

**THE PRACTICAL IMPLICATIONS OF TAXING THE INFORMAL  
SECTOR IN ZIMBABWE**

A mini thesis submitted in partial fulfilment of the  
requirements for the degree of

**MASTER OF COMMERCE (TAXATION)**

of

**RHODES UNIVERSITY**

by

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February 2022

## DECLARATION

I, Fredy Mashate, declare that the work presented in this thesis is original. It has never been presented to any other University or Institution. Where other people's works have been used, references have been provided. It is in this regard that I declare this work as originally mine. It is hereby presented in partial fulfilment of the requirements for the award of the Degree of Master of Commerce (Taxation).

SIGNED



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DATE: 14<sup>th</sup> February, 2022

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## ABSTRACT

The taxation of informal sector business is increasingly becoming a topical issue in many developing countries, and Zimbabwe is no exception. The Zimbabwean government has been experiencing shrinking revenue in the wake of an increased informal sector and a declining formal sector. In an effort to broaden the tax base and increase revenue for government in Zimbabwe, presumptive tax levied against certain informal sector activities was first introduced in 2005 and later expanded to other sectors. Despite the effort, the informal sector has responded with low tax morale and non-compliance, which creates the need to reassess the current administrative strategies in a bid to build a successful tax system for the informal sector.

The main goal of the research is to establish clear, innovative and practical administrative strategies that can be adopted by the Zimbabwe Revenue Authority in taxing the informal sector in Zimbabwe. An initial investigation was done to identify the current state of affairs in relation to informal sector taxation in Zimbabwe. A number of challenges were recorded and the research sought to learn from examples of recent innovation in administrative strategies successfully applied in taxing the informal sector in other jurisdictions like Tanzania and Ghana. Learning from these examples, a number of practical administrative strategies that are mindful of the Zimbabwean economic context were proposed.

Keywords: informal sector, taxation, presumptive tax, tax administration, administrative strategy, tax morale, tax compliance, Zimbabwe Revenue Authority (ZIMRA), Tanzania, Ghana, Zimbabwe

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## **ABBREVIATIONS AND ACRONYMS**

BMS	Block Management System
GDP	Gross Domestic Product
GRA	Ghana Revenue Authority
IMF	International Monetary Fund
OECD	Organisation for Economic Co-operation and Development
TRA	Tanzania Revenue Authority
VAT	Value Added Tax
ZIMRA	Zimbabwe Revenue Authority

## CHAPTER 1: INTRODUCTION

### 1.1 Context of research and problem statement

The question whether the informal sector should be taxed has for decades been subject to arguments both for and against the proposals. Those who write in opposition of the idea, represent the school of thought that the potential revenue yields are low, administrative costs are high, tax incidence is likely to be regressive, and the broader growth and governance gains remain insufficiently proven.<sup>1</sup> Even where the law of general application would dictate that tax should be applied to everyone, whether in the formal sector or informal sector, it is submitted that the inherent challenges with implementation are real.

The counter argument largely focuses on the potential benefits of informal sector taxation in terms of revenue, growth, and governance. Schneider and Klinglmair explain that the informal sector contributes a large and, in many countries, growing share of the Gross Domestic Product (GDP) and thus represents a potentially significant source of tax revenue.<sup>2</sup> Torgler<sup>3</sup> and Terkper<sup>4</sup> argue that taxing the informal sector may also be essential to maintain tax morale and tax compliance among larger firms. It is conceivable that the formalisation of informal sector firms may accelerate the growth of these firms. Loeprick explains that these firms would gain access to formal bank loans and government tenders, and this creates new employment opportunities in the process.<sup>5</sup> With respect to governance, the payment of taxes by firms in the informal economy may be a way of engaging firms with the state, and thus promoting good governance and political accountability.<sup>6</sup>

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<sup>1</sup> E Babbie & J Mouton *The Practice of Social Research (2009)* Cape Town: Oxford University Press Southern Africa.

<sup>2</sup> F Schneider & R Klinglmair "Shadow Economies Around the World: What do we Know?" (2014) *IZA Discussion Paper No. 1043, CESifo Working Paper Series No. 1167*, p5.

<sup>3</sup> B Torgler *Tax Morale in Latin America* WWZ Discussion Paper, Basel: Wirtschaftswissenschaftliches Zentrum, University of Basel (2003) 131.

<sup>4</sup> S.E Terkper *Managing Small and Medium-Size Taxpayers in Developing Economies*. (2003) Tax Notes International.

<sup>5</sup> J Loeprick *Small Business Taxation: Reform to Encourage Formality and Firm Growth, Investment Climate in Practice: Business Taxation (2009)* Washington DC: World Bank, 1.

<sup>6</sup> A Joshi, W Prichard & C Heady "Taxing the Informal Economy: Challenges, Possibilities and Remaining Questions" 2013 *Blackwell Publishing Ltd* [Online]. Available: <http://onlinelibrary.wiley.com/doi/10.1111/j.2040-0209.2013.00429.x/pdf> [Accessed 09 September 2017], 6.

While there is a growing interest in taxing the informal sector, and well-established thinking about appropriate policy measures for taxing the informal sector, progress in practice has been comparatively slow.<sup>7</sup> In part, this reflects the administrative complexity of locating and taxing very large numbers of small firms that are eager to evade being captured in the tax net.

There are a number of theories of taxation. These include the following:

1. The Benefit theory of Taxation: The benefit theory asserts that taxes should be imposed or levied upon individuals in proportion to the professed benefit received.<sup>8</sup>
2. Ability to Pay: This theory advocates that the taxation burden should be fairly spread. The theory asserts that all members of the community or country must pay tax based on their ability.<sup>9</sup>
3. The Cost of Service Theory: The cost of service theory suggests that persons should not expect any free services or benefits from the government.<sup>10</sup>
4. 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.<sup>11</sup>

With the aid of these theories, the rationale for informal sector taxation can be investigated. It is vital to review the body of literature on informal sector taxation in light of these theories, in an effort to either justify or discard the notion of informal sector taxation, in a given context.

The multiple taxes imposed by the government of Zimbabwe on the informal sector overburden the citizens and threaten the survival of small businesses.<sup>12</sup> The informal sector forms a large and growing component of the Zimbabwean economy, absorbing the bulk of retrenched and

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<sup>7</sup> A Joshi, W Prichard & C Heady "Taxing the Informal Economy: Challenges, Possibilities and Remaining Questions" 2013 Blackwell Publishing Ltd [Online]. Available:

<http://onlinelibrary.wiley.com/doi/10.1111/j.2040-0209.2013.00429.x/pdf> [Accessed 09 September 2017], 6.

<sup>8</sup>F.O Kwabena *An assessment of tax compliance by the self-employed in the New Juaben Municipality*. (CEMBA Thesis, Kwame Nkrumah University of Science and Technology, 2011) 30-32.

<sup>9</sup> D Simiyu *Challenges affecting collection of turnover tax in Nairobi County–Kenya* (MBA Thesis, Kenyatta University, 2013) 10.

<sup>10</sup> E Appah & O.T Ebiringa 2012. "Petroleum profit tax and economic growth in Nigeria" (2012) vol. 1, issue 9 *International Journal of Management Science and Business Research* 12-22.

<sup>11</sup> G.N Ogbonna & E Appah "Impact of Tax Reforms and Economic growth of Nigeria: A Time Series Analysis" (2012) vol. 4(1) *Current Research journal of Social Sciences* 62-68.

<sup>12</sup> E Chiringa "Concerns over Zim's multiple taxes" 2017. *DailyNews Live*. [Online] Available: <https://www.dailynews.co.zw/articles/2017/03/29/concern-over-zim-s-multiple-taxes> [Accessed 3 September 2017].

unemployed graduates who join the uneducated people who occupied this economic space in the earlier days of Zimbabwe.<sup>13</sup> For some time now, the government has been eager to find a way to tax the informal sector players, who include traders and manufacturers of an assortment of household and industrial products.<sup>14</sup>

Zimbabwe introduced a presumptive tax system for certain informal sector traders in 2005 to broaden the tax base, but this failed due to non-compliance.<sup>15</sup> In another effort, the government introduced a number of new taxes in April 2017 targeted at the informal sector, including a tax on hairdressers, commuter omnibuses, airtime vendors, driving school owners, tobacco farmers and many others.<sup>16</sup> As expected, this has been met with strong resistance.

The Financial Gazette recorded that in April 2017, the government introduced a 10 percent withholding tax on tobacco farmers without tax clearance certificates, but that attempt was abandoned after farmers protested at tobacco auction floors.<sup>17</sup> The current economic situation has pushed the government to look for anything they can tax to meet their monthly obligations. It seems abrupt decisions are made in response to the pressure to grow the tax pool and increase revenue, but major questions remain about how (in practice) to achieve meaningful improvements in informal sector taxation.

This research seeks to draw on the extensive body of knowledge and research, paying attention to new ideologies on how to strengthen informal sector taxation. Joshi, Prichard and Heady argue that improving taxation of the informal economy will demand not only technically appropriate policy choices, about which much is known through literature, but also broader administrative and institutional reform strategies that can generate both greater acceptance among taxpayers and leadership among political and administrative actors.<sup>18</sup> It is submitted that Tanzania and Ghana are good examples in this area. In their quest to tax the informal sector

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<sup>13</sup> ZIMCODD. "Zimbabwe's Tax system: Opportunities and threats for enhancing development in Zimbabwe" (2014) *Zimbabwe Tax Justice*.

<sup>14</sup> The Financial Gazette. "ZIMRA to Tax Informal Sector" 2017 [Online]. Available: <http://www.financialgazette.co.zw/139567-2/> [Accessed 03 September 2017].

<sup>15</sup> E Munjeyi, S Mutasa, S.E Maponga & K.C Muchuchuti "The Informal Sector Tax Revenue Potential: A Case of Zimbabwe" 2017. *Research Journal of Finance and Accounting*, vol. 8, ISSN 2222-1697. [Online] Available: <http://www.iiste.org/Journals/index.php/RJFA/article/view/36782/37799> [Accessed 09 September 2017] 143.

<sup>16</sup> The Financial Gazette, 2017.

<sup>17</sup> *Ibid.*

<sup>18</sup> Joshi, Prichard & Heady "Taxing the Informal Economy: Challenges, Possibilities and Remaining Questions" 2.

within their respective jurisdictions, they employ innovative strategies to address major barriers to successful taxation.

Tanzania has reorganised tax administration through the Block Management System (BMS).<sup>19</sup> Under this system trading areas are mapped and divided into blocks on the basis of geography, administrative boundaries, or a few streets. Each block is mandated to operate all tax functions of identification, registration, assessing and accounting for revenue collected. A team of trained personnel with relevant skills to perform these functions is tasked to identify, register, educate and interact with taxpayers, particularly those in the informal sector. This reform is intended to allow services to be more specifically tailored to the needs and realities of small firms.<sup>20</sup> Joshi, Prichard and Heady suggest that the BMS has resulted in an increased number of informal businesses registering with the Tanzanian tax administration.<sup>21</sup>

Ghana, on the other hand, has implemented associational taxation. From 1987 to 2003 the Ghanaian Internal Revenue Service delegated the responsibility for collecting tax from the informal sector to various informal sector associations. This strategy is called Identifiable Grouping Taxation. The arrangement overcomes some of the problems associated with tax collection from microbusinesses. From the perspective of the tax administration, Identifiable Grouping Taxation reduced collection costs to a fixed 2.5 per cent, which was paid to the associations for their work in collection.<sup>22</sup> The associations bore the burden of identifying members and ensuring that they complied. From the perspective of the associations, becoming tax compliant granted them legitimacy, and helped to protect them from more arbitrary harassment by public officials and police.<sup>23</sup> The system allowed for micropayments (initially the system collected taxes daily and then shifted to weekly payments. This suited the uncertainty of earnings in the sector and did not become a visible burden. The Identifiable Grouping Taxation system instilled a culture of taxpaying within businesses in the informal economy in Ghana.

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<sup>19</sup> Joshi, Prichard & Heady "Taxing the Informal Economy: Challenges, Possibilities and Remaining Questions" 2.

<sup>20</sup> International Monetary Fund. "Revenue Mobilisation in Developing Countries, Washington DC: International Monetary Fund" 2011. [Online] Available: <http://www.imf.org/external/np/pp/eng/2011/030811.pdf> [Accessed 09 September 2017].

<sup>21</sup> Joshi, Prichard & Heady "Taxing the Informal Economy: Challenges, Possibilities and Remaining Questions" 2.

<sup>22</sup> *Ibid.*

<sup>23</sup> Joshi & Aye "Autonomy or Organization? Reforms in the Ghanaian Internal Revenue Service" (2009).

The examples of Tanzania and Ghana are proof that taxing the informal sector is not as bleak as it appears and governments fearing a backlash from attempting taxation may find that the informal sector is not as averse to taxation as one might be led to believe.<sup>24</sup> A study of the policy and strategy implemented by the two countries will provide insight into how tax law and policy can be enforced in Zimbabwe in practice.

## **1.2 Goals of the research**

The main goal of the research is to establish clear, innovative, and practical administrative strategies that can be adopted by the Zimbabwe Revenue Authority (ZIMRA) in taxing the informal sector in Zimbabwe. In order to achieve this, the following sub-goals will be addressed:

1. Explore the advantages and disadvantages of taxing the informal sector in Zimbabwe.
2. Discuss:
  - 2.1 the current efforts, in legislation and policy, that seek to tax the informal sector in Zimbabwe; and
  - 2.2 the recorded practical challenges.
3. Explore recent research around effective administrative strategy in taxing the informal sector, and, in particular, how Tanzania and Ghana have adopted innovative tax administration strategies to counter the challenges associated with taxing the informal sector within their respective jurisdictions.
4. Make practical recommendations that are mindful of the Zimbabwean economic context.

## **1.3 Methods, procedures and techniques**

The research will be conducted by means of a literature review. An interpretative research approach will be adopted for the present research as it seeks to understand and describe.<sup>25</sup> The research also adopts a reform-oriented approach as it seeks to promote change. A qualitative analysis and review of relevant tax-related legislation, policies and strategies will be

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<sup>24</sup> Joshi, Prichard & Heady "Taxing the Informal Economy: Challenges, Possibilities and Remaining Questions" 2.

<sup>25</sup> Babbie & Mouton *The practice of social research*.

undertaken. The research will review journals, academic literature, discussion papers, opinion papers, online sources, newspaper articles, among other documentation.

The research will be conducted in the form of an extended argument, supported by documentary evidence. The credibility of the research and the conclusions will be ensured by placing greater evidential weight on primary data, and particularly legislation, and the writings of acknowledged experts in the field, and discussing opposing viewpoints and concluding, based on a preponderance of credible evidence.

#### **1.4 Ethical considerations**

As all the data are publicly available, no ethical considerations arise. Interviews will not be conducted, and opinions will be considered in their written form.

#### **1.5 Chapter overview**

The thesis is divided into five chapters. Chapter one served as an introduction to the thesis. Chapter two explores the context of informal sector taxation and highlights some of the challenges that have been encountered in taxing the informal sector in Zimbabwe. The third chapter is interested in recent research regarding effective administrative strategy in taxing the informal sector. Further, the chapter investigates how Tanzania and Ghana have adopted innovative tax administration strategies to counter the challenges associated with taxing the informal sector within their respective jurisdictions. Chapter four of the thesis will make recommendations based on lessons derived from chapter three and propose a variety of priority areas for administrative reform in taxing the informal sector in Zimbabwe. Lastly, chapter five of the thesis will summarise the research with a specific interest in the findings of chapters two to four.

## **CHAPTER 2: TAXING THE INFORMAL SECTOR IN ZIMBABWE**

### **2.1 Introduction**

The economic crisis in Zimbabwe has had a negative impact on the labour market, and the largely growing informal sector is increasingly viewed as a potential source of tax revenue by the government.<sup>26</sup> Employment opportunities in the formal sector have shrunk along with the economy but this same environment has since fostered the rapid growth of the informal sector.<sup>27</sup> The contraction of the economy has had a negative impact on the government's ability to collect tax revenues and this affects the government's ability to meet various obligations.<sup>28</sup> In this context, investing in taxing the informal sector is a justifiable stance in an effort to broaden the tax base.

The chapter will discuss the evolution of informal sector taxation in Zimbabwe. This will broadly include discussions related to the economic environment under which informal sector taxation was introduced, the administrative path taken in introducing informal sector taxation, and finally the response of the taxpayers as reflected by tax morale. The main focus of the chapter is to discuss the challenges faced by the Zimbabwean Revenue Authority (ZIMRA), thus far, in taxing the informal sector. The goal is to highlight areas that ZIMRA (working together with the government) can improve to ensure effective administration of presumptive tax. It will, therefore, be important for this chapter to establish a holistic picture of the taxation of the informal sector in Zimbabwe.

### **2.2 Theories of taxation and link to informal sector tax**

There are number of theories of taxation that may be appropriate in guiding tax policy in relation to the taxation of the informal sector.

#### **2.2.1 The benefit theory of taxation**

The benefit theory asserts that the state should levy taxes on individuals according to the benefit conferred on them.<sup>29</sup> The more benefits a person derives from the activities of the state, the

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<sup>26</sup> Government of Zimbabwe *Mid-term Fiscal Policy Review* (2005).

<sup>27</sup> Dude G. *Informal Sector Taxation: the case of Zimbabwe* (PhD Thesis, University of KwaZulu-Natal, 2014) 56.

<sup>28</sup> *Ibid.*

<sup>29</sup> Kwabena *An Assessment of Tax Compliance by the Self-employed in the New Juaben Municipality* 30-32.

more he or she should pay to the government. For example, the theory suggests that the state's right to tax is evoked where a trader (whether formal or informal) is found to draw a benefit from the government. A benefit is not always easy to measure, for example, childless couples may not always feel they should contribute to the provision of state education, and yet indirectly they will derive a benefit from living in an educated community.<sup>30</sup>

The general sentiments of the Zimbabwean informal sector operator question why they should pay taxes when there is no benefit derived from the government. Transport operators, for example, pay toll fees but the roads continue in a poor state across the country.<sup>31</sup> Other informal sector operators are of the opinion that the government should have provided formal employment as a benefit of a functional state and therefore the government cannot benefit from the "people's individually created hustles".<sup>32</sup>

Critics of the benefit theory propose that maintaining a certain connection between the benefits conferred and the benefits derived is against the basic principle of the tax. A tax is a compulsory contribution made to the public authorities to meet the expenses of the government and the provisions of general benefit and there is no direct *quid pro quo* in the case of a tax.<sup>33</sup> This compels everyone (including informal operators) to contribute to the public pocket. Moreover, most of the expenditure incurred by the state is for the general benefit of its citizens and it is not possible to estimate the benefit enjoyed by a specific individual every year.

### **2.2.2 The cost of service theory**

The cost of service theory is very similar to the benefits-received theory. It emphasises the semi-commercial relationship between the state and the citizens.<sup>34</sup> The implication is that the citizens are not entitled to any benefits from the state and if they do receive any, they must pay the cost thereof.<sup>35</sup> In terms of this theory, the state provides basic protective and welfare functions and taxation allows the state to recover the cost of these services.

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<sup>30</sup> Kwabena *An Assessment of Tax Compliance by the Self-employed in the New Juaben Municipality* 30-32.

<sup>31</sup> G Dube *Informal Sector Taxation: the case of Zimbabwe* 86-89.

<sup>32</sup> *Ibid.*

<sup>33</sup> D Simiyu *Challenges Affecting Collection of Turnover Tax in Nairobi County–Kenya* (MBA Thesis, Kenyatta University, 2013) 11.

<sup>34</sup> *Ibid.*

<sup>35</sup> E Appah & O.T Ebiringa *Petroleum Profit Tax and Economic Growth in Nigeria* (2012) 16.

