



## Tax Compliance Cost of SMEs in Ghana

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### **Abstract**

**Purpose:** The study sought to identify and measure the tax compliance costs incurred by SMEs in Ghana. It further sought to ascertain the compliance benefits earned by taxpayers.

**Methodology:** Data was collected through a self-administered survey of 116 SMEs in five regions in Ghana.

**Findings:** The study found that SMEs incur a gross compliance cost of GHC2 315 annually (excluding technological cost) or GHC4 687 where technological cost is included. The breakdown of the gross TCC by components showed the Internal Cost of GHC1 048, Incidental Cost of GHC121 and External Cost of GHC1 146. This study could not estimate the tax compliance benefits, even though most of the respondents agreed to the existence of benefits irrespective of their size. Small businesses were found to spend mostly on tax computational activities while medium and larger firms spent on tax planning activities. The results also depict the regressive nature of income tax in Ghana.

**Originality/Value:** Very little is known about the magnitude of resource SMEs in Ghana devote to complying with tax. The paper thus provides a reference point for tax compliance cost against which future studies and improvement to the tax system could be measured. This study fills the literature gap on TCC in Ghana.

## **Introduction**

SMEs in Ghana provide approximately 85% of manufacturing employment. SMEs are also believed to contribute about 70% to Ghana's GDP and, according to the Ghana Statistical Service IBES report of 2014, account for about 99.6% of businesses. More generally, SMEs' development is seen as accelerating the achievement of wider economic and socio-economic objectives, including poverty alleviation (Cook & Nixon, 2000: 1).

Given their economic weight in Ghana, SMEs have a crucial role in stimulating growth, generating employment and contributing to poverty alleviation. Despite their importance, SMEs are faced with various tax regulations (ITC, 2016: 4). SMEs incur certain costs to comply with these regulations, of which the most significant one is the cost of compliance (Smulders & Stiglingh, 2008: 355). The compliance cost incurred may be a result of the complexity in the tax system (Ariff et al. 1997: 1253; Pope, 1993: 20). In 2015, Ghana's government took a policy initiative to assist SMEs via the commencement of a full-scale self-assessment tax system (SAS). This was intended to ensure efficiency, reduce complexity and compliance cost. SAS is an example of a simple tax system. It depends on taxpayers filing annual returns and declaring income, adjustments, exemptions and deductions honestly to arrive at the income tax owed (Marshall, 1997: 9). Taxpayers are responsible for maintaining proper books and retaining records in safe custody (Okello, 2014: 11).

Under SAS, tax compliance requirements increase the cost of SMEs (Abdul-Jabbar & Pope, 2008: 3). The World Bank in 2011 conducted a study surveying firms on tax compliance costs and found sufficient evidence to indicate that countries with SAS incur higher compliance costs. Some of the costs they incur are the cost of hiring bookkeepers and tax consultants. Compliance costs are very relevant to taxpayers as these costs represent the value of resources expended in complying with their tax obligation (Tran-Nam et al., 2000: 231). These compliance costs may overburden SMEs. High compliance costs can diminish small firms' profitability and, consequently, slow down economic growth (Schoojans et al., 2011: 606).

This research is motivated by the fact that very little is known about the magnitude of resource SMEs in Ghana devote to complying with tax. We know even less about the particular characteristics of individual firms which contribute to these costs. Furthermore, the SAS requirements impose costs on SMEs. These compliance costs may have a relationship with compliance behaviour (Slemrod, 2004: 25) and, subsequently, on the government's tax revenue.

Therefore, the study primarily seeks to identify and measure the tax compliance costs SMEs in Ghana incur under the SAS. The study also aims to ascertain the benefits attained by taxpayers as a result of being tax compliant. The paper will also provide a reference point for tax compliance cost against which future studies and improvement to the tax system could be measured. This research fills the literature gap and contributes to the existing research on tax compliance costs. The study's findings will also provide insight for the GRA regarding compliance costs incurred by taxpayers under the SAS.

The next section provides a brief review of literature, followed by the method adopted for this study; the section after that will discuss the study results. The conclusion of the paper is then presented.

