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The Informal Sector Tax Revenue Potential: A Case of Zimbabwe

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Abstract
In this paper we sought to analyse the performance of informal sector tax revenue and to establish whether economic resources should be channelled to this sector in a bid to tax it. The study employed literature review method. The evidence suggests that the informal sector play an important role in the Zimbabwean economy such as creating jobs, poverty eradication and also as a test bed from which willing taxpayers can graduate into mainstream however their contribution to the national tax revenue is insignificant despite Government efforts. We established that Zimbabwe has no effective mechanism to collect revenue from the informal sector. The study recommends that more resources be channelled to the informal sector due to high revenue potentials.
Keywords: Informal sector, presumptive tax, Tax revenue

1. Introduction

Governments, world over impose various taxes on its citizens to achieve many purposes. Taxation as explained in the literature is the most reliable and predictable way of revenue generation for development unlike debts from International Monetary Fund),World Bank or other nationalities (ZIMCODD 2014). Literature sources reviewed indicate that taxation has been a source of domestic revenue of ancient times and remains a key aspect of citizen's daily lives (ZIMCODD 2014). Taxation is regarded as the most influential fiscal instruments for any government in accomplishing its goal of strong economic growth and development as well as poverty alleviation.

Araujo-Bonjean and Chambas (2003) shows that there is low tax revenue level and the tax burden is unevenly distributed. The explanations accorded to low tax revenue level is the under taxation of the urban informal sector. Joshi, Prichards and Heady (2014:1325) affirm that informal sector represents a potentially significant source of tax revenue for a cash-strapped government thus taxing the informal sector is vital to sustain tax morale and tax compliance among firms in the formal sector. Since 1980 to period 2000, Zimbabwe government received tax revenue from the formal sector however a decade ago the formal sector shrunk leading to the reduction in revenue from taxation (Sikwila, Kareza & Mungadza, 2016).

In a bid to raise the much needed revenue the government of Zimbabwe sought to expand its tax net by incorporating the growing informal sector into tax net. Presumptive tax (under presumptive tax Act Chapter 23:06) was introduced in order to collect revenue from the informal sector. Many tax authorities in the Sub Saharan Africa are experiencing challenges in collecting tax revenue from the informal sector (Chartered Institute of Taxation of Nigeria 2014). ZIMRA (2009) acknowledges that there is indeed a significant amount of money that goes untaxed in the informal sector and this poses a threat to the stabilization of the economy. In the light of the above developments, this paper seeks to review the performance of presumptive income tax since 2005 and ascertain whether it is economic productive to devote more resources to taxing the informal sector.

2. Informal sector

The common definition of informal sector is those economic activities and the income derived from them that circumvent or otherwise avoid government regulation, taxation or observation (PWC, 2016). This means that informal sector involves all unreported to tax authorities with the express purpose of evading payment of income taxes arising from legal or illegal activities, and which do not comply with any law. (Schneider and Williams, 2013, Tatariyanto , 2014, Schneider, Raczkowski & Mroz, 2015)

The key characteristics of informal sector include: (i) low entry costs, and general ease of entry, (ii) unregulated and competitive markets, (iii) reliance on indigenous resources, (iv) family ownership of enterprises, (v) small scale of operation and diverse, (vi) labour intensive and simple technology, and (vii) skills acquired outside formal schooling system.) (viii) often mobile in operations, poor record keeping, (ix) predominantly cash-based transactions, (x) low levels of illiteracy and unable to afford accountants, (xi) no culture of tax compliance as different rules, values and beliefs apply, huge in developing countries and (xiii) challenges in compliance and monitoring. These characteristics of the informal sector have been endorsed by academic literature on informal sector (see Udoh, 2015; Mpapale, 2014).

