

TAXING THE INFORMAL SECTOR IN DEVELOPING COUNTRIES: THE CASE OF GHANA

By

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ABSTRACT

Taxing the informal sector poses a significant challenge to every tax authority. The task of designing a system to encourage voluntary tax compliance in the informal sectors of developing economies is a particularly important task given the relative sizes of these sectors in their domestic economies. Due to lack of reliable data about the operators of the informal economy it is difficult to comprehensively understand what produces tax non-compliance, and even less what motivates compliance, however, this information is critical to the design of effective policy. Most tax authorities resort to using blunt and often punitive measures designed to deter evasion rather than promoting long term voluntary compliance.

Existing literature on informal sector taxation in developing countries is limited, and what does exist emphasises development of the tax system rather than understanding the taxpayer. This study draws on research designed for better understanding of taxpayer behaviour in the formal sector and apply it to informal sector taxpayers to explore the degree to which it may inform us of tax compliance motivations in this sector also. The study uses the Ayres and Braithwaite (1992) Responsive Regulatory Theory (RRT) to analyse the impact of a responsive regulatory tax administration on the tax compliance decision of informal sector operators.

Three methods of data collection are used – face-to-face interview, survey and field observation to collect data from the informal sector operators and tax officers in Ghana.

The findings from this study indicate that due to the difficulty in obtaining information about taxpayers and the ease in concealing taxable activities, adopting purely command-and-control and deterrence based compliance approaches such as intensive auditing and heavy fines will not promote voluntary compliance. The study thus finds that tax morale, relationship with the officials, trust, tax education/knowledge, and tax revenue usage do have significant influence on compliance decisions in this sector in similar ways to those operating as part of formal tax systems.

DEDICATION

I dedicate this to mother, Mary Dansowaa, and the memory of the three closest people I have lost in the last few years. My dad, J.K Ampaabeng, and my two sisters - Hagar Ampaabeng and Lydia Osei Ampaabeng. You're forever in my memory. May the Angels look after you!

Also to all my children and family who had limited attention during these years.

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May God bless us all

AMEN.

Contents

ABSTRACT.....	i
DEDICATION	ii
ACKNOWLEDGEMENT.....	iii
LIST OF TABLES.....	xii
LIST OF ABBREVIATIONS	xiii
CHAPTER ONE	1
INTRODUCTION AND THESIS OVERVIEW	1
1.0. Introduction	1
1.1. Research problem	6
1.2 Why Ghana?	8
1.3. Research Objectives	9
1.3.1 Research questions	11
1.4. Significance of the study	11
1.5. Research design and methodology	13
1.6. Scope of study	14
1.7. Content of the thesis.....	14
CHAPTER TWO	16
THE INFORMAL ECONOMY	16
2.0. Introduction	16
2.1. What is the informal sector?	16
2.2. Theories of the informal sector	18
2.2.1. The dualists' view of the informal economy	18
2.2.2. The structuralists' view of the informal economy	19
2.2.3. The Legalists' theory of the economy	20
2.2.4 Informal sector policy recommendations from the three theoretical standpoints	21
2.3. The size and role of the informal sector	22
2.4. Mechanisms to support informal sector operation.....	26
2.5. Informal sector taxation challenges - evidence from existing literature.....	28
2.6 Presumptive Taxation	32
2.6.1 Introduction	32

2.6.2 Why use Presumptive Taxation?.....	33
2.6.3 Methods of Presumptive Taxation.....	34
2.6.4 Presumptive taxation systems in selected advanced and middle-income countries	39
2.6.5 Forms of Presumptive Taxation	40
2.7. Summary	42
CHAPTER THREE	44
INFORMAL SECTOR TAXATION IN GHANA	44
3.0. Introduction	44
3.1. Ghana – Country background	44
3.1.1. Ghana’s employment sector	45
3.2. Tax Administration in Ghana.....	46
3.2.1. The GRA integration.....	48
3.3. Formal Sector taxation in Ghana	48
3.3.1. Income taxes	48
3.4. Taxpayer identification	49
3.4.1 Usefulness of the TIN	50
3.5. Ghana’s informal sector	50
3.5.1. Classification Ghana’s informal sector businesses for tax purposes	52
3.5.2. GRA classifications of informal sector businesses	53
3.5.3. Challenges to effective taxation of the informal sector in Ghana	56
3.6. Informal sector taxation approaches in Ghana	59
3.6.1. Standard Assessment 1970 – 1986	59
3.6.2. Associational taxation 1987 - 2004	60
3.6.3. Vehicle Income Tax (VIT) 2003 - present	62
3.6.4. Small Business Tax Stamp 2005 - Present	62
3.6.5. The VAT Flat Rate Scheme (VFRS). 2007 - Present	64
3.7. GRA tax Objections and Appeal	65
3.7.1 GRA Objection process.....	65
3.7.2. GRA tax appeal	66
3.7.3. Offenses and penalties - administrative	66
3.8. Summary	67

CHAPTER FOUR	68
TAX COMPLIANCE – LITERATURE REVIEW	68
4.0. Introduction	68
4.1. What is Tax Compliance?	68
4.2. Why Tax Non-compliance - Why people don't pay their taxes?	69
4.3. Why do people pay taxes?	72
4.4. Tax Morale and Tax compliance	73
4.5. Administrative and Compliance cost of taxation	74
4.6. Tax compliance determinants – evidence from the literature	77
4.6.1. Socio-economic factors	77
4.6.2. Demographic variables	77
4.6.3. Education and Tax knowledge	78
4.6.4. Economic determinants of tax compliance	79
4.6.5. Tax Rate and tax complexities	80
4.6.6. Audit Probabilities and fines	82
4.6.7. Trust in the state	83
4.7 The trend in tax compliance research.....	86
4.7.1. The trend of tax compliance studies.....	86
4.8. Key compliance theories and models	89
4.8.a. Pillar 1 Theories.....	90
4.8.1. The Utility / Economics of crime Theory.....	90
4.8.b. Pillar 2 Theories	91
4.8.2. Psychological [Tax] Contract Theory (PCT)	91
4.8.3. The Theory of Reasoned Action (TRA)	93
4.8.c. Pillar 3 Theories.....	94
4.8.4. The 'Slippery Slope' Model (SSM).	94
4.9. Theory of the study.....	97
4.9.1. Responsive Regulation Theory (RRT)	97
4.10. Responsive regulation in tax administration	102
4.11. Responsive regulation and the informal sector.....	106
4.12. Responsive Regulation Theory – The key challenges	109

4.13. Responsive Regulation Theory in the context of this study.....	110
CHAPTER FIVE	112
RESEARCH METHODOLOGY, APPROACH, AND THESIS	112
5.0. Introduction	112
5.1 Study Objectives	112
5.2. Research Questions	114
5.2.1. Research Question 1.	114
5.2.2. Research Question 2.	115
5.2.3. Research Question 3.	115
5.2.4. Research Question 4.	116
5.2.5. Research Question 5.	116
5.2.6. Research Question 6.	116
5.3. Study Approach.....	117
5.4. Research Methods	119
5.4.1 Face-to-face interviews.....	121
5.4.1.a. Study parameters and population	124
5.4.2. Sampling frame and interview/survey procedure	125
5.4.3. Research Assistants: selection and justification	126
5.4.4. Validity testing - Personal face-to-face interview questions	127
5.5. Sampling.....	128
5.5.1. Sampling technique.....	129
5.5.2. Strategy for increasing participation and obtaining reliable data	132
5.5.3. Sampling Strategy	133
5.6. Nature of activities and area of coverage of interview Questions.	135
5.6.1. Interview questions, coding, and themes.	135
5.7. Questions for tax officials and policy advisors from international organisations	136
5.8. Drop-off and Pick-up Self-Administered Questionnaire Survey	137
5.9 Field Observation	139
5.10 Summary	140
CHAPTER SIX.....	141
DATA ANALYSIS AND RESULTS.....	141

6.1. Face-to-face Interviews of sector operators.....	141
6.2. Theme A. Why do people pay taxes?.....	144
6.2a. Themes from prior literature:	145
6.2b. Emerged Theme	154
6.2.10. Theme A summary	155
6.3. Theme B - Drivers for tax non-compliance in the informal sector	155
6.3.a. Existing themes	156
6.3.b. Emerged themes	161
6.3.11. Theme B Summary	164
6.4. Theme C – Future Expectations of informal sector operators.....	165
6.4.1. The six pillars of informal sector voluntary tax compliance	165
6.4.2 Summary	168
6.5. Tax Officials Face-to-Face Interviews.....	169
6.5.1. Understating of the taxpayers	169
6.5.2. Justification of the current tax rates.....	170
6.5.3. Views on the success of current strategies.....	171
6.5.4. Dealing with corrupt practices/favouritism	172
6.5.5. Approaches to encouraging voluntary compliance	173
6.5.6. Taxpayers engagement	174
6.5.7. The distress action process of the GRA.....	175
6.5.8 What should be changed to increase compliance level?	176
6.6. Field observation studies	177
6.6.1. Introduction	177
6.6.2. Types of businesses and individuals observed	178
6.6.3. Field tax officers, questions	179
6.6.4. Officers’ attitude	182
6.6.5. Tax knowledge of people observed	182
6.6.6. Level of fairness	182
6.6.7. On-field tax education	183
6.6.8. Summary.	183
6.6.9 Tax experts’ interviews - Adam Smith International	184

6.6.9.a. EIQ1	184
6.6.9.b. EIQ2	185
6.6.9.c. EIQ3	186
6.6.9.d. EIQ4	186
6.6.9.e. EIQ5	187
6.6.9.f. Summary	187
6.7.0. The Survey data for the study	188
6.7.a. PART A - Descriptive statistics	188
6.7.b. PART B - Data and existing literature	195
6.7.c. PART C - the responsive regulation theory and the study	207
6.8.0. Summary	213
CHAPTER SEVEN	215
DISCUSSION	215
7.0. Introduction	215
7.1. Part A – Key findings from this study	216
7.1.1. Moral Obligation	216
7.1.2. The ‘Past Tax Interaction Influence’ (PTII)	217
7.1.3. Tax revenue usage	219
7.1.4. Compliance is through punitive measures – A wishful thinking	220
7.1.5. The two dimensions of informality	222
7.1.6. Tax Education and Tax Knowledge	224
7.1.7. Auditing	225
7.1.8. Compliance Process	226
7.1.9. Low Tax rate	227
7.1.10. Study findings summary	228
7.2. Part B – Research questions	229
7.2.1. RQ1	229
7.2.2. RQ2	232
7.2.3. RQ3	233
7.2.4. RQ4	234
7.2.5. RQ5	235

7.2.6. RQ6.....	236
7.3. PART C - Applying Responsive Regulation in Ghana's informal sector	238
7.3.1. High Morale and High Knowledge Taxpayers	240
7.3.2. High Morale and Low Knowledge Taxpayers	240
7.3.3. Low Morale and High Knowledge Taxpayers	241
7.3.4. Low Morale and Low Knowledge Taxpayers.....	241
7.4.0. Summary	241
CHAPTER EIGHT.....	243
CONCLUSION.....	243
8.0. Introduction	243
8.1. The key evidence which came out of the study.....	245
8.2. The results of this study compared to the findings of other studies.....	248
8.3. Presumptive taxation – A modified approach	249
8.4. Academic contributions	251
8.5. Policy implications – the usefulness of the study for tax administrators.....	253
8.6. Limitations.....	257
8.7. Areas for future research	259
LIST OF REFERENCES	261
APPENDIXES	297
Appendix 1 - Summary of Informal sector causal theories and policy recommendations.....	297
Appendix 2 - Income tax rates and allowances – effective from January 2016	298
Appendix 3 - Formal sector (business) tax rates in Ghana	299
Appendix 4 - Ghana Revenue Authority offences and penalties.....	301
Appendix 5 - Example of presumptive taxes in selected countries.	303
Appendix 6 - Tax Compliance Survey Questions.....	305
Appendix 7 - Informal sector operators Interview Questions	311
Appendix 8 - Interview questions for tax Officials.....	315
Appendix 9 - Tax experts interview on Presumptive Taxation	317
Appendix 10 - Item-Total Statistics	322

LIST OF ILLUSTRATIONS

		Page
Figure 2.0	Tax and shadow (informal) economy, Low-income countries	23
Figure 2.1	Tax and shadow (informal) economy, OECD countries	23
Figure 3.0	Map of Ghana showing the regions	44
Figure 3.1	Ghana employment distribution by sector	46
Figure 3.2	Ghana Vehicle Income Tax (VIT)	54
Figure 3.3	Sample Ghana business tax stamps	54
Figure 4.1	The Laffer curve	81
Figure 4.2.	Tax Compliance Paradigm	85
Figure 4.3	Theory of planned behaviour	93
Figure 4.4	The Slippery Slope Model	96
Figure 4.5	Responsive Regulation Compliance Pyramid	98
Figure 4.6	Pyramid of sanctions and support	101
Figure 4.7	EPA South Australia's application of Responsive Regulation	102
Figure 4.8	Actions and Possible responses of the ATO model	104
Figure 6.1	Interview main themes	143
Figure 6.2	Tax Compliance Themes	143
Figure.6.3	Religion (composition)	192
Figure 6.4.	Monthly income of participants	193
Figure 6.5	Years in business	193
Figure 6.6	Gender and Tax information availability	197
Figure 6.7	Relationship between tax officials' visits and tax knowledge	203
Figure 6.8	Taxpayers' preference for Presumptive Taxation	205
Figure 6.9	Current level of tax education	206
Figure 6.10	Tax Morale of the informal sector operators	209
Figure 6.11	Tax Knowledge of participants	210
Figure 6.12	Perception towards tax authority	213
Figure 7.1	Responsive regulation in Ghana's informal sector	239
Figure 7.2	Types of Taxpayers in the informal sector from the study	240

LIST OF TABLES

	Page
Table.1.1	The taxonomy of the informal economic activities 05
Table 3.1	Informal Organisations in Ghana 51
Table 3.2	GRA initial Informal Sector Business Classification 53
Table 3.3	Presumptive tax rates of selected informal sector operators 55
Table 4.1	Corporation Tax compliance costs as a percentage of turnover 76
Table 5.1	Interview schedule 128
Table 6.0	Interview Themes and supporting literature 142
Table 6.1	Key classification variables of interview respondents 144
Table 6.2	Field observation data summary 179
Table 6.3	Summary of questionnaire distribution and response 189
Table 6.4.	Type of business ownership 190
Table 6.5	Age distribution of respondents 190
Table 6.6.	Marital status 191
Table 6.7.	Highest educational qualification 191
Table 6.8	Chi Square test – Gender vs Tax information 196
Table 6.9	Gender, Past officer visit and Tax Knowledge 203
Table 8.10	Parameter estimates for loglinear test 203
Table 7.1	Type of informal sector operators/activities 222

LIST OF ABBREVIATIONS

ACALAN	-	African Academy of Languages
AMA	-	Accra Metropolitan Assembly
ATO	-	Australian Taxation Office
ATRN	-	African Tax Research Network
CEE	-	Central Eastern European
CEPS	-	Customs, Excise and Preventive Service
DOPU	-	Drop-Off and Pick-Up
EUT	-	Expected Utility Theory
FBT	-	Fringe Benefits Tax
FIRS	-	Federal Inland Revenue Service
FROQ	-	Field Revenue Officers Questions
GDP	-	Gross Domestic Product
GNI	-	Gross National Income
GNP	-	Gross National Product
GPRTU	-	Ghana Private Road Transport Union
GRA	-	Ghana Revenue Authority
GSS	-	Ghana Statistical Service
GUTA	-	Ghana Union of Traders Association
HIPC	-	Heavily Indebted Poor Countries
HMRC	-	Her Majesty Revenue and Customs
IAS	-	International Accounting Standards
ICT	-	Information Communication Technology
IGT	-	Identifiable Grouping Taxation
ILO	-	International Labour Organisation
IMF	-	International Monetary Fund
IRS	-	Internal Revenue Service
KMA	-	Kumasi Metropolitan Assembly
LTO	-	Large Taxpayer Office

MOFEP	-	Ministry of Finance and Economic Planning
MTO	-	Medium Taxpayer Offices
NGI	-	Gross National Income
NMPs	-	Non-Monetary Payments
NMTs	-	Non-Monetary Transactions
NRS	-	National Revenue Secretariat
OECD	-	Organisation for Economic Co-operation and Development
PAS	-	Public Address System
PAYE	-	Pay As You Earn
PTII	-	Past Tax Interaction Influence
RAGB	-	Revenue Agencies Governing Board
RAS	-	Russian Accounting Standards
RRT	-	Responsive Regulation Theory
SSM	-	Slippery Slope Model
STO	-	Small Taxpayer Offices
TIN	-	Taxpayers Identification Number
UN	-	United nations
UNCTAD	-	United Nations Conference on Trade and Development
UNDP	-	United Nations Development Programme
UNWTO	-	United Nations World Tourism Organization
VAT	-	Value Added Tax
VATS	-	Value Added Tax Service
VFRS	-	VAT Flat Rate Scheme
VIT	-	Vehicle Income Tax
WBG	-	World Bank Group
WESP	-	World Economic Situation and Prospects
WIEGO	-	Women in Informal Employment: Globalizing and Organizing

CHAPTER ONE

INTRODUCTION AND THESIS OVERVIEW

1.0. Introduction

This chapter presents an introduction to this research and a general overview of the key issues addressed in this study. The initial stage deals with a definition of tax in general, the informal sector and more specifically presumptive taxation as the main approach for taxing the informal sector. The subsequent sections in the chapter present the problem statement, the research objectives, the significance of the study, the research methodology adopted, and the scope of the study.

Taxation is the most significant source of income for most governments in the world and plays a key role in promoting economic growth in many countries. Lymer and Oats (2015, p.3) defined taxation as “a compulsory levy, imposed by government or other tax raising body, on income, expenditure, or capital assets, for which the taxpayer receives nothing specific in return”. However, it is important to note at this stage that not all payments to government are considered as taxes, for example, charges, tolls, and other levies that are paid to request specific services are not tax payments (Lymer and Oats, 2015, p.3). Apart from its fundamental function of raising revenue for the government, taxation plays other vital roles such as being a mechanism for income redistribution to bridge the inequality gap, acting as corrective instrument to influence consumption patterns, (for example, the high taxes on tobacco and alcohol in the UK to promote public health and to ease pressure on the health service,) or simply as a bait to encourage investors to undertake decisions they otherwise would find unprofitable.

Implementing any tax strategy comes with one key challenge – compliance. Tax compliance involves complying freely and fully with all tax laws in one’s country. Cummings (2007) defined tax compliance as the degree to which a taxpayer complies with the tax rules of his or her country, for example, by declaring income, filing a return, and paying the tax due on time. On the other hand, tax non-compliance is the failure of a taxpayer to meet tax obligations whether the act is done intentionally or unintentionally (James and Alley, 2004), and this may include failing to file a tax return; under-reporting of taxable income; overstating tax claims such as deductions, reliefs and exemptions and failing to pay tax liabilities in a timely manner (Kirchler, 2007).

Although the level of tax compliance is influenced by many factors (Torgler, 2003), the nature of the economy, whether formal or informal may have a significant influence. Within every economy, taxing national and multinational corporations or businesses operating in the formal economy could be less problematic - *ceteris paribus* - the main option for avoiding taxes for such businesses is through exploiting ambiguities in the tax system (Garman and Forgue, 2009), by resorting to activities that may not be necessarily illegal but may be seen as unethical practices. For example, using tax credits and deductions with the view to reducing tax liabilities (Tooma, 2008).

However, taxing individuals and businesses in the informal economy and other hard-to-tax activities a significant component of which is in the informal sector – presents a different challenge for tax administrators in both developing and advanced countries (Alm and Martinez-Vazquez, 2007). Within this sector, tax evasion is relatively high and attempts to improve compliance are difficult and relatively expensive and therefore may be seen as unprofitable and less feasible to undertake in comprehensive, fair, ways. Individuals and small scale enterprises operating in the informal sector often resort to illegal practices to escape from taxation (Tooma, 2008). Here, taxable income and other receipts subject to tax are concealed or deductions are fraudulently claimed. For example, studies by Cobham (2005)¹ found that developing countries lose about US\$285 billion annually due to tax evasion in the informal economy.

A key problem with managing compliance in this sector is the fact that tax administrators may have insufficient information about taxpayers and often very limited resources to manage the assessment and collection of taxes from individuals and businesses operating in this segment of the economy.

While in advanced countries, the tax system can marginalise informal sector taxation as the sums at risk, the relative high cost of collection, and the range and number of taxpayers involved is relatively limited (albeit not unimportant), this is not so easily marginalised in developing countries where such revenue streams are of greater importance. This is because a significant percentage of employment and other taxable economic activities are undertaken within this sector in such economies, for example, Ghana has about 80% of its economic activities undertaken within the informal economy (GSS 2012).

¹ The calculation is based on estimates of the size of the domestic informal economy by Schneider (2005).

Aryee (2007) argued that the approach to taxing this sector in developing countries cannot be the same as for the formal sector because of the low compliance culture in the sector and because of the limited resources available to tax authorities to address this issue. Due to these challenges, tax authorities often adopt a presumptive based approach to taxing the informal sector.

Under presumptive taxation, most tax authorities in developing countries use blunt, non-taxpayer responsive or individually orientated, punitive measures to deter evasion. Taxation under this system is based on ‘assumed’ or ‘estimated’ income using a number of factors as the basis for measuring the tax payable at any point or assessment period. The approach encompasses a ‘number of procedures under which a ‘desired’ base for taxation (direct or indirect) is not measured but is inferred from simple indicators which are more easily measured than the base itself’ (Ahmad and Stern, 1991 p. 276). See chapter four for discussion on presumptive taxation.

In response to the informal sector taxation challenges, researchers have also undertaken studies from various angles to help shape our understanding of the sector. However, these studies are mainly inconclusive. For example, recent work includes assessing the psychology side of operators in the informal economy (Kirchler, 2007); taxpayers and government reciprocities (Frey and Torgler, 2007); cultural differences and tax morale in the sector (Torgler, 2005; Alm and Torgler, 2006; Alm, Martinez-Vazquez, and Torgler, 2007); using taxpayer compliance programs to create compliance (Russell, 2010); law and policy effects on voluntary taxpayer compliance (Ongwamuhana, 2011). Besides, there have been numerous proposals put forward by the World Bank, UN, OECD, and the IMF about taxing the informal sector. For example, the UN suggests that promoting equity and transparency would improve tax compliance within the informal sector (UN, 2009), the World Bank proposes that countries adopt ‘incentive-orientated policies’ to encourage a formal sector operation by informal sector businesses (World Bank, 2010). However, the IMF’s policy recommendations are that greater transparency, consultation, and visibility of public spending of tax revenue are the main drivers to promoting voluntary compliance among operators of the informal sector (IMF, 2011).

It is interesting to point out that although these studies are conducted from different angles [albeit mostly within advanced countries’ settings], they all draw one conclusion - that the

informal sector is indeed a very complex tax segment to create compliance and to raise revenue from.

A fundamental question to be addressed before reviewing this literature further, is what is meant by the “informal sector” and what types of activities are classed within its bracket?

A study by Feige (1994) defined the informal sector as all economic activities which contribute to the officially calculated (or observed) Gross National Product, but which are currently unregistered. Employment within the informal sector is mainly cash-in-hand (William, 2004), and traders operate on a ‘cash-only’ basis (Ofori, 2009). The sector may include activities such as the illegal production of trademarked goods, drug dealing, commercial vice and prostitution, illegal gambling, barter, loan sharking, the employment of illegal migrants, do-it-yourself projects, skimming of business revenue and tax evasion (Shelak, 1997 cited in Kirchler, 2007). Similarly, Smith (1994) described the sector as a market-based production of goods and services, whether legal or illegal that escapes detection in the official estimates of GDP. Mirus and Smith (1997) provided some clarification on the constituents of legal activities (which forms the basis of this study) and illegal informal sector activities (see Table 1.1 below).

Table.1.1 The taxonomy of the informal economic activities

Type of Activity	Monetary Transactions		Non-Monetary Transactions	
ILLEGAL ACTIVITIES	Trade in stolen goods; drug dealing and manufacturing; prostitution; gambling; smuggling and fraud		Barter: drugs, stolen goods, smuggling etc. Produce or growing drugs for own use. Theft for own use.	
	Tax Evasion	Tax Avoidance	Tax Evasion	Tax Avoidance
LEGAL ACTIVITIES	Unreported income from self-employment; Wages, salaries and assets from unreported work related to legal services and goods	Employee discounts, fringe benefits	Barter of legal services and goods	All do-it-yourself work and neighbour help

Source: Mirus and Smith, 1997.

Terkper (2003) offers a very simple definition to the informal economy describing it as ‘taxpayers who often fail to register voluntarily’. This view is supported by Alm and Martinez-Vazquez (2007), who added that even when they do register, they generally fail to keep appropriate records of their earnings and costs, do not file their tax returns, and they frequently tend to be tax delinquent.

In this study, the informal sector is defined as all [legally] taxable economic activities which are undertaken within the economy in reference to activities which are not undertaken in the formal regulated sector and which stand the risks of being either underreported (i.e. partial reporting) or fully concealed from the public eye. Illegal activities within the informal sector are excluded from this study since by their nature [of being illegal], tax authorities do not recognise them for tax purposes and therefore have no defined systems and approaches to bring them into the tax net.

Studies on the informal sector taxation within developing countries are limited and the emphasis of most of the existing literature is based on the systems of taxation rather than understanding the taxpayers, and what motivates their compliance decisions.

This study is conducted in a developing country context [Ghana's informal economy] with the central aim of exploring the tax compliance determinants of informal sector taxpayers undertaking legal activities.

1.1. Research problem

Prior research has indicated that in tax systems a variety of factors combine to create any single taxpayer's compliance/non-compliance behaviour across the range of decisions that they are able to make in their interactions with the tax system. Firstly, tax knowledge and education are identified to be key variables when explaining tax non-compliance behaviours. As noted by Andreoni et al. (1998) tax compliance measurement research can usually make the assumption (often for modelling ease) that all taxpayers are of the same level of tax knowledge. This is not an accurate assumption as taxpayers' understanding of the tax law varies and this influences their compliance behaviour (Torgler, 2003). Tax specific education or knowledge should not be mistaken for formal education as research has indicated that people with university or college degrees may not have sufficient tax knowledge to make them necessarily more or less compliant than those with lower formal education – although there is some evidence that formal education can also affect compliance (Loo and Ho, 2005). Therefore, to improve tax compliance, substantial tax education and ease of access to tax information to raise tax knowledge are required.

Previous tax compliance studies have shown that non-compliance could also be attributed to the interactions with individuals in the taxpayer's inner circle of contacts/peers. Taxpayers are “not simply independent, selfish and utility maximisers, they also interact with other people with different attitudes, beliefs, norms and roles” (James and Alley, 2000), which may subsequently influence their compliance behaviours. This interaction is what Lewis (1982) termed the tax subculture, and he argued that there is a strong likelihood that individuals whose peers do not pay taxes are less likely to comply. Findings from other studies, (Torgler, 2003; Frey and Torgler, 2007) also support this idea that compliance behaviour increases when taxpayers know others are paying and vice versa.

Furthermore, lack of trust in the tax authority and the absence of a strong legal system have been identified amongst the factors influencing tax non-compliance behaviours (see Torgler, 2003; Frey, 2003; Kirchler and Wahl, 2010; María-Dolores et al., 2010). These studies found that people, sometimes choose not to pay their taxes due to lack of trust in the state regarding

the use of tax revenues and weakness in tax law enforcement which fails to detect and punish tax evaders.

A higher tax rate also increases tax non-compliance, as evasion becomes more 'profitable'. A study by Clotfelter (1983), argued that high tax rates will evoke high non-compliance rates, and his findings have since been supported by several recent studies (Ivanova et al., 2005; Takats and Papp, 2008; Kirchler et al., 2010; and Matthews, 2011). They all concluded that a lower tax rate decreases the incentive for evasion or avoidance. The policy question this finding raises is 'what tax rate is low'? As businesses and individuals have different income levels, and circumstances that affect their tax obligations, it becomes difficult to determine in practice which rate will be 'low' enough to boost compliance levels without adversely affecting tax receipts.

While significant improvements have been made in effective tax system design in advanced countries, designing effective and efficient tax systems remains a difficult task for developing economies. This is because adequate data for decision making by the tax authorities is seldom available, or available in a timely enough fashion due to the difficulty of tracking economic activities in these countries. This is compounded in developing country settings by significant economic activities being carried out in the informal economy where cash transactions dominate (Grown and Valodia, 2010), and operators keep very minimal records.

In seeking to better understand tax compliance in the informal sector, a key part of the puzzle that needs addressing is why operators in this sector pay taxes in the first place. Most neoclassical studies on tax compliance in the formal economy, conclude that there is far more compliance than such models would indicate should be expected, and that most people pay most of their taxes most of the time, (Alm, 2013). In formal systems, the percentage of taxes which are subject to thorough audit is generally small, often under 1 percent of all returns, and even where people are caught for tax avoidance, the penalties that can be imposed are not always imposed, or not often visibly imposed so are only known to the tax authorities and taxpayers, and may not be substantial as a percentage of the tax evaded (Alm, 2013, p4). This therefore suggests that the basic theoretical model of economics of crime first applied by Allingham and Sandmo (1972), and which posits that taxpayers are rational economic agents who weigh up the economic benefits of successful tax evasion against penalties for non-compliance, cannot fully explain the reasons for the levels of tax compliance in any economy. Based on these utility maximisation theories, one can argue that most operators in

the informal economy (where information about tax operators and their activities are very difficult to track) should not be paying taxes at all. There is an element of tax compliance which cannot be explained by economic factors and, as suggested by Alm et al (2010, p.4), even in the least compliant economies, tax evasion does not exceed the levels predicted by a purely economic analysis, and in fact there are many [honest] taxpayers who pay all (or most) of their taxes all (or most) of the times, regardless of economic incentives or the enforcement activities by tax regimes.

Previous studies have proposed several plausible compliance determinants. For example, studies by (Witte and Woodury, 1985; Kirchler and Wahl, 2010; Slemrod, 1989) found that a perception of fairness regarding the tax system influences tax compliance decisions, the same way as the compliance process and cost (Copp, 2001²; Evans and Tran-Nam, 2001; Smulders and Stiglingh, 2008). Interestingly, recent research on tax compliance has shifted to a new paradigm of exploring the intrinsic motivation (moral) to help explain compliance decisions, (see Kirchler, 2007; Torgler, et al., 2007; Braithwaite, 2009; Pope and McKerchar, 2011; Benk et al., 2011; Modugu et al., 2012). The tax compliance theories and models underpinning these studies are discussed in chapter four.

As the emphasis is usually placed on the tax system rather than the taxpayer when examining informal sector taxation, the existing literature [on informal sector taxation] offers little to explain how the intrinsic motivations influence compliance decisions within that sector. This study thus seeks to contribute to this gap in the knowledge of informal sector tax compliance.

1.2 Why Ghana?

This study uses Ghana as a case study. Ghana is ranked by the World Bank as low middle income due to its \$1,590 per capita GNI (World Bank, 2014). Also, both the IMF and the UN rank the country among developing countries.

Furthermore, Ghana is still an active member of the debt relief programme targeted at developing countries; the Heavily Indebted Poor Countries (HIPC) initiative (UN, 2012; IMF, 2013, World Bank ,2014), and therefore qualifies as a developing economy.

² Cited in (Evans 2003)

In addition, Ghana has an estimated 80% of all its economic activities coming from the informal sector (GSS, 2012). As the study seeks to assess tax compliance within the informal sector of developing countries, Ghana fits perfectly as a country for this study.

Also, just as others at the same level of development, the country has a high illiteracy rate of about 40% (UNDP, 2011). In addition, businesses in its informal sector operate on a cash-only basis, employment within the sector is mainly based on cash-in-hand, operators have poor record-keeping (refer to earlier discussions in sections 1.0 and 1.1). There are little or no barriers to entry to most of the sectors in which informal businesses operate. Informal sector operators are often largely ignorant of the tax laws, and the country is dominated by a high corruption rate and poor administration (Aryee, 2007).

Another key factor that contributed to the choice of Ghana, is the country's stable economic and political environment. Unlike other developing countries, Ghana has a stable democratic system of government and has not had any political conflict for almost 40 years (BBC, 2016). This implies that results from this study may be useful to or comparable with countries at the same level of development.

Refer to chapter three for further discussion on Ghana's informal sector taxation.

1.3. Research Objectives

In every tax compliance study, the underlying question is 'What drives people to pay their taxes?' As noted in section 1.1, one possible explanation to this question put forward by the literature is the impact of the deployment by tax authorities of 'coercive strategies' - i.e. those involving the use of deterring punitive measures to discourage tax non-compliance – taxpayers comply as they fear the consequences of non-compliance. Research work which explores this relationship includes the compliance model proposed by Allingham and Sandmo (1972) on the economics-of-crime theory. This study has since been developed further (for example Frey, 1997; Frey and Jegen, 2001).

However, Frey (1997) proposes that intrinsic motivation could be negatively influenced by external interventions, which in the case of taxation, may include issuing commands and imposing rules and regulations and carrying out punitive measures. Frey, therefore, proposes

a more co-operative model to encourage compliance where taxpayers are treated as clients and ‘served’ by tax authorities.

Kirchler (2007, p.188) suggests neither the ‘cops and robbers’ approach as implied in the case of Allingham and Sandmo (1972) or the ‘service and client’ approach, (Frey 1997; Frey and Jegen, 2001) offer full explanations to the question of ‘why people pay taxes’ and indeed, may contradict each other in some cases.

Therefore, studies on this question are shifting towards exploring ‘tax morale’ to help explain and understand tax compliance behaviours. Examples of work on tax morale include Torgler, 2002 and 2003; Cummings et al., 2005; Frey and Feld 2002; Kirchler, 2007; Pope and McKerchar 2011; Alm and McClellan, 2012. All of these studies link tax compliances with ‘intrinsic motivation’ (i.e. morale).

Interestingly, existing studies on tax compliance within the informal sector, do not embrace this paradigm shift, and most tend to look at the systems of taxation rather than understanding the compliance needs of the sector operators. For example, tax compliance in the informal sector is based on a reciprocal arrangement with the state (Aryee, 2007), incentives to encourage tax compliance (Russell, 2010) or simply having workable laws and policies to regulate the sector (Ongwamuhana, 2011).

This study draws on the utilitarian and tax morale research paradigms designed for better understanding of taxpayer behaviour in the formal sector and applies it to informal sector taxpayers, to explore the degree to which it may inform us of tax compliance motivations within this [informal] sector.

To achieve the above objective, the study adopts the following specific research objectives:

- Examine the effects of the relationship between the taxpayers and tax authorities on voluntary compliance in the informal sector. This objective is addressed by drawing on the Responsive Regulation Theory (RRT) first proposed by Ayres and Braithwaite (1992) to assess compliance decisions, by exploring the relationship taxpayers and tax authority in the informal sector and how this interplay manifests into tax compliance/non-compliance.
- Assess how different compliance approaches influence compliance decisions of informal sector taxpayers.
- Identify and analyse variables that make individuals and small business operators in the informal sector “‘difficult-to-tax”’.

- Assess the effectiveness of presumptive based taxation, as the dominant form of taxing informal sector economic activities in developing economies.
- Analyse and compare the key tax compliance determinants of informal sector operators with those in the formal sector. This is done by comparing the study results with the findings from existing literature on formal sector tax compliance variables.

1.3.1 Research questions

To accomplish the research objectives above, empirical evidence is produced to answer the following questions:

- i. Are there more effective ways to tax informal sector economic activities in developing countries than are currently employed?
- ii. To what extent does the relationship between a taxpayer and the tax authority shape voluntary compliance decision of the informal sector taxpayer?
- iii. To what extent does moral obligation contribute to the tax compliance decisions of informal sector operators?
- iv. How effective is presumptive based taxation on the compliance decisions of operators in the informal sector?
- v. What key social/demographic variables influence tax compliance in the informal sector of developing economies?
- vi. What are the impacts of increased auditing mechanisms on voluntary tax compliance in the informal sector?

Details of the research objectives and the questions are discussed under the methodology section in chapter five.

1.4. Significance of the study

There have been numerous works on personal and small business taxation in the informal sector [mostly in advanced countries] by several tax researchers in a bid to help understand tax compliance within this sector (see discussion in chapter two). There have also been several proposals from the World Bank, UN, OECD, and the IMF particularly targeting developing countries (see further discussion on taxing the informal sector in chapter two). In all these studies, as noted earlier, the emphasis has been placed on the tax system, which

conforms to the approach to taxing this sector by most tax authorities - presumptive based methods which take little or no account of the taxpayers' needs. Such systems ignore two of the key fundamental principles of an efficient tax system – vertical and horizontal equity.

This research adds to the literature on tax compliance, providing more insight into personal, small businesses and informal sector taxation in developing countries. Although there are significant volumes of work undertaken in business taxation, there is much less literature on the subject, particularly studies which assess individual taxpayer compliance variables in the informal sector. This study is the first to assess tax compliance in the informal sector within a developing country setting from two angles – Regulators' / Tax officials' perspective versus Taxpayers' perspective.

As noted earlier, this study contributes to the tax compliance discussion, by drawing on the Responsive Regulation Theory to assess compliance decisions, by exploring the relationship between taxpayers and the tax authority (the regulatory approach adopted) in the informal sector and how this interplay manifests into tax compliance/non-compliance. This discussion draws on the two key components (pillars) of the theory – (1) regulatory pillar of support and (2) regulatory pillar of sanctions, to provide an understanding of the actions by taxpayers.

The theory advocates for graduated response [either in the form of support or sanctions] that considers the actions of taxpayers as the most effective way to engage taxpayers and improve compliance.

Using the 'responsive regulatory lens' this study explores and analyses how tax compliance behaviour of the informal sector operators are shaped by a regulatory approach that recognises taxpayers' actions and employs support/sanctions that are linked to the level of taxpayer's commitments.

More specifically, the study aims to:

- improve understanding and suggest better mechanisms to create a 'tax compliance culture' among individuals and small businesses operating in the informal sector in developing countries;
- shape our understanding of how responsive regulatory approach can influence tax compliance decisions of operators in the informal sector.
- improve understanding of why individuals make decisions to be tax compliant (in part or whole) in developing countries;

- improve our understanding of how formal tax compliance process influences voluntary tax compliance in the informal sector in a developing country;
- establish how the relationship between a taxpayer and the tax authority influences voluntary compliance.

In addition to these academic contributions, this study has important policy implications as it suggests useful ways for governments and tax policymakers to redesign and administer taxes for individuals and businesses operating in the informal economy.

A single study cannot be fully conclusive on taxation in developing economies, therefore, this work will also provide a useful platform for future studies on informal sector taxation.

1.5. Research design and methodology

As observed earlier (see sections 1.1 and 1.3), this study addresses the activities of individuals as well as small businesses operating in the informal sector. It also includes the tax compliance behaviours of those working in the formal sector but who have the chance to underreport their total incomes where some of it arises from informal sector activity. Ghana is used as a case study.

This study uses interviews, observations, and questionnaire survey techniques to collect data from informal sector operators and tax officials in Ghana. To inform the results, the final part of the study also involves interviewing personnel from the international tax policy advisors, Adam Smith International.

The interviews and survey questions targeted at the informal sector operators are designed to explore informal taxpayers' intrinsic motivations (tax morale issues) on tax compliance decisions. The study also assesses taxpayers' compliance decisions in relation to their:

- the regulatory approach adopted by the tax authority and the overall relationship with the tax authority, including the perception of tax revenue usage;
- tax knowledge - tax education and general awareness of their tax obligations and how to meet them;
- perception of fairness and equity of the tax system, both horizontal and vertical;
- tax compliance process and cost,

- perception of auditing probabilities and nature of fines,

These themes emanate from prior tax compliance literature in advanced countries and relate to formal tax systems to explore the study proposition that a better understanding of these issues will help improve our understanding of tax compliance of the informal sector in developing countries and help establish the differences/similarities with those in the formal sector.

The first stage of the study involved interviewing participants. The results of the analysis of the interviews informed the design of the survey instrument that sought to validate and extend the details from the interview responses. See chapter seven for a discussion of the study methodology.

1.6. Scope of study

The Ghanaian informal economy is used as the case study. The research comprises studying the tax compliance behaviours of informal sector operators in the country's two largest regions by population and which have the highest informal sectors (Aryee, 2007). The decision to limit the study to these two out of the ten regions in the country is because there are no significant differences concerning taxable economic activities in the informal sectors of the other eight regions based on the classifications given by Aryee (2007) which form the basis of the sampling for this study. Therefore, selecting these two will provide a true representation of the country's informal sector businesses.

As it is a study limited to the informal sector; taxable activities and individuals which are purely formal and undertake a formal tax assessment are excluded.

1.7. Content of the thesis

Chapter one of the study outlines the objectives of the study which are to explore the design of informal sector taxation in developing countries and also to identify the key tax compliance determinants of the informal sector operators.

Chapter two is devoted to analysing the concept of the informal economy. The section makes a distinction between the types of informal economy – illegal underground activities (exempt from this thesis) and economic activities in the informal economy which generates taxable

incomes (which is the focus of this study). This chapter also discusses some of the common forms of presumptive taxation approaches as the common form of taxing informal sector economic activities.

Chapter three discusses the tax administration in Ghana. More specifically, the tax system of the country is analysed with a particular emphasis on the approaches used by the Ghana Revenue Authority (GRA) to tax economic activities in the informal sector.

Chapter four looks at the concept of tax compliance. The reasons why people pay taxes are discussed alongside the drivers for tax noncompliance. In this section, responsive regulation and tax morale as an area of modern tax compliance research are further discussed.

Chapter five systematically describes the research design and the methodology employed to find answers to the research questions, which includes survey methodology and face-to-face interviews.

Chapter six describes and presents the results of the data collected. The initial part of this chapter analyses the data gathered through the face-to-face interviews with the three main participant groups described in chapter seven. The rest of the chapter presents a descriptive analysis of the questionnaire data and detailed accounts of the field observations and tax expert interviews.

Chapter seven undertakes a detailed discussion of the results of the study in relation to existing literature. This discussion is based on the objectives of the study and answers each of the research questions posed for this study. In addition, the chapter discusses theoretical issues which emerged in relation to the data and the literature on informal sector tax compliance.

This final part, *chapter eight* presents the summary of the study, the academic contributions, and key limitations and offers directions for future study.

CHAPTER TWO

THE INFORMAL ECONOMY

2.0. Introduction

This chapter discusses the concept of the informal economy. It begins by analysing the various definitions and measurements of the sector from different prior studies. The section also draws a distinction between the two broad divisions of the informal economy – (a) those involving illegal activities such as prostitution and drugs and, (b) those involving legal and taxable economic activities. Also, this chapter the vital question for informal sector taxation studies that researchers have over the years attempted to answer - should the informal sector be formalised for tax purposes?

Finally, this chapter discusses presumptive taxation. As a pre-transactional tax and one of the simplest form of taxes to administer, presumptive taxation is the most common type of tax used for the informal sector, particularly in developing economies (Thuronyi, 1996, p.1; World Bank, 2011, p.130)

2.1. What is the informal sector?

Within the existing literature, the term ‘informal sector/economy’ has been differently and sometimes loosely defined and under different names (Misati, 2007). For instance, previous researchers have used names such as; unofficial, irregular, parallel, shadow, informal, subterranean, invisible, unrecorded, moonlighting, informal or hidden economy/sector (Torgler and Schneider, 2007) or simply grey economy, non-observed, clandestine or the black economy (Abiodun and Larry, 2007).

Even though different researchers have described the sector in different ways, they all directly or indirectly refer to activities which are not formal and therefore are either only partially regulated, or not regulated at all. Usually, the meaning attached to this term is determined by the nature or purpose of the study (Abiodun and Larry, 2007). Crucially, some of these studies have identified the distinction between legal and illegal activities within the informal economy

Smith, 1994; Mirus and Smith 1997; Eilat and Zinnes, 2004); however, the terminologies

used to refer to the informal sector have always remained the same. In this study, as discussed in chapter one, informal economy is used in reference to [legal] activities or the actions of people which generate taxable economic activities but are either underreported or fully concealed from authorities.

Knowing what aspect of the informal sector this study focuses upon, the key question is now to define ‘what constitutes the informal economy?’ What are the characteristics or what shapes informal sector activities? What motivates people to operate in the informal sector?

Finding answers to these questions in the existing literature begins with the need to define the concept of ‘informality’ in the economy.

The International Labour Organisation (ILO) defined the term “informal economy” as all economic activities by workers and economic units that are – in law or in practice – not covered, or insufficiently covered, by formal arrangements. ‘Their activities are not included in the law, which means that they are operating outside the formal reach of the law; or they are not covered in practice, which means that, although they are operating within the formal reach of the law, the law is not applied or not enforced, or the law discourages compliance because it is inappropriate, burdensome, or imposes excessive costs’ (ILO, 2002, p.53). Similarly, Palmade and Anayiotis, (2005) state that the informal economy is a common terminology used to describe the output and workforce of firms not registered with the government as well as the unreported activities and workforce of registered firms.

Feige (1994) defined the informal economy as involving all currently unregistered economic activities which contribute to officially calculated GNP in the country/economy. Smith (1994) extended this definition by arguing that the informal economy is the market-based production of goods and services, whether they are or not legal, which are not detected in estimating the official Gross Domestic Product of the country.

Earlier on, the ILO (1993) described the informal sector as broadly consisting of units engaged in the production of goods or services with the core aim to generate employment and incomes to the persons concerned. These units, according to the ILO (1993), usually operate at a low level of organisation, on a small scale and in most cases, there is little or no distinction between labour and capital, as the factors of production are fused. Therefore, labour relations are based mostly on casual employment, kinship or personal and social relations rather than contractual arrangements with formal guarantees. Clearly, operating in an environment where capital and labour are fused and where there are no formal enforceable

contracts or appropriate labour regulations, will prove a daunting task to any policymaker in getting the required information for decision making.

2.2. Theories of the informal sector

The relationship between the formal and the informal sector is varied but can be broadly categorised into three main views. Some studies identify a fourth causal theory seeking to explain the informal economy, for example (Maloney 2004). However, the discussion in this section adopts the views adopted in the World Bank's study in 2004. This study suggests that there are three³ main schools of thought regarding the relationship between the formal and informal economies.

2.2.1. The dualists' view of the informal economy

The underlying causal theory of the informal economy, according to the dualists view, is that it is created due to exclusion from the economic opportunities in the formal economy. This is the result of the imbalances between population growth and industrial employment, and people's skills in relation to the structure of the economic opportunities presented as a result of that growth.

The dualists' view sees the informal economy as a separate, marginal economy which is not directly linked to the formal economy, and which provides income or a safety net for the poor (ILO, 1972). The concept of the informal economy was originally derived from the literature on the problems of developing countries (Gerxhani, 2006), and it was thus believed that this economy existed within the formal economy to absorb excess labour, those who would otherwise be unemployed and would have no means of survival. Researchers who share this notion, believe that referring to the informal sector as 'informal' or hidden or illegal, is inappropriate as it simply represents an alternative approach or strategy to achieving survival needs (Schneider, 2005; Abiodun and Larry, 2007). According to this notion, the study of the informal sector/economy specifically becomes less relevant, it exists mainly for providing basic needs, with no profit motive in mind, and therefore operators have one basic interest – subsistence. However, a major drawback to this argument is that

³ These schools of thought were adapted from the World Bank Group report (2004) – 'Fact finding study on the informal economy', (WBG, 2004; p10).

informality does not apply only to poor or developing countries, but it is a phenomenon that is also present in advanced economies, where subsistence could not be the main driving force since there exist in these countries social security (benefits) systems, which provide for basic needs. The ILO's stance on the nature of the informal economy has consistently adopted the dualist view as its predominant motivation. All its studies relating to the informal economy, notably (2002) and most recently, (2010) are concerned with reducing poverty in order to reduce the size of the informal economy in developing countries. Other studies that support the dualists' views, for example, Elijah and Uffort (2007), and Schneider (2009) also propose that the rates at which the informal economy increases are in line with countries' poverty levels.

From the standpoint of the dualists, one can argue why tax compliance is a big challenge within this sector – after all survival and not profit is the main drive for operating in the sector.

2.2.2. The structuralists' view of the informal economy

Adopters of this view conform to the premise that the informal economy comes about due to the growth of capitalism and firms' desire to reduce costs and/or gain competitive advantage (WIEGO, 2016).

The structuralists, for example, Castells and Portes (1989), believe the informal economy to be subordinate to the formal economy. To reduce costs, privileged capitalists seek to subordinate small producers and traders (Moser, 1978). In addition, the influence of powerful labour unions and stringent state regulations such as taxes, health and safety, and other social regulations encourage formal organisations to engage in informal operations (Chen, 2012). These formal businesses see the 'loose' regulation in the informal sector by the government compared to the formal sector as an opportunity to increase revenue and reduce tax liabilities. The structuralists assert that the informal sector is influenced by and directly linked to the activities of formal sector operators. This view sees the informal sector as existing to provide goods and services 'on the cheap' to the formal economy. These arrangements usually take the form of casual employment and sub-contracting to 'informal businesses' and individuals by formal local organisations or off-shore industries. The structuralists also suggest that the large firms which engage in informal sector operations do so not only to avoid the stringent

regulations by the government but also to enrich themselves by deliberately dominating and exploiting the informal sector labour force (Chen, 2012).

The low level of tax compliance in the informal sector may be explained by the motive that drives individuals and businesses to operate in the sector. From the structuralists perspective, operators of the informal sector are mainly influenced by the less regulation in the informal sector and the over regulations in the formal sector including tax laws. This suggests that tax avoidance and evasion are central to the initial decisions by the sector operators to engage in informal economic activities.

2.2.3. The Legalists' theory of the economy

The stance of the legalists is based on the premise that a hostile legal system creates informal economic activities. The cost of becoming formal, including registration and licensing, as well as the cost of maintaining a formal status such as compliance to taxes and other formal arrangements, encourages some business to remain informal. To legalists, informal work arrangements are a rational response by micro-entrepreneurs to over-regulation by government bureaucracies (De Soto, 1990). In this sense, they argue that a high tax burden, inefficient or excessive economic regulations, and high and unnecessary bureaucracy, lead to growth in the size of the informal sector in most economies.

Rao and Walton (2004, p.10) provided some interesting twist to the debate on informality claiming some native cultures are not compatible with a modern market economy. They propose that some societies have large informal economies because their cultures develop in such a way that the informal economy is a natural manifestation, and thus, their people actively shy away from the form economy. Therefore, in such economies, indigenous institutions may not be compatible with a modern market economy, indicating that a culture change is required to make people accept reforms for formality.

In a comparative study of the informal sectors of Peru, Egypt and Tanzania, from the legalists perspective, Rogers (2009) refutes the culture argument, and asserts that culture and history influence the way people adapt to the market but these factors do not suggest that they are incapable of participating in a modern market economy (i.e. formal sector setting).

Rogers (2009, p.39) concludes that 'majority of people are restricted to participation in the informal economy because the regulations of the formal economy do not permit them to easily carry out all the functions necessary to realize daily economic transactions'. Just as the

structuralists view, the legalists stance indicates that regulations including tax payment could explain the size of the informal economy.

2.2.4 Informal sector policy recommendations from the three theoretical standpoints

The dualists, structuralists and the legalists offer various policy recommendations for the informal sector.

As noted in section 2.2.1, the Dualists subscribe to the notion that informal sector operators and their activities have limited (if any) linkages to the formal economy. The units and activities within the informal sector operate as a distinct separate sector of the economy and that the informal workforce, who are largely self-employed and believed to be the less advantaged of the labour market, pay relatively little attention to the links between informal enterprises and government regulations (ILO, 1972; Chen, 2012). For the informal sector to be an active sector in poverty alleviation strategies and as a source for revenue mobilisation to the state, it is recommended that the government creates more jobs and provides social services, infrastructure and credit, and business development services to informal operators (Chen, 2012).

The Structuralists who see the informal and the formal economies as intrinsically linked believe that both informal enterprises and informal wage workers as subordinated to the interests of capitalist development, providing cheap goods and services. The structuralists argue that governments should address the unequal relationship between “big business” and subordinated producers and workers by regulating both commercial and employment relationships (Moser, 1978; Castells and Portes, 1989; Chen, 2012).

The Legalists assert that excessive regulations and complex bureaucratic systems within the formal sector increase the informal sector (see section 2.2.3). A hostile legal system, according to this view, leads the self-employed to engage in informal operations. The legalists argue that to reduce the size of the informal sector, and/or to ensure its proper functioning, governments should have less regulation within the formal sector, particularly within the labour market (Swaminathan, 1991). The legalists also propose more free-market policies to facilitate the growth potentials of the entrepreneurs within the informal sector (De Soto, 2000). Besides, governments should introduce ‘simplified bureaucratic procedures to encourage informal enterprises to register and extend legal property rights for the assets held by informal operators to unleash their productive potential and convert their assets into real

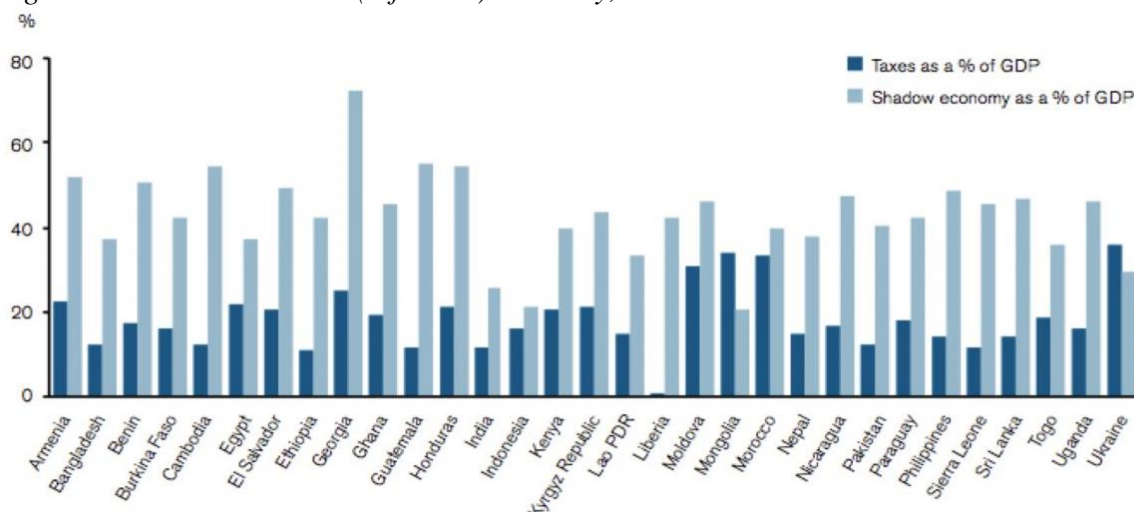
capital' (Chen, 2012). Appendix 1 presents a summary of policy recommendations for the three theories of the informal sector

This study focuses on all three views of the informal sector – The Dualists, the Structuralists, and the Legalists. Even though the dualists' view asserts that there are no profit intentions among operators of the informal sector and that people operate in this sector for subsistence needs making it difficult to assess the tax compliance determinants. However, most developing countries adopt presumptive based taxation systems (see further discussion in the last part of this chapter), which do not consider profits made by individuals and businesses. By these [presumptive taxation] systems, all individuals undertaking income generation, and not necessarily taxable economic activities fall within the tax net, regardless of their income levels, therefore omitting the dualists' view could make the findings inconclusive. In spite of the varying views about the informal sector, it plays a vital role in the national economy. The next section (2.3) assesses the role and impact of the informal sector.

2.3. The size and role of the informal sector

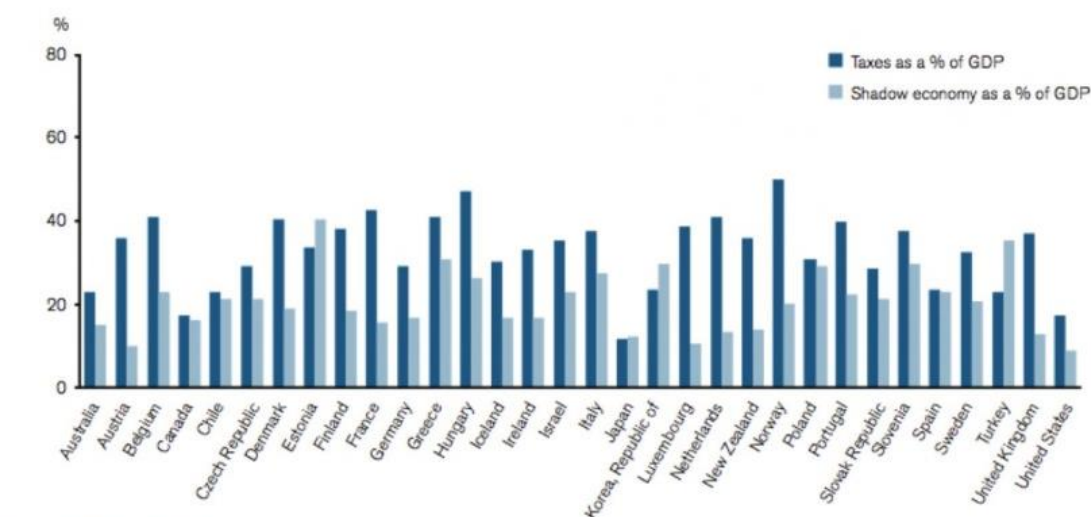
The size of the informal sector and its contribution to developing economies, has long attracted the attention of both policymakers and scholars alike (Ishengoma and Kappel, 2006). The informal sector is a very important part of the economic activities of developing economies, and forms a significant part of the tax revenues and the GDPs of these countries, as compared to the advanced nations where the size [of the informal sector] relative to the overall economy is small albeit significant, for example the OECD nations. Figure 2.0 and 2.1 show the size of the informal sector as a percentage of the GDP of elected developing and advanced countries.

Figure.2.0 Tax and shadow (informal) economy, Low-income countries



Source: World Bank (2013).

Figure.2.1 Tax and shadow (informal) economy, OECD countries



Source: World Bank (2013).

Figures 2.0 and 2.1 show the size of informal economies in developed versus developing countries. Countries in Sub-Sahara Africa and South Asia have mostly similar and the largest size of informal economies compared to those in Europe, North America, and Eastern Asia.

To assess the importance of the informal sector in the developing economies, it is first important to ask the question; do the governments of the developing countries such as those in Sub-Saharan Africa pay unemployment or any form of direct [cash] state benefits to the disabled, the elderly or the unemployed? The answer to this question is certain – No. How

then do these categories of people and others in the developing world who have no formal jobs and any form of [formal] continuous incomes survive over time?

The informal sector is known to be less regulated, with no or minimal barriers to entry and with most activities in the informal economy requiring minimal capital, people easily find themselves there to earn a living which otherwise would have been difficult to achieve. This is the view of the informal economy mainly held by the dualists (ILO 1972) which has since been supported by several studies (Gerxhani, 2004; Schneider, 2005; Abiodun and Larry, 2007).

In developing countries, many people survive from small trading activities such as street hawking of small volume items such as water or sweets or simple services like shoe shining, up to larger ventures such as grocery shops and taxi cabs, and informal car garages (World Bank, 2004). Misati (2007), in support of the structuralists' ideology of the informal economy, found that in most developing economies neither the public sector nor the formal private sector is able to provide adequate employment prospects to cater for the rise in the labour force, leaving informal sector work (usually in the form of self-employment) the only obvious choice. Self-employment could simply represent any form of activity that the operators could engage in for survival. Judging by such simple justification, would it be worth having stiff policies to regulate the sector? Could the people in the informal sector who are without formal jobs [in the absence of social benefits] still survive? Any form of stiff regulation of the sector in such circumstances would be counterproductive in the long term as the formal economy just cannot absorb them (at survival rates of pay at least). In addition, the dynamism and entrepreneur spirit within the informal sector which is the result of competition, innovation and higher efficiency due to the low level of regulation, (Schneider and Klingmair, 2004) could be lost if the sector becomes over-regulated.

Realistically, no matter how small the tax rate will be, taxing all activities within the informal economy is an impossibility. Since most tax authorities use presumptive based approaches which take no consideration of one's profit/income in determining tax liability, there is a high possibility that the taxes raised could be higher than the income generated by some operators. Therefore, from the dualists' perspective, a clear distinction should be made by policymakers about what activities are regulated but untaxed and what are both regulated and taxed accordingly.

In terms of its contribution to the overall economy, some researchers believe that the sector is characterised by activities that have negative social and economic consequences, and that the state must discourage the operation within the informal sector (for example, Grabiner, 2000; Gallin, 2001). Others support the promotion of the development of the sector especially those adopting the dualist's perspective (Schneider and Enste, 2000; Palmade and Anayiotis, 2005; Williams et al., 2007; Feld and Schneider 2010).

The informal economy has a crucial role to play in the economic growth of countries particularly the economies of the developing world. As noted earlier, whereas opponents of the positive role of the informal sector argue that governments should institute programs to encourage operators to move to the formal economy, supporters have strong opposing views. For instance, Misati (2007) believes that there should be no need to design policies aiming to bring the informal sector to the fold of the formal economy because there will always be an informal economy even in heavily industrialised and advanced nations (Gërxhani, 2014). Misat (2007) further states that if a government tries to introduce restrictions in one area of the economy, an informal market is created in the other. For instance, if the government tries to protect domestic producers by imposing restrictions on foreign goods, such barriers will in effect create an incentive for smuggling of the banned goods into the economy by illegal or informal means, meaning a new informal economy is created for the banned goods⁴. This does not suggest that the informal sector should not be without any form of regulation. Singer (1992) suggested that the informal sector is not homogeneous and grouped the activities of the sector into two parts. These are the *upper layer* or the *intermediate sector* and the *working poor*. The upper layer are businesses and activities of individuals which are for profit-seeking whilst the working poor are those engaged in the sector purely for survival needs. This classification conforms to the structuralist idea (intermediate sector – profit-seeking) and the dualist's view (working poor, for survival needs). This indicates that no single policy for the informal sector will be appropriate. Singer (1992, p.77) therefore suggested a two-fold policy approach for the informal sector – (a) policy for the upper layer or the intermediate sector should be directed towards promoting productivity, linkage and integration with the formal economy and (b) policies for the 'working poor' part of the informal economy should aim at poverty alleviation and welfare promotion.

⁴ Misati, (2007) gave this example to explain the impact of stringent regulations on the informal sector – (i.e. adopting a legalist perspective on the justification for an informal sector).

Ishengoma and Kappel (2006) added that the informal sector plays a very crucial role in the overall economy, from job creation to producing goods otherwise would not be made available by the formal sector. They also share the structuralists view and argued that the informal sector has a strong intermediary role as it provides production linkages that help both the informal and the formal sectors, and which subsequently affect the aggregate economy. This relationship, according to Ishengoma and Kappel (2006), occurs most commonly in a forward linkage - where the informal sector operators supply to businesses in the formal sector, and this type of relationship usually helps the informal sector supplier in return. However, as identified by (Arimah, 2001), where this occurs there may be concerns of exploitative linkage as there are minimal regulations protecting the businesses in the informal economy. This exploitative relationship offers one of the reasons why policies may be required to regulate the informal sector, not only for tax collection purposes but also to help protect its operators and increase their capacity to produce.

In summary, the informal sector offers a range of support and links to the formal economy which finally impacts on the aggregate economy. These range from supplying scarce products and services to offering employment opportunities to the disadvantaged. Also, as concluded by Misati (2007), there will always be an informal sector as an attempt to formalise one area will undoubtedly lead to the creation of a new informal economy. There is also evidence of a positive relationship between informal sector activities and investment, and as suggested by Singer (1992) also see (Misati, 2007), the creation of wealth and reduction of poverty among developing economies particularly in Sub-Sahara Africa is directly linked with having a larger informal sector.

