

## BRIDGING THE GAP: ENHANCING TAX COMPLIANCE IN NIGERIA'S INFORMAL SECTOR

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### Abstract

The informal sector in Nigeria represents a significant portion of the economy, yet it remains largely untaxed, leading to substantial revenue losses for the government. This review paper explores the challenges and opportunities associated with enhancing tax compliance in Nigeria's informal sector. The paper reviews existing literature to identify the key barriers to tax compliance, such as institutional inefficiencies, socio-economic factors, and cultural norms. It also examines strategies employed in other developing economies to improve tax compliance, including the use of technology, simplification of tax processes, and targeted taxpayer education campaigns. The findings reveal that while there are significant challenges to taxing the informal sector, there are also viable strategies that can be adapted to the Nigerian context. The paper offers recommendations aimed at improving voluntary tax compliance and strengthening enforcement mechanisms in Nigeria's informal sector. These recommendations include the need for a simplified tax regime tailored to the informal sector, increased transparency in tax administration, and the integration of technology to streamline tax collection processes. The paper also highlights areas for future research, including specific impacts of digital finance and mobile money on tax compliance in various contexts in Nigeria.

**Keywords:** informal sector, informal taxation, tax compliance, Nigeria

### Introduction

An informal sector can be defined as a portion of the economy that is not formally recognized and ungoverned by tax laws or systems. In Nigeria, the informal sectors significance cannot be overstated in that it generates income and create jobs despite the country's low-level chances of employment (Shelleng, 2024). Previous studies indicate that the informal sector contributes approximately 50-65% to the Gross Domestic Product (GDP) and accounts for 80% of employment (Forbes Africa, 2024; International Labour Organization, 2020; Stillwaters Law, 2017). Although, the informal sector may have contributed a lot to the Nigerian

economy but its exclusion from the tax net have cost Nigeria's government quite significant revenues. Many developing countries are faced with these unwavering challenges due to the informal sectors' presence in the economic sector (Adekoya, Olaoye & Lawal, 2020).

For many decades, the oil sector has been the largest source of income to Nigeria's economy, which lead to overdependency on oil revenue. Although, like every other sector the oil sector is not without its own challenges it's faced with dwindling production alongside unstable global oil prices (Okonjo-Iweala, 2021). The aforementioned challenges have warranted the

revenue sources to be expanded, thereby underscoring improvement of revenue generation from non-oil sectors. The informal sector has the capacity to broaden Nigeria's tax base due to its huge economic contribution (Ogbonna & Appah, 2012). Insufficient data, the volatile nature of informal businesses and a generally established distrust of tax departments and government are some of the ranges of challenges encountered whilst attempting to tax the informal sector. Moreover, illiteracy, poverty and inadequate finances are prevalent in the informal sector hence compounding the challenges (BOI, 2023). The taxation of the informal sector is often considered burdensome and inefficient, as the majority of these businesses operate without significant oversight and generate minimal returns (Forbes Africa, 2024).

This paper aims to examine the advantages and challenges associated with improving tax compliance in Nigeria's informal sector. Previous studies have identified several obstacles to achieving tax compliance in this sector, including socio-economic inadequacies and insufficient data (Joshi, Prichard, & Heady, 2014). As stated by Fjeldstad & Heggstad (2012), the various challenges are compounded by the misconception of taxation as onerous and lack of trust of the taxation agencies. To enhance the tax compliance into Nigeria's informal sector, this paper will research plausible approaches and policies to tackle the unending series of challenges that hinders the inclusion of informal sector into the formal structure. Drawing on successful models and lessons from other developing economies, particularly in the African continent, this review will assess the applicability of these strategies within the Nigerian context. The main aim at the end of this study is to provide guidance and direction as to how best to improve informal sector tax compliance in Nigeria.

Nigeria will position itself as a very high revenue generating economy by spreading its wings around all sectors particularly the informal sector that has so much untapped potentials. The strategic expansion of revenue sources will enhance sustainable growth and

development thereby influencing macroeconomic conditions of a country.

