

CATHOLIC UNIVERSITY COLLEGE OF GHANA

ASSESSING KNOWLEDGE ON TAX REVENUE IN THE  
INFORMAL SECTOR: A CASE STUDY OF THE SUNYANI TAX  
DISTRICT

COMFORT APPIAH

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BY  
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Administration, Catholic University College of Ghana, in partial fulfilment of  
the requirements for the award of Master of Business Administration degree in  
Accounting

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## **DECLARATION**

### **Candidate's Declaration**

I hereby declare that this dissertation is the result of my own original research, and that no part of it has been submitted for another degree in this University or elsewhere.

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

Name:.....

### **Supervisor's Declaration**

I hereby declare that the preparation and presentation of the dissertation were supervised in accordance with the guidelines for supervision of dissertation laid down by the Catholic University College of Ghana.

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

Name:.....

## ABSTRACT

The informal sector or informal economy as defined by governments, scholars, banks, etc. is the part of an economy that is not taxed, monitored by any form of government, or included in any gross national product (GNP), unlike the formal economy. A large number of the country's active labour force is employed in the informal sector and accordingly generates significant amount of income that is subject to income tax. The sector is expected to expand exponentially in the near future and perhaps serve as a "goldmine" for higher revenue mobilization. In view of this the study sought to assess accounting records kept by the informal sector, assess the perception of the operators under the informal sector in the Sunyani Tax District towards taxation, Know the motives for taxing the informal sector, Identify the variables that make informal sector "difficult-to-tax" and to provide some suggested recommendations on the way forward on the taxation of the informal sector. The study adopted mixed method approach is the general term for when both quantitative and qualitative data collection techniques and analysis procedure are used in a research design. After analysis, it was found that the level of education had impact on other variables responsible for non-compliance. The Study then recommended that the GRA through IRS intensifies its tax information and education using both print and electronic media. With regards to the informal sector tax information in all major Ghanaian languages should be printed as hand bills containing information on the need to pay taxes and the benefits to be derived

## **ACKNOWLEDGEMENT**

I thank the Lord Almighty for giving us the opportunity to pursue this programme and the grace to complete it successfully. My special gratitude goes to my supervisor, Mr Frimpong for his keen guidance, patience and his invaluable support. I am also very grateful to my husband for his unfailing support and advice.

## **DEDICATION**

To my husband and kids.

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## **CHAPTER ONE**

### **INTRODUCTION**

#### **Background to the Study**

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

The size of the informal sector is also an obstacle to income tax collection. The income tax base in Ghana is very narrow. About 30% of the work force is employed for wages and salaries. The rest are in the informal sector. In some cases, it is almost impossible to determine the income of those in the informal sector because they are mainly self-employed and therefore the greater part of their real income cannot be satisfactorily assessed. As a result, majority of the informal sector are income tax evaders.

#### **Some of the informal organisation in Ghana**

1. Ghana Private Schools Association
2. Progressive Transport Owners Association (PROTOA)
3. Ghana National Chemical Sellers Association
4. Ghana National Tailors and Dressmakers Association
5. Musician Union of Ghana
6. Traditional Healers, Fetish Priests, Mallams and Drug Peddlers Association
7. Ghana Gold and Silver Smiths Association

8. Ghana Private Road Transport Union (GPRTU)

9. Ghana Cooperative Transport Society (GCTS)

The informal sector or informal economy as defined by governments, scholars, banks, etc. is the part of an economy that is not taxed, monitored by any form of government, or included in any gross national product (GNP), unlike the formal economy. In developing countries, some 70% of the potential working population earn their living in the informal sector. Most of them live and work in this sector not because it is their wish or choice, but because they have no chance to be hired by an employer from the formal sector except for a few hours or days, with no legal right to be hired again.

In describing this sector, one should bear in mind that the informal economy is not a deviation of the formal economy, because all economic activities started informal and formed the basis from which the formal economy sprang, with firms and annual accounts, taxes, chambers of commerce, etc. In Ghana, the informal sector constitutes about 60% of the economy. One sector in Ghana which has a great potential for the necessary domestic revenue mobilization and to reduce huge budget deficits is the informal sector/economy.

A large number of the country's active labour force is employed in the informal sector and accordingly generates significant amount of income that is subject to income tax. The sector is expected to expand exponentially in the near future and perhaps serve as a "goldmine" for higher revenue mobilization. The effective and efficient imposition of income tax on the informal sector holds the great prospect of closing the yawning gap in the domestic revenue generation. The widening of tax net, as much as possible, to include most of the participants in the informal sector will broaden the tax base and hence lower the rates.

According to an article written by the World Bank, “attempts to increase government revenue while at the same time lowering the tax rates have resulted in the need to adopt policies to broaden the tax base” (World Bank ,2002). Historically the businesses engaged in the formal sector have suffered extremely high tax rates due to narrowness of the tax base resulting from most informal businesses being outside of the tax net. This situation can only be reversed when the tax base is broadened by the inclusion of every single income earner in the informal sector. Bagahwa and Naho (1995) state that “public revenue remains weak in numerous sub-Saharan African countries and the tax burden appears to be unevenly distributed. Two sectors are often considered as agricultural and the unrecorded urban sectors. Its under-taxation results in considerable losses in tax revenue. What is worse, the development of unrecorded activities is threatening the official sector which plays a crucial role in collecting government resources”

Following from this assertion, it is patently clear that under-taxation of the informal sector is accounting for the imbalances in the tax system. The economy of Ghana is largely made up of individual and small-scale enterprises. That sector provides diverse sources of income which, if taxed, could increase government internally generated revenue.

The Institute of Statistical, Social and Economic Research (ISSER), 2003, stated that “the main source of employment in Ghana is the informal sector. The sector provides employment opportunities for at least 80% of the labour force” (ISSER, 2003). The estimated size of the informal sector presupposes that, the sector makes significant contribution to the Gross Domestic Product (GDP) and so the sector could equally make a major

contribution to the tax revenue. A survey conducted in Accra by Jobs and Skills Programs for Africa (JASPA) in 1990/91 established that the informal sector accounts for about 22% of Ghana's real GDP (ISSER, 2003). If the GDP contribution could be translated into tax revenue, government revenue could make significant appreciation. With the focus of successive and present governments on the private sector (which is dominated by the informal businesses) as the engine of development, it can be suggested that the sector will witness tremendous expansion and subsequently more tax revenue.

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

### **Statement of the Problem**

Among the major challenges confronting the governments of the third world including Ghana in their forward march to the socio-economic development is how to manage the phenomenon of the growing informal economy and maximization of income tax from that sector. This assertion was recognised by Anuradha and Ayee (2001), when they state that "how to tax the informal sector remains a pressing question. Fiscally constrained governments undertaking liberalizing economic reforms are looking for new ways to augment state revenues. The informal sector is an obvious focus of attention as it forms

a significant and growing proportion of the economy in the developing countries, yet pays little in the form of taxes” (Anuradha and Ayee, 2002).

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

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

A number of researches have taken a look at factors considered as accounting for the continuous growth of the informal sector. However, there has been no conclusive evidence on those factors. Even the exact definition of the informal sector continues to remain a great controversy. According to Schneider and Enste (March, 2000: 78), “disagreement persists about definitions and estimation procedures of the informal economy”



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

Again, the informal sector is likely to grow faster than it is now if government can draw up concrete policies to facilitate the economic activities of the sector. The revenue capacity is expected to increase drastically as a consequence if government can put in place policies to build the capacity of the participants of that sector. Indeed, ISSER states that, “the significant role of the informal sector has not been fully incorporated in Ghana’s development efforts. This is partly manifested in the sector’s low productivity, a characteristic that clearly reflects the fact that after 50 years of independence, there is still no comprehensive policy framework for a sector that contains about 80% of Ghana’s work force” (ISSER, 2003:193).

Indeed, the informal sector has the potential of inching very close to the formal sector in terms of their respective income tax contribution to national development. The peculiar problems of the informal sector such as predominant cash transactions, non-existent or poor record keeping, itinerant in nature, little or no barriers to entry et cetera, makes the sector extremely difficult to tax. This

situation has resulted in massive tax evasion of all forms from complete non-declaration of income to under-declaration of income.

### **Research Objectives**

The taxation of the informal sector in Ghana since independence remains a key challenge to governments. The tax inflow from the informal sector relative to its sheer size can be said to be woefully insufficient. There are many informal sector participants that either deliberately evade tax payment or are not captured by the Internal Revenue Service. It is on this premise that the researcher objectives seek to find the following;

The general objectives of the study are to:

- a. Assess accounting records kept by the informal sector
- b. Assess the perception of the operators under the informal sector in the Sunyani Tax District towards taxation.

The specific objectives are to:

- c. Know the motives for taxing the informal sector.
- d. Identify the variables that make informal sector “difficult-to-tax”
- e. To provide some suggested recommendations on the way forward on the taxation of the informal sector.

### **Research Questions**

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

- a. What kind of accounting records kept by the informal sector practitioners that makes it difficult to determine the taxable income?
- b. What reasons account for the taxing of the informal sector?
- c. Why is the informal sector very difficult to tax?

- d. Which variables influence the high tax non-compliance of the informal sector businesses?
- e. How can the GRA derive maximum tax benefits from the informal sector?

### **Significance of the Study**

The relevance of this study is aimed at addressing the critical issue of revenue mobilization from the informal sector of the Ghanaian economy. Specifically, this study's significance would be experienced in the following critical areas.

