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AN ECCENTRIC PROPOSITION FOR THE TAXATION OF THE INFORMAL SECTOR IN NIGERIA

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The informal sector of a nation's economy is usually considered to be a highly unregulated sector, primarily because it is comprised of workers and businesses that are unregistered and thus difficult to monitor. The informal sector is so called under tax regimes because it is outside the tax net, especially for the payment of income taxes by its teeming operators and workforce.

However, under careful scrutiny, it is not entirely accurate to allege that the informal sector players absolutely do not pay any form of tax. If the value-chain of production and consumption is properly traced, we find that the workers in the informal sector do pay VAT for goods purchased from businesses in the formal sector. These VAT payments, in actuality, are a form of tax that they pay from their income, although the emphasis here, as is often the case, is that they do not pay direct income tax.

It is imperative to tax the informal sector because they are important players in the Nigerian economy. By the degree of the contribution of the sector to the Gross Domestic Product of the Nation, which by the National Bureau of Statistics as of June 2016, was 41.43 percent,[1] and the size of the sector of the economy is 65% and spans a wide range of economic activities,[2] the sector has the potential to contribute substantially to the economy.

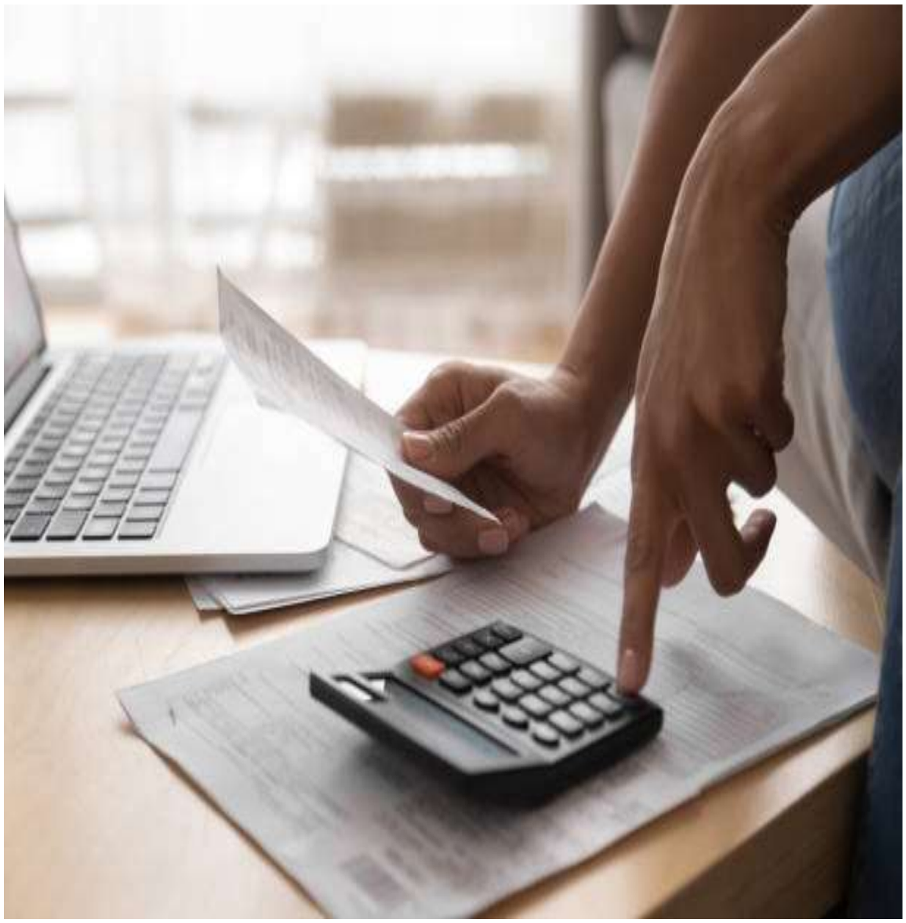
It is arguable that it is impracticable to enforce the payment of income tax in the informal sector for various reasons, like the fact that the operators of this sector do not keep proper records or books of account to enable taxing authorities review and/or audit their accounts and calculate the applicable income tax to such organizations, or that the operators in the informal sector tend to mix personal funds and funds meant for the business by using the same bank account for both their business and private use. This failure to partition funds and assigns dedicated accounts is a problem for taxing authorities because they cannot accurately differentiate between the business owner's funds and the business' funds. In fact, this even becomes a concern if the business owner uses a bank account at all, since oftentimes they don't. With such

