

**TAX EVASION AND AVOIDANCE OF SMALL AND MEDIUM SCALE  
ENTERPRISES (SMES): A STUDY OF SELECTED ENTERPRISES IN KUMASI**

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## DECLARATION

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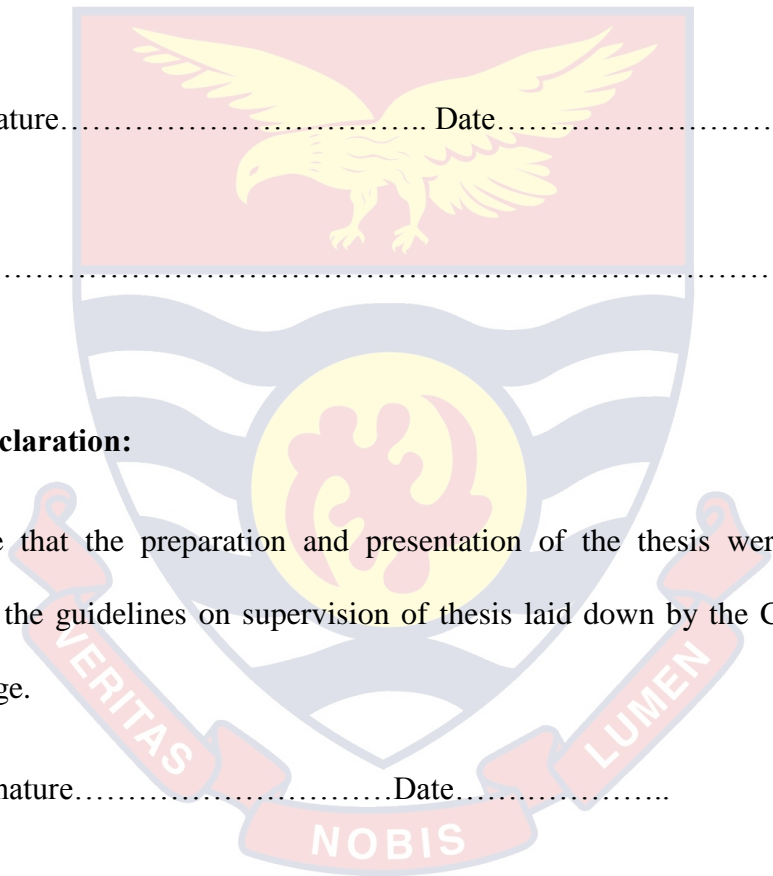
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## ABSTRACT

In Ghana, the government mobilize huge amount of money from taxing the informal sector. Yet, Small and Medium Enterprises (SMEs) are noted as tax evaders and avoiders. This study therefore sought to assess the factors that have contributed to tax evasion and avoidance among owners of SMEs in Kumasi. Questionnaires were used to collect data from 150 owners of SMEs in Subin, Suame and Bantama in the Kumasi Metropolis through face-to-face interview. Also, 10 tax officials from the GRA were interviewed using interview guide. The results from this study indicated that tax evasion and avoidance among the owners of SMEs in Kumasi was attributed to infrequent public education by the tax officials, illiteracy of taxpayers on taxation, high penalty rate, low returns, lack of tax incentives, and lack of enforcement of tax laws, lack of transparency and accountability and corruption. The correlation results indicated a significant relationship between high penalty rate on taxes and the influence on the decisions of taxpayers to pay their income taxes. The positive correlation significance of 0.173 indicated that the higher the penalty rate, the more owners of SMEs were committed to honor their tax obligation that also reduces tax evasion. It was also found that owners of SMEs evade tax through non-declaration of their income to the tax authorities and failure to pay income tax on the number of business they owned. The strategies used by tax officials from the GRA to minimize tax evasion and avoidance included the introductions of tax amnesty, field visits, tax court, tax education, tax incentives and the use of animators. It is recommended in this study that the existing strategies for minimizing tax evasion and avoidance should be strengthened through capacity building of tax officials from the GRA.

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## DEDICATION

To my family for their constant love and support and all my dedicated lecturers, who made this awesome journey with me and never failed to show me the way. I also dedicate this work to all MSc. Accounting and Finance students.



## TABLE OF CONTENTS

Declaration

Abstract

Acknowledgement

Dedication

### CHAPTER ONE

#### INTRODUCTION

1.1 Research Background.....	1
1.2 Statement of Research Problem.....	3
1.3 Research Objectives.....	5
1.4 Research Questions.....	6
1.5 Scope of the Study.....	6
1.6 Justification of the Study.....	7
1.7 Limitations of the Study.....	7
1.8 Methodology in Brief.....	8
1.9 Organisation of the Study.....	9

### CHAPTER TWO

#### LITERATURE REVIEW

2.1 Introduction.....	10
2.2 Concepts and Definitions.....	10
2.2.1 Taxation.....	10

2.2.2 Tax Evasion.....	11
2.2.3 Tax Avoidance.....	12
2.2.4 Informal Sector: Small Scale Enterprises (SME).....	13
2.3 Theoretical Reviews.....	16
2.3.1 Theory of Taxation.....	16
2.3.2 A-S Theory of Tax Evasion.....	17
2.3.3 Development in the Theory of SMEs.....	19
2.4 Implications for Taxing the SMES.....	22
2.4.1 Revenue and Equity Implications.....	22
2.4.2 Implications for the Growth and Development of the SMES.....	23
2.4.3 Governance Implications.....	24
2.5 Taxation and the Tax Act of Ghana.....	25
2.5.1 History of Taxation.....	25
2.5.2 Income Tax Act.....	28
2.6 Ways Tax Is Evaded and Avoided.....	30
2.6.1 Mode of Tax Avoidance by the Informal Sector.....	30
2.6.2 Mode of Tax Evasion.....	31
2.7 Review of Studies.....	32
2.8 Mechanisms to Reduce Tax Evasion.....	34
2.8.1 Instituting Effective Punishment to Tax Defaults.....	34
2.8.2 Ceding Control to Local Government.....	35
2.8.3 Introduction of the Tax Stamp.....	36
2.8.4 Standard Assessment.....	37
2.8.5 Presumptive Taxes.....	37
2.8.6 Re-Organizing Tax Administration: Segmental Organization	

and the Block Management System (BMS).....	38
2.8.8 Associational taxation: Identifiable Grouping Taxation (IGT).....	39
2.8.9 Encouraging Compliance through Transparency, Services and Engagement.....	40
2.8.10 Introduction of the Tax Amnesty System.....	40
2.9 Conceptual Framework.....	41

### **CHAPTER THREE**

#### **METHODOLOGY AND ORGANIZATIONAL PROFILE**

3.1 Introduction.....	46
3.2 Research Design.....	46
3.2.1 Mixed method research.....	46
3.2.2 Survey Research Approach.....	47
3.3 Population of the Study.....	47
3.4 Sampling Procedures.....	48
3.4.1 Sample Frame.....	48
3.4.2 Sample Size and Sampling Methods.....	48
3.5 Source of Data.....	49
3.6 Data collection tools and procedures.....	49
3.6.1 Questionnaires.....	49
3.6.2 Observations.....	50
3.6.3 Interview Guide.....	50
3.6.4 Mode of Data Collection.....	50
3.7 Validity and Reliability.....	51
3.8 Research Ethics.....	52
3.9 Variables in the Study.....	52



3.10 Method of data analysis and reporting.....	54
3.10.1 Quantitative analysis.....	54
3.10.2 Qualitative Analyses.....	55
3.11 Study area.....	55

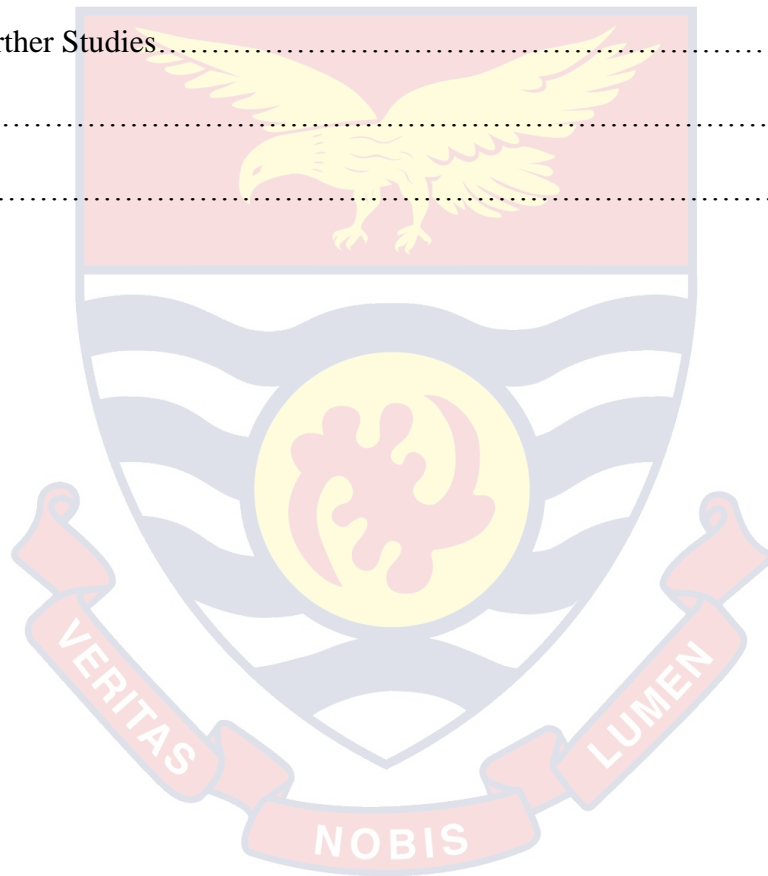
## **CHAPTER FOUR**

### **DATA PRESENTATION, ANALYSIS AND DISCUSSION OF FINDINGS**

4.1 Introduction.....	57
4.2 Demographic Characteristics of Owners of SMEs in Kumasi.....	57
4.3 Factors that Influence Individual Decisions to evade income tax in Kumasi.	63
4.3.1 Lack of Enforcement of Laws.....	64
4.3.2 Low Returns from SME Activities.....	65
4.3.3 High Tax Rate.....	66
4.3.4 Lack of Transparency and Accountability.....	67
4.3.5 Illiteracy of Owners of SMEs on Tax.....	68
4.3.6 Infrequent Education on Income Tax.....	68
4.3.7 Low Tax Morale.....	69
4.3.8 Level of Corruption.....	70
4.3.9 Lack of Adequate Tax Incentives.....	70
4.3.10 Non/Low Provisional of Social Services.....	70
4.3.11 High Penalty Rate.....	71
4.3.12 Poor Relationship between Taxpayers and Tax Collectors.....	72
4.3.13 Factors Contributing to Tax Evasion.....	76
4.4 Analysis of How Owners of SMEs Evade and Avoid the Payment Income Tax.....	76

4.4.1 Status of Payment of Income Tax by Owners of SMEs in Kumasi.	76
4.4.2 How the Informal Sector Evade Income Tax.....	77
4.4.3 How the Informal Sector Avoid the Payment of Income Tax.....	80
4.5 Mechanism for Reducing Tax Evasion and Avoidance in Kumasi.....	86
4.5.1 Introduction of Tax Amnesty.....	87
4.5.2 Introduction of Tax Stamp.....	87
4.5.3 Field Visit/Inspection.....	87
4.5.4 Introduction of Tax Courts and other Punishment.....	89
4.5.5 Introduction of Segregation Approach.....	89
4.5.6 The Use of Animators.....	90
4.5.7 Rejection of Fraud Software used by Owners of SMEs.....	90
4.5.8 Closing Down of Shops.....	91
4.6 Summary of Results.....	91
<b>CHAPTER FIVE</b>	
<b>SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS</b>	
5.1 Introduction.....	93
5.2 Summary of Major Findings.....	93
5.2.1 Factors that have Influenced Decisions of Owners of SMEs to Evade and Avoid the Payment of Income Tax.....	93
5.2.2 Ways Owners of SMEs Evade and Avoid the Payment of Income Tax.....	94
5.2.3 Success of Mechanism used by GRA to reduce Tax Evasion and Avoidance.....	96
5.3 Recommendation for Effective Income Tax Collection from the	

Informal Sector.....	96
5.3.1 Addressing the attitude of Evading and Avoiding Income Tax:.....	96
5.3.2 Strengthening of Field Inspection.....	97
5.3.3 Building the Capacity of Staff.....	97
5.3.4 Strengthen Review of Tax Law.....	98
5.3.5 Provision of Incentives to Staff.....	98
5.4 Conclusion.....	98
5.5 Areas for Further Studies.....	99
References.....	100
Appendix.....	107



## LIST OF TABLES

Table 3.1: Variables for objective two.....	32
Table 4.1: Demographic Characteristics of Owners of SMEs in Kumasi.....	58
Table 4.2: Response from Owners of SMEs on Factors that can lead to Income Tax Evasion.....	64
Table 4.3: Correlation Analysis of Factors Influencing Owners of SMEs in Kumasi towards Tax Evasion.....	74
Table 4.4: Number of times Owners of SMESs paid their Income Tax last Year.....	76
Table 4.5: Ways the Informal Sector Evade Income Tax (Responses from Tax Officers)..	77
Table 4.6: Response from Owners of SMEs on Non-Declaration of Income to Tax Officials Last Year.....	78
Table 4.7: Number of Business and Payment of Income Tax.....	80
Table 4.8: Ways the Informal Sector Avoid Income Tax (Responses from Tax Officers)..	82
Table 4.9: Assessment of Mechanisms for Addressing Tax Evasion and Avoidance.....	88

## LIST OF FIGURES

Figure 2.1: Conceptual Framework for the Study.....	42
Figure 3.1: Map of Kumasi metropolis.....	56
Figure 4.1: Records of Purchase invoice.....	81
Figure 4.2: Response on Engagement of Consultants in the Preparation of Statement of Accounts.....	83
Figure 4.3: Source of Capital to the Establishment and Running of SMEs.....	85



## CHAPTER ONE

### INTRODUCTION

#### 1.1 Research Background

It is stated that the growth and development in a country depend on the ability of the institutions to explore and raise more revenues to implement programs and projects to enhance the wellbeing of its citizens. The government of a country mobilize its resources through the taxes which is collected from the citizens (Crawford, 2004). Other sources of revenue to a government include the grants from donor agencies. In the Organization for Economic Co-operation and Development (OECD) countries, taxation contributes about 36 percent to gross national income. In Africa, taxation contributes about 23 percent. It also contributes about 18 percent to national income in Latin America (German Technical Cooperation, GTZ, 2006). This underscores the relevance of taxation in national development. It is therefore the most effective means of raising revenue (Clara and Ampratwum, 2011). However, this depend efficient tax system and institutional capacity to check and collect the taxes (Gberegbe, 2007). In Ghana, people are taxed directly and indirectly. The direct tax includes capital gain tax, corporate tax, and income tax, transfer tax Indirect tax includes sales tax value added tax and goods and services tax (Crawford, 2004).

The informal sector, more especially, the Small and Medium Scale Enterprises (SMEs) is the major contributor to taxation in Ghana (Crawford, 2004). They also help in reducing the huge budget deficits in countries (Farrell *et al.*, 2000). SMEs contribute to Gross Domestic Product (GDP), employs majority of the population

and contribute to poverty reduction in Ghana. The sector contributes about 70 percent to GDP and over 80 percent to employment (Clara and Ampratwum, 2011). Hence, through an effective tax administration system, SMEs will still continue to contribute greatly to the national revenue generation. Yet, SMEs are noted as tax evaders in Ghana (Clara and Ampratwum, 2011). This is due to the nature and lack of control of the sector by the government agencies. Farrell *et al.*, (2000) attributed the problem of tax evasion to the fact that, SMEs is not recorded in the certified figures such as the Gross Domestic Product and or the general financial reports of the country. Therefore, they escape tax on obligations.

Notwithstanding this, most developing countries are confronted with social, political and administrative difficulties in establishing a sound public finance system which has contributed to tax evasion (GTZ, 2006). The SME behaves in two different ways in the payment of taxes. They rather escape from paying the tax (tax evasion) or they take advantage of the tax code and participate in activities that are lawful but run counter to the reason of the tax law (Ronan, 2007). In Ghana, most of the policy interventions by government agencies such as the Metropolitan, Municipal, and District assemblies (MMDs) have had effects on the operations of the SMEs. A practical example is the decongestion practices carried out by the task force from the Kumasi Metropolitan Assembly. This intervention makes most of them escape from the payment of taxes (Clara and Ampratwum, 2011).



Tax evasion has caused great loss to developing countries (GTZ, 2006). A study conducted by GTZ (2006) indicates that an amount of US\$854 billion was a loss accrued to African countries over the period 1970-2008 as a result of tax evasion and avoidance. The revenue lost for not taxing the SMEs globally amounts to 35-55 percent of the total tax revenue (Mbilinyi and Mutalemwa, 2010). According to estimates reported by Baker (2005), African countries have lost \$858.6 billion to \$1.06 trillion as a result of tax evasion and avoidance from the SMEs in 2006. In Ghana, it is recorded that an amount more than \$22.4 billion loss is accrued every years as a result of the incidence of tax evasion and avoidance (Raymond, 2008).

Thus, tax evasion and avoidance have received attention in recent times (Mbilinyi and Mutalemwa, 2010; GTZ, 2006). To strengthen domestic resource mobilisation, developing countries expand the tax base and strengthening revenue administration. To make certain the honesty of the tax system, it therefore becomes imperative to recognise and close up gaps in the tax system by offering chances for tax evasion and avoidance, and to uphold strong enforcement. The study investigates the factors that influence the behaviour of tax payers to avoid or evade the payment of income tax in Kumasi.

## **1.2 Statement of Research Problem**

The activity of the SMEs is not recorded in the official statistics in Ghana and as such the opportunity for the SMEs to evade tax payment is very high (Clara and



Ampratwum, 2011). The question of how to tax the SMEs has become a challenge facing governments in Ghana. Though, SMEs form noteworthy and increasing percentage of economic activities in the Ghana, up till now they pay small of income taxes (Joshi & Aryee, 2009). It is predictable that, concerning economic activities, about 80 percent is done by the self-employed sector mostly operating in the SMEs in Ghana. Out of the number less than 30 percent pay taxes (Clara and Ampratwum, 2011).

According to Fjeldstad (2005) revenue collection administrations are often inefficient and large amounts of revenue are left uncollected by the tax collectors. The ability of tax payers to escape from paying levies as part of their civil responsibilities has resulted in low revenue performance of government agencies in Ghana (Clara and Ampratwum, 2011). This therefore becomes necessary to investigate into the reasons why the SMEs continuous to evade or avoid tax despite the efforts made by governments over the years.

There have been measures to strengthen tax collection in Ghana since 1983 such as Group or Association Tax and later, the use of Tax Stamp which has its individual challenges. The Ghana Revenue Authority (GRA) was established to re-organize the institutional structure for tax collection (Clara and Ampratwum, 2011). The issue is that, the GRA had not been able to extract income tax from the broader nation and it has constantly relying excessively on effortlessly mobilized taxes, instead of direct taxes (Clara and Ampratwum, 2011). Ghana established the

Large Tax Payer Unit (LTPU) in 2004 with the aim of increasing revenue from taxes.

