, 2016). According to Tallaha et al. (2014), procedural tax knowledge can be distinguished and exist independently of legal tax knowledge. They discovered that taxpayers' willingness to use e-filing is unrelated to their (legal) tax knowledge. Tallaha et al. (2014) agree that the ability to use E-filing does not always imply that taxpayers have filed their tax returns correctly. Based on this, it is proposed that procedural tax knowledge be expressed in terms of interacting with the tax authority (submitting forms, paying the amount due, dealing with queries), and maintaining the necessary tax records (Bornama & Ramutumbu, 2019). Many countries require the completion of numerous complex forms as well as the keeping of detailed records. Therefore, the "know-how" to submit tax returns electronically, register online, and submit supporting documentation to the tax authority is an element of tax knowledge needed by a taxpayer to be tax compliant (Bornama & Ramutumbu, 2019). Based on the description above, the hypothesis is formulated as follows:

H3: Procedural tax knowledge has a significant positive effect on taxpayers' compliance.

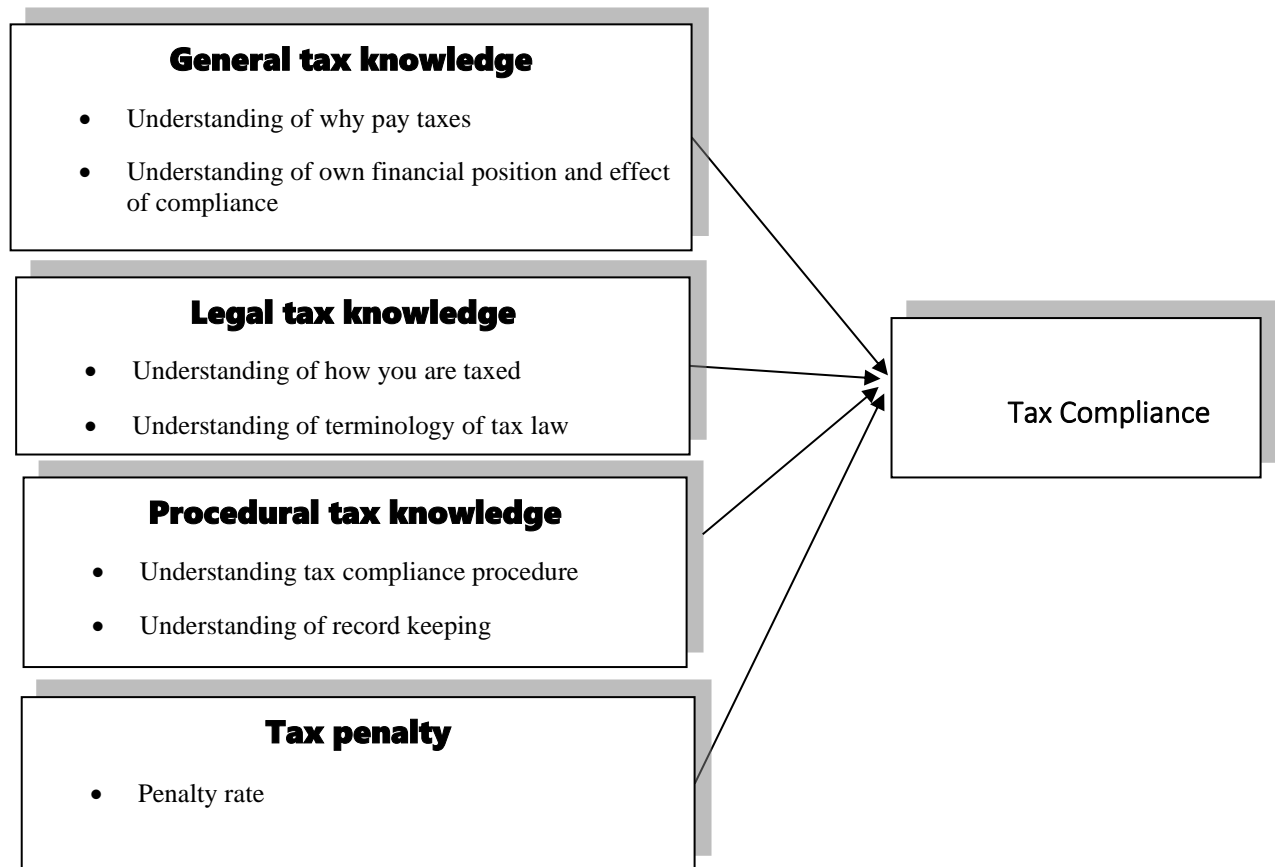
The effect of tax penalty on compliance

Tax penalties in the form of fines have an effect on taxpayer compliance, according to research by (Erani & Meiliana, 2016) and (Siregar, 2017). Tax penalties will enhance compliance among business taxpayers themselves if they are applied consistently and in a systematic manner. Because the behavior is externally generated or externally influenced, attribution theory is relevant to tax penalties in this situation. As a result, tax penalties in the form of fines play a crucial role in teaching those who break tax laws a lesson, and taxpayers will abide by the law if the penalty causes them

to suffer more financial loss. Based on the description above, the hypothesis is formulated as follows:

H4: Tax penalty has a significant positive effect on taxpayers' compliance.

Based on the above theoretical and empirical reviews the study used the model as presented in the figure below. It is developed based on the objectives of the study and the knowledge obtained from the literature review. From the kinds of literature, assuming that general tax, legal tax, and procedural tax knowledge, as well as a tax penalty, are independent variables whereas tax compliance is the dependent variable.



Independent Variables

Dependent Variable

Source: Modified from Bornama and Ramutumbu (2019). Conceptual framework for tax knowledge

Fig 2.1 Conceptual Framework

CHAPTER THREE

RESEARCH DESIGN AND METHODOLOGY

Introduction

This chapter presents the methodology or approaches used such as quantitative, qualitative admixed approaches concerning this research paper. In this part, research types and approach, population and sample size, sample frame, data type and data sources, method of data analysis, and reliability and validity instruments are presented.

3.1. Description of Study Area

Addis Ababa is the capital of Ethiopia. This city covers an area of 527 square kilometers in Ethiopia. It is the largest city in the country with a total population of 3,384,569 according to the 2007 census. In 2017, the population was close to 4 million. Due to security concerns between 2017 and 2018, the latest census is scheduled for the 2018-2019 fiscal year. Addis Ababa is a charter city and is considered a city and a state. Per the population recorded at the last census, the city of Addis Ababa has a higher population of female residents than male residents. Almost one-quarter of all people in Ethiopia that live in urban areas live in the capital city.

3.2. Research Design

According to Singh, (2006), research design is essentially a statement of the object of the inquiry and the strategies for collecting the evidence, analyzing the evidence, and reporting the findings. There are different types of scientific research, namely: Exploratory research, Descriptive research, and Explanatory research (Bhattacharjee, 2012). Accordingly, this research used explanatory type of research design in order to explain the relationship between the tax knowledge and tax penalty and tax compliance.

3.3. Research Approach

According to John, (2014), Research approaches are plans and procedures for research that span the steps from broad assumptions to detailed methods of data collection, analysis, and interpretation. The selection of a research approach is based on the nature of the research problem or issue to be addressed, the researchers' personal experiences, and the audiences for the study.

There are three basic approaches to research (a) qualitative (b) quantitative (c) mixed methods. According to Christensen, (1985) quantitative survey is the most appropriate one to use if the purpose of an investigation is to describe the degree of relationship that exists between the variables. Accordingly, this research employed quantitative research approach. Hence, it examined and measured the relationship between tax knowledge and tax penalty and tax compliance.

3.4. Data Type and Source

In this study, primary data sources have been used. Primary data was collected by using self-administrative questionnaires to gather information from targeted employees that can help the research in addressing the objective of the study. The secondary sources are mainly used to review the related literature on the topic under study. These include books, publications, research studies, and refereed journal articles. In addition, various annual performance reports and manuals of the branch office, websites of the Ministry of Revenue (MOR), published and unpublished written materials, and other related documents from different sources will be also used. For primary data collection, the questionnaire was distributed to the small taxpayers in the west Addis Ababa small taxpayers' branch. The questionnaire was structured in close-ended questions by which the respondents choose one of the alternatives.

3.5 Target population and Sample

3.5.1 Target population

In Ethiopia, taxpayers are segmented by Proclamation No. 979/2016 into either Category A, B, or C taxpayers. Category A is comprised of organizations or individuals with a gross annual income of ETB 1million (US\$35,000) or more. Category B covers those taxpayers with gross annual incomes between ETB500,000 (US\$17,500) and ETB 1million and Category C includes taxpayers with annual income less than ETB500,000. Ministry of Revenue (MOR) further segments Category A into large taxpayers with annual turnover over ETB35 million and medium taxpayers with annual turnover less than ETB35 million. At the federal level, there are five taxpayer offices in Addis Ababa. these are the Large Taxpayers Office, Medium taxpayers' office, West Addis Ababa Small taxpayers branch office, Eastern Addis Ababa Small taxpayers branch office, and North-West Addis Ababa small taxpayers branch office. The current study only addresses West Addis Ababa small taxpayers with total taxpayers of 11,815 at the time of the study conducted.

