The Nexus between Taxation of the Informal Sector and Inequality in Tanzania

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Executive Summary

1.1. Background

Tax raises government revenue that is essential for funding basic public social economic services, national development goals and is at the heart of the social contract between citizens and state. The tax system can directly reduce inequality by redistributing incomes from rich to poor, by taxing the rich adequately and giving the government revenues. In Tanzania, there is a challenge of a large informal sector which is characterized by high level of under-regulation by the government, cash transactions and improper-record keeping, which has often gone untaxed hence subjecting a higher tax burden on the few within the formal sector. As a result of these problems, the informal SME sector has been very complex to tax.

The informal sector tax challenges entail that little or none of the income generated in the informal sector is transferred to the government in form of tax. Therefore, a very high percentage of potential tax revenue is unaccounted for. This in a way contributes to inequality because the informal sector partly constitutes High Net Worth Individuals (HNWIs) whose incomes are not often subjected to tax. Also, those subjected to presumptive tax which may at times taxed higher than what they actually earn and thus makes the presumptive tax regime unfair.

1.2. Objectives of the study

The general objective of this study is to conduct research on the Nexus between *Taxation of the Informal Sector and Inequality in Tanzania*. Specifically, the research:

I.   Analyzes the trends of the growth/decline of the informal sector in Tanzania over the years 2010/11- 2016/17.
II. Analyzes revenue collections foregone from the informal sector over the years 2010/11-2016/17.
III. Establishes the level of inequality due to taxation or non-taxation of the informal sector.
IV. Provides recommendations on how to improve revenue collections from the informal sector while at the same time reducing inequality in Tanzania.

1.3. Research methods, approach and the team

Based on the above objectives of the study, the research employed six independent but complementary methodologies. These included [1] Desk study or literature reviews, [2] field research survey [3] data analysis, [4] initial report writing and presentation, [5] presentations, consultative meetings and workshops and [6] final report writings and submission. The research study was undertaken by a team of researchers from the Department of Economics (DoE) of the University of Dar es Salaam, (UDSM).

2.0. Main Findings

The research study has come up with the following major findings; there is large dynamic but unstable informal sector growth. Unstable informal sector contributes to large revenue foregone and inappropriate taxation of the informal sector. These effects lead to high income inequality.

2.1. Large dynamic of the informal sector growth lead to the low performance of the sector

The informal sector in Tanzania is large and dynamic in the sense that the rate of entry for new entrants is high and the life span for many entrants into the sector is low (approximately less than five years) thus rate of exit is also higher. Also, there is dominance of traditional business, mostly operated by youth and adult operators characterized with basic education conducting mainly trade as the main activity in the sector. Also, the informal sector is dynamic but unstable.

The dynamism of the sector is also associated with the nature of the entrepreneurships participants whereby most of the sector operators have basic education with limited entrepreneurial education, and the nature of economic situation prevailing such that low effective demand which affect the business cycle has been mentioned as among the reasons for short survival of many of informal sector operators. With presence of many small businesses which are not registered, low capital equipment and machinery usage and lack of permanent sites of business operation difficult the formalization process and tax collection into the informal sector. This behavior rises concern about the potential of the informal sector to be depended as another main source of government revenue.

2.2. Unstable informal sector leads to large revenue foregone

Informal sector exhibits an unstable pattern in contributing to the government revenue and thus revenue foregone from the sector get larger overtime. Despite presence of presumptive tax and increased contributors to the tax net, still the informal sector has not contributed substantially to the total revenue. There is large dependency on few large tax payers. This is because most of the operators in the sector have no business licenses and do not pay tax which cause large untapped potential of taxation in informal sector and hence increases the revenue foregone. The burden of tax increases to the few payees while there are many of untaxed firms thus causing the rising of inequality in income among the operators of the sector and between the formal and informal sector.

The use of presumptive income tax has contributed to the improvement of tax revenue as it registers a positive growth of the amount collected each year. This implies that the instituted mechanisms to bring informal sector into the tax bracket are working and thus need to be enhanced and promoted. On the other hand, the increase of revenue foregone is associated with the difficulties of taxing the informal sector due to limited information about the business operators. There are some reasons for informal sector to escape paying taxes in Tanzania. These include; small capital turnover, immature business and economic hardship, Inadequate benefits of paying tax, nature of business and absence of proper business premises are the major factors for the SMEs not paying taxes. Also, inadequate knowledge and education on tax paying advantages, registration and business management practices, cumbersome procedure, bureaucracy and corruption, by the tax revenue collection units, have their contribution.

2.3. Inappropriate taxation of the informal sector leads to high inequality

Presumptive income tax system works better in attempting to collect revenue from the informal sector. However, it may infringe few who are small and are not in the position to pay the taxes or tax less some who are supposed to be in higher income category. This leads to the rise of Inequality which has been viewed as the major policy issue in the country in many sectors. The existence of inequality among the informal sector in the country has been mainly contributed by taxes, size of the informal sector, and Income distribution.

The concern on the tax system particularly the Presumptive tax system is that, many presumptive regimes are deliberately designed to reduce the tax payments of smaller firms. Thus, this fuels the problem of firms not wishing to graduate onto the standard regime when they are able to, and large firms making themselves appear small, and hence leads to inequality. The increasing level of inequality in the society has direct influence in the increase level of poverty, increased level of classes, failure of other business as well as decline of the economy.

3.0. Policy Implication and Recommendations

3.1. Enhanced formalization and performance of graduating informal sector
The size of informal sector in the country is growing overtime and it is owned by mostly youths and adult groups. This implies that, government revenue collection base gets narrowed hence, increase the burden of tax to the formal sector and government itself to cover the provision of public services. Also, this situation characterizes the high level of unemployment among youth and adult's population thus, most of them engaged themselves in the informal activities. Thus, the government should strengthen the formalization process of the graduated informal sector in the country through the following strategies: -
i.   Establishment of informal sectors/SMEs formalization criteria
ii. Improvement of ICT in business SMEs operation, (E-SMEs)
iii. Intensify the use of EFD machines in the business operation
iv. Stabilize economy so as to stimulation effective demand
v.   Ensure provision of dynamic and effective business advisory services
vi. Revise business registration processes so as to stimulate informal business registration

3.2. Widened tax base in the country
With unstable contribution of informal sector to the total revenue, which results to large revenue foregone indicates that the informal sector is not so stable sector for the government to depend on it for its revenue. Currently, tax revenue depends mostly to the large tax payers as compared to the large proportional of other tax payers. In order to widen the existing tax base, the following strategies should be considered:
i.   Ensure continuous monitoring performances of taxable and non-taxable informal businesses,
ii. Raise awareness on taxation matters and business operation among SMEs
iii. Stabilize economy so as to stimulation effective demand
iv. Ensure the improvement of tax systems
v.   Revise business registration processes so as to stimulate informal business registration

3.3. Optimal tax system to the informal sector
The study found that, the existence of inequality among the informal sector in the country has been mainly contributed by taxes, size of the sector, and income distribution. This indicates that, there is high level of inequality in the country which should be minimized or eliminated through the following strategies:
i.   Enhance Research and Development on equity and equality on the informal
ii. Raise awareness on taxation matters, equity and equality of the informal sectors/SMEs in business operation.
iii. Ensure the improvement of the informal sectors/SMEs tax systems
iv. Strengthening financial supports and business environment (infrastructure facilities and reliable market access) to the informal sectors
v.   Establishment of specific business operating areas for the informal sectors

List of Abbreviations

BDS	Business Development Studies
BRELA	Business Registration and Licensing Agency
CSOs	Civil society organizations
DJs	A disc jockey
DoE	Department of Economics
EFD	Electronic Fiscal Device
FDI	Foreign Direct Investment
FGD	Focus Group Discussion
HNWIs	High Net Worth Individuals
ICT	Information and Communication Technology
ILO	International Labor Organization
ISIC	International Standard Industrial Classification of All Economic Activities
LGAs	Local Government Authority
MC	Mic Controller
MoFP	The Ministry of Finance and Economic Affairs
MPs	Members of Parliament
MSME's	Micro, Small and Medium Enterprises
OCD	Organization Co-operation and Development
OECD	The Organization for Economic Co-operation and Development
PF	Policy Forum
PPP	Public Private Partnership
SIDO	Small Industries Development Organization
SMEs	Small and Medium Enterprises
SPSS	Statistical Package for Social Science
TCCIA	Tanzania Chamber of Commerce, Industry and Agriculture
TIC	The Tanzania Investment Centre
TIN	Tax Identification Number
TRA	The Tanzania Revenue Authority
TRA	Tanzania Revenue Authority
TSHS	Tanzania Shillings
UDSM	University of Dar es Salaam
URT	United Republic of Tanzania
VAT	Value Added Tax
VETA	Vocational Educational and Training Authority
ZBR	Zanzibar Revenue Board

Chapter One

1.0. Introduction

1.1. Background
Tax raises revenue that is essential for funding basic public services and national development goals and is at the heart of the social contract between citizens and state. The tax system can directly reduce inequality by redistributing income from rich to poor, by taxing the rich more heavily and giving the government revenues to spend on public services.

In Tanzania, there is a challenge of a large informal sector (or informal micro, small and medium sector) which has often gone untaxed hence subjecting a higher tax burden on the few within the formal sector. This informal sector is generally characterized by a high level of under-regulation by the government, cash transactions (which makes it difficult to properly track the amount of revenue generated), and improper-record keeping.

As a result of these problems, the informal sector has been and remains very difficult to tax. This challenge of taxing the activities in the informal sector means that little or none of the income generated in the informal sector is transferred to the government in form of tax. Therefore, a very high percentage of potential tax revenue is unaccounted for.

This in a way contributes to inequality because the informal sector partly constitutes High Net Worth Individuals (HNWIs) whose incomes are not often subjected to tax. However, there could also be rising inequality because those within the informal sector have often been subjected to a presumptive tax which may at times be higher than what they actually earn. The fact that the informal sector is mainly comprised of people with no or low level of education, women and youth (many of whom are just starting out at business upon failure to acquire stable unemployment), makes the presumptive tax regime unfair.

In 2015/16, the number of taxpayers registered in Tanzania reached 2.2 million1. This number is against a taxable population of about five million people. This shows that less than half of the potential tax payers are actually captured in the tax bracket. Due to the large informal sector, a smaller section of the population has been subjected to a huge burden of tax thus encouraging growth of the inequality gap in Tanzania.

