

**KWAME NKRUMAH UNIVERSITY OF SCIENCE
AND TECHNOLOGY, KUMASI**

INSTITUTE OF DISTANCE LEARNING

**DETERMINANTS OF TAX COMPLIANCE: A CASE STUDY OF
VAT FLAT RATE SCHEME TRADERS IN THE ACCRA
METROPOLIS**

The logo of Kwame Nkrumah University of Science and Technology (KNUST) is centered in the background. It features a yellow eagle with spread wings perched on a green shield. Above the eagle is a red flame. Below the eagle is a yellow banner with the text 'NYANSIN WA NYANNA'. The entire logo is rendered in a light, semi-transparent style.

BY

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JUNE, 2011

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**A Thesis submitted to the Institute of Distance Learning, Kwame Nkrumah
University of Science and Technology, Kumasi in partial fulfilment of the
requirements for the degree of**

COMMONWEALTH EXECUTIVE MASTERS OF BUSINESS ADMINISTRATION

JUNE, 2011

DECLARATION

I hereby declare that this submission is my own work towards the CEMBA and that, to the best of my knowledge, it contains no material previously published by another person nor material which has been accepted for the award of any other degree of the university, except where due acknowledgement has been made in the text.

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DEDICATION

This work is dedicated to my parents, Vincent Agbadi and Juliana Agbadi and all my siblings. I do not forget my lovely children namely, Esther, Wisdom and Faustine.

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To GOD be the glory for His mercy, protection and provision that has seen me through this course. I am so grateful.

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Lastly, I am grateful to all whose works have been cited in this paper. Have my acknowledgement and appreciation.

ABBREVIATIONS/ACRONYMS

ATRACO	-	Accra Teachers Training College
CEPS	-	Customs Excise and Preventive Service
GDP	-	Gross Domestic Produce
IRB	-	Internal Revenue Board
IRD	-	Inland Revenue Department
IPS	-	Institute of Professional Studies
IRS	-	Internal Revenue Service
LPM	-	Linear Probability Model
MLE	-	Maximum Likelihood Estimate
MCE	-	Metropolitan Chief Executive
NHIL	-	National Health Insurance Levy
OLS	-	Ordinary Least Square
RAGB	-	Revenue Agencies Governing Board
SMEs	-	Small and Medium size Enterprises
TRA	-	Theory of Reasoned Action
TPB	-	Theory of Planned Behavior
VAT	-	Value Added Tax
VFRS	-	VAT Flat Rate Scheme

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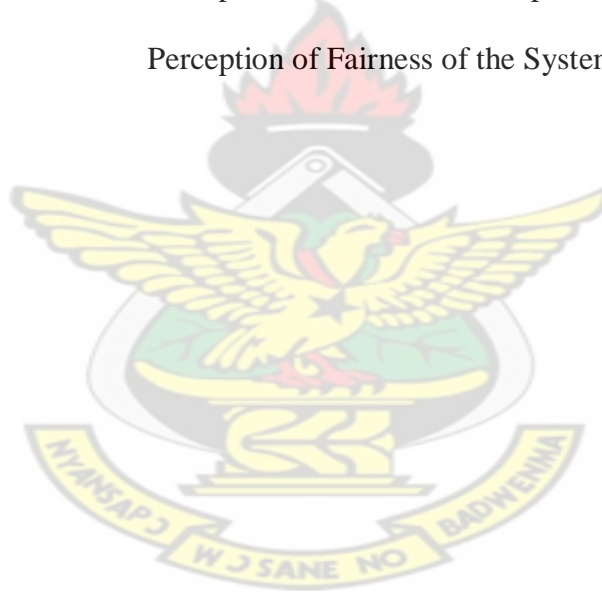
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Abstract

Taxation is one of the important elements in managing national income, especially in developed countries and has played an important role in civilized societies since their birth thousands years ago. Tax compliance is an important issue in every economy recognizing the role revenue from tax play in national development. This study aimed at investigating the tax compliance level among traders in the Accra Metropolis and to determine the factors that influence tax compliance among traders.

Data was gathered by interviews with the use of structured questionnaires and interview guides. Tables, graphs and charts were used to present the result of the analysis. Logistic regression model was used to determine the factors that influence tax compliance. Simplicity of tax returns and administration has positive and significant relationship with VAT compliance ($p= 0.0001$). The results also indicate that tax education also has a positive and significant relation with VAT compliance ($p=0.0023$).

This study contributes to current global literature in this field of the relative importance of tax knowledge in affecting tax compliance, as well as exploring the factors that make people pay taxes, and discusses methods of increasing tax compliance among traders.

CHAPTER ONE

INTRODUCTION

1.1 BACKGROUND INFORMATION

1.1.1 Introduction

Questions about tax compliance are as old as taxes themselves and will remain an area of discovery as long as taxes exist. There is almost no civilization that did not tax. Six thousand years ago, tax history started with records on clay cones in Sumer, with the inscription, "There were the tax collectors" (Adams, 1993). History has shown that there has always been a reluctance to pay tax. A major reason for this attitude is that the taxpayer does not always perceive that he receives any benefits from parting with his hard earned cash.

Most citizens, however, realize that state expenditure for the purpose of creating or maintaining national infrastructures, such as services and roads, is a necessity. But, citizens object to having to finance unnecessary state expenditure. In this regard, everyone has his own understanding of what is unnecessary. Taxpayers feel that whatever is contributed by way of tax is mostly squandered away and the social responsibilities the government is expected to discharge get neglected. The government's bad image because of its failure to discharge functions is a great disincentive for paying taxes. Most people feel that tax is a burden and should be avoided. Taxpayers feel that they are being treated harshly and the punitive provisions in the tax laws are applied ruthlessly against them. Hence, it is better to be away from the tax department and the number of non-filers of tax returns is increasing (Coetzee, 1996).

Tax evasion is a universal phenomenon that takes place in all societies and economic systems including both developed and developing countries. In the US, it is estimated that the extent of tax gap (the difference between taxes owed and taxes filed) for 2001 were US\$ 353 billion (IRS, 2006). This concern is particularly severe for developing countries given the rapid growth of investment in their economies and their lack of adequate experience in dealing with this problem. In China, the tax evasion by multinationals resulted in revenue loss amounting to US\$ 3.88 billion each year (Asia Times, 2007). In Hong Kong, the Inland Revenue department reported that about US \$ 1.15 billion was collected between 2003 and 2007 as back tax and penalties (IRD, 2007). Thus, tax compliance is a growing international concern for tax authorities and public policy makers as tax evasion seriously threatens the capacity of governments to raise public revenue.

Revenue authorities have a central role (vested interest) in ensuring that taxpayers and other parties understand their obligations under the revenue laws. For their part, taxpayers and others have an important role to play in meeting their obligations as, in many situations, it is only they who are in a position to know that they may have an obligation under the law. While the exact obligations placed on a taxpayer are going to vary from one taxation role to another and from one jurisdiction to the next, four broad categories of obligation are likely to exist for almost all taxpayers, irrespective of jurisdiction. 'Compliance' will essentially relate to the extent to which a taxpayer meets these obligations.

These broad categories of taxpayer obligation are:

- Registration in the system;

- Timely filing or lodgment of requisite taxation information;
- Reporting of complete and accurate information (incorporating good record keeping); and
- Payment of taxation obligations on time.

If a taxpayer fails to meet any of the above obligations then they may be considered to be non-compliant. However, there are clearly different degrees of non-compliance. For example, under the definition given above, non-compliance may be due to unintentional error as well as intentional fraud — and might include overpayment of tax. In addition, a taxpayer may technically meet their obligations but compliance may be in question due to interpretational differences of the law. In such circumstances, clarity of the taxation law represents a category of risk to be addressed — either by changing the law or changing the way in which it is administered.

Ghana has a relatively long history of tax administration. The first customs law was passed under colonial rule in 1855 and later replaced in 1876 by a customs law based on the U.K. Customs Consolidated Act, 1876. Income tax was introduced in Ghana under the Income Tax Ordinance in 1943 (GoG, 1997). As noted above, the two main revenue institutions currently are the CEPS and the IRS. It is proposed to establish a third service with the introduction of VAT in 1995 to consolidate domestic tax administration in the country.

Until 1986, both the CEPS and the IRS formed part of the civil service. In 1985, two laws, the Customs, Excise and Preventive Law (PNDC Law 144) and the Internal Revenue Service Law (PNDC Law 143), were enacted to grant full operational and

partial financial autonomy to these institutions. It is important to note that the provisions of these laws, which establish the IRS and the CEPS as Services of the Republic, are upheld by the Constitution of the Fourth Republic.

In Ghana, there are broadly two types of taxes: (1) Direct taxes, which are taxes on individual and corporate incomes and (2) Indirect taxes, which are taxes on expenditure.

Value Added Tax (VAT) falls in the category of indirect taxes. Value Added Tax was introduced as an improved form of taxation to replace a number of taxes including sales tax, gaming and betting tax and service tax. It was introduced in Ghana as an integral part of tax reforms initiated by Government in 1983 and was designed primarily to address the defects of sales and service taxes which it replaced. It was introduced to ensure successful management and sustainable development of VAT in Ghana. They are to mobilize revenue for national development by engendering public confidence in the administration of VAT through continuous education and fair application of the tax laws as a means of promoting voluntary compliance (VAT, 2010).

Value Added Tax (VAT) Service was brought into being to administer the short-lived 1995 VAT instituted under the VAT Act, 1994 (Act 486). The Act, which was promulgated in December 1994, became operational in March 1995. The introduction of VAT in 1995 was not well received by the Ghanaian population, as a result, it led to demonstrations by various groups of people; this was known as “kumi preko” [meaning kill me completely] demonstration in which some civilians lost their lives. Following implementation problems it was suspended and the Act repealed after three and half months (105 days) of its inception. As a consequence, VAT Service was contracted into

a much smaller VAT Project for the purpose of planning and implementing the re-introduction of the repackaged tax. For the purpose of its administration, a new VAT Act (Act 546), which was backed by a vigorous public education, was passed in March 1998. Effective collection of the tax started on 30th December 1998.

The following amendments have been issued since the coming into force of Act 546:

Value Added Tax (Amendment) Act, 2000 (Act 579); Value Added Tax (Amendment) Act, 2001 (Act 595); Value Added Tax (Amendment) Act, 2002 (Act 629); Value Added Tax (Amendment) Act, 2003 (Act 639); Value Added Tax (Amendment) Act, 2004 (Act 671); Value Added Tax (Amendment) Act, 2006 (Act 696); Revenue Agencies Retention of Part of Revenue Act, 2002 (Act 628).

VAT Service is one of the three revenue institutions established under the Revenue Agencies Governing Board (RAGB) for the collection of taxes. It is therefore responsible to the Ministry of Finance just like Internal Revenue Service and CEPS. The importance of VAT to the State cannot be overemphasized. The Service collects approximately a third of the nation's total tax revenue.

In the year 2000, total VAT collected was 28.82% of the nation's total tax revenue. In 2001, it was 29.39%, in 2002, it was 28.03%, 2003, it was 24.89% and in the year 2004, total VAT contributed 26% of national total tax revenue (Research, Monitoring and Planning Unit, 2005). Given the fact that internal revenue mobilization accounts for less than 50% of total revenue needed by Government, and with the bulk coming from foreign donors, clearly the need to improve revenue generation internally is very important.

The Value Added Tax Service at the beginning of the year is given a target by the Ministry of Finance. The VAT Service is then invited to argue for reasons why the target should be lowered as is the case most times. This target once agreed is then broken down by the Service into regional levels. Invariably the VAT Service always argues for a reduction in the target citing a myriad of reasons including limited resources, logistics, the willingness of the traders to pay the tax, attitude of the traders, compliance of the traders, and the need to draw a fine line between maximizing revenue collection and not over burdening the trader population.

1.1.1 VAT Flat Rate Scheme (VFRS)

The VAT Flat Rate Scheme (VFRS) is a VAT collection/accounting mechanism that applies a marginal tax rate of 3%, representing the net VAT payable, on the value of taxable goods and supplies. It is an alternative to the invoice-credit method (or Standard VAT Scheme) which charges a given percentage on sales (in this case 3%) for each transaction without recourse to input tax deduction.

The scheme is restricted to all retailers of taxable goods, except those authorized by the Commissioner of the VAT Service to operate the invoice-credit scheme (an authorization which is given in the interest of safeguarding national revenue) and operates concurrently with the invoice-credit method. The standard rate/invoice-credit scheme charges 15% tax on output (sales) and takes credit of input tax paid on purchases (output-input analysis).

The VFRS was instituted in September, 2007 to address some of the challenges faced by retailers operating the Standard rate scheme (15% rate).

It is also worth noting that, as is the case under the invoice-credit scheme, all exempt items under schedule 1 of the VAT Act as amended (e.g. agricultural inputs, essential drugs as approved by Ministry of Health, mosquito nets, petrol, diesel, kerosene etc) shall remain exempt under the VFRS. Thus, the VFRS is not a separate tax handle or an additional impost; it is only an alternative collection mechanism with the principal aim of simplifying the VAT accounting system and consequently, deepening public faith and confidence in VAT administration in Ghana. The use of a marginal tax rate of 3% which is the effective VAT rate of the retail sector for the VFRS makes it inappropriate for the inclusion of other sectors such as the manufacturing and service sectors, where value added could be as high as 100%.

Key features of the Scheme

The following are the main features identified with the VFRS:

- VFRS operators apply a marginal tax rate of 3% on the value of taxable supplies for each sale or transaction.
- VFRS operators issue a simplified monthly VAT/NHIL invoice for each sale /transaction
- They also submit simplified monthly VAT/NHIL returns which do not show input taxes.
- VFRS operators are not required to keep or maintain a separate register on input taxes and do not take credit for input taxes, but recover such input taxes as part of their costs in arriving at selling prices.
- VFRS operators are issued with the regular VAT Certificate of registration upon registration.

- Minimal records are kept to the extent that records are adequate in determining correct VAT/NHIL payable to the VAT Service.

The scheme is simple to operate with simplified and easy to complete return forms. It solves the problems at the informal retail level of what input tax one can or cannot claim. It curtails the submission of repayment returns (credit returns) by retailers. The simplicity of the scheme encourages more retailers who were hitherto not registered with the VAT Service to register. This is consequently broadening the tax base and boosting revenue collection. The scheme holds tremendous promise for the removal of the compliance and enforcement barriers that have plagued the administration of VAT at the informal retail level where value added is least and the incidence of non-compliance highest.

1.2 Problem statement

Taxation is one of the important elements in managing national income, especially in developed countries and has played an important role in civilized societies since their birth thousands years ago (Lymer and Oats, 2009). Tax is defined as ‘a compulsory levy, imposed by government or other tax raising body, on income, expenditure, or capital assets, for which the taxpayer receives nothing specific in return’ (Lymer and Oats, 2009).

