

## **Effective taxation of informal sector through local community partnership**

### ***Policy recommendations***

1. Government should set up efficient data collection system which covers the informal sector, focused on increased capacity for collecting and disaggregating data by sector, types and number of economic operatives.
2. Government should seek better collaboration with various trade associations, business groups and cooperatives, especially in the informal sector, to enable easy tax registration and levy collection through community-based structures.
3. Tax offices should leverage social structures to widen the formal tax net and improve efficiency in tax collection.
4. Radical reforms should be implemented at the local government level to make them autonomous, fiscally responsible and lead agents in tax administration and grassroots development.

### ***Introduction***

Nigeria's informal sector consists of several artisans, traders, shop owners and market women and men. Unlike the formal sector where it is easier to track and collect Pay as You Earn (PAYE), Value Added (VAT) and Withholding (WHT) taxes, the informal sector is a big, potential taxable businesses and services pool. However, it has been extremely difficult for successive Nigerian governments at the federal, state and local levels to devise an effective means of tax collection which extends fully to the informal sector. Yet, the incipient shift away from Nigeria's oil dependency creates significant scope for building a more efficient tax system that will effectively bring informal economic activities into the tax net.

### ***Towards efficient taxation***

For decades, governments at various levels have not tapped the informal sector as a revenue generator but have rather concentrated attention on the formal sector. This gave birth to Nigeria's narrow tax base which places so much burden on formal businesses. Nigeria currently collects less than ten percent tax from its economy of almost half a trillion US dollar, which is far lower than taxes collected for countries at a similar level of development.

Interestingly, Nigeria's informal economy is large in terms of its overall volume and number of individuals and business units it encompasses, and would significantly increase the tax revenue base if adequately harnessed. According to recent statistics, Nigeria's informal sector accounts for as much as 57.9 percent of the nation's rebased Gross Domestic Product (GDP). Data for 2010-2013 produced by the National Bureau of Statistics and the Joint Tax board show a meagre tax collection from informal sector of ₦44.2 million (0.43% of GDP) for 2010; ₦345.5 million (2.96%) for 2011; ₦368.6 million (2.73%) for 2012; and ₦624.5 million (4.06%) for 2013. The data showed average revenue collections of 2.54% from the informal sector for the four years preceding the fall in oil prices.

With the precipitous decline in Federal allocation, many states have been unable to meet up with statutory obligations due to overdependence on the allocation as many states hardly are able to generate revenues internally to even pay salaries. Lagos impressively increased its IGR from N15bn in 1999 to N237bn in 2013, an increase of N222bn within 14 years. Unlike other states, only Lagos could boast of a contribution of about seventy-nine percent from tax to the state's Internally Generated Revenue (IGR) in 2015. The internally generated revenue of Lagos State in 2015 was N268bn; higher than the N257bn of 32 states put together (excluding Rivers, Delta and Ogun states).

It is particularly desirous at this period to extract taxes from economic players that have been free-riding on infrastructure and other benefits funded through others' taxes. Without prejudice, it is not a call for higher taxes, but a widening of the net to capture those businesses and individuals that have hitherto never paid taxes.

To this end, various avenues exist to effectively grow the contributions of the informal sector to government's tax revenue. A systemic shift is needed, which goes beyond one stop solutions and encompass piecemeal improvements on many levels. A starting point for successful transformation is data collection that is up to date, disaggregated by sector, number of operatives, types of trade and services, and trade associations and their membership etc. This is because armed with this knowledge, more accurate projections and planning becomes possible and designing an effective and sustainable collection system also comes within easier reach. On the long term, the populace stands to benefit more from accurate projections and properly delivered services from government. Without a system in place by which individuals and businesses are registered on a regularly updated database, as largely obtains now, it will be extremely difficult to harness the revenue opportunities in the sector. Furthermore, these possibilities should be explored in the context of each Nigerian state and local councils as tax administering authorities and units.

### ***Equitable taxation requires partnership***

In fashioning such an improved system, government needs to collaborate with various trade associations, business groups and cooperatives that abound in the informal sector. Government will provide the enabling environment and facilitate a streamlined system for registration of the associations and business groups in order to bring them together under one umbrella. This platform will enhance inclusiveness and participation of all the members and engender greater commitment to decisions reached. Oftentimes, these associations usually have dues which are paid judiciously and they have measures in place to ensure compliance. Tax offices should leverage on these structure to both widen the official tax net and bring about efficiency in tax collection.

An effective and functional local government system is very important for this revenue drive since many actors in the sector reside or own businesses within the jurisdiction of the local authority. This calls for adequate reforms such that the Local Government Areas (LGAs) are truly autonomous and fiscally responsible to be

entrusted with such funds. Many residential houses have corner shops and kiosks integrated into them, purveying considerable amount of trade and services with substantial monetary turnover. Government has barely paid attention to these. Where small household businesses have attracted attention at all, governments often seem at a loss as to how to bring them into an effective tax collection system. It is obvious that a conventional tax collection system will most likely not address the coverage challenge.

### ***Incentives-led community engagement***

The various community development associations and other community based organization are also key to effective tax administration that is well understood by citizens and seen as legitimate. These community structures are known to be involved in many self-help initiatives within their locales and many times undertake the functions of government. They pay levies and manage projects within the communities. Government can extend to such organizations incentives such as matching grants, counterpart funding and seed grants to encourage tax payment. The community development association (CDAs) in partnership with the Internal Revenue Service will come up with innovative ways to make their members pay. Such taxes collected must be put to judicious use within the community. To promote inclusiveness, the community should have a voice on what project or services will be provided for by the taxes.

Government can bolster and leverage such associations by engaging them to implement government contracts and procurement processes, help to build their capacities and lift them up to meet required standards. Periodic stakeholder meeting should be organized to address issues towards building consensus and for the sake of monitoring and evaluation. Efforts must also be put in place to ensure that this forum does not become partisan in any way as this would become counter-productive.

### ***Conclusion***

The above options are only practical in a system that is transparent, accountable and inclusive. By and large, as citizens begin to see value for money, the burden of enforcement becomes lighter. People will pay taxes when they see the good use that tax revenues are put to. Encouraging tax compliance demands not only lowering costs but also strengthening the potential benefits of formalisation, from increased security to new economic opportunities. It has been said that the first level of fiscal responsibility of any citizen is to pay tax. Citizens have legitimate right to demand accountability and good governance when they pay tax no matter how small. Revenues from taxes paid by citizens are more likely to be put to proper use when citizens ask questions about the way and manner the money is spent. Integrating citizens in new systems evolved to grow taxes in partnership with community associations is also crucial. This will stand in contrast to the easy money derived from oil revenues, which is seen in the popular consciousness as a "national cake" and often not earmarked properly and accounted for. Most crucially, a community

taxation emphasis will bring citizens centrally into governance and better empower them to demand and monitor accountability.