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Research Paper

Submitted to RO

June, 2021

Abstract

This study was conducted with the aim of investigating challenges and prospects of presumptive tax in Tabor Sub City of Hawassa. By distributing a total of 150 questionnaires to Category C sample taxpayers and 25 questionnaires to employees of Tabor Sub City, the study tried to explore the major challenges of presumptive tax system, how Category C taxpayers tax liability is assessed, the issues of tax evasion, corruption and tax compliance with that of presumptive tax assessment and collection procedure, and lastly awareness level of Category C taxpayers. The findings show that lack of transparency, subjectivity in tax liability assessment, discretionary use of indicators and low level of awareness were major challenges of presumptive tax assessment and collection procedures. It was also found that standard presumptive tax assessment procedure was vulnerable to corruption and tax evasion. Despite such problems, a presumptive tax assessment procedure increases tax compliance. Thus, it can be concluded that presumptive taxation assessment procedures in the sub city are entangled with implementation problems, which mostly arise from inefficient and incapable tax administration, which needed to be addressed by the tax authority for the betterment of benefits from presumptive tax. In general, it is recommended that even though presumptive tax is the second best alternative in taxing small businesses theoretically; presumptive tax can be less efficient than the conventional tax system if not implemented properly and with caution. Therefore, the tax authority is advised to increase taxpayers' awareness through all possible ways, conduct tax assessment systematically and objectively, enhance voluntary compliance through considerate and accurate treatment of taxpayers, improve capacity of tax authority and provide special training programs to employees.

Key Word ; Tax, Challenges, Tax authority, Presumptive tax, The standard assessment, Estimated assessment and Category C taxpayers

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CHAPTER ONE

INTRODUCTION

1.1 Background of the study

Tax is a compulsory payment levied on individuals and businesses in a country. It is one of the major sources of income for a government to execute its activities. Collective consumption of goods and services necessitates putting some of our income into government hands. These public goods like roads, power, municipal services, and other public infrastructures have favorable results on many business enterprises, industries and the general public. These goods are normally supplied by public agencies due to their natures of non-rivalry and non-excludability. Consumption of public goods is such that consumption by one does not reduce consumption for others. Besides, consumption of public goods by an agent does not exclude others from doing the same. This nature of public goods therefore makes them impossible for private suppliers to avail them at market prices like other commodities. Government intervention in the supply of public goods is therefore inevitable and can only be done if the public pays taxes for the production and supply of such goods (Jira et al, 2005).

It is generally understood that most people do not like to pay taxes, and, because of this fundamental reason, it is hard for tax administrations to levy and collect taxes anywhere and anytime. Even though most people and businesses know that it is a must to have a government with a capacity to provide public service which can't be provided by the market, they become reluctant when it comes to paying tax in the right amount, time, and, place. (Richard and Wallace, 2004).

The application of the standard taxation regime generally requires keeping appropriate books and records. For small businesses, complying with standard record keeping requirement is not only costly, but also often exceed the capacity and skill of the small businesses operators. Non-compliance with obligatory bookkeeping requirements, even if is unintentional, can severely hurt

the small businesses. Therefore, method needs to be identified to adjust the tax system for small businesses which is appropriate to their low level record keeping and accounting capabilities.

In designing a tax system for small businesses operation, simplified presumptive tax system is the most frequent and popular approach used. Some sort of presumptive tax system for small business can be found in a large number of developed and developing countries worldwide. These systems vary considerably in their scope of application, the criteria used to determine the tax liability of the small business, and their performance. There are neither standard principles nor uniform experience with the design and application of presumptive systems. This tax system which involves the use of indirect means to ascertain tax liability, and which differ from the usual rules based on the taxpayer's accounts, is one means to overcome the above mentioned problems and to get tax revenue from those taxpayers which might otherwise go completely untaxed. If used properly, presumptive tax may: broaden the tax base by increasing the number of taxpayers and their tax payment, reduce tax evasion, and enhance the efficiency and equity of the tax system, all at relatively low administrative cost. It can also be effective in cutting auditing time and cost, particularly in countries where accounting illiteracy is widespread (Engelschalk, 2007).

Even though the principal source of a government's revenue should be taxation, in many sub-Saharan African nations this is often not the case. These nations with low economic growth, large population below the poverty line and dependent on tertiary economy, finance most of their expenditure through non tax revenue. This is the reason that technical assistant providers like the International Monetary Fund (IMF) and World Bank recommend introduction of simplified tax regimes in sub Saharan African countries with the key motives of improvement of the business environment, the facilitation of tax administration and the fight against the underground economy. Nonetheless doing so is hampered by large informal sector, under reporting of income by businesses, weak tax administration, considerable tax evasion and avoidance, corruption, lack of awareness and trust of government (*ibid*).

Ethiopia is in a worst position as compared with most Sub Saharan African countries when it comes to aid to GDP ratio which indicate the bulk of government expenditure is financed through non tax revenue. That is why the government of Ethiopia is trying to improve taxation

system along different fronts. One of these fronts is broadening the tax base by bringing most of the small business into the tax system through presumptive taxation.

Taxpayers are categorized into A, B and C in Ethiopia. Category A taxpayers is corporate enterprises which have annual turnover of Birr 500,000 or more. Category B are those which have annual turnover between Birr 100,000 and 500,000 and Category C taxpayers are those which have annual turnover of less than Birr 100,000. Category A and B are required to maintained adequate books of accounts and their income tax are subject to the statements of accounts they produced. While Category C taxpayers are not required to maintain accounts. This makes it difficult for the tax administrations to collect taxes from this group using conventional tax system. Thus, income tax on Category C taxpayers is determined by lump sum method, which is called a “Standard Assessment” (Gebrie, 2008).

Category C taxpayers are not required by law to declare their income or keep book of accounts, and considered as hard-to-tax group. According to Article 68(1) and (2) of the Income Tax Proclamation –No 286/2002, standard assessment method shall be used to determine the income tax liability of Category C taxpayers (taxpayers with annual turnover of less than Birr 100,000). The standard assessment shall be a fixed amount of tax determined in according with council of ministers regulations established schedule of standard assessment amount that reflect variation in the type of business, business size and business location. To estimate taxable income of Category C taxpayers using standard assessment, the daily sales, item/service type and quantity ,time it take to convert goods / service into cash, taxpayer’s expenses such as living expenses for himself and his dependents and expenses incurred for the acquisition of assets are taken into consideration.

Standard assessment table or schedules contain 69 categories of business activities. The schedule appears progressive with low tax burden on small merchandise traders and the highest tax burden on professional, transport and other services. For this purpose, the estimated average annual profitability rate varies in the range of 10% to 70% depending on the nature of business service sectors. The basic amount of 100, 000 is divided in to 19 divisions starting with the division of up to Birr 100, 000 and thereafter an increment of 5,000 Birr each for subsequent divisions (Federal NegaritGazeta, 2002).

In Ethiopia presumptive tax is used to assess tax liability of Category C taxpayers. This paper tries to investigate the challenges and prospects of presumptive tax system in Tabor sub City of Hawassa.

1.2 Statement of the Problem

Tax is a legal liability imposed by government on individual citizens of a country to finance its expenditure. Tax plays an important role in the development and growth process of countries. There are different ways to determine the tax liability that every individual has to pay. One of them is presumptive tax. Presumptive taxation is one type of income tax determination mechanism. It is an estimation of tax payable that are used in dealing with incomes or activities that are hard to tax. It involves the use of indirect means to assess tax liability, which differ from the usual rule which is based on the tax payer's account. Presumptive tax offers the possibility of reducing noncompliance and tax evasion at low cost and broadening the revenue base.

Ethiopia as one of the world's least developed counties introduces presumption tax to broaden the tax base and to increase tax revenue. Even though presumptive taxation is the second best alternative to tax small businesses which don't have financial records, its application is facing different challenges.

There is little research done on presumptive tax in Ethiopia. For instant the research done by Mussa (2010) tried to investigate the problems in designing presumptive tax and the challenges faced in implementing it from the tax authorities perspectives using descriptive method of research and finds out that there are problem in the design of presumptive taxation which leads to implementation challenges.

Another research done by Gebreamlak (2012) tries to see the challenge of Category C taxpayers for tax authorities using a mixed method conclude that tax evasion, lack of awareness, failure to keep book of account as a major challenges in taxing Category C taxpayers.

According to study conducted by Yohannes and Zerihun (2013); assessing the gaps and problems that exist between the business community and tax authority of dire dawa administration, Nontransparent, non-participatory of standard assessment, Lack of fairness or equity of taxation among similar businesses of category "C" are the reason for tax payers lack of trust in the employees of the authority and in the overall tax estimation, assessment and collection

procedures. Presumptive taxation mechanism also gives a chance for tax payers to hide their daily income.

They also stated that many developing countries have weaknesses in their tax administration that make it difficult to levy effective taxes. Especially those in the category “C”, have been facing various problems related to the taxation system (tax administration). On their study they have found that most of the surveyed tax payers stated that what they are paying is beyond their ability to pay and that they neither have trust in the employees of the authority nor in the overall tax estimation, assessment and collection procedures. In light of these facts, the study concluded that the tax authority of the city administration is not being effective or is being reluctant in making the tax procedures objective, transparent and understandable to taxpayers

So in this research attempt were made to see the challenges and prospects of presumptive tax in Hawassa particularly in Tabor sub city from both taxpayers’ and tax authorities’ perspectives. This research is different from the previous research as it gives more attention to the perspectives of taxpayers and tries to compare the perspectives of taxpayers and tax authorities on the way. In doing so the paper may fill the gap of literature about presumptive taxation from the taxpayers’ perspective.

1.3. Objective of the Study

1.3.1. General objective

The main objective of this research is to assess the challenges and prospects of presumptive taxation in Hawassa city particularly in Tabor sub City.

1.3.2. Specific Objectives

- ✓ To evaluate the practices of Tax liability assessment of Category C taxpayers.
- ✓ To explore the prospect of presumptive tax system.
- ✓ To identify the main challenges of presumptive tax assessment and collection procedures.
- ✓ To observe the extent of presumptive taxation system's exposure to corruption and tax evasion.
- ✓ To evaluate whether presumptive tax make small business more compliant or not.
- ✓ To examine the level of information taxpayers and employees of the tax authority have on presumptive taxation.

1.4. Research Question

Specifically the study tried to answer the following research questions:

- ✓ What is the extent of tax liability assessment practices of Category C taxpayers?
- ✓ What are the prospects of presumptive tax system?
- ✓ What are the main challenges of presumptive tax?
- ✓ What is the extent of presumptive taxation system's exposure to corruption and tax evasion?
- ✓ Does presumptive tax makes small business more compliant?
- ✓ What are the levels of information taxpayers and employees of the tax authority have about presumptive tax?

1.5 Significance of the Study

One of the mechanism in which countries raise revenue to finance their spending on public goods is taxes. Taxation generates a substantial amount of revenue for government in developed countries then in developing countries.

Factors like; large hard to tax sector, low development of formal sector, weak tax administration, tax avoidance, tax evasion and expensive and difficulties for startup enterprises to comply with complex tax law made the contribution of tax revenue low in developing countries.

In this regard government of developing countries and scholars in this area should conduct researches that identify the problem in this area and possible recommendation to bring tax system that is characterized by economic efficiency, administrative simplicity, flexibility, political accountability and fairness. Putting this in mind, the researcher tries to demonstrate the basic problem of taxing Category C taxpayers in Hawassa Tabor sub City.

In doing so the researcher attempted to recommend solutions for the identified problem that may be used by tax administrators to minimize administrative cost and increase tax revenue. In addition as there have been very few studies both theoretically and empirically done on taxation in general and presumptive tax in particular in Ethiopia, this paper may make a contribution to literature of the presumptive tax in Ethiopia.

1.6 Scope and Limitation of the Study

The study analyses the challenges and prospects of presumptive tax in Tabor sub city of Hawassa city. In particular the tax assessment procedure used for Category C taxpayers was considered in the study. While studying the prospects and challenges of presumptive tax, the present study, considered only the challenges faced in the application of presumptive tax system by taking one sub city in Hawassa city. The study is limited to one sub city mainly due to cost and time factors.

The findings of the research would have been more satisfactory if it had covered all sub cities of Hawassa city. Besides this the existence of only few empirical research done on presumptive tax particularly in Ethiopia and generally in developing countries, has created a difficult situation to support the findings with more empirical work.

1.7. Key Term Definition

Tax is a compulsory contribution by taxpayers without expectation of direct and equivalent return from government for the contribution made

Presumptive tax is one where the desired tax base is not itself measured but is inferred from some simple indicators (turnover, assets, farm size, shop size, etc.), which are more easily measured than the base itself.

The standard assessment shall be a fixed amount of tax determined in according with council of ministers regulations established schedule of standard assessment amount that reflect variation in the type of business, business size and business location.

Estimated assessment is somewhat refined and sophisticated presumptive taxation technique then standard assessment as tax liability is a function of different indicators and estimated income or profit can be adjusted for sudden or several income shocks by a business or an individual.

Category C taxpayers are not required by law to declare their income or keep book of accounts, and considered as hard-to-tax group. According to Article 68(1) and (2) of the Income Tax Proclamation –No 286/2002, standard assessment method shall be used to determine the income tax liability of Category C taxpayers (taxpayers with annual turnover of less than Birr 100,000).

