

UNIVERSITY FOR DEVELOPMENT STUDIES, TAMALE

EVALUATING THE AWARENESS OF TAX LAWS AND COMPLIANCE BY
SMALL AND

MEDIUM SIZE ENTERPRISE IN THE GHANAIAN ECONOMY USING
BUSINESSES IN

TAMALE METROPOLIS AS A CASE STUDY

BY

DABUO YELKU-ANG EMMANUEL

(UDS/MCM/0016/13)

(BACHELOR OF COMMERCE)

THESIS SUBMITTED TO THE DEPARTMENT OF ACCOUNTANCY

AND COMMERCE, SCHOOL OF BUSINESS AND LAW, UNIVERSITY

FOR DEVELOPMENT STUDIES IN PARTIAL FULFILLMENT OF THE

REQUIREMENTS FOR THE AWARD OF MASTER OF COMMERCE

DEGREE IN ACCOUNTANCY

MARCH, 2017



DECLARATION

Student's Declaration

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

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

Name:

Supervisors' Declaration

I hereby declare that the preparation and presentation of the thesis was supervised in accordance with the guidelines on supervision of thesis laid down by the University for Development Studies.

Principal Supervisor's Signature: Date:

Name:



ABSTRACT

This research was aimed at evaluating the awareness of tax laws and compliance by Small and Medium size Enterprise in the Ghanaian economy using businesses in Tamale Metropolis as a case study. This study was conducted with the following as its objectives;

Ascertain the level of awareness and knowledge of tax laws and regulations by SMEs, Examine factors affecting compliance with tax laws among SMEs and lastly to Evaluate tax agencies effort to ensure compliance. Employing the use of descriptive survey to describe the situation, phenomenon, attitudes, behavior, beliefs as well as opinions of people on the subject matter. A cross-sectional design was also used to guide in focusing on a snapshot to explore, describe and explain the situation of SMEs and compliance to tax laws. Through the analysis of data obtained using the above stated methodology, the following were revealed;

Taxes paid by respondents include; income tax, TMA levy, VAT and property tax, majority of the respondents pay their taxes regularly despite not receiving any major form of tax education for the past one year, most respondents ranked the taxes they pay as high. A large proportion also indicated the amount paid including compliance cost as the major constraints to tax compliance, the majority of respondents were of the opinion that a reduction in the taxable amount, coupled with the use of taxes for the intended purposes, as well as penalty enforcement on non-compliance would promote tax compliance.

Based on the findings of the study it can be concluded that most of the respondents are aware that tax compliance is mandatory and non-compliance is punishable by law.

The study recommends that efforts must be made toward stamping out corruption among the officialdom in addition to publishing such practices on television and



newspapers, among others. Tax agencies also need to intensify education on tax laws so as to meet revenue target for economic growth and development.



ACKNOWLEDGMENT

To God be the glory, great things He has done. I thank God for his guidance and protection throughout this research work. I also thank Mr. Alhassan Musah, my Supervisor, who despite his heavy schedule of work was able to read through my scripts and advised me accordingly. His desire and unselfish guidance, inspiration, patience and untiring efforts gave me the strength to endure on till the end. He has thought me a lot and for me, he is more than just my Supervisor.

My special thanks also go to the management of Ghana Revenue Authority, the management of all the enterprises and companies whose staffs responded to my questionnaires in gathering information for the study.



DEDICATION

I wish to dedicate this work to my family, Mrs. Dabuo Paulina and to my kids, Ethel K. Dabuo, Rabani Z. Dabuo, Elizabeth N. Dabuo, Pearl F. Dabuo and Emmauella Y. Dabuo, for their unconditional love and support throughout my educational career.



Table of Contents

DECLARATION.....	ii
ABSTRACT	iii
ACKNOWLEDGMENT	v
DEDICATION.....	vi
List of Tables	x
List of Figure	xi
CHAPTER ONE.....	1
1.1 Introduction.....	1
1.2 Background	3
1.3 Statement of the Problem.....	7
1.4 Research Objectives.....	9
1.5 Research Questions	10
1.6 Significance of the Study	10
1.7 Organization of Study	11
CHAPTER TWO.....	12
LITERATURE REVIEW	12
2.1 Introduction.....	12
2.2 Definition of SMEs	12
2.3 Characteristics and Economic Importance of Small and Medium Enterprises.....	14
2.4 Challenges to SMEs Development	20
2.5 Historical Perspectives of Tax	21
2.6 Tax System in Ghana	25
2.7 Tax Laws and Administration in Ghana	32
2.8 Attitude and Perceptions towards Tax Compliance.....	38
2.9 Tax Accountability by Government.....	38
2.10 The influences of Tax Policies on SMEs Growth.....	39



2.11 Tax Policy and Voluntary Compliance among SMEs	40
2.12 Reforming a Tax System for Small Businesses	42
2.13 Theoretical Literature of Tax Compliance	45
2.14 EMPIRICAL LITERATURE	49
2.15 Conceptual Framework	60
2.16 Conclusions	61
CHAPTER THREE	64
RESEARCH METHODOLOGY	64
3.1 Introduction	64
3.2 Background of Study Area	64
3.3 Research Design	65
3.4 Specific Study Design	66
3.5 Study population	67
3.6 Sampling Techniques	68
3.7 Sampling Technique	68
3.8 Sampling Method	69
3.9 Data Collection	71
3.10 Sources of Data	71
3.11 Data collection procedure and instrument	71
3.12 Data analysis procedure	73
CHAPTER FOUR	74
RESULTS AND DISCUSSIONS	74
4.1 Introduction	74
4.2 Analysis of Demographics	74
4.3 Analysis of Awareness and Knowledge of Tax Laws and Regulations by SMES	77
4.4 Factors affecting Compliance with Tax Laws among SMEs	83



4.5 Efforts by Tax Agencies to Ensure Compliance	88
CHAPTER FIVE	92
SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS	92
5.1 Major Findings of the Study	92
5.2 Conclusions	93
5.3 Recommendations	93
REFERENCES	95
Appendix A.....	106
Appendix B lists of SMEs	112



List of Tables

Table 1: Share of Tax Revenue, GDP Per Capita Growth and Population Growth (2000-2012)30

Table 2: Annual Tax Rates - Effective June 2010.....33

Table 3: Monthly Tax Rates-Effective June, 2010.....34

Table 4: Offences and Penalties36

Table 5: Factors Influencing the Compliance Behavior of Businesses55

Table 6: Offences and Penalties59

Table 7: Descriptive Statistics76

Table 8: Factors affecting compliance with tax laws84

Table 9: Type of Tax Paid by Respondents.....86

Table 10: Logit Model Prob chi2 0.000 psedo R2=0.6388

Table 11: Factors that could promote tax compliance.....90



List of Figure

Figure 1: Factors affecting tax compliance	61
Figure 2: Sex of Respondents	74
Figure 3: Respondents by Business types.....	75
Figure 4: Nationality of Respondents	77
Figure 5: Tax Registration	78
Figure 6: Authority Registered with	79
Figure 7: Understanding of Tax Laws	80
Figure 8: Respondents' knowledge on some tax regulations	81
Figure 9: Educational level of SMEs on Tax issues	83
Figure 10: Tax as Obligatory	86



CHAPTER ONE

1.1 Introduction

Many countries, including Ghana, depend on taxation as a means of generating the required resources to meet their expenditure requirements.

These countries will likely find themselves in growing fiscal imbalance when their revenue productivity falls below their expenditure. The need for fiscal adjustment then becomes particularly necessary to restore balance in government budget (The African Economic Research Consortium, 1998). A strong and efficient tax system provides the basis for enhanced economic growth and development. The governance of fiscal policy, which controls the amount and structure of taxes, expenditure and the debt management, is a powerful instrument for stabilizing the economy. It ensures the efficient allocation of public resources and serves as a precondition for economic growth (Compos and Pradhan, 1996).

The only way to ensure that taxpayers receive real value for their money is when the government establishes a long term goal through investment and tax reforms. Investment and tax reforms will encourage the foundation for a stronger and more productive economy. An important element in any successful administrative reform is simplicity and enforceable laws to administer. It is equally important to simplify procedures for taxpayers, for example, by eliminating demands for unnecessary information in tax returns and payment invoices. The job is particularly difficult in developing countries with large informal sector, low levels of literacy and public morality, poor salary structure for public servants, poor communication, malfunctioning judicial systems and entrenched interests against radical reform (Auriol and Warlters, 2002).



Despite such handicaps, the experience of several countries in recent years shows that substantial improvement can be achieved with determined effort and an appropriately designed strategy. What a tax administration can do however, and how it can best be reformed depends largely upon the environment in which it operates. Ghana's fiscal structure prior to 1983 had generally been characterized by low tax revenues compared with other developing countries in sub Saharan Africa (ISSER, 2004). At the same time, the need to lay the foundation to propel higher economic growth resulted in persistent high fiscal deficits. The burden on the financial system, as a result of government resorting to the domestic economy to finance high deficits as well as the general deterioration of macroeconomic fundamentals during the period, precipitated the need to seek appropriate policy measures to set things right. In this direction the prescription offered by the International Monetary Fund (IMF) and the World Bank under the Economic Recovery Programme (ERP) and the Structural Adjustment Programme (SAP) became attractive.

Tax reforms constituted one of the essential ingredients of SAP and have assumed diverse dimensions over the past two and half decades. The overall reforms throughout the period have significantly impacted on domestic revenue outcomes in recent times (Bank of Ghana, 2001). Since attaining independence, Ghana has introduced a number of tax reforms aimed primarily at improving revenue mobilization between 1984-2007 and quite recently in 2008 and 2009. The pre-tax reforms period covers the period 1970-1983 while the period 1984-2009 represents the post-tax reforms era. The evidence demonstrates that the tax reforms have had considerable impact on the overall tax system and revenue performance in Ghana, especially in recent times. (Bank of Ghana, 2009).



1.2 Background

1.2.1 Overview of SMEs

Small and Medium Enterprises (SMEs) play a major role in most economies, particularly in developing countries. Formal Small and Medium Enterprises (SMEs) contribute up to Forty-Five percent (45%) of total employment and up to Thirty-Three percent (33%) of national income (GDP) in emerging economies. These numbers are significantly higher when informal Small and Medium Enterprises (SMEs) are included. According to estimates, Six hundred million (600 million) jobs will be needed in the next 15 years to absorb the growing global workforce, mainly in Asia and Sub-Saharan Africa. In emerging markets, most formal jobs are with Small and Medium Enterprises (SMEs), which also create four (4) out of five (5) new positions. However, access to finance is a key constraint to Small and Medium Enterprises (SMEs) growth; without it, many Small and Medium Enterprises (SMEs) languish and stagnate.

Small and Medium Enterprises (SMEs) are less likely to be able to secure bank loans than large firms; instead, they rely on internal or “personal” funds to launch and initially run their enterprises. Fifty percent (50%) of formal Small and Medium Enterprises (SMEs) don’t have access to formal credit. The financing gap is even larger when micro and informal enterprises are taken into account. Overall, approximately 70 percent of all Small and Medium Enterprises (SMEs) in emerging markets lack access to credit. While the gap varies considerably between regions, it’s particularly wide in Africa and Asia. The current credit gap for formal Small and Medium Enterprises



(SMEs) is estimated to be US\$1.2 trillion; the total credit gap for both formal and informal Small and Medium Enterprises (SMEs) is as high as US\$2.6 trillion.

A World Bank Group study suggests there are between 365-445 million micro, small and medium enterprises (SMEs) in emerging markets: 25-30 million are formal SMEs; 55-70 million are formal micro enterprises; and 285-345 million are informal enterprises. Moving informal SMEs into the formal sector can have considerable advantages for the SME (for example, better access to credit and government services) and to the overall economy (for example, higher tax revenues, better regulation). Also, improving SMEs' access to finance and finding solutions to unlock sources of capital is crucial to enable this potentially dynamic sector to grow and provide the needed jobs.

1.2.2 Taxation of SMEs

Fiscal policy is one of the main components of macroeconomic policy and its tasks have been considered in a double context: first, the core of fiscal policy, and second, the consistency with the monetary policy (Holban, 2007). In general terms, the choice of tax policy to employ depends on the use of one or both groups of instruments; the first one being the use of special tax preferences and the other incentives to support start-up and growth of small companies. The incentives include the lowering of corporate income tax rates, special tax exemptions and reliefs for small businesses.

The fundamental purpose of taxation is to raise revenue effectively, through measures that suit each country's circumstances and administrative capacity. In fulfilling the revenue function, a well-designed tax system should be efficient in minimizing the distortionary impact on resource allocation, and equitable in its impact on different groups in society (Bolnick, 2004). It is important that the country's situation is properly



analyzed before employing any tax policy in order to have a properly working tax system because according to Slemrod, J. (n. d) many of the difficulties with the tax authorities are the consequence of poorly conceived tax policies and a lack of certainty regarding future policy changes. The objective of a tax policy should be to achieve collection cost savings while minimizing the revenue loss, disruption to the economy, and the inequity and capriciousness of the tax burden, Ojochogwu W. A. et al (2012)

An effective and efficient tax administration system is integral to any country's well-being, it is as a result of this that Baurer (2005) believes that the tax administration must provide an even playing field for business by ensuring that all taxpayers meet their tax filing and paying requirements The tax administration must balance its educational and assistance role with its enforcement role.

The rationale behind the whole system of tax is consistent with two of the three major theories of tax namely; the ability-to-pay principle and the equal distribution principle. These two principles stress equality and fairness.

While the ability-to-pay talks pushes that individuals should be levied taxes based on their ability to pay, the equal distribution principle suggests that income, wealth, and transaction should be taxed at a fixed percentage; that is, people who earn more and buy more should pay more taxes, but will not pay a higher rate of taxes. (Gabay, Remotin, &Uy, n.d)



1.2.3 Tax Compliance and SMEs

According to Marti (2010) tax compliance is a complex term to define. Simply put, tax compliance refers to fulfilling all tax obligations as specified by the law freely and completely.

It has been found that regulatory burdens fall disproportionately on small and medium enterprises internationally (Pop & Abdul-Jabbar, 2008). Their size and nature makes the issue of tax compliance one of particular importance especially since most SMEs have access to limited resources and inadequate expertise to comply with diverse and complicated regulation. He also believes that high compliance costs can result in tax avoidance, tax fraud, and inhibit investment by way of diminishing competitiveness of the country in terms of taxation attractiveness.

Tax non-compliance may be in one of many forms; it could either be failure to submit a tax return within the stipulated period or non-submission, understatement of income, overstatement of deductions, failure to pay assessed taxes by due date (Kasipillai & Abdul Jabbar, 2006) and in some cases non-compliance may mean an outright failure to pay levied taxes. Studies have shown that the problem of tax evasion is a widespread one (Kasipillai & Abdul Jabbar, 2006).

Furthermore, Fagbemi, Uadile & Noah (2010) found that it is prevalent in developing countries and it hinders development thereby leading to economic stagnation and other socio-economic problems. Chipeta (2002) identified tax rates as one of the causes of tax evasion. He pointed out that a higher tax rate increases taxpayers' burden and reduces their disposable income therefore, the probability of evading tax is higher. Relying on the recent wave of the World Values Survey data, Ibrahim et al., (2015) employed the



probity model to investigate the determinants of motivation to pay tax – tax morale – in Ghana. Their study found a U-shaped relationship between age and tax morale suggesting that as age increases, tax compliance decreases up to a point after which it begins to increase – an evidence suggesting that the level of tax compliance is higher (lower) among the aged (young). Further findings from their study show that, the level of education, marital status, patriotism, sector of employment, satisfaction with democracy and one’s “fear of God” do not influence tax morale or compliance. While income may be thought to be a significant conduit of tax compliance, Ibrahim et al., (2015) show that the economic class of a person per se is far from being a significant driver and that people are intrinsically motivated to pay tax once they are satisfied with their financial situation, have trust in government as well as confidence in parliament.

1.3 Statement of the Problem

Developing countries have a relatively high ratio of Small and Medium size Enterprises (SMEs). Considering their potential contributions to economic growth and development, governments have over the years, come up with various stimulus packages for the growth of SME’s. Despite the success of SMEs as a result of government interventions, the majority of developing countries such as Ghana have realized that the impacts of SME’s to the economy have been less satisfactory especially in terms of revenue mobilization. This has thus resulted in governments’ haven to annually finance budget deficits by borrowing internally and/or externally under condition that in the long run create more challenges to the economies.

A broadened tax base through tax policy reforms and mobilizing of domestic resources is absolutely essential for sustaining poverty reduction over the long run. With the informal sector being effectively immune from taxation, governments of developing



countries have fewer tax instruments than their counterparts in rich countries .Imposing taxes on some branches of the economy and not others creates high economic distortions. The average taxation ratio of developed countries as a proportion of GDP is estimated between 29 and 32%, whereas the corresponding range for developing countries in the medium income category was from 17 to 22%. The average taxation ratio in the poorest countries lies between 13 and 16 %.(Djankov et al, 2000).

The problem is a vast gap exists between tax payments required by law and those actually collected and surrendered to the state. The reason, among others, can be attributed to a large informal sector that is not completely captured on to the tax net. Though governments have made attempts to encourage small businesses to be formalized and thus enter the tax nets, many of these firms continue to remain informal. Something obviously is not right. The tax regime for small businesses is possibly not appropriate enough to motivate businesses to get formal and be captured under the tax net. Achieving high levels of voluntary tax compliance and/or maintaining current compliance rates as well as increasing the marginal levels are issues of concern to fiscal policy makers in developed and developing countries alike. This is the case because, irrespective of the nature of the economy, the principal objective of taxation is one and the same: to raise revenue towards the financing of public goods and services, and funding of governments (Martina et al., 2008). Indeed taxes are a major part of the means through which monetary resources are mobilized by governments for the prosecution of projects and programmes. These projects and programmes are usually undertaken with the view to providing varied services to the citizenry ranging from; road infrastructure, internal security, protection against external aggression, sewage services, disaster management and to the new phenomenon of counterterrorism.



Ghana has recently achieved a lower middle income status; as a result of rebasing of the economy by the Statistical Services of Ghana in 2011 (Francisco et al., 2013). Substantial investment in productive infrastructure is required to maintain this exalted status and to prevent the country from sliding. These infrastructural projects, as stated earlier are financed from a myriad of sources including taxation. To this end, taxpayers' attitude towards tax payment is seen as a major precondition for effective revenue mobilization in all countries and Ghana is not an exception. In this light the research will examine the tax compliance of small and medium Enterprises and ascertain their compliance level.

1.4 Research Objectives

Small firms constitute more than half of business establishments in most developing countries and in Ghana for that matter (WP/BOG-August 2009). For the various revenue agencies to raise the needed revenue for developmental purposes, small firms have to be given serious consideration in terms of revenue mobilization and compliance. Though it is generally believed that it is not economically feasible raising revenue from small firms, the saying by Internal Revenue Service (IRS) Ghana, "little drops of taxes build a nation" debunks this belief.

The general objective of the study is to assess the extent of tax awareness and compliance among small and medium business to encourage growth and formalization.

1.4 The specific objectives of the study are therefore to;

1. Ascertain the level of awareness and knowledge of tax laws and regulations by SMEs
2. Examine factors affecting compliance with tax laws among SMEs



3. Evaluate tax agencies effort to ensure compliance.

1.5 Research Questions

1. What is the level of awareness of tax laws among SMEs?
2. What factors influence tax compliance among SMEs?
3. What efforts are tax agencies exerting to influence tax compliance?

