TAX SYSTEM IN THE INFORMAL SECTOR: A CASE STUDY OF HARARE INFORMAL SECTOR TAX SYSTEMS

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ABSTRACT

The study looked at an in-depth understanding of the tax systems in relation to the informal sectors in Harare, Zimbabwe. The research design for the study was a descriptive survey. The study methodology was mixed methods. The study used interviews and surveys as data collection tools. The findings revealed that presumptive tax is the main tax system used by tax authorities on the informal sector. In addition to this, the study revealed that players in the informal sector were not willing to formalise their operations for non-recognition in the formal system. The study recommended that presumptive tax must not be punitive and should not cripple the operations of the informal sector.

KEYWORDS

Informal sector (SMEs), Tax systems, Presumptive tax, formal credit

1. INTRODUCTION

These informal SMEs are generally entrepreneurial owner financed and managed, but flexible and adaptive to the economic challenges currently being encountered in the Zimbabwe economy. They do not have access to formal lines of credit and financial services mainly due to their non-corporate nature and lack of formal accounting record keeping practices that aid disclosure and accountability. Numerous informal enterprises across the globe mainly in the Sub Saharan Africa and Latin America are not registered in the standard tax systems (IMF, 2007). As a counter intervention measure, 25 out of 44 African countries and 14 out 17 Latin American countries have introduced specialised tax systems.

There is no general or agreed consensus among the academic fraternity regarding the definition of SMEs that adequately capture all the characteristic facets of SMEs regarding fundamental issues including size, number of employees, annual turnover, accounting records and business organisational set up (European Commission, 2008) The Informal SMEs have been defined by OECD (2002) as unregistered operating units of households that continuously produce and distribute goods and services using labour intensive processes and without adequate accounting records The informal sector which employs the majority of the economically active population contributing to the informal economy and informal employment is a serious challenge to policy makers who lack the requisite data to improve legal, social protection and working conditions and productivity in the informal sector activities through regulatory framework, advocacy, training, access to credit and financial services (Pant and Suwal, 2009).

Numerous informal sector enterprises have suffered the fate being imposed a specialised tax, normally referred to as presumptive tax, based on an aggregate assumption of the actual tax that included sales, income and economic activity capacity (Bird and Wallace, 2003). The ever

growing informal sector worldwide (Bird and Zolt, 2008) currently constitute that largest share of economic activity, and their informal nature greatly impacts negatively numerous government s to effectively regulate and tap revenue .

Zimbabwe's informal economy is arguably largely dominated by the informal sector enterprises (non formal SMEs), who seem unrecognised despite their immense key contributions to the formal economy in both public and private sectors various initiatives. These informal SMEs are generally entrepreneurial owner financed and managed, but flexible and adaptive to the economic challenges currently being encountered in the Zimbabwe economy. They do not have access to formal lines of credit and financial services mainly due to their non-corporate nature and lack of formal accounting record keeping practices that aid disclosure and accountability. The manufacturing informal SMEs that were used in this study were those defined by the threshold of International Labour Organization (ILO,2008) as HUEMs (Household Unincorporated Enterprises whose primary objectives are to generate employment and the production of goods and services on a regular basis for a country's domestic consumption or exports. A study of SMEs (formal and informal) is therefore critical given their immense contribution to individual national accounting systems, economic systems, employment and poverty reduction. Access to formal credit by SMEs is indeed critical, just like for larger corporate, for capitalization and working capital requirements.

According to the Reserve Bank of Zimbabwe (RBZ, 2009), Zimbabwe SMEs are the principal drivers of economic growth, employment creation, and wealth creation with a high skilled base and complement the economic private and public sectors in the overall country development. Africa and the rest of the World have also benefited immensely from SMEs in economic growth, and employment creation accounting for some countries like Indonesia (98%), Japan (81%), Thailand (78%) and OECD countries (50%) of productive workforce (RBZ, 2009). Inadequate accounting record keeping practices of SMEs has taken a negative toll effect on the formal financing models to SMEs in different sectors (RBZ, 2009).

The Reserve Bank of Zimbabwe (2006) revealed that although SMEs are an economic engine of growth of the Zimbabwean economy, they are plagued with the key challenge of lack of access to finance and formal credit in Zimbabwe and also the World at large mainly due to the obstacles of negative perceived risks and lack of collateral. Additionally (RBZ, 2006) SMEs face challenges operationally in terms of weak business structures, poor regulatory frameworks, and absence of supportive institutional stakeholders.

The informal sectors in Harare, range from sole traders to informal enterprises dealing in the mining, transport, flea markets, commodity broking and manufacturing. They contribute immensely through the informal economy to the formal economy and the employment creation. They also contribute directly through the payment of Value added tax (VAT), Intermediated Money Transfer (IMM) and customs excise duty. Indirectly the informal sector contributes mainly through presumptive tax.

1.1. Statement of the Problem

Poor record keeping and operating `informally` are challenges which serious affect the operations of the informal sector. Due to this, the informal sector is struggling to formalise their operations as a result of presumptive tax. How can the informal sector perform under such taxation systems? The purpose of the study was to have an in-depth understanding of the taxation system in the informal sector.

1.2. Objective

The objective of this study was to analyse the tax systems of informal sectors to its contribution towards national revenue.

2. METHODOLOGY

The population of the study comprised of 60 (sixty) members from the informal manufacturing industry and the informal retail shops. The study employed a mixed method approach. Purposive sampling technique was used to select the 45 (forty-five) members who participated in the study. Interviews with members of the manufacturing informal sector and surveys with informal retail shop owners were the data collection tools used. A non-rated measure tax system was based on target population.