These interventions steadily increased revenue by about 86 percent between 2003 and 2005 (GTZ, 2006). However, government policies rely on a huge degree on indirect taxes that include value-added taxes (VAT) at the expense of looking into direct taxes of the SMEs which forms the majority of businesses in Ghana thus making the proportion of total tax revenue from the sector still low (Siehi, 2010). Moreover, it is clear that there had been ineffective tangible policy of the nation on how to effectively identify and control the operations and activities of the large people in the SMEs in order to speed up the collection of income taxes (ISSER, 2003). Also, there is lack of adequate and accurate data on taxable items and inadequate requisite expertise or qualification for effective tax collection (Botchie, 2000; NDPC, 2009). These contribute to tax evasion and avoidance of the SMEs. The study seeks to explore the factors that influence the decision of SMEs to evade taxes and to propose measures to strengthen the capacity of tax institutions to improve their tax collection systems.

### **1.3 Research Objectives**

The principal aim of this study is to examine the factors that have influenced the behavior of owners of SMEs towards tax evasion and avoidance in Kumasi. The specific objectives of this study are stated below.

1. To examine how owners of SMEs evade or avoid payment of income taxes in Kumasi.

2. To analyse the factors that influence individual decisions to evade income tax in the Kumasi.
3. To examine the mechanisms used by the GRA in reducing the incidence of income tax avoidance and evasion in the Kumasi Metropolis.

#### **1.4 Research Questions**

The research questions to be answered include the following.

1. How do the owners of SMEs evade or avoid payment of income tax in the Kumasi?
2. What factors influence individual decisions to evade income tax in the Kumasi Metropolis?
3. What have been the mechanisms GRA has adopted reduce income tax evasion and avoidance of among owners of SMEs in the Kumasi?

#### **1.5 Scope of the Study**

The study is focused on the owners of SMEs in the Kumasi. The Kumasi Metropolis is divided into ten sub-metros. The study focused on Suame and Bantama sub-metros since they contain the largest SMEs in the Kumasi Metropolis. Contextually, the study focused on the factors that lead to income tax evasion and avoidance. The SME is defined in the study as those engaged in activities such as the fitting shops, leather works, seamstress and tailoring, commerce, food processing and wood product industry.

### **1.6 Justification of the Study**

The SMEs in Ghana has been identified as a potential for domestic revenue mobilisation. The sector contributes 70 percent to Ghana's GDP and over 80 percent to employment (Clara and Ampratwum, 2011). Therefore research that focuses on the SMEs would assist decision makers to follow the contributions from the sector to national development. Again, the SMEs are identified as the sector that escapes the regulation of government by evading and avoiding the payment of income tax. Therefore, any study that tries to find out what factors contributes to tax evasion and avoidance of the SMEs is definitely justifiable.

Findings from this study could provide adequate sources of data on the activities of SMEs. This study would form secondary data for those that may do research in the informal sector. Aside from the core of this study that could become a point of reference to notify people for future research, it may update decision makers combing for data on the activities of the informal sector their reaction to income tax obligations. Finally, findings from this research could be a direction to be used to improve the capacity of the GRA towards revenue collection especially in Kumasi Metropolis.

### **1.7 Limitations of the Study**

Every human endeavor is liable to factors that inhibit its progress. In the same way this study encountered some limitations which challenged its progress. The collection of data was a difficult task. Most of the respondents were not willing to

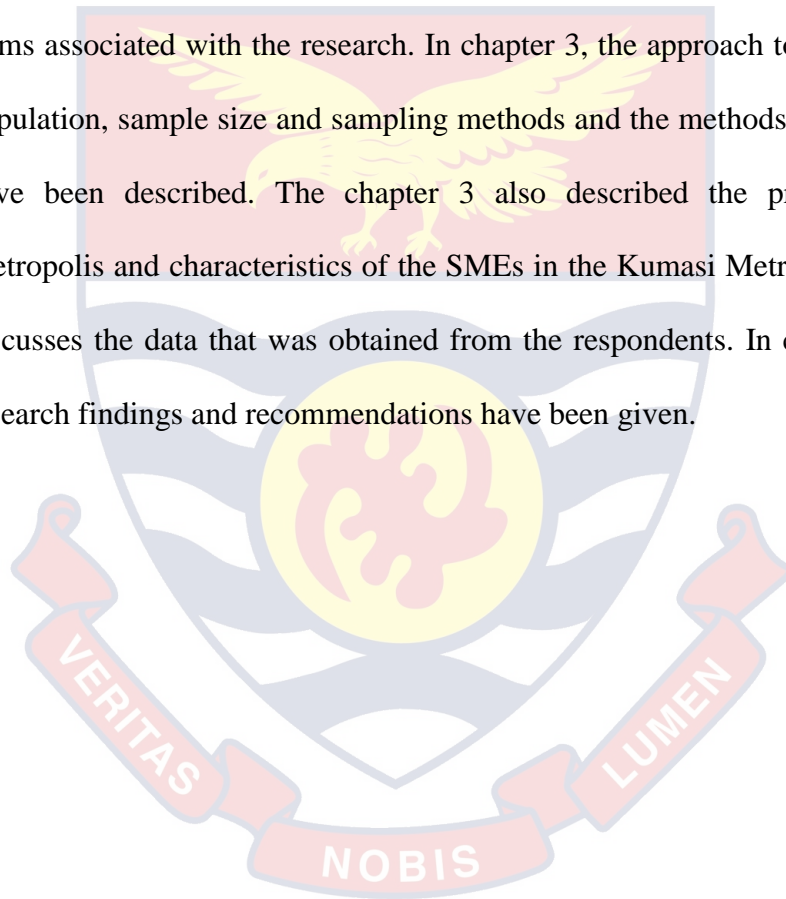
provide us data for the work. Due to the nature of SME activities in Kumasi, the respondents did not get enough time to answer the questions in the questions. It therefore took four weeks for the collection of the data.

### **1.8 Methodology in Brief**

Although philosophical ideas remain largely hidden in research (Slife & Williams, 1995 cited by Creswell, 2011), they still influence the practice of research and need to be identified. There are four philosophical positions in research namely, positivism/post positivism, interpretive or social constructivist, advocacy and pragmatic position (Creswell, 2009). According to the advocacy and participatory researchers, research should be conducted in a way to include participants in designing questions, collecting and analyzing data, which forms the core of qualitative research. The Social constructivist assumes that for individual's effort to understand the world in which they live, they develop meanings that are subjective. These meanings vary making the researcher to investigate the complexity of the meanings rather than constricting to few ideas. This study is situated within the pragmatic worldview that believes belief that it is not necessary to adopt one particular approach to research (being it qualitative or quantitative) rather, to focus on the research problem and combine all methods to understand the problem and develop new knowledge from the problem (Creswell, 2009).

## 1.9 Organisation of the Study

The research is organized into 5 chapters. The chapter 1 outlines the introduction of the study that includes the study background, problem statement, the objectives and questions of the study, the scope, the significance and structure of the research. In chapter 2 review of relevant literature was done on tax evasion, tax avoidance, the causes of tax evasion and avoidance. It also defines some key terms associated with the research. In chapter 3, the approach to the research, the population, sample size and sampling methods and the methods of data collection have been described. The chapter 3 also described the profile of Kumasi Metropolis and characteristics of the SMEs in the Kumasi Metropolis. Chapter 4 discusses the data that was obtained from the respondents. In chapter 5, the key research findings and recommendations have been given.



## CHAPTER TWO

### LITERATURE REVIEW

#### 2.1 Introduction

In this chapter, a review of the perceptions on taxation is done. Also, the reasons why owners of Small and Medium Enterprises (SMEs) fail to pay income tax have been discussed in this chapter. The impact of tax evasion and avoidance in an economy has been discussed. Again, measures that are in place to reduce tax evasion and avoidance have been discussed in this chapter.

#### 2.2 Concepts and Definitions

##### 2.2.1 Taxation

Taxation is a system of law discussed and passed by parliament giving effect to what one must believe to be the democratic will of the citizens (Crawford, 2004). Taxes are of two types namely direct tax and indirect tax. Direct taxes consist of taxes deducted from the income of the tax payer, capital gain tax, corporate and transfer tax. The indirect tax is a form of tax that is comprised of taxes from sales of goods and services and VAT and goods and services tax (Crawford, 2004). Nonetheless, this study focused on direct taxes where income of owners of SMEs was examined. Income tax is the tax levied on income received by individuals in the informal and informal sectors and vocations. Income tax was introduced in Ghana under the Income Tax Ordinance in 1943 (Terkper, 1992).



This Ordinance was restructured on the universal philosophy behind the Act of the income tax in the United Kingdom. It forced the income tax on income taking the source in Ghana in order that income from foreign countries would not be accountable except it is forwarded in the country. The man personal reliefs and deductions formed one of the features of the income tax ordinance. Income tax ever since its introduction has had a greater impact on the total revenue of Ghana. For example, it is stated that taxes on income as a amount of overall revenue were about 21 percent and 28 percent respectively from 1980 to 1993 and 1996 to 1998 in that order (Crawford, 2004).

### **2.2.2 Tax Evasion**

Tax evasion was defined by Muhammed and Muhammed (2012) as the effort made by a tax payer to evade the payment of tax through an illegal means. Tax evasion is the absolute fraudulent action taken by the tax payer with the purpose to stop paying the tax through the illegal means. It is the intention of the tax payer to perform a premeditated action on exclusion or based on commission that was made up of illegal actions beneath the regulations of the taxes (Adebisi and Gbegi, 2013). The act of omission or commission may include the following; the failure of the tax payer to pay tax, failure of the tax payer to submit returns to the tax authorities; overstating expenses, misstatement of figures from the business returns, failure to answer queries, the failure of the tax payer to give the correct income he/she earned. The tax evasion is the minimization of a person's tax legal



responsibility through strategies that infringe what is stipulated in the tax law (Ronan, 2007).

Therefore tax evasion is the unlawful ways an individual or the tax payer takes to escape his/her responsibility to pay income tax. This implies that taxes on income, income predisposed to tax and some economic activities are covered up, the income source of the tax payer is not true and means of deducting and exempting taxes are vulgar. Tax evasion in general refers to illegal practices to escape from taxation. This implies that, taxable income, profits liable to tax or other taxable activities are concealed, the amount and/or the source of income are misrepresented, or tax reducing factors such as deductions, exemptions are deliberately overstated. Tax evasion is defined in this study as the deliberate and conscious attempts to illegally escape the payment or full payment of taxes by individuals, organizations and firms.

### **2.2.3 Tax Avoidance**

Dissimilar to tax evasion, the avoidance of tax is the lawful utilization of the tax systems to favor someone's interest so as to minimize the quantum of tax the person is required to pay that is acceptable in the law (Mohammed and Mohammed, 2012). Adebisi and Gbegi (2013) also explained that the avoidance happens in a circumstance where an individual organizes his/her monetary matters in order to pay less of the quantum of the tax devoid of violating the tax law. Ani *et al.*, (1978) cited by Adebisi and Gbegi (2013) explained tax avoidance as the situation whereby the tax payer take advantage of the law and organizes his/her

activity so as to avoid the full payment of income tax. That is, the tax payer plays a lawful trick to reduce the tax burden. Tax avoidance on the other hand occurs inside the lawful framework of the tax system where an individual or firm enjoy the benefits of the tax law and utilize the weaknesses of the law (GTC, 2010). Tactical planning of arranging the monetary affairs of the tax payer to reduce the amount of tax to pay for a period is mentioned as an example of tax avoidance (Ronan, 2007).

Tax evasion and avoidance was described by James and Nobes (2008) as the two evils that retards the development of a nation. The key difference between tax evasion and avoidance is about the legal procedures of the two. Tax avoidance is legally accepted and tax evasion is an offense that attracts punitive measures (Adebisi and Gbegi, 2013). Tax avoidance is also defined in this study as the legal non-compliance with tax payment by firm or individuals through the gap in the tax system. Tax avoidance is paradoxical, meaning that, tax payers are seen as honoring their tax obligations, but rather doing so in a manner that benefit them but cost it is a cost to the nation.

#### **2.2.4 Informal Sector: Small Scale Enterprises (SME)**

The definition of SMEs has been debated by researchers since the 1970s. The Bolton Committee (1971) defined SMEs based on “economic” and “statistics” criteria. Under the economic definition, Bolton Committee (1971) outlined three conditions for defining the SMEs. These conditions include the following; the SME that has records of small market share, owned and controlled in a

personalized manner but about the medium of a uniform organizational procedures, it is not dependent such that it does not form the basis of huge businesses. With the statistical definition, SMEs is defined on the size and the role it plays in the creation of employment opportunities and GDP, employment and exports (Bolton Committee, 1971). The critique of Bolton Committee's was that the economic description that SMEs is owned and controlled in a personalized manner but about the medium of a uniform organizational procedures is mismatched in the sense that the SME can employ about 200 workers.

When the SME expands, the owners of the business do not take major conclusions however; delegate their mandates to its subordinates. For instance, an SME with 100 workers would be very difficult to be controlled and managed in a personalized ways indicating that the economic as well as the statistical description of SME is mismatched (Storey, 1994). The statistical definition of SMEs was criticized based on 3 dissimilar higher restrictions of earnings that was included for the diverse areas and two diverse higher restrictions revealed for workers constitute the explanation difficulty to make room for comparison among countries. Making comparison of the financial issues in line with the time needed for calculating the index figures to consider the changes in prices. Again, the financial ups and downs contribute to the difficulties in making global comparison (Storey, 1994).

The critique of the Bolton Committee's (1971) definitions of SMEs led to alternative definitions by the European Commission (EC). The commission defined SMEs on three components that include those with zero to nine employees as micro enterprises, nine to ninety nine workers classified as small enterprises and hundred to four hundred and ninety nine workers classified as medium enterprises (World Bank, 1992). This definition was justified and supported by significant issue for policy development and implementation. It was argued that the definition of SME using the 100 workers as the baseline is accepted because of the rising productivity in the last two decades. The definition given by the EC also does not indicate that the SME is homogenous. In other words, it gives distinctive features between the medium and small SMEs therefore its adoption by researchers (World Bank, 1992). It was from then that different definitions of SME were developed. The IFAC (2008) defined SMEs regarding the capital, income and the number of workers (quantitative definition) and the attentiveness of possession and control of few workers (qualitative definition). The definition of SME depends on a country's socio-economic characteristics therefore the need to look into how SME is defined by countries and draw inferences from it. In Ghana, SME is defined by the NBSSI to include business with 9 workers and more having plants and equipments such as structures, vehicles and having less than GH¢10,000,000 as the financial resources. It can be argued from the above definitions of SMEs that different kinds of criteria are used in defining SME which includes the number of workers, contribution to GDP, fixed assets, total number of capital, and sales turn over. However, one criterion is

employed in all the definitions that is the number of employees. On this ground, an SME is defined in this study as an enterprise with an employee not exceeding 100.

## **2.3 Theoretical Reviews**

### **2.3.1 Theory of Taxation**

#### **(a) Ability-to-Pay Principle Theory of Taxation**

The ability to pay principle stipulates that the amount to be paid as tax should be levied based on the financial capacity of an individual to pay. This implies that the amount of income an individual earn from economic activity he/she engages in may determine the amount of tax to be paid. This shows a common feature of progressive tax as the tax rises by the rise of a person's income. Due to the versatility and reasonable nature of "Ability-to-Pay Principle", it has been extensively used in most developed and developing countries. It is argued that the "Ability-to-Pay Principle" is based on sacrifice. That is tax payment is viewed as a withdrawal to the tax payer. This is because the tax payer surrenders money which he/she could have used to the government. However, according to Eftekhari (2009) cited in Adebisi and Gbegi (2013) the effective and strong means to calculate and estimate the fairness is lacking. He therefore proposed three approaches to measure sacrifice in the theory. The first approach is for the taxpayer to surrender the same absolute measure of utility he/she gets from the income. The second approach was that the tax payer forfeits to the similar amount

of service he/she gets from earnings. The third proportion is that the tax payer offers the similar amount of service for his/her earnings.

### 2.3.2 A-S Theory of Tax Evasion

The Allingham-Sandmo (A-S) model was developed by Sandmo (2004) to explain the behavior of the taxpayer towards the payment of income tax. The theory stipulated that no account is made of the decisions of the tax payer regarding his/her labor supply. Therefore, the taxpayer's gross income and income from capital are taken as given. The theory positions the taxpayer at the situation of filling in his/her income tax return. The taxpayer decides how much income he/she would account and submit to authorities in the tax institutions and the amount of tax evaded (the amount of underreporting). The amount the taxpayer is willing to pay based on his reported income to the tax authority is calculated by subtracting the amount of underreporting (tax evaded) from the gross income of the tax payer. However, if the tax authorities discover that the taxpayer has underreported his/her income, the person will be charged a penalty of tax on the amount of tax evaded.

Though it is argued that all income is equally known to the tax authority, by Sandmo (2004) challenged that it is not always the case. He explained that in most countries, the income of taxpayers is reported to the tax authority by the employer. In that case, the employee's part of his income may not in fact be underreported to the tax authorities unless he/she acts in agreement with his



employer. Though the explanation given by Sandmo (2004) may be true, it can be mostly applied to employees in the formal sector. In developing countries, the tax authorities found it very difficult to determine or know the income one earns in the informal sector more especially, the small scale enterprises. Therefore, the analysis should be done in such a way that it applies to that part of income which the taxpayer can evade without conviction of detection. The theory explains that the taxpayer chooses the amount of tax to evade so as maximizing his/her utility.

Sandmo (2004) further explained that a higher penalty rate and higher level of detecting tax evasion usually tend to reduce tax evasion. It is argued that the more the taxpayer earns higher gross income, the higher he/she may evade tax. This occurs based on the assumption that the tax payer becomes more willing to involve in risky activities as he/she get richer. The theory therefore explains that a rise of the rate of tax has implications on payment of tax. That is the more the tax rate, the more the taxpayer evades the tax. This is because the higher tax rate makes the taxpayer poorer and less willing to take any risks. This however depends on the tax administration system in a country. A country that implements the ability-to-pay principle of taxation may increase tax evasion especially when there is increase in the taxpayer's gross income. Thus, the higher tax rate is likely to lead to tax evasion.

### 2.3.3 Development in the Theory of SMEs

#### (a) Theory of Excess Labour Surplus

This theory was developed by Lewis (1995) to describe how the SMEs emerge in a country. The theory states that the factors that influence the occurrence and development of SMEs are because of excess supply of labour in the country. It mentioned that the excess supply of labour is difficult to be taken by the government and huge firms owned by the private individuals and as such they are forced into the SMEs despite the fact that there is low salary level and productivity. It is argued that the SME emerges because of the high unemployment rate in a country. That is, it plays the role as the last resort for the unemployed people that do not get the opportunity to work at the formal sector. This implies that the SMEs are anticipated to expand and develop during economic crises if it happens that the formal sector expands slowly to employ the large labour force. But, if it happens the formal sector expands, the SMEs are anticipated to accept to contract again. This therefore leads to an anti-cyclical association in a country (Lewis, 1955).