1.6 Significance of the Study

The state has over the years carried out policy reforms geared towards improving revenue mobilization in order to perform her duties effectively and efficiently. Ghana's fiscal structure prior to 1983 had generally been characterized by low tax revenue compared with other developing countries in sub-Saharan Africa (IMF, African Department database, March, 2007)

Ghana's major changes in tax administration and fiscal policies played a key role in improving the country's revenue mobilization and overall fiscal health (Osei, 2006).

Since most workers in sub-Saharan Africa are employed in agriculture and in small enterprises (Gordon and Li, 2005) tax policy reforms geared towards this group would go a long way to improve revenue needed by governments in these economies to sustain these economies. The recognition of the fact that most of Ghana's labour force is employed in small enterprises and that their contribution to tax revenue is crucial in raising the essential revenue needed by government to spend on public goods and services for the benefit of the populace would encourage both government and small business to attach some seriousness to tax administration and compliance.



While it is the preoccupation of many governments to raise domestic tax revenue, little attempt have been made to systematically understand the knowledge of tax laws in Ghana. The study therefore aimed at establishing a better understanding of the bottlenecks inhibiting the manifestation of the contributions of SMEs to the overall development of our economy by first of all determining the levels of awareness and knowledge of tax laws by the operators of SME's, the factors that undoubtedly affect compliance and contribution of this enterprises to economic growth. The study also focused on challenges faced by the revenue mobilization agencies in policy administration, collection, and compliance so as to identify possible remedies.

This study will also contribute significantly to academic literature given the dearth of research in this area especially for Ghana and to make recommendations that will inure to the benefit of the economy.

1.7 Organization of Study

The study is made up of five chapters. The first chapter consists of the background to the study, statement of the problem, research objectives, research questions, significance of the study, and the structure of the study. Chapter two dealt with literature review of concepts relevant to the study. It also extensively discusses both theoretical and empirical literature on the tax knowledge and compliance nexus.

Chapter three presents the methodology adopted to conduct the research. This chapter contains issues such as the research design, instrument and data collection tools. Chapter four focuses on data presentation, discussion and analysis. Finally, chapter five deals with the findings of the study, conclusion and recommendations for policy.



CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter critically reviews relevant literature on tax knowledge and compliance. It is divided into four sections. First section discusses tax laws and tax administration in Ghana while the second section discusses tax policy and voluntary compliance among SMEs. The third section reviews the theoretical literature while the final section extensively reviews the empirical literature on tax knowledge and compliance relationship.

2.2 Definition of SMEs

There are numerous definitions for SMEs by scholars because several criteria are used in defining SMEs. Most definitions are made based on variables such as the number of employees, annual turnover, ownership of enterprise, and value of fixed assets. As asserted by Kayanula & Quartey (2000) that, there have been issues on what constitutes a small or medium enterprise by researchers? Different writers have usually given different definitions to this category of business. Storey (1994) discussed the danger of using size to define the status of a firm by stating that, in some sectors, all firms may be regarded as small, whilst in other sectors there are possibly no firms which are small. The Bolton Committee (1971) first formulated an “economic” and “statistical” definition of a small firm. Under the “economic” definition, a firm is said to be small if it meets the following three criteria: it has a relatively small share of their market place; it is managed by owners or part owners in a personalized way, and not through the medium of a formalized management structure; and it is independent, in the sense of not forming part of a large enterprise. Under the “statistical” definition, the Committee proposed the



following criteria to determine the size of the small firm sector and its contribution to GDP, employment, exports, etc.: the extent to which the small firm sector's economic contribution has changed over time; and applying the statistical definition in a cross-country comparison of the small firms' economic contribution.

The European Commission (EC) defined SMEs largely in terms of the number of employees they have: firms with 0 to 9 employees - micro enterprises; 10 to 99 employees - small enterprises; and 100 to 499 employees - medium enterprises. Thus, the SME sector is comprised of enterprises (except agriculture, hunting, forestry and fishing) which employ less than 500 workers. In effect, the EC definitions are based solely on employment rather than a multiplicity of criteria. Secondly, the use of 100 employees as the small firm's upper limit is more appropriate, given the increase in productivity over the last two decades (Storey 1994). In Ghana, the Ghana Statistical Service, in their 1987 Ghana industrial census considered firms employing between 5 and 29 employees and with fixed assets not exceeding \$100,000 as small scale, while those employing between 30 and 99 employees as medium scale category.

Finally, the EC definition did not assume that the SME group is homogenous; that is, the definition makes a distinction between micro, small, and medium-sized enterprises. However, the EC definition is too all embracing to be applied to a number of countries. Researchers would have to use definitions for small firms that are more appropriate to their particular "target" group (an operational definition). It must be stated that debates on SME definitions turn out to be sterile, unless size is a factor that influences performance. For instance Storey (1994) argued that, the relationship between size and performance matters when assessing the impact of a credit programme on a target group



2.3 Characteristics and Economic Importance of Small and Medium Enterprises

According to Olorunshola (2003), the concept of SMEs, is relative and dynamic. SMEs are characterized by innovation, evolution and uncertainty. Therefore, a good understanding of SMEs would require a good knowledge of its features.

As put out by Olorunshola (2003), SMEs in Ghana are usually small, owner or family managed businesses offering basic goods and services, which tend to lack organizational and management structures with the urban ones tending to be more structured than their rural counterparts. This is one of the most generic features of SMEs in Ghana. They further state that SMEs are mostly sole proprietorships or partnerships although on the surface, they may be registered as Limited Liability Companies however they are usually not separate legal entities. Olorunshola (2003) further explains that this ownership style has led small and medium enterprises to have a simple management structure. Factors also contributing to the reasons small and medium enterprises have a simple management structure are few number of employees and the owners' low level of education. However it can be observed that recent improvement in the education sector and the fact that young people are now interested in doing business has attracted a lot of educated people in to the SME sector. Since there is no legal personality between the small and medium enterprise and its owners, it means the lifespan of the enterprise is dependent on the lifespan of its owners i.e. there is no perpetual continuity.

In terms of financial reporting, research focusing on internal preparation seems to suggest that financial awareness amongst owner-managers of the smallest entities is quite low and that there is inadequate recordkeeping (UNCTAD, 2002). Inadequate



financial record keeping and the consequent failure to make good use of available financial information, is characteristic of SMEs and many small businesses in developing economies (Holtmann *et al.* 2000). Furthermore, Hanefah *et al.*, (2002) reported that the production processes of SMEs are usually labour intensive and they often serve as suppliers for the larger manufacturing firms with their operations being highly dependent on raw materials sourced locally. The decisions of the managers have a higher tendency to be subjective given that they are managed and controlled by the same individual. The employee-employer relationship found in most SMEs is predominantly informal. Another key feature of the SME sector in any country is that it is heterogeneous varying in size from small retail outlets to highly paid professionals, and substantial manufacturing enterprises. SMEs are likely to vary in organizational form from sole proprietorships (with or without employees), small corporations (public or private), professionals and partnerships. This feature usually results in different obligations for record keeping for the enterprise.

SMEs are thought to be engine room of innovation. This is because entrepreneurial activities such as innovation, risk bearing, employment creation, finding new opportunities and the commercialization of their inventions have contributed to the prosperity in all regions of the world. Therefore, any country wishing to remain innovative will support SME growth because they also enhance competition and entrepreneurship and hence have external benefits on economy-wide efficiency, and aggregate productivity growth. Furthermore, SME proponents frequently claim that SMEs are more productive than large firms are, but financial market and other institutional failures impede SMEs development. Thus, pending financial and institutional improvements, direct government financial support to SMEs can boost



economic growth and development (Avolio, n. d; Beck *et al.* 2005). It is agreed that SMEs foster economic growth through innovation and during the economic globalization period and under fierce competition conditions, the research and development activities of small and medium-sized enterprises play an irreplaceable role in promoting technology innovation and national economic development because of their adaptive ability to changes in the market, flexible operation mechanism, as well as innovation spirit. As a result, they can adapt to new situations more easily than large corporations can. Innovation is also critical for getting new ideas into the economy (Hendy 2003). Small and medium enterprises serve as the link between the large business enterprises and the consumers; and, as such, large enterprises can hardly survive without them. Therefore, the importance of small business enterprises cannot be over emphasized.

Small and medium scale enterprises, have contributed greatly in accelerating rural development while decreasing urban immigration and the problems of congestion in large cities, this is because they have less competition by serving dispersed local markets; are closer to their resources; and are cheaper to establish. In the Rural areas entrepreneurs are attracted to invest thus discouraging rural-urban migration and making way for an even development. SMEs also contribute to domestic capital formation, play a value-adding role, mobilize private savings and harness them for productive purposes. There is general consensus that the performance of SMEs is important for both economic and social development of developing countries. From the economic perspective, SMEs provide a number of benefits (Advani 1997). SMEs have been noted to be one of the major areas of concern to many policy makers in an attempt to accelerate the rate of growth in low-income countries. These enterprises have been



recognized as the engines through which the growth objectives of developing countries can be achieved. They are potential sources of employment and income in many developing countries as SMEs provide employment and income to a large portion of the urban labour force and are a significant source of total output (Aryeetey 2001). It is also estimated that SMEs generate about 50 per cent of national output and provide about 60 per cent of employment to Ghanaians López & Aybar (2000) sees SMEs as a quasi-sponge for urban employment and a provider of inexpensive consumer goods with little or no import content, serving an important pressure-releasing and welfare-augmenting function. SMEs also contribute to long-term industrial growth by producing an increasing number of firms that grow up and out of the small-scale sector. The emergence of wholly modern small/medium scale Ghanaian industries is likely to be a prerequisite for any enduring industrialization.

Other contributions made by SMEs to the economy, according to Hendy (2003), include being able to remain profitable even in turbulent conditions because they are accustomed to operating in highly fragmented and heterogeneous markets, They can also serve a special role in creating social capital (that is, they are often ‘entrenched’ in local communities). Another advantage is that, because they are fast and flexible, and close to their customers, they can be a competitive spur to large firms. With respect to output growth, they perform important sub-contract functions; and they can perform an important import substitution role, while others are exporters.

SMEs have been an important tool of economic development in Ghana. The future of any growing economy such as Ghana’s depends on the entrepreneurial energy of vibrant SMEs because many large businesses start out as SMEs. Many authors believe that SMEs are the starting point of development in the economy moving towards



industrialization. SMEs seem to have advantages over their large-scale competitors in that they are able to adapt more easily to market conditions, given their broadly skilled technologies. They are able to withstand adverse economic conditions because of their flexible nature (Kayanula & Quartey 2000).

SMEs are more labour intensive than larger firms are, and therefore have lower capital costs associated with job creation. They perform useful roles in ensuring income stability, growth and employment. Since SMEs are labour intensive, they are more likely to succeed in smaller urban centers and rural areas, where they can contribute to a more even distribution of economic activity in a region and can help to slow the flow of migration to large cities. Due to their regional dispersion and their labour intensity, it is argued that small-scale production units can promote a more equitable distribution of income than large firms can. They also improve the efficiency of domestic markets and make productive use of scarce resources, thus facilitating long-term economic growth (Kayanula & Quartey 2000).

According to López & Aybar (2000) the SMEs sector is considered very important in that it enhances the contribution of the private sector and provides the critical building blocks for industrialization and sustainable economic growth.

SMEs broaden the base of participation in society, decentralize economic power and give people a stake in the society's future. Given that a large proportion of Ghana's population relies either directly or indirectly on small and medium enterprises for survival, their importance cannot be overemphasized.



A major contribution made by SMEs is in the area of employment (Yaobin 2007). SMEs are a key source of new jobs, innovation, economic dynamism and greater social inclusion in the world. They play an important role in secondary labour markets (that is, they offer a high amount of employment in casual, part-time, low training, low-skilled jobs); they are an invaluable source of ‘entrepreneurship’ and employment growth. Findings from a study carried out by Chu *et al.* (2008) suggest that people consider entrepreneurship as an avenue leading to job security and improving their livelihood. They also regard business ownership as a means of controlling their destiny and deriving self-satisfaction. Being more labour intensive, SME expansion is more likely to boost employment than large enterprises where expansion means a higher degree of automation and machinery. Hence, SME subsidization will lead to poverty alleviation (Beck *et al.* 2005). From an economic perspective, however, enterprises are not just suppliers, but also consumers; this plays an important role if they are able to position themselves in a market with purchasing power: their demand for industrial or consumer goods will stimulate the activity of their suppliers, just as their own activity is stimulated by the demands of their clients. Demand in the form of investment plays a dual role, both from a demand-side (with regard to the suppliers of industrial goods) and on the supply-side (through the potential for new production arising from upgraded equipment). In addition, demand is important to the income-generation potential of SMEs and their ability to stimulate the demand for both consumer and capital goods.

Furthermore, SMEs tend to utilize mainly local raw materials that would otherwise be neglected and have less foreign exchange. They mobilize and utilize financial resources that are otherwise dormant like family savings. SMEs by their activities promote indigenous know-how.



2.4 Challenges to SMEs Development

Ghana has experienced a lot of economic reforms for the past number of years. In view of this SMEs still encounter a variety of constraints owing to the difficulty of absorbing large fixed costs, the absence of economies of scale and scope in key factors of production, and the higher unit costs of providing services to smaller firms. A World Bank study found that about 90% of small enterprises surveyed stated that credit was a major constraint to new investment (Parker et al, 1995). Some of the challenges facing SMEs in Ghana and for that matter the Tamale Metropolis include:

2.4.1 Managerial Inadequacies

The SME sector in Ghana is often dominated by the less educated people and hence their managerial know-how is often questioned. Owners or managers of SMEs have limited managerial knowledge, attitude and skills in spite of the numerous institutions providing training and advisory services. They mostly develop their own approach to management through a process of trial and error. Most SMEs are owner managed and these owners often lack the requisite skills and expertise to keep the company moving in today's turbulent environment. In the few cases where skills have been acquired through other formal or informal ways, the right attitude to work, maintenance, law and civil life is often inadequate to manage the ever changing business environment.

2.4.2 Market Constraints

SMEs are normally faced with greater external competition mostly from foreign giant enterprises and the need to expand market share. The nature of the impoverished



population also adds to this. The few who can afford the goods and services fall unto those produced by foreigners.

2.4.3 Input Constraint

According to Levy (1993), SMEs face a range of constraints in factor market. However, factor availability and cost are the most common constraints. Many of the SMEs in Ghana emphasized the high cost of obtaining local raw materials; this may stem from their poor cash

2.4.4 Financing and Access to credit facility

Of all the constraints that SMEs face in Ghana, finance remains the major and dominant constraint of all. Credit constraints pertaining to working capital and raw materials have been the single biggest drawback to the SMEs in Ghana. Aryeetey et al (1994) reported that 38% of the SMEs surveyed mention finance as a major constraint; SMEs have limited access to capital markets locally and internationally, in part because of the perception of higher risk, serious management weaknesses, informational barriers, and the higher costs of intermediation for smaller firms

2.5 Historical Perspectives of Tax

The fact that taxes play a critical role in a nation's development is not an arguable fact since man's creation. However human nature and attitudes towards paying taxes has often been cynical. All forms of government rule through control of tax revenues, it has been a necessity of civilization since time began. For Lewis (1982), taxation is the principal means by which governments can attempt to redistribute wealth and bring



about social change through various social policies. In Ghana a larger percentage of funds for government social intervention programs often come from taxes.

Webber and Wildavsky (1986) noted that the structures of financial administration that appeared repeatedly in the ancient civilizations surveyed resulted from parallel efforts to solve such problems common to them all. Governments of Mesopotamian city-states, beginning in the third millennium B.C., ancient Egypt and Crete (3100-100 BC), Mauryan India (300 BC – AD 200), China during the Shang (1523-1027 BC) and Han (200 BC – AD 200) dynasties, Japan up to the nineteenth century, the Bronze Age civilizations of sub-Saharan Africa (AD 1200-1532) all had well-developed, similar systems of financial administration. Although widely dispersed in space and time, these governments produced similar solutions to the problems of supporting monarchs. Similar kinds of taxes were levied, administered in similar ways and the funds were used for their nation's development

According to Webber and Wildavsky (1986) many generations governments collected only a few types of taxes. They levied direct taxes on part of the produce of land (that is, those who grew crops paid by the bur of millet, the catty of rice, or the bushel of oats; or in livestock, lambs and kids, salmon or herring). Governments also assessed head taxes.

The aggressive nature put out by governments in this era at collecting taxes, the revenue accrued increased dramatically. Unfortunately for the taxpayer, so did expenditure. As wars became more common and more expensive, the tax burden increased. In England, an attempt was made in 1404 to collect real taxes based on the people's wages. However, the public refused the proposal and the method was repealed. Tax records were burned.



The first development of modern income tax occurred in England around 1719. This tax was used to finance warfare against France during the Napoleonic Wars. This helped Britain and its other European allies win in 1815. After the war, the people again demanded its repeal and so it was in 1816. The tax records were again burned for the second time. The “pay as you earn” system, which has been an effective counter to evasion, was introduced under the impetus of the Second World War. Before the war, less than a fifth of the working population paid income tax.

However, by 1948 this figure had increased to two-thirds and now stands at more than 90% (Rose & Karran, 1987). Other European countries like Germany, the Netherlands, Sweden, Switzerland and others adopted the method and thus it was spread. In the U.S., a direct tax was placed on citizens after drafting the Constitution in 1787. The Supreme Court supported the government's first income tax during the Civil War in 1862. The Union government found financial burdens for warfare, just by using taxes based on tariffs so the government used income tax for emergency reasons. It was then renewed in 1864 and was achieving a good rate since it imposed heavier tax burdens on people with a larger income than most. After the war, it was repealed in 1872.

Venter et al. (2004) explain that taxes are usually categorized as *direct* (income) or (consumption). Direct taxes are more visible to the taxpayer (income tax, capital gains tax) whereas indirect taxes (VAT and excise duty) are often less visible and are collected by an intermediary. The rate structure of a tax is usually described as being progressive, proportional or regressive. Taxes that take an increasing proportion of income as it rises, are progressive (income tax levied on natural persons), those that take a constant portion



(income tax on companies at a fixed rate) are proportional, and those that take a decreasing proportion are regressive (VAT).

2.5.1 Brief History: Taxation in Ghana

Taxation in Ghana as captured by Amoah (2012) began in the then Gold Coast by the Income Tax Ordinance 1943 (Ordinance No. 1943). However, this Ordinance has been amended several times. The Consolidated Edition was first amended in 1961 by Act 68, followed by Acts 178 and 197 in 1963. Thus between 1961 and 1963, additional taxes and duties were introduced. Among these were Property Tax (1961), Entertainment Duty Tax (1962) Airport Tax, Hotel Customers Tax, Standard Assessment and Excess Profits Tax, all in 1963.

In July 1961, the tax year was changed to 1st July-30th June. The Pay As You Earn (PAYE) system was also introduced. In July 1963, with the addition of more taxes, the Income Tax Department was renamed Central Revenue Department to reflect the broad scope of taxes collected. This was followed by the Income Tax Decree in 1966 – No. 78 and the Income Tax Decree – SMCD5 in 1975. Section 71 of the Income Tax Decree 1975 provides for a Commissioner who is responsible for the assessment and collection of income tax.

All these years – 1943 to 1985 – the Department was a civil service department. In July 1986 government took a decision on structural changes in the Department. The Internal Revenue Service, Law – 1986 (PNDCL, 143) – was passed. This law transformed the hitherto Central Revenue Department into a public service organization, the Internal



Revenue Service, with its own Board of Directors. The current Income Tax Law is the Internal Revenue Act, 2000 (Act 5592) (Ali-Nakyea, 2008).

