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## Informal Sector Taxation in Tanzania

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### 1.0 Introduction:

One of the challenges facing most developing countries including Tanzania is the presence of highly growing informal sector; the presence of this sector is a challenge for taxation, regulation, financing, reforms, and provision for social services with efforts to alleviate poverty. The informal sector in Tanzania consists of mainly the unregistered and hard-to tax groups such as small scale traders, farmers, small manufacturers, craftsmen, individual professionals and many small scale businesses. The number of informal operators in Tanzania is growing fast and their share to the GDP is large (currently estimated at 40%); indicating that when they are not taxed substantially, the Government loses revenue. Few success lessons can be drawn from countries such as Ghana and Cameroon.

The complexity of collecting income tax from the sector arises from its characteristics that include: absence of business premises, mobile nature of the operators, high tax collection cost, aggressive nature of the

actors, cash operation and absence of data and information. These characteristics make it hard to tax the sector, hence posing bigger challenges for income tax revenue collection.

### 2.0 Objective of the Discussion

The discussion was organized with the view of providing a platform to forum members to discuss and express their view on the importance of **Informal Sector Taxation in Tanzania** and to find out what should be done to enhance government revenue collection and options to curb the income tax evasion problem in the informal sector.

The total number of contributing entries was 66 from 17 participants. It is not entirely fair to single out individuals for commendation but Omari Mwinyi Khamis, Apronius Mbilinyi, Getrude Mugizi and Rah Kachwa stand out for mentioning due to the frequency of their interventions. Many of the contributions have been very useful and resourceful. The exchanges have commented on: (i) challenges of unreliability of data on informal sector operators,

(ii) tax payment and administration practices in Tanzania, (iii) tax laws, compliance and payment monitoring, (iv) tax collection capacity of TRA and local councils, (v) tax payment motivations and disincentives, and (vi) other options for boosting government revenue besides taxes and levies imposed on the informal sector.

Why the discussion of the subject on Taxation of the Informal Sector digressed into wide ranging ideas that may seem to cross beyond the core subject, was succinctly provided by the Moderator of the discussion (Apronius Mbilinyi). He said: ***“One may wonder why the discussion of informal sector taxation goes as far as touching governance and other issues such as transparency, accountability, fiscal policies such as budget and state management of the economy. The reason is that in principle tax links a state and its citizens. Once the state is run by citizens’ taxes, it has to be accountable for them and use the revenue collected from taxation to provide public services such as education, health, roads, safety, etc. The contrary is that if the***

*government is run from other sources (say aid or grants) that link may be lost”.*

### 3.0 The Rationale for Informal Sector Taxation

As indicated earlier, the informal sector in Tanzania contributes about 40% to GDP. ***“the revenue lost from not taxing the informal sector amounts to 35-55 per cent of the total tax revenue”.*** These statistics should be taken in with caution as some of the participants question the definition used to describe the sector. Yet all agree that the current tax base is too narrow and those who bear the tax burden are complaining (Khamis). Intriguingly, Khamis counters the popular belief that the informal sector escapes taxation, by saying ***“if you observe carefully these informal business people are indirectly paying tax.”*** He means for instance that they pay VAT through purchases of goods and services and even direct tax such as through sale of agricultural produce. Also PAYE was mentioned in this regard as a direct taxation that has embraced the low income earners.

### 4.0 Tax Administration Practices and Challenges

Lack of reliable records on numbers of expected tax payers, let alone informal sector operators, has haunted tax planners and collectors (Mbilinyi, Khamis, Getrude Mugizi, Festo Maro). This problem might be alleviated under the pending issuance of national ID cards although, as some TAKNET commentators mentioned, it is not certain if the IDs will have the facility to cater for such potential specific requirements. In

developed countries, a lot of businesses are still run as SMEs and even as informal sector but because of efficient business registration and national ID records these sectors do not escape the ambit of the taxman. In Tanzania such all-encompassing nationwide business registration is still nascent (under the Business Activities Registration Act or BARA of 2007). The MKURABITA initiative has also been mentioned as a good attempt to legalise ownership of fixed assets that would enhance the worth of informal sector activities and thus increase areas of taxable opportunities.