### **Material and Methods**

The most commonly used principle for defining SME is the number of employees of an enterprise. Most studies (Kamleitner et al., 2012; Smulders, 2013) define SME to have employees of 0 to 250. This study uses the Ghana Statistical Service (GSS) definition, which considers firms with less than 30 employees as small scale enterprises and their counterparts with more than 30 employees as medium and large-sized enterprises engaging more than 100 employees (Naah, 2018: 2). According to the GSS study, there were 638 234 registered businesses in Ghana, out of which SMEs constitute the largest (99.6%).

The theoretical recognition of TCC was identified in the work of Smith (1977). Three of Smith's canons of taxation (certainty, convenience and efficiency) were wholly concerned with tax compliance costs (Evans, 2008: 449). It requires compliance costs incurred by SMEs to be negligible in order not to violate the principles of a good tax

system. Sandford et al. (1989: 10) classified costs incurred by SMEs into internal, external, and psychic costs. The psychic costs are negative taxpayer experiences, such as anxiety and frustration in dealing with tax rules and legislation.

Various studies have been conducted from both developed and developing nations outside Africa. These studies provided critical lessons on the study of compliance cost. Some of the lessons were on measurement issues that have to be considered in compliance costs estimates (Shekidele, 2001; Tran-Nam et al., 2000); compliance cost increases with complexity in the tax system (Shekidele, 2001; Sapiei, 2012); The studies also found that compliance costs were mainly regressive and varied according to industry/sectors (Sanford et al., 1989; Sandford and Hasseldine, 1992; Ariff et al., 1997; Lignier, 2006; Sapiei, 2012). Finally, compliance cost is primarily made up of internal and external costs; while tax planning constitutes a greater proportion of the external cost for most large business (Sanford et al., 1989; Pope, 1993; Tran-Nam, 2001)

A review of TCC studies conducted in African nations found very few studies. The few studies were conducted mainly by the World Bank/IFC. In South Africa, FIAS (2007) and Govender and Citizen (2007) found that TCC for SMEs were regressive. Smulders *et al.* (2012) performed a further study on TCC for small enterprises in South Africa. The study estimated that it costs small enterprises R53 356.81 every year on internal tax compliance activities and R9 982 to get outside tax compliance support. Smulders *et al.*'s (2012) study agreed with prior studies in South Africa that gross tax compliance costs are regressive.

In Ethiopia, the World Bank group in 2016 published a study that assessed tax compliance costs and businesses' views on taxation in Ethiopia. The study estimated the total TCC to be ETB 5.8 billion (approximately USD 309.5 million) and ETB 7.5 billion (USD 400.5 million) depending on the inclusion of the procurement and maintenance cost of software and hardware. The study's outcomes also suggest a regressive tax.

A summary of Africa's empirical review indicates that TCC is quite significant and highly regressive. It also shows a great disparity in the TCC, and TCC is largely under-researched on the continent.

The study utilised self-administered questionnaires to SMEs randomly chosen from five (Greater Accra, Central, Ashanti, Eastern and Western) regions. The five regions were selected because of the high number of SMEs (74.5% of total SMEs). In each region, one major city or town is selected using the urban population size as a criterion. A final sample of 200 was used for the study. Data was collected for the 2018 year of assessment.

This study measured tax compliance costs based on the methods utilised in the literature (Sapiei, 2012; Pope, 1993; Sandford, 1998; Slemrod & Venkatesh, 2002). TCC was thus measured as the summation of the internal cost, the external cost and incidental cost incurred. The mathematical model used for this study was developed using the research objectives of the study and shown as:

$$\text{Tax Compliance Cost} = \beta_0 + \beta_1\text{Sector} + \beta_2\text{Size} + \beta_3\text{Ownership} + \beta_4\text{Premises} + \beta_5\text{Length} + \beta_6\text{Technology} + \text{Error term}$$

Where  $\beta_0, \beta_1, \dots, \beta_6$  are coefficients.

### **Results and discussions**

Out of the 200 questionnaires administered, 132 were received; 16 of these were rejected after the screening, leaving useable questionnaires of 116 representing a response rate of 58%.