2.6 Tax System in Ghana

There are two main types of tax levied by the government which are direct and indirect taxes. Examples of direct taxes are personal income taxes, company taxes, capital gain taxes, toll taxes, poll taxes gift taxes and property taxes to mention a few. Indirect taxes on the other hand include Value Added Taxes (VAT), Tariffs, and import and export duties. Direct Taxes have two major components, these are individual income tax and corporate tax, as other direct taxes, including capital gains, property and rent taxes, contribute very little revenue due to extremely weak enforcement. Ghana's income tax system which is influenced by that of the United Kingdom (Thuronyi, 2003) falls under the common law legal system. Individual income tax is a progressive tax with a top rate of 25%, while the corporate tax rate has been significantly reduced over the past few years from 32.5% in 2001 to 25% in 2006. Principle legislation regarding direct taxation is the Income Tax Act 592 (2000) which comprises Personal Income Tax (PIT) and Corporate Income Tax / Profit Tax (CIT). Recently the act was amended by Amendment 622 (2002). The Act sets out tax policy as well as tax procedures.

Personal income tax in Ghana has always been progressive, thus tax rates are graduated with higher income earners paying more tax. The progressive rates are divided into six bands with tax rates set between 5 and 25 per cent. Tax payments of employees are withheld monthly. All resident individuals in receipt of business, investment or employment income accruing in derived from, brought into or received in Ghana are liable to pay income tax. Over the years other taxes and duties were added to the income



tax. These were Minerals Duty in 1952, Betting Tax in 1952, and Casino Revenue Tax in 1955. These reductions in the corporate tax rate, coupled with improved ease of compliance, were reflected in Ghana's gains in the World Bank Doing Business survey, climbing from 83rd position to 77th position in a League of 175 countries. Ghana was for that period among the top ten movers in the World Bank Doing Business survey (Prichard & Bentum, 2009).

In revenue terms, corporate taxes and individual income taxes comprise almost identical shares of the total tax rate, which is the end result of steady gains in the area of individual income taxation. Of individual income taxes the overwhelming share (88.7% in 2007) comes from withholding taxes on formal sector wages (PAYE), with only tiny share accruing from the self-employed, which encompasses most of the informal sector and many professional occupations, such as consultants. Arguably the most glaring weakness of the direct tax system is the almost total failure to tax property or rental income. While this failure is common across most of sub-Saharan Africa, it nonetheless represents a major revenue loss, and erodes the redistributive capacity of the tax system. The housing market in Accra in particular is dominated by rental properties, while rental prices and property values are remarkably high given the relatively low-incomes of most citizens (Cooperative Housing Foundation [CHF], 2004). As such taxation of rental incomes and property could yield potentially very significant additional revenues, which some estimate at as much as 1-2% of GDP. Property taxation would have the added advantage of implicitly clarifying ownership, which would represent a major success given that land tenure disputes are a source of major conflicts in Ghana, and one of the major causes of inefficiency and high costs in the property and real estate markets (CHF, 2004).



Indirect taxes and for that matter taxes on goods and services mainly composed of the VAT and excise taxes, the latter of which have declined consistently over time (Prichard & Bentum, 2009). The VAT was initially introduced to replace the existing sales tax in 1995 under significant pressure from the IMF, which was concerned about high levels of indebtedness in the aftermath of huge expenditure increases surrounding the 1992 election. Because of the looming fiscal crisis it was introduced at a relatively high rate of 17.5%, with somewhat less public education that might have been desirable, and without the support of the opposition, which was boycotting parliament over alleged electoral irregularities.

The consequence of these three factors was the outbreak of massive street demonstrations against the tax, with the protests becoming incorporated into broader demands for political liberalization. The government eventually revoked the tax and only reintroduced it three years later at the much lower rate of 10% (Osei, 2000). The rate was subsequently increased to 12.5% in 1999, but was earmarked for the newly created Ghana Education Trust (GET) Fund in order to secure political support. In 2003 the rate was effectively further increased to 15%, though political concerns led the government to go so far as to identify it as an independent tax item, the National Health Insurance Levy (NHIL), which was earmarked for funding a new health insurance scheme (Osei & Quartey, 2005). Though smaller in absolute terms, the most volatile element of indirect taxation has been the share of petroleum taxes in total revenue. The change of government at the end of the year 2000 saw a renewed surge in petroleum taxes, but this began to be reversed by 2005, while further major cuts in petroleum taxes were announced in the run-up to the 2008 elections.



The reach of the VAT is significantly wider than income tax, as it is, in principle, levied on all forms of consumption. Because the VAT is levied on every transaction along the value chain, even goods that are not taxed at the final point of sale may carry a significant tax component that was levied at an earlier stage (Prichard & Bentum, 2009). That said it is worth noting various factors that reduce the tax burden on lower income taxpayers. First, the Value Added Tax Act contains a fairly wide range of exemptions primarily on basic consumption goods, which reduces the burden on lower income taxpayers. Likewise, in 2008 there were 46,842 traders registered (up from 30 377 in 2006), of whom 36,000 filed tax returns, which represents only a fraction of the total number of businesses in the country (Prichard & Bentum, 2009). In an effort to bring small traders into the tax net the government introduced the VAT Flat Rate Scheme (VFRS) in September 2007 at a flat rate of 3% of turnover. In principle every trader is meant to be registered, irrespective of the VAT threshold, though the VAT Service estimates that only about 26.4% of potential informal sector traders are currently registered.

2.6.1 The Role of Tax in Development

Countries use taxes for many purposes. Taxes are used to raise revenues to fund government services, to correct market imperfections, and to encourage or discourage certain types of behaviour (Bird & Zolt, 2005). Thus taxes of all form could be levied to achieve national goals such as economic stability, equity, economic growth and protectionism. It could as well be employed to mobilize revenue into the nation's coffers as reserves.



On the economic stability, for example, wild fluctuations (ups and downs) in prices are very harmful for the development of the economy of the country. Declining prices, for example, as witnessed during the recent Global Financial crisis, causes depression which leads to a fall in company profits, saving, investments, employment and the Gross Domestic Product (GDP). Taxation therefore supports the Government's goals by ensuring that the public finances are sustainable, contributing to a stable environment that promotes economic growth. This environment is important in building a stronger, more enterprising economy and a fairer society, extending economic opportunity and supporting those most in need to ensure that rising national prosperity is shared by all (Thuronyi, 2003 in Pfeuffer & Weißert, 2006).

Though economic growth could be attained through the employment of taxation, the excessive use of taxation may be counterproductive (Baafi, 2010). For example, if tariffs on food imports including rice, edible oil, and fish and poultry products are astronomically increased as has been the case, the effects trickle down to affect consumers. Currently, there has been a drastic increase in the Roads and Bridge tolls which is still hanging over commuters. Price hikes of water (pure water) and alcoholic beverages including 'Akpeteshie' having been taxed 20%. Tariffs on electricity and water are also up and also to be pushed down the throat of the ordinary man on the street. All these tax initiatives go a long way to further reduce incomes. Because of low incomes and mass unemployment in our society, we must carefully levy taxes and skew it towards equity. Below is a table of tax revenues for the period 2000 – 2012.



Table 1: Share of Tax Revenue, GDP per Capita Growth and Population Growth (2000-2012)

Year	Tax revenue (% of GDP)	GDP per capita growth (Annual %)	Population growth (Annual %)
2000	16.3	1.3	2.4
2001	17.2	1.5	2.5
2002	17.5	1.9	2.5
2003	18.5	2.5	2.6
2004	21.8	2.9	2.6
2005	21.3	3.2	2.6
2006	12.8	3.7	2.6
2007	13.9	3.7	2.6
2008	13.9	5.7	2.6
2009	12.6	1.4	2.5
2010	13.6	5.5	2.4
2011	13.4	12.4	2.3
2012	14.9	6.4	2.2
Average (2000-2012)	16.0	4.0	2.5

Source: World Development Indicators (2014)

Taxation could be to strive towards equitable distribution of income to create peace and harmony in the society by bridging the gap between the rich and the poor (Baafi, 2010). Progressive forms of taxation could be used for that matter. Ali-Nakyea (2008) summarized the role of taxation in the national economy. It is emphasized that taxation



raises revenue to defray the cost of services provided by the state; reduce inequality arising from the distribution of wealth; restrain consumption of certain types of goods; protect indigenous industries, and controls the country's economy.

2.6.2 Taxation of SMEs

Fiscal policy is one of the main components of macro-economic policy and its tasks have been considered in a double context: first, the core of fiscal policy; and second, the consistency with the monetary policy (Holban 2007). In general terms, the choice of tax policy to employ depends on the use of one or both of two groups of instruments: the first one being the use of special tax preferences; and the other incentives to support start-up and growth of small companies. The incentives include the lowering of corporate income tax rates, special tax exemptions and relief for small businesses. The fundamental purpose of taxation is to raise revenue effectively, through measures that suit each country's circumstances and administrative capacity. In fulfilling the revenue function, a well-designed tax system should be efficient in minimizing the distortionary impact on resource allocation, and be equitable in its impact on different groups in society (Bolnick 2004; Gbadago & Awunyo- Vitor 2015). It is important that the country's situation is properly analyzed before employing any tax policy in order to have a properly working tax system. This is because many of the difficulties with the tax authorities are the consequence of poorly conceived tax policies and a lack of certainty regarding future policy changes. The objective of a tax policy should be to achieve collection cost savings while minimizing the revenue loss, disruption to the economy, and the inequity and capriciousness of the tax burden.

For an economy such as Ghana that is still in the throes of a recession, the tax regime must be versatile enough to encourage savings, stimulate investment and reward social



responsibility and research funding. To widen the tax net, policy makers must never forget the urgency to provide infrastructure; create jobs and reduce unemployment; expand the productive sectors of the economy; stimulate exports; and substantially raise public revenues (Awunyo-Vitor 2015). Hence, tax policies should aim to bring all taxable adults into the tax net with a graduated rate that should ensure that the well-off pay their own share while the low income earners are given savings-enhancing incentives. An effective and efficient tax administration system is integral to any country's well-being. It is as a result of this that Baurer (2005) stated that the tax administration must provide an even playing field for business by ensuring that all taxpayers meet their tax filing and paying requirements.

2.7 Tax Laws and Administration in Ghana

2.7.1 Tax Administration in Ghana

The institution responsible for tax collection in Ghana was Income Tax Department in the Income Tax ordinance (No. 27) of 1943. With the introduction of the other taxes and duties between 1961 and 1963, the name was changed to Central Revenue Department with effect from 1st July 1963. This has undergone re-organization in 1986 and by virtue of the enactment of P.N.D.C law 143 of 1986, the name was again changed to Internal Revenue Service (Internal Revenue Service, Act 2000). Today the name is Domestic Tax Revenue Division of Ghana Revenue Authority upon passing the Ghana Revenue Authority Act 2009 (Act 791). Ghana Revenue Authority thus replaces the Ghana Revenue Agencies in the Administration of Taxes and Customs Duties in the country. (GRA News, 2010)



The main objective of the Domestic Tax Revenue Division is to collect direct taxes for the state. Taxes administered includes Pay As You Earn (PAYE), Personal Income Tax, Corporate Tax and Miscellaneous Taxes including Stamp Duty, Capital Gains Tax, Gift Tax, Rent Tax, Dividends Tax, Mineral Royalties, among others. Corporate Tax is paid by companies and personal Income Tax is paid by self-employed persons who are required to pay Income Tax at graduated rates in four equal installments. The current tax rate took effect from June 2010. Pay-As-You-Earn (PAYE) is withholdings from salaries of employees in order to satisfy their Income Tax responsibilities. The Pay As You Earn is computed with the rates as shown in Table 2.

Annual Tax Rates - Effective June 2010.

Table 2: Annual Tax Rates - Effective June 2010

Chargeable Income Gh¢	Rate (%)	Tax Gh¢	Cumulative Chargeable Income	Cumulative Tax Gh¢
First 1,008	Free	Nil	1,008	Nil
Next 240	5	12	1,248	12
Next 270	10	72	1,968	84
Next 14,232	17.5	2,490.60	16,200	2,574.60
Exceeding 16,200– 25%				



Table 3: Monthly Tax Rates-Effective June, 2010

Chargeable Income Gh¢	Rate (%)	Tax Gh¢	Cumulative Chargeable Income	Cumulative Tax Gh¢
First 84	Nil	Nil	84	Nil
Next 20	5	1	104	1
Next 60	10	6	164	7
Next 1,186	17.5	207.55	1,350	214.55
Exceeding 1350-25%				

Source: GRA News, 2010

In addition, the Division Collects taxes from certain identifiable groups. The Division entered into agreements with the Executive members of such groupings and Associations and collect taxes at rates negotiated with the executive members on daily, weekly and monthly basis. Such groupings include Ghana Private Roads and Transport Union, Beauticians and Hairdressers Association, Dressmakers Association and Ghana Union of Trade Association.

Ghana Revenue Authority has three main divisions. These include Custom Division, Domestic Tax Revenue Division and Support Services Division. However, for the purpose of this research, Domestic Tax Revenue Division is the main focus.

The vision of the Domestic Tax Revenue Division is to be the world class revenue administration, recognized for professionalism, integrity and excellence. The mission is to mobilize revenue for national development in a transparent, fair, effective and



efficient manner, through professional and friendly client services, promotion of voluntary compliance, application of modern technology, effective border protection, and a well-trained, disciplined and highly motivated staff. Core values include integrity and fairness in our service delivery, teamwork, innovation and professionalism being the hallmark (GRA News, 2010). This philosophy is operationalised into the strategy of the service. This organization believes in masculinity whereby preference is given to achievement, assertiveness, importance of work and tax collection performance results. Performance is measured based on target achievement.

The structure of the authority includes the Commissioner General as the overall head; the three major divisions are each headed by a commissioner. Structure is pyramidal and designed to be a world class Revenue Administration Agency. According to Drucker (1979), good organizational structure does not by itself produce good performance but a poor organizational structure makes good performance impossible no matter how good the individual managers may be. This excellent structure does not have the desired impact on the operations of Tamale Tax Office thus confirming Drucker (1979).

2.7.2 Tax Laws and Enforcement Strategies

In the Domestic Tax Division, efficient application of the tax laws has a direct impact on the tax collection performance. The following penalties and in some cases criminal liability apply for the under listed offences (see Table 4). Penalties have been prescribed for offences committed by authorized and unauthorized persons and entities. Under the fines (penalty units) Act 2000 (Act 572) as amended by LI 1813, a penalty unit is equal to GH¢ 12.00



Table 4: Offences and Penalties

Offences	Penalties
1.Failure to keep books of accounts	1.5% of the amount of tax payable
2.Failure to furnish a return	2. Individual pay ₵1.00 and company pays ₵2.00 for each day of default.
3. Failure to pay tax on due date	3. Where the default is not more than 3month, 10% of tax payable but 3 or more months is 20%
4. Understating estimated tax payable by installment	4. 30% where estimate is less than 90% of chargeable income.
5. Making false or misleading statements	5. Double or three times of the amount of underpayment of the tax may result.
6. Aiding and abetting	6. Three times of the amount of the underpayment.
7. Failure to comply with the Act	7. Where resulting underpayment is more than 500.00, 50-300 penalty units may be applied.
8. Failure to withhold tax	8. Personal liability to pay the commissioner the tax due but not withheld.

Source: Collection Manual, IRS: 1996

Whether these penalties are rightly applied by the tax office is the matter of concern to this research. It must be emphasized that the offences and their penalties alone may not work without proper employee enforcement strategies including staff motivation



2.7.3 Tax Avoidance and Evasion

Tax Avoidance is the legal utilization of the tax regime to one's own advantage, in order to reduce the amount of tax that is payable by means that are within the law. In contrast, tax evasion is the general term for efforts not to pay taxes by illegal means. The term tax mitigation is a synonym for tax avoidance. Its original use was by tax advisors as an alternative to the term tax avoidance. Some of those attempting not to pay tax believe that they have discovered interpretations of the law that shows that they are not subject to tax: these individuals and groups are sometimes called tax protesters.

Unsuccessful tax protesters have been attempting openly to evade tax while successful ones avoid tax. Tax resistance is the declared refusal to pay a tax for conscientious reasons (because the resisters do not want to support the government or some of its activities). Tax resisters typically do not apply to tax (as tax protesters do) and they are more concerned with not paying for particular government policies that they opposed. (<http://web.singnet.com>)

Tax evasion on the other hand is the general term for effort by individual firms, trust and other entities to evade taxes by illegal means. Tax evasion usually entails taxpayers deliberately misinterpreting or concealing the true state of their affairs to the tax authorities to reduce their tax liability, and includes; in particular, dishonest tax reporting such as declaring less income, profits or gains than actually earned (<http://web.singnet.com>). All these activities impact negatively on tax collection performance thereby creating problems in tax administration.



2.8 Attitude and Perceptions towards Tax Compliance

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

2.9 Tax Accountability by Government

According to Alm et al., (2011) Taxpayers' perception on the fairness of tax systems influence their ability to pay taxes. Revenues generated by taxpayers for the government are expected to be accounted for meaningfully by the state Young et al., (2013). There should always be a link between compliance to taxes by taxpayers and the tax accountability by the government such as securing the safety and security of individuals including taxpayers' right to property (Thorndike, 2009). The existence of tax accountability generally comprises of two parties; the one entrusted with something that results into accountability and the principal who gave the mandate (Moore & Rakner, 2002). Correlation was established between governance and accountability and income tax revenue performance, for example South Africa, Nigeria and Uganda had income tax ratio to good governance score as 14.4%: 69.4%; 2.5%: 49.6%; 3.8%: 57.9% respectively in 2006 (Rortberg & Gisselguist, 2009). The function of the degree to which governments can better the lots of its people is through the state political obligation as stated by Azeez (2009). The accountability of governments can correspond to tax payment by citizens thereby increasing the willingness to pay taxes and reducing the cost of tax collections. However, the non-accountability of government can also result in



the likelihood of the demand of high taxes by the state which may also result in protest and violence by the citizens.

In the Ghanaian community, most owners of SMEs have negative perception towards the taxes collected by the government. Although, they may be aware of the use of taxes as major source of government revenue as well as the funding of public expenditures, they also have a perception that taxes paid to the government are not used for their intended purposes. Recently, the economy of Ghana is on a recess despite the numerous taxes paid by taxpayers. With respect to this issue, SMEs in Ghana see no reason to comply with taxes because the government is not able to align the payment of taxes to the socioeconomic development of the country. SMEs in Ghana may perceive tax obligations favourably when the government acts in a trustworthy manner. There may be existence of high levels of trust and tax morale if government makes good use of tax revenues.

2.10 The influences of Tax Policies on SMEs Growth

Resources directed towards the compliance of taxes can be used for reinvestment to facilitate future growth (Tomlin, 2008). Complex tax policies can put uneven pressure on smaller businesses. Reduction in tax rates increases the profit margin of SMEs as well as intensifying government tax revenues since such provisions reduce the size of the shadow economy (Vasak, 2008). Complex tax systems distort the development of SMEs and often result in the morphing of groups that offer a lower or no tax burden hence resulting in tax systems that levies high expenses on the economy (Masato, 2009). Poor implementation of tax policies connote high collection charges, low efficiency, time wastage for taxpayers and staff, deviation from optimum allocation of resources



and low amount of tax revenues argued by Farzbod (2000). The efficiency of tax policies depend on the designing of appropriate and rational tax rates, reducing tax burden of the indigent people and intensifying the fight against the corruption and the evasion of taxes (Shahrod, 2010). The complex nature of tax policies such as multiple taxes, high ports charges etc. can exert serious burden on SMEs. Such complexity in tax policies may results in SMEs hiring agents to explain tax policies which result in additional cost for SMEs. Public corporations possess vast knowledge on tax systems than SMEs. For example, the accounting requirements of public corporations are much sturdier than sole proprietors because employees of such corporations may be subject to the awareness of requirements relating to withholding income taxes and social contributions (International Tax Dialogue Conference, 2007). Taxation of SMEs has a negative effect on SMEs sector growth and the economy by reducing sales, profit, capital and employment level (Machira, 2007). Accumulation of assets is a key indicator of a firm's growth and performance.