One TAKNET commentator lamented the removal of the poll tax in the 1960s. In the current realistic situation calling for more self-reliance in resourcing budget funds, the poll tax may be was one way of mobilising everybody including those owning or working in the informal sector to contribute to the cost of providing public services. Many known businesses are not easily taxed at present. Those mentioned in the discussion include rented houses (***“Many people have rented their houses, apartments and rooms for accommodation and business but do not pay income tax - Mbilinyi. Others include,*** tourist operators and craftsmen and privately operating professionals such as accountants, lawyers, economists, engineers, builders, carpenters, welders, or even fishermen, gemstone dealers, etc, (Khamis, Michael Mpombo).

A wild guess was that the informal sector participants may have as many as 4-5 million potential tax payers who are not paying income tax at the

moment. Another figure (which should also be taken with vigilance) was that only 590,909 people out of the country's population (Maro) are paying direct tax (income tax)! In this regard, TRA has been blamed for lacking inventiveness to set up in this area a suitable administrative structure to capture all potential tax revenues, in which they could use the existing street/village level administrative structure to ***“get information of who is working where, who does what, which businesses are registered, which house is for renting, which motor vehicle/motorbike is registered, etc”*** (Maro). It was argued that if TRA lacks capacity in this respect it should resort to development partners to offer needed assistance or to development banks for that matter. Whether or not accurate (Nikubuka Shimwela), it was suggested that TRA's lack of effort to net more tax payers was because ***“some of the activities are owned by big shots”*** (Maro, Mbilinyi, Japhet Makongo).

Other challenging features pointed out by commentators (especially Kachwa, Mugizi,) and in trying to explain why the informal sector is eschewing public records and statistics for taxation are: (i) existence of a multiplicity of operators with very low-income levels and thus low tax yielding potentials for TRA, that therefore entail high transaction costs to deal with, (ii) most of these operators also do not interface with traditionally record-keeping establishments such as banks and other formal business entities, and (iii) they themselves may not be keeping records anyway.

In addition, the problem of records was aggravated by lack of

business and sales transaction receipting even by those registered as tax payers. In this regard, the TAKNET commentators (Ram Lyer, Khamis, Maro) commended TRA for introducing the Electronic Fiscal Devices, although more training on their use for businessmen and the public at large is still required. Enforcement of receipting will go a long way toward ensuring that collected taxes at the consumer level are remitted to Government/TRA coffers and will leverage equal treatment of all tax-paying subjects, including engendering equity for tax-paying businesses that have to compete with those that hitherto have not been issuing sales receipts and thus cheating the government.

Yet another problem, perhaps more fundamental in trying to broaden the tax base through the informal sector, is the perception of citizens on the merits of paying taxes in general. Mugizi says "*Studies have shown that generally voluntary tax compliance increases as people's faith in what the government is doing with their taxes increases.*"

*Voluntary tax compliance is necessary to persuade the informal sector potential taxpayers to even allow themselves to be identified*". Mbilinyi, Kachwa, Makongo, Shabbir Zavery and Deo Mutalemwa corroborate this view by stressing that trust in the state (and even tax compliance) is enhanced by the latter providing social and economic infrastructure services accessible to business operators. Mutalemwa and Mugizi add the dimension of judicious spending of public funds and the ability of tax payers (and auditors) being

able to question the quality of spending. Mbilinyi quoted a primer guide from the World Bank saying "**...successful broadening the tax base to informal activities should pay attention to government accountability, since the culture of compliance depends on tax morale i.e. the extent to which the citizens trust the state. ....**"

## 5.0 Recommendations

The following recommendations have been discerned from the contributions: *Enhance TRA Capacity* (Mugizi): Here people warned about the danger of deflecting the actual target of spending capacity building funds by for instance spending them exceedingly on training, work shopping and all sorts of allowances. *Track emerging businesses* (E. Ngwandu, Japhet Makongo): register them, support them, regulate them and tax them, e.g. boda boda, ghutas, bajaj, road side flower growers, mama ntilie, etc.

