

Taxing The Informal Sector In Developing Countries: An Empirical Investigation From Rivers State Of Nigeria

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Abstract

Most developing countries of the world currently battle with the problem of inadequate funds to meet their financial needs. In a bid to solve that problem, some have resorted to taxing the informal sector. This study examined effects of taxing the informal sector in Nigeria. To achieve that, the researchers distributed a total of 110 questionnaires to respondents within Port Harcourt metropolis and its environs. The responses were presented using descriptive statistical tools of tables and bar charts. Formulated hypotheses were tested using the Kruskal Wallis and Chi square tests. Findings revealed that taxing the informal sector would boost revenue generation and also impact positively on the economic development of developing countries. The researchers therefore recommended: effective tax monitoring and audit of the informal sector operators, enhanced capacity building of staff of the Revenue Authorities, immediate establishment of revenue courts to try offenders where necessary, reduction of multiple taxes, etc. as some of the steps to be taken to ensure compliance to tax payments by informal sector operators.

Keywords: Taxation, Informal Sector, Tax, Economic Development, Tax avoidance.

1. Introduction

Many third world countries globally, are faced with a plethora of financial problems. This is not unconnected with the negative “economic indices” which have become a global concern in recent times. The case Nigeria is mind-boggling because of its peculiarity. Nigeria’s economy is mono-

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culturally depended on oil. The implication is that over 90% of the nation's revenue is based on crude oil sales and the gap is often financed with borrowings and aids (external and internal) which makes the country's economy totally dependent on variables beyond its control. Faced with rising government expenditure needs vis-à-vis dwindling internally generated revenue, acute shortage of foreign exchange, fall in crude oil prices globally, galloping inflation, high poverty rate among its citizens, lack of basic infrastructure, etc., it has become pertinent to go back to the basics- embarking on other sources of internally generated revenue via taxation. Accordingly, taxing the informal sector, therefore, portends one of the veritable options available to the government; in this regard.

1.1 Problem Statement

Oil booms are no more. Many developing countries, who predominantly are dependent economies, now struggles. Because of that, there has been a change in thinking in governments' attention (in Nigeria and other developing countries) towards taxing the informal sector, which before now were missing in the tax net; in order to boost their revenue base. This paper examined the perceived impacts of taxing the informal sector on revenue generation in Nigeria.

1.2 Research Objectives.

During the study, the researchers came up with the following research questions:

1. Will the taxation of the informal sector have any positive impact on revenue generation in Nigeria?
2. Will taxation of the informal sector enhance economic development of Nigeria?

1.3 Hypotheses

To achieve the above objectives, the following hypotheses were formulated:

H01: Taxation of the informal sector will not significant increase revenue generation in Nigeria.

H02: Taxation of the informal sector will promote economic development in Nigeria.

2. Literature Review

Taxation is seen globally as the best means of raising revenue for governments internally. Nigeria's economy is sectorised into formal and informal sector. Of the two sectors, the informal sector employs over 75% of the labour force. According to the World Bank, the informal sector accounts for the 40% of gross national products(GDP) of low-income countries. "Despite their significant contributions to the economies of developing countries, they are the least taxed" (Patrick, 2011). Njeru (2012) & Mbiliayi, (2012) argued that "taxing the booming informal sector presents the hope of generating extra income to make up for the deficit in tax revenue, yet this is not without its problems". Joshi and Ayee (2009) opined that "how to tax the informal sector remains a pressing question".

Njeru (2012) further opined that “there seems to be a consensus that African governments and their tax authorities would have to work around the clock to bring the informal sector into tax bracket, as efforts by governments to widen the tax base will greatly increase revenue leading to a reduction in the reliance on donor funding and in incidences where governments are forced to increase taxes on basic commodities. Despite the low compliance by this sector, the government is still determined to expand the tax net (base) to the informal sector since ignoring the sector’s activities will dampen compliance morale of the few already complying and by extension lead to not just further drop in tax revenue but increased rise on generalized non-compliance among tax payers in the both sectors”.