3. DATA PRESENTATION, ANALYSIS AND DISCUSSIONS

The study wanted to find out how players in the informal sector understood tax presumption. The following results were obtained:

Interviews data gathered with the informal sector players indicated that all informants indicated they were aware of presumptive tax system which was used by the Zimbabwe Revenue Authority (ZIMRA). One key informant says "Presumptive tax is a system used by ZIMRA. This tax system is based on the assumptions of goods sold to the formal market by the informal sector". Data gathered through survey concurs with data collected from interviews. This shows that the informants were aware of what presumptive tax system is all about.

According to African Development Bank (ADB, 2016), presumptive tax systems are based on the fact that informal sector enterprises do not keep accounting records. Records which are in use according to ADB are not adequate enough to use for taxation purposes. Hussmann (2004) reiterates that there are current controversies and no agreed or general consensus regarding the definition of the informal sector and concepts which have different meanings, interpretations and viewpoints on the observations and measurement of the data. The major weakness of such a definition is that it is country-specific, depending on the prevailing administrative, legal or statistical framework; the sector will expand or contract with a change in the underlying yardstick over time.

The study wanted to find out if the informal sector in Zimbabwe was willing to register with ZIMRA. The following results were obtained:

N=45

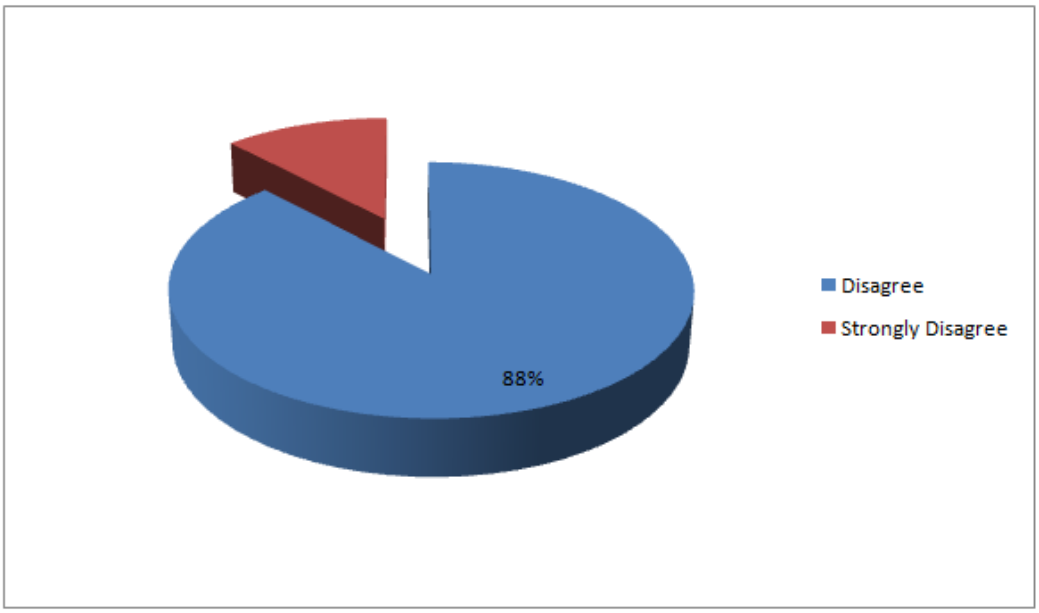

Fig 1: Willingness of informal sector to register for taxation at ZIMRA

3.1. Source: Primary Data

SMEs virtually unanimously disagreed (88%) with strong disagreement (12%) with registration with ZIMRA

Through data gathered through interviews, all informants indicated that the informants were not willing to register with ZIMRA. When probed further, the informants indicated that it was not necessary to register because there was no recognition by formal financiers. One informant said ".....why should I bother to meet stringent requirements to get registered for no value addition to my business?"

Basically, informal sector players in Zimbabwe were not willing to register. The main reason is that there was no benefits out of the registration exercise with ZIMRA. This being the case, there is no distinction between being registered or not.

Ghersi (1997) argues that SMEs manufacturers also referred to as Industries are classified mainly into two (2) groups namely formal and informal SME manufacturers, the formal actors being those formalize portions of their production for regulation and taxation purposes and the informal actors who are unregulated and working in their homes or small workshops. The main criteria widely adopted across the world for the classification of SMEs include: number of employees, sales volume, financial strength, relative size, initial capital outlay and independent ownership.
Variations of this classification argument was also contended by Kalyani (2016) who argued that the major characteristics of India's unorganised/ informal SMEs are informal employer – employee relations, workplace scattered and fragmented, employees in unorganised sectors, no regulatory framework, easy entry/exit, illiterate and ignorance, minimum capital requirements, labour intensive and manual equipment / machinery. The classifications criteria of SMEs are what makes them Country specific, due to differences in country economic advantages, economic systems, contributions to GDPs, Taxation thresholds, skilled labour force, legal framework, political orientation and dispensation, regulatory frameworks and country economic groupings like OECD, SADC, EU amongst others.

3.2. Findings

The study revealed that the ZIMRA`s presumptive tax system on the informal enterprises are punitive in nature. However, the presumptive tax system complies with the understanding at continental level. More to this, the study revealed that players in the informal sector were not willing to register formally with the regulatory authorities.

4. RECOMMENDATIONS

The study recommended that presumptive tax must not be punitive and should not cripple the operations of the informal sector.

The Ministry of Small and Medium Enterprise should provide incentives for registered informal sector plays. This would motivate them to register and formalise their operation. By so doing, tax collection system would be effective.

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