Precipitants of tax evasion in the Informal Sector in Zimbabwe: A case study of Bulawayo Metropolitan Province.

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Abstract – The paper sought to find out factors that cause tax non-compliance in the informal sector in Zimbabwe. This study employed survey research design, questionnaires and interviews were used to collect primary data. Six (6) Zimbabwe Revenue Authority (ZIMRA) officers and Four (4) Bulawayo City Council (BCC) officers were interviewed to elicit information on tax compliance issues in the informal sector. Out of the one hundred and twenty (120) questionnaires issued to the owners of Hair salons and Flea markets one hundred and eight (108) were returned and data were analyzed using SPSS version 22. The study publicized that high tax rates, corruption of tax administrators, economic performance and lack of transparency in expending tax revenue by the government were the major precipitates of tax evasion. There is a need for the government to reduce tax rates, increase in taxpayer education, and deal with corrupt ZIMRA officers and giving tax benefits to those who obey the tax laws and simplification of the tax system. The government should come up with a strategy tax administration that will be adopted by the informal sector and all economic players who deal directly or indirectly with the informal traders.

Keywords: Tax evasion, Informal sector, Presumptive tax, Economic development, Zimbabwe.

1.0 INTRODUCTION

Zimbabwe is confronted with a serious challenge of raising adequate revenue to equilibrate government expenditures, hence there is a national budget deficit. Tax revenue is generally used to fund government operations, for instance, the provision of infrastructures like education, roads, stable power supply, health and security services (Mughal, and Akram 2012). Zimbabwean government used to raise most of its revenue from the formal sector, nevertheless, the shrinking of the sector led to an increase in the informal sector (Sikwila, 2013). In 1992, the government introduced an Economic Structural Adjustment Program (ESAP) (Zvobgo, 2003; Magure, 2014) aiming to cut the poverty level and reducing government expenditure but this inversely led to a reduction in the government revenue collection. With the increase in informal sector business activities, a presumptive tax was introduced in 2003 so as to broaden the revenue base. There is a significant economic growth contribution from Micro, Small and Medium Enterprise (MSME) sector of about 50% of the Gross Domestic Product (GDP) (2016 National Budget Statement). In a study by the Ruzivi Trust in 2013, it was estimated that 30% of the MSME sector are small to medium enterprises, leaving 70% to micro and informal, and the 76% of the informal is owned by women (Lubinda, 2015). Zimstat (2012) reported that 94.5% of the employed were found in the informal sector. According to Finmark Trust (2014) in Zimbabwe, 36% of the 5, 7 million informal traders earn above $301.00 that is more than the minimum taxable threshold of $300.00, yet 16% were paying taxes, the bulk persisted outside the tax net (RBZ, 2012). Policies to improve revenue collection from this sector were implemented yet the players are not complying with tax laws. The informal sector is fast growing but the growth does not seem to match the revenue collections from the informal sector.

The ZIMRA chairman reported in their annual performance report that in 2015 there was a decline in the revenue collection from "other taxes" the category in which informal sector presumptive tax falls. The decline may be attributed to tax evasion in the informal sector which may be unintentional and intentional depending on the taxpayers' knowledge on tax obligations, tax laws, tax remittance procedures and compliance attitudes (Christina, et al 2003). Prior statistical evidence and reports have established that the input of presumptive tax to total tax revenue remained constantly low and rather coarctating despite the fact that the sector dominants in the country. Despite the growth in size, revenue collections are not matching the rate at which this sector is growing. This shows that despite the measures set to enforce compliance and its rapid growthstill the informal sector is adamant to remit taxes. Presumptive tax is reported together with "other" taxes and records by ZIMRA show that revenue collections in this category have actually been falling between 2013 and 2015.