3.5.2 Sample size determination

Generally, one can say that the sample must be of an optimum size i.e., it should neither be excessively large nor too small. From the total of 11,815 taxpayers in west Addis Ababa small taxpayers branch office, the researcher took a sample of 400 taxpayers. Convenience sampling technique was used to select the sample target respondents. This type of sampling can be very useful in situations when the researcher needs to reach a targeted sample quickly. Therefore, based on this fact the researcher had selected this research method. The sample selection focuses on company managers and employees who are involved in tax computation and payments of the tax such as accountants and tax consultants. Accordingly, adopting Yamane's formula at a confidence level of 95%, and the margin of error 5%, the sample size of the population was determined using sample size determining formula as follows:

$$n = \frac{N}{1+N(e)^2}$$
$$n = \frac{11,815}{1 + 11,815(0.05)^2} \approx 400$$

Where: - n = the sample size

N = the target population size

e = precision

3.5.3 Sample selection procedure

Once the sample size was determined the next step is determining the number of respondents that are going to be selected from west Addis Ababa small taxpayers branch office taxpayers. To do that convenience sampling technique was implemented. Convenient sampling method is used where members of the target population meet certain practical criteria, such as easy accessibility, geographical proximity, availability at a given time where reaching all respondents is impossible and sample need to be drawn (Ilker, Sulaiman & Rukaya, 2016).

3.6. Data Collection Procedures

The research adopts self-administrative questionnaires to gather information from targeted taxpayers that can help the research address the objective of the study. The questionnaires were structured into close-ended questions from which the respondents were choose one of the

alternatives. The Likert scale included five scales ranging from 1 to 5.1 represents "strongly disagree", 2 represents "disagree", 3 represents "neutral", 4 represents "agree" and 5 represents "strongly agree". The questionnaire has three sections. Section I contains questions related to demographic details. Section II has been divided into four parts that represent each of the independent variables of the study, which are general tax knowledge, legal tax knowledge, procedural tax knowledge, and penalty. Section III inquired about tax compliance among small taxpayers. For section II, five statements were developed for each independent variable, which was adapted and modified from previous studies.

3.7. Data Analysis and Presentation

3.7.1 Methods of Data Analysis: Explanatory tools

The data was collected and analyzed quantitatively. To analyze and interpret the results of the primary data from the respondent's experiences and observations, which were used to examine the relationship between tax knowledge and tax compliance as well as penalty and tax compliance of taxpayers. The data collected from the questionnaires were carefully coded and checked for consistency and entered the computer applications of Statistical Package for Social Science (SPSS) software package in combination with excel spreadsheets were used as a tool for the analysis purpose. The descriptive statistics of the variables along with multiple regression analysis **was** applied to examine the relative predictive power of the independent variables (tax knowledge and tax penalty) on the dependent variable (tax compliance). For descriptive statistics, percentages, graphs, and tables were used.

3.7.2 Model Specification

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

$$Y = A + B_1 X_1 + B_2 X_2 + B_3 X_3 + B_4 X_4 + \epsilon$$

Where, Y = Tax compliance

A = Constant

X1 = General Tax Knowledge

X2 = Legal Tax Knowledge

X3 = Procedural Tax Knowledge

X4 = Penalty

B1, B2, B3, B4 = Coefficients indicating a rate of change of tax compliances tax knowledge, and penalty.

ε = Error term

3.7.3 Measurement of variables

In the study, the dependent variable is the tax compliance behavior of taxpayers in the west Addis Ababa small taxpayers 'branch. The independent variables are the three elements of tax knowledge (general, legal, and procedural) and tax penalty.

General tax knowledge (X1)

General tax knowledge includes an awareness of why taxes should be paid and who is responsible for paying taxes, as well as understanding your own financial position and the consequences of your decision to be compliant or not (Bornman & Ramutumbu ,2019). As suggested, general tax knowledge includes an understanding of the aims of governmental fiscal strategies and an understanding of one's own financial position and the effect of compliance on your own finances. For example, doing business complying with tax laws, understanding tax matters, paying different types of taxes such as income tax, VAT, profit tax, withholding tax, etc.

Legal tax knowledge (X2)

Bornman and Wassermann (2020) defined legal tax knowledge citing (Tallaha et al. 2014) and (Lai et al. 2013) as an understanding of how one is taxed and has two dimensions. The first one is understanding legal terms and legislation (knowing that something is taxable) and second the ability to apply the legal knowledge to specific situations to be able to calculate the tax effect (knowing how). Bornman and Ramutumbu (2019) specify that legal tax knowledge includes a 'broad understanding of legal terminologies' and 'the ability to apply specific rules and regulations to accurately determine one's tax liability. Legal tax knowledge can be determined by understanding different tax regulations such as income tax regulation VAT regulation and understanding of the legislation in the context of one's specific business for example tax allowable expenditures, taxable and nontaxable allowances, etc.

Procedural tax knowledge (X3)

As previously stated, procedural knowledge refers to the need to understand the procedures associated with being tax compliant and includes knowledge of tax forms, systems, and interacting with tax authorities, as well as knowing how to keep records to be tax compliant (Bornman&Ramutumbu,2019). According to research, procedural knowledge is a distinct component of the concept of "tax knowledge." It is difficult to understand and maintain tax return procedures due to changes in tax authorities' requirements. Procedural knowledge refers to knowing how to perform the fundamental actions required to fully comply with tax legislation, such as knowing how to complete forms, filing on time, and understanding how and which records to keep for accounting and tax purposes.

Penalty (X4)

If tax penalties were imposed on a regular and orderly basis, they would likely increase taxpayer compliance (Siregar,2017). Tax penalties play an important role in avoiding or reducing tax evasion, and taxpayers will comply with taxes if the penalty is more severe in terms of financial loss. Penalty systems, penalty types, and penalty rates vary by county. Penalty rates are applied by various tax subjects, such as individual income tax, business income tax, value-added tax, and so on. Furthermore, the penalty rates for each tax subject are differentiated by the different types of non-compliance, such as non-filing, underreporting, and no bookkeeping of invoices and receipts.

3.8 Reliability and Validity Issues

Meeting the regression analysis assumptions was a critical step to validate that the generated data truly represented the sample, and that the researcher obtained the best results (Hair et al., 1998). The three assumption tests for regression analysis were used in these studies which were discussed for individual variables like Multicollinearity, Linearity, and Normality test. The Cronbach's Alpha values are also tested and validated. As a result, the tolerance and variance inflation factors (VIF) values show that there are no multicollinearity indications, and the conditions for linearity and normality are met.

3.9 Ethical Consideration

Ethics are the moral distinction between right and wrong, and what is unethical may not necessarily be illegal (Bhattacharje,2012). In order to be ethical, a researcher should consider voluntary participation and harmlessness. Subjects in a research project must be aware that their participation in the study is voluntary, that they have the freedom to withdraw from the study at any time without

any unfavorable consequences, and they cannot be harmed because of their participation or non-participation in the project. Accordingly, name of the respondents was not asked in order to increase the confidentiality of the information they gave, the questionnaire explains that the purpose of the research is for academic purpose only, the respondents were included based on their willingness, and finally the researcher tried to avoid misleading or deceptive statements in the questionnaire as well as the questionnaires were distributed only to voluntary participants.

CHAPTER FOUR

DATA ANALYSIS, INTERPRETATION AND DISCUSSION

Introduction

This chapter discusses, the data collected using questionnaires' and presented based on the objectives of the study. The research tried to examine the effect of tax knowledge and penalty on tax compliance the case of ministry of revenue west Addis Ababa small taxpayers. This chapter also focused on elaborating variable tax knowledge and tax penalty (general tax knowledge, legal tax knowledge, procedural tax knowledge, and penalty) and tax compliance. Moreover, the data collected were analyzed by using SPSS version 22. Correlation and regression analysis are applied in the quantitative analyses. A total of 400 questionnaires were distributed and 329 returned and used for analysis. The nonresponse rate is 71 (17.75%).

4.1 Response Rate

Table 4.1 : Shows the Response Rate of Questionnaire

Number of Questionnaire Returned	Target Number of Respondents	Response Rate (%)	Nonresponse rate (%)
329	400	82.25	17.75

A total of four hundred questionnaires were distributed to the respondents of west Addis Ababa small taxpayers and out of these questionnaires a total of 329 questionnaires were successfully completed and returned. The total response rate was 82.25%. As a result, the analysis of this research was based on the number of questionnaires collected.

4.2 Reliability Statistics

Table 4.2 above shows the reliability scale for all five dimensions and also, the reliability scale for each dimension calculated when each item is deleted from the dimension to see if the deleted item is genuine or not. In case Cronbach's alpha for a dimension increases when an item is deleted it shows that item is not genuine in that dimension. From the reliability coefficients of all four dimensions in table 4.2 the dimension general tax knowledge, legal tax knowledge, procedural tax

knowledge, and penalty showed coefficients higher than 0.7 and higher, meaning these dimensions comprising of various items show a true measure of tax knowledge and tax penalty.