As in other countries, Ghana suffers from revenue loss due to the problems of tax non-compliance and income tax evasion. On average, about 30 per cent of all taxpayers fail to submit their annual returns to the VAT Service, and many each year face prosecution for failing to file complete returns (Mahfar, 1994). This low level of tax compliance is thought to come from a number of factors. Marketing the Service and projecting the

product of the Service will call for the employment of service marketing strategies, an apt tool in a service industry. Implicit in the success of the service is the commitment of the staff of the Service in pursuing the objective of the Service. How committed the staff is will play a crucial role if the Service intends to set and achieve higher targets. The staff must be convinced and have commitment if the objectives of the organisation are to succeed.

The VFRS has the potential to maximize revenue for national development. There is evidence, however, that the introduction of the VFRS stands to increase VAT return by eliminating the procedural complexities, thus, enhancing compliance. Within six months of implementation, the VAT Service had registered a total of 14,143 operators and has been able to raise a revenue of GH¢5,015,052 from the VFRS. Progressively, the Service has been carrying out audits on the registered trader population to unearth under declaration of the VAT by the traders. These audits have not contributed even 10% of the total VAT collected by the Service at the end of the year. That is to say, audits carried out by the Service to unearth under declarations of tax by traders have contributed less than 10% of the total tax collected by the Service. Despite the successes chalked with the scheme, there are still implementation challenges with particular reference to registration, issuance of VAT invoices, submission of accurate returns, keeping basic records of transactions for verification and prompt payment of tax due (Daily Graphic, 2008).

The problem facing the Service therefore is twofold, yet interdependent: How to get the trader population to embrace the idea of voluntarily paying the right amount of tax,

(increase their compliance level) and how to get the staff committed to push the Service objective.

1.3 Rationale

It is important to combat tax non-compliance, for if it becomes widespread it can have a major impact on the structure of prices, on the effectiveness of macroeconomic policy and on the trust of taxpayers that the government is concerned with distributional justice. Persistently the government's annual budget is financed with at least 50% of foreign donor inflows. Its effect on developmental programs is well documented. Donor countries have been known to hold governments to ransom till certain conditions have been met with their attendant insistence on the type of agencies and institutions to oversee such developments. There is therefore the need for the government to improve on its internal revenue mobilisation. This will enable the government to control and plan its programs with a marked degree of certainty. The VAT Service, being one of the three main revenue mobilisation agencies, needs to improve on its performance. There is the need to set higher targets for the Service. The Service can actually improve on its revenue collection by improving on the compliance attitude of the trader population and the commitment of the staff.

Various strategies have been introduced by the Internal Revenue Department (IRD) to overcome this problem and, while there is some literature, there has as yet been no comprehensive study of this VAT noncompliance among traders in Ghana. The extent of the impact of attitudes and attitude change on tax compliance behaviour is not well understood and studies in this area have not been carried in Ghana. This research is being undertaken to make some contribution to filling this gap. It was for this reason that this

study attempted to find out how taxpayers' attitudes influence tax compliance behavior in Ghana.

The study begins by reviewing the literature on the various dimensions of tax compliance and examining some of the initiatives that have been introduced by the VAT Service. It then attempts to document the level of VAT compliance in Ghana, to analyze the main characteristics of VAT compliance and to propose some improved strategies for overcoming this problem.

1.4 Research Questions

The main research question is what is the level of awareness and compliance of the VFRS traders. Specifically, research questions that emerge from the background review of the situation of rural financial services are:

1. Are traders aware of the VFRS and how it works?
2. What is the VAT compliance level among VFRS traders in the Greater Accra Region?
3. What demographic characteristics influence compliance of traders to VAT?
4. What are the factors relating to service provision that influence VAT compliance among VFRS traders?

1.5 Objectives of Study

The main objective of the study is to identify ways of improving VAT compliance among traders

Specifically, the study objectives are:

1. To determine the characteristics and the level of tax knowledge of individual taxpayers;

2. To determine the VAT compliance level among traders in the Accra Metropolis
3. To identify the determinants of VAT compliance among the various traders in the Greater Accra Region
4. To establish relationship between attitudes and tax compliance behavior among traders in the Accra Metropolis
5. To recommend internal service marketing strategies for strengthening the organisation's ability to improve staff performance which is a pre-requisite for the success of external service marketing, aimed at the traders.

1.6 Organization of the Study

The project work is categorized into five main chapters. Chapter one focuses on the background to the study, problem statement, objectives, significant of the study, research methodology, limitations and delimitations.

Chapter two is devoted to systematic review of existing literature with emphasis on history and Introduction of VAT in Ghana, increasing effect of VAT on the economy of Ghana, benefits derived on the imposition of VAT, keeping of proper financial records and accounts.

The third Chapter deals with research methodology including population, sampling techniques, methods of Data Collection and the research instruments employed.

Chapter four is also made up of detailed analysis of data collected and presentation of information with the aid of quantitative and statistical models.

The fifth chapter covers the summary, conclusion and recommendations.

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CHAPTER TWO

REVIEW OF RELATED LITERATURE

2.0 Introduction

The definition of tax compliance in its most simple form is usually cast in terms of the degree to which taxpayers comply with the tax law. However like many such concepts, the meaning of compliance can be seen almost as a continuum of definitions. This ranges from the narrow law enforcement approach, through wider economic definitions and on to even more comprehensive versions relating to taxpayer decisions to conform to the wider objectives of society as reflected in tax policy (James & Alley, 2004). Tax

compliance is multi-faceted measure. The Organization for Economic Cooperation and Development (2001) advocates that 'Compliance' is divided into categories, considering the definition of tax compliance. These categories are administrative compliance and technical compliance. Administrative compliance refers to complying with administrative rules of lodging and paying, otherwise referred to as reporting compliance, procedural compliance or regulatory compliance and the latter refers to complying with technical requirements of the tax laws in calculating taxes or provisions of the tax laws in paying the share of the tax. Theoretically, it can be defined by considering three distinct types of compliance such as payment compliance, filing compliance, and reporting compliance (Brown and Mazur, 2003). Views of the taxpayers and tax collectors are that tax compliance means adhering to the tax laws, which are different from one country to another.

There is the question whether 'compliance' refers to voluntary or compulsory behavior. If taxpayers 'comply' only because of dire threats or harassment or both, this would not appear to be proper compliance even if 100 % of the tax were raised in line with the 'tax gap' concept of noncompliance. Instead, it might be argued that successful tax administration requires taxpayers to comply willingly, without the need for enquiries, obtrusive investigations, reminders or the threat or application of legal or administrative sanctions. A more appropriate definition could therefore include the degree of compliance with tax law and administration, which can be achieved without the actual application of enforcement activity.

The goal of tax administration is to foster voluntary tax compliance (Silvani, 1992) and hence reduce tax gap (difference between taxes paid and owed for all taxes and all

taxpayers) and “compliance gap.” However, tax compliance, according to Cobham (2005), is a problem for many countries as measured by tax to GDP ratio although it has been improving for many countries. For example, it is one-third of GDP in rich countries; Latin America and the Caribbean - 17% of GDP and low-income countries (in Sub Saharan Africa) showed less than 15% to GDP (the recommended rate). It remains a big challenge to low income countries. This has promoted radical tax reforms in countries like Bolivia, Uruguay, Colombia, Jamaica and Spain with notable success (Bird & De Jantscher, 1992). According to Ajzen’s (1991) Theory of Planned Behavior, attitude relates to one’s own personal views about behaviour. Attitude may also be defined as positive or negative views of an “attitude object”; i.e. a person, behavior or event. In relation to taxation, taxpayers’ attitudes may be defined as positive or negative views of tax compliance behavior.

In Ghana, the government continues to seek more non-oil revenue by reforming tax administration and improving the efficiency of the tax system. This effort entails broadening the operations of the large taxpayer unit to ensure that very large companies receive one-stop tax service. Tax revenue as a percentage of GDP has increased from less than 17% to about 23% over the period 2000-09. But the effective tax base in Ghana remains low. This is because many people operate in the informal sector outside the tax net (African Economic Outlook, 2011).

The outcome of positive views is tax compliance and negative views are tax non compliance. These views may be explained by Psychology-based theories which reveal that taxpayers’ attitude may be influenced by the following factors which eventually influence taxpayer’s behavior. Taxpayer’s perceptions of the tax system and Revenue

Authority (Ambrecht, 1998); peer attitude / subject norm (Toumi, 2000); taxpayers' understanding of a tax system / tax laws (Silvani, 1992; Le Baube, 1992); motivation such as rewards (Feld, Frey & Torgler, 2006) and punishment such as penalties (Allingham & Sandmo, 1972); cost of compliance (Slemrod, 1992; Le Baube, 1992); difference across - culture; perceived behavioral control ; ethics / morality of the taxpayer and tax collector; equity of the tax systems (Trivedi & Shehata, 2005); image of the government based on whether it is achieving the tax objectives under prescribed principles of taxation; Demographic factors such as sex, age, education and size of income (Murphy, 2004).

A final definition of compliance might therefore be: the willingness of individuals and other taxable entities to act in accordance within the spirit as well as the letter of tax law and administration without the application of enforcement activity, (James and Alley, 2001).

There is no measure of such a definition which is both simple and accurate. However this definition does indicate the main features which should be considered in judging the compliance of taxpayers with the tax system.

2.1 Reasons for Non-Compliance

Revenue Institutions and a variety of academic disciplines suggest that there are two approaches to explaining the reasons for non compliance. One is to analyse compliance in terms of economic decisions based on the likely economic incentives and costs of complying or not. The other has been to examine the effects of other factors on compliance decisions, particularly as they relate to taxpayer behaviour and sometimes tax agency behaviour. This is concerned with wider behavioural issues and draws heavily on concepts and research from disciplines such as psychology and sociology.

The economic discipline suggests that most people will look at expected benefits of evading tax as against the risk of detection and the application of penalties. It is common to believe that individuals will wish to maximise their personal income and wealth and hence will not comply with the tax system unless the benefits of doing so exceed the cost of not doing so in the form of fines and penalties. This is known as “calculus of pleasure and fun” in pecuniary terms (Jevons, 1871). This view looks on individuals as immoral and operates in some sort of social vacuum. As Bernasconi, (1998) put it ‘evading tax is like gambling’. There are gains to be made if the evasion is successful and costs in terms of penalties if it is not. It is just a matter of adding up the expected utility in financial terms of every decision to comply or not to comply with the requirements of the tax system. This narrow economic view assumes that individuals are immoral and operate in some sort of social vacuum.

However, this economic approach to explaining tax compliance has its limitations. For instance, the economic approach’s definition of compliance seems not consistent with taxpayer behaviour; indeed according to Smith and Kinsey (1987), there is empirical evidence that many people are inherently honest and will disclose their financial affairs accurately regardless of the incentive to cheat (Errard & Feinstein, 1994; Gordon, 1989). Furthermore, experimental evidence (Baldry, 1986) suggests that some people never evade even if it will be favourable to them. Despite these limitations, the economic approach is still relevant as it is reasonable to assume that to a large extent, financial considerations do influence taxpayer behaviour. For corporate bodies, it might be argued that monetary considerations and maximisation of shareholder wealth are likely to take precedence over other corporate goals (Brealey & Meyers, 2000).

Then there is the behavioural approach which draws on academic disciplines in suggesting that other factors are important in motivating tax payers regarding compliance. Sociologists identify a number of possible explanatory factors such as social support, social influence, attitudes, certain background characteristics such as age, gender, race and culture (Meyer and Johnson, 1977). According to such proponents, attitudes towards the state and revenue authorities are important as are perceptions of equity. Individual roles in society and accepted norms of behaviour are also important. The essential thrust of these contributions from sociology and psychology are that individuals are not simply independent, selfish, utility maximisers (though this may be partly true). They also interact with other human beings according to differing attitudes, beliefs, norms and roles. The result is that tax compliance may be viewed as “behavioural problem and that the success of a tax depends on co-operation” (Schmolders, 1970).

Some of the reasons for taxpayers low compliance attitude has also been found to include complexity of the tax system, tax rates, professionalism of the tax administration, level of tax payer awareness, state of information systems, effectiveness of enforcement mechanisms and the availability of resources to undertake effective implementation of programs (VADA, 2007).

An ideal tax system should be easy to implement and simple. Complexities in the tax system promote evasion and avoidance and these should be minimised as best as possible. A high tax rate creates incentives for tax evasion by both registered traders and customers. The experience in Kenya, for example, during the early years of the introduction of VAT was that very little was collected from goods that were subjected to very high tax rates such as cars and jewellery which were subjected to a VAT rate of 210% (VADA, 2007).

Compliance in any tax system especially VAT requires self declaration by the tax payers.

A situation where taxpayers go to great lengths to hide their transactions and where punitive measures are most favoured by the tax administrators results in compounding compliance problems. Too much concentration on the technical aspect of the tax at the expense of other important matters like customer relations, training for tax administrators also does not help an already bad situation.

Low level of tax payers' awareness has been a hindrance to tax compliance in most African countries (VADA, 2007). There is the need to concentrate resources in educating the populace on their obligations and rights under relevant tax laws.

Further, effective enforcement of compliance in the VAT system depends on the availability of information. In Kenya for example, it has been found out that certain weaknesses within the tax system has contributed to low compliance rate. These include delay in processing data, underdevelopment of their information technology systems, lack of tools to audit computerised records and limited exchange of information and interaction with stakeholders (VADA, 2007).

2.2 Taxpayer's characteristics and level of knowledge

The influence of knowledge on compliance behavior has been proven in various researches (Mohamad Ali et. al., 2007). Harris (1989) divided tax knowledge into two aspects, namely, knowledge through common or formal education received as a matter of course and knowledge specifically directed at possible opportunities to evade tax. In the first case, the level of education received by taxpayers is an important factor that contributes to the general understanding about taxation especially regarding the laws and regulations of taxation (Eriksen and Fallan, 1996). Previous studies have evidenced that

general tax knowledge has a very close relationship with taxpayers' ability to understand the laws and regulations of taxation, and their ability to comply with them (Singh, 2003).

Knowledge as one of the factors in compliance is related to the taxpayers' ability to understand taxation laws, and their willingness to comply (Viswanathan, 1992). The aspect of knowledge that relates to compliance is the general understanding of taxation regulations and information pertaining to the opportunity to evade tax. One question that has been raised by previous researchers is whether enhancement in the knowledge will propel tax evasion.

Attitude towards tax compliance can be improved through the enhancement of taxation knowledge (Eriksen & Fallan, 1996). When a taxpayer has a positive attitude towards tax, this will reduce his or her inclination to evade tax payment. With the transition from OAS to SAS, knowledge has been conceded as a crucial factor to enhance Malaysian taxpayers' understanding of the new system, which in turn will help implement it smoothly.

Taxation knowledge is necessary to increase public awareness especially in areas concerning taxation laws, the role of tax in national development, and especially to explain how and where the money collected is spent by the government (Mohani, 2003). More importantly, it is necessary that current and future taxpayers are exposed to the roles that they could play in developing the country. This exposure could be given through seminars, dialogue sessions, or collaboration with the Ministry of Education to introduce the subject of Taxation at secondary schools.