Tax noncompliance has proved to be greater because of the challenge faced by tax authorities in taxing the informal sector. The real drivers of this tax evasion are not known. Therefore the aim of the study was to illuminate on the factors that cause tax evasion behaviour of the Zimbabwean informal sector and also elucidate on measures that can be taken by ZIMRA to improve tax compliance. Prior studies focused on challenges faced by SMEs in Zimbabwe in fulfilling tax obligations (Zivanai, Chari, Nyakurimwa, (2015). A study conducted by Utaumire, et al. (2013) they focused on the "effectiveness of the presumptive tax system in Zimbabwe"; they failed to study determinants of tax evasion in the informal sector. Dlamini, (2017) also conducted a study on factors causing tax non-compliance in the SME sector and the research did not consider the micro-entities which constitute more than 70% of the total MMSE sector. The research will also offer in-depth insights into the Zimbabwean government in the formulation of future tax policies for the informal sector. These findings of the study will inform policymakers about the degree of compliance and reasons for non-compliance. Therefore policymakers will be better equipped to enact rules and regulations that will increase compliance and the country's revenue base.

1.1 Objectives of the study

- To identify the major causes of tax evasion by the Zimbabwean informal sector.
- To recommend possible means of edifying tax compliance in the Zimbabwean informal sector.

2.0 LITERATURE REVIEW

2.1 Definition of Informal Sector:

According to Schneider (2005), the informal sector is defined "as those economic activities and the income derived from them that circumvent or otherwise escape government regulation, taxation or observation". Masarirambi, (2013) also defined it as that portion of the economy that is unsupervised by the government and not taxed as compared to the formal sector. Fiege (1989) and Somuah (2011) also defined this sector as an unregistered and undocumented economic activities though with a contribution to the official computation or perceived gross national product. From these definitions, the informal sector is that part of the economy which is not registered and does not pay homage to illegal activities such as drug dealing, smuggling or armed robbery even if they may provide income to the perpetrator since there is little or no value addition to the society and the economy (Fambon, 2006).

2.2 Taxation in the Informal Sector

Taxation is the collection of state revenue by the designated tax authority, it can be compulsory or coercive. According to Nyatanga (2016) taxation relates to all forms of coercive levies on earnings and other gains (capital or estate). Bird (1992) also defined taxation as an autonomous right used by the government in conveying resources to public consumption in an attempt to attain political and economic objectives. Kristoersen (2011) outlined that tax evasion is prominent in the informal sector as these businesses are not formally registered. In the past, the informal sector had been excluded for consideration for tax purposes because of their little productivity and low income (ILO, 1972). According to ILO (1972) and Potts (2008), economic activities in the informal sector seem to be operating underground due to lack of registration and they are deemed to be illegal in the view of the tax authorities. In the late 1980s through to 2000, this sector was viewed as a distorter of labour and products in the formal markets and an undesirable sector by policymakers. Different governments had sundry views as to taxing the informal sector and the reason for excluding the informal sector for tax purposes was because of government sympathy to the people who deemed to have lost their formal employment (Sethuraman, 1976: Masarirambi, 2013).

Gupta, (2002); Fledman and Slemrod (2005) and Hai (2011) noted the following as the causes of tax evasion; tax complexity, high tax rates, the probability of audit, knowledge of peer behaviour, the view of equality of the tax system, gender as well as age of the taxpayer. Financial constraint, tax audit, tax education and abuse of public funds by authorities are some of the precipitates of tax evasion (Dlamini, 2017). Dube, (2014) notes that the poor tax administration is the other cause of non-compliance. There is a need to make the tax system simple and also avoiding the abuse of public funds increases the view of equality of the tax system and successively reduces tax evasion. In order to rectify tax evasion in the informal sector, a presumptive tax was introduced to the informal traders and it is calculated on the basis of presumed income (Nyatanga, 2016).

2.3 Presumptive Tax

In 2005 the government of Zimbabwe introduced a presumptive tax which is administered following the provisions of the Income Tax Act. The promulgation of the presumptive tax was an attempt to increase the tax base for the aligned with the growth of business in the informal sector. Finance Act (Chapter 23:04) stipulated specific amounts be collected from a various selected section of the informal sector as sections like the transport sector, saloons and free markets were targeted to in a drive to enhance the contribution of the sector in government revenue base. In one of its notices, ZIMRA (2014), a presumptive tax was explained as 'a levy on the earnings of small traders who may not be required to register for Income Tax'. This levy is based It is based on presumed earnings and if one returns a presumptive tax they are no longer supposed to retime income tax returns. The submission dates for presumptive tax were given; the 10th day of the month of January, April, July and October (ZIMRA, 2014).