2.4. Mechanisms to support informal sector operation

Policymakers should not only be concerned about what they get directly from the informal sector in the form of business and other direct taxation, but it is vital that the sector is viewed from a positive angle, as a direct partner to the formal sector in all poverty reduction strategies in the long run (Singer, 1992).

If possible, adopting an appropriate macroeconomic policy that suits both the informal and formal sectors could be ideal. In most instances, and because of the negative lenses through which most policy makers and scholars view the informal sector, policies that regulate the

overall economy seem to always favour the formal sector. As discussed earlier, looking at the interrelationships that exist between these two sectors, in certain circumstances, in theory, combined policies could be designed to suit both. However, in some situations where they serve completely different purposes (i.e. if some aspects of the informal sector follow a dualist motivation) there should be appropriate policy adjustment (Singer, 1992), to ensure that enterprises in the informal sector are not disadvantaged, and that there is adequate motivation for firms to operate in the informal economy just as in the formal sector. The study by the UNESCAP (2006) demonstrates this positively and concludes that macroeconomic policies which aim to promote pro-poor growth and are also sensitive to gender-related issues, would suit the informal economy.

Another difficult hurdle faced by informal sector operators is the availability of capital, a factor which usually impedes their ability to reach their full potential or to raise productivity. As businesses may operate under capacity, it implies that they do not generate enough capital, in the course of their operation, to be able to provide for suitable reinvestment. Also, due to limited capital, they may have less opportunity to buy materials or resources in bulk and therefore at cheap prices. To obtain capital for reinvestment, according to the study by UNESCAP (2006), informal sector operators tend to borrow from friends, families and informal lenders, however, the informal sector participants may be better off if they were to obtain such capital from formal sources such as the commercial banks. The study further cited a lack of awareness among the operators of the informal sector regarding the availability of credit facilities in the formal economy, in addition to the levels of collateral normally demanded by these banks to grant credit facilities, as the main obstacles denying them from obtaining larger capital for investment (UNESCAP, 2006).

Education and training have a positive impact on the performance of a worker (King, 2011), and governments could consider making training facilities and programs accessible to informal sector operators. Informal sector workers often have limited or no formal education, and as described by Rafiq (2010) low educational levels can affect not only productivity but also the awareness and understanding of their contribution to the state [about the need for, when and how much] in the form of payment of taxes. The state could provide education and training programs which could be tailored to enhance the skills and productivity of the informal sector worker (World Bank, 2004), which would subsequently have a positive impact on the aggregate economy by enhancing the net contributions of the sector through job creation and taxes.

Besides, it would be very important to have formal regulations, labour rights, and effective legal systems available to the informal sector operators, so law enforcement and contracts are respected just as within the formal sector. Workers in the informal sector may be poorly paid, work in unsafe environments or be more susceptible to being cheated due to a lack of formal contract or their lack of awareness of the legal services available to them, (Broadman and Isik, 2007).

Furthermore, physical infrastructure has always been a major problem for informal sector participants. Most informal sector participants operate in areas with poor infrastructure, in the form of roads, storage facilities, electricity, and water, (World Bank, 2004). Farmers of perishable goods for example, who have no access to the better means of transport, may lose out as their produce could get damaged before reaching the market. In addition, with most areas having unstable power, businesses relying on electricity will not be able to operate at certain periods. Improving access to infrastructure could enhance productivity and reduce operational costs, therefore, to integrate the informal sector within the overall economy, physical infrastructure is one of the key areas that policymakers need to address (UNESCAP, 2006).

Among others, the ILO, taking the dualist perspective, recommends the promotion of the bargaining power of small enterprises in order to manage growing opportunity and risks, and the expansion of formal entrepreneurship and access to markets by streamlining registration and other bureaucratic processes, the reduction of transaction costs and the need of making available tax incentives for micro-enterprises (ILO, 2012, p.2). The ILO's (2012) study, also argued from the legalist perspective. It stressed that strengthening the legal framework to ensure respect for informal sector workers such as freedom of association, and eradication of forced labour, as well as improving labour legislation and codes of practice, are some of the effective measures that could help integrate the informal sector to the overall economy.

2.5. Informal sector taxation challenges - evidence from existing literature

Having explained the fact that developing countries need to obtain tax revenue from their informal sectors [and that the process and discipline of tax application on this sector have other benefits to the country beyond its tax-raising contribution alone] this section explores some of the challenges facing tax authorities in taxing the sector.

The key challenge faced by developing economies to having an effective tax system in the informal sector is tax administration, due primarily to the diverse and complex nature of the activities within the sector and the difficulty of obtaining relevant data for decisions as operators seldom keep records.

Studies have suggested various ways of tackling the problem, but the pressing issue is whether we could have a 'fix it all' approach that developing countries could adopt.

For instance, on tax policy for developing economies, the United Nations (2009) proposes broadening the tax base as a solution to bringing the informal sector into the tax net. In administration, the UN suggests equity and transparency are the two main strategies to encourage greater tax compliance. On the expenditure of tax revenue, it proposed that governments should target to address key challenges and development priorities; and must be transparent, as this will gradually cultivate a compliance culture.

A study by the World Bank (1997) found that operators of the informal sector are poorly protected by the legal system; they have limited access to capital markets and mainly find themselves disadvantaged and distant from the use of public services such as skills training programmes and government-sponsored credit facilities (i.e. some aspects of the legalist perspective can be said to apply in such situations). Such disadvantages faced by these operators in the informal sector may thus influence their commitment levels to the state and could explain the low compliance rate or their resistance to tax. In a more recent study, also proposing legalistic perspective solutions, the World Bank (2010) suggests that removing factors which encourage individuals and businesses to operate in the informal sector, and bringing more of the informal taxable activities into the fold of the formal economy, could systematically reduce the hurdle of dealing with a culture of low tax compliance. However, this study fails to reflect the fact that it is impossible to reduce the informal sector to zero as that there will always be informal sector operators (Misati, 2007). Therefore, policy instruments should be specific for the informal sector operation and should not seek ways to bring them into the fold of the formal sector since dualist and structuralist perspective policies may be required in certain circumstances. No matter how attractive the formal sector will be, there will still be individuals or businesses who may find the informal sector more attractive for their businesses to operate within. Thus, individuals and businesses who operate in the informal sector do so, either for survival needs as proposed by the dualists' theory (ILO, 1972), or to escape the stringent state regulations of the formal economy, as suggested

by the structuralists (Castells and Portes, 1989). This implies that attempting to make the formal sector attractive is not likely to be the only approach to bringing the informal sector operators into the tax net.

There is an argument in the literature that building capacity in core tax administration functions such as registration, filing and payment enforcement, debt collection, audit, taxpayer services, and the processing of appeals will promote voluntary compliance (e.g. Russell, 2010). Russell (2010) however, recognised the impact of technology in promoting compliance tax stressing that information and communications technology are increasingly playing a critical role in compliance management. He argues that the use of ICT, especially in the informal sector is crucial, stating it could promote detection and compliance through the automatic gathering of third-party information as a by-product of natural business processes.

Ongwamuhana (2011), adopts the legalist perspective and argues that low tax compliance could be attributed to the failings of government which include corruption, authoritarianism, wastefulness, and unfairness in the tax system. He states that some people use these failings of the state to claim legitimacy for tax non-compliance. Ongwamuhana (2011) again argues that when people find the tax rates unfair and there is evidence of state failings, they will avoid tax completely or in worse situations, will opt for payment of bribes to corrupt tax officials to escape big payments to the government. In his view, a tax policy will be much more effective for informal sector elements that are created by legalistic perspective concerns if it first addresses these issues (government failings) and works towards building trust in the government and the legal system then the result will lead to promoting improved voluntary compliance.

Even though all these proposals may be suitable in their own right, what they fail to address is the extent of support that revenue authorities could/should offer to individuals to promote voluntary tax compliance, either from the dualist, structuralist or the legalist perspective. For example, what impact could a 'free tax skills training' or workshops have on compliance? Such training could be effective as small businesses and individuals may not have to rely on payment to tax experts (at their own cost), to be compliant. Also, what effect could a local government funding tailored to tax registration and the formalisation of business operation have on small businesses and individuals operating in the informal economy? Such a scheme could promote tax registration, payment, and subsequently promote compliance as businesses

and individuals try not to conceal activities to qualify for subsequent assistance. However, these could be difficult to achieve within a developing country.

Difficulties in understanding the tax laws could also explain why there's low compliance, especially among informal sector operators. In response to tax law complexities, many countries have responded by simplifying their tax laws. New Zealand for example, opted to write their tax law in 'plain English' in response, but no change could be attributed to compliance as a result (Kirchler, 2007). What constitutes a "plain language" in most developing countries which have diverse communities with high disparities in literacy rates and numerous dialects?

Aside from this, most of these developing economies, especially those in Asia and Africa, face the problem of language [and this coupled with the high illiteracy rate could be a potential explanation to the misunderstanding of existing tax laws]. For example, there are an estimated 2,000 different languages spoken among just 53 African nations with Nigeria, Angola, Ghana, Zambia, Cameroon, and Chad having over 150 on average, of existing and spoken local dialects (ACALAN, 2012)⁵. A policy challenge, which confronts these countries, is how easy it would be for tax authorities to publish tax information in succinct of these languages to provide adequate coverage with its population.

Again, the existing tax compliance literature has been silent on one of the biggest challenges many developing economies face, adult illiteracy⁶, particularly in Sub-Saharan Africa⁷, the Caribbean, West and South Asia and North Africa, which account for an estimated 79% of the world's illiterate adults, (UNESCO, 2008).

Corruption is another obstacle preventing developing countries from not only the design of optimal tax policy in the informal sector but also in raising the substantial tax revenue. The corrupt practices of tax officials, including the taking of bribes from business owners, is a major drawback to achieving an effective and efficient tax system in these sectors. The influence of bribery and corruption constantly affects the success of tax policies, therefore strengthening the legal framework to counter corruption is important, but ensuring an

⁵ ACALAN is the acronym for African Academy of Languages which is an affiliate of the African union. details of this data is also available at: http://www.nationsonline.org/oneworld/african_languages.htm

⁶ (UNDP, 2011) defines Adult literacy rate as the percentage of the population ages 15 and older who can, with understanding, both read and write a short simple statement on their everyday life.

⁷ A recent survey even reveals much worse situation for these countries and shows about 60% of adult to be literate (UNDP, 2011).

effective and vigorous application of those laws is essential to detect, deter and prosecute corrupt practices, (OECD, 2009). The key prepositions identified in this chapter (much of which have not been addressed in the informal sector in the developing countries context) form the basis of this study and are tested empirically.

As observed earlier in this chapter, due to the challenges posed by the informal sector, and for administrative convenience, most countries adopt presumptive tax approaches to taxing this sector. The subsequent sections of this chapter discuss some of the presumptive based taxation approaches normally used for the informal sector.

2.6 Presumptive Taxation

2.6.1 Introduction

Presumptive taxation involves the use of an indirect means of ascertaining tax liability, which is different from the usual rules based on the taxpayer's accounts. The term "presumptive", is used to indicate that there is a legal presumption that the taxpayer's income is no less than the amount resulting from application of the indirect method (Thuronyi, 1996, p.1; World Bank, 2011, p.130).

Adopting presumptive taxation helps to combat tax evasion by those taxpayer groups who do not keep accurate financial records or completely fail to keep any financial records for tax purposes, as it allows the authorities to presume their incomes and assign an appropriate amount of tax.

Presumptive taxation is sometimes seen as a 'win-win situation' for both tax authorities and taxpayers. It at least partly addresses the concerns of both parties by providing a simplified tax compliance process without full financial transparency and without involving excessive tax compliance or administration costs (World Bank, 2011).

Achieving the optimal aim of every tax regime – promoting fairness in the form of vertical and horizontal equity - is a challenge when adopting presumptive taxation, however, there are a number of factors which influence the widespread use of presumptive based taxation in developing countries, and section 2.6.2 below discusses some of them.

2.6.2 Why use *Presumptive Taxation*?

As opposed to the conventional form of taxation where tax paid is based on specific tax rates levied on income or profit made, or a flat figure (in the case of VAT and duties), presumptive taxation takes a different approach to tax income. Taxation under this system is based on ‘assumed’ or ‘estimated’ income using a number of factors as the basis for measuring the tax payable at any point or in any particular assessment period. Presumptive taxation encompasses a ‘number of procedures under which a ‘desired’ base for taxation (direct or indirect) is not measured but is inferred from simple indicators which are more easily measured than the base itself’ (Stern and Ahmad, 1991, p.276).

The hard-to-tax, which normally comprises of small retail establishments, professionals, and farmers, are of particular importance to developing countries, however, they are the category of taxpayers who require a different treatment to the refined method of tax administration and provisions in the revenue code, which are those often directly drawn from industrialised countries (World Banks 1987, p.253). For these types of businesses, the World Bank’s publication (1987) suggested that using presumptive taxation is the most realistic approach of bringing them to the tax net.

Jacobs (2013) argued that small businesses, farmers and the self-employed represent a substantial number of the taxpaying public in developing economies, but are the segment that mostly lacks the ability or the desire to comply with tax obligation voluntarily. These groups of taxpayers may not keep proper books and accounting records to self-assess their tax liabilities. They are the group that poses to every tax authority the greatest difficulty - they are the most expensive to properly, and efficiently, administer to collect the desired amount of taxes. Consequently, in most cases, many taxpayers may elude the tax net and may completely escape being taxed altogether (Jacobs, 2013). These groups of taxpayers are therefore best served by the tax authority designing, promoting and establishing an optional presumption scheme (Jacobs, 2013, p.12). Typical options proposed for the design of a presumptive tax system include;

- *standard assessments* – a lump-sum tax levied on taxpayers based on their business activity;

- *estimated income* - presumption taxation based on assessments of indicators or proxies of wealth which are specific to a particular activity or occupation – indicators may include business location, employees or capacity/size of business;
- *minimum taxes* – fixed minimum tax liability regardless of the taxpayers' income or activity; and,
- *gross turnover/receipt* - lump-sum presumptive taxation based on business turnover declared and filed.

Presumption taxation is one of the most common approaches to taxing informal sector activities, not only in developing countries but it also can be found in more advanced economies such as France (Stern and Ahmad, 1991, p.276; Makedonskiy, 2005). The main justification for the widespread use of presumption taxation in the informal sector is partly attributed to the high collection cost, capacity constraints, and incentive constraints⁸ (Brautigam et al., 2008). The following section looks at different presumptive taxation approaches usually used to tax the informal sector.

2.6.3 Methods of Presumptive Taxation

The type of presumptive income taxation approaches which may be adopted by a tax authority may include standard assessment, estimated assessment, visible signs of wealth, the value of assets, and change net wealth. These methods which are used in deciding the applicable presumptive tax payable by a particular taxpayer group in a country are discussed below. Also, see appendix 5 for list of presumptive taxes in selected countries.

2.6.3.1 Standard Assessment

The standard assessment method is the most widely used in presumption taxation regimes. The standard assessment method of presumption tax involves assigning lump-sum taxes to taxpayers based on their occupation or business activity (Jacobs, 2013).

⁸ Educated Tax Officials may not find patrolling poorer areas to identify tax evaders an attractive compared to working in other areas of tax enforcement such as VAT or Customs; or sometimes officers may just dislike dealing with illiterate operators, dangerous and violent tax payers, a feature which is predominant within the informal sector and more importantly associated with Presumptive Taxation.

The standard assessment presumption taxation is established by first identifying the average taxable income of a few individuals and businesses selected at random which is normally determined by establishing the average hour's input, with an average level of effort, undertaken with an average level of risk (Valevich et al., 2004). For example, Ghana adopted these steps to determine the tax liabilities for taxpayers when it first introduced a standard assessment in the 1970s (World Bank, 2011).

The standard assessment method is open to less corruption compared to the estimated assessment method (see section 2.6.3.2 below), however, the issue of equity is difficult to address with this approach.

Despite its simplicity, the standard assessment does not always produce the desired results. For example, Ghana's 2002 budget indicated that the standard assessment tax collected from the Small and Medium Taxpayers (SMT) group was over 75% short of the potential revenue target (Terkper, 2003, p.213).

A study by the World Bank (2011) also recognises the shortfall of the standard assessment presumptive method and suggests that it could be a poor way to mobilise revenue unless the fixed payments are indexed to inflation, and that taxpayers are regularly assessed and, where necessary, are moved to different tax categories as their taxable incomes change. Without these measures, the standard assessment may not be horizontally equitable and may be generally regressive, as taxpayers in the same category but with different situations⁹ and incomes may pay the same amount.

2.6.3.2 Estimated Assessment

The estimated assessment is also another common method of the presumptive tax system which is used predominantly in sectors or activities which are hard to tax.

In designing this type of tax, tax authorities establish criteria which relate to the use of indicators such as labour, physical input, location, and floor space to determine the amount of taxes a taxpayer should be liable to (Ahmad and Stern, 1991). This approach is used to tax individuals and businesses who do not keep any accurate financial records. France administers this through the *Forfait* system where the tax authority involves sector representatives on deciding the coefficients and indices (IMF, 1996; Thuronyi, 2004).

⁹ Standard assessment disregards taxpayers personal situations such as family sizes or losses made in a particular year

Switzerland also has a ‘lump sum’ (same as the Forfait) taxation which is based on the annual rental value of a taxpayer’s residential property. South Korea and Israel have similar systems called ‘*tachshiv*’ presumption (Ahmad and Stern, 1991; Thuronyi, 1996).

The Israeli Tachshiv is an estimated assessment presumption tax designed around sets of objective indicators to estimate the income of taxpayers in different occupations. To arrive at a more representative figure, the Tachshiv is prepared for each industry, usually after years of extensive research and visits to sample businesses. This then follows a discussion of the average profit of a particular industry and its relationship with the assigned indicators with industry representatives before the final tax to be paid on the assessment is issued. Typical indicators may include business location, seating capacity (in the case of a restaurant) or a number of employees (for factories/shops) (Valevich et al., 2004, p.3).

2.6.3.3 Changes to Net Wealth Presumption Taxation

This type of presumption tax involves determining the differences between the beginning and end of year net wealth for tax purposes (Ahmad and Stern, 1991). However, compared to other methods of presumption taxation, it is not popular due to the difficulty and the complexity of establishing net wealth and the two points. It was once a common form of taxation among many South American countries such as Columbia, Mexico, and Argentina, but the difficulty in administering the ‘net wealth’ over the period of assessment led to its widespread abolition in the late 1980s and the early 1990s (Bird, 1991, p.323).

With high inflation in developing countries, estimating net wealth will always be problematic. Furthermore, a system based on net wealth also has the potential of encouraging taxpayers to increase their liabilities to reduce taxable net wealth. Tanzi (1985, p.235)¹⁰ states that the administrative constraints within developing countries render the application of net wealth taxes unproductive and inequitable and that it has proved rather costly to those developing countries which tried to implement it. Therefore, it is not now a widely-used form of taxation in developing countries.

¹⁰ Cited in (Bird 1991, p323)

2.6.3.4 Value of Asset Presumptive Taxation

The values of certain types of assets are used to estimate the amount of taxes that the owners of such assets should pay in some tax regimes (IMF, 1987).

This is very common in some South American countries such as Mexico, Colombia, and Chile, and despite the issue of valuation inaccuracies, it is argued that this approach leads to a more accurate application of tax since it is based on income generated by the asset over the year (Thuronyi, 1996, p.15). In Chile, farmers who do not have accurate financial records for tax purposes, pay a 10% fixed rate of tax on the assessed value of their farm for the year. However, farmers are allowed to challenge such taxes if they are able to demonstrate a lower income than that estimated (i.e. usually rebuttable). Columbia, on the other hand, adopts the irrebuttable system and levies an 8% rate on all taxpayers without any possibility to challenge it (IMF, 1987).

Taxing on the value of assets is useful in countries which experience high economic downturns, particularly those with persistently high inflation. It is argued that taxes on enterprises cannot generally be relied upon during periods of high inflation, due to the fact that viable businesses may declare losses to the inflation effects, thereby eroding the tax revenue otherwise generated (Sadka and Tanzi, 1993). In this instance, the system of taxation is based on the value of assets and it disregards other macroeconomic effects on businesses.

The idea of a tax on the value of assets has been in place for several years, believing to be first introduced by the Romans in Milan back in the 17th Century. It replaced the net wealth taxes in Argentina and Mexico from the 1990s partly to ensure that businesses contributed their fair share to the Treasury and also to promote efficiency among business enterprises (Sadka and Tanzi, 1993). A challenge to this form of taxation is whether the tax liability should be based on the net or gross value of the assets and if there should be a consideration for indexation (in this case depreciation of the asset's value) over time.

2.6.3.5 Gross receipts / Turn-over

This is an approach which involves the application of a fixed minimum income tax (OECD, 2009, p.127) regardless of the size of the business or the level of its activities (Reinikka and Collier, 2001, p.286). This is credited against the actual business tax; however, it does not allow any refunds in the event of shortfalls in income or profit made.

Under a gross receipts presumption tax, businesses are required to pay a fixed amount of tax on gross incomes received without any consideration to costs incurred in relation to that receipt for which the payment is due (Reinikka and Collier, 2001). In most countries where there exists gross receipt presumptive taxation, there also exists a minimum tax. Put simply, some schemes specify a tax burden or minimum tax irrespective of the taxpayer's level of income or economic activity; others levy the tax as a relatively low percentage of turnover or assets, and where both systems exist, businesses tend to pay the larger of the two (World Bank, 2011).

From January 2013, the Seychelles Revenue Commission (SRC) adopted a gross receipt presumptive tax system in an attempt to improve voluntary compliance through a simplified compliance tax process. This system is for businesses with an annual turnover not exceeding SR 1 million (approximately £51,505)¹¹. The SRC justifies the rationale for this tax regime stating, 'we want to make it easier and cheaper for businesses to comply with their obligations as taxpayers with a system that reduces compliance burden in terms of time, money and effort required' (SRC, 2013). The rate is capped at 1.5% of the business' annual turnover¹². The annual turnover is determined on a cash basis on gross receipts derived from its activity. Businesses expenses are not taken into account, and businesses are put into brackets. The actual business receipt is not used in determining the tax liability; instead, the SRC uses the previous year's gross receipts as the tax base for the current year. The presumptive tax return of these businesses is done once a year on a simplified 'one-page' document, compared to the multiple page tax returns required to be completed by small business owners in previous years (SRC, 2013).

2.6.3.6 Visible signs of wealth

This is a type of presumptive tax approach which involves the tax authority using certain indicators as a presumption to determine the amount of tax to be paid by a taxpayer. Using this approach, the tax authorities for example in Italy, France, and other Francophone African countries, build tax codes using these visible signs to determine the cash income equivalence (Ahmad and Stern, 1991, p.278). Indicators used may include the main or secondary residence, air travels, electricity consumption (Thuronyi, 1996). The challenge with this

¹¹ Exchange rate (£1 = SY 19.5) on 10th January, 2018 (www.xe.com)

approach is obvious – how does a tax authority codify a cash equivalence of a particular sign of wealth? In addition, do all signs of wealth necessarily equate to wealth? For instance, someone may have a servant in the house for disability needs rather than being rich or may travel for family or health reasons rather than business or holidays, etc.

Furthermore, this approach may encourage illegal activities. For example, a tax authority which adopts the visible signs of wealth rather than physically conducting an assessment to determine real wealth may be encouraged to tax illegal activities such as drug dealing – attention may be shifted to the tax revenue rather than assessing the legality of the activity being taxed.

2.6.4 Presumptive taxation systems in selected advanced and middle-income countries

Although presumptive taxation schemes are popular around the world, there are differences in the systems used across countries as almost every tax regime tries to operate the system in a different way. Studies by Engelschalk, (2005, p.5) outlined a number of presumptive tax practices across different countries. For example, Albania uses gross turnover tax where taxpayers with income of £13,500 - £55,000¹³ pay 4% on their gross receipts. On the other hand, Lithuania operates an optional presumptive tax system where taxpayers with income under £19,500 pay a fixed amount or undertake formal assessment. Russia uses a number of factors to determine the tax liability under its presumption tax system, such as type of industry, number of employees and type of ownership (i.e. entrepreneur or company). France operates a more complex lumpsum presumptive tax system where a taxpayer must furnish information with respect to the preceding year: purchases, sales, the value of closing inventory, number of employees, amount of wages paid, and number of cars owned by the taxpayer, etc. to determine the tax liability. See appendix 5 for common presumptive taxes in selected countries.

The differences among the types of the presumption taxes may be explained by both the economic and the general business environment of the countries, however, Engelschalk (2005) pointed out that largely these presumptive tax systems are the result of recommendations from key donors and policy advisors such as the World Bank and IMF. Apart from revenue generation, some of the key motives for these presumptive tax regimes

¹³ Turnover 2-8 million Lek. Exchange rate: £1 = 144.5 Lek on 24/05/18 from www.xe.com

are the improvement of the business environment or the simplification of tax administration and the fight against the informal sector as noted by Engelschalk (2005). The next sections analyse some of the forms of presumptive taxation.

2.6.5 Forms of Presumptive Taxation

Presumptive taxation may take different forms. The form a particular country adopts depends on the rights and involvement of the taxpayers. While some systems allow a degree of taxpayer involvement, others have full control of the system vested in the hands of the tax officials/authority.

Presumptive taxation is evident in almost every tax jurisdiction, even in advanced economies, but it's very much a common feature of developing countries where large informal sectors are present and difficult to tax (World Bank, 1987). The different types and forms of presumptive taxation have different motives which include incentive effects, revenue effects, distributional consequences, and administration costs considerations which are discussed below;

2.6.5.1 Rebuttable Presumption Taxation

The rebuttable presumption taxation approach adopts an administrative process to reconstruct the taxpayer's income in the event of a perceived discrepancy in the tax to be otherwise paid by the taxpayer (Thuronyi 1996, p.403). Under a rebuttable presumption tax system, if a taxpayer disagrees the tax levied, there exists an arrangement for the taxpayer to appeal by providing the actual income for the period and proving that the tax to be paid under normal assessment is less than the one levied under the presumption arrangement. The rebuttable arrangement is thus seen as not much of a departure from the normal rules of assessing tax liability. It encourages taxpayers to disclose actual incomes and may be useful in taxing those who may otherwise deliberately conceal incomes in order to evade taxes, for example, where structuralists' motivations may exist for the operation of the informal sector.

The simplified taxation system in Russia and the forfait system in France are examples of rebuttable presumptive tax systems as in both jurisdictions taxpayers have the right to choose between special treatments and general taxation procedures (Makedonskiy, 2005).

2.6.5.2 Irrebuttable Presumption Taxation

The irrebuttable presumption taxation, on the other hand, does not allow for any adjustment to taxes levied under the presumption system and any amount levied by the tax authorities cannot be challenged. Thus, irrebuttable presumption taxation imposes restrictions on the rights of the taxpayer under special treatment by them being unable to contest a tax liability imposed, therefore this approach requires greater precision in terms of the legislative determination of the procedure for the application and accrual of the tax (Makedonskiy, 2005, p.7).

The irrebuttable approach has some key features which differentiate it from the rebuttable system. For example, an irrebuttable presumption tax system may have a ‘minimum tax’ element, which implies that a taxpayer will not have a tax liability less than that determined under the presumption rules; and an *exclusive* system where tax liability is determined under the presumption alone, even if the regular rules might lead to a higher liability (Thuronyi, 1996). An example of the exclusive arrangement of presumption taxation may be a fixed tax on a farmer based on the estimated value of the land rather than the harvest proceeds for the year. An exclusive presumptive tax does not depend on actual income, it encourages the taxpayer to strive for additional income, due to the non-taxable marginal yield.¹⁴

2.6.5.3 Mechanical and Discretionary presumptive taxation

Presumptive taxation can also be identified by two main approaches, based on the degree of freedom exercised by the tax authorities in determining the tax liabilities. These are mechanical or formal and discretionary approaches.

2.6.5.3i. Mechanical / Formal Presumptive Taxation

A presumption tax may take the form of a formal or discretionary. Under this system, the tax liability is determined by an established set of rules. These rules may be specific to a particular tax regime, country or the nature of the activity to be taxed under presumptive arrangements. Tax officials in such circumstances apply no discretion in determining tax liabilities. Makedonskiy (2005) argues that the mechanical presumptive tax system may lead

¹⁴ Since the taxes levied under this system, does not depend on actual income, the major drawback of the exclusive presumptive taxation is the frequent violation of the principle of fair taxation. (Makedonskiy, 2005, p8)

to excessive taxation, as the system does not consider the specific circumstances of individual taxpayers. However, in situations where the tax authority does not have the administrative capacity, this approach becomes the most viable option for reaching those whom they find it difficult to tax.

2.6.5.3ii. Discretionary Presumptive Taxation

In contrast to formal rules establishing tax liabilities, under the discretionary presumptive tax system, the tax official is allowed to employ a high degree of discretion in determining the tax liability at any point. This presupposes that the formal process is less prone to corruption, favouritism and general tax frauds, compared to the discretionary system which could be exposed to several loopholes. For instance, taxpayers with strong negotiation skills may benefit from this approach and this may not be a fair and balanced system due to a high possibility of bribery and the abuse of tax officials' discretionary powers.

2.7. Summary

This chapter discussed the concept of the informal economy and distinguished between the two main divisions of the informal sector - illegal activities (excluded from this study) and legal/taxable economic activities (the focus of this thesis).

This chapter also presented the three schools of thoughts of the informal sector – dualist, legalist and the structuralist ideologies and the policy recommendations of each theory for the informal sector. The discussion points out that designing a standard policy to deal with the informal sector is not realistic and that different elements of the informal sector may suggest a particular or a combination of policy responses from different theoretical perspectives.

Finally, this chapter reviewed some of the existing literature on presumptive taxation as the dominant form of taxing informal sector economic activities in many countries.

Evidence from the literature suggests that despite the challenges associated with presumptive based taxation, it is by far the most popular form of taxes applied in most developing countries.

Although a well-designed and effectively administered presumptive taxation scheme can help reduce corruption, it could promote the discretionary power of tax officials, which may breed corrupt practices (Shukla et al., 2011, p22). As noted in this chapter, most of the presumptive tax approaches involve at least some element of the discretionary procedure to determine tax liabilities. Terkper (2003, p.230) concludes that ‘failed presumptive tax systems result in corruption of officials, arbitrary use of powers, and decline in inspections’.

Ghana, like most developing countries, adopts presumptive taxation for its informal sector, and over the years this has undergone several changes. The next chapter describes Ghana’s informal sector and the strategy for taxing economic activities within it.

CHAPTER THREE

INFORMAL SECTOR TAXATION IN GHANA

3.0. Introduction

As discussed in chapter one, Ghana has been chosen as the case country for this study. This chapter, therefore, reviews details of Ghana as it relates to an understanding of its socio-economic makeup and an understanding of the formal versus informal sectors.

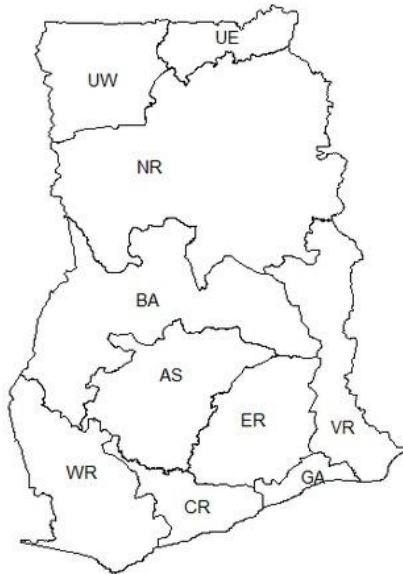
The chapter first discusses the tax administration in Ghana and the country's informal sector.

A brief background of the country is given in the first part, which is followed by a discussion of the country's tax system and its informal sector. Here, the discussion is limited to the nature of activities within the sector, its size, contribution to the economy and its general composition. The types of taxes administered in the country are also discussed with particular attention to informal sector taxation approaches. Finally, notable tax offenses and their associated penalties are also addressed.

3.1. Ghana – Country background

Located in Sub-Saharan Africa, Ghana has a population of 24.6 million (GSS, 2012) and geographically, the country is divided into 10 regions¹⁵

Figure. 3.0 Map of Ghana showing the regions



Source: (TCPGhana, 2012)

¹⁵ Greater Accra, Ashanti, Eastern, western, Volta, Central, northern, Brong Ahafo, Upper East, and Upper West

The population of Ghana is made up of 97.6% Ghanaian nationals, while 2.4% are Non-Ghanaians.

The overall literacy rate in the country is 74.1% whilst English literacy [the official national language] rate stands at 67.1% (Unicef, 2012; GSS, 2012). Literacy is defined by the Ghana Statistical Services as the ability to read and write in any language (GSS, 2012).

The country has a diversity of religious denomination but it's dominated by people of Christians faith (71.2%)¹⁶, followed by Islam (17.6%), traditional religion (5.2%), and the non-religious including Atheists (5.3%) (GSS, 2012).

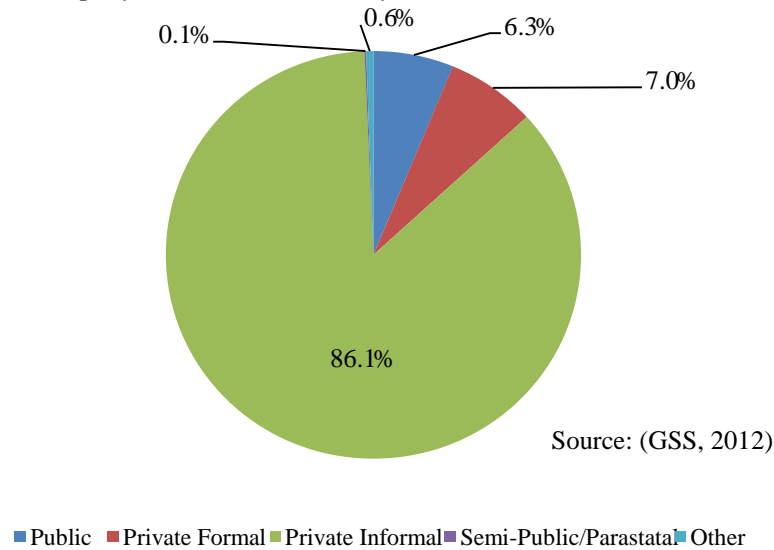
In the discussion and conclusion chapters, these demographic variables are analysed to assess their possible influence on the tax compliance decisions of the informal sector operators in the country.

3.1.1. Ghana's employment sector

The Ghana statistical services (GSS) records indicate that the employment sector of employed persons in the country is dominated by the informal economy which accounts for 86.1% (GSS, 2012). The minimum wage stands at GH¢4.48 per day (MOFEP, 2012), the equivalent of £1.62 (FxExchange.com, 2012).

¹⁶ Christianity is an umbrella term in this sense comprising of Pentecostal/Charismatic 28.3%, Protestant 18.4%, Catholic 13.1%, other 11.4%

Figure.3.1 – Ghana employment distribution by sector



3.2. Tax Administration in Ghana

The Gold Coast, now Ghana, became an official British colony in 1874 (Brown University, 2014) following the *Treaty of Fomena* which ended the third war between the British and the Ashantis, the main rulers and dominant force in the country (Crawford, 1996). Although Thomas Windham made the first English recorded trading voyage to the Coast back in 1553 (IBP USA, 2002), it was in 1821 when the British Government took control of the British trading forts on the Gold Coast (Noble, 2012, p.192).

The British appointed colonial officials were headed by a governor to rule the colony. The Colonia officials established a legislative council, which included appointed representatives (from 1889) and elected members (from 1925), (Brown University, 2014). The governor replicated the British system of governance in the Gold Coast in all areas, and even though Ghana gained its independence from British rule in 1957, the country still maintains many of the fundamental administrative systems established during the colonial era, and tax administration is an example.

Taxation started in Ghana back in April 1852 when the then British Empire passed the Poll Tax Ordinance under which each man, woman or child in districts under British protection paid one shilling per head per year to raise money to finance the increasing cost of British Administration (Ali-Nakyea, 2008, p.3). Formal taxation was introduced in the Gold Coast in 1943 by the British Colonial Government, in the heat of World War II, the Income Tax Ordinance (No. 27) of 1943 and it was administered by the Income Tax Department (Ali-

Nakyea, 2008). Between 1961 and 1963, different taxes and duties were introduced and the name of the tax administration office of the Government was changed to the Central Revenue Department.

Since the 1980s, the Ghanaian tax system has undergone several reforms to improve revenue collection. The Ghanaian government in 1986, introduced the National Revenue Secretariat (NRS) (Devas et al., 2001). The NRS worked with the Ministry of Finance in policy formulation in areas relating to revenue. Two separate revenue authorities were created under the NRS to give operational autonomy. These two authorities were, the Internal Revenue Service (IRS) and the Customs, Excise and Preventive Service (CEPS).

In addition to its role of formulating revenue policies and managing tax reforms, the NRS was responsible for supervising the activities of the two tax bodies (CEPS and IRS) (ATRN, 2014). Following several challenges, opposition and policy conflicts, the two separate tax authorities were brought under the control of the Ministry of Finance in 1991. In 1998, the country introduced a Value-Added Tax (VAT), also, the Value-Added Tax Service (VATS) was introduced as a division to oversee all consumption taxes. In the same period, Parliament passed a law to create the Revenue Agencies Governing Board (RAGB) to provide supervisory services to the VATS, CEPS, and the IRS and this replaced the NRS (ATAF, 2013).

In its recent restructuring, the Ghana Revenue Authority (GRA) was established by an Act of Parliament, Act 2009 (Act 791) to merge all the three tax revenue agencies (i.e. VAT, CEPS, IRS) and the RAGB. The GRA is tasked with three main responsibilities, to:

- integrate Internal Revenue Service (IRS) and Value Added Tax Service (VATS) into domestic tax operations on functional lines.
- integrate the management of Domestic Tax and Customs
- modernise Domestic Tax and Customs operations through the review of processes and procedures with ICT as the backbone

(GRA, 2016)

To promote operational efficiency and to cater for taxpayers' specific needs, in 2013, the GRA segmented taxpayers into three main categories (GRA, 2016). The categories [and the total number of each in the country] are:

- a) 1 Large Taxpayer Office (LTO), with a commissioner as general overseer.
- b) 15 Medium Taxpayer Offices (MTO) headed by an assistant commissioner and,
- c) 50 Small Taxpayer Offices (STO) headed by chief revenue officers

3.2.1. The GRA integration

The integration, according to the GRA (2016), aims to:

- reduce administrative and tax compliance cost and to provide better services to taxpayers;
- provide a one-stop service for taxpayers for the submission of returns and payment of taxes;
- provide common tax procedures that enable tax payers to be governed by a single set of rules;
- improve information linkage and the sharing of information among the Divisions of the Authority

3.3. Formal Sector taxation in Ghana

Various forms of taxes are administered within the formal sector. The main taxes include Personal Income and Corporation Taxes, Value Added Taxes (VAT), Rent and Property Taxes, Social Security Contributions, Capital Gains, and Gift Taxes.

3.3.1. Income taxes

The GRA splits income taxes into three;

- **Corporate income tax** - This is the tax paid by companies on their profits in the year. The current tax rate is 25%. (see appendix 3).
- **Personal Income Tax** – This is paid by self-employed persons who pay at graduated rates in four equal installments during the financial year.
- **Pay As You Earn (PAYE)** - The PAYE contributions are withholdings from salaries of employees in order to satisfy their income tax responsibilities. The PAYE is computed with the Personal Income Tax rates (as shown in Appendix 2).

The Domestic Tax Revenue Division administers various taxes as the PAYE, Personal Income Tax, Corporation and other forms of taxes such as the Value-Added Taxes (VAT), Gift Taxes, National Health Insurances and various duties and levies (GRA, 2016).

Appendixes 2 and 3 show details of income tax rates and bands paid by individuals and companies in the country.

In addition, for resident individuals, there is a general 5% withholding tax on payments for contracts for the supply or use of goods or property or services of any kind and for the supply which involves a resident person and another resident person – on account of tax liability (KPMG, 2012, p1). Non-resident individuals are, however, subject to a range of withholding taxes on incomes accruing in Ghana or derived from Ghana.

Non-resident companies pay different rates of corporation taxes compared to resident companies and their rates are presented in appendix 3.

3.4. Taxpayer identification

Currently, Ghana has no national identity card system (although there are ongoing steps to start one soon), therefore the Taxpayers Identification Numbering (TIN) system was introduced by the Taxpayers Identification Numbering Systems Act 2002 (Act 632) with the view to enabling better identification of taxpayers (Ali-Nakyee, 2008).

The TIN is required by and issued to, anyone liable to pay taxes. Thus, any person who is ‘liable to pay tax, or from whom taxes are withheld at source by employers or agents through payroll deductions and /or other business transactions under any enactment is required to register’ (GRA, 2016). The TIN does not carry any direct welfare benefits; however, it can

be likened to the National Insurance Number (NI) in the UK. The TIN, just as the NI allows the tax authority to assess the tax status of all taxpayers, such as tax under or overpayment.

3.4.1 Usefulness of the TIN

To make the TIN useful and to enable the tracking of transactions, the GRA states that anyone without the unique registration number [TIN] is not allowed to undertake certain transaction (GRA, 2016, also see Ali-Nakyea, 2008, p.59) such as:

- clearing any goods in commercial quantities from any port or factory in the country,
- registering any title to land, any interest in land or any document affecting land,
- obtaining any Tax Clearance Certificate from the Internal Revenue Service, Customs Excise and Preventive Service or the Value-Added Tax Service,
- obtaining a Certificate to commence business or a business permit issued by the Registrar-General or a District Assembly,
- receiving payment from the Controller and Accountant General or a District Assembly in respect of a contract for the supply of any goods or the provision of any services.

3.5. Ghana's informal sector

Like many developing economies, Ghana's informal domestic economy is large and very heterogeneous. The sector involves activities which include businesses in cities as well as small activities in the rural communities which receive minimal regulation. The activities taking place within this sector are diverse and as identified by (Aryee, 2007) may include activities such as trading, agriculture, transport, tailoring, Susu (i.e. credit facilities), herbalists, distilleries, corner shops, hawking, shoe-makers, food preparation vendors, see sample list in table 3.1 below. The list in table 3.1 shows a number of informal associations

which relate to some of the activities of the sector and which form the basis of the informal sector taxation in the country discussed in section 3.6. Looking at the list in table 3.1 below, though the list is not exhaustive, it at least gives an indication of the enormous size of the informal sector which makes it extremely difficult for tax planners to design a tax system to suit this heterogeneous sector. As most transactions in this sector involve unofficial credit arrangements or cash exchanges, determining the income of businesses in this sector for tax purposes is a very hectic task.

Table 3.1 Some of the Informal Organizations in Ghana

1. Ghana Private Road Transport Union (GPRTU)	17. Sandcrete Block Manufacturers Association
2. Ghana Cooperative Transport Society (GCTS)	18. Ghana Gold and Silver Smiths Association
3. Progressive Transport Owners Association (PROTOA)	19. Second Hand Clothes Dealers Association
4. Ghana National Chemical Sellers Association	20. Radio and Television Repairers Association
5. Ghana National Tailors and Dressmakers Association	21. Ghana Cooperative Distillers Association Ltd
6. Musician Union of Ghana	22. Cornmill Owners Association
7. Phonogram Producers Association	23. Licensed Diamond Winners Association
8. Ghana Tape Recorders Association	24. Ghana Association of Private Sports Papers
9. National Drinking Bar Operators Association	25. Ashiaman Livestock Breeding and Traders Association
10. National Garage Owners Association	26. Butchers Association
11. Greater Accra Second Hand Spare Parts Dealers Association	27. Ghana Livestock and Meat Marketing Association
12. Refrigeration and Air-Conditioning Workshop Owners Association	28. Video Operators Association
13. Chop Bar Keepers and Cooked Food Sellers Association	29. Ghana Private Schools Association
14. Hair Dressers Association of Ghana	30. Day Care Centres Association
15. Susu Collectors Association	31. Akpeteshie Distillers Association
16. Traditional Healers, Fetish Priests, Mallams and Drug Peddlers Association	32. Second Hand Car Dealers Association
	33. Ghana Union Traders Association (GUTA)

(Source: Aryee, 2007)

Despite the large informal sector, a study by the African Tax Research Network (ATRN) shows that the sector accounts for 2.4% of domestic (income) tax revenue while large enterprises, which make up less than 1% of the country's businesses, contribute 74.4% to domestic tax revenue. The remaining 23.2% make up the contributions from the medium scale enterprises (ATRN, 2014).

3.5.1. Classification Ghana's informal sector businesses for tax purposes

In 2006, for tax purposes, the GRA grouped Ghana's informal sector businesses into the following categories (Table 3.2). This was the initial classification¹⁷ and a more recent classification of businesses for presumptive tax purposes is shown in table 3.3. Each of these categories is subsequently placed in a (presumptive) tax bracket. The tax paid in each bracket is a flat rate. This classification forms the basis of Ghana's presumptive tax system. See chapter two for a detailed discussion of presumptive taxation.

¹⁷ Details of this classification is also available on the GRA website: http://www.gra.gov.gh/docs/info/guide_tax_stamp.pdf . The GRA has types 2-8, and no records of type 1

Table 3.2 GRA initial Informal Sector Business Classification

Class of persons	Sub-Class of Persons	Quarterly¹⁸ Amount of tax¹⁹
Type 2 - Dressmaker/ Tailor	Category A- Large Kiosk B –Medium C -Small	GH¢ 15 GH¢ 10 GH¢ 5
Type 3 - Susu Collectors	Category A- Cities B- Urban C- Rural	GH¢ 15 GH¢ 10 GH¢ 5
Type 4 - Chop Bar Owners/ Cooked Food Sellers	Category A- Large Kiosk B- Medium C - Small D - Table Top	GH¢ 15 GH¢ 10 GH¢ 5 GH¢ 3
Type 5 – Butchers	Category A- Large Kiosk B Medium C Small D Table Top	GH¢ 15 GH¢ 10 GH¢ 5 GH¢ 3
Type 6 - Hairdressers and Beauticians/ Barbers	Category A- Large Kiosk B-Medium C- Small	GH¢ 15 GH¢ 10 GH¢ 5
Type 7 - Garage Owners	Category A -Cities B -Urban C –Rural	GH¢ 15 GH¢ 10 GH¢ 50
Type 8²⁰ - Diamond/Gold Winners and Sellers	Category A - Licensee B – Sub Agent	GH¢ 15 GH¢ 10

Source: (GRA, 2006, p.4)

Table 3.2 above shows the initial business classification for the stamp duty introduced in 2005. The most recent classification is in table 3.3.

3.5.2. GRA classifications of informal sector businesses

Most recent classifications of the GRA of the informal sector businesses use categories A, B, and C, with each having a different tax stamp colour for identification purposes (see table 3.3 for the colour of categories) (ATRN, 2014). The tax stamp, which has to be displayed

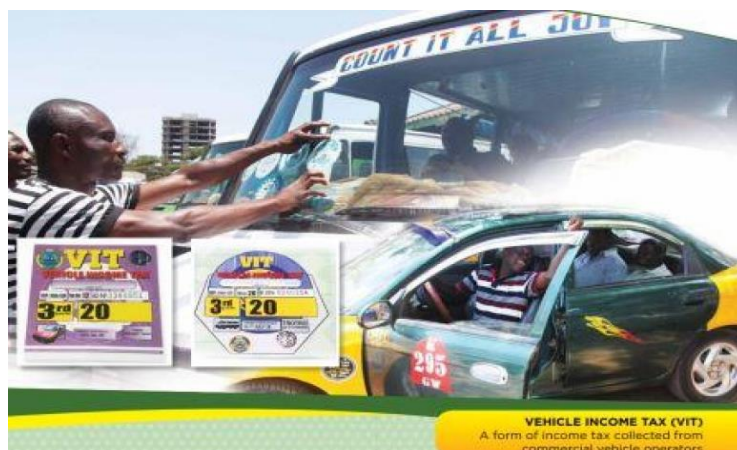
¹⁸ The tax is paid quarterly in advance i.e. 15th January-15th April, 15th July and 15th October.

¹⁹ Exchange rate is based on (equivalent) redenomination rate in May 2006 of £1 = GH¢ 1.71 (i.e. GHs 17,100). Where ¢10,000 = GH¢ 1 (GNA) stated on (Ghanaweb.com, 2006).

²⁰ Type 8 and no category C. from the GRA publications

throughout its validity, contains basic taxpayer information such as name [of a person or business], validity period, and the amount paid. To prevent duplication, there are security features embedded in these round-shaped stamps. Below are some sample pictures of the tax stamps.

Figure 3.2 Ghana Vehicle Income Tax (VIT) being displayed on Van/car windscreen



Source: (GRA, 2016)

Figure 3.3 Sample Ghana tax stamps of different trades/businesses (by colour)²¹



Source: (GRA, 2006)

All operators of the informal sector are required to purchase the tax stamp quarterly²² from the domestic tax revenue division, and the stamp which is a form of estimated presumptive

²¹ Amount shown in tax stamps indicate Ghana currency before redenomination in 2007. Ghana redenominated its currency, the cedi by setting ten thousand cedis to one new Ghana Cedi (GH¢). That is $\text{¢}10,000 = \text{GH¢} 1$. The rate at redenomination was $\text{¢}17,400 = \text{£}1$ (Bank of Ghana, 2007).

tax system, must be ‘conspicuously displayed at the business premises or carried along (in the case of itinerant traders) for inspection at any time’ (GRA, 2014). The tax stamp forms the main basis of the collection of taxes through the presumptive system.

The Small Taxpayer Office (STO) of the Ghana Revenue Authority (GRA) administers the tax stamp. The STO administers the taxes of all [small] businesses with an annual turnover of up to GH¢90,000 (i.e. approximately £16,000)²³. Businesses which operate a permanent structure (e.g. with a fixed location) which fall under this income threshold and are registered, go through the formal assessment process, however, those falling within this income level but do not meet the ‘permanent structure’ and are unregistered, are taxed under the tax stamp system. The tax stamp was introduced in 2004, although it came into effect in 2005, it aimed to expand the tax base by bringing such businesses hitherto untaxed into the tax net (Danquah and Osei-Assibey, 2016, p.16).

Table 3.3 Quarterly presumptive tax rates of selected informal sector operators

Category		Rate per quarter (GH¢)	Rate per quarter in (GBP £) ²⁴
A	Large	45	8.04
	Medium	30	5.36
	Small	10	1.79
	Table-Top	3	0.54
B	Large	35	6.25
	Medium	20	3.57
	Small	5	0.89
	Table-Top	3	0.54
	Large	25	4.46
	Medium	15	2.68
	Small	3	0.54
	Table-Top	3	0.54

Source: Ministry of Finance (2011).

3.5.2a. Category A activities

This group comprises of businesses specialising in commerce - retail trade; “Susu collectors²⁵”, pubs and ‘chop bar²⁶’ owners. This group may also include bakeries, Internet

²² Ghana tax year begins on 1st January and ends on 31st December (KPMG, 2017).

²³ Danquah and Osei-Assibey (2016). Exchange rate: £1 = GH¢ 5.6 (FxExchange, 2017)

²⁴ Exchange rate: £1 = GH¢ 5.6 (FxExchange, 2017). Rate on year of article publication, 2011 was £1 = GH¢ 2.57 (FxExchange, 2011)

cafés, rental agents, building block and terrazzo (e.g. tiles) sellers, sand/stone sellers, and contractors. Finally, this segment of taxpayers may also include the activities of licensed diamond and gold sellers/buyers (ATRN, 2014).

3.5.2b. Category B activities

This category consists of individuals and businesses engaged in vocational activities such as tailors and seamstresses; barbers/salon and beauty shops, artisans; hiring services; photographers; and car washing bays (ATRN, 2014).

3.5.2c. Category C activities

This group consists of agriculture-related activities such as charcoal and firewood sellers, traditional doctors (healers), butchers, corn millers, and other businesses determined by the Ministry.

Also, all businesses, other than hawkers, operating in the city, are classified as large, whilst those businesses in bigger towns that are not categorised, are classified as medium. Those businesses in rural areas and small communities are grouped under the ‘C’ category. (ATRN, 2014).

3.5.3. Challenges to effective taxation of the informal sector in Ghana

As discussed in chapters 1 and 2, the difficulty in designing and successfully implementing an effective tax for the informal sector emanates from the fact that most businesses operate on a cash-only basis, as noted by Ofori (2009), and may not accept cheque or any other form of payments. This payment method provides the opportunity for enterprises not only to record inaccurate figures for tax avoidance but also to eliminate any form of third party information that could lead to them being caught on any underreporting activities and thus

²⁵ Thrift and credit businesses.

²⁶ Local /mini restaurants

aid such businesses to conceal their taxable profits. This justifies the current presumptive approaches.

No active record keeping implies that tax authorities are not able to determine the tax liabilities of businesses in this sector in the way of typical formal sector taxation where the incidence for determining tax liability is based on the proper assessment of a business's internal records. At one level, it can be argued that this could perhaps be attributed to the high level of illiteracy among informal sector operators (as discussed in chapter 2). However, this is likely to be only partly an explanation for poor record-keeping.

The difficulty in establishing an appropriate tax system in Ghana informal sector is not due just to the lack of data to assess tax liabilities, rather the tax officials sometimes lack the morale and motivation to engage with the informal sector. Some tax officers believe that the sector is unrewarding, demeaning of their status or potentially a dangerous area to enforce compliance in some circumstances (Joshi and Ayee, 2006).

In certain situations, tax officials patrol these informal sectors to collect and also to identify tax evaders, with minimal resources, (e.g. walking long distances). Such conditions are disliked by many educated officials who also do not want to interact with the illiterate poor, disenchanted and at times violent citizens who see little or no reason for paying business taxes. Again, many tax officials dislike dealing with those in the informal sector due to the low possibility of job progressions (Aryee, 2007).

The lack of incentives for tax revenue staff working in the informal sector has been identified as one key element accounting for the low tax revenue from the sector. A study of Nigeria's informal sector by the Civil Society Legislative Advocacy Centre (CISLAC) found that tax officers are usually reluctant to be assigned to the informal sector, citing factors such as a gap in education, social status and some inherent dangers (CISLAC, 2008, p.7). This low level of motivation may impact on their level of engagement with taxpayers which may subsequently lead to a reduction in tax revenue. The CISLAC study further suggests that the lack of motivation may stem from the nature of the work which sometimes involves patrolling remote and poor areas to identify tax evaders, which officers sometimes feel that they do not get the required recognition as other revenue officers working in the tax offices. The study thus concludes that compared to those working on corporate taxes or customs, tax officers working in the informal sector have limited promotion opportunities especially considering the fact that the environment offers relatively low status, it's unrewarding and there are risks

associated with patrolling in these poorer areas, especially where officers have to deal with serious evasion cases involving taxpayers who are violent.

Most developing economies, including Ghana, design the informal sector taxes in a similar way to those in the formal sector, with limited consideration of the taxpayers in the informal sector (Ritchie, 2006). With little known information about operators, direct presumptive taxation becomes more promising. In presumptive systems, assessments are based not on calculations of actual income, but on broad indicators of the scale of profits likely being made (Bird and Wallace, 2003; Sadka and Tanzi, 1993; cited in Bräutigam et al., 2008). Presumptive tax is discussed in more detail in chapter two.

Bräutigam et al. (2008) suggest that, depending on the nature of the economic activity, tax policy planners could use indicators such as the size and capacity of machinery, commercial space in terms of footage occupied, number of employees or the number of customers served, as bases for presumptive tax. This approach, complemented with a simplified self-assessment method, has been used widely in Ghana since the eighties and in many other developing economies (Bird and Wallace, 2003).

Capacity constraint is also a major issue for the effective taxation of the informal sector as observed in chapter two. Budget for the tax administration function of most developing countries, including Ghana, is tight in terms of personnel and taxing the informal economy requires at times, twice or three times the effort of taxing the formal sector (Bird and Wallace, 2003). As noted earlier, Ghana and most countries overcome this by adopting presumptive based approaches to taxing informal sector economic activities.

A further major hurdle for the effective design and implementation of a successful tax system in the informal sector is the influence of corrupt political leaders and apparent lack of political will to tax the sector for the obvious reason – political expedience (election votes from a dominant sector). High illiteracy rates in developing countries make it possible for taxpayers to be influenced by promises made by corrupt politicians (for example promise of no or a low rate), which, after an election, the taxpayers try to live by, thus making tax compliance a real daunting task. This is what Tendler (2002) cited in (Aryee, 2007) describes as the ‘devil’s deal’—an unspoken arrangement between politicians and informal sector operators:

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

The resulting impact is that public officials and politicians deliberately refuse to implement any tax enforcement program in this sector particularly those that are more likely to be disliked by taxpayers, to retain and broaden their support base during election times.

3.6. Informal sector taxation approaches in Ghana

Ghana has historically employed many strategies to tackle the problem of low compliance level within the informal sector including standard assessment, using tax stamps, and attempting the use of an association form of presumptive taxation for several years in the late 1970s to mid-2000s. The next sections assess the various tax administration strategies employed by the Ghana revenue authority since the 1970s.

3.6.1. Standard Assessment

1970 – 1986

During this period, operators in the informal sector were subject to a lump-sum of tax, which was levied based on the nature of activities undertaken by individuals and businesses. Some changes were made to the system during its operation. The standard assessment tax approach was a complete flat system, which implied that small businesses in the informal and larger companies in the formal sector were in effect, paying the same level of taxes. There were virtually no considerations for individual business's financial situation or nature of the activity as in the case of current tax stamp regime. The operators of the informal sector perceived this approach as unfair and discriminating (Joshi and Ayee, 2002b). Again, this system gave little attention to businesses in the informal sector, which predominantly operate on small scales, and therefore paying flat taxes, the same as large businesses in the formal sector, was deemed unfair.

With huge corruption and several loopholes, the system was abolished in 1986 in place of the use of (an indirect) associational basis for taxation rather than collecting taxes directly from informal sector taxpayers (ATRN, 2014).

Associational taxation is believed to be an ideal way to tax an informal sector if the motivation is to move it towards the development of a formal and more compliant tax system in contexts like that found in Ghana, (Bräutigam et al., 2008). This strategy has a potentially wide reach, compared to the standard assessment method as it can capture more taxpayers easily, with informal sector associations acting as agents for income tax collection (i.e an indirect tax approach). These associations have detailed knowledge of the activities of members and possibly their earnings and the key customer base and could thus collect taxes with less effort than other available systems.

While associational taxation, in theory, provides a political solution to the taxation of the informal sector, the informal sector operators' poor attitudes to paying taxes in Ghana was in part the result of the initial aim of the internal revenue service to introduce a more collective approach to their taxation. This approach introduced a scheme called the Identifiable Grouping Taxation (IGT), where a particular form of association tax was initiated that relied on associations in the informal sector to collect taxes from their members (Ofori, 2009)²⁷. These are voluntary associations which need not be registered formally, and are created mainly to promote members' welfare. The transportation sector, with its largest union, the Ghana Private Road Transport Union (GPRTU), according to Joshi and Ayee (2006) was at the forefront of this movement towards associational taxation, however, they soon outlined how the presumptive system posed so many challenges to their members and many flaws and unfairness were discovered in the implemented system. For example, as the system, just as previously, was based on a standard assessment, which required members to pay quarterly, it was not affordable as drivers were to pay a lump sum in advance. Again, the system failed to take account of the loss of income due to the breakdown of vehicles or lost workdays, and corruption was prevalent in the filing of taxes and when obtaining tax certificates, for example, people were fabricating certificates (Joshi and Ayee, 2002b).

Following the initial trial with the transportation sector, the association taxation system was then extended to all other informal sector associations. Such 'associational taxation' was quite successful in raising revenues from an area of the economy which had not been paying

²⁷ See table 3.1 for the list of some of such associations in Ghana. The number of such associations in operations could be anything up to thousand and keeps growing daily, and therefore became a difficult task for the revenue Authority to identify and fully utilise them for its tax planning and administration.

taxes. Although the amounts collected (especially in the early years) were small in relation to the total revenue of the Internal Revenue Service, the success story was that a culture of taxpaying was created in a sector that had until then largely avoided taxation (Joshi and Aryee, 2006).

In 2003, the Hoteliers Association of Ghana complained about the irrationally high tax imposed by the government (Obosu-Mensah, 2011). In the same year, despite helping to bring in some taxes, the IRS abolished the system of associational taxation for the informal transportation sector because of the large gap between revenue expected and revenue collected. A further standard assessment system, called the Vehicle Income Tax (VIT), was introduced under which transport owners and drivers paid income tax quarterly through a sticker system. The stickers were sold for cash to the associations to make them easily available to operators. In the first two months after its introduction, in 2003, the IRS exceeded the amount collected the same period during the previous year by 3.4% (Daily Graphic, March 9, 2004, p.20) cited in (Aryee, 2007).

Although associational taxation did not make up a significant contribution to the Internal Revenue Service's revenue, it's believed that applying this tax in Ghana was a very useful approach. This is because ignoring the tax liabilities of informal sector activities could lower morale and increase the risk of lower tax compliance elsewhere (Terkper, 2003). Therefore, taxing the informal sector in Ghana is a positive step forward in the government's bid to improve overall tax compliance in the economy.

Aryee (2007) summed his views regarding his study on the associational taxation in Ghana, stating that if one views associational taxation as one step in the long process of moving towards a more formalised conventional system of taxation, then it appears to have been a promising step. Associational taxation has encouraged a culture of taxpaying among informal sector operators and has led to a steady increase in state revenues. Although this approach has been replaced by more conventional systems of taxation such as standard assessment approaches including the VIT stickers and tax stamps as described in section 3.6.4, from all accounts, it seems that focusing on the informal sector as a separate taxpayer segment with distinct characteristics, has paid off in increasing the taxes taken from this sector.

3.6.3. *Vehicle Income Tax (VIT)*

2003 - present

As briefly discussed in section 3.6.2 above, the Vehicle Income Tax (VIT) was introduced as a tax which is paid by commercial vehicle operators every quarter through the purchase of VIT stickers from the local offices of the GRA. This is a presumption based taxation system based on a standard assessment approach as the amount paid depends on key indicators such as passenger capacity and type of operation. These stickers are displayed in front of the windscreen and monitoring is undertaken with the aid of the police force who report, stop and cease any vehicle found operating without a VIT sticker. Following the initial success, the IRS later introduced the tax stamp to other small businesses and individuals operating in the informal sector who pay quarterly and are issued with a sticker which has to be produced upon request.

In summary, Ghana's informal sector taxation has undergone a number of changes with successive governments introducing various types of taxes and /or enforcement strategies. Although associational taxation is no longer applied within the Ghanaian tax system, trade associations in the country have had a significant influence on the taxation of their members and as noted earlier in this chapter, unions such as GPRTU and GUTA have played significant roles in vehicle income taxation and flat rate VAT respectively. However, trade associations still do take part in negotiations and at times, the designing of taxes affecting their members.

The current presumptive system allows taxpayers to appeal against their tax liabilities through various stages as discussed in section 3.7.

3.6.4. *Small Business Tax Stamp*

2005 - Present

Previous attempts to bring more taxpayers in the informal sector into the tax net did not yield the desired results. Although most informal sector operators in Ghana do earn incomes from all three major sources – employment, business and investment, majority of these ‘pay absolutely nothing in the form of taxes’ (Ofori 2009, p.23). In response to this, the IRS introduced a further standard amount based presumptive tax in 2005 called the ‘tax stamp’.

The tax stamp is a standard assessment presumptive tax which imposes quarterly lumpsum of taxes on taxpayers.

The tax stamp targets low-income business operatives such as street hawkers, table-top shops, hairdressers, mobile-to-mobile operators, etc. The tax stamp aims to ensure that more economic activities within the informal sector are brought into the tax net

Unlike the associational taxation which relied on agents for the tax collection, the tax stamp was directly administered by the tax authority.

