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### **Causes of business tax payers' evasion and remedies to develop tax payment in Ethiopia**

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#### **Abstract:**

Tax is obligatory revenue to every government to manage the economic requirements in within the nation and global wise. In a perfect world, all taxpayers might voluntarily pay their taxes. But in fact, no one enjoys by means of paying tax to the government and taxpayers will apply the strategies to avoid the tax payments in so many unethical ways. The researcher fixed a goal of the take a look at became to check the possible reasons why enterprise / Business income taxpayers avoid their taxable earnings and no longer to pay real amount of tax to the authorities. This paper describes the nine factors to know the causes why the tax payer is not willing to pay tax amount. To do the proper information from the respondents, the researcher used descriptive research analysis and extraction statistical method. To maintain more accuracy in factor analysis he applied Eigen, rotation ranking values. 270 taxpayers from different categories were responded in Ethiopia for this research; in addition, the researcher collected information from various books and websites. All information have been analyzed the use of descriptive facts and the study diagnosed the viable reasons of tax evasion and also discussed remedies to develop the tax payment by tax payers. Researcher used current model of SPSS for statistics results.

**Key words:** 1. Tax 2. Tax payer 3. Tax Evasion 4. Awareness

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#### **1. Introduction**

The gross domestic product of the developed countries and average revenue ratio were 35% in the year 2005, whereas in developing countries the share was 15% and in third world countries also not more than 12% (Mughal, 2012). In the developing world, countries have no system to collect a sufficient amount of tax from their taxpayers. The expected amount of revenue cannot be enhanced due to different reasons. Among the reasons tax operation of the system may not be smooth, tax evasion and lack of awareness creation for the taxpayers are common in the developing world, and citizens

are not committed to paying the expected amount of tax for their countries (Fagbemi et al., 2010).

Tax evasion practices are more worsen in developing countries than when we compare against the developed countries. Tax evasion is like a pandemic for the countries because they are unable to control it. Therefore, governments were negatively affected by tax evasion to improve the life standard of its citizens and to allocate a budget for public expenditure, and it became a disease for the country's economy and estimated to cost 20% of income tax revenue (Ameyaw et al., 2015; degl'Innocenti & Rablen, 2019; Palil et al., 2016).

The overall procedure of tax collection faced different challenges especially tax evasion the most important one. Tax evasion is done intentionally by taxpayers by avoiding and hiding different documents that become evidence for the tax collection authorities. It is simply an illegal act to pay the true amount of the tax (Aumeerun et al., 2016; Storm, 2013). Tax evasion is a crime that is able to distort the overall economic, political, and social system of the country. The economic aspect of tax evasion affects fair distribution of wealth for the citizens.

One kind of taxpayers absolutely involves implementing the strategies for the reduction of tax amount. These strategies are none authenticated to implement everywhere, taxpayers implement their own skills and some are involving in the unethical procedures (for example, developing fake costs or moving money offshore). The tax workplace normally refers to many tax collection techniques to competitive tax making plans but tax payer will not follow the government tax structure by the cause of several factors such as Lack of awareness/motivational, training programmes for paying income/Business tax, No encouragement for honest tax payers, Income tax structure collecting high rate of taxes, Negligence, illiteracy of tax payers, Inefficiency/indiscipline of tax administration department and No government actions on tax evasion etc.,

In the entire world, all taxpayers could voluntarily pay their taxes and comply with all of their tax duties willingly. But no one enjoys paying tax, and on the end of each financial year, taxpayers will think how to pay lower tax amount on their higher profits or income. Each year, the U.S. Loses an anticipated \$189 billion in corporate tax, around Thirteen percent of GDP. China has the second-highest annual losses in absolute phrases with \$66.8 billion at the same time as Japan is likewise badly affected with \$47 billion unaccounted. But Tax is the benchmark and turning point of the country's overall development and changing the livelihoods and enhancing per capital income of the individuals.