The cost of service principle can be applied to some extent in those cases where the services are rendered at a cost that is easy to determine.<sup>36</sup> However, most of the expenditure incurred by the state cannot be fixed for each individual because it cannot be exactly determined. For instance, it is not easy to measure the cost of service of the police, armed forces, judiciary, etc., for different individuals.<sup>37</sup>

The major weakness of this theory in relation to informal sector taxation in Zimbabwe is the very fact that the informal sector does not believe that the government is providing them with any services. The theory could, however, be used where the government allocates to informal traders the space in which to sell their goods. Where the given space is secure, the provision of electricity, water, etc., can be taxed as a service rendered. It is appreciated, however, that the cost of the service would remain a difficult factor to ascertain.

### **2.2.3 Ability to pay theory**

The ability to pay theory asserts that all members of the community or country must pay tax based on their ability.<sup>38</sup> The theory is most widely cited and commonly accepted for equity purposes in taxation. It appears reasonable that taxes should be levied based on the taxable capacity of an individual.

The theory suggests that there is no commercial or semi-commercial relationship between the state and the citizens.<sup>39</sup> The basis of this theory is that the burden of taxation should be shared by the members of society on the principles of justice and equity and that these principles necessitate that the tax burden is apportioned according to their relative ability to pay.<sup>40</sup> For example, if the taxable capacity of A is greater than the B, the former should pay more taxes than the latter.

Whilst this approach is plausible, a problem arises when it comes to deciding on the best indication of a person's "ability to pay".<sup>41</sup> Economists have tried to establish indicators of

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<sup>36</sup> Simiyu *Challenges Affecting Collection of Turnover Tax in Nairobi County–Kenya* 11.

<sup>37</sup> *Ibid.*

<sup>38</sup> Simiyu *Challenges Affecting Collection of Turnover Tax in Nairobi County–Kenya* 11.

<sup>39</sup> *Ibid.*

<sup>40</sup> *Ibid.*

<sup>41</sup> Kwabena *An Assessment of Tax Compliance by the Self-employed in the New Juaben Municipality* (2011) 35.

“ability to pay” but there is no agreement on what indicators best serve the purpose. In a bid to answer what “ability to pay” means, some economists accept ownership of property as a valid indicator of capacity to pay.<sup>42</sup> In opposition to this position, critics have raised the argument that if a person earns a large income but does not spend it on buying any property, he or she will then escape taxation, whilst those who might earn less but buy property will incur tax.<sup>43</sup> This would contravene the principles of equity and justice.

Other economists assert that the “ability to pay” tax is based on the expenditure that a person incurs.<sup>44</sup> The greater the expenditure, the higher should be the tax and *vice versa*. The weakness of this viewpoint is that where two individuals receive the same income, they may incur different expenditure based on their responsibilities.<sup>45</sup> For example, a person with a large family to support has to spend more than a person with a small family. Where “ability to pay” is subject to expenditure, the individual already burdened with a large family is expected to pay more taxes than the individual who has a small family. This, too, would contravene the principles of equity and justice.

The most popular and widely accepted indicator of the “ability to pay” is the consideration of the person’s income.<sup>46</sup> The use of income as the basis of taxation *prima facie* appears to be the most justifiable theoretical basis. This means that the greater the income of a person the greater the tax. A person who earns a higher income should pay more towards the support of government. Whilst income seems more equitable as an indicator of ability to pay, it is difficult to use it in cases of informal sector traders, most of whom do not keep any record or account of income. It is submitted that a combination of property, expenditure and income can be considered in the case of informal sector operators.

In Zimbabwe, Mrs Bonyongwe, the director of the Zimbabwean Revenue Authority (ZIMRA), whilst encouraging the informal sector to pay tax, revealed that ZIMRA sees evidence of the lavish lifestyles, characterised by various state-of-the-art residential properties, expensive

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<sup>42</sup> K R Chauke M P Sebola and N E Mathebula “Reflection on the Ability to Pay Theory of Taxation in the Context of South African Municipalities” (2017) *Public Administration and Development Alternatives* 407-408.

<sup>43</sup> *Ibid.*

<sup>44</sup> *Ibid.*

<sup>45</sup> K R Chauke M P Sebola and N E Mathebula “Reflection on the Ability to Pay Theory of Taxation in the Context of South African Municipalities” (2017) *Public Administration and Development Alternatives* 407-408..

<sup>46</sup> *Ibid.*

vehicles and the apparent high spending power of the Zimbabwean people on luxurious and high-end consumer goods and services.<sup>47</sup> It would be a fair assertion, therefore, to suggest that taxation of the informal sector in Zimbabwe should be based on the “ability to pay” and that all three indicators (property, expenditure and income) are used to determine the “ability to pay”.

#### **2.2.4 The expediency theory**

The expediency theory asserts that every tax proposal must pass the test of practicability.<sup>48</sup> This must be the only consideration when the authorities are choosing a tax proposal. Economic and social objectives of the state should be treated as irrelevant.<sup>49</sup> The proposition of this theory is reasonable to the extent that it is useless to introduce a tax that cannot be levied and collected efficiently.

There are pressures from economic, social and political groups.<sup>50</sup> Every group tries to protect and promote its own interests and authorities are often forced to reshape tax structure to accommodate these pressures.<sup>51</sup> Sometimes the administration set up may not be efficient in collecting the tax at a reasonable cost of collection and if tax authorities are oblivious to this practical test, then they set themselves up for failure.

In the case of informal sector taxation in Zimbabwe, under this theory, ZIMRA must consider the practicality of taxing the informal sector (whether as a whole, or specific operations). Taxation provides a powerful set of policy tools to the authorities and these must be used for remedying economic and social ills of the society such as income inequalities, regional disparities and unemployment amongst others. The test of practicality must be incorporated if the adopted tax policy is to succeed.

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<sup>47</sup> W Bonyongwe *Revenue Performance Report for the Quarter Ended 30 September (2017)*.

<sup>48</sup> Simiyu *Challenges Affecting Collection of Turnover Tax in Nairobi County–Kenya* 10.

<sup>49</sup> *Ibid.*

<sup>50</sup> O Zivanai O Manyani N Hove L Chiriseri and M Mudzura *The Effectiveness of Presumptive Tax and Its Impact On Profitability of SMEs in Zimbabwe. Case of Commuter Transport Operators in Bindura (2014) Research journal's Journal of Commerce Vol.2 No.7 ISSN 2348-0955, p3.*

<sup>51</sup> *Ibid.*

### 2.3 Informal sector taxation: the Zimbabwean journey

The Zimbabwe National Statistical Agency survey on the labour force in 2011 revealed that 84% of economic activity occurred in the informal sector, 11% occurred in the formal sector and 5% could not be classified.<sup>52</sup> This survey supports the claim that the informal sector in Zimbabwe is significantly larger than the formal sector.

The informal sector is defined as economic activities that are not included in a nation's data on GDP, and not subject to formal contracts, licensing, and taxation.<sup>53</sup> 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.<sup>54</sup> In Zimbabwe, the informal sector activities are known as “kukiya-kiya”, an expression that in local parlance refers to multiple forms of “making do”.<sup>55</sup> In the absence of a formal economy, Zimbabweans had to come up with innovative ways of “making do” in order to meet their financial socio-economic obligations. Activities of “making do” range from cross-border trading, hair dressing, street vending, transport services, and others. Most are neither regulated nor registered under the laws of Zimbabwe, this categorising them as informal activities.

ZIMRA has for many years worked together with the Zimbabwean government in an effort to collect taxes from the informal sector. In trying to understand the rationale behind taxing the informal sector, Godwin Dube interviewed informants from ZIMRA. The main question to be answered queried the motivation for introducing informal sector taxes in Zimbabwe.<sup>56</sup> It is recorded that all informants cited revenue collection as the main motivation for informal sector taxation. In relation to some of the key informants, Dube records them to have said the following:

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<sup>52</sup>O Zivanai O Manyani N Hove L Chiriseri and M Mudzura *The Effectiveness of Presumptive Tax and Its Impact On Profitability of SMEs in Zimbabwe. Case of Commuter Transport Operators in Bindura* (2014) Research journal's Journal of Commerce Vol.2 No.7 ISSN 2348-0955, p3.

<sup>53</sup> L Shinder “Zimbabwe's Informal Sector” 1998. Available: <https://www.bls.gov/opub/mlr/1998/03/intrep.pdf> [Accessed 15 September 2017].

<sup>54</sup> G Dube D Casale *The Implementation of Informal Sector Taxation: Evidence from Selected African Countries* (2016) eJournal of Tax Research vol.14 No.3, p601.

<sup>55</sup> JL Jones “Nothing is straight in Zimbabwe’: The Rise of the Kukiya-kiya Economy 2000–2008” (2010) *Journal of Southern African Studies*, 36:2, 285-299, DOI: [10.1080/03057070.2010.485784](https://doi.org/10.1080/03057070.2010.485784) 285.

<sup>56</sup> Dube *Informal Sector Taxation: the case of Zimbabwe* 97-99.

There was a realization that the informal sector was performing well and that it also had to contribute through the payment of taxes. Another key informant said, there was a dramatic increase in the informal sector as a result of the economic meltdown. This is an attempt to widen the tax base by incorporating the informal sector.<sup>57</sup>

In a bid to tax the informal sector in Zimbabwe, research was carried out by ZIMRA between 2003 and 2005 to determine the profitability of urban public passenger transport enterprises.<sup>58</sup> A ZIMRA research team went around the country and collected data on the operations of the transport sector, which comprised of minibus taxis, taxicabs, driving schools and haulage trucks. The team investigated operational costs, turnover and profitability with a view to taxing these enterprises. Based on the results of this research, recommendations were made to the Ministry of Finance to effect presumptive taxes upon the informal transport sector.<sup>59</sup>

In November 2004 the Minister of Finance, in his Budget Estimates and Taxation Proposals for the 2005 Financial Year, referred to the following:

Mr. Speaker Sir, a significant number of small to medium scale businesses and those in the informal sector largely remain outside the tax system. In some instances, the income generated by this sector exceeds that earned by registered taxpayers. To broaden the tax base and uphold the principle of equity in taxation, it is desirable to bring income earned from this sector into the tax net. I propose implementation of presumptive taxation on selected sectors during the course of the year, through subsidiary legislation.<sup>60</sup>

Based on the research by ZIMRA and support from the Finance Minister, presumptive taxes were first implemented in 2005, although limited to the informal urban transport operators.<sup>61</sup> Other informal sector activities were later added to the presumptive tax schedule; these included hairdressing salons and cross-border traders in 2008, and cottage industry and bottle-store operators in 2009. Unlike the transport industry, no research was done by ZIMRA on the profitability of subsequently taxed operations and presumptive tax categories.<sup>62</sup> Despite being

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<sup>57</sup> Dube *Informal Sector Taxation: the case of Zimbabwe* 97-99.

<sup>58</sup> Dube & Casale *The Implementation of Informal Sector Taxation: Evidence From Selected African Countries* (2016) 612.

<sup>59</sup> Dube *Informal Sector Taxation: the case of Zimbabwe* (2014).

<sup>60</sup> Zimbabwe The 2005 National Budget Statement (2004).

<sup>61</sup> Dube & Casale *The Implementation of Informal Sector Taxation: Evidence from Selected African Countries* 612.

<sup>62</sup> *Ibid.*

in operation for over a decade, the presumptive tax system in Zimbabwe has remained largely unexamined.<sup>63</sup>

## 2.4 Presumptive taxes

Central to the idea of presumption is the notion of potential taxability, as something capable of determination independently of self-declaration by the taxable entity, on the basis of presumptive norms.<sup>64</sup> The presumptive approach improves the technological capability of the tax administration to handle large numbers of taxpayers without the self-defeating incremental cost of attempting to do so within the existing system. Scarce administrative resources are best deployed in the devising of presumptive norms applicable to those outside the tax net, whether because of failure to file, or under-declaration of incomes, which will survive tests of justice and fairness, rather than in the individual pursuit of each entity unbacked by guidelines.<sup>65</sup> Slemrod and Yitzhaki<sup>66</sup> agree that presumptive tax systems are common in most developing countries and are appropriate when the desired income cannot be objectively ascertained.

Presumptive taxes are therefore simplified taxes levied on presumed rather than actual income. Presumptions are based on turnover in cases where enterprise owners are expected to keep basic records of sales or indicators of income capacity, like the number of passengers a taxi can take.<sup>67</sup> In other cases, the presumption is just a standard lump sum assessment paid by all in a particular activity or occupation.<sup>68</sup> This system of tax uses presumptions or estimates of tax payable in dealing with income or activities that are hard to tax, like the informal sector. It is argued that presumptive tax is cost effective and simpler to administer and, therefore, it is a generally favoured way of taxing the informal sector.<sup>69</sup> Informal sector operators are not required to keep the detailed records necessary under the standard tax regime, and the revenue

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<sup>63</sup> G Dube D Casale "Informal sector taxes and equity: Evidence from presumptive taxation in Zimbabwe" (2017) *Development Policy Review* 37(1), 44-66.

<sup>64</sup> I Rajaraman K Singh "Report on Presumptive Direct Taxation" (1995) *National Institute of Public Finance and Policy New Delhi* 2.

<sup>65</sup> *Ibid.*

<sup>66</sup> J Slemrod and S Yitzhaki "Analyzing The Standard Deduction as a Presumptive Tax" (1994) *International Tax and Public Finance* 1(1):25-34.

<sup>67</sup> J Loeprick "Small Business Taxation : Reform to Encourage Formality and Firm Growth" (2009) *Investment Climate in Practice; No. 1. World Bank, Washington, DC. © World Bank. Available: <https://openknowledge.worldbank.org/handle/10986/1057> ."* [Accessed 18 September 2021]

<sup>68</sup> *Ibid.*

<sup>69</sup> *Ibid.*

authorities can avoid the costs associated with the conventional verification and assessment procedures.

Both developing and developed economies are constantly strategizing on ways to maximize revenue collections and the implementation of presumptive taxation system is one such strategy. In the case of Zimbabwe, ZIMRA concedes that presumptive tax legislation was introduced to broaden the revenue base in view of the increase in informal business activities.<sup>70</sup> Selected sectors of the economy were targeted to ensure the participation of informal businesses in tax payment in line with experiences of other developing countries. It is submitted that this decision, though largely criticised, was a positive foresight and action, given the economic decline that the country would face. It is recorded that in the few years that followed, the country's GDP decreased dramatically, the formal economy went into a shrinking spiral and the informal sector grew by the year.

Zimbabwean presumptive tax is levied in accordance with the Twenty-Sixth Schedule of the Income Tax Act (Chapter 23:06).<sup>71</sup> The section provides the following:

there is charged, levied and collected throughout Zimbabwe at the rate from time to time in the charging Act, a tax on the basis of the presumed income (commonly known as a "presumptive tax") of those persons engaging in any of the trades, occupations or undertakings.<sup>72</sup>

The presumptive tax is charged based on the presumed income of those persons engaging in any of the trades, occupations or undertakings listed under the presumptive tax schedule for tax purposes. The presumptive tax rates were last reviewed on 1 January 2017 and these are payable monthly.<sup>73</sup> Details relating to the current presumptive tax schedule, rates and due dates of the various categories of presumptive tax are published on the ZIMRA website. There are eight categories of presumptive tax; these are Transport Operators' Presumptive Tax, Hairdressing Salon Operators' Presumptive Tax, Informal Traders' Presumptive Tax, Small-

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<sup>70</sup> ZIMRA "Presumptive Tax" (2017). Available: <https://www.zimra.co.zw/domestic-taxes/presumptive-tax> [Accessed 25 September 2017].

<sup>71</sup> ZIMRA "Presumptive Tax: Taxman's Corner" (2018). Available: <https://www.zimra.co.zw/news/22-taxmans-corner/2127-presumptive-tax-2> [Accessed 23 October 2018].

<sup>72</sup> Income Tax Act (Chapter 23:06).

<sup>73</sup> *Ibid.*

Scale Miners' Presumptive Tax, Cross-Border Traders' Presumptive Tax, Operators of Restaurants or Bottle Stores' Presumptive Tax, Cottage Industry Operators' Presumptive Tax and Commercial Waterborne Vessels' Presumptive Tax.

#### **2.4.1 Methods used to determine the presumptive tax rate**

Diverse presumptive norms are employed in different places in deciding a presumptive tax rate. The methods to determine presumptive tax can be classified into four categories.<sup>74</sup> These are:

- methods that guess the taxpayer's income based on the nature of the business, staffing, assets and location;
- methods that use a computed return on business assets;
- methods that consider gross turnover, such as the French “forfeit”; or
- methods that assess the taxpayer's income on the basis of indicators such as personal expenditure or wealth.

The Israeli “tachshiv” and the French “forfeit” methods are more commonly used in developing countries.<sup>75</sup> Under the “forfeit” method, which originated in France, the determination of income is a matter of negotiation between the taxpayer and the tax inspector.<sup>76</sup> Upon agreement, the accepted amount applies for two years regardless of the taxpayer's actual income for the period.<sup>77</sup> Under the prescripts of this method, the taxpayer must supply information to the tax authorities regarding its purchases, sales, number of employees, and value of its inventory.

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<sup>74</sup> M Ayyagari B Thorsten and A Demirguc-Kunt “Small and Medium Enterprises Across the Globe: A New Database” (2005) *Policy Research Working Paper NO.3127*. World Bank, Washington DC. Available : <https://openknowledge.worldbank.org/handle/10986/18131License:CCBY3.0IGO> [Accessed 28 September 2017].

<sup>75</sup> R M Bird and S Wallace “Is It Really So Hard to Tax the Hard-to-Tax? The Context and Role of Presumptive Taxes” (2004) *Contributions to Economic Analysis* 268:121-158. Available: [https://www.researchgate.net/publication/235298696\\_Is\\_it\\_Really\\_so\\_Hard\\_to\\_Tax\\_the\\_Hard-to-Tax\\_The\\_Context\\_and\\_Role\\_of\\_Presumptive\\_Taxes](https://www.researchgate.net/publication/235298696_Is_it_Really_so_Hard_to_Tax_the_Hard-to-Tax_The_Context_and_Role_of_Presumptive_Taxes) [Accessed 5 November 2017].

<sup>76</sup> V Thuronyi *Presumptive Taxation: Tax Law Design and Drafting* (1996) Washington, International Monetary Fund 71-94.

<sup>77</sup> *Ibid.*

The “tachshiv” method, which originated in Israel, is based on various ascertainable factors to be taxed, which are found in the specific industry, and the objective is to determine net profit.<sup>78</sup> For example, a restaurant may be taxed on the basis of location, number of seats, and average price of items on the menu. The “tachshiv” does involve an element of agreement between taxpayers and the tax authorities, but the agreement is on the “tachshiv” in general (being negotiated with industry representatives), not on its application to specific taxpayers.<sup>79</sup>

The Zimbabwean presumptive tax system is very similar to the Israeli “tachshiv”, where the rates are pre-determined and fixed.<sup>80</sup> The method is explained as a complex calculation using information on sales, employees, assets and location.<sup>81</sup> For example, an assumed gross income of \$9,000 per quarter was ascribed to operators of bottle stores, restaurants and cottage industries and 60% of this figure was estimated to cover operational costs and the remainder was considered to be profit. Using the complex formula, the presumptive tax payable was set at \$300 per quarter for bottle stores and restaurants.<sup>82</sup>

## **2.5 Tax compliance and challenges in fulfilling tax obligations**

Although many positive attributes can be associated with the character of presumptive tax, its introduction in Zimbabwe has not to date achieved intended targets. In a revenue performance report published in 2017, Mrs Bonyongwe the ZIMRA Board Chairperson pleaded that the “informal” economic players should comply with the country’s tax laws.<sup>83</sup> The report noted that presumptive tax compliance was low. In a bid to show that compliance was not subject to incapacity to pay but rather simple evasion, as was indicated above, the lavish lifestyles, characterised by various state-of-the-art residential properties, expensive vehicles and the apparent high spending power of the Zimbabwean people on luxurious and high-end consumer goods and services, mostly imported without paying taxes, were identified as proof of this.<sup>84</sup>

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<sup>78</sup> V Thuronyi *Presumptive Taxation: Tax Law Design and Drafting* (1996) Washington, International Monetary Fund 71-94.

