

CHRISTIAN SERVICE UNIVERSITY COLLEGE



SCHOOL OF BUSINESS

DEPARTMENT OF ACCOUNTING AND FINANCE

WHY SME'S FAILS TO HONOUR THEIR TAX OBLIGATIONS

(A CASE STUDY IN KUMASI METROPOLIS)

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**A THESIS SUBMITTED TO THE DEPARTMENT OF ACCOUNTING AND
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AWARD OF A DEGREE IN BACHELOR OF BUSINESS ADMINISTRATION**

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STATEMENT OF AUTHENTICITY

We have read the university regulations to plagiarism and certify that this report is all our own work and do not contain any acknowledged work from any other source.

We also declared that we have been under supervision of for this report herein submitted.

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DECLARATION

Declaration we hereby declare that is our own research toward the award of a degree in bachelor of business administration and it contains no material formally published by neither any other persons or any material which has been accepted for the award of any other degree of the university except where suitable accepted acknowledge has been made in the text.

DEDICATION

We wish to dedicate this work to the Almighty God for granting us wisdom and blessing throughout the period of our course.

We also dedicated the work to our parents, guardians and friends for their support and contribution towards our education.

ABSTRACT

This research was conducted to evaluate the factors contributing to tax evasion by SMEs and its effect on economic development of Kumasi metropolis. The aim was to assess the causes of tax evasion, the effects of tax evasion and the appropriate measures to put in place to encourage taxpayers to pay. This study was undertaken in the Kumasi metropolis, the administrative capital of the Ashanti region and the Ghana Revenue Authority office in particular; it is the second largest city in Ghana. We sampled 50 out of a total population size of 65 for the study. The researchers used questionnaires which were distributed to the traders and the officials of the Ghana Revenue Authority. Random sampling was used to select the respondents to answer the questions for the study. From the findings, it was revealed that tax evasion affects income generation, infrastructures in the society and economic growth. Tax evasion hampers the development of the economy. Tax evasion retards the provision of social amenities. Appropriate measures should be put in place to encourage taxpayers when due. The researchers therefore recommend that future researchers use other research methods such as focus groups and interview guides to gather information from SMEs and the Ghana Revenue Authority so as to enable them have a more concrete reasons for SMEs failure to oblige to their tax obligations.

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CHAPTER ONE

1.1 Introduction

This chapter constitutes the background of the study, statement of the problems, objective, research question, limitations and organization of the work.

Governments all over the world need money to pursue their various political programs. A greater portion or percentage of the revenues that the governments get for their programs comes from taxation. However; tax evasion by the citizenry of the country does not support government programs.

1.2 Background of the Study

Taxation is the commonest and oldest source of government revenue in the world. It is an instrument of public policy. Taxation in Ghana dates back to 1943. It began with the collection of income tax. The income tax ordinance of 1943 was introduced as a law to tax income earners. Income tax is a direct form of taxation levied directly on income.

Taxation can be said to be a means by which government finance their expenditure by imposing charges on citizens and corporate entities. It can also be said to be a pecuniary burden laid upon individuals or property owners to support the government of a nation.

Basically, there are two types of taxation and they are direct tax and indirect tax. Direct taxes may be adjusted to the individual characteristics of the tax payer whereas; indirect taxes are levied on transactions irrespective of the circumstance of buyer or seller (Atkinson 1977). Direct taxes include income tax, corporate tax, transfer tax, and capital gain tax. While indirect taxes include sales tax, value added tax and goods and services tax (GST).

Throughout history, taxation has always been one of the most important policies for every government, regarding the raising of revenues for developmental projects. Taxation was

introduced in Ghana in 1943 to create more avenues for government source of income in order to fund variety of public services.

‘Taxation is a necessity for any nation seeking civilization since there is no civilized state in the world where some form of taxation is not a necessity’ (Lugard 1918). However, taxation has always been one of the most important policies for every government, regarding the raising of revenues for developmental projects. Like all other policies, taxation also includes a problem within itself, although it was established on the objectives of equity, efficiency, positive economic growth and proper administrative costs. Certain lapses in tax policies, coupled with various schemes adopted by tax payers, have led to the problem of tax evasion and tax avoidance. It is a very serious societal problem, which is causing much concern and major setback on revenue collection in Ghana.

Tax avoidance arises in a situation where the tax payer arranges his financial affairs in a way that will make him pay the least possible amount of tax, without infringing on the legal rules. It is paying the minimum amount of tax using all available legal methods.

Tax evasion is planned and takes different forms which include evasion of custom duty through under invoicing and no declaration of quantities, smuggling of goods through unauthorized borders, evasion of value added tax among many others.

Many researchers have been undertaken in many jurisdictions to identify the underlining motivation for this immoral practice of evading taxes.

The government must build a data base to collect information about citizens and expatriate in the country which can inform the revenue agencies about whom and who have not paid tax.

We also need a technical infrastructure to track the population in the country. Again, one sure way of reducing tax evasion is to change the perception of people with respect to corruption in the government and the revenue agencies. It is perceived that if tax levels are high then tax evasion will also be high. If the need to pay tax can be appropriately justified to the populace

then it will also go a long way to reduce tax evasion in the country. Furthermore, tax evaders do not disclose their real assets and properties in order to also reduce their tax liabilities.

Government authorities do not implement the law set to eradicate tax evasion effectively. Tax avoidance and tax evasion thus, on the part of SMEs have not been completely eliminated on the Ghanaian economy despite the efforts of the Internal Revenue Service and their reform programs.

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 alleviate this economic pandemic, which is fast draining our national coffers.

1.3 Problem Statement

Tax as a major source of government revenue has been helping greatly to finance government expenditure in every country. There is however some underlying problem affecting tax revenue in Ghana. First and foremost, due to lack of commitment to honor tax obligation by the payers and in this case the SMEs. Also, some fail to furnish their tax and impending tax administration.

Secondly, unlawful demand and receipt of money to help others evade tax, delay in tax payment and lack of record or poor record keeping are also some problems. It is in the light of these problems that a research into tax evasion by SMEs has become necessary. The researchers among other reasons are to assess the GRA in its efficiency and effectiveness.

Tax avoidance and tax evasion are anti-social and unpatriotic; they continue to shrink government revenue, thereby hindering any meaningful development in the country. Tax avoidance and evasion have continued to thrive despite various reform programs aimed at reducing or totally eliminating the problem by the Internal Revenue Service (IRS).

Tax avoidance and tax evasion have continued to reduce tax revenue to the government. For the country to meet up with its aspiration of a better economy by 2020, SMEs should be compelled to oblige to their tax obligations.