1.2. Objectives of the study
The general objective of this study is to conduct research on the *nexus between taxation of the informal sector and inequality in* Tanzania. Specifically, the research:

I.   Analyzes the trends of the growth/ decline of the informal sector in Tanzania over the years 2010/11- 2016/17.
II. Analyzes revenue collections foregone from the informal sector over the years 2010/11-2016/17.
III. Establishes the level of inequality due to taxation or non-taxation of the informal sector.
IV. Provides recommendations on how to improve revenue collections from the informal sector while at the same time reducing inequality in Tanzania.

1.3. Target Audience

The outcomes of the research targeted various players including Ministry of Finance and Planning (MoFP), Tanzania Revenue Authority (TRA), Members of Parliament, Tanzania Investment Centre (TIC), *Local Government Authorities, (LGAs)*, Civil society organizations (CSOs), Private Sector and Media.

1.4. The Research Team Composition

The study undertaken by a team of researchers from the Department of Economics (DoE) of the University of Dar es Salaam (UDSM). A research team was led by Semboja Haji Hatibu, who has extensive experience of more than 25 years in conducting research studies with triangulated knowledge, experience, and expertise; and excellent understanding of Budgeting, Planning and Policy processes and Protocols and Laws and supported by 4 research assistants namely (1). Amos Samson Pangani, (2). Raya Ali, (3) Victor Mtui and (4) Jackline Makongoro.

The overall team of researchers has direct experience on the informal sectors taxation issues through different studies such as Risk Management in formal Small and Medium Enterprises (MSME'S) and Poverty and Social Impact Analysis of Proposed Presumptive Tax Reform in Tanzania: (A Research Report Submitted to the World Bank by the Department of Economics in 2015).

1.5. Research Methodology and Approaches

The research study employed six independent but complementary methodologies which were [1] Desk study or literature reviews, [2] field research survey [3] Data Analysis, [4] Initial Report Writing and Presentation, [5] Presentations, Consultative Meetings and Workshops and [6] Final Report writings and submission.

1.5.1. Planning, Design and Preparation

The planning, design and preparation was a collaborative task between Policy Forum and Tax Justice Network Africa. The designing, planning, and preparation of data collection, management and analysis which involved the activities such as administrative organization and field work organization are already done.

1.5.2. Desk Review

The first stage of the study was literature reviews. Researchers undertake extensive literature desk reviews and make use of documents available at relevant Government's offices including policy documents, investments' agreements, legal instruments and published reports. The researchers collected secondary data and information on [I] the trends of the growth/ decline of the informal sector (SMEs) in Tanzania over the years 2010/11- 2016/17; [II] Revenue collections foregone from the informal sector (SMEs) over the years 2010/11-2016/17 and [III] the level of inequality due to taxation or non-taxation of the informal sector (SMEs). The literature review helped to refine research instruments and inception report.

1.5.3. Field Research Work

The field research consisted of four independent but complementary methodologies. These include [1] Direct interview and consultations with SMEs, [2] Direct observations on the SMEs activities, [3] In-depth Interview with key stakeholders such as TRA, TCCIA, SIDO and City Councils and lastly, [4] Focus Group Discussions with identified SMEs themselves and their stakeholders.

The field research survey intended to obtain primary data and information about the Nexus between Taxation of the Informal Sector and Inequality in Tanzania with the specifications of performance of informal sectors in Tanzania and the nature/trend of actual and desired tax revenue, also to provide recommendations on how to improve revenue collections from informal sectors with consideration of reducing inequality.

This primary data collection method was executed by three major research groups covering the total study sample of *906 respondents* in different social economic sectors from four selected representative regions namely *Dar es Salaam, Mwanza, Arusha and Mbeya.* The representative sample was selected randomly from all informal sectors (SMEs) and its stakeholders, the selected representative regions were based on the presence of large number of informal sectors.

1.5.4. Interviews and Consultations
The interview involved structured one-to-one interviews with selected samples of individual and key informants of informal sectors (SMEs) operators based on their knowledge and diverse views from all selected regions and stakeholders such as Multi-National Corporations, Indigenous companies, Government officials from the Tanzania Revenue Authority, City Councils authorities, SIDO and TCCIA.

These helped to collect in-depth qualitative, quantitative, pictures and sound information and data about performance of informal sectors in Tanzania and the nature/trend of actual and desired tax revenue, also the recommendations on how to improve revenue collections from informal sectors with consideration of reducing inequality in the country.

1.5.5. Direct Observation
The direct observation method was employed where the researchers record what they saw and hear about informal sectors performance, trend of revenue collections from informal sector firms as well as impacts of taxation system to the operation/performance of informal sectors in the respective areas by using a detailed observation form. The observations mainly involved physical surroundings and ongoing activities, processes or discussions among and around SMEs sectors.

1.5.6. Focus Group Discussion
The researchers used standard and generic focus group discussion (FGD) technique to collect primary data from the informal sector and other SMEs stakeholders. FDG helped to collect qualitative information and data on performance of informal sectors in Tanzania, factors that influencing the informal sector inequality, impacts of taxation on the informal sectors also recommendations on how to improve revenue collections from informal sectors while reducing inequality in Tanzania. The FGD covers the informal sectors, small businessman, and other potential stakeholders like TRA, SIDO, and City Council Staffs in a small group of 10-15 members. The discussion covered three major parts, firstly general understanding of informal sector, secondly performance (factors influencing informal sector and impacts of taxation on the informal sectors) and thirdly policy recommendations. Finally, this method helps to come up with information on the level of inequality due to taxation or non-taxation of the informal sector and policy recommendations on how to improve revenue collections from the informal sector while at the same time reducing inequality in Tanzania.

1.5.7. Key Informants Interview

Key informant interviews involved in-depth interviews with Multi-National Corporations, Indigenous companies, Government officials from the Ministry of Finance and Planning, Tanzania Revenue Authority, SIDO, TCCIA and Tanzania Investment Centre. The purpose of key informant interviews was to collect information from a wide range of SMEs stakeholders, practitioners who have knowledge about informal sectors (SMEs) and taxation in the country. These key informants with their particular knowledge and understanding on SMEs and Taxation, provided confirmatory information based on trends of the growth/ decline of the informal sector in Tanzania over the years 2010/11- 2016/17; Revenue collections foregone from the informal sector over the years 2010/11-2016/17; the level of inequality due to taxation or non-taxation of the informal sector and policy recommendations on how to improve revenue collections from the informal sector while at the same time reducing inequality in Tanzania.

1.6. Data Management, Analysis and Report Writing

Conventionally, two types of data are envisaged, namely primary data and secondary data. Primary data was obtained from the field-research surveys through specific questionnaires, interviews and consultations. And secondary data was obtained from published or unpublished sources from other public and private sources. These included data on the size of informal sector which helped in analyzing the performance, and the desired/planned and actual tax revenue in Tanzania that helped in analyzing the revenue forgone from informal sector.

1.7. Data Management and Analysis

The total sample of **906** mined data and information collected from the questionnaire were keyed into the computer using SPSS for further definitive analysis. Data management involved data entry, processing and analysis. Field research survey conducted in major four selected regions namely ***Dar es Salaam, Mbeya, Arusha and Mwanza*** generated different data set. Data sorting were done in order to arrange items in some sequence and/or in different sets. The main purpose of sorting information is to generate a final secondary data set optimize its usefulness for specific tasks.

1.8. Report writing

Initially the researcher and his team prepared the report about the data collection and analysis processes undertaken during the study and the observed findings. Presentation zero draft and study report will be done to the Internal Policy Forum Management and letter to the Management (Ministry of Finance and Planning (MoFP), Tanzania Revenue Authority (TRA), Members of Parliament (MPs), Tanzania Investment Centre (TIC), Civil Society Organizations, Private Sector, Media) for their information and attention. Then there will be internal consultations and communication with Policy Forum management staff and other Stakeholders about the submitted study report so to gain their views and comments for refinement of the report.

1.8.1. Report format

The structure of the report is composed of five chapters. ***Chapter one*** covers the introduction of the study objectives and methodology. ***Chapter two*** analyses the trend of growth/decline (Performance) of the Informal Sector over the years 2010/11 to 2016/17. ***Chapter three*** analyzed the revenue collections foregone from the informal sector over the years 2010/11-2016/17. ***Chapter four*** covers Level of Inequality due to taxation or non-taxation of informal sector, and ***Chapter five*** covers the Conclusion, Recommendations and policy Implications on how to improve revenue collections from the informal sector while at the same time reducing inequality in Tanzania.

Chapter Two

2.0. Performance of the Informal Sector Firms

2.1. Micro, Small and Medium Scale Enterprises

According to World Bank Presumptive Tax report of 2010, the micro, small and medium scale enterprises or simply the *informal sector* in Tanzania is among the strategic sector yet contributes marginally to tax revenue generation. The micro, small and medium scale enterprises (MSEs) is the second main employing sector after "agriculture" by employing about 10.1 percent of the employed persons, followed by other private sectors with 8.6 percent, where agriculture employed 75.1 percent (Integrated Labor Force Survey, 2006). This situation is happening only due to 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 as the result of ambiguity in the meaning and general understanding of the informal agriculture sector.

In Tanzania informal sector includes non-agricultural enterprises owned by individuals or households that are not constituted as separate legal entities independent of their owners, have limited set of accounts and produce some of their goods and services for sale, (Integrated Labor Force Survey, 2014). It consists of mainly the registered, unregistered and hard-to tax groups such as micro scale traders, street vendors, retailers and in rare cases wholesalers who trade in products such as food, clothes and electronic appliances, small manufacturers, craftsmen, individual professionals and other small scale businesses, (Mbilinyi, 2010).

