

KWAME NKRUMAH UNIVERSITY OF SCIENCE AND  
TECHNOLOGY

EXAMINING THE INCIDENCE OF TAX EVASION AMONGST  
SOME SELECTED GROUPS IN THE INFORMAL SECTOR IN  
THE KUMASI METROPOLIS

By

BOAKYE ELIJAH  
B.ED ACCOUNTING

A Thesis submitted to the Department of Accounting and Finance, Kwame  
Nkrumah University of Science and Technology in partial fulfillment of the  
requirements for the degree of

MASTER OF BUSINESS ADMINISTRATION (ACCOUNTING OPTION)

School of Business, KNUST

College of Art and Social Sciences

JULY, 2015

## **DECLARATION**

I hereby declare that this submission is my own work towards the Master of Business Administration (Accounting Option) degree, 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.

Elijah Boakye (PG 9604313)

Student Name and ID

.....

Signature

.....

Date

Certified by:

Mr. Edward Yeboah

Name of Supervisor

.....

Signature

.....

Date

Certified by:

Dr. K.O. Appiah

(Head of Department)

.....

Signature

.....

Date

## **ABSTRACT**

Taxation has been one of the principal sources of revenue to the government. Funds raised through taxation have been used by the state to finance its spending programmes. In spite of the benefits of taxes, their payment and collection has been a problem for the Ghana Revenue Authority particularly in the informal sector. In undertaking a study to look into the incidence of tax evasion in the informal sector, there was the need to choose a reasonable number of taxpayers to form the target population so that a concise research could be carried out with reasonable probability of success. In view of this, the researcher chose three hundred and seventy-eight operators in the informal sector. Stratified random sampling technique was used to administer the questionnaire. The researcher used his personal judgment to select artisans, drugstores, beauticians, petty traders, grocery stores, dressmakers and caterers. The views of Tax Officials were gathered through in-depth interviews. The research found that most of the businesses in the sector do not pay income tax due to the fact that they are not registered and lack permanent business location which makes it difficult to trace them. Again, most of the taxpayers in the sector carry out transactions on cash basis and do not file income tax to the tax authorities. From the research conducted, it could be concluded that the level of tax evasion in the sector is very high. It is therefore recommended that the GRA inform and educate the taxpaying public on the need to pay taxes and also simplify the filling of income tax returns process to ensure better understanding of the tax system by the operators. They should also organize training programmes for entrepreneurs to acquire basic financial accounting skills to help them keep records. Records should be computerized to keep track of businesses and tax administration should be improved to ensure extension of services to majority of operators in the informal sector.

## **AKNOWLEDGEMENT**

I am most grateful to the Almighty God for seeing me through this course successfully.

I am also thankful to Mr. Edward Yeboah, my supervisor for his fruitful comments and suggestions to make this work complete. My appreciation again, goes to the Mr. Kwabena Owusu Nketiah, Mr. Wilson K. Nimsaah, Mr. John Kesse Donkor, Mr Samuel Fosu and Victoria Benewaa for their financial and spiritual support.

I also thank the tax officials from GRA and all respondents who availed themselves to answer the questionnaire. Finally, special appreciation goes to Miss Sylvestina Abada and Stella Sefa for their assistance in typing of this work.

## **DEDICATION**

I dedicate this thesis to my mother, Margaret Mensah and my siblings for their support throughout this course

## **TABLES OF CONTENTS**

Title Page

Declaration .....ii

Abstract .....iii

Acknowledgement.....iv

Dedication.....v

Table of Contents.....vi

List of Tables.....xii

List of Figures.....xii

### **CHAPTER ONE**

#### **INTRODUCTION**

1.0 Background of the Study .....1

1.1 Statement of the Problem .....3

1.2 Objectives of the Study .....4

1.3 Research Questions .....4

1.4 Significance of the Study.....4

1.5 Scope of the Study.....5

1.6 Limitation of the Study.....5

1.7 Organization of the Study.....6

## **CHAPTER TWO**

### **LITERATURE REVIEW**

2.0	Introduction...	7
2.1	Tax Administration in Ghana ...	7
2.2	Definition of Tax...	9
2.2.1	Purpose of Taxation...	9
2.2.2	Nature of Tax .....	9
2.2.3	Principles of Taxation.....	10
2.3	The Informal Sector in Ghana.....	11
2.3.1	Classification of Informal Sector in Ghana.....	12
2.3.2	The Rural Informal Sector.....	13
2.3.3	Forms of Labour in Rural Informal Economy.....	13
2.3.4	Urban Informal Sector.....	14
2.3.5	Features of Urban Informal Economy in Ghana.....	16
2.3.5.1	Features of the Workers in the Informal Sector.....	16
2.3.5.2	Enterprise Features of the Activities in the Informal Sector.....	17
2.3.5.3	Habitat Features of Land and Housing in the Informal Sector .....	18
2.3.5.4	Features of Informal Credit Markets.....	19
2.3.6	The Role of the Informal Sector to the Economic Development of Ghana.....	19
2.3.6.1	Contribution to National Output.....	19
2.3.6.2	Creation of Jobs and Income Distribution.....	20
2.3.6.3	Acquisition of Skills through Training.....	20
2.3.6.4	Increase in the Pace of Innovation.....	20
2.4.0	Difference between Tax Evasion and Tax Avoidance.....	21
2.5.0	Incidence of Tax Evasion in the Informal Sector.....	22
2.6.0	Factors Accounting for Tax Evasion in the Informal Sector.....	25

2.7.0	Reasons for Tax Evasion and Tax Avoidance.....	29
2.7.1	Low Level of (Voluntary) Tax Compliance.....	29
2.7.1.1	Low Quality of the Service in return for Taxes.....	29
2.7.1.3	Tax System and Perception of Fairness.....	29
2.7.1.4	Low Transparency and Accountability of Public Institutions.....	30
2.7.1.5	High Level of Corruption.....	30
2.7.1.6	Lack of Rule of Law and Weak Fiscal Jurisdiction.....	30
2.7.1.7	High Compliance Costs.....	30
2.7.2	Weak Enforcement of Tax Laws.....	31
2.7.2.1	Insufficient Tax Collection.....	31
2.7.2.2	Weak capacity in detecting and prosecuting inappropriate tax practices.....	31
2.8.0	Mechanism of Checking Tax Evasion in Ghana.....	32

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

3.0	Introduction .....	34
3.1	Research Design.....	34
3.2	The Study Population... ..	34
3.3	Sample Size and Sampling Techniques .....	35
3.4	Data Collection Instruments .....	36
3.4.1	Questionnaires.....	36
3.4.2	Interviews.....	36
3.5	Data Analysis.....	37

## **CHAPTER FOUR**

### **DATA ANALYSIS AND DISCUSSIONS**

4.1	Introduction.....	38
-----	-------------------	----



4.2	Demographic Characteristics.....	38
4.2.1	The Ages of Respondents.....	39
4.2.2	Gender .....	40
4.2.3	Marital Status of Respondents.....	40
4.2.4	Level of Education .....	40
4.2.5	Types of Business.....	40
4.3.0	Incidence of Tax Evasion in the Informal Sector.....	41
4.3.1	Business Registration.....	41
4.3.2	Permanent Business Location.....	42
4.3.3	Years of Experience.....	43
4.3.4	Annual Income.....	44
4.3.5	Awareness of the Ghana Revenue Authority.....	45
4.3.6	Tax Compliance of Respondents.....	46
4.3.7	Necessity to pay Tax.....	47
4.4.0	Incidence of Tax Evasion in the Informal Sector.....	48
4.7.1	Cash Basis of Business Transactions.....	49
4.4.2	Improper Record Keeping.....	49
4.4.3	Failure to File Tax Returns to GRA.....	49
4.4.4	Failure to Disclose True Income to GRA.....	50
4.4.5	Inflating Allowable Deduction to reduce Income Tax.....	50
4.5.0	Level of Tax Evasion in the Informal Sector.....	51
4.5.1	Cheating on Tax.....	52
4.5.2	Reporting less Income in order to pay less Tax.....	53
4.5.3	Not reporting on source of Income which you are in doubt.....	53
4.5.4	Tax Evasion as Economic Necessity.....	53

4.5.5	Voluntary Payment of Tax.....	54
4.5.6	No one to be blamed for Tax Evasion.....	54
4.6.0	Reasons for Tax Evasion in the Informal Sector.....	54
4.6.1	No Penalization.....	55
4.6.2	Misuse of Tax Revenue.....	56
4.6.3	High Probability of not being caught leads to Tax Evasion.....	56
4.6.4	High Tax Rates leads to Tax Evasion.....	57
4.6.5	Lack of Transparency leads to Tax Evasion.....	57
4.6.6	High Compliance Cost leads to Tax Evasion.....	58
4.7.0	Causes of Tax Evasion in the Informal Sector.....	58
4.8.0	Measures to Curb Tax Evasion in the Informal Sector.....	59
4.8.1	Tax Education.....	60
4.8.2	Substantial Fine.....	60
4.8.3	Court Prosecution.....	60
4.8.4	Provision of Taxpayer Services.....	61
4.8.5	Simplifying Tax Forms and Mode of Payment.....	61
4.8.6	Improvement in Tax Agency Website and Phone Advice Service.....	62
4.9.0	Suggested Measures to address Tax Evasion by GRA.....	62

## **CHAPTER FIVE**

### **SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS**

5.0	Introduction .....	63
5.1	Summary of Findings .....	63
5.1.1	Incidence of Tax Evasion.....	63
5.1.2	Level of Tax Evasion in the Informal Sector.....	63

5.1.3	Reasons for Tax Evasion in Informal Sector.....	64
5.1.4	Mechanism to Check Tax Evasion in Informal Sector.....	64
5.2	Conclusions .....	64
5.3.0	Recommendations .....	65
5.3.1	Tax Information and Tax Education.....	65
5.3.2	Improving Record Keeping amongst Entrepreneurs.....	65
5.3.3	Simplification of Procedures for filling Returns.....	65
5.3.4	Computerization of Informal Sector Businesses.....	65
5.3.5	Improvement in Tax Administration.....	66
5.4	Suggestion for Further Research.....	66
	References.....	67

## **Appendices**

Appendix I	Questionnaire for Taxpayers.....	71
Appendix II	Questionnaire for Tax Officials.....	74

## LIST OF TABLES

Table Title Page

4.1	Demographic Characteristics... ..	38
4.2	Years of Experience.....	43
4.3	Incidence of Tax Evasion in Informal Sector.....	48
4.4	Level of Tax in Informal Sector.....	51
4.5	Reasons of Tax Evasion in Informal Sector.....	55
4.6	Measures to Curb Tax Evasion in Informal Sector.....	59

## **LIST OF FIGURES**

Figure Title Page

4.1	Responses on Registration status of Taxpayers' Business.....	41
4.2	Permanent Location of Business.....	42
4.3	Responses on Level of Income.....	44
4.4	Awareness of GRA.....	45
4.5	Tax Compliance.....	46
4.6	Necessity to pay Tax.....	47

## **CHAPTER ONE**

### **INTRODUCTION**

#### **1.0 Background of the Study**

Taxation plays very significant role in the development of the country. It has been the key source through which most developing countries generate revenue. It helps in the allocation of resource, redistribution of wealth and protection of the local industries by restraining imports. It is sometimes used to correct negative externalities by foreign countries. In spite of these benefits, many developing nations continue to find it difficult to mobilize the required funds to finance their spending programmes (Fuest and Riedel, 2009)

Ghana, like other developing nations, relies so much on taxes to generate the much required revenue for public services. Due to this, Ghana's tax system has seen several structural reforms as a way of reducing the complex nature of the tax system to enhance efficiency, minimize shadow economy, discourage tax evasion and raise enough revenue.

In 1985, the initial tax reform measure of the fiscal adjustment programme was designed largely to reestablish the tax base which has been hindered by the over-valuation of the local currency. The administrative reform of 1985 also centered on measures to augment the efficiency of the tax administration and ensure equity in the tax system. A major component of this reform was the change of the Internal Revenue Service (IRS), Value Added Tax (VAT), and Custom, Excise and Preventive Service (CEPS) into the Ghana Revenue Authority (GRA), an autonomous corporate entity with new organizational structure in 2009. This new institution is set up to strengthen the role of the revenue institutions in achieving increased revenue collection and to improve the tax system to make it more efficient and equitable.

In 2007, the tax administration information system was computerized where unique identification number was assigned to tax payers to make it easy for tax collectors to trace tax payers. More so, there has been effort to reduce tax rates and also eliminate multiple tax rates in order to reduce the distortions that arise from such tax system. The e-government project was introduced in 2011 to electronically link Ghana Revenue Authority to the Registrar General's Department to ensure GRA has access to registered businesses for easy tracking and collection of tax payments.

In spite of these efforts by the state to reduce tax burden and discourage activities of the underground economy, tax evasion continue to be a problem in Ghana. The presence of a large shadow economy implies activities which can be taxed are hidden from tax authorities and such tax revenue is not collected. Tax evasion thus reduces government revenue, and reduces public services that the citizens of the country receive. It also causes distortion in the economy which influences policy makers' decision.

It must be emphasized that the economy of Ghana depends largely on individuals and small-scale businesses. The sector has different source of income which could increase state funds if well managed. According to Statistical, Social and Economic Research (ISSER, 2003), "the main source of employment in Ghana is the informal sector. The sector provides about 80% employment opportunities to the labour force". The estimated size of the informal sector of Ghana presupposes that the sector contributes significantly to the Gross Domestic Product (GDP) and if so managed well could equally make significant contribution to the tax revenue. Jobs and Skills Programme for Africa (JASPA), in a survey conducted in Accra in 1990/91 revealed that the informal sector contributes about 22% to the real GDP of Ghana (ISSER, 2003). This means that if the GDP contribution could be translated into tax revenue, government could achieve significant increase in tax revenue.

However, focus of the past and present governments of Ghana has been on the formal sector with respect to the direct tax collection. It can be suggested that if attention is paid to the private sector as the main focus of development, then the sector will experience tremendous improvement and afterwards increase tax revenue. The informal sector has been overlooked for a considerable period of time, resulting in low income tax revenue from the sector.

There seems to be no particular state policy on how the informal sector activities could be properly organized and regulated so as to increase tax collection in the sector. ISSER (2003) stated that “data on the activities of the sector are lacking in many respects due to their fragmented, unregulated and unrecorded nature”. The sector depends to a great extent, on the state resources and makes considerable profits. In spite of this, the state does not benefit that much from the profits they earn; yet, their activities cause so much damage to the environment. This calls for the need to rope these businesses in the informal sector into the tax net so as to increase government tax revenue.

### **1.1 Statement of the Problem**

Taxation has been one of the principal sources of revenue to the state. Funds raised through taxation have been used by the state to finance its spending programme. In spite of the benefits of taxes, their payment and collection has been a problem for the Ghana Revenue Authority particularly in the informal sector. It has been estimated that about 86.3% of self employed in the informal sector carry out their economic activities from informal structures. Out of this percentage, less than 30% are assessed to tax Ghana Statistical Survey (2008). This is due to unreformed tax laws, inefficient legislation, corruptions, lack of patriotism, poverty and ineptitude on the part of successive government to strengthen the ways through which tax is generated in the country. As a result, tax evasion has continued to reduce tax



revenue to government and for the nation to achieve increased tax revenue; tax evasion should be checked to reduce its incidence especially in the informal sector.