## **Literature Review**

### **Understanding the Informal Sector**

The informal sector, also known as the shadow or underground economy, usually comprises businesses that carry out activities outside the formal regulatory and legal environment. Due to the nature of these activities, governments find it difficult to monitor and integrate them into the formal economy (Schneider & Enste, 2000). Nigeria and West Africa's informal sector activities include trade, manufacturing, technical work, transportation, farming, and services. These sectors accommodate many people who do not fit into the formal sector. Often, informal enterprises are small, family-owned businesses relying on unpaid labor and minimal capital (Chen, 2012). They usually lack access to formal financial services, infrastructure, and markets, limiting their growth and making them susceptible to economic shocks (OECD, 2009). In Nigeria, the informal economy plays a vital role by providing jobs for many unemployed citizens and offering affordable goods and services to poor consumers (Yusuf, 2014). The sector benefits from operating without bureaucratic regulations and needing minimal formal education (Awojobi, Ayakpat, & Adisa, 2014). It significantly contributes to employment and national GDP. Beyond only creating jobs and revenue, the informal sector is essential. It gives low-income people easy access to reasonably priced goods and services, particularly in areas without formal shops (Benjamin, Beegle, & Recanatini, 2014). Furthermore, it encourages entrepreneurship and creativity among people who are not given access to formal economic possibilities (Porta & Shleifer, 2014).

### **Barriers to Enhancing Tax Compliance**

The efficiency of tax collection measures within the informal sector is impeded by a combination of institutional and socio-economic barriers. These obstacles diminish tax compliance and make it difficult to incorporate the informal sector into the formal economy.

### **Institutional Barriers**

One of the main institutional obstacles to increasing tax compliance is the ineffectiveness of tax administration and enforcement. The technology and other resources required to efficiently monitor and enforce tax compliance are lacking in many emerging economies. The use of manual tax procedures has made the inefficiencies already present worse and raised the risk of corruption and mistakes. For example, Bird and Wallace (2004) contended that when taxing the “hard-to-tax” groups, such as the informal sector, administrative difficulties usually result in poor enforcement and unsatisfactory compliance outcomes. Corruption and problems with transparency in the tax collection procedures further erode tax compliance. If taxpayers believed that tax authorities were reliable, not dishonest, and that services would be delivered effectively, they would often comply. Otherwise, there’s a good chance they will be engaged in tax evasion. These difficulties frequently result in underdevelopment and a large decrease in government revenue (Fjeldstad & Heggstad, 2012).

### **Socio-Economic Barriers**

Voluntary tax compliance in the informal sector is also affected by socioeconomic issues. Part of the major impediments to voluntary tax compliance is poverty. Given the level of poverty in Africa, particularly Nigeria, with 133 million people that are multidimensionally poor (National Bureau of Statistics, 2022), people and small businesses faced with multidimensional livelihood challenges are unlikely to prioritize meeting their tax obligations. This is difficult for businesses that operate in the informal economy. In addition, the financial burden of taxes coupled with formalization costs may encourage corrupt practices and tax fraud by the informal sector players. Furthermore, other factors that contribute to noncompliance are literacy level and lack of financial education which is widespread among the informal sector operators. Most of the informal sector operators are either unformed of their tax obligations or lack the necessary knowledge to handle the complexities of the tax system. Therefore, in an

environment where there is little or no support available to the taxpayers, compliance becomes intimidating and burdensome Tanzi and Zee (2000).

Moreso, compliance behaviors are influenced by culture and informal norms. In many countries, these factors often influence how businesses operate than by formal laws. It is becoming a norm to avoid paying taxes in such economies especially when people feel like the government is not meeting their expectations in terms of service delivery. Moore (2023) opined that there is a strong connection between tax compliance and perceived benefits by the people. As such, the government needs to earn public trust by providing better public services to enhance voluntary tax compliance.

### **Theoretical Approaches to Informal Sector Taxation**

The theoretical approaches to informal sector taxation are fundamental in understanding how to effectively adapt formal tax systems in the informal sector. These approaches can be extensively classified into fiscal approaches and developmental approaches.

