TANZANIA REVENUE AUTHORITY

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Review of Informal Sector for Taxation Purposes

First Draft Report

TRA HEADQUARTERS,
DAR ES SALAAM,
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Contents
List of Tables ................................................................................................................... vi
List of Figures ................................................................................................................ viii
List of Abbreviation ......................................................................................................... ix
Executive Summary ........................................................................................................ xi

1.1. Introduction ........................................................................................................ xi

1.1.1. The study Background ................................................................................. xi
1.1.2. Objective of the Study .................................................................................. xi
1.1.3. Study Approach and Methodology ............................................................... xi

1.2. Main study findings ............................................................................................ xi

1.2.1. Informal Sector ............................................................................................ xi
1.2.2. Adequate Policy, Legal, Regulatory and Institutional Frameworks .......... xiii
1.2.3. Presumptive Income Taxation Performance in Tanzania .......................... xiv
1.2.4. Informal Sector Firms outside Tax System ............................................... xvii

1.3. Proposed Simple Presumptive Income Tax ..................................................... xix

1.3.1. The general and specific benefits and policy objectives ............................ xix
1.3.2. Legal Framework ....................................................................................... xix
1.3.3. Institutional Framework .............................................................................. xix
1.3.5. Maximum Taxable income .......................................................................... xx
1.3.6. Introduction of Flat Tax Rate ...................................................................... xx
1.3.7. Net Effects of the Proposed Presumptive Income Tax ............................... xx

1.0. Introduction ......................................................................................................... 1

1.1. Background ......................................................................................................... 1

1.1.1. Informal Sector Size and Performance in Tanzania ................................. 1
1.1.2. Taxing the Informal Sector .......................................................................... 2
1.1.3. Efforts to Formalize Informal Sector in Tanzania ..................................... 2
1.1.4. Presumptive Tax System for Informal Sector ............................................ 3

1.2. TRA Study on Presumptive Tax-2010 ............................................................ 3

1.3. Scope of Internal TRA Study 2010 ................................................................. 3

1.4. Significance of Study ......................................................................................... 4

1.5. Methodology ..................................................................................................... 4

1.6. Expected Output from the Study ...................................................................... 5

1.7. The Review of Informal Sector for Taxation Purposes .................................... 5

1.7.1. Objective of the Current Research Consultancy Service ........................... 5
Chapter Two: Performance of Informal Scale Sector .................................................. 8

2.1. General behaviour of the sector........................................................................... 9
  2.1.1. Size and Magnitude of the Informal Sector by Workforce ......................... 9
  2.1.2. Size and Magnitude of the Informal Sector by Gross Domestic Product ... 10
2.2. Types of the Social Economic Activities in the Sector........................................ 15

2.3. Value of Gross Output, Value Addition and Operating Surplus From Informal Economy................................................................. 18

2.4. Number and Quality of Operators .................................................................... 20
  2.4.1. Informal Sector can not Adhere to BRELA Governance Standards and Norms 20
  2.4.2. Business Registration and Licensing............................................................... 22

2.5. Size by Labour Employment ........................................................................... 24
  2.5.1. Employment by Gender by Main Social Economic Activities in the Informal Sector 25
  2.5.2. Average Number of Persons Engaged Including Party time Workers ...... 26

2.6. Capital Investment ........................................................................................... 28
  2.6.1. Capital Investment..................................................................................... 29
  2.6.2. Sources of Financing................................................................................. 31

2.7. Legal Status of Informal Sector ........................................................................ 31

2.8. Forms and Types Ownership Status ................................................................. 33

2.9. Intermediate Inputs used in the Sector ............................................................... 35

2.10. Product market environment ......................................................................... 35

2.11. Problem, Challenges and Opportunity to Informal Sector .............................. 39

Chapter Three: Policy, legal, regulatory and institutional frameworks ......................... 40

3.1. Policy Environment .......................................................................................... 41
  3.1.1. First Generation Policy Reforms ................................................................. 41
  3.1.2. Second Generation Reforms ..................................................................... 42
  3.1.3. Broad Based National Development Policies ............................................ 43
  3.1.4. The SME Development Policy ................................................................. 44
  3.1.5. Sector Specific National Development Policies ........................................ 46
  3.1.6. Other Policies, Strategies and Efforts ......................................................... 50
  3.1.7. National Strategy for Growth and Reduction of Poverty I and II ............ 50
  3.1.8. Property and Business Formalization Program ........................................ 51
5.2.2. Levels of Taxpayer Compliance Attitudes ................................................................. 95
5.3. Business Registration in Tanzania ............................................................................. 97
   5.3.1 Business Registration Legal Framework ................................................................. 97
   5.3.2. Registration Requirements and Practices ................................................................. 97
   5.3.3. Reasons for Informal Sector to Escape Registration in Tanzania ....................... 102
5.4. General Problems Affecting Business Operations by Business Registration Status ................................................................. 102
5.5. Informal Sector Perception on the Tax System .......................................................... 104
5.6. Reason for Not Paying Taxes (Tax avoidance and evasion) ..................................... 107
5.7. General Problems Affecting Business Operations by Tax Payment Status .............. 108
   5.7.1. Lack of Effective Market Demand ........................................................................ 109
   5.7.2. Lack of Finance Capital, Inflation and High Interest Rates .................................. 109
   5.7.3. Unreliable Power Supply and Poor Infrastructure ............................................... 111
Chapter Six: Proposed Simple Presumptive Income Tax .................................................. 112
   6.1. Theoretical and Policy Framework .......................................................................... 112
      6.1.1. Theoretical Framework ..................................................................................... 112
      6.1.2. The General Policy Objective ........................................................................... 113
      6.1.3. The Specific Strategic Objectives ..................................................................... 113
   6.2. Legal Framework .................................................................................................... 114
   6.3. Institutional Framework .......................................................................................... 114
      6.3.1. Adopting the Block Tax Management System (BTMS) .................................... 114
      6.3.2. New Forms of Business Registration and Formalization Systems .................. 115
   6.4. New Proposed Presumptive Income Taxation Structure .......................................... 120
      6.4.1. Tax Base and Target Group .............................................................................. 120
      6.4.2. Maximum Taxable Income .............................................................................. 121
      6.4.3. Introduction of Flat Tax Rate ........................................................................... 123
   6.5. Comparison with other East African Countries ....................................................... 124
   6.6. Analysis and Scenario of New Tax Structure .......................................................... 125
   6.7. Taxpayers with Turnover of 20m to 40m ................................................................. 128
      6.6. Simulations of Proposed Presumptive Income Tax .............................................. 129
         6.6.1. Scenario for the introduction of Flat Tax Rate ................................................. 129
         6.6.2. Turnover Thresholds ....................................................................................... 131
         6.6.3. Net Effects of the Proposed Presumptive Income Tax .................................. 132
   6.7. Efficacy, gains and relevance of inclusion of Taxpayers with Turnover of 20m to 40m ................................................................. 133
Chapter Seven: Conclusion ................................................................................................. 133
7.1. Study background, objectives, research approach and methodology .......... 134
  7.1.1. The study Background ........................................................................ 134
  7.1.2. Objective of the Study ...................................................................... 134
  7.1.3. Study Approach and Methodology .................................................... 134
7.2. Main study findings .................................................................................. 134
  7.2.1. Informal Sector .................................................................................. 135
  7.2.2. Adequate Policy, Legal, Regulatory and Institutional Frameworks .... 139
  7.2.3. Presumptive Income Taxation Performance in Tanzania .................. 139
  7.2.4. Informal Sector Firms outside Tax System ....................................... 143
7.3. Proposed Simple Presumptive Income Tax .............................................. 146
  7.3.1. The general policy objective .............................................................. 146
  7.3.2. Legal Framework ............................................................................ 146
  7.3.3. Institutional Framework .................................................................... 146
  7.4.4. Maximum Taxable income ............................................................... 147
  7.4.5. Introduction of Flat Tax Rate ............................................................ 147
  7.4.6. Net Effects of the Proposed Presumptive Income Tax ...................... 147
REFERENCES .................................................................................................... 148
List of Tables

Table 2.1A: Size of Informal Sector in Developing Countries by Workforce .................. 10
Table 2.2: Types of the Social Economic Activities in the Sector ................................. 17
Table 2.3A: Value of Gross Output, Value Addition and Operating Surplus From Informal Economy .......................................................................................................................... 18
Table 2.3B: Percentage of Profitability by Output Performances ................................... 19
Table 2.4A: State of Business Record Keeping in the Informal Economy ...................... 21
Table 2.4B: State of Business Growth against Record Management Practices ............... 21
Table 2.4D: Business Registrations by Main Social Economic Activities ....................... 23
Table 2.5A: Employment by Economic Activities Gender and Status ........................... 25
Table 2.5C: Average minimum wages per sector in the informal sector in Tanzania .... 28
Table 2.5D: Level of Education of Informal Operators by Economic Activities .......... 29
Table 2.5E: Average Capital Investment in Informal Sector .......................................... 30
Table 2.5F: Sources of Financing Capital Investments in the Informal Sector 2010 .... 31
Table 2.6A: Business Registration of the informal sector .............................................. 32
Table 2.6B: Percentage of Legal Status of the Informal Sector in Tanzania ................. 33
Table 2.7A: Market Channels for the Informal Sector Products / Services .................... 37
Table 2.7B: Market Channels for the Informal Sector Products / Services .................... 37
Table 2.8A: Pricing System in the Informal Sector ........................................................ 38
Table 2.9C: Average capital investment in Informal Sector .......................................... 30
Table 2.9D: Sources of Financing Capital Investments in the Informal Sector 2010 ..... 31
Table 2.10: Challenges and limitations of the Informal Business Activities ................. 39
Table 4.1.a: TRA Staff Number by main departments and unit ..................................... 74
Table 4.1.b: Block Management System Manning Structures and Performances .......... 75
Table 4.2: The New Presumptive Tax Rates after Merger ............................................ 77
Table 4.3: Presumptive Taxes System: Advantages and Disadvantages ........................ 79
Table 4.4: Presumptive Income Tax Basic Statistics ...................................................... 81
Table 4.5: Registration of Presumptive Business Entities ............................................. 81
Table 4.6: Tax Rate Structures ..................................................................................... 82
Table 4.7: EAC Comparative Tax Structure for Small Business Taxpayers - Turnover Taxes .......................................................................................................................... 83
Table 4.8: Effect of the current Block Management System and Presumptive Taxation .... 89
Table 5.1: Status of Business Registrations and Tax Payment ....................................... 92
Table 5.3 Reasons for Informal Sector to Escape Registration in Tanzania .................. 102
Table 5.4: General Problems Affecting Business Operations by Business Registration Status .......................................................................................................................... 103
Table 5.5: Informal Sector Perception on the Tax System ............................................. 105
Table 5.6: Reason for Not Paying Taxes ..................................................................... 107
Table 5.7: General Problems Affecting Business Operations by tax Payment Status ... 109
Table 6.1: Business Registration and Formalization Systems ....................................... 116
Table 6.2: Taxable Income Ranges under Presumptive Income Tax System .......... 121
Table 6.3: The Current and Proposed New Presumptive Tax Rates ............................ 123
Table 6.4: Presumptive Tax Turnover and Flat Rates in East African Countries 2010 .... 125
Table 6.5: Results of the Revenue Implication of Different Tax Structure ................. 130
Table 6.6: Summary of tax rate and threshold reform proposal on revenue implication for 2009/10FY and implied for 2011/12FY.
List of Figures

Figure 2.5A: Share of informal Economy in Non agriculture employment in selected Region (2002) ................................................................. 24
Figure 2.5B: Average Earning by Sector and Gender in Tanzania 2000/01 and 2006.. 26
Figure 4.1.a Total and Presumptive Income Tax Trend in Absolute Figures ........... 85
Figure 4.1.b: Total and Presumptive Income Tax Payers Trend Index (2005/2006=1) . 85
Figure 4.1.c: Trend of Presumptive Taxpayers against Total TRA taxpayers ......... 86
Figure 4.2: Individual Tax Revenue Performance .................................................. 87
Figure 4.3: Share of Individual Taxes as a Percentage of GDP .............................. 88
Figure 4.4: Performance Share of Presumptive Tax Revenue to Total Direct Taxes .... 88
Figure 4.5: Percentage of Registered TRA Taxpayers to Tanzania Population ....... 89
Figure 4.6: Tax paid under the Current Presumptive Tax Structure ....................... 90
Figure 4.7: Effective Tax Rate of the current Presumptive Tax Structure.............. 90
Figure 4.8: Simulation for the Proposed 3.5% and 4.0% tax rates with nil band of 2.0mil and 2.5mil................................................................. 127
Figure 4.9: Comparison of effective tax rates using different flat rate and threshold... 127
Figure 6.1: Simulation of the Outlook of the Proposed 4.0% tax rates .................... 130
Figure 6.2: Status of Winners and Losers due to New Proposed Tax Structure ....... 132
List of Abbreviation

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>AGOA</td>
<td>African Growth Opportunity Act</td>
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<tr>
<td>AVGM</td>
<td>Average Gross Margin</td>
</tr>
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<td>BIS</td>
<td>Basic Industrial Strategy</td>
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<td>BOP</td>
<td>Balance of Payments</td>
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<td>BoT</td>
<td>Bank of Tanzania</td>
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<td>BRELA</td>
<td>Business Registrations and Licensing Agency</td>
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<td>BTMS</td>
<td>Block Tax Management System</td>
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<tr>
<td>CAMARTEC</td>
<td>Centre for Agriculture Mechanization and Rural Technology</td>
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<tr>
<td>CCM</td>
<td>Chama Cha Mapinduzi</td>
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<tr>
<td>CDR</td>
<td>Commercial Dispute Resolutions</td>
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<tr>
<td>CSPro</td>
<td>Census and Survey Processing System</td>
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<td>CSR</td>
<td>Corporate Social Responsibility</td>
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<tr>
<td>CTI</td>
<td>Confederation of Tanzania Industries</td>
</tr>
<tr>
<td>DoE-UDSM</td>
<td>Department of Economics of University of Dar Es Salaam</td>
</tr>
<tr>
<td>DRD</td>
<td>Domestic Revenue Department</td>
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<tr>
<td>E.U</td>
<td>European Union</td>
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<tr>
<td>FDI</td>
<td>Foreign Direct Investment</td>
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<tr>
<td>FY</td>
<td>Financial Year</td>
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<td>GDP</td>
<td>Gross Domestic Product</td>
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<tr>
<td>GM</td>
<td>Gross Margin</td>
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<tr>
<td>GNI</td>
<td>Gross National Income</td>
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<tr>
<td>IIDMP</td>
<td>Integrated Industrial Development Master Plan</td>
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<td>ILFS</td>
<td>Integrated Labour Force Survey</td>
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<tr>
<td>IPI</td>
<td>Institute of Production Innovation</td>
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<tr>
<td>ISI</td>
<td>Import Substitution Industries</td>
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<tr>
<td>LGAs</td>
<td>Local Government Authority</td>
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<tr>
<td>MDGs</td>
<td>Millennium Development Goals</td>
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<tr>
<td>MITM</td>
<td>Ministry of Industry, Trade and Marketing</td>
</tr>
<tr>
<td>MKUKUTA</td>
<td>Mkakati wa Kukuza Uchumi na Kupunguza Umaskini</td>
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<tr>
<td>MoFEA</td>
<td>Ministry of Finance and Economic Affairs</td>
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<td>MSEs</td>
<td>Medium and Small Enterprise</td>
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<tr>
<td>MTSP</td>
<td>Mid Term Strategic Plan</td>
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<td>MVA</td>
<td>Manufacturing Value Addition</td>
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<td>NBS</td>
<td>National Bureau Of Statistics</td>
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<td>NDV 2025</td>
<td>National Development Vision 2025</td>
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<td>NGOs</td>
<td>Non Government organization</td>
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<td>NPES</td>
<td>National Poverty Eradication Strategy</td>
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NSGRP  National Strategy for Growth and Reduction of Poverty
NSIC  National Small Industrial Corporation
OECD  Organization of Economic and cooperation Development
PBFP  Property and Business formalization Programme
PPP  Public-Private Partnership
PRSP  Poverty Reduction Strategy Paper
PSRP  Public Sector Reform Programmes
SIDO  Small Industries Development Organization
SIDP  Sustainable Industrial Development Policy
SIDP 2025  Strategic Industrial Development Process
SME  Small and Medium Enterprises
SPSS  Statistical Package for Social Sciences
TAFOPA  Tanzania Food Processor Association
TAS  Tanzania Assistance Strategy
TASISO  Tanzania Small Industrial Organization
TBS  Tanzania Bureau of Standards
TCCIA  Tanzania Chamber of Commerce, Industry and Agriculture
        Tanzania Engineering and Manufacturing Design
TEMDO  Organisation
TFDA  Tanzania Food and Drug Authority
TIC  Tanzania Investment Centre
TR  Total Revenue
TRA  Tanzania Revenue Authority
TVC  Total Variable Costs
TZS  Tanzanian Shilling
UNIDO  United Nations Industrial Development Organization
URT  United Republic of Tanzania
US  United States
US$  United States Dollar
VAT  Value Added Tax
VETA  Vocation Education and Training Authority
VIBINDO  Vibindo Vikundi Vya Biashara Ndogondogo
Executive Summary

1.1. Introduction

1.1.1. The study Background

The informal sector in Tanzania is among the most buoyant sectors yet contributes marginally to tax revenue generation. According to the Integrated Labour Force Survey, 2006 (ILFS) the informal sector was the second main employing sector after agriculture by employing 10.1 percent of the employed persons, followed by other private sectors with 8.6 percent, where agriculture employed 75.1 percent. This may be explained by the fact that the main activity in rural areas is agriculture, which may not necessarily be defined as an informal sector activity in some cases.

It is known that the informal sector has a significant job, income generation potential and stimulation of social economic growth in both urban and rural areas. However, the social, economic and political realities of the informal sector translate to a complicated operational reality for business formalization and the tax administration. The effective taxable workforce is usually quite small and there are views that taxation evasion is huge, deliberate and systematic due to various reasons. These include lack of knowledge and information and heavy costs of compliances resulting from their varieties and sizes.

1.1.2. Objective of the Study

In order to address the problem of taxation of informal sector in 2010 TRA conducted a policy research study aiming to pull small and medium enterprises into the tax net. The Tanzania Revenue Authority, (TRA), conducted an internal investigative research seeking to estimate the size, the dynamics and assess tax revenue generation potential of the informal sector. The TRA research study (2010) aimed at promoting an enabling and supportive environment to the development and presumptive income taxation of the informal sector in the country.

1.1.3. Study Approach and Methodology

In order to accomplish the objectives of the research study that flowed from the general research consultant objectives, four independent but complementary methodologies were used. These were included major [1] desk study reviews, [2] field research survey, [3] data, policy analysis, report writing and [4] internal TRA consultative meetings and capacity building.

1.2. Main study findings

1.2.1. Informal Sector
Size and magnitude of the informal sector by workforce

The 2006 Integrated Labour Force Survey (ILFS) indicated that in 2006, 40 percent of all households in Tanzania Mainland are in informal sector activities as compared to 35 percent in 2001. In 2006, the urban informal sector employed about 66 percent of the people for whom informal sector work is the main activity and only 16 percent of those for whom it is the secondary activity. In contrast, 34 percent of the people for whom informal sector work is a main activity are in rural areas and 84 percent for whom this work is a secondary activity. This suggests that informal sector is a source of employment for majority poor Tanzanians.

Size and magnitude of the informal sector by gross domestic product

The study used several basic national account statistics to measure the size of the informal sector for Tanzania. The study adopted informal sector statistics based on the Jacques Charmes (2006) method. It is estimated that the size of the Tanzanian informal sector is significantly large. However, the informal sector GDP contribution dropped from 62.5 percent in 1991 to about 39.5 percent in year 2010. It is claimed that the key determinants of the size of informal sector are the structure and nature of economy, burden of taxation, government regulations and social security contributions. Tanzanian economy depends on agriculture and thus rather than trying to “merely “formalize” the informal sector, one need to realize that the most significant obstacle to growth in informal sector is the lack of access to product markets and resources, most notably, factor and financial markets.

Types of the socio-economic activities in the sector

The TRA Study found that about 55.3 percent of the informal sector operators in year 2010 are engaged in wholesale and retail; repair of motor vehicles and motorcycles. Wholesaling and retailing are the final trade service steps in the distribution of goods. Goods bought and sold are also referred to as merchandise. This is consistent with the 2006 Integrated Labour Force Survey (ILFS) which suggested that where the informal sector activity is the main activity, the wholesale and retail trade employs 57.5 percent of the people. About 21.6 percent of the informal sector operators were in manufacturing. There were cases of small and medium scale manufacturing units which are engaged into value addition activities or processing materials or contracting with other units to process their materials for them.

Positive profitability index and output performances

Using business turnover as output index, the study found that there is a positive correlation between profitability index and output performances such that the value of profitability index increase with the increase in output. The study indicates that the output band value between Tshs 1-1.62 million has a profitability index of 62.49 percent where else the output band value of between Tshs 30- 35 millions has profitability index of 92.9 percent on average showing a parallel increase of output and profitability index in the informal sector.
Since the turnover is the principle determinant of amount of presumptive income tax paid, the findings imply that there is unequal treatment of tax payers within the informal sector as individual lying between two or more groups may share similar tax band despite their differences in profitability index. The implication of such inequality gives incentives for taxpayers to underestimate sales, not to keep records and evade tax payment.

**Informal sector do not adhere to good corporate governance standards and norms**

About 22.4 percent of informal operators do not keep any written business records while 74.7 percent keep general informal records for personal use. The records are kept in form of rough pieces of papers, text book and personal diaries. These results suggest that most of operators in the informal economy do not adhere to these good corporate governance norms and accounting standards. Consultations suggest that most of informal operators lack business management education, experience and skills such as proper record keeping, product arrangements, product pricing and marketing of their products.

**Business registration and licensing**

Despite, policy, legal, regulatory and institutional reforms, Tanzania has complex business registration and licensing systems. There are many and various ways of registering and licensing a business entity. Each business operating in Mainland Tanzania shall be required to obtain a certificate of registration from the Business Registration Centre within the local authority where the business is located. Every business registration shall be valid for the entire life of the business.

For the case of Tanzania business operation should be done in legally accepted premises and should be registered by three up to four administrative authorities depending on type of activities namely local government, BRELA and TRA and other relevant institution governing such sector. The study found that about 58.3 percent businesses to have been registered in any of the three administrative authorities while the remaining was not registered. About 61.1 percent of the wholesale and retail trade activities are registered. About 53.5 percent of manufacturing businesses are not registered. These operate as typical informal manufacturing firms.

**1.2.2. Adequate Policy, Legal, Regulatory and Institutional Frameworks**

Tanzania has, in the past 15 years been undergoing social economic and political changes, legal and regulatory and institutional reforms, which have re-oriented the economy from a government-led to a competitive market and private-sector-led one. The Micro, Small and Medium Scale Enterprises, (MSME) or the informal sectors are major private sector businesses owned, managed and operated by the indigenous Tanzanians. Tanzania has made significant progressive in the formulation, implementation and performances of social economic development efforts intending to empower Tanzanians in owning, managing and operating own social economic activities. The first and second generation reforms that were pursued since
early 1980s up to day 2010 have been very critical to formation and development of the MSME/informal sector in Tanzania.

1.2.3. Presumptive Income Taxation Performance in Tanzania

Policy Framework

The presumptive income tax is rationalized and based on solid sector and fiscal policy foundations. The rationalization and use of presumptive scheme is in line with the Small and Medium Enterprise sector policy (SMEs Policy of year 2003) with objectives of enhancing business registration and tax system to be simple. In specific, the SME’s Policy 2003 seeks to simplify tax system and introduce tax incentives to nurse SMEs.

Legal Framework

In July 2004, the Government rationalized the presumptive scheme by introducing a new simplified taxation schedule for small business taxpayers as part of a drive to make it easier for informal sector operators (including start-up businesses) to register, formalize and start paying taxes. The First Schedule of the Income Tax Act of 2004 (and thereafter amendments done in 2006) defines and provides content and structure of Presumptive Income Tax in Tanzania.

Institutional Framework

The presumptive Income Tax is administered, managed and operationalize by comprehensive and elaborative institutional organization framework of Department of Domestic Revenue in the Tanzania Revenue Authority. TRA is considered to be an efficient and effective public institution, a corporate and central body for the assessment and collection of specified revenue, to administer and enforce the laws relating to such revenue and to provide for related matters in the Tanzanian economy.

In order to have the more taxpayers in the tax net, expand the tax base and optimize tax revenue collection, Tanzania Revenue Authority (TRA) proposed to introduce the Block Management System, (BMS). The basic objective of BMS is to promote compliance and register all eligible small and medium scale enterprises within a particular business, sectoral or geographical area, capturing their correct level of economic activities and gathering valuable tax information.

Human Resource Framework

TRA has made concerted efforts to develop quality human resources administering the presumptive income tax system. The study found that the total number of staff engaged in TRA from year 2000/2001 – 2009/2010 by main departments and units. The total number of staff increased from 2,772 in 2000/2001 to about 3,727 in year 2009/2010. The increase in number of employees occurred in all departments and units. The study suggests that majority of these
staffs were deployed in the Domestic Revenue (53 percent) and in Customs and Excise (33.2 percent) during year 2009/2010.

**Block Management System is operational but ineffective**

In order to enhance presumptive income tax system and administration, TRA prepared, uses trained and skilled staff under the Block Management System, (BMS). However, the BMS has not been fully operationalized and or rolled over to other regions. According to TRA Block Management Report 2010 Kariako Ilala Kigogo model (KIK) manning level is a big problem that hinders smooth implementation of Block tax Management system. The study found serious shortage of staff whereby out of 10 staff required to work in KIK Block only 2 or only 20 percent staff were allocated. KIK is a pilot model that lacked desired human resources.

**Presumptive Income Tax on Increase**

The study found that both presumptive income taxes for individual with accounts and individuals with no accounts have been increasing during the sample period. It is interesting to note that presumptive income taxes for the first category has been high suggesting that TRA has instituted tax incentives to encourage firms preparing and keeping formal accounts. However, the contribution of total presumptive income tax has been very small compared with other forms of income taxes, number of taxable entities and desired tax transformation targets.

The total number of registered tax payers increased from 288,680 in year 2005/2006 to about 617,877 in year 2009/2010 and presumptive income tax payers increased from 199,448 in year 2005/2006 to about 376,673 in year 2009/2010. The total number of presumptive income tax payers as percent of total TRA tax payers increased from 69 percent in year 2005/2006 to about 75 percent in year 2006/07 and then starting to drop to about 61 percent in year 2009/2010.

**Presumptive Income Tax Rate Structures**

The adopted Tanzanian presumptive income tax structure is good and simple in Africa. The study found that the rate in the 1\textsuperscript{st} band for minimum turnover is 0 percent and 1 percent for maximum turnover of 3 million. In the 2\textsuperscript{nd} band the scheme imposes 3 percent on minimum sales of TShs 3 million and decreases to 1 percent on maximum sales of TShs 7 million. In the 3\textsuperscript{rd} and 4\textsuperscript{th} bands the situation is similar that the minimum sales suffer higher tax rates than the maximum sales of 4 percent, 2 percent and 3 percent respectively. The differential application of rates in this scheme made traders to object graduation from upper end to the next lower band for fear to pay more tax. However, the system is regressive as non-record-keepers are more likely to lack the capacity to keep proper accounts.

**Positive and Increasing Total and Presumptive Income Tax Payers Trend**

The study found that both total and presumptive income tax payers have been increasing during the last five years. However, it is noted that since 2007/2008 the number of total income tax
payers have been increasing faster than the number of presumptive income tax payers. This suggests that much as these efforts of presumptive scheme have been undertaken to simplifying the tax regimes, their outcomes have been significant in pulling the informal and semi informal sector operators into formal and hence, bringing them in the formal TRA tax net. That is, after a lag of three to four years, the new system is operational, effective; and this is need for appraisal and to be enhanced.

**Overall Performance of Individual Income Tax Revenue Collections has not been satisfactory**

The study suggests that before introducing presumptive taxes in year 2001/02, the overall performance share of individual taxes to total direct taxes was 7.3 percent in year 1996/97 and accounted for 1.8 percent to total TRA revenue collection and 0.22 percent of GDP in the same year. This overall performance share index deteriorated to 6.0 percent to total direct tax, 1.5 percent of TRA revenue collection and 0.15 percent of GDP in year 2000/01. When the Government introduced presumptive taxes in year 2001/02 the performance shares continued to deteriorate. The share of Individual taxes as a percentage of GDP had not been stable. This slightly increased from 0.14 percent of GDP in 2001/02 to a pick of 0.19 percent of GDP in year 2005/06 before slowing down to 0.16 percent of GDP in 2009/10.

**Efficacy, gains and relevance of inclusion of Taxpayers with Turnover of 20m to 40m**

The study found that given the current presumptive income tax system, these taxpayers with turnover of 20m to 40m; and since they have been already preparing books of accounts and in practical they have been paying their taxes with the effective tax rate of almost 27 percent in their business, this group may continue with their status of maintaining books of record and be charged as individual taxpayers as per personal income tax rate if they are individuals, otherwise be charged with corporate tax structure rates. If there are no other efforts, any suggestion of incorporating them with the small presumptive taxpayers will weaken efficacy, gains and relevance of the TRA taxation system and government revenues.

**Net effect of presumptive income tax**

The presumptive income tax is considered in order to decrease administrative and compliance costs, but its benefits are potentially larger as information gathering instruments in a dynamic environment. Moreover, it has been used to curve widespread tax evasion in the small and medium scale sector and avoidance by reducing enforcement costs, which is likely to generate positive externalities in taxpayer compliance. However, careful analysis is required as their effects in terms of use, efficiency, transparency, governance are multiple and can be large, and the exact desired presumptive tax structure is ultimately linked to the characteristics of the targeted tax base. The study found that that the desired presumptive income tax is more likely to be able to improve on the outcome of two system tiers on desired direct domestic tax revenue where (i) formalization of small and medium scale firm is done jointly with all core government and public institutions.
1.2.4. Informal Sector Firms outside Tax System

Status of Business Registrations, Tax Payment and the Missed Tax Revenues

The study found that about 58.3 percent of the surveyed firms are semi formal and formal or registered business entities and about 41.7 percent are not registered. About 60 percent are captured in the TRA tax network in one form or another and about 40 percent operate outside the tax system. That is, about 40 percent of the informal sector firms are not paying taxes or complying with Tanzanian taxation system. The study suggests that on the one hand TRA is missing over 40 percent of presumptive income tax revenues, since these business operations are not captured in the tax network.

Factors Influencing the Compliance Behaviour of Businesses

The study identified two broad approaches to the problems of compliances. The first stems from an economic rationality perspective and has been developed using economic analysis. The second is concerned with wider behavioural issues and draws heavily on concepts and research from disciplines such as psychology and sociology. Economic and behavioural approaches are sometimes regarded as competing explanations. However, each approach can be valuable in terms of understanding tax compliance and the issue is to determine how the two approaches might be used to reinforce each other.

Reasons for Informal Sector to Escape Registration in Tanzania

Despite all social economic policies, legal and institutional reforms, there are number of businesses which are not registered or captured in the government systems. The study found three major reasons for informal sector to escape registration in Tanzania. These included [1] lack of knowledge and education (taxpayer, registration, business management practices) (about 36.2 percent), [2] lack of proper business premises (unrestricted premises) about (28.4 percent and [3] cumbersome procedure, bureaucracy and corruption, (about 16.4 percent). The study suggested that avoiding tax payment, high taxes, levies, running from government are not major reasons for informal sector to escape registering their business operations. Later the study noted major constraints affecting business performances.

Informal sector perception on the tax system

Different firms have different perceptions on the Tanzanian tax system. Few that is about 22 percent perceived Tanzania tax system as normal, acceptable and therefore is good for civilized society. The majority of the interviewed stakeholders had negative perception on the Tanzanian tax system. About 30.4 percent of the interviewed firms are either not aware or are not concerned with taxation system. The lack of effective access to information provisions and the absence of credible review mechanisms increase the risk of corrupt dealings. About 28.1 percent perceived that tax rates are high and about 4.1 percent perceived that the tax system is
poor. This confirms that the informal sector is still operating in a dark, complex, unfriendly and bureaucratic environment.

**Reason for not paying Taxes (Tax avoidance and evasion)**

Tanzania is facing different forms of taxation problems related with tax avoidance and evasion. Tax avoidance is the *legal* utilization of the tax regime to one’s own advantage, to reduce the amount of tax that is payable by means that are within the law. This may be based on policy framework were there efforts to provide tax exemptions to micro and small scale business entities. The study found that about 60.4 percent argue that they do not pay tax because of small sizes of capital, turnover and profit generated from their operations. Not paying or negative taxes legally or subsidies are one of the best ways to increase business net worth faster and keep more of the wealth for the purpose of further investments. Negative taxes help micro and small businesses to survive and grow and get ahead in life significantly.

**General problems affecting business operations**

The following are general problems affecting business operations

**Lack of effective market demand**

Small and medium scale firms perceived that problems related to unfaithful and unreliable customers, i.e., product market demand constraints, as *the first and foremost constraints* affecting their business performances in the year 2010. About 36 percent of firms outside the tax net complained on behaviour of their customers. In economics terms, this problem can be interpreted as lack of effective market demand or insufficient demand, which is a complex function of continued poverty and economic crisis. Insufficient demand is a reflection of an imperfect competitive market system, which affects behaviour, lifestyle and standard of living of Tanzanians.

**Lack of finance capital, inflation and high interest rates**

*The second major problem* is related with lack of finance. Many small and medium scale firms in Tanzania have very limited access to formal long-term credit due to weak and non-competitive financial system. The financial system is very costly (in terms of high interest rates), too complex and has a lengthy loan application process and too short maturity for the specific case of bank loans. An average of 14.4 per cent of sample small and medium scale business entities argued that lack of capital or inadequate working capital and about 6.3 percent accounted for inflation, high interest on loans.

**Poor Economic Infrastructure**

*The third most constraints* are related to unreliable power supplies and poor infrastructure. About 8.5 percent of the small and medium scale firms identified economic infrastructure to
include, among others; poor roads and networks, inefficient and inadequate communication networks, inadequate and unreliable power and water supplies, lack of waste disposal facilities, and bottlenecks in trade facilitation services.

1.3. Proposed Simple Presumptive Income Tax

The study proposes the need to put in place a more simplified presumptive income tax structure in Tanzania that will promote an enabling and supportive environment to the development and taxation of the informal sector.

1.3.1. The general and specific benefits and policy objectives

Based on the general informal sector business environment, the benefits and general policy objectives of proposed Presumptive Income Tax systems are to reward success, encourage start-ups and formalization, i.e., transformation, facilitation, promotion and development of sustainable small and medium scale businesses, income and job creation social economic activities and reduction of poverty in Tanzania.

The proposed interventions will benefit TRA administration through different ways. In specific, the proposed interventions will enhance good tax practice in reducing regulatory and administrative barriers to formalization. The specific strategic benefits and objectives include;

[1] Simplify tax administration. Tax administration is more often cited as a problem than tax rates.

[2] Consider single taxes for semi-informal MSEs as a way of reducing the number of payments. Offer different payment options that including either or one-off or by instalment.

[3] Avoid retroactive taxation for businesses that formalize: enterprises will be reluctant to formalize if they fear a large tax bill.
Share information with other government ministries, departments and agencies on businesses activities, developments, what taxes are used for, and how businesses will benefit from enhanced services. Evidence suggests that compliance rates go up when businesses are know what they are getting in return for their investments and payments.

1.3.2. Legal Framework

The proposed simple presumptive income taxation system will be based on the Income Tax Act, CAP 162 which was introduced in Tanzania and put into use in January 2001. However, there will be a need to review, refine and make few amendments on the First Schedule of the Income Tax Act of 2004 (and amendments done in 2006).

1.3.3. Institutional Framework

The administration of the proposed presumptive income tax functional activities and issues will continue to be under the TRA, Department of Domestic Revenue. Regional and district tax offices will manage, implement and monitor compliances of small and medium scale operators
and taxpayers through a geographically based block management system, (BMS). Under this BMS, business areas are divided into ‘geographical blocks’. There will be a need for effective Block management teams carry out the functions of registering, assessing, collecting and accounting for tax revenue collected.

1.3.4. New forms of business registration and formalization systems

TRA has to learn and design new institutional framework for management, coordination and operationalization of BMS in collaboration with the central and local government authorities. The basic objective of the newly collaborative institutional framework for BMS is to formalize, i.e., to promote compliance and register all eligible traders within a particular business, sectoral or geographical area, capturing their correct level of economic activities and gathering valuable tax information.

1.3.5. Maximum Taxable income

The study has proposed two maximum taxable income levels. The first is the base case, which is Shillings 20,000,000. The second proposed threshold income level is Shillings 50,000,000 (US$ 40,000 when Tshs 1250 per US$) as an alternative case and amount taking into account the regional integration and globalization trend. The proposed thresholds referred to in subparagraph (1) (b) under the First Schedule will be pegged to take in account inflation, foreign exchange rate fluctuations, regional integration and global competitiveness. It is proposed that the VAT threshold should be adjusted to about TSH 50 million to provide consistent graduation, regional and global economic integration and development.

1.3.6. Introduction of Flat Tax Rate

To avoid unfair/unequal treatment among the taxpayers this study proposes the use of flat rate instead of bands. The use of flat rate assumed to have a fair and equal treatment among the taxpayers and also expected to increase in compliance level as well as increase in revenue collection. Thus this study proposes the use of flat tax rate of 4.0 percent as a base case and flat rate of 3.0 as an alternative case in each shilling that exceeds threshold.

1.3.7. Net Effects of the Proposed Presumptive Income Tax

The new proposed structure in aggregate is a revenue enhancing measure by significant positive percent over and above from the current tax regime with other institutional and human resource factors changing.

1.4. General Policy Recommendations and the Way Forward

It is the interest of TRA to have a vibrant and dynamic SME sector that ensures effective utilization of available resources to attain accelerated and sustainable growth. That is, there is need to foster job creation and income generation through promoting the creation of new SMEs
and improving the performance and competitiveness of the existing ones to increase their participation and contribution to the Tanzanian economy

**Simplification and rationalization of procedures and regulation**

TRA has to intensify programmes aimed at simplification and rationalization of procedures and regulations so as to encourage tax compliance and minimize transaction cost.

TRA has to collaborate with BRELA, central and local government authorities and other regulating authorities in simplifications of business registration and licensing procedures and simplification of tax system, administration and introduce tax incentives to nurse SMEs. This will entail simplifying bureaucratic procedures in taxation, regulatory aspects, licensing and registration by shifting some of the procedures from the national headquarters to the regions and districts, i.e. decentralization of domestic resource mobilization responsibilities and duties.

**An inefficient collaborative multi-institutional framework**

TRA has set in place an efficient collaborative multi-institutional framework facilitating, supporting, promoting and regulating the small and medium scale (informal) sector firms. The proposed institutional arrangement has to the importance of greater transparency, good corporate governance and the rule of law.

The objective of proposed institutional framework is to stimulate and foster optimum economic participation and democracy, to enhance effective mobilization of domestic financial resources and to promote efficient delivery of core outputs for sustainable SMEs sector.
1.0. Introduction

1.1. Background

1.1.1. Informal Sector Size and Performance in Tanzania

The informal sector in Tanzania is among the most social, economic and political sensitive and buoyant sector yet contributes marginally to revenue generation. The informal sector is increasingly being referred to as the informal economy to get away from the idea that informality is confined to a specific sector of economic activity but rather cuts across many sectors, (Becker, 2004). The informal economy also emphasises the existence of a continuum from the informal to the formal ends of the economy and thus the interdependence between productive activities.