<sup>79</sup> *Ibid.*

<sup>80</sup> S Kamutanho “The Effectiveness of Zimbabwe’s Presumptive Tax Regime on Informal and Small Businesses” (2016). Available: <https://vdocuments.net/2016-atrn-annual-congress-home-ataf-18-2016-atrn-annual-congress-the.html> [Accessed 10 October August 2017].

<sup>81</sup> O Zivanai, F Chari and C Nyakurimwa *Tax Compliance Challenges in Fulfilling Tax Obligations among SMEs in Zimbabwe: A Survey of SMEs in Bindura* (2015) *International Journal of Science & Engineering Research*, Vol7, Issue 2, 1547 .

<sup>82</sup> *Ibid.*

<sup>83</sup> *Bonyongwe Revenue Performance Report for the Quarter Ended 30 September* (2017).

<sup>84</sup> *Ibid.*

The Institute of Certified Tax Accountants in Zimbabwe presented interesting statistics in 2011. These are reflected in the table below:

**Table 1.1: Tax heads, contribution to revenue, financial year 2011**

Tax head	Actual % contribution	Expected contribution to GDP
Value-Added Tax (VAT)	39	40%
Customs Duties (Duty)	26	
Individuals (PAYE)	15	
Non-tax revenue	6	
Companies	4	
Presumptive and other taxes	3	60%

Source: The Institute of Certified Tax Accountants in Zimbabwe, 2011

The table reflects that whilst presumptive and other taxes are expected to contribute 60% towards the GDP, in 2011 only a 3% contribution was realised. In a revenue performance report for the year ended 31 December 2017, Mrs Bonyongwe notes that the Presumptive Tax reflected reduced rates in the 2017 National Budget.<sup>85</sup> She admits that this sector, which is dominated by informal traders, remains challenged by low taxpayer compliance.<sup>86</sup> Considering the fact that presumptive tax has been operative in Zimbabwe for more than a decade, this prompts the question: Which areas need improvement for increased compliance?

Presumptive taxes are generally usually favoured for their administrative simplicity and economic efficiency.<sup>87</sup> They are regarded as simpler to administer than direct taxes on income as informal sector operators are not required to keep the detailed records necessary under the standard tax regime, and the authorities can avoid the costs associated with the conventional verification and assessment procedures.<sup>88</sup> While the present research appreciates these administrative advantages of presumptive tax, these did not immediately translate into successfully taxing the informal sector in Zimbabwe. Numerous challenges have been faced

<sup>85</sup> *Bonyongwe Revenue Performance Report for the Quarter Ended 30 September (2017)*.

<sup>86</sup> *Ibid.*

<sup>87</sup> *Terkper Managing Small and Medium-Size Taxpayers in Developing Economies (2003)*.

<sup>88</sup> *Loeprick Small Business Taxation: Reform to Encourage Formality and Firm Growth, Investment Climate in Practice: Business Taxation (2009) 2*.

by ZIMRA in trying to collect presumptive tax in Zimbabwe. Dube notes that resource constraints within ZIMRA, corruption, selective application of regulations and high tax amounts in some categories in relation to earnings, have made administration of presumptive tax difficult.<sup>89</sup> All these factors affect the tax morale of informal sector operators in one way or another. The result is little interest in compliance and, in some cases, evasion.

## 2.6 Tax morale

Tax morale is discussed in the tax compliance literature, but it is usually mentioned as a residual explanation without referring to the factors that shape tax morale. This research postulates that challenges in presumptive tax compliance cannot be adequately examined without considering the morale of the Zimbabwean taxpayer. Research by the Organisation for Economic Co-operation and Development (OECD) shows a significant correlation between tax morale and tax compliance in both developing and developed countries.<sup>90</sup> It therefore seems that tax morale may be a key determinant in enhancing tax compliance. In the case of Zimbabwe, a range of socioeconomic and institutional factors influence people's willingness to pay presumptive taxes. Certain of these, which are thought to be critical factors and need urgent attention if tax morale is to positively change, are discussed below.

### 2.6.1 Trust in government

Citizens are more likely to perceive tax obligations more favourably when their government is seen to be acting in a trustworthy manner.<sup>91</sup> A government seen to be making good use of tax revenue (among other factors) is associated with higher levels of trust and tax morale.<sup>92</sup> Informal sector operators in Zimbabwe are, however, not satisfied with the way tax revenues are used by the Zimbabwean government.<sup>93</sup> The general perception is that there is little or no benefit from paying tax. Transport operators, for example, pay toll fees but the roads continue to be in a poor state across the country.<sup>94</sup> The newly elected President (August 2018) and his

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<sup>89</sup> Dube & Casale *The Implementation of Informal Sector Taxation: Evidence from Selected African Countries* 613-614.

<sup>90</sup> OECD *What Drives Tax Morale?* (2013) *Tax and Development*. Available : <https://www.oecd.org/tax/tax-global/what-drives-tax-morale.pdf> [Accessed 24 November 2017].

<sup>91</sup> *Ibid.*

<sup>92</sup> *Ibid.*

<sup>93</sup> Dube *Informal Sector Taxation: the case of Zimbabwe* 107-108.

<sup>94</sup> *Ibid.*

government is faced with this reality. There is a need to awaken the taxpayer's confidence in the government's priorities in relation to expenditure. Further, increased efforts to clarify the benefits from taxes in relation to expenditures can positively influence tax morale.

## 2.6.2 Corruption

The OECD acknowledges that there is a relationship between tax morale and the perception of corruption.<sup>95</sup> Further, tax evasion is associated with perceptions of corruption in public institutions, whilst higher levels of tax morale are reported when corruption is (perceived to be) controlled.<sup>96</sup>

Corruption is commonplace within ZIMRA and the nation's police force (which assists ZIMRA in collecting taxes from the informal sector).<sup>97</sup> In 2010 the Zimbabwe Republic Police (traffic police in particular) was found to be the most corrupt in the Southern Africa Development Community region.<sup>98</sup> Corruption usually occurs in two different forms, mainly bribes and extortion.<sup>99</sup> Bribes occur when ZIMRA officials and police officers accept either cash or gifts for not enforcing tax regulations, while extortion happens where the taxpayer is coerced into paying a bribe.

An important factor that perpetuates bribes is high tax amounts. A taxpayer is more comfortable with evading tax knowing that when caught they will be only "liable" for a bribe.<sup>100</sup> Even where a person endeavours to pay presumptive tax as required, the collecting officers find other problems that would warrant a fine of some sort to elicit a bribe.<sup>101</sup> This form of extortion also defeats the object of showing good citizenry by paying for tax.

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<sup>95</sup> OECD "What Drives Tax Morale?" (2013).

<sup>96</sup> *Ibid.*

<sup>97</sup> Dube *Informal Sector Taxation: the case of Zimbabwe* 107.

<sup>98</sup> Anti-Corruption Trust of Southern Africa "Corruption by Traffic Police Officers and Vehicle Drivers in Botswana, Namibia and Zimbabwe - Mini-assessment report" (2010). Available : [http://www.kubatana.net/docs/demgg/act-sa\\_traffic\\_police\\_corruption\\_101111.pdf](http://www.kubatana.net/docs/demgg/act-sa_traffic_police_corruption_101111.pdf) [Accessed: 28 December 2017]

<sup>99</sup> Dube *Informal Sector Taxation: the case of Zimbabwe* (2014).

<sup>100</sup> Dube & Casale *Informal sector taxes and equity: Evidence from presumptive taxation in Zimbabwe* 59-60.

<sup>101</sup> *Ibid.*

The state of corruption contributes negatively to the taxpayers' morale. There is great need to campaign against corruption and restore taxpayer's confidence in public institutions. Corruption must be (perceived to be) controlled before high tax morale can be achieved.

### 2.6.3 High tax amounts

There is wide dissatisfaction with the presumptive tax rates.<sup>102</sup> Taxpayers are of the belief that ZIMRA did not conduct enough research and consultation before deciding on tax rates.<sup>103</sup> An example of an issue in contention would be the fact that ZIMRA expects a hair salon on the outskirts of town to pay the same rate of tax as a hair salon in the central business district. This uniform presumptive tax takes no consideration of the vicinity in which the business operates and the type of clientele and charge that a salon can attract. Where the taxpayer believes that there is disconnect between amounts charged and earnings, the taxpayer is most likely not to comply with the tax imposed.

The bid to tax the informal sector in Zimbabwe began with research on the subject by ZIMRA from 2003 to 2005. Research, coupled with consultation, was important for establishing the potential of taxability and ultimately identifying a justifiable tax rate for presumptive tax.<sup>104</sup> An important factor for tax compliance is that the taxpayer should believe in the processes that gave rise to the tax obligation. Although ZIMRA had done research on the subject of informal sector taxation, there is not enough evidence of consultation with parties of interest throughout the whole process.<sup>105</sup> The majority of informal traders complained about not being consulted in the determination process of tax rates.<sup>106</sup> Insufficient research and consultation can easily lead to high tax liabilities and a probable response to this would be non-compliance by the taxpayer.

In September 2005, Kudzai Chawafambira, writing for the Herald, reported that the Zimbabwe National Chamber of Commerce had hosted a seminar on presumptive taxation for the

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<sup>102</sup> B Utaumire E Mashiri and K Mazhindu "Effectiveness of Presumptive Tax System in Zimbabwe: Case of ZIMRA Region One" (2013) *Research Journal of Finance and Accounting* vol. 4 No.7 ISSN 2222-2847. Available : <https://www.iiste.org/Journals/index.php/RJFA/article/view/6284/6646> [Accessed 3 February 2018]

<sup>103</sup> *Ibid.*

<sup>104</sup> Rajaraman & Singh *Report on Presumptive Direct Taxation: National Institute of Public Finance and Policy New Delhi* (1995).

<sup>105</sup> Dube & Casale *The Implementation of Informal Sector Taxation: Evidence from Selected African Countries* 614.

<sup>106</sup> Utaumire, Mashiri & Mazhindu *Effectiveness of Presumptive Tax System in Zimbabwe: Case of ZIMRA Region One* 117-118.

commuter transport operators and small-scale miners, where the parties present expressed disgruntlement at the lack of adequate consultations before the introduction of presumptive tax.<sup>107</sup> He also recorded that the chairperson of the Commuter Omnibus Operators' Association of Zimbabwe (at that time), Mr Tererai Katema, said that thorough consultations should have been held to ensure that everyone played a part in the decision-making process.<sup>108</sup> Concerns raised by the Chairman of the Zimbabwe National Chamber of Commerce are an indicator of how members of this Association would respond to tax levied.

Dube records that despite the displeasure with the inadequate amount of research and consultation during the period of 2003 to 2005, no research was done by ZIMRA on the profitability of subsequently taxed categories of informal sector activities in 2009.<sup>109</sup> The validity of the indicators used to propose tax rate without adequate research on the potential of taxability can be questioned. Whilst research had been carried out in the period from 2003 to 2005, it is accepted that different categories of informal sector activities demand diverse unique research and consultation mechanisms to ensure a justifiable tax rate. The absence of this has the potential to lead to high tax liabilities that are prone to be met with non-compliance by taxpayers.

Another important issue under the topic of high tax is the “dollarisation” of Zimbabwe.<sup>110</sup> When presumptive taxes were introduced in 2005, Zimbabwe was using the Zimbabwean dollar as the currency. As a result of high inflation, the country changed to the use of the United States Dollar as currency. It is noteworthy that 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 tax rates that many sectors felt were not feasible.<sup>111</sup> Although currency is not the focal point of this research, this omission by the Minister may help to explain high tax rates and non-compliance.

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<sup>107</sup> K Chawafambira Zimbabwe: Operators Grumble Over Presumptive Tax (2005) The Herald, 23 September 2005. Available: <https://allafrica.com/stories/200509230244.html> [Accessed 8 March 2018].

<sup>108</sup> Available: <https://allafrica.com/stories/200509230244.html> [Accessed 8 March 2018].

<sup>109</sup> Dube & Casale *The Implementation of Informal Sector Taxation: Evidence from Selected African Countries* 612.

<sup>110</sup> Dube *Informal Sector Taxation: the case of Zimbabwe* 126.

<sup>111</sup> *Ibid.*

There is clearly an important relationship between high tax rates and low tax morale. While it can be argued that ZIMRA has not performed well in consultations and setting justifiable rates, it is submitted that this provides a great opportunity for progressive collaboration going forward. ZIMRA has the opportunity to reach out to representative associations of various informal sector activities. These include (but are not limited to) the Home Industries Association, Cross Border Traders Association, Commuter Omnibus Association and the Vendors Association of Zimbabwe.

There is a need to constantly review the presumptive tax rates; while recognising the constantly changing socio-economic climate in the country. Tax morale, together with compliance, can be improved where this is done in continuous consultation with stakeholders.

### **3.3.3 Ceding control to local government**

Collaborative action between the state and informal sector player is important but a question remains whether national revenue authorities are likely to have the capacity and interest to engage in negotiating with these collective actors.<sup>112</sup> In a context where the informal sector is not well organised, often with several rival associations, negotiation implies understanding and interacting with several small collective actors with diverse interests and this this might prove to be difficult in practice.<sup>113</sup> In response, decentralization of tax administrative responsibilities to sub-national government has been appreciated as a viable reform towards taxing the informal sector.<sup>114</sup>

Bodin and Koukpaizan extensively explore this option, suggesting four benefits that may be drawn from this approach.<sup>115</sup> The benefits include the following:

local governments have a greater need of resources, and will have stronger incentives to pursue taxation in the informal economy; tax collection will be closer to, and thus responsive to, local conditions; local governments are better placed to negotiate productively with informal sector actors, and respond by supplying relevant services; and

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<sup>112</sup> Joshi, Prichard and Heady *Taxing the Informal Economy: Challenges, Possibilities and Remaining* 27-28.

<sup>113</sup> *Ibid.*

<sup>114</sup> Joshi, Prichard and Heady *Taxing the Informal Economy: The Current State of Knowledge and Agendas for Future Research* 1338.

<sup>115</sup> Joshi, Prichard and Heady *Taxing the Informal Economy: Challenges, Possibilities and Remaining* 20.

it may encourage greater coherence, as there are, at present, frequently large and harmful overlaps between taxes levied by different levels of government.<sup>116</sup>

These advantages are indicative of opportunities in following this route but this approach is likely to face challenges if there are capacity constraints within local authorities, many of which are perceived as “highly corrupt”.<sup>117</sup>

In Cameroon, the national revenue authority does not have a vested interest in collecting informal sector tax because of the perceived low revenue potential. This has led to talks of ceding control to local government. Local mayors were keen to take on this responsibility with some of them demanding the application of this strategy as *modus operandi*.<sup>118</sup> Ethiopia presents another example where this administrative strategy has been adopted. The small businesses were subjected to presumptive tax and the administration and control of tax collection was ceded to regional governments rather than the federal state. In a bid to legitimise the process and ensure fairness of the system, the regional government included business representatives on the tax assessment committees.<sup>119</sup> This led to public engagement and small business taxation developed to be an important topic during the contested 2005 elections, showing the potential benefits of bringing the informal sector taxation closer to revenue authorities.<sup>120</sup>

### 3.6.4 Education and awareness

Research by Utaumire in 2013 revealed that many informal sector operators do not know about presumptive taxes.<sup>121</sup> Dube confirmed this with evidence gathered through interviews in 2014.<sup>122</sup> Both studies acknowledged that, while informal sector operators seem to know about taxes in general, they did not know about presumptive taxes. While the common saying that

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<sup>116</sup> Joshi, Prichard and Heady *Taxing the Informal Economy: The Current State of Knowledge and Agendas for Future Research* 1340.

<sup>117</sup> OH Fjeldstad, F Henjewe, G Mwambe, E Ngalewa and K Nygaard “Local Government Finances and Financial Management in Tanzania” (2004) *CMI Working Paper: Special Paper No.16*.

<sup>118</sup> Joshi, Prichard and Heady *Taxing the Informal Economy: The Current State of Knowledge and Agendas for Future Research* 1341.

<sup>119</sup> *Ibid.*

<sup>120</sup> *Ibid.*

<sup>121</sup> Utaumire, Mashiri & *Mazhindu Effectiveness of Presumptive Tax System in Zimbabwe: Case of ZIMRA Region One* 114.

<sup>122</sup> Dube *Informal Sector Taxation: the case of Zimbabwe* 149.

“ignorance is no defence” is acknowledged, it remains a fact that a person is less likely to comply with an obligation that they do not know about. It is therefore a correct assertion that tax awareness or the lack thereof is a contributing factor to low tax morale and compliance in Zimbabwe.

In response to the suggestion of lack of awareness of presumptive taxes, a ZIMRA respondent said that the Revenue Authority convened stakeholder meetings to which the informal sector associations were invited.<sup>123</sup> The respondent continued:

We have launched educational campaigns, which have involved all stakeholders. There has also been an awareness campaign through our ‘Did you know’ column in the media. There have been workshops to educate informal traders, we have also placed adverts and written some newspaper articles on presumptive taxes.<sup>124</sup>

The question should never be how much work has been done to educate the population, but rather whether efforts have produced the desired result; whether methods used are effective enough to get a general saloon owner in the outskirts of the city well informed about his or her obligations with regard to presumptive tax. Where informal sector operators continue to be ignorant, ZIMRA needs to rethink their awareness strategy.

Recommendations have been made that ZIMRA intensifies presumptive tax awareness campaigns at “grassroots” level.<sup>125</sup> Whilst seminars and newspaper articles are a good way of communication, these seem not to be getting the word to the important people at this level. Tax workshops mostly attract those who are in close proximity to the workshop venue, the majority of whom are already paying taxes.<sup>126</sup> Newspaper articles, on the other hand, are difficult to evaluate regarding their reach. Not everyone who buys the newspaper is an informal operator and more importantly not everyone that buys the paper will read the “did you know” section.

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<sup>123</sup> Dube *Informal Sector Taxation: the case of Zimbabwe* 149.

<sup>124</sup> *Ibid.*

<sup>125</sup> Zivanai, Manyani, Hove, Chiriseri & Mudzura *The Effectiveness of Presumptive Tax and Its Impact On Profitability of SMEs in Zimbabwe. Case of Commuter Transport Operators in Bindura* 1554.

<sup>126</sup> Utaumire, Mashiri & Mazhindu *Effectiveness of Presumptive Tax System in Zimbabwe: Case of ZIMRA Region One* 117.

Education and awareness should also broadly focus on why the informal economy should pay taxes like any other formally employed person.<sup>127</sup> Emphasis has been placed on the obligation to pay tax, but informal sector operators seem not to understand why they are requested to pay tax.<sup>128</sup> There is a strong perception in Zimbabwe that those in the informal sector (even the relatively prosperous ones) do not have “proper” jobs and therefore should not be subject to tax.<sup>129</sup> The need to raise revenues for government expenditure is a legitimate function of governments and the public needs to know and understand how they fit into this agenda.

Education and awareness campaigns have the necessary capacity to increase tax morale amongst informal sector operators. Whilst there is evidence of efforts being made in awareness campaigns, ZIMRA needs to do more to ensure that the presumptive tax obligation is known and understood, producing the desired response in tax morale and compliance.

### **2.6.5 Fairness and equity**

Presumptive assessment methods are designed as administrative expedients, but they can also be used to promote efficiency and the equity goal of compliance.<sup>130</sup> Presumptive tax is not accurate, but is a feasible way to tax the hard-to-tax groups like the informal sector thereby bringing equity between those in the formal sector and those in the informal sector. Whilst this is true, it is justifiable to question how fairness can be measured where presumptive taxes are not accurate.

A tax is considered to be fair if individuals at the same economic level incur the same tax burden (horizontal equity) while those with a greater ability to pay contribute more to the *fiscus* (vertical equity).<sup>131</sup> Presumptive taxes may violate the principle of horizontal equity because they tend not to have tax-free minimum income thresholds, as is the case with most personal/individual income tax regimes.<sup>132</sup> This means that the informal sector may bear a higher tax burden than their counterparts in the formal sector who are exempted from taxation

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<sup>127</sup> *Ibid.*

<sup>128</sup> Dube *Informal Sector Taxation: the case of Zimbabwe* 135.

<sup>129</sup> *Ibid.*

<sup>130</sup> L Kayaga *Tax Policy Challenges facing Developing Countries. A case study of Uganda* (Master's Thesis: Queen's University, 2007).