## **1.2 Objectives of the Study**

### **1.2.1 General Objective**

To examine the incidence of tax evasion amongst some selected groups in the informal sector in the Kumasi Metropolis.

### **1.2.2 Specific Objectives**

1. To find out the incidence of tax evasion amongst some selected groups in the informal sector from GRA perspective.
2. To assess the level of tax evasion amongst some selected tax payers in the informal sector.
3. To examine the reasons for the incidence of tax evasion amongst these selected tax payers in the informal sector.
4. To examine the mechanism put in place to check tax evasion in the informal sector.

## **1.3 Research Questions**

1. How does tax evasion occur amongst some selected groups in the informal sector from GRA perspective?
2. What is the level of tax evasion in the informal sector?
3. What factors account for tax evasion amongst the selected groups in the informal sector?
4. What mechanism has been put in place to check tax evasion in the informal sector?

## **1.4 Significance of the Study**

Governments in developing countries continue to lose huge sums of money in the form of uncollected tax revenue especially in the informal sector. A large part of this sector continues

to slip out of the tax net, even as government ponders and intensely seeks to evaluate this problem. This has necessitated the need to delve into this problem in the informal sector, hence the study sought to look into the incidence of tax evasion in the informal sector and how it could be reduced.

The outcome of this study is expected to provide a vivid understanding of the extent of tax revenue which is left uncollected and the factors contributing to its existence which is necessary for smooth formulation and implementation of policy in order to reduce tax evasion. The outcome of this study is also expected to compliment the body of existing literature on the topic particularly in developing countries like Ghana

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

This study attempted to find out the incidence of tax evasion in the Ghanaian economy with respect to individuals and small-scale enterprises in the informal sector within Kumasi Metropolis. It examined the incidence of tax evasion; the level of tax evasion; the reasons for tax evasion and the mechanism to check tax evasion in the informal sector.

### **1.6 Limitations of the Study**

As a result of the small size of the sample used for this research, the researcher believes that the outcome of this study may not be generalized beyond the specific population out of which the sample was drawn. It is believed that the respondents sampled for the study may not have responded to the questions with sincerity and that the findings from the study based on the sampled group might not show true reflection of the opinion of all the people in the included population. This is more so due to the fact that people are unwilling to give correct information concerning their incomes and tax issues (Coskum and Savasan, 2009).

## **1.7 Organization of the Study**

The study has been organized into five chapters. Chapter one focused on the overview of the study which included the background of the study, statement of the problem, objectives and significance of the study. Research questions were forth put and concluded with the scope and limitations of the study. Chapter two considered the review of related literature on tax evasion in the informal sector in Ghana. Chapter three covered the methodology of the study which gives detailed explanation on how the research was conducted. It employed such tools as research design, population and sampling techniques. In chapter four, opinions of respondents and tax officials on the topic sought were analysed and discussed andchapter five presented the summary, conclusion and recommendations of the study.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.0 Introduction**

The aim of this chapter is to give a thorough insight to the incidence of tax evasion in the informal sector in Ghana, comprising all related literature which was reviewed under sub-headings. The review is essentially structured into theoretical and empirical as well as explanation of terms.

#### **2.1 Tax Administration in Ghana**

Despite dramatic improvement in tax collection, there is little doubt that the state continue to loose huge sums of money in the form of taxes. In 1943, the income tax department per the provision in the Income Tax Ordinance (No. 27) was responsible for tax collection in Ghana. The name was changed to Central Revenue Department in 1965 as a result of the introduction of other taxes and duties. This has undergone re-organization in 1986 and was replaced by Internal Revenue Service (Internal Revenue Service Act, 2000). This law transformed the central department into a public sector organization. Before the passage of the P.N.D.C. law 143 in 1986, the government in 1985 set up the National Revenue Secretariat (NRS) to supervise the revenue agencies. The Ministry of Finance gave them the autonomy to carry out their work. In 1991, the Secretariat lost its power and put between the sectors ministry. Ghana has undertaken series of tax reforms since the commencement of the Fourth Republic in 1992. The Value Added Tax was introduced in 1995 but was withdrawn as a result of mass protest by the citizens of the country and it was reintroduced in 1998 after comprehensive education of citizens.

Besides, measures have been put in place to encourage direct (personal and corporate) tax payment by small-scale self-employed business persons. A major reform in recent times

(2009) has resulted in the integration of the three major revenue institutions - Internal Revenue Service, the VAT Service and the Custom, Excise and Preventive Service, (CEPS) into a single agency - Ghana Revenue Authority (GRA). Ghana Revenue Authority has been divided into three divisions. These comprise of the Domestic Tax Revenue Division, Custom Division and Support Services Division. The Authority has a Commissioner General as the overall head and a Commissioner heading each division. This gives a pyramidal organizational structure with the view of making it one of the world class revenue administration agencies.

According to Drucker (1979), the absence of a good organizational structure makes a good performance very difficult but the structure itself cannot produce good performance. Though the Authority has good organizational structure, its desired impact on operations especially in the informal sector is yet to be felt. For effective and efficient discharge of duties, the functions of the Authority have been defined as:

- i. to make assessment and collection of taxes, interest accrued and punishment on taxes due to the Republic;
- ii. to deposit into the Consolidated Fund the amount collected unless otherwise provided by the Act and other Acts;
- iii. to carry out tax education and promote tax compliance;
- iv. to fight tax fraud and evasion in collaborated effort with revenue agencies in other countries and other competent law enforcement agencies;
- v. to advise the District Assemblies on how to assess and collect their tax revenue;
- vi. to assemble and print out reports and statistics related to its revenue collection;
- vii. to make suggestions to the Minister on revenue collection policy; and
- viii. to carry out any other duties as prescribed by the Minister or by any other enactment relating to revenue.

## **2.2 Definition of Tax**

Dalton (1920) defines tax as a mandatory contribution applied by a public authority, regardless of the amount of service rendered to the taxpayer in return, and not as penalty for any legal offence. The Webster's New World Dictionary defines tax as a mandatory payment, normally a percentage, imposed on income, property value, sales price, to mention but a few, for the support of a government. Hunter (1965) defined tax as "contribution from citizens for the support of the state". The key aspect evident in the above definitions is that there is a legal compulsion to pay and that they are imposed by law.

### **2.2.1 Purpose of Taxation**

Ali Nakyea Abdallah outlined the main purpose of taxation in his book "Taxation in Ghana" as:

- i. collecting revenue to pay the cost of services rendered by the state;
  - ii. reducing unfairness resulting from wealth distribution;
  - iii. protection of indigenous industries;
  - iv. reduction in certain types of consumption and control of certain aspects of the economy, for example, balance of payment, productivity, investment and savings
- (Abdallah 2008)

### **2.2.2 Nature of Tax**

Three general forms of tax exist. These are proportional, progressive and regressive taxes. Each form of tax is grouped in accordance with how the tax burden changes with income Clayton (1983).

#### **i. Proportional Tax**

This tax does not consider the income of the taxpayer but levies the same percentage rate of tax on every taxpayer. If the percentage tax rate is constant, the average tax rate is constant,

regardless of income. The percentage of tax paid in taxes on income does not change irrespective of income.

**ii. Progressive Tax**

Under this system of taxation, the percentage rate of tax charged on income increases as the income of the person increases. This means that the amount and percentage of income paid in taxes increase as income increases.

**iii. Regressive Tax**

This tax imposes a higher percentage rate of tax on low income than on high income. The person with lower income pays higher percentage of total income in taxes than the person with higher income.

### **2.2.3 Principles of Taxation**

Adam Smith (1778) describes the qualities as canons of taxation and gave four important qualities which are still important today:

**i. Equity**

The people who are supposed to pay the tax must see some fairness in the tax system as it is their duty to support the government in proportion to their respective abilities. Ability to pay refers to the economic resources that a person has control over.

**ii. Certainty**

A good tax system should enable people to ascertain the amount of tax payable with some fair degree of accuracy. The taxpayer should not find it difficult to determine the amount of tax payable at any point in time. Tax administrators should not use discretionary power to determine the amount of tax payable and the system should be unambiguous.

### **iii. Convenience**

A good tax system should be simple for the government to manage and for the people to pay. The taxpayers must not suffer too much in order to comply with the tax laws and it should be convenient for the contributor to pay it.

### **iv. Economy**

A good tax system should not be too costly for government to operate. The managerial cost of gathering and administering the tax should not exceed the total revenue produced by the tax.

## **2.3 The Informal Sector in Ghana**

In lay person view, the informal sector refers to businesses that are run on small scale which employ simple skills to generate income and which are not bound by any government regulations. The sector mainly operates on subsistence basis with few employees, who are mostly self-employed individuals. Different researchers have come out with different definitions about the term in the existing literature and some of the definitions are given below:

"All economic activities that contribute to the officially calculated gross national product but currently unregistered" (Fiege 1994)

"Market - based production of goods and services, whether legal or illegal, that escape detection in the official estimates of the gross domestic economic enterprises or activities" (Hart 1970)

Farrell et al. (2000) gives two approaches to describe informal sector activities: the Definitional and Behavioral approaches. According to Farrell et al. (2000), the Definitional Approach of informal sector "is economic activity unrecorded in the official statistics such as the gross domestic product and/or the national income account". Behavioral approach on the



other hand, considers that "informal sector is based on whether or not activity complies with the established judicial, regulatory, and institutional framework" (Farrell et al., 2000). The International Labour Organization (ILO) thus defines the informal sector as "one characterized by easy entry, reliance on indigenous resources, family ownership of enterprises, small scale of operation, labour - intensive and adapted technology, skills acquired outside the formal school system, and unregulated competitive markets".

From the above definitions of the informal sector, it is evident that the informal sector does not have one concise definition which is acceptable worldwide. However, from the varied definition of the concept in the existing literature, they all talk about the unregistered nature of informal sector enterprises. This makes it very difficult for tax authorities to administer tax in the sector.

According to Ghana Statistical Service (2008) report on rural Ghana, the informal sector work mainly involves fishing, fish processing, agriculture and agro-based processing. In contrast, non-agricultural activities engage more urban workers (45%) than the agricultural activities. The informal sector covers a wider part of the economy in contrast to the view many hold as micro and small business such as vendors and hawkers. Many businesses such as public transport, housing, and other related services, industries are run under the guise of informal sector with the purpose of escaping the tax net.

### **2.3.1 Classification of Informal Sector in Ghana**

Adu-Amankwah (1999) grouped informal sector in Ghana into two broad headings in his analysis of Ghana Trade Union Congress (GTUC) leadership group survey in 1995 as: Rural Informal Sector and Urban Informal Sector.

### **2.3.2 The Rural Informal Sector**

The rural informal sector is characterized by the following:

#### **i. Agricultural Activities**

The agricultural activities are mostly farming units which depend largely on people in the family and they comprised of a large number of small farmers in the rural and semi-urban areas. These farmers have not acquired any formal training and are mostly illiterate or semi-literate. Farming skills are obtained through apprenticeship and farm land is usually acquired through inheritance.

#### **ii. Fishing and Fish Processing Activities**

These activities are found normally in the coastal areas and the operators are mostly married males. These workers are dominantly illiterates who get their swimming skills from their childhood experiences. The wives and close relatives of these fishermen basically undertake value adding and processing activities that include smoking and marketing of the fish.

#### **iii. Rural Agro-Based Processing Activities**

These activities involve processing of raw materials into finished or semi-finished products such as palm wine tapping, local pito brewery, traditional soap making and others. These workers are mostly married with no formal education. They usually acquire their skills from within the family and normally experience seasonal unemployment

### **2.3.3 Forms of Labour in Rural Informal Sector**

According to Adu-Amankwah (1999), the form of labour in the rural informal sector is determined by the contract of employment under which rural labourers are engaged and they include:

**i. Family Labour**

This type of labour is a typical feature of rural informal labour. It is regarded essential for the survival and sustainability of the business. It is used as a kind of apprenticeship to pass on skills from one generation to the next

**ii. Casual Labour**

This is another key type of labour in the rural informal sector. It is mostly found in areas where workers are needed to clear land, prepare mounds, plant and weed, apply fertilizer and harvest farm produce. They usually migrate from the northern part of the country to work in the southern half of Ghana. Those who are not migrants, normally grow food on subsistence basis. They usually receive payment by cash and sometimes in kind.

**iii. Apprenticeship**

According to Monk et al (2008), apprenticeship makes up nearly 25% of working-age Ghanaians. The system of apprenticeship is highly developed which provide people with skills under the tutelage of their masters which are used primarily in the informal sector. These apprentices are not normally paid but are given pocket money or catered for in kind.

**iv. Communal Labour**

This is a practice whereby farmers within an area come together to help each other in turns. Most Ghanaian communities have depended on forms of co-operative labour to provide social amenities. People living in small towns would come together from time to time under the supervision of the chief or elders to provide or maintain certain socio-amenities in the town.

### **2.3.4 Urban Informal Sector**

The study conducted by Hart in the 1970s on urban informal economy in Ghana which is seen as the foundation for further studies on informal economies around the world reveal a heterogeneity and variety in the operations in the informal sector which he grouped under the following headings: service, construction, and manufacturing.

#### **i. Service**

Service workers comprise of urban food traders and processors, health and sanitation workers, repairers, garages, graphic designers, audio-visual workers and private security men who normally do not have the chance to advance their careers and also have no social security protection;

#### **ii. Construction**

Workers in the construction industry comprise of carpenters, steel benders, masons, and electricians, house-wiring and small-scale plumbers who are often young males with low educational standards. They normally receive their training through the system of apprenticeship except electricians who often receive some basic training;

#### **iii. Manufacturing**

The predominant activities in the manufacturing sector in the informal sector include textile and garments, wood processing, food processing, and metal works. Men dominate metal works and wood processing while women dominate food processing. Skill acquisition and employment are received through years of apprenticeship.

### **2.3.5 Features of Urban Informal Sector in Ghana**

Ofori (2009) highlighted certain characteristics that have been associated with urban informal sector in his work on Taxation and the Informal Economy in Ghana, which have been grouped into four main categories:

- i. Features of workers in the Informal Sector
- ii. Features of the activities in the Informal Sector
- iii. Features of Land and Housing in the Informal Sector
- iv. Features of the Informal Credit Market (Farrell et al, 2000)

#### **2.3.5.1 Features of the Workers in the Informal Sector**

##### **i. Lack of Protection and Attention**

Most of the enterprises in the sector, for fear of being taxed, do not want their identity to be established and hence, are not protected by state machinery in the form of legislations which are meant to protect them from vicious fraudsters (Farrel et al, 2000; Ofori, 2009)

##### **ii. Dominance of Self - Employment Work**

Most of the operators in the urban informal sector like doing things alone than in group and the presence of varied activities make it very difficult to form trade unions to protect their interest. They usually fear that by forming trade unions may expose them and subsequently identified for tax purpose.

##### **iii. Lack of Trade Union Organizations**

Urban informal sector operators are individualistic in nature with a wide range of activities which make it very difficult to form trade unions to protect their interest. They usually fear that formation of trade unions may expose them and risked being formalized and subsequently pay tax.