In 2006, 40 percent of all households in Tanzania Mainland were in the informal sector activities as compared to 35 percent in 2001. In 2006, the urban informal sector employed 66 percent of the people for whom informal sector work is the main activity and only 16 percent of those for whom it is the secondary activity. In contrast, 34 percent of the people for whom informal sector work is a main activity are in rural areas and 84 percent for whom this work is a secondary activity. This may be explained by the fact that the main activity in rural areas is agriculture, which in some cases is not defined as an informal sector activity.

Where the informal sector activity is the main activity, the wholesale and retail trade employs 57.5 percent of the people. In contrast, where the informal sector activity is the secondary activity, construction engages 48.5 percent of the people and the wholesale and retail trade only 14 percent. For both the main and secondary activity, the most common occupation is service and shop sales workers (55.2 percent and 52.8 percent), followed by craft and related workers by 22.6 percent and 25.1 percent respectively and elementary occupations by 15.7 percent and 10.3 percent respectively. This suggests that service sector occupations account for a larger proportion of female than male workers in informal sector.

Over four-fifths i.e., about 84 percent of the persons employed in the informal sector as their main activity and 92 percent employed in this sector as their secondary activity are self employed without employees. For both the main and secondary activities, the overriding reasons for male and female engagement in the informal sector are the employment and income generation and thus poverty reduction sector for indigenous population with inability to find other work in the formal sector. More than 76 percent of the people involved in the informal sector as their main activity and 86 percent for the secondary activity have no training at all. The most common sources of loans for
informal sector operators are relatives or friends (34.6 percent for main and 53 percent for secondary activity).

**1.1.2. Taxing the Informal Sector**

The social, economic and political realities of the informal sector translate to a complicated operational reality for business formalization and the tax administration. The taxable workforce is usually quite small and the domestic labour market often does not have an ample supply of the education and experience needed by tax administrations.

In terms of taxation of the sector, the views appear to be widespread that evasion is deliberate and systematic, but there are other definitive reasons for supposing that a variety of barriers deter tax payment. These include heavy costs of compliance resulting from their varieties and sizes. Other constraints include insufficient working premises and limited access to finance. In addition, institutional business development services, namely services related to entrepreneurship, business training, marketing, technology development and information are underdeveloped and not readily available. On the other hand, SME operators lack knowledge and information as well as appreciation for such services and can hardly afford to pay for the services. As a result, operators of the sector have rather low skills.

It is also argued that there is huge revenue potential available from the sector. These facts allude to the growth potential existing in the sector and hence potential capacity to contribute meaningfully to the public revenue. It is clear that the informal sector is of great importance to the national economy in many developing economies as opposed to what is taken.

**1.1.3. Efforts to Formalize Informal Sector in Tanzania**

Tanzania recognizes that a substantial amount of economic activities taking place in the small and medium business are not well recognized and regulated. Under the poverty reduction programs, Tanzania plans to increase the level of government expenditure and transfer payments to take care of the poorer sections of the population. Thus, government revenue may need to grow at a rate that exceeds the growth of national income. With the limited revenue generated from the formal sector unable to cope with expenditure requirements, the extension of the tax net becomes a necessity.
Initiatives are being put in place to ensure gradual transition of economic activities from informal to formal. For informal sector operators to be afforded opportunity to expand, they have first and foremost to be formal. Only then can finances be channelled to the sector to bridge the savings-investment gap in the sector. The Property and Business Formalization Programme (PBFP) recognizes this fact and is currently working towards formalization of the informal sector businesses. The initial stages involved profiling the range of activities and businesses in the sector.

1.1.4. Presumptive Tax System for Informal Sector

In order to address the problem of taxation of informal sector in 2010 TRA conducted a policy research study aiming to pull small and medium enterprises into the tax net and introduced presumptive taxation scheme. Whereas the scheme has managed to simplify the taxation for operators in the informal sector to enter in the tax net, significant number of the operators in the informal sector still operate outside the net. The informal sector therefore remains a key to future economic growth. It is an economic reserve and provide as kind of small scale training for budding entrepreneurs. It also provides a kind of economic lubricant which keeps local economies functioning. Its growth holds out the promise of greater employment, greater local manufacturing, greater service provision, and eventually, more tax payments and more tax revenue.

1.2. TRA Study on Presumptive Tax-2010

The Tanzania Revenue Authority, (TRA), conducted an internal investigative research seeking to estimate the size, the dynamics and assess tax revenue generation potential of the informal sector. The TRA research study (2010) aimed at promoting an enabling and supportive environment to the development and taxation of the informal sector in the country. With that in mind, the internal TRA research study focused mainly on the following specific objectives:

a. Identify and analyse the informal sector activities with a view to establishing their size and revenue potentials,

b. Analyse empirically contribution of informal sector to central government revenue in the form of taxes in other developing countries,

c. Review the revenue performance of the presumptive income tax since its establishment,
d. Evaluate possibility for implementing effective presumptive tax system in the informal sector, and propose the viable presumptive tax system to Tanzania,

e. Assess how tax administration can benefit from existing interventions aimed to formalise the informal sector,

f. Assess the efficacy, gains and relevance of inclusion of taxpayers with turnover exceeding Tshs. 20 million but not qualifying for the VAT registration threshold within the presumptive tax scheme

1.3. Scope of Internal TRA Study 2010

The current internal TRA research study 2010 covered five years from financial year 2005/06 to 2009/10; using sample data for small and medium taxpayers, individuals and limited companies final assessments reserved in TRA machineries. Primary data was collected using questionnaires to respondents in eight (8) regions namely; Ilala, Temeke, Dodoma, Singida, Kigoma, Shinyanga, Mwanza and Arusha. These included informal sector operators, TRA officials and Trade Officers from LGA. Additional data on the taxpayers’ was retrieved from the taxpayer’s files in the TRA hard files.

1.4. Significance of Study

The internal TRA research study output identified taxation loopholes in the informal sector and proposed best ways that will bring informal sector into the tax net without hindering the sector from formalization, development and growth.

1.5. Methodology

The internal TRA research study employed both qualitative and quantitative analyses. Qualitative analysis was used in [1] identifying barriers to formalisation of the sector from the business machineries, [2], investigating the extent to which the informal sector evades tax, assessing the ability of the informal sector players to paying tax, and [3] investigating the perceptions of the informal sector player on taxation. Quantitative analysis was employed to determine the revenue contribution of the sector, investigate the determinants of growth of the sector and evaluate the performance of the sector and simulating the estimation of the proposed new presumptive structure.

Quantitative data was manually extracted from the sample of presumptive taxpayer’s files, individuals and limited companies to assist in the simulation of horizontal and vertical equity of the taxpayer segments. Descriptive data was obtained from the
administered questionnaire in TRA officers and Trade Officers from Local Government and/or some business sector machineries. For the purpose of this study, concentration was put more on stored TRA hard files data and few sampled respondents from TRA and Local Government officials for the questionnaire and few informal sector operators.

1.6. Expected Output from the Study

The following were the expected outputs from the internal TRA study 2010:

- An estimate of the magnitude of the sector and the missed tax revenues from the informal sector.
- Empirical analysis of the tax revenue contribution of the sector with some other developing countries.
- Analytical performance of the presumptive income tax since its establishment
- Results of scenarios of revenue implications of inclusion of taxpayers with turnover exceeding Shs. 20 million but not qualifying for the VAT registration threshold within the presumptive tax scheme.
- Final draft of comprehensive report including summary of findings and required output recommendations.

1.7. The Review of Informal Sector for Taxation Purposes

1.7.1. Objective of the Current Research Consultancy Service

Based on the outcome of above internal TRA study, the general objective of this the current research consultancy service was to review, assess and evaluate respective outputs indicated in Section 1.5 in relation to the Presumptive Tax Structure in Tanzania. More specifically incorporating their outputs by reviewing the following:

I. Analyze the current institutional setup and devise best approach to tax the informal sector with win-win solution.
II. Devise the Presumptive Tax Structure that will assist in formalizing the informal sector
III. Review and propose viable Presumptive Tax Structure to Tanzania
IV. Review and rewrite the whole study report to have proper chronological presentation.

1.7.2. Methodology and Approach of the Study

Study Consultant Team
In order to execute the tasks as required above in Section 2.1, a team of one lead consultant supported by two research assistants from the Department of Economics (DoE), of the University of Dar es Salaam (UDSM), constituted a team for the assignment. Dr. Semboja Haji provided guidance as the Lead Researcher.

The approach is for the DoE-UDSM research team to work in collaboration with the TRA research team as part of capacity building programme on matters related with informal sector and presumptive taxation in Tanzania. The research team consulted and exchanged views with other key departments in the main government ministries, departments and agencies, Bank of Tanzania, (BoT), and National Bureau of Statistics. The aim of the participatory approach was to exchange views and opinions and to involve and enlighten core stakeholders on main aspects of informal sector development, tax systems and administration in Tanzania.

1.7.3. Study Methodologies

In view of the composition of the team, approach and so as to accomplish the objectives of the research study that flowed from the general research consultant objectives, four independent but complementary methodologies were used. These were outlined in the Work Plan included major [1] desk study or literature reviews, [2] field research survey, [3] data, policy analysis a report writing and [4] internal TRA consultative meetings and capacity building.

*Desk Study - Literature Review*

*First* and the main research methodology was the desk study to review informal sector and presumptive taxation performances in Tanzania during the last five years.

Around the world, there are strong indications for an increase of the informal economy and much is still not known about its size in transition, developing and developed countries for the year 2010. Literature about the informal, the underground, second or parallel economy is increasing. Topical issues on recent publications cover, among others, the measurement methodologies of the informal sector, its causes, and its effect on the official economy. Available literature point to a number of possible approaches that can be employed to estimate the size of informal sector, namely the direct approaches (including survey and tax auditing), the indirect approaches and the model/latent estimation approaches.

Review of all available documents on the sector including reports of the government, TRA and other sources for information. Secondary data was collected during literature
review and some during fieldwork interviews by collecting relevant documents/statistics or literature, as they were made available by different stakeholders. This consultancy was carried out through a review of available official and academic sources of information and discussions with TRA officials and key informants among stakeholders in various sectors.

**The Field Research Surveys**

Second was the main field research survey conducted in few selected regions in Tanzania. The DoE-UDSM research team worked in collaboration with internal TRA research team. The study covered five years from financial year 2005/06 to 2009/10; used sample data for small and medium taxpayers, individuals and limited companies final assessments reserved in TRA machineries. Primary data was collected using questionnaires to respondents in eight (8) regions namely; Ilala, Temeke, Dodoma, Singida, Kigoma, Shinyanga, Mwanza and Arusha. These included informal sector operators, TRA officials and Trade Officers from LGA. Additional data on the taxpayers' was retrieved from the taxpayer’s files in the TRA hard files.

**Data and Information Sources**

Conventionally two types of data were envisaged: primary data and secondary data. The former was be undocumented information and data that was obtained from the field-work surveys (i.e., through specific questionnaire) and some unprocessed information from official data files. The later was documented and/or processed information to be obtained from the boards and other published or unpublished sources from other public and private sources.

The main tool of data collection was a detailed structured questionnaire based on the study objectives. On the basis of the study objectives, the questionnaire mainly focused on the performance of the informal sector in the context of production efficiency, productivity, capacity utilization, contribution to national income, contribution to taxes and domestic market, constraints, and policy environment. To complement the structured questionnaire, the researchers used open-ended questions with a purpose of evaluating the real qualitative issues impacting performances, formalization and taxation of the informal sector.

**Data and Policy Analysis**
The third research approach was data processes and policy analysis. Data processing and analysis entailed three activities, namely data entry and validation, data processing and data analysis. The edited data from the questionnaire was keyed into the computer using CSPro data entry package and exported to SPSS for further definitive analysis. Final data processing, analysis, simulations and tabulations was done using SPSS statistical package basing on the pre-designed tabulation plan and intended output.

On the basis of both the primary and secondary data obtained in the field research survey, data and policy analysis was employed in examining the performance of the informal sector in Tanzania in terms of production efficiency, productivity, capacity utilization, contribution to national income, contribution to taxes and domestic market, constraints, and policy environment.

Internal Consultative Meetings and Editing

The fourth research steps were the internal consultative meetings with TRA staff, management and board of directors. These internal consultative meetings aimed at soliciting views, comments and contributions from TRA on the contributions of presumptive taxes by the informal sector in Tanzania. The purpose of these consultative meetings was to gain additional inputs for the report to be used as a basis for developing a strategy for formalization and taxation of the informal sector in Tanzania. To have effective study outcome and ownership, participatory approach was used where most consultations and discussions with various TRA stakeholders will be conducted.

Chapter Two: Performance of Informal Scale Sector

Chapter Two examines performance of micro, small and medium scale enterprises in Tanzania between 2001/02 to 2009/10. In specific, the chapter will [1] identify and analyse the informal sector activities with a view to establishing their size and revenue potentials and [2] analyse empirically contribution of informal sector to central government revenue in the form of taxes in other developing countries. We loosely define, identify and treat micro, small and medium scale enterprises as informal sector firms. In specific the chapter will investigate the general behaviour of the micro, small and medium enterprises or informal sector firms, types of the social economic activities performed, their outputs from the sector, number of operators, size by labour employment, legal status of those entities, ownership status, intermediate inputs used in the sector and market challenges during 2010. This chapter seeks to estimate the current size of the informal sector, study the operational dynamics and inherent problems.
2.1. General behaviour of the sector

2.1.1. Size and Magnitude of the Informal Sector by Workforce

Let us examine the size and magnitude of the informal sector. One of the notable features of informal economy in all developing countries is the great composition of self-employment as compared to wage employment in the informal employment statistics. In Sub Saharan Africa, self employment comprises 70 percent of informal employment. With exclusion of South Africa, the share increases to 81 percent. The same picture happens to exist in North Africa, Latin America and Asia where by the composition of self employment stand at 62, 60 and 59 percents of informal employment respectively. As a result, informal wage employment in the developing countries constitutes only about 30 to 40 percents of the informal employment outside of agriculture sector. In deed over the past few decade it has become evident that substantial employment and income is born out of informal sector\(^1\)

The recent estimates show that the nonagricultural employment share of the informal workforce is about 78 percent in Africa, 57 percent in Latin America and the Caribbean, and between 45 and 85 percent In Asia. During the past decade, it is estimated to have accounted for almost 80 percent of non-agricultural employment, over 60 percent of urban employment and over 90 percent of new jobs in Africa\(^2\). For women in Sub-Saharan Africa, the informal economy represents 92 percent of the total job opportunities outside of agriculture (against 71percent for men). Almost 95 percent of these jobs are performed by women as self-employed or own-account workers, and only 5 percent as paid employees.

In Sub-Saharan Africa in particular, street vending predominates in much of the informal economy. Taken together, they represent 10 to 25 percent of the total workforce in developing countries. Within these two groups, women in the developing world constitute 30 about 90 percent of all street vendors, 35 to 80 percent of all home-based workers and over 80 percent of home workers (industrial outworkers who work at home)\(^3\)

The 2006 Integrated Labour Force Survey (ILFS) indicated that in 2006, 40 percent of all households in Tanzania Mainland have informal sector activities as compared to 35 percent in 2001. In 2006, the urban informal sector employs 66 percent of the people for whom informal sector work is the main activity and only 16 percent of those for whom it is the secondary activity. In contrast, 34 percent of the people for whom informal sector

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\(^1\) Chen M.et al, Supporting Workers in the Informal Economy: a Policy Framework, 2002  
\(^2\) J. Charmes, cited at Women in Informal Employment: Globalizing and Organizing (WIEGO), Second Annual Meeting, Cambridge, Massachusetts, 22–24 May 2002  
\(^3\) ILO, Women and Men in the Informal Economy, A Statistical Picture, 2002
work is a main activity are in rural areas and 84 percent for whom this work is a secondary activity. This may be explained by the fact that the main activity in rural areas is agriculture, which is not defined as an informal sector activity (URT, 2006).

Table 2.1 suggests that Africa harbors the largest workforce in the informal sector in terms of non agriculture employment, urban employment and creation of new jobs. Latin America and Caribbean are the next informal economy providers. The increase in the informal economy was attributed, on the one hand to growth of the labour force due to demographic factors, a rise in the activity rate (particularly of women), substantial rural-urban migration and contraction of employment in the formal economy.  

Table 2.1A: Size of Informal Sector in Developing Countries by Workforce

<table>
<thead>
<tr>
<th>Informal Workforce as share of:</th>
<th>Africa</th>
<th>Latin America</th>
<th>Caribbean Asia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-Agricultural Employment</td>
<td>78 %</td>
<td>57 %</td>
<td>45–85 %</td>
</tr>
<tr>
<td>Urban Employment</td>
<td>61 %</td>
<td>40 %</td>
<td>40–60 %</td>
</tr>
<tr>
<td>New Jobs</td>
<td>93 %</td>
<td>83 %</td>
<td>N/A</td>
</tr>
</tbody>
</table>

Source: ILO (2002)

Although the MSE sector has high potential for employment creation in Tanzania, findings of some studies suggest that many MSEs serve as a means of survival with limited opportunity for growth, rather than being demand-driven undertakings with potential for growth. Nonetheless, MSEs have played an important role in supplementing low and falling incomes in the formal sector as second jobs, and in serving some of those who have lost their jobs in the formal sector or search for new employment opportunities, (Tibandebage, et al. 2001). It is contended that the quality of jobs created in MSEs is poor. Consultations suggest that employees in MSEs work in a non-conducive and non-motivating environment. Remuneration levels are lower compared to those in other sectors, many workers operate in an insecure and unstable environment, with limited provision for social protection and personal development to acquire or enhance skills. This suggests the need for the government to reduce tax burden for the informal sector to stimulate employment and output improvement.

2.1.2. Size and Magnitude of the Informal Sector by Gross Domestic Product

One of the strategic Terms of Reference of this report is to establish the size and revenue potentials of the informal sector in Tanzania. This section uses national and other international statistical definitions, methods and approaches of computing and establishing the size of the informal sector in the economy, (URT 2006 and Jacques

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4 ILO, Decent work and the informal economy, International Labour Conference 90th session, 2002
Charmes, 2006). It has been noted that the main statistical characteristics of the informal sector include a subset of household enterprises or unincorporated enterprises owned by households. In statistics, the informal sector comprises informal own account enterprises as well as enterprises of informal employers. The distinction between own account enterprises and enterprises of informal employers is based on whether or not the enterprises of informal employers employ workers on a continuous basis as contrasted with the employment of employees on an occasional basis and the employment of unpaid family helpers. Enterprises rendering professional or business services (e.g. doctors, teachers, lawyers etc) are included in the definition if they meet the requirements of informal own account enterprises or informal employers.

Table 2.1B presents contribution of informal sector to GDP in various regions and selected Sub-Saharan African, (SSA), countries based on the study done by Jacques Charmes, 2006. Table 2.1C presents contribution of informal sector to GDP in Tanzania for selected years 1991, 2001 and 2005 – 2010 based on the TRA study done in 2010. The TRA study uses methods and approaches developed by Jacques Charmes in 2006 and the Integrated Labour Market Surveys done in Tanzania, (URT, 2002 and 2006). In many cases, statistical definitions and computations of informal sector are complex functions of nature, structure and level of economic development of an economy. In the case of developing economies, nature, structure and level of agriculture sector relates and determine contribution of the informal sector. Other factors include institutional organizational legal characteristics, input and output markets.

Let us first examine the GDP contribution of the informal sector at regional levels and Tanzania. Table 2.1B suggests that Sub-Saharan Africa is outstanding with a contribution of nearly 55 percent of the GDP by the informal sector (including agricultural informal sector). It can be noted that this share rises up to 60 percent if we exclude relatively developed nations such as Botswana and South Africa. Tanzania was about 62.5 percent in year 1991. The indicator of the share of informal sector (without agriculture) in non-agricultural GDP shows a ranking of regions from Sub-Saharan Africa (with the highest share, at 37.7 percent) to Transition economies (with the lowest share, at 13.9 percent), with North Africa (30.4 percent), Asia (26.8 percent), Latin America (25.9 percent) and the Caribbean (21.2 percent) in intermediate positions.

Table 2.1B: Contribution of informal sector to GDP in various regions and selected Sub-Saharan African Countries

<table>
<thead>
<tr>
<th></th>
<th>Informal sector (including agriculture) in %</th>
<th>Informal sector (excluding agriculture) in %</th>
<th>Informal sector (excluding agriculture) in %</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Sub-Saharan Africa</strong></td>
<td>55.0%</td>
<td>60.0%</td>
<td>55.0%</td>
</tr>
<tr>
<td><strong>Transition economies</strong></td>
<td>13.9%</td>
<td>14.4%</td>
<td>13.9%</td>
</tr>
<tr>
<td><strong>North Africa</strong></td>
<td>30.4%</td>
<td>30.8%</td>
<td>30.4%</td>
</tr>
<tr>
<td><strong>Asia</strong></td>
<td>26.8%</td>
<td>27.2%</td>
<td>26.8%</td>
</tr>
<tr>
<td><strong>Latin America</strong></td>
<td>25.9%</td>
<td>26.3%</td>
<td>25.9%</td>
</tr>
<tr>
<td><strong>Caribbean</strong></td>
<td>21.2%</td>
<td>21.6%</td>
<td>21.2%</td>
</tr>
</tbody>
</table>
Table 2.1C presents our estimated main informal sector basic statistics for Tanzania for year 1991, 2001 and 2005 – 2010. There are six informal sector statistics, IS1 – IS6. The first IS1 shows the GDP contributions of the agriculture sector in percent for the selected years. Many would consider agriculture sector as an informal sector, owned, managed and operated by the household sector in form of subsistence or and monetized sector. Table 2.1C shows that the relative GDP contribution of the sector has decreased from about 30.1 percent in 1991 to about less than 25 percent in years 2009 and 2010. Various studies suggest that Tanzania economy is undergoing significant economic structural transformation with increasing contributions of service and industry sectors, (URT (Economic Surveys (various issues)). As a nation develops, the economic opportunities increase, but also formal compliance efforts are strengthened leading to gradual transformations and formalization of the informal sector. These two last modern sectors, i.e., service and industry sectors have potential to be monetized and taxable.
The second informal sector statistic, IS2, is the GDP per capita in US Dollar retrieved from the World Bank (2010) and US Statistic data for international comparisons. The GDP per capita has increased from US$ 209.8 in 1991 to about US$ 499.2 in 2010. If we make strong assumptions that inequality index has not changed much, then the GDP per capita may be used to measure income poverty levels. The table suggests that income levels have gone up and few people are moving out of poverty and thus are taxable economic entities.

The third informal sector statistic, IS3, is the contribution of the non-monetized informal sector to the GDP for the selected years based on the Economic Surveys (URT 2010). This is the single and most important national informal sector statistic. Table 2.1C shows that informal sector contribution to GDP has been decreasing from about 17.0 percent in year 1991 to about 13.5 percent in year 2010. The IS3 suggests that the non-monetized economy is not very large and has been decreasing overtime. Many economic entities are producing, trading and consuming via the market system. The size of formal taxable economy is increasing and formalization of informal sector must follow, with increasing policy, legal, regulatory and institutional reforms.

The fourth and fifth informal sector statistics IS4 and IS5 are our estimated informal sector statistics based on the Jacques Charmes (2006) method for year 1991 and extrapolations for rest of the period done using IS1 and IS2. The IS4 shows the Informal sector (including agriculture) in % of total GDP for the selected years and IS5 shows the Informal sector (excluding agriculture) in % of non agricultural GDP. Both IS4 and IS5 are relatively larger than IS3. These two informal sector statistics suggest that the size of the Tanzanian informal sector is large and larger than the size of the computed traditional agriculture sector. However, the IS4 index dropped from 62.5 percent in 1991 to about 39.5 percent in year 2010. The IS4 national results are consistent with international informal sector statistics. We noted that Schneider (2002) in his assessment of the informal sector in 110 countries found that in 2000, the average size of the informal economy as a per cent of the Gross National Income (GNI) was 41% in developing countries, 38% in transition economies and 18% in Organisation for Economic Co-operation and Development (OECD) countries. It is claimed that the key determinants of the size of informal sector are the structure and nature of economy, burden of taxation, government regulations and social security contributions. Tanzanian economy depends on agriculture and thus rather than trying to “merely” formalize the informal sector, one need to realize that the most significant obstacle to growth in informal sector is the lack of access to product markets and resources, most notably, factor and financial markets.

We note that the existence of the informal economy as integral part of the agriculture economic process. The size of the informal sector reflects the ease with which
agriculture sector can be transformed or commercialized, enter and grow within the economy. The agriculture sub-sectors have a greater contribution to the transformed economy if they operate as large scale and commercial farms in the formal sector.

The last informal sector statistic, IS6 shows that the informal sector (excluding agriculture) in % of total GDP. This is slightly smaller than IS4 and IS5, and somehow similar to IS3. Data implies that, if we zero rate the agriculture sector, then the size of taxable economy becomes much smaller. The IS6 index dropped from 19.5 percent in 1991 to about 12.3 percent in year 2010. This suggests that the legal structure of the non agriculture sector is changing with increasing contribution of formal economic entities. Given this statistic, IS6 the informal sector is minimal in size or thus potentially to be formalized and became taxable sector in the long run.

Table 2.1C: Contribution of Informal sector to GDP in Tanzania 1991, 2001 – 2010

<table>
<thead>
<tr>
<th>Year</th>
<th>1991</th>
<th>2001</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>IS1- Agriculture GDP Contribution</td>
<td>30.1</td>
<td>29.0</td>
<td>26.1</td>
<td>25.4</td>
<td>24.6</td>
<td>24.0</td>
<td>24.0</td>
<td>23.8</td>
</tr>
<tr>
<td>IS2- GDP per capita in US$ 8</td>
<td>209.</td>
<td>269.</td>
<td>330.0</td>
<td>380.0</td>
<td>450.</td>
<td>470.</td>
<td>482.</td>
<td>499.</td>
</tr>
<tr>
<td>IS3- IS as % of Total GDP =2001</td>
<td>17.0</td>
<td>16.1</td>
<td>14.6</td>
<td>14.4</td>
<td>14.1</td>
<td>13.9</td>
<td>13.7</td>
<td>13.5</td>
</tr>
<tr>
<td>IS4- IS as % of total GDP *</td>
<td>62.5</td>
<td>48.5</td>
<td>43.6</td>
<td>42.4</td>
<td>41.1</td>
<td>40.1</td>
<td>40.1</td>
<td>39.7</td>
</tr>
<tr>
<td>IS5- IS (ex.agr) as % of NA-GDP**</td>
<td>43.1</td>
<td>33.4</td>
<td>30.1</td>
<td>29.3</td>
<td>28.3</td>
<td>27.7</td>
<td>27.7</td>
<td>27.4</td>
</tr>
<tr>
<td>IS 6- IS (ex.agr) as % of total GDP ***</td>
<td>19.5</td>
<td>15.1</td>
<td>13.6</td>
<td>13.2</td>
<td>12.8</td>
<td>12.5</td>
<td>12.5</td>
<td>12.4</td>
</tr>
</tbody>
</table>

Data Sources: IS1- Agriculture GDP Contribution in % from various URT Economic Surveys
IS2- GDP per capita in US$ from UN Statistics and World Bank
IS3- Informal Sector (IS) as % of Total GDP =2001 from various URT Economic Surveys
We have used the GDP or national income as a measurement of the output of goods and services produced in Tanzania economy - that is, the aggregate of all economic activities that generate goods and services. However, in Tanzania it is the agriculture and informal sectors that play more important role in the country’s economy. Tanzania economy is a rural economy and thus informal sector generally consists of small-scale producers and their employees, including the self-employed in the rural areas. A large number of those active in the informal sector work at home. The rural household sector cannot be directly measured because many economic transactions are not observable and or monetized. It is thus clear that measuring the informal sector is fraught with multiple social, economic and political complexities.

The non-measurement of the informal economy has implications for many aspects of public policies in Tanzania. First of all, the official GDP estimates are significantly underestimated and hence the calculation of the rate of change of economic growth is equally inaccurate. Second, TRA looses significant portion of income tax revenue each year. This either raises the tax burden on those very few who pay tax or it reduces the amount available for government to spend on social economic development. For a poor country like Tanzania, the lost income tax revenue is crucial for sustainable economic development. Lastly, since the informal sector is the employer of a large section of the population, the estimates of all income related statistics are highly questionable. Hence, given its importance, there is an urgent need to measure the total and actual informal sector activities on a regular national census for all important economic sectors.

2.2. Types of the Social Economic Activities in the Sector

Table 2.2 shows types of the social economic activities in the informal sector in Tanzania by the main ISIC sectors. Traditionally informal sector existed only in some of the social and economic activities in most of economies specifically those linked with retail trade and agriculture in traditional sector. However, in the modern economy, the concept of informal sector has disappeared due to existence these activities not only in traditional sector rather in almost all economic activities. The implication of this transformation from some marginally traditional sector to all economic activities substantiate the significance of this sector and its acceptance to majority of people as well as its vertical and horizontal growth in developing world and in Tanzania specifically.

The 2006 Integrated Labour Force Survey (ILFS) suggested that where the informal sector activity is the main activity, the wholesale and retail trade employs 57.5% of the people. In contrast, where the informal sector activity is the secondary activity, construction engages 48.5% of the people and the wholesale and retail trade only 14%. For both the main and secondary activity, the most common occupation is service and
shop sales workers (55.2% and 52.8%), followed by craft and related workers (22.6% and 25.1%) and elementary occupations (15.7% and 10.3%). Service and shop sales and elementary occupations account for a larger proportion of female than male workers in both main and secondary activity, (UTR, 2006).

Over four-fifths (84%) of the persons employed in the informal sector as their main activity and 92% employed in this sector as their secondary activity are self employed without employees. The proportion of self-employed (non-agricultural) with employees is larger for males than females for both the main and secondary activities. For both the main and secondary activity, the overriding reasons for male and female engagement in the informal sector are the inability to find other work and the need for families to get additional income. A larger proportion of females than males consider the need for families to get additional income as an important reason to be involved in the informal sector.

Table 2.2 shows that about 55.3 percent of the informal sector operators are engaged in wholesale and retail, repair of motor vehicles and motorcycles. Wholesaling and retailing are the final trade service steps in the distribution of goods. Goods bought and sold are also referred to as merchandise. Also included in this section are the repair of motor vehicles and motorcycles. Sale without transformation is considered to include the usual simple operations (or manipulations) associated with trade, for example sorting, grading and assembling of goods, mixing (blending) of goods (for example sand), bottling (with or without preceding bottle cleaning), packing, breaking bulk and repacking for distribution in smaller lots, storage (whether or not frozen or chilled), cleaning and drying of agricultural products, cutting out of wood fibreboards or metal sheets as secondary activities.

There are many wholesale activities in the urban areas done by relatively rich or medium and large scale entrepreneurs. Wholesale is the resale (sale without transformation) of new and used goods to retailers, to industrial, commercial, institutional or professional users, or to other wholesalers, or involves acting as an agent or broker in buying goods for, or selling goods to, such persons or companies. There are many micro and small scale trade retailing activities in both urban and rural areas in Tanzania. Retailing activity is the resale (sale without transformation) of new and used goods mainly to the general public for personal or household consumption or utilization, by shops, department stores, stalls, sales persons, hawkers and peddlers, consumer cooperatives, etc

Table 2.2 suggests that about 21.6 percent of the informal sector operators are in manufacturing. Informal sector units engaged in manufacturing are often described as
plants, factories or mills and characteristically use power-driven machines and materials-handling equipment, well organized in terms of markets and financing. In Tanzania, informal sector units that transform materials or substances into new products by hand or in the worker’s home and those engaged in selling to the general public of products made on the same premises from which they are sold, such as bakeries and custom tailors, are very common and spread throughout the country.

There are cases of small and medium scale manufacturing units which are engaged into value addition activities or processing materials or contracting with other units to process their materials for them. These manufacturing processing units can easily camouflage into informal manufacturing sector. However, their outputs are for final consumption and thus easy to be captured in the VAT system. There are very few cases small and medium scale informal manufacturing producing semi-finished outputs. Semi-finished outputs are those treated as inputs for further manufacturing.

Table 2.2 shows that about 23.1 percent of the informal sector operators are in service sectors such as education, health, business support, transportation, and other services. Of this about 2.4 percent are engaged in agriculture, forestry and fishing activities. Characteristics and nature of informal economic activities in Tanzania resemble in almost every economy where the sector predominate, however the size and concentration into various economic activities varies considerably mainly on the account of available natural resources, economic social policies, flexibility in the labour market, nature of economic activities and as well as laws and regulation governing particular economic activities. It has become evident that in countries where agriculture has comparative advantage over other economic activities, micro and small scale units in the informal sector tend to follow the same trend.

Table 2.2: Types of the Social Economic Activities in the Sector

<table>
<thead>
<tr>
<th>Main Economic Activity</th>
<th>Operators</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture, forestry and fishing</td>
<td>23</td>
<td>3.9%</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>129</td>
<td>21.6%</td>
</tr>
<tr>
<td>Construction</td>
<td>9</td>
<td>1.5%</td>
</tr>
<tr>
<td>Wholesale and retail trade; repair of motor vehicles and motorcycle</td>
<td>330</td>
<td>55.3%</td>
</tr>
<tr>
<td>Transportation and storage</td>
<td>1</td>
<td>0.2%</td>
</tr>
<tr>
<td>Accommodation and food service activities</td>
<td>4</td>
<td>0.7%</td>
</tr>
<tr>
<td>Financial and insurance activities</td>
<td>1</td>
<td>0.2%</td>
</tr>
<tr>
<td>Administrative and support service activities</td>
<td>8</td>
<td>1.3%</td>
</tr>
<tr>
<td>Education</td>
<td>23</td>
<td>3.9%</td>
</tr>
<tr>
<td>Economic Activities</td>
<td>Gross Output</td>
<td>%</td>
</tr>
<tr>
<td>--------------------------------------------------</td>
<td>----------------</td>
<td>-----</td>
</tr>
<tr>
<td>Agriculture, forestry and fishing</td>
<td>29,140,000.00</td>
<td>2.4%</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>248,897,333.33</td>
<td>20.2%</td>
</tr>
<tr>
<td>Construction</td>
<td>14,203,000.00</td>
<td>1.2%</td>
</tr>
<tr>
<td>Wholesale and retail trade; repair of motor vehicles and</td>
<td>756,120,250.00</td>
<td>61.3%</td>
</tr>
<tr>
<td>Transportation and storage</td>
<td>1,120,000.00</td>
<td>0.1%</td>
</tr>
<tr>
<td>Accommodation and food service activities</td>
<td>7,460,000.00</td>
<td>0.6%</td>
</tr>
<tr>
<td>Financial and insurance activities</td>
<td>2,000,000.00</td>
<td>0.2%</td>
</tr>
<tr>
<td>Administrative and support service activities</td>
<td>39,593,333.33</td>
<td>3.2%</td>
</tr>
<tr>
<td>Education</td>
<td>56,415,000.00</td>
<td>4.6%</td>
</tr>
<tr>
<td>Human health and social work activities</td>
<td>49,674,444.44</td>
<td>4.0%</td>
</tr>
<tr>
<td>Arts, entertainment and</td>
<td>1,920,000.00</td>
<td>0.2%</td>
</tr>
</tbody>
</table>
Substantial amount of non agriculture output value of informal sector is resulting from wholesale and retail trade services and manufacturing sector specifically simple hand craft manufacturing activities composing about 61.3 percent, 60.9 percent and 60.5 percent and 20.2 percent 21.5 percent and 21.9 percent of output, value added and operating surplus respectively. These findings show that manufacturing sector and trade sector are not only valuable to growth of gross domestic products but as well to individual incomes and government revenue generation as in both activities the value of operating surplus which is the proxy variable of profitability index in particular economic activities are as high as 21.9 and 60.5 percent of total operating surplus in the informal sector.

However, given the nature and characteristics features of operational of informal sector, usually the output and services produced fall short of quality standard. Lack of appropriate technology, technical skills such as quality management, customer care, marketing, and business management is among the reasons accounted deficiency in the output value added and operating surplus from informal operators. The present output and value addition could be enhanced if appropriate technical and technological skills are availed operators in this sector which will add on the existing value of products and service delivered in this economy and eventually profitability.

It is not always the case that output from informal economy fall short of quality standards. Traditional technology in arts and crafts, carpentry and some weaving industries produce as quality as any output produced in formal sector. There is need for integrating formal system of technical education and informal traditional skills so as to improve traditional technology and eventually improve the output of informal operators.

Table 2.3B: Percentage of Profitability by Output Performances

<table>
<thead>
<tr>
<th>Turnover bands</th>
<th>Percentage of Profitability Index to Value Added</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Operators number</td>
</tr>
<tr>
<td>1- 1,620,000)</td>
<td>396</td>
</tr>
<tr>
<td>1,620,001 - 5,000,000</td>
<td>143</td>
</tr>
<tr>
<td>5,000,001 - 10,000,000</td>
<td>27</td>
</tr>
<tr>
<td>10,000,001 - 15,000,000</td>
<td>13</td>
</tr>
</tbody>
</table>

Source: TRA Informal Sector Study Data, 2010
Positive Correlation between profitability index and output performances

In principle there exist relationships between the value of output, business turnover and the business profitability in the sense that higher output is the reflection of good business performance irrespective of profit margin in that sector. Using business turnover as output index, the study has found that there is a slightly correlation between profitability index and output performances such that the value of profitability index increases with the increasing in output. Table 2.3B shows that the output band value between Tshs 1-1.62 million has a profitability index of 62.49 percent where else the output band value of between Tshs 30- 35 millions has profitability index of 92.9 percent on average showing a parallel increase of output and profitability index in the informal sector.

Since the turnover is the principle determinant of amount of presumptive income tax paid, the findings imply that there is unequal treatment of tax payers within the informal sector as individual lying between two or more groups may share similar tax band despite the difference in profitability index. The implication of such inequality gives incentives taxpayer to underestimate sales, not to keep records and evade tax payment. The issue of equity in the eyes of both authority and tax payers themselves is very important in tax compliance. A progressive tax system should be designed in reflection to output performance and profitability index however the cost of input should as well be considered in determining the amount of tax paid by individual in order to correct the inequality in the existing tax system.

2.4. Number and Quality of Operators

2.4.1. Informal Sector can not Adhere to BRELA Governance Standards and Norms

The term quality of operators is herein referred to as standard business management practice (accounting record keeping, customer care, product pricing and arrangement) and business premises of informal operators. Regardless of formal registration of
informal operators, standard business management procedures determine the quality of operation of the informal operators. Table 2.4A shows the field research survey results on the state of business record keeping in the informal economy. Table 2.4A suggests that 22.4 percent of informal operators do not keep any written business records while 74.7 percent keep general informal records for personal use. This is the classical way of keeping records in form of pieces of papers, textbook and personal diaries. Usually, the informal records kept are daily sales and purchases while labour costs and other fixed costs are kept off records. Table 2.4 suggests that about only about 3 percent have formal recording keeping. These results suggest that most of operators in the informal economy do not adhere to the BRELA quality corporate accounting governance standards. Consultations suggest that most of informal operators lack business management education, experience and skills such as proper record keeping, product arrangements, product pricing and marketing of their products.

