

# **FACTORS THAT INFLUENCE RENTAL TAX PAYERS' COMPLIANCE WITH TAX SYSTEM: AN EMPIRICAL STUDY OF MEKELLE CITY, ETHIOPIA**

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## **ABSTRACT**

The primary goal of a revenue authority is collect the taxes and duties payable in accordance with the law and to do this in such manner that will sustain confidence in the tax system and its administration. The actions of taxpayers — whether due to ignorance, carelessness, recklessness, or deliberate evasion — as well as weaknesses in a tax administration mean that instances of failure to comply with the law are inevitable. Therefore, tax administration should have in place strategies and structures to ensure that non-compliance with tax law is kept to a minimum. Understanding the rental income taxpayers' attitude and their compliance with tax system is one of the most important factors for increasing the revenue of a government. However, the amount of tax that has to be collected from rental income is not sufficient enough to undertake developmental activities. A number of reasons may be attributable for low compliance and attitudinal differences of rental taxpayers such as lack of awareness and inability in capturing the tax laws and regulations. Hence, the purpose of this study is to identify and understand the major factors that influence attitudes of rental taxpayers and their compliance behavior with tax system. Moreover, it is also designed to establish a relationship between the attitudes of rental taxpayers and their tax compliance behaviors.

**Keywords:** Tax evasion, Attitude, compliance, rental tax payers and tax system.

## INTRODUCTION:

Tax is a contribution exacted by the state. It is a non penal but compulsory and unrequited transfer of resources from the private to the public sector, levied on the basis of predetermined criteria. The classical economic were in view that the only objective of taxation was to raise government revenue. But with the changes in circumstances and ideologies, the aim of taxes has also been changed. These days apart from the object of raising the public revenue, taxes are levied to affect consumption, production and distribution with a view to ensuring the social welfare through the economic development of a country. Taxation is central to the current economic development agenda. It provides a stable flow of revenue to finance development priorities, such as strengthening physical infrastructure, and is interwoven with numerous other policy areas, from good governance and formalizing the economy, to spurring growth. Fundamentally, tax policy shapes the environment in which international trade and investment take place. Thus, a core challenge for African countries is finding the optimal balance between a tax regime that is business and investment friendly, and one which can leverage enough revenue for public service delivery to enhance the attractiveness of the economy.

Rental income taxes are important source of revenue to government in both developing and developed countries. But the amount of revenue to be generated from these sources for its expenditure programme depends among other things, on the willingness of the individuals to comply with tax laws of a country. The failure to follow the tax provisions suggests that a rental taxpayer may be committing an act of noncompliance. Tax non-compliance occurs through failure to file tax return, misreporting income or misreporting allowable subtractions from taxable income or tax due (Kirchler, 2007).

Hence, the purpose of this research is to bring attitudes and these factors to light in relation to the rental taxpayers and show how they affect tax compliance. In explaining rental taxpayers' compliance behavior, that is, the reasons why they comply and do not comply, there were broadly two classes of theories – economic based theories, which emphasize incentives, and psychology- based theories which emphasize attitude (Shehata & Trivedi, 2005).

## STATEMENT OF THE PROBLEM:

Taxation in developing countries is a challenging topic and has attracted increasing attention in the last two decades. Many problems observed like poor administration, failing to collect sufficient tax revenues, tax structures where tax horizontal and vertical equity considerations are not integrated, lack of government and economic stability. In many developing countries it is observed that there is low capacity of tax administration to monitor compliance among rental taxpayers (Tanzi, 2000). Ethiopia, like any other developing countries, faces difficulty in raising revenue to the level required for the promotion of economic growth. Hence, the country has been experienced a consistent surplus of expenditure over revenue for sufficiently long period of time. To address this problem, the government introduced the imposition of tax (direct and indirect), among others; as major and important sources of public revenue. However, this imposition of tax couldn't still bring the required result due to a number of reasons such as lack of clear understanding about the tax system by the taxpayers, taxpayers don't comply with their tax obligation, hostility between the taxpayers and tax officials, negative attitude of taxpayer towards the tax system, that is, understating their taxable income by significant amount,... etc. For these reasons, the actual amount of tax couldn't be collected properly (Tadele, 2010).