Many previous studies on informal sector conducted in Tanzania (such as Bagachwa and Ndulu, 1975, Maliyamkono and Bagachwa, 1990 and ILO, 1991) identified important factors that relates to the structure and potential of informal sector in the country. These includes;

i. The sector consists of semi-organized and unregulated activities undertaken largely by the self-employed which provides latitude and flexibility for a broad range of decisions in terms of personal initiative and innovation, the size of the enterprise, the choice of technique and the utilization of income,

ii. There are only minor barriers to entry in all of these activities thus creating a potential base for rapid expansion once the opportunities and incentives are present,

iii. The sector is relatively more labor-intensive, more efficient, more profitable, saves more on skilled labour and foreign exchange, and can generate more jobs with smaller capital outlays than large scale formal sector activities, and

iv. Informal Sector entrepreneurs can mobilize their own savings. This reduces its vulnerability to external shocks compared with the levels faced by the formal sector.

Consultations and views from the Validation Workshop which was held on the 10th October 2018 at Stella Maris Hotel, Bagamoyo considered the characteristics of the informal economy to include (1)Unregistered and outside of the scope of government regulation, (2) Hard to trace, (3). Dynamism of activities in terms of location (merchants moving around) and type of good (selling different items from one day to another); i.e., strategic sector for economic transformation; (4) Ease of entry and exit; (5) Unorganized or lack of proper record-keeping; (6). Cash economy – or interchanging between cash and/or mobile money; (7). Difficult to access credit and (8) Lack of protection – social, economic and political

Although it is a strategic sector for economic transformation, the presence of highly growing informal sector in many developing countries like Tanzania has been viewed as the challenge for taxation, regulation, financing, reforms, and provision for social services with efforts to alleviate poverty overtime (UN, 1996). The players in the sector characterized by absence of business premises, mobile nature of the operators, aggressive nature of the actors and cash operation. These characteristics in line with absence of data and information on the trend and size of informal sector poses the bigger challenges for income tax revenue collection by the government from this sector.

This chapter analyzes the current trends of the growth / decline (performance) of the informal sector in Tanzania over the years 2010/11 to 2016/17. Specifically, the chapter is divided into twenty-four sections. Section 2.2 analyzes the trend of informal sector in Tanzania. Section 2.3 analyses email address, while section 2.4 examines age distribution of interviewees. Section 2.5 describes gender status, while section 2.6 presents the marital status of the respondents. Section 2.7 covers the presentation on the level of education but, section 2.8 analyzes further education or training skills. Section 2.9 explains the type of production by industry, section 2.10 covers the location of business studied and section 2.11 analyzes the place where the business is operated. On the other hand, section 2.12 is elaborating the essence of business license, section 2.13 presents the business registration, section 2.14 presents motivation for going into business as well as section 2.15 explains about the time for the firm to be in operation.

Section 2.16 covers the nature of capital invested to start business, section 2.17 analyzes annual sales from firm's outputs while section 2.18 describes the capacity utilization rate by the firm. Not only that, but also, section 2.19 covers the details on the level of business profitability, section 2.20 explains the employment level of the firm, section 2.21 presents the nature of social security membership status among the business operators while, section 2.22 explains the major limitations affecting business operation and section 2.23 explains the status of Capital Equipment machinery and Technology used by the business/firm. Lastly, section 2.24 is entitled to cover the description of major useful forms of assistance that needed in business/firm, section 2.25 is describing the impact of increasing performance of business on net income whereby section 2.26 presents the major findings from this chapter.

2.2. Increase Size of Informal Sector in Tanzania

Measuring the size of the informal sector depends on how the concept of informality is treated, operationalized, managed and what empirical information is relevant and available for the particular purpose. According to the Integrated Labour Force Survey (ILFS) 2006, the number of informal sector operators in Tanzania is growing fast and their share to the GDP is significant indicating that when they are not taxed substantially, the Government loses revenue. The figures show that in 2006, 40 percent of all households in Tanzania Mainland (excluding agriculture) were in the informal sector activities as compared to 35 percent in 2001, (NBS, 2014).

When including agriculture, ILFS, 2006 reported that 94.1 per cent of Tanzania's population were working in the informal sector of which the agricultural sector was by far the main sector of employment with a share of 74.2 per cent of total employment, (NBS, 2006). In Tanzania Mainland, 91 per cent of all employed (including agriculture) work in the informal economy and only 3 per cent work in the formal sector, accommodating mostly those with formal education. The majority of those in the informal sector are people with low level of education or no education and women. These comprised of adults aged 35-64 years who comprises the majority of persons engaged in informal sector activities as their primary activity with 42.4 percent followed by youth aged 25-34 with 33.5 percent, (NBS, 2014). Thus this shows that, most of the active population of the country are engaged primarily in informal sector activities.

The tables 2.1 and 2.2 present the current trend and distribution of the informal sector size using number of people employed by informal sector in Tanzania based on the Integrated Labour Force Surveys (ILFS) in 2006, 2014 and projections of year 2017.

Table 2.1: Size of Informal Sector in Tanzania

Year	2006	2014	2017*
Employed population by Informal sector	1,682,383	4,344,580	5,416,107

Source: **Integrated Labour Force Survey, 2014 and Own Estimates**

From the table 2.1, the number of people employed by informal sector in Tanzania is increasing significantly from 1,682,383 total number of employees in year 2006 to 4,344,580 in 2014 and estimated to be 5,416,107 people in year 2017. This indicates that, there is a significant increase in the number of people engages in informal sector activities in the country thus signifies the importance of this sector. It is also estimated that Informal sector employs about 31.2 percent of currently employed persons in the country, (NBS, 2014).

The informal sector exhibits a high degree of job creation in Tanzania. However, it is faced with a number of constraints and suffers from low labor productivity and use of low technology or elementary tools. The reason for this is that informal economy organizations in the country, like elsewhere in South Saharan Africa, are basically micro and small enterprises, (Aikaeli, and Mkenda, 2014). The size of informal sector in Tanzania can also be envisaged with consideration to gender and industry with which informal sector activities exists. Table 2.2 shows the percentage of persons employed in informal sector by gender and industry in year 2014.

Table 2.2 indicates that, wholesale and retail trade is the dominant industry that composed of many of the informal activities accounting for 47.9 percent of total informal employment in the country. The second industry with a significant contribution of employed persons in informal sector as main activities is accommodation and food service activities with 14.5 percent. Other sectors with high employment rate are manufacturing with 9.8 percent and the rest of industries not mentioned which accounts for 10.5 percent. This shows that, wholesale and retail trade, accommodation and food activities and manufacturing are the major industries with larger share of the informal activities and thus employs many people directly and indirectly in these activities.

Table 2.2: Persons Employed (%) In Informal Sector by Gender and Activity in 2014

Industry	Male	Female	Total
Mining and quarrying	3.2	1	4.2
Manufacturing	5.2	4.6	9.8
Construction	6.2	0.1	6.3
Wholesale and retail trade; repair of motor vehicles and motorcycles	22.3	25.6	47.9
Transportation and storage	5.9	0.2	6.1
Accommodation and food service activities	2.4	12	14.4
Human Health and social work activities	0.4	0.4	0.8
Others	3.4	7.1	10.5
Total	**49**	**51**	**100**

Source: **Integrated Labour Force Survey, 2014**

Also the table shows that, female constitute 51 percent of the total informal employment while male has 49 percent during the period of survey. *Focus group discussions suggested that* among the overriding reasons for the males' and females' engagement in the informal sector are the inability to find other work and the need for families to get additional income. Other common reasons include the fact that the sector provides good income opportunities and that these businesses do not require much capital. Thus trade, repair of motor vehicles, food services and manufacturing are the easier areas where many informal opportunities arises and looks as the potential industries for informal employment in Tanzania.

Recent observations indicate increasing short term economic difficulties, firms tend to reduce size, retrenching workers in order to reduce their costs of operation while other business collapse, (Rains and Stewart, 1999). Consequently, retrenched workers seek for alternative sources of income for survival and in most cases it turns out to be in the informal sector, (Tokman, 2001). The growth of the informal sector and the decline in the employment rate are associated with lower economic growth, (ILO, 2004). All the above mentioned factors together with the high population growth rate of the country result in the rapid expansion of the sector. However, a raise in the economic growth rate does not automatically shift the informal sector to a formal one, (ILO, 2004 and UNDP, 2001). In this regards, the performance of informal sector in the country has been decreasing thus, increase level of both income and opportunity inequality in the society.

2.3. Limited ICT Communication Uses

With global business transactions continually increasing, the need for effective and efficient communication to meet global demands is also increasing. Managers/business operators and employees must know how to effectively communicate with the company's internal and international stakeholders through different means of communication such as telegram; telecommunication; courier; phones; electronic means like email, fax; postal address; radio and television, so as to build the strong base of the business performance, (Postmes *et al*., 2001, and De Ridder, 2003). This part elaborates the use of means of communication especially email to the informal business.

Table 2.3: Email Address

	Frequency	Percent
Yes	148	16.33
No	758	83.66
Total	**906**	**100**

Source: **Policy Forum Survey, 2017**

Data in table 2.3 shows that, majority of the informal sector at about 83.66 percent do not use/have email address as their means of communication compare to small portion of 16.33 percent which use email address for communication. Many SMEs use traditional means of communications. This means, many business operators in Tanzania are operating with limited modern ICT and thus they do not use other market search techniques such as online systems due to limited business knowledge and awareness in the use of online market and limited capital to purchase the email devices, (E-commerce) trade.

It's projected that, many small and medium-sized enterprises (SMEs) in developing countries have the possibility to benefit enormously in the form of increased productivity, expansion of market, stabilization of business as well as reduction of business operation costs from mobile telephony, the internet including the use of email address and other forms of information and communication technology (ICT) in their day-to-day business activities.

2.4. Youth and Few Adults Domination in the Informal Sectors

It can be seen from table 2.4 that, significant number of the informal sectors population at about 50.66 percent are youth aged 18-35 years old while low number of the selected population at about 48.12 and 1.21 percent are dominated by adults aged 35-60 years and elders with the age above 61 years old respectively. This suggests that, the informal sectors/SMEs in Tanzania is dominated mostly by youths and energetic adults

Table2.4: Age Distribution of SMEs in Tanzania

	Frequency	**Percent**
Youth (18-35)	459	50.66
Adults (35-60)	436	48.12
Elders (61-+)	11	1.21
Total	**906**	**100**

Source: **Policy Forum Survey, 2017**

Youth and adults participates in the informal sector as the way of generating income and opportunity for self-employment. Through self-employment, there is more employment opportunities creation, technological progress, and increase per capital income as well as reduction of absolute poverty, (Tanzania Human Development Report, 2014). The government recognizes youth as significant group in the national development strategies, (URT, 2002). Several programmes are targeting youth entrepreneurship and transformation to formal sector that can be more sustainable and enable government collect tax.