Past studies have shown that demographic factors influence tax compliance behaviors (Mottiakavandar, et al., 2004). Lin & Carrol (2000), meanwhile, studied the relationship between enhanced tax knowledge and attitudes towards tax compliance among taxpayers in New Zealand. Their findings suggested that intensification in tax knowledge did not have a significant relationship with tax compliance. Research findings have suggested that there was a significant difference between taxpayers who had tax knowledge and taxpayers who did not have tax knowledge on tax compliance among taxpayers in Malaysia. The study by Mohammed Ali et al (2007) also found a significant relationship between taxpayers' knowledge and compliance.

2.3 Determinants of tax compliance

Factors influencing tax compliance are categorized into three main parts, namely;

- Structure of tax system (tax rates, tax audits, complexity, simplicity of the tax returns, staff attitude and performance, efficiency of the tax authority)
- Attitude and perceptions (perceptions of fairness, ethics and attitude, perceptions of government spending, poor influence)
- Socio demographic characteristics (age, income level, education, gender) and

The division into these categories is based on Kirchler (2007) and Loo (2006) in which they approached tax compliance from an interdisciplinary perspective which represents a wider perspective of tax compliance determinants compared to other researchers. For example, Kirchler (2007) divided tax compliance determinants into five categories and the study was based on psychological and tax authority-taxpayers' view namely, political perspectives, social psychological perspectives, decision making perspectives, self employment and interaction between tax authorities and taxpayers.

2.3.1 Structure of the tax system

These are concerned with economic factors in relation to tax compliance (actions which are associated with the costs and benefits of performing the actions) and other factors in associated with the structure of the tax system (Loo, 2006). Hasseldine (1993), Song and Yarbrough (1978) and Torgler and Schneider (2005) assumed that taxpayers are rational economic evaders who likely would assess the costs and/or benefits of evasion. They would attempt to minimize their tax liability, for example, by intentionally under reporting their income and would enjoy tax savings if they were not detected by the tax authorities. On the other hand, they would be willing to pay more, including a penalty, if they were caught (Song and Yarbrough, 1978; Torgler, 2007). In the following subsections, the tax compliance determinants associated with economic factors i.e. tax rates, tax audits and perceptions of government spending are explored in more detail.

2.3.1.1 Tax rates

Clotfelter (1983) claimed that “reducing tax rates is not the only policy that has the potential to discourage tax evasion but the tax rate is an important factor in determining tax compliance behaviour although the exact impact is still unclear and debatable (Kirchler, 2007). Clotfelter also suggests that there was a significant relationship between tax rates and evasion due to tax rates being used as an instrument that can be manipulated for policy goals in particular. Raising marginal tax rates will be likely to encourage taxpayers to evade tax more (Whitte and Woodbury, 1985; Ali, Cecil and Knoblett, 2001; Torgler, 2007) while lowering tax rates does not necessarily increase tax compliance (Trivedi, Shehata, and Mestelmen, 2004; Kirchler, 2007) This uncertainty and conflicting issue (for example reducing tax rate to increase compliance) has attracted

the attention of tax researchers aiming to come up with more certain and concrete evidence of the impact of tax rates on evasion.

In a previous attempt by Allingham and Sandmo (1972) to find a relationship between actual income, tax rates, penalty and investigation and tax evasion using statistical modeling, they concluded that taxpayers may choose either to fully report income or report less, regardless of tax rates. Tax rates appeared to be insignificant in determining tax evasion.

Other economic models of rational compliance decisions however, perceived that tax rates have a mixed impact on tax compliance or predict that increasing tax rates will increase compliance behaviour (Kirchler, Hoelzl and Wahl, 2008). In contrast with Allingham and Sandmo, various studies found that increasing tax rates encouraged noncompliant behaviour or produced mixed findings (Pommerehne and Wech-Hannemann, 1996; Park and Hyun, 2003). Porcano (1988) claimed that tax rates have no effect on tax compliance while most experimental studies found that increasing tax rates leads to tax evasion (Park and Hyun, 2003).

Since the impact of tax rates was debatable (positive, negative or no impact on evasion), Kirchler *et. al.* (2008) and McKerchar and Evans (2009) suggested that the degree of trust between taxpayers and the government has a major role in ascertaining the impact of tax rates on compliance. When trust is low, a high tax rate could be perceived as an unfair treatment of taxpayers and when trust is high, the same level of tax rate could be interpreted as contribution to the community (Kirchler *et. al.*, 2008).

In summary, evidence suggests tax rates have mixed impact on tax compliance i.e. decreasing tax rates does not necessarily always increase compliance (Kirchler et al, 2008) and increasing tax rates will not necessarily always decrease compliance behavior (Allingham and Sandmo, 1972). The following subsection discusses how tax audits influence tax compliance.

2.3.1.2 Tax audits

Some studies claimed that audits have a positive impact on tax evasion⁸⁵ (Jackson and Jaouen, 1989; Shanmugam, 2003; Dubin, 2004). These findings suggest that in self assessment systems, tax audits can play an important role and their central role is to increase voluntary compliance. Audits rates⁸⁶ and the thoroughness of the audits could encourage taxpayers to be more prudent in completing their tax returns, report all income and claim the correct deductions to ascertain their tax liability. In contrast, taxpayers who have never been audited might be tempted to under report their actual income and claim false deductions.

Butler (1993) also found that tax audits can change compliance behaviour from negative to positive. These findings complement the Witte and Woodbury (1985) and the Beron, Tauchen and Witte (1988) studies. Witte and Woodbury in their study of small proprietors found that tax audits have a significant role in tax compliance. They did not empirically test individual taxpayers, thus left open room to conduct research in this area. While Butler (1993) and Witte and Woodbury (1985) found significant results.

From another point of view, Evans, Carlon and Massey (2005) studied the tax compliance of Small and Medium size Enterprises (SME) in Australia. Their objective was to examine the relationship between record keeping practices of SMEs and the potential exposure to tax compliance problems. The study hypothesized that low tax

compliance among SMEs might better encourage the tax authority to increase audits and investigations. Using mail surveys, this study found that audit history, including frequency, audit outcome and the type of audit of small business owners has a significant indirect impact on tax compliance (in terms of record keeping). The result also evidenced that the primary objective of the small business owners doing their record keeping is tax compliance related rather than part of their management of their business. Thus, as the audits investigations increase, many SMEs will make more of an effort at proper record keeping.

2.3.1.3 Role (efficiency) of the tax authority/government

A for many aspects of tax compliance, there is a debate in the literature as to how the effective operation of the tax system by the tax authorities influences taxpayers' compliance behaviour as researchers from different countries have been unable to achieve agreement about this issue which appear to differ from country to country. Therefore different countries have proposed and develop different solution to the relationship between taxpayer compliance and their operation of the tax system.

In the US for example, the IRS views tax non-compliance as a big challenge as the tax gap has increased tremendously in the last few decades. In 1976, an Internal Revenue Service report estimated under reported income was \$75 to \$100 billion - about 7% to 9% of reported income (IRS 1979a: 11)⁸⁷. While Guttman (1977)⁸⁸ and Fiege (1979)⁸⁹ estimated that in reality it was probably higher than this. Guttman (1994)⁹⁰ revealed that in 1993 the tax gap in the US was more than \$170 billion (around 70% to 126% increase compared to the IRS estimate in 1976).

The role of the tax authority in minimizing the tax gap and increasing voluntary compliance is clearly very important. Hasseldine and Li (1999) illustrated this, placing the government and the tax authority as the main party that need to be continuously efficient in administering the tax system in order to minimise tax evasion. The government plays a central role through designing the tax systems itself, and the specific enforcement and collection mechanisms (Hasseldine and Li, 1999: 93). Furthermore, Roth *et. al.* (1989) suggested that in order to increase compliance, maximise tax revenue and be respected by taxpayers, a government must first have an economical tax system, which is practicable⁹¹; they must discourage tax evasion and not induce dishonesty; they must avoid the tendency to dry up the source of the tax and should avoid provoking conflict and raising political difficulties; they should also have a good relationship with the international tax regime.

A recent study conducted by Richardson (2008) also suggested that the role of government has a significant positive impact on determining attitudes toward tax. His study attempted to investigate the determinants of tax evasion across 47 countries including the USA, the UK, Argentina, Thailand, Canada, Chile and Brazil. Richardson also suggested that the government should increase their reputation and credibility in order to obtain trust from the taxpayers.

In summary, although previous studies could not provide conclusive results on the measurable impact of the efficiency of the government on compliance, however, researchers from different countries have discussed this issue and some authors have describe how the role of government in inducing tax compliance is important and relevant in self assessment systems (Richardson, 2008; Hasseldine and Li, 1999).

2.3.1.4 Simplicity of tax returns and administration

As tax systems have become increasingly complex over time in many developed countries, complexity has become an important determinant of tax compliance behaviour. The main feature of SAS is self-completed tax returns which require at least a reasonable level of simplicity because taxpayers come from various backgrounds, with differing levels of education, income and most importantly levels of tax knowledge. In helping taxpayers to complete the tax returns accurately, the tax authority should have come up with a simple, but sufficient, tax return. The information required in the return must be at minimum level and be readily available from taxpayers' business and personal records.

The VFRS system was introduced in Ghana to help minimize some of the complexities associated with the VAT system and by this improve compliance among traders. Silvani and Baer (1997) discuss the importance of the tax authority having a simple tax return and system from the taxpayers' point of view. Although the word 'simple' carries multiple interpretations, at least the majority of taxpayers require that the tax return should be as simple as possible. The tax authority may assume its tax return is simple and easy to complete but it may not be from the taxpayers' point of view. Therefore, it is good practice, before the final version is delivered to taxpayers, to ensure that 'pilot' tests have taken place first so that the tax return is really as simple and easy as it can be.

In addition, Silvani and Baer (1997) added that simplifying the tax return will encourage taxpayers to complete the tax return on their own rather than employing a tax agent and thus reducing compliance costs. From another point of view, previous studies have

evidenced that complexity of reporting requirements has a high association with errors detected by audits (Long 1988). This finding (by Long) of course is perhaps to be logically expected by tax authorities. If many errors are detected in tax returns and the same errors happen every year by different taxpayers, it means that the wordings or the sentences of the format in tax return may be at least partly to blame.

As the tax regulations and laws in most countries are amended almost every year as part of annual budget process, the current regulations might be no longer relevant in the future. This situation will encourage taxpayers to make mistakes. Simplifying tax administration is important because it can facilitate efficient and enhanced administration and reduce costs (Mohani, 2001; Bird, 1998; Silvani and Baer, 1997). Thus, non compliance in terms of inaccurate tax returns is not only caused by taxpayers evasive behaviour (either intentional or unintentional), but may also be because of the tax authority's mistakes or weaknesses in developing and designing the systems. Interestingly, Richardson (2008) in his study extending studies by Riahi-Belkaoui (2004) and Jackson and Milliron (1986), found that out of seventeen variables tested across 45 countries, complexity is found to be the most important determinant of tax evasion. He therefore concluded that 'a more simple tax system and administration can improve tax compliance level'.

2.3.2 Attitude and perceptions

While taxpayers are influenced by the system of tax structure either to comply or not, evidence suggest that attitude and perceptions of the taxpayer also play an important role in their compliance decisions. These involve perceptions of government spending,

perceptions on the fairness of the system, poor social influence and the ethics and attitudes towards compliance.

2.3.2.1 Perceptions of government spending

There are limited studies on the relationship between the specifics of actual government spending and tax compliance, particularly on tax evasion. Logically, taxpayers, and especially those who pay high amounts of tax, will be sensitive to what the government spends their money on. Although there is limited empirical evidence, it is reasonable to assume that taxpayers will tend to evade tax if they perceive that the government spends tax money unwisely.

Lewis (1982) suggests that attitudes should be examined for the degree to which they are a product of myth and misperception. He argued that when myths and misperceptions are replaced by knowledge, a change in attitudes towards taxation will occur even if the taxpayers' basic ideology and values remain unchanged and the tax law is unchanged. He also claimed that misperception probably plays a major role shaping fairness evaluations. Meanwhile, Roberts, Hite and Bradley (1994) also suggest that attitude to one's own tax evasion (tax ethics), and attitude to other people's tax evasion are important. If the government is wisely spending the national revenue, for example for basic facilities like education, health and safety and public transportation, it is likely that voluntary compliance will increase. In contrast, if taxpayers perceive that the government is spending too much on something considered unnecessary or unbeneficial to them then taxpayers will feel betrayed and attempt to evade.

2.3.2.2 Perceptions of equity or fairness

Equity or fairness can be perceived via two dimensional views –horizontal equity (people with the same income or wealth brackets should pay the same amount of taxes) and vertical equity (taxes paid increase with the amount of the tax base). The driving principle behind vertical equity is the notion that those who are more able to pay taxes should contribute more than those who are not. Wenzel (2003) suggested three areas of fairness from the taxpayers' point of view (social psychology): 1) distributive justice (viewed as the exchange of resources i.e. benefit and cost); 2) procedural justice (viewed as the process of resource distribution) and 3) retributive justice (viewed as the appropriateness of sanctions when norm-breaking occurs).

In distributive justice, an individual is concerned about the fairness of their actions, and wants to be treated in relation to his merits, efforts and needs (Kirchler *et. al.*, 2008). If he feels that his tax burden is higher than other people within the same income group, his tax compliance probably decreases more widely at group levels; taxpayers want a fair treatment of their group relative to other income groups. If a specific group perceives that their tax liability is higher than other groups, then tax evasion might occur among the group members (Spicer and Becker, 1980). At a society-wide level, tax compliance is less likely if the perception is held that the tax system is unfair; wide scale tax evasion is likely to occur (Allingham and Sandmo, 1972; Barjoyai, 1987). In contrast, if the society perceives that the tax system is equitable and fair, voluntary compliance is expected to increase.

With regard to procedural justice, the main elements for perceived fairness are neutrality of procedures used, trustworthiness of the tax authorities, and the polite, dignified, and respectful treatment of taxpayers as individuals or groups (Tyler and Lind, 1992).

Taxpayers expect that tax authorities will provide sufficient information about the tax law and regulations so that they can complete their tax return as accurately as possible. It is argued therefore that increased information about tax law and regulations can increase fairness perception and compliance (Wartick, 1994). Retributive justice, unreasonable and intrusive audits and unfair penalties lead to stressful and dissatisfied taxpayers (Spicer and Lundsted, 1976). Unfavorable retributive justice perceptions could lead to non compliant behaviour and consequently increase tax evasion and inflate the tax gap.

Spicer and Becker (1980) examined the relationship between fiscal inequity and tax evasion. An experiment (simulation of completing a tax return) of 57 University of Colorado students, revealed that high income groups (“high-tax group”) had the highest percentage of tax evasion cases compared to other groups (“low tax and medium tax group”). They suggested that tax evasion increases when taxpayers perceive fiscal inequity (equity) because they feel to be victimised by an imbalance of income redistributions. The perceived fairness of the tax system also has an influence on the inclination towards tax evasion (Richardson, 2008).