1.4 Objectives of the Study

The main aim of this study is to investigate why SMEs avoid their tax obligations and evade tax. The specific objectives however are as follows:

-) To find the causes of SMEs' failure to honor their tax obligations.
-) To find the effects of tax evasion and tax avoidance.
-) To evaluate the appropriate measures to put in place to encourage SMEs in honoring their tax obligations.

1.5 Research Question

To come out with the most appropriate remedy to the problem at hand, the study seeks to answer the under listed questions;

1. What are the causes of SMEs' failure to honor their tax obligations?
2. What are the effects of tax evasion and tax avoidance?
3. What are the appropriate measures to put in place to encourage SMEs in honoring their tax obligations?

1.6 Significance of the Study

Tax plays an important role in the development of nations. A study of this nature will help educate SMEs about the essence of paying tax.

Firstly, the research will enable the researcher to know the relevant books that are kept in GRA in order to discover the causes of SMEs tax evasion or their failure to honor their tax obligations

Secondly, the study will look at the problems that are militating against the efficiency of the work of the GRA and recommend steps to correct these inefficiencies in the system. This will also enable the government of Ghana especially GRA to understand the problems and also institute credible measures to address them.

Thirdly, the study would provide other organization facing similar problems, the opportunity to improve on their accounting practices. It is believed that through the identified problems and recommendations workable.

Finally, the study would create a platform for other researchers to conduct further researches in the GRA.

1.7 Scope and Limitation of the Study

The scope of the study will be limited to some selected SMEs in the Kumasi metropolis and Ghana Revenue Authority in Kumasi, due to financial and time constraints. The project work will be undertaken with a lot of difficulties which include the following;

Firstly, difficulties in accessing information from authorities of the GRA will be too economical in giving information relevant for this study.

Secondly, the time frame within which this study will be carried out. The time will be a little bit inadequate for us to develop deeper into the causes, impacts and other related activities.

Finally, financial constrains will be a difficult task for us to raise money for this exercise due to economic condition during and after our stay on campus.

It must be noted however that, even though the study may suffer the above mentioned limitation, it may not invalidate any information which may be contained in this piece of work.

The conclusion and recommendations are relevant, credible and useful to the GRA, SMEs and other interested parties.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter spells out the definition of SMEs from various school of thoughts, emphasizes on review of relevant literature on SMEs failure to oblige to their tax obligations. This chapter again depicts the conceptual framework regarding SMEs and defines some inevitable terms embraced in this study.

2.2 Definition of SMEs

There is hardly any unique, universally accepted definition of SMEs because the classification of business into small and large scale is a subjective judgment (Ekpeyong&Nyong, 1992). Egbuogu (2003) noted that definitions of SMEs vary both between countries and between continents. The major criteria use in the definitions according to Carpenter (2003) could include various combinations of the following: Number of employees, financial strength, sales value, relative size, initial capital outlay and types of industry.

Inang&Ukpong (1992) however, stressed the indicators prominent in most definitions namely, size of capital investment (fixed assets), value of annual turnover (gross output) and number of paid employees. In countries such as the United States of America, Britain and Canada, small and medium business is defined in terms of annual turnover and number of paid employees. In Britain, for instance, a small and medium business is defined as that business with an annual turnover of €2 million or less with fewer than 200 paid employees. The Research institute for Management Sciences, University of Delft, The Netherlands, has classified businesses into four groups and defined small-scale industry as one employing 10 –

99 persons in which the Manager personally performs all the functions of management without actually taking part in the production.

Stanley and Morse (1965) stated that post World War Japan defines small and medium enterprises as one either having capital not exceeding Y50m or having not more than 300 employees in manufacturing industry, and either having capital not greater than Y10m or having not more than 50 employees in commerce and service sectors. They further reported an Indonesia Agency for Small and Medium Enterprises as defining small scale enterprises to mean all enterprises, household or cottage, employing less than 10 full time workers and not using motive power or machinery, and medium sized industry as one employing between 10 – 50 workers and using motive power. From the point of view of quantitative measure, the Indian official version defines small scale industry as comprising manufacturing enterprises with investment in plant and machinery not exceeding 750,000 Rupees. In the definition, employment was emphasized, thus reflecting India's preoccupation with problems of scarcity of capital and unemployment.

In Ghana, the definition of SMEs also varies from time to time and according to institutions. The Ghanaian Government has used various definitions and criteria in identifying what is referred to as micro and small sized enterprises. At certain point in time, it used investment in machinery and equipment and working capital. At another time, the capital cost and turnover were used. However, the Ministry of Trade and Industry, under whose jurisdiction the micro and small sized enterprises are, has adopted a somewhat flexible definition especially as to the values of installed fixed cost.

The Statistical Service of Ghana (SSG) which published the industrial statistics defined small scale industries as those employing 29 employees or fewer, the rest are all considered as medium and large-scale enterprises. According to the Venture Capital Fund Act 2004 (Act 680) in Ghana, an SME is an industry, project, undertaking or economic activity which

employs not more than 100 people and whose total asset base, excluding land and building, does not exceed the cedi equivalent of \$1 million in value. Also, according to the records of the Registrar General's Department in Ghana, about ninety percent (90%) of registered companies are SMEs. Data from the Social Security National Insurance Trust (SSNIT) supported this assertion as it shows that 90 percent of companies employ less than 20 persons. The National Board for Small Scale Industries (NBSSI) describes Micro and Small Enterprises as those enterprises employing 29 or fewer workers. Micro enterprises are those that employ between 1-5 people with fixed assets not exceeding USD 10,000 excluding land and building. Small enterprises employ between 6 and 29 or have fixed assets not exceeding USD 100,000 excluding land and building. The National Board for Small Scale industries (NBSSI) further classified SMEs as follows: Micro enterprise: less than 5 employees; Small enterprise (6 – 29) employees; Medium enterprise (30 – 99) employees; and Large enterprise (100 and more) employees

2.3 Review of Literature

Literature on the fiscal exchange between taxpayers and government (Alma et al., 1993; Spicer & Becker, 1980) and whether government spends tax monies in accordance with taxpayers' wishes has been found to affect compliance. The exchange viewed by the taxpayers as their fair will determine their willingness to contribute to taxes (Schmolders 1970). In addition to that, if government trusts the taxpayers, they will be rewarded by greater trust in government by improving tax morale (Feld & Frey, 2002; Kircher, Hoedel & Wahl 2008). It has been shown that taxpayers can be induced to comply if they have been positively rewarded for their honest behavior (K. Smith, 1992; K. Smith & Stalans, 1991) and given that, it would be fruitful for tax authorities to motivate taxpayers to comply by assisting and trusting them to do the right thing instead of merely enforcing tax laws. To

understand whether taxpayers are being motivated to comply, information should be gathered from the taxpayers regarding their interaction with tax authorities via tax audits and/or tax query experiences. Tax authorities have been found to be helpful to some SME operators (Mckerchar, 1995) as well as unhelpful to others (Bird, 1992; Noble, 2000), with some SME showing strong resentment towards the tax system and tax levels (Australian Taxation Office, 1996; Coleman & Freeman, 1994; McIntosh & Veal, 2001) from the tax system than larger businesses and they admit to paying less than their fair share of taxes (Ahmed & Braithwaite, 2005). They are more likely to experience greater conflict with, and sanctions from, the tax authorities (Ahmed & Braithwaite, 2005; S. Morse et al., 2009; Noble, 2000).