- a. This work will add to the existing body of knowledge and literature on the subject of the taxation of the informal sector. This study will give an insight as to the importance of the informal sector to contribute their quota to the national development.
- b. This study could serve as a basis for future and further research and study in the area by other students and researchers. This study cannot be conclusive on the subject of taxing of the informal sector. As the social order changes and dynamics vary, further work could be carried out in the near future.
- c. This study will be a useful source of reference to government generally, and to GRA and the Ministry of Finance especially, in policy making decision concerning taxation of the informal sector.

### **Delimitations and Limitations**

1. The main area of study covered the Sunyani Tax District of the Brong Ahafo Region. According to ISSER “.....most of the participants in the rural informal sector are engaged in agriculture,

the urban informal sector is dominated by those engaged in retail trade” (ISSER, 2003, 193). Based on ISSER’s assertion, it means that this study concentrated on urban informal sector and biased towards the retail trade participants. There is therefore, a likelihood of some amount of error in extrapolating the findings based on the sample to the population.

2. A major limitation on this study is the fact that people are generally very suspicious and wary of anyone talking on tax issues; hence participants in the informal sector, most of whose activities are invisible may be very reluctant to voluntarily disclose information on their business activities and their tax status. It may mean this study will be skewed towards the participants who will voluntarily provide information and this could lead to a particular category of informal sector participants dominating the findings.
3. Finally, limited resources on the part of the researchers may limit the number of questionnaires to be distributed and the number of interviews to be conducted. This might affect the validity, to some extent, of results of the study.

### **Organisation of the Study**

The remainder of this long essay was organized into four chapters. Chapter two reviewed the existing literature of the informal sector in Ghana. Chapter three in concerned with the methodology used in gathering information. Chapter four presented the findings and analysis of data gathered from the field. Finally, recommendations and summary of the findings were discussed in chapter five.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **Introduction**

This chapter critically reviewed existing literature on the definition and measurement of the informal sector which remains debatable in the study of the sector. A number of authors and researchers have given their own working definition of the informal sector. Some definitions given in the past may be too narrow to meet the modern-day informal sector as a result of constant changes in the form, activities and shape of that sector. A number of attempts have been made to define exactly what the informal sector is made up of. First, attempts to measure the informal sector faced the problem of definition (Schneider and Enste, 2000). The informal sector has been defined as all economic activities that contribute to the officially calculated (or observed) gross national product but are currently unregistered (Schneider and Enste, 2000).

#### **The Origin of the Informal Sector**

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

## **The Definition of the Informal Sector**

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

- a. “All economic activities that contribute to the officially calculated gross national product but currently unregistered” (Feige, 1989).
- b. “Market-based production of goods and services, whether legal or illegal, that escapes detection in the official estimates of the gross domestic product”. (Smith, 1994).
- c. “Unregulated economic enterprises or activities” (Hart, 1973).

Farrell et al (2000) stated that “currently there are two approaches to defining informal sector activity: the definitional and behavioural”.

‘Informal sector according to the definitional approach is economic activity unrecorded in the official statistics such as the gross domestic product and /or the national income accounts’ (Farrell et al, 2000).

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

According to Thomas (1992), the definition one uses is driven by the research question: ‘definitional approach’ is used to estimate the size and

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

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

Ghana’s informal sector is large and diverse. It covers activities such as trading, spare parts, transportation, construction, agriculture, livestock, food preparation, credit facilities, electricals, dressmaking, gold and silver smithing and traditional healing. Because of its sheer size, it has become difficult for the Ministry of Finance and Economic Planning and the Statistical Service to have a reliable data on their membership and activities.

The size of the informal sector is also an obstacle to income tax collection. The income tax base in Ghana is very narrow. Only about 20% of the work force is employed for wages and salaries. The rest are in the informal sector. In some cases, it is almost impossible to determine the income of those in the informal sector because they are mainly self-employed and therefore the greater part of the real income cannot be satisfactorily assessed. As a result, majority of the informal sector have been the worst income tax evaders. The evasion takes three forms, namely, non-declaration of income, under-declaration and inflation of deductions from income.

### **Some Informal Organizations in Ghana**

1. Ghana Private Schools Association
2. Progressive Transport Owners Association (PROTOA)
3. Ghana National Chemical Sellers Association
4. Ghana National Tailors and Dressmakers Association
5. Musician Union of Ghana

6. Traditional Healers, Fetish Priests, Mallams and Drug Peddlers Association
7. Ghana Gold and Silver Smiths Association
8. Ghana Private Road Transport Union (GPRTU)
9. Ghana Cooperative Transport Society (GCTS)

### **Historical methods of taxing the informal sector in Ghana**

Taxation of the informal sector has been extremely difficult for all past and present governments. With the ever-growing pressure on the government to meet the socio-economic and infrastructural developmental needs of the society, there is an urgent need for government to generate more local revenue. One potential source of the much-needed revenue is the large informal sector which largely remains untaxed. The government of Ghana continues to lose billions of cedis, if not trillions, in tax revenue from the informal sector (World Bank, 2002).

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

#### **Standard Assessment**

The first attempt in Ghana to tax the informal sector was in 1963, when the Standard Assessments Act, 1963, Act 205 was enacted. This Act has gone through various amendments over the years and consolidated into the Internal Revenue Act, 592, 2000. The standard assessment was a scheme in which a fixed lump-sum tax was levied on individuals and businesses on the basis of



business activity in which they engaged. The levies correspond to some average income level presumed to be earned by members of a particular occupation or business grouping.

In principle, the standard assessments were payments on accounts to be set-off against the amount of income tax actually payable. However, in practice and with the tax authorities, the standard assessments increasingly represented the final tax liabilities from the various occupational groups covered (World Bank, 2002). In contrast to the usually prescribed lump-sum payment under standard assessment, the Standard Assessments Act, in Ghana incorporated graduation for some occupational groups, for example doctor dentists had to pay varying lump-sum taxes according to the number of years in practice while the lump-sum amounts paid by fishermen were calibrated by the length of their vessel.

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

- a) The weak administrative capacity of the tax administration did not allow the effective monitoring of the scheme. For example in the large informal transport sector, inspection of clearance certificates were left in the hands of other law enforcement agencies like the police and the

License Office, who colluded with noncompliant persons and cashed in on the scheme instead of ensuring compliance (World Bank, 2002).

- b) The annual lump-sum payments were deemed too high by the highly impoverished informal sector. Evasion was quite rampant by small-scale informal sector operators who did not effectively require clearance certificates to undertake business activities (World Bank, 2002).
- c) The scheme violated the principle of vertical equity, to the extent that it imposed the same tax liability on high and low income professionals such as doctors and lawyers. Hence, some low-income professionals were not encouraged to comply (World Bank, 2002).
- d) Though the scheme was mooted to be effective in taxpayer identification by creating list of small businesses and professionals, the over centralized tax administrative set-up could not achieve this policy objective. Information gathered was left to gather dust without being put too much use.

### **Occupational Grouping Taxation**

In Ghana, some small-scale businesses and informal sector operators belong to some occupational groupings. Such occupational groupings include GPRTU, market women union, seamstresses and tailors union, hawkers association, etc. The members of these occupational groupings found it difficult paying the annual lump-sum levies under the Standard Assessment Scheme. Again, ineffective monitoring of the scheme because of the weak administration allowed for massive evasion of tax.

The tax policy of the informal sector therefore shifted to the normal practice of raising provisional assessment and demanding quarterly payments.

This was equally difficult for businesses in the informal sector and again, allowed for noncompliance. Thus in 1986 when the government under the Economic Programme; Structural Adjustment Programme (SAP) undertook tax reforms with the view to strengthening the administrative structures of the tax institutions, there was the need to review the policy objective that sought to increase government revenue, by broadening the tax systematically lowered to reduce the tax

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

Two categories of tax payments were identified. One category made up of taxis and buses according to passenger capacity. The second category comprising of long distance and cargo trucks paid a percentage of their gross takings per trip. Economic Recovery Programme (ERP) and Structural Adjustment Programme was used so that the tax rates could not be a burden (World Bank, 2002). Persons who owned any specified vehicle was to pay intra-city commuter services of a specific cedi amounts on daily basis.

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

to them (World Bank, 2002). The World Bank article titled ‘Tax Compliance and the Informal Sector in Ghana identified some merits and demerits of the Identified Grouping Taxation. The merits are first examined.

- a) The scheme was most attractive to tax authorities because it was comparatively simple and easy to administer, despite the weak tax administration capacity in Ghana. Tax authorities were relieved of the need to go through auditing and investigation procedures to ascertain or verify a particular individual tax income.
- b) The scheme also enhanced horizontal equity to the extent that the levy captured small businesses and the self-employed who previously escaped taxation. However, the informal sector businesses that did not fall into any identifiable occupational groupings escaped being taxed.
- c) Closely related to the problem of weak tax administration capacity and the low salary levels of tax administrators in Ghana which encouraged corruption amongst tax officials, the scheme minimized opportunities for corruption and collusion since there was no discretion on the part of tax officials.
- d) The scheme has to a limited extent increased compliance rate of the informal sector. Tax collection from hard-to-tax informal sector especially the transport sector has improved substantially. Before February 1987, the procedure for taxing informal sector followed the same procedure for the formal sector. Provisional assessments were raised and quarterly payments demanded. This system resulted in very low tax collection figures from the sector.

e) Finally, the scheme has also improved to some extent with taxpayer identification. Since the executives of the associations could tell the location of their members and in their anxiety to achieve horizontal equity for members of the same occupational groupings, they (executives) are always prepared to fish out members to ensure identical cost structure in the industry (World Bank, 2002). The scheme however was afflicted with certain demerits:

### **Storage and Auditing of Receipt Books**

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

### **Embezzlement of Tax Revenue**

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

### **Cost of Collection was Exorbitant**

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

### **Poor record Keeping by the Associations**

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

### **Tax Stamp**

The various attempts in the past to rope in the informal sector in the tax net have not achieved the desired results. There still remain a large number of the informal sector enterprises outside the income tax net. Indeed, some informal sector operators earn income from all the three main sources of income under the tax law namely employment, business and investment yet pay absolutely nothing and this has necessitated the introduction of a new scheme called 'tax stamp'. The tax stamp is a type of standard assessment scheme which imposes a lump-sum of tax paid quarterly. The tax stamp is being operated by IRS itself unlike in the case of identifiable groupings taxation where agents were used to collect tax on behalf of IRS. This system has come to some extent correct the weaknesses in the predecessor systems/form of tax. The effort at getting more informal sector to pay tax

The tax stamp system has grouped the informal sector businesses into categories based on the turnover of the business. Each informal sector business is expected to produce tax stamp as and when a tax officer demands for it. Failure to produce a tax stamp amounts to an offence liable to a fine, not less than GH¢20.00 and not exceeding GH¢50.00 to purchase the tax.