2.11 Tax Policy and Voluntary Compliance among SMEs

Small taxpayers under the regular system of taxation are discriminated against, since the compliance requirements, cost of compliance and tax rate are the same for both small and large enterprises. Reducing the compliance costs and tax rate increases the small enterprises profit margin. It also increases the Government's tax revenue, since the simplified provisions for small and medium enterprises reduce the size of the informal economy and the number of non-complying registered taxpayers (Vasak, 2008). Furthermore, SMEs usually have to operate in an overbearing regulatory environment with the plethora of regulatory agencies, multiple taxes, cumbersome importation procedure and high port charges that constantly exert serious burden on their operations.



An overly complex regulatory system and tax regime or one opaque in its administration and enforcement makes tax compliance unduly burdensome and often have a distortionary effect on the development of SMEs as they are tempted to morph into forms that offer a lower tax burden or no tax burden at all (Masato, 2009), and this results in a tax system that imposes high expenses on the society. A poorly executed tax system also leads to low efficiency, high collection charges, waste of time for taxpayers and the staff, and the low amounts of received taxes and the deviation of optimum allocation of resources (Farzbod, 2000). Existing empirical evidence clearly indicates that small and medium sized businesses are affected disproportionately by these costs: when scaled by sales or assets, the compliance costs of SMEs are higher than for large businesses (Weichenrieder, 2007).

SMEs constitute untapped revenue potential and an uneven playing field in many countries (International Tax Dialogue, 2007) as such they need to be captured by the tax net. However, though legislations are necessary regulator for protection of the business environment and security of the economic agents, for establishment of the necessary social security regulations, they may also hamper compliance and the growth of business through additional expenditures and administrative obstacles. Thus Shahroodi, (2010) stated that for a tax system to be efficient, the tax policy needs to be designed such that the tax rates are appropriate and rational, the exemptions are lower in amount, the tax collection organization are more efficient, the tax burden of the indigent people should be lighter and the fight against corruption and tax evasion should be much more intense.

Tax policies can be designed in such a way that they do not only directly affect SMEs but also indirectly push for voluntary compliance and their growth. Yaobin (2007),



emphasized declared that special tax regimes for SMEs may be appropriate policy instruments for minimizing the cost of collection. Because awareness of the dangers of inadequate taxation of SMEs has grown because of the potential of uneven tax enforcement to cause distortions of competition, voluntary compliance by larger enterprises and by wage earners, (International Tax Dialogue, 2007), government intervention should help maintain balance while ensuring that countries exploit the social benefits from greater competition and entrepreneurship. Pro-business (and Pro-SME) Tax regimes and enforcement should be simple, consistent and predictable should to lower compliance and administrative costs, and hence reduce uncertainty faced by taxpayers as well as improve the levels of voluntary compliance (Kasipillai, 2005).

2.12 Reforming a Tax System for Small Businesses

Reforming a tax system for small businesses is not without complications. No single best practice can solve all the issues that arise in trying to implement a tax system that is simple, administrable and equitable. When small business taxation is considered solely from a revenue perspective, its potential for developing countries is often overlooked. The benefits of a wider tax base in the medium to long term may not seem to offset the comparatively high cost of administering small contributors (ITD, 2007).

However, small business taxation should be seen as an entry point to formality. A good tax regime for small firms is a key policy tool to pave their way out of the “informality trap” of low growth, limited access to markets, and exclusion from formal financial services (Kenyon et al. 2005). A formal small business sector advances reciprocal relationships between the state and the majority of its citizens – those involved in small scale economic activities. Innovative and successful taxation strategies to encourage



formalization are in short supply, even though the parameters for a good regime seem relatively straightforward. Small business taxation should be designed with minimal compliance costs requirements commensurate with taxpayer capacity and skills (in accounting, for instance), and very few interaction with government officials to limit opportunity for corruption (FIAS, 2006). Compliance should be linked to the benefits of being formal. The administrative cost of dealing with small taxpayers must be kept to a minimum for resource and capacity constrained tax authorities. Combining and reconciling these objectives into detailed and actionable strategy is difficult; tax policy makers always face trade-offs between simplicity, fairness, efficiency, and administrative feasibility.

Informality comes at a price to both firms and governments. For many reasons, informal firms are less apt to grow and invest. Governments suffer both from lack of formal entrepreneurship that can drive economic growth and the loss of tax revenues to pay for public goods and services. Informal firms suffer one or more of the following:

1. Firms in the informal sector need to operate under the radar of the tax administration. Therefore, they often prefer to restrict firm size and growth to avoid attracting attention.
2. The lack of access to formal financial services limits firm investments.
3. Informal firms are usually excluded from public procurement contracts, which often constitute a considerable part of economic activities in developing countries.
4. Operating informally is not free of charge, informal firms may need to frequently change location or activities, pay bribes, or split their business into several smaller units at various locations.



5. Informal firms tend to have lower productivity because they operate in an uncertain state and do not invest in their business and employees (Loeprick, J (Feb.,2009).

It is gratifying to note that the cost and process of formalization are among the reasons why businesses remain informal. A cross-country study of 75 countries by Djankov et al. (2000) indicates that the official cost of setting up a firm entails fees worth at best 1.4% of GDP per capita in Canada and at worst 260% per capita in Bolivia. On top of these official monetary expenses, the authors show that registering business can be very complicated and time consuming. In the best case, establishing a new firm requires 2 days and 2 steps in Canada and in the worst case requires 82 days and 20 procedures in Bolivia. The study by Djankov et al (2000) concludes that firm entry barriers are higher in countries with lower GDP per capita. Thus, the main reason why many micro enterprises stay informal in developing countries is because becoming formal involves large fixed costs, most of them sunk. Official registration is simply beyond the reach of (informal) entrepreneurs.

The findings by Djankov et al (2000) is supported by a survey among MSEs in Ghana which revealed that, the costs and duration of business registration differ substantially, depending on the channel an entrepreneur chooses to register a business. However, even facilitating institutions mentioned (Registrar General's Department, Business Advisory Commission, and Post Office) reported registration costs varying from Ghc25.50 at the post office to Ghc60.00 at the Business Advisory Centers (BACs) with an average duration of 3 months. Entrepreneurs even paid up to Gh300.00.



2.13 Theoretical Literature of Tax Compliance

Various opinions exist about the best ways to improve tax compliance. Given the chance, a lot of businesses will not pay taxes unless there is a motivation to do so. Some believe that the best way is to increase incentives (Feld & Frey, 2007) others believe the best way is to increase penalties. Tax compliance theories can be broadly classified into two. They are; economics based theories and psychology based theories.

2.13.1 Economic Based Theories

They are also known as deterrence theory and they place emphasis on incentives. The theory suggests that taxpayers are amoral utility maximizers- they are influenced by economic motives such as profit maximization and probability of detection. As such they analyze alternative compliance paths for instance whether or not to evade tax, the likelihood of being detected and the resulting repercussions and then select the alternative that maximises their expected after tax returns after adjusting for risk. This process is referred to as “playing the audit lottery” by Trivedi and Shehata (2005). Therefore according to the theory, in order to improve compliance, audits and penalties for non-compliance should be increased. A notable economic theory of tax compliance behavior is the Allingham and Sandmo (1972) model.

2.13.1a Allingham and Sandmo (1972) Model

This theory dates back to 1968 in which Nobel laureate Becker theorized the economics of crime on the basis of which Allingham and Sandmo (1972) produced an economic model of tax compliance. The model was seminal for it was followed by a large number of contributions to the literature which extended the original model in a number of directions. In the model, the taxpayer is assumed to have an income **I** and must choose the amount to declare to the tax agency (Alm, Jackson and McKee, 1992). Declared



income **D** is taxed at the rate **t**; undeclared income is not taxed, but the taxpayer will face a probability of detection **p** at which point a fine **f** will be imposed for cheating. The taxpayer has the choice between two strategies: (1) He may declare his true income or (2) he may declare less than his true income. If he chooses the latter strategy his payoff will depend on whether or not he is investigated by the tax authorities. If he is not, he is clearly better off than under strategy one. If he is investigated, he is worse off as the audit may lead to penalties. Thus the taxpayer chooses **D** to maximize the expected utility of the evasion gamble. This framework suggests that declared income depends upon **I, p, f** and **t**:

$$D = f(I, p, f, t)$$

This model shows that declared income **D** varies directly with **income**, the probability of **detection (audit rate)** and the **penalty (fine rate)**, but inversely with the **tax rate**. There are however other factors that affect compliance decision; while government “taketh away, it also giveth back” (Alm, Jackson and McKee, 1992) and this definitely exerts influence on compliance or evasion. The declared income **D** may be modified to reflect individual’s receipt of Government expenditures **G** as follows: $D = f(I, p, f, t, G)$. Thus compliance is also directly related to individual’s perceived benefits from public good funded by their tax payments.

2.13.1b Evaluation of the Allingham and Sandmo Model of 1972

The assumption of this economics-of-crime approach and its extensions is that an individual pays taxes *only* because of the economic consequences of the evasion gamble and because they fear detection and punishment. However, it is clear that compliance cannot be explained entirely by such purely economic considerations and level of



enforcement. In fact it has been shown that the percentage of income tax returns that are subject to a thorough tax audit is generally quite small in most countries, almost always well less than 1% of all returns (Alm, 2012). Therefore, although the Allingham and Sandmo Model of 1972 is splendid in its simplicity, many potentially relevant noneconomic factors are necessarily omitted. This goes to state that several noneconomic factors explain the attitudes of tax payers for that matter SMEs to compliance of tax regulations.

2.13.2 Psychology Theories

Psychology theories on the other hand posit that taxpayers are influenced to comply with their tax obligations by psychological factors. They focus on the taxpayers' morals and ethics. The theories suggest that a taxpayer may comply even when the probability of detection is low. As opposed to the economic theories that emphasize increased audits and penalties as solutions to compliance issues, psychology theories lay emphasis on changing individual attitudes towards tax systems. Below are some psychological and sociological theories of tax compliance;

2.13.2a Institutional Anomie Theory (IAT)

This theory is based on the concept of sociological. The Anomie theory holds that individuals make decisions based on socialized values, which separately may be contradictory but together, balances each other out, producing behavior considered "normal" by society. When one holds an imbalanced set of values, decisions made on that set may produce deviant behavior, such as everyday crime (Itashiki, 2011). Institutional Anomie Theory highlights four theoretically derived sets of national



cultural dimensions likely to promote or suppress tax evasion. They include individualism, achievement orientation, assertiveness and humane orientation.

Individualistic cultural values set the stage for behaviors that emphasize the pursuit of firm self-interest, largely neglecting concern for ethical consequences. According to IAT, individualistic cultural values encourage firm's decision makers to choose goal achievement beyond concerns for the ethical or legal means to achieve goals (Bame-Aldred, Cullen, Martin & Parboteeah, 2011). Thus, in such societies, firms more willingly deviate from accepted norms and evade taxes. On the contrary, collectivist cultures favor allegiance to the greater collective rooted in the notion that societal members are interdependent (Triandis, 1995) and, as such, should deter individual gains at the expense of the collective. This suggests that individualistic cultural values should inflate temptations for firms to evade taxes.

2.13.2b Theory of Planned Behavior

The Theory of Planned Behavior (Figure 1) was proposed by Ajzen (1985) as an extension of the Theory of Reasoned Action, which had been proposed a decade earlier, by (Fishbein & Ajzen, 1975). According to the Theory of Reasoned Action, people are more likely to do a behavior if they evaluate the suggested behavior as having positive results (attitude) and if they think their significant others want them to perform the behavior (subjective norm). A high correlation of attitudes and subjective norms to behavior has been confirmed in many studies (Sheppard, Hartwick, & Warshaw, 1988). However, the same authors have raised a counterargument against the high relationship between attitude, subjective norms and behavior. They argued that because of circumstantial limitations, attitude and subjective norms do not always lead to behavior.



To improve on the predictive power of the Theory of Reasoned Action Ajzen added a new component "perceived behavioral control" to help account for behaviors that arise where an individual's control over the behavior is incomplete. By this, he extended the Theory of Reasoned Action to include the role of non-volition in predicting behavior. The extended version is called the Theory of Planned Behavior.

Behavioral, Normative and Control beliefs: In addition, the three predictors are determined as follows: Attitude is a function of behavioral belief or salient information, which is the perceived likelihood that performing the particular behavior will lead to certain consequences, weighted by the extent to which these consequences are valued. Subjective norm is a function of normative belief which is the perceived pressure from specified referents to perform the target behavior, weighted by the motivation to comply with the people one cares about. Perceived behavioral control is determined by control belief which is the perceived access to the necessary resources and opportunities to perform a behavior successfully, weighted by the perceived power or effect of the particular control factor

2.14 EMPIRICAL LITERATURE

2.14.1 Tax Knowledge and Tax Compliance

This section discusses the relevance and the role of tax knowledge, particularly in determining taxpayers' attitude towards taxation. Literature from prior studies, different approaches, a range of variables and findings would be discussed in this section.



The level of tax knowledge is of importance to the way people understand the reality underlying taxation and the associated attitude to taxation that is expressed (Palil, 2005). Education attainment is an important determinant of tax evasion (Richardson, 2006). It usually relates to a taxpayer's ability to understand and comply or not comply with tax laws (Jackson & Million, 1986). Enhancing the level of general fiscal knowledge may lead to improving tax compliance because of more perceptions about taxation. Increase knowledge of tax evasion opportunities has a negative influence on tax compliance as it assists non-compliance (Mukasa, 2011).

The influences of tax knowledge on tax compliance behaviour of taxpayers have been proven in prior researches (Mohamad Ali, Mustafa, & 2007). It has been argued by Jackson and Milliron (1986) that education has two elements; the general degree of fiscal knowledge and the specific degree of knowledge regarding tax evasion opportunities. Similarly, Harris (1989) divided tax knowledge into two aspects namely; knowledge through formal education in pursuing a course and knowledge specifically directed possible opportunities to evade tax. The general knowledge received by taxpayers is a key factor that contributes to the general understanding of tax laws and regulations (Eriksen & Fallan, 1996). Similarly, vast majority of studies examining the impact of education on tax evasion use taxpayers' general education level as the approach to measure attitude towards tax evasion (Richardson & Sawyer, 2001). According to Carners&Cuccia (1996) higher tax knowledge is assumed to lead to higher compliance rates.

Previous studies have shown evidence that general tax knowledge has a very close relationship with taxpayers' ability to comprehend the laws and regulations of taxation,



and their ability to comply with them (Singh, 2003). Given the evidence that tax knowledge affects taxpayers understanding, an obvious question that have been asked by previous researchers (Mukasa, 2011; Palil, 2010; Singh, 2003; Eriksen & Fallan, 1996; Harris, 1989) is whether improving taxpayers' knowledge will increase the level of tax compliance. In lieu of this, the relationship between tax knowledge and tax compliance is described here.

Mukasa (2011) concludes that there exists a significant positive relationship between tax knowledge and tax compliance. This implies that it is most likely that taxpayers' better understanding of tax matters will compel them to fulfill their tax obligation, and as such do not engage in tax evasion practices. Mukasa (2011) claimed that when small business taxpayers' knowledge about tax improves, then they are more likely to fulfill their tax obligation. Mukasa's study was divided into four main parts. Firstly, the study focused on relationship between tax knowledge and perceived tax fairness. Secondly, the research tries to establish the relationship between tax knowledge and tax compliance. Thirdly, it looks at perceived tax fairness and tax compliance and finally the study focuses on relationship between tax knowledge, perceived tax fairness and tax compliance.

In order to establish the relationship between tax knowledge and tax compliance the researcher used cross sectional research design and the approach was purely quantitative, involving descriptive and inferential analysis of the relationships. The study was conducted on 6200 SMEs in Kampala Central Division Comprising 5000 small businesses and 1200 Medium sized businesses. The researcher use a sample size of 361 respondents using stratified sampling to select respondents from both categories of



businesses. Specific tax knowledge was measured in relation to ability to calculate tax liabilities on income and wealth for different taxpayers in different situations. Specific tax knowledge combined information about tax rules with financial knowledge. The questions were framed in concrete terms to address specific tax knowledge issues while standard survey items denoted “abstract” were also used in assessing the general tax knowledge as used by Jonas (2003). The researcher measured tax compliance basing on four items used by Wenzel (2001) which included: Non-lodgment, tax debt, pay income and promptness.

The predominant result was indicating a significant positive relationship between tax knowledge and tax compliance. The positive relationship implies that as tax knowledge increases compliance level also increases. This result is in line with previous study by Palil (2010). Palil produces a similar result that tax knowledge has a significant impact on tax compliance using both indirect and hypothetical questions. Palil’s study was divided into two main parts. Firstly, the research focused on tax knowledge and tax compliance behaviour and the second one was on determinants at tax compliance. The researcher used national mail survey to distribute the questionnaires to a total number of 5,500 individual taxpayers selected at random from telephone directories throughout Malaysia. The study approach was purely quantitative. Tax knowledge was measured based on the following (i) taxpayers’ responsibilities and rights (ii) knowledge about employment income (iii) knowledge about dividend and interest (iv) knowledge about reliefs (v) knowledge about rebates and (vi) awareness of offences, penalties and fines.

From the study, the relationship between tax knowledge and tax compliance direct questions shows that knowledge about child relief; responsibilities and rebates appear to



be significantly correlated with tax compliance. An estimated co-efficient of correlation between (R = 0.36) shows a reasonable linear correlation between tax knowledge and tax compliance. Furthermore, the Estimated Coefficient of determination, R^2 is 0.13 indicating that 13% variance of tax compliance was explained by the variance of tax knowledge. These positive relationships illustrate that taxpayers with tax knowledge potentially tend to be more compliant.

However, Loo and Ho (2005) study produced a counter result in their study in Malaysia from a random mail survey of 250 questionnaires. The researcher wanted to examine salaried individual competency in self-Assessment system in and prior to 2003 and in and after 2004. In their study, tax knowledge was measured in terms of chargeable income, exemptions, reliefs, rebates and tax credits. The result of the study indicated that although the respondents have attained tertiary education yet, their tax knowledge in relation to personal taxation was considered to be relatively low thus making them incompetent and not ready to exercise appropriate compliance.

In contrast, Eriksen and Fallan (1996) claimed that knowledge about tax law is assumed to be of more important for preferences and attitude towards taxation. Their study was divided into three main parts. Firstly, the study focused on taxpayers' knowledge. Secondly, the research tries to reveal the overall effect of tax knowledge on tax compliance behavior and finally, the research involves tax agent's influence in ascertaining taxpayers' behaviour. They conducted their study through quasi-experiment with pre and post – testing of two different students groups. The pre-test included 149 student whilst the post-test included 123 students. Tax knowledge was measured using a score calculated form 12 questions and 28 questions concerning tax allowances and tax



liabilities for the pre and post-testing respectively. The result of the study suggested that tax knowledge has a positive correlation with perception of fairness, tax ethics and attitudes to others' tax evasion. According to Eriksen and Fallan (1996) tax attitudes can be improved through better tax knowledge and thus turn to increase compliance and reduce inclination to evade taxes

However, Collins, Million, and Toy, (1992) study in the United States from a random mail survey at 700 households from telephone directories. Out of 220 usable responses, Collins et. al., found that tax knowledge and the level of education were negatively correlated about tax law. In conclusion, considering the findings from previous studies, it is obvious that improving taxpayers' knowledge is an important element in operating a successful tax system particularly on small and medium taxpayers. In order to achieve the revenue target of government, taxpayers need to be well educated, informed on tax related issues.