2.1 Tax And Taxation Defined

The black law dictionary defines tax as “money charge imposed by the government on persons, entities or property levied to yield public revenue. Put differently, tax can be defined as “a charge on income of individuals and corporate bodies by the government” (Abdulahi 2012). In simple terms, a tax is a compulsory contribution levied by a sovereign power (usually the government or its agencies) on the incomes profits, goods, services, or property of individual and corporate persons, trusts and settlements. Such taxes when collected are used in carrying out governmental activities; for example, maintenance of law and order, provision of infrastructures, health, and education of her citizens, or as a fiscal tool for controlling the economy. Aptly put, any compulsory payment by an individual or a company to government, which does not result in commensurate or direct economic benefit to the payer, is a tax. This could take different forms and may be collected and administered in different ways. For instance, direct taxes are imposed directly on the incomes of individuals and corporate bodies. Examples of direct taxes are personal income tax, company income tax, etc. Indirect tax on the other hand is a tax on goods and services where the burden can be shifted to the tax payer. Examples include; value added tax or sales tax, customs duties, etc.

Taxation, on the other hand, is the process involved in administering and collecting taxes. It involves formulation up to utilization (Abdulahi 2011).

2.2 The Informal Sector

The role of the informal sector to local economic development has been discussed by many authors (Tutik, 2014). Different persons, authors or groups have defined the term “informal sector” their own ways. Tutik, (2014) defined the” informal sector as one group of economic arrangements which are not subject to government arrangements, which are not subject to government regulations, and which the nature of employment is both self-employment such as home production and petty trading and wage employment such as casual labour, contract labour and piecework, characterized by small

competitive firms, petty retail and services, labour-intensive methods, free entry, and market-determined factor and product prices”.

The informal sector in Nigeria refers to economic activities in all sectors of the economy that are operated outside the preview of government regulation.

The features and characteristics of this very critical sector include among others, their mobile nature, small scale operation, cash transaction and unwillingness to keep business records make it very hard to tax the sectors actors, since the taxation of this commonly referred to as ‘hard-to-tax sector’ requires enormous effort and seeming tasking. This sector may also be invisible, irregular, parallel, non-structured, backyard, underground, subterranean, unobserved, or residual (Magbagbeola, 1996) cited in (Ekpo and Umoh 2014). Yankon (1992) stated that the operators of this sector mostly lack adequate financial resources to import more advanced technology so the sector heavily relies on labor-intensive mode; for its production. Ekpo and Umoh (2014) further summarized that “activities in the informal sector in Nigeria are difficult to measure; they are highly dynamic and contribute substantially to the general growth of the economy and personal or household income”.

2.3 Challenges of Taxing the Third Sector

In as much as it is relatively easy to tax the formal sector (regulated sector), the informal sector, which serves as the hub of employment for many people, poses a big challenge to tax officials.

There are three major reasons why taxation of the informal sector has been almost universally unsuccessful. The first he called “capacity constraints”. Talking about capacity, many tax authorities or governments lack the resources (in terms of men, materials, and technology) to initiate, implement, monitor, and enforce tax laws. In fact, the large number of people engaged in the sector, coupled with its complex nature, creates additional logistical problems for the tax authorities for collection of taxes. The second, he identified as “notions of equity”. Here he asserted that informal sector operators have very low incomes thereby the argument of them to be exempted from taxation. The third he called “political reasons”. Here, he argued state officials and politicians turn blind eye to activities in the informal sector to pressurize government officials to reduce enforcement because informal sector workers form a substantial vote have for politicians (Joshi and Ayee 2009 & Abdulali, (2012)).