2.4 Efficacy of Presumptive Tax

Alm et al. (2003) stated that presumptive tax is most appropriate where self-assessments for taxable income is unreliable, hence, presumptive tax broaden the tax base and reduces tax evasion. Slemrod et al. (1994) also cited that where taxable income is difficult to be measured, verified and monitored by the tax authority it is ideal to use presumptive tax. Thuronyi (1996) posits that the means of taxation includes the usage of secondary efforts to determine tax obligation that vary with the accustomed guidelines grounded on the taxpayer's records. The taxpayer should have an opportunity to counter the ascertainment of the tax administrator if they are keeping proper records since presumptive assessment is used to ascertain the taxpayer's income where there is insufficient data. Somuah (2011) noted that the greatest challenge for taxing the informal sector is that this division is predominated by huge cash dealings, poor book-keeping, high illiteracy rates, and obliviousness of the tax rules. As a result, the revenue base will continue to shrink and this proves that the taxation framework is negatively correlated to informal sector tax returns in Zimbabwe.

2.5 Forms of Tax Evasion

2.5.1 Tax Evasion

Tax evasion is an intended criminal behaviour relating to direct defilement of tax regulations to evade payment of levies (Olayinka et al., 2010). Tax evasion is said to be the utmost practice in developing countries and this has hindered effective administration of the tax system (Kiable and Nwankwo, 2009). In concurrence with the above views, Browing (1979) postulates that tax evasion is the failure to remit taxes that are legally due and payable to the government In other words, there is a deliberate and willful decision by a taxpayer to defraud the state through non-disclosure and a gross misrepresentation of facts. The illiteracy level is deemed to be high in the informal sector and this has created avenues for noncompliance, in particular, evasion. In view of the above, tax evasion is thus a deliberate failure by concerned parties to pay due taxes to the government.

2.5.2 Tax Avoidance

Haupt (2013) described tax avoidance as an attempt by taxpayers to minimize the tax liability such that one will pay the minimum amount payable or will not pay at all. Kay (1980) defined tax avoidance as an act where all the shreds of evidence of a transaction are given, however, those facts would be organised in a mode that results in their tax administration is different from that specified by the regulation. Cowell (2000) also cited that tax avoidance might be lawful or unlawful, what matters is that the taxpayer might escape with it with minimal risk. Dalu et al (2012) as cited by Kiabel and Nwokah (2009) pointed out that tax avoidance has an effect on government revenue by creating investment distortions were the purchase of assets by investors are under-valued for tax purposes or exempted from tax totally thus depriving the authority the total revenue due and payable to it. Tax avoidance occurs in a legal perspective within the tax system where people seek to capitalize on the loopholes within the system like applying for tax credits in order to reduce their tax liability (The BMZ 2010). This can be identified in cross border traders who undervalue their wares in order to circumvent higher payment of presumptive tax (Wetzel, 2002).

2. 6 Models of Tax Non-Compliance

There are numerous presumptive taxpayers in the developing countries who parade a comparatively high proportion of tax evasion. To help demystify this, a couple of theories have been scrutinized to understand this phenomenon. According to Kidder and Craig, (2000) both the taxpayer and the tax authority or tax lawmaker are at times responsible for tax non-compliance. The decisions made by the taxpayer and the tax lawmaker are both said to result in tax compliance or non-compliance. Lewis, (1982) pointed out that political or tax administrators decisions are also reflected in the taxpayers' actions of compliance and noncompliance. This advocates that the issue of tax non-compliance or non-compliance is a function of both the tax lawmaker and the taxpayers so all their actions should be considered when studying about issues of tax compliance.