It is also argued that people engage in SMEs because the sector demands low capital to operate and it does not require more knowledge or educational background unlike the formal sector. In spite of the fact that it may be clear that manufacturing or production demands extra asset than trade, SMEs activities may demand extra operational asset than small-scale production so as to protect an amount of earning. This is due to the fact that value added is less for the trader



than for the producer. Again, in small scale production, the client mostly demand to offer for advancement in materials whilst the small scale trader need to offer credit most likely, extra than huge formal traders. Thus, it can be argued that there is much difficulties to the degree by which the SME may function as means of last resort during economic difficulties (Grierson and Mead, 1995).

### **(b) Output-Demand Theory**

This theory was developed by Grierson and Mead (1995) because of the ready demand and market for the goods and services from the SMEs, its development is great. They therefore stated that SMEs may continue to produce and develop a cyclical correlation with a country. It is also likely that the SMEs can develop to compete with the large firms and their expansion or development can be limited by the development of the formal sector because its monopolist nature. Policies such as the structural adjustment from governments can limit monopolist nature of businesses and can also generate competition that would not be to the advantage to the SMEs. This is due to the fact that this may not give the opportunity to them to absorb the market shares with the huge firms.

Studies have indicated that, based on the theory of out-demand that concentrate on the higher point of the SMEs more importantly, the production firms and the huge effective SME that has the opportunity to expand and develop to become formal. The empirical studies have suggested that the SMEs should be strengthened through the creation of social networks with the formal firms in a

country. This recommendation has been discussed to have less impact on the operation and success of firms in Africa because of the numerous problems such as the poor state of infrastructure and lack of confidence among actors. This has resulted to unbalanced situations and minimise the effectiveness of the formal sector to operate and have opportunity to access the market (Ryan, 2005).

### **(c) Firm Growth Theory**

The third theory of SMEs development explains that because of the rate of industrialization and the expansion of an economy, the operations of SMEs are not unlikely to vanish and be taken by the contemporary large firms. The theory of firm growth is argued to be inappropriate because of the fact that the SMEs usually show less competition with the large firms. However, they mostly decide to sustain the small firms synchronized with the large firms that occurrence the World Bank (2004) has referred to it as the ‘missing middle’ (Ryan, 2005). Liedholm and Mea (2006) mentioned that as the collective per capita income rises, it may lead to orderly prototype development of SMEs in the direction of larger firms on the basis of larger locality, supplying extra valued commodities. Yet, there is critique of this view that the explanation of the development of SMEs should concentrate on the variations in effectiveness of other operations, the kind of factors that affect them in a country, the variation in the educational attainment of the people, the dynamisms of the functions of female industrialist and the social and economic variations (Liedholm and Mead, 2006).

It can be deciphered from the above discussions that the development of the SMEs towards addressing poverty gap has been common and evidenced. But the development of SMEs in most developing countries is a challenge to the government. This is due to the fact, it is argued that the informal sector mostly evade income tax. It can be understood from the theory of excess labour that the motive for people to engage in SME is because the government cannot provide employment opportunities to majority of labour and therefore there is excess labour. Unlike the formal sector where the employee cannot escape the payment of income tax, the informal sector can easily evade the tax. This can be due to the fact that in most developing countries, the tax administration system is poor. Therefore, taxpayers especially those in the informal sector mostly evade tax.

## **2.4 Implications for Taxing the SMES**

### **2.4.1 Revenue and Equity Implications**

The tax imposed on the informal sector has the implications of the development of a larger tax base. Taxing the SMEs seems to be crucial sources of revenue to the government of a country because of the fact that they constitute the largest in a country (Schneider and Klinglmair, 2004). However, there are critics to the taxation of the SMEs. Critics say that the individual income from the SME businesses are low while the costs of collection and overall administrative burden are very high, owing to the large number of individual firms and the difficulty of monitoring. Further opposition to the taxation of the SMEs is sometimes raised on equity grounds, as the operators of enterprises are frequently low-income, thus

making taxation of such firms potentially regressive (Pimhidzai and Fox, 2012). From the critics, it can be argued that taxing the SMEs should involve identifying those sectors which are not liable to pay tax and giving them tax free. It also involves identifying those sectors which are liable to pay tax and tax them hugely.

#### **2.4.2 Implications for the Growth and Development of the SMES**

It is argued that increasing the taxes of the SMEs may ultimately hinder their growth, and that the implications may far outweigh the revenue benefits to the government. The logic behind engaging in the SMEs is because they believe that informality of the nature of the business will benefit them, given the burdens of formality. And as a result to this, taxing the sector has implications for growth of the sector. However, despite this fear that taxation may hinder growth, a growing body of research suggests that formalization of the entry into the tax net is a central component that may have significant benefits for growth or may not hinder growth (Anuradha *et al.*, 2012).

It is suggested that, the SMEs carries a variety of costs to firms and are not allowed from enjoying certain benefits that the formal sector may enjoy. These includes greater access to credit, increased opportunities to engage with large firms and the government, reduced harassment by police, and tax officers and access to broader training and support programs (Anuradha *et al.*, 2012). The increased number of people participation in the informal sector sends a signal that, there remain important barriers to formality, that the potential benefits to bringing firms into the tax net is likely to be dependent on the particular features

of how this goal is achieved, and that any costs and benefits are likely to vary across firms (Anuradha *et al.*, 2012).

### 2.4.3 Governance Implications

It is argued that the important factors in taxing the SMEs may be a way of promoting good governance and political accountability (Prichard, 2010). This argument builds on a broader body of research suggesting that tax payment may contribute to broader governance gains through three related channels. First, in order to encourage quasi-voluntary tax compliance, the state may be more responsive and accountable to groups that pay taxes. Secondly, individuals may be more likely to make demands for responsiveness and accountability if they are paying taxes, as it may foster a sense of ownership over government activities (Prichard, 2010). Thirdly, efforts to tax the SMEs may encourage collective action and political engagement by the SMEs providing a longer term foundation for expanded bargaining (Prichard, 2010).

The above indicates that there is a connection between governance and taxing the SMEs. The expanded taxation of the informal economy, if pursued in a comparatively contractual manner could become an important basis for expanding political voice among relatively marginalized groups (Moore, 2008). Joshi and Ayee (2008) show that government efforts in Ghana to tax the SMEs resulted in at least some degree of bargaining between informal sector associations and the government. In a similar vein, Prichard (2010) finds that expanded taxation of the informal sector in Ethiopia prior to elections in 2005 triggered some public

mobilisation and prompted the government to include greater business involvement in overseeing the presumptive tax regime. As such, these issues remain a potentially powerful argument for taxing the informal sector operators. This is summarised by Joshi and Ayea (2008) who posited that, the payment of taxes by firms in the informal economy may be a way of engaging firms with the state, and thus promoting good governance and political accountability.

## **2.5 Taxation and the Tax Act of Ghana**

### **2.5.1 History of Taxation**

Taxation in Ghana started far back in 1852 when the Governor of the Gold Coast, Major Hill, introduced a poll tax of one shilling per head per every adult to finance the administration of the Gold Coast colony. Income tax was first introduced in 1943, on 22<sup>nd</sup> September 1943; income tax ordinance No.27 of 1943 was passed and set up the department to collect tax from only a few limited liability companies and very small number of individuals (Adebisi and Gbegi, 2013).

The 1943 ordinance was replaced after 22 years by the Income Tax Decree 1966(NRCD 78), which was in turn replaced by the income Tax Decree, 1975 (CMCD.5). However this was also replaced by the Internal Revenue Act, 2000 (Act 592) in 2000. Between 1961 and 1963 additional taxes and duties were introduced. These are property tax (1961), entertainment duty tax (1962), airport tax, hotel customers tax, standard assessment and excess profits in 1963. the introduction of pay-as you-earn (PAYE) on 1 July 1961 for employees and



assessment of self employed However the base year for taxation was also changed to July to June instead of from April to March (Adebisi and Gbegi, 2013).

In July 1963 the Income Tax Department was renamed Central Revenue Department to reflect the broad scope of taxes collected. From 1943 to 1985, the department was a civil service department .in July 1986 the provisional National Defense Council (PNDC) government took a decision on structural changes in the organization and legislation. The internal Revenue Service's (IRS) Law, 1986 (PNDC.143) was passed. The law transformed the hitherto central Revenue Department, which was a civil services department to a public services Department. The introduction of Ghana Revenue Authority Act 2009(Act 971) marked a significant landmark in the history of the revenue administration in Ghana (GRA, 2015).

In Ghana, the idea in promoting functional organization is that, it is in consonance with promoting self-assessment by the taxpayer, followed by varying degrees of examination by the tax office. The Ghana Revenue Authority is the umbrella of other agencies such as Internal Revenue Service (IRS), Value Added Tax (VAT) Service and the Customs, Excise and Preventive Service (CEPS) in income tax assessment and collection (GRA, 2015).

Since the 1980s, measures have been put in place to strengthen tax assessment and collection in Ghana. Currently, under the PNDC Law 330, 1993, the taxpayer is primarily responsible for assessing his own tax. For instance, the Ghana Revenue Authority (GRA) published for the information of taxpayers in 2013 to

do their self-assessment of income accrued with guidelines such as; preparation of estimates, computation and payment of tax, scope of estimates (not less than 90% by which it is subject to penalty of 30%) and revision of estimates (GRA, 2013). The Customs, Excise and Preventive Law (PNDC Law 144) and the Internal Revenue Service Law (PNDC Law 143) were enacted in 1985 to grant full operational and partial financial autonomy to these institutions backed by the Constitution of the country (GRA, 2015).

In December 2009, the three tax revenue agencies, the Customs, Excise and Preventive Service (CEPS), the Internal Revenue Service (IRS), the Value Added Tax Service (VATS) and the Revenue Agencies Governing Board (RAGB) Secretariat were merged in accordance with Ghana Revenue Authority Act 2009, Act 791. The Ghana Revenue Authority (GRA) thus replaces the revenue agencies in the administration of taxes and customs duties in the country (GRA, 2015).

The Ghana Revenue Authority (GRA) has been established to:

1. Integrate the management of Domestic Tax and Customs
2. Modernise Domestic Tax and Customs operations through the review of processes and procedures
3. Integrate Internal Revenue Service (IRS) and Value Added Tax Service (VATS) into domestic tax operations on functional lines.

The establishment of the GRA is a culmination of years of plans to streamline the administration of tax collection in Ghana which began in 1986 when CEPS and IRS were taken out of the Civil Service and made semi- autonomous and self



accounting public sector institutions with separate boards. The same year, the National Revenue Secretariat (NRS) was set up to formulate revenue policies, manage tax reforms and supervise the activities of CEPS and IRS (GRA, 2015).

In 1998, the Value Added Tax Service was established to administer VAT and other consumption taxes. The Revenue Agencies Governing Board (RAGB) also began operations in 2001 to supervise and monitor the operations of the Revenue Agencies. In 2002, the Taxpayer Identification Number was introduced to enhance information interchange and risk profiling. Then in 2004, the Large Taxpayer Unit (LTU) was set up to operate on functional lines as a pilot programme for the future integration of tax administration in Ghana as well as to serve the needs of large taxpayers as a one stop shop operation. It is envisaged that the integration of the Revenue Agencies will bring the following benefits to taxpayers and tax administration (GRA, 2015).

1. Reduced administrative and tax compliance cost
2. Better service delivery
3. Improved departmental information flow.
4. Holistic approach to domestic tax and customs administration
5. Enhanced revenue mobilisation

### **2.5.2 Income Tax Act**

The institution responsible for tax collection in Ghana was Income Tax Department in the Income Tax ordinance (No. 27) of 1943. With the introduction

of the other taxes and duties between 1961 and 1963, the name was changed to Central Revenue Department with effect from 1<sup>st</sup> July 1963. This has undergone re-organization in 1986 and by virtue of the enactment of P.N.D.C law 143 of 1986, the name was again changed to Internal Revenue Service (Internal Revenue Service, Act 2000). Today the name is Domestic Tax Revenue Division of Ghana Revenue Authority upon passing the Ghana Revenue Authority Act 2009 (Act 791). Ghana Revenue Authority thus replaces the Ghana Revenue Agencies in the Administration of Taxes and Customs Duties in the country (GRA News, 2010).

The main objective of the Domestic Tax Revenue Division is to collect direct taxes for the state. Taxes administered includes Pay As You Earn (PAYE), Personal Income Tax, Corporate Tax and Miscellaneous Taxes including Stamp Duty, Capital Gains Tax, Gift Tax, Rent Tax, Dividends Tax, Mineral Royalties, among others. Corporate Tax is paid by companies and personal Income Tax is paid by self-employed persons who are required to pay Income Tax at graduated rates in four equal installments. The current tax rate took effect from June 2010 (GRA News, 2010).

Efficient application of the tax laws has a direct impact on tax collection performance. Penalties are prescribed for offences committed by authorized and unauthorized persons and entities. This is effectively implemented under the fines (penalty units) Act 200 (Act 572) as amended by LI 1813 supported by Income Tax Law, Internal Revenue Act 2000 (Act 592). Under these legal framework, a

penalty unit is equal to GH¢ 12.00 (GRA News, 2010). The question is whether these legal frameworks of tax administrative system are applied effectively. However, these penalties are not applied in isolation. There are other strategies which the law mandates to ensure an effective and efficient tax administration system. These are discussed in the sections in the following pages.

## **2.6 Ways Tax Is Evaded and Avoided**

### **2.6.1 Mode of Tax Avoidance by the Informal Sector**

Adebisi and Gbegi (2013) outlined four ways taxes are avoided. Owners of the SMEs seek for professional advice in order to minimize the amount of taxes to pay from their income. The financial advisors are consultants that provide guidance to the SMEs on how to identify the loopholes in the tax system and take advantage of it to avoid the tax. Another mode of tax avoidance is through the reduction of one's income by submitting claims for expenses in earning the income. Also, some of the owners of the SMEs increase the number of children so that the tax burden would be minimized. In Nigeria, Adebisi and Gbegi (2013) stated that the maximum allowable of number of children is four. Again, owners of the SMEs take additional life assurance policies to reduce the tax burden. From the above, it can be argued that tax avoidance is considered to be a matter of being sensible in dealing with the tax system.

## 2.6.2 Mode of Tax Evasion

### (a) Trade Mispricing

One of the modes of tax evasion is trade mispricing through faked invoices between colluding tax collector and the tax payer. This serves as a commonly used way to illegally evade tax according to the Global Financial Integrity (GFI, 2010). Coted'Ivoire and Nigeria had been victim of substantial illegal capital outflows that where based on deliberate over-invoicing.

### (b) Under-Reported Income

Most evasion takes the form of under-reported income. The evasion by the difficult-to-tax group (that is largely informal sector businesses) may take three forms: non-declaration of income.

### (c) Tax Fraud

Another mode of tax evasion and avoidance of the informal sector is tax fraud. False statements of business transactions represent a type of tax evasion that has attracted increased attention in developing countries. Fraud includes under-reporting of sales by falsifying records and accounts allowing the fraudster to collect taxes without remitting them to the tax authority (Keen and Smith, 2007).

#### (d) Bribery of Tax Officials

The above notwithstanding, bribery of tax official is identified as a common mode to tax evasion and avoidance. Sub-Saharan African countries that face problems in the management of taxes are open to corruption by large firms exposed in for example Bangladesh where the import of sugar is about 90 percent evaded (TJN, 2003).

#### 2.7 Review of Studies

Lefebvre *et al.*, (2011) conducted a study on the behavior of taxpayers and how it influence their decisions to pay taxes in three countries-Netherlands, France and Belgium. They used the mixed method approach to research to analyze response from 200 respondents and the result was that tax payers adopted less evaded behavior in tax treatment than in welfare treatment. They also indicated that taxpayers evade more tax in Netherlands and France but tax evasion is more in Flemish than Walloons.

Liadiale *et al.*, (2010) cited by Adebisi and Gbegi (2013) examined the relationships between tax evasion and cultural factors such as religion, trust in the government and legal enforcement in Nigeria. The survey covered 250 respondents using surveys and the result was that there were positive relationships between tax evasion and the level of trust taxpayers had in the government and the legal enforcement. But, there was no significant relationship between religion and culture and tax evasion.

Further, Boylan and Sprinkle (2001) conducted a study of 310 respondents using experiment technique to examine the behavior of taxpayers. The main objective of the study was to identify the factors that motivate the tax compliance and characteristics of noncompliant taxpayers. The result was that the income level, tax rate, tax morale and educational background of taxpayers influenced compliance to tax.

Pommerehne *et al.*, (1994) cited by Adebisi and Gbegi (2013) conducted a study of 150 respondents on the determinants of tax evasion using regression analysis. They used the presence of grievance in absolute terms in their study. The result indicated a positive relationship between the presence of grievances and tax evasion. The implication was that the increased in sentiments of grievance, the increased in the level of tax evasion. They also found a negative relationship between tax evasion and the level of tax morale. The implication was that the decrease in the level of tax morale of the taxpayer, the increase in the tax evasion.

Fisher *et al.*, (1989) examined the relationships between tax evasion and tax compliance of 120 respondents using the random survey technique. The result was that there was a negative relationship between tax evasion and tax compliance. The implication was that the higher the tax compliance, the lower the tax evasion. The reverse is also true for a lower tax compliance with tax evasion. Skinner and Slemrod (1985) cited by Adebisi and Gbegi (2013) conducted a study of 400 respondents using the seminal models to examine the determinants of tax



evasion. The result was that factors such as income level of the taxpayer, tax rate and age of the tax payer determined the level of tax evasion.

Srinivasan (1973) cited by Adebisi and Gbegi (2013) also conducted a study using the seminal theoretical models to examine the determinants of tax evasion. The result was that factors such as auditing, level of risk aversion, and the amount of penalty imposed influenced the behavior of the taxpayer to evade taxes. They also reported that there was a relationship between the income of the taxpayer and tax evasion. Orewa (1957) cited by Adebisi and Gbegi (2013) conducted a study on the characteristics of tax evasion in Nigeria using 150 respondents. The result was that the soaring level of mobility is attributed to principal aim of tax evasion on the part of taxpayers. He argued that the mobility of wage earners and self-employed persons with permanent and known addresses is an important factor of tax evasion because they keep themselves in movement from one place to another in order to earn legal money. He also found the reasons of partial evasion such as: resentment toward illiterate persons that present only their salaries and wages as taxable income and traders maintain inadequate records.

## **2.8 Mechanisms to Reduce Tax Evasion**

### **2.8.1 Instituting Effective Punishment to Tax Defaults**

Alm *et al.*, (2012) suggested that increasing likelihood and the threat of punishment could be used to improve the tax collection system. This involves increasing the number of audits, improving the quality of the audits, using more



systematic audit selection methods, improving information-sharing across governments, increasing penalties for tax cheating, publicizing tax evasion convictions in the media as an alternative non-financial type of penalty, applying penalties often and consistently, relying more heavily on source-withholding, granting additional power for collecting delinquent accounts, and increasing taxpayer registration and identification via better use of third-party inform.

