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COLLEGE OF HUMANITIES AND SOCIAL SCIENCES

SCHOOL OF BUSINESS

DEPARTMENT OF ACCOUNTING AND FINANCE

**CHALLENGES OF INCOME TAX COMPLIANCE IN THE INFORMAL SECTOR OF
ADANSI NORTH DISTRICT**

**A DISSERTATION PRESENTED TO THE DEPARTMENT OF ACCOUNTING AND
FINANCE IN PARTIAL FULFILLMENT OF THE REQUIREMENT FOR THE
AWARD OF MASTERS IN BUSINESS ADMINISTRATION**

BY

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DECLARATION

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

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SUPERVISOR'S DECLARATION

I declare that I have supervised the student in undertaking the study submitted herein and I confirm that she has my permission to submit it for assessment.

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Dr. K. O. Appiah (Head of Department)	DATE

DEDICATION
TO GOD AND FAMILY

ACKNOWLEDGEMENT

I am deeply indebted and thankful to my supervisor- Mr. Edward Yeboah, my mother madam Theresa Serwaa, father - Mr. A. Y. Klue and adorable sister Vivian Klu.

Special thanks go out to all other family members and individuals who encouraged and helped me to pursue the Masters programme.

Thank you and may God richly bless you all.

ABSTRACT

Governments and their tax authorities have been working around the clock to bring the informal sector into the tax bracket. Efforts by governments to widen the tax base will greatly increase revenue leading to a reduction in the reliance on donor funding and in incidences where governments are forced to increase taxes on basic commodities. The study set forth to determine the level of income tax compliance by the informal sector, the challenges faced by the informal sector in complying with income tax liabilities and the reasons for the non-compliance of income tax by the informal sector of Adansi North District. The study reviewed literature related to income tax compliance in general and employed a quantitative and qualitative methodology. The questionnaires and follow up interviews were used as the main instrument in the collection of data. The study used a sample size of 230 which comprised entrepreneurs in the informal sector of Adansi North District. The research questions were analyzed through the use of statistics tools (Tables, percentages, pie charts, and bar charts). This study identified that majority of respondents were mostly into retail/commerce and agriculture. On the average the amount of tax paid by the informal sector deviated from expected tax to be reported and paid to GRA by 25.25%. Participants recounted inefficiencies with GRA as part of the reasons for income tax non-compliance. Another reason identified for tax non-compliance and evasion by the study included the perceived misuse of the revenues collected by GRA. Challenges identified from the work ranged from high rate of taxation, cost of complying with tax, skill and education base in the sector to firm wide performance. In the light of the above findings to the study, the researcher proposes that GRA should focus on strengthening its structures to eradicate the loopholes as well as ensure proper use and allocation of revenues.

TABLE OF CONTENTS

Contents

DECLARATION.....	ii
DEDICATION	iii
ACKNOWLEDGEMENT.....	iv
ABSTRACT	v
TABLE OF CONTENTS	vi
LIST OF TABLES	ix
CHAPTER ONE.....	1
INTRODUCTION.....	1
1.0 Background of the Study.....	1
1.1 Problem Statement	5
1.2. Objective of the Study.....	6
1.2.1 General Objectives	6
1.2.2 Specific Objectives.....	6
1.3 Research Questions	6
1.4 Significance of the Study	6
1.5 The Scope of the Study	7
1.6 Limitation of the Study.....	7
1.7 Organization of the Study.....	7
CHAPTER TWO.....	8
LITERATURE REVIEW.....	8
2.0 Introduction	8
2.1 Definition and Concept of Taxation.....	8
2.2 Taxation in Ghana- A Historical Perspective.....	10
2.3 Classification of Taxes	13
2.3.1 Tax Base	13
2.3.2 Direct/Indirect	13
2.3.3 Distribution Of The Tax Burden	14
2.3.4 Income Tax.....	15
2.3.5 Inheritance Tax.....	15
2.3.6 Sales Tax	15
2.3.7 Corporation Tax	16
2.4 Income Tax Concepts.....	16

2.5 The Administration of Taxation in Ghana	17
2.6 Taxation and Compliance.....	18
2.7 Concepts of Income Tax Evasion, Avoidance and Default.....	22
2.8 The Informal Sector in Ghana	25
2.8.1 Classification of the Informal Sector.....	27
2.9 Determinants of Tax Compliance.....	29
2.9.1 Structure of the Tax System	30
2.9.2 Tax Rates	30
2.9.3 Tax Audits	32
2.10 Reasons for Non-Compliance	33
2.11 Empirical Research.....	35
CHAPTER THREE	40
METHODOLOGY	40
3.0. Introduction	40
3.1 Research Design	40
3.2 Sources Of Data	41
3.2.1 Primary Data.....	41
3.2.2 Secondary Data.....	42
3.3 Population.....	42
3.4 Sample and Sampling Technique	42
3.5 Data Collection Instrument.....	43
3.5.1 Questionnaires.....	43
3.6 Data Collection Procedure.....	43
3.7 Data Analysis.....	44
3.8 Validity And Reliability.....	44
CHAPTER FOUR	45
DATA ANALYSIS AND DISCUSSION OF RESULTS	45
4.0 Introduction	45
4.1 Respondents Reaction	45
4.2 Analysis of Responses from Respondents.....	46
4.2.1 Gender	46
4.2.2 Age Distribution.....	47
4.2.3 Level of Education	47
4.2.4 Occupational Distribution	48

4.3 Level Of Income Tax Compliance	49
4.3.1 Extent of Compliance	49
4.3.2 Level of Voluntary Compliance	50
4.3.3 Opinions on Income Tax Evasion	51
4.3.4 Income Tax Payment.....	52
4.3.5 Opinions on Income Tax Compliance	55
4.3.5 Motivation for Income Tax Compliance	57
4.4 Challenges in Complying with Income Tax Laws	60
4.5 Reasons for Non-Compliance	63
4.6 Measures to Adopt in Improving Income Tax Compliance.	66
CHAPTER FIVE.....	68
SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS	68
5.0 Introduction	68
5.1 Summary of Findings	68
5.1.1 Dominant Economic Activity in the Informal Sector.....	68
5.1.2 The Level of Income Tax Compliance by the Informal Sector of Adansi North District.....	69
5.1.3 Reasons for Income Tax Non-Compliance	69
5.1.4 Motivation for Income Tax Compliance	70
5.1.5 The Challenges Faced by the Informal Sector in Complying with Income Tax Liabilities.....	70
5.2 Conclusion.....	70
5.3 Recommendations	71
5.3.1 Proper Administration of Income Tax Revenues	71
5.3.2 Elimination of Loopholes	72
5.3.3 Improved Means of Income Tax Collection.....	72
5.3.4 Compulsory Registration of Businesses.....	72
5.3.5 Strict Enforcement of Income Tax Policy	72
APPENDIX ONE.....	73
Reference:.....	73
APPENDIX TWO:	77
Questionnaire.....	77

LIST OF TABLES

<i>Table 4.1 Respondents Reaction to the Questionnaires</i>	45
<i>Table 4.4 Income Tax Evasion</i>	53
<i>Table 4.9 Level of Satisfaction for GRA Services</i>	63
<i>Table 4.10 Compliance Challenges</i>	66

CHAPTER ONE

INTRODUCTION

1.0 Background of the Study

National revenue is raised through various ways. These include direct taxes, indirect taxes, royalties and others. Both the formal and informal sectors of the economy contribute in mobilizing revenue for national development. While the formal sector is well structured to prevent evasion of taxes, the informal sector is not well organized (Ofori, 2009). The corporate income tax is an important source of federal revenue and must be considered in dealing with the nation's long-term fiscal imbalance (GAO, 2006). Taxation refers to the inherent power of the state, acting through the legislature, to impose and collect revenues to support the government and her recognized object, and taxes are enforced proportional contributions from persons and property, levied by the law-making body of the state by virtue of its sovereignty for the support of the government and all public needs.

Governments and their tax authorities have been working around the clock to bring the informal sector into the tax bracket. Efforts by governments to widen the tax base will greatly increase revenue leading to a reduction in the reliance on donor funding and in incidences where governments are forced to increase taxes on basic commodities. However, a large chunk of this sector continues to slip through the noose of tax authorities, even as governments grapple with the complex problem of how to avoid this. The informal sector in many African countries encompasses a wider section of the economy. In most Sub-Saharan African (SSA) countries, revenue collection is negatively affected by the existence of a large and growing informal sector, high tax evasion, and weak tax administration. Raising tax revenue is a major concern

for most developing countries; this is because not only is their tax revenue collection level small, but also the tax compliance is said to be low (Tripp, 2002). Many scholars have tried to define the informal sector concept as, the economic activities/transactions which are not captured or are under-reported in the official statistics. The 1972 ILO report on Kenyan unemployment was the first step to popularize the informal sector concept, the report defined informal activities as ‘all economic activities that are neither monitored nor taxed by the government, and are not included in the government GNP statistics’ (ILO, 1972:4).’ The informal sector in Africa as a percentage of GDP was 42 percent in 2000, and accounted for 48 percent of the official labour force on the continent. Zimbabwe, Tanzania and Nigeria had by far the largest informal economies with 59.4, 58.3 and 57.9 percent respectively, and Mozambique, Côte d’Ivoire and Madagascar in the middle with 40.3, 39.9 and 39.6 percent. At the lower end are Botswana with 33.4 percent, Cameroon 32.8 percent and South Africa with 28.4percent. The benefits of taxing the informal sector are two-fold: it increases government revenue as well as recognizes the sector as a legitimate source of economic activity, which in turn increases economic participation.

Developing countries need to rely substantially on domestic revenue mobilization in order to avoid excessive foreign financing which may in the long run lead to problem of debt sustainability, (Gupta, 2007). To strengthen domestic resource mobilization, developing countries have to rely on taxation and seek to raise additional revenue by expanding the tax base and strengthen revenue administration. Taxation is the most efficient and effective means of raising revenue for the government (Gberegbe, 2007). The Ghanaian economy is divided into formal and informal sectors. While the formal sector employs about 14% of the labour force, the informal sector (including agricultural sector) is the source of livelihood for the remaining

86% of the working population (GTUC, 2004). Despite the significant contribution of the informal sector to the economies of developing countries, they are the least taxed.

Although difficult to quantify with any degree of accuracy, revenue bodies generally acknowledge that non-compliance associated with their respective informal sector of the economy is a significant area of tax risk and tax revenue leakage. Furthermore, dealing effectively with such non-compliance presents many challenges, given a range of factors:

1. Economic transactions comprising the informal sector of the economy can be difficult to detect, given the relatively large number of participants involved, the informality of the economic activities concerned, and the deliberate steps taken to conceal transactions;
2. Participants rarely maintain adequate books and records of their economic activities, making it a difficult and time-consuming task for revenue officials to quantify unreported income; and
3. For many participants the amounts of tax involved are relatively small; however, given the large numbers involved, the aggregate tax revenue at stake is sizeable.

The difficulties of dealing with such non-compliance emphasize the importance of revenue bodies exchanging details of their approaches and experiences, successful or otherwise, in dealing with these issues (OECD, 2012). Tax non-compliance is a range of activities that are unfavorable to a state's tax system. This may include tax avoidance, which is tax reduction by legal means, and tax evasion, which is the criminal non-payment of tax liabilities. The use of the term 'noncompliance' to refer to tax avoidance, however, is not universal or standard, and similar terms are also used differently by different authors. For example, in the United States the use of the term 'noncompliance' often refers only to illegal misreporting. Laws known as a General Anti-Avoidance Rule (GAAR) statutes which prohibit "tax aggressive" avoidance have

been passed in several developed countries including the United States (since 2010), Canada, Australia, New Zealand, South Africa, Norway and Hong Kong. Though the specifics may vary according to jurisdiction, these rules invalidate tax avoidance which is technically legal but not for a business purpose or in violation of the spirit of the tax code. Related terms for tax avoidance include tax planning and tax sheltering.

Individuals that do not comply with tax payment include tax protesters and tax resisters. Tax protesters attempt to evade the payment of taxes using alternative interpretations of the tax law, while tax resisters refuse to pay a tax for conscientious reasons. Tax protesters believe that taxation under the Federal Reserve is unconstitutional, while tax resisters are more concerned with not paying for particular government policies that they oppose. Because taxation is often perceived as onerous, governments have struggled with tax noncompliance since the earliest of times. The GRA recognizes three types of voluntary compliance: filing compliance (the timely filing of any required return); reporting compliance (the accurate reporting of income and of tax liability); and payment compliance (the timely payment of all tax obligations). This study focuses on both filing compliance and reporting compliance. The most basic measure of voluntary compliance is what the taxpayers actually did: how many returns were filed, and how much income and offsets they reported on those returns.

Reducing the revenue losses arising from non-compliance with tax laws is a critical objective of all revenue bodies. Nowhere is this more important than in the small/medium enterprise (SME) sector of the tax-paying population, which a number of countries have shown to be the least compliant of all taxpayer segments. A major component of non-compliance in the SME sector arises from economic activities that go unreported for tax (including social contributions) and

sometimes other regulatory purposes (e.g. health and safety, social security, and licensing). These unreported activities take many guises and exist across a diverse array of economic participants and together constitute part of what the OECD describes as a country's non-observed economy (OECD 2012).

1.1 Problem Statement

Income tax non-compliance is an activity commonly associated with the informal economy. One measure of the extent of non-compliance is the amount of unreported income, which is the difference between the amount of income that should be reported to the tax authorities and the actual amount reported. The informal sector comprise of income generating enterprises that operate on small scale using simple skills (Schneider, 2002). Anecdotally, the Adansi North informal sector entrepreneurs' degree of income tax compliance is very low.

The Ghanaian income tax system operates on a self-assessment basis where the government expects taxpayers to determine their own tax obligations and to pay voluntarily whatever is due both regularly (through withholding from wages and through estimated tax payments, if necessary) and at year end (by filing tax returns and paying any additional balances due). By placing the onus on taxpayers, the government avoids the costly alternative of determining each individual's tax liability and doing whatever it must to collect it. However, one cost of relying so heavily on the voluntary compliance of taxpayers is that not all tax is voluntarily paid therefore denying the statutory state institutions the opportunity of meeting or exceeding their set target. Non-compliance results in the state losing quite a substantial amount of revenue earmarked for developmental activities and largely, deficit on financial health.

1.2. Objective of the Study

1.2.1 General Objectives

To assess the challenges of income tax compliance in the informal sector in the Adansi North District of Ashanti Region.

1.2.2 Specific Objectives

1. To determine the level of income tax compliance by the informal sector of Adansi North District.
2. To examine the challenges faced by the informal sector in complying with income tax liabilities.
3. To find out the reasons for the non-compliance of income tax by the informal sector of Adansi North District.

1.3 Research Questions

1. What is the extent of income tax compliance by the informal sector?
2. What are challenges of tax compliance in the informal sector of Adansi North?
3. What accounts for income tax non-compliance in the informal sector?

1.4 Significance of the Study

A complex tax code, complex business transactions, and multinational corporate structures make determining corporate tax liabilities and the extent of corporate tax avoidance a challenge. Opportunities exist to improve corporate tax compliance and include simplifying the tax code, obtaining better data on non-compliance, continuing to oversee the effectiveness of GRA enforcement, leveraging technology, and sending sound compliance signals through increased collections of taxes owed (GAO, 2006).The informal sector plays significant roles in Ghana and

can be considered as one of the pillars of the economy. This study when successfully carried out will provide policy makers and businesses with information that will enable them implement strategies to enhance taxation. The key findings and the recommendation thereof will also guide academicians for further research so as to contribute repertoire of knowledge to the world.

1.5 The Scope of the Study

The study involved enquiries into the challenges of income tax compliance in the informal sector. Attention was focused only on the informal business sector in Adansi North District taking into account such taxpayers as petty traders, hawkers, hairdressers, dressmakers, artisans and so on. Selected businesses were adopted from the aforementioned District for the study.

1.6 Limitation of the Study

The challenges encountered in undertaking this study was in respect of inadequate time to conduct interview with larger sample size, which was desired for reliability and validity considerations. In addition, the sample was scattered across the selected geographical area that made selection of the sample difficult. Notwithstanding, efforts were made to mitigate the impact of these constraints in order to limit their impact on the outcome of study.