2.3.2.3 Ethics and attitudes toward tax compliance

Taxpayers’ standard of ethics is ‘extremely important in a tax system which is based largely on voluntary compliance (Song and Yarbrough, 1978). Song and Yarbrough (1978) conducted a survey study in the United States. The survey was conducted in a university town (in eastern North Carolina) with over 11,000 university students, more than 600 faculty members and other related university staff and family members. The city selected could not be used as representative of the whole population of North

Carolina; however, the city does have one major characteristic which tends to distinguish it from the conservative, rural, character typical in other areas in North Carolina: the university-environment population make it closer to the national patterns in terms of level of education and demographic factors like age, gender and income. Although this area of the sample (the university town) does not represent the whole population of the United States and thus no generalizations could be made about national populations even in the USA, the researchers believe that the findings generally could produce some 'indication of tax knowledge, attitudes and perceptions of taxpayers in general' (Song and Yarbrough, 1978).

Ethics are a subjective continuum and the level of ethical behavior is heavily reliant on how people perceive the behavior being considered (Ajzen, 1988). Studies on tax psychology which predicts people's behavior using the Theory of Reasoned Action (TRA) and Theory of Planned Behavior (TPB) was first introduced by Fishbein and Ajzen (1975) and Ajzen (1991). These theories attempt to predict people's behavior based on their intentions. It is assumed that ethics encourage individuals to act according to them and a taxpayer with a negative attitude towards tax evasion tends to be less compliant (Kirchler *et. al.*, 2008).

Orviska and Hudson (2002) and Trivedi, Shehata and Mestelmen (2004) found a significant (but weak) relationship between tax evasion and ethics. Elffers, Weigel and Hessing (1987) earlier found that ethics, attitudes and moral beliefs impacted upon tax compliance behaviour according to their psychological model of tax compliance. The evidence clearly shows various attitudes towards taxation, such as tax ethics and the fairness of the tax system and that these have an influence on the inclination towards tax

evasion (Jackson and Milliron, 1986). It is consequently important to get more details about how these attitudes are influenced. Roth *et. al.* (1989) identified two primary factors in taxpayer compliance, namely financial self interest⁹⁵ and moral commitment.

Individuals comply with tax laws because it is in their own financial interests to minimize their tax bill, but also because of their perceived moral obligation to obey tax laws. Roth *et. al.* (1989) validates that there was a consistently positive relationship between moral commitment and compliance behaviour. Roth *et. al.*'s (1989) finding seems to theorise that ethics have a positive effect on compliance behaviour, more so than financial self interest. Ajzen and Fishbein (1980) claimed that the best predictor of a person's behavior is ethics, but argued that this link can be disrupted by the passage of time, unforeseen events or new information. In addition, low involvement behaviours are likely to be based on few, weakly-held or possibly unstable views.

In summary, as suggested by previous studies by Kirchler *et. al.*, (2008); Trivedi *et. al.* (2004); Orviska and Hudson (2002); Jackson and Milliron (1986), attitudes and ethics remain important in determining evasion behavior. Based on Ajzen (1991) the theory of reasoned action or the intention to evade will encourage a taxpayer to behave negatively toward taxation and thus attempt to under-report income. On the other hand, attitudes towards the tax authority are also important as tax attitudes and ethics generally depend on perceived use of the money collected by the government (Kirchler *et. al.*, 2008).

2.3.3 Socio demographic characteristics

These are tax compliance determinants from a social and demographic perspective and are the most common variables used in tax compliance research (Devos, 2005). These include age, gender, income and level of education.

2.3.3.1 Age

Demographic factors such as age have long been studied by researchers; however the findings from different studies remain inconclusive. For example Tittle (1980), Warneryd and Walerud (1982) and Wahlund (1982) posit a negative association -i.e. older people are less compliant. In contrast, Clotfelter (1983), Dubin and Wilde (1986) and Beron *et. al.* (1992) argued that age was positively related with compliance. However, there have been a significant number of studies that have found no relationship (Spicer and Lundstedt ,1976; Spicer and Becker, 1980 and Porcano, 1988).

Chan *et. al.* (2000) also concentrated on age and compliance behaviour and further suggested that age has a direct, positive effect on income and a direct, positive (negative) effect on education in the US (Hong Kong). These inconsistent findings are explained by Torgler (2007) as first, age does not impact compliance in all taxpayers; secondly, inconsistent non-compliance definitions used in the research; third, the effect on taxpayers compliance is diluted when age is associated with a number of other variables and fourth, the assessing interaction of age with other variables is problematic.

In summary, previous studies have evidenced that age could have various effects on compliance, for example age has a negative effect on compliance (Tittle (1980); Warneryd and Walerud (1982) and Wahlund (1982), positive effect (Clotfelter (1983), Dubin and Wilde (1986) and Beron *et. al.* (1992)) and some studies have found no

relationship at all between age and compliance (Spicer and Lundstedt (1976); Spicer and Becker (1980) and Porcano (1988). The next subsection discusses the relationship between income level and tax compliance.

2.3.3.2 Education

According to the Fischer Model, non compliance opportunities can affect tax compliance both directly and indirectly through attitudes and perceptions. Chan *et. al.* (2000) investigates the direct and indirect effects of two noncompliance opportunities, namely educational and income level. Previous literature supports the direct, negative relationship between educational level and taxpayer compliance but a direct relationship between income level and tax compliance is unclear. Chan *et. al.* (2000) also postulate that greater education is directly linked to a likelihood of compliance. They argue that educated taxpayers may be aware of non compliance opportunities, but their potentially better understanding of the tax system and their higher level of moral development promotes a more favorable taxpayer attitude and therefore greater compliance. Chan *et. al.* also suggested that those with a higher education level are more likely to have a higher level of moral development and higher level attitudes toward compliance and thus will tend to comply more.

Hite and Hasseldine (2001) investigate the current developments in the USA, highlighting that tax academics need to emphasise teaching and development. In other countries, tax education, as well as tax development is not as good as in the USA. Their study was expected to be able to help academics in other countries to adapt what has been done in the USA, especially in teaching methodology (in tax courses) so that other countries can learn how to educate taxpayers more effectively and efficiently.

Traditionally, the US taxation courses are taught within accounting departments only. The first paper introduces students to personal taxation; by the end of the course, the students will be able to prepare the tax return. The weaknesses of this method had been commented upon by Jones and Duncan (1995). They noted that this narrow approach in the long run does not fulfill the education needs for the students because most students are not aiming to become accountants or tax professionals. This scenario happened in other countries as well, when the education systems itself indirectly narrowed the students' mindset to be focused only on a taxation field without then relating this to other fields (Craner and Lymer, 1999). A formal tax education is only taught to accounting students in higher learning institutions. Other than this, they could not easily find any tax related courses but in other countries such as the USA, there are a lot of accounting (tax) education programmes offered to the public.

While the education levels become more important in increasing tax compliance across countries, Mohani (2001) suggested that one of the measures to increase voluntary compliance is by assuring that taxpayers have a certain level of qualifications, ability and confidence to exercise their tax responsibility. In contrast, the most recent study, by Richardson (2008) also revealed that there is a negative association between education and compliance.

In summary, greater education potentially increases compliance, as educated taxpayers may be more aware of their responsibility as well as the sanctions to be imposed if they were not compliant with tax laws, although other authors found a negative association between education and compliance. The following subsection discusses the gender effect on compliance.

2.3.3.3 Gender

The association between gender and tax compliance has received some attention in prior literature however, findings vary across studies. Some studies found that males are more compliant but others found the other way around. Although the agreement among the findings is still in discussion, the need to explore this more fully is still relevant especially in a SAS, in order to help tax administrators to plan and determine the framework of their tax audits and help target tax education programmes effectively.

Hasseldine and Hite (2003) found that males were more persuaded by negatively framed messages while females were more persuaded by positively framed messages. Although the result of the study can be considered as convincing, nevertheless, this study does not compare with the other two approaches of framing, which are risky choice framing and attribute framing. Levin *et. al.* (1998) mentioned that the research evidence for goal framing is less homogenous than other types of framing because of greater variations in operationalising goal framing.

In summary, the impact of gender on tax compliance is inconsistent, and a recent study by Richardson (2008) continues to find no association between gender and compliance. A greater longitudinal emphasis could be undertaken to examine the impact of gender as well other important variables on changes in tax evasion levels.

CHAPTER THREE

METHODOLOGY

3.0 Introduction

This chapter presents the methodological concerns used in conducting this research, and provides a justification for each step taken. It involves the General Research Perspectives, Data Collection, Theoretical Framework, Research Strategies, Access Strategies, and Credibility of the Research.

3.1 Profile of study area

AMA has a total land size of 200 square kilometers and is made up of six sub metros namely Okaikoi, Ashiedu Keteke, Ayawaso, Kpeshie, Osu Klotey and Ablekuma.

The Southern boundary of the Metropolis of Accra is the Gulf of Guinea from Gbegbeyese to the Mukwe Lagoon near Regional Maritime Academy. The boundary continues along the Maritime Road to join the Accra-Tema road to Nungua Police Station Barrier.

It turns right to the Ashaiman Municipal road till the Railway overhead Bridge on the Motorway and continues to Mile Post 91/2. From there the boundary continues to the road between the Institute of Professional Studies (IPS) and the Accra College of

Education (ATRACO), westwards crossing the Accra-Aburi Road to the University of Ghana behind the great Hall to Kisseman and Christian Village to join the Accra - Nsawam Road at the Achimota Brewery Road Junction.

It turns left for 500m to the Aayeayeeffee Street junction and through the Aayeayeeffee Street to the Bridge over the Achimota Stream, then turns right along the stream to the high tension lines to the Achwilage Street and through Achwilage Street to the range of the Awoshie Hills and turns left again along the hills to the boundary between Kokroko and Awoshie (Ga South Municipal), from here it turns left along the swampy area and crossing the motorway through the swampy area to the bridge on the Sakumono Stream on the Accra-Winneba road and streatching along the stream till the starting point at Gbegbeyese.

The economically active population of AMA is estimated to be 823,327. However, the daily influx of people from dormitory towns makes the figure higher than estimated. It is worthwhile to state that the estimated figure of all the economically active population who dwell within the Metropolis excludes the workers of both formal and informal sectors who commute daily to engage in various economic activities.

Accra is a major centre for manufacturing, marketing, finance, insurance, transportation and tourism. It has about 350 major industrial establishments, a Central Bank, 9 Commercial Banks (with 81 Branches), 4 Development Banks (with 19 Branches), 4 Merchant Banks (with 7 Branches), 3 Discount Houses, 1 Home Finance Mortgage Bank, Building Societies, a Stock Exchange, 218 Foreign Exchange Bureaus, 9 Finance Houses, 9 Insurance Companies, 12 Insurance Brokerage Firms, 2 Savings and Loans Companies and a host of Real Estate Developers. The road network in the Metropolis is about 1,117.89 km made up of 918.10 km paved and 199.8 km of unpaved roads.

There are over 50,506 identified residential properties and about 4,054 commercial/Industrial/mixed properties with a total rateable value of ₺138,490,137.77. There are also 29 markets, 36 facilities for both on – street and off-street parking and over 120,000 units of wholesale, retail and other self-employed businesses as well as several facilities for the promotion of sports, recreation and many tourist centres.

The sectors of AMA economy consist of Primary Sector (farming, fishing, mining and quarrying), Secondary Sector (manufacturing, electricity, gas, water, construction) and Tertiary Sector (Wholesale trade, retail trade, hotel, restaurant, transportation, storage, communication, financial intermediation, real estate service, public administration, education, health and other social services). As an urban economy the service sector is the largest, employing about 531,670 people. The second largest, secondary sector employs 22.34% of the labour force (that is 183,934 people). Accra has 114,198 of its labour unemployed, making an unemployment rate of 12.2%.

3.2 Research perspectives

Research methodology defines the systematic and scientific procedures used to arrive at the results and findings for a study against which claims for knowledge are evaluated (Nachamias et al., 1996; Saunders et al., 2007). A Research methodology is usually shaped by the perspective that the researcher adopts for a study. According to Saunders et al (2007) the perspectives that shape a research work can be categorized into five: Research Philosophy, Research Approach, Time Horizon, Research Strategy and Type of Data collected.

3.3 Research philosophy

Research philosophy refers to the assumptions and beliefs that govern the way we view the world (Saunders et al. 2007). It therefore, forms the basis of the general direction that a researcher chooses for a research. Two philosophies that shape a research are positivism and phenomenological beliefs. Research philosophy is positivism if “knowledge or the world is thought to exist independent of people’s perceptions of it and that science uses objective techniques to discover what exist in the world” A phenomenological philosophy on the other hand, is where “... reality of the world is thought to arise out of the creation and exchange of social meaning during the process of social interactions” (Sullivan, 2001). Saunders et al (2007), Cooper and Schindler (2006) as cited by Gyasi Nimako and Azumah (2009) agree that research can be influenced by positivism or phenomenological beliefs (Sullivan T. J. as cited in Gyasi Nimakoh & Azumah 2009).

The philosophy that guided this study was positivism. This is because the researcher believes that the issue of tax compliance with respect to VFRS can be described objectively, through the use of established frameworks and structured instruments to assess and analyse it, upon which generalizations can be made from the findings (Sullivan, 2001).

3.4 Research Approach

A research may be approached from a deductive or inductive perspective. A deductive approach begins with a theory or hypothesis and designs a strategy to test the hypothesis in a contest to accept or reject it. It therefore, proceeds from general to specific. On the contrary, the inductive approach begins with an observation of a phenomenon in an environment, data is then collected based upon which a theory is developed or a generalization is made. The inductive approach therefore, progresses from specific to

general. In short, the inductive approach is the exact opposite of the deductive. The researcher's approach to the study was inductive because of his observation that many traders are not compliant with tax laws, and that he wants to find out the reason behind this state of affairs. This approach begins with an observation of a phenomenon in an environment, data is then collected based upon which a theory is developed or a generalization is made. The inductive approach therefore, progresses from specific to general.

3.5 Time horizon

The time horizon of research refers to the time period during which a research is conducted. There are two main time horizons for researches. These are the cross-sectional and longitudinal time horizons. A cross-sectional study studies a particular phenomenon or phenomena at a specific period of time. It is therefore, possible to have a single cross-sectional study (involving one object) or multiple cross-sectional studies (involving two or more). A longitudinal study rather involves the study of a specific phenomenon or phenomena at different times or periods. It is also possible to have single longitudinal study (involving one) or multi-longitudinal studies (involving two or more). That is, while the cross-sectional study is conducted once, the longitudinal study is conducted over different time periods. Based on the objectives of this study, the researcher chose the cross-sectional study because data will be collected on the exposure and outcome variables at the same time.