2.14.2 Factors influencing the level of tax compliance

The overall level of tax compliance in a country is determined by a number of factors.

These are partly business-related and partly reflect the economic and social environments. The educational level of MSE/SME operators, the general tax morale in the country, and the fear of the tax authority can also be important factors in this regard.

Research carried out by the OECD has produced the following list of key determinants for the tax compliance behavior of businesses:



Table 5: Factors Influencing the Compliance Behavior of Businesses

Category	Generic characteristics
Business profile	Structure – sole trader, partnership, company, trust Size and age of the business Type of activity carried out Business focus – local versus international Financial data – capital investment Business intermediaries
Industry factors	Definition/size of the industry Major participants in the industry Profit margins Cost structures Industry regulation Working patterns Industry issues such as level of competition, seasonal factors and infrastructure issues
Sociological factors	Cultural norms Ethnic background Attitude to government Age and gender Educational level
Economic factors	Investment Demographic interest rates



	The tax system Government policies International influence Inflation Markets
Psychological factors	Greed, risk, fear, trust Values Fairness/equity Opportunity to evade

Source: OECD, Compliance risk management

On the basis of the general impact of external factors on the tax compliance attitude of the SME community, combined with personal characteristics (e.g. level of risk aversion) of the individual SME operator, four levels of taxpayer compliance attitudes can be distinguished.

1. **The disengaged:** At the peak is an attitude of disengagement. It characterizes those who have decided not to comply. People with this attitude either deliberately evade their responsibilities or choose to opt out. Cynicism about the tax system is usually matched by cynicism about the role of government.

2. **Resisters:** The attitude of resistance characterizes active confrontation. The system is seen as oppressive, burdensome, and inflexible. This attitude characterizes those who don't want to comply but who will if they can be persuaded that their concerns are being addressed.



3. **Triers:** Those who are basically willing to comply have a more positive attitude.

But they also have difficulty complying and don't always succeed. They may have difficulty understanding or meeting their obligations, but their expectation is that, in any dispute, trust besides cooperation will prevail.

4. **Supporters:** The attitude here is one of willingness to do the right thing. There is a conscious commitment to support the system and accept and manage effectively its demands. There is an acceptance of the legitimacy of the role of tax officers and a belief that they are fundamentally trustworthy.

2.14.3 Financial condition as a moderator for attitude and tax compliance

The inconsistency of findings on the relationship between tax compliance and some of its determinants most especially the deterrents factors (Dubin et al., 1987), has encouraged suggestion in the literature that the relationship may be moderated by certain variables (Kirchler et al., 2007). There are indications in other behavioural studies that financial (requirement) and family obligations moderate the relationship individuals' commitment and performance (Brett et al., 1995). Empirically, some behavioural studies have shown support for the moderating effects of financial requirement on individual's behaviour (Brett et al., 1995).

The implication of moderating effect of individual financial condition on tax compliance and its determinants may be more obvious in the society where there is high family responsibility and poverty rate as the case in some developing countries including Ghana (Brett et al., 1995). Therefore, financial condition of individual may have positive or negative effect on the relationship between his/her attitude and compliance behaviour. Bloomquist (2003) identified financial strain as one of the sources of taxpayer's stress



and said that individual taxpayer with little financial resources may be tempted by his bad financial condition to be noncompliant where the expenses of his household are more than his income.

2.14.4 Risk preference as a moderator for attitude and tax compliance

One attribute of an individual is his Risk preference behaviour that influences his actions to tax (Sitkin and Pablo, 1992). In a complete conceptualization of risk preference, three models are possible. These include: risk aversion, risk neutrality and risk seeking. A number of researchers and scholars have suggested that the attitude of taxpayer to risk cannot be underestimated in his/her compliance behaviour. Torgler (2007) submitted that individual taxpayers' decision could be affected by their attitude toward risk. Individual risk preference is one of the components of several theories relating to decision making including tax compliance theories like expected utility theory, prospect theory etc. Individual by nature tends to be inconsistent in their decision making as a result of changing situation. Therefore, when attitude and tax compliance are predicted to have strong positive relationship it may not be so because of the effect of individual taxpayers' risk preference which varies according to situation and individual to individual

In countries with a high percentage of MSE operators who fall under the categories of supporters and triers, one can expect a direct and visible impact of compliance facilitation initiatives on the actual level of voluntary tax compliance.



Noticeable improvements in the compliance behavior of resisters require a broader set of measures, comprising in particular of strengthening tax enforcement capacity and developing programs to change their overall attitude towards government.

2.14.5 Tax Laws and Enforcement Strategies

In the Domestic Tax Division, efficient application of the tax laws has a direct impact on the tax collection performance. The following penalties and in some cases criminal liability apply for the under listed offences. Penalties have been prescribed for offences committed by authorized and unauthorized persons and entities. Under the fines (penalty units) Act 2000 (Act 572) as amended by LI 1813, a penalty unit is equal to GH¢ 12.00

Table 6: Offences and Penalties

Offences	Penalties
1.Failure to keep books of accounts	1.5% of the amount of tax payable
2.Failure to furnish a return	2. Individual pay ¢1.00 and company pays ¢2.00 for each day of default.
3. Failure to pay tax on due date	3. Where the default is not more than 3month, 10% of tax payable but 3 or more months is 20%
4. Understating estimated tax payable by installment	4. 30% where estimate is less than 90% of chargeable income.
5. Making false or misleading statements	5. Double or three times of the amount of underpayment of the tax may result.



6. Aiding and abetting	6. Three times of the amount of the underpayment.
7. Failure to comply with the Act	7. Where resulting underpayment is more than 500.00, 50-300 penalty units may be applied.
8. Failure to withhold tax	8. Personal liability to pay the commissioner the tax due but not withheld.

Source: Collection Manual, IRS: 1996

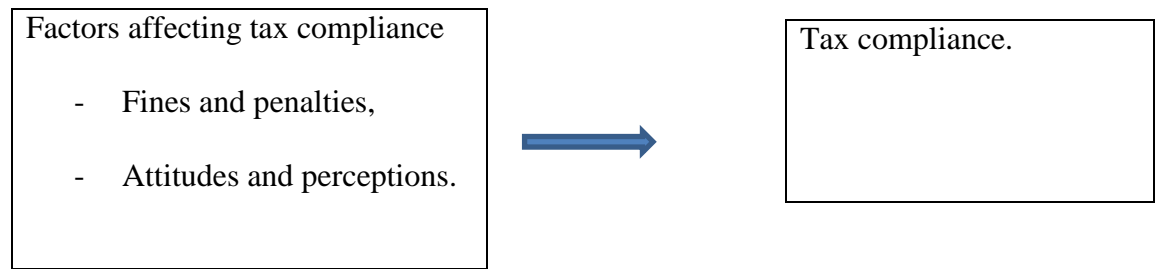
Whether these penalties are rightly applied by the tax office is the matter of concern to this research. It must be emphasized that the offences and their penalties alone may not work without proper employee enforcement strategies including staff motivation.

2.15 Conceptual Framework

This study adopted a conceptual framework where factors affecting tax compliance were taken as independent variables while tax compliance was taken as dependent variable. This is illustrated in the conceptual figure below.



Figure 1: Factors affecting tax compliance



2.16 Conclusions

The literature review highlighted a number emergent issues or lessons.

Firstly, it is observed that studies on Small and Medium Enterprises (SMEs) tax compliance level in developing countries for which Ghana is very limited. The few studies conducted used stratified sampling procedure as their basis of sampling technique to select the respondents (Chebusit et. al., 2014; Nkuah et. al., 2013; Mukasa, 2011). The basis for the use of this technique is the nature of heterogeneity of SMEs. Most of the studies were purely quantitative. However, a study conducted by Chebusit et al., (2014) on compliance of SMEs in Kitale-Kenya adopted a descriptive research design involving both qualitative and quantitative research methodology. Their study also used stratified as well as simple random sampling together with purposive sampling techniques.

In the case of Mukasa (2011), the researcher used a cross sectional design and purely quantitative. A stratified sampling was used to select 361 respondents from a target population of 6200 SMEs. Similar to Chebusit et al., (2014) questionnaires were administered to collect primary data, and analyzed using SPSS applying descriptive and



inferential analysis. In contrast, Mukasa's study used secondary data in addition to the primary data collected. On measurement, Mukasa (2011) measured tax knowledge in relation to ability to calculate tax liabilities on income and wealth for different tax payers in different situations. Tax compliance on the other hand, was measured based on; non-lodgment, tax debt, pay income and promptness.

Furthermore, Palil (2010) study on factors affecting tax compliance behavior in Self-assessment system in Malaysia was carried out through a national mail survey. The study was purely quantitative since hypotheses were formulated on the relationship between tax knowledge and tax compliances as well as the various determinants of tax compliance. A total number of 5500 mail surveys were distributed to individual taxpayers throughout Malaysia. The selection was done at random from telephone directories. The data collected was analysed predominantly by t-test, one-way analysis of variance (ANOVA), multiple regressions and stepwise multiple regressions. On measurement of variables, tax knowledge was measured based on the variables stated in section 2.7. On the determinants of tax compliance, a total of nine variables were used and it includes: Probability of being audited ; Perception of government spending; Perception of equity and fairness; Penalty; Financial constraint; Changes to current government policies; Referral group; The role of the tax authority and Tax knowledge.

From the literature, it is observed that there is no unique definition of small and medium enterprises. Every researcher defines it based on the characteristics of the various businesses in their respective countries. This lack of uniqueness may affect comparability of findings from different countries. Furthermore, those researchers like Mukasa (2011) application of only stratified sampling technique may not after all be



fully representative of the SMEs because, small businesses may be in the form of sole proprietorship, partnership and Limited Liability Company with the sole proprietorship dominating.

In addition, the establishment of tax compliance among SMEs may not be accurately ascertained due to the differences in the taxation of the various categories of the SMEs. For instance, sole proprietorship and partnership business are taxed using the graduated tax table in Ghanaian perspective whilst companies are taxed as a corporate entity. In the light of the above, further investigation is required to establish the tax compliance level of SMEs.

Conclusion the chapter reviewed the relevant literature on the research problem. In the first place, the study looks at the Ghanaian tax system focusing on the types of taxes. Further, definitions and characteristics of SMEs were looked at before looking at the concepts of tax compliance. Two theories of tax compliance were reviewed (economic based and sociological and psychological theories). Out of the two theories, the sociological and psychological theory was adopted for the study since the study is looking at the perception of owners/managers of SMEs behavior towards tax compliance. Finally the study reviewed the empirical evidence on tax knowledge, factors affecting tax compliance and measures tax authorities adopt to encourage compliance as well as the relationship between tax compliance and tax knowledge.



CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This section of the study describes the research methodology that was employed to collect relevant data for the study. It deals with the research design, the population, sample size and sampling procedure, research instruments, data collection procedure and data analysis.

3.2 Background of Study Area

Tamale is the capital town of the Northern Region of Ghana. It is Ghana's third city and the second largest by area and has for some time now been categorized among the fastest growing cities in West Africa. The town is located 600 km north of Accra. As of 2012, the population of the Metropolis was projected to be 444,074 people.

Tamale is one of the six Metropolitan Assemblies in the country and the only Metropolis in the Northern sector of Ghana. It is both the administrative capital of the region and the capital of the Metropolis. The Tamale Metropolis is one of the 26 administrative districts in the Northern Region. It is located in the central part of the Northern Region and shares boundaries with five other districts namely the Savelugu- Nanton and Sagnarigu districts to the North, Yendi Municipal Assembly to the East, Tolon-Kumbungu to the West, Central Gonja to the South West and East Ganja to the South.



Due to Tamale's central location, it serves as a hub for all administrative and commercial activities in Northern region, thus making it home to several kinds of SME's. The central business district is also home to regional branches of several financial institutions.

There has been an increase in growth in the local economy with the expansion of Small and Medium Scale Enterprise development that has led to a reduction in the high unemployment rates. Majority of the working class are engaged in agriculture and related activities such as sales, services, transport and production. As stated earlier, majority of the populace are engaged in the sale of food items (processed food by the road side such as kenkey, rice fried/cooked/roasted yam, 'tuo zaafi', 'gabile' etc) and non-processed food items such as vegetables and fruits, the sale of second hand clothes, sandals and shoes, household appliances and the provision of services such as the repair of bicycles, motor bikes, vehicles, jewelry, electrical appliances, among others.

3.3 Research Design

The study employed descriptive survey. Creswell (2003) defines descriptive survey as a method of collecting data for the purpose of testing hypothesis or answering research questions concerning the current status of the subjects under study. In the opinion of Cohen and Marion (1999) descriptive survey is a design used to gather data at a particular point in time with the intention of describing the nature of existing conditions or identifying standards against which existing conditions can be compared or determining the relationship that exist between events. Thus, a descriptive study is undertaken in order to ascertain and be able to describe the characteristics of the variables of interest in a situation. This is done through the use of strategies and



procedures to describe, clarify and interpret existing variables that constitute a phenomenon.

Descriptive survey is associated with some disadvantages. Setert and Hofnung (1997) maintained that there is the difficulty of ensuring that the questions to be answered in descriptive survey are clear and not misleading. This is so because survey reports can vary significantly because of the exact wording of questions. Newman (2003) also claims that the method may produce unreliable results because questions asked eat into private matters that people may not be willing to talk about.

The above disadvantages notwithstanding, the descriptive survey is found to be most appropriate for the study. This is largely due to the fact that the design is considered to be relatively easy to conduct because data are fairly easy to obtain and interpret by the use of simple descriptive statistics (Blaike 2000; Sarantakos, 2006). The present study will adopt the descriptive design because it has the advantage of producing a good amount of responses from a wide range of managers, collectors, assessors and the taxpaying public in the Tamale Metropolis on issues concerning effectiveness and efficiency in tax collection.

3.4 Specific Study Design

There are several study designs that can be used. Firstly, descriptive survey – this is used to describe a situation, phenomenon, attitudes, behaviour, beliefs as well as opinions of people. This design can be used as a pre-cursor to more quantitative research design with the general overview giving some valuable pointers. Furthermore, the approach collects a large amount of data for detailed analysis (Anastas, 1999). Similarly it can yield a rich data that lead to important recommendation in practice, and can be a useful tool in



developing a more focus study (Anastas, 1999). However, this design cannot be used to discover a definite answer or to disprove a hypothesis, and is heavily dependent on the instrumentation for measurement of objectives.

Secondly, a cross-sectional design is usually used when the population is large, and it focuses on snapshot, one point in time to explore, describe or explain a given situation. Another design that could be used is correlation design which discovers, and establishes relationships / interdependence between and among variables. The design however, is incapable of establishing cause-and-effect just like the cross-sectional design. In addition, the cross-sectional study results are static and time bound, and as such cannot indicate sequence of events or historical or temporal context (Hall, 2008).

Empirical evidence shows that Mukasa (2011) adopted cross-sectional design since the target population of that study was 5,000 SMEs. Similarly, Asaph (2011) also used the cross-sectional design together with explanatory and analytical designs. In the same vein as Mukasa (2011), the target population was 3280 SMEs. However, Atawodi and Ojeka (2012) and Palil (2010) both used the survey design in their respective studies.

In the light of above theoretical and empirical evidence, the study used descriptive survey together with correlation design to answer the research questions since the study is focus on attitude and behaviour of taxpayers on tax compliance, and to establish relationship between tax knowledge and tax compliance.

3.5 Study population

The study population consists of all small and medium registered taxpayers with Ghana Revenue Authority (GRA). There are 861 active registered Small and Medium



Enterprises in the Tamale Metropolis with a composition of 678 small taxpayers and 183 medium tax payers (list obtain form both the STO and MTO of the Ghana Revenue Authority-Tamale). Therefore, the target population is 861.

3.6 Sampling Techniques

Sekaran (2003) wrote that sampling is the process of selecting a sufficient number of elements from a population so that by studying the sample and understanding the properties or characteristics of the sample, researchers will be able to generalize the properties of the sample to the population. Convenience sampling was used to select the respondents. With this, sampling is chosen for ease or convenience rather through random sampling. This is often used at least in pilot studies or short term projects where is insufficient time to construct a probability sample.

This ensured that all categories of employees and customers have the chance of being selected as respondent. It was used to ensure greater representation thus, avoiding any significant bias on the part of the researchers.

3.7 Sampling Technique

The units of analysis for this study are small and medium enterprises. Both probability and non-probability sampling was used in this study. Probability sampling is a method of sampling that utilizes some form of random selection. In order to have a random selection method, you must set up some process or procedures that assure that the units in the population have equal probability of being chosen. The type of probability sampling that was used is the systematic sampling method.



Systematic sampling is a statistical method involving the selection of elements from an ordered sampling frame. With systematic sampling, it starts by selecting an element from the list at random and then every k^{th} element in the frame is selected where k , the sampling interval is calculated. This type of sampling will be used to interview the SMEs. By using the systematic sampling, after the first (1st) SME owner is interviewed, every 5th SME owner will be interviewed until we reach the sample size of 255.

Non-probability sampling technique is where samples are gathered in a process that does not give all the individuals in the population equal chance of being selected. Subjects in a non-probability sample are usually selected on the basis of their accessibility or by the purposive personal judgment of the researcher. Purposive sampling on the other hand is a technique whereby a researcher chooses the subjects who in his/her opinion are relevant to the study. With this study, tax authorities were purposively selected to provide information on the tax paying culture of SMEs in the Metropolis.

3.8 Sampling Method

Considering the fact that the study covers such a large sector, not all the respondents can be included in the study. It is thus significant to draw a sample from the population. Both the probability and non-probability methods were employed to select the sample for the study.

In terms of the non-probability method, the purposive sampling method was used to select staff of the Domestic Tax Division office in the metropolis Tax office. In the tax Office, three officers were selected namely, the District Manager, Assessor and Collector. The purposive sampling method is used because it is deemed the appropriate



means of getting respondents who are knowledgeable and well abreast with the subject matter of interest (Sarantakos, 2006).

The probability method was used to select respondents from the SME taxpaying public for the study. In order to get a sample size from the taxpaying population, the Fisher, Laing, Stoeckel and Townsend (1998) formula for determining sample size is employed to select from a population of 861 tax payers at the end of December, 2010. This formula is given as:

$$n = z^2 pq / d^2$$

Where:

n= the desired sample size

z= the standard normal deviation, usually set at 1.96 which corresponds to 95 percent confidence level;

p= the proportion of the target population that have desired characteristics; (effectiveness and efficiency)

q= 1.0-p; and

d= the degree of accuracy desired, this is usually set at 0.05

Assuming the percentage of SME taxpaying public who pay their taxes (p) is 84.5% which is equivalent to 0.845, with the z statistic being 1.96 and the degree of accuracy set at 0.05, then the sample size (n) for the three offices were as follows:

$$n = (1.96)^2 (0.845) (0.155)$$

$$0.052$$

$$n = 200$$



The calculated sample size (n) of 200 members of the taxpaying public was selected for the study. In addition, the three staff from the various offices was added to the taxpaying public which brings the total sample for the study to 203.

3.9 Data Collection

This section discusses the data sources, instruments used in collecting the data from the respondents and the main questionnaires design.

3.10 Sources of Data

Data for the study was collected from both primary and secondary sources. The administration of questionnaires forms the basis for primary data. Data collected from this source was centered on the background characteristics of respondents, identification of reasons for voluntary tax compliance, reasons for low collection of taxes, challenges involved in the collection of taxes and the ways of ensuring that tax collection in the Metropolis is made effective and efficient.