Other challenges identified as bedeviling the taxation of the informal sector in Nigeria include: Poor understanding of tax laws processes, poor understanding of benefits of paying tax by operators, lack of proper records or improper recording of business transactions, culture of deliberate tax evasion, avoidance and general reporting on the part of operators, Non-disclose of or incorrect business addresses, challenge of multiple taxes, challenge of corruption by tax officials, challenge of bad

governance thereby making operators not to set the need to pay taxes since they do not enjoy government services, predominance of cash transaction, lack of effective regulation, high level of illiteracy amongst informal sector operators, lack of education and proper sensitization by the tax authorities to encourage compliance, structure of our economy, which is the predominantly agricultural, administrative problem bordering on chronic shortages of trained officials and ICT facilities to facilitate the process of taxation, ineffective implementation of withholding taxes and non-establishment of revenue or tax counts to quickly try and punish offenders of tax laws (Stuart, 2013).

2.4 Methods of taxing the Informal Sector

Joshi and Aye (2008) & Gupta, (July,2007) suggested among others, direct presumption taxation as a method of taxing the informal sector. Other methods of taxing informal sector, identified by Ifueko, (2010). were;

- 1.The occupational and sector-specific standards Assessment where a fixed lump sum is to be paid by person or enterprises engaged in a certain business or profession.
- 2.Another is the estimated lump sum assessment system, an indicator based system where the tax liability is estimated on observed features or indicators such as business size, premises, skills of and number of employees, location, energy and water bills, service capacity of the business such as restaurants, hotel rooms, number of seats in the transport vehicles, etc. This method involves some elements of discretion on assessments that may invite corruption and inconsistencies.
- 3.The presumptive minimum assessment. This tax system is used to assess the minimum corporate profit tax liabilities which may be graduated yearly. Minimum lump sum tax could also be based on percentage rate on gross receipt where only few apply it (Lisa, 2007).
- 4.The lump-sum minimum plus a percentage of gross receipts. This is applied in some jurisdiction. Here a specific lump sum is assessed together with a percentage of gross receipt of the enterprise in question for tax purposes.

Tutik (2014) & Bird, (1992) opined that one of the suggested methods of collecting tax from the informal sector is using the unions of informal sector as collection agents. Considering the unions have detailed knowledge of the activities of members and could collect taxes without much effort, collecting through unions will probably be the most effective.

3. Research Methodology

The study focused on taxing the informal sector. The study was carried out in Port Harcourt metropolis of Rivers State of Nigeria. The researchers made use of judgmental or convenient sampling technique. Primary data were collected through questionnaires. A total of 110 questionnaires were administered amongst accountants, Owners of Small businesses, street vendors, artisans as well as tax

practitioners (mainly from the Informal sector unit of Rivers State Internal Revenue and the Federal Inland Revenue Services). Descriptive statistical tools (mainly tables and bar charts) were used to present and analyze the data collected while Kruskal Wallis and Chi-square tests were employed to test the formulated hypotheses,

4. Data Analysis And Results

4.1 Kruskal Wallis Test on the impact of taxing the third sector on revenue generation.

H01: Taxation of the third sector will not significant increase revenue generation in Nigeria.

Decision Rule: Accept H0 if p-value > significant level, Reject H0 if p-value < significant level.

Table 1 Ranks

	Option	N	Mean Rank
Responses	NS	5	8.6
	SD	5	3.3
	D	5	12.1
	A	5	20.90
	SA	5	20.1
	Total	25	

Key: SA=Strongly Agree, A=Agree, D= Disagree, SD=Strongly Disagree, NS= Not Sure

Table 2 Test of statistics	
	Response
Chi-square	21.25
df	4
Asymp Sig.	0
a. Kruskal Wallis	
b. Grouping Variable: Option	

4.2 Chi-square test on the impact of taxing the third sector on promoting economic development in Nigeria.

H0 2: Taxation of the third sector will promote economic development in Nigeria.

Decision Rule: Accept H0 if p-value > significant level, Reject H0 if p-value < significant level.

Table 3. Chi-Square Test Result.

