

Income Tax Evasion in the Ghanaian Informal Sector: Insights from Abossey Okai Spare-Parts Traders

Emmanuel Juior Tenakwah¹
TG Holdings Ghana Ltd, Accra, Ghana

Abstract

Tax evasion is a problem which has caused the Ghanaian tax system right from the colonial times. While some have blamed the situation on the tax authorities for not living up to expectation with regards to tax administration, others attribute it to the unpatriotic attitude of the taxpayers. It was in the light of these challenging positions that this research was carried out using a survey involving tax authorities and individual taxpayers in Abossey Okai, Accra. The study examined the factors contributing to tax evasion in the informal sector, identified the various ways through which tax evasion is perpetrated and the challenges faced by tax authorities in generating tax revenue from the informal sector. The study made use of convenient sampling technique where both taxpayers and tax authorities were selected. The survey revealed that the informal sector of the Ghanaian economy is largely characterized by activities of sole-proprietors who are involved in retailing, wholesaling as well as repairs. It was also revealed that the dominance of sole-proprietorship business in the informal sector has made it difficult for tax authorities to levy taxes on them. The dominance of this business unit is associated with many characteristics which induces tax evasion. These characteristics include but not limited to business registration, lack of permanent business location and predominance of cash transactions. Tax evasion and for that matter the informal sector has caused a great deal of harm to Ghana through its direct and indirect consequences and if care is not taken will gain deep roots in this country. It is therefore recommended that for the Government of Ghana to meet the needs of the citizenry, it would be appropriate to take a look at the factors responsible for the incidence of high tax evasion in the economy.

Keywords: Evasion, Ghana, Informal, Sector, Tax.

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¹ Corresponding author's email: emmanueljnrtentakwah@yahoo.com

Introduction

Tax evasion is a phenomenon that prevails in all sectors of the economy, one of such sectors is the informal sector (Clemens, 2009). The informal sector according to Smith (1994) is a “market-based production of goods and services, whether legal or illegal, that escapes detection in the official estimates of the gross domestic product”. The informal sector according to (Schneider and Ernste 2000: Schneider, 2004) also refers to a broad phenomenon, including a variety of activities related to the labour market; tax evasion, tax avoidance, activities against government regulation, criminal activities and more. However, many studies have focused on one of these activities in isolation, even though they are often directly or indirectly related to each other. This study therefore focuses on one of the phenomena related to the informal sector, tax evasion. The extent of tax evasion is extremely difficult to determine in any country, especially in the developing countries. Attempts have been made in the developed economies to estimate the extent of its occurrence. One of such studies in the United States of America (USA) compared the totals reported on federal incomes tax returns to those determined in the national income accounts. The differences in these two income totals provided an approximated evidence of the extent of tax evasion. The lack of similar studies in most developing countries renders it quite difficult to determine the magnitude of tax evasion in such countries, though it is an apparent feature of their tax systems.

Governments world-wide seek to maximise its tax revenue to enhance its developmental agenda. Most especially governments of developing countries are pushing this agenda to it to be self-reliant in its activities rather than borrowing. In recent years various government have step up its efforts to reduce the amount of tax revenue that it perceives to be lost as a result of various forms of tax evasion. Its responses include the development of the tax disclosure rules, under which certain tax planning schemes have to be notified to the tax authorities after they are implemented. All these are meant to reduce the tax losses made throughout the tax period. Although efforts are been made reduce tax losses, tax evasion appears to be prevalent in thwarting governmental effort to increase tax revenue. Tax revenue from the formal sector appears simple and easier as compared to the informal sector. Tax evasion is prevalent in the informal sector according to some researchers (See Ayodele, 2006; Lefebvre, Pestleau, Riedl, & Villeval, 2011; Muhammed & Muhanimed, 2012). Tax evasion is usually associated with the commission of a criminal offense. It can be considered to consist of willful and conscious non-compliance with the laws of a taxing jurisdiction which can include a deliberate concealment of facts from revenue authorities. Tax evasion is an action by which a taxpayer tries to escape legal obligations by fraudulent or other illegal means. There are many challenges confronting the government of Ghana in championing the socio-economic development and one of such challenges is how to manage the growing informal economy and the maximization of the income tax from the informal sector (Anuradha and Ayee, 2007). The informal sector of the Ghanaian economy employs about 80% of the workforce (Ayee and Anuradha, 2007). However, income tax collection from the informal sector seems to be very difficult for tax authorities in Ghana (Agyei, 1984). This difficulty has therefore resulted in high tax evasion in the informal sector. The question one may then ask is what are the reasons for high tax evasion among the informal sector of the economy? And why are tax authorities finding it difficult in taxing

the informal sector. Furthermore, there is lack of literature and empirical evidence on how the government can expand its revenue base. To answer these questions coupled with the little literature on income tax evasion in the informal sector implies that there is the need for more research into this area, hence the need for this study.

Literature Review

Taxation as a concept was originally aimed at raising revenue for subsequent expenditures by the government of a country. The government financing through taxation has a fundamental influence on the standard of living of all citizens as it aims at improving the lives of the citizens. In these modern times, the development of political and economic structure of society has become more complex. The government responsibilities have increased towards the citizenry in general. As a consequence, taxation now serves far wider purposes than before. However, taxation continues rising of revenues and remains the primary source of the income required by the government to ensure the protection, social welfare and prosperity of its citizens. Adam Smith, in his 1776 book, “The Wealth of Nations” argued that a good taxation system should treat all people of a country equally, clearly define the tax a person is required to pay, be convenient for both tax payer and tax collector at all times, and be cheap to pay and collect tax. Those canons of taxation from Adam Smith’s perspective are equality, certainty, convenience and efficiency as a set of criteria by which to judge taxes. Taxation has always been an issue for the government and its citizens alike from the early years of civilization to date. The issue of taxation has generated a lot of controversies and severe political conflicts between the government and its citizens over time. According to its importance, several economic theories have been proposed to run an effective system (Eftekhari, 2009). Taxes are generally classified under three different theories as given: ability to pay principle, benefit approach and equal distribution principle. Although these are broad principles, citizens have always devised means to either reduce their taxes or evade taxes through several means.