2.5. Male Domination in Informal Sectors

The business ownership distribution by gender is an important factor in characterizing the informal sector. Table 2.5.1 presents the gender distribution of business owners covered by the informal sector study. Table 2.5.1 shows that significant i.e., about 64.12 percent are male while few respondents, i.e., about 36.07 percent are female. The information suggests that, the informal sector in Tanzania is more dominated by male population due to the existence of socio-cultural factors such as patriarchal systems, the issues of being subordinate to their male counterparts, limited voice in business decision making, less autonomy, fewer opportunities and lowered self-esteem, (Mwaba, 2010). Also women have limited access to critical resources like education, land, technology, and credit (Tinuke, 2012).

Table 2.5.1: Gender Distribution

	Frequency	**Percent**
Female	325	36.07
Male	581	64.12
Total	**906**	**100**

Source: **Policy Forum Survey, 2017**

If the majority of women will participate in the informal sector as it has been shown by different literatures, the situation would be more strategically survival as they take over aspects of household maintenance that men can no longer afford, although they tend to face stiff competition from new entrants, including men who have lost or cannot obtain formal sector employment (Tinuke, 2012).

It is illusion therefore to implement effective trade and tax programmes for the economic and social development of the country without the full participation of women in the formal trade sector. The structure suggests traditional gender based constraints and the use of customary law-relating to property, inheritance and land rights-play a key role in undermining women's economic empowerment, (World Bank, 2011).

On the other hand, the cross tabulation of gender and age suggests that, youth male aging 18-35 years old are more participants in the informal sector business compare to female groups. In this regards, Tanzania micro enterprises appears to be male youth dominated.

Table 2.5.2: Gender and Age Distribution

		Gender		Total
		Female	Male	
Age	Youth (18-35)	152	307	459
	Adults (35-60)	168	268	436
	Elders (61-+)	5	6	11
Total		325	581	906

Source: **Policy Forum Survey, 2017**

As illustrated in the presumptive report of 2014, large number of small business entities in tanzania and other developing countries still swims in the business gender-differentiated constraints such as information and business networks; access to and control over key assets; education, skills development, and training; trade facilitation, logistics, and transportation and cultural biases and gender norms. Box 2.1 shows the clarifications of gender related constraints facing women in developing countries including Tanzania. It also describes the sense of inequality existing in the sector between men and women in the full participation in the sector

Box 2.1 suggests that the gender-ownership structure in the business sector is likely to change in a positive manner with increasing social, economic and political reforms in the country, in particular reforms that are gender sensitive typically designed to address critical gender challenges. The numbers of women are likely to increase their ownership in small and medium scale businesses. The changes are likely to be attributed by changing culture, policies, laws, economic and technological development in the country, (Gamberoni and Reis, 2011).

Box 2.1: Gender-Differentiated Constraints to Business
• Information and business networks: Many women lack access to crucial business information including requirements to formally operate a business venture and potential opportunities in the market. In addition, men typically dominate business networks and organizations, such as chambers of commerce and unions, and the government institutions established to support exporters or business community in general.
• Access to and control over key assets: Relative to men, women globally tend to have lower levels of access to the natural, physical, financial, and human capital necessary to fulfill their trade and export potential.
• Education, skills development, and training: While in many countries, education enrolment and completion rates between women and men are equalizing, women still lag behind in skill development programs and on-the-job training, particularly in technical and management-related fields. This was the case noted during consultations that most women compared to men have not had any opportunity for skill development programmes.

- Trade facilitation, logistics, and transportation: Women face gender-intensified constraints at border crossings and are often less equipped to negotiate complex customs procedures or tax obligations than their male counterparts. They are likely to be in a weaker position when negotiating terms and prices with powerful buyers and intermediaries, and are disproportionately disadvantaged when it comes to transportation infrastructure.
- Cultural biases and gender norms: Cultural and gender norms have implications for women's engagement with export markets. Gendered expectations regarding responsibilities for women and men. Women are socially not expected to engage in street business that involves frequent fight with municipal auxiliary police

Source: Gamberoni and Reis 2011 and Author Compilation Synthesis from Survey 2013

According to SMEs policy of United Republic of Tanzania, (URT, 2002), Women are a significant part of the Tanzanian labor force and as such any meaningful development effort must mainstream women. Unfortunately, they have less access to productive resources such as land, credit and education due to cultural barriers.

2.6. Married Couples domination in the Informal Sectors

Table 2.6 elaborates the distribution of respondents in the performance of informal sectors based on their marital status in a tabular form.

According table 2.6, married men and women are the once who engage more in the informal business sector at about 61.25 percent of the whole sampled population followed by single people at about 34.32 percent. In this regards, married category of SMEs marital status are more dominant of the business environment due to their nature of immobility, responsibility and life experience, (AmanDeep and Manisha, 2013).

Table 2.6: Marital Status

	Frequency	Percent
Single	311	34.32
Married	555	61.25
Divorced	21	2.31
Widow	19	2.09
Total	**906**	**100**

Source: **Policy Forum Survey, 2017**

In spite of their contributions to different areas, both kinds of SMEs regardless of their marital status are confronted with various problems including heavy costs of compliance resulting from their size, insufficient working premises and limited access to finance. In addition, Business Development Services, namely services related to entrepreneurship, business training, marketing, technology development and information are underdeveloped and not readily available. Also, SME operators lack information as well as appreciation for such services and can hardly afford to pay for the services, (URT, 2003).

2.7. Basic Education Dominance in the Informal Sectors

Education is a critical element of business growth and social distribution effects. It can be an additional input to the value of production in the economy and also to the income of the person.

Table 2.7: Highest Level of Education

	Frequency	**Percent**
Non	23	2.53
Adult Education	19	2.10
Primary	350	38.63
Secondary	377	41.61
Advance	69	7.61
University/College	68	7.50
Total	**906**	**100**

Source: **Policy Forum Survey, 2017**

Table 2.7 presents the distribution of informal sectors based on their level of education in the study. Data shows that, the informal sector has been dominated by people with secondary education at about 41.61 percent and followed by those with primary education at about 38.63 percent while other levels including University/Colleges comprises of 19.74 percent. In general, *critical masses of business owners have only basic education.*

Tanzania as one among the developing countries seeks to improve their education systems so as to improve employability skills, level of profitability, full utilization of available business opportunities and resources including digital markets and technologies, raise individual and national income as well as reducing if not eliminating the level of unemployment especially youth unemployment as well as inequalities in economic outcomes and utilization of available resources found within their societies, (OECD, 2010).

Across the Africa over 80 percent of small and medium enterprises are in cluster with secondary education as a highest level, (Wood and Mayer, 2001). Wood and Mayer, 1998 shows, that Africa' land abundant per worker combined with its low level of skills, is an important determinant of its high share of primary products in its total trade. On the other hand, the resulted level of education covered by the informal sector in the study indicates that, the sector has contributed in the existence of the level of revenue inequality. Thus, fostering human capital enhances business growth and diversification into high technology products.

2.8. Large number of Informal Sectors with no entrepreneurship education/ training skills

In Tanzania, further entrepreneurial education, training, workshops and skills can be provided under both private and Government organization such as Vocational Educational and Training Authority (VETA), Small Industries Development Organization (SIDO), Tanzania Chamber of Commerce, Industry and Agriculture (TCCIA) and many other international organizations. This part of the report covers the elaboration of further education, training and other entrepreneurial respondent's distribution in the informal sector.

Table 2.8: Further Education or Training Skills in Entrepreneurship

	Frequency	Percent
Non	695	76.71
VETA	94	10.37
SIDO	64	7.06
NGOs	51	5.62
TCCIA	2	0.22
Total	**906**	**100**

Source: **Policy Forum Survey, 2017**

Respondents views on table 2.8 indicates that, majority that is about 76.71 percent has not received any further business education and training skills from any organization while few that is about 23.29 percent has received further business education and other training skills for the development of their business. *This situation implies that, majority of the informal sectors in Tanzania have limited further entrepreneurial education, training, workshops and other skills.* This is due to limited awareness of such education, unstable financial ability (Income Inequality) which make difficult in payment of training and workshop fees, bad believes of some business operators in terms of the relation between their tribe and business (they don't want to attain those education and other training since they have been born in the business family and tribes) and also unsatisfactory implementation of trade and education policies especially in the parts of business entrepreneurial education, training, workshops and other training, (Mariam, 2015).

Presence of large number of informal sector with no other additional skills has contributed to the decrease in production, economic growth and development, employment opportunities as well as increase in the Income Inequality. Rising awareness of the importance of entrepreneurship education, training and other skills will enhance informal sectors to sustain in the business cycle, increase the ability of explore the available resources and other business opportunities, stabilize the business in the trade competition and removal the business duplication tendency through the increase of innovation and invention among SMEs, (Rwamitoga, 2011).

One of the main reasons for the explain state of affairs is that, Tanzania's education and training system does not consciously develop values, attitudes and skills that enable people to see and realize the potentials in the country. Moreover, in developing nations, the contribution of these entrepreneurial education, training and other further skills is also very low. For instance, Private sector contributions are growing only slowly, due to a lack of trust between public and private stakeholders and only 2-6 percent of educational budgets are allocated to technical and vocational skills development in most of African countries, (International Growth Centre, 2017).

Skills development enhances both people's capacities to work and their opportunities at work, offering more scope for creativity and satisfaction at work. Good-quality primary and secondary education, complemented by relevant vocational training and skills development opportunities, prepare future generations for their productive lives, endowing them with the core skills that enable them to continue learning, (ILO, 2010). These contributions are very small in Tanzanian informal sector since the area does not have full exploitation and utilization by the trade sector.

2.9. Significant number of Wholesale and Retail Trade Operators in Informal Sectors

Table 2.9 presents the distribution of the informal sectors by sectors based on the selected categories in the study. Table 2.9 suggests that many, that is about 41.50 percent of total respondents are engaging in Wholesale and retail trade and few i.e., about 12.03 percent are in accommodation, grocery and food service activities. This situation has contributed to the increase competition over few areas of production, distribution and consumptions activities, with high rate of business duplication within the areas, limited availability of other sectors products where producers and distributors are not operating and increase in the sector development imbalance within the country.

