

UNIVERSITY OF CAPE COAST

ASSESSMENT OF PAYMENT OF INCOME TAX IN THE INFORMAL
SECTOR: A CASE STUDY OF CAPE COAST TAX DISTRICT

BY

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Management.

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DECLARATION

Candidate's Declaration

I hereby declare that this dissertation is the result of my own original work and that no part of it has been presented for another degree in this university or elsewhere.

Candidate's Signature..... Date.....

Candidate's Name: Frederick Opoku Annor

Supervisor's Declaration

I hereby declare that the preparation and presentation of the dissertation were supervised in accordance with the guidelines on supervision of thesis laid down by the University Of Cape Coast.

Supervisor's Signature..... Date.....

Supervisor's Name: Mr Stephen Asante

ABSTRACT

The Millennium Development Goals is a key scheme of the United Nations to empower all nations to develop using their own resources. The scheme aims at assisting nations to realize potential areas of the economy from which revenue can be generated for national development.

National revenue is raised through direct taxes, indirect taxes, royalties, etc. The formal and informal sectors of the economy contribute in mobilizing revenue for national development. While the formal sector is well structured to prevent evasion of taxes, the informal sector is not well organized and various researchers in Ghana have observed the poor generation of revenue from the informal sector.

In this study, , the researcher used Cape Coast, Elmina, Mankesim and adjoining communities with a sample size of 200 informal sector operators. Primary data was mainly used with mostly closed-ended questions and multiple answers provided to limit respondents to choices to select from.

Analysis of data collected established that the factors that make the informal sector hard-to-tax were very high in Ghana as a result of the predominance of cash transactions, poor record keeping, high illiteracy rate, little or no barriers to entry, and the peripatetic nature of the informal sector in Ghana.

It is recommended that government should embark on capacity building, tax information and education, and simplicification of filing procedures to aid in revenue mobilization from the informal sector.

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DEDICATION

To my lovely wife, Joyce Opoku Annor and my boys- Nana Yaw Edusi
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ABBREVIATIONS

AGI	-	Adjusted Gross Income
CRD	–	Central Revenue Department
DNL	–	Department of National Lotteries
EAP	-	Economically Active People
ERP	-	Economic Recovery Programme
GCTS	-	Ghana Cooperative Transport Owners Association
GDP	-	Gross Domestic Product
GPRTU	-	Ghana Private Road Transport Union
GUTA	-	Ghana Union Traders Association
ILO	-	International Labour Organization
IRS	-	Internal Revenue Service
ISSER	-	Institute of Statistical, Social and Economic Research
JASPA	-	Jobs and Skills Programmes for Africa
MDG's	-	Millennium Development Goals
MFEP	-	Ministry of Finance and Economic planning
PNDC	–	Provisional National Defence Council
RAGB	–	Revenue Agencies Governing Board
SAP	-	Structural Adjustment Programme
UNO	-	United Nations Organization
WIEGO	-	Women in Informal Employment, Globalizing and Organizing

CHAPTER ONE

INTRODUCTION

Background of the Study

Though the informal sector, in all the ambiguity of its connotation, has come to constitute a major structural feature of society, both in industrialized and less developed country (Portes and Castelli, 1989), the informal sector is known by many different names according to different contexts and point of view. It is variously referred to as the informal economy, unregulated economy, unorganized sector or unobserved employment, to cite but a few of its titles. This sector typically refers to both economic units and workers involved in a variety of commercial activities and occupations that operate beyond the realm of formal employment (Williams & Winderbank, 1998).

Again, the informal sector can be defined in the urban context as small enterprise operators selling goods or offering services and thereby involving the cash economy and market transactions. This so called “urban informal sector” is more diverse than the rural one and includes a vast and heterogeneous variety of economic activities through which most urban families earn their livelihoods. Activities of the urban informal sector in the public arena of cities are particularly apparent in street based trading, which is widely known as street vendors. Although these street enterprises are mostly hidden from the state for tax, they involve very visible structures, and are often subject to certain limited administrative processes such as simple registrations or daily collection fees.

The main forms are retail trade, small scale manufacturing, construction, transportation, and other form of services. These economic

activities involve simple organizational, technological and production structures. They also rely heavily on family labour and few hired workers who have low levels of economic and human capital and work on the basis of unstandardized employment laws (Suharto, 2000; 2001; 2002).

One sector in Ghana which has a great potential for necessary domestic revenue mobilization and to reduce huge budget deficits is the informal sector. A large number of the country's active labour force is employed in the informal sector and accordingly generates significant amount of income that is subject to income tax. The sector is expected to expand exponentially in the near future and perhaps serve as a "goldmine" for higher revenue mobilization.

The effective and efficient imposition of income tax on the informal sector holds the great prospect of closing the yawning gap in the domestic revenue generation. The widening of tax net, as much as possible, to include most of the participants in the informal sector will broaden the tax base and hence lower the rates. According to an article written by the World Bank, "attempts to increase government revenue while at the same time lowering the tax rates have resulted in the need to adopt policies to broaden the tax base" (World Bank). Historically the businesses engaged in the formal sector have suffered extremely high tax rates due to the narrowness of the tax base resulting from most informal businesses being outside of the tax net. This situation can only be reversed when the tax base is broadened by the inclusion of every single income earner in the informal sector. Bagahwa and Naho (1995) state that "public revenue remains weak in numerous sub-Saharan African countries and the tax burden appears to be unevenly distributed.

Two sectors are often considered as being under – taxed: the agricultural and the unrecorded urban sectors. Its (i.e. unrecorded sector) under-taxation results in considerable losses in tax revenue. What is worse, the development of unrecorded activities is threatening the official sector which plays a crucial role in collecting government resources” (Bagahwa and Naho, 1995). Following from this assertion, it is patently clear that under-taxation of the informal sector is accounting for the imbalances in the tax system.

The economy of Ghana is dominated by the activities of enterprises in the informal sector. It is estimated that, in terms of economic activity, about 86.3% is carried out by the self-employed sector mostly operating informal structures. (Ghana Living Standard Survey, 2000), even though quite a significant number could easily be classified as earning below the taxable threshold of income liable to tax. The economy of Ghana is largely made up of individual and small-scale enterprises. That sector provides diverse sources of income which, if taxed, could increase government internally generated revenue. The Institute of Statistical, Social and Economic Research (ISSER), 2003, stated that “the main source of employment in Ghana is the informal sector. The sector provides employment opportunities for at least 80% of the labour force” (ISSER, 2003). The estimated size of the informal sector presupposes that sector makes significant contribution to the Gross Domestic Product (GDP) and so the sector could equally make a major contribution to the tax revenue.

A survey conducted in Accra by Jobs and Skills Programs for Africa (JASPA) in 1990/91 established that the informal sector accounts for about 22% of Ghana’s real GDP (ISSER, 2003). If the GDP contribution could be

translated into tax revenue, government revenue could make significant appreciation. With the focus of successive and present governments on the private sector (which is dominated by the informal businesses) as the engine of development, it can be suggested that the sector will witness tremendous expansion and subsequently more tax revenue.

However, the government, through the Ghana Revenue Authority, has been overly concentrating scarce economic resources on the formal sector with respect to the direct tax collection. The excessive focus on the formal sector and the neglect of the informal sector arguably may be accounting for the abysmal poor collection of tax revenue from the informal sector. The informal sector has been neglected for a considerable period of time, hence the woefully inadequate income tax from that sector.

There appears to be no concrete national policy on the way to properly organize and regulate activities of the huge chunk of participants in the informal sector so as to facilitate direct taxation of the income of that sector. This is corroborated by ISSER when it states that “data on the activities of the sector are lacking in many respects due to their fragmented, unregulated and unrecorded nature” (ISSER, 2003).

The informal sector relies heavily on the state resources- social, economic and infrastructure to run and make some level of profits. Some of the activities of the informal sector cause so much damage to the environment and so it makes economic and social sense to rope into the tax net all the participants in the informal sector. By taxing the informal sector, the participants at least contribute for the repair and restoration of the environment they damaged. According to records at the Registrar General’s Department,

Ghana, there are 266,760 self-employed registered in the informal sector. It is however sad to note that only 53,352 have been registered and are being assessed to tax.

Again, available data from the Cape Coast IRS district office indicates that, at the end of June 2009, the number of active cases of taxpayers were 1,199; 289; and 195 with respect to self employed (informal activities), registered companies and formal employees respectively. This means the self-employed constitute 71.24% of the taxed population in the district. However, in terms of contribution, the self employed contributed 488,276.32 out of the total collection of 1,907,576.18 representing 25.59%.

The government of Ghana placed premium on taxation as against borrowing, user charges, and printing of money as a feasible way of checking the local industries, redistribution of income to bridge the gap between the rich and the poor as well as generating revenue to finance its ever increasing capital and recurrent expenditures in its attempt to attain social development, hence the introduction of income tax in 22nd September 1943 (Tax Ordinance No. 27) in the then Gold Coast. However, the available statistics show that the original objective has since not been attained and It is against this background that this study has being embarked upon to find out the reasons behind the low payment rate of income tax in the informal sector.

Statement of the Problem

Among the major challenges confronting the governments of the third world in their forward march to the socio-economic development is how to manage the phenomenon of the fledging informal economy and maximization

of income tax from that sector. This assertion was recognised by Anuradha and Ayee (2001), when they state that “how to tax the informal sector remains a pressing question. Fiscally constrained governments undertaking liberalizing economic reforms are looking for new ways to augment state revenues. The informal sector is an obvious focus of attention as it forms a significant and growing proportion of the economy in the developing countries, yet pays little in the form of taxes” (Anuradha and Ayee, 2002).

The taxation of the informal sector in Ghana since independence remains a key challenge to governments. The tax inflow from the informal sector relative to its sheer size can be said to be woefully insufficient. There are many informal sector participants that either deliberately evade tax payment or are not captured by the Internal Revenue Service. The informal sector remains very fluid as there is no concrete regulatory policy in place to monitor activities of the sector.

Although the concept of the informal sector has been debated since its “discovery” in Africa in the early 1970s, it has continued to be used by many policy makers, labour advocates and researchers because the reality it seeks to capture- the large share of the global workforce that remains outside the world of full time, stable and protected jobs – continues to be important and has likely been increasing over time. At present, there is renewed interest in informal work arrangements or informal labour markets. This current interest stems from the fact that informal work arrangements have not only persisted and expanded but have also emerged in new guises and unexpected places (Informal Economy, 2002). A number of researches have taken look at factors considered as accounting for the continuous growth of the informal sector.

However, there has been no conclusive evidence on those factors. Even the exact definition of the informal sector continues to remain a great controversy. According to Schneider and Enste, “disagreement persists about definitions and estimation procedures of the informal economy” (Schneider and Enste, 2000).

Over the years, governments have made desperate efforts to effectively rope the participants into the tax net but very little have been achieved in that direction. The strategies and methods include: standard assessment (a scheme in which a fixed lump-sum tax is levied) on individuals or business; occupational (identifiable) grouping taxation (which failed abysmally because of corruption) and very recently, tax stamp (where informal sector participants pay tax on quarterly basis). The named methods of taxing the informal sector are replete with seemingly insurmountable challenges and shortcomings; hence there remains the singular question as to how to tax the informal sector to raise the needed revenue for national development.

Again, the informal sector is likely to grow faster than it is now if government can draw up concrete policies to facilitate the economic activities of the sector. The revenue capacity is expected to increase dramatically as a consequence if government can put in place policies to build the capacity of the participants of that sector. Indeed, ISSER states that, “the significant role of the informal sector has not been fully incorporated in Ghana’s development efforts. This is partly manifested in the sector’s low productivity, a characteristic that clearly reflects the fact that after 50 years of independence, there is still no comprehensive policy framework for a sector that contains about 80% of Ghana’s work force” (ISSER, 2003).

Indeed, the informal sector has the potential of inching very close to the formal sector in terms of their respective income tax contribution to national development. The peculiar social underlying imperatives of the informal sector such as high unregulation, predominant cash transactions, non-existent or poor record keeping, itinerant in nature, little or no barriers to entry et cetera, makes the sector extremely difficult to tax. This situation has resulted in massive tax evasion of all forms from complete non-declaration of income to under-declaration of income.