### **Background information of taxpayers**

The main characteristics of SMEs represented in this study are shown in Table 1.

**Table 1** Background information of firms

<b>Variable</b>	<b>Frequency</b>	<b>Per cent</b>
<b>Firm sector/main business activity</b>		
Manufacturing	19	16.4
Service	54	46.6
Property and construction	4	3.4
Plantation and agriculture	3	2.6
Finance and banking	5	4.3
Trading (retail)	31	26.7
<b>Ownership structure</b>		
Sole proprietor	71	61.2
Partnership	27	23.3
Private limited company	18	15.5
<b>Tenancy status</b>		
Rented	57	49.1
Owned	59	50.9
<b>Firm Size/turnover - 2018</b>		
Less than GHC50 000	42	36.2
GHC50 000-GHC100 000	41	35.3
GHC100 001-GHC200 000	10	8.6
GHC200 001-GHC500 000	14	12.1
GHC500 001-GHC1 000 000	9	7.8
<b>Tax liability - 2018</b>		
Nil (no tax liability)	4	3.4
Less than GHC10 000	57	49.1
Between GHC10 000 and GHC50 000	43	37.1
Between GHC50 000 and GHC100 000	6	5.2
More than GHC100 000	6	5.2
<b>Firm age</b>		
Less than 10 years	63	54.3
10-20 years	41	35.3
More than 20 years	12	10.3
<b>Total</b>	<b>116</b>	<b>100.0</b>

**Source:** Field Data (2020)

These include the organisation's sector, ownership structure, tenancy status, firm size/turnover, tax liability and firm age. From Table 1, almost half of the firms surveyed were service organisations, while about 26.7% of them were retail firms, 16.4% of them were manufacturing firms, whereas the rest were in other sectors such as construction, agriculture, finance and banking. The findings reflect that most SMEs in Ghana are service and retail firms (Kayanula & Quartey, 2000). From Table

1, 61% of firms surveyed were registered as a sole proprietorship, 23.3% were partnerships, while 15.5% were private limited liability companies. More than half owned their premises, whereas the rest had rented their premises. Also, more than half of the firms had been in operation for less than ten years, 35.3% had been in operation between 10 and 20 years, whereas the remaining firms had been in operation for more than 20 years.

Furthermore, about 36.2% of firms had a turnover that was less than GHC50 000 in 2018, about 35.3% had a turnover between GHC50 000 and GHC100 000, while the rest (28.5%) had a turnover above GHC100 000.

### **Tax compliance cost estimates**

As stated earlier, the TCC was measured by the internal cost, the external cost and incidental cost incurred by SMEs. Each of these components will next be discussed and computed.

#### **Internal staff costs**

Internal staff costs are made up of the actual time spent by a firm's staff in dealing with issues involving tax and the cost of time expended. The cost was estimated using a mathematical formula adapted from literature (Evans *et al.*, 1997; Sapiei, 2012).

#### **Internal staff time**

The number of staff who handled tax matters in the firms surveyed (based on 90 cases of firms) with internal costs showed that firms with finance directors/CFOs/CFCs had a maximum of two people holding such positions per firm. Also, 50 firms had accountant/tax managers with a maximum of three positions per firm. About 29 of the firms had general/non-financial managers with a maximum of 4 positions per firm. Again, 36 firms had accounting staff with a maximum of 15 positions per firm. Similarly, 26 firms had other (general) employees that handled tax matters with a maximum of three employees per firm. Further, the time (per year) spent exclusively on tax issues by staff who handle tax within the firms surveyed is presented in Table 2.