Table 4. 2: Reliability Statistics Result

Reliability Statistics				
S/N	Dimensions	Number of Items	Cronbach's Alpha	Justification
1	General Tax Knowledge	5	.708	Optimal
2	Legal Tax Knowledge	5	.847	Optimal
3	Procedural Tax Knowledge	5	.709	Optimal
4	Penalty	5	.827	Optimal
5	Tax Compliance	3	.758	Optimal
Total	Overall reliability statistics	23	.892	Optimal

Source: Authors Analysis (2022)

4.3 Descriptive Statistics

4.3.1 Demographic Composition of Respondents

Demographic information's how the characteristics of the components in the sample size is: As such the researcher required to establish the general information of the respondents, which forms the basis under which the analyses are done. And the demographic information includes the respondent's gender, age, education level, and duration of time in Using west Addis Ababa small taxpayers. Based on this, demographic characteristics are presented as follows.

Table 4.3 : Demographic Characteristics

	Description	Frequency	Percent
Gender	Male	173	52.6
	Female	156	47.4
	Total	329	100.0
Age	20-30	64	19.5
	31-40	63	19.1
	41-50	90	27.4
	Above 50	112	34.0
	Total	329	100.0
Educational Level	High school incomplete	113	34.3
	High school completed	91	27.7
	College diploma	49	14.9
	BA degree	51	15.5
	MA and above	25	7.6
	Total	329	100.0
Work How long you have stayed in the business (in years)	1-5	85	25.8
	6-10	55	16.7
	11-20	114	34.7
	Greater than 20	75	22.8
	Total	329	100.0

Source: Authors Analysis (2022)

Demographic factor one examined 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. Fifty-two-point six percent (52.6%) of the respondents were male whereas forty-seven-point four percent (47.4%) were female. The gender finding indicate that males take more parts on the tax system than females.

Demographic factor displays the age brackets of respondents, (19.5%) of the respondents are between 20-30years of age, (19.1%) are between 31- 40 years, (27.4%) are in the 41-50 age bracket. Respondents above 50 years are (34%). This result demonstrates that most of the taxpayers generally 41- 50 and above 50 years. This signifies that most of the taxpayers age lies on the right

time for rationalized and analyzed the effect of the tax on countries economy. So, most of the respondents are taxpayers that are available on the right working stage.

Demographic factor examines the academic identifications of the respondents. The information is necessary to assist the researcher to recognize whether the respondents are educated or illiterate. Information on the academic qualifications of the respondents is statistically shown in table 4.3 below. It reflects the academic qualifications of the respondents. Thirty-four point three (34.3%) have an incomplete high school certificate, twenty-seven-point seven percent (27.7%) hold a high school completed certificate; fourteen point nine percent (14.9%) have a Certificate/diploma, fifteen point five percent (15.5%) have a BA Degree, seven point six percent (7.6%) have PHD. Regarding to “Work How long you have stayed in the business”, Respondents that they have been around 1-5 with 25.8 percent, respondents with 6-10 have been around with 16.7 percent, respondents with 11-20 have been around with 34.7 percent, and respondents with 11-20 have been around with 34.7 percent, and respondents with greater than 20 years have been around with 22.8 percent. This shows that respondents have full information about the tax knowledge and penalty with respect to the tax compliance the sector itself.

4.3.2 Respondents Perception towards tax knowledge, tax penalty and tax compliance

The response analysis was conducted using mean and standard deviation. They were used to present the various characteristics for data sets. In this study, descriptive statistics helps to enables us to present the data in a more meaningful way, which allows simpler interpretation of the data. The researcher compared the mean and standard deviation score of each variable against settled standard by (Best, Hawkins, and Albaum, 1977), the mean values of the Tax Knowledge and Penalty and Tax Compliance variable ranged from 1 to 1.8, reflecting lowest levels of agreement from the respondent to the variable; from 1.8 up to 2.6, is assumed as low; from 2.6 up to 3.4 is assumed as medium; from 3.4 up to 4.2 is assumed as high and from 4.2 up to 5 is taken as highest. Moreover, the whole survey results are summarized here below in the table as follows.

4.3.2.1 Respondents Perception towards General Tax Knowledge

In this section, descriptive statistics was done in the form of mean and standard deviation for five items, and it is presented in the following table. And it was developed by items using Likert scale. Thus, all statements were measured on Likert scale.

Table 4.4 : Summary of Response for General Tax Knowledge

S/N	Items of General Tax Knowledge	N	Mean	Std. D
1	I am aware that paying taxes is a civic duty	329	2.96	1.30
2	I am familiar with Ethiopia's tax system	329	3.12	1.09
3	I have general understanding of types of taxes and duties in Ethiopia	329	3.89	0.93
4	As far as I am aware everyone who earns income sourced in the country is taxable regardless of whether that person is a resident or not	329	3.76	1.05
5	I have general understanding how tax influence my financial position	329	3.72	0.98
	Cumulative mean of General Tax Knowledge	329	3.49	1.07

Source: Authors Analysis (2022)

The above table showed that general tax knowledge has the mean value scored of 3.49. According to (Best, Hawkins, and Albaum, 1977), if the mean value falls between 3.4 up to 4.2 it is assumed as high. The finding indicates that Ministry of Revenue West Addis Ababa Small Taxpayers perception about general tax knowledge such as, paying taxes is a civic duty, familiar with Ethiopia's tax system, general understanding of types of taxes and duties, earns income sourced in the country is taxable regardless of whether that person is a resident or not, and general understanding how tax influence my financial position is in a positive way since the mean score of the statement validated bench mark for this variable state as per the interpretation law set by (Best, Hawkins, and Albaum, 1977) it is thoroughly high/agreed.

4.3.2.2 Respondents Perception towards Legal Tax Knowledge

In this section, descriptive statistics was done in the form of mean and standard deviation for five items, and it is presented in the following table. And it was developed by items using Likert scale. Thus, all statements were measured on Likert scale.

Table 4.5: Summary of Response for Legal Tax Knowledge

S/N	Items of Legal Tax Knowledge	N	Mean	Std. D
1	I know how much tax I have to pay.	329	2.96	1.30
2	I understand how taxes are calculated.	329	3.12	1.09
3	I am familiar with most tax laws and guidelines pertaining to the taxation of business income.	329	3.61	1.09
4	I am capable of interpreting taxation laws when calculating taxes.	329	3.49	1.05
5	I'm not sure what deductions I can claim as a taxpayer in calculating my tax liability	329	2.79	1.08
	Cumulative mean of Legal Tax Knowledge	329	3.20	1.12

Source: Authors Analysis (2022)

That's what the above table showed general tax knowledge has the mean value scored of 3.20. According to (Best, Hawkins, and Albaum, 1977), if the mean value falls between 2.6 up to 3.4 is assumed as medium. The finding indicates that Ministry of Revenue West Addis Ababa Small Taxpayers awareness about legal tax knowledge such as, realize the amount of duty he/she possess to pay, comprehend how charges are determined, acquainted with most expense regulations and rules relating to the tax collection from business pay, fit for deciphering tax collection regulations while working out charges, derivations that he/she can guarantee as a citizen in computing my duty risk is in a positive way since the mean score of the statement according to Likert scale was lies above the 3 cut - off scale. And the research validated benchmark for this variable state as per the interpretation law set by (Best, Hawkins, and Albaum, 1977) it is thoroughly medium/moderate.

4.3.2.3 Respondents Perception towards Procedural Tax Knowledge

In this section, descriptive statistics was done in the form of mean and standard deviation for five items, and it is presented in the following table. And it was developed by items using Likert scale. Thus, all statements were measured on Likert scale.

Table 4. 6: Summary of Response for Procedural Tax Knowledge

S/N	Items of Procedural Tax Knowledge	N	Mean	Std. D
1	I know how to announce all business income taxes to the tax authority	329	3.61	1.09
2	I have no problem completing and submitting the required tax return form(s).	329	3.58	1.11
3	I know how to keep records/documents relating to income and expenses for a period that should be declare	329	3.65	1.08
4	I understand everything that is expected of me in terms of my business profit tax obligation.	329	3.28	0.97
5	I am certain about the period and where to pay my tax liability	329	2.79	1.08
	Cumulative mean of Procedural Tax Knowledge	329	3.38	1.06

Source: Authors Analysis (2022)

The above table presented that Procedural tax knowledge has the mean value scored of 3.38. According to (Best, Hawkins, and Albaum, 1977), if the mean value falls between 2.6 up to 3.4 is assumed as medium. The finding indicates that Ministry of Revenue West Addis Ababa Small Taxpayers perception about procedural tax knowledge such as, report all business personal duties to the duty authority, finishing and presenting the necessary assessment form structure, keep records/archives connecting with pay and costs for a period that ought to be proclaim, comprehend all that is required from me as far as my business benefit charge commitment, and sure about the period and where to pay my expense responsibility is in a positive way since the research validated bench mark for this variable state as per the interpretation law set by (Best, Hawkins, and Albaum, 1977) it is thoroughly medium.

4.3.2.4 Respondents Perception towards Tax Penalty

In this section, descriptive statistics was done in the form of mean and standard deviation for five items, and it is presented in the following table. And it was developed by items using Likert scale. Thus, all statements were measured on Likert scale.