### **2.8.2 Ceding Control to Local Government**

This approach looks at decentralizing responsibility to sub-national government. Local governments already levy significant taxes, and extending their responsibility may encourage voluntary compliance and strengthen political and administrative commitment to taxing the informal sector (Corthay, 2009). Boudin and Koukpaizan (2008) argue four possible benefits to such a strategy: firstly, local governments have greater need of resources, and may thus have stronger incentives to pursue taxation of informal firms; secondly, taxes are expected to be closer to, and thus responsive to, local conditions; thirdly, local governments may be better placed to negotiate productively with informal sector actors, and respond by supplying relevant services to informal sector operators; and lastly, it may encourage greater coherence, as there is, at present, frequently large and harmful overlap between taxes levied by different levels of government.

This approach is adopted by countries such as Cameroon and Ethiopia. In Cameroon, there has been recent discussion of ceding responsibility for collection

of taxes from the informal sector to local government. Experience in Ethiopia has followed a similar path, and offers some tentative support to the viability of decentralized taxation of small firms (Prichard 2010). The challenges of adopting this policy have focused particularly on the risk that local government lacks the capacity to collect these taxes effectively and fairly. There is also little coordination between tax administration and budget administration at the local level (Loeprick, 2009).

### **2.8.3 Introduction of the Tax Stamp**

This is a tax collected from small-scale self-employed persons in the informal sector on quarterly basis. Under the tax stamp system, businesses operated in the informal sectors are grouped according to the business types. For example, dressmakers, Susu collectors etc. (GRA, 2013). The tax stamp was purposefully introduced to get the informal sector to pay tax. The system groups the informal sector based on their profit and the size of the firm. Entrepreneurs pay the tax through the purchase of tax stamp. The tax stamp serves as the receipt which is issued anytime the tax collector requested for it. Those people who fail to purchase the stamp is charged a fine. The tax stamp was successful with the Taxi Drivers than the other sectors. This is because; the police were made to understand that any taxi without the stamp could be arrested. This scared people and therefore they honored their tax obligations. However, this scheme was difficult implementing it to the mobile informal sector operators and therefore entrepreneurs of these sectors still remained outside the tax net (Ofori, 2009).

#### **2.8.4 Standard Assessment**

The first attempt in Ghana to tax the informal sector (i.e. small businesses and self-employed) was in 1963, when the Standard Assessments Act, 1963, Act 205 was enacted. The standard assessment was a scheme in which a fixed lump-sum tax was levied on individuals and businesses on the basis of business activity in which they engaged. The standard assessments increasingly represented the final tax liabilities from the various occupational groups covered (World Bank, 2002). The scheme enhanced the vertical equity in tax collection. However, the scheme was faced with challenges such as weak administrative capacity of the tax administration and the annual lump-sum payments were deemed too high by the informal sector (World Bank, 2002).

#### **2.8.5 Presumptive Taxes**

Presumptive taxes are applied to the informal sector to curb the problems of high compliance costs taxpayers and high costs of collection for tax administrations. These taxes use a simplified indicator of the tax base (profits), in order to simplify record keeping for firms and the estimation of tax liabilities by tax collectors. Loerprick (2009) outlines the available options for presumptive taxation. They include; using a non-financial indicator of tax liability, such as the number of employees. This is the simplest approach, and allows the estimation of tax liabilities by tax collector even in the absence of accounts, but also has the most obvious drawbacks. In Ethiopia, instead of being subject to income tax and VAT, mid-sized firms are required to pay a presumptive tax on income (based on

turnover). Kenya levies a 3 percent flat rate on turnover to replace both income tax and VAT. Tanzania operates a scheme in which tax is a progressively increasing proportion of turnover, and those without adequate records pay a larger amount. In Ghana the government operates a flat rate turnover tax of 3 percent for small firms to replace standard VAT, while micro businesses are covered by a tax stamp regime, in which a fixed tax is paid on a quarterly basis (Prichard, 2010).

### **2.8.6 Re-Organizing Tax Administration: Segmental Organization and The Block Management System (BMS)**

The administrative strategy for improving informal sector taxation is to re-organise tax administration, so as to strengthen monitoring and provide more focused incentives for administrators to target the sector. Segmental organization involves a separate department to deal with small, medium and large firms, respectively. Such reform is intended to allow for services more specifically tailored to the needs and realities of the informal sector, and to ensure that tax administrators have incentives to focus on these firms despite potentially low revenue yields (Internal Monetary Fund IMF, 2011). Segmental organization is adopted by Tanzania as means of instilling compliance in informal sectors and registering all eligible traders within particular sectoral or geographic areas. The Block Management System (BMS) is also used by Tanzania to map trading areas and divided into blocks on the basis of geography, administrative boundaries or a few streets. Existing evidence suggests that the BMS has resulted in increasing the number of businesses registering with the tax administration. In 2006-2007,

16 percent of new registrants were through the BMS. In 2007-2008, the number had grown to 43 per cent, and this was sustained in 2008-2009 at 41 percent in Tanzania (Anuradha *et al.*, 2012)

### **2.8.8 Associational taxation: Identifiable Grouping Taxation (IGT)**

This approach focuses on effective collective and credibility to tax the informal sector coupled with the creation of institutional channels to facilitate bargaining and cooperation between informal sector associations and the state. This approach is used in Ghana. A study conducted in Ghana by Joshi and Ayee (2008) indicates that from 1987 to 2003 the Ghanaian Internal Revenue Service delegated responsibility for collecting income tax from the informal sector to the associations of the informal sector – a strategy called Identifiable Grouping Taxation (IGT). The arrangement originated in the politics of the corporatist relationship between the largest passenger transport union, the Ghana Private Road Transport Union, and the Rawlings regime (1981-2000), and continued after the electoral victory of the opposition (Joshi and Ayee 2008). From the perspective of the tax administration, IGT reduced collection costs to a fixed of 2.5 per cent, which was paid to the associations for their work in collection and overcomes some of the problems associated with tax collection from micro businesses. One of the big achievements of the system was inculcating a culture of taxpaying within businesses in the informal economy in Ghana.

### **2.8.9 Encouraging Compliance through Transparency, Services and Engagement**

Enforcement and quite explicit negotiation and cooperation are seen as efforts aimed at fostering voluntary compliance by emphasizing transparency, taxpayer services and engagement. Establishing a link between tax payment and the provision of social services is an evidence to prove to tax payers to build trust in tax collection authorities thereby not hesitating to honor their tax obligations. This approach has gained root with positive results from countries such as Sierra Leone, Guinea and Gambia. Research by Korsun and Meagher (2004) finds that the most successful efforts have been in Bo City Council, where the government has gone to great lengths to communicate revenue and expenditure data to the public, including informally highlighting connections between specific taxes and public expenditure.

### **2.8.10 Introduction of the Tax Amnesty System**

The Tax Amnesty System was introduced as a panacea to reduce tax evasion and avoidance among people. It is intended to regularise the tax affairs of persons who have defaulted in meeting their tax obligations and to improve the tax compliance culture. The Tax Amnesty Act, 2012 (Act 853) was passed by Parliament and it is currently in operation. The Tax Amnesty is a limited time opportunity for taxpayers who have defaulted to pay their taxes to discharge their tax obligations in exchange for forgiveness of a tax liability (including interest and penalties) without fear of criminal prosecution. The Tax Amnesty system targets people who

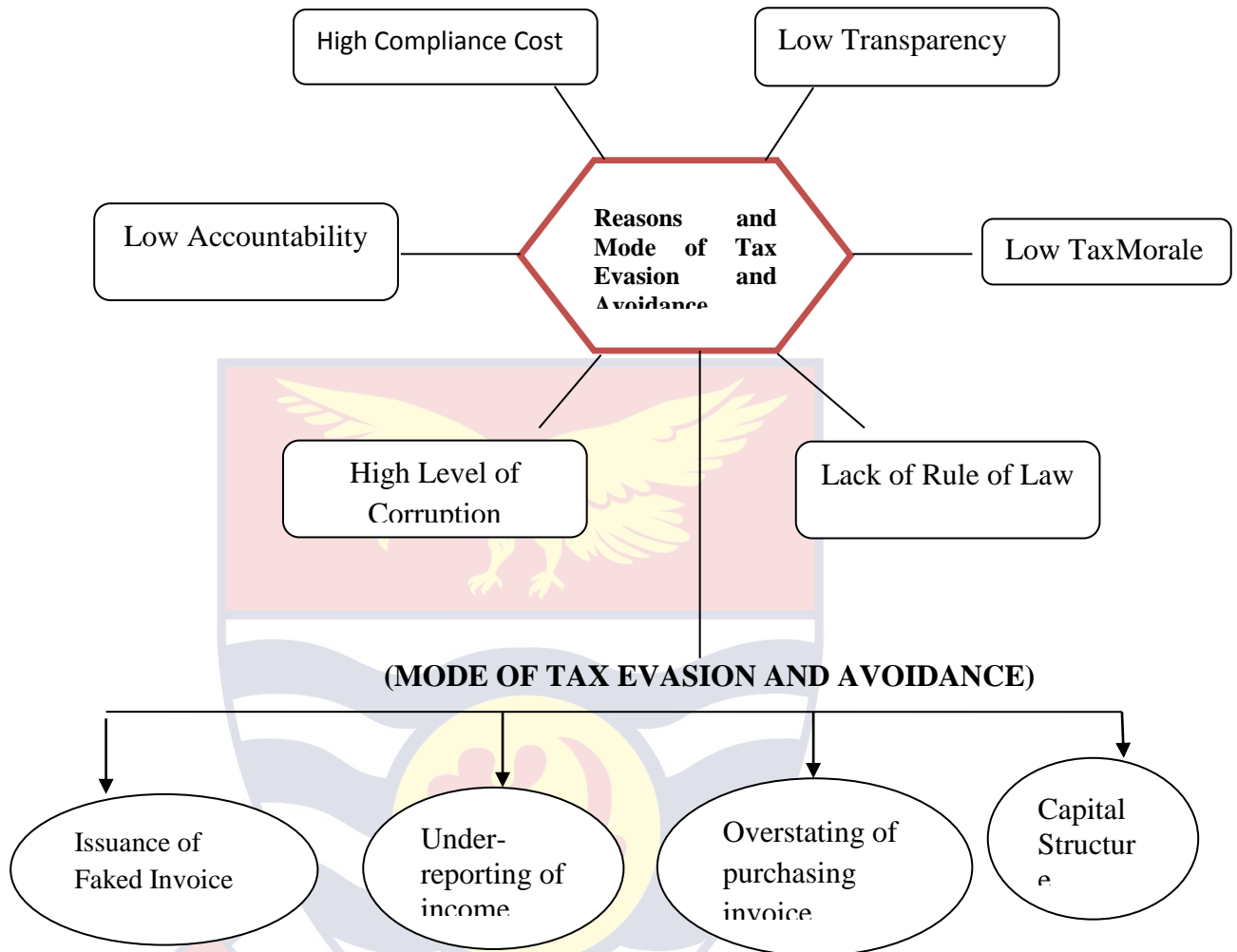


have previously registered with the Ghana Revenue Authority (GRA) but has not renewed the registration or is registered with the GRA but has not submitted all returns or made full disclosure of all incomes earned in previous years of assessment. It also targets those who are liable to pay tax but who have not been previously registered with the GRA. These target people are required to submit an application to the Commissioner-General of the GRA on a Tax Amnesty Application form (GRA, 2013).

## 2.9 Conceptual Framework

Figure 2.1 shows the conceptual framework of the study. The framework explains the factors that contribute to tax evasion and avoidance of the Small and Medium Enterprises. The study indicates variables/factors for tax evasion and avoidance of the informal sector and mode of tax evasion and avoidance. The framework indicates that the behavior of the informal sector to evade or avoid taxes is influenced by certain factors such as low transparency, low tax morale, low transparency, and high level of corruption, lack of rule of law and weak fiscal jurisdiction, and high compliance cost.





**Figure 2.1: Conceptual Framework for the Study**

Source: Author's Construct, 2017.

**(a) Educational Background of the Taxpayer**

The level of education is measured in number of years of schooling that is the higher the level of education the more the respondent is exposed to national issues and the need to pay taxes and therefore stands a greater chance of the tax. It is therefore expected that there would be a positive correlation between educational

level and payment of taxes. However, the obligation of the taxpayer to honour tax obligations is influenced by the individual's belief (tax morale), and low quality of the service in return for taxes. Tax payers expect some kind of service or benefit in return. When the government fails the necessary basic amenities in return for payment of taxes, the taxpayer may not be willing to pay the taxes and tax default will be the consequence (Everest-Phillips, 2008).

### **(b) Age and Gender of the Taxpayer**

It is assumed that the older one is, the more experienced in life the person is, and therefore would better understand the essence of paying taxes. Males who are mostly the owners of the SMEs are expected to pay their taxes more than the females. However, the ability of the tax payer (being male or female or irrespective of age) needs to have knowledge or know a little more about the manner and ways the tax collected by the authorities is disbursed or allocated. Thus transparency and accountability plays an important role in influencing the decisions of the tax payer in honouring their tax obligations (Fraser and Ellis, 2009; Kaufmann *et al.*, 2007).

### **(c) Income Level of the Taxpayer**

As discussed from the theory of tax evasion, Sandmo (2004) mentioned that the amount of income the taxpayer earns determines whether he/she will evade the tax. It can therefore be assumed that the taxpayer with a reliable source of income is better positioned to pay tax. However, the income of the tax payer may be

influenced by high tax rates. High property rates and tax is intrinsically linked together (Chipeta, 2002).

**(d) Low Tax Morale**

The willingness of people to pay tax stems from the morale attached to it. High level of tax compliance results from the tax morale of society that fosters self-enforcement of tax compliance. According to Alm *et al.*, (2007) countries without the habit of paying tax find it difficult to establish tax morale. The low tax morale is attributed to two factors. These are the low quality of the service in return for taxes and the tax system and perception of fairness. A related argument suggests that the failure of informal firms to pay taxes can be viewed as a source of unfairness by formal firms. This may lower general tax morale and discourage tax compliance among larger firms, leading to reduced government revenue (Torgler, 2003).

**(e) High Compliance Cost**

The cumbersome and time consuming procedures of compliance to tax have become a burden to the informal sector. The cost in gathering the necessary information, fill out tax forms is another reason for tax evasion of the informal sector. The World Bank's 2008 World Development Indicator for "time to prepare and pay taxes" shows huge differences between countries: While preparing and paying taxes requires 210 hours on average in high income OECD countries, the required time extends to 1080 hours and even 2600 hours in

most countries. This situation has led most businesses to worry more about the administrative burden than about the actual tax burden. In such a situation it can be assumed that compliance costs are very high and the probability of the taxpayer complying with such a great variety of taxes is low (Everest-Philips, 2008).



## CHAPTER THREE

### METHODOLOGY AND ORGANIZATIONAL PROFILE

#### 3.1 Introduction

The research design, population of the study, the sampling procedures and methods of data analysis has been described in the chapter. Also, the profile of Ejisu-Juaben Municipality is given in this chapter.

#### 3.2 Research Design

##### 3.2.1 Mixed method research

Three common approaches are used in conducting research. They include quantitative, qualitative and mixed methods approaches to research (Williams, 2007). The mixed method approach was used to achieve the research objectives described in chapter one. The mixed method of research gives the opportunity in research by closing the deficiency gap of either the qualitative or quantitative approach and therefore the margin of error is also minimal. The nature of the research objectives posed in chapter one required the use of mixed method research. The research objective one that seeks to examine the perceptions of owners of SMEs on taxation requires numeric data which is a custom of quantitative research. The research objective two that seeks to analyze the factors that influence individual decisions to evade income tax in the Kumasi Metropolis demand quantitative analysis to achieve it. However, research objective three that seeks to examine how owners of SMEs evade or avoid income taxes in the Kumasi Metropolis requires qualitative approach of research to achieve. Again,

the research objective four that seeks to examine the mechanisms used by the GRA in addressing the issue of income tax evasion and avoidance in the Kumasi Metropolis requires narrative data which is a custom on qualitative approach to research.

### **3.2.2 Survey Research Approach**

Researchers adopt the survey design or descriptive as the study design. Since this study involves data collection from participants on the field, where the responses are tabulated and converted into percentages, it becomes appropriate to use survey as the study design (Leedy & Ormrod, 2002). Two main survey designs are used in research namely the cross-sectional survey and longitudinal survey. The cross-sectional survey was appropriate to be used in this study since it involves collecting data at one particular time and it is also economical compared with the longitudinal survey (Babbie, 2002).

### **3.3 Population of the Study**

The population of the study consists of all taxpayers in the Kumasi Metropolis. This means that all owners of small, medium and large scale activities in Kumasi were considered in the population. Due to the heterogeneous nature of the population, the exact population would be difficult to ascertain. This is because the tax authorities do not have the records of all the SMEs in the Kumasi Metropolis. The staffs (tax officials) from the Ghana Revenue Authority (GRA) also formed part of the study population.

### **3.4 Sampling Procedures**

#### **3.4.1 Sample Frame**

The sample frame consisted of tax officials from the GRA and owners of small and medium enterprises in the Kumasi Metropolis. The SMEs include those engaged in activities such as the fitting shops, leather works, and seamstress and tailoring, commerce, food processing and wood product industry in Kumasi. This implies that owners of large scale enterprises in the Kumasi Metropolis were exempted from the list of respondents in this study.

#### **3.4.2 Sample Size and Sampling Methods**

Due to the fact that the sample frame and population of owners of SMEs was difficult to be obtained from the tax authorities, a mathematical method cannot be used in calculating for the sample size. Rather, the stratified sampling was appropriate to select 150 respondents who were owners of SMEs in the Kumasi Metropolis. With the stratified sampling, Kumasi was grouped into ten zones. The zones include Bantama, Kwadaso, Suame, Tafo, Manhyia, Asawase, Oforikrom, Asokwa, Nhyiaeso and Subin. It was found from tax officials of GRA that SMEs was much concentrated in Bantama, Suame, Oforikrom, Subin, Asawase and Tafo.

However, in terms of the zones that contribute immensely to revenue collected by the tax authorities, it was found that Bantama, Subin and Suame contribute less compared with the others. This may imply that these three zones are major contributors to tax evasion in Kumasi. Therefore, the Subin, Suame and Bantama



were selected among the other zones as the focus in this study. The convenient sampling procedure was adopted to select 150 respondents in the three zones in Kumasi. The purposive sampling procedure was also used in this study to select 10 tax officials in the Ghana Revenue Authority in Kumasi.

### **3.5 Source of Data**

Data on the demographic characteristics were collected from all the respondents. Data on the perceptions of taxation, factors that accounts for tax evasion and how tax are evaded were collected from the taxpayers in Subin, Suame and Bantama. Data on how tax is avoided was collected from the taxpayers and the tax authorities. Also, data on the mechanisms for reducing tax evasion and avoidance were collected from the tax authorities in Kumasi. These data formed the primary data for the results and discussions. In addition, review of literature was done using secondary data from articles and books.