Under the tax stamp scheme, to determine the amount of taxes due, businesses are grouped by turnover and the type of activity as outlined in section 3.5. These form the main seeding through which further classifications are carried out based on sizes/classes to arrive at the final tax rates (GRA, 2016).

Individuals liable for the payment of the tax stamps must purchase them in advance for each of the four instalment due dates – i.e. 15th January, 15th April, 15th July, and 15th October.

The tax stamp must be openly displayed in the business premises, and in the case of itinerant operators, they are required to carry the tax stamp always and must produce them upon request by a revenue officer.

Failure to produce a tax stamp amounts to an offense liable to a fine, not less than GH¢20.00 and not exceeding GH¢50.00 (Ofori, 2009, p.24).

The tax stamp has seen some successes with respect to the Vehicle Income Tax (VIT) as vehicle owners are expected to purchase them quarterly in advance and they must be openly displayed on the vehicle windscreen. Failure to display a valid sticker leads to arrest by the police and sanctions are applied. By taking away the tax collection function from the transport union (GPRTU), the Internal Revenue Service (IRS) realised an increase of 176.8% in tax revenue in the first few months, compared to the previous annual figure.

In a press conference on 18th January 2005, the then commissioner general of the Internal Revenue Service, Mrs. Janet Opoku-Akyeampong stated ‘in 2002, GPRTU collected 10.875 billion cedis, but when IRS took over and introduced the Vehicle Income Tax in 2003, the

collection increased to 30.103 billion cedis in the third quarter of 2003²⁸ and as at November 2004, 42.154 billion cedis had been collected' (Modern Ghana, 2005)

The increased visibility of the police officers on the road has contributed to its success. However, the enforcement of the tax stamp has been less effective with itinerant traders, and with the majority of operators of Ghana's informal sector found in this group, there is still a large number of taxpayers who are outside the tax net.

Again, as noted earlier, the low morale on the part of tax officers to patrol some of the remote areas also has negative implications on the tax stamp. High corruption rate in the country including some cases involving police officers means that the effectiveness of the VIT (which the police are to enforce) could be compromised.

However, Ofori (2009, p.24) noted that the tax stamp has improved compliance rate and has overcome some of the challenges with the previous approaches especially the high corruption associated with the associational taxation scheme, although there have been reported cases of counterfeit tax stamps.

Despite the challenges, the tax stamp remains the main approach to taxing trading activities undertaken by informal sector operators in Ghana.

3.6.5. The VAT Flat Rate Scheme (VFRS). 2007 - Present

Despite the progress and promise towards compliance in the informal sector using association taxation, the Internal Revenue Service attempted to move slowly away from it. However, the VAT service introduced it for informal sector businesses, when it reached an agreement with the Ghana Union of Traders Association (GUTA) for a new flat-rate VAT for businesses in the informal sector.

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 (Prichard and Bentum, p.14). The Flat Rate Scheme aimed to bring into the tax net, those traders in the informal sector on whom the standard VAT record-keeping requirements proved more complicated and

²⁸ This is equivalent to GBP 1, 780,083.97 raised in 2003 compared to the GBP 643,072.56 raised in 2002 under the associational tax approach. Exchange rate (1GBP = 16,911 cedis) is based on Ghana Interbank rate on published on January 13th, 2005 (within a week of the press conference). Rate is available here: <https://bit.ly/2JGNnZU> accessed on 18/07/2018.

burdensome (Adom et al., 2014). Thus, this scheme aimed to see through the hurdles of the informal sector operators particularly those with no or minimal formal education, complying with the record-keeping requirements of a standard VAT.

The VFRS does not allow businesses to claim input VAT. Businesses are required to charge a standard 3% on taxable goods supplied and then pass this on to the tax authority. ‘The marginal rate of 3% represents the net VAT payable and is the difference between the output tax and the input tax of a wholesaler/retailer if the taxpayer were operating the Standard Rate Scheme. Thus, the VFRS is an alternative to the invoice-credit (or input-output) method of VAT accounting’ (GRA, 2013, P.3).

The tax authority has an appeals procedure to deal with disputes arising between the GRA and taxpayers. The aim is to bring confidence in the system and promote compliance. The next sections discuss the various options available to the taxpayer.

3.7. GRA tax Objections and Appeal

The current GRA has objection and appeal processes which taxpayers must follow if they have any concerns about their tax rates, assessment or penalties imposed within the tax system. The various stages are outlined below.

3.7.1 GRA Objection process

There are series of processes which a taxpayer can go through in event of objections with their taxes, although this is not clear for informal sector operators, who do not have to go through formal assessment.

The GRA defines an objection as “the initial written expression of dissatisfaction with an assessment, penalty or interest raised on a taxpayer by the Tax Office” (GRA, 2010).

The system allows taxpayers, where they find their rates to be excessive and needing review, to raise objections and to appeal against their tax rates or the assessments given by tax officer(s) through the following steps:

- an objection must be in writing and sent to the GRA;

- Grounds for objection must be clearly stated;
- Taxpayers have nine months from the commencement of basis period within which to lodge an objection against a provisional assessment;
- In the case of final assessment and penalties, taxpayers must appeal within 30 days of the issuance of the assessment.

3.7.2. GRA tax appeal

Where objections are not dealt with by the relevant GRA offices, or where a taxpayer does not feel his/her grievances have been fully addressed, they then have the right to take the matter to the court and seek redress.

However, objections will not be accepted by the court unless the taxpayer pays 30% of the amount payable as contained in the notice. This reduces any spurious claims of taxpayers which are solely to delay any payment of tax (GRA, 2010). This tends to discourage taxpayers from taking the tax authority to court. Although there are no data to assess decided cases, there is the general perception that it will be highly unlikely for individuals to win cases against the tax authority, and even when someone wins, the process to get the 30% upfront payment could be another challenge.

3.7.3. Offences and penalties - administrative

The GRA currently applies a number of penalties to deal with tax evasion behaviours. This includes minimum daily rate, 5%, 10%, 20% depending on the nature of offence and length of time. The fines could also be severe to include doubling the liability, as well as fixed court fines and other court sanctions. See Appendix 4 for full list of fines and the nature of offenses.

3.8. Summary

In summary, this chapter has presented an insight into the nature of the informal sector in Ghana. The history of taxation of this sector in the country has been outlined, alongside the role of the tax administration functions of the revenue authority (GRA). The discussion points out that Ghana has undergone a series of phases on informal sector taxation from the '70s to date. In most cases, the informal sector is currently taxed by a presumptive approach using available sets of parameters, although these parameters, and how they are applied, have changed over the years. Critically, an attempt to turn the presumptive tax system into an indirect tax was explored for some years before being abandoned for a direct approach again from the mid-2000s.

CHAPTER FOUR

TAX COMPLIANCE – LITERATURE REVIEW

4.0. Introduction

This chapter reviews the literature on tax compliance and first addresses the question – why don't people pay their taxes? The subsequent sections in the chapter then analyse tax compliance, here addressing the question 'why do people pay their taxes?'. In answering these two questions, the analysis will be based on 'factors influencing people's decisions on tax payments. The section also reviews major international organisations' policy recommendations on tax compliance and key tax compliance theories and models. It concludes with the underlying theory for this study.

4.1. What is Tax Compliance?

At the simplest level, tax compliance refers to a taxpayers' willingness to pay taxes, and this compliance can be voluntary or enforced by authorities. Non-compliance refers to the failure to pay one's taxes due (Kirchler and Wahl, 2010, p.3).

Kirchler et al. (2010) argue that where tax authorities are trusted by taxpayers, variables such as knowledge, attitude, moral appeals, fairness, and democracy may influence individuals to voluntarily comply with tax obligations hence intrusive auditing could corrupt tax morale (i.e. the intrinsic drive to comply voluntarily). In the same way, increasing fines and auditing probabilities may be effective in situations of distrust as the high power of the authorities is required to enforce compliance.

James and Alley (2002) suggest that tax compliance is a two-fold phenomenon. On the one hand, there is a commitment to society and a government's objectives, and on the other, is the role of law enforcement²⁹.

McBarnet (2001, p.6) identifies four different compliance behaviours;

- *committed compliance* which refers to taxpayers who comply willingly without complaint;
- *capitulative compliance*, which involves taxpayers who give in and pay their taxes. They may pay unwillingly, may complain, but pay up nonetheless;

²⁹ This includes auditing and detections and punishments/fines

- *creative compliance* covers the activities of taxpayers who find ways (including the use of experts' knowledge) to reduce their tax liabilities within the brackets of the law; and
- *non-compliance* group who may choose to flee the tax jurisdiction, invest abroad or engage in the 'cash economy'³⁰.

Relating McBarnet's (2001) types of compliance behaviours to James and Alley's (2002)³¹ two-fold concept, there is at one end of the continuum a committed or voluntary compliance, and at the other end, the capitulative compliant who gives in due to efficient audit probabilities and heavy fines (Kirchler and Wahl, 2010).

Whether people pay taxes as a result of a government's coercive tactics - detection and punitive measures - or do so voluntarily by their intrinsic motivation (moral judgement or other tax morale motivations), policies and strategies to motivate people to honour their tax obligations are always a difficult hurdle for every government be it in a developing country or in an advanced economy. In a tax compliance experimental study, Torgler (2004, p.243) supports this, stating that a 'total tax compliance is all but impossible under any conditions, except when the tax authorities could place a tax administrator under each tax payer's bed'.

Murphy (2008, p.113) also stressed that determining the 'most effective regulatory enforcement strategy which will promote and achieve sustained voluntary compliance from taxpayers is a very difficult challenge for all tax authorities around the world'.

In response to these challenges, Kirchler (2007) developed the slippery slope model (see chapter four for a detailed discussion) which suggests that tax compliance is directly influenced by trust in and the power of the tax authority.

4.2. Why Tax Non-compliance - Why people don't pay their taxes?

Tax non-compliance is a major issue for virtually every tax jurisdiction and poses a battle that tax authorities will not win in totality, but a battle too, that authorities will never give up on. Thus, it's impossible to find an economy with a 0% tax gap³², and at the same time, impossible to find a revenue authority which has given up on reducing the non-compliance rate. Some level of tax non-compliance is inevitable in every economy regardless of the level

³⁰ The cash economy here refers to the shadow economy, underground, hidden, and similar related terms as used in this thesis as the informal sector

³¹ Cited in (Kirchler and Wahl, 2010)

³² The 'tax gap' is the difference between the tax that would have been determined if all taxpayers had reported all of their activities and transactions correctly, and the tax determined in practice (Villios, 2011, p.1).

of development (Schneider and Enste, 2000). Non-compliance matters as it reduces state revenue and subsequently affects government spending on all areas, including welfare provisions and other important government functions, and as Torgler and Schaltegger (2005) point out, it can be supposed that while no-one likes paying taxes, the fact is that everyone knows how essential tax revenue is to the state.

In 2015/16, the HMRC reported a 9.8% tax gap for VAT (HMRC, 2017, p.24), and in the same year, Australia's Goods and Service Tax (GST)³³ gap rose from 6.1% in 2013/14 to 6.7% in 2014/15 and then to 7.3% in 2015/16 (ATO 2017).

The tax gap according to Dubin (2012, p.5) is the product of three categories of noncompliance:

- *underreporting*, which is the amount of lost revenue from filed tax returns that underreported the amount of taxes owed;
- *underpayment*, which represents the difference between amounts that were reported to be owed, and amounts actually paid for correctly filed tax returns, and
- *non-filing*, which is the amount of tax revenue lost from not filing returns (i.e. tax evasion).

What exactly then is tax non-compliance and what drives people not to pay their taxes?

Tax non-compliance refers to failures to meet tax obligations, whether or not those failures are intentional. Thus, non-compliance may be legal tax avoidance or the violation of tax law (evasion) (Kirchler and Wahl, 2010, p.3).

Early researchers into tax compliance, Allingham and Sandmo, (1972) noted that the decision by taxpayers to comply is based on the individual weighing up of the benefits of noncompliance against detection and fines. In this sense, the argument is made that the decision not to pay taxes is purely based on an individual's level of risk aversion. Subsequent research suggested that taxpayers are rational and these works have models of non-compliance to reflect such rationality.

The Internal Revenue Service (IRS- USA) (1978)³⁴ published a list of factors which influences tax (non-)compliance behaviour. Some of these factors include the age of the taxpayer, marital status, education, criminal history, employment status, level of tax expertise, analysts and others. Most of these factors have been explored in many subsequent studies, some of which are analysed below.

³³ The GST is Australian version of VAT which is widely used in the EU and other nations.

³⁴ Cited in Flynn 2003

The OECD emphasised that the reason taxpayers may not comply with their tax obligations depends on a number of factors, which may include age, education level, moral compass, gender, industry, personality, circumstances, the perceived cost of compliance and assessment of the risk involved (OECD, 2004, p.71).

Just as noted by Kirchler and Wahl (2010), the Internal Revenue Service states that not all noncompliance behaviours are intentional, and some people fail to comply due to ignorance of the tax law and their obligations (IRS, 1994).

Closely related to the issue of ignorance of the tax system is the issue of the complexity of the tax law. If tax laws are complex and cannot easily be understood, the chances are high that such taxes may not be paid or paid in full. However, research findings on the impact of tax law complexities on tax compliance have been mixed. For example, Clotfelter (1983) noticed that understanding the tax law (i.e. complexity) actually contributes greatly to the decision not to comply. Interestingly, studies by Witte and Woodury (1985) and Slemrod (1989) both find that tax complexity and its influence on tax noncompliance vary across different individual taxpayer's characteristics such as their perception of fairness, and the possibility for evasion as a result of such complexities.

Witte and Woodury (1985) and Slemrod (1989) also find that the perception of fairness of the tax system influences tax non-compliance decisions. In other words, if people perceive the tax system to be unfair, there is a high possibility of engaging in non-compliance activity to either reduce the burden (avoidance) or avoid paying entirely (evasion).

Tax knowledge and education are also important variables which help explain tax non-compliant behaviours. As noticed by Andreoni et al. (1998), all tax compliance measurements assume all taxpayers to be at the same level of tax knowledge, which is a wrong assumption and people's understanding of the tax law influences their compliance behaviour (Torgler, 2003). Further, tax specific education or knowledge should not be mistaken for formal education. Research has shown that people with university or college degrees may not have sufficient tax knowledge to make them compliant (Loo and Ho, 2005). This implies that for an improvement in tax compliance, substantial tax education and ease of access to tax information to raise tax knowledge is required.

Studies also show that non-compliance is the result of interactions with individuals in the taxpayer's inner circle. Taxpayers may not comply with their tax obligations simply because of the noncompliant behaviours of their peers, and other taxpayers. James and Alley (2000, p. 33) argue that "individuals are not simply independent, selfish and utility maximisers but

they also interact with other human beings according to differing attitudes, beliefs, norms, and roles”. This interaction is what Lewis (1982) describes as the tax subculture and he? concludes that there is a strong likelihood that individuals whose peers do not pay, will not comply either. A number of studies (Torgler, 2003; Frey and Torgler, 2007) support this view, that compliance behaviour increases when taxpayers know others are paying and vice versa.

Furthermore, a lack of trust in the tax authority/state and the absence of a strong legal system have been identified as other factors influencing non-compliance behaviours (Torgler, 2003; Frey, 2003). These studies point out that people choose not to pay their taxes in part due to a lack of trust in tax revenue usage and a weak legal system to detect and punish tax evaders. Therefore, the higher the level of trust in government, and the more likelihood of an audit revealing their non-compliance, the higher the rate of tax compliance.

A high tax rate also increases tax non-compliance as evasion becomes more ‘profitable’. An early study (Clotfelter, 1983) found that high tax rates will evoke a high non-compliance rate. This view has since been supported by more recent studies (Ivanova et al., 2005; Takats and Papp 2008; Kirchler et al., 2010; Matthews, 2011), all suggesting that a low tax rate decreases the incentive for evasion hence raising the tax compliance rate.

Even with these factors, it is without a doubt that different individuals will still respond differently to tax compliance decisions. The following section answers the question which has attracted the most attention in tax research in recent times – *why do people pay taxes?*

4.3. Why do people pay taxes?

In trying to better understand reasons for tax evasion and tax compliance, that research to date has been able to answer, many studies on taxation, particularly from the early 1990s, have tried to address the question “*Why do people pay taxes?*” The interest here is, by understanding *what* drives people to pay taxes, one will have a better understanding of *why* tax evasion and avoidance occur, and in so doing, many theories have been proposed, some of which will be analysed throughout this chapter.

A plausible explanation as to why people pay taxes is the deployment of ‘coercive strategies’ which involve the use of deterring punitive measures to discourage tax non-compliance. An early work which backs up this assertion is the model by Allingham and Sandmo (1972), who proposed that the decision to comply with one’s tax obligation is positively correlated

with the level of existing punishment and the probability of detections. This view has, however, been criticised by many researchers including (Frey, 1997; Frey and Jegen, 2001) suggesting that some people comply regardless of direct punitive measures. Contrary to the economic-of-crime model proposed by Allingham and Sandmo (1972), which states that taxpayers weigh up their benefits of evasion against detection and fines, other studies have different views on compliance. For example, Frey (1997) provides an insight into the ‘crowding-out theory’ stating that not only rewards but intrinsic motivation could be negatively influenced by all external interventions, which in the case of taxation policies may include issuing commands and imposing rules and regulations and carrying out punitive measures. In truth, the ‘cops and robbers’ approach as in the case of Allingham and Sandmo (1972) or the ‘service and client’ approach, for example Frey (1997) and Frey and Jegen (2001) as proposed by Kirchler (2007, p.188) do not seem to offer precise explanations to the initial question of ‘why people pay taxes’. What both do is offer a partial view of some of the factors which move people to comply with the existing tax rules and regulations. The other part of this chapter assesses other tax compliance drivers which could help explain what motivates people to comply.

4.4. Tax Morale and Tax compliance

In recent years, attention has shifted to ‘tax morale’ to help further explain and understand tax compliance behaviours (Torgler, 2001; Cummings et al., 2005; Frey and Feld, 2002; Kirchler, 2007; Pope and McKerchar, 2011; Alm McClellan, 2012). All of these studies emphasise explaining the concept of compliance with the understanding of the ‘intrinsic motivation’ (i.e. morale) to undertake to pay taxes rather than the extrinsic (external) forces or stimuli to respond to tax obligations. For example, Pope and McKerchar (2011) argue that the traditional economic deterrence model does not go far to offer a concrete explanation to an individual’s compliance with taxes as the fear of facing prosecution and stiff punitive measures (Braithwaite, 2009) are considered alone, rather than considering a person’s moral judgement to act. Individuals are not ‘remote-controlled’ and people’s approach to risk [in this case the economic deterrence model of prosecution and fines] will differ. Thus, understanding a person’s intrinsic drive to pay taxes will help explain not only their taxpaying behaviour, but also offer ways to improve voluntary compliance. Pope and McKerchar (2011) suggest that tax morale can explain the ‘gap’ between expected and actual

tax compliance. In a recent survey of Irish taxpayers' motives and attitudes towards taxation, Walsh (2012, p.470) found that deterrence, the conventional tax administration tool is important, but not sufficient to explain the level of tax compliance and suggested that the influence of personal norms (i.e. morale) are key to understanding a tax payer's attitude towards taxation.

Interestingly, Frey and Feld (2002) noted that all studies trying to understand tax morale tend to treat the intrinsic motivation as external to other elements, and this has made it even more difficult, not only to understand where tax morale emanates but how it could be sustained for effective tax administration.

What actually shapes an individual taxpayer's morale? Modugu et al. (2012, p.71) suggest that people's internal motivations, social norms, personal values, cognitive processes and sense of moral obligation collectively shape their tax morale, and subsequently explain the motivation for voluntary tax compliance. High morale accordingly signals high voluntary tax compliance and the opposite holds (Modugu et al., 2012).

4.5. Administrative and Compliance cost of taxation

Sandford et al. (1989) describe the cost of taxation as the 'hidden costs' which may either be;

- a) start-up costs - cost incurred to effectively deal with the new changes/taxes which may include the purchase of new computers, training of one's self or staff to understand and use the new system, or
- b) recurrent/regular costs - incurred in complying with the annual/periodic tax obligations.

Evans and Tran-Nam (2001) broadly defined the total cost of taxation to the tax authorities and the taxpayers as the '*tax operation cost*' which involves the;

- compliance cost incurred by the taxpayers to honour their tax obligations and,
- the administrative costs which are incurred by the tax authorities in designing, communicating, staff training and overseeing the whole tax system.

The compliance cost, according to Evans and Tran-Nam (2001, p.3) is the cost associated with complying [by tax payers] with their taxation obligations. This may include the costs of labour³⁵ and time for completing the activities, the cost of expert knowledge to assist in the

³⁵ This may include time and efforts by owners of the business, managers, unpaid assistance obtained, internal bookkeepers and accountants and the physical input of other employees who handle taxes for the business.

completion of the tax activities as well as the incidental expenses incurred in the process, and these 'costs are critical in assessing the efficiency of a tax regime', (World Banks, 2011, p.2). Thus, compliance cost may have both monetary and non-monetary expenses which confront the taxpayer, for example, the attempt to decipher a potential complex tax law and how to file tax returns, therefore representing costs above the payment of the actual tax obligation (Mann, 2002).

Pope (2001) poses a compelling argument that small business tax compliance costs are regressive as these costs are not proportional to income and the fact of most being 'fixed-cost' imply that relatively, businesses with small revenues pay higher.

Furthermore, Lignier and Evans (2012) study conclude that business tax compliance costs are "regressive and hit disproportionately the lower end of the small business spectrum" (p.630). A survey by Lopes (2012) on the compliance costs of Portuguese business taxpayers also found that compliance costs are regressive, similarly reporting that, as most parts of these costs are fixed costs, there are economies of scale in the process of compliance. As a 'business grows or increases, the compliance costs decrease in the percentage of the turnover' (Lopes, 2012, p.79).

By being regressive, the compliance costs raise fairness and equity concerns within the tax system. This could be a catalyst to tax avoidance/evasion especially if a business organisation operates in an environment where increased tax burdens cannot be passed on to customers due to competition or government regulations on prices or anti-profiteering rules. Kauser et al. (2001) study on the taxation of SME's in the UK found that small businesses' VAT compliance cost is six times as much as for larger businesses. Analysing these costs for businesses, and from a time and a cost perspective, registering, preparing, completing and submitting VAT returns, assuming it is filed each quarter of the year, could increase the costs of businesses (Smulders and Stiglingh, 2008, p.369). This supports the earlier argument by (Pope, 2001) that compliance costs are regressive. In other words, the smaller the business, the heavier the burden, which leaves small firms with two major difficulties – by becoming vulnerable to the compliance burden and being in a competitively disadvantaged position (Smulders and Stiglingh, 2008). Again, Sandford and Hasseldine (1992) study of New Zealand businesses also concluded that compliance costs were significantly higher, making 2.5% of the country's GDP, regressive and fall disproportionately higher on small businesses. Furthermore, Slemrod and Venkatesh (2002) also found business tax compliance

cost in the US to be very regressive in nature. The table below compares the business tax compliance costs of findings from two studies (Sandford et al., 1989; Kauser et al., 2005).

Table 4.1 Corporation Tax compliance costs as a percentage of taxable turnover

<i>Taxable turnover (£)</i>	Study / Compliance costs as a % of Taxable income	
	<i>Sandford et al. (1989)</i>	<i>Kauser et al. (2005)</i>
0 – 100,000	0.97	0.31
100,001 – 500,000	0.17	0.24
500,001 – 1,000,000	0.07	0.13
1,000,001 – 10,000,000	0.03	0.11
10,000,000 and over	0.01	0.04

Sources: Sandford et al. (1989); Kauser et al. (2005)³⁶

Reviewing the literature on compliance costs, it is difficult to make direct links to the situation faced by businesses in the informal sector in developing countries. For example, how does compliance cost influence compliance decisions under a presumptive tax regime? This question is addressed in chapters 8 and 9 to add to this literature, for informal sector businesses.

In compiling studies relating to the administration and compliance costs of taxation, Evans (2003) recognised the interconnection between tax law design and implementation. He stated that sensible tax law design must be informed by an understanding of the impact of that design on the burden that taxpayers will face and the administrative cost that the revenue authority will be required to carry. To Evans (2003), such impact does not only have to be the cost borne by the state in the implementation/administration process but also the cost to be faced by taxpayers in the compliance process, which may include their physical time, appeals processes (Copp, 2001)³⁷, and the psychological cost of the tax burden (Evans and Tran-Nam, 2001).

³⁶ Cited in Chittenden et al 2010

³⁷ Cited in (Evans 2003)

4.6. Tax compliance determinants – evidence from the literature

In this section, the theoretical framework and the surveys of past studies underpinning tax compliance are analysed as the foundation of the rationale of this research - Tax Compliance in developing economies.

4.6.1. Socio-economic factors

The starting point in the theoretical framework for this study is to assess the influences other taxpayers' behaviours have on individual taxpayer's compliance behaviour. An early study into these social influences and their impact on tax compliance is by Lewis (1982). In his study entitled 'The Psychology of Taxation', Lewis (1982) theorised that voluntary tax compliance is dependent on the behaviour of the immediate peers' and fellow citizens' tax compliance behaviour. Lewis (1982, p.144) found that a taxpayer may say “*...I am more likely to evade not only because I have friends who, I know, have got away with it (so why shouldn't I?) but also because evasion is ethically acceptable among my friends.*”

Similarly, a study by Torgler (2003) also concludes that tax morale decreases if people notice that tax evasion is common and they believe that others are dishonest about their taxes, it causes their willingness to comply with their tax obligations, to degenerate.

Adapting Falk and Fehr's (2002) theory of reciprocity to tax compliance, Frey and Torgler (2007, p.138) believe that if many citizens pay their taxes, an individual taxpayer may feel obliged to also comply with his/her tax obligations, and vice versa.

Also, Lavoie (2009) found out that not only is it the deterrence or trust in the government that influences tax compliance among the taxpayers, but an important factor is a trust that people have in fellow taxpayers that they equally comply honestly to their tax obligations.

4.6.2. Demographic variables

Certain demographic variables have been identified as influencing people's tax morale, and hence compliance behaviour.

Previous studies have found that gender influences a taxpayer's compliance behaviour (Hasseldine, 1999; Torgler, 2003). In most cases, women are found to be more compliant

with their taxes than men (Richardson and Sawyer, 2001; Oxley, 1993; Frey and Torgler, 2004; Torgler and Valev, 2007).

The age of taxpayers has been suggested by many researchers as an influential variable on voluntary tax compliance, with the proposition that young people tend to evade taxes more than old people. Torgler (2003, p.358) proved in his study that taxpayers aged under 29 years were the highest tax evaders, and those aged 30-65 were slightly better in honouring their tax obligations. Again, the older people get, the higher the intrinsic motivation to pay their taxes, and Torgler (2003) proved this with the results of people over 65 years achieving 12.5 percentage points over those under 65 years. In addition, studies by Richardson and Sawyer (2001) and Devo (2005) all discovered that there is a strong correlation between age and tax compliance with younger taxpayers more likely to evade taxes than older people.

Interestingly, some studies (e.g. Dubin and Wilde, 1988) found that tax compliance varies substantially across taxpayer groups. However, Feinstein, (1991) could not find any correlation between age and tax compliance. In a subsequent study, Torgler found that single people tend to be less compliant with taxation. He claimed, ‘married people or people who live together have significantly higher tax morale than singles’ (Torgler, 2003, p.224).

4.6.3. Education and Tax knowledge

Models for tax compliance have often been based on the premise that all taxpayers are fully informed of tax laws and the reporting process (Andreoni et al., 1998), but this is a wrong assumption to hold as the level of tax knowledge may differ among individuals (Torgler, 2003).

One reason for tax evasion is sometimes the complexity of the tax laws (Torgler, 2003). The more educated, in the form of understanding of the tax laws and policies people are, the more they understand the benefits of paying taxes, as they understand the fiscal connections and taxation due to their ability to analyse the benefits that come out taxation (Lewis, 1982). Contrary to this, Torgler et al. (2007) states that the more educated people are, both in terms of general education and tax knowledge, the higher the probability of evading taxes, as they understand the opportunities for evasion and avoidance and could also be more critical of the ways tax revenues are used by the state. In an earlier study, Torgler (2003) argues that the complexity of tax laws influences tax knowledge and subsequently tax compliance, as

taxpayers tend to use their knowledge of the complex tax laws in a ‘creative’ way to their advantage. Krause (2000) has a similar view pointing out that a complex tax law promotes a variety of interpretations and that makes it almost impossible to distinguish honest taxpayers from tax evaders.

Loo and Ho (2005) distinguished between formal education and tax knowledge when they conducted a tax knowledge study involving taxpayers who have completed tertiary education. Tax knowledge was measured in terms of understanding of chargeable income, exemptions, reliefs, rebates and tax credits. The study concluded that, although the participants had a strong formal education, their tax knowledge was low making them ‘incompetent’ to undertake self-assessment.

In a survey of American taxpayers, Hite (1997), assessed the relationship between gender, education and tax compliance and found out those females with college degrees or higher are more compliant than females without college degrees. Not all studies have reported the same findings of tax compliance and education. For example, Vogel’s (1974) study suggests that less educated taxpayers have low exposure to tax information and as a result are less informed about relevant tax regulations and may evade taxes due to a lack of access to information which otherwise would make them compliant.

In this study, compliance is not measured on the assumption that all taxpayers have equal knowledge of the tax laws. Tax knowledge is measured by a series of questions taking into account education and other demographic variables. Education in this context is measured in two-fold – (i) fiscal knowledge in terms of understanding of tax obligation and reporting requirements, and (ii) general education attainment.

4.6.4. Economic determinants of tax compliance

Tax compliance involves an element of cost to the taxpayer, not only the monetary costs but the cost involved in computing the tax liability which in some cases involves the use of paid expert advice (Krause, 2000).

As one of the early researches in theoretical analysis of tax evasion, the Allingham and Sandmo (1972) literature pointed out that tax evasion is to a greater extent within the discipline of microeconomics as individual taxpayers tend to choose between the option ‘to

evade' or 'not to evade' depending on the perceived/expected gains or losses of the other. The taxpayer, in this case, is seen as a utility maximiser.

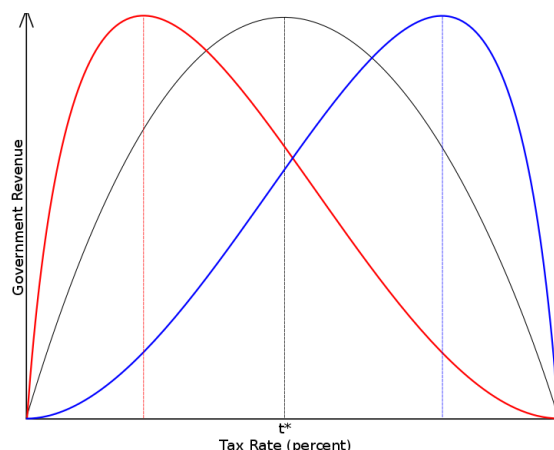
Taxpayers, according to Allingham and Sandmo (1972) weigh the tax savings obtainable for not declaring income; the probability of being caught through auditing which will attract costs higher than the compliance cost and their ability to continually cover up income, depending on their level of risk aversion. Therefore, fiscal policy components such as the tax rate, tax audits, and perceived government spending of tax revenue, potential penalties, and fines for non-compliance are key variables when studying tax compliance (María-Dolores et al., 2010)

4.6.5. Tax Rate and tax complexities

The tax rate determines how much of a taxpayer's income, wealth or expenditure is actually transferred to the state. So, to what extent does the rate of tax influence compliance decisions? What rate of tax will promote voluntary compliance? Will a high rate of tax automatically decrease tax compliance? On the one hand, there is the assertion that a high tax rate reduces effective income and therefore, makes tax evasion more profitable; and on the other hand, is the belief that by reducing effective income, absolute risk aversion increases, and therefore evasion should be reduced (Kirchler et al., 2010).

Takats and Papp (2008) demonstrate that a low tax rate (for example a tax cut) will have an immediate Laffer effect as this will raise the effective tax by eroding the incentives for evasion and avoidance. Thus, a low tax rate will increase the compliance rate as tax evaders and avoiders pay more taxes.

Figure 4.1 The Laffer curve



(Source: Blinder, 1981, p.82)

The Laffer Curve (above) states that an increase in tax rate above the optimal tax rate (t^*) will result in low tax revenue as tax evasion will rise, supporting previous studies (Clotfelter, 1983; Ivanova et al., 2005; Takats and Papp, 2008; Matthews, 2011) that a low tax rate increases the tax compliance rate.

Analysing the Russian flat tax of 13% which replaced the previous three-tiered 12, 20 and 30 percent rates, and which gave substantial tax cuts to most taxpayers Ivanova et al. (2005) discovered that personal income tax as a percentage of GDP increased from 2.4 to 2.9% the following year and 3.3% the year after. This study clearly showed the relationship between tax rate and compliance and subsequently, total tax revenue.

In an empirical study, Clotfelter (1983) analysed a US taxpayer compliance measurement program (TCMP) data in 1969 which involved three different taxpayers (business, non-business and farmers) using Tobit maximum likelihood estimation to determine underreported income under different auditing probabilities, and found that tax evasion increases with a rise in marginal tax rates. Matthews (2011, p.19) suggests that low tax rates reduce the financial benefits³⁸ of evasion behaviour. At a lower rate of tax, the perceived gains from evasion reduce faster than the perceived cost, therefore the rate of tax is negatively correlated with tax evasion (Clotfelter, 1983, also see Crane and Nourzad, 1992). Contrary to the results of (Clotfelter, 1983), Feinstein (1991)³⁹, adopted a similar approach using 1982 and 1985 TCMP data and found no significant impact between marginal tax rate and tax compliance rates.

³⁸ The aggregate financial gain (i.e. amount of tax saved) for noncompliance

³⁹ The findings of Feinstein are mixed. He finds a negative relationship between tax rates and compliance when

The HMRC (2012, p.7) noticed that the impact of the tax rate on evasion is dependent on how taxpayers view the tax rate as ‘being permanent or temporary’ and states that ‘a temporary rate change may mean that some individuals are less likely to undertake behavioural responses that have significant upfront costs’. The impact of the tax rate on tax compliance is evident in the amount of tax raised by the HMRC in 2009-10 and 2011. Due to the announcement of the 50p tax rate, taxpayers earning over £150,000 forestalled about £18bn of their income to the 2009-10 tax year, and the year (i.e. 2010-11) when the tax was officially introduced it fell short of £1.5bn of the projected revenue target (HMRC,2012).

Aside from tax rate structures, other structural factors external to the taxpayer’s control such as the tax administration procedures and practices and the complexity of the tax system could equally be important in influencing a tax payer’s compliance behaviour, (Alm et al., 1992)

4.6.6. Audit Probabilities and fines

Audit probabilities have a profound impact on tax compliance and more importantly the amount of declared income. ‘...an increase in the probability of detection will always lead to a larger income being declared’ (Allingham and Sandmo 1972, p.330). The standard economic model of tax evasion assumes that the taxpayer tries to maximise the outcome of a compliance decision by weighing up the gains of successful evasion against detection and punishment (Kirchler et al., 2010, p.10). Previous studies which support audit probabilities and compliance include (Lewis 1982; Alm et al., 1995; Trivedi et al., 2003; Palil, 2010; Palil and Mustapha, 2011).

However, Gërxhani and Schram (2006) also Andreoni et al. (1998) could not find any strong correlation between audit probabilities and tax compliance rate.

Fines are closely linked to the impact of auditing probabilities. Alm et al. (1995) found that fines on their own will have minimal or no strong effect on compliance, however, when it is parallel with high audit rates, the impact will be significant on compliance rate and reported income.

Murphy (2008), in a study involving 652 tax offenders who had been penalised by the Australian Tax Authority, suggests⁴⁰ that by handing out harsh punishment and penalties to

the data for 1982 and 1985 are analysed separately, but the relationship is positive in the pooled data, (Ali et al, 2001).

⁴⁰ Suggestion based on the deterrence model

rule-breakers, this will deter them from re-offending in the future. Even though audits and their associated threats of prosecution or actual prosecution have time limits on taxpayers' compliance behaviours, however, studies have also shown that those who comply are not necessarily bothered about audits, but want to see those who do not comply, punished (OECD, 2004).

4.6.7. Trust in the state

Taxpayers' compliance behaviour is also influenced by taxpayers' relationship with the government and the perceived level of confidence and trust held by the individual taxpayers in the state. In other words, the role of the state has a significant influence on people's decision to evade or comply with taxes (María-Dolores et al., 2010). As discussed in chapter six, the incidence of corruption (e.g. tax officers handling cash and embezzling tax revenue) do have significant implications for future voluntary compliance decisions.

As observed by Gracia and Oats (2012), the [tax]regulatory environment is a relational process that creates, negotiates and enforces the boundary between acceptable and unacceptable practice (p.305). This implies that actions by the tax authority which may jeopardise the trust held by taxpayers would have direct implications on future compliance.

Kirchler and Wahl (2010, p.3) believe voluntary and enforced compliance as well as tax avoidance and evasion, are the result of the interaction between taxpayers' trust in authorities and authorities' power to monitor taxpayers. They further argue that when there is a high level of trust in authorities, voluntary tax compliance is high, and vice versa. However, when trust is low, but authorities' have strong powers to effectively carry out audits and to sanction wrong behaviours, compliance is enforced, as taxpayers are motivated to reduce their taxes within the legal range of the law and engage in tax avoidance, but are deterred from illegal reductions or evasion (Kirchler and Wahl, 2010, p.3).

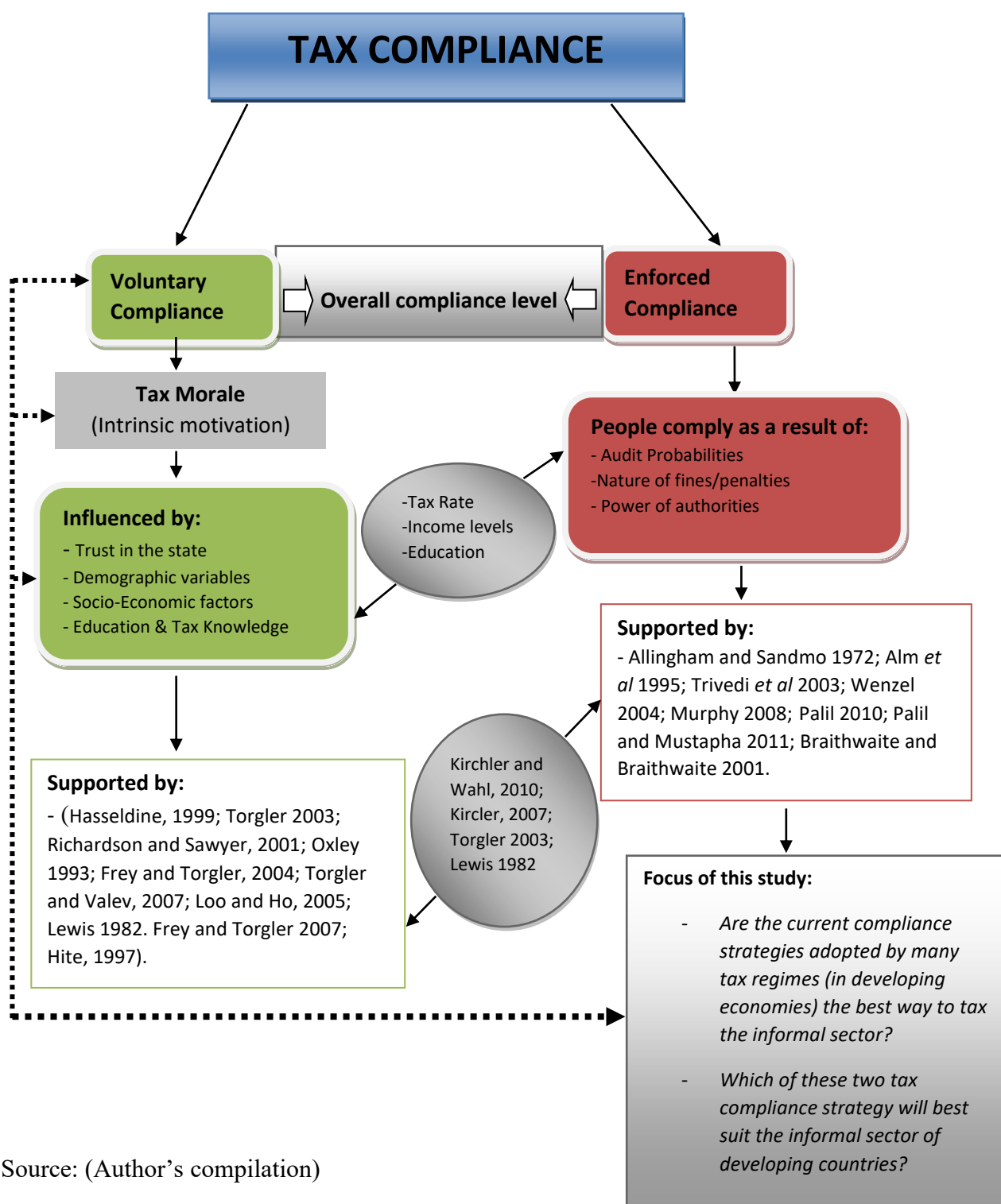
The tax authority has a central role and as Hasseldine and Li (1999)⁴¹ point out, the government is the main player in tax administration and must be efficient at all times if a high tax compliance level is to be achieved. As noted in section earlier, tax compliance also depends on the simplicity of the tax system, the probability of detection in the event of evasion/avoidance, and the perception of government spending. If the government spend tax revenue on basic necessities such as education, healthcare, security, and public transport,

⁴¹ Cited in Palil, 2010

voluntary tax compliance will be increased (Palil, 2010, p.188) also see (Kirchler and Wahl, 2010). The state also has the responsibility of developing and implementing an effective and fair tax system, as this equally influences compliance behaviour.

The tax compliance literature discussed so far, is represented in figure 4.2 below, which is further explored in section 4.7.

Figure 4.2. Tax Compliance Paradigm



The next section analyses some of the theories and models of tax compliance and introduces the underlying theory of the study. It also reviews some of the practical applications of some existing models in different tax jurisdictions.

4.7 The trend in tax compliance research

This section looks at the key theories and models of tax compliance as they relate to this study and offer a further explanation of the compliance determinants discussed in the previous sections of this chapter. It analyses the trends in tax compliance research from the 1970s to the present. The section concludes with the theoretical framework for this study that seeks to build on this prior foundation.

4.7.1. The trend of tax compliance studies

The first part of this section discusses tax compliance studies in the 1970s, followed by research in the 1980s and then from the 1990s to the present.

4.7.1.1. Studies in the 1970s

The study of the causes and consequences of crime has a long pedigree in the social sciences; however, it was not until the 1960s that the analysis of illegal activities entered the domain of economics with Becker (Merlo, 2004, p.677). Becker's work was built on the premise that economic theory can provide important insights into the analysis of individuals' criminal behaviour. By modeling individuals' responses to incentives, Becker was able to improve our understanding of how the certainty and severity of punishment could affect an individual's decision to engage in illegal activities (Merlo, 2004).

Following the work of Becker as observed by Merlo (2004) that deterrence, which is the product of detection and penalties, was within the control of society to evoke compliance, Allingham and Sandmo (1972) extended the economics of crime model with the use of the expected utility theory (EUT) suggesting that the taxpayer is a utility maximiser. Thus, the EUT believe that the individual weighs up the benefits of evasion and the probability of being audited and the nature of potential fines. The individual complies if the possibility of being caught and fined are higher than the benefit of a successful evasion.

4.7.1.2. Studies in the 1980s

Studies in the 1980s on tax compliance expanded but mainly with the underlying premise that economic sanctions were the most effective way of promoting tax compliance. Thus, the studies in this period were mainly based on expanding those designed around the EUT. Following the surge in tax evasion in the US in the 1980s, and as a policy response to the then-new research paradigm, the United States government extended existing and introduced a new range of penalties in a bid to influence compliance but these measures did little to curb the issue (Devos, 2014).

Considering the ineffectiveness of the pure economic deterrence approaches to reduce tax non-compliance, tax compliance research shifted to looking outside this model to help explain tax noncompliance. Graetz and Wilde (1985) criticise the economic deterrence model as being too simplistic suggesting that to improve compliance, the punitive measures of auditing and fines should be accompanied by lowering the tax rate. There was also the belief that too many fines and severe sanctions could make taxpayers revolt as they may feel alienated and could become ‘antagonists’ to the tax laws and will not feel the need to comply voluntarily.

Graetz et al. (1986) moved the tax compliance debate further by analysing the interaction between the taxpayers and the tax authority (the IRS in their case). Their finding suggests that a positive relationship between the taxpayers and the tax authority increases voluntary compliance and vice versa.

Other researchers have attempted to extend the economics of crime model to include labour decisions in order to assess the influence of the taxpayer’s income (Franzoni, 1999; Isachsen and Strom, 1980; Isachsen, Samuelsen and Strom, 1985; Cowell, 1985). For example, Cowell (1985), found that although the EUT is good in explaining the tax evasion decision where the taxpayer decides on how much of their income to conceal in the face of known penalties and known possibilities of being caught, the model does not explain all situations of tax evasion. For example, in situations of ‘working off the books’. Here, instead of concealing an amount of tax from a proportion of income which is undistinguished from its source, the taxpayer evades taxes by taking more than one job, which could be in addition to or in place of their main job where income is administratively hard to detect or tax. In this case, according to Cowell, to fully understand tax non-compliance, other noneconomic objectives have to be considered. Cowell (1985) therefore concludes that taxpayer decisions

are made in a two-fold way; a decision about how many hours to work; and a decision on how many of the total hours is to be allocated to legitimate and illegitimate activities (in other words, how much to declare and how much to conceal).

The economic model was criticised for not including other factors which may equally influence tax compliance decisions. For example, Slemrod (1989) found that tax law complexities also increase tax evasion due to the associated increased cost of compliance.

4.7.1.3. Studies in the 1990s - present

During the 1990s and the early 2000s, the paradigm of tax compliance studies moved to address the shortfalls of the economic deterrence models.

Falkinger and Walther (1991) considered persuasive measures and their associated impacts on compliance and found that a tax system which combines punitive and persuasive measures tends to be more effective than one which centers mainly on enforced compliance. In other words, Falkinger and Walther's (1991) work is based on the premise that positive inducement may serve as a deterrent to noncompliance, at least in part (Devo, 2014, p.19).

Ayres and Braithwaite (1992) found that deterrence approaches are not effective and that tax compliance should focus on 'responsive regulations' which embraces a forward-looking approach rather than relying on punitive measures only. This idea is explored later in this chapter and forms the basis of this study.

Frey (1997) examined external interventions such as fines and intense audits and proposed that these forces could negatively affect the compliance behaviour of taxpayers.

Tax compliance discussion moved further and Andreoni et al. (1998) study found that tax knowledge has a direct impact on compliance behaviour.

During this period, the debate moved further to incorporate social interactions on tax compliance decisions. James and Alley (2000) found that compliance is not only a function of economic factors but also social factors such as the attitudes of one's inner circle towards compliance. In addition, Onu and Oats (2016) pointed out that a number of studies using surveys and experiments have revealed that taxpayers' compliance attitudes and behaviours tend to change by their interaction with others.

The compliance debate at this stage moved into the spheres of shared responsibility, involving taxpayers on the one side and the tax authority on the other. This new direction of research found that tax compliance is positively correlated with trust in the government such as law enforcement and tax revenue usage (Torgler, 2003; Frey, 2003).

The late 2000s saw a surge of research related to the emergence of seeking to explore the moral obligation aspects of tax compliance. Many studies during these years sought to explain the tax compliance behaviours of people by looking at the inner drive (intrinsic motivation) to comply rather than the extrinsic (external forces such as fines and audits). These studies (see Kirchler, 2007; Torgler, et al., 2007; Braithwaite, 2009; Pope and McKerchar, 2011; Alm McClellan, 2012; Modugu et al., 2012) suggest that economic deterrent approaches cannot alone fully explain tax compliance; instead, it is also affected by other issues such as the individual's feelings about their role in contributing to society as a responsible citizen. The next section of this chapter reviews some of the key tax compliance models and theories for the study.

4.8. Key compliance theories and models

Analysing the studies in tax compliance since the 1970s, point out that, tax compliance research has evolved around three main pillars, with various studies attempting to modify and enhance our understanding under each of these areas or approach:

- **Pillar 1 - *Economic of crime*** - Compliance is based purely on punitive measures
- **Pillar 2 - *Psychological contract*** - Compliance is achieved by psychological contract. Underlined with trust and power, this theory is concerned with the reciprocal arrangements between the taxpayer and the tax authority and the resulting compliance.
- **Pillar 3 - *Responsive regulation encompassing tax morale*** - Tax compliance is achieved by mixing persuasive and punitive measures based on different taxpayer groups with tax morale the underlying factor.

4.8.a. Pillar 1 Theories

4.8.1. The Utility / Economics of crime Theory

As discussed earlier, most studies in recent years have been based on the economics-of-crime theory/utility theory as first applied by Allingham and Sandmo (1972). The economics of crime theory asserts that the individual's final decision to comply rests on his or her perception of being caught and fined if all income is not declared.

This theory affirms that an increase in the penalty rate with high auditing probabilities will lead to an increase in the percentage of or decision to, declare income. The penalty rate is thus seen as a tool to combating tax evasion, (Obid, 2004).

A study by Mittone (2006) and Kastlunger et al. (2009) also support this theory and both suggest that taxpayers are more likely to comply to their tax obligations if they expect an audit and vice versa.

In a study to assess the effectiveness of audit probabilities and fines, Maciejovsky et al. (2007, p.679) found that 'tax compliance decreases immediately after a random audit', suggesting that taxpayers may be prone to misperception of chance.

In a recent computerised tax-evasion experiment, Mittone and Saredi (2016, p.109) also confirm this assertion suggesting that tax 'evasion increases immediately after an audit'. Thus, tax compliance decrease when an immediate audit is perceived unlikely.

Furthermore, some of the recent tax compliance study embracing this stance has confirmed to this and have identified the '*Bomb Crater Effect*' (BoCE) in tax compliance (Mittone et al, 2017, p.225). Originally introduced by Mittone (2006), the *Bomb Crater Effect* refers to the fact that tax compliance drops immediately after a taxpayer is audited.

Mittone et al. (2017) likened taxpayers' behaviour to war field, and argue that 'troops under heavy enemy fire hide in the craters of recent explosions, believing that it would be highly unlikely for subsequent bombs to fall exactly at the same spot in a short time span' (Mittone et al 2017, p.226).

Previous studies which support this theoretical stance (i.e. audit probabilities and tax compliance) include Lewis (1982), Alm et al. (1995), Trivedi et al. (2003), Palil (2010), Palil and Mustapha (2011).

The major criticism of this theory is the fact that it sees every taxpayer as a ‘moral profit seeker’ who is purely motivated by perceived financial gains for their actions. Also, it is believed that taxpayers are willing to, and seeking to, evade taxes unless penalties and audit probabilities exceed the expected gain for evasion. This theory fails to recognise other factors which may influence individuals’ behaviours as noted in the studies in the 1980s, 1990s and the late 2000s. There are many recent studies which have found that the rate of tax auditing and penalty rates are that small, people should not be paying the amount of tax revenue realised by tax authorities. To these group of researchers, (example Bajada and Schneider, 2005; Feld and Frey, 2007; Alm and Kirchler, 2012) taxpayers, based on economics of crime theory, should evade more than they actually do, implying that enforcement and perceived auditing probabilities do not necessarily by themselves evoke tax compliance, or even if they do, they do not influence all taxpayers the same way.

Another key critique of the economics-of-crime theory is that the key explanation of tax compliance is the fundamental values (tax morale) which are inherent in taxpayers (Torgler, 2003; 2007; Kirchler, 2002; Feld and Frey 2007; Alm and Kirchler, 2012). In the same way, the relationship between taxpayers and the state has also been identified as an important factor in tax compliance decision making (Feld and Frey, 2005).

4.8.b. Pillar 2 Theories

4.8.2. Psychological [Tax] Contract Theory (PCT)

The psychological tax contract considers the factors which shape tax morale, which is drawn in part from crowding theory (Frey, 1997). The psychological tax contract assesses the interactions between incentives and the intrinsic motivation to pay taxes (Feld and Frey, 2005). Incentives in this model may be positive (rewards) or negative (deterrence) and may influence tax morale, which may subsequently affect tax compliance.

The social-psychological approach gives a better understanding of the behaviour of the taxpayer (Pope and Mohdali, 2010), therefore, approaches to improve tax compliance should consider the psychological aspect because the taxpayer is influenced by things that exist within the taxpayer’s immediate environment (Damayanti et al., 2015).

The psychological tax contract is also based on the premise that taxpayers and the tax authority see and treat each other as partners, which involves transparency and honesty towards each other. The theory states that if tax authorities treat taxpayers anything different from this ‘partnership relationship’, the psychological tax contract will be seen as violated and citizens may feel they have a good reason not to stick to their part of the contract and may evade taxes⁴² (Frey and Feld, 2002).

The theory suggests that visible expenditures of tax revenue may serve as a motivating factor for taxpayers to comply, especially when the taxpayers value these goods and services they receive (Bello and Danjuma, 2014, p.36). From this theoretical standpoint, even in the absence of detection and punitive measures, taxpayers will still comply voluntarily when they are satisfied with the provision of goods and services from the government (Torgler, 2003), and conversely, compliance will fall with dissatisfaction on tax revenue usage (Palil, 2010).

In the psychological contract, deterrence measurements such as punishment and fines are still seen as acceptable to enforce certain behaviours. However, the satisfaction from taxpayers in terms of what they get in return, (as contract partners) is the government playing its part (Reinganum and Wilde, 1986), which should go over and above the usual provision of goods and services and instead include fairness, loyalty and building ties (Feld and Frey, 2005). The psychological tax contract asserts that tax compliance is influenced by central government policy, tax authorities’ behaviour, and state institutions.

The theory holds the belief that tax compliance depends on three key elements;

- The *physical exchange* of taxpayers getting goods and services for the payment of taxes
- The *political process* and procedures that create such an exchange and;
- The *personal relationships* existing between taxpayers and tax administrators.

Supporters of the theory (for example, Frey and Feld, 2002) argue that it provides a means to bridge economics, law, and policy by ‘genuinely’ rewarding taxpayers in the exchange relationship.

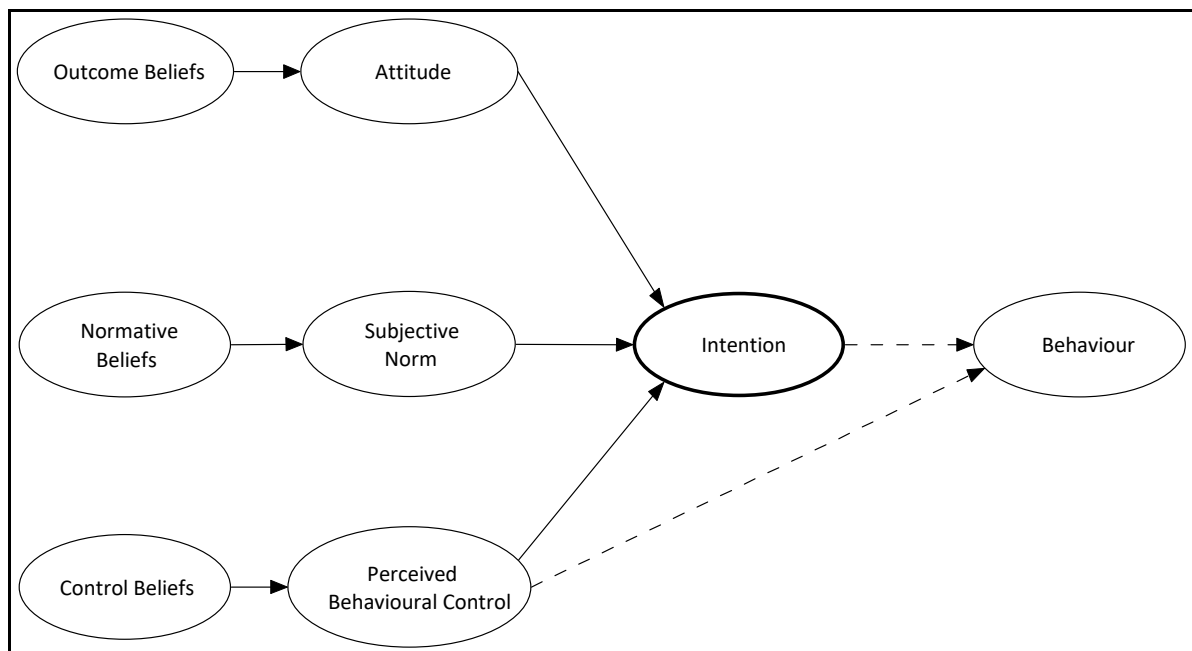
⁴² Cited in (Feld and Frey, 2006; p4)

4.8.3. The Theory of Reasoned Action (TRA)

Previous studies have suggested that human behaviours are determined by both social influence and dispositional (attitude) factors ((Banduri, 1991; Deci and Ryan, 2002). This is consistent with the literature on tax compliance which has found that social influences (interpersonal relationships) and intrinsic (morale) motivations are key determinants of tax compliance decisions (Torgler 2001; Cummings et al., 2005; Frey and Feld, 2002; Kirchler 2007; Pope and McKerchar, 2011; Alm McClellan, 2012).

Originating from learning theory, the TRA asserts that behaviours towards an object or situation are determined by the intention to perform that behaviour. An offshoot from Ajzen and Fishbein's (1975) Theory of Reasoned Action (TRA), Ajzen (1991) developed the Theory of Planned Behaviour (TPB) to include a measure of perceived behaviour control (PBC). PBC, according to Ajzen, influences both intention and behaviour. The reason for adding perceived behaviour control was that it would allow prediction of behaviours that were not under complete volitional control (Armitage and Conner, 2001, p.472), compared to the TRA which predicts behaviours that were relatively under volitional control (*ibid*, p.472). Ajzen states that the transmission of intention into action is to a greater extent determined by personal and environmental barriers.

Figure 4.3 Theory of planned behaviour



Source: Armitage and Conner (2001, p.471)

Illustrated in figure 4.3 above, intention, the cornerstone of the theory of planned behaviour and the performance of a particular behaviour or its transmission into a different behaviour depends on the intention that the individual has generated towards the behaviour (Benk et al., 2011, p.181). The intention in this case is defined as the factor indicating the degree of individual efforts to perform a certain behaviour (Ajzen, 1991)⁴³. Thus, the person's conscious plan to exert effort to carry out a behaviour (Eagly and Chaiken, 1993, p.168). It hypothesises that behaviour is predicted by the intention to engage in a given behaviour. Intention in return is predicted by two factors – (a) An individual's attitude towards the outcome of the behaviour, and (b) the opinions held by people in the person's environment, referred to as the subjective norm (Fishbein and Ajzen, 1975). This is the opinions of the people who are important to the individual and who the individual sees as a reference regarding to his/her behaviour (Benk et al., 2011, p.181).

4.8.c. Pillar 3 Theories

This pillar which comprises of responsive regulation and tax morale assert that tax compliance is influenced by a combination of factors which fall under three broad domains – intrinsic drive, persuasive and punitive measures. The next section discusses the slippery slope model (persuasion and punishment) followed by responsive regulation (the theory adopted to help explain and inform the results of this study).

4.8.4. The 'Slippery Slope' Model (SSM).

The slippery slope framework proposed by (Kirchler, 2007), and developed further in subsequent studies (for example, Kirchler, Hoelzl and Wahl, 2008) suggests that tax compliance is influenced by two main variables. 'Trust' in, and the 'Power' of, the

⁴³ Cited in Benk et al, 2011

authorities and the associated interactions between the actors⁴⁴ in the tax compliance process (Kastlunger and Kirchler, 2010). Thus, maximum compliance depends on both power (of authority) and trust (of citizens) and the 'absence of either or both reduces the efficiency of tax collection' (Oats and Pemberton, 2012, p.53).

This model rejects a 'pure economic assumption that individual taxpayers try to avoid taxes whenever the evasion pays off and it's built on the assumption that the majority of individuals do pay their taxes willingly without considering the evasion and avoidance possibilities (Torgler, 2007; Kirchler, 2007; Frey and Feld 2002; Alm et al., 2012).

Kirchler et al (2008, p.212) refer to the power of authorities as the taxpayers' perception of the tax authority's ability to detect and punish tax-related crimes. Thus, power here refers to how the taxpayer views the tax authority in terms of detecting illegal tax evasion, for example by conducting frequent and thorough tax audits, punishing evasion, for example by fining evaders to a deterrent amount. However, as outlined above, the impact of these deterrent measures on compliance has produced mixed results among the existing literature. For example, Frey (1997) found that voluntary compliance is negatively affected by increased audits and heavy fines, Kirchler and Wahl (2010, p.3) on the other hand, found that even where trust is low but the authorities have strong power, tax-related crimes are avoided.

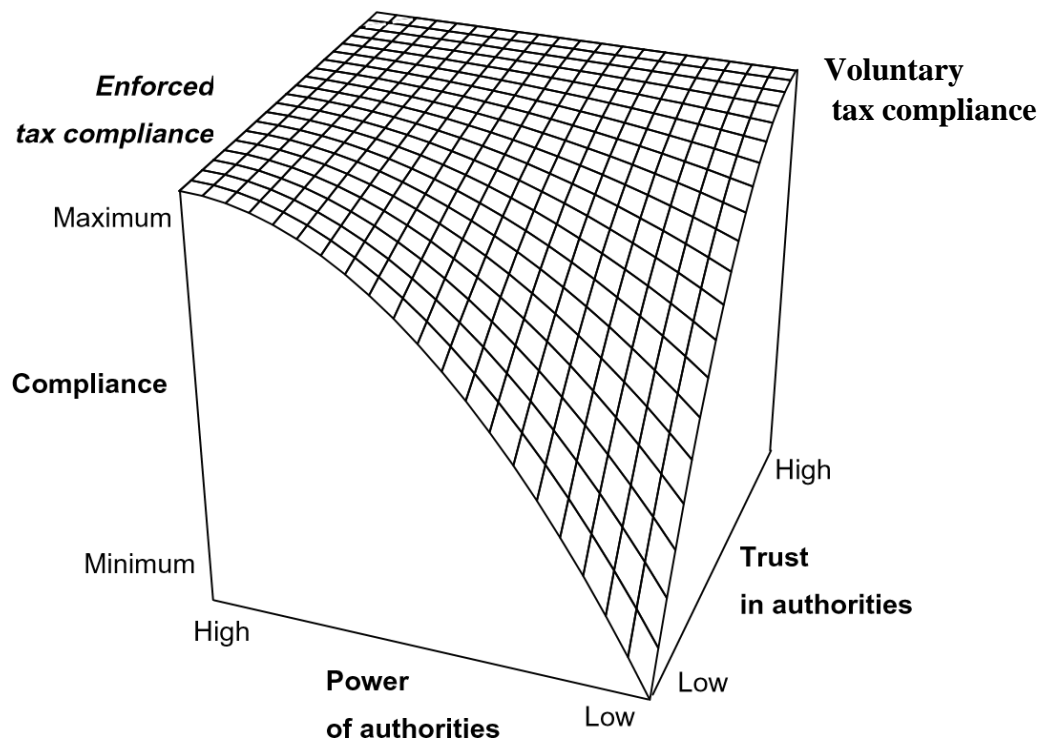
Trust is defined by Kirchler et al (2008, p.212) as "a general opinion of individuals and social groups that the tax authorities are benevolent and work beneficially for the common good".

