European Journal of Business and Management
ISSN 2222-1905 (Paper) ISSN 2222-2839 (Online)
Vol 4, No.7, 2012

Sanctions: Panacea for Income Tax Non-Compliance Among Ghanaian Self-Employed?

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Abstract

Income tax from self-employed is very important for governments but compliance among self-employed leaves much to be desired. This study used hypothetical questionnaire to a sample of 380 self-employed in the Accra Metropolis. Appling simple regression analysis and Analysis of Variance, this study finds positive effect each of sanction and cooperation on compliance. Though the coefficient of the sanction as enforcement strategy is insignificant, a joint significance test of sanctions and cooperation on tax compliance shows that sanction and cooperation jointly significantly influence tax compliance among self-employed. The study recommends that tax authorities should switch their approach to tax administration from a one-size-fits-all enforcement model (sanctions) to a blend of strategies and possible use sanctions as last resort.

Keywords: Tax Compliance, sanctions, SME Tax

1. Introduction

According to Otieku (1992), a country cannot experience any meaningful economic growth "without positive stimulus from intelligent governments". However, the development agenda and programmes of a country like Ghana can only be brought to reality through the availability of funds. A reliable source of government revenue is taxes. Studies on tax compliance have however showed that income tax compliance among the self-employed leaves much to be desired.

Bird (1984) shows that more than half of the potential tax revenues in most developing countries tend to remain uncollected. This Bird further attributed to the large size of the informal sector, dominated by the self-employed. Flynn (2003) also noted that revenue loss from non-compliance by individual taxpayers, particularly the self-employed were estimated to range from $93.20 billion to $95.30 billion for the tax year 1992. Ghana's IRS, recognizing the high level of income tax non-compliance among the self-employed, has devised various unconventional means of taxation (standard assessment, identifiable groupings and, most recently, the tax stamp) over the years to rope into the tax net as many self-employed persons as possible.

Song and Yarbrough (1978) demonstrate that in Ghana non-compliance by the self-employed is a major factor accounting for tax authorities receiving less than what the law allows. An effective income tax enforcement strategy is therefore warranted but the available studies in the field of taxation have mainly centered on the problems of tax administration (Otieku, 1988), public perception of tax evasion (Song and Yarbrough, 1978) and managing small size taxpayers (Terkper, 2003).

The present study departs from the previous studies by looking at the enforcement strategies that will help combat the menace of income tax non-compliance among the self-employed. However, determining which regulatory enforcement strategy will be most effective has been a daunting challenge for taxing authorities. A long-standing debate in the taxation literature has been between those who believe in the institution of severe sanctions in tackling the problem of non-compliance (Wenzel, 2004), and those who believe that persuasion and cooperation works in ensuring compliance (Braithwaite, 2003).

This study used hypothetical questionnaire to a sample of 380 self-employed in the Accra Metropolis. Appling simple regression analysis and Analysis of Variance, this study finds positive effect each of sanction and cooperation on compliance. Though the coefficient of the sanction as enforcement strategy is insignificant, a joint significance test of sanctions and cooperation on tax compliance shows that sanction and cooperation jointly significantly influence tax compliance among the self-employed.

The rest of the paper are as follows; review of the related literature is presented in section 2, section 3 looks at the methodology; section 4 presents the analysis of results and conclusion, recommendation in section 5.

2. Review of Related Literature

James and Alley (1999), consider tax non-compliance in terms of the tax gap, which measures the difference between the tax that ought to have been collected and that actually collected. Again, researchers such as Jackson and Milliron (1986) Richardson and Sawyer (2001), Tan and Sawyer (2003) consider tax non-compliance as inaccurately reporting on an individual's revenue and expenses to arrive at the appropriate income, not following the right procedures for filing returns and not filing returns at the appropriate time in accordance with applicable statute and court decisions at the period of filing. Several reasons have been identified to account for income tax non-compliance. Researchers such as Fischer, Wartick and Mark (1992), Tam and Sawyer (2003) and Chau and Leung (2009) find some of the reasons for non-compliance to include but not limited to complex tax system, peer influence, income levels and weak enforcement of tax laws. Though sanctions have been and continue to serve as a major panacea to tax non-compliance, some researchers strongly think that dialogue and cooperation would result in a much improved compliance to tax laws.

