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The implementation of informal sector taxation: Evidence from selected African countries

Godwin Dube¹ and Daniela Casale²

Abstract

This paper adds to a growing literature on informal sector taxation in developing countries by describing and analysing the experiences of four African countries (Ghana, Tanzania, Zambia and Zimbabwe) that have implemented informal sector taxes in recent decades. These taxes are analysed in terms of their revenue, technical (that is, administrative effectiveness, equity and efficiency) and governance implications. The evidence suggests that the revenue potential from informal sector taxation is low, in part because of the difficulty in designing and administering effective informal sector tax regimes. Based on the experiences in these countries, negotiating with informal sector associations might be a useful strategy to improve administrative effectiveness and state-citizen relations.

Keywords: informal sector taxation, presumptive taxes, Africa

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1. INTRODUCTION

There is a growing interest, in both academic literature and policy arenas, in the possibility of taxing the informal sector in developing countries. This has been precipitated in part by the fiscal pressures experienced in many of these countries in the face of changing global trade and labour markets. Many developing countries traditionally relied on trade taxes as their main source of tax revenue (Bahl & Bird, 2008; IMF, 2011). With trade liberalisation (and the consequent drop in tariff rates) an important source of tax revenue has been undermined, creating concerns in the tax community around how developing countries can overcome the shortfall (Baunsgaard & Keen, 2005; Glenday, 2006). In addition, the large, and often growing, informal sector in many developing countries has resulted in a significant erosion of the formal tax base (Bird & Zolt, 2008). Given the limited tax revenues being generated from the small formal sector, there have been a number of calls to consider taxing informal sector enterprises (Bird & Zolt, 2008; Gupta & Tareq, 2008; Joshi et al., 2014).³

The existing literature on informal sector taxation can be divided into two main strands. The first, and larger body of work, focusses on the rationale for taxing those in the informal sector, with the main motivations including revenue collection, equity, efficiency, and governance considerations. Although the informal sector is difficult to tax because of administrative challenges, it is increasingly viewed as a potential source of tax revenue due to its large contribution to Gross Domestic Product (GDP) in many developing countries (Benjamin & Mbaye, 2012; Taube & Tadesse, 1996). In terms of equity, taxing those in the informal sector would alleviate concerns among formal sector taxpayers who view the non-payment of taxes by those with similar incomes in the informal sector as unfair (Fjeldstad & Heggstad, 2011; Terkper, 2003). From an efficiency perspective, it is argued that informal firms, in attempts to avoid the attention of tax authorities, may engage in behaviour that leads to lower output (Demenet & Razafindrakoto, 2013). The recent literature has also emphasised political and governance considerations in taxing the informal sector in developing countries. Taxation is seen as a way of promoting good governance because taxpayers will be motivated to hold leaders accountable (Joshi & Ayee, 2008; Joshi et al., 2014; Prichard, 2009).

The second strand in the literature analyses the general approaches that can be used to tax those in the informal sector. While extending existing indirect or direct taxes that apply to formal firms (but at lower rates, for example,) are possibilities in taxing the informal sector, the most common approach has been the use of presumptive taxes specifically designed to tax informal sector activities (Bird & Zolt, 2003; Joshi et al., 2014; Loepnick, 2009; Pashev, 2006). Presumptive taxes are generally based on presumed, rather than actual, income. For example, a fixed lump-sum amount paid quarterly by minibus taxis based on their carrying capacity (that is, number of seats) would constitute a presumptive tax. This type of tax is relevant for the informal sector because actual incomes are notoriously hard to monitor.

However, in the growing literature on informal sector taxation, very little has been written on the actual implementation of these taxes in countries where they have been

³ Also, there are increasing demands by international finance institutions for developing countries to finance their own development by mobilising domestic resources (IMF, 2003; OECD, 2015a).

introduced (see Bruhn & Loeprick, 2014).⁴ This paper aims to contribute to this area by describing and analysing the experiences of four African countries that have implemented informal sector taxes in recent decades, namely Ghana, Tanzania, Zambia and Zimbabwe. In particular, the paper will interrogate the revenue, technical (that is, administrative effectiveness, equity and efficiency) and governance implications of informal sector taxes based on the evidence available for these four country case studies. Drawing on the findings of this work, we also make suggestions for future research that is more policy-oriented in nature.

The paper is organised as follows. Section 2 clarifies the terminology used in this literature and defines key concepts, while Section 3 provides a brief review of the existing literature on the rationale for informal sector taxation in developing countries. Section 4 describes the policy and implementation of informal sector taxes in each of the four country case studies. Section 5 synthesises the findings, evaluating the general experiences in these countries in terms of the revenue, technical and governance criteria, and suggests areas for future research. Section 6 contains the conclusion.

2. INFORMAL SECTOR TAXATION: TERMINOLOGY AND KEY CONCEPTS

The concept of informal sector taxation is often met with some confusion, not least because the informal sector itself is a contested construct, but also because informal sector taxation can refer to quite different practices in tax policy, and often these are not clearly delineated in the literature. In this section we specify our definition of the informal sector and we attempt to shed some light on the different approaches that have been used in informal sector taxation.

We use the most common approach to defining the informal sector, namely the enterprise approach, which classifies as informal, businesses or operations that are not registered under the relevant national regulations, such as taxation or social security laws (Hussmans, 2004; ILO, 2002). The terms ‘informal sector’ and ‘informal economy’ (the latter term used to collectively refer to unregistered enterprises and workers without formal contracts in formal and informal enterprises) are often used interchangeably in the tax literature. However, we prefer to use the term ‘informal sector’ here, as taxing the informal economy (which usually also includes social security contributions for workers) will involve a different set of considerations from taxing unregistered enterprises falling outside the standard tax system. In addition, tax policy in most countries that have attempted to collect revenue from those outside the standard tax regime, concentrates on unregistered enterprises.