Objectives of the Study

General Objective

To assess the low payment of income tax in the informal sector of Ghana.

Specific objectives

- a. To analyze the factors that make informal sector “difficult-to-tax” by the tax authorities,
- b. To proffer suggested recommendations on the way forward on the taxation of the informal sector.

Research Questions

To facilitate arrival at sound findings to achieve the objectives set out above the following research questions will be presumed and answers provided.

- a. What features make informal sector intrinsically very difficult to tax and hence a great number of the participants remain outside the tax net?
- b. Which variables influence the high tax noncompliance of the informal sector businesses?

c. What is the nature of accounting records kept by the informal sector entrepreneurs which makes it difficult to determine the taxable profits?

Significance of the Study

Tax revenue generation is a critical area of concern to any development oriented government. In most developed countries, they rely heavily on tax revenues to cater for their capital and recurrent expenditures. It is logical that, the ability of government to increase its tax revenue will lead to high economic growth, infrastructural development, high standard of living, increase in reserves, robust economy to withstand shocks, reduction of borrowing, reduction of debt, and reduction of over reliance of donor partners. This means, economy that relies on internally generated funds are healthier.

In view of the critical nature or role that tax revenue plays, it is proper to assess why a greater number of people who engages in informal work do not pay income tax. It is also essential at this moment to assess the contributing role of the revenue agency towards the stated problem with regards to tax payment. In the light of the foregoing, the significance of the study will include the following:

- The findings will help policy makers to come to grips of the problems confronting informal sector tax payers and tax officials so that appropriate mechanism could be adopted or the restructuring of the existing mechanism for effective and efficient taxing of the sector.
- The findings of this study could be seen as a contribution to existing work on the informal sector and this will indeed contribute immensely in building up academic knowledge.

- The study would also play a significant role of engineering further research into the subject matter or other related issues concerning the informal sector.

Thus through the above, the study would contribute significantly to the knowledge box of policy makers and also offer policy recommendation which directly contribute to the development of the economy and the general well being of the populace.

Scope and Limitation of the Study

- The main area of study covered Cape Coast IRS tax district (Cape Coast, Elimina, and Mankessim). According to ISSER “.....most of the participants in the rural informal sector are engaged in agriculture, the urban informal sector is dominated by those engaged in retail trade” (ISSER, 2003). Based on ISSER’s assertion, it means that this study concentrated on urban informal sector and biased towards the retail trade participants. There is therefore, a likelihood of some amount of error in extrapolating the findings based on the sample to the population.
- A major limitation on this study is the fact that people are generally very suspicious and wary of anyone talking on tax issues; hence participants in the informal sector, most of whose activities are invisible may be very reluctant to voluntarily disclose information on their business activities and their tax status. It may mean this study will be skewed towards the participants who will voluntarily

provide information and this could lead to a particular category of informal sector participants dominating the findings.

- Finally, limited resources on the part of the researcher may limit the number of questionnaires to be distributed and the number of interviews to be conducted. This might affect the validity, to some extent, of results of the study.

Organisation of the Study

The study was organized into five chapters. Chapter one is the introduction which includes background of the study, statement of the problem, objectives of the study, significance of the study, scope of the study, as well as the organization of the study.

Chapter two also reviews the related literature on the informal sector. The chapter highlights on income tax and its low rate of payment in the informal sector as well as the history of IRS.

Chapter three focuses on the methodology. The chapter highlights on population description, sampling methods, design of instruments, data collection and analysis as well as problems encountered during data collection exercise.

Again, chapter four covers the presentation and discussion of data collected. Responses to all questionnaires will be presented and discussed in detail.

Chapter five contains the summary of the findings, conclusions and recommendations.

CHAPTER TWO

LITERATURE REVIEW

Definition of the Informal Sector

Since the discovery of the concept, 'informal sector,' in Africa, it has not lent itself to a comprehensive and a universally accepted definition. A number of attempts by different researchers and national authorities (i.e. governments) to define the concept have resulted in diverse definitions. Friedrich and Dominik (2000) state that, 'attempts to measure the shadow economy (i.e. informal sector) first faced the problem of defining it'. There are varied definitions of the concept in the existing literature. Some definitions given in the literature are presented as follows:

(a) "All economic activities that contribute to the officially calculated gross national product but currently unregistered". (Feige, 1989).

(b) "Market-based production of goods and services, whether legal or illegal, that escapes detection in the official estimates of the gross domestic product".(Smith , 1994).

(c) "Unregulated economic enterprises or activities"(Hart,1973).Farrell et al (2000) stated that "currently there are two approaches to defining informal sector activity: the definitional and behavioural". According to the definitional approach, 'Informal sector is economic activity unrecorded in the official statistics such as the gross domestic product and /or the national income accounts' (Farrell et al, 2000).

Behavioural approach, on the other hand, maintains that 'informal sector is based on whether or not activity complies with the established judicial, regulatory, and institutional framework (Farrell et al, 2000).

According to Thomas (1992), the definition one uses is driven by the research question:

‘Definitional approach’ is used to estimate the size and economic value of the informal activity, and the ‘behavioural approach’ is used to explain the causes of the informal sector.

The Origin of the Informal Sector

The literature has it that the concept of the informal sector originated in Africa in the early 1970s. The concept since 1970s has attracted the attention of a number of researchers around the globe. According to Women in Informal Employment, Globalizing and Organizing (WIEGO), “.....the concept of the informal sector has been debated since its discovery in Africa in the early 1970s”. The term informal sector, according to Sethuraman (1981), originated from International Labour Organization (ILO) reports on Ghana and Kenya at the beginning of the 1970s.

According to these studies, the key problem in these two countries was not unemployment, but rather the vast number of working poor ‘struggling to produce goods and services without their activities being recognized’ (Sethuraman, 1981). According to another source, the concept of the informal sector was introduced into international usage in 1972 by the ILO in its Kenya Mission Report, which defined informality as a “way of doing things characterized by (a) ease of entry; (b) reliance on indigenous resources; (c) family ownership; (d) small scale operations; (e) labor intensive and adaptive technology; (f) skills acquired outside of the formal sector; (g) unregulated and competitive markets.” The concept of the informal sector, therefore, has its origin specifically in Ghana and Kenya.

Although informal sector was found in Africa, made up largely of developing countries, the phenomenon is not found exclusively in transitional or developing economies, but is present in developed countries as well. Tanzi (1982) and Portes et al (1989) state that, ‘in fact, informal sectors in many industrial countries increased during the economic recession and reorganization of the 1970s and 1980s and continue to exist today – such as the notorious sweatshops that flourish in New York’.

Distinguishing Characteristics of the Informal Sector

The informal sector is associated with certain characteristics that have been grouped into four main categories according to the existing literature. These include the following:

- i. Employment (characteristics of the people engaged in the informal sector);
- ii. Enterprise (characteristics of the activities in the informal sector);
- iii. Habitat (characteristics of the informal sector land and housing); and
- iv. Credit (characteristics of the informal credit markets) (Farrell et al, 2000)

The above mentioned characteristics are now examined as follows:

Employment characteristics of the people engaged in the informal sector:

The persons operating in the informal sector do exhibit certain unique trademarks which either favour or go against them. These characteristics are considered as follows:

- a) Absence of official protection and recognition

The informal sector entrepreneurs do not enjoy protection from the state machinery in the form of legislations against any unscrupulous fraudsters who may defraud such entrepreneurs in the course of business dealings. Because

the operators in the informal sector do not want to be identified for fear of being taxed avoid being recognized and hence do not enjoy the protection that may be available to them from the state (Farrell et al, 2000).

b) Non coverage by minimum wage legislation and social security

Most, if not all, employed in the informal sector often get paid far below the national minimum wage and most informal sector employers fail to contribute to pension scheme on behalf of their employees. These employers escape appropriate sanctions as their illegal activities are hidden from the law enforcement agencies (Farrell et al, 2000). The employees also fail to report their employers either for fear of been 'fired' or out of gross ignorance of the law (Farrell et al, 2000).

c) Predominance of self-employment work

There is no gainsaying the fact that operators in the informal sector are self-employed operating from their homes most often, with others using any available public space (popularly referred to as 'no man's land'). With a table and a chair one could easily start up own business with family assistance (Farrell et al, 2000).

d) Absence of trade union organization

Informal sector operators are individualistic in nature with a wide range of activities which make it extremely difficult for the formation of trade unions for the protection of the interest of the members. At any rate, formation of such trade unions may 'exposed' the informal operators and risked being formalized (registering with an appropriate body) and subsequently pay tax for which reason some operate informally.

e) Low income and wages

The people employed in the informal sector are generally paid low salaries and wages due largely to the fact that there is excess labour supply and lack of skills that may attract higher wages. The entrepreneurs also get low return on their investment as a result of keen competition in that sector (Farrell et al, 2000).

The enterprise characteristics of the activities in the informal sector: The economic activities taking place within the informal economy exhibit certain unique characteristics which are considered below:

a) Unregulated and competitive markets

Nobody, not even the government is able to regulate the activities of the informal sector because of its fluid nature. The cost of such an enterprise (i.e. regulation of the informal sector) will far exceed the benefits and in fact such an attempt will be a 'wild-goose chase'. It will be an impossible mission. (Farrell et al, 2000).

Again, because of the many operators in that sector the market arena is highly competitive as competitors attempt to outdo one another for customers. A classical case in point is pure water sellers in the streets of Accra as they chase vehicles to sell. It is the 'survival of the fittest'.

b) Small scale operation with individual or family ownership

According to Yankson (1992) "the typical informal sector enterprise is individually-owned and operated, generally for less than five years duration". Often, the size is determined in terms of the number of employees including apprentices and family members engaged or capital invested. The average size of employment is four though the number may vary with the nature and type

of activity – from sole-ownership to partnership and family ventures and cooperatives.

c) Ease of entry

The capital requirement for operating in that sector is rather very low and so anybody at all at any time may decide to set up business in the informal sector. There are also no regulatory requirements for entering into that sector. Yankson (1992) indicates that “capital intensity in this sector is low – most of the entrepreneurs use labour-intensive technology, with the largest units having the most fixed capital per employee”.

d) Reliance on locally available resources

Informal sector businesses are quite small in size and lack capacity to do off-shore acquisition of resources- material, human and financial – for the running of the business. Hence the informal sector businesses tend to rely more, if not solely, on the local resources. The resources are acquired from various sources, sometimes new or second-hand or self-constructed but very rarely imported. So also for their raw materials, informal sector entrepreneurs depend largely on the local resources, primarily from the formal sector units in the cities (Barwa, 1995).

e) Family ownership

Family ownership dominates the ownership of the informal sector businesses. This is largely due to the fact that family provides cheap source of labour for the business. The lack of trust on the part of individuals does not promote formation of partnerships and joint ventures in the informal economy.

f) Labour intensive and adopted technology

The level of technology, employed in the informal sector business units surveyed in Ghana by Yankson (1992), was reported low and in poor conditions. The equipment used by informal sector entrepreneurs are self-crafted or bought locally with subsequent improvements made by the entrepreneurs. The informal sector displays ‘technological ingenuity’ by using locally made equipment. The operators lack adequate financial resources to import more advanced technology. The sector relies heavily on the labour for its production.

Habitat characteristics of the informal sector land and housing: These characteristics relate to the use of land and housing by the informal sector operators.

a) Unauthorized use of vacant public or private land

The unpublished report on the Mission of UNIDO official to National Board for Small Scale Industries, Accra, has it that informal sector operators function from clusters, closer to cities, especially those engaged in auto repairs, metal works, but may also be strategically located at specific points to reach the maximum number of clients. In developing countries, kiosks and small containers owned by the informal sector operators litter every conceivable nook and cranny in the cities and towns (Barwa, 1995).

b) Unauthorized construction of structure and buildings: Informal sector operators tend to put up houses on the land from where they operate their businesses. They have no legal title to the land on which they construct such structures. This in some cases has resulted in environmental disaster such as ‘Sodom and Gomorrah’ in Accra (Barwa, 1995).

c) Reliance on low cost and locally available scrap construction materials: The operators in the informal sector cannot afford to purchase quality building materials due to the high cost involved. They tend to put up structures that are of poor standards resulting from the poor quality of the materials used. The end result of these structures is the slums springing up in the urban centres. This situation is associated with environmental and health challenges to the governments of various states especially in the developing countries.

