

Original Research Article

**RELATIONSHIP BETWEEN TAX POLICY, SME_s
COMPLIANCE, PERCEPTION AND GROWTH: AN
EMPIRICAL REVIEW OF GHANA**

ABSTRACT

Tax plays a significant role in the growth of small and medium enterprises (SME_s). In a developing country like Ghana, SME_s play important roles in the development of the economy. Therefore, it is vital for policy makers to consider the alignment of tax systems to the growth needs of SME_s. Government uses taxation and tax regimes to provide means for SME_s to participate in the economic growth of Ghana. Keeping emphasis on this issue, the paper critically analyses the relationship between tax policies and SME_s in Ghana. The specific objectives of this paper are: To find out if SME_s complies with their tax obligations and policies; To examine SME_s perception on tax policies; and To identify the effects of tax policies on SME_s growth in Ghana. The research was primarily carried out at the Accra Metropolitan Assembly and it covers four markets of Kantamanto market, Makola market, Malata market and Dome Market. Respondents from these markets were small and medium business owners in operation from 2002 to 2015. The survey was administered using questionnaire and a total of 200 respondents was used with 50 respondents from each market. Data was analysed using SPSS version 21. Multiple regression analysis was employed in this study and the findings of this research indicated that majority of respondents' perceived adverse impacts of tax policies on SME_s compliance, growth and perception in Ghana. The findings will be beneficial to stakeholders in reforming measures to bridge tax policies to SME_s in an efficient and effective manner.

Keywords: *Taxation, Tax policy, Tax systems, small and medium scale businesses*

1.0 Introduction

SME_s stimulates entrepreneurial spirits and the diffusion of skills because SME_s enjoys wide geographical presence than big companies in developing countries [1]. In 1998, recommendation was adopted by the International Labour Conference to recognise the need for policy and legal framework in setting an environment for the development of small enterprises [2]. Taxation contributes to the development and welfare of an economy through three fonts; generation of sufficient funds for public service financing and social transfers at high level of quality, incentive for more employment and reallocation of income [3]. Likewise the income and need for survival of SME_s should also be considered. The Organisation for Economic Cooperation and Development (OECD) issued a "Bologna Charta on SME policies" in which governments from OECD countries recognised the roles of SME_s as well as recommending broad policy orientations conducive for their growth [4].

A study conducted by the Ghana Statistical service in 1992 revealed approximately 93% of registered business in Ghana are of SME category. The recognition of SME_s in Ghana started in the early 1960s due to the springing up of small enterprises. Agriculture was seen as the main dominance of the economy before the 1960s. At that time, approximately 70% of agriculture holdings was managed by farmers whereas not more than 10% was managed by the government. The inclusion of agriculture and rural businesses into SME_s contributed greatly to the Kenyan economy [5]. The performance of SME_s in Ghana have not achieved its goal of playing significant role in the growth of the Ghanaian economy. Governments have stepped up efforts to promote SME_s development through the increase of incentive schemes comprising of

budgetary allocations for technical assistance. The engine for the growth of the Ghanaian economy depends on the private sector which consist of SMEs. 70% of all industry establishment in Ghana is made up of SMEs. The SMEs contributes about 22% to the Gross Domestic Product (GDP) as well as accounting for 92% of businesses in Ghana and engrossing over 60% of labour force [6]. Likewise, 85% of overall employment growth in Ghana stems from SMEs [7]. This statistics makes SMEs the most important sector in the Ghanaian economy.

The Government of Ghana imposes several types of taxes to protect infant industries and ensure fair competition among SMEs. Growth of SMEs is dismayed by high tax rates and tax complicity [8]. Taxes increases the cost of production of goods and services which eventually surges higher prices of goods to final consumers. However, revenues mobilised from taxes represents major funding for government expenditures [9]. Taxes are perceived to be a major problem for both upcoming and established firms [10]. Attention should be geared towards the adverse effects of taxes on SMEs irrespective of the contribution of taxes to GDP because SMEs is seen as the driving force for the growth of the Ghanaian economy. This triggers the need for thorough studies on the challenges thwarting the development of effective tax policies, particularly in the context of SMEs. This study seeks to address the impact of tax policies on SMEs in the Accra Metropolitan Assembly.