Table 4.7: Summary of Response for Tax Penalty

S/N	Items of Penalty	N	Mean	Std. D
1	I know the types of penalties and rates that apply in Ethiopia	329	3.28	0.973
2	I am aware that non-tax compliance is an offense that leads to punishment.	329	3.53	0.95
3	The penalty rates are low, and I can pay the penalty without complaint.	329	3.57	0.90
4	Increasing penalty rates make me more of my duty to declare all my taxes on time and properly.	329	3.39	1.02
5	The current penalty rate is enough to discourage noncompliance	329	3.49	1.03
	Cumulative mean of Penalty	329	3.45	0.97

Source: Authors Analysis (2022)

The above table displayed that general tax knowledge has the mean value scored of 3.45. According to (Best, Hawkins, and Albaum, 1977), if the mean value falls between 3.4 up to 4.2 it is assumed as high/agreed. The finding indicates that Ministry of Revenue West Addis Ababa Small Taxpayers perception about penalty tax knowledge such as, the kinds of punishments and rates that apply in Ethiopia, mindful that non-charge consistence is an offense that prompts discipline, punishment rates are low, and suffer the consequence without objection, increasing punishment rates make me a greater amount of my obligation to pronounce every one of my expenses on time and appropriately, and the ongoing punishment rate is sufficient to put loyalty down is in a optimistic way and this implies that penalty makes the taxpayers to be non-compliance their taxes on the right time and amount. Since the mean score of the statement according to Likert scale was lies 3.45. And the research validated benchmark for this variable state as per the interpretation law set by (Best, Hawkins, and Albaum, 1977) it is thoroughly high/agreed.

4.3.2.5 Respondents Perception towards Tax Compliance

In this section, descriptive statistics was done in the form of mean and standard deviation for three items, and it is presented in the following table. And it was developed by items using Likert scale. Thus, all statements were measured on Likert scale.

Table 4.8: Summary of Response for Tax Compliance

S/No	Items of Tax Compliance	N	Mean	Std. D
1	I record the financial business regularly and correctly.	329	3.47	0.94
2	I fill out and report tax notification letters honestly, completely, and correctly in accordance with applicable rules.	329	3.62	0.98
3	I pay taxes voluntarily according to the rules and on time.	329	3.67	0.92
	Cumulative mean of Tax Compliance	329	3.58	0.94

Source: Authors Analysis (2022)

The above table demonstrated that general tax knowledge has the mean value scored of 3.58. According to (Best, Hawkins, and Albaum,1977), if the mean value falls between 3.4 up to 4.2 it is assumed as high. The finding indicates that Ministry of Revenue West Addis Ababa Small Taxpayers perception/ interpretation of the existing reality about tax compliance such as, record the monetary business routinely and accurately, finish up and report charge notice letters sincerely, totally, and accurately as per material principles, pay burdens deliberately as per the standards and on time is in a encouraging way since the mean score of the statement according to Likert scale was lies 3.58 and the research validated bench mark for this variable state as per the interpretation law set by (Best, Hawkins, and Albaum,1977) it is thoroughly high.

4.4 Inferential Statistics

4.4.1 Testing Assumptions

When we analyze data using ordinal regression, part of the process involves checking to make sure that the data can actually be analyzed using ordinal regression. Because it is only appropriate to use ordinal regression if data passes four assumptions that are required for ordinal regression to give valid results.

4.4.1.1 Multi-Collinearity Test

Multicollinearity refers to a situation in which there is exact (or nearly exact) linear relation among two or more of the input variables. The VIF (Variance Inflation Factor) for each term in the model measures the combined effect of dependence among the repressors on the variance of that term.

One or more large VIF indicate multicollinearity. The assumption assumes that independent variables are not highly correlated with each other. The assumption is tested by Variance Inflation Factor (VIF) statics as follows:

Table 4.9: Variance Inflation Factor (VIF) statics result

		Collinearity Statistics	
S/N		Tolerance	VIF
1	General tax knowledge	.566	1.766
2	Legal Tax Knowledge	.364	1.750
3	Procedural Tax Knowledge	.568	1.762
4	Penalty	.649	1.540

Source: Authors Analysis (2022)

Tolerance and VIF value were used to check Multicollinearity. Based on the practical experience that indicates that if any of the VIF results exceeds 5 or 10, and tolerance value less than 0.2, it is an indication that the associated regression coefficients are poorly estimated because of multicollinearity. The above Table 4.9 shows that the VIF and tolerance value of general tax knowledge, legal tax knowledge, procedural tax knowledge, and penalty are less than 5 and greater than 0.2 respectively and no collinearity is observed on this data and passed for further regressions analysis.

4.4.1.2 Normality Test

The figure below displays the frequency distribution of the standardized residual compared to normal distribution. As can be understood from the figure, the data points are close to the diagonal line confirming that there is normality.

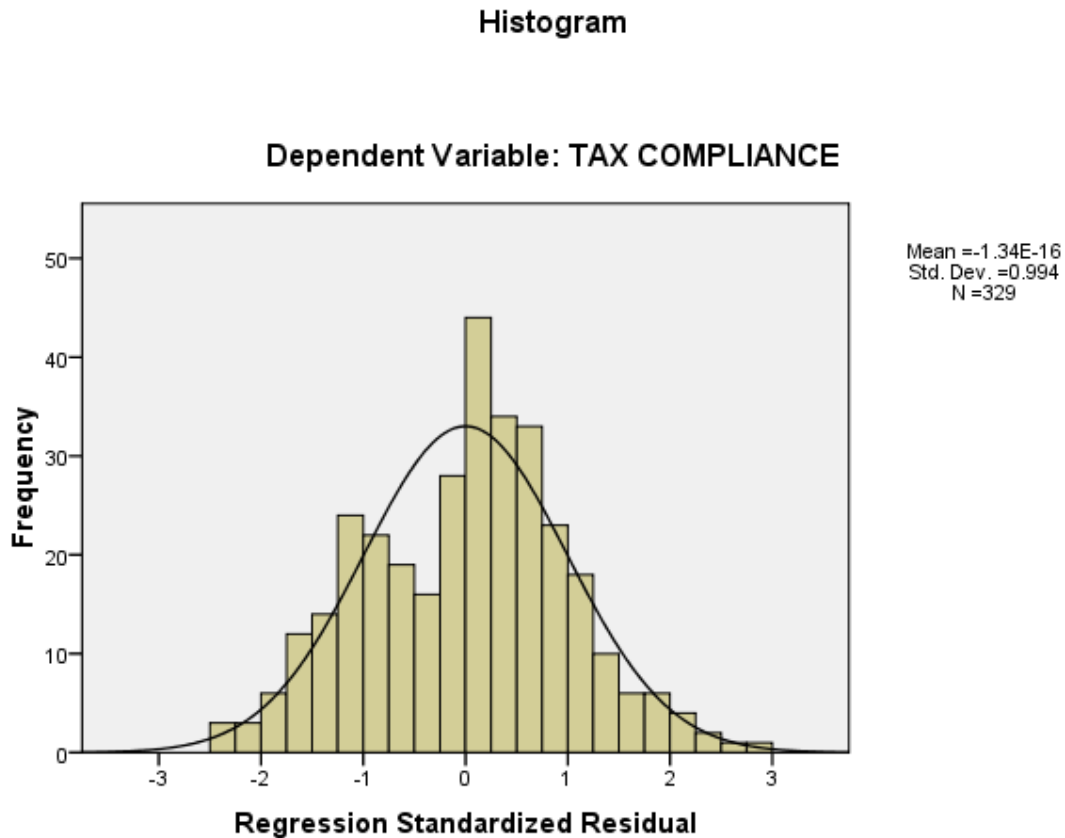


Figure 4.1 Normality Test

The graphs above show the histogram that is a plot of how often possible values occurred. It's one way to see if there is anything strange in your data - any extreme values, or all the scores piled up on one side. Paramount, normality through histogram – the study used a histogram plot indicating normality of residuals. It produced a bell-shaped curve that shows the normal distribution of the series. In this study, the figure above shows a bell-shaped distribution of the residuals. The figure shows that X-axis shows the residuals, whereas Y axis represents the density of the data set. As a consequence, this histogram plot confirms the normality test results from the two tests in this study.

4.4.1.3 Linearity

Test Linearity refers to the degree to which the change in the dependent variable is related to change in the independent variables.

Normal P-P Plot of Regression Standardized Residual

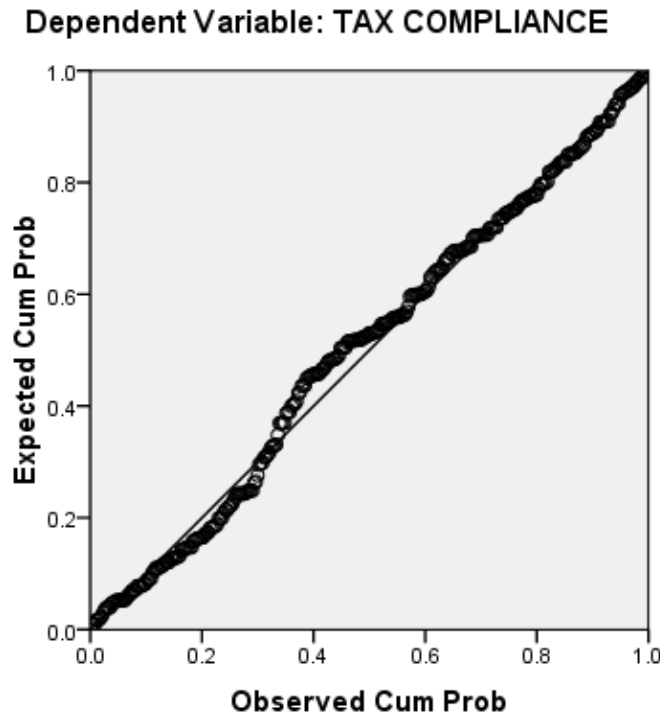


Figure 4.2 Linearity Test for tax compliance

To determine whether the relationship between dependent variable (tax compliance) and the independent variables (general tax knowledge, legal tax knowledge, procedural tax knowledge, and tax penalty) is linear, plots of regression residuals through SPSS had been applied. The scatterplot of residuals displays no big differences in the spread of the residual as we look from the left to the right in the above figure. This result advocates that the relationship that is being predicted is linear; consequently, the assumption is satisfied.

