

Reasons of Tax Evasion and Tax Avoidance: Case of Debre Markos Town, East Gojjam Zone, Amhara National Regional State

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Abstract

The main purpose of this study is to examine the causes of tax evasion and tax avoidance of tax payers' reflection from Debre Markos town. Stratified sampling technique was applied to select respondents based on the nature of the tax payers by category A, B and C tax payers. The required sample was determined through proportional random approach from each stratum & a total of 365 taxpayers were taken as a sample. For the accomplishment of this study, the researcher used primary sources of data. Primary data were obtained through distribution of self-administered questionnaires to sampled respondents of 365 tax payers. The collected data has been analyzed through descriptive statistics by statistical package for social science (SPSS) software for the purpose of this study. The implications of these results were low quality of the service in return for taxes, absence of tax morality, non-existence of an equitable & efficient tax system and the existence of high tax rate. Poor relationship of tax payers & the authority, lack of adequate enforcement for default, lack of adequate tax incentives and greed and selfishness are not the major reasons for tax evasion and tax avoidance in the study area. Therefore, I recommended that, the town's tax authority should promote the quality of public services, transparency and control of the public budget and minimize low tax morale by promoting a tax-paying citizen culture and educating taxpayers.

Keywords: Tax Evasion, Tax Avoidance, Taxpayers, Causes, Ethiopia

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1. Introduction

Taxes have very important role in the implementation of development as a source of revenue to finance the necessary expenditures, however, is not easy to impose taxes on the people because if too high people will be reluctant to pay taxes, on the contrary, if too low, it will be short of funds so that development will not run as expected. There is consensus in the literature that tax evasion and tax avoidance are the root cause of the shortage of public finances in developing countries. This caused so much loss of potential tax revenue that could be reduced the burden on the state budget deficit. This is done by not reporting or reporting, but not according to the actual situation on the income that can be taxed. The reason is that, tax systems in many developing countries are characterized by tax structures being not in line with international standards by lack of tax policy management, low compliance levels and inappropriate capacities in tax administration (Bhatia, 2008).

As taxes constitute the principal source of government revenue to fulfill public infrastructure to aid economic development, the greatest problems facing in Ethiopian tax system is evasion and avoidance of tax by tax payers. Bhatia(2008) also conducted that, tax evasion is the willful and deliberate violation of the law in order to escape payment of tax which is unquestionably imposed by law of the tax jurisdiction where as tax avoidance is the active means by which the taxpayer seeks to reduce or remove altogether the tax liability without actually breaking the law. Thus, even though the tax evader and tax avoider have a similar end (i.e reduce tax liability) their means to that end differ (Ayua, 1999). The evader is a criminal while the avoider is just smart taxpayer who exploits loopholes in the tax laws (and related laws) to reduce tax liability. These "Twin devils" have created a great gulf between actual and potential revenue. This creates, lacking in public service provisions and subverts the efforts to increase people living standard especially in developing countries and slow down the economic growth (Mughal and Akram, 2012).

That is why the ability of any country to finance the public sector which may undermine due to tax evasion and tax avoidance of tax payers (Kiabel and Nwokah, 2009) .On the other hand, it is also perceived that both tax evasion and tax avoidance are linked with underground economy. Schneider and Enste (2000) reported that underground economy is that economy in which people do not show their real income and taxable income that they have earned through legal activities.

Underground economy is a reality in Ethiopia. Emerta (2010) exhibited in his finding that there is a significant amount of economic activity (>36% of the recorded economy) that is not reported and captured by the official statistics in Ethiopia. He also stated that out of this, the amount of tax evasion reached 10% of the economy. This shows that evasion and avoidance of tax by business income tax payers are the main cause of underground economy in Ethiopia.

In similar fashion Debre Markos town have faced large amount of tax evasion and tax avoidance problems (report of revenue office, 2013). These two evil spirits have generated a gap among probable and actual revenues in Debre Markos town, Ethiopia. The revenue office of the town has protested against these two above mentioned evils for a number of times but tax payers, make use of tax evasion and tax avoidance strategies to get away the taxes or they willfully employ fake techniques to evade the tax and are not paying the right amount of tax to the tax authority (Panel discussion, 2013). This makes the researcher trigger to know the causes or reasons of tax evasion and tax avoidance in the town. There is no research conducted regarding tax evasion and tax avoidance of tax payers in Ethiopia particularly in Debre Markos town as to my knowledge. Consequently, this study tried to fill the gaps in the literature as well.

