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RESEARCH ARTICLE

TAX PAYERS' PERCEPTION AND TAX COMPLIANCE BEHAVIOUR IN TIGRAY

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ABSTRACT

The present study was aimed to investigate the two aquaculture pond waters of physio-chemical parameters and microbial analysis at Alwarkurichi village, Tirunelveli district. The physio-chemical parameters are pH, conductivity, dissolved oxygen, BOD (Biological oxygen demand), calcium, magnesium, total hardness, chloride, phosphate, nitrate, and total dissolved solid were tested by Tamilnadu water supply and Drainage board, District water testing laboratory, Palayamkottai. Subsequently, the water samples microbial colonies were identified with standard methods. They are Klebsiella pneumoniae, Pseudomonas aeruginosa and Vibrio cholera as more dominant in the two ponds. Hence, the identified three pathogenic bacteria were treated with some commercially popular chemicals at various concentrations. The antibacterial activity of three compounds Sodium chloride, Formalin and Copper sulfate was studied against three pathogenic bacteria using agar well diffusion method. The growth suppression rate exhibited by Copper sulfate vial higher at 0.08mg/10ml when equivalence to others. When compared to copper sulfate, size of the acquired growth distinct was less when examined with ampicillin. Copper sulfate was identified as the most efficacious against absolutely the three pathogens.

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INTRODUCTION

1.1 Background of the study

According to Lymer and Oats (2009:1) cited in Palil (2010), taxation is one of the important elements in managing national income, especially in developed countries and has played an important role in civilized societies since their birth thousands years ago (Palil, 2010). Tax is defined as 'a compulsory levy, imposed by government or other tax raising body, on income, expenditure, or capital assets, for which the taxpayer receives nothing specific in return' (Palil, 2010). Awareness of different taxes generally follows the distinction between direct and indirect taxes. Direct taxes, including income and property taxes, as well as many local taxes, are paid directly by taxpayers to the government. By contrast, indirect taxes, of which the two most important are customs duties and sales taxes, are often invisible to consumers. Trade taxes are paid at the port, and are thus captured in consumer prices, but never explicitly. Similarly, VAT (Value Added Tax) is often not paid by small retailers, on whom most customers rely. Yet the retailers, and their customers, are, in fact, paying VAT due to tax payments made earlier in the value chain. Different researchers stated several points about the objectives of imposing certain taxes on the public. For example, Singh, (1999); Shanmugam, (2003); Lymer and Oats, (2009: 2) cited

by Palil (2010), to generate revenues for the government for public expenditure, to reduce inequalities through a policy of redistribution of income and wealth so that income gap between the rich and the poor is not as significant. Moreover, tax systems are designed for social purposes, such as discouraging certain activities which are considered undesirable and protecting the environment. For instance, the excise taxes on alcohol and tobacco are (at least partly) exercised to decrease consumption and thus encourage a healthier lifestyle. Taxes are also expected to ensure economic goals through the ability of the taxation system to influence the allocation of resources including transferring resources from the private sector to the government to finance the public investment programme (Palil, 2010).

Palil agreed with Adam Smith's definition towards tax system. Smith noted in his book entitled 'The wealth of Nations' which was published in 1776 a tax system is practiced based on certain principles, namely equity, certainty, convenience and efficiency (Palil, 2010). *Equity*: a tax should be seen to be fair in its impact on all individuals; *Certainty*: taxes should not be arbitrary, the taxpayer should know his or her liability and when and where to pay it; *Convenience*: it should be easy for taxpayers to pay what they owe; and *Efficiency*: the tax system should not have an impact on the allocation of resources and it should be cheap to administer (Adapted from Lymer and Oats 2008: 43). Nations at different economy development earn different amount of taxes. For instance, as Organization for Economic Co-operation and Development (OECD) reported, in

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2007, tax collection as percentage of Gross Domestic Products (GDP) in developed countries like the United States of America and the United Kingdom were 28.33% and 36.6% respectively (average Organization for Economic Co-operation and Development (OECD) countries in 2006 were 35.9%) (OECD, 2009). For developing countries, like Indonesia and Malaysia in 2008, the tax collection as percentage of GDP were 13.35 and 15.3% respectively (average Asian countries 22.5%) (Asian Development Bank, 2009). However, in sub-Saharan countries like Ethiopia its contribution is very low. For example, according to African Economic Outlook report (2012), the Ethiopia tax contribution to GDP in the year 2011 was 11.3%, and the projection contribution of 2012 and 2013 are 11.6% and 11.8%, respectively. Another researcher, Cobham (2005) as cited by AJBUMA (2010), has also consistently verified low tax contribution to GDP. For example, it's one-third of GDP in rich countries; Latin America and the Caribbean 17% of GDP and low-income countries (in Sub Saharan Africa) showed less than 15% to GDP (the recommended rate). It remains a big challenge to low income countries.

The importance of tax systems as a major revenue source in a country is undeniable (Slemrod, 1989 cited by Palil, 2010); the statistics have evidenced that tax revenues are one of the main income source for many governments throughout the world but as Palil (2010) cited in his research (Allingham and Sandmo, 1972), to maximize tax collection and minimize tax evasion among taxpayers is difficult in practice.

As Adams noted, (1921:536,556), cited by professor Ruanda Oberholzer (2008), a government's success or failure to levy (collect) tax rests primarily upon the honesty of taxpayers. Consistently Oberholzer (2008) stated, one of the main reasons for the tax gap is non-compliance by taxpayers and potential taxpayers, with tax legislation. One of the causes of non-compliance has been demonstrated to be the attitudes and perceptions of people.

Empirical evidence on the ground has also shown there have been some factors which influenced tax payers' behavior towards tax system. As AJBUMA reported (2010), understanding the taxpayers' behaviour in terms of factors which influence their behaviour towards tax compliance. In explaining taxpayers' compliance behaviour, that is, the reasons why taxpayers comply and do not comply, like wise Trivedi & Shehata, 2005 cite on AJBUMA (2010) report, there are broadly two classes of theories – economic based theories, which emphasize incentives, and psychology-based theories which emphasize behaviour. As AJBUMA (2010) reported:

Economic theories of tax compliance are referred to as deterrence theory. According to Trivedi and Shehata (2005), economic theories suggest that taxpayers "play the audit lottery," i.e. they make calculations of the economic consequences of different compliant alternative, such as whether or not to evade tax; the probability of detection and consequences thereof, and choose the alternative which maximizes their expected after tax return/profit (possibly after adjustment for the desired level of risk). The theories suggest that taxpayers are amoral utility maximizes hence; economic

theories emphasize increased audits and penalties as a solution to compliance problems. Economic based studies suggest that taxpayers' behaviour is influenced by economic motives such as profit maximization and probability of detection (Trivedi and Shehata, 2005), underreporting (Erard and Ho, 2002; Cobham, 2005), business income taxpayers operating in informal economy (Etchberry, 1992) among many factors. Psychology theories of tax compliance assume that psychological factors – including moral and ethical concerns are also important to taxpayers and so taxpayers may comply even where the risk of audit is low. Psychology theories de-emphasize audits and penalties and instead focus on changing individual attitudes towards tax system.