4.4.1.4 Homogeneity

Homoscedasticity is checked whether the residual is equally distributed, spread far apart or tend to bunch together at some random values or at other values. The data in homoscedasticity looks a shot gun blast rather than a cone or fan shape in which points are equally distributed above or below the X-axis to the left/right of zero on the y-axis. Figure 4.3 below shows the spread of residuals

randomly distributed variance or homogeneity of variance which is constant across the linear model and as a result homoscedasticity is not violated.

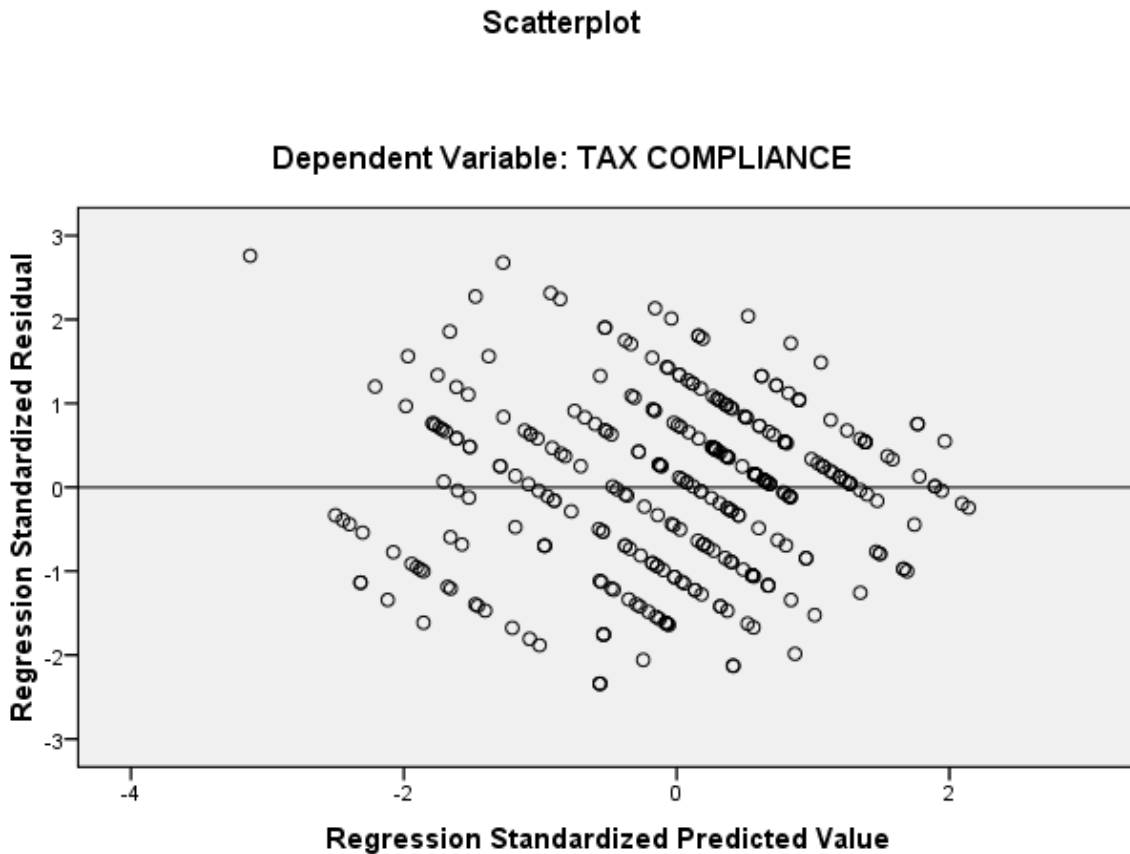


Figure 4.3 Homogeneity Test for tax compliance

4.4.2 Results of the Inferential Statistics

4.4.2.1 Correlation Analysis

Correlation is a measure of association between two variables. According to Kothari (2004), positive values of r indicate positive correlation between the two variables (i.e., changes in both variables take place in the same direction), whereas negative values of r indicate negative correlation i.e., changes in the two variables taking place in the opposite directions. A zero value of r indicates that there is no association between the two variables. When $r = (+) 1$, it indicates perfect positive correlation and when it is $(-) 1$, it indicates perfect negative correlation. In the same way, Cohen (1998) cited by Waroka (2012), also interpreted the coefficient of correlation between 0 and 1 as in the following manner. The correlation coefficient (r) ranging from 0.10 to 0.29 may

be regarded as indicating a low degree of correlation, r ranging from 0.30 to 0.49 may be considered as a moderate degree of correlation, and r ranging from 0.50 to 1.00 may be regarded as a high degree of correlation.

Table 4.10: Correlation Analysis

		1	2	3	4	5
General tax knowledge	Pearson Correlation	1				
	Sig. (2-tailed)					
	N	329				
Legal Tax Knowledge	Pearson Correlation	.650**	1			
	Sig. (2-tailed)	.000				
	N	329	329			
Procedural Tax Knowledge	Pearson Correlation	.365**	.620**	1		
	Sig. (2-tailed)	.000	.000			
	N	329	329	329		
Penalty	Pearson Correlation	.258**	.534**	.515**	1	
	Sig. (2-tailed)	.000	.000	.000		
	N	329	329	329	329	
Tax Compliance	Pearson Correlation	.430**	.326**	.450**	.593**	1
	Sig. (2-tailed)	.000	.000	.000	.000	
	N	329	329	329	329	329

Source: Authors Analysis (2022)

Table 4.10 illustrates that the association between dependent (tax compliance) variable and independent (general tax knowledge, legal tax knowledge, procedural tax knowledge, and penalty) variable. As it was tested in a two-tailed Pearson's correlation analysis, the association of each dependent and independent variable was described below.

When general tax knowledge with tax compliance correlate, ($r = 0.430$) shows that there was a moderate degree of correlation, there was statistically significant relationship between general tax knowledge with tax compliance. Because the Pearson correlation coefficient (r) was 0.430 which found between 0.30 and 0.49, therefore the strength was moderate and significant at 0.01 confidential levels. Thus, the association between general tax knowledge with tax compliance in

Ministry of Revenue West Addis Ababa Small Taxpayers was associated as positive, moderate, and statistically significant.

When Legal Tax Knowledge with tax compliance correlate, ($r = 0.326$) shows that there was a moderate degree of correlation, there was statistically significant relationship between Legal Tax Knowledge with tax compliance. Because the Pearson correlation coefficient (r) was 0.326 which found between 0.30 and 0.49, therefore the strength was moderate and significant at 0.01 confidential levels. Thus, the association between Legal Tax Knowledge with tax compliance in Ministry of Revenue West Addis Ababa Small Taxpayers was associated as positive, moderate, and statistically significant.

When Procedural Tax Knowledge with tax compliance correlate, ($r = 0.450$) shows that there was a moderate degree of correlation, there was statistically significant relationship between Procedural Tax Knowledge with tax compliance. Because the Pearson correlation coefficient (r) was 0.450 which found between 0.30 and 0.49, therefore the strength was moderate and significant at 0.01 confidential levels. Thus, the association between Procedural Tax Knowledge with tax compliance in Ministry of Revenue West Addis Ababa Small Taxpayers was associated as positive, moderate, and statistically significant.

When Penalty with tax compliance correlate, ($r = 0.593$) shows that there was a high degree of correlation, there was statistically significant relationship between Penalty with tax compliance. Because the Pearson correlation coefficient (r) was 0.593 which found between 0.50 and 1.00, therefore the strength was high and significant at 0.01 confidential levels. Thus, the association between Penalty with tax compliance in Ministry of Revenue West Addis Ababa Small Taxpayers was associated as positive, high, and statistically significant.

4.4.2.2 Multiple Regression Analysis

In the course of investigating research objectives i.e., “what is the Effect of Tax Knowledge and Penalty on Tax Compliance?” or “To determine empirically the relationship between Tax Knowledge and Penalty and tax compliance in terms of general tax knowledge, legal tax knowledge, procedural tax knowledge, and penalty” multiple regression was conducted. Multiple Regression analysis tells that how much each independent variable has an effect or relationship with the dependent variable. The following basic and common assumptions are considered. To this, a regression analysis was carried out to determine the level of significance that existed in

relationships, and when all the variables between tax knowledge and penalty practices such as general tax knowledge, legal tax knowledge, procedural tax knowledge, and penalty are applied.

Coefficient value: It shows the negative or positive effect of the variables. If the coefficient value is positive, it shows that independent variable is affecting the dependent variable in a positive way. If the sign is negative, it shows that the effect is negative.

T-statistic: T-statistic tells us the effect of one variable on another variable. So, it is a “one variable test”. If $t > 2$, then it means that independent variable has a significant effect on the dependent variable. If $t < 2$, then it shows that the result is insignificant.