2.6.1 Fischer Model

Fischer model mainly focused on the factors of tax compliance, since the factors that affect tax compliance translates into factors of tax noncompliance, the model is therefore used to explain the factors of tax noncompliance. The model classified the factors of compliance, videlicet; demographic, non-compliance opportunity, attitudes and the tax system (Chau & Leung, 2009) and these will be discussed below. It is noted that most taxpayers who report an increase in their income evade tax hence increase in income, increase tax evasions (Andreoni et al, 1998; Houston & Tran, 2001; Chau & Leung, 2009). The model noted if there are better tax non-compliance opportunity individuals opt for income sources which are not subject to tax returns. The study by Fjeldstad and Semboja (2001) based on the poll in Tanzania revealed individuals who pay tax over a tax withholding system are likely not to evade tax as compared to those who do self-assessment. If the taxpayers are of the view that the tax administrators and government are abusing the tax revenue and taxpayers are overpaying compared to service provision from the government, the taxpayer is likely to evade the tax (Jackson &Milliron, 1986; Chau & Leung, 2009). According to Grasmick and Scott (1982) taxpayers who have friends or relatives who evade taxes are probably also going to evade taxes likewise.

A study that was carried by Mason et al. (1975) established that taxpayers who evade taxes tend usually to chat tax evasion issues with their peers. Research by Chan et al. (2000) revealed that if tax evasion is constantly repeated in the group and becomes a group norm with no penalties imposed to group members, taxpayers will continue evading taxes. In the Fischer Model, the intricacy of the tax system, rules and procedures affect the success of the system. Jackson and Milliron (1986) tax rules and tax computations should be clearly understood and known by the taxpayers. If the tax system is complex and sophisticated there would be greater underreporting of tax returns (Clotfelter, 1983). Richardson (2006) furthermore reports that tax law complication is considerably correlated to tax non-compliance. The model further postulates that austere fines and complex audit possibilities discourage tax evasion, hence if the tax penalties and chance are high to be caught, taxpayers will remit taxes according to the stipulated rules. In agreement with the Fischer model is the results of studies carried by Ofori (2009) as well as Saad (2012) who agreed that the taxpayers in informal sector evade if tax audits are rarely done and penalties are not severe.

2.6.2 Classical Approach Model

Allingham and Sandmo (1972), cited by Moldovan et al (2012), as advocates of the classical approach, disqualified the standard deterrence theory in explaining tax non-compliance. The model understands the taxpayers as sagacious individuals who make informed economic judgements. Fischer et al. 1992 postulated that the "choice to evade tax is rooted in expected gains or losses linked to that decision to evade or not evade the tax". It can be ideally elucidated by the perception of efficacy maximization if benefits enjoyed by choosing to evade tax are greater than benefit enjoyed when paying tax, the taxpayer opts to elude tax, so the objective of evading tax is the maximization of utility. But tax audit is high and the probability of being caught is ineluctable whilst the corresponding fines are too high, a taxpayer who wants to maximize will comply with tax laws (Bătrâncea, et al., 2012). Allingham and Sandmo (1972)'s study suggested an increase in tax penalties to increase compliance. In contrast, Tanzi and Shome (1993) disputed that high tax penalties will change the taxpayer attitude. However, tax penalties are largely used to oblige taxpayers to conform to tax rules. Therefore the two theories could help explain possible reasons for noncompliance, however, they differ and in fact, they are polarized. They have shortcomings hence the need to explore other subsidiary theories to buttress the two (Moldovan, 2012).

2.6.3. Behavioural Model of Tax Compliance

The behavioural models were, contrived on the basis of sociological and psychological bases. The model advocates that taxpayers are perceived as individuals who are persuaded to remit tax based on various precipitants, scilicet perspective, norms, beliefs, age, gender, and not as egocentric utility maximizers (Coleman & Freeman, 1997; Frey, 1997; Mumford, 2001; Wenzel 2005 Moldovan, 2012). In agreement with Fischer model, the model believed that taxpayer perceptions regarding the authorities' trustworthiness in the use of public funds to determine the level of compliance. Both trusts and power of authorities tend to upsurge compliance through the level of compliance differs. Furthermore, the optimal level of tax compliance is obtained where there is a high trust of the tax authorities and also where their power is high. Against these realities, more weight for the 'slippery slope' model is that it encourages the provision of better services and client approach on taxpayers (Moldovan, 2012).