**iv. Lack of Social Security and Minimum Wage Legislation Coverage**

Many of the workers in the sector are often underpaid and do not receive their employer's contribution towards their pension. These activities go unpunished because the law enforcement agencies find it difficult to detect such illegal acts. These activities are often not reported to the enforcement agencies by the employees for fear of being sacked (Farrel et al, 2000; Ofori, 2009).

**v. Lack of or little Job Security**

Employees in the urban informal economy often do not have binding contract with their employers which give them the legal power to challenge them in case of wrongful dismissal. They often lose their jobs at any point in time and receive little or no compensation (Farrel et al, 2000; Ofori, 2009)

**2.3.5.2 Enterprise Features of the Activities in the Urban Informal Sector**

**i. Easy Entrance**

The startup capital required for running a business in the sector is very low and so people may easily form businesses in the sector. There is also no strict entry requirement in the sector. According to Yankson (1992), entrepreneurs in the urban informal sector usually employ labour-intensive technology.

**ii. Over Reliance on Local Resources**

Most businesses in the sector are quite small in size and do not have the capacity to do off-shore acquisition of resources to run their businesses. Hence, the sector businesses rely largely on the resources available on the local markets. These resources are obtained from different sources which are sometimes self-made or second-hand. They also depend on the local resources for their raw materials which are normally from the formal sector units in the cities (Ofori, 2009; Barwa, 1995)

### **iii. Dominance of Small Scale Operations**

Urban informal sector businesses are often owned by individuals and generally last for less than five years. The size is often determined by the number of family members and apprentices engaged Yankson (1992).

### **iv. Family Ownership**

Urban informal sector businesses are mostly dominated by family ownership. This is largely due to cheap source of labour provided by family to these businesses. Individuals do not form partnership and joint ventures due to lack of trust.

## **2.3.5.3 Habitat Features of Land and Housing in the Informal Sector**

### **i. Unauthorised Use of Available Public or Private Land**

Most of the operators in the informal sector operate from clusters which are nearer to cities particularly those engaged in metal works, auto repairs, but may be located at strategic points in order to reach out to clients. In developing nations, operators mostly use small containers and kiosks to run their businesses which are found almost every corner in the towns and cities (Barwa, 1995; Ofori, 2009)

### **ii. Unauthorised Construction of Structures and Buildings**

Operators in the urban informal sector usually put up their houses at where they normally carry out business operations. They sometimes lack legal title to the land they use for such structures.

### **iii. Reliance on Low Cost Materials**

They usually build structures that are of poor quality as a result from their inability to meet the high cost of quality building materials. This has resulted in the springing up of slums in

the urban centers which poses serious health and environmental challenges to the governments in most of the developing countries (Ofori, 2009).

#### **2.3.5.4 Features of Informal Credit Markets**

##### **i. Easy Accessibility**

Most of the businesses in the urban informal sector grant credit to their clients due to the fact that people who patronize their goods and services are largely from the poor class. The only way of sustaining business in the informal sector is to grant credits (Ofori, 2009; Barwa, 1995).

##### **ii. Availability of Small and Short Term Credits**

Businesses in the urban informal sector normally grant small credit due to the small nature of businesses. The credit is often granted for a short term and to people whom the operators personally know who do not need critical assessment (Ofori, 2009; Barwa, 1995).

#### **2.3.6 The Role of Informal Sector to the Economic Development of Ghana**

Operators in the informal sector make enormous contribution to the national development. The informal sector contribution to national development of Ghana include acquisition of skills, creation of jobs and production of goods and service (ISSER, 2003). Some of the contributions of the informal sector to national development include:

##### **2.3.6.1 Contribution to National Output**

The informal sector has helped to produce different kinds of goods and services to support national growth. It was confirmed in a survey conducted by JASPA (1989) that the sector contributes about 22 percent of real GDP on value-added economic activities. The non-agricultural sector also made a contribution of about 52 percent in trade and commerce while the industry, service and transport contributed 28 percent, 12 percent and 8 percent



respectively. The rural informal sector plays crucial role by providing food to feed the nation from the agriculture sector.

#### **2.3.6.2 Job Creation and Distribution of Income**

The informal sector has seen great expansion due to the fact that the formal sector cannot provide enough job opportunities to the citizens of the country. The informal sector has become the main source of employment in Ghana and provides employment to about 80 percent of the workforce in the country as indicated in the ISSER (2003) report. The retrenchment and privatization of the public sector by the Government of Ghana between 1988/89 and 1991/92, brought to light the crucial role of the informal sector as employment source. As a result of this exercise, the total workforce in the informal sector increased significantly.

The informal sector operators receive income in return for their labour. This has been a major source of income to the poor and illiterates who cannot find work in the formal sector. Furthermore, the role of the informal sector was felt during the economic decline from 1970 to 1983 where income per labourer in the urban centers declined considerably. The sector helped to alleviate the mass poverty that hit the urban centers. (ILO/JASPA, 1989)

#### **2.3.6.3 Acquisition of Skills through Training**

The informal sector is well-noted for providing training to the labour force to acquire non-industrial skills. This is normally obtained through the apprenticeship system and it does not provide adequate manpower training required for industrial employment (Yankson, 1992).

#### **2.3.6.4 Increase in the Pace of Innovation**

Most small businesses in the informal sector make unproportionate commitment to innovation while the number and significance of innovation vary by industry. Despite the fact

that there is high rate of failure among small enterprises as a result of extra risk they incur, they play very significant role in bringing out productive thoughts which can be enhanced into competitive commodity and processes. Sometimes, many of these innovative firms cannot be found again not because they have attained their objectives or merged into another firm, but they serve as bedrock for the innovation.

#### **2.4 Difference between Tax Evasion and Tax Avoidance**

There exist no clear-cut difference between tax evasion and avoidance. One needs to classify which practices violate or abuse the tax codes. Tax evasion in general means using illegal way to avoid tax liability. Thus, the income of individuals, profits from business activities and other activities subject to tax are concealed, the income source are falsified, or intentionally overstating the allowable deductions (Alm and Vazquez, 2001; Chiumya, 2006). In contrast, tax avoidance occurs where individuals and firms take advantage of the tax code and exploit "loopholes" in it. It usually embraces special activities which seek to reduce tax liabilities. Examples of tax avoidance include tax postponement income splitting, and tax arbitrage across income that faces different tax treatment.

Kay (1980) argues that tax evasion occurs when the nature of transaction is concealed or misrepresented. However, tax avoidance occurs when the facts of the transaction are admitted but they have been arranged in a way that the resulting tax treatment differs from that intended by the relevant legislation. Thus, the distinguishing feature of evasion is illegality. Most often these actions concern individual income tax but corporate and other taxes can also be the object of tax evasion.

## **2.5 Incidence of Tax Evasion in the Informal Sector**

Tax administrators in the developing nations are confronted with the challenge of tax evasion especially in the informal sector which employs the largest active Ghanaian labour force and functions as the potential source of revenue to the government to meet its spending programmes, largely remains untaxed. According to World Bank (2002) report the government of Ghana continues to lose large sum of money from tax revenue in the informal sector.

Several attempts have been made to tax the informal sector in the past. The methods adopted were to some extent, successful and they were largely presumptive in nature. The first attempt made to tax the informal sector in Ghana was initiated in 1965, when the Standard Assessment Act, 1963, Act 205 was passed. This Act has seen several changes over the years before it was consolidated with The Internal Revenue Act, 592, 2000. Under the scheme, individual firms in the informal sector were charged fixed lump sum tax based on their business activities. The levies charged were determined by the average income earned by members of a particular occupation or business grouping. One major advantage of the scheme was that vertical equity is improved, in that some professionals such as dentist, doctors, and lawyers were required to pay some amounts even though was proportional to their personal efforts. (World Bank, 2002).

In spite of this advantage, the scheme could not achieve its objectives due to some setbacks. "The World Bank in its article titled "Tax compliance and Informal Sector in Ghana" identified the following setbacks:

- i. Ineffective monitoring by tax administration as a result of poor administrative capacity exhibited by them. This manifested in the informal transport sector, where inspection of clearance certificate, which were to be done by the tax administrators

were left in the hands of the police and licensee office, who colluded with the operators and collected cash instead of ensuring compliance (World Bank, 2002)

- ii. The tax payers in the informal sector deemed the lump sum payments to be too high which resulted in tax evasion by small-scale businesses who did require clearance certificate in order to start business activities (World Bank, 2002)
- iii. The over centralized tax administration affected the achievement of the policy objectives even though the scheme did well to identify and create list of small businesses.

Another attempt to tax the informal sector in Ghana was made through the introduction of the Identified Grouping Taxation to replace the standard assessment scheme. Under this, members were grouped according to their occupation to form unions such as GPRTU, market women union, hawkers union, and others. With this in place, the tax policy shifted attention to usual practices where provisional assessment and quarterly payments are made. Again, businesses in the informal sector found it difficult to comply with and resulted in tax evasion.

In 1986, the standard assessment scheme was refined and reintroduced again which was known as Identifiable Grouping Taxation. A prototype was enrolled in the transport sector and the outcome resulted in the enactment of the Income Tax Amendment Law 1987, PNDCL 177. This law required persons owning specified vehicles to pay a specific rate of tax. The tax payment was categorized into two; one category comprised of taxi and inter-city commuter who were required to pay certain daily amount based on number of passengers and the second category comprising of cargo and, long distance trucks which were made to pay a certain percentage of their gross sales per trip.

The scheme which was considered to be final tax payment was later on, replaced by installment payment which required transport owners to file their returns at the end of the

assessment year. Agents were appointed from the occupational groups and were given commission ranging from 2% to 2.5% of their annual collections (World Bank, 2002). Again, the effort to widen the tax net in the informal sector brought about a new scheme called "tax stamp". Under this scheme, lump-sum of tax is paid quarterly and it was administered by the Internal Revenue Service (IRS). The scheme was adopted as a way of correcting the weakness as in the aforementioned schemes. The tax stamp scheme worked very well with the transport operators as they are required to purchase the stamp at the beginning of each quarter and fix them on their windscreen. Fine is imposed on any operator who fails to produce a tax stamp upon request by the authorities. However, the enforcement of the tax stamp on informal sector operators became very difficult because of mobility of these operators. Hence, sizeable number of operators in the informal sector still remained outside the tax net.

Gold Smith (1951) identified three ways through which tax evasion in the informal sector occur: understatement of income; non-declaration of income; and overstatement of allowable deduction.

**i. Understatement of Income.**

Taxpayers often evade taxes by reporting less income in order to pay fewer taxes. The Internal Revenue Act outlines sources through which businesses earn income as income from business, investment and employment. Most of these operators do not disclose all of their income sources. This makes it very difficult for tax authorities to make fair assessment of income tax.

**ii. Non- Declaration of Income**

According to the Internal Revenue Act, 2000, Act 592, income earners are expected to furnish the tax authorities with statement of their income within the four months after the

basis period. Majority of operators in the informal sector fail to furnish return of income annually and this is by far the obvious source through which people evade taxes in the informal sector. The furnishment of the income tax returns is the surest way to determine the actual income and ascertaining the tax payable by the taxpayer.

### **iii. Overstatement of Allowable Deductions**

Most businesses in the sector inflate their deductions in order to report smaller amount of taxable income. Section 13 of Internal Revenue Act, 2000, Act 592, spells out what constitute allowable expenses which shall be deducted from income for tax purposes. Yet, many operators in the sector mingle their personal activities with that of the business which tend to inflate their expenses which is charged against their income thereby reducing their tax liability (Otioku, 1992)

## **2.6 Factors Accounting for Tax Evasion in the Informal Sector**

All present day contemporary societies are grounded on the mandatory payment of taxes. Hence, great efforts are made to enforce tax compliance. According to Cummings et al. (2009), tax administrators in developing economies face the problem of encouraging high levels of tax compliance. Developed countries' tax revenue as a proportion of their GDP is much higher than developing countries. The distinction in tax revenue between the developed and developing nations of the world is completely classified by the weakness of direct taxation. For instance, Sub-Saharan Africa countries have direct tax proportion of 7 % of GDP while industrial countries have direct tax proportion of 22% of GDP. In comparison, developing countries mobilization of funds from direct taxation is roughly 10% of GDP, which is the same level as developed countries Auriola and Walters (2005). This plainly demonstrates a low level of tax compliance in developing countries.

Herschel (1978) cited in Sookram and Watson (2005) founded that tax evasion in developing countries tend to be broader, since these countries depend largely on few large businesses, less affluent individuals, low tax morale, decreased chances to fall back on tax avoidance schemes and less utilization of tax experts. Furthermore, Jimenez et al.(2000) in their research have pointed out that, the reason for evasion include certain feature of the countries in the region, for example, the vast underground economy, the financial limitation of taxpayers, and the high concentration of income

One outstanding literature on tax evasion by Jackson and Milliron (1986) identified fourteen major factors that contribute to tax evasion. This study considered the impact of six (6) of Jackson and Milliron (1986) key variables which include:

**i. Knowledge of Tax Evasion Opportunities**

An increased knowledge of tax evasion opportunities tends to have adverse effect on tax compliance as it aids non-compliance. On the other hand, most of the studies examining the effect of education on tax evasion use taxpayers general education level as the approach to measure tax evasion Richardson (2006). Another study conducted by Wallschutzky (1984) has shown an adverse relationship between the general educational level of taxpayers and tax evasion

**ii. Sources of Income**

Source of income refers to the nature or type of income of the taxpayer Jackson and Milliron (1986). Schmolder (1970) cited in Richardson (2006) and Wallschutzky (1984) demonstrate that income taxation is unsuccessful when majority of a country's labour force are engaged in the agriculture and petty trading. The least chance being taxpayers whose source of income is reliant on wages or salaries subject to withholding such as from the service sector.

### **iii. Tax Rates**

Research carried out by Clotfelter (1983) found the relationship between tax rates and tax evasion. He pointed out that there is a positive relationship between marginal tax rate and tax evasion, while Feinstein (1991) shows a negative relationship between them. Richardson (2006) contended that not controlling the connection between the marginal tax rates and income level may result in this variation.

### **iv. Fairness and Tax Evasion**

Studies conducted by Barth et al (2006) and Jackson and Milliron (1986) pointed out that there is a relationship between fairness and tax evasion. The significance of taxpayers perceive knowledge of fairness should not be overlooked. Richardson (2006) discovers an important negative relationship between the two variables generally. Song and Yarbrough (1978) in Richardson (2006) likewise distinguish negative relationship between these variables, with 75 percent of taxpayer subjects expressing that the fairness concept of 'ability to pay' is more important for tax evasion than is the 'benefit' concept.

### **v. Tax Morale**

Cummings et al (2005) has contended that tax morale influences tax compliance, while Jackson and Milliron (1986) stressed that tax morale is a fairly obscure idea in light of the fact that it portrays the moral standards or qualities people hold about paying taxes. Early survey research by Tittle (1980) discovers that tax morale of individuals has an adverse relationship with tax evasion.

### **vi. Revenue Authority Initiated Contact**

Richardson (2006) has argued that revenue authority initiated contact is also key determining factor for tax evasion. In a major study of tax structures in Europe, it was noticed that countries which have the history of enforcing tax compliance, have the lowest tax compliance



rates Jackson and Milliron (1986). Study conducted by Wallschutzky (1984) also supports this view.