Credit characteristics of informal credit markets: These characteristics deal with credit facilities in the informal sector.

a) Easy accessibility

Indeed, some if not most, of the informal sector businesses thrive on granting credit to their clients. Informal sector goods and services are primarily patronized by the poor class. Credit, therefore, is an inevitable practice for success in the informal sector (Barwa, 1995).

b) Availability in very small and for short terms

The credit is granted on very small scale as the informal sector businesses are not big to grant large credit. Hence the credit is usually for relatively short term (Barwa, 1995).

c) Low administrative and procedural cost

Compared to the formal sector procedures in granting credit – such as creditworthiness assessment, on the contrary, in the informal sector credit is usually granted to people known to the operators hence no need to critically assess the individuals being granted credit (Barwa, 1995).

d) Little or no collateral requirement

Generally, because the credit granted is very small no collateral security is demanded. As stated earlier, it is the poor class who patronize the goods and services produced by the informal sector hence such individuals lack collateral (Barwa, 1995).

f) Little or no job security

The employees in the informal sector could lose their jobs at anytime at the whims and caprices of their employers. The employees cannot take any legal actions for any unfair dismissal as there is usually no binding contract of employment. No compensation is usually paid for such dismissal (Farrell et al, 2000).

Informal Sector in Ghana

Ghana has a large and diverse informal sector. It spans activities such as trading, spare parts, transportation, construction, agriculture, livestock, food preparation, credit facilities, refrigeration, electricity, dressmaking, foot wear, distilleries, gold and silver smiting, traditional healing and etc. Because of its sheer size, it has become difficult for the Ministry of Finance and Economic Planning and the statistical Service to have a reliable data on their membership and activities.

The size of the informal sector is also an obstacle to income tax collection. The income tax base in Ghana is very narrow. Only about 20% of the work force is employed for wages and salaries. The rest are in the informal sector. In some cases, it is almost impossible to determine the incomes of those in the informal sector because they are mainly self-

employed and therefore the greater part of the real income cannot be satisfactorily assessed.

As a result, majority of the informal sector have been the worst income tax evaders. The evasion takes three forms, namely, non declaration of income, under declaration and inflation of deductions from income.

Some of the Informal Organisations in Ghana

1. Ghana Private Road Transport Union (GPRTU)
2. Ghana Cooperative Transport Society (GCTS)
3. Progressive Transport Owners Association (PROTOA)
4. Ghana National Chemical Sellers Association
5. Ghana National Tailors and Dressmakers Association
6. Musician Union of Ghana
7. Phonogram Producers Association
8. National Drinking Bar Operators Association
9. National Garage Owners Association
10. Ghana Tape Recorders Association
11. Greater Accra Second Hand Spare Parts Dealers Association
12. Refrigeration and Air Conditioning Work Shops Owners Association
13. Chop Bar Keepers and Cooked Food Sellers Association
14. Hair Dresses Association of Ghana
15. Susu Collectors Association
16. Traditional Healers, Fetish Priests, Mallans and Drug Peddlers Association
17. Sandcrete Block Manufacturers Association

18. Ghana Gold and Silver Smiths Association
19. Second Hand Clothes Dealers Association
20. Radio and Television Repairers Association
21. Ghana cooperative Distillers Association Limited
22. Corn mill Owners Association
23. Licensed Diamond Winners Association
24. Ghana Association of Private Sports papers
25. Ashiaman Livestock Breeding and Traders Association
26. Butchers Association
27. Ghana Private Schools Association
28. Video Operators Association
29. Ghana Private Schools Association
30. Day care Centers Association
31. Akpeteshie Distillers Association
32. Second Hand Car Dealers Association
33. Ghana Union Traders Association (GUTA)

The Magnitude, Size and measurement of Informal Sector

The informal sector in various countries across the globe has been estimated and provided for as a percentage of the total economy. The population of Ghana was 18.9million in 1999, about 80 percent higher than the 10.7 million in 1980. The labour force is 9 million people, with women forming 51 percent. The informal sector employs 80 percent of the total labour force (World Bank, 2001).

Size of the Informal Sector

Because of its very nature, the informal economy poses tremendous challenges to researchers attempting to estimate its size, and while they have attempted a variety of approaches, the measurement process remains an inexact science. Despite differences in technique, and results, what emerges clearly from the data is the understanding that the informal economy in Ghana is surprisingly large. Four of these approaches and the estimates that they produce are presented. The four principal methods of measurement reviewed are:

Percent of the Gross National Product:

Early researchers estimated the size of the informal economy by calculating what they believed to be the dollar (\$) value of production occurring outside what is counted in the GNP and measured as a percentage of the Gross National Product (GNP). Their estimates varied dramatically, and were based in simple terms on calculating the difference between the actual amounts of currency in circulation versus the amount expected to be there based on “legitimate” needs of the economy. Gutimann was the first to calculate the size of the informal economy in that way.

Percent of Adjusted Gross Income:

More recent research suggests that the informal economy may have been erroneously estimated using the percent of GNP measure and proposed percentage of the Adjusted Gross Income (AGI). According to Feige (1997:6), “A common error in presenting estimates of unreported income is to display unreported income as a percentage of GNP. Since GNP includes non-taxable government and private expenditures, the appropriate scale measure for presenting estimates of unreported income is Adjusted Gross Income

(AGI), which forms the basis for assessing taxable income”. Feige then suggests the AGI gap as an unofficial measure of the informal economy, as it serves as a measure of unreported income.

Percentage of Economically Active People:

Using a third approach, social scientists, especially sociologists, have but more emphasis on the structure of the informal economy, attempting to determine who participates, in which geographic areas and in which industries. The studies also provide detailed analyses of the types of informal economic activities (Frey, Bruno, Schneider & Freiderich, 2000). This approach results in estimates of the percent of economically active people (EAP) engaged in informal economic activities in specific components of the economy.

Estimates of Number of Enterprises Operating Informally:

Finally, the last form of measurement is the estimate of the number of enterprises operating informally at least part time. This measure is perhaps the most conjectural, based on estimates made by researchers who have observed the behaviour of many Very Small Establishments (VSEs). These firms defined as those with fewer than eight or ten employees represent a significant portion of the Ghanaian economy.

Internal Revenue Mobilization in Ghana

The non-tax sources include domestic borrowing through the purchase of treasury bills, bonds and other such debt instruments from the public. Domestic borrowing is a limited source of government revenue because incomes are generally low and the public can ill afford to patronize it continuously. Others sources of domestic revenue are fines by the courts and

other such authorities, user charges or fees, profits from state-owned enterprises and dividend from jointly owned enterprises, and rents from public property (Azeem, 2002).

The Government of Ghana also generates domestic revenue from lottery through the Department of National Lotteries (DNL), as well as divesting its interest in some state properties through sales. The government divestiture policy is, however, limited and will run out when properties earmarked for sale are sold. Another source is the printing of currencies, though this is rarely used because of its inflationary tendencies.

However, the main source of raising domestic revenue is from tax revenue. These taxes are broadly classified into direct and indirect taxes, and import and export duties. On the importance of taxation in internal revenue mobilization, Azeem (2002) concludes that: Taxation is the main and certain source of government revenue in Ghana. The government relies on taxation in meeting the bulk of its spending needs. Even in cases of grants, aids and foreign loans for specific projects or programmes, a local component is usually a condition for granting them and the government has to turn to taxation to meet such conditions” (p.16).

In Ghana, the Ministry of Local Government and Rural Development empowers the District and Municipal Assemblies levy various fees and rates on individuals and businesses in their areas of jurisdiction. The three main revenue collecting agencies, however, are the IRS, CEPS and VAT Service. The interest of this study, however, is in the role of the IRS in domestic revenue mobilization.

History of Internal Revenue Service in Ghana

Taxation started in the Gold Coast (now Ghana) in the form of customs duty in 1850. This was an indirect tax levied on imported goods by the British after they had taken over the Danish forts and trading posts to meet the cost of administering the colony. The Dutch and the chiefs, however, opposed this form of taxation, which forced the colonial rulers to resort to direct tax as a substitute. A land tax was then considered but it was later changed to pool tax. All the Governors who came to the Gold Coast tried to introduce taxation but they all met protests from the chiefs who refused to co-operate with them. A breakthrough, however, came on February 23, 1943 when Governor Sir Allen Burns weathered the storm and enforces taxation in the Gold Coast. Its success was partly because all other British colonies including Nigeria and the Gambia were already paying income tax.

The Legislative Council passed the Income Tax Bill that formally introduced the payment of income tax in the Gold Coast on September 22, 1943. The law that enforced it, the Income Tax Ordinance (No. 27), however, became operational on April 1, 1944. In addition to income tax the new Income Tax Department was to collect Mineral Duty, Betting Tax and Casino Revenue Tax. The original name was the Income Tax Department (ITD). However, the Department underwent re-organization and other taxes such as Property Tax, Entertainment Duty, Airport Taxes, Hotel Customers' Tax and Standard Assessment were introduced between 1961 and 1963, and the name was changed to the Central Revenue Department (CRD). The CRD also had to undergo re-organization in 1986 and by virtue of the enactment of PNDC

Law 143 of 1986; a new service came into being. The name was again changed to the Internal Revenue Service (IRS) on July 1, 1986 as part of the Public Services of Ghana.

These changes were introduced to strengthen the Department and to make it more efficient in the generation of domestic revenue for the government. The taxes that were to be collected by the new service included Stamp Duty, Capital Gains Tax, Gift Tax, Casino Revenue Tax, Selective Aliens Empowerment Tax, Minerals Royalty and Service Tax. The taxes that are collected presently, however, are simply defined by the Internal Revenue Act, 2000 (Act 592) as Income Tax (Corporate, self employed and employees taxes), Gift Tax and Capital Gains Tax.

Historical Methods Of Taxing The Informal Sector In Ghana

Ghana, since independence has depended on taxes for its national development. In view of this successive governments have instituted tax administrative structures to administer the various tax regimes in order to maximize tax revenue for national development. These structures cover both the formal and informal sectors alike.

Taxation of the informal sector (i.e. the largest employer of the active Ghanaian labour force) has been extremely difficult for all past and present governments. With the ever growing pressure on the government to meet the socio-economic and infrastructural developmental needs of the society, there is an urgent need for government to generate more local revenue. One potential source of the much needed revenue is the large informal sector which largely remains untaxed. The government of Ghana continues to lose

billions of cedis, if not trillions, in tax revenue from the informal sector (World Bank, 2002)

In the past, some attempts were made to tax the informal sector which is considered as “difficult-to-tax”. The methods used have been successful to some extent. These methods are largely presumptive in nature, that is, it assumed a taxable income. The various approaches adopted in the past to tax the informal sector are examined as follows:

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. This Act has gone through various amendments over the years and consolidated into the Internal Revenue Act, 592, 2000. 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 levies correspond to some average income level presumed to be earned by members of a particular occupation or business grouping.

In principle, the standard assessments were payments on accounts to be set-off against the amount of income tax actually payable. However, in practice and with the tacit acceptance of the tax authorities, the standard assessments increasingly represented the final tax liabilities from the various occupational groups covered (World Bank, 2002).

In contrast to the usually prescribed lump-sum payment under standard assessment, the Standard Assessments Act, in Ghana incorporated graduation for some occupational groups, for example doctors and dentists had to pay varying lump-sum taxes according to the number of years in

practice while the lump-sum amounts paid by fishermen were calibrated by the length of their vessel.

The main advantage of the scheme was that “the scheme enhanced the vertical equity. Self-employed professionals such as doctors, lawyers, and dentists whose incomes are several times the national average were made to make some payments, though not in direct proportion to their personal efforts” (World Bank, 2002). However, despite the advantage, the scheme was beset with some drawbacks that prevented it from achieving the policy objectives. The major drawbacks were identified in the article titled “Tax Compliance and Informal Sector in Ghana” by the World Bank.