Trivedi and Shehata (2005) concluded that some taxpayers' behaviour may follow economic theories while others may follow the psychological theories and a mixture of the two is also possible. To study a taxpayer's behavior towards taxation, as many research showed, is difficult (Palil, 2010; AJBUMA, 2010; Oberholzer, 2008 etc.). Therefore, this study will focus on highlighting the perceptions amongst the various population groups surveyed (Palil, 2010). Moreover, as ATO advocated on the journal "*Taxing Democracy*", this was edited and reported by Braithwaite "*understanding taxpayer behaviour is risk management of a tax system*" (ATO, 2009).

A number of researchers suggest that taxpayer acceptance is important for the workability of the tax system (Musgrave 1996, Song and Yarbrough 1978, and Rawlings 2003). Satisfied taxpayers, as Mohamad *et al.* (2008) confirmed, are normally complied with the requirement to submit the tax return on time. These conclusions are also consistent with prior researches (Richardson, 2006; Belkoui, 2004). Furthermore, empirical studies shows that complied taxpayers are more understand of the importance of the tax revenue to the economic growth of a country.

Influencing taxpayer behavior is not a new concept in tax administration as evidenced by the vast array of programs in place to assist taxpayers comply as well as to deter taxpayers from non-compliance. However, what is relatively new is the extent of research being undertaken to better understand what motivates tax compliance OECD (2010). Better understanding of taxpayer behavior can be expected to place revenue bodies in a stronger position to design and implement effective compliance strategies, which contributes to the sustainability of taxation systems. Moreover, OECD (2010) noted:

"Encouraging tax compliance is among the most basic tasks of any tax system. Doing so demands a careful understanding of taxpayer perceptions of the tax system, and thus of how compliance could be more effectively encouraged. Research on the determinants of tax compliance illustrates the importance of encouraging "quasi-voluntary" compliance, which depends on taxpayers trusting the government to provide reciprocal services, tax administrators to treat them fairly and other taxpayers to pay their fair share. However, these conclusions derive overwhelmingly *from more* developed countries. Surprisingly little is known about taxpayer perceptions, the incidence of different taxes and taxpaying experiences in low-income countries. Work in this area will focus on enhancing

our understanding of taxpayer experiences, through a combination of survey study evidence.” The best instrument which the governments can use as a source of revenue, as many researchers proved, is taxation. It can be said, therefore, that a major function of taxation is to marshal the necessary funds to finance the ever-expanding level of public expenditures (EBDSN, 2005).

As in all other countries, one of the purposes of taxation in Ethiopia is the raising of as much revenue as possible to meet the ever-expanding public expenditure for the supply of public goods and services which otherwise would not be available to the general public by the market. The central aim of the tax system in Ethiopia is to collect sufficient money to finance the administrative machinery of the government as well as to finance the fulfillment of basic infrastructures like roads, telecommunication, electricity and other basic social services like education, health and water supply facilities (EBDSN, 2005). In Ethiopia, like other developing countries of the world, business profit taxpayers frequently complain that the tax assessment method is based on subjective estimation. As a result of which they are frequently exposed to over-taxation. Of course, this does not imply that the people are always right or that they base their judgments on correct information, or that they are immune from propaganda or prejudice. It does assume, however, as ATO recommended, that people’s perceptions matter, and that when such perceptions are strongly held and enduring, principles of good governance demand responsiveness from relevant authorities (ATO, 2002).

A document reported by EBDSN in 2005, shown that most business profit taxpayers i.e., category B and C business profit taxpayers, do not have simplified access to and clarification on information of the tax laws, they lack awareness on tax rules and regulations and their implementation. Additionally, they do not keep their books properly, which invited to general estimations, which are often arbitrary (EBDSN, 2005). Similarly in Tigray, as one part of Ethiopia, this practical problem has been observed. For instance, even if no legal obligation for category B and C tax payers to hold financial statement, the most recent pilot study conducted by researchers shows that among 4625 category B and 13987 category C taxpayers who legally registered by the authority, only 1294 (28%) of category B and none (0%) category C taxpayers voluntarily submitted financial statement. Likewise, as a pilot study shows that till October 29, 2012 there are around 22% claims has reported by taxpayers. This may adversely affect the government’s expectation from tax to GDP contribution (15% projection at the end of 2015). Therefore, with these all the paper was emphasized on understanding and analyzing business profit taxpayers’ perception and compliance behavior.

1.2. Objective of the Study

General Objective of the Study

The general objective of the study was to understand business profit taxpayers’ perception and compliance behavior towards the tax system in three selected areas of Tigray.

Specific Objectives of the Study

In order to achieve the broad objectives, the study addressed the following specific objectives.

1. To explore why business taxpayers make complaint.
2. To analyze taxpayers perception towards tax system
3. To assess business profit taxpayers level of tax knowledge.
4. To examine the association between factors influencing tax compliance behavior.

Research Questions

1. Why business taxpayers make complaint?
2. Is there difference on taxpayers’ perception towards tax system based on their category, business sector, geographical area, and taxpaying experience?
3. Is there difference on taxpayers’ level of tax knowledge based on their category, and geographical area?
4. What is the relationship between taxpayers’ perception and level of tax knowledge with their tax compliance behavior?

Research Hypothesis

To achieve the above objectives the following hypothesis were developed.

- H_{0a1}: There is no difference between category B and category C taxpayers’ perception towards tax system.
- H_{0a2}: There is no difference between geographical areas and taxpayers’ perception towards tax system.
- H_{0a3}: There is no difference between taxpayers’ sector and their perception towards tax system.
- H_{0a4}: There is no difference between taxpayers’ taxpaying experience and their perception towards tax system.
- H_{0b1}: There is no difference between category B and category C taxpayers’ level of tax knowledge.
- H_{0b2}: There is no difference between geographical area taxpayers’ and level of tax knowledge.
- H_{0c}: There is relationship between taxpayers’ perception, tax knowledge and their compliance behavior.