### **3.6 Data collection tools and procedures**

#### **3.6.1 Questionnaires**

Questionnaires were used to collect data from the respondents. According to Williams (2007) questionnaires are very effective for securing information about people's ideas, practices and condition as well as for enquiring into the opinions and attitude of the subject. The use of questionnaires promised a wider coverage since it can be used to cover large numbers of respondent. The questionnaires in this study contain the five likert scale ranging from Strongly Disagree as response

1 to Strongly Agree as response 5. The questionnaires were also made up of both open-ended and close-ended questions.

### **3.6.2 Observations**

Apart from the questionnaires, observation was used in this study. The activities of the SMEs were observed and recorded. This data formed part of the socio-economic characteristics of the respondents. Pictures were also taken on the SMEs in the Kumasi Metropolis.

### **3.6.3 Interview Guide**

Interview guide was also used in this study to collect data from the key informants. The response from officers from the Ghana Revenue Authority and those from the three zones were recorded in a notebook to aid in the data analysis.

### **3.6.4 Mode of Data Collection**

The questionnaires were administered through face-to-face interview. This means that the respondents were asked questions and they answered verbally which was indicated in the questionnaires. To facilitate the data collection, the services of Field Research Assistants (FRAs) were hired to assist in the data collection. Two weeks were used to administer all the questionnaires on the field. With the key informants, interview was used to collect data from them. The English Language was used as the medium of communication with the key informants. However,

with the owners of SMEs, the Akan Twi was used as the medium of communication.

### **3.7 Validity and Reliability**

Reliability refers to whether the questionnaires measures the purpose it is intended to measure. To ensure reliability of the research questionnaires, the questionnaires were simply and carefully constructed to avoid ambiguity. The open-ended questions were included in the questionnaires to offer the opportunity for respondents to express their views. Again, a pilot study was conducted to ascertain questions that needed to be modified. Ten of the questionnaires were piloted. Respondents were not made aware that it was piloting. This was done so that they would not feel reluctant to give the correct information.

### **3.8 Research Ethics**

Before the data was collected from the staffs from the GRA, the researcher wrote a letter to them to ask for permission. The letter was replied by the GRA after two weeks and permission was granted. With owners of SMEs in Kumasi, the researcher used his identity card to show them that the data was to be used for academic purpose and nothing else. They agreed to respond to the questions in the questionnaires before the interview begun.

### 3.9 Variables in the Study

Table 3.1 shows the variables that were used in the study. The variables were obtained from the conceptual framework on tax evasion and avoidance. The variables were broadly grouped in economic and social determinants of tax evasion. The economic determinants/factors include tax rate, income and penalty rate.

**Table 3.1: Variables for objective two**

Factor	Variables	Description	Type of scale	Type of variable
Economic	Income	It is defined as the amount of earned income from the SME activities in the month	Continuous data	Independent
	Tax rate	It is defined as the degree of tax charged for evading income tax	Ordinal data	Independent
	Penalty rate	It is defined as the degree of tax charges for delaying in paying the income tax	Ordinal data	Independent
Social	Gender	It is defined as whether the person is a male or female	Nominal data	Independent
	Religion	It is defined as the type of religious affiliation one engages in	Nominal data	Independent

Culture/ethnicity	It is defined as the type of ethnic group the person belongs	Nominal data	Independent
Education	It is defined as the highest educational attainment of the person at the time of the survey	Continuous data	Independent
Transparency	It is defined as the ability of the tax authorities to makes accountable of the revenue they collect	Ordinal data	Independent
Tax morale	It is defined as the willingness to pay the income tax	Ordinal data	Independent
Age	It is the years the person had lived at the time of the survey	Continuous data	Independent
Tax evasion	It is defined as the number of times taxpayer had paid tax for a year	Ordinal data	Dependent

Source: Author's construct, 2017

The social determinants/factors include gender, religion/culture, education, transparency and accountability and tax morale. All the variables have been described as ordinal data except income and age which are a continuous data. Correlation analysis was used to examine the linkage between variables. The null hypothesis ( $H_0$ ) was that age, gender, education, tax morale, income, penalty rate,

religion, culture, transparent does not determine tax evasion. The null hypothesis is rejected at a significant value of more than 0.05.

### 3.10 Method of data analysis and reporting

#### 3.10.1 Quantitative analysis

Descriptive statistics such as mean and standard deviations were used to analyze the data. The Relative Importance Index (RII) was used to rank in order of importance, the perceptions of taxpayers on what factors contribute to tax evasion. The formula for the RII is stated as  $\frac{\sum W}{A*N}$  ( $0 \leq RII \leq 1$ ), where “W” represents the mean weight. This is the weight assigned to each factor by the traders. It ranges from strongly disagree (1) to strongly agree severe (5) The “A” represents the highest weight (that is strongly agree=5) and “N” represents the number of respondents that were interviewed (150).

Correlation analysis was performed to assess the strength and direction of the relationships between the dependent and independent variables as indicated in Table 3.1. The guidelines suggested by Rowntree (1991:170) cited in Fisher (2007) for interpreting correlation coefficient was used to assess the strength of the relationships. The guidelines states that correlation coefficient at 0.0 to 0.2 is regarded as very weak; 0.2 to 0.4 is weak; 0.4 to 0.7 is moderate; 0.7 to 0.9 is strong and 0.9 to 1.0 is very strong. The significant value of less than or equal to 0.05 is regarded as significant. The IBM Statistical Package for Social Sciences (SPSS, version 21) was used to perform the correlation. It was also used to

produce the descriptive statistics (mean, standard deviations) and tables as well as figures to aid the analysis of data. Again, cross tabulation with Chi-Square test was used to examine the significance differences of the responses.

### 3.10.2 Qualitative Analyses

The study collated the qualitative responses from respondents, edited and combined them with descriptive statistics. The study used direct quotes from respondents to support the quantitative analysis to give clear and in-depth understanding of the discussions.

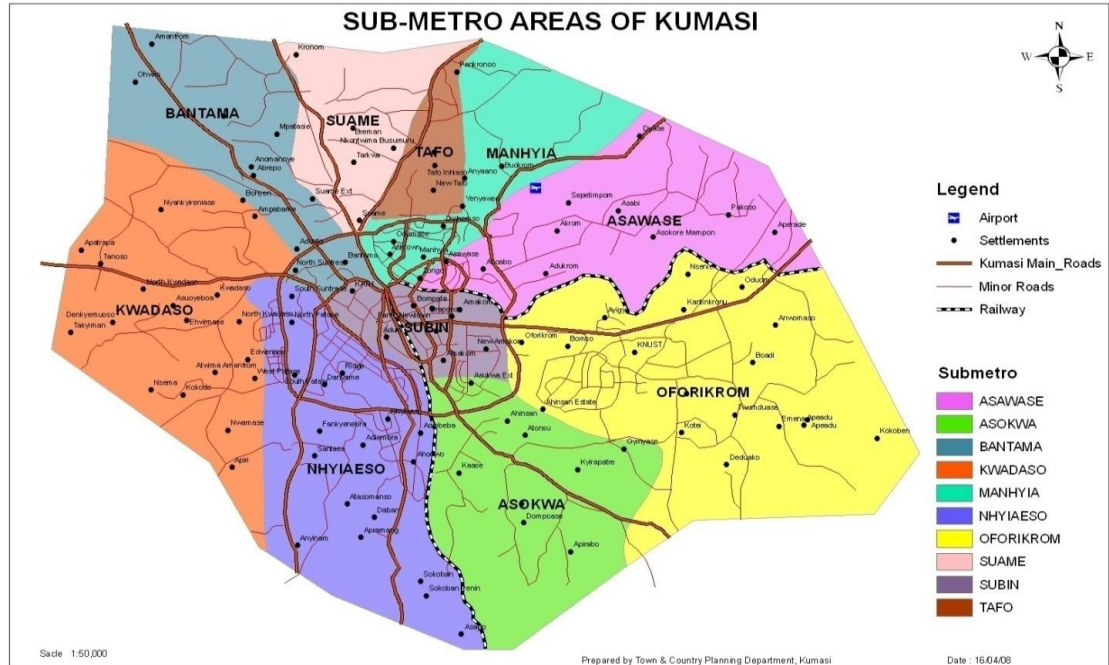
### 3.11 Study area

Figure 3.1 shows the map of the Kumasi Metropolis in the Ashanti Region of Ghana. The metropolis is divided into 10 zones which include Bantama, Kwadaso, Suame, Tafo, Manhyia, Asawase, Oforikrom, Asokwa, Nhyiaeso and Subin.

#### Distribution of population

The population of the Central Business District, which stretches to cover Adum, Central Market, Asafo and Ash town, experiences high population growth during the day whilst the dormitory towns, which are predominantly located, quiet a distance away from the Central Business District (CBD) experiences low population. The main pull-factor of population in Adum, Asafo and Ash town is the concentration of economic activities in these areas (GSS, 2014).





**Figure 3.1: Map of Kumasi metropolis**

Source: KMA (2017)

**Informal sector**

The informal sector of Kumasi, which is the backbone of the Metropolis, is characterized with a host of petty traders dealing in all kinds of items ranging from food stuffs to clothing, stationeries, small-scale mechanical shops and beverage manufacturing industries. Significant size of the active labour force is employed in this sector. This explains the low mobilisation of Internally Generated Fund by the Assembly since there is no data base on these businesses (GSS, 2014).

## CHAPTER FOUR

### DATA PRESENTATION, ANALYSIS AND DISCUSSION OF FINDINGS

#### 4.1 Introduction

In this chapter, three objectives have been achieved with the data collected from the field. First the factors that influence owners of SMEs to avoid the payment of income tax have been discussed. Second, the ways owners of SMEs adapt to evade and avoid income tax have also been discussed. Third, the mechanisms that have been used by staffs from Ghana Revenue Authority (GRA) are discussed in this chapter.

#### 4.2 Demographic Characteristics of Owners of SMEs in Kumasi

##### (a) Gender of Owners of SMEs in Kumasi

The demographic characteristics of owners of SMEs in Subin, Suame and Bantama in Kumasi are presented in Table 4.1. It was found that majority of the owners of SMEs were females (74.7 percent) compared with the males (25.3 percent). The dominance of females in the SMEs agrees with the results from the 2010 Population and Housing Census with a population of 55 percent of females and 45 percent of males in Kumasi.

##### (b) Age of Owners of SMEs in Kumasi

As shown in Table 4.1, it was found that about 42 percent of the respondents were between the ages of 30 and 39 years. Also, about 26 percent of them were between the ages of 40 and 49 years. Again, about 15 percent of them were

between the ages of 20-29 years. Only few (4 percent) of them were below 18 years. It can be deduced from this results that greater proportion of the respondents were within the youthful age (16-39 years). However, the 4 percent that engaged in trading in Kumasi violate the stipulated condition in the 1992 Constitution of Ghana that states that a person under 18 years is not supposed to work. Meanwhile, taxes were collected by the tax officials from SMEs without giving attention on the ages. The youthful population of SMEs in Kumasi signifies that they are active to continue trading for longer period of time. This can be a potential for officials from the GRA to collect taxes from these active population for longer years.

**Table 4.1: Demographic Characteristics of Owners of SMEs in Kumasi**

Characteristics	Frequency	Percent
<i>Gender</i>		
Male	38	25.3
Female	112	74.7
Total	150	100.0
<i>Age (in years)</i>		
Below 18	18	4.0
20-29	22	14.7
30-39	63	42.3
40-49	38	25.5
50-59	21	14.1
Total	150	100.0

<i>Ethnic Group</i>		
Akan	102	68.0
Ga-Dangbe	10	6.7
Ewe	18	12.0
Guan	12	8.0
Gurma	8	5.3
<b>Total</b>	<b>150</b>	<b>100.0</b>
<i>Religion</i>		
Christian	103	68.7
Islam	35	23.3
Traditional	12	8.0
<b>Total</b>	<b>150</b>	<b>100.0</b>
<i>Education</i>		
Basic	75	50.0
SHS	38	25.3
Diploma	7	4.7
First Degree	10	6.7
Second Degree	1	.7
No Formal Education	19	12.7
<b>Total</b>	<b>150</b>	<b>100.0</b>

<i>Sector of Employment</i>		
	16	10.7
Fitting Shop		
Leather Work	13	8.7
Textile Work	10	6.7
Commercial Activity	44	29.3
Food Processing Work	27	18.0
Wood Product Work	17	11.3
Metal Work	23	15.3
<b>Total</b>	<b>150</b>	<b>100.0</b>
<i>Years in Business</i>		
1-3	28	18.7
4-6	84	56.0
7-10	11	7.3
10 and more	27	18.0
<b>Total</b>	<b>150</b>	<b>100.0</b>

Source: Field Survey, 2017

**(c) Ethnic Groups**

It can be found from Table 4.1 that two out of every three owners of SMEs were Akans in Kumasi. This may be attributed to the reason that Kumasi is an Akan community and such there are concentration of Akans compared with other ethnic groups. Owners of SMEs who were Ewes constituted 12 percent while 8 percent was made up of Guans. Also, about 7 percent of them were Ga-Dangbe. It can be

deduced from the results that the ethnic groups one belongs to can determine his/her way of life. Therefore, the culture and/or ethnic group can have influence on a person attitude towards payment of taxes.

#### **(d) Educational Background of Owners of SMES**

As indicated in Table 4.1, half (50 percent) of owners of SMEs had completed the Basic School. Also, about 25 percent of them had completed the Senior High School (SHS) while 13 percent had not been to formal education. It can be deduced from Table 4.1, that about 11 percent of them had completed post SHS. This was made up of about 7 percent that had obtained first degree and 5 percent that had obtained diploma. Only few (.7 percent) of them had obtained second degrees. It can be deduced from the results that the education background of owners of SMEs in Kumasi was low. This is due to the reason that about 63 percent of them had not attained post SHS. Although ethnicity may determine the attitude of a person towards payment of taxes, the educational background can also play important role. It can be argued that without sufficient sensitisation on the relevant of paying tax, owners of SMEs in Kumasi may not develop the habit of paying taxes in Kumasi. This is because of their low educational background that may lead to their limited knowledge in the relevance of honouring tax obligations. Aside from this, it can also be argued that those with high level of education (Diploma, First and Second Degrees) are those that usually evade the payment of income tax. This is because with their educational background, they



are capable of identifying the loopholes in the tax law and take advantage of it to avoid or evade the payment income tax.

**(e) Number of Years People had engage in the SME Activities**

As shown in Table 4.1, more than half (56 percent) of owners of SMEs had engaged in the activity for 4-6 years. Also, about 19 percent of them had engaged in the SME for 1-3 years. Again, 18 percent had engaged in SME activities for more than 10 years. It can be deduced from the results that about 81 percent of the respondents had engaged in the SME activities for more than 3 years. It can therefore be argued that they had had experience in the job and in the payment of taxes. They may have knowledge on income taxes in Kumasi for being in the activity for more than 3 years.

**(f) Religion of Owners of SMEs**

It was found that Christian Religion dominates in Kumasi. This is due to the reason that one out of every three (68.7 percent) of owners of SMEs were Christians. This was followed by 23 percent of them that were affiliated to Islamic religion and 8 percent that were traditionalists. The religion one engages in may influence their attitude towards payment of income tax. This due to the reason that it is the belief of religious people to pay tax or levy in a community they live. This belief is demonstrated in the alms and offering they give at their religious activities. Therefore, through this belief, one may have lessons on the obligations of paying tax to the government.



**(g) Category of SMEs in Kumasi**

It was found that seven categories of SMEs activities were operated in Kumasi. They included fitting shops, leather works, textile works, commercial activities, food processing works, wood product works and metal works. Among these SMEs, it was found that commercial activities had the highest number of people that were engaged in petty trading. This was followed by 18 percent that engaged in food processing works and 15 percent that engaged metal works. The type of activity a person engaged in can influence his or her attitude towards payment of income tax. This can be explained that some of the activities were not located at a specific place that may become difficult for tax officials to trace them and collect tax. Interview with the tax officials indicated that the type of SME determines the amount of income tax to pay. Officials from the GRA group the taxpayers according to their sectors/type of business activity and calculate or predict the amount of income for a period of time.

**4.3 Factors that Influence Individual Decisions to Evade Income Tax in Kumasi**

The owners of SMEs in Kumasi were asked to mention the factors that may influence them to devoid from paying income tax to the GRA. The factors have been ranked using the Relative Importance Index (RII).

### 4.3.1 Lack of Enforcement of Laws

As shown in Table 4.2, owners of SMEs in Kumasi mentioned that lack of enforcement was the most influential factors towards their decision to evade income tax. As shown in Table 4.2, the mean score of 4.04 and a standard deviation of 1.080 indicated average responses of those that agreed that lack of enforcement of tax laws by the tax officials have influenced them to evade the payment of income tax. With a RII of 0.005387, it is ranked as the first factor. Though enforcement is somehow done, the respondents complained that it is ineffective. They further explained that they know people fail to pay income tax but they have not seen any one being prosecuted at the law court. This implies that there is no effective deterrent mechanism in place to enforce income tax payment and thus owners of SMEs take the advantage of this and also evade income tax.

**Table 4.2: Response from Owners of SMEs on Factors that can lead to Income Tax Evasion**

Factors	N	Minimum	Maximum	Mean	Std. Deviation	RII	Ranking
Lack of Enforcement of Laws	150	1	5	4.04	1.080	0.005387	1 <sup>st</sup>
Low Returns from SME	150	1	5	3.97	1.077	0.005293	2 <sup>nd</sup>
High Tax Rate	150	1	5	3.91	1.095	0.005213	3 <sup>rd</sup>

Lack of Transparency and Accountability	150	1	5	3.80	.983	0.005067	4 <sup>th</sup>
Illiteracy on Tax	150	1	5	3.73	1.473	0.004973	5 <sup>th</sup>
Infrequent Education	150	1	5	3.65	1.221	0.004867	6 <sup>th</sup>
Low Tax Morale	150	1	5	3.50	1.246	0.004667	7 <sup>th</sup>
Level of Corruption	150	1	5	3.24	1.294	0.00432	8 <sup>th</sup>
Lack of Adequate Tax Incentives	150	1	5	3.12	1.456	0.00416	9 <sup>th</sup>
Non/Low Provisional of Social Services	150	1	5	2.85	1.485	0.0038	10 <sup>th</sup>
High Penalty Rate	150	1	5	2.47	1.482	0.003293	11 <sup>th</sup>
Poor Relationship between Taxpayers and Tax Collectors	150	1	5	2.37	1.109	0.00316	12 <sup>th</sup>

Source: Author's Construct, 2017

#### 4.3.2 Low Returns from SME Activities

It was found that the low profit from SME activities in Kumasi influenced attitude of people towards the payment of income tax. As indicated in Table 4.2, the mean score of 3.97 showed the average response of that that agreed that because of low

returns from their trading activities, they felt reluctant to pay their income tax. With the RII score of 0.005293, it is ranked as the second influential factors attributed to tax evasion. They complained that their income from the sale of goods is very low to encourage them to pay income tax. They further complained that the low income is attributed to the low purchase of their goods. Others also complained that sometimes the amount they earn in the quarter was small. When this happens, they try to forget the payment of income tax and shift it to next quarter. This leads to accumulation of much money to be paid as income tax for the year. When the tax amount becomes huge for them, they cannot afford to pay and therefore find a way of reducing the accumulated amount of the income tax and pay less. Some of them even fail to pay for the whole year because of ineffective law enforcement. This reduces the number of times they are requested to pay as income tax in a year. This results support the claim made by Sandmo (2004) that the amount of income the taxpayer earns determines whether he/she will evade the tax.