According to Coskun (2009) as well as Alm, et al. (2011) the behaviour of the taxpayers towards compliance or non-compliance is influenced by the taxpayers' perspective on the fairness of the tax system. Alabede et al. (2011) also stated that there is a significant relationship between the perceived equality of the tax system and tax compliance. Allingham &Sandmo (1972) and Andreoni et.al, (1998) in their study concluded that the interrelationship between or among various variables such as awareness, use of public funds, efficiency in the tax system have bearing on tax compliance. The study carried out by Palil and Mustapha (2011) reveals that tax evasion is reduced and tax compliance increases when the taxpayer's tax knowledge increases and their tax attitudes are positive. Therefore, this suggests that if you train large groups in the informal sector there are higher chances of preventing or reducing tax non-compliance. Kasipillai and Mustafa (2000) and Dlamini (2017) posits that knowledge about tax regulation, the perspective of the taxpayers towards the tax system are paramount in dealing with tax evasion. This is in agreement with the study by Pali and Mustapha (2011).

2.7 Empirical Evidence

Table 1: Review of Tax Evasion Studies

Author(s)	Year	Method	Country	Findings of the study
Munieyi et al.	2017	Literature review	Zimbabwe	The study revealed that Zimbabwe has no effective mechanism of collecting tax revenue in the informal sector.
Dube	2014	Literature review	Zimbabwe	The finding of the study showed that the level of tax evasion in the sector is alarmingly high.
Nyamwanza	2016	Descriptive survey (50 Business retails)	Zimbabwe	The study revealed that small business operators evade tax by paying bribes, keeping two sets of records, relocating to new locations without informing the authorities.
Ameyaw et al	2016	Descriptive&Regression analysis (600 respondents)	Ghana	The findings of the study revealed that attitudes, perceived behaviour control and subjective norms are the main determinants of informal tax non-compliance.
Udoh	2015	Descriptive survey	Nigeria	The study revealed that poor tax education, poor funding and inadequately qualified staff

				are the major contributors of tax evasion among small business units.
Marti	2010	Descriptive statistics and correlation.	Kenya	The findings revealed that taxpayers' attitudes and tax compliance are strongly significant related to one another.
Frey & Feld	2002	Descriptive statistics and regression analysis	Switzerland	Tax morale is elevated if the tax officials serve the taxpayer professional.
Ofori	2009	Descriptive survey	Ghana	The study revealed that factors of tax evasion of the informal sector to be a dominance of cash sales which leaves no evidence that there has been a sale, poor level of book-keeping and high level of illiteracy in the informal sector
Zivanai et.al,	2015	Survey	Zimbabwe (Bindura)	The findings indicated that mistrust in the tax authority and evasions that are done by other fellow informal traders encourages other taxpayers not to comply.
Maseko	2014	Descriptive statistics and correlation	Zimbabwe (Harare, Chitungwiza and Bindura)	The results indicated that high tax rates and the priorities of government spending significantly disturb tax evasion negatively.

3.0 METHODOLOGY

This study followed a survey study design with the study objectives in mind, quantitative data was collected from informal traders using questionnaires with closed-ended questions, using an eight-point Likert scale (Dlamini, 2017). Interviews were used in the collection of qualitative data from the rest of responded other than informal traders. Informal traders who own Hair salons and Flea markets operating in the Central Business District of Bulawayo province were considered as the sample of the study. The respondents comprised of twenty (30) hair salons owners, fifty (50) flea markets owners, six (6) ZIMRA officials and two (2) members from Bulawayo City Council (the section responsible for issuing licences to those operating on designated market stalls). The responses were analysed and processed using SPSS software (version 22) and Excel spreadsheets.