The tax stamp scheme looks effective with respect to informal sector transport operators as at the beginning of each quarter the drivers and/ or owners are to purchase Vehicle Income Tax (VIT) sticker. This sticker is expected to

be pasted on the front windscreen of the vehicle for the inspection by the police. The driver who fails to comply is arrested and made to face sanction. This serves as potent deterrence for non-compliance.

However, for the mobile informal sector operators, it is very difficult to enforce tax stamp. Hence, a good number of the entrepreneurs still remain outside the tax net.

The compliance rate seems to be highest compared to the old standard assessment scheme and identification grouping taxation. Again, the corruption associated with the identification group taxation, to a large extent has been overcome by the tax stamp system.

### **Distinguishing Characteristics of the Informal Sector**

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

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

### **Reasons for Taxing the Informal Sector**

For many small entrepreneurs in Africa, the choice to pay tax or remain in the informal sector is simple: most firms will choose to stay in the informal sector if they can because the perceived benefits outweigh the perceived costs. Firms in developing countries in particular rarely see their tax contributions at

work in the form of government services. If compliance costs; both financial and time - are added into a firm's cost-benefit analysis of paying taxes, the disincentive to comply with tax requirements becomes even stronger.

On the government's side, too, there is also a strong disincentive to collect taxes from small businesses, as the cost of monitoring and collecting tax from small businesses usually outweighs the revenues generated by small businesses, and revenue authority resources are usually scarce. But there are compelling reasons for the small entrepreneur and the government to join the tax net. On the small and medium-sized enterprise's (SME's) side, participating in a tax regime brings a firm into the formal sector, and allows the firm to access formal credit markets, government procurement, and access to markets including export. On the government's side, by encouraging firms to fully enter the formal sector through registering for and paying taxes, government promotes a culture of compliance and sets the stage for the firm to grow and become a bigger taxpayer; additionally, firms in the formal sector are more likely to comply with all other regulations and official obligations than those in the informal sector. Finally, there is extensive evidence that growth is severely hampered by the existence of an informal sector working in parallel with the formal sector. There has been a growing interest in taxing the informal sector in most developing countries for a number of reasons. They include the following:

- i. **Revenue needs:** The introduction of neo-liberal reforms under structural adjustment programmes (SAP) with emphasis on liberalization, downsizing and changing tax policy as well as tax administration has brought to the fore the urgent practical necessity of increasing revenues, which will



enable the state to deliver basic services. In fact, revenue maximization is the primary objective of tax policy. The informal sector therefore becomes the obvious avenue to be drawn into the tax net having been mostly out of it; considering the fact that the informal sector has a wider market area than the formal sector, with the effort to bring in the informal sector government is likely to even double its revenue generation. This will help reduce the dependency on the foreign support for the government budget every year.

ii. **The phenomenal size and growth of informal sector:** The liberalization of economies as a result of SAP has pushed many formal businesses into the informal sector in most developing countries. Recent calculations estimate that the size of the informal sector in developing countries varies between about twenty percent in Indonesia to around sixty seven percent of GDP in Bolivia (Schneider 2002). The informal sector is complex and heterogeneous comprising of large enterprises and small; urban firms and rural ones; visible activities as well as invisible ones; owners as well as workers; local activities as well as those that cross jurisdictional boundaries;

iii. **Impact on tax compliance in the formal sector:** Legitimate taxpayers in the formal sector perceive the state as being unfair in pursuing them for taxes while the informal sector continues to operate untaxed. Ignoring informal sector activities will lower compliance morale and increase the risk of generalized non-compliance (Terkper 2003). There is some evidence from Latin America suggesting that tax compliance in the formal sector is higher in countries which have a relatively small informal sector (Torgler 2005).

iv. **State legitimacy:** Informal activities might be indicative of the fact that operators see no value in engaging with the state in the protection of

life and property, and therefore legitimacy becomes a serious concern. In order to regain legitimacy, governments are looking for ways to incorporate informal activities into formal systems. Taxation is a good route into the problem, as it enables governments to recognize informal activities without legitimizing the breaking of other rules and regulations. Broadening the tax base and developing a 'culture of compliance' can achieve more than simply increasing revenues; it can be a way of re-engaging citizens with the state. The recent registration of businesses and individual for their tax identification numbers and their business certificate by the Ghana revenue authority and the registrar's general department is one way of ensuring the engagement of the informal sector into the state activities.

v. **Demands from the informal sector:** Research shows that those within the informal sector are willing to pay taxes, specifically when these are in exchange for some legitimacy, stability and protection from arbitrary harassment from state agents (Dickovick 2003, Baross 1990). For many within the sector, the tax burden is not tiring, especially as they are paying informally anyway, although as bribes to law enforcement agencies on the street, in order to continue operating. Invariably, due to poor monitoring and inability of the tax officials to identify and properly assess the sector, moneys from the sector end up in the pockets of those who pursue them with various threat to their market. Invariably these informal sector end up even paying more on a daily bases compared to what they would have may be paid through their assessments by the tax official to pay at the end of every month or for the whole year.

vi. **Tax-Accountability link:** Governments that are dependent upon earned revenues such as taxes as opposed to unearned revenues such as

aid or mineral wealth are more likely to be responsive to their citizens for various reasons. The other side of the argument suggests that citizens who pay taxes will demand more responsive governments (Gloppen 2002). By encouraging people within the informal sector to come within the tax net, it is thus assumed that they will start the process of a constructive engagement with the state of gaining from services and rights and becoming full citizens. In other words, widening the tax net will spark off a virtuous cycle of taxation and accountability that is at the heart of consolidating democracies (Joshi and Aye, 2006). It will also encourage governments to be more responsible towards their citizens. It will also enable the government to be cautious about its spending and the type of project to undertake in order to benefit the majority of citizen that are now paying their taxes.

### **Difficulties in Taxing the Informal Sector**

Taxing the informal sector in Ghana is a difficult task due to the varied activities within the sector and the difficulty in identifying all of them and the things they do. In the 2007 budget statement, it was acknowledged that; one of the major challenges facing Ghana is how to broaden the tax net. Out of a pool of 5 million potential taxpayers, only 1 million are paying income taxes. Apart from employees on the Government payroll, only about 350,000 employees in the private formal sector pay taxes. ... the fact that the vast majority of Ghanaians in the informal sector makes revenue generation a daunting task. Experience in other countries indicates that nations making the transition from informal to formal economies have to use innovative methods to mobilize tax resources (Republic of Ghana 2006: 296). In the recent budget of 2012 read to parliament, the minister asked for tax amnesty to be granted to individuals and

firms that have for some time not paid their taxes to enable them start the process of capturing all such groups to the tax net and to encourage especially the informal sector to pay their taxes.

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

Two general difficulties can be discerned. First, most business transactions are done in cash and even some establishments would not accept bank cheques. The transaction of all business in cash is one of the means by which a businessman can conceal taxable profits. By so doing, they are able not only to manipulate their records and turnover figures for tax reduction purposes but they are also to eliminate all third-party information leading to their purchases and sales. Secondly, most self-employed people are indifferent to proper record keeping. However, in tax administration a very important task is the correct determination of the income of the taxpayer so that a meaningful assessment of the tax liability could be made. Without proper record keeping, this cannot be done. The low standard of record keeping is mainly due to illiteracy (Agyeman 1982). Some of the specific difficulties are as follows:

### **Inappropriateness of Tax Mechanisms**

Ghana has used direct and indirect mechanisms to collect tax from the informal sector. Direct taxing through formal systems of accounting and income

calculation and formal payment channels has not worked effectively because collection costs tends to be high in relation to the amounts collected and discretionary. To overcome these problems, the less discretionary VAT was initially withdrawn and later reintroduced (Ayee 1997). In spite of its introduction, the VAT has not been to penetrate into the informal sector activities. To strengthen the capacity of government to mobilize resource, the Ghana Poverty Reduction Strategy I focused on increasing revenues not by increasing taxes but by instituting measures that will widen the tax base and involved minimizing revenue leakages, reducing the incidence of tax avoidance and strengthening the capacity of the revenue collecting institutions (Republic of Ghana 2003).