Trust in authorities is linked to the general perception and opinions held by taxpayers that the tax revenue is used by the tax authority for the common good (María-Dolores et al., 2010; Kirchler and Wahl, 2010; Kirchler et al., 2010).

Tax compliance, according to this model, is therefore directly achieved through a mix of power and trust, and the level of one element is directly linked to the weight placed on the other by taxpayers which are demonstrated in the 'slippery slope' model represented in figure 4.4 below;

⁴⁴ The actors in the tax compliance process are the authority and the taxpayer

Figure 4.4 the Slippery Slope Model



(Source: Kirchler et al., 2008, p.212)

The model is based on the following four conditions;

- Even with low trust in the authorities, tax compliance will increase through high auditing and detection probabilities with heavy fines. Increasing power results in enforced compliance.
- Under the condition of low power, compliance increases with a degree of trust. Increasing trust increases voluntary compliance.
- Strong power and high trust lead to high compliance. Strong trust and strong power evoke enforced and voluntary compliance.
- Moderating the effects between power and trust influences taxpayers' relationships and compliance – when power is at its maximum, variations in the trust are irrelevant because the authorities can enforce maximum compliance and when trust is at its maximum, variations in power do not matter because citizens contribute their share regardless

(Kirchler et al., 2008, p.212)

The slippery slope model ignores the individual's intrinsic drive to act without being subject to control. Again, the model assumes that only two variables impact on tax compliance and sees the taxpayer as a 'reactor' who will only react based on how they perceive the tax authority.

As this study looks at the impact of the relationship between taxpayers and tax authorities, and how this subsequently influences compliance decisions, it adopts Ayres and Braithwaite's responsive regulation theory (as used in some recent tax-related studies, see section 4.13), to help explain and inform results.

4.9. Theory of the study

The study is conducted on an inductive basis and did not test any of the underlying tax compliance theories or models discussed earlier in this chapter. The study, following the data collections and analysis (see next chapters) uses existing theories to explain tax compliance in the informal sector. Based on the aims of this study, to assess compliance determinants of informal sector operators (see chapter one), the work of Ayres and Braithwaite (1992) which has been successfully been used in recent tax research (see Braithwaite et al., 2007; Gunningham, 2007; Baldwin and Black, 2008; Ventry, 2008; Book, 2009; Leviner, 2009, and Holmes, 2011) is adopted to assess the extent to which responsive regulation approach in tax administration can influences compliance decisions of informal sector operators.

4.9.1. Responsive Regulation Theory (RRT)

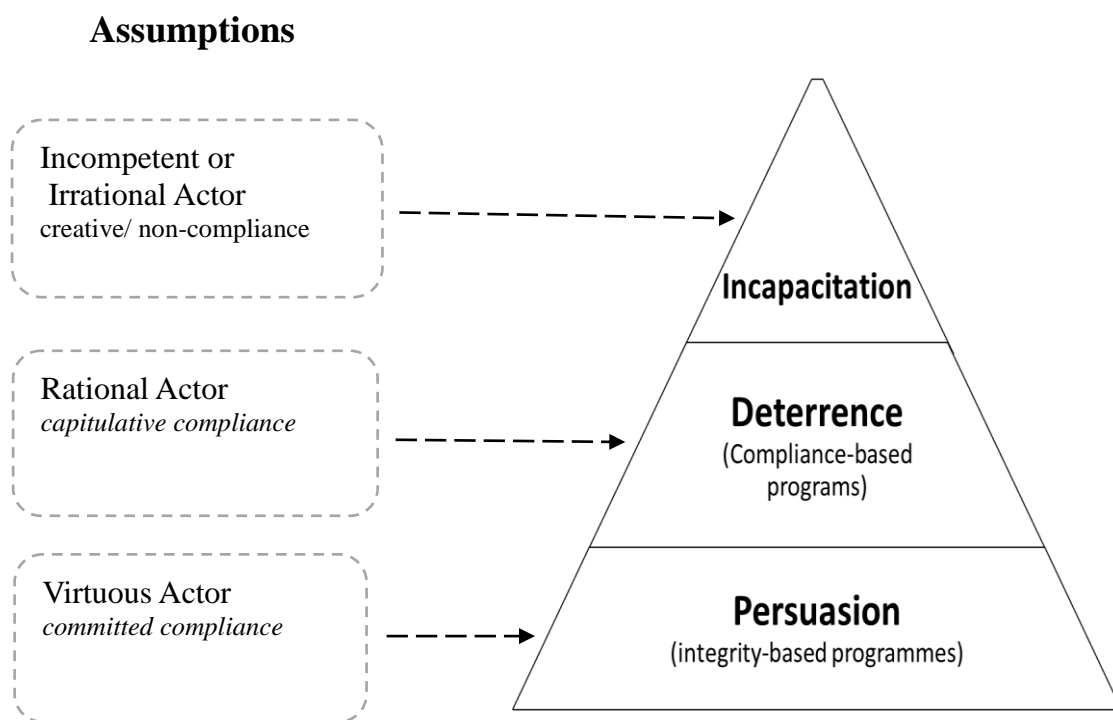
Ayres and Braithwaite (1992) moved the regulation debate from deterrence and enforced compliance paradigm to incorporate principles of responsive regulation which moves away from the 'big stick' approach and embraces a more comprehensive, strategic, and forward-looking method of enforcement (Leviner, 2008).

The concept of 'responsive regulation' entails administration of determinate law by officials who tailor their regulatory behaviour according to the compliance posture adopted by individuals subjected to the relevant law' (Whait, 2012, p.108).

The main feature of the concept of responsive regulation is the pursuit of cooperation by the regulator with the regulatee. The theory is built around a set of possible compliance behaviours and attitudes and suggested regulatory actions to shape compliance decisions. These compliance behaviours and associated regulatory responses are presented in the form of enforcement pyramid (see figure 4.5). In explaining the responsive regulation pyramid, Ayres and Braithwaite (2001) summed up the hallmark of the concept:

‘Regulatory pyramids offer the advantage of handing regulators a set of tools that can be applied without having to have a detailed understanding of why non-compliance has occurred. One starts with the expectation of co-operation; escalation on the pyramid occurs only when one sees the other defaulting and becoming non-co-operative’ (Ayres and Braithwaite, 2001, p.7)

Figure 4.5 Responsive Regulation compliance pyramid



Source: Author's compilation from the literature

The enforcement pyramid (see figure 4.5 above and the ATOs approach in fig. 4.8 below) is a dynamic and gradual application of less to more severe sanctions and regulatory interventions. These sanctions and interventions balance the conventional (and often more

antagonistic) authoritarian approaches with strategies which employ persuasion and encouragement through three states of communication: cooperation, toughness, and forgiveness (Leviner, 2009, p.385).

Considering the motivations, problems, and conditions of the regulatee, responsive regulation emphasises voluntary compliance through persuasion and cooperation (Ayres and Braithwaite, 1992, p.4). Responsive regulation deemphasizes threats and promotes support and regulatees capacity building. In their support for responsive regulation, Job and Honaker (2003, p.113) suggest that sanctions should be available and imposable, escalating in ever-increasing intensity with recalcitrant non-compliance.

The concept advocates for mutual trust between the regulatees and the regulatory authority and a conscious desire for cooperation between the two (Demin, 2018, p.17). Trust in this context means a ‘relationship where the other player can be taken at his or her word, where there is a commitment to an honest communication, to understand the needs of the other, to agreed rules of fair play and a preference for cooperation’ (Ayres and Braithwaite, 1992, p.86).

A regulatory authority that adopts this approach commits itself to investigation and takes into account the problems, motivations, and circumstances of the regulatees (Leviner, 2008, p.369). RRT adopts a dynamic approach to regulation, and assumes a total commitment to assisting regulatees’ compliance efforts; and strives to enforce compliance across the board, even when the regulatees are highly defiant (Ayres and Braithwaite 1992, p.35).

Responsive regulation theory has been successfully adopted in regulating a number of sectors (in different countries), example National Audit Office (Australia); Food and Safety (Australia, New Zealand and Netherlands); Health and Safety at work (Canada); Health and Safety Commission – enforcement policy statement (UK); Patients safety commission (Oregon, US); and Prudential regulation (Australia), just to mention but a few (Ivec and Braithwaite, 2015, p.2).

Subsequent studies (following the initial work by Ayres and Braithwaite, 1992) has moved the responsive regulation theory into two pillars – the regulatory pillars of *sanctions* and *support*, which are discussed in the next section.

4.9.2. The Regulatory Pillars of Sanctions and Support

As observed earlier in this section, the enforcement pyramid, the bedrock of the responsive regulation theory suggests the escalation of sanctions as a means of enforcing compliance.

Ayres and Braithwaite (1992) argue that businesses are more likely to defect from cooperation where a regulator has only one deterrence option, even if that option is cataclysmic. In addition, for political, moral or sometimes legal reasons, such a strong penalty/fine is unlikely to be applied if it is disproportionate to the nature of the crime (Davidson, 2016, p.188). For example, criminal prosecutions involving long prison terms are unlikely to be initiated for relatively minor business transgressions, such as creating a low level of pollution. This further adds up to the previous argument that a graduated response (pyramid of sanctions) that considers (at each stage) the actions of the regulatees is the most effective way to engage taxpayers and improve voluntary compliance. An example of a regulatory pyramid of sanctions is persuasion — warning letter — monetary penalties — criminal prosecution — temporary suspension of license — permanent revocation of license (Davidson, 2016, p.189).

A key benefit of the regulatory pyramid is that it allows the regulator to recognize efforts of the regulatee and adopts sanctions accordingly. The regulator thus begins at the ‘bottom, assuming cooperation, assuming virtue, but when this assumption is not met or when the regulatee exploits this cooperative strategy, the regulator escalates and adopts a stronger enforcement posture, first using measures like improvement and prohibition notices, but if that doesn't work, escalate into higher enforcement approaches’ (Johnstone, nd., p.25)⁴⁵.

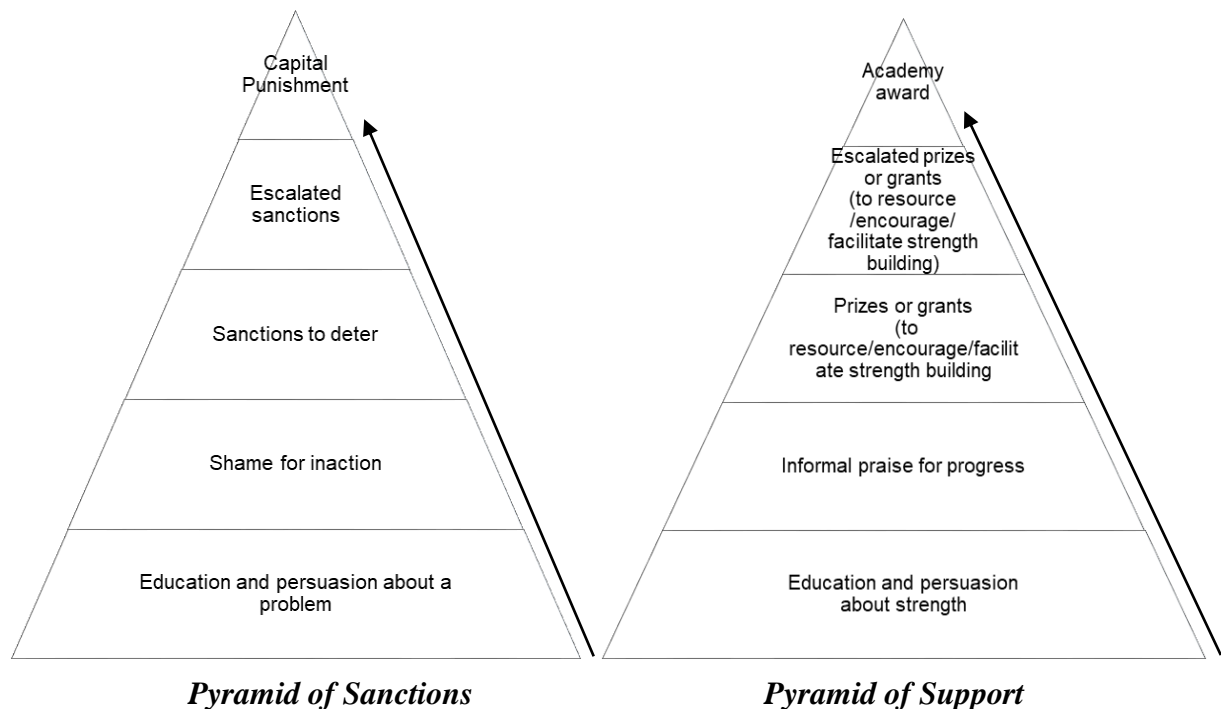
Although the pyramid of sanctions recognizes the efforts of regulatees in the compliance process and recommends a variation of sanctions to suit nature of the offense, its focus is primarily on punishment rather than supporting the regulatee to comply.

Therefore, as a complementary approach to the enforcement pyramid and to recognize the support needs of regulatees who may want to do the right thing but may not [genuinely] have the capacity to do so, the pyramid of support (mainly referred to as the strengths-based pyramid) has been proposed in recent regulatory literature (see Braithwaite et al., 2007; Braithwaite, 2008; Healy, 2011; Ivec and Braithwaite, 2015; Davidson, 2016).

⁴⁵ Interview transcription of Prof. Richard Johnstone, Director, National Research Centre for OHSU, ANU. Interview is available on Australia's Safework website (<https://bit.ly/2YOG7i8>).

In other words, the pyramid of support/rewards is recommended where there is compliance. As shown in the figure.4.6, at the bottom of the pyramid of rewards, the regulator may provide support in the form of education, which can escalate to praise, positive recognition, by spreading the word about the approach the regulatee has adopted in its compliance efforts. To further boost compliance, the regulator can move to the top of the pyramid and nominate the regulatee for a prize.

Figure. 4.6. Pyramid of sanctions and pyramid support showing the intensity of sanctions/support

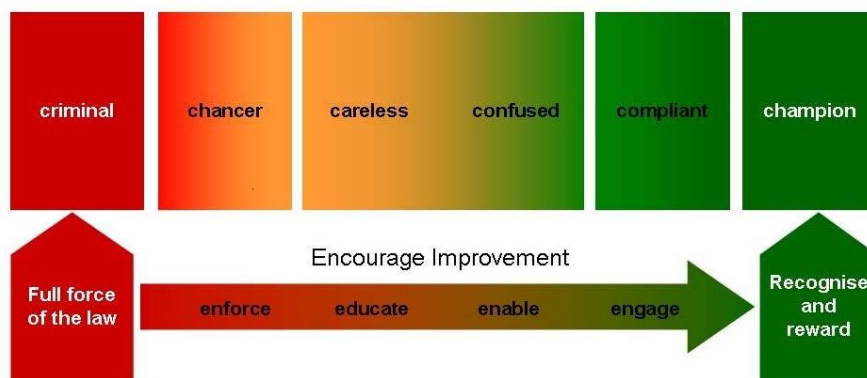


Source: Author's compilation

Because there are irrational, rational and virtuous taxpayers, the most effective approach is a blend of the two approaches to achieve a balance and ensure that the needs of specific taxpayer groups are met. For example, whereas structuralists (operators of the informal economy) who have tax evasion as a motive may be better served by the pyramid of sanctions, adopting the same approach for the legalists may not be appropriate. The legalists who mainly operate in the informal sector due to the heavy regulations or excessive cost of maintaining formal status may be willing to comply voluntarily with their tax obligations if they are offered the needed support.

An example of a more blended practical approach of the responsive regulation theory is the one used by South Australia's Environmental Protection Agency (EPA). The EPA as a risk-based regulator adopts a mix of sanctions and support based approaches (see figure 4.7 below) to design actions and responses which are tailored to risks, attitudes, and behaviours posed by individuals, industries, and sectors (EPA, 2013, p.8).

Figure 4.7 EPA, South Australia's application of responsive regulation.



Source: (EPA, 2013, p.8)

As shown in figure 4.7 above, the EPA's regulatory stance is that 'significant majority of entities want to comply. A small percentage do comply willingly with limited support or direction from the EPA (deep green zone) – These groups are recognized and rewarded. A large proportion of entities need help to comply (faded green and orange zones)—the EPA provides support and guidance to assist these groups. A small proportion of entities will wilfully flout the law (red zone)—the EPA uses the full force of the law to deal with these groups' (EPA, 2013, p.8).

4.10. Responsive regulation in tax administration

Within the field of taxation, responsive regulation (in tax administration) has been explicitly adopted by wide range of regulators, including the Her Majesty Revenue and Customs (MRC, UK) Canada Revenue Agency (CRA, Canada), the Inland Revenue Department (IRD, New Zealand), the Dutch Tax and Customs Administration (Belastingdienst, Netherlands),

the Internal Revenue Service (IRS, USA), and the pioneer, the Australian Tax Office (ATO, Australia) and several countries within the European Union (Rollins, 2016).

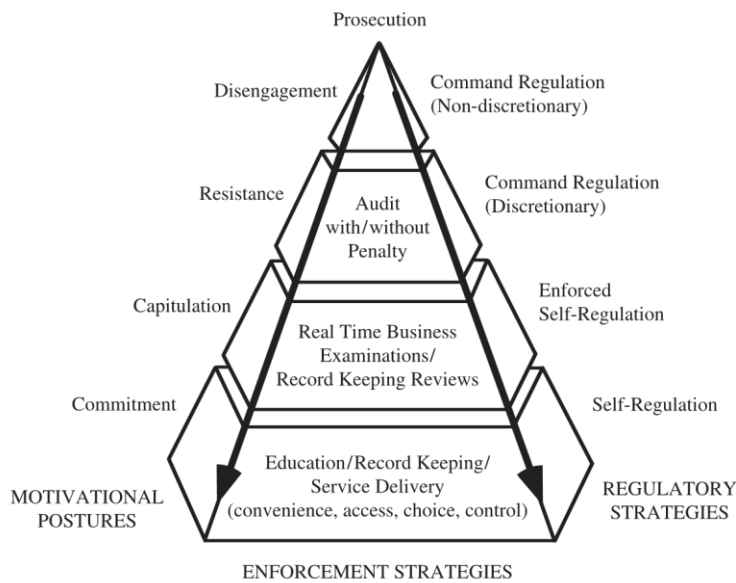
Within tax administration, responsive regulation focuses on the 'taxpayer - tax authority' relationship, and as noted by Ayres and Braithwaite (1992), this relationship plays a vital role in tax compliance. It is based on the premise that the regulator has the authority to own up to its administrative responsibilities and explore different ways to manage this relationship. This is not only to enforce compliance from potential non-compliance but also to strengthen ties and to manage compliance more fairly and efficiently with the aim to improving voluntary compliance, especially in the face of complex tax laws, which keep evolving (Leviner, 2008).

The Australian Tax Office (ATO) describes responsive regulation as a structured way of understanding and improving taxpayer compliance as it helps the tax authority to better understand the factors that influence taxpayer behaviour to apply the most appropriate compliance strategy' (ATO, 2009).

As demonstrated in figure 4.5, at the base of the pyramid are taxpayers who are willing to comply voluntarily, and at the end are those who try all options to evade or who will only comply based on the threat of audit and severity of potential fines (Kirchler and Wahl, 2010). The responsive regulation approach, therefore, assumes that there are taxpayers who want to do the right thing or try to comply, but do not always succeed, so the approach is to make compliance easy, or to assist them to comply. There are also non-complying taxpayers, who need suitable sanctions to comply. In this case, enforcing the law helps maintain overall taxpayer confidence in the tax system and encourages ongoing compliance (IRD, 2005).

Thus, responsive regulation requires regulators to be responsive to the conduct of those they seek to regulate, and devise the most appropriate intervention (Ayres and Braithwaite, 1992).

Figure 4.8 Actions and responses of the ATO model



Source: Braithwaite, 2003

A regulatory pyramid, as illustrated in ATOs model in figure 4.,8 above, sets out a series of options that a tax authority might use to win compliance, sequenced from the least intrusive at the bottom to the most intrusive at the top (Braithwaite, 2007, p.4). Another strong assumption held by responsive regulation theory is that procedural justice and fair treatment of taxpayers by the tax authority will improve voluntary compliance.

This theory assumes that most taxpayers are voluntarily compliant with tax laws. Therefore, most taxpayers' compliance behaviour is self-regulated and are at the base of the compliance pyramid. The theory asserts that most of these taxpayers will interact with the tax authority when they are lodging necessary forms, receiving tax assessments, or making payments (Whait, 2012, p.110). They require very limited intervention from the tax authority and the regulatory objective of the tax authority towards this group of taxpayers is to make the tax equitable and certain and the compliance process convenient (easy) as possible.

In between the base and the top end of the pyramid are the capitulative compliance group of taxpayers. This segment involves taxpayers who are 'at the edge of non-compliance'. They may have different views about the tax law and how it should be applied, may be unsure how to comply or may have motivations towards noncompliance. This is the most important phase of the responsive regulation compliance pyramid (Whait, 2012, p.110). The strategy for the tax authority at this stage is to persuade the taxpayer to comply.

The role of the taxpayer over the years has shifted from a passive (observer) to an active participant in the taxation process (Belevich, 2012). Therefore, for improved voluntary compliance, a tax authority must critically evaluate this role and provide the necessary mechanisms to ensure taxpayers involvement. With its inclusivity, responsive regulation responds to this demand well. Responsive regulation makes provisions to accommodate situations where taxpayers may be resistant to tax laws. Where taxpayers adopt a noncooperative position, the tax authority is less likely to adopt corporative strategies and may resort to the conventional deterrence approaches such as audit actions and/or fines to enforcement compliance (Braithwaite, 2003). These deterrence strategies may be escalated to include court actions, especially in situations where the taxpayer becomes completely disengaged from the system.

Assessing the various phases of the compliance pyramid and the recommended policy responses, it's evident that responsive regulation (in taxation) believes that a tax authority that actively engages the democratic will of the people, may not need coercion (at the top of the pyramid) to win compliance. Although the taxpayers appreciate the existence of coercive force which may be used by the tax authority, they will, however, comply through persuasion and education. In a typical tax compliance environment, responsive regulation adopts systematic and directed approach that is respectful of regulatees, helpful in filling information gaps and attentive to opposing or resisting arguments, yet very firm on administering sanctions that escalate in intensity in response to the absence of genuine efforts on the part of the regulatees to meet required standards (Braithwaite, 2007, p.5). Thus, responsive regulation welcomes the voices of [dissident] regulatees and deliberates on shared community goals and understanding. Its preferred approach is through teaching (education), persuasion and encouragement for those who fall short, however, responsive regulation encourages the use of punishment when necessary to achieve its regulatory objective. As observed in the early part of this section, responsive regulation refutes the outright use of the command-and-control approach to tax enforcement which presumes that taxpayers are programmed to respond identically to certain regulatory demands.

One major challenge that a tax authority may face in adopting a responsive regulation approach is tailoring punishment (Belevich, 2012) to make concessions for self-regulatory efforts. Braithwaite distinguished regulatory formalism and responsive regulation, citing that although there are some useful attributes of regulatory formalism which can be adopted in

typical tax enforcement situations. For example, automated letters from the tax enforcement agencies do not have to be couched in a legally dense and unfamiliar language, making them incomprehensible to ordinary people, nor do they have to be accusatory and offensive in tone (Braithwaite, 2007, p.6). Again, regulatory formalism advocates for fair and respectful treatment of the taxpayer (Bentley, 1998), however, ‘humanizing’ regulatory formalism is not the fundamental principle of responsive regulation. Responsive regulation is a ‘process’ that openly engages the taxpayers to think about their obligations and accept responsibility for regulating themselves in line with the provisions of the tax law.

Most current tax codes are complex and often ambiguous, therefore using command-and-control approaches will not promote long-term voluntary compliance. At times, tax officers need to consult, network and employ a sound judgement in dealing with the grey side of the tax laws which, and in most cases, taxpayers may find outcomes as unreasonable or unfair which could negatively impact on the legitimacy and the authoritativeness of the tax authority but which is a beacon of the regulatory formalism approach. Thus, regulatory formalism may impose order on a dispute in the tax domain, however, it may not promote clarification of what the intention of the law is in the community at large and how that law connects with notions of justice and reasonableness (Braithwaite, 2007, p.7). Adopting a responsive regulation, therefore, ensures an inclusive dialogue to empower the powerless and challenge the domination of tax authority in the enforcement process.

In addition, Fred and Frey (2002) use the ‘crowding theory’ to argue that tax morale is nurtured through tax authority honouring their side of the contract and providing an inclusive and participatory process for citizens and not through deterrence approaches (command-and-control).

Responsive regulation thus assumes that there is a responsible taxpayer with underlying moral self that can be unearthed by a good regulator which will enable tax evaders/avoiders to change their ways and self-regulate more effectively in the future.

4.11. Responsive regulation and the informal sector

Assessing the compliance challenges in the informal sector (see chapter two), particularly the difficulty of obtaining credible taxpayer information to inform effective tax policy implies

that adopting purely command-and-control and other less corporative approaches may be less effective in promoting long-term voluntary compliance among these operators.

As evidenced by the study of Australia's cash economy (Braithwaite, 2003), designing an inclusive system where taxpayers trust that there exist strong mechanisms of support and enforcement may be more effective.

Evidence from literature (in chapter two) indicates that there are different motives which drive people to conduct their activities informally – From survival needs, over-regulations to profit motives, including tax evasion. This suggests that adopting a responsive regulation approach to deal with different operators differently could yield positive results.

From informal sector compliance perspectives, implementing responsive regulation must involve the three key pillars as suggested by Braithwaite and Braithwaite (2001, p.6);

- a) availability of a full range of credible sanctions which are known to the taxpayer,
- b) a clear signal of the tax authority's willingness to cooperate initially with the taxpayer, and
- c) a clear intention (known to the taxpayer) to escalate the intensity of regulatory interventions in the absence of effort from the taxpayer to meet required regulatory standards.

Escalating the intensity of regulatory interventions within responsive regulation is to inculcate institutional legitimacy and procedural fairness, both of which are influential in promoting compliance, as taxpayers will regard tough enforcement action as more procedurally fair when persuasion has been tried first (Braithwaite and Braithwaite, 2001, p.6). Makai and Braithwaite (1996) described citizen's perceptions of procedural fairness as being more than 'just a political asset' for the tax authority, and if properly managed, procedural fairness could increase voluntary compliance, especially where regulatory actor believes s/he is treated as someone who is trusted, and procedures (systems and structures) are fair (Williams, 2016).

In a typical informal sector tax environment, responsive regulation could increase voluntary compliance through the belief (of most taxpayers) that tax officers trust them at a personal level, but also want officers to keep distrustful enforcement strategies in place to deal with others who cannot always be trusted. Thus, knowing that there are strong and trusted

institutional mechanisms in place to deal with those who cheat builds community confidence and the legitimacy of the tax system (Braithwaite and Braithwaite, 2001, p.7)

Trust plays an important role in regulatory relations (Murphy et al., 2009). Central to the responsive regulation theory is trust. As discussed earlier, RRT advocates for a dynamic regulatory strategy of dialogue and trust as a first choice, followed by escalation to more punitive regulation when trust is abused (Braithwaite and Makkai 1994, p.1). Braithwaite (2002, p.36) further showed that lawbreakers are more likely to comply with the law in the future if they believe that they are treated as trustworthy by regulators. To assess this correlation, Braithwaite and Makkai (1994) conducted an empirical study of compliance behaviour of adult nursing homes (caregivers) towards the inspection framework in Australia. The study found that the regulatees' perception of regulator trust in them increased their compliance levels in the subsequent inspection, which were usually 18 to 20 months later.

In a study to assess the impact of trust between taxpayers and the Australian Tax Office (ATO), Murphy (2004) found that taxpayers trust in the tax office leads to higher voluntary compliance.

The responsive regulation theory asserts that an effective corporative compliance must have three key elements; (1) regulators employ a tit-for-tat regulatory strategy; (2) regulators adopt a hierarchical range of sanctions (the enforcement pyramid); and (3) the most severe sanctions (at the top of the pyramid) are sufficiently high to deter abuses (Ayres and Braithwaite, 1992, p.40) – These elements directly address the three key drivers of informal sector operations discussed in chapter two.

The tit-for-tat strategy according to Six (2012) is based on game theory. In this strategy, actors start with the cooperation and if the other actor reciprocates, a cooperative exchange may develop. If the other actor responds with defection, taking advantage of the initial trust, then the first actor retaliates with defection (Six, 2012, p.2). This is more of a passive regulation where the regulator reacts with the regulatees actions, which Ayres and Braithwaite (1992) referred to as cooperation trust.

Over the years, tax researchers have produced a large body of work on the application of responsive regulation to tax administration. These studies have shaped and supported

responsive tax administration as a viable alternative for organizing the administration of the tax system.

Responsive tax administration approach has influenced compliance scholars around the world and related tax compliance research. For example, Ventry (2008), Book (2009), Leviner (2009), and Holmes (2011) have advocated explicitly for the adoption of responsive tax administration as the best way to improve voluntary compliance, although the literature on responsive regulation about informal sector taxation from developing countries perspective is still lacking.

The theory has also been regularly applied, developed, and tweaked (Nielsen and Parker, 2009) by other scholars (e.g. Haines, 1997; Gunningham and Grabosky, 1998; Parker 2002; Simpson, 2002; Braithwaite et al., 2007; Gunningham, 2007; Baldwin and Black 2008).

Numerous other tax scholars have supported programs aimed at improving tax compliance and improving efficiency in the tax system, and have used responsive tax administration as a model for policy analysis (Osofsky, 2012). Other similar ideas developed as a result of responsive regulation include *Tit-for-Tat regulatory enforcement* (Scholz, 1991; Harrison, 1995) *Flexible Enforcement* (Rees, 1994), and *Creative Enforcement* (May and Burby, 1998) all of which share the key features of the responsive regulation theory.

4.12. Responsive Regulation Theory – The key challenges

A major drawback of this theory is that it assumes that all taxpayers have the competence and positive intentions to do what the law (the tax authority) requires of them. Regulators in RRT are assumed to have the skill and will to act responsively towards regulatees, to be tough on the bad guys and soft on the good guys (Six, 2012, p.2). This may not be the case always, as studies have also shown that sometimes there are capacity constraints within the tax administration, particularly those within developing countries (Brautigam et al., 2008).

In addition, the RRT assumes that trust (persuasion) and control (deterrence) are substitutes such that when there is trust, control does not apply and when control is applied it's an indication of lack of trust (Six, 2012). However, this is not always the case and trust and

control are not necessarily substitutes but compliments, which may be applied simultaneously and may reinforce one another (Weibel, 2007).

Furthermore, trust, as defined in the responsive regulation theory, is based on deterrence. However, deterrence based trust according to Rousseau et al. (1998) is not necessarily trust but ‘low distrust’, which is not an opposite of trust. Six (2012) pointed out that using sanctions as a deterrence to achieve corporation is not the same as trusting, and that corporation is not the same as trust. Thus, trust is not based on corporation - people can corporate without trusting each other, the same way people can trust each other without being corporative.

However, despite these few challenges, the RRT presents an excellent opportunity to assess compliance behavior based on the interrelationship (support/trust) between taxpayers and the tax authority. Considering the fact that this study is conducted inductively and intends to assess compliance behavior of individuals (and effectiveness of current compliance approaches), adopting this theory will help explain the study results (current level of compliance) from the perspectives of both the regulators (tax authority) and regulatees (taxpayers) vis-à-vis existing sanctions and support

4.13. Responsive Regulation Theory in the context of this study

Having explored other theories, in this chapter, the researcher argues that the responsive regulation theory can help analyse the data and be used to inform discussion on tax compliance within the informal sector especially considering the shift in taxpayer role in the tax system from a passive (observer) to an active participant (Belevich, 2012). Braithwaite (2003) observed that responsive regulation was successfully used as the basis by the ATO in designing an inclusive framework for Australia’s cash economy in early 2000.

As noted earlier in this chapter, responsive regulation has been used in several tax compliance research (See Osofsky, 2012; Ventry, 2008; Leviner, 2009; Book, 2009; Holmes, 2011) and has been adopted by many tax authorities (e.g. UK, Australia, New Zealand, and Canada) in designing their tax administration functions.

Furthermore, central to the responsive regulations theory is trust. The theory advocates for trust and dialogue at the initial stages before escalating to sanctions and penalties to enforce

compliance. Trust has been used in several tax compliance studies, (for example, work by Braithwaite and Braithwaite, 200; Torgler, 2003; Frey, 2003; Murphy, 2004; Torgler and Schneider 2005; Pitters et al., 2007; Kirchler, et al., 2008; Kirchler and Wahl, 2010; María-Dolores et al., 2010; Oats and Pemberton ,2012) all assessed tax compliance from a trust perspective⁴⁶ and concluded that trust has a positive correlation with tax compliance decision.

The theories of the informal sector (discussed in chapter two) further indicate that different operators in the informal sector may have different intentions for choosing to engage in that sector, therefore adopting this theory would help explain how responsive regulation approach to tax administration could help analyse informal sector tax compliance behaviour from the perspectives of the dualists, structuralists and the legalists ideologies.

This theory fits within the limits of this study as it helps analyse how the individual's compliance decisions are shaped by the regulatory approach adopted by the regulator including the relationship between them (regulator and the regulates). As discussed in chapter two, due to lack of reliable data about the operators of the informal economy it is difficult to comprehensively understand what produces tax non-compliance, and even less what motivates compliance, however, this information is critical to the design of effective policy. In response to this challenge, most tax authorities resort to using blunt, non-taxpayer responsive and often punitive measures designed to deter evasion rather than promoting long term voluntary compliance. Using the RRT, the study assesses how informal sector taxpayers are influenced by responsive regulation approaches, which represents a gap in recent literature.

In summary, using the 'responsive regulatory lenses', the study explores and analyses compliance behaviours of taxpayers in relation to the practices within the tax environment (the nature of compliance strategy adopted by the revenue authority) and how this shapes compliance behaviour.

⁴⁶ This includes taxpayers trust in the tax authority and the systems and also the belief that that tax authority trusts them

CHAPTER FIVE

RESEARCH METHODOLOGY, APPROACH, AND THESIS

5.0. Introduction

This chapter of the study systematically describes the research design and the methodology employed to find answers to the research questions posed in chapter one. This chapter is further grouped into sections to describe the different stages and processes of the methodology used.

The initial part provides an explanation of the survey methodology used and the justification for its selection for this study.

As the study is a case study of the Ghanaian informal sector, the next part of this section concentrates on the survey/data collection methods used in Ghana. These include the survey instrument and the procedures involved, sampling frame and size and the questionnaire development. The remaining sections of the chapter describe the research framework and link to the data analysis chapter (chapter six) to conclude other chapters of the study.

5.1 Study Objectives

Kirchler, (2007, p.188) theorised two main approaches to understanding the interaction between taxpayers and tax authorities - ‘cops and robbers’ and ‘service and client’ approaches.

The ‘service and clients’ approach carries the assertion that taxpayers are cooperative citizens who are willing to comply if they understand tax laws and the procedures of paying taxes. This study is aiming⁴⁷ to establish the assertion that operators of the informal economy would be compliant if they understood the tax law and deemed it to be fair – i.e. that they would respond to similar motivations to pay taxes, as found to be the case in studies of developed country taxpayers.

In addition, the study analyses the procedural fairness effect on tax compliance in terms of the tax payment decisions making by informal sector operators. The study also adopts the approach⁴⁸ by Dijke and Verboom on procedural fairness who found that “low trust in

⁴⁷ By analysing factors which influence taxpayers compliance decisions in the informal sector away from the conventional approach to studying the sector which look at systems rather than taxpayer motivations.

⁴⁸ Dijke and Verboom, (2010) used students from the Open University Amsterdam, as research assistants, and

authorities makes procedural fairness rules relating to leader behaviour more effective in stimulating voluntary compliance with authorities’’ (Dijke and Verboom, 2010, p.90). With this in mind, a section of the interview questions is designed to investigate the state - citizen – relationships. Here the study draws on the ‘regulatory pillars of support and sanctions’ in the Responsive Regulation Theory discussed in chapter four to assess how different compliance approaches influence tax compliance behaviour of the informal sector taxpayer. In addition, the perceived level of reciprocity and fairness⁴⁹ (of the state) by informal sector are analysed to assess their impact on compliance decisions. Theories in pillar 2 as discussed in chapter four help explain this aspect. It is proposed that taxation engages citizens/taxpayers to collectively make claims on the state for reciprocity either through decision making or the provision of ‘something’ in return for honouring their tax obligations, this is one of the key strategies to promoting tax compliance (OECD, 2008; Prichard ,2009). Studies show that aside from the understanding of tax laws as well as one’s obligations and the relationship between the state and citizenry, there are social and other demographic factors which generally influence tax compliance behaviour (as outlined in chapters four). In addition, financial constraints and the availability and quality of accounting records kept for the business also influences compliance (Singh and Bhupalan, 2001). Therefore, the interviews and survey questionnaire for the informal sector operators are designed to cover among others, the following areas;

A. *The compliance process* – this section of the questions assesses;

- The stages and difficulty of the compliance process including compliance approaches adopted by the tax authority
- The availability of tax information to aid compliance decisions
- Taxpayers’ understanding of tax laws and their obligations within these laws
- Tax compliance costs in the form of direct financial costs and other indirect costs to businesses and individuals

B. *Social*⁵⁰ *issues* which could impact on people’s compliance behaviour including relationship between actors in the tax field (i.e. taxpayers and tax authority)

designed scenarios/questions to test taxpayers compliance decision based on procedural fairness

⁴⁹ The research will investigate the responsiveness of the state to the needs of the informal sector and how involved the sector feels they are to policies that affect them, perceived benefits to paying taxes and the resulting impact on tax compliance.

⁵⁰ Social issues will incorporate all demographic variables such as gender, religion, age, family status (i.e. married/single), taxpayer-authority relationships and influence of reference groups

C. Financial constraints and types of accounting records kept and dominant transaction type⁵¹

D. Corruption / perceived fairness in the tax system/trust - in the state as responsible government and perception of spending

More specifically, the objectives of the study as discussed in chapter one are to:

- Examine the effects of the relationship between taxpayers and the tax authorities on the voluntary compliance of taxpayers in the informal sector.
- Assess how different compliance approaches influence compliance decisions of informal sector taxpayers.
- Identify and analyse the variables that make individuals and small business operators in the informal sector “difficult-to-tax”.
- Assess the effectiveness of presumptive based taxation, as the dominant form of taxing informal sector economic activities in developing economies.
- Analyse and compare the key tax compliance determinants of informal sector operators with those in the formal sector.

5.2. Research Questions

In order to accomplish the research objectives, empirical evidence is produced to answer the following questions:

5.2.1. Research Question 1.

Are there more effective ways to tax informal economic activities in developing countries than those that are currently employed?

To address this question, the study first identifies what ways through the survey instrument, may be effective in motivating higher voluntary tax compliance in the informal economy.

Some of the survey questions are therefore designed around different tax administration strategies, and aimed to explore whether the informal sectors in developing countries (in this

⁵¹ This area will look at whether cash only transactions accepted or cheque and bank transfers are the dominant form of payment for their business activities

case Ghana) are best served using presumptive taxation approaches such as ‘tax disc/sticker/stamps etc. (Bird and Wallace 2003; Loeprick, 2009; Joshi and Ayee, 2002b; Bräutigam *et al.*, 2008; Prichard, 2009), as currently being applied or by moving to a formal assessment based taxation.

5.2.2. Research Question 2.

To what extent does the relationship between a taxpayer and the tax authority shape voluntary compliance?

The relationship between taxpayers and the tax authority have been identified as having a profound impact on compliance decisions in studies involving the formal sector (Richardson and Sawyer, 2001; Torgler 2003; Frey and Torgler, 2004; Torgler and Valev, 2007; Loo and Ho, 2005; Frey and Torgler, 2007). However, this has not been tested within the informal economy, specifically within the developing countries context, and therefore remains a gap in research knowledge. This question seeks to contribute to the debate of shaping our understanding of the impact of the tax field (taxpayer versus tax authority relationships) on compliance decisions.

This question is answered by drawing on the responsive regulation theory to assess compliance decisions, by exploring how the regulatory approach shape compliance decision of the informal sector operator.

5.2.3. Research Question 3.

To what extent does moral obligation contribute to the tax compliance decisions of informal sector operators?

Most recent studies within tax compliance have shifted from seeing the taxpayer solely as a utility maximiser, to exploring the wider intrinsic drive to comply with tax obligations (see chapter four for detailed discussion on tax morale). This question assesses how tax morale

influences the compliance decisions of the informal sector operators, drawing on the previous formal sector studies, for example (Kirchler, 2007; Frey and Torgler 2007; Pope and McKerchar 2011; Alm and McClellan, 2012).

5.2.4. Research Question 4.

How effective is presumptive based taxation on informal sector operators' compliance decisions?

Presumption taxation is by far the most common form of taxing the informal sector in most countries (Stern and Ahmad, 1991, p.276; Makedonskiy, 2005). The reason for its popularity is mainly due to the high tax collection costs and the capacity constraints of other solutions available (Brautigam et al., 2008). (See chapter two for discussion on the nature and principles of presumptive taxation). This question assesses the effectiveness of the use of a presumptive strategy in taxing the informal sector from the perspective of the taxpayers.

5.2.5. Research Question 5.

What social/demographic variables influence tax compliance in the informal sector of developing countries?

This question seeks to establish any possible linkage of different demographic variables and an individual's tax compliance behaviours. Individual's tax compliance responses are assessed against variables such as sex, age, and marital status to establish possible correlations. This will help assess such relationships in the informal sector and compare results with existing evidence within formal sector settings.

5.2.6. Research Question 6.

What are the impacts of increased auditing mechanisms on voluntary tax compliance?

Research question six is addressing how increased auditing/detection mechanisms and punitive measures such as fines may impact on voluntary compliance in the informal sector. Previous studies have produced mixed results on the impact of tax audits on compliance decisions in informal settings. Some (for example Allingham and Sandmo 1972, Lewis, 1982; Mogudu and Anyaduba, 2014) believe that such actions influence compliance decisions, whilst other studies (for example McKerchar, 2001; Torgler, 2001) found that conventional audits and fines do not improve compliance, especially in the long term.

5.3. Study Approach

This study employs both qualitative and quantitative approaches in seeking to address its objective and specific research questions. Qualitative data collection is undertaken through the use of face-to-face interviews, a field trip observation [with GRA tax officials], and the quantitative data collection method is by the use of a questionnaire survey. The research design for the study, therefore, involves the use of both exploratory (interviews) and descriptive design (questionnaires). Data collected through the qualitative methodology is analysed through the use of content analysis with the development of themes from the interview data using Nvivo, and the quantitative data (questionnaire) collected is analysed with the aid of statistical software, SPSS.

Using both qualitative and quantitative research approaches ensures that rich search sets of data are generated for the study as each approach helps address the various research questions from a different angle which adds extra impetus and rigour to the overall study. Bryman (2012, p.36), states that ‘quantitative research can be construed as a research strategy that emphasises quantification in the collection and analysis of data and that;

- entails a deductive approach to the relationship between theory and research, in which the accent is placed on the testing of theories;
- has incorporated the practices and norms the natural scientific model and of positivism in particular; and
- embodies a view of social reality as an external, objective reality’.

Qualitative research can be construed as a research strategy that usually puts an emphasis on words rather than quantification in the collection and analysis of data and that;

- predominantly emphasises an inductive approach to the relationship between theory and research, in which the emphasis is placed on the generation of theories’;
- has rejected the practices and norms of the natural scientific model and of positivism in particular, in preference of an emphasis on how individuals interpret their social world; and
- embodies a view of social reality as a constantly shifting emergent property of the individuals’ creation.’

The qualitative approach, however, dominates the two main methods employed in this study since the study is mainly a qualitative inquiry. As one of the most widely used analytical strategies, content analysis is used in coding the data. Most recent studies within the social sciences employ qualitative content analysis, which addresses some of the weaknesses of the quantitative approach in generating needed data for analysis (Zhang and Wildemuth, 2009).

Using qualitative content analysis helps serve a number of vital purposes such as:

- an approach of empirical, methodological and controlled analysis of texts within their context of communication, following content analytic rules and step by step models, without rash quantification” (Mayring, 2000, p.2)
- a method of qualitative data reduction and sense-making effort that takes a volume of qualitative material and establish consistencies and meanings” (Patton, 2002, p.453), and
- a method for the subjective interpretation of the content of data through a systematic classification process of coding and identifying themes or patterns to ease analysis (Hsieh and Shannon, 2005, p.1278).

The vital functions illustrated above, according to Zhang and Wildemuth (2009), demonstrate that qualitative content analysis emphasises an integrated view of speech/texts and their specific contexts in establishing one’s stance on an issue of inquiry.

Apart from the obvious benefit of adopting content analysis and a general qualitative research approach in a social science enquiry, another reason for adopting a qualitative

approach for this study is the pioneering stage of this field of inquiry. There is currently no suitable tested and universally agreed-upon theoretical framework for the research of informal sector taxation undertaken in the developing economy context, which this study could adopt as the foundation or the theoretical framework for testing in this particular case or to seek to develop further in the course of this study. Therefore, using a qualitative inquiry approach enables the researcher to assume an inductive stance and to explore areas of key interest. As argued by Fu (2012), there is a clear and significant distinction between western societies and those of the developing world, it is, therefore, unwise to test a western theoretical framework (in this case of tax compliance in an advanced economy) in a developing country (and more specifically in an informal economy) context. As a result of this, this study does not seek to test theories via a deductive approach. Instead, it takes an inductive stance in analysing, presenting and seeking to gain an understanding of developing country informal sector tax compliance issues. This approach may, however, then help serve as the theoretical framework for future studies in the field of informal sector taxation in developing countries.

The nature of the research questions implies that using a mixed methodology, it was possible to create the interaction required to establish the views of the informal sector operators through face-to-face interviews, hand-delivered questionnaires and field observations, which other methods such as experiments would be less able to fulfil.

5.4. Research Methods

This study uses three approaches – interviews, questionnaires and field observation as the main methods to collect the required data from the informal sector operators and tax officials from the national and local authorities – namely the Kumasi Metropolitan Assembly (KMA), the Accra Metropolitan Assembly (AMA) and the Ghana Revenue Authority (GRA).

This study, thus, uses mix methods for data collection. Mixed methods involving an interview and field surveys have been adopted in a number of recent tax research studies (see Saad, 2014; Mohdali and Pope, 2014; Sikayu, 2016; Rosid et al., 2016), and the use of observation in tax taxation studies is equally gaining prominence.

Adding field observation to the survey and the face-to-face interview methods offers extra advantage and rigour to the data collection. Yesegat (2009, p.104) observed that this helps

researchers to gain perspectives from different types of data or different levels within the study'. Observation has been used in a number of recent tax studies, for example, Caro et al. (2014) adopted it to assess household beverage purchases in Chile following the implementation of the new sugar-sweetened beverage (SSB) tax (from 13% to 18%); Chetty et al. (2009) assessed the effect of alcohol taxes on alcohol consumption in the United States using experiment and observational techniques. Within the field of tax compliance, Yesegat, (2009) uses surveys, experiment, and interviews to assess how compliance cost of VAT shapes compliance decisions in Ethiopia; Hayes and Baker (2014) use a participant's observation to assess the resolution of audit engagement challenges in government tax compliance audits; and Boll (2014) adopts observation and interview to assessed how the daily interaction between bookkeepers and business owners influence tax compliance.

Although in most studies, interviews are used as a follow-up with individual respondents after questionnaires to further investigate their responses (McNamara, 1999), this study takes the opposite view. Surveys are designed to provide a 'snapshot of how things are at a specific time (Denscombe, 1998). In this study, using the interview first allow the researcher to explore the compliance variables broadly and used content analysis to establish themes. The survey technique is then followed to collect data on key aspects of the established themes which the researcher wanted to further investigate. The order one adopts does not matter as noted by Kelly et al. (2003) who stated that the approach which suits individual project should be the deciding factor. In this study adopting an exploratory (interview) approach at the initial stage to establish trends to inform the survey questionnaire design was considered appropriate.

Furthermore, the choice of research method and approach was influenced by a lack of secondary data and the unreliable nature of the available data within the sector generally, which implies that the only reliable method, at present, to collect data for such sensitive research is the use of the three approaches.

Whilst Hanousek and Palda (2003) suggest that in such countries, survey methods are the main source of information for tax compliance studies since the data needed for other research methods is unreliable due to inadequate national statistics, Charmes (2002) observed that mixed methods are the best approach for collecting information for the informal sector studies, because the weakness in one method will be compensated by the strength in the other. Thus, using mixed-methods help deal with some of the challenges of using only one

method such as a survey. Again, a mixed method design is recognised as a superior approach and capable of providing more comprehensive answers than a single method design (Loo et al, 2005, p.185).

5.4.1 Face-to-face interviews

As the starting point of the study, a semi-structured interview was conducted with individuals and businesses in the informal sector, as an exploratory investigation to generate an understanding of the operation of the sector in relation to taxation. As the study aims to explore the relationship between taxpayers and tax officials and how this influences compliance, it was envisaged that (as the starting point) interviews would be the most effective data collection method, due to their ability to explore wider areas in the course of the process, for example using probes. Conducting the interview at the first stage of the data collection helped to gather more in-depth insights on participant attitudes, thoughts, and actions (Kendall, 2008). This led to the emergence of new themes that did not form part of the initial questions designed from using existing literature, but found to be relevant to the study objectives and as a result were developed further and became an integral part of the survey data collection.

The interview questions were designed to establish linkages and to seek clarification of possible linkages to the results of existing studies in the area of tax compliance, both in developing and in advanced economies contexts (as outlined in chapter four).

To be able to get a good insight into the issues in the informal sector by getting open responses from interview participants, this study, rather than using a direct approach to measure tax evasion and avoidance practices in the informal sector, employed an indirect approach. 'Indirect methods look for traces of evasion behaviour that are left in various indicators that can be identified, so that evasion is not measured directly but rather indirectly via these measurable traces', (Alm, 2012, p.58). Using this strategy as a guide, questions were designed to explore respondents' tax compliance behaviour and key variables/indicators which could increase or decrease compliance rates.

The interviews were conducted among small businesses and informal sector operators and involved a face-to-face session with the minimum interview duration lasting 51 minutes, and the longest session one hour thirty-five minutes. The interviews were made up of 17

participants from various businesses with different income levels and demographic differences selected⁵² from two regions of Ghana. The interview responses were organised around three major themes. These themes were identified during the literature review. The themes were further grouped under sub-themes for further analysis – The sub-themes include themes from existing literature and those which emerged (new trends) during the interviews (see chapter six for interview themes).

The interview was followed by a questionnaire survey (section 5.8) and field observation (section 5.9).

Tax compliance studies in developing countries, “involves additional complicating factors that make it even harder to get reliable answers”, (Gerxhani, 2006, p.561) regardless of the methodology adopted. These complicating factors come as a result of the fact that people are not used to paying taxes. Also, people’s attitudes towards the government may be hostile and as such, any issues involving taxes may be seen as exposing their private lives to the state, and they may resist giving complete and truthful answers in interviews or when filling in a questionnaire. This issue could be reduced by assuring respondents of their anonymity, (Gerxhani, 2006; Torgler et al., 2010; Molero and Pujol, 2012) an approach which was successfully applied for the interview and the questionnaire administration in this research. Again, this issue is addressed in this study by adopting a modified approach⁵³ of the three principles used by Govender (2008) in the informal sector study of South Africa;

- Firstly, to overcome a possible language barrier, a research assistant accompanied the researcher, and where necessary offered translations. For anonymity, the research assistant is not selected from the same community to ensure that they are not known to the interviewees. The criterion for selecting the research assistant is based on their understanding of research and their fluency of the local language.
- Secondly, a snowballing approach was adopted so that the interviewees could direct the researcher to other people whom they felt would be comfortable and willing to answer the questions, and who are known to them either as customers or business associates.

⁵² The justification for sample selection is detailed in the methodology section.

⁵³ These three approaches are further explained in later stage under ‘*strategy to increasing participation and obtain reliable data*’.

- Finally, a strong confidential agreement and parameters are then outlined to participants to further guarantee confidentiality.

In choosing a research method to investigate tax compliance, consideration needs to be given to the sensitivity of the nature of the issues being asked about so that an appropriate technique is chosen which it is hoped makes people feel comfortable enough to provide unbiased answers to generate more accurate data for which the research is seeking.

The sensitivity nature of tax research is also raised by (Gerxhani, 2006) who cautioned that before any research method is chosen to investigate peoples' tax compliance decisions, it is important to recognise that it is a very sensitive area where people may not provide the right answers if the wrong approach or method is applied. In suggesting two⁵⁴ approaches to dealing with the sensitive issues in tax research, Gerxhani first stated that "people do not like being confronted with questions such as "Do you pay your taxes?", as such questions may intimidate respondents who may be dishonest (Gerxhani, 2006, p.558). In addressing this issue, both the interview and the questionnaire use less direct questions and instead make use of more gradual approaches through indirect questions to assess the attitudes of the sample population's approach to taxation. During the interview stage, questions are normally followed by probes for further clarifications.

This research also adopts some of the key variables used by Frey and Torgler (2007) in their comparative study of tax compliance behaviour among Central Eastern European (CEE) and Former Soviet Union (FSU) countries. The controlled variables in their experiment are included and explored in this study to assess how an informal sector operator's tax compliance behaviour is influenced by age, peers' compliance behaviour, educational levels, marital status, and religion. Although corruption and perceived fairness in the tax system is investigated, the study, however, did not adopt fully the institutional quality (i.e. the six governance variables)⁵⁵ used by Frey and Torgler (2007), as the study is more interested in tax field relationships, morale, demographic, and other factors which directly affect informal sector operators' tax compliance behaviour. This does not mean the study completely ignored institutional factors. To understand tax administration and the impact of the relationship

⁵⁴ Gerxhani proposes use of a direct and a gradual approach. The direct approach asks respondents directly about their (non)compliance with taxes, whereas the gradual approach formulates such sensitive questions concerning social and fiscal fraud to deduce individuals compliance behaviour

⁵⁵ The variables include; voice and accountability, political stability and absence of violence, government effectiveness, regulatory quality, rule of law, and control of corruption.

between taxpayers and the tax authority in tax compliance, a series of questions are designed to test such a relationship or correlation.

Frey and Torgler (2007) also used indirect questions in their survey. Some sample questions for their study are;

- a. *“Please tell me for each of the following statements whether you think it can always be justified, it can never be justified, or it falls somewhere in between: . . . Cheating on tax payments if you get the chance.”* (p141).
- b. *“According to you, how many of your compatriots do the following: Cheat on taxes if they get the chance?”* (p142).

The questions⁵⁶ for the survey data take a similar pattern to these questions above.

Another study which uses the indirect approach to asking survey questions also suggests that “these types of questions should increase the reliability of the measure of tax morale: since they do not directly ask whether a person has evaded taxes, hence the degree of honesty can be higher” (Barone and Mocetti 2011, p.728).

In summary, considering the nature of the population within which this study is conducted, a mixture of both direct and indirect questions are considered as ideal to help generate the right responses for the study

5.4.1.a. Study parameters and population

This study investigates the main challenges hindering the achievement of efficient and effective tax systems in the informal sectors of developing countries. It also analyses the tax compliance behaviours of those working in the formal sector but who have the chance to under-report their incomes. The study is thus not limited to purely the informal sector operators, but also those in the formal sector but who have some degree of informality in their operations. Activities and individuals who are mainly formal and undertake a formal tax assessment are excluded from the study. This approach enables the study to speak to the structuralist perspective on the motivations for the existence of informal sectors, as well as the dualist and legalist perspectives (as outlined in chapter two).

⁵⁶ See appendix 6 for full lists of questions for this study.

The research involves studying the tax compliance behaviour of individuals' small businesses in the informal sector in the two largest [by population] regions of the Country – the Ashanti region and Greater Accra.

The decision to select these two regions stems from the fact that they are the two largest in terms of business operations, and they have a wide variety of types of business activities, involving various sectors of the country's informal economy (Aryee, 2007). Although Ghana has ten regions, the decision to restrict the study to only two is that a preliminary analysis of the other eight regions did not report any major differences in terms of economic activities. With large informal economic activities in these two regions, they will give true representations of taxable economic activities within the country's informal economy, which makes it possible to draw generalisations.

In summary, studying these two regions with their large informal sectors and their similarities to the other regions means that the outcomes from the study are representative of various forms of businesses and the results indicate an accurate picture of informal sector tax compliance within the country.

5.4.2. Sampling frame and interview/survey procedure

A series of structured and semi-structured interviews and 'drop-off and pick up' questionnaire approaches were used to gather information from personal and small business owners operating within the informal economy from the selected regions of the country and tax officials.

The researcher was assisted in each region by a Research Assistant during the interviews and also for the questionnaire distribution and pick-ups. As the researcher speaks fluent Twi which is the main language in one of the regions, Ashanti, the research assistant for the Ashanti region only assisted in the questionnaire administration.

However, as the researcher does not speak the Ga language, the main language spoken in the Greater Accra region, the research assistant for this region helped in translation where respondents could not speak English. Using a research assistant who speaks the same language as the participants was deemed useful in generating reliable data, and as stated by Grewal and Ritchie (2006) common language and ethnicity are very important for data collection through qualitative interviews. Also, the idea of using the two research assistants is

to establish trust of the community in order to gain access to them as suggested by Ryan et al (2011), who in analysing the insider/outsider status of research argued that such an approach reduces suspicion surrounding certain communities in potentially sensitive research. Using locals with their ‘insider status’ has a significant benefit in community-based research because of their ethnic, religious, linguistic backgrounds or networks within a specific neighbourhood (Ryan et al., 2011).

5.4.3. Research Assistants: selection and justification

The research assistants were recruited based on personal recommendations during the researcher’s initial data collection stage. In total, there were five candidates, from whom the researcher selected two based on them having had experience in supporting research before. Both research assistants are graduates from two tertiary institutions in Ghana and have both written dissertations as part of their qualifications. These key qualities made it somewhat easier to work with them. The selection was further based on their understanding of the local area and language capability especially in the case of the research assistant for the Greater Accra Region.

To strengthen the confidentiality arrangements put in place for respondents from the onset, research assistants were not selected from places where the actual interviews were conducted, but by virtue of their ability to speak the local language or general knowledge of the local area. The reason for this decision was that it was envisaged that in situations where people are not complying with tax obligations, for whatever reason, they may feel uncomfortable to reveal certain practices if they are known personally to the research assistants. Furthermore, using someone who speaks the language but who is not a resident in the community also eradicates the issue of the research assistant nominating his family and friends for convenience. With this in mind, the area of residence within the city of the research assistants was the first issue tackled before they made fully aware of the task and their role in the study.

After selection, the research assistants were given briefing/ training on ethical considerations, timing, appearance and general presentation, which was then followed by a formal university ethical approval⁵⁷.

These training and briefing sessions are of paramount importance as it gave the research assistants the techniques and skills required to effectively interpret and help conduct fair interviews without interrupting the interviewee during the sessions or without them presenting personal opinions or assumptions rather than those presented by the interviewees.

5.4.4. Validity testing - Personal face-to-face interview questions

Before undertaking the interviews with the operators in the informal sector, a pilot study was conducted to test the validity of the proposed questions. The pilot study was conducted among randomly selected members of the public in the Ashanti Region capital, Kumasi. This helped to refine the questions and helped improve the reliability of the interview process. The pilot survey includes four respondents whose responses form no part in the actual study.

The face-to-face personal interviews for the study were semi-structured to generate more information from the sector operators' taxpaying behaviour. Oral consent was sought from each participant before interviewed and they were given the chance to opt-out at any stage of the process. As the interviews form a very critical part in the study, the researcher and the research assistant were very patient, giving all the necessary assurance to encourage people to freely and openly talk about their tax issues without fear of having their details passed on to the authorities. In doing so, each interviewee was given a strong assurance during the interview scheduling phase, and also at the time of the interview, this was further emphasised to reinforce the assurances made. The confidentiality was assured with the fact that no personal or business data was collected. For instance, no data was collected relating to a business address, telephone, or individual names. These excluded parameters were very useful as they assisted respondents to feel assured of confidentiality.

⁵⁷ All research carried out at the University of Birmingham involving human subjects, or which raises other ethical issues (e.g. work with animals) will require ethics review. Details of the ethical approval process if found here: <https://intranet.birmingham.ac.uk/finance/RSS/Research-Support-Group/Research-Ethics/index.aspx>

The interviews were carried out over 4 weeks within the two selected cities of the country. However, the overall interview process lasted for nine weeks starting from the 28th February 2013 to 22nd April 2013.

See table 5.1 below on the pairing of the selected regions of the country, and a week by week schedule for interviewing the sample population.

Table 5.1 interview schedule

Week Number	City	Region(s)
One – Two (28 th February 2013 – 12 th April 2013)	Kumasi	Ashanti
Three – Four (13 th April 2013 – 22 nd April 2013)	Accra	Greater Accra

On average, four interviews were conducted in each week with the other time being taken up with search and identify or referral system on informal sector activities/operators as explained in section 5.5.2.

5.5. Sampling

This part of the data collection involves identifying and interviewing different sectors/business activities within the informal sector (for example, transport, service, woodwork/carpentry, electronics, food vending, and similar sectors) as defined in section 5.5.1 below. The idea of interviewing people in different sectors is to establish if there is any trend in tax compliance for particular business activity within the informal sector. Also, as the informal sector is dominated by many different business activities, interviewing different business operators helps to assess if there are any differences in compliance decisions between operators of different sectors.

In identifying the population from which to draw the sample, the researcher adopted the most recent work on Ghana's informal sector activities by Aryee (2007), for the World Bank. Represented in table 2.1, this study summarised the various forms of informal sector businesses and associations existing in Ghana. This classification is used as a guide of the

nature/category of activities for this research. This list covers almost all kinds of activities that are legal and most likely to be found in the informal sector, (Mirus and Smith, 1997).

However, this list by Aryee (2007) is used as a guide and is not the final list. It is envisaged that in the course of the field work other activities could be of interest to the researcher in the form of potential taxable activities, which are then studied. Also, such flexibility further promotes the reliability of results as the researcher is not under pressure to find the initially defined sets of activities ‘at all cost’.

These lists of informal sector Associations in Ghana as identified by Aryee (2007) (table 2.1) could be challenged in a sense that as businesses and individuals form associations, they are in principle well organised and could be classified as more formal businesses even if not as such for tax purposes. However, it is vital to also note the distinction between such associations from the notion of ‘economics’ as members of these informal sector associations which are usually organised informally do so for their individual welfares such as accompanying and supporting a member to family events such as weddings, engagements and funerals, rather than formal unions. On this basis, the list of Ghana’s informal sector operators as identified by Aryee (2007) serves as a useful starting point in defining activities in the informal sector, and more importantly in selecting the sample for the study.

In collecting the data for this study, both the survey and face-to-face interview used the same sample technique and approach (i.e. searching, identifying and interviewing or giving survey questionnaire). Therefore, the following sections describe the sampling technique adopted for both the survey and the interview process.

5.5.1. Sampling technique

The main challenge for the study is defining the sampling frame that will be deemed sufficient and appropriate for the analysis of the informal sector of Ghana. This is because there is no adequate record or proper account of the sector in terms of the shape and its size, therefore defining the general population from which a sample is to be drawn is a difficult task. To get reliable data, which will be a clear representation of the informal sector, the researcher stratifies the sample by location of business; the scale of operation, and more

importantly for this study, the type of business activity. However, the stratification of the sample poses a significant challenge because there are no clear general population parameters. The lack of reliable data on the national, municipal and district levels of the country means an alternative plan had to be devised to determine what business activities form the population from which the sample is drawn for the study.

The research, therefore, made use of the business activities in the most recent study in the Ghanaian informal Economy for the World Bank⁵⁸ in 2007 as the basis for the sampling.