#### **Fiscal Approaches**

Fiscal approaches stresses on widening the tax net to incorporate shadow economy activities, which is critical for enhancing government revenue generations and ensuring public finance stability. Fiscal approaches are driven by optimal tax theory, which strives to design and implement a system of taxation that maximize social welfare whilst minimizing economic imbalances. As reported by Mankiw, Weinzierl, and Yagan (2009), optimal tax theory suggests that taxes should be designed to optimally minimize unfavorable outcomes on economic behavior whilst effectively raising government revenue. This approach is applicable to informal sector, where traditional taxation methods tend to be unproductive. Although, the adoption of optimal tax theory in the informal sector comes without its challenges. For example, the theory claims that individuals respond to tax policies homogenously as expected and that all economic activities are identifiable. In reality, individuals and enterprises tend to respond to

taxation nonuniformly and the informal sector is lowly identifiable (Jellal, 2009). The pervasiveness of tax avoidance and evasion hinders the application of optimal tax principles. Besides, the informal sector runs on small profit margins, signifying that even minimal taxes can have maximal effects on economic activity, perhaps driving more businesses into informality. Dual economy theory is also a significant principle within the fiscal approaches, which regards the informal sector as a distinct economic entity mutually existing alongside the formal economy. This theory proposes that informal sector businesses should be taxed in a manner that promotes phased formalization, hence broadening the tax base in the long run (Lewis, 1954). Nonetheless, this approach has been condemned for trivializing the correlation between the formal and informal sectors as well as downplaying the challenges associated with transforming informal businesses to formal status.

### **Developmental Approaches**

Taxation should not be seen as mainly a source of generating revenue to the government. Other socio-economic consequences should also be considered when designing and implementing tax policies. Chen (2012) opined that broader development goals like poverty alleviation, making social benefits more accessible and protecting workers' rights should also be considered. Governments, through formalization of business establishments in the informal sector can enhance job conditions and make it easier for operators in the informal sector economy to access financial services. This approach is supported by social contract theory. The theory posits citizens are morally obligated to pay tax to support government in providing valuable public goods and services. This position has made many citizens to be socially responsible and voluntarily meet their tax obligations without being enforced. To enhance tax voluntary tax compliance in the informal sector, governments should design policies that will increase taxpayers' trust. Nevertheless, this approach has its shortcomings as it requires substantial investments in public infrastructure and services which can be challenging in environments with limited

resources. Furthermore, tax reliefs, access to credit and support services, streamlines tax processes are often advocated by developmental approaches to promote formalization and widening the tax base. However, these policies need to be properly managed to avoid the risk of tax evasion and decreasing the tax base, even though some benefits may be derived in the short run.

### **Previous Studies on Informal Sector Taxation**

Many emerging economies are posed with the problem of how best to integrate the informal sector into their tax system. Therefore, numerous empirical research has been carried out to determine the best possible approaches to enhance tax compliance and achieve optimum results. The study by Balengla, Massil, Noah, and Belaya (2024) on digital finance impact, which analyzed 97 countries over a period of 30 years. The study focused on mobile money services on tax revenue in emerging economies. In situations where there is a large informal sector, digital finance increased the rate at which revenue from taxes are collected thereby making payment of taxes more efficient and trustworthy. Mobile money systems transformed cash transactions into digital channels which pass through formal and structured systems that can be kept under surveillance and easily tracked for tax purposes. Likewise, Gnanngnon and Brun (2018) using data from 164 countries within a period of 19 years added that revenue collection can be enhanced by increasing access to internet facilities. The authors emphasized the significance of digital systems in improving tax compliance, limiting the omnipresent cases of tax evasion and widening the tax base thereby bolstering the economy of developing countries. Similarly, Frimpong (2023) studied the cape coast region of Ghana and analyzed the challenges hampering the country's revenue collection from the informal sector as well as approaches and policies put in place to mitigate them. Just like every other informal sector the Ghanaian informal sector is not an exception as it is featured by improper accounting policies and practices, inadequate documentation, low education levels which further exacerbate the issues associated with tax compliance and

collections. About 396 respondents and five elite interviews was carried out during the study in a mixed method research approach where it was ascertained that revenue collection is largely hindered by informal sectors usage of temporary business locations and highly unmotivated tax officials. Frimpong also discovered the interrelation between enhanced tax collection and digital tools. Therefore, the study recommends that to enhance revenue collection from informal sector policies should be put in place to motivate tax collectors hence broadening the tax net and adopting accounting best practices.