- a. The weak administrative capacity of the tax administration did not allow the effective monitoring of the scheme. For example in the large informal transport sector, inspection of clearance certificates were left in the hands of other law enforcement agencies like the police and the License Office, who colluded with noncompliant persons and cashed in on the scheme instead of ensuring compliance (World Bank, 2002).
- b. The annual lump-sum payments were deemed too high by the highly impoverished informal sector. Evasion was quite rampant by small-scale informal sector operators who did not effectively require clearance certificates to undertake business activities (World Bank, 2002).
- c. The scheme violated the principle of vertical equity, to the extent that it imposed the same tax liability on high and low income professionals such as doctors and lawyers. Hence, some low-income professionals were not encouraged to comply (World Bank, 2002).

- d. Though the scheme was mooted to be effective in taxpayer identification by creating list of small businesses and professionals, the over centralized tax administrative set-up could not achieve this policy objective. Information gathered was left to gather dust without being put too much use.

Occupational (identifiable) grouping taxation:

In Ghana, some small-scale businesses and informal sector operators belong to some occupational groupings. Such occupational groupings include GPRTU, market women union, seamstresses and tailors union, hawkers association, etc. The members of these occupational groupings found it difficult paying the annual lump-sum levies under the Standard Assessment Scheme. Again, ineffective monitoring of the scheme because of the weak administration allowed for massive evasion of tax. The tax policy of the informal sector therefore shifted to the normal practice of raising provisional assessment and demanding quarterly payments. This was equally difficult for businesses in the informal sector and again, allowed for noncompliance. Thus in 1986 when the government under the Economic Recovery Programme (ERP) and Structural Adjustment Programme (SAP) undertook tax reforms with the view to strengthening the administrative structures of the tax institutions, there was the need to review the policy objective that sought to increase government revenue, by broadening the tax base so that the tax rates could be systematically lowered to reduce the tax burden (World Bank, 2002).

The standard assessment scheme was reintroduce in an enhanced form which became known as ‘Identifiable Grouping Taxation’. The pilot scheme started with the large transport sector and culminated in the government enacting the Income Tax Amendment Law, 1987, PNDCL 177. The law

decreed that every person who owned any specified vehicle was to pay tax at a specified rate. Two categories of tax payments were identified. One category made up of taxis and intra-city commuter services were made to pay specific cedi amounts on daily basis according to passenger capacity. The second category comprising of long distance and cargo trucks paid a percentage of their gross takings per trip.

Initially, the scheme was made a final tax payment because of the problem encountered under the earlier Standard Assessment Scheme. However, for reasons of equity the scheme was changed into instalment payment on account that transport operators in the informal sector are required to file returns and amounts at the end of the year of assessment. Contrary to the standard assessment scheme, the occupational groups were appointed as agents and commission ranging from 2% to 2.5% of their annual total collection was paid to them (World Bank, 2002).

The World Bank article titled 'Tax Compliance and the Informal Sector in Ghana identified some merits and demerits of the Identified Grouping Taxation. The merits are first examined.

- a. The scheme was most attractive to tax authorities because it was comparatively simple and easy to administer, despite the weak tax administration capacity in Ghana. Tax authorities were relieved of the need to go through auditing and investigation procedures to ascertain or verify a particular individual tax income.
- b. The scheme also enhanced horizontal equity to the extent that the levy captured small businesses and the self-employed who previously escaped

taxation. However, the informal sector businesses that did not fall into any identifiable occupational groupings escaped being taxed.

- c. Closely related to the problem of weak tax administration capacity and the low salary levels of tax administrators in Ghana which encouraged corruption amongst tax officials, the scheme minimized opportunities for corruption and collusion since there was no discretion on the part of tax officials.
- d. The scheme has to a limited extent increased compliance rate of the informal sector. Tax collection from hard-to-tax informal sector especially the transport sector has improved substantially. Before February 1987, the procedure for taxing informal sector followed the same procedure for the formal sector. Provisional assessments were raised and quarterly payments demanded. This system resulted in very low tax collection figures from the sector.
- e. Finally, the scheme has also improved to some extent with taxpayer identification. Since the executives of the associations could tell the location of their members and in their anxiety to achieve horizontal equity for members of the same occupational groupings, they (executives) are always prepared to fish out members to ensure identical cost structure in the industry (World Bank, 2002).

The scheme however was afflicted with certain demerits:

- a. Storage and auditing of receipt books

The instalment payment of taxes on daily basis requires volumes and volumes of receipt books and stationery for recording payments. Used unaccounted receipts are bagged in sacks and could be found in every available space at the head office and district offices. This situation has created problems for

auditing purposes to the extent that some management staff responsible for monitoring the scheme has found themselves in police cells when some receipt books could not be accounted for.

b. Embezzlement of tax revenue

The weak administrative capacity makes it difficult to monitor the numerous payments made on weekly basis. These executives of the groups keep tax collection to themselves and turn them over before paying to the tax authorities. This causes problems of delayed payments. In extreme situations, the executives embezzle monies collected without much action for recovery by the tax authorities.

c. Cost of collection was exorbitant

The cost of stationery and printing receipt books coupled with commission paid to the executives made cost of collection high in spite of its simplicity in collection. This high cost violates the Adam Smith's economy- one of the four cannons of tax system.

d. Poor record keeping by the associations

High levels of illiteracy and the low level of education among members of the association, result in poor record keeping by the association making accounting and auditing procedures difficult (World Bank, 2002).

Tax Stamp:

The various attempts in the past to rope in the informal sector in the tax net have not achieved the desired results. There still remain a large number of the informal sector enterprises outside the income tax net.

Indeed, some informal sector operators earn income from all the three main sources of income under the tax law namely employment, business and

investment yet pay absolutely nothing in the form of tax. The effort at getting more informal sector to pay tax has necessitated the introduction of a new scheme called 'tax stamp'. The tax stamp is a type of standard assessment scheme which imposes a lump-sum of tax paid quarterly.

The tax stamp is being operated by IRS itself unlike in the case of identifiable groupings taxation where agents were used to collect tax on behalf of IRS.

This system has come to some extent correct the weaknesses in the predecessor systems. The tax stamp system has grouped the informal sector businesses into categories based on the turnover of the business. Each informal sector business is expected to purchase the tax stamp (a sticker) and expected to produce it as and when a tax officer demands for it. Failure to produce a tax stamp amounts to an offence liable to a fine, not less than GH¢20.00 and not exceeding GH¢50.00.

The tax stamp scheme looks effective with respect to informal sector transport operators as at the beginning of each quarter the drivers and/ or owners are to purchase Vehicle Income Tax (VIT) sticker. This sticker is expected to be pasted on the front windscreen of the vehicle for the inspection by the police. The driver who fails to comply is arrested and made to face sanction. This serves as potent deterrence for non-compliance.

However, for the itinerant and mobile informal sector operators, it is very difficult to enforce tax stamp. Hence, a good number of the entrepreneurs still remain outside the tax net. The compliance rate seems to be highest compared to the old standard assessment scheme and identification grouping taxation. Again, the corruption associated with the identification group taxation, to a large extent has been overcome by the tax stamp system.

Dimensions Of Tax Evasion In The Informal Sector In Ghana

Tax evasion has been identified as one of the major problems confronting tax administration especially in the developing countries. Evasion of tax is more problematic with respect to the informal sector. Agyei (1984) state that “in Ghana, one of the greatest problems facing tax administration is that of income tax evasion”. Otieku, (1988) in his later study of the problems facing tax administration in Ghana also identified tax evasion as a problem.

Tax evasion is the deliberate distortion of the facts relating to an assessment after the tax liability has been incurred so as to reduce the liability. According to Otieku, (1988), “any deliberate attempts by a taxpayer, his agent or tax officer to reduce the ultimate tax liability of the taxpayer by the use of any unlawful means constitute tax evasion. It is the deliberate attempt by the taxpayer to distort facts relevant for an objective ascertainment of his liability” (Otieku, 1988). The tax evasion is as a result of factors such as large scale of illiteracy among populace, ignorance of tax laws, dominance of difficult-to-identify sole-proprietor, inadequate number of tax offices and officers, complex tax laws etc (Otieku, 1988).

Evidence of income tax evasion is difficult to obtain in any country, particularly the developing countries, since it is an illegal activity. However, in developed countries, more is known about tax evasion than in developing ones. This is due to the fact that there is refinement of statistics and wealth of research resources in the developed countries (Agyei, 1984). Tax evasion, apart from resulting in loss of revenue to the government undermines

confidence in the fairness of the tax law. The extent of tax evasion is extremely difficult to determine in any country, especially in the developing countries. Attempts have been made in the developed economies to estimate the extent of its occurrence. One of such studies in the United States of America compared the totals reported on the federal incomes tax returns to those determine in the national income accounts.

The difference between these two income totals provided an approximated evidence of the extent of tax evasion (Otiaku, 1988). The evasion by the 'difficult-to-tax' (i.e. largely informal sector businesses) group may take three forms: non-declaration of income; under-declaration of income; and inflation of deduction from income (Gold Smith, 1951).

Non-declaration of income: Under the Internal Revenue Act, 2000, (Act 592), every income earner is expected to furnish return of income not later than four months after the end of a basis period of that person within the year. This is used to determine the final tax liability of the income-earner. The overwhelming majority of the informal sector operators do not furnish return of income annually. The 'non-declaration of income' form of evasion which involves principally failure to file tax returns is by far the most glaring source of evasion by the difficult-to-tax group.

The request for the furnishing of income tax returns to the tax office is the first step in the process of establishing the true income and determining the tax liability of the taxpayer. In the words of Otiaku (1988) "...where majority of tax payers fail to file these returns either out of ignorance or deliberately, it becomes very difficult to identify them, ascertain their income and assess them

to tax. The refusal to file return is one means of keeping one's incomes outside the reach of the tax authorities and thus evades the taxes thereon".

Under-declaration of income: This form of evasion is where the taxpayer although furnish or file returns of income but the income stated on the returns is understated. Under the IRS Act, the major sources of income have been identified as income from employment, business and investment. A good number of people operating in the informal sector although earn income from the three sources but may disclose income from one or two sources resulting in the under-declaration of income. It is, however, extremely difficult on the part of the tax authorities to detect such under-declaration as the activities of the informal sector are hidden from the tax officials (Otieku, 1988).

Inflation of deductions from income: Under 'inflation of deductions from income' the deductible expenses from income are overstated so that a smaller amount of taxable income is reported. It is not only the informal sector operators that are guilty of this form of tax evasion but formal sector businesses as well. Income tax law specifically state that *"for the purpose of ascertaining the income of a person for a basis period from any business, employment, or investment there shall be deducted: (a) all outgoings and expenses wholly, exclusively and necessarily incurred during that period by that person in the production of the income; (b) any other deductions as may be prescribed by Regulations made under section 114"* [Section 13 of IR Act 592].

The existing literature on tax has it that 'wholly' refers to the amount of expenditure; 'exclusively' refers to the purpose for which the expenditure was

incurred; and 'necessarily' is the element of compulsion to qualify the expenditure as allowable. The informal sector operators tend to commingle their private expenses with that of business leading to higher expenses being charged against business income which ultimately reduces one's tax liability (Otiaku, 1988).

Factors Contributing To Income Tax Evasion

Tax evasion is the symptom of a gamut of interconnected factors. It is a cause-and-effect relationship. A number of factors have been identified as causing tax evasion. These factors presence is glaring and more accentuated in the informal sector. Some of these factors include illiteracy, lack of voluntary compliance, cash transactions, low standard of record-keeping, inaccessibility to tax offices, etc. (Otiaku, 1988).

High illiteracy rate: It is well established that about sixty percent of the informal sector entrepreneurs are unlettered. Associated with this problem (i.e. illiteracy) is the problem of filing out of income returns, preparation of accounts and in general the lack of voluntary compliance. Generally, income return forms are complex to complete and hence calls for one to be fairly educated to enable one peruse the return and complete it appropriately. Again, the income return form does not come in the local languages that the illiterates can easily understand, hence the non-declaration of income form of tax evasion (Otiaku, 1988).