2.4 Conceptual Framework

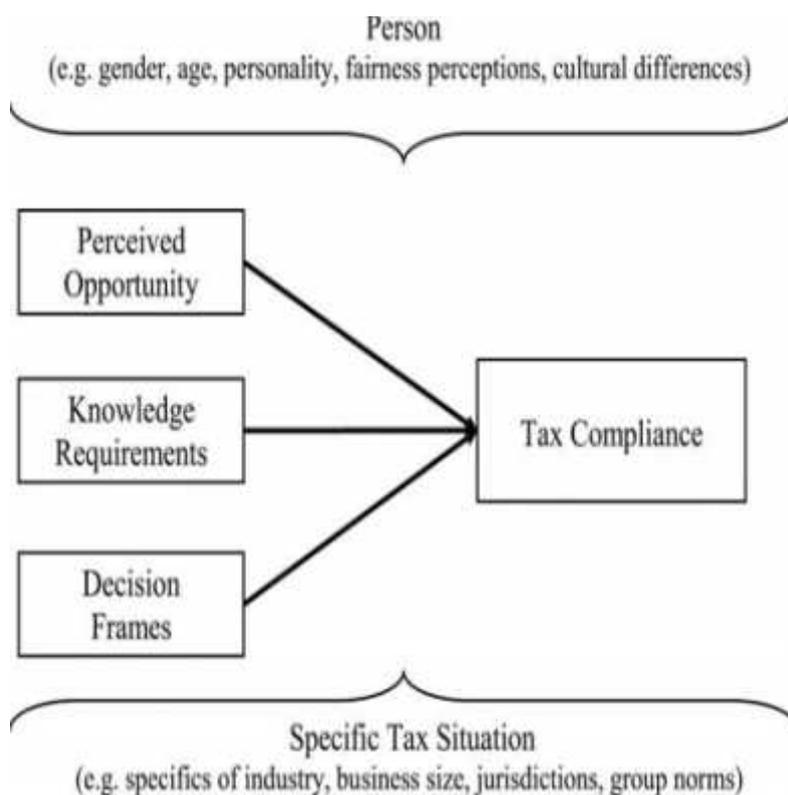


Figure 1.

A framework of factors influencing small and medium size enterprise tax compliance

2.5 Definition of terms

2.5.1 Contribution of Taxation to Economic Development

Tax is a contribution exacted by the state. It is a non-penal but compulsory and unrequited transfer of resources from the private to the public sector, levied on the basis of predetermined criteria. The classical economic were in view that the only objective of taxation was to raise government revenue. But with the changes in circumstances and ideologies, the aim of taxes has also been changed. These days apart from the object of raising the public revenue, tax is levied to affect consumption, production and distribution with a view to ensuring the social welfare through the economic development of a country. For economic development of a country, tax can be used as an important tool in the following manner;

Optimum allocation of available resources, tax is the most important source of public revenue. The imposition of tax leads to diversion of resources from the taxed to the non-taxed sector. The revenue is allocated on various productive sectors in the country with a view to increasing the overall growth of the country. Tax revenues may be used to encourage development activities in the less development areas of a country where normal investors are not willing to invest.

Raising government revenue, in modern times, the aim of public finance is not merely to raise sufficient financial resources for meeting administrative expenses, for maintenance of law and order and to protect the country from foreign aggression. Now the main object is to ensure social welfare. The increase in the collection of tax increases the government revenue. It is safer for the government to avoid borrowings by increasing tax revenue. Encouraging savings and investments, since developing countries have mixed economy, care has also to be taken to promote capital formation and investment both in the private and public sectors. Taxation policy is to be directed to raising the ratio of savings to national income. Reduction of inequalities in income and wealth, through reducing inequalities in income and wealth by

using an efficient tax system, government can encourage people to save and invest in productive sectors. Acceleration of economic growth, tax policy may be used to handle critical economic situation like depression and inflation. In depression, tax is set to increase the consumption and reduce the savings to increase the aggregate demand and vice versa. Thus the tax policy may be used to strengthen incentives to savings and investment.

Price stability, under developed countries, there is another role to maintain price stability to ensure growth with stability. Control mechanism, tax policy is also used as a control mechanism to check inflation, consumption of liquor and luxury goods and to protect the local poor industries from the uneven competition. Taxation is the only effective weapon by which private consumption can be curbed and thus resources transferred to the state. Thus the economy can ensure sustainable development. Thus, it can be said that the economic development of a country depends various reasons one of them are on the presence of an effective and efficient taxation policy.

2.5.2 Impact of Tax Evasion on Economic Development

Ghana loses several million of cedis to tax evasion and tax avoidance every year which has eaten into the moral fabric of the society considering its effects on revenue and national accounts. This practice which is common in both developed and developing countries poses a great threat to both economic and national development, as it negatively affects the gross domestic product. Ghana lost approximately £36 million to tax evasion on mining revenues between the year 2007 and 2009 which was repatriated without taxes to the government. Christian aid came out with a report in 2008, drawing a research by Barkar estimate that low income country like Ghana lost over \$22.4 billion in tax revenue annually to tax evasion which was comparable to the total amount of foreign aid received by the country (Barkar R. 2008). Throughout history, taxation has always been one of the most important policies for

every government regarding the raising of revenues for developmental projects. Like all other policies, taxation also includes a problem within itself although it was established on the objective of equity, efficiency and positive economic development and proper administration costs. Certain lapses in tax policies coupled with various schemes adopted by the tax payer has led to the problem of tax evasion and tax avoidance.

Many researchers have been undertaking in many jurisdiction to identify the underlining motivation for this immoral practice of evading taxes. It is well noted that people who evade taxes have reasons for such actions. It must be known that the average human abhors the payment of tax. People see taxation as a discredited imposition and evidently obnoxious. This stems mainly from the absence of a 'quid pro quo' which means something of value given in return (by the government) for the taxes they pay. That is, if tax payers do not see the good use of their taxes by the government, then they will adopt ways and means of not paying taxes or reduce their tax liability.