Otieku (1988) also outlined number of factors that account for tax evasion in the informal sector which include dominance of cash transactions, low standard of record keeping, lack of voluntary compliance, illiteracy, and inaccessibility to tax office.

**i. Domination of Cash Transaction**

In Ghana, most businesses in the informal sector transact business on cash basis ignoring the use of cheques. Dealing in cash transaction, which is paying for goods and service with cash makes it very difficult to trace transactions. This creates room for businesses to evade tax since they can manipulate records and figures for tax reduction purposes.

**ii. Low Standard of Record Keeping**

Many businesses in the informal sector in the developing countries do not keep records of their business transaction. Some do keep record but at a very poor state and in tax administration, the proper assessment of tax liability lies in the correct determination of the income of the tax payer (Otieku, 1988). Agyei (1984) has it that low standard of record keeping occur due to three contributing factors: illiteracy, high fees charged by the accountant and general shortage of qualified accountant. These factors make it difficult for the self-employed taxpayers to hire the service of the accountants to keep good records of their businesses.

**iii. Lack of Voluntary Compliance.**

Satisfactory income taxation depends largely on the willingness of the taxpayer to comply with the tax laws. In society when attempts by taxpayers to evade tax receive little or no moral disapproval become extremely difficult for tax administrators to achieve their

objective. The need to work at voluntary compliance is the key to achieving sustainable tax compliance over the use of force Otieku (1988).

#### **iv. High Level of Illiteracy Rate.**

It is well established that about sixty percent of the informal sector operators are illiterates who find it difficult to file income returns and prepare accounts. This is as a result of complexity in the completion of the income tax return form and this makes it difficult for fair assessment of income of taxpayers by tax authorities to be made Otieku (1988).

### **2.7 Reasons for Tax Evasion and Tax Avoidance**

Variety of reasons account for tax evasion and tax avoidance which is categorized into those factors which adversely affect taxpayers' compliance and the reasons behind the low capacity of tax administration and fiscal courts to enforce tax liabilities. These include:

#### **2.7.1 Low Level of (Voluntary) Tax Compliance**

##### **2.7.1.1 Low Quality of the Service in return for Taxes**

In general, people expect some kind of benefit or service in return for the taxes they pay. If the government fails to provide basic public goods and services or they are inadequately provided, people may be unwilling to pay taxes resulting in tax evasion (Everest-Phillips, 2008; Lieberman2002; Pashev, 2005; Brautigam et al, 2008)

##### **2.7.1.2 Tax System and Perception of Fairness**

Some researchers have argued that there is an inverse relationship between tax rates and tax evasion. This means that as tax rates increase, the tax burden too increase which affect the disposable income of the taxpayer (Chipeta, 2002; Alligham and Sandmo, 1972). However, the tax rate may not be the only determining factor but how the entire tax system has been structured could also influence people's decision to pay tax.

### **2.7.1.3 Low Transparency and Accountability of Public Institutions**

The willingness of taxpayers to evade taxes largely depend on their lack of trust for both the tax system and the government resulting from lack of transparency and accountability in the use of public funds Kirchler et al (2007)

### **2.7.1.4 High level of corruption**

The willingness of taxpayers to pay taxes suffers where there is perception of high levels of corruption as to how public funds are used Kirchler et al (2007). A taxpayer would be eager to bribe tax auditor if the cost of doing so is lower than the potential benefit from tax evasion.

### **2.7.1.5 Lack of Rule of Law and Weak Fiscal Jurisdiction**

Strong fiscal courts are crucial to ensure taxpayers are protected from arbitrariness. In a situation where this is lacking, people tend to fear arbitrariness, unequal attendance, discrimination and so on. This lack of rule of law decrease transparency of public action and encourages doubts amongst people. Therefore, people may be unwilling to fund the state through taxes and choose to avoid these liabilities Kirchler et al (2007)

### **2.7.1.6 High Compliance Costs**

The costs associated with gathering and filing out tax returns form can also be a reason for tax evasion. The World Bank's 2008 World Development Indicator for " time to prepare and paying taxes" reveals huge contrasts between countries: In Organization for Economic Cooperation and Development (OECD) countries with high income, an average of 210 hours is required to prepare and pay taxes while the required average time in Ghana extend to 224 hours and even 2600 hours in Brazil.

Similarly, small and medium sized enterprises (SME) in Sub-Saharan African countries experience high compliance costs. A survey conducted in South Africa by SBP (2005)

showed that taxes are seen as the problematic set of rules followed by labour regulations. Most importantly, it is the printed materials that must be studied carefully in order to comply with tax legislation which hinder firms from paying the appropriate taxes. The research further revealed that about 18 percent reiterated their desire to evade tax if the cost of coping with regulation on running their business is high.

## **2.7.2 Weak Enforcement of Tax Laws**

### **2.7.2.1 Insufficient Tax Collection**

Most developing nations face the challenges with regard to sound tax administration, particularly with identification of taxpayers for tax purposes. Even though these economies have experienced great improvement yet they continue to find it difficult to have a well-functioning tax registers in place to trace taxpayers. The problem of insufficient capacity most of the time occur resulting from the relationship between the structure of the tax administration and the Ministry of Finance (Fjeldstad and Moore, 2009; Chiumya, 2006).

### **2.7.2.2 Weak Capacity in Detecting and Prosecuting Inappropriate Tax Practices**

The absence of sufficient capacity in tax administration decreases the chance of detecting tax fraud that impacts the decision of a taxpayer as to whether to evade or not. More so, the legal framework is an essential condition for any enforcement activity. For instance, the size and nature of punishments that is required for tax evasion has been detected to have a direct connection to the level of tax compliance (Fishlow and Friedman, 1994)

Again, frequent changes in tax laws in many countries, especially in developing countries results in instability and low transparency of the tax code. These changes very often than not, confuse tax administrators and taxpayers alike. This provides ample opportunity for tax avoidance Mo (2003). This situation leads to tax evasion which is not intentional, but occurs as a result of lack of knowledge ignorance. In extreme cases, tax evasion and avoidance even

becomes inescapable when the taxpayers find the tax laws to be too complex or contradictory to follow.

## **2.8 Mechanism of Checking Tax Evasion in Ghana**

Maximizing tax revenue and minimizing tax evasion has been a challenging task at every stage of development of tax administration. This is not just about maximization or minimization but rather, optimization as indicated by Shome (2005). A plan of action by which the government can adopt to check the problem of tax evasion can be grouped into those which define and criminalize tax evasion and those which seek to appeal to create group norms of complaint behavior (Oberholzer, 2008). Shome (2005) also pointed out that tax evasion could be checked if an arrant taxpayer is subject to genuine threat and continuous conduct of audit, investigation, scrutiny, punishment and penalty.

However, Lewis (1982) cited in Oberholzer (2008) is of the opinion that tax evasion could be checked by initiating two major policies: increasing the deterrence capabilities of tax authorities and seeking an improvement in taxpayers' attitude and perceptions. He is of the opinion that emphasis should be made on compliance to rules prompted by conscience, rather than fear of punishment. Furthermore, Shome (2005) outlined some methods to be adopted by tax administrators to keep tax evasion in check as follows:

- i. Tax administration should include genuine threat of punishment but ensure due process. He said, in order to do this, the tax administration must be sufficiently resourced and structured;
- ii. Computerized as many administrative processes as possible to minimize direct contact between tax officials and taxpayers; and to design tax policy and laws which are simple to understand and operate.

Green (2009) also stated how tax evasion can be controlled by pointing out the following measures:

- i. the Tax Code must show clearly the distinction between lawful and unlawful behaviour and also draw a line to distinguish what constitute criminal from civil violation of the code;
- ii. attempts should be made to organize tax education programmes to highlight the importance of tax revenue and modify priorities for government spending and also show more clearly the difference between choate and inchoate violation.

Chiumya (2006) also reiterated that checking tax evasion is one of the most challenging activities in tax administration for the reason that it takes many forms and facets. He clearly spelt out that understanding the behavior of the taxpayer and the reasons that account for such specific behavior are the major keys of checking tax evasion. He, therefore, took into consideration the emphasis made by Vogel (1974) cited in Oberholzer (2008) on the significance of information and education in the process of opinion formation. A deep understanding of the benefits that tax revenue provides, in addition to the technical reasons for tax laws and regulations, are inevitable requirements to both positive attitudes about the tax system and appropriate fiscal behaviour

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.0 Introduction**

This section outlines the various techniques and methods used in gathering and analyzing data for this research. The major areas that were of great concern in the study in the section included:

- i. Research Design
- ii. The Study Population
- iii. Sample Size and Sampling Techniques
- iv. Data Collection Instruments
- v. Data Analysis

#### **3.1 Research Design**

The study employed both qualitative and quantitative methods such as questionnaires and interviews in collecting data. Primary data was collected through questionnaires which were administered to the taxpayers in the informal sector in the Kumasi Metropolis. Interviews were also held with tax officials from two different GRA branches. The latter was sampled through convenience sampling while the former used the quota sampling method. The primary data was supported by secondary data sources such as surveys, articles, and other studies carried on the informal sector in Ghana by development economists and organized labour.

#### **3.2 The Study Population**

The informal sector in Ghana was the target population of this study. The sample frame was restricted to the informal sector in the Kumasi Metropolis with a population of about 567,189 operators according to the 2010 Population and Housing Census. The sample frame was further stratified into categories of informal businesses with common features. This was

adopted because the informal sector activities are very heterogeneous in nature, so the sample frame needed to be stratified so as to achieve a fair representation of the sample size as indicated by Lillian Trager (1987). As a result, some selected groups of workers in the informal sector were chosen for this study which included; Drugstores, Beauticians, Grocery stores, Artisan, Catering services, Dressmakers and Petty traders.

### 3.3 Sample Size and Sampling Techniques

The sample size used for this study was 378 operators in the informal sector in the Kumasi Metropolis and this number was determined by using the sample size formula as given by Fisher et al. (1998) below:

$$SS = \frac{Z^2 \times (P) \times (1-P)}{C^2}$$

Where: SS = sample size

Z = Z-Value<sup>A</sup> (the standard deviation, usually set at 1.96 which corresponds to 95)

P = Percentage of population expressed as decimal

C = Confidence interval expressed as decimal (which was set at 0.05)

Assuming the percentage of the population (p) is 56.7% which is equivalent to 0.567, with the z statistic being 1.96 and the confidence interval set at 0.05, then the sample size for the population is determined as:

$$\begin{aligned} \text{Sample Size (SS)} &= \frac{(1.96)^2 \times (0.567) \times (1 - 0.567)}{(0.05)} \\ &= 378 \end{aligned}$$

The calculated sample size of 378 members of informal sector operators within Kumasi Metropolis was selected for the study. In addition, ten (10) staff from Ghana Revenue Authority was added to the number to bring it up to 388 as total sample size for the study.



The researcher used the stratified random sampling method in this study to group the operators in the informal sector by their specific occupation. Having stratified the workers by occupation and arrived at which occupational group to select the samples from, the researcher then employed the quota sampling method to assign some percentages to the groups selected to determine the number of operators to be used in the administration of the questionnaire which was based on the data provided in the 2010 Population and Housing Census. The sampling methods adopted were less costly and quicker to use and had the ability to represent a high degree of spread in the data collection (Kumkpor, 2002; Marchal and Wathen, 2003).

### **3.4 Data Collection Instruments**

The researcher used both questionnaire and interview to collect data for this study.

#### **3.4.1 Questionnaires**

A structured questionnaire comprised of 35 questions was used to restrict and help reduce variation in responses from respondents. A seven-point Likert scale was used for 22 of the survey questions. Closed and open-ended questions were employed. The close-ended questions were used because majority of informal sector operators are illiterates which facilitated completion of the questionnaire with ease.

A few open-ended questions were included to seek information on attitudes, opinions and beliefs of the respondents with respect to taxation in the informal sector. Respondents who could read and write completed the questionnaire on their own.

#### **3.4.2 Interviews**

Structured interview guide was conducted by the researcher to solicit the views of tax officials from Ghana Revenue Authority on taxation in the informal sector in Ghana. Top tax officials were interviewed from different branches of Ghana Revenue Authority in Kumasi Metropolis.

### **3.5 Data Analysis**

Data collected from the field was analyzed using descriptive statistics. The Statistical Package for Social Sciences (SPSS) version 19.0 software was used to process and analyze the instruments. Frequencies, percentages, charts and tables were used to analyze the data.

## CHAPTER FOUR

### DATA ANALYSIS AND DISCUSSION

#### 4.1 Introduction

The chapter deals with the data gathered from the field. The data were collected in accordance with the objectives of the study. It contains descriptive information of the sampled taxpayers as well as that of the tax official of Ghana Revenue Authority (GRA). The data were presented in the form of graphs, charts and tables.

Taxpayers' samples were selected based on non-probability sampling method of random sampling, particularly the purposive sampling technique. This method ensured that representative samples of all the known elements of the population were fairly covered in the sample. A total of 378 questionnaires were applied out of which 371 were successfully returned. The return rate was 98%. In addition to the 371 successfully returned, 10 tax officials were also engaged.

#### 4.2 Demographic Characteristics

**Table 4.1 Demographic Characteristics**

Variable	Frequency	Percentage
<b>Age Group</b>		
18 – 25 years	82	22.1%
26 – 35 years	103	27.8%
36- 45 years	91	24.5%
46 years & above	95	25.6%
<b>Gender</b>		
Male	152	41.0%

Female	219	59.0%
--------	-----	-------

#### **Marital Status**

Married	207	55.8%
---------	-----	-------

Single	140	37.7%
--------	-----	-------

Divorced	24	6.4%
----------	----	------

#### **Level of Education**

Basic/ MSLC	148	40%
-------------	-----	-----

SHS/ Commercial	103	27.8%
-----------------	-----	-------

Diploma	45	12.2%
---------	----	-------

Degree	5	1.3%
--------	---	------

No Formal Education	70	18.9%
---------------------	----	-------

#### **Types of Business**

Artisan	48	12.9%
---------	----	-------

Beautician	47	12.7%
------------	----	-------

Catering	49	13.2%
----------	----	-------

Grocery	50	13.5%
---------	----	-------

Drug store	50	13.5%
------------	----	-------

Petty Trading	63	17.0%
---------------	----	-------

Dressmaking	65	17.2%
-------------	----	-------

---

Source: Author's Survey July 2015

#### **4.2.1 The Ages of Respondents**

Out of the 371 taxpayer sampled, 82 of them representing about 22% falls within the ages of 18-25 years. This is closely followed by 26-35 age group which constitute about 28% (103) of the respondents. This shows that majority of the respondents were in the youthful age. About 24% representing 91 respondents fall within the 36-45 year group. About 26% representing 95 respondents aged 46 years and above.

#### **4.2.2 Gender**

About 41% (152) of the respondents were male taxpayers while 59% (219) of the respondents were female taxpayers. The research showed a ratio of 1:1.44 with respect to male and female distribution. The ratio showed enough evidence of about 59% of female dominance, thus, supporting the assertion that there is an unfair gender balance in the informal sector in the Kumasi Metropolis.

#### **4.2.3 Marital Status of Respondents**

About 56% (207) of the respondents stated they were married. About 38% (140) of the respondents stated they were single. About 6% representing 24 of the respondents reported they were divorced.