According to Bill Vorley, *et al* (2008), Small and Medium Enterprises (SMEs) are increasingly tied to these areas of production due to the tied models in markets and agro-industries through business linkages driven by producers, buyers as well as intermediaries including NGOs and alliances with each other and with other value chain stakeholders. Also other factors such as producer organization, market coordination and intermediation, business support and financial services, buyer behavior, and enabling policies limited knowledge of people in other areas of production, limited entrepreneurial knowledge and skills and infrastructure influence sustained and greater justifiable inclusion of small business actors in the discovered major production sectors.

Table 2.9: Type of SMEs by Industry

	Percent
Wholesale and retail trade	41.50
Repair of motor vehicles and motorcycles	4.08
Manufacturing furniture and wood product	5.07
Manufacturing Metal product	5.30
Manufacturing of lather product	3.31
Financial services (Bureau De Change, M-Pesa, T-Pesa, Airtel Money, Vikoba etc)	5.00
Agriculture	7.17
Mining and Quarrying	2.53
Construction	2.31
Education (tuition centers and kindergarten)	2.10
Arts, entertainment and recreation (MC, DJs,)	6.29
Accommodation, grocery and food service activities	12.03
Rental and leasing activities	0.66
Heath	3.00
Total	**100**

Source: **Policy Forum Survey, 2017**

Further, the concentration of small and medium business operators on trade service sectors is due to lack of appropriate policy, development strategy, and sector oriented support agencies, thus, restrain the development and expansion of SMEs (HAGOS, 2012). On the other hand, unlike Tanzania, Nigeria small and medium sector is mostly dominated by service oriented ventures, craftsmanship, agriculture, processing, manufacturing and commerce, (Gerald, *et all*, 2017). In Zimbabwe, the key players in the informal sectors comprises of manufacturing of general products markets operators, furniture manufacturers, suppliers and producers of agricultural products, food vendors, (Clainos, 2011).

2.10. Informal Sectors Domination in the Urban Centre

In choosing the location of business the following factors should be considered; assessment of the costs, estimation of benefits as well as availability of any help from either Government of non-Government entities. Table 2.9 shows the distribution of informal sectors/SMEs location based on the study.

Table 2.10: Location of the business

	Frequency	Percent
Village	3	0.33
Town	52	5.73
Municipal	586	64.67
City	265	29.24
Total	**906**	**100**

Source: **Policy Forum Survey, 2017**

The table 2.10 suggests that, many that is about 64.67 percent of informal activities are located in municipal, significant number 29.24 percent are in Cities and few that is 5.73 percent are in towns. Very few that is about 0.33 percent are in village areas. In this regards, large number of Informal Sectors/ SMEs are urban areas where there is high population pressure; well improved infrastructures as well as easy availability of products and other requirements like accessibility of technology, business training, workshops and seminars. The informal sector is seen as a heterogeneous set of activities, urban or rural, which have the common features of catering to the mass of low-income consumers, existing competitively due to the low supply price of labour, and being capable of retaining an important role in economies with widely varying levels of development so long as this supply price remains low, (Livingstone, 1991). With more than 70 percent of non-agricultural economic activities and non-agricultural jobs located in urban areas, this draws many of our young in search of opportunities, **(**Rugasira, 2016).

2.11. Majority of Informal Sectors operation in Rented areas

Businesses operate in different places including permanent building, in fixed structure, in the vehicles, temporally structure, along roadside and within designated market areas or alongside market areas. This section examines the state and distribution of business operation based on their selected areas.

Table 2.11: Where the Business Operated

	Frequency	Percent
Temporary structure	40	4.42
Fixed structure	37	4.08
Rented	716	79.02
Improvised/Permanent post on the road	23	2.53
Vehicle (car, truck, bike, etc)	1	0.11
Customers home	7	0.77
Taxi/Bus station in permanent structure	6	0.66
At central market place	42	4.63
Within own (Operators) home	32	3.53
Other (specify)	2	0.22
Total	**906**	**100**

Source: **Policy Forum Survey, 2017**

According to table 2.11 majority of informal sectors/SMEs i.e., at about 79.02 percent operate their business activities in the rented areas while few, that is, about less than 5 percent of Informal Sectors operates in other areas such as at central market place, temporary structure, fixed structure, vehicles etc. This implies that *development of commercial/ business centres is critical for promoting SME formalization*

Most of the Informal Sectors/SMEs in Tanzania prefer renting premises, (*Frames*) due to financial inadequacy to construct or buy a premises; reducing financial risk due to depreciation and transaction costs, especially for real estate which might be needed only for a short amount of time and also mobility nature of many SMEs in Tanzania. These Frame-SMEs activities are temporary or transitional social economic activities. SME renting premises do not need to worry about lifespan and maintenance.

However, *running business in rented and small sized temporary structures does not only affect business growth and constrain access to finance; it strongly affects visibility and sustainability for such business to pay tax.* There are also very few (4.63 percent) operating in central business market place, this means, commercial centres must provide additional permanent space for small and medium enterprises to operate their business and pay tax. Programmes to improve business environment for SMEs must clearly articulate the need to provide business premises and oversee its implementation in collaboration with local government.

Comparatively, in recent International Labor Organization survey, 43 percent of the informal sector were working in agriculture, 28 percent occupied fixed stall or other permanent structure. When the business location is informal or non-permanent it has implications on women's employment. One of the sectors mostly affected is the informal sector. When informal sector operators don't have for example land tenure on the area of operation they have major threats. City authorities normally evacuate them at no or very short notice. To avoid loses women move with their children so that they can salvage as much as possible in minimum time when city authorities strike.

2.12. Many SMEs Sector's operation under Business License

This part of the report presents the distribution of business license status among the selected informal sectors respondents. Data in table 2.12 shows that, many that is about 60.5 percent have business license compare to some at about 39.5 percent do not have. This suggests that, in spite of the importance of registering business, Tanzania informal sectors still lagging behind due to cumbersome procedures, large number of legal requirements with almost the same features, high costs of business registration accompanied with corruption as well as too many registration agencies for only one business registration, (URT, 2010 and UDSM, 2014).

Focus group discussions suggested that; due to large proportional of informal sector without business license the expected revenue collection is low; increase tax burden to few registered business operators (Revenue Inequality); limited provision of public service by the government and limited economic growth and development.

Table 2.12: Do you have Business license

	Frequency	Percent
Yes	548	60.5
No	358	39.5
Total	**906**	**100**

Source: **Policy Forum Survey, 2017**

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.

2.13. SMEs in the Business Registration Environment

According to Business activities registration Act, 2005, Part I, pg.4, assert that there will be a business registration Centre in every local authority. Today, the government Business Registration and Licensing Agency, (BRELA), do all business registration. In addition, registration with the Tanzania Revenue Authority, (TRA), is of interest here too. TRA registers all businesses by granting Tax Identification Number, (TIN) through which it is able to collect taxes as per Income Tax Act, 2004.

Table 2.13a: Business Registration

	Frequency	Percent
BRELA/Business Registration	332	57.94
Local Government Authority (LGAs)	60	10.47
Both	181	31.59
Total	**573**	100

Source: **Policy Forum Survey, 2017**

Table 2.13a presents the nature of business (SMEs) registration based on the study. According to data many i.e., about 57.94 percent of the total registered sample are registered by BRELA. Very few (10.47) part of the study population are registered by Local Government Authority. Significant part i.e. about 31.59 percent operate have both registrations. These results indicate that, improvement made to the BRELA agency in terms of distance, cost and time as well as efficiency has influence business operators to register their business under this agency. However, what is the important here is for a business to operate under business registration umbrella regardless of which agency is it registered.

Several reasons can be used by business owners to justify their operation without registration of their business. Some of these reasons have their basis on the limited registration awareness (ignorance) among businessman or voluntary escapement of registration process for their own benefits. According to the literature, businessman who did not register their business justifies this action as they are in the process of being registered; nature of their business does not support registration thus is why they don't need to be registered; lack of awareness if they supposed to undergo registration; presence of too many registration requirements; too much costs in terms of financial and time on the registration process and others point out the issue of presence of too many taxes, (URT, 2010).

Table 2.13.b indicates that, many that is about 35.59 do not need to register. These see registration as useless bureaucratic procedure. Some are unaware of registration and others fear for negative consequences. Simplification of the registration procedures through introduction of online registration which reduce registration time cost; increase awareness on the importance and benefits of registering business to the business operators; introduction of computerization systems of registration which reduce bureaucracy and corruption among the agencies; introduction of registration programmes,

seminars, workshops and training as well as strengthen of registration and tax collection rules and regulations has been the hub to the improvement of business registration among business operators especially the informal once, (URT, 2010 and consultations with TRA staffs, 2017).

Table2.13b: Reason for Not Registering Your Business

	Frequency	Percent
In the process of being registered	90	25.42
Do not need to register my business	126	35.59
Do not know if I have to register	33	9.32
Too many requirements to complete registration	25	7.06
Have to pay too much to register	19	5.37
Could be bad for my business	56	15.82
Too many taxes, levies and fees	5	1.41
Average		14.3

Source: **Policy Forum Survey, 2017**

Registering of business is important since it construct the strong base of professionalism that makes traders more particular as justify the sense of not a fly-by-night operator and are here for a long term. Also, registration helps the business to get assistance such as loan and investors from the banks and other parts of the business; simplify customer payments through bank transaction system; it simplifies the process of employment within the firm as well as easy access of assistance and services from the Government, (URT, 2010). Unlikely 2014 where BRELA possessed only 9.4 percent of Small and Medium enterprises (SMEs) under its registration umbrella, the number grows to 56.6 percent in 2017, (URT, 2014).

2.14. Motivation for Doing Business

Table 2.14 presents motivations for doing SMEs business. Motivation for doing business covers the main aim, or purpose, objective or driving force which drives the person to establish a certain business/activity. The table suggests that Tanzanian Informal Sector/SMEs are mostly driven by two major factors; *firstly*, limited number of job opportunities in other areas for the whole period of time, that is why they opt to engage in such business (about 61 percent) and *secondly*, the desire of putting their acquired training knowledge and skills in practical, (about 30 percent).