Chiumya, (2006), sees tax evasion in general terms as illegal practices to escape from taxation. To this end, taxable income, profits liable to tax or other taxable activities are concealed, the amount and/or the source of income are misrepresented, or tax reducing factors such as deductions, exemptions or credits are deliberately overstated. Tax evasion can occur as an isolated incident within activities that are – in other aspects – legal. Or tax evasion occurs in the informal economy where the whole activity takes place in an informal manner – this means the business is not only evading tax payments but is also not registered as formal enterprise at all (Vazquez, 2001). Tax evasion amounts to using illegal means to reduce one’s tax liability. These illegal means could include non-disclosure of income, falsification of books of accounts and claiming deductions for expenditure that was not actually incurred or spent within the period (Adebisi, and Gbegi, 2013). Tax evasion is a criminal offence and a taxpayer who is found culpable will be subject to severe penalties. An example of tax evasion would be where a taxpayer claims an expense on a business activity as a deduction from his/her gross income when, in fact, the trip was not undertaken for business purposes but, rather, for personal purpose.

Studies have shown that citizens engage in tax evasion due to the following reasons:

Low tax morale

It appears that taxpayers' willingness to pay taxes differs widely across the various countries of the world. Simply put, it cannot be viewed as depending on the tax burden. Empirical research has rather shown that taxpayers throughout the world pay more taxes than can be explained by even the highest feasible levels of auditing, penalties and risk aversion (Alm et al. 1992, 2007). These high levels of tax compliance result from the tax morale of society that fosters self-enforcement of tax compliance. Tax morale is, however, not easy to establish. Especially countries without a deep-rooted 'culture' and habit of paying taxes find it difficult to establish tax morale. The willingness to pay taxes by the taxpayer is influenced by several factors:

- Low quality of the service in return for taxes in general, citizens expect some kind of service or benefit in return for the taxes paid. If the government fails to provide basic public goods and services or provides them insufficiently, citizens may not be willing to pay taxes and tax evasion will be the consequence (Pashev, 2005; Everest Phillips, 2008; Brautigam et al., 2008). Also, the average human being hates the payment of tax. The taxpayer sees taxation as a discredited imposition and evidently obnoxious. This stems mainly from the absence of a "quid pro quo" that is something of value given in return by the government for the taxes paid. It is commonly argued, taxes should not be paid as the authority does not provide amenities which are in any way commensurate with the taxes paid. There is no guaranteed compensatory benefit.

- Tax system and perception of fairness. Some studies suggest that high tax rates foster evasion. The intuition is that high tax rates increase the tax burden and, hence, lower the disposable income of the taxpayer (Allingham and Sandmo, 1972; Chipeta, 2002). However, the level of the tax rate may not be the only factor influencing people's decision about paying taxes. In fact, the structure of the overall tax system has an impact as well. If, for example, the tax rate on corporate profits is relatively low, but individuals are facing a high tax rate on their personal income, they may perceive their personal tax burden as unfair and choose to declare only a part of their income. Similarly, large companies can often more easily take advantage of tax loopholes, thereby contributing to the perceived unfairness of the system. Tax rates and the overall structure of the tax system, therefore, have a significant effect on the disposition to evade and avoid taxes.

- Low transparency and accountability of public institutions. Lack of transparency and accountability in the use of public funds contributes to public distrust both with respect to the tax system as well as the government. This, in turn, increases the willingness to evade taxes (Kirchler et al., 2007). When the public sees that their money cannot be traced to any particular activity then they begin to evade taxes.

- High level of corruption. If due to high levels of corruption, citizens cannot be certain whether their paid taxes are used to finance public goods and services their willingness to pay suffers and it becomes more likely that they evade their tax liabilities. A taxpayer might consider evading taxes if the cost of bribing a tax auditor is lower than the potential

benefit from tax evasion. More often than not there are reports in the media of how government functionaries misuse taxpayer's money. Evidences of wastage of public funds abound in the form of inflated contract prices, in unexecuted but paid contracts or in the criminal acts of using diverse methods and loopholes to exhaust funds voted for ministries and governmental departments before the financial year run out. The cumulative effect thereby produced is the resolve of many honest taxpayers never to pay theft due taxes again, or at most pay under compulsion.

- Corruption by the tax officials. Corruption by the tax officials often renders control of evasion difficult. Corrupt tax officials cooperate with the tax payers who intend to evade taxes. When they detect an instance of evasion, they refrain from reporting in return for illegal gratification or bribe. Corruption by tax officials is a serious problem for the tax administration in a huge number of underdeveloped countries. It is often alleged that tax lawyers and chartered accountants as a middleman help taxpayers including firms and companies in evading taxes. In the same vein, the Clearing and Forwarding agents help in evasion of Customs duties. It has been suggested that removal of human interface is a reliable solution to this problem.

- A study in Nigeria by Adebisi, and Gbegi (2013), revealed that, in many parts of Nigeria citizens are opposed to the payment of any form of taxes and rates on the ground that government had been unfair in the distribution of amenities and other good things of life. This thinking is often a root cause of most civil disturbances in parts of the country.

- Absence of spirit of civic responsibility. Orewa (1957) investigated the characteristics of evasion and found that complete evasion results from high degree of inter-district mobility on the part of the taxpayers. According to him, due to mobility, evasion is more pronounced on the part of self- employed taxpayers who move from compound to compound at frequent intervals than it is, with salary and wage earners with known and permanent address. Kiabel (2001) has also argued that some businessmen do not see any reason why they should pay tax irrespective of the fabulous profits made- This is the direct display of the spirit of non-patriotism: Such people take the stand that no matter the income or revenue that was acquired during the year nothing will be paid as tax.

High compliance costs

High compliance costs are the costs the taxpayer has to bear to gather the necessary information and submit tax returns and this can be an additional reason for tax evasion. In 2008, World Development Indicator for "time to prepare and pay taxes" a world bank report shows huge differences between countries: While preparing and paying taxes requires 210 hours on average in high income OECD countries, the required time extends to 1080 hours in Bolivia and Vietnam and even 2600 hours in Brazil. Similarly, Everest-Philips (2008) describes a recent mapping of local taxes in Yemen which found over 1500 different taxes, licenses and fees covering various bases at different rates. This situation has led businesses to worry more about the administrative burden than about the actual tax burden. In such a situation it can be assumed that compliance costs are very high and the probability of the taxpayer complying with such a great variety of taxes is low.