#### **4.2.4 Level of Education**

The research revealed that out of 371 who responded to this, 40% (148) of the entire respondents had basic/MSLC education; about 28% (103) respondents had SHS/ Commercial education. The study also revealed that about 12% (45) of the respondents had diploma qualification. About 1% (5) of the respondents had degree. About 19% (70) of respondents had no formal education. Since more than 80% had had some form of education it was assumed that the respondents had some knowledge on tax.

#### **4.2.5 Type of Business**

About 12% (48) of the respondents were artisans while about 12% (47) of the respondents were beauticians. The study reviewed that about 13% (49) of the respondents were engaged in catering service. About 14% (50) of the respondents were engaged in the grocery store. 14% (50) of the respondents were engaged in drugstores. About 21% (63) of the respondents

were engaged in petty trading while the remaining 18% (64) of the respondents were engaged in dressmaking.

### 4.3 Incidence of Tax Evasion in the Informal Sector

#### 4.3.1 Business Registration

From figure 4.1 below, 40% (148) of the respondents had registered while 60% (223) of the respondents had not registered their businesses. Majority of the respondents who indicated they had not registered their businesses stated they had just started or they did not know they were required to register their businesses with the Registrar General.

Figure 4.1: Responses on Registration Status Taxpayers' Business



Source: Field Survey, July 2015

On the issue of registration of businesses in the informal sector, majority of the GRA respondents stated that it was not encouraging. The study further revealed that once owners of businesses had not registered their businesses they were assumed not to be taxpayers. From the point of view of GRA and for the purpose of taxing an income earner, the person must have Tax Identification Number (TIN) which is required for paying taxes. As the survey results shows, most of the respondents asserted that they had not registered their business and therefore were evading taxes.

#### 4.3.2 Permanent Business Location

Figure 4.2: Permanent Location of Businesses



Source: Field Survey, July 2015

From Figure 4.2 above, about 92% (341) of the respondents did not have permanent business location while as low as 8% (30) of the respondents indicated they had permanent business location. Majority of the respondents who indicated they did not have permanent location stated they did not have enough funds to acquire offices to do business. A sizeable number of operators sampled in the informal sector have no permanent place to carry out business; hence they move from place to place to sell their products.

From the perspective of GRA and for the purpose of taxing the income earner, the taxpayer should carry out business from a location where they can easily reach out to them. As indicated by the outcome of the survey, this fundamental condition for taxation is to a great extent missing in the informal sector and can be concluded that tax evasion in this sector is high.

### 4.3.3 Years of Experience

Table 4.2: Years of Experience

Variable	Frequency	Percentage
0 - 5 years	140	37.7%
6 – 10 years	82	22.2%
11- 15 years	53	14.3%
16 – 20 years	22	5.9%
21 years and above	74	19.9%

Source: Field Survey, July 2015

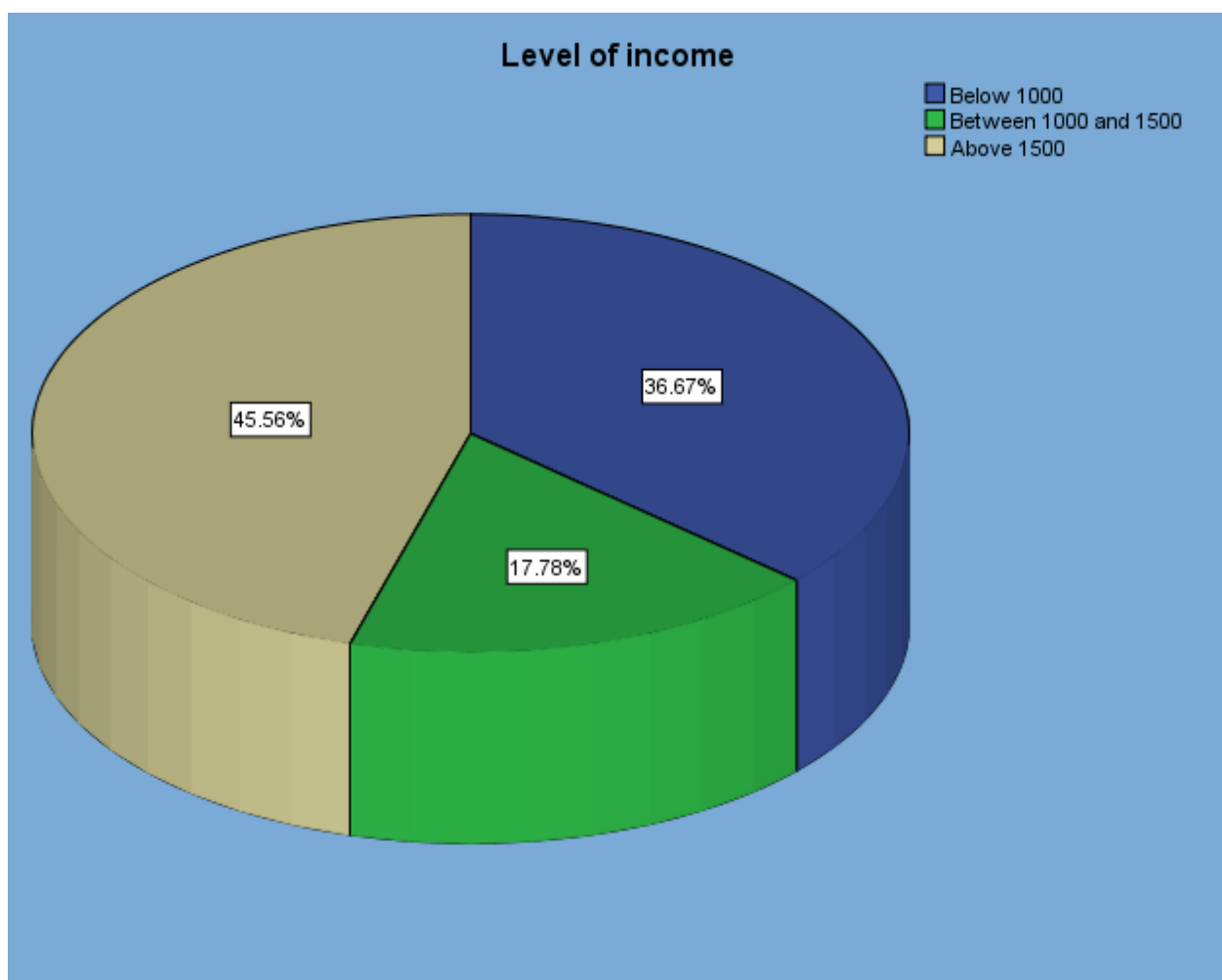
From Table 4.2 above, 38% representing 140 respondents stated they had 0- 5 years of experience in business while 82 respondents representing 22% stated they had 6 -10 years of



experience in business. About 14% representing 53 respondents indicated they had between 11 to 15 years of experience in their businesses. About 6% (22) of the respondents representing the minority had between 16 to 20 years of experience in their current businesses. 20% (74) had over 21 years of experience in business.

#### 4.3.4 Annual Income

Figure 4.3: Responses on Level of Income



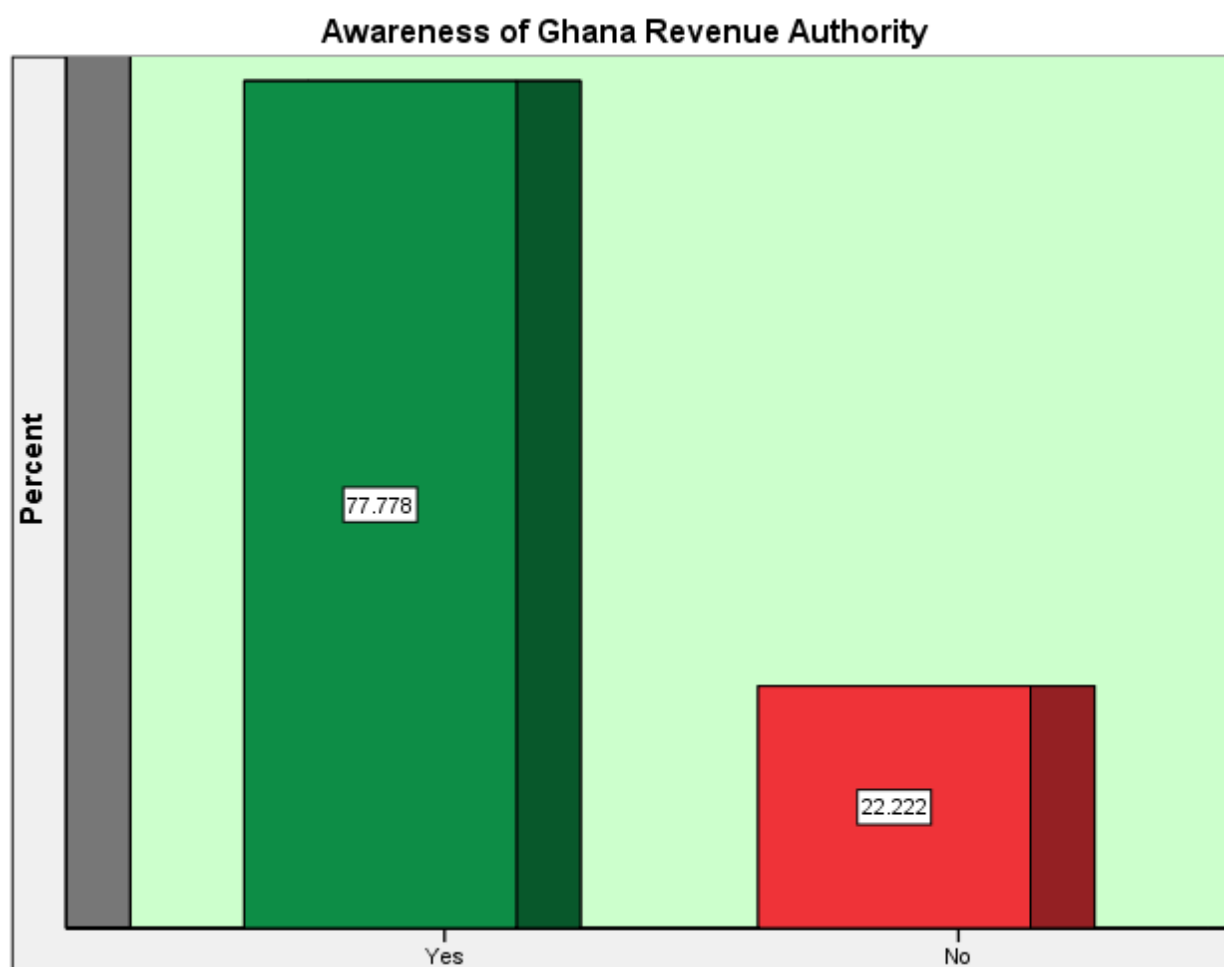
Source: Field Survey, July 2015

From Figure 4.3 above, about 45% (167) of the respondents earned over 1500 cedis as their annual income. About 37% (137) of the respondents had less than 1000 cedis as their annual

income. About 18% (67) of the respondents had between 1000 cedis and 1500 cedis as their annual income.

#### 4.3.5 Awareness of the Ghana Revenue Authority

Figure 4.4: Awareness of GRA

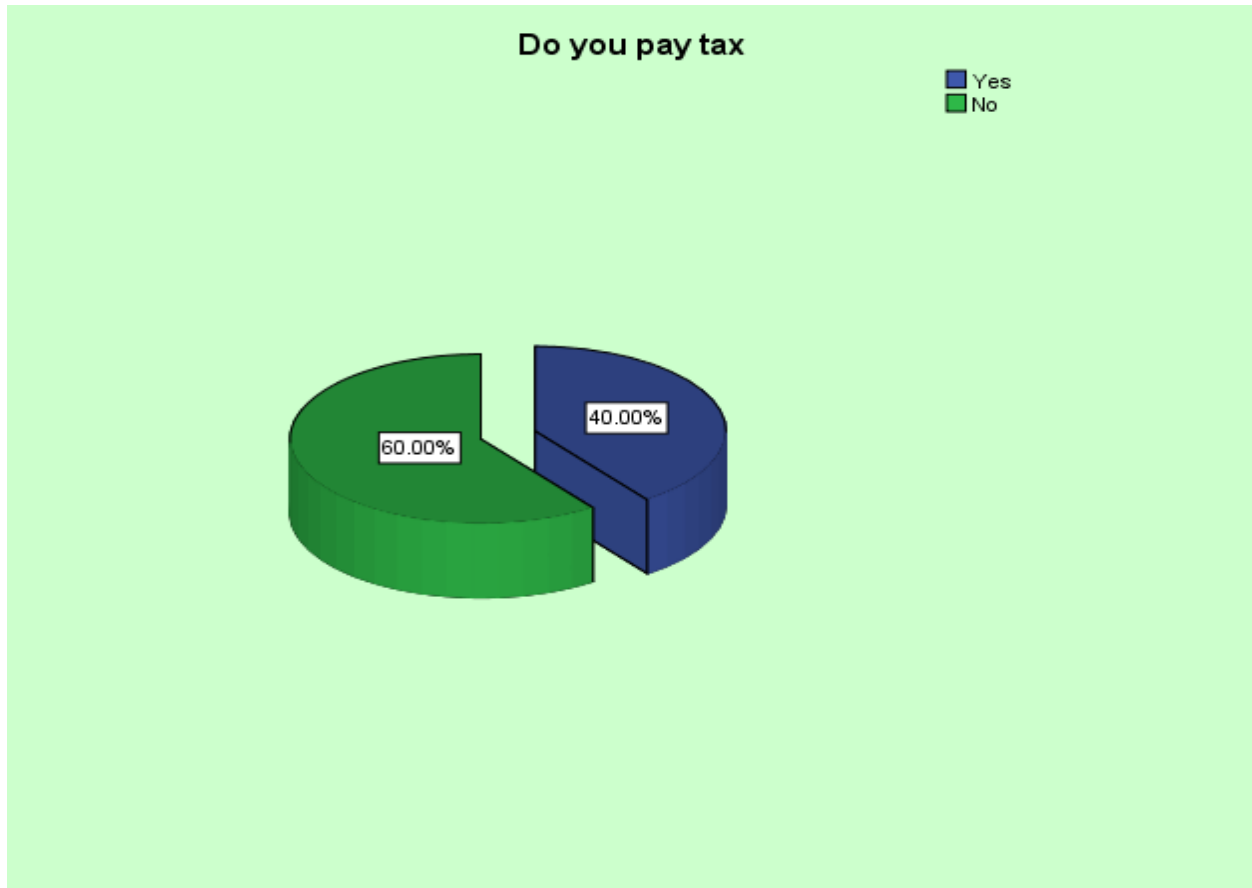


Source: Field Survey, July 2015

From Figure 4.4 above, about 78% (289) of the respondents were aware of the GRA. However about 22% (82) of the respondents indicated they were not aware of the GRA. Majority of the respondent who indicated they were not aware of the GRA stated that they had not heard of the institution and what they do. Among the respondents who indicated they were aware of the existence of the GRA, majority of the respondents stated they heard from the media.