Mazhar and Méon (2017) studied the correlation between fiscal policy tools and the informal sector. The authors argued that the grey economy undermines the efforts of the formal tax system which spirals into higher inflation rates and tax evasion. The research further puts emphasis on issues associated with taxing the informal economy as they are boundaryless in nature. The informal sector negatively impacts the Central bank's monetary policy as well as the fiscal policy thereby rendering the economy unstable. According to Dabla-Norris, Gradstein, and Inchauste (2008) firms make conscious effort to remain an unobservable economic entity and went ahead to analyze the basis of this decision. The study indicates that businesses basically strive to remain informal to avoid unwanted pressures from regulatory bodies, tax officials and biased legal systems. The research suggested that economic entities can be persuaded to accept organized and structured systems by making the legal and regulatory environment less cumbersome, appealing and more suitable to the businesses. Similarly, Gordon and Li (2009) contributed to the literature by comparing the formal tax systems in developed economies with its counterpart in emerging economies. The research identified that the government in developed countries are faced with less challenges associated with taxing informal businesses due to the economic entities operations within the structured systems using digital tools as opposed to the use of untraceable cash basis in unorganized systems as found in emerging economies. Hence, the differences in

their taxation systems. Circumstances like this prompt the government to tax areas where the economic activities are well structured and controlled like heavy metal industries whilst providing incentives and policies to curb the effects of unequal taxes.

Ghura (1998) study explored how Non-Mediterranean Africa's revenue mobilization is heavily influenced by corruption and poor economic policies. Using comprehensive data from 39 countries over a span of 11 years period, where it identified the relationship between tax revenue as a percentage of GDP, corruption and government policies. The study points out that tax revenue is spontaneously enhanced, and corruption eliminated when there is human capital development, proper government reforms, and a lowered to no inflation. The research further stresses the negative correlation between corruption and tax revenue, thereby recommending strong anti-graft measures and good economic policies to improve revenue generation. Crivelli and Gupta (2014) examined the problems associated with revenue generation in developing countries endowed with rich natural resources alongside large informal sectors. The study utilized data from 35 emerging countries over a span of almost 20 years where it found out that as resource revenues rise, tax revenues on the other hand tend to decline. The study indicates that governments in these countries may depend excessively on resource income, consequently overlooking the development of strong non-resource tax systems. The overdependence on the rich resources can lead to resource curse hence stagnating economic growth. The authors make emphasis on the significance of multi-dimensional revenue generation sectors that is tax base inclusive.

Schneider and Enste (2000) offers a detailed examination of the shadow economy using a large dataset from 76 developing countries. This is an analysis on the determinants of the magnitude of shadow economy, influenced by corruption, immoderate legislations and high tax burdens. The official GDP declines with excessive taxes and legislations which tend to force formal businesses into the shadow economy. According to the research, large

shadow economies interfere with ever changing tax generation and job market balance, thereby tasking decision makers with huge issues on how best to incorporate informal economic activities into the formal and regulated sector. Tanzi and Zee (2000) scrutinized the problems and best approaches to device a functional tax system in developing economies. The study highlights how inappropriate it is to apply the same tax models found in developed countries to emerging economies with large informal market, stressing on the need to decomplexify the tax systems, implement efficient tax policies and maintain transparency. The authors recommend the assumption of taxes that will limit cases of evasion and are simple to implement like value-added taxes (VAT) to boost revenue mobilization and tax compliance. The research further emphasizes that in order to achieve optimum results, a strong tax administration system should be set up for effective implementation of strategic tax policies.