Particularly small and medium sized enterprises (SME) suffer from high compliance costs. A survey among South African firms on the regulatory costs of doing business revealed that taxes, in particular VAT, are perceived as the most problematic set of regulations followed by labour regulation (SBP, 2005). Above all it is the manual work that has to be changed to comply with tax legislation which is deterring firms from paying their taxes appropriately. When asked on their strategy to cope with regulatory costs of running their business about 18 percent responded to simply try to avoid or evade taxation.

Methodology

The study adopted a survey design focusing of informal activities in Abossey Okai a suburb of Accra in the Greater Accra Region. The research made use of both qualitative and quantitative approaches to research. The population of interest for this study is the informal sector in Abossey Okai. The sample frame on the other hand contains all traders in Abossey Okai and officials of the Domestic Tax Revenue Division of Ghana Revenue Authority. Non probability sampling technique was adopted for this research. Convenient sampling was used to select some of the traders in Abossey Okai. On the other hand, a purposive sampling was used where principal officers of the Domestic Revenue Division of the Ghana Revenue Authority were selected and interviewed. This method was considered more appropriate for this study because it allowed respondents to be selected across the target population and therefore reduced personal prejudice in the selection of the respondents. The study made use of both primary and secondary sources of data. The study gathered data through administration of questionnaires and unstructured interviews. It also gathered data from reports from institutions such as the Domestic Tax Revenue Division. The internet also served as an important secondary data source. Closed and open-ended self-administered questionnaire with clear cut questions based on the objectives of the study was adopted. This was to ease and limit the analysis of response-variation among respondents. Closed-ended questions were largely used because of the fact that majority of the study population were illiterates and to facilitate completion of the questionnaires with ease. This also helped in reading out and explaining the questions to those who did not understood the English language before the person makes a choice. A few open-ended questions were also used to draw out information on opinions, attitudes and beliefs of the respondents towards tax evasion in the informal sector. One hundred and fifty (150) copies of the questionnaire were sent out: ten copies were administered on officials of the Domestic Tax Revenue Division of the Ghana Revenue Authority in the rank of Principal Inspectors and Senior Inspectors of tax. A total of one hundred and twenty five (125) copies were duly completed and retrieved from the taxpayers. The study was eventually based on one hundred and thirty respondents. The data collected were collated and analyzed quantitatively to draw valid conclusions and inferences. Tables and charts were used.

Analysis and Discussion of Findings

Demographic Data

Demographic information is important because, the sex of a person for instance play an important role in the informal sector (Schneider et al. 2001). Depending on the institutional structures also, age can have varying influence on whether an individual will participate in the informal sector or not (Gerxhani 2006, Anderson 1998). Educational level on the other hand, has a complicated effect on tax compliance (Alm *et al.*, 2006; McGee and Bose, 2007). The demographic data from the survey have been analysed below. The findings shows that about 72% of the 125 respondents are male whilst the remaining 28% are female. It is clear that male participation in the informal sector is more as compared to their female counterparts. This finding confirms Giese and Hoffman (1999) assertion that males tend, more than women, to sell their labour services in the informal sector.

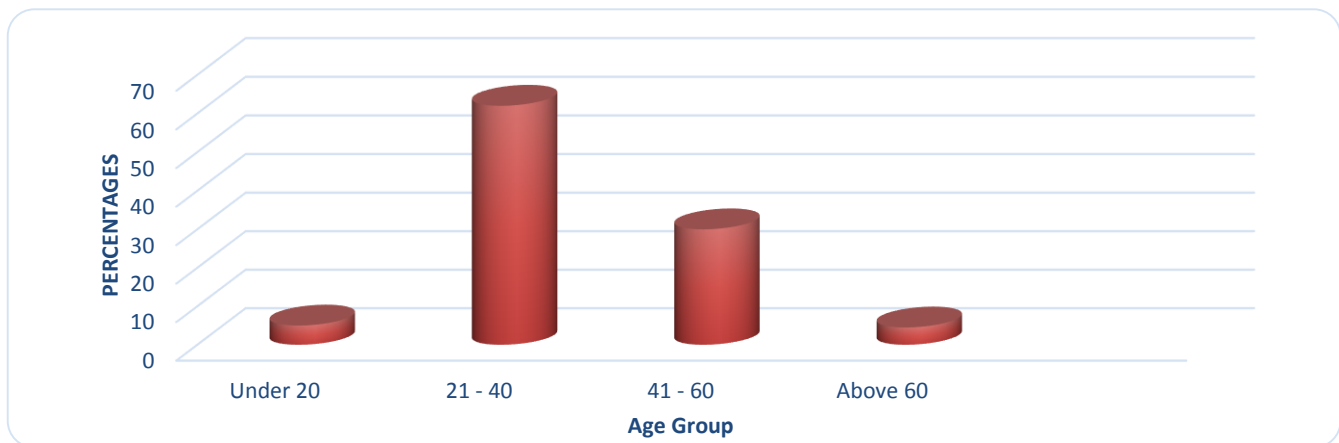


Figure 1 Age Group of Respondent
Source: Field Survey, 2016

As shown in figure 1, majority (62% percent of the respondents are within the productive years of 21– 40 years. This gives an indication that the informal sector is dominated by young people. This finding is contrary to Portes et al's (1986) finding that retired persons are more prone to participate in the informal sector to supplement or maintain income levels.