Table 2.4A: State of Business Record Keeping in the Informal Economy

<table>
<thead>
<tr>
<th>Frequent</th>
<th>Valid Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>No written records kept</td>
<td>133</td>
</tr>
<tr>
<td>Informal records for personal use (in textbooks on buying &amp;</td>
<td>443</td>
</tr>
<tr>
<td>Simplified accounting format required for tax payment</td>
<td>6</td>
</tr>
<tr>
<td>Detailed formal accounts (balance sheets)</td>
<td>10</td>
</tr>
<tr>
<td>Other (specify)</td>
<td>1</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>593</strong></td>
</tr>
</tbody>
</table>

Source: TRA Informal Sector Study Data, 2010

It is very difficult for most of informal operators to determine the stock and trend of capital development as substantial amount of operators does not even remember their starting capital as well as the present stock of capital in his or her business. The implication of this finding can be seen on products pricing and as well as in tax assessment. Most of operators charge products or services without taking into account the operational and fixed costs as no such information is kept and even if kept how to be used is a problem. This explains the fact that some of informal operators are rarely operating at breakeven point and thus prone of collapsing in case of any mild shock.

Table 2.4B: State of Business Growth against Record Management Practices

<table>
<thead>
<tr>
<th>Business maintenance/keeping of records/accounts</th>
<th>Performance of the business</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Growing</td>
<td>Constant</td>
</tr>
<tr>
<td>No written records kept</td>
<td>45</td>
<td>7.6%</td>
</tr>
</tbody>
</table>
### Table 2.4B

<table>
<thead>
<tr>
<th>Category</th>
<th>Count</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Informal records for personal use (in textbooks)</td>
<td>184</td>
<td>31.0%</td>
</tr>
<tr>
<td>Simplified accounting format required for tax payment</td>
<td>3</td>
<td>0.5%</td>
</tr>
<tr>
<td>Detailed formal accounts (balance sheets)</td>
<td>6</td>
<td>1.0%</td>
</tr>
<tr>
<td>Other (specify)</td>
<td>1</td>
<td>0.2%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>238</td>
<td>40.1%</td>
</tr>
</tbody>
</table>

Source: TRA Informal Sector Study Data, 2010

Table 2.4B explores further relationship between record management and business performances. Table 2.4B shows that about 49.7 percent of the surveyed informal sector firms experienced constant or satisfactory business performance and about 40.1 percent of informal sector firms experienced positive or good business performance. Few firms, about 10.1 firms have not been performing well. Table 2.4 B suggests that a significant positive relationship between good records keeping and the growth of business. The number of operators declaring growth of their business increases with proper record management practices while those declaring constant decreases with proper record management practice.

It is clear that among other factors; records management is an important variable determining business performances in informal sector. Therefore, sector policy strategies on harnessing growth potential of informal sector should indeed include intensive business management training programs among other things.

**2.4.2. Business Registration and Licensing**

One way and a step towards formalization of a business entity are registration and licensing procedures. These are other crucial aspects regarding the quality of informal operators and they are within the legal and regulatory framework requirement of their operations. Tanzania has complex business registration and licensing systems. There are many and various ways of registering and licensing a business entity. Each business operating in Mainland Tanzania shall be required to obtain a certificate of registration from the Business Registration Centre within the local authority where the business is located. The owner, manager, worker or person in-charge of a regulated business specified in the regulations who wishes to register his business shall produce to the Registrar a valid certificate of compliance with the relevant regulatory statute before a certificate of registration under this Act is issued. Every business registration shall be valid for the entire life of the business. For the case of Tanzania business operation should be done is legally accepted premises and should be registered by
three up to four administrative authorities depending on type of activities namely local
government, BRELA and TRA and other relevant institution governing such sector.

Table 2.4D shows business registrations by main economic activities in the Tanzanian
informal sector. Table 2.4D shows that transport, financial and insurance activities and
health activities have high registration levels. Apart of business registration there social
economic activities are required to have licenses and are highly regulated. Arts,
entertainments and recreation are the least registered or / and regulated. On average, a
total number of 347 equivalents to 58.3 percent business responded to have been
registered in any of the three administrative authorities while the remaining were not
registered. About 61.1 percent of the wholesale and retail trade activities are registered.
About 53.5 percent of manufacturing businesses are not registered. These operate as
typical informal manufacturing firms.

Literature suggests that easing registration procedures in terms of both number of
processes and administrative units, legal requirements as well as lowering cost of
registering accompanied by intensive sensitization on the importance of having a
registered entity rather than paying tax will reinvent the situation. Control and supportive
measures such as tax exemption, small taxes for registered entities proved to have worked remarkably in formalization processes

<table>
<thead>
<tr>
<th>Main Economic Activity</th>
<th>Yes</th>
<th>No</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture, forestry and fishing</td>
<td>13</td>
<td>9</td>
<td>22</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>60</td>
<td>69</td>
<td>129</td>
</tr>
<tr>
<td>Construction</td>
<td>6</td>
<td>3</td>
<td>9</td>
</tr>
<tr>
<td>Wholesale and retail trade: repair of motor vehicles and mo</td>
<td>201</td>
<td>128</td>
<td>32.9</td>
</tr>
<tr>
<td>Transportation and storage</td>
<td>1</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>Accommodation and food service activities</td>
<td>3</td>
<td>1</td>
<td>4</td>
</tr>
<tr>
<td>Financial and insurance activities</td>
<td>1</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>Administrative and support service activities</td>
<td>4</td>
<td>4</td>
<td>8</td>
</tr>
<tr>
<td>Education</td>
<td>18</td>
<td>5</td>
<td>23</td>
</tr>
<tr>
<td>Human health and social work activities</td>
<td>22</td>
<td>2</td>
<td>24</td>
</tr>
<tr>
<td>Arts, entertainment and recreation</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>Other service activities</td>
<td>17</td>
<td>25</td>
<td>42</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>347</td>
<td>248</td>
<td>595</td>
</tr>
</tbody>
</table>

Source: TRA Informal Sector Study Data, 2010
2.5. Size by Labour Employment

The informal sector has been recognized as significant sector in employment creation, income generation, poverty alleviation and a base for industrial development. It is also estimated that it employs about 20 percent Tanzanian labour force (SMEs development policy, 2003) and it has greater potential for employment generation. Besides the high proportion of women and self-employment there are also a number of other defining characteristics of informal workers in term of education levels, wages, hours worked and overall employment conditions. In particular, informal employment is characterized by the lack of decent work or deficits in comparison with employment in the formal segment of the economy.

![Figure 2.5A: Share of informal Economy in Non agriculture employment in selected Region (2002)](image)

Source: International Labour Office statistics
Almost in all countries where the informal economy prevails, informal employment represents roughly 50 to 75 percent of total nonagricultural employment. Taking agriculture into account increases the relative importance of informal employment, in India, from 83 percent of non-agricultural employment to 93 percent of total employment and in South Africa, from 28 to 34 percent. In Sub Saharan Africa, (SSA) informal economy composes an average of 72 percent of non-agriculture employment with women holding 84 percent of employment compared to men who are 63 percent. The Figure 2.5 illustrates that SSA holds a largest share of informal economy non-agriculture employment as compared to other countries however the dispersion is also high in this region indicating difference in economic settings and macro policies performances within the regions. The limited capacity of agriculture and the formal economy to absorb surplus labour, together with increasing numbers of job seekers, has boosted the size of the informal economy in Tanzania. Tanzania has high rate of population growth, and increasing rural urban migration, and thus informal economy tends to absorb most of the growing labour force in the urban areas when the manufacturing industry and off-farm activities in general do not grow at the same pace.

### 2.5.1. Employment by Gender by Main Social Economic Activities in the Informal Sector

Table 2.5A shows employment by gender by main social economic activities in the surveyed informal sector in Tanzania. Table 2.5A shows that, there are more female gender about 67.1 percent number of workers employed in the informal sector in year 2010. Table 2.5A shows that, there are wide variations in female gender employment between and within social economic sectors. Table 2.5A suggests that female gender employment is high in accommodation, food services, arts, entertainments and recreation, agriculture, and administration and support services. Given limited opportunities in the formal modern sectors, the majority of women are self-employed in the informal small scale manufacturing sectors such as tailoring, handicrafts, food processing and cottage industries.

<table>
<thead>
<tr>
<th>Economic Activities</th>
<th>Female</th>
<th>Males</th>
<th>Total</th>
<th>Permanent</th>
<th>Temporal</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture, forestry and fishing</td>
<td>77.5</td>
<td>22.5</td>
<td>226</td>
<td>43.0</td>
<td>57.0</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>68.0</td>
<td>32.0</td>
<td>477</td>
<td>54.1</td>
<td>45.9</td>
</tr>
<tr>
<td>Construction</td>
<td>9.4</td>
<td>93.8</td>
<td>61</td>
<td>41.7</td>
<td>58.3</td>
</tr>
<tr>
<td>Wholesale and retail trade; repair of motor vehicles and motorcycle</td>
<td>66.3</td>
<td>34.2</td>
<td>739</td>
<td>52.6</td>
<td>47.4</td>
</tr>
<tr>
<td>Transportation and storage</td>
<td>100.0</td>
<td>0.0</td>
<td>2</td>
<td>100.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Accommodation and food service activities</td>
<td>83.3</td>
<td>16.7</td>
<td>11</td>
<td>28.6</td>
<td>71.4</td>
</tr>
<tr>
<td>Financial and insurance activities</td>
<td>70.0</td>
<td>30.0</td>
<td>4</td>
<td>100.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Service Activity</td>
<td>Permanent</td>
<td>Temporary</td>
<td>Fulltime</td>
<td>Parttime</td>
<td>Total</td>
</tr>
<tr>
<td>---------------------------------------------</td>
<td>-----------</td>
<td>-----------</td>
<td>----------</td>
<td>----------</td>
<td>-------</td>
</tr>
<tr>
<td>Administrative and support service activities</td>
<td>70.0</td>
<td>30.0</td>
<td>75</td>
<td>17.0</td>
<td>83.0</td>
</tr>
<tr>
<td>Education</td>
<td>47.6</td>
<td>52.4</td>
<td>79</td>
<td>54.7</td>
<td>45.3</td>
</tr>
<tr>
<td>Human health and social work activities</td>
<td>39.0</td>
<td>61.0</td>
<td>111</td>
<td>58.2</td>
<td>41.8</td>
</tr>
<tr>
<td>Arts, entertainment and recreation</td>
<td>75.0</td>
<td>25.0</td>
<td>7</td>
<td>71.4</td>
<td>28.6</td>
</tr>
<tr>
<td>Other service activities</td>
<td>67.3</td>
<td>32.7</td>
<td>93</td>
<td>55.8</td>
<td>44.2</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>67.1%</strong></td>
<td><strong>33.1%</strong></td>
<td><strong>1885</strong></td>
<td><strong>68.7</strong></td>
<td><strong>31.3</strong></td>
</tr>
</tbody>
</table>

Source: TRA Informal Sector Study Data, 2010

2.5.2. Average Number of Persons Engaged Including Party time Workers

Table 2.5A shows average number of total persons engaged including permanent and temporary or party time workers by sub-sectors. Table 2.5A shows that about 68.7 percent of the surveyed informal sector business units employ on permanent basis. About 31.3 percent work as part time or temporary workers in the informal sector in Tanzania. Very few people, about 17 percent are employed on permanent basis in the accommodation and food services.

In terms of waged and non waged (self) employment, Sub-Saharan Africa appears to have the largest mean share of non-wage employment in non-agricultural informal employment compared to other country, however, accompanied by high dispersion. Female workers in non-agricultural informal employment are more likely to be self-employed than male workers.

Tanzania experience in informal economy employment is more or less similar to other Sub Saharan Africa. Informal economy generated about 97 percent which is equivalent to about 1.3 million employments during the year 2007 to 2008. In terms of age structure 52.7 percent of informal sector employees are between the age of 15 and 34 years old whereby 43.6 are within the age of 35 and 64 years old. Figure 2.5 suggests that despite of its hugeness the sector earning is the lowest among all sectors in Tanzania with slightly improvement as year’s advances. On average female earn less income as compared to male in this sector as depicted in the figure below. Lack of formal procedure of employment, low earnings resulting from lack of managerial and technical skills are the main reasons for employment behavior in the informal sector.

Figure 2.5B: Average Earning by Sector and Gender in Tanzania 2000/01 and 2006
Source: Integrated labour force survey 2006

According to the findings from this survey, on average the informal sector minimum wage stand at Tshs 83,385 per employee below government minimum wage, with accommodation and food services sector holding the highest minimum wage of Tshs 151,250 and Arts, entertainment and recreation activities having the lowest minimum wage of Tshs 30,000 per employee. The finding is slightly above the situation presented by ILS of 2006 indicating an increase in the informal sector wages. The increment is partly attributed by inflation factor though, business performance, the rise in minimum wage in the formal sector trigger a corresponding increase in informal sector wages though not in one to one ratio. Though in principle profitability index is the principle determinant in determining wages, the survey has found that the principle does not apply in the informal sector in the country as shown in the table below.

Though accommodation and food service offer relative higher wages, its profitability index is the least (22.2) than all sector. In comparison to art, entertainment and recreation sector which has profitability index of 68.4 percent and offering a relative minimum wage than all sectors, it is evident that wages are determined by other factor than profitability index in informal sector. However, taking into consideration of working allowance such as transport and food, the minimum wages provided would accelerate into high values as in almost all sector, employee are provided with these allowances with exception of transport and storage sector. Most of these operators prefer to provide these allowances as most of them are inbuilt (family food, home transports) such that no direct cost can be seen as a result of such provision.
Table 2.5C: Average minimum wages per sector in the informal sector in Tanzania

<table>
<thead>
<tr>
<th>Sector</th>
<th>Average min. salary/wages</th>
<th>Offering subsistence allowance (i.e. transport, etc)</th>
<th>Profitability index</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture, forestry and fishing</td>
<td>78,923</td>
<td>Yes 10</td>
<td>% 45.5</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>92,996</td>
<td>83 64.8</td>
<td>% 67.26</td>
</tr>
<tr>
<td>Construction</td>
<td>130,000</td>
<td>6 66.7</td>
<td>32.65</td>
</tr>
<tr>
<td>Wholesale and retail trade; repair of motor vehicles and mo</td>
<td>69,613</td>
<td>250 76.9</td>
<td>51.61</td>
</tr>
<tr>
<td>Transportation and storage</td>
<td>60,000</td>
<td>0 0.0</td>
<td>58.93</td>
</tr>
<tr>
<td>Accommodation and food service activities</td>
<td>151,250</td>
<td>2 50.0</td>
<td>% 22.21</td>
</tr>
<tr>
<td>Financial and insurance activities</td>
<td>60,000</td>
<td>1 100.0</td>
<td>28.75</td>
</tr>
<tr>
<td>Administrative and support service activities</td>
<td>76,667</td>
<td>6 75.0</td>
<td>-</td>
</tr>
<tr>
<td>Education</td>
<td>108,075</td>
<td>18 78.3</td>
<td>69.39</td>
</tr>
<tr>
<td>Human health and social work activities</td>
<td>99,048</td>
<td>19 82.6</td>
<td>63.05</td>
</tr>
<tr>
<td>Arts, entertainment and recreation</td>
<td>30,000</td>
<td>3 100.0</td>
<td>% 68.43</td>
</tr>
<tr>
<td>Other service activities</td>
<td>92,059</td>
<td>24 60.0</td>
<td>37.25</td>
</tr>
<tr>
<td>Sector Average</td>
<td>83,385</td>
<td>422 71.9</td>
<td>% 54.23</td>
</tr>
</tbody>
</table>

Source: TRA Informal Sector Study Data, 2010

2.5.3. Education and Vocation Training

In terms of education and vocation training, statistics from ILFS of 2001 and 2006 indicates that Primary education is the dominant level of education among the self-employed in the informal sector for both main and secondary activities while no formal vocation training attained by most of the operators. According to the standard definition, operators who have completed primary school constitute 64 percent in the main activities and 53 percent in the secondary activities, while those who have not completed primary education comprise 16 percent and 21 percent respectively.

The study findings complement the general picture provided in the ILFS as primary education dominated by 51.4 percent the informal sector operator’s (employers and employees) education level by having followed by secondary education (32.1 percent), however the possibility of higher education operators should not be ruled out as 7.6 percent of operators declare to hold a university degree mainly from education, accommodation and food, human health and administrative sector. This could explain
the reason as why accommodation and food service sector operators enjoy relative higher wages as education level in the sector is also high.

Table 2.5D: Level of Education of Informal Operators by Economic Activities

<table>
<thead>
<tr>
<th>Highest level of education</th>
<th>None</th>
<th>Adult education</th>
<th>Primary</th>
<th>Secondary</th>
<th>Technical</th>
<th>Commercial</th>
<th>University or College</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture, forestry and fishing</td>
<td>0.0</td>
<td>0.0</td>
<td>91.0</td>
<td>4.5</td>
<td>4.5</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>2.4</td>
<td>1.6</td>
<td>52.0</td>
<td>26.0</td>
<td>11.8</td>
<td>0.0</td>
<td>6.3</td>
</tr>
<tr>
<td>Construction</td>
<td>0.0</td>
<td>11.1</td>
<td>33.3</td>
<td>33.3</td>
<td>11.1</td>
<td>0.0</td>
<td>11.1</td>
</tr>
<tr>
<td>Wholesale and retail trade; repair of motor vehicles and motorcycle</td>
<td>1.5</td>
<td>0.9</td>
<td>54.7</td>
<td>35.0</td>
<td>4.3</td>
<td>0.3</td>
<td>3.3</td>
</tr>
<tr>
<td>Transportation and storage</td>
<td>0.0</td>
<td>0.0</td>
<td>100.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Accommodation and food service activities</td>
<td>0.0</td>
<td>0.0</td>
<td>25.0</td>
<td>0.0</td>
<td>25.0</td>
<td>0.0</td>
<td>50.0</td>
</tr>
<tr>
<td>Financial and insurance activities</td>
<td>0.0</td>
<td>0.0</td>
<td>100.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Administrative and support service activities</td>
<td>0.0</td>
<td>0.0</td>
<td>37.5</td>
<td>37.5</td>
<td>0.0</td>
<td>0.0</td>
<td>25.0</td>
</tr>
<tr>
<td>Education</td>
<td>0.0</td>
<td>0.0</td>
<td>4.3</td>
<td>30.4</td>
<td>4.3</td>
<td>4.3</td>
<td>56.5</td>
</tr>
<tr>
<td>Human health and social work activities</td>
<td>0.0</td>
<td>0.0</td>
<td>25.0</td>
<td>41.7</td>
<td>4.2</td>
<td>0.0</td>
<td>29.2</td>
</tr>
<tr>
<td>Arts, entertainment and recreation</td>
<td>0.0</td>
<td>0.0</td>
<td>25.0</td>
<td>75.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Other service activities</td>
<td>0.0</td>
<td>0.0</td>
<td>53.7</td>
<td>36.6</td>
<td>7.3</td>
<td>0.0</td>
<td>2.4</td>
</tr>
<tr>
<td>Average per level of education</td>
<td>1.4</td>
<td>1.0</td>
<td>51.4</td>
<td>32.1</td>
<td>6.1</td>
<td>0.5</td>
<td>7.6</td>
</tr>
</tbody>
</table>

Source: TRA Informal Sector Study Data, 2010

It can be concluded that informal sector activities are more of low level education employee and employers as the percentage disparity of higher to lower education level in the sector is relatively high. It is thus among other factor lack of education is main reasons as why people opt for informal economy as they are un qualified to work in the formal and high paying jobs.

2.6. Capital Investment

2.6.1. Capital Investment

A capital investment is the acquisition of a fixed asset that is anticipated to have a long life of use before it has to be replaced or repaired. Two of the most easily recognizable examples of capital investments are land and buildings. For micro and small scale
enterprises, human capital constitutes as an important and limiting factor of production. However, a capital investment is made any time that a company purchases goods and services or inputs that will be benefit the operation of the business, but will not be used to cover the operational costs of the business.

Of course, for many small and medium scale operators capital investment does not have to be an asset that is along the lines of equipment or land. A capital investment can be something as simple as own savings, that is, an amount of money that is set aside in some sort of interest bearing account. Since the resource is not being used to cover business expenses, capital assets of this type is free to be used for the purpose of generating additional revenue by accruing interest. Thus, it would be proper to consider an initial amount of money that is used to open a standard saving account as a capital asset, with the fact that a rate of interest will be realized from the principal each year turning the asset into a capital.

Table 2.5E: Average Capital Investment in Informal Sector

<table>
<thead>
<tr>
<th>Capital Invested (Tshs.)</th>
<th>Money/capital invested to start the business</th>
<th>Number</th>
<th>%</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 - 1,620,000</td>
<td></td>
<td>401</td>
<td>68.8%</td>
<td>235,028,011</td>
</tr>
<tr>
<td>1,620,001 - 5,000,000</td>
<td></td>
<td>125</td>
<td>21.4%</td>
<td>383,347,000</td>
</tr>
<tr>
<td>5,000,001 - 10,000,000</td>
<td></td>
<td>38</td>
<td>6.5%</td>
<td>285,400,000</td>
</tr>
<tr>
<td>10,000,001 - 15,000,000</td>
<td></td>
<td>9</td>
<td>1.5%</td>
<td>120,000,000</td>
</tr>
<tr>
<td>15,000,001 - 20,000,000</td>
<td></td>
<td>3</td>
<td>0.5%</td>
<td>56,000,000</td>
</tr>
<tr>
<td>20,000,001 - 25,000,000</td>
<td></td>
<td>3</td>
<td>0.5%</td>
<td>74,000,000</td>
</tr>
<tr>
<td>35,000,001 - 40,000,000</td>
<td></td>
<td>3</td>
<td>0.5%</td>
<td>119,000,000</td>
</tr>
<tr>
<td>40,000,000+</td>
<td></td>
<td>1</td>
<td>0.2%</td>
<td>50,000,000</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>583</td>
<td>100.0%</td>
<td>1,322,775,011</td>
</tr>
</tbody>
</table>

Source: TRA Informal Sector Study Data, 2010

Table 2.5.F shows average capital investment in the surveyed informal sector firms in Tanzania 2010. Table 2.5F suggest that on average, the informal sector firms invest between one and five millions Tanzania shillings to establish business in the country. The study has shown that about 90.2 percent of informal sector operators employ capital value of Tshs of between 1 and 5 millions where by 68.8 percent has a capital base below 1.62 millions as shown in Table 2.5E below. Very few informal sector operators, that is less than 2 percent have capital investment exceeding fifteen million Tanzanian shillings.
A low capital investment outlay is a complex function of input and output markets, policies, laws, regulatory and institutional factors. Financing new capital and investments in the informal sector is probably easier said than done. Getting credits from financial bank institutions is out of the question. Also micro-credits appear to be absent within informal sector economy. Left are family and other personal connections. The rest is almost exclusively expensive loans granted by moneylenders. In conclusion, investments in the informal sector are to a large extent financed by personal savings. As these in general are small, so is the degree of new investments.

2.6.2. Sources of Financing

Table 2.5F shows the main sources of financing for the surveyed informal sector in year 2010 in Tanzania. Table 2.5 F suggests that own savings, loans from banks, relatives, SACCOS and other financial NGOs are major sources of financing informal sector. The study has revealed that despite the aggressive campaigning or entrepreneurship supported by extensive existence of micro credit institutions in the country as part and parcel of implementation of SMEs policy of 2000, it has done little in terms of financing capital needs of informal sector. More than 74.9 percent of capital needs of informal economy are financed outside the formal credit windows provided by microfinance institutions in the country. Loans from banking institutions compose 17.7 percent while from SACCOS is as meagre as 1.5 percent.

<table>
<thead>
<tr>
<th>Sources of the capital</th>
<th>Number</th>
<th>Number</th>
<th>Amount</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Own savings</td>
<td>332</td>
<td>56.4%</td>
<td>570,901,011</td>
<td>43.3%</td>
</tr>
<tr>
<td>Loan from bank or promotional agency</td>
<td>58</td>
<td>9.8%</td>
<td>233,095,000</td>
<td>17.7%</td>
</tr>
<tr>
<td>Loan from relative or friend</td>
<td>73</td>
<td>12.4%</td>
<td>232,980,000</td>
<td>17.7%</td>
</tr>
<tr>
<td>Loan from SACCOS</td>
<td>14</td>
<td>2.4%</td>
<td>19,550,000</td>
<td>1.5%</td>
</tr>
<tr>
<td>Grant from relative</td>
<td>62</td>
<td>10.5%</td>
<td>78,953,000</td>
<td>6.0%</td>
</tr>
<tr>
<td>Grant from NGO</td>
<td>9</td>
<td>1.5%</td>
<td>79,600,000</td>
<td>6.0%</td>
</tr>
<tr>
<td>Others, (specify)</td>
<td>41</td>
<td>7.0%</td>
<td>103,786,000</td>
<td>7.9%</td>
</tr>
<tr>
<td>Total</td>
<td>589</td>
<td>100.0%</td>
<td>1,318,865,011</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

Source: TRA Informal Sector Study Data, 2010

Table 2.5F suggests that the informal sector has limited access to formal financing system.

2.7. Legal Status of Informal Sector

5 The informal sector and formal competitiveness in Senegal, 2009:8 Minor Field Study Series
Basically, an entity will be regarded to acquire legal status if it is formed (incorporated), registered and or licensed according to the laws of the country. In Tanzania an entity will be regarded to acquire legal status if it is registered and formed according to the Companies Act, 2002. When an entity acquires a legal status, it will separate itself from its owners thus stands and be liable on its own. For a business entity to acquire legal status in Tanzania, it should be registered with accordance to the requirement of laws stipulated hereunder.

Table 2.6A shows status of the business registration in the surveyed informal sector firms. Table 2.6A shows that registered entities are 58.3 percent while unregistered entities are about 41.7 percent.

Table 2.6A: Business Registration of the informal sector

<table>
<thead>
<tr>
<th>Does your business have any form of registration?</th>
<th>Number</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>347</td>
<td>58.3</td>
</tr>
<tr>
<td>No</td>
<td>248</td>
<td>41.7</td>
</tr>
<tr>
<td>Total</td>
<td>595</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: TRA Informal Sector Study Data, 2010

In principle any legal business entity must be registered, licensed and formal known by relevant government ministries, department and agencies. The principle registration authority in Tanzania BRELA which authorises and protect the copy right of business name registered such that no other entity shall operate under such name. Procedural requirement for registering a business entity require primal authorization from local authority of the presence of such entity in particular area mainly for physical recognition of where about of business operation.

Thus village and ward government as representative of local government machinery play a vital role in business registration in Tanzania. Other mandatory authority that a business entity is required is TRA mainly for acquiring Taxpayer Identification Number for tax payment. Apart from the given authorities, depending on the type of economic activities carried out, a business entity is required to register in various authorities such as TFDA (Food and chemical products entities), VETA (Vocation education entities), TBS and ministries responsible for governing operation of such activity. Practical experience and literatures on the nature and operations of informal economy suggest that many operators within this sector fall short of known legal registration requirements such that an entity can operate with no formal recognition from any of the registration authorizes be it a local government, business registration board or revenue authority or holding a partial registration throughout.
2.8. Forms and Types Ownership Status

Table 2.6B presents types of legal status in terms of ownership organisation in the surveyed informal sector in Tanzania in year 2010. The table indicates that about 88.3 percent are sole proprietorship establishment. These are entities where a single individual is the owner and manager of the business, though other members of his family participate in business operations and work therein. The liability of the business owner is unlimited. All of his personal assets are at risk of losses incurred in the business. Among the notable features of this form of ownership is the easiness in making quick business decisions, little or no division between labour and capital as factors of production and small scale of operations.

Table 2.6B indicates that about 6.6 percent are partnership establishments whereby two or more individuals put their capital together set up their business and shares the profits. Partnership – is a type of business entity in which partners (owners) share with each other the profits or losses of the business. Table 2.6B suggests that about 2.6 percent are business entities owned, managed and operated as cooperatives.

The table suggests that 88.0 percent of informal entities were registered as sole proprietor’ where else 4.6 percent were registered as ordinary partnership. Most of these entities possess partial registration such that most of them are registered in one or two authorities only. Most of these entities which are registered under local government authority (LGA) while the rest are legally registered under Tanzania Revenue Authority (TRA) and other authorities like BREALA.

<table>
<thead>
<tr>
<th>Legal status of the business/activity</th>
<th>Business/activity registered?</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Yes %</td>
<td>No %</td>
</tr>
<tr>
<td>Single proprietor / Individual business or farm</td>
<td>309</td>
<td>88.0%</td>
</tr>
<tr>
<td>Ordinary partnership with members</td>
<td>16</td>
<td>4.6%</td>
</tr>
<tr>
<td>Corporation (stock or non stock, nonprofit)</td>
<td>4</td>
<td>1.1%</td>
</tr>
<tr>
<td>Cooperative</td>
<td>9</td>
<td>2.6%</td>
</tr>
<tr>
<td>Others specify:</td>
<td>5</td>
<td>1.4%</td>
</tr>
<tr>
<td>Total</td>
<td>343</td>
<td>97.7%</td>
</tr>
</tbody>
</table>

Source: TRA Informal Sector Study Data, 2010

With reference to legal status of registered entities, some of the informal sectors entities operates in form unregistered entities or households, they operates as sole
proprietorship or sole trader, partnership, trusts and cooperatives. Most entities are not separate from their owners. However there are various laws which guides either formation or registration of these entities so that to give them legal recognition.

Over the time there has been increase in number of incorporated entities. These entities are owned by households and most of them are operating in small scale. Most of the enterprises are continuing to operate as household enterprises or unregistered enterprises because the current legal framework governing properties and business is unfriendly as well the cost and bureaucracy involved in the process.

Lack of clear understanding of the relations and influence of ownership status of the business against the performance and expansion of the business prove to be among the reason for increasing incorporate entities. Other notable reasons are such as inability to find work, need for families to get additional income and it does not require much capital.

The informal sector of the Tanzanian economy is a changing, heterogeneous mixture of enterprises operating wholly or partially outside of the government system of regulation, (Edwin G. Nelson and Erik J. De Bruijn (2005). It flourishes partly because informality offers opportunities of economic necessity to the poor, most of who will never be able to assimilate the costs of formalization, and partly because it offers others a low cost arena for experimentation that can lead to business growth. Some enterprises do formalize voluntarily, the stimulus for which can be represented as an economic function determined by the values that operators assign to institutional incentives, opportunity costs and formalization costs, and the process can be represented as an exchange transaction with government.

Government tolerates the informal sector because it reduces unemployment and contributes to poverty alleviation, but it is not officially recognized and government is under some pressure to formalize it.

A policy based on formalization seen as a voluntary transaction between operators and government could focus on mutual benefits and reduce the risk of damaging fragile enterprises and livelihoods for little benefit. In Tanzania there are policies which have addressed the issue of forms and ownership status in the informal sector. One of the policy results on policy implementation is the adoption of Property and Business Formalization Program (MKURABITA). Property and Business Formalization Programme (MKURABITA) was launched in October 2004. The programme objective is to formalize businesses and properties owned by ordinary Tanzanians. Such properties/assets can then be used as collateral for accessing credit from financial
institutions taken by the government to ensure formalization in of entities and businesses in the informal sector.

2.9. Intermediate Inputs used in the Sector

This section examines performance of material input utilization in the informal sector as important factor determining firm’s performances, firm-level productivity and competitiveness. The material input consumption covers costs of material inputs used in the production processes. A material can be anything: a finished product in its own right or an unprocessed, intermediate and raw material. These inputs are integrated into a new cycle of production and finishing manufacturing processes to create finished materials, ready for distribution, further manufacturing and final consumption.

The informal sector consumes many and different types of inputs depending on the nature of production technologies, output and market. These include materials, intermediate goods, energy, industry services, non-industry services and other inputs. Material and supplies costs includes raw materials, utilities, chemicals and other consumables including spare parts and components for repair and maintenance of machinery and equipment provided that their working life is less than one year. Utilities include electricity, water, fuel for machines and vehicles; gas; and wood, charcoal and peat.

Studies indicate that the costs of material and supplies are largest input costs in many informal manufacturing and business activities in Tanzania. Most of material inputs (70 – 80 percent) are sourced from domestic markets and about 20 – 30 percent are imported intermediate inputs. Material inputs for mining, extraction of crude petroleum, paper and paper products, transport and furniture manufacturing sectors are sourced from domestic markets. There are two major types of domestic materials, namely natural and raw agriculture outputs.

The informal sector is both a producer and consumer of industry services. Industrial services include contract and commission paid for work done, cost of repairs and maintenance; and waste treatment costs. Most of industry services are related with repairs and maintenance. Maintenance, repair, and operations involve fixing any sort of mechanical or electrical device should it become out of order or broken (known as repair, unscheduled or casualty maintenance).

2.10. Product market environment
The product market environment is a marketing term and refers to all of the forces outside of marketing that affect marketing management’s ability to build and maintain successful relationships with target customers. The product market environment consists of the macro environment, microenvironment and internal environment.

Table 2.9A shows main product market targets for the informal sector in Tanzania by year of establishment. Table 2.9A shows that about 77.9 percent of the surveyed informal sector firm’s sell their products and services within the vicinity. Very few informal sector firms have access to outside the locality, that is very far markets. Table 2.9A suggests that new micro and small scale informal firms target local or neighbourhood markets. About 46.7 percent of firms with 20 or more year’s business experiences tend to go for outside markets. Search for outside market is a complex function of the internal scales of operations and micro-environment factors. The micro-environment influences the informal sector directly.

It includes suppliers that deal directly or indirectly, consumers and customers, and other local stakeholders. Also includes all departments, such as management, finance, research and development, purchasing, operations and accounting. Each of these departments has an impact on marketing decisions. But looking on the informal sector in Tanzania operates on small scale with poor management with no departments such as finance, research and development which can influence the improvement the products.

**Table 2.9A: Product Market Targets for the Informal Sector**

<table>
<thead>
<tr>
<th>Start of business (main activity)?</th>
<th>Product Market Targets</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Within the same building</td>
</tr>
<tr>
<td>Less than one year ago</td>
<td>89.3</td>
</tr>
<tr>
<td>1 but less than 3 years ago</td>
<td>86.6</td>
</tr>
<tr>
<td>3 but less than 5 years ago</td>
<td>86.7</td>
</tr>
<tr>
<td>5 but less than 10 years ago</td>
<td>76.3</td>
</tr>
<tr>
<td>10 but less than 20 years ago</td>
<td>75.2</td>
</tr>
<tr>
<td>20 or more years ago</td>
<td>53.3</td>
</tr>
<tr>
<td>Total</td>
<td>77.9</td>
</tr>
</tbody>
</table>

*Source: TRA Informal Sector Study Data, 2010*

Table 2.9B shows market channels for the informal sector products/services in Tanzania during 2010. The informal sector has two main product market channels. These are direct self marketing or retail trading system and whole sale trade systems. Table 2.9B suggests that majority, i.e., about 96 percent prefer to sell their products
through direct retail trading system. Tables 2.9A and 2.9B suggest that most of the operators in the informal sector within the selected regions tend to sell their products directly to the customers, this enable them to find out the desire of their customers. In this context, microenvironment describes the relationship between informal sector operators and the driving forces that control this relationship. It is a more local relationship, and the traders may exercise a degree of influence. Also the microenvironment refers to the forces that are close to the company and affect its ability to serve its customers. It includes the company itself, its suppliers, marketing intermediaries, customer markets and competitors.

Pricing behaviour is an important feature of informal sector competition. The TRA Informal Sector Survey 2010 suggests that the majority informal sector operators about 95.9 percent in 2010 set the prices of their products as a mark up over costs, whereas a few, about 4.1 percent take market prices as given. Table 2.9C shows that most of start-up firms (about 100 percent) in the informal sector fixes own product prices. These micro and small scale informal sector operators tend to focus on local market and thus use limited product market information. When this information is sought in a different way; firms rank input costs as the most important determinant of product prices, competition with domestic firms as important but competition About 13.3 percent of firms with 20 or more years in business operation use market determined prices. These have gained knowledge and information on the macroeconomic environment.

<table>
<thead>
<tr>
<th>Start of business (main activity)?</th>
<th>System of marketing your products/services?</th>
<th>Through middleman/agents</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Self marketing</td>
<td>Through middleman/agents</td>
</tr>
<tr>
<td>Less than one year ago</td>
<td>100.0</td>
<td>0.0</td>
</tr>
<tr>
<td>1 but less than 3 years ago</td>
<td>99.2</td>
<td>0.8</td>
</tr>
<tr>
<td>3 but less than 5 years ago</td>
<td>97.9</td>
<td>2.1</td>
</tr>
<tr>
<td>5 but less than 10 years ago</td>
<td>97.2</td>
<td>2.8</td>
</tr>
<tr>
<td>10 but less than 20 years ago</td>
<td>95.0</td>
<td>5.0</td>
</tr>
<tr>
<td>20 or more years ago</td>
<td>86.7</td>
<td>13.3</td>
</tr>
<tr>
<td>Total</td>
<td>96.0</td>
<td>4.0</td>
</tr>
</tbody>
</table>

Source: TRA Informal Sector Study Data, 2010

Pricing Behavior

The macro-environment includes all factors that can influence the informal sector but that are out of their direct control. It includes concepts such as demography, economy, natural forces, technology, politics, and culture. Looking on the economic factor this
refers to the purchasing power of potential customers and the ways in which people spend their money but for the case of informal sector does not generally influence any laws.

Also on the side of natural environment is another important factor of the macro environment of the informal sector. This includes the natural resources that informal sector uses as inputs and affects their marketing activities. The concern in this area is the increased pollution, shortages of raw materials and increased governmental intervention. As raw materials become increasingly scarcer, the ability of the informal operators to create products gets much harder.

<table>
<thead>
<tr>
<th>Start of business (main activity)?</th>
<th>Pricing of your products/services?</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Through market forces</td>
</tr>
<tr>
<td>Less than one year ago</td>
<td>0.0</td>
</tr>
<tr>
<td>1 but less than 3 years ago</td>
<td>0.8</td>
</tr>
<tr>
<td>3 but less than 5 years ago</td>
<td>2.2</td>
</tr>
<tr>
<td>5 but less than 10 years ago</td>
<td>3.1</td>
</tr>
<tr>
<td>10 but less than 20 years ago</td>
<td>5.1</td>
</tr>
<tr>
<td>20 or more years ago</td>
<td>13.3</td>
</tr>
<tr>
<td>Total</td>
<td>4.1</td>
</tr>
</tbody>
</table>

Source: TRA Informal Sector Study Data, 2010
The market situation of the informal sector in Tanzania is largely constituted by unpredictable behaviours from both producers and customer’s point of view. Due to congestion of operators in terms of geographical locations as well as indifferent products, determining market share is very difficult. The sector market is very competitive where by buyers are not only responsive to market price but also the per person relationship between producers and customers. The study data revealed that the focus of most of operators in terms of market access is within the spatial area of his or her operation within the average size of one square kilometre meaning that the business is principally to serve the demand of neighbours.

This finding is complimented by the fact that there no need for having distribution agents in the operations of informal sector. Also in terms of product price prevailed market price is the only price that operators have in order to sell their products. The issue of experience in the business has shown to have a changing face in the market aspect of informal sector. A reasonable degree of market access expansion from internal to
external neighbourhood is emerging with increase in experience same applies to price control and system of marketing (percentage of outside are increase with increase in experience)

2.11. Problem, Challenges and Opportunity to Informal Sector

Informal economic activity is an integral part of the overall economy in underdeveloped economies and will continue to be so in the future. Previous modernization perspectives conceived of informal economic activity as residual activity that will eventually disappear. Evidence suggests that contemporary processes of economic globalization, flexibility and the reconfiguring of state activity have further stimulated the growth of informal work. In policy terms this reality needs to be recognized. For developing economies informal economic activity is a major resource in areas where resources are in short supply and misused.