1.1 Research Objectives

The broad objective of this paper is to analyse the impact of tax policies on small and medium scale enterprises in Ghana. Specifically, the study seeks to satisfy the following objectives:

1. To analyse the effect of tax policies on compliance to taxes by SMES in Ghana
2. To examine the influence of tax policies on SMEs in Ghana.
3. To determine the impact of SMEs perception on tax policies.

1.2 Hypothesis

1. H_1 : There is significant relationship between tax policies and tax compliance in Ghana.
2. H_2 : There is significant impact of tax policies on SMEs growth in Ghana.
3. H_3 : There is a bad perception by SMEs on tax policies in Ghana.

2.0 LITERATURE REVIEW

2.1 Definition and characteristics of SMEs

The commonly used criterion in the definition of SMEs is the number of employees. The Ghana Statistical Service (GSS) considers firms with less than 10 employees as Small Scale and Enterprises whiles firms with more than 10 employees are also considered as Medium and Large-Sized enterprises. Ironically, in the national accounts of GSS, firms with 9 employees are considered as Small and Medium Enterprises. Alternatively, SMEs can be defined according to the number of fixed assets in the organisation. The National Board of Small Scale Industries (NBSSI) in Ghana uses both the fixed assets and number of employees in defining SMEs. The NBSSI defines SMEs as a firm with no more than 9 employees with plant and machinery of not more than 10 million Ghana Cedis excluding land, buildings and vehicles. An upper limit of 10 million Ghana Cedis is also used by the Ghana Enterprise Development Commission (GEDC) to define SMEs. However, the problem with this definition is that the continuous depreciation in the exchange rate as well as the processes involved in valuing fixed assets makes such definitions unacceptable. SMEs can be classified into three categories. (i) Micro: firms employing less than 6 workers; (ii) Very small; firms employing between 6 and 9 workers; (iii) Small firms; firms employing between 10 and 29 workers [11].

The concepts pertaining to SMEs are relative and dynamic [12]. In an attempt to gain an in-depth understanding of SMEs, it is important to obtain knowledge on it features. SMEs in Ghana consist of individual ownership or family owned businesses that tends to lack good management structures to help in their development. SMEs comprises of sole proprietorship or partnership although they may be registered as limited liability [13]. SMEs tends to have few number of

employees which makes the lifespan of the enterprise dependent on the owners' lifespan. Most SMEs owners possess low level of education because they comprises of market woman and well established small businesses. Additionally, SMEs requires lower start-up capital as compared to the larger companies whereas managers' decision may be subjective because the same individuals are managed and controlled every day. The organisational forms of SMEs are also likely to vary from sole proprietorships (with or without employees), small corporations (public or private), professionals and partnerships which may result into different management practices and record keeping for the enterprise. Notwithstanding all these features, SMEs haven't been vibrant enough to increase in output production even though many larger manufacturing companies rely on them for supplies [14].

2.2 Challenges faced by SMEs

SMEs faces several challenges that hinders their development. Surprisingly, these challenges are the same irrespective of the geographical location of their businesses. Lack of access to land, import procedures and utility instillation and services were recognised as a constraint to the growth of SMEs [15]. In developing countries, the challenges faced by SMEs cannot only be emphasized on introduction of ineffective tax policies but also much emphasis should be placed on market failures in respective regions [16]. Generally, other factors affecting SMEs are the dependability of import, lack of access to technology, high inflation, unreliable management practice to combat macro-economic issues and high debt burden on a particular country. In developing countries where corruption is seen as a major issue confronting all the sectors of the economy, SMEs faces problems of high operation cost, lack of transparency in all processes and designs that aims at protecting the development and growth of SMEs.

2.3 Concept of taxation

Taxes are the compulsory transfer of money from citizens of a country to the government as a source of revenue [17] whereas [18] emphatically claimed that taxes cannot be avoided without attracting punishment. Tax policies are implemented either to: (i) finance a budget deficit, (ii) promote long run growth or (iii) counter other influences in the economy [19]. Taxes differs according to economic policies adopted by governments and are instruments of social engineering in stimulating economic growth [20]. Taxation consist of four principles: certainty, equality or equity, convenience and economy [21]. The observant of rules and regulations for tax assessment collection and implementation can be referred to as the principles of taxation [22]. This include Fairness: Taxes should be fair to taxpayers as well as being aligned to the benefits received by taxpayers; Economic growth: taxes payed should gear towards the achievement of goals required for the economic growth of a country; Equity: taxpayers revenues and expenditure should correspond to their tax liabilities; Convenient: systems on the manner of paying taxes should be suitable to taxpayers [22].