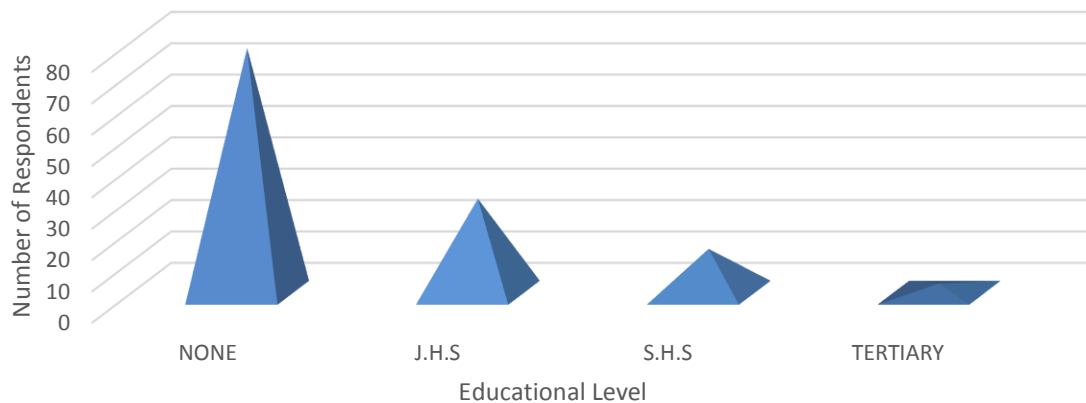


Figure 2: Educational level of Respondents
Source: Field Survey, 2016

Figure 2 indicates that about seventy (78) of the respondents have no formal education. This means the informal sector is dominated by uneducated persons who will find the interpretation and understanding of the tax laws difficult, therefore resulting to evading of such laws. This finding is similar to that of Ahmad *et al.*, (2007) who found that there is significant difference between taxpayers who have tax knowledge and taxpayers who did not have tax knowledge on tax compliance; also the insufficient knowledge may have an effect on interpretation and understanding of the tax law. Illiteracy also makes tax collection difficult as confirmed by (Crentsil-Taylor, 2010 and Asada, 2010).

Factors Contributing to Tax Evasion in the Informal Sector

A number of factors have been identified from the data gathered as the major factors contributing to tax evasion in the informal sector. These factors include; nature and scope of work in the informal sector; Level of Bookkeeping and Level of Tax Knowledge and Tax Compliance.

Nature and Scope of Work in the Informal Sector

Inherent to the informal sector is the difficulty of collecting taxes (Smith, 1994). This difficulty is attributed to a number of factors. In order to examine how the nature and scope of work contributes to tax evasion, the study considered the type of business informal participants do, how this business is carried out, their business location, average sales per week as well as the mode in which these sales are made.

The survey revealed that the informal sector of the Ghanaian economy is characterized by activities of sole-proprietors. This revelation is in conformity with Yankson (1992) and Otieku (1988). These sole-proprietors are involved in activities such as retailing, wholesaling as well as repairs. Figure 4.3 illustrates the various activities of the sole-proprietor.

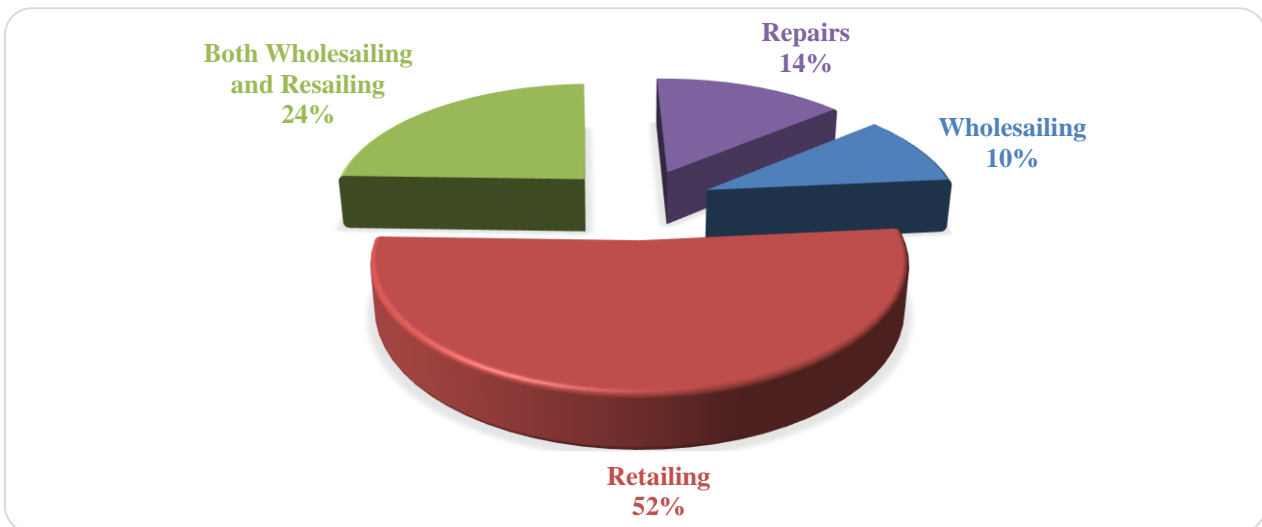


Figure 3 Activities of Sole-Proprietors
Source: Field Survey, 2016

It can be observed from figure 3 that, retailing is the main activity of the dominant sole-proprietors. The dominance of sole-proprietorship business in the informal sector has made it difficult for tax authorities to levy taxes on them. These difficulties are as a result of certain characteristics associated with the sole-proprietorship business.

The survey indicated that many of the sole-proprietors have not registered their businesses with the appropriate authorities. Because of this, identifying such sole-proprietors for tax purposes or to capture them into the tax net becomes difficult for tax authorities. This however, has resulted in many of them evading taxes. As observed, out of the one hundred and twenty five (125) sole-proprietors contacted, only twenty (21) of them have registered their businesses. This means majority of these sole proprietors are out of reach from the tax authority. This finding is not surprising as the legal regulatory framework within which sole-proprietors operate are less strict as compared to partnerships and companies. For instance, unlike partnerships and companies, sole-proprietors are not required by law to indicate their registered offices or places of business, auditors before commencing their business operations.

The survey further revealed that majority of the sole-proprietors have no permanent business location especially those who are into the repairs business and those who describe themselves as “affairs men”. This became evident when a question that sought to ascertain whether participants had permanent business locations or not.

It is interesting to note that sixty four percent (64%) of the sole-proprietors had no permanent business locations. This phenomenon has resulted in the inability of tax authorities partly in identifying most of the eligible taxpayers. This confirms the findings of Otieku (1988) that there are difficulties associated with tax collection from sole-proprietors who do not have permanent locations. Orewa (1957) in a similar finding in Nigeria indicated that businesses with sole ownership are likely to evade taxes because of their ability to “float” from one location to another.