De Mel, McKenzie, and Woodruff (2013) conducted a study in Sri Lanka on the effects of formalization incentives on unobservable economic entities. The research reveals that financial incentives provided directly to the informal businesses prove to be more effective in formalizing the entities compared to providing them with useful information and refunding costs incurred during business registration which have negligible effect. The study revealed that formalization process can be quite complex and leads to high profits in fast growing businesses but little to no effects on informal businesses at large, stressing how incentives like tax breaks can be significant but inadequate for an all-round change. Besley and Persson (2014) critically examined why developing countries generate and collect low tax revenue compared to developed countries with about 10%-20% of GDP and 40% respectively. The authors argue that the disparity is determined by economic and non-economic factors like ineffective expansion of tax base, overdependence on foreign assistance, a plethora of informal firms, poor political system, low tax compliance and weak rule of law. Revenue generation and tax collection can

be improved in developing countries when there is openness and fairness, institutional development and socio-political elements also well established.

Joshi, Prichard, and Heady (2014) provide a thorough examination of the shadow economy. They stressed that too much attention has been centered on maximizing revenue and designing policy while abandoning the effects of growth and institutional issues. An all-inclusive strategy should be employed to improve all the advantages accruing from standardization of informal sectors, like enhancing safety and economic opportunities, governmental and institutional support is highly required for a successful reform in taxation. The study is emphasizing the greater outcome that will be derived from taxing informal businesses and away from focusing on just decreasing cost of compliance. Dube and Casale (2016) thoroughly scrutinized the strengths and weaknesses of taxing the shadow economy in four African countries namely Zimbabwe, Zambia, Tanzania and Ghana. The implementation of informal businesses taxed via presumptive tax system into the tax net usually encounters issues associated with administration and compliance. In conclusion, Enhanced government capacities and citizens-government relationships can be achieved by having discussions and agreements with shadow economy unions thereby leading to a successful taxation of the informal sector.

Mugoda, Esaku, Nakimu, and Bbaale (2020) study provided a detailed analysis of the issues confronted by Uganda's grey economy, using a dataset gathered from entrepreneurs. This paper identified how level of education is directly proportional to the business type employed, individuals with high level of education tend to operate businesses requiring maximal skills and vice versa. They stressed that strategies enacted should assist and encourage rather than inflict penalties on shadow sector participants, highlighting the requirement for an increased access to resources and legal requirements that promote instead of halting the growth, development and standardization of businesses. Poor infrastructure, high crimes levels, inadequate finance and onerous regulatory frameworks are the major impediments highlighted. This research identified the

obstacles to formalization and development of businesses in Uganda hence call on the need for assistance and refrainment from penal actions.

Bird and Wallace (2004) study examined the complications associated with taxing the informal sector in emerging economies. Theoretical or presumptive taxation plays a part in easing tax procedures through gauging liabilities using obvious signs instead of precise reporting of income generated. According to the authors, the method is empirical but difficult to implement. The research revealed that presumptive taxation is paramount to widening the tax net of the informal sector, and challenges facing the tax system can be reduced through prudent planning and execution. Similarly, Asmare, Yimam, and Semreab (2023) thoroughly analyzed equity implications on the shadow economy in Addis Ababa of Ethiopia's revenue-based tax system. The research reveals notable partialities, where uneven tax system impacts businesses run by women, 44% of the informal businesses despite not making up to the formal system lower tax limit is taxed. The writers suggest a swift transformation of the system to check the obscure nature of ascertaining tax burdens that leads to crosswise inequities. The study highlights the necessary demand for a fair and impartial method of taxing informal businesses in Ethiopia, in the light of the various economical facts surrounding informal enterprises.

A research work by Kawimbe and Mulonga (2024) explores the systematic and functional issues inhibiting the successful taxation of the informal enterprises in Zambia. The analysis reveals the major hinderances like insufficient tax administration, taxpayer education deficiency and the intricate nature of the tax system, leading to minimal level of compliance and revenue collection from the informal sector. The authors stress that dealing with these obstacles requires a goal-oriented strategic reforms, such as improving administrative capabilities, facilitating tax processes and extending assistance to informal enterprises to boost their seamless incorporation into the structured tax system. In a similar study, Mpofu (2023) Examines the deep-rooted institutional challenges impeding effective taxation of Zimbabwe's informal sector. The study uses a

multi-method approach, integrating qualitative sessions and quantitative surveys analyze the administrative, implementation and compliance challenges faced by tax departments. Furthermore, systematic issues like corruption, bureaucratic inadequacies and political intrusion compound to the challenges associated with taxing the shadow economy. In addition, Mtonga (2023) analyses the factors influencing tax evasion in Lusaka's informal sector, focusing on issues confronted by Zambia Revenue Authority (ZRA) during tax collection. The research utilized a convergent parallel mixed-methods design, collecting data from 68 participants via interviews with open and closed-ended question techniques, and three additional ZRA informants. According to the study, notable causes of tax evasion are minimum income, high tax rates, lack of education and complicated tax processes. The research also indicates issues of temporary offices, improper record-keeping and transactions on cash basis.