1.7 Organization of the Study

The study is organized into five chapters; where chapter one covered the background of the study with well spelled out objectives of the study. Chapter two and three embodied review of relevant literature and methodology respectively. The chapter four and five contained the analysis and presentation of results of the study and discussions, conclusions and recommendations of the study respectively.

CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

The definition of tax compliance in its most simple form is usually cast in terms of the degree to which taxpayers comply with the tax law. However, like many such concepts, the meaning of compliance can be seen almost as a continuum of definitions. This ranges from the narrow law enforcement approach, through wider economic definitions and on to even more comprehensive versions relating to taxpayer decisions to conform to the wider objectives of society as reflected in tax policy (James et al., 2004). This chapter seeks to overview, summarize and evaluate current state of knowledge about existing literature by researchers and accredited scholars relating to the topic under study. The chapter reviews the concept of income tax compliance in the informal sector. It also reviews empirical study on the scope of income tax compliance and challenges with respect to tax compliance.

2.1 Definition and Concept of Taxation

The art of taxation consists in so plucking the goose as to obtain the largest possible amount of feathers with the smallest possible amount of hissing (Colbert, 1665 cited in, Smith, 2008). Taxation is the mode by which governments make exactions for revenue in order to support their existence and carry out for their legitimate objectives. It is indispensable and inevitable price for civilized society; without which the government would be paralyzed. Aberas-Calayag, (2011). Government cannot exist and function without the means to pay her expenditures. Taxation is for public purpose- the proceeds of the tax must be used for the support of the state or for some recognized objects of government or to directly promote the welfare of the populace.

Taxation is inherently legislative – it is inherent power of sovereignty. Taxation is exercised only within territorial jurisdiction of the taxing authority.

A tax (from the Latin *taxo*; "rate") is a financial charge or other levy imposed upon a taxpayer (an individual or legal entity) by a state or the functional equivalent of a state such that failure to pay, or evasion of or resistance to collection, is punishable by law. Taxes are also imposed by many administrative divisions. Taxes consist of direct or indirect taxes and may be paid in money or as its labour equivalent. Eshag (1983) argues that, the amount of tax revenue generated by a government for its expenditure programmes depends among other things, upon the willingness of the taxpayer to comply with the tax laws of the country. This willingness could also be attributed to the attitude that taxpayers demonstrate at any given point in time on the one hand and the purpose of the tax on the other hand (Noami and Joel, 2009).

Organization of Economic Co-operation and Development (OECD) on a debate concluded that the term tax could be “confined to compulsory unrequited payment to government”. From this definition, one can draw the following conclusion or implications:

1. Tax is an imposition
2. It is a compulsory levy
3. Tax is a no quid pro qua payment to the tax payer
4. It involves capital or funds outlay

Taxation is a compulsory levy and an imposition by the government or the authority that be. The conclusion drawn from this exposition is that, taxes have been and still continue to be a vexatious issue because one can cite several instances of peoples’ resentment to taxes.

2.2 Taxation in Ghana- A Historical Perspective

Taxation was first introduced in Ghana, then the Gold Coast, in 1943 by the British Colonial Government at a time when World War II was raging. It should be noted, however, that before the introduction of Income Tax in 1943, several attempts had been made. For example, as far back in April, 1852, the Poll Tax Ordinance was passed to raise money to finance the increased cost of British Administration (Ali-Nakyea, 2008). Under the Ordinance, every man, woman or child residing in districts under British Protection was to pay one shilling per head per year. These early experiments of the introduction of direct taxation failed because of the weakness inherent in the system of collection and the fact that the first proceeds were mainly used to pay the increased salaries of British officials and not for the construction of roads, schools and other infrastructural facilities. The first Income Tax Law was thus the Income Tax Ordinance (No.27), 1943. This Ordinance was modeled to a large extent on the general principles underlying the Income Tax Act then in force in the United Kingdom (Ali-Nakyea, (2008).

It imposed the tax generally on incomes having sources in Ghana so that foreign source income was not liable unless it was remitted in Ghana. One main feature of this Ordinance was the numerous personal reliefs and deductions that it contained after attaining her political independence and as a new sovereign state, Ghana needed funds to run the state machinery, to consolidate the newly won independence and also to meet the developmental aspirations of her people. For these reasons there was the need for drastic changes in the Tax system inherited from the colonial masters. For example, in 1961, drastic amendments were made to the consolidated edition under Act 68, followed by Act 178 in 1963 and sealed off by Act 132 in 1965. A second consolidated edition (The Income Tax Decree, 1966-No. 78) was published in September, 1966.(Ali Nakyea, 2008) Further steps aimed at consolidating the Income Tax

System led to a series of amendments to the ordinances until the Income Tax Decree 1975, S.M.C. Decree 5 was enacted. The current Income Tax Law is the Internal Revenue Act, 2000 (Act 592).

Like many developing countries, Ghana depends heavily on taxes to generate the much needed revenue for development. Hence, in an attempt to reduce the complexity of the tax system in order to enhance efficiency, minimize the underground economy, discourage tax evasion and generate sufficient revenue, Ghana's tax system has undergone several structural reforms since the past three decades. In 1983, the initial tax reform measure of the fiscal adjustment programme was designed largely to restore the tax base which had been battered by the constant over-valuation of the domestic currency. This measure was expected to broaden the tax net, lower the tax burden on economic agents and reduce tax evasion. The reform also included the strengthening of production incentives with the introduction of an Investment Code (PNDC Law 116, 1985) and a new Minerals Law (Minerals Commission Law, 1986). This code identified four sectors-tourism, manufacturing, construction and building and agriculture as targeted sectors of investment. The code also provided a wide range of tax incentives and benefits to foreign and domestic investors with enterprises engaging in activities in any of the four areas.

The introduction of the Value Added Tax in 1995, which cut across a wide range of commodities, was expected to minimize changes in the behavior of economic agents. The administrative reform of 1985 also focused on measures to enhance the efficiency of the tax administration and improve upon the equity of the tax system. A major component of this reform was the conversion of the Internal Revenue Service (IRS) and Customs, Excise and Preventive Service (CEPS) into the Ghana Revenue Authority, an autonomous corporate body

with new organizational structures (GRA) in 2009. Its objective is to strengthen the role of the revenue institutions in achieving increased revenue collection and changing the structure of the tax system to make it more efficient and equitable.

In spite of its current middle income status, Ghana continues to face challenges with regard to mobilization of tax revenues, and there seems to be no end in sight in this regard. For example, only 1.5 million citizens out of the estimated taxable population of 6 million pay direct taxes (Ghana, 2011). This represents only 25% rate of compliance. The share of personal income tax to total tax revenue has been the lowest in the past 15 years (Ghana, 2012). Historically, Ghanaians vehemently resisted Act 486 of 1994, the law that initially introduced the Value Added Tax (VAT). The famous “Kumipreko” demonstrations and other resistance protests against the introduction of the tax were fierce (Ali-Nakyea, 2006). Quite recently, the general public’s response to the introduction of the Communication Service Tax (CST) christened “Talk tax” was negative.

In 2007, the tax administration management information system was computerized and a unique identification number assigned to taxpayers for easy tracking by tax collectors. In addition, there has been gradual reduction of tax rates and elimination of multiple tax rates to reduce the distortions that arise from such tax systems. The introduction of the e-government project in November 2011 is aimed at linking Ghana Revenue Authority (GRA) to the Registrar General’s Department (RGD) electronically to ensure GRA has access to the database of registered businesses for easy tracking and collection of tax payments. In spite of the several fiscal reforms implemented to minimize tax burden and discourage activities of the underground economy, tax evasion continues to be a problem in

Ghana. The presence of a large shadow economy implies activities which are liable to tax payments are hidden from the tax authorities and the related tax revenues are not collected.

2.3 Classification of Taxes

A tax is a compulsory contribution, imposed by government, and while taxpayers may receive nothing identifiable in return for their contribution, they nevertheless have the benefit of living in a relatively educated, healthy and safe society. Taxes can be classified in the following ways:

2.3.1 Tax Base

Taxes have to be levied on some basis or other, and a convenient way of classifying a tax is to do so according to what is being taxed. Three main tax bases are used in the present Ghana tax system. Using the tax base is a convenient classification for economic analysis, for example, in examining who exactly bears the burden of a tax, known as the incidence of taxation; but the tax base can cause problems in terms of definition how, for example, should income be defined?

2.3.2 Direct/Indirect

Taxes can either be classified as either direct or indirect. Example of the former is the income tax and the latter is the sales tax. There is much disagreement among economists as to the criterion for distinguishing between direct and indirect, and it is unclear into which category certain taxes, such as corporate tax and property taxes should be classified. Direct tax is one of the incident of which cannot be shifted by the tax payer to someone else with relative ease.

2.3.2.1 Direct Taxes

Direct taxes are primarily taxed on persons; they are aimed at the individuals' ability to pay as measured by his income or his wealth. It is based on the principles of pay as you Earn (PAYE) and it is directly levied on the income earned or to be received. Direct tax is therefore money

paid out directly to the government based on what the individual earns. Direct taxes are borne wholly by the individual paying it and it is not transferable but progressive. This tax includes income tax, property rate, gift tax and capital gains tax.

2.3.2.2 Indirect Taxes

Indirect tax is indirectly paid by the final consumer of goods and services. The incidence of tax can be shifted or transferred to another person who is receiving the goods and services or transaction. It includes general and selection taxes on sales of consumable goods, value added tax (VAT) on goods in the process of production, taxes on legal transactions, customs duties and excise duties on locally manufactured goods.

2.3.3 Distribution of the Tax Burden

The way in which the burden of tax is distributed among the taxpaying community is another way in which taxes may be classified. The rates of tax can be set in such a way so that they are:

1. Progressive: Progressive taxes take an increasing portion as the value of the tax base rises and depend on the marginal rate of tax being greater than the average rate of tax.
2. Proportional: Proportional taxes take a constant portion of the value of the tax base and depend on the marginal and average rates of tax being equal.
3. Regressive: A tax is regressive when tax rate declines as income rises. In other words, a tax is said to be regressive and not progressive if the lower the income, the higher the proportion of income paid in tax.

Furthermore, there are several kinds of taxes. Some of these taxes are: Ad valorem, Capital gains tax, Consumption tax, Corporation tax, Environment Affecting Tax, Excises, Income tax, Inheritance tax, Poll tax, Property tax, Retirement tax, Sales tax, Tariffs, Toll, Transfer tax, Value Added Tax / Goods and Services Tax, Wealth (net worth) tax (OECD,2004).

2.3.4 Income Tax

This is a tax paid on income whether individual or business income. It may be levied on Employment income, Pension income, Social security income, Self-employed income from a trade, profession or vocation, Property income, Savings and investment income, Miscellaneous income. An income tax can be progressive, proportional, or regressive (Advice guide, 2009).

2.3.5 Inheritance Tax

This is usually paid on an estate when somebody dies and it is imposed on the people (beneficiaries) who receive property from the deceased. The tax is calculated separately for each beneficiary, and each beneficiary is responsible for paying his or her own inheritance taxes (Dianne, 1998). It's also sometimes payable on trusts or gifts made during someone's lifetime (HM Revenue and Customs, 2009).

2.3.6 Sales Tax

This a tax charged as a percentage of the sale price at the point of purchase for certain goods and services. It can be either included in the price or added at the point of sale, with the economic burden of tax falling on the consumer. It could be a retail sales tax; where the tax burden only falls on final end user, seller or vendor tax; where a gross receipt tax is imposed on all sale of a business, consumer excise tax; which is on high value items or a value added tax; which is charged on all sales. This kind of tax is infamously known to be regressive in nature, since low income families spend a greater share of their income on taxable consumption in a given year (OECD, 2004).

2.3.7 Corporation Tax

This is a tax on the taxable profits of limited companies and some organisations including clubs, societies, associations, co-operatives, charities and other unincorporated bodies. Taxable profits for Corporation Tax include: profits from taxable income such as trading profits and investment profits - except dividend income which is taxed differently and capital gains - known as 'chargeable gains' for Corporation Tax purposes (Business Link, 2009). According to Encarta 2009, it is one of the most controversial types of taxes because it leads to double taxation of corporate income. Income is taxed once when it is earned by the corporation, and a second time when it is paid out to shareholders in the form of dividends. Thus, corporate income faces a higher tax burden than income earned by individuals or by other types of businesses

2.4 Income Tax Concepts

Income tax is based on a system of rules and regulation that determine the treatment of various items of income and expenses. The key point to be made is that income taxation is based on a system. As such, it shares the characteristics of any type of system. Income tax system has been developed around general concepts that guide in its application to various types of transactions. There are, of course, exceptions that do not follow from the application of the general concepts. These exceptions generally stem from the desire to use the tax system to promote some social, economic or political goals. Income tax concepts can be grouped into their major functions within the income tax system. Before beginning the discussion of the concepts, it is necessary to introduce a bit of terminology. A concept is a broad principle that provides guidance on the income tax treatment of transaction. A construct is a mechanism that has been developed to implement a concept. A doctrine is a construct that has been developed by the courts. Thus, construct and doctrines are the interpretive devices necessary to apply a concept. A fundamental

concept underlying the income tax structure is the ability-to-pay concept. This concept states that the tax levied on a taxpayer should be based on the amount that the taxpayer can afford to pay. The first result of this concept is that the income tax base is a net income number (i.e. income minus deductions and losses) rather than a gross Figure such as total income received. Therefore, the tax base recognizes different deduction levels incurred by taxpayers as well as different levels of income.

2.5 The Administration of Taxation in Ghana

In the administration of tax in Ghana, there are three main organizations that are involved. Whereas the Customs, Excise and Preventive Service (CEPS) and the Value Added Tax Service (VAT Service) are in charge of the administration of Indirect Taxation, the Internal Revenue Service (IRS) takes charge of the administration of Direct Taxation. In administering Direct Taxation, the Ghana Revenue Authority currently uses as its main legal document, the Internal Revenue Act 2000, Act 592 which came into effect in January, 2001 with other subsequent amendments and other related complimentary legislations. As part of the requirements for all businesses in Ghana, the Internal Revenue (Registration of Business) Act 2005, Act 684, provides that “A person shall not carry on any business unless that person has registered the business with the Commissioner.” Sections 10 and 11 of the Internal Revenue Act 2000, Act 592 state that, “Income accruing to or derived by an exempt organization other than Income from any business” shall be exempted from tax. To make the provision more operational Section 94 also states that an “exempt organization” means a person who or that is and functions as a religious, charitable or educational institution of a public character”. In Section 94(b) it is stated that “exempt organization” means a person who or that has been issued with a written ruling by the Commissioner currently in force stating that it is an exempt organization;

and (c) “none of whose income or assets confers, or may confer, a private benefit, other than in pursuit of the organization’s functions referred to in paragraph (a). Looking at the above provisions of the Income Tax Laws, the first condition that has to be satisfied before an organization can be exempted from tax is that the person is and functions as an organization of one of the types as provided in Paragraph (a) (i) – (v). It is not sufficient that the organization be classified as of the relevant type; it must also function in that manner. So an organization which was established for a relevant purpose will not be an exempt organization until it functions in a manner consistent with the purpose.

2.6 Taxation and Compliance

Tax compliance is a major problem for many tax authorities and it is not an easy task to persuade taxpayers to comply with tax requirements even though ‘tax laws are not always precise’ (James and Alley, 2004). The exact meaning of tax compliance has been defined in various ways. For instance, Andreoni, et al. (1998) claimed that tax compliance should be defined as taxpayers’ willingness to obey tax laws in order to obtain the economy equilibrium of a country. Kirchler (2007) perceived a simpler definition in which tax compliance is defined as the most neutral term to describe taxpayers’ willingness to pay their taxes. A wider definition of tax compliance, defined in 1978 by Song and Yarbrough suggested that due to the remarkable aspect of the operation of the tax system in the United States and that it is largely based on self-assessment and voluntary compliance, tax compliance should be defined as taxpayers’ ability and willingness to comply with tax laws which are determined by ethics, legal environment and other situational factors at a particular time and place.

Similarly, tax compliance is also defined by several tax authorities as the ability and willingness of taxpayers to comply with tax laws, declare the correct income in each year and pays the right

amount of taxes on time (Internal Revenue Service Act, 2000 Act592). Alm (1991) and Jackson and Milliron (1986) defined tax compliance as the reporting of all incomes and payment of all taxes by fulfilling the provisions of laws, regulations and court judgments.