Table2.13: Motivation for going into this business

	2014	2017
	Percent	Percent
Fewer job opportunities elsewhere	49.7	60.8
Put training into use	18.1	30.1
Lost a job or was laid off or retrenched	13.6	1.8
Because parents/relatives were in the business	18.6	7.3

Source: **Poverty and Social Impact Analysis of Proposed Presumptive Tax in Tanzania Study, 2014 & Policy Forum Survey, 2017**

These results imply that majority of SMEs would have a courage to do something better if they have given a chance since they try to fight in business. This makes some of them grow and successes because they are always fight for their best and consider business undertaking as a major and

permanent bread winner strategy. Regardless of them being in the business cycle as the results of fewer job opportunities in other sectors and being hindered by its diversity nature, it's clear that, SMEs/Informal Sectors are the major job creation engine in the developing countries including Tanzania.

2.15. Time to be in Operation and Member of Social Security Fund Status

Table 2.15 presents the relationships between informal sector/SMEs time of operation and social security fund status among the sector. Table 2.15 suggests that many firms, i.e., 43.7 percent have been operational for about 2 to 5 years. Few firms i.e., about 13.6 percent are new and 21.4 are old with more than 5 years. This suggests that SMEs activities are characterized with systemic entries and exits. Also, the table suggests that very few, i.e., about 10.5 percent of SMEs are in the Social Security Fund System. Only older SMEs are members of Social Security System.

Table 2.14: Time to be in Operation and Member of Social Security Fund Status

		Are you a member of social security fund?		
		Yes	No	**Total**
For how long does your business/firm has been in operation?	Less than 7 months	7	116	**123**
	7months – 2years	2	191	**193**
	2- 5 years	47	349	**396**
	more than 5 years	39	155	**194**
Total		**95**	**811**	**906**

Source: **Policy Forum Survey, 2017**

Majority of informal sectors are not in the social security fund system due to limited awareness of its functions and benefits, low income which is the results of income and opportunity inequality hence, limiting ability to pay the monthly fees, high expenses of the system and the system is deficiencies in the level of protection and coverage scope, (ILO, 2001)**.**

Lack of access to social security is often a direct consequence of informality, loss of man powers, increase dependency and increase certainty of decrease on the poverty alleviation strategies, (Mchomvu, 2002). A growing body of evidence shows that, the extension of social security coverage, promoting access to health care and education, contributes to enhancing nutrition and health status and plays an important role in promoting productive employment, as well as economic and social development.

In Tanzania social security is mostly characterized by limited coverage in   terms of membership and access to benefits. This low level of social security coverage automatically implies limited resilience to economic shocks and increased vulnerability, especially among women, who are mostly employed in low-paid occupations in the informal sector, (Social Policy Gender in Tanzania, 2017). Comparatively, it is recorded that whereas in the industrialized nations more than 90 per cent of the population is covered by various forms of state or market-organized social security systems. In Sub Saharan Africa and South Asia only 5 to 10 percent of the active population are covered by social security schemes. In general, only 20 percent of workers enjoy adequate social security coverage worldwide (Olivier, 2012).

2.16. Capital Invested To Start The Business (In TSHS)

Capital Investment covers the main aspects of management of capital expenditure such as fixed capital in the business, long term financial policies, capital and financial structures and control of capital expenditure within the firm. Table 2.15 presents views of respondents on the informal sector's capital invested when starting their businesses.

Table 2.15 shows that significant number ie., about 54.1 percent invested between 1 million to 5 million when they started their business. Very low, i.e., about 20 percent invested less than 1 million and, 14.1 percent invested between 5 million to 10 million and 12.9 percent invested more than 10 million at the initial stage of their business. This suggests that, many SMEs have started their business through financial investment decision of between 1 million to 5 million.

Table 2.16: Capital Invested to Start the Business (In TSHS)

	Frequency	Percent
Less than 1,000,000	171	18.9
1,000,000-5,000,000	490	54.1
5,000,000-10,000,000	128	14.1
Above 10,000,000	117	12.9
Total	**906**	**100**

Source: **Policy Forum Survey, 2017**

Small amount of capital investment is due to limited access of finance to them, low capacity of risk taking among the business operators, presence of loans that accompanied with difficult conditions such as very high interest rates as well as absence of qualification to some SMEs of being helped in the general operation of their business as they are not registered by any registration agency in the country, (URT, 2003).

Focus group discussions suggested that; investment decision is the strategic SMEs financial management. This is because of the fact that, of all the major aspects of financial management such as management of capital expenditure, investment decision, working capital management, profit management, tax management, merger and combination. The success or failure of an enterprise depends on the general management of this part of capital.

2.17. Changing Patterns of SMEs Annual Sales

Turnover is a key variable in determining firm's performance during a financial year. It does not only provide financial performance but also implicitly shows how the firm is operationally and functionally fairing. It is a critical indicator of competitiveness in a given market that suggests potentials for growth. Table 2.17 presents the annual sales form firms output surveyed.

Table2.17: Annual Sales from Firm's Outputs

	2010/11	2016/17
	Percent	Percent
Below 4 mill	64.3	19.3
4mill-10mill	9.7	38.2
10mill-40mill	14.6	29.5
40mill-80mill	6.2	8.8
80mill and above	5.2	4.2
Total	**100**	**100**

Source: **Policy Forum Survey, 2017**

Table 2.17 suggests that annual sales less than Tshs 4 million decreased from about 74.0 percent of total sampled population in year 2010/11 to about 57.5 percent in year 2016/17 and annual sales of above Tshs 10 million increased from 26.5 percent in year 2010/11to about 42.5 percent in year 2016/17. This change of annual sales distribution suggests that SMEs are performing.

A poor economy, such as a recession in year 2016/2017, can cause a dramatic drop in sales and low purchasing power. SMEs caught in this situation may have no choice but to scale down operations or change pricing models and product lines until the economy recovers. The Tanzanian informal sector is more dynamic with unstable fluctuating rate of turnover growth rates as it is in other developing nations. This is true given limited access to business support instruments in some areas that the formal sector enjoys, including modification of registration and tax systems. The instability problem is linked to lack of capabilities by business owners to transform efficiently and effectively in general performance, social and time resources into goods and services that can be availed to the market at competitive prices.

2.18. Moderate Capacity Utilization Rate

This part presents the distribution of informal sector capacity utilization rate. This rate used to measure the proportion of potential economic output that is actually realized by the firm given capacity utilization levels on the insight of the overall slack of the firm at a given point in time. Table 2.18 shows that significant number of SMEs that is about 45 percent are operating under less than 40 percent of installed capacity utilization rate. Also, significant number that is 25 percent are operating at about 50 percent and about 30 percent are operating above 60 percent.

The moderate capacity utilization rate is associated with relative improvement of power supply; decrease in the inflation rate; improvement in the skilled workers wage rate and improved human capital (Akpan, *et all,* 2011 and Mojekwu, *et all*, 2012).

Low capacity utilization rate is a concern for firm or Government fiscal and monetary authorities that are willing to engage in economic stimulation and transformation. For instance, in 2015 and 2016, several European economies, such as France and Spain, were struggling with the effects of low capacity utilization rate.

Table 2.18: Capacity Utilization Rate by the firm

	Frequency	Percent
0-20%	136	15.0
21-40%	275	30.4
41-60%	223	24.6
61-80%	138	15.2
81-100%	134	14.8
Total	**906**	**100**

Source: **Policy Forum Survey, 2017**

Despite the onset of monetary stimulus leading to historically low interest rates, inflation remained below target levels for extended periods and the threat of deflation loomed. With so much excess capacity, rising product activity did not require significant capital investment but the presence of conducive environment that stimulate fair competition among business operators, increase employment opportunities for producers, easy financial accessibility, as well as sound economic and trade policies.

2.19. Level of business profitability in 2010/11 and 2016/17

One of the indicators on general firm's performance, viability and sustainability is profitability level. Graph 2.1 shows the level of business profitability based for the years 2010/11 and 2016/17.

Graph 2.1: Level of Business Profitability in 2010/11 and 2016/17

Source: **Policy Forum Survey, 2017**

Moderate level of profitability for the sector is due to many factors. These include: unfavorable legal and regulatory framework, undeveloped infrastructure, poor business development services, limited access of SMEs to finance, ineffective and poorly coordinated institutional support framework and decrease business cycle, (URT, 2003 and consultation with TRA and SIDO staffs, 2017). There is low business cycle which is the result of limited money supply in the society, introduction of many new small taxes apart from TRA system, political changes and low level of knowledge of business management as contributive majors for performance stagnation.

Low profitability is the greatly contributed by limited SMEs access to the capital especially financial capital to fund their growth and expansion, limited access of adequate market due to the stiff and unfair competition from street vendors; unfavorable market environment which does not attract buyers and lastly high operational costs due to large number of taxes and tariffs/charges (URT, 2002, 2003, Nichter & Goldmark 2009, Arbiana 2013 and consultation with SIDO and TCCIA staffs, 2017).

2.20. Employment and Member of Social Security Fund

According to ILO, 2012 informal employment is a job-based concept and encompasses those persons whose main jobs lack basic social or legal protections or employment benefits and may be found in the formal sector, informal sector or households. Table 2.18 shows that few i.e., about 10.5 percent of respondents are operating under the social security fund.   Many SMEs are self-employees. Few employ persons outside family network.

Comparing to the report of 2005/6 report of ILO the number of employment in the informal sectors was far more at about 51.7 percent. In Uganda in 2010, was ahead by having 59.8 percent of person employed in informal sector, (ILO, 2012). Recent decrease level of both direct and indirect

employment in the informal sectors has contributed into decrease Government revenue; increase unemployment base; increase level of income and opportunity inequality; decrease market level and also deteriorate of economic growth and development, (Consultation with TRA, SIDO and TCCIA, 2017). Tanzania has a decreasing rate of employment due to decreasing rate of level of profitability associated with low level of business cycle, increase number of other small taxes and of political integration.

Table 2.18: Employment and Member of Social Security Fund

		Are you a member of social security fund?		
		Yes	No	Total
Do you have employees?	Yes	53	166	219
	No	42	645	687
Total		**95**	**811**	**906**

Source: **Policy Forum Survey, 2017**

According to Patricia Jones, 1999, education plays an important role in economic development and growth. At the aggregate level, there are strong theoretical reasons for linking the expansion of education to higher rates of economic growth, firm performance, productivity and economic development. The more education employee has, the more firm performance attained, hence, its more profitable for the firm to employ an employee with high education level since it reduce the business decline risk.