Haavik and Cissé (2024) examine the relationship between tax authorities and informal sector participants in an informal set up and a delicate state. Using qualitative approach, through interviews and discussion groups, the research reveals four means of interrelationship: tax bargaining, tax evasion, forced taxation and harsh sanctions. The study indicates the different levels of effects amongst informal participants alongside the forceful means of tax administration in Mali. The authors insists that comprehension of the tax nature of the informal sector is utmost, recommending a trust relationship and discussions to reduce social stratifications and improve interaction between the state and society in the fragile states. Similarly, Sebele-Mpofu (2023) examine the complex correlation between tax morale, compliance and the shadow economy within the social and political set up in Zimbabwe. The research stresses that an implied agreement between members of the society affects tax compliance in the informal sector, taxes are readily paid where there is a sense of benefit attached, equitable tax administration and confidence in the government. The study employs a multimethod approach which identifies how tax morale influences abidance,

thereby highlighting that tax revenue from the informal sector could be improved by buttressing the implied social contract. Furthermore, Rogan (2022) thoroughly explores the intricate correlation between the shadow economy and taxation in emerging economies. According to the research, taxation is perceived to reinforce the state vs citizens social contract, however, this interaction is not without setbacks in the case of the informal sector, where the state fails to hold their end of the bargain by rendering public service. Rogan analyzes the state-society relationship and identifies how informal sector participants receive little to no advantageous utility from the state while being consistently taxed by the government. Hence, questioning the idea that taxation reinforces state-society relationship. The finding identifies that lack of benefits to the informal sector in return for taxation may worsen the disparity and lead to distrust in government instead of bolstering the social contract.

Nganga (2024) analyzes the interrelationship between government accountability and tax compliance in Kenyan motor garages. Using mathematical models, the research identifies that voluntary tax compliance tends to be enhanced when there is a social and organizational accountability culture embedded in the system, whereas economic accountability lacks analytical impact. The study recommends that tax payer enlightenment and tax audits are vital in enhancing abidance to tax laws. According to the research work, compliance to tax laws in the shadow economy is fostered by establishing trust and transparency. Similarly, Adekoya, Agbetunde, and Lawal (2022) underscores the crucial significance of trust in influencing compliance to tax laws amongst informal sector participants in emerging economies. The study reveals that tax payers trust in government agencies and tax authorities is a factor influencing tax compliance. The authors highlighted the diminishing effects lack of trust have on compliance with regards to moral decay on the part of the tax authorities, recommending the need for an enhanced transparency between informal sector operators and tax bodies thereby widening the tax base in developing countries.

Thoto, Jayne, Yeboah, Honfoga, and Adegbi (2024), impugns the bifurcation of business formalization into “registered” and “not registered”. Their study was derived from analysis of a dataset of 819 agribusinesses in Benin, establishes a subtle analysis model that reflects a multidimensional formalization, inclusive of business registration status, compliance and adherence to taxation and labor laws. The research identifies multiple stages of formalization within which agricultural businesses operate, where only 3% are found to be fully formal. According to the study, advanced levels of formalization are influenced by financial status, high literacy level, urbanization, formalization procedure insights alongside enhanced tax morality. The study makes emphasis on the need for regulations to tackle the existences in agribusinesses to enhance formalization.