**Table 2** Hours spent on tax activities by staff categories

Staff categories	Mean	Minimum Number of Hours	Maximum Number of Hours	Standard Deviation
Finance director/CFO	45.3	12	168	36
Accountant/tax manager	57.1	12	168	38
General/non-financial manager	33.1	12	96	21
Accounting staff	45.7	12	168	48
Other staff	31.8	12	144	32
<b>Overall</b>	<b>213</b>	<b>60</b>	<b>744</b>	<b>174</b>

Based on 90 cases of firms with internal costs

**Source:** Field Data (2020)

Table 2 indicates that for the 90 firms who provided information on the time, they spent an average of 213 hours per year exclusively on tax activities. The time spent ranged from 60 hours to 744 hours. An analysis of the time in terms of job position indicates that an average of 45 hours was spent by finance directors/CFOs/CFCs per year. In contrast, accountants/tax managers spent an average of 57 hours per year on tax activities. Therefore, the average time spent by each firm on tax activities was 83 hours per year, ranging from a minimum of 12 hours to a maximum of 384 hours with a standard deviation of 80 hours.

Moreover, based on Evans et al. (1997)'s recommendations, the researcher utilised the standard wage rate approach to calculate internal time spent. The standard wage rate of relevant staff categories was obtained from the salary survey report of Paylab Ghana (2020). The wage rates were converted to hourly rates by dividing monthly wages per staff category by the total number of working hours per month.

In line with Sapiei (2012) and Evans *et al.* (1997), the mean internal time spent exclusively on tax activities per staff category per year was then multiplied by the hourly rates per staff category. Consequently, each firm's internal staff costs estimate is obtained by adding all the staff costs on tax activities for all relevant staff categories. The result is shown in Table 3.



**Table 3** Internal time staff costs

	Mean GHC	Minimum GHC	Maximum GHC	Standard Deviation
Internal staff costs	1 048	39	5 715 84	1 171

Based on 90 cases of firms with internal costs

**Source:** Field Data (2020)

From Table 3, the internal staff costs per firm ranged from thirty-nine Ghana Cedis (GHC39) to five thousand seven hundred and sixteen Ghana Cedis (GHC5 716), with an average of one thousand and forty-eight Ghana Cedis (GHC1 048).

The internal staff time costs per turnover categories are presented in Table 4. The results show that internal staff time costs increase with increased firm size/turnover.

**Table 4** Internal staff time costs per turnover

Turnover	Frequency	Mean GHC
Small (<GHC50 000)	31	531
Medium (GHC50 000-GHC100 000)	32	1 067
Large (>GHC101 000)	27	1 620
<b>Overall</b>	<b>90</b>	<b>1 048</b>

**Source:** Field Data (2020)

### Incidental tax compliance costs

About half (49.1%) of the firms surveyed provided information on their incidental costs for complying with tax laws. The costs ranged from twenty Ghana Cedis (GHC20) to three hundred Ghana Cedis (GHC300) per annum, with an average of one hundred and twenty-one Ghana Cedis (GHC121). The incidental cost was computed per the turnover categories are presented in Table 5.

**Table 5** Incidental costs per turnover

Turnover	Frequency	Mean GHC
Small (<GHC50 000)	12	80
Medium (GHC50 000-GHC100 000)	26	108
Large (>GHC101 000)	19	164
<b>Overall</b>	<b>57</b>	<b>121</b>

**Source:** Field Data (2020)

It is observed from table 5 that incidental costs increase with increased firm size/turnover. The main incidental cost was transportation costs (travelling, dispatch

and delivery service costs) accounting for 51% of the total cost. This was followed by the cost of printing documents, stationery and photocopy charges (19%). The rest were indirect cost (11%), food and water (10%), and telephone and internet (9%).

### **External tax fees**

Four in five (82.8%) firms engaged the services of external tax professionals on tax issues. The fees charged by these external tax professionals represent the external tax compliance costs of each firm. The fees paid by SMEs to external tax professionals ranged from two hundred Ghana Cedis (GHC200) to four thousand Ghana Cedis (GHC4 000), with an average tax fee of one thousand one hundred and forty-six Ghana Cedis (GHC1 146). The external tax fees per turnover categories also showed that the fees increase with increased firm size/turnover.

### **Tax psychological costs**

Two questions were asked in the questionnaire to taxpayers to estimate psychological costs. First, the respondents were asked to estimate how much they were willing to pay if someone else were to attend to their firm's tax affairs (internal psychological costs). Second, they were asked to estimate how much they were willing to pay if someone else were to relieve the firm of the inconvenience of attending to tax advisers etc. (external psychological costs). The internal psychological costs of the firms that provided data ranged from fifty Ghana Cedis (GHC50) to one thousand five hundred Ghana Cedis (GHC1 500), with an average of seven hundred and sixty-nine Ghana Cedis (GHC769).