[1] Formal and Informal Sector Split of the Gross Domestic Product. http://www.nigerianstat.gov.ng/download/403 (last accessed 28/05/2020.)

[2] CISLAC Policy Brief on Expanding the Tax Base in the Nigerian Informal Sector https://maketaxfair.net/policy-brief-on-expanding-the-tax-base-in-the-nigerian-informal-sector/ (last accessed 28/05/2020.)

incongruent "business" practices, tax authorities are outrightly handicapped from being able to determine the payable tax of such entities.

Determining whether a business is taxable and the amount of income tax payable thereof is predicated on the business having proper accounting records and periodically audited accounts, because these are what taxing authorities rely upon to determine payable tax and when due. In many instances, the operators of the informal sector are generally unskilled and uneducated, and demanding that they comply with these formalities would be asking too much, at least to them. What matters most to these people is the ability to meet their daily basic needs, which is why they venture into their respective trades. As such, they are not in business to build a lasting enterprise, hence their indifference to the importance and potential benefits of a structured business entity. Thus, examples of failure to comply with these regulatory conditions, and the attendant negative effects on the economy, are bristling on a thousand pages of research on this subject.



Some other problems faced by tax authorities arise from the fact that it is not easy to determine the number of business owners in the informal sector, either because they cannot be tracked or because they are scarcely identifiable. However, a paradoxical fact to the authorities' inability to impose income tax on the informal sector is that, while we may agree that it will create more financial burden on the sector, the operators thereof usually pay local government levies and associational dues and other fees, especially those with identifiable physical premises. Thus, in some sense, their indisposition towards income taxing may be a strategy to impugn on the government's protracted failed promise to create a favorable atmosphere for the growth of SMEs. Consequently, there is therefore the need to classify and categorize the operators in the informal sector in order to ascertain the businesses that are hiding under the guise of informality to evade taxes while actually operating taxable businesses – whether or not they are registered entities. This will help in determining whether there is need for revised taxing regulations to be made in order to capture and monitor such businesses, and, where necessary, demand compliance.

The table below presents a graphical example of the proposed classification:

Features	Informal Economy			Formal economy
	A Subsistence Enterprises	B Microenterprises and Small Businesses	C Small and Medium Businesses	D Small, Medium and Large Businesses
Degree of informality	Totally informal	High proportion of sales undeclared and workers not registered	Some proportion of sales undeclared and workers unregistered	Labour and firms registered and regulated
Type of activity	Street traders, cottage/microenterprises, subsistence farmers	Small manufacturers, service providers, distributors, contractors	Small and medium manufacturers, service providers	Range of manufacturing and services
Technology	Labour intensive	Mostly labour intensive	Mixed labour and capital intensive	Knowledge and capital intensive
Owner profile	Poor, low education, low level of skills	Poor and non-poor, likely educated, skilled	Non-poor well educated, high level of skills	Non-poor, highly educated, sophisticated level of skills
Markets	Low barriers to entry, highly competitive, high product homogeneity	Low barriers to entry, highly competitive, some product differentiation	Some barriers to entry, established markets	Significant barriers to entry, established market/product niche
Finance needs	Working capital	Working capital, some investment capital, supplier credit	Investment capital and working capital, letters of credit, supplier credit	Investment capital and working capital, letters of credit, supplier credit
Other needs	Personal insurance, social protection, security	Personal and perhaps business insurance and business support services, security	Personal and business insurance, business development services	Personal and business insurance, business development services
Tax implications	Earnings can be below minimum tax threshold, no recordkeeping, cash transactions	Liable for tax, difficult to identify and assess, poor or no recordkeeping, cash transactions	Liable for tax, underreported earnings, use loopholes, escape formal tax assessments	Taxed under formal tax assessment
Tax design desired features	No tax liabilities	Low rate to encourage registration, minimal compliance costs, low administration costs	High rate to encourage graduation into formal regime.	