Description of study area

Tigray Region is located in the Northern Ethiopia and has an estimated total population of about 4.3 million; among which 19.5% are urban inhabitants (CSA, 2008). The region is primarily agricultural as more than 80% of the population is employed in the sector. Livestock plays significant role in the rural economy of Tigray. They are sources of investment, draft power for tillage and transportation, cash income from sale of livestock and livestock products and source of food for household consumption and manure to maintain soil fertility. In Tigray region there about 3758 category A, 4625 category B and 13987 category C business profit tax payers. The research is embedded mainly within Mekelle city, Southern zone and South west zones of Tigray business tax payers.

1.3. Scope and Limitation of the Study

This study was conducted in Mekelle zone, Southern zone, and South east which are zone located in Tigray regional state. Even though there are different registered taxpayers category by the revenue authority of the region this study was confined

only on category B and C taxpayers. Furthermore, any of the analysis and finding of this research was confined only to the selected case study area. The results and conclusions in this finding may not be valid to places outside of the case study area.

Besides, the study focuses only on taxpayers' perception and tax compliance behavior of the selected area and shall not include other issues like economic factors. Both qualitative and quantitative approaches were employed to deal with the analysis of the data collection from the targeted population. Data that was obtained through in-depth interviews has been analyzed qualitatively. And the survey results have been presented through descriptive and statistical approaches using simple and cross tabulation. Since the study was survey it has some limitations. For example, the focus of this study was on category B and C taxpayers however, category A taxpayers may have different perception and behavior. Second, since taxpayers' behavior is more malleable because of several factors that influence their behavior, the behavior that taxpayers portray under this study may not be truth representation of their actual behavior.

1.4. Methodology of the study

1.4.1. Types and Source of Data

Type of Data

This study incorporated both quantitative and qualitative research approaches in order to generate the advantage of both approaches like; to address different objectives of the study, which cannot be achieved by a single method; and to enable one approach to inform another approach, either in design or in interpretation. As well as to triangulate the findings of different approaches (either performed concurrently or sequentially) in an effort to provide greater confidence to the study. McKerchar (2010) argues that *"each strategy has its strength and weaknesses and the drive for mixed method research....is to use one strategy to either inform, validate or compensate for the weaknesses of another"*.

Quantitative Data

According to Leedy and Ormrod (2005), a study is classified as quantitative, if the researcher wants to quantify the variation in a phenomenon, situation, problem or issue, if information is gathered using predominantly quantitative variables, and if the analysis is geared to ascertain the magnitude of the variation. Additionally, quantitative research is used to develop and employ mathematical models, theories, and hypotheses pertaining to natural phenomena. Therefore, quantitative data in this study was collected to search out desirable answer particularly issues that are directly related to taxpayer's perception and compliance behavior of business profit tax payers.

Qualitative Data

A study is categorized as qualitative, if its intention is primarily to describe a situation, phenomenon, problem, or event. i.e., the

information is gathered using variables measured on nominal or ordinal scales (that is, qualitative measurement scales); and an analysis is done to establish the variation in the situation, phenomenon or problem without quantifying it (Leedy and Ormrod, 2005). Thus, qualitative data is used for this study which focuses to get desirable answers for assessing perception and compliance behavior of business profit taxpayers.

Source of Data

The intended source of data for this research includes primary source. The sources of primary data for this study was obtained from sampled business profit tax payers (who which was acquired through probability proportional to size (PPS) using stratified random sampling technique), 30 in-depth interview with actual complaints of business profit taxpayers (10 purposively selected business profit tax payers from each sampled zones which are leading by tax compliant and not in better position by paying tax as of information gathered through pilot survey), Mekelle, Southern zone, and South West were intended as a focal primary sources. The instruments that was applied to use for this study are questionnaires (both close ended and open-ended questionnaires), and in -depth interviews has been conducted so as to obtain relevant information to make the research findings more valuable.

Target Population and Sampling

The study has been conducted in Tigray regional state in three zones: Mekelle zone, Southern zone, and South West zone. But, the study only focuses on three urban towns one from each. Hence, the study used multi-stage sampling. In the first stage, seven zones including Mekelle are stratified in to three purposively based on their tax payment status. In the second stage, registered business profit taxpayers are stratified into three namely category A, category B and category C of which B and C categories are selected. The reason why the two categories are selected is that, the researcher's expects that they have negative perception towards tax system as of the pilot survey.

1.4.2. Sample design

It is a common practice in research to use sample in order to generalize about the targeted populations. Tabachnick and Fidell (2001) noted that ideally, samples are selected on randomly bases this indicates the representative of the population. The intention of the study is to generalize the findings to all taxpayers and potential taxpayers in Tigray regional status business profit taxpayers as well to obtain a large and sufficiently diverse sample in order to obtain a meaningful spread of perceptions concerning tax system. Therefore, the sample designs and mode of collecting data was statistically representative of the perceptions of the all business profit taxpayers of Tigray region. Sample selection about broader potential respondents giving equal chance of selection is vital to increasing the representativeness of the sample. Therefore, the target for the sample includes population consists of all business profit taxpayers in Tigray region. There are 4625 category B and 13987 categories C registered business profit taxpayers in Tigray region as the information

gathered from regional state of Tigray Revenue Development Authority as of October 18, 2012. Thus, taking the available resources, time, budget, data, and geographic distances into account, using simple random sampling technique a sample size of 250 were taken from the total of 18612 registered business profit taxpayers.

1.4.3.Data Collection

Primary Data collection

Questionnaire

Questionnaire was used to collect data from sample business profit tax payers using semi-structured questionnaire. The questionnaire was pre tested, coded and modified before the execution of the survey to make the study more tangible and valuable. The researcher is greatly expect that this method of data collection was more useful to collect data that provides answer for the research question of the study

In-depth interview

In depth interview was conducted with key informants those are selected from business profit taxpayer in Mekelle, Southern zone, and South West which are not in better position on tax payment. The intension of this method of data collection is to gather relevant information about objectives of the study.

1.4.4.Method of Data Analysis

The data that was collected from data source has organized and following this, statistical computation was made to explore the inherent relationships among the different variables. The qualitative data that was obtained through in-depth interview were stated qualitatively in the form of statements. And these data was analyzed using Likert scale to understand taxpayers' level of knowledge and perception towards tax system. Responses from the business profit taxpayer survey were filled in to computer and analyzed using STATA software. Simple quantitative analysis techniques such as percentage and frequency were employed. Finally, the results were summarized into simple tabulations and cross tabulations, and the analysis and meaningful interpretation of results were made to draw implication and conclusion.

Thus, the study was used statistical tools such as T-test and OLS in order to explore the association between factors influencing tax compliance behavior and tax system.