<sup>131</sup> Dube & Casale *Informal sector taxes and equity: Evidence from presumptive taxation in Zimbabwe* 50.

<sup>132</sup> *Ibid.*

at low incomes.<sup>133</sup> Furthermore, where the same tax liability in amount is expected from people at different income levels, the principle of vertical equity is violated.<sup>134</sup> The informal sector is characterised with low and often variable incomes and where this fact is overlooked, the principle of equity and fairness is under threat.

To show how vertical equity is violated, a few examples from the presumptive tax schedule as published on the ZIMRA website can be used. Omnibuses that transport 8 to 14 people are required to pay presumptive tax that amounts to \$150 per quarter for each vehicle or \$40 per month.<sup>135</sup> The set presumptive tax does not take into consideration geographic location, route embarked on and ultimately income margins in different areas of operation within this same category. In the case of salon presumptive tax, every operator of a hairdressing salon is required to pay presumptive tax amounting to US\$10.00 per chair per month. Again, no consideration is given to geographic location, type of clientele and income margins. This trend is seen throughout the different taxed categories.

While it is appreciated that an advantage of presumptive taxes is that they are simplified taxes levied on presumed rather than actual income, a few disadvantages can be cited in relation to equity. Where ZIMRA fails to adequately consider the impact of geographical location on income and the ability to pay set tax, it is most likely that those earning less feel that the tax imposed is not fair and this directly affects their attitude to compliance. Operators in the same informal sector category are more likely to get more income and profit when located in the city than those located in the outskirts. Expecting the two to pay the same presumptive tax amount does not reflect equity and fairness and will have an impact on tax morale.

Guevara proposes the “Equities and Exchange” theory that is based on the assumptions that taxpayers are rational and self-centered and that they assess justice in terms of proportionality of output to inputs between the parties to an exchange transaction.<sup>136</sup> The theory proposes that the taxpayer is less compliant and would evade tax if he or she perceives inequity in taxation, and is compliant if he or she perceives equity. ZIMRA should re-evaluate the need for equity to elicit the perceptions of fairness if significant compliance is to be realised.

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<sup>133</sup> *Ibid.*

<sup>134</sup> *Ibid.*

<sup>135</sup> ZIMRA “Presumptive Tax” (2017). Available: <https://www.zimra.co.zw/domestic-taxes/presumptive-tax> [Accessed 25 September 2017].

<sup>136</sup> M Guevara Designing Presumptive Tax regimes (2008).

## 2.6.6 ZIMRA's workforce and enforcement

Another factor that is connected to low tax morale levels in response to presumptive tax is ZIMRA's low workforce levels. ZIMRA has offices that specifically deal with large taxpayers who make up the bulk of tax payments, however, it does not have a dedicated office for the small taxpayers.<sup>137</sup> The result of this is that large taxpayers, those who generate higher revenues, enjoy priority in terms of tax compliance monitoring, education and support services.<sup>138</sup> Where compliance monitoring, education and support services are low, tax morale is more likely to be low.

ZIMRA's main method of monitoring presumptive tax compliance is through occasionally raiding known informal sector establishments such as flea markets and hairdressing salons.<sup>139</sup> Raids on driving schools, taxis and minibus taxis are conducted at roadblocks, which are mounted in collaboration with traffic police.<sup>140</sup> The objective of these raids is to monitor compliance and issue penalties (fines) in cases of non-compliance. In some extreme cases relating to flea market operators, ZIMRA confiscates goods when they encounter non-compliance, a tactic regarded as not fair by many.<sup>141</sup>

Random occasional raids might seem to be an effective way to elicit compliance in a context where there is shortage of staff, but results suggest otherwise. These raids are labelled as confrontational and coercive in nature.<sup>142</sup> This breeds a hostile environment characterised by low tax morale and no tangible revenue collection. Officers deployed on raids usually have very little to show for their efforts.<sup>143</sup> Whilst raids work to a certain extent, their major disadvantage is that informal sector operators perceive them as a battleground, rather than an opportunity for compliance and contribution to the country's GDP. In this setting high tax morale is highly improbable.

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<sup>137</sup> Dube *The design and implementation of minibus taxi presumptive taxes* (2018).

<sup>138</sup> *Ibid.*

<sup>139</sup> *Ibid.*

<sup>140</sup> Dube *Informal Sector Tax Administration in Zimbabwe* (2014).

<sup>141</sup> *Ibid.*

<sup>142</sup> *Ibid.*

<sup>143</sup> M Guevara *Designing Presumptive Tax regimes* (2008).

The low workforce number also means that these raids cannot be carried out on every informal sector operator taxed under the presumptive tax schedule. When raiding, it is known that ZIMRA targets known and “easy to tax” informal sector establishments such as flea markets and hairdressing salons.<sup>144</sup> The results of Dube’s study indicate that most informal sector operators (especially those operating cottage industries) have never experienced these raids, in spite of having operated for more than two years.<sup>145</sup> This directly feeds into the perception of fairness as discussed above, which negatively affects tax morale.

### **2.6.7 ZIMRA’s attitude**

Another factor that has the potential to affect tax morale is the perceived attitude of ZIMRA to collecting presumptive tax. Although there is consensus regarding the hidden revenue potential in taxing the informal sector, most ZIMRA officials feel that focusing on this would be a waste of scarce resources.<sup>146</sup> A ZIMRA informant was recorded as having said the following: “We dispatched a team of officers to Mupedzanhamo (flea market) for the whole week but they collected little revenue. Informal sector taxation sucks.”<sup>147</sup>

It seems that ZIMRA collecting officials have a negative attitude towards collecting presumptive tax. The attitude may be related to countless efforts, with little success, in collecting presumptive tax revenue. It is easier to collect (at the border) a presumptive tax equal to 10% of the value for duty purposes (VDP) on all cross-border traders who import commercial goods into Zimbabwe, whereas taxes that require the commitment of scarce resources, such as staff, are implemented with less enthusiasm.<sup>148</sup>

Informal sector operators, ZIMRA informants and newspaper articles seem to indicate that the initial enthusiasm for enforcing presumptive tax regulations shown by ZIMRA in 2009 seems to have died down.<sup>149</sup> Lack of enthusiasm amongst ZIMRA officials will directly affect the tax morale amongst the general informal sector operators. ZIMRA should be perceived to believe that taxing the informal sector is an attainable goal and further acting upon this belief. There is

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<sup>144</sup> Dube *Informal Sector Tax Administration in Zimbabwe* 56-57.

<sup>145</sup> *Ibid.*

<sup>146</sup> *Ibid.*

<sup>147</sup> *Ibid.*

<sup>148</sup> *Ibid.*

<sup>149</sup> *Ibid.*

a need for ZIMRA to reignite a positive attitude towards the collection of presumptive tax as this has an impact on the attitude of the taxpayers.

## **2.7 Conclusion**

Tax revenues provide governments with the funds they need to invest in development, relieve poverty, deliver public services and build the physical and social infrastructure for long-term growth. This chapter established that presumptive tax was introduced in a bid to broaden the Zimbabwean tax base. This was a reasonable stance given the economic background against which presumptive tax was introduced in Zimbabwe. Further, despite the time lapse since the introduction of presumptive tax, challenges in the collection of the tax have been a reality. Presumptive tax compliance has been low and ZIMRA is convinced that non-compliance is not a result of incapacity to pay but rather simple evasion. Further, that the lavish lifestyles and apparent high spending power of the Zimbabwean people on luxurious and high-end consumer goods is indicative of the ability to pay. In the view of this, the research investigated the factors that contribute to tax evasion and non-compliance, and revealed evidence of low tax morale amongst the informal sector populace, and various factors were cited in this regard. These are summarised in the paragraph below.

The informal sector does not trust the government to put the revenue collected to good use and therefore sees no benefit in paying tax. Corruption does not help the situation as bribery and extortion perpetuates tax evasion. The levying of unacceptably high tax amounts due to inadequate research and consultation has also contributed to low tax morale. The chapter also found that the informal sector business people are not aware of the presumptive taxes or the obligations that arise, and this is due to inadequate education and awareness campaigns. The lack of equity and fairness in the taxes were also identified as contributing to low tax morale and non-compliance – where blanket presumptive tax amounts are introduced in the absence of adequate considerations of the impact of the geographical location on income and the ability to pay the tax, taxpayers are likely to feel that tax amounts are unfair, which contributes towards low tax morale. ZIMRA's low workforce levels are probably linked to low tax morale. With an inadequate workforce, the informal sector is neglected to an extent and the formal sector enjoys more attention because of its higher contribution towards the national fiscal. Lastly, it was established that ZIMRA officials have a negative attitude towards presumptive tax because they feel that chasing the informal sector is a waste of scarce resources. In the face of these

diverse challenges, presumptive tax is likely to fail. The challenge going forward is to develop innovative ways to address these challenges and instil high tax morale and compliance amongst the informal sector in Zimbabwe.

The next chapter will draw on the extensive body of knowledge and research, paying attention to new ideologies on how to strengthen informal sector taxation. It is appreciated that improving taxation of the informal economy will demand not only technically appropriate policy choices, about which much is known through literature, but also broader administrative and institutional reform strategies that can generate both greater tax morale amongst taxpayers and leadership among political and administrative actors.<sup>150</sup> Tanzania and Ghana are good examples in this area. In their quest to tax the informal sector within their respective jurisdictions, they employ innovative strategies to address major barriers to successful taxation. The intention is to learn from these innovative strategies, appreciating that there are ways to increase tax morale other than through coercion.

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<sup>150</sup> Joshi, Prichard and Heady *Taxing the Informal Economy: Challenges, Possibilities and Remaining Questions* (2013).

## **CHAPTER 3: EXAMPLES OF POLICY STRATEGY AND INNOVATIVE ADMINISTRATION OF INFORMAL SECTOR TAXATION**

### **3.1 Introduction**

Chapter two of the research focused on taxation of the informal sector in Zimbabwe. It was established that the Zimbabwean government introduced presumptive tax on selected informal sector activities. This was done in a bid to broaden the tax pool. It was further established that diverse challenges have been encountered in this journey and further that these have had a negative impact on tax morale and compliance.

This chapter will examine and review available literature on effective policy strategy and innovative administration of informal sector taxation employed by other developing countries in Africa. The goal is to learn from the available body of knowledge, paying particular attention to successfully implemented administrative strategies and their role in strengthening informal sector taxation.

### **3.2 Policy strategies for taxing the informal sector**

A lack of a clear taxing policy strategy, it is suggested, will often result in low success when implementing tax systems. The formulation of a tax strategy that is attractive for the taxpayer can easily translate into higher morale and tax compliance. This section of the research will draw on some of the popular policy strategies used to tax the informal sector. Although the research is more focused on the idea of strengthening the administration of informal sector taxes, it is important as a starting point to examine policy strategies that can be employed when taxing the informal sector.

There are three broad, but not mutually exclusive, main policy strategies in taxing the informal sector.<sup>151</sup> These can be listed as follows:

1. taxing indirectly through trade taxes;
2. expanding the reach of major formal sector taxes; and
3. developing specialised presumptive tax regimes.

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<sup>151</sup> A Joshi W Prichard and C J Heady "Taxing the Informal Economy: The Current State of Knowledge and Agendas for Future Research" (2014) *The Journal of Development Studies* 1325-1347.

It is accepted that all economies that have taxed the informal sector have used at least one of these policy strategies. These will be individually discussed below.

### 3.2.1 Indirect taxation of the informal sector

Indirect taxation of the informal sector entails taxing the goods and services that operators buy and sell.<sup>152</sup> This is mainly done through Value-Added Tax (VAT) and import and export duties.<sup>153</sup> Another indirect approach is the reliance on withholding taxes on transactions with informal firms, which are collected by formal firms or the government.<sup>154</sup> Withholding taxes provides an incentive to become formal because withheld payments can be credited against formal tax liabilities.

The most important source of indirect tax revenue in most developing countries is VAT. It is popular in most developing countries as a source of indirect tax and recent years have witnessed a broad shift from import tariffs to VAT.<sup>155</sup> This sudden interest in VAT has been credited to the fact that VAT is less economically distorting.<sup>156</sup> VAT has the potential to tax a wide range of activities and more importantly carries an inherent benefit in incentives for informal sector firms with actual or prospective dealings with formal sector firms to enter the formal tax system in order to claim tax credits.<sup>157</sup>

Indirect taxation is regarded as one of the simplest ways of dealing with the informal sector because operators are not themselves registered as taxpayers, but are nonetheless taxed by virtue of taxes paid on goods and services higher up and lower down the value chain.<sup>158</sup> It is perceived that this form of taxation incurs low compliance costs because the system does not require any active informal sector participation, such as filing tax returns.

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<sup>152</sup> A Joshi W Prichard and C J Heady "Taxing the Informal Economy: The Current State of Knowledge and Agendas for Future Research" (2014) *The Journal of Development Studies* 1325-1347.

<sup>153</sup> M Keen "Vat Attacks!" (2007) *CESifo (Center for Economic Studies and Ifo Institute) Institute for Fiscal Studies (IFS)*. Available at SSRN: <https://ssrn.com/abstract=1007891> [Accessed 19 April 2018].

<sup>154</sup> TC Kundt "Opportunities and Challenges for Taxing the Informal Economy and Subnational Taxation, K4D Emerging Issues Report" (2017) *Brighton, UK: Institute of Development Studies*. Available: <https://opendocs.ids.ac.uk/opendocs/handle/20.500.12413/13836> [Accessed 27 August 2018].

<sup>155</sup> Joshi, Prichard and Heady *Taxing the Informal Economy: The Current State of Knowledge and Agendas for Future Research* 1332.

<sup>156</sup> *Ibid.*

<sup>157</sup> *Ibid.*

<sup>158</sup> *Ibid.*

### 3.2.2 Expanding the reach of major formal sector taxes

Reliance on existing taxes on formal sector firms as a policy strategy for taxing the informal sector operators entails strengthening enforcement and compliance with formal taxes.<sup>159</sup> Authorities must be prepared to use resources towards controlling tax arrears and other offences. Various steps are taken to encourage informal operators to participate in formal tax and non-compliance is met with harsh punitive measures to discourage ignorance.<sup>160</sup>

While strengthening the enforcement of formal sector taxes may be appropriate for larger firms within the informal sector, for very small firms the administrative costs for the government are likely to be extremely high and present the risk of harassment and abuse.<sup>161</sup> The idea of spending scarce resources trying to monitor several taxpayers who contribute insignificant amounts to revenue is avoided by many developing countries. Many have set relatively high thresholds for both VAT and income taxes to exclude most small and micro businesses, which are instead captured by presumptive tax regimes.<sup>162</sup>

### 3.2.3 Developing specialised presumptive tax regimes

Presumptive taxes have been extensively discussed in the chapter two and there is no reason to discuss this policy strategy in detail in this chapter. Taxing informal sector operators is mainly hindered by high compliance costs for taxpayers and high costs of collection for tax administrations;<sup>163</sup> presumptive taxes are believed to sufficiently respond to these hindrances. It is appreciated that despite some administrative advantages, presumptive taxes also encounter challenges in their practical implementation.

Whilst the policy concept remains the same, presumptive tax regimes differ across countries in their specific features.<sup>164</sup> In Zimbabwe tax rates are fixed and pre-determined by a complex

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<sup>159</sup> Terkper *Managing Small and Medium-Size Taxpayers in Developing Economies* (2003).

<sup>160</sup> *Ibid.*

<sup>161</sup> Joshi Prichard and Heady *Taxing the Informal Economy: The Current State of Knowledge and Agendas for Future Research* 1.

<sup>162</sup> *Ibid.*

<sup>163</sup> Loeprick *Small Business Taxation: Reform to Encourage Formality and Firm Growth* 1.

<sup>164</sup> Joshi, Prichard and Heady *Taxing the Informal Economy: The Current State of Knowledge and Agendas for Future Research* 1333.

calculation that uses information on sales, employees, assets and location of the business.<sup>165</sup> Tanzania operates a scheme in which tax is a progressively increasing proportion of turnover, and those without adequate records pay a larger amount.<sup>166</sup> In Ghana, the government operates a flat rate turnover tax of 3 per cent for small firms to replace standard VAT, while micro businesses are covered by a tax stamp regime, of a fixed tax per quarter.<sup>167</sup> There is an important trade-off between simplicity and equity in the choice of presumptive systems.<sup>168</sup> In introducing a presumptive tax system to follow, countries should always be mindful of their unique contexts to ensure feasibility.

### 3.3 Recent innovations in reform

The subject of informal sector taxation has been tested over years. New research shows traces of “experimental reform efforts” in a bid to maximise the potential that lies in pursuing informal sector taxation.<sup>169</sup> These reforms are indicative of the potential range of strategies available to policy makers to increase tax morale and compliance. This comes with acceptance that whichever policy strategy is adopted by a tax administrator, some basic instruments to increase tax morale, deter evasion, and facilitate compliance are critical for strong compliance. A few of these are studied below.

#### 3.3.1 Segmentation of tax administration

Taxpayer segmentation is the practice of partitioning taxpayers into distinct groups for different treatment by the tax authorities (often on some measure of size).<sup>170</sup> One challenge noticed in the study of the Zimbabwean Revenue Authority’s efforts towards taxing the informal sector

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<sup>165</sup> Zivanai, Chari and Nyakurimwa *Tax Compliance Challenges in Fulfilling Tax Obligations Among SMEs in Zimbabwe: A Survey of SMEs in Bindura* (2015).

<sup>166</sup> Joshi, Prichard and Heady *Taxing the Informal Economy: The Current State of Knowledge and Agendas for Future Research* 1333.

<sup>167</sup> W Prichard “The politics of taxation and implications for accountability in Ghana 1981-2008” (2009). *Working paper series, 330. Brighton: IDS*. Available:

<https://opendocs.ids.ac.uk/opendocs/handle/20.500.12413/4162> [Accessed 2 February 2019].

<sup>168</sup> Joshi, Prichard and Heady *Taxing the Informal Economy: The Current State of Knowledge and Agendas for Future Research* 1333.

<sup>169</sup> *Ibid.*

<sup>170</sup> International Monetary Fund “Current Challenges in Revenue Mobilization: Improving Tax Compliance” (2015) *Policy Papers Vol. 2015: Issue 005*. Available:

[https://www.elibrary.imf.org/configurable/content/journals\\$002f007\\$002f2015\\$002f005\\$002f007.2015.issue-005-en.xml?t:ac=journals%24002f007%24002f2015%24002f005%24002f007.2015.issue-005-en.xml](https://www.elibrary.imf.org/configurable/content/journals$002f007$002f2015$002f005$002f007.2015.issue-005-en.xml?t:ac=journals%24002f007%24002f2015%24002f005%24002f007.2015.issue-005-en.xml) [Accessed 8 April 2019].

was the very fact that they did not have a department that specifically dealt with informal sector taxation. The result was that taxpayers who generate higher revenues, were given priority in terms of monitoring tax compliance, education and support services, whilst the informal sector is neglected to a degree.

Tax administrations need to be reorganised so as to strengthen compliance monitoring, taxpayer education and support services towards the informal sector. New research recognises segmental organisation of tax administration, with separate departments to deal with small, medium, and large firms, respectively, as a progressive reform and strategy to boost tax morale and compliance.<sup>171</sup>

Large, medium, small, and micro businesses offer very different revenue possibilities and compliance concerns. Enforcement efforts need to balance considerations in the treatment of different taxpayer types and a segmentation-based approach is well-suited to do this.<sup>172</sup> It allows services to be specifically tailored to the needs and realities of specific types of firms (including the informal economy), and this is more likely to boost tax morale amongst the informal sector. Tanzania took this approach, as part of a broader set of reforms targeted at micro and small firms since 2002;<sup>173</sup> in a later section the chapter will extensively investigate how this has worked for Tanzania.

### **3.3.2 Increased collaboration with informal sector associations**

Another reform that has received attention is that of increased collaboration between the state and diverse informal sector associations. The idea is to encourage increased partnership by establishing an environment of collective action, negotiation, and dialogue between the state and the informal sector associations.<sup>174</sup> Evidence in chapter two of this research indicated that informal sector associations felt side-lined from the taxing process. They openly criticise efforts of the state and this directly feeds into low tax morale and compliance.