According to these scholars, this phenomenon has a very negative implication for tax collection especially in the informal sector. It can thus be inferred that tax collection in the informal sector would continue to be a difficult exercise unless these businesses of the sole-proprietors are formally registered with business names and permanent locations. The informal sector of the Ghanaian economy is dominated by cash transactions. As such raising revenue through income taxes and consumer taxes are minimal (Ayee, 2007). Tax payers have limited ability to keep accounts and where they do so may not reflect the real outcomes of their transactions. People desirous of evading taxes prefer to have cash transactions, thus in the process generate un-accounted money. According to Rai (2004) when cash transactions dominates in an economy, it becomes extremely difficult for tax authorities to assess the income or expenditure of individuals and even that of the corporate sector. Governments are deprived of billions of legitimate tax revenue (Rai, 2004). This is because there would be no reliable permanent record to trace these cash transactions. From the data gathered it became indicative that cash is the mode of business transaction for most sole-proprietors. The figure 4.5 makes a comparison between weekly sales made by the sole-proprietors and the mode with which these sales are made.

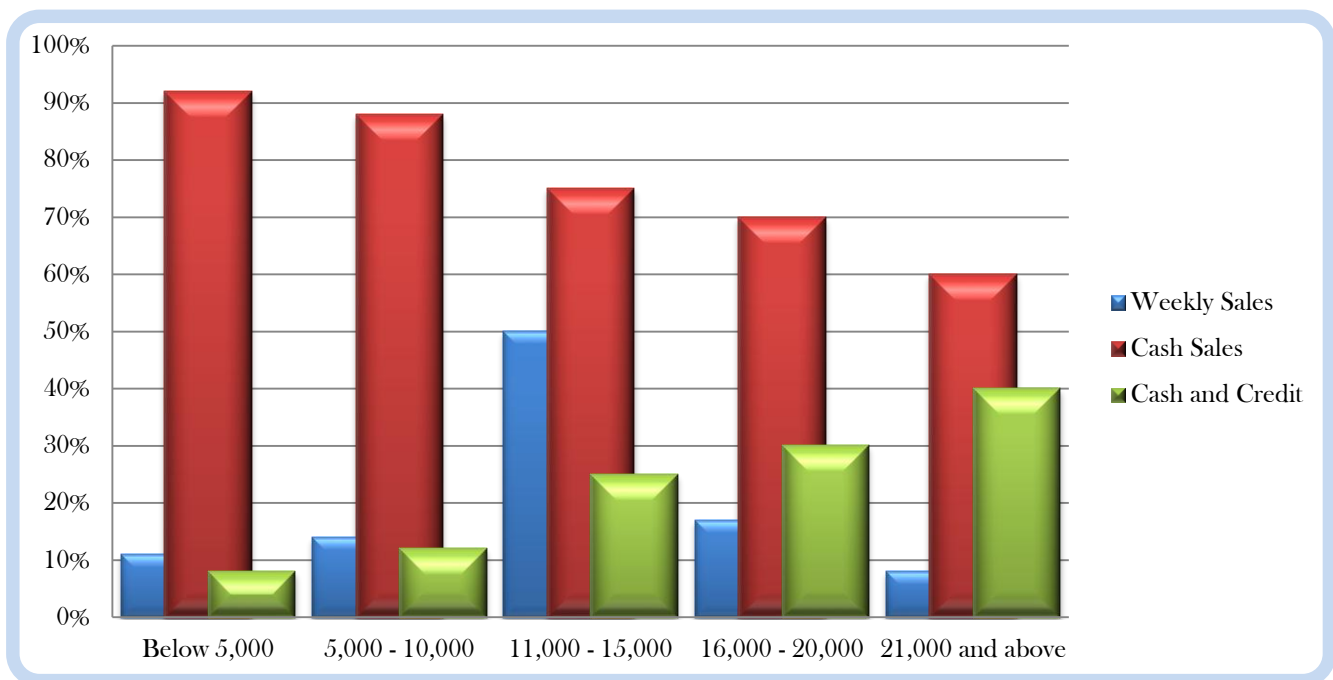


Figure 4 Comparisons between Weekly Sales and Mode of Payments for Sales
 Source: Field survey 2016

From figure 4.4, it is evident that although many of the sole-proprietors make an average weekly sales more than GH¢10,000, they prefer making these sales on cash basis. The implication of these practices is that, there would be no traces of documentary evidence of the real outcomes of their transactions. Tax authorities therefore find it difficult to determine the income of the sole-proprietor on which taxes are imposed. This confirms Rai’s (2004), revelation of India’s economy, that predominance of cash transactions is a contributing factor to tax evasion in most developing countries of which

Ghana is no exception. It can also be deduce from figure 4.4 that the lower an individuals' weekly sales, the more he or she transact business on cash basis.

Level of Book Keeping

The basis of every tax stems from available records (Djankov et al. 2003). It is therefore impossible to generate tax revenue without recourse to proper books of accounts. However, our survey revealed that many of the informal participants are very indifferent to proper record keeping. This practice therefore makes it difficult if not impossible for any proper assessment of income to be determined by the tax authorities. It is indicative that whereas thirty percent (30%) of the sole-proprietors reported keeping proper records of their business operations, majority are those who are not keeping proper accounts of their operations. This finding is not surprising, because whereas companies and partnerships are required by law to keep proper accounting records of their operations, there are no such requirements with respect to sole-proprietorship.

The survey further revealed that although many of the participants recognizes the importance of records keeping to the survival and growth of their business, they cannot keep the books by themselves and cannot also hire professionals to assist because of the cost associated with the service. Consequently, because most of the sole-proprietors are illiterates, they fear when they hire the services of experts they might expose their business information to other third parties or might even manipulate them.

Level of Tax knowledge and compliance

As an important introductory step in motivating voluntary compliance with tax laws among taxpayers to minimize tax evasion, it is reasonably necessary that taxpayers have good knowledge of some relevant features of the existing tax laws. It is being suggested that where taxpayers have a good knowledge of such issues as which of their incomes are subject to tax, the reliefs available to them and the penalties for flouting tax laws, voluntary compliance can be improved. Insufficiency or inadequacy of knowledge on the part of taxpayers may have an effect on interpretation and understanding of the various tax laws (Kasipillai *et al.*, 2003).