#### 4.3.6 Tax Compliance of Respondents

Figure 4.5: Tax compliance

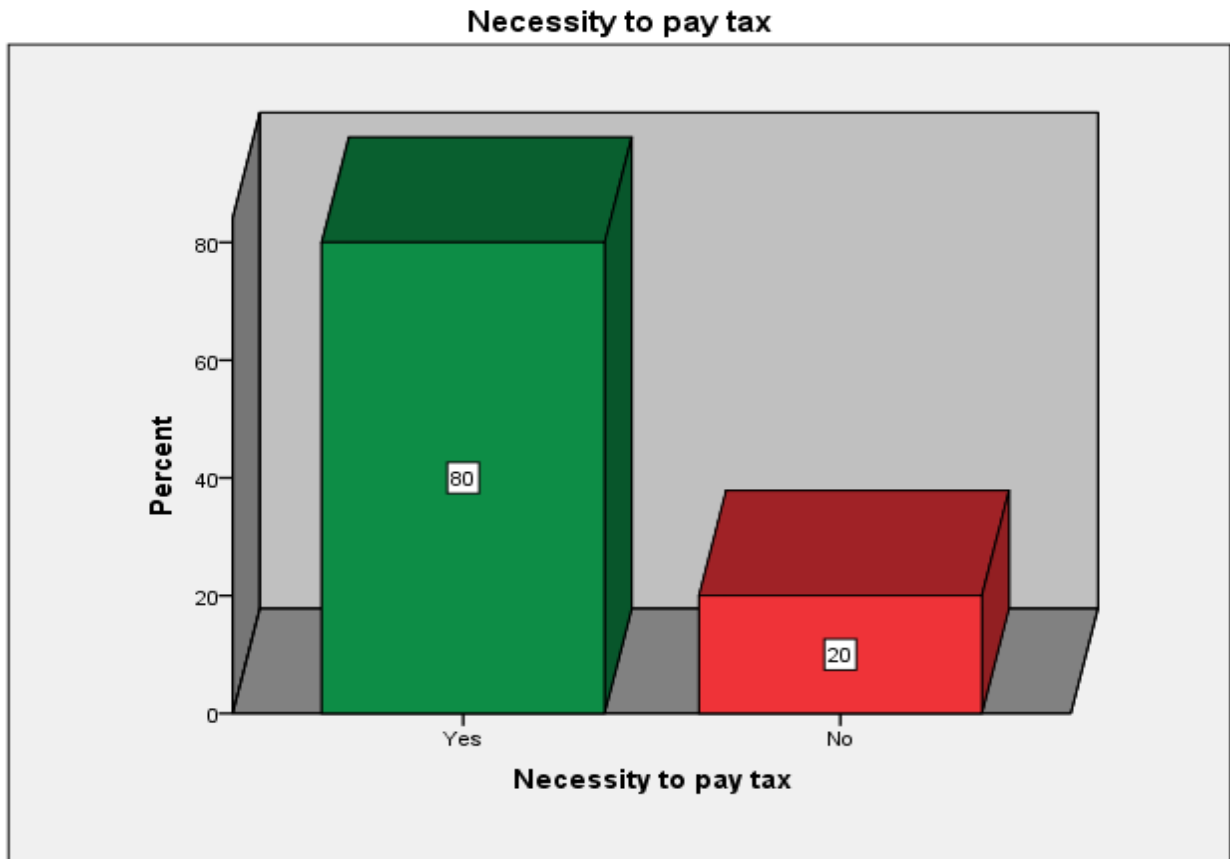


Source: Field Survey, July 2015

From Figure 4.5 above, about 40% (148) of the respondents indicated they honoured their tax obligation to the state. However about 60% (223) of the respondents indicated they did not honour tax obligation to GRA. Majority of the respondents who indicated they did not pay taxes to the GRA stated that they pay container permit and store license to Kumasi Metropolitan Assembly (KMA). It was noted that KMA had revenue collectors who move to communities to collect the levies. The Assembly had Task Force which ensured tax compliance.

#### 4.3.7 Necessity to Pay Tax

Figure 4.6: Necessity to pay tax



Source: Field Survey, July 2015

From Figure 4.7 above, 80% (297) of the respondents thought it was necessary to pay while 20% (74) of the respondents thought it was not necessary to honour their tax obligation.

Majority of the respondents who thought it was not necessary to pay tax stated that they did not honour their tax obligation because of perceived misapplication of funds.

#### 4.4 Likert Scale on the Incidence of Tax Evasion in informal sector

The respondents were to indicate which of the following is an incidence of Tax Evasion in the Informal Sector:

1. cash basis of business transactions
2. improper records
3. failure to file Income Tax returns to GRA
4. failure to disclose Income
5. inflating deductions

Table 4.3: Incidence of Tax Evasion in Informal Sector

	Scale 1 Strongly Agree	Scale 2 Slightly Agree	Scale 3 Somewhat Agree	Scale 4 Neutral	Scale 5 Somewhat Disagree	Scale 6 Slightly Disagree	Scale 7 Strongly Disagree
Responses	Frequ- ency%	Frequ- ency%	Frequ- ency%	Frequ- ency %	Frequ- ency %	Frequ- ency %	Frequ- ency %
1	334 (90%)	22 (5.6%)	3(1%)	12(3.3%)	-	-	-
2	289 (77.8%)	62(16.7%)	12(3.3%)	8( 2.2%)	-	-	-
4	260 (70%)	66(17.8%)	21(5.6%)	16(4.4%)	8(2.2%)	-	-
5	243 (65.6%)	82(22.2%)	16(4.4%)	25( 6.7%)	4(1.1%)	-	-
6	169 (45.6%)	132(35.6%)	33(8.9%)	29(7.8%)	-	4(1.1%)	4(1.1%)

Source: Field Survey, July 2015

From Table 4.3 above a Likert Scale marked 1- 7: 1 being “Strongly Agree”, 2 for “slightly Agree”, 3 for “somewhat Agree”, 4 for “Neutral”, 5 for “Somewhat Disagree”, 6 for “slightly disagree” and 7 for “strongly disagree”.

#### **4.4.1 Cash Basis of Business Transactions**

About 90% (334) of the respondents indicated that they strongly agree that cash basis of business transaction was an incidence of tax evasion in the informal sector. About 6% (22) slightly agreed; about 1% (3) somewhat agreed; and about 3 % (12) remained neutral.

Majority of the respondents sampled in the informal sector sell their goods and services for cash. Dealing in cash transaction, which is paying for goods and service with cash or by cheques made out to “cash” and not payee’s name makes it very difficult to trace transactions. This leaves no documentary proof as businesses in the informal sector usually do not keep records of such transactions. This incidence makes it very difficult to ascertain the actual income of the entrepreneur and, hence, determine liability of the tax payer. As a result, tax assessment becomes extremely difficult if not possible Otieku (1988).

#### **4.4.2 Improper Record Keeping**

About 78 % (289) of the respondents indicated that they strongly agree that improper record keeping was an incidence of tax evasion in the informal sector. About 17% (62) slightly agreed; about 3% (12) somewhat agreed; and about 2% (8) remained neutral. The data collected for this study has confirmed the views in the existing literature that operators in the informal sector have very poor record keeping practices. As majority of the operators in the informal sector do not keep proper records, it becomes very difficult for fair assessment of income tax to be made. Accounting records prepared by businesses serve as the basis upon which taxable income is computed and the absence of such records makes it difficult to tax income earners in the sector

#### **4.4.3 Failure to File Income Tax Returns to GRA**

About 70% (260) of the respondents indicated that they strongly agree that failure to file income Tax returns to GRA was an incidence of tax evasion in the informal sector. About

18% (66) slightly agreed; about 6% (21) somewhat agreed and about 4% (16) remained neutral. About 2% (8) somewhat disagreed. According to the literature reviewed, Otieku (1988) found that majority of people in the informal sector fail to file income tax returns to GRA, which he said is by far the obvious source of tax evasion in the sector.

Data gathered for the this study has shown that majority of the respondents representing 94 percent generally consented that many operators in the sector fail to file income tax return to GRA which was an indication of incidence of tax evasion in the sector. This has been confirmed in the study conducted by Otieku (1988).

#### **4.4.4 Failure to Disclose True Income to GRA**

About 65.6% (243) of the respondents indicated that they strongly agree that failure to disclose true income to GRA was an incidence of tax evasion in the informal sector. About 22% (80) slightly agreed; about 4% (16) somewhat agreed; and about 7% (25) remained neutral. About 1% (4) somewhat disagreed. Internal Revenue Act, 2000, (Act 592) outlines the major source of income as income from business, employment and investment. If tax payers disclose income from one or two source but fail to disclose other source of income, tax authorities would not be able to make fair assessment of income tax to be paid. This tends to reduce the tax liability of the taxpayer which is in a way, a form of evading tax as indicated in the literature. This has been confirmed by the response from the survey conducted where about 91.5 percent generally agreed that it was wrong to disclose all of their income to the tax authorities. This shows that greater number of people in the informal sector have not been disclosing their true income for tax purpose which amounts to tax evasion.

#### **4.4.5 Inflating Allowable Deduction to Reduce Income Tax**

About 46% (169) of the respondents indicated that they strongly agree that inflating allowable deduction to reduce income was an incidence of tax evasion in the informal sector.

About 36% (132) slightly agreed; about 9% (33) somewhat agreed; and about 8% (29) remained neutral. About 1% (4) slightly disagreed; about 1% (4) strongly disagreed. In an interview with GRA respondents, it was noted that there was high rate of tax evasion in the informal sector. About 91 percent of the respondents sampled generally agreed that they would inflate their deductions in order to pay less income tax. The existing literature on the subject has given detailed explanation on the allowable deductions enshrined in the section 13 of IR Act, 592.

Thus, the intuition is that majority of operators in the informal sector as indicated by the survey conducted inflate their deduction in order to report less income, thereby paying less tax. This seems to support the findings of Otioku (1988) that businesses in the informal sector mingle their personal activities with that of the business which leads to inflated expense which is charged against the business income thereby reducing the tax liability.

#### **4.5 Likert Scale on the Level of Tax Evasion in Informal Sector**

The respondents were to indicate which of the following are levels of Tax Evasion in informal sector:

1. cheating on tax
2. undeclared income
3. not reporting on sources of income which you are in doubt
4. Tax Evasion as Economic necessity
5. voluntary payment of tax
6. no one to be blamed for Tax Evasion

**Table 4.4:** Level of Tax Evasion in informal sector

Scale 1	Scale 2	Scale 3	Scale 4	Scale 5	Scale 6	Scale 7
Strongly Agree	Slightly Agree	Somewhat Agree	Neutral	Somewhat Disagree	Slightly Disagree	Strongly Disagree



Responses	Frequ- ency %	Frequ- ency %	Frequ- ency %	Frequ- ency %	Frequ ency %	Frequ- ency %	Frequ- ency %
1	214 (57.8%)	58(15.6%)	12(3.3%)	256.7%)	16(4.4%)	8(2.2%)	38(10%)
2	154(41.4%)	53(14.4%)	77(21.1%)	16(4.4%)	25(6.7%)	21(5.6%)	25(6.7%)
3	227(61.1%)	66(17.8%)	25(6.7%)	12(3.3%)	21(5.6%)	4(1.1%)	16(7%)
4	152 (41.1%)	74(20%)	58(15.6%)	29(7.8%)	21(5.6%)	21(5.5%)	16(4.4%)
5	99(26.7%)	16(4.4%)	21(5.6%)	25(6.7%)	33(8.9%)	-	177(47.8%)
6	174(46.7%)	74(20%)	53(14.4%)	25(6.7%)	12(3.3%)	4(1.1%)	29(7.8%)

Source: Field Survey, July 2015

From Table 4.4 above a Likert Scale marked 1- 7: 1 being “Strongly Agree”, 2 for “slightly Agree”, 3 for “somewhat Agree”, 4 for “Neutral”, 5 for “Somewhat Disagree”, 6 for “slightly disagree” and 7 for “strongly disagree”.

#### 4.5.1 Cheating on Tax

About 58% (214) of the respondents indicated that they strongly agree that cheating on tax was a level of tax evasion in informal sector. About 16% (58) slightly agreed; about 3% (12) somewhat agreed; and about 7% (25) remained neutral. About 4% (16) somewhat disagreed that cheating on tax was a level of tax evasion in informal sector. About 2% (8) slightly disagreed; and about 10% (38) strongly disagreed. About 77 percent of the respondents sampled generally agreed that they would cheat on tax if they have the chance. Earlier information gathered from the respondents has indicated that majority of the operators in the informal sector do not have permanent place of work and this makes it difficult for tax authorities to trace them for tax. It can be inferred from their assertion that they would cheat in tax if they have the chance to mean that sizeable number of operators cheat on tax due to the fact that they cannot be traced

#### **4.5.2 Reporting Less Income in Order to Pay Less Tax**

About 41% (152) of the respondents indicated that they strongly agree that reporting less income in order to pay less tax was a level of tax evasion in informal sector. About 14% (53) slightly agreed; about 21% (77) somewhat agreed; and about 4% (16) remained neutral. About 7% (25) somewhat disagreed that reporting less income in order to pay less tax was a level of tax evasion in informal sector. About 6% (21) slightly disagreed; and about 7% (25) strongly disagreed.

#### **4.5.3 Not reporting on source of Income which you are in doubt**

About 61% (227) of the respondents indicated that they strongly agree that not reporting on source of income which you are in doubt was an indication of the level of tax evasion in informal sector; about 18% (66) slightly agreed; about 7% (25) somewhat agreed; and about 3% (12) remained neutral. About 6% (21) somewhat disagreed that not reporting on source of income which you are in doubt was an indication of the level of tax evasion in informal sector; about 1% (4) slightly disagreed and about 4% (16) strongly disagreed. Inference can be made from this to mean that most of the operators in the informal sector do not account for other sources of income when they are in doubt and this impede fair assessment of tax liability of the taxpayer resulting in decrease in tax liability.

#### **4.5.4 Tax Evasion as Economic Necessity**

About 41% (152) of the respondents indicated that they strongly agreed that tax evasion as economic necessity was an indication of the level of tax evasion in informal sector. About 20% (74) slightly agreed; about 16% (58) somewhat agreed and about 8% (29) remained neutral. About 6% (21) somewhat disagreed that tax evasion as economic necessity was an indication of the level of tax evasion in informal sector; about 5% (21) slightly disagreed; and about 4% (16) strongly disagreed. About 77 percent of the respondents sampled generally

agreed that they evade taxes as a result of economic hardship. It can therefore be concluded that the level of tax evasion in the informal sector is high.

#### **4.5.5 Voluntary Payment of Tax**

About 27% (99) of the respondents indicated they strongly agree that taxpayers would voluntarily pay tax without public coercion; about 4% (16) slightly agreed; about 6% (21) somewhat agreed; and about 7% (25) remained neutral. About 9% (33) somewhat disagreed that taxpayers would voluntarily pay tax without public coercion; and about 47% (177) strongly disagreed. Majority of the respondents sampled, 56 percent generally disagreed that they would voluntarily pay tax if they are not forced to do so. This seems to confirm the findings of Otioku (1988) that there is lack of voluntarily compliance in the informal sector and this show the level of tax evasion in the sector.