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<sup>171</sup> Joshi, Prichard and Heady *Taxing the Informal Economy: The Current State of Knowledge and Agendas for Future Research* 1339.

<sup>172</sup> *Ibid.*

<sup>173</sup> *Ibid.*

<sup>174</sup> *Ibid.*

Collaborative administrative arrangements are more likely to increase consensus and trust between the state and informal sector operators. Ghana is a good case study on this subject and a detailed discussion will be presented, later in the chapter. In Ghana informal sector associations and unions collect taxes from their members and pass them on to the state.<sup>175</sup>

Informal sector associations already have a degree of legitimacy in the eyes of their members and this is an advantage that the state can exploit in a bid to raise morale. Another advantage that may be realised from this approach is reduced monitoring and collection costs, as much of this would be done by associations who should have some sort of membership record. Collaboration builds up a level of organisation and active citizenry and this is good for trust. As the famous African idiom says, “if you want to go fast, go alone but if you want to go far, go together.” The objective of this strategy is to build profitable relations with related stakeholders whilst ensuring long-lasting tax gains.

### 3.3.4 Tax farming

Tax farming has existed for a while, dating back to Roman times but recent research has highlighted its potential in successfully taxing the informal sector.<sup>176</sup> Under this system, the state transfers the right of collection to private individuals called tax farmers in exchange for a certain fee.<sup>177</sup> While this subject is not explored by many researchers, Katera and Ngalewa are of the view that privatisation of tax collection at the local government level in Tanzania led to greater and more predictable revenue collection.<sup>178</sup>

Research has also shown the disadvantages of this strategy. While privatisation provides clear incentives for the maximisation of tax collections in principle, its practical implementation has resulted in abuse and harassment of the taxpayer.<sup>179</sup> This leads to resentment and even rioting amongst taxpayers and this negates the idea of increased tax morale for higher tax compliance.

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<sup>175</sup> A Joshi & J Ayee “Associational taxation: A pathway into the informal sector?” In D. Brautigam, O. Fjeldstad, & M. Moore (Eds.), “Taxation and State-Building in Developing Countries: Capacity and Consent” (2009) 183-211. Cambridge: Cambridge University Press. Available: <https://www.cambridge.org/core/books/abs/taxation-and-state-building-in-developing-countries/associational-taxation-a-pathway-into-the-informal-sector/9DC2C70E3E841CEF269EC27E0FFE1626> [Accessed 7 July 2019].

<sup>176</sup> G Dube *Informal Sector Taxation: the case of Zimbabwe* (2014).

<sup>177</sup> The Great Soviet Encyclopaedia 3rd Edition (1970-1979) (2010).

<sup>178</sup> OH Fjeldstad L Katera and E Ngalewa *Outsourcing Revenue Collection to Private Agents: Experiences from Local Authorities in Tanzania* (2009) REPOA Special Paper No.28, p10.

<sup>179</sup> *Ibid.*

Further, the strategy does not encourage “negotiation, voluntary compliance, or more productive interaction between state and society”.<sup>180</sup>

### 3.3.5 Fostering a culture of engagement, transparency and service delivery

A good tax strategy should raise tax morale whilst inspiring voluntary tax compliance, and fostering a culture of engagement, transparency and service delivery is believed to be an effective administrative strategy in this regard. The importance of prioritising engagement, transparency and services in the design of tax administrative reforms is widely accepted in principle, but in practice the focus has shifted towards a narrower operational focus on quantitative indicators of administrative success like total revenue collection.<sup>181</sup>

Transparency can be achieved through explicit earmarking as a strategy.<sup>182</sup> This promotes stronger trust among taxpayers by delivering well-defined benefits or tax services.<sup>183</sup> A popularly cited example in this regard is that of Sierra Leone; Jibao and Prichard report that the Bo City Council raised tax morale and support for tax collection by prioritising transparency, outreach and equitable tax enforcement.<sup>184</sup> Information relating to revenue and expenditure was made public and revenue increases were linked to specific public expenditures.<sup>185</sup> Although this example exhibits reform primarily aimed at property taxation, it demonstrates administrative success in strengthening market and business taxation as a result of transparency in engagement, coupled with improvements in service delivery.

In a similar style, Guinea is recorded to have doubled its market tax collection by simply linking revenue to the construction of new market facilities.<sup>186</sup> These examples indicate that taxpayers

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<sup>180</sup> OH Fjeldstad L Katera and E Ngalewa *Outsourcing Revenue Collection to Private Agents: Experiences from Local Authorities in Tanzania* (2009) REPOA Special Paper No.28, p10.

<sup>181</sup> S Jibao & W Prichard “Rebuilding Local Government Finances After Conflict: Lessons from a Property Tax Reform Programme in PostConflict Sierra Leone” (2016) *The Journal of Development Studies*, 52:12, 1759-1775. Available: <https://www.tandfonline.com/doi/pdf/10.1080/00220388.2016.1153073?needAccess=true> [accessed 15 January 2022].

<sup>182</sup> Joshi, Prichard and Heady *Taxing the Informal Economy: The Current State of Knowledge and Agendas for Future Research* 1340.

<sup>183</sup> *Ibid.*

<sup>184</sup> Jibao & Prichard *Rebuilding Local Government Finances After Conflict: Lessons from a Property Tax Reform Programme in Post-Conflict Sierra Leone* 1170.

<sup>185</sup> *Ibid.*

<sup>186</sup> G Korsun P Meagher *Failure by Design? Fiscal Decentralization in West Africa* in M S Kimenyi P Meagher (eds) *Devolution and Development* (2004) Routledge.

are more likely to voluntarily comply with tax payment in an environment where there is engagement, transparency and clear service deliverables.

The disadvantages for the tax collector in this scenario are the fact that, whilst the strategy encourages tax morale on one side, it reduces budget flexibility on the other.<sup>187</sup> It also creates an expectation that taxes should function on a direct service delivery basis.<sup>188</sup>

The Gambia Revenue Authority decided to take a slightly different strategy through strengthening taxpayer services. In their quest for improved service delivery, the authority adopted a diverse range of measures aimed at improving the taxpayer's experience. Some of these measures included the decentralisation of tax offices, cost-effective tax tribunals, tax clinics to help with the filing of taxes, and a taxpayer education programme, that promote a culture of engagement between the Gambia Revenue authority and the taxpayer.<sup>189</sup> The impact of this strategy is not well articulated in research, however, the measures have the potential to create a well-established tax system that affords taxpayers easy access to relevant information and tax services. Taxpayers can also engage with their tax rights and obligations with ease.

Another strategy in this regard is for revenue authorities to actively foster the development of informal sector associations whilst cultivating effective platforms for negotiation and dialogue between the revenue authority and the associations.<sup>190</sup> This strategy is in line with the notion of increased collaboration with informal sector associations. The Rwanda Revenue Authority provides a perfect example of how this strategy would work. The revenue authority in this case worked with the Private Sector Federation, which is an umbrella organisation for all kinds of business. The main purpose of this relationship was to improve dialogue with smaller firms. The relationship allowed for the creation of platforms of engagement where the revenue authority developed an understanding of industry-related issues, such as profitability, constraints to growth, and service needs; while the Private Sector Federation sought to use the

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<sup>187</sup> Joshi, Prichard and Heady *Taxing the Informal Economy: The Current State of Knowledge and Agendas for Future Research* 1340.

<sup>188</sup> *Ibid.*

<sup>189</sup> *Ibid.*

<sup>190</sup> *Ibid.*

opportunity to understand taxpayer rights and obligations and filter them through to its members.<sup>191</sup>

### **3.4 The example of Tanzania and Ghana**

Increasing tax morale and compliance amongst the informal sector continually demands innovative strategies in policy and administration. Research shows clear scope for reform aimed at improving the effectiveness and equity of existing taxing practices. The present research is interested in Ghana and Tanzania because they have put some of the above-mentioned reforms into practice. It is therefore vital to investigate the practical implementation of these reforms and the effect on tax morale and compliance amongst the informal sector.

#### **3.4.1 Tanzania**

In a paper released by the International Monetary Fund (IMF), Tanzania was listed as having made “impressive advances” in tax reform and successful administrative implementation.<sup>192</sup> Major reforms of policy and administration have been undertaken over the past decade to address low revenue collection. The Tanzania Revenue Authority (TRA) led this agenda and were supported by development partners.<sup>193</sup> It is these reforms that interest the present research. The TRA is a central body tasked to assess and collect specified revenue, to administer and enforce the laws relating to such revenue, and to provide for related matters in the Tanzanian economy.<sup>194</sup> More directly relevant to this research, the TRA is responsible for dealing with the informal sector taxation in Tanzania. An integrated labour force Survey in Tanzania indicated that the informal sector was the second main employing sector after agriculture, employing 10.1% of the employed persons, followed by other private sectors with 8.6%, where agriculture employed 75.1%.<sup>195</sup>

In recognition of the potential of the informal sector, presumptive taxes were first introduced in 2001 as a way to bring the informal sector within the tax net.<sup>196</sup> Presumptive taxes were

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<sup>191</sup> Joshi, Prichard and Heady *Taxing the Informal Economy: The Current State of Knowledge and Agendas for Future Research* 1340.

<sup>192</sup> International Monetary Fund *Revenue Mobilisation in Developing Countries* (2011).

<sup>193</sup> *Ibid.*

<sup>194</sup> Tanzania Revenue Authority *Review of Informal Sector for Taxation Purposes First Draft Report* (2011).

<sup>195</sup> *Ibid.*

<sup>196</sup> *Ibid.*

levied on small individual traders with an annual business turnover of not more than an amount set by the state.<sup>197</sup> Informal traders were not required to maintain audited accounts but the system aimed to encourage basic record-keeping by levying higher rates on those with incomplete records.<sup>198</sup> Keeping audited records attracts lower taxes and this acts as an incentive for informal traders.

In a bid to strengthen the presumptive system and thus to expand the tax base and optimize tax revenue collection, the TRA introduced the BMS in 2005.<sup>199</sup> The basic objectives of BMS are to promote compliance and register all eligible small and medium scale enterprises within a particular business, sectoral or geographical area, capturing their correct level of economic activities and gathering valuable tax information.<sup>200</sup> 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.<sup>201</sup>

The BMS has been commended for assisting tax administration in improving tax collections and assuring quality assessments, while allowing revenue authorities to closely monitor the informal sector in order to fight tax evasion.<sup>202</sup> Under this system, trading areas are mapped and divided into blocks on the basis of geography, administrative boundaries or a few streets.<sup>203</sup> Each block is mandated to operate all tax functions of identification, registration, assessing and accounting for revenue collected.<sup>204</sup> A team of trained personnel with relevant skills to perform these functions is allocated to each block, subject to rotation after a certain length of stay in one block.<sup>205</sup> To measure performance, each block is allocated targets, which are measured against set time frames and benchmarks, and these are used to evaluate tax performance.<sup>206</sup>

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<sup>197</sup> Dube & Casale *The Implementation of Informal Sector Taxation: Evidence From Selected African Countries* 609.

<sup>198</sup> *Ibid.*

<sup>199</sup> Tanzania Revenue Authority *Review of Informal Sector for Taxation Purposes First Draft Report* (2011).

<sup>200</sup> *Ibid.*

<sup>201</sup> Dube & Casale *The Implementation of Informal Sector Taxation: Evidence From Selected African Countries* 610.

<sup>202</sup> Dube & Casale *The Implementation of Informal Sector Taxation: Evidence From Selected African Countries* 610.

<sup>203</sup> Joshi, Prichard & Heady *Taxing the Informal Economy: The Current State of Knowledge and Agendas for Future Research* 1339.

<sup>204</sup> *Ibid.*

<sup>205</sup> Tanzania Revenue Authority *Review of Informal Sector for Taxation Purposes First Draft Report* (2011).

<sup>206</sup> Tanzania Revenue Authority *Review of Informal Sector for Taxation Purposes First Draft Report* (2011).

As a reform measure, the BMS simplified the registration of traders, and brought non-filers and nonpayers into the tax net through closer monitoring and collaboration with local government authorities.<sup>207</sup> The reform also allowed for tax services that are more specifically tailored to the needs and realities of small firms. This made it easier to reach out to the “hard to tax” operations, whilst broadening the tax base in the process. The system has resulted in an increased number of informal businesses registering with the Tanzanian Tax Administration.<sup>208</sup> The Africa Tax Administration Forum applauded the BMS as a progressive reform, recommending its implementation in member countries.<sup>209</sup>

An important component of the BMS is the human resources needed to make it happen. The TRA has made concerted efforts to develop the necessary human resources to administer the presumptive income tax system.<sup>210</sup> The total number of staff increased from 2,772 in 2000/2001 to about 3,727 in year 2009/2010.<sup>211</sup> The increase in the number of employees is reflective of the manpower needed for successful administration of the BMS. Despite the increase in employees, a 2010 Block Management Report noted a serious shortage of staff. It was found that where 10 staff members were required to work in the Kariako Ilala Kigogo block, only 2 staff (20%) were allocated.<sup>212</sup> The report showed that low manpower capacity hindered the smooth implementation of the BMS.

Despite notable advantages, the enormous human resources needed for successful administration of the BMS is a setback. Critics have labelled the system as “invasive and probably counter-productive” and demonstrating “the potential for conflict between revenue collection, governance, and administrative efficiency”.<sup>213</sup> High costs have been associated with the BMS in raising tax revenues, and again the human resource demand is a contributing factor.

Apart from the BMS, another innovative tax administrative strategy worth investigating is outsourcing revenue collection by the Local Government Authorities in Tanzania. Outsourcing

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<sup>207</sup> *Ibid.*

<sup>208</sup> Joshi, Prichard and Heady *Taxing the Informal Economy: The Current State of Knowledge and Agendas for Future Research* 1339.

<sup>209</sup> Dube & Casale *The Implementation of Informal Sector Taxation: Evidence From Selected African Countries* 610.

<sup>210</sup> Tanzania Revenue Authority *Review of Informal Sector for Taxation Purposes First Draft Report* (2011).

<sup>211</sup> *Ibid.*

<sup>212</sup> Tanzania Revenue Authority *Review of Informal Sector for Taxation Purposes First Draft Report* (2011).

<sup>213</sup> Dube & Casale *The Implementation of Informal Sector Taxation: Evidence From Selected African Countries* 610.

of revenue collection can establish a platform for effective and efficient revenue collection when appropriately managed and monitored.<sup>214</sup> Local government tax collection is labour intensive and often requires direct contact between tax collector and taxpayer, which also has the potential to facilitate corruption.<sup>215</sup> In the absence of outsourcing revenue collection, council employees are preoccupied by tax collection but outsourcing allows employees the opportunity to be deployed to other tasks, allowing for effective use of human resources.<sup>216</sup> In most cases local revenue collection requires fluctuating input due to seasonal revenue sources. Council employees are employed on a permanent basis and their costs are fixed throughout the year, whilst private agencies have the flexibility to increase or reduce human capacity when needed.

Outsourcing revenue collection to private collection agencies incorporates administrative effectiveness and efficiency, which can lead to an increase in revenue, without affecting either the tax base or rate while protecting taxpayers.<sup>217</sup> Outsourcing revenue collection achieves administrative efficiency and reduces collection costs by shifting revenue collection related costs to the private collector.<sup>218</sup>

Outsourcing also has the potential to reduce corruption at the collection point. The private collector has a vested interest in the result of revenue collection because it is closely linked to profit margins and the ability to successfully fulfil the contractual obligations due to the council by virtue of the contract of engagement.<sup>219</sup> Private revenue collection is therefore more likely to have more effective mechanisms to penalise poor performance by a collector, which discourages corruption at collection point. Despite this positive attribute, the risk of corruption continues to exist in the bid awarding process, which may undermine the credibility of outsourcing altogether.<sup>220</sup>

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<sup>214</sup> Fjeldstad, Katera and Ngalewa *Outsourcing Revenue Collection to Private Agents: Experiences from Local Authorities in Tanzania* 11-12.

<sup>215</sup> *Ibid.*

<sup>216</sup> *Ibid.*

<sup>217</sup> S Jang R Eger III *The Effects of State Delinquent Tax Collection Outsourcing on Administrative Effectiveness, Efficiency and Procedural Fairness* (2018) *The American Review of Public Administration*. Available: [https://calhoun.nps.edu/bitstream/handle/10945/57873/The\\_Effects\\_of\\_State\\_Delinquent\\_Tax\\_Collection.pdf;jsessionid=684FF73C71A599F89911E35FCD1357B8?sequence=1](https://calhoun.nps.edu/bitstream/handle/10945/57873/The_Effects_of_State_Delinquent_Tax_Collection.pdf;jsessionid=684FF73C71A599F89911E35FCD1357B8?sequence=1) [Accessed 8 September 2021] 5.

<sup>218</sup> *Ibid.*

<sup>219</sup> Fjeldstad, Katera and Ngalewa *Outsourcing Revenue Collection to Private Agents: Experiences from Local Authorities in Tanzania* 13.

<sup>220</sup> *Ibid.*

In Tanzania, outsourcing revenue collection was enhanced by the guidelines on outsourcing local government services as issued in 2001 by the President's office.<sup>221</sup> Since this pronouncement a range of different private entities have been used to collect taxes like market fees, parking fees, bus stand fees and property tax, amongst others. Outsourcing is based on an open tender process which starts off with an assessment to assess revenue potential by the council and tender bids are expected to fall within the council's revenue estimates.<sup>222</sup>

By outsourcing, the revenue to be paid over to the council is predetermined by the contract of engagement, allowing for predictable budgeting and planning by councils. It is conceivable that councils may not always receive the revenue stipulated in the contract due to potential default in payment by the contractor. To minimise losses that result from defaults in payment, applicants are required to submit a bank guarantee or an asset as security to ensure that revenue is not lost when private collection agencies default in payment. Some councils have put in place a system where contractors are required to submit revenue to the council in instalments, most commonly on a weekly basis or a fortnightly basis, but in some instances also daily.<sup>223</sup> The system ensures that contractors do not keep large sums of money, in case they are tempted to misuse it.

In 1996 Mwanza City Council pioneered the outsourcing of revenue collection in Tanzania. The decision to outsource revenue collection was influenced by the citizens who complained about the council's revenue collectors, and that they did not see the benefits of the collected revenue.<sup>224</sup> Their experience is important because, as the first council to implement outsourcing of revenue, they had no local experience to learn from. Critical mistakes were made that other councils could learn from.

Based on a survey conducted by the city council to identify revenue potential, the revenue collection from Mwaloni fish market and Central market were outsourced to different

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<sup>221</sup> *Ibid.*

<sup>222</sup> *Ibid.*

<sup>223</sup> *Ibid.*

<sup>224</sup> Fieldstad, Katera and Ngalewa *Outsourcing Revenue Collection to Private Agents: Experiences from Local Authorities in Tanzania* 5.

bidders.<sup>225</sup> The reform initially achieved substantial collections, surpassing the revenue that was previously collected by city council.<sup>226</sup> Other bids to outsource revenue collection that followed in 1997 were characterised by poor assessment of revenue potential and political interference during the tendering process, and therefore did not yield good returns.<sup>227</sup> The city council suffered substantial losses as agents retained more revenue than what they handed over to the city council.<sup>228</sup> This serves as a good example of the adverse effects of political interference with administrative processes and failure to put in place an effective monitoring and evaluation systems.

Katera and Ngalewa found that outsourcing revenue collection to private collection agencies has the potential to achieve administrative efficiency. In particular, they point out that the initial impact and long-term successful administration of outsourcing depend on three main elements. These include:

- the strength and quality of the management of the local government authority;
- political commitment to support the reform; and
- transparency reflected in the provision of accessible and updated information to the general public of the tendering process and bids received, as well as data on the revenue potential and actual potential.