3.6 Research strategy

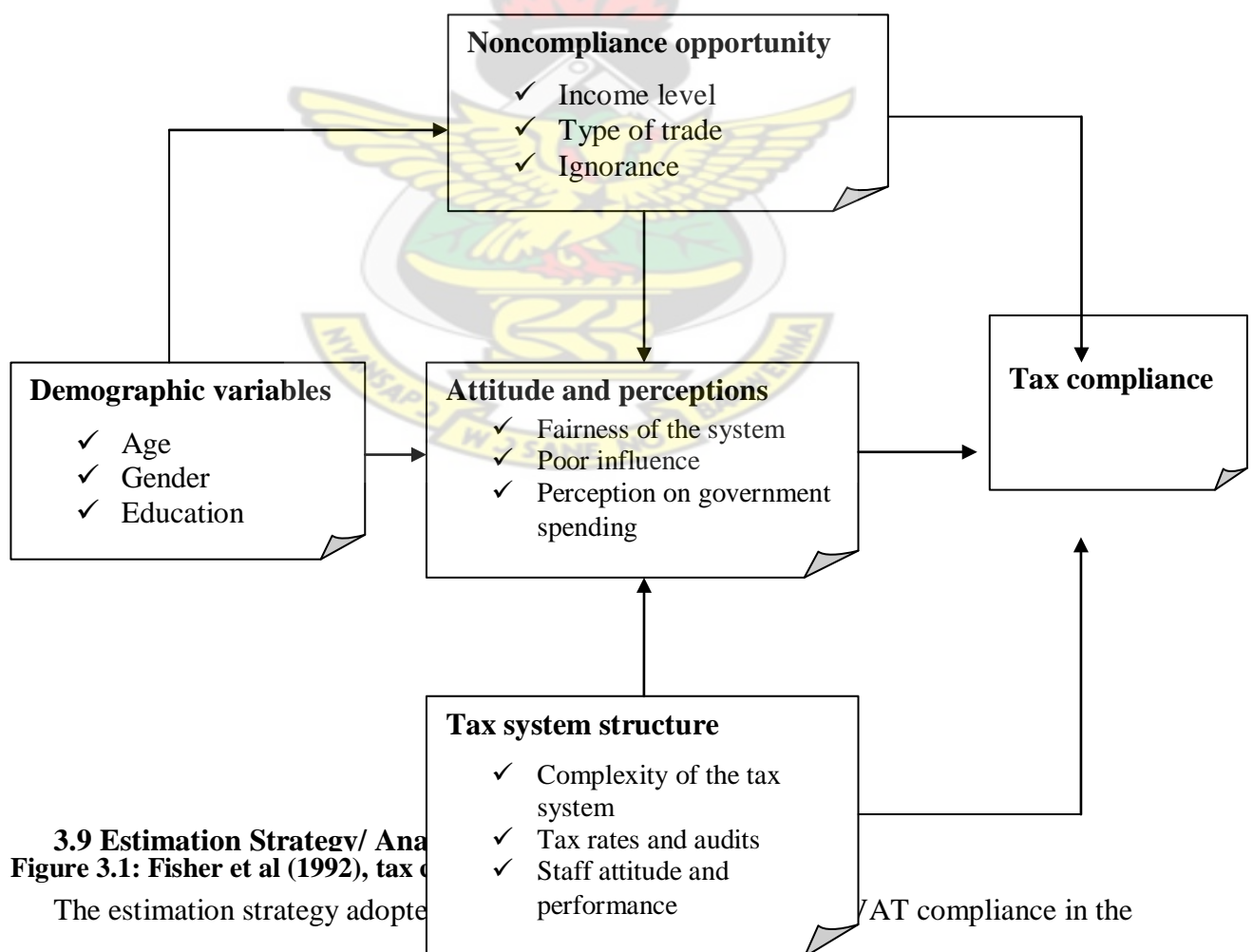
Research strategy is a general plan of how to answer the research questions. It is mainly guided by the research questions and research objectives among other things. It

determines to a large extent the choice of data collection methods. The main research strategies are action research, ethnographic studies, experiment, survey, case study, grounded theory or archival research (Saunders et al., 2000, 2007; Cooper and Schindler 2006; Malhotra and Birks 2007).

3.7 Type of data collected

Data used for the research are predominantly primary in nature. Primary data refers to data originated by the researcher for the specific purpose of addressing the research problem (Malhotra N. K. & Birks D. F. 2007, p.94). It is what the researcher originally collects from the sample or target population. In this research, the primary data were those obtained through questionnaire and interview guide.

3.8 Conceptual framework



3.9 Estimation Strategy/ Analysis
Figure 3.1: Fisher et al (1992), tax compliance

The estimation strategy adopted for the study of VAT compliance in the Accra Metropolis (AMA) are discussed in this section.

A decision by a respondent to comply is assumed to be influenced by the individual and institutional characteristics as well as institutional factors. Let us represent compliance of VAT by latent variables (Y_i'). Thus the latent response depends on a vector of explanatory variables, individual and household's characteristics as well as institutional factors (X_i). This leads to qualitative response model which can be presented as:

$$Y_i = \alpha + \beta'X_i + \mu_i.$$

Where Y_i take value of 1 if a respondent comply with VAT through participation in the flat rate system and zero if the respondent does not. The equation is estimated using Maximum Likelihood Approach (MLAp).

Table 3.1 Study Variables

Dependent variables			
	Name	Type	Description
Compliance	COMP	Binary	Measured as registration in the system, timely filing or lodgment of requisite, taxation information, Reporting of complete and accurate information Payment of taxation obligations on time 1, if respondent comply ; 0 otherwise
Independent variable			
Individual characteristics			
Variable	Symbol	Type	Description
Age	AGE	Continuous	The age of the respondent in years. Divided into 8 groups, 20-25, 26-30, 31-35, 36-40, 41-45, 46-50, 51-55, >56
Gender	GEN	Binary	1 if respondent is Male and 0 otherwise
Education	EDUC	Continuous	Highest level of formal education. Divided into 5 levels; none, basic, secondary, tertiary and others
Attitude and perceptions			
Perception on fairness	PERF	Binary	1 if respondent have negative perception on fairness and 0 otherwise
Perception on equity	PERE	Binary	1 if respondent have negative perception on equity and 0 otherwise
Institutional characteristics			
Tax audit	TaxAUD	Binary	1 if respondent have ever received tax audit and 0 otherwise

Tax rate	TaxRAT	Binary	1 if respondents perceive tax rate to be too high and 0 otherwise
Tax education	TaxEDU	Binary	1 if respondents perceive tax education positively influences their understanding of the system and 0 if otherwise
Simplicity of tax administration and returns	SimAD	Binary	1 if respondent have positive perception on the simplicity of tax administration and 0 otherwise

3.10 Sampling Method

The sampling frame for the study comprised the traders who are operating within the Accra metropolis who were eligible for the VFRS.

The study employed clustered sampling to select a representative sample from the various sub metros in the Accra metropolis. A random sampling technique was then used to select the respondents from the various clusters.

3.11 Sample Size

With the proportion of trader population in the sub metro put at 30% ($p=0.30$)

The degree of error, 5 %--($d=0.05$)

And 95% confidence interval (Coefficient of reliability $Z = 1.96$);

The sample size n estimated to be $= Z^2 \times p (1-p) \div d^2$

$$n=1.96^2 \times 0.30 \times 0.70 \div 0.05^2 = 323$$

Given 10% non respondent rate, total sample size $= 32 + 323 = 355$

3.12 Pre-testing

The questionnaires were translated from English to Ga and Twi and then back to English. Questionnaires were pretested in the Kasoa District with similar characteristics to check for clarity, consistency and acceptability of the questions to respondents. Following this,

the necessary corrections were made and questionnaires finalized for the actual field work.

3.13 Data Handling and Storage

At the end of each day, questionnaires were checked for completeness and internal consistency. Questionnaires were then sorted, numbered and data coded before entry into Access software.

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CHAPTER FOUR

DATA PRESENTATION, ANALYSIS AND DISCUSSION

4.0 Introduction

This chapter presents the results of the field study that was conducted. In particular the responses to the questionnaire that was sent to the two stakeholder groups are presented. The chapter is divided into two; the first deals with the responses of traders and the second part presents the views and analysis of staff concerning the reasons for low compliance among the trader population.

The trader population was given a set of questionnaire that sought to elicit from them factors influencing compliance. It is the aim of this chapter to analyze these answers and come out with recommendations on measures and ways that can help improve the compliance level or attitude of the registered trader population.

The staff of the VAT Service is the engine of the Service. How successful the Service will be depends on the commitment of the staff in pushing the objectives of the Service. By the very nature of VAT, a de motivated staff will be a big problem for the Service. Thus the questionnaire directed at the staff sought to bring to the fore a twofold problem. One was to seek the opinion of the staff on what they thought were the reasons for the perpetual low compliance of the registered trader population. This will enable the study to come out with recommendations to improve compliance. The second was to solicit from the staff views on whether the staff of the Service is well motivated to push the objectives of the service. This will enable the paper to come out with measures to improve motivation. This is tied to the fact that it is the staff that is the frontline contact with the traders. How well the aims of the Service will be propagated will all be determined by how committed the staff is. The rest of the chapter presents traders and staff views on important factors that the paper believes affect the compliance rate.

4.1 Backgrounds of respondents

This section describes respondents' demographic and tax background including age, gender, educational levels and experience of being audited by the tax authority. Some descriptive statistics are also illustrated in this section.

Data was collected from three hundred and fifty-five (355) small and medium size enterprises taxpayers, in Accra Metropolis. All the traders responded constituting a 100% response rate. The respondents comprised of 195 (55%) females and 160 (45%) males.

Figure 4.1 represents the age statistics. Since this study emphasized individual taxpayers, a minimum age of 20 years old was considered reasonable. There were eight age groups involved in this study with a 5-year range in each group except for 'above 56 years old' category. The largest group of the respondents, (92 or 26%) was aged between 26 and 30 years old and respondents in the group of above 56 years old was the lowest number with 7 responses (2%). Cumulatively, respondents aged between 20 and 40 years old made up the largest portion with 262 responses (74%).

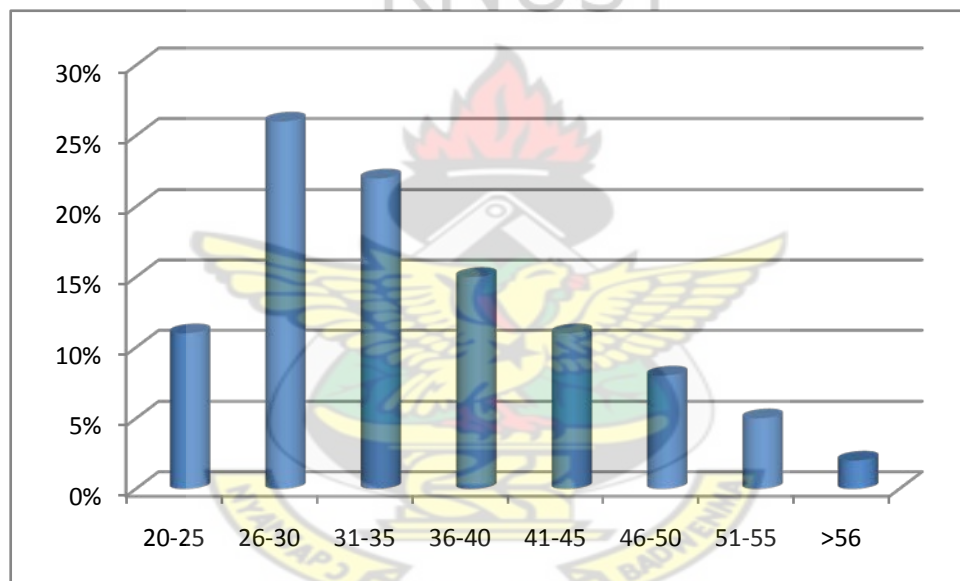


Figure 4.1 Age of respondents

A total of 243 (66%) respondents were married, 96 (27%) were single, 11 (3%) and 14 (4%) were widows/widowers and separated as shown in figure 4.2.

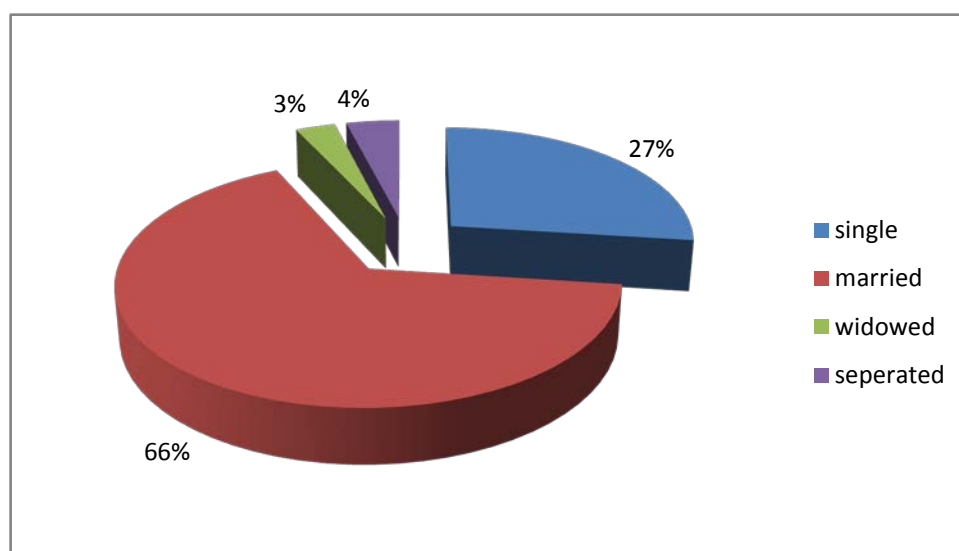
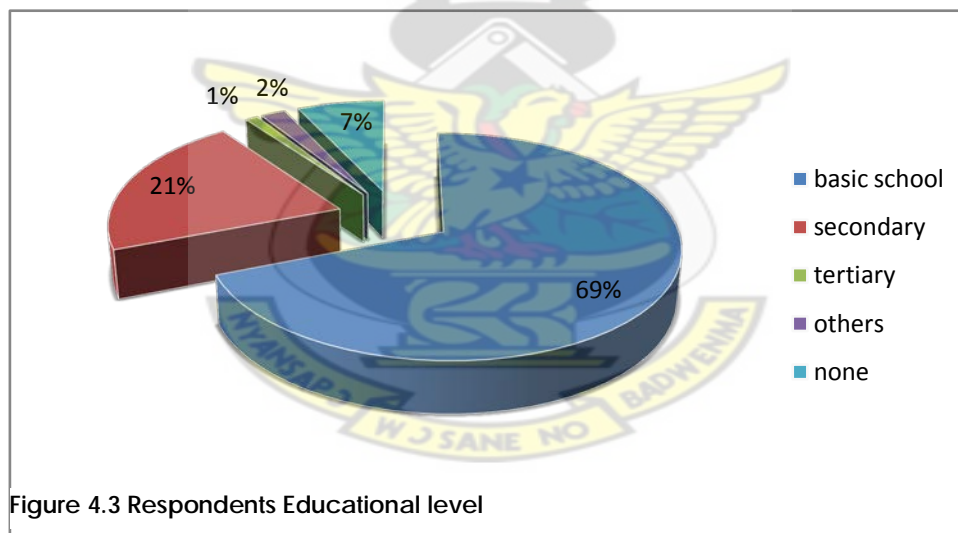


Figure 4.2 Respondents marital status

As presented in Figure 4.3 below, most of the respondents had no good academic qualifications: a total of 245 respondents representing 69% had completed basic school while 24 (7%) respondents had not been to school before. Six (6) of the respondents representing 2% had other certificates or had sat a professional exam and 76 (21%) had completed the Senior High school.