Taxation based on formal systems of income calculation, accounts and payment options is not appropriate to match that of the informal sector. Direct presumptive taxation may be more promising. In presumptive systems, assessments are based not on calculations of actual income, but on broad indicators of the scale of profits likely being made (Bird and Wallace 2003, Chipeta 2002, Sadka and Tanzi 1993). Depending on the nature of the economic activity, the indicators may be the size and capacity of machinery, the square footage of commercial space, number of employees or the number of customers served. The introduction of presumptive taxation is usually combined with the simplification of self-assessment systems. It has been initiated widely in the developing world. Ghana, has had a form of presumptive tax since the early eighties. While presumptive taxation has been met with some success, it also has failed to adequately penetrate the informal sector and the returns to efforts have been low (Terkper 1995; Appiah-Kubi 2003).

### **Capacity Constraints**

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

### **The Incentive Problem**

Compared to virtually all alternatives, including corporate taxation or customs and excise, working on the informal sector is relatively low status, unrewarding, and sometimes even dangerous. Patrolling poorer areas to identify tax evaders and monitor tax payments with nowhere near the required level of resources is a thankless task. In particular, educated tax officials dislike interacting with illiterate poor, disenchanting and sometimes violent citizens who resent being harassed for taxes when they are attempting to eke out a meagre living. The scope for corrupt supplementation of earnings is low relative to other types of postings, and corruption typically will imply taking money in small amounts from already poor people. Even though tax officials

and the revenue agencies are over-stretched, their staff try to avoid working on the informal sector due to its inherent problems and low motivation for such workers.

Our own research in Ghana shows, motivation tends to be low among tax officials assigned to work with the informal sector. Promotion prospects are few, and they are excluded from the more lucrative positions (Ayee, 2007). The Internal Revenue Service (IRS) does not have the capacity to implement, monitor and enforce taxation. It is the only revenue agency which is yet to be computerized. This coupled with inadequate logistics such as vehicles, office space and inadequate conditions of service to motivate staff have made it impossible to make significant inroads into informal sector taxation. Strategies employed by the IRS such as on-the-spot checks, closing down of shops, public education on tax and the demand of tax clearance certificate for appointment to public office to stimulate tax consciousness in the informal sector has achieved marginal success. These are jobs to be avoided, especially by the more senior officials. In such circumstances, it is hard for governments to focus more on taxing the informal sector.

### **The Politics of Taxing the Informal Sector**

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

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

Public officials and politicians are willing to turn a blind eye to informal activities in order to retain their support base. The process of bargaining with the informal sector over the payment of tax is itself a gesture of concession and accommodative, which is fraught with political overtures and undertones. For instance in the run up to the election 2008 various promises were made to the electorate including the reduction of taxes on fuel by the then opposition party (NDC), and the subsequent reduction of fuel prices by the then government (NPP) just before the second run of the presidential elections.

Even though successive governments made public statements for widening the tax net and taking tough measures to sanction tax defaulters, there was a gap between their intentions and actions, possibly because of the serious consequences, for instance, losing electoral support, in pursuing the actions to the logical conclusion.. There is hard evidence to support this contention because we still know little about the politics of the informal sector in general, let alone the specific issue of taxation. However, the notion provides yet another plausible explanation of why governments often are unable or unwilling to directly tax the informal sector. Sanyal's (1991:39) comment more than a decade ago continues to be relevant: "The voluminous research on the urban informal sector (UIS) has centred on analysing the UIS as an economic entity: of its politics we still know little... Neither do we know about the politics of its external relationships with the government, with established political parties or with organized labour in the formal sector."

### **Dimensions of Tax Evasion in the Informal Sector in Ghana**

Tax evasion has been identified as one of the major problems confronting tax administration especially in the developing countries. Evasion



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

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

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

The extent of tax evasion is extremely difficult to determine in any country, especially in the developing countries. Attempts have been made in the developed economies to estimate the extent of its occurrence. One of such

studies in the United States of America compared the totals reported on the federal incomes tax returns to those determine in the national income accounts.

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

### **Non-Declaration of Income**

Under the Internal Revenue Act, 2000, (Act 592), every income earner is expected to furnish return of income not later than four months after the end of a basis period of that person within the year. This is used to determine the final tax liability of the income-earner. The overwhelming majority of the informal sector operators do not furnish return of income annually.

The ‘non-declaration of income’ form of evasion which involves principally failure to file tax returns is by far the most glaring source of evasion by the difficult-to-tax group.

The request for the furnishing of income tax returns to the tax office is the first step in the process of establishing the true income and determining the tax liability of the taxpayer. In the words of Otioku (1988) “...where majority of tax payers fail to file these returns either out of ignorance or deliberately, it becomes very difficult to identify them, ascertain their income and assess them to tax. The refusal to file return is one means of keeping one’s incomes outside the reach of the tax authorities and thus evades the taxes thereon”.

### **Under-Declaration of Income**

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

### **Inflation of Deductions from Income**

Under ‘inflation of deductions from income’ the deductible expenses from income are overstated so that a smaller amount of taxable income is reported. It is not only the informal sector operators that are guilty of this form of tax evasion but formal sector businesses as well.

Income tax law specifically state that “for the purpose of ascertaining the income of a person for a basis period from any business, employment, or investment there shall be deducted: (a) all outgoings and expenses wholly, exclusively and necessarily incurred during that period by that person in the production of the income; (b) any other deductions as may be prescribed by

Regulations made under section 114” [Section 13 of IR Act 592]. The existing literature on tax has it that ‘wholly’ refers to the amount of expenditure; ‘exclusively’ refers to the purpose for which the expenditure was incurred; and ‘necessarily’ is the element of compulsion to qualify the expenditure as allowable. The informal sector operators tend to commingle their private

expenses with that of business leading to higher expenses being charged against business income which ultimately reduces one's tax liability (Otiaku, 1988).

### **Factors Contributing to Income Tax Evasion**

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

#### **High Illiteracy Rate**

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

#### **Lack of Voluntary Compliance**

A large degree of voluntary compliance on the part of taxpayers is required for satisfactory income taxation. Income taxes cannot be collected by the best administrative organization satisfactorily from the self-employed when evasion is generally attempted and incurs little or no moral disapproval from the public. The use of force in tax compliance is not sustainable over a long period of time hence the need to work at voluntary compliance (Otiaku, 1988).

### **Predominance of Cash Transaction**

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

### **Poor Standard of Record Keeping**

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

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

### **Management and Personnel of Tax Administration**

The nature of personnel running tax administration and the management style can also encourage tax evasion. A corrupt and low-morale tax officer may result in tax evasion as some of the officers may collude with the taxpayers in non-payment of tax. A strong and effective tax administration may, to some extent, reduce tax evasion.

## **Difficulties in Taxing the Informal Sector**

Taxing the informal sector is different from other enterprises because there seems to be no culture of compliance. Its sets of rules, values, beliefs and institutions are different from those of the formal sector. These have been so due to the following:

- i. **Inability of the revenue agencies to develop closer links with the informal sector:** This has been recognized by the 2006 Budget Statement. For instance, the VAT Service will “seek to increase contact with the Trade and Business Associations through frequent meetings to identify and address policy, operation and other related issues for improvement of their understanding of tax procedures” (Republic of Ghana, 2006: 255).
- ii. **Inability of the revenue agencies to gather reliable data and inadequate and time-series studies of the informal sector to track its dynamics:** In this regard, the computerization process of the IRS, especially in the Accra-Tema Metropolitan Area which together contribute more than 80% of IRS annual collection is to be initiated to place more tax payers on the “list of self-assessed tax payers and thereby reduce the burden of manual assessment so that more labour and time could be available for widening the tax net” (Republic of Ghana, 2006: 244-5).
- iii. **Inadequate record-keeping on the part of the informal sector:** This difficulty has been recognized by both the IRS and the VAT Service. Accordingly, in appreciation of the difficulties faced by the informal sector operators in complying with the record keeping requirements of the standard VAT, a Flat Rate VAT scheme, easier to operate and more simplified in its record keeping requirements is to be developed in

partnership with the Ghana Union Traders Association (GUTA) for the distributive trade sector. This, it is hoped, will not only ease the cost of “VAT compliance for small and medium scale operators in the distribution sector but also provide a platform for bringing in more traders into the VAT net” (Republic of Ghana, 2006: 255).

- iv. Large size tax payers, who are spread over a wide geographical area and cannot either therefore be easily reached and or found it difficult to access tax collection points:** Decentralization and a focus on taxpayer services can increase information about taxpaying and ease the processes of compliance. Customer interaction including gaining information, distribution of forms and filing of taxes, can now all be undertaken at a single, conveniently located tax office. Decentralization of IRS operations and the devolution of power to regional and district offices appears to have improved efficiency. The IRS is currently divided into 10 regional offices, 54 district offices, 36 sub-district offices and 26 collection points making a total of 127 tax offices in addition to the Large Taxpayer Unit (LTU) Office located in Accra. Collection points have also been established at almost all land, sea and air entry points to Ghana. Also, the IRS is collaborating with the VAT service by allocating space at IRS offices for VAT officials and vice versa to improve the sharing of information regarding potential taxpayers and to coordinate assessments. To reduce the “inconveniences to tax payers and bring tax payment to the door steps of tax payers”, the IRS intends to acquire new district office buildings and open sub-offices and collection points and improve its overall operational environment (Republic of Ghana, 2006: 255). These moves to deepen the

presence of GRA on the ground are in keeping with the recent moves towards increasing taxpayer services and improving ease of compliance for taxpayers (Joshi and Ayee, 2006b).

In considering tax compliance, one is concerned with the ability of the system to ensure that the tax payer pays his tax and do other things like filing tax returns and providing necessary information in accordance with the requirements of the law. As a result of the lack of tax-paying culture, compliance is not voluntary but mainly through coercion. The IRS and VAT Service officials literally compel tax payers in the informal sector to fulfill their tax obligations.