Question items	Strongly Agree	Agree	Disagree	Strongly Disagree	Not Sure	Total
1. Will increase IGR	45	62	2	1	0	110
	41.0	64.40	3.8	0.60	0.20	
	0.39	0.09	0.85	0.27	0.20	
2. Increased economic development	47	61	1	1	0	110
	41.0	64.40	3.8	0.60	0.20	
	0.88	0.18	2.06	0.27	0.20	
3. Reduce tax evasion	36	70	3	1	0	110
	41.0	64.40	3.8	0.60	0.20	
	0.61	0.49	0.17	0.27	0.20	
4. Encourages transparency and efficiency	40	67	3	0	0	110
	41.0	64.40	3.8	0.60	0.20	
	0.02	0.10	0.17	0.60	0.20	
5. Reduces tax avoidance	37	62	10	0	1	110
	41.0	64.40	3.8	0.60	0.20	
	0.39	0.09	10.12	0.60	3.20	
Total	205	322	19	3	1	550
<i>Chi-Square=0.39+0.09+0.85+0.27+0.20+0.88+2.06+0.27+0.20+0.61+0.49+0.17+0.27+0.20+0.02+0.10+0.17+0.60+0.20</i>						
<i>0.39+0.09+10.12+0.60+3.20=22.61, DF=16, P-VALUE=0.00</i>						

Table 4 & 5 Test of statistics	
	Response
Chi-square	20.078
df	4
Asymp Sig.	0
a. Kruskal Wallis	
b. Grouping Variable: Option	

Table 6: Ranks showing percentages of responses

Question items	Strongly Agree	Agree	Disagree	Strongly Disagree	Not Sure	Total
1. Will increase IGR	45	62	2	1	0	110
% of Responses	40.91	56.36	1.82	0.91	-	100

Table 7: Ranks showing percentages of responses

Question items	Strongly Agree	Agree	Disagree	Strongly Disagree	Not Sure	Total
1. Will improve economy	47	61	1	1	0	110
% of Responses	42.73	55.45	0.91	0.91	-	

Figure 1. Percentage distribution of responses on the effect of taxing the third sector on increased revenue generation in Nigeria.

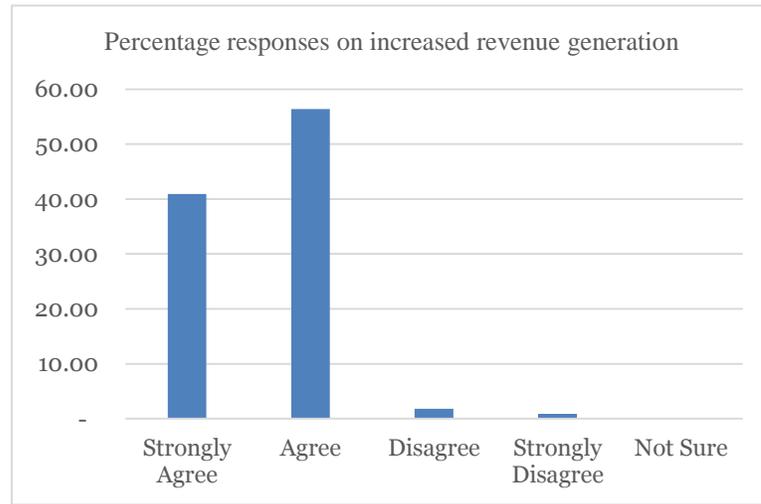
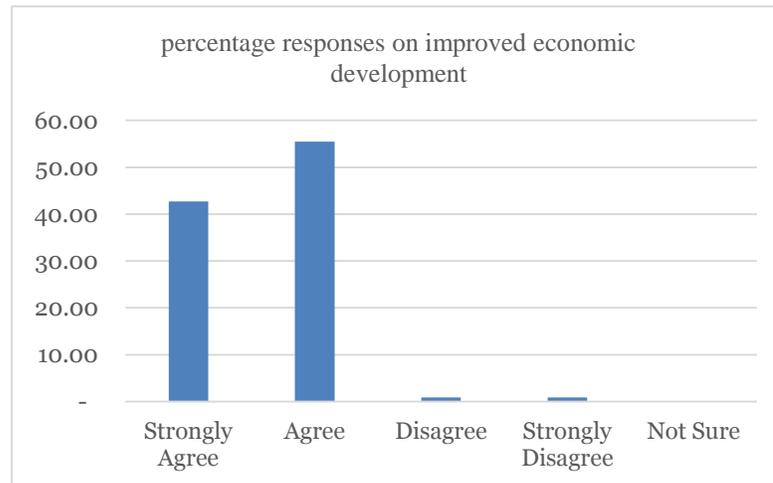