The following factors have contributed immensely towards the growth of the informal sector and these are: overregulation together with an inefficient and corrupt system of compliance control; inadequate education system; economic hardship and poverty; rigid and out-dated legal framework in the labour market; war environment in the nineties and high growth in unemployment; lack of a guilty conscience, lack of confidence in the government predominance of cash transactions and incentives to exit the formal economy among others (see Porta and Shleifer 2014; Udoh 2015; Schneider & Williams 2013; Mukherjee 2016;)

The presence of informal sector creates challenges in (i) resource sharing, (ii) low tax drive among formal sector, (iii) disbelief toward the competence of any presence government; (iv) unfair advantage over formal and informal sector as the informal sector can get cheap labor due to lack of labour regulations and (v) the informal sector remain small because of lack of finance (Kristoffersen, 2011; Fernando de Holanda Barbosa Filho 2012). Also the sector contributes to the creation of employment, poverty eradication and also as a test bed from which willing taxpayers can graduate into mainstream (Rahim 2015).

3. Overview of taxation

Kwaako, Laribik, James, Kumah and Patience (2012) view taxation as an imposition of compulsory contributions by the tax authorities/ government, to finance the cost of its operations and provision of services to its citizens. Government raises revenue through imposition of tax to its citizens in order to: empower government to redistribute wealth or resources to its citizens; stabilise the economy; set and defines the economy and encourage optimal economic growth (Boakye 2011; Ramabu & Ndlovu 2012). Research suggests that in 1778 Adam Smith postulated the cannons of taxation and these are equity; certainty; convenience, economy; Diversity; simplicity; flexibility; elasticity and productivity (Ramabu & Ndlovu, 2012). These attributes define a good tax system. Boakye (2011) believes that the tax principles are vital as features of a good tax system. Bird (2008) asserts that a good tax system for any country should show its economic structure, capacity to administer, public service needs and its accessibility to other revenue sources. In the words of Bird (2008), the best tax system should take into account the following variables (i) tax morale; (ii) tax culture and (iii) other good governance related issue. This implies that sustainable tax system demand some high level of tax compliance and to achieve such degree of compliance the tax system must mirror at least basic values such as tax culture and tax morale among others (Har 2013).

3.1. Theories of taxation

(a) The Benefit theory of Taxation: The benefit theory asserts that taxes should be imposed or levied upon individual in proportion to the professed benefit received (Kwabena 2011).

(b) Ability to Pay: The theory advocates that taxation burden should be fairly spread. The theory asserts that all member of the community or country must pay tax based on their ability (Simiyu 2013).

(c) The Cost of Service Theory: The cost of service theory posits that persons should not expect any free services or benefits from the government activities (Appah & Ebiringa 2012;)

(d) Socio-Political theory: The socio-political theory asserts that the social and political objectives should be the chief determinants in selecting taxes in any given community (Ogbonna & Appah 2012).

3.2. informal sector taxation

Taxing informal sector is complex and complicated task requiring sophisticated approaches of recognising, observing and reporting underground income as well as creating a tax paying culture within the informal sector operators (Wedderburn *et al,* n.d). Udoh, (2015) highlights that the once neglected informal sector is now at the heart of every debate in developing countries reflecting the increased acknowledgement of the potential tax revenue to the economy. Some of the approaches adopted by some countries include: presumptive tax system (ZIMCODD, 2014**;** TRA, 2010); simplified tax model for the informal sector (Heggstad *et al,* 2011), corporation tax for the informal sector (Mpapale, 2014), turnover tax system (Mpapale, 2014), Value Added Tax, Block Management System (TRA, 2010), Unified revenue tax for the informal sector (Heggstad *et al,* 2011), Tax stamp system (Amoah, 2012), Identified groupings (Ofori, 2009) and PAYE (Mpapale, 2014).