Spicer (1974) in his dissertation, behavioral model of income evasion concluded that evasion by an individual was also found to be positively related to the number of his friends or colleagues who they believe are evading taxes. Beattie (1982) is of the opinion that, the desire to own more wealth is one of the reasons for evading taxes. This is because ultimate benefit of the sales of a businessman is the amount of money remaining after he has paid all expenses including taxes. His goal is to reduce cost, reduce his price to obtain a bigger share of the market and thus increase the cash available to the business at the end of the financial year. Studies have shown that the tax payer attitude and decision to evade tax is based on different reasons. They include excessive corruption on the part of government officials, problems of assessment, collective and enforcement of tax administrators' incompetence on the part of tax authorities, general dishonesty among Ghanaians, political culture, ignorance,

unfairness of the tax system and lack of regard for equity, law and justice, unpatriotic Ghanaian citizen (Ablordepy, 2006).

Again, some also evade tax because they perceive inequitable distribution of amenities in the country. Others evade tax due to misuse or mismanagement of funds raised from the tax collected. At the corporate level, businesses commit tax evasion if the government is relaxed in enforcing tax laws and there are significant lapses in the tax system. Corruption by tax officials and under-resourced tax administration are also some of the notable reasons for evading taxes.

Tax evasion and tax avoidance have caused a great harm to many nations and if care is not taken this will gain a deep root in the country. These two twin devils have created a great gap between actual and potential revenue which poses a great threat to economic development. 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 alleviate this economic pandemic which is fast draining our national coffers (Taylor 2011).

2.5.3 Tax Relief

A tax relief is any program or incentive that reduces the amount of tax owed by an individual or business entity. The underlying factor that governs taxation is ability to pay. Section 39 of the Ghana Revenue Act 2000 (Act 592) provides for the following tax relief; marriage or responsibility that is granted to any person with a dependent spouse but a new Act 731 took effect from May, 2007. The new tax reliefs are personal 240, marriage 35, children's education (maximum of three30, disabled persons 25%, old age (60 years plus) 35, aged dependents (2) 25, (all in Ghana cedis) (GRA Act 2000, 592, 731)

2.5.4 Tax Evasion, Tax Avoidance and Tax Expenditure in Developing Countries

The provision of public service and infrastructure is the key factor for economic development and growth. Many developing countries fail to raise tax revenue required to finance their public sectors. In 2005, the average tax revenue to GDP ratio in the developed countries was approximately 35%. In the developing countries, it was equal to 15% and in the poorest of these countries, the group of low income countries tax revenue was just 12% of GDP.

Tax avoidance and tax evasion are widely believed to be important factors limiting revenue mobilization. This study reviews existing empirical estimates of tax gaps, that is, tax revenue losses due to tax avoidance and tax evasion in developing countries, the role of tax expenditures and other determinants of revenue mobilization.

Governments in most developing countries do not consider the principles of economy (Smith, 1978) in collecting tax revenues. This concept means that the cost of collecting tax such as labor cost, machinery, stationery and other tax instruments must be abridged drastically. That is, it should not be anywhere close to the tax revenue. Evidence has proven that most developing countries have high rate of tax expenditure and this reduces tax revenue immensely. The structure for tax collection must be reviewed so that tax expenditure can merely be minimized.

Existing empirical studies on tax revenue losses due to tax avoidance and evasion in developing countries distinguishes between a domestic component and an international component. The domestic component includes tax evasion which occurs due to the domestic shadowed economy. The international component includes profit shifting by corporations and off-shore holdings of financial assets by private individuals.

The most widely cited study of the domestic component of tax evasion is Cobham (2005), who estimates that developing countries lose \$286 billion USD per year due to tax evasion in the domestic shadow economy. Cobham's calculation of the tax evasion is based on estimates

of the size of domestic shadow economy by Schneider (2005). This approach has a number of limitations. Most importantly, the number derived by Cobham (2005) should not be interpreted as an increase in tax revenue which could possibly be achieved by better tax enforcement or other policy measures.

This is not only due to the fact that it is practically impossible to tax all economic activity in the shadow economy. In addition, the measured size of the shadow economy may be the result of deliberate policy choices made by developing countries like Ghana. This would imply that paradoxically, crowding back the shadow economy may neither increase tax revenue nor be in the interest of national welfare. Secondly, shadow economy activities as quantified in Schneider estimates include illegal activities which would be stopped if detected and thus would not generate tax revenue. Thirdly, measures of the shadow economy as those provided by Schneider have to be interpreted with caution. Due to estimation method used, the change of these measures over time is likely to be more informative than to change the levels of these estimates.

If estimates of level of tax evasion are based on measurement of the size of the shadow economy, the accuracy of this measure is of key importance. Cobham (2005) relies on shadow economy estimates based on macro indicators. The approach has the advantage that the data is publicly available. We compare to other methods to quantify the (domestic) tax gap. These approaches can be broadly divided into:

- i. Macro approaches: this uses data from national accounts.
- ii. Macro indicators to quantify the tax gap.
- iii. Macro approaches: this uses household or firm level data retrieved from surveys and audits.
- iv. In general macro approaches based on information from tax audits of randomly selected tax payers are most likely to deliver reliable tax gap estimates. In contrast,

methods to quantify the domestic tax gap based on macro indicators are less reliable and informative. However, data to implement micro method is seldom available for developing countries.

2.5.5 Tax Avoidance

Wikipedia, the free encyclopedia defined tax avoidance as the legal utilization of the tax regime to one's own advantage. This occurs when the tax payer arrange his or her affair in accordance with the requirement of the tax legislation in order to reduce the overall charge to tax or minimizing tax liabilities legally by means of full disclosure to the tax authorities.

Tax payers especially the self-employed persons can take advantage of the tax avoidance to reduce their tax burden by exploring the tax reliefs, for instance, contributing part of their taxable income or gains as insurance or premium to the pension scheme as security for retirement at the Social Security National Insurance Trust (SSNIT).

2.5.6 Tax Default

Is a failure to fulfill or refusal to pay tax due at a stipulated time, should this happen, the defaulter is asked to pay a penalty on the tax. Tax nationwide seizure of 301 vehicles by the Custom Excise and Preventive Services (CEPS), whose owners failed to pay the necessary custom duties and about 40 owners of such vehicles who paid 220 million in penalties published by the Daily Graphic on February 9, 1999, is an example of tax default.

2.5.7 SMEs and Tax Compliance

Tax literature has unanimously found that SMEs bear a disproportionate tax compliance cost(G. Cooper,1998 Hasseldine, 1995).The efforts and compliance cost involved in collecting and accounting for taxes can be substantial for some SMEs(Evans, Carlon,

&Massey, 2005; Prescott & Hooper , 2009). At present most tax policies adopt the tax authority-centric perspective of what tax compliance should be, and of the expected behavior from SMEs taxpayers. This perspective focuses on the different regulatory approaches for the different SMEs behaviors, such as commitment, disengagement, retaliation, and resistance towards the tax system (Braithwaite, 2003a; Inland Revenue, 1998). On the other hand, the taxpayer-centric perspective emphasizes the processes and decisions taxpayers (SMEs) undertake in order to comply.