F-statistic: F-statistic tells us the effect of more than one variable on the dependent variable. For example, to measure that how general tax knowledge, legal tax knowledge, procedural tax knowledge, and penalty simultaneously affect tax compliance, F-statistic will be used. If $F > 4$, it means that there is a significant effect on a dependent variable by independent variable and that the model is a good fit (reliable). Whereas, if $F < 4$, then it means the results are insignificant.

R-square: R-square is the coefficient of determination; it explains how much variation in the dependent variable is taking place due to tax knowledge and penalty.

Constant: Constant is basically the intercept. Therefore, the value of constant cannot be ignored but it does not affect the result in a direct or indirect way. It just shows that even if the independent variable has zero value, there will be still some value of the dependent variable.

Probability: Probability and t-statistics basically indicate the same results. Either both or just one of them can be taken because in any way the results will show similar indication overall.

Table 4.11: Model Summary

Model Summary^b

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
					R Square Change	F Change	df1	df2	Sig. F Change	
1	.721	.520	.514	.54496	.520	87.810	4	324	.000	1.718

a. Predictors: (Constant), General tax knowledge, Legal Tax Knowledge, Procedural Tax Knowledge, and Penalty

Model Summary^b

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
					R Square Change	F Change	df1	df2	Sig. F Change	
1	.721	.520	.514	.54496	.520	87.810	4	324	.000	1.718

b. Dependent Variable: Tax Compliance

Source: Authors Analysis (2022)

This statistical measurement is clued-up by concluding the value of R^2 to explain the magnitude of the effect of the independent variable on the dependent variable. The above table 4.11 depicted and enlightened as the linear regression of four independent variables and dependent variable. As shown in the above table, the overall bundle of determinant factors of the four independent variables were 52% ($R^2 = .520$) explained the dependent variable (tax compliance). This suggests that 52% of tax compliance in the surveyed organization clearly depends on the independent variables while the remaining 48% is determined by other unaccounted factors in this study.

Table 4. 12: ANOVA

ANOVA^b

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	104.312	4	26.078	87.810	.000 ^a
	Residual	96.222	324	.297		
	Total	200.534	328			

a. Predictors: (Constant), General tax knowledge, Legal Tax Knowledge, Procedural Tax Knowledge, and Penalty

b. Dependent Variable: Tax Compliance

Source: Authors Analysis (2022)

Table 4.13: Regression Coefficients

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
	B	Std. Error	Beta			Tolerance	VIF
(Constant)	.468	.191		2.450	.015		
General tax knowledge	.529	.056	.485	9.485	.000	.566	1.766
Legal Tax Knowledge	.562	.078	.461	7.226	.000	.364	1.750
Procedural Tax Knowledge	.290	.057	.261	5.104	.000	.568	1.762
Penalty	.605	.050	.580	12.15	.000	.649	1.540

a. Dependent Variable: Tax Compliance

Source: Authors Analysis (2022)

The above last Regression Coefficient table 4.13 results shows as there is a positive and significant effect of General tax knowledge practice (.485; $P < .05$) and tax compliance. The beta coefficient result shows $\beta=.485$. This implies that taking all the independent variable zero, a one unit increases in General tax knowledge practices will lead to an increase in tax compliance by 48.5%.

This study also found similar results as there is a positive and significant effect of Legal Tax Knowledge (.461; $P < .05$) and tax compliance. The beta coefficient result shows $\beta=.461$. This implies that taking all the independent variable zero, a one unit increases in Legal Tax Knowledge practices will lead to an increase in tax compliance by 46.1%.

This study also found similar results as there is a positive and significant effect of Procedural Tax Knowledge (.261; $P < .05$) and tax compliance. The beta coefficient result shows $\beta=.261$. This implies that taking all the independent variable zero, a one unit increases in Procedural Tax Knowledge practices will lead to an increase in tax compliance by 26.1%. Among the four-predictor Procedural Tax Knowledge have the least effect on tax compliance of Ministry of Revenue West Addis Ababa Small Taxpayers.

This study also found similar results as there is a positive and significant effect of Penalty (.580; $P < .05$) and tax compliance. The beta coefficient result shows $\beta=.580$. This implies that taking all the independent variable zero, a one unit increases in Penalty practices will lead to an increase in

tax compliance by 58%. Among the four-predictor performance appraisal have the higher effect on tax compliance of Ministry of Revenue West Addis Ababa Small Taxpayers.

4.4.3 Discussion Result

From the above empirical studies, thesis study tests the following hypothesis that were constructed to demonstrate the effect of Selected tax knowledge and penalty practice on tax compliance. Hypothesis testing is a mathematical method in which analysts test a hypothesis about a population parameter. Using sample data, it is used to determine the credibility of a hypothesis. From the literature, it appears that tax compliance has been the topic of comprehensive empirical study. In the determinant factors of tax compliance, however, no comparable result has been obtained. There have been several explanatory factors suggested in the literature.

H1: General tax knowledge has a positive effect on taxpayers' compliance.

According to the above table 4.13 and this figure, it can be seen that the General tax knowledge is affecting the tax compliance in a positive way. Coefficient values of General tax knowledge indicate that it has a positive effect on tax compliance. In the above table, β is showing that change in General tax knowledge by one unit can affect tax compliance by 485. After that value of t shows the significance or insignificance of independent variable upon dependent variable. If the value of $t > 2$, then it means results are significant. Here the value of t is 9.485 which shows the significance of general tax knowledge on tax compliance. Thus, here the hypothesis is accepted. This finding supported by previous studies of; (Joseph, 2003) and (Akalu, 2016), which evidenced that tax knowledge could have a positive effect on tax compliance. However, some other study by (Goitom and Tadesse, (2014) indicate that education and tax knowledge have no effect on tax compliance. Several studies show that tax knowledge is considered as one of the most influential factors, which determine taxpayers' voluntary compliance or noncompliance behavior. Richardson (2006) study on 45 countries, found that complexity as the most important determinant of non-compliance, apart from education, income source, fairness, and tax morale. Kanbiro Orkaido Deyganto (2018) examined in his study the factors influencing tax voluntary compliance attitude with tax system in Gedeo Zone of Southern Ethiopia. The result of his study showed that out of fourteen explanatory variables incorporated in the model, seven variables such as gender, age, lack of tax knowledge, simplicity of tax system, awareness on penalty, probability of being audited, and perception on tax rate were found to be key factors influencing taxpayers' voluntary compliance attitude with tax

system in the study area. Whereas variables such as education level, tax authority efficiency, peer influence, occupation, income level of taxpayers, perception on government spending, and perception on fairness and equity have no significant influence on tax voluntary compliance attitude. Furthermore, the result indicated that knowledge of taxpayer, quality service of tax authority and transparency of tax system had influence on tax compliance of taxpayer, and they have positive and significant relationship with tax compliance of large business taxpayer.

H2: Legal tax knowledge has a significant positive effect on taxpayers' compliance.

According to the above table 4.13 and this figure, it can be seen that the Legal Tax Knowledge is affecting the tax compliance in a positive way. Coefficient values of Legal Tax Knowledge indicate that it has a positive effect on tax compliance. In the above table, β is showing that change in Legal Tax Knowledge by one unit can affect tax compliance by 0.461. After that value of t shows the significance or insignificance of independent variable upon dependent variable. If the value of $t > 2$, then it means results are significant. Here the value of t is 7.226 which shows the significance of general tax knowledge on tax compliance. Thus, here the hypothesis is accepted. This result is in agreement with Geletaw (2015) made his research on determinants of taxpayers' tax compliance behavior. In his research, six tax compliance determinants were examined; these determinants were: tax knowledge; feeling of fairness; the influence of peer groups; income level of taxpayers; detection & punishments and perception on government spending. The results of the research suggest that Addis Ababa City business profit taxpayers tax compliance behavior have been highly and significantly affected by tax knowledge; feeling of fairness; the influence of peer groups; income level of taxpayers and detection & punishments variables while confidence in government spending doesn't have as such significant effect on tax compliance behavior of businesses. there have been a relatively few studies covered tax fairness issues in developing countries (Anna Azmi and Kamala A. Perumal 2008; Serkan Benk et al. 2012; Abubakari Abdul – Razak and Adafula 2013), including Ethiopia (Tessema 2015, Samuel Alemnew Belay and P. Viswanadham2016), especially in the case of business profit tax system. Ethiopia like many developing countries suffers from tax revenue loss due to tax noncompliance.

H3: Procedural tax knowledge has a significant positive effect on taxpayers' compliance.