### 3.4.2 Ghana

Where the Zimbabwean Revenue Authority struggled to get informal sector associations to support presumptive tax, Ghana presents a classical case study for Associational Taxation. The Ghanaian Internal Revenue Service delegated the responsibility for collecting income tax to informal sector associations. This strategy is called Identifiable Grouping Taxation. It was originally part of an arrangement between Jerry Rawlings and mass movements, but survived the transition to democracy.<sup>229</sup> The arrangement was found to be a success in the early years

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<sup>225</sup> Fieldstad, Katera and Ngalewa *Outsourcing Revenue Collection to Private Agents: Experiences from Local Authorities in Tanzania* 5.

<sup>226</sup> JD Chindengwike, AR Kira & JF Manyanga "The Influence of Approved Budget on Promoting Outsourced Revenue Collection Performance of Local Government Authorities in Developing Countries" (2021) *IJIRMP* Vol 9, Issue 2, p35.

<sup>227</sup> *Ibid.*

<sup>228</sup> *Ibid.*

<sup>229</sup> Joshi & Ayea *Associational taxation: A pathway into the informal sector?* (2008).

and was extended to associations in 32 other informal sector activities.<sup>230</sup> Identifiable Grouping Taxation has since been credited with increasing revenue generated from the informal sector, an important factor in relation to this thesis.

Evidence from Ghana suggests that Associational Taxation may improve administrative effectiveness, taxpayer morale and tax compliance.<sup>231</sup> Identifiable Grouping Taxation as a form of associational taxation in Ghana is recorded to have overcome some of the problems associated with collecting tax from micro businesses.<sup>232</sup> From a tax administration perspective, Identifiable Grouping Taxation reduced collection costs to a fixed 2.5 per cent, which was paid to the associations for their work in collection.<sup>233</sup> Associations helped to cut official manpower (employees of the revenue authority) needed to monitor and carry out tax collection.

The Identifiable Grouping Taxation model has also improved tax revenues from the informal sector. As a percentage of total tax revenue, a gradual rise from 0.97 per cent in 1988 to 1.6 per cent in 1991 was realised.<sup>234</sup> While this might seem like a small margin in increase, it remains a success story if one is to consider the decline narrative in presumptive tax collected in Zimbabwe (discussed in chapter two).

Tax morale was built around the idea that becoming tax compliant granted associations, together with their members, legitimacy and this protected them from arbitrary harassment by public officials and police.<sup>235</sup> High morale meant high compliance and to this end, one of the primary achievements of Identifiable Grouping Taxation recorded was to inculcate a culture of taxpaying among informal sector businesses.<sup>236</sup> The culture of paying tax is credited with enabling a smooth transition from Identifiable Grouping Taxation to a more common presumptive tax regime, in recent years, which was introduced without any significant

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<sup>230</sup> *Ibid.*

<sup>231</sup> Dube & Casale *Informal sector taxes and equity: Evidence from presumptive taxation in Zimbabwe* 64.

<sup>232</sup> Joshi, Prichard and Heady *Taxing the Informal Economy: The Current State of Knowledge and Agendas for Future Research* 1339-1340.

<sup>233</sup> *Ibid.*

<sup>234</sup> Dube & Casale *Informal sector taxes and equity: Evidence from presumptive taxation in Zimbabwe* (2017).

<sup>235</sup> Joshi, Prichard and Heady *Taxing the Informal Economy: The Current State of Knowledge and Agendas for Future Research* 30.

<sup>236</sup> Joshi, Prichard and Heady *Taxing the Informal Economy: The Current State of Knowledge and Agendas for Future Research* 30.

resistance from small firms.<sup>237</sup> The Identifiable Grouping Taxation model provided a good foundation for the culture of taxpaying, which will contribute to state-building in the long run.<sup>238</sup>

The Identifiable Grouping Taxation example is well-known for stressing the benefits of strengthening collective negotiation between the state and informal sector associations. It may also be seen that mutually beneficial outcomes are possible, consequently, negotiations between the government in power and informal sector associations produced modest revenue gains, whilst on the other hand improving conditions for informal sector actors.<sup>239</sup>

The IGT system, however, worked well until the dawn of a new government in the year 2000 when there were tensions between the new party in power and the unions.<sup>240</sup> Sectors of unions were reported to have collected taxes from its members but not handed the revenue over to the authorities.<sup>241</sup> This indicates the disadvantages of the administration of revenue collection where political relations or interests are at play. The default by unions was a demonstration against the new government but at the expense of destroying a tax system that had worked for many years.

### 3.5 Conclusion

The success of any tax system will depend on the effectiveness of the administration, irrespective of policy choices.<sup>242</sup> Any aspiration to build a successful tax regime should be based on an appreciation that “tax administration is tax policy” and that the two are equally important in any tax system.<sup>243</sup> The final section of the chapter highlighted a range of recent innovations that warrant attention for their ability to marry tax policy with tax administration.

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<sup>237</sup> Joshi, Prichard and Heady *Taxing the Informal Economy: The Current State of Knowledge and Agendas for Future Research* 25.

<sup>238</sup> *Ibid.*

<sup>239</sup> *Ibid.*

<sup>240</sup> C Erica “Taxing Ghana’s Informal Sector: the Experience of Women” (2011) *Christian Aid Occasional Paper Number 7*. Available: <https://www.christianaid.org.uk/sites/default/files/2017-08/taxing-ghana-informal-sector-november-2011.pdf> [Accessed 16 January 2022].

<sup>241</sup> *Ibid.*

<sup>242</sup> Joshi, Prichard and C J Heady “Taxing the Informal Economy: Challenges, Possibilities and Remaining Questions” 22.

<sup>243</sup> M Gillis C Shoup and G P Sicut *Value Added Taxation in Developing Countries* Washington DC: World Bank (1990) 171-179.

The chapter highlights recent research around effective administrative strategies in relation to informal sector taxation. The Tanzanian BMS along with the Identifiable Grouping Taxation from Ghana provide a good reference point for the practical implementation of these administrative strategies. Both systems are evidence that informal sector taxation can be successfully implemented when paired with sound administrative strategies. It is also evident that there is a strong link between the administration of tax and high tax morale and compliance.

The Identifiable Grouping Taxation reflects an administrative strategy that are aimed at increasing voluntary tax compliance and facilitating collective action by informal sector associations which is useful in improving prospects for informal sector tax reform. This strategy is attractive because of its potential to simultaneously strengthen political incentives for reform, expand prospective benefits for informal sector players, and improve long-term governance of the informal sector. The goal is to fundamentally shift prevailing disincentives to reform by generating improved outcomes for both state revenues and the informal sector.

On the other hand, the BMS from Tanzania is evidence of an effective segmental approach to taxation. It promotes compliance through the registration of all eligible small and medium scale enterprises within a particular business, sectoral or geographical area, capturing their correct level of economic activities and gathering valuable tax information. Although this system requires a large human resource for effective implementation, it ensures close monitoring and tailor-made support programs that allow informal sector firms to grow. Where the costs of tax administration are high, outsourcing revenue collection to private agents provides a fair alternative.

Chapter four of this research will seek to borrow from the innovations detailed in this chapter and establish policy and administrative recommendations to boost informal sector tax morale and compliance in Zimbabwe.

## **CHAPTER 4: RECOMMENDATIONS TO INCREASE TAX MORALE AND COMPLIANCE AMONG THE INFORMAL SECTOR IN ZIMBABWE**

### **4.1 Introduction**

The main goal of the research is to establish clear, innovative and practical administrative strategies that can be adopted by ZIMRA in taxing the informal sector in Zimbabwe. The present chapter addresses the fourth sub-goal of the research – making practical recommendations that are mindful of the Zimbabwean economic context. This research has revealed convincing evidence that indicates that effective informal sector taxation is viable when combined with efficient administrative strategies. The case for informal sector taxation in Zimbabwe is no different.

Presumptive tax was first introduced in Zimbabwe in 2005 in an effort to broaden the tax base. Despite the passing of time, low tax morale coupled with non-compliance have hampered the success of presumptive taxes in Zimbabwe. The research strongly suggests that the various challenges faced by ZIMRA in trying to effectively tax the informal sector can be narrowed down to the need for a revised administrative strategy. An effective administrative strategy should seek to encourage high tax morale, which should inevitably lead to high tax compliance.

It is proposed that Zimbabwe is well positioned to learn from and adopt recent innovations in administrative strategies that have worked in other developing countries like Tanzania and Ghana. Any attempt to adopt these administrative strategies should seek to employ only those measures that will directly address the challenges and ultimately increase tax morale and compliance amongst the informal sector in Zimbabwe. The main objective is to employ reform strategies that carry the inherent power to address the revenue needs of governments whilst acknowledging the need for growth and development of informal sector firms.<sup>244</sup>

This chapter proposes a number of key priority areas to be addressed in introducing tax reform in Zimbabwe.

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<sup>244</sup> Joshi, Prichard and Heady. *Taxing the Informal Economy: The Current State of Knowledge and Agendas for Future Research* (2014) 2.

## 4.2 Presumptive tax system

Presumptive tax is the most popular method of taxing the “hard to tax” informal sector.<sup>245</sup> From an administrative point of view, presumptive tax is favourable because of its low compliance costs for taxpayers and low costs of collection for revenue authorities.<sup>246</sup> The informal sector in Zimbabwe, like in many other developing countries, is not registered and does not have the necessary skills or resources to keep the detailed records necessary under the standard tax regime. Presumptive tax allows ZIMRA to avoid the costs associated with the conventional verification and assessment procedures, and informal traders can enjoy low compliance costs because the system does not require any active informal sector participation such as filing tax returns.

The present research acknowledges the abilities of presumptive taxes to broaden the tax base and raise revenue. Presumptive taxation is popular for its simple techniques to capture income that frequently escapes conventional taxation. Evidence provided by Tanzania and Ghana, along with other developing countries, highlights that presumptive taxes were adopted in a bid to rise revenue. This confirms that the presumptive tax system is an effective administrative instrument to broaden the tax base and raise revenue. In the wake of a low revenue collections due to a shrinking formal sector, and a rapidly growing informal sector in Zimbabwe, widening the tax net is arguably vital, and presumptive taxation is evidently designed for that purpose.

Presumptive taxes simplify tax administration whilst encouraging formality.<sup>247</sup> A well designed presumptive tax regime carries the inherent power to encourage the movement of economic activities from the informal sector into the formal sector, without encouraging formal sector firms to abandon normal tax in search of presumptive tax benefits.<sup>248</sup> In Tanzania under the BMS, keeping audited records attracted lower taxes and this acted as an incentive for informal traders to gradually employ adequate bookkeeping as done by formal sector firms.<sup>249</sup> ZIMRA should seek to bring the informal sector within the tax base, while at the same time

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<sup>245</sup> Joshi, Prichard and Heady. *Taxing the Informal Economy: The Current State of Knowledge and Agendas for Future Research* (2014) 2.

<sup>246</sup> Loeprick *Small Business Taxation: Reform to Encourage Formality and Firm Growth* 1.

<sup>247</sup> F Mpofu and Mususa “How Successful is Presumptive Tax in Bringing Informal Operators into the Tax Net in Zimbabwe? A Study of Transport Operators in Bulawayo” (2019) 80.

<sup>248</sup> *Ibid.*

<sup>249</sup> Dube & Casale *The Implementation of Informal Sector Taxation: Evidence From Selected African Countries* 609.

encouraging informal sector businesses to gradually formalise. Presumptive tax is an appropriate strategy to achieve this.

Presumptive taxes are also effective in bringing about horizontal (and vertical) equity, ensuring equal tax contributions by individuals of equal net income and assets.<sup>250</sup> In both the examples of Tanzania and Ghana, presumptive taxes were central to bringing the informal sector within the tax net and promoting equity. People are generally drawn into areas of the economy where tax avoidance and evasion are easiest,<sup>251</sup> and the informal sector is clearly one of these areas. The growing informal sector in Zimbabwe is a threat to equity and an assumed flat rate, as enabled by presumptive taxes, ensures equal treatment among taxpayers of equal ability.

Research provides evidence that the concept of presumptive tax is the same, in policy, across regimes with notable differences in their specific features.<sup>252</sup> For example, Tanzania operates a scheme in which tax is a progressively increasing proportion of turnover, and those without adequate records pay a larger amount.<sup>253</sup> In Ghana, the government operates a flat rate turnover tax of 3 per cent for small firms to replace standard VAT, while micro businesses are covered by a tax stamp regime, of a fixed tax per quarter.<sup>254</sup> Despite these differences, there is general appreciation in both countries that a presumptive tax policy is the most feasible way of taxing the informal sector. Further to that, administrative strategies like the BMS applied in Tanzania or the Identifiable Grouping Taxation of Ghana are key in ensuring the successful implementation of presumptive tax, irrespective of the notable differences in the specific features that make up their presumptive tax policy.

In Zimbabwe presumptive tax rates are fixed and pre-determined by a complex calculation which uses information on sales, employees, assets and the location of the business.<sup>255</sup> This approach is borrowed from the “tachshiv” method, which originated in Israel and is based on

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<sup>250</sup>F Mpfu and Mususa “How Successful is Presumptive Tax in Bringing Informal Operators into the Tax Net in Zimbabwe? A Study of Transport Operators in Bulawayo” (2019) 80.

<sup>251</sup> *Ibid.*

<sup>252</sup> Joshi, Prichard and Heady Taxing the Informal Economy: The Current State of Knowledge and Agendas for Future Research 1333.

<sup>253</sup> *Ibid.*

<sup>254</sup> W Prichard *The politics of taxation and implications for accountability in Ghana 1981-2008* (2009).

<sup>255</sup> O Zivanai F Chari and C Nyakurimwa Tax Compliance Challenges in Fulfilling Tax Obligations Among SMEs in Zimbabwe: A Survey of SMEs in Bindura (2015).

various ascertainable factors, which are found in an industry to be taxed.<sup>256</sup> For example, a restaurant may be taxed on the basis of location, number of seats, and average price of items on the menu. The approach provides an effective administrative tool to ascertain a justifiable tax rate for the informal sector, in the absence of proper accounting records. The present research has demonstrated the effectiveness of this approach in taxing the “hard to tax” informal sector, but argues for an accompanying clear administrative strategy that is informed by the recent innovations adopted in other developing countries like Tanzania and Ghana. Despite the challenges associated with the administration of presumptive taxes in Zimbabwe, both Tanzania and Ghana provide evidence that a presumptive tax policy can work when paired with innovative and effective administrative strategies.

### **4.3 Theoretical foundation and alignment**

Tax policy should be supported and built on the foundation of sound theory. This research (in chapter 2) has discussed a range of theories that support informal sector taxation, but a question remains which theoretical approach best suits the Zimbabwean context. An effective administrative strategy will require an alignment between an adopted theoretical framework, proposed tax policy and the context in which it will operate.

The general sentiments of the informal sector in Zimbabwe question the need for tax levies in the absence of direct or indirect benefits derived from government.<sup>257</sup> The informal sector in Zimbabwe considers itself to be a self-effort towards “kukiya-kiya” (making do) in an economy where the government has failed to provide for the needs of the informal sector. This is probably more of a political question but its effects have a direct bearing on tax morale and compliance. A theoretical approach that is cognisant of this reality should yield a tax system and administrative strategy that is responsive to this context.

The *Benefit Theory of Taxation* therefore provides a theoretical framework that is appropriate in the Zimbabwean context. Where taxes are levied according to the benefit theory, an obligation is imposed on the government to link tax collections to meaningful benefits. The approach restores the taxpayers’ trust in the government and encourages high tax morale and

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<sup>256</sup> V Thuronyi *Presumptive Taxation: Tax Law Design and Drafting* (1996) Washington, International Monetary Fund 71-94

<sup>257</sup> G Dube *Informal Sector Taxation: the case of Zimbabwe* 86-89.

compliance. On a practical level and by way of example, it is recommended that tax levied against the transport sector should be seen to support the sector by constructing and maintaining good roads across the country. In the same measure, taxes levied against “flea market” traders should be seen to support the growth of the sector by building safe and suitable trading areas. This is ideally a sound place to start building a mutually beneficial relationship between the informal sector and government, whilst promoting engagement and the culture of paying tax. This approach secures tax revenue for government but also supports the growth and sustainability of the informal sector.

The Ghanaian example of Identifiable Grouping Taxation is well-known for creating a conducive environment for collective negotiation between the state and informal sector associations.<sup>258</sup> In this setting, informal sector associations were critical in highlighting the needs of the informal sector and ensuring improved working conditions for the informal sector.<sup>259</sup> It is argued that the success of the Identifiable Grouping Taxation was in part linked to the mutual benefits derived from collective negotiation, which strengthened the relationship and encouraged high tax morale. In the same way, ZIMRA should foster a mutually beneficial relationship between government and the informal sector. Revenue collection should be married to an improved informal sector and the benefit theory is at the heart of this approach.

While the benefit theory is a suitable premise for imposing presumptive taxes, the other theories cannot be ignored. If the presumptive taxes ignore the ability of informal traders to pay the tax, tax morale and compliance will suffer. The *Expediency Theory*, demands that tax proposal must pass the test of practicability and is therefore also important as it ensures that the levying of a presumptive tax is practicable.

#### **4.4 Good tax policy**

The examples of tax administration seen in Tanzania and Ghana (cited in chapter 3) indicate the presence of good tax policy. Any suggestion to modify a tax system, whether major or minor, requires an effective framework that is informed by appropriate tax policies.<sup>260</sup> Based

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<sup>258</sup> A Joshi W Prichard and C J Heady Taxing the Informal Economy: The Current State of Knowledge and Agendas for Future Research (2014).

<sup>259</sup> *Ibid.*

<sup>260</sup> The Unified Voice of AICPA and CIMA Guiding principles of good tax policy: A framework for evaluating tax proposals (2017)

on widely accepted principles, a good tax policy is characterised by a range of elementary pillars, including fairness, adequacy, simplicity, transparency, and administrative ease, amongst others.<sup>261</sup> For purposes of this research, only the principle of fairness will be explored in greater detail because of its direct relevance to the administration of presumptive tax in Zimbabwe.

#### **4.4.1 Fairness achieved through regular research on taxability**

The principle of fairness, or equity, dictates that everybody should pay a fair share of taxes.<sup>262</sup> Although presumptive tax policy is effective in bringing the informal sector within the tax base and ensuring a level of equity between the formal firms that are liable for income tax and other taxes and the hard to tax informal sector, it leaves much to be desired when it comes to its general application amongst informal sector players. By nature, presumptive tax is not accurate and can easily negate the principle of fairness in the absence of regular research to assess taxability and ensure fair tax amounts.

Presumptive tax policy in Zimbabwe, as was discussed in chapter 2, was initiated by an assessment for taxability between 2003 and 2005, which informed the initial list of presumptive taxes, but subsequent additions to the presumptive tax list were not justified by successive substantial research efforts to assess the taxability of sectors added.<sup>263</sup> It is also noted that when presumptive taxes were introduced in 2005, Zimbabwe was using the Zimbabwean dollar as the currency. Many years later, the current Zimbabwean economy is driven by a multicurrency system with different degrees of market forces determining the exchange rate,<sup>264</sup> but again, there has never been dedicated taxability research to review the impact of inflation or the fluctuating exchange rates on the informal sector's profitability and capacity to pay tax. This has resulted in the introduction of high tax amounts and wide dissatisfaction with the presumptive tax rates.<sup>265</sup>

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<sup>261</sup> Oklahoma Policy Institute "Characteristics of an Effective Tax System". Available: <https://okpolicy.org/resources/online-budget-guide/revenues/an-overview-of-our-tax-system/characteristics-of-an-effective-tax-system/> Accessed 16 January 2022) p 1.

<sup>262</sup> The Unified Voice of AICPA and CIMA Guiding principles of good tax policy: A framework for evaluating tax proposals (2017) p7.

<sup>263</sup> Dube & Casale The Implementation of Informal Sector Taxation: Evidence from Selected African Countries (2016).

<sup>264</sup> K Jefferis *Zimbabwe's currency 'curse' and the economic malaise* Policy Brief Institute for Security Studies (2020) 5.