The internal tax psychological cost of GHC769 means that SMEs incur a cost of GHC769 per annum psychologically in complying with tax regulations in Ghana. Similarly, the external psychological costs of firms that provided data ranged from ten Ghana Cedis (GHC10) to one thousand six hundred Ghana Cedis (GHC1 600), with an average of five hundred and fifty-seven Ghana Cedis (GHC557) and a standard deviation of 362.

### **Technology costs**

Respondents were asked to indicate the cost incurred on hardware and software they used for tax purposes over three years (2016, 2017 and 2018). The result was

divided by three to obtain the average amount per annum. The results showed that SMEs spend between sixty-three Ghana Cedis (GHC63) and one hundred and fifty thousand three hundred and eighty-three Ghana Cedis (GHC150 383) on the cost of technology acquisition for tax purposes with an average of six thousand and forty-eight Ghana Cedis (GHC6 048) spent on technology across 48 firms.

### Tax compliance costs

As the various components have been computed, this section summarises the TCC obtained in this study. TCC includes internal costs, incidental costs and external costs. Psychological costs were not included since their measurements are unreliable and usually excluded in TCC studies (Evans *et al.*, 1997; Sapai, 2012). The results are shown in Table 6.

**Table 6** Estimated mean compliance costs by components

Cost Component	Mean GHC	Cost Breakdown (%)
Internal Costs (ICC)	1 048	45.3
Incidental Costs (IDC)	121	5.2
External Costs (EC)	1 146	49.5
<b>Overall</b>	<b>2 315</b>	<b>100.0</b>

Note: Based on cases with relevant cost components

**Source:** Field Data (2020)

Table 6 shows that the largest share of the average cost was related to external costs (49.5%) among the three main cost components. This was followed by internal costs (45.3%) and incidental costs (5.2%) in complying with tax laws. Each firm's overall mean compliance cost by cost component was two thousand three hundred and fifteen Ghana Cedis (GHC2 315).

The estimated TCC at the firm level (excluding technological cost) ranged from fifty Ghana Cedis (GHC50) to nine thousand seven hundred and sixteen Ghana Cedis (GHC9 716), with an average total compliance cost of one thousand nine hundred and seventy-four Ghana Cedis (GHC1 974). The TCC was also computed per turnover categories as presented in Table 7. The results showed that TCCs increase with increased firm size/turnover.

**Table 7** TCC per turnover

Turnover	Frequency	Mean GHC
Small (<GHC50 000)	38	1 020
Medium (GHC50 000-GHC100 000)	37	2 122
Large (>GHC101 000)	32	2 936
<b>Overall</b>	<b>107</b>	<b>1 974</b>

**Source:** Field Data (2020)

Where technological costs are factored in, the average compliance costs at the firm level stands at four thousand six hundred and eighty-seven Ghana Cedis (GHC4 687), with a minimum cost of one hundred Ghana Cedis (GHC100) and a maximum of one hundred and fifty-two thousand three hundred and ninety-six Ghana Cedis (GHC152 396). In addition, the TCC (including technology) per turnover categories indicated that TCC was higher for medium-sized businesses (7 508) than other types of businesses: Large (5 232) and small (1 482).

In order to improve the reliability of the data from the survey, a reliability check for compliance cost estimation was included in the questionnaire. The respondents were asked to indicate how much compensation they could claim from the government for the time and money spent dealing with corporate income tax for 2018. The possible compensation amounts stated ranged from one hundred Ghana Cedis (GHC100) to fifteen thousand Ghana Cedis (GHC15 000) with an average compensation amount of two thousand nine hundred and twenty-eight Ghana Cedis (GHC2 928). However, the average compensation amount was slightly above the mean compliance cost estimate at the firm level and the average TCC computed by cost components. The slight difference may be as a result of either the taxpayers tending to over-claim expenses or it represents an element of the psychological cost incurred by the taxpayers.