According to the above table 4.13 and this figure, it can be seen that the Procedural Tax Knowledge is affecting the tax compliance in a positive way. Coefficient values of Procedural Tax Knowledge

indicate that it has a positive effect on tax compliance. In the above table, β is showing that change in Procedural Tax Knowledge by one unit can affect tax compliance by 0.261. After that value of t shows the significance or insignificance of independent variable upon dependent variable. If the value of $t > 2$, then it means results are significant. Here the value of t is 5.104 which shows the significance of procedural tax knowledge on tax compliance. Thus, here the hypothesis is accepted. The findings identified high compliance costs, a lack of clarity and access to information about tax regulations, arbitrary behavior of tax officials and a lack of transparency in the tax authority makes taxpayers unaware of their rights and exposes them to discretionary treatment by corrupt officers. In addition, the study found that taxpayer is encountered a lot of inconveniences, including from misconduct of the tax officers like an impersonal, insensitive, and heartless bureaucracy and imbalance between location and accessibility of the tax office with number of taxpayers. In addition, A study performed by Belay and Viswanadham, (2016) to evaluate the business income taxpayers' level of tax knowledge, perceived complexity of the income tax system and tax compliance issues in Amhara regional state of Ethiopia shows taxpayers' have inadequate technical knowledge and perceive the income tax system as complex. The result also revealed that tax knowledge and tax complexity as important factors towards non-compliance behavior among business income taxpayers. Moreover, both taxpayers and tax authority believe that fairness of the tax system is one of the major determinants of tax compliance. Fairness can be seen from two angles: equity of trade, which is related with the benefit received from paid tax and the other is equity in relation to burden of tax liability in comparison to other taxpayers (Ahmed and Kedir, 2015).

H4: Penalty has a significant positive effect on taxpayers' compliance.

According to the above table 4.13 and this figure, it can be seen that the penalty is affecting the tax compliance in a positive way. Coefficient values of penalty indicate that it has a positive effect on tax compliance. In the above table, β is showing that change in penalty by one unit can affect tax compliance by 0.580. After that value of t shows the significance or insignificance of independent variable upon dependent variable. If the value of $t > 2$, then it means results are significant. Here the value of t is 12.15 which shows the significance of penalty on tax compliance. Thus, here the hypothesis is accepted. This is supported by the results of Arvian and Djani (2018), Gunarso (2016), and Kamil (2015) found that tax penalties had a significant effect on taxpayer compliance in paying taxes. Sheikh Obid (2014) discusses the effect of tax penalties on taxpayers' compliance and the

finding suggests that penalty rate, as well as audit detection rate, does have a significant influence on tax evasion. Mohd, Yusof, Lai & Yap, (2014) finds the relationship between tax penalties rate and tax non-compliance is insignificant. On the other hand, the study carried out Mohdali, Isa and Yusoff (2014) appear at the effect of the threat of punishment on tax compliance and noncompliance attitudes in Malaysia recommend that the threat of punishment has influenced taxpayers to emerge as less compliant which would maybe point out their rebellious act toward the authorities.

Table 4.14 Research Hypothesis

S/N	Hypothesis	Method	Result	Reason
1	General tax knowledge has a positive effect on taxpayers' compliance	Regression	Accepted	P - value <0.05
2	Legal tax knowledge has a significant positive effect on taxpayers' compliance	Regression	Accepted	P - value <0.05
3	Procedural tax knowledge has a significant positive effect on taxpayers' compliance	Regression	Accepted	P - value <0.05
4	Penalty has a significant positive effect on taxpayers' compliance	Regression	Accepted	P - value <0.05

CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATION

The study sought to examine the effect of tax knowledge and penalty on tax compliance the case of Ministry of Revenue West Addis Ababa small taxpayers. This chapter presents a summary of major findings, conclusion, and recommendations of the study findings. The conclusion narrates directly to the research objectives and the recommendations were derived from the discussion of the study findings and conclusion. The chapter also presents suggested studies that could be carried out in future to extend knowledge in this particular area.

5.1 Summary of Findings

- The present study targeted surveyed institution in Ethiopian Ministry of Revenue West Addis Ababa small taxpayers. A total of 400 taxpayers in the study area were sampled from this institution. The summary of the study findings presented herein followed the research hypotheses formulated in chapter two of the study. The study attended 82.75 % of responses rate as 329 questionnaires were properly returned out of 400 self-administrated or distributed questionnaires. This study mainly used primary data and self-administrated/close ended questionnaire.
- To examine the relationship between tax knowledge and penalty (general tax knowledge, legal tax knowledge, legal tax knowledge, procedural tax knowledge) and tax compliance a correlation analysis was conducted. The correlation analysis shows that tax knowledge and penalty with tax compliance have positive and significant relationship. The first highest correlation is between penalty and tax compliance, procedural tax knowledge is next to penalty. The third highest correlation is between general tax knowledge and tax compliance and the fourth highest correlation is between legal tax knowledge and tax compliance. From this the researcher can say that all the four-tax knowledge and penalty practices and tax compliance have positive and statistically significant relationship.
- To evaluate the extent to which the selected tax knowledge and penalty (General tax knowledge, Legal Tax Knowledge, Procedural Tax Knowledge, and Penalty) influence tax compliance, a

regression analysis was conducted. From the regression Model summary 52% of tax compliance in the surveyed institution clearly depends on the independent variables (General tax knowledge, Legal Tax Knowledge, Procedural Tax Knowledge, and Penalty) while the remaining 48% is determined by other unaccounted factors in this study.

5.2 Conclusion

In light of the descriptive and inferential analysis of the effect of tax knowledge and penalty on tax compliance, the following conclusions have been drawn.

- This study found that the General tax knowledge positively affect tax compliance. This infers that the level of awareness or sensitivity of the taxpayers to the tax legislation. Tax knowledge refers to the processes, by which taxpayers become aware of tax legislation and other tax-related information. And the level of formal general education received by taxpayers is an important factor that contributes to the understanding of tax requirements, especially regarding registration and filling requirements had effect on how taxpayers act of filling the income tax form, 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.
- According to the regression coefficients result, the Legal Tax Knowledge positively affect tax compliance. This concludes that knowledge on government true expenditures and the cost of public services provided by the government. Hence, those taxpayers without tax knowledge are compelled to solicit the service of tax professionals and high awareness by the society would encourage people to fulfill their obligations to register as taxpayer reporting and paying taxes properly are forms of national and civic responsibility had effect on how true reporting of the tax base, correct computation of the liability (accuracy), timely filing of the return, and timely payment of the amounts due.
- According to the regression coefficients result, Procedural Tax Knowledge positively affect tax compliance. This infers that understanding tax compliance procedures and need to be in touch with the tax authority to know how to comply with tax filing, prepare supporting documents, and pay their taxes on time and this had effect on how demonstration of filling the personal tax document, pronouncing all available pay precisely, and dispensing all payable charges inside the specified period without hanging tight for follow-up activities from the power.

- According to the regression coefficients result, the tax penalty positively affects tax compliance. This deduces that the precept of legitimacy can't be separated from taxation laws and imposing regulations. Taxpayers who intentionally do not fulfill their tax responsibilities will be penalized. Tax sanctions are ensuring that the requirements of tax policies obeyed and had effect on how exhibition of filling the individual expense archive, articulating all suitable compensation definitively, and administering all payable charges inside the predefined period without keeping it together for follow-up exercises from the power.

5.3 Recommendation

- The tax system should not only provide a clear and simple guideline on how to fill tax returns but also enhance taxpayer education services to enable the taxpayers understand their rights and obligations as taxpayers. This way tax compliance levels will increase.
- The Ethiopian Ministry of Revenue West Addis Ababa Small taxpayers' revenue office should strengthen the tax follow up and collection system so as to monitor informal suppliers transacting without using legal receipts and to include all Ethiopian Ministry of Revenue West Addis Ababa Small taxpayers into the tax system. And it should be extended to have consultative session with elderly, taxpayers' representatives, clan and religious leaders and other individuals that have high respect from society to influence the overall society to have positive compliance attitude by reducing negative attitude towards taxation.
- Technology in tax administration means helps individuals to integrate with the officials at the comfort of the home and workplace without necessarily moving to the government offices. This increases and eases the time used to carry out obligations. This can be enhanced by having accessible websites and easy inputs with descriptions user guide for different functionalities.
- There is need for the tax authority to engage actively with them in order to build their knowledge capacity on taxation principles and not just equipping them with the basic principles of tax returns but also to ensure that they are able to reduce their costs while filing their returns. By doing this, it is increasing their knowledge of tax and improves their compliance level minimizing incidences of evasion of tax. Furthermore, regular sensitization and other programs to be organized for the purposes of enhancing tax awareness and education for proper uptake of tax system for ease of filing returns and fulfilling their tax obligations.

5.4 Suggestions for future research

- There is need to not only carry out further research in other towns in Ethiopia but also compare the level of tax compliance retrospectively and in comparison, with medium and large taxpayers with the aim of identifying the gaps that are common among them. It is also imperative that there are other factors not covered in this study that can have effect on tax compliance. Having that in mind, it is only prudent that is need for further study by exploring other factors that are important in tax compliance in order to increase taxpayers' compliance.

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Appendix



**ST. MARY'S UNIVERSITY
SCHOOL OF GRADUATE STUDIES**

Dear respondents,

This is a questionnaire intended to obtain relevant information to examine the impact of knowledge of tax and penalty on taxpayers' compliance with the selected Western Addis Ababa small taxpayers at federal level. The finding of the study greatly depend on your cooperation for which are grateful in advance to achieve this you are kindly requested to cooperate giving response for the following question by ticking against the appropriate answer and by filling in the space provided. Your responses will be used only for research purposes.