In case of Ethiopia, The Federal Inland Revenue (FIRA) has classified taxpayers on business profit into three major categories as category "A", category "B", and category "C". FIRA has used their legal personality and annual turnover sales revenue amounts as

basis for taxpayers' categories. Category "A" taxpayers: include businesses that have separate legal personality such as share company, PLC, public enterprises and public financial agencies having annual sales of Birr 500,000 and above. Such taxpayers are required to maintain proper book of accounts and other documents, Misrak T.(2008).Category "B" taxpayers: include businesses with no legal personality and their annual sales revenue is between Birr 100,000 and Birr 500,000. Like category "A" taxpayers, category "B" taxpayers shall maintain proper books of accounts and shall use the type and quantity of voucher registered and approved by the tax authority. Category "C" taxpayers: include any other businesses which are not classified in category "A" and category "B" taxpayers. Such type of businesses does not have separate legal entity and whose annual sales revenue is estimated below Birr 100,000. Category "C" taxpayers are not required (not mandatory) to maintain books of accounts and to prepare financial statements.

Tax evasion was higher during the 1970's and 1980's reaching as high as 10.4% of the recorded economy. Although the share as percentage of GDP is declining recently, it is growing on average by about 19 percentage points in nominal terms since 2000. It remained high but declining since 1991 while tax revenue to GDP ratio start to increase before it start to bend downward since 2004. Note that tax-to-GDP ratio in Ethiopia is one of the lowest in sub-Saharan Africa which is 9.7% (MoFED, 2010) as compared to over 18% for the rest of Africa. It is even much lower than good performers such as South African and Namibia where tax revenue reaches 25% and 30.1%, respectively (Volkerink, 2009).

Prevent or control the tax evasion is not an easy task to any government. Charging high penalties, framing authoritarian acts in the parliament for punishments and perfect audit system never change the taxpayer's behaviour. Tax department and government should create awareness to the people to change their mindset. Taking training classes, motivating the taxpayers by instil the social responsibility and develop the information passing system about the dependency of government services to the public by using tax income etc...

### **1.1 Statement of problem**

Different scholars done their research at different moment in time on the factors that hide the collection of true amount of tax revenue by the government in Malaysia, Check Republic, China, USA, Kenya, Uganda, and so on though tax evasion factors vary based on the context. But, as per the researcher's knowledge there is no published research regarding tax evasion causes and prompt payment of tax remedies in the country of Ethiopia, Thus, the researcher became highly initiated to do this study in order to fill the gap and also the researcher believed this study will have great contribution to the tax authority to rate the factors that become obstacle to collect true amount of tax and provides feedback how taxpayers hide their true amount of taxable income in the study area.

## **1.2 Objective of Study:**

The literature of tax evasion is growing rapidly but still offers lot of research scope to study this phenomenon in terms of reasons for evasion in Ethiopia. The goal of the present study is to determine the main reasons of tax evasion in Ethiopia and convey these results through appropriate media to the policy makers. The study emphasizes the following objectives:

1. To examine the reasons for the Evasion of Income Tax in Ethiopia
2. To suggest the ways for the stoppage for the Income Tax Evasion.

## **1.3 Scope of the Study**

The study was limited on the following aspects:

- ✓ It focused on some selected tax payers in Ethiopia to estimate the actual level of tax payments evasion.
- ✓ The study also mainly focused on those taxpayers that are engaged on different business activities in the study area since tax evasion is mostly expected on business profit income.

## **1.3 Limitations of the study**

- ✓ Selected factors are considered by this paper for evaluating the tax evasion in Ethiopia. Entrepreneurs below 18 years, gender variation and education etc., were not considered.
- ✓ Selected cities only considered and randomly selected respondents for collecting data.
- ✓ This paper analyses exploratory computed values through SPSS (version 21)

## **2. Methodology**

### **Research Design and Instruments**

To study the research objectives and to determine the reasons for tax evasion among businesses in Ethiopia it used the descriptive-cum-exploratory research design on the basis of initial literature review on tax evasion. Data has been collected through primary and secondary sources. Primary data is collected mainly through structured questionnaire. It was designed with 9 factors and used five-point Likert scale for further analysis. It was designed and coded as strongly disagree=1, disagree=2, neutral=3, agree=4, strongly agree=5.