Another definition of tax compliance is a person's act of filing their tax returns, declaring all taxable income accurately, and disbursing all payable taxes within the stipulated period without having to wait for follow-up actions from the authority Singh (2003). Furthermore, tax compliance has also been segregated into two perspectives, namely compliance in terms of administration and compliance in terms of completing (accuracy) the tax returns Chow (2004) and Harris (1989).

Compliance in pure administrative terms therefore includes registering or informing tax authorities of status as a taxpayer, submitting a tax return every year (if required) and following the required payment time frames Ming Ling et al (2005). In contrast, the wider perspective of tax compliance requires a degree of honesty, adequate tax knowledge and capability to use this knowledge, timeliness, accuracy, and adequate records in order to complete the tax returns and associated tax documentation (Singh and Bhupalan, 2001). In line with this, Singh, et al. (2003), claimed that the wider perspective of compliance becomes a major issue in a self-assessment system since the total amount tax payable is highly dependent on the levels of tax compliance this perspective reveals, although it is inevitable that tax authorities will seek to 'influence' the areas taxpayers have influence over determining to reduce the risks of non-compliant behavior they face otherwise e.g. through continuously conducting tax audits of different sorts and other means such as various compliance influencing activities including tax education.

Some authors have viewed tax compliance from a different perspective. For example, Allingham and Sandmo (1972) described tax compliance as an issue of ‘reporting an actual income’ and also claimed that tax compliance behavior was influenced by a situation whereby taxpayers have to make a decision under uncertainty Clotfelter (1983) i.e. either taxpayers would enjoy tax savings due to under-reporting income or have to pay tax on the undeclared amount at a penalty rate which is higher than they would have paid had the income been fully declared at the correct time.

McBarnet (2001) suggested tax compliance should be perceived in three ways, namely;

1. Committed compliance - taxpayers’ willingness to pay taxes without complaint;
2. Capitulative compliance - reluctantly giving in and paying taxes and
3. Creative compliance – engagement to reduce taxes by taking advantage of possibilities to redefine income and deduct expenditures within the bracket of tax laws.

Spicer and Lundstedt (1976) perceived degrees of tax compliance as ‘a special form of gambling’ (which, may involve the likelihood of detection and penalties) which requires the tax authority to understand the factors underlying taxpayers’ decision to comply with tax laws. Some literatures like Allingham and Sandmo (1972), Spicer and Lundstedt (1976), Lewis (1982) and Andreoni, et al. (1998) therefore characterize and explain tax compliance as the output of interrelation among variables including perception of equity, efficiency and incidence (public finance views).

Tax enforcement aspects like penalties and the probability of detection also relate to tax compliance while other labor market behavior factors including an individual’s wages and tax bracket also contribute to tax compliance (Kirchler 2007). Based on previous authors’

definitions, there are some keywords, which were widely and interchangeably used to define tax compliance. For example, the words ‘obey’, ‘ability’ and ‘willingness’ McBarnet, (2001); Andreoniet al. (1998); IRS (2009). Other keywords were also relevant in defining tax compliance i.e. ‘reporting all income’ Alm, (1991); Jackson and Milliron, (1986), ‘act of filing tax returns’ Singh, (2003), ‘declare the correct income’ IRS, (2000).

In addition, some authors also included ‘timeliness’, ‘right amount of tax’ Song and Yarbrough (1978) Ming Ling, et al (2005) as part of their definitions. The wider perspective of tax compliance was also illustrated in the definition provided by Andreoni *et. al.* (1998) in which they included the desired outcome as a result of obedience to tax laws – ‘to obtain an economic equilibrium’; Allingham and Sandmo (1972) and Spicer and Lundstedt (1976) ‘enjoy tax saving’ or ‘penalty’. Singh (2003) described tax compliance as voluntary action – ‘without having to wait for follow up actions from tax authority’. Apart from these, Song and Yarbrough (1978) included some factors of compliance in their definition i.e. ‘determined by ethics, legal environment and other situational factors’.

Since there have been many empirical studies attempts made to define tax compliance, for the purpose of this study, based on Alm (1991); Jackson and Milliron (1986) and Kirchler (2007)), tax compliance is defined as taxpayers’ willingness to comply with tax laws, declare the correct income, claim the correct deductions, relief and rebates and pay all taxes on time. In contrast with tax compliance, tax non-compliance is defined as taxpayer’s failure to remit a proper amount of tax, perhaps on account of the complexity or even contradictions in the tax legislation or tax administration procedure Jackson and Milliron, (1986), Kesselman (1994), Kasipillai and Jabbar, (2003). Non-compliance is also perceived as the failure of a taxpayer to report (correctly) the actual income, claim deductions and rebates and remit the actual amount of tax

payable to the tax authority on time Kirchlner (2007). Some studies also segmented income tax non-compliance into unintentional and intentional behavior Loo (2006), and Allingham and Sandmo, (1972).

Thus, in conclusion, based on the researches of Jackson and Milliron (1986), Kesselman (1994), Kasipillai and Jabbar (2003) non-compliance is defined for the purpose of this study as failure to comply with tax laws and/or report incorrect income, the act of claiming incorrect deductions, relief and rebates and/or paying the incorrect amount of tax beyond the stipulated time frame. Tax compliance is a wide concept and can be viewed from many perspectives, including public finance, economic, legal and also psychological. James and Alley (2004) suggested two contrasting approaches pertaining to tax compliance as a summary of the extremes of ways of defining this topic. A final definition of compliance might therefore be: the willingness of individuals and other taxable entities to act in accordance within the spirit as well as the letter of tax law and administration without the application of enforcement activity. There is no measure of such a definition that is both simple and accurate. However, this definition does indicate the main features, which should be considered in judging the compliance of taxpayers with the tax system.

2.7 Concepts of Income Tax Evasion, Avoidance and Default

The concept of tax evasion is extremely complex. The varied interpretation of the tax evasion is established in the controversy over the operational definition and meaning attached to the avoidance to manipulation of the legal organs of the state to reduce or eliminate the liabilities of the taxpayer, whilst others stress the time dimension as a denominator of assessing tax avoidance. From another angle, tax evasion constitutes failure of the taxpayer, whilst others

stress the time dimension as a denominator of assessing tax avoidance. From another angle, tax evasion constitutes failure of the taxpayer to comply with the provisions of the tax laws.

Tax evasion occurs when one willfully, whilst others stress the time dimension as a denominator of assessing tax avoidance. From another angle, tax evasion constitutes failure of the taxpayer to comply with the provisions of the tax laws. Tax evasion occurs when one willfully and consciously fails to notify the taxing authorities of the taxable assets or income activities. Thus it's a deliberate failure to pay tax legally owed or the use of fraud to conceal the existence of taxable income and/or obtain allowances or the repayment of taxes. Tax avoidance on the other hand occurs when one arranges his affairs in such a way as to take advantage of weakness or ambiguities in the tax law to reduce his or her tax liabilities, without really breaking the law. Although tax avoidance may be regarded as immoral, the techniques are legal and the conduct involved is not fraudulent. From the tax avoidance point of view, tax payers especially self- employed persons can reduce their tax incidence by taking advantage of the tax relieves, for example paying part of their taxable gains as insurance over or as contribution to the Social Security and National Insurance Trust (SSNIT) pension scheme as security for old age. Tax avoidance is therefore the legal exploitation of the tax regime to one's own advantage to reduce the amount of tax that is payable by means that are within the law whilst making a full disclosure of the material information to the tax authorities. By contrast tax evasion is a crime in almost all countries and subjects the guilty party to fines or even imprisonment depending on the extent of seriousness and the particular country in question.

Various schools of thought have also defined the term tax evasion. Some include; Kath Nightingale, in her book, Theory and Practice of Taxation, defined tax evasion as the illegal arrangement of taxpayers' affairs in order to minimize the tax liability. Tax evasion involves the

intentional disregard of the legislation in order to escape the liability to tax. It may be achieved by understating income, overstating expenses, the liability to tax. It may be achieved by understating income, overstating expenses, making false claims for allowances or failing to disclose chargeability to tax. Undeclared income probably counts for the bulk of evaded taxes and is referred to as the “black economy” where this sort of tax evasion or moon lighting may be carried out by individuals who are lower paid or unemployed to escape the poverty trap or unemployment trap. It has been suggested that as many as 1.6 million workers receive unrecorded income.

Johnson (1982) states however that, ‘there is a view that, provided evasion is not widespread, its existence could have the effect of reducing distinctive effects of taxation’. Dora Hancock in her book *Taxation Policy and Practice* (Sixth Edition 1998/99) said, ‘Tax evasion, unlike tax avoidance is illegal’. For example if a trader conceals some of his/her revenues from the authorities in order to reduce his/her burden of taxation, he/she is evading tax, but if he/she legally arranges his/her affairs so as to reduce the amount of tax payable, this is tax avoidance and is permissible. For example a man may transfer investment to his non-working wife in order for the income from them to escape tax. Tax Default on the other hand is where traders refuse to pay tax at a time limit given. If it happens, then, that person is asked to pay penalty on the tax. Example, on February 9, 1999, the Daily Graphic stated the Customs, Excise and Preventive Service (CEPS) has in a nationwide exercise impounded 301 vehicles whose owners failed to pay the necessary customs duties and about 40 owners of such vehicles have paid ₦220million in penalties.

2.8 The Informal Sector in Ghana

Efforts by governments to widen the tax base will greatly increase revenue leading to a reduction in the reliance on donor funding and also in incidences where governments are forced to increase taxes on basic commodities. But a large chunk of this sector continues to slip through the noose of tax authorities, even as governments grapple with the complex problem of how to avoid this. Some recommendations have been put forth in the highlighted cases, on how to address this issue. What then is this tricky informal sector?

According to Schneider (2002), the informal sector can be defined as income generating enterprises that operate on small scale using simple skills and are not tied to any government regulations. The difference with the formal sector is mainly the regulation bit. The informal sector mainly operates on small scale on a subsistence level with fewer employees, though most are really just self-employed individuals. The International Labour Organization (ILO) thus defines the informal sector as one characterized by ease of 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 and competitive markets.

There is however need to broaden these definitions to reflect the reality of the Ghanaian economy. When talking of the informal sector the first picture that comes to mind for many is the micro and small business such as hawkers and street vendors. The truth however is that the informal sector in many African countries encompasses a wider section of the economy beyond the above mention group. Increasingly many businesses in sectors such as housing, public transport and other related service industry in Ghana operate under the guise of informal sector purposefully to escape the tax net. Many of this business draw incomes much higher than those

in the formal employment such as teachers and other civil service employees and yet do not pay the due taxes. The benefits of taxing the informal sector are two-fold; it increases government revenue as well as recognizes the sector as a legitimate source of economic activity which in turn increases economic participation. This means that the sector will be included in economic infrastructure, service provision and other development initiatives all which in the long run, will spur economic growth. Taxing the informal sector is one of the ways of achieving tax justice in Africa; it is only fair for businesses to give back to the government that has contributed to creating an enabling environment for them to do business. It is hoped that this move could ease the burden on the formal sector which in many cases, shoulder the burden of tax revenue deficit.

A move to tax the informal sector will most likely encounter resistance, but when governments are more accountable to taxpayers through the provision of essential services such as water, sewerage systems and security, this resistance is likely to be significantly reduced. In my opinion, most of these enterprises pay fees to local authorities in the areas where they operate, so it should not really be hard to net them. This said, the cash-based system that leaves no paper trail makes it difficult for tax authorities to estimate exactly how much revenue is earned thus making non-compliance easy on the part of actors in this sector.

A research paper presents the challenges, possibilities and remaining questions of taxing this sector while taking a political view. An article by Apronius Mbilinyi takes us through the growth of the sector, the importance of taxing it as well as ways of doing it, in presenting the case of Tanzania. Nana from Ghana draws linkages between gender and the informal sector in taxation while making reference to a study conducted by the Ghana Integrity Initiative (GII).

2.8.1 Classification of the Informal Sector

The informal sector may be broadly characterized as consisting of units engaged in the production of goods or services with the primary objective of generating employment and incomes to the persons concerned. These units typically operate at a low level of organization, with little or no division between labour and capital as factors of production and on a small scale. Labour relations – where they exist – are based mostly on casual employment, kinship or personal and social relations rather than contractual arrangements with formal guarantees.

Becker (2004) defines the informal sector as the unregulated, non-formal portion of the market economy that produced goods and services for sale or for other forms of remuneration. In effect, the term informal economy as, it is often used to denote informal sector, refers to all economic activities by workers and economic units that are not covered or are insufficiently covered by formal arrangements. The informal economy is largely characterized by: low entry requirements in terms of capital and professional qualifications; small scale of operations; skills often acquired outside of formal education; and, labour-intensive methods of production and adapted technology.

Due to observed heterogeneous nature of the informal economy, numerous definitions have been elaborated according to different classifications in terms of activity, employment category, location of actors, and income and employment enhancing potential. Our analysis will however, concentrate on few of these classifications including the definition by activities; the definition by employment categories; and, definition by income and employment enhancing potential.

2.8.1.1 Definition of the Informal Economy/Sector by Economic Activity

This has been recognised as the most traditional of the various definitions. This is a definition based on production units. By this definition, the informal sector or economy consists of units engaged in the production of goods and services with the primary objective of generating employment and incomes to the persons involved. These units typically operate at a low level of organisation, with little or no division between labour and capital as factors of production and on a small scale. (International Conference of Labour Statisticians, 1993).

2.8.1.2 Definition of the Informal Economy/Sector by Employment Categories

Informal employment comprise of both self-and wage-employment that are usually not recognized, regulated, or protected by legal or regulatory frameworks. Informal economy has been identified according to the following employment categories (Amin, 2002; ILO, 2002, 2003; World bank, 2003):

1. Self-employment, including own-account workers, heads of family businesses, and unpaid family workers;
2. Wage workers, including employees of informal enterprises, casual workers without a fixed employer, home workers, paid domestic workers, temporary and part-time workers, and unregistered workers; and,
3. Employers, including owners and owner operators of informal enterprises.

2.8.1.3 Definition of the Informal Economy/Sector by Income and Employment Enhancing Potential

This definition recognises the heterogeneous nature of the informal sector. The definition identifies the informal sector as comprising of enterprises or work with growing market demand that reflect high income-elasticity of demand, such as tourism services, and those that reflect

low income-elasticity of demand, such as barbing services. It classifies the informal sector into three main segments including (Oberay et al, 2001; ILO, 2002):

1. Enterprises with the potential of becoming a significant contributor to national economy and that take up informal economic activities because of their potential for generating growth or wealth. These enterprises can be linked to organised and emerging national or international markets;
2. Individuals or households who take up informal activities for survival purposes. Factors attracting these individuals include relative ease of entry, reliance on local resources, and minimum capital investment requirements;
3. Individuals that devote part-time to informal activities while working elsewhere, because of incidence of low and irregular salaries.

2.9 Determinants of Tax Compliance

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

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

The division into these categories is based on the work of Kirchler (2007) and Loo (2006) in which they approached tax compliance from an interdisciplinary perspective which represents a wider perspective of tax compliance determinants compared to other researchers. For example, Kirchler (2007) divided tax compliance determinants into five categories and the study was

based on psychological and tax authority-taxpayers' view namely, political perspectives, social psychological perspectives, decision making perspectives, self-employment and interaction between tax authorities and taxpayers.

2.9.1 Structure of the Tax System

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

2.9.2 Tax Rates

Clotfelter (1983) claimed that “reducing tax rates is not the only policy that has the potential to discourage tax evasion but the tax rate is an important factor in determining tax compliance behavior although the exact impact is still unclear and debatable (Kirchler, 2007). Clotfelter also suggests that there was a significant relationship between tax rates and evasion due to tax rates being used as an instrument that can be manipulated for policy goals in particular. Raising marginal tax rates will be likely to encourage taxpayers to evade tax more (Torgler, 2007) while

lowering tax rates does not necessarily increase tax compliance (Trivedi et al., 2004) This uncertainty and conflicting issue (for example reducing tax rate to increase compliance) has attracted the attention of tax researchers aiming to come up with more certain and concrete evidence of the impact of tax rates on evasion. In a previous attempt by Allingham and Sandmo (1972) to find a relationship between actual income, tax rates, penalty and investigation and tax evasion using statistical modeling, they concluded that taxpayers may choose either to fully report income or report less, regardless of tax rates. Tax rates appeared to be insignificant in determining tax evasion. Other economic models of rational compliance decisions however, perceived that tax rates have a mixed impact on tax compliance or predict that increasing tax rates will increase compliance behavior (Kirchler, et al. 2008).