The challenge therefore is whether and how to build upon the positive elements in such a manner that complements efforts to tackle the negative aspects of informal economic activity as well as promote and harness the positive attribute of informal economy. Table 2.10 summarizes main problems, challenges and constraints affecting performance of the informal sector firms during 2010 in Tanzania. These include access to credit facilities, lack of market and unfaithful and unreliable clients are among the leading bottleneck in informal sector business performances. These limitations are as described hereunder.

Table 2.10 suggests the first major problem and challenge limiting performance of the informal sector is lack of credit facilities. About 34.1 percent of the surveyed informal sector firms pointed that is the informal sector borrowing is very limited. This hinders the performance of the sector.

From the lender point of view the informal sector are subjected to high rate of business failure, high administrative cost, low productivity, under capitalization, shortage of skills, poor attitudes of the borrowers, collateral, legally registration as a limited liability company; and submission of feasibility studies (business plan and thus are illegible for credit facility and if proved otherwise the interest rate is high to offset the risks associated with such loan.

Table 2.10: Challenges and limitations of the Informal Business Activities

<table>
<thead>
<tr>
<th>Limitation affecting business activity</th>
<th>Business/Activity Registered?</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td></td>
<td>Number</td>
<td>Table %</td>
</tr>
<tr>
<td></td>
<td>Number</td>
<td></td>
</tr>
</tbody>
</table>

- Table %
The Tanzania informal economy is quite heterogeneous in terms of capital invested, technology in use, adopted management practices, productivity levels and net earnings, its players also constitute a heterogeneous informal operators. In fact, there are few informal small-scale modern manufacturing and service enterprises. There are increasing numbers of typical mobile /HTT informal sector operators such as street vendors selling seasonal agriculture products and imported manufacturing products and domestic service providers. The last spectra is strongly gender-biased and in particular regarding the access to rights and justice. In between are ranges of primary service activities such as informal transport services, small trading and commercial establishments. Our main focuses are informal enterprises with the potential of becoming a significant contributor to the national economy and that take up informal economic activities because of their potential for generating revenues, growth or wealth. What attracts some is the fact that many informal activities are thought to be not fully regulated and taxed and, therefore, to have the potential for autonomy and profits. These semi formal enterprises can be linked to organized and emerging national or international markets

**Chapter Three: Policy, legal, regulatory and institutional frameworks**

Chapter Three reviews current institutional setup factors which are crucial for the development of the small and medium scale sector in Tanzania. The report considers institutional factors to include the general policy framework, the regulatory framework, infrastructure, facilitating institutions, technical and managerial skills and business

<table>
<thead>
<tr>
<th>Nonpayment of debts</th>
<th>54</th>
<th>9.1%</th>
<th>36</th>
<th>6.1%</th>
<th>90</th>
<th>15.2%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unavailability of credit facilities</td>
<td>119</td>
<td>20.1%</td>
<td>83</td>
<td>14.0%</td>
<td>202</td>
<td>34.1%</td>
</tr>
<tr>
<td>Lack of management skills</td>
<td>5</td>
<td>0.8%</td>
<td>1</td>
<td>0.2%</td>
<td>6</td>
<td>1.0%</td>
</tr>
<tr>
<td>Lack of Capital equipment</td>
<td>12</td>
<td>2.0%</td>
<td>14</td>
<td>2.4%</td>
<td>26</td>
<td>4.4%</td>
</tr>
<tr>
<td>Lack of skilled personnel</td>
<td>4</td>
<td>0.7%</td>
<td>4</td>
<td>0.7%</td>
<td>4</td>
<td>0.7%</td>
</tr>
<tr>
<td>Heavy taxes and license fees</td>
<td>31</td>
<td>5.2%</td>
<td>4</td>
<td>0.7%</td>
<td>35</td>
<td>5.9%</td>
</tr>
<tr>
<td>Lack of raw materials/irregular supply</td>
<td>7</td>
<td>1.2%</td>
<td>4</td>
<td>0.7%</td>
<td>11</td>
<td>1.9%</td>
</tr>
<tr>
<td>Lack of space</td>
<td>2</td>
<td>0.3%</td>
<td>7</td>
<td>1.2%</td>
<td>9</td>
<td>1.5%</td>
</tr>
<tr>
<td>Theft</td>
<td>12</td>
<td>2.0%</td>
<td>8</td>
<td>1.4%</td>
<td>20</td>
<td>3.4%</td>
</tr>
<tr>
<td>Shortage of water and electricity</td>
<td>7</td>
<td>1.2%</td>
<td>4</td>
<td>0.7%</td>
<td>11</td>
<td>1.9%</td>
</tr>
<tr>
<td>Lack of market</td>
<td>39</td>
<td>6.6%</td>
<td>47</td>
<td>7.9%</td>
<td>86</td>
<td>14.5%</td>
</tr>
<tr>
<td>No difficulties</td>
<td>28</td>
<td>4.7%</td>
<td>13</td>
<td>2.2%</td>
<td>41</td>
<td>6.9%</td>
</tr>
<tr>
<td>Others (specify)</td>
<td>25</td>
<td>4.2%</td>
<td>26</td>
<td>4.4%</td>
<td>51</td>
<td>8.6%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>345</strong></td>
<td><strong>58.3%</strong></td>
<td><strong>247</strong></td>
<td><strong>41.7%</strong></td>
<td><strong>592</strong></td>
<td><strong>100.0%</strong></td>
</tr>
</tbody>
</table>

Source: TRA Informal Sector Study Data, 2010
culture. These institutional factors are taken into account when evaluating possibility for implementing effective presumptive tax system in the informal sector and propose the viable presumptive tax system to Tanzania.

3.1. Policy Environment

Tanzania has, in the past 15 years been undergoing social economic and political changes, legal and regulatory and institutional reforms, which have re-oriented the economy from a government-led to a competitive market and private-sector-led one. The Micro, Small and Medium Scale Enterprises, (MSME) or the informal sectors are major private sector businesses owned, managed and operated by the indigenous Tanzanians. Tanzania has made significant progressive in the formulation, implementation and performances of social economic development efforts intending to empower Tanzanians in managing own social economic activities. The first and second generation reforms that were pursued since early 1980s up to day will be examined and linked to performance of the MSME/informal sector in Tanzania.

3.1.1. First Generation Policy Reforms

Since the mid 1980s, Tanzania has introduced a series of policy reforms intended to restore macroeconomic balance, stimulate economic growth and facilitate social and political development (URT, 1996 and Semboja, 2004). Experience with the first generation reforms in 1986 - 1996 suggests that individual initiative and market-oriented economic systems propel higher growth rates than centrally planned economic systems. These broad based measures included the fiscal, liberalization of internal and external trade, the removal of restrictive tendencies, the liberalization of the foreign exchange market and the institution of a general policy environment, which is more favourable to formal and informal private sector expansions.

Most relevant for informal sector development are the fiscal policy reforms which had several dimensions. The government has established the Tanzania Revenue Authority (TRA), which has contributed to increased revenue collections. The government has increased control and cut expenditure using the cash budget system and civil service and parastatal reforms have curbed expenditure and raised government revenues.

The country shifted from its previous reliance on public control mechanisms to a predominantly market-oriented environment and private enterprise development. Significant progress has been made with the development of a more market-oriented financial system with the liberalization of interest rates. A substantial number of both
local and foreign banks and non-banking institutions have been established to provide short, medium and long-term loans to the formal private sector.

### 3.1.2. Second Generation Reforms

Based on the experiences of implementation of first generation macro-reforms during 1985/6 – 1995/6, the government was conscious of the need for long term perspective development plans and has made a more comprehensive review of its micro-economic and sector policies to resolve social economic problems, which are still inherent in the informal and formal sectors and to also ensure that the current interest by investors in the economy is enhanced and sustained. These second generation reforms pursued between 1996/7 and 2009/10, when many of these Sub-Saharan economies are facing huge debt problems making poverty an important policy issue. Hence, these second-generation reforms are still focusing on macro-micro linkages subject to intensification of first generation reforms in terms of continuation of fiscal, monetary, legal, regulatory and institutional reforms.

In addition, the second-generation reform policies aim at facilitating pro-poor economic growth as the basis for poverty reduction by putting in place appropriate policies and strategies. These policy strategies promote the creation of enabling environment for good governance, effective co-ordination and peoples participation; capacity building for enhancing economic growth and equity through a conducive macroeconomic, sectoral (agriculture, industry and mining) and infrastructure (financial, transport, communication, energy (electricity) and marketing) policies and strategies; education, health, water supply and sanitation, employment opportunities, protection and preservation of the environment and housing and settlement. All these reforms are important in facilitating, supporting, promoting and sustaining the informal sector in Tanzania.

It is during the second generation reform period when the government initiated and implemented various programmes and strategies for socio-economic development which included Property and Business Formulation Program (PBFP/MKURABITA), Tanzania Mini-Tiger Plan 2020 (TMTP 2020) and Business Environment Strengthening for Tanzania (BEST/MKUMBITA).

The BEST Programme that aims at reducing the costs of establishing and operating business by removing the obstacles emanating from policy, legal, regulatory, procedural and institutional frameworks that impede the growth of the private sector.

In 2005, the government started to implement Tanzania Mini Tiger Plan 2020 by using the experience and success of the South East Asian countries. The aim of this plan is to
increase the rate of growth of the economy as the basis for increasing the average income; to increase exports of goods and services, and to increase employment opportunities in order to reduce poverty.

3.1.3. Broad Based National Development Policies

The formulation and implementation of the series of sector specific, macro-economic and other broad based national development policies supporting development of the private sector mark the second-generation reforms. These broad-based policies include; National Development Vision 2025 (URT, 1999b National Poverty Eradication Strategy, (URT, 1998b); Tanzania Assistance Strategy, (URT, 1999a) and Poverty Reduction Strategy Paper, (URT, 2000).

The Tanzania Vision (1999)

Tanzania envisioned is that the society by 2025 will be a substantially developed one with a high quality livelihood. Abject poverty will be a thing of the past. In other words, it is envisioned that Tanzanians will have graduated from a least developed country to a middle income country by the year 2025 with a high level of human development. The economy will have been transformed from a low productivity agricultural economy to a semi-industrialized one led by modernized and highly productive agricultural activities, which are effectively integrated and buttressed by supportive industrial and service activities in the rural and urban areas. A solid foundation for a competitive and dynamic economy with high productivity will have been laid. Consistent with this vision, Tanzania of 2025 should be a nation imbued with five main attributes: [1] High quality livelihood, [2] Peace, stability and unity; [3] Good governance, [4] A well educated and learning society; and [5] A competitive economy capable of producing sustainable growth and shared benefits.

Poverty Reduction Strategy Paper, 2000

The Government of Tanzania, GoT, had in 2000 prepared, endorsed and implemented the First Poverty Reduction Strategy Paper (PRSP-1) after being declared eligible for debt relief under the enhanced HIPC initiative and as a condition to reach Decision Point before the end of FY 2000/2001. Preparation process of the PRSP-1 involved intensive consultations and participation of many stakeholders included civil society, high learning and research institutions and development partners that identified key areas of concern on poverty reduction in Tanzania. The implementation plan of PRSP-1 was well integrated into the MTSP, MTEF and annual budgets. In specific, PRSP focused on specific goals for poverty reduction, improvement of social indicators,
specific public policies and institutional changes, to reach the poverty reduction objectives articulated in the Tanzania Development Vision 2025.

3.1.4. The SME Development Policy

The Vision, Mission and General Policy Objectives

The SME Development Policy is the core policy governing development of the small and medium scale sectors in Tanzania. The vision of the SME Development Policy is to have a vibrant and dynamic SME sector that ensures effective utilization of available resources to attain accelerated and sustainable growth. The mission of this Policy is to stimulate development and growth of SME activities through improved infrastructure, enhanced service provision and creation of conducive legal and institutional framework so as to achieve competitiveness.

The overall objective of this SME policy is to foster job creation and income generation through promoting the creation of new SMEs and improving the performance and competitiveness of the existing ones to increase their participation and contribution to the Tanzanian economy.

A policy assessment of the SME

An assessment of the SME sector suggests that it is facing constraints which need to be addressed adequately through the comprehensive policy framework. Given the importance of the sector and the need to transform it to a vibrant and dynamic one, it is crucial to put in place strategies that will facilitate the removal of those constraints so that it can attain the desired vision and identified objectives. In the SME Development Policy strategies have been identified focusing on areas which have maximum impact on the sector.

The major areas of focus include: creation of the enabling business environment, developing the infrastructure, strengthening financial and non-financial services and establishing and strengthening institutions supportive to SME development.

Specific Policy Objectives and Strategies

In this policy, the specific policy objectives and strategies are specified as follows:
[1] **Simplification and rationalization of procedures and regulation**

The Government will enhance implementation of programmes aimed at simplification and rationalization of procedures and regulations so as to encourage compliance and minimize transaction cost. Specific policy strategies include simplifications of business registration and licensing procedures and simplification of tax system, administration and introduce tax incentives to nurse SMEs.

[2] **Improving the physical infrastructures and provision of utilities**

The Government will continue to improve the physical infrastructures and provision of utilities in collaboration with local authorities, private sector and development partners. Specific policy strategies include the need for local government authorities to allocate and develop land for SMEs and to develop industrial clusters and trade centres.

[3] **Promote entrepreneurship**

The Government will promote entrepreneurship development through facilitating improved access of SMEs to financial and non-financial services. Specific policy strategies include the need to inculcate through education, training and other programmes values and attitudes that are conducive to development of entrepreneurship; to review school curricula to accommodate entrepreneurship development and to introduce entrepreneurial programmes in vocational and technical training.

[4] **Enhance financial reforms**

The Government will enhance financial reforms aimed at further liberalization of the financial sector and the creation of financial intermediaries to cater for SMEs. Specific policy strategies include the need to promote transferring lessons and good practices from traditional financing mechanisms into suitable financial products for financing SMEs; facilitating opening up of SME windows in financial Institutions; promoting innovative financial products for SMEs such as hire purchase scheme, leasing, inventory financing, venture capital SMEs and, Saving and Credit Schemes; promote improving access of SMEs to bank financing through simplification of procedures; and mobilizing resources and promote development of new financial institutions for financing SMEs.

[5] **Facilitate the establishment of manufacturing enterprises in rural areas**
The Government will facilitate the establishment of manufacturing enterprises in rural areas so as to add value to agro products. Specific policy strategies include strengthening extension services aimed at promoting industrialization through SMEs, facilitating the establishment of industrial clusters/business centres at regional, district and ward levels, facilitating the transfer of technology to rural areas, including upgrading of existing technologies and supporting establishment of rural industrial cooperatives.

3.1.5. Sector Specific National Development Policies

The National Micro Finance Policy, (2001)

Microfinance is about providing financial services to the poor who are traditionally not served by the conventional financial institutions, that is the informal sector. Three features distinguish informal microfinance from other formal financial products. These are: (i) the smallness of loans advanced and or savings collected (ii) the absence of asset-based collateral, and (iii) simplicity of operations.

The National Micro Finance Policy recognized the existing informal institutions and brings them within the supervisory purview of the Bank of Tanzania would not only enhance monetary stability, but also expand the financial infrastructure of the country to meet the financial requirements of the Micro, Small and Medium Enterprises (MSMEs). Implementation of the policy expected to create a vibrant microfinance sub-sector that would be adequately integrated into the mainstream of the national financial system and provide the stimulus for growth and development. It would also harmonize operating standards and provide a strategic platform for the evolution of microfinance institutions promote appropriate regulation, supervision and adoption of best practices. In these circumstances, an appropriate policy has become necessary to develop a long-term, sustainable microfinance sub-sector.

In this context, the National Micro Finance Policy is a typical pro informal sector policy which covers the provision of financial services to small and micro enterprises in rural areas as well as in the urban sector that are engaged in all types of legal economic activities.

The Sustainable Industrial Development Policy, (SIDP), provides for identification of priority activities on a phased time span with short, medium and long-term perspectives. The policy aims, among other things, to enhance sustainable development of the industrial sector. Human development and creation of employment opportunities are identified as some of the national goals towards which the industrial sector will be geared.

The policy clearly states the special efforts on “promotion of small scale industries and the informal sector activities organised in all industrial branches which offer broad based entrepreneurial development potential for employment and income generating opportunities”. For promotion of MSEs, the policy emphasises the following:

(i) Supporting existing promotional institutions and new ones with the view to strengthen the national capacity to tackle problems facing promotion of MSEs as pertaining to technology, finance, consultancy, training and management.

(ii) Simplifying bureaucratic procedures in taxation, regulatory aspects, licensing and registration by shifting some of the procedures from the national headquarters to the regions, i.e. Decentralisation of responsibilities.

(iii) Undertaking financial reforms that shall include mechanism to provide MSEs with credit under softer terms.

(iv) Developing informal sector by gradually transforming it into formal MSEs.

The role of co-ordinating the policy is entrusted to the Ministry of Industry, Trade and Marketing in close collaboration with the Ministry of Finance and Economic Affairs. The latter two are expected to co-ordinate and manage the inter-sectoral linkages, which is important in assuring balanced development. Other key actors whose roles are specified in the policy include organisations representing MSEs, CBOs and NGOs, and labour associations.

**The National Employment Policy (1997 and 2008)**

The vision of the current National Employment Policy 2008 is to have a society engaged in sustainable decent gainful employment, capable of generating a decent income for the improvement of the quality of life and social well being for Tanzanians, and to reduce poverty as envisaged in the Tanzania Development Vision 2025, as well as addressing the emerging challenges of globalisation. The Mission is to enhance and develop human capital as well as its utilisation, to assure productive and sustainable employment in the rural and urban economies, by improving knowledge and skills, adequate income earning opportunities and labour market services.
The overall objective of the National Employment Policy 2008 is to stimulate national productivity, to attain full, gainful and freely chosen productive employment, in order to reduce unemployment, underemployment rates and enhance labour productivity.

The specific policy objectives of National Employment Policy 2008 that are relevant for promotion and facilitation of SMEs include the need to [1] promote a common understanding of the unemployment problem among key stakeholders and generate collaborative and current efforts towards solving it, [2] enhance skills and competencies for those in the formal and informal sector especially rural areas; [3] promote the goal of decent and productive employment as a national priority and enable all participants in the labour force to gain productive and full employment, [4] promote equal access to employment opportunities and resources endowments for vulnerable groups of women, youth and People with Disabilities (PWDs), [5], put in place conducive and enabling environment to promote growth of the private sector and transformation of the informal sector into formal, [6] ensure income security and social inclusion, [7] safeguard the basic rights and interests of workers in accordance with International Labour Standards, and [8] foster faster economic growth and adequate allocation of investment resources to employment potential sectors such as agriculture, non-farm activities in rural areas, manufacturing and agro-processing industries, and infrastructure and social services sectors.

Co-operative Development Policy, 1997

The Co-operative Development Policy of 1997 is another pro-informal sector which targets people who are disadvantaged in terms of lack of adequate “knowledge of, and experience in modern production and management methods”. Disadvantaged groups mentioned are smallholder farmers, the landless, women, youth, craftsmen, disabled and the elderly.

Objective of the policy include creation of “a conducive environment in which people are free to associate in exploiting their resources for social and economic development”, and “provision of assistance to co-operative development, particularly in areas of human resource development and institutional capacity building without effect on their independence.

The policy affirms government support of the co-operative vision and its recognition of the diversity of the co-operative sector. Among the recognised co-operatives are service, handicraft, worker’s productive co-operatives, labour contracting co-operatives, savings and credit co-operations and co-operative banks.
The policy identifies the government role as that of facilitator and catalyst “with emphasis on information provisions sensitisation, education, training, inspection and supervision.” Encouraging women participation in co-operatives by reviewing inhibiting barriers is also government commitment in the policy. The policy also provides overall and specific implementation strategies including instituting security of employment in co-operatives to attract and retain good personnel and empowerment of members through member education on obligations and rights. Other strategies include operationalizing self help principles through, for example, introduction of co-operative financial institutions. The policy goes into detail of strategies for implementation in the various sectors.

**Rural Development Policy 2001**

The Rural Development Policy 2001 was developed using a bottom-up participatory process to ensure ownership of the policy remains in the hands of the stakeholders. This was intended to ensure accountability and sustainability of the policy outcomes once its implementation begins. The policy outlines existing problems and provides a rationale for the need of a rural development policy. Roles for different stakeholders are described including those for actors at the central government and local government levels, the private sector, co-operatives and rural associations.

The importance of MSEs in rural development is recognised as reflected by the areas identified as priority because of their importance in accelerating development. These are [1] Private sector promotion; [2] Development of export processing zones, [3] Small-scale rural industry particularly cottage industries and those developed by women, [4] Development of the informal sector; [5] Investment promotion and financing of industries, and [6] Human resources development and indigenous entrepreneurship development.

**The Minerals Policy of Tanzania 1997 and 2010**

Since 1997, the Government has taken efforts to formalize artisanal miners into small-scale miners and provide extension services. Inspite of these efforts, the contribution of small-scale mining to the economy is insignificant. This is due to the use of inappropriate technology and lack of capital. The Government is still committed to support small scale mining through provision of supportive extension services and establishment of mechanisms for accessing capital.

The Minerals Policies of Tanzania, (1997 and 2010) identify the artisanal and small scale mining operations as a major target group to be promoted through improved
access to finance and availability of tools, equipment and consumables, supportive extension services, simplified licensing and enhanced marketing opportunities.

One of the mining policy objectives of 2010 is to support and promote development of small scale mining so as to increase its contribution to the economy. The Government will [1] develop and implement programmes to transform and upgrade small scale mining into organized and modernized mining; [2] cooperate with stakeholders to facilitate small-scale miners to access market for minerals, geological information, technical and financial services; and [3] will continue to collaborate with stakeholders to ensure that small scale miners preserve the environment.

### 3.1.6. Other Policies, Strategies and Efforts

There are also a number of government policies and strategies already in place aimed at facilitating growth of the economy, which have a bearing on the development of the SME sector. These include: Gender and Women Development Policy, Cooperative Development Policy, the National Energy Policy and the National Environmental Policy and Rural Development Strategy.

Central to all these policies, is a creation of an enabling environment, building of a robust private sector and articulation of strategies that will create a sustainable growth. A number of institutions, both public and private were established to implement and coordinate various programmes arising from these policies.

### 3.1.7. National Strategy for Growth and Reduction of Poverty I and II

The National Strategy for Growth and Reduction of Poverty (NSGRP I (2005) and II (2010) ) is a second national PRSP-2 organizing framework for putting the focus on poverty reduction high on the country’s development agenda. The NSGRP-I kept in focus the aspirations of Tanzania’s Development Vision (Vision 2025) for high and shared growth, high quality livelihood, peace, stability and unity, good governance, high quality education and international competitiveness. It is committed to the Millennium Development Goals (MDGs), as internationally agreed targets for reducing poverty, hunger, diseases, illiteracy, environmental degradation and discrimination against women by 2015. It will strive to widen the space for country ownership and effective participation of civil society, private sector development and fruitful local and external partnerships in development and commitment to regional and other international initiatives for social and economic development.
NSGRP II 2010 has a well articulated general strategic framework. The strategic framework constitutes of three major building blocks including the principles and ongoing reforms. The major clusters of desired outcomes for poverty reduction are (i) growth and reduction of income poverty; (ii) improved quality of life and social well-being; and (iii) good governance and accountability. It is recognised that while growth is essential for poverty reduction, it is not sufficient; equity and conditions that foster it are quite as vital. The broad outcomes of interventions Cluster I for growth for reduction of income poverty include [1] inclusive and accelerated growth achieved and sustained, [2] employment opportunities for all, including women and youth created and [3] good economic governance ensured and enhanced.

Strategies in this cluster emphasizes on accelerating growth of the economy to levels that increases in per capita income. Thus, the thrust of Cluster I is sustaining high growth rate of the economy in an inclusive and substantially poverty-reducing manner.

In this medium term, interventions are directed to ensure that GDP growth is mainly propelled by growth sectors, namely agriculture, manufacturing, tourism, mining, and infrastructure. Such interventions should also implements in a manner that the resulting growth generates decent employment (self employed or employees) able to lift the majority of the poor out of poverty. Thus, strategic interventions have to be directed to promote growth where the poor are major beneficiaries (inclusive growth), taking into account the structure of the labour force (population), where the youth have the highest rate of unemployment.

Specific interventions that are relevant for the MSMEs and for the transformation the manufacturing sector include [1] provision of industrial parks served with adequate supportive infrastructure for efficient production and international competitiveness, [2] improving the business environment further in order to reduce the cost of doing business for both large scale manufacturers and MSMEs, [3] availing capital, credit guarantees to the private sector, and other supporting services, especially for MSMEs, [4] promoting agro processing in order to deepen value addition, including MSMEs; [5] availing technological information and support to entrepreneurs to enhance productivity MSMEs and enable them to compete in local, regional and international markets and [5] scaling up role of informal sector through formalization.

3.1.8. Property and Business Formalization Program

The government of Tanzania has established the Property and Business Formalization Program described in Kiswahili as *Mpango wa Kurasimisha Rasilimali na Biashara za Wanyonge* Tanzania, (MKURABITA). The objective of the MKURABITA is build an
architecture of property and businesses that will bring together, standardize and modernise the prevailing local customary arrangements dispersed throughout the country, so as to create on Tanzanian property and business legal system that incorporate all sectors of the society. The program aims at ensuring that assets of the poor, which are held and exchanged outside the existing legal system, are adequately documented, formalized and standardised into universally accepted property records that can be used to create liquidity. The overall strategy is to identify assets and guarantee property rights. The procedure to register new companies will be focused on, which means many rules and regulations will be looked into as well to enable MSME companies should grow.

3.1.9. Informal Sector Policy Implementation Evaluation

While many good pro-informal sector policies have been prepared alongside the core national development policies, there has been lack of accompanying serious implementation strategies, plans and programs. This is a serious problem applying to all major policy areas guiding the economy. Lack of effective implementation of national development policies has been identified, during the political elections in 2005 and 2010.

It is clear that objectives of specific many national social economic development policies aim to promote investment in the private sector and growth of existing SMEs, achieving this depends on how effectively policies are implemented, and this is yet to be fully realised. One indicator of this shortfall is that although some of the policies have been in place for a number of years, there are still complaints by owners/managers of informal sector firms on problems that are supposed to have been addressed in line with objectives of the policies. The primary problems facing the informal/MSE sectors include limited access to financial credit, lack of effective market demand, legal bottlenecks, and bureaucratic hurdles in tax administration and business licensing and registration. Yet these are basic constraints most of the policies seek to address. Lack of effective and committed human resources, institutional management and co-ordination in the MSME sector, are other problems pointed out in many studies, which adversely affect policy implementation. Completion and subsequent implementation of the relevant SME policies will go a long way in improving institutional co-ordination in the formal sector, which, many studies argued, is “disorganised, with too many uncoordinated actors”.

3.2. Legal and Regulatory Framework

Just like large corporations, micro, small and medium scale businesses are affected by a large number of laws and regulations that may impact their operations. Tanzania has
many laws and regulations that are related with business start up, sector specific, operations, investments, production, trade, and consumption.

3.2.1. **Business Laws and Regulations**

There are specific old and new laws and regulations related with business start-up/early development. It is important to make sure that the business is legal and formally recognized. This requires that firms register their businesses and obtain required licenses, permits and registrations. It is known that, formalizing businesses will enable them to have easy access to a lot of technical, professional, market and financial services provided by the government and other service providers, and in particular financial institutions catering to SMEs.

**The Business Activities Registration Act, 2006**

An Act to provide for the establishment of a business activities registration system, Business Registration Centres and to provide for matters related thereto. The Chief Executive Officer of BREL is hereby in Section 5.-(1) designated to be the Chief Registrar of business. The functions of the Chief Registrar shall be: (a) to receive quarterly updated registers of businesses from the Registrars of each local authority; (b) to establish and maintain one composite register of all businesses registered under this Act; (c) to publish quarterly the composite registers of all Business Registration Centers within three months after the end of the quarter; and (d) to ensure that each Registrar maintains minimum acceptable standards of the registry in his jurisdiction.

Section 6.-(1) establishes a Registry which shall consist of the registries under the Companies Act, the Business Names (Registration) Act and any other registry or data base which may be integrated under this Act. Business registration” means the process of registering business undertaking, business entity, enterprise, with a Registrar in a designated Local Authority in accordance with the provisions of this Act;

Section 7 establishes in each local authority a Business Registration Centre. Each Business Registration Centre shall be a section of the local authority. The functions of the Business Registration Centre include: (a) to register all businesses undertakings, business entities and enterprises in the area of its jurisdiction; (b) to collect business information in the area of its jurisdiction for the purpose of public consumption; and (c) to ensure all business information collected is available for the purpose of public record;

It shall be necessary to obtain a certificate of registration from the Business Registration Centre in respect of every business. Each Registrar shall notify the Chief Registrar on
each regulated business that has been licensed to undertake any specified business by the respective Regulatory body. The owner, manager or person in-charge holding a valid certificate of compliance with the regulated business has no obligation to obtain a certificate of registration.

Any business which is not regulated under any written law shall upon application be issued with certificate of registration. A person shall not carry on business at two or more premises unless particulars of both premises are registered. Every business registration shall be valid for the entire life of the business.

Nothing in this Act shall entitle any person to carry on business or business to be conducted in contravention of any law or regulation governing activities of that business, including but not limited to (a) town planning regulations; (b) health regulations; (c) safety regulations; (d) environmental regulations; (e) in relation to foreigners, the immigration requirements; or (f) any regulation governing the conduct of any specific type of business or profession.

The Companies Act, 2002

The Act stipulates that (I) any two or more persons, associated for any lawful purpose may, by subscribing their names to a memorandum of association and otherwise complying with the requirements of this Act in respect of registration, form an incorporated company, with or without limited liability. Such a company may be either - (a) a company having the liability of its members limited by the memorandum to the amount, if any, unpaid on the shares respectively held by them (in this Act termed "a company limited by shares"); or (b) a company having the liability of its members limited by the memorandum to such amount as the members may respectively thereby undertake to contribute to the assets of the company in the event of its being wound up (in this Act termed "a company limited by guarantee"); or (c), a company not having any limit on the liability of its members (in this Act termed "an unlimited company").

The Act defines a 'public company' as a company limited by shares or limited by guarantee and having a share capital, being a company the memorandum of which states that it is to be a public company. Also, the "private company" means a company which by its (a) restricts the right to transfer its shares; and (b) limits the number of its members to fifty, not including persons who are in the employment of the company and persons who, having been formerly in the employment of the company, were while in that employment, and have continued after the determination of that employment to be, members of the company, and (c) prohibits any invitation to the public to subscribe for any shares or debentures of the company.
CHAPTER III of the Act is about ANNUAL RETURN. The act stipulates that in 128.-(I) Every company shall deliver to the Registrar, successive annual returns each of which is made up to a date not later than the "return date", that is: (a) the anniversary of the company's incorporation, or (b) if the company's last return delivered in accordance with this Chapter was made up to a different date, the anniversary of that date.

The Act demands that registered companies to prepare certain data and information for the purpose of monitoring and evaluation. The annual return of a company having a share capital shall contain the information specified under subsections (2), (3), (4) and (5) with respect to its share capital and members. The annual return shall state the total number of issued shares of the company at the date to which the return is made up and the aggregate nominal value of those shares. The annual return shall state with respect to each class of shares in the company -(a) the nature of the class, and (b) the total number and aggregate nominal value of issued shares of that class at the date to which the return is made up.

Chapter V is about accounts and audit. Every company shall keep in English or Swahili proper books of account which are sufficient to show and explain the company's transactions and are such as to - (a) disclose with reasonable accuracy at any time, the financial position of the company, at that time; (b) enable the directors to ensure that any balance sheet, profit and loss account and cash flow statement prepared under this Chapter complies with the requirements of this Act. (2) The books of account shall in particular contain -entries from day to day of all sums of money received and expended by the company and the matters in respect of which the receipt and expenditure takes place; (a) entries from day to day of all sums of money received and expended by the company and the matters in respect of which the receipt and expenditure takes place; (b) all sales and purchases of goods by the company; (c) the assets and liabilities of the company. The books of account shall be kept at the registered office of the company or at such other place in Tanzania as the directors think fit, and shall at all times be open to inspection by the directors. The books of account which a company is required to keep under this section shall be preserved by it for six years from the date on which they are made up.

Assessment of Business Laws and Regulations

Licensing and registration requirements apply to all types and sizes of businesses and no special considerations are given to MSEs, which, as other studies have shown, have limited start-up capital. Furthermore, evidence show that procedures for registration and obtaining a business licence are often costly and cumbersome.
The original Investor Roadmap research (The Service Group, 1997) provides a list of steps a businessperson has to go through before commencing operation. They include the following:

- Business registration,
- Name registration.
- Licenses.
- Land approval.
- Land fees (taxes) business property tax + business property registration.
- Registration for sales tax.
- Inspection of facilities.
- Issue of sales tax number.
- Registration for stamp duty.
- Inspection of facilities in receipt of a stamp duty license.
- Issuing a composition number.
- Application for sewage services.
- Inspection and estimation of costs.
- Obtain Workman’s Compensation Insurance from the NIC.
- Submission of forms to the NPF/NSSF.
- Obtaining the Registration Number.

### 3.2.2. Sector Specific and Business Operational Laws

**The Small Industries Development Organisation Act, 1973**

This Act established the Small Industries Development Organisation and gave it mandate to develop and promote small industries. Its tasks as set out in the Act include (i) provision of services necessary for development of small industries; (ii) provision of technical assistance to people engaged in small industries; (iii) provision and promotion of training facilities to those employed; or to be employed in small industries and; (iv) advising the government on all matters related to the development of small industries and; provision of management and consultancy services to small enterprises in Tanzania.

Its support is limited to the industry sector only so small enterprise operators in services and trade are not covered. Moreover, SIDO has been severely constrained by lack of financial resources and has therefore not been able to provide support to small industries effectively.
Cooperative Societies Act, 2003 (No. 20 of 2003).

An Act to make better provisions for the formation, constitution, registration and operation of cooperative societies, and for other matters incidental to or otherwise connected to those purposes.

This Act provides for the definition of objects of cooperative societies, for the appointment of a Registrar and the registration of cooperative societies, for the formation and organization of cooperative societies, rights and liabilities of members, duties and privileges of cooperative societies, the management of cooperative societies, amalgamation, dissolution and divisions of cooperative societies and the definition of offences.

3.2.3. Finance and credit laws and regulations


An Act to provide for comprehensive regulation of banks and financial institutions; to provide for regulation and supervision of activities of savings and credit co-operative societies and schemes with a view to maintaining the stability, safety and soundness of the financial system aimed at reduction of risk of loss to depositors; to provide for repeal of the Banking and Financial Institutions Act, (Cap.342) and to provide for other related matters.

In exercising the power under subsection (3), the Bank shall regulate and supervise the activities of all savings and credit cooperative societies and schemes whose deposits have surpassed an amount equivalent to the minimum core capital for a micro-finance company.

The savings and credit cooperative societies and schemes shall be regulated by the Bank in accordance with the regulations made in respect of micro-finance companies.

For purposes of compliance with subsection (4), the Bank may source a public or private body and devise mechanism for the expeditious identification of such societies and schemes.

The Act defines micro-enterprise” as a small personal and family business that operates in the informal sector with no formal accounting or financial records and whose real assets, if any, can hardly be pledged or reasonably accepted as collateral. And also defines “micro-finance Company” as a financial institution incorporated as a company
limited by shares formed to undertake banking business primarily with households, small holder farmers and micro-enterprises in rural or urban areas of Tanzania Mainland and Tanzania Zanzibar.

3.2.4. Taxation policies, laws and regulations

Value Added Tax (VAT) Act, 1997

The Act makes provisions for the imposition of Value Added Tax (VAT) on supplies of goods and services and for related matters. The VAT on taxable supply of goods or services is payable by a taxable person at the end of a prescribed accounting period or as may be prescribed by the Commissioner.

The Act has defined taxable supplies as; any supply of goods or a service made by a taxable person in the course of or in furtherance of his business after the start of the VAT and includes;
(a) the making of gifts or loans of goods,
(b) the leasing of goods on hire;
(c) the appropriation of goods for personal use or consumption by the taxable person or by any other person;
(d) barter trade and exchange of goods;

VAT is charged at the rate of 18 percent of the taxable value. The Act specifies who should register for the VAT, i.e. any person whose taxable turnover exceeds, or the person has reason to believe will exceed, the prescribed turnover. At present the set minimum from which a person becomes eligible to register for the VAT is Tshs. 20,000,000.00.

The Income Tax Act, 2004

The Act makes provision for “the charge, assessment and collection of Income Tax, for the income to be charged and for other related matters”.

The Act defines a "business" to include - (a) a trade, concern in the nature of trade, manufacture, profession, vocation or isolated arrangement with a business character; and (b) a past, present or prospective business, but excludes employment and any
activity that, having regard to its nature and the principal occupation of its owners or underlying owners, is not carried on with a view to deriving profit.

Also employment" means -(a) a position of an individual in the employment of another person; (b) a position of an individual as manager of an entity other than as partner of a partnership; (c) a position of an individual entitling the individual to a periodic remuneration in respect of services performed; or (d) a public office held by an individual, and includes a past, present and prospective employment.

Investment" means the owning of one or more assets of a similar nature or that are used in an integrated fashion, on similar terms and subject to similar conditions, including as to location and includes a past, present and prospective investment, but does not include a business, employment and the owning of assets, other than investment assets, for personal use by the owner

PART II stipulates Imposition of Income Tax. Section (1) of Part II stipulates Income tax to be charged and to be payable for each year of income in accordance with the procedure in Part VII by every person- (a) who has total income for the year of income; (b) who has a domestic permanent establishment that has repatriated income for the year of income; or (c) who receives a final withholding payment during the year of income. The amount of income tax payable by a person for a year of income shall be equal to the sum of the income tax payable with respect to subsection (1)(a), (b) and (c).

Section 5 of Part I stipulates that -(1) the total income of a person shall be the sum of the person's chargeable income for the year of income from each employment, business and investment less any reduction allowed for the year of income under section 61 relating to retirement contributions to approved retirement funds. (2) The total income of each person shall be determined separately.

Subdivision B is about Chargeable Income Section 6.- (1) The chargeable income of a person for a year of income from any employment, business or investment shall be- (a) in the case of a resident person, the person's income from employment, business or investment for the year of income irrespective of the source of the income; and (b) in the case of a non-resident person, the person's income from the employment, business or investment for the year of income, but only to the extent that the income has a source in the United Republic

The Stamp Duty Act, 2006
This Act provides for charging stamp duty set as a percentage of total monthly sales of the business. Stamp duty is paid by businesspersons who are not registered for VAT. In paying stamp duty, businesspersons with a special contract with TRA the rate has been set at 1.2 percent of total revenue, while for those without a contract the rate is 4 percent of the selling price. In the latter case stamps are placed on sale receipts.

**The Local Government Finances Act, No. 9 of 1982 and amendments of 1999**

Local government authorities in Tanzania fund their expenditures from three main sources, notably intergovernmental transfers, own source local revenues, and local government borrowing. Intergovernmental transfers fund roughly 90 percent of all local government spending, while local governments' own source revenues (including local rates and other locally collected revenue sources) account for approximately 10 percent of local financial resources. Local borrowing only accounts for approximately 0.1 percent of local spending.


Generally speaking, the revenue base of local authorities is weak. In a move to strengthen this, the Local Government Finance Act was amended in 1999 to appoint local authorities to be licensing authorities in respect of the business of commission agents, manufacturers' representatives, brokers, travel agents, buying and selling motor vehicles, import trade, regional trade, companies' cooperative societies and so forth. The fees collected are to be treated as revenue accruing from the local authorities in question. Legislation was also amended to require the central government to pay block grants to local authorities to meet the cost of development and maintenance of services particularly education, health, water, roads and agriculture. Block grants may vary from one authority to the other depending on the grades and standards as may be prescribed by the Ministry of Local Government.