The ability to read and write influences one's ability to understand and interpret the tax laws. Proper record keeping requires fluency in reading and writing. From research data, 93% indicated they have the knowledge to write and read, as 7% indicated that they don't have such fluency. This is a clear indication that the taxpayers can understand, interpret the tax laws, and at the same time keep correct books of account and records. The challenge of lack of knowledge of tax compliance behaviour towards a tax system is

serious on the grounds that it may have played part in the short falls in tax collection, even after aggressive marketing by the VAT service.

4.2 Structure of the tax system and compliance

4.2.1 Tax Audit

A question of whether traders are audited by VAT officers was posed to the traders to assess the influence of tax audit on compliance. A total of only 36 (6%) of the respondents had been audited while a large number of them, 1,028 (94%) had never been audited. Figure 4.4 represents the respondents who had experienced being audited by the VAT service.

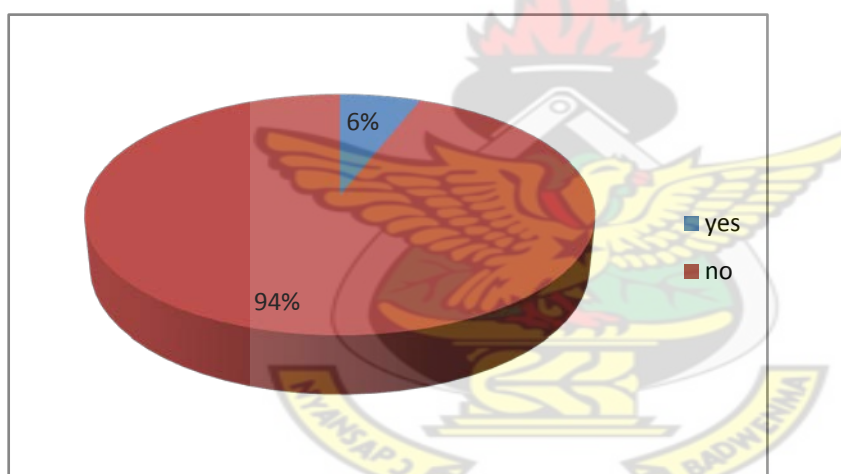


Figure 4.4 Tax audit on compliance

Tax audits have been found to have a positive impact on tax. These findings suggest that in self assessment systems, tax audits can play an important role and their central role is to increase voluntary compliance. Audits rates and the thoroughness of the audits could encourage taxpayers to be more prudent in completing their tax returns, report all income and claim the correct deductions where necessary to ascertain their tax liability. In contrast, taxpayers who have never been audited might be tempted to under report their actual income and claim false deductions.

4.2.2 Tax Rate

A question was posed to the respondent's on their view about the tax rate. Majority of the respondents agreed that the rate was high; 29.3% strongly agreed that the tax rate was high, and 19.5% agreed that the rate was high. This was on a 5-likert scale, where strongly agree = (1); Agree = (2); Neutral = (3); Disagree = (4); strongly disagree = (5).

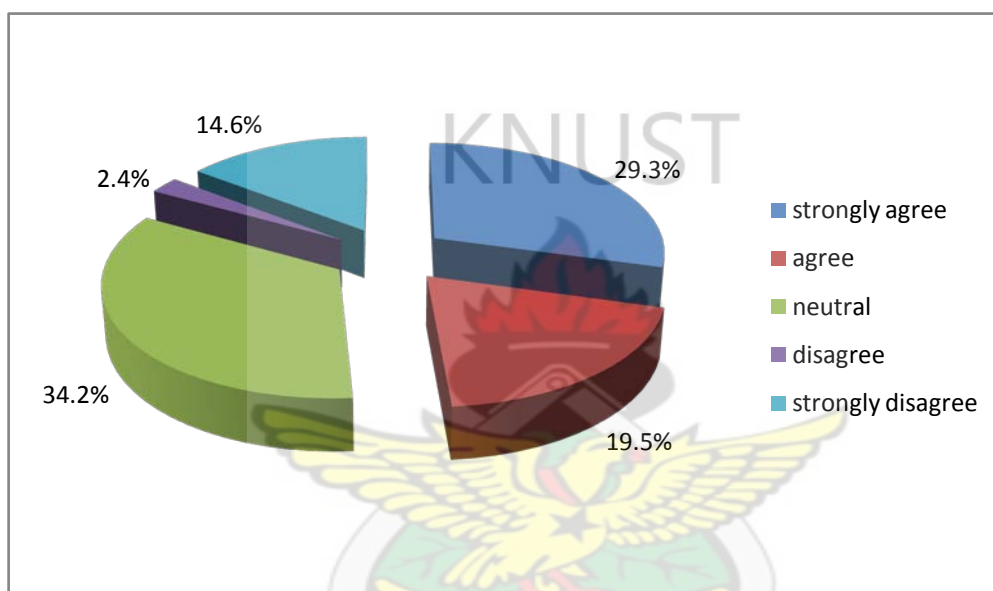


Figure 4.5 Respondent's view on tax rate

The idea that high marginal tax rates decrease tax compliance certainly has an intuitive appeal. If the traders perceive the rate to be on the high side, they tend to feel that they are paying too much of their monies to the state.

Other economic models of rational compliance decisions however, perceived that tax rates have a mixed impact on tax compliance or predict that increasing tax rates will increase compliance behaviour (Kirchler, Hoelzl and Wahl, 2008). In contrast with Allingham and Sandmo, various studies found that increasing tax rates encouraged noncompliant behaviour or produced mixed findings (Pommerehne and Wech-

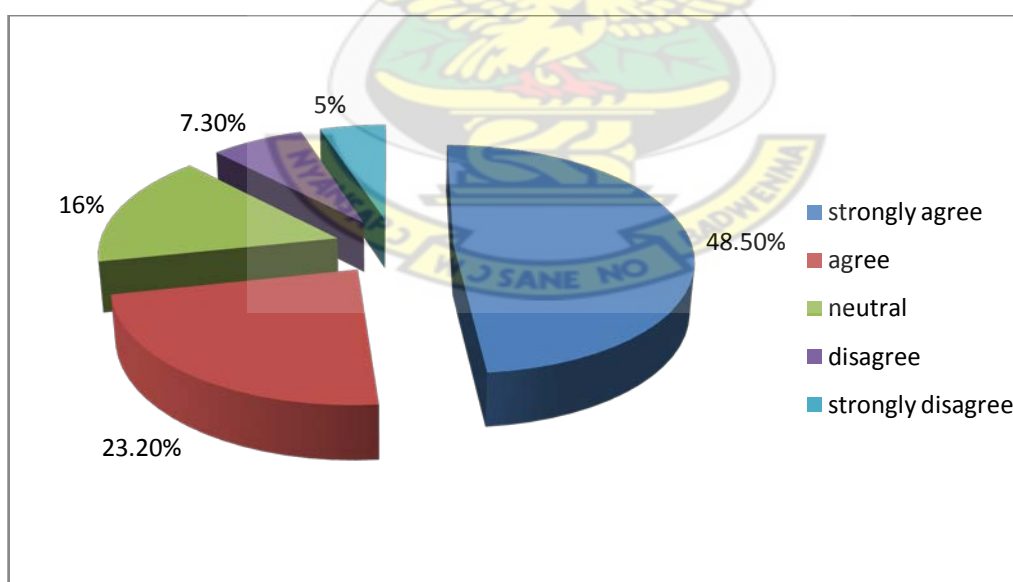
Hannemann, 1996; Park and Hyun, 2003). Porcano (1988) claimed that tax rates have no effect on tax compliance while most experimental studies found that increasing tax rate leads to tax evasion (Park and Hyun, 2003).

For such a trader the effect of the tax rate is not what determines his prices. He will rather identify the effect of fuel, which has the tendency of changing often. The VAT rate has changed twice since its inception (from 10% to 12.5% and to 15% (3% VFRS)).

4.2.3 Simplicity of tax returns and administration

This part of the questionnaire seeks to determine the effect of customer service on traders' decision to comply or not. The paper sought to find from the traders how easy it was to calculate and file returns as compared to the Standard rate system. 71.7% of the traders thought the whole process was simple, 12.3% disagreed that the whole process was not difficult whilst 16% were neutral.

Table 4.6 Simplicity of the tax system



Compared to all existing self assessing taxes in Ghana, the VAT return is arguably simpler. The VFRS forms are simpler than the Standard Rate form. The forms expect

you to declare your sales and pay three (3%) flat as tax. Return forms that must be filed are collected by traders on quarterly basis.

Silvani and Baer (1997) studied the effect of simplicity in filing returns on compliance and found that this will encourage taxpayers to complete the tax return on their own rather than employing a tax agent and thus reducing compliance costs. From another point of view, previous studies have evidenced that complexity of reporting requirements has a high association with errors detected by audits (Long 1988). This finding of course, is perhaps to be logically expected by tax authorities. If many errors are detected in tax returns and the same errors happen every year by different taxpayers, it means that the wordings or the sentences of the format in tax return may be, at least, partly to blame.

Traders were also asked about their views on the accessibility of the VAT offices.

Majority of traders (48.8%) thought that the offices were not easily accessible, 12.2% disagreed and 39% were neutral. This question is interesting for many reasons.

Depending on the trader's location, one might find the VAT offices close or far off. Also if the trader thought that transportation was an additional cost, he might think of lowering his tax to offset such inconveniences. The VAT Service has its biggest offices called Local VAT Offices (L.V.O) in some regional capitals. These are followed by smaller offices yet still in regional capitals. Very few districts are covered by the Service. In Accra where majority of the business is, the Service has three LVOs namely, Adabraka, Osu and Kaneshie Industrial Area and has recently opened offices in places like Okaishie, Madina, Abossey Okai and Spintex Road. Traders in such places hitherto had to come to the LVOs. It is a confirmation of traders' response to the above question that the Service is now opening offices to bring the service closer to the customer.

The study also sought to reinforce this idea of customer service but in a different manner. Traders were asked about how serviceable VAT staff was. Majority of respondents were neutral (43.9%), 31.7% either agreed or strongly agreed that staff was serviceable, whilst 24.4% disagreed that staff was serviceable.

4.2.4 Tax Education and Compliance

On the question as to whether the low compliance was as the result of traders' ignorance of the laws and regulations, 65.6% of the respondents agreed/strongly agree that ignorance was a main factor for low compliance, 14.6% were neutral and 19.8% disagreed that compliance was not a factor for low compliance.

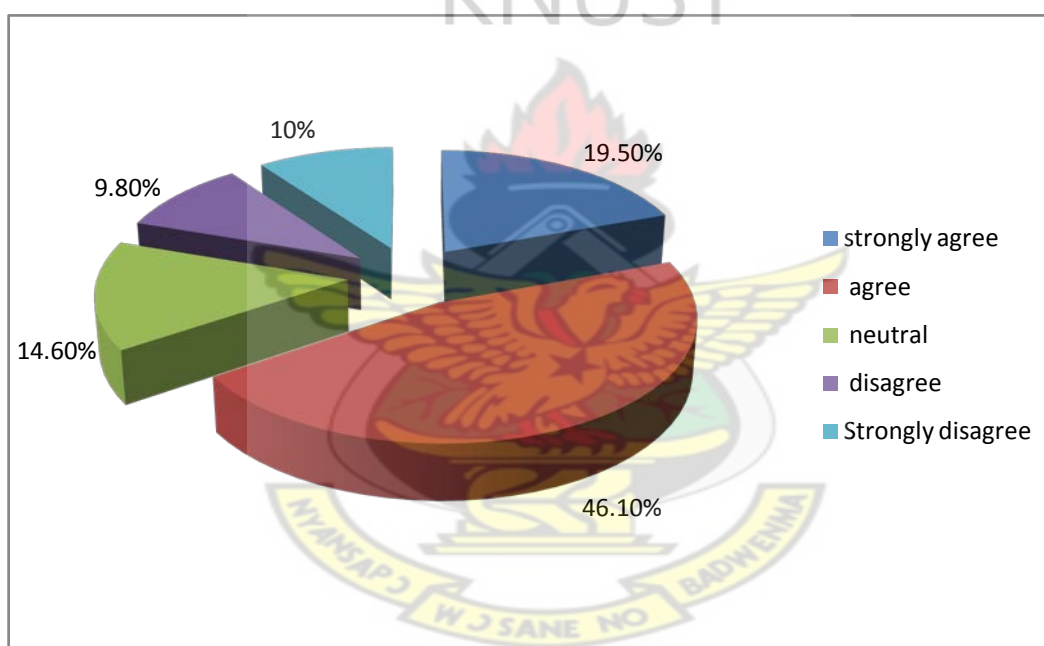


Figure 4.7 Traders knowledge of VAT laws and regulations

In an effort to reinforce the question, traders were also asked if the VAT Service efforts in educating them have resulted in improved understanding of the system. 4.9% strongly agreed that education was satisfactory, 26.8% agreed, majority (39%) were neutral and 29.3% disagreed that education was not up to appreciable level.

These results can be looked at in relation to the VAT Service's own efforts at educating the trader population. Historically, the service has been meeting and interacting with traders on topical issues. That is whenever there is a new development the VAT Service mobilizes to inform the populace in general and the trader population in particular. For example, there was a massive education of the trader population when the tax rate was increased from 12.5% to 15% in August 2004 and in September 2007 when the VFRS (3%) was introduced. Television adverts and programs are increased immediately after the reading of the annual budget especially if there are changes affecting VAT.

During the 'normal' period, there are virtually no programs or educational seminars. In

the absence of constant education and programs, the assertion by traders that education

and outreach are not appreciable may be an excuse, but the issue is whether this assertion

is true. Authorities such as Hite (1998) have suggested that there are many different

approaches of achieving compliance, these include incorporating specific messages into

programs for targeted groups or the use of television to change the attitude of traders

towards fairness and compliance (Roberts, 1994). Thus looking at the approach of the

service towards trader education, it is not difficult to agree that promotional and

educational programs must be stepped up.

Quite a lot of traders rely on agents and accounting firms to file their returns for them.

The big traders employ full time accountants and sometimes tax consultants. For such

traders the view on service will likely be neutral since they feel they really do not need to

concern themselves with such details; it is someone else's work.

For traders who are satisfied with the output of the service, the reason is likely to be that

they either take it on themselves to seek explanations or then again, they rely on agents

and accountants to fulfill their obligations. In which case, they have not fallen foul of the

law.