In contrast with Allingham and Sandmo, various studies found that increasing tax rates encouraged noncompliant behavior or produced mixed findings (Pommerehne and WechHannemann, 1996; Park and Hyun, 2003). Porcano (1988) claimed that tax rates have no effect on tax compliance while most experimental studies found that increasing tax rates leads to tax evasion (Park and Hyun, 2003). Since the impact of tax rates was debatable (positive, negative or no impact on evasion), (Kirchler et al, 2008) and McKerchar and Evans (2009) suggested that the degree of trust between taxpayers and the government has a major role in ascertaining the impact of tax rates on compliance. When trust is low, a high tax rate could be perceived as an unfair treatment of taxpayers and when trust is high, the same level of tax rate could be interpreted as contribution to the community (Kirchler et al, 2008).

In summary, evidence suggests tax rates have mixed impact on tax compliance i.e. decreasing tax rates does not necessarily always increase compliance (Kirchler et al, 2008) and increasing

tax rates will not necessarily always decrease compliance behavior (Allingham and Sandmo, 1972). The following subsection discusses how tax audits influence tax compliance.

2.9.3 Tax Audits

Some studies claimed that audits have a positive impact on tax evasion (Jackson and Jaouen, 1989; Shanmugam, 2003; Dubin, 2004). These findings suggest that in self-assessment systems, tax audits can play an important role and their central role is to increase voluntary compliance. Audits rates and the thoroughness of the audits could encourage taxpayers to be more prudent in completing their tax returns, report all income and claim the correct deductions to ascertain their tax liability. In contrast, taxpayers who have never been audited might be tempted to under report their actual income and claim false deductions. Butler (1993) also found that tax audits can change compliance behavior from negative to positive. These findings complement the Witte and Woodbury (1985) and the Beron, et al., (1988) studies. Witte and Woodbury in their study of small proprietors found that tax audits have a significant role in tax compliance. They did not empirically test individual taxpayers, thus left open room to conduct research in this area. While Butler (1993) and Witte and Woodbury (1985) found significant results.

From another point of view, Evans, et al (2005) studied the tax compliance of Small and Medium size Enterprises (SME) in Australia. Their objective was to examine the relationship between record keeping practices of SMEs and the potential exposure to tax compliance problems. The study hypothesized that low tax compliance among SMEs might better encourage the tax authority to increase audits and investigations. Using mail surveys, this study found that audit history, including frequency, audit outcome and the type of audit of small business owners has a significant indirect impact on tax compliance (in terms of record keeping). The result also evidenced that the primary objective of the small business owners

doing their record keeping is tax compliance related rather than part of their management of their business. Thus, as the audits investigations increase, many SMEs will make more of an effort at proper record keeping.

2.10 Reasons for Non-Compliance

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

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

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

Then there is the behavioral approach which draws on academic disciplines in suggesting that other factors are important in motivating tax payers regarding compliance. Sociologists identify a number of possible explanatory factors such as social support, social influence, attitudes, certain background characteristics such as age, gender, race and culture (Meyer and Johnson, 1977). According to such proponents, attitudes towards the state and revenue authorities are important as are perceptions of equity. Individual roles in society and accepted norms of behavior are also important.

The essential thrust of these contributions from sociology and psychology are that individuals are not simply independent, selfish, utility maximizers (though this may be partly true). They also interact with other human beings according to differing attitudes, beliefs, norms and roles. The result is that tax compliance may be viewed as "behavioral problem and that the success of

a tax depends on co-operation” (Schmolders, 1970). Some of the reasons for taxpayers low compliance attitude has also been found to include complexity of the tax system, tax rates, professionalism of the tax administration, level of tax payer awareness, state of information systems, effectiveness of enforcement mechanisms and the availability of resources to undertake effective implementation of programs (VADA, 2007). An ideal tax system should be easy to implement and simple. Complexities in the tax system promote evasion and avoidance and these should be minimized as best as possible. A high tax rate creates incentives for tax evasion by both registered traders and customers. The experience in Kenya for example, during the early years of the introduction of VAT was that very little was collected from goods that were subjected to very high tax rates such as cars and jewellery which were subjected to a VAT rate of 210% (VADA, 2007).

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

2.11 Empirical Research

Tax research in Ghana, like other developing countries, seems to focus greater attention on the twin issues of administrative reforms of taxation and reduction of corruption (Richard, 2003). For example, Terkper (2007) explored ways of improving the tax accounting systems of SME’s in Ghana while Ayee (2007) discussed strategies for achieving compliance through building and improving reciprocity with government. The study by Atuguba (2006) profiled the tax culture of

Ghanaians. It however fell short of examining specific attitudinal antecedents of tax-paying behavior.

In relation to taxation, taxpayers' attitudes may be defined as positive or negative views of tax compliance behavior. In Ghana, the government continues to seek more non-oil revenue by reforming tax administration and improving the efficiency of the tax system. This effort entails broadening the operations of the large taxpayer unit to ensure that very large companies receive one-stop tax service. Tax revenue as a percentage of GDP has increased from less than 17% to about 23% over the period 2000-09. But the effective tax base in Ghana remains low. This is because many people operate in the informal sector outside the tax net (African Economic Outlook, 2011). The outcome of positive views is tax compliance and negative views are tax non-compliance. These views may be explained by Psychology-based theories which reveal that taxpayers' attitude may be influenced by the following factors which eventually influence taxpayer's behavior. Taxpayer's perceptions of the tax system and Revenue Authority (Ambrecht, 1998); peer attitude / subject norm (Toumi, 2000); taxpayers' understanding of a tax system / tax laws (Silvani, 1992; Le Baube, 1992); motivation such as rewards (Feld, et al, 2006) and punishment such as penalties (Allingham and Sandmo, 1972); cost of compliance (Le Baube, 1992); difference across - culture; perceived behavioral control ; ethics / morality of the taxpayer and tax collector; equity of the tax systems (Trivedi and Shehata, 2005); image of the government based on whether it is achieving the tax objectives under prescribed principles of taxation; Demographic factors such as sex, age, education and size of income (Murphy, 2004).

A study by Falkinger and Walther (1991) looked beyond punitive factors and considered persuasive factors. Their evidence suggested that a tax system that combines both penalties and rewards is more effective in maximizing compliance than a system that focuses solely on

sanctions. As such, positive inducements for compliance may also have a key role to play in deterrence. Whether these inducements come in the form of quicker tax refunds, or a percentage reduction in tax payable, however, was and is still open to question. Alm, et al. (1995) also examined other non-economic factors in their study and concluded that most empirical work carried out to date tends to refute the economic model of compliance in its basic form. For example, it has been demonstrated by means of laboratory experiments that even where the deterrence factor is so low that evasion makes obvious economic sense, some individuals will nevertheless comply. Such findings may be particularly relevant in the context of a self-assessment environment.

2.11.1 Measurement of Income Tax Evasion and Non-Compliance

A major difficulty in analyzing evasion is in its measurement. After all individuals have incentives to conceal their cheating. Several methods have been developed to measure evasion, all subjects to imprecision and controversy. One method relies on information generated by the authority as part of its audit process. The internal Revenue conducts line-by-line audit of individual tax return for its Taxpayer compliance Measurement Program (TCMP). This audit yield an estimate of the tax payers “true income”, allowing measures of individual and aggregate tax evasion calculated. However, the audits do not detect all under reported income, non-filers are not often captured and final audit adjustments are not included. Another direct method involves surveys. These surveys are typically designed to illicit tax payers’ attitudes about their reporting but such surveys can also be used to estimate non-compliance. However, the accuracy of surveys if ascertained, individuals may not remember their reporting decisions, they may not report truthfully or at all the respondents may not be representative. In Germany, it

has been deemed likely that three hundred thousand workers in the construction industry alone or not reported to tax officials (Keindal 1977).

Higgers (1980) has revealed methods of meeting tax evasion. One of the most obvious ways to be identified was to trace the relevant tax enforcement statistics. However, he continued that the department's investigative techniques might change considerably from year to year. Another approach outlined involved micro measures including close examination of the income and expenditure data for a small proportion of the work forces, for example, traders and businessmen that have long been suspected as harboring many tax evaders (Bean 1975). From the above, there is much that we do not know about tax evasion. We are constantly struggling to measure its extent to discover its impact, to estimate individual responses and to implement appropriate policies. As long as there are taxes, this struggle will continue.

2.11.2 Effects of Non-compliance of Income Tax

Countries whose citizens evade tax do not have better developmental infrastructure such as hospitals schools, roads, transportation, housing, water, electricity, payment of wages and salaries to public workers etc. which would have otherwise improve the living standard of these citizens. If the right amount of taxes were paid for example, the availability of hospitals will help improve the quality of health care delivery in the country.

In the area of education, apart from the physical structures, government still subsidizes the fees paid by individual students of public schools. The bulk of the country's agricultural produce comes mostly from the hinterlands or remote areas. The availability of good accessible roads helps to transport these produce with ease to the urban areas. In most developed countries, the

government put up apartment from the revenue generated from taxes to accommodate individual citizens at a lower cost compared with privately owned apartments.

Revenue generated by the government through tax is being used to extend electricity, water and other utilities to other parts of the country. Part is also used to subsidize both electricity and water cost to the individual. And efficient tax administration may result into increase in tax revenue. This may have the effect of narrowing the fiscal gap or budget deficit resulting in reduced government borrowing.

CHAPTER THREE

METHODOLOGY

3.0. Introduction

This chapter describes how the research was carried out outlining step by step activities involved in designing the approach, observation, questionnaires and interviews. It explains the various sources of data used for the project. This study used a mixed method design, which is a procedure for collecting, analyzing and “mixing” both quantitative and qualitative data at some stage of the research process within a single study, to understand a research problem more completely. When used in combination, quantitative and qualitative methods complement each other and allow for more complete analysis (Green et al., 1989).

According to Welman and Kruger (2001) research involves the application of various methods and techniques in order to create a scientifically developed knowledge by using objective methods and procedures. The technique must be appropriate for the tasks. Therefore, in order to gather the necessary data, the researcher employed qualitative method using questionnaire and interview approach to source for respondents views.

3.1 Research Design

A research design is the overall plan for relating the conceptual research problem to relevant and practicable empirical research. In other words, it provides a plan of what data to gather and how to analyze the data. In this work a case study approach was adopted from the survey research design (Bloom, 2000). A case study research offers researchers the opportunity to have an in-depth understanding of a problem or situation under study. In this research, the design enabled the researcher to determine the level of income tax compliance by the informal sector of

Adansi North District. The study involved a critical study of the challenges faced by the informal sector in complying with income tax liabilities.

A case study approach was adopted because it provided a rich understanding of the reasons for the non-compliance of income tax by the informal sector in Ghana in a real life context. It enabled the researcher gather rich and detailed data.

3.2 Sources of Data

Sources of data for studies are broadly categorized into two: primary data and secondary data (Saunders et al., 2007). Yin (2003) asserts that no single source of data has a complete advantage over the other(s) and that the various sources of data collection are highly complementary. This means that using various data gathering tools enrich data for the study and also improved reliability of the data for the study. Data for studies could be broadly gathered from two sources: primary and secondary. Depending on the nature and scope of the study, both sources may become useful (Saunders et al., 2007).

3.2.1 Primary Data

This refers to data collected purposely for a particular study. Such data could be gathered through questionnaire administration, interviews or observations (Saunders et al., 2007).

The data collected for this research were from both primary and secondary sources. The primary data was collected with the help of structured questionnaires to players in the informal sector (petty traders, hawkers, small businesses and others) and staff of Ghana Revenue Authority.

3.2.2 Secondary Data

Secondary data refer to already existing data or information which may become useful in a particular study. Sources of such data include journal, articles, company reports, government publications, indexes and others. In addition to the primary sources of data, secondary sources of data was assessed from journals, books, internet and news bulletins related to the study area

3.3 Population

Population refers to the complete set of individuals, subjects or objects or events having common observable characteristics in which the researcher is interested in. In this write up, the targeted groups were the informal sector in Adansi North District in the Ashanti Region. According to the 2010 Population and Housing census, out of the total population of 105,324 members in the district, about 23,000 are self-employed and an estimated 10,000 are in the informal sector.

3.4 Sample and Sampling Technique

According to Saunders et al (2007), a choice of sample size is important and depends on the confidence the researcher needs to acquire data, margin of error the researcher can tolerate, the type of analysis and the size of the total population. For a 95% confidence level with a margin of error of 5%, the sample size for the population of 10,000 is 370, (Saunders et al, 2007). The computation of sample size was derived by Saunders et al (2007) who developed a Table of varied sample sizes given a population size, confidence level and a margin of error. The study however considered only 62% of the sample size of 370 due to time and resource constraints. The study employed both purposive and convenience sampling technique in selecting respondents.

3.5 Data Collection Instrument

The nature of the study required relying solely on primary data, which were gathered with the aid of questionnaires.

3.5.1 Questionnaires

The questionnaires developed for the study were mainly made up of close-ended items, structured on a 5-point scale, where 1=strongly disagree, and 5=strongly agree. Close-ended questions were opted because they are quick to answer, easy to code and it shows no bias between articulate and inarticulate respondents. Some questions were however open-ended so as to enable greater freedom of expression, non-bias due to limited response ranges and also to enable respondent qualify their answers. The items on the questionnaires were structured under four (4) thematic areas: demographic information, tax compliance status, challenges in tax administration and reasons for non-compliance.

A pre-test of the questionnaires preceded the main fieldwork. The purpose of the pre-test activity was to ensure that the questionnaires were meaningful, easily understood and appropriate for the main fieldwork. The activity enabled the researcher and the field assistants to become more familiar with items of the questionnaires and prepare them adequately for the main fieldwork. Finally, these questionnaires were scanned to ensure that data on key concepts was collected and various responses were appropriately coded for the analysis of data in chapter four.

3.6 Data Collection Procedure

Pragmatic steps were taken to source for the correct and detailed information on the subject matter. The researcher made a visit to the district involved in the study before administering the

questionnaires. The questions were explained to those who in one way or the other found it difficult to understand aspects of the questionnaires and the responses of those who were interviewed were duly recorded. A period of two weeks was allowed for the respondents to complete the questions. After two weeks, the researcher personally went back to collect the questionnaire.

3.7 Data Analysis

The data that were collected and gathered were analyzed using simple statistics such as a frequency distribution Table. Considerable attention was given to the use of computer software such as Statistical Package for Social Sciences (SPSS) and Microsoft Excel for analyzing data gathered. The findings were reported using frequencies, percentages, means, and standard deviation and reported using Tables and graphs.

3.8 Validity and Reliability

The researcher is convinced beyond doubts that the data collected for the study were valid and reliable. For instance, questionnaires were carefully designed and subjected to the scrutiny, comments and suggestions before the questionnaires were administrated. With the enumerated procedures employed and the objectivity and consistency of the collected information, the methodology employed and the critical analysis, in addition to the suggestions offered, the researcher is convinced about the validity and reliability of the data collection technique.

CHAPTER FOUR

DATA ANALYSIS AND DISCUSSION OF RESULTS

4.0 Introduction

This chapter presents and discusses the results of the study. The results were based on the data obtained from the questionnaires administered and interviews conducted. The results have been analyzed according to the research questions formulated in chapter one.

4.1 Respondents Reaction

In order to avoid the research from being bias, a sample of broad base respondents was covered. This included entrepreneurs in the informal sector of Adansi North District. Analysis of the responses obtained from the administered questionnaires has been given below. The Table 4.1 below gives a picture of the respondents' reaction to the questionnaires administered.