4.0 RESULTS AND DISCUSSION

4.1 Result Summary

Table 2: Correlations

		TAX COMPLIANCE	TAX RATE	TAX EDUCATION	corruption	ep
Pearson Correlation	TAX COMPLIANCE	1.000	-.948	.425	-.573	.695
	Tax rate	-.948	1.000	-.432	.538	-.679
	Tax education	.425	-.432	1.000	-.232	.228
	Corruption	-.573	.538	-.232	1.000	-.425

	Economic performance	.695	-.679	.228	-.425	1.000

Table 3:Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.945[a]	.901	.906	6271.423

a. Predictors: (Constant), Tax rate, Tax education, Corruption, Economic performance

Table 4: ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	40753974520.081	4	10188493630.020	259.047	.000[b]
	Residual	4051067113.104	103	39330748.671		
	Total	44805041633.185	107			

a. Dependent Variable: Tax Compliance

b. Predictors: (Constant), Tax rate, Tax education, Corruption, Economic performance

Table 5: Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	183398.203	12695.005		14.446	.000
	Tax rate	-646.531	36.193	-.833	-17.863	.000
	Tax education	.005	.007	.026	.792	.430
	Corruption	-152.724	67.218	-.080	-2.272	.025
	Economic performance	134.325	61.266	.089	2.193	.031

Preliminary analysis was done as shown in table 2 above and all independent variables had acceptable inter correlation values of less than 0.7 which is an acceptable cut off point (Pallent, 2011). The regression analysis results shown in Table 3 are used to examine the correlation between tax compliance and tax rate, tax education corruption by tax authorities and economic performance in the Zimbabwean informal sector. The model is highly predictive with an adjusted R squared of 0.901; 90.1% of variations in tax compliance is described by the tax rate, tax knowledge corruption by tax authorities and economic performance. The model appears sufficiently valid as it was run at 5% level of significance since the results are p-value=0.000 which is less than the cut-off point of 5% (Pallent, 2011). The tax rate has a significant negative relationship with tax compliance as shown by a beta of -646.531 and significance value of .000. If the tax rate is high, the rate of tax evasion is also high, the results are the same with the findings of Ojeka and Ojochugwu (2012); Freire-Serén&Panadés, (2013). Maseko, (2014); Alasfour, et.al, (2016) also stated that higher tax rate stimulates tax non-compliance.

Tax education has a positive insignificant relationship as shown by a positive beta of .005 and significance value of 0.43, it has a low influence on tax compliance Mello, (2008). Corruption in the tax authority has a significant negative relationship with tax compliance as shown by a beta of -152.724 and significance value of 0.025. Corruption in the tax administration reduces tax compliance, if public funds are abused and there is lack of transparency tax evasion increase, these results are correlated with results by Moore (2004); Mukhlis, Utomo&Soesetyo, (2014); Dube (2014); who agreed that there is a strong negative relationship between transparency in the tax administration and tax non-compliance. Economic performance has a positive significant relationship as shown by a positive beta of 134.325 and significance value of 0.031, economic hardship is increasing tax non-compliance as businesses will be struggling for survival. The tax rate has the highest unstandardized beta hence it has the highest contribution on tax non-compliance whilst tax education has the lowest in the informal sector, this is an indication that taxpayers are aware of their tax obligations when they default or evade tax they are fully aware of what they are doing.

4.0 CONCLUSIONS AND RECOMMENDATIONS

The study examined the factors influencing tax evasion in the informal sector in Zimbabwe. Evidence gathered from the study revealed that most players in the informal sector are not registered for tax purposes and non-registration is aggravated by the fact that most flea market owners have no fixed premises from which they operate. They are too mobile and their mobility makes it difficult for ZIMRA to carry out their audits to identify the number of operators in the informal sector. The study revealed that presumptive tax does not contribute much revenue towards the fiscus. The study concluded that the major precipitates of tax evasion were identified as high tax rates, low income due to low economic activity and lack of transparency by the government in the use of tax revenue. High level of corruption, weak penalties for tax evasion, ZIMRA personnel receiving bribes from the non-complying taxpayers and lack of tax incentives.

It is recommended that the government should reduce tax rates as the majority of the respondents felt that they are too high. ZIMRA should increase in tax education which may help taxpayers in the informal sector change their attitude towards paying tax. There should be an improvement in transparency in the spending of the taxpayers' money by the government and give tax incentives to those who comply with the tax laws for this may help improve tax morale. There is also a need for ZIMRA to carry out regular tax audits and develop a mechanism to deal with ZIMRA personnel who receive bribes from the non-complying taxpayers. A further study can be conducted in the precipitates of tax evasion in the informal sector in relation to taxation and economic growth in Zimbabwe.

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