CHAPTER TWO: REVIEW OF RELATED LITERATURE

The aim of this chapter is to review the literature in the area of "Taxpayers perception and compliance behavior of business profits Taxpayers".

This section also establishes the framework for the study and highlights the strengths and weaknesses of the previous studies, which help in clearly identifying the gap in the literature and formulating the research question for the study.

2.1. Theory of Tax compliance

Accepting tax laws is referred to as tax compliance. Franzoni (1999) defines tax compliance as it is the true reporting of the tax base, correct computation of the tax liability, properly and timely filing of returns, and the timely payment of taxes due. As Singh (2003) stated, tax compliance is an action that a person filing his Income Tax Form (usually referred to as Returns), declaring all taxable income properly, and spend the payable tax within the predetermined time, without getting the tax authority to keep reminding or taking action against those noncompliance taxpayers. Noncompliance refers to not obeying the tax laws. Noncompliance can be; Firstly, the case of reporting; the noncompliance refers to non filing of returns to the tax authority will lead to tax gap i.e. the amount of unpaid taxes due foregone. Second, the non-payment compliance refers to untimely taxes paid, that means payment not made in a predetermined time to the tax authority. Tax payment is important to the tax authority if it is paid on time. The responsibility received now will used for the government's expenditure otherwise, the insufficient fund needs to borrowed and incur additional cost.

The last one is the issue on noncompliance and tax underreporting. This can be considered as criminal offence that imposes severe penalty. The taxpayer practices not reporting by way of evasion and avoidance; both of them are the same except that the later is legal while the former is illegal. This area of noncompliance can lead a serious problem to tax authority because these taxpayers hide tax and their burden pushed to the other complying taxpayers. This is where the fair and equitable tax system is under question mark Wubishet (2011). Hence, behavioral research can contribute to tax authority to understand why taxpayers are compliant or not. This can inform the work of tax administrations across a range of their functions.

2.1.1.Factors that Determine Level of Compliance

Factors that determine the level of compliance in a taxpayer population have been identified as follows. These factors are grouped under headings adapted from research by the OECD Forum of Tax Administration (OECD, 2010) includes: deterrence; norms which composes both personal and social; fairness and trust; opportunity and complexity; and the role of government and economic factors.

2.1.1.Deterrence Effects

The standard model of tax compliance, which derived from Becker (1968), Allingham and Sandmo (1972), assumes that a rational taxpayer analyzes the costs and benefits of evading taxes. If the planned benefits (less income "lost" to tax) outweigh the costs (the chances of a non-compliant taxpayer being caught and the sanctions incurred) then the taxpayer will evade tax. Thus, taxpayers' makes a rational choice after considering the options.

Braithwaite (2009) and Phillips (2010) stated as the standard model alone is not enough to explain the level of compliance in society. The evidence confirms that, given the probability of

being caught evading taxes and the size of the punishment if caught, the level of tax evasion should be greater than it is in many countries (i.e., that taxpayers should evade taxes more than they actually do). One explanation is the tendency of people to overestimate the probability of being audited and the sanctions that might follow if evasion is not covered (Reeson and Dunstall, 2009). However, others factors beyond deterrence can also influence taxpayers and these are discussed below. According to Slemrod (2007), deterrence or the risk of detection and the punishments incurred, should positively influence taxpayer compliance. However, the empirical evidence is somewhat mixed, OECD (2010) additionally discusses several studies that examine the role of deterrence. Some findings are as expected, which means, increases in the probability of detection improve compliance but the effects are quite weak. The main reason is that auditing compliant taxpayers is found to sometimes undermine their willingness to comply. In some cases taxpayer behavior is found to worsen after an audit either to get back "losses" or in the belief that they will not be targeted again.

2.1.2. The Impact of Norms on Behavior

As of Wenzel (2005), a key factor in tax compliance is a widespread aspiration to "do the right thing". They seek to comply because they believe it the right thing to do, not because of fear of punishment if they do not comply. The interest of a taxpayer to comply is strongly linked to behavioral norms, both the personal norms and beliefs of the individual taxpayer and the social norms that prevail in society at large. Personal norms are the outcome of a combination of factors inherent to the individual. These will guide a taxpayer's posture to the tax administration but are difficult to influence (OECD, 2010; Kirchler, 2007). Tax administrations can try to send messages that stress the importance of compliance to educate/ train taxpayers and build up positive personal norms. Engagement by tax administrations with early working age or younger can influence their personal norms and this benefits tax compliance in the long-term.

OECD, (2010) stated as there is evidence from diverse areas (not just tax related) that people seek to conform to social norms and that the behavior of others strongly influences an individual's choices. This influence is help full though in many cases people do not consciously realize it. This effect can be heightened when the relationship to the social grouping is stronger or closer peers or neighbors may exert greater influence than those more distant to the individual. Social norms have also influence taxpayer behavior. If there is a perception that tax evasion is limited and the majority of the people are compliant, this makes people less willing to evade taxes themselves. Often people tend to believe that non-compliance is more prevalent than it is in practice, so correcting misperceptions regarding the scale of evasion is also a positive way to reinforce compliance.

2.1.4. Fairness and Trust in Tax Administration

There is no objective or general scientific basis for stating that one tax is fairer than another. Common principles of taxation such as equals should be treated equally to provide some

guidance on issue of fairness, but for the most part what is considered fair is a matter of personal opinion (Sjoquist, 2001). Feld and Tyran (2002) suggested that, a contractual relationship implies duties and rights for each contract partner. This may be looked at from a pure exchange perspective, whereby citizens pay their taxes if their fellow citizens contribute their fair share of the taxes. If a person expects the other to cheat on the tax code, he/she will cheat on the tax code as well. It could also be argued that the government should provide public services to the citizens in the exchange of their tax payments. The principle of equity asserts that tax payers of the same levels should be taxed similarly that is to say tax payers with equal abilities should pay the same amount of tax. Citizens with great ability should pay more. The principle of equity is also viewed as fairness by most

The other idea generated by (Braithwaite, 2009; Delaney and Harmon, 2009) explained whether an outcome is perceived to be fair will often influence behaviour. Experiments have shown that people prefer an option in which they receive no reward to an option in which they are rewarded but are perceived as unfair – they are rejecting an outcome that would make them better off. Often trust and legitimacy are linked to fairness, as the perceived fairness of an outcome will be contingent upon them.