Despite the fact that people need to pay taxes based on rationales of vertical and horizontal equities, it is not always the case that tax systems are comprehensible and transparent for rental tax payers especially for those who are less literate individuals. Tax systems are usually not elaborated properly with the society. Consequently, the rental taxpayers complain that the tax assessment method is based on subjective estimation as a result of which they are frequently subjected to over-taxation. The extent of the impact of attitudes and attitudinal change on tax compliance behavior was not well understood and studies in this area have not been carried out in Mekelle city. Therefore, addressing this attitudinal or knowledge gap among the rental taxpayers is the primary purpose of this study. It is for this reason that this study attempted to find out how the factors that influence rental tax payers' compliance with tax system in Mekelle city.

## OBJECTIVE OF THE STUDY:

The overall objective of this study was to know the factors that influence rental tax payers' and their degree or level of compliance with the tax system in mekelle city.

## METHODOLOGY:

### SAMPLE SIZE AND METHOD:

The total population of this research is the individual rental tax payers of Mekelle city. Out of the total rental tax payers in Mekelle city, only three administrative areas (Kebeles) from a total of seven kebeles were selected by taking in to account their densities or availabilities. These kebeles are with highly densely populated rental tax payers which is representative of the entire population. Since this research is a qualitative type of research, purposive sampling technique was used which helps to acquire an in-depth data about the research. Therefore, taking in to account the previous research studies and judgments, on trend analysis, the researcher had drawn 140 sample size out of 5,480 total population which constitutes 37 rental tax payers from Hadnet, 41 from Hawelti and remaining 62 from Kedamay weyane.

### DATA SOURCES AND COLLECTION INSTRUMENTS:

The required data for this study were collected both from primary and secondary data. The primary data were collected through structured questionnaire. The questionnaire was consisting of close-ended and open-ended questions to understand rental taxpayers' general ideas about the tax system. The secondary data were also gathered from the city's tax authority office manuals, documents and reports. These data include the number of individual rental tax payers available in each of the local administrative areas or kebeles and some important annual reports.

### METHODS OF DATA ANALYSIS:

The data were analyzed using the descriptive statistics like mean and standard deviations and statistical package for social science (SPSS) software version 16.1 was also used to summarize and present it in tabular form representing proportions and percentages.

### DATA ANALYSIS AND INTERPRETATION:

#### PERSONAL DATA OF RESPONDENTS:

When the respondents were asked about their personal data such as sex, age, educational qualifications and renting experience, then they provided the following information as follows:

**Table - 5.1.1: Sex of respondents**

Sex	Area (kebele) of the respondents			Total	Percent (%)
	Hadnet	Hawelti	Kedamay weyane		
Male	14	23	38	75	62.5
Female	18	12	15	45	37.5
<b>Total</b>	<b>32</b>	<b>35</b>	<b>53</b>	<b>120</b>	<b>100</b>

Source: (Questionnaire, 2012).

The above table shows that the numbers of male respondents were 75 which represent 62.5% of the total respondents and the numbers of female respondents were 45 which accounts to 37.5% of the total respondents. By considering each of the local administrative areas (kebeles) separately, it can be understood that in Hadnet kebele, 14 of the respondents were male and 18 were female indicating that majority of rental tax payers in that kebele are females and minority are males. However, unlike that of Hadnet, in Hawelti kebele, the number of male respondents was greater than female respondents where there were 23 male respondents and 12 female respondents. Similarly, in Kedamay weyane, the number of male respondents was greater than female respondents.