The institution of sanctions in combating income tax non-compliance is premised on the aged long works of Beccaria's (1797), Bentham's (1788) and Becker's (1968) economic analysis of punishment for criminal and unacceptable behavior. According to these researchers individuals are rational actors who will not comply when the benefit for non-compliance far outweigh the cost of sanctions, and as such, proffered severe sanctions as a solution to general criminal behavior. Allinghan and Sando (1972) adapted and conceptualized the work of Becker (1968) on the economics of crime in the field of taxation as a solution to non-compliance.

Tyler (1990) posits that the institution of sanctions in tax laws would improve compliance. The argument is that taxpayers will regard severe sanctions as more procedurally fair, resulting to improved compliance with tax laws. According to Aryes & Braithwaite (1992) the mere knowledge of the existence of regulatory means to deal with non-compliance builds community confidence and the legitimacy of the tax system. Indeed, numerous researchers, such as Jackson and Jones (1985), Andreoni, Erard and Feinstein (1998) and Frazoni (2001) have all found a significant relationship between the severity of sanction and the level of compliance. Again, Wenzel (2004) undertook a study into the relationship between the severity of sanction and the level of compliance, and found a positive relationship between the two variables.

The results of these researches have influenced and dominated tax policy formulation of many countries. An example is found in Ghana's income tax act, Act 592, where section 141 to 153 stipulates some of the non-compliance behaviors together with their associated sanctions. As contained in Act 592, monetary fines and prison sentences are the main means of sanctioning non-compliance. However, in the performance of its duties, the Internal Revenue Service, which is the regulatory arm of inland or domestic tax, in addition to the use of monetary fines and prison sentences do apply what is termed as distress action. This is where the property of a recalcitrant non-compliant taxpayer is confiscated and if possible sold to defray his or her indebtedness.

There are equally numerous studies that found no relationship between sanctions and tax compliance. Murphy (2008), Fehr and Rokenbach (2003) concluded in their studies that, sanctions, instead of deterring non-compliance, can sometimes result and deepens non-compliance. Tittle and Logan (1973) found out that sanction in itself does not guarantee compliance. As Devos (2005) puts it, taxpayers would choose to be non-compliant as long as the payoff from non-compliance is greater than the expected cost of being caught and punished. Again, the application of sanctions itself are also clothed with some setbacks. Sanctions or punitive measures provide tax authorities with a set of tools that can be applied without regard to reasons for non-compliance (Braithwaite, 2003). Thus the use of sanctions according to Braithwaite (2003), do not take into consideration the core of every regulatory non-compliant, that is, reasons for non-compliance. Another criticism of the deterrence model is that it does not clearly explain the high levels of voluntary compliance observed in many situations particularly among many public organizations. Again, deterrence system tends to be costly to maintain. The limitations of sanctions alone to improve compliance culminated in the need to deploy and test other compliance enforcement models that apply strategies that are entirely different or compliment the traditional deterrent compliance model (Owens and Hamilton, 2003).

Other researchers therefore started to question the essence of sanctions alone in enforcing tax compliance. This shifted the attention of tax compliance researchers such as Braithwaite (2003), Feld and Fray (2007), Kornhauser (2007) and Job, Stout and Smith (2007) from focusing on sanctions as the sole means of enforcing compliance to explore other enforcement strategies. This led to the discovery of cooperation as a strong tool in enforcing compliance. According to Grabosky and Braithwaite (1986), a striking feature of the accommodative approach is that it aims to establish a collaborative and friendly relationship between regulatory authorities and those they regulate.

These researchers unanimously concluded that the use of cooperation better deals with the menace of non-compliance. According to Braithwaite (2003), the use of cooperation takes into consideration the reasons for non-compliance, which is the core of any regulatory enforcement. These researchers were however quick to add that, the cooperative strategy on its own cannot achieve maximum compliance, unless it is viewed and applied as a compliment to the use of sanctions.