1.8 Organization of the Study

The study has been organized in the following way. The first chapter is introductory which consists of introduction, statement of the research problem, objective of the study, significance of the study, scope of the study and research limitations. The second chapter provides the literature reviews. Chapter three is about the research design and methodology that has been used to collect and analyze data. Chapter four presents descriptive analysis of data and discussion based on data collected. Chapter five presents conclusions and recommendations.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

Tax is a compulsory contribution by taxpayers without expectation of direct and equivalent return from government for the contribution made. Taxes are important sources of public revenue. The existence of collective consumption of goods and services necessitates putting some of our income into government hands. Such public goods like roads, power, municipal services, and other public infrastructures have favorable results on many families, business enterprises, industries and the general public. Public goods are normally supplied by public agencies due to their natures of non-rivalry and non-excludability. The nature of consumption of public goods is such that consumption by one does not reduce consumption for others. Besides, consumption of public goods by an agent does not exclude others from doing same. Such nature of public goods therefore makes them impossible for private suppliers to avail them at market prices like other commodities. Government intervention in the supply of public goods is therefore inevitable and can only be done if the public pays taxes for the production and supply of such goods (Jira el at., 2005).

There are many ways in which taxes are levied on individuals and businesses. Taxes may be levied on consumption, flow of income or wealth and asset possessed. In all countries some individuals and businesses remain outside the tax system through use of different types of evasion and/or avoidance. In many cases, it is easier for individuals and businesses to remain outside the tax system by becoming unseen able to the tax administration. Tax administrators are often put in a position to choose between going after large firms with potentially large tax revenue or to go after less lucrative small sample taxpayers. When it comes to sub-Saharan Africa, tax authorities face serious difficulties in identifying and assessing tax liability. In this part of the world, conventional methods of assessing and collecting taxes have been found to have a limited use because of factors like weak tax administration, tax avoidance, tax evasion and difficulties for startup enterprises to comply with complex tax law, the existence of large hard to tax sector, limited recorded keeping by businesses and considerable tax evasion, limited tax compliance and weak administration capacity (Wallace, 2002).

The very nature of small businesses in sub-Saharan countries is small contribution to tax revenue, high level of informality, poverty, and lack of access to education, imply that taxing these firms appropriately is difficult at best. These specific characteristics have led many sub-Saharan countries to implement specific tax system to counter this problem. Presumptive tax is one means to overcome these problems and to get tax revenue from those taxpayers who might otherwise go completely untaxed (Stern and Barbour, 2005).

The dictionary meaning of the term presumptive is having a reasonable basis or ground for belief or acceptance. Consequently presumptive tax involves the use of indirect means to ascertain tax liability, which differ from the usual rules based on the taxpayer's accounts (Makedonskiy, 2005). The term "presumptive" is used to indicate that there is a legal presumption that the taxpayer's income is no less than the amount resulting from application of the indirect method. Presumptive tax is one where the desired tax base is not itself measured but is inferred from some simple indicators (turnover, assets, farm size, shop size, etc.), which are more easily measured than the base itself. It is one type of Income tax determination mechanism. It is an estimation of tax payable that are used in dealing with incomes or activities that are hard to tax. It is used mostly as a proxy for an income tax on small businesses. It may also be used as a substitute for an income tax on small farmers, owners of rent property, professionals, independent contractors, and other hard to tax groups. If used properly it can broaden the tax base by increasing the number of sample taxpayers and their tax payment, it may reduce tax evasion, and enhance the efficiency and equity of the tax system, all at relatively low administrative cost. It can also be effective in cutting auditing time and cost, particularly in countries where accounting illiteracy is widespread (selamawit and Parameswaran, 2006, Thuronyi, 2003,).

Presumptive tax exists when legislators are using one tax base to approximate another tax base. It is used when there is asymmetry of information, high transaction, compliance and administrative cost. In reality the ideal tax base used to assess particular tax may not be easy to measure and verify, it can be easy to hide from the tax inspector, or it can be too costly to identify and measure it (Yitzhaki 2007).

It is employed primarily in economies where Hard to tax taxpayers comprises the majority of the population and taxpayers lack the financial transparency needed for effective taxation (selamawit and Parameswaran, 2006).

Central to the idea of presumption is the notion of potential taxability, as something capable of determination independently of self-declaration by the taxable entity, on the basis of presumptive norms. In so doing, the presumptive approach improves the technological capability of the tax administration handle larger numbers of taxpayers without the self-defeating incremental cost of attempting to do so within the existing system. Scarce administrative talent is best deployed in the devising of presumptive norms applicable to non-filers and under-declared returns, which will survive tests of justice and fairness, rather than in the individual pursuit to teach entity unbaked by guidelines (Rajaraman 1995).

Presumptive taxation establishes the link between tax liability and observable entity-specific indicators. Criteria that come into play in the selection of indicator are ease of observation; difficulty of concealment, falsification, or substitution; and stability in relation to income. The common classes of indicators are Estimation based on flow indicators, Capacity-based presumption based on stock indicators, Flat presumption indicators. Credible presumptive taxation requires that indicators be chosen specific to each sector or occupation, and that the taxes themselves be established on survey or other objective evidence. A levy that is not arrived at on some such objective basis does not earn the presumptive label (*ibid*).

Every tax system trades off accuracy for simplicity to some degree. And how much of a sacrifice in accuracy is required depends on the context. The term presumptive tax had traditionally been used to describe tax regimes in environments in which administrative/enforcement costs are unusually high and therefore accuracy of income measurement is unusually expensive. Such environments are often found in developing countries, where it is necessary to make unusually large sacrifices in income-measurement accuracy in order to be able to collect any taxes at all. Indeed the main virtue of presumptive taxation is that it may be the only effective way to tax small businesses in developing countries (Gustavo &Vettori, 2010).

2.2 Objective of Presumptive Tax

Government has different objectives when levying tax. These can be maximizing tax revenue, bringing equity, ensuring economic stability (Dodson and Wodon, 2008). There is a growing awareness that tax systems can go beyond merely maximizing revenue collection but over the medium- to longer-term can inculcate a higher degree of tax compliance and build a platform to support entrepreneurship and business development. The main objective of small business taxation should be increase the size of the formal sector, promote growth and provide education and training on how to monitor business activities (Stern and Barbour .2005).

Presumptive tax for small businesses can be used to reduce the compliance burden for this business segment. This objective generally can be achieved if small business tax laws do not require small businesses to keep books and records and also permit simplified accounting and return filing. (Engelschalk, 2005).

Governments introduce presumptive taxation in order to broaden tax base by preparing citizens and businesses in the informal sector to enter the formal tax net, reduce tax evasion and avoidance of small business, increase compliance culture through reducing tax complying and administrative cost to small business and simplifying small businesses tax system (Wallace, 2002).

Simple presumptive taxes, such as small business license fees, can be used as a way to raise revenues and as an easy way to bring new taxpayers into the tax net and compile information that will eventually allow them to be transferred to the standard tax system (Engelschalk, 2005).

Generally presumptive techniques can be used to achieve different objectives (selamawit and Parameswaran, 2006):

- ✓ Large number of small business: small business includes farmers, traders, small scale manufacturing operation and craftsman, individual professional and many small scale services. It is difficult to tax this large small business using the conventional method of taxation as it will bring high administrative and compliance cost.
- ✓ One of the main reasons for designing a presumptive tax for small businesses is to reduce the compliance burden for this business segment. The objective can be achieved if small business

tax laws do not require small business to keep books and records and also permit simplified accounting and return filing.

- ✓ Combat tax avoidance or evasion: presumptive tax can reduce tax evasion. This is possible only if the indicators on which the presumption is based are more difficult to hide than those forming the basis for accounting records.
- ✓ By providing objective indicators for tax assessment, presumptive methods may lead to a more equitable distribution of the tax burden, when normal accounts-based methods are unreliable because of problems of taxpayer compliance or administrative corruption.
- ✓ The revenue potential of presumptive taxes is considerably large by adjusting tax rates and bringing the actual tax burden more in line with the standard tax system. However, this would also require a restructuring of the tax, establishing closer links between tax rates and business activities to avoid an over-taxation of certain businesses, and a much improved collection and analysis of data on business profit margins
- ✓ Rebuttable presumptions can encourage taxpayers to keep proper accounts, because they subject taxpayers to a possibly higher tax burden in the absence of such accounts.
- ✓ Presumptions of the exclusive type can be considered desirable because of their incentive effects—a taxpayer who earns more income will not have to pay more tax.
- ✓ Presumptions that serve as minimum taxes may be justified by a combination of reasons (revenue need, fairness concerns, and political or technical difficulty in addressing certain problems directly as opposed to doing so through a minimum tax).

In the following sections 2.2 and 2.3, type and Main categories of presumptive taxes assessment methods are listed as discussed in many public finance literatures. (For example; (Taube and Helaway, 1996), Thuronyi, (1996),Rajaraman (1995) ,yitzhaki 2006, Wallace 2002 ,(selamawit and Parameswaran,2006) and Makedonskiy 2005).

2.3 Types of Presumptive Tax

Reputability vs. Irrefutability

Reputability

The reputability as regards presumptive taxation involves for the taxpayer the opportunity to justify that his tax liability accrued on the basis of general taxation rules is smaller than the one calculated under the conditions of special treatment. In other words, the taxpayer can arrange the reduction of his tax liabilities with the tax authorities in the framework of an *administrative procedure*.

Irrebuttability

The irrebuttability means that that taxpayer cannot contest his liability on the basis of proving his actual income. Thus, irrebutable taxation imposes restrictions on the rights of the taxpayer under special treatment. Therefore, the application of irrebutable taxation requires a greater precision in terms of legislative determination of the procedure for application and accrual of the tax.

Depending on the degree of rebuttability, mixed types of taxation can also be introduced. For example, the Russian system of simplified taxation and the French *forfeit* system are rebuttable in the sense that the taxpayer has a right to choose between special treatment and general taxation procedure. However, if the Russian or French taxpayer (as a result of negotiations with the tax inspector) chose special treatment, the tax becomes irrebutable.

Minimum vs. Exclusive Presumptive

Presumptive Minimum Tax

Presumptive minimum tax establishes a tax liability that cannot be smaller than the liability established according to the rules of presumptive taxation. Presumptive exclusive tax establishes a tax liability exclusively on the basis of the rules of presumptive taxation, even if application of the general taxation rules may lead to higher tax liabilities. As an example of the presumptive exclusive tax can serve agricultural tax, the basis of this is determined only by the value of the land, regardless of the actual crop yields.

Presumptive Exclusive Tax

Because tax liabilities do not depend on the actual income, an exclusive tax encourages the efforts of the taxpayer to earn extra income. In other words, such tax does not affect the taxpayers' marginal yield. Exclusive taxes are very similar to non-distorting lump-sum taxation. Stimulating effect of the tax depends on the factors used for the assessment of marginal yield. Such effect will be smallest if the supply of factors is not elastic (e.g., land is namely such a factor). In fact, presumptive exclusive tax is the tax on the accountable factors, rather than a tax on the income. However, it can be compared to the tax on potential income, if production factors are taken into account, or profit tax, if it is assessed on the basis of the lifestyle.

Formal or Discretionary Methods

Formal Methods

Here presumptive taxation tax liabilities are determined in accordance with the preliminarily set rules. Mechanical methods can be both rebuttable and irrebuttable. In some cases the method can be mechanical and irrebuttable, however, the tax authorities can be free to apply or not apply it upon their discretion. Formal methods can lead to excessive taxation, since they do not take into account the specific circumstances of individual taxpayers. Generally speaking, in the case of limited administrative resources is appropriate to use formal methods of presumptive taxation.

Discretionary Methods

Here presumptive taxation implies high degree of freedom of the tax authorities when determining tax liabilities. Discretionary methods are, as a rule, rebuttable, since otherwise the tax authorities would get too broad opportunities for arbitrary actions. The application of discretionary methods creates pre-conditions for corruption.

2.4 Main Categories of Presumptive Taxes Assessment Methods

There are different ways in which presumptive tax is on income or profit is levied. Countries which employ presumptive tax uses different method to estimate tax liability based on income, assets, turnover and /or wealth. If the taxpayer has failed to file a return or has substantially understated his or her income, and the transactions giving rise to income cannot be traced, the tax authorities are usually authorized to assess income on their best judgment. The level of economic sophistications in a country influences the choice of presumptive tax methods. Countries with least sophistications typically use very simple presumptive tax methods, while those with more sophisticated taxes may apply highly developed methods. The commonly used types of methods are:

Standard Assessment

Standard assessment assigns a fixed sum of money on tax payer based on sample taxpayers' occupation or business. Different occupation or business activities are simply assigned different lump-sum tax dues which corresponding to some average income level expected to be earned by members of a particular occupation or business grouping. It broadens the tax base and considered as less equitable than estimated assessment and less open to corruption. Standard assessment can be poor revenue –mobilizing method of taxation unless the fixed payments are indexed to inflation and taxpayers are moved to categories as their taxable income increase over time (Selamawit and Parameswaran, 2006)

In Africa standard assessment has been used and is being used by many countries. Ghana was the first sub Saharan countries to use standard assessment in 1963 to tax small and self-employed business. Following Ghana several sub Saharan countries incorporated standard assessment into their tax system. Some of them were Nigeria, Mozambique, Lesotho, Sierra Leone and Ethiopia. Ethiopia has applied standard assessments for about 150 different business and professions since the 1960s. Standard assessment has been used in many subsaharan countries for many reasons. For one thing standard assessment which bring fixed lump sum tax is comparatively simple to administer. The other thing lump sum amount corresponding to a certain average

presumed income can have a positive incentive effect, as any additional earning above the average presumed income level are effectively taxed at a zero rate. It also helps to capture small business and self-employed who previously escaped taxation which enhance horizontal equity. Lastly but not least it reduces opportunity of corruption and collusion since there is no discretion on the side of the tax officials instead lump sum payment pre-determined and derived from table or matrices that simply show occupation or business type on one side and corresponding tax liability on the other (Taube and Helaway, 1996).