**The Urban Authorities (Rating) Act, 1983 (As amended up to 30th June 2000)**

The Act is meant to be a beacon in the administration of the collection of levy on property. The Act applies to urban authorities and township authorities established under the Local Government (Urban authorities and District Authorities Acts respectively). The Act has implications on MSEs in terms of cost of rental for business
premises, which are likely to reflect the property tax component. The tax burden is, in most cases, borne by the end user, in this case, it is passed on to the one renting the premises. The burden is borne as well in the case where one owns the premises.

**Assessment of the Taxation Laws and Regulations**

The exposition above shows that MSEs are required to pay a substantial number of taxes at the central and local government levels. Taxes at local government level may differ according to set by-laws in different local authorities. A more comprehensive list of the types of taxes an owner of a micro or small enterprise has to pay includes:

- VAT
- Stamp duty
- Income tax
- Payroll levy
- Customs duty
- Development levy (local)
- Property tax (local)
- Other types of Levy/user charges on various services as may be set by respective local authorities, for example charges for garbage disposal.

These taxes are many for a micro or small business operator and can be confusing to taxpayers who, do not understand their objectives, or do not see what the paid taxes do for them in return. Sometimes entrepreneurs, not only in MSE but larger enterprises as well are not aware of their rights and requirements with regard to paying taxes.

The complex tax regime has been identified by entrepreneurs as the reason behind fear of many MSEs becoming formal. Central government taxes are administered by the Tanzania Revenue Authority (TRA), and local government taxes by respective local authorities. Application of the Local Government Authorities Act No. 9 of 1982 / 1999 means existence of varying taxes instituted under powers granted to make by-laws. These can be levied at different levels of local governments including ward and village level.

3.2.5. **Labour Laws**

**Employment and Labour Relations Act of 2004**

Tanzania’s labor laws are compiled in the extensive Employment and Labour Relations Act of 2004. The act covers almost all aspects of labor law and establishes a regulatory
authority to oversee disputes between employers and employees. The act also gives several broad rights to workers. These include the right to form unions, the right to strike and the right to a written statement of their contract and work expectations from their employer. The act has several broad regulations, including a prohibition against child labor (up to age 14) and forced labor. Additionally, discrimination is not allowed in Tanzanian employment, including on the grounds of nationality, sex, pregnancy or HIV/AIDS status.

PART III of the Act is about employment standards. In Part III of the Act requires that there shall be a written statement of particulars. 15.- (1) Subject to the provisions of subsection (2) of section 19, an employer shall supply an employee, when the employee commences employment, with the following particulars in writing, namely - (a) name, age, permanent address and sex of the employee; (b) place of recruitment; (c) job description; (d) date of commencement-, (e) form and duration of the contract; (f) place of work; (g) hours of work; (h) remuneration, the method of its calculation, and details of any; benefits or payments in kind, and (i) any other prescribed matter.

The act creates a Labour Court to hear disputes between employees and employers. The court may issue injunctions (though only with 48-hour notice) as it sees fit. Additionally, the court may refer cases to the Commission for Mediation and Arbitration at its discretion.

The National Social Security Fund Act, 1997

PART II of the Act established the National Social Security Fund to be known as the National Social Security Fund into which shall be paid all contributions and other moneys required by this Act. PART III defines the Insured Persons and Contributing Employers. The Act defines an Insured person as every person who is a member of the existing Fund shall be an insured person under this Act. Every person who is self employed or who is employed in the private sector, other than in a body which is a parastatal organisation under the Parastatal Pension Fund Act, 1978, shall be registered as an insured person.

The Act defines a 'private company" as a company in the private sector which restricts the right to transfer its shares, limits the number of its members to fifty and prohibits any invitation to the public to subscribe for any shares or debentures of the company. "private sector" means anybody, corporate or un incorporate, including a private or public company and a nongovernmental organization, fifty percent or more of whose shares are not owned by the government or in which the government has no control or influence. The considers "employer' to mean, the person with whom the employees
entered into a contract of service or apprenticeship, and who is responsible for the payment of wages of the employees;

PART IV is about the registration of employees and contributions to the fund. Subject to the provisions of this Act, every contributing employer shall, unless such employer has been registered under the existing Fund, within one month, register under this section in the prescribed manner. A contributing employer who registers or is registered under the NSSF must register as an insured person every person who is or who subsequently becomes an employee in his service, by notifying the Director General of the particulars of such employees as may be prescribed.

A contributing employer shall for every contribution period after the appointed day during which he employs an insured person pay to the Fund a contribution that consists of the employer’s contribution and the employees contribution at the percentage stipulated in the Act. Every contribution due under the Act shall be paid to the Fund within one month after the end of the month in which the last day of the contribution period to which it relates falls.

Local Government (Urban Authorities) Act, 1982

The Local Government authorities in Tanzania are under the jurisdiction of the Minister responsible for local government affairs. According to the Local Government (District Authorities) Act of 1982 and Local Government (Urban Authorities) Act of 1982 and their amendments, the village, district and urban authorities are responsible for: planning, financing and implementing development programmes within their areas of jurisdiction.

Local Government (District) Authorities Act of 1982 creates district based local government authorities in Tanzania. The Act provides for; inter alia, the establishment, composition, functions and legislative powers of district, township councils and village authorities.

At the village level, the government structure is comprised of a village assembly consisting of all persons aged 18 and above. The corporate entity of a registered village is the village council comprising of a chairman or chairperson elected by the village assembly. There are also village committees covering such matters as planning, finance, economic affairs, social services, security, forest protection, water resources etc [Section 35].
The village council's functions and roles include planning and coordinating activities, rendering assistance and advice to the villagers engaged in agriculture, forestry, horticultural, industrial or any other activity, and to encourage village residents to undertake and participate in communal enterprises. Propose by-laws must be adopted by the village assembly before being submitted to the District Council for approval [Section 163]. In addition, Section 29 of the Act provides for division of districts into wards. As an administrative subdivision between the village and the district, the ward reviews the proposed village council's projects in its jurisdiction and approves them for passage up the line to the District Development Committee.

3.2.6. **National Economic Empowerment Act No. 16 of 2004**

The Government has expressed its aspirations through the National Economic Empowerment Policy of 2004 that, natural resources, trade, agriculture, industry and other economic opportunities must generate wealth, boost the Small and Medium Enterprise (SME) sector, in order to bring about a sustainable affirmative action and facilitate genuine and positive economic empowerment to the population of Tanzania.

Economic Empowerment is a central means for bringing about economic growth and social justice among people which is necessary for the promotion of peace, tranquillity and social stability. The National Economic Empowerment Act of 2004 was enacted by the Parliament to provide legal strength in the implementation of the NEEP with a view of Promoting rapid economic growth that will facilitate broader economic ownership by Tanzanians; and Establishing structures and mechanisms to redress the existing economic inequalities among various sections of the population.

The objectives of the Act are twofold:

[1] To establish the National Economic Empowerment Council for the promotion and facilitation of ownership of income generating activities and assets by Tanzanians; and to provide legal and institutional framework for the Council; and

[2] To establish the National Economic Empowerment Fund for facilitating equity ownership of property among Tanzanian, creation of employment opportunities, and a link to institutions engaged in economic empowerment activities.

3.2.7. **Assessment of the Laws and Regulations**

The business of business registration is a complex formalization process that involves both national and local governments. Making it simpler and easier for applicants is a challenge that confronts all parties. There are recent formalization and business support
efforts by the national government to spur productivity, generate employment, incomes and improve competitiveness, and a focus of attention is how to simplify the business registration requirements of national agencies.

There are specific laws and regulations which deter formalization of micro, small and medium scale business operators. For example Tanzania has a number of labour laws and regulations which play a key role in promoting a good working environment and interaction between employers and employees as they ensure workers' welfare, security and development. These laws are thus important to workers in MSEs as well. However, in practice these are complex, restrictive and costly to implement. These limit formalization, graduation and growth of micro, small and medium scale firms.

Tanzania has put in place adequate number of laws governing all forms of business operations, which may appear overwhelming and complex for micro and scale operators. These are government efforts geared to assist navigating through bureaucratic documents and ensure legal compliances with the authorities. The government has made concerted efforts through BEST facilitate smooth business relations through reforming employees: Environment, Health, Competition and Anti-Trust Law and Taxation Laws. There are also other laws/regulations that vary according to business activities. For example, groceries, hotel, catering and hospitality businesses will need to deal with health regulations.

3.3. Institutional Framework

Effective implementation of any national policies, strategies, programmes and activities depends institutional framework and in particularly, on clarity on assigning responsibilities and roles to different stakeholders. This facilitates smooth operationalization of development efforts with clear demarcation of levels of accountability. Since informal sector/SMEs cut across institutional mandate of various government ministries and executive agencies, various private sector agencies, different development partners and range of NGOs, organization, management and institutional coordination are of critical importance. An institutional environment and mechanisms conducive to participation and consultation are desirable in various interventions aimed at implementing the policy as well as in facilitating its effective monitoring and evaluation of impact. In this regard the roles of various stakeholders must be clear as follows:

3.3.1. Government
The government plays a central role in the development of the formal and informal private sectors. It determines the general policy, is responsible for the creation of an enabling environment and directly intervenes by providing subsidies and services. It is now widely accepted that the role of the state in the development of the private sector should be directed towards the creation of an enabling environment rather than direct interventions. SME-development consists essentially of market-oriented activities which imply that the private sector be allowed to play its role. If this is not possible then intermediary bodies should be used, e.g. NGO’s. Only if these are not able to meet the needs of the firms the government enters the picture. If the government provides subsidies for SSE development it can do so directly, by giving subsidies to the ultimate beneficiaries, or it can provide means to private institutions that serve the SSEs.

The Government’s main role is to create conducive macroeconomic environment that will allow informal sector/SMEs to emerge, survive and grow. In addition, the government has the responsibility of putting in place the requisite infrastructural facilities, which will provide a basic support for the growth of the sector. There is need to develop entrepreneurship through education and training and fostering pro-active entrepreneurship attitude within the civil service. In the financial services sector, the Government will take measures that will reduce the risks and transaction costs of lending to increase competition in the financial sector and strengthen the capabilities to serve small enterprises.

In the non-financial services sector, major role of the Government will be to encourage and support market development to facilitate greater demand and supply of BDS. The government will support the establishment and strengthening of extension services for the SMEs. The Government will promote consultations and partnership with the private sector. This will be achieved by ensuring appropriate representation of SME relevant issues on the agenda of the Tanzania National Business Council.

**The Ministry of Industry, Trade and Market**

The Ministry of Industry and Trade (MITM) is the overall responsibility for coordinating the implementation of the SME Development Policy. MITM functions as the secretariat of the SME Forum and publish the Annual SME Report that will include information on the status of the SME sector. The Ministry is in the processes of establishing a data bank to function as research and information clearing house, interconnected with major stakeholders. The Ministry will also coordinate the activities of all SME stakeholders and will be responsible for organizing monitoring and evaluation of implementation of the SME Development Policy.
Small Industries Development Organization (SIDO)

The first major public sector institution framework to support business activities of MSME’s in Tanzania was undertaken in 1966 when the National Small Industries Corporation (NSIC) was formed under the National Development Corporation (NDC). The NSIC set up small industrial clusters, which were basically training cum production workshops. Thereafter, the Small Industries Development Organization (SIDO) was established in 1973 by Act of Parliament to plan, coordinate, promote and offer every form of service to small industries.

SIDO remains the main government arm for promoting MSMEs in the country. Some of the measures employed in the process included:- the construction of industrial estates with more adequate number of 140 sheds at regional headquarters; the establishment of training-cum-production centres that offered simple rural based technologies; introduction of hire purchase programs through which more than 3000 entrepreneurs were assisted with machines and working tools; and setting up of regional extension services offices that rendered advice on setting up of new industries, choice of technology, preparation of feasibility studies, preparation of economic surveys, installation, operation of machinery, maintenance and marketing of products.

3.3.2. Technical, Education and Other Supporting Institutions

Apart from SIDO, various public institutions were established to support enterprise development in Tanzania. These institutions cater for the whole enterprise sector including MSMEs. They include the Tanzania Industrial Research Development Organisation (TIRDO) which supports local raw materials utilization; Centre for Agricultural Mechanization Rural Technology (CAMARTEC) which is involved in promotion of appropriate technology for rural development; Tanzania Engineering and Manufacturing Design Organisation (TEMDO) responsible for machine design; Tanzania Bureau of Standards (TBS) mandated to promote standards; Board of External Trade (BET) which is instrumental in promotion of exports mainly through trade fairs; and the Institute of Production Innovation (IPI) now known as Technology Transfer Centre which is active in proto-type development and promoting their commercialization.

3.3.3. Private Sector

The private sector has assumed the leading role in carrying out direct investment in industries. Given this role they are expected to be the major investor in the SME sector. They will have to mobilize resources, implement projects, manage operations and in so
doing ensure that the policy is put into effective implementation. Furthermore, it will, through their constituencies provide BDS which will foster the creation of a competitive SME sector. Through their associations they will strengthen the representation of SMEs to promote advocacy in the respective dialogue with the government. The most important actors are of course the entrepreneurs with their respective capacities. We use the term ‘entrepreneur’ in a wide sense and do not restrict its meaning to ‘somebody who takes risks and is innovative’. People may be forced into setting up a business due to the lack of reasonable alternatives to earn a living. Moreover many entrepreneurs in the SSE sector are not innovators.

*Private membership organisations* include associations, federations, trade and business organisations, co-operative organisations and chambers of commerce. These organisations provide business support services (information, training, advice, lobbying) to their members. The members generally pay an admission or membership fee.

*Private services providers* sell services to the SSE sector in order to make profits. They include commercial banks, enterprises that provide business support services and utility providers like electricity companies.

### 3.3.4. Non Governmental Organizations, (NGOs)

NGO’s interventions in supporting SMES in Tanzania range from institutional capacity building, direct provision of financial and non-financial services to infrastructure development. In recent years, the country has witnessed the mushrooming of Non-Government Organizations, NGO’s, which are doing a commendable job in promoting MSMEs. Most of the NGOs are mainly involved in credit delivery, business training, providing general consultancy, supporting market linkages and addressing gender and environmental issues. However, most of the institutions supporting MSMEs are rather weak, fragmented, concentrated in urban areas and uncoordinated. This calls for the need to strengthen the institutions supporting small and medium enterprises. Therefore, the MSME Development Policy intends to support and strengthen these institutions.

### 3.3.5. Donors

The interests of the donor community in the development of the SSE sector as strategic poverty reduction institution has increased substantially the last two decades. Donors see the SSE sector as a driving force in the economic development of the LDC. Substantial efforts have been implemented to establish ‘best practices’ in marketing, input, and information technology and business supports of the SSE sector. The
participation of donors in the SSE-development is crucial if they provide funds, which the national or local governments lack, or essential technical assistance.

3.3.6. **Institutional Framework Issues**

**An inefficient multi-institutional framework**

Tanzania has set in place a complex multi-institutional framework facilitating, supporting, promoting and regulating the small and medium scale (informal) sector. It is unfortunate that, even with reforms, the institutional arrangement has not adjusted to the importance of greater transparency, good corporate governance and the rule of law.

The state machinery is aware of the importance of the informal sector, only at political level. Very little has been translated to put people at the centre of its development, i.e., formalization and promotion. There are several leading government ministries, department and agencies responsible in facilitating informal sector. However, these are uncoordinated and there is lack of clarity of responsibilities among the national implementing centres.

These government institutional entities have failed to stimulate and foster optimum economic participation and democracy, to enhance effective mobilization of domestic financial resources and to promote efficient delivery of core outputs for sustainable SMEs sector.

**Institutional obstacles faced by informal enterprises**

Enterprises in the informal economy are facing institutional obstacles that are sometimes similar to those experienced by formal enterprises. However, informal enterprises are much more constrained and vulnerable in relation to these problems. The study noted that there are several strategic government and public facilitating, supporting and promoting services which should have been provided to the private sector. These public services are necessary for formalization, transformation and development of the private sector. The following are some of common obstacles related to poor institutional services;

**Infrastructure services and facilities**

These include poor infrastructure such as transport, storage facilities, water, and electricity; lack of working premises and poorly developed physical markets.
**Institutional organization services and facilities**

These include no access to formal training and, as a result, lack of skills in particular as regards basic economic skills and managerial expertise; lack of formal schooling sometimes even resulting in illiteracy; limited access to land and property rights; limited access to formal finance and banking institutions; reliance on self-supporting and informal institutional arrangements; too restrictive or cumbersome taxation systems and labour laws; excessive government regulations in areas such as business start-up, in particular as regards cumbersome, time demanding and costly procedures for business registration; limited access to employers’ organisations, i.e. limited possibilities to exercise influence; lack of access to official social security schemes’ lack of information on prices, viability of products, etc. and fewer market opportunities due for instance to non-compliance to international standards.

**Economic governance and services**

These include excessive registration and transaction costs of starting or operating businesses; limited access to technology; lack of opportunities for bulk purchase of inputs; low incomes or lack of regular income as household consumption competes for the use of business earnings; lack of working capital: credit has to be obtained from informal sources such as friends or relatives or non-banking financial agencies with unfavourable terms and insufficient funds do not allow for further investments.

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**Chapter Four: Presumptive Income Taxation Performance in Tanzania**

Chapter Four examines operational dynamics and inherent problems in the existing presumptive tax regime in Tanzania. The chapter reviews revenue performance of the
presumptive income tax since its establishment. It will also provide an estimate of the magnitude of the sector and the missed tax revenues from the informal sector. There will be attempt to do an empirical analysis of the tax revenue contribution of the sector with some other developing countries and comparing with Tanzania situation.

Presumptive tax system is a pervasive element in the tax system of most economies, in particular, the case of Tanzania. It has made sense in the Tanzania environment where the otherwise desirable income tax base is difficult for the tax authorities to measure, verify, and monitor, (Joel Slemrod and Shlomo Yitzhaki, 1994 and Seth Terkper 2003). On the one hand, it is argued that the resource costs of collecting various types of taxes in Tanzania are important in enhancing domestic revenue mobilization. On the other hand, there are views that the budget of the TRA is a small fraction of the total resource cost of collection comparing with other SSA countries, with the largest part being borne by few large taxpayers and not the majority presumptive income tax payers. Between 2003/04 and 2007/08, tax administration costs (excluding capital expenditure) as a percentage of revenue collected has been reasonable, averaged at around 3% a year.

During that period, tax administration costs as a percentage of tax revenue declined from 3.8% (2003/04) to 2.8% (2007/08), but grew at an average annual growth rate of 21.9%. The largest expenditure by far was on personnel emoluments, which on average consumed around 57% of the total budget, (African Development Bank Group (2010). However, it is significant that the number of tax staff available for every 1,000 persons is 0.05. This tax staff per population ratio is very low compared to the World average of 0.82 but higher than the Sub-Saharan (SSA) average of 0.03717. These tax statistics suggest that TRA is an effective resource mobilization institution.


The current presumptive income tax is rationalized and based on solid sector and fiscal policies foundations. The rationalization of presumptive scheme was in line with the Small and Medium Enterprise sector policy (SMEs Policy of year 2003) with objectives of enhancing business registration and tax system to be simple. In specific, the SME’s Policy 2003 and MKUKUTA II seek to simplify tax system and introduce tax incentives to nurse SMEs. The generic policy objectives of presumptive scheme found in the literature include, ((Christian R. Jaramillo, 2004 and African Development Bank Group, 2010),

i. To rationalize turnover tax regime
ii. To increase an administrative efficiency by minimizing real resources needed by TRA to administer income tax and stamp duty payable by small businesses separately.
iii. To enhance compliance by minimizing time and trouble expended to fill in the relevant forms and up and down movements to TRA offices every month

iv. To eliminate avenue for evading taxes through submission of false sales declarations by taking advantage of sections 9 and 10 of the Stamp Duty Act, 1972.

v. To solve the problem of evading paying Stamp Duty by taxpayers once they pay income tax.

vi. The simplified tax regime is applicable to small business taxpayers (SBTs).

4.2. The Current Legal Framework

In July 2004, the Government rationalized the presumptive scheme by introducing a new simplified taxation schedule for small business taxpayers as part of a drive to make it easier for informal sector operators (including start-up businesses) to register, formalize and start paying taxes. The First Schedule of the Income Tax Act of 2004 (and thereafter amendments done in 2006) defines and provides content and structure of the current presumptive income tax in Tanzania. Section 1 defines tax rates to be charged to individual resident and non-resident. Section 2 defines presumptive income tax based on turnover.

Where a resident individual meets the specific requirements under for a year of income the individual's income tax payable with respect to section 4(1)(a) for the year of income shall be equal to the amount of presumptive income tax provided for in subparagraph (3): It is stipulated that (a) the individual's income for a year of income consists exclusively of income from a business having a source in the United Republic; (b) the turnover of the business does not exceed the threshold in subparagraph (2); and (c) the individual does not elect to display this provision for the year of income.

The current threshold referred to in subparagraph (1) (b) is Shillings. 20,000,000. There are two types of presumptive taxes under this act. The first type is tax payable where there are incomplete records and the second is taxable income where records are kept complete.

The presumptive income taxation therefore seemed a very appropriate method of tax administration for a specific relatively low income group of people earning less than Tshs. 20,000,000; especially those semi-informal firms who do not keep records and do not qualify for VAT registration.
4.3. The Current Institutional Framework

4.3.1. Use of a Block Tax Management System

At the institutional level, the presumptive Income Tax is administered, managed and operationalizing by Department of Domestic Revenue in the Tanzania Revenue Authority. TRA is a central body for the assessment and collection of specified revenue, to administer and enforce the laws relating to such revenue and to provide for related matters in the Tanzanian economy.

In order to have the more taxpayers in the tax net, expand the tax base and optimize tax revenue collection, Tanzania Revenue Authority (TRA) opted to introduce /experiment and use the Block Management System, (BMS). The basic objectives of BMS are to promote compliance and register all eligible small and medium scale enterprises within a particular business, sectoral or geographical area, capturing their correct level of economic activities and gathering valuable tax information.

The BMS assists tax administration in improving and assurance of quality of assessments, as well as monitoring closely their business activities and be able to fight tax evasion. BMS has simplified registration of traders, brought non-filers and non-payers into the tax net through closer monitoring and collaboration with local government authorities. By reaching out to the unreached the BMS is expected to widen the tax base.

The set up of the BMS consists of areas of trading concentrations are mapped up in small territories / segments, defined on the basis of geographical or administrative set up, or a combination of a few streets to form a block. Each Block is mandated to operate all the tax functions of registering, assessing, collecting and accounting for revenue collected. Each Block is allocated staff to carry out those functions, subject to rotation after a certain length of stay in one Block. To measure performance, each Block is allocated targets (including revenue collection targets) measured against set time frames and benchmarks. To enable smooth functioning, each Block has a leader who is answerable to an Assistant Manager and assisted by a number of subordinates.

The advantages of BMS are evident. As such the Domestic Revenue Department (DRD) is currently working on modernization (automation) of BMS by improving on the registration, coverage, information capturing and enforcement strategies. However, the survey on informal sector made by TRA / NBS (2010) shows that BTMS is yet to be fully adopted as evidenced by absent of records for registered presumptive traders for the years 2004 to 2007. More over business entities in Blocks are still being administered
remotely from RMS or DMS offices. Tax officers are not stationed to the Block as operational system originally assumed.

4.3.2. The current human resource development levels and structures

TRA has made concerted efforts to develop needed human resources administering the presumptive income tax system. Table 4.1.a shows the total number of staff engaged in TRA from year 2000/2001 – 2009/2010 by main departments and units. The total number of staff increased from 2,772 in 2000/2001 to about 3,727 in year 2009/2010. The increase in number of employees occurred in all departments and units. Table 4.1.a shows that majority of these staffs were deployed in Customs and Excise (33.2%) and Domestic Revenue (53%) during year 2009/2010. Under the act, TRA has freedom to pay its staff competitive salaries. To that end, it undertakes salary surveys every two years. In recent years, TRA has implemented the recommendations of independent salary surveys undertaken in 2004/05 and 2007/08 TRA is institutionally organized along functional lines, (TRA, 2008 and African Development Bank Group 2010). A Large Taxpayer Department (LTD) established in 2001, serves around 380 taxpayers (0.1% of all taxpayers). The Domestic Revenue Department (DRD) provides services to all other domestic revenue taxpayers. DRD taxpayers are segmented into large18, medium and small taxpayers.

Table 4.1.a: TRA Staff Number by main departments and unit

<table>
<thead>
<tr>
<th>Department</th>
<th>2000/2001</th>
<th>2009/2010</th>
<th>% in 09/10</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commissioner General</td>
<td>12</td>
<td>20</td>
<td>0.5</td>
</tr>
<tr>
<td>Customs and Excise</td>
<td>807</td>
<td>1,236</td>
<td>33.2</td>
</tr>
<tr>
<td>Domestic Revenue</td>
<td>1,631</td>
<td>1,974</td>
<td>53.0</td>
</tr>
<tr>
<td>Finance</td>
<td>31</td>
<td>55</td>
<td>1.5</td>
</tr>
<tr>
<td>Human Resources and Administration</td>
<td>84</td>
<td>130</td>
<td>3.5</td>
</tr>
<tr>
<td>Information Systems and Technology</td>
<td>21</td>
<td>32</td>
<td>0.9</td>
</tr>
<tr>
<td>Internal Audit</td>
<td>10</td>
<td>28</td>
<td>0.8</td>
</tr>
<tr>
<td>Large Taxpayers</td>
<td>77</td>
<td>109</td>
<td>2.9</td>
</tr>
<tr>
<td>Research and Policy</td>
<td>16</td>
<td>35</td>
<td>0.9</td>
</tr>
<tr>
<td>SBCC</td>
<td>15</td>
<td>21</td>
<td>0.6</td>
</tr>
<tr>
<td>Tax Investigations</td>
<td>55</td>
<td>68</td>
<td>1.8</td>
</tr>
<tr>
<td>Taxpayer Education Services</td>
<td>13</td>
<td>19</td>
<td>0.5</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>2,772</strong></td>
<td><strong>3,727</strong></td>
<td><strong>100.0</strong></td>
</tr>
</tbody>
</table>

Leadership and capacities

In order to enhance presumptive income tax administration TRA is led by trained and skilled staff in the Block Management System. BMS leadership comprises of Senior Tax Officers as heads of blocks, Tax Officers, Assistant Tax Officers and Tax Assistants
from compliance and enforcement sections are assigned with all duties and responsibilities relating to that block. These administrators are required to register all the traders within the block, collect all the revenue and manage tax debts, and provide taxpayer service.

The desired human capacity i.e., the required number of staff in the block depends on the size of the block and the number of staff available in the Region. They deal with all types of taxes in the block and refer cases to the Audit Department which require to be audited. Duration of stay by members of the block in a single block is two years, so that they rotate and work interchangeably for effective and efficient control of the block.

According to TRA Block Management Report 2010 Kariako Ilala Kigogo model (KIK) Manning capacity level is a constraint or primary problem that hinders smooth implementation of Block tax Management system. Table 4.1.b shows serious shortage of staff whereby out of 10 staff required to work in KIK Block only 2 or only 20% staff were allocated. It is only 20 percent of desired human resource that is available. The number is not sufficient in discharging all presumptive income tax duties and responsibilities in the Block. Limited human resource constraint for the BMS is a problem that cut across the country. This is suggests that the BMS is still in piloting and not in full operation.

Table 4.1.b: Block Management System Manning Structures and Performances

<table>
<thead>
<tr>
<th>No.</th>
<th>Cadre</th>
<th>Current Situation</th>
<th>Required Number</th>
<th>Existing Shortage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Head of Model block (STO)</td>
<td>Nil</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>2</td>
<td>Tax Officers</td>
<td>2</td>
<td>3</td>
<td>1</td>
</tr>
<tr>
<td>3</td>
<td>Assistant Tax Officers</td>
<td>Nil</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>4</td>
<td>Tax Assistant</td>
<td>Nil</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td></td>
<td><strong>Total</strong></td>
<td><strong>2</strong></td>
<td><strong>10</strong></td>
<td><strong>8</strong></td>
</tr>
</tbody>
</table>

Significant number of semi formal SMEs interact with the tax offices where they are registered, many of which deal mainly with presumptive income taxes. The SMEs often deal with filed desk officers or case officers who control virtually all of their engagement with the tax office. In practice, the attempt to combine man and overlapping functional activities under a single officer means concentration on assessment. Some of overlapping functions include registration, application forms and tax returns, taxpayer service programs, routine audit assignments, tax enforcement duties and tax data processing and analysis. It may lead to improper procedural arrangements, weak internal controls, corrupt and arbitrary use of power, and conflict of interests, (Seth
The preoccupation with assessments may lead to a sharp decline in field inspections, even for formal SMEs taxpayers. These weak or unsuitable administration procedures impede SME compliance and presumptive income tax performance.

The above suggests that “efforts to intensify the use of presumptive methods must be accompanied by strengthening the institutional capacity of tax domestic revenue department and in particular the need to operationalize and roll out the Block Management System.

There are views that BMS has not been fully utilized or operationalized due to limited human resources. This clearly shows the importance of tax procedures in streamlining the TRA tax administration regimes, linking human resource development and effective use of manpower at the operational levels. That goal can be achieved by not generalizing the weaknesses of SMEs, especially those of small and medium entities with fixed locations in most urban areas. There is need to optimize use of BMS in the application of standard identification, assessments, registering, managing and formalization.

Nonetheless, the first step is to make the design, implementation, monitoring and review of the BMS effective and not allow them to be undermined by weak TRA planning, research, and coordination functional objectives.

### 4.4. Presumptive Income Tax System

#### 4.4.1. Taxable Categories

Before July 2005, SMEs with sales turnover of less than 20 million per annum were paying two types of taxes to TRA; stamp duty on receipt, and presumptive income tax (TRA Reports (2000)). By then, these taxes were assessed on the basis of values of sales, that is, on the same base. In order to reduce compliance costs for such businesses it was proposed in July 2005 to abolish stamp duty on receipt and increase presumptive income tax rates to partly compensate the loss of resulting loss from the measure. In short the two taxes were merged in to one best known as turnover - based taxes. During the same period, that is July 2005, VAT threshold was increased from TShs 20 million to TShs 40 million that caused some VAT registered taxpayers to drop from VAT system and join the presumptive taxation system (TRA Reports (2003)). The resulting new annual rates of presumptive tax were adjusted.

Table 4.2 shows two categories of taxpayers. The first category are those individual taxpayers who do not keep records for their businesses and the second category are those who keep complete records for their business transactions and in both cases, as mentioned earlier on, the rates are applicable only if their business turnover is less than
TShs 20 million. Within these categories, the First Schedule introduces four bands or income level brackets.

Above suggests that the Tax Income Act introduced and accepts some aspects of informality. In many cases and in practise, the SMEs are classified as semi-formal or informal on the basis of their potential ability to comply with administrative procedures. Some of these individual tax payers are not legally registered or licensed by other government authorities but accepted as semi-formal business entities and taxable in this system.

Table 4.2: The New Presumptive Tax Rates after Merger

<table>
<thead>
<tr>
<th>ANNUAL TURNOVER</th>
<th>TAX PAYABLE WHERE SECTION 80 IS NOT COMPLIED WITH</th>
<th>TAX PAYABLE WHERE SECTION 80 IS COMPLIED WITH</th>
</tr>
</thead>
<tbody>
<tr>
<td>Where turnover does not exceed TAS 3,000,000.</td>
<td>TAS.35,000/=</td>
<td>1.1% of the annual turnover</td>
</tr>
<tr>
<td>Where turnover is between TAS.3,000,000 and TAS.7,000,000.</td>
<td>TAS.95,000/=</td>
<td>TAS.33,000/= plus 1.3% of the turnover in excess of TAS.3,000,000.</td>
</tr>
<tr>
<td>Where turnover is between TAS.7,000,000 and TAS.14,000,000.</td>
<td>TAS.291,000/=</td>
<td>TAS.85,000/= plus 2.5% of the turnover in excess of TAS.7,000,000.</td>
</tr>
<tr>
<td>Where turnover is between TAS.14,000,000 and TAS.20,000,000.</td>
<td>TAS.520,000/=</td>
<td>TAS.260,000/= plus 3.3% of the turnover in excess of TAS.14,000,000/.</td>
</tr>
</tbody>
</table>

Source: TRA- Domestic Revenue Department, Income Tax Act, (R.E 2009)

The weak SME management and financial systems can make it easy for these owner/managers and associates to override the limited controls that may exist, leading to malfeasance such as suppression of transactions and falsification of accounting records, (Seth Terkper 2003). The act provides fiscal incentives and or nurses informality. Of course, there are those taxpayers falling in the first category and do keep complete records for their business transactions. Their informal bookkeeping records are accepted as official accounts and therefore enjoy all benefits (by paying less presumptive income tax than business entities in the same income band as stipulated in the Income Tax Act 2004.
The Act introduces elements of transformation from informal to formal business entities. That is, the Act has both bad and good fiscal incentives intended to support development of the informal / SME sector. Apart from reducing the tax burden to this segment of taxpayers, the measure will provide incentive for better record keeping among small businesses. Furthermore, if satisfactory records of income and expenses are kept and produced to TRA, they (taxpayers) will file returns and be assessed on their profits rather than turnover, which is paler.

On the administration side, since small businesses are excluded from the tax regime, and those small businesses who do pay the presumptive tax found to contribute very little to the overall tax, there has been a great attention on the interaction with the Tanzania Revenue Authority (TRA) and the sector. However, the doing business environment in the country has made difficult to administer the presumptive income taxation scheme and/or help firms graduate to the standard tax regime. More the perceivable benefit of paying taxes by small businesses has made no incentive to pay taxes at all.

In addition, it is difficult for small businesses to have a collective body to represent them, given the diversity of operators of the business and thus interests. Thus, there is no effective mechanism for small entrepreneurs to voice their tax concerns. This has made difficult to administer small businesses despite the current use of Block Management System by the authority.

Due to the nature and environment of businesses in the country, many small businesses tend to opt for the presumptive regime, (Joel Slemrod and Shlomo Yitzhaki, 1994). Although this simplifies the tax administration, it does not contribute to creating or strengthening a culture of compliance among small businesses. In addition, although small businesses are not required to register for Value Added Taxes (VAT), staying out of the VAT net may be more of a tax burden than paying the tax. This burden is compounded by taxes and fees at the municipal or district levels which tend to be very significant for small business. As much of the economy is made up of small businesses, most of which are informal, this study suggests that tax compliance and recording requirements are strong deterrents to registering a business and paying taxes in which has to be applied and insisted for the small businesses.

4.4.2. Advantages and Disadvantages of Presumptive Taxes System

Table 4.3 presents advantages and disadvantages of the presumptive taxes system in Tanzania. The presumptive taxes system used in Tanzania is well known as the Turnover Based PT System. In this system different business segments may have substantially different turnover/net profit ratios. To avoid major differences in the real
(net) income tax burden, it is necessary to apply different tax rates on turnover according to the average profit ratio.

The differentiation will have to be kept at a minimum, however, for reasons of simplicity, and to avoid tax evasion possibilities and disputes between taxpayers and the tax administration over the rate to apply, (Christian R. Jaramillo, 2004). Typically, such an approach differentiates between traders and businesses in the service sector. The approach tends to increase the fairness of the system but is difficult to administer for small businesses carrying out both trade and service activities. Turnover-based presumptive tax system seems easy to design. They also reduce risks of disputes over the applicable tax rate and do not require complicated comparisons of profit margins in different small business segments.

There is a substantial design challenge, however, when it comes to fixing the level of standard deduction from turnover/gross income, or the tax rate to be applied. An implicit feature of turnover-based systems is that they may result in a comparatively high tax burden for businesses with a comparatively low profit margin, and a relatively low tax burden for MSEs with very high profit margins, (Christian R. Jaramillo, 2004).

Table 4.3: Presumptive Taxes System: Advantages and Disadvantages

<table>
<thead>
<tr>
<th>Type of system</th>
<th>Tax base/Indicator</th>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Turnover based system</td>
<td>Business turnover</td>
<td>Guarantees minimum level of vertical and horizontal equity</td>
<td>High risk of turnover under declaration</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Easier transition from presumptive to standard regime, as turnover is also decisive element of tax calculation in standard systems.</td>
<td>High risk of corruption</td>
</tr>
<tr>
<td></td>
<td></td>
<td>High revenue potential compared to other presumptive systems</td>
<td>System generally favors businesses with high profit margins</td>
</tr>
</tbody>
</table>

On the one end of the spectrum such a situation forces MSEs to either opt out of the system or bear the substantially higher compliance costs of the standard tax system or to cease formal business activities. On the other end of the spectrum it creates incentives for businesses above the threshold to under-declare turnover or to split up in order to be able to move into the presumptive system, thus causing revenue losses for the Treasury.
A high tax rate on turnover quickly becomes prohibitive, as can be seen from the example of Cuba. As the attractiveness of the simplified regime largely depends on the actual profit margin of the business, more sophisticated small taxpayers in high cost/turnover business sectors get an unintended incentive to move out of the system, which can significantly change the mix of small taxpayer categories taxed on a presumptive basis. Such experience has been made in Hungary with the application of the simplified entrepreneurial tax. There is no general guideline for the determination of the tax rate in case of a turnover-based presumptive system. Extensive analysis into average MSE profit margins is required before setting the rate.

4.5. Presumptive Income Tax Performances

Table 4.4 summarizes performances of presumptive income tax in Tanzania from year 2005/2006 to 2009/2010. In addition the table has summary statistics of other tax indicators. Table 4.4 suggests that Tanzania has significantly improved the domestic revenue mobilization. The tax revenue as percent of total GDP increased from 11.6 percent in year 2005/2006 to about 14.2 percent in year 2009/2010. This increased hand in hand with the increasing of presumptive income taxes during the same sample period.

Table 4.4 shows that both presumptive income taxes for individual with accounts and individuals with no accounts have been increasing during the sample period. However, it is interesting to note that presumptive income taxes for the first category has been high suggesting that TRA has instituted tax incentives to encourage firms preparing and keeping formal accounts.

Table 4.4 suggests that the total presumptive income tax has been very small compared with other forms of income taxes, number of taxable entities and desired tax transformation targets.

4.5.1. Number of Registered Presumptive Income Tax Payers

Table 4.4 shows the total number of registered tax payers increased from 288,680 in year 2005/2006 to about 617,877 in year 2009/2010 and presumptive income tax payers increased from 199,448 in year 2005/2006 to about 376,673 in year 2009/2010. The total number of presumptive income tax payers as percent of total TRA tax payers increased from 69 percent in year 2005/2006 to about 75 percent in year 2006/07 and then starting to drop to about 61 percent in year 2009/2010. Whereas some studies acknowledge the increase to have partly been contributed by improvement of presumptive scheme system, the study also feels that other tax administrative measures have largely contributed to this achievement. Block tax Management system,
tax survey and patrols, tax severance and tax audits surely have their contributions to this achievement.

