Taxing the Informal Sector:
On Your Marks, Set, Go!

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Introduction

Benjamin Franklin, one of America's founding fathers reportedly said: *"In this world nothing can be said to be certain, except **death and taxes.**"* Whilst this underscores the importance of tax in any society, it may not be true for tax systems that allow the informal sector to operate on its fringes. This has been a long standing issue in Nigeria, and the need for everyone to pay their fair share of taxes to aid national development has never been more compelling.

With dwindling public revenues resulting from low crude price, the conversation on taxing the informal sector - which accounts for more than N38.7 trillion, or 41.1% of Nigeria's GDP as at 2015 - has again been elevated to the front burner of national tax discourse. Sadly, tax administrators have shown little interest in this area due to uncertainty in its potential revenue yield, high administrative cost and regressive incidence of tax. Nigeria's relative low tax to GDP ratio and the size of the informal economy show that as with many of Nigeria's long standing problems, if concerted action is not taken, we would still be talking about taxing the informal sector in the coming decades.

This article examines the potency of taxing this large population of businesses in Nigeria while comparing approaches and strategies adopted in other jurisdictions in achieving credible tax compliance by their respective informal sectors.

The Informal Sector in Nigeria

According to the ILO (1972), the 'Informal Sector' (Sector) represents small and micro enterprises that are outside the purview of government regulation and taxation, and ranges from small-scale (subsistence economic activity) to large self-employed activities cutting across retail, trade, transport, restaurant, repair, financial, and personal services. It is not uncommon to find that operators in the Sector are not compliant with labour, tax and corporate laws. Many operate under unincorporated platforms and therefore lack corporate personality, income derived from such economic activity is regarded as personal income thus liable to Personal Income Taxation (PIT). Some may argue that being unincorporated, income derived from the Sector should not be subject to income tax. Assuming without conceding informality approximates to their activities being illegal, such illegality would not preclude the Revenue from assessing their income, see *Federal Commissioner of Taxation v. Snowden (2013) 12 TLRN 28*. While the Sector contributes immensely to Nigeria's GDP, there is little or no commensurate tax revenue from the Sector to the Revenue.

Taxability of the Informal Sector: To be or not to be?

One of the questions often asked about taxing the Sector has been whether it is really worth it, considering the resources expended in ensuring compliance and expanding the tax net. In response to this, one may swiftly point out that the motive for taxing the Sector is much more than raising government's revenue but to create a culture of compliance with operators in the Sector. Besides, it may be unfair and inequitable on tax compliant entities if their tax is used to provide essential services to those who evade tax in the guise of practising in the Sector.

It has been argued, that enforcing a strict tax regime would impede growth of small firms thereby having an adverse effect on the economy. Without dismissing this argument as illogical, the utility of taxation as a means of income redistribution and the financing of public spending in providing essential services to the citizenry cannot be

overemphasized. Accordingly, if the essence of tax is to be realised, the Sector must play its role since it benefits from the activities of government.

Taxing the Informal Sector through the Window of Personal Income Tax (PIT)?

Personal Income (PI) of persons resident in Nigeria is taxed by virtue of the **Personal *Income Tax Act (PITA)*, Cap. P8, LFN 2004**. ***Section 1(a)* PITA** imposes PIT on the income of individuals, communities, and families after due assessment, computation and enforcement of their respective tax liability by the Revenue. Usually, this assessment takes into cognisance allowable deductions of expenses wholly, exclusively and necessarily incurred from the aggregate earnings or gross income ***(section 20 PITA)***. The balance is then subject to income tax for the year of assessment.

There is no doubt that operators in the Sector are theoretically subject to incidence of indirect taxes through Value Added Tax (VAT) and Withholding Tax (WHT), but their informal operations essentially enables them avoid these compliance requirements. However, our focus here is the application of PITA on the incidences of direct tax on the income derived from the Sector.

Due to the inadequacies in PITA with regards to unascertainable income peculiar with operators in the Sector, it was amended in 2011. ***Section 36(6)*** PITA, seeking a leeway to tax the Sector through a presumptive tax regime provides: "*notwithstanding any of the provisions of this Act, where for all practical purposes the income of the taxpayer cannot be ascertainable or records are not kept in such a manner as would enable proper assessment of income, then such a taxpayer shall be assessed on such terms and conditions as would be prescribed by the Minister in regulations by order of gazette under a presumptive tax regime.*"

The Minister as empowered by the Act may make regulation on the tax rate for operators in the Sector. By relaxing computation/ assessment rules and imposing a flat rate, it would further facilitate compliance by operators in the Sector. Surprisingly, it appears the Revenue, with the exception of Lagos State and a few other 'forward looking' States is yet to take full advantage of section 36(6) PITA. For instance, in Lagos State, where it was estimated that only 5 million residents are tax compliant – 90% of which are organised private sector employees and public servants whilst the Sector contributes only 10% - the Lagos State Internal Revenue Service (LSIRS) set up channels to ensure ease of compliance by the operators in the Sector. LIRS introduced simplified tax forms in local languages (Yoruba and Pidgin), set up 38 tax stations across the State, a 24 hour hotline where taxpayers can make enquiries on tax payment in any of the three (3) major languages, and reduction in the cost of issuance and replacement of electronic tax payment cards. LIRS also created a flat tax rate of N5,000 under the presumptive regime for artisans and tradesmen within the State. Undoubtedly, this expanded the tax net and contributed to the increased revenue generation of the State as it recorded more than N301 billion in the first half of 2016.