2.4 Tax Policy and Reforms in Ghana

Appropriate policies have been made by the World Bank in reforming tax policies [23]. In creating an enabling and suitable environment for the success of businesses, governments reform taxes to garb long term economic objectives [21]. Taxation policy was passed by governments to promote and protect SMEs [18]. However, [24] probed into tax policies by asking these three questions: How much money should government gather as taxes? ; How can tax liabilities be distributed among potential taxpayers? ; How can the economic cost of taxation be absorbed or minimised? Irrespective of these questions on tax policies, tax policies should create a serene environment in which SMEs can expand their activities.

In Ghana, tax policies and reforms have been instituted to ensure compliance to taxes. For example, the Internal Revenue Service (IRS) and the Custom Exercise and Preventive Service (CEPS) was merged into the Ghana Revenue Authority (GRA) to enhance the payments of taxes and to improve efficiency in tax systems. Furthermore, the e-government project was introduced

in November 2011 by the government of Ghana to link the GRA to the Registrar General's Department (RGD) in order to electronically keep tabs on the payment of taxes from registered businesses.

Tax reforms has been enacted to protect SMEs. In 1998, an attempt for the re-introduction of VAT systems failed because of extensive public opposition in 1995. The Value Added Tax (VAT) flat rate scheme was enacted by an Act of Parliament in 2007, Act 734 and it served as an amendment to the VAT Act, 1998, Act 546. For example, the Tax Stamp instituted a flat tax on various SMEs retailers in Ghana. These SMEs retailers were grouped into three categories. Category A consist of retail trades; Category B consist of dressmakers, hairdressers, beauticians and artisans; Category C consist of butchers, individual undertakers and traditional healers. Despite these groupings, the Value Added Tax (VAT) flat rate scheme-retailers charged a flat rate of 3% without recourse to input tax.

2.5 Policies adopted to Promote SMEs in Ghana

The role of SMEs in boosting the economic growth of a country cannot be underestimated. SMEs are seen to be the largest employer of workers. Initiatives has been undertaken to promote SMEs by various governments. In 2005, the Growth and Poverty Reduction Strategy (GPRS II 2006-2009) reported that the private sector competitiveness should be promoted in order to direct the economy towards achieving middle-income economy by 2015. According to the World Bank/IMF's Annual Business Report in 2008, Ghana was ranked in the top ten global reformer for two consecutive years in 2006 and 2007. This rankings was based on the diversified nature of state-owned enterprises and the increasing number of private businesses. As stated earlier, report from the National Industrial Census (NIS) concluded that approximately 70% of industrial establishments are in the sector of SMEs which contributes to 22% to GDP as well as accounting for nearly 92% of businesses in Ghana [6]. Various private and public institutions with the aim of serving as a catalyst to SMEs growth have been established. These institutions provides assistance to SMEs comprising of entrepreneurship development, training, good management advisory services, placing emphasis on the usage of made in Ghana goods, protection of their interest etc. Such institutions include the NBSSI, Association of Ghana Industries (AGI), Private Enterprises Foundation (PED) and some Non-Governmental Organisations,

2.6 Tax Compliance of SMEs

Tax compliance has been hindered by the substantial changes to tax laws, which exhibited complexity to the extent that only tax experts can understand. This might lead to challenges for taxpayers who do not have access to tax specialist to enlighten them on the complex nature of tax laws [25]. Correlation cannot be established between enforcement of tax laws and tax non-compliance because certain tax measures can lead to SMEs being under severe liquidity pressure [26]. Realisation to tax compliance can only be noticed when the liabilities of taxpayers are accurately computed by realising the factors that can be linked to tax liability [27]. There is the likelihood that illiterate taxpayers can either be under-paying or over-paying taxes. SMEs admitted to have possessed low competence and independence relating to tax issues corresponding to the recruitment of tax agents by SMEs for aggressive tax planning [28]. Lack of expertise on tax laws is responsible for low tax compliance [29]. Tax policies in developing countries often favours large firms who have higher tax revenue payback returns than SMEs with lower tax revenue payback returns [30]. Registration of business for tax payments by SMEs are not done voluntarily whereas those who fail to register fail to file their tax returns and accurately settle their tax liabilities [26]. Tax evasion by SMEs is predicted to be high whereas high investment in auditing might prove futile without adequate audit trail [28].The above literature reviewed leads us to our first hypothesis:

H₁: There is significant relationship between tax policies and compliance to taxes by SMEs in Ghana.