Table 4.1 Respondents Reaction to the Questionnaires

Respondents	Number of Questionnaire Administered	Number of Questionnaire Received	Number of Questionnaire Accepted
Entrepreneurs	230	219	215

Source: *Researcher's fieldwork, 2015*

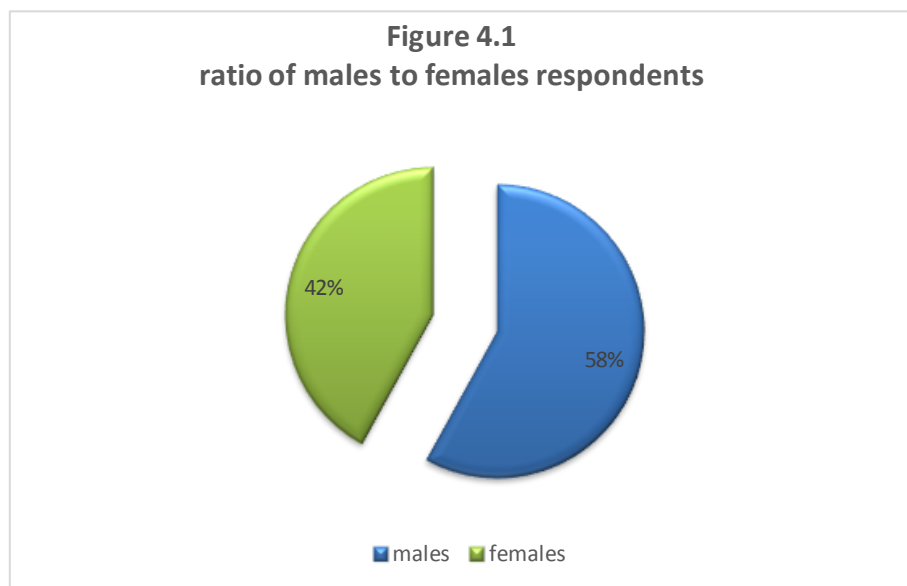
From the survey, out of the 230 copies of the questionnaires given to the respondents who are entrepreneurs in the informal sector, 219 were actually received however only 215 were accepted.

4.2 Analysis of Responses from Respondents

4.2.1 Gender

It came to light from the research that there are more men in trade or business than there are women in the informal sector. As depicted in Figure 4.1 below, 42% of SME owners contacted were females and the remaining being males. The male to female ratio is a close representation of the gender distribution in Ghana.

Figure 4.1 Respondents' Sex Distributions



Source: *Researcher's fieldwork, 2015*

Data gathered on respondents' age indicates that most entrepreneurs in the informal sector are well over thirty five years. As show in the Table 4.2 below, 50.7% of respondents contacted were above 48 years; 28.4% were between 38 to 47 years and the rest were below 28 years. Table 4.2 below displays this result.

4.2.2 Age Distribution

Table 4.2 Respondents Age Distribution

Age	Respondents	Percentage
18-27	17	7.9
28-37	28	13
38-47	61	28.4
Above 48	109	50.7
Total	215	100

4.2.3 Level of Education

As indicated in Table 4.3 below, 13.5% of informal sector entrepreneurs considered for the research had JHS education; 27 % had SHS level of education; 29.3% had tertiary and ‘others’ comprising Middle School Leaving Certificate holders, ‘O’ level holders and ‘A’ level holders constituted 30.2% Of the population. This goes to show that over 60% of the entrepreneurs in the informal sector do not have higher education.

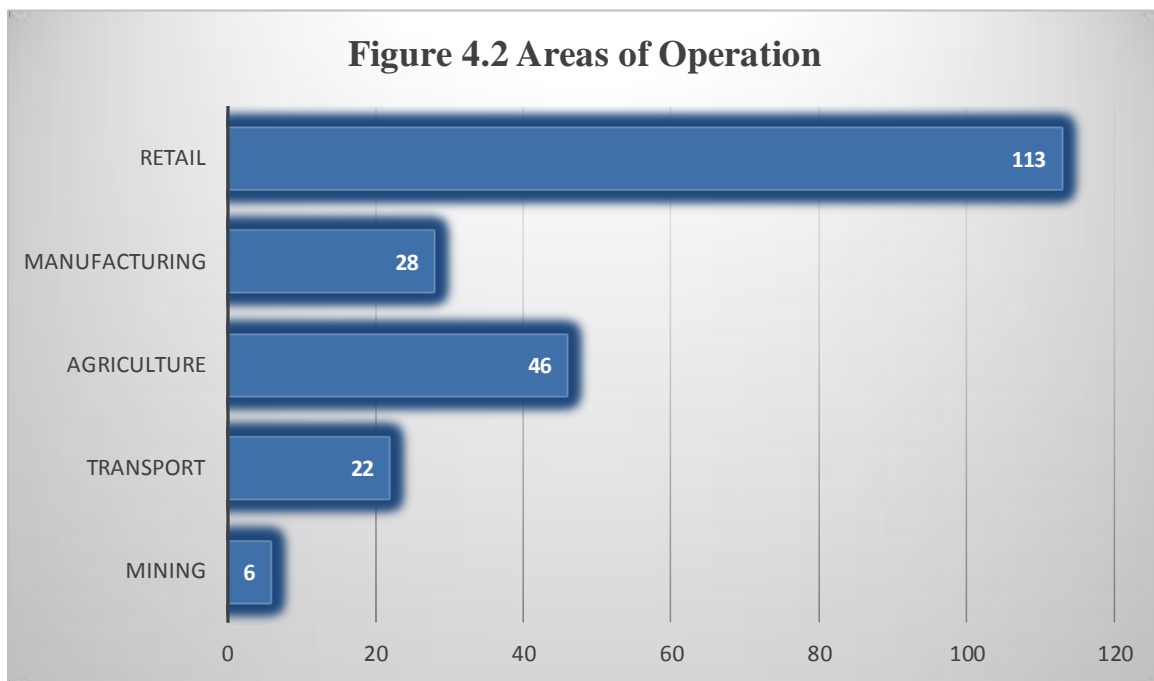
Table 4.3 Level of Education

Highest Educational Level	Number	Percent
Others	65	30.2
JHS	29	13.5
SHS	58	27
Tertiary	63	29.3
Total	215	100

Source: Researcher’s fieldwork data 2015

4.2.4 Occupational Distribution

The study identified that majority of respondents are into retail/commerce and agriculture. Just a handful is into manufacturing or processing and transport. Anecdotally, in Ghana, the agriculture sectors especially and by extension to the retail sector are occupied by low income individuals in society.



Source: *Researcher's fieldwork data 2015*

From the Figure 4.2 above, 52% of the respondents were into retail/commerce. This is followed by agriculture with 21%, then manufacturing; 13%. 10% of respondents were into services which comprises bakery services, fuel and gas services, hairdressing and tailoring among a few. The nature of the occupational distribution depicts clearly the level of development of Adansi North District. The highest percentage with trade indicates that majority of the population are engaged in that sector. The study revealed that the capital required to engage in trade and agriculture was relatively small. Most entrepreneurs find it difficult to engage in other sectors

because of the inadequate finance to acquire the needed machinery; low level of technology and the level of managerial skills. These issues raised are the key bottlenecks identified to the industrial growth and development in the District.

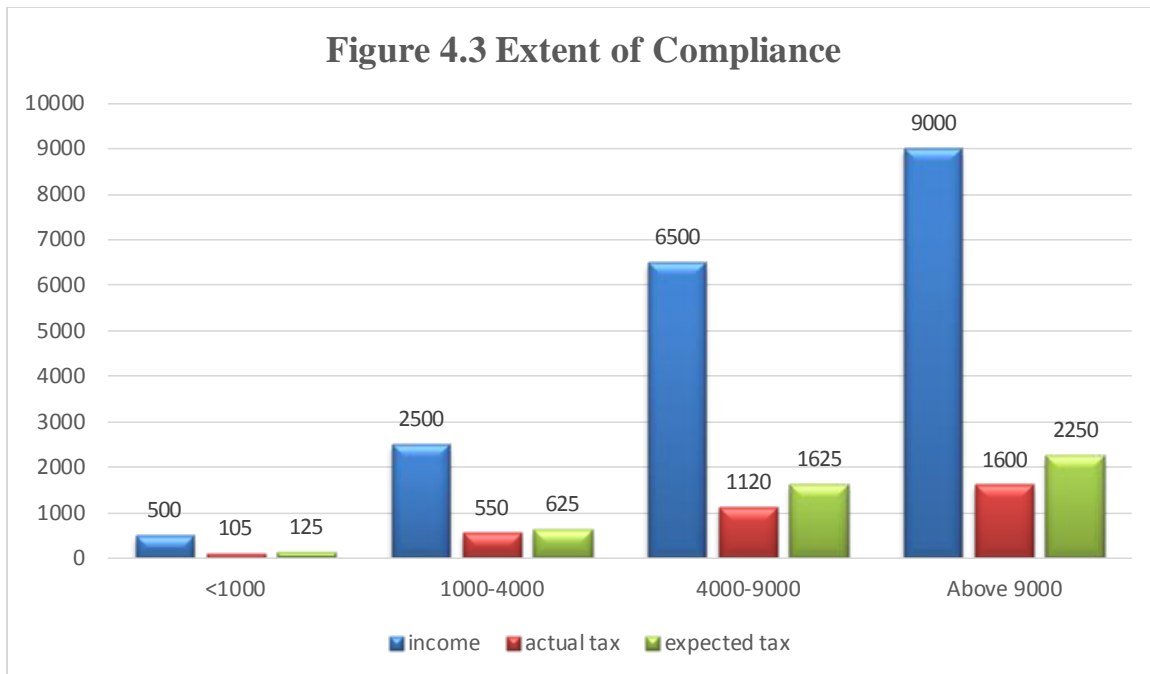
Most businesses in Adansi North have not been registered with the registrar of companies. 135 of the entities considered were not registered whilst only 80 of them were registered. Reasons given for non-registration of businesses are as follows:

- i. Unawareness of such registration of businesses.
- ii. Time constraint.
- iii. There is no importance of such registration to the profitability of the business' operation
- iv. Registration of business is another cost on their little revenue.

4.3 Level of Income Tax Compliance

4.3.1 Extent of Compliance

Respondents were allowed to state their average income and how much they pay as tax. The income tax rate for the period as given by Ghana Revenue Authority is supposed to be 25% but apparently the entrepreneurs in the district of Adansi North are not in the known. According to them income tax charged to them is done through a vague estimation done by the GRA, relying on the type of business as an income fetcher. The average amount of tax paid given on their reported income deviated from expected tax to be reported and paid to GRA. On average, income tax paid compared to expected income tax deviated by 25.25%. The Figure 4.3 below picturesquely displays this.

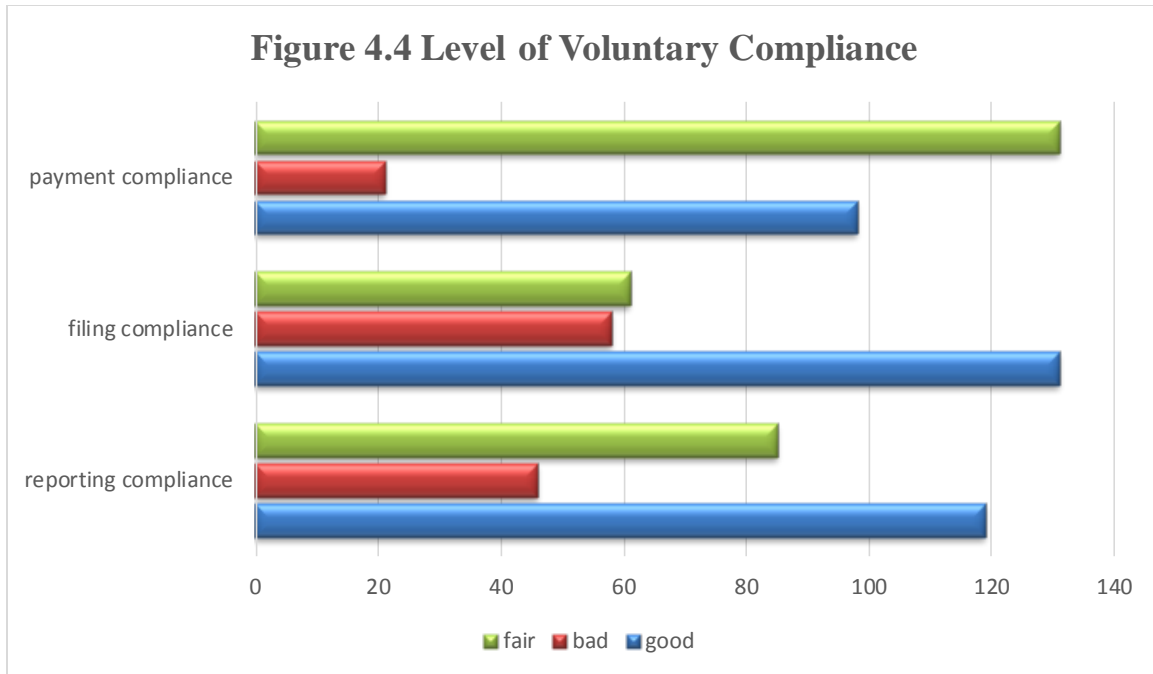


Source: *Researcher's fieldwork data 2015*

Generally, the informal sector is largely inaccessible when income tax is involved. Cobham (2005) found that the overall level of tax revenue lost due to tax evasion in developing countries to be equal to roughly US-\$ 385 billion per year. In Ghana, based on results herein presented, it is no doubt that the informal sector contributes mammothly to this figure.

4.3.2 Level of Voluntary Compliance

The Ghana Revenue Authority recognizes three types of voluntary compliance thus: payment compliance, filing compliance and reporting compliance. Respondents were asked to indicate the accuracy and adequacy of records they keep on their financial transactions. Responses to this effect could be found in Figure 4.4 below.



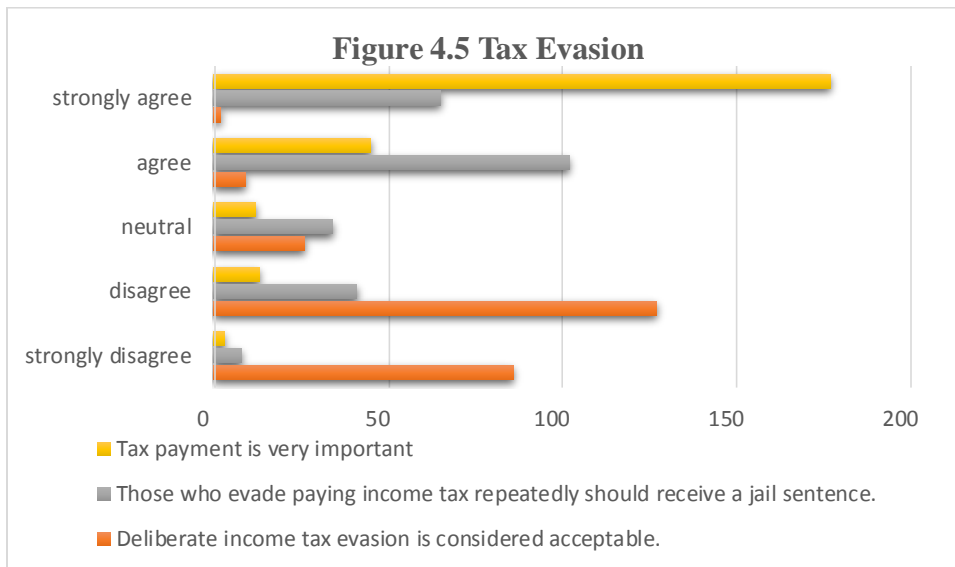
Source: *Researcher's fieldwork data 2015*

Based on observations and responses, it was deduced that a large majority of entrepreneurs in the informal sector are unable to maintain enough records of their daily financial transactions. This is affirmed by their level of education. By extension, this has a negative impact on payment and reporting compliance. In respect of timeliness of filing required returns, the study realized that the compliance level was low because of the level of education of the respondent/entrepreneur. Generally, filing compliance was just well below GRA's requirements.