To have effective tax policies, it is necessary for the tax authority to understand what and how tax compliance activities are undertaken and perceived by SME taxpayers. Based on initial review of the literature on SMEs' tax behavior, three characteristics of SMEs' situation emerged: due to self-reporting and limited control of most of the owners over underlying money flows, they have the opportunity for non-compliance; due to the need for self-reporting and facing different taxes, they require substantial knowledge in order to understand the rules and comply; and due to receiving sums that then have to be partly passed on to tax authorities, they face differential possibilities for framing taxes (cf. Weigel et al.,1987).

In our framework of factors influencing SMEs' tax behavior, we have adopted a psychological perspective and propose that the three identified main characteristics determine SMEs' tax behavior (Figure 1). The framework assumes that the three main factors play a universal role for SMEs. It acknowledges, however, that the specific extent of for example perceived opportunity is co-determined by inter-individual factors such as risk-seeking, age, and gender(for effect of gender see Kastlunger et al., 2010; Robben et al., 1990b), and situational factors such as line of industries (e.g. Androeni et al., 1998; Schuetze, 2002), relevant group (social) norms and social networks (e.g. Peterson, 2001; Rothengatter, 2005; Smith and Oakley, 1994).

CHAPTER THREE

METHODOLOGY

3.1 Introduction

This chapter deals with research instrument, scope of the study, profile of the study area, sampling, data collection, data analysis procedure, validation of questionnaires, mission statement, objectives and limitation of the study.

3.2 Research Instrument

The researcher used questionnaires to collect data for the study. Questionnaires are much more relied on for information. These targeted groups such as the traders and the Ghana Revenue Authority were visited on their various premises to observe and distribute questionnaires. The questions were straight forward and it generated interest of the respondents to give quick response.

These questions were made of open-ended, two choice questions, multiple choice questions and close ended questions. The questions were structured in such a way that, the names of the respondents were not required. The questionnaires were also designed in such a way that it will enable the respondents express their views as far as possible depending on the issue raised.

The traders and the Ghana Revenue Authority officials had questions suitably addressed to them. The need for interviews cannot be waived.

3.3 Scope of the Study

Many people evade tax which hampers the development of the economy. The research team undertakes a study to unravel factors contributing to tax evasion and its effects on economic development of the Kumasi Metropolis. The study is based mainly around the traders and the

Ghana Revenue Authority. These respondents are chosen because they do not prepare final accounts for tax purpose.

3.4 Profile of the Study Area

The study was undertaken in the Kumasi Metropolis, the administrative capital of the Ashanti region of Ghana in general and the Ghana Revenue Authority office in particular, it is the second largest city in Ghana with a total population of 4,780,380 with a total number of 2,316,052 males and 2,464,328 females and a growth rate of 32.3%. The Kumasi metropolis covers an area of 24,389 square kilometers and has wholesalers and retailers all over the metropolis.

The city attracts population from all over the Ashanti Region and the major economic activity is trading and servicing. The mission statement of the Kumasi Metropolitan Assembly states, it exist to enhance the quality of life of the people by facilitating the maintenance of law and order and mobilizing the physical and financial resources to provide quality socio-economic services especially in education and health in collaboration with other developmental agencies and in conformity to broad national policies. (www.ashantiregion.com.gh)

3.5 Sampling

Probability sampling method was used for the study. This gave an equal chance for all elements in each sector to be selected. A sample random sampling technique was used in selecting the staff. This was adopted because it ensured representativeness of all the characteristics of the target population.

3.6 Data Collection

Two months was used in collecting data. This afforded the researchers the opportunity to go into the performance of the Ghana Revenue Authority. The time frame was not enough to allow the researchers to go into some relevant issues.

Data collection was made possible by the use of primary and secondary source. The primary data collected from the traders was done by the use of questionnaires that was prepared and administered. The questionnaires were designed to include close-ended and open-ended questions. The questionnaire as a method of data collection was chosen because of the following reasons;

1. It was be less expensive than other method.
2. Bias or errors caused by the presence of an interviewer was avoided.
3. Enough time was given to the respondent to check on his/her information when necessary.
4. It provided a consistent and uniform mode of data collection.
5. Quick responses were provided and time spent on data collection was be shortened.

The questionnaires were self-administered by the respondent from the department and most of the responses were recorded by the respondent themselves, except in some cases that the researcher had to assist.

Two set of questionnaires were designed to the traders and the Ghana Revenue Authority. Questionnaires for the traders' background had its items and it has information as regards to the background information, concept of tax evasion. Questionnaires for the staff of the Ghana Revenue Authority had items with information such as status and concept of tax evasion.

3.7 Data Analyze Procedure

The nature of the issue and process requires the need for statistical tools like tables for analysis. This was made possible to analyze data collected. Due diligence was taken throughout this stage of the study. This was reflected in the presentations and the final analysis as well as the conclusion and recommendation made.

3.8 Validation of Questionnaires

To ensure that the questionnaires were more reliable and capable of achieving the intended result of the research, carefully planned tests was conducted on them.

Firstly, the questionnaires were presented to the supervisor for his comments and secondly, it was administered to our follow students for their response. This gave the researcher hope that the results of the questionnaires may meet the needs of the study.

CHAPTER FOUR
PRESENTATION AND ANALYSIS OF DATA

4.1 Introduction

This chapter deals with the analysis and presentation of data gathered. The findings from data gathered from interviews and questionnaires administered to the staff of the Ghana Revenue Authority and the traders.

Table 4.1 Operation period of respondents

The table below presents the operation distribution of employees

Operation period(years)	No of respondent	percentage
LESS THAN OR EQUAL TO 5	20	40%
6 TO 10	14	28%
11 TO 15	7	14%
16 AND ABOVE	9	18%
TOTAL	50	100%

Source: field study 2015

The table above shows how long a business has been operating and their respective percentages. From the table above, twenty (20) respondents who constitute 40% of the sample population have be in business for less than or equal to 5 years, and fourteen (14) respondents who also constitute 28% of the sample population were also 6 to 10years in operating, 7 respondents which constitute 14% of the sample population, 9 of the respondents were within 16 and above, which represent 18% of the sample population.

The analysis also revealed that most of the respondent from small and medium enterprises (SMEs) are less than or equal to 5 years.

Table 4.2 Payment of money by the Traders

HAVE YOU EVER PAID MONEY IN THE FORM OF TAX TO IRS?	No of respondent	percentage
YES	32	64%
NO	18	36%
TOTAL	50	100%

Source; field study 2015

The table above shows the number of respondents who pay money to IRS where 32 respondents agree to pay tax to IRS which represent 64% of respondent, 18 respondents agree not to pay tax to IRS which also represent 36% of the total population.