**Table -5.1.2: Age of respondents**

Age ( years)	Area (kebele) of the respondents			Total	Percent (%)
	Hadnet	Hawelti	Kedamay weyane		
From 25 to 35	4	6	5	15	12.50
From 35 to 45	11	13	13	37	30.83
From 45 to 60	15	12	25	52	43.33
Above 60	2	4	10	16	13.34
<b>Total</b>	<b>32</b>	<b>35</b>	<b>53</b>	<b>120</b>	<b>100</b>

Source: (Questionnaire, 2012).

Table 5.1.2 shows that the number of respondents whose age in between 25 to 35 years were 15 which accounts 12.5% of the total respondents and those whose age in between 35 to 45 years were 37 which represent 30.83% of the total respondents. Moreover, there were 52 rental tax payers were in between 45 to 60 years and 16 and above 60 years age group people were 16; each of them accounting 43.33% and 13.34% of the total respondents respectively. Therefore, from the above table, one can easily understand that the majority of the respondents were in between 45 to 60 years, indicating that most rental tax payers were old and the minority age group of the respondents were in between 25 to 35 years.

On the other hand, when the age of respondents were observed in each of the kebeles independently, it can be analyzed that in Hadnet kebele and Kedamay weyane kebele, the majority of the respondents were in between 45 to 60 years and minority of the respondents were above 60 years for Hadnet, but in between 25 to 35 years for Kedamay weyane. However, for Hawelti kebele, the majority age group of the respondents was in between 35 to 45 years which shows that rental tax payers in that kebele were in the productive ages and the minority age group was above 60 years.

**Table - 5.1.3: Educational qualification**

Educational qualification	Area (kebele) of the respondents			Total	Percent (%)
	Hadnet	Hawelti	Kedamay weyane		
Elementary school	14	11	16	41	34.17
Secondary school	8	10	15	33	27.50
Certificate	7	9	13	29	24.16
Diploma	3	5	9	17	14.17
<b>Total</b>	<b>32</b>	<b>35</b>	<b>53</b>	<b>120</b>	<b>100</b>

Source: (Questionnaire, 2012).

Concerning educational qualification, the above table illustrates that 41 respondents were completed elementary school and 33 were secondary school; each of them accounting 34.17% and 27.5% of the total respondents respectively. On the other hand, the numbers of respondents who were certificate and diploma holders were 29 and 17; each of them representing 24.16% and 14.17% of the total respondents respectively. Therefore, this indicates that the majority of the rental tax payers were not well educated. Consequently, they may lack knowledge about how their taxable income is computed.

In addition to the above analysis, when the educational qualification of the respondents were observed in each of the administrative areas (kebeles) separately, then it can be observed that in each of the kebeles the majority of the respondents were elementary school complete and minority were diploma holders. Therefore, this poor educational qualification of the respondents necessitates the government to provide tax training on a regular basis in order to develop their awareness.

**Table - 5.1.4: Renting Experience**

Renting experience	Area (kebele) of the respondents			Total	Percent (%)
	Hadnet	Hawelti	Kedamay weyane		
Below 5 years	12	15	13	40	33.33
From 5 to 10 years	8	9	17	34	28.34
From 10 to 15 years	7	7	14	28	23.33
From 15 to 20 years	5	4	9	18	15
<b>Total</b>	<b>32</b>	<b>35</b>	<b>53</b>	<b>120</b>	<b>100</b>

Source: (Questionnaire, 2012).

With respect to the renting experience of the respondents, the above table shows that 40 respondents had the experience of below 5 years which account 33.33% of the total respondents and 34 respondents had the experience of 5 to 10 years which represent 28.34% of the total respondents. Moreover, there were 28 respondents whose renting experience was between 10 to 15 years and 18 respondents were in between 15 to 20 years; each of which constitutes 23.33% and 15% of the total respondents respectively.