On the background of these two main tax enforcement strategies, Braithwaite (2003) formulated the ATO model of tax enforcement which was adopted by the Australian Tax Office in enforcing tax compliance. Indeed, the ATO model of tax enforcement has actually led to a cultural shift, and can be viewed as "best practice" in tax enforcement. The model is a pyramid that combines the two main enforcement strategies of sanctions and cooperation and conceptually represents taxpayers' motivational postures ranging from commitment (at the base) through capitulation, resistance and disengagement (at the peak). The ATO model favors the initial application and use of cooperation in enforcing compliance. According to Braithwaite (2003), sanctions must however be maintained and applied only in the extreme cases of recalcitrant non-compliance. Thus appropriate strategies for tax authorities include discretionary regulations such as Enforced Self-Regulation to Self-Regulation (at the base, which is the preferred option) and non-discretionary regulation (at the peak). According to Braithwaite (2003) and supported by Hasseldine and Hite (2007), the ATO model is consistent with the customary goal of voluntary compliance, where tax authorities can focus on enabling efforts such as education and service delivery at the base. At the middle levels, strategies such as business examinations and record keeping can be embarked upon, then moving to the top are audits with or without sanctions and finally sanctions

3. Methodology

The research design employed in collecting, analyzing and interpreting the data is the survey strategy. The choice of survey strategy over other research designs such as experimental and casual-comparative was informed by the assertion of Saunders, Lewis, and Thornhill (2007) that survey is an appropriate and common strategy in business and management research. The choice of survey strategy allowed for the collection of large amount of data from the population in a highly economical way. The accessible population forming the sample frame was the self-employed in trading who are on the toll roll of Accra Metropolitan Assembly. The size of the accessible population is estimated to be about 10,318 self-employed. Simple random sampling technique using the lottery method was used to select a sample of 380 self-employed in the study area. The use of the simple random sampling technique was to give each and every self-employed in the study area equal opportunity to be selected as part of the sample. Again, the use of simple random sampling technique made it possible for the findings of the study to be generalised about the population understudied. Data for the study was collected using questionnaire. Responses to the survey were confidential and participants gave no names.

3.1 Model Specification

The primary data collected was analysed using three variables regression model specified as follows:

$$Y = a + \beta_1 x_1 + \beta_2 x_2$$

where,

Y = the dependent variable representing the level of compliance

a= the intercept

x_1 *is sanctions and* x_2 *is cooperation*

β_1 *and* β_2 *are the sentivity of tax compliance to sanction and cooperation as tax enforcement strategies respectively*

The intuition behind this specification is drawn from the debate in the literature between sanction and cooperation as possible means of improving compliance among self-employed. Per the discussion in the literature, we expect positive response of tax compliance to sanction and cooperation respectively (i.e. $\beta_1, \beta_2 > 0$).

4. Presentation And Analysis Of Data

To achieve the objective of this paper, response of specific questionnaires were analyzed and presented. Respondents were whether the imposition of penalties in tax laws deters non-compliance particularly from the self-employed and the responses have been presented in table 1. About 68% of respondents indicated that imposition of penalties in tax laws would deter non-compliance, whilst the remaining 32% percent thought otherwise.

Table 1: Does the imposition of sanctions deter non-compliance?

Responses	Frequency	Percentage
Yes	182	68.2%
No	85	31.8%
Total	267	100%

Source: Field Survey (2010)

This shows that majority of the self-employed are of the view that deterrence or sanctions deter non-compliance. This finding confirms the studies of Becker (1968) and Franzoni (2001) that reported evidence of a relationship between sanctions and crime rate (including tax non-compliance). The very awareness of the existence of sanctions in our tax laws would deter some self-employed from non-compliance. The specifics of sanctions investigated revealed that monetary fines and prison sentences as punitive measure have the tendency to improve tax compliance whilst distress action is perceived as not important for tax compliance (see table 2).

On the question of whether the imposition of sanctions alone serves as a sufficient deterrent from non-compliance, about eighty-six percent (86%) of respondents do not think penalties alone serve as a sufficient deterrent from non-compliance whiles the remaining fourteen percent (14%) of respondents think the imposition of penalties alone would deter non-compliance (see table 3). This finding supports the evidence of Job, Stout and Smith (2007) who questioned the value of deterrent alone in regulating non-compliance behaviour. It is clear therefore that, though deterrent deters non-compliance that alone cannot sufficiently check the menace of income tax non-compliance.