Standard assessment has these limitations. They are poor performance with respect to revenue mobilization. This is due to the use of fixed lump sum levies for occupation or business groupings whose member may have highly divergent income, tend to set the levies based on the incomes of the poor performer instead of on the averages. In addition the levies are rarely indexed to inflation or updated regularly to account for changing economic conditions. Both of the above mentioned features made standard assessment to contribute small amount of tax revenue. For example it used to bring around 1% of tax revenue from agriculture in Ethiopia even though agriculture accounts about 50% of GDP and employs 80% of population of the country (*ibid*).

To improve tax assessment of Category C taxpayers, Ethiopia introduced standard assessment method as of 2003/2004 fiscal years by replacing estimated assessment method. Under standard presumptive tax assessment method, fixed amount of tax is payable by Category C taxpayers, which is determined by income tax regulation No.78/2002 (Misrak, 2008).

Estimated Assessments (Indicator Based System)

In estimated assessments, tax liability is estimated based on certain indicators or on information tax assessors suppose to be relevant. In this assessment method, tax liability of individual sample taxpayers is estimated based on indicators or wealth specific a given profession or economic activity. The key indicators can range from location of property to number of skilled employees to seating capacity. This method employs a variety of techniques to derive taxpayers' income, both simple which are based on single factor such as a taxpayer's total asset, net wealth or value of business assets, gross receipts of business and visible signs of wealth and complex methods which are based on two or more of the above indicators (Makedonskiy, 2005).

The use of indicators to estimate taxable income is the central characteristics of estimated assessment. Theoretically many indicators can be used to estimate taxable income of small business. According to Rajaraman (1995) a good indicator should be easy to observe and record, less returnable to concealment, falsifications or subtractions and lastly but not list ability to correlate with income and stability of this correlation over time. The common indicators used in many developing countries includes the size of a business premises, the number of employees, the amount of installed machinery and the level of inventory. When it comes to service providers' indicators like seating capacity of a restaurant or a bar, the number of room in hotels, electric and other utility bills if the businesses are assumed to consume, are used. There are two ways of estimating tax liability in estimated assessments method. One way is to estimate a taxpayer's income or profit and then applying the regular personal or business income tax rate. The other way is to simply presume a tax liability owed directly. Sub Saharan African countries use both type of ways of assigning tax liability .Angola, Chad, Malawi, and Madagascar use the first approach which is to estimate taxpayers income and apply the regular personal or business income tax rate.

Estimated assessment is somewhat refined and sophisticated presumptive taxation technique then standard assessment as tax liability is a function of different indicators and estimated income or profit can be adjusted for sudden or several income shocks by a business or an individual. It is less prone to tax evasion as it is more complicated to conceal the existence or the size and amount of most of the common indicators in use than to under-declare business turnover. It also gives less reason for disputes between the business owner and the tax administration over the presumptive tax liability. It surpasses even basic bookkeeping requirements and thus may reduce tax compliance costs even further than a turnover-based system (Taube and Helaway, 1996).

But estimated assessment is not without limitation. For one thing this type of assessment requires extensive and well-documented research on profit margins in the various business segments covered. Otherwise, there is a risk of ongoing disputes with the small businesses community over the estimates used. Beside this it can be difficult to the tax administrators to select the appropriate indicators with characteristics mentioned above because of time and cost constraints. It is difficult to define indicators that sufficiently reflect the profit potential and a small business

owner's ability to pay. It is not obvious, for example, that the mere size of business premises allows drawing a conclusion regarding business profits.*(ibid)*.

The other important limitation of estimated assessment is that it opens a door to corruption by giving discretionary power to tax assessors. This is inevitable in sub Saharan countries where there is low civil service salary and weak tax administration. Last but not least indicator-based systems may have undesirable effects on business decisions. Estimated assessment method may affect the size of business premises or act as an incentive for either a staff reduction or for not registering employees. This is linked to an uneven impact of marginal tax rates: They create a particular problem for start-ups and loss-making small business. Special relief provisions for start-up businesses need to be designed to avoid that the presumptive tax system leads to inappropriate tax liabilities for new businesses. Lastly the profit potential of comparable businesses with identical indicators considerably depends on the business location. A retail store in a busy main street downtown generally is much more profitable than a similar business in a remote village. Many indicator-based presumptive systems therefore introduce an additional factor of quality of business location, which makes the system nontransparent and overly complicated.*(Taube and Helaway, 1996)*.

Net Worth Method

In the absence of substantial information about the taxpayer's actual income, a commonly employed method is to estimate income by determining the change in the taxpayer's net worth over the year and adding to this amount the estimated personal consumption expenses determined by examining the taxpayer's lifestyle. In principle, any use of funds other than those that would be reflected in increased net worth should be included as personal consumption expenses for this purpose. As a matter of income tax theory, this approach cannot be faulted, since income can be defined as consumption plus change in net worth *(Thuronyi, 1996)*.

Bank Deposit Method

Another method auditors use to determine income in the absence of an adequate declaration is to secure records of deposits into the taxpayer's bank accounts (in both foreign and domestic banks) and to presume, unless the taxpayer can show the contrary, that the deposits constitute income.

Depending on the taxpayer's financial and business practices, this can, of course, lead to either a grossly exaggerated or a grossly understated estimate of net income. Nevertheless, courts have allowed this method of estimating income, again on the principle that if the taxpayer considers it unfair, he or she can furnish details of actual income. The effectiveness of this method obviously depends on the state of development of a country's financial institutions. In countries where most amounts are transferred in cash, it is not likely to be very helpful (Thuronyi, 1996).

Expenditures Method

When evidence of the taxpayer's net worth is not available, income can be presumed on the basis of total cash expenditures. In countries where methods of indirect proof of income are not codified, this can be one possible approach under the authority to make best judgment assessments. It may be impossible to use the net worth method because evidence of net worth is unavailable. In some countries, taxation on the basis of personal expenditures has been codified, in which case a difference in result can occur from the best judgment assessment in the sense that personal expenditures, instead of being an indirect method of proving taxable income, become a tax base in their own right in situations contemplated by the statute. Previously in France, individuals could be taxed on the basis of their "open and notorious" personal expenditures, but this method has now been repealed. A similar rule has also been repealed in Germany (Wallace 2002).

Minimum Tax

There are different methods of assessing minimum presumptive tax assessment. Some levy specific tax liability irrespective of the taxpayer's levy of income or economic activity. Others levy tax liability as a relative low percentage of turnover or assets. It is levied with the assumption that a taxpayer can be assigned some minimum level of income in any given year. The basic idea of a minimum tax is to insure that some minimum level of tax payment are made by business which engaged in very lucrative activities but declare only little or no income from these activities or often show loss for tax purposes irrespective of the loss claims, creative accounting or special tax provision that the owners might use to their advantage. Even though minimum tax can save tax authority from complete tax evasion and underreporting of profit by some business, they can also tend to freeze business tax liabilities' at a minimum level. (Yitzhaki2006)

2.5 Tax evasion and Presumptive tax

The provision of public services and infrastructure is a key factor for economic development and growth. Many developing countries fail to raise the tax revenue required to finance their public sectors. In 2005, the average tax revenue to GDP ratio of the developed world was approximately 35%. In developing countries, it was equal to 15%, and in the poorest of these countries, the group of low income countries, tax revenue was just 12% of GDP. Even though there are many reasons for this tax evasion, it is one of the most contributing factors (Fuest and Riedel, 2009).

Tax evasion, which is a general term for efforts by individuals, firms, trusts and other entities to evade taxes by illegal means, has probably existed ever since the first tax was imposed. But tax evasion is not equally performed by all people. Tax evasion usually entails taxpayers deliberately misrepresenting or concealing the true state of their affairs to the tax authorities to reduce their tax liability, and includes, in particular, dishonest tax reporting (such as declaring less income, profits or gains than actually earned; or overstating deductions).

Tax evasion is an activity commonly associated with the underground economy and one measure of the extent of tax evasion is the amount of unreported income, namely the difference between the amount of income that should legally be reported to the tax authorities and the actual amount reported. Tax evading behaviors have many determinants. The main determinants are: the probability of being detected, the amount of penalty imposed, demographic characteristics like age and sex, culture, educational level, religiosity and many others.

Tax evasion may cause social welfare losses due to the incentives of some taxpayers to invest in the concealment and of tax authorities to invest in the detection of tax evasion. Reducing the investment of both parties at the same time would then lead to a Pareto improvement. Given that concealment and detection costs are hardly measurable in reality, we show in a controlled laboratory experiment that the welfare losses from a concealment–detection contest depend positively on the prevailing tax rate, but not on the penalty which is imposed in case of detected tax evasion. Hence, policy makers who are concerned about socially inefficient concealment and enforcement costs should focus on tax rates rather than penalty rates (Bayer and Sutter, 2009).

Tax evasion is found to be threatening to tax authorities, especially in developing countries. It limits the capacity of the government to meet its obligations, distorts the macroeconomic policy, threatens the legitimacy of the tax system and erodes the moral standards of the taxpaying society. The finding uncovers that weaknesses of tax authorities in enforcing tax laws, prevalence of fiscal corruption in tax environment, low level of penalties and weak penalty enforcement, poor perception of taxpayers towards the government spending policy and less trust to the political system are among the major factors that cause tax evasion these developing countries (Fjeldstad and Moore, 2006).

Some form of presumptive tax have become a popular way to combat tax evasion .Particularly in developing countries the problems of taxing small businesses are well-documented, but at a smaller scale, problems of tax evasion of small businesses may also be disproportionate in developed economies.

Tax simplification may also be a solution here. Several middle income countries have embarked on legislating presumptive taxation. While a “real system” of business income taxation is based on actual income less expenses, presumptive tax regimes imply procedures under which the desired tax base is not itself measured but is inferred from some simple indicators (turnover, assets, farm size, shop size, etc.), which are more easily measured than the base itself.. Indeed, the search for tax simplification and the fight against tax evasion have motivated presumptive schemes also among many developing countries. But the use of presumptive tax to decrease tax evasion will not be thinkable is approximation of real income impossible rather presumptive tax simply inducing an under-declaration of income instead of true income (Engelschalk, 2005).

2.6 Corruption and Presumptive tax

Corruption is likely to reduce the tendency of individuals in a given state to accept and trust their government in general and comply with the tax burden in particular. Tax administration has to keep the tax administration itself honest. No government can expect taxpayers to comply willingly with a tax structure that they consider unfair or when they are unconvinced that any of the money collected is put to good use. But even sound tax structure and sound expenditure policy can be vitiated by capricious and corrupt administration. It took the developed countries centuries to develop and implement sound tax administrative practices to keep the obvious temptations to dishonest tax officials in check. Developing countries which try to sustain much large governmental structure has to solve this problem shortly if they are to survive (Webber and Wildavsky, 1986).

Tax officials must therefore be adequately compensated, so that they do not need to steal to live. They should be professionally trained, promoted by merit, and judged by their adherence to the strictest standards of legality and morality. To remove temptation, the money should be kept out of the tax administration and channeled through banks. Officials should have relatively little direct contact with taxpayers and even less discretion in deciding how to treat them. How they behave in such contacts must be monitored in some way. These are all commonplaces, no doubt, but they are common places because they are true and, unfortunately, more honored in the breach than in the observance in all too many developing and transitional countries (Bird, 2003).

To tackle the problem of corruption from both side taxes reform measures should tackle both the demand (businesses) and supply (tax administration) side drivers of corruption. The challenges of weak administration and pervasive corruption are closely related and mutually reinforcing. Thus, good-practice reform measures aimed at tax corruption also reflect the key features of modern tax administration. Simplifying tax instrument and processes, providing training and capacity building tax officials, reorganizing the tax system and service based on type of taxpayers need, ensuring tax authority's autonomy can be some of the reform that should be incorporated in tax reform program to combat corruption (Rahman 2009).

It is sometimes argued that presumptive taxation can help reduce corruption in the tax administration. However, the success of presumptive taxation in reducing corruption will depend both on the structure of the scheme and the overall administrative environment and capacity in

the tax administration. A presumptive taxation scheme can in fact increase the discretionary power of tax officials and in a worst case scenario increase corrupt practices. One of the benefits of a less complex structure and a less ambiguous tax law is that it should reduce the frequency of face to face interaction between tax officials and taxpayers. There is a much support in tax literature that such a reduction will reduce temptation and practical scope for tax officials to solicit bribes or to accept those offered. Presumptive tax is effective way of reducing the need for face to face interaction (Robinson, 2006).

However the obvious danger with presumptive taxation is the possibility of arbitrage on the part of the tax administration that could generate more corruption and irritation than revenue. The various alternative in this regard seek to minimize discretion on the part of tax administration and protect the rights of taxpayers, while preserving the revenue bases. The ability of presumptive tax to reduce corruption depends on the structure of the tax system, how tax rules defined, availability and transparency of data and the general administrative capacity of the tax authority. If not designed and implemented carefully, presumptive tax can increase discretionary power to the tax authority and corruption. A carefully designed presumptive taxation scheme can help reduce corruption, but can never be a substitute for much needed capacity building and administrative reforms within the tax administration (Ter-Minassian, 1997).

A well-designed simplified presumptive tax system should establish clear and transparent rules for the taxation of small businesses. Only a high degree of transparency reduces the costs of compliance and the risk of corruption and harassment of businesses. Experience has shown that the objective of simplicity presumptive tax system could not always be achieved because of an excessive number of presumptive taxes and lack of clarity in defining taxpayer categories (Engelschalk, 2005).

2.7 Tax Compliance and Presumptive tax

The informal sector or informal economy is the part of an economy that is not taxed, monitored by any form of government, or included in any gross national product (GNP), unlike the formal economy. It is prominent feature of economic reality in many developed and transition countries. Avoidance of income tax, compliance costs, and social contributions are identified as the main advantages of being informal. During the 90's the average size of the informal sector was 12% of GDP for OECD countries, 23% for transition countries and 39% for developing countries (Schneider and Enste, 2002).