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

### **The Incentives for People to Pay their Tax**

A number of reasons have been advanced for the willingness of people to pay their tax. First, payment of tax is regarded as a social or collective choice, that is, the relationships between the preferences of the individual members of the state or society and the collective choices made by governments. People are willing to pay tax because of the “social contract” that exists between them and their governments. Citizens expect government to provide goods and services, whether public or private goods and their effective provision enable citizens to pay tax in return for the enjoyment of these goods. In other words, government



expenditures require the generation of revenues and people pay tax as a result of a combination of the public interest and self-interest (Bird and Oldman 1975; Brown and Jackson 1978).

Secondly, people pay tax because it is linked to governance. People pay because of government's effective coercion since people will not pay voluntarily. In the words of Friedman (2003:1) "we obey the rules when the government does its job and ensures that the systems are in place to force us to comply".

Thirdly, people pay tax voluntarily because they feel they are contributing to a state with which they identify or a government programme which they support.

Fourthly, and more importantly, tax-paying depends on an underpinning culture, which does not necessarily depend on the claim that it stemmed originally from loyalty to a political order. The existence of a tax-paying culture among tax payers through embedding in a set of rules, values and relationships ensures that: a technically efficient tax authority may be able to use the routines and attitudes which underpin that culture to enhance collections... the use of public embarrassment of individuals by the South African Revenue Authority has been extremely successful because there is a culture which makes exposure of non-payment a source of shame (Friedman, 2003: 8).

Fifthly, people are willing to pay tax depending on the technical efficiency of the revenue authority that includes not only on its administrative and accounting techniques but also "understanding the culture of the informal sector (companies and individuals) from whom compliance is sought and the network of rules and understandings which underpin tax behaviour ... through

the recruitment of officials with history of working in private accounting firms, who share common understandings with the people from whom they are collecting tax” (Friedman 2003: 10, 14).

## **CHAPTER THREE**

### **RESEARCH METHODS**

#### **Introduction**

The chapter discusses the various methods of analysis that will be used to address the objectives and the conceptual framework that guides the present study. A research methodology must be systematic, methodological, rigorous, conventional and unbiased if research is to be considered scientific (Mason and Marchal, 1999). The major areas that were of particular concern to the proper execution of this study included: descriptions of the sampling procedure, the validity and reliability of where and how data will be collected, study area and target population, analysis techniques used in arriving at the solution to the problem under study.

#### **Research Design**

In order to find facts and to describe and assess the contribution to tax revenue by the informal sector, the assessment type of research design was used. The evaluation method was also used so as to make judgment about the tax contribution of the informal sector to the national economy.

Assessment and evaluation types of research design was used for the study and was modelled after the orientation of a survey conducted by the researcher to obtain information on the willingness of the informal sector to pay taxes and also the difficulty faced by tax authorities in collecting these taxes. Since the purpose of the study was to assess the contribution to tax revenue by the informal sector, a multiple perspective approach was used. Mixed method approach is the general term for when both quantitative and qualitative data collection techniques and analysis procedure are used in a research design.

Mixed method research uses quantitative and qualitative data collection techniques and analysis procedure either at the same time (parallel) or one after the other (sequential) but does not combine them.

Bryman (2006) conducted an examination of over 200 social science articles reporting research in which quantitative and qualitative method were combined. An examination of the research methods and the research design employed suggest that on the quantitative side structured interview and questionnaire research within a cross sectional design tends to predominate, while on the qualitative side the semi-structured interview within a cross-sectional design tend to be the prevalent.

### **Study Area**

The target area of this study will be restricted to the Sunyani Tax District. The target population of this study was the informal sector in Ghana. The sample frame to be used for the informal sector will largely be restricted to towns within the district due to the limited time for the research and resources constraints. The sample size for this study will be 100 informal sector entrepreneurs/operators. Again, the selected area is the most convenient as the researchers and those to be engaged to assist in data collection are located in the named areas and this will ensure effective and efficient administration of the questionnaires and interviews. This in the long run will facilitate the collection of primary data within the limited stipulated time for the submission of the final work. This study, to a very large extent will use primary data and where necessary some secondary data. A structured survey questionnaire with unambiguous questions will be used to limit and ease the analysis of response-variation among interviewees. Face to face interview will also be adopted.

## **Target Population and Sample Composition and Selection**

The target population of this study was the informal sector in Ghana. The sample frame used for the informal sector was largely restricted to Sunyani and other surrounding rural communities due to the limited time for the research and resources constraints. The sample frame was further stratified into categories of informal enterprises with common characteristics. There is no doubt, the fact that informal sector activities are very heterogeneous in nature, hence the justification for stratification of the sample frame so as to achieve a fairly representative sample size from the frame.

According to Saunders et al (2000), “dividing the population into a series of relevant strata means that the sample was more likely to be representative, as you can ensure that each of the strata was represented proportionally within the sample”. Within each stratum a simple random sampling was done for the selection of cases.

The informal sector businesses were divided into the following strata (or categories) as provided by Yankson (1992): Food Processing, Textile/Leather Works, Woodworking, Metal Fabricating, Beverages, Repair Services, Auto repairs, Handicrafts, Commerce and Building Construction.

### **Sample Size**

The sample size for this study was 100 informal sector entrepreneurs/operators. A sample of 10 persons was drawn from each strata named above. This in the researcher’s view gave a fair representation of the sample frame. It was extremely difficult, if not impossible, to get a representative sample of a given large population such as informal sector enterprises in Ghana.

## **Data Collection Procedure and Instrument**

This study, to a very large extent, used primary data and where necessary some secondary data was used. Researchers have established the fact that informal sector entrepreneurs are very averse to talking to ‘unknown persons’ on their tax payments as most of the informal sector operators fail to discharge their tax obligations. Informal sector operators, therefore, do not willingly and easily give information about their tax obligations for fear of being discovered and made to face the sanctions for non-compliance with the tax laws.

Again, developing empirical research on informal sector offers a number of major challenges and difficulties. The lack of conceptual clarity and the presence of disciplinary functionalism have created considerable difficulties in formulating an appropriate methodological perspective from which to study the phenomenon (i.e. informal sector) (Ferman, et al 1987).

### **The Questionnaire Design**

A questionnaire is a research instrument consisting of a series of questions and other prompts for the purpose of gathering information from respondents. The questionnaire and the interview guide were design taking into consideration the objective of the research.

A structured survey questionnaire with unambiguous questions was used to limit and ease the analysis of response-variation among interviewees. A number of question formats were used in designing questionnaire so as to elicit appropriate information from the respondents. Closed- and open-ended questions and multiple-choice questions were mostly used to limit the interviewee to choices to be selected from. Closed-ended questions were largely used because of the fact that a majority of the informal sector entrepreneurs are

illiterates and to facilitate completing questionnaires with ease hence the format adopted. This enabled the researcher and his assistants to read out the questions and explain the questions to those who may not understand English language before the person made a choice which was either ticked or circled.

A few open-ended questions were used to elicit information on opinions, attitudes and beliefs of the interviewees towards taxation of the informal sector. Those who were able to write completed such questions on their own while those who could not write were assisted to do so as they talked to the researcher. Rating scale questions were used.

The researcher was well informed of the fact that a good number of the informal sector entrepreneurs were illiterate and very averse towards tax issues, and therefore used interviewer-administered questionnaire in about 70% cases while the rest were self-administered questionnaires.

### **Interviews**

An **interview** is a conversation between two or more people (the interviewer and the interviewee) where questions are asked by the interviewer to obtain information from the interviewee.

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

### **Official Documentations**

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

### **Data Analysis Procedure**

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

### **Validity and Reliability**

A number of research methods were adopted to make sure information gathered are reliable and valid. Also, the data collected from the sample size was representative of the actual population size of the study. Some of the validity methods used included external and population validity whereas the reliability methods included instrument and statistical reliability



## **CHAPTER FOUR**

### **RESULTS AND DISCUSSION**

#### **Introduction**

This chapter presents the results, analysis, discussions and findings of the data collected. Analysis of responses was done according to the research objectives. The layout of this chapter is consistent with the objectives of this study. It aimed at addressing the critical issue of revenue mobilization from the informal sector of the Ghanaian economy by looking at the various objectives by assessing accounting records kept by the informal sector, assessing the perception of the operators under the informal sector in the Sunyani Tax District towards taxation with specific objectives geared towards knowing the motives for taxing the informal sector, identifying the variables that make informal sector “difficult-to-tax “and providing recommendations on the way forward on the taxation of the informal sector.

#### **Demographics of Respondents**

The respondent’s characteristics considered for this study are age, Gender and educational level. These demographics are really essential for the research as the specific characteristics a respondent possesses affect or impact their responses. Basically, these were chosen because they are thought to have influence on people perception.

#### **Gender of Respondents**

With reference to Table 1, majority of the respondents were males with a frequency of 53 to 46 for female. This indicates that, the male population is dominant in the business sector as compared to females specifically in the informal sector.

**Table 1: Gender of Respondents**

Gender	Frequency	Percentage (%)
Male	53	53.54
Female	46	46.46
Total	99	100.00

Source: Field survey (2020)

**Age of Respondents**

From the responses in Table 2, 56,57% of the respondents were aged between 18 – 30 years, indicating that more of the young ones in society are in the informal sector. 33.33% were also between ages 31 – 40, whereas 10.10% were respondents above 41years.

**Table 2: Age of respondents**

Age(yrs.)	Frequency	Percentage (%)
18 – 30	56	56.57
31 – 40	33	33.33
41 and above	10	10.10
Total	99	100.00

Source: Field survey (2020)

It could be seen from the table that more than 90% of the respondent are youth full of energy to generate revenue for themselves and the state.