Lack of voluntary compliance: A large degree of voluntary compliance on the part of taxpayers is required for satisfactory income taxation. Income taxes cannot be collected by the best administrative organization satisfactorily from the self-employed when evasion is generally attempted and incurs little

or no moral disapproval from the public. The use of force in tax compliance is not sustainable over a long period of time hence the need to work at voluntary compliance (Otiaku, 1988).

Predominance of cash transaction: In Ghana, most informal businesses carry out business transactions on cash basis as some do not accept bank cheque for fear of bouncing. The prevalence of cash transactions creates room for tax evasion. Cash transaction leaves no traces of evidence of the income from such transactions. Cash transaction also enables one to manipulate records and figures for tax reduction purposes (Otiaku, 1988).

Low standard of record keeping: In most developing countries many businessmen keep no records of their business transactions. Here in Ghana most self-employed persons are totally indifferent to proper record keeping. However, in tax administration, a very crucial task is the correct determination of the income of the taxpayer so that a proper assessment of the tax liability could be made (Otiaku, 1988).

According to Agyei (1984) *“three main factors contributing to this low standard of record-keeping could be recognized: illiteracy; general shortage of accountants; and high fees charged by the accountants. The high fees charged by the accountants make it even more difficult for the few self-employed taxpayers who are willing to keep accounts of their business to hire the services of the accountants”*.

Management and personnel of tax administration: The calibre of personnel running tax administration and the management style can also encourage tax evasion. A corrupt and low-morale tax officer may result in tax evasion as some of the officers may collude with the taxpayers in non-

payment of tax. A strong and effective tax administration may, to some extent, curtail tax evasion.

The Framework Of Tax Noncompliance In The Informal Sector

Admittedly, tax noncompliance is very high in the informal sector as compared to the formal sector businesses which are far more visible to IRS officials. Noncompliance arises not only by the actions and inactions of the taxpayers but also by the tax law makers. “Noncompliance could be said, therefore, to be a product of the decisions of rule makers as of the actions of the taxpayers” (Kidder and Craig, 2000). At any single point in time, compliance and noncompliance are the result of decisions of political, legal, and administrative actors and of the behaviour of taxpayers (Lewis, 1982). This suggests that tax noncompliance is not only the function of the taxpayers but also the actions and inactions of the “powers that be” in charge of tax administration as a whole.

In studying the tax noncompliance behaviour of the informal sector entrepreneurs and businesses, this thesis adopts the “typology of noncompliance” presented by Kidder and Craig, (2000).

The noncompliance type variables are examined below:

- Procedural noncompliance- this results from failure to follow rules about when to file and which forms to file. Such violations do not necessarily result in understatement of tax liability but have to do with the procedures by which the taxpayer declares income and deductions. Compliance with IRS rules and procedures is time and resources consuming hence it is only a few informal sector entrepreneurs who can afford to comply.

- Unknowing noncompliance- this involves underpayment of taxes through ignorance of complex, changing, and sometimes ambiguous rules. Since the enactment of the IR Act in 2000 there has been a series of amendments in every year as the government fiscal statement is presented.
- Lazy no ncompliance- this occurs when individuals discover that they cannot document legitimate expenses for business or health costs or fail to keep track of outside earnings for which there is no withholding. Indeed, recording keeping practices in the informal sector seems to be poor hence the noncompliance.
- A social noncompliance- this occurs when the income earner arranges his business activities so as to be invisible to the IRS officials. This is done by transacting business in cash and moving from one place to another so as not to attract attention of the tax man. Many informal sector entrepreneurs engage in this form of noncompliance
- Symbolic noncompliance- takes place to protest for perceived unfairness and inequities in tax laws. Refusal to pay tax as a protest against what one perceives as unfair tax laws and abuse of tax revenue by the government officials.
- Social noncompliance- this results from peer pressure and social influence on the taxpayer not to comply with the tax laws. This is where network of individuals collectively refuse to pay tax hence anybody in that network must conform to the group norm.
- Brokered noncompliance- this takes place upon the advice of a knowledgeable expert such as accountant, lawyer, or bond dealer. The

taxpayer is advised by the accountant hired to prepare the accounts not to pay tax and in return account may be compensated for non-payment of tax.

- Habitual noncompliance- this emerges over time as the taxpayer establishes a pattern of non-declaration of income or under declaration of income.

Difficulties in Taxing the Informal Sector in Ghana

Like any developing country, taxing the informal sector in Ghana is a herculean task. This has been acknowledged by the 2007 Budget Statement:

...One of the major challenges facing Ghana is how to broaden the tax net out of a pool of 5 million potential taxpayers only 1 million are paying income taxes. Apart from employees on the Government payroll, only about 350,000 employees in the private formal sector pay taxes... the fact that the vast majority of Ghanaians in the informal sector makes revenue generation a daunting task. Experience in other countries indicates that, nations making the transition from informal to formal economies have to use innovative methods to mobilize tax resources (Republic of Ghana, 2006, p. 296).

To enhance revenue collection and bring a fairer distribution of the tax burden which is currently borne by those employed in the formal sector, the budget proposes that during 2007 “the government will develop and implement a system to assess and collect income tax using the value of vehicles registered ...because a significant percentage of vehicle registrations are from informal sector operators most of whom are not tax payers” (Republic of Ghana, 2006, p. 296).

Two general difficulties can be discerned. Firstly, most business transactions are done in cash and even some establishments would not accept bank cheques. The transaction of all business in cash is one of the means by

which a businessman can conceal taxable profits. By so doing, he is able not only to manipulate his records and turnover figures for tax reduction purposes but also to eliminate all third party information leading to his purchases and sales. Secondly, most self-employed is indifferent to proper record keeping. However, in tax administration a very important task is the correct determination of the income of the taxpayer so that a meaningful assessment of the tax liability could be made. Without record keeping, this cannot be done. The low standard of record keeping is mainly due to illiteracy (Agyemang, 1982).

Some of the specific difficulties relating to tax collection are as follows:

In appropriateness of Tax Mechanisms:

Ghana has used direct and indirect mechanisms to collect tax from the informal sector. Direct taxing through formal systems of accounting and income calculations and formal payment channels has not worked effectively because collection costs tended to be high in relation to the amounts collected and discretionary. To overcome those problems lead to the withdrawal of Value Added Tax (VAT) and later reintroduced (Aryee 1997). In spite of its introduction, the VAT has not been able to penetrate informal sector activities. To strengthen the capacity of Government to mobilize resources, the Ghana Poverty Reduction Strategy one(1) focused on increasing revenues not by increasing taxes but by instituting measures that will widen the tax base and involved minimizing revenue leakages, reducing the incidence of tax avoidance and strengthening the capacity of the revenue collecting institution (Republic of Ghana 2003).

Capacity Constraints:

Although the introduction of VAT and presumptive income taxes has eased the assessment and collection processes, there is still a need for effective tax administration for monitoring and enforcement. The Internal Revenue Service and VAT Service do not have adequate capacity. In the Budget Statement for 2006, for instance, the “Human Resource Department and the Training Division of the IRS will develop a comprehensive Training Programme that would sharpen the technical and managerial competencies of IRS employees” while “the VAT Service will initiate Customer Care Programmes to ensure that the right approach is adopted by VAT Service personnel in all their undertakings, with regard to both their Internal and External stakeholders” (Republic of Ghana, 2005:255).

The Incentive Problem:

Not only are the three revenue agencies over stretched, but typically their staff tried to avoid working with the informal sector. Compared to virtually all alternatives including corporate taxation or including corporate taxation on Customs and Excise, working with the informal sector is relatively perceived as low status, unrewarding, and sometimes even dangerous. For example, patrolling poorer areas to identify tax evaders and monitor tax payments with nowhere near the required level of resources is a thankless task. In particular educated tax officials dislike interaction with illiterate when they are attempting to eke a meagre living. The scope for corrupt supplementation of earnings is low relative to other types of postings, and corruption typically will imply taking money in small amounts from already poor people. As our own research in Ghana Shows, motivation tends to be low among tax officials

assigned to work with the informal sector. Promotion prospects are low and they are excluded from the more lucrative positions (Ayee 2007).

The Internal Revenue Service (IRS) does not have capacity to implement, monitor and enforce taxation. It is the only revenue agency which is yet to be computerized. This coupled with inadequate logistics such as vehicles, office space, and inadequate conditions of service to motivate staff, have made it impossible to make significant inroads into informal sector taxation. Strategies employed by the IRS such as on the spot checks, closing down of shops, public education on tax and the demand of tax clearance certificate for appointment to public office to stimulate tax consciousness in the informal sector has achieved marginal success. These are jobs to be avoided especially by the more senior officials. In such circumstances, it is hard for governments to focus more on taxing the informal sector.

The Politics of Taxing the Informal Sector:

Whether one likes it or not, the informal sector constitutes a substantial vote bank for politicians. Consequently there has been what Tendler calls the “devel’s deal”. This is an unspoken arrangement between politicians and the informal sector operators:

If you vote for me, ... I won’t collect taxes from you, I won’t make you comply with other tax environmental or labour regulations and I will keep the police and inspectors from harassing you (Tendler 2002:99).

Public officials and politicians are willing to turn a blind eye to informal activities in order to retain their support base. The corporate relationship that existed between the Ghana Private Road Transport Union (GPRTU) and Rawlings Provisional National Defence Council in the mid 1980s is a case in

the point. The process of bargaining with the informal sector over the payment of tax is itself a gesture of concession and accommodative which is fraught with political overtures and undertones. Even though successive governments made public statements for widening the tax net and taking tough measures to sanction tax defaulters, there is always a gap between their intentions and actions possibly because of the serious consequences for instance losing electoral support in pursuing those actions to the logical conclusion. There is hard evidence to support this contention because we still know little about the politics of the informal sector in general. Let alone the specific issue of taxation. However, the notion provides yet another plausible explanation of why governments often are unable or unwilling to directly tax the informal sector.

The Implications of the Informal Sector

A growing informal sector is an indication that something is wrong – existing laws and regulations are making transaction costs exorbitant. A large informal sector has serious consequences for private sector activity, economic growth and development, and the consolidation of democracy. These implications are relevant for policymakers, government officials, entrepreneurs and employees in the formal and informal sectors, trade unionists, and members of international and regional organizations. This section discusses the pernicious implications of high transaction costs and sizeable informal sectors and indicates why this should be of concern to every group in the society.

Undemocratic decision-making and misguided policies

Because members of the informal sector operate clandestinely, they have little opportunity to voice their concerns to government officials and thus policies are less responsive to their needs. Brunetti et al (1997) study indicates that businesses (formal and informal) often have little input into the policy making process and would like to have more. Historically, under such circumstances, if the institutional framework is not reformed, countries remained underdeveloped and prone to revolution (de Soto 1989).

Moreover, their lack of property rights fosters a concentration of economic power in the hands of a small number of elites who control government policymaking and large portions of economic activity through monopolies or oligarchies. This arrangement weakens check and balance mechanisms, potential opposition to the government, and government accountability vis à vis the general public thereby jeopardizing democracy (Louw 1996). Because informal sector activity is not included in official statistics, government policies and regulatory institutions that affect the entire population are made without data on a substantial amount of economic activity. This leads to misguided policy responses. For instance, welfare programs to assist government-recorded unemployed who are working in the informal sector may be inflationary, and should be targeted to those who are even more marginalized and are in greater need of assistance than informal sector (Farrell et al. 2000). Moreover, the large flight of capital to the informal sector complicates macro-economic management.

Erodes competitiveness

Coase (1937) points out that the absence of well-designed, cost-efficient, and stable institutions protecting property rights and contracts prompts businesses to minimize costs and risks by integrating vertically. This reduces firms' flexibility and mutes market signals. Moreover, the lack of these institutions hinders companies from decentralizing, specializing, subcontracting with competitive suppliers, offering reasonable insurance premiums, and attracting investment -- foreign and domestic.

It also complicates the use of sophisticated and creative asset combinations such as incorporated companies or flexible shareholding arrangements such as debt-equity swaps, or engaging in long-term investments and contracts essential for economies of scale. As a result, an economy will not be equipped to compete globally and will run the risk of being excluded from global markets.