Compliance with the tax law typically means true reporting of tax bases, correct computation of the tax liability, timely filing of returns and timely payment of the amount due. The total resource cost to business of a given tax system may be considered as consisting of two parts – the amount of money that taxpayers are required to pay to government, to meet their tax liabilities and the amount of administrative resources not paid to government but required to determine, document and make tax payments – so-called ,tax compliance costs. Tax compliance cost tend to increase with increase in number of tax a given tax payer is required to pay, the complexity of the tax rules, the frequency of submitting tax return and with number of levels of government involves in levying and collecting tax. Measures that reduce tax compliance costs (e.g. less frequent filing and payments of a given amount of tax liability) may involve reduced payments to government. Likewise, measures that adjust the statutory tax burden, or the way the tax burden is computed, may result in decreased (or increased) tax compliance costs. Non-neutral treatment implies welfare (efficiency) losses, and may encourage businesses subject to regular income tax to operate in the informal economy.

An ideal taxation scheme for small business is the one that can be monitored with minimal effort, easily measurable, and reduces reporting and bookkeeping requirements. The most drastic reform of the small business taxation is the introduction of a single presumptive tax. Such systems are usually based on turnover or on specific indicators (i.e. floor space, number of employees, electricity consumption). Presumptive regimes trade fairness for simplicity.

Indicators are usually very crude proxies for business profitability and turnover based systems are burdensome for firms with low profit margins and generous for those with high margins. Presumptive tax can be collected in ways that best fit with cash –flow patterns in informal enterprises (Engelschalk, 2007).

(Alm and Wallace 2004) has emphasized, the attention paid to the informal sector may well be justified in order to control the negative externalities imposed by the informal sector: reducing tax compliance morale and increasing the risks of generalized non-compliance. Besides the presumptive taxation of informal sector may not only reduce evasion and increase revenue collections and equity, but it may also lead to significant efficiency gains, given that higher effort and the resulting higher incomes are usually not penalized by presumptive taxes.

Presumptive taxation is an optimal method of reducing widespread noncompliance without employing excessive government resource because it addresses the concern of both taxpayers and tax authorities. It provide taxpayers with a simplified option for tax compliance with ought requiring full financial transparency and it offers a streamlined method for moving from the informal sector .income here is no longer assessed from accounting records but from indicators such as the value of asset, turnover or individual wealth. Researches find out that formal sample taxpayers perceived the state as being unfair in pursuing them for taxes while the informal sector continues to operate untaxed. Ignoring informal sector activity lowers moral and increases the risk of low tax compliance elsewhere (Brautigam etal, 2008).

The presumptive tax enables the small business to avoid complicated book-keeping system that may be redundant for running the small business and is only needed to satisfy the regulations of the tax authorities. Moreover, in these cases there is a temptation to tamper with the books. Therefore it leaves the book-keeping as a choice variable for the small business and this way simplifies compliance with the tax law. It is believed that the compliance cost issue is the crucial factor in determining the desirability of presumptive taxation. If it is accepted that book-keeping system and record keeping are essential for running the (small) business, and the only reason for

not using it is the opportunity to evade, then presumptive taxation could not be justified. If, on the other hand, it is accepted that a small business does not need a book-keeping system and the only reason it uses one is because the tax authorities require it, then presumptive taxation can help small businesses compete with large businesses. Since the burden on the small business is composed of the tax and compliance cost, it may happen that the lion's share of this burden is the compliance cost. To sum up: the major advantage of presumptive taxation is in reducing the bureaucratic burden on the taxpayer (Yitzhaki, 2006).

A common argument for presumptive tax systems is to reduce such compliance costs which are known to be relatively more burdensome for smaller businesses most presumptive systems base tax liability on such “objective” factors as number of employees, size of premises, class or category of business, etc. In economic terms, of course, such system are taxing the factors on which liability is based rather than “income” “sales” or some other alleged tax base.

In principle, to calculate the appropriate presumptive amounts assessed with respect to different factors requires a high degree of knowledge of the business and considerable administrative expertise, although once calculated, the rules set out could of course be administered by much less expert personnel. In administrative terms, if the tax liability assessed by such methods is too low (relative to that would be imposed by the normal system), there is a danger of too many taxpayers “migrating” into the more favorable presumptive system. To put it another way, as with “infant industry” protective policies, presumptive systems that excessively favor small business act an incentive never to grow up and may hence check the expansion of the tax base that would normally be expected to accompany economic growth (Bird, 2003).

Advantage and Disadvantage of Presumptive Tax

Advantage

- ✓ As tax is imposed on the characteristic of the business and their property, presumptive taxes bring horizontal equity in the sense that business with similar characteristics are taxed similarly. Even though presumptive tax doesn't violate the principle of horizontal equity among businesses in the same category, it can violate the principle of horizontal equity among different categories.
- ✓ Presumptive taxation is simple and it reduces both compliance and administrative cost.
- ✓ Presumptive taxation enables the small business to avoid complicated book-keeping system that may be redundant for running the small business and is only needed to satisfy the regulations of the tax authorities .It also help tax authority to collect tax revenue with small cost.

Disadvantage

- ✓ Presumptive tax is less accurate then the classical tax which is based on a bookkeeping system violating the principle of ability to pay. But the violation is moderate if classification of business is sufficiently large variation with group rather than between groups.
- ✓ Presumptive taxation is arbitrary. This comes from the use of indicators that are not rigid to determine income generated by business. Beside the procedure used to estimate income through various indicators could be expensive to develop and maintain, may involve negotiation between sample taxpayers and tax authorities, and may significantly over or understate income. Presumptive taxation is a ceiling on the tax which reduces the ex -post progressivity of the tax. Presumptive methods are only as good as the system of determining the tax parameters and updating them.

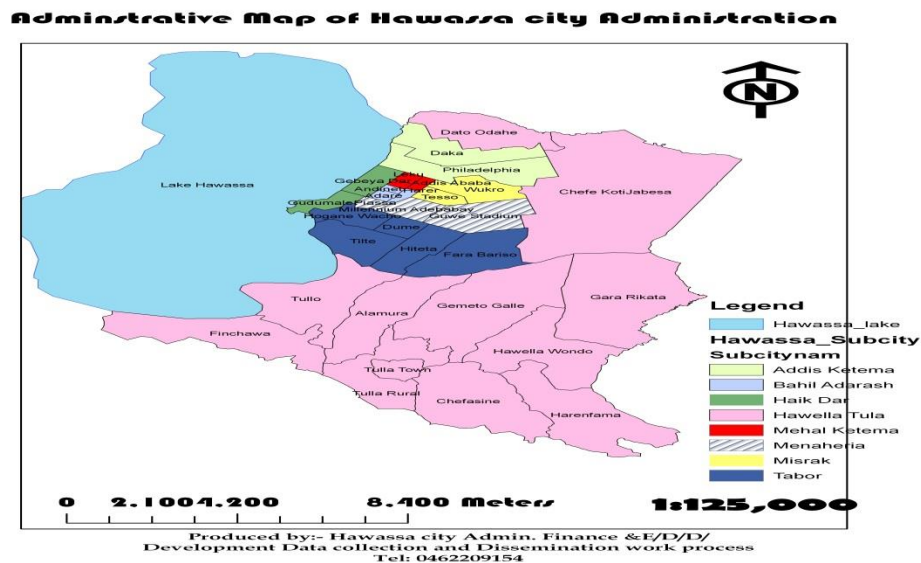
CHAPTER THREE

RESEARCH DESIGN AND METHODOLOGY

3.1. Study Area

Hawassa is a city in Ethiopia on the shores of Lake Awassa in the Great Rift Valley. It is 273 k.m south of Adiss Abeba through Bishoftu, 130 k.m east of Sodo and 75 k.m north of Dilla. The town serves as the capital of the sidama region. Its name comes from a sidamic word meaning "wide body of water"

Figure 1: Maps of Study area



Based on the 1999 E.c/ 2007 G.c National population and Housing census, the current projected population of Hawassa is 329,734 inhabitants of whom 169,677 were male and the rest 160,677 females. The five largest ethnic groups reported in Awassa were the Sidama(48.67%), the Amhara (17.43%), the Wolayta (13.9%), the Oromo (5.21%) and the Gurage (2.33%); all other ethnic groups made up 12.46% of the population. Amharic is spoken as a first language by 47.97% of inhabitants, 21.01% speak Sidamo, 9.58% speak Wolayta and 2.07% Oromiffa; the remaining 9.37% spoke all other primary language reported.

Hawassa city Administration has eight sub cities which is namely Hawella-Tulla, Tabor, Menehariya, Mahale, Hayekdar, Adis Ketema , Misrak and Baheladarash. Of the eight sub-cities Hawell-Tulla had the highest population with a total of 119,058 inhabitants, followed by Tabor

with 59,522 and Menehariya with 32,945 inhabitants Tabor sub city is one of these sub cities which found in the Hawassa city administration. The sub-city is one of the expansionary found in the city and it is predominantly residential area. The sub city has large number of small businesses operating in the major three sectors namely manufacturing, service and merchandises. In Ethiopia presumptive tax is used to assess tax liability of Category C taxpayers. So that, Tabor sub city will be taken in the study.

3.2. Research Design

There are two different logical scientific reasoning important for any type of scientific research, deductive reasoning and inductive reasoning (inductive-deductive mode of thinking). Induction moves forward from particular to the general. Deduction is backward movement from general to particular. Quantitative researchers primarily follow a deductive route. Quantitative research is based on the measurement of quantity or amount. Quantitative research involves analysis of numerical data. Qualitative researchers primarily follow inductive route and involves analysis of data such as words (Kothari, 2004). This study was used mix of quantitative and qualitative research. It is quantitative as it quantifies data and generalizes results from a sample to the population of interest and it measures the incidence of various views and opinions in a chosen sample. It will be qualitative as it tries to see different attitude of taxpayers and employees of tax authorities on presumptive tax system. According to Kotharie (2004), descriptive research studies are those studies which are concerned with describing the characteristics of a particular individual, or of a group. Descriptive studies concerned with specific predictions, with narration of facts and characteristics concerning individual, group or situation. In descriptive studies, the researcher must be able to define clearly, what he wants to measure and must find adequate methods for measuring it along with a clear cut definition of ‘population’ he/she wants to study. In this research descriptive research design was followed.

3.3 Target Population of the Study

According to Hawassa city administration Tax authority (2012 e.c) in May, 2012 at the time of small business tax assessment and estimation the number of small business operators were 7,619 in Hawassa.

The sampling framework for this study was 2500 small business taxpayers residing in “Tabor sub-city” tax office, Hawassa. Tabor sub-city tax authority office there is 25 employees engaged

in assessment and administration presumptive taxation. All Category C taxpayers in Tabor sub city of Hawassa and employees engaged in presumptive tax assessment are target populations.

3.4. Sampling Design

3.4.1. Sample Size Determination

Reliability and cost are taken into consideration in the sample size determination of taxpayers. In addition to this, the research objectives and the characteristics of the taxpayers (such as size and diversity) were taken in to consideration in the sample size determination of taxpayers.

According to Fowler (1984) for a population, the level of precision increases steadily up to sample sizes of 150 to 200 and after this point the gain from increasing sample size is modest. The most important characteristic of a sample, therefore, is its representativeness, not its size

3.4.2. Sampling Technique

The researcher was used census technique for office employees and also employed Stratified random sampling technique to select sample of respondents from tax payers.

Stratified random Sampling was used. This technique was choosing because the sampling frame could be categorized into relatively homogeneous groups (strata) in their business type. The stratum designed based on their type of sectors includes; such as, Retailer (merchandizing), Services rendering and Manufacturing sectors. After stratification, random sampling technique from the probability methods was used to draw the final sampling units which were made to be proportional to the total number of enterprises in each stratum

Table 1 Sampling proportion

No	Sector	Total enterprise	Sample size determination by proportion	Samples taken
1	Retailers	1200	Group 1 = $\frac{1200 * 150}{2500}$	72
2	Services providers	1000	Group 2 = $\frac{1000 * 150}{2500}$	60
3	Manufacturing enterprise	300	Group 2 = $\frac{300 * 150}{2500}$	18
	Total	2500		150

Source, field survey (2022)

This study was used census method to select 25 samples of tax authority employees of Tabor sub city and was employed stratified random sampling technique to select 150 sample of taxpayers' respondent.

Finally, this study has total 175 samples of the respondents had conducted the challenges and prospect of presumptive tax system in Tabor sub-city, Hawassa. .

3.5 Data Type

In this research both primary and secondary data was used. Primary data is the major source of data for this research as there are no research works done on presumptive tax in Tabor sub city both empirically and theoretically. Secondary data has their contribution as they are helpful to define the research problem, methods that were used in data collection and analyses.

3.6 Method of Data Collection

In this research both self-administered questionnaires and unstructured interview was used collected primary data. Two types of self-administered questionnaires were used to get detail information from sample taxpayers of Tabor sub City and employees of Tabor sub City. The questionnaire for the sample taxpayers is close – ended questions. This questionnaire is design for sample taxpayers typically to help extract information on the characteristics of the sample taxpayers, their attitude towards presumptive tax system. The questionnaire was prepared for the

employees of the tax authority are also consisted of closed end questions. It was aimed at getting information like challenges faced by the authority in assessing tax liability of Category C taxpayers. Unstructured interview was made with the manager of small businesses tax in the sub city and small business tax team leaders to get detailed information. The data collections instruments were used in this paper are attached under appendix A up to C of this paper.

3.7 Method of Data Analysis and Presentation

To analyse challenges and prospects of presumptive tax in Hawassa city particularly at Tabor sub City, descriptive statistics was used. After data were collected and coded into SPSS, descriptive statistics tools like tables, figures and graphs were used to classify and present it. Moreover, information was obtain through unstructured interview is analysed qualitatively using discourse.