Some scholars find the concept of informal sector taxation confusing, precisely because of the common association of informality with tax evasion or being unregistered. However, as Joshi and Ayee (2008: 186) point out, informal sector taxation, is not an ‘oxymoron’. A common misperception is that taxing the informal sector always has as its main goal formalisation (that is, simply drawing unregistered firms that are eligible into the standard tax system), but in reality there are a range of practices which fall along a spectrum. At the one end, is what we might call ‘taxation

⁴ Two possible reasons suggested by Bruhn and Loeprick (2014) for the dearth of literature on the implementation and impact of presumptive taxes are the small contribution of informal sector taxes to total revenues, and the scarcity of information on the operations of small firms.

as formalisation', where informal sector tax policy is indeed mainly concerned with registering eligible firms and/or bringing them into the standard tax net. At the other end, informal sector taxation refers to simplified taxes specifically designed to raise revenue from informal businesses without the intention of necessarily formalising these enterprises.

In some countries the implementation of simplified taxes specifically meant for those in the informal sector is viewed as a kind of formalisation by governments and researchers, placing them somewhere along the spectrum (Bruhn & Loeprick, 2014; De Mel et al., 2012; Fajnzylber et al., 2011). For example, in Brazil, the *Simples Nacional* (for firms with gross revenues between US\$120 000 and US\$1.2 million) and *Microempreendedor Individual*, taxes covering even the smallest enterprises (and workers in those enterprises) with gross revenues below US\$20 000, are viewed as a process of formalisation. Similarly, in Uruguay, the simplified *monotributo*, a tax which is supposed to be paid by all microenterprises in the informal economy, has as its principal goal formalisation (ILO, 2014: 6–8; OECD, 2015b).

In this paper, we focus on countries in which informal sector tax policy has involved the levying of administratively simple taxes, where unregistered businesses are allowed to remain in the informal sector as long as they pay the taxes designed specifically for their sector. The distinction between this form of informal sector taxation on the one hand and 'taxation as formalisation' on the other is important, as these two approaches are likely to have different policy goals and implications. For example, the taxation as formalisation literature (De Mel et al., 2012; McKenzie and Sakho, 2010) emphasises the benefits of formalisation on firm growth (for example, greater access to markets, credit and finance) and looks at the possible ways in which incentives for this growth can be implemented. However, growth may not be important to informal sector firms that have a small optimal size (Kanbur, 2014). Therefore, these firms will require different (that is, non-growth related) incentives for tax compliance, such as the provision of services specific to this sector or the opportunity to engage policy-makers on matters of concern to their operations (such as crime or harassment by officials) (Joshi et al., 2014).

Collecting taxes from small unregistered operators clearly comes with its own set of challenges, which is why taxing the informal sector through the standard tax regime is difficult.⁵ Enterprises in this sector are usually highly mobile, with high churn out rates, informal business structures and weak accounting systems. Also, determining which firms, in a highly heterogeneous sector (Kanbur, 2014; Zinnes, 2009), have incomes that are high enough to be eligible for the standard tax system (but are simply not paying these taxes), and which cannot reasonably be expected to pay at standard rates, is not easy, especially when incomes in this sector are highly variable.

An increasingly popular way of taxing the informal sector in developing countries, therefore, is through a 'single tax', generally in the form of a presumptive tax that replaces the various taxes that are usually paid separately under the standard tax

⁵ It is possible to collect revenue from small informal firms through the extension of existing taxes by, for example, using reduced corporate income tax (CIT) rates for microenterprises below the VAT registration threshold (Bird & Wallace, 2003). However, Loeprick (2009) argues that this approach is unlikely to be appropriate in developing countries that have large informal sectors, as the filing of returns would make it difficult for many small businesses to comply.

system (that is, VAT on sales⁶, personal income tax, corporate income tax, and so forth). According to Ahmad and Stern (1991: 276), ‘the term presumptive taxation covers a number of procedures under which the “desired” base for taxation (direct or indirect) is not itself measured but is inferred from some simple indicators which are more easily measured than the base itself’. For example, presumptive tax rates can be based on turnover (for firms that maintain records of sales), estimates of taxable income based on indicators of income capacity or business performance (for example, a minibus taxi’s carrying capacity), a fixed lump-sum tax (that is, standard assessment) for all operators in a particular informal sector activity, or a combination of these approaches (OECD, 2015b). Although presumptive taxes may introduce equity and efficiency concerns, the main objective of these taxes is to simplify tax administration through reducing both compliance and collection costs, while raising some revenue from informal enterprises (Bird and Zolt, 2003; Pashev, 2006; Taube & Tadesse, 1996).⁷

3. MOTIVATIONS FOR TAXING THE INFORMAL SECTOR

An important question, given the inherent difficulties in collecting taxes from the informal sector, is why then do governments engage in this practice? The most obvious, and it seems the most common motivation, is to raise revenue. The informal sector’s contribution to GDP in developing countries is large, and in some cases, growing (Benjamin & Mbaye, 2012; Schneider et al., 2010). For instance, in sub-Saharan Africa, the informal sector’s contribution to GDP rose from 24.1 per cent in the 1990s to 31.3 per cent in the 2000s, while in Latin America the increase was from 13.6 per cent in the 1990s to 24 per cent in the 2000s (Charmes, 2012: 119–120, 128). However, the focus on the share of GDP as an indicator of revenue potential may obscure the fact that this sector has numerous small enterprises with low incomes (Djankov et al., 2002; Phiri & Nakamba-Kabaso, 2012). Therefore, segmenting this sector into firms that cannot be expected to pay taxes and those that can is a challenging but important consideration in informal sector tax policy (IMF, 2007).

Very few studies give an indication of the tax revenues collected from the informal sector. Data, even on basic revenue information, is often difficult to obtain in many developing countries. However, the available evidence indicates that revenue collections from the informal sector are low (Araujo-Bonjean & Chambas, 2004; Mwila et al., 2011). The costs of administering informal sector taxes can be high though, both in terms of the costs incurred by the tax authorities in identifying taxpayers and collecting the taxes, and the costs incurred by informal enterprise owners in complying (Loeprick, 2009). It is therefore not surprising that in the past decade many governments have focused on improving administrative effectiveness by making presumptive tax systems simpler, in an effort to improve the revenue to cost ratio of collection.