2. Related Literature Review

As stated in many literatures, taxpayers' willingness to pay taxes differs widely across the world. It cannot be viewed as simply depending on the tax burden. Rather, empirical research indicates that taxpayers throughout the world pay more taxes than can be explained by even the highest feasible levels of auditing, penalties and risk-aversion (Alm et al., 2007). In general, citizens expect some kind of service or benefit in return for the taxes paid. If the government fails to provide basic public goods and services or provides them insufficiently, citizens may not be willing to pay taxes and tax evasion and avoidance will be the consequence (Pashev, 2005; Everest-Phillips, 2008; Lieberman, 2002; Bräutigam et al., 2008).

On the other hand, some studies suggest that high tax rates foster evasion. The intuition is that high tax rates increase the tax burden and, hence, lower the disposable income of the taxpayer (Chipeta, 2002). Besides to this, Kirchler et al., (2007) pointed out that the structure of the overall tax system, lack of transparency, accountability and high levels of corruption in the use of public funds contributes to public distrust both with respect to the tax system as well as the government.

Cai and Liu (2009) investigated Chinese industrial firms to avoid corporate income tax. The study also estimated the effects of competition on the relationship between firms' reported accounting profits and their imputed profits based on the national income account. The study examined that firms in more competitive environments engage in more tax avoidance activities. According to the investigation of Chen & Been-Lon (2003) about tax rate, tax evasion and economic growth, and compared them with otherwise identical economies except those without tax evasion. The study found out that an increase in both unit cost of tax evasion and punishment-fines reduced tax evasion, whereas an increase in tax auditing reduced tax evasion only if the cost of tax enforcement is not too high. Green (2009) has highlighted ten reasons of tax evasion. The paper have also suggested that part of the reason the norms against tax evasion are so unstable is that there is confusion about exactly why tax evasion should be regarded as morally wrong. To that end, the debate over the moral content of tax evasion is revisited and extended.

3. Research Methodology

The study was conducted at Debre Markos, former capital of Gojjam Province, is a city and woreda in northwest Ethiopia located in the Misrak Gojjam Zone of the Amhara Administrative Region. It has a latitude and longitude of 10°20'N 37°43'E and an elevation of 2,446 meters. The researcher selected Debre Markos town because of familiarity and awareness of area. The town is among the Local Government Authorities in Amhara regional state that is challenged with tax evasion and avoidance to enhance local revenue.

The target population for this study comprised of all registered tax payers which are found in Debre Markos town Administration. There are 4187 registered tax payers in Debre Markos town Administration as the information gathered from Debre Markos Revenue Administrative office in January 2013 with three Categories of taxpayers (category A, B & C).

For the purpose of this study, stratified sampling technique was applied to select the respondents. The total population was divided in to three stratum based on the nature of the tax payers by category A, B and C tax payers. The required sample was determined through proportional random approach from each stratum & a total of 365 taxpayers were taken as a sample as shown below:

For the accomplishment of this study, the researcher used primary sources of data. Primary data were obtained from responses administered through questionnaires to taxpayers. For primary sources of data, the study utilized open and close ended type of questionnaires. The questionnaires were designed and distributed to sampled tax payers. Furthermore, prior to data collection the questionnaires were translated into Amharic to avoid communication barriers because of the disparity in educational status and language level.

After the data has been collected, proper tools and techniques were used for classification and analysis of the data. There are many different techniques that have been used in the analysis of data. This study used descriptive statistics such as percentages and frequency to explain reasons of tax evasion and tax avoidance of tax payer. Moreover, tables and graphs that are appropriate to present the findings have been used.

4. Results and Discussion

4.1 Response Rate

The questionnaires were distributed for all randomly selected tax payers. That is, a total number of three hundred sixty five (365) questionnaires were administered for each of the respondents chosen, of which three hundred twenty (320) questionnaires were return. The remaining Forty five (45) of them were not returned. This indicated that there was 88% repose rate and a non- response rate of 12%. This shows that the response rate considered as fair. (Dillman, 2007) pointed out that the response rate for a personal delivery approach varies considerably from the lower of 28 percent to the highest of 50 percent.