4.3 Traders attitude and perceptions

4.3.1 Perception of government spending

The paper sought to find out the traders appreciation of what the taxes they pay are used for. Traders were asked if their taxes were used to improve the social amenities, which impacted on their well being.

46.4% of the traders saw no correlation between the taxes they pay and the provision of social amenities in the country. 39.0 % were neutral on taxes and its provision of social amenities, whilst 14.6% saw some uses of their taxes.

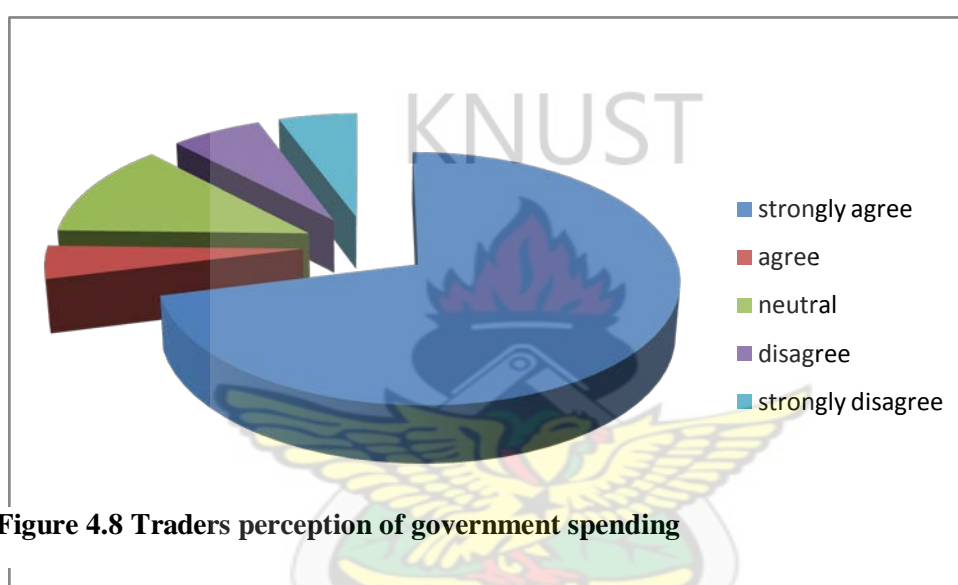


Figure 4.8 Traders perception of government spending

of the usefulness of the taxes they pay. If the traders are of the opinion that they are throwing monies away, they will certainly like to diminish their losses by evading the tax. Conversely, traders may not be too disgruntled if they are appreciative of what their taxes are being used for. There is evidence that tax evasion is adversely affected by the perceived inequity between the tax paid and public spending benefits (Wallschutzky, 1984).

With regards to perceptions of government spending, those who engage in tax evasion often justify such behavior by suggesting that the government wastes tax revenue and spends unwisely; such arguments can decrease voluntary compliance in the long run

(Braithwaite *et. al.* 2009). It is expected that if the government spends taxpayers' money wisely, for example on basic facilities like education, health and safety and public transportation, it is assumed that voluntary compliance will increase. In contrast, if taxpayers perceive that the government spends too much on something else, taxpayers might feel betrayed and attempt to evade. In judging their own behaviour, people tend to believe the cause is due to external attributes. Therefore, the government should spend taxpayers' money wisely so that tax compliance will increase, thus the tax collection will also increase.

4.3.2. Fairness of the system

Respondents view on how fair the tax system is, was elicited using a likert scale. Respondents were asked to agree or disagree with the view that the system is not fair and the results displayed in figure 4.9

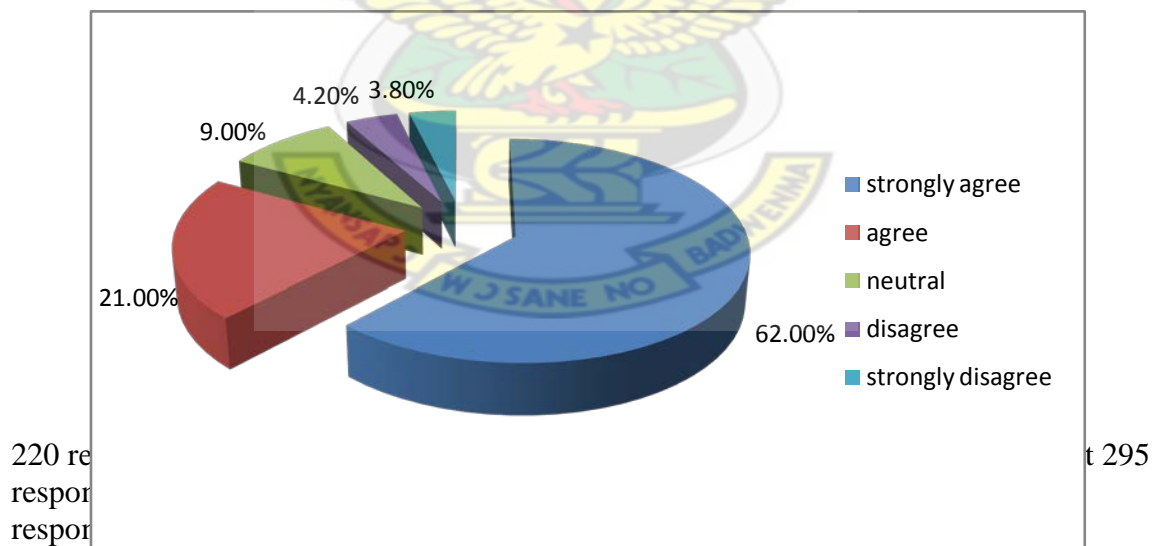


Figure 4.9 Traders perception on the fairness of the system

This was supported by the study by Spicer and Becker (1980), Andreoni *et. al.* (1998) and Wenzel (2003) which claimed that if a specific group perceived their tax liability was higher than other groups, then tax evasion might occur among the group members.

At a social level, tax compliance with regards to fairness is viewed as a national concern. If taxpayers perceive that the tax system is unfair, tax evasion is more likely to occur (Allingham and Sandmo, 1972; Baldry, 1999).

A belief in the legitimacy of the authority and trust in it, with a sense of procedural fairness augments, also increase identification with the group and compliance with its norms. Although a belief in the legitimacy of the tax system is ultimately tied to the greater issue of legitimacy of the government which the taxes support, individuals' direct contacts with the tax authority greatly influence their perception of whether an authority is legitimate and procedurally fair (Taylor, 2005). The lack of responsiveness, according to some scholars, is a major cause of the ultimate act of non-compliance in the tax area—revolt.

4.4 Estimation of result

The result of the factors influencing VAT compliance is presented in table 4.2. Out of the nine (9) variables, four (4) of them have significant relationship with VAT compliance. Level of education, tax audit, tax education and simplicity of tax administration exhibited positive and significant relationship with tax compliance among traders.

EDU had a positive and significant relationship effect on compliance. This implies those traders who have high educational level are more likely to comply with VAT Service in Ghana than those who are not. Chan *et. al.* (2000) also postulate that greater education is directly linked to a likelihood of compliance. They argue that educated taxpayers may be aware of non compliance opportunities, but their potentially better understanding of the

tax system and their higher level of moral development promote a more favorable taxpayer attitude and therefore greater compliance. In contrast, the most recent study, by Richardson (2008) also revealed that there is a negative association between education and compliance.

Greater education potentially increases compliance, as educated taxpayers may be more aware of their responsibility as well as the sanctions to be imposed if they were not compliant with tax laws, although other authors found a negative association between education and compliance.

In the case of tax audit, the coefficient has the expected sign and it is significant at 1% level. The explanation to this observation may be that, tax audits can change compliance behaviour from negative to positive (Butler, 1993). These findings complement the Witte and Woodbury (1985) and the Beron, Tauchen and Witte (1988) studies. Witte and Woodbury in their study of small proprietors found that tax audits have a significant role in tax compliance. They did not empirically test individual taxpayers, thus left open room to conduct research in this area. While Butler (1993) and Witte and Woodbury (1985) found significant results.

Table 4.2: Data output from estimation of Logistic Regression Model for factors influencing tax compliance

Logit regression		Number of obs = 355		
		LR chi2(11) = 103.46		
0.0000		Prob > chi2 =		
Log likelihood = -344.01797		Pseudo R2 =		
0.1307				
Variables	Coefficient	Standard .Error	Marginal Effect	p-value
EDU	1.587848	0.271745***	0.396288	0.0234
TaxAUD	0.241867	0.133262**	0.05133	0.0054

TaxED	0.6566	0.00531*	0.00034	0.0023*
AGE	-0.05546	0.048006	0.01784	0.0430
SimAD	0.28913	0.130826**	0.05038	0.0001*
TaxRAT	-1E-05	9.19E-06	0.00320	0.023
GEN	-0.18613	0.133965	0.05138	0.3111
PERF	-0.0671	0.00531	0.0002	0.1123
PERE	-0.25439	0.221671	0.08632	0.432
_cons	0.671791	1.075992	0.05133	0.033

The asterisks indicate level of significance. *** is significant at 1%, ** significant at 5% and * is significant at 10%.

Simplicity of tax returns and administration has positive and significant relationship with VAT compliance ($p=0.0001$). This can be explained by the fact that more traders find the return form of the VFRS simple and that makes it easy for them to comply as compared to the Standard rate System. This is further supported by a study by Silvani and Baer (1997) which added that simplifying the tax return will encourage taxpayers to complete the tax return on their own rather than employing a tax agent and thus reducing compliance costs.

Tax education also had a positive and significant relation with VAT compliance ($p=0.0023$). This can be explained on the basis that, when traders are educated on the VAT service, tax administration and filling of returns, it improve their understanding and help them comply with the various procedures and processes involved with filing their returns.

This result also suggests that other variables such as perceptions of equity and fairness, Age of respondents, gender of respondents, tax rate and perception about government spending were not significantly correlated with tax compliance at the time of this study.

CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSION, AND RECCOMENDATIONS

5.1 Summary of Findings

This chapter summarizes the purpose and objectives of the study, the major findings and conclusions and its implications and makes recommendations for further studies. The study examined VAT compliance among traders in the Greater Accra Region from the perspective of VFRS.

The purpose of this research was to assess the VAT compliance level among traders and to understand the factors that influence compliance.

All of the three hundred and fifty-five (355) sampled population responded to the questionnaire. Based on an objective analysis of data and discussion of findings, the following are the summary of major findings and conclusions of this study. As pointed out earlier in the beginning of the paper, the compliance level of the trader population has been discouraging and it has become a big factor in the revenue mobilisation efforts of the VAT Service. Time in time out, the service has had to factor in the compliance

level of the trader population when targets are being set. This has had a negative effect on the revenue mobilisation of the VAT Service.

5.1.1 Survey of Trader Population

Trader population identified the following factors as responsible for the low compliance:

a. High Tax Rate

On the issue of the tax rate, most traders were of the opinion that the rate was high whereas evidence on the ground points to the fact that the VAT rate compares favourably to VAT rates in many countries especially in Africa.

a. Lack of Appreciation of Welfare Effect of Tax:

Most traders were not appreciative of what the taxes they pay are used for especially how the tax benefited them directly. This tends to adversely affect their willingness to comply.

c. Difficulty of tax administration and returns

Traders had problems with the tax system and expressed various difficulties with filling tax returns. Traders reported they had to hire the services of experts to work on this for them anytime they had to pay the VAT. This affects their willingness to comply.s

d. Tax Education

Traders overwhelmingly agreed that their low compliance was partly the result of lack of education on the basic VAT laws and regulations.

e. Low Tax audit

Most traders reported they had never been audited by the VAT Service and those who had received an audit before showed willingness to comply with VAT.

f. Lack of fairness of the system

On the issue of fairness, most of the traders believed that the VAT system in Ghana is not fair in terms of its norms of honesty, and politeness in its communications and interactions with taxpayers. The more the VAT Service strengthens this, the more customers will view the Service as fair.

An estimation of how these factors and other demographic characteristics (age, gender, level of education) influence compliance also revealed a positive and significant relationship between level of education, tax education, tax audit and simplicity of tax administration and returns.

5.2 Conclusion

Consistently for the years under review, the Service has exceeded its target for revenue mobilisation. Ironically, this high performance lends credence to the fact that targets set by the VAT Service can be set much higher and revenue mobilisation increased. The whole exercise of this study was to come out with measures to improve the compliance level of the trader and consequently improve revenue mobilisation of the Service.

The paper recognised the fact that historically, one of the biggest problems of the Service has been the compliance pattern of the registered trader population. These are the people who are registered by the Service as agents to collect the VAT from the consuming public. In setting revenue targets for each year, one recurring consideration has been the low compliant nature of the trader population. The Service has had to consider this factor as part of potential hindrances year in year out.

The paper also recognised the fact that the efforts of the Service in improving compliance must be carried out by the staff of the Service. To this end, how well the

Staff is committed to perform also becomes crucial in addressing the compliance problem.

In view of the low level of compliance among VFRS traders, the study has the following as its objectives;

- To determine the characteristics and level of tax knowledge of the individual tax payers
- To determine the VAT compliance level among traders in the Accra Metropolis
- to identify the determinants of VAT compliance among various traders in the Greater Accra Region
- the paper seek also to establish the relationship between attitude and tax compliance behaviour as well as recommending internal market strategies for VAT as an organisation

The scope of the paper includes the VFRS trader in the catchment areas of Accra Metropolis in the Greater Accra Region. Cluster Sampling was done in order to have equal representation of all the six Sub Metropolitan Assemblies on board. Random Sampling technique was then used to select respondents from the various clusters. The aim of the exercise was to elicit from the sample, reasons for the low compliance. The traders were sent questionnaires that sought to elicit their opinions on issues ranging from tax rate through tax filing process to accessibility of the revenue agencies. This was meant to identify factors responsible for their low compliance. They were then asked to come up with their own measures to improve compliance.

5.3 Recommendations

5.3.1 Tax Education

Although tax morale has strong affective components, education can still play a major role in maintaining and improving compliance. Knowledge increases taxpayers' sense of control of their tax situations and also increases the chances of filing accurate and timely returns. Consequently, knowledge can decrease feelings of frustration as well as decrease the actual amount of time a taxpayer must spend on taxes. Education is also a powerful tool for increasing taxpayer morale by strengthening feelings of identity, reciprocity, fairness, procedural justice. Furthermore, education can ensure that VAT Service personnel act—and are perceived as acting—in a fair manner which is essential for tax morale. The need to educate the traders is very important. If the traders think the tax rate is on the high side, they will tend to find avenues to evade the tax. This has a direct relation on the compliance level of the trader population. The moment the traders are not appreciative of the uses of the tax, they will find ways and means to evade and avoid it. These factors will also be worsened by the perception of the traders that some of their colleagues are free riding.

Lessons can be drawn from how different countries treat this issue of compliance: In the United Kingdom for example, there is emphasis on communicating with the taxpayers to provide simple and clear forms and guidance as well as accurate information. In Australia for example, the Service places much emphasis on advising taxpayers regarding their obligation and assisting them to comply.

