THE CONTRIBUTION OF KNOWLEDGE FOR TAX COMPLIANCE: AN INVESTIGATION IN TO SMALL AND MEDIUM SCALE ENTERPRISES POINT OF VIEW IN BAHIR DAR CITY, ETHIOPIA

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ABSTRACT

The objective of this study was to examine the contribution of knowledge for tax compliance in Bahir Dar city from small and medium scale (SMEs) tax payers' point of view in 2020. A quantitative approach with an explanatory research design was employed and the study has collected data from 296 respondents using a proportionate stratified random sampling technique through a five point Likert scaled questionnaire and it has been analyzed using EVIEWS for a simple linear regression analysis. The study revealed that knowledge can pave the way for tax compliance positively and statistically significantly. Accordingly, the study recommends that government shall raise tax awareness through tax education, training etc. if tax revenue is to be used as a deriving engine of its economy.

Keywords: Knowledge, Small and Medium Scale Enterprises, Tax Compliance.

INTRODUCTION

There is no doubt that tax plays a very important role and matters the development of nations in the world (Nguyen, 2017). That's why to all the countries tax liability is compulsory to everyone yet many taxpayers have been intentionally and unintentionally finding ways to evade the tax (Franzoni, 2000). Policy attention to tax evasion was spotlighted after the financial crisis of 2008, the Great Recession and the large deficits that followed (Slemrod, 1989). It's a universal problem which transcends national boundaries in developed as well as developing countries (Saruc, 2001) and the case sound the same in Ethiopia.

Accordingly, scholars defined tax noncompliance as an attempt or illegal practice of not paying taxes, by not reporting income, reporting expenses not legally allowed, delaying taxes owed with the intention at paying nothing or something lesser than one's tax liability (Franzoni, 2000). It drastically reduces the amount of state budgets every year all around countries globally and it denies every government tax revenue due to the system, which results in a gap between the potential and actual tax collection (Adebisi & Gbegi, 2013) even it's a global phenomenon that has been practiced globally. And, it takes place in developed as well as developing countries, in virtually all societies and cultures (Ahmed et al., 2018).

The problem of tax noncompliance is a major concern for developing countries like Ethiopia; as economic development can be significantly hampered by poor tax revenues because of the problem of tax evasion (OECD, 2010; Tarekegn, 2015; Gupta, 2017). Based on the trend analysis, Yesegat & Fjeldstad (2016) and Tarekegn, (2015) found Ethiopia having lowest tax to GDP ratio (10.7%) far below the average for Sub Saharan African and low income countries in general, and noncompliance contributes a lot to this poor performance (Bayu, 2016) and (Martini, 2014) and Bahir Dar city by no means can't be an exception to this.

In Ethiopia, since most business owners especially SMEs don't have simplified access to and clarification on the tax laws and procedures, they lack awareness on tax rules and regulations and this has an impact on the practicability of the tax compliance of SMEs they are not required to have sufficient filing and reporting but it provides that a person commits an offence if the person, with intent to evade tax, conceals income, fails to file a tax declaration, or fails to pay tax by the due date (Tax Administration Proclamation No. 983/2016 Article 125 (1)).

Most of the leading theories, hypotheses and empirical studies are originally developed based on developed countries. Indeed, it has been conducted in some developing countries like Kenya, Pakistan, India, Malaysia and Ethiopia to some extent. However, the issue of tax evasion of developed countries by no means is alike with developing countries (Ahmed et al., 2018; Devos, 2014; Asaminew, 2010; Martini, 2014). Therefore, conducting this study on developing countries specifically in Ethiopia seems logical and the researcher intended here to test whether the said theories, hypotheses and empirical evidences are similar with developed countries where they formerly originated from.

Moreover, a serious tax evasion among business community in different parts of the country has been observed by in Jimma, (Tarekegn, 2015) in Dessie, (Derar, 2016) and (Bayu, 2016) in Addis Ababa and (Ethiopian Ministry of revenue, 2019). This is a typical indication of non-compliance of tax payers in the country. Ipso facto, Bahir Dar city is none exceptional to tax noncompliance due to the fact that, it is governed by the aforesaid ministry.