Table 2.19: The Minimum Employee Education Level for Different Job Categories

	Skilled workers 2010/11	Skilled workers 2016/17	Unskilled workers 2010/11	Unskilled workers 2016/17	Casual Laborers 2010/11	Casual Laborers 2016/17
	%	%	%	%	%	%
Primary Education	31.25	19.67	65.12	54.55	86.28	87.34
Secondary Education	34.38	37.70	32.56	42.05	13.73	12.66
Diploma Education	21.88	22.95	2.33	3.41	0	0
University Education	12.50	19.67	0	0	0	0
Total	**100**	**100**	**100**	**100**	**100**	**100**

Source: **Policy Forum Survey, 2017**

Table 2.19 suggests that nowadays 2010 - 2017 many SMEs employees are secondary school leavers. Also many of casual laborers in SMEs are primary school leavers. There are few diploma and university graduates, engaged as skilled workers in the SMEs. This situation is the results of the favorable characteristics of workers who possess low education level such as low wages, limited social security and other requirements, less/or absence investment in training costs and hardworking to the business/firm owners, (Didier, 2010).

Table 2.20 shows the distribution of Minimum Employee Wage level for different job categories between 2010/11 and 2016/17.

Table2.20: The Minimum Employee Wage level for different job categories

		Less than 50,000	51,000 to 100,000	101,000 to 150,000	151,000 to 200,000	201,000 and Above	Total
Minimum wage Skilled worker in 2010/11	%	7.41	3.70	22.22	11.11	55.56	**100**
Minimum wage skilled workers in 2016/17	%	1.82	3.64	20.00	16.36	58.18	**100**
Minimum wage Unskilled worker in 2010/11	%	17.02	23.40	25.53	12.77	21.28	**100**
Minimum wage Unskilled worker in 2016/17	%	14.61	28.09	28.09	10.11	19.10	**100**
Minimum wage casual workers in 2010/11	%	41.82	27.27	14.55	9.09	7.27	**100**
Minimum wage casual workers in 2016/17	%	34.67	21.33	21.33	12.00	10.67	**100**

Source: **Policy Forum Survey, 2017**

Table 2.20 suggests that many that is about 58.18 percent of employees earn above Tshs 201,000 per month in year 2017. Few that is between 7.27 percent and 21.28 percent of the unskilled and causal workers earn above Tshs 201,000 per month in year 2017. Table 2.10 suggests SMEs workers earn less than Tshs 201,000 per month in year 2017. These are low income earners. They earn less than minimum wages. Minimum wage policy is a powerful tool for supporting decent work goals and can be a crucial complement to the strengthening of social protection levels and poverty alleviation efforts in mostly developing countries. This tool has become even more relevant as many of these countries need to boost domestic sources of growth in order to counteract the weakening of exports to crisis-hit advanced economies, (Rami, *et all*, 2013). Also, rising minimum wages can help to rebalance sources of growth even with limited fiscal space in the country and firm in general. So it's better to play both cards with regards to the prevailing environment and functional demands for wages.

2.21. Major limitations affecting business operation

There are permanent and transitory limitations of the business that hinder the performance of the business towards the attainment of planned goals. Table 2.21 lists some these limitations and constraints. Table 2.21 suggests that there are many, various and complex factors, constraints, limitations and challenges affecting performances of SMEs in Tanzania.

The Business Cycle or Economic Fluctuations

Many of the respondents, i.e., about 59 had the views that currently, small business circle are main factors behind poor performances of the SMEs. These short term fluctuations typically involve shifts over time between periods of relatively rapid economic growth (expansion or booms), and periods of relative stagnation or decline (contractions or recessions). Currently, many people in Tanzania have the opinion that the country is in the later periods characterized with rapid and severe contraction; with crisis (*stock exchanges crash and multiple bankruptcies of firms occur*) and at the same time recession (*drops in prices and in output, high interest-rates*).

The experienced social economic difficulties in year 2016/2017 are transitory whereby business cycles reflect the possibility that the economy may reach short-run equilibrium at levels below or above full employment. If the economy is operating with less than full employment, i.e., with high unemployment. Keynesian theory states that monetary policy and fiscal policy can have a positive role to play in smoothing the fluctuations of the business cycle. The *partisan business cycle* suggests that cycles result from the successive elections of administrations with different policy regimes. The growing recognition of the important role of SMEs play in economic development will vanish to the horizon as the result of declining of large number of SMEs that attacked by the prevailing limitations especially limited business circle, (Ackah and Vuvo, 2011).

There is a low socio economic activities, low purchasing power as the result of Income inequality, inflation and low welfare of the business owners due to distortion of income of the owner of firm by different limitations. This has no big difference on situation at Ethiopia whereby the main challenges facing informal sectors in business operation are inadequate skills, government police and private shop guards, lake of demand, lake of experience, multiple constraints, (Sibhat, 2012). Similarly, the International Labour Conference (2013) shows other sides of limitations that still justifies the presence of large number of business operation blocks. They state that, while some activities offer reasonable livelihoods and incomes, most people engaged in the informal economy are exposed to inadequate and unsafe working conditions, and have high illiteracy levels.

Table 2.21: Major limitations affecting business operation

	Percent
Nonpayment of debts	8.3
Small business circle	59.1
Unavailability of credit facilities	5.5
Lack of management skills	2.1
Lack of Capital equipment	2.3
Lack of skilled personnel	2.3
Taxes/market levy and license fees	4
Lack of raw materials/irregular supply	3.2
Lack of space	1.9
Theft	1.5
Shortage of water and electricity	4.1
No difficulties	3.3
Improper Infrastructure	0.8
presence of street vendors	1.7
Average	**7.14**

Source: **Policy Forum Survey, 2017**

Also, they have low skill levels and inadequate training opportunities, less certain, less regular and lower incomes than those in the formal economy, suffer longer working hours, absence of collective bargaining and representation rights and, often, an ambiguous or disguised employment status.

2.22. Capital Equipment machinery and Technology used by the business/firm

Tables 2.22 a - i present the nature of informal sectors capital equipment machinery and technology. Table 2.22.a shows that, most operators, that is about 77.3 percent do not own, manage and use process and grilling capital equipment machinery and technology in their business/firm compared to significant number, i.e., about 22.7 percent who do. This is due to the high cost of purchasing the required equipment and limited technological skills among the business operators hence, the equipment is of no use to them.

As SMEs in Tanzania face increasing challenges and competition as the result of globalization, it is apparent that they need to upgrade their technological capabilities. Technology provides SMEs with the opportunity to increase their efficiency and productivity with tools to better manage their business. In India where 85 percent of informal sectors use grinding equipment and technology in the business operation while in Tanzania and Malaysia the number is small but in developed countries the percentage of using grinding machines and technology is high.

According to the information in table 2.22b, many that is about 51.94 percent of the Grinding capital equipment machinery and technology are from outside the country compared to small number of respondents at about 48.06 percent which are from domestic. Data suggests that, there is improvement in the production of these equipment due to very small difference between imported and domesticated equipment and technology used by the firms.

Table 2.22.a: The use Processing/ Grinding capital equipment machinery and technology in business /firm

	Frequency	Percent
Yes	206	22.7
No	700	77.3
Total	**906**	**100**

Source: **Policy Forum Survey, 2017**

Table 2.22.B: Originality of Capital Equipment Machinery and Technology

	Frequency	Percent
Imported	107	51.94
Domestic	99	48.06
Total	**206**	100

Source: **Policy Forum Survey, 2017**

Table 2.22.c indicates that, many of the Grinding capital equipment machinery and technology used by the informal sectors/SMEs in their business activities are used/or old at about 77.67 percent. Few that is about 22.33 percent of the study respondents use new imported capital equipment and machinery. The use of old equipment is related to financial constraints among SMEs as well as durability of the equipment since some of the products are more durable even if they are already used by other firm.

Table2.21c: Status Of The Processing Capital Equipment Machinery And Technology

	Frequency	Percent
New	46	22.33
Old/used	160	77.67
Total	**206**	100

Source: **Policy Forum Survey, 2017**

Table 2.22d indicates that, most of the selected informal sector operators at about 91.58 percent own, manage and operate storage capital equipment machineries and technologies while very few i.e., about 8.43 percent use to rent. In this juncture, there is improvement in business operators due to the functions of some awareness creation agencies like SIDO and TCCIA.

Based on the data in table 2.22e, majority, that is, about 92.6 percent do own, manage and operate transportation capital equipment machinery and technology in the business associated to very low part of the study population at about 8.42 percent which are using. This implies that, the performance of informal sectors business is still low as a results of different things such as number and amount of taxes, unfavorable infrastructures, financials problems as well as nature of their business does not require the use of such equipment

Table2.21d: Ownership of the Storage capital equipment machinery and technology

	Frequency	Percent
Own	87	91.58
Rented	8	8.42
Total	**95**	100

Source: **Policy Forum Survey, 2017**

Table 2.22e: The use of Transportation capital equipment machinery and technology in the business

	Frequency	Percent
Yes	67	7.4
No	839	92.6
Total	**906**	**100**

Source: **Policy Forum Survey, 2017**

According to table 2.21f suggest that majority, that is, about 92.65 percent of the used Transportation capital equipment machinery and technology are domestically oriented compared to very few i.e., about 7.35 percent of the imported once.

Table2.22f: Originality of the Transportation capital equipment machinery and technology used in business/form

	Frequency	Percent
Imported	5	7.35
Domestic	63	92.65
Total	**68**	100

Source: **Policy Forum Survey, 2017**

Table 2.21g suggests that most, i.e., 82.09 percent of the Transportation capital equipment machinery and technology used in business/form used/or old in contrasts to very low, that is about 17.91 percent which are new.

Table2.22g: Status of Transportation capital equipment machinery and technology used in business

	Frequency	Percent
New	12	17.91
Old/used	55	82.09
Total	**67**	100

Source: **Policy Forum Survey, 2017**

Table 2.21h revealed that, many, i.e., about 66.18 percent own transportation capital equipment machinery and technology whilst few i.e., about 33.82 percent used to rent the machine and technology.