OECD (2010) also discusses three types of fairness in taxation these are:

1. Distributive fairness: deals with the perception that government acts as a wise spender of tax revenues.
2. Procedural fairness: deals with the perception that the tax administration adheres to procedures that are fair in dealing with taxpayers; and
3. Retributive fairness: concerned with the perception that the tax administration is fair in applying punishments when the rules are broken. The latter two are more relevant to and can be influenced by tax administrations. Distributive fairness depends on policy-makers.

According to Murphy (2004), if taxpayers do not trust the tax administration to collect tax fairly, this will increase non-compliance. A perception of fairness and trust are important tools for a tax administration in attempting to reduce evasion. The main reason to establishing trust is to frame the collection of taxes to the population in a transparent manner and emphasise the perceived fairness of the approach taken. Norms and the motivation to pay taxes are influenced by fairness – both in how a person is treated by the administration individually and perceptions of fairness of the taxation system in general (whether other people are also paying their fair share). If a tax administration can demonstrate its commitment in these areas, there should be a compliance benefit (Reeson and Dunstall, 2009).

Furthermore, Rothstein and Uslaner, (2005) stated trust it is generally considered as important for social and economic development in societies. According to the tax compliance literature (Roth *et al.*, 1989), social or generalized trust is an important reason why people tend to pay taxes (Scholz and Lubell, 1998). The reason is found in the rational choice theory

and the social dilemma literature (Rothstein, 2003) and is rather self explaining:

If I trust that most other citizens pay their share, then I am more inclined to pay mine. Alternatively, if I do not trust that others contribute properly, then the incentives for me to contribute are rather small. Seen from a welfare system perspective, if the theory of social dilemma is correct, then a large number of distrusting citizens (regardless of whether their suspicions are correct or not) may jeopardize the welfare state system in the long run. Empirical findings show that trust in the government, public officials and in the legal system has a significant positive effect on tax morale, Scholz and Lubell, (1998) and Torgler, (2003), (2004). However, this is hampered by the level of corruption in the country. Higher trust in the state might improve taxpayers' positive attitudes and commitment toward paying taxes, with a positive effect on overall tax compliance. Taxpayers are more inclined to comply with the law if the exchange between the paid tax and the performed government services are found to be equitable. Thus, if taxpayers trust the government, the legal system, the justice system, and or the public officials, they are more willing to be honest in the payment of their taxes and previous studies found support for such a relationship (Torgler, 2004, 2005; Alm and Torgler, 2006).

Fairness is multifaceted and is connected to trust and both concepts are relevant for compliance. In order to promote compliance through fairness the distribution ought to be even-handed, the procedures must be fair and the sanctions for evasion should be appropriate.

2.2. Opportunity and Complexity in the Tax System

A key assumption in decision-making is that people are capable of assessing a range of complex choices, and by correctly evaluating all of the available information, select the option with the best outcome for them. In reality it is rare to find situations in which people are fully informed of all their choices and always select the best option. In many cases, people fail to make the optimal choice. When faced with a range of choices, picking the correct option depends on calculating probabilities of events or risks occurring but in practice people tend to revert to rules of thumb (heuristics). While these rules of thumb may work in many cases, which explain why people fall back on them, they will be subject to biases by the person and this can lead to poor choices.

2.3. Tax Knowledge

Tax knowledge is an essential element in a voluntary compliance tax system (Kasipillai, 2000), particularly in determining an accurate tax liability (Palil, 2005; Saad *et al.*, 2003). More recent studies undertaken in Malaysia (Loo, 2006; Loo *et al.*, 2008; 2009) also suggest tax knowledge to be the most influential factor to determine taxpayers' compliance behaviour under the self-assessment system. This is empirically established by several other studies (for example, Kasipillai *et al.*, 2003; Kirchler *et al.*, 2006), which document that possessing tax knowledge will lead to higher compliance rates.

On the contrary, the absence of tax knowledge may lead to non-compliance behaviour among taxpayers, either intentionally or unintentionally. This is postulated by McKerchar (1995) who studied small business taxpayers in Australia. She suggests that small business taxpayers are not even aware of their tax knowledge shortfall and this may lead to unintentional non-compliance behaviour. Such evidence was also documented among individual taxpayers in Malaysia who unintentionally committed mistakes in their tax return forms (Loo *et al.*, 2008). In this study, a mixed method design was used by conducting mail survey, quasi-experiment and case study concurrently between November 2005 and July 2005.

The abovementioned studies, which indicate a positive relationship between tax knowledge and compliance behaviour, however, are not consistent with an earlier study by Harris (1989), who claimed that tax knowledge has no direct significant effect on taxpayers' compliance behaviour. One possible explanation for such inconsistent results is the difference in tax jurisdictions. The studies mentioned above were either conducted in Malaysia or Australia, while this study was conducted in the US. Another potential reason may be that the different measures were used in the studies.

Harris (1989) further claims that tax knowledge had an indirect effect on compliance behaviour through fairness perceptions. In that study, Harris (1989) separated tax knowledge into fiscal awareness and technical knowledge, and observed the impact of each type of knowledge on fairness perceptions. The findings show that the types of tax knowledge impact on fairness perceptions and consequently compliance behaviour. The influence of tax knowledge on fairness perceptions was further documented by Schisler (1995) who carried out a study comparing tax preparers and taxpayers. Taxpayers were selected amongst MBA students with at least five years working experience while tax preparers comprised of tax practitioners from certified public accountant (CPA) firms in the US. Based on the analysis, he found that taxpayers have significantly lower fairness perceptions compared to tax preparers. The result might be due to the absence of tax knowledge among taxpayers compared to tax preparers. Fallan (1999) later confirmed these findings that tax knowledge significantly changed attitudes towards the fairness of the tax system. In that experimental study, the author measured tax knowledge through an additive index of 12 questions concerning tax allowances and tax liabilities.

Consistent with the findings of Schisler (1995) and Fallan (1999), some other studies also indicate that an increase in tax knowledge strengthens taxpayers' perceptions about the fairness of the income tax system (see Christensen *et al.*, 2000; Eriksen and Fallan, 1996; Maroney *et al.*, 2002). However, Loo *et al.* (2008), who conducted a study in a Malaysian environment, reveal a contradictory finding to the general contention, where they documented that increases in taxpayers' knowledge would have a negative impact on their perceptions on exchange fairness. In this respect, individual taxpayers with good knowledge of tax felt that they are not receiving their fair share of benefits funded by tax revenue. While the benefits have been provided in terms of public facilities such as free education and subsidized health system, the fact that the

detailed information on the source of expenditure are not publicly available may have created this negative perceptions on the fairness of the income tax system in Malaysia. In New Zealand environment, inconsistent results with the previous studies on the relationship between tax knowledge and fairness perceptions were documented by Tan and Chin-Fatt (2000). The study which involved tertiary students who enrolled in an introductory taxation course revealed no significant impact of increased tax knowledge on fairness perceptions. In this study, the researcher believes that the use of university students as a proxy for actual taxpayers may to certain extent explain such contradictory findings.