Following the political instability the country went through over the past few years, tax payers retreated from paying given they are going to trade with contraband, fake ID and soon and it is not surprising that the effect of knowledge on tax compliance calls for research.

To the knowledge of the researcher some researches have been conducted on the issues of tax compliance in Ethiopia like (Bayu, 2016; Tarekegn, 2015). They are, however, by far different from this one in various methodological aspects like approach, design, data type and source, study area and period given the calls for further research.

Therefore, by mixing those of the aforementioned practical problems with gaps in literature, the researcher is intended to add further insights on whether knowledge paves the way fortax compliance.

The main objective of the study was to examine the impact of knowledge on tax compliance and to applaud possible recommendations. To achieve the aforementioned objective the study hypothesized that better knowledge in tax issues would increase tax compliance.

METHODOLOGY

This research applied quantitative research approach with an explanatory research design so as to offer insight in measuring causal relationship between knowledge and tax compliance by selecting a cross sectional sample of population at single point on time 02 April to 02 September, 2020 in Bahir Dar city, Ethiopia.

This study was conducted on 1897 small and medium scale enterprises /SMEs/ point of view with a stratified proportionate random sampling technique based on their activities given by the city administration office in to trade, agriculture, service, construction, mining and manufacturing. It is because proportionate stratified random sampling method enhances a representativeness of samples since they were selected from each stratum to conduct the study (Creswell & Creswell, 2017).

Accordingly, Yamane's (1967) formula was employed to select respondents from the total population as shown below.

$$n = \frac{N}{1 + N(Ne)^2} = \frac{1897}{1 + 1897(0.05)^2} = 331$$

Where; n= required sample size, N= total population and Ne= margin of error noted that problem solving research design are followed by the selection of the data collection technique and then the data were collected through a total of eleven (11) items five point Likert scaled structured closed ended questionnaire with in each variables which is common in big investigations since it's considered as heart of survey operation.

The questionnaire was distributed with exactly with the same phrasing and in the same order for all respondents. Additionally, in order to make assure questions quality and to ensure quality of data collected by questionnaire, the researcher had pay attention to the questionnaire sequence to prepare questionnaire and a trained research assistants were used to help respondents aware each question. Moreover, the questionnaire was distributed in the form of Amharic version so as to include both illiterate and literate enterprises as well as all respondents were necessarily speaker of the aforesaid language.

In this study, a quantitative data analysis technique was used to explain the population from the sample via descriptive and inferential statistics tools in order to organize, summarize, analyze and explain the data. Hence, up on competition of data collection, data were edited, coded and entered into SPSS version 20 and a series of Likert type item that represent similar feature were combined into single composite variable by using mean index and it was analyzed through a simple linear regression model to determine the effect of independent variable (knowledge) on dependent variable (tax compliance). Accordingly, the study employed the analytical model presented here under.

TC= β0 + β1knf+ ε; which later gave the following equation.

TC = 0.014896 + 0.961441 KNF + ε

Where,
TC= Tax compliance
KNF= Knowledge
B0= constant term
B1= beta coefficients
E = statistical discrepancy

Before the basic regression, all the necessary diagnostic tests of this model have been dully undertaken which led the study to proceed to the regression process.

Moreover, to avoid the doubt of questions and to know understanding of respondents, Chronbach's Alpha was used to measure internal consistency of the instrument before conducting the actual study and to assure the reliability of measurement for further analysis and a 0.978 was scored.

RESULTS AND DISCUSSION

The study administered 331 questionnaires and distributed to small and medium scale enterprises provided that 296 (89.4%) of which 108, 119, 35, 18, 15 and 1questionnaires were returned back by trade, service, manufacturing, agriculture, construction and mining sectors respectively and used for further analysis.

A correlation analysis resulted knowledge has a positive correlation with tax compliance which was about 0.956. Meanwhile, all the require diagnostic tests for the assumptions of classical linear regression model namely the error have zero mean, heteroskedasticity, autocorrelation, normality and multicollinearity (Brooks, 2008) were tested and the model has find fitted for further regression (Amina & Saniya, 2015).