2.7 Tax Accountability by government.

Taxpayers' perception on the fairness of tax systems influence the ability to pay taxes [31]. Revenues generated by taxpayers to the government are expected to be accounted for meaningfully by the state [32]. There should always be a link between compliance to taxes by taxpayers and the tax accountability by the government such as securing the safety and security of individuals including taxpayers' right to property [33]. The existence of tax accountability generally comprises of two parties; the one entrusted with something that results into accountability and the principal who gave the mandate [34]. Correlation was established between governance and accountability and income tax revenue performance, for example South Africa, Nigeria and Uganda had income tax ratio to good governance score as 14.4%: 69.4%; 2.5%: 49.6%; 3.8%: 57.9% respectively in 2006 [35]. The function of the degree to which governments can better the lots of its people is through the state political obligation [36]. The accountability of governments can correspond to tax payment by citizens thereby increasing the willingness to pay taxes and reducing the cost of tax collections. However, the non-accountability of government can also result in the likelihood of the demand of high taxes by the state which may also result in protest and violence by the citizens.

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

2.8 Tax Policies influence on SME_s Growth

Resources directed towards the compliance of taxes can be used for reinvestment to facilitate future growth [37]. Complex tax policies can put uneven pressure on smaller businesses. Reduction in tax rates increases the profit margin of SME_s as well as intensifying government tax revenues since such provisions reduces the size of the shadow economy [38]. Complex tax systems distorts the development of SME_s and often results into the morphing of groups that offer a lower or no tax burden hence resulting into tax systems that levies high expenses on the economy [39]. Poor implementation of tax policies connotes to high collection charges, low efficiency, time wastage for taxpayers and staff, deviation from optimum allocation of resources and low amount of tax revenues [40]. The efficiency of tax policies depends on the designing of appropriate and rational tax rates, reducing tax burden of the indigent people and intensifying the fight against the corruption and the evasion of taxes [41]. Tax policies can be implemented to enhance the growth of SME_s. For example, in China, tax policy has been designed to encourage the financing of SME_s by providing business tax exemptions for corporations that guarantee loans to SME_s. Also, tax deductions are awarded to market entities and venture capitalist who invest in SME_s to the tune of 70% of the amount of investment. The complex nature of tax policies such as multiple taxes, high ports charges etc. can exert serious burden on SME_s. Such complexity in tax policies may results in SME_s hiring agents to explain tax policies which results into additional cost for SME_s. Public corporations possess vast knowledge on tax systems than SME_s. For example, the accounting requirements of public corporations is much sturdier than sole proprietors because employees of such corporations may be subject to the awareness of requirements relating to withholding income taxes and social contributions [42]. Taxation of SME_s has a negative effect on SME_s sector growth and the economy by reducing sales, profit, capital and employment level [43]. Accumulation of assets is a key indicator of a firm's growth and performance. Inaccurate taxation policies and uncertainties hinders SME_s from acquiring assets to strengthen their growth [44].

In Ghana, SME owners sees taxes as just governmental way of earning revenue with no much good to the SME_s and the society at large. SME_s under the regulatory system of taxation are

discriminated against since the requirement of compliance, cost of compliance and tax rate are the same for both small and large corporations. As stated earlier, such uneven nature of tax policies can exert serious burden on SME_s and might distort their development. Therefore, policy changes should be implemented to align SME_s revenue generation to the percentage of taxes paid. The growth of SME_s will result to a significance boost of the Ghanaian economy. This therefore leads us to our second hypothesis:

H₂: There is a negative impact of Tax Policies on SME_s growth in Ghana.