#### **4.5.6 No one to be blamed for Tax Evasion**

About 47% (174) of the respondents indicated that they strongly agree that no one was to be blamed for tax evasion was a level of tax evasion in informal sector; 20% (74) slightly agreed; about 14% (53) somewhat agreed; and about 7% (25) remained neutral. About 3% (12) slightly disagreed; about 1% (4) slightly disagreed; and about 8% (29) strongly disagreed. Greater number of respondents sampled as indicated above, generally agreed that since everybody evade taxes, one can hardly be blamed for doing it. Otioku (198) pointed out that in society when attempts by tax payer to evade tax receive little or no moral disapproval; it becomes difficult for tax authorities to achieve their objectives. This reveals the level of tax evasion in the informal sector.

#### **4.6 Likert Scale on Reasons for Tax Evasion in Informal Sector**

The respondents were to indicate which of the following are levels of Tax Evasion in informal sector:

1. no penalization
2. misuse of tax revenue
3. high probability of not being caught leads to tax evasion
4. high tax rates lead to tax evasion
5. lack of transparency leads to tax evasion
6. high compliance cost leads to tax evasion

Table 4.5: Reasons for Tax Evasion in informal sector

	Scale 1	Scale 2	Scale 3	Scale 4	Scale 5	Scale 6	Scale 7
	Strongly	Slightly	Somewhat		Somewhat	Slightly	Strongly
	Agree	Agree	Agree	Neutral	Disagree	Disagree	Disagree
Responses	Frequ- ency %	Frequ- ency %	Frequ- ency %	Frequ- ency %	Frequ- ency %	Frequ- ency %	Frequ- ency %
1	247 (66.7%)	62(16.7%)	21(5.6%)	12(3.3%)	-	8(2.2%)	21(5.6%)
2	297 (80%)	58(15.6%)	12(3.3%)	4(1.1%)	-	-	-
3	115(31.1%)	91(24.4%)	70(18.9%)	58(15.6%)	12(3.3%)	-	25(6.7%)
4	244(65.6%)	49(13.3%)	21(5.6%)	33(8.9%)	4(1.1%)	4(1.1)	164.4%)
5	276(74.4%)	42(11.1%)	12(3.3%)	16(4.4%)	4(1.1%)	-	21(5.5%)
6	133(35.6%)	86(23.3%)	115(31.1%)	21(5.6%)	12(3.3%)	4(1.1%)	-

Source: Field Survey, July 2015

From Table 4.6 above a Likert Scale marked 1- 7: 1 being “Strongly Agree”, 2 for “slightly Agree”, 3 for “somewhat Agree”, 4 for “Neutral”, 5 for “Somewhat Disagree”, 6 for “slightly disagree” and 7 for “strongly disagree”.

#### 4.6.1 No Penalization

About 67% (247) of the respondents indicated that they strongly agree that not being punished for tax evasion was a reason for tax evasion in informal sector; about 17% (62) slightly agreed; about 6% (21) somewhat agreed; and about 3% (12) remained neutral. About

2 % (8) slightly disagreed that not being punished for tax evasion was a reason for tax evasion in informal sector; and about 6% (21) strongly disagreed. Many of the respondents sampled generally agreed that they would pay less tax if they received no punishment for their actions. The field data lends credence to the empirical paper presented by Kirchler et al (2007) which found that lack of rule of law decrease transparency of public actions and encourages doubts amongst citizens. Therefore, citizens may not be willing to fund the state through taxes and choose to avoid these liabilities.

#### **4.6.2 Misuse of Tax Revenue**

About 80% (297) of the respondents indicated that they strongly agreed that misuse of tax revenue was a reason for tax evasion in informal sector; about 16% (58) slightly agreed; about 3%(12) somewhat agreed; and about 1%(4) remained neutral. About 99 percent of respondents sampled agreed that misuse of tax revenue is one of the reasons why people do not honor their tax obligation to the GRA. Kirchler et al (2007) pointed out that the willingness of taxpayers to pay taxes suffers where there is perception of high levels of corruptions as to how their taxes paid are used to finance public goods and services.

#### **4.6.3 High probability of not being caught leads to Tax Evasion**

About 31% (115) of the respondents indicated that they strongly agreed that high probability of not being caught was a reason for tax evasion in informal sector; about 24% (91) slightly agreed; about 19% (70) somewhat agreed; and about 15% (58) remained neutral. About 3% (12) somewhat disagreed that high probability of not being caught was a reason for tax evasion in informal sector; and about 7% (25) strongly disagreed. A well working body of tax investigation is crucial for the detection and prosecution of cases of fraud. About 74 percent of the respondents sampled generally agreed that they would cheat on tax if the probability of being caught is low. This supports the findings from research carried out by Fishlow and

Friedman (1994) that the absence of sufficient capacity in tax administration decrease the chance of detection which influences the taxpayer decision as to whether to evade or not.

#### **4.6.4 High Tax Rates lead to Tax Evasion**

About 66% (244) of the respondents indicated that they strongly agreed that high tax rates was a reason for tax evasion in informal sector; about 13% (49) slightly agreed; about 6% (21) somewhat agreed; and about 9% (33) remained neutral. About 1% (4) somewhat disagreed that high tax rates was a reason for tax evasion in informal sector; about 1% (4) slightly disagree; and about 1% (4) strongly disagreed. Data gathered from the respondents sampled shows that about 85 percent attributed their failure to pay tax to the high rate of taxes. The intuition is that high tax rates tend to increase the tax burden and, hence, reduce the disposable income of the taxpayer (Allingham and Sandmo, 1972; Chipeta, 2002). This means that operators in the informal sector would willingly pay taxes if they deem tax rates are not too high.

#### **4.6.5 Lack of Transparency leads to Tax Evasion**

About 74% (276) of the respondents indicated that they strongly agree that lack of transparency in tax administration was a reason for tax evasion in informal sector; about 11% (42) slightly agreed; about 3% (12) somewhat agreed; and about 4% (16) remained neutral. About 1% (4) somewhat disagreed that lack of transparency in tax administration was a reason for tax evasion in informal sector; and about 6% (21) strongly disagreed. According to Kirchler et al (2007), the willingness of taxpayer to evade tax largely depends on their distrust to the tax system as well as the government resulting from lack of transparency and accountability in the public fund. This has been confirmed by the responses from the respondents sampled, where about 88 percent of the respondents indicated lack of

transparency and accountability in the use of public funds has prompted their decision to evade tax

#### **4.6.6 High Compliance Cost leads to Tax Evasion**

About 36% (133) of the respondents indicated that they strongly agree that high compliance cost was a reason for tax evasion in informal sector; about 23% (86) slightly agreed; about 31% (115) somewhat agreed and about 6% (21) remained neutral. About 3% (12) somewhat disagreed that high compliance cost was a reason for tax evasion in informal sector; and about 1% (4) slightly disagreed. About 90 percent of the respondents sampled generally indicated that high compliance cost was a reason for tax evasion in the informal sector. This gives credence to the World Bank 2008 World Development which revealed sharp contracts between countries in terms of time to prepare and paying taxes. Again, it confirms the result from the survey conducted in South Africa by SBP (2005) that taxes are seen as the problematic set of rules to follow which sometimes hinder taxpayers from paying the appropriate taxes.

#### **4.7 Causes of Tax Evasion in the Informal Sector**

Majority of GRA respondents identified the causes of tax evasion as; desire not to pay taxes; ignorance; expansion activities not reported; and lack of incentive to pay tax.

#### 4.8 Likert Scale on Measures to curb Tax Evasion in informal sector

The respondents were to indicate which of the following measures to curb Tax evasion in informal sector are:

1. tax education
2. substantial fine
3. court prosecution
4. provision of taxpayer services
5. simplifying tax forms & mode of payment
6. tax agency website improvement and phone advice service

**Table 4.6 presents Measures to curb Tax Evasion in Informal Sector**

**Table 4.6: Responses on Measures to curb Tax Evasion in Informal Sector**

	Scale 1	Scale 2	Scale 3	Scale 4	Scale 5	Scale 6	Scale 7
	Strongly	Slightly	Somewhat		Somewhat	Slightly	Strongly
	Agree	Agree	Agree	Neutral	Disagree	Disagree	Disagree
Responses	Frequ- ency %	Frequ- ency %	Frequ- ency %	Frequ- ency %	Frequ- ency %	Frequ- ency %	Frequ- ency %
1	293(78.9%)	49(13.3%)	25(6.7%)	4(1.1%)	-	-	-
2	255(68.9%)	29(7.8%)	29(7.8%)	25(6.7%)	4(1.1%)	8(2.2%)	21(5.6%)
3	255(68.9%)	35(8.9%)	25(6.7%)	16(4.4%)	8(2.2%)	16(4.4%)	16(4.4%)
4	235(63.3%)	57(15.6%)	50(13.6%)	21( 5.6%)	8(2.2%)	-	-
5	276(74.4%)	42(11.1%)	12(3.3%)	16(4.4%)	4(1.1%)	-	21(5.5%)
6	99(26.7%)	49(13.3%)	57(15.6%)	83(22.2%)	33(8.9%)	25(6.7%)	25(6.7%)

**Source: Field Survey, July 2015**



From table 4.6 above a Likert scale marked 1- 7: 1 being “Strongly Agree”, 2 for “slightly Agree”, 3 for “somewhat Agree”, 4 for “Neutral”, 5 for “Somewhat Disagree”, 6 for “slightly disagree” and 7 for “strongly disagree”.

#### **4.8.1 Tax Education**

About 79% (293) of the respondents indicated that they strongly agree that tax education was a measure to curb tax evasion in informal sector. About 13% (49) slightly agreed; about 7% (25) somewhat agreed; and about 1% (4) remained neutral. About 99 percent of the respondents generally agreed that more emphasis should be put into education. Vogel (1974) cited in Oberholzer (2008) laid emphasis on the significance of education and information in the process of opinion formation. The tax payer should have a deeper understanding of the benefits that taxes provide as well as the technicalities of the tax laws to enable taxpayers form positive attitude about the tax system.

#### **4.8.2 Substantial Fine**

About 69% (255) of the respondents indicated that they strongly agree that substantial fine was a measure to curb tax evasion in the informal sector. About 8% (29) slightly agreed; about 8% (29) somewhat agreed; and about 7% (25) remained neutral. About 1% (4) somewhat disagreed; about 2% (8) slightly disagreed; and about 6% (21) strongly disagreed. About 99 percent of the respondents generally agreed that more emphasis should be put into education. This shows that about 85 percent of the respondents generally agreed that substantial fine should be given to people who evade taxes to deter others from doing same.

#### **4.8.3 Court Prosecution**

About 69% (255) of the respondents indicated that they strongly agree that court prosecution was a measure to curb tax evasion in informal sector; about 9% (35) slightly agreed; about 7% (25) somewhat agreed; and about 4% (16) remained neutral. About 2% (8) somewhat

disagreed that court prosecution was a measure to curb tax evasion in informal sector; about 4% (16) slightly disagreed; and about 4% (16) strongly disagreed. Many of the respondents sampled generally agreed that prosecuting tax evaders in the court would check tax evasion in the informal sector. Fishlow and Friedman (1994) found that there is direct connection between the size and nature of punishment and the level of tax compliance. This means that if tax evaders are given punishment for their actions would influence the level of tax compliance in the sector.

#### **4.8.4 Provision of Taxpayer Services**

About 63% (235) of the respondents indicated that they strongly agree that provision of taxpayer services was a measure to curb tax evasion in the informal sector; about 16% (57) slightly agreed; about 13% (50) somewhat agreed; and about 6% (21) remained neutral. About 2% (8) somewhat disagreed that provision of taxpayer services was a measure to curb tax evasion in informal sector. The study has revealed that majority of the operators in the informal sector do not keep proper records due to illiteracy, high fee charged by accountants and general shortage of qualified accountants Agyei (1984). This implies that tax authorities should assist taxpayer in filling returns and payment of tax as a way of detecting tax evasion in the sector. This has been confirmed by the survey conducted in which about 92 percent of the respondents generally agreed that taxpayer services provided by the tax authorities would help check tax evasion.

#### **4.8.5 Simplifying Tax Forms and Mode of Payment**

About 74% (276) of the respondents indicated that they strongly agree that simplifying tax forms and mode of payment was a measure to curb tax evasion in informal sector; about 11% (42) slightly agreed; about 3% (12) somewhat agreed; and about 4% (16) remained neutral. About 1% (4) somewhat disagreed that simplifying tax forms and mode of payment was a

measure to curb tax evasion in informal sector; and about 5% (21) strongly disagreed. About 88 percent of the respondents sampled indicated that tax authorities should simplify tax forms and mode of payment to foster compliance in the sector. This has given credence to the findings from Shome (2005) which suggested that tax authorities should design tax policy and laws which are simple to understand and operate.

#### **4.8.6 Improvement in Tax Agency Website and Phone Advice Service**

About 27% (99) of the respondents indicated that they strongly agree that tax agency website and phone advice service was a measure to curb tax evasion in informal sector; about 13% (49) slightly agreed; about 16% (57) somewhat agreed; and about 22% (83) remained neutral. About 9% (33) somewhat disagreed that improvement in tax agency website and phone advice service was a measure to curb tax evasion in informal sector; about 7% (25) slightly disagreed; and about 7% (25) strongly disagreed. About 56 percent of the respondents indicated that improvement should be made in tax agency website and phone service so that operators can easily get access to key information with ease. This will enhance the understanding of the taxpayers' knowledge on the tax laws and services in the sector.

#### **4.9 Suggested Measures to Address Tax Evasion by GRA**

Majority of respondents stated measures to address tax evasion as tax education; stiffer punishment to tax evaders; and encouraging voluntary compliance.

## **CHAPTER FIVE**

### **SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS**

#### **5.0 Introduction**

This chapter presents the summary of the research findings, conclusion drawn from the study and recommendations. The aim of this research was to find out the incidence of tax evasion in the informal sector in the Kumasi Metropolis.

#### **5.1 Summary of Findings**

##### ***5.1.1 Incidence of Tax Evasion in the Informal Sector***

The study established that majority of business in the sector are not registered and therefore do not have Tax Identification Number (TIN) for tax purposes. It again revealed that most of the businesses in the sector have no permanent place to carry out business operation and therefore cannot be traced by tax authorities for tax purpose. Poor record keeping was also found to be prevalent among the operators in the sector owing to the fact that most of them are illiterates. Majority of the operators indicated their unwillingness to disclose their true income and also inflate their allowable deductions in order to reduce the taxable income for fear of paying higher taxes.

##### ***5.1.2 Level of Tax Evasion in informal sector***

The study further establish that taxpayer in the sector explore ways to evade taxes because they deem taxes to be too high. It is again revealed that most of the taxpayers would not voluntarily pay taxes without public coercion and claimed that one cannot be blamed for evading taxes since everyone evades taxes.

### **5.1.3    *Reasons for Tax Evasion in Informal Sector***

Many of the respondents attributed evasion in the sector to high income taxes they pay which they said takes too much of their income. Again, most of the respondents were of the view that there is no proper accountability as to the use of public fund and that they would readily comply with tax laws if tax revenue is used judiciously. Many of the respondents reiterated their desire to pay income taxes if the money collected is used judiciously by the government. Some attributed tax evasion in the sector to high compliance cost and loopholes in the legal system in dealing with tax evasion cases.