<sup>265</sup> B Utaumire E Mashiri and K Mazhindu "Effectiveness of Presumptive Tax System in Zimbabwe: Case of

#### 4.4.2 Horizontal and vertical equity

With regard to fairness, horizontal equity ensures that taxpayers with equal abilities to pay should pay the same amount of tax, and where one taxpayer has a greater ability to pay than another taxpayer, the concept of vertical equity requires that taxpayer to pay more tax.<sup>266</sup> The currently prevailing presumptive tax system has been opposed for imposing exorbitantly high blanket tax amounts without conducting the relevant research to support the taxes. In the absence of regular taxability research, the presumption of a fair tax policy falls away. The evidence provided supports the need to reassess the current tax list, together with the associated tax rates levied against the informal sector in Zimbabwean.

In a bid to ensure fair tax policy, it is recommended that ZIMRA needs to “legitimise” tax levies by carrying out regular research, which should inform tax rates. Both Tanzania and Ghana provide valuable points of reference on this subject.

#### 4.4.3 The Block Management System

The BMS in Tanzania was built around promoting compliance and registering all eligible small and medium scale enterprises within a particular business, sectoral or geographical area, capturing their correct level of economic activities and gathering valuable tax information.<sup>267</sup> Adopting this strategy as an administrative action would allow for a focused segmental approach to taxation in Zimbabwe. Given the size of informal sector traders in big cities, there is incentive to map and divide city blocks into smaller segments for effective assessment, support and monitoring. This shift should seek to clearly distinguish between those earning too little to be subject to the presumptive tax and those using informal trade to evade taxes.

The BMS has been commended for improving and ensuring quality assessments.<sup>268</sup> Although traders were not required to maintain audited accounts, the system encouraged basic record-

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ZIMRA Region One” (2013) Research Journal of Finance and Accounting vol. 4 No.7 ISSN 2222-2847. Available: <https://www.iiste.org/Journals/index.php/RJFA/article/view/6284/6646> [Accessed 20 January 2022]

<sup>266</sup> The Unified Voice of AICPA and CIMA Guiding principles of good tax policy: A framework for evaluating tax proposals (2017) p7.

<sup>267</sup> *Tanzania Revenue Authority Review of Informal Sector for Taxation Purposes First Draft Report (2011)*.

<sup>268</sup> Dube & Casale The Implementation of Informal Sector Taxation: Evidence From Selected African Countries 610.

keeping by imposing higher rates on traders with incomplete records, which allowed for quality tax assessments. In this system tax proposals are underpinned by focused research and consultations with the informal sector traders who in turn understand the imposed levies as active participants in the assessment process.

#### **4.5 An office and workforce responsible for the informal sector and presumptive tax**

Administrative reforms will require an adequate workforce whose responsibility will be to implement and monitor reform strategies. ZIMRA has offices that specifically deal with large taxpayers who make up the bulk of tax payments, but does not have offices that specifically deal with the informal sector and presumptive tax.<sup>269</sup> Effective administration requires a dedicated human resource team that is equipped to implement and monitor the set objectives. The success of the BMS in Tanzania is tied to a team of trained personnel who were allocated to each block, subject to rotation after a certain length of stay in one block.<sup>270</sup> A couple of lessons can be drawn from this approach. Each block enjoys priority monitoring, education and support services. Another important element is the training received by the teams deployed. Administrative efficiency is achieved when the human resources are trained for purpose. Finally, the rotation of employees after a certain period of time is also an important factor to consider. It ensures that revenue authorities are not stationed in the same block long enough to establish relations that could create room for bribery and extortion.

A similar approach would serve ZIMRA and the presumptive tax system well. ZIMRA should introduce a dedicated office and a trained workforce to oversee the implementation, support and monitoring of the informal sector and presumptive tax in Zimbabwe, in order to achieve administrative success. The workforce should be large enough to allow for rotation to discourage the development of corrupt relations. Finally, the dedicated office and workforce should work on set targets, which provide defined goals to be attained and encourage strict tax collection.

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<sup>269</sup> Dube The design and implementation of minibus taxi presumptive taxes (2018).

<sup>270</sup> Tanzania Revenue Authority Review of Informal Sector for Taxation Purposes First Draft Report (2011).

It is counterproductive when the same set of employees work on compliant large taxpayers in the formal sector while also looking after the informal sector and presumptive tax.<sup>271</sup> The reality is that the large compliant sector will enjoy greater attention, which hampers efforts to broaden the tax base. It is also important to note that the needs of large taxpayers will always be different from those of smaller informal sector taxpayers and this reinforces the need for a dedicated office and workforce.

#### **4.6 Increased collaboration with informal sector associations**

Research and consultation should be based on an increased collaborative effort between ZIMRA and informal sector associations, as witnessed in Ghana. Associations are on the ground daily and are better placed to give an objective assessment on behalf of their members. In doing this, the perception of fair tax policy will be promoted and contribute towards high tax morale and compliance. The Ghanaian Internal Revenue Service provides a classic case of associational taxation. The success of the presumptive tax system was mainly built on collaborative work between the informal sector associations and the Revenue Authority. The *Identifiable Grouping Taxation* model contributed greatly to administrative convenience by reducing collection costs to a fixed 2.5 per cent, which was paid to the associations for their work in collection, as well as reducing the workforce needed to monitor and carry out tax collection.<sup>272</sup>

The literature (in chapter 2) reflects either a strained or non-existent relationship between ZIMRA and various informal sector associations. Whilst the present research is reluctant to recommend to ZIMRA to fully employ Ghana's approach, there is sound reason to start forging a working relationship between the informal sector associations and ZIMRA in Zimbabwe. Associations should be invited to stakeholder meetings and should be thoroughly consulted ahead of significant decisions. Their buy-in to the programs of the Revenue Authority is important in positively influencing high tax morale and compliance amongst their members. They can also play a significant role in facilitating tax education campaigns. Finally, their knowledge and experience of the sector is valuable in influencing a sound tax system.

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<sup>271</sup> Dube & Casale The Implementation of Informal Sector Taxation: Evidence From Selected African Countries 610.

<sup>272</sup> Joshi, Prichard and Heady Taxing the Informal Economy: The Current State of Knowledge and Agendas for Future Research 1339-1340.

As highlighted above, the *Identifiable Grouping Taxation* example from Ghana is well-known for the stressing of the benefits of strengthening collective negotiation between the state and informal sector associations. Mutually beneficial outcomes were made possible where modest revenue gains were achieved by the state on one hand, and the conditions of the informal sector were improved on the other.<sup>273</sup> The strength and success of associational taxation is based on a well-defined relationship, where roles and responsibilities are clearly articulated to avoid uncertainty or undue exercise of authority by the associations.

Despite all these positive aspects, it is interesting to learn that the *Identifiable Grouping Taxation* system worked well until the advent of a new government in Ghana, which sparked tensions between the new party in power and the unions.<sup>274</sup> This strongly suggests that political alignment can directly affect efforts to foster a relationship between informal sector associations and government. Although this thesis does not address the politics at play in Zimbabwe, it is interesting to note that Stan Zvorwadza, leader of the Zimbabwe Vendors Union, is on record protesting against corruption, injustice and poverty, and has been arrested numerous times on account of promoting public violence.<sup>275</sup> This raises the question whether the prospects of associational taxation have been hindered by politics. Despite this, there remains a pressing need to build bridges and forge a relationship for the sake of progressive presumptive tax administration.

#### **4.7 Budget transparency and engagement**

Some reforms are fairly simple and more straightforward to implement than others. Budget transparency and engagement are perfectly aligned with the *Benefit Theory of Taxation* as proposed above. Despite the general consensus regarding the administrative advantages of adopting transparency as a strategy to increase tax morale, tax revenue authorities fall into the trap of following a narrow operational focus on quantitative indicators of administrative

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<sup>273</sup> Joshi, Prichard and Heady *Taxing the Informal Economy: The Current State of Knowledge and Agendas for Future Research* 1339-1340.

<sup>274</sup> C Erica "Taxing Ghana's Informal Sector: the Experience of Women" (2011) Christian Aid Occasional Paper Number 7. Available: <https://www.christianaid.org.uk/sites/default/files/2017-08/taxing-ghana-informal-sector-november-2011.pdf> [Accessed 16 January 2022].

<sup>275</sup> GroundUp "Harare 'mega' protest flops because of fear and feuds - Heavy police presence mutes protest aimed at Mugabe government" (2016). Available: <https://www.groundup.org.za/article/harare-mega-protest-flops-because-fear-and-feuds/> [Accessed 16 January 2022].

success like the amount of revenue collected.<sup>276</sup> ZIMRA should adopt transparency and engagement as a strategy to build a solid foundation for tax morale and presumptive tax compliance.

Transparency and engagement are simple concepts that can bring about positive progress when effectively adopted as a strategy. ZIMRA should actively seek to open communication lines between their office and the informal sector. Their budget and programmes should be made public and engagement is at the forefront of this strategy. The goal is to establish a trust relationship and an awareness around the need for and use of revenue collected. Transparency will also raise ZIMRA's level of accountability to the public and encourage a tax system that is responsive to the needs of the taxpayers.

The Bo City Council in Sierra Leone (discussed in chapter 3) provides a perfect example of this concept in practice. Tax morale and support for tax collection was raised by simply prioritising transparency, outreach and equitable tax enforcement.<sup>277</sup> Information relating to revenue and expenditure was made public and revenue increases were linked to specific public expenditures.<sup>278</sup> In the same vein the presumptive tax policy in Zimbabwe should be founded on transparency, and information relating to revenue and expenditure should be made public through engagement and outreach programmes.

#### **4.8 Administrative action to discourage corruption**

The persistence of corruption will hamper any efforts towards progressive administrative reform. The literature (in chapter 2) highlighted that corruption usually occurs in two different forms, mainly bribes and extortion.<sup>279</sup> Corruption is perpetuated by ZIMRA employees tasked with collecting tax and responsive strategies should be targeted at them. A straightforward recommendation would be to remove the human element from collecting revenue by introducing electronic payment methods. Where this approach is too expensive, setting

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<sup>276</sup> S Jibao & W Prichard "Rebuilding Local Government Finances After Conflict: Lessons from a Property Tax Reform Programme in PostConflict Sierra Leone" (2016) *The Journal of Development Studies*, 52:12, 1759-1775. Available: <https://www.tandfonline.com/doi/pdf/10.1080/00220388.2016.1153073?needAccess=true> [Accessed 15 January 2022].

<sup>277</sup> Jibao & Prichard *Rebuilding Local Government Finances After Conflict: Lessons from a Property Tax Reform Programme in Post-Conflict Sierra Leone* 1170.

<sup>278</sup> *Ibid.*

<sup>279</sup> Dube *Informal Sector Taxation: the case of Zimbabwe* (2014) 107.

collection targets and imposing strict consequences for defaulting employees could provide an alternative. Further, periodic rotation of tax collectors (as discussed above) could also assist by discouraging the formation of personal relations that create a conducive environment for corruption.

As a last resort, and when everything else fails, ZIMRA should consider outsourcing revenue collection to private collectors as is done by the Local Government Authorities in Tanzania (discussed in chapter 3). Outsourcing of revenue collection can establish a platform for effective and efficient revenue collection, which is free from corruption.<sup>280</sup> The article by Fjeldstad, Katera and Ngalewa made it clear that corruption is reduced substantially by outsourcing; the private collector has a vested interest in the result of revenue collection as it is closely linked to profit margins and the ability to successfully fulfil the contractual obligations due to the revenue authority by virtue of the contract of engagement.<sup>281</sup> Furthermore, private tax collectors would have effective mechanisms to penalise poor performance by employees, which discourages corruption at collection point.<sup>282</sup>

The point is that ZIMRA should be seen to be dealing with corruption. Tax morale cannot be established where bribes and extortion thrive. Taxpayers will always consider corruption as an easier way out, especially in a context where a culture of paying tax is not firmly established.

#### **4.9 Promote an awareness, appreciation and understanding of tax through education programmes**

Tax education programmes are vital administrative tools in ensuring a successful tax system. The literature (in chapter 2) indicates that many informal sector operators in Zimbabwe do not know about presumptive taxes.<sup>283</sup> ZIMRA has made strides to reach out to the informal sector through seminars and newspaper columns, but there is overwhelming evidence to suggest that their approach has not been effective.<sup>284</sup> The lack of effective tax awareness and education

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<sup>280</sup> Fjeldstad, Katera and Ngalewa Outsourcing Revenue Collection to Private Agents: Experiences from Local Authorities in Tanzania 11-12.

<sup>281</sup> Fjeldstad, Katera and Ngalewa Outsourcing Revenue Collection to Private Agents: Experiences from Local Authorities in Tanzania 13.

<sup>282</sup> *Ibid.*

<sup>283</sup> Utaumire, Mashiri & Mazhindu Effectiveness of Presumptive Tax System in Zimbabwe: Case of ZIMRA Region One 114.

<sup>284</sup> Dube Informal Sector Taxation: the case of Zimbabwe 149.

programmes is certainly a contributing factor towards low tax morale and compliance among the informal sector in Zimbabwe, and ZIMRA should respond innovatively to this challenge.

The segmental organisation of tax administration as seen in Tanzania and the BMS again provides a progressive reform and strategy for effective educational programmes. It is certainly easier to present educational programmes that are targeted at mapped blocks in a city than to try to reach everyone at once. ZIMRA should innovate along these lines and refrain from mainly using mass media and government gazettes to engage with the informal sector. The *Identifiable Grouping Taxation* system of Ghana is also relevant. Associations helped to cut official man power (employees of the revenue authority) needed to monitor and carry out tax collection. In the same way, ZIMRA does not need to drive education campaigns on the strength of its workforce capacity, partnering with associations is an effective strategy in working with a scarce resource and limited workforce.

It is further proposed that ZIMRA should seek to promote an awareness, appreciation and understanding of presumptive tax through education. Thus, an awareness of the prevailing tax laws and obligation is not adequate to boost tax morale if it is not accompanied by an appreciation and understanding of the tax system and the need for revenue. Education programmes should be designed to promote a culture of engagement between ZIMRA and the informal sector taxpayer.

This thesis recommends that the design of these educational programmes should be guided by three fundamental elements, which are content selection, mode of delivery and the person or voice behind the message. The informal sector should be able to clearly understand the message (content) delivered. The adopted mode of delivering these educational programmes should be founded on the principle of engagement, where questions and concerns can be raised and furnished with adequate answers. Finally, people tend to listen to familiar voices. That is to say, the voice carrying the message, whether person, newspaper or electronic platform, should be familiar to encourage a receptive audience. The adoption of these three fundamental elements in educational programs will allow for effective communication and the promotion of an acute awareness, appreciation and understanding of presumptive tax and encourage high tax morale and compliance by the informal sector in Zimbabwe.

#### **4.10 Government support**

The successful implementation of these recommendations is fully dependent on the support received from the Zimbabwean Government. It is a justifiable assumption that the success of the BMS and the Identifiable Grouping Taxation was partly achieved because of governmental support, which provided the funds and infrastructure needed to run these tax systems. In the same way, the Zimbabwean government will need to provide the necessary budgetary support for an independent presumptive tax office, presumptive tax research, education programmes, the training of revenue officials and any other aspect that may need funds.

#### **4.11 Conclusion**

This chapter recommends critical administrative reforms that could create a conducive environment for high tax morale and compliance. It is proposed that the state of low tax morale and non-compliance among the informal sector in Zimbabwe is effectively an administrative challenge that requires innovative strategies to ensure a thriving presumptive tax system. The chapter draws evidence from recent innovative administrative strategies that have been tried and tested in other developing countries, and poses them as possible solutions to challenges faced by ZIMRA in taxing the informal sector. This might not be an exhaustive list of areas for reform, but these appear to be easily and expeditiously implementable.

#### ***Summary of Recommendations***

The Zimbabwean government, through the agency of ZIMRA should consider the administrative reforms detailed below.

**Table 4.1 Administrative Tax Reforms**

- Ensure that reform strategies carry the inherent power to address the revenue needs of the government, whilst acknowledging the need for growth and development of informal sector firms.
- The *Benefit Theory of Taxation* supported by the *ability to pay* and the *Expediency Theory* should form the theoretical basis of administrative reform.
- Continue the presumptive tax system as already adopted; it provides the most feasible way of taxing the informal sector in Zimbabwe. From an administrative point of view, presumptive tax is favourable because of its low compliance costs for taxpayers and low costs of collection for ZIMRA.
- Employ good tax policy that deliberately seeks to uphold the tax principles of fairness and equity by:
  1. re-assessing the current taxes being applied, together with the associated tax levied against the various sectors of the informal sector through regular taxability research;
  2. mapping and dividing informal sector traders in the cities and towns into smaller segments for effective assessment, support and monitoring; and
  3. clearly distinguishing between those earning too little to meet the presumptive tax threshold and those using informal trade to evade taxes.
- Introduce a dedicated office and workforce responsible for the informal sector and presumptive tax in Zimbabwe, together with ensuring sufficient skilled revenue authority capacity.
- Promote an awareness, appreciation and understanding of tax through education programmes.
- Be intentional about building relationships with informal sector associations.
- Foster a culture of transparency and engagement:
  1. information relating to revenue and expenditure should be made public through engagement and outreach programmes; and
  2. some of the revenue from presumptive taxes should be allocated towards improving the working conditions of informal sector businesses in an effort to ensure their growth and sustainability.
- Employ a variety of administrative actions to discourage corruption by:
  1. introducing electronic payment methods, where feasible;
  2. setting collection targets and imposing strict consequences for defaulting tax collectors;
  3. enforcing periodic rotation of tax collectors to discourage the formation of personal relations that create a conducive environment for corruption; and
  4. outsourcing revenue collection to private collection agents.
- Lastly, the Zimbabwean government should provide the necessary budgetary support to effect the proposed reforms.

In concluding, chapter five will summarise this research and explore the key findings of the research. The chapter will describe the findings in chapters two to four, with a link to the research goals of this thesis.

## CHAPTER 5: CONCLUSION

Over the past number of years there has been a growing interest in taxing the informal sector in developing countries. This interest 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. In 2011, the Zimbabwe National Statistical Agency conducted a survey on the labour force, which revealed that 84% of economic activity in Zimbabwe occurred in the informal sector.<sup>285</sup> This survey supports the claim that the informal sector in Zimbabwe forms a large and growing component of the Zimbabwean economy.<sup>286</sup>

The research identified the problems being experienced in taxing the Zimbabwe informal sector, based on the current tax legislation. The research established that the government of Zimbabwe imposes multiple taxes on the informal sector, which in turn overburdens the citizens and continuously threatens the survival of their small businesses. It is acknowledged that the problems in taxing the informal sector may be causing ZIMRA to lose potential tax revenue. This motivated the research, and one of the primary goals was therefore to determine the current efforts in legislation and policy, that seek to tax the informal sector in Zimbabwe and the challenges encountered in doing so. The research further set out to investigate recent administrative innovations adopted in taxing the informal sector in Tanzania and Ghana, two other developing countries in sub-Saharan Africa, with the goal to learn from these innovations in order to make practical recommendations that respond to challenges encountered in Zimbabwe, while being mindful of the Zimbabwean economic context.

This chapter will therefore summarise the findings in chapters two to four, linking these conclusions to the research goals.

### 5.1 Taxing the informal sector in Zimbabwe

Chapter 2 involved an analysis of the evolution of the informal sector taxation in Zimbabwe. The chapter briefly discussed the economic environment that led to the introduction of the

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<sup>285</sup>O Zivanai O Manyani N Hove L Chiriseri and M Mudzura *The Effectiveness of Presumptive Tax and Its Impact On Profitability of SMEs in Zimbabwe. Case of Commuter Transport Operators in Bindura* (2014) Research journal's Journal of Commerce Vol.2 No.7 ISSN 2348-0955, p3.

<sup>286</sup>ZIMCODD. "Zimbabwe's Tax system: Opportunities and threats for enhancing development in Zimbabwe" (2014) *Zimbabwe Tax Justice*.

informal sector taxation, the administrative path that was taken to effect the tax and the response of taxpayers to the taxation. The chapter mainly focused on the challenges faced by ZIMRA in taxing the informal sector.

