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## RESEARCH ARTICLE

# CAUSES OF BUSINESS TAX PAYERS EVASION AND REMEDIES TO DEVELOP TAX PAYMENT IN ETHIOPIA, BAHIRDAR TOWN

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### ABSTRACT

Tax is an obligatory price calculated by using an economic unit paid to a central authority without the expectancy of proportional enjoyment from the government. In a perfect world, all taxpayers might voluntarily pay their taxes and follow all their tax duties willingly. But in fact, no one enjoys by means of paying tax to the government and a plenty of viable financial units tries to limit its tax burden by using any means. The well-known goal of the tax payers is to take a look to evaluate the possible reasons why enterprising income taxpayers avoid their taxable earnings and no longer pay actual amount of tax to the authorities. The researchers suggest remedies to create attention to full payment of tax by means of default by tax payers. The study has diagnosed the viable reasons of tax evasion as lack of tax payer's awareness on the subject and also discussed remedies to develop the tax payment by tax payers.

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## INTRODUCTION

In an ideal world, all taxpayers would voluntarily pay their taxes and comply with all of their tax obligations willingly. But let's face it, no one enjoys paying tax, and at the end of each financial year some people think as to how they can best arrange their affairs to pay as little tax as possible. This may simply involve making use of strategies by different taxpayers, that allows to legally minimizing tax (for example, increasing superannuation contributions or negative gearing of an investment property). These strategies are non-aggressive tax planning strategies. Alternatively, however, there are strategies that may involve non-compliant or fraudulent activity that could be most appropriately described as tax evasion (for example, creating false expenses or shifting money offshore). Tax office commonly refers to so many tax evasion strategies called as aggressive tax planning. All over the world, the economy is losing every year billions of dollars by tax evasion. Estimates of the sheer scale of the losses fluctuate wildly with the IMF reporting that around \$600 billion is lost due to profit shifting every year. A new paper published by UNU-WIDER took a closer look at the issue at country level, finding that the United States loses the highest amount in absolute terms by far. Every year, the U.S. loses an estimated \$189 Billion in corporate tax, around 1.13 percent of GDP. China has the second highest annual losses in absolute

terms with \$66.8 billion while Japan is also badly affected with \$47 billion unaccounted money. The IMF has reported that OECD [Organisation for Economic Co-operation and Development] countries lose approximately 2 to 3 percent of their total annual tax revenue while lower-income countries lose substantially more. Central African nation loses \$950 million in tax revenue every year. Even though that might seem insignificant compared to other countries, those losses have a far-reaching impact equating to around 7 percent in their GDP. Tax evasion is happening from all categories of taxpayers. In the present scenario, corporate tax payment seems to occupy more space where the countries declared status as developed, but these are also not effective to control the tax evasion. The following bar chart explains the tax losses of the corporate sector in selected countries. Prevention or control of 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 taxpayers' behaviour. Tax department and government should create awareness in the people to change their mindset. Taking training classes, motivating the taxpayers by instilling the importance of social responsibility and develop the information passing system about the dependency of government services to the public by using tax income etc. will have to be undertaken.

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**Statement of problem:** Different scholars have done their research at different moment of time on the factors that hinder

the collection of true amount of tax revenue by the governments in Malaysia, Czech Republic, China, USA, Kenya, Uganda, etc. 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 researchers got interested to do this research in order to fill the gap and also the researchers believed that this study will have great contribution to the tax authority to rate the factors that become obstacle to collect true amount of tax and to provide feedback on how the taxpayers hide their true amount of taxable income in the study area.



### Objective of the Study

- ) To investigate the reasons as to why the taxpayer exclude their taxable income and resist paying true amount of tax to the government
- ) To find out the avenues to create awareness to taxpayers to avoid the tax Evasion for prompt payment of tax in a case of Bahirdar town.

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.

**Possible causes of tax evasion:** Kinsey (1987) argue that tax noncompliance is an intentional behaviour. In countries like Ethiopia where most of the business community have no access to information, lack of awareness cannot be simply overlooked rather it can be assumed as a major determinant of tax compliance behaviour. Phillips & Sandall (2008), explain the relationship between governance and tax reforms. The study explains that three key dynamics reflects the relationship between governance, taxation and investment climate. Firstly good tax system positively depends on good governance. Secondly a fair domestic taxation system promotes good governance because efficient tax system allows population to pay fairly. Similarly, Brooks (2001) states that

fairness has always been widely regarded as the most important criteria in judging a tax system. The problem of unfairness is that a tax system allows taxes to be shifted from dishonest to honest taxpayers. The fairness of a tax system may also be perceived in different ways by the taxpayers and tax authorities. What is fair in the eye of the tax authorities may not have the same image in the mind of the taxpayers.