Table 4.4: Presumptive Income Tax Basic Statistics

<table>
<thead>
<tr>
<th>TRA TIN REGISTRATIONS</th>
<th>2005/06</th>
<th>2006/07</th>
<th>2007/08</th>
<th>2008/09</th>
<th>2009/10</th>
</tr>
</thead>
<tbody>
<tr>
<td>GENERAL TRADERS</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>TIN Registered</td>
<td>288,680.0</td>
<td>334,724.0</td>
<td>398,080.0</td>
<td>487,983.0</td>
<td>617,877.0</td>
</tr>
<tr>
<td>VAT Registered</td>
<td>6,154.0</td>
<td>7,723.0</td>
<td>9,036.0</td>
<td>10,844.0</td>
<td>13,253.0</td>
</tr>
<tr>
<td>MOTOR VEHICLE Taxpayers</td>
<td>120,223.0</td>
<td>164,780.0</td>
<td>218,301.0</td>
<td>262,698.0</td>
<td>320,744.0</td>
</tr>
<tr>
<td>Population of Tanzania</td>
<td>36,861,759.0</td>
<td>37,908,714.0</td>
<td>38,882,947.0</td>
<td>40,078,983.0</td>
<td>41,298,802.5</td>
</tr>
<tr>
<td>GDP-mp (in Million TShs.)</td>
<td>16,953,280.5</td>
<td>19,444,835.5</td>
<td>22,782,917.1</td>
<td>26,474,230.5</td>
<td>30,585,125.8</td>
</tr>
<tr>
<td>Revenue/GDP ratio</td>
<td>11.6%</td>
<td>13.2%</td>
<td>14.8%</td>
<td>15.1%</td>
<td>14.2%</td>
</tr>
</tbody>
</table>

Presumptive Statistics (Million Tshs.)

<table>
<thead>
<tr>
<th>2005/06</th>
<th>2006/07</th>
<th>2007/08</th>
<th>2008/09</th>
<th>2009/10</th>
</tr>
</thead>
<tbody>
<tr>
<td>Individual (Account cases)</td>
<td>23,932.6</td>
<td>20,542.0</td>
<td>25,915.0</td>
<td>31,197.9</td>
</tr>
<tr>
<td>Individual - Non Account Cases (Presumptive) tax revenue</td>
<td>7,612.2</td>
<td>8,962.3</td>
<td>8,669.0</td>
<td>10,911.8</td>
</tr>
<tr>
<td>Presumptive taxpayers</td>
<td>199,448.0</td>
<td>250,003.0</td>
<td>290,051.0</td>
<td>322,403.0</td>
</tr>
</tbody>
</table>

Table 4.5: Registration of Presumptive Business Entities

<table>
<thead>
<tr>
<th>Variable</th>
<th>TRA</th>
<th>LGA</th>
<th>BRELA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Registered</td>
<td>293</td>
<td>178</td>
<td>80</td>
</tr>
<tr>
<td>Resp.</td>
<td>537</td>
<td>537</td>
<td>537</td>
</tr>
</tbody>
</table>

Source: TRA Database 2010

Table 4.5 shows number of surveyed registered presumptive income tax payers. Table 4.5 suggests that there is a big population of business operators who have not been registered by TRA, LGA and BRELA. Almost 45 percent of responds do business without TIN, outside the tax net and thus represents missed tax revenues. About 67 percent operates without local government business licences and thus are outside the formal system. About 86 percent their businesses were not registered by BRELA, suggesting that very few firms are formal business operators.

Table 4.5: Registration of Presumptive Business Entities
4.5.2. Presumptive Income Tax Rate Structures

In order to administer these semi informal business entities effectively TRA has adopted various administrative tax rate structures. Table 4.6 shows TRA adopted presumptive income tax structures. Though the system is good and simple, a further analysis of the system indicates the system to tax traders in the same band differently. Table 4.6 shows that the rate in the 1\textsuperscript{st} band for minimum turnover is 0\% and 1\% for maximum turnover of 3 million. In the 2\textsuperscript{nd} band the scheme imposes 3\% on minimum sales of TShs 3 million and decreases to 1\% on maximum sales of TShs 7 million. In the 3\textsuperscript{rd} and 4\textsuperscript{th} bands the situation is similar that the minimum sales suffer higher tax rates than the maximum sales of 4\%, 2\% and 3\% respectively. The differential application of rates in this scheme made traders to object graduation from upper end to the next lower band for fear to pay more tax.

Table 4.6: Tax Rate Structures

<table>
<thead>
<tr>
<th>Bands</th>
<th>Band 1</th>
<th></th>
<th></th>
<th>Band 2</th>
<th></th>
<th></th>
<th>Band 3</th>
<th></th>
<th></th>
<th>Band 4</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Min</td>
<td>Max</td>
<td>Min</td>
<td>Max</td>
<td>Min</td>
<td>Max</td>
<td>Min</td>
<td>Max</td>
<td>Min</td>
<td>Max</td>
<td>Max</td>
</tr>
<tr>
<td>Turnover in TAS</td>
<td>0</td>
<td>3,000,000</td>
<td>3,000,001</td>
<td>7,000,000</td>
<td>7,000,001</td>
<td>14,000,000</td>
<td>14,000,001</td>
<td>20,000,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax payable</td>
<td>35,000</td>
<td>35,000</td>
<td>95,000</td>
<td>95,000</td>
<td>291,000</td>
<td>291,000</td>
<td>520,000</td>
<td>520,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Effective Tax rates</td>
<td>0</td>
<td>1%</td>
<td>3%</td>
<td>1%</td>
<td>4%</td>
<td>2%</td>
<td>4%</td>
<td>3%</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: TRA Database 2010

4.5.3. EAC Comparative Tax Structure for Small Businesses

This section attempts to examine the tax revenue contribution of the sector with some other East African Community, (EAC) countries and comparing with Tanzania situation. The Tanzania economy, like any other developing economy, is also characterized by the existence of recorded and unrecorded (informal sector) segments.

Incidentally, the economies of EAC (Kenya, Tanzania, Uganda, Burundi and Rwanda) also manifest a similar economic characteristic. This common characteristic has pushed
the Revenue Authorities in the region to seek a common approach in tackling the tax administration implications of the phenomenon. All these countries use presumptive income tax system for the small and medium scale enterprises. However, different countries have used different tax rates and systems. For example whereas Tanzania uses mixture of fixed and progressive tax rate with marginal tax rate of 3.3 percent, Kenya uses flat rate of 3 percent.

Table 4.7: EAC Comparative Tax Structure for Small Business Taxpayers - Turnover Taxes

<table>
<thead>
<tr>
<th>Country</th>
<th>Criteria (Annual)</th>
<th>Tax Rate Type</th>
<th>2009 Exchange rates</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Currency</td>
<td>Minimum</td>
<td>Maximum</td>
</tr>
<tr>
<td>Tanzania</td>
<td>Tanzania Shillings</td>
<td>1</td>
<td>20,000,000</td>
</tr>
<tr>
<td>Kenya</td>
<td>Kenya Shillings</td>
<td>500,000</td>
<td>5,000,000</td>
</tr>
<tr>
<td>Uganda</td>
<td>Uganda Shillings</td>
<td>5,000,000</td>
<td>20,000,000</td>
</tr>
<tr>
<td>Rwanda</td>
<td>Rwandan Francs</td>
<td>1</td>
<td>400,000,000</td>
</tr>
<tr>
<td>Burundi</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>


Tanzania Revenue Authority initially designed a presumptive scheme to apply only to small business individuals who do not maintain sets of business accounts and it was decided to extend its application to similar small business individuals keeping complete records as a mechanism to promote, formalize or induce the former to emulate the latter in keeping complete business records. The presumptive Tax was designed to serve two functions.

Firstly, to reach out to those not reachable through the formal Personal Income Tax (PIT) and ensure equitable tax system; and secondly, to institute in-built attributes to motivate operators under the Presumptive Scheme to graduate into the preferred tax system. When the Scheme was introduced in Tanzania, it was meant to cover all taxpayers not registered under the VAT Scheme. In July, 2004, a twin-reform was undertaken to revise VAT threshold from annual turnover of Shs. 20 million per annum
to Shs. 40 million per annum and merge the presumptive income tax scheme with the receipt-based stamp duty.

The proposal to raise the VAT threshold from Shs. 20 million to Shs. 40 million annual turnovers was not followed suit with the increase in maximum turnover to Shs 40 million under the presumptive turnover. This has resulted into the application of two different schemes for income taxation applicable to businesses with turnover below VAT registration threshold, namely the presumptive income tax scheme for businesses with turnovers not exceeding Shs. 20 million per annum and the personal income tax scheme for businesses with turnover above Shs. 20 million per annum but not exceeding Shs. 40 million per annum.

The presumptive regime in Tanzania, while well designed, still exhibits the following anomalies:

- The system is regressive as non-record-keepers are more likely to lack the capacity to keep proper accounts.

- For ‘non-record keepers’, the system is not consistently progressive. For example for a firm with a turnover of TSH 1 million, the effective tax rate is 3.5%, whereas it is only 1.4% for a turnover of 7 million.

- The system is inconsistent and inequitable with respect to Personal Income Tax, which has an initial tax-exempt band for annual total income of less than TSH 1,620,000\(^6\). Under the presumptive regime, businesses in the bottom band (turnover below TSH 3 million) that do not maintain records are required to pay TSH 35,000 irrespective of their actual turnover. An exempt band for small taxpayers, introduced in 2001 by the TRA, was abolished in 2003 to improve taxation of the informal sector.

- The exit threshold for the presumptive regime of TSH 20 million is inconsistent with the VAT threshold of TSH 40 million.

4.5.4. Total and Presumptive Income Tax Payers Trend

Figures 4.1.a and 4.1.b show the total and presumptive income tax payer’s trend index from year 2005/2006 to year 2009/2010 both in absolute figures and relative where we

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\(^6\) Income Tax Act. No. 11 of 2004, Individual income tax rates for residents with effect from 01/07/2010
pegged year 2005/2006 is equal to 1. Figure 4.1.a shows that both total and presumptive income tax payers have been increasing during the last five years.

However, figure 4.1.b suggests that since 2007/2008 the number of total income tax payers have been increasing faster than the number of presumptive income tax payers. This suggests that much as these efforts of presumptive scheme have been undertaken to simplifying the tax regimes, their outcomes have been significant in pulling the informal and semi informal sector operators into formal and, hence, bringing them in the TRA tax net. That is, after a lag of three to four years, the new system is effectively in operation and this need to be enhanced.

However, the study suggests that still significant a number of the operators in the informal sector are still operates outside the TRA net. Stakeholders are however concerned that, the scheme is inconsistent with the P.A.Y.E (Equity considerations) whereby traders with small turnover are highly charged than those with higher turnover in the same band. They feel that the scheme should be harmonized with PAYE (to include the nil tax bands) and the threshold should be harmonized with increased VAT registration threshold.

**Figure 4.1.a Total and Presumptive Income Tax Trend in Absolute Figures**

![Graph showing total and presumptive income tax trend](source: TRA Database 2010)

**Figure 4.1.b: Total and Presumptive Income Tax Payers Trend Index (2005/2006=1)**
4.5.5. Magnitude of Individual Income Tax Revenue Collections
The individual tax revenue is taken as a proxy of an overall presumptive income tax performance. Figure 4.2 shows the ratios of individual tax to total and direct TRA tax which are used to measure the performance of presumptive tax in Tanzania.

Figure 4.2 suggests that before introducing presumptive taxes in year 2001/02, the overall magnitude or performance share of individual taxes to total direct taxes was 7.3 percent in year 1996/97 and accounted for 1.8 percent to total TRA revenue collection and 0.22 percent of GDP in the same year. This overall performance share index deteriorated to 6.0 percent to total direct tax, 1.5 percent of TRA revenue collection and 0.15 percent of GDP in year 2000/01. When the Government introduced presumptive taxes in year 2001/02 the performance shares continued to deteriorate.

Since then, the performance of tax collected from the individual tax (which includes the presumptive taxes) has been continuously deteriorating. When the presumptive scheme was introduced and become in operation from year 2001/02, the scheme did not reverse the downward performance trend. However, the share of Individual taxes as a percentage of GDP had not been stable. This slightly increased from 0.14 percent of GDP in 2001/02 to a pick of 0.19 percent of GDP in year 2005/06 before slowing down to 0.16 percent of GDP in 2009/10.

**Figure 4.2: Individual Tax Revenue Performance**

[Diagram showing individual tax revenue performance]

Much as the magnitude of individual taxes reversed the downward trend from year 2003/04, of which could be part of the performance of the new introduced presumptive tax scheme, the scheme did not help in maintaining the upward trend after the peak of year 2005/06. This suggests that the performance of both presumptive (who are the
non-account cases) and the individual (account cases) taxes were all not doing well in-
terms of its administration and tax income collection performance.

**Figure 4.3: Share of Individual Taxes as a Percentage of GDP**

![Graph showing share of individual taxes as a percentage of GDP from 1996/97 to 2010/11.](image)

*Source: TRA Database 2010*

**Figure 4.4: Performance Share of Presumptive Tax Revenue to Total Direct Taxes**

![Graph showing performance share of presumptive tax revenue to total direct taxes from 1996/97 to 2010/11.](image)

*Source: TRA Database 2010*
Table 4.8 shows the effect of the current Block Management System and Presumptive Taxation during 2006/7 and 2009/2010. The table suggest that the TRA through the Block Management System (BMS) mechanism has shown that the BMS has an effective way of increasing taxpayers, leave alone assessing their taxes.

Table 4.8: Effect of the current Block Management System and Presumptive Taxation

<table>
<thead>
<tr>
<th>Effect of BMS on taxpayer registration</th>
<th>2006/07</th>
<th>2007/08</th>
<th>2008/09 (Jul - Dec)</th>
</tr>
</thead>
<tbody>
<tr>
<td>New registration</td>
<td>46,274</td>
<td>57,011</td>
<td>29,993</td>
</tr>
<tr>
<td>Through BMS</td>
<td>16,476</td>
<td>24,972</td>
<td>13,138</td>
</tr>
<tr>
<td>Effect of BMS on taxpayer registration</td>
<td>36%</td>
<td>44%</td>
<td>44%</td>
</tr>
</tbody>
</table>

Source: Block Management Report Presented To TRA Board

Figure 4.5 shows the percentage of Registered TRA Taxpayers to Tanzania Population. The figure suggests that as a whole TRA needs to do much as up to the current, the Authority has managed to register up to 1.5% of the Tanzania population in general traders.

Figure 4.5: Percentage of Registered TRA Taxpayers to Tanzania Population

4.6. Analysis and Scenario of the Current Presumptive Tax Structure

Figure 4.6: shows tax paid under the current presumptive tax structure. The current presumptive tax structure exhibits the characteristics of punishing those with lower turnover than those with higher turnover within each band.
Figure 4.6: Tax paid under the Current Presumptive Tax Structure

Figure 4.7: Effective Tax Rate of the current Presumptive Tax Structure

Source: TRA informal Sector Study Data 2010
As it can be seen on Figure 4.6, the current structure does not obey the horizontal and vertical equity principle. Within each band the effective tax rate of taxpayers with small turnover is higher than those with high turnover. Taxpayers in the same tax band who have small turnover their effective tax rate is higher than those taxpayer with higher turnover within the same tax band as is shown in Figure 4.7.

Figure 4.7 shows that the current presumptive tax structure punishes severely those with lower income turnovers within each band and taxes less than those with higher turnovers within the same band.

4.7. Progressive Turnover-Based Presumptive Taxation

Tanzania uses progressive turnover-based presumptive taxation as an effective domestic finance resource policy instrument for reducing the SMEs compliance burden and bringing informal SMEs into the tax net. In this case, different SMEs segments are still treated uniformly; however, the tax rate increases according to the level of business turnover.

The application of presumptive systems has been limited to small and medium scale businesses having difficulties in keeping proper books and records. The study found that, the system has facilitated migration into the semi standard tax system.

The progressive turnover-based presumptive taxation system has obliged small and medium scale businesses to keep at least some basic books and records without imposing any burdensome accounting requirements on SMEs operators. As a consequence of the requirement to observe basic bookkeeping standards, the transition from the presumptive to the standard tax regime is facilitated. Turnover has the potential of being a better proxy for profit estimation than indicators such as the size of business premises or the number of employees. However, the turnover-based system entails a risk of tax evasion due to under-declaration of business turnover.
Chapter Five: Informal Sector Firms outside Tax System

Chapter Five presents social economic dynamics and factors affecting the informal/SMEs who are out of the tax net i.e. non-compliance business operators. The overall level of tax compliance in a country is determined by a number of factors. These are partly business-related and partly reflect the economic and social environments, (Centre for Tax Policy and Administration, 2004).

5.1. Status of Business Registrations and Tax Payment

We will first and foremost examine relationship between business environment and taxation system in the country. We will use business registration as a proxy for business environment. Table 5.1 presents status of business registrations and tax payments of the surveyed firms in year 2010. Table 5.1 shows that about 58.3 percent of the surveyed firms are semi formal and formal or registered business entities and about 41.7 percent are not registered. Table 5.1 shows that about 60 percent are captured in the TRA tax network in one form or another and about 40 percent operate outside the tax system. That is, about 40 percent of the informal sector firms are not paying taxes or complying with Tanzanian taxation system. The study suggests that on the one hand TRA is missing over 40 percent of presumptive income tax revenue, since these business operations are not captured in the tax network.

On the other hand, tax compliance will essentially relate to the extent to which a taxpayer meets specific formalization obligations. The broad categories of taxpayer obligation are: [1] registration in the system; [2] provision of necessary and timely data and taxation information, [3], reporting of complete and accurate information (incorporating good record keeping); and [4] payment of taxation obligations on time. If a taxpayer fails to meet any of the above obligations then they may be considered to be non-compliant. There are clearly different degrees of non-compliance and thus forms of informalities, (Centre for Tax Policy and Administration, 2004).

<table>
<thead>
<tr>
<th>Business / activity registered</th>
<th>Paying any taxes?</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td></td>
<td>Number</td>
<td>Number</td>
</tr>
<tr>
<td></td>
<td>Table %</td>
<td>Table %</td>
</tr>
<tr>
<td>Yes</td>
<td>327</td>
<td>20</td>
</tr>
<tr>
<td></td>
<td>55.0%</td>
<td>3.4%</td>
</tr>
<tr>
<td>No</td>
<td>30</td>
<td>218</td>
</tr>
<tr>
<td></td>
<td>5.0%</td>
<td>36.6%</td>
</tr>
<tr>
<td>Total</td>
<td>357</td>
<td>238</td>
</tr>
<tr>
<td></td>
<td>60.0%</td>
<td>40.0%</td>
</tr>
</tbody>
</table>

Source: TRA informal Sector study Data 2010
The table suggests that about 55 percent are registered business entities paying taxes, [G1.1] and about 3.4 percent are registered but not paying taxes [G1.2]. The last group, [G1.2] will be categorised as semi informal business operators of category A. This table suggests that about 36.6 percent of firms are not registered and not paying taxes, [G2.2]. These are hard-to-tax or classical informal sector operators outside the government system.

There are about 5.0 percent of firms which are not registered and are captured in the tax network, [G2.1]. These will classified as semi-informal business actors of category B. Group G1.2 are classical tax evaders, like taxpayers, come in many shapes, sizes, and guises. At the upper end, some may conduct much or all of their business through a baffling array of corporate vehicles and complex and convoluted financial transactions, many allegedly or actually taking place off-shore. Group G2.2 are staying completely off the fiscal radar – so-called “ghosts” who transact business solely in cash and avoid normal business channels and all contact with government agencies. However, we will note that even those captured in G1.1 in some cases are the most difficult and important to deal with and are those who, to a greater or a lesser degree, hide some of their sales or income or claim deductions or exemptions improperly, (Richard M. Bird and Sally Wallace, 2003).

5.2. Factors Influencing the Compliance Behaviour of Businesses

While above suggests that there is a certain correlation between the size of the underground economy and the level of non-compliance with the tax system, a complete equation would be misleading. Informality can take different forms and dimensions, (Centre for Tax Policy and Administration, 2004). Again let us summarize these forms as follows;

i. MSE operates entirely outside the informal sector {G2.1}
ii. MSE comply with the a small number of legal and regulatory obligations but not with others, {G1.2}
iii. MSE comply with most number of legal and regulatory obligations, {G1.1}
iv. MSE formally comply with legal and regulatory obligations but not entirely respects all obligations, {G1.2}

The study will note that non-compliance with tax obligations is not always and necessarily the main element of informality. In countries with a high social security burden or in countries with particularly cumbersome labour laws, small businesses may be willing to register for tax purposes, but may not want to comply with labour and social standards, {G2.1}.

The research literature identifies two broad approaches to the problem of compliance, (Centre for Tax Policy and Administration, 2004). The first stems from an economic rationality perspective and has been developed using economic analysis. The second is
concerned with wider behavioural issues and draws heavily on concepts and research from disciplines such as psychology and sociology.

Economic and behavioural approaches are sometimes regarded as competing explanations. However, each approach can be valuable in terms of understanding tax compliance and the issue is to determine how the two approaches might be used to reinforce each other. From few researches the following factors emerge as significant.

5.2.1. Economic factors

Financial Burden
There appears to be a relationship between the amount of tax owed and compliance behaviour. For example, if a business owner has a tax liability that can easily be paid they may be willing to comply. However, if the liability is large — potentially threatening the viability of the business — the owner may avoid paying at all or try to adjust the data reported so as to incur a smaller (but incorrect) tax liability;

The Cost of Compliance
Taxpayers appear to face a number of common costs of having to comply with their tax obligations over and above the actual amount of tax they pay. These include the time taken to complete requirements, the cost of having to rely on accountants and the indirect costs associated with the complexity of tax legislation and administration. These can include corruption and ‘psychological’ costs such as stress that comes from not being certain that they have met all of the tax rules or even knowing what those rules are. Furthermore, small businesses often express resentment about being ‘unpaid tax collectors’ because of their role in collecting and paying both indirect and direct taxes;

Disincentives
Investigations into the impact of deterrents, such as financial penalties and threats of prosecution(s), suggest that they may have a time limited effect on compliance behaviour of taxpayers. However, studies have shown that those who are compliant want those who are non-compliant to be punished

Incentives
Giving taxpayers incentives may have a positive effect on compliance behaviour (i.e. taxpayers becoming more compliant), though this needs further exploration.

5.2.2. Behavioral factors

Individual differences
While some taxpayers comply with their tax obligations, many do not. Individual factors influencing behaviour include gender, age, education level, moral compass, industry, personality, circumstances, and personal assessment of risk;

**Perceived Inequity**

Taxpayers who believe ‘the system’ is unfair or who have personal experiences of ‘unfair’ treatment are less likely to comply;

**Perception of Minimal Risk**

If a taxpayer has the opportunity not to comply and thinks that there is only a minimal risk of being detected, he or she will take the risk. This presumably accounts for the greater under-reporting of certain types of income. For example, salary and wage income is usually highly ‘visible’ to a tax authority because of third party reporting. However, other forms of income may be much less visible and therefore subject to more ‘creative’ accounting.

**Risk Taking**

Some people view tax avoidance as a game to be played and won: they like to test their skills in avoiding their obligations and avoiding being caught.

5.2.2. Levels of Taxpayer Compliance Attitudes

Table 5.2 presents levels compliance behaviour of businesses. Table 5.2 suggests that there are many and complex factors affecting behaviour of informal sector tax compliance. Based on the general impact of external factors on the tax compliance attitude of the MSE community, combined with personal characteristics (e.g. level of risk aversion) of the individual MSE operator, four levels of taxpayer compliance attitudes, (OECD, Compliance Risk Management, 2004 and Braithwaite, 1998) can be distinguished as follows:-

i). **The disengaged**: At the top of the pyramid is an attitude of disengagement. It characterizes those who have decided not to comply. People with this attitude either deliberately evade their responsibilities or choose to opt out. Cynicism about the tax system is usually matched by cynicism about the role of government.

ii). **Resisters**: The attitude of resistance characterizes active confrontation. The system is seen as oppressive, burdensome, and inflexible. This attitude
characterizes those who don’t want to comply but who will if they can be persuaded that their concerns are being addressed.

ii). **Trying units:** Those who are basically willing to comply have a more positive attitude. But they also have difficulty complying and don’t always succeed. They may have difficulty understanding or meeting their obligations, but their expectation is that, in any dispute, trust and cooperation will prevail.

iii). **Supporters:** The attitude here is one of willingness to do the right thing. There is a conscious commitment to support the system and accept and manage effectively its demands. There is an acceptance of the legitimacy of the role of tax officers and a belief that they are fundamentally trustworthy.

**Table 5.2: Levels of Compliance Behaviour of Businesses**

<table>
<thead>
<tr>
<th>Category</th>
<th>Generic Characteristics</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business profile</td>
<td>Structure – sole trader, partnership, company, trust</td>
</tr>
<tr>
<td></td>
<td>Size and age of the business</td>
</tr>
<tr>
<td></td>
<td>Type of activity carried out</td>
</tr>
<tr>
<td></td>
<td>Business focus – local versus international</td>
</tr>
<tr>
<td></td>
<td>Financial data – capital investm</td>
</tr>
<tr>
<td></td>
<td>Business intermediaries</td>
</tr>
<tr>
<td>Industry factors</td>
<td>Definition/size of the industry</td>
</tr>
<tr>
<td></td>
<td>Major participants in the industry</td>
</tr>
<tr>
<td></td>
<td>Profit margins</td>
</tr>
<tr>
<td></td>
<td>Cost structures</td>
</tr>
<tr>
<td></td>
<td>Industry regulation</td>
</tr>
<tr>
<td></td>
<td>Working patterns</td>
</tr>
<tr>
<td></td>
<td>Industry issues such as level of competition, seasonal factors and infrastructure issues</td>
</tr>
<tr>
<td>Sociological factors</td>
<td>Cultural norms</td>
</tr>
<tr>
<td></td>
<td>Ethnic background Attitude to government</td>
</tr>
<tr>
<td></td>
<td>Age and gender</td>
</tr>
<tr>
<td></td>
<td>Educational level</td>
</tr>
<tr>
<td>Economic factors</td>
<td>Investment</td>
</tr>
<tr>
<td></td>
<td>Demographic interest rates</td>
</tr>
<tr>
<td></td>
<td>The tax system</td>
</tr>
<tr>
<td></td>
<td>Government policies</td>
</tr>
<tr>
<td></td>
<td>International influence</td>
</tr>
<tr>
<td></td>
<td>Inflation</td>
</tr>
<tr>
<td></td>
<td>Markets</td>
</tr>
<tr>
<td>Psychological factors</td>
<td>Greed, risk, fear, trust</td>
</tr>
<tr>
<td></td>
<td>Values</td>
</tr>
<tr>
<td></td>
<td>Fairness/equity</td>
</tr>
</tbody>
</table>
Source: OECD, Compliance risk management 2004

In countries with a high percentage of MSE operators who fall under the categories of supporters and triers, one can expect a direct and visible impact of compliance facilitation initiatives on the actual level of voluntary tax compliance. Noticeable improvements in the compliance behaviour of resisters require a broader set of measures, comprising in particular of strengthening tax enforcement capacity and developing programs to change their overall attitude towards government.

5.3. Business Registration in Tanzania

5.3.1 Business Registration Legal Framework

Tanzania has put in place an elaborative legal framework requiring that all businesses must be registered. There is an Act of 2006 that provides for the establishment of a business activities registration system, Business Registration Centres, (BRELA). The BRELA Act of 2006 establishes in each local authority a Business Registration Centre. Each Business Registration Centre shall be a section of the local authority. One of the functions of the Business Registration Centre is to register all businesses undertakings, business entities and enterprises in the area of its jurisdiction (i.e. block registration management). Every business registration shall be valid for the entire life of the business.

Nothing in this Act shall entitle any person to carry on business or business to be conducted in contravention of any law or regulation governing activities of that business, including but not limited to (a) town planning regulations; (b) health regulations; (c) safety regulations; (d) environmental regulations; (e) in relation to foreigners, the immigration requirements; or (f) any regulation governing the conduct of any specific type of business or profession.

Part VII of the Act is about Offences and Penalties. It is an offence or illegal for any business to operate without a license. Section 28 states that any person who- (a) carries on business without being registered under this Act; (b) provides false information at the time of registration; (c) conducts business without observing other legislation or regulations governing such activity; (d) carries on business at any place not specified in the certificate of registration; (e) fails to surrender certificate of registration which has been suspended, revoked or cancelled to Registrar.

5.3.2. Registration Requirements and Practices
The following are generic steps or and requirements and registration procedures in Tanzania.

Procedure 1: Apply for clearance of the proposed company name at the Registrar of Companies

Time to complete: 1 day
Cost to complete: no charge

Practices Requesting for clearance of a proposed company name can be done by mail to the Registrar. Applicants submit a letter for name clearance after which the registry clears it after search. The registry search is to establish:

a) The availability or non availability of the applied name, and
b) Desirability of the name.

Applicants are then advised if the name is available or not after which they prepare a Memorandum and Articles of Association and submit the same for registration process.

Where the Memorandum and Articles of Association are prepared and presented for registration, using an un-cleared name, search is done at the time of registration with a probability of rejection if the search reveals existence of a similar name in the register. Name clearance has been sped up with the computerization of the registry.

Procedure 2: Apply for a certificate of incorporation and of commencement to Registrar of Companies

Time to complete: 7 days (maximum)
Cost to complete: TZS 206200

Practices: Registration Fee (As per the New Companies Act 2002)

Nominal Share Capital Registration Fee for;
Share capital between 20,000 to 500,000 Tshs. 50,000
Share capital between 500,000 to 1,000,000 Tshs. 80,000
Share capital between 1,000,000 to 2,000,000 Tshs. 100,000
Share capital between 2,000,000 to 3,000,000 Tshs. 120,000
Share capital between 3,000,000 to 5,000,000 Tshs. 150,000
Share capital between 5,000,000 to 10,000,000 Tshs. 180,000
Share capital between 10,000,000 to 30,000,000 Tshs. 200,000
Share capital between 30,000,000 upwards Tshs. 300,000
Filling Fee: Flat rate of Tshs. 45,000

Stamp Duty: The Original Memorandum and Articles of Association is charged Stamp Duty of Tshs. 6,200 and additional copies are charged Tshs. 5,000

The practice: A subscriber, secretary or a person named in the Articles of Association of the Company as director has to fill in the following forms: Form 1 (Particulars of Directors); Form 14 (Statement of Compliance with the Requirements of the Company Ordinance) and Form 15 (Notice of Registered Office of the Company). Upon lodging of the documents the certificate of incorporation is usually processed within 2-3 days after the certificate of incorporation. Registration forms are free. Business trade names (Cap 213) and companies (Cap 212) can only be registered in Dar es Salaam. A lawyer is not required, but using one is the standard practice. There are no standard articles of association, but one is free to adopt Table "A" of the Schedules to the Companies Ordinance. The fee for capital below 1 million should be 10%, but fee is negotiable.

Procedure 3: Order a company seal

Time to complete: 1 day
Cost to complete: TZS 100

Procedure 4: Apply for TIN (Tax Payers' Identification Number) with the Tanzania Revenue Authority

Time to complete: 2 days
Cost to complete: no charge

The practice: No fee payable on registration of both VAT and TIN. However there is payment of provision Income Tax at this stage, which is about US$350 per quarter. This amount can be deferred until commencement of business. Tax registration has been fully computerized. It takes a minimum of 2 days for one to obtain TIN number depending on the number of request made to the Revenue Authority at a particular time.

Procedure 5: Income tax officials inspect the office site of the new company

Time to complete: 1 day, included in procedure 4
Cost to complete: no charge

Procedure 6*: Apply for PAYE with the Tanzania Revenue Authority
Procedure 7: Apply for business license from the regional trade officer (depending on the nature of business)

Time to complete: 7 days
Cost to complete: TZS 20000

The practice: The procedure has to be performed within 21 days of commencing business (they submit documents for approval also to the licensing board committee). Three signatures are collected from the town or planning officer, health officer, and trade officer. All but the trade officer will inspect the premises. Firm provides transport. Two-thirds of the license fee is paid up-front and the rest is due after 8 months. The business license also automatically registers the company for various taxes imposed by the Dar es Salaam City Commission, e.g. the development levy.

There is no charge for Companies with a turnover of less than Tshs 20,000,000 and certain health providers. A uniform fee of Tshs 20,000 was introduced for companies with turnover of over Tshs 20,000,000. The license category system was simplified and the number of licensed activities reduced to 2.

Procedure 8*: Have the land and town-planning officer inspect the premises and obtain his signature

Time to complete: 1 day, included in procedure 7
Cost to complete: transport cost, trivial

The practice: Firm provides transport.

Procedure 9*: Have the health officer inspect the premises and obtain his signature

Time to complete: 2 day, included in procedure 7
Cost to complete: transport cost, trivial

The practice: Firm provides transport.

Procedure 10: Apply for VAT certificate with the Tanzania Revenue Authority
The practice: VAT registration takes 3-5 days if the intended company will have a threshold income of T.Shs.20 million. The procedure takes from 3 to 5 days

Procedure 11*: VAT/stamp duty inspection

Time to complete: 1 day, included in procedure 10
Cost to complete: no charge

The practice: Manufacturing firms can apply to the Commissioner for VAT for exemption of VAT on Capital Goods by filing in Form 225. The VAT registration and inspection takes 4 days.

Where the business per annum turnover is less than $20,000 the business has to register under stamp duty instead of VAT. The composition number gives the right to pay a lower stamp duty than otherwise (this explain the inspection).

Procedure 12: Register for the workmen's compensation insurance at the National Insurance Corporation or other alternative insurance policy

Time to complete: 1 day
Cost to complete: no charge

The practice: The employers may opt to take a policy of insurance in place of the workmen compensation claims. The insurance business is liberalised in Tanzania. To register for the workmen's compensation insurance, employers are required to fill out the "Workmen's Compensation Tariff Proposal Form". This form should be completed once the firm begins hiring employees and just before the firm becomes operational.

Procedure 13: Obtain registration number at the National Social Security Fund (NSSF)

Time to complete: 7 days
Cost to complete: no charge

The practice: It takes 1 week to obtain the registration number.
Note: Procedures sometimes take place simultaneously. Instances of this are marked with an asterisk (*).
5.3.3. Reasons for Informal Sector to Escape Registration in Tanzania

Above are many, generic and complex steps or and requirements and registration procedures in Tanzania. SMEs may found them impractical and unnecessary for private sector business operations and developments. We noted in Chapter Three that the government has made concerted efforts to have policies, laws and regulations and put in place an adequate institutional framework to support development of private sector business entities. Despite all government efforts, there are number of businesses which are not registered or captured in the government systems. Table 5.3 presents reasons for informal sector to escape registration in Tanzania. The three main reasons include [1] lack of knowledge and education (taxpayer, registration, business management practices) {about 36.2 percent}, [2] lack of proper business premises (unrestricted premises) about {28.4 percent and [3] cumbersome procedure, bureaucracy and corruption, {about 16.4 percent}. Table 5.3 and Table 5.5 suggest that avoiding tax payment, high taxes, levies, running from government are not major reasons for informal sector to escape registering their business operations.

5.4. General Problems Affecting Business Operations by Business Registration Status

Table 5.3 present general problems affecting business operations by business registration status. There are many and complex problems or constraints affecting performances of small and medium scale businesses in Tanzania. The survey found that the problems related with unfaithful and unreliable customers are most constraints accounting for about 29.7 percent. Other problems include lack of capital and unreliable power supplies. High tax rates are also considered as problematic and in particular for registered business activities.

Table 5.3 suggests that the decision to operate outside the formal economy can be motivated by manifold reasons and is not always linked primarily to taxation. However, the majority of other empirical studies on the growth of the informal economy conclude that tax and social security contributions are key factors discouraging MSEs to operate in the formal sector (Schneider/Klinglmair). This is equally true for developing and developed countries. Among OECD countries, Schneider (2007) found that the direct tax burden in Austria (including social security payments) has the biggest influence on taxpayers’ behaviour, followed by the intensity of regulation and the complexity of the tax system (OECD 2000).

Table 5.3 Reasons for Informal Sector to Escape Registration in Tanzania

<table>
<thead>
<tr>
<th>Reasons for not wanting to register</th>
<th>Operators</th>
<th>Percent</th>
</tr>
</thead>
</table>

102
Lack of knowledge and education (taxpayer, registration, business management practices) | 208 | 36.2%
Lack of benefits of registering business (financial, security, assistant from government) | 34 | 5.9%
Cumbersome procedure, bureaucracy and corruption | 94 | 16.4%
High cost of registration | 24 | 4.2%
Unaware of registration authorities and procedures | 14 | 2.4%
Small capital, turnover, immature business, economic hardship | 5 | 0.9%
Lack of proper business premises (unrestricted premises) | 163 | 28.4%
Avoiding tax payment, high taxes, levies, running from government | 3 | 0.5%
Nature of business (seasonal, unpredictable, restricted) | 29 | 5.1%
Total | 574 | 100.0%

Source: TRA Informal Sector Study Data, 2010

In the Scandinavian countries, the average direct tax rate, the average total tax rate, and the marginal tax rates are key factors in the decision to work in the informal economy Schneider, (1986). Looking at developing and transition countries, Schneider and Torgler found that tax morale plays a significant role in determining the size of the shadow economy Schneider (2007). Schneider and Hametner (2007) found unemployment and taxation to be the main factors driving the shadow economy in Columbia. Nashchekina and Timoshenkov (2005) identify taxation as the main barrier to business development in Ukraine.

Table 5.4: General Problems Affecting Business Operations by Business Registration Status

<table>
<thead>
<tr>
<th>General problems affecting business operations</th>
<th>Business/activity registered?</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Lack of permanent business centers</td>
<td>13</td>
<td>18</td>
</tr>
<tr>
<td>Unfaithful and Unreliable customers</td>
<td>89</td>
<td>86</td>
</tr>
<tr>
<td>Robbery</td>
<td>13</td>
<td>7</td>
</tr>
<tr>
<td>Poor business education</td>
<td>9</td>
<td>5</td>
</tr>
<tr>
<td>Counterfeit products</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>Lack of advanced machines</td>
<td>0</td>
<td>2</td>
</tr>
<tr>
<td>Inflation</td>
<td>20</td>
<td>7</td>
</tr>
<tr>
<td>High interest rates on loans</td>
<td>14</td>
<td>6</td>
</tr>
<tr>
<td>High tax rates</td>
<td>27</td>
<td>3</td>
</tr>
<tr>
<td>Corruption</td>
<td>5</td>
<td>1</td>
</tr>
<tr>
<td>Poor technology</td>
<td>7</td>
<td>6</td>
</tr>
<tr>
<td>Problem</td>
<td>No.</td>
<td>%</td>
</tr>
<tr>
<td>-------------------------------</td>
<td>-----</td>
<td>-------</td>
</tr>
<tr>
<td>Unreliable power supply</td>
<td>34</td>
<td>9.8%</td>
</tr>
<tr>
<td>Business competition</td>
<td>10</td>
<td>2.9%</td>
</tr>
<tr>
<td>Lack of enough capital</td>
<td>31</td>
<td>9.0%</td>
</tr>
<tr>
<td>High operation cost</td>
<td>9</td>
<td>2.6%</td>
</tr>
<tr>
<td>No problem</td>
<td>33</td>
<td>9.5%</td>
</tr>
<tr>
<td>Unreliable raw materials</td>
<td>17</td>
<td>4.9%</td>
</tr>
<tr>
<td>Poor quality of some products</td>
<td>1</td>
<td>0.3%</td>
</tr>
<tr>
<td>Total</td>
<td>346</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

Source: TRA Informal Sector Study 2010

According to the World Bank/PricewaterhouseCoopers (PWC) global report on Paying Taxes companies in 90% of surveyed countries rank the tax system among the top five obstacles to doing business. The main reasons for business problems with the tax system are: (i) the large number of business taxes to pay; (ii) lengthy and complex administrative procedures, (iii) complex tax legislation; and (iv) high tax rates. Consequently, the report finds a direct relationship between burdensome taxation and the level of informality.