The tax administrations focus on continuous registration of little income generating businesses in non-Mediterranean Africa is condemned by Moore’s (2023) research. The research suggests that there is a bigger political and organizational game at play, where the emphasis on registering low income generating enterprises and steady use of the term “informal sector” acts as a decoy from the insufficient taxation of larger and more advantaged businesses. Utilizing efforts from a recent study and engagements with tax administrators, the author highlights how these approaches provide an inefficient deployment of resources to register a tremendous amount of taxpayers. The research encourages adjustment of tax laws that concentrates solely on the shadow economy, indicating that these measures are likely to be more of a facade than actual revenue collection. Hammond, Kwakwa, Berko, and Amissah (2023) offers a detailed examination on the efficacy of modified taxation, presumptive taxation in particular, as an approach for informal sector taxation in Sub-Saharan Africa. The authors utilized the Best-Worst Method (BMW) a mathematical method used in multi-criteria decision making (MCDM) to arrive at 20 possible challenges and 12 approaches to implement this tax reform. They further emphasized that to overcome the challenges, there is a need to earn trust amongst tax payers



with regards to tax administrators, with the general perception of the latter proving to be the major bottleneck in achieving a successful tax implementation. The research provides an action plan to tackle the intricacies associated with the challenges of integrating the shadow economy into a structured formal system of taxation. Mokgatle's (2023) provides a thorough analysis of obstacles encountered by shadow economy participants in compliance with tax liabilities. Utilizing qualitative research methods, the analysis discloses the challenges faced by these participants, including mistrust in tax departments, insufficient tax processes awareness, and convoluted tax laws & regulations. The research recommends the need for a suitable tax system that aligns with the compliance requirements of the informal sector participants, emphasizing that formalization and compliance can be achieved via a robust and more friendly tax framework.

Finally, Ndlovu and Mohale (2022) examines the difficulties associated with the South African minibus taxi industry's tax compliance and collection, an unregulated sector worth around R90 billion. However, in 2021 the South African Revenue Service (SARS) only generated R5 million, albeit the sectors economic weight thereby sounding alarm on the issue of tax evasion. The authors analyze the drawbacks of the existing turnover tax framework and provides recommendations of bespoke tax policies designed to suit the industry's informal sector, using measures like mileage and automobile passenger capacity. They further underscore the need for stakeholder consultations in order to seamlessly implement new tax policies to enhance abidance and acceptability. The research findings aim to assist South Africa's National Treasury in designing a robust tax framework capable of boosting tax collection whilst maintaining governments Robinhood effect of income redistribution.

The aforementioned empirical studies offer an in-depth insight of the complexities associated with the taxation of informal sector around the world, primarily in African countries. The extensive knowledge accrued from these studies are priceless in terms of policy formulation that can significantly improve tax compliance,

enhance revenue mobilization and support the formalization of the informal sector, specifically in a setting similar to Nigeria.

### **Methodology**

This review employed a narrative approach. The methodology focusses on a comprehensive assessment and consolidating prior findings on taxation of the informal sector. The paper covers studies and research reports issued in government reports, peer-reviewed articles and official institutional publications that deal with informal sector taxation in emerging economies, particularly in Africa. Utmost precedence was given to studies concentrating solely on policy recommendations, research frameworks, and empirical findings related to tax compliance in the informal sector. The research findings from this review serves as the reference point for the paper's recommendations, with the aim of enhancing voluntary tax compliance and improving implementation systems within Nigeria's informal sector.

### **Conclusion**

Enhancing informal sector tax compliance is of major significance to the economic growth and stability in Nigeria. The informal sector is a substantial part of the economy and incorporating it into the formal tax net could uncover significant income sources to Nigeria. Nevertheless, a multifaceted strategy that addresses several challenges identified in this reviewed literature will be required to attain this goal. Tax systems complexity, high regulatory requirements, tax departments corruption, and presumptive tax policies inequities are amongst the key challenges encountered. These challenges are exacerbated by socio-economic metrics including poor literacy skills, poverty and high distrust in government agencies. Multiple approaches have been suggested to tackle these issues.