3.8. Ethical Consideration

In ethical consideration, the participant was informed ahead about the aim of the study. They also participated in the study based on their own willingness. Privacy and confidentiality also maintained. As per the work plan and schedule acceptable procedures was followed by effectively undertaking the research process. In the beginning all legal permissions was secured and pre visit of the area was made for initial contact with institutions and individuals.

CHAPTER FOUR

Data Analysis and Presentation

The second stage of research involves collection, analysis and presentation of data. To do so, two different questionnaires were distributed to sample taxpayers and employees of tax authority. A total of 150 questionnaires were distributed to Category C taxpayers of Tabor sub city out of which 114 returned filled completely and properly. This made the return rate around 76%. In the same way a total of 25 questionnaires were distributed to employees of Tabor sub city small businesses tax task desk out of which 23 were returned filled completely and properly which make the response rate 92%. Beside the questionnaires, in depth and unstructured interviews were held with the manager of Tabor sub city tax authority office and Team leaders in assessment and administration presumptive taxation in the Tabor sub city. In order to enrich information obtained through questionnaire. After the data was collected, checked for errors and completeness, it was analyzed using descriptive research techniques.

4.1 General Attribute of Respondents, Type and Age of Businesses

Table 2: Demographics characteristics of sample taxpayers

Item	Description	Sampled taxpayers %
Sex	<i>Male</i>	47.6 %
	<i>Female</i>	52.4 %
	Total	100 %
Age	<i>25 - 40 years</i>	56.14%
	<i>41 – 55 years</i>	35.09%
	<i>More than 55 years</i>	8.77%
	Total	100 %
Level of education	<i>Illiterate</i>	13.5 %
	<i>Primary school completed</i>	22.9 %
	<i>Secondary school completed</i>	18.7 %
	<i>Certificate</i>	15.6 %
	<i>Diploma</i>	12.6 %
	<i>First degree</i>	16.7 %

	Total	100 %
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The compositions showed that more than half 60(52.4 %) of the sample taxpayers are females and the remaining 54(47.6 %) were males.

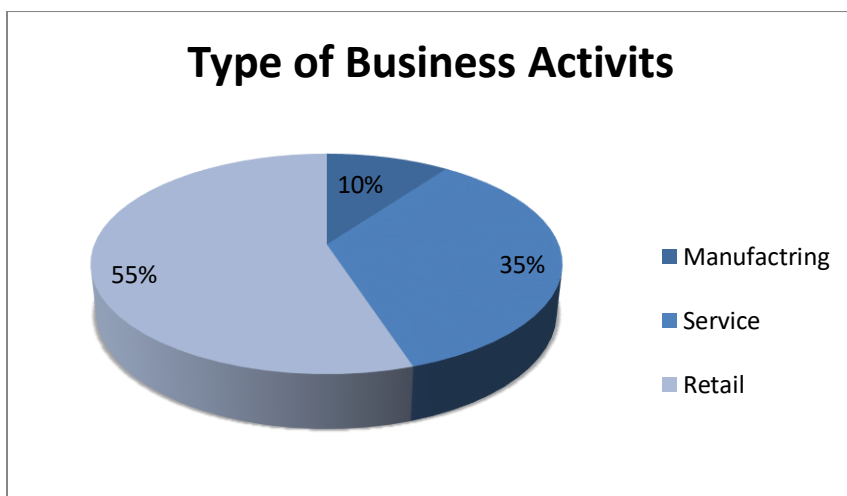
The age distribution of the respondent who participated in the study is provided in item 2 tables 2 above. The sample age categories were divided with a range of 25 years up to age more than 55. Accordingly, the results showed that majority of respondents in the small businesses are 64(56.14%) were aged between 25 and 40 years old and 40 (35.09%) were between 41 and 55 years of age. while 10(8.77%) were more than 55 years old.

The formal educational background of the respondents and the survey result shown that in Table 2, item 3, 15(13.5%) sample taxpayers were illireat,26(22.9%) were primary School completed,22(18.7%) were secondary school completed,18(15.6%) were certificate holders,14(12.6%) were college diploma holders,19(16.7%) of them were First degree holders.

Type of Business Activities and Stay in Business

Most of the sample taxpayers 63(55%) are engaged in retail business, followed by service provision activities which account for the 40(35%) and the remaining 11(10%) in manufacturing.

Figure 2: Types of Business Activities

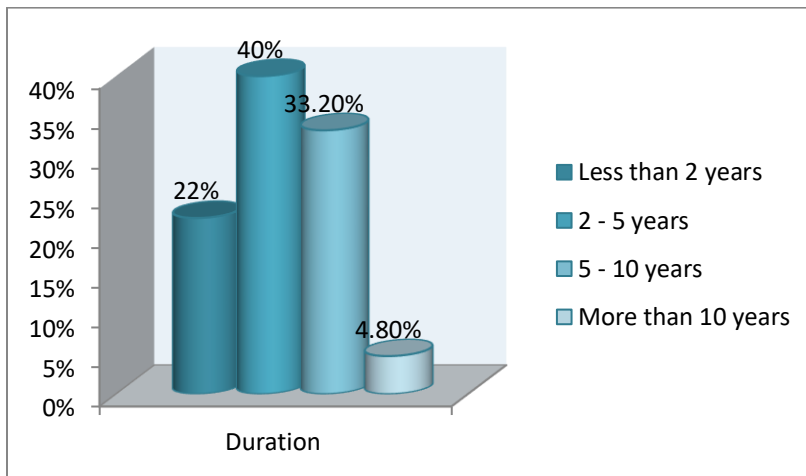


Source: Research survey, 2022

One of the main reasons behind using presumptive tax is to bring taxpayers into the tax net and then to transfer them to the regular tax system. This can be done by setting tax rates under small business tax system at a reasonable rate (not too high nor too low), providing incentives for those joining the regular system or imposing a limit regarding the number of years that taxpayers of a particular size may last on presumptive taxation system (Wallace, 2002).

As can be seen from Figure 3 below, 40 % of the tax payers have been in the business from 2 to 5 years, followed by 33.2 % of them with 5 -10 years . 22 % of sample taxpayers have been in the business for less than 2 years. Only very few (4.8%) stayed of them in the business for more than 10 years. From this, it can be understood that number of taxpayers that remain in presumptive tax system for long (more than five years) is 38%, which should raise concerns to the tax authority. As stated in the literature presumptive tax system should have a way of identifying those taxpayers that need to be transfer to the normal tax system. Even though it is difficult to conclude those businesses that stay in the system for more than five years has to go the normal taxation system, tax authority should be cautious in handling business who has been operating for more than some years by assessing them with more effort than those with less years of stay in the business.

Figure 3: Age of Business



Source: Research survey, 2022

4.2 Objectives and Methods of Presumptive Tax Assessment

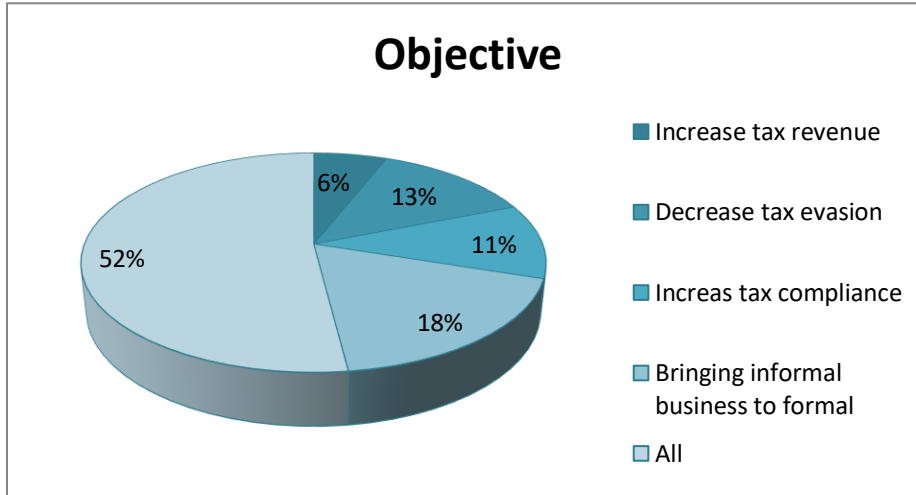
4.2.1 Objectives

As presented in the literature government has different objectives like maximizing tax revenue, bringing equity, ensuring economic stability. There is a growing awareness that tax systems can go beyond merely maximizing revenue collection but over the medium- to longer-term can inculcate a higher degree of tax compliance and build a platform to support entrepreneurship and business development. The main objective of small business taxation should be increase the size of the formal sector, promote growth and provide education and training on how to monitor business activities. The primary goals of most governments that introduce presumptive taxation beside revenue maximization are: broaden tax base by preparing citizens and businesses in the informal sector to enter the formal tax net, reduce tax evasion and avoidance of small business, and increase compliance culture through reducing tax complying and administrative cost to small business and simplifying small businesses tax system.

Employees of the tax authority were asked about the major objectives of government in introducing presumptive tax in taxing small businesses. More than half (52%) of them responded that presumptive tax has combined objective of increasing tax revenue, decreasing tax evasion and compliance. The next group which comprises of 18% employees of tax authority said that the main objective is to bring those in the informal sector to formal sector and to broaden the tax base. On the other hand, 13% and 11% of the sampled employees of tax authority agree that presumptive tax is used to decrease tax evasion and increase tax compliance respectively. On the other hand, 6 % of employees of tax authority said that the primary objective of presumptive tax is to increase tax revenue.

In the interviews conducted, interviewees said that the main reasons behind using presumptive tax system to tax small businesses are: to broaden the tax base, to increase number of taxpayers and to bring those working in the informal sector to the tax system. In addition to this, interviewees said that presumptive tax is used to decrease administrative costs and reduce tax compliance cost of taxpayers.

Figure 4: Objective of Presumptive Tax System



Source: Research survey, 2022

4.2.2 Presumptive Tax Assessment

Tax assessment is the processes of determining tax liability on the income obtained with in specific period. There are different ways in which tax is levied on income or profit. Countries which employ presumptive tax use different methods to estimate tax liability based on income, assets, turnover and /or wealth.

As presented in the literature in Ethiopia, standard assessment method is used to assess tax liability of Category C taxpayers since 2002/2003 by replacing estimated assessment used before. Standard assessment assigned different lump sum tax liability to different businesses or an occupation which corresponds to the presumed income supposed to be earned by a member of a particular occupation type or businesses.

Sample taxpayers were asked about which type of presumptive tax assessment method they prefer. As indicated under item 1, table 3, the majority, which accounts for about 76% of sample taxpayers, prefer a presumptive tax system based on standard assessment. On contrary,14% prefer presumptive tax based on estimated assessment and the remaining 10% preferred an assessment tax based on turn over and expenses. Looking this from the tax authority employees’

point of view, 54% of them prefer assessment based on standard assessment followed by based on estimated assessment which account for about 33 % of the sampled employees of tax authority. The remaining 6% and 7% prefer presumptive tax based on turnover and on expenditure methods respectively. This generally indicates that more than half of sample taxpayers and employees of tax authority choose presumptive tax based on standards assessment. This is encouraging as the common preference between the two parties helps to facilitate smooth working environment.

In the interview conducted, interviewees were asked how they conducted presumptive tax assessment. They replied that assessments are conducted by a group of five people consisting of the sub city administrator, one traders' representative, one from law task desk and two from micro businesses tax desk of the sub city. The assessment was conducted by using a standard form which contains about ten questions. The basic issues raised were: daily average sales, daily personal and business expenses, purchases, income from any other source, time required to turn goods or services in to cash and others. After taxpayers were asked these questions and replies were made, the group finally decided taxpayers' daily average sales by cross checking the raised questions and other aspects of the business from their perspectives. This estimated daily average sale was used to determine yearly income. Then this estimated income is multiplied by the fixed profit rate for each business or occupation as putted in the standard estimation schedule. Once the profit is determined business tax rate is used to determine the tax liability. On this amount, 2% for business or 10% for services of the yearly income is added as a turnover tax. One point that was raised by the interviewees was that most taxpayers give the true amount of their expenses and other information while they usually falsify their daily sales wrongly assuming that average daily sales matters exclusively.

From the above response it can be said that it is the combination of estimated and standard method that is being used to assess tax liability of category C taxpayers rather than standards assessment that was supposed to be used. This is a critical deviation which needs to be evaluated by the tax authority for two reasons. First, this might be indication of implementation problems of presumptive tax system as what is declared to be used is totally different from what is actually being used. Second, an estimated assessment that was used before 2003 was changed to standard assessment as estimated assessment was susceptible to corruption, bring more work load to

administer, and dispute between taxpayers and tax authorities .So it is standard assessment that has to be used as pouted in the regulation not estimated method. The same thing was found by Mussa (2010) in his research that Category C taxpayers’ tax liabilities were determined through estimation of daily income.

In 2012/2013 some changes were made on the member of group used to assess the tax liability as it was found difficult to bring those five people from different places at a same time. Instead it was decided to use a group of three to five people rather that five people used before. Beside new graduate students from universities were recruited assuming that this will reduce corruption as they had minimum or no personal contact with either the existing coworkers or the taxpayers.

Sample taxpayers and employees of tax authority were asked if the 2012/2013 assessment brought more taxpayers to the tax system or not. As seen under item 2 of Table 3, 71.4 % and 84 % sample taxpayers and employees of tax authority respectively agree with the claim that the recent assessment brought more taxpayers to the tax system. This shows that tax authority has done a good job in bringing more taxpayers to the tax net.