Country-specific surveys in South Africa highlight that paying taxes, bureaucratic procedures attached to formalization, and government levies are among the main reasons for operating in the informal economy (OECD, 2004). In Kenya, research in rural villages showed that villagers identified taxation as one of the most important barriers to achieving a satisfactory living (Freeman/Ellis/Allison, 2003).

In Pakistan, 67% of small businesses list tax regulations as most problematic, while 28% of SMEs felt that taxes in the country are too high (World Bank/ DFID, 2007). In Bulgaria, small businesses consider the tax burden to be the most significant barrier for their investment (Ahmet Salik Ikiz, 2002). In Ukraine, a survey showed that out of the four key problems hindering entrepreneurship, three were related to taxation: high tax rates; many different taxes; and frequently changing tax reporting (IFC, 2002).

5.5. Informal Sector Perception on the Tax System

Perception is the process of attaining awareness or understanding of sensory information. The word "perception" comes from the Latin words *perceptio, percipio,* and means "receiving, collecting, and action of taking possession, apprehension with the mind or sense. What one perceives is a result of interplays between past experiences, knowledge, information including one’s social, political and culture, and the
interpretation of the perceived ideas. Summation of many stakeholders’ perceptions may reflect a reality.

Table 5.5 presents informal sector perception on the tax system by the surveyed informal sector firms in Tanzania, 2010. Different firms have different perception on the Tanzanian tax system. About 24.2 percent perceived Tanzania tax system as normal and therefore is good for civilized society. However, the majority of these TRA’s stakeholders had negative perception on the Tanzanian tax system.

The current TRA survey 2010 indicates that about 30.4 percent of the interviewed firms perceived that they don’t know tax system. These are either not aware or are not concerned with taxation system. These lack adequate information and knowledge about taxation system. Just as one object can give rise to multiple precepts, so an object may fail to give rise to any percept at all: if the percept has no grounding in a person's experience, the person may literally not perceive it. About a third, about 28.1 percent perceived that tax rates are high and about 4.1 percent perceived that the tax system is poor. The survey’s findings confirm that the informal sector in Tanzania is still operating in a dark, complex and bureaucratic environment that disadvantage the sector from development. The informal sector firms are the majority tax payers with very little contributions to the total tax revenue and therefore play a very strategic position in the search for enhancing revenue collection process. Their perceptions on tax system may help TRA to understand the complexity of tax system and the need to take measures to correct noted anomalies. The objectives of this section had been to investigate the suggestions of tax consultants for simplifying the complex tax procedure.

It was also found that some of the respondents were not satisfied with important issues like tax rates, tax administration (e.g., TIN, registration) and information systems.

<table>
<thead>
<tr>
<th>Attributes</th>
<th>Operators</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bureaucracy in registration of the business</td>
<td>20</td>
<td>3.8</td>
</tr>
<tr>
<td>High tax rates</td>
<td>151</td>
<td>28.1</td>
</tr>
<tr>
<td>Don’t know about tax system</td>
<td>163</td>
<td>30.4</td>
</tr>
<tr>
<td>Poor tax system</td>
<td>22</td>
<td>4.1</td>
</tr>
<tr>
<td>Tax system is normal</td>
<td>140</td>
<td>24.2</td>
</tr>
<tr>
<td>No follow up to the customers</td>
<td>21</td>
<td>3.9</td>
</tr>
<tr>
<td>Lack of tax education</td>
<td>20</td>
<td>3.7</td>
</tr>
<tr>
<td>Need for tax exemption in provision of basic goods</td>
<td>1</td>
<td>0.2</td>
</tr>
</tbody>
</table>
No transparency in tax system  |  6  |  1.1  
Delay in the provision of TIN to the customers |  3  |  0.6  
**Total** | **537** | **100**  

**Source:** TRA Informal Sector Study Data, 2010

In this area of public service the incentives to engage in corrupt behaviour are high for both officials, who can enrich themselves, and bribe payers, who evade taxes. At the same time, taxation regulations are often so complex, that opportunities for corruption abound. The complicated regulations create opportunities for public officials to exercise discretionary powers, thus giving a push to corruption, (Odd-Helge Fjeldstad, 2003). Indeed, reduction of opportunities for corruption in tax administration and the change of the incentive structures for tax officers while keeping tax policies simple is one of the most important entry points for curbing corruption in revenue administration.

On a general note, a distinction is worth keeping in mind between the public officials being collusive (colluding with non-payers) and abusive (extorting from the compliant tax payers) when discussing the issue of corruption in the tax field. Few indicators can be used to determine the probability of corruption in the current tax administration. These include indicators related to the institutional context. Consultations suggests that the institutional features, high tax rates red tape and inadequate enforcement of regulations are, if not indicative of corruption, definitely a factor that increases the likelihood of corruption in the tax system.

Our consultations suggest that in a highly corrupt environment such in Tanzania, tax evasion is more likely to occur than in a regulated environment with generally functioning institutions. While tax evasion is, by itself, not necessarily linked to corrupt activities, it can, nevertheless, create the opportunity for illicit deals when it is detected. An assumption of a connection between perceived corruptibility of public officials and the underreporting of income by small and medium scale operators can thus be made.

Along the same lines, corruption (and certainly inefficiency) in tax administration can - but does not have to - be suspected if there is an unexplained discrepancy in the ratio between the estimated amount of cash in circulation and the actual tax revenue. The lack of effective access to information provisions (which would ensure taxpayers are aware of their rights and less exposed to discretionary treatment by corrupt officials) and the absence of credible review mechanisms increase the risk of corrupt dealings." Personal contact between tax officials and tax payers, and discretion in the interpretation of unclear regulations, are conducive to illicit practices and thus lower government tax revenue, (Odd-Helge Fjeldstad, 2003).
Finally, the perception of the corruption of tax officials among members of the public is certainly suggestive of corruption actually taking place.

5.6. Reason for Not Paying Taxes (Tax avoidance and evasion)

Data suggests that very few people pay taxes, i.e., less than 2 percent of total population. This may suggest that Tanzania is facing different forms of taxation problems related with tax avoidance and evasion. Tax avoidance is the legal utilization of the tax regime to one’s own advantage, to reduce the amount of tax that is payable by means that are within the law. This may be based on policy framework were there efforts to provide tax exemptions to micro and small scale business entities.

Table 5.6 presents reasons for not paying taxes as perceived by small and medium scale business entities. There are many interrelated factors. Table 5.6 shows that about 60.4 percent don not pay tax because of small capital, turnover and profit generated from their operations. In simple terms, these argue that, they are too poor to pay taxes. These are classical reasons for most tax evaders. Tax evasion is the general term for efforts not to pay taxes by illegal means. Not paying taxes legally is one of the best ways to increase business net worth faster and keep more of the wealth for the purpose of further investments and thus increased production and income. It helps micro and small businesses to survive and grow and get ahead in life significantly. Many think about what you can do with all that tax money they currently pay and misused by the government through increased parasitic public consumptions.

It must be noted that tax evasion is the general term for efforts by individuals, firm’s, trusts and other entities inside and outside the tax network to evade taxes by illegal means. Tax evasion usually entails taxpayers deliberately misrepresenting or concealing the true state of their business operations and affairs to the tax authorities to reduce their tax liability, and includes, in particular, dishonest tax reporting (such as declaring less income, profits or gains than actually earned; or overstating deductions.

<table>
<thead>
<tr>
<th>Table 5.6: Reason for Not Paying Taxes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reasons for Not Paying Taxes</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Lack of information, knowledge, education taxes payment</td>
</tr>
<tr>
<td>Paying to other institutions/ authorities (VETA,TFDA,...)</td>
</tr>
</tbody>
</table>
Table 5.6 shows that about 6 percent do not to pay tax because of lack of information, knowledge and tax education. Some of those attempting not to pay tax believe that they have discovered interpretations of the law that show that they are not subject to being taxed: these individuals and groups are sometimes called tax protesters. An unsuccessful tax protestor has been attempting openly to evade tax, while a successful one avoids tax.

There are those who do not pay tax because of other social political reasons such as lack of understanding the use of government revenues. These are tax resisters. Tax resistance is the declared refusal to pay a tax for conscientious reasons (because the resister does not want to support the government or some of its activities). Tax resisters typically do not take the position that the tax laws are themselves illegal or do not apply to them (as tax protesters do) and they are more concerned with not paying for particular government policies that they oppose.

### 5.7. General Problems Affecting Business Operations by Tax Payment Status

Table 5.7 presents many and complex general problems, constraints and limitations affecting business operations by tax payment status as perceived by surveyed small and medium scale firms in year 2010. These affect both those in the tax net and those outside the tax system.
5.7.1. Lack of Effective Market Demand

In general, small and medium scale firms perceived that problems related to unfaithful and unreliable customers, i.e., product market demand constraints, are first and foremost constraints affecting their business performance in year 2010. About 36 percent of firms outside the tax net complained on behaviour of their customers. In economics terms, this problem can be interpreted as lack of effective market demand or insufficient demand.

Insufficient demand may be a reflection of an imperfect competitive market system, which affects behaviour, lifestyle and standard of living of Tanzanians. Unfair competition from illegal imports (do not pass through official channels and thus do not pay taxes) has been and still is problematic, especially among medium and large-scale firms. On the other hand, increased domestic competition as subjectively perceived by the small and medium scale firms is no surprise: it barely reflects the fact that, in effect, propelled by increased liberalization and private sector participation, the output markets have become increasingly competitive, which many import substitution firms were not well prepared for.

5.7.2. Lack of Finance Capital, Inflation and High Interest Rates

The second major problem is related with lack of finance. Many small and medium scale firms in Tanzania have very limited access to formal long-term credit due to weak and non-competitive financial system. The financial system is very costly (in terms of high interest rates), too complex and has a lengthy loan application process and too short maturity for the specific case of bank loans. Table 5.6 suggests that difficulty to access credit and its immediate consequences on the working capital as the most problematic constraints affecting performance of informal sector firms in Tanzania. An average of 14.4 per cent of sample small and medium scale business entities argued that lack of capital or inadequate working capital and about 6.3 percent accounted for inflation, high interest on loans.

However, it is important to note that the credit access situation in the year 2010 is much better than in the last ten years, i.e., in 2000. The improvement is due to increased liberalization, globalization, sector reforms, and private sector participation in the financial sector. The new private financial banks are willingly to offer short-term credit at a significant cost. Due to the general credit limitations in the financial institutions, especially the banking sector, manufacturing firms face problems of inadequate investment and working capital.

Table 5.7: General Problems Affecting Business Operations by tax Payment Status

109
### General problems affecting business operations

<table>
<thead>
<tr>
<th>General problems affecting business operations</th>
<th>Paying any taxes?</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Yes</td>
</tr>
<tr>
<td></td>
<td>Number</td>
</tr>
<tr>
<td>Lack of permanent business centers</td>
<td>15</td>
</tr>
<tr>
<td>Unfaithful and unreliable customers</td>
<td>90</td>
</tr>
<tr>
<td>Robbery</td>
<td>16</td>
</tr>
<tr>
<td>Poor business education</td>
<td>10</td>
</tr>
<tr>
<td>Counterfeit products</td>
<td>3</td>
</tr>
<tr>
<td>Inflation, high interest rates on loans</td>
<td>32</td>
</tr>
<tr>
<td>High tax rates</td>
<td>28</td>
</tr>
<tr>
<td>Corruption</td>
<td>5</td>
</tr>
<tr>
<td>Poor technology</td>
<td>7</td>
</tr>
<tr>
<td>Unreliable power supply and poor infrastructure</td>
<td>43</td>
</tr>
<tr>
<td>Business competition</td>
<td>10</td>
</tr>
<tr>
<td>Lack of enough capital</td>
<td>34</td>
</tr>
<tr>
<td>High operation cost</td>
<td>9</td>
</tr>
<tr>
<td>Other problems</td>
<td>34</td>
</tr>
<tr>
<td>Unreliable raw materials</td>
<td>17</td>
</tr>
<tr>
<td>Poor quality of some products</td>
<td>1</td>
</tr>
<tr>
<td>Total</td>
<td>354</td>
</tr>
</tbody>
</table>

Source: TRA Informal Sector Study Data, 2010

In the absence of substitute informal domestic credit sources, many small and medium scale firms are severely constrained in their ability to invest in new equipment or machinery, and retained earnings or the entrepreneur's savings thus remain basically the only solution to finance such investments. As to the consequences of lack of short-term credit, given that Tanzanian firms have no excess to long-term financing, and given that most firms are net providers of trade credit, limited access to short-term external finance may result to inadequate working capital, which itself has several possible consequences. It hinders potential firm efforts aimed at increasing productivity or competitiveness by preventing firms from having the necessary financial resources to acquire technological innovation, training of their personnel. Poor access and lack of working capital often results also in liquidity problems that, in many cases, they may lead to exit and or deter potential entry.

The persistent capital related constraints may indicate either macro-economic reforms are incomplete or and that there are high credit risks and uncertainties in lending to the small and medium scale firms in Tanzania.
5.7.3. Unreliable Power Supply and Poor Infrastructure

Poor Economic Infrastructure

The third most constraints are related to unreliable power supplies and poor infrastructure. About 8.5 percent of the firms identified economic infrastructure to include, among others; poor roads and networks, inefficient and inadequate communication networks, inadequate and unreliable power and water supplies, lack of waste disposal facilities, and bottlenecks in trade facilitation services. These are mostly considered as external problems to the private sector firms sector and reflect the government's inability to provide adequate and reliable infrastructure facilities. Several studies and our consultations suggest that infrastructure is one of most constraining factor affecting performance of the micro, small and medium scale firms in Tanzania. However, it is important to note that there are significant improvements in telecommunication sector where increased participation of private mobile companies, television stations, radio broadcasting and ICT related service providers have increased quality and reduce cost of communication services in Tanzania.

The Provision of Electricity

One of the infrastructure problems is related to the provision of electricity. This is in terms of its costs, supplied quantity and quality. Electricity demand in the manufacturing sector is constantly growing and in higher than existing generating capacities in the entire country. TANESCO is the major producer and distributor of this power but is still in financial and management distresses due to a number of factors including long delays in its electricity billings and customers’ non-payment for power consumed. Frequent power cuts by TANESCO, interrupts the manufacturing process. Some of large scale and power intensity factories have put up own power generators. However, many micro, small and medium scale firms are unable to establish sufficient power generation facilities. At the national level, the energy costs have scared potential foreign investment, and intensified the existing problems related to capacity utilization.

Road Transport

The lack of infrastructure affects the input and output market and distribution networks due to poor state of the road network/feeder roads into the regions and rural areas where a large population resides. Transport costs in Tanzania are rather high in the entire Sub-Saharan Africa. The high road transport costs may in the short-run provide natural protection for domestic firms and inhibit specialization of urban-based firms to serve a wider market beyond district, regional and national boundaries. In addition to
the freight forwarders’ costs, many firms have to pay road maintenance levies and transit charges for cross-border transports.

Chapter Six: Proposed Simple Presumptive Income Tax

Chapter Six proposes a simplified presumptive income tax structure in Tanzania that will promote an enabling and supportive environment to the development and taxation of the informal sector. In specific the chapter will [1] propose new institutional setup and devise best approach to tax the informal sector with win-win solution, [2] devise the Presumptive Tax Structure that will assist in formalizing the informal sector and [3] review and propose viable Presumptive Tax Structure to Tanzania. The Chapter will also assess the efficacy, gains and relevance of inclusion of taxpayers with turnover exceeding shillings twenty million but not qualified for VAT registration threshold within the presumptive income tax scheme. Sections 6.1 to 6.3 present the current policy, legal, regulatory and institutional setup for the proposed simple presumptive income tax system that will devise best approach to tax the informal sector with win-win solution. Section 6.4 devises the presumptive tax structure that will assist in formalizing the informal sector.

6.1. Theoretical and Policy Framework

6.1.1. Theoretical Framework

The literature reviews suggest that presumptive techniques may be employed for a variety of tax policy objectives, (Victor Thuronyi, 1996 and FIAS, 2006). The first is about simplification, particularly in relation to the compliance burden on small scale taxpayers with very low turnover (and the corresponding administrative burden of evaluating, monitoring behaviour of such semi-informal taxpayers). The second is to combat tax avoidance or evasion (which works only if the indicators on which the presumption is based are more difficult to hide than those forming the basis for accounting records). Third, by providing objective indicators for tax assessment, presumptive methods may lead to a more equitable distribution of the tax burden, when normal accounts-based methods are unreliable because of problems of taxpayer compliance or administrative corruption. Fourth, rebuttable presumptions can encourage taxpayers to keep proper accounts, because they subject taxpayers to a possibly higher tax burden in the absence of such accounts. Fifth, presumptions of the exclusive type (see below) can be considered desirable because of their incentive effects—a taxpayer who earns more income will not have to pay more tax. Sixth and finally, presumptions that serve as minimum taxes may be justified by a combination of reasons (revenue need, fairness concerns, and political or technical difficulty
Chapters Three and Four noted that SMEs need “enabling regulatory frameworks, which are developed taking into account the needs of SMEs and facilitating their integration into the formal sector.” This requires in particular tax systems that entail low compliance costs. Above policy considerations suggest the importance of “fostering the implementation of transparent, stable, and non-discriminatory tax regime. Chapter Three noted the importance of improving and simplifying the business environment for business start-up. The chapter found that a difficult or complex regulatory environment can discourage entrepreneurship and the creation of new businesses.

This chapter proposes to apply “the ‘Think Small First’ concept, which takes account the interests of SMEs at the earliest stage of considering new legislation and its accompanying procedures. This includes in particular where appropriate, introduction of derogations, thresholds, or simplified procedures benefiting SMEs;

6.1.2. The General Policy Objective

Based on the general business environment, the benefits and general policy objectives of proposed Presumptive Income Tax systems are to reward success, encourage start-ups and formalization, i.e., transformation, facilitation, promotion and development of sustainable small and medium scale businesses, income and job creation social economic activities and reduction of poverty in Tanzania, (Victor Thuronyi, 1996 and FIAS, 2006).

6.1.3. The Specific Strategic Objectives

The proposed interventions will benefit TRA administration through different ways. In specific, the proposed interventions will enhance good tax practice in reducing regulatory and administrative barriers to formalization. The specific strategic benefits and objectives include;

- Simplify tax administration. Tax administration is more often cited as a problem than tax rates. Consider single taxes for semi-informal MSEs as a way of reducing the number of payments.
- Offer different payment options that including either or one-off or by instalment.
- Avoid retroactive taxation for businesses that formalize: enterprises will be reluctant to formalize if they fear a large tax bill.
- Share information with other government ministries, departments and agencies on businesses activities, developments, what taxes are used for, and how businesses will benefit from enhanced services. Evidence suggests that compliance rates go up when businesses are know what they are getting in return for their investments and payments.
Above suggests that purpose of the introduction of the proposed presumptive income tax structure is among others to simplify tax administration of the small and medium scale enterprises that are largely outside the formal tax bracket, (Victor Thuronyi, 1996 and FIAS, 2006). As it has been observed in this study many micro, small and medium scale taxpayers do not maintain records of accounts and most of them rely on unpaid labour services. This study proposes some measures that could make the system ease and simple as compared to the existing one of using bands.

The proposed areas to improve the tax structure of presumptive scheme include the shift from using many tax bands to the flat rate and introduction of the exemption of a certain amount in the presumptive scheme. Thus, government tax policies toward semi-informal SME sectors need not to focus initially on stringent application of the law or rapidly increasing revenue, since these are not realistic short-term goals.

In the long term, however, effective SME’s/informal sector programs can stabilize, transform or even raise revenue and reduce the risk of general noncompliance — especially if they focus on sustainable small and medium scale entities. Also, since semi informal SME’ sector routinely preoccupy tax agencies, the need to improve institutional reform coordination and management programs can enhance efficiency by reducing compliance and administration costs for the many offices that deal almost exclusively with this type of taxpayer. Those joint institutional programs can also make the tax system fairer, particularly among similar groups of small and medium scale taxpayers.

6.2. Legal Framework

The proposed simple presumptive income taxation system will be based on the Income Tax Act, CAP 162 which was introduced in Tanzania and put into use in January 2001. There will be a need to review, refine and make amendments on the First Schedule of the Income Tax Act of 2004 (and amendments done in 2006). There will be a need to redefine and propose new content and structure of Presumptive Income Tax in Tanzania. Section 1 has to be redefined to introduce new proposed tax rates to be charged to individual resident and non-resident. Section 2 needs to be redefined to introduce new proposed presumptive income tax based on turnover which flexible, dynamic and reflect changes in inflation, foreign exchange rate, regional integration and globalization competitiveness.

6.3. Institutional Framework

6.3.1. Adopting the Block Tax Management System (BTMS)

The administration of the proposed presumptive income tax functional activities and issues will continue to be under the TRA, Department of Domestic Revenue. Regional
and district tax offices monitor compliance of small and medium scale operators and taxpayers through a geographically based block management system, (BMS). Under this BMS, business areas are divided into ‘geographical blocks’. Block management teams carry out the functions of registering, assessing, collecting and accounting for tax revenue collected.

The ‘block management system’ attempts to deal with the poor compliance culture amongst small businesses. However, the direct and frequent interaction between tax officials and taxpayers raises risks of abuse of the system. Clear separation of tax assessment and collection functions by officials could help reduce some of these risks. Another approach is to introduce effective joint or collaborative monitoring and evaluation institutional framework. This approach should be appropriately balanced with measures to encourage efficiency, voluntary compliance through systematic education and outreach programs.

In order to have the taxpayers in the tax net, expand the tax base and optimize tax revenue collection, Tanzania Revenue Authority (TRA) has to perfect and operationalize the BMS. The operationalization of BMS entails optimal use of internal organization systems and capacities and working in collaboration with other government ministries, departments and agencies. In specific, TRA has to work hand and hand with local government authorities at regional, district, ward, village and street levels. The most relevant grass root government ministries, departments and agencies include Ministry of Trade, Industry and Marketing, Local Government Authority and Tanzania Police Force.

### 6.3.2. New Forms of Business Registration and Formalization Systems

TRA has to learn and design new institutional framework for management, coordination and operationalization of BMS in collaboration with these other government ministries, departments and agencies. The basic objective of the newly institutional framework for BMS is to formalize, i.e., to promote compliance and register all eligible traders within a particular business, sectoral or geographical area, capturing their correct level of economic activities and gathering valuable tax information, (Victor Thuronyi, 1996 and FIAS, 2006). Table 6.1 presents proposed institutional framework for business registration and formalization systems in Tanzania. BMS is taken as both as a means and end to formalization. Table 6.1 shows four levels, categories or and types of formalization. These business formalization types are determined by laws, regulations and institutions that facilitate, support and promote business environment in Tanzania. Let us define terms in this proposal.

**Levels, Categories or and Types of Formalization**
Let use Table 6.1 and define informal or extralegal as an economic activity that takes place outside the law (i.e., outside the F1. – F4 and or is limited or handicapped by the law, and to economic agents or business and real estate assets that are missing fundamental legal and economic mechanisms that not only empower all economic agents, small as well as big, but are indispensable for the creation of wealth, the elimination of poverty, and the foundation of an inclusive, modern economy. Informal sector or extralegal entrepreneurs do not have easy access to contracting mechanisms and the standard forms of business organization (i.e., sole proprietorships, partnerships, joint stock companies with limited liability, corporations) that provide legal entrepreneurs with the tools needed to create the kind of internal governance that will divide labour productively within each enterprise and protect the rights of workers, management, and creditors in the event that the owners sell the business, go bankrupt or die.

**Table 6.1: Business Registration and Formalization Systems**

<table>
<thead>
<tr>
<th>Nr</th>
<th>Name of Institution</th>
<th>Core Function</th>
<th>Collaborating Functions</th>
<th>Formalization Activities</th>
</tr>
</thead>
<tbody>
<tr>
<td>F.1</td>
<td>Local Government Authority at Village /Street Level</td>
<td>See the Acts</td>
<td>CF1: Collect, organize, maintain data and information of all business entities in their localities for the purpose of licensing, policy, planning and budgeting development projects and programmes</td>
<td>FA1: License and register them and use standard LGA codes/numbers. Include TIN and other official identification number</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>F.2</td>
<td>Tanzania Police Force at District, Ward and Village levels, (e.g., Polisi Kata)</td>
<td>See the Acts and PGO’s</td>
<td>CF2: As part of Community Policing, the TPF at Ward Level to collect, organize; maintain data and information of all business entities in their localities for the purpose of provision of public safety and security services.</td>
<td>FA2: Register them and use standard Police Identification codes/numbers. Include TIN, LGA numbers and other official identification number</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>F.3</td>
<td>TRA-DRD at District, Ward and Village levels,</td>
<td>Income Tax Act 2004 - 2006</td>
<td>CF3: As part of Block Management System, the DRD at District, Ward and Block Levels to collect, organize; maintain data and information of all business entities in their localities for the purpose of presumptive income tax.</td>
<td>FA3: Register them and use standard TRA Identification codes/numbers. Include TPF-Number LGA numbers and other official identification number</td>
</tr>
</tbody>
</table>
As a result, extralegal enterprises cannot entice the best technicians, financial and professional managers to join the enterprise and assist in breaking down production functions so as to raise the productivity of each worker. They are also unable to contract for and adopt the best and most appropriate technology, inputs and financial resources for their production or business lines. Nor can they assure that the business assets are clearly differentiated from those of the owner, and, therefore, more attractive to investors and creditors.

We will define semi-informal as a business entity or activity carried on by an operator who appears on a local licensed enterprise authority (F1 and F2) list of licensed operators of enterprises but is not registered with either or TRA and BRELA. For example, two forms exist in at street, village and ward levels in Tanzania: The first cases are hawkers’ licences or any form of local government business licence. The second cases are those entities registered under F1 and F2 and also are in the presumptive income tax system under TRA.

Any business entity irrespective of type, scale of business operation and fulfil all F1- F4 business obligation and requirements is highly formal business entity. In most cases, these are medium and large scale business operators and belong into full fledged TRA taxation system. It must not be allowed to be under the presumptive income tax system. A highly formalized position, under F1-F4, is one in which an operator has established, operated and developed an enterprise as a separate legal entity from him or herself, governed by internal rules and systems, complying with market rules and practices and those of the formal business community, benefiting from the legitimacy and rights of legal status, complying with the terms of the formalization transaction, including regulations protecting employees, consumers, the environment and contractual parties.

**Formalization Processes**
Informal, semi-formal and formal status under as articulated in Table 6.1 provides a basis for an unambiguous typology of enterprises and a ‘de jure’ process of formalization proceeding in two main steps, i.e., [1] from informal to semi-formal and then [2] to full formal status. Additional steps are possible within both semi-formal and formal status bands. Each step takes the form of a bureaucratic event that changes the legal status of an enterprise. To each level of legal status there is attached a different package of obligations designed to protect consumers, employees and the environment, and to raise public revenue. The burden of institutional reforms and obligations become heavier with higher institutional legal status (F4).

A second formalization progression can be observed as a continuum comprising many progressive acts of compliance with obligations to proposed institutional framework for coordination and management and operation of the presumptive income tax and with the norms of doing business in the formal sector; the term used for this being ‘de facto’ formalization.

Whereas de jure formalization is a change of institutional legal form, de facto formalization frequently represents a change of substance concerning behaviour and business systems. De jure graduation and the de facto continuum can be separate or parallel progressions.

**Formalization Mechanisms**

De jure change to a higher legal form is an acceptance of proposed institutional framework offer of formalization, implying an agreement of terms between the two parties (business operator and local and central government institutions), in which the operator gains recognition, the right to operate freely and property rights in exchange for the payment of taxes and submission to government regulation.

This perception of formalization as an exchange transaction places it within the context of the theory of new institutional economics and raises to prominence the issue of the transaction costs, incentives and benefits. With co-operation and efficient coordination of their actions, the parties to a transaction can in principle maximize the aggregate benefits they realize from it (a win–win outcome). Conversely, by competing to maximize their self-interests, it is possible that they would minimize their aggregate benefits.
In this respect, formalization can be regarded as a measure of the quality of enterprises in an economy. Both the growth and quality of a formal small-scale enterprise sector in a developing economy is determined by whether or not enterprises can meet, first, the cost of pre-conditions of entry to the de jure process of formalization and second, the cost of de facto compliance with subsequent obligations.

**Collaborating functions and formalization activities**

Table 6.1 lists main collaborating institutions, functions and formalization activities for respective institutions, laws and regulations. The collection, organization, maintenance and sharing of data and information are major collaborating functional activities needed in presumptive income tax system. Government sets the terms of a formalization systems and transactions. Terms stipulated under F.3 and F.4 are too costly obstruct the entry of small-scale enterprises to the first step in the formalization process and render other government initiatives to facilitate the process redundant (such as access to business development services). Enterprises that do enter the process and find it too costly respond by adopting evasion tactics that place them outside of the law again.

Formalization is the abandonment of that position through a change of form and orientation during which an enterprise becomes established within a different framework of norms and rules of behaviour that raise transactional costs. Voluntary formalization is an exchange transaction between an operator and government in which the operator accepts the government offer of legal status with legitimacy and rights in exchange for an implied agreement to comply with government regulations. During the enactment of the transaction, an enterprise adapts to it new institutional position by adopting a coping strategy that offsets transactional costs against the benefit of improved business performance and/or by adopting cost-reduction or evasion tactics.

The proposed multi-institutional framework is to improve and assure quality of assessments, as well as monitoring closely their business activities, formalize and be able to fight tax evasion. This will also simplify registration of traders, brought non-filers and non-payers into the tax net through closer monitoring and collaboration with local government authorities. By reaching out to the unreached the BMS will collaborate with other institutions in widening the tax base for social and economic development of the country.

The set up of the BMS will consists of areas of trading concentrations to be mapped up in small segments, defined on the basis of geographical or administrative set up, or a combination of a few streets to form a block. Each Block is mandated to operate all the tax functions of registering, assessing, collecting and accounting for revenue collected.
Each Block is allocated staff to carry out those functions, subject to rotation, collaboration with other government institutions after a certain length of stay in one Block. To measure performance, each Block is allocated targets (including revenue collection targets) measured against set time frames and benchmarks. To enable smooth functioning, each Block has a leader who is answerable to an Assistant Manager and assisted by a number of subordinates.

There are compelling reasons for the small scale entrepreneurs and the government to join the tax net. On the small and medium scale enterprises side, participating in a tax regime brings a firm into the formal sector, and allows the firm to access formal credit markets, government procurement, and access to output markets including for export. On the government’s side, by encouraging firms fully enter the formal sector through registering for and paying taxes, government promotes a culture of well behaving business entities, legal compliance and sets the stage for the firm to grow and become a bigger taxpayer; additionally, firms in the formal sector are more likely to comply with all other regulations and official obligations than those in the informal sector.

Finally, there is extensive evidence that growth is severely hampered by the existence of an informal sector working in parallel with the formal sector. In addition, there are numerous risks associated with proposed institutional framework. These include [1] bureaucratic delays and corruptions and thus increased costs of doing businesses; [2] resistances from TRA’s staff due to increased transparency and involvement of other government systems in monitoring tax administration issue.

6.4. New Proposed Presumptive Income Taxation Structure

The above proposed institutional framework and the new First Schedule will define the new presumptive income tax structure consisting of the targeted taxable group, tax base and rate.

6.4.1. Tax Base and Target Group

The new proposed presumptive income tax system will specify the individual's income tax payable with respect to section 4(1) (a) for the year of income which shall be equal to the amount of presumptive income tax provided for in subparagraph (3): (a) the individual's income for a year of income consists exclusively of income from a business having a source in the United Republic; (b) the turnover of the business does not exceed the threshold in subparagraph (2); and (c) the individual does not elect to display this provision for the year of income.
6.4.2. Maximum Taxable Income

We noted in Chapter Four that the exit threshold for the presumptive regime of TSH 20 million is inconsistent with the VAT threshold of TSH 40 million. However, an exit threshold that is too high undermines the standard tax system and allows too many businesses to benefit from the special regime.

Any realignment of the thresholds must ensure that the rates applied to the TSH 20-40 million bands are not too low so as to make the special regime too attractive relative to the standard regime. One of the objectives of the proposed simplified presumptive income tax system is to give incentives to businesses to graduate to the standard regime over time (other measures can also encourage graduation). In addition, a voluntary opt-in to the standard regime should be encouraged, (Victor Thuronyi, 1996 and FIAS, 2006).

Table 6.2 presents proposed taxable income ranges / levels under the proposed simplified presumptive income tax system. The business turnover is the most widely used criteria to define and identify levels of scales of business operations. Turnover is a criteria used frequently in the tax system, and therefore a turnover-based MSE definition facilitates the coordination of the MSE tax regime with the standard tax regime. Table 6.2 shows three types or income levels to be identified and proposed.

The study proposes two maximum taxable income levels. The first level is the base case, which is Shillings 20,000,000. The second threshold income level is Shillings 50,000,000 (US$ 40,000 when Tshs 1250 per US$) as an alternative case and amount taking into account the reality on the ground. The proposed threshold referred to in subparagraph (1) (b) under the First Schedule will be pegged to take in account inflation, foreign exchange rate fluctuations, regional integration and global competitiveness. It is proposed that the VAT threshold should be adjusted to about TSH 50 million to provide consistent graduation.

Table 6.2: Taxable Income Ranges under Presumptive Income Tax System

<table>
<thead>
<tr>
<th>Nr</th>
<th>Base Case Scenario</th>
<th>Proposed Case</th>
<th>Tax Net Consideration</th>
</tr>
</thead>
<tbody>
<tr>
<td>G.1</td>
<td>Below Tshs 2,500,000</td>
<td>Below Tshs 6,000,000</td>
<td>Not Income Taxable Group</td>
</tr>
<tr>
<td>G.2</td>
<td>Tshs 2,500,000 - Tshs 20,000,000</td>
<td>Tshs 6,000,000 and 50,000,000</td>
<td>Presumptive Income Tax Net</td>
</tr>
<tr>
<td>G.3</td>
<td>Above Tshs 20,000,000</td>
<td>Above Tshs 50,000,000</td>
<td>Graduate to full TRA Income Tax</td>
</tr>
</tbody>
</table>
The threshold for the application of Presumptive Income Tax system can serve as one proxy for the definition of micro and small scale businesses for tax purposes. This threshold must vary considerably from time to time due to changes in social, political and economic conditions, inflation, globalization, and technological development. Table 6.2 shows three main income categories.

The first income group, G.1, are micro and small scale business entities in the informal sector / extralegal entrepreneurs with low income levels (i.e., below Tshs. 2,500,000 for base case and Tshs. 6,000,000 for proposed case) and are vulnerable taxpayers that should be exempted from most tax obligations. That is, Table 6.2 proposes to designate a zero rated band at the bottom end for small firms so as to harmonize with personal income tax, (FIAS, 2006).

The common organizational forms (sole proprietorships and informal partnerships) are usually controlled by owner-managers and a network of close family members, professional associates, friends, and employees. However, there are two risks associated with this. These are low voluntary tax compliance and risk of not keeping proper records or manipulating of the records kept. The current presumptive tax system addresses these risks. There is always a challenge in voluntary compliance and filing of returns is expected to be poor due to many reasons including low level of education, lack of knowledge and information on generic advantages in the formal sector. This will make it difficult to achieve the overall objective of the regime in enhancing tax compliance of the sector at minimal costs. There is also the risk of vendors who were initially maintaining books of accounts for tax purposes to stop doing so since they will now fall below the threshold. This will eventually lead to a huge number of them enjoying a lower tax obligation.

The second group, G.2, are small and medium scale business operators in the semi-informal sector and taxpayers that pay presumptive taxes in lieu of income and consumption taxes as per First Schedule. This group may contain medium and large scale business entities in the formal scale are capable but fail to comply with formal accounting rules and regulation defined in F.4 and for whom presumptive measures must be used primarily. That is, presumptive tax regimes should be limited to small businesses operated by individuals or incorporated firms could be subject to the standard taxation regime if feasible. However, caution must be taken since some MSMEs may tend to stagnate in the presumptive regime instead of graduating to the next regular regime, especially where tax liability is suspected to increase with graduation.
Table 6.2 proposes increase presumptive threshold from TSH 20 million to TSH 50 million to which will be harmonized with new VAT threshold at TSH 50 million. Allow opt-in to the standard corporate income tax regime for small businesses below the presumptive threshold, if they comply with record keeping and compliance obligations. Also, there is a need to allow easy opt-in for VAT registration, (Victor Thuronyi, 1996 and FIAS, 2006). Businesses should be able to opt into the VAT system without need for prior government approval for small businesses turnover below the registration threshold of TSH 40 million.

The third group G.3, are medium and large scale business entities in the highly formal business entity and are capable to comply with most formal accounting rules and business regulations defined under F.4 in Table 6.1 and for whom must graduate from paying presumptive income tax to full scale TRA income tax net as defined in the Act.

6.4.3. Introduction of Flat Tax Rate

It has been revealed above that the current tax administration on presumptive scheme has created a distortion effect among the taxpayer within the same band. Taxpayers whose turnover is the minimum in the bands suffer by paying high tax rates compared to taxpayers whose turnover is the maximum within the same band. In additional there is a substantial design challenge, however, when it comes to fixing the level of standard deduction from turnover/gross income, or the tax rate to be applied.

Table 6.3: The Current and Proposed New Presumptive Tax Rates

<table>
<thead>
<tr>
<th>ANNUAL TURNOVER</th>
<th>TAX PAYABLE WHERE SECTION 80 IS NOT COMPLIED WITH</th>
<th>TAX PAYABLE WHERE SECTION 80 IS COMPLIED WITH</th>
<th>Proposed Flat Tax Rate</th>
<th>Other East African Countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>Where turnover does not exceed TAS. 3,000,000.</td>
<td>TAS.35,000/=</td>
<td>1.1% of the annual turnover</td>
<td>4%</td>
<td>Kenya use 3%</td>
</tr>
<tr>
<td>Where turnover is between TAS.3,000,000 and TAS.7,000,000.</td>
<td>TAS.95,000/=</td>
<td>TAS.33,000/= plus 1.3% of the turnover in excess of TAS.3,000,000.</td>
<td>4%</td>
<td>Uganda use 1%</td>
</tr>
<tr>
<td>Where turnover is between TAS.7,000,000 and TAS.14,000,000.</td>
<td>TAS.291,000/=</td>
<td>TAS.85,000/= plus 2.5% of the turnover in excess of TAS.7,000,000.</td>
<td>4%</td>
<td></td>
</tr>
<tr>
<td>Where turnover is between TAS.14,000,000 and TAS.20,000,000.</td>
<td>TAS.520,000/=</td>
<td>TAS.260,000/= plus 3.3% of the turnover in excess of TAS.14,000,000./=</td>
<td>4%</td>
<td></td>
</tr>
</tbody>
</table>
Source: TRA- Domestic Revenue Department, Income Tax Act, (R.E 2009)

An implicit feature of turnover-based systems is that they may result in a comparatively high tax burden for businesses with a comparatively low profit margin, and a relatively low tax burden for SMEs with very high profit margins. On the one end of the spectrum such a situation forces SMEs to either opt out of the system or bear the substantially higher compliance costs of the standard tax system or to cease formal business activities. On the other end of the spectrum it creates incentives for businesses above the threshold to under-declare turnover or to split up in order to be able to move into the presumptive system, thus causing revenue losses for the government. In this case despite that the scheme has remained good in tax administration it has created unfair and unequal treatment among the taxpayers.

To avoid unfair/unequal treatment among the taxpayers this study proposes the use of flat rate instead of bands. The use of flat rate assumed to have a fair and equal treatment among the taxpayers and also expected to increase in compliance level as well as increase in revenue collection. Thus this study proposes the use of flat tax rate of 4.0 percent as a base case and flat rate of 3.0 as an alternative case in each shilling that exceeds threshold. These scenarios used to come up with this desired solution are simulated as presented here below.

