



EFFICIENT TAXATION OF THE INFORMAL SECTOR IN AFRICA

SUMMARY BRIEF

June 2021

INTRODUCTION

This summary brief summarises the Guidebook on the Efficient Taxation of the Informal Sector in Africa (hereinafter, the Guidebook) which was developed by the African Tax Administration Forum (ATAF) to articulate the rationale for taxing the informal sector in Africa and provides pragmatic best practices and home-grown options. Over the years, numerous attempts have been made to find a suitable definition and scope of the term “informal sector”. This led to debates on the most appropriate definition to be used, which is crucial considering the nature of informal sector activities. Among competing definitions include one by the International Labour Organisation (ILO) (2009: iii) which defines informal sector to

include “all economic activities by workers and economic units that are – in law or practice – not covered or insufficiently covered by formal arrangements.” Schneider and Buehn (2009) consider the informal sector to include all market-based legal production of goods and services that are intentionally concealed (hidden) from public authorities to avoid payment of income, value added tax (VAT), social security contributions, legal labour market standards and administrative procedures. The most suitable and preferred one (adopted from the Informal Sector Study/Project) defines the informal sector as “all economic activities by workers and economic entities which are not covered or insufficiently covered by formal arrangements including underground production activities and not registered by Revenue Authorities (RAs) or



The establishment of a taxation model should be simple in its application by informal sector actors, flexible in its governance by the tax authorities and far from the limiting effects of their perceived need for an excessive simplicity in this sector.



Tax Administrations (TAs)".¹ The preferred definition is chosen given that it explicitly takes on board informal sector activities which are not registered by revenue authorities, thus not paying (direct) taxes. It is worth noting that informal sector economic activities are prevalent in both developing and developed economies, and they are not a temporary, marginal, or peripheral phenomenon, but a permanent feature.

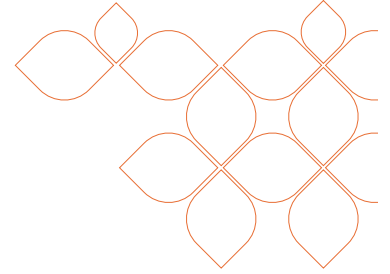
Overall, the informal sector remains the main source of livelihood to the majority of African citizens since, in general, it employs about 70% of the labour force in Sub-Saharan Africa and approximately 62% in North Africa (African Development Bank (AfDB), 2013). Despite this evidence about the size of the informal sector in Africa, the sector has not been contributing significantly to Domestic Resource Mobilisation (DRM) as far as payment of taxes to respective national revenue authorities is concerned.

The ATAF Secretariat embarked on a research project funded by the AfDB to assess the current state of the taxation of the informal sector in Africa and to propose a framework for the efficient taxation of the sector.

Ultimately, a Guidebook on the efficient taxation of the informal sector was developed. The information and data used in developing the Guidebook were obtained via surveys and Focus Group Discussions (FGDs) with diverse experts and stakeholders including officials from African RAs, officials from Government Ministries responsible for finance, informal sector players, academia and other independent tax experts. Some of the findings from the FGDs are published in the ATAF's Best practices Booklet on Taxation of the Informal Sector in Africa (hereafter, the Booklet) to showcase the activities of participating tax and customs administrations in order to encourage peer-learning and benchmarking across African RAs. Through the Guidebook and the Booklet, ATAF seeks to promote initiatives geared towards improving informal sector taxation in Africa. As one of the landmarks of the guidebook, ATAF proposed a framework for the efficient taxation of the informal sector.

The ATAF framework proposes a taxation model with its essential elements comprising knowledge of the activities carried out, turnovers and margins in the various sectors, the established structure, number of entrepreneurs and employees by sector

1 Revenue Administration (RA) and Tax Administration (TA) are used interchangeably in the context of this Guidebook to refer to integrated revenue authorities (domestic tax and customs) and non-integrated tax departments within the Ministry of Finance, respectively.



and challenges encountered. This Summary brief outlines the objective of the guidebook, methodology used, major findings, and the framework for efficient taxation of the informal sector in Africa. Of note is that policymakers should take cognizance of the need for optimal taxation, institution of a culture of good governance, promotion of tax compliance benefit, putting in place robust technical requirements for the taxation model implementation, ensuring a simplified tax system and the introduction of binding tax, as well as recognising the heterogeneity of the informal sector in Africa.