High transaction costs also affect the degree of competitiveness of formal businesses vis à vis their informal counterparts. Those in the informal sector are not paying taxes or expending their resources to comply with government laws and regulations which, according to some, give them (i.e. informal sector businesses) an unfair competitive advantage over formal businesses.

Lack of access to and higher costs for essential public services

In many countries utility connections (water, electricity and telephone) require a legally recognized property title or lease as a form of securitization. Because most informal sector operators do not have property titles, they may

be deprived of water, electricity and phone service. In some cases, informal sector operators have little choice but to tap electrical, water and telephone lines illegally, thereby raising the cost for regular subscribers. If there is widespread illegal usage, no private company will be willing to provide these services forcing the government to do so either at a high cost or at a loss (de Soto 1996).

Less government revenue for public services

Johnson et al. (1997) argued that countries with complex and costly taxation and regulatory schemes end up in an economically unproductive equilibrium with a large informal sector. High taxes induce non-compliance, that is, informal businesses. This reduces government revenue and thus the amount of funds available to provide and maintain market-supporting, public sector goods and services such as the court system, government administration agencies, roads and so on. The fewer funds and the impossibility of preventing informal sector operators from using many of these services without paying for them diminishes their quality, increases prices, and leads to congestion. This, in turn, encourages even more entrepreneurs to leave the formal sector to avoid bearing an increasing share of the tax burden for poor goods and services.

A good equilibrium is one where tax revenues are used to provide quality public services that encourage participation in the formal sector and discourage informal sector activity (Johnson et al. 1997). Moreover, quality and cost-efficient public services such as law and order and regulatory frameworks are important production inputs. Their absence or weakness jeopardizes economic performance. In the end, countries become trapped in a

vicious, unproductive cycle. De Soto (1989) and Pei (1995), each provide examples of how entrepreneurs were able to remain competitive by devising informal mechanisms of doing business when the legal and regulatory framework was ill- suited to their needs.

The Role of the Informal Sector in Ghana

Most small-scale enterprises operate in informal sector, making contributions to the national development. The informal sector is rapidly growing and expected to expand its productive capacity so as to make more contribution to the overall national GDP. The contribution of the informal sector to the growth and development of economy includes the production of goods and services, job creation and skills acquisition (ISSER, 2003).

Since the discovery of the informal sector, it has made significant contribution to socio-economic growth of Ghana. According to ISSER (2003) “a critical look at the operations of the informal sector visa-a-vise the economy’s growth pattern demonstrates the significant contribution that it makes to national development”. Some contributions of the informal sector worthy of specific mention follow.

Contribution to national output

Collectively, the operators in the informal sector produce diverse goods and services that added up to the national output. Certain goods and services are better provided by the informal sector as against the formal sector. According to ISSER (2003) “the role of the informal sector in the domestic economy is demonstrated in the wide variety of goods and service produced by the sector. Based on the value-added estimates from JASPA

(1989) survey, it was established that the sector accounts for about 22 percent of real GDP, with the contribution of rural informal activity outstripping that of the urban sector. In the non-agricultural sector, contribution of trade and commerce is the largest accounting for 52 percent, followed industry with 28 percent, services 12 percent, and transport 8 percent (ISSER, 2003).

The rural informal sector plays a critical role in the agriculture sector to feed the nation. Without the informal sector there would have been gross under provision of the raw foodstuffs.

Job creation and income distribution

As stated earlier, one of the main causes of the informal sector is the paucity of job opportunities in the formal sector. Informal sector in Ghana provides avenue for unlimited job opportunities. Hence, those people who are unable to secure formal jobs tend to seek solace in the informal sector. In the ISSER's (2003) report, it is stated that "the main source of employment is the informal sector. The sector provides employment opportunities for at least 80 percent of the labour. The sector as of 2000 provided jobs for about 6.7 million people..."

The importance of the informal sector as a source of employment was very clear between 1988/89 and 1991/92 when, in the wake of public sector retrenchment and privatization, the proportion of informal sector workers in the total workforce rose sharply from 79 percent to 88 percent. Small enterprises (considered mostly informal) tend to be relatively labour-intensive, utilizing low levels of technology and relying heavily upon the physical and mental skills of owners and employees. According to Stanley and Morse, 1965, this is a strategy which is conducive for expansion of the small

enterprise sector and consistent with employment and income generation objectives

By providing employment, the informal sector participants receive some level of income for their labour. Informal sector provides a major source of income for the poor and illiterates who may never get the chance to work in the formal sector. In the words of Kuipo (1996) “In Ghana, the importance of small-scale enterprises in providing income-earning opportunities outside formal wage of employment is reflected in the growing attention to micro-enterprises and the “informal sector”.

Further, “It is generally believe that during the period of economic decline especially from 1970 to 1983 when income per head declined substantially in the urban centres, the role of the informal sector was significant in alleviating large-scale poverty in the urban centres. It is usually argued that the bulk of the urban labour force engages in one form of informal sector activity or the other, either on a full time or part time basis-a phenomenon which partially helps to explain the absence of any marked poverty in the urban areas especially in the situation of the declining real wages and employment growth in the formal sector” (ILO/JASPA, 1989).

Skills acquisition in training

Another area in which the informal sector contributes immensely is in the area of the training of the labour force in the acquisition of artisanal skills. This is achieved through the traditional apprenticeship system. Though this is not a perfect system for training manpower for industrial employment because of inadequacy of the methods used in training, through this function, the informal sector plays an important role in the development of

the indigenous entrepreneurship particularly in artisan activities in both the urban and rural areas in Ghana (Yankson, 1989).

Successful industrialization must have an indigenous base. The expansion of the small enterprise sector will help develop the experienced managerial and entrepreneurial class that is needed as a basis for more efficient indigenous instrument and management of large-scale industries (Bruton,1990). Although some informal sector enterprises noted to fold up in the first five years of operation, some do survive and grow from being informal to formal and becoming big time businesses employing hundreds and thousands of workers.

The important role in increasing the pace of innovation

Small and very large firms make disproportionate contribution to innovation, while the number and importance of innovations vary by industry, according to a study by Rothwell (1986). Rothwell observed that failure rates among small firms are often higher because, in incurring extra risk, they play an important role in establishing promising ideas which can be nurtured into competitive products and processes. Sometimes many of these innovative companies also disappear, not because they succeed and are purchased by large companies which can market the products more effectively. There is thus a useful interaction between small and large companies as the small firms provide the means of increasing the motivation for the innovation and hence the pace of change which all firms can build on.

CHAPTER THREE

RESEARCH METHODOLOGY

Introduction

This section considered the various techniques and methods used in collecting and analyzing data for this research. A research methodology must be systematic, methodological, rigorous, conventional and unbiased if research is to be considered scientific (Mason and Marchal, 1999). The major areas that were of particular concern to the proper execution of this study included: study area and target population, the collection of primary and secondary data, and the data analysis techniques used in arriving at the solution to the problem under study. The Statistical Package for Social Sciences (SPSS) was used in analyzing the data.

Study Area

The target area of this study was restricted to Cape Coast, Elimina, and Mankesim all in the central region. The preliminary survey conducted by the writer showed that every form of informal sector enterprises and activities in Ghana can be found in the areas selected for the study. Again, the selected area is the most convenient as the researcher and those to be engaged to assist in data collection are located in the named areas and this will ensure effective and efficient administration of the questionnaires and interviews. This in the long run will facilitate the collection of primary data within the limited stipulated time for the submission of the final work.

Target Population and Sample Composition and Selection

The target population of this study was the informal sector in Ghana. The sample frame used for the informal sector was largely restricted to Cape Coast, Elimina, Mankesim and other surrounding rural communities due to the limited time for the research and resources constraints.

The sample frame was further stratified into categories of informal enterprises with common characteristics. There is no gainsaying the fact that informal sector activities are very heterogeneous in nature, hence the justification for stratification of the sample frame so as to achieve a fairly representative sample size from the frame. As indicated by Lillian Trager, (1987) “No one doubts that informal sector is heterogeneous, all the data indicate a wide variety of activities among informal sector enterprises and entrepreneurs”. According to Saunders et al (2000), “dividing the population into a series of relevant strata means that the sample was more likely to be representative, as you can ensure that each of the strata was represented proportionally within the sample”. The informal sector businesses were divided into the following strata (or categories) as provided by Yankson (1992): Food Processing, Textile/Leather Works, and Woodworking, Metal Fabricating, Beverages, Repair Services, and Auto repairs, Handicrafts, Commerce and Building Construction.

The sample size for this study was 200 informal sector entrepreneurs/operators. A sample of 20 persons was drawn from each strata named above. This in the writer’s view gave a fair representation of the sample frame. It was extremely difficult, if not impossible, to get a representative sample of a given large population such as informal sector

enterprises in Ghana. Colin Fisher (2004) buttressed writer's assertion when he states that "the problem is that no sample can be guaranteed to be representative. If you could take a large number of different samples from the same population, some would overestimate and some underestimate the true figure".

In the United States of America, University of Michigan, "using personal interviews of 284 households", conducted a research in the informal economies to establish exchanges in that sector (Ferman et al, 1987). Again, Otieku, (1988), in studying the problems of income tax administration in Ghana used a sample of a little over 300. In the light of similar studies and the sample size used, it is the researcher's view that a sample of size of 200 sufficed for this study.

Data Collection Procedure and Instrument

This study, to a very large extent, used primary data and where necessary some secondary data was used. Researchers have established the fact that informal sector entrepreneurs are very averse to talking to 'unknown persons' on their tax payments as most of the informal sector operators fail to discharge their tax obligations. Informal sector operators, therefore, do not willingly and easily divulge information about their tax obligations for fear of being discovered and made to face the sanctions for non-compliance with the income tax laws. Again, developing empirical research on informal sector economies offers a number of major challenges and difficulties. The lack of conceptual clarity and the presence of disciplinary functionalism have created considerable difficulties in formulating an appropriate methodological

perspective from which to study the phenomenon (i.e. informal sector) (Ferman, et al 1987).

The Main Questionnaire Design

A structured survey questionnaire with unambiguous questions was used to limit and ease the analysis of response-variation among interviewees. A number of question formats were used in designing questionnaire so as to elicit appropriate information from the respondents. Closed- and open-ended questions and multiple choice questions were mostly used to limit the interviewee to choices to be selected from. Closed-ended questions were largely used because of the fact that a majority of the informal sector entrepreneurs are illiterates and to facilitate completing questionnaires with ease hence the format adopted. This enabled the researcher and his assistants to read out the questions and explain the questions to those who may not understand English language before the person made a choice which was either ticked or circled.

A few open-ended questions were used to elicit information on opinions, attitudes and beliefs of the interviewees towards taxation of the informal sector. Those who were able to write completed such questions on their own while those who could not write were assisted to do so as they talked to the researcher. Rating scale questions were used. The researcher was well informed of the fact that a good number of the informal sector entrepreneurs were unlettered and very aversive towards tax issues, and therefore used interviewer-administered questionnaire (i.e. where the researcher completed a questionnaire on the basis of the respondent's answers) in about 70% cases while the rest were self-administered questionnaires (i.e.

questionnaire completed by the respondents themselves). Considering the sheer number of the sampling units, the researcher sought the assistance of some students in the universities in administering questionnaires.

Personal Interviews

To complement the data gathered by the questionnaires, the researcher employed both structured and unstructured face-to-face interview to elicit more information on the tax paying behaviour of the respondents. Interviews were very critical as it took a lot of patience and persuasion for people to freely and openly talk on tax issues, particularly when asked whether one had been paying tax.

Official Documentations

Secondary data were collected from documents of IRS and Ghana Statistical Service on the level of tax contributions and the current size of the informal sector in Ghana.

Data Analysis Procedure

The data collected were analysed using tables to group respondents in order to establish percentages of the groups and interpreting those percentages within the conceptual framework. The Statistical Package for Social Sciences (SPSS) was used in the analysis of data.

CHAPTER FOUR

DATA ANALYSIS AND DISCUSSION OF FINDINGS

Introduction

This chapter presents data collected during the field work and analysis and discussion of significant findings thereof.