In the United States the IRS has developed a comprehensive strategy to promote compliance: the eight point strategy in the Compliance Document of the IRS stresses on

the need to increase 'preventive education' as well as increase awareness of tax responsibilities in schools. The second point in the document stresses on the need for better publicity on how the tax system works, how taxpayers benefit by complying. In Japan, for example, the tax administration has established an environment that seeks to encourage taxpayers to submit proper returns and pay taxes voluntarily. These include communication with taxpayers through public relations, general guidance and consultations. They use the audit visits also to improve taxpayers understanding of the tax system.

Managers of the tax system in Ghana can draw lessons from the above. As stated in earlier chapters, the education of traders is not on a constant basis. There is the need to establish a permanent communication channels with the traders, applying the various approaches by the countries stated in the study.

5.3.2 Establish educational/ media programs

Knowledge of mere facts does not necessarily change people's attitudes nor increase their compliance with norms or laws since people are often guided by heuristics, cognitive processes and other short cuts or rules of thumbs rather than rational thought. At first glance, then, it might seem that there is little role for education. This is not the case. People can be trained to think logically. Furthermore, the more they know about a subject, the easier it is for them to think and act based on logic and information and not on unexamined biases, frames, and other unconscious cognitive processes. More importantly, information can influence these very processes and both social and personal norms.

Education enhances compliance in a variety of ways. Most obviously, people make fewer unintentional mistakes the more they know. They also will be less frustrated when trying to comply with the tax laws. Knowledge gained from education should also decrease a taxpayer's time spent on taxes which should also decrease frustration and increase compliance. Research shows that education also enhances compliance in more complicated ways that increase tax morale. Various techniques can encourage tax morale in the short term, but as the literature review has shown, many of the attitudes and personal norms that are components of tax morale begin to form early and accumulate over time. Consequently, efforts to improve tax morale must be ongoing and begin in a person's formative years—childhood. One education program will not suit all taxpayers. People have different learning styles— some learn better visually; others aurally, and so forth. Different audiences also require different content. In some contexts this is obvious.

A program for tax preparers should be different from one for individual taxpayers to meet the different types of tax payers' need, as well as their level of sophistication.

5.3.3 Improved client-service relationship

This looks at improving the relationship between the customers and the VAT through the staff who directly interact with clients. The organisations employees come in continuous contact with consumers and create good or bad impressions about the organisation. It is therefore important that service organisations figure out how to institute a genuine customer orientation and service mindedness in their employees (Kotler, 1991).

Staff can be trained specifically on customer service to augment the service's own in-house training. Because most services are provided by people, the selection, training and motivation of employees can make a huge difference in customer satisfaction (Booms

and Bitnor, 1998). Ideally employees should be competent, caring, responsive and problem solving (Kotler, 1991).

These measures can go a long way to create a good encounter situation for taxpayers. All things being equal, such encounters will encourage traders to file their returns regularly and pay the correct taxes.

5.3.4 Simplifying procedures

Complexity of tax administration systems is also another factor that can discourage tax compliance seriously; traders are of the opinion that the returns are cumbersome to fill and the tax offices are also not easily accessible. This is an issue that can go a long way to discourage a trader who already thinks that it does not make economic sense to pay taxes since other traders are already evading it.

In the United Kingdom, one of the objectives under the Public Spending Agreement (2002) cites the need to communicate with tax payers and to provide clear and simple forms, guidance, accurate and complete information. The Australian Tax Agency uses a model that shows responses to different levels of compliance; the model states that for traders who are willing to comply, the tax office must make it easy for the taxpayer.

Strong emphasis is placed on advising the taxpayer regarding their obligations and assisting them to comply.

The United States Inland Revenue Agency outlined in its document Compliance 2000, 'simplicity is necessary because continuous changes and complexity in tax law have a negative effect on compliance' (Internal Revenue Service, 1991).

The introduction of the VFRS has been a major step in this angle as traders now find the returns forms simple to fill. Most of the traders reported that, they are now encouraged to file their returns than when the Standard rate system was in place.

Although the questionnaire results showed that staff attitude was generally satisfactory, 17% thought staffs were rude and their concerns need to be addressed. Service marketing strategies can be employed to address this problem. The whole process of service marketing is based on the recognition that contact between service providers and their customers is the basis of a process of building relationships. People, is an essential ingredient in the service marketing mix. Recruiting the right staff and training them appropriately in the delivery of their service is essential. As stated earlier, a service encounter can be spoilt by a rude front desk officer. There should be desks manned by appropriately trained staff to address complains of traders. These desks could be removed from the main offices and situated in smaller structures like kiosks and containers closer to the trading communities.

5.3.5 Improved tax payer understanding

They should also make the taxpayer feel and understand that they are not paying unfair share of tax. This will involve improving the norms of the service to ensure trust from the customers. Customers understanding of fairness also depend on the relationship between the service and the clients and their total perception about the service. This also include measures that can be taken to educate the traders on issues bothering them that range from filling the forms to what expenditures are deductible from their sales etc. If the traders are appreciative of the fact that the tax rate is not high, that by the very nature

of the tax, not all traders can be registered, that the taxes they collect are used for development of the country, they will be more willing to comply.

In addition, writers such as Hitte (1989) have made some suggestions; this includes incorporating specific messages into adverts which have been shown to increase compliance and the use of television to change taxpayers' attitude. The issue of education can not be underestimated. It seems to be the main factor on which the whole concept of improving compliance rests.

The service should reach out to the traders more often and consider them as partners in this endeavour. Seminars should be organised more regularly, specific messages should be targeted at traders, advertisements on television etc. These should be on a constant basis and be made easy to understand.

The paper conclude by recommending that the recommendations stated above can be applied to address the age old problem of the VAT Service, i.e. the low compliance level of the trader population. The findings could be an important input, particularly to the IRB (or to other developing countries' tax administrators) in general in designing their various policies in order to enhance compliance and achieve the missions of SAS. If the trader population increase their compliance, this will go along way to improve the revenue mobilisation of the service which will also augment government's efforts at improving on internal revenue mobilisation.

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APPENDIX A

CONSENT FORM

TITLE OF THE RESEARCH:

Determinants of vat compliance among VFIRS traders in the Accra Metropolis

Purpose(s) of research:

The purpose of the research is to assess your knowledge on VAT regulations and administration and the factors that affect compliance.

Procedure of the research, what shall be required of each participant and approximate total number of participants that would be involved in the research:

You will be asked a set of using questionnaire that will assess your knowledge and past experience on contraception, among others. Information about your age, occupation, educational status would also be collected.

Expected duration of research and participant's involvement:

You are expected to spend about 30 minutes to answer the questions.

Risk(s):

The sensitive nature of the questions you will be answering is taken note of. No comments that would affect you negatively would be made and no judgment would be passed by any of the staff involved in this study.

Cost to the participants, in, or joining the research.

Your participation in this research will not cost you anything.

Benefit(s):

This study is to assess the factors that influence your compliance to VAT, which will help officials to make informed choice and authorities to improve on their service provision strategies as well as make the processes simple. Your doubt and misconception about VAT would be addressed. You are encouraged to ask any question bordering you as far as contraception and prevention of unwanted pregnancy is concern.

Confidentiality:

All information collected in this study will be recorded without your name or any identity. Your responses cannot be linked to you in anyway. Your name and identity would not be taken in this study and therefore publication of result of this study would not be linked to you at all. Your responses would not be divulged to any body. No information from this study would be used as evidence against you anywhere.

Voluntariness:

Your participation in this research is entirely voluntary and you are at liberty to withdraw from the study at any time.

Alternative to participation:

If you choose not to participate, this will not affect you in any way.

Due inducement(s):

You will not be paid any fees for participating in this research.

Consequences of participant's decision to withdraw from research and procedure for orderly termination of participation:

You can also choose to withdraw from the research at anytime without untoward consequences to you.

Modality of providing treatments and action(s) to be taken in case of injury or adverse event(s):

Statement of person obtaining informed consent:

I have fully explained this research to ----- and have given sufficient information, including about risks and benefits, to make an informed decision.

DATE: ----- SIGNATURE: -----

NAME: -----

Statement of person given consent:

I have read the description of the research or have had it translated into the language that I understand. I have also discussed it over with the interviewer to my satisfaction. I understand that my participation is voluntary. I know enough about the purpose, methods, risks and benefits of the research study. I understand that I can withdraw from the study at anytime. I have received a copy to this consent form and additional information sheet to keep for myself.

DATE: ----- SIGNATURE: -----

NAME: -----

WITNESS' SIGNATURE (IF APPLICABLE):-----

WITNESS' NAME (IF APPLICABLE): -----

APPENDIX B

SEMI-STRUCTURED INTERVIEW WITH TRADERS

Name of interviewer _____
 Sub metro _____
 Date _____

NB:

- Introduction of study and interview
- Consent requested

A. Socio-demographic characteristics

- 1) Age years
- 2) Marital status
- | | |
|---------------|--------------------------|
| i. married | <input type="checkbox"/> |
| ii. Single | <input type="checkbox"/> |
| iii. Divorced | <input type="checkbox"/> |
| iv. Separated | <input type="checkbox"/> |
| v. Widowed | <input type="checkbox"/> |
- 3) Educational level
- | | |
|--------------------------|--------------------------|
| i. Primary | <input type="checkbox"/> |
| ii. Secondary/ technical | <input type="checkbox"/> |
| iii. Tertiary | <input type="checkbox"/> |

B. Tax compliance issues

1. The VAT flat rate 3% is high that it acts as a deterrent to compliance.

Strongly agree 5 ☐ agree 4 ☐ neutral 3 ☐ disagree 2 ☐ strongly disagree 1 ☐

2. Do you see the VATS as an agency which is just in to collect your money?

Strongly agree 5 ☐ agree 4 ☐ neutral 3 ☐ disagree 2 ☐ strongly disagree 1 ☐

3. The VAT Service has done a lot as far as outreach and promotions and education are concerned to increase awareness and compliance.

Strongly agree 5 ☐ agree 4 ☐ neutral 3 ☐ disagree 2 ☐ strongly disagree 1 ☐

4. The VAT collected by the service goes a long way to improve your condition of living. i.e. Social amenities.

Strongly agree 5 ☐ agree 4 ☐ neutral 3 ☐ disagree 2 ☐ strongly disagree 1 ☐

5. The probability that the service will detect any evasion is so remote that it acts as an incentive to evade the tax.

Strongly agree 5 ☐ agree 4 ☐ neutral 3 ☐ disagree 2 ☐ strongly disagree 1 ☐

6. Penalties imposed when an evasion is detected are so severe it acts as a deterrent to tax evasion.

Strongly agree 5 ☐ agree 4 ☐ neutral 3 ☐ disagree 2 ☐ strongly disagree 1 ☐

7. Do you find the attitude of the personnel of the service very confrontational?

strongly agree 5 ☐ agree 4 ☐ neutral 3 ☐ disagree 2 ☐ strongly disagree 1 ☐

8. The whole process of complying with the calculation and filling of VAT returns is very cumbersome.

strongly agree 5 ☐ agree 4 ☐ neutral 3 ☐ disagree 2 ☐ strongly disagree 1 ☐

9. The locations of the service's offices are not easily accessible.

strongly agree 5 ☐ agree 4 ☐ neutral 3 ☐ disagree 2 ☐ strongly disagree 1 ☐

10. At the premises of the service, the personnel are most of the time friendly and ready to help.

Strongly agree 5 ☐ agree 4 ☐ neutral 3 ☐ disagree 2 ☐ strongly disagree 1 ☐

11. One of the main reasons why compliance is not encouraging is that most traders are ignorant about the VAT law and regulations.

Strongly agree 5 ☐ agree 4 ☐ neutral 3 ☐ disagree 2 ☐ strongly disagree 1 ☐

12. Non compliance is heightened because traders perceive that many competitors are not registered and thus those who are registered and being cheated.

Strongly agree 5 ☐ agree 4 ☐ neutral 3 ☐ disagree 2 ☐ strongly disagree 1 ☐

13. Most traders evade the tax because other traders do the same. It is an accepted norm among them.

Strongly agree 5 ☐ agree 4 ☐ neutral 3 ☐ disagree 2 ☐ strongly disagree 1 ☐

14. Traders believe that in the event of being caught by the service an agreeable settlement can be arrived at that is satisfactory to both the trader and personnel of the service.

Strongly agree 5 ☐ agree 4 ☐ neutral 3 ☐ disagree 2 ☐ strongly disagree 1 ☐

15. Non compliance is heightened by the perception that personnel of the service are enriching themselves at the expense of the service and the traders.

Strongly agree 5 ☐ agree 4 ☐ neutral 3 ☐ disagree 2 ☐ strongly disagree 1 ☐

16. In you opinion, state any 5 reasons why compliance is low?

.....

.....

.....

.....

.....

.....

.....

SEMI-STRUCTURED INTERVIEW WITH STAFF

Name of interviewer _____

Date _____

NB:

- Introduction of study and interview
- Consent requested

1. Do you believe that consistent education of trader population would improve compliance level?

strongly agree 5 ☐ agree 4 ☐ neutral 3 ☐ disagree 2 ☐ strongly disagree 1 ☐

2. Traders are not compliant because the tax is too high.

strongly agree 5 ☐ agree 4 ☐ neutral 3 ☐ disagree 2 ☐ strongly disagree 1 ☐

3. Do you believe the VAT Service personnel are not very motivated to work?

strongly agree 5 ☐ agree 4 ☐ neutral 3 ☐ disagree 2 ☐ strongly disagree 1 ☐

4. Logistics available to the service to carry out its enough.

strongly agree 5 ☐ agree 4 ☐ neutral 3 ☐ disagree 2 ☐ strongly disagree 1 ☐

5. The attitude of the staff towards the trader affects compliance.

strongly agree 5 ☐ agree 4 ☐ neutral 3 ☐ disagree 2 ☐ strongly disagree 1 ☐

6. Compliance will improve if the staff is able to channel feedback from traders to management and the management act upon the feedback.

strongly agree 5 ☐ agree 4 ☐ neutral 3 ☐ disagree 2 ☐ strongly disagree 1 ☐

7. The service has put in place schemes and incentives to retain its staff.

strongly agree 5 ☐ agree 4 ☐ neutral 3 ☐ disagree 2 ☐ strongly disagree 1 ☐

8. Communication channels between the traders and the service are ideal.

strongly agree 5 ☐ agree 4 ☐ neutral 3 ☐ disagree 2 ☐ strongly disagree 1 ☐

9. The service training programs are sufficient to properly equip staff to handle issues raised by traders.

strongly agree 5 ☐ agree 4 ☐ neutral 3 ☐ disagree 2 ☐ strongly disagree 1 ☐

10. The quality of staff employed by the service is good.

strongly agree 5 ☐ agree 4 ☐ neutral 3 ☐ disagree 2 ☐ strongly disagree 1 ☐

11. In your opinion state any 5 reasons why compliance is low.

12. State 5 measures that can be undertaken to improve compliance.

THANK YOU

KNUST