#### **4.3.3 High Tax Rate**

As shown in Table 4.2, the mean score of 3.91 and a standard deviation of 1.095 indicated average response of those that agreed that high tax rate is a factor that influenced them to evade the payment of income tax. With a RII of 0.005213, it is ranked as the third influencing factor. The owners of SMEs in Kumasi complained that tax rate coupled with the low returns from the activities discouraged or prevented them from paying income tax. The petty traders for

instance complained that the tax rate is high for them and as such they do not have a permanent place to sell their goods. They also complained that they pay tax to the Kumasi Metropolitan Assembly (KMA) and as such, do not see the need to pay additional tax to the GRA. The double payments of taxes are very high for them and therefore fail to honor their tax obligations. A statement from the respondents was that:

“When the tax officials meet to fix the amount of tax we need to pay, they forget to involve us. After fixing the tax, then they remember us by imposing it on us. This is not fair and as such we also find ways of escaping the payment of tax”.

#### **4.3.4 Lack of Transparency and Accountability**

It was found that lack of transparency and accountability was among the factors that influenced people’s decision to pay income tax in Kumasi. The mean score of 3.80 and a standard deviation of .983 indicated average response of those that agreed that the inability of tax officials to make accountability and transparency in the utilisation of the taxes lead to the evasion of income tax. With a RII score of 0.005067, it is ranked as the fourth factor for evading income tax. Transparency and accountable is one of the tools to make governance closer to the public. When proceeds from taxes are accountable and transparent, people would see the need to pay income taxes without forcing them. Owners of SMEs in Kumasi complained that tax authorities had never made account of the taxes they collect from them before. They complained in a statement they made that:

“We have been informed that taxation contributes to national development. But the duties of tax officials to make accounts of taxes they collect had not been done. The tax administrators have failed in their duty in the first place let alone going rounds to collect income tax. We would also fail in our duty to honour our tax obligations”.

It can be argued from the above statement that there is no doubt that owners of SMEs would continue to evade the payment of income tax if their needs are unmet.

#### **4.3.5 Illiteracy of Owners of SMEs on Tax**

It was found that the illiteracy of Owners of SMEs regarding their inability to complete higher level of education influenced their attitude towards the payment of income tax. As shown in table 4.2, the mean score of 3.73 and a standard deviation of 1.473 indicated average response of those that agreed that illiteracy was a factor that influenced their attitude to evade the payment of income tax in Kumasi. With a RII score of 0.004973, it was ranked as the fifth influential factors towards tax evasion.

#### **4.3.6 Infrequent Education on Income Tax**

It was found that aside the educational background of owners of SMEs, they lack education on taxation. The mean score of 3.65 and a standard deviation of 1.221 indicated average response of those that agreed that infrequent education on tax

influenced them to evade the payment of income tax in Kumasi. With a RII score of 0.004867, it was ranked as the sixth influential factors that had lead to tax evasion. The infrequent education on taxation has made owners of SMEs illiterate because they lack adequate information on taxation. It can be argued from the results that when there is infrequent tax educations, taxpayers may be ignorant about their responsibility to pay income tax. Interview with the tax officials indicated that they rarely conduct tax education. The officials complained that they incur more cost in the collection of income tax and therefore do not frequently organize sensitization exercise to educate the taxpayers. This shows the ineffectiveness of the GRA in tax administrations in Kumasi.

#### **4.3.7 Low Tax Morale**

As indicated in Table 4.2, the mean score of 3.50 and a standard deviation of 1.246 showed the average response of those that agreed that low tax morale can be a cause to tax evasion in Kumasi. With RII score of 0.004667, it was ranked as the seventh contributing factor to tax evasion. Tax morale shows the level of commitment or willingness towards the payment of income tax. The low tax morale of owners of SMEs is a sign of their unwillingness or commitment to pay income tax. This occurs when there is low level of tax compliance as mentioned by Alm *et al.*, (2007).



#### **4.3.8 Level of Corruption**

It can be found from Table 4.2 that corruption may be contributing factor to tax evasion. The mean score of 3.24 and a standard deviation of 1.29 indicated average response of those that somehow agreed that corruption can contribute to tax evasion. With RII score of 0.00432, it is ranked as the eight contributing factors to tax evasion. The owners of SMEs suggested that since there is lack of transparency and accountability, they think that tax authorities are corrupt. That is, they use the proceeds from the taxes as their personal gain instead of developing the metropolis.

#### **4.3.9 Lack of Adequate Tax Incentives**

As indicated in Table 4.2, the mean score of 3.24 and a standard deviation of 1.294 showed the average response of those that agreed somehow that lack of adequate tax incentives influenced their decisions to evade the payment of income tax. With RII score of 0.00416, it was ranked as the ninth contributing factor to tax evasion. They explained that there were no tax incentives for them to enjoy. This becomes annoying sometimes for them to continue the payment of taxes.

#### **4.3.10 Non/Low Provisional of Social Services**

As shown in Table 4.2, the mean score of 2.85 and a standard deviation of 1.485 indicated average response of those of those that agreed somehow that the non provision or inadequate provision of social amenities can influenced them to evade the payment of income tax in Kumasi. With RII score of 0.0038, it was

ranked as the tenth contributing factor to tax evasion. As discussed earlier, the non provision of basic social services can lead to unwillingness of people to pay income tax. As explained by Torgler (2003), low tax morale is attributed to the low quality of service provisions in return for taxes and the perception of fairness.

#### **4.3.11 High Penalty Rate**

It was found that high penalty rate instituted by tax officials did not lead to tax evasion in Kumasi. As shown in Table 4.2, the mean score of 2.47 and a standard deviation of 1.482 indicated average responses of those that disagreed to the statement that high penalty rate can influence the decision of owners of SMEs to evade the payment of income tax. With RII score of 0.003293, it was ranked as the eleventh contributing factor to tax evasion. Owners of SMEs in Kumasi made it clear that:

“The high penalty rate for failure to pay income tax is a deterrent to tax defaulters. We are encouraged by this strategy to honor our tax obligations. However, when the penalty becomes very high, the person may be discouraged to pay the income tax. He may even stop running the enterprise. Since there is weak enforcement of byelaws, it becomes bad debt”.

#### **4.3.12 Poor Relationship between Taxpayers and Tax Collectors**

It was found that the good relationship between taxpayers and tax collectors resulted to the unwillingness of taxpayers in the payment of income tax in Kumasi. As shown in Table 4.2, the mean score of 2.37 and a standard deviation of 1.109 indicated average response of those that disagreed to the statement that

poor relationship is a cause to tax evasion. With RII score of 0.00316, it is ranked as the twelfth contributing factor to tax evasion among owners of SMEs. The owners of SMEs explained that majority of the tax collectors established good relationship with taxpayers. The cordial relationship occurs where the tax officials give enough time for taxpayers to pay their income tax.

They further mentioned that when tax authorities come to them to collect tax for the quarter and they are not ready to pay, time is provided for them together money and pay in the next quarter. Though this may encourage taxpayers to pay their income tax at convenient time, it can also lead to tax evasion. This is due to the fact that through this relationship, taxpayers may take advantage of it and refuse to pay the accumulated amount of income tax. Taxpayers can also pay bribe to tax officials and pay small accumulated amount of the income tax. This is a common in most developing countries where inefficiencies in the administration and enforcement of taxes are exposed to bribing activities (See TJN, 2003). Therefore it can be argued that the relationship between tax officials and taxpayers can contribute to tax evasion.

#### **4.3.13 Factors Contributing to Tax Evasion**

The Spearman Rank Order Correlation was performed to assess the factors that contribute to income tax evasion among owners of SMEs in Kumasi. The dependent variable was tax evasion (the number of times owners of SMEs have paid income tax for last year) and the independent variables were income, tax

rate, penalty rate (economic factors), gender, religion, ethnicity, education, transparency, tax morale and age (social factors). As indicated in Table 4.3, among the factors, high tax rate was the only significant contributing factor that influenced decisions of owners of SMEs in Kumasi to pay income tax. The significant value of .034 showed that there was a significant relationship between high tax rate instituted by tax officials in Kumasi and the number of times they paid their income tax. This implies that the result do not happen by chance.

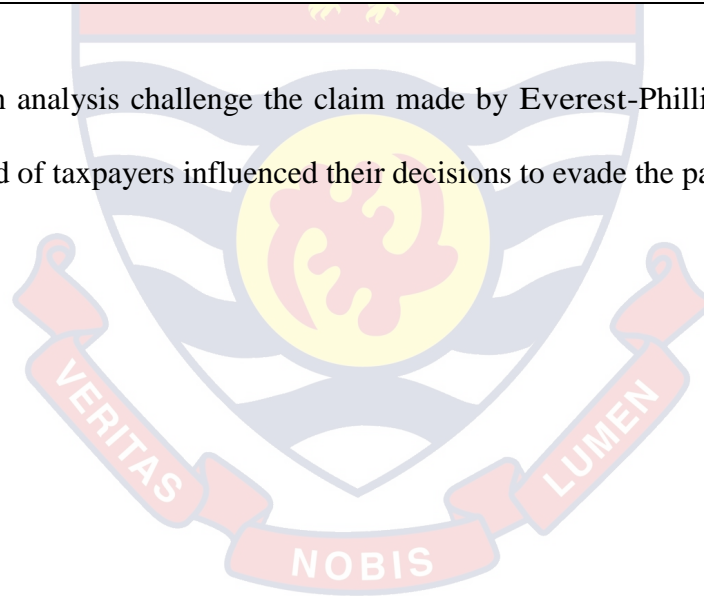
However, the other social and economic factors did not show statistical relationship with the number of times owners of SMEs paid income tax in Kumasi. This is due to the fact that the significant values exceed the alpha value of 0.05. Therefore, the null hypothesis that there is significant relationship between income, tax rate, religion, ethnicity, education, transparency, tax morale and age and tax evasion is rejected. It is therefore concluded in this study that high tax rate showed significant contribution to the number of times owners of SMEs paid their income tax. The positive correlation coefficient value of 0.173\* indicated that the high the penalty rate, the more owners of SMEs paid their income tax. Using the guidelines proposed by Rowntree (1991:170) for interpreting correlation coefficient was used to assess the strength of the relationships, it can be concluded that there was very weak relationship between high penalty rate and tax evasion among owners of SMEs in Kumasi.

**Table 4.3: Correlation Analysis of Factors Influencing Owners of SMEs in Kumasi towards Tax Evasion**

		Income	Tax rate	Penalty rate	Gender	Religion	Ethnicity	Education	Transparency	Tax morale	Age	Times paid income tax for last year
Income	Correlation	1.000	-0.247**	-0.140	-0.157	.048	-0.029	0.069	0.178*	-0.103	0.048	-0.078
	Coefficient											
Tax rate	Significance score	.	0.002	0.088	0.055	.563	0.722	0.403	0.029	0.211	0.560	0.345
	Correlation	-	1.000	-0.112	0.076	0.002	0.006	0.076	0.142	-0.086	-0.034	0.032
Penalty rate	Coefficient	0.247**	.	0.172	0.353	0.981	0.945	0.357	0.083	0.298	0.680	0.697
	Significance score	0.002	.	0.172	0.353	0.981	0.945	0.357	0.083	0.298	0.680	0.697
gender	Correlation	-0.140	-0.112	1.000	0.135	-0.186*	-0.074	-0.120	-0.253**	0.174*	0.043	0.173*
	Coefficient											
Religion	Significance score	0.088	0.172	.	0.100	0.023	0.368	0.145	0.002	0.034	0.604	0.034
	Correlation	-0.157	0.076	0.135	1.000	-0.137	-0.165*	0.079	0.010	0.046	-	-0.027
Ethnicity	Coefficient	0.055	0.353	0.100	.	0.094	0.044	0.339	0.903	0.573	0.041	0.740
	Significance score	0.048	0.002	-0.186*	-0.137	1.000	-0.071	0.189*	0.163*	-0.084	-0.037	0.058
Education	Correlation	0.563	0.981	0.023	0.094	.	0.387	0.021	0.046	0.306	0.653	0.484
	Coefficient	-0.029	0.006	-0.074	-0.165*	-0.071	1.000	-0.176*	-0.035	-0.127	0.103	-0.024
Transparenc y	Significance score	0.722	0.945	0.368	0.044	0.387	.	0.031	0.667	0.121	0.210	0.774
	Correlation	0.069	0.076	-0.120	0.079	0.189*	-0.176*	1.000	0.177*	-0.146	-0.114	-0.072
y	Coefficient	0.403	0.357	0.145	0.339	0.021	0.031	.	0.030	0.075	0.167	0.383
	Significance score	0.178*	0.142	-0.253**	0.010	0.163*	-0.035	0.177*	1.000	-	0.100	0.036
										0.294**		

	Significance score	0.029	0.083	0.002	0.903	0.046	0.667	0.030	.	0.000	0.225	0.666
Low tax morale	Correlation Coefficient	-0.103	-0.086	0.174*	0.046	-0.084	-0.127	-0.146	-0.294**	1.000	-0.062	-0.121
	Significance score	0.211	0.298	0.034	0.573	0.306	0.121	0.075	0.000	.	0.453	0.140
Age	Correlation Coefficient	0.048	-0.034	0.043	-0.167*	-0.037	0.103	-0.114	0.100	-0.062	1.000	-0.076
	Significance score	0.560	0.680	0.604	0.041	0.653	0.210	0.167	0.225	0.453	.	0.354
Times paid income tax for last year	Correlation Coefficient	-0.078	0.032	0.173*	-0.027	0.058	-0.024	-0.072	0.036	-0.121	-0.076	1.000
	Significance score	0.345	0.697	0.034	0.740	0.484	0.774	0.383	0.666	0.140	0.354	.

The results from the correlation analysis challenge the claim made by Everest-Phillips (2008), Fraser and Ellis (2009) that age, gender and educational background of taxpayers influenced their decisions to evade the payment of income tax.



#### 4.4 Analysis of How Owners of SMEs Evade and Avoid the Payment Income Tax

##### 4.4.1 Status of Payment of Income Tax by Owners of SMEs in Kumasi

Owners of SMEs in Kumasi were asked to mention the number of times they have paid their income tax for last year. It was found from the tax officials that the SMEs paid income tax every three months in year. This means that there are four quarters in a year and therefore it is expected that owners of SMEs paid income tax four times last year. As indicated in Table 4.4, it was found that about 39 percent of owners of SMEs in Kumasi had not paid income tax at all last year. Also, about 23 percent of them paid income tax only once last year. Again, about 17 percent paid income tax four times last year.

**Table 4.4: Number of times Owners of SMESs paid their Income Tax last Year**

Payment of Income Tax	Frequency	Percent
Once	35	23.3
Two Times	16	10.7
Three Times	15	10.0
Four Times	25	16.7
Not At All	59	39.3
Total	150	100.0

Source: Field Survey, 2017

It can be deduced from Table 4.4 that only few (16.7 percent) of the owners of SMEs interviewed in Kumasi paid all their income taxes last year. The remaining about 83 percent of them did not pay their income tax fully last year. It can



therefore be argued that majority of owners of SMEs interviewed in Kumasi were victims of tax evasion.

#### 4.4.2 How the Informal Sector Evade Income Tax

Ten officials from the Ghana Revenue Authority (GRA) were asked to explain how owners of SMEs in Kumasi evade the payment of income tax. They defined tax evasion as the illegal means to reduce tax liabilities. The officials referred tax evasion and avoidance as the “Twin Devil” indicating that it is a cost to the economy. As indicated in Table 4.5, according to the tax officials, owners of SMEs in Kumasi evade income tax through non-declaration of income, number of business activity they own and their locations.

**Table 4.5: Ways the Informal Sector Evade Income Tax (Responses from Tax Officers)**

Ways Tax is Evaded	Participants										N=10	Percentage
	1	2	3	4	5	6	7	8	9	10		
Non-Declaration of Income	1	1	1	1	1	1	1	1	1	1	9	90
Number and Location of Business Activities	-	1	1	1	1	1	1	1	1	1	8	80

Source: Field Survey, 2017

**a) Non-Declaration of Income by Owners of SMEs to Tax Officials from GRA**

As shown in Table 4.5, it was found that 90 percent of the tax officials mentioned that non-declaration of right amount of income to them is a way owners of SMEs evade the payment income tax. It was found from the owners of SMEs in Kumasi that they fail to declare their income to the tax officials. As shown in Table 4.6, it was found that 64 percent of owners of SMEs did not declare their full amount of income to the tax officials last year.

**Table 4.6: Response from Owners of SMEs on Non-Declaration of Income to Tax Officials Last Year**

	Declaration of income to GRA			Total
	Often	Not often	Not at all	
Fitting Shop	6	3	7	16
Leather Work	0	5	8	13
Textiles	1	5	4	10
Commerce	6	11	27	44
Food Processing Work	2	5	20	27
Wood Product Work	4	2	11	17
Metal Works	1	3	19	23
Total	20 (13.3%)	34 (22.7%)	96 (64.0%)	150 (100.0%)

Source: Field Survey, 2017

Pearson Chi-Square (22.893), Asymp. Sig. (0.029)

It was also found that about 23 percent of owners of SMEs in Kumasi did not often declare their income to the tax officials. Only about 13 percent of them declared their full income to the tax officials last year. It can be argued from this result that majority of owners of SMEs in Kumasi had not declared their income to tax officials. The Pearson Chi-Square value of 22.893 and a significance of .029 indicated that there was significant difference of the type of business activities and the willingness of the owners to declare their income to tax officials. It can be deduced from Table 4.6 that out of the 64 percent that had not declared their income to the tax officials, majority of them were petty traders. This confirms the statement made by the 90 percent of tax officials that owners of SMEs in Kumasi evade income tax through non-declaration of income.

**(b) Number and Location of Business Activities**

As shown in Table 4.5, 80 percent of the tax officials mentioned that the number of business activity one has and their locations is one of the means taxpayer used to evade the payment of income tax. They explained that someone may have more business activity in Kumasi, register them with a single name in order to pay income tax for all of them. This was confirmed by the data obtained from the owners of SMEs in Kumasi as indicated in Table 4.7. It was found that about 49 percent of owners of SMEs had one business activity in Kumasi. Out of this, majority of them (71.6 percent) had not paid income tax.