Secondary data were collected from documents of Internal Revenue Service (IRS) /Ghana Revenue Authority (GRA) and Ghana Statistical Service (GSS) on the level of tax contributions and the current size of SMEs in the metropolis.

3.11 Data collection procedure and instrument

This study, to a very large extent, used primary data and where necessary some secondary data.

Researchers have established the fact that informal sector entrepreneurs are very averse to talking to ‘unknown persons’ on their tax payments as most of the informal sector



operators fail to discharge their tax obligations. Informal sector operators, therefore, do not willingly and easily divulge information about their tax obligations for fear of being discovered and made to face the sanctions for non-compliance with the income tax laws. Again, developing empirical research on informal sector economies offers a number of major challenges and difficulties. The lack of conceptual clarity and the presence of disciplinary functionalism have created considerable difficulties in formulating an appropriate methodological perspective from which to study the phenomenon (i.e. informal sector) (Ferman, et al 1987).

3.11.1 The main questionnaire design

A structured survey questionnaire with unambiguous questions was used to limit and ease the analysis of response-variation among interviewees. A number of question formats were used in designing questionnaire so as to elicit appropriate information from the respondents.

Closed- and open-ended questions and multiple choice questions were mostly used to limit the interviewee to choices to be selected from. Closed-ended questions were largely used because of the fact that a majority of the SME sector is 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 SME 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 SME sector were unlettered and very averse towards tax issues, and therefore used interviewer-administered questionnaire (i.e. where the researcher completed a questionnaire on the basis of the respondent's answers) in about 70% cases while the rest were self-administered questionnaires (i.e. questionnaire completed by the respondents themselves).

3.11.2 Personal interviews

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

3.12 Data analysis procedure

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



CHAPTER FOUR

RESULTS AND DISCUSSIONS

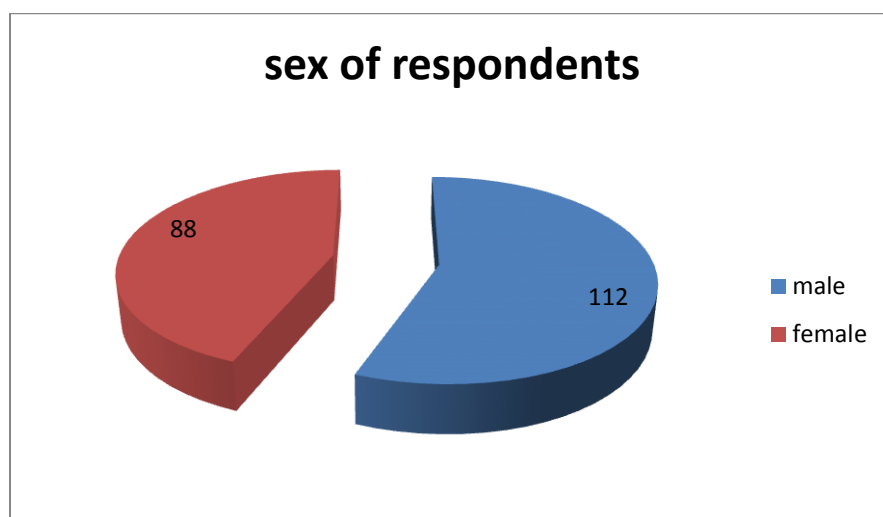
4.1 Introduction

This chapter presents the results and findings of the study. A detailed description of demographic and socioeconomic characteristics of SMEs as well as their knowledge and compliance attitudes to tax in the Tamale Metropolis of the Northern Region is presented. Data was collected from two hundred (200) SMEs in the Tamale Metropolis. Further results on the factors affecting tax compliance have also been presented.

4.2 Analysis of Demographics

From the data collected, 112 respondents of SMEs representing 56% were owned and managed by males, while 88 SMEs representing 46% were owned and managed by females. This is represented in figure 2 below. This represents a fairly reasonably distributed gender ratio of SMEs around Tamale.

Figure 2: Sex of Respondents

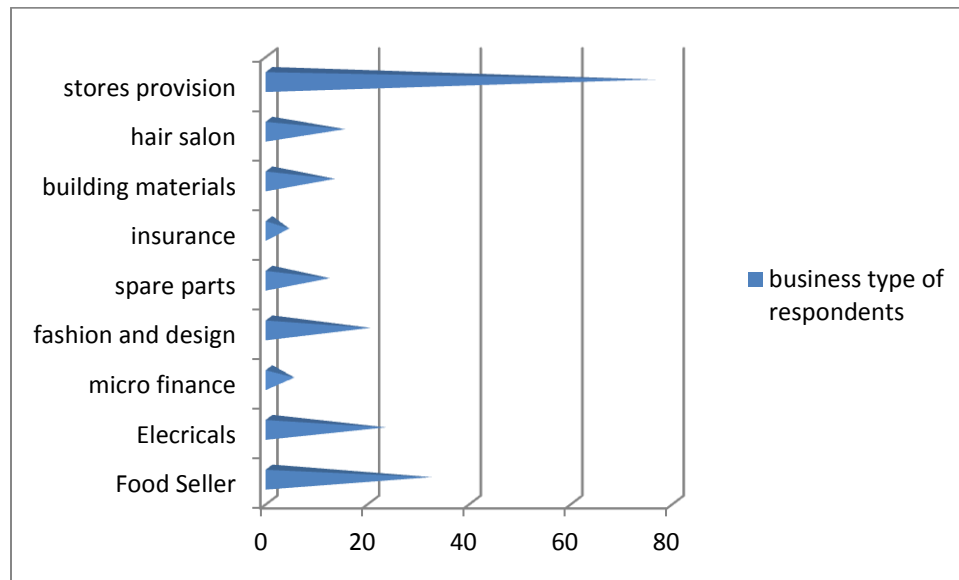


Source: Field Survey, 2016



It was however discovered that a greater percentage of SMEs in Tamale Metropolis are owned by private people as 100% of the respondents were private entities. The figure 3 below summarizes the business type engaged by respondents in the Tamale Metropolis.

Figure 3: Respondents by Business types



Source: Field Survey, 2016

From the figure 3 above 32 (16%) of the respondents stated that their business type was food vending. This is typical of the Tamale Metropolis as most business undertaking by a greater majority of women is food vending. The study revealed that provision stores accounted for the highest majority of business undertaking by respondents with a high percentage of 38%. Electrical and hair salon recorded 11.5% each. Micro finance and insurance were the least recorded businesses of respondents with 2.5% and 2% respectively. The study also included in the sample Fashion and design workers which accounted for about 10% of the total respondents. There were also spare parts dealers and building material sellers constituting 6% and 3% respectively.

The SMEs were at different stages of development with some being older and hence more established than others – 26% of them were new businesses with an age range of



0-3 years, 42% had an age range of 4-7 years and 32% of the SMEs were more established businesses being 8 years old and over. The average age of SMEs was 6.56 with a minimum and maximum ages being 1 and 17 years respectively. This is presented in table 7 below:

Table 7: Descriptive Statistics

Descriptive Statistics						
	N	Minimum	Maximum	Mean	Std. Deviation	
Years in business	200	1	34	6.56	4.107	
Age of respondent	200	25	80	39.27	10.906	
Years of Education	200	1	22	7.94	5.203	

Source: Field survey, 2016

From table 7 above, the average age of respondents were 39.27 years and the minimum and maximum being 25 and 80 years respectively. Those who were older than the average age group, was found to be generally knowledgeable with tax rules and regulations. 20% percent of the respondents were below 30 years, which shows that young people are starting businesses. 46% of the respondents were between 30- 40 years and the remaining 34% of SME owners were over 40 years. There was however no relationship between age and tax compliance. There was no evidence that one's age influenced compliance from the logit regression model of compliance. The average years of education of SME owners were 7.49. This indicates that, most of the SME

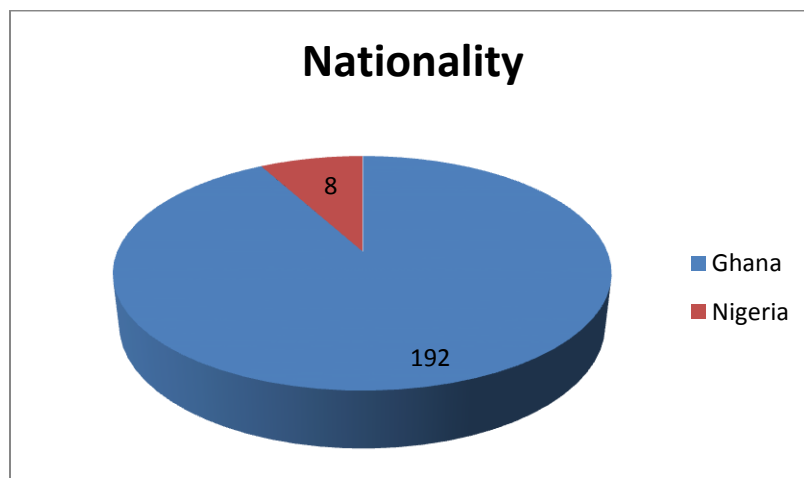


owners have attained basic education with few having Diploma and Degrees. There was a strong relationship between education level and tax compliance.

From the research, 184 respondents (92%) are nationals of Ghana while 16 respondents (8%) are Foreigners, particularly Nigerians. This means it can be said with certainty that a large percentage of SMEs in Tamale Metropolis are nationals of Ghana.

This is represented in figure 4 below.

Figure 4: Nationality of Respondents



Source: Field Survey, 2016

There was however no relationship between tax compliance and one's nationality.

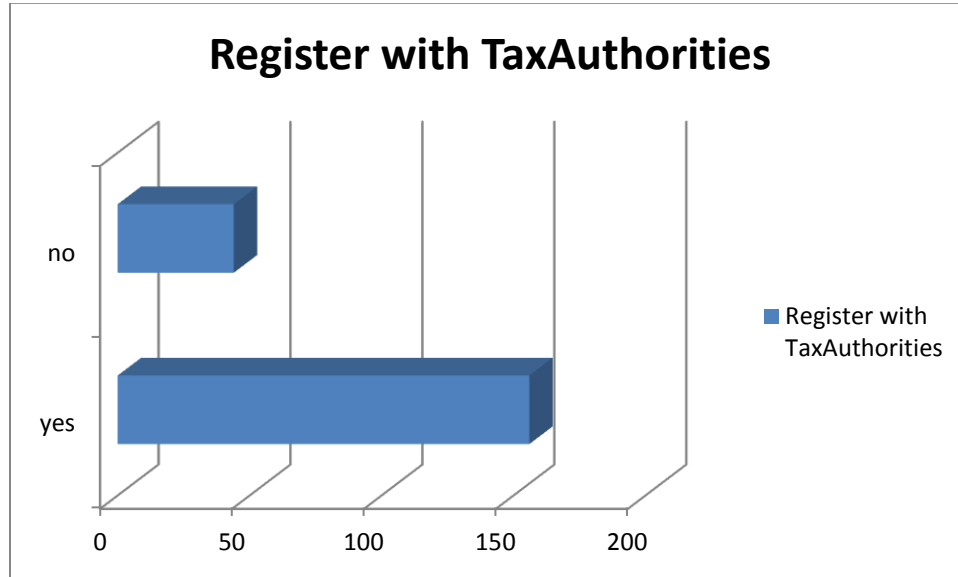
4.3 Analysis of Awareness and Knowledge of Tax Laws and Regulations by SMES

Respondents were asked whether they are registered with relevant tax authorities in Ghana. According to Razack&Adafula (2013) about 79% of SMEs in the Tamale Metropolis have had their businesses registered with the Domestic Tax Revenue Division of the Ghana Revenue Authority.



The table below summarizes the findings of this study about SMEs registration with relevant Tax authorities as backed by the literature cited above:

Figure 5: Tax Registration



Source: Field Survey, 2016

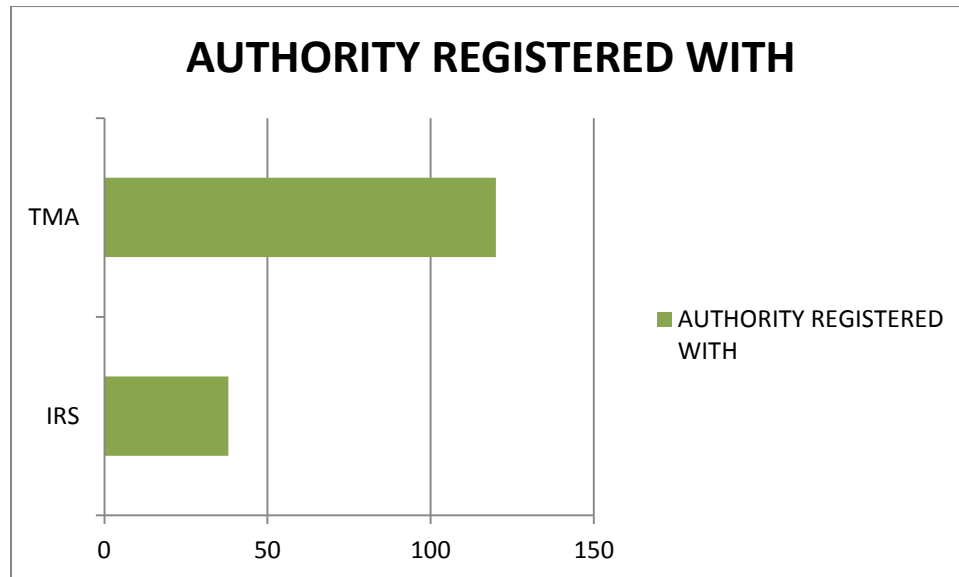
From the figure above 158 of the respondents representing 79% are registered while only 26% of the sampled respondents of SMEs are unregistered. The majority have registered since it was required of them to do so at the workplace while for others it is because of lack of understanding of the requirements imposed upon them by the Government.

With regard to the Authority registered with, all the 76% of the 158 respondents who registered have registered with the Tamale Metropolitan Assembly and about 24% revealed that they have registered with the Ghana Revenue Authority (GRA). The results are shown in the next page below:

This is contained in the figure 6 below:



Figure 6: Authority Registered with



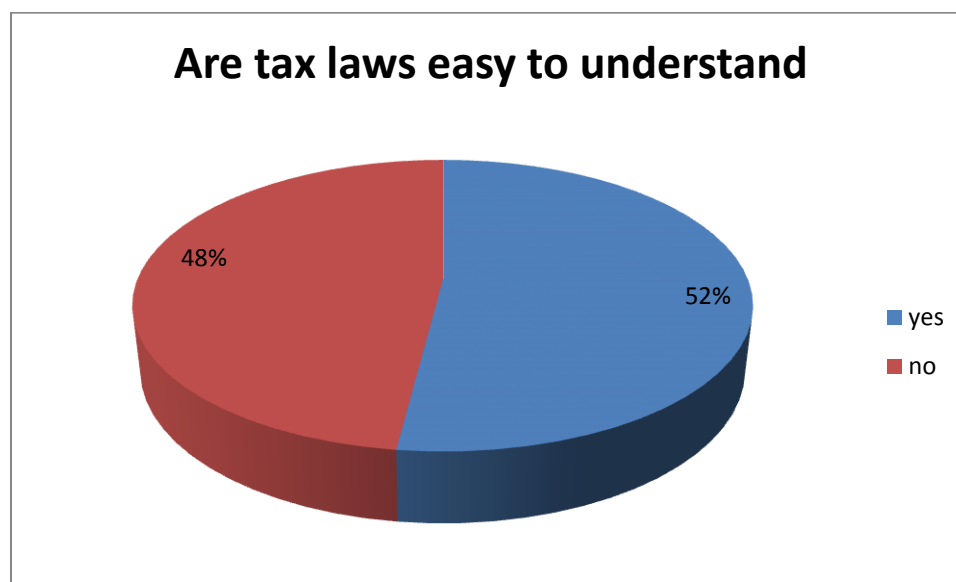
Source: Field Survey, 2016

Respondents were asked whether tax laws in Ghana are difficult to understand. From the responses gathered 102(52%) of the respondents agreed that tax laws in Ghana are easy to understand whiles 98 respondents representing 48% asserted that tax laws and regulations in Ghana are difficult to understand.



The responses are shown in figure 7 below:

Figure 7: Understanding of Tax Laws



Source: Field Survey, 2016

Tax knowledge is significantly correlated with tax compliant attitude in Africa. An increase in the extent of difficulty to know the type of taxes to pay by one point reduces the probability of tax compliance attitude by 4% and 10%. Andreoni, Erard and Feinstein (1998), stated that the understanding of the tax laws had significant relationship to tax compliance, because if taxpayers understand the tax laws that taxpayers can comply with their tax obligations correctly, so that tax laws should be made as simple as possible in order not to complicate the taxpayer. In the opinion of Krause cited Santoso (2008) that the taxpayer's knowledge or understanding of the tax laws may affect whether or not abiding taxpayers. Krause opinion is in line with the OECD (2001) which states that understanding the taxpayer will determine the level of tax compliance.

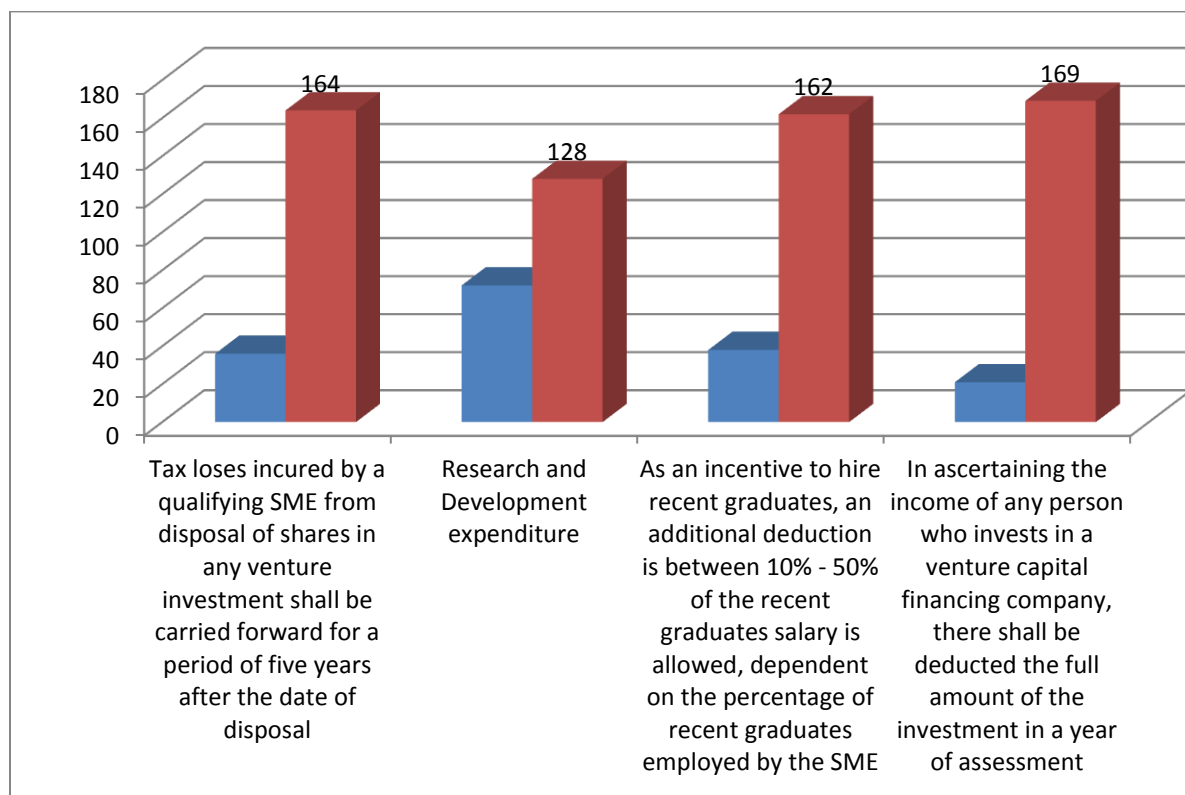


On the issue of understanding of the tax laws, a greater number of people demonstrated poor understanding of the tax laws. There was strong agreement that, the tax laws are written in a language that is difficult to understand and to apply.