4.3.3 Opinions on Income Tax Evasion

Entrepreneurs in the informal sector were required to submit their take on income tax evasion in general. There was a general strong disagreement to deliberate tax evasion as displayed in Figure 4.5 below. 88.8% of the 215 respondents indicated that income tax evasion is unacceptable. About 7.4% said it was neither acceptable nor unacceptable while the remaining

3.7 stated it was somewhat acceptable. The respondents in this array corroborated their assertions with the fact that in so far as income tax revenues are misappropriated, it does not make non-payment unacceptable. Nonetheless, it is the opinion of about 70% of the respondents that those who evade income tax should not necessarily be made to face jail terms. Rather, they should be fined or be made to pay interest based on the duration and amount outstanding. It was in no doubt that respondents recognized the importance of tax. But they indicated certain elements which encumber their willingness and ability to pay the required income tax on timely basis.



Source: *Researcher's fieldwork data 2015*

4.3.4 Income Tax Payment

Some respondents recounted inefficiencies with GRA as part of the reasons for income tax non-compliance. It is the opinion of the respondents that due to inefficiencies at GRA, income tax evasion is on the rise. As identified by Torgler (2003), there is a closer link between taxpayers and the authorities through democracy, more local government; more direct democracy is

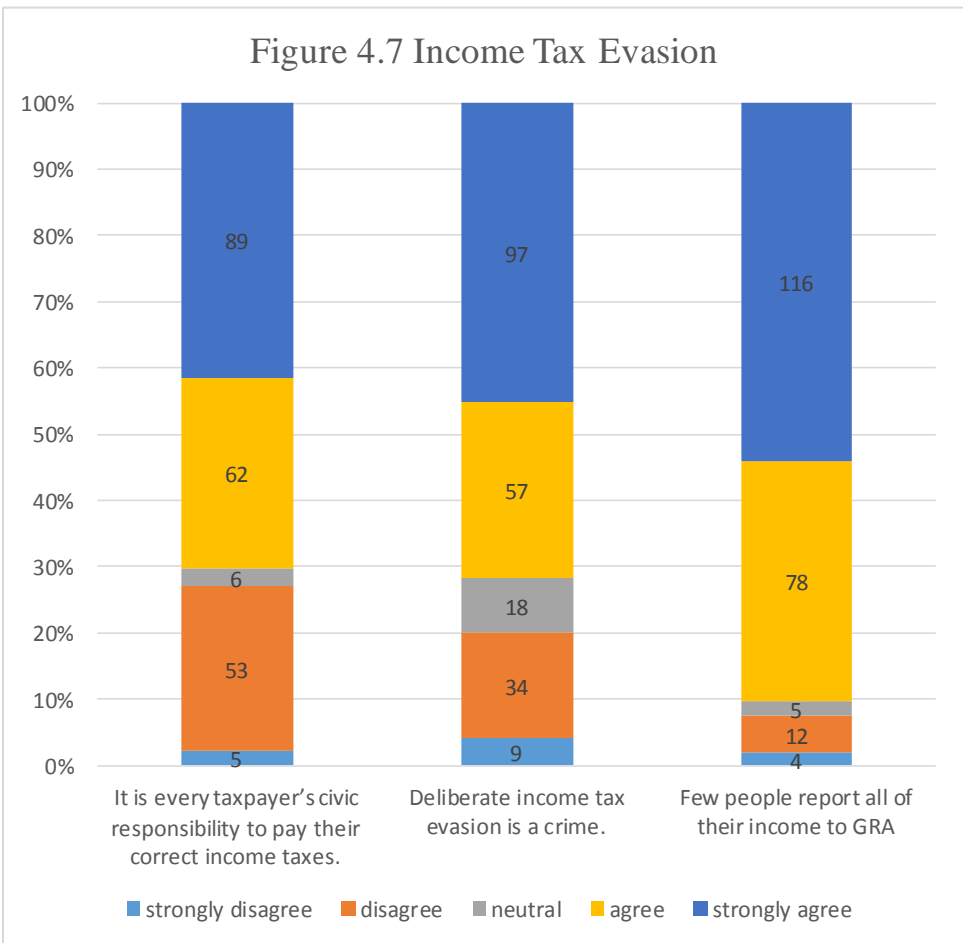
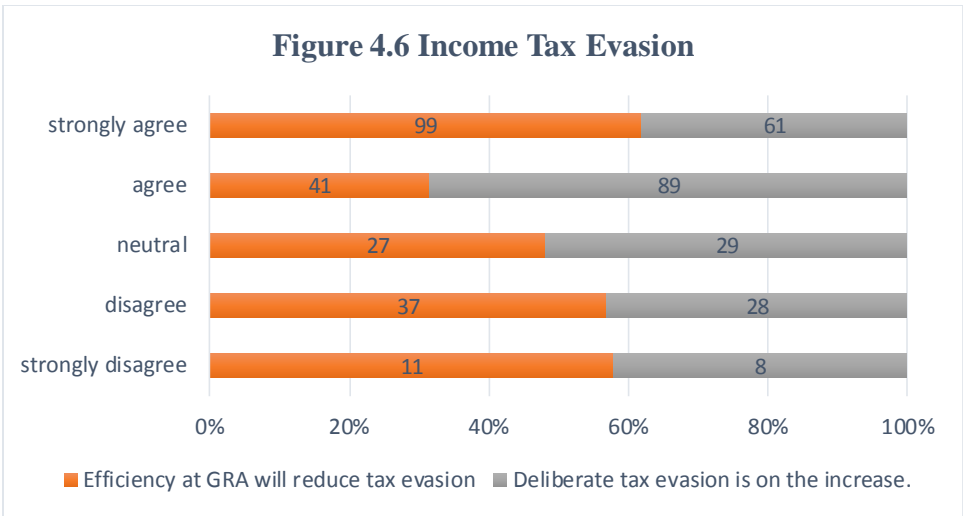
conducive to higher tax morale. The inefficiencies identified were in respect of personnel, strict law enforcement and monitoring of activities in the informal sector of Adansi North District. The Table 4.4 below tabulates the responses on participants in this regard.

Table 4.4 Income Tax Evasion

Deliberately not paying required income tax		
	responses	percentage
completely unacceptable	129	60%
somewhat unacceptable	62	28.8%
neither/nor	16	7.4%
somewhat acceptable	8	3.7%
completely acceptable	0	0.0%
total	215	100.0%

Source: *Researcher's fieldwork data 2015*

The finding of Andreoni, Erard and Feinstein (1998) also lends a hand to the main moral and social factors that are relevant in this context. Moral rules and sentiments; the taxpayer's perception of the fairness of the tax system and burden; and finally the degree of satisfaction that taxpayers have with respect to the public authorities, notably with respect to their satisfaction in the provision of public goods and services affects their willingness to comply with tax obligations. The responses submitted have been picturesquely displayed in the Figure 4.6 below.



Source: Researcher's fieldwork data 2015

This section of the study aimed at exploring the informal sector entrepreneurs' opinion on income tax evasion. As identified in the Figure 4.7 above, income tax evasion is frowned upon by majority of the participants. However a section of the population which fall in the minority bracket still do not see the need to give away a substantial amount of their earnings to the government when in their opinion, their community's infrastructural development and business environment still leaves so much to be desired. 35.6% agree that it is every tax payer's civic responsibility to pay the correct income tax whilst about 2.4% strongly disagree. Again, 24.4.8% disagreed to the assertion that deliberate income tax evasion is a crime.

4.3.5 Opinions on Income Tax Compliance

The submissions below measure moral attitude of respondents to income tax compliance. In some cases, people knowingly demand services or goods whose income tax would not be declared to Ghana Revenue Authority. To what extent this attitude is acceptable or not, 68.8% of respondents reiterated it is completely unacceptable, 16.7% said it is somewhat unacceptable whilst 6.1% said it is somewhat acceptable. Although respondents expressed varied opinions in this subject, it is the case that the knowledge of strict punitive measure coerce people to avoid such temptations. These results are captured in table 4.5

Table 4.5 Income Tax Compliance: Buying services

buying services whose income would not be declared		
	responses	percentage
completely unacceptable	148	68.8%
somewhat unacceptable	36	16.7%
neither/nor	18	8.4%
somewhat acceptable	13	6.1%
completely acceptable	0	0.0%
total	215	100.0%

Source: *Researcher's fieldwork data 2015*

People sometimes use their wits to outsmart the law. Loopholes do exist in most laws and in respect of tax laws and policies, entrepreneurs might find a way of taking advantage of these gaps. To what extent this is good or bad is a question of morality and patriotism. The view of 21.4% of the respondents is that avoiding income tax legally by using loopholes in legislation is unacceptable. 73.5% see nothing wrong with this attitude. These views are displayed in the Table 4.6 below.

Table 4.6 Income Tax Compliance: Loopholes in Legislation

Avoiding Tax Legally By Using Loopholes In Legislation		
	responses	percentage
completely unacceptable	38	17.7%
somewhat unacceptable	8	3.7%
neither/nor	11	5.1%
somewhat acceptable	78	36.3%
completely acceptable	80	37.2%
total	215	100.0%

Source: *Researcher's fieldwork data 2015*

Payment non-compliance amounts to tax evasion which is illegal. From Table 4.7, at least 86.5% of respondents emphasized that not reporting all income earned and thence paying the appropriate liability is unacceptable. It was the opinion of 8.8 per cent of respondents that income tax evasion is neither acceptable nor unacceptable whilst 1.9% saw the practice to be completely acceptable. The over 12% who did not see the wrong in evading tax by extension contributes to the array of people in the informal sector who evade tax.

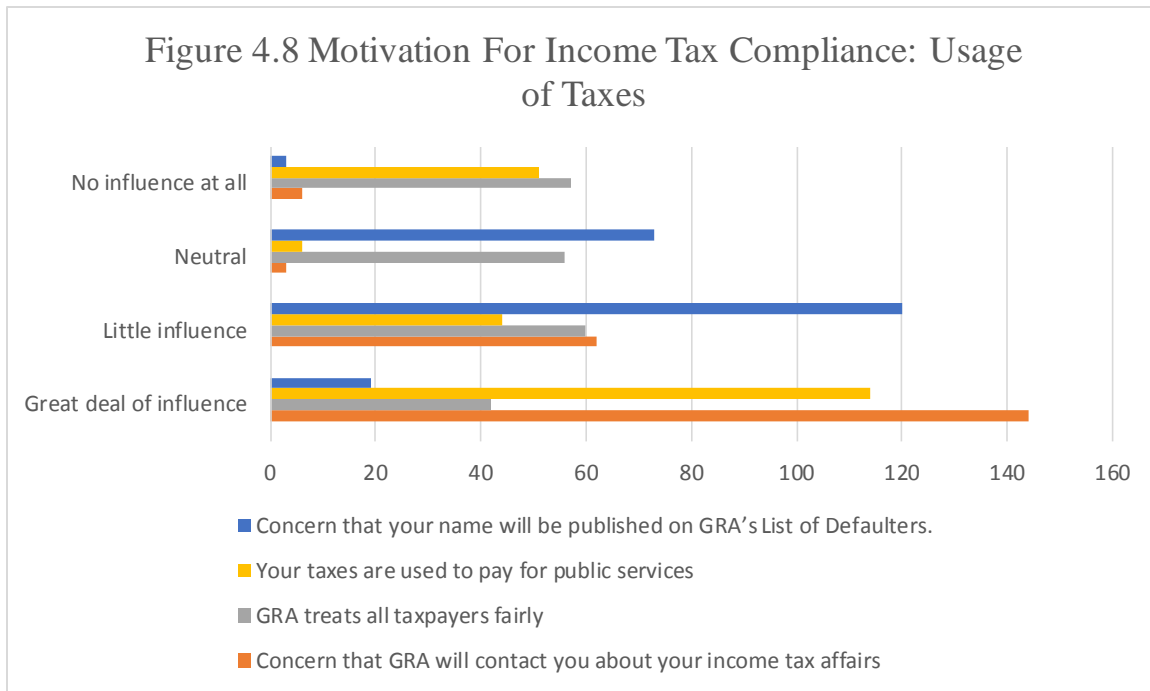
Table 4.7 income tax compliance: Income Reporting

not reporting all income earned		
	responses	percentage
completely unacceptable	108	50.2%
somewhat unacceptable	78	36.3%
neither/nor	16	8.8%
somewhat acceptable	6	2.8%
completely acceptable	4	1.9%
total	215	100.0%

Source: *Researcher's fieldwork data 2015*

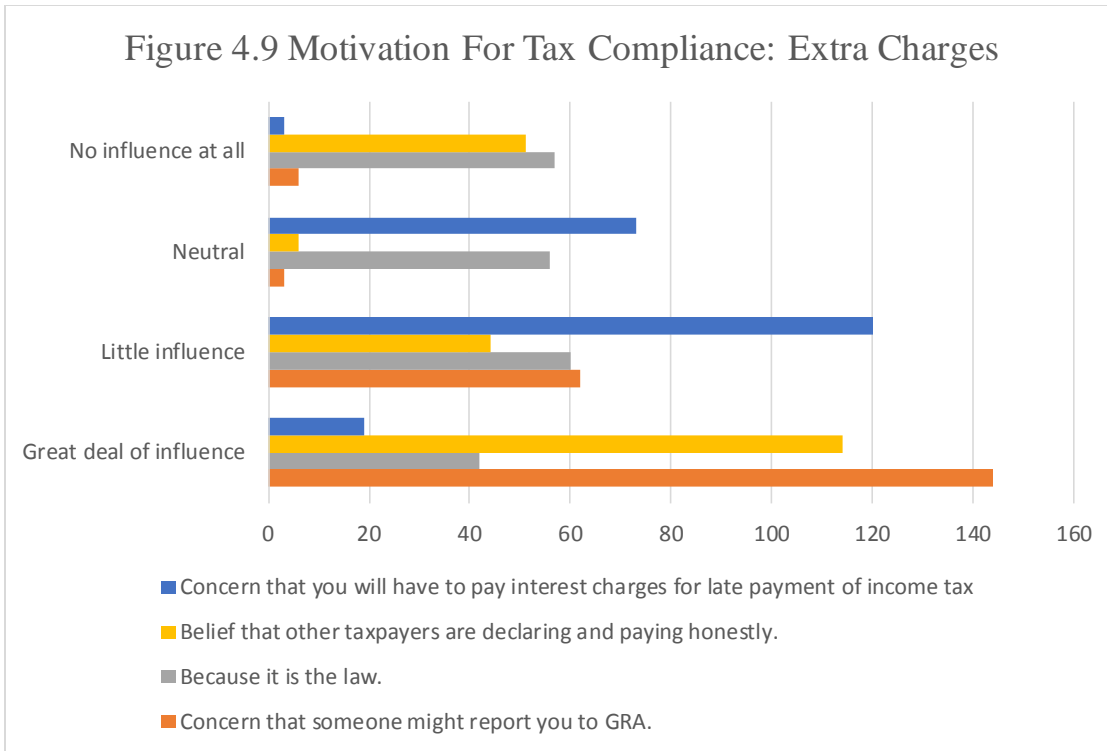
4.3.5 Motivation for Income Tax Compliance

The study went further to identify what inspires or serve as incentive for income tax compliance in the informal sector. The results of this study is contrary to the findings of Coricelli et al. (2010)who acknowledged that a treatment in which the pictures of evaders were overtly displayed few seconds at the end of the period favoured compliance. Responses from entrepreneurs in the informal sector of Adansi North District, as represented in the Figure 4.8, indicated that for the fact that defaulters' are unaware their names would be published by GRA should they default and so they are neutral to that and to those who are aware of such publications, it has little influence on their income tax compliance. Rather people are quick to pay their taxes because GRA would pursue them and lock them out of their facilities and also because they know taxes help to ensure development.