⁶ Informal firms will pay VAT on their inputs purchased from the formal sector, as they will not be able to claim a refund for the VAT on inputs. However, if informal enterprises purchase a significant portion of their inputs from other informal traders or produce these themselves, they would be able to escape the VAT net too.

⁷ Methods using turnover are generally fairer than those using estimates of income or lump-sum amounts (especially if profit rates are similar across businesses in the informal sector activity in question), however, they require those in the informal sector to keep records of sales, and many informal businesses do not.

From an equity perspective, there have been arguments for an almost total exemption from direct taxes for the informal sector, particularly those taxes paid to central government (Pimhidzai & Fox, 2012; Prichard & Bentum, 2009). Pimhidzai and Fox (2012) argue that informal sector taxes tend to be regressive, threatening the viability of the smallest enterprises (considering that most of them might already be paying local taxes such as trading licenses, operating permits or user fees). Informality may be the only viable alternative for many people in developing countries who have been 'excluded' from participating in the formal sector. In such cases, attempts to tax these enterprises may not only result in inequity (Carroll, 2011) but may also destroy informal jobs (La Porta & Shleifer, 2014).

While this may be true for the smaller enterprises, there is evidence that those in the informal sector are not always poor (Gurtoo & Williams, 2009; ILO, 2002). Not taxing these informal enterprises similarly gives rise to inequities and dissatisfaction among those with similar or lower incomes in the formal sector (Fjeldstad & Heggstad, 2011). There is a dearth of empirical evidence on the equity implications of presumptive taxes in countries where they have been implemented. The few existing studies have mostly just highlighted that the lack of tax-free thresholds in many presumptive tax systems, a feature common to most personal income tax (PIT) systems, is likely to result in inequity vis-à-vis the PIT (Memon, 2013; TRA, 2011).

Economic efficiency refers to the optimal allocation of resources in the economy. Taxes may distort economic decisions resulting in misallocations and a loss of welfare over and above the revenues collected—the excess burden of taxation (Rosen, 1995). By not paying taxes, informal enterprises are therefore escaping the distortionary effects of taxation, and bringing these firms into the tax net may actually hinder their operations through tax-induced behavioural changes that result in reduced output (Alm et al., 2004).

However, while informal enterprises may escape taxation (and its distortionary effects), non-compliance can create inefficiencies too. Informal firms often have to devise means of avoiding attention (and harassment) by the police and government authorities. Corrupt payments to government officials may be higher than tax liabilities (Joshi & Ayee, 2008). Also, for those informal firms that want to grow, not paying taxes may exclude them from accessing larger product markets, formal credit, or business training and support programmes. This is likely to result in such firms operating at a sub-optimal level. However, apart from the taxation as formalisation literature with its focus on firm growth and productivity (Fajnzylber et al., 2011; Leal Ordonez, 2014), very little has been written on the efficiency implications of informal sector presumptive taxes.

Increasingly, attention is being paid in the literature to the potential political and governance benefits of informal sector taxation, with the suggestion that informal sector tax policy should go beyond revenue and technical considerations (Fjeldstad & Heggstad, 2011). Joshi et al. (2014) identify from this literature a number of channels through which these benefits may transpire. The state, as a way of encouraging quasi-voluntary compliance, may be more responsive to taxpayers (Bodea & LeBas, 2014; Moore, 2004), and taxpayers may be more likely to make demands from the state and hold government officials to account (Prichard, 2009). In addition, taxing informal enterprises may encourage bargaining between the state and its citizens, through the involvement of informal sector associations, for example, a benefit which may not be

insubstantial in countries where the informal sector accounts for a large share of GDP or employment (Joshi & Ayee, 2002).

4. TAXING THE INFORMAL SECTOR IN PRACTICE

According to the IMF (2007: 27), more than 25 countries in sub-Saharan Africa and 14 countries in Latin America have a special tax regime for small enterprises (which includes the informal sector). The literature on informal sector taxation described above has focused mainly on conceptual issues, however, with little empirical evidence available on how these taxes have been implemented, and with what effect. In this section, we describe the various practices and experiences of four countries that have implemented presumptive taxes in recent decades—Ghana, Tanzania, Zambia and Zimbabwe. These countries were selected as there was relatively more evidence available in the literature and in government records on the presumptive tax policies implemented in these countries, including changes in coverage over time and revenue collected. It goes without saying however, that the experiences of these countries may not be representative of informal sector tax implementation more generally, and at the very least, will provide some insight into presumptive taxation in sub-Saharan Africa specifically.⁸

4.1 Identifiable Grouping Taxation (IGT) in Ghana

Efforts to tax the informal sector in Ghana began as early as 1963 with a standard assessment that was levied on individuals and small businesses on the basis of their activities (requiring quarterly lump-sum payments regardless of turnover) (Joshi & Ayee, 2002: 5). Ghana's Internal Revenue Service (IRS), after consulting with informal sector associations, replaced the standard assessment with a new presumptive tax system called Identifiable Grouping Taxation (IGT) in 1987. The main motivation for collecting revenues from the informal sector under this new system, using associations as agents, was to broaden the tax base and 'ensure a fairer distribution of the tax burden' (Ayee, 2007: 4). The IGT, which Joshi and Ayee (2002: 184) refer to as 'associational taxation', in which associations were used as agents in the collection of taxes (essentially a form of tax farming),⁹ replaced a system which had been riddled with corruption (Joshi & Ayee, 2008). This new arrangement, first implemented in the transport sector, was extended to associations in 32 other informal sector activities later in 1987 (Joshi & Ayee, 2002: 6).

⁸ Although the implementation of informal sector taxation has been documented for some Latin American countries (Fajnzylber et al., 2011; ILO, 2014; OECD, 2015b), as noted earlier, the practice in these countries is closer to 'taxation as formalisation' which we do not focus on in this paper.