300 questionnaires were floated to the tax payers in the Ethiopia to know the ways and causes of tax evasion. The researcher was applied random sampling technique and finalized 270 questionnaires which are provided answers sufficiently. Remaining 30 questionnaires were discarded due to inadequate/irrelevant data information. The researcher applied average sampling technique to analyse the data from category "A, B & C" business profit, income taxpayers.

Out of the total respondents, researcher collected information on equal proportion from Category A (90 questionnaires), B (90) and C (90) taxpayers. However, response rate for questionnaires is 90%. Secondary data is obtained through websites, books, online magazines, journals and research papers of various researchers. The researcher employed latest version of SPSS (version 21) to sort the collected data properly.

### 3. Data Analysis:

This paper collected primary information from respondents those who are not willing to pay tax or not paying tax to the government by different causes. Researchers tried to identify some factors and analysed as per his wider area of knowledge to rectify the problem on the basis of exploratory research design method.

#### Data Analysis and Interpretation

For the purpose of analysis statistical tools like arithmetic mean, standard deviation, factor analysis etc. has been applied using SPSS statistics version 21.

Before doing the analysis reliability of the questionnaire has been tested with Cronbach's alpha. It is a measure of internal consistency, that is how related a set of items are as a group. Cronbach's alpha can be written as a function of number of test items and the average inter-correlation among the items. Value of Cronbach alpha (0.9) is more than 0.75, which can be considered reasonably excellent for further data analysis vis-à-vis justifying the reliability of research instrument.

**Table I: KMO and Bartlett's Test**

Kaiser-Meyer-Olkin (KMO) Measure of Sampling Adequacy		0.931
Approx Chi-Square		4101.3
Bartlett's Test of Sphericity	df	36
	Sig.	0

**Source: SPSS**

It is reflected from table I that KMO value is 0.931 that is more than the requisite value of 0.7 for the appropriateness of factor analysis, it means that 93.10% sample is error free and in the remaining 6.90% there can be the chances of error. Bartlett's test of Sphericity is used to examine that the original variables are sufficiently correlated. The Significant value of this test is ( $p < 0.05$ ) means appropriateness of factor analysis for the present study.

**Table - 2: Total Variance Explained Reasoned of Tax Evasion with Initial Eigen Values**

SL. No	Factors	Total	% of Variance	Cumulative %
1	Lack of awareness/motivational, training programmes for paying income/Business tax	5.832	64.645	64.645
2	No encouragement for honest tax payers	1.262	14.024	78.8
3	Income tax structure collecting high rate of taxes	0.945	10.567	89.3
4	Negligence, illiteracy of tax payers	0.862	9.584	98.9
5	Inefficiency/indiscipline of tax administration department	0.052	0.58	99.48
6	No government actions on tax evasion	0.031	0.34	99.82
7	Time consuming tax departmental procedures;	0.027	0.08	99.9
8	Exemption of receipts of casual and non-recurring nature	0.016	0.00025	99.992
9	Political interference.	0.009	0.00081	100

**Extraction method: Principal component analysis Computed by SPSS**

Table two explains the factor analysis which question has showing more impact on taxpayers on tax evasion. Eigen values describe the total variance attributed to the factor; highest Eigen value shows the highest variance which will be explained by the factor. In the table two, Eigen value of factor one is 5.832 and its variance 64.645. This result is explaining factor one is impacting more to the people for tax evasion. Lack of awareness, lack of motivational and training programmes are major factor to collect the tax revenue, voluntarily public will not ready to pay tax from their incomes/profits. The second highest value of Eigen is 1.262 and showing 14.024 then respondents are gave 2<sup>nd</sup> priority for factor two. Eigen gave result the remaining in the same pattern. But first 5 factors occupied 99.48 cumulative frequencies. Hence, these are effectively showing more impact tax Evasion.