To extend the studies on tax knowledge and fairness perceptions, researchers have investigated possible ways to improve tax knowledge among taxpayers, and consequently their fairness perceptions. For instance, White *et al.* (1990), in their experimental study on tax students, suggested that a formal class in taxation would enhance their knowledge about the law and appreciation of fiscal policy goals, thus increasing perceived fairness. This study is supported by Wartick (1994), who claimed that exposure of information during a tax law change will improve taxpayers' knowledge, and subsequently mitigate their perceptions that the tax system is unfair. Apart from the impact of tax knowledge and fairness perceptions, a review of previous studies also provides overall picture of taxpayers' level of knowledge in several countries.

While it is not appropriate to compare the findings (due to different measures used, different times, different tax jurisdictions and nature of the study), the information would be useful for the researcher to have a general understanding of taxpayers' knowledge of taxation as a whole. For instance, a study in Malaysian environment conducted by Loo and Ho (2005) suggests that a large majority of taxpayers possess relatively low knowledge of taxation, notwithstanding their tax filing experiences. This finding is, however, not supported by Kamaluddin and Madi (2005) and Madi *et al.* (2010) who claim that Malaysian taxpayers are generally tax literate. One possible explanation for the contrasting results could be the different items used to measure tax knowledge between studies.

In relation to this finding, Ahmad *et al.* (2006) conducted an experimental study in Malaysia and documented that taxpayers receiving formal tax education have significantly better tax knowledge compared to those without such education. In that study, Ahmad *et al.* (2006) use postgraduate students who are also taxpayers to form the experimental and the control group. The difference between the groups is that the control group did not take the taxation course in their study, while the experimental group did. The findings are consistent and therefore provide support to Fallan (1999) who carried out a similar experimental study overseas. Instead of focusing on taxpayers, Coetzee and Oberholzer (2009) studied the tax practitioners in South Africa to gauge their perceptions on the trainees' tax knowledge. The results reveal that majority of tax practitioners (about 85 percent) believed that trainees mainly have general knowledge and also a working knowledge of individual income tax. It is not surprising that they possess such a good tax knowledge as the trainees are the future tax

professionals who will be assisting less specialist taxpayers. It is expected of such trainees to possess such a high level of knowledge, as suggested by tax practitioners and educators (Tan and Veal, 2005).

CHAPTER THREE: DISCUSSION AND ANALYSIS

3.1. Taxpayers Perception and level of Knowledge

3.1.1. Demographic Profile of Respondents

This section describes about the respondents' tax category, geographical areas, business sectors and their taxpaying experience using cross tabulation.

Demographic Profile	B		C		Total	%age
	Frequency	%age	Frequency	%age		
i). Sector						
Manufacture	13	43.30%	17	56.70%	30	12.80%
Trade	39	31.20%	86	68.80%	125	53.20%
Service	18	22.50%	62	77.50%	80	34.00%
Other	0	0.00%	0	0.00%	0	0%
Total	70	29.80%	165	70.20%	235	100%
ii). Experience (year)						
Less than 1 year	10	40.00%	15	60.00%	25	10.60%
1 up to 5 years	32	23.20%	106	76.80%	138	58.70%
6 up to 10 years	18	36.00%	32	64.00%	50	21.30%
above 10 years	10	45.50%	12	54.50%	22	9.40%
Total	70	29.80%	165	70.20%	235	100%
iii). Education						
Below grade 10/12	22	31.40%	67	40.60%	89	37.90%
Grade 10/12 complete	23	32.90%	42	25.50%	65	27.70%
Diploma	12	17.10%	28	17.00%	40	17.00%
First degree	12	17.10%	26	15.80%	38	16.20%
Second degree or above	1	1.40%	1	0.60%	2	0.90%
other	0	0.00%	1	0.60%	1	0.40%
Total	70	29.80%	165	70.20%	235	100%

Source: Survey, 2013

Table 3.1 item- i show data were collected from category B (29.8%) and category C (70.2%) taxpayers and from three sectors namely manufacturing, trade and service. In comparing to other sectors the number of people who are engaged in trade sector is large and also sampling unit selection method was convenient. As a result in both categories majority of respondents (i.e., 53.2%) were from trade sector.

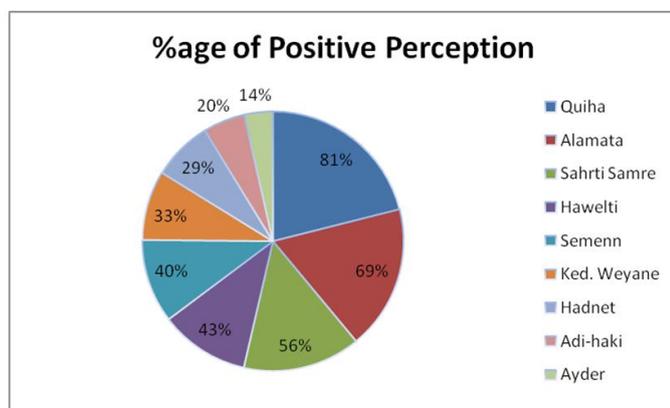
Information on the period of experience of the businesses was important in order to confirm whether they have been compliant in the past years or not. Hence, regarding to respondents' business experience with respect to their category depicted on Table 3.3 item-ii above. The table reveals that most of the respondents had been in business from 1-5 years with 58.7%. This indicates most businesses stay in their businesses from 1 year to 5 year thus showing infancy of businesses. On the other hand, 72 (30.7%) of respondents had been in business for more than 5 years. This implies that they can express their tax perception and compliance behavior.

Item-iii was designed to show the demographic aspects of respondent concerning their level of education and the type of business category. Hence, based on the result depicted in the Table, 45 (64.3%) of the respondents are categorized under level "B" tax payers' with a level of education below and 12th

they have bad perception towards the tax system. On the other hand, the remaining 18(60%) respondents have attained above average score point which implies they have good perception to taxation system. In addition, amongst the 125 respondents of Trade sector, 66(53%) have a bad perception and the remaining 59(47%) have good perception regarding the tax system. Moreover, when we look at the responses of 80 Service sector business tax payers, 43(54%) participants have scored less than average that indicates they have bad perception whereas the rest 37(46%) of the respondents have good perception towards the tax system. Generally, among the total 235 respondents from all sectors majority 121(51%) have negative perception while the remaining 114(49%) respondents have negative perception towards the taxation system.