The internal-external values of TCC were also analysed in terms of the firm characteristics: firm sector, ownership structure, firm size, and age. The results are analysed as follows.

#### **Firm sector**

SMEs in the manufacturing and service sectors had almost even internal-external cost ratios. The external costs were significantly higher for the retail (trading) sector,

with the internal-external cost ratio being 39:61. For other sectors (such as plantation, agriculture, finance and banking, and construction), the internal costs were significantly higher with an internal-external cost ratio of 57:43.

### **Ownership structure**

Sole proprietorships and partnerships were significantly more likely to spend a higher proportion of their compliance costs on external tax fees. On the other hand, private limited liability companies spend a significant proportion of their compliance costs internally.

### **Firm size/turnover**

The results further show that small-sized firms (firms with a turnover of less than GHC50 000) were more likely to spend a higher proportion of their compliance costs on external tax fees. On the other hand, medium-sized firms (firms with a turnover between GHC50 000 and GHC100 000) and large-sized firms (firms with a turnover above GHC100 000) were more likely to spend almost equally on internal and external compliance costs.

### **Firm age**

Firms that have been in operation for 20 years or less were more likely to spend a higher proportion of their compliance costs on external tax fees. In contrast, firms operating for more than 20 years were more likely to spend more on internal compliance costs.

### **Compliance costs analysis by computational-planning cost ratios**

Tax compliance costs were analysed in terms of computational and planning activities. The respondents were asked to state how much they spent on routine income tax return activities (computational) and tax planning activities. The breakdown of these costs was further requested for both internal and external tax compliance cost. This method of computation was used in literature by Pope *et al.* (1994), Ariff *et al.* (1997) and Sapiei (2012).

The study found that the nature of compliance costs for internal and external tax compliance is quite similar. Nonetheless, the proportion of computational work for external tax compliance (56%) was higher than that of planning (44%), whereas the

opposite is true for internal tax compliance, where the planning proportion (53%) was higher than computational (47%). An overall computational-planning ratio was 52:48. The ratio implies that most tax compliance cost burdens for SMEs are related to routine income tax returns. The computational-planning cost was further analysed in terms of the firm characteristics and shown in Table 8.

**Table 8 Computational-planning compliance costs ratios by firm characteristics**

Variable	Frequency	Compliance Cost Ratio (%)	
		Computational (%)	Planning (%)
<b>Firm sector</b>			
Manufacturing	19	52	48
Service	48	45	55
Trading (Retail)	29	54	46
Others (plantation, Agric, banking, construction)	11	44	56
<b>Ownership structure</b>			
Sole Proprietor	66	50	50
Partnership	23	46	54
Private Limited Company	18	48	52
<b>Firm size/turnover</b>			
Small (<GHC50 000)	38	52	48
Medium (GHC50 000-GHC100 000)	37	50	50
Large (>GHC101 000)	32	44	56
<b>Firm age</b>			
Less than 10 years	55	49	51
10-20 years	40	50	50
More than 20 years	12	45	55
<b>Overall</b>	<b>107</b>	<b>49</b>	<b>51</b>

**Source:** Field Data (2020)

**Firm sector**

From the perspective of SMEs' sectors, manufacturing and retail (trading) firms had a higher proportion of computational costs. In contrast, service and other sectors had a higher proportion of planning costs. This result means manufacturing and retail firms incurred most of their internal compliance costs on tax computational activities than tax planning activities. On the other hand, service and other sectors spend more on tax planning than tax computational activities.

### **Ownership structure**

An analysis of the computational-planning cost in terms of ownership structure shows that sole proprietorships had an even proportion of their internal compliance cost for computational and planning costs. In contrast, both partnerships and private limited liability companies had higher proportions of planning costs. As companies normally try to take advantage of tax planning opportunities in the tax laws, this result was expected.

### **Firm size/turnover**

Small-sized firms (firms with a turnover of less than GHC50 000) had higher proportions for computational costs. Medium-sized firms (firms with a turnover between GHC50 000 and GHC100 000) had an even proportion of their internal compliance cost for computational and planning costs. Large firms (firms with a turnover above GHC100 000) had higher proportions of planning costs. This result collaborates with the ownership structure findings, as larger firms may have more resources (skills and funds) to engage in tax planning in-house.

