

Taxing the Rural Informal Sector: Myth or Reality?

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Abstract
The size of the informal sector in the Zimbabwe in 2012 was estimated at approximately US$7.4 billion (Fin Mart 2012). Various reasons were posted as to the causes of the informal sector world over and more recommendations were made to address the informal sector. This paper sought to establish whether it is economically sound to tax the rural informal sector in Zimbabwe. The method adopted was purely desk and library research. It was found that until the government recognise the informal sector in terms of economic development and invest in it (informal Sector), it should not in any case impose taxes on the poor rural informal sector. The paper recommends that the Government of Zimbabwe must integrate pro-poor policies into the tax system and revamp the once vibrant formal sector.
Keywords: Informal Sector; Rural Informal sector, Taxation, Zimbabwe

1. Introduction

Many emerging economies depend largely on taxation as a source of revenue. 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 instrument for any government in accomplishing its goal of strong economic growth and development as well as poverty alleviation. Taxation as explained in the literature is the most reliable and predictable way of revenue generation for development unlike debts from International Monetary Fund (IMF),World Bank (WB) or other nationalities (ZIMCODD, 2014).

A study conducted by Araujo-Bonjean and Chambas (2003) shows that there is low tax revenue level and the tax burden is high on the formal sector in most African countries. The study further suggests that the public revenue in most of developing nations, is weak 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.

2. Overview of Informal Sector and Taxation

The growth of the informal sector holds the potential for employment, greater local manufacturing, quality service delivery and eventually more tax revenue collection leading to more national tax revenue (Tanzania Revenue Authority (TRA) 2010). However the existence of large informal sector presents negative impacts such as Export dumping; Productive inefficiencies, Lack of compliance with consumer protection, environment employment regulations and laws; less tax revenue; influences public opinion and reduces tax morale (PricewaterhouseCoopers 2010)

In Zimbabwe, the reality is that the growing rural informal sector has not yet significantly contributed to tax revenues. Thus taxing the ballooning informal sector presents the opportunity of revenue generation to fill the gap in the tax revenue. This will also increase the visibility of the informal sector in national programmes and in the economy (Africa Tax Spotlight 2012; CAGE 2013). Taxing the informal sector will improve revenue collection, growth and governance, enhance productivity, the provision of infrastructure, public education and health care, tax morale, redistribution of income and wealth and (political) representation as well as provide an interface between the government and the stakeholders (Aranjo-Bonjean et al 2003; Gobham 2005; Myles 2007; Africa Tax Spotlight 2012).

Bairagya (2011) argues that the government should tax the informal sector to increase the tax yield of government, hence improved service delivery and governance. In his remarks, Bairagya (2011) asserts that the over-protection of this sector as a special category and in particular, the so-called inability to pay taxes and conform to other regulations, has an adverse effect on the economy at large. In this regard, policy makers must view the informal sector as the hub of development that will stimulate economic growth and improve the gross domestic product of a country.

Extant literature suggest that informal sector can be brought into tax net through the following ways: application of existing income tax regime, indirect taxes (such as VAT), some special tax (such as presumptive taxe) and application of tax holidays and exemptions (Dube 2014, PricewaterhouseCoopers 2010). In this light

Tanzania has introduced a Block Management System aimed at identifying potentially taxable firms and creating a culture of paying tax. The governments of Rwanda and Cameroon have focused on improving the quality of service delivery and Ghana initiated negotiations with the informal sector to facilitate positive compliance (Africa Tax Spotlight 2012). Ghana adopted a number of strategies and methods in trying to rope in the informal sector and include standard assessment on individuals or businesses, occupational grouping taxation (which failed due to massive corruption and political factors) and tax stamp (Ofori 2009). Phiri (2013) concludes that revenue from the informal sector, as a proportion of total tax revenue income has relatively been low and poor. Zimbabwe has introduced presumptive tax legislation to broaden the tax revenue base in view of the ever-growing informal sector (ZIMRA 2009) but the revenue collected from this sector is insignificant and contributes 3% of the total revenue.

Extant literature shows that the implementation of presumptive tax is not effective as it leaves out a number of informal sector activities and many are still outside the tax net due to one of the following reasons: ignorance of tax head, lack of follow ups by Zimra and non-participation by informal sector players in setting of tax rates (Utamire, Mashiri & Mazhindu: 2013).The presumptive tax has not achieved the desired results as statistics show that presumptive tax head is contributing only 3% to total tax revenue against its 60% contribution to gross domestic product, despite various attempts (Ofori: 2009, Utamire et al 2013).