Besides to the above analysis, when the renting experience of the respondents were illustrated in each of the administrative areas (kebeles), it is easily observed that in Hadnet and Hawelti, the majority of the respondents renting experience were below 5 years and minority respondents were with experience of 15 to 20 years. However, in Kedamay weyane majority of the respondents had an experience in between 5 to 10 years and minority of them had between 15 to 20 years. Therefore, it can be said that the rental tax payers had relatively average experience of renting their buildings.

## 5.2. TAX COMPLIANCE STATUS:

In wider definition, tax compliance should be defined as taxpayers' ability and willingness to comply with tax laws which are determined by ethics, legal environment and other situational factors at a particular time and place. Similarly, tax compliance is also defined by several tax authorities as the ability and willingness of taxpayers to comply with tax laws, declare the correct income in each year and pays the right amount of taxes on time. According to the income tax proclamation No 286/2002, the compliance requirements of rental tax payers include keeping up to date books of accounts, determining the taxable income according to the stipulated rules and regulations, accurate determination of tax liability, filing of returns on income by prescribed date, paying of tax due by prescribed date, payments of fines and penalties for overdue taxes and allowing of audit by the tax collectors if deemed necessary. Therefore, respondents were asked to indicate the extent to which they agreed or disagreed with the factors that influence their compliance with rental tax law requirements. This was on a five point likert scale, where strongly disagree = (1); Disagree = (2); Uncertain = (3); Agree = (4); Strongly Agree = (5). On the scale 1 to 2, it is assumed as noncompliance; as from 4 to 5, is taken as compliance; as 3 is between compliance and noncompliance, and the results are summarized here below in the table as follows:

**Table – 5.2.1: Factors that Influence Rental Tax Payers' Compliance with Tax System**

No	Statements	Mean	Std. deviation
1	Level of actual income	3.6904	0.5792
2	Fair tax rates	4.6231	0.9800
3	Fairness of tax system	3.7852	0.5014
4	Tax fines and penalties	4.0158	0.2810
5	Attitudes towards tax system	4.2911	0.7315
6	Personal, social and national norms	2.983 1	0.3601
7	High degree of being detected for tax non payment	4.6603	0.6532
8	Government image in achieving tax objectives	3.8100	0.4225
9	Easy understanding of tax laws	4.7232	0.7215
10	Aggressive enforcement efforts by tax officials	1.9587	0.4182

**Source:** (Questionnaire, 2012).

According to the above table, most of the respondents disagreed, with mean value of approximately 2 and standard deviation of insignificant value, that aggressive enforcement effort by tax official results in increasing the tax compliance. This means that if the tax officials were aggressively enforced the rental tax payers to make them pay tax, then this discourage them to comply with the tax system. Most respondents were also indifferent, with mean value of approximately 3 and insignificant standard deviation, with the statement that personal, social and national norms affect tax compliance behavior. This means that it can facilitate either tax compliance or tax non compliance.

Respondents also agreed, with mean value of approximately 4 and insignificant standard deviation, that level of actual income, fairness of the tax system; payment of tax fines and penalties for those who don't pay tax on time; attitudes towards the tax system and government image in achieving its objectives facilitate the rental taxpayers' compliance. These indicate that if the level of actual income declines, then this may discourage tax compliance and vice versa. Moreover, if the attitude of rental taxpayers is positive and if they perceive the tax system fairly, then tax compliance increase. Besides to that, for those who are not paying their tax obligation, fines and penalties must be imposed. The image of government by the rental tax payers is also important. This means that if the government is perceived to be a developmental, then this increases compliance and vice versa. Most respondents also strongly agreed, with mean value of approximately 5 and insignificant value of standard deviation, that tax rates, high degree of detection for non payments and easily understandability of the tax laws are important factors for facilitating tax compliances. This means that if the tax rates are fair, then rental taxpayers will be more likely to comply with the tax laws and regulations and vice versa. Besides this, if the degree of detecting nonpayment of tax is high, then this also increases compliance. Tax compliance is also directly related with the degree of understandability of tax laws. The easier the tax laws to be understood, the greater the degree of tax compliance and vice versa.