**Table 3: Total Variance Explained Reasoned of Tax Evasion - (Rotation sum of Squared models)**

Factors	Total	% of Variance	Cumulative %
Lack of awareness/motivational, training programmes for paying income/Business tax	3.195	39.467	39.467

No encouragement for honest tax payers	2.017	32.764	72.231
Income tax structure collecting high rate of taxes	1.695	23.215	95.446
Negligence, illiteracy of tax payers	0.985	2.443	97.889
Inefficiency/indiscipline of tax administration department	0.655	0.824	98.713

**Source: Computed by SPSS**

Table three is showing rotation sum of squared model, after rotation also, Eigen value is showing 3.195 and first three factors cumulative values are 95.446. That means, the three factors are occupied huge impact place on tax evasion. The total five reasons are highlighted total 98.713 percentages. The government and tax administration departments in Ethiopia should take initiation to observe and take action to solve the factor issues. On the basis of these results null hypothesis ( $H_0$ ) that there is no significant reason for evasion income tax in Ethiopia may be rejected.

**Table 4: Top Five Reasons of Tax Evasion**

Sr. No	Particulars	% of	Ran	Mean	Rank	Standard
		Variance	k			Deviatio n
1	Complicated income tax structure	39.467	1	3.86	1	2.984
2	Honest tax payers are not given incentives	32.764	2	2.66	3	2.022
3	Lack of awareness/motivational programs for paying income/corporate tax	21.215	3	2.89	2	2.313
4	Illiteracy of tax payers	4.043	4	2.59	4	1.878
5	Inefficiency/indiscipline of tax administration department	0.998	5	1.95	5	0.841

**Source: computed by SPSS**

According to Table four, five reasons compared means with total variances. The factor Complicated income tax structure placed the first position in total variance factor analysis and also in arithmetic mean. The descending order of variance percentage mentioned the ranks of factors from one to five. The researcher can estimate the priority of public through this ranking order. When analysis came to arithmetic mean, ranks are differed with variance rankings. The factor Complicated income tax structure occupied first place and surprisingly 2<sup>nd</sup> place occupied by 3<sup>rd</sup> factor which is indicating the lack of

awareness of the tax payers. This factor placed in the 2<sup>nd</sup> position in variance column. In the mean column, the 3<sup>rd</sup> place came to incentives of taxpayers. This was in 2<sup>nd</sup> place in the variance column. Respondents' opinion was different based on mean, but when it compared with more accuracy analysis variance is slightly differed. Finally, from 1<sup>st</sup> to 5<sup>th</sup> ranks are showing high impact on tax evasion in Ethiopia. The mean and variances are providing a proper action taking information to the tax department and the government.

**Table 5: Factors correlation of Tax evasion and tax payment**

Factors	1	2	3	4	5	6	7	8	9
1	1								
2	0.953	1							
3	0.939	0.941	1						
4	0.936	0.976	0.921	1					
5	0.911	0.821	0.917	0.901	1				
6	0.874	0.948	0.929	0.933	0.895	1			
7	0.904	0.932	0.942	0.918	0.863	0.835	1		
8	0.844	0.967	0.895	0.915	0.822	0.892	0.867	1	
9	0.866	0.973	0.976	0.925	0.843	0.815	0.812	0.916	1

**Source: computed by SPSS (factors order as per table 2)**

Table five shows each factor's correlation with tax evasion and tax payment. Generally, tax payment is the deciding factor of tax evasion. All reasons of tax evasion are dependent variables. When tax payment is more, tax payers will apply strategies to reduce the tax payment. The highest correlation value is 0.976 is located in row two and column two. The 4<sup>th</sup> factor negligence and illiteracy were correlated with the 2<sup>nd</sup> factor of no encouragement to tax payers in Ethiopia. These two reasons play major role in evaluating tax evasion., All factors from 1 to 5 show more than 0.9 values that means the relation between one factor to another very near to perfect correlation level 1. Factor 8 and 9 are not correlated with the same factors. The least value 8.12 located at 9<sup>th</sup> row of 8<sup>th</sup> column. The analysis was described there is no perfect correlation between government involvement in tax evasion and tax payment. The highest tax payment became an unbearable headache to the tax payers.