3.3. Informal sector presumptive tax

Zimbabwe introduced presumptive tax system in 2005 to widen tax base (BDO, 2013; Rahim, 2015; Dalu, Maposa, Dalu, & Pabwaungana, 2013.). The following specific informal traders are required to pay the following presumptive tax: operators of restaurants or bottle stores and operators of cottages industries - $300 per quarter, commuter omnibus carrying: 15-24 passengers - $175, 8-14 passengers - $150, 25-36 passengers- $300 and 37 and above passengers- $450, small scale miners 20% based on the gross value of the mineral and informal trader (10% of rentals paid by the informal trader) (Tax Bulletin Zimbabwe: 2014, Masarirambi 2014). The government of Zambia introduced presumptive tax to motivate informal sector to participate in the national tax revenue and to register on the national tax system. Zambia's presumptive tax was levied annually based on the vehicle carrying capacity with a 64 seater and above is levied K7 200 per vehicle and below 12 seater K600 per vehicle and the small business with a turnover below K200 million pay 3% tax. Tanzania adopted presumptive income tax and was levied as follows: Firstband for minimum turnover is 0% and 1% for maximum turnover of 3 million; In the second band levies 3 % on minimum sales of TShs 3 million and falls to 1% on maximum sales of TShs 7 million. In the third and fourth bands the situation is similar that the minimum sales suffer higher tax rates than the maximum sales of 4 %t, 2 % and 3 % in the same order (TRA 2010:XV).

4. Methodology

The authors study employed desktop research by reviewing relevant tax related policies at national and international level, ZIMRA websites, journals, academic literature, discussion papers, opinion papers, online sources, newspaper articles and data, among other critical tax documentation. The authors also reviewed literature from published and unpublished journal articles, OECD, International Tax Justice and other regional and international tax boards as well as Government published circulars related to tax.

5. Findings: Performance of Presumptive tax in Zimbabwe

From the review of literature the authors found out that:

(i) Generally Presumptive tax revenue head has been performing dismally and this tax head is classified under other taxes.
(ii) There has however been minimal progress in terms of tax collection from the informal sector due to noncompliance by players in the informal sector.
(iii) The following informal sector are not taken in the tax network the:
a) Rural area shops ,kiosks and saloons
b) Flea markets-the are too many flea markets in Zimbabwe and most of them are not registered with ZIMRA hence they are not covered in presumptive taxation
c) Farms- it is hard for the tax authorities to get the information on how much income farmers earn so it will be difficult for them to charge taxes
d) Shares sold by SMEs and money market
e) Foreign dealings
(iv) The Presumptive Tax head is classified under “other”. It is important to note that the following are the components of other indirect taxes head: withholding tax on Tenders; Stamp Duties; Banking levy; ATM Levy; Road Access Fees and Presumptive Tax. The fact that this tax head is not standalone means ZIMRA is not committing itself.
(v) Zimbabwe has no effective mechanism to collect revenue from the informal sector.
(vi) increase of tax education promotions all over the nation

6. Conclusion

The poor revenue raised from the informal sector raises the question of whether there is possibility for more informal sector taxation in Zimbabwe. The government of Zimbabwe must commit resources toward taxation of informal sector to raise the much needed revenue given the revenue potentials in this sector. This paper concludes that informal sector in Zimbabwe has become visible in every part of Zimbabwe and is *the new formal sector* in the contemporary world. It may be concluded that the informal sector is Zimbabwe’s today formal sector. The authors suggest that the government of Zimbabwe must:

(a) Introduce Principles of Taxation and Tax compliance subjects on the education curriculum (catch them young)
(b) Empower Anti-Corruption Commission to deal with such issues.
(c) Train (business skills and bookkeeping) and business mentoring Informal sector
(d) Provide market access facilitation
(e) Facilitate on technology adoption and diffusion
(f) Provide incubation programs
(g) Build competencies in quality and efficiency, to encourage import substitution and export oriented products
(h) Engage the informal sector and their associations on tax discussions
(i) Account for various tax heads collected and give tangible feedback in order to gain community confidence
(j) Correct the misconception on the definition of informal sector
(k) Intensive and regular field inspection

Bornman (2014:331) concludes that ‘there is no simple innovation that will provide a “quick fix” solution to the problem of tax compliance, and no single solution- rather, a variety of strategies is necessary”.

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