**Level of Education**

Level of education basically refers to the formal education attained by respondents. Table 4.3 displays the level of education of respondents. With reference to the Table below, it could be seen that 18.37% of informal sector workers have low/no education, 73.47% have attained medium level of

illiteracy and only 8.16% of the informal sector entrepreneurs have high education.

**Table 3: Level of Education**

Educational level	Frequency	Percentage (%)
Low/no education	18	18.37
Medium (Secondary)	72	73.47
High (Tertiary)	8	8.16
Total	98	100

Source: Field survey (2020)

Collectively, 81.63 percent of the total respondents have attained a certain level of education. These figures point to the fact that a large number of the informal sector have had some level of education to be able handle income tax issues such as filing income tax return forms and this will have made it a bit easy for taxing such informal businesses.

A higher education of the informal sector entrepreneurs will to a large extent facilitate taxation of informal businesses and vice-versa.

### **The Variables that make Informal Sector “Difficult-to-Tax”**

Various studies have shown that the informal sector compared to the formal sector workers is very difficult to tax when it comes to generating revenue for the state (Joshi et.al 2014). This is mainly due to certain factors such as location of business, Mode of payment for goods and services, Level of accounting practices, etc.

#### **Location of Business**

According to Alli et al. (1991), Location is one of the business choices that must be made cautiously. Past research has demonstrated that business

locations have had relationship with business' prosperity. Location is important because that factors greatly into how your initial customers can find you, and how often your existing customers visit. Basically, a business just wants to be wherever its customers are and make it as convenient as possible to contact them. This could adversely impact a newly established business or firm.

For example, in the restaurant industry, the theme, food quality, ambiance, aesthetics, the service, and economic shifts play a vital role in the success and the failure of the business (Kimelberg and Williams 2013). Nevertheless, selecting the wrong customer neighbourhood, poor accessibility, and a less dense population in the surroundings may unfavourably impact the new establishments (Murillo 2010),

**Table 4: Location of Business**

Location	Frequency	Percentage (%)
Permanent	73	73.74
Roaming	21	21.21
Both	5	5.05
Total	99	100.00

Source: Field survey (2020)

The study sought to establish if respondent's businesses were located at specific places. From the data analysed as presented in Table 4, 73.74% of the informal sector workers surveyed had a permanent place from where they carried out their business or offered services to clients, while only 21.21% did operate by roaming to get their goods and services sold. From the perspective of the IRS and for the purposes of effectively taxing an income earner he/she should have a permanent and visible place of business where tax authorities can

easily locate the taxpayer. As the survey results indicates this essential condition for taxation is somehow absent in the informal sector hence the difficulty in taxing that sector. The few informal sector operators who get taxed are almost always those with permanent places of business.

Some reasons were provided by the respondents for not having a permanent place of business. These reasons included affordability, nature of the business and attraction of clients (Schmenner, 1994).

### **Mode of Payment for Goods and Services**

According to the oxford dictionary, Payment is the transfer of one form of goods, services, or financial assets in exchange for another form of goods, services, or financial assets in acceptable proportions that have been previously agreed upon by all parties involved. Payment can be made in the form of funds, assets or services.

The survey showed that most of the respondents receive cash only in return to products sold and services rendered, whilst others also sell for both cash and on credit. Only few respondents sell purely on credit. Table below depicts the picture.

**Table 5: Payment Mode in the Informal Sector**

Payment mode	Frequency	Percentage (%)
Cash only	43	43.43
Credit only	3	3.03
Both	53	53.54
Total	99	100.00

Source: Field survey (2020)

Table 5 indicate that, 43.43% of the informal sector entrepreneurs prefer to sell only for cash and 53.54% sell on credit and for cash. Only 3.03% of the respondents sell on credit basis only. Cash transactions leave no documentary as informal businesses usually do not keep record of such transactions (Ofori, 2009). Cash sales, therefore, make it difficult to tax income generated.

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

### **Level of Accounting Practice**

The data gathered for this study on the level of accounting and recording keeping practices in the informal sector confirms the view in the existing literature of very poor level of record keeping practices in that sector. Below is the data gathered on the practice levels.

**Table 6: Level of Accounting Practice**

Accounting practice level	Frequency	Percentage (%)
Low/poor	56	56.57
Medium	36	36.36
High/very good	7	7.07
Total	99	100.00

Source: Field survey (2020)

As indicated in Table 6, 56.57% of the sampled informal businesses fell into low/poor level of accounting practice, 36.36% of the respondents came under medium level of accounting practice and 7.07% of respondents followed high/very good level of accounting practice. With the majority of the informal businesses maintaining poor accounting and record keeping practices it becomes extremely difficult for an objective assessment of income tax of that sector.

Accounting records serve as the basis for the computation of taxable income and the absence of such accounting records makes it practically impossible to tax an income earner (Ofori, 2009). This situation indicates that there are many informal sector businesses that do not maintain any form of accounting records at all and this will make them very difficult, if not impossible, to tax by IRS(Somuah,2011). This culture of poor record keeping practices in the informal sector makes it very difficult for that sector to be taxed. This is so because the accounting net profit which IRS adjust to determine taxable income is not determinable. Even in the event of IRS wanting to reconstruct the accounts of such informal businesses there are inadequate records to do so hence still the difficulty in taxing that sector.

One of the major reasons identified for the poor accounting practices in the informal sector is the inability and unwillingness on the part of the entrepreneurs to hire accountants to take charge of their accounting functions. This is shown in Table 7 below.

**Table 7: The Use of Accountant in the Informal Sector**

Response	Frequency	Percentage (%)
Yes	15	15.15
No	84	84.85
Total	99	100.00

Source: Field survey (2020)

As indicated in Table 7, only 15.15% of the sector surveyed used accountant for the business transactions whilst 84.85% have no regard for using accountant for their transaction. This also makes assessment of income difficult for the IRS of the GRA.

The respondents gave various reasons why they do not make use of the services of the accountants. Some of the key reasons are presented in table 8 as follows:

**Table 8: Reasons for not Using Accountants**

Response	Frequency	Percentage (%)
High service fee	13	15.12
Fear of embezzlement	13	15.12
No Need	60	69.77
Total	86	100.00

Source: Field survey (2020)

From Table 8, 69.77% of the respondent sees no need for using accountant whilst 15.12% attributed high service fee and another 15.12% also had fear of embezzlement of their money by accountant as their reason for not using accountants.



High service fees charges on the parts of accountants deters prospective clients from employing the services of professional accountants. Even though the code of conduct for International Ethics Standard Board of accountants admonishes professional accountants against embezzlements of funds, there has been several reported cases of embezzlements of funds in both private and public organizations. On the 7<sup>th</sup> of March ,2010 as reported by the Ghana news agency, Joseph AkatinWintamah, an accountant of the Forestry Commission, who allegedly embezzled GH¢47,000 appeared before an Accra Circuit Court on Friday. Cases like this has waned off the interest in these respondents in relation to engaging the survives of an accountant.

#### **Factors Accounting for high tax non-compliance in the Informal Sector**

Taxation involves the institutionalisation of the revenue-raising capacity of a modern stateand, at the same time, it can motivate citizens to hold the government accountable andfacilitate collective bargaining between the ruler and the ruled (Bräutigam, 2008). Literature on taxation of the informal sector stated that there is a very high level of tax noncompliance in the informal sector, especially in developing countries. It is believed that government losses huge amount of tax revenue from the informal sector (Aina et al. 2017). The data gathered for this study identified some reasons why there is high incidence of tax noncompliance in the informal sector. The reasons respondents gave have been categorized into the following broad non-compliance variables: unknowing, procedural, accounting, habitual, and asocial. Each of these reasons is examined in this section.

### **Unknown Non-Compliance**

A good number of the respondents attributed their failure to file income tax return to the fact that they do not know about income tax return. Some respondents claimed that they were not aware they have to declare their income at the nearest IRS office. This non-compliance is an indicative of the low level of tax awareness among the informal sector operators in particular and among Ghanaians in general (Ofori,2019). Table 9 shows the number of the respondents, out of a total sampled, who ticked unknowing non-compliance as the reason for tax non-compliance.

**Table 9: Unknown Non-Compliance for Tax Obligation**

Response	Frequency	Percentage (%)
Yes	36	36.36
No	63	63.64
Total	99	100.00

Source: Field survey (2020)

As indicated in Table 9, 63.64% of the respondents attributed tax noncompliance to the fact that they were not aware they had to declare their total income to the IRS, while 36.36% of the respondents stated that they were aware that they must annually file income tax returns at any IRS office.

### **Accounting Non-Compliance**

Another reason given by the respondents for not complying with the income tax laws regarding filing of income tax return is that they do not keep adequate accounting records of business transactions to enable them complete the income tax returns. As revealed earlier in this chapter, most of the informal sector businesses transact business on cash bases and do not keep adequate

accounting records of their business transactions in terms of revenue/income and expenditure (Joshi et al., 2014). Table 4.10 shows the number of the respondents who assigned tax noncompliance to their inability to keep proper records.

**Table 10: Keeping of Accounting Records**

Response	Frequency	Percentage (%)
Yes	43	43.43
No	56	56.57
Total	99	100.00

Source: Field survey (2020)

As indicated in Table 10, 56.57% of respondents mentioned that they do not keep accounting records and that account for the reason for tax noncompliance. The 43.43% they said they keep records, further interview reviewed that they only keep the part of the debt that people owe them as indicated in the Table. These figures go to confirm one of the reasons that make the informal sector hard-to-tax. Due to poor record keeping, majority of the informal sector entrepreneurs do not have information on actual turnover and expenditure (Osei-Boateng and Ampratwum, 2011). This makes it extremely difficult for such informal businesses to be able to complete the income tax return.