### **5.1.4    *Mechanism to Check Tax Evasion in Informal Sector***

The study found that most of the taxpayers acknowledged the need to embark on education programmes to sensitize the public on the need to pay tax. Majority of the respondents cited payment of fine and prosecution of offenders in court of law as measures to check evasion in the sector. More so, it was the view of many that tax forms and mode of payment of taxes should be made simple and also taxpayer services should be rendered to assist them in filling returns and payment of taxes. Others indicated improvement in the tax agency website and phone advice service would help check evasion.

## **5.2       Conclusion**

The factors that cause tax evasion in the informal sector were all established to be on the high in the informal sector in Ghana as shown by the percentages of the causes of tax evasion. Again, reasons discussed in the literature have all been discovered to be true in the informal sector in Ghana according to the analysis of the responses from respondents which indicates high percentage ranges.

## **5.3 Recommendations**

### **5.3.1 Tax Information and Tax Education**

This study suggests that GRA should increase its tax information and education by utilizing both the electronic and print media. If possible, tax information should be printed out in all major local languages in the form of hand bills to remind people on the essence of tax revenue. The Ministry of Information should also assist by providing information vans to talk to the people and also disseminate these hand bills with the view of creating awareness amongst the populace on tax issues. This should be pursued vivaciously and must be sustained to bring about improvement in the level of compliance in the sector.

### **5.3.2 Improving Record Keeping Amongst Entrepreneurs**

The GRA in collaboration with the Ministries of Finance should mount training programmes for the entrepreneurs in the informal sector to equip them with basic skills on how to keep records of business activities. The programme should be spread out to include all major identifiable entrepreneurs to train them to acquire such skills.

### **5.3.3 Simplification of Procedures for Filing Returns**

The research findings identified the process of filing returns to be too complex and this in a way contributes to low return of tax. The researcher is of the view that GRA should devise a simple income tax return form for the operators in the informal sector to enable them file their returns with ease. Again, steps should be taken to assist them in the income tax return process which will encourage them to file their returns.

### **5.3.4 Computerization of Informal Sector Businesses**

The Government through GRA should create a database to keep track of informal sector businesses and to link it to all branches of GRA nationwide. This could be achieved by

engaging the national service personnel and the unemployed graduates in the exercise. Conscious efforts should be made to ensure the sustainability of the exercise by updating the data as and when necessary.

#### **5.3.5 Improvement in Tax Administration**

Although the GRA has improved in its services over the last few years which are evidenced by the numerous tax offices across the country, yet, tax revenue from the sector is still not appreciable as indicated by the tax officials during the interview. The researcher is of the view that their offices should be located in areas where there is dominance of informal sector businesses, if possible, kiosks and containers should be placed close to them in order to provide essential services to them to improve upon tax collection in the sector. Nonetheless, the tax authority should take into consideration the cost-benefit analysis.

#### **5.4 Suggestion for Further Research**

Due to financial constraints, the sample size used for the study was too small. Further research could therefore be undertaken using a larger sample size. Further research could also be undertaken across the ten regions of Ghana to ascertain whether there are regional differences in tax compliance in the informal sector in Ghana

## REFERENCES

ABDALLAH, N. (2008), *Taxation in Ghana, principles, practices and planning*, 2<sup>nd</sup> Ed. Accra; Black mask publications.

ADU-AMANKWAH, K. (1999), **Trade unions in the informal sector in Trade unions in the informal sector: Finding their bearings**. Nine country papers. Labour Education 1999/3. No.116, ILO

AGYEI, A. K. (1984), **Income Tax Evasion-The Ghanaian Experience**. The Journal of Management Studies, Vol.1, No. 2, p.40.

ALLINGHAM, M. G. and SANDMO, A. (1972), **Income tax evasion: A theoretical analysis**, Journal of Public Economics 1, pp. 323-338.

ALM JAMES and JORGE LUIS MARTINEZ-VAZQUEZ (2001), **Societal Institutions and Tax Evasion in Developing and Transition Countries**. A paper prepared for a public finance in developing and transitional countries conference, Georgia State University.

BARWA, S. D. (1995), **Structural Adjustment Programme and the Urban Informal Sector in Ghana**, Issues in Development, Discussion Paper.

BRAUTIGAM, DEBORAH, FJELDSTAD, O. and MICK MOORE (2008), **Taxation and State-Building in Developing Countries**. Capacity and Consent, Cambridge University Press.

CHIPETA, C. (2002), **The Second Economy and Tax Yield in Malawi**. Research Paper No. 113, African Research Consortium, Nairobi.

CHIUMYA, C. (2006), **Counteracting tax evasion in Malawi: An Analysis of the Methods and a Quest for Improvement**. MPRA (Munich Personal RePEc Archive) Paper No. 9892.



CLAYTON, E.G and BROWN, E.J (1983). **Economics, Principles and Practices.** *Columbus*; Merrill Publications.

CLOTFELTER, C. (1983), **Tax Evasion and Tax Rates: An Analysis of Individual Tax Returns.** *Review of Economics and Statistics*, 65, 3, pp. 363-373.

COSKUN, C.A and SAVASAN, F. (2009), **Tax Morale: Empirical Evidence from Turkey.** *Annual Meeting of the European Public Choice Society.*

DALTON, H. (1920). **The Measurement of the Inequality of Incomes.** *Economic Journal* 30 pp 348

EVEREST-PHILLIPS, M. (2008), **Business Tax as State-Building in Developing Countries: Applying Governance Principles in Private Sector Development.** *International Journal of Regulation and Governance* 8(2), pp. 123–154.

FARRELL, G., JOHN, R. and FLEMING, M. (2000), **Conceptualizing the Shadow Economy.** *Journal of International Affairs*, Spring, Vol. 53, No. 2 pp 318-409

FIEGE, E. L. (1994), **The Underground Economy and the Currency Enigma.** *Supplement to Public Finance*, Cambridge University Press p. 119

FEINSTEIN, J. (1991), **An Econometric Analysis of Income Tax Evasion and its Detection.** *Rand Journal of Economics*, 22 (1), 14-35.

FISHLOW, A. and FRIEDMAN, J. (1994), **Tax evasion, Inflation and Stabilization.** *Journal of Development Economics*, Vol. 43, No. 1, pp. 105-123.

FJELDSTAD, O. and MICK M. (2009), **Revenue Authorities and Public Authority in Sub-Saharan Africa.** *Journal of Modern African Studies*, 47, I (2009), pp. 1-18

FUEST, C. and RIEDEL, N. (2009), **Tax Evasion, Tax Avoidance and the Tax Expenditure in Developing Countries: A Review of the Literature.** Report prepared for the United Kingdom Department for International Development (DFID).Oxford University for Business Taxation

GHANA STATISTICAL SERVICE (2008), **Population and Housing Census**

GHANA STATISTICAL SERVICE (2010), **Population and Housing Census**

GOLDSMITH, S. F. (1951), **Appraisal of Basic Data Available for Constructing Size Distribution**. Conference on Research in Income and Wealth, New York, (1951), p. 302.

HART, J K. (1970), **Small-Scale Entrepreneurs in Ghana and Development Planning**. The Journal of Development Studies Vol. 6, No.4, p.104.

INTERNATIONAL LABOUR ORGANISATION (1993), **15<sup>th</sup> International Conference of Labour Statisticians**. Report of the Conference, Geneva

JACKSON, B. and MILLIRON, V. (1986), **Tax Compliance Research: Findings, Problems and Prospects**. Journal of Accounting Literature, 5, 125-165.

KIRCHLER, E., MUEHLBACHER, S., KASTLUNGER, B and WAHL, I. (2007), **Why Pay Taxes? A Review of Tax Compliance Decisions**, International Studies Program, Working Paper 07/30, Andrew Young School of Policy Studies Georgia State University.

LIEBERMAN, E. (2002), **Taxation Data as Indicators of State-Society Relations: Possibilities and Pitfalls in Cross-National Research**. Studies of Comparative International Development 36(1), pp. 89-115.

MO, P. L. L. (2003), **Tax Avoidance and Anti-Avoidance Measures in Major Developing Economies**. Westport.

OECD (2010a), African Economic Outlook 2010, Paris.

OECD (2010b), Promoting Transparency and Exchange of information for tax purposes.

OTIEKU, J. K (1988), **An Examination of the Problems of Income Tax in Ghana and Prospect of their Solution**. MBA Thesis, University of Ghana, Legon, p. 158.

PASHEV, K. (2005). **Tax Compliance of Small Business in Transition Economies: Lessons from Bulgaria.** Working paper 05-10. Andrew Young School of Policy Studies. Atlanta Georgia.

RICHARDSON, G. (2006), **Determinants of Tax Evasion: A Cross Country Investigation.** *Journal of International Accounting, Auditing and Taxation*, 15, pp. 150-169.

SBP (2005): Counting the cost of red tape for business in South Africa.

SOOKRAM, S. and Watson, P.K. (2005), **Tax Evasion, Growth and the Hidden Economy in Trinidad and Tobago.** Available at: [www.cavehill.uwi.edu/salises/conference/2005/Tax Evasion. Pdf](http://www.cavehill.uwi.edu/salises/conference/2005/Tax%20Evasion.Pdf).

THE INSTITUTE OF STATISTICAL, SOCIAL AND ECONOMIC RESEARCH (ISSER),  
The State of the Ghanaian Economy in 2003, p. 193

WALLSCHUTZKY, I. G. (1984), **Possible Causes of Tax Evasion.** *Journal of Economic psychology*, 5 (4), 371-384.

YANKSON, P.W.K (1992), **Formation of Enterprises in the Urban Informal Sector in Ghana.** *Journal of Management Studies*, University of Ghana. 1991, Vol. 7.

## **APPENDIX I**

### **Incidence of Tax Evasion Amongst Some Selected Groups in the Informal Sector in the Kumasi Metropolis**

#### **Introduction**

This questionnaire is designed to help address the problem of low tax revenue from the informal sector in Ghana, particularly Kumasi Metropolis. It looks at some of the factors that make the sector difficult-to-tax and reasons why people evade tax. Your participation in this study is strictly voluntary and your responses will be strictly confidential.

#### **Questionnaire for Taxpayers**

##### **Background Data**

1. Age Group: 18 - 25 years ( ) 26 - 35 years ( ) 36 - 45 years ( )  
46 years and above ( )
2. Gender: Male ( ) Female ( )
3. Marital Status: Married ( ) Single ( ) Divorced ( )
4. Level of Education: Basic/MSLC ( ) SHS/Commercial ( ) Diploma ( )  
Degree ( ) No Formal Education ( )
5. Type of Business: Artisan ( ) Beautician ( ) Catering Service ( )  
Grocery Store ( ) Drugstore ( ) Petty Trading ( ) Dressmaking ( )

##### **Section A: Incidence of Tax Evasion in Informal Sector**

- 6 a. Have you registered your business? Yes ( ) No ( )  
b. If No, why? .....
- 7 a. Do you have a permanent business location? Yes ( ) No ( )  
b. If No, why? .....
8. How long have you been in business? 0 - 5 years ( ) 11 - 15 years ( )  
16 - 20 years ( ) 21 years and above ( )
9. What is your level of income annually? Below ₵ 1,000 ( )  
Between ₵ 1,000 and ₵ 1,500 ( )  
Above ₵ 1,500 ( )
- 10 a. Have you heard about Ghana Revenue Authority? Yes ( ) No ( )  
b. If No, why? .....  
c. If yes, where did you hear about them? Media ( ) Friend ( ) Tax Education Programme ( )  
Other.....
- 11 a. Do you pay tax to the Ghana Revenue Authority? Yes ( ) No ( )

- b. If No, what form of levy do you pay? .....
- c. What body collects that levy? .....
12. Do you think it is necessary to pay tax?                      Yes ( )                      No ( )
- b. If No, why? .....

**Kindly circle the answer to indicate whether you agree or disagree with the questions below.**

**Point Scale**

**1 - Strongly Agree**

**2 - Slightly Agree**

**3 - Somewhat Agree**

**4 - Neutral**

**5 - Somewhat Disagree**

**6 - Slightly Disagree**

**7 - Strongly Disagree**

- |   |   |   |   |   |   |   |   |
|---|---|---|---|---|---|---|---|
| 13. Do you agree some businesses carry out transactions on cash basis?      | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| 14. Do you agree some businesses do not keep proper records?                | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| 15. Do you agree some businesses fail to file return of income to GRA?      | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| 16. Do you agree some businesses do not disclose their true income to GRA?  | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| 17. Do you agree some businesses inflate their deductions to reduce income? | 1 | 2 | 3 | 4 | 5 | 6 | 7 |

**Section B: Level of Tax Evasion in Informal Sector**

- |  |   |   |   |   |   |   |   |
|--|---|---|---|---|---|---|---|
| 18. You would cheat on tax if you have the chance  | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| 19. It is wrong if a taxpayer does not report all of his or her income in order to pay less income tax | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| 20. If in doubt about whether not to report a certain source of income, you would not report it.       | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| 21. taxes are so heavy that tax evasion is an economic necessity for many to survive                   | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| 22. You pay taxes voluntarily without public coercion  | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| 23. Since everybody evades taxes, one can hardly be blamed for doing                                   | 1 | 2 | 3 | 4 | 5 | 6 | 7 |

**Section C: Reasons for Tax Evasion in Informal Sector**

- |  |   |   |   |   |   |   |   |
|--|---|---|---|---|---|---|---|
| 24. You pay less tax if you know that you would not be penalized.            | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| 25. You pay taxes if most of the money collected is spent on worthy projects | 1 | 2 | 3 | 4 | 5 | 6 | 7 |

26. You would evade tax if the probability of getting caught is low 1 2 3 4 5 6 7
27. Do you agree people evade taxes if they think the amount of  
income tax is too high? 1 2 3 4 5 6 7
28. You would evade tax if there is lack of transparency and  
accountability in the use of public funds 1 2 3 4 5 6 7
29. Do you agree businesses evade taxes if there is high compliance cost? 1 2 3 4 5 6 7

#### **Section D: Mechanisms to check Tax Evasion in Informal Sector**

30. Do you agree education from tax authorities on the need to pay tax  
would reduce evasion? 1 2 3 4 5 6 7
31. Do you agree paying substantial fine would deter people from  
evading tax if the IRS detect tax evasion? 1 2 3 4 5 6 7
32. Do you agree tax evaders prosecuted in court would deter people  
from evading tax if IRS detect tax evasion? 1 2 3 4 5 6 7
33. Do you agree providing taxpayers services to assist them in filing  
returns and paying taxes would reduce tax evasion? 1 2 3 4 5 6 7
34. Do you agree tax evasion would reduce if tax authorities simplify tax  
form and mode of payment of taxes? 1 2 3 4 5 6 7
35. Do you agree improving the tax agency website and phone advice  
service would reduce tax evasion? 1 2 3 4 5 6 7

## **APPENDIX II**

### **Questionnaire for Tax Officials**

1. What is the extent of registration of businesses in the informal sector?
2. How do you keep track of unregistered businesses for tax purposes?
3. What is the level of file returns on income from the registered businesses?
4. What is the level of tax evasion in the informal sector?
5. What are some the factors that account for tax evasion in the informal
6. What measures have you put in place to prevent or reduce tax evasion in the sector?