Again where majority of taxpayers do not have any good knowledge of their rights and duties under the tax laws, they are most likely to develop unfriendly attitudes towards the duty of tax payment and this will intend result to tax evasion. Taking into account the importance of taxpayers' knowledge of tax laws to improve tax compliance, attempts were made to ascertain the level of tax knowledge. The respondents were asked whether they are aware of any law that requires them to pay taxes. It can be observed that majority of the taxpayers representing eighty two percent (82%) were aware of certain laws that compels them to pay taxes, except for some few, eighteen percent (18%) who reported not having knowledge of such laws.

Furthermore, it was observed that apart from the general knowledge among taxpayers that every income earner must pay taxes on his incomes, majority of the taxpayers are ignorant of some important aspects of the income tax laws such as filing of tax returns.

In order to establish, the extent to which they have been complying with the law for which majority claim they know. It is indicative that, though many of the participants were aware of a law that requires them to pay taxes; their compliance level is low. It can be observed from the figure that when it comes to filing of tax returns, respondents are reluctant. More than ninety (90) of them reported not filing their returns regularly.

The reasons for respondents for not filing their tax returns as indicated in (figure 4.7) can be attributable to the fact that, many of them are not in the records of tax authorities therefore detection becomes difficult. Illiteracy also contributes to inability to file returns. Since majority of the respondents are illiterates who do not keep proper record of accounts, as shown in (figure 4.2 and 4.5) respectively, they may find it difficult file the returns. On the part of those who reported filing their tax returns, the survey tried to seek their opinions on the tax rate since tax rate is an important factor in determining an individual's tax compliance (Torgler, 2007). The response is presented in the figure 4.5.

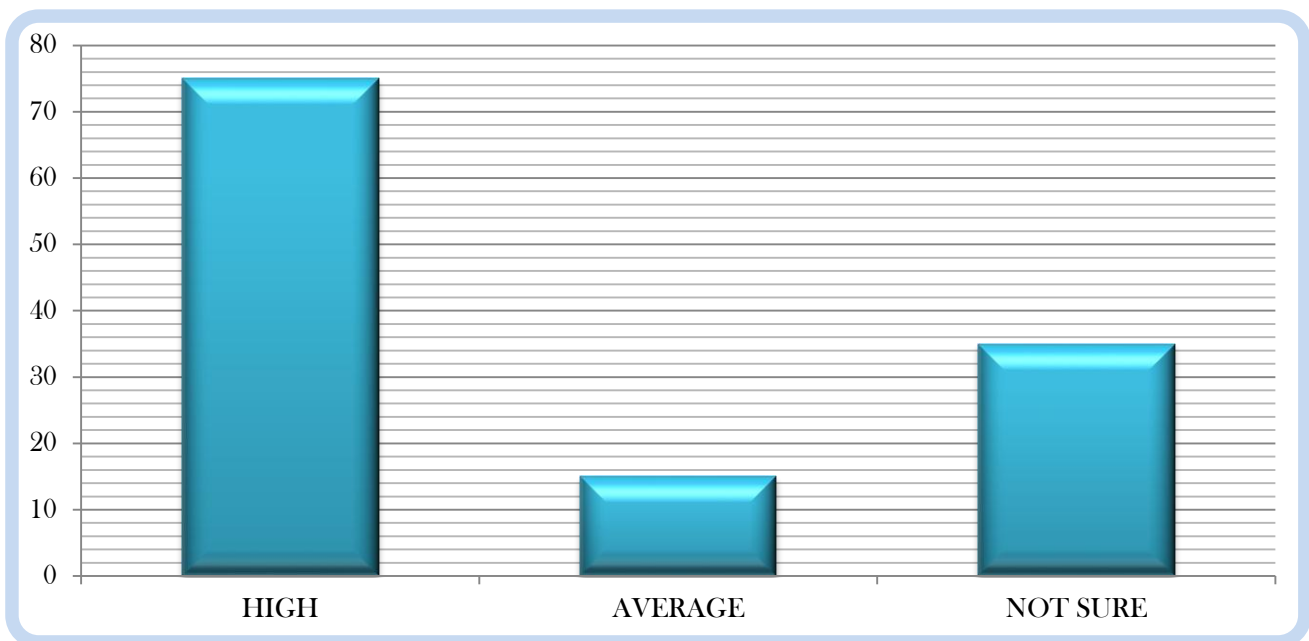


Figure 4 Respondents Opinion on Tax Rates
Source: Field Survey, 2016

As observed from figure 4.8 majority of the respondents have the perception that the tax rate is high. Whereas fifteen of them (15) are of the opinion that the tax rate is average, thirty five (35) are indifferent to the tax rate.

Ways of Perpetrating Tax Evasion in the Informal Sector

There are various ways through which tax evasion can be perpetrated. The most commonly adopted strategies identified during the survey include:

Bribery of Tax Officials

Information gathered from the Domestic Tax Revenue Division of the Ghana Revenue Authority indicates that, taxpayers in the informal sector sometimes bribe some tax officials for them not to be prosecuted when they are caught evading taxes. And because taxpayers know whenever they are caught for tax evasion they can give something in exchange for their freedom, they will continue to practice this criminal act. Majority of the taxpayers also mentioned that they sometimes give monies to some tax officials to ensure smooth clearance of their imported goods from the port without paying for the appropriate tax associated with the goods. Kiabel and Nwokah (2009) did no dispute this fact, when their studies confirmed that “the common way of tax evasion is through corrupt practices and bribery of tax officials” in most of the States in Nigeria.

Misclassification of commodities or line of business

Another source of tax evasion stems from misclassification of commodities subject to different VAT rates with the purpose to evade tax liabilities. The survey confirmed this when most of the sole-proprietors who reported to be dealing only in wholesaling were actually dealing in wholesaling as well as retailing. What this means is that, their tax liability will always be subject to the wholesaling and not both wholesaling and retailing. This point is no different from the findings revealed by the International Tax Compact (ITC, 2010) that tax evasion stems from the misclassification of commodities subject to different VAT rates with the purpose to reduce tax liabilities or increase claims for tax refunds.