### **Firm age**

Firms that had been in operation for 20 years or less had an almost even proportion of internal compliance cost for computational and planning costs. In contrast, firms operating for more than 20 years had higher proportions of planning costs.

### **Distribution of compliance costs (assessing the regressive nature of taxes)**

This study also examined how the TCC was distributed in relation to the turnover of the firms. The nature of the distribution help determines the regressive nature of the income tax in Ghana. The costs per category of turnover were divided by the average turnover of small (GHC25 000), medium (GHC75 000) and large firms (GHC200 000), respectively. The results were that TCC represents 0.04% of the turnover of small firms. The proportion, however, drops to 0.02% with medium firms and 0.01% with large firms. The result appears that the tax compliance burden mainly was on small businesses in all the cost categories assessed, with large firms being the least affected. The trend in the distribution of TCC was the same when the various components of the TCC were analysed. This confirms the regressive nature of the

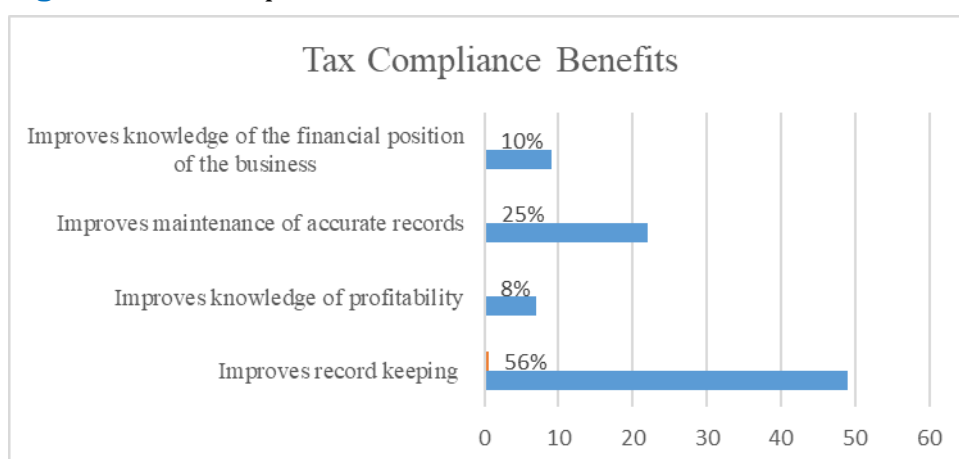
income tax in Ghana. On the other hand, where TCC was inclusive of technological costs, the worse affected firms were medium-sized firms (0.1%).

### Tax Compliance Benefits

Tax compliance does not only involve cost. Tran-Nam et al. (2000), Chattopadhyay and Das-Gupta (2002), and Sapiei (2012) have all identified three main benefits associated with tax compliance. These are cash flow, managerial and tax-deductible benefits. This study focused on managerial benefits only as they are expected to be more significant with small business than the other benefits (Smulders et al., 2012). Managerial benefits arise in several forms, such as an improved record-keeping and the use of technology (Tran-Nam et al., 2000; Sapiei, 2012; Smulders et al., 2012). SMEs were asked to state their agreement that complying with tax has some benefits to their business. The majority (84%) of the respondents, irrespective of their size, agreed to the existence of benefits. However, the study could not quantify the benefits as 98% of the respondents indicated that they were unable to estimate these benefits accurately.

The respondents were further given four statements to rank based on their benefits from keeping tax records. The ranking was on a scale of 1 to 4, where 1 = strongly agree and 4 = not sure. The result is shown in figure 1.

**Figure 1:** Tax Compliance Benefits



The results show that SMEs perceived improved record-keeping as the prime benefit of the tax compliance obligations. More than half of the respondents agreed to this benefit irrespective of the business's size. Improvement in knowledge of business's



financial position and improved accurate records maintenance were ranked the second and third benefits, respectively. The least ranked benefit was the improvement in the knowledge of profitability.