4.3.1 Respondents' knowledge on some tax regulations

Respondents were asked to indicate whether they know some of the rules and regulations of tax in Ghana. The figure 8 below shows the responses gathered from the research.

Figure 8: Respondents' knowledge on some tax regulations



Source: Field Survey, 2016

From the figure 8 above, the study revealed that, most of the aspects of tax regulations and laws in Ghana are not understood by respondents particularly SME,s in the Tamale



Metropolis. With respect to their knowledge on Tax losses incurred by a qualifying SME from disposal of shares in any venture investment shall be carried forward for a period of five years after the date of disposal, only 36 (18%) of the respondent responded yes, indicating that they know the regulation and the rest of the 82% do not know the regulation. Again the study revealed that, 64% of the respondents do not know that tax deductions are applied on SMEs embarking on research and development expenditure. The study further ascertained that as many as 86 % of the SMEs in the Tamale Metropolis do not know that as an incentive to hire recent graduates, an additional deduction is between 10%-50% of the recent graduates salary is allowed dependent on the percentage of recent graduates employed by the company or enterprise. This shows one of the reasons why graduates unemployment levels in Ghana is fast ascending.

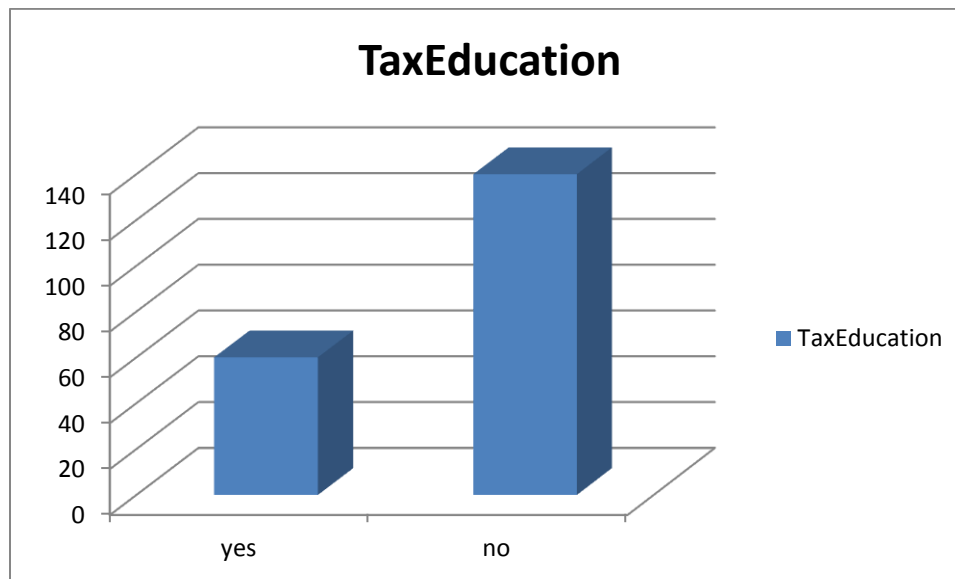
High awareness by the society would encourage people to fulfill their obligations to register as taxpayer reporting and paying taxes properly as forms of national and civic responsibility. Most citizens do not have much understanding of what tax laws mean and why the tax system is structured and administered as it is Braithwaite, V. (2007). Palil, M.R. (2010) states that tax knowledge reveal that there is a relationship with taxpayers' ability to understand the laws and regulation of taxation and their ability to comply. In this study, SMEs did not consider local authority levies to be different from government taxes because they lacked tax knowledge.

With regards to whether the usually get tax education from the tax authorities, 140 of the respondents representing 70% indicated that they have not received any form of tax education from the tax authorities for the past one year. Only 60 representing 30% of the respondents have indicated that they have received some form tax education for the past



one year. These are the SMEs which have good formal structures and are more organized. The is presented in the figure 9 below;

Figure 9: Educational level of SMEs on Tax issues



Source: Field Survey, 2016

4.4 Factors affecting Compliance with Tax Laws among SMEs

Respondents were asked to among of other things, their level of agreement with some factors that affect compliance with tax laws. These questions have five options from 1-5. Option 1 indicates strong disagreement to option 5 with strong agreement. Point of neutrality is at point 3. Any mean value greater than 3 indicates some level of agreement and mean value below 3 also indicates disagreement. From the table 4.2 below, respondents agreed that higher tax rates affects compliance with tax laws with a mean value of 3.78 and a standard deviation of 0.1512. Again from the research, respondents do not agree that poor morale and tax mentality of citizens affects compliance with tax laws.

Summarized below are the results in table 8;



Table 8: Factors affecting compliance with tax laws

Factors	N	Mean	Standard dev
High tax rates are the primary problem of tax payers	200	4.78	0.151967
Poor tax morale and tax mentality of citizens	200	2.36	0.163532
Inappropriate public expenditure to the preferences of tax payers	200	4.02	0.174473
Disbelief in the existence of effective public spending inability to pay principle	200	4.28	0.148571
Non compliance of tax payers due to unfriendly state- citizen relations	200	3.82	0.187006
Poor structure of the tax system and tax administration that does not meet the expectation and needs of tax payers	200	2.36	0.184634
Non compliance of tax payers due to economic and political structures	200	2.8	0.171429
Low level of governmental accountability and transparency	200	3.92	0.158668

Source: Field Survey, 2016

Reduction in tax rates increases the profit margin of SMES as well as intensifying government tax revenues since such provisions reduce the size of the shadow economy, Vasak (2008). Complex tax systems distort the development of SMES and often result in



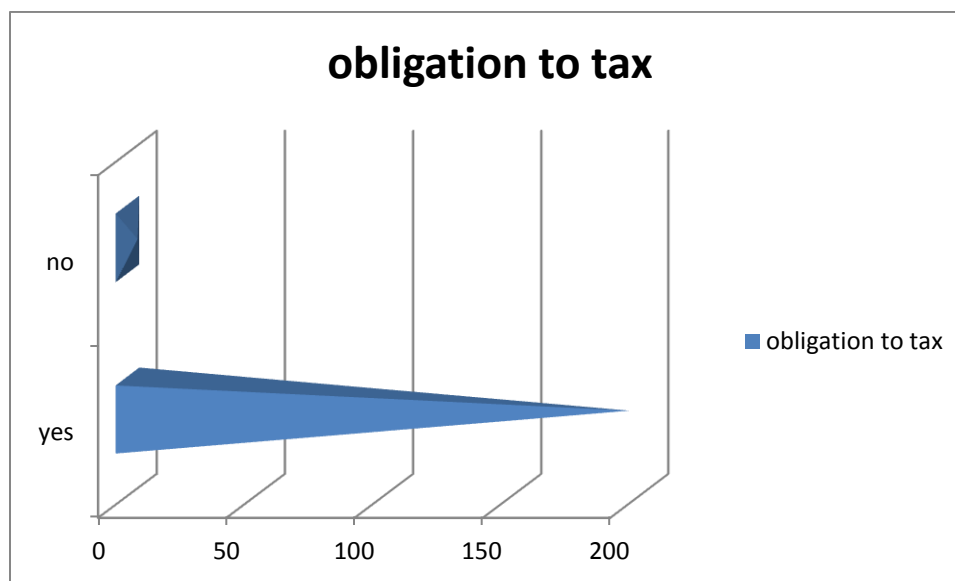
the morphing of groups that offer a lower or no tax burden hence resulting in tax systems that levies high expenses on the economy Masato (2009). Poor implementation of tax policies connote high collection charges, low efficiency, time wastage for taxpayers and staff, deviation from optimum allocation of resources and low amount of tax revenues Farzbod (2000).

The strongest agreement in terms of the mean scores (4.28) was that collected taxes are not well-spent as public service in Ghana. In other words, respondents thought that they are not moderately benefiting from public funds the Government gets from tax revenue. Citizens usually expect that collected taxes & other public funds must be used by government rational, equitable & economical. If they believe that public funds are used wasteful by government, their subjective feelings about tax burden increase more and more. In this context, the majority of respondents think that collected taxes never return as public services. The second strongest agreement that common belief in Ghana is that “the people evade tax, so I also have a right to evade tax” may affect them as well. It can be said that the thoughts of tax payers about others’ attitudes is another individual factor affecting compliance to tax.

Respondents were also asked to indicate whether tax is obligatory. The data revealed that about 98% of the respondents agreed that tax is obligatory with only 2% stating otherwise. This is shown in a figure 10 below;



Figure 10: Tax as Obligatory



Source: Field Survey, 2016

4.4.1 Type of Tax Paid by Respondents

Table 10 below shows the types of taxes that are being paid by respondents. The question was a multiple response giving respondents an opportunity to choose more than one. It shows that 50 of respondents pay income tax representing 25% of the total number of respondents, 150 of the respondents pay TMA levy representing 75% of the total number of respondents, 102 of the respondents pay VAT representing 51% of the total number of respondents and about 74 of the respondents pay property tax representing 37% of the total number of respondents. This is revealed in a table 9 below:

Table 9: Type of Tax Paid by Respondents

Type of tax paid	Frequency	Percentage (%)
Income tax	50	25
TMA levy	150	75



Value Added Tax (VAT)	102	51
Property tax	74	37
Total	200	100

Source: Field Survey, 2016

Most respondents pay TMA levy (75%) and the Value Added Tax (VAT) OF (51%) because they are the most common taxes respondents know of, and are charged by the Ghana Revenue Authority (GRA) and TMA respectively. Property tax also recorded a good percentage of about 37% of the total population because of the aggressiveness of tax authorities on its payment. While a few respondents pay income tax (25%). Income tax recorded the lowest because many people do not want to disclose their earnings and those who do often under state their earnings to avoid tax liabilities. The number of respondents who reported paying VAT (51%) in reality should exceed the figure presented but due to the fact that some of the respondents do not have knowledge that they pay for it as it is mostly paid together with other taxes and it is relatively smaller in amount as compared to the income tax. Again property tax (37%) is also due to the fact that most of the respondents are not the owners of the places where they do business as most of them almost always rent the place therefore having the real owners of the place pay for the property tax. VAT is collected by IRS while TMA levy and property tax are collected by TMA. The payment of income tax and VAT by the respondents conform to the type of taxes that are supposed to be paid by SMEs according to GRA. For example, according to GRA, SMEs are supposed to pay income tax, VAT and customs tax. Customs tax, as we have seen, has not been listed by respondents as part of what they



pay because this tax is paid by users of sea and air ports including land borders which the respondents do not use in their businesses.

4.5 Efforts by Tax Agencies to Ensure Compliance

The study also sought to measure statistically, the efforts used by the Tax Authorities to ensure compliance of tax regulations. The results of the Logit regression model indicate that the factors were able to explain the model with a goodness of fit level above 50% which was significant at the 1% significance level. From the table below years of education is positively related to compliance. The greater ones education, the more likely a person will comply with tax regulations. The data revealed a one year increase in education will increase ones compliance level by 0.6%. This was significant at the 1% significance level with a standard error of 0.21208. Years of business were also positive but not significant even at the 10% level. But this shows that the duration of SME in business will greatly enhance its knowledge on tax laws and hence compliance.

With regards to tax aggressiveness of tax authorities as an effort to ensure compliance, the study found a positive relationship which is significant at the 1% alpha level. Fear of being detected however was not significant but positively related to tax compliance. The use of informants was also significant at the 10% with a standard error of 1.3469.

The rest are presented in the logit table 10 below;

Table 10: Logit Model Prob chi2 0.000 psedo R2=0.63

Tax complied	coefficient	standard error	z value
Years of education	0.55396	0.2120	2.61***
Years of business	0.112228	0.13097	0.86



Tax aggressive	3.55611	1.28222	2.77***
Detective	1.40297	2.01896	-0.69
Informants	2.86469	1.34691	1.70*
Fines	1.64432	2.08927	-0.79
Tax audit	1.45112	1.14292	1.27
Cons	- 4.39012	2.67491	-1.64

Notes: * and *** respectively denote $p < 0.001$ and $p < 0.10$.

Source: Field Survey, 2016

From the data in table 10 above, Fines and tax Penalties were positively related to tax compliance but however was not significant. The study of authors found that the more positive attitude of the taxpayer on the implementation of administrative penalties also increase taxpayer compliance. The results support the research Andreoni, Erard and Feinstein (1998), Alm& McKee (1998), Alm, Bahl and Murray (1990), which also shows that the attitude of the taxpayer on the implementation of administrative penalties have positive impact to tax compliance. The coefficient of the model is negative indicating that individuals for that matter SME will probably like to invade or avoid paying tax.

4.5.1 Factors that could promote tax compliance

Respondents were asked to among of other things, their level of agreement with some factors that could promote compliance with tax laws. These questions have five options from 1-5. Option 1 indicates strong disagreement to option 5 with strong agreement. Point of neutrality is at point 3. Any mean value greater than 3 indicates some level of



agreement and mean value below 3 also indicates disagreement. This is summarized in a table 11 below;

Table 11: Factors that could promote tax compliance

Motivation for Compliance	Disagree	Neutral	Agree	Mean
Reduction in tax amount	4(2%)	12(6%)	184(92%)	4.04
Avoid tax penalties	32 (16%)	40(20%)	128(64%)	3.68
Easy and simple tax procedures	-	8 (4%)	192 (96%)	4.12
Tax education	-	-	200(100)	4.72
Tax used for intended purpose (development)-	-	-	200 (100%)	4.81

Source: Field Survey, 2016

From the table 11 above 92% of the respondents (with a mean of 4.04) agreed that a reduction in the tax amount would serve as a source of motivation for them to pay their tax; 64% of respondents (with a mean of 3.68) agreed that, avoidance of tax penalties could ensure compliance, 96% of them agreed that easy and simple tax rules will increase compliance with a mean of 4.12. With the use of taxes for the intended purpose (development) 100% of the respondents agreed that it would serve as a source of motivation for them to pay their tax and 100% of the respondents also agreed that, tax education will greatly improve compliance with a mean score of 4.72. Most respondents agreed that the reduction in the tax amount; the use of taxes for the intended (development) purpose; the penalties on tax non-compliance; tax education; and easy and simple tax procedures were the top factors that could encourage tax compliance. This is supported with OECD's (2010) findings that another avenue for making tax compliance



easy is effective education of tax payers by way of communicating in plain language; easy accessible websites; easy tax forms; more automatic tax; accessibility of personal relevant information; and simplification of the tax system and reduction of rules. With penalties on tax non-compliance the findings of this study is being complemented by the findings of Fischer et al. (1992) that deterrence has a greater general positive effect on tax compliance. It can also be seen that most SMEs are of the opinion that reduced tax rates will encourage tax compliance. This also agrees with the findings Lavinia & Alexandrina (2006) who observed that a high tax rate is the main cause of tax non-compliance among SMEs.



CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

5.1 Major Findings of the Study

This research was aimed at evaluating the awareness of tax laws and compliance by Small and Medium size Enterprise in the Ghanaian economy using businesses in Tamale Metropolis as a case study. The research revealed that taxes paid by respondents include; income tax, TMA levy, VAT and property tax. The study also revealed that, majority of the respondents has not had any form of tax education for the past one year. However, a large number of respondents pay their taxes regularly. Most respondents ranked the taxes they pay as high. A large proportion also indicated the amount paid including compliance cost as the major constraints to tax compliance. The majority of respondents were of the opinion that a reduction in the taxable amount, coupled with the use of taxes for the intended purposes, as well as penalty enforcement on non-compliance would promote tax compliance. Based on the findings of the study it can be concluded that most of the respondents are aware that tax compliance is mandatory and non-compliance is punishable by law. High tax is a major constraint to SMEs' tax compliance obligations and there was low tax education amongst SMEs. It can also be concluded that some of the motivational factors for tax compliance for SMEs include a reduction in tax amount; using taxes for the intended purposes (development); penalties for tax non-compliance; and tax education



5.2 Conclusions

Based on the findings of the study presented above, the following conclusions can be drawn as factors affecting SMEs in Ghana, specifically Tamale Metropolis.

- ❖ High tax rates are the primary problem of tax payers
- ❖ Poor tax morale and tax mentality of citizens
- ❖ Inaccurately paid taxes
- ❖ Inappropriate public expenditure to the preferences of tax payers
- ❖ Disbelief in the existence of effective public spending
- ❖ Poor tax education

5.3 Recommendations

- It is recommended that, the Tax Authority should revamp and revitalize the taxpayer award scheme. The aim should be to award consistency and faithfulness in income declaration and prompt payment of taxes. This will encourage other taxpayers not to indulge in tax evasion. Individuals will continue to willingly pay their taxes if they know that their taxes are being put to good use (Ayee, (2007).
- It is also recommended that the government through the ministry of information should continuously educate the taxpaying public about ongoing projects which are being finance from their taxes. When taxpayers get feedback from their governments in connection with the use to which their taxes are put, their compliance levels may increase as a result.
- Again tax authorities must do a lot to educate small businesses on issues relating to Tax. It came out strongly that a lot of SMEs in the Tamale Metropolis are in the dark regarding Tax issues. The government may introduce other ways of



motivating tax payers such as introducing rewards for those who comply.. This will likely widen the current envelop of taxable incomes and in consequence increase the amount of tax revenues to be generated by government for development purposes. It is worth reiterating that there is the need for government through the National Commission for Civic Education in collaboration with the ministry of information to undertake sensitization programmes aimed at educating the public about their fundamental obligations as citizens. Again It is thus evident that authorities are putting in minimal effort to enforce regulations.

- Finally efforts must be made toward stamping out corruption among the officials in addition to publishing such practices on television and newspapers, among others.



REFERENCES

Abdallah, A. N. (2008). Taxation in Ghana, Principles, Practice and Planning. 2nd edition. (Unpublished).

Abdul razack, A., & Adafula, C.J. (2013). Evaluating taxpayers' attitude and its influence on tax compliance decisions in Tamale, Ghana. *Journal of Accounting and Taxation*. Vol. 5 (3), pp. 48-57

Advani, A. (1997), Small and medium scale enterprises: The Nigerian situation. [Power Point Slides] Capital Partners Limited. Retrieved from [www.capitalpartnersltd.com/Small %20Medium%20Scale.ppt](http://www.capitalpartnersltd.com/Small%20Medium%20Scale.ppt)

Ali-Nakyea, A. (2008). *Taxation in Ghana: Principles, practice and plannin*. Accra: Black Mask Limited.

Alm, J., Kirchler, E., Muehlbacher, S., Gangl, k., Hofmann, E. & Kogler, C. (2011) Rethinking the Research Paradigms for Analysing Tax Compliance Behaviour. "The Shadow Economy, Tax Evasion and Money Laundering" *Munster:FOCUS*. p34.

Alm, J. & McKee, M. (1998). Extending the Lessons of Laboratory Experiments on Tax Compliance to Managerial and decision Economics, *John Wiley & Sons*, 19 (4/5), 259-275

Alm, J. Bahl, R. & Murray, N. Mathew, (1990). Tax Structure and Tax Compliance. *The Review of Economics and Statistics*, 72 (4), 603-613



Amoah, P.T. (2012). Small Business Owners' Attitude Towards Tax Stamp: A Case Study Of Taxpayers in Sekondi. *University of Cape Coast: Ghana*.

Andreoni, J., B. Erard & Feinstein J. (1998). Tax compliance. *Journal of Economic Literature*, 36, 818-860.