⁹ This form of tax farming is different from the practice of many colonial administrations (that required colonies to be self-financing) where traditional leaders or native administrators were used to collect hut and poll taxes (Bräutigam et al., 2008). Although there are similarities between the collection of hut taxes and associational taxation (that is, both involve a delegation of authority to collect taxes on behalf of the state), there are important differences. Firstly, the hut tax applied to every male over eighteen years of age in a village (Konczacki et al., 2016) whereas associational taxation in Ghana was only collected from the members of that association operating in the informal sector (Ayee, 2007). Secondly, chiefs and native administrators in Africa were part of the government administrative structure and therefore should have been, at least in theory, interested in both the process and outcome of tax collection (Boahen, 1985; Stella, 1993) whereas associations in Ghana were not part of government administration and were concerned only with the outcome of tax collection (Joshi & Ayee, 2002).

In the transport sector, the tax was initially levied daily and later weekly (as a way of reducing daily printing and monitoring costs), and only when vehicles were actually operating. This allowed the tax authority to keep its collection costs at 2.5 per cent of the total revenue collected, as this was paid to the informal sector associations as a collection fee (Ayee, 2007: 10).¹⁰ In this new system, taxi-cabs and minibus taxis paid a fixed amount related to the vehicle's capacity while long distance vehicles paid a percentage of their turnover per trip (Joshi & Ayee, 2002).

The arrangement was a result of the good relations that the Ghana Private Road Transport Union (GPRTU) had with the Rawlings regime (1981–2000). As a result of this arrangement with associations, tax revenues from the informal sector (as a percentage of total tax revenue) gradually rose from 0.97 per cent in 1988 to 1.6 per cent in 1991 (Ayee, 2007: 15). Although these figures are low, they are still much higher compared to the other countries reviewed.

Nonetheless, the system was not without its problems. Even though tax revenue collection was outsourced to the associations, the IRS's administrative capacity was weak and it did not effectively monitor the associations (Joshi & Ayee, 2002). According to Ayee (2007), in many instances, these associations failed to pass on revenue collections to the IRS and were often not internally democratic. Ayee (2007: 15) points out that from a peak of 1.6 per cent in 1991, the following years saw decreases in the revenues collected and by 2002 these amounted to only 0.39 per cent of total revenues. This resulted in the abolition of this system in 2003 and its replacement with a new presumptive tax, the Vehicle Income Tax (VIT). The VIT is a lump-sum tax that is paid quarterly, with presumptive tax amounts ranging from US\$3 to US\$60 depending on the type of vehicle (ATAF, 2014a: 10).¹¹ Ayee (2007: 15) reports that in Ghana in 2003, revenue from these presumptive taxes increased to 5.3 per cent of total revenues after the tax authorities stopped using associations in the collection of revenues.

These changes in the presumptive tax system in Ghana point to the difficulty in taxing the informal sector in a fair and administratively effective manner, even in a country with relatively well-organised informal sector associations. Nonetheless, according to Ayee (2007), although the use of associations in the collection of tax revenues from transport operators was discontinued, important lessons had been learned. The experiences in Ghana showed that informal sector associations can, under certain circumstances, be used to collect taxes from their members. By the time it was abolished, the system had also inculcated a taxpaying culture among those in the urban informal transport sector. The compliance rate in the transport sector in 2010 was estimated at 85.5 per cent (ATAF, 2014a: 14). Further, it showed the importance of bargaining and negotiations around taxation between the state and those in the informal sector.

¹⁰ Although these collection costs are much lower than those incurred by other tax authorities that have implemented similar taxes (for example, Zambia, discussed later in this section), they are higher than collection costs in the formal sector in countries such as South Africa at 0.97 per cent in 2013–14 (National Treasury/South African Revenue Service, 2014: 13) and the Organisation for Economic Co-operation and Development (OECD) countries where collection costs ranged from 0.30 per cent in Switzerland to 1.72 per cent in Poland (OECD, 2011: 126–127).

¹¹ For example, for a commuter omnibus with a carrying capacity of 19 people, the quarterly tax amount in 2013 was US\$7 (ATAF, 2014a: 21).

However, as Joshi and Aye (2008) point out, the effectiveness of this approach is likely to depend on contextual factors. These factors include such things as the informal activity in question (for example, associational taxation might not be possible with cross-border traders), the level and depth of organisation within the informal sector associations, the willingness of the state to engage these associations, and its ability to monitor their performance. The last point is particularly important if corruption is not merely to be transferred from the tax authority to associations.

4.2 The block management system: Tanzania

According to the Tanzania Revenue Authority (TRA)¹², presumptive taxes were introduced in 2001 as a way of widening the tax base and simplifying registration procedures (TRA, 2011). These taxes were levied on small individual traders with an annual business turnover of not more than Tshs 20 million (US\$9359)¹³ (TRA, 2015). Although traders are not required to maintain audited accounts, the system aims to encourage basic record-keeping by levying higher rates on those with incomplete records. In the absence of complete records, turnover is estimated by the commissioner (TRA, 2015). The progressive turnover-based presumptive tax rates are divided into five bands as shown in Table 1

Table 1: Presumptive tax rates in Tanzania

Annual turnover	Tax payable if records are incomplete	Tax payable if records are complete
Not exceeding Tshs 4 Million	NIL	NIL
Above Tshs 4 Million but not exceeding Tshs 7.5 Million	Tshs 150 000	3% of the turnover in excess of Tshs 4 Million
Above Tshs 7.5 Million but not exceeding Tshs 11.5 Million	Tshs 318 000	Tshs 135 000 + 3.8% of the turnover in excess of Tshs 7.5 Million
Above Tshs 11.5 Million but not exceeding Tshs 16 Million	Tshs 546 000	Tshs 285 000 + 4.5% of the turnover in excess of Tshs 11.5 Million
Above Tshs 16 Million but not exceeding Tshs 20 Million	Tshs 862 500	Tshs 487 000 + 5.3% of the turnover in excess of Tshs 16 Million

Source: TRA (2015).

¹² This section draws largely from a research report investigating informal sector taxation conducted by the Tanzania Revenue Authority (TRA, 2011).

¹³ US\$1:Tshs 2137 in November 2015.