### **SME taxpayers views**

This section presents the SME taxpayers' opinions regarding the difficulties they face concerning tax issues and the reasons why they engage external tax professionals.

### **Tax-related difficulties for SMEs**

SMEs were asked to state and rank the criticality of the difficulties they faced on a scale, where 1 = most important and 9 = least important. Table 9 depicts how the items were rated as well as their related ranks.

**Table 1** Highest-ranked associated difficulties faced by SME Clients

<b>Difficulties</b>	<b>Mean</b>	<b>Rank</b>
Estimating income tax payable	1.83	1
Understanding income tax changes	1.96	2
Implementing income tax changes	1.98	3
Maintaining records for income tax purposes	2.2	4
Cash flow position when paying quarterly tax instalments	2.44	5
Dealing with tax authorities	2.52	6
Dealing with external advisors (such as tax agents)	2.64	7
The short period to lodge tax returns	2.77	8
<b>Total</b>	<b>2.29</b>	

**Source:** Field Data (2020)

Table 9 shows the key difficulty faced by SMEs regarding tax matters was the ability to estimate the income tax payable. This was followed by the ability to understand income tax changes, implement income tax changes, maintain records for income tax purposes, cash flow position when paying quarterly taxes, dealing with tax authorities, dealing with external advisors, and the short period to lodge tax returns, in descending order of importance.

### **Conclusion**

The study primarily sought to identify and measure TCC incurred by SMEs' in Ghana. SMEs were found to incur a gross compliance cost of two thousand three hundred and fifteen Ghana Cedis (GHC2 315) annually (excluding technological cost). Where technological costs are factored in, a firm's average gross compliance costs stand at

four thousand six hundred and eighty-seven Ghana Cedis (GHC4 687). The breakdown of the gross TCC by components showed that SMEs incurred Internal Cost (ICC) of GHC1 048, Incidental Cost of GHC121 and External Cost (EC) of GHC1 146. Tax compliance does involve not only cost but also benefits. The majority (84%) of the respondents, irrespective of their size, agreed to the benefits resulting from the tax compliance obligations.

The distribution of compliance costs showed that the tax compliance burden was mostly on small businesses in all the cost categories assessed, with large firms being the least affected. This confirms the regressive nature of the income tax in Ghana. This result agrees with findings in studies conducted in Africa and other parts of the world.

An analysis of SMEs' costs found that SMEs had almost even internal and external costs, with external costs being marginally greater than internal costs. The study further showed that small-sized firms were more likely to spend a higher proportion of their compliance costs on external tax fees. On the other hand, medium-sized firms and large-sized firms were more likely to spend almost equally on internal and external compliance costs.

The study also found that TCC burdens for SMEs are related to routine income tax returns. A review of the computational and planning costs showed that small-sized firms had higher proportions for computational costs. Medium-sized firms had an even proportion of their internal compliance cost for computational and planning costs. Large firms had higher proportions of planning costs. From the perspective of SMEs' sectors, manufacturing and retail (trading) firms had a higher proportion of computational costs. In contrast, service and other sectors had a higher proportion of planning costs.

The result of the study provides an estimated cost of compliance to tax incurred by SMEs that had not been known before and could serve as a benchmark for future studies in this area. The study further provides information on the benefits of tax compliance. The measurement of tax compliance benefits is very limited in TCC literature. The study thus helps to fill this gap in the literature.

The study results indicate that SMEs in Ghana incur a significantly high TCC, and these compliance costs are highly regressive. As a high cost might hinder the growth prospect of SMEs and reduce the tax compliance and subsequently government revenue, Government and tax administrators must take steps to minimise these cost. Compliance costs assessments should be a major component of any tax policy reviews to provide information about the likely consequence of particular tax legislation. The current study also measured the compliance cost incurred in complying with income tax only. Further studies could estimate the compliance cost incurred in complying with other taxes such as customs duties and value-added tax (VAT). As there are also limited studies on Tax compliance cost in Africa, future studies could look at collaboration with other researchers in Africa to provide an inter-country measurement and comparison of compliance costs.

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