In a bid to tax the informal sector, ZIMRA carried out a research which led to the implementation in 2005 of a presumptive tax for the informal urban transport operators, and this tax was also levied on other sector activities in 2008 and 2009. It was established that the government introduced presumptive tax to broaden the Zimbabwean tax base. This was a reasonable stance given Zimbabwe's economic decline, the growth of the informal sector, and the decrease in the country's GDP.<sup>287</sup> Evidence was provided to demonstrate that, since the introduction of presumptive tax in Zimbabwe, it has not achieved its intended outcome. A revenue performance report published in 2017 revealed that the "informal" economic players were not complying with the country's tax laws.<sup>288</sup> The literature surveyed revealed that presumptive tax non-compliance was due to a number of factors, which include a range of socioeconomic and institutional factors, and also the low tax morale of the Zimbabwean taxpayers, which is a key factor in enhancing tax compliance. These factors were discussed, and it was established that they needed urgent attention to positively change and boost tax morale and broaden the tax base.

Trust in government is one factor that affects tax morale. It was found that citizens are more likely to perceive tax obligations in a positive light when their government is seen to be acting in a trustworthy manner. Zimbabweans operating in the informal sector are not satisfied with the way tax revenues are used by the government and their general perception is that they derive no benefit from paying tax. This prompted the conclusion that there is a need to boost the taxpayer's confidence in the government, as this will positively influence tax morale.

Corruption was also identified as a factor that influences people's willingness to pay presumptive taxes. Higher levels of tax morale are reported when corruption is perceived to be controlled. Corruption is common within ZIMRA, occurring as either bribes or extortion. The literature indicated that taxpayers in Zimbabwe are more willing to evade tax knowing that

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<sup>287</sup> ZIMRA "Presumptive Tax" (2017). Available: <https://www.zimra.co.zw/domestic-taxes/presumptive-tax> [Accessed 25 September 2017].

<sup>288</sup> Bonyongwe *Revenue Performance Report for the Quarter Ended 30 September* (2017).

when caught they will only be “liable” for a bribe.<sup>289</sup> Even where a person endeavours to pay presumptive tax as required, the collecting officers find other problems that would warrant a fine of some sort to elicit a bribe.<sup>290</sup> This form of extortion also defeats the object of showing good citizenry by paying tax. Corruption is negatively affecting taxpayer morale and there is an urgent need to deal with it so as to restore taxpayers’ confidence.

High tax amounts were also identified in the literature as factors affecting taxpayer morale. There is a general dissatisfaction by the taxpayers that ZIMRA did not conduct enough research and consultations before deciding on tax rates. Additionally, it was found that whilst research had been carried out from 2003 to 2005, this was only for the transport sector, and no further research was done to determine the profitability of subsequently taxed categories of the informal sector activities in 2009. These different sectors required in-depth research and consultations to ensure a justifiable tax rate. The absence of the necessary research greatly contributed to non-compliance by taxpayers. Furthermore, in 2009 Zimbabwe “dollarised” and again there were no consultations on the presumptive tax amounts. This omission also contributed to non-compliance by the taxpayers. It was demonstrated that tax morale and compliance can be improved where on-going consultations are held with stakeholders; it improves transparency, awareness, and taxpayer participation in the process.

The lack of education and awareness was identified as a further factor affecting tax morale. It was found that many informal sector operators do not know about presumptive taxes; therefore, they are less likely to comply with an obligation that they do not know about. It was recommended that ZIMRA should intensify its presumptive tax awareness campaigns through newspapers, seminars and also at “grassroots level”.<sup>291</sup> These awareness campaigns should also focus on why informal sector operators need to pay tax in order to educate the general public so that they understand the role of taxes in the economy. ZIMRA needs to present more education and awareness campaigns to ensure that the presumptive tax obligation is understood, and also to increase tax morale.

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<sup>289</sup> Dube & Casale *Informal sector taxes and equity: Evidence from presumptive taxation in Zimbabwe* 59-60.

<sup>290</sup> Dube & Casale *Informal sector taxes and equity: Evidence from presumptive taxation in Zimbabwe* 59-60.

<sup>291</sup> Zivanai, Manyani, Hove, Chiriseri & Mudzura *The Effectiveness of Presumptive Tax and Its Impact On Profitability of SMEs in Zimbabwe. Case of Commuter Transport Operators in Bindura* 1554.

Fairness and equity are also factors that affect tax morale. Where taxpayers perceive inequity in taxation they are more inclined to evade tax. Given that fact that presumptive tax is not accurate, it may violate the principle of horizontal and vertical equity because these taxes tend not to have tax-free minimum income thresholds, unlike most personal or individual income tax regimes.<sup>292</sup> This means that the informal sector may bear a higher tax burden than their counterparts in the formal sector, who are shielded from taxation at low incomes.<sup>293</sup> Furthermore, where the same tax liability in amount is levied on people at different income levels, the principle of vertical equity is also violated.<sup>294</sup> Equity and fairness principles are violated, and ZIMRA should thus re-evaluate the need for equity in the presumptive tax system to promote equity and perceptions of fairness.

Another factor that is connected to low tax morale levels in response to presumptive tax is ZIMRA's insufficient workforce levels. It was established that ZIMRA lacks a dedicated section that specifically deals with the small taxpayers.<sup>295</sup> ZIMRA's main method of monitoring presumptive compliance is through occasional raids. However, because of an inadequate workforce and dedicated officers to monitor the informal sector taxpayers, these raids can only be carried out on a very small number of informal sector operators who are meant to be taxed under the presumptive tax schedule. This means there is little or no compliance monitoring, education or support, which in turn causes low tax morale amongst informal sector taxpayers. This directly feeds into the perception of fairness as discussed above, which negatively affects tax morale. This led to the conclusion that ZIMRA should put in place a department that is dedicated to monitoring compliance amongst informal sector operators.

Another factor that has the potential to affect tax morale is the perceived attitude of ZIMRA to collecting presumptive tax. ZIMRA's collecting officers feel that collecting presumptive tax is a waste of scarce resources. This lack of enthusiasm among ZIMRA officers will directly affect the tax morale of the informal sector operators. ZIMRA needs to re-ignite a positive attitude towards the collection of presumptive tax.

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<sup>292</sup> Zivanai, Manyani, Hove, Chiriseri & Mudzura *The Effectiveness of Presumptive Tax and Its Impact on Profitability of SMEs in Zimbabwe. Case of Commuter Transport Operators in Bindura* 1554.

<sup>293</sup> *Ibid.*

<sup>294</sup> *Ibid.*

<sup>295</sup> Dube *The design and implementation of minibus taxi presumptive taxes* (2018).

The chapter established that ZIMRA's challenge going forward is to develop innovative administrative strategies to increase both tax morale and compliance in Zimbabwe.

## **5.2 Examples of policy strategy and innovative administration of informal sector taxation**

Chapter three investigated the measures Ghana and Tanzania have introduced to address the challenges associated with taxing the informal sector in their respective jurisdictions. The chapter began by discussing recent innovations in informal sector taxation that are being used in a bid to increase tax morale and compliance. Segmentation of tax administration is one of these reforms, which is a practice of partitioning taxpayers into distinct groups for different treatment by tax authorities. This new approach, which recognises segmental organisation of tax administration with separate departments to deal with small, medium and large firms, was demonstrated to be a progressive reform that will boost tax morale and compliance. This reform allows services to be tailored to the needs and realities of specific types of firms, including the informal economy.

Associational taxation is another reform that has received attention in taxing the informal sector. This reform is based on an effort to promote a partnership between the state and the informal sector by establishing an environment of collective action, negotiation and dialogue between the state and the informal sector associations. This reform should boost tax morale and compliance as it involves the informal sector associations in the taxing process.

Delegating control to local government has also been accepted as a viable reform initiative in taxing the informal sector. Local governments have a greater need of resources; therefore, they will have stronger incentives to pursue taxation in the informal economy. Local governments are better placed to negotiate productively with informal sector actors, and respond by supplying relevant services; and it may encourage greater coherence between taxes levied by different levels of government.<sup>296</sup> While there are advantages of using this reform, the literature revealed that it is likely to face challenges if there are capacity constraints within local authorities, many of which are perceived as “highly corrupt”.<sup>297</sup>

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<sup>296</sup> Joshi, Prichard and Heady *Taxing the Informal Economy: The Current State of Knowledge and Agendas for Future Research* 1340.

<sup>297</sup> OH Fjeldstad, F Henjewe, G Mwambe, E Ngalewa and K Nygaard “Local Government Finances and Financial Management in Tanzania” (2004) *CMI Working Paper: Special Paper No.16*.

Tax farming was also identified as a viable reform capable of successfully taxing the informal sector. With this reform the state transfers the right of collection to private individuals called tax farmers in exchange for a certain fee. It was identified that, while privatisation provides clear incentives for the maximisation of tax collection, the practical implementation of this reform has resulted in abuse and harassment of the informal traders. Additionally, the strategy does not encourage “negotiation, voluntary compliance or more productive interaction between state and society”.

Fostering a culture of engagement, transparency and service delivery is also a strategy that will increase tax morale and compliance. Transparency can be achieved through explicit earmarking of tax revenues. This approach was used in Guinea and tax collection doubled as a result of engagement, transparency and clear service deliverables. Rwanda also adopted this approach and it allowed for the creation of platforms of engagement where the revenue authority developed an understanding of industry related issues, such as profitability, constraints to growth, and service needs, while the Private Sector Federation used the opportunity to understand taxpayer rights and obligations and filter them through to its members.<sup>298</sup>

Ghana and Tanzania have put some of the above-mentioned reforms into practice. Tanzania introduced presumptive taxes in 2001. These taxes were levied on small individual traders with an annual business turnover of not more than an amount set by the state. In a bid to strengthen the presumptive system and thus to expand the tax base and optimize tax revenue collection, the TRA introduced the BMS in 2005.<sup>299</sup> As a reform measure, the system allowed for tax services that are tailored to the needs and realities of small firms, whilst broadening the tax base in the process. The system has resulted in an increased number of informal businesses registering with the Tanzanian Tax Administration.<sup>300</sup> Regardless of these notable advantages, the system has been labelled as “invasive and probably counter-productive” and demonstrating “the potential for conflict between revenue collection, governance, and administrative

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<sup>298</sup> OH Fjeldstad, F Henjewe, G Mwambe, E Ngalewa and K Nygaard “Local Government Finances and Financial Management in Tanzania” (2004) CMI Working Paper: Special Paper No.16.

<sup>299</sup> Tanzania Revenue Authority Review of Informal Sector for Taxation Purposes First Draft Report (2011).

<sup>300</sup> Joshi, Prichard and Heady *Taxing the Informal Economy: The Current State of Knowledge and Agendas for Future Research* 1339.

efficiency”. Despite this criticism, there is overwhelming evidence supporting the idea that the BMS was largely successful in its effort to tax the informal sector.

Outsourcing of revenue collection is another innovative tax administrative strategy that Tanzania is currently engaged in. The decision to outsource revenue collection was influenced by the citizens who complained about the council’s revenue collectors and that they did not see the benefits of the collected revenue.<sup>301</sup> Since this system started, a range of different private entities have been used to collect taxes. It was found that outsourcing revenue collection allowed employees in the revenue department the opportunity to be deployed to other tasks instead of being preoccupied by tax collection. Additionally, outsourcing to private agencies increases administrative effectiveness and efficiency, which can lead to an increase in revenue without affecting either the tax base or rate, while protecting taxpayers.<sup>302</sup> Outsourcing was also found to have the potential to reduce corruption at the collection point, because a private collector has a vested interest in the result of revenue collection. A disadvantage of this strategy was experienced in 1997, when the city council suffered substantial losses as agents retained more revenue than what they handed over to the city council.<sup>303</sup> This was an adverse effect of political interference with administrative processes and failure to put in place an effective monitoring and evaluation systems.

The chapter also focused on Ghana, as it has successfully managed to get informal sector associations to support presumptive tax. The Ghanaian Internal Revenue service delegated the responsibility of collecting tax to informal sector associations, under a strategy it called Identifiable Grouping Taxation. This strategy has increased revenue generated from the informal sector, improved administrative effectiveness, and taxpayer morale and tax compliance. Despite the system’s many successes, there is always a risk of it being affected by political interference.

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<sup>301</sup> Fieldstad, Katera and Ngalewa *Outsourcing Revenue Collection to Private Agents: Experiences from Local Authorities in Tanzania* 5.

<sup>302</sup> S Jang R Eger III *The Effects of State Delinquent Tax Collection Outsourcing on Administrative Effectiveness, Efficiency and Procedural Fairness* (2018) *The American Review of Public Administration*. Available: [https://calhoun.nps.edu/bitstream/handle/10945/57873/The\\_Effects\\_of\\_State\\_Delinquent\\_Tax\\_Collection.pdf;jsessionid=684FF73C71A599F89911E35FCD1357B8?sequence=1](https://calhoun.nps.edu/bitstream/handle/10945/57873/The_Effects_of_State_Delinquent_Tax_Collection.pdf;jsessionid=684FF73C71A599F89911E35FCD1357B8?sequence=1) [Accessed 8 September 2021] 5.

<sup>303</sup> *Ibid.*

The adoption of policies and administrative strategies that are aimed at increasing voluntary tax compliance and facilitating collective action by informal sector associations, was found to be useful in improving prospects for informal sector tax reform.

### **5.3 Recommendations to increase tax morale and compliance among the informal sector in Zimbabwe**

Chapter four addresses the fourth sub-goal of the research – making practical recommendations that are mindful of the Zimbabwean economic context. The chapter sought to derive lessons from the recent administrative innovations discussed in chapter three, that are employed by other developing countries like Tanzania and Ghana in taxing the informal sector. A number of key priority areas to be addressed in introducing administrative tax reform in Zimbabwe were proposed.

For a number of reasons, presumptive tax was found to be the most appropriate system for taxing informal sector traders. From an administrative point of view, presumptive tax was attractive because of its low compliance costs for taxpayers and low costs of collection for revenue authorities.<sup>304</sup> It was found to be the most effective instrument to broaden the tax base and raise revenue. Further, presumptive tax is effective in promoting horizontal and vertical equity, whilst encouraging formalisation of informal sector businesses. Despite the challenges associated with the administration of presumptive taxes in Zimbabwe, the chapter acknowledged that Tanzania and Ghana provide evidence that a presumptive tax policy can work when paired with innovative and effective administrative strategies.

Establishing a clear theoretical foundation was another key priority area identified in the chapter for the purpose of making a policy recommendation. It was established that the *Benefit Theory of Taxation* best responded to the Zimbabwean context, with the capacity to encourage high tax morale and restore a level of trust towards government by informal sector players. The aspects of collective bargaining as characterised by the Identifiable Grouping Taxation of Ghana was of particular interest, given its success in ensuring mutual benefits for the state that received revenue, and the informal sector traders that achieved better working conditions. It was proposed that a revenue collection policy should be associated with an improved informal

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<sup>304</sup> Loeprick Small Business Taxation: Reform to Encourage Formality and Firm Growth 1.

sector, and the *Benefit Theory of Taxation* was found to be at the heart of this approach. It was also appreciated that other theories like the *Ability to Pay* and the expediency theory were also critical in ensuring a sound theoretical framework for informal sector taxation.

Another key priority area is the introduction of good tax policy that deliberately seeks to uphold the tax principles of fairness and equity through a range of administrative efforts. ZIMRA needs to engage in regular taxability research to re-assess the current taxes being applied, together with the associated tax levied against the various sectors of the informal sector. Inspired by the BMS of Tanzania, it was also recommended that ZIMRA should map and divide informal sector traders in the cities and towns into smaller segments for effective assessment, support and monitoring. Lastly, ZIMRA should clearly distinguish between those earning too little to meet the presumptive tax threshold and those using informal trade to evade taxes.

The introduction of a dedicated office and trained workforce responsible for the informal sector and presumptive tax in Zimbabwe was also identified as a priority area. Lessons from Tanzania revealed that the success of the BMS was linked to a team of trained personnel who were allocated to each block, subject to rotation after a certain length of stay in one block.<sup>305</sup> The introduction of a dedicated office and trained workforce was found to be key in ensuring a tailor-made approach to presumptive tax and informal sector taxation in Zimbabwe. It was also recommended that ZIMRA should be intentional about building a working relationship with informal sector associations. Associational taxation and the Identifiable Grouping Taxation contributed greatly to administrative convenience by reducing collection costs to a fixed 2.5 per cent in Ghana.<sup>306</sup> The same administrative convenience was proposed for ZIMRA, noting that associations can take the lead in building high tax morale through education campaigns, and ensuring that the needs of their members are considered through collective bargaining. To simply propose that ZIMRA should fully employ Ghana's approach was avoided, where associations were given the full right to collect informal sector tax, but it was established that there is great benefit in strengthening relationships between the informal sector associations and ZIMRA in Zimbabwe.

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<sup>305</sup> Tanzania Revenue Authority Review of Informal Sector for Taxation Purposes First Draft Report (2011).

<sup>306</sup> Joshi, Prichard and Heady Taxing the Informal Economy: The Current State of Knowledge and Agendas for Future Research 1339-1340.

Another key priority area for administrative reform was identified as the need to foster a culture of transparency and engagement. The Bo City Council in Sierra Leone provided a perfect reference point for this concept – where tax morale and support for tax collection was raised by simply prioritising transparency, outreach and equitable tax enforcement. In the same way, it was recommended that information relating to revenue and expenditure should be made public through engagement and outreach programmes.

Addressing corruption was also identified as a key priority area for reform. It was recommended that ZIMRA should employ a variety of administrative strategies to discourage corruption. A number of options were presented in this regard. The introduction of electronic payment methods was found to be effective in eliminating the “prominent human element” and therefore reducing corruption. Where this is not immediately possible, ZIMRA was encouraged to set collection targets and impose strict consequences for employees that fail to meet the set target. Enforcing periodic rotation of tax collectors to discourage the formation of personal relationships that create a conducive environment for corruption was also proposed as a possible solution. As a last resort and when all else has failed, it was recommended that ZIMRA could adopt the outsourcing of revenue collection to private collection agents. The point was that ZIMRA should actively fight corruption to encourage high tax morale and compliance.

Promoting awareness, appreciation and understanding of tax through education programmes is another area proposed for reform. It was recommended that the design of educational programmes should be guided by three fundamental elements, which are content selection, mode of delivery and the person or voice behind the message. Content selection involves packaging messages in clear, precise and understandable communication. The mode of delivery should be informed by engagement and reciprocal communication. Finally, the voice carrying the message, whether person, newspaper or electronic platform, should be familiar to encourage a good audience. It was established that the adoption of these three fundamental elements in educational programmes will allow for effective communication and the promotion of an acute awareness, appreciation and understanding of presumptive tax, whilst encouraging high tax morale and compliance by the informal sector in Zimbabwe.

Lastly, it was recognised that the successful implementation of these recommendations is fully dependant on support received from the Zimbabwean government. Reforms are costly and the

government will need to make a budgetary provision of the funds needed to carry out these recommendations.

## **5.4 Conclusion**

The main goal of the research was to establish clear, innovative, and practical administrative strategies that can be adopted by ZIMRA in taxing the informal sector in Zimbabwe. A number of sub-goals were identified as critical in achieving this goal. The first and second sub-goal required an exploration of the advantages and disadvantages of taxing the informal sector in Zimbabwe, an examination of the current efforts (in legislation and policy) that seek to tax the informal sector, and identifying challenges encountered by ZIMRA in their efforts. This was investigated in chapter two of this research, which established the context of informal sector taxation in Zimbabwe. The third sub goal was an investigation into recent administrative innovations in taxing the informal sector, adopted in Ghana and Tanzania, and how these assisted in overcoming the challenges associated with taxing the informal sector within their respective jurisdictions. This was dealt with in chapter three, which highlighted recent innovative administrative strategies and lessons that Zimbabwe can learn from. The fourth sub-goal was to make practical recommendations that are mindful of the Zimbabwean economic context. This was done in chapter four of this research, where recommendations were made for administrative reforms, based on the literature and innovations explored in chapter three.

A final note of concern is the possible lack of political will to carry out the necessary reforms of the presumptive tax system and the associated policies needed to carry out these reforms.

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