As a way of strengthening the implementation of presumptive taxes, the TRA in 2005 introduced the block management system (BMS). The main objective of this system was to ensure tax compliance by identifying, registering and collecting tax information from all eligible small and medium-sized businesses in a particular sector or geographic location (ATAF, 2014b). Where there are many informal traders, city blocks were mapped and divided into small segments consisting of a few streets or a specific geographical area.

This focus on small unregistered enterprises necessitated a reorganisation of how the TRA operates and efforts were made to develop the human resources required for this new approach to informal sector taxation. Each block, under a team leader, was tasked with managing all the tax functions (that is, identifying, registering, educating and collecting taxes) for that particular block, with these teams being rotated after a certain period. Specific revenue targets were set as a way for measuring performance.

The evidence suggests an increase in the number of businesses registering for tax purposes as a result of the BMS. Of the new enterprises that registered in the period 2006 to 2007, 16 per cent did so through the BMS. This increase continued in 2007 to 2008 and 2008 to 2009 where the new registrations resulting from the BMS grew by 43 per cent and 41 per cent respectively (Joshi et al., 2014: 1343). The BMS is also partly credited with the increase in the number of presumptive tax payers from 199 448 in 2005 to 2006 to 376 673 in 2009 to 2010 (TRA, 2011: 81).

Although the BMS has shown some apparent success in terms of the number of businesses covered, there are still concerns around viability. Revenues from these taxes have been low, with presumptive tax revenues as a percentage of total direct taxes remaining below 1 per cent for much of the period between 2003 and 2011 (they rose slightly above 1 per cent only in 2005 to 2006 and 2006 to 2007) (TRA, 2011: 88). Research by the TRA also indicates that there have been two major problems in administering these taxes. The first has been that of human resource constraints, with some blocks only having 20 per cent of the required manpower and others being administered remotely (TRA, 2011: 75). The second problem is that concentration of all the tax functions of identification, registration and assessment under a single tax officer may lead not only to poor internal controls and corruption but also the arbitrary use of power.¹⁴

Although the BMS has been lauded by the African Development Bank (AfDB, 2010) and the Africa Tax Administration Forum (ATAF), with the ATAF recommending its implementation in member countries, it has been criticised by the OECD. Labelling the system 'invasive and probably counter-productive' and illustrating 'the potential for conflict between revenue collection, governance, and administrative efficiency', the OECD (2012: 100) argued that the BMS is not an effective way of administering taxes due to the high costs incurred in raising tax revenues. However, we could not find any indication of the actual costs of administering the BMS as a percentage of revenue in Tanzania.

¹⁴ Although the BMS system concentrated the functions of taxpayer identification, registration and assessment with one officer, there are parallels with the problems experienced in Senegal and (other francophone countries) where functions were concentrated to some extent in a local tax office (see Benjamin & Mbaye, 2012; Dafflon & Madies, 2012).

In terms of equity, a TRA report opined that the BMS system is regressive as it penalises those who do not record their business transactions. These are the informal entrepreneurs who are more likely 'to lack the capacity to keep proper accounts' (TRA, 2011: 84). However, record-keeping (for tax purposes) is not only important in the implementation of fairer taxes but could also result in business performance improvements. Despite these various concerns, the BMS is still being used to collect taxes from Tanzania's informal sector (ATAF, 2014b).

4.3 Informal sector taxes in Zambia

The Zambia Revenue Authority (ZRA) started implementing informal sector taxes in 2004 to raise revenues (Phiri, 2013). There are four main types of informal sector taxes in Zambia. First, there is the Turnover Tax (TOT), which is levied at 3 per cent on individuals and small firms with an annual turnover of up to ZMK200 million (US\$50 000)¹⁵. Second, there is the presumptive tax on minibus taxis, with annual taxes ranging from ZMK600 000 (US\$150) for a seating capacity below 12 to ZMK7.2 million (US\$1 800) for a seating capacity of 64 or above in 2009 (Mwila et al., 2011: 16). Third, ZRA levies the Advance Income Tax (AIT), a withholding tax collected from cross-border traders of 6 per cent of the value of imports exceeding US\$500. Fourth, there is the base tax of ZMK500 a day (US\$0.13), collected from marketeers (Mwila et al., 2011: 76–77). The TOT and presumptive tax on minibus taxis were introduced in 2004 with the base tax and AIT introduced in 2005 and 2007 respectively (Phiri, 2013).

The aim of the TOT is to make compliance easy for taxpayers by only requiring enterprises to keep track of total sales. The AIT is levied on the imports of those who are not registered with ZRA or who cannot provide proof of tax compliance. ZRA appoints agents to collect the base tax and presumptive tax on minibus taxis. These agents are selected through a competitive tender process and they are paid a commission commensurate with their bid which ranges from 10 per cent to 15 per cent of collections. In order to make compliance easy, the presumptive tax on minibus taxis was designed to allow operators to pay a fixed amount on days that the bus is in operation and they are not required to file any tax returns (Mwila et al., 2011).

According to Mwila et al. (2011: 77–78), whose report covered the implementation of informal sector taxes between 2004 and 2009, informal sector tax revenues rose from ZMK5.4 billion (US\$1.35 million) in 2004 to ZMK90.9 billion (US\$22.7 million) in 2009. As a share of total income tax collected, the informal sector contributed 0.3 per cent in 2004, reaching 0.9 percent in 2007, and 1.8 percent in 2009. In 2009, most of the presumptive tax revenue came from AIT (71 per cent) and TOT (27 per cent), with the tax on minibus taxis and the base tax contributing 2 per cent and 0.03 per cent respectively.¹⁶

Zambia segmented its revenue authority into three specialised offices dealing with large, medium and small taxpayers. However, the comparatively large small tax office (STO) has not brought in much revenue. For example, according to Phiri (2013: 34–35), the ZRA's STO consists of 14 per cent of all employees but collects 2

¹⁵ US\$1:ZMK4000 in 2009.