Comparative Approaches by Other Jurisdictions

How has other jurisdictions tackled this problem? It may be prescient to consider the experience of other developing economies like Nigeria's including African countries. Clearly, building more efficient tax systems has not been solely dependent on policy choices but a combination of various factors including; administrative and institutional reforms.

A 2014 publication asserts that Ghana has the Sector contributing more than 86% of the entire labour force. In a bid to expand its tax base, the Ghanaian Revenue Authority (GRA) began to take conscious steps through administrative reform of its tax collection and remittance. One of the approaches of the GRA was the *Identifiable Grouping Taxation (IGT)*. This is underscored by the belief that in approaching informal sector taxation, there should be a collaborative effort by all the stakeholders, with the GRA coordinating the collection through smaller units of the Sector.

Consequently, the collection of tax from operators in the Sector was delegated to smaller groups: associations and guilds. The system was first introduced into the informal transport sector and having proved successful, gained expansion into other areas of the Sector activities. This led to considerable increase in the government's revenue.

The system reduced the tax administrative cost previously incurred, by passing same to the association saddled with the responsibility of collecting the tax, identified potentially taxable microbusinesses and ensured compliance. From the perspective of the collecting association, being tax compliant granted them "legitimacy" and protected them from undue harassment from untoward public officials and the police – as the police are used to check the tax compliance status of the associations.

More so, micropayments were introduced which ultimately reduced the tax compliance burden, in terms of cash flow management. This ensured that daily or weekly payments were remitted to the association for onward transmission to the GRA who thereafter issued tax clearances to the association covering its members.

Cameroun

While the Ghanaian jurisdiction established IGT, in her own case, the Camerounian regulator sought to cede tax administration of the Sector to local governments (LGs). It was argued that although LGs are constitutionally empowered to administer some levies, they could also be saddled with the additional responsibility of administering this tax due mainly to the fact that: they have greater need of resources, and may thus have stronger incentives to pursue taxation of informal firms; they are closer to the people and therefore can leverage their 'local' knowledge which makes them familiar with local circumstances; they are better placed to negotiate with actors within the Sector. Notwithstanding these, greater coherence is promoted through harmonization of the existing taxes and implementation of collection strategies.

Options for Effective Taxation of the Informal Sector in Nigeria

Presumptive Tax Regime

Presumptive taxation is a tax regime aimed at generating revenue from the Sector. It is fashioned out to bring business operators in the Sector into the tax net of the Revenue and predicated on taxpayers' presumed income. That is, the desired tax base is inferred from simple indicators rather than a complex mode of assessment i.e. turnover, assets, business size, etc.

Presumptive taxing system offers the Revenue the potential to increase its annual collection from the Sector as it promotes voluntary compliance. This system is however not peculiar to Nigeria, it has also been practiced with high success rate in Czech Republic and France. Most times, the methods employed in estimating income and assessing tax liability varies from standard and estimated assessment, value of land, asset value, net worth and presumptive minimum taxes.

One major challenge with this regime is the administrative capacity of the Revenue. It employs trade associations; National Union of Road Transport Worker (NURTW) who often do not remit directly to the Revenue but individuals. Also, there is no efficient recording system that could be properly audited when the need arises. It therefore becomes imperative that the Revenue evolve ways to plug any form of revenue leakage. In plugging this leakage, the Revenue must make provision for appropriate technology tools that would limit human interface with the collection and remittance of taxes from these associations

Electronic Tax Payment System (eTPS)

To achieve optimum revenue yield by the Revenue, there is need to evolve tax administration by incorporating Electronic Tax Payment System (*eTPS*) in the Sector. This system would ensure that every taxable person is captured within the tax net and increase the ease of payment of tax. Here, the taxpayer is issued an electronic card/pin with which micropayments are made directly to the Revenue from the taxpayers' bank account. Upon payment, receipts are issued to the taxpayer who thereafter takes it to small revenue stalls for the issuance of Tax Clearance Certificate (TCC).

By incorporating eTPS, the cumbersome and time consuming process of filing formal application forms is eliminated. This would eliminate third party interference and reduce the risk of revenue leakage. In a bid to promote compliance by the Sector, the LIRS in 2016 announced that it has taken steps to ease tax compliance by making provision for multiple electronic channel of payment – Point of Sale (PoS), Mobile Pay (mPay), and online payment – which is facilitated by an e-filing process.

Again, a major challenge the Revenue would be faced with is simplifying compliance requirements considering the fact that most operators in the Sector are not computer literate. To address this, the Revenue would need to partner with the collecting banks and mobile network providers to continually send out short messages (sms) to operators in their indigenous language or Pidgin English. More so, within the States, the registration of SIM cards, opening of bank accounts and use of government services should require the electronic tax clearance certificate (e-TCC) number which could be linked with the taxpayer's Bank Verification Number (BVN). Such initiative may require support of the Joint Tax Board, sectoral regulators and even legislative action.

Conclusion

If the Revenue is desirous of significantly raising its collections profile, it must boldly address the germane issues of taxing the Sector; the solution to the tax deficit does not lie in increasing the amount of tax but in expanding the tax net to accommodate operators in the Sector. More so, with collaboration with banks, telecom providers and among various government agencies, the usage of government services could be predicated upon the presentation of an e-TCC issued by the Revenue.