6.5. Comparison with other East African Countries

Table 6.4 presents sample cases of presumptive income tax turnover and flat rates in the East African Countries 2010. All these countries use presumptive income tax system for the semi formal and formal SME sector. These countries use turnover. Kenya has the highest maximum threshold turnover at about US Dollar 62,500 and Tanzania has the lowest maximum turnover at about US Dollar 16,000. These large variations may be function of level of economic development, inflation, per capita incomes and taxation system. The applied flat income tax rates range between 1 as minimum and 4 as maximum.

Table 6.4 suggests that there is no ideal system threshold for the application of a presumptive regime that can be applied to all countries. The key design requirement is to avoid an overlap of the presumptive tax regime with the standard VAT. Harmonizing thresholds also requires using business turnover as the sole criteria to determine the threshold for the application of the presumptive system.
While other criteria, such as the number of business employees, patents, type of services, sometimes are used as additional system limitations, there is little value added in broadening the set of threshold criteria, and additional criteria risk negatively affecting business decisions. The desirability of coordination with the VAT threshold also argues for a uniform threshold for all small scale taxpayer categories in these East African countries. However, some EA countries operate lower VAT registration thresholds for businesses in the service sectors than for general traders. Such differentiation could also be applied to determine the presumptive tax threshold. A further threshold differentiation based on more specific MSME categories is not appropriate. A system threshold should apply to all MSME categories without any exception.

The system applied in some countries, where certain professions are taxed under a presumptive regime without any size limitation generally is not appropriate and impairs the fairness of the tax system.

Table 6.4: Presumptive Tax Turnover and Flat Rates in East African Countries 2010

<table>
<thead>
<tr>
<th>Nr</th>
<th>Name of the Country</th>
<th>Maximum Turnover</th>
<th>Flat Rate</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Kenya</td>
<td>US$ 62,500</td>
<td>3%</td>
<td>Highest Turnover</td>
</tr>
<tr>
<td>2</td>
<td>Rwanda</td>
<td>US$ 38,000</td>
<td>4%</td>
<td>Highest Tax Rate</td>
</tr>
<tr>
<td>3</td>
<td>Tanzania</td>
<td>US$ 16,000</td>
<td>1 – 3.5% /4</td>
<td>Lowest Turnover</td>
</tr>
<tr>
<td>4</td>
<td>Uganda</td>
<td>US$ 27,000</td>
<td>1%</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Average EA Countries</td>
<td>US$ 35,875</td>
<td>2.3% - 2.9%</td>
<td>Proposed Case</td>
</tr>
<tr>
<td>5</td>
<td>Zambia</td>
<td>US$ 51,000</td>
<td>3%</td>
<td>Above EA Countries</td>
</tr>
</tbody>
</table>

6.6. Analysis and Scenario of New Tax Structure

The analysis has shown that, most of these taxpayers do not maintain records of accounts and will not in the near future do so, rely on unpaid labour services, and some operate in their own premises for which they do not pay rent. Many are thus subsidized in their operations and also since there are not paying at the subsequent levels (there are not available to many other taxes i.e. consumption tax), we have considered to
assume their amount to be exempted will base on the profitability index obtained of 63.62%. Therefore basing on that, for the purposes of harmonising the current PAYE nil band, scenario have been worked using the monthly nil band of TShs. 135,000/= and suing the profitability index we ended up getting around TShs. 212,917.4/= turnover to be exempted per month from the presumptive taxpayers per month. Summing that amount to annual turnover we got TShs. 2,546,369 per year. In addition to that due to study limitation observed before of failing to generalize the whole results to the whole populations, we decided to use all possible margins of threshold (as shown in Table X) and analyse its revenue implications for further decision.

Refer to the weaknesses shown on **Figure 4.7** for the different effective tax rate within each bands and also refer on Section 1.1.6 on Table 1.1.6 for the EAC Comparative tax structure available in the region, we have decided to go opt for the flat rate (ad valorem) structures, with the possibility of using either 3.0%, 3.5%, 4.0%, 4.5% and 5.0% rates as shown in Table 4.7.

**Table 4.7: Scenario for the appropriate tax structure for the Presumptive taxpayers**

<table>
<thead>
<tr>
<th>Proposed Annual Turnover Nil Threshold/Band to be Exempted</th>
<th>Used Flat Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1,620,000</td>
<td>2,000,000</td>
</tr>
<tr>
<td>3.0%</td>
<td>3.5%</td>
</tr>
<tr>
<td>Revenue Implications basing of different threshold and tax rate</td>
<td></td>
</tr>
</tbody>
</table>

Following the sensitivity analysis scenario done, the alternative tax structure and threshold brought the following results with their revenue implications using the current tax revenue paid in year 2009/10.

**Table 4.8 Results of the revenue implication of different tax structure**

<table>
<thead>
<tr>
<th>Proposed Annual Turnover Nil Threshold/Band to be Exempted</th>
<th>Used Flat Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1,620,000</td>
<td>2,000,000</td>
</tr>
<tr>
<td>3.0%</td>
<td>(1,095,450,971)</td>
</tr>
<tr>
<td>3.5%</td>
<td>833,007,221</td>
</tr>
<tr>
<td>4.0%</td>
<td>2,761,465,413</td>
</tr>
<tr>
<td>4.5%</td>
<td>4,689,923,604</td>
</tr>
<tr>
<td>5.0%</td>
<td>6,618,381,796</td>
</tr>
</tbody>
</table>
As it can be seen on Table 4.8, it is out of discussion to consider using the Flat rate of 3.0 percent, since that rate with all possible thresholds; the revenue implications will be negative. The appropriate tax rate therefore proposed flat rates of 3.5% and 4.0% with the nil threshold of turnover TShs. 2,000,000/= and or 2,500,000/= per year. 

**Figure 4.8:** Simulation for the Proposed 3.5% and 4.0% tax rates with nil band of 2.0mil and 2.5mil

Analysis conclude by opting to the flat rates options with proposed nil threshold for further decision due to the fact that the proposed flat rates and threshold gives an equitable effective tax rates required for each source.

**Figure 4.9:** Comparison of effective tax rates using different flat rate and threshold
Using the same compliance rate of presumptive taxpayers, we propose to leave away with the issue of tax bands structure and go for the introduction of flat tax rate of 4.0 percent with the exempt threshold of turnover of TShs. 2,000,000/= per year. This is expected to be revenue enhancing reform with around TShs. 1,884 million. However, if there will be special effort put in the tax administration and enhance the compliance of the presumptive taxpayers, the Government can decide to opt for 3.5 percent with the same exempt threshold of turnover of TShs. 2,000,000/= per year, although this can be taken as a revenue neutral reform since the magnitude obtained is insignificant. The magnitude of the second reform will only increase if the compliance will be increased.

Table 4.9 Summary of reform proposal

<table>
<thead>
<tr>
<th>Scenario to consider</th>
<th>Nil threshold</th>
<th>Flat rate</th>
<th>Revenue Implication (Mill. TShs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Enhance revenue collection</td>
<td>2,000,000</td>
<td>4.0%</td>
<td>1,884,4</td>
</tr>
<tr>
<td>2. Revenue Neutral</td>
<td>2,000,000</td>
<td>3.5%</td>
<td>65,5</td>
</tr>
</tbody>
</table>

6.7. Taxpayers with Turnover of 20m to 40m

Analysis has shown that, given the current presumptive income tax system, these taxpayers since they have been already preparing books of accounts and in practical they have been paying their taxes with the effective tax rate of almost 27 percent in their business, this group may continue with their status of maintaining books of record and be charged as individual taxpayers as per personal income tax rate if they are individuals, otherwise be charged with corporate tax structure rates. If there are no other efforts, any suggestion of incorporating them with the small presumptive taxpayers will weaken the Government revenue.
Tanzanians are making effective use of presumptive methods of taxation, even though that such method inherently involve unfairness, because they involve a departure from the normal accounting methods used to determine the tax base as per National Income Act of 2004. Many small and medium scale taxpayers who genuinely have uncertain low income have ended up having to pay tax under a presumptive method that is not rebuttable.

On the other hand, since compliance with and administration of the current income tax is so uneven that the normal rules do not lead to equal treatment of taxpayers with equal income, then presumptive methods has been natural choice for many infant small and medium scale business operators, (Victor Thuronyi 1996). Of fundamental importance is the organizational structure and capacity of the tax administration to handle the current presumptive income tax system. For example, there are reasons to believe that corruption of tax service personnel is a serious problem in domestic revenue department, and then an approach along the lines of the French contractual method is a recipe for disaster.

6.6. Simulations of Proposed Presumptive Income Tax

The following are simulation analysis of the impact of proposed presumptive income tax in Tanzania.

6.6.1. Scenario for the introduction of Flat Tax Rate

While simulating for the needed flat rate and nil turnover, the following were the assumptions applied;

(i) Assumed the use of the existing tax base with the same current tax structure

(ii) Existing tax machinery to prevail (manpower and other inputs)

(iii) Assumed the same existing compliance rate

(iv) Productivity index used to determine the operating cost

(v) The current PIT Nil Threshold used as a proxy to determine the nil turnover threshold for the Informal Sector Taxation.

(vi) Macro Economic indicators
**3% and 3.5% tax rates for all possible thresholds**

Table 6.5 shows that by using scenario one that is 3% tax rate for all possible thresholds, the revenue implication is negative and thus insignificant. The sensitivity analysis scenario done in Table 6.5, on the alternative tax structure and threshold has been established and resulted in to different revenue implications using the current tax revenue paid in year 2009/10. Similarly by using flat rates of 3.5% it’s only two proposed threshold that may result in significant revenue implication.

| Proposed Annual Turnover Nil Threshold/Band to be Exempted |
|-----------------|-----------------|-----------------|-----------------|
| Used Flat Rate  | 1,620,000.0     | 2,000,000.0     | 2,200,000.0     | 2,500,000.0     |
| 3.0%            | (1,095,450,971) | (1,753,259,901)| (2,097,156,548)| (2,604,473,260)|
| 3.5%            | 833,007,221     | 65,563,469      | (335,649,286)  | (927,518,783)  |
| 4.0%            | 2,761,465,413   | 1,884,386,839   | 1,425,857,977  | 749,435,693    |
| 4.5%            | 4,689,923,604   | 3,703,210,209   | 3,187,365,239  | 2,426,390,170  |
| 5.0%            | 6,618,381,796   | 5,522,033,579   | 4,948,872,501  | 4,103,344,647  |

Source: TRA Informal Sector Study Data, 2010

**4% tax rate for all possible thresholds**

For the proposed flat rate of 4.0% it shows that for the tested nil thresholds revenue implication is positive and significant. Despite that the flat rate of 5.0% generates positive results, however, the experience learnt from other country such as Kenya and Rwanda have used 3% and 4% respectively. Moreover, since this study seeks to into account regional integration issues and come up with the effective measures that will induce the taxpayer compliance level and to formalize them and also more revenue generation, we have opted for the flat rate of 4%. Figure 6.1 shows the outlook of the new structure.

**Figure 6.1: Simulation of the Outlook of the Proposed 4.0% tax rates**
Source: TRA Informal Sector Study Data, 2010

6.6.2. Turnover Thresholds

For the purpose of harmonising the thresholds and tax rate for the presumptive taxation scheme, we have considered the use of the current PAYE nil threshold of Tshs. 135,000/= as the basis for designing the nil threshold for the turnover. Contrary to PIT scheme, presumptive income taxpayers, like any other companies/entities have to net out their operating costs.

Thus we have computed the operating cost basing on the obtained profitability index of 63.6% from the study results. As a result the total computed monthly threshold of Tshs. 212,197.4/= were converted to annual turnover of Tshs. 2,546,369.1/= approximately to Tshs. 2,500,000/=.$ For this reason it is also advised that if it happens of any change in PIT tax scheme/structure of nil threshold, also this has to be reflected in the presumptive nil threshold too.

Recalling to the effective tax rates, that have brought for the different levels of effective tax rates existing in the current regime within each bands, this study therefore suggests the use of the nil threshold of 2,500,000 using the flat rate of 4.0 percent.
Table 6.6: Summary of tax rate and threshold reform proposal on revenue implication for 2009/10FY and implied for 2011/12FY

<table>
<thead>
<tr>
<th>Scenario to consider</th>
<th>Nil threshold to be used</th>
<th>Flat rate</th>
<th>Revenue Implication in 2009/10* (Mill. TShs.)</th>
<th>Implied Revenue implication in 2011/12* (Mill. TShs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Using same current tax machineries</td>
<td>2,500,000</td>
<td>4.0%</td>
<td>749.4</td>
<td>974.7</td>
</tr>
</tbody>
</table>

Source: TRA Informal Sector Study Data, 2010

By using the current tax machineries and compliance of presumptive taxpayers, the proposed flat tax rate of 4.0 percent with the exempt threshold of annual turnover of TShs. 2,500,000/= per year is recommended. This structure is expected to be revenue enhancing reform estimated to increase about Tshs. 974.7 million in the year 2011/12 (Table 6.5) over and above the current collections made in year 2009/10.

6.6.3. Net Effects of the Proposed Presumptive Income Tax

The new proposed structure in aggregate is a revenue enhancing measure by 5.9 percent over and above from the current tax regime (other factors remain constant). The proposed nil threshold is going to reduce around 40 percent of the current presumptive traders basing on their threshold being below Tshs. 2,500,000/= . This will have to be encountered by enhancing registration of the established potential of the unregistered traders which turns out to reach about 330,000 by year 2011/12.

Overall the new proposed tax structure has positive and negative effects depending on the level of band used before as shown in Figure 6.2. The revenue implications has affected other bands more than the other, for example by opting to the new structure, in aggregate taxpayers who were in band 1 has gained by almost 11 percent whereas traders who were in band 4 has lost by about 15 percent.

Figure 6.2: Status of Winners and Losers due to New Proposed Tax Structure
Source: TRA Informal Sector Study Data, 2010

6.7. Efficacy, gains and relevance of inclusion of Taxpayers with Turnover of 20m to 40m

It has been observed from our consultations and survey data that, since the current income taxpayers with turnover of Tshs 20 m and Tshs 40 m are already preparing books of accounts and in essence they have been paying their taxes with the effective tax rate of almost 27 percent in their businesses, this study recommends these formal business operators and taxpayers to stay where they are. It is efficient if these formal taxpayers continue with their statuses of maintaining books of accounts and be charged as individual taxpayers as per personal income tax rate if they are individuals, otherwise be charged with corporate tax structure rates. These are small and medium scale businesses and graduate taxpayers and thus they need to be maintained, supported and facilitated during its transformation to fully corporate entities and to enjoy economies of scale. They will be good taxpayer examples and models for others intending to expand and transform their business operations. Any other suggestion of incorporating and lowering them with into the small presumptive tax system will be inconsistent, detrimental to taxation system, risk and may weaken the current government revenue flows.

Chapter Seven: Conclusion

Chapter Seven presents conclusion consisting of main study findings and recommendations.
7.1. Study background, objectives, research approach and methodology.

7.1.1. The study Background

The informal sector in Tanzania is among the most buoyant sectors yet contributes marginally to tax revenue generation. According to the Integrated Labour Force Survey, 2006 (ILFS) the informal sector was the second main employing sector after Agriculture by employing 10.1 percent of the employed persons, followed by other private sectors with 8.6 percent, where agriculture employed 75.1 percent. This may be explained by the fact that the main activity in rural areas is agriculture, which is not defined as an informal sector activity.

It is known that the informal sector has a significant job, income generation potential and stimulation of social economic growth in both urban and rural areas. However, the social, economic and political realities of the informal sector translate to a complicated operational reality for business formalization and the tax administration. The effective taxable workforce is usually quite small and there are views that taxation evasion is huge, deliberate and systematic due to various reasons. These include heavy costs of compliances resulting from their varieties and sizes.

7.1.2. Objective of the Study

In order to address the problem of taxation of informal sector in 2010 TRA conducted a policy research study aiming to pull small and medium enterprises in the tax net and introduced presumptive taxation scheme. The Tanzania Revenue Authority, (TRA), conducted an internal investigative research seeking to estimate the size, the dynamics and assess tax revenue generation potential of the informal sector. The TRA research study (2010) aimed at promoting an enabling and supportive environment to the development and taxation of the informal sector in the country.

7.1.3. Study Approach and Methodology

In order to accomplish the objectives of the research study that flowed from the general research consultant objectives, four independent but complementary methodologies were used. These were include major [1] desk study reviews, [2] field research survey, [3] data, policy analysis a report writing and [4] internal TRA consultative meetings and capacity building.

7.2. Main study findings
7.2.1. Informal Sector

Size and magnitude of the informal sector by workforce

The 2006 Integrated Labour Force Survey (ILFS) indicated that in 2006, 40 percent of all households in Tanzania Mainland have informal sector activities as compared to 35 percent in 2001. In 2006, the urban informal sector employs 66 percent of the people for whom informal sector work is the main activity and only 16 percent of those for whom it is the secondary activity. In contrast, 34 percent of the people for whom informal sector work is a main activity are in rural areas and 84 percent for whom this work is a secondary activity. This may be explained by the fact that the main activity in rural areas is agriculture, which is not defined as an informal sector activity.

Size and magnitude of the informal sector by gross domestic product

The study uses several basic national account statistics to measure the size of the informal sector for Tanzania for year 1991, 2001 and 2005 – 2010. The study adopted estimated informal sector statistics based on the Jacques Charmes (2006) method. It is suggested that the size of the Tanzanian informal sector is large. However, the informal sector GDP contribution dropped from 62.5 percent in 1991 to about 39.5 percent in year 2010. We noted that Schneider (2002) in his assessment of the informal sector in 110 countries found that in 2000, the average size of the informal economy as a percent of the Gross National Income (GNI) was 41 percent in developing countries, 38 percent in transition economies and 18 percent in Organisation for Economic Co-operation and Development (OECD) countries. It is claimed that the key determinants of the size of informal sector are the structure and nature of economy, burden of taxation, government regulations and social security contributions. Tanzanian economy depends on agriculture and thus rather than trying to “merely “formalize” the informal sector, one need to realize that the most significant obstacle to growth in informal sector is the lack of access to product markets and resources, most notably, factor and financial markets.

Types of the social economic activities in the sector

The TRA Study found that about 55.3 percent of the informal sector operators in year 2010 are engaged in wholesale and retail; repair of motor vehicles and motorcycles. Wholesaling and retailing are the final trade service steps in the distribution of goods. Goods bought and sold are also referred to as merchandise. This is consistent with the 2006 Integrated Labour Force Survey (ILFS) which suggested that where the informal sector activity is the main activity, the wholesale and retail trade employs 57.5 percent of the people.
The TRA Study found that about 21.6 percent of the informal sector operators are in manufacturing. There are cases of small and medium scale manufacturing units which are engaged into value addition activities or processing materials or contracting with other units to process their materials for them. These manufacturing processing units can easily camouflage into informal manufacturing sector. However, their outputs are for final consumption and thus may be captured in VAT system. Very few cases micro and small scale informal manufacturing produces semi-finished outputs. Semi-finished outputs are those treated as inputs for further manufacturing.

The study found that the rest i.e., about 23.1 percent of the informal sector operators are in service sectors such as education, health, business support, transportation, and other services. Of this about 2.4 percent are engaged in agriculture, forestry and fishing activities.

**Positive profitability index and output performances**

Using business turnover as output index, the study found that there is a positive correlation between profitability index and output performances such that the value of profitability index increase with the increase in output. The study indicates that the output band value between Tshs 1-1.62 million has a profitability index of 62.49 percent where else the output band value of between Tshs 30-35 millions has profitability index of 92.9 percent on average showing a parallel increase of output and profitability index in the informal sector.

Since the turnover is the principle determinant of amount of presumptive income tax paid, the findings imply that there is unequal treatment of tax payers within the informal sector as individual lying between two or more groups may share similar tax band despite the difference in profitability index. The implication of such inequality gives incentives for taxpayers to underestimate sales, not to keep records and evade tax payment.

**Informal sector can not adhere to BRELA governance standards and norms**

The study found that currently in year 2010 about 22.4 percent of informal operators do not keep any written business records while 74.7 percent keep general informal records for personal use. The records are kept in form of rough pieces of papers, text book and personal diaries. These results suggest that most of operators in the informal economy do not adhere to these BRELA quality accounting standards. Consultations suggest that most of informal operators lack business management education, experience and skills.
such as proper record keeping, product arrangements, product pricing and marketing of their products.

**Business registration and licensing**

Tanzania has complex business registration and licensing systems. There are many and various ways of registering and licensing a business entity. Each business operating in Mainland Tanzania shall be required to obtain a certificate of registration from the Business Registration Centre within the local authority where the business is located. Every business registration shall be valid for the entire life of the business.

For the case of Tanzania business operation should be done in legally accepted premises and should be registered by three up to four administrative authorities depending on type of activities namely local government, BRELA and TRA and other relevant institution governing such sector. The study found that about 58.3 percent businesses to have been registered in any of the three administrative authorities while the remaining was not registered. About 61.1 percent of the wholesale and retail trade activities are registered. About 53.5 percent of manufacturing businesses are not registered. These operate as typical informal manufacturing firms.

**Employment by gender and age by main social economic activities in the informal sector**

The study found that there are more female gender about 67.1 percent number of workers employed in the informal sector in year 2010. However, there are wide variations in female gender employment between and within social economic sectors. The female gender employment is high in accommodation, food services, arts, entertainments and recreation, agriculture, and administration and support services. Given limited opportunities in the formal modern sectors, the majority of women are self-employed in the informal small scale manufacturing sectors such as tailoring, handicrafts, food processing and cottage industries.

About 68.7 percent of the surveyed informal sector business units employ on permanent basis. About 31.3 percent work as part time or temporary workers in the informal sector in Tanzania. Very few people, about 17 percent are employed on permanent basis in the accommodation and food services.

Tanzania experience in informal economy employment is more or less similar to other Sub Saharan Africa. Informal economy generated about 97 percent which is equivalent
to about 1.3 million employments during the year 2007 to 2008. In terms of age structure 52.7 percent of informal sector employees are between the age of 15 and 34 years old whereby 43.6 percent are within the age of 35 and 64 years old.

**Other informal sector findings**

The study found that about 90.2 percent of informal sector operators employ capital value of Tshs of between 1 and 5 millions where by 68.8 percent has a capital base below 1.62 millions as shown in Table 2.5E below. Very few informal sector operators, that is less than 2 percent have capital investment exceeding fifteen million Tanzanian shillings. More than 74.9 percent of capital needs of informal economy are financed outside the formal credit windows provided by microfinance institutions in the country. Loans from banking institutions compose 17.7 percent while from SACCOS is as menial as 1.5 percent.

The study found that about 88.3 percent are sole proprietorship establishment. These are entities where a single individual is the owner, manager and operator of the business, though other members of his family participate in business operations and work therein. The liability of the business owner is unlimited. All of his/her personal assets are at risk of losses incurred in the business. Among the notable features of this form of ownership is the easiness in making quick business decisions, little or no division between labour and capital as factors of production and small scale of operations.

The study found that about 77.9 percent of the surveyed informal sector firm’s sell their products and services directly and within the vicinity. Very few informal sector firms have access to outside the locality, that is very far markets. It is suggested that new micro and small scale informal firms target local or neighbourhood markets. About 46.7 percent of firms with 20 or more year’s business experiences tend to go for outside markets. Search for outside market is a complex function of the internal scales of operations and micro-environment factors. The micro-environment influences the informal sector directly.

**Problem, Challenges and Opportunity to Informal Sector**

Informal economic activities are an integral part of the overall dynamic economy in underdeveloped economies and will continue to be so in the future. Previous
modernization perspectives conceived of informal economic activity as residual activity that will eventually disappear. Evidence suggests that contemporary processes of economic globalization, flexibility and the reconfiguring of state activity have further stimulated the growth of informal works. In policy terms this reality needs to be recognized. The challenge therefore has been whether and how to build upon the positive elements in such a manner that complements efforts to tackle the negative aspects of informal economic activity as well as promote and harness the positive attribute of informal economy.

The sector has been facing various complex problems, challenges and constraints affecting its performance. These include access to credit facilities, lack of market and unfaithful and unreliable clients are among the leading bottleneck in informal sector business performances. These limitations are as described hereunder. About 34.1 percent of the surveyed informal sector firms pointed that the informal sector borrowing is very limited. This hinders the performance of the sector. From the lender point of view the informal sector are subjected to high rate of business failure, high administrative cost, low productivity, under capitalization, shortage of skills, poor attitudes of the borrowers, collateral, legally registration as a limited liability company; and submission of feasibility studies (business plan and thus are illegible for credit facility and if proved otherwise the interest rate is high to offset the risks associated with such loan.

7.2.2. Adequate Policy, Legal, Regulatory and Institutional Frameworks

Tanzania has, in the past 15 years been undergoing social economic and political changes, legal and regulatory and institutional reforms, which have re-oriented the economy from a government-led to a competitive market and private-sector-led one. The Micro, Small and Medium Scale Enterprises, (MSME) or the informal sectors are major private sector businesses owned, managed and operated by the indigenous Tanzanians. Tanzania has made significant progressive in the formulation, implementation and performances of social economic development efforts intending to empower Tanzanians in owing, managing and operating own social economic activities. The first and second generation reforms that were pursued since early 1980s up to day 2010 have been very critical to formation and development of the MSME/informal sector in Tanzania.

7.2.3. Presumptive Income Taxation Performance in Tanzania

Policy Framework
The presumptive income tax is rationalized and based on solid sector and fiscal policy foundations. The rationalization of presumptive scheme was in line with the Small and Medium Enterprise sector policy (SMEs Policy of year 2003) with objectives of enhancing business registration and tax system to be simple. In specific, the SME’s Policy 2003 seeks to *simplify tax system and introduce tax incentives to nurse SMEs*.

**Legal Framework**

In July 2004, the Government rationalized the presumptive scheme by introducing a new simplified taxation schedule for small business taxpayers as part of a drive to make it easier for informal sector operators (including start-up businesses) to register, formalize and start paying taxes. The First Schedule of the Income Tax Act of 2004 (and thereafter amendments done in 2006) defines and provides content and structure of Presumptive Income Tax in Tanzania.

**Institutional Framework**

At the institutional level, the presumptive Income Tax is administered, managed and operationalize by Department of Domestic Revenue in the Tanzania Revenue Authority. TRA is a central body for the assessment and collection of specified revenue, to administer and enforce the laws relating to such revenue and to provide for related matters in the Tanzanian economy.

In order to have the more taxpayers in the tax net, expand the tax base and optimize tax revenue collection, Tanzania Revenue Authority (TRA) proposed to introduce the Block Management System, (BMS). The basic objective of BMS is to promote compliance and register all eligible small and medium scale enterprises within a particular business, sectoral or geographical area, capturing their correct level of economic activities and gathering valuable tax information.

**Human Resource Framework**

TRA has made concerted efforts to develop needed human resources administering the presumptive income tax system. The study found that the total number of staff engaged in TRA from year 2000/2001 – 2009/2010 by main departments and units. The total number of staff increased from 2,772 in 2000/2001 to about 3,727 in year 2009/2010. The increase in number of employees occurred in all departments and units. The study suggests that majority of these staffs were deployed in the Domestic Revenue (53 percent) and in Customs and Excise (33.2 percent) during year 2009/2010.
**Block Management System is operational but ineffective**

In order to enhance presumptive income tax system and administration, TRA prepared, uses trained and skilled staff under the Block Management System, (BMS). Tax officers comprising Senior Tax Officers as heads of blocks, Tax Officers, Assistant Tax Officers and Tax Assistants from compliance and enforcement sections are assigned with all duties and responsibilities relating to that block. They are required to register all the traders within the block, collect all the revenue and manage tax debts, and provide taxpayer service.

However, the BMS has not been fully operationalized and or rolled over to other regions. According to TRA Block Management Report 2010 Kariako Ilala Kigogo model (KIK) manning level is a big problem that hinders smooth implementation of Block tax Management system. The study found serious shortage of staff whereby out of 10 staff required to work in KIK Block only 2 or only 20 percent staff were allocated. KIK is a model and yet has such a big shortage of staff.

**Presumptive Income Tax on Increase**

The study found that both presumptive income taxes for individual with accounts and individuals with no accounts have been increasing during the sample period. However, it is interesting to note that presumptive income taxes for the first category has been high suggesting that TRA has instituted tax incentives to encourage firms preparing and keeping formal accounts. However, the contribution of total presumptive income tax has been very small compared with other forms of income taxes, number of taxable entities and desired tax transformation targets.

The total number of registered tax payers increased from 288,680 in year 2005/2006 to about 617,877 in year 2009/2010 and presumptive income tax payers increased from 199,448 in year 2005/2006 to about 376,673 in year 2009/2010. The total number of presumptive income tax payers as percent of total TRA tax payers increased from 69 percent in year 2005/2006 to about 75 percent in year 2006/07 and then starting to drop to about 61 percent in year 2009/2010.

Whereas some studies acknowledge the increase to have partly been contributed by improvement of presumptive scheme system, the study also feels that other tax administrative measures have largely contributed to this achievement. Block tax Management system, tax survey and patrols, tax severance and tax audits surely have their contribution to this achievement.
Presumptive Income Tax Rate Structures

TRA adopted presumptive income tax structure is good and simple. The study found that the rate in the 1st band for minimum turnover is 0 percent and 1 percent for maximum turnover of 3 million. In the 2nd band the scheme imposes 3 percent on minimum sales of TShs 3 million and decreases to 1 percent on maximum sales of TShs 7 million. In the 3rd and 4th bands the situation is similar that the minimum sales suffer higher tax rates than the maximum sales of 4 percent, 2 percent and 3 percent respectively. The differential application of rates in this scheme made traders to object graduation from upper end to the next lower band for fear to pay more tax. The system is regressive as non-record-keepers are more likely to lack the capacity to keep proper accounts.

Positive and Increasing Total and Presumptive Income Tax Payers Trend

The study found that both total and presumptive income tax payers have been increasing during the last five years. However, it is noted that since 2007/2008 the number of total income tax payers have been increasing faster than the number of presumptive income tax payers. This suggests that much as these efforts of presumptive scheme have been undertaken to simplifying the tax regimes, their outcome has been significant in pulling the informal and semi informal sector operators into formal and, hence, bringing them in the TRA tax net. That is, after a lag of three to four years, the new system is in operation and this need to be enhanced.

Overall Performance of Individual Income Tax Revenue Collections has not been satisfactory

The study suggests that before introducing presumptive taxes in year 2001/02, the overall performance share of individual taxes to total direct taxes was 7.3 percent in year 1996/97 and accounted for 1.8 percent to total TRA revenue collection and 0.22 percent of GDP in the same year. This overall performance share index deteriorated to 6.0 percent to total direct tax, 1.5 percent of TRA revenue collection and 0.15 percent of GDP in year 2000/01. When the Government introduced presumptive taxes in year 2001/02 the performance shares continued to deteriorate. The share of Individual taxes as a percentage of GDP had not been stable. This slightly increased from 0.14 percent of GDP in 2001/02 to a pick of 0.19 percent of GDP in year 2005/06 before slowing down to 0.16 percent of GDP in 2009/10.

Taxpayers with Turnover of 20m to 40m
The study found that given the current presumptive income tax system, these taxpayers *with turnover of 20m to 40m; and* since they have been already preparing books of accounts and in practical they have been paying their taxes with the effective tax rate of almost 27 percent in their business, this group may continue with their status of maintaining books of record and be charged as individual taxpayers as per personal income tax rate if they are individuals, otherwise be charged with corporate tax structure rates. If there are no other efforts, any suggestion of incorporating them with the small presumptive taxpayers will weaken the Government revenue.

**Net effect of presumptive income tax**

The presumptive income tax is considered in order to decrease administrative and compliance costs, but its benefits are potentially larger as information gathering instruments in a dynamic environment. Moreover, it has been used to curve widespread tax evasion in the small and medium scale sector and avoidance by reducing enforcement costs, which is likely to generate positive externalities in taxpayer compliance.

However, careful analysis is required as their effects in terms of use, efficiency, transparency, governance are multiple and can be large, and the exact desired presumptive tax structure is ultimately linked to the characteristics of the targeted tax base, (Christian R. Jaramillo, 2004).

The study found that that the desired presumptive income tax is more likely to be able to improve on the outcome of two system tiers on desired direct domestic tax revenue where (i) formalization of small and medium scale firm is done jointly with all core government and public institutions, (Seth Terkper 2003).

**7.2.4. Informal Sector Firms outside Tax System**

**Status of Business Registrations and Tax Payment**

The study found that about 58.3 percent of the surveyed firms are semi formal and formal or registered business entities and about 41.7 percent are not registered. About 60 percent are captured in the TRA tax network in one form or another and about 40 percent operate outside the tax system. That is, about 40 percent are not complying with Tanzanian taxation system.

**Factors Influencing the Compliance Behaviour of Businesses**
The study identified two broad approaches to the problem of compliance. The first stems from an economic rationality perspective and has been developed using economic analysis. The second is concerned with wider behavioural issues and draws heavily on concepts and research from disciplines such as psychology and sociology. Economic and behavioural approaches are sometimes regarded as competing explanations. However, each approach can be valuable in terms of understanding tax compliance and the issue is to determine how the two approaches might be used to reinforce each other.

**Reasons for Informal Sector to Escape Registration in Tanzania**

Despite all government efforts, there are number of businesses which are not registered or captured in the government systems. The study found three major reasons for informal sector to escape registration in Tanzania. These included 
1. lack of knowledge and education (taxpayer, registration, business management practices) {about 36.2 percent},
2. lack of proper business premises (unrestricted premises) about {28.4 percent and
3. cumbersome procedure, bureaucracy and corruption, {about 16.4 percent}. The study suggested that avoiding tax payment, high taxes, levies, running from government are not major reasons for informal sector to escape registering their business operations.

**Informal sector perception on the tax system**

Different firms have different perceptions on the Tanzanian tax system. Few, that is about 22 percent perceived Tanzania tax system as normal and therefore is good for civilized society. The majority of the interviewed stakeholders had negative perception on the Tanzanian tax system.

About 30.4 percent of the interviewed firms perceived that they don’t know tax system. These are either not aware or are not concerned with taxation system. These lack adequate information and knowledge about taxation system. The lack of effective access to information provisions (which would ensure taxpayers are aware of their rights and less exposed to discretionary treatment by corrupt officials) and the absence of credible review mechanisms increase the risk of corrupt dealings.” Personal contact between tax officials and tax payers, and discretion in the interpretation of unclear regulations, are conducive to illicit practices and thus lower government tax revenue, (Odd-Helge Fjeldstad, 2003).

About 28.1 percent perceived that tax rates are high and about 4.1 percent perceived that the tax system is poor. This confirms that the informal sector is still operating in a
dark, complex and bureaucratic environment that disadvantage the sector from development.

**Reason for not paying Taxes (Tax avoidance and evasion)**

Tanzania is facing different forms of taxation problems related with tax avoidance and evasion. Tax avoidance is the *legal* utilization of the tax regime to one's own advantage, to reduce the amount of tax that is payable by means that are within the law. This may be based on policy framework were there efforts to provide tax exemptions to micro and small scale business entities. The study found that about 60.4 percent argue that they do not pay tax because of small capital, turnover and profit generated from their operations. In simple terms, these argue that, they are too poor to pay taxes. Not paying or negative taxes legally or subsidies are one of the best ways to increase business net worth faster and keep more of the wealth for the purpose of further investments and thus increased production and income. Negative taxes help micro and small businesses to survive and grow and get ahead in life significantly.

**General problems affecting business operations by tax payment status**

**Lack of effective market demand**

Small and medium scale firms perceived that problems related to unfaithful and unreliable customers, i.e., product market demand constraints, as the first and foremost constraints affecting their business performances in the year 2010. About 36 percent of firms outside the tax net complained on behaviour of their customers. In economics terms, this problem can be interpreted as lack of effective market demand or insufficient demand. Insufficient demand is a reflection of an imperfect competitive market system, which affects behaviour, lifestyle and standard of living of Tanzanians.

**Lack of finance capital, inflation and high interest rates**

The second major problem is related with lack of finance. Many small and medium scale firms in Tanzania have very limited access to formal long-term credit due to weak and non-competitive financial system. The financial system is very costly (in terms of high interest rates), too complex and has a lengthy loan application process and too short maturity for the specific case of bank loans. An average of 14.4 per cent of sample small and medium scale business entities argued that lack of capital or inadequate working capital and about 6.3 percent accounted for inflation, high interest on loans.
Poorest Economic Infrastructure

The third most constraints are related to unreliable power supplies and poor infrastructure. About 8.5 percent of the small and medium scale firms identified economic infrastructure to include, among others; poor roads and networks, inefficient and inadequate communication networks, inadequate and unreliable power and water supplies, lack of waste disposal facilities, and bottlenecks in trade facilitation services.

7.3. Proposed Simple Presumptive Income Tax

The study proposes a simplified presumptive income tax structure in Tanzania that will promote an enabling and supportive environment to the development and taxation of the informal sector.

7.3.1. The general policy objective

Based on the general informal sector business environment, the general policy objective of proposed Presumptive Income Tax systems is to reward success, encourage start-ups and formalization, i.e., transformation, facilitation, promotion and development of sustainable small and medium scale businesses, income and job creation social economic activities and reduction of poverty in Tanzania.

7.3.2. Legal Framework

The proposed simple presumptive income taxation system will be based on the Income Tax Act, CAP 162 which was introduced in Tanzania and put into use in January 2001. However, there will be a need to review, refine and make few amendments on the First Schedule of the Income Tax Act of 2004 (and amendments done in 2006).

7.3.3. Institutional Framework

The administration of the proposed presumptive income tax functional activities and issues will continue to be under the TRA, Department of Domestic Revenue. Regional and district tax offices will manage, implement and monitor compliances of small and medium scale operators and taxpayers through a geographically based block management system, (BMS). Under this BMS, business areas are divided into ‘geographical blocks’. There will be a need for effective Block management teams carry
out the functions of registering, assessing, collecting and accounting for tax revenue collected.

**New forms of business registration and formalization systems**

TRA has to learn and design new institutional framework for management, coordination and operationalization of BMS in collaboration with these other institutions. The basic objective of the newly institutional framework for BMS is to formalize, i.e., to promote compliance and register all eligible traders within a particular business, sectoral or geographical area, capturing their correct level of economic activities and gathering valuable tax information.

7.4.4. Maximum Taxable income

The study has proposed two maximum taxable income levels. The first is the base case, which is Shillings 20,000,000. The second threshold income level is Shillings 50,000,000 (US$ 40,000 when Tshs 1250 per US$) as an alternative case and amount taking into account the reality on the ground. The proposed threshold referred to in subparagraph (1) (b) under the First Schedule will be pegged to take in account inflation, foreign exchange rate fluctuations, regional integration and global competitiveness. It is proposed that the VAT threshold should be adjusted to about TSH 50 million to provide consistent graduation.

7.4.5. Introduction of Flat Tax Rate

To avoid unfair/unequal treatment among the taxpayers this study proposes the use of flat rate instead of bands. The use of flat rate assumed to have a fair and equal treatment among the taxpayers and also expected to increase in compliance level as well as increase in revenue collection. Thus this study proposes the use of flat tax rate of 4.0 percent as a base case and flat rate of 3.0 as an alternative case in each shilling that exceeds threshold.

7.4.6. Net Effects of the Proposed Presumptive Income Tax

The new proposed structure in aggregate is a revenue enhancing measure by significant positive percent over and above from the current tax regime with other institutional and human resource factors changing.
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