Figure 2: Percentage responses on the effect of taxing the third sector on economic development in Nigeria.



5. Discussions

The result in Table 1 showed that most of the respondents agreed that taxing the third sector will boost or enhance revenue generation in Rivers State and Nigeria by extension. The Chi-square measure obtained is 22.61 and a p-value of 0.00 which falls on the rejection region. That means that the null hypothesis was rejected since the $p\text{-value} = 0.00 < \alpha = 0.005$, at a 95% confidence level. Also, as displayed in Table 1, it was observed that most respondents agreed that taxing the third sector will boost revenue generation since the highest mean rank of 20.9 was obtained for “agree”.

From Table 3, most respondents agreed that the taxation of the third sector will impact positively on the economic development of the state and Nigeria at large. This agrees with the bar chart in Figure 1. Table 2 expressed that the taxation of the third sector will enhance economic development since the Chi-square measure obtained was 20.078 and the corresponding p-value of 0.001 which falls on the rejection region of the hypothesis. Hence the null hypothesis was rejected since $p\text{-value} = 0.01 < \alpha = 0.05$, assuming a 95% confidence interval. Figure 2 showed that majority of the respondents concurred that the taxation of the third sector would obviously enhance economic development of the country, if the resources are properly utilized.

6. Conclusion And Recommendations

Learning from the discussion of findings above, we concluded that taxing the informal sector will not only improve revenue generation but will also enhance economic development of Nigeria. The researchers therefore made the following recommendations to revenue authorities towards solving the problem of informal sector taxation in Nigeria:

1. Tax laws should be made simple and to the understanding of the informal sector operators. This will enhance voluntary compliance.
2. The tax authorities or the government carry out tax census aimed at capturing all tax payers and bring in more into the tax net. An up to date tax data base of tax payers, well classified into formal and informal sectors, should be maintained by the authorities for effective monitoring.
3. Tax Identification Numbers (TIN) should be made free and mandatory for every tax payer; including those in the informal sector. If possible, TIN should be made as a condition for accessing government healthcare, education and other infrastructures provided by government.
4. A special agency of government, such as SMEDAN, be charged with the responsibility of identifying, registering, training and guiding all informal sector operators on how to keep accurate records, how to market their products, access cheap funds, etc. as these will make them feel recognized and will aid voluntary compliance.

5. The tax authorities should also grant tax amnesty to operators who were owing for reasons of ignorance and unawareness. This will reduce their exposure to penalties and will in turn encourage compliance.
6. The authorities should embark on aggressive monitoring and effective enforcement of all tax laws. Logistics should be provided in that regard to make for seamless and effective monitoring.
7. Public establishments and sensitization campaigns should be regularly carried out by the revenue authorities on the benefits of paying taxes. Such methods as radio, television, and newspaper programmes, adverts in local languages, holding of town hall meetings should be regularly carried out by tax authorities.
8. A bill to establish tax courts should be passed by all the federal states and local government tax authorities. This will make for a quick dispensation cases related to non-compliance
9. The tax authorities should recruit, train and properly motivate high level skilled personnel to administer taxes in their various jurisdictions.
10. Finally, concrete steps should be taken at the federal, state and local government levels to curb the menace of multiple-taxation.

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