4.2 Demographic Characteristics of the Respondents

There are various reasons for tax evasion and tax avoidance. In order to develop methods and instruments for fighting tax evasion and avoidance, it is important to foremost establish a broad understanding of the different reasons underlying these problems. Sex, age, educational level and other factors are expected to influence the attitude of tax payers in relation to tax evasion and tax avoidance.

Out of the total respondents 64.9 percent are males and 35.1 percent of them are females. This indicates that males are engaged in business activities in the town compared to females and the participation of females are low in this study compared to males.

With regarded to age distribution majority of the respondents are in between the age of 18 - 30 years which is (42.9 percent) and followed by age of 31- 40 years which is (29.2 percent). This indicated that the businesses are run by the productive part of the people in the town.

Regarding to level of educational status, Most of the respondents are degree holders about 36.4 percent and followed by certificate and diploma holders with 29.9 percent while, the rest 17.5 percent and 16.5 percent are secondary school and primary school completed respectively. This indicated that 66.3 percent of the respondents are educated.

With regard to types of business, as per the outcomes of the survey, about 51.9 percent of the respondents were engaged in merchandise while 43.5 percent and 4.5 percent were to be engaged in service and manufacturing sectors respectively. This indicated that large share of respondents are account for merchandise activities.

In terms of forms of business ownership 89 percent of the respondents were sole proprietorship. Moreover, 6.5 percent and 4.5 percent of respondents were participated in partnership and Private Limited Companies respectively. This indicated that most the business activities of the town were covered by sole proprietorship.

4.3 Causes of Tax Evasion and Tax Avoidance

The reasons or causes of tax evasion and tax avoidance are numerous. But in this study the researcher was assessed by surveying different reasons or causes of tax evasion and tax avoidance of taxpayers depicted in table1 below. As stated in table, most tax payers evaded and avoided tax due to low quality of the service in return for taxes, absence of tax morality, non-existence of an equitable & efficient tax system and the existence of high tax rate.

On the other hand, some respondents had evaded and avoided taxes due to poor relationship of tax payers & the authority, lack of adequate enforcement for default, lack of adequate tax incentives and greed and selfishness. This indicated most respondents evaded and avoided taxes due to the government insufficiently provide basic public goods and services, increase the tax burden and unfairness of tax payment and the development of deep-rooted 'culture' of the taxpayers.

Table 1. Causes of Tax Evasion and Tax Avoidance

Item	Frequency	Percent
Low quality of the service	98	30.63
Absence of tax morality	87	27.19
Non-existence of an equitable & efficient tax system	83	25.94
The existence of high tax rate	35	10.94
Poor relationship of tax payers and the authority	6	1.88
Lack of adequate enforcement for default	4	1.25
Lack of adequate tax incentives	3	0.94
Greed and Selfishness	3	0.94
Other	1	0.63

Source: Survey Questionnaire, 2019

5. Conclusion

Tax evasion and avoidance have an inverse impact on the economic condition of the country in general and tax revenue of the government in particular (Mughal & Akram,2012; Adebisi and Gbegi, 2013; Lalit and Virender,2012). This paper gives an overview of tax evasion and tax avoidance of business profit taxpayers in Debre Markos town on the available knowledge. Although the topic of tax evasion and tax avoidance represents a problem for developed and developing countries, literature and data concerning this topic are still scarce. This is partly explained by the fact that the extent of tax evasion and avoidance is hard to estimate as the phenomena are difficult to observe and precise data is lacking. So far there are no reliable empirical findings which provide a clear picture of the size of the problem.

The major reasons of tax evasion and tax avoidance in the study area were low quality of the service in return for taxes, absence of tax morality, non-existence of an equitable & efficient tax system and the existence of high tax rate. Poor relationship of tax payers & the authority, lack of adequate enforcement for default, lack of adequate tax incentives and greed and selfishness are not the major reasons for tax evasion and tax avoidance in the study area.

6. Recommendations

- The town's tax authority should promote the quality of public services, the transparency and control of the public budget or the fight against corruption to the tax payers.
- Taking into consideration the benefits of taxes for the welfare of the state and its citizens creating awareness should be required for business profit tax payers to minimize low tax morale by promoting a tax-paying citizen culture, by preparing organization of an annual taxpayer's week and the awarding of certificates, prizes and educate tax payers.
- The overall structure of the tax system of the tax authority should be fair that makes tax payers vulnerable to evade and avoid taxes.

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