Table 4.3 Refusal Payment of Taxes Ratio of Respondents

The table below shows the total number of respondents to the questionnaires who refused to pay tax to IRS of the respondents covered by the study.

HAVE YOU EVER IN ANY TIME REFUSED TO PAY TAX TO IRS OFFICIAL?	No of respondent	percentage
YES	27	54%
NO	23	46%
TOTAL	50	100%

Source; field study 2015

The table above indicates the respondents and their respective percentages, from the table twenty-seven (27) of the respondents from the Ghana Revenue Authority which constitute 54% of the population agree to pay tax and twenty-three(23) of the respondents also do not agree to pay tax which also constitutes 44% of the population.

Table 4.4 Sex Ratio of the Traders

DO YOU PROPER RECORDS ON TAX PAID TO IRS?	No of respondent	percentage
YES	12	24%
NO	38	76%
TOTAL	50	100%

Source; field study 2015

The table above shows the gender and the total number of the respondents to the questionnaire, it can be clearly seen from the table that out of the total number of the respondent majority of them are females which are sixty (60) constituting 60% of the total population and the remaining forty (40) of them are also males which also constitute 40% of the total population.

Table 4.5 Responds of the SMEs

ARE YOU BEING FORCED BEFORE PAYING TAX?	No of respondent	Percentage
YES	18	36%
NO	32	64%
TOTAL	50	100%

Source; field study 2015

The table above shows the total number of respondent who are forced before paying tax, 18 respondents are force before paying tax which represent 36% of the total population and 32 respondent also respond no which represent 64% of the total population.

Table 4.6 The Effects of Tax Evasion

Section B of the questionnaire to the staff of the Ghana Revenue Authority contains statements related to the effects of tax evasion in the Kumasi Metropolis.

	The Effects of Tax Evasion	DA	N	A
1	Is the development of the metropolis affected by tax evasion?	0%	4%	96%
2	Is the economic growth affected by tax evasion?	10%	2%	88%
3	Does the evasion of tax affects revenue generation?	0%	4%	96%
4	Are the infrastructures in the society affected by tax evasion?	4%	2%	94%

Source; field study 2015

Considering the effects of tax evasion, 96% of the respondents agreed when the researcher asked is the development of the metropolis affected by tax evasion, 4% of the respondents were neutral and none of the respondents disagreed. This means that evasion of tax has affected the development of the metropolis. Where respondents were asked is the economic growth affected by tax evasion, 88% of them agreed, 10% of them also disagreed and 2% of them were also neutral. Where the respondents were asked does the evasion of tax affects

revenue generation, 96% of the total population agreed and the remaining 4% of them were also neutral and none of them disagreed.

Also where the researcher asked the respondents are the infrastructure in the society affected by tax evasion, 94% of them agreed, 4% of them disagreed and the remaining 2% were also neutral.

Table 4.7 The Appropriate Measures to Encourage Tax Payers

Section C of the questionnaire to the Ghana Revenue Authority staff contains statements related to the appropriate measures to encourage tax payers in the Kumasi Metropolis.

	Appropriate Measures to Encourage Tax Payers.	DA	N	A
5	Should early tax payers be granted reliefs?	20%	8%	72%
6	Is it necessary for tax collectors to educate tax payers on tax payment?	2%	6%	92%
7	Should tax payment be made a month after filing returns?	40%	10%	50%
8	Do you agree to pay your tax on installment?	54%	4%	42%
9	Is it important for tax payers to know the purpose of tax payment?	8%	12%	80%

Source; field study 2015

Considering the appropriate measures to encourage tax payers the researcher asked the respondents should early tax payers be granted reliefs, 72% of the total respondents agreed, 20% of them disagreed and 8% of them also were neutral.

When asked is it necessary for tax collectors to educate tax payers on tax payment, 92% agreed, 6% were neutral and 2% disagreed. When the researcher asked the respondents should tax payment be made a month after filing returns, 40% out of the total population disagreed, 10% of the respondent neutral and 50% of them also agreed?

When asked should tax payment be made on installment, 54% of them disagreed, 4% of them neutral and 42% of them also agreed.

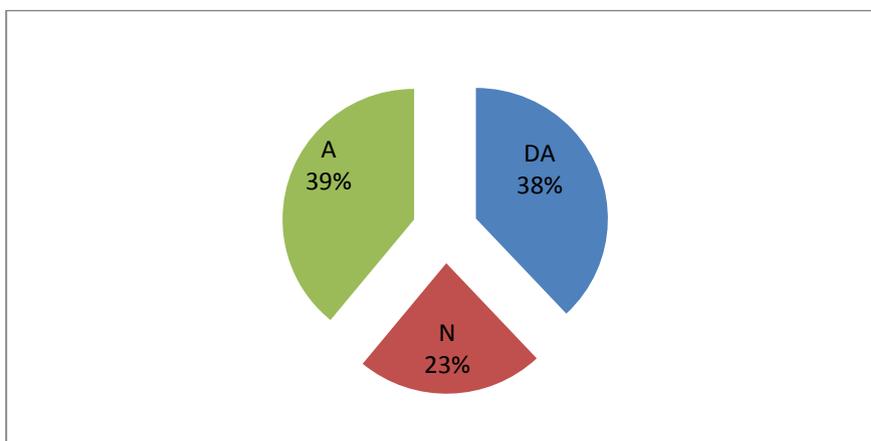
This means that tax payment should not be paid on installment.

Here, the researcher asked the respondents is it important for tax payers to know the purpose of tax payment, majority of the respondents constituting 80% of the total population agreed, 12% neutral and 8% of the respondents also disagreed.

4.2 The Causes of Tax Evasion

Section B of the questionnaire to the traders contains statements related to the causes of tax evasion in the Kumasi Metropolis.

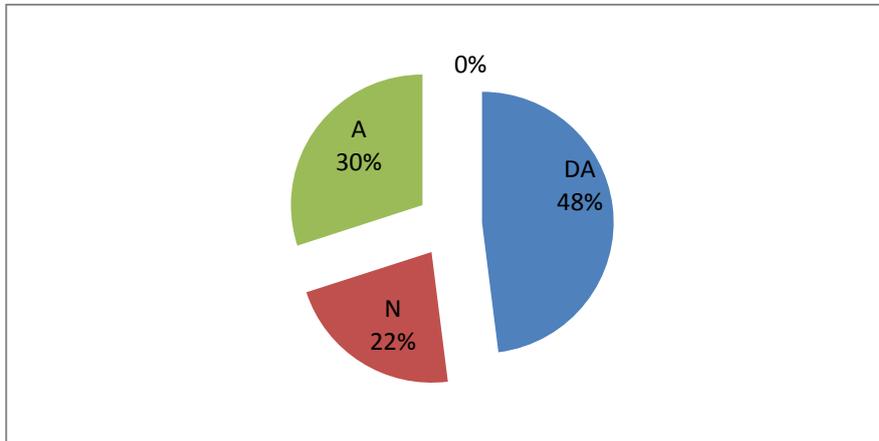
Figure 4.1



Source; field study 2015

From the diagram above, it is indicated clearly that 39% of the total population agreed, 38% of them also disagreed and 23% of them also were neutral when the researcher asked do you agree with the system of tax collection.