The sample of people and businesses for the study are drawn from small businesses in each of the two cities, and this is further stratified by four major groups⁵⁹;

- Legal Entity
- Form of Operation
- Registration
- Nature/Type of Business activity

A. Legal Entity

- a) Sole Proprietor
- b) Partnership
- c) Family Business

B. Form of Operation

- a) Mobile
- b) Permanent Location –Office/Shop
- c) Home Business

C. Registration

- a) Fully Registered Business
- b) Part Registered Business⁶⁰
- c) Unregistered Business

⁵⁸ The World Bank study was conducted in Ghana by Aryee (2007), see table 3.1 for full list of informal sector activities identified in the country.

⁵⁹ Each main group will be further classified with relevant variables during the questioning/data analysis to incorporate variables such as education, turnover, years of operation, religious and other demographic variables.

⁶⁰ This is when a part of a business is registered rather than the complete chain of activities for which an individual is engaged in

D. Nature of Business

a) Finance

- i.** Financial services/Susu Collection/Loans
- ii.** Real Estate
- iii.** Business Services.

b) Travel and Tourism

- i.** Hotels/Guest Houses
- ii.** Taxis and commercial Vans and Buses
- iii.** Restaurant
- iv.** Travel and tour operators
- v.** Visa and immigration
- vi.** Food vendors

c) Construction

- i.** Plumbing
- ii.** Handy work
- iii.** Carpentry

d) Manufacturing

- 1.** Local soap and drink manufacturers

e) Communication and Personal Services

- i.** Barbers/Hairdressers
- ii.** Communication/ internet cafes
- iii.** Lawyers and professional advisors
- iv.** Shoemakers

f) Grocery

- i.** Retail shops
- ii.** Market women
- iii.** Hawkers

- g) Entertainment Sports and Leisure**
 - i. Pubs
 - ii. Night clubs
 - iii. Sports centres
 - iv. Gym/fitness
- h) Fashion and Clothing**
 - i. Tailors and Seamstresses
 - ii. Clothing Boutiques
 - iii. Second-hand clothes/shoes sellers
- i) Health and Spiritual Care**
 - i. Personal/traditional Doctors/local Surgeries
 - ii. Fetish Priests/Occultism
 - iii. Traditional healers/Herbalists
 - iv. Drug Peddlers
- j) Electrical and Electronics**
 - i. Electricians
 - ii. Spare Parts and Garages
 - iii. Electronic Sales – computers, sound systems, fridges
 - iv. Electrical repairers
- k) Other** (all other activities not listed above).

5.5.2. Strategy for increasing participation and obtaining reliable data

Having established the sample frame, which guided the nature of business activities and individuals to be included in the study, the sampling strategy was then formulated.

The researcher initially anticipated that securing participation would be a very difficult hurdle to tackle, as the operators of the informal sector often carry the belief that such participation could lead to them having greater exposure to the tax authorities. Consequently, this might result in them being targeted by such officials. This is however true, as to some extent as by definition; the informal sector is dominated by operators who conduct their activities outside the formal regulated economy to escape direct state control and/or tax authorities (World Bank, 2012).

To overcome this problem, a modified approach of the Govender, (2008) study on the informal economy of South Africa (as discussed in section 5.4) is adopted for this research. To improve participation, and data reliability, the study also uses snowballing to identify potential respondents, aside from the usual ‘search, identify and give’ questionnaire (during the survey stage) and ‘Search, Identify, and Interview (SII)⁶¹’ approaches that the researcher and the research assistants used. After identifying and handing over questionnaires or interviewing participants, referral techniques are used to gain access to other respondents. This approach was found very useful, as respondents who felt comfortable about the study provided referrals of other informal sector operators who in most cases were business partners, suppliers or by virtue of their social relationships or proximal locations, and such personal referrals assisted further in lowering the discomfort levels especially in relation to the sensitive information sought.

5.5.3. Sampling Strategy

As data and information about the informal sector and its operators are lacking, the researcher resorts to the use of snowball sampling technique as an easy but efficient approach compared to other options. Hoppitt et al (2011) defined snowball sampling as a strategy that involves tapping into existing participants’ networks to identify links with other potential participants’. Hoppitt et al.(2011) stressed that it is the most useful approach to studying a population which is ‘hidden’ or ‘hard-to-reach’. This approach has been used successfully in recent years in studies involving “most-at-risk populations” (MARPs) such as drug users, prostitutes, HIV, and AIDS patients, and other social stigmatised and sensitive issues. Examples of recent studies which involved respondent-driven sampling include Malekinejad et al. (2008); Kendall et al. (2006); Browne, (2005) and Ekstrand et al. (1999).

Recruiting participants for this study, just as with any other sensitive social research study was problematic as it focuses on specific individuals or groups whose behaviours, in this case of tax non-compliance, are not validated by society (Browne, 2005).

⁶¹ Research Assistants were given the list of ‘Business activities which form the sample and searched within the designated locality and hand over survey questionnaire or lead the researcher to interview individuals and business owners whose activities fall within the sample.

The fear of stigmatisation and prosecution makes getting participants for sensitive research very difficult. Faugier and Sargeant (1997, p.791) also conclude that the 'more sensitive or threatening the phenomenon under study, the more difficult sampling will be'. However, using the snowballing approach has clear practical advantages in obtaining information on difficult-to-observe phenomena, in particular in areas that involve sensitive, illegal or deviant issues, (Faugier and Sargeant, 1997, p.792). Sarantakos (1998) further mentions that social networks and the personal acquaintances of participants are used in making the process easier.

Since this study involves a hard-to-reach population, with no reliable data about the population and subsequently without a readily available sampling frame, snowball sampling is the only feasible method available as suggested by Faugier and Sargeant, (1997).

A modified approach of the snowball sampling strategy adopted by Browne (2005) is employed in the research. The sampling strategy begins by first initiating recruitment chains within the target population, and using this 'seed' to form the quota (Faugier and Sargeant 1997) among different economic activities in the informal economy. The 'seeds' are selected from the list or similar informal sector associations or businesses in table 2.1.

Apart from the proposed 'search and identify approach' and informal associations, the researcher recruited participants through attending religious and social events. The researcher, in total, attended two social gathering and four church events from 28th February 2013 to 10th March 2013 with the view to recruiting participants for the study. The two social gatherings yielded minimal results, as people did not seem to be in the 'mood' to discuss business during their 'party times'. The researcher also found that the unwillingness on the part of people to partake in the study from this group could also be that they may not have wanted to draw the researcher into their 'space' or boundaries and alliances (Edwards et al., 1999). The fact that people were attending church or a party did not matter to this study, but these approaches were adopted to see if people would feel comfortable to talk to the researcher as being 'part of them'.

However, throughout the church events, two individuals were recruited, who in return recommended colleagues. The rationale for using these social and religious events for the snowball sampling was that recruiting participants by using this approach builds up the trust as the researcher is considered part of the 'community' (Hopitts et al., 2011). Also by using recruits (i.e. seeds) personal contacts and networks, it means that participants do not have to attend a certain social event or be part of an association to be part of the study.

5.6. Nature of activities and area of coverage of interview Questions.

For this study, the informal sector is limited to only ‘Legal Activities’ as identified by Mirus and Smith (1997), in table 1.1, chapter one.

As discussed in chapter one, this research is interested in taxable economic activities which are underreported or concealed entirely and therefore no tax is paid or the correct amount of tax has not been paid. These include personal and businesses under-reported and concealed incomes within the informal sector.

5.6.1. Interview questions, coding, and themes.

Face-to-face interviews were initially projected to last for approximately 30 minutes, but, following the piloting stage, the research plan anticipated an hour would be needed. However, on average, the interviews lasted about one hour 20 minutes.

The interviews were semi-structured, with closed and open-ended questions (see appendix 7). Each interviewee was given a total of 54 sets of questions, and written notes of responses were taken. There were no electronic recordings as initially planned due to the reluctance on the part of people to be recorded. Therefore, all interview responses were handwritten and were subsequently transcribed verbatim onto a Microsoft Word document where they were sorted and exported to Nvivo 10 for the coding (see chapter six for codes/themes).

The emerging themes from the interview responses and transcriptions also shaped the next stages of the data collection, as detailed in this chapter – the questionnaires which were sent to some informal sector operators, as well as the tax officials’ interviews and the researcher’s field observation trip with the tax collection officers.

The study adopted two stages of categorising the themes – a ‘focused’ and an ‘open coding’ approach (Charmaz, 2006) were used and the responses coded into Nvivo nodes, with the three major themes forming the parent nodes. In the first stage, the transcripts were read line by line and extracts of meaningful text coded into the emerging themes (per process as outlined in Braun and Clarke, 2006), followed by a process of reassembling the highlighted data to ensure that there were connections to it and the research objective. The next step assessed each code carefully, analysing the meaning of the codes in the context of the study,

and codes with similar meanings were merged (Razzaq, 2012). This stage is also important to prevent a situation of having an unnecessarily large number of codes

Overall, there were 450 key references coded into three main themes and 32 sub-themes. Sub-themes are essentially themes-within-a-theme, which help to structure large and complex themes and also for demonstrating the hierarchy of meaning within the data (Braun and Clarke 2006, p22).

5.7. Questions for tax officials and policy advisors from international organisations

A further part of the primary data collection for this study was conducted through one – on – one interview with tax officials. The reason for including the tax officials in the study is to seek an expert opinion on the questions set for this study and to better understand informal sector tax compliance from the tax administration perspective of the country. Also, comparing these expert views with the informal sector operators' view is considered useful in drawing meaningful conclusions from the major stakeholders of the sector. The researcher interviewed senior tax officials at the Ghana Revenue Authority in Accra and Kumasi, as well as the revenue sections of the municipal authorities⁶² which administer different types of local taxes from the national one which is under the GRA. By interviewing these officials, the study can assess the impact of this relationship (taxpayer-tax authority), and the compliance strategy used and how this interplay influences compliance decisions.

To gain access to key tax officials to ask them to take part in the study, an introductory letter was given by the University through the project supervisor. This letter stated the purpose and nature of data to be collected. This letter was handed to the tax offices, and a suitable person and date were agreed with the researcher.

Initially, the study planned on interviewing IMF and World Bank country representatives as main donors, funding sources and policy advisors for many developing countries, to seek their views on current approaches about taxing the informal sector. However, difficulties in obtaining access mean that the country representatives of these international organisations were excluded from the study. In place of these organisations, personnel from Adam Smith International (ASI)⁶³ were interviewed. ASI is a UK based non-profit organisation –

⁶² The Municipal Authorities which the interview took place are the Kumasi Metropolitan Assembly (KMA) and the Accra Metropolitan Assembly (AMA).

⁶³ Details of this interview is in chapters' eight, nine and ten. Link to Adam Smith International:

providing policy advice to countries and major international organisation on local governance and tax-related issues.

5.8. Drop-off and Pick-up Self-Administered Questionnaire Survey

At the second stage of the data collection, hand-delivered questionnaire surveys were distributed to 500 small businesses and entrepreneurs through random selection using the search and identify strategy adopted for the interview. A survey methodology has been used in many tax research studies both form and informal sector contexts (Torgler et al., 2010) and informal economies (Gerxhani, 2006).

The target for usable returned questionnaires for this study was 350 (to achieve a statistically relevant sample), based on previous tax research studies (example, Junainah, 2002; Loo and Ho 2005; Manaf et al., 2006). Therefore, 500 questionnaires (using drop-off and pick-up approach) were considered reasonable to achieve the target. The questionnaires are delivered in person by the two Research Assistants. At this stage, it was important to maintain the same research assistants as they had developed good experience and had a strong understanding of the project and its ethical considerations. A possible high non-response rate associated with other methods such as telephone and postal surveys meant that the best option, considering the sensitive nature of the study, was hand delivery, hand retrieval and a self-administered questionnaire (i.e. drop off-pick up approach).

The nature of Ghana's address system coupled with the target population meant that the only reliable methods of reaching participants are through drop-off and pick-up questionnaire surveys and the snowballing method. Ghana still uses the Post Office letter collection method (i.e. the P. O. Box system) for mail. This implies that there is no guarantee as to how often people visit their inbox as post offices are usually situated in major town centres which could be miles away from the residents or may not be used at all by the informal sector operators. As the study involves the informal sector, information about their addresses and nature of business is not available within the country, and the researcher believes by going through the formal address system, the focus of the study will be shifting to a more 'formal sector' taxation inquiry. Therefore, using the 'drop-off and pick-up' approach for targeted individuals and activities was deemed the ideal method for the study.

Furthermore, due to the high illiteracy rates within the country (Ofori, 2009, p.28), this approach made it possible for the Research Assistants to offer extra support to the respondents including in some instances, helping to complete the questionnaire for those who could not read and write.

Steele et al. (2001), describe the ‘drop-off, pick-up’ (DOPU) method of data collection as an effective approach to collecting data on sensitive issues. This data collection technique has been successfully applied in many previous studies where response rates have been excellent and in most cases over 80% response rate has been achieved. For example Di Pofi (2002) used the hand-delivered approach successfully⁶⁴ to understand change management; Bourke (1994) obtained a 94% response rate in his study about hazardous waste in rural Utah; Meidan and Edris (1990) had a response rate of over 60% from households in the UK regarding the impact of nutritional labelling on food choices; Olsen et al. (1998) achieved a 93% response rate in a community interest-based study; and Brennan and Luloff (2007), had a 65% response rate for studies of the residents of two villages in exploring the ‘role of community agency in the rural community and economic development processes’. Most of the aforementioned studies involved the use of research assistants for the field study (i.e. research assistants dropped-off and picked-up the completed questionnaire).

By using the DOPU approach, and knowing that the majority of the informal sector operators are uneducated, the research assistants can further explain the questions to them or help them to complete the questionnaire based on their responses.

The researcher in many instances, except the times when on the field trip or when conducting the tax officials’ interview, accompanied the research assistants for the drop-off and the pick-up process. In a few instances, respondents asked for the support of the research team to complete the questionnaire on the spot without them having to go back.

The Government of Ghana’s fiscal year runs from 1st January to 31st December, and tax declaration is within four months of the end of the tax year (Deloitte, 2011), as a result, the interview data collection exercise was carried out between February and April, when most people have to pay their taxes.

Within this period, it was envisaged that people would be aware of taxes being collected in the formal settings so taxpayers (including those in the informal sector) would be more aware

⁶⁴ Di Pofi (2002) did not involve the use of Research Assistants, however, the questionnaires were attached to employee payslips and were given days when Admin managers collected the completed questionnaire on behalf of the researcher, and response rate was just under 40%.

of the 'tax period' process than may be the case at other times of the year. The timing was also in relation to the studies by Song and Yarbrough (1978) who conducted tax ethics of taxpayers with similar timing and argued that such timing reduces respondents' biases.

5.9 Field Observation

To gain further insight into the relationship between the taxpayers and the revenue authority on a typical tax collection day, the researcher went for a field trip with the ground staff for the revenue collection exercise.

Observation techniques have been used in a number of tax compliance studies, for example, Chetty et al (2009), Yesegat (2009), Caro et al. (2014), Hayes and Baker (2014), Boll (2014), see section 5.4 for a discussion on the inclusion of this methodology.

The researcher followed two male enforcement officers for a full day's trip for tax collection. According to the GRA, there is no basis for the gender of the tax officer sent out, and it depends on knowledge of the area and staff availability. The day for the field trip was randomly chosen by the researcher, following the acceptance of the introductory letter, by the tax authority.

The purpose of this approach was to assess the physical interaction between the tax authorities and the taxpayers. This was the third phase of the data gathering and emphasis was placed on observing behaviour-responses between the two parties. The behaviour-response interactions are represented in table 6.2 with colour coding (red, green, amber and grey), to indicate the nature of the relationship. Red indicates severe compliance issues as a result of the observed relationships; Green shows a compliance situation, where the taxpayer has complied and has evidence of tax payment. It also shows a cordial relationship or a situation where each party, particularly the revenue officers, performed their duty diligently. The Amber depicts a situation with some degree of low compliance and/or tax officials exhibiting a behaviour that it is believed could impact on voluntary compliance in the future. Finally, Grey indicates a situation where the tax officials' approach was seen to encourage future voluntary compliance and/or taxpayers are deemed to have appropriate tax knowledge, have a clear understanding of tax obligations and compliance processes, but are not currently compliant or have no evidence of compliance but have agreed to be compliant and the interaction is deemed cordial. The age and other demographic data were unknown due to lack of one-to-one contact with the taxpayers.

The observation was not so much to dwell on the actions of the tax officials, due to the impact that the researcher's presence could have on their attitudes, so although observed, the emphasis was on the reaction of the taxpayers and how they reacted to the activities of the tax officers.

The respondents were given numeric codes and a letter at the end of each number. The letters at the end of the numbers indicate the sex of the observed individual (F =Female; M=Male). They were further grouped into M, O, and Y - Y= young, perceived to be under 30; M=Middle aged, perceived to be between 30-45; and O = mature taxpayers, assume to be over 45.

There was no pre-planned number to observe, and although many interactions occurred, it was ten that were of interest to the researcher, mainly due to language barriers – Sometimes the language used between the taxpayers and the tax officers was not understood by the researcher. (See chapter six for details of the observation data).

5.10 Summary

Chapter five presented the research methods and approaches adopted for this study. As a relational study, this thesis first used face-to-face interviews to assess the nature of the relationship between taxpayers in the informal sector and the Ghana revenue authority. Taxpayers and tax officials from the national and municipal authorities were interviewed. This was followed by a set of self-administered questionnaires to the taxpayers using a drop-off and pick-up approach. In addition, the researcher also embarked on a field trip with tax collection officers to assess the interaction (during tax collection) between taxpayers and the field tax officers. Details of the data collected from these approaches are presented in chapter six.

CHAPTER SIX

DATA ANALYSIS AND RESULTS

6.0. Introduction

This chapter systematically describes the results of the study. The section includes a description of the survey sample, response rate, participants' profiles and results of the interviews, questionnaire and the observation data.

The initial part of this section analyses the data gathered through the face-to-face interviews with the three main participant groups described in chapter five (i.e. informal sector operators, tax officials from the GRA and officers from the two local/municipal authorities). Extracts of interviews with tax experts from Adam Smith International (ASI) is also presented in this section.

The final part of this chapter presents a descriptive analysis of the questionnaire data and field observations. A detailed discussion of the three methodologies employed in this section is presented in section 5.4.

6.1. Face-to-face Interviews of sector operators

The data collected from the face to face interview is analysed using themes. The themes are grouped into three with sub-themes – the first two (A and B) are mainly informed by and developed from existing literature whilst factors exclusive to the final theme, which looks at future tax compliance is derived from the interview responses. Table 6.0 below shows the themes/sub-themes and supporting literature.

Table 6.0 Interview themes and supporting literature

Theme	Underlying assumptions/sub themes	Supporting literature
A. Reasons for complying with current tax obligations	Moral obligation / Tax knowledge	Torgler, 2001; 2002; Cummings et al., 2005; Frey and Feld 2002; Kirchler, 2007; Palil, 2010; Pope and McKerchar, 2011; Alm McClellan, 2012
	Trust in government and reciprocity	Frey and Torgler 2007; Lavoie, 2009; María-Dolores <i>et al</i> , 2010; Kirchler and Wahl, 2010.
	Tax rate and the cost of compliance, High audit probabilities and fines	Allingham and Sandmo 1972, Krause, 2000; Ivanova <i>et al.</i> , 2005; Kirchler <i>et el.</i> , 2010; Matthews, 2011; Palil and Mustapha, 2011
B. Current non-compliance determinants	Low audit rate/fines, High tax rate,	Allingham and Sandmo 1972, Maciejovsky <i>et al</i> (2007, p679) Mittone and Saredi (2016)
	Poor education /low tax knowledge /unfairness	Torgler, 2003; Loo and Ho, 2005; Palil, 2010
	Corruption / Poor reciprocity	Terkper, 2003; OECD, 2009; Shukla et al, 2011
	Poor previous taxpayer vs tax authority interactions	Richardson and Sawyer, 2001; Frey and Loo and Ho, 2005; Torgler and Valev, 2007; Gracia and Oats, 2012.
C. Future compliance expectations	Flexible payment Incentives/breaks	Responses gathered from interview responses ⁶⁵

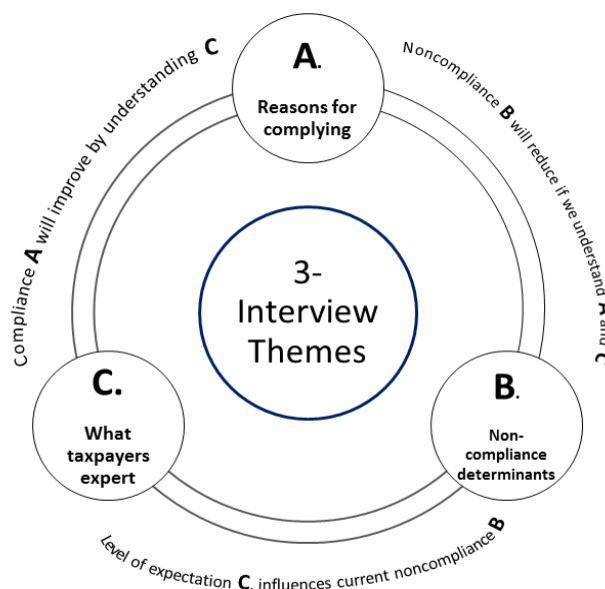
Braun and Clarke (2006, p10) describe a theme as ‘capturing’ something important about the data in relation to the research question, and represents some level of *patterned* response or meaning within the data set”. They further state that the ‘keyness’ of a theme is not necessarily dependent on quantifiable measures but the ability to capture something important in relation to the research question, and this was the main determinant to the themes selected during the interview design (see chapter five) and the coding stages of this study.

⁶⁵ This is only the factors exclusive to Theme C. Factors such as corruption, tax education which also appears in this theme is already captured in the literature under Themes A and B.

As seen in table 6.1, the code selected for study are:

- A. Reasons for complying with current tax obligations
- B. Current non-compliance determinants
- C. The future – what taxpayers expect

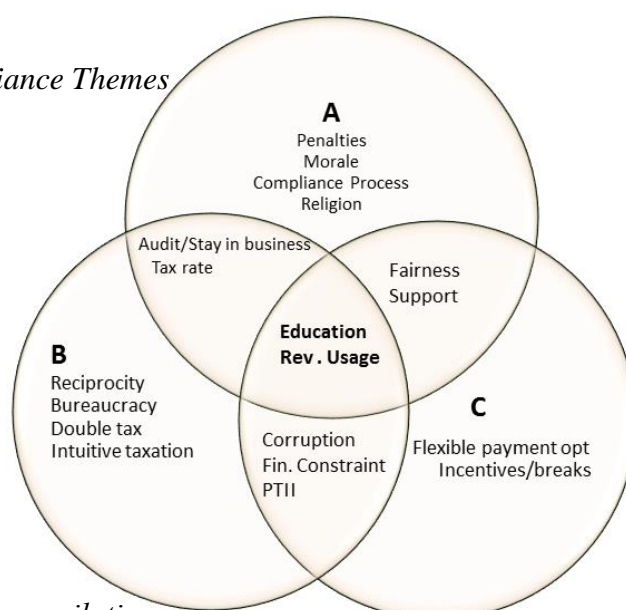
Figure 6.1 Interview main themes



Source: Author's compilation

These themes (figure 6.1) are further elaborated with sub themes in figure 6.2. below:

Figure 6.2 – Tax Compliance Themes



Source: Author's compilation

It is important to note that the compliant and the non-compliant taxpayers are split from the panel by the responses given per theme. The table below shows key attributes of the interview respondents

Table 6.1 Key classification variables of interview respondents

Years in Business		Age Range		Business Registration		Education		Nature of activity	
Up to 1	4	41- retired		MA ⁶⁶ Only	3	O'levels/A'levels/SSCE	8	Saloon/Hairdressing	4
2 - 5	6	26 – 40	9	RGOC ⁶⁷ only	2	HND/Professional	3	Mobile technician	1
6 -10	4	Up to 25	4	Unregistered	7	Degree	3	Plumber / Handyman	1
Over 10	3			GRA ⁶⁸ , MA and RGOC	5	Masters' and Above	3	Electrical shop	1
								Grocery shop	2 ⁶⁹
								Mobile electrician	1
								Taxi driver	1
								Travel and tour	1
								Traditional herbalist	1
								Healthcare / Gym	2 ⁷⁰
								Food seller/vendor	2 ⁷¹

Source: Author's compilation

The results from the themes are now discussed in relation to the themes and the research questions.

Excerpts from the interviews are provided for further illustration. For confidentiality, the interview respondents are given alphabetical codes.

6.2. Theme A. Why do people pay taxes?

As the study focuses on tax compliance behaviours, the starting point of both the interview and the analysis is addressing the question '*why do these people pay their taxes after all?*'

⁶⁶ MA (Municipal Authority)

⁶⁷ RGOC (Registered General of Companies)

⁶⁸ GRA (Ghana Revenue Authority)

⁶⁹ One is full-time teacher and operates grocery as part time business

⁷⁰ One is employed full-time in a health clinic and operates in the informal sector as a part-time food supplement seller where income is commission based. Other owns a local health centre (formally registered) and operates a gym where members pay subscription (unregistered/informal)

⁷¹ One is a seasonal foodstuffs seller and employed in the formal sector on full time basis (as administrator) and the other is food vendor.

This theme analyses what respondents believe are the key determinants for their tax compliance decisions. There are ten sub-themes making the ‘*reasons for paying taxes*’ main theme, although only four of the ten are exclusive as the remaining sub-themes interlink with other themes which are represented in figure 6.2 and each is further explored from the interview responses. Education, fairness, tax authority support, and a low tax rate are the lowest among the reasons behind current compliance levels as they are the ones people made the least reference to. The moral obligation (tax morale) sub-theme represents the factor respondents gave as the key determinant for their current compliance decisions. The themes are divided into existing themes (themes from existing literature) and the themes that emerged from the interviews:

a) Themes from prior literature:

- i. Moral obligation
- ii. Auditing probabilities
- iii. Nature of potential penalty fines
- iv. Compliance process
- v. Tax education
- vi. Fairness
- vii. Religion
- viii. Benefits and Social Amenities
- ix. Low tax rate

b) Emerged Theme

- i. Tax Authority support

6.2a. Themes from prior literature:

6.2a. (i) Moral Obligation

Moral obligation emerged as the greatest determinant to current tax compliance levels among the respondents. A majority of the interviewees (12) comply mainly due to their instincts (moral) to pay taxes rather than other external stimuli, such as auditing or fines. This supports previous studies (Frey and Feld, 2002; Torgler, 2002; Kirchler, 2007; Pope and McKerchar, 2011) that there are taxpayers who comply willingly due to their intrinsic drive rather than extrinsic (external) forces.

Paying taxes as a moral obligation was raised many times by the respondents. 12 of the 17 respondents stated that the main or at least a factor which moves them to pay their taxes is the duty they morally believed is bestowed upon them to perform as citizens of the state.

The results from the face-to-face interviews (in this section) is consistent with findings from the survey data presented in section 6.7.c(i) which also indicates the majority of informal sector operators pay their taxes due to the intrinsic drive to do so.

Analysing the responses of these group of taxpayers, punitive measures and other direct enforcement tactics used by the GRA, although they could have an impact, may be ineffective on their own to evoke voluntary compliance.

‘..I think I should pay my taxes to get the government money to run the country. I see it as my duty to pay what they want me to pay, to help contribute to developing the country (MF)

‘.... as a citizen, I know when you work you should pay something to the state in the form of taxes (KM)

‘I see tax payment as a basic responsibility’ (JF)

‘I see it as an obligation as a citizen who enjoys state services’ (EM)

‘The need to contribute as a working citizen who enjoys state benefits (e.g. Security, roads, water, etc...)’ (BM)

Although moral obligation has been identified as having a strong influence among respondents’ compliance decisions, there are instances when people who are influenced by their moral obligation, need further assurance of revenue usage to comply voluntarily;

‘I pay taxes for my kid’s future.... If I’m educated, and they (GRA) can also convince us that the taxes-are for roads, hospitals, etc. then why not?’ (CF).

This implies that although morale is key to tax compliance among the respondents, the intrinsic motivation to pay on its own may not be enough to encourage voluntary compliance as in the case of 'CF'.

6.2a. (ii) Auditing probabilities

Respondents acknowledged that they were influenced to paying their taxes due to the high auditing (constant tax officers' visits) probabilities. The interview respondents reported that the more they perceive a high possibility of their business activity being audited/visited by tax officials, the higher the chances that they will comply and pay on time.

These taxpayers can be likened to the 'capitulative' group of taxpayers as identified by McBarnet (2001) who tend to give in unwillingly due to audits and detection mechanisms. Also see (Kirchler and Wahl, 2010), although the impact of such actions (according to Alm et al., 1995) is minimal and mostly short-lived.

This theme emerged as the second-highest determinant of the current compliance level after 'moral obligation' and 10 out of the 17 said they pay up as a result of this.

"....the GRA visiting me to check if I have paid my taxes is very likely and they come every two or three months. It influences me greatly since you can't operate without paying and displaying your tax receipt" (IF).

"They (GRA officers) do come around most often, so if there's a slight delay in payment, they will come to inspect unexpectedly" (JF)

The average GRA audit visits were reported as being approximately every 2 months (based on all participants' accounts). However, tax officers from both the municipal authority (KMA) and the GRA gave different periods for visiting. In an interview with KMA officials, it was confirmed *'We do send out for collections/compliance checks on daily basis'* (KMA 3). The GRA stated *'we send officers out once or at times twice a week'* (GRA A1). Because tax officers visit taxpayers in turn, the two months average revisiting/auditing interval stated by the interview participants could conform to the officers' timings. Regarding frequency, the tax officials' interviews further revealed that due to the nature of the informal sector, especially as some people do not have fixed locations, it is impossible to have accurate

compliance data, hence the decision to send enforcement officers regularly for compliance checks.

6.2a. (iii) Nature of potential penalty fines

The fines imposed for non-compliance also play a crucial part in the compliance decisions with four respondents stating it influenced them directly.

'I think people will always pay because the tax officers are not so easy to get away with when they visit' (CF).

Respondents explained some of the consequences of non-compliance, which include the possibility of significant penalties being enacted on the spot, examples of having business premises closed with new padlocks put on by the tax authorities. They also explained the impact of the stigmatisation (by customers and business partners) and the stress they go through to deal with the fines and how they also play a key role in their compliance decisions. Thus, the penalties that influenced them were not just the effect of the monetary value, but also the non-monetary issues of loss of reputation with others.

'I pay just to avoid confrontation from the GRA or the KMA tax collectors, and importantly avoid the fines to pay to open my office /shop by officers, following closures' (GF).

I do not want to face such fines and humiliations so I always ensure my taxes are paid on time (IF)

Avoiding penalties and just to stay open and conduct business (i.e. an extra monetary cost for non-payment) is a key compliance determinant. There are those (10) who 'pay taxes only or partly to be seen compliant, to continue operating'.

'.....paying means I can continue to operate, '...without thinking of the arrival of the tax offices or possible closures' (CF).

Respondents were also asked if they have any fears or concerns which influence their compliance decisions, and again the respondents indicated that the possibility of having their businesses closed is the main fear.

'Not a fear per se, but I am just concerned about the tax officers and their approach to businesses which have not paid their taxes when they come for the inspection' (GF)

'The only fear is how ruthless (regarding physical intimidation) the tax authority's tax officers can be' (IF).

Even respondents who have issues about tax revenue usage [EM, IF, GF] and may otherwise not pay taxes, as a result, accepted the need to comply if their business is to continue without facing fines which include closures by the revenue authorities.

'It's worrying when you think about the tax revenue usage, but if you want to operate your business successfully, you have to play by the game [...by paying the least you can to stay in business]' (EM).

6.2a. (iv) Compliance process

Cost and ease of payment which make up the tax compliance processes appear to be important determinants of the tax payment decisions, as many studies had identified them as likely key impacts on the process of compliance of an individual's compliance decisions (Copp, 2001; Evans and Tran-Nam, 2001). During the interview and data analysis stages, the compliance process was defined to include the financial and other non-financial costs and a three-stage definition of the theme as involving;

- the financial cost involved in the compliance process such as the real cost of the tax and the cost of paying for advisory/support services to aid compliance (Evans, 2003);
- the physical time needed for filling forms, attending appeals and tribunals (Copp, 2009); and
- the psychological cost of the tax burden (Evans and Tran-Nam, 2001).

Some (8) respondents believe the decision to pay their taxes are purely or partly due to the compliance process, including the financial cost of compliance;

'I do not have to do anything. They come around to give the bill and I make payment in my shop. I prefer how it is now' (CF).

'It makes compliance decision easy as I do not have to go through any lengthy processes' (IF)

'In terms of the process, it's simple as I do not have to go anywhere. They [tax officers] come to my business directly with receipt booklets (tax stamp) to collect payment' (FF).

Although these respondents believe their compliance decisions are partly influenced by the process, some showed concerns about paying taxes through visiting tax officers through negotiations and other means, as it may give special treatment to certain taxpayers.

'previously, I was paying through my trade association (which was ok) but the current system of paying through visiting tax officers, is open to corruption/unfairness' (BM).

Officers are believed (according to BM) to favour people they like by giving low rates and there is a doubt that the amounts collected are reported properly to the GRA. Although the compliance process is seen as simple, there were concerns raised as all 17 respondents believed that it is possible to negotiate with the tax collectors for a lower rate. Results from the survey data presented in section 6.7.b iv also suggest that the compliance process (with field officers) do have a negative impact on future compliance decisions.

6.2a. (v) Tax education

Tax education relates to taxpayers who pay as a result of their awareness of tax education campaigns by the revenue authority in audio (e.g. radio), video (television), printed media (newspapers, magazines, billboards, etc.) or in person through interactions with field tax collectors. Tax education as represented by this theme, includes *tax knowledge* which measures taxpayers understanding of their tax obligations about to *when, how* and *where* to pay their taxes.

'Tax education' is one of only two sub-themes to have appeared in all three major themes (i.e. Themes A, B, and C). Thus, in Theme A, as shown below, few taxpayers attribute their compliance decisions to tax education, under theme B, some don't pay because of lack of appropriate tax education and in theme C, taxpayers expect more targeted tax education to be compliant. This indicates the significance of tax education to tax compliance, interestingly though, only four respondents [HM, IF, JK and KM] confirmed that they have heard of tax information/education from the GRA in the last 12 months.

Two of the respondents emphasised the importance of tax education, and information availability to their tax compliance decisions (HM and IF);

‘I do hear of radio, newspaper and TV adverts on taxes quite a lot’ (HM).

‘I have a clear understanding of the tax system particularly areas relating to my business sector; ‘....GRA officers who come for the taxes do educate us (taxpayers)’ (IF).

Not only does the revenue authority’s tax education and information availability help some taxpayers to comply now, but such information influences their voluntary compliance decisions in the future. Three respondents (IF, JF and HM) pay their taxes voluntarily due to the influence of past GRA tax education campaigns.

Interestingly, not all taxpayers who are exposed to tax education run by the GRA, find it useful in making compliance decisions. The fourth and the last respondent to make positive reference to the GRA’s tax education [KM] although they confirmed hearing of tax education/information of some sort in the last 12 months, they felt that, such information does not in any way play any part in the compliance decision making due to the nature of the message stressing that;

“....I usually hear of adverts /information on radio, and even on the TV but the nature of the information points to people with shops/offices, but not mobile workers as I am” (KM)

The other three (3) respondents share the views of KM that although tax education/information is provided by the GRA, they are however not always relevant to their situation. The message content is usually directed towards big businesses, or where they do target them, there is little or no understanding of how the rates are determined, when, how or even where to pay taxes. Although ‘KM’ has a Bachelor’s Degree qualification and has been operating in the same business for at least 6 years, the business is still unregistered, and he appears to have no understanding of the key tax issues relating to his business. Thus, the level of tax education campaign may be high in the country, and people may be exposed to the messages as in the case of KM, however, the tax knowledge which will directly influence compliance may be limited.

Findings from the survey data are consistent with findings from the interview data that there is a lack of ‘appropriate’ tax education/information to aid compliance. Although there were mixed results from the survey data as people who have registered their businesses indicated

there is adequate tax information. Overall though, most taxpayers expressed a lack of adequate information (from the survey data) to aid compliance (section 6.7.b vii and 6.7.b ix). Again, the on-field observation also indicated weak tax knowledge among the observed taxpayers (see section 6.6.7) as tax officers' presence rather created scenes violence.

6.2a. (vi) Fairness of the tax system

Respondents were also asked if their compliance decision is influenced by their perception of their tax rate compared to what they believe that others are paying and also if the current rate is reasonable for their business activity. Surprisingly, a majority of the respondents (15) were not concerned about unfairness as being a factor to their compliance or non-compliance decisions. A few (5) believed that the amounts they pay are very small, and this small tax bill is the main factor to their overall decisions to comply.

'I pay simply because the tax rate is reasonable' (MF).

Although people still have concerns about how their tax bill is calculated.

'It's reasonable - however, I do not know how they come by the rates (i.e. GHs 300 / £55 a year in my case)' (AM).

6.2a. (vii) Religion and compliance decision

Religious influence on tax compliance was also explored during the interviews.

Here, the researcher focused on how people relate their religion to tax compliance in the informal economy, and 3 respondents stated their decision to comply is influenced in part by their religion.

'My religion as a Christian plays a part [in my tax compliance decisions], although I know the tax revenue is not used effectively' (AM)

Some respondents linked tax compliance to the payment in their church as stated in the Bible as well as the yearly contribution to gods in the case of traditional believers (idol worshipers).

'I know from Tithe payment you can't cheat on God, so the same way I won't cheat on the Government' (BM)

Despite these strong religious beliefs demonstrated during the interviews, out of the three who stated that they are influenced in part by their religion, one (BM) is reluctant to pay justifying the decision not to comply as due to corruption among tax officials and misuse of the tax revenue.

'I pay my Church tithe without [pastors] humiliation or embarrassments as I see the obligation towards God as a Christian. In the same way, if the system is ok and GRA do the right thing, I will pay without hesitation' (BM).

6.2a. (viii) Benefits and Social Amenities

Perception of revenue usage especially in the form of social amenities was identified to be an influence on why people pay their taxes in the informal sector in a few cases. 3 of the 17 interviewed are influenced by the visible signs of tax use through the provision of social amenities.

'I see it as an obligation as a citizen who enjoys state services such as roads, water, electricity, hospitals and schools' (EM).

'....think it's advisable to at least pay something as the government relies on these monies to finance its projects and basic amenities' (FF).

This is different from moral obligation as here taxpayers will only pay taxes because there is evidence of social benefits to them, reinforcing the social contract (i.e. reciprocal arrangements with the government)

This sub-theme appears strongly in part B, and some taxpayers stated that visible signs of tax revenue usage, to a greater extent, influence their decisions.

6.2a. (ix) Low tax rate

As observed in section 1.1, evidence shows that a low tax rate decreases the incentives for evasion (Ivanova et al., 2005; Kirchler et al., 2010; Matthews, 2011). This section uses the interview responses to assess this view from the informal sector perspective.

Here, respondents were asked if the rate of tax (actual tax rate, excluding any compliance costs) in any way influences their decision to comply with their tax obligations. Some (5) interviewees confirmed that the low level of taxes they pay influences their decision to comply.

'The rate I was charged (by the tax officer) was too small so I did not challenge it. However, if I am charged a higher rate in the future I will challenge it'. (AM).

'Knowing I have to pay only GHc30/£6 means no point challenging as this covers me for a whole year' (HM).

6.2b. Emerged Theme

6.2b. (i) Tax authority support

During the interviews, the theme of *tax authority support* emerged as respondents stressed the impact of receiving support from the tax authority when paying taxes and the effects this would make on their overall compliance behaviour.

Tax authority support in this context is distinguished from education to specifically include the authority providing advice and support services including taxpayers' advice lines which people could contact for general tax advice, as opposed to running adverts and information/reminder campaigns.

'...officers from the GRA have come to physically work with me to show me practically how to do the tax (VAT) returns, which was complicated earlier, but now I'm confident in myself' (JF).

Considering the high level of illiteracy in Ghana, informal sector operators are not exempt, respondents (HM, IF, JF) therefore raised the importance of receiving support from the GRA

'It makes life easier when you could speak to someone when they visit than information on say newspapers. I cannot read so it's better for me this way' (IF).

JF who has to do quite complex compliance exercises such as VAT returns believes that if

there is support readily available, and what taxpayers are required to do is well explained with direct one-to-one support from the revenue authority, people will comply voluntarily.

6.2.10. Theme A summary

The results from this section indicate that informal sector taxpayers are influenced by high tax morale like those in the formal sector who were identified by existing formal sector literature discussed in chapter four. In the same way, it is evident from this section, that auditing probabilities and the severity of the penalties imposed by the tax authorities also have a significant influence in tax compliance decision of the informal sector operators. However, as the evidence shows, those who refer to auditing as the main reason for complying or as partially influencing their compliance decisions, are mainly those who believe there is inadequate tax education, high corruption, and a poor relationship with the tax authority or they faced a high tax rate as discussed in theme B.

6.3. Theme B - Drivers for tax non-compliance in the informal sector

Following on from the initial stage of assessing *why people pay taxes*, this section (theme B) analyses the interview responses of the *key determinants for non-compliance to tax obligations*. The non-compliance issues in literature which are potentially relevant to this study and themes which emerged in this section include:

6.3.a. Existing themes

- i. Inadequate tax education
- ii. Perceived tax revenue usage
- iii. Corruption
- iv. Bureaucracy and system complexities
- v. No visible benefit of tax payment
- vi. Low auditing probabilities
- vii. Financial constraints

6.3.b. Emerged themes

- i. Past Tax Authority Interaction (PTAI)

- ii. Intuitive taxation and perceived double taxing

6.3.a. Existing themes

6.3.a. (i) Inadequate Tax Education

Tax education helps taxpayers to understand the overall tax system, including their tax obligations to the state, the rate of tax to pay, when to pay and how to pay. The level of tax education within the tax jurisdiction has been found in previous tax compliance studies of formal tax to influence people's compliance decisions (Torgler, 2003), and education in this context is not necessarily a formal (non-tax) education (Loo and Ho, 2005). Having a higher level of formal education may not automatically improve tax knowledge which is instead the function of the availability, quality, and level of tax education.

Most respondents (12) believe that there is a lack of appropriate tax education which specifically addresses their situation or business activity. Some qualifying⁷² taxpayers do not pay at all or try to pay the least they can. Although some appear to have the desire to pay, lack of appropriate tax education to inform them of their basic tax obligation means they are not fully compliant as a result. When asked about tax education and its impact on their compliance decisions, some stressed:

'Tax education does play a role in my decision not to pay taxes. I do not know how or what to pay therefore I don't pay voluntarily (CF).

'... I don't know how and when to pay taxes' (LM).

'the tax authority does not give any information about tax rates, I understand there is a tax but I have no idea how much or when and how to pay (AM).

'...they only come and tell you to pay an amount you have no idea how it is calculated'' (IF).

Again, among these taxpayers, some believe that they are tax-exempt by the nature of their employment:

⁷² Qualifying taxpayer in this context is measured by the fact that they (respondents) are in employment, and the informal sector taxation in Ghana takes not into account a 'threshold' which one must earn before paying taxes. Therefore, 'iced water sellers', bread sellers, Hawkers, load carriers (popularly known in Ghana as 'Kaya yoo') all pay taxes, be it municipal or GRA, they are classified, a form of taxation for the study.

I do not pay any taxes - My decision not to pay is based on the nature of my employment and no clear information from the GRA about operators like me regarding the compliance process. They go to those with shops to collect, so people without fixed location should be educated about what to do if we are also to pay'' (KM).

The issue of the complete lack of, insufficient or irrelevant tax information has been identified throughout the interview response from those who comply as well as those who do not. Some (7) respondents believe that the available tax information is too general, and as they (informal sector operators) pay taxes which are different from the formal (standard assessment) taxes, information about their taxes should be specific to their sectors or type of activity. These taxpayers believe their non-compliance is justifiable because there is not adequate information about who, when, where and most importantly how much to pay.

I do not pay any taxes voluntarily there is no clear information from the GRA about operators like me about the compliance process. They go to those with shops to collect, so people without fixed location should be educated about what to do if one chooses to comply (KM)

“.....It's very confusing now. I used to pay my taxes through 'Garage Operators Association' which was straightforward but now you pay through visiting officers. I will say I do not know much about the tax system now'' (BM)

“...it's difficult to determine how much and when to pay. This means that I have to bargain for cheaper rate anytime a tax officer comes around (FF)

“I do not know how the tax system works. The tax authority does not give any information about tax rates'' (GF)

Tax education is an issue raised in almost every interview conducted, even those who are currently tax compliant still believe that much could be done to make things clearer especially the way tax rates are determined.

“...I do not know how the tax system works. The tax authority does not give any information about tax rates” (AM).

6.3.a. (ii). Perceived tax revenue usage

Many respondents raised the perception of tax revenue usage as having a strong influence on compliance decisions. However, this influence varies, and so do their reactions to this.

Most (11) who do not comply voluntarily associate the decision not to do so to their perception of tax revenue misuse by tax authorities;

“I do not want to pay money which I know will not be used for any good cause” (AM)

“Government misuse of tax revenue discourages me from paying” (CF)

“My perception is like everyone in this country. The tax revenue does not go anywhere useful than politicians and tax officers’ pockets” (HM)

“I know am obliged to pay tax but I feel our tax [revenue] are not put into good usage so am not encouraged to pay” (LM)

The way the taxes are collected and the nature of records kept by the revenue authorities also influence certain types of taxpayers’ perception of the destination of the collected revenue and its use.

‘I know for the fact that just a fraction of the revenue from taxes goes to a good cause. They don't even know from their system if you have paid, so how are accounts made’ (GF).

6.3.a. (iii). Corruption

Corruption here refers to the practices of individual tax officers rather than the government as a whole (which is discussed under revenue usage). In response to how payment receipts work, a taxpayer admitted having seen someone nearby use the payment receipt of a friend as evidence of payment when inspectors visited, without them being caught, and has seen officers asking or being offered bribes by taxpayers.

‘‘With the current loopholes and corrupt system, its easy people will pay less or may even use someone's payment receipt (and show to visiting officers as evidence of payment). I have witnessed this before’’ (AM).

6.3.a. (iv). Bureaucracy and system complexities

The system complexities and bureaucracy, include the compliance processes (for example, a taxpayer having to travel by car or bus to the center of the city to pay a tax bill of say GHC15/£3, which could have been paid locally if such options existed.) In addition, there are times where there are complexities in the tax system which are not well communicated to the taxpayer. Small taxpayers may, therefore, be discouraged to pay due to their inability to contract an advisor to interpret such complex laws.

‘‘The system is so complex; the authorities do not have the right measures/mechanisms in place for people who want to comply to easily do so’’ (EM).

Those with engagement in the formal sector also opt to have informal sector engagement due to the complex regulations in the formal sector (i.e. complexities in the formalisation process)

In an attempt to register and formalise the informal sector activity one taxpayer stated;

‘...I was asked to register for a TIN from the GRA, but the GRA officer I met in the office said I should pay GHC50⁷³ per shareholder (GHC 200 in total). Meanwhile, according to what I read from the GRA the TIN is free, so I decided not to register’ (DF).

This supports the legalists stance on informality, who asserts that the cost of registration and maintaining legal status including system bureaucracies breeds informality.

6.3.a. (v). No visible benefit of tax payment

The direct benefit of taxation is defined in this study as a benefit which taxpayers see as reciprocal, immediate and directly related to the taxes paid. Taxpayers who stress reciprocal arrangements, demand direct benefit for paying taxes. Not having a direct benefit to business

⁷³ Exchange rate: £1 = GH¢ 5.6 (FxExchange, 2017), so GHC50 = £8.92

owners and individuals for paying taxes is a factor for non-compliant decisions among these respondents.

“If I know the benefits I will get, I will surely pay (voluntarily), but for now, I am not convinced about the need” (AM).

“I know I have to pay taxes, but I need benefit for doing so” (BM)

The taxpayers expect a direct and visible return for the tax payment. However, their reason for not paying is that there is nothing directly linked to the previous tax payments. Their arguments seem to suggest that ‘after all, they will enjoy the state services whether they pay taxes or not, just as anyone else’. This belief is directly explained by the psychological contract theory which asserts that compliance is enhanced through trust and reciprocal arrangements between the taxpayer and the tax authority (see detail discussion of pillar 2 theories in section 4.8)

Findings from this section are consistent with the survey data analysis (in section 6.7.c. iii) ‘trust in authority’, which suggests that the low tax compliance rate is mainly due to lack of visible benefits of tax payments

6.3.a. (vi). Low auditing probabilities

Despite the high auditing probabilities reported by the majority of respondents referred to earlier, some respondents (AM, EM, KM), are not paying their taxes because they believe there are no ways the GRA or the Municipal authorities could find out their taxable activities, mainly due to the nature of their business (e.g. mobile operators).

‘I know they (GRA tax inspectors) won’t come, so no point paying or worrying about paying’ (AM).

‘I know I wouldn’t be inspected so I do not think I should pay any taxes. Possibility for detection does not influence me’ (KM).

These types of taxpayers accept the risks and pay as and when they are caught. They will therefore not pay voluntarily or for fear of being audited, instead, they will pay in the unfortunate scenario of being caught. This suggests that, as discussed earlier, auditing probabilities, by themselves, do not evoke long term voluntary compliance in the case of mobile traders at least. This also supports the bomb crater effects (See Mittone et al., 2017)

discussed in section 4.8.1, which states that tax compliance is likely to decrease if taxpayers expect no immediate audits.

6.3.a. (vii). *Financial constraints and double taxation*

A few (3) taxpayers made interesting remarks about the tax system. They are unable to honour their tax obligations because the fixed tax rate regardless of income (presumptive system) makes tax payment unsustainable. These taxpayers believe that the profit/income they make cannot even pay the tax liabilities demanded of them, so financially it is not possible to comply, even if a desire to be compliant is there. These taxpayers would prefer a formal assessment based system where taxes are paid on profit or income or a variable presumptive method which is not based on fixed (for example self-assessed presumptive taxes).

‘My sales fluctuate so it becomes difficult to accept a fixed rate of taxes. These fluctuations can be very high and not just a small difference.

I know people who close their shops when tax officers are coming because their incomes are low’’ CF.

A major challenge for these taxpayer groups is that their incomes are reported as below the GRA’s £16,000 threshold to be able to opt for formal self-assessment (see chapter three for discussion on taxpayer groups and assessment methods).

In this case using the standard assessment of levying a lump sum based on taxpayer’s income as described by Jacobs (2013) may be effective as compared to the estimated approach.

6.3.b. *Emerged themes*

6.3.b.(i) *Past Tax Authority Interaction*

Another influential factor to tax non-compliance described in the literature on formal sector compliance is what is described in this thesis as the ‘Past Tax Interaction Influence’ (PTII). The past tax interaction influence is the outcome of the previous interaction between officers from the tax authority and the taxpayer. Thus, it is the product of the tax officer’s support,

cooperation, knowledge, fairness, and attitude towards the taxpayer and the taxpayer's perception of the officer in discharging of his/her duties.

Some (10) taxpayers report that they view the interaction between them and the officials as a key factor in future compliance decisions. One taxpayer has decided not to pay any taxes at all and finds all means to avoid paying due to his past interaction with a revenue official;

‘I once had a serious argument with an official who decided to charge me about 20 times my tax liabilities (compared to the previous year). I was paying GHs15 a year before when sales were much higher, but he gave me a tax bill of GHs300.... when I challenged them, they were so harsh and rude....I have decided not to pay any taxes again, and I have not been inspected for over three years now’’ (BM)

‘.....I am just concerned about the tax officers and their approach to businesses which have not paid their taxes when they come for the inspection. They have no time to try to understand the reasons for delay/non-payment of taxes’ (GF).

‘‘The experience I had with the GRA officers when they visited, was very bad. Having paid my taxes for the period, I wasn’t expecting a non-compliance check which demanded my payment receipts – I guess I should have been on their system as paid. They were rude too, and seem not to care’’ (GF)

‘‘.....I could have been forced to pay some taxes plus a penalty for late payment, even though there was no prior notice to tell me I owe any amount (FF).

Even though the full tax for the year, according to FF had already been paid, the taxpayer could have been forced to pay another one due to poor data/record keeping about the informal sector by the tax authority. As noted in chapter two, tax authorities in developing countries major reason for having an ineffective tax system for the informal sector is lack of data from the operators to design an effective system, however, information from the interviews suggest that the tax authorities (at least in the case of Ghana) are equally bad regarding record-keeping. This does not create confidence within the system among the sector operators.

6.3.b. (ii). Intuitive taxation and perceived double taxing

The informal sector operators in Ghana are taxed under a presumption tax system in principle, which has clearly defined rules for determining the tax rates for different businesses (GRA, 2013) as shown in tables 3.5 and 3.6. About a third (6) of all interviewees reporting to be non-compliances (voluntarily) suggest that the presumptive system is not well explained and the process in deciding the coefficients and indices upon which the presumption rates are determined, are not communicated properly or are non-existent. These taxpayers believe that there's just 'an intuitive form of taxation' rather than a proper presumption system which has clear factors that are used to determine liability. These taxpayers have very interesting descriptions of the meaning and administration of the 'Ghanaian Presumptive Taxation'. Asked about how they would describe the tax system in Ghana, responses were generally negative:

'No published data about the rates. Officers just give you a tax rate they deem fit during their on-site visit''. (AM)

'GRA would not even tell you in advance how much to pay. how much you pay is at the discretion of the visiting officer''. (BM).

'..the rate you pay depends on the officer who comes around and your negotiation skills'' (GF)

'Very unfair, poorly planned' (IF)

Findings from the survey data (see section 6.7.b.iii) directly mirrors this finding as the results indicate that taxpayers do not have a clear understanding of how their tax rates are calculated. The observations from the field trip also seem to suggest a lack of understanding of how tax rates are determined as taxpayers constantly questioned 'why' they were being given the liabilities.

Some taxpayers have an interesting understanding of what constitutes double taxation. Some (i.e. those with formal employment) believe that their informal employment income is tax-exempt because they are already paying through PAYE and that any additional tax payment outside their PAYE will constitute double taxation;

‘I pay PAYE taxes on my main job but do not pay any taxes on my second (informal sector) activity’ (HA).

‘..I don't understand the tax system at all. One thing I know is that your employer pays your taxes. That's the reason I am not bothered about my tax obligations on the self-employed work done alongside (EM).

The tax authority, therefore, needs to ensure that people are educated to understand that paying taxes on additional income outside the formal employment does not constitute double taxation

6.3.11. Theme B Summary

Theme B provides several factors which influence tax non-compliance decisions among the operators of the informal sector. An inadequate or generalised tax education can be equated to no tax education as taxpayers in this sector largely believe that messages not directed to them have no impact on compliance decisions. The main source of tax education to most taxpayers in the informal sector is through the visiting tax officers, who are mostly there for the collection of taxes rather than to educate taxpayers and may thus not apply the correct rules due to corruption. Furthermore, non-compliance decisions in the sector are also the result of a perception of poor tax revenue usage.

Crucially, the relationship between the taxpayers and the officers (tax authority) has a direct relationship with tax compliance decisions. A positive interaction evokes future voluntary compliance whilst hostilities produce negative attitudes towards future voluntary compliance decisions.

It is also noted that presumptive tax approaches can breed potential corrupt practices where there are no fixed, well-understood indices for determining tax liabilities, as officers tend to use intuitive approaches, this can potentially put some taxpayers into disadvantaged positions.

6.4. Theme C – Future Expectations of informal sector operators

This section presents issues raised by interview participants as factors which could influence their future decisions to comply voluntarily with their tax obligations. These stem from the two main opposing themes - Compliance vs non-compliance decisions. The presence of these factors (expectations of taxpayers) most participants believe, will make them compliant, however, some are already complying. These taxpayers' expectations are represented in figure 6.2 (Circle C in the Venn diagram).

Six of the factors which the taxpayers believe could influence their decisions to comply voluntarily in the future are discussed in themes A and B (see figure 6.2). These include fairness in the tax system, support from the tax authority, curbing corruption, financial constraints, tax education, and awareness creation, and tax revenue usage. Two factors were exclusive to future compliance decisions – flexible payment options and incentives/breaks. As evident from section 6.3.a.(vii), taxpayers who wish to comply, are faced with the challenge that their income cannot even cover the tax liabilities. In this case, evasion becomes profitable (Takats and Papp, 2008; Kirchler et al., 2010).

Incentives and tax breaks just as the ones given to large companies, especially multinationals could also influence voluntary compliance, as people see the direct benefit of their compliance. Also, these incentives serve to establish a cordial relationship with the tax authority, in the form of 'recognition and rewarding good /compliance behaviours'

The future expectations are further described under the six pillars of voluntary tax compliance in section 6.4.1 below:

6.4.1. The six pillars of informal sector voluntary tax compliance

Based on the evidence from themes A and B, the study identifies six key variables, which could shape the future of taxpayers' decisions, and which are regarded as the most influential factors to informal sector taxpayers' voluntary compliance decisions. These are:

- Tax liabilities directly sent from the GRA / formal assessment
- Tax education and awareness campaigns
- Visible sign of tax revenue usage, and
- Tax Morale (the feel to contribute to state building)

- Tightened tax collection process and curbing corruption
- Positive tax authority interaction /support

Tightening the tax collection process will increase taxpayer confidence in the tax system. The current Ghanaian informal sector taxation, which involves predominantly tax collection officers going around to collect taxes from sector operators, is seen as a weak system, which is susceptible to favouritism and corruption due to the increased power of tax officials.

Taxpayers have some perception that tax collection officers do not report the actual taxes collected due to the way the taxes are currently administered. Some suggest that to comply voluntarily, the tax authority must tighten tax collection procedures and monitor/audit officers, by implementing systems which tackle such loopholes to prevent potential revenue leakages.

When asked what will be an ideal tightening method that they would recommend, some interesting approaches were suggested;

‘No officers to collect taxes. officers should only come around to give reminders but the actual tax payment must take place at GRA designated offices’’ (EM)

‘I will like to see a system that automatically sends the payment collected by the tax officer directly and instantly to the tax authority electronically’’ (FF).

Participants challenged the current system of tax officers issuing paper receipts as evidence of payment stating that the officers could design and issue their own receipts and not that from the GRA and the money may not be collected for the tax authority.

Some (6) taxpayers also feel distanced from the tax authority as a result of the current tax collection process, and they believe that they have no access to the tax authority at the head offices, and rather deal solely with field officers whose words are final. These (2) respondents suggested what they want changed;

‘I will give every taxpayer tax code and offer the chance to deal with GRA directly’ (BM).

‘Effective collection approaches; a system to allow us (taxpayers) to raise concerns and have them resolved.....also I’ll like to see occasional taxpayers satisfaction surveys’ (FF).

Even though the majority of taxpayers see the regular visits of tax officers in the collection process as unnecessary intrusion into their business, interestingly almost half of the respondents believe that no matter the collection approach adopted; regular checks from tax officers will help raise the overall compliance rate.

In addition, the results indicate that taxpayers want direct visible benefits for paying the taxes, for example, the provision of basic amenities such as good quality water, street lighting, roads, sanitation, etc.

Asked if a transparent tax revenue use (as they suggested earlier) will make them comply voluntarily, (5) respondents believe this will directly influence their decision positively and will make them comply without the need for the tax authority having to chase them:

‘I will comply fully and voluntarily when I know every tax will come back to benefit us’ (IF).

‘Most important thing is that tax revenue use will play a big role. If people are to comply voluntarily they must not see the state misusing the revenue’. (EM).

‘Use of tax revenue should be transparent; Projects which are built by taxes should be indicated. For example, notice on a building that it was built by tax revenue, etc.’ (JF)

‘When people have the perception of tax revenue poorly used, they will just pay as little as possible just to remain in business’ (GF).

In summary, all participants would comply voluntarily and the GRA will spend less on monitoring when the revenue usage is transparent and people who embezzle tax revenues are punished publicly.

Taxpayers were asked to recommend approaches they would wish to see adopted regarding tax education in order to improve voluntary compliance among the informal sector operators:

‘Clearly published tax rates and education to create awareness’ (EM)

‘Good planning and education- both informative and reminder campaigns’ (GF)

“Complete overhaul of the system, which includes effective administration, removal of the "middle man" [tax officers] and publishing tax rates (education) so it's clear how much to pay, how, where and when to pay. As the system is, I am sure most people are paying less and few might be paying more” (FF)

Also in most cases, tax liability changes are not communicated to taxpayers and most believe the figures are made up by the tax officers on the field.

‘I have made up my mind not to pay until I get a letter from GRA telling me why my tax liability went up over 20 times, within 12 months and how they reached that figure’ (BM).

All these are the result of not having the factors used in determining the tax rates published or if there exists, such a publication is not properly communicated to taxpayers. Again, it could also be attributed to low literacy rates among the sector operators. This as per participants’ accounts, has a greater influence on their compliance decisions.

Also, although published by the GRA from time to time, the rates for presumptive tax are not on their website.

Furthermore, not understanding how the rates are determined makes the system unfair, and offers loopholes for officers to explore and exploit.

Other factors such as flexible payment options and a dedicated tax support team with direct contact numbers for informal sector operators to contact in times of need for assistance are things which people want to see to comply voluntarily.

Besides, the interview results suggest that, generally, respondents oppose the current presumptive tax system, and would rather see a self-assessment based taxation where the tax paid takes into account the amount of profits made.

6.4.2 Summary

In summary, the taxpayers’ interviews reported that there are several factors which may influence voluntary tax compliance decisions (as listed under the six pillars above) among the informal sector operators.

In addition, the indices used to determine the tax rates must be clearly explained and the actual tax rates must be available to taxpayers, for example, in the form of leaflets to them or on the GRA's website, and via other media outlets taking into account the illiteracy rate in the country. This will reduce the discretionary powers of tax officers and corruption.

6.5. Tax Officials Face-to-Face Interviews

This section analyses the interview responses of tax officials from the Ghana Revenue Authority (GRA) and the Metropolitan Assemblies⁷⁴ as discussed in chapter seven.

6.5.1. Understating of the taxpayers

In this section, questions were designed to find answers to 'how well does the tax authority know the taxpayers?'

The questions to assess tax officers' understanding of what the 'informal economy' is, produced some interesting responses;

The degree of informality is;

"determined by turnover" (GRA A1)⁷⁵.

The informal sector is defined by;

"the threshold of a business as defined by the GRA, and includes those taxpayers who are liable to pay their taxes through the tax stamp such as tailors, hairdressers, and carpenters" (GRA K1)⁷⁶.

The two definitions of informal sector businesses by the two GRA officers is quite different from the one offered by the local authority, which suggests different approaches by the two bodies to their informal sector tax administration.

The Metropolitan Assembly classifies businesses in the informal sector '*by their sizes, location and nature*' (KMA 1).

⁷⁴ The main municipal authorities which were interviewed are the Accra Metropolitan Authority (AMA) and the Kumasi Metropolitan Assembly (KMA).

⁷⁵ Ghana Revenue Authority Officer in Accra number 1 (GRA A1).

⁷⁶ Ghana Revenue Authority Officer, Kumasi 1 (GRA K1).

The uncertainty of what constitutes the informal sector is even evident on the GRA's official website where there is no clear definition of informality and businesses are grouped by class/size to arrive at the rate to be paid based on the class or size. This presupposes that even if a business formerly registers which is ideally a formalisation process, to be able to file its tax returns, the system as it stands now, will still classify such business as informal and subject to presumptive taxation. The informality, in this case, is by the size of income rather than registration status.