Table 3: Presumptive Tax Assessment

No	Items	Type of assessment /level of agreement	Sampled taxpayers %	Employee of tax authority %
1	Preferred Ways of Presumptive Tax Assessment	Based on turn over	3.8	5
		Based on expenditures	6	7
		Based on estimated assessment	14	36
		Standard assessment	76.2	54
		Total	100	100
2	The recent assessment has brought more taxpayers to the tax regime.	Strongly disagree	14.3	4
		Disagree	14.3	12
		Agree	47.6	32
		Strongly agree	23.8	52
		Total	100	100

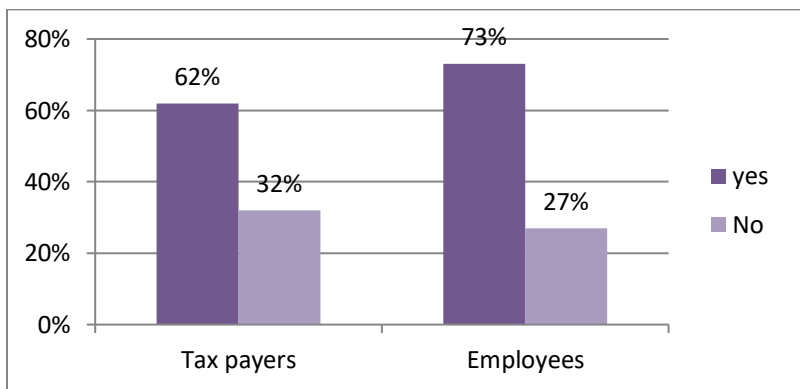
Source: Research survey, 2022

4.3 Problems with Presumptive Tax Assessment and Administration

In order for taxpayers to comply with tax laws it is necessary that they know when and why they pay tax and how tax liability is assessed and tax is levied. Nevertheless from the survey, sample taxpayers responses indicate that about two third (62%) of them, said they lack basic knowledge of presumptive tax and this hinders them from obeying the tax law properly. Similarly 73% of the employees of tax authority have the same understanding.

From the interview conducted with employees of the tax authority, lack of understanding of the tax law is believed to be among the major reasons for taxpayers in not compiling the tax law. One interviewee explained the lack of awareness of tax payers by rising how taxpayers replay to questions in assessment time. She said that most taxpayers replied for most of the questions raised honestly but they falsify their daily sales as thinking only daily sales is used to calculate their tax liability not the other aspects rose, which comes from their lack of awareness. This shows that there is a need for extensive educational program in order to enhance taxpayers' awareness.

Figure 5: Understanding of Tax Law by taxpayers

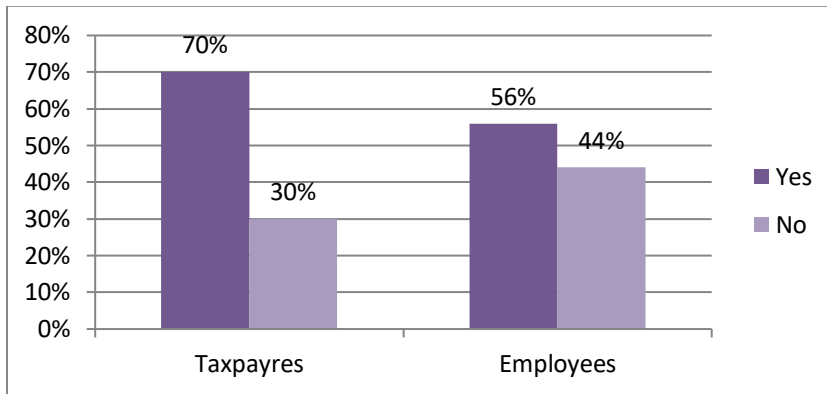


Source: Research survey, 2022

Simplicity in tax laws enables taxpayers to understand the rules and comply with them cost-effectively, reduces the number of errors, improves compliance, and increases respect for the system, promotes transparency and cost-effective collection. Sample taxpayers and employees of the tax authority were asked their beliefs on whether the tax laws in general are simple to understand and to comply with or not. The results are presented in Figure 5, in which over 70% of the sample taxpayers and 56% of the employees of tax authority respectively consider the

laws not simple enough to understand and comply with, while the remaining proportions consider them to be simple.

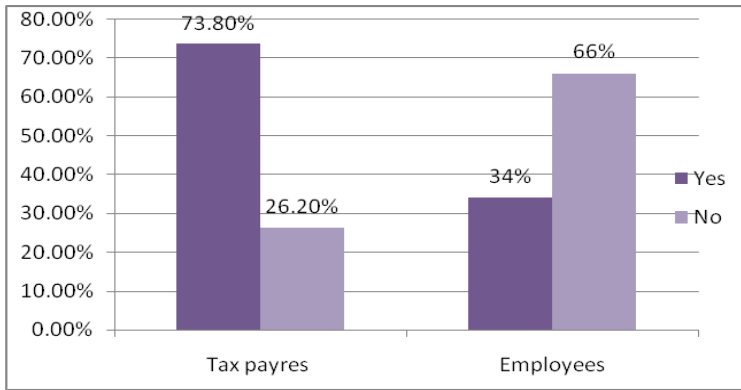
Figure 6: Simplicity of Tax Laws



Source: Research survey, 2022

Tax administrations have to convince taxpayers in paying tax timely and without enforcement. By providing good service in tax collection, enhancing awareness about tax and its usage and compliance handling procedures, tax authority can increase both voluntarily and timely payment of tax. Regarding this both employees of tax authority and sample taxpayers were asked whether there were a problem of paying tax voluntarily and on time. The majority of sample taxpayers, which were about 73.8% disagree with the idea that they have a problem of paying tax voluntarily and timely and only 34 % of employees of tax authority feel that there is no problem of paying tax voluntarily and timely. But, considerable number of employees of the tax authority (66%) says that timely and voluntarily paying of tax is one of the problems they face in collecting and assessing tax from small business.

Figure 7: Willingness to Pay Tax at Time and Voluntarily

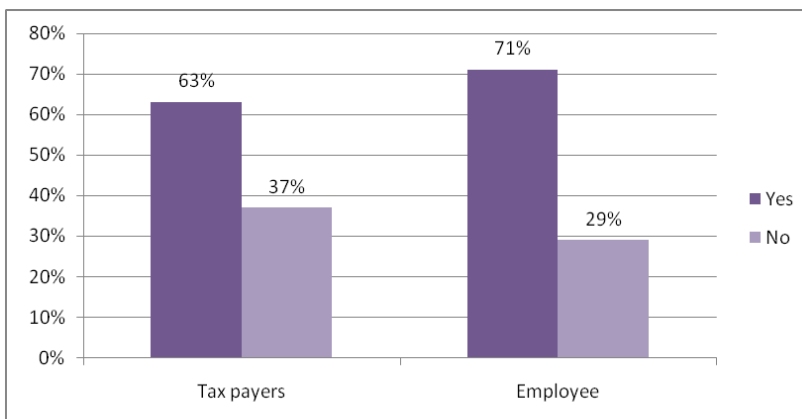


Source: Research survey, 2022

One quality of good tax system is being fair and objective among taxpayers. If tax system is unfair and subjective it will make collecting tax involuntarily and delayed. In such condition, taxpayers might not have a positive attitude towards paying tax or/ and tax authority.

Putting this in mind sample taxpayers and employees of tax authority were asked about their opinion whether presumptive tax assessment and collection were fair and objective. The results are shown Figure 7, where 37% and 29% of sample taxpayers and employee of tax authority respectively says that the way presumptive tax assessed and collected is fair and objective. But significant number (63%) of taxpayers and (71%) of employees of the tax authority replied that presumptive tax assessment is unfair and subjective.

Figure 8: Subjective Assessment of Presumptive Tax



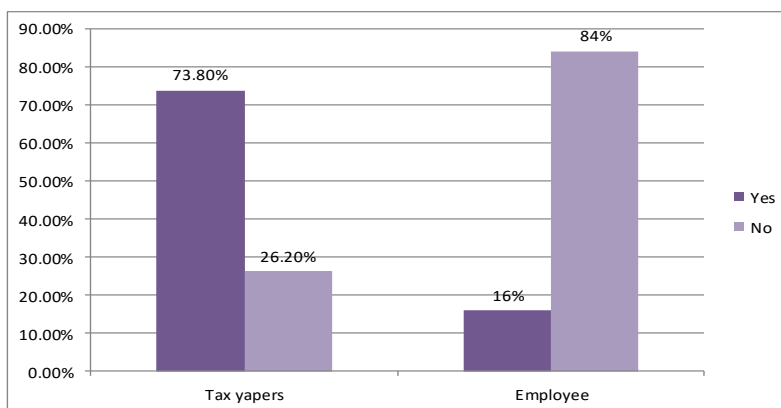
Source: Research survey, 2012

As presented in the literature one of the inherited problems of presumptive tax is its subjectivity. Tax authorities should put this in mind in designing and implementing presumptive tax. As

discussed above, even though it is standard assessment which is supposed to be used to assess Category C tax payers tax liability, from the interview conducted it was found that , in practice it is estimated method used to estimate daily average sale despite its limitations like subjectivity, inconsistency, discretion and vulnerability to corruption to estimate daily income of taxpayers. Therefore, these analysis shows that presumptive tax assessment is subjective. This may be as a result of estimating daily income rather than assigning lump sum tax liability based on occupation or business type which doesn't need estimation of daily sales.

For the effectiveness of tax law, transparency is a critical issue. Taxpayers should know what tax means, how and when it is levied upon them and similar issues. Transparency makes compliance easier and avoids mistakes that arise from illiteracy. As can be seen from Figure 8 below, the majority (73.8%) of sampled taxpayers believe that presumptive tax system lacks transparency. Employees of tax authority were also asked if there were lack of transparency regarding presumptive tax system. More than three fourth of them say there were no problems of transparency in the assessment and collection procedure of presumptive tax. This contradiction arises from different perspectives of the two parties or because there exist problems related to transparency in the system. What matters is that as service giving organizations which strive to exercise a good tax administration, the tax authority should focus on improve the transparency of the tax system.

Figure 9: Lack of Transparency in Tax Assessment



Source: Research survey, 2022

4.4 Tax Evasion

Wherever taxes are levied, there are agents who try to avoid or evade them. As Hillman (2006) stated people who regard taxation as excessive, face the alternatives of not working or working and evading taxes. Choosing tax evasion is then means of personal escapes from the burden of taxation and also from the accompanying excess burden of taxation. Economists have recognized the importance of such behavior in the design of optimal tax systems, and have paid increasing attention to the analysis of schemes for detecting and modifying such behavior. Presumptive taxation like any other tax system is exposed to evasion. However the exposure of presumptive tax as compared to other tax systems is different as many of the taxpayers are small businesses characterized by large in number and limited proper book keeping know how. So this specific behavior of small businesses coupled with some features of presumptive tax can make the tax system more exposed to tax evasion.

As can be seen from the item 1 table 4 below about two third (64%) of the sample taxpayers and (66%) of employees of tax authority agreed that presumptive tax system is vulnerable to tax evasion. In item 2 table 4 about 62% of sampled taxpayers agree that presumptive tax increase tax evasion while the remaining (38 %) do not believe so. The same question was raised to employees of tax authority and a significant number of them (75 %) agree that presumptive tax increase tax evasion.

Table 4. Tax Evasion

No	Items	Level of Agreement	Sampled taxpayers %	Employee of tax authority %
1	<i>The way presumptive tax assessed and collected is vulnerable to tax evasion</i>	<i>Strongly disagree</i>	10.4	8
		<i>Disagree</i>	26	24
		<i>Agree</i>	39.6	44
		<i>Strongly agree</i>	24	22
		Total	100	100
2	<i>Presumptive Tax system increase tax evasion</i>	<i>Strongly disagree</i>	16	10
		<i>Disagree</i>	22	15
		<i>Agree</i>	42	35
		<i>Strongly agree</i>	20	40
		Total	100	100

Source: Research Survey.2022

4.5 Corruption

Corruption is likely to reduce the tendency of individuals in a given state to accept and trust their government in general and comply with the tax burden in particular. One of the benefits of a less complex structure and a less ambiguous tax law is that it should reduce the frequency of face to face interaction between tax officials and taxpayers. There is much support in tax literature that such a reduction will reduce temptation and practical scope for tax officials to solicit bribes or to accept those offered. Presumptive tax is an effective way of reducing the need for face to face interaction. However the obvious danger with presumptive taxation is the possibility of arbitration on the part of the tax administration that could generate more corruption and irritation than revenue. (Ter-Minassian, 1997).

As it can be seen from item 1 and 2 of Table 5 below, about 81 % of the sampled taxpayers agree that the tax assessors' attitude toward corruption, embezzlement and fraud has an impact on the amount of tax assessed. Likewise 76% of employees of tax authority support the idea that tax assessors' attitude towards corruption, embezzlement and fraud has an impact on the amount of tax assessed. 71 % of sampled taxpayers and 64% of employees of tax authority agree that presumptive tax increases corruption.

A good tax system distribute tax burden on tax payers equally in proportion to their earnings as much as possible. People should contribute toward support of government in proportion to what they earn. By providing objective indicators for tax assessment, presumptive methods may lead to a more equitable distribution of the tax burden, when normal accounts-based methods are unreliable because of problems of taxpayer compliance or administrative corruption. Balestrino and Galmarini, 2005, have argued that presumptive taxation may be a useful instrument for raising the welfare of the less well-off and sometimes of all citizens, although it may achieve this outcome in a somewhat unexpected fashion. Tax payers and employee of tax authority were asked their opinion whether Presumptive tax system brings a more equitable distribution of tax burden. As it can be seen from item 3 of Table 5, 62% of tax payers and 64% employee of tax authority disagree that presumptive tax bring equitable distribution of tax liability. The disagreement between the survey result and Balestrino and Galmarini and other research on the redistribution capacity of presumptive tax may call for further study.