### **Procedural Non-Compliance**

Procedural non-compliance was not a major reason for tax noncompliance. This was because a good number of the respondents did not even know they had to file their tax returns as shown in Table 11 and therefore have never filed income tax return before and so have not encountered

cumbersome and complex income tax filing procedures. Some respondents who in the past filed income tax returns but faced difficulty with the procedures for filing gave procedural complexity as the reason for not filing income tax return currently. The results of the respondents are shown below;

**Table 11: Complying with Accounting Procedure**

Response	Frequency	Percentage (%)
Yes	18	18.18
No	81	81.82
Total	99	100.00

Source: Field survey (2020)

As shown in Table 11, 81.82% of the respondent did not select procedural noncompliance as the reason for their noncompliance. it is only a very small percentage of 18.18% of the respondents who attributed tax noncompliance to the complex income tax filing procedures. This is because there is generally high tax noncompliance in the informal sector.

#### **Non-compliance due to Habit**

Some of the respondents simply do not comply with their tax obligation for no apparent reason. Tax noncompliance has become part and parcel of them resulting from a long period of noncompliance (Feruta, 2014). Noncompliance effectively can be said to have become their habit. The data on habitual noncompliance is presented in Table 13 with reference from Table 12;

**Table 12: Necessity to Pay Tax**

Response	Frequency	Percentage (%)
Yes	64	64.65
No	35	35.35
Total	99	100.00

Source: Field survey (2020)

From table 12, 64.65% of the respondent affirms that it is necessary to pay tax whereas 35.35% indicates that it of no necessity to pay tax. Nonetheless, considering the percentage that affirms the necessity to pay tax, the reverse is the situation in table 13. Below, this is what make habitual a reason for tax noncompliance.

**Table 13: Percentage of Income Paid as Tax**

Percentage of income	Frequency	Percentage (%)
5%	16	16.16
10%	8	8.08
15%	10	10.10
20%	4	4.04
None	61	61.62
Total	99	100.00

Source: Field survey (2020)

From Table 13, it could be said that of the total respondent, 61.62% did not pay anything of their income as tax to the IRS even though from table 12, 64.65% accepted the fact that it was necessary to pay tax. This shows that even

though they are aware that they need to pay tax, they have a habit of non-compliance to tax.

### **Social Non-Compliance**

This reason was also cited by a good number of the informal sector entrepreneurs for not complying with their tax obligations. Some of the informal entrepreneurs know for a fact that their colleagues in the self-employment/ in the informal sector do not pay taxes and so they would also not pay. This is a form of peer pressure from other informal sector entrepreneurs on the other entrepreneurs. The data on the asocial noncompliance is presented in Table 14.

**Table 14: Payment of Tax by Other Colleagues in the Private Sector**

Response	Frequency	Percentage (%)
Yes	14	14.29
No	84	85.71
Total	98	100.00

Source: Field survey (2020)

As shown in Table 14, 85.71% of the respondent attributed tax noncompliance to the fact that their colleagues in the informal sector do not pay taxes and so they do not see why they should pay taxes. The remaining 14.29% of the respondents did not trace their noncompliance to the fact that other entrepreneurs are not paying taxes. This study reveals the stark reality that the general level of noncompliance in the informal sector may further discourage the few informal sector businesses that do pay taxes currently from doing so in future (Kundt, 2017).

## **Illiteracy Rate and its Relationship with other Variables for Non-Compliance**

The Oxford dictionary defines illiteracy as lack of knowledge in a particular subject or is the inability to write and read. When a person is not able to read even simple books and is not able to write anything more than his own name, this is an example of illiteracy. According to Kemi (2018), the level of illiteracy of the informal sector has some effect on the tax compliance regime of any economy as indicated in the literature. This is confirmed in the following data analysis;

**Table 15: Illiteracy Rate and its Relationship with other Variables for Non-Compliance**

Variables	1	2	3	4	5	6	7
Level of education	1						
Mode of Transaction	0	1					
Level of Accounting Practice	.354**	.727**	1				
Use of Accountant	-.298**	.357**	0	1			
Declaration of Income	-.278**	.741**	.488**	.570**	1		
Taking advice not to comply with tax obligation	0	.374**	.291**	.793**	.452**	1	
Necessity to Pay Tax	-.268**	-.393**	-.527**	-.215*	-.556**	-.312**	1

\*\* . Correlation is significant at the 0.01 level (2-tailed).

\* . Correlation is significant at the 0.05 level (2-tailed).

Source: Field survey (2020)



To assess the association between the independent variables, a simple bivariate correlation was carried out in Table 15 which reports the intercorrelation matrix of these variables with the main aim on the relation between them and the level of education of respondents. The result portrayed multicollinearity among variables. The highest correlation coefficient was found between Level of education and level of accounting practice since the main focus of this analysis was to look at the relationship between level of education and the other variables. A two-tailed spearman correlation was used in order to ascertain the direction of the relationship between the variables since initially the direction was not known.

Table 15 shows a Spearman correlation matrix among independent variables. The correlation coefficient values ranged between 0 and 0.345 in relation to education levels of respondents. Relationships between variables were either positive or negative. Mode of transaction and level of education had no relationship with the coefficient value being zero (0). This simply implies that entrepreneurs' decision for a choice on mode of transaction either by cash only, credit or both is not influenced by the level of education. The same results were determined for the variable "taking advice not to comply with tax obligation" which also had a no relationship with educational level of respondents( $r=0$ ). This shows that as to people taking the advice of others not to pay tax does not depend on their educational level.

Some variables such as use of an accountant ( $r=-0.298$ ,  $p<0.01$ ), Declaration of Income to IRS ( $-0.278$ ,  $p<0.01$ ) and necessity to pay Taxes to IRS ( $r=-0.268$ ,  $p<0.01$ ) all had a negative correlation with level of education of respondents. This insinuates that even though there is relationship between

these variables and level of education, their relation is a negative relationship. It can then be easily explained that ones the level of education of the respondents increases, their interest in finding it necessary to pay tax, employing and accountant purposely to manage their finances and declaration of income to IRS reduces. It therefore goes to attest to the existing literature the ignorance and lack of education accounts for some of the factors inhibiting people from paying their tax.

The only positive correlation was between level of accounting practice and level of education ( $r= 0.34, p<0.01$ ). This means that the higher the level of education, the higher the probability of adopting accounting practice in your business transaction. There is no wonder the poor accounting practice among the informal sector considering the fact that more than 90% of the respondent had a medium and low/no educational background.

#### **Tax contribution as per the level of income**

To ensure fairness and equity in the payment of tax, the tax policy for income tax has been that the higher you earn the more you pay (i.e. pay as you earn – PAYE). This therefore implies that in assessing individuals for the payment of tax, those who earn more must pay more. The data in table 16 goes to affirm this.

**Table 16: Tax Contribution as per the Level of Income**

Income Level	5%	10%	15%	20%	None	Total
Below GHS 1,000	3	1	0	0	44	48
	18.75	12.50	0.00	0.00	72.13	48.48
Between GHS 1,000 – GHS 1,500	10	7	2	2	15	36
	62.50	87.50	20.00	50.00	24.59	36.36
Above GHS 1,500	3	0	8	2	2	15
	18.75	0.00	80.00	50.00	3.28	15.15
Total	16	8	10	4	61	99
	100.00	100.00	100.00	100.00	100.00	100.00

Source: Field survey (2020)

From Table 16, it can be asserted that with a probability of ( $P < 0.01$ ), and looking at the levels of income and their contribution to tax, the high-level income earners pay more taxes than the low-level income earners. Again, on the issues of compliance, the higher-level income earners complied with their tax obligation as seen in Table 16 where out of a total respondent of 48 in the low-income bracket, only 4 complied with their tax obligation.

#### **Benefit for paying tax and measure to ensure voluntary compliance**

Paying your taxes is considered a civic duty, although doing so is also a requirement of the law. If you do not pay your taxes, the government agency that oversees taxes, the Internal Revenue Service or IRS will require you to pay your taxes or else face penalties, such as fines or going to jail. Naturally people are motivated to do something that they find to be beneficial to them. In trying to find the variable that motivates the informal sector to pay tax, the following response was gathered.

**Table 17: Benefits of Paying Tax**

Response	Frequency	Percentage (%)
Provision of social amenities	53	53.0
Payment of Govt. Workers' salaries	3	3.00
No benefit	44	44.00
Total	100	100.00

Source: Field survey (2020)

From the Table above, 53% of the respondent said they benefit from the provision of social amenities including school, hospitals, market, roads etc, only 3% attributed the benefit to the payment of government workers salaries whilst the remaining 44% said they derived no benefit from paying tax. The reason they gave for that option included perceived corrupt practices of both tax officials and politicians.

### **Measures to Overcome Non-Compliance**

A key aspect of analysing tax compliance is to identify relevant determinants as this allows implementing efficient policy measures against tax non-compliance. Initially, the focus was more on external economic variables such as tax rate, income, audit probability, severity of fines, unemployment rate and self- versus third party reporting (Schmutz, 2016)

Due to the numerous occurrences of non-compliance in relation to payment of taxes, respondents were asked on measures that will aim at curbing the current problem.