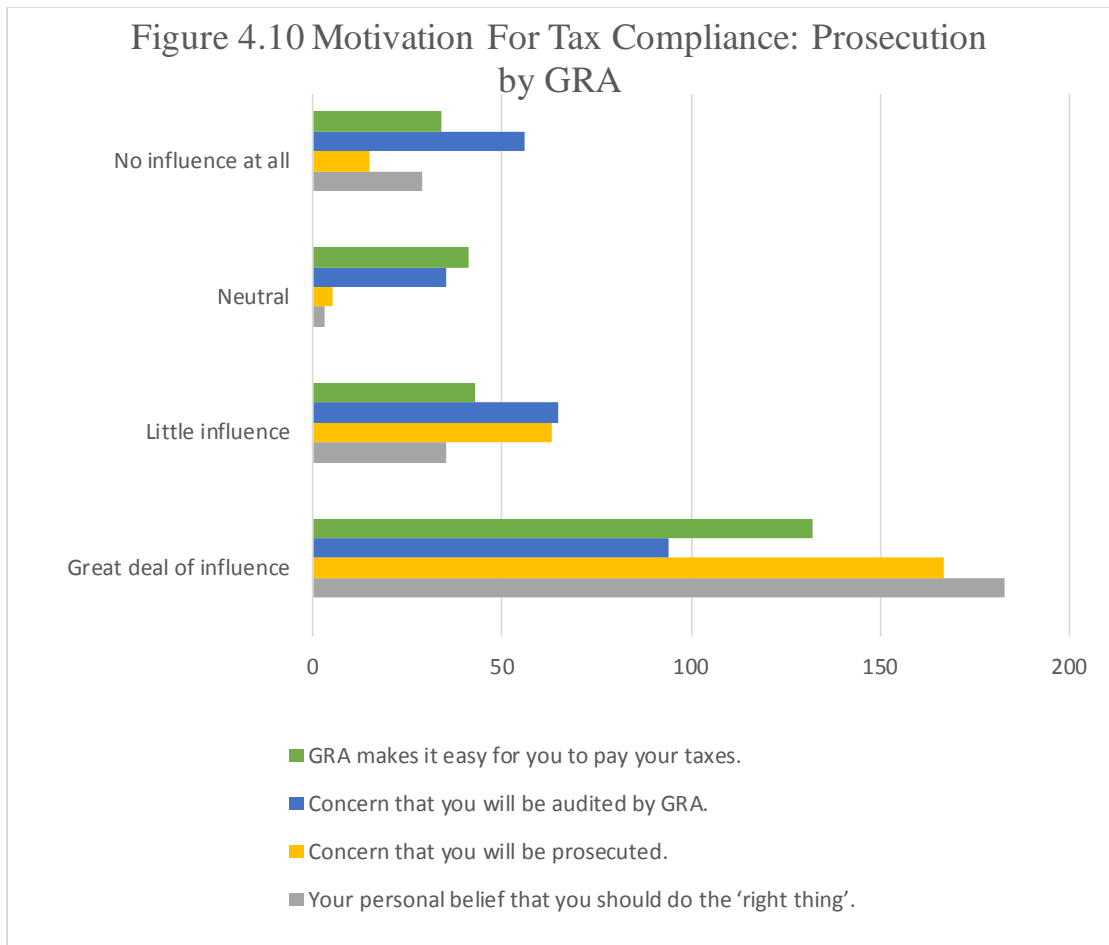
Source: *Researcher's fieldwork data 2015*

Submissions herein support the findings of Haidt, (2003) and Tangney & Dearing, (2002) who found that people would desist from non-compliance for guilt of being caught and publicly denounced. The above responses also suggest that GRA must constantly monitor businesses in the informal sector if they want to mobilize the required income tax returns. Again the public must be conspicuously made to see that their taxes translate in developmental projects.



Source: *Researcher's fieldwork data 2015*

The Figures 4.9 above and 4.10 below portray that, that people know religiously that it is their legal obligation to pay tax as well as the fact that filing and payment non-compliance might attract interest charges is what prompts them to do so; but not the believe that their colleagues in the industry are paying honestly or the concern that someone might report them. Again, the result herein asserts that people pay tax because in their view, it is the right thing to do. As was identified by Maciejovsky et al. (2011), an interaction effect of cognitive and emotional priming to moral judgments is related to tax evasion. In the informal sector, the tax payers moral believe has a great deal of influence on the level of tax compliance.



Source: *Researcher's fieldwork data 2015*

Knowledge of a possible criminal action against defaulters also motivates people to make good their income tax obligations as indicated in Figure 4.10. It seems to be the case that GRA does not create the enabling environment conducive enough to compliance. Finding of Falkinger and Walther (1991) infer that a tax structure that combines both punishments and rewards is extra effective in maximizing compliance than a system that focuses exclusively on sanctions.

4.4 Challenges in Complying with Income Tax Laws

As covered by the demographic part of this study and also supported in the literature, the informal business sector is composed of entrepreneurs whose level of education is not that

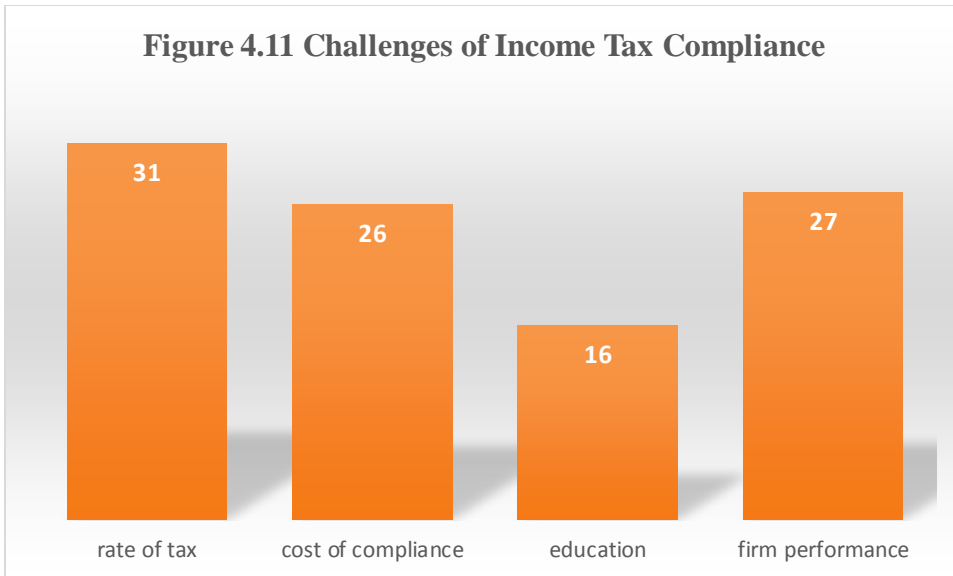
pronounced. Out of the 215 respondents considered for this study only 29.3% have acquired tertiary education tertiary. According to Schneider (2002), the informal sector can be defined as income generating enterprises that operate on small scale using simple skills. A kind of skill set is required to prepare accurate and adequate accounts of revenue and expenditure upon which income tax calculations are done. Respondents in this study iterated that incomplete records hinder their ability to declare accurate income taxes. As shown in Table 4.8 below, of the target considered, 21% indicated that record keeping does not affect income tax compliance. Over 60% however identified incomplete records as accounting for accurate reporting and payment of income tax obligations.

Table 4.8 Compliance Challenges: Incomplete Records

Incomplete records hinder ability to declare accurate tax		
	responses	percentage
Yes	104	48.4%
No	46	21.4%
Sometimes	65	30.2%
total	215	100.0%

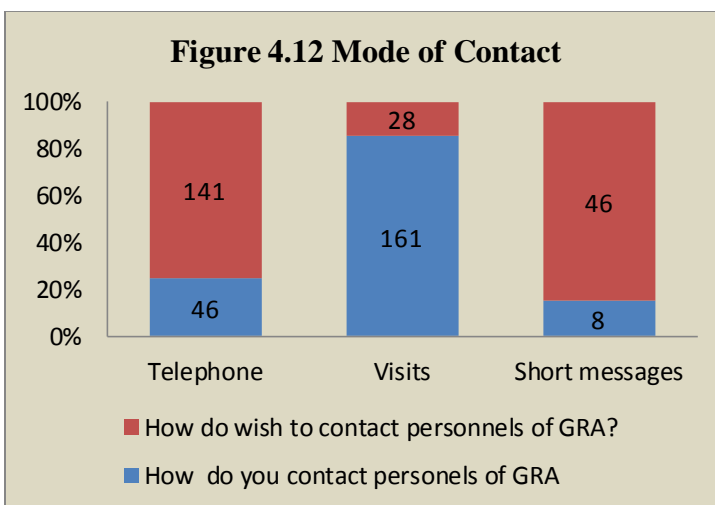
Source: *Researcher's fieldwork data 2015*

Challenges identified in the informal sector range from high rate of taxation, cost of complying with tax, skill and education base in the sector to firm wide performance. Table 4.11 indicates that taxation in the sector is a major problem which bedevils organizational profitability. It scored 38 per cent. Cost of complying with tax laws and policies which include accurate book-keeping scored 25%. Education as indicated in the chart below was the least of challenge in the informal sector, however, cumulatively, these issues affect tax compliance. This result links to a study by Lignier and Evans (2012), who realized that tax compliance costs are significant for small business taxpayers.



Source: *Researcher's fieldwork data 2015*

The study also sorts to look at the mode of interaction between the tax payers and tax authorities. The aim was to establish if it adds to tax payers' challenges. Among the three means of contact identified, it was the case that personal visits were the most frequently used. It came to light that only entrepreneurs who are well established and who have some sort of personal relationship with authorities could use electronic mails and telephone communication.



Source: *Researcher's fieldwork data 2015*

It is the desire of the people that moving forward communication be extended to simple text messages to a registered short code for GRA and facsimiles. From the Figure 4.12 above, it could be counted that respondents showed preference for simple text messages and telephone interactions rather than visits to and fro tax offices.

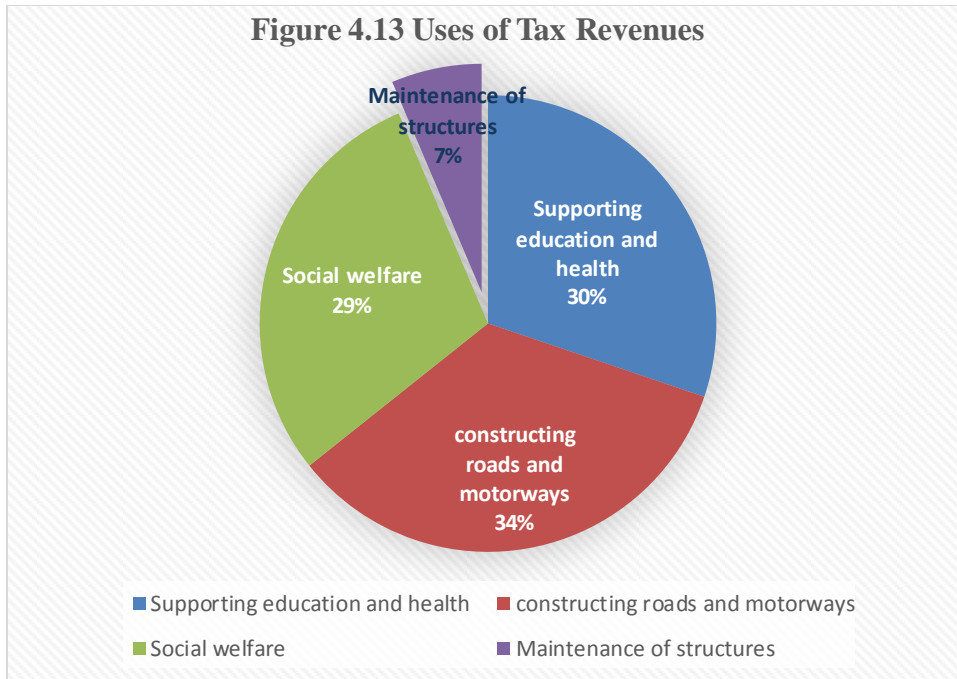
More is desired of the level of performance of Ghana Revenue Authority. 47.4% of clients deemed the services of GRA satisfactory whilst 47% were unsatisfied with service delivery of GRA. This is displayed in the Table 4.9 below.

Table 4.2 Level of Satisfaction for GRA Services

level of satisfaction for GRA services		
	responses	percentage
very satisfactory	3	1.4%
quite satisfactory	99	46%
neither/nor	12	5.6%
Quite dissatisfactory	78	36.3%
Very dissatisfactory	23	10.7%
total	215	100.0%

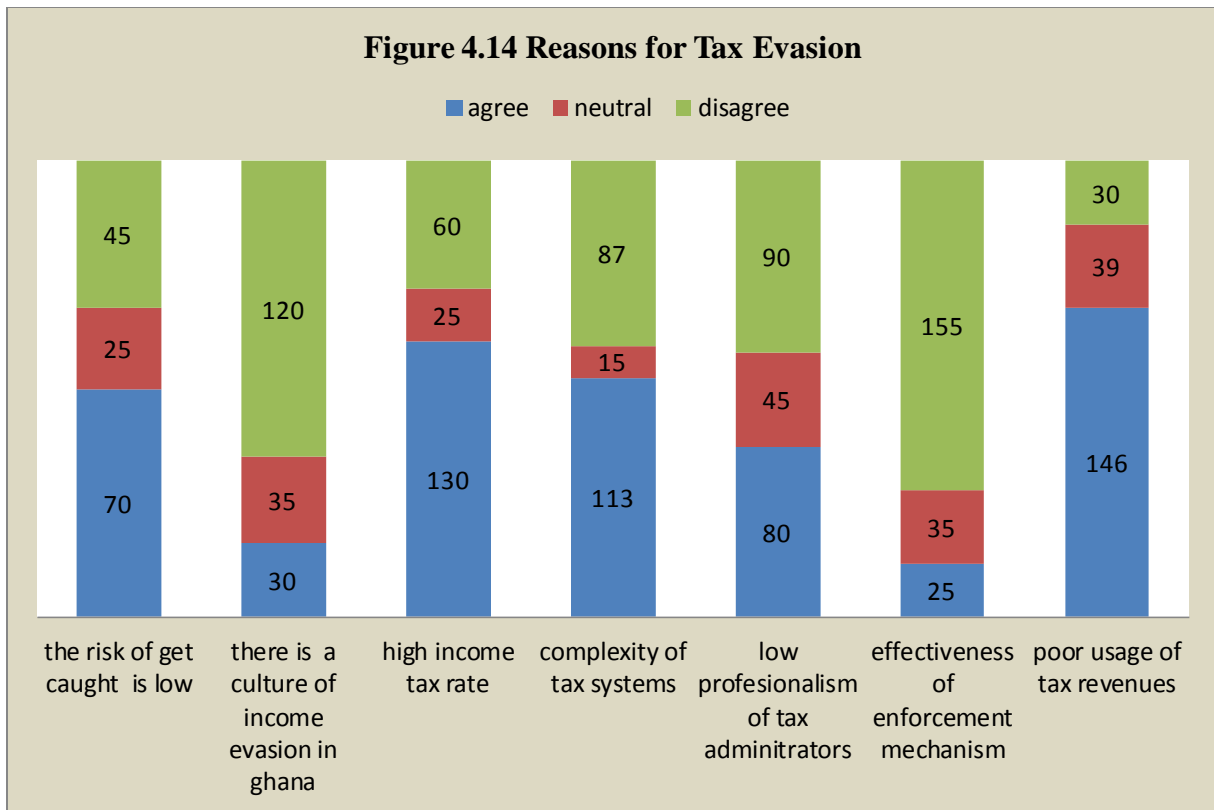
4.5 Reasons for Non-Compliance

The results of this study identified tax compliance to be a cognitive response to incidence of tax payment and not just a behavioral issue as elaborated by Schmolders, (1970). The study first and foremost identified the knowledge base of the respondents with respect to uses of taxes. The responses as displayed below (see fig 4.12) inferred that entrepreneurs are not oblivious of the relevance of taxation. Then after, the reasons for non-compliance were investigated.



Source: *Researcher's fieldwork data 2015*

Research by VADA (2007) expounded some of the reasons for taxpayers' low compliance attitude and listed; complexity of the tax system, tax rates, professionalism of the tax administration, level of tax payer awareness, state of information systems, effectiveness of enforcement mechanisms and the availability of resources to undertake effective implementation of programmes. From the study conducted into the operations and business environment of Adansi North District Informal Sector, the aforementioned reasons and many others contribute to low income tax compliance. The degree strength of the obstacles to compliance are diagrammatically presented in Figure 4.14 below and emphasized in Table 4.10.



Source: *Researcher's fieldwork data 2015*

From the responses identified in Figure 4.14 above and the Table 4.10 below, it could be acknowledged that the ultimate reason for tax evasion is the fact that the potential consequences (e.g. fines and penalties, prosecution) of getting caught are not serious enough to stop people evading paying their taxes. Again, in consonance with results of VADA (2007), professionalism of the tax administration and effectiveness of enforcement mechanism account extensively for tax evasion in the informal sector.