3. Statement of the Problem

The performance of presumptive tax head from the informal sector does not correspond with the growth of informal sector in Zimbabwe. It is alleged that Zimbabwe has been declared an informal economy as more that 85% of the population employed is in the informal sector and about $7.4 billion is exchanging hands in the informal sector (Fin Mart, 2012) yet contributes marginally to tax revenue generation. Literature suggests that governments should strive hard to improve the domestic revenue base but the challenge is on how to collect revenue from this promising sector in an efficient and effective way that will built trust and confidence of the taxpayers in general (Ebifuro, Mienye & Oduubo 2016).. There appears to be a substantial tax gap between the tax that is theoretically collectable from economically active persons in the country and the tax that is actually collected (Amoah, 2012). The sluggish performance of informal sector taxes raises the question of whether there is scope for more informal sector taxation in many developing countries (Phiri & Nakamba-Kabaso, 2012). Another problem in the existing literature is that many researchers are not specifying the types of informal sector to be targeted for tax, rural or urban informal sector. In the light of the above developments, this paper seeks to establish whether it is economically viable or socially acceptable to tax the rural poor informal sector?

4. Methodology

This research was predominantly desk research and library research, where several journals, articles, government minutes, debates and thesis were perused.

5. Findings, Conclusions and Recommendation

From the literature reviewed the following issues were found:

- The rural informal sector operators are poor,
- Taxation of the informal sector is an anthill task in the rural areas but for equate purpose they must be taxed,
- The informal sector pays VAT and imposing another form of tax will be unethical,
- The government is not doing justice to the rural areas in terms of developmental programmes, it appears that developments were channelled in urban areas and these facilities include:
  - Schools
  - Hospital
  - Information and Communication Technology Centres
  - Recreational centres
  - Provision of safe, clean waters
  - Shopping malls among others
- The Zimbabwe tax system theoretically, is integrating poor people but practically that group is indeed over taxed at the expense of the rich
- Some businesses that are attached to politicians remain immune to tax
- Tax revenue generated does not benefit the rural areas
- Poor reputation of the Zimbabwe Revenue Authority: there were several media reports about high corruption and bribery, including political interference, were rife and tax collectors had the reputation of being high-handed in their dealings with the public
- The majority of Zimbabweans perceived that taxation is now regarded as a disciplinary measure, or simply a cash cow for those in position of influence (as a means by which tax inspectors could augment

their own inadequate salaries)
- The government budgeted for the rural areas development since 1980 to date but no implementation of such projects
- Its a waste of resource to tax the poor informal sector in both rural and urban areas and the revenue to be generated will not cover the effort injected
- The Zimbabwe rural informal sector's economic activities come mainly from selling of beer (commonly known as Ndari/Ngoto/Utshwala)
- Even those that involve in some form of retailing their mode of payment is mainly barter trade (exchange of clothes for groundnuts or other grains)
- The quality of service delivery was poor; there was no tradition of political accountability (in most rural areas of Zimbabwe), whilst the tragedy of politically motivated violence strife (during wartimes and 2000-2008) had made the public services largely dysfunctional in most parts of Zimbabwe.
- The attention has been shifted to the informal sector as a last resort to raise revenue following the closure of more than 75% formal companies, departure of Farmers and indigenisation policies

Conclusions

From the above findings, the paper concludes, that until the government recognises the informal sector in terms of economic development and invest in it (informal Sector), it should not in any case impose taxes on the poor rural informal sector. It will be a mere waste of economic resources and socially immoral to collect taxes from the poor rural informal sector

Recommendations

The following recommendations were made:

- The Government of Zimbabwe must integrate pro-poor policies into the tax system, this entails policy strategies that are designed to enable the poor to actively participate in and significantly benefit from economic activity. This can be attained by ensuring that economic growth occurs in those sectors or regions in which the poor are employed, and focuses on using the factors of production they already possess direct financial transfers, investment in the assets of the poor, or provision of basic social services. Pro-poor growth requires that taxes be designed to burden the rich more than the poor and alleviate the worst effects of poverty regardless of cause
- The government should come up with a budget for Constituency/ village development fund lessons from the Republic of Botswana
- Identify potential taxable (Income Potential of a taxpayer) entities and – at least in principle – being able to estimate the amount of the tax base for each if it proves necessary to do so
- Stimulate Foreign Direct Investment (FDIs) so that millions of jobs will be created and this is the only way the government can collect taxes effectively (i.e. PAYE)
- Focus attention on the large formal sector, and formalise some urban informal sector, but compulsory formalization can fail since it does not address the structural causes of informality
- Political will: all elected members to be appraised on the number of people they have registered for tax purpose.

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