It is pointed out by Adams (1921) that the success of income tax rests primarily upon the honesty of taxpayers. Some authors (Brooks, 2001) indicated that tax morality has declined over the past few decades and this is attributed to wasteful, inefficient, and even perverse governments. Adams further states that one of the factors that contribute to the dishonesty of the taxpayers is the complexity of the tax system, as it may lead to administrative failures. This can be viewed as it has relation with the tax culture of the society. Practically it is difficult to obtain genuine information from taxpayers regarding their income. Hence, tax gap is created to the extent the taxpayers hide information regarding their business activity.

**Data analysis:** The researchers collected primary information from respondents who are not willing to pay tax or not paying tax to the government for different causes.

**Table 1. Tax payers Profile**

Gender	Frequency	Percentage
Male	105	70
Female	45	30
Total	150	100
<i>Level of Education</i>		
Primary	21	14
Secondary	33	22
Certificate	37	24.67
Diploma	35	23.33
BA degree and above	24	16
Total	150	100
<i>Business type</i>		
Service	50	33.33
Manufacturing	35	23.33
Merchandising	65	43.33
Total	150	100
<i>Taxpayers' category</i>		
Category "A"	45	30
Category "B"	50	33.33
Category "C"	55	36.67
Total	150	100

Source: Primary data

The above table shows that out of 150 taxpayers 105 (70%) are male and 45 (30%) are female. Here female proportion is very low. It's indicating only 30%. In that, most of the female are supporting male to share the work. Female entrepreneur proportion showing very less percentage, may be most of the females are house wives even though they completed graduation and financially manageable. As per respondents academic profile, 21 (14%) have gone to primary school, 33(22%) have gone to secondary school, 37(24.67%) were at certificate level, 35 (23.33%) were diploma holders, and only 24 (16%) of the respondents have gone to the university. The low rates of those who attended university explain that the intellectuals are involved in business activities. Those who stopped their education at primary and secondary level are running small businesses and they are not maintaining any record. These are only paying individual tax. Regarding their business type, 50(33.33) of the respondents were engaged on service giving enterprises, [Like small scale transport services, Cafeteria and restaurant, Warehousing services, tourist

services, beauty salons, internet café, garage and assembly work, poultry, animal feed processing and fruit and vegetable production and selling etc.]35 (23.33%) of the respondents were engaged in manufacturing activities (like manufacturing, construction, trading, mining quarrying sector] and the rest 65(43.33%) on merchandising businesses. Out of the total respondents, 45 (30%) were registered in category "A" taxpayers, 50 (33.33%) were registered in category "B" taxpayers and the remaining 55(36.67 %) were registered in category "C" taxpayers. From the above observed data in this study, more taxpayers are registered in category "A" and category "B" at Bahirdar town as compared with the others.

### Reasons for tax evasion

**Table 2. General reasons of Tax Evasion**

	<i>Frequency</i>	<i>Percentage</i>
Lack of awareness	63	42
Unfair tax rate	34	22.667
Lack of good governance	16	10.667
Rent seeking thinking of the taxpayers	15	10
Lack of trust on the government	7	4.667
Lack of continuous follow up by the authority	9	6
All of the above	6	4
Total	150	100

Source: Primary Data

According to the above table 2, 63(42%) respondents responded that the lack of adequate awareness regarding the purpose of taxation as the primary reason for tax evasion. In their opinion they evade taxes because of fluctuating income levels from year to year, lack of education, lack of social responsibility, Zero based business (without bill) etc. Previous studies by Anna A. and Kamala A. (2008 identified that taxpayers' perception on the tax system was important because fairness of the tax system will instil compliant behaviour among taxpayers. Understanding taxpayers' motivation and developing tax policies and strategies that can influence compliance will bring more revenue and less administrative cost to the tax authority. On the other hand, 34 (22.667%) of the respondents responded that unfair tax rate is the second cause for tax evasion, these category expressed that the government collecting 35% taxes after crossing a certain limit of income is unfair and some are willing to pay 20% of tax from their income or profit. Dr. Rao an Indian expatriate said that "Tax payer is not a deluder; he is created by government by charging high tax rates on their taxable incomes". The actual scenario in Ethiopia is that more than 75% of the business people belong to the middle class.