3. Taxpayers' Perception by geographical area

Chart 3.1. Taxpayers' Perception by geographical area



Source: Survey, 2013

According to Palil (2010), there is positive relationship between taxpayers' perception towards tax system and tax compliance behaviour. With this in line the survey study conducted in the selected areas of Tigray shows Quiha (81%), Alamata (69%) and Seharti Samre (56%) taxpayers have strongly positive perception towards the tax system. In contrast to these Ayder (14%), Adi-haki (20%) and Hadnet (33%) taxpayers have negative perception towards the tax system. In terms of taxpayers' town, those taxpayers who are found in Alamata have relatively positive perception towards the tax system.

2. Taxpayers' Perception by their taxpaying Experience

Table 3.5 Taxpayers' Perception by their taxpaying Experience (Cross tabulation)

Score point	Experience in years							
	Less than 1		1 up to 5		6 up to 10		Greater than 10	
	Number	Percent	Number	Percent	Number	Percent	Number	Percent
Less than Average	14	56	74	54	26	51.5	7	32
Greater than Average	11	44	64	46	24	48.5	15	68
Total	25	100	138	100	50	100	22	100

Source: Survey, 2013

According to the data depicted in Table 3.5, from the 25 respondents who have less than one year taxpaying experience, majority 14(56%) have a negative perception but the rest 11(44%) have a positive perception. Coming to the 138 respondents with 1 up to 5 years experience, similarly majority

74(54%) of the respondents have bad perception and the remaining 64(46%) of the respondents have good perception. When we look at the 50 tax payers having 6 to 10 years of experience, again majority 26(51.5%) of the respondents have negative perception whereas the rest 24(48.5%) have good perception. To the contrary, among the 22 respondents with greater than 10 years of taxpaying experience; majority 15(68%) of the respondents have score point greater than average which indicates they have good perception. However, the rest 7(32%) of the respondents have bad perception to the taxation system. These facts may imply that taxpayers when they have long experience they will understand better the taxation system and develop positive perception towards the tax system.

3.1.3. Taxpayers' level of Tax Knowledge

As many researchers studied (Palil, 2010, Lewis, 1982; Eriksen and Fallan, 1996; Loo, 2006; Kim, 2008), tax knowledge appears to be an important element in tax compliance but the degree of required level of knowledge varies among countries. The following two sections present the findings of taxpayers' level of knowledge by their category and geographic areas.

1. Taxpayers' level of Tax Knowledge by Category

Table 3.6. Taxpayers' Knowledge by Category (Cross-tabulation)

Score point	Tax Payer Category				Total
	B		C		
	Number	Percent	Number	Percent	
Less than Average	34	48.5	80	48.5	114
Greater than Average	36	51.5	85	51.5	121
Total	70	100	165	100	240

Source: Survey, 2013

Table 3.7. Taxpayers' Knowledge by category (t-test result)

Two-sample t test with equal variances

Group	Obs	Mean	Std. Dev.	[95% Conf. Interval]	
0	70	40	7.287074	38.26246	41.73754
1	165	39.81212	7.828643	38.60872	41.01552
combined	235	39.86809	7.656323	38.8841	40.85207
diff		.1878788		-1.968254	2.344011

diff = mean(0) - mean(1) t = 0.1717 Ho: diff = 0 degrees of freedom = 233

Ha: diff < 0 Ha: diff != 0 Ha: diff > 0
Pr(T < t) = 0.5681 Pr(|T| > |t|) = 0.8638 Pr(T > t) = 0.4319

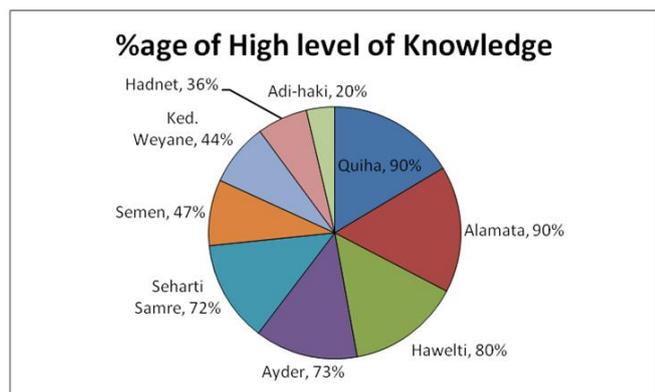
According the data shown in Table 3.6, in both tax payers' categories majority 121(51.5%) of the respondents are with score point greater than average that indicates they have good knowledge, on the other hand, 114(48.5%) of the respondents

have score point less than average that means they have less knowledge to tax system.

As shown in the above Table 3.7, there is no difference between category B and category C taxpayers' level of knowledge. Because, the hypothesis result shows as the null hypothesis with an assumption of "there is no difference between category B and category C tax payers' on level of knowledge towards tax system" is fact and is accepted.

1. Taxpayers' level of Tax Knowledge by geographical areas

Chart 3.2. Taxpayers' level of Knowledge by geographical areas



Source: survey 2013

As can be seen clearly from Chart 3.2 among the sub-cities of Mekelle included in the survey the taxpayers of Quiha sub-city is found to be the highest tax knowledge scoring 90 percent of the taxpayers. Moreover, amongst the taxpayers outside Mekelle which are included in the study Alamata city business taxpayers are with the highest tax knowledge scoring similar with that of Quiha that is 90 percent. On the other hand, Adi-haki, Hadnet and Kedamay Weyane business taxpayers are with low level of tax knowledge.

3.2. Taxpayers Compliance Behaviours

Table 3.8. Results of Regression Comply, Perception and Tax Knowledge

Result	Taxpayers' Perception	Taxpayers' Knowledge	Overall Tax Compliance
R ²	0.0806	0.2076	0.2309
Adjusted R ²	0.0767	0.2042	0.2243
Standard error	0.0431427	0.0388804	
F-value	20.43	61.04	34.83
P-value	0.0000	0.0000	0.0000
Perception	0.195(0.001)***	0.313(0.001)***	0.110(0.01)**
Knowledge	0.295(0.001)***	0.304(0.001)***	0.271(0.001)***

Source: Survey, 2013

Results from the multiple regression analyses undertaken found that all the three regression analyses undertaken were statistically significant at the five percent level. Pertaining to taxpayers' perception, the predictor variables accounted for almost 8 percent of the variability in the compliance behavior of business taxpayers (F=20.43, p<0.000). Regarding taxpayers' knowledge, the predictor variables explained around 21 percent of compliance behavior (F=61.04, p<0.000). Similarly, with regards to overall compliance, the independent variables explained almost 23.1 percent of the variability in the

compliance behavior of business taxpayers (F=34.83, p<0.000).