**Table 4.7: Number of Business and Payment of Income Tax**

	Payment of tax on all businesses		Total	Percent
	Yes	No		
One	21	53 (71.6%)	74	49.3
Two	12	20 (62.5%)	32	21.3
Three	8	15 (65.2%)	23	15.3
Four	3	12	15	10.4
More Than Four	0	6	6	4.0
<b>Total</b>	<b>44 (29.3%)</b>	<b>106 (70.7%)</b>	<b>150</b>	<b>100.0</b>

Source: Field Survey, 2017

Also, about 21 percent of them owned two business activities but about 63 percent of them paid income tax on one of them. Again, about 15 percent of them owned three business activities in Kumasi but about 65 percent of them paid income tax on only one of the business. It can be argued from the results that about 51 percent of them owned more than one business activity in Kumasi but only 29 percent of them paid income tax on all of them. This means that the remaining about 70 percent of them had not paid income tax on all the business they owed. This explains how people evade the payment of income tax in Kumasi.

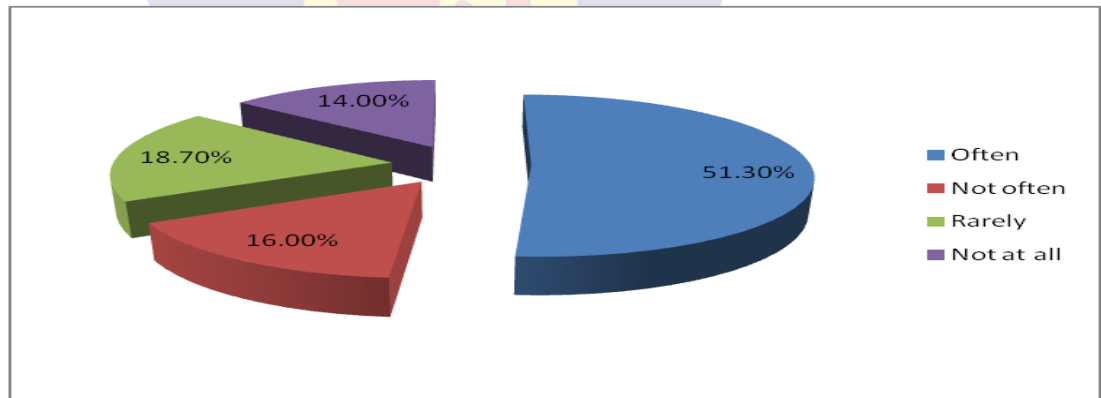
#### **4.4.3 How the Informal Sector Avoid the Payment of Income Tax**

The tax officials explained tax avoidance on the other hand could be explained as the legal means of re-arranging tax affairs in such a way that one pays little. They

further explained it as the ability of the taxpayer to take advantage of the legal loopholes to reduce tax liabilities.

**(a) Use of Purchase Invoice**

As indicated in Table 4.8, 90 percent of the tax officials mentioned that owners of SMEs in Kumasi used purchase invoice to reduce the amount of tax they are supposed to pay. They explained that the taxpayers compile and keep copies of any purchase they make in order to reduce the amount of tax to be paid. To validate this finding from the tax officials, owners of SMEs were asked whether they keep copies of purchase invoice and the reason for doing that. As indicated in Figure 4.1, about 51 percent of owners of SMEs in Kumasi kept copies of purchase invoices.



**Figure 4.1: Records of Purchase invoice**

**Source: Field Survey, 2017**

It was also found that about 19 percent of them rarely keep copies of purchase invoice while 16 percent did not often keep copies of purchase invoice. Again, it was found that 14 percent of them often kept copies of purchase invoice. It can be deduced majority of owners of SMEs in Kumasi kept copies of purchase invoice.

The reason why owners of SMEs keep copies of purchase invoice was that they deduct the VAT component of the invoices from their sales for the quarter or year. The tax officials explained that the tax law allows that when a retailer buys from a wholesaler, the wholesaler pays VAT on behalf of the retailer. This therefore becomes necessary to deduct the VAT component of the invoice from the sales of the retailer. This reduced the income of the taxpayer and therefore pays less income tax. This is another way the owners of SMEs used to avoid the payment of income tax.

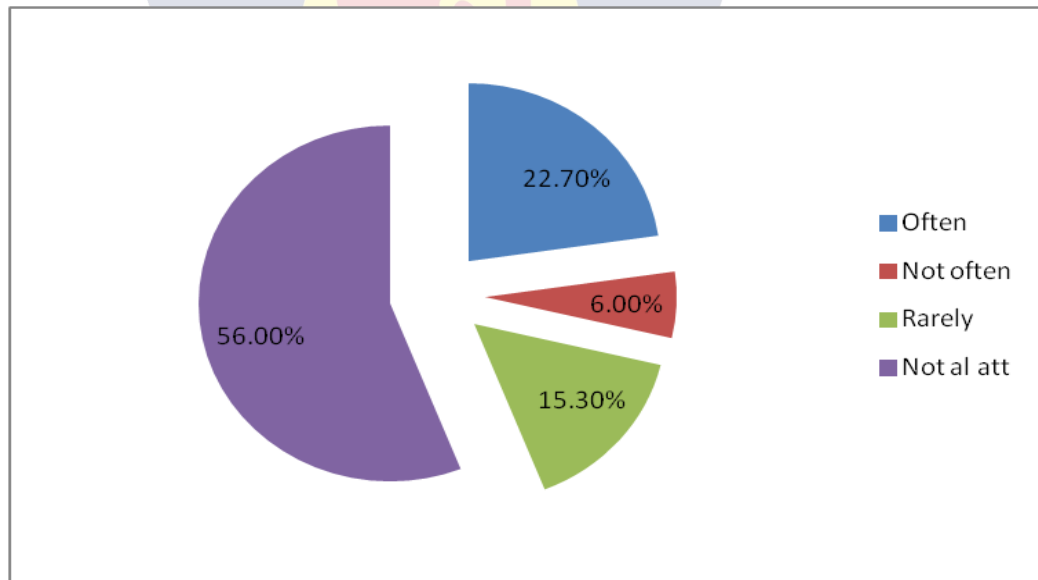
**Table 4.8: Ways the Informal Sector Avoid Income Tax (Responses from Tax Officers)**

Factors	1	2	3	4	5	6	7	8	9	10	N=10	Percent	
Purchase Invoice										✓	10	90	
Engagement of Consultants									✓	-	8	80	
Income Splitting	-	-								✓	✓	7	70
Capital Structure					-				✓	-	-	7	70

Source: Field Survey, 2017

**(b) Engagement of Consultants**

As shown in Table 4.8, 80 percent of the revenue officials mentioned that owners of SMEs in Kumasi sometimes engage the services of consultants to assist them reduce the amount of income tax. They explained that the consultants know much about the tax law and some of them are part of the formulation of the tax law in Ghana. By implication, these experts know much about the loopholes in the tax system and therefore assist taxpayers to avoid income tax. To support this argument, owners of SMEs were asked to mention whether they engage consultants or not. As indicated in Figure 4.2, more than half (56 percent) of owners of SMEs in Kumasi mentioned that they had not engaged the services of consultants in determining the amount to be paid as income tax before. This may be attributed to the small size of their business.



**Figure 4.2: Response on Engagement of Consultants in the Preparation of Statement of Accounts**

**Source: Field Survey, 2017**



Also, about 23 percent of them mentioned that they often engaged the services of consultants while 15 percent rarely engaged them in the preparation of statement of accounts. These consultants could assist them to re-arrange their financial documents or statements in such a way that they make less profit and therefore pay less income tax.

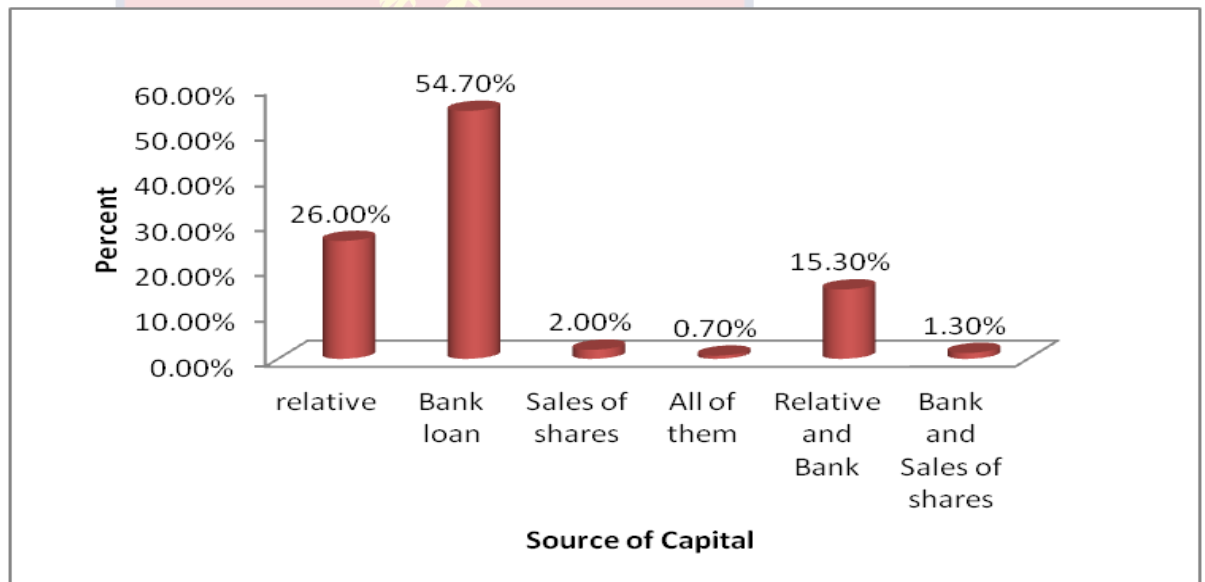
### **(c)Income Splitting**

As indicated in Table 4.8, 70 percent of the tax officials mentioned that income splitting is a way owners of SMEs adopt to avoid the payment of income tax. Income splitting according to the tax officials is a situation whereby the income earned is divided into more than one source so as to minimize income tax. The taxpayer simply arranges its financial statements in such a way that income is diverted to the other partner (wife, husband, siblings etc) with the lower marginal tax rate. They further explained that taxpayer set up investment in the name of the partner with lower income. As a result of this, the individual pays less tax because it reduces his/her profit. According to the tax law, the taxpayer is allowed to pay income tax based on the income he/she has made in a month or quarter or a year. The taxpayer takes advantage of this and split its income into various sources so as to avoid income tax payment.

### **(d) Capital Structure**

As shown in Table 4.8, 70 percent of the tax officials mentioned that owner of SMEs in Kumasi avoids the payment of income tax through debt and equity

capital. The tax officials explained that business is established or run based on two major sources of capital; equity capital and debt capital. The equity capital is the capital the individual used to run a business which is financed by relatives or friends or profit from selling shares. The debt capital is the capital or money the person obtains from the bank as a loan and pays the principal and interest on it. Based on this information, owners of SMEs were asked to state the source of their capital for running their business. As shown in Figure 4.3, it was found that about 55 percent of owners of SMEs in Kumasi obtained loans from the bank to establish their businesses.



**Figure 4.3: Source of Capital to the Establishment and Running of SMEs**

Source: Field Survey, 2017

It was also found that 26 percent of them obtained capital from their relatives to establish their businesses. Also, about 15 percent of the obtained capital from relatives and bank loans to establish their businesses. Others obtained capital from sales of shares (2 percent) and bank loans and sales of shares (1.3 percent). It can

be deduced from Figure 4.3 that majority of owners of SMEs in Kumasi run their businesses using bank loans. The equity capital (capital from relatives/friends and sales of shares) constituted 28 percent while the debt capital (loans from the bank) constitutes the 54.7 percent. According to the tax officials, the debt capital structure attracts less income tax as compared to the equity capital. This is because the interest the person pays on the loan is calculated as an allowable expense and it is deducted from the sales or profit the person makes in a quarter or year.

The study revealed that there is no legal action taken against tax avoiders. This is because, tax avoidance is legal and it is treated as such. Even if the person is caught, he/she is brought to the tax base. For example, if a business owner explains that he/she has taken much more loans from the bank (debt capital) to run a business and it is found out from the person's bank statement that it is not the case, the person is brought to the tax base. The only thing the tax officer will do is to use his/her own discretion to calculate the amount of tax the person is supposed to pay which might be very higher than what he/she used to pay.

#### **4.5 Mechanism for Reducing Tax Evasion and Avoidance in Kumasi**

Various mechanisms or strategies to reduce income tax evasion and avoidance of the informal sectors have been developed and implemented by tax officials from the GRA. Prominent among them include the introduction of tax stamp, tax amnesty, regular field inspection, introduction of the tax court, tax education, provision of tax incentives (reduction of the tax rates) and segregation of tax. The

mechanism used by the tax officials to improve income tax collection and reduce tax evasion and avoidance was assessed in this study.

#### **4.5.1 Introduction of Tax Amnesty**

The Internal Revenue Service use the tax amnesty as an incentive to give the informal sector the opportunity to settle their tax obligations to avoid the attraction of punishment. The tax amnesty was passed in parliament in 2011 and introduced in 2013. It was a incomplete instance chance for SMEs who failed to pay taxes to pardon their tax responsibilities in switch over for pardon of a tax legal responsibility devoid of terror of illegal tribunal. As indicated in Table 4.9, all the tax officials mentioned that tax amnesty was successful (40 percent) and strongly successful (60 percent). According to the tax officials, tax amnesty increased the number of businesses registration and income tax payment. This indicates that the tax amnesty mechanism was helpful in reducing tax evasion and avoidance.

#### **4.5.2 Introduction of Tax Stamp**

According to the tax officials, tax stamp was introduced in 2006 as a conduit for reducing income tax evasion in Kumasi. AAs indicated in Table 4.9, 70 percent of the tax officials mentioned that the tax stamp was successful (30 percent) and strongly successful (40 percent). However, 30 percent of them mentioned that tax stamp was unsuccessful (20 percent) and strongly unsuccessful (30 percent).

**Table 4.9: Assessment of Mechanisms for Addressing Tax Evasion and Avoidance**

Mechanism	Year of Introduction	Number of Respondents			
		Strongly Unsuccessful	Unsuccessful	Successful	Strongly Successful
Introduction of Tax Stamp	2006	10%	20%	30%	40%
Tax Amnesty	2013	0%	0%	60%	40%
Field Inspection	2005	0%	0%	30%	70%
Tax Court	2010	40%	20%	20%	20%
Tax Education	2006	50%	10%	40%	0%
Tax Incentives	2007	30%	30%	20%	20%
Tax Segregation	2008	20%	40%	10%	30%
Use of Animators	2010	20%	0%	50%	30%

Source: Field Survey, 2017

#### **4.5.3 Field Visit/Inspection**

Tax payers of were assessed by the tax officials from GRA through regular field visit. The tax officers mentioned that they visited each shop or business in the Kumasi Metropolis to if they have paid their income tax. Officers inspect the income or financial statements of business owners, receipts, check stamps, and invoices. This helped them to identify those who were tax evaders and tax avoiders. As indicated in Table 4.9, all the tax officers mentioned that field visit was successful (30 percent) and strongly successful (70 percent) in reducing income tax evasion and avoidance. It was also found that the tax officers observed the type of activity and compare it to the amount of income tax the person is supposed to pay for the quarter or year. This was done to check whether the type of activity has bearings on the amount of income tax the person pays.

#### **4.5.4 Introduction of Tax Courts and other Punishment**

The tax court is a place tax officials prosecute income tax defaulters. It was introduced into the system in 2010. According to the tax officials, when a tax defaulter is sent to court, he/she is made to pay the tax and a fine. The intention was to deter people from evading the payment of income tax. As shown in Table 4.9, 60 percent of the tax officials mentioned that the introduction of tax court was unsuccessful (40 percent) and strongly unsuccessful (20 percent) in reducing the practice of tax evasion among owners of SMEs in Kumasi.

#### **4.5.5 Introduction of Segregation Approach**

Another mechanism tax official used to reduce tax evasion and avoidance was segregation. it was introduced by the GRA in 2008. The tax structure is segregated into Small Tax Officers (STO), Medium Tax Officers (MTO), and Large Tax Officers (LTO). This strategy has helped tax officials to meet each target group and to identify tax evaders and avoidance. As indicated in Table 4.9, the study revealed that 20 percent of the tax officials said that the segregation approach was strongly unsuccessful. To some (30 percent) it was strongly successful.

#### **4.5.6 The Use of Animators**

According to an interview with the tax officers, GRA used people who look around to identify new businesses and report to them. As indicated in table 4.9, the study revealed that 50 percent of the tax officers said that the use of animators was strongly successful while 30 percent said it is successful.

#### **4.5.7 Rejection of Fraud Software used by Owners of SMEs**

To add to the above, the study revealed that GRA did not accept specific software used by the owners of SMEs. It was found that some of the owners of SMEs used I-TEC technology to calculate their sales and profit for the quarter or year. The technology is manipulated to reduce the profit of the individual to pay less income tax. Tax officials from the GRA addressed this situation by rejecting the profit of SMEs that used the technology. The tax officials go by the manual way of checking the profitability of owners of the informal sectors.



#### 4.5.8 Closing Down of Shops

Other punishments such as closing down of shops of tax evaders, cessation of assets or property were used as strategies by the tax officials to improve tax collection system and to reduce tax evasion in Kumasi. The tax officials mentioned that in 2011, about 215 shops were closed down and within a week, more than 150 of the shop owners came to the office to pay their income tax. The number of closed down shops reduced from 215 in 2011 to about one hundred and fifty in 2012. This is an indication that the mechanism of closing down shops of those who do not honor their tax obligations is effective.

#### 4.6 Summary of Results

This chapter has presents the analysis of data collected from the field. The chapter analyse tax evasion and avoidance behavior of individuals in Kumasi, factors that influencing their decisions and the measures used to reduce tax evasion. The study revealed that the lack of enforcement, low returns, and high tax rate, lack of transparency and accountability and illiteracy of tax payers on taxation made the largest influence on the behavior of tax payers to evade income tax. The study revealed that the owners of SMEs evade income tax through their non-declaration of income. Owners of SMEs evade income tax through the issuance of fake receipts, conniving with tax officials and non-submission of income statements to GRA. The owners of the SMEs also avoid income tax payment through the use of purchase invoices, involvement of consultants, income splitting and capital structure. The study revealed that owners of SMEs in the Kumasi avoid and

evaded the payment of income tax. Tax officials have put some measures in place to reduce tax evasion. These include the use of tax amnesty, tax stamp, field visits and closing down shops.



## CHAPTER FIVE

### SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS

#### 5.1 Introduction

In this chapter the analysis of the data obtained from respondents has been discussed. It therefore gives recommendations and conclusion of the entire work. The perspective of this chapter does not only recommend solutions but presents the findings in relationship to how policies or strategies could transformed into practices to ensure effective tax collection and to minimize the occurrence of tax evaders and avoidance of the informal section.