¹⁶ Interestingly, the base tax collected from market traders, even though it provided very low revenues, was only successfully collected in areas where agents worked with local authorities, suggesting that the administration of this tax could be ceded to local government (Mwila et al., 2011).

per cent of total income tax revenue with many in the informal sector going untaxed in Zambia. In contrast, the medium taxpayers' office has 10 per cent of the ZRA's employees and collects 18 to 23 per cent of the income tax revenue. The LTO has a staff complement of 3.3 per cent of total employees but collects 75 to 80 per cent of the income tax revenues. Clearly, given the difficulty of implementing and enforcing presumptive taxes among informal businesses, the cost-benefit ratio related to collecting taxes from small taxpayers in Zambia is much higher compared to that related to collecting taxes from larger taxpayers, as is the case in many countries (see Benjamin & Mbaye, 2012; TRA, 2011). Mwila et al. (2011: xi) suggest the ZRA engage informal sector associations as the STO on its own is unlikely to collect significant revenues from this sector.

Mwila et al. (2011) argue that three main factors contributed to the limited success in collecting revenues from the informal sector in Zambia. First, poor record-keeping among those in the informal sector, many of whom are poorly educated, resulted in low revenues from the TOT. Second, the labour-intensive nature of informal sector tax administration in a sector where many people are not aware of these taxes, resulted in low revenues relative to collection costs. In the case of the base tax for example, the high collection costs operated as a disincentive to agents required to collect this tax from numerous marketeers in geographically dispersed areas. Third, agents who were appointed to collect presumptive taxes were not always viewed as legitimate by marketeers and minibus taxi operators, and were not able to impose sanctions on non-compliant informal sector taxpayers.

4.4 Presumptive taxes in Zimbabwe

The political and economic crisis in Zimbabwe has resulted in a large and growing informal sector, increasingly viewed as a potential source of tax revenue by the government (Government of Zimbabwe, 2005; Utaumire et al., 2013). The introduction of presumptive taxes, first implemented in 2005, was informed by research carried out by the Zimbabwe Revenue Authority (ZIMRA) on informal urban transport operators in particular. Other informal sector activities were later added to the presumptive tax schedule, such as hairdressing salons and cross-border traders in 2008, and cottage industry and bottle-store operators in 2009, although, unlike with the transport industry, no research was done by ZIMRA on the profitability of these sub-sectors.¹⁷ Table 2 shows Zimbabwe's presumptive tax schedule for 2010 to 2011, which includes ad valorem and lump-sum presumptive taxes, depending on the sector of activity.

¹⁷ The Ministry of Finance did not consult ZIMRA on presumptive tax amounts for the various sectors after dollarisation in 2009, and the Ministry went on to set the fares charged by minibus taxis at levels many in the informal sector felt were not feasible (Dube, 2014b).

Table 2: Presumptive taxes in Zimbabwe, 2010 to 2011

Type of activity	Description	Presumptive tax (USD per quarter) 2011
Minibuses	8 to 14 passengers	150
	15 to 24 passengers	175
	25 to 36 passengers	300
	From 37 passengers and above	450
Taxi-cabs	All	100
Goods vehicles	More than 10 tonnes but less than 20 tonnes	1000
	More than 20 tonnes	2500
	10 tonnes or less but with combination of truck and trailers of more than 15 but less than 20 tonnes	2500
Cross-border traders (VDP)	10% of value of goods imported	
Hairdressing salons	All	1500
Cottage industries	All	300
Bottle-stores	All	300
Small-scale miners	2% of value of minerals	
Driving schools	Class 4 vehicles	500
	Class 1 and 2 vehicles	600
Informal traders	10% of rental amount (for those renting premises and cannot provide proof of having paid any of the above presumptive taxes)	

Source: ZIMRA (2011)

Note: For minibuses, taxi-cabs and goods vehicles, the tax is charged per vehicle.

There has been some limited success in the implementation of presumptive taxes in Zimbabwe. Revenue from presumptive taxes increased from US\$1.39 million in 2009 to US\$13.3 million in 2011, although this represented only 0.14 per cent and 0.45 per cent of total tax revenues in 2009 and 2011 respectively (Dube, 2014a: 51). These figures suggest that the presumptive taxes collected are below the potential revenue from this sector given the extent of informality in Zimbabwe (as pointed out by many within ZIMRA itself).

There have been numerous challenges in the collection of informal sector presumptive taxes in Zimbabwe. The evidence indicates that resource constraints within ZIMRA, corruption, the selective application of regulations, high tax amounts in some sectors relative to earnings, and low tax morale have made the administration of these taxes difficult. In a survey of 150 informal traders conducted between 2011 and 2013 in Harare, 23 per cent of informal entrepreneurs reported not trusting the government, 41 per cent reported that tax revenues were 'ill-spent and mismanaged by government' and the majority did not feel that there were any programmes that benefitted the informal sector (Masarirambi, 2013: 170). Also based on interviews with informal traders (in the area encompassing Kariba, Chinhoyi, Kurima House Station and

Municipality of Kariba), Utaumire et al. (2013) found that a large number of traders were not even aware of informal sector taxes, and many expressed concern that they were not consulted in the setting of these taxes. In qualitative work by Dube (2014b), where around 50 informal operators in Harare were interviewed at length, there were also reports of coercive tax collection methods and frequent payments that had to be made by informal entrepreneurs to non-state actors such as touts and ruling party-aligned militias and 'committees' (Dube, 2014b).¹⁸ These actions are likely to undermine the potential, discussed in the literature (Meagher, 2013; Prichard, 2015), for informal sector taxation to promote better state-citizen relations.

In the study by Dube (2014b) the equity implications were also assessed, with respect to equity both within the informal sector and between informal sector operators and those in the formal sector. The study found that informal entrepreneurs generally bore a higher tax burden than those with similar incomes in the formal sector, given high presumptive tax rates and the lack of minimum income thresholds. However, there were income levels at which the CIT and PIT were inequitable vis-à-vis presumptive taxes in some informal activity classes (for example, taxi-cab and minibus taxi operators), with informal traders paying less in taxes than those paying CIT/PIT with comparable incomes. In addition, within the informal sector, operators in certain activity classes were eligible for much higher taxes than operators in other activity classes at the same income level (hairdressing salons bore a particularly high tax burden for example). The selective enforcement of presumptive tax collection (sometimes politically motivated) was another major source of inequity within the informal sector, and acted as a disincentive to continue paying taxes for those who were compliant.