#### 4. Conclusion

Though the government is working to improve the awareness of taxpayers regarding to the purpose of taxation, still there are citizens that resist disclosing their true amount of taxable income which is used to levy tax by the tax authority. Lack of taxpayers' awareness on the purpose of taxation can be happened due to low educational status of the taxpayers, un willingness to take tax related education by the taxpayers, rent seeking thinking of the taxpayers, and the authority's low effort to create adequate tax awareness to taxpayers using different mechanisms like panel discussion, media, brusher and so on. So, the study identified that lake of awareness and lack of taxpayers'

experience in paying significant amount of tax to the government are the causes why taxpayers evade their taxable income and not willing to pay adequate amount of tax to the government in the study areas. To collect adequate amount of tax revenue from citizens, tax administrative issues like having fair tax rate, establishing transparent and easy accessible tax rules and regulations, having suitable tax levy techniques, implementing appropriate tax compliance resolution methods, and positive treatment of taxpayers play an important role. Due to the tax rate does not consider the taxpayers ability to pay, absence simple and easily accessible tax rules and regulations, imposing tax without having reliable evidences by simple and wrong estimation, absence of managing the taxpayers' compliance in a good manner, and lack of equal treatment of taxpayers by the authority's employees ; citizens may resist to disclose their true amount of taxable income and may not volunteer to pay adequate amount of tax to the government by their own selves. Thus, the study also indicated that administrative problems are another causes for tax evasion in the study areas.

#### **5. Recommendations to overcome tax evasion:**

There are numerous countries which are suffering this issue of tax Evasion. Here are some of the means recommended by the researcher can be taken to cure the issue of tax Evasion.

- **Lower Tax Rates:** tax payers worried about high tax rates. In Ethiopia, more than 35% tax paying by the tax payers after crossing some limitation of earnings. It is compulsory to the government for develop the wealth of the nation and facilities enhancement to the public but tax payers are not willing to pay 35% for every 100 birr. Voluntarily, most of the tax payers are not willing to come forward for taxpayment. Increase the percentage of tax payers is a responsibility of government. When high tax rate is applicable the proportion of tax payers becomes low at the same time tax payers proportion increase when rates are low. The low tax rate is use full to the nations in long run. Ethiopian government should take initiation to reduce the tax rate for taxpayers' comfort zone.
- **Explain the government role to the taxpayers:** most of the tax payers are thinking that why the government collecting more taxes and looting our money on the name of tax. Lack of awareness on the tax payment is a real problem. Government should take the initiation to explain the procedure of refunding by tax amount for the development of the society.
- **Provide information and regular training:** Under the government regulations tax authority should conduct the training classes to the public and all categories of tax payers. If the tax payers regularize their income by paying proper taxes, what benefits they will get in future and if denied to pay tax how it is illegal and punishable, strictly inform in the training.
- **Avoid zero market:** most of the taxpayers in Ethiopia doing their transactions without bill. Their purchases and sales maximum depends on local people only. If the business firms are not maintaining proper accounting system, identifying their

exact income not possible. Taxpayers are simply escaping from tax limitations by maintains this zero-market system. If government should take action on proper payment system and they provide legality for every business transaction then only possible to identify taxable income. In practicality it is not that much easy task.

- **Identify the unregistered businesses:** government should control the mediation system. In between manufacturers and customers some are acting like agents or mediators. These agents are selling items without taking any legal permission from the government. In this case, manufacturer has to show proper income statement but mediator should not accountable for sales because of this system, manufacturing firm paying more commission to the mid system and getting less profits. Finally its taxable income becomes low.
- **Introduce accurate invoice system:** in under developed countries banking system not developed properly. Online systems also not that much effective so business people are doing most of the financial transactions by cash to bill method. Here, taxpayers are taking advantage to write the bill of transaction on another date. Their intention to change the tax slab. Eg. When taxation year ending date is 31<sup>st</sup>December, a tax payer writes his 300,000-birr sales bill on 1<sup>st</sup>January of next year because of this, 300,000 birr not entered in last year transaction it came to next year. Finally he avoided the maximum tax level slab. If he entered in last year that he would have come to maximum slab level. To control above things government should encourage all transactions through bank.
- **Prompt implementation of currency changing system (Demonetization);** taxpayers maintain secrecy about their actual income to avoid tax payment. People will be keeping unaccountable amount in the secret places. Every 5 years government give the priority to introduce new notes in the place of old currency the secrecy amount will deposit in the banks by the tax payers. Then the government will get the existing currency levels and also people income levels for collecting actual tax.

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