Figure 4.2

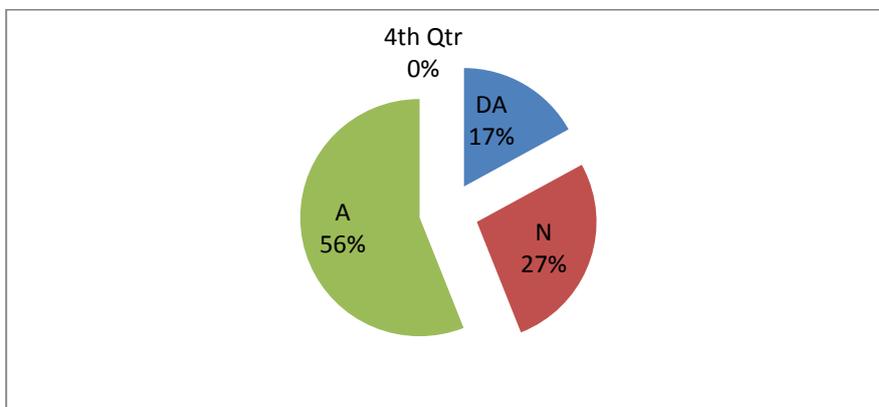


Source; field study 2015

The researcher asked the respondents are tax payers compelled to pay their taxes on time, majority of them constituting 48% of the population disagreed, 30% of them agreed and 22% of them also neutral.

Meaning majority of them disagreed to it that tax payers should be compelled to pay their taxes.

Figure 4.3



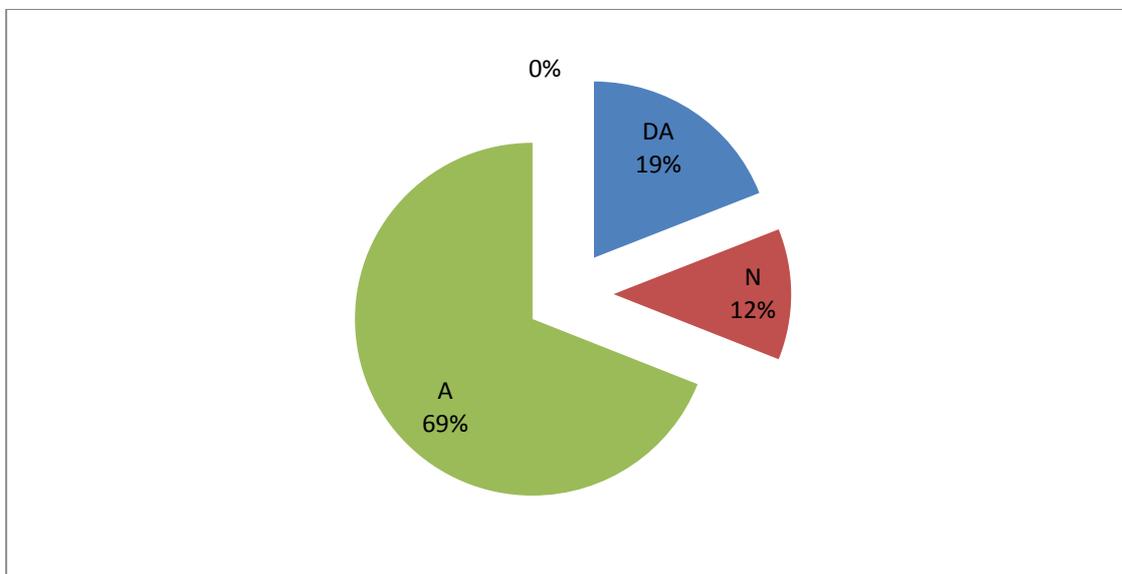
Source; field study 2015

The researcher asked the respondents do tax payers easily locate the tax collectors' office, 56% of the total population agreed, 27% of them neutral and 17% of them also disagreed to it. It is shows clearly that the tax payers should easily locate the tax collectors' office.

4.3 The Effects of Tax Evasion

Section C of the questionnaire to the traders contains statements related to the effects of tax evasion in the Kumasi Metropolis.

Figure 4.4

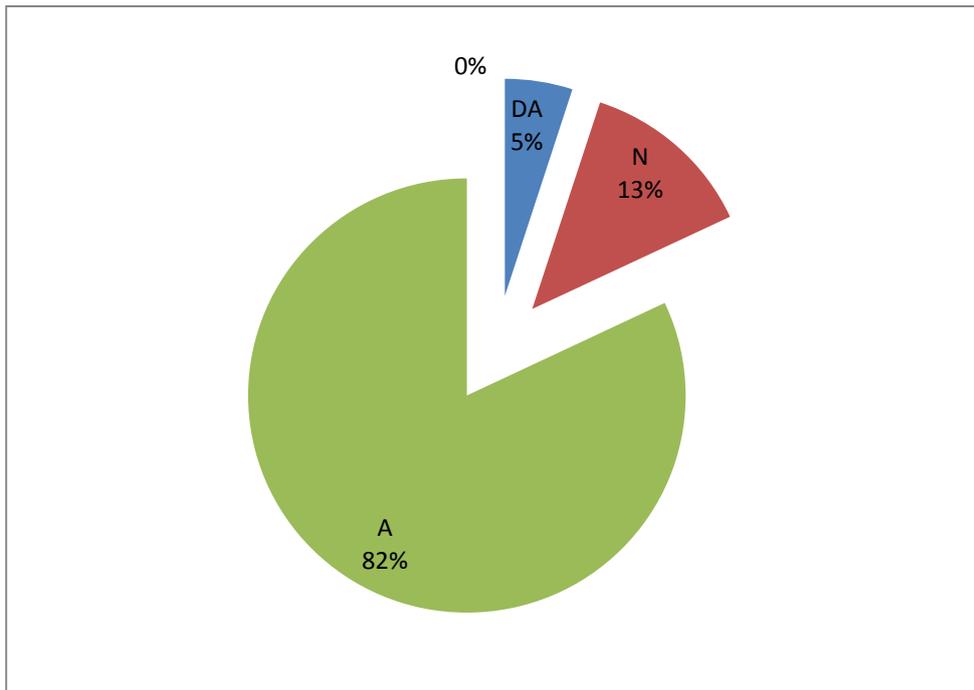


Source; field study 2015

4.4 The Appropriate Measures to Encourage Tax Payers

Section D of the questionnaire to the traders contains statements related to the appropriate measures to encourage tax payers in the Kumasi Metropolis.