Using the reported and observed behavioural changes resulting from the implementation of presumptive taxes, Dube (2014b) found that economic efficiency was potentially being undermined. Public passenger operators reported using long circuitous routes and parking their vehicles to avoid the police checkpoints, which would also result in man-hours being wasted if workers are not transported to their workplaces on time. An observation made by ZIMRA officials concerning hairdressing salon operators was that some of them were moving from areas of high visibility, such as the central business district, to residential areas. This could result in a reduction in output if clients can no longer get to the new site or the new site is not visible to potential customers.

5. DISCUSSION

In all four of the country case studies, the quest for revenues appeared to be the main motivation for introducing presumptive taxes. While the evidence indicates that the introduction of these taxes did result in increased revenues for the fiscus, presumptive tax revenue as a proportion of total revenue is nonetheless reported to be very low. It is possible that the sector's revenue potential has not been fully tapped, with many informal enterprises escaping the tax net, however, the challenges experienced at the administrative level suggest that this is unlikely to be easily remedied. The nature of

¹⁸ Corruption was identified as a particularly serious problem in Dube (2014b). One example of this was the practice of police officers, whose job it is to enforce the collection of presumptive taxes in the informal transport sector, also owning minibus taxis. According to the transport operators, this led to extortion and the harassment by police of their 'competitors'.

the informal sector makes it hard to tax. It is difficult to identify potential taxpayers, particularly when informal operators do not always have a fixed location, and many informal businesses have highly variable incomes and weak accounting systems.

Discussion on how to improve informal sector tax administration in the tax literature has included the setting up of STOs, tax farming (using agents to collect taxes) and fiscal decentralisation (using local authorities to collect tax revenues) (Kiser & Baker, 1994; Loepnick, 2009; Terkper, 2003). According to this literature, an STO can improve enforcement and offer targeted taxpayer services (for example, education, feedback, and a channel for handling complaints and appeals). However, an STO on its own is unlikely to have a significant impact on administrative effectiveness. Tax authorities in most developing countries do not have the resources and manpower to effectively monitor and enforce compliance in the large informal sectors on their own (Araujo-Bonjean & Chambas, 2004; Mwila et al., 2011). As the case studies show, staff shortages were cited by tax authorities as a major constraint even in a country like Zambia with an STO.

Tax farming and fiscal decentralisation are the other approaches that have been suggested to improve the administration of presumptive taxes. The main objective of these approaches is to free the tax authority to focus on monitoring and selective audits.¹⁹ However, the Zambian and Ghanaian examples show that the effectiveness of tax farming depends on the capacity of the agents tasked with this collection and the ability to eliminate corruption.²⁰ Although there is growing literature on the importance of empowering local governments to collect taxes as they are closer to the informal sector (Bodin & Koukpaizan, 2008; Teobaldelli, 2011), this approach is likely to face the same challenges as those of tax farming if there are capacity constraints within local authorities, many of which are viewed as 'highly corrupt' (Fjeldstad, 2004: 10).

A possible way of improving informal sector tax administration is through the use of information technology. Internet-enabled phones, which are proving popular for such things as e-banking and e-payments in developing countries, could be used to allow taxpayers to pay their liabilities online, thus not only reducing the administrative burden but also reducing opportunities for rent-seeking behaviour among tax officials (Loepnick, 2009; Mwila et al., 2011). Investigating the ways in which information technology can be used in administering presumptive taxes is potentially an important area of further research.

There are indications that improvements in the administration of presumptive taxes, especially the encouragement of quasi-voluntary compliance, are likely to depend on the state engaging those in the informal sector (Joshi et al., 2014). The evidence suggests that involving informal sector associations may not only facilitate the acceptance of these taxes (a possible explanation for the relatively higher revenues

¹⁹ There are parallels between tax farming and public-private partnerships where agents are contracted by the government to provide services. There is a vast amount of literature on private-public partnerships which may prove useful in better understanding (and identifying solutions to) the problems of implementation in tax farming, and this may be an interesting area for future research. Further reading on this topic can be found in Osborne (2002), Bovaird (2004), and Hodge and Greve, (2007).

²⁰ While tax farming provides incentives for the maximisation of enforcement and collection, it is prone to abuse and corruption and has often resulted in overzealous tax collection. This is largely due to its incentive scheme which allows the tax collector to retain a portion of the taxes collected (Stella, 1993).

from presumptive taxes in Ghana) but also reduce administrative costs and improve state-citizen relations.

However, more research is needed on what Bräutigam et al. (2008: 3) refer to as the 'governance dividend' from informal sector taxation and, from the review of the literature, two main threads are suggested. First, while the few examples in the literature suggest that informal sector associations are important (Joshi & Ayee, 2002; Meagher, 2013; Prichard, 2015), very little has been written on the contextual factors that would result in fruitful negotiations and improved state-citizen relations. The specific ways in which these associations can be used (for example, involvement in tax design, tax collection or education campaigns) are likely to vary depending on the informal activity and various country-specific factors. Secondly, there are many informal sector operators who cannot be expected to pay presumptive taxes to central government on equity grounds (and who may not belong to associations). However, these operators are likely to pay various user and license fees to local authorities. There is therefore a need to investigate the type of (probably non-associational) bargaining that could occur at the local level, possibly through street committees (Mkhize et al., 2013), so as to allow operators who are not organised into associations to have a legitimate voice in negotiations.

Another way in which quasi-voluntary compliance might be encouraged is through the provision of amenities and work related infrastructure (a function that should be performed by local government but rarely is), business support and training, and the development of trade specific tax negotiation forums (which are consulted regularly as is often the case in formal sector/tax authority consultations) (Meagher, 2013; Prichard & Bentum, 2009). Quasi-voluntary tax payment is likely to be higher if taxpayers feel that they will get 'value for money' for the taxes that they are paying (Coolidge & Ilic, 2009; Therkildsen, 2006).