**Table 18: Measures to Overcome Non-Compliance**

Response	Frequency	Percentage (%)
Proper management of tax revenue by politicians	31	31.00
Provision of incentives for tax payers	3	3.00
There should be tax education for the public	65	65.00
Proper book-keeping must be kept	1	1.00

Source: Field survey (2020)

The data in Table 18 indicates that majority of the respondent believed that public education on taxation would influence voluntary compliance to the payment of tax. The percentage that supported education was 65%, 31% of the respondent believed that if the politicians change their attitude and make them believed that the tax is put into good use it will also help the situation. Their assertion was based on the numerous corrupt practices by government officials as this prevents citizens from performing their basic civic responsibilities.

The low percentage of 3% and 1% for the provision of tax incentives and proper book-keeping respectively emanates from the fact that most of the respondent had low/no education on those issues.

## **CHAPTER FIVE**

### **SUMMARY, CONCLUSIONS AND RECOMMENDATIONS**

#### **Introduction**

This study has brought out the issues affecting taxation of the informal sector in Ghana. The study investigated the contribution of the informal sector to tax revenue and the factors that make informal sector extremely difficult to tax and the variables affecting tax noncompliance behaviour of the informal sector entrepreneurs were also examined. It aimed at addressing the critical issue of revenue mobilization from the informal sector of the Ghanaian economy by looking at the various objectives by assessing accounting records kept by the informal sector, assessing the perception of the operators under the informal sector in the Sunyani Tax District towards taxation with specific objectives geared towards knowing the motives for taxing the informal sector, identifying the variables that make informal sector “difficult-to-tax “and providing recommendations on the way forward on the taxation of the informal sector.

#### **Summary of Findings**

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

#### **Factors accounting for the difficulty in taxing of the informal sector**

The major factors identified as responsible, among other factors, include: location and nature of the informal sector businesses, predominance of cash transactions, poor accounting and record keeping practices and high illiteracy rate among the informal sector entrepreneurs. It was found that some of the informal sector businesses were nomadic as the entrepreneurs did not have a permanent place of business. The informal sector businesses sampled

indicated that 21.21% of the respondents had no permanent business location while only 73.74% had a permanent business place.

The sales among the informal sector businesses were largely made on the basis of cash only, while a few respondents sold both on credit basis. The data collected showed that 43.43% of the respondents sold for cash only, while only 3.03% sold on credit. It is well established in the literature that cash sales leave no evidence of sales and therefore some revenue may not be captured in total revenue. The high cash basis of sales is largely informed by the fear of default by customers and the roaming nature of some of them.

It was also found out that people were ignorant on the fact that they need to declare their income to the IRS for tax assessment. The result of the survey showed that 63.64% of the respondent did not know that they need to declare their income to the IRS. The few that knew of the declaration voluntarily decided not to pay tax. Again, the survey showed that more than 60% of the respondent did not pay any percentage of their income as tax to the IRS of the GRA

### **Illiteracy rate and its relationship with other variables for non-compliance**

The study found out that the illiteracy level of majority of the people in the informal sector accounted for their non-compliance to tax regulation in the country. The highest correlation coefficient was found between Level of education and other variables were either positive or negative. Mode of transaction and level of education had no relationship with the coefficient value being zero and also for the variable “taking advice not to comply with tax obligation” which also had a no relationship with educational level of respondents The only positive correlation was between level of accounting

practice and level of education which meant that the higher the level of education, the higher the probability of adopting accounting practice in your business transaction. This confirmed the assertion that the poor accounting practice among the informal sector considering the fact that more than 90% of the respondent had a medium and low/no educational background.

### **Variables of tax non-compliance in the informal sector**

The variables of tax noncompliance behaviour identified in the literature review were all identified to some extent to be present in the Ghanaian informal sector. The tax noncompliance variables include: unknowing, procedural, accounting, habitual, and asocial. The level of tax noncompliance variables identified based on 99 respondents' responses for each question on a particular noncompliance variable in terms of percentages is as follows: unknowing 63.64%, procedural 81.82%, accounting 56.57%, habitual 61.62%, and asocial 85.71%. Asocial variable ranks as the highest with accounting variable as the least. This situation indicates that among the respondents the independent variable that seems to dominate noncompliance behaviour is asocial variable at 85.71%, while accounting variable was found to be the least at 56.57%.

The dominance of asocial noncompliance variable indicates the extent of influence that other people who do not pay tax has on those who honour their obligation. The problem can also be attributable to the informal sector not using the services of accountant due to the nature of their business which do not make them think of keeping proper books of accounts. The data gathered showed that 84.85% of the respondent does not employ the services of accountant and this situation can be explained by high service fees charged and fear of embezzlement by the accountant and no need for them.



## **Conclusions**

The research has shown that the contribution from the informal sector to tax revenue is insignificant considering the size of the sector and the varied activities taking place in that sector because taxing the informal sector is a difficult task and that the prospects for making a significant advance are not so bright, given the various mechanisms used. However, the importance of attempting to do so by the government is undeniable. It must be pointed out that taxing the informal sector for a long time will depend on a combination of approaches and mechanisms. There is therefore no single mechanism which can provide that maximum contribution of tax. Tax collection is an important governance challenge that depends on a compliance culture, the values and norms of a society, its history and above all the capacity of the government to deliver.

The factors making the informal sector difficult to tax were all identified to be very high in the Ghanaian informal sector as the percentages of the difficulty to tax factors, based on the respondents, ranges from the lowest of 43.43% of predominance of cash transactions to the highest of 84.85% for not using accounting staff for their business thereby having a poor accounting record keeping system. This indicates that hard-to-tax factors can be said to be almost equally strong determinants of the hard-to-tax nature of the Ghanaian informal sector.

Although reasons for tax noncompliance were all found to be present in the Ghanaian informal sector, based on the percentage analysis of the responses, a social non-compliance and compliance with accounting procedure came out as the foremost reason for tax noncompliance with the very high percentage

of 85.71% and 81.81% respectively, this discourages the few tax payers within the tax net from continuing to pay tax.

In conclusion, the researcher believes that the contribution from the informal sector to the domestic revenue generation is not adequate and encouraging considering the size of the sector, a further research into compliance strategies for the informal sector is therefore recommended.

### **Recommendations**

To address the problem of low-income tax from the informal sector, the following suggestions are proposed to enable the Ghana Revenue Authority (GRA) to derive the maximum tax revenue from the informal sector.

#### **1. Capacity building programmes in record keeping**

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

## **2. Tax education**

There is no denying the fact that tax information and education is fairly very poor in Ghana and especially with respect to the informal sector. This problem was quite evident in how many informal entrepreneurs did not know much about the declaration of income to the IRS and some did not see any benefit from paying tax. This study, therefore, suggests that the GRA through IRS intensifies its tax information and education using both print and electronic media. With regards to the informal sector tax information in all major Ghanaian languages should be printed as hand bills containing information on the need to pay taxes and the benefits to be derived. The Ministry of Information should be involved where information vans are used to educate the informal entrepreneurs. Tax education should be pursued vigorously and on a sustained basis which with time is likely to encourage voluntary compliance from the informal sector. Education on tax should be organised for Junior and Senior High School graduate before they leave school since they form a substantive part of the informal sector when they terminate their education at that level.

## **3. Simplification of filing procedures**

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

#### **4. List of informal businesses**

The GRA must embark on nationwide exercise to establish a list of all the informal sector businesses that are easily identifiable and their locations. This could be done by employing the services of national service personnel and a large number of unemployed graduates out there. This exercise may be updated annually

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**APPENDIX A**

**QUESTIONNAIRE**

**CATHOLIC UNIVERSITY COLLEGE OF GHANA**

I am undertaking a research into the ‘The Informal sector and its contribution to tax revenue in Ghana – case study of Tano South District. This survey is therefore meant to collect data and relevant information from target audience (informal sector workers) to provide information on the tax contribution of the informal sector. Any information collected would be treated confidentially and shall be used only for the intended academic purpose. Please I would appreciate it if you could spend some few minutes answering this questionnaire. Thank you.

Questionnaire number:

**DEMOGRAPHIC DATA**

1. Name of Respondent .....
2. Address .....
3. Age .....
4. Gender.....
5. What is your level of education?
  - a. Low/no Education
  - b. Medium (Secondary)
  - c. High (Tertiary)
6. Marital Status
  - a. Married
  - b. Single
  - c. Divorced

## ORGANISATIONAL CHARACTERISTICS

7. What is the name of your business?

.....

8. Type of Business engaged in

a. ....

b. ....

c. ....

d. ....

e. Other specified

9. What is the Level of Income (per annum)

a. Below GH¢1,000

b. Between GH¢1,000 – GH¢1,500

c. Above GH¢1,500

10. Do you have a permanent business location?

a. Permanent

b. Roaming

c. Both

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

a. Cash only

b. Credit only

c. Both cash and credit

12. What is the level of accounting practice in your business?

a. Low/poor

b. Medium

c. High/very good

13. Do you use accountants for your business at all?
- a. Yes
  - b. No
14. If no, why don't you use accountants?
- a. High service fee
  - b. Fear of embezzlement
  - c. No need
15. Do you know you have to declare your total income to IRS?
- a. Yes
  - b. No
16. Do you keep accounting records?
- a. Yes
  - b. No
17. Do you comply with accounting procedures?
- a. Yes
  - b. No
18. Do you protest against the perceived corrupt practices of tax officials?
- a. Yes
  - b. No
19. Do you take advice from colleagues not to comply with your tax obligation?
- a. Yes
  - b. No
20. Do you think all your colleagues in the private business pay tax?
- a. Yes
  - b. No

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

- a. Yes
- b. No

22. What percentage of your income do you pay as tax to the Domestic division of the GRA.

- a. 5%
- b. 10%
- c. 15%
- d. 20% (e) none

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

.....

.....

.....

.....

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

.....

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