The last thing it was raised to tax payers was whether they were satisfied or not with the existing presumptive tax assessment and collection procedures in general. As the result in item 4 of Table

5 shows almost three fourth (75%) of the respondents are dissatisfied with the existing presumptive tax assessment and collection procedure. The remaining 25% said that they are satisfied with the presumptive tax system in general.

As Ter-Minassian, 1997 said, the ability of presumptive tax to reduce corruption depends on the structure of the tax system, how tax rules defined, the amount of discretion on the part of tax administration, availability and transparency of data and the general administrative capacity of the tax authority.

Table 5 Corruption

No	Items	Level Agreement of	Sampled taxpayers %	Employee of tax authority %
1	<i>Tax assessor attitude toward corruption, embezzlement and fraud has impact on the amount of tax assessed.</i>	<i>Strongly disagree</i>	14.3	3.8
		<i>Disagree</i>	4.8	19.2
		<i>Agree</i>	33.3	42.5
		<i>Strongly agree</i>	48	34
		<i>Total</i>	100	100
2	<i>Presumptive tax increase corruption.</i>	<i>Strongly disagree</i>	10%	24%
		<i>Disagree</i>	19%	12%
		<i>Agree</i>	47.60%	46%
		<i>Strongly agree</i>	23.40%	18%
		<i>Total</i>	100	100
3	<i>Presumptive tax system brings a more equitable distribution of tax burden</i>	<i>Strongly disagree</i>	28%	44%
		<i>Disagree</i>	34%	20%
		<i>Agree</i>	26%	20%
		<i>Strongly agree</i>	12%	16%
		<i>Total</i>	100	100
4	<i>I am satisfied with the existing presumptive tax assessment and collection procedures.</i>	<i>Strongly disagree</i>	50	-
		<i>Disagree</i>	25	-
		<i>Agree</i>	10	-
		<i>Strongly agree</i>	5	-
		<i>Total</i>	100	-

Source: Research Survey.2022

4.6 Tax Compliance

As presented in the literature, presumptive tax is used mostly when there are large numbers of small businesses and administrative resources are scarce. This tax system is considered as an optimal way of reducing noncompliance without costing much resource. It enables small businesses to avoid complicated book-keeping system which is costly and time consuming for taxpayers.

In the survey conducted, sample taxpayers were asked whether presumptive tax system increase compliance or not. As can be seen from item 1 of Table 6 below, the majority which is about 84% of the sample taxpayers agree that presumptive tax increase compliance. The same issue was raised to employees of tax authority and a large number of them (68%) agree with the idea that presumptive tax increase compliance. Empirical studies by (Luigi *etal*, 2008) show that presumptive tax was implemented in Argentina in order to improve tax compliance and to simplify the tax system and had brought significant changes.

Sample taxpayers and employees of the tax authority were asked if complexity of tax system has effect on compliance. Almost all (90.5%) of sampled taxpayers and 84% employees of the tax authority agree that the complexity of tax system made compliance difficult as shown in item 2 of Table 6.

One of the primary things that brings more compliance in the tax administration is having a good way of timely and properly handling of complains of sampled taxpayers. The tax authority has to understand that collecting tax is not the end by itself. Taxes are required to overcome the problem of free riding inherent in the financing of public goods, to control market imperfections, and to achieve social justice by redistribution. To do this, both parties (taxpayers and tax authority) have to work in coherence.

Regarding this both sample taxpayers and employees of tax authority were asked whether there were timely and proper handling of complains by the tax administration. As putted in item 3 of table 6, sampled taxpayers were almost divided into two regarding the issue. About 55% disagree with the idea that there is timely and proper handling of complains. The remaining 45 % agreed that there is timely and proper handling of compliance. When it comes to employees of tax authority, the majority (84%) of them said that compliance handling service provided by them is

timely and proper .Only 16 % of them believed that compliance handling service provided by them is not timely and proper. The important thing that has to be understood is that the perception of service user is more important than that of the service provider. Therefore the tax authority is advised to look into the way complains are handled and see if there are things that need to be corrected and modified to realize a higher satisfaction from taxpayers in particular and to exercise good governance in general.

Table 6: Tax Compliance

No	Items	Level of agreement	Sample taxpayer s %	Employee of tax authority %
1	<i>Presumptive tax increases tax compliance.</i>	<i>Strongly disagree</i>	-	16
		<i>Disagree</i>	16	16
		<i>Agree</i>	32	20
		<i>Strongly agree</i>	52	48
		<i>Total</i>	100	100
2	<i>The tax system is complex and this made compliance difficult.</i>	<i>Strongly disagree</i>	9.5	-
		<i>Disagree</i>	-	16
		<i>Agree</i>	57.2	32
		<i>Strongly agree</i>	33.3	52
		<i>Total</i>	100	100
3	<i>The tax authority handle complains in timely and proper manner.</i>	<i>Strongly disagree</i>	35	4
		<i>Disagree</i>	20	12
		<i>Agree</i>	25	60
		<i>Strongly agree</i>	20	24
		<i>Total</i>	100	100

Source: Research Survey.2022

4.7 Level of Information about Presumptive Tax

The timely provision of information for taxpayers is an important factor for the effective collection of taxes. However, the failure to inform taxpayers about the existing and new tax laws is one of the weaknesses of the tax authority causing noncompliance of those taxpayers who want to be law abided but can't do so because of lack of necessary knowledge on taxation and tax law. Regarding this sample taxpayers were asked if providing awareness about tax enhances voluntary compliance.

The result of respondents' reaction is presented under item 1 of table 7. The majority (84%) of sample taxpayers agree that providing awareness about tax enhances voluntary compliance of tax. Majority of the employees of tax authority (76%) agree that providing awareness about tax enhances voluntary compliance of tax.

The issue regarding the level of knowledge about presumptive tax was raised to both sample taxpayers and employees of tax authority. Accordingly, 33% and 65% of sample taxpayers and employees of tax authority respectively agree that they have the basic knowledge about presumptive tax. A noticeable part of sample taxpayers (67%) and employees of tax authority (35%) admit that they don't have the basic knowledge about presumptive tax. From the above questions, we can understand that the tax authority should realize that the majority of taxpayers wish to obey the law and fulfill their obligations but they mostly failed to do so since they lack adequate knowledge. Therefore, taxpayers should be notified any changes made, be given proper training in time and raise their general awareness about tax and it's merit to the society. The tax authority is advised to arrange training programs to train its employees regarding their responsibilities.

Item 3 under Table 7 is about orientation and training session provided by tax authority regarding presumptive tax. Majority of sample taxpayers (85.5 %) and more than half of the employees of tax authority (64 %) agree that the orientations and training session given by the tax authority were not enough.

Item 4 under table 7 raises the issue of whether the tax authority provides sufficient written documentation explaining tax laws or not. 73.6 % of sample taxpayers disagree on the authority's provision of enough written documentation explaining tax laws. Similarly, 86% of sample taxpayers say that, the tax authority didn't use media outlets to provide information on presumptive tax.

Generally it can be concluded that the overall level of awareness of taxpayers and the training and other awareness creation programs of tax taxpayers of the tax authority are low. So the tax authority is advised to evaluate its awareness creation programs in depth and come up with a better, well planned and goal oriented programs.

To build tax system with enough capacity, the primary thing is to have task force with the necessary knowledge, skill and ethics. Two questions were raised to tax authority employees in this regard.

The first was whether the tax authority has a manual which properly explain and describe how presumptive tax is assessed and collected. As it can be seen from item 6 of table 7 the vast majority (92%) of the employees of the tax authority agree that they have a manual which properly explains how presumptive tax is assessed and collected.

The second issue that was raised was if they had been given regular training about presumptive tax assessment and collection procedure and 64% of them agree that proper trainings were given to them.

Table 7: The level of information /knowledge/ about Presumptive Taxation

No	Items	Level of agreement	Sampled taxpayers %	Employee of tax authority%
1	Providing awareness about tax enhances voluntary compliance of Category C sampled taxpayers	Strongly disagree	10	12
		Disagree	6	12
		Agree	56.4	40
		Strongly agree	27.6	36
		Total	100	100
2	I have the basic knowledge about presumptive tax.	Strongly disagree	31	12
		Disagree	36	23
		Agree	27	20
		Strongly agree	6	45
		Total	100	100
3	The orientation given by the tax authority about presumptive tax assessment method is not enough.	Strongly disagree	7.9	4
		Disagree	6.6	32
		Agree	35.5	40
		Strongly agree	50	24
		Total	100	100
4	The tax authority provides sufficient written documentation explaining tax laws	Strongly disagree	34.2	-
		Disagree	39.4	-
		Agree	13.4	-
		Strongly agree	14	-
		Total	100	-
5	There is sufficient information provided through media outlets about presumptive tax.	Strongly disagree	39.7	-
		Disagree	46.3	-
		Agree	14	-
		Strongly agree	-	-
		Total	100	-
6	The tax authority has a manual which properly explain and describe how presumptive tax is assessed and collected.	Strongly disagree	-	-
		Disagree	-	8
		Agree	-	44
		Strongly agree	-	48
		Total	-	100
7	I have been given the necessary and regular training about presumptive tax assessment and collection procedure.	Strongly disagree	-	16
		Disagree	-	20
		Agree	-	48
		Strongly agree	-	16
		Total	-	100

Source: Research Survey.2022

CHAPTER FIVE

Summary of Findings Conclusion and Recommendations

5.1 Summary of findings

More than half (52%) of employees of the tax authority responded that presumptive tax has combined objective of increasing tax revenue, decreasing tax evasion, and compliance. 18 % of employees of tax authority said that the main objective of presumptive tax is to broaden tax base and brings those in the informal sector in to the tax net. 13% and 11% said that the main objective behind presumptive tax is to reduce tax evasion and increase tax compliance respectively. The remaining 6% say the main objective is to increase tax revenue.

Tax assessment is the process of determining tax liability on the income obtained within a specific period. In Ethiopia standard assessment method is used to assess tax liability of category C tax payers since 2002/2003 by replacing estimated assessment used before. From the survey conducted 76.2 % and 54% of tax payers and employee of tax authority prefer presumptive tax based on standard assessment. 14 % and 33% of tax payers and employee of tax authority prefer presumptive tax based on estimated assessment.

Considerable numbers of (62%) of tax payers said that lack of understanding of tax law is one of the major challenge that hinder them from obeying tax law properly. 73% of employees of the tax authority feel the same.

Over 70 percent of the tax payers and 56 % of employees of the tax authority consider the tax laws not simple to understand and comply, with only a very small minority believing them to be simple. 76% of tax payers disagree that similar businesses were assessed similarly.

The majority, which is about 73.8% of tax payers states that, they pay tax voluntarily and timely. 34% of employees of tax authority feel the same. But considerable number of employee of tax authority (66%) say that timely and voluntarily paying of tax is one of the challenges they face in collecting and assessing tax from small business.

Both two thirds (63%) of tax payers and 71% of employees of tax authority believed that there is subjectivity in tax assessment procedure used.

73.8% of tax payers believe the tax system to lack transparency. 84% of employees of the tax authority say the assessment and collection procedures of presumptive tax are transparent.

64% of the tax payers and 66% employees of tax authority agree that presumptive tax system is vulnerable to tax evasion About 62% of tax payers agree that presumptive tax increase tax evasion while the other believed otherwise. 75 % of the employees of the tax authority agree that presumptive tax increase tax evasion.

81 % of the tax payers and 76% employee of tax authority of agree the tax assessor attitude toward corruption, embezzlement and fraud has impact on the amount of tax assessed. 71 % of tax payers and 64% of employees of tax authority agree that presumptive tax increase corruption.62% of tax payers and 64% employee of tax authority disagree that presumptive tax bring equitable distribution of tax liability.

84% of tax payers and 68% employees of tax authority agree that presumptive tax increase compliance. Almost all (90.5%) of tax payers and 84% employee of the tax authority agree that the complexity of tax system made compliance difficult . 55% of tax payers and 82% employees of the tax authority agree with that there is of timely and proper handling of complains.

84% of tax payers and 76% employees of tax authority agree with the idea that providing awareness about tax enhances voluntary compliance of tax. 33% and 65% of tax payers and employee of tax authority agree say that they have the basic knowledge about presumptive tax. Majority of tax payers (85.5 %) and more than half employee of tax authority (64 %) agree on the idea that the orientations and training given by the tax authority were not enough.

73.6 % of tax payers say that that tax authority does not provides sufficient written documentation explaining tax laws. 86% of tax payers say that, the tax authority didn't use media outlets to provide information about presumptive tax.

88% of the employee of the tax authority said that they have manual which properly explain how presumptive tax is assessed and collected.64% of employees of the tax authority agree that they

have been given the necessary and regular training about presumptive tax assessment and collection procedure.

75% of the tax payers are dissatisfied with the existing presumptive tax assessment and collection procedure. The remaining 25% said that they are satisfied with the presumptive tax system in general.

5.2 Conclusions

Small business taxation is one of the difficult areas to handle in almost all tax systems of developing countries. Even though the contribution of small businesses to tax revenue is small, taxing them is costly and difficult, yet governments have to tax them. Not taxing them will bring moral hazard for those who pay tax and it will raise the question of equity to the general tax system. It can also impose negative externality which will reduce tax compliance moral and increase the risk of generalized non-compliance.

Considering the enormous growth of the small business sector in Ethiopia, the lack of a true voluntary compliance culture and the weak tax administration capacity, simplified taxation has been an important element of a strategy to address the problem of a growing informal economy in Ethiopia. Ethiopia like many sub Saharan countries, use presumptive tax to tax individuals with annual income of less than or equal to Birr 100,000. Taking in to account the significance of taxing small businesses to the country this research tried to investigate the challenges and the prospects of presumptive tax assessment and collection in Hawassa Tabor Sub-City. Particularly this paper tried to investigate; the main challenges of presumptive tax assessment and collection, the dealing of tax compliance, tax evasion, corruption and with that of presumptive tax, and the level of information sample taxpayers have about presumptive tax.