2.9 SME_s Perception on Tax Policies

SME_s faces numerous complications during their business operations. Such complications include the payment of taxes before SME_s start production of goods and services as well as the payment of other forms of taxes like payroll levy, sales tax, corporate tax etc. [45]. The informal sector deems tax authorities to be among the most feared institutions in terms of institutionalising their activities. Institutionalising the activities of the informal sector operators includes registration with tax authorities, the requirement to pay relevant taxes etc. In order to avoid such institutionalising activities which serves as an additional cost, informal sector operators avoid the payment of taxes. Tax regulations and company laws are primary regulations that negatively impact SME_s [46]. The three key situations affecting SME_s owners' perception on tax policies are: meaningful tax knowledge; decisions that portrays taxes as a painful loss; perception about non-compliance opportunities.

In Ghana, most SME_s perception on tax policies is not quite appealing. Tax policies are seen by SME_s as an attempt made by the government to deter their growth. Most SME_s in Ghana have had enough of such policies that minimises their overall profit of business operations. Of course, there are tax policies that also encourages the growth of SME_s. SME_s perception on tax policies may not only stem on the imposition of taxes but also the rate of illiteracy of the SME_s. It can be noted that most owners of SME_s in Ghana are mostly market women who may have little or no knowledge on tax policies. Therefore, it is important to address SME_s perception of tax policies in Ghana. Based on this, we derive our third hypothesis as:

H₃: There is a bad perception by SME_s on tax policies in Ghana.

3.0 CONCEPTUAL FRAMEWORK

The conceptual framework of this study is illustrated in Figure 1. According to the conceptual framework, we seek to analyze the perception of SME_s on tax policies as well as analyzing whether tax policies leads to the compliance of taxes. Lastly we seek to conclude whether tax policies have a significant impact on SME_s.

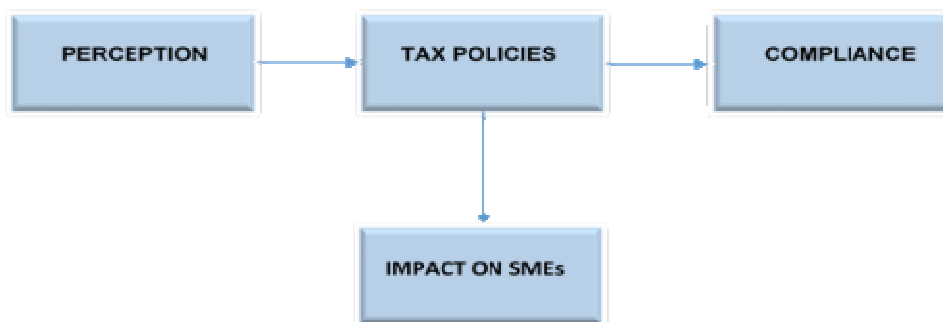


Figure 1: Conceptual framework

Source: Authors' Construct

4.0 RESEARCH METHODOLOGY

4.1 Research Design

In analysing the research questions, qualitative and quantitative method was employed in both data collection and hypothesis testing to ensure the effective interpretation of the data by using SPSS version 21.

4.2 Research Population

The population comprises of SME_s owners from Kantamanto, Makola, Malata and Dome market. Taxpayers in each selected market were asked to provide an evidence of tax payment receipts. This enabled us to identify SME_s owners who pay taxes to the GRA. Purposive sampling method was used to identify respondents to aid in our research.

4.3 Sample Size

A sample of 200 respondents was selected from four markets of the Tema Metropolitan Assembly of which 50 respondents were selected from each of the four market. This sample size was selected from each market because it is enough to generate and generalize the findings of a bigger population. Purposive or judgemental was employed in this research because respondents have information that is vital to this research process.

4.4 Data Source

The collection of data was done through primary sources. Primary data was obtained from SME_s owners by the administering of questionnaires and interview guide.

4.5 Data Collection Instruments and Procedures for Data Analysis

Unstructured interview lasting for 30 minutes was used for the collection of qualitative data whereas questionnaires was used to collect quantitative data from respondents. A 5 point Likert-scale was employed in the administration of questionnaires with scales ranging from “Strongly Disagree” denoted by 1 to “Strongly Agree” represented by 5 with neutral scores amid the two extremes. Regression analysis was used for the analysis of the data obtained from the survey.

5.0 STATISTICAL FINDINGS

5.1 The following interpretations and discussions were based on the analysis and findings of the study.

Table 1 depicts an R-square value of 0.804 indicating that the predictors (compliance, growth and perception) account for approximately 80% of the variation on tax policies. The R value of 0.897 signifies a strong positive correlation between compliance, growth, perception and tax policies. This shows that compliance, growth and perception have a strong relationship with tax policies.