Table 3: Does the imposition of sanctions alone deter non-compliance?

Responses	Frequency	Percentage
Yes	37	13.9%
No	230	86.1%
Total	267	100%

Source: Field Survey (2010

Recognizing the necessity but not sufficient for sanctions alone to improve tax compliance, a regression analysis was conducted to determine the joint effect of sanctions and cooperation on tax compliance. The results presented in table indicate satisfactory goodness of fit with "R-square" value of 64%.

Table 4: Coefficients of the linear regression model

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95% Confidence Interval for B	
		β_i	Std. Error	Beta			Lower Bound	Upper Bound
1	(Constant)	.857	2.160		.443	.658	-3.303	5.217
	Sanction	.279	.144	.124	1.937	.054	-.005	.562
	Cooperation	.385	.043	.572	8.912	.000	.300	.470

R^2= 642 F-stat. = 2.542

Coefficients

It is obvious from the table 4 that sanction and cooperation positively affect tax compliance though the coefficient of sanction variable is not significant. The significant of the cooperation variable reinforce ATO model propounded by Braithwaite (2003) to improve tax compliance; which suggests that tax authorities must focus on educating taxpayers on their tax obligations as well as help them improve their record keeping practices. Sanctions must however be preserved and reserved as the last resort, part)icularly in cases of deviant non-compliance. These, according to Braithwaite's (2003: 2007) and Owens & Hamilton (2003) view would help improve tax compliance. This finding from the regression seems to contradict the response recorded in table 1. Taken cognizance of findings presented on table 3, we test the joint significance of the sanction and cooperation in predicting tax compliance presented in table 5

Table 4: ANOVA test of significance of the predictor in the model

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	522.304	2	261.152	40.417	.000
	Residual	1253.513	194	6.461		
	Total	1775.817	196			

From Table 5, the extent to which the two independent variables (cooperation and sanctions) jointly associate with each other is located at sig. value on the ANOVA table. The sig. value of the variable is .000 less than the alpha value of .050. This is an indication that the two variables jointly improve income tax compliance significantly.

5. Conclusion

The paper used a survey of self-employed in Accra Metropolis to find out the enforcement strategies likely to improve tax compliance among self-employed. Analyzing the response of questionnaires administered, the study found high likely tax compliance response to sanction. It is also recorded that sanctions alone are deterrent enough to increase tax compliance. The study further implemented regression analysis to establish whether there causal relationship between tax compliance, sanctions and cooperation. The results indicated that sanctions though positively influence tax compliance but it is insignificant. The study observed positive and significant effect of cooperation on tax compliance. A joint significance test of sanctions and cooperation on tax compliance shows that sanction and cooperation jointly significantly influence tax compliance among self-employed.

The IRS like many other taxing authorities already has in place and makes use of various forms of sanctions, including monetary fines, prison sentences and distress action. These forms of sanctions however per the findings of the study are not enough and sufficient to causes compliance. The IRS should therefore assume that majority of the people (taxpayers) are good citizens and would be willing to comply if they understood the tax system and are helped to comply. It should however be made known that if the trust of the IRS is breached, it will evoke its punitive measures. On this basis, sanctions must be preserved in tax laws but as the last resort in enforcing compliance.

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Appendix

Table 2: Role of sanctions in enforcing income tax compliance

Forms of sanctions	Extent of Agreement						
	Strongly Agrees	Agrees	Neutral	Disagrees	Strongly Disagrees	Totals	Mean
Monetary fines	5 1.9%	180 67.4%	72 30%	10 3.7%	0 0%	267 100%	3.42
Distress action	0 0%	5 1.9%	64 24%	114 42.7%	84 31.4%	267 100%	1.96
Prison sentence	51 19.1%	117 43.8%	69 25.8%	16 6.0%	14 5.3%	267 100%	3.23
Standard Mean							3.00

Source: Field Survey (2010)