The main problems faced by authorities in taxing the informal sector, according to officials in the three authorities (i.e. GRA, KMA, and AMA) were identified with three key variables – illiteracy, information availability, and a lack of proper address system in the country.

On what is considered as the biggest problem officers have similar views;

“The main problem is the lack of information – difficulty extracting information about people. Also, most taxpayers do not understand the purpose of paying the taxes” (GRA K1)

‘Lack of effective address system in the country to be able to identify peoples’ businesses and locations and also lack of information flow from the tax authority to the taxpayers’ (GRA A1).

‘High illiteracy rate in the country means people do not see the relevance of paying taxes;’ (KMA 1).

Similar to the issues raised by the taxpayers during the interview, the tax officers equally appreciate that lack of education which is blamed on capacity constraints, and understanding of tax revenue usage are the biggest problems in taxing the informal economy of the country, although lack of a proper address system (e.g. post coding) is equally a challenge.

6.5.2. Justification of the current tax rates

The study explored the success of the current approaches and tactics employed by the tax authority in Ghana, including seeking justification for some of the current enforcement strategies.

Most taxpayers found it ‘criminalising’ when the tax collection officers are accompanied by police officers and believe these practices draw unnecessary attention to their businesses, but the revenue officers justify these acts;

‘People could be very violent towards the officers, therefore the police are used purely for protection’ (GRA K1);

‘there have been instances when some of our officers have been beaten by the people’ (KMA 1).

On the issue of intuitive taxation (discretionary presumptive system) being applied, officers gave had various responses.

‘The rate they pay is based on their business size, type of business etc. and officers who determine the rates are trained in these areas to properly work out the tax liabilities’ (KMA2)

‘‘There is a minimum charge which officers could not go below that, although they use their discretion in most cases during the assessment’’ (GRA A1).

Officers also stated there will always be discretion in presumptive taxes, and that the GRA has a complaints procedure to deal with unfair treatment:

‘‘The amount of tax they (taxpayers) pay is based on a fixed rate from the industry/business/activity or profession which they fall under, and if a taxpayer is not happy with his taxes, he could bring it to the attention of the GRA’’ (GRA A1),

‘‘The rate we charge is very low to ensure affordability’’ (KMA1).

As observed from the interviews, some taxpayers object to the use of the current presumptive taxation system, however, responses from the tax officers indicate that it is the approach the GRA and the municipal authorities consider appropriate.

6.5.3. Views on the success of current strategies

The success of current tax strategies will undoubtedly affect future approaches and strategies. The study also attempted to assess how successful or otherwise have the current taxing strategies, for the informal sector been. Responses from the tax officials did not provide

much insight into this issue, neither did the responses indicate any degree of certainty of how the current strategies are working.

‘People tend to comply due to fear of prosecution’ (GRA A1), and *‘the detection mechanisms have also been very successful’* (GRA K1).

There is no information provided about which business or activity type is least compliant, and this perhaps suggests why there is no precise information about the impact of current tax strategies.

In trying to understand which business/activity is least compliant, the officers stressed that the informal sector collections are not computerised and therefore no accurate data exists on compliance statistics.

‘It’s difficult to specify because we do not have such classifications’ (KMA 3);

‘the payments from the informal sector is not computerised’ (GRA A1)

Although the authorities blame lack of information (see section 6.5.1) from the sector for improving policy design, the authorities are doing little to help the situation.

6.5.4. Dealing with corrupt practices/favouritism

Earlier in this chapter, taxpayers raised the issue of the corruption and abuse of discretionary powers by tax officers as factors influencing their compliance behaviour. There was, therefore, the need to find out from the tax officials what measures are currently in place for combatting corrupt practices and promoting fairness in the system.

To reduce the incidence of corruption and favouritism due to the possibility of a tax officer getting used to certain locations which may lead to the establishment of informal contacts, the GRA undertakes an annual rotation of tax officials:

‘We do rotate our officers every year; however, since the merger (in 2009), I don’t think it has happened’ (GRA K1).

Another issue raised by the officers is the right of the taxpayer during an assessment.

‘The taxpayers have to sign and accept the assessment/tax rate given by the tax officer’ (GRA AK1),

However, officers could not tell what the consequences were but pointed to the GRA's distress action process in section 6.5.7. Taxpayers did state that if one refuses to sign/disagree, their businesses could be temporarily closed down; indicating that signing to agree the tax rate is a mere formality in reality.

Regarding the question of how do they know which business to visit on their visits, both confirmed that collections are not computerised so officers do not usually (though not in all cases) know which informal sector operator has paid, so businesses may be visited over-and-over again, and they are required to produce a payment receipt as evidence of payment. During compliance visits, a business is required to buy or show (on demand) a valid tax stamp.

6.5.5. Approaches to encouraging voluntary compliance

To find answers to one of the research aims of establishing 'the most effective ways to cultivate voluntary tax compliance culture among informal sector operators in developing countries', the researcher asked revenue officers about the current approaches they employ to encourage voluntary compliance, particularly in the long term.

"We try to establish a cordial relationship with the taxpayers and we do this by sending them reminder letters before visits. We also run TV and radio campaigns to remind people and we have a van going around the city to provide information about taxes" (GRA A1).

"Few do comply voluntarily, and to make life easier for them, people can come for free tax advice at the taxpayers' service section of the GRA" (GRA K1).

Interestingly revenue officers from the metropolitan assembly do not believe voluntary compliance is a possibility, considering the current economic situation.

"Voluntary tax compliance will be difficult due to the hardship in the country. The economy is not doing well so people are tight and therefore reluctant to pay" (KMA 3).

The KMA strategy is not about achieving voluntary compliance, but rather to rely on enforced compliance, which gives people no choice. The officers at the KMA also confirmed that there would soon be a taxpayers' court to deal with tax-related issues, and this they believe, will help achieve voluntary compliance.

On the possibility of an informal sector operator being allowed to file tax returns, there exist restrictions of who can file tax returns in the country.

“Ability to file for tax returns is dependent on a threshold, and people/businesses are moved over when they reach that turnover” (GRA A1).

6.5.6. Taxpayers engagement

To establish the relationship between the taxpayers and the tax authority in the country, and to assess how the taxpayers are involved in the tax planning, officers were asked how the current strategies engage taxpayers.

The KMA do involve the taxpayers from the planning phase of the taxes through representatives who decide on rates through a democratic system, balloting.

“The tax rate is decided by the assembly-men⁷⁷ of the local communities; they also decide on categorising of the businesses and the associated rates. Afterwards, a vote is cast by them using a simple majority before such taxes come into force” (KMA 3).

This does not directly involve the informal sector taxpayers. Although there are stakeholder meetings, these are usually for businesses with representatives, and not the informal sector operators who do not have the possibility of being represented as indicated by the KMA3 officer:

‘We organise stakeholder meetings to get the views of various stakeholder groups, but not with the informal sector operators. The informal sector is excluded from such meetings (KMA 3), however, no justification was offered to the exclusion.

These valuations and classifications, according to the KMA are usually done every 5 years.

The GRA taxpayer engagement programme includes running campaigns in the local languages through the use of a van with a Public-Address System (PAS) and via the local radio stations (GRA K1).

Interestingly, the results from the interview data and the survey proves the opposite. The results indicate that taxpayers have no idea how their tax rates are determined. This is further

⁷⁷ Local representatives of the council

confirmed during the on-field observation where it was observed that most taxpayers observed questioned the basis of their tax liabilities

6.5.7. The distress action process of the GRA

This part asks officers the strategies they use in the event of tax non-compliance. The officers (GRA K1 and GRA K2) outlined the following steps:

- **Stage 1 - Assessment:** an assessment is done and a tax rate/liability given. This gives the taxpayer 21 days to pay the taxes due. After the 21st day, the money starts attracting interest, however, the GRA is flexible in situations where people are unable to pay and may enter into negotiation.
- **Stage 2 – Immediate demand notice:** After the initial period given during an assessment elapse, then an immediate demand notice is issued which gives the taxpayer 14 days to pay.
- **Stage 3 – Final demand notice:** Failure to comply up to this stage means the taxpayer enters into the third stage where the GRA issues a ‘final demand notice’ which requires that the taxpayer pays within 7 days of issue of the letter.
- **Stage 4 - The warrant:** After the taxpayer fails to pay, the local office builds a dossier (distress action) and the Head Office issues the warrant.
- **Step 5 – Garnishment:** The GRA at this stage arranges with the debtors of the taxpayer to pay to the GRA directly an amount equal to the taxes owed. At this stage, the revenue officers in charge take inventory of all items. This normally happens after the business has been closed by the GRA. Where a business is to be closed for non-payment of taxes, the local press is involved to report to raise awareness of the consequences of non-compliance.

However, these approaches point more to formal sector operators, although officers did say they use it for the informal sector too. The operators’ interviews did not confirm these

practices, instead by their account, tax officers could close a taxpayer's shop or confiscate his/her goods on the same day of being found non-compliant.

6.5.8 What should be changed to increase compliance level?

The officers raised several points they believe could help raise tax compliance levels, particularly those in the informal sector:

“People don't know the purpose of paying taxes. The politicians need to educate the taxpayers from the top. They do listen to them than we at the local level” (GRA K2)

“Flexible payment terms, although I know it's an obligation, but the tax should be designed in a way that taxpayer feels it is right to pay. I will also suggest constant campaigns/reminders and promotions. Example, first 200 to pay will get a present/discount” (GRA A1).

“More education and threats of court action will encourage people to comply” (KMA 3).

6.5.9. Summary

The results from the tax officials' interviews indicate that the tax authority does not have a complete understanding of the operators of the informal sector, and therefore try to apply the 'best' approach to get as much tax revenue as possible. For example, the tax payment records of the informal sector are not computerised and therefore at any point in time, the tax authority is unable to determine how many of the taxpayers are yet to comply.

With regards to inclusiveness, the tax authority stressed that various taxpayer groups are consulted before the introduction of new approach, or the amendment of any existing approach (section 6.5.6.), although this is a practice carried out by the municipal authorities, and not the GRA.

One interesting thing which emerged from the officials' interviews is the fact that, the tax authority believes that taxes are being put to very good use, but there is not much publicity to inform taxpayers

Finally, the main issues affecting the design of an effective tax system for the sector (based on the reports from the GRA and municipal authorities), are illiteracy, information availability, and lack of a proper address system in the country.

6.6. Field observation studies

6.6.1. Introduction

This section presents data collected through a critical field observation study, which involved the assessment of the interaction between the tax authorities and the taxpayers. This form the third phase of the data gathering and emphasis was placed on observing behaviour-responses between the two parties. The behaviour-response interactions have been represented in the table below with colour-coding, indicating the level of severity. Red - indicates severe compliance issues as a result of the observed relationships; Green - shows a compliance situation where the taxpayer has complied and has evidence of tax payment. It also shows a cordial relationship or situation where each party, particularly the revenue officers, perform their duty diligently. Amber - depicts a situation of concern; low compliance from taxpayers and officers could do more with their responses by not being aggressive, instead adopt a consistent and fair approach. Grey - shows a situation where the taxpayer is deemed to have appropriate tax knowledge, has a clear understanding of tax obligations and compliance processes, but is not currently compliant or there is no evidence of compliance but they have agreed to be compliant and the interaction is deemed cordial.

In total, the researcher was present at 23 potential observable taxpayers/incidences during the trip. However, in only 10 were people observed and interactions recorded, it was these (10) that were of interest to the researcher, this was due to language barriers – sometimes the language used between the taxpayers and the tax officers was not understood by the researcher, and also situations where both officers were attending to taxpayers, the researcher observed only one. Therefore, some interactions which could have been useful to the study were excluded.

6.6.2. Types of businesses and individuals observed

Age and other demographic data are unknown due to a lack of one-to-one contact with the taxpayers. The researcher followed two male enforcement officers. There is no basis for the gender of the tax officer sent out on any compliance visit day, and it depends on knowledge of the area and staff availability, as confirmed by the officers.

Also, concerning the taxpayers, officers had no formal pattern and no parameters (apart from being a trader/hawker) were agreed in advance by the team of who exactly they were visiting. The approach was purely random 'stop and check' which had no predetermined basis.

The observed participants in this field observation were given numeric codes and a letter at the end of each number. The letters at the end of the numbers indicate the sex of the observed individual [F =Female; M=Male].

They are further grouped into M, O and Y [Y= young, perceived to be under 30; M=Middle aged= perceived to be between 30-45 and O = mature taxpayers, assumed to be over 45 years]. The ages assigned to respondents are based purely on the researcher's judgement as there was no direct communication with respondents to ask about age or other factors of the interaction. As the researcher was with the revenue officers, the reactions and attitudes of the taxpayers were not influenced, as they (taxpayers) considered the researcher as part of the revenue officers.

Table 6.2 – Field observation data summary

ID	Sex	Age	Type of business	Officers' actions	Taxpayers response/reaction	Issue code
1M	M	Y	Handbags	Seized goods/ Serious exchange	No receipt, argued heatedly that he is selling for his boss who is out of town. Angrily left goods with officers.	
2F	F	Y	Cold drinks	Verbal Warning.	No receipt/ selling for mum who has receipt	
3F	F	Y	Used Clothes	Serious exchange	Seller finally paid	
4M	M	O	Books	Verbal warning	No sales for the day, so unable to pay. Will pay when makes sales or next time	
5M	M	M	Herbalist	Demanded tax receipt	No tax receipt. Paid for one peacefully	
6F	F	M	Bread	Checked receipts	Produced valid tax ticket	
7F	F	Y	Jewellery	Verbal Warning.	No receipt/ selling for mum who has receipt	
8 F	F	Y	Fruits	Verbal warning	Challenged officers of no sales. Promised to pay next time	
9F	F	M	Snacks	Seize goods	Insulted officers as bringing bad luck and driving customers away when they touched her goods last time	
10 m	M	M	Mixed items/Hawker	Verbal warning	Tax paid but left receipt at home. Promised to carry it around next time	

6.6.3. Field tax officers, questions

The field tax collection officers are asked a series of questions after the observation exercise. The questions are denoted with FROQ (to signify field revenue officers' questions). Table

6.2 above shows that the officers take several enforcement strategies during the field trip, and the purpose of further questioning is to help explain these practices.

6.6.3.i FROQ1

What do you do with the seized goods?

The senior revenue officer said:

‘The goods are taken to the office and we keep it until when they pay then they can come for it by showing receipt of payment’. (AMA Senior revenue officer 1).

The issue of selling the goods to defray the tax liability is not common, but it’s done as the last resort according to the officer.

6.6.3.ii FROQ2

What do you do with perishable items?

The officer stated that they leave them in the office until they come to pay, and if a taxpayer does not return for the goods, they are binned, although this is a rare case as taxes demanded are usually a fraction of the cost of the goods.

‘The amount of tax we ask them to pay is very small in comparison to the goods, so they will always come for the goods’ (AMA senior revenue officer1)

6.6.3.iii FROQ3

How do you know whom you have issued verbal warnings to when people do not have fixed locations and you do not keep any records of whom you have warned?

‘It’s impossible to do anything, especially hawkers, as you rightly said, they do not have fixed locations so I just try as much as I can to give strong warning with the view that it will deter them from selling without license /tax receipt in the future’ (AMA senior revenue officer 2)

This approach indicates that an itinerant trader could escape detection for these taxes for a longer period without being detected.

6.6.3.iv FROQ4

Why do you let some people off and give others a strong warning when they are all committing the same offense (Non-complying)?

“When someone shows the desire to pay and for genuine reasons do not have the receipts, I use my judgment based on what they say, and I am sure most will pay. However, there are others who will not pay, and you could see from their responses, so in these cases, I make sure the action is deterrent enough, which include seizing of goods.

However, some of the sellers will not pay following seizure of their goods, because they know someone senior within the office (AMA) who will plead on their behalf to collect their goods. These kinds of behaviours make our work difficult” (AMA senior revenue officer 2)

Such practices confirm the initial findings from the informal sector operators’ interviews, that there is no fairness within the system due to favouritism and corruption.

For clarification (regarding FROQ4), the officer is asked:

Has there been any instance as you explained above, and what did you do?

“I could do nothing, these are my superiors. These send wrong signals to the people and usually, it discourages going to the field or seizing goods, but I do it for the good of the country” (AMA Field Revenue Officer 2)

The response suggests that the tax officials equally face challenges from other officers within the tax authority in enforcing compliance.

6.6.4. Officers' attitude

The overall attitudes of the field officers were keenly observed too.

The attitude of the field revenue officers can be described as 'not good' – even though they could be biased towards better behaviour than usual because of the researcher's presence. Although the researcher's presence could have influenced their behaviour, the overall attitude and their relationships with the taxpayers is not good enough to encourage voluntary compliance even at a future date. Officers shouted at taxpayers who had not paid their taxes. In some situations, things got very confrontational and quite personal, therefore, the integrity of the tax authority, not the officers could be brought into disrepute. Overall, the interpersonal relationship exhibited by the officers is an issue, and seems very likely to have a negative influence on voluntary compliance in the future, if this is typical of other officers' behaviour.

6.6.5. Tax knowledge of people observed

Overall, the levels of tax knowledge exhibited by those engaged by field officers were good. It was only in one instance that a taxpayer indicated he had no knowledge of paying for a license to sell. The taxpayer, in this case, was a youngster who confirmed he was selling for his boss who had travelled, and was unsure if he had the receipt.

6.6.6. Level of fairness

The researcher's field observation suggests that there are examples of favouritism and inconsistent practices among tax officers. In most instances, people were let off when they do not argue with the tax officers. However, most of those who argued were people the researcher believed needed education, and the people the revenue officers should have taken the opportunity to educate. On the contrary, they received harsh responses. For example, taxpayers 1M, 2M, 4M, 7F, 8F, 9F, and 10M all committed the same offense – non-compliance. However, 1M, 9F who questioned the officers about the reasons for payment, etc. had their goods seized. The researcher believes that because the officers have no records of who they have warned before, people who adopt a 'nice way' to communicate with the

officers and come up with good excuses could go long periods without complying if they play the system suitably.

6.6.7. On-field tax education

On-field tax education appeared very poor and not an obvious feature of the role of compliance officers. Tax officers were more interested in the tax collection than educating the taxpayers. In one instance a revenue officer shouted to a taxpayer;

‘....but you should know that [payment of sellers license] is compulsory before you came to the market....You either pay or I take your goods to the office’.

Such approaches do not build a good relationship between the taxpayers and the tax authority for the future, especially operators who are new to the market.

In most part, of the situations observed, tax officers offered very little time to educate taxpayers who were not familiar with these taxes (selling license). It appeared to the researcher that the officers assumed that all the taxpayers were of the same level of understanding as suggested by Andreoni et al (1998), which could be a wrong assumption, according to Torgler, (2003).

6.6.8. Summary.

Overall, there were mixed incidences during the visits and officers used different strategies /approaches in handling them. There was no consistency in officers’ actions, and there were few situations where favouritism was shown towards some taxpayers. Although using discretion is part of the process, however, there were instances where officers seized goods belonging to taxpayers but other similar situations attracted only a verbal warning. This does not send the right message to other taxpayers, especially because the majority of taxpayers in the informal sector operate in an open market where officers’ actions are open to view by others.

In terms of tax education, there is clear evidence that most of the taxpayers observed are well informed of their tax obligations and fully understand when and how to pay.

The excuse of ‘I have left my payment receipt home’ and ‘I’m selling for someone, I don’t know I have to pay’ were common excuses given by taxpayers. Officers used mixed approaches in dealing with such situations, which raises fairness concerns relating to this system.

6.6.9 Tax experts’ interviews - Adam Smith International

This section presents extracts of the interview responses from experts on informal sector taxation from Adam Smith International. Detailed interview questions and responses are presented in appendix 9. The interview was participated by [REDACTED] and [REDACTED]. The experts’ interview questions are denoted by (EIQ). For example, ‘EIQ1’ represents experts interview question one.

The issue of tax officials abusing their power, engaging in negotiation and favouring people was evident throughout the study (as seen in this chapter) so the question of how to tackle this issue was put forward:

6.6.9.a. EIQ1

Question: How do we deal with corrupt tax officials for an effective presumptive tax system to be achieved?

This produced some interesting responses from the participants;

‘What we recommend is something transparent, and kind of guideline on how tax officers assess, and how the judgment is made, and give the shop owner the basis to agree or disagree. Also, a place to take complaints to if a taxpayer disagrees’ [REDACTED].

‘If I look at the Kosovo context, two important things are in Kosovo

- **One:** *The presumptive tax was self-assessed, so it’s self-assess by the taxpayer, not the revenue officer. The tax officer provides the forms, but the people complete the details and then provide how much they are going to pay (which is based on their assessment)*

- **Two:** *The taxpayers take the money to the bank and pay themselves*

So, the Kosovo system which I understand is different from Ghana is: Self-assessed, and payment into the tax authority's bank account by the taxpayers' themselves' [REDACTED].

Even though they believe in helping the taxpayers, but both [REDACTED] and [REDACTED] agree that the tax officers must not take away the responsibility of the taxpayers away from them and suggested they are allowed to go and make direct payments. On the issue of small and regular payments, it is suggested;

'...Point of Sales (POS) technology, – where people are issued with receipts on the spot by the revenue officers but the receipts must reconcile with the recorded transactions on the machine which the officer takes to the bank later on which will help deal with leakage problems' [REDACTED].

In the absence of these, they suggested mobile money payment which is now very common across most developing countries.

Proper assessment or auditing of taxpayers in the informal sector has always been difficult a task hence officers tend to use an intuitive approach to issue tax bills. The experts' views were sort on this issue.

6.6.9.b. EIQ2

Question: What will you recommend as the best auditing mechanism for these field tax officers?

Response: *'Monitoring could be done using other sources to check taxes collected are reasonable. For instance, by checking import data records, assess what government contracts they have, size of the business utility bills, etc.'* [REDACTED]

Evidence from the data in this study presented in this chapter suggests that there are often no clear guidelines on when businesses are moved from presumption to other forms of taxes apart from using turnover. To find out more, the question was posed;

6.6.9.c. EIQ3

Question: What should be the key determinants/triggers to moving businesses from presumptive assessment to formal/standard tax assessment – any cut-off point?

Response: *As a general we want as many people to keep more books/records as possible so expect people to move from presumption. One example is if you are a new business, and you are running at a loss, under presumptive tax you still have to pay taxes and under standard assessment you pay nothing.*

In Kosovo⁷⁸, we allowed people below the threshold to move over as long as they have good records, but also once they decide to do so, they must stay three years before going back, to prevent people going backward-and-forwards. Also, particular taxpayer groups were moved out of presumptive taxes where they were deemed to be able to keep records, for example, professionals.

Also, the IMF recommended that they (countries) do encourage using high rates of taxes for the presumption to encourage people to move over to formal assessment’ [REDACTED].

Taxing petty traders and hawkers who could barely meet their tax obligations came up as an issue during the interactions with the informal sector operators, and the GRA do not seem to have any reason to remove certain businesses from taxation. Expert opinions were sought on this in EIQ4 below.

6.6.9.d. EIQ4

Question: As you are aware, countries like Ghana do not have any social benefits system, and people have to hawk (sell in the streets) to survive. I spoke to people making as little as £2 a day during my fieldwork, but may pay 30p 40p in tax [tickets] a day, considering your experience in developing country taxation, do you think it’s advisable to tax all these people as well?

Response: *‘As a general rule, anyone making an income, we recommend taxing them for the sole reason of participating in running the country and for democracy. But we also*

⁷⁸ [REDACTED] and [REDACTED] indicated they were involved in designing the recent tax reform.

recommend charging a small amount. Small is better than nothing. Low thresholds to promote an all taxpayer led system and also as a way to engage citizens [REDACTED].

‘...when people are already paying, they are already on the system, for future taxation [REDACTED]

The next question seeks a response on dealing with complaints issues in the informal sector.

6.6.9.e. EIQ5

Question: What I have noticed in most tax regimes, is that when it comes to tax complaints, taxpayers are asked to put in writing, which I think could be difficult to countries like Ghana and other developing economies, either due to illiteracy or nature of the system. What will you recommend as the best way to dealing with taxpayer complaints in the informal economy or under presumption regimes in developing countries context?

Response: *It shouldn't be in writing only, and this can apply to both federal and state levels. For example, a dedicated complaints support officer sitting in the local office on a desk, it could be telephone complaints or a small call center may also be used or even in this modern era, an online complaints procedure may be adopted.*

Being able to walk in and talk to someone is a standard recommendation [REDACTED]

6.6.9.f. Summary

The data presented in this section shows that although the informal sector presents some challenges making it difficult to be taxed effectively, there are ways to dealing with these. A tailored approach to suit individual countries or situations as suggested above could be effective.

Tax officials' powers which are abused under the presumptive system could be overcome with taxpayers taking their responsibility for physically making the tax payments, although this could discourage some taxpayers who may be busy to go to banks or who do not have mobile money.

Finally, to ensure fair and consistent billing, using third party information such as electricity consumed, water used, or customs data, etc. may be helpful.

6.7.0. The Survey data for the study

This section of the chapter presents the questionnaire results of the study and it's presented in three sections. In part A, the key demographic information of respondents is presented. This is presented in the form of descriptive statistics which provides summaries of the demographic data in tables and diagrams. This is then followed by part B which analyses the data in relation to existing literature. The final part (part C), presents evidence from the survey and assesses how new evidence is linked to the core theory of the study – the responsive regulation theory

6.7.a. PART A - Descriptive statistics

6.7.a. (i). Questionnaire distribution and response rate

Using a drop-off and pick-up technique, 500 survey questionnaires were distributed across the two selected regions of the country (refer to chapter seven for a detailed discussion of the process). 77 of the returned questionnaires were unusable, due to incomplete questionnaires or a selection of multiple responses by a respondent. Out of these, 43 were from the Greater Accra Region, and 34 from the Ashanti Region. Overall, 334 of the 500 distributed surveys were usable responses representing 66.8%. The actual response rate was 82.2% and the non-response⁷⁹ rate was 17.8%.

⁷⁹ This figure excludes returned but non-usable responses.

Table 6.3 Summary of questionnaire distribution and response

<i>Region</i>	<i>Survey distributed</i>	<i>Non-returns</i>	<i>Total Returns</i>	<i>Invalid returns</i>	<i>Usable response</i>	<i>Total valid response %</i>
<i>Ashanti / Kumasi</i>	300	46	254	34	220	73.3
<i>Greater Accra/Accra</i>	200	43	157	43	114	57.0
<i>Total / Valid Res. (%)</i>	500	89	411	77	334	66.8

6.7.a. (ii). Background of respondents

This section describes the key demographic characteristics of respondents and presents descriptive statistics of these respondents including age, gender, level of education, and income. In doing so, a mixture of data presentation techniques such as tables, and graphs are used to present the data. The graphical representation reduces the complexity of the data (for the reader), shows trends and distribution whilst the tables promotes simplicity and reduces large data sets to a meaningful summarised form.

95.8% of the survey participant' declared their nationality as Ghanaian. People from other African countries made up 3%, whilst 0.3% were from Asia, the same as Europe (0.3%). This reflects the nature of the country's recent population census described in chapter three, which is predominantly Ghanaians (97.6%).

The respondents comprised of 188 (56.3%) males, 140 (41.9%) females and 6 (1.8%) non-disclosures. 265 (79.3%) of the participants operate as sole traders with 52 (15.6%) being in partnership and 17 (5.1%) family businesses.

Table 6.4. Type of business ownership

	Frequency	Percent	Valid Percent	Cumulative Percent
Sole Owner	265	79.3	79.3	79.3
Partnership	52	15.6	15.6	94.9
Family business	17	5.1	5.1	100.0
Total	334	100.0	100.0	

Table 6.5. Age distribution of respondents

	Frequency	Percent	Valid Percent	Cumulative Percent
Under 25 Years	21	6.3	6.4	6.4
25-40 Years	171	51.2	52.3	58.7
41-50 Years	86	25.7	26.3	85.0
Over 50 Years	49	14.7	15.0	100.0
Total	327	97.9	100.0	
Missing (No response/blank)	7	2.1		
Total	334	100.0		

The age of the participants is represented in table 6.5 above. Four age groups are used for the study [under 25years; 25-40 years; 41-50 years; and over 50 years]. The dominant age group is the 25-45 year olds who make up 171 (51.2%), followed by the 41-50 year olds, 86 (25.7%). People in the over 50 age group amounted to 49 (14.7%). There are 21(6.3%) respondents from those aged under 25, and 7 (2.1%) participants did not declare their age.

The majority of the participants are married 191 (57.2%) and the remaining are single 102 (30.5%), cohabiting 29 (8.7%), and in 'other relationship' 9 (2.7%). 0.9% of the participants did not disclose their marital status. This demographic data shares similar trends with the recent (2010) national census, which reported that 51.8% of the population were married, 29.6% single, and consensual union (cohabiting) 6%, (GSS, 2012, p.33). The age distribution of the census data is different from the study and as such cannot be compared to assess representativeness with research data.

Table 6.6. *Marital status*

	Frequency	Percent	Valid Percent	Cumulative Percent
Married	191	57.2	57.7	57.7
Single	102	30.5	30.8	88.5
Cohabiting	29	8.7	8.8	97.3
Other	9	2.7	2.7	100.0
Total	331	99.1	100.0	
Missing No response/blank	3	.9		
Total	334	100.0		

Table 6.7. *Highest educational qualification*

	Frequency	Percent	Valid Percent	Cumulative Percent
O Level/A Level/SSCE	150	44.9	45.2	45.2
HND/Professional	52	15.6	15.7	60.8
Degree	32	9.6	9.6	70.5
Masters degree & Above	1	.3	.3	70.8
No formal education	97	29.0	29.2	100.0
Total	332	99.4	100.0	
Missing No response/blank	2	.6		
Total	334	100.0		

The educational level of participants is grouped into five classifications – (a) No formal education, (b) basic education - O’Level/A/Level/SSCE, (c) HND/Professional, (d) Degree, and (e) Master’s degree and above.

As shown in table 6.7 only one (0.3%) participant declared a Masters’ degree or above as the highest held qualification. The largest education bracket is those with the basic education (O’level/A’levels/ SSCE) representing 150 (44.9%) of the sample. People who have ‘No Formal Education’ are the second highest in the sample making up 97 (29.0%). Those with HND/Professional level qualifications are at 52 (15.6%), and Degree holders 32 (9.6%).

This trend is similar to the national trends as recorded by the recent population census- No formal education 28.5%, JSH, SSCE (O-levels / A-levels) 49.8%, Vocational/HND/Professional 7.5% Degree 2.5%, and Masters degrees and above 0.5% (GSS, 2012, p61).

Figure.6.3 Religion

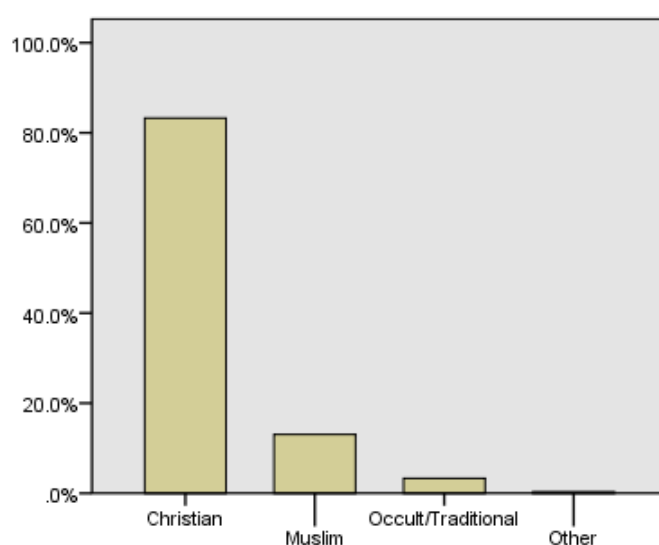
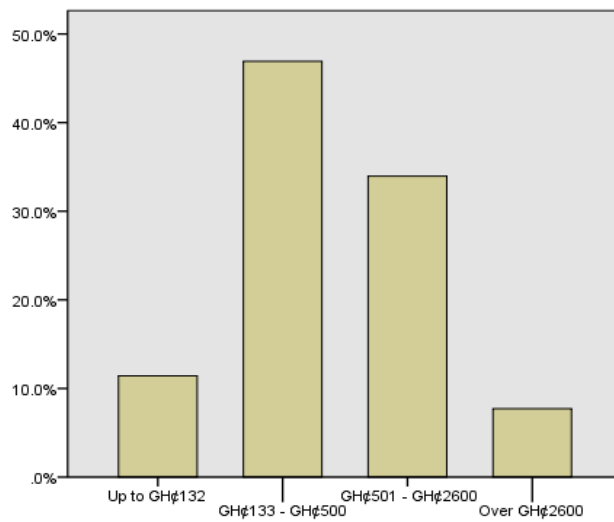


Figure 6.3 represents the religious denomination of the participants. Christianity dominates the sample and represents 274 (82.0%). Muslims are second 43 (12.9%), Traditional and Occultism represent 11 (3.3%), and other religious groups make up 1 (0.3%). Five people (1.5%) did not disclose their religion. At the national level, Christians are 71.2%, Islam 17.6%, Traditional believers 5.2% and all others including non-believers are 5.3% of the population (GSS, 2012, p.6)

The income of the participants is shown in figure 6.4. Grouped into three, the highest income group is those earning between GH¢133 - GH¢500⁸⁰ per month who are 152 (45.5%). The income bracket GH¢501 - GH¢2600 is made up of 110 (32.9%). Those earning up to GH¢132, which equals the tax-free Personal Allowance limit for those in a formal employment (GRA, 2013), are 37 (11.1%) of the sample. Participants in the highest income category of over GH¢2600 constitute 25 (7.5%). No reliable data for income distribution nationally was obtained and the recent census did not capture such data, therefore there is no way to compare this with national data.

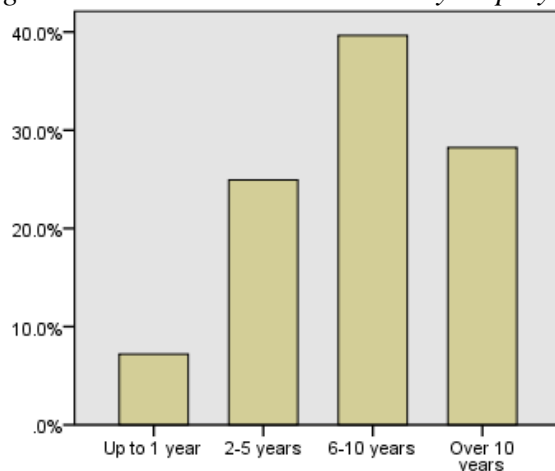
⁸⁰ Exchange rate GH¢5.1 to GBP 1 (Barclays Corporate, 29th May, 2014).

Figure 6.4. Monthly income



The years in business as shown in figure 6.5 is almost evenly distributed. People operating between 6 – 10 years are 132 (39.5%), over 10 years 94 (28.1%), 2-5 years 83 (24.9%) and up to 1 year 24 (7.2%).

Figure 6.5. Years in business activity/employment



6.7.a. (iii). Reliability and internal validity

Assessing the reliability and validity are key steps before any further data analysis is undertaken and they go a long way to determining the internal consistency and reliability of the test scores. The intercorrelation between the test scores are maximised when all items measure the same construct, as a result, Cronbach's alpha becomes useful in determining internal validity. Quality tests are important to evaluate the reliability of data, and

Cronbach's alpha is a commonly used index for determining such consistencies (Tavakol and Dennick, 2011).

In order to determine the reliability and internal validity of the data for this study, to measure the degree at which the analysis yields a consistent result, and as the first step before the formal analysis of the responses, Cronbach's alpha coefficient is applied to test the data (Tavakol and Dennick, 2011) of the completed questionnaire ($n = 334$).

Again, measuring the internal consistency helps to estimate correlation and enables the researcher to understand how good the scales are in terms of producing reliable outcomes. Using Cronbach's alpha helps to determine if the questionnaire gives the same result, under the same conditions (Field, 2009 p.673).

The acceptable level of Cronbach's alpha considered good is derived from the indicators set forth by Hair et al. (2010) who put 0.9 as excellent (high stake testing) and 0.70 as acceptable. However, Hair et al. (2010) conceived that for certain studies, especially exploratory research, a 0.60 is considered appropriate to provide the required internal validity and reliability. Cronbach's alpha-coefficients for the key factors upon which the data for the questionnaire survey is analysed, indicate good internal consistency - tax education and tax knowledge has a Cronbach's alpha of 0.881, tax morale 0.635; compliance process and cost 0.764; perception of fairness and equity 0.688; taxpayers' and tax officials' relationship 0.652. The strong test results from Cronbach's alpha suggests that the research instrument employed has a high degree of validity.

The test also demonstrates internal strength in scale choice, with each validity test depicting a strong inter-item correlation of above 0.3, the threshold level suggested by Hair et al. (2010, p118). Again, a selected corrected item-total correlation shown in appendix 10, which indicates how much each item correlates with the overall questionnaire score, shows strong correlations as just one of the variables is under 0.5, the benchmark for determining the strength of an item's correlation with the rest of group (Hair et al., 2010).

From appendix 10, the highest is 'understand own tax' with a corrected item-total correlation of $r = .776$, with the lowest being 'not paying taxes is bad' ($r = .398$).

6.7.b. PART B - Data and existing literature

This section of the chapter conducts a detailed analysis of the data to explore and explain trends and patterns in relation to existing studies. The analysis begins with the results of a Chi-Square test to establish associations between the key variables of the study.

6.7.b. (i). Chi-Square test

The initial part of this section (questionnaire data) is analysed using a chi-square test. As the variables are in Likert scales measures, individual dummy variables are introduced. The newly created variables are dichotomised which condense the five-point into (a two-point) scale. As suggested by Robbins, there are several ways of coding positive and negative responses for Likert scale questions, but choosing one depends on how the researcher codes undecided answers (Robbins, 2008, p.177). In this case, besides the undecided or neutral responses, the highest-numbered code denotes the highest level of agreement and the lowest numbered code is assigned to the lowest level of agreement (Robbins, 2008, p.175).

The ‘strongly disagree and disagree’ are coded as negative responses and the ‘strongly agree and agree’ are positively coded into the new variables. In doing so, neutral responses are discarded. The rationale for this approach is to establish and analyse only the positive versus the negative responses [with other variables] either as dependent or independent variables.

Clark and Watson (1995), argued that respondents erroneously chose the neutral response when they don’t have a response. Thus, labels like “neither agree nor disagree” and “neutral,” denote attitude response options labels such as “undecided,” or “indifferent,” which can be interpreted as nonresponse. Again, Alwin and Krosnick (1991) found that allowing neutral responses has no effect on the reliability of attitude survey questions.

Introducing the neutral responses helps to create bound in the responses (i.e. negative on one end and positive on the other). For example, in tax education variables (see Q.38 in the survey), the key is to determine whether taxpayers in the informal sector believe there is adequate tax education to aid their tax compliance decisions. After creating the new variables, initial descriptive statistics are undertaken to determine the frequencies used for the chi-square tests.

6.7.b. (ii). Tax information and Gender

A chi-square test for association is conducted between gender and the ‘adequacy’ of tax information from the tax authority. All the expected cell frequencies, except one, were less than 5, however, a Chi-square test is still possible in this case as this is only 16.7% of the cells (Lunsford and Fink, 2010, p.12). The test proved that there exists a statistically significant association between gender and availability of tax information, $X^2(2) = 6.177$, $p = .046$. The results of this association test also indicate that there is a moderately strong association (see table 6.8) between gender and tax information availability, $\phi = 0.144$, $p = .046$.

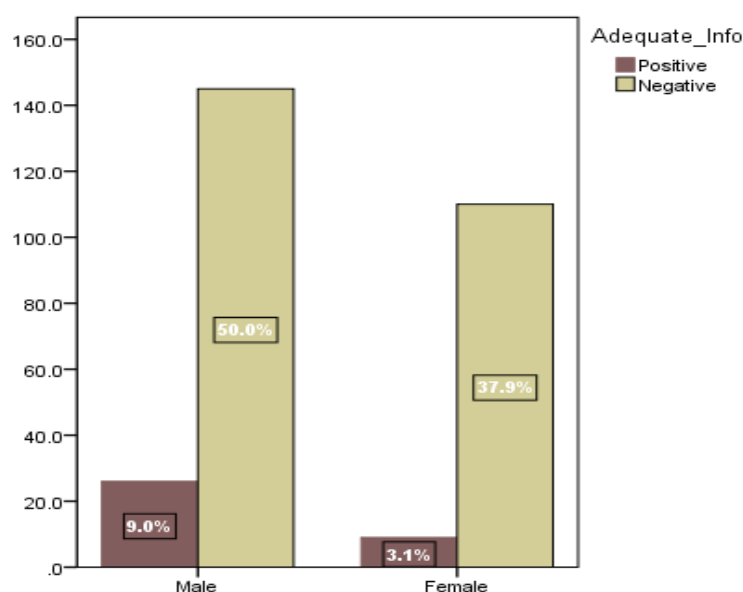
Table 6.8 – Chi Square test – Gender vs Tax information

Chi-Square Tests			
	Value	df	Asyp. Sig. (2-sided)
Pearson Chi-Square	6.177	2	.046
Likelihood Ratio	5.859	2	.053
Linear-by-Linear Association	2.211	1	.137
N of Valid Cases	296		

Symmetric Measures			
		Value	Approx. Sig.
Nominal by	Phi	.144	.046
Nominal	Cramer's V	.144	.046
N of Valid Cases		296	

The cross-tabulation frequency results also indicate overall that 87.9% of respondents believe that there is not adequate tax information from the GRA to help educate them and make people compliant (see figure 6.6). Breaking it down, this represents a male population of 50.0% in relation to the total sample and 37.9% females who believe that there is a lack of adequate tax information to aid their tax compliance decisions. This distribution is represented in figure 6.6 below. Figure 6.6 also shows that only 9% of males and 3.1% of females believe that there is adequate tax information to aid their compliance decisions.

Figure 6.6 - Gender and Tax information availability



6.7.b. (iii). Relationship between the taxpayers and the tax authority

The underlying theory of the study, responsive regulation, focuses on the taxpayer-tax authority relationship (Ayres and Braithwaite, 1992) as the main variable which shapes long term voluntary compliance. Results from this section also help in answering research question two (*i.e. to what extent does the relationship between a taxpayer and the tax authority shape voluntary compliance decision of the informal sector taxpayer?*)

Thus, this part, therefore, tries to explore the relationship between the tax officials and the taxpayers - which results from both the face-to-face interviews and the field observation indicate it's not cordial.

To test this relationship, the study adopts an ordinal logistic regression. Specifically, a cumulative odds ordinal logistic regression with proportional odds is used. The choice of a test to assess this relationship is because the dependent variables are ordinal and the independent variables are categorical/nominal/dichotomous.

The relationship between the taxpayers and the tax officials (Model A); the helpfulness of the tax officers/GRA (Model B); and the availability of tax advice (Model C) are measured by variables⁸¹ contained within the survey instrument.

Model A is measured with equation 6.1. Equations 6.2 and 6.3 measure models B and C respectively. The choice of variables for each model is derived from the literature and interview data (refer to interview themes analysed in section 6.1). The models used by Stock,

⁸¹ The questions used in equation are abbreviated. See appendix 6 for detailed question and possible responses.

(2012, p.167) and Palil (2010, p.259) in their tax morale and tax compliance studies also provided a useful guide in constructing these models for the study.

Model A

$$PPTOE_i = \alpha + \beta_1 BPHIS_i + \beta_2 GENDER_i + \beta_3 RWTB_i + \beta_4 AGE_i + \beta_5 EDUC_i + \beta_6 YRBUS_i + \beta_7 UNHTP_i + \varepsilon_i$$

(Equation 6.1)

Where:

<i>PPTOE_i</i>	-	<i>Perception of Past tax officers/office encounter</i>
<i>BPHIS_i</i>	-	<i>Bribe Payment History</i>
<i>GENDER</i>	-	<i>Gender of taxpayer</i>
<i>RWTB_i</i>	-	<i>Received written tax bill directly from the tax office in the past</i>
<i>AGE_i</i>	-	<i>Age of taxpayer</i>
<i>EDUC_i</i>	-	<i>Highest educational qualification held by taxpayer</i>
<i>YRBUS_i</i>	-	<i>Number of years in business</i>
<i>UNHTP</i>	-	<i>Understands how to pay own taxes</i>

Model B

$$POTAH_i = \alpha + \beta_1 BPHIS_i + \beta_2 YRBUS_i + \beta_4 AGE_i + \beta_5 EDUC_i + \beta_5 GENDER_i + \beta_5 OWNERSHIP_i + \varepsilon_i$$

(Equation 6.2)

Where:

<i>POTAH_i</i>	-	<i>Perception of Tax authority helpfulness</i>
<i>BPHIS_i</i>	-	<i>Bribe Payment History</i>
<i>YRBUS_i</i>	-	<i>Number of years in business (employment)</i>
<i>AGE_i</i>	-	<i>Age of taxpayer</i>
<i>EDUC_i</i>	-	<i>Highest educational qualification held by taxpayer</i>
<i>GENDER_i</i>	-	<i>Taxpayer's gender</i>
<i>OWNERSHIP_i</i>	-	<i>Type of business ownership</i>

Model C

$$ABTA_i = \alpha + \beta_1TKNG_i + \beta_2NOYIB_i + \beta_3PTAV_i + \beta_4BUSREG_i + \beta_5AGE_i + \varepsilon_i$$

(Equation 6.3)

Where:

$ABTA_i$	-	<i>Availability of tax advice</i>
$TKNG_i$	-	<i>Tax Knowledge of the taxpayer</i>
$NOYIB_i$	-	<i>Number of years in business (employment)</i>
$PTAV_i$	-	<i>Previous Tax authority visit</i>
AGE_i	-	<i>Age of taxpayer</i>
$BUSREG_i$	-	<i>Taxpayer's [business] registration status</i>

To ensure that two or more of the predictor variables in each of the regression models are not highly correlated (i.e. posing difficulty in determining which variable contributes to the explanation of the relationship being tested), independent tests for Variance Inflation Factor (VIF) is carried out for each predictor of the models (A, B and C) above.

The results indicate that all the tolerance values are >0.1, with the smallest being 0.765, which also implies that all the Variance Inflation Factors (VIF) are within the acceptable levels of under 10 (Hair et al., 1995; Kennedy, 1992; Neter et al., 1989).

The goodness of fit statistic, which helps to determine how well a model fits the data (Field, 2009) is also used in this section. The deviance goodness of the fit test on 'model C' above indicates that the model was a good fit to the observed data $X^2(492) = 355.526$, $p=1.0$. Although the Pearson goodness of fit test indicated the opposite $X^2(492) = 800.007$, $p<.001$, but this did not influence the choice of the method since 'the deviance statistic is generally preferred to the Pearson statistic (Collett, 1991)⁸².

Finally, the likelihood-ratio test indicates that the final model (302.313) [statistically] significantly predicts the independent variables rather than the intercept-only model (397.256), $X^2(10) = 459$, $p < .001$.

⁸² cited in (Hallett, 1999)

6.7.b. (iv). Perception of the Previous Encounter with Tax Office

This section helps throw more light on research questions one⁸³ and four⁸⁴- it assesses key demographic variables and their impact on tax compliance and tests if the current presumptive system is the best way or there are better alternatives to taxing the informal sector.

The odds of people who have received a written tax notice in the past, considering their previous encounter with visiting tax officers as good (95% CI, .769 to 3.323) has a statistically significant effect $X^2(1) = 9.864$, $p = .002$.

Similarly, taxpayers who confirmed they fully understand how to pay their taxes also found their previous encounter with the visiting tax officers as positive [95% CI, -.3.587 to -285] has a significant effect $X^2(1) = 5.281$, $p = .022$. The test for model A, also found that men considered their past encounter to be more positive with the tax officials than females.

Another interesting finding from the test is that people who have a history of giving bribes to visiting tax officers, including those who have only given in once, have had positive previous encounters with the tax officers. In addition, the descriptive statistics initially conducted indicate that men are 10 times more likely to give bribes than females. This finding, and the fact that men consider their relationship with visiting tax officers as good indicates that bribery history in which men dominate, could help explain whether or not taxpayers are satisfied with their past interaction with visiting tax officers.

Furthermore, this is consistent with the observations from the field. The constant heated interactions between taxpayers and the tax authority observed shows that field officers do not improve taxpayers' knowledge by their field visits. Again, findings from the interview suggest that officers visit can breed corruption due to discretionary powers of field officers (6.2.a iv).

6.7.b. (v). Perception of Tax Authority Helpfulness

The test on the perception of tax authority helpfulness by taxpayers also produced some interesting findings as it helps in analysing research question two.

⁸³ Are there more effective ways to tax informal sector economic activities in developing countries than are currently employed?

⁸⁴ What key social/demographic variables influence tax compliance in the informal sector of developing economies?

The odds of people who have given in on bribery demands by tax officers in the past, considering the tax officers to be helpful, has a strong statistical significance (95% CI, .081 to 2.552) has a statistically significant effect $X^2 (1) = 4.129$, $p = .035$. Those with a written tax notice in the past considering their previous encounter with visiting tax officers as good (95% CI, .082 to 2.541) has a statistically significant effect $X^2 (1) = 4.368$, $p = .037$. Also, a statistically significant effect is recorded among people who are in their first year of business - $X^2 (1) = 4.226$, $p = .040$; people who operate as sole traders [$X^2 (1) = 8.930$, $p = .003$] as well as those who have A level qualifications or above $X^2 (1) = 961.008$, $p = .000$. However, there is no statistical significance in terms of gender or the age of taxpayers. These variables do not influence how people perceive ‘how helpful’ the tax authority is to the taxpayers. Interestingly, and just as the findings in *model A* above, bribe history proved to be of high significance. People who have paid bribes in the past consider the tax officers (GRA) to be very helpful.

6.7.b. (vi). Availability of Tax Information

As observed in chapter four, tax compliance is based on tax knowledge which is influenced by tax education/information. This section assesses the availability of tax information to influence peoples’ compliance decision, whether by voluntary (moral obligation – research question three) or enforced (increased auditing – research question six). Availability of tax information/education is further analysed using composite scores in section 6.7.b. (ix).

Results from the earlier interview data suggest that there is a lack of appropriate⁸⁵ tax information to aid taxpayers’ compliance decisions.

The perception of taxpayers, with regards to tax advice /information availability regarding their tax payment, is also used to model the relationship between the authorities and the taxpayers. The results again produce a strong statistical significance for taxpayers who have a bribe payment history (95% CI, .013 to 2.634) a statistically significant effect $X^2 (1) = 3.919$, $p = .048$. This result thus suggests that taxpayers with a bribe history perceive there’s good tax advice/information available to aid their compliance decisions.

Just as model B above, people who have been in their businesses for one year or below reported the availability and ease of tax advice from the tax office regarding payment [Wald Chi Sqr = 9.525, $p = .002$]. The results also indicate that taxpayers who have formally

⁸⁵ Tax information which is relevant to the informal sector. Interviewers indicate that most tax education tend to be generic and are not specific to informal sector taxpayers (i.e. presumptive based tax specific information).

registered their business with the registrar of companies and the tax authority believe that it's easier to get tax advice, $p < 0.05$. Taxpayers who indicated that they fully understand the tax system, particularly areas involving their sector/business (including applicable rates) also believe there is easily accessible tax advice from the tax authorities [Wald Chi Sqr = 25.319, $p = .000$]. Taxpayers who are 40 years or under also indicated the availability of information, and accessibility to tax advice from the tax authority, $p < 0.05$.

6.7.b. (vii). *Relationship between tax officials' visit and tax knowledge.*

Most taxpayers stressed that there is inadequate tax information to aid their compliance decisions, and most taxpayers only get to know about their taxes during the field officers visit.

Interestingly, the initial interviews and field visit discussed in the initial part of this chapter found that the tax officials do not educate taxpayers during visits to improve the tax knowledge of the taxpayers. To explore this finding further, this section conducts a three-way variable interaction log-linear analysis to establish the relationship between taxpayers' gender, tax officers' visits, and tax knowledge. The introduction of gender is to determine if [gender] has any statistical significance for the relationship between tax knowledge and the officers' visits. Determining the association involving multivariable, as in this test, could be complex, however, Miller et al. (2002, p.194) emphasise the use of log-linear analysis as one of the efficient ways to establishing this form of multivariable associations.

A three-way log-linear analysis was performed to determine the hierarchical unstructured model for the association between gender, tax officers' visits and tax knowledge. The process produced a model which includes the main effects and the two-way associations of gender versus past officers' visits, and officers' visit versus tax knowledge. The likelihood ratio and the parameter estimates are presented in tables 6.9 and 6.10 respectively.

Table 6.9 – Partial Associations for Gender, Past officer visit, and Tax Knowledge

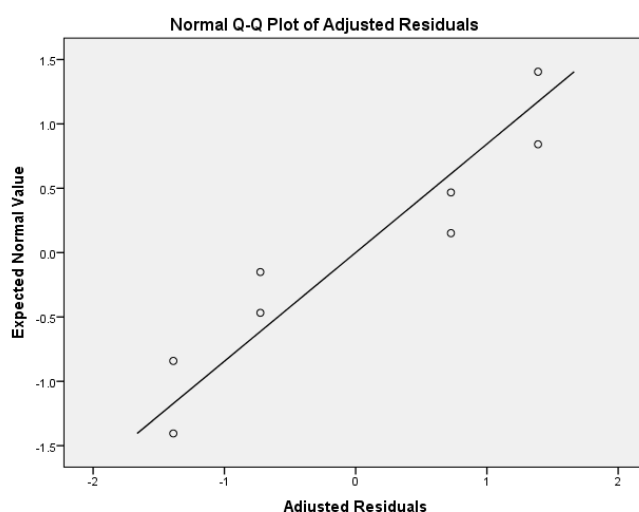
Effect	Parameter Estimates			Sig.	95% Confidence	
	Estimate	Std. Error	Z		Interval	
					Lower Bound	Upper Bound
Gender*TaxRate	.127	.080	1.575	.115	-.031	.284
Awareness*PastOfficerVisit						
Gender*TaxRateAwareness	.148	.080	1.839	.066	-.010	.306
Gender*PastOfficerVisit	.064	.080	.794	.427	-.094	.222
TaxRateAwareness*PastOfficerVisit	-.021	.080	-.259	.796	-.179	.137
Gender	.211	.080	2.620	.009	.053	.368
TaxRateAwareness	-.423	.080	-5.260	.000	-.581	-.265
PastOfficerVisit	.738	.080	9.172	.000	.580	.896

Table 6.10 - Parameter estimates for loglinear test

Effect	Partial Association X ² (df=1)	Sig.
Gender*TaxKnowledge	13.479	.000
Gender*PastOfficerVisit	0.007	0.933
TaxKnowledge*PastOfficerVisit	0.053	0.818
Gender	8.137	0.004
Tax Knowledge	43.643	.000
Past Officer Visit	147.831	.000

The model produces a good fit to the data with a non-statistically significant difference $X^2(3) = 2.403$, $p = .493$. The residuals (adjusted residuals) are approximately normally distributed as shown on the Q-Q plot shown below

Figure 6.7 Q-Q Plot – Relationship between tax officials' visits and tax knowledge



The test also indicates that gender has no statically significant association on the perception of past officer visits, $X^2 (1) = 0.007$, $p = .933$. Unsurprisingly, people's tax knowledge does not improve with on-field officers' visits as the interview results and the field observation suggested in the initial part of this chapter. In addition, there is no statistically significant association on the result in the test on the two variables - tax knowledge and tax officers visit, $X^2 (1) = 0.053$, $p = .818$. This is quite obvious considering the initial findings from the interview and the field observation which both suggest that tax officers field visits have no direct impact on improving taxpayers' knowledge to aid their compliance decisions in the future.

6.7.b (viii).Preference for presumption taxation

The degree at which respondents prefer presumptive tax for their informal sector activities (which research question four seeks to investigate) is analysed using the scores of the preference for a fixed rate (presumptive tax) over formal assessment (tax based on profit).

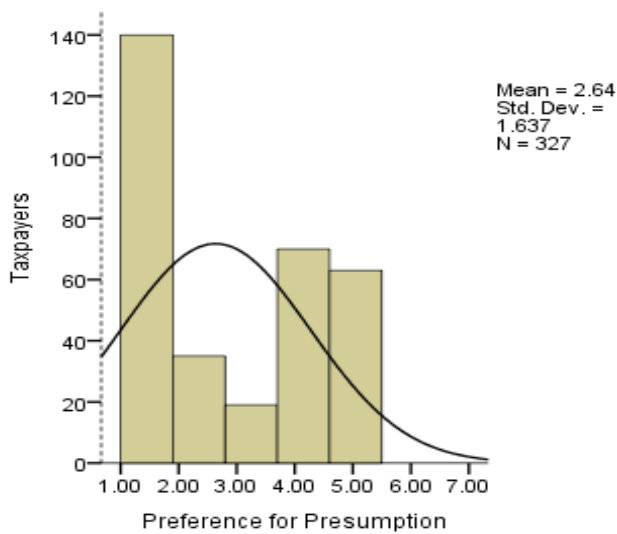
The variable 'profit-based taxation' was reverse coded on the Likert scale to bring the highest score for the composite score⁸⁶ to 6, and 0 the minimum. The neutral score is therefore 3, which measures the response of taxpayers who are neither in favour nor against presumptive taxation. A high score suggests a preference for presumptive taxation.

As shown in figure 6.8 below, the results indicate that there is a slight bias against presumption taxation. The mean score of $(\bar{x}) = 2.64$ is 0.36 below the neutral score, again indicating that over half of the respondents are not in favour of the presumption taxation approach as it is currently applied.

This confirms with results from the initial interviews (section 6.3.b. ii) that taxpayers are against presumptive taxation due to how it is being administered (i.e. method of determining tax rate not determined and it's seen as more of intuitive based taxation).

⁸⁶ Presumption Tax preference composite scores [Q.11 and Q.19R]

Figure 6.8 Taxpayers' preference for Presumptive Taxation



6.7.b. (ix). Tax Education

Evidence from the literature (see chapter four) suggest that tax education is influenced by knowledge of where to seek tax advice, tax education campaigns and the availability of tax advisory services to improve understanding of the tax system.

Results from the interviews data (see section 6.2.a. v) and field observations (section 6.6.7) suggest low tax education which could potentially explain the low tax knowledge and the subsequent low compliance rate. This section, building on from section 6.7.b. (vi) above, measures tax education from these three variables;

Tax education ($TEDUC_i$) is determined by:

$$TEDUC_i = KWSTA_i + CMRTC_i + AOTAS_i + \varepsilon_i$$

Where;

$KWSTA_i$ = Knowledge of where to seek tax advice/information

$CMRTC_i$ = Current tax education/campaigns in the country

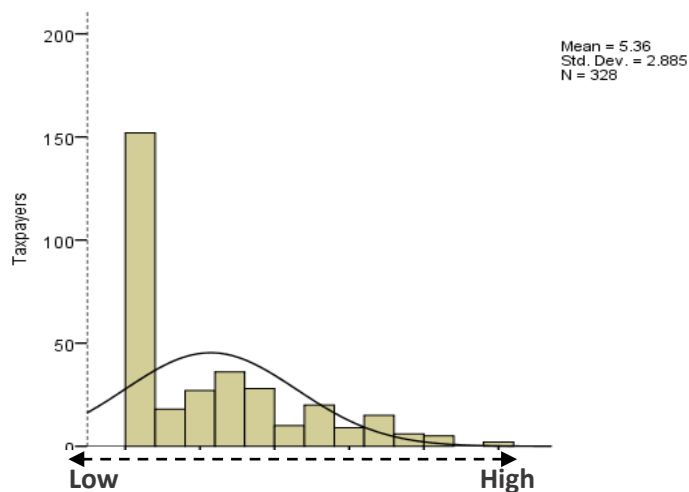
$AOTAS_i$ = Availability of tax advice services

Using the composite scores of the three items (see next section, part C below for a discussion on composite scores), with 5 scores each ranging from 1 (the lowest) to 5 (highest), the highest level of tax education is placed at 15, and 3 the lowest. The mean score is $(\bar{x}) = 5.36$ (also shown by a movement towards the left by the distribution line in figure 6.9) and the Standard deviation (σ) = 2.885. The results suggest that taxpayers' views about the level of

tax education run by the authority are low. This supports the interview data (see sections 6.2a.(v) and 6.3.a.(i)) which also indicates that most people who fail to comply are those who believe they do not have the information to aid their compliance decisions. The results are represented in figure 6.9 below.

Assessing the movement of the two graphs, (figure 6.9 and figure 6.11), there is a clear indication that the low level of tax education has manifested into the low level of tax knowledge exhibited by the respondents.

Figure 6.9 – Current level of tax education



6.7.b. (x). Tax rate awareness (knowledge) and bribe history

Initial findings from this study suggest that taxpayers who have paid bribes in the past on their taxes believe their previous encounters with the field tax officers were good (6.7.b.(iv)), the tax authority are very helpful (6.7.b.(v)) and that there is good tax information to aid compliance decisions (6.7.b.(vi)). These results are different from taxpayers who have no history of paying bribes. Therefore, the study further assesses the impact of positive bribe history on tax knowledge. Results from this test help in assessing the impact of the presumptive based taxation on compliance decisions (research question four) and the impact of regular audits on compliance decisions of the informal sector taxpayers (research question six)

An independent sample t-test is considered appropriate for this test. The independent t-test is used to determine the differences between two samples when the samples do not include the same participants (Willians et al., 2008, p.140) (in this case those who have bribe history and

tax education). It helps to determine if a sample (i.e. those with bribe history) differs from the population (Thomas et al, 2011, p.149)

The independent sample t-test is used to check taxpayers' bribe history and awareness of tax rates (tax knowledge), $t(288) = 2.39, p = .017$

As predicted, taxpayers who have given in on bribes in the past about their taxes, are found to be those who respond positively about knowing how their tax rates are determined. This suggests that taxpayers who give in on bribes, may not want to find out how much their tax rates are or how their overall tax is determined. This further indicates that high auditing probabilities do not necessarily lead to increased compliance when there exists the opportunity for bribes.

6.7.c. PART C - the responsive regulation theory and the study

In this section, results from the study are used to inform and explain the concepts underlying the responsive regulation theory (here emphasis is on regulatory pillars of sanctions and support).

In this section, composite scores of variables (relevant to explaining these underlying factors) are used in the analysis.

The composite scores approach has been adopted in several recent studies for analysis, for example, Ward et al. (2009) used this analysis for a patient education intervention study; De Pauw et al. (2009) adopted the approach to evaluate relationships among personality traits, self-esteem, and psychopathology among children. White (2005, p.35) used composite scores from the world value survey and Transparency International for a study which measures people's confidence in state institutions and the police. In recent tax morale and attitude towards tax compliance research, Stock, (2015 p167-8) used composite scores to assess support for progressive taxation and perception of tax evasion.

In using composite variables for analysis, Song et al. (2017) advised that the composite should be meaningful with respect to the context and purpose of the study, and that 'once a composite variable has been created and used in analyses, results should be interpreted at the level of the composite variable, and not at the individual original variables' (Song et al., 2017).

6.7.c. (i). Tax Morale

The responsible individual

As observed earlier, the responsive regulation theory asserts that there is a responsible taxpayer with underlying moral self that can be unearthed by a good regulator which will change the behaviours of tax evaders/avoiders self-regulate more effectively in the future. This suggests that the pyramid of support is very important in responding to the compliance needs of responsible taxpayers who may just ‘need basic support to comply’. The results from the interview data support this. Using the survey data, this section tests this premise (i.e. tax morale of the informal sector taxpayers) to help answer question three. Thus, the intrinsic motivation to pay taxes by the taxpayers (termed tax morale) and discussed in chapter four is measured in this study to help assess the level of such motivations within the informal sector operators. Tax morale in this study is measured by 8 variables contained within the survey instrument.