Misreporting and non-declaration of taxable income

Misreporting and non-declaration of personal income and trade profits is a normal activity in the informal sector (Nwokah 2009). From the survey, since most of the transactions in the informal sector are on cash basis, it will be extremely difficult for tax officials to ascertain the actual taxable income for determination of tax liability. For instance many of the sole-proprietors reported making an average weekly sales between GH¢11,000 and GH¢15,000 of which a greater portion is on cash basis. The implication of this is that, since there are no documentary evidences, such as receipts, it will be difficult for one to confirm its authenticity. Non declaration of taxable income is easily perpetrated by the fact that most of the taxpayers do not keep proper records of their business transactions.

Failure to Keep Adequate Records

Another way through which tax evasion is perpetrated in the informal sector is through poor record keeping. Poor record keeping is one of the characteristics associated with informal sector workers (Agyeman, 1982; Otieku, 1988). Proper and adequate records keeping enable tax authorities to ascertain the real income of an individual or institutions in order to determine the tax liability. However, majority of the sole-proprietors from our survey do not keep records and the few who do, intentionally engage in keeping different records based on the needs or uses it would serve. This point was observed in Kiabel and

Nwokah (2009) findings. Tax officials strongly agreed that failure to keep adequate records is one of the main ways through which taxes are evaded as individuals conceal taxable profits through this act.

Under-invoicing and mis-declaration of quantities

Tax evasion is perpetrated through under-invoicing and mis-declaration of quantities. This point was included in the findings of Crentsil-Taylor (2010) when he stated emphatically that one of the common ways by which tax evasion is perpetrated is through under invoicing of quantities. The tax officials on the other hand, believe under-invoicing can be one of the ways through which taxes are evaded, but is not one of the main points. During the survey, it was revealed that many of the customers of the respondents do not take up receipts after buying. The implication of this is that, these items will not be accounted for even if a tax liability is to be established. Many of the tax officials agreed that under-invoicing and mis-declaration of quantities is one way through which taxes are evaded.

Challenges to Tax Revenue Generation in the Informal Sector

The Ghana Revenue Authority (GRA) and for that matter the Domestic Tax Revenue Division (DTRD) have not been able to generate enough tax revenue from the informal sector due to some challenges. A number of challenges have been identified as major factors inhibiting the smooth operations of the GRA. These include; low capacity of GRA and logistical difficulties; high illiteracy rate; lack of voluntary compliance on the part of taxpayers; loopholes and leakages in the tax system; undue political interference and victimisation; and Inappropriateness of tax mechanisms and Narrow tax base.

Lack of voluntary compliance on the part of taxpayers

In most developing countries, many people especially those in the informal sector have to be forced before they pay taxes. It is easy and less costly to implement tax laws when majority of the taxpayers really understand the rationale behind these laws. Where voluntary compliance is low, a lot of resources must be committed before tax revenue can be generated. In fact this has the tendency of increasing the operational cost and in some cases renders the tax collection in some sectors or areas ineffective. Unfortunately in Ghana, the level of voluntary tax compliance is very low. Apart from the few liability companies and partnerships who by law are obliged to pay taxes, majority of tax payers have to be compelled, by any means possible, to pay their taxes even those in the formal sector. Also, many people find it difficult to part with money especially in relation to payment of taxes which does not directly accord them any benefit. This really explains why most Ghanaians are hostile towards tax officials.

Low capacity and logistical difficulties

The GRA like any other public institution face a number of challenges in relation to generating tax revenue in the informal sector. Drawing strength from the hesitant nature of taxpayers, a lot of revenue collectors have to be dispatched to market centres and other

areas where revenue can be generated in order to achieve revenue targets. The Domestic Tax Revenue Division (DTRD) does not have the capacity to implement, monitor and enforce tax laws. This coupled with inadequate logistics such as vehicles, office space and inadequate conditions of service to motivate staff, has made it impossible to make significant penetrations into informal sector taxation. This challenge was observed by Aboagye (2011).

The incentive problem

Not only is the Ghana Revenue Agency (GRA) over-stretched, but typically their staff try to avoid working on the informal sector. Compared to virtually all alternatives, including corporate taxation or customs and excise, working on the informal sector is relatively low status, unrewarding, and sometimes even dangerous. Patrolling poorer areas to identify tax evaders and monitor tax payments with nowhere near the required level of resources is a difficult task. According to Ayee (2007), educated tax officials dislike interacting with illiterate poor, discouraged and sometimes violent citizens who hate being harassed for taxes. Motivation tends to increase output level; however, it is low among tax officials assigned to work with the informal sector. The implication is that, tax officials will be reluctant in discharging their duties which will increase tax revenue.

High Illiteracy rate

Many of the informal business operators are illiterates. As indicated from the data gathered, about sixty two per cent (62%) of the taxpayers contacted had no formal education which goes on to confirm the fact that they do not have knowledge of issues relating to tax laws, the penalties for flouting tax laws, and other opportunities available to them when they pay their taxes regularly. This point is in conformity with Otioku's (1988) study "tax administration in Ghana" where high illiteracy rate was mentioned as one of the problems that hinders effective tax administration in Ghana. A good knowledge of these tax issues has the tendency of inspiring voluntary compliance. In Ghana's informal sector where majority of the taxpayers do not have any good knowledge of their rights and duties under the tax laws, they are most likely to be hostile towards tax officials. It is not surprising when issues of such nature arise in the area under studied.

Undue political interference

Whether one likes it or not, the informal sector constitutes a substantial vote bank for politicians. Consequently, there have been what Tendler (2002) calls the 'devil's deal'—an unspoken arrangement between politicians and the informal sector operators: Public officials and politicians are willing to turn a blind eye to informal activities in order to win their sympathy to retain power. These unduly interferences sometimes encourage more people to evade because they know at any point in time the government can intervene on their behalf. In sum, while in developed countries tax evasion is considered a serious crime and so governments do not discriminate in terms of prosecuting or punishing people who evade taxes. It is however not the case in our part of the world. Aboagye (2011) in his findings on a study conducted to identify the various challenges encountered by the tax officials in tax collection, acknowledge this point.