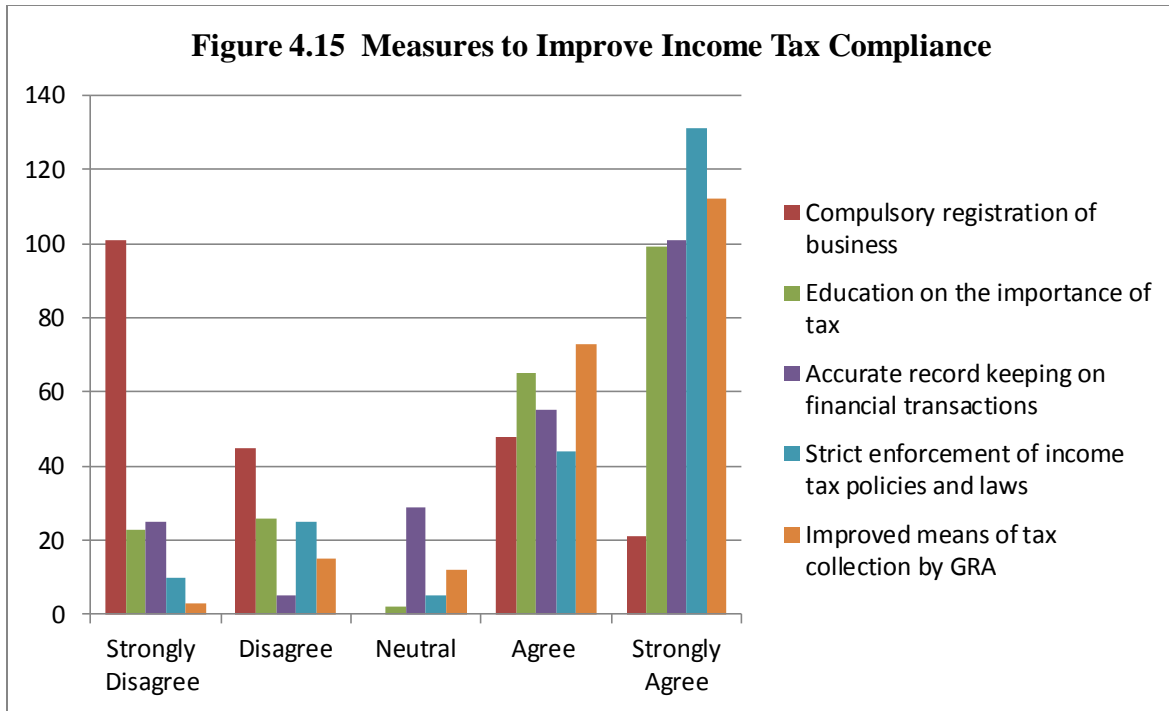
Table 4.3 Compliance Challenges

Reasons for tax evasion	Disagree	Neutral	Agree
The risk of getting caught is low.	107	40	68
There is a culture of income tax evasion in Ghana	67	29	139
The taxes collected are used poorly.	37	42	136
The potential consequences of getting caught are serious enough	50	9	156
High income tax rate	48	27	140
complexity of the tax system	114	19	82
low professionalism of the tax administration	52	24	139
level of tax payer awareness	76	22	117
state of information systems	57	30	128
effectiveness of enforcement mechanisms	38	3	174
ARITHMETIC MEAN	63.6	24.5	127.9

Source: Researcher's fieldwork data 2015

4.6 Measures to Adopt in Improving Income Tax Compliance.

The views of entrepreneurs were sought on how best income tax compliance can be improved in the district of Adansi North and when the issue of compulsory registration of businesses was raised and as indicated by Figure 4.15, 190 of respondents raised objection to it while the rest consented to it. 164 entrepreneurs agreed to the need for education on the importance of income tax. Out of the 215 respondents, 175 respondents suggested there should be proper book keeping by businesses and 180 entrepreneurs accepted that there should be strict enforcement of tax policies and laws. Finally 187 respondents out of the 215 respondents agreed the means of collecting tax revenue in the district should be improved. The Figure below is the representation of views of respondents as to how best to improve income tax compliance in the informal sector of Adansi North district.



Source: *Researcher's fieldwork data 2015*

CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS

5.0 Introduction

This chapter contains the summary of research findings, conclusion as well as recommendations. The focus of the study was to establish the tax compliance level in the informal sector of Adansi North District and further to assess the challenges faced by tax payers from the informal sector in meeting its voluntary income tax compliance. Also, the reasons for the non-compliance of income tax by the informal sector of Adansi North District were investigated.

5.1 Summary of Findings

5.1.1 Dominant Economic Activity in the Informal Sector

The study identified that majority of respondents were mostly into retail/commerce and agriculture. Just a handful worked in the manufacturing or processing and service. This can be explained by the fact that the capital requirement for engaging in agriculture or retail business was low compared to the other sectors. Thus the findings have confirmed this view and buttressed it. Most entrepreneurs find it difficult to engage in other sectors because of the inadequate finance to acquire the needed machinery; low level of technology and the level of managerial skills. These issues are the key bottlenecks identified to the industrial growth and development in the District.

5.1.2 The Level of Income Tax Compliance by the Informal Sector of Adansi North District

Tax compliance is the willingness of individuals and other taxable entities to act in accordance within the spirit as well as the letter of tax law and administration without the application of enforcement activity. It was identified from the work that the income tax rate for the period as given by Ghana Revenue Authority was 25%. However, on the average the amount of tax paid by the informal sector deviated from expected tax to be reported and paid to GRA by 25.25%. From this, the researcher found out that, most of the respondents were not paying the correct amount of income tax per their level of income.

5.1.3 Reasons for Income Tax Non-Compliance

Some respondents recounted inefficiencies with GRA as part of the reasons for income tax non-compliance. It is the opinion of the respondents that due to inefficiencies at GRA, income tax evasion is on the rise. Another reason identified for tax non-compliance and evasion by the study included the perceived misuse of the revenues collected by GRA. In their opinion, participants indicated that their community's infrastructural development and business environment still leaves so much to be desired.

Also a large number of these entrepreneurs do not keep proper record of their financial transactions and therefore rendering income tax estimation not an actual of the 25% of income.

A sizeable number of the respondents indicated that they evade tax because of the loopholes in the enforcement of tax collection. Thus a minority of the entrepreneurs take advantage of the system. The view of 74% of the respondents is that avoiding income tax legally by using loopholes in legislation is acceptable.

5.1.4 Motivation for Income Tax Compliance

The study went further to identify the incentive for income tax compliance in the informal sector. Contrary to the findings of Coricelli et al. (2010) that the public display of tax evaders encouraged compliance, at Adansi North District, entrepreneurs acknowledged having their names published by GRA had no influence on their income tax compliance. Rather they were quick to pay their taxes because GRA would pursue them with security forces to lock up their businesses and also because they were aware that their taxes helped to promote development.

5.1.5 The Challenges Faced by the Informal Sector in Complying with Income Tax Liabilities.

Challenges identified from the work ranged from high rate of taxation, cost of complying with tax, skill and education base in the sector to firm wide performance. The high rate of tax in the sector scored 38% is a moderate issue which bedevil informal sector profitability. Cost of complying with tax laws and policies which included accurate book-keeping scored 25%. Education as indicated in the outcomes of the study was the least of the identified challenge in the informal sector. In general all these factors and issues cumulatively, affected tax compliance.

5.2 Conclusion

From the on-going analysis it has become evident that voluntary income tax compliance in the informal sector is interlinked with Ghana Revenue Authorities having the proper structures and processes in place. This is because a lot of individuals have been evading tax through the loopholes existing in the GRA structures. From the results of the study it can be concluded that inefficiencies with GRA and the misuse of generated revenues by the authorities are the main reasons for the high incidence of tax non-compliance and evasion in the Adansi North District

and Ghana as a whole. On the other hand, the entrepreneurs would rather adhere to their income tax requirement from the fear of GRA pursuing them with security forces like the police. Also the income tax evasion is reduced by the view that revenues generated from the taxes helped to promote development. In all, It is acknowledged from the study that ultimately the potential consequences (e.g. fines and penalties, prosecution) of getting caught in Ghana for evading income tax is not serious enough to prevent people from engaging in the evasion. This is in consonance with results of VADA (2007) who identified that lack of professionalism of the tax administration and effectiveness of enforcement mechanism account extensively for tax evasion in the informal sector. Furthermore, issues like the high rate of taxation, cost of complying with tax, skill and education base in the sector to firm wide performance are the challenges that mitigate against tax compliance by the informal sector.

5.3 Recommendations

5.3.1 Proper Administration of Income Tax Revenues

Revenues from taxes are used in developmental efforts in the area of infrastructures and the payment of tax revenue plays an important role in the spate at which development is undertaken in Ghana. Therefore, it is very essential and imperative for Ghana Revenue Authority to ensure that it gets the maximum benefits from correct application in operations. This study recommends that GRA should ensure proper use and allocation of revenues as well as accountability to encourage and motivate people to pay their correct income tax voluntarily. The premise of this recommendation is that if people are assured that their taxes would be used appropriately, they will pay their taxes willingly.

5.3.2 Elimination of Loopholes

In the light of the above findings to the study, the researcher proposes that GRA should focus on strengthening its structures to wipe out the loopholes. If Ghana Revenue Authority has established proper structures, it will make it difficult tax evasion to occur even in the informal sector.

5.3.3 Improved Means of Income Tax Collection

The mode of contact to GRA should not be limited to personal contacts only, but should be extended to telephone calls and simple short messages. This will help to improve the way income tax payers in the informal sector of Adansi North District and hence enhancing filing and payment compliance.

5.3.4 Compulsory Registration of Businesses

Business should be made to compulsorily register. Registered businesses have their database with tax authorities. The database which indicates location of business, names and areas of business operations would give Ghana Revenue Authority a better guide and ease of monitoring entrepreneurs in the informal sector of Adansi North District.

5.3.5 Strict Enforcement of Income Tax Policy

Most income tax payers evade payment of tax because they believe that GRA is lenient in enforcing income tax laws. GRA should therefore subject income tax laws to strict enforcement so as to scare people from evading payment.

APPENDIX ONE

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APPENDIX TWO:

Questionnaire

KWAME NKRUMAH UNIVERSITY OF SCIENCE AND TECHNOLOGY, KUMASI.

SCHOOL OF BUSINESS

QUESTIONNAIRE FOR BUSINESS OWNERS

THIS QUESTIONNAIRE IS DESIGNED SOLELY FOR ACADEMIC PURPOSE IN SOLICITING INFORMATION ON “**INCOME TAX COMPLIANCE IN THE INFORMAL SECTOR OF ADANSI NORTH DISTRICT**”. ASSURANCE IS GIVEN FOR THE CONFIDENTIALITY OF THE INFORMATION TO BE PROVIDED.

PLEASE WRITE IN THE SPACE AND TICK WHERE APPROPRIATE
SECTION A1: DEMOGRAPHIC INFORMATION

1. Sex: Male [] Female []
2. Please indicate the range within which your age falls.
a) 18 – 27 [] b) 28 – 37 [] c) 38 – 47 [] d. 48 and above []
3. What is your level of education?
a) University [] b) Advance/ Ordinary Level [] c) Senior High []
d) Others, please specify.....
4. How many employees do you have?
a) 1 – 5 [] b) 6 – 10 [] c) 11 – 20 [] d. 20 and over []
5. What type of business operation are you engaged in?
a) Retail [] b) general manufacturing [] c) services []
d) Others, please specify.....
6. Has your business been registered?
a. Yes [] b. No []
7. If you answered **No**, to question 5 above, why has your business not been registered?
.....
.....

SECTION A2: LEVEL OF INCOME TAX COMPLIANCE

8. On average, how much do you realize as monthly revenue?
a) less than 1,000 cedis [] b. 1,000 to 4,000 cedis [] c) 4,000 to 9,000 cedis. []
d. 9,000 cedis and above. []
9. On average, how much do you pay as monthly income tax liability?
a) less than 250 cedis [] b. 250 to 1,000 cedis [] c) 1,000 to 2,250 cedis. []

d. 2,250 cedis and above. []

10. How often do you pay income tax?

a. monthly [] b. yearly [] c. weekly []

11. Do you keep enough records to help you declare accurate income tax?

a. yes b. no c. fairly

12. Do you pay your income tax liability on time?

a. yes b. no c. fairly

From the statements below, please indicate your level of agreement or disagreement to the following statements. Please use the scale below

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

	opinion on income tax evasion	1	2	3	4	5
13	Deliberate income tax evasion is considered acceptable by the Ghanaian society.					
14	Those who evade paying income tax repeatedly should receive a jail sentence.					
15	Tax payment is very important					
16	The more successful GRA is at dealing with income tax evaders the less likely citizens will be to evade their taxes.					
17	Deliberate tax evasion is on the increase.					
18	It is every taxpayer's civic responsibility to pay his or her correct income taxes.					
19	Deliberate income tax evasion is a crime.					
20	Few people report all of their income to GRA					

From the statements below, please indicate your opinion on the acceptability or unacceptability the following statements. Please use the scale below:

1=completely unacceptable 2=somewhat unacceptable 3=neither/nor 4=somewhat acceptable 5=completely acceptable

	opinion on income tax compliance	1	2	3	4	5
21	To deliberately not pay the income taxes you are supposed to pay.					
22	To buy services knowing that the income from them will not have been declared to the tax authorities.					
23	To legally avoid paying income taxes by using loopholes in legislation.					
24	PAYE taxpayers not reporting all income earned in their spare time.					
25	To declare some income but not all of your income for tax purposes.					
26	Exaggerating business expenses to reduce the amount of income taxes you pay.					

Rate the factors below in relation to what motivates people to personally pay their taxes in full and on time.

	Motivation for income tax compliance	Great deal of influence	Little influence	Neutral	No influence at all
28	Concern that GRA will contact you about your income tax affairs				
29	GRA treats all taxpayers fairly				
30	Your taxes are used to pay for public services				
31	Concern that your name will be published on GRA's List of Defaulters.				
32	Concern that someone might report you to GRA.				
33	Because it is the law.				
34	Belief that other taxpayers are declaring and paying honestly.				
35	Concern that you will have to pay interest charges for late payment of income tax				
37	Your personal belief that you should do the 'right thing'.				
38	Concern that you will be prosecuted.				
39	Concern that you will be audited by GRA.				
40	GRA makes it easy for you to pay your taxes.				

SECTION B: CHALLENGES IN COMPLYING WITH TAX LIABILITIES

- 41.** Does incomplete records hinder your ability to declare accurate income tax liability?
a. yes b. no c. Sometimes
- 42.** How do you contact personnel of Ghana Revenue Authority?
a. telephone b. personal visit C e-mail
- 43.** How do you wish to contact personnel of Ghana Revenue Authority?
a. telephone b. personal visit C e-mail

44. In your opinion, what are income taxes used for? Tick as many as apply.

	Supporting education	
	Rehabilitation of roads and motorways	
	Social welfare	
	Maintenance of structures	
	Health services	
	Do not know	

45. Level of satisfaction of services of Ghana Revenue Authority

- a. very satisfactory [] b. quite satisfactory [] c. neither/ nor []
d. quite dissatisfactory [] e. very dissatisfactory [].

SECTION C: REASONS FOR NONCOMPLIANCE

From the statement below, please indicate your level of agreement or disagreement to the following statements. **1=disagree 2=neutral 3=agree**

		1	2	3
46	The risk of getting caught is low.			
47	There is a culture of income tax evasion in Ghana – everyone who has the opportunity to evade tax does so.			
48	The taxes collected are used poorly.			
49	The potential consequences (e.g. fines and penalties, prosecution) of getting caught are not serious enough to stop people evading paying their taxes.			
50	High income tax rate			
	complexity of the tax system			
	professionalism of the tax administration			
	level of tax payer awareness			
	state of information systems			
	effectiveness of enforcement mechanisms			

From the statements below, please indicate your level of agreement or disagreement to the following statements. Please use the scale below

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

	Measure to improve income tax compliance	1	2	3	4	5
52	Compulsory registration of business					
53	Education on the importance of tax					
54	Accurate record keeping on financial transactions					
55	Strict enforcement of income tax policies and laws					
56	Improved means of tax collection by GRA					