Aryeetey, E. & Ahene, A. (2004), Changing regulatory environment for small-medium size enterprises and their performance in Ghana. CRC Working Paper No. 30594, *Centre on Regulation and Competition (CRC)*. Retrieved from <http://ageconsearch.umn.edu/bitstream/30594/1/cr050103.pdf>

Aryeetey, E., A. Baah-Nuakoh, T. Duggleby, H. Hettige, & W. F. Steel, (1994). "Supply and Demand for Finance of Small Scale Enterprises in Ghana", *Discussion Paper No. 251*, World Bank, Washington, DC.

Atawodi, O. W., and Ojeka, S. A. (2012). Factors That Affect Tax compliance among Small and Medium Enterprise in North Central Nigeria. *International Journal of Business Management*, Vol. 7., No. 12: June 2012.

Avolio, C. (n. d.), Policies for business in the Mediterranean Countries Slovenia. Retrieved from <http://unpan1.un.org/intradoc/groups/public/documents/caimed/unpan018702.pdf>



Ayee JR (2007). Building Tax Compliance Through Reciprocity with Government. *Enterprise Formalization in Africa* (pp. 6 - 7). Accra: Foreign Investment Advisory Service of the World Bank Group.

Azeez, A. (2009). Contesting “Good Governance” in Nigeria: Legitimacy and accountability perspectives. *Journal of Social Science*. 21(3):217-224.

Baafi, A. B. (Feb. 2010). The essence of taxation in nation building. *Featured Article* . Retrieved from www.ghanaweb.com

Background paper prepared for the ITD conference Buenos Aires October 2007:<http://www.itdweb.org/SMEconference/ConferencePapers.aspx>

Beck, T., Demircuc-Kunt, A. & Levine, R. (2005), SMEs, growth, and poverty: cross country evidence. NBER Working Paper 11224, *National Bureau of Economic Research*. Retrieved from <http://www.nber.org/papers/w11224.pdf>

Bird, R. M., & Zolt, E. (2005). Redistribution via taxation: The limited role of the personal income tax in developing countries. *International Tax Program Paper 0508*. Toronto: Joseph L. Rotman School of Management.

Blaikie, N. (2000). *Designing Social Research: The Logic of Anticipation*. Malden, Wardsworth Learning Inc.



Braithwaite, V., Reinhart, M. & Graham, R. (2001). *Preliminary findings from the Community Hopes, Fears and Actions Survey*.

Chu, H. M., Kara, O., & Benzing, C. (2008). An empirical study of Nigerian Entrepreneurs: success, motivations, problems, and stress. *International*

Cohen, T and Marion, H. (1994). *Case Study Research-Design and Methods*. Newbury Park, Sage Publications. *Approaches* (2nd Ed). California, Sage Publications.

Collins, J. H., Million, Y. C., and Toy, D. R. (1992). Determinants of tax compliance: A contingency approach. *The Journal of Public Economics*, 11, 135 – 42.

Creswell, J.W. (2003). *Research Design: Qualitative, Quantitative and Mixed Methods*

Drucker P.F. (1979). *Management in organization*. New York, Pan Paperbacks.

Eriksen, K., and Fallan, L. (1996). Tax knowledge and attitudes towards taxation: A report on a quasi-experiment. *Journal of Economic psychology*, 17, 387 – 402.

Farzbod, J. (2000), Investigation of the Effective Factors in the Tax Efficiency. Unpublished master's thesis, Governmental Management Training Center, Tehran.

Ferman L. A., Stuart H., & Hoynman M., Issues and Prospects for the Study of Informal Economies: Concepts, Research Strategies and Policy, *Annals of the American Academy of Political and Social Science*, (1987), Vol. 493, p. 161.



FIAS-DFID Tax Group, 2007, *Analysis of the Effects of the Taxation System on Business Investment in Africa*,

Fischer, C., Wartick, M. & Mar, M. (1992). Detection Probability and Taxpayers Compliance: A Review of Literature. *IIJ Accounting Literature*

Fisher, A. A., Laing, J. E., Stoeckel, J. E., & Townsend, J. W. (1998). *Handbook for Family planning operations research design*. New York, Population Council.

Fjeldstad, 2007, *A Political-Economy Analysis of the Effects of the Taxation System on Business Investment in Africa*, Report prepared for the FIAS-DFID Tax Team

Ghana Revenue Authority (2010). Mission, Vision and Core Values of the new Ghana Revenue Authority. *GRA Newsletter* 1(1) 10-11.

Hanefah, M., Ariff, M. & Kasipillai, J. (2002), Compliance Costs of Small and Medium Enterprises. *Journal of Australian Taxation*, 4(1), 73-97.

Harris, T. D. (1989). *The effect of type of tax knowledge on individuals' perceptions of fairness and compliance with the federal income tax system: an empirical study*. PhD. Thesis, University of South Carolina.

Heady, 2002, *Tax Policy in Developing Countries : What Can be Learned from OECD Experience?*, OECD, Paris



Hendy, P. (2003), Threats to Small and Medium sized Enterprises from Tax and other Regulations. *Paper presented at the Australian Taxation Studies Program Small Business Tax Symposium, Developing Good Tax Policies for SMEs*, Sydney.

Holtmann, M. (2000), "SME Financing: Lessons from Microfinance." *SME Issue* 1(November):1-8.

International Tax Dialogue. (2007). "Taxation of Small and Medium Enterprises-Background Paper for the International Tax Dialogue Conference" Buenos Aires.

Itashiki, M. (2011). Explaining "everyday crime": a test of anomie and relative deprivation theory. *Unpublished doctor of philosophy dissertation*. University of North Texas.

Jackson, B. R., and Million, V. C. (1986). Tax compliance research. Findings, problems, and prospects. *Journal of Accounting Literature*, 5, 125 – 65.

Jonas, E. (2003). Attitudes towards Taxation: Ignorant and Incoherent? *Scandinavian Political Studies*, 26(2), 145 – 167.

Kayanula, D. & Quartey, P. (2000), "The Policy Environment for Promoting Small and Medium Enterprise (SME).

Lavinia, R. & Alexandrina, D. (2006), *Romanian small and medium sized enterprises-challenges upon accession into the European Union*.



Levy, B. (1993), “Obstacles to Developing Indigenous Small and Medium Enterprises: An Empirical Assessment”, *The World Bank Economic Review*, Vol. 7 No.1.

Lewis, A. (1982). *The psychology of taxation*. Oxford: Robertson.

Loeprick, J (Feb., 2009), In Practice, Investment Climate, Small Business Taxation.Reforms to Encourage Formality and Firm Growth.

Loo, E. C., and Ho, J. K. (2005).Competency of Malaysian Salaried individual in relation to tax compliance under self assessment system. *Journal of Tax Research*, 3(1), 45 – 62).

Lopez G. J. & Aybar A. C. (2000), “An Empirical Approach to the Financial Behavior of Small and Medium sized Companies”, *Small Business Economics*, 14, pp 55-63.

Machira, J.M. (2007) Taxation and SMES Sector Growth. *Asian Journal of Business and Management Sciences*. V2(3):01-07

Masato, A. (2009), Globalization of Production and the Competitiveness of Small and Medium sized Enterprisesin Asia and the Pacific: Trends and Prospects. *Publication of United Nations Economic and SocialCommission for Asia and the Pacific (ESCAP)*, Studies in Trade and Investment Series chapter 1, 1-31.

Messner, S., & Rosenfeld, R. (2001). *Crime and the American dream*. Belmont,CA: Wadsworth



Mohamad Ali, A., Mustafa, H., and Asri, M. (2007). *The effects of knowledge on tax compliance behaviours among Malaysian taxpayers*. International Conference on Business and Information July 1 – 13, Tokyo, Japan.

Moore, M. & Rakner, L. (2002) ‘Introduction: The New Politics of Taxation and Accountability in Developing Countries’, *IDS Bulletin*. p33:3.

Mukasa, J. (2011). *Tax knowledge, perceived Tax Fairness and Tax compliance in Agenda. The case of Small and Medium Income Taxpayers in Kampala Central Division*. Master’s thesis. Makerere University.

Neuman, W. L. (2003). *Social research method* (5th ed). Boston, Pearson Education.

Organization For Economic and Corporation Development(OECD), (2001). *Compliance Measurement*, Practice Note :1-2

Osei, P. (2000). Political liberalisation and the implementation of Value Added Tax in Ghana. *Journal of Modern African Studies* 38 (2), 255– 278.

Osei, B., Baah-Nuakoh, A., Tutu, K. A. & Sowa, N. K. (1993), “Impact of Structural Publications, London. (eds.), Structural Adjustment, Financial Policy and Assistance Programmes in Africa, IT Adjustment on Small-Scale Enterprises in Ghana”, in Helmsing, A. H. J. and Kolstee, T. H. 228 *International Research Journal of Finance and Economics* - Issue 39 (2010).



Palil, M. R. (2005). Does Tax knowledge Matters in Self Assessment Systems? Evidence form Malaysian Tax Administrative. *Journal of American Academy of Business*, 80 – 84.

Palil, M. R. (2010). *Determinants of Tax Compliance in Self Assessment System in Malaysia*. PhD. Thesis. University of Birmingham.

Parker, R., Riopelle, R., & W. Steel, W. (1995). “Small Enterprises Adjusting to Liberalization in Five African Countries”, World Bank Discussion Paper, No 271, *African Technical Department Series, The World Bank, Washington DC*.

Richardson, G. (2006). The impact of tax fairness dimensions on tax compliance behaviour in an Asian Jurisdiction: The case of Hong Kong. *International Tax Journal, Winter*, 29 – 42.

Richardson, M., and Sawyer, A. J. (2001). A taxonomy of a tax compliance literature: Further findings, problems and prospects. *Australian Tax Forum*, 16, 137 – 320.

Rose, R., & Karran, T. (1987). *Taxation by political inertia*. London: Allen and Erwin

Rotberg, R.I. & Gisselguist, R.M. (2009). Strengthening African governance: Index of African governance results and rankings. Cambridge: *World Peace Foundation*

Santoso, W. (2008). Analisis Risiko Ketidapatuhan Wajib Pajak Sebagai Dasar Peningkatan Kepatuhan Wajib Pajak, *Jurnal Keuangan Publik*, 5 (1), 85-137



Sarantakos, S. (2006). *Social Research* (3rd Ed). London, Macmillan Press Ltd.

Shahrodi, S.M.M. (2010) Investigation of the effective factors in the efficiency of tax system. *Journal of Accounting and Taxation*. V2(3): p42-45.

Singh, V. (2003). *Malaysian Tax Administration*. 6th ed. Kuala Lumpur: Longman.

Storey, D. (1994), "Understanding the Small Business Sector", Routledge, London.

Thorndike, J. J. (2009) The Unfair Advantage of the Few: The New Deal Origins of "Soak the Rich" Taxation. *The New Fiscal Sociology: Taxation in Comparative and Historical Perspectives*. p;26-28.

Thuronyi, V. (2003). *Comparative tax law*. The Hague: Kluwer Law International

Tomlin, B. (2008). Clearing hurdles: Key reforms to make small businesses more successful. (Commentary No. 264). Toronto, Ontario C.D. *Howe Institute*. Available: www.cdhowe.org/pdf/commentary_264.pdf

UNCTAD. (2002), Accounting by small and medium-sized enterprises: *A report by the ad hoc consultative group of experts on accounting by small and medium-sized enterprises*; TD/B/COM.2/ISAR/16/Add.4.



Vasak, S. (2008), Small, medium, and large enterprises. *USAID Business Climate Reform*. Retrieved from;http://pdf.usaid.gov/pdf_docs/PNADQ675.pdf

Venter, J. M. P., Hamel, E. H., & Stigingh, M. (2004). *A student's approach to income tax: Natural persons*. Durban: Lexis Nexis Butterworths

Webber, C., & Wildavsky, A. (1986). *A history of taxation and expenditure in the Western world*. New York: Simon and Schuster.

Wenzel, M. (2001). The impact of outcome orientation and justice concerns on tax compliance; the role of taxpayer's identity. *Centre for Tax System Integrity, Working paper No. 6*. Canberra: The Australian National University.

Yaobin, S. (2007), Tax, small business, growth: effect of taxation on investment and cross border trade. *Paper presented at the ITD Conference on Taxation of SMEs*.

Young, A., Danny, C. & Daniel, H.(2013) A Study of the Impace of Culture on Tax Compliance in China. *International Tax Journal*; CCH Incorporated.



Appendix A

UNIVERSITY FOR DEVELOPMENT STUDIES

QUESTIONNEER ON THE DEVELOPMENT OF SMALL MEDIUM ENTERPRISES AND THEIR IMPACT TO THE GHANAIAAN ECONOMY

This questionnaire attempts to measure the awareness of tax laws and compliance by SMEs in the Ghanaian economy. The challenges faced by the sector, some recommended solutions to these challenges and the way forward.

The research is being done in partial fulfillment for the award of an MCOM, Accounting Option from the University for Development Studies (UDS). Hence the information given will only be used for academic purpose with full surety of confidentiality.

Respondent ID.....

Date.....

Questionnaire no.....

A. Background Data

1. Country.....
2. Name of Business.....
3. Industry and ownership (Private/ Public).....
4. Level of education (1) none (2) primary (3) secondary (4) tertiary
5. Date business was formed.....
6. Sex () male () female
7. Age.....



B. awareness and Knowledge of Tax Laws and Regulations by SMES

8. Are the Tax laws in Ghana easy to understand?

1 = Yes [] 0= No []

9. Have you received any form of tax education for the past one year?

1 = Yes [] 0= No []

10. Do you think the language used by our law makers makes the tax laws in Ghana difficult to understand?

1 = Yes [] 0= No []

11. Do you know that it is compulsory to pay tax on income earned?

1 = Yes [] 0= No []

Please do you know that the following tax deductions are applied with respect to SMEs and corporations, please tick yes/no

	Regulations of deductions	(1)yes	(0) No
12.1	Tax losses incurred by a qualifying SME from disposal of shares in any venture investment shall be carried forward for a period of five yearsafter the date of disposal		
12.2	Research and development expenditure		
12.3	As an incentive to hire recent graduates, an additional deduction is between 10%-50% of the recent graduates salary is allowed dependent on the percentage of recent graduates employed by the company		
12.4	In ascertaining the income of any person who invests in a venture capital financing company, there shall be deducted the full amount of the investment in a year of assessment		



Please tick your level of awareness and knowledge with respect to the following tax regulations and offences

- 1- Not known at all
- 2- Not known
- 3- Not sure
- 4- Known
- 5- Well known

S/N	OFFENCE	PENALTY	Level of Knowledge				
			1	2	3	4	5
	<i>Please tick the appropriate box</i>						
13.1	Failure to keep books of account	5% of the amount of tax payable					
13.2	Failure to furnish a return	Individuals pay GH¢1 and companies pay GH¢2 per day for each day of default					
13.3	Failure to pay tax on due date	Where default is not more than 3months, 10% of tax payable and where default exceeds 3 months 20%. If it is withholding tax the penalty for offences less than 3 months and more than 3 months is 20% and 30% respectively					
13.4	Understating	30% where estimate is less					





	estimated tax payable by installment (self assessment)	than 90% of chargeable income					
13.5	Making false or misleading statements	Double or three times of the amount of the underpayment of the tax which may result if not detected					
13.6	Aiding and abetting	Three times of the amount of the underpayment of the tax which may result if the offence went unnoticed					
13.7	Failure to comply with the Act.	Where resulting underpayment is more than GH¢500 to between 50 and 300 penalty units in any other case between 10 and 100 penalty units.					
13.8	Failure to withhold tax	Personal liability to pay to the Commissioner the tax due but not withheld					

C. Factors affecting Compliance with Tax Laws among SMEs
Please rate

the following from 1 to 5 as a measure of the extent of your agreement of the factors affecting compliance with tax laws in Ghana.

1- Strongly disagree

- 2- Disagree
- 3- Neutral
- 4- Agree
- 5- Strongly agree

S/N	Factors affecting compliance	Extent of agreement				
		1	2	3	4	5
	<i>Please tick the appropriate box</i>					
14.1	High tax rates are the primary problem of tax payers					
14.2	Poor tax morale and tax mentality of citizens					
14.3	Inappropriate public expenditure to the preferences of tax payers					
14.4	Disbelief in the existence of effective public spending Inability to pay principle					
14.5	Noncompliance of tax payers due to unfriendly state-citizen relations					
14.6	Poor structure of the tax system & tax administration that doesn't meet the expectations & needs of tax payers					
14.7	Noncompliance of tax payers due					



	to economic & political structures					
14.8	Low level of governmental accountability and transparency					

D. Efforts by Tax Agencies to Ensure Compliance

(15) Do you regularly pay your taxes?

1 = Yes [] 0= No []

(16) Do you think that there are aggressive tax enforcement efforts by GRA

1 = Yes [] 0= No []

(17) There is a high degree of being detected for non-payment of tax

1 = Yes [] 0= No []

(18) GRA use informants to report tax evaders

1 = Yes [] 0= No []

(19) SMEs fear paying tax fines and penalties

1 = Yes [] 0= No []

(20) Are Tax audits and prosecutions usually done?

1 = Yes [] 0= No []

(21) Rewards are given to taxpayers

1 = Yes [] 0= No []

(22) Please, give any comment on any needs that you see as relevant but not addressed by the questionnaire.



.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

Thank you for your support in undertaking this important exercise

Appendix B lists of SMEs

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Ben 10 ventures	1	2.0	2.6	2.6
A &A Ventures	1	2.0	2.6	5.3
Abena's enterprise	1	2.0	2.6	7.9

Al-Amin ventures	1	2.0	2.6	10.5
Al-tamiranus' ventures	1	2.0	2.6	13.2
Alafeilana Venture	1	2.0	2.6	15.8
AlhajTayimaku spare parts	1	2.0	2.6	18.4
AnashawaEnt	1	2.0	2.6	21.1
Big Sharf Barbering	1	2.0	2.6	23.7
Cynthia Beauty salon	1	2.0	2.6	26.3
Davis bakery	1	2.0	2.6	28.9
DikuNyelala	1	2.0	2.6	31.6
Dinnani photos and business center	1	2.0	2.6	34.2
Dram's ventures	1	2.0	2.6	36.8
HajiaSawda food Complex	1	2.0	2.6	39.5
Hamdia tailoring shop	1	2.0	2.6	42.1
Jafflou Enterprise	1	2.0	2.6	44.7
Joe Lexis Micro Finance	1	2.0	2.6	47.4
Kelvin and Family ventures	1	2.0	2.6	50.0
KuzembellaEnt	1	2.0	2.6	52.6
Lady J. Hair Plaza	1	2.0	2.6	55.3
Mugees Spare parts	1	2.0	2.6	57.9



Mugeesspareparts dealer	1	2.0	2.6	60.5
Nasam ventures	1	2.0	2.6	63.2
Nasara enterprise	1	2.0	2.6	65.8
NazillaEnt	1	2.0	2.6	68.4
Opha Joe and son's spareparts	1	2.0	2.6	71.1
PagnaaEnt	2	4.0	5.3	76.3
Shasaki ventures	1	2.0	2.6	78.9
Suzzy's inn	1	2.0	2.6	81.6
Tizoora ventures	1	2.0	2.6	84.2
Voggudoo enterprise	2	4.0	5.3	89.5
Wumpini ventures	1	2.0	2.6	92.1
Yamba and son's ventures	1	2.0	2.6	94.7
Zaapayim ventures	1	2.0	2.6	97.4
ZubashEnt	1	2.0	2.6	100.0
Total	38	76.0	100.0	
Missing no response	12	24.0		
Total	50	100.0		