The tax morale is thus measured by:

$$LOTM^{87} = RTRB_i + WTDAL_i + ATBP_i + ITIAA_i + OATTP_i + RTUTR_i + ATTNC_i + ATCOMP_i + \varepsilon_i$$

Where:

$LOTM_{i(8-40)}$	-	<i>Level of Tax Morale</i>
$RTRB_i$	-	<i>Right to register a business with Tax authority</i>
$WTDAL_i$	-	<i>Willingness to declare all income if required</i>
$ATBP_i$	-	<i>Attitude towards bribe payment</i>
$IAOTC_i$	-	<i>Influence of auditing on tax compliance</i>
$PTPC_i$	-	<i>Perception of tax payment and citizenship</i>
$RTUTR_i$	-	<i>Reaction to unfair tax rate</i>
$ATTNC_i$	-	<i>Attitude towards tax non-compliance</i>
$ATCOMP_i$	-	<i>Paying and Complaining (using right channels to challenge unfairness)</i>

⁸⁷ TaxMorale is measured by the following items in the survey [ItsRightToRegister + WillDeclareIncome + WillTakeBribe + RegularOfficerVisit + TaxAsDuty - PayEvenUnfairRC + BadNotToComply + PayAndComplain]

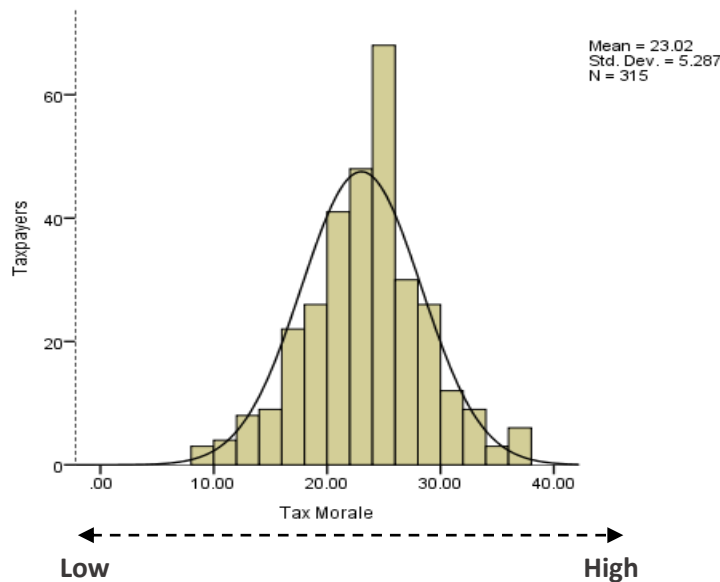
The composite scores of the 8 variables (above) are used to measure the level of morality among the respondents.

Each variable is ranked 1-5; therefore, a total (composite) score of 8 represents taxpayers with the lowest level of tax morale, whilst a score of 40 indicates the highest level of tax morale that one can achieve.

The Mean score for the 8 composite variables is $(\bar{x}) = 23.02$ and the Standard deviation (σ) = 5.287. With the highest possible tax morale rate of 40 (as per the scores), a mean of 23.02 indicates that the respondents have a high⁸⁸ level of tax morale. The results suggest that the majority of the taxpayers will comply voluntarily – caeteris paribus. In addition, the respondents have negative attitude towards tax non-compliance, and giving bribes to tax officials regarding their taxes. The results also show that the taxpayers will declare incomes if the tax systems require that and are willing to register with the tax authority.

The results of the composite scores are also plotted in a histogram and it's shown in figure 6.10 below. The concentration of the bars towards the high end of the morale level (40) indicates that the level of tax morale among the respondents is high.

Figure 6.10 - Tax Morale of the informal sector operators



⁸⁸ Considering score of 8 represents taxpayers with the lowest level of tax morale, 23.02 thus represents a high score relative to the lowest expected score.

The results in this section also support the findings from the initial interview conducted among the informal sector operators (section 6.2a.(i)) where it emerged that moral obligation was the main determinant for the current tax compliance level.

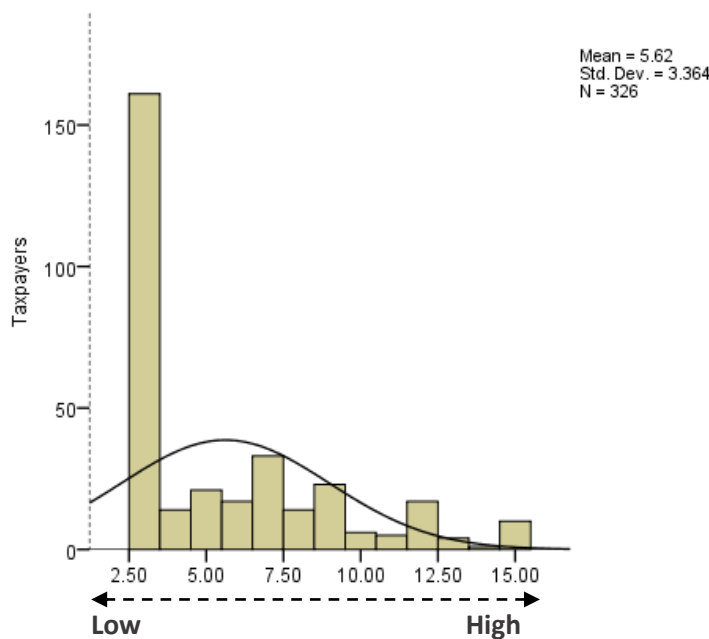
6.7.c. (ii). Tax Knowledge

Taxpayers' capacity

Responsive regulation deemphasizes threats and promotes support and regulatees capacity building. Responsive regulation asserts that an empowered taxpayer (i.e. informed taxpayers) will voluntarily take their responsibilities. Again, the pyramid of support, therefore, believes that education to improve tax knowledge is crucial to improving long term voluntary compliance Taxpayer capacity is measured by tax knowledge and tax education (see detail discussion in 6.4.2).

Tax Knowledge ($TKNWG_i$)⁸⁹ is also measured using the aggregate scores from 3 items which measure taxpayers' understanding of 'how to pay' taxes, 'when to pay', and understanding of own tax rate' / liability is determined. The mean scores (\bar{x}) = 5.62 and the Standard deviation (σ) = 3.364.

Figure 6.11 – Tax Knowledge



⁸⁹ TaxKnowledge1=HowToPay + WhenToPay + UnderstandOwnTax.

The level of tax knowledge, as shown above, is measured out of 15. Therefore, the most knowledgeable taxpayers achieved a score of 15, whilst the least knowledgeable ones get 3. The average informal sector taxpayer achieves 5.62, an extremely low score, which again conforms with the evidence described above on the low level of tax education in the country (see sections 6.2a.(v), 6.3.a.(i), 6.6.7.) The low mean score suggests that the average taxpayer in the informal sector has a very limited understanding of the tax system. As shown in figure 6.11, with the curve measuring the distribution of the tax knowledge towards the left, it indicates majority of the taxpayers have very limited understanding of ‘how’, ‘when’ to pay their taxes, and above all where they pay them; they do so in most instances without understanding of how their rates/liability are determined.

Furthermore, to assess the impact of gender on tax knowledge, Mann Whitney and Wilcoxon tests are used. The results indicate that gender has no significance on the level of tax knowledge among the informal sector operators ($p = .190$, $z = -1.312$).

Finally, to assess the impact of auditing on the tax knowledge of taxpayers, Mann Whitney and Wilcoxon tests were conducted using the scores from tax knowledge items. Results from Mann Whitney and Wilcoxon tests suggest that field tax officers’ visits /audits have no impact on tax knowledge ($p = .275$, $z = -1.092$).

6.7.c. (iii). Taxpayers and tax authority relationship

Trust in Authority

Central to responsive regulation theory is regulates trust in authority. It carries the notion that trust in authority automatically leads to compliance. It, therefore, places responsibility on the authority for a conscious effort to maintain such a relationship (Demin, 2018, p.17). Also, evidence from the study on Australia’s informal economy (Braithwaite, 2003) points out that where taxpayers trust the system, compliance improved accordingly.

Evidence from literature and the initial interviews conducted among informal sector operators suggest that one possible explanation of tax noncompliance in the sector is the perception operators of the sector hold about the tax authorities. This perception is developed further in this section and is measured with 4 items, each with a score of 1-5. On each item, 5 is the highest (positive) perception and 1 the lowest (negative) perception towards the tax

authority. Therefore 20 represents the highest and most positive perception, and 4 the lowest, and strong negative perception.

Where;

$$POTA^{90}_i = TRU_i + GRAHELP_i + TAXADV_i + DEFPAY_i + \varepsilon_i$$

$POTA_i$ - Perception of tax authority

TRU_i - Tax revenue usage

$GRAHELP_i$ - How easy to deal with the tax authority

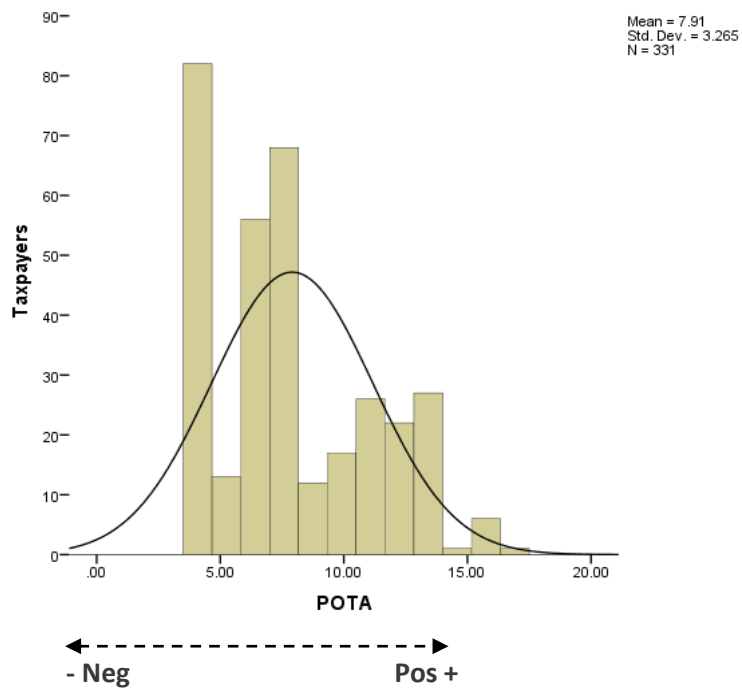
$TAXADV_i$ - Availability of and access to tax advice

$DEFPAY_i$ - Tax authority's willingness to accept deferred payments in difficult times

The perception of taxpayers of the tax authority is again measured by the composite scores of the survey question; perception of tax revenue usage, how easy it is for the taxpayers to deal with the tax authority, availability, and ease of access to tax advice, and the willingness of the tax authority to accept deferred payments in periods of genuine financial difficulties. The deferment of payment is added to the variables to determine the overall perception because since presumption taxation is based on a fixed amount and not on profit, there could be situations when the taxpayer does not have the means to pay. Also, this issue came up repeatedly during the interview stages of the data collection, hence the need to include it in this model. The results from the interview suggest that taxpayers have very limited trust in the tax authority especially in areas of tax revenue usage which influence compliance decisions (section 6.3.a.ii and 6.3.a.iii, and 6.4.1) same as reported in the results of the interview data in section 6.3.a. (v).

⁹⁰ Perception of Tax Authority (POTA) = RevenueUsage + GRAHelpful + TaxAdvice + DeferredPayment

Figure 6.12 Perception towards tax authority



A higher score indicates a positive perception of the tax authority. The test produced a mean score of $(\bar{x}) = 7.91$ and Standard deviation $(\sigma) = 3.265$. The mean (7.91) shows that there are a large number of people who have the lowest possible perception (4) score.

Thus, the results indicate that a majority of taxpayers have a negative perception of the tax authority, which could affect compliance decisions. This is consistent with the interview results presented in sections (6.2a.(viii), (6.3.a.(ii)), and (6.7.c.(iii)). A high negative perception of the tax authority confirms the hostile relationship between the two parties as indicated in the interviews and the field observations. As suggested by responsive regulation theory, such relationships will undoubtedly influence the sector operators' compliance decisions (Braithwaite and Braithwaite, 2001).

6.8.0. Summary

The chapter analysed data from interviews, surveys and field studies to assess factors influencing compliance decisions by taxpayers in the informal sector.

The initial part of the chapter assessed the compliance behaviour of the informal sector taxpayers using interviews. The interview results suggest that moral obligation is the highest determining factor for tax compliance decisions by informal sector operators.

Results from the survey data also show that the operators in the informal sector have high tax morale, but low tax knowledge and a negative perception of the tax authority, which could in part explain the low compliance rate in the sector.

The results further suggest that overall, in line with existing literature; there are numerous factors which influence the compliance decisions of the informal sector taxpayer. The results of this chapter are further presented in the next chapter (discussion chapter) where a detailed analysis is conducted on the key factors influencing tax compliance decisions in line with theories and existing literature on tax compliance.

CHAPTER SEVEN

DISCUSSION

7.0. Introduction

This chapter discusses the results of the study as presented in chapter six, in relation to the existing literature. This section also uses underlying theory: Responsive Regulation Theory, to help explain the practices within the tax environment of the informal sector in Ghana. This discussion is based on the objectives of the study, which is to explore the design of the taxation for the informal sector in a developing country context.

The discussion is presented in three parts - the first section, part A, presents key findings of this study, and part B discusses the research questions in relation to the findings and the analysis presented in the previous chapter. Based on the discussions of the first two sections and the study results presented in chapter six, part C provides an analysis of the practical application of the responsive regulation theory within the Ghanaian informal sector based on the various compliance postures identified in the study.

The theoretical position of this study is anchored within the broader (individual) compliance decision making theories of taxation as discussed in chapter four. Theories and models that look into factors influencing an individual's compliance decision making, in particular, are consulted in the course of the study (see chapter four). Although these theories were designed mainly to test formal tax systems, there they assess tax compliance from different perspectives. For instance, the findings from this study find some evidence for the *utility theory* - taxpayers in the informal sector are influenced by auditing probabilities and fines (see section 6.2a.(ii)). A high auditing probability and heavy fines evoke compliance. However, the results further suggest that where there are possibilities for taxpayers to pay bribes; auditing and fines become less effective (section 6.7.b.(x)).

Also, the theory of reasoned action assumes that a taxpayer's compliance decision is the product of perceived outcomes and controls and ignores situations where people comply without controls. If the assumption in this theory holds, then the operators of the informal sector in developing countries operating in an environment with limited possibilities of detection should not be paying at all (see chapter two on informal sector tax challenges). Although the results presented in chapter six, indicate that the assumptions in the Theory of Reasoned Action are evident within the informal sector context.

Furthermore, the psychological contract theory has helped explained some tax compliance behaviours in the informal sector. This study found that social contract is a determinant of tax non/compliance. For example, it was found that taxpayers will voluntarily comply with their taxes if there are visible benefits of tax payment (sections 6.2a.(viii) and 6.3.a.(v)).

The slippery slope model which measures compliance on a tax authority's power and trust offers some interesting insight into the findings of this study too. This power which is assumed to be an antagonistic environment evokes enforced compliance in the informal sector through regular audits and heavy fines (section see section 6.2a.(ii)), although power (in terms of the ability to detect noncompliance was reported as weak (see chapter six). Contrary to power, trust which relates to a synergistic climate to promote voluntary compliance was found to be lacking. Heavy corruption, poor past tax authority interactions, lack of visible benefits of tax payments, and bureaucracy and system complexities (6.3.a.(iv)) have manifested into a low trust in the authority, therefore affecting voluntary tax compliance among informal sector operators.

Although these theories and models helped in shaping this study, and have provided some interesting insights, as discussed in chapter four, they do not sit comfortably within the environment and the context of this study, and as such offer only limited guidance in explaining the study results as outlined above, partly because this is an exploratory study.

As discussed in chapter four, this study focuses more directly on responsive regulation theory (Ayres and Braithwaite, 1992) to assess compliance decisions, by exploring how the regulatory approaches shape the relationship between the taxpayers and the tax authority in the informal sector and how this interplay manifests into tax compliance/non-compliance.

7.1. Part A – Key findings from this study.

This section presents the key findings of the study. This then informs the discussions on the research questions.

7.1.1. Moral Obligation

Results from the study indicate that moral obligation emerged as the most influential (determinant factor) for current tax compliance among the informal sector operators (see section 6.2a.(i) and 6.7.c.(i). and figure 6.10). The results further suggest that just as the

formal sector, informal sector taxpayers do comply with their tax obligation because of their perceived moral obligation as citizens. Although, there are taxpayers who were not compliant (despite results classifying them as having high tax morale) because there was no evidence of tax revenue usage. It is therefore important for the tax authorities to have a firm view of the informal sector and their compliance needs, so effective programmes could be implemented to promote voluntary compliance.

This finding supports the compliance stance of the responsive regulatory theory which states that ‘a tax authority that actively engages the democratic will of the people, may not need coercion to win compliance’ although taxpayers must appreciate that there exist punitive measures to deal with dissident taxpayers (Braithwaite, 2007, p.5). Therefore, an open, responsible and transparent tax revenue usage to ensure the visible benefits of tax payment, intensive appropriate tax education, consistent billing, and open and transparent tax liability assessment could all contribute greatly to ensuring voluntary compliance.

7.1.2. The ‘Past Tax Interaction Influence’ (PTII)

Taxpayers do come into contact⁹¹ with the tax authority in various forms in the course of conducting their business (Whait, 2012, p.110), and the results from the study suggest that compliance decisions are in part shaped by the experience of such interactions. This is consistent with responsive regulation’s assertion that compliance is achieved through trust. The theory asserts that a positive relationship creates voluntary compliance without the need to resort to enforced measures. Ayres and Braithwaite (1992), stressed that the relationship between the regulatees (taxpayers) and the regulator (tax authority) plays a vital role in tax compliance. It is based on the premise that the regulator has the authority to own up to its administrative responsibilities and explore different ways to manage this relationship

This interaction, defined in this study as the product of tax officer’s support, cooperation, knowledge, fairness and attitude towards the taxpayer/situation and the taxpayer’s perception/response to the officer or the situation is particularly important especially for new taxpayers and those with weak tax knowledge (see section 6.3.b.(i)).

The results from this study (see section 6.3.b.(i)) suggest that taxpayers who have had past interaction with the tax authority are likely to comply if the outcome of such interaction was positive. Also, new taxpayers who experience a positive first interaction are more likely to

⁹¹ This interaction may be in the form of tax collection, auditing, or for support

comply in the future voluntarily. Taxpayers not likely to comply after an interaction, are those who perceive the (field) tax officers as being dishonest, insensitive to their plights⁹², rude or those who question the integrity of the collection process. Therefore, to improve voluntary tax compliance in the informal sector, the tax authority needs to ensure that trust is improved among the sector operators. There should be clear indices for determining tax liabilities and tax collection officers must apply these indices fairly. In addition, tax revenue should be put to good use in order to ensure visible benefits of tax payment. One way to ensure the visible benefits of tax payment is by earmarking tax revenue. By earmarking the tax revenue for specific projects (or expenditure) the tax authority is committed to ensuring that the tax revenue is used on projects and areas beneficial to taxpayers. This will subsequently build trust and improve voluntary compliance. Also, those who default on tax obligations must be openly punished to serve as a deterrent to future tax evaders.

The findings indicate that the relationship between the taxpayers and the tax authority is generally poor. As the informal sector taxes are mostly administered using tax collection officers, as in the case of Ghana, a cordial interaction between the field tax officers (tax collectors) and the taxpayers will have a greater influence on compliance decisions.

In some instances, people are reluctant to pay because they do not see the tax officers as honest and question the integrity of the collection process, especially record-keeping. Therefore, the cultivation of a more professional and structured relationship between the field officers and taxpayers could make the difference between higher or lower levels of compliance and evasion. As taxpayers complain of inconsistent treatment, double taxation, and rude tax officials, as indicated in this study, the long-term compliance decisions will be affected as a result.

Another interesting finding (see section 6.7.b. (x). and 6.7.b. (v)) is that people who have a history of giving bribes found their encounter with tax officers good. Therefore, to design an effective tax system for the informal sector, the tax authorities need to appreciate the impact of bribery on compliance decisions and adopt strategies that will mitigate this. For example, rotating tax collection officers could help reduce the incidence of bribery, as it's likely that such (bribery) practices stem from long-term established relationships between taxpayers and tax officers.

⁹² This refers to presumptive tax situations where taxpayers reported they had no money and how officers responded.

The results from the field observation (section 6.6 and table 6.2) demonstrate the significance of the interaction between the taxpayers and the tax officers. For example, during the field trip, the tax officers did not always apply the same treatment for taxpayers who were in the same situation (non-compliance). There were instances of (unnecessary) heated exchanges and personal confrontations. It was noted that most of these situations tend to be with taxpayers who asked the ‘why, how, when and what’ questions, possibly to enrich their tax knowledge in what were not unreasonable ways. Interestingly, the officers responded in diverse ways, and mostly in an aggressive manner. The field officers, based on the evidence from the field trip, adopted the ‘cops and robbers tactic in promoting compliance (Kirchler, 2007). Such actions will not promote long-term voluntary compliance. Although these actions could deter tax avoiders, the balance has to be right in order not to discourage honest taxpayers. Officers must, therefore, be educated to understand which taxpayers require additional information to comply and to distinguish those who are asking for this as a way to attempt to avoid their tax obligations. In these instances, adopting the responsive regulation model as applied by the ATO may be a useful strategy (see detail discussion in four).

7.1.3. Tax revenue usage

The perception of government spending of tax revenue has a profound impact on taxpayers’ compliance decisions. Existing studies suggest that if governments spend tax revenue judiciously; voluntary tax compliance is positively affected (Palil, 2010, p.188; Kirchler and Wahl, 2010).

Tax revenue usage has a direct relationship with tax compliance decisions among the informal sector operators, based on the findings of this study (sections 6.3.a.(ii) and 6.3.a.(v)). Taxpayers stressed the importance of the perception they hold about the tax revenue usage on their compliance decisions. The findings indicate that informal sector taxpayers want direct [visible] benefits for paying taxes, such as the provision of basic amenities e.g. quality drinking water, street lighting, roads, sanitation etc. The absence of these visible benefits increases tax non-compliance. The perception that revenue is easily squandered and that the perpetrators go unchallenged is a big contributor to the non-compliance decisions as the findings suggest. In general, over two-thirds of taxpayers will comply voluntarily and the tax authority will thus spend less on monitoring if the revenue

usage is transparent and the people who embezzle tax revenues are punished appropriately and openly. Tax authorities in developing countries, therefore, need to ensure that there are appropriate checks in place to ensure that tax officers do not embezzle tax revenues, and where they do, they are visibly punished to serve as a deterrent. In addition, tax revenue spending could be earmarked to ensure the transparency of its use. Citizens will be better placed to openly assess how their money is being used. Although the main challenge facing most developing countries is that as taxes are pulled together into a consolidated account, where the greater part goes into debt servicing, the earmarking of tax revenue becomes difficult.

7.1.4. Compliance is through punitive measures – A wishful thinking

Evidence from previous studies indicates that a lack of reliable data (Tanzarn, 2008), the variable nature of informal sector activities (Aryee, 2007), and operators' deliberate attempts to conceal their activities (Russell, 2010) for the purpose of evading taxes, (Andreoni et al., 1998; Feige, 1979) make it difficult to design a tax system which effectively and efficiently captures taxable economic activities (Terkper, 2003) within the informal economy. The results from the face-to-face interviews undertaken with tax officials are consistent with previous studies. This study found (based on tax officials' accounts) that the main challenge to taxing the informal sector more effectively lies in the difficulty of extracting information from informal sector participants. The tax authority has a very limited understanding of the informal sector taxpayers' compliance needs since the data collected for tax system design is not usually done in an organised fashion. During the interviews (see chapter six), the tax officials stated that the informal sector taxpayers are hugely involved during the design phases of taxes specific to the sector. The tax officials indicated that taxpayer representatives are selected and debated upon and vote for any tax before it is imposed. However, there was no information on who qualifies for selection to attend those discussions (apart from the assemblymen/assemblywomen), and when further questions were asked, officers could not give consistent answers regarding the population selected to partake in taxation issues affecting the informal sector. For example, is it the same individuals who are always selected? What business(s) /individuals qualify for selection? What location, income level, gender or age groups are selected? How independent and transparent is the selection process?

How free is the discussion and voting process? What are the consequences for a taxpayer saying no?

The officers who took part in the interviews are not involved in this process and therefore could not give clear answers.

Lack of evidence to support these key questions makes it difficult to measure the degree of involvement of the informal sector operators regarding the issues relevant to them.

Again, this study found the '*chicken-or-the-egg*' dichotomy in relation to the 'lack of information' for taxing the informal sector. The results of the face-to-face interviews with the informal sector operators suggest that a lack of data about taxpayers is equally the responsibility of the tax authorities. The findings point out that the section of taxpayers who have not been complying with their tax obligations attribute this to the lack of information that is specific to their sector or nature of the activity. This confirms with the responsive regulation theory's assumption that there are taxpayers who want to do the right thing, or try to comply, but do not always succeed, so the approach is to make compliance easy, or to assist them to comply using the pyramid of support (see Braithwaite et al., 2007; Braithwaite, 2008; Healy, 2011; Ivec and Braithwaite, 2015; Davidson, 2016). It is on this premise that responsive regulation deemphasizes threats, and instead advocates for support and regulatees capacity building (Ayres and Braithwaite, 1992, p.4).

Again, this study found that the tax authority mainly relies on enforced compliance approaches when taxing informal sector operators. There is minimal effort from the tax authority to discover and capture useful information to help with policy design for the sector to improve voluntary compliance. The strategy is to create compliance through a punitive deterring measure, as a result, the relationship has been mainly the 'cops versus robbers' approach as identified by Kirchler (2007, p.188). This finding supports the previous work by Chiumya (2006) that tax authorities usually find the informal sector unprofitable to tax and as a result do not usually invest enough resources there to gain a better understanding of it. This is despite evidence that the sector's information needs are different and that using the same taxing strategies as the formal sector tends to fail (Aryee, 2007).

Thus, the broader [and often loose] classification of businesses for tax purposes and the lack of appropriate and targeted educational campaigns for the informal sector contribute to low tax compliance rates. Also, the tax authorities in developing countries, need to design appropriate and more representative data collection approaches for the informal sector to

have a better understanding of the sector and its taxpayers' needs for effective tax policy design.

7.1.5. The two dimensions of informality

Prior literature has attempted to define the sector, as per the definitions given in chapter two – the definitions given are usually based on the nature and the aims of the study being conducted.

The findings from this study identify the two main informal sector operators/activities as opposed to the three schools of thoughts (theories) discussed in chapter two – the dualists, structuralists and the legalists. These are categorised as A and B operators in this study (table 7.1) and explained below.

Table 7.1 Type of informal sector operators/activities

<i>Cat A. Fully informal</i>	Cat B. Partially informal
Purely informal/non-registered individuals and businesses. Their main source of income is from the informal sector e.g. most shoemakers, and street hawkers (they tend not to have fixed location for their activity)	Registered [formal] business with arrangements to operate in the informal sector. (i.e. formal businesses operating a branch within the informal market). e.g. registered businesses employing people to sell their products in the informal market (Mostly local drug producers and traditional healers) This category also includes formally employed individuals undertaking undeclared jobs in addition to their formal employment

7.1.5a. Category A – Fully informal

These are the activities of individuals and businesses who operate mainly in the informal sector. These are the operators described in chapter two as the dualists. They operate in the informal sector mainly for their survival needs. There was no evidence from the study to suggest that they engage in the informal sector because of regulations in the formal sector as

suggested by the legalists, or that they are subordinates to formal sector operators as in the case of the structuralist view. Survival needs and a lack of opportunities in the formal sector (for example lack of skills to get jobs in the formal sector) drive these operators to engage in the informal sector.

7.1.5.b. Category B – Partially informal

Category B comprises of businesses which are fully registered and known to the tax authorities. However, they undertake extra activities, mainly by employing individuals who sell products and deliver services on their behalf under informal arrangements, therefore concealing the proceeds from taxes. This may also include individuals who are employed in the formal sector and are subject to PAYE taxes, but with some part-time engagement (for example part-time jobs or businesses) in the informal sector. This finding supports both the *structuralist's* and the *legalists'* views of the informal sector proposed by the ILO (1972), (see chapter two). For example, from the *structuralists'* stance, the informal economy is subordinated to the formal economy. Similarly, the legalists assert that informal economy operation is sometimes the rational response by businesses to over-regulation, high tax burdens, unnecessary bureaucracy and corruption (De Soto, 1990; Kirchler, 2007). The results from the study indicate that high tax rates and corruption are the two most influential factors influencing decisions to operate in the informal sector despite individuals having formal sector engagement.

The tax compliance behaviours of formal sector workers (or business owners) operating in the informal sector was found to be the lowest amongst all the categories of taxpayers interviewed. From the findings (see sections 6.3.ai; 6.3.a.iv; 6.3.a.vii), almost all the operators interviewed who engage in these practices, do not pay taxes on the extra incomes from the informal operations. Some of the reasons provided to justify the non-compliance are that paying taxes in the second activity constitutes double taxation. The high tax rate also influences voluntary compliance decisions. For example, the current tax-free amount (Personal Allowance) is too small (i.e. too high a tax rate on PAYE) from the main employment, therefore there's a 'sense' for concealing the income from the informal sector engagement (see section 6.3.a.vii).

7.1.6. Tax Education and Tax Knowledge

This study assesses the effectiveness of the educational campaigns run by the tax authority on the tax knowledge of taxpayers. Tax education, in this case, is measured by the perception of the taxpayers regarding the tax authority's informative and reminder campaigns, and knowledge is then assessed by the taxpayers' understanding of their tax obligations concerning *what, why, when, how* and *where* to pay.

The findings from this study point out that most informal sector operators believe the tax authorities present messages which are not relevant to their businesses. Thus, most taxpayers believe that tax education message content in the country are usually directed towards the formal sector /big businesses. Those who comply without any tax education, do so because of the actions of the enforcement officers or their moral obligation to do so.

Unsurprisingly, some qualifying⁹³ taxpayers have never paid any taxes at all despite having businesses which have turnovers as high as some businesses in the formal sector. Although some did express their desire to comply, an appropriate tax education to aid compliance decisions is lacking, and the taxpayers are, therefore, not complying as a result.

The interview results from the tax officers appear to potentially contradict the results of the sector operators' as the officers claimed to carry on campaigns targeted at the informal sector taxpayers consistently through a public address (PA) system on vans which go around and give messages, including conveying the messages in different languages alongside regular radio campaigns (section 6.5.6). However, few taxpayers confirm this and stated that these campaigns are mainly run through a few streets, which are within the market areas / ring roads, and most importantly, are carried out within the major cities. Taxpayers not located in these areas do not receive any tailored tax information. To improve tax compliance, substantial tax education and an easing of access to tax information to raise tax knowledge are required. The tax authorities must adopt other mediums such as the radio and TV to broadcast more 'targeted' messages to the informal sector.

One major issue linked to tax education is that almost all the taxpayers interviewed were not aware of how their tax rates are arrived at. The findings from the field observations also suggest that officers do not offer proper education to taxpayers. In this case, not only is tax education required to explain to people about the benefit of tax payment but making the parameters used for determining tax rates also accessible to taxpayers could be equally

⁹³ Qualifying taxpayer here refers to anyone engaging in a taxable economic activity in the informal sector

useful. Tax officers, particularly those in the field, should be trained to have sufficient knowledge to explain to taxpayers about how these indices are used to determine tax liabilities.

Furthermore, the results from the questionnaire data are consistent with both the interview and field observation findings, that the presence of the field officers does not improve the tax knowledge of taxpayers.

The overall tax knowledge of all the study participants could be graded as ‘very weak’. Most taxpayers were unable to explain the very basic details of the tax system that applies to their situation.

The GRA website, which promises to be the information hub for the country’s taxpayers, has very limited useful information for the informal sector. Therefore, updating the website with relevant and up to date information could help educate people about their taxes and how they are determined, which may subsequently raise compliance levels as people become aware of why, what, how and when to pay their taxes. Thus, with the Ghanaian informal sector estimated to be about 80% of the total economic activities in the country (GSS, 2012), the government needs to ensure that the tax education for this sector is specific and the content of the messages is relevant to the sector operators. Information and documents explaining how the presumption tax rates are determined must equally be made available and easily accessible to improve voluntary compliance.

7.1.7. Auditing

The debate surrounding the impact of tax auditing on compliance decisions has been raging for years. However, the influences of perceived audit probabilities and prior audit encounters [with tax authorities] on tax compliance decisions have been somewhat labyrinthine. Some studies have found that there is a positive relationship between auditing and tax evasion whilst other report negative impact (see chapter four).

Results from this study (section 6.2a.(ii)) indicate that the possibility of being audited (detected) and the severity of the fines imposed, influence the compliance decisions of those operating in the informal sector, which appear to be the same way as the examples reported in studies involving formal sector operators. However, the results further suggest that if fines are not high, or if there exists an opportunity to pay bribes to inspectors, taxpayers would

rather pay their way out than comply, which weakens the argument that high auditing probabilities evoke voluntary compliance.

Ghana currently employs several severe punitive measures for non-compliance, which for small businesses and individual includes shop lockdown/closure, stock seizure, taking over debtors' accounts, and the reselling of goods to defray tax liabilities. The results from this study (sections 6.2a. (ii)) indicate that harsh penalties could be extremely effective. The results also suggest that auditing (and associated punishments such as closing shops) creates potential stigmatisation of customers and business partners during heated interactions with auditors/inspectors. Business owners who do not want to face the consequences of such stigmatisation are thus likely to comply.

This suggests that tax policymakers need to ensure that there are effective auditing mechanisms in place within the informal sector. Such audits not only act as deterrent themselves but also should be backed by visible deterring penalties to be even more effective. This is supported by the responsive regulation theory which is built on the premise that it's good to trust taxpayers and support them, however, taxpayers also want officers to keep distrustful enforcement strategies in place to deal with others who cannot always be trusted. Taxpayers need to know that 'there are strong and trusted institutional mechanisms in place to deal with those who cheat builds community confidence and the legitimacy of the tax system' (Braithwaite and Braithwaite, 2001, p.7)

7.1.8. Compliance Process

In this study (see section 6.2a.(iv)), the compliance process is defined to include the actual financial cost, the physical time for filing returns and the psychological (thoughts) of the tax burden.

As seen in section 6.2a.(ix), the financial cost of compliance among the informal sector operators is very low in Ghana, which is one of the current tax compliance determinants in the sector. Tax payment is through field officers who circulate for tax collection/inspection, although there are options to pay at designated tax offices.

Although the findings suggest that the compliance process, to some extent, influences tax payment decisions, some showed concern about paying taxes through field tax officers. As the current process involves negotiations, taxpayers question the 'fairness' of the system, due

to the possibility of giving special treatment to certain taxpayers or those with strong negotiation skills (section 6.3.b.(ii)). All the taxpayers interviewed, confirmed to have negotiated for lower tax rates, at least once in the course of operation. This again raises a concern about trust in the system. Therefore, the intuitive approach (for tax bills) currently being used widely by tax officers for the informal sector must cease, and a formal assessment process must be followed. Thus, to give taxpayers a guarantee of a fair tax rate and equal treatment, the indices used to calculate the presumptive taxes must be clearly explained and information on these must be made easily available to the taxpayers. Such information could be published on the GRA websites (which has virtually no information on these presumptive taxes) and at the local tax offices. Copies of the mode of assessment could also be given to the taxpayers. In this case, the taxpayers, by nature of their activity can assess their rates/liabilities. Alternatively, a ‘self-assessed’ presumptive taxes could be implemented. With this approach, taxpayers, by nature of their activities and the published sets of factors for determining the tax liability, can complete a simplified self-assessment tax return. However, this may not apply to all businesses or individuals, for example, those who subject to the weekly, monthly or quarterly tax stamps.

7.1.9. Low Tax rate

The low level of the presumptive tax rate in Ghana influences the payment decisions of the informal sector operators. This is consistent with previous studies in the formal sector (Clotfelter, 1983; Graetz and Wilde, 1985; Ivanova et al., 2005; Takats and Papp, 2008; Matthews, 2011). The study results (section 8.2a.(ix)) show that some taxpayers will comply voluntarily with low tax rates. This is likely to give misleading information on the true tax compliance behaviour in the informal sector. This is because taxpayers ranked the low tax rate higher [in terms of factors influencing their compliance decisions] than other tax compliance variables such as education and tax knowledge, or auditing which have in the past received greater attention among researchers and policymakers. However, there are also businesses where a higher tax rate will lead to evasion or being completely out of business. The low tax rates must be maintained especially for such small businesses to keep them in the tax net and to make them compliant. Also, by including these small taxpayers, it will promote vertical equity as everyone will be contributing to state-building.

7.1.10. Study findings summary

Evidence from this section confirms that presumptive taxation as currently used in the informal sector, will ultimately to a large extent depend on field tax officers being successful. It is therefore crucial that the tax authorities, in designing informal sector taxation, understand the impact of human interactions on tax compliance. Officers must be properly trained to be firm and also fair when dealing with taxpayers to ensure that, they leave a positive experience with taxpayers. The issue of using ‘key contacts’ in the office to evade or avoid taxes must be crucially looked into. Field officers must be given appropriate channels to report such issues of senior figures influencing tax payments. For instance, whistleblowing, and other forms of checks must be put in place to ensure the work of field officers is not undermined by the influence of corrupt managers in the tax offices.

Considering the size and the nature of economic activities in Ghana’s informal sector (see chapter three), the government must give it a serious attention to be able to tap the huge revenue potential there. The recent introduction of the Taxpayers’ Identification Numbering (TIN) system, where everyone needs the TIN to be able to access most government services is a good initiative, however, this approach on its own will not achieve voluntary tax compliance in the informal sector. For example, an individual can register for the TIN, but may not pay any taxes and will still be able to access such services. The key objective for the tax authority to pursue is sustained voluntary tax compliance in the sector. As the evidence presented in chapter six suggests, voluntary tax compliance in the sector is possible through actions which impact the overall tax environment, for example, influencing the values and beliefs, promoting education and awareness, and building trust and creating a supportive environment for taxpayers. More specifically, the following factors could help promote voluntary tax compliance in the informal sector;

- good and targeted tax education
- fair, transparent and consistent billing system
- doing visible things with the tax revenue, especially what benefits the informal sector taxpayer
- enhancing taxpayer and tax authority relationships – a more customer service approach to dealing with taxpayers.

- doing more to publicize what the tax authority already does with tax revenue
- openly punishing tax evaders and state officials who embezzle tax revenue etc...

These factors, among others, will help create trust with the tax authority which will subsequently manifest into voluntary compliance.

The next section uses these findings, the underlying theory, and existing literature to find answers to the research questions.

7.2. Part B – Research questions

This section presents the research questions designed for the research in relation to the existing literature and discusses the implications of the findings from the study.

7.2.1. RQ1

Are there more effective ways to tax informal economic activities in developing countries than are currently employed?

Results from the study indicate that the current taxing strategies for the informal sector have a number of challenges, and where they appear to be effective, is mainly due to high auditing rates, and a low tax rate which people find ‘too small not to pay or challenge’ (section 6.2a.(ix)).

There are clear indications from the results presented in this study that presumptive taxation, for example, lump-sum tax is very unpopular among informal sector taxpayers, even though this is the most widely used mechanism to tax the informal sector (Engelschalk, 2005, p.5). This study shows that most taxpayers do not approve of the current system partly due to the high degree of the power vested in the collection officers who tend to abuse such powers by offering favourable treatments to certain taxpayers.

In addition, Ghana operates a very complex tax system and does not define clear stages for moving taxpayers across to a formal or a different segment of the presumptive tax system (see chapter six). In most cases, turnover is used as the basis of moving taxpayers from presumptive taxation, and professional businesses that could easily keep books and may want to voluntarily opt for self-assessment, for example, are not allowed to do so.

The resulting impacts are that taxpayers who feel their rates are unfair tend to pay bribes to avoid or evade the tax payment completely.

Most existing strategies of taxing the informal sector adopt the ‘cops and robbers’ approach (see discussion in chapter four), by using more punitive and harsh deterrent mechanisms to force compliance. With these strategies, there is little or no consideration of the taxpayer when designing the approaches. This means that the tax authority misses vital taxpayer group-specific characteristics that could influence compliance decisions, and which when taken into account could lead to a continuous and sustained voluntary compliance. Such approaches have limited effects, and do not in the long term, cultivate voluntary compliance behaviours among taxpayers.

This approach could partly explain the low level of tax compliance in the informal sector. Most current tax codes are complex and often ambiguous as in the case of Ghana, therefore using a command-and-control approaches (especially in a country with such a high illiteracy rate) do not promote long-term voluntary compliance, hence the best approach is by adopting a responsive regulation approach where the taxpayer commits to understanding taxpayers and designing support or sanctions accordingly (Ayres and Braithwaite, 1992).

It is therefore vital that the tax authority embraces a more customer service approach to build trust and a positive relationship with the taxpayers.

The informal sector taxation system in most economies, particularly those employing the same system as Ghana’s fixed/lumpsum system, could have more effective ways not only to increase revenue but to promote future voluntary compliance within the sector. For example, where the presumptive system is to be used in this sector, defining a clear tipping point where taxpayers are moved over to a new tax structure would be ideal. Effective tax education to enrich taxpayers’ knowledge would undoubtedly also improve voluntary compliance. Treating all taxpayers as ‘potential evaders’ and adopting a strict and less accommodating strategy could have a negative impact on those taxpayers who have no intention to evade or avoid taxes. Therefore, adopting a system which awards, recognises and supports honest taxpayers, such as the ATO’s Responsive Regulatory System (Ayres and Braithwaite 1992, p. 5), in the informal sector would provide more positive results than the current strategies. With this approach, the tax authority commits itself to investigation and taking into consideration the issues, motivations, and circumstances of the taxpayers (Leviner, 2008, p.369). As observed earlier, using this strategy, the tax authority resorts to situation-specific approaches to tax regulation by adopting a total

commitment to assisting the taxpayers in their compliance efforts, and to force compliance across the board, even when the taxpayers are highly defiant (Ayres and Braithwaite 1992, p.35–40 and 47–51)⁹⁴. Although adopting this model for a developing country would be costly and the tax authorities may end up collecting taxes only to fund an expensive system. However, the tax authorities in these economies could adopt a similar system which recognises the effort of honest taxpayers and provides the required support whilst openly punishing those who evade taxes to serve as a deterrent to potential evaders. This strategy would work better with improved trust and a positive relationship between taxpayers and the tax authority.

In addition to adopting a dynamic approach to taxing the informal sector, bringing the tax office to the taxpayers (for example, creating small collection offices in market places) could be very useful as this will help reduce tax avoidance /evasion. Due to the frequency of the tax payment in most presumptive taxation systems, for example, daily, weekly or monthly payments, travelling a distance to tax offices [to make small payments] may discourage voluntary compliance and therefore establishing a sub-tax office (or a tax kiosk) could be useful for busy taxpayers. The taxpayers in these situations are also able to go to these ‘sub-offices’ not only for payment but for advice. In addition, as observed in this study, allowing taxpayers who have reached a stipulated threshold and also professional businesses to file formal assessments will be appealing (see section 6.6.9.c). For instance, it would not be effective to allow professional businesses which can keep proper accounts (e.g. guest houses, travel and tour operators etc.) not to file for formal assessment, and rather tax them on presumption because they exhibit certain characteristics which are within the presumptive approach such as location of business or number of employees. Therefore, not only the physical locations, the number of employees or the turnover, but also the nature of business should be used to move businesses out of the presumptive system. Simply, individuals and businesses, which demonstrate the ability to produce good accounts, may be considered for formal assessment (see section 6.6.9.c), as this will reduce the administrative costs of the tax authority (see section 3.5.2) on restrictions for formal assessment).

⁹⁴ Cited in Leviner, (2008, p 369)

7.2.2. RQ2

To what extent does the relationship between a taxpayer and the tax authority shape voluntary compliance?

The taxpayer and tax authority relationship defined in this study as the Past Tax Interaction Influence (PTII,) is the outcome of the previous interaction(s) between the tax officers from the tax authority and the taxpayers (6.3.b.(i)). The PTII includes the support, cooperation, fairness and attitudes of the tax officer towards the taxpayer and the resulting taxpayer's perception/response to the officer or the situation in the form of compliance or otherwise.

Different studies have shown that a strong relationship exists between tax compliance and tax authority interactions in the formal sector, for example, (Richardson and Sawyer, 2001; Loo and Ho, 2005; Torgler and Valev, 2007). The results of this study are consistent with these findings. The results indicate that taxpayers in the informal sector are more likely to comply voluntarily in the future if their previous interaction with the tax authority was good (sections 6.3.b.(i); 6.7.c.(iii)). The results from the composite scores (section 6.7.c.(iii)) indicate a strong relationship between previous tax authority encounters (i.e. relationship) and future tax compliance.

This outcome can be explained using responsive regulation which holds the notion that compliance is achieved through mutual trusts between taxpayers and tax authority and a conscious desire for corporation between the two, and where the regulator has the authority to own up to its administrative responsibilities and explore different ways to manage this relationship (Demin, 2018, p.17).

The evidence of this study thus suggests that with a positive previous interaction (encounter), taxpayers are more likely to comply in the future. It is therefore advisable for the tax authority not to adopt a generalised response to dealing with all taxpayers in the informal sector. By adopting a responsive regulation approach, the tax authority can tailor supportive measures to help virtuous and committed taxpayers, whilst employing deterring measures such as regular audits and fines for the capitulative compliance group. Finally, those taxpayers who are disengaged can be subject to strong deterrence measures such as heavy fines, license revocations or prison terms to discourage future evasion practices.

The current approach employs more of enforced compliance across the board (see (sections 6.2a.(iii), 6.3.b.(i)), thus ignoring the support needs of honest taxpayers. In this case, as suggested (see section 7.3.1), adopting the responsive regulation model to support and

reward honest taxpayers whilst punishing defiant taxpayers to serve as a deterrent for potential future evasion behaviours, would be a good objective to pursue.

7.2.3. RQ3

To what extent does moral obligation contribute to the tax compliance decisions of the informal sector operators?

As discussed earlier, most recent studies in tax compliance look at the taxpayer not as a utility maximiser, but as one whose compliance decisions are shaped by an intrinsic drive to do so. For example, studies by Kirchler (2007), Frey and Torgler (2007), Pope and McKerchar (2011), Alm and McClellan (2012) all found that tax compliance decisions cannot be only explained by the economic deterrent variables. However, each of these prior studies was conducted within a formal sector setting.

Among all the tax compliance variables analysed for this study, moral obligation appeared the highest determinant of tax compliance decisions among informal sector operators (see sections 6.2a.(i), 6.2.10 and 6.8.0).

This study supports previous findings that taxpayers in the informal sector, just like those in the formal sector have the moral drive to comply with their tax obligation and do not comply purely by the impact of auditing and other punitive measures as previous studies suggest (see sections 6.2a.(i) and 6.2.10). This also supports a study by Alm (2013), that even in the formal sector the percentage of taxes which are subject to thorough audit is often under 1 percent of all returns, and where people are caught for tax avoidance, the penalties are not often visibly imposed so are only known to the tax authorities and may not be substantial enough as a percentage of the tax evaded to discourage tax crimes (Alm, 2013, p.4). This refutes the models and theories treating the taxpayer as a utility maximiser, who weighs up the economic benefits of successful evasion. Considering the informal sector and the ease of concealing taxable activities, the current level of compliance cannot be explained by only punitive and deterring measures. The study results indicate that in complying with tax obligations, taxpayers in the informal sector are equally influenced by the same level of moral obligation as those in the formal sector.

This implies that adopting more auditing and punitive measures to influence compliance will be unpopular among most taxpayers in the informal sector. Most of these taxpayers (i.e. those with high tax morale) will, therefore, need factors which will encourage them to comply with their taxes, suggesting that the responsive regulation theory's pyramid of support will be useful compliance strategy for the informal sector. Other factors such as responsible tax revenue usage, ease of access to tax information, open and transparent billing, support from the tax authority, etc. will all play vital roles in promoting voluntary compliance among the informal sector operators. This also suggests that the tax authorities need to ensure that enforced compliance is applied carefully, and not across the board. Although not all taxpayers may prefer enforced compliance approaches, people would want to see enforced compliance approaches to deal with tax evaders to bring trust in the overall system and also to influence taxpayers' perception towards the tax authority's ability to use its powers.

7.2.4. RQ4

How effective is presumptive based taxation on informal sector operators' compliance decisions?

Presumption taxation is by far the most common form of taxing the informal sector in most countries (Stern and Ahmad, 1991, p.276; Makedonskiy, 2005). The reason for its popularity, as observed in chapter two is mainly due to the high tax collection costs for the sector, capacity constraints, and incentive constraints. This question (RQ5) assesses the effectiveness of the strategy in taxing the informal sector from the perspective of the taxpayers.

The findings from this study indicate that over half of the informal sector operators are not in favour of presumption taxation as it currently exists in Ghana (see sections 6.3.b.(ii) and 6.7.b.(viii)). The main reasons for the dislike are a lack of understanding of the indices used to determine the presumption tax rates as noted earlier and the use of the intuitive approach where field tax officers could decide, at their discretion, one's tax liabilities instead of the use of the formal presumptive system (see section 6.3.b.(ii)).

The study found that presumptive taxation in the informal sector is likely to fail where the system is not well explained and the process for deciding the coefficients and indices upon

which the presumption rates are determined, are not communicated properly or are non-existing.

As it stands, the presumptive system currently being applied in Ghana is not effective as a majority are against it. People who currently comply do so due to the low rate or high auditing probabilities within the area where they operate (see sections 6.2a. (ii) and 6.2a. (ix)). This implies that an increase in tax rate or a reduction in auditing could result in a substantial reduction in tax revenue.

To ensure the effectiveness of the presumptive tax system within the informal sector, the tax authority needs to ensure that the system (the basis of the presumption) is well communicated and centrally planned. Also, clearly defining the basis of the presumption and adopting a consistent billing approach will reduce the power and corrupt practices of the field tax officers. This will further bring confidence in the system and therefore improve voluntary compliance.

7.2.5. RQ5

What social/demographic variables influence tax compliance in the informal sector of developing economies?

The prior literature within the formal sector (see section 5.6.2) shows that demographic variables have a profound impact on tax compliance. For example, in analysing the relationship between gender and tax compliance, Richardson and Sawyer (2001), Frey and Torgler (2004) and Torgler and Valev (2007) all found women to be more compliant.

The results of this study indicate that women are less likely to give bribes in presumptive taxation environments (see section 6.7.b.(iv)). Given the opportunity, men are more likely to pay bribes to tax officials than to comply when there is limited tax education in the system, suggesting that women are more compliant than men. This implies that for an effective system, the discretionary presumptive tax approach as being currently applied in Ghana needs to be replaced with a formal presumptive system where the basis of assessment is open and transparent. To positively influence male taxpayers, the tax authority could adopt strategies which are indirectly geared towards them, for example, using male models in tax adverts.

Age, according to Torgler (2003, p.358) also has a significant influence on tax compliance decisions, with younger taxpayers (under 29 years) more likely to evade taxes. Contrary to previous findings (such as Ritsema et al., 2003; Richardson and Sawyer, 2001; Devo, 2005), this study supports Feinstein, (1991) that age does not have any impact on the compliance decisions among informal sector operators. Therefore, having age-specific provisions within the tax system may not have any positive impact on overall tax compliance levels in the informal sector.

The results also suggest that marital status influences peoples' compliances choices with married people (particularly women) exhibiting the highest level of tax morale. This mirrors the findings from a study by Torgler, (2003, p.224).

Since the current presumptive system in Ghana (just as in many developing economies) is administered through field officers and is coupled with the issue of bribery, the tax authorities need to ensure that potential opportunities which may evoke bribe payments are addressed. For example, constantly rotating⁹⁵ tax officers between zones, or openly publishing the indices used to determine the tax liabilities could all help reduce bribery and corruption.

Also, those officers and individuals who engage in bribery and corrupt activities should be openly punished to serve as a deterrent to others and to build confidence within the system.

7.2.6. RQ6

What are the impacts of increased auditing mechanisms on voluntary tax compliance by informal sector operators?

The results from this study indicate that the possibility of being audited (detected) and the severity of the fines imposed, influence the compliance decisions of those operating in the informal sector (section 6.2a.(ii)). This mirrors the results reported in studies involving formal sector operators (Kirchler and Wahl, 2010; Murphy, 2008). It is less clear whether this strategy will aid long term voluntary compliance (see section 6.2a.(ii)) and is subject to decreasing motivation potentially as each period passes without any auditing or as taxpayers fail to see audits being imposed on their peer groups or on those they see to be tax evading.

⁹⁵ Although officers admitted during the tax officers' interviews (see chapter six) that they are rotated, they confirmed that this is not so frequent.

To discourage future evasion practices, the tax authorities need to ensure that those who evade taxes are punished openly with a fine which is much higher than the tax evaded for it to serve as a deterrent.

Interestingly, the study finds that regardless of the nature of the fines, if there exists an opportunity to pay a bribe, there are a group of taxpayers who would rather pay their way out than comply with the tax assessment received. In the same way, taxpayers who have a history of giving bribes during tax audits are less likely to comply in the future. (see section 6.7.b.(x)). This further weakens the argument that high-auditing probabilities evoke voluntary compliance as suggested in many previous studies (Allingham and Sandmo, 1972, p.330; OECD, 2004; Kirchler and Wahl, 2010, p.3).

Increased auditing, which Kirchler (2007) described as a cops and robbers approach has the tendency to create a hostile environment between the agents (taxpayers and tax authority). This suggests that administering informal sector taxation with only visiting officers as the sole collection method may be less effective. Thus, the possibility of bribery and the associated lack of trust in the system because of the possible abuse of tax officers' discretionary powers could impede voluntary compliance. This is because a high level of human interaction could create corrupt behaviour. Allowing alternative (and less human interaction) methods such as mobile payments could help reduce the incidence of corruption. In addition, to reduce the level of corruption and the discretionary powers exercised by the tax officers, adopting a modified presumptive system could be more effective. For example, a self-assessed presumptive tax approach where the taxpayers undertake a self-assessment (based on the indices determined by the tax authority) and forward to the tax authority how much tax is to be paid (see section 6.6.a). The tax authority, in this case, could use the tax officers only for monitoring purposes to ensure that what taxpayers have declared on the assessment forms complies with their business activity and turnover. Also, adopting mobile money for tax payment takes away the 'middlemen' role played by the field officers which breeds most bribery and favouritism practices.

Finally, imposing heavy fines on taxpayers who bribe officers as well as openly punishing tax officers who engage in bribery and favouritism could also help reduce the incidence of losing tax revenue through these practices.

Having discussed key findings from this study and answered the research questions, the next section of this chapter takes a critical view of the key findings and link them to responsive

regulation to offer insight into the practical application of this approach to informal sector tax administration.

7.3. PART C - Applying Responsive Regulation in Ghana's informal sector

As results from this study indicate, the responsive regulation approach is by far the best approach to dealing with the huge informal sector tax non-compliance. This supports previous work by Ventry (2008), Book (2009), Leviner (2009), and Holmes (2011). Since key information about the taxpayer's business is barely known, using the conventional harsh and often punitive/deterring measures will be less effective, as study evidence in chapter six suggests.

As shown in section 6.7.c. (iii), central to responsive regulation theory is regulatees trust in authority. Thus, responsive regulation is built on the assumption that trust (by high morale taxpayers) in authority will automatically lead to compliance. Therefore, for improved tax compliance in Ghana, the tax authority must take practical steps to build such trust. Also, as advised by Ayres and Braithwaite (1992) for improved compliance, the tax authority should understand the taxpayers' specific compliance needs, for example, the high illiteracy rate among the Ghana informal sector operators (see section 1.2, 2.5 and 5.8).

Also, as observed in section 7.1.1., taxpayers in the informal sector have high tax morale and therefore adopting an approach that rewards honest taxpayers whilst making sure there exist a system that will deal with dishonest taxpayers will also help promote compliance as observed by Braithwaite and Braithwaite (2001, p.7).

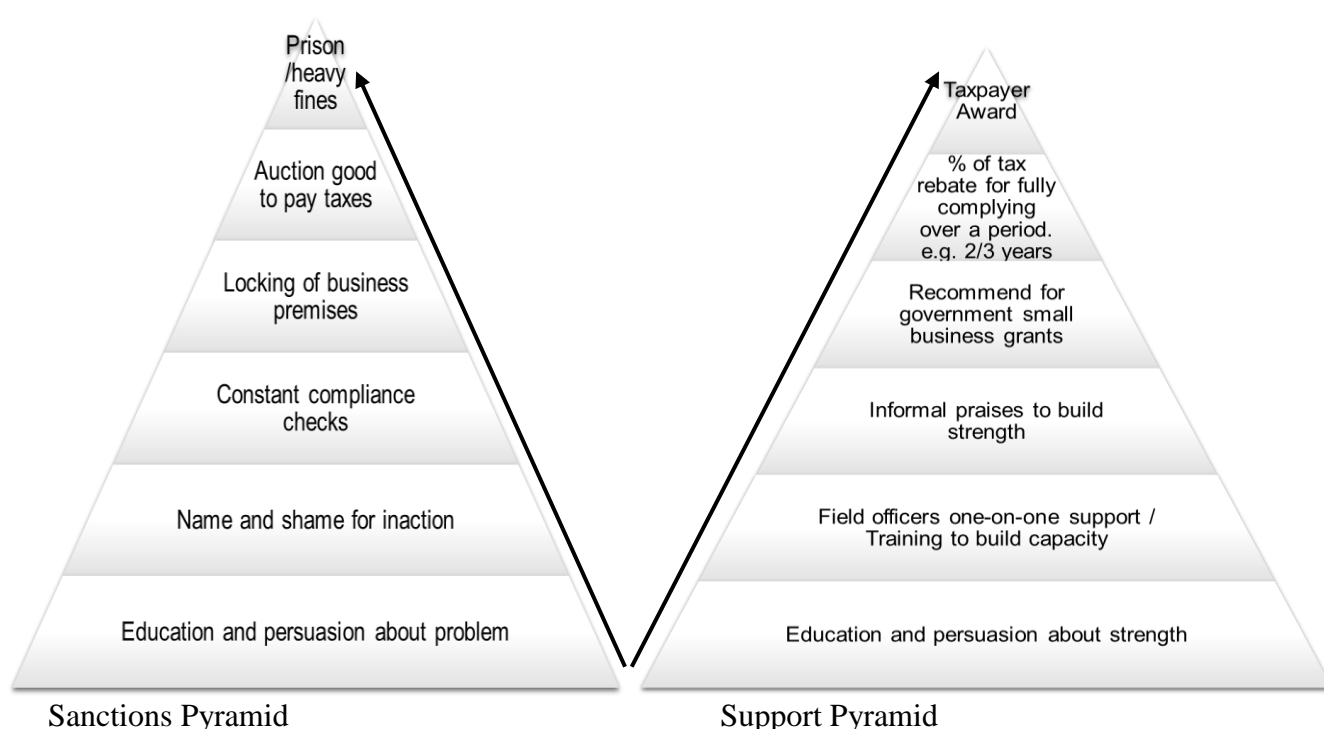
Furthermore, both the interview and the statistical analysis suggest low tax knowledge among the taxpayers – thus, there are taxpayers who want to do the right thing (comply) but are not supported (see section 7.1.4), therefore the responsive regulation with its pyramid of support will be very useful in building relationship and promoting long-term voluntary compliance whilst maintaining the sanctions for other taxpayers.

In summary, Ghana's informal sector taxation challenges could be partly addressed by adopting a responsive regulation approach. As it stands, the GRA has penalties and sanctions for non-compliance taxpayers, but there is no recognition for those in the informal sector

who are compliance, although there exist the Annual Taxpayers' Awards⁹⁶ and the Ghana Club 100⁹⁷ to recognise corporate taxpayers.

A model of responsive regulation approach encompassing the pyramid of sanctions and pyramid of support for Ghana could take the form as shown in figure 7.1 below.

Figure 7.1 Applying Responsive Regulation in Ghana's informal sector with Support and Sanctions



Source: Author's recommendations

As shown in the figure above, the tax authority could balance support and sanctions to respond to different taxpayer compliance behaviours in the informal sector. As the results of this study (see chapter six) suggest, there is high tax morale in the informal sector, indicating that a significant proportion of informal sector operators want to comply. Based on the data

⁹⁶ See link of most recent awards <https://bit.ly/2XGQpET>

⁹⁷ The Ghana Club 100 (GC 100) is an annual compilation of the top 100 companies in Ghana to give due recognition to successful enterprise building and was launched in 1998 by the Ghana Investment Promotion Centre (GIPC). The GC 100 is about corporate excellence, across all aspects of the organisations, but tax clearance (full tax payment) is the key requirement to be nominated and it's organized by the GIPC with the GRA. See link: <http://gipcghana.com/about-gc-100>

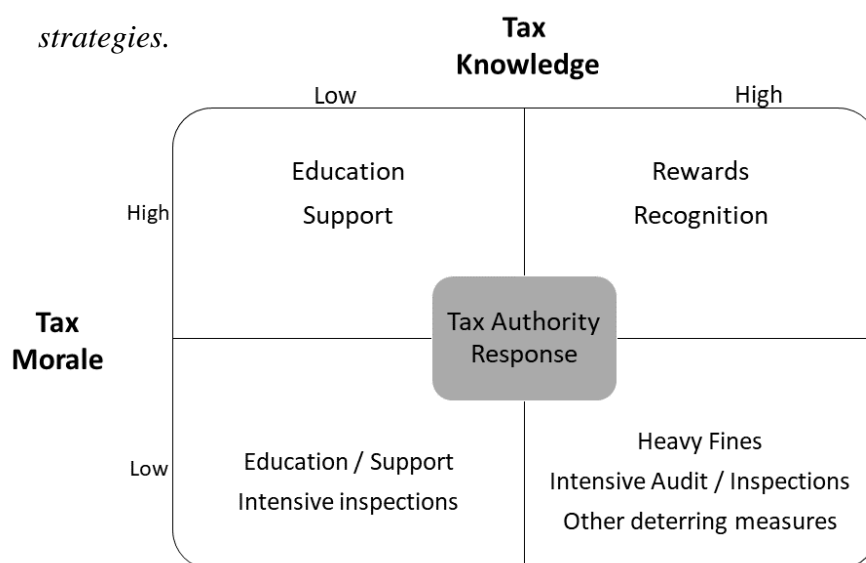
analysis. And the two pyramids above, these taxpayers can be split into two with each given different responses to enhance compliance;

7.3.1. High Morale and High Knowledge Taxpayers - These are the ‘ideal taxpayers’ that the tax authority spends less on in terms of administration. They must be recognised and rewarded to ensure sustained compliance. This group represents the ideal taxpayer group, and they must be kept satisfied to help enhance revenue and encourage other taxpayer groups to improve their compliance behaviours.

7.3.2. High Morale and Low Knowledge Taxpayers - These are taxpayers who have the desire to pay but are constrained by weak tax knowledge. They must be educated about what, why and when, and must be supported on how to comply. For example, tax officers could provide one-to-one support [to illiterate taxpayers] on how to comply, whilst providing general tax education to improve their tax knowledge.

Apart from these two taxpayers, the analysis in chapter six also suggests other taxpayer groups, based on their compliance postures – Low Morale and High Knowledge, and Low Morale and Low Knowledge Taxpayers. By using the responsive regulation approach (i.e. the support and sanctions pyramids above), the tax authority could adopt several approaches, see figure 7.2 below, to deal with these taxpayer groups.

Figure 7.2. Informal sector taxpayer types and recommended responsive regulation strategies.