To sum up, respondents replied that aggressive tax enforcement efforts by tax officials have negative effects on rental tax payers' compliance behavior. However, they also replied that factors such as fines and penalties, level of actual income, fairness of tax rates and tax system; attitudes towards tax system, high degree of detection for tax nonpayment; government image in achieving tax objectives and easy understanding of tax laws have a positive effect on the rental tax payers' compliance behavior.

**Table – 5.2.2: Tax Compliance Status**

No	Questions	Yes	No
1	Does non compliance of others' have an effect on your compliance?	57%	43%
2	Rental tax payers commit evasion if they get the opportunities?	37.5%	62.5%

**Source:** (Questionnaire, 2012).

Table 5.2.2 shows that the respondents who replied the non compliance of other tax payers have an effect on their compliance were 57% and those who replied that it doesn't have any effect were 43%. This shows that majority of the respondents were affected whenever others were not complying, i.e. committing tax evasion. This means that if others are not paying tax, then this will affect the compliance behavior of honest rental tax payers. Respondents were also asked whether rental tax payers commit tax evasion whenever they get the opportunities and replied that 37.5% "Yes" and 62.5% "No". This indicates that majority of the respondents comply with their tax law even though they get the opportunity of evading. However, there are still some rental tax payers who commit evasion if they get the opportunities.

### 5.3: EVALUATION OF TAX AUTHORITY PERFORMANCE:

Evaluating the performance of tax authorities from the perspective of rental tax payers is important in analyzing their effectiveness. Therefore, respondents were also asked to evaluate them on different bases. The following table analyzes the reply of respondents:

**Table – 5.3.1: Evaluation of Tax Authority Performance**

Parameters	Excellent (%)	Very good (%)	Good (%)	Poor (%)
Tax law enforcements	12	25.5	36.5	26
Tax collection efficiency	13.5	31.25	34.5	20.75
Creation of awareness	6	17.5	32	50.5
Service delivery to the public	10	27.5	30	32.5

**Source:** (Questionnaire, 2012).

Regarding to table 5.3.1, majority of the respondents ranked the parameters from excellent to poor except creation of awareness. With respect to tax law enforcement, 12% replied excellent, 25.5% replied very good, 36.5% replied good and 26% replied poor respectively. This shows that majority of the



respondents replied the tax law enforcement capacity of the tax authority was good. However, still there were respondents who replied it is poor. Therefore, this indicates that the tax authority is not very much effectiveness in the tax law enforcements. Respondents were also asked concerning the tax collection efficiency of the tax authority and replied that 13.5% excellent, 31.25% very good, 34.5% good and 20.75% poor. This demonstrates that the tax collection efficiency of the tax authority is relatively better and more efficient than its tax law enforcement.

Concerning the creation of awareness of the tax authority, even a single respondent didn't reply that it is excellent (0%). However, 17.5% replied very good, 32% good and remaining 50.5% poor. Therefore, this shows that half of the respondents agreed that the tax authority is not doing to the maximum of their capacity in order to create awareness to the rental tax payers about the tax payment. What is the purpose of paying tax and where it is spent, still the rental tax payers were not well aware of that. Consequently, they are resulting in less compliance with the tax laws. Concerning the service delivery to the public, 10% of the respondents replied that it is excellent, 27.5% replied very good, 30% replied good and 32.5% replied poor. This shows that majority of the respondents are saying that service provision is good. However, still there were many respondents who replied that it is poor. Hence, the tax authority's capacity of delivering service to the public is not yet sufficient enough.