### **Recommendations:**

As already established by the empirical studies, recommended strategies can be adopted to enhance voluntary compliance and bolster tax enforcement in the shadow economy, specifically in Nigeria. These recommendations

deal with the significant issues discovered in the empirical studies which are discussed below:

1. Nigeria should on leverage digital finance to enhance tax compliance. In light of the success of digital finance in improving tax generation, as revealed by Balengla et al. (2024) and Gnanngnon and Brun (2018), Mobile money systems should be incorporated into Nigeria's tax collection processes, thereby reducing over reliance on cash based transactions and improving monitoring of the processes.
2. Additionally, bureaucratic barriers should be minimize to simplify regulatory processes. Capitalizing on the accomplishment of studies by Dabla-Norris, Gradstein, and Inchauste (2008) and Gordon and Li (2009) which suggests that informality is driven by complex regulations. Tax registration and compliance procedures should be streamlined and optimized in Nigeria to improve accessibility and scale down the cumbersomeness for informal sector players. Minimal clerical work and oversimplified tax laws and regulations can motivate informal sector operators to formalize their businesses and comply with tax laws.
3. Reinforce anti-corruption measures to tackle corruption practices and improve governance. Tax compliance is largely impeded by corruption within tax departments, as demonstrated by Ghura (1998) and Adekoya et al. (2022). Nigeria should ramp up efforts to eradicate corruption lurking within its institutions particularly tax departments by means of increasing transparency and integrity, implementing effective monitoring frameworks, and ensuring that revenue generated from tax are noticeably utilized in providing non-excludable goods. This will aid in restoring trust and rebuild confidence in tax administration thereby promoting voluntary compliance.
4. Design presumptive tax systems so as to implement equitable and inclusive tax policies. As highlighted by Bird and Wallace (2004) and Asmare, Yimam and Semreab (2023), standardized tax rate can be efficient provided it is developed to prevent inequalities. Nigeria should design a tailored presumptive tax system that suits the wide-ranging circumstances peculiar to its informal sector and ensure it does not unfairly weigh down low-income earners. This could entail varied tax rates depending on income levels, size of business or industry.
5. Also, to improve compliance, there should be improvement in public service delivery associated with tax revenue to build trust while strengthening the social contract. Building trust between government and taxpayers tends to have a positive correlation with compliance, as indicated by Sebele-Mpofu (2023) and Rogan (2022). Nigeria should transparently expend tax revenues generated on state services that directly impact the informal sector. There should be clear and obvious enhancements in education, infrastructure and healthcare amongst other basic amenities to strengthen the implied social contract and improve voluntary compliance by informal sector operators.
6. Interaction with Informal sector associations for consultations and collaborations is also a proven strategy to improve compliance. Owing to studies like Dube and Casale (2016) and Ndlovu and Mohale (2022), making emphasis on the significance of engaging with informal sector unions. Nigeria should consult these unions with the aim of developing and enforcing tax policies that will cater to the specific needs of the informal sector. Hence, the collaboration will trigger a sense of belonging and by extension compliance by the informal sector participants.
7. Improve tax education through taxpayer education campaigns and awareness. Studies like Mpofu (2023) and Nganga (2024) revealed that inadequate awareness of tax obligations and procedures is a key factor hindering tax compliance. Extensive tax education campaigns should be invested in Nigeria, focusing on the informal sector with the aim of encouraging formalization. There should be awareness on the utilization of digital tools for tax remittances and how to abide by tax regulations to enhance

compliance. Media outlets like radio and tv alongside other digital platforms and community outreach can be used to undertake these campaigns.

8. Lastly, financial incentives and support services should be available to promote formalization. Provision of financial services can considerably enhance the rates of formalization as highlighted by De Mel et al. (2013) studies. Nigeria should grant tax reliefs, credit facilities amongst other economic incentives to motivate informal enterprises to formalize. Barriers to formalization can further be minimized by offering support services like simplified accounting software and business registration assistance.

### Future Research Directions

While this study has made an attempt to provide insightful contributions from previous empirical studies on informal sector taxation, there still exist a gap that future studies should fill. Future studies should focus on precise impact of digital finance on tax compliance within the informal sector in various regions of the country, especially where the use of these technologies are rapidly developing. Nigeria, being a multiethnic and multicultural society, further research on the influence of socio-cultural elements on tax compliance should be explored. Also, given the various anti-corruption measures put in place, specific research on its impact on tax administration and compliance would provide further insights into the strengths and weaknesses of these measures and helpful in policy direction.

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