Table 1 REGRESSION RESULT				
Dependent Variable: TCS				
Sample: 1 296				
Variable	Coefficient	Std. Error	T-Statistic	Prob.
C	0.0149	0.03418	0.43582	0.6633
KNF	0.96144	0.01719	55.9292	0
R-squared	0.91409	Durbin-Watson stat		2.09028
Adjusted R-squared	0.9138			
F-statistic	3128.08			
Prob(F-statistic)	0			

Source: Survey of sampled SMEsand own computation, 2020

Accordingly, the Table 1 above reports regression results between the dependent variable (tax compliance) and the explanatory variable (knowledge). The R-squared value measures how well the regression model explains the actual variations in the dependent variable (Brooks, 2008).

The adjusted R2 value in table 1above indicates that 91.37% of the total variability of tax compliance of the SMEs was explained by the variable in the model. The regression F-statistic (31.28) and the p-value of zero attached to the test statistic reveal that the null hypothesis that all of the coefficients are jointly zero should be rejected. Thus, it implies that the independent variable in the model were able to explain variations in the dependent variable (Tilahun & Yidersal, 2014).

As shown in the introduction and literature sections above, this study hypothesized that better knowledge in tax issues would increase tax compliance. The result is in line with the hypothesis. In particular, the coefficient on knowledge was positive and statistically significant at five percent level with a p-value of 0.0000. This means that the more the small and medium scale enterprises (SMEs) are knowledgeable about tax issues they are more likely to comply and then to pay tax (OECD. 2010).

The study revealed that tax payers had knowledge of tax issues concerning tax proclamations, calculates, finalization and return as well as the regulations in detail. Surprisingly it is revealed that the SMEs are awarein tax issueswhich influence them to comply (Martini. 2014).

The result is consistent with theory of planned behavior which suggests that an individual's control over the behavior is incomplete; that means possessing tax knowledge would

lead to higher compliance (Asaminew, 2010). Rates and the compliance behavior among taxpayers there by influences them to comply (Gupta, 2017).

The findings of this study is concurred with the study of Kasipillai, who documented that possessing tax knowledge, would lead to higher compliance rates. It's also consistent with the work of Ali et al. (2013), who come into a conclusion that tax knowledge and awareness are found to be positively correlated with tax compliance attitude. It's also concurrent with the study of because both infers that government can gain more revenues and obviously will benefit from these revenues if it do more on tax knowledge (Creswell & Creswell, 2017).

Moreover, this study is also disproved the study of and Newman & Nokhu (2018 who concluded that the tax knowledge is not significantly correlated with their tax compliance behavior in general. Also it antagonized the study of Harris who claimed that tax knowledge has no direct significant impact on taxpayers' compliance behavior.

The study is confronted with the study of who documented that possessing tax knowledge would lead to higher tax evasion which is the cause of non-compliance. It's also confronted with the study of who come into a conclusion that limited tax knowledge cause to unintentional non-compliance. The study also revealed contrary Nguyen (2017) who concluded that if people possessing a better knowledge on tax issues tend to evade taxes more.

Hence, knowledge is revealed as an important factor in paving the way for tax compliance among the points of view of small and medium scale enterprises in Bahir Dar city, Ethiopia. This result clearly supports the hypothesis that better knowledge in tax issues would increase tax compliance (Abebe, 2019).

CONCLUSION

This study set out to estimate empirically whether knowledge paves the way for tax compliance. Accordingly, the it found that better knowledge about tax issues such as tax proclamations, calculates, finalization and return as well as the regulations can pave the way for tax compliance indeed.

Therefore, the study recommends that government shall raise tax awareness through tax education, training etc. If generating tax revenue is used to be used as a driving engine of funding development projects, financing public goods and services including stimulation of economic growth.

Future research might be directed towards inclusion of additional variables like tax policy fairness and religiosity including the same predictor among other tax payers' points of view.

Data availability: The data used to support the findings of this study are available from the corresponding author upon request.

Conflict of Interest: The authors declares that they have no conflicts of interest.

Authors Contribution: This article has two authors who reviewed it together thoroughly.

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