### 5.3.2: POSSIBLE MEASURES TO BE UNDERTAKEN TO IMPROVE TAX AUTHORITY PERFORMANCES:

Respondents were also asked to respond on the possible measurements that must be undertaken in order to improve the performance of the tax authority. Consequently, their responses are summarized in the following table as given below:

**Table – 5.3.2: Possible measures**

No	Possible measurements	Mean	Std. deviation
1	Strengthening legal enforcements and penalties	3.3750	0.4861
2	Improving relationships with the public	4.6250	0.6020
3	Creating awareness through training and education	4.8750	0.3351
4	Providing information about service provisions	4.6730	0.2763
5	Reducing tax rate and making collection procedures simple	4.8841	0.4299

**Source:** (Questionnaire, 2012).

By observing the above table, it can be easily understand that with the exception of strengthening legal enforcements and penalties, respondents agreed that all other possible measurements should be undertaken in order to improve the tax collection effectiveness of the tax authority. This supports the analysis made in table 3.15 where majority of the respondents were not satisfied about the effectiveness of the tax authority. With respect to the strengthening of legal enforcement and penalties, majority of the respondents become indifferent, with mean value of 3.3750 and standard deviation of insignificant value, whether to undertake it as a possible measure of improving the tax collection effectiveness of the tax authority. However, majority of the respondents were strongly agreed that, with mean value of > 4.5 and standard deviation of insignificant value, the remaining possible measurements such as improving relationships with the public, creating awareness through training and education, providing information about service provisions and reducing tax rates and making collection procedures simple and transparent should be undertaken so as to enhance the performance of tax authority in collecting tax. Especially, reducing the tax rate and introducing simple and transparent tax collection procedures was what the respondents strongly agreed as best possible measurement. Therefore, this clearly indicates that rental tax payers are not well satisfied with performances of the tax authority.

Besides to the above close ended questions, respondents were also provided with opportunity to fill the open ended question and state whatever they think is important and what were not incorporated by the researcher. Accordingly, they responded general comments and overviews on the tax system. The responses were many but, in one way or another they were similar with what were discussed in the close ended once. The important points were summarized in the following points.

One of the points that respondents commented was about tax laws and regulations stating that it was difficult to understand. This means that the rules and regulations pertaining tax system was not transparent enough that every rental tax payer could understand without requesting support from other individuals. The other point is that the tax system was unfair. Although the principle of tax stated that tax payment should be based on the ability of the rental tax payer, respondents said that it is beyond what they can pay. Similarly, they also stated that individuals who rent similar buildings are exposed to different tax rates. Moreover, they also commented that even there were persons who don't pay tax properly to the government.

In addition to the above points, respondents also suggested that tax authority were not conducting continuous training which focus on awareness creation and enhance the smooth relationships with rental tax payers. Moreover, they also commented on the service provision of the government.

According to the respondents, rental tax payers demand different infrastructural facilities in return to their contribution or payment of tax although the benefit is indirectly. If the government is not providing sufficient services, then rental tax payers may perceive that their money is not used for the intended purposes. Consequently, their willingness and motivation to pay tax in full and on timely basis may be influenced.

## CONCLUSION:

Based on the results obtained from the analysis and interpretation part of the study, the following conclusions are drawn:

The study indicated that there were some dishonest rental tax payers. According to the information obtained from the respondents, it can be observed that some rental tax payers were intentionally understating their taxable income by substantial amounts. Even there are some individually who entirely don't report their taxable income to the concerned body. Consequently, this result in affecting the attitudes and compliance behavior of genuine rental tax payers towards the tax system. In addition to the above, the study also disclosed that with the exception of minority of the rental tax payers who hold certificate and diploma, majority of them were with an educational background of elementary and high school completed. Hence, it can be concluded that rental tax payers lack knowledge of easily understanding the laws and regulations of the tax system and how their taxable income is computed. With respect to providing tax awareness training, it is the duty and responsibility of the tax authority to conduct a series training to the rental tax payers, especially for these whose educational background was elementary school and secondary school completed. However, the research indicated that majority of the respondents didn't attain the tax training sessions. This may be either as a result of poor control and follow up mechanism of the tax authority or due to lack of awareness of the rental tax payers. Therefore, it can be concluded that still many respondents are not attending or participating in the tax training session.

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