*Improve tax administration including simplification of payment procedures.* Kachwa made comments, suggesting for instance more effective use of the presumptive taxes stipulated in the Income Tax Act 2004, citing the example of Chile under which "*a VAT simplified regime- in this case the threshold and management is simplified to cater for SMEs*". He also suggested amendment of the Income Tax Act 2004 so that a withholding tax system can be applied in areas like rent income whereby individual tenants can submit rent tax to the revenue authority.

*Introduce incentives for tax*

*payment* like bonus for good tax payers and special recognition to those making full compliance (Makongo). Also in order to enhance the willingness of paying taxes, in some cases link taxes with specific infrastructure improvements (e.g. parking lots and roads for daladala or selling space for market sellers in Kariakoo – Makongo).

*Carry out a comprehensive review exercise of government spending generally* (Edward Shigula, Khamis, Mutalemwa). "*Our government has to learn to spend less and this is possible - Shigula*". Several people expressed revulsion against extravagance on spending on missions, expensive vehicles (shangingi), and too many government ministries. We need "*a shift of mindset from being CONSUMPTIVE to INVESTING and a notion of saving and investing is to be inculcated into our leaders (and the general public) into our cultures.*" says Kachwa. A more broad view on reversing the mind-set and culture of spending on non-priorities embraced by the government and the citizens in general was evoked (Mutalemwa, Khamis, Mugizi, and others).

*Reintroduce the poll tax* (Khamis); call it any suitable name if necessary (poll tax or Kodi ya Kichwa abolished in 1969 or even the development levy abolished in 2003).

*Privatise tax collection* (Marja-Liisa Swantz, Mbilinyi).

*Investigate alternative sources of government revenue* (i.e. as an accompaniment to pursuing taxation on the informal sector). Khamis incessantly mentions the mining sector, advocating for

further reduction of tax exemptions and reliefs, breaking the current taboo of government taking up significant shares in mineral ventures (Swedish government invests in iron ore). Maximising government revenue from land rents collected by government was also mentioned (Mbilinyi) but this has to be facilitated by more vigorous efforts in plot surveying in urban areas.

*Improve tax records*, including exploring the possibility of using the anticipated national Identity Card to link citizens access to various public and private services and funds to the imperative of paying taxes. Khamis cites possible link of taxes to permission to make money remittances abroad, to allow persons to travel out of the

country or accessing services in the banks.

Finally, an in-depth study (survey) should be carried out to determine the magnitude of the informal sector that is liable to paying tax.

## 6.0 Conclusion

The TAKNET forum has made it clear that moulding the mind-set of citizens to recognise the duty of paying taxes is an important ingredient in the democratisation process. Paying taxes empowers them to assertively demand accountability in government spending, especially at the local level where they can see what their money (not aid money) is actually being spent on. Mbilinyi made a powerful statement that ***“in principle, tax links a state***

***and its citizens”***. He add that it is ***“Not surprising to find the state is being accountable to donors and not its citizens”*** if it relies on donors to finance its budget. This needs reversing through, *inter alia*, informal sector income taxation as a way of broadening the tax base.

*The TAKNET forum is very grateful for the contributions received during the discussion of this topic from: Omary Mwinyi Khamis, Ram Lyer, Degratias Mutalemwa, Getrude Mugizi, Rah Kachwa, Edward Shighula, Maria Liisa, Idelphonse Mabamba, Nikubuka Shimwela, Japhet Makongo, Edward Ngwandu, Shabbir Zavery, Godwin Nyelo, Michael Mpombo, Abdallah Hassan, Festo E. Maro and Apronius Mbilinyi.*

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