#### 5.2 Summary of Major Findings

##### 5.2.1 Factors that have Influenced Decisions of Owners of SMEs to Evade and Avoid the Payment of Income Tax

The study revealed that infrequent/no public education on income tax payment, illiteracy, high tax rates, lack of adequate tax incentives, non-provision of social services, low returns (income), lack of transparency and accountability, low enforcement of tax laws, level of corruption were the reasons why the informal sector fail to pay income tax which invariably leads to tax evasion and tax evasion. Among the factors, it was found that lack of enforcement of tax laws; low returns and high tax rate were the major contributing factors to tax evasion and avoidance. This is shown with relative importance index scores of 0.005387, 0.005293 and 0.005213 respectively. Though enforcement is somehow done, the respondents complained that it is ineffective. They further explained that they know

people fail to pay income tax but they have not seen any one being prosecuted at the law court. Owners of SMEs complained that their income from the sale of goods is very low to encourage them to pay income tax.

They further complained that the low income is attributed to the low purchase of their goods. Others also complained that sometimes the amount they earn in the quarter was small. When this happens, they try to forget the payment of income tax and shift it to next quarter. The petty traders for instance complained that the tax rate is high for them and as such they do not have a permanent place to sell their goods. They also complained that they pay tax to the Kumasi Metropolitan Assembly (KMA) and as such, do not see the need to pay additional tax to the GRA. The double payments of taxes are very high for them and therefore fail to honor their tax obligations. The correlation analysis showed that among the factors, high tax rate showed significant relationship with ability of the taxpayer to honor their tax obligations. The correlation coefficient of .173 implies that the higher the tax rate, the more it deters people and therefore make them pay their income taxes.

### **5.2.2 Ways Owners of SMEs Evade and Avoid the Payment of Income Tax**

It was found that owners of SMEs in Kumasi evade income tax through non-declaration of income, number of business activity they own and their locations. It was found that 64 percent of owners of SMEs did not declare their full amount of income to the tax officials last year. Also, 80 percent of the tax officials mentioned that the number of business activity one has and their locations is one

of the means taxpayer used to evade the payment of income tax. They explained that someone may have more business activity in Kumasi, register them with a single name in order to pay income tax for all of them. Again, 90 percent of the tax officials mentioned that owners of SMEs in Kumasi used purchase invoice to reduce the amount of tax they are supposed to pay. They explained that the taxpayers compile and keep copies of any purchase they make in order to reduce the amount of tax to be paid. Moreover, 80 percent of the revenue officials mentioned that owners of SMEs in Kumasi sometimes engage the services of consultants to assist them reduce the amount of income tax. They explained that the consultants know much about the tax law and some of them are part of the formulation of the tax law in Ghana.

About 70 percent of the tax officials mentioned that income splitting is a way owners of SMEs adopt to avoid the payment of income tax. Income splitting according to the tax officials is a situation whereby the income earned is divided into more than one source so as to minimize income tax. The taxpayer simply arranges its financial statements in such a way that income is diverted to the other partner (wife, husband and siblings) with the lower marginal tax rate. It was found that 70 percent of the tax officials mentioned that owner of SMEs in Kumasi avoids the payment of income tax through debt or equity capital. According to the tax officials, the debt capital structure attracts less income tax as compared to the equity capital. This is because the interest the person pays on the loan is calculated as an allowable expense and it is deducted from the sales or profit the person makes in a quarter or year.

### **5.2.3 Success of Mechanism used by GRA to reduce Tax Evasion and Avoidance**

The study revealed that the GRA used Tax Courts and other Punishment, Tax Amnesty and Segregation Approach to reduce tax evasion and avoidance of the informal sector. According to the tax officials, the mechanisms have increased the number of businesses registration and income tax payment. The number of closed down shops reduced from two hundred and fifteen (215) in 2011 to about one hundred and fifty (150) in 2012. This is an indication that the mechanism of closing down shops of those who do not honor their tax obligations is effective and was successful. The study revealed that there is no legal action taken against tax avoiders. This is because, tax avoidance is legal and it is treated as such.

## **5.3 Recommendation for Effective Income Tax Collection from the Informal Sector**

### **5.3.1 Addressing the attitude of Evading and Avoiding Income Tax:**

There is the need to close the gaps that is, given the informal sector opportunity to continue to evade and avoid income taxes in Ghana. There should be a rapport between tax officers and tax payers. Tax payers should be given the room to express their views rather than imposing certain policies or measures on them. The provision of enough tax incentives packages to tax payers of the informal sector is a step in the right direction to reduce tax evasion and avoidance and therefore it should be strengthened.

There should be intensive and regular public education on the need and relevance of taxation to an economy. Such programs could be organized quarterly within a year. Tax officials from GRA could collaborate with other agencies such as the Ministry of Information (MoI) and other international bodies/Non-Governmental Organizations (NGOs) to assist in educating the public especially the informal sector on the need to pay tax. IRS should strengthen enforcement of tax evaders. The law should be made to deal with any victim irrespective of the person's background. This would better serve as a deterrent. IRS should make the informal sector realize the benefits of paying tax. Social accountability should be incorporated into the tax administration system so that the tax payer would know and feel why he/she is paying income tax.

### **5.3.2 Strengthening of Field Inspection**

Tax officers should frequently embark on field inspection of tax payers of the informal sectors. This would help to unearth secrets behind payment of income taxes. It would also help in revealing tax evaders and avoiders of the informal sector so that decisions could be taken to address them as they emerge.

### **5.3.3 Building the Capacity of Staff**

Capacity building programs should be organized frequently to tax officials from the GRA. The capacity programs could cover areas such as how to identify income tax evaders, how to identify income tax avoiders and how to improve income tax collection of the informal sector. Also, issues like record keeping,



database management among others could be organized for GRA S staffs to build their capacity. This will make them more effective and efficient in carrying out their duties.

#### **5.3.4 Strengthen Review of Tax Law**

The study revealed that the informal sector avoidance and evasion of income tax could be partly attributed to the loopholes in the tax law. GRA in collaboration with other agencies should strengthen the review of the laws so as to minimize such behavior of avoiding and evading income tax.

#### **5.3.5 Provision of Incentives to Staff**

To achieve much success in reducing tax evasion and avoidance of the informal sector, it is recommended that GRA should provide adequate incentives in the form of yearly bonuses and other allowances to its staff. This will boost them to perform well. Moreover, GRA should employ or deploys more qualified revenue staffs to help in the effective collection of income tax from the informal sector.

#### **5.4 Conclusion**

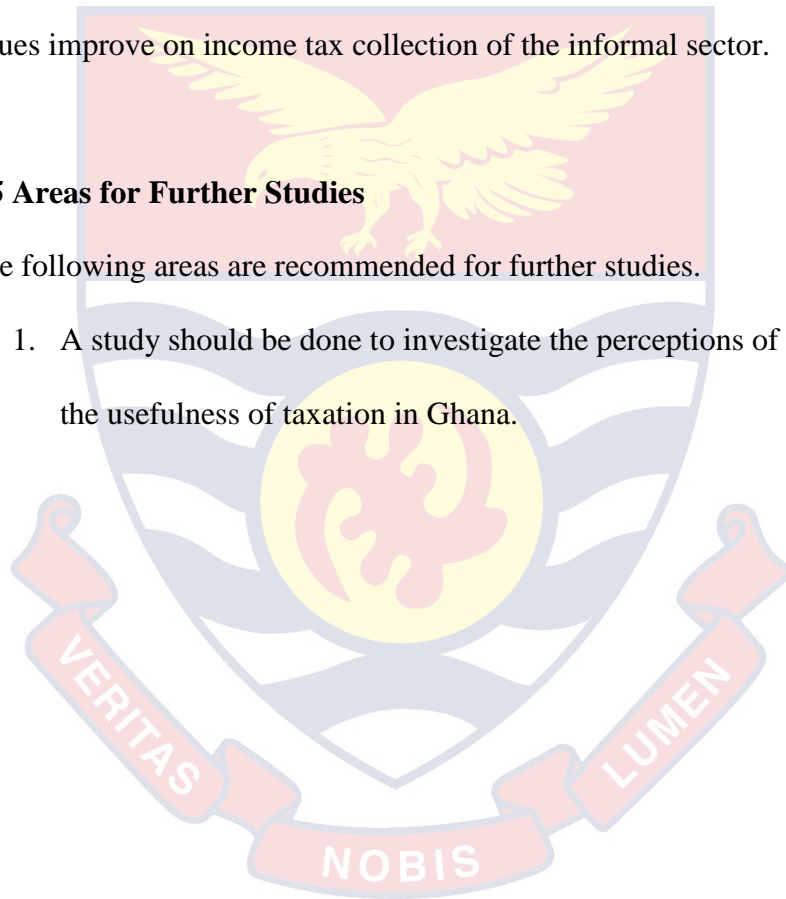
Tax evasion and avoidance of the SMEs has become a major problem to the government in Ghana. Owners of SMEs have developed strategies of taking advantage of the loopholes in the tax system to evade and avoid income tax payment. The study revealed that owners of SMEs in the Kumasi avoid and evaded the payment of income tax. Owners of SMEs evade income tax through

the issuance of fake receipts, conniving with tax officials and non-submission of income statements to GRA. Income tax is also avoided by the informal sector through the engagement of consultants, the use of purchase invoices, splitting of profit among other. An attempt to reduce income tax evasion and avoidance of the informal sector has lead to the introduction of mechanisms by the GRA. Strengthening policies and strategies of GRA could help address most of these issues improve on income tax collection of the informal sector.

### **5.5 Areas for Further Studies**

The following areas are recommended for further studies.

1. A study should be done to investigate the perceptions of the taxpayers on the usefulness of taxation in Ghana.



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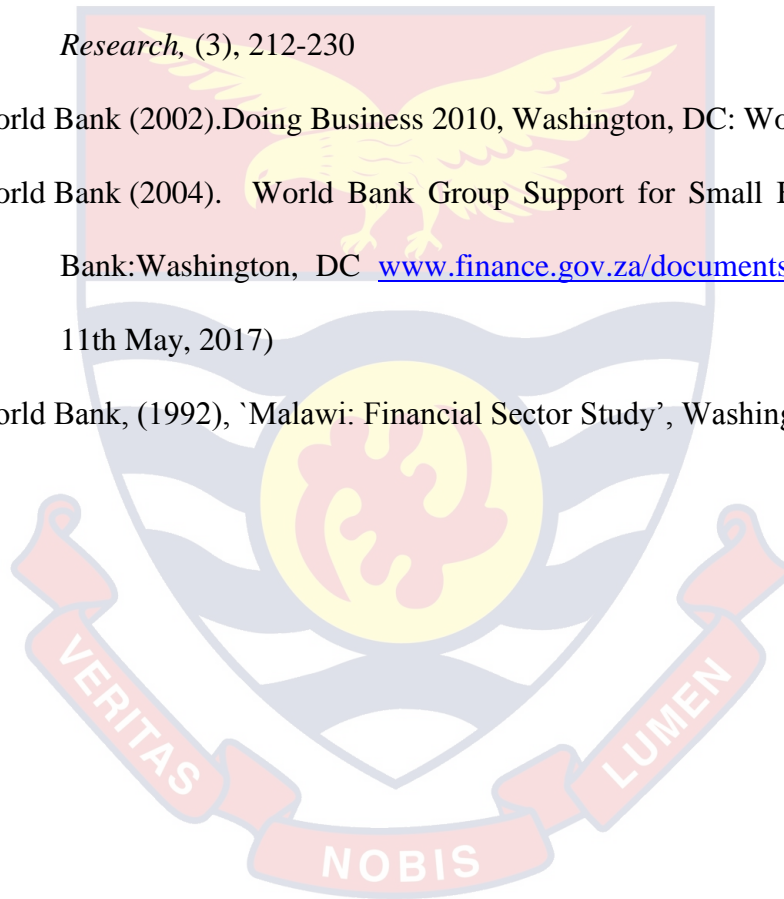
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## APPENDIX I

### RESEARCH INSTRUMENT

#### QUESTIONNAIRES FOR OWNERS OF SMES

#### “TAX EVASION AND AVOIDANCE AMONG THE SMEs IN THE KUMASI METROPOLIS”

This survey instrument is designed to seek empirical data for the conduct of the above stated purely academic exercise. This will be submitted for the partial fulfillment of a Masters in Business Administration. Your support and co-operation is very much anticipated and your responses will be treated with maximum confidentiality.

#### **PART I: DEMOGRAPHIC CHARACTERISTICS**

1. Gender  Male  Female

2. Age

20 – 29

30 – 39

40 – 49

50-59

60-69

70 years and more

3. Which of the following ethnic groups do you belong?

1.  Akan 2.  Ga-Dangme 3.  Ewe 4.  Guan 5.  Gurma 6.

Mole-Dagbani 7.  Grusi 8.  Mande

4. What is your religion ? 1.  Christian 2.  Islamic 3.  Traditional  
4.  Other (specify): .....

5. Highest Education Attained  Basic level  
 Senior High School/Voc/Tech  
 Diploma  
 First Degree  
 Second Degree (Masters Degree)  
 No education  
 Others

(specify).....

6. Sector of Employment:  Machinery works industry  
 Leather base  
 Textiles  
 Commerce  
 Food processing industry  
 Wood products industry  
 Metal works industry  
 Others

(specify).....

7. Number of years in the Business ( ) 1-3 year  
( ) 4-6 years  
( ) 7-10 years  
( ) 10 years and above

8. Per the number of years you have being in the Business, how many times have you pay income tax? .....

**PART II: HOW INCOME TAX IS EVADED AND AVOIDED**

9. Do you declare your total income to GRA?

- ( ) Yes  
( ) Don't Know  
( ) I know but I don't do it

10. What is your reason above

.....  
.....  
.....

11. Do you think it is necessary to pay tax income at all? i. ( ) Yes ii. ( ) No

12. Provide reason(s)

.....  
.....

13. Do you pay income tax? i. ( ) Yes ii. ( ) No

14. If yes, how often do you pay income tax?

- ( ) Yearly ( ) Quarterly ( ) others

(specify).....

15. How much do you pay as income tax for the year/quarter? GH¢.....

16. How many times do you pay income tax for the year/quarter?

17. When was the last time you paid income tax?.....

18. How many businesses do you have in the Metropolis?.....

19. Do you pay income tax on all the business? i. Yes ( ) ii. No ( )

20. Give reason if answer in question 14 is no,

.....  
.....

21. Have you sold or bought a company/business/shop to someone/from someone before? i. Yes ( ) No ( ) If yes, when was that?.....

22. Have you connive with tax officers on income tax payment before? Yes ( ) No ( ) I don't remember ( )

23. Do you keep records of purchase invoices? i Yes ( ) No ( )

24. If yes, what do you do with it?

.....  
.....

25. What is the source(s) of capital for running your business? (Multiple responses are allowed)

i. Relatives/friends ( )

ii. Bank as loans ( )

iii. Sales of Shares ( )

26. What proportion (%) of your capital comes from bank as loans?( if the person obtains loans from a bank).....

27. Do you apportion your profit for the year/quarter to other partner (husband, wife)? i. Yes ( ) ii No ( )

28. Please provide reason(s).....

29. What encourages you to pay income tax?.....

30. Do you engage consultants in the preparation of statements of profit?

Yes ( ) No ( )

31. Please provide reasons for your answer.....

**PART II: FACTORS THAT DECISIONS TO EVADE INCOME TAX**

32. How much do you earn in the month?.....

33. Please to what extent to do agree or disagree on factors you think can influence your decisions to evade income tax (1= strongly Disagree 2= Disagree 3= Undecided 4= Agree 5= strongly Agree)

S/N	Information-Sharing	1	2	3	4	5
a	Infrequent/No public education on income tax payment					
b	Illiteracy					
c	High tax rates					
e	Tax morale					
f	High penalty rate					
g	Income of the taxpayer					



H	Lack of adequate tax incentives					
I	Poor relationship between Taxpayers and tax authority					
J	Non-provision of social services					
K	Lack of adequate enforcement					
L	Non-provision of social services					
M	Lack of Transparency and Accountability					
n	Level of Corruption					

**QUESTIONNAIRES FOR STAFFS OF IRS**

1. Number of years in the Business ( ) 1-3 year  
 ( ) 3-5 years  
 ( ) 5-8 years  
 ( ) 8 years and above
2. What is your Position in the Department?.....
3. What is your role in the office?  
 .....4.
- How many years have you been working with IRS?.....
5. What problems do you face in your quest to perform your duty?  
 .....

**PART II: ASSESSMENT OF TAX PAYERS OF SMEs**

6. How does GRA assess or identify tax payers (informal sector) in the Kumasi Metropolis?.....

7. How does the informal sector evade income tax?  
.....

8. How does the informal sector avoid income tax?  
.....

9. What do you do to those who evade income tax?  
.....

10. What do you do to those intentionally avoid income tax?  
.....

11. What do you think could be the possible reason(s) for tax evasion and avoidance of the informal sector?

- ( ) Infrequent/No public education on income tax payment
- ( ) Illiteracy of the informal sector
- ( ) Inadequate human resource capacity of GRA
- ( ) Poor relationship between Taxpayers and tax authority
- ( ) Lack of rule of law and weak fiscal jurisdiction
- ( ) Low level of experience of GRA
- ( ) Low returns (income) of the entrepreneurs
- ( ) Low transparency and accountability of public institutions
- ( ) High Compliance Cost

**PART II: MECHANISM/ STRATEGY FOR REDUCING TAX EVASION  
AND AVOIDANCE**

1. What measures have you put in place to reduce income tax evasion of SMEs?

.....

2. What measures have you put in place to reduce income tax avoidance of the SMEs?

.....

.....

3. How were the mechanisms developed and implemented in 5 years ago?

.....

.....

4. What has been the success of the various income tax evasion and avoidance reduction strategies used by GRA in 5 years ago? Please answer by filling the Table below.

Mechanism	Year Introduced	Success of Mechanism			
		Strongly Successful	Successful	Somehow successful	Not successful

5. Do you have new strategy of reducing ;

i. Tax evasion ( ) Yes ( ) No

ii. Tax Avoidance ( ) Yes ( ) No

6. If yes, what are the strategy and its effectiveness?

.....  
 .....

7. If no, is the Office planning to introduce new strategy of reducing income tax evasion and avoidance of the informal sector? ( ) Yes ( ) No

8. Who are responsible for income tax collection of the informal sector in the municipality?

.....  
 .....

9. How adequate are the tax collectors?

.....

10. What are the qualifications of tax collectors? Please answer by filling the table below;

Qualification	Number of Income Tax Collectors
JHS/MIDDLE	
SHS/VOC/TECH	
DIPLOMA	
DEGREE	
Others (Specify)	

11. How often do tax collectors collect taxes from the informal sector?.....

12. How do you make the informal sector see the relevance of paying tax?

.....  
.....

13. To what extent are you satisfied with the compliance level of the self employed businesses in your tax district?

( ) Highly satisfied ( ) Somehow Satisfied ( ) Not satisfied ( )

14. Do taxpayers file their returns with you annually? A. Yes ( ) B. No ( )

5. If No, what do you do to make sure tax payers file their returns to you?

.....  
.....

16. How do you determine the taxes of those who do not keep proper books of accounts or submit accounts?

**THANK YOU FOR YOUR CO-OPERATION**