Figure 4.5



Source; field study 2015

Table 4.8 Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
do you agree with the system of tax collection	50	1.0	5.0	2.540	1.6062
are smes compelled to pay their taxes on time	50	1.0	5.0	2.260	1.4542
do smes easily locate the tax collectors office	50	1.0	5.0	2.740	1.3219
should premium be placed on the filing of returns	50	2.0	5.0	3.740	.7775
are tax evaders punished for such acts	50	1.0	5.0	2.380	1.7130
has the evasion of tax affected development	50	1.0	5.0	3.560	1.7747
are the infrastructures in the society affected by tax evasion	50	1.0	5.0	3.240	1.6483
is the economic growth affected by tax evasion	50	1.0	5.0	3.420	1.2792
has tax evasion affected revenue generation	50	4.0	5.0	4.680	.4712
should early tax payers be granted reliefs	50	1.0	5.0	4.240	.9161
is it necessary for tax collectors to educate on tax payment	50	1.0	5.0	4.140	1.1954
should tax payment be made a month after filing returns	50	2.0	5.0	2.860	.9478
do you agree to pay your tax on instalment	50	2.0	5.0	3.820	.9190
is it important for tax payers to know the purpose of tax payment	50	3.0	5.0	4.740	.4870
Valid N (list wise)	50				

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATION

5.1 Introduction

This chapter summarizes the findings which were obtained from the study and then goes further to give conclusion and recommendation on factors contributing to tax evasion and its effects on economic development in the Kumasi metropolis. In analyzing the data, careful attention was paid to the details in order to come out with conclusion and recommendation that would benefit the institution concerned. All information that formed the basis of the conclusion drawn and recommendation made is original and reliable. It is our hope that recommendation given would go a long way in strengthening the institutional framework of Ghana Revenue Authority (GRA)

5.2 Limitation

Limitations encountered during the period among others include, first, the short period of the study and unwillingness of the respondents to disclose certain facts relevant to the study. In addition to this, inadequate funding was another serious drawback to our work. Time frame within which this study was carried out was not enough. In spite all of these limitations enough data were gathered and critically analyzed to enable us to draw our conclusion and recommendations.

5.3 Recommendation

On a whole, the effectiveness of cases and impacts on tax evasion is currently encouraging. However, there is still more room for improvement as the business world is dynamic and more so in the light of rapid growing of computerization, the service needs to cope with the

present day situation and other emerging challenges. It is in the light of this that the researchers put forward the following suggestions and recommendation for consideration by the management of GRA

Enforcement of controls.

In spite of strict adherence of controls the Ghana Revenue Authority should not rest on its operations, but ensure that the internal control systems are under regular review to eliminate any weakness in the system. The Ghana Revenue Authority should ensure strict compliance to the financial administration act. The internal control system should be strengthened in order to prevent fraud and embezzlement through collection of taxes.

Education.

The staff of the Ghana Revenue Authority should devote their time in educating the tax payers on the importance of paying tax. The tax payers need to understand why they should pay tax and by so doing tax payers may not hesitate in paying tax.

-) Communication on tax must be done from time to time to keep the tax payers abreast with tax systems. When tax payers are communicated to all the time, tax payment will not be difficult.
-) Traders should be encouraged to file their income tax returns forms. Failure to do so should be enforced by the law.
-) Qualified accounting personnel should be employed by the service to handle accounting functions and also to assess their tax liabilities.
-) Early tax payers should be granted reliefs because when granted reliefs it may compel others who delay tax payments to pay as early as possible, they may do this just to be granted reliefs.

) Tax payers should be allowed to make payments on installment, tax due may be spread over a period of time to pay.

5.3 Conclusion

Tax evasion hampers the development of the economy. Tax evasion retards the provision of amenities such as schools, hospitals, roads, etc. and others.

However, to curb these unfortunate phenomena from happening in the future, the government through tax authorities should make the tax policies flexible in order to expand the tax net for more people to contribute towards national development by educating tax payers on the essence of paying tax.

From the data collected from the study, the researchers came to a conclusion that tax evasion has actually impacted negatively on the economic development in the Kumasi metropolis. Each year Ghana losses several millions of cedis due to tax evasion which has eaten into the moral fabric of the society considering the effects on revenue. This practice which is common in the country possesses a great threat to both economic and national development as it negatively affects the gross domestic product.

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APPENDIX

CHRISTIAN SERVICE UNIVERSITY COLLEGE.

DEPARTMENT OF ACCOUNTING AND FINANCE

A questionnaire solely designed for academic purpose acquiring information on factors contributing to SMEs failure to oblige to their tax obligation and the effects on economic development. A case study of Kumasi Metropolis.

Assurance is given for the confidentiality of the information to be provided. Please write or tick where necessary.

Questionnaires for Small companies/ Medium companies

SECTION A

- 1 How long has the company been operating?.....
- 2 Have you ever paid money in the form of tax to the IRS? Yes () No ()
- 3 Have you ever in any time refused to pay tax to IRS officials? Yes () No ()
- 4 If Yes why?
- 5 Do you keep proper records on tax paid to IRS? Yes () No ()
- 6 Are you being forced before paying tax? Yes () No ()
- 7 Explain

SECTION B

SD-Strongly Disagree, **D**-Disagree, **N**-Neutral, **A**-Agree and **SA**-Strongly Agree

	The causes of tax evasion	SD	D	N	A	SA
8	Do you agree with the system of tax collection?					
9	Are SMEs compelled to pay their taxes on time?					
10	Do SMEs easily locate the tax collector's office?					
11	Should premium be placed on the filing of returns?					
12	Are tax evaders (SMEs) punished for such acts?					

SECTION C

	The effects of tax evasion	SD	D	N	A	SA
13	Has the evasion of tax affected development?					
14	Are the infrastructures in the society affected by tax evasion?					
15	Is the economic growth affected by tax evasion?					
16	Has tax evasion affected revenue generation?					

SECTION D

	The appropriate measures to encourage tax payers	SD	D	N	A	SA
17	Should early tax payers (SMEs) be granted reliefs?					
18	Is it necessary for tax collectors to educate SMEs on tax payment?					
19	Should tax payment be made a month after filing returns?					
20	Do you agree to pay your tax on installment?					
21	Is it important for tax payers to know the purpose of tax payment?					