The Reasons Why the Informal Sector Is Hard-To-Tax

This section presents the findings on the key factors making taxation of income of the informal sector extremely difficult. According to Kidder and Craig (2000), some of the factors influencing noncompliance of tax payment in the informal sector are as follows: Peripatetic informal sector businesses, Predominance of cash transactions, Poor record keeping practices, and High illiteracy rate

Peripatetic Informal Sector Businesses

A large number of the sampled informal sector entrepreneurs do not have a permanent place of business; hence they are always roaming to get their goods and services sold. The response of the respondents to the question as to whether they have a permanent place of business is presented in Table 1

Table 1: The informal sector businesses at permanent location

Answers	Number of Respondent	Percentage
Yes	76	38
No	124	62
Total	200	100

Source: Fieldwork (2012)

Table 1. indicates that 62% of the entrepreneurs surveyed did not have a permanent place from where they carried out their business, while only 38%

did operate from a fixed place of business. From the perspective of the IRS and for the purposes of effectively taxing an income earner he/she should have a permanent and visible place of business where tax authorities can easily locate the taxpayer. As the survey results indicates this essential condition for taxation is largely absent in the informal sector hence the difficulty in taxing that sector. The few informal sector operators who get taxed are almost always those with permanent places of business.

A number of reasons were provided by the respondents for not having a permanent place of business. These reasons included affordability, nature of the business and attraction of clients.

Predominance of Cash Transactions

Most of the respondents sampled in the informal sector sell only for cash. While a minority of the informal sector businesses/entrepreneurs sell on cash and on credit not even a single respondent sells on credit basis only. This picture is presented in Table 2

Table 2: The Basis of Sales in the Informal Sector

Basis of Sales	Number of Respondent	Percentage
Cash Only	134	67
Credit Only	0	0
Both Cash & Credit	66	33
Total	200	100

Source: Fieldwork (2012)

As Table 2. indicates, 67% of the informal sector entrepreneurs prefer to sell only for cash and only 33% sell on credit and for cash. None of the

respondents sell on credit basis only. Cash transactions leave no documentary as informal businesses usually do not keep record of such transactions. Cash sales, therefore, make it difficult to tax income generated.

The entrepreneurs who sometimes sell on credit are those with established business in vicinity where they sell on credit only to those customers who they are familiar with and of course whose houses are nearby for the purposes of effective debt collection. Most of those who sell on cash basis do not keep any accounting records of sales or at best only keep a piece of paper on which they record daily sales. However, those selling on both cash and on credit keep proper record of debtors. This situation makes it very difficult to determine the sales income of entrepreneurs who sell for cash only. Taxing such income earner is extremely difficult if not impossible.

Poor Record Keeping Practices

The data gathered for this study on the level of accounting and recording keeping practices in the informal sector confirms the view in the existing literature of very poor level of record keeping practices in that sector. The responses of the respondents as to the kinds of financial records they maintained is summarized in Table 3. The responses have been grouped into the three main variables as defined in Chapter Two.

Table 3: Level of accounting and recording keeping practices in the informal sector

Level of Accounting Practice	Number of Respondent	Percentage
Low/Poor	125	62.50
Medium	45	22.50
High/Very Good	30	15.00
Total	200	100

Source: Fieldwork (2012)

As indicated in Table 3, 62.50% of the sampled informal businesses fell into low/poor level of accounting practice, 22.50% of the respondent came under medium level of accounting practice and 15% of respondents followed high/very good level of accounting practice. With the majority of the informal businesses maintaining poor accounting and record keeping practices it becomes extremely difficult for an objective assessment of income tax of that sector. Accounting records serve as the basis for the computation of taxable income and the absence of such accounting records makes it practically impossible to tax an income earner.

Among the low/poor level of accounting and record keeping practices there are further categorization into those who do not maintain any records at all and those who maintain only debtors' records. Out of 125 respondents forming low level accounting practice, 56 respondents or 44.80% maintain no accounting records while 69 respondents or 55.20% maintain only debtors' records. This situation indicates that there are many informal sector businesses that do not maintain any form of accounting records at all and this will make

them very difficult, if not impossible, to tax by IRS. This culture of poor record keeping practices in the informal sector makes it very difficult for that sector to be taxed. This is so because the accounting net profit which IRS adjust to determine taxable income is not determinable. Even in the event of IRS wanting to reconstruct the accounts of such informal businesses there are inadequate records to do so hence still the difficulty in taxing that sector.

One of the major reasons identified for the poor accounting practices in the informal sector is the inability and unwillingness on the part of the entrepreneurs to hire accountants to take charge of their accounting functions. Table 4, presents the response of the businesses to the question as to whether they use the services of accountants for their accounting functions. As shown in Table 4, a whopping 79.50% of the informal sector businesses do not use the services of accountants for their accounting functions and only 20.50% make use of the services of accountants. This situation explains the general poor level of accounting practice in the informal sector. It is only the 20.50% of the informal sector businesses that are able to prepare a complete set of accounts as stated earlier, because they make use of accountants who are capable of preparing financial statements.

Table 4: Informal Businesses using the services of Accountants

Answers	Number of Respondent	Percentage
Yes	41	20.50
No	159	79.50
Total	200	100

Source: Fieldwork (2012)

The respondents gave various reasons why they do not make use of the services of the accountants. Some of the key reasons are presented as follows:

- a. High service fee – one of the major reasons the informal sector entrepreneurs gave for not employing or hiring the services of the accountants is due to the high fees charge. According to some respondents, they have made effort to employ accountants or hire them but they could not afford the fee being charged. Those who have succeeded in employing accountants, most of those accountants sooner than later quit for a better offer in the formal sector.
- b. Fear of embezzlement of business funds – some respondents also cited reason of fear that accountants may one day bolt away with the business hard earned money. Indeed, some respondents claimed that in the past they had accountants who have embezzled business money running into millions of cedis and hence have decided to dispense with the services of accountants
- c. No need for accountant’s services – other respondents also claimed that they do not see they need for the services of the accountants. They cannot see any tangible benefits of using accountants.

High Illiteracy Rates

A large number of the informal sector entrepreneurs sampled have very low educational level. They, therefore, are very ignorant about tax system and the fact that they have an obligation to pay tax to the state for the effective running of the state machinery. The data gathered from the field work on the level of education of the informal sector entrepreneurs/self-employed is presented in Table 5.

Table 5: The Level of illiteracy among the informal sector entrepreneurs

Level of illiteracy	Number of Respondent	Percentage
High Education (Polytechnic/University)	19	9.50
Medium (Secondary School)	60	30
Low/No Education (Primary)	121	60.50
Total	200	100

Source: Fieldwork (2012)

From Table 5, 60.50% of informal sector entrepreneurs have low/no education, 30% fell into medium level of illiteracy and only 9.50% of the informal sector entrepreneurs have high education. These figures point to the fact that a large number of the informal sector entrepreneurs are not well educated to handle income tax issues such as filing income tax return forms and this will make it difficult in taxing such informal businesses. A higher education of the informal sector entrepreneurs will to a large extent facilitate taxation of informal businesses and vice-versa.

The Factors Accounting For High Tax Noncompliance

Literature on taxation of the informal sector stated that there is a very high level of tax noncompliance in the informal sector, especially in developing countries. It is believed that government loses huge amount of tax revenue from the informal sector. The data gathered for this study centred on seven main reasons identified why there is high incidence of tax noncompliance in the informal sector. The reasons respondents gave have

been categorized into the following broad noncompliance variables: unknowing, procedural, accounting/lazy, habitual, brokered/advised, protest/symbolic and asocial. Each of these reasons is examined in this section.

Unknowing noncompliance

A good number of the respondents attributed their failure to file income tax return to the fact that they do not know about income tax return. Some respondents claimed that they were not aware they have to complete income tax return at the nearest IRS office. This noncompliance is an indicative of the low level of tax awareness among the informal sector operators in particular and among Ghanaians in general. Table 6. shows the number of the respondents, out of a total of 200 sampled, who ticked unknowing noncompliance as the reason for tax noncompliance.

Table 6: The Unknowing Reason for Noncompliance

Answers	Number of Respondent	Percentage
Yes	135	67.50
No	65	32.50
Total	200	100

Source: Fieldwork (2012)

As indicated in Table 6, 67.50% of the respondents attributed tax noncompliance to the fact that they were not aware of the income tax returns and the need to annually or quarterly file such returns, while 32.50% of the respondents stated that they were aware that they must annually or quarterly file income tax returns at any IRS office.

Accounting (lazy) noncompliance

Another reason given by the respondents for not complying with the income tax laws regarding filing of income tax return is that they do not keep adequate accounting records of business transactions to enable them complete the income tax returns. As revealed earlier in this chapter, most of the informal sector businesses do not keep adequate accounting records of their business transactions in terms of revenue/income and expenditure. Table 7. shows the number of the respondents who assigned tax noncompliance to their inability to keep proper records.

Table 7: The Accounting Lazy Reason for Noncompliance

Answers	Number of Respondent	Percentage
Yes	152	76
No	48	24
Total	200	100

Source: Fieldwork (2012)

As shown in Table 7, 76% of respondents mentioned poor accounting records as the reason for tax noncompliance. These figures go to confirm one of the reasons that make the informal sector hard-to-tax. Due to poor record keeping, majority of the informal sector entrepreneurs do not have information on actual turnover and expenditure. This makes it extremely difficult for such informal businesses to be able to complete the income tax returns. The remaining respondents of 24% did not attribute tax noncompliance to poor accounting records. IRS, in determining taxable profit, do so based on

accounting records and so absence or poor accounting records would make it difficult a determination of taxable profit.

Procedural noncompliance

Procedural noncompliance was not one of the major reasons proffered by the respondents for tax noncompliance. This is because a good number of the respondents have never filed income tax return before and so have not encountered cumbersome and complex income tax filing procedures. Some respondents who in the past filed income tax returns but faced difficulty with the procedures for filing gave procedural complexity as the reason for not filing income tax return currently. The results of the respondents are presented in Table 8.

Table 8: The Procedural Reason for Noncompliance

Answers	Number of Respondent	Percentage
Yes	31	15.50
No	169	84.50
Total	200	100

Source: Fieldwork (2012)

As shown in Table 8, it is only a very small percentage of 15.50% of the respondents who attributed tax noncompliance to the complex income tax filing procedures. This is because there is generally high tax noncompliance in the informal sector. This particular reason was given by the respondents who have in the past years filed income tax returns and who faced some difficulties in completing the tax return, and getting to know their final tax liability. A large number of the respondents of 84.50%, as shown in Table 8, did not select procedural noncompliance as the reason for their noncompliance.

Protest (symbolic) noncompliance

Some respondents mentioned protest noncompliance as a reason for not complying with tax payment. This is a result of perception that the tax system is unfair, the tax rates are too high and do not see any direct benefits of taxes paid in terms of socio-economic development. The respondents in the informal sector felt generally that government has not put to efficient use the taxpayers' monies and so think that it is not worth paying taxes. Some of the respondents cited corrupt practices among government officials who they perceived as dissipating tax revenue for their self-aggrandizement. The informal entrepreneurs, therefore, use non-payment of tax as a form of protest against the perception of the misuse of tax revenue. Table 9. shows the number of respondents who use non-payment of taxes as a protest and for that matter tax noncompliance.

Table 9: The Protest Reason for Noncompliance

Answers	Number of Respondent	Percentage
Yes	139	69.50
No	61	30.50
Total	200	100

Source: Fieldwork (2012)

As shown in Table 9, 69.50% of the respondents admitted that they failed to comply with tax payment as a form of protest against the unfair tax system and flagrant misuse of taxpayers' monies. The remaining 30.50% of the respondents did not associate tax noncompliance to protest noncompliance. If these findings are anything to go by, it would mean that development

policies of government can induce tax noncompliance. Again, some of the informal sector entrepreneurs perceive tax officials to be corrupt in that the taxes paid end up in the tax officials' pockets. This situation has positively affected the high level of tax noncompliance.