OBJECTIVES OF THE INFORMAL SECTOR TAXATION STUDY/PROJECT AND THE METHODOLOGY USED

The Guide book elaborated a situational analysis of the informal sector, proposed a taxation model aimed at efficiently taxing the informal sector, evaluated current administration of the informal sector taxation, presented a monitoring and evaluation tool aimed at tracking implementation of informal sector taxation, and provided key recommendations. Primary and secondary data collection approaches were employed. For primary data collection, country questionnaires were developed and sent to RAs, policy makers and taxpayers (informal sector players). The country survey was administered from 8th September to 28th October, 2020 and sent to tax officials, policymakers and informal sectors players. Also, FGDs were conducted virtually between 30th November and 11th December, 2020 and included various stakeholders such as informal sector players, policy makers and

tax administrators. Lastly, consultative expert meetings were organised where experts provided inputs and shared good practices and country experiences. The secondary data collection included the background analysis of respective countries, such as national statistical agencies, RAs and Ministries of Finance, among others. To ensure ownership, the Guidebook was validated by all the aforementioned experts and stakeholders during a virtual webinar held on the 4th and 5th March, 2021. A total of 27 ATAF member countries attended the validation workshop with more than 50 individual experts, participating in the webinar.



The creation of a robust database of informal sector actors that can serve as a decision-making tool in the fiscal management of the sector is necessary.



The situational analysis of informal sector taxation in Africa showed the following:

- The informal sector in Africa comprises many and diverse activities with a wide range of average annual turnover, and with the total number of individuals employed in sectors like agriculture exceeding 1 million, in some countries. Some of the activities harbouring informality include: agriculture, trading, construction, manufacturing, food processing, transport, entertainment,

catering, saloons, hospitality, water production, fishery, mining, sculpture and crafting, to mention a few.

- During the period 1991 to 2015, the contribution of informal sector activities to GDP of African countries declined from 42% in 1991 to 35% in 2015 (Medina and Schneider, 2018). Evidence shows that informal sector activities are high in Zimbabwe whereby the sector contributed an average of 61% to the country's GDP in 2015, an increase from 57% which was recorded in 1991; followed by Nigeria (57% of GDP in 1991 which declined to 52% in 2015). Mauritius is the country with least informal economy activities in Africa, which averages 23% to national GDP. The trend shows that informal economy activities for Mauritius have dropped from contributing 26% to the country's GDP in 1991 to contributing only 19% of its GDP in 2015.
- The informal sector contributes significantly to African labour employment since it accounts for almost 80% of non-agricultural jobs, over 60% of urban employment, and over 90% of new jobs (ILO, 2018). Gender-wise, the informal economy represents 92% of the total job opportunities for women outside of agriculture (against 71% for men). Women perform almost 95% of these jobs as self-employed or own-account workers, and only 5% as paid employees (ILO, 2018).
- The informal sector in African countries is characterised by; (i) low productivity, (ii) numerous enterprises that are not formally registered with any government

agent, (iii) entities that do not normally pay (direct) tax to revenue authorities, (iv) enterprises that do not have permanent working premises but rather work from temporary structures, and (v) entities that are mostly located in populous markets and city centres (rather than remote rural areas), among others.

- The main reasons and motivation for operating in the informal sector are poor relationship with tax administration, insufficient tax information, difficult tax calculation, difficulty in filing and reporting as well as complicated and confusing tax laws.
- The major constraints and challenges faced by informal sector actors in formalising their business enterprises are: (i) costly registration process; (ii) large documentations/paperwork requirements; (iii) high tax rates and many tax heads; and (iv) lack of credit lines and challenging business environment.

MAJOR FINDINGS

The survey conducted by ATAF yielded the following findings:

1. EXISTING TAXATION PROGRAMMES

The various taxation programmes that have been implemented by African countries on the informal sector over the years, include personal tax and value-added tax as the leading tax programmes. Other programmes range from turnover tax, withholding tax to corporate tax. Some of the major weaknesses