Corruption and Victimization

Most people in higher positions in the public service unduly make gains out of their position and the GRA is no exception. Some field officers are also sometimes treated unfairly by their superior officers in the course of discharging their lawful duties. It was disclosed by some of the field officers of Domestic Tax Revenue Division that they are sometimes forced to rescind their decisions after a lawful sanction have been applied on a tax evader (*example, closing down of shops*). This normally happens when the tax payer is a relative to the superior officer. When these orders of the superior officer are not obeyed, they go into the bad books of the superior, who sometimes are excluded from the more lucrative positions. Some tax officials also collude with some taxpayers to deprive the government of tax revenue due him.

Inappropriateness of Tax Mechanisms

Ghana has used direct and indirect mechanisms to collect tax from the informal sector. Direct taxing through formal systems of accounting and income calculation and formal payment channels has not worked effectively because collection costs tended to be high in relation to the amounts collected and discretionary. According to Bird (2003), taxation based on formal systems of income calculation, accounts and payment options is not appropriate to much of the informal sector. Direct presumptive taxation may be more promising. In presumptive systems, assessments are based not on calculations of actual income, but on broad indicators of the scale of profits likely being made.

Narrow Tax Base

A good tax base provides a good tax rate and high tax revenue to every country. Any inadequacy in the tax base affects the tax net and therefore refuses to capture all qualified taxpayers thereby reducing the revenue accruing from these taxes. Majority of the economic activities in the informal sector are not captured in the statistics of the government therefore reducing the tax revenue accruing to the country. The narrow tax base is due to some characteristics associated with participants in the informal sector. That is many businesses have not been registered with permanent location, thereby making their identification impossible for taxes to be levied.

Conclusion

Tax evasion in the informal sector of Ghana can be seen more as the ultimate consequence of most of the problems confronting tax administration. Such factors as the large scale illiteracy among the dominance sole-proprietor, inadequate number of tax offices and officers, complex and inconsistent nature of tax laws, etc. have resulted in the low tax consciousness in the country. This problem manifests itself in such other forms as the non-filing of returns, poor quality of record-keeping, low levels of voluntary compliance, etc. These problems provide the opportunity for the large scale tax evasion in the country. Tax evasion is having uncalculated effects on our economy just like it has in many other jurisdictions. In Russia, it is estimated that tax evasion is widespread and the aged economy in which taxes are not paid account for over forty per cent (40%) of

Russian GDP. The incidence seems to be worst in most advanced countries like US and UK where over fifty-two thousand worthy individuals are suspected of evading tax by using offshore account to conceal assets and thus causing the states several billions of dollars (Crentsil-Taylor, 2011).

Tax evasion and for that matter the informal sector has caused a great deal of harm to Ghana through its direct and indirect consequences and if care is not taken will gain deep roots in this country. Furthermore, tax evasion is known to have created a great gap between actual and potential revenues which poses a great threat to economic growth and development of the country. The government and the entire Board of the Ghana Revenue Authority will have to adopt the necessary measures over the short and long term to improve this economic pandemic, which is fast draining our national coffers. Undoubtedly tax evasion specifically in the informal sector is a problem under any tax system. It is a major and growing problem under the current tax system of Ghana, despite very substantial efforts and increasingly harsh treatment of the taxpaying public. Almost forty percent (40%) of the public, according to the DTRD, is out of compliance with the present tax system, mostly unintentionally due to the huge complexity of the present system. This breeds disrespect for the tax system and the law, and makes a system based on taxpayer self-assessment less and less viable. It is hoped that if the measures prescribed in this study are implemented, it will go a long way in reducing the problem of tax evasion to a reasonable level.

For the Government of Ghana to meet its revenue targets especially in relation to taxation it would be appropriate to take a look at the factors responsible for the incidence of tax evasion since a check on these factors will go a long way in reducing if not eliminating the problem. The fact of the matter is that the seriousness attached to this problem in one way or the other will justify what is generated by way of taxes annually. In other words when government empowers the GRA, it will take the course to demand more from the GRA. Also just like any national and economic issue, tax evasion in the country must be given the appropriate attention and adequate resources must be directed to address it. In view of this, the following recommendations have been made.

Taxpayers education

First of all, in order to be able to collect taxes and reduce evasion, the government must educate the masses about the need for them to regularly pay their taxes and the sanctions associated with nonpayment of taxes. The average person must be made to understand that tax evasion is a threat to national development as the government cannot undertake projects the citizens' demand without money. It should also not be reluctant to use other means of publicity such as radio messages, television advertisement, post bills as well as the use of town criers to inform taxpayers of changes in tax legislation and the need for compliance. Regular tax information on changes in tax rates and other components will entice people to pay voluntarily without forcing them to do so.

Evaluation and review of collection procedures

The GRA should properly review and evaluate the assessment and collection procedures so as to encourage compliance by the taxpayers. The usual practice of reprinting parts of the tax laws and sending same to the taxpayers expecting that they would understand is not encouraging since these laws are written in legal terms that are not easily understood. Moreover, tax forms should be made less complex. Vast improvement can be made by improving the design of the forms. Sometimes these forms are very difficult to be filled by the so called elites let alone the illiterates.

Changing of negative perception among taxpayers

Again, one sure way of reducing tax evasion is to change the perception of people with respect to corruption in government and the revenue agencies. It is perceived that if tax levels are high then tax evasion will also be high. If tax hikes can be appropriately justified to the populace then it will also go a long way to reduce tax evasion in the country.

Strict enforcement of tax laws

The regulatory function of the government must be properly performed. Government through its tax revenue institutions should enforce rules and regulations governing tax compliance. Those found to have defaulted must face the sanctions. In this connection, the closing down of businesses embarked upon by the Domestic Tax Revenue Division and the VAT Service must be intensified. Those individuals in the informal sector who fail to pay their tax must be prosecuted. Special tax courts must be established to deal promptly with cases of tax non-compliance. There is frustration on the part of the tax agencies for the inability of the courts to deal efficiently with tax cases brought before them.

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