Brokered (advised) noncompliance

It is only a very few respondents who based tax noncompliance upon the advice of another person such as accountants. The respondents who proffered this reason happened to belong to the informal sector entrepreneurs who do not have accountants but hired accountants to help them prepare accounts as to reduce the tax liability of the business. Table 10. presents the respondents responses on brokered noncompliance.

Table 10: The Brokered Reason for Noncompliance

Answers	Number of Respondent	Percentage
Yes	19	9.50
No	181	90.50
Total	200	100

Source: Fieldwork (2012)

As shown in Table 10. it is only 9.50% of the respondents who claimed tax noncompliance is based on the advice of their accountants. This form of noncompliance raises issues of morality and ethics on the part of the accountants who advised their clients not to pay taxes or grossly understate their tax liability. However, a huge number sampled constituting 90.50% as shown in Table 10, did not associate tax noncompliance to brokered variable. These figures imply that largely noncompliance among the informal sector

entrepreneurs is not based on the advice given to the businesses by the accountants.

Asocial noncompliance

This reason was also cited by a good number of the informal sector entrepreneurs for not complying with their tax obligations. This reason arises from the fact that some of the informal entrepreneurs know that their colleagues in the self-employment/ in the informal sector do not pay taxes and so they would also not pay. This is a form of peer pressure from other informal sector entrepreneurs on the other entrepreneurs. The data on the asocial noncompliance is presented in Table 11.

Table 11: Asocial Reason for Noncompliance

Answers	Number of Respondent	Percentage
Yes	117	58.50
No	83	41.50
Total	200	100

Source: Fieldwork (2012)

As shown in Table 11, 58.50% attributed tax noncompliance to the fact that their colleagues in the informal sector do not pay taxes and so they do not see why they should pay taxes. The remaining 41.50% of the respondents, as indicated in Table 11, did not trace their noncompliance to the fact that other entrepreneurs are not paying taxes. This study reveals the stark reality that the general level of noncompliance in the informal sector may further discourage the few informal sector businesses that do pay taxes currently from doing so in future. This is a disturbing signal that must be dealt with by IRS so as not to worsen the problem of high noncompliance.

Habitual noncompliance

Some of the respondents simply did not have any reason for tax noncompliance. They do not comply with their tax obligation for no apparent reason. Tax noncompliance has become part and parcel of them resulting from a long period of noncompliance. Noncompliance effectively can be said to have become their habit. It will take massive tax education and strict enforcement of sanctions under IRS law to change this ingrained habit. The data on habitual noncompliance is presented in Table 12.

Table 12: Habitual Reason for Noncompliance

Answers	Number of Respondent	Percentage
Yes	71	35.50
No	129	64.50
Total	200	100

Source: Fieldwork (2012)

As shown in Table 12, 35.50% of the sampled respondents could not attribute their noncompliance to any specific reason. They have simply not been complying with income tax laws over the years. So though they earn income on which they are liable to pay tax they will simply not pay tax for any apparent reason. However 64.50% of the respondents, as shown in Table 12, by implication had one or other reason for noncompliance. These figures indicate clearly that a large number of the informal sector operators at least have one reason for tax noncompliance.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

Introduction

This study has thrown the search light on the issues affecting taxation of the informal sector in Ghana. The study investigated the factors that make informal sector extremely difficult to tax and the variables affecting tax noncompliance behaviour of the informal sector entrepreneurs were also examined.

Summary of Major Findings

The following summaries are presented based on the findings presented in chapter four of this study.

Factors accounting for the Hard-to-Tax nature of the informal sector and hence low payment of income tax

The major factors identified as responsible, among other factors, include: peripatetic nature of the informal sector businesses, predominance of cash transactions, poor accounting and record keeping practices and high illiteracy rate among the informal sector entrepreneurs. It was found that many informal sector businesses were peripatetic as the entrepreneurs did not have a permanent place of business. The informal sector businesses sampled indicated that 62% of the respondents had no permanent business location while only 38% had a permanent business place.

The sales among the informal sector businesses were largely made on the basis of cash only, while a few respondents sold both on cash and credit basis. The data collected showed that 67% of the respondents sold for cash

only, while 33% sold for both cash and on credit. It is well established in the literature that cash sales leave no evidence of sales and therefore some revenue may not be captured in total revenue. The high cash basis of sales is largely informed by the fear of default by customers.

Another reason identified as creating the hard-to-tax informal sector is the poor level of accounting and record keeping practices among the informal sector businesses. This study categorized the levels of accounting practice into three: poor level, medium level and high/very good level. Out of the sample, 15% of the respondents fell into high level, 22.50% medium and 62.50% scored poor accounting practice.

The high level of illiteracy among the informal sector entrepreneurs was also identified as one of the factors. Among the informal sector entrepreneurs sampled, 60.50% were identified as having low/no education, 30% had medium level of education and only 9.50% had high education (i.e. up to the tertiary level). These figures present a gory picture of poor level of education background of the entrepreneurs in the informal sector which raises serious questions of our national educational system.

Variables of Tax Noncompliance in the Informal Sector

The seven variables of tax noncompliance behaviour identified in the literature review were all identified to some extent to be present in the Ghanaian informal sector. The tax noncompliance variables include: unknowing, procedural, lazy (accounting), habitual, brokered, symbolic and asocial. The level of tax noncompliance variables identified based on 200 respondents responses for each question on a particular noncompliance variable in terms of percentages is as follows: unknowing 67.50%, procedural

15.50%, lazy 76%, habitual 35.50%, brokered 9.50%, symbolic 69.50% and asocial 58.50%. Accounting variable ranks as the highest with brokered variable as the least. This situation indicates that among the respondents the independent variable that seems to dominate noncompliance behaviour is accounting/lazy variable at 76%, while brokered variable was found to be the least at 9.50%. The dominance of accounting noncompliance variable indicates the extent of poor accounting and record keeping practices in the Ghanaian informal sector. This is largely due to the informal sector entrepreneurs not employing the services of accountants. This situation can be explained by high illiteracy of the informal sector participants; high service fees charged and fear of embezzlement by the accountant.

Conclusions

The following conclusions are drawn based on the research findings:

The factors making the informal sector hard-to-tax were all identified to be very high in the Ghanaian informal sector as the percentages of the hard-to-tax factors, based on the respondents, ranges from the lowest of 62.50% for the poor record keeping to the highest of 67% of predominance of cash transactions. This indicates that hard-to-tax factors can be said to be almost equally strong determinants of the hard-to-tax nature of the Ghanaian informal sector.

Although reasons for tax noncompliance were all found to be present in the Ghanaian informal sector, based on the percentage analysis of the responses, accounting/lazy noncompliance came out as the foremost reason for tax noncompliance with the very high percentage of 79.50%.

Recommendations

To address the problem of low income tax from the informal sector, the following suggestions are proposed.

1. Capacity building programmes in record keeping

The government must take active role in building the capacity of the informal sector entrepreneurs in terms of training them to be equipped with basic financial and accounting skills so as to be able to keep the basic accounting and financial records that will enable IRS make objective assessment of income tax. These training programmes should be developed by the IRS in conjunction with the Ministries of Finance and Local Government. The programmes should be decentralized to the unit committee levels so that all major identifiable informal entrepreneurs are trained to be able to keep adequate financial records which will track all business activities of the informal businesses. This will go a long way to enable IRS objectively exact tax from, as many as possible, in the informal businesses. This suggestion is very critical as accounting variable was identified as number one predictor of tax noncompliance in the informal sector.

2. Motivation

Incentives such as national awards for tax compliance should be instituted to motivate people to pay taxes. By rewarding those who fulfil their obligations, it will go a long way to stimulate individuals and groups in the informal sector to be alive with their tax obligations and again projects being done with tax revenue must be made known to erase the perception that tax revenues are been misused.

3. Tax information and tax education

There is no gainsaying the fact that tax information and education is fairly very poor in Ghana and especially with respect to the informal sector. This problem was quite evident in how many informal entrepreneurs did not know much about the tax amnesty. This study, therefore, suggests that IRS intensifies its tax information and education using both print and electronic media. With regards to the informal sector tax information in all major Ghanaian languages should be printed as hand bills containing information on the need to pay taxes. The Ministry of Information should be involved where information vans are used to educate the informal entrepreneurs. Tax education should be pursued vigorously and on a sustained basis which with time is likely to encourage voluntary compliance from the informal sector.

Simplification of filing procedures

One of the reasons identified for tax noncompliance, is the fact that some informal sector entrepreneurs complained about *complex* filing procedures which has even made some of them who once paid taxes not to pay income tax presently. The IRS should develop very simple income tax return forms for the informal entrepreneurs which will encourage the filing of income tax return. The IRS should also take steps to educate the entrepreneurs on how to complete income tax returns which may go a long way to encourage filing.

4. Master list of informal businesses

The IRS must embark on nationwide exercise to establish master list of all the informal sector businesses that are easily identifiable. This could be

done by employing the services of national service personnel and a large number of unemployed graduates out there. This exercise may be up-dated annually.

5. Improving tax administration

The last but not the least recommendation has to do with the tax machinery itself. Although, over the years there have been tremendous improvement in the number of tax offices across the length and breadth of the country and other logistical support, the researcher believes that there is more room for improvement. The IRS should continue to expand its offices to every nook and cranny in Ghana where there are a good number of informal businesses. However, this should only be done taking into account the cost-benefit analysis.

Concluding Remarks

In conclusion, the researcher believes that taxation of the informal sector is a hydra-headed and complex issue that calls for further research especially on the factors that make that sector hard-to-tax and tax noncompliance behaviour of the informal sector entrepreneurs.

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APPENDICES

QUESTIONNAIRE FOR TAX PAYERS

INTRODUCTION

This study is purely an academic work aimed at assessing the low payment rate of income tax in the informal sector of Ghana and Cape Coast Tax District has been selected as a case study.

The objective is to identify the reasons and factors responsible for the low payment rate of income tax in the informal sector. The findings would add to the existing knowledge and problems confronting taxing the informal sector. The research is not to probe people’s private lives nor collect private information for government or its agencies. I have selected you as a respondent and humbly request that you respond to the questions as frankly as possible.

I wish to state that your responses would be kept strictly confidential. Thank you for your time and cooperation.

BACKGROUND DATA

Name of interviewer:.....

Name of District:

Type of Business engaged in:.....

Language of interview:

Date and Time of interview:.....

Signature of interviewer:.....

1. Questionnaire No.

2. Name of Respondent

.....

3. Address

.....

4. Age

5. Gender.....

6. Marital Status

- (a) Married
- (b) Single
- (c) Divorced

7. Type of Business engaged in

- (a)
- (b)
- (c)
- (d)
- (e) Other specified

8. Level of Income (per annum)

- (a) Below GH¢1,000
- (b) Between gh¢1,000 – GH¢1,500
- (c) Above GH¢1,500

9. Do you have a permanent business location?

- (a) Permanent
- (b) Roaming
- (c) Both

10. What is normally the mode of payment for your goods or service?

- (a) Cash only
 - (b) Credit only
 - (c) Both cash and credit
11. What is the level of accounting practice in your business?
- (a) Low/poor
 - (b) Medium
 - (c) High/very good
12. Do you use accountants for your business at all?
- (a) Yes
 - (b) No
13. If no, why don't you use accountants?
- (a) High service fee
 - (b) Fear of embezzlement
 - (c) No need
14. What is your level of education?
- (a) Low/no education
 - (b) Medium (Secondary)
 - (c) High (Tertiary)
15. Do you know you have to declare your total income to IRS?
- (a) Yes
 - (b) No
16. Do you keep accounting records?
- (a) Yes
 - (b) No
17. Do you comply with procedures?
- (a) Yes

(b) No

18. Do you protest against the perceived corrupt practices of tax officials?

(a) Yes

(b) No

19. Do you take advice from colleagues not to comply?

(a) Yes

(b) No

20. Do you think all your colleagues in the private business pay tax?

(a) Yes

(b) No

21. Do you think it is necessary to pay tax at all?

(a) Yes

(b) No

22. What benefit (s) do you derive from paying tax?

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

23. What suggestions if any do you have to overcome this problem of non-compliance?

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.....
.....