Table 1. Regression Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1				
1	.897 ^a	.804	.801	.52610

a. Predictors: (Constant), Compliance, Growth and Perception.

Table 2 shows an ANOVA Table of regression model. At $\alpha=0.05$, $P < .000$ indicate statistically significant predictors (Compliance, Growth and Perception) for the dependent variable (tax

policies). Additionally, $P = .05$ suggests a good fit data for the regression model. As a result, there is enough evidence against the null hypothesis.

Table 2. ANOVA^a

Model	Sum of squares	Df	Mean Square	F	Sig
1 Regression	223.146	3	74.382	268.742	.000 ^b
Residual	54.249	196	.277		
Total	277.395	199			

a. Dependent Variable: Tax policies

b. Predictors: (Constant), Compliance, Growth, Perception

5.2 Determining the regression equation

From Table 3, it is obvious that compliance, growth and perception are all significant at $\alpha=0.05$. The first column of the coefficient table contains the beta coefficients (β_0 , β_1 , β_2 , and β_3). From the table, $\beta_0 = 0.005$, $\beta_1 = 0.376$, $\beta_2 = -0.096$, $\beta_3 = 0.586$

The regression equation therefore becomes:

$$Y = 0.005 + 0.376X_1 - 0.096X_2 + 0.586X_3$$

Accordingly, a unit change in tax policies should improve compliance by 0.376 holding all variables constant. Furthermore, a unit change in tax policies must concurrently decrease growth by 0.096 holding all variables constant. Lastly, for every unit change in tax policies must improve perception by 0.586 holding all other variables constant. From the regression equation, it is evident that there exist a positive correlation between tax policies and compliance, growth, perception.

Table 3. Coefficients^a

Model	Unstandardized Coefficients		Standardized Coefficients		
	B	Std. Error	Beta	t	Sig.
(Constant)	.005	.172		.031	.975
Compliance	.376	.066	.0365	5.660	.037
Growth	-.096	.046	-.072	-2.098	.000
Perception	.586	.066	.548	8.847	.000

a. Dependent Variable: Tax Policies

Significant at 0.05 level

6.0 CONCLUSION AND RECOMMENDATION

SME_s will be excited in an ideal world for the instigation of tax policies only if there is a realisation that tax policies will positively impact their operations. However, in Ghana, the introduction of tax policies poses a serious threat to SME_s in relation to payment of taxes which concurrently affect the profitability of SME_s business operations. The study was conducted to depict whether there is a significant relationship between tax policies and SME_s compliance, growth and perception in

Ghana. Interestingly, all the three objectives developed to aid in our research proved significant. It is evident from the hypothesis that all the three predictors satisfies the regression model:

$$Y = 0.005 + 0.376X_1 - 0.096X_2 + 0.586X_3$$

The research portrayed that tax policies impacts SME_s growth negatively. Additionally, tax policies was found to affect tax compliance by SME_s whereas conclusion was drawn that SME_s perception on tax policies looks unappealing. It is very imperative for governments, policy makers and institutions in Ghana and the world at large to come out with pragmatic measures to design tax policies to protect the growth of SME_s as well as increasing the revenue mobilisation of taxes by the government. Therefore, the following recommendations are made in order to improve SME_s growth as well as government revenue mobilisation on taxes to an appreciable level.

1. Tax systems governing SME_s should be simplified to encourage compliance to taxes. For example technology can be introduced in the filing of taxes to ease the cumbersome processes in the payment of taxes. Also clear and simple tax regulations should be instigated.
2. SME_s should be educated on issues concerning taxes such as enlightening their expected tax incentives and tax exemptions they are liable for. Also tax administrators should improve upon their duties efficiently with integrity in order to help eradicate the issue of multiple taxes.
3. The government of Ghana should harmonise the payment of taxes by defining sanctions for the non-compliance of taxes by SME_s as well as reviewing the cost of legislative compliance which imposes more burden on SME_s.
4. Government should appropriately define in simple and clear sentences the usage of tax revenues in order to eradicate the unappealing perception by SME_s on matters relating to taxes.
5. A well define strategy should also be adopted by government to aim at the development of SME_s as well as increasing the mobilisation of tax revenues to help fund government expenditures.

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