Their yearly income/profits are not sufficient to fulfil their minimum requirements but the government is collecting taxes if their sales revenue exceeds 100000 birrs. There is no guarantee that everyone will cross the 100 thousand birr revenue line one. Even if they crossed, the margin of profits will not exceed 20% or 30%, which means that these categories of taxpayers are getting only 20,000 birr to 30,000 birr profit per annum. The monthly average profit earning by the taxpayer is less than the 5,000 birr. This amount is not sufficient to manage the family requirements and therefore the taxpayer do not even think about prompt payment of taxes to the Government. 16(10.667%) of the respondents felt that lack of good governance by the tax authorities as the other reason for tax evasion, 15 (10%) of the respondents responded that one of the reason for tax evasion is the thought of seeking rent, 7(4.667%) of the respondents responded that lack of trust

on the government is the reason for tax evasion, 9(6%) of the respondents responded that lack of continuous follow up of the business people transactions by the tax authority is another reason for tax evasion, and the remaining 6 (4%) of the respondents said that all of the above reasons can be the possible reasons for tax evasion. This implies that lack of experience in paying significant amount of tax, unfair tax rate, rent seeking thinking of the business people, lack the authority of continuous follow up, lack of good governance, and lack of trust on the developmental activities of the existing government are the reasons for business people evading their true taxable income and not to pay true amount of tax to the government from top to bottom sequences respectively from the eyes of the taxpayers. This result is consistent with previous studies which had been done by Roth Scholz and Witten (1999); Murphy K. (2004); Rametse and Yong (2009); Omweri et al. (2005); Desta K. (2010) identified that unfair tax rate, lack of good governance, rent seeking thinking of the taxpayers, and lack of trust on the government are the reasons why most business profit taxpayers in developed, developing and under developed countries evade their true amount of taxable income and governments unable to collect adequate amount of tax revenue from their citizens.

**Overcome Taxevasion:** There are many nations which are dealing with this hassle of tax evasion. Although it looks like they're helpless, this is not the case. Here are a number of steps suggested by researchers that can be taken to remedy the problem of tax evasion.

- ) Lower Tax Rates: It is crucial for the nation to recognize that a better tax charge does not suggest more tax collection. In fact, it may imply the complete opposite. People have a tendency to cover their earning whilst tax rates grow. A very excessive tax fee may additionally discourage human beings from properly paying taxes.
- ) Explain the government role to the taxpayers: most of the tax payers are thinking that the government is collecting more taxes and looting their money in the name of tax. Lack of awareness on tax payment is a real problem. Government should take the initiation to explain the procedure of refunding the 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. They should be informed that if the tax payers regularize their incomes by paying proper taxes, they will get benefits in future and if they do not pay the taxes it is illegal and is a punishable offence.
- ) Avoid zero market: most of the taxpayers in the Bahirdar town are doing their transactions without an invoice or a bill. Their purchases and sales depends on local people only. If the business firms are not maintaining proper accounting system, identifying their exact income is not possible. Taxpayers are simply escaping from tax limitations by maintaining this zero market system. The government should take action on improper payment of taxes.
- ) Identify the unregistered businesses: The government should control the mediation system where some people are found to be acting like agents or mediators between manufacturers and customers. These agents

are selling items without taking any legal permission from the government. In this case, the manufacturer has to show proper income statement but mediator is not made accountable for sales. Due to this system, the manufacturing firms are paying more commission to the middlemen and getting less profits resulting in the low amount of taxable income.

- J) Introduce accurate invoice system: In Ethiopia banking system is not developed properly. Online systems are also not effective and therefore business people are conducting most of the financial transactions by cash to bill method. Here, taxpayers are taking advantage to write the bill of transaction on a future date. Their intention is to change the tax slab. For example, 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> April of next year. Due to this, the taxable income of 300,000 birr will not be entered in the last year transaction and is conveniently shifted to the next financial year thereby avoiding the maximum tax level slab. To control the tax evasion, the government should encourage all transactions through bank.
- J) Prompt implementation of currency changing system (Demonetization); Most of the taxpayers maintain secrecy about their actual income to avoid tax payment. Unaccounted money are hoarded in secret places. Therefore every 5 years government should give priority to introduce new notes in the place of old currency and the hoarded money will be deposited in the banks by the tax payers.

## Conclusion

Though the government is working to improve the awareness of taxpayers regarding the importance of taxation, there are citizens who resist to disclose 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 is due to low educational status of the taxpayers, unwillingness to take tax related education by the taxpayers, rent seeking thoughts 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 lack of awareness of taxpayers in paying significant amount of tax to the government is the main cause of why the taxpayers evade their taxable income and are 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. Since the tax rate does not consider the taxpayers ability to pay, absence of 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.

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