Section I. Background information of respondents

1 Gender

Male Female

2 Age

20-30 41-50
 31-40 Above 50

3 Level of Education

High School Incomplet
 High School Completed
 College Diploma
 BA Degree
 MA & Above

4 How long you have stayed in the business (in years)

0-5 11-20
 6-10 >20

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No.	Statements	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
1	I am aware that paying taxes is a civic duty					
2	I am familiar with Ethiopia's tax system					
3	I have general understanding of types of taxes and duties in Ethiopia					
4	As far as I am aware everyone who earns income sourced in the country is taxable regardless of whether that person is a resident or not					
5	I have general understanding how tax influence my financial position					

B. Legal tax knowledge

No.	Statements	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
1	I know how much tax I have to pay.					
2	I understand how taxes are calculated.					
3	I am familiar with most tax laws and guidelines pertaining to the taxation of business income.					
4	I am capable of interpreting taxation laws when calculating taxes.					
5	I'm not sure what deductions I can claim as a taxpayer in calculating my tax liability					

C. Procedural Tax Knowledge

No.	Statements	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
1	I know how to announce all business income taxes to the tax authority					
2	I have no problem completing and submitting the required tax return form(s).					
3	I know how to keep records/documents relating to income and expenses for a period that should be declare					

4	I understand everything that is expected of me in terms of my business profit tax obligation.					
5	I am certain about the period and where to pay my tax liability					

Section III. Survey questionnaires about Penalty

No.	Statements	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
1	I know the types of penalties and rates that apply in Ethiopia					
2	I am aware that non-tax compliance is an offense that leads to punishment.					
3	The penalty rates are low, and I can pay the penalty without complaint.					
4	Increasing penalty rates make me more of my duty to declare all my taxes on time and properly.					
5	The current penalty rate is enough to discourage noncompliance					

Section IV. Survey questionnaires about Tax Compliance

E. Tax Compliance						
No.	Statements	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
1	I record the financial business regularly and correctly.					
2	I fill out and report tax notification letters honestly, completely, and correctly in accordance with applicable rules.					
3	I pay taxes voluntarily according to the rules and on time.					



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የተከበሩ የጥናቱ ተሳታፊ

ይህ በምዕራብ አዲስ አበባ አካባቢ ግብር ከፋዮች ቅ/ ጽ/ቤት የግብር ከፋዮች የግብር ግንዛቤ፣ ዕውቀት እና የታክስ ቅጣት በግብር ከፋዮች ላይ የሚኖረውን ተፅዕኖ ለመፈተሽ አስፈላጊ መረጃ ለማግኘት የታሰበ መጠይቅ ነው። የጥናት ውጤቱም በእናንተ ትብብር ላይ በእጅጉ የተወሰነ ነው። ለሚከተለው መጠይቅ በቀረበው ቦታ ላይ በመሙላት ተገቢውን ምላሽ እንዲሰጡ በአክብሮት እንጠይቃለን። የእርስዎ ምላሾች ለጥናቱ ዓላማ ብቻ ጥቅም ላይ እንደሚውሉ ላረጋግጥልዎ እፈልጋለሁ።

ስለትብብርዎ በጣም አመሰግናለሁ

ክፍል.1 የታክስ ከፋዮች አጠቃላይ መረጃ

1 ጾታ

ወንድ ሴት

2 ዕድሜ

ከ 20-30 ከ 41-50
 ከ 31-40 ከ 50 በላይ

3 የትምህርት ደረጃ

ሁለተኛ ደረጃ ያላጠናቀቀ
 ሁለተኛ ደረጃ ያጠናቀቀ
 ዲፕሎማ
 ዲግሪ
 ሁለተኛ ዲግሪ እና በላይ

4 በስራ ላይ ለምን ያህል ጊዜ ቆይተዋል (በዓመት)

ከ 0-5 ከ 11-20
 ከ 6-10 ከ 20 ዓመት በላይ

እባክዎ በሚቀጥለው ስንጠረዥ ውስጥ ላሉት ሃሳቦች የ "✓" ምልክት በማድረግ አስተያየትዎን ያስቀምጡ

ክፍል 2.ግብር ከፋዮች ስለግብር ያላቸው ግንዛቤ እና እውቀት በተመለከተ የዳሰሳ መጠይቆች

ሀ። ስለግብር አጠቃላይ ግንዛቤን በተመለከተ						
ተ.ቁ	ሃሳቦች	ፈጽሞ አልሰማም	አልሰማም	ገለልተኛ ነኝ	እስማማለሁ	በጣም እስማማለሁ
1	ግብር መክፈል የዜግነት ግዴታ መሆኑን አውቃለሁ					
2	የኢትዮጵያን የግብር ስርዓት ጠንቅቄ አውቃለሁ					
3	በኢትዮጵያ ውስጥ ስላሉ የግብር (ታክስ) ዓይነቶች አጠቃላይ ግንዛቤ አለኝ					
4	ማንኛውም ገቢ የሚያገኝ ሰው ኢትዮጵያ ውስጥ ነዋሪ ሆነም አልሆነም የገቢ ምንጩ በአገሪቱ ውስጥ ከሆነ ግብር የመክፈል ግዴታ አለበት					
5	ግብር በንግድ ስራዬ ላይ ምን ዓይነት ተጽዕኖ እንደሚያሳድር አጠቃላይ ግንዛቤ አለኝ					
ለ. የግብር(የታክስ) ህግ ዕውቀትን በተመለከተ						
ተ.ቁ	ሃሳቦች	ፈጽሞ አልሰማም	አልሰማም	ገለልተኛ ነኝ	እስማማለሁ	በጣም እስማማለሁ
1	የንግድ ገቢ ግብርን በሚመለከቱ አብዛኛዎቹን የግብር ህጎች እና መመሪያዎች አውቃለሁ					
2	ግብር በማስላት ጊዜ የግብር ህጎችን የመተርጎም ችሎታ አለኝ					
3	ድርጅቱ ምን ምን ዓይነት ግብር መክፈል እንዳለበት አውቃለሁ					
4	ግብር የሚከፈልበትን ገቢ ለመወሰን ተቀናሽ እና ተቀናሽ ያልሆኑ ወጪዎችን በግልፅ አውቃለሁ					
5	የቅጥር ገቢ ግብርን ሳሰላ ታክስ የሚከፈልባቸው እና ታክስ የማይከፈልባቸው አበል እና ጥቅሞች ምን ምን እንደሆኑ አውቃለሁ					
መ. የስርዓተ ግብር (የታክስ ስርዓት) ዕውቀትን በተመለከተ						
ተ.ቁ	ሃሳቦች	ፈጽሞ አልሰማም	አልሰማም	ገለልተኛ ነኝ	እስማማለሁ	በጣም እስማማለሁ
1	ሁሉንም ገቢዎች ለግብር ባለስልጣን እንዴት ማስታወቅ እንደሚቻል አውቃለሁ					
2	የሚፈለገውን የግብር ማሳወቂያ እና የክፍያ ቅጾችን(ፎርሞችን) መሙላት እና ለታክስ ባለስልጣን ማቅረብ ምንም ችግር የለብኝም					
3	ወጪ እና ገቢዎን እንዴት መመዘገብ እንዳለብኝ እና ለምን ያህል ጊዜ የሂሳብ ሰነድ ማስቀመጥ እንዳለብኝ አውቃለሁ					
4	ከንግድ ትርፍ ታክስ ግዴታዬ አንጻር የሚጠበቀኝን ሁሉ ተረድቻለሁ					
5	የግብር እዳዬን የት እንደምከፍል እና ስለ መክፈያው ጊዜው እርግጠኛ ነኝ					

ክፍል 3. ግብር ከፋዮች የግብር ግዴታን ባለመወጣት የሚደርስ ቅጣትን በተመለከተ የዳሰሳ መጠይቆች

ተ.ቁ	ሃሳቦች	ፈጽሞ		ገለልተኛ ነኝ	በጣም	
		አልሰማማም	አልሰማማም		አስማማለሁ	አስማማለሁ
1	በኢትዮጵያ ውስጥ የሚተገበሩ የግብር ቅጣት አይነቶችን እና የቅጣት መጠናቸውን አውቃለሁ					
2	ግብርን አለማሳወቅ እና አለመክፈል ቅጣትን የሚያስከትል ጥፋት መሆኑን አውቃለሁ					
3	አሁን ያለው የቅጣት መጠን አነስተኛ ስለሆነ መክፈል እችላለሁ					
4	የቅጣት መጠን መጨመር ሁሉንም ተግባሮቼን በጊዜ እና በአግባቡ የማሳወቅ ግዴታዬን እንደገነዘብ ያደርገኛል ብዬ አምናለሁ					
5	አሁን ያለው የግብር ቅጣት መጠን የግብር ህጎችን ተከትሎ ለመስራት በቂ ነው ብዬ አምናለሁ					

ክፍል 4. ግብር ከፋዮች ለግብር ህግ ተገዥነትን በተመለከተ የዳሰሳ መጠይቆች

ተ.ቁ	ሃሳቦች	ፈጽሞ		ገለልተኛ ነኝ	በጣም	
		አልሰማማም	አልሰማማም		አስማማለሁ	አስማማለሁ
1	የድርጅቴን ገቢ እና ወጪ በመደበኛነት እና በትክክል አመዘግባለሁ					
2	በግብር ህግ እና ደንብ መሰረት የግብር ግዴታዎቼን ሙሉ በሙሉ በታማኝነት እና በፍቃደኝነት አወጣለሁ					
3	የሚጠበቅብኝን ግብር በተሰጠኝ የጊዜ ገደብ ውስጥ መክፈል እንዳለብኝ አውቃለሁ					