Based on the result of the study, the following conclusions are made.

Even though it is standard assessment that has to be used to assess tax liability of Category C taxpayers, actually the mix of estimated assessment and standard assessment is actually being used. That is due to the estimation of daily income using indicators which is a typical nature of estimated assessment and the standard assessment schedule used to determine tax liability of tax payers once the annual sale is determined. The uses of estimated daily sales to estimate yearly

sales contradict the basic definition of standard assessment. In standard assessment, it is business or occupation type not estimated daily income that determines fixed tax liability. This application can bring many problems: limitation of estimated assessment like loop hole for corruption and discretionary use of indicators, misunderstanding between taxpayers and tax authority, and incoherent design and implementation of the system.

It can be concluded that, the main challenges regarding presumptive tax assessment and collection in the study area are; lack of transparency, subjectivity in tax assessment, lack of awareness, vulnerability to tax evasion and corruption, inefficient tax administration and complexity of tax laws. From these it can be concluded that the assessment and collection procedures of presumptive tax is suffering from many problems that arise from both tax payers and tax authority.

Tax evasion of some extent exists almost in all tax systems and countries. But the severity and extent vary from region to region and from one tax type to another. In this respect, presumptive tax as a frame work is believed to reduce tax evasion by bringing more taxpayers to the tax net and simplify compliance. But in its implementation presumptive tax is vulnerable to tax evasion and tends to increase if not implemented carefully. Presumptive tax assessment and collection in Tabor sub-city of Hawassa is considered to be susceptible to evasion from both taxpayers' and tax authority employees' perspectives. Among other things subjective assessment and lack of transparency made presumptive tax vulnerable to tax evasion.

Even sound tax structure and expenditure policy can be affected by unreliable and corrupt administration. It is sometimes argued that presumptive taxation can help to reduce corruption in the tax administration. But this happens when the structure of the system and the overall administrative is well capacitated. Presumptive tax in Tabor sub city is considered prone to corruption and may increase corruption from tax payers and employees of the tax authority viewpoint. Though there are many reasons that might cause corruption in tax system, the lack of transparency and subjectivity in tax assessment are main reasons for corruption in the sub city.

It is recognized that presumptive tax provides a tool to increase tax compliance by making tax system simple and less costly. Similarly presumptive tax found to increase compliance in Tabor

sub city of Hawassa. But the unease of the tax law and complain handling condition that exist in the sub-city may make it difficult the effort to further increase compliance culture of taxpayers.

Information related to tax is very crucial for taxpayers. It is needed; to pay tax on time and voluntarily, to know amount of tax to be paid, to have an insight of why to pay tax and to understand the general tax system as a whole. In this regard, the sub city is expected to work hard as there are; lack of knowledge about presumptive tax, insufficient awareness creation programs, and insufficient use of media like written materials, TV and radio to educate taxpayers the basics of presumptive tax in particular and tax in general. Considering the awareness of employees of the tax authority ,the sub city is advised to increases its effort to prepare more training sessions and redesign manuals to make its employees more skilled and competent in assessing presumptive tax.

5.3 Recommendations

The sub city is recommended to reassess the standard assessment method of presumptive tax to evaluate if whether it is used as designed and implemented accordingly. The belief that the present presumptive tax system lack objectivity by most taxpayers may largely be attributed to daily income estimation of the present system that can be removed if standard assessment is used totally for both determination of the taxable income and the tax liability.

The sub city is advised to reevaluate its presumptive tax assessment procedures to see if it lacks transparency and take necessary measures if there is lack of transparency. The sub city may do these through creating awareness on how tax is assessed and tax liability is determined, what procedures are used to assess tax liability and how and where complains and questions will answered. The sub city may build ways that examine and evaluate whether assessments are done in accordance with the assessment procedures or not. Making the system more transparent helps the tax system to reduce corruption, and to increase compliance in parallel.

Removing subjectivity all together from presumptive tax system can be difficult as the method used to assess liability in presumptive tax has same degree of subjectivity. So the sub city is advised to find a way to make assessor employee understand these limitations well and be ethical enough in assessing tax liability by avoiding bias and discrimination. This can be achieved by

giving different trainings and making tax assessors who go against the law accountable. In addition, the tax authority is advised to invest on resources used in analyzing tax returns to find out the rigid parameters that determine the income that can be generated from a business, and to convince the general public that presumptive taxation system is fair. Making the system less subjective and arbitrary helps the tax system in reducing corruption, tax evasion and increasing compliance.

In order to make taxpayers more compliant, understand tax law and cooperate with the sub-city, a lot may be done to educate taxpayers. To guarantee more improvement in compliance, the introduction of presumptive tax has to be combined with administrative improvement, in particular improvements in tax enforcement and the development of a compliance management strategy. In addition to this orientation and training sessions are advised to be increased both in terms of number and quality and should be consistent and goal specific. Different outlets like TV, radio has to be used to educate sample taxpayers instead of relying on public gathering and infrequent door to door education sessions.

In addition to educating on how to comply with the law and basic accounting skills, the tax authority could also educate businesses on what becomes available (access to finance, markets, cooperatives, etc.). Such activities would increase number of small businesses in the tax net, and capacity building would occur in short run. This would have an impact on short-run economic growth. But in the long run, many of these firms will potentially grow and become larger taxpayers. The net result would be an increase in revenue for the government and contribute to higher economic growth in general.

General, it is suggested that even though presumptive tax is the second best alternative in taxing small businesses theoretically; presumptive tax can be less efficient than the conventional tax system if not implemented properly and with caution. Therefore the tax authorities have to increase sample taxpayers' awareness through all possible ways, tax assessment should not be done arbitrary, voluntary compliance should be enhanced through considerate and accurate treatment of sample taxpayers, adopt intensive anti-corruption programs, resource capacity of the tax authority should be enhanced, special training programs should be arranged for employees and lastly grievances should be handled through effective mechanisms.

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Appendix A
INFOLINK COLLEGE
Department of Accounting and Finance
Msc. Accounting and Finance
Questionnaire prepared for sampled taxpayers

Dear Respondents,

The purpose of this questionnaire is to collect data for the thesis work in requirement for partial fulfillment of MSc degree in Accounting and Finance in Infolink College. The study aimed at examining the challenge and prospect of presumptive tax in Hawassa city. I, Gashaw Afework would like to emphasize that your response are extremely valuable for the successful completion of this paper and I would immensely appreciate your response for all questions genuinely. I can assure you that the information you provide will be completely anonymous and will not be used for any other purpose it will use only for academic purpose.

Thank you very much in advance for your cooperation and for sacrificing your invaluable time.

Part One: Personal Data of respondent.

Number	Question
1	Which age group does you belongs to? <input type="checkbox"/> 25-40 Years <input type="checkbox"/> 41 – 55 years <input type="checkbox"/> More than 55 years
2	To which sex group do you belong? <input type="checkbox"/> Females <input type="checkbox"/> Males

3	<p>To which Educational level do you belong?</p> <p><input type="checkbox"/> Illiterate</p> <p><input type="checkbox"/> Primary school completed</p> <p><input type="checkbox"/> Secondary school completed</p> <p><input type="checkbox"/> certificate</p> <p><input type="checkbox"/> Diploma</p> <p><input type="checkbox"/> Bachelor's Degree</p>
4	<p>Which is the type of your business?</p> <p><input type="checkbox"/> Manufacturing</p> <p><input type="checkbox"/> Trade/Merchandising</p> <p><input type="checkbox"/> Service</p>
5	<p>How long has your business kept on in this category?</p> <p><input type="checkbox"/> < two year</p> <p><input type="checkbox"/> 2 – 5 years</p> <p><input type="checkbox"/> 5 -10 years</p> <p><input type="checkbox"/> >10 years</p>

1B: Types and Recent assessment presumptive tax

6. How do you prefer the different types of presumptive tax regimes?

- Based on turn over
- Based on expenditures
- Based on estimated assessment
- Standard assessment

7. The recent assessment has brought more taxpayers to the tax regime.

- Strongly Agree
- Agree
- Disagree
- Strongly Disagree

Part two: Attitude of tax payers toward presumptive tax

2A. Challenge and practice of presumptive tax assessment and collection

8. Taxpayers' awareness in understanding the tax laws

Yes

No

9. The tax laws in general are simple to understand, and comply

Yes

No

10. Taxpayers' willingness to pay tax bills

Yes

No

11. Presumptive tax assessment is subjective assessment

Yes

No

12. Assessment procedure which is not transparent

Yes

No

2B. please provides your level of agreement to the following statement about tax evasion, corruption, compliance and level of information about presumptive tax system

No.	Questions	Strongly Agree	Agree	Disagree	Strongly Disagree
1	The way presumptive tax is assessed and collected is vulnerable to tax evasion.				
2	Presumptive tax system increase tax evasion.				
3	Tax assessor behavior of corruption, embezzlement and fraud has impact on the amount of tax assessed.				
4	Presumptive tax increase corruption.				

5	Presumptive tax system brings a more equitable distribution of tax burden				
6	I am satisfied with the existing presumptive tax assessment and collection procedures.				
7	Presumptive tax increases tax compliance				
8	The tax system is complex and this made compliance difficult..				
9	The tax authority handle complains in timely and proper manner.				
10	Providing awareness about tax enhances voluntary compliance of Category C sampled taxpayers				
11	I have the basic knowledge about presumptive tax.				
12	The orientation given by the tax authority about presumptive tax assessment method is not enough.				
13	The tax authority provides sufficient written documentation explaining tax laws				
14	There is sufficient information provided through media outlets about presumptive tax.				
15	The tax authority has a manual which properly explain and describe how presumptive tax is assessed and collected.				
16	I have been given the necessary and regular training about presumptive tax assessment and collection procedure.				

Appendix B

INFOLINK COLLEGE

Department of Accounting and Finance

Msc. Accounting and Finance

Questionnaire prepared for Employee of Tabor Sub City Tax Department

The purpose of this questionnaire is to collect data for the thesis work in requirement for partial fulfillment of MSc degree in Accounting and Finance in Infolink College. The study aimed at examining the challenge and prospect of presumptive tax in Hawassa city. I, Gashaw Afework would like to emphasize that your response are extremely valuable for the successful completion of this paper and I would immensely appreciate your response for all questions genuinely. I can assure you that the information you provide will be completely anonymous and will not be used for any other purpose it will use only for academic purpose.

Thank you very much in advance for your cooperation and for sacrificing your invaluable time.

Part one: Background of Employees respondents

Number	Question
1	<p data-bbox="345 1171 902 1205">To which Educational level do you belong?</p> <p data-bbox="365 1222 812 1260"><input type="checkbox"/> Primary school completed</p> <p data-bbox="365 1276 842 1314"><input type="checkbox"/> Secondary school completed</p> <p data-bbox="365 1331 604 1369"><input type="checkbox"/> certificate</p> <p data-bbox="365 1386 587 1423"><input type="checkbox"/> Diploma</p> <p data-bbox="365 1440 714 1478"><input type="checkbox"/> Bachelor's Degree</p> <p data-bbox="365 1495 708 1533"><input type="checkbox"/> Master's or above</p>

2	<p>What is the tax authority objective in using presumptive tax?</p> <p><input type="checkbox"/> Increasing Tax revenue</p> <p><input type="checkbox"/> Bringing those in the informal sector to formal sector</p> <p><input type="checkbox"/> Increasing tax compliance</p> <p><input type="checkbox"/> Reduce tax evasion</p> <p><input type="checkbox"/> All</p>
3	<p>The main objective of presumptive tax is/are?</p> <p><input type="checkbox"/> To increase tax revenue</p> <p><input type="checkbox"/> To bring those in the informal sector to formal sector</p> <p><input type="checkbox"/> To increase tax compliance</p> <p><input type="checkbox"/> To decrease tax evasion</p> <p><input type="checkbox"/> All</p>
4	<p>Which type of presumptive tax assessment method do you prefer?</p> <p><input type="checkbox"/> assessment based on turnover</p> <p><input type="checkbox"/> assessment based on expenditure</p> <p><input type="checkbox"/> assessment based on estimation method</p> <p><input type="checkbox"/> standard assessment</p>

Part two: Attitude of tax payers toward presumptive tax

2A. Challenge and practice of presumptive tax assessment and collection

5. Taxpayers' awareness in understanding the tax laws

Yes No

6. The tax laws in general are simple to understand, and comply

Yes No

7. Taxpayers' willingness to pay tax bills

Yes No

8. Presumptive tax assessment is subjective assessment

Yes No

9. Assessment procedure which is not transparent

Yes

No

2B: Please provides your level of agreement to the following statement about tax evasion, corruption, compliance and level of information about presumptive tax system

No	Questions	Strongly Agree	Agree	Disagree	Strongly Disagree
1	.The way presumptive tax is assessed and collected is vulnerable to tax evasion.				
2	Presumptive tax system increase tax evasion.				
3	Tax assessor behavior of corruption, embezzlement and fraud has impact on the amount of tax assessed.				
4	Presumptive tax increase corruption.				
5	Presumptive tax increases tax compliance				
6	The tax system is complex and this made compliance difficult..				
7	The tax authority handle complains in timely and proper manner.				
8	Providing awareness about tax enhances voluntary compliance of Category C sampled taxpayers				
9	The orientation given by the tax authority about presumptive tax assessment method is not enough.				

10	The tax authority provides sufficient written documentation explaining tax laws				
11	There is sufficient information provided through media outlets about presumptive tax.				
12	The tax authority has a manual which properly explain and describe how presumptive tax is assessed and collected.				
13	I have been given the necessary and regular training about presumptive tax assessment and collection procedure.				
14	Presumptive tax system brings a more equitable distribution of tax burden				

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