Understandably, there are many concerns around whether it is equitable to tax the informal sector, especially given perceptions that informal sector operators are mostly survivalist in nature. Presumptive taxes can result in inequities between informal and formal sector firms at comparable incomes, but also within the informal sector itself because of uneven coverage and differential rates by activity. In addition, because of their simple structure (often lump sum taxes, with no minimum thresholds), presumptive taxes tend to be regressive, taxing those with lower incomes proportionately more. Also, when based on (presumed) turnover or capacity, these taxes do not take into account losses in a particular month. Progressive presumptive taxes that are based on actual turnover, such as those implemented in Tanzania, go some way in addressing equity issues, but they require operators to keep basic records of sales. Even with good recordkeeping however, there could be inequities resulting from differences in profit margins among informal traders.

Issues of equity in taxation go beyond the facts; tax morale is important. The evidence suggests that many in the informal sector perceive presumptive taxes to be unfair vis-à-vis formal sector taxes even in cases where they are not. For example, in Zimbabwe, there were instances where the CIT and PIT were inequitable vis-à-vis presumptive taxes (with those on the CIT/PIT paying more at comparable incomes). In spite of this, some respondents in the informal sector who were receiving favourable treatment still felt that these taxes were unfair (Dube, 2014b). These misperceptions can discourage those in the informal sector from paying, resulting in low revenue collection. This incomplete coverage leads to disenchantment among

those in the informal sector who are compliant (or who cannot avoid the tax net). Outreach programmes, possibly using informal sector associations, may be an important way of increasing taxpayer awareness of the equity implications of these taxes.

The public finance literature shows that there is a direct relationship between tax rates and the economic inefficiency or excess burden created by taxation (Slemrod & Yitzhaki, 1996). Presumptive taxes at low rates therefore potentially can minimise the economic inefficiency associated with taxation. Basing the tax rate on average ratios (profits to sales) and average income may even be able to incentivise these enterprises to be more efficient in their business operations, as the marginal tax rate on the additional income above the average would be zero (Pashev, 2006).²¹ However, the evidence suggests that in some countries (for example, Zimbabwe), poorly researched presumptive tax design and high effective rates (which are sometimes so high that no enterprise can reasonably be expected to pay them), have been counter-productive. Indeed, there are reports of operators reducing operations or moving to less visible areas in order to avoid the attention of the tax authorities (Dube, 2014b). Few studies mention economic efficiency in informal sector taxation (Dube, 2014b; Memon, 2013; Taube & Tadesse, 1996), pointing to the need for more work in this area.

In summary, presumptive taxes, which are designed to reduce both collection and compliance costs in informal sector taxation, will inevitably result in trade-offs between administrative effectiveness and equity, and potentially efficiency. Informal sector tax implementation has largely focused on simplification (and enforcement) without sufficiently considering the equity and efficiency implications of raising revenue through these taxes. Pashev (2006: 418) argues that this focus is justified as presumptive taxes should not try to 'compete' with the standard tax system and trying to make these taxes fairer may result in a complicated tax system. However, there are both theoretical and empirical reasons for the inclusion of equity and efficiency considerations, as poorly designed presumptive tax systems which do not address these issues may actually compromise collection and compliance efforts.

While the challenge of balancing the need for simplicity with equity and efficiency also exists in formal sector taxation, the unique nature of informal sector activity presents additional complications. The encouragement of basic recordkeeping among operators, more research on informal sector operations by the relevant authorities, the engagement of informal sector associations, and the constant monitoring of tax rates/amounts (given high inflation rates in many developing countries), are some of the factors that may contribute to better designed informal tax systems.

²¹ However, there is very little empirical evidence in support of this argument (Skinner, 1991). Also, the heterogeneous nature of informal enterprises means it is difficult to make reliable estimates on the appropriate tax level that would increase productive efficiency (Rajaraman, 1995).

6. CONCLUSION

In this paper we described the experiences of four African countries (Ghana, Tanzania, Zambia and Zimbabwe) that have implemented informal sector presumptive taxes in recent decades, assessing the revenue, technical and governance implications of these taxes. We found that although presumptive tax collection has increased revenues for the fiscus in these countries, informal sector revenue as a percentage of total tax revenues has remained low. This is in part due to the weak administration of often poorly designed tax systems, with resource constraints in revenue collection resulting in widespread evasion. In addition, there is some evidence that these taxes are generally viewed by informal sector operators as inequitable vis-à-vis formal sector taxes (even if in some cases they may not be, at comparable incomes) and that they tend to be regressive due to the lack of minimum thresholds, the use of flat rates, and the reliance on presumed income. Varying tax rates and uneven collection across different activity classes in the informal sector further contributes to inequity within the sector. There are also some indications that these taxes may be compromising efficiency as they are perceived to be too high leading to behavioural responses that reduce output, and in turn welfare.

Based on the country case studies, we have shown that relying only on reforms within the tax authority (for example, establishing STOs) or outsourcing the collection of taxes to agents has not resulted in effective tax administration or necessarily strengthened state-citizen relations. The high number of informal sector enterprises in developing countries, and the variability and mobility in their operations, is likely to make it difficult for even the most capable tax authorities to effectively administer these taxes. There is some evidence that negotiating with those in the informal sector on taxation issues through associations, and perhaps even at the local government level, might not only improve administrative effectiveness but may be an important way of increasing the governance benefits of informal sector taxation. Quasi-voluntary compliance may also be encouraged if the costs of taxation were more clearly linked to the benefits, such as the provision of services specifically tailored to those operating in the informal sector. Education campaigns that raise awareness about the benefits that result from the taxes collected, and about the efforts made by tax authorities to reduce unfairness (such as introducing low but graduated tax rates according to turnover for instance), may also improve tax morale and ultimately revenue collection.

Nonetheless, our paper highlights the need for much more research in this area, particularly of a policy-oriented and context-specific nature, where the focus is on practical solutions to overcoming the challenges in implementing informal sector taxation in specific countries. Given the legitimate need for governments to raise revenue in developing countries in the face of (growing) informality, how to design and implement informal sector tax systems without further disadvantaging or alienating those who can least afford it, is paramount.

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