Source: Adapted from Joshi et. al. (2012:8) from Zinnes' (2009:8) adaptation of Djankov et. al. (2002).

Without a doubt, people cannot be compelled to pay taxes with guns or bayonets to their heads, but it is highly recommended that the categorization above be keenly and strategically considered to help find the nooks and crannies through which revised regulations can be enacted to ensure that the informal sector is properly and tenderly taxed.

As seen in the table above, Category C businesses in the informal sector can be monitored and thus should be taxed directly. For businesses under categories A and B, the most effective method to achieving the payment of income tax would be an indirect form of taxation. Direct taxation cannot, as of this moment, work with them because the operators therein do not have proper, or even any, accounting record or basic knowledge of accounting and are either below the minimum tax threshold – which is difficult to ascertain – or are liable for tax but can hardly be identified as such, for reasons earlier stated.

It is instructive to note that, as pointed before, many of the operators in the informal

sector have some form of associational body or the other that they belong to, and they pay stipulated levies to these associations, while the associations are, at present, not under any obligation to pay any form of tax. Hence, experts have aptly proposed that instead of attempting (mostly in vain) to create tax burdens for the operators in categories A and B of the informal sector, the focus should be switched to the associations and bodies under which these persons are registered and pay levies. Presently, these associations are not accountable to the government in form of tax remittances because they are registered under Part C of the Companies and Allied Matters Act and it is presumed that they do not make profit. On this premise, these associations should either be subjected to the payment of income tax or be made to collect presumptive tax from the operators of categories A and B and remit to the government.

Such associational taxation, in either of the suggested forms, would help generate the needed revenue from the informal sector because the tax base would have been broadened while creating less tax burden on MSMEs that are seeking to grow their business. It is common knowledge that associations try to comply with accounting principles and recordkeeping in order to be able to account for the monies received. The books of account of these associations can thus be assessed and invariably taxed.

A fundamental concern worthy of note is that, sometimes, some associations house operators in categories A, B and C of the informal sector altogether, and if the operators of category C are already being made or proposed to be made personally liable for tax payments while the association's income would also be taxed; taking into consideration the amount of money accruing from these category C persons to the association, how

should the double taxation threat be tackled? In effect, it is recommended that the amount of money accruing from these businesses be deducted from the overall income of the associations and then tax can be calculated based on the resulting amount. That is only fair on all parties.

Already, there exists a precedence for how this proposition can be strategically implemented. In Ghana, such associations were made to collect taxes from there members through the Identifiable Grouping Taxation (IGT) that placed the responsibility of collecting income tax from the informal sector on associations servicing the sector, and when the operators thereof were used to being taxed, the government subsequently introduced a standardized form of presumptive taxation and the associations were removed from the equation. This is replicable in Nigeria, with appropriate and prudent supportive bylaws to power the regulation.

It is proposed that presumptive taxation should be used as a punitive method to encourage these operators into keeping proper accounting records and paying income taxes. This is because where a business realizes that the presumptive taxes are too much of a burden on their business, they will be more inclined to keeping proper accounts so they can present same for assessment and due taxing.

As earlier pointed out, it will be necessary to differentiate between the operators of the informal sector that are actually unable to meet the requirements of the law and those that are simply hiding under the general presumption that the informal sector cannot be taxed to evade paying required taxes.

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