3.3. Reasons why Taxpayers complain

As the research was intended to know taxpayers perception level towards the tax system, the questionnaire was designed to elicit responses towards the same. Accordingly, respondents have been asked whether they ever complain and the causes for complain about the tax system in general and its application in particular. Without any reservation all of them responded that paying tax is their responsibility and are ready to adhere rules and regulations of tax. In fact, their perception of improvement in the tax system is increasing positively from time to time appreciating the steps taken by the responsible bodies. However, due to some inconsistencies in practice they also experienced dissatisfaction in the process of revenue collection. Their main causes of complaints are tax estimation problems and failure to get prompt answer to their complaints.

44.4 percent of the respondents have complained due to exaggerated or unfairly levied tax on their business and 36.5 percent have got solutions for their cases. If we look this geographic wise, 41 percent of Mekelle respondents, 33 percent of Alamata and 15 percent of Seharti Samre responded positively to complaint handling and giving responses. Further diagnosis of the collected data, 55.6 percent of the respondents have not filed any complaint. Assuming taxpayers are rational and if any compliant is there will not keep it; one can infer that this majority of respondents are satisfied with the tax collection process. This is of course a plus to future endeavor of the revenue office.

However, 63.5 percent of taxpayers who have registered their cases and did not any response remain dissatisfied for the reason that their complaints have not been addressed. From this, regardless of the outcome- corrections for any error made or confirmation of the amounts as no problem is expected from the revenue office. The researchers really have observed that such taxpayers convinced themselves to not complain any time in the future because they believe that it is only wastage of time and effort. This negative image towards the tax system could lead to hampering the effort of the revenue office and the overall development by instilling bad behaviour in the taxpayers.

The main reasons for their complaints were;

- Unreasonable tax estimation and leaving
- Revenue office workers' inability to handle complaints and poor customer services
- Lack of transparency
- Incompetent and inexperienced tax collectors
- Wrong attitude of revenue office workers (treating all taxpayers as tax evaders)

CHAPTER FOUR: CONCLUSION AND RECOMMENDATION

Based on the finding discussed in the previous chapter the following conclusions and recommendations are drawn with respect to research objectives.

4.1. Conclusion

The first section of the previous chapter (discussion and analysis part) was pertaining on analyzing whether there are differences on taxpayers' perception and level of tax knowledge by their tax category, sector, area and taxpaying experience or not. Thus, the study has been conducted considering two variables. One was based on the first research question and hypothesis that was whether there is differences between taxpayers' perception and their category, sector, area and taxpaying experience. The other one was whether there is difference between taxpayers' level of tax knowledge and their category, sector, area and taxpaying experience based on the second research question and hypothesis. Regarding to the taxpayers' perception towards tax system the results from the study proved the first hypothesis of the study; i.e., *there is no difference between category B and category C taxpayers' perception*. In contrast to this, taxpayers' sector, area and taxpaying experience have different results. Specifically, the group of taxpayers from manufacturing sector has positive perception whereas from service and trade sectors have negative perception towards the tax system.

This finding is consistent with the finding of Walsh (2012) i.e., *"certain economic sectors have negative perception towards the tax system"*. Pertaining to taxpayers' area those respondents who lived in Mekelle generally or Ayder, Adi-haki and Hadnet sub-cities specifically have negative perception towards the tax system but taxpayers from Alamata and Seharti Samre have positive perception. Likewise, taxpayers' perception has differences by their taxpaying experience. For instance, out of the total sample respondents taxpayers with above 10 years experiences only have positive perception on the tax system. The second variable that has been analyzed in this section was taxpayers' level of tax knowledge. The finding in this part showed category B and category C taxpayers do not have significant difference on their level of tax knowledge. Apart from this taxpayers have difference on their level of tax knowledge by their geographical areas. From all these findings researchers concluded that there is no differences on taxpayers' perception and level of tax knowledge by category. However, there is a different perception and tax knowledge of taxpayers by their business sector, geographical areas and taxpaying experience.

The second section of the discussion made on chapter three on section 3.2 was about the relationship between taxpayers' perception and level of tax knowledge and tax compliance behaviour. Analysis was made using both descriptive and simple statistical tools such as frequency, t-test and simple regression methods. The detailed has been shown that (i.e., on the previous section 3.2). Unsurprisingly, the finding is consistent with the previous studies (Chan *et al.* (2000), Sjoquist (2001), Feld and Tyran, (2002)).

The third part of the previous chapter was discussed on the reasons why taxpayers made complain. The detailed has been discussed on section 3.3 above. From the findings the researchers concluded the main causes of complaints are tax estimation problems and failure to get prompt answer to their complaints.

As Palil cited (2010), empirical evidences illustrated tax knowledge appears to be an important element in tax compliance but the degree of required level of knowledge varies among countries (Lewis, 1982; Eriksen and Fallan, 1996; Loo, 2006; Kim, 2008).

4.2. Recommendation

In line with the conclusions drawn above the researchers recommended the following points to strengthen and/or improve taxpayers' compliance behaviour.

Since taxpayers' perception and tax knowledge is similar on both taxpayers' categories, their perception is varying by business sector, geographical areas and taxpaying experience. Hence, in improving taxpayers' compliance behavior the tax authority should consider taxpayers' business sector, geographical areas and taxpaying experiences. Specifically:

- The tax authority should improve the taxpayers' perception and level of knowledge whose sectors are trade and service, their geographical area is Mekelle, specifically Ayder, Adi-haki and Hadnet sub-cities and also those taxpayers' whose taxpaying experience fall between from 1 up to 10 years. Similar to this in improving taxpayers' level of knowledge the authority should emphasized on Adi-haki sub-city's taxpayers.
- Especial attention should be given to new entrants (orientation should be given with their licenses).
- Prizes to consummate taxpayers.
- Besides to these the authority should endeavor to build the capacity of its employees through continuous training, seminars and experience sharing and sensitization tax collectors.
- Hire competent tax workers and prizes to encourage high performer tax collectors.
- Pertaining to the finding of taxpayers' taxpaying behavior researchers recommended to conduct further research by the authority to investigation the reason why those taxpayers whose taxpaying experience fall between 1 year and 10 years.
- To solve complaints that made by taxpayers the tax authority should ensure justice in levying tax and tax assessment through auto machine and data recording, proper consideration of taxpayers' location, encourage non-discriminatory practices, establish compliant handling unit and measure of standards (i.e., time to take/give response) etc....

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