Source: Author's recommendations

7.3.3. *Low Morale and High Knowledge Taxpayers* - These are taxpayers who clearly understand the taxes but may opt to evade or under-report, or in the case of those subject to presumptive taxes, they may under-declare their assets to pay low presumptive tax rates. These taxpayers tend to increase the administration cost of the tax authority. For this group, the tax authority must adopt strong enforcement/detering measures such as regular inspections and heavy fines (or imprisonment in extreme cases).

7.3.4. *Low Morale and Low Knowledge Taxpayers* - This may be taxpayer group who have no interest in paying taxes and therefore unwilling to understand the tax laws. Adopting a mixture of education (to improve knowledge) and enforcement (to improve compliance) measures could be useful.

7.4.0. Summary

The findings from this study show that there are several factors which influence the compliance behaviour of the informal sector taxpayer – which are mainly the same as those affecting formal sector taxpayers. The constant taxpayer-tax authority interactions, as in the case of the current presumptive taxation system in Ghana imply that having a good previous interaction could positively influence taxpayers' compliance decisions.

The informal sector has huge revenue potential which could be a good source of domestic resource mobilisation for developing countries if appropriate steps are taken, for example, good and targeted tax education, fair and transparent billing with a clear and published basis of assessment, enhanced taxpayer-tax authority relationships, effective and visible evidence of tax revenue usage, etc.

As found in this study, not all taxpayers in the informal sector are motivated by the economic benefits of evasion, therefore adopting a blended strategy as outlined in the responsive regulation theory could have a strong impact. In this case, honest taxpayers are rewarded and supported (using the pyramid of support) whilst those who evade are punished, for example with heavy fines to deter future tax evasion practices (using the pyramid of sanctions).

Finally, a discretionary presumptive tax system breeds corruption and the abuse of discretionary powers by tax officers. This tends to lead to a lack of trust in the tax system

which subsequently (and negatively) influences compliance decisions. As suggested in this section, adopting a modified presumptive tax system where taxpayers could do self-assessment or where all the basis of assessment are published and are available for taxpayers could help reduce the abuse of such discretionary powers. In the same way, openly punishing people engaging in corrupt practices would bring confidence in the system which will influence long-term voluntary tax compliance.

CHAPTER EIGHT

CONCLUSION

8.0. Introduction

This chapter presents the conclusions drawn from the study which are based on the findings in relation to the research objectives.

As observed throughout this thesis, taxing economic activities in the informal sector poses significant challenges to all tax authorities whether in developed, emerging or developing economies. However, authorities in developing countries are exposed to an even more difficult challenge due to a lack of data about informal sector operators and their activities which is seldom available in sufficient detail. Tax avoidance and evasion are very high among operators in the informal sector, and any attempt to make them compliant with the tax laws tends to be very difficult, costly and some authorities see it as unprofitable to undertake tax compliance programmes. What fuels this low tax compliance rate is the fact that most operators in this sector are illiterate, operate on small scales, and keep little or no formal records. Unlike the formal economy where tax avoidance dominates tax non-compliance strategies (Garman and Forgue, 2009), individuals and businesses, especially small scale enterprises operating in the informal sector, normally resort purely to illegal practices to escape taxation (tax evasion) (Tooma, 2008). They avoid taxes by mainly concealing taxable economic activities from the authorities.

In response to these challenges, and in an attempt to bring these taxpayers (informal sector operators) into the tax net, many tax authorities, particularly those in developing countries use a presumptive form of taxation as this study and previous studies (Stern and Ahmad, 1991, p.276; Makedonskiy, 2005; Brautigam et al., 2008) suggest. This form of taxation has the advantage of reducing the administrative costs to the tax authorities as well as the compliance cost of the taxpayers (Tanzi 1985, p.235; Terkper, 2003, p.230). However, this comes at a cost in terms of avoidance and evasion opportunities, corruption (Terkper, 2003) inequity of application and the promotion of the discretionary power of tax officials (World Bank, 2011).

As noted earlier, in previous research on informal sector taxation, the emphasis is on the systems of taxation rather than the ‘taxpayer’ – little is thus known of the tax compliance issues of the informal sector taxpayer. For example, informal sector taxation studies (such as

Khan; 1993; Rajaraman and Bhende, 1998; Pashev, 2006; Shlomo, 2007; Joshi and Ayee, 2008; McKenzie and Sakho, 2010; De Mel et al., 2013; and Joshi et al., 2014), have mainly attempted to find ways of designing effective tax systems or structures to deal with the 'complex' tax environment of the informal sector but attempts to understand the informal sector taxpayers' compliance needs are somewhat limited. Why is this the case? Are informal sector taxpayers influenced by the same key tax compliance factors that are faced by formal sector taxpayers such as (a) intrinsic motivations (tax morale issues), (b) tax knowledge (tax education and general awareness of their tax obligation and how to meet them), (c) Perception of fairness and equity (of the tax system both horizontal and vertical), d) the tax compliance process and cost (d) and tax authority versus taxpayers' interactions (relationship)? By understanding the compliance decisions of the taxpayers in this sector, this study proposes that our understanding of the informal sector operators, and the best way to tax economic activities in this segment of the economy, will improve. Finding an answer to the key question, which most of the existing literature has tried to answer: what is the most effective way to tax informal sector economic activities? - will, to an extent be determined by our understanding of the informal sector taxpayers and their compliance needs.

To make a specific contribution to this gap in the literature, this study, therefore, explored informal sector taxation in developing countries particularly the design of informal sector tax systems and the key factors which influence the compliance decisions of the sector operators. Using three forms of data collection techniques, the study provides evidence to develop the existing literature about informal sector tax compliance.

The evidence from this study was gathered from a developing country context (Ghana). Ghana shares several key characteristics with other developing countries especially in the area of taxing economic activities (Nielsen, 2011). The country's stable economic and political environment implies that the results may be useful to, or comparable with, countries at the same level of development.

The study adopted Ayres and Braithwaite's responsive regulation theory to help interpret the results and to explain how responsive tax compliance strategies positive interactions between taxpayers and the tax authority shapes compliance decisions.

Using interviews, survey responses, and observation techniques, the study assesses the tax compliance determinants of informal sector taxpayers, particularly the influences of intrinsic

motivations, tax knowledge, tax education, fairness and equity issues, as well as the impact of the tax authority versus taxpayers' interactions on compliance.

This chapter summarises the results of the study, and how it can be useful to Ghana and countries of similar economic standing. It also outlines the contributions made to the knowledge on informal sector taxation, details the limitations of the study and proposes various areas for future research.

8.1. The key evidence which came out of the study

The study provides evidence that tax revenue usage has a particularly strong influence on tax compliance decisions among the informal sector operators. The results point out that visible benefits of tax payment are a very powerful determinant for future compliance decisions. The findings indicate that informal sector taxpayers want direct (visible) benefits for paying their taxes, such as the provision of basic amenities e.g. quality drinking water, street lighting, roads, sanitation, etc. The absence of these visible benefits significantly increases the likelihood of tax non-compliance rates among informal sector taxpayers. The study asserts that visible government spending of tax revenue is positively correlated with voluntary tax compliance in the informal sector (see sections 6.2a.(viii), 6.3.a.(v)).

The perception which taxpayers hold about the tax authority has a direct relationship with their compliance decisions from the evidence gathered in the survey data of this study (see section 6.7.b. (iii); 6.7.b. (iv); and 6.7.c. (iii); and 6.7.b. (v)) The more positive the perception taxpayers hold of the tax authority, the higher the voluntary compliance level, therefore reducing the cost of tax administration particularly in the areas of monitoring and detection. This evidence indicates that tax authorities using more enforced compliance strategies generate higher negative perceptions and lower levels of trust among taxpayers.

Furthermore, the study suggests that low tax compliance in the informal sector is partly due to the low level of trust taxpayers have in the state. Relating these results to the 'trust' as described in the responsive regulation theory, the low trust in authorities is linked to the general perception and opinions held by taxpayers that tax revenue is not used for the common good by the tax authority which negatively affects compliance decisions (María-Dolores et al., 2010; Kirchler et al., 2010). This also correlates with the evidence from existing national and international tax compliance studies which employ different

methodologies, for example, interview research (Lavoie, 2008), Survey (Murphy, 2004; Torgler and Schneider 2005) and an experimental study (Pitters et al., 2007), which all conclude that trust is positively correlated with tax compliance.

Lack of appropriate tax education particularly on how tax rates are determined (in the case of presumptive taxation, the indices used to determine the tax liability) has a significant influence on compliance. This is evidence from the practical application of responsive regulation in Ghana (see section 7.3) which suggests that there are taxpayers who have the desire but may lack the relevant tax knowledge to comply. This study finds that most informal sector taxpayers who avoid/evade taxes do so at least in part due to a lack of understanding of how their tax rates are determined and a lack of information about how to challenge tax authority decisions. The evidence from the study suggests that the tax authority's tax education campaigns mainly target the formal sector or mostly are too general and not specific enough to address the particular needs of those in the informal sector.

Furthermore, the study provides additional evidence that moral obligation is the most important determinant of tax compliance decisions by informal sector operators. The intrinsic motivation, the feeling of citizenship, and the desire to contribute for the state benefits enjoyed rather than high auditing probabilities and heavy fines are what influence the compliance decisions of most taxpayers (see section 6.2a.(i), 6.2.10, and 6.7.c.(i)). In other words, informal sector taxpayers are influenced in the same way as the other taxpayers in the economy and tax compliance determinants such as tax morale, tax education/knowledge, perception of fairness and equity all play a significant role in the compliance decisions of the sector operators. For example, studies by Kirchler (2007), Torgler et al. (2007), Braithwaite, (2009), Pope and McKerchar (2011). Alm and McClellan (2012), and Modugu et al. (2012) all conclude that economic deterrent approaches cannot on their own help explain tax compliance, rather the taxpayer's free will about the need to contribute to society as a responsible citizen is also needed to complete the full picture in describing the compliance level found. Interestingly, an existing study on informal sector taxation tends to emphasise the 'system', rather than the taxpayer, and this has not aided our understanding of the sector operators. The findings from this study, therefore, suggest that understanding the taxpayers and their compliance needs is equally important in promoting voluntary tax compliance within this sector in the long term.

This study also finds that voluntary tax compliance among informal sector taxpayers is directly linked to the cost of compliance. The lower the cost of compliance, the higher the compliance levels, and vice versa. This evidence supports the current presumptive tax approach used by the Ghana Revenue Authority and other countries where tax officers are sent out for the tax collection in the informal sector, resulting in little compliance cost (see 6.2a.(iv)).

Furthermore, this study's results point out that individuals and businesses with lower incomes prefer formal assessment methods compared to those with higher incomes. Businesses with higher receipts (based on the results), tend to favour the lump sum presumptive based taxation which gives fixed tax liability regardless of profits. On the other hand, small businesses favour formal assessment, as these individuals and businesses believe it will take them completely out of the tax bracket whilst larger ones believe a formal assessment could increase their tax liability.

Overall, the results from this study suggest that most taxpayers in the informal sector will often prefer presumptive taxation to formal assessment, but with some modifications. For example, a system which allows the taxpayers to 'self-assess' using a published set of indices for determining the amount of tax liability. In addition, presumptive taxation with a limited influence of field tax officers appears popular mainly due to the amount of discretionary power exercised by the tax officers within discretionary presumptive tax regimes as in the case of Ghana. As discussed in section 6.7.b(viii) taxpayers who prefer the current presumptive system do so mainly due to the low rate, simplicity, and the low compliance costs. However, these factors will not sustain the tax system, since they are not supportive of a long term voluntary compliance building strategy. For example, a small increase in the tax rate or a slight rise in compliance costs could see a disproportionate decline in tax revenue.

The study finds no relationship between demographic variables such as age and religion on tax compliance in the informal sector. Although during the initial interviews some respondents related their tax compliance decision to the tithe payment at church, which is voluntary. However, other variables such as marital status and gender show a degree of association with tax compliance. Women are found to be more likely to be compliant to their tax obligations than men, and married individuals, especially women, are less likely to evade or avoid taxes.

8.2. The results of this study compared to the findings of other studies

The study provides evidence that is contrary to some of the existing literature on informal sector taxation, (for example Aryee, 2007). The informal sector taxpayers in Ghana are found not to be as different from formal sector taxpayers in the economy as other studies suggest and are influenced by the same tax compliance variables. These results suggest compliance strategies targeting the informal sector should not only be limited to the system or structures of taxation. Tax morale and other factors influencing compliance which are found to be effective in the formal sectors will be effective in developing compliance in informal sectors.

Evidence from the study contradicts the findings from tax compliance studies, for example, Ritsema et al. (2003), Richardson and Sawyer (2001) and Devo (2005), which suggest that age has a significant relationship with tax compliance. This study refutes this assertion and instead confirms Feinstein's (1991) findings that age does not have any significant impact on the tax compliance decisions of informal sector operators.

The findings of this study are, however, consistent with existing literature in that marital status influences people's tax compliance choices with married people (particularly women) exhibiting the highest level of tax morale and subsequently compliance. This confirms previous studies (Richardson and Sawyer, 2001; Frey and Torgler, 2004; Torgler and Valev, 2007) which found that women are more likely to comply with taxes than men.

Furthermore, the findings from this study suggest that the possibility of being audited (detected as non-compliant) and the severity of the fines imposed, influence the compliance decisions of some of the operators of the informal economy, the same way as reported formal sector studies (see Kirchler and Wahl, 2010 and Murphy, 2008). However, the influence of these strategies tends to be short-lived, making them a less useful tool for promoting voluntary compliance within the informal sector in the long-term. Although further analysis confirms that if fines are not high, people are less likely to comply.

On tax revenue usage and its impact on tax compliance, the findings from this study are also consistent with those of recent studies on tax compliance which suggest that if governments spend tax revenue judiciously, voluntary tax compliance is positively affected (e.g. Palil, 2010, p.188; Kirchler and Wahl, 2010).

Tax morale is found to be a strong determinant of tax compliance in the informal sector. This finding supports the work by Frey and Feld (2002); Torgler (2002); Kirchler (2007); Pope and McKerchar (2011) who collectively illustrate that most people comply with their tax

obligations due to their intrinsic drive (moral obligations) rather than being solely driven by external compliance forces.

8.3. Presumptive taxation – A modified approach

The presumptive taxation approach as it's currently being applied in Ghana's informal sector, faces several challenges, although there are a number of factors which support the use of the system as an effective tax collection approach in the context faced. For example, with the high level of illiteracy among the informal sector operators, adopting a formal tax system will pose a difficult hurdle if a self-assessment approach is adopted. This will subsequently raise compliance cost as individuals and businesses in the sector may have to pay for the services of tax advisors, which could have a negative impact on compliance decisions.

Evidence from the study indicates that most of the operators of the informal sector in Ghana have very low incomes. With 57% of the respondents having a monthly income of GHC500 (i.e. GBP 81)⁹⁸ or less, presumptive tax is by far the ideal option as a formal assessment is not feasible. A formal assessment may be more expensive in both cost and time to file tax returns and could be unpopular among the informal sector operators. In addition, such an approach may pose administrative challenges, as it may be too expensive to administer by the tax authorities, relative to the revenue generated.

However, many issues need addressing if a presumptive tax system is to be made more effective in the county.

First, before the tax liability is determined, tax officers go around and make a judgment based on the size of the shop/business, its location and how much stock is available and assess the tax on this basis. This poses one major issue – tax officials usually use their discretion and this has the tendency to create unfair practices.

In response to overstatement of tax liabilities, Davies and Burnett (2014)⁹⁹, suggest that the method to determine the tax liability should be transparent with guidelines on how tax officers assess and how judgments are made, whilst offering the taxpayer the basis to agree or disagree and an opportunity for clarification and a place to make formal complaints. A

⁹⁸ Currency converted from www.xe.com on 15/02/2018.

⁹⁹ [REDACTED] and [REDACTED] of Adam Smith international were interviewed as part of the studies on 18th February, 2014.

presumptive tax system which is currently being successfully employed in Kosovo (Davies and Burnett, 2014) is operated on the following two principles:

- **One:** The presumptive tax is self-assessed by the taxpayer, not the revenue officer. The tax officer provides the forms but the taxpayers complete the details and then provide how much they are going to pay [which is based on their own assessment]. With this approach, the tax authority can conduct its audit at any point to confirm the information presented, for example, by comparing third party sources of information such as accessing custom data (in the case of shipping companies), checking contracts, assessing supplier information, etc.
- **Two:** The taxpayers take the money to the bank or other designated pay points (including online) and pay themselves rather than paying the tax officials directly.

In the context of Ghana or other developing economies, payment methods pose challenges as most taxpayers feel an extra burden on them especially when there are regular small amounts involved as taking these to the bank each time could be daunting.

Another modification which could make presumptive tax systems more effective in developing economies is by introducing Point Of Sales Technology (POST) – enabling taxpayers to be issued with receipts on the spot by the officers. Receipts must reconcile with the recorded transactions on the machine which the officer takes to the bank later which help deal with ‘leakage’ problems. As an added security, this system could also be linked directly to the tax authority’s system which could help the monitoring of tax revenues collected by an officer at any point in time. Introducing the Point of Sales Technology (POST) would involve few stakeholders, such as the local tax authority, the banks, and the revenue collection officers, and the success of it thus depends on each fulfilling their obligations.

In addition, other payment methods such as payment by mobile phones could also prove useful as this will also help eradicate the issue of tax officers embezzling tax revenue. Such approaches, by reducing the leakages in the collected tax revenue, will further offer confidence in the tax system and subsequently improve compliance.

The idea of enabling direct payment to the tax authority is that they mitigate corruption where particularly tax officers do the assessment and take payments, an issue which was raised many times in this study.

Another issue this study uncovered within the informal sector tax system in Ghana is that certain ‘professional’ businesses could easily file tax returns and be taxed the same way as other businesses. Businesses such as legal firms, accountants, daycare centers (i.e. nurseries), and travel and tour operators, who by nature of their businesses can undertake formal assessments could be moved into the formal assessment system. The interviewing officers did not provide a definitive answer as to when people and businesses should be moved over from the presumption to the formal assessment system. In response to this, Davies and Burnnet (2014) suggest that ‘even when there’s threshold, people with income below that should be allowed to move over as long as they have good record keeping, but once they decide to do so, they have to stay for a certain period, for example, three years, before going back, to prevent people going backward-and-forwards. Without imposing a time limit on when people could revert could thus be producing the potential for under or overpayment and will subsequently increase tax compliance burdens on all parties. Implementing this in the current informal tax system in Ghana could have a positive compliance response while at the same time reducing administration costs.

8.4. Academic contributions

This study has made contributions to the tax compliance literature particularly in areas relating to understanding taxpayers operating in the informal sector and on presumptive taxation systems in developing countries by demonstrating that, contrary to some existing literature and the resulting taxing approaches used in some countries, informal sector taxpayers may not be as different from other (formal) taxpayers than has been proposed who therefore deserve a similar approach. Therefore, designing a tax system for the informal sector should consider key tax compliance variables which are normally given attention in the formal sector tax design.

The study also contributes to existing knowledge in taxation by elaborating on specific characteristics of individuals operating in the informal sector which are relevant to tax compliance decisions, for example, taxpayers who have a bribery history are more likely to evade taxes. The study also suggests various factors which appear to have little influence on compliance decisions in this sector, for example, age and religion.

In addition, the study identified four types of taxpayers within the informal sector (see section 7.3). This suggests that the low level of tax compliance in the informal sector could be partly explained by the lack of understanding of specific approaches to deal with different taxpayer groups. For example, as noted in section 7.3, taxpayers who have low tax morale but high tax knowledge may need more enforcement approaches compared to those with high tax morale but low tax knowledge who may need education and support to improve their tax knowledge. This is the first study to identify these types of taxpayers in the informal sector from a developing country setting.

In terms of the methodology and approach, this is the first study which specifically targets informal sector tax compliance in developing countries from the perspectives of the taxpayer. The study is so far, the only informal sector taxation research which focuses on the taxpayer, rather than primarily the tax system itself, to investigate tax compliance determinants. This is also the first study in informal sector taxation which adopts three approaches to collect and triangulate data – interviews (17 taxpayers, 8 tax officials), observations (10 taxpayers' interactions observed) and a survey (334 participants). With a high level of similarity in economic activities across the country's informal sector to those of other developing countries, the results from this research can thus be generalised as representing the informal sector taxation in developing economies - particularly those of Sub-Saharan African countries.

In its contribution to improving our understanding of taxation of the informal sector, this study, in addition to the above points, has assessed the impact of tax morale on tax compliance in the informal sector and finds that tax morale positively influences compliance in the informal sector far more than other extrinsic (external) variables such as high auditing probabilities and heavy fines. This result further suggests alternative ways of designing the tax systems for the operators in the informal sector which tax authorities could consider. For example, the investigations undertaken in the study have helped to enrich our understanding of informal sector taxation and to see that the conventional approach which emphasises treating taxpayers in the informal sector as potential evaders/avoiders and therefore concentrates on punitive measures, is not as effective as it could be. This in part explains the low compliance rate in the sector mostly described in studies as the 'hard-to-tax'. In effect, this study further enriches tax administrators' understanding of the needs of the informal sector taxpayers and as such offers guidance to authorities to design the tax systems for the

informal sector to include approaches to reinforcing taxpayers' tax morale to improve compliance rates rather than solely spending more on enforcement.

Furthermore, the study's results also suggest that where there exists the possibility to offer bribes, taxpayers will pay their way out rather than comply even when the tax rates are below the bribes paid. This helps shape our knowledge that with a low level of tax knowledge, the government could lose substantial tax revenue. Therefore, tax administrators are enlightened through this study that by better educating taxpayers in the informal sector, particularly with regards to how their tax rates are determined, taxpayers are more likely to comply than giving in to bribes to tax officers who may portray their tax liabilities much higher than should be the case, thereby making bribe payments an attractive option to the taxpayers.

With these factors, the study has made various contributions to the field of taxation with new empirical evidence about key determinants of tax compliance decisions of informal sector operators and suggests main approaches to improving voluntary tax compliance in the informal sector, especially those of developing countries. The study results could, therefore, be useful as a guide by tax authorities in designing an appropriate form of taxation for their informal economies. Detailed policy implications are discussed in the next section.

8.5. Policy implications – the usefulness of the study for tax administrators

A part of the results from this study support some of the previous work on tax compliance whilst other parts help uncover new issues relevant to tax compliance in the informal sector. For example, the importance of tax education and tax knowledge on tax compliance were previously demonstrated as being valuable contributors to voluntary tax compliance in the formal sector taxation context, this indicates that suitable and targeted tax education from the tax authority helps enhance tax knowledge which subsequently impacts positively on voluntary compliance among informal sector operators also. The implication for the tax authorities is that there should be targeted tax education campaigns to educate informal sector operators, especially issues on how their tax liabilities are determined. This study has however demonstrated that the current campaigns which target the formal economy have little impact on those in the informal sector and therefore specific education needs to be created to target the informal sector's needs.

The results from this study suggest that informal sector taxpayers are more influenced to comply with their tax obligations by tax morale than the fines and or auditing probabilities. Policymakers and tax administrators could help to improve tax education and emphasise the variables which improve tax morale such as recognition, and effective tax revenue usage rather than resorting to even more rigorous enforcement strategies and more punitive measures which may have short term results but will not improve voluntary compliance in the long term.

The study results suggest that informal sector taxpayers are particularly concerned about the way their taxes are determined as in most cases tax officials use their discretionary powers [and taxpayers' negotiation skills] and this subsequently affects their compliance decisions, this offers useful insight to the tax authority in determining presumptive tax rates. For example, tax authorities could adopt a presumptive system for the informal sector which is 'self-assessed'. This approach (self-assessment) recognises the needs of the sector operators as it actively involves the taxpayers during the design and implementation process. Again, a modified presumptive system such as a 'self-assessed' form of presumptive taxation would be more effective than most strategies being currently employed to tax the informal sector. This is because the approach takes away the discretionary powers of the field tax officers to favour a certain group of taxpayers and will promote fairness in the tax system. With this approach, the taxpayers may feel more involved and the feeling of being involved in the tax planning process could positively influence voluntary compliance, and subsequently reduce the cost of tax administration. As observed by Oats and Pemberton, (2012, p.57) there is a degree of discretionary power that smooths the process of revenue collection in every tax jurisdiction, however, too much discretion could negatively influence tax morale as it could potentially erode trust and create costly uncertainty.

This study's results indicate that corruption, especially the perception of field tax officers embezzling tax revenue, is a strong determinant in reducing voluntary tax compliance among informal sector taxpayers. The findings suggest that taxpayers will better trust a system which limits the tax officers' ability to handle cash. Therefore, the tax authorities could improve taxpayer confidence by implementing innovative ideas such as a point of sales technology where a device will be used to record taxes paid electronically which is automatically linked to the head office and the taxpayer has to sign on the device to confirm the total taxes collected by the tax officers. In the same way, mobile tax payment using

mobile phones could equally boost confidence and subsequently improve voluntary tax compliance.

Trust in the tax authority is reported to be very low in this study, which subsequently influences compliance decisions. Therefore, measures should be put in place to improve on trust, which supplements authority power, in order to achieve maximum compliance. Addressing trust among taxpayers, Oats and Pemberton (2012, p.53) stressed that ‘securing the trust of the taxpayer population includes ensuring providing certainty and reliability in the interpretation and application of tax rules. It also includes ensuring consistency between the tax policy as widely understood and the way that policy is operationally implemented by the tax administration at a practical level’. As noted earlier, the discretionary presumptive tax system as currently applied in Ghana gives too much power to the tax officers who usually abuse it and this tends to affect trust levels and subsequently compliance decisions. See chapter two for discussion on the discretionary presumptive tax system and its application in Ghana respectively. Trust can be established within a presumptive tax system in the informal sector by publishing the factors used to determine tax liabilities, in this case, tax officers, could do little to influence the amount an individual must pay.

As indicated by this study’s results, cash transactions are the most common form of transaction among the informal sector operators in the developing countries. This medium of payment has been described as ‘intrinsically the most difficult for revenue agencies to identify and monitor’ (Russell, 2010, p.13). As a response, tax authorities in developing countries should, therefore, work with telecommunication companies, banks, and other financial institutions to develop and promote alternative payment mechanisms to reduce the sector’s demand for cash. For example, adopting tax payment through mobile money.

Visible benefits for tax payment could also help reduce tax non-compliance according to the results of the study. As a policy response, governments could improve compliance levels by ensuring that the informal sector taxpayers are given visible benefits for the taxes they pay. For example, sanitation or lighting provided to the community market, etc., particularly at local government levels, could be an effective way to promote voluntary compliance.

The study finds that the relationship between the taxpayers and the tax officers is vital to promoting compliance. Therefore, tax authorities looking to promote tax compliance in the informal sector need to ensure that their field tax officers are given appropriate professional training to ensure that they exhibit the required professional standards and not to be defensive

or aggressive as found during the field observations (see section 6.6). In the field, tax officers represent the tax authority, and any negative perception could have negative repercussions on voluntary compliance in the long run.

For effective tax policy design, the tax authority needs to see the informal sector and the overall regulatory environment as ‘one field’, where people’s future behaviours are shaped constantly by the interactions they have with others within the tax environment (Kraal, 2013). Thus, the informal sector tax field is comprised of agents – who are made up of individuals, groups and institutional structures, including the tax authority. A taxpayer’s decision to comply, in this case, may be influenced by the regulatory environment which is shaped by his/her interaction with the others and the associated rules governing the (tax) environment. A more responsive regulatory environment could help build stronger and positive relationships between taxpayers and the tax authority. Thus, honest taxpayers could be supported to be compliant whilst non-compliant taxpayers could be gradually moved into the compliant zone using a series of strategies – supporting, rewarding or punishing.

Gracia and Oats (2012) described the [tax] regulation environment as ‘a relational process that creates, negotiates and enforces the boundary between acceptable and unacceptable practice (p.305). This boundary according to Gracia and Oats (2012) depicts compliant and non-compliant regulatees (whom tax authorities try to move into the compliance zone using a series of strategies). The compliance boundary in this context is not imposed on either the tax authority or the taxpayers as they both engage with it and through constant interaction and interpretation, contribute to its development and positioning as well as shaping the wider tax field. This, therefore, suggests that, as a policy response, the tax authority must ensure that their role in shaping the ‘compliance boundary’ is anchored in transparency, respect, and fairness. A hostile regulatory approach will create a ‘belligerence compliance boundary’ which will undoubtedly have a negative effect on long-term voluntary compliance decision.

The findings from the study could be a useful guide for other governments in developing countries particularly those within Sub-Sahara Africa where economies, cultural and other social factors are similar to that of Ghana. These countries could use this study as a benchmark to promote tax compliance in their informal sectors.

Overall, this study has helped shape our understanding of informal sector taxation particularly in a developing countries context and the findings which have emerged from the research could offer useful guidance for decision-makers and tax administrators.

In conclusion, the study supports the use of a presumptive form of taxation for the informal sector but with some modifications as suggested in this section rather than the current and the conventional ‘corps versus robbers’ approach (Kirchler, 2007, p.188), being used in most developing countries.

8.6. Limitations

The study involved interviewing tax officials of different levels within the country’s tax system. This was very useful as it helped shape the research, especially in providing the perception of the tax officials towards the informal sector. An attempt to interview the key policy-makers in Ghana’s finance ministry, including the Minister of Finance, failed. This could have given a stronger insight into the policies and approaches currently being applied to the sector, which are normally passed by the Ministry and the tax administrators have the sole responsibility of implementing these policies. It would also have allowed more testing of proposed developments to the presumptive tax system with officials responsible for taxing the informal sector.

The study uses observation to collect part of its data. The observation was carried out to enable a better understanding of their possible application in the Ghanaian setting. This offered a very interesting and useful insight into the relationship between the tax officers and the taxpayers during the collection process. However, to fully understand this interaction, it’s believed that more observation trips may be required. Also, observing more tax officers and different taxpayers on different days and in different situations could potentially influence the understanding of the interactions. Unlike the taxpayers who were observed, the field tax officials were aware of the researcher’s presence, this could influence their behaviour towards taxpayers and how they handled the various situations that emerged.

Although the country’s informal economy is similar in all of its 10 regions, a study which was undertaken in all 10 regions instead of only the 2 which this study is limited to, could extend and deepen the study results.

Considering the survey data collection and the interviews with the informal sector operators, a snowballing approach was the only feasible sampling method deemed viable to access the operators in this sector. This means the researcher had limited influence on the participants

especially those involved in the interview. This could have had a potential impact on the study results.

Furthermore, the 'search and identify' approach used during the interview phase has some limitations. The strategy might cause some taxpayers (for example those working from home or in locations, not within the defined parameters) to be excluded entirely from the sample frame thereby increasing sampling error. This issue was, however, balanced with the mix methods approach of a survey and field observation employed in the data collection.

The drop-off and pick-up approach used for the survey data collection could also in part influence responses. As discussed in chapter six, with high illiteracy rates, some respondents could not complete the questionnaire and had to be supported by the research assistants who read the questionnaires and ask for their possible response options. Compared to situations where respondents could fill in questionnaires without any intervention, the presence of the research assistants in such situations could have had an impact on the responses.

Tax morale was measured by a series of 8-Likert scale questions. Misunderstanding of questions and possible response biases means that this may not give true and accurate results and the conclusion may thus not give a true representation of the informal sector taxpayers.

Furthermore, tax knowledge was measured using the aggregate scores of three variables – understanding of one's tax rates alongside when and how to pay. Issues such as knowledge of tax policies/laws and complaints procedures which could equally shape one's tax knowledge were not measured. A study which includes and extends such variables could impact on the outcome.

Also, tax compliance measurement is a judgment based measure using a series of indirect questions. Considering the sensitive nature of the subject, respondents may not feel comfortable answering the questions without any control or direct contact. The responses may not be a true reflection of actual taxpayers' behaviour in the informal sector. 'Acknowledging this constraint, however, it is believed that this is the most suitable way to predict taxpayers' compliance behaviour, as direct questions might lead respondents to answer the questions dishonestly and could be potentially embarrassing for respondents' (Palil, 2010, p.283).

Finally, there was no data according to the GRA about taxes collected from the informal sector, as tax revenues are pulled together. This made it impossible to make any reference to

tax revenues generated from the sector, which could have had a useful impact on assessing the effectiveness of the current system. Having data that captures tax revenue from the sector each year will be vital to make comparisons and to assess the effectiveness of each of the numerous strategies the GRA have been using to tax the sector in the last few years.

8.7. Areas for future research

This study, which is the first to look into informal sector taxation in developing countries from the taxpayers' and tax authorities' perspectives could be used as the foundation for further detailed research into the field of informal sector taxation within developing economies.

In the past, some tax compliance studies have been undertaken in developed countries using an experiment as the main method (for example Cummings et al., 2005, Wartick et al., 1998 and Alm et al 1992) There has been no research into the informal sector in developing countries using this approach. Therefore, a critical look at this phenomenon using experiments could offer some interesting results.

In spite of the similarities between the economies of developing countries, a study which looks at the informal sectors of two or more developing countries at the same time, especially from different regions/continents may help improve the understanding of and offer detailed insight into, the informal sector taxation in the developing economies context.

In this study, there was evidence found of registered businesses in the formal sector having individuals and business subsidiaries in the informal sector which are used in part to evade/avoid taxes. However, this was not developed fully in this study. Future research which looks specifically at how formal sector operators use subsidiaries in the informal sector to evade taxes could also offer a different perspective of the situation and further improve our understanding of informal sector taxation.

In chapter three it was observed that association taxation was very popular in Ghana from 1987 - 2004 and this was also reported in section 6.2.a.iv of the interview data analysis by a respondent. Although no data was collected to assess this, however, a study looking at the impact of Associational taxation and how it may impact on tax compliance in the informal sector of developing countries could provide some useful insight for policymakers.

Furthermore, benefits in kind and non-monetary exchanges [as forms of payment] are common practices within the informal economy but not attention was given to this area during this study. Future work could seek to address this phenomenon to assess their real impact on tax compliance within the informal sector.

Levels of perceived corruption and tax revenue usage came up as strong variables which decrease tax compliance rates. Therefore, a full study which undertakes a detailed investigation into these variables either separately or jointly could offer a very useful insight into tax non-compliance. Also, by limiting a study to only these variables, their true impact in relation to informal sector taxation could be made clearer.

This study was conducted from an inductive perspective and uses the responsive regulation theory to help explain taxpayer versus taxpayer interactions and how these shape compliance decisions. Using this theory or any suitable theory to undertake a 'theory led' inquiry into the sector could offer new paradigms and better our understanding of the informal taxation within developing economies.

Finally, the informal sector as observed from chapter two forms the greater part of the economic activities of most developing countries. There is, therefore, an urgent need for academic work into the informal sectors of these countries to help policymakers in designing efficient and effective taxation systems to capture taxable economic activities.

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APPENDIXES

Appendix 1 - Summary of Informal sector causal theories and policy recommendations

Theory	View of the informal economy	Causes of informality	Policy recommendations
Dualist	Informal economy is the result of exclusion from economic opportunities in the formal economy due to the imbalances between population growth and industrial employment, and peoples' skills in relation to the structure of the economic opportunities presented because of that growth. There is minimal (or no link) with formal sector. Operators have only survival needs as a motive.	Exclusion from modern economic opportunities due to high labour supplier relative to opportunities brought by industrialisation and/or people's skills and structure of modern economic opportunities	Regulation should be aimed at fostering informal sector productivity by increasing operators' access to resources, including capital, in addition to the removal of unnecessary state restrictions.
Legalist	The informal sector is the response to a hostile legal system and bureaucratic procedures within the formal sector. It is a rational and market-led response to overregulation in the formal economy.	Excessive state regulation.	Less state regulation and more free market policies to enable accelerate growth of informal entrepreneurs (particularly through the legalisation of informal property rights).
Structuralist	Adopters of this view conform to the premise that the informal economy comes about due to the growth of capitalism and firms' desire to reduce cost and/or gain competitive advantage	Growth of capitalism and attempts by formal firms to reduce labor costs and increase competitiveness	More regulation of commercial and employment relationships between the informal and formal economies in order to address unequal relationships between 'big business' and subordinate producers.

Source: Author's compilation from literature

Appendix 2 - Income tax rates and allowances – effective from January 2016

Annual income tax rates

Chargeable Income (GH¢)	Rate (%)	Tax (GH¢)	Cumulative Chargeable Income (GH¢)	Cumulative Tax (GH¢)
First 2,592	Free	NIL	2,592.00	NIL
Next 1,296	5	64.80	3,888.00	64.80
Next 1,812	10	181.20	5,700.00	260.00
Next 33,180	17.5	5,806.50	38,880.00	6,052.50
Exceeding 38,880	25			

Monthly Tax Rates

Chargeable Income (GH¢)	Rate (%)	Tax (GH¢)	Cumulative Chargeable Income (GH¢)	Cumulative Tax (GH¢)
First 216	NIL	NIL	216	NIL
Next 108	5	5.40	324	5.40
Next 151	10	15.10	475	20.50
Next 2,765	17.5	483.88	3240	504.38
Exceeding 3,240	25			

Exchange rate in January 2017 is £1 = GH¢ 5.6¹⁰⁰

Source (GRA, 2016)

¹⁰⁰ (FxExchange, 2017)

Appendix 3 - Formal sector (business) tax rates in Ghana

Resident Companies	
Corporation tax	
Standard rate	25%
Rate applicable to companies listed on the Ghana Stock Exchange	22% (1st three years)
Rate applicable to companies in hotel industry	22%
Rate applicable to companies that engage in non-traditional exports	8%
Rural and community banks and free zone developers and enterprises	8% (after tax holiday period)
Financial institutions in respect of income from financing farming enterprises and leasing companies	20%
Agro-processing companies and cocoa by-products companies	0%-20% (after tax holiday period)
Petroleum income tax	Not exceeding 50% (subject to rate per Petroleum agreement)
Capital gains	15%
Dividends	8% *
Royalties	Taxed as ordinary income (Residents)
Rent on properties	8% *
Resident Individuals	
Income tax	0-25% **
Capital gains	15%
Dividends	8% *
Interest	Exempt (Paid by Financial Institutions and Government of Ghana on bonds; otherwise taxed as ordinary income)
Royalties	Taxed as ordinary income
Non Resident Companies	
Company income	As for residents but only on Ghanaian source income. 15% withheld at source on part or whole amount.
Branch repatriated profits tax	10% *
Tax on shipping, aircraft, cable, radio, optical fibre, satellite communications operations	10% * of gross receipts
Capital gains	As for residents but only on Ghanaian source capital gains.

Dividends	8%*
Interest	8%*
Royalties	10%*
Management and Technical Service Fees	15%*
Natural resource payments	10%*
Rent	10%*
Individuals	15%*

* Tax is withheld at source. Source: (KPMG, 2012)

* Tax is withheld at source. ** Individual income tax bracket applicable

(Source: KPMG, 2012)

Appendix 4 - Ghana Revenue Authority offences and penalties

Offences

Sanctions/Penalties

1. Failure to maintain records	5% of tax payable by that person for each year
2. Failure to furnish a return by due date	For each day that the return remains outstanding – a penalty of GH¢2.00 in the case of companies GH¢1.00 in the case of self-employed
3. Failure to pay Income Tax on Due date	<ul style="list-style-type: none"> - Failure of not more than 3 months - penalty of 10% plus unpaid tax - Failure exceeding 3 months penalty of 20% plus unpaid tax
4. Failure to pay Withholding Tax on Due Date	<ul style="list-style-type: none"> - Failure of not more than 3 months- penalty of 20% plus unpaid tax - Failure Exceeding 3 months- penalty of 30% plus unpaid tax
5. Self-Assessment . Understating estimated tax payable by instalments	30% of the difference between tax in respect of the estimated chargeable income and the tax calculated on 90% of the actual chargeable income, where the estimated chargeable income is less than 90% of actual chargeable income
6. Making False or Misleading statement	Double or treble the amount of the underpayment of the tax, which may result if not detected.
Court Sanctions	
Offences	Sanctions/Penalties
1. Failure to comply with the Act (Section 148)	Where the underpayment is more than GH¢500.00 – a fine of between GH¢100.00-GH¢600 - In any other case - a fine of between GH¢20.00-GH¢200.00
2. Failure to pay tax (Section 149)	-Where the amount involved is more than GH¢100.00 – <ul style="list-style-type: none"> - a fine of between GH¢50-GH¢200 or term of imprisonment between 3 months and not more than one year or to both. <ul style="list-style-type: none"> - In any other case - a fine of between GH¢ 10-GH¢50 or imprisonment between one – three months or to both.

3. Making False or Misleading Statement (Section 150)	<p>-Where the statement or omission is made without reasonable excuse, resulting in underpayment of tax exceeding GH¢100.00</p> <ul style="list-style-type: none"> - a fine of between GH¢50-GH¢200 or imprisonment between 3months – 1 year or to both - In any other case – a fine of between GH¢10-GH¢50 or imprisonment between 1 month – 3 months or to both. - Where the offence is made knowingly or recklessly and the resultant underpayment of tax is more than GH¢100 – - a fine of between GH¢100-GH¢400 or imprisonment between 1 – 2 years or to both. - In any other case: - a fine of GH¢20 – GH¢100 or imprisonment between 6 months – 1 year or to both.
4. Impeding Tax Administration	<p>-Where a person, without reasonable excuse, obstructs an officer of IRS in the performance of duties under the Act</p> <p>-or impedes the administration of the Act, commits an offence and is liable to</p> <p>a fine of between GH¢50-GH¢400 or imprisonment of not more than 2 years or to both.</p>
5. Aiding and Abetting	<p>-A person who aides or abets another person to commit an offence which results in an underpayment of tax exceeding GH¢100. is liable to</p> <ul style="list-style-type: none"> - a fine of GH¢100-GH¢200 or imprisonment of between 1-2years or to both -In any other case – - a fine of between GH¢20-GH¢100 or imprisonment of between 6 months – 1 year or both
Failure to withhold tax	Personal liability to pay the tax due but not withheld

Source: (GRA, 2010)

Appendix 5 - Example of presumptive taxes in selected countries.

Country	Kind of system	Remarks
Albania	Lump sum or gross turnover Tax	Fixed tax for micro businesses = annual turnover under 2 million Lek (US\$14,000) 4% gross turnover tax for small businesses = annual turnover 2-8 million Lek (US\$57,000)
Armenia	Lump sum	Fixed payment for small-scale activities such as hairdressers, gas stations, commercial fishing, and trading activities conducted in locals with trading areas less than 30 square meters
Azerbaijan	Gross turnover tax	2% gross turnover tax when turnover less than 300 times the minimum tax-exempt wage (US\$ 6400)
Belarus	Lump sum	Lump sum tax for stores that are single owned and total trading space less than 25 square meters, plus public catering enterprises, and at markets and sales Exhibitions
Bulgaria	Lump sum	For individuals in specific business sectors with annual turnover under 75,000 BGN
France	Lump sum	The taxpayer must furnish information with respect to the preceding year: purchases, sales, value of closing inventory, number of employees, amount of wages paid, and number of cars owned by the taxpayer etc.
Georgia	Lump sum	For enterprises with turnover less than GEL 24,000 (US\$ 11,000)
Hungary	Lump-sum	Small entrepreneurs may choose an itemized presumptive tax in lieu of personal income tax and VAT
Kazakhstan	Lump sum or gross income tax	Special regime based on simplified return for individuals with not more than 15 staff and gross income max. T 4.5 million and legal persons with not more than 25 staff and gross income max. T 9 million. Lump-sum tax for gambling business.
Kosovo	Lump sum tax	Any taxpayer other than an insurance company with gross receipts less than 15,000 DEM
Kyrgyzstan	Gross turnover tax	SMEs (total revenue up to 3 million Soms, approximately US\$ 63,000) may pay from 5 to 10% gross turnover tax instead of all national taxes. Individual entrepreneurs can optionally obtain a patent and pay a monthly gross turnover tax, i.e., in retail trade 4%
Lithuania	Presumptive tax	Optional for firms with gross income less than 100,000 LTL (US\$ 26,000)
Moldova	Lump sum	Individual entrepreneurs can buy patents which involve a monthly fee
Romania	Gross income tax	Micro enterprises with less than 10 employees and an annual turnover less than Euro 100,000
Russia	Uniform (unified) tax Single tax	Uniform tax for entrepreneurs and companies in selected industries – retail trade, public catering, car maintenance, transportation services, personal and veterinarian services: 15% imputed income tax. Single tax for entrepreneurs and companies with up to 100 employees and 11 million RUR (US\$ 352,000) turnover: 6% gross turnover tax, and 15% gross turnover minus expenses tax. Both taxes replace profits/personal income tax, property tax, sales tax and single social security tax;

		exempt firms and entrepreneurs from VAT, and provide tax credit for pension contributions.
Turkmenistan	Lump sum	Lump sum licence for entrepreneurs without a legal entity and with an annual turnover of less than 72 million manats (US\$ 14,000)
Ukraine	Unified (gross turnover) tax, fixed tax; trade permit; small enterprise tax	Unified tax for companies with up to 50 employees and turnover less than UAH 1 million (US\$ 190,000) and individuals with up to 10 employees and turnover less than UAH 500,000: 6% gross turnover tax which does not exempt actor from VAT, or 10% gross turnover tax, which does exempt firms from VAT.
Uzbekistan	Gross turnover tax or lump sum tax	Unified tax on gross revenues for wholesale trade 3-5% of turnover (depending on location), for public catering 7-10% of turnover (depending on location). Lump sum tax for individual entrepreneurs without a legal entity

Source: (based on Engelschalk, 2005, p.5)

Appendix 6 - Tax Compliance Survey Questions



Department of Accounting & Finance
Birmingham Business School.
University Of Birmingham.
B15 2TT, UK
Tel:
Tel:
Email:

Dear valued Respondent,

You have been selected to participate in a study on the Ghanaian economy by a researcher from the University of Birmingham, UK, and permit me to say a big thank you for your time as you complete these questions.

I would like to first of all assure you that this is purely for academic purposes ONLY, and your participation in this study will have no impact on you or your business. Your identity, your business details or your location will not be disclosed to anyone. After completion of this questionnaire, the Research Assistant who handed this to you will come and collect it.

The purpose of the study is to understand Government approaches to small business taxation and the resulting responses of the owners of small scale enterprises.

Your participation in this study is completely voluntary, and you do not have to answer all the questions asked if you do not want to, however, I would greatly appreciate it if you could complete all the questions and as honestly as you can, to help the outcome of the study.

It will take no more than 20 minutes to complete the questionnaire.

I will also like to assure you that the completed forms will be kept securely at the Researcher's office at the University of Birmingham for the purpose of the study, and will be securely destroyed afterwards.

The Research Assistant will be coming on the to collect your completed questionnaire.

For any information or issues regarding the completion of the questionnaire, please contact me on any of the numbers above.

Yours sincerely,

Alex Ampaabeng (Researcher)

This Research is being conducted at the University of Birmingham, UK, under the supervision of:

- Professor Andy Lymer
- Dr Dan Herbert

INSTRUCTIONS:

Please state your opinion for questions in tables using the following scales:

1. Strongly disagree
2. Disagree
3. Unsure / on the fence
4. Agree
5. Strongly agree

All other questions, please tick the option that applies.

TABLE A

1. Is Your Business activity registered? (Tick one)

☐ Yes ☐ No

1a. If yes, who with? (Tick all that apply)

☐ GRA/Inland Revenue ☐ Registrar General of companies ☐ Municipal Authority ☐ Trade Association

1b. If No, Why Not?

☐ Not aware of need to register ☐ Cost of registration ☐ To avoid State interference/Taxman
☐ Other (please state).....

2. How long have you been in this business? (Tick one)

☐ Up to 1 year ☐ 2-5 years ☐ 6-10 Years ☐ Over 10 Years

3. Which of the following describes the ownership of your business? (Tick one)

☐ Sole Owner ☐ Partnership ☐ Family business ☐ Other (please state).....

4. Who makes all the major decisions in the business? (Tick one)

☐ Owner only ☐ Partners ☐ The entire family ☐ Other (please state).....

5. Do you keep any financial records of your business e.g. receipts, statement, orders/invoices?

☐ Yes ☐ No

a) If you answered Yes to Q5 above, briefly explain what you do:

.....
.....

b) If your answer is NO, please briefly explain why:

.....

6. Do you have business bank account for your business? (Tick one)

☐ Yes ☐ No

6a. If you do not have a bank account, do you have any micro-finance account or part of a 'Susu' group? (Tick one)

☐ Yes ☐ No

7. What payment method do you mainly accept from your customers? (Tick one)

☐ Cash only ☐ Cash and Cheque/Bank Transfer

		Disagree				Agree
8.	The nature of my business influence my tax payment decisions	1	2	3	4	5
9.	I believe it's right to register a new business	1	2	3	4	5

PART B

		Disagree				Agree
10.	I believe my business tax rate is fair	1	2	3	4	5
11.	Fixed tax rate promotes fairness	1	2	3	4	5
12.	I prefer my tax rate decided by a visiting tax officer than direct from GRA / Inland Revenue	1	2	3	4	5
13.	When they have to, visiting tax officers are always fair in issuing tax bills	1	2	3	4	5

PART C

14. Are you aware of the tax rate relating to your business? (Tick one)

☐ Yes ☐ No

14a. If Yes to 14 above, have you paid tax before on your business? (Tick one)

☐ Yes, Always ☐ Yes, few times ☐ Yes, once ☐ Never

14b. If No to question 14 above, how does this influence your compliance decision? (Tick one)

☐ I do not pay as a result ☐ I pay because I have no option ☐ I try to pay as little as possible ☐ Other (please specify).....

15. What do you think could make people with small business like yours not to be tax compliant in Ghana? (Tick one)

☐ High Tax rate ☐ Perceived misuse of tax revenue/corruption in country ☐ Not understanding how their tax rate is calculated ☐ Perception of what is received in return

		Disagree			Agree		
16.	The tax payment process is simple	1	2	3	4	5	
17.	The tax payment process influence my payment decision	1	2	3	4	5	
18.	If required, I will declare all my income for tax purposes	1	2	3	4	5	
19.	Paying taxes based on percentage of profit made is better than at a fixed rate	1	2	3	4	5	
20.	My tax compliance cost is reasonable	1	2	3	4	5	
21.	I have received reminder notice(s) from GRA regarding my taxes in the past	1	2	3	4	5	
22.	I fully understand how to pay my taxes	1	2	3	4	5	
23.	I do not need any advice about when to pay my taxes	1	2	3	4	5	

PART D

24. If you are approached by tax collector or Government official that for a small fee, s/he will write off all your business taxes for the entire year, and you would not have to worry about being caught, what would your response be? (Tick one)

- ☐ I definitely will accept the offer
 ☐ depending on his fees, I may opt for it
 ☐ I may be suspicious, else will opt for it
 ☐ I will refuse it & pay my normal tax

25. How many of your friends/business partners/family, do you think may be interested in the offer in question 23 above? (Tick one)

- ☐ Almost all
 ☐ About 50% of them
 ☐ Just one or two
 ☐ None

26. Would regular visits by tax officers affect your tax payment behaviour? (Tick one)

- ☐ Yes, definitely
 ☐ Very little influence
 ☐ Not sure
 ☐ No influence

27. Have you ever been approached by a tax official demanding personal payment/bribes regarding your business taxes? (Tick one)

- ☐ Yes, always
 ☐ Yes, few times
 ☐ Yes, just once
 ☐ Never

28. Have you ever given in on bribery demands or offered some payment to tax collectors? (Tick one)

- ☐ Yes, many times
 ☐ Yes, few times
 ☐ Yes, just once
 ☐ Never

		Disagree			Agree		
29.	Tax Payment is a basic duty of every citizen	1	2	3	4	5	
30.	If one think that tax is unfair, it is justifiable not to pay at all.	1	2	3	4	5	
31.	Not paying taxes is the worst thing a person can ever do to the state.	1	2	3	4	5	
32.	Even if tax rate is unfair, one needs to pay first and then complain later or ask for refund	1	2	3	4	5	
33.	I pay taxes because I want to be seen paying something	1	2	3	4	5	
34.	The main reason I pay my taxes is to avoid a potential penalty (e.g. pay a fine or have my business closed)	1	2	3	4	5	

PART E

35. Have you ever been sent a written tax bill directly from the Ghana Revenue Authority?
(Tick one)

☐ Yes ☐ No

36. Have you been visited by a Tax Official before? (Tick one)

☐ Yes ☐ No

37. If Yes to the question above, which authority? ((Tick all that apply)

☐ Metropolitan Assembly ☐ Inland Revenue / GRA ☐ Other (please state).....

		Disagree			Agree	
38.	There are adequate tax information from the GRA	1	2	3	4	5
39.	I understand the tax system, particularly areas relating to my business	1	2	3	4	5
40.	I know where to seek free tax advice, when needed	1	2	3	4	5
41.	Overall, Tax education in the country is good	1	2	3	4	5

PART F

		Disagree			Agree	
42.	The tax revenue collected by the GRA is well spent.	1	2	3	4	5
43.	The tax office /Ghana Revenue Authority are always helpful	1	2	3	4	5
44.	Previous encounter with tax officers was good	1	2	3	4	5
45.	It's easy to get tax advice from the Tax office/GRA	1	2	3	4	5
46.	When faced with financial constraints, it's always possible to negotiate with Tax authority to arrange and pay at a later date	1	2	3	4	5

PART G

47. Gender (Tick one)

☐ Male ☐ Female

48. Which age group do you fall within? (Tick one)

☐ Under 25 years ☐ 25-40 Years ☐ 41-50 Years ☐ Over 50 years

49. Marital status (Tick one)

☐ Married ☐ Single ☐ Cohabiting ☐ Other (Please state).....

50. Highest educational qualification you currently hold (tick one)

☐ O'Level/A'level/SSCE ☐ HND/Professional ☐ Degree ☐ Masters' Degree & Above
☐ No formal education

51. Your Religious denomination (Tick one)

☐ Christian ☐ Muslim ☐ Occult/Traditional ☐ Other (please state).....

52. Your average monthly income (*Tick one*)

☐ Under
GH¢132

☐ Between GH¢133 -
GH¢500

☐ Between GH¢501
GH¢2600

☐ Over
GH¢2600

53. Occupation / Type of business (please be specific).....

END OF QUESTIONS

THANK YOU

Appendix 7 - Informal sector operators Interview Questions

PART A – BUSINESS ACTIVITY, REGISTRATION & INCOME

1. Is Your Business activity registered?

☐ Yes ☐ No

1a. If yes, who with?

☐ GRA ☐ Registrar General of companies ☐ Municipal Authority ☐ Trade Association ☐ Other (Please state).....

1b. If No, Why?

☐ Not aware of Registration ☐ No need for me ☐ Cost ☐ Other (Please state).....

2. How long have you been in this business?

☐ Under 1 year ☐ 1-5 years ☐ 5-10 Years ☐ Over 10 Years

3. Is your income regular?

☐ Yes ☐ No

4. How does this pattern of income flow influence your tax payment behavior?

5. What is your average monthly income?

☐ Under GH¢120.00 ☐ Between GH¢180.00 - GH¢300.00 ☐ Between GH¢500.00 - GH¢2400.00 ☐ Over GH¢2400.00

PART B – TAX KNOWLEDGE AND EDUCATION

6. How will you describe your understanding of the Ghana tax system?

7. What do you think are your obligations within this tax system?

8. Can you explain any experience(s) you have had with the Ghana Tax Authority?

9. In what ways does these [interactions] influence your tax compliance decisions?

10. Has any of your friends, family or business partners had any experience with the GRA you would like to share?

11. To what extent do these experiences and interactions influence you?

12. How will you describe the access to, and availability of tax related education or information from the GRA
13. What role do these information play in your tax payment decisions?
41. Your general thoughts/Opinion about the Ghana tax system for businesses and individuals in your circumstance?

PART C –COMPLIANCE PROCESS AND COST

15. Have u ever filed for a tax return?
16. Can you describe your experience in the process of filing the returns?
17. This is anonymous conversation; please tell me how much income you do declare. If you have not undertaken tax returns before, how much will you declare if you have to?
18. Can you tell me what motivates you to declare some of your income?
19. Are there any fears on concerns which play part in your decision to declare some of your income?
20. What factors will make you declare all income?
21. How will you describe your employment status?
22. To what extend does this [employment status] influence your tax payment decisions
23. Have you been audited recently?
24. How was your experience?
25. Does this influence your future decisions in any way?
26. What percentage of your income is related to?
 - i) non-monetary:
 - ii) Barter?
27. What sort of percentage of your small business in cash do you not declare?
28. If you are engaged in cash in hand activity or undeclared income sources, please describe factors which influence your decision to do so
29. What factors will you like to see that will influence your decision to operate formally
30. If you receive cash payment with limited or no chance of detection, how will you declare such incomes?

retired

3. Marital status

☐ Married ☐ Single ☐ Cohabiting ☐ Divorced/Widowed

4. Do you have any children or dependants

☐ Yes ☐ No

5. How would you describe your ethnic background?

☐ Black African ☐ Asian ☐ White European ☐ Other Black background (State)..... ☐ Other White background (State)..... ☐ Other (Please state).....

6. What is your current nationality?.....

7. Highest educational qualification you currently hold

☐ O'Level/A'level/SSCE ☐ HND/Professional ☐ Degree ☐ Masters Degree & Above

8. What is your Religious denomination

☐ Christian ☐ Muslim ☐ Traditionalist/Occult ☐ Non-Believer/Atheist

9. What does that mean in your fate? / Are u a practicing?

☐ Yes ☐ No, I was born into it

Appendix 8 - Interview questions for tax Officials

1. What in your opinion is the right definition for a business classified as ‘informal sector’ operator?
2. What will be your best description of the informal sector tax compliance rate in Ghana?
3. What will you say it the biggest problem to taxing the informal sector
4. How are the informal sector tax payers involved in the tax planning?
5. I have been told [through my initial interview] by number of tax payers in the informal sector that when they delay payment, without notice, tax officials usually come with padlocks and police officers to close their shops.
 - 5.i Why are notices not sent to remind tax payers?
 - 5.ii Why are the police involved in the first instance?
6. Almost all tax payers interviewed have told me their tax rates are not sent from the Authorities, but are determined by the visiting officers. Why visiting tax collecting officers and not the GRA are determines the tax rate an individual or business should pay?
7. Tax payers have stressed that the amount of tax they pay is regardless of their income, and few are considering leaving their business as they are unable to pay the taxes levied on them. How is the issue of affordability addressed in the tax design for operators of the Ghana informal sector?
8. What measures are in place to ensure that tax payers in this sector (amidst potential officers’ favours) are taxed fairly knowing amount paid is not based on their income?
9. How successful has the current informal sector taxing strategies?
10. Are there any education/awareness/training programmes targeted at the informal sector operators?
11. What auditing and detection mechanisms do you have in place for the informal economy?

12. How successful, do you think are these mechanisms above in reducing non-compliance?
13. What strategies are the GRA adopting to promote voluntary tax compliance among the informal sector operators?
14. How often are tax officials sent out to businesses in the informal economy?
15. Are the visiting tax collecting officers rotated overtime?
16. Which segment /group is least compliant of their tax obligations within the underground economy?
17. What do you think needs to be done to improve compliance rate among the operators of the hidden economy of Ghana?

Appendix 9 - Tax experts interview on Presumptive Taxation

Date: 18/02/2014

Theme: *Exploring the design, implementation, and general policy recommendations for Presumptive taxation in developing countries.*

Interviewer: Alex Ampaabeng (PhD Student) **Moderator:** Prof. Andy Lymer (Supervisor)

Interview Participants - from Adam Smith International:

Summary

The interview explores the design, the implementation and general policy recommendations for presumptive taxation in a developing country context. The interview involved [REDACTED] and [REDACTED] who both work for Adam Smith International, the international advisory firm which specialise in offering practical advice on economic and government reform across countries. The interview help gain first-hand information from people who on daily basis offer practical advice to state and central governments, most of which are centered on developing countries. The questions for the interview were derived from existing academic literature, IMF and World Bank policy recommendations and some were prompts.

Questions / Responses

1. *I have been reviewing some your previous work with the World Bank in Kosovo, you suggested in number 58 of your policy recommendations (IMF, 2011) that tax system should minimise contact with the tax officials to limit corruption.*

One of the biggest challenge interviewing some of these small businesses and informal sector operators, is how corrupt the tax officials are and the presumptive system do give tax officers powers as it was clear in Ghana that there isn't [or not easily accessible] clear coefficients and indices which determines the [presumption]

rate that a business or individual must pay, so it tend to be a kind of negotiation between the tax officers and the taxpayers to reach an agreement [implying contact is always going to be highly maintained]. What will you recommend for a country like Ghana in this instance, to help tackle any kind of such corrupt behavior or at least to take away some of the powers from the visiting tax officers?

[REDACTED]

[REDACTED]

- [REDACTED]
- [REDACTED]

[REDACTED]

2. *The point of sales technology came up in my interview where one respondent recommended this kind of technology, which is a kind of machine similar to what we use in the UK for 'Signed for' and 'Special delivery' letters from Royal Mail, where*

the recipient appends signature. In this case the taxpayer signs against their names/account for the amount paid to the officer which is electronically recorded. My worry is, how is this feasible in countries with low level of technology like Ghana and Nigeria?

[Redacted text block]

[Redacted text block]

[Redacted text block]

3. *So, is there any country which has implemented the POS technology?*

[Redacted text block]

[Redacted text block]

4. *As Ghana has not implemented any of these technologies such as the POS as it stands, what will you recommend as the best auditing mechanism for these visiting tax officers?*

5. *How do we audit business which abuse presumptive taxes and may underreport in order not to be moved to standard assessment?*

6. *What should be the key determinants/triggers to moving businesses from presumptive assessment to formal/standard tax assessment – any cut-off point?*

7. *I spoke to some tax officer who believe some businesses will not be literally moved over due to government policy to maintain certain level of revenue. What is your take on this?*

[REDACTED]

8. *As you are aware, countries like Ghana do not have any social benefit system, and people have to hawk (sell in the streets) to survive. I spoke to people making as little as £2 a day during my field work, but may pay 30p 40p in tax [tickets] a day, considering your experience in developing country taxation, do you think it's advisable to tax all these people as well?*

[REDACTED]

9. *What I have noticed in most tax regimes, is that when it comes to tax complaints, taxpayers are asked to put in writing, which I think could be difficult to countries like Ghana and other developing economies, either due to illiteracy or nature of the system, what will you recommend to be the best way to dealing with taxpayer complaints in the informal economy or under presumption regimes*

[REDACTED]

[REDACTED]

Appendix 10 - Item-Total Statistics

<i>Main/Sub Variables</i>	<i>Scale Mean if Item Deleted</i>	<i>Scale Variance if Item Deleted</i>	<i>Corrected Item-Total Correlation</i>	<i>Squared Multiple Correlation</i>	<i>Cronbach's Alpha if Item Deleted</i>
A. Tax Morale/Ethics:					
<i>Payment is a basic duty of citizen</i>	15.72	14.492	.575	.804	.665
<i>Non-payment bad</i>	16.09	15.848	.398	.338	.711
<i>If unfair, pay and complain later</i>	15.70	13.978	.646	.822	.645
<i>To be seen paying something</i>	15.72	13.063	.527	.390	.674
B. Tax Education					
<i>Understand own tax</i>	11.19	35.013	.776	.649	.840
<i>Availability of tax information</i>	11.25	36.227	.734	.636	.846
<i>Knows where to seek advice</i>	10.12	33.656	.719	.535	.847
<i>Overall tax education</i>	11.31	38.788	.571	.429	.866
<i>Understand of how to comply</i>	11.00	35.091	.715	.554	.847
<i>Do not need advice</i>	11.04	36.455	.555	.381	.870
<i>Easy to get tax advice</i>	10.92	37.622	.535	.336	.871