Table2.22h: Ownership of the Transportation capital equipment machinery and technology used in business/firm

	Frequency	Percent
Own	45	66.18
Rented	23	33.82
Total	**68**	100

Source: **Policy Forum Survey, 2017**

Table 2.22i suggests that, majority i.e., about 84.2 percent among informal sectors are not using ICT in running their business while very few of them (15.6 percent) of informal sectors use ICT in their business operation. This implies that many informal sectors have low skilled in using ICT, do not understand importance of ICT in modern world business, have poor business operation.

Table 2.22i: The Use of ICT Capital Equipment Machinery and Technology

	Frequency	**Percent**
Yes	141	15.6
No	765	84.4
Total	**906**	**100**

Source: **Policy Forum Survey, 2017**

Compared to Kenya use ICT is high as reported by Opiyo, and K'Akumu, 2006 that 50 percent use mobile phones, 19.3 percent use landline (private), 23.1 percent use landline (public), 3.8 percent use fax and 3.8 use email and internet in their business operation. Better ICT services expand overall economic potential by allowing firms to be more accessible and hence more productive and attracting more investment to a particular area. ICT may be required to meet basic business life support needs. The decision by businesses to locate in a particular area is greatly influenced by the availability of adequate information and appropriate communication networks and facilities.

A successful informal sector of sustainable ICT clusters requires that the ICT provided are the ones in demand by the entrepreneurs and that they should be located strategically, in order to generate optimal utilization and avoid the loss of man-hours by the informal sector having to search for the services.

2.23. The Major Useful Forms of Assistance That Needed In Business

The development and prosper of SMEs in developing nations is in the hands of the assistance from different government private and public actors. Most of them need assistance in various areas such as production, expansion of their investment, transportation of their products and goods, availability of reliable markets as well as modern technology.

Table2.23: The Major Useful Forms of Assistance that Needed in Business/Firm

	Percent
Provision of permanent site	29.6
Better access to loans	26.6
Easing in Government regulations/and market levy	26.8
Improved infrastructure system systems	2.1
Training for self	5.6
Training for workers	0.8
Access to marketing techniques	3
Access to modern technology	5.5

Source: **Policy Forum Survey, 2017**

Most of the literature identified different kinds of assistance needed by most of SMEs in their operation. These are provision of permanent sites; access of better and affordable loans; simplification of government regulations and market levy; improvement of infrastructure systems; provision of entrepreneurial training and workshops for both business owners and their workers; ensure the accessibility of modern market techniques and the provision of business modern technologies. Table 2.23 summarizes major useful forms of assistance that needed in business/firm by SMEs in Tanzania.

The main constraints for the growth of informal sectors is that most of SMEs are not in position to afford permanent premises for their business, lack of access to credit, lack of management skills, and very limited access to new technology all of these are detrimental to the growth of business, (Juz, 2008). Caroline, (2005) noted that in South Africa same problem exist in informal business due to lack of government support to informal sectors, lack of ownership of land or collateral for accessing loans and poor level of education which result lack of managerial skills. Many SMEs believe that they fail to grow to formal business due to the presence of those obstacles. SIDO provides rented areas for informal businessman to handle their business operation but from interview with SMEs it was found out that renting areas are expensive.

2.24. The Impact of increasing performance of business on net income

Table 2.24 summarizes views on the impact of increasing performance of business on net income. The table suggests that that many that is, about 50.2 percent have the view that increasing performance have a positive impact on the net income of SMEs fin Tanzania. That is high level of business performance contributes largely to higher net income of the business operators. The enabling business environment and level of education stimulate business performance which in turn lead high income to the business operators.

Studies on profitability of informal micro enterprises in developing countries converge on the fact that, supportive business environment erodes SMEs profitability level, (OECD, 2004), yet very few get supernormal profit. Compared to other countries like India and South Africa level of business performance among SMEs is high due to use of new technology, high level of education, strategic flow of provision credit to SMEs. In Tanzania Survey on Poverty and Social Impact Analysis of Proposed Presumptive Tax in 2014 indicated low level of business performance and low significance profitability among SMEs.

Table 2.24: The Impact of Increasing Performance of Business on Net Income

	Frequency	Percent
Very high	282	31.1
High	173	19.1
Moderate	239	26.4
Little	156	17.2
Very little	56	6.2
Total	**906**	**100**

Source: **Policy Forum Survey, 2017**

2.25. The Changing Character and Increasing Growth of The SMEs Activities

The character and size of informal sector in Tanzania have been changing during the last ten years. The service and in particular wholesale and retail trade is the dominant informal sector in Tanzania. Majority of the SMESs are not formal and these do not use email addresses/ICT as their means of communication. The married, youth and adults own, manage and operate informal sector activities. The critical masses of business owners have basic primary and secondary education and limited entrepreneurial education, *training, and other skills*.

Majority SMEs activities are located in urban centres, in particular; municipal, cities and towns and many operate their business activities in the rented areas. Many have business licenses. The increasing SMEs activities are mostly driven by two major social economic factors; *firstly*, limited number of job opportunities in the formal sector, that is why they opt to engage in such small and medium scale businesses and *secondly,* the current desire of putting their acquired training knowledge and skills in practical. SMEs activities are characterized with systemic entries and exits. Also, very few SMEs are in the Social Security Fund System.

Many SMEs have started their businesses through financial investment decision of between Tshs 1 million to Tshs 5 million. Both capacity utilization and profit levels are moderate. There are many, various and complex factors, constraints, limitations and challenges affecting performances of SMEs in Tanzania. Some are permanent and transitory limitations. These include small business circle, unavailability of credit facilities; lack of management skills; lack of adequate capital equipment; lack of skilled personnel; taxes/market levy and license fees; shortage of electricity; improper infrastructure and presence of street vendors.

3.0. Tax Revenue Collections from The Informal Sector

3.1. Introduction

African countries have made significant efforts to strengthen their tax policy and tax administration capacities, however, they continue to face the challenges of large informal sector, and a narrow tax base, particularly in resource-rich countries that make them vulnerable to unstable resource revenues. According to Revenue Statistics in Africa, 2017, the informal sector tends to be high in countries where the cost of tax and other regulatory requirements are higher. The demand for countries to increase their tax bases is even higher if they are to meet the Sustainable Development Goals, (SDG), for 2030.

In Tanzania, third generation social economic and political reforms pursed during last twenty years have improved relationships between business environment and taxation systems. These reforms have compelled the small and medium scale entrepreneur in the urban and major cities to join the tax net. On the small and medium-sized enterprises; (SME's) 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 markets including for export, (Stern and Barbour, 2005). On the government's side, by encouraging firms fully enter the formal sector through registering for and paying taxes, government promotes a culture of 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.

The TRA research study (2010) aimed at promoting and enabling and supportive environment to the development and presumptive income taxation of the informal sector in the country. Review of informal sector for taxation purposes 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 (*ibid*). This suggests that as much as the efforts of presumptive scheme have been undertaken to simplify the tax regimes, their outcomes have to be significant in pulling the informal sector operators into formal sector, hence bringing them in the formal TRA tax net.

The chapter three is organized into nineteen sections. Section 3.1 covers the introduction. Section 3.2 analyses issues related to presumptive income tax in Tanzania, while section 3.3 describes advantages and disadvantages of Presumptive Taxes System. Section 3.4 analyses impacts of presumptive Income Tax to the informal sectors. Section 3.5 presents Performance of Presumptive Income Tax. Section 3.6 elaborates the payment of tax status to the government by the SMEs. Section 3.7 analyses the period when the business/firm start paying taxes. Section 3.8 describes the types of taxes paid by the business/firm and section 3.9 present respondents' views on the amount of taxes paid by the business/firm. Section 3.10 analyzes the influence of tax system to the trend of informal sector and Section 3.11 presents the use of EFD machine in business/firm.

Section 3.12 presents the level of satisfaction on the EFD machine performance in the business while section 3.13 analyzes the contribution of EFD machine to the performance of business / firm. Section 3.14 presents the views and acceptability of the system of taxes used by the business/firm. Section 3.15 analyzes the impacts of the system on income as well as section 3.16 presents impacts

of tax system on the effectiveness of products/service or competitiveness. Moreover, section 3.17 presents the contribution of taxation system of informal sectors to the performance of business/firm without living aside. Sections 3.18 and 3.19 describe reasons for SMEs not paying tax and revenue collections foregone from the informal sector over the years 2010/11-2016/17 respectively.

3.2. Presumptive Tax System in Operation in Tanzania

Presumptive tax system in operation is a special tax measures or *tax preferences*" and pervasive element in the income 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, (Slemrod and Yitzhaki, 1994 and Terkper, 2003). This is an income tax system where individuals are taxed based on their annual turnover. The taxpayers under this system are not obligated to prepare and submit audited accounts to the TRA. However, they may opt not to apply the system and prepare audited accounts and pay tax based on profits. To qualify for this system, the taxpayer must meet the following conditions;

i. The Taxpayer must be a resident individual

ii. The annual turnover of the business does not exceed the threshold of TSHS 20 million.

iii. The taxpayer must conduct business only for the year of income hence not be engaged in any other activities such as employment or investments. Under the presumptive tax system, individual's income must be derived solely from business sources. If income is derived from other sources such as employment and/or investment the presumptive scheme cannot be used.

iv. The individual's income for any year must consist exclusively of income from business with sources in the United Republic of Tanzania.

3.2.1. Many Taxable Categories by Income Group

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, 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 into 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, 2003). The resulting new annual rates of presumptive tax were adjusted.

Table 3.1: Rates of Tax Under Presumptive Tax System: 2017/2018

Annual turnover	Tax payable when records are incomplete	Tax payable when records are complete
Where turnovers does not exceed TSHS 4,000,000	NIL	NIL
Where turnover exceeds TSHS 4,000,000 but does not exceed TSHS 7,500,000	TSHS 150,000	3% of the turnover in excess of TSHS 4,000,000
Where turnover exceeds TSHS 7,500,000 but does not exceeds TSHS 11,500,000	TSHS 318,001	TSHS 135,000+3.8% of the turnover in excess of TSHS 7,500,000

Where turnovers exceeds TSHS. 11,500,000 but does not exceed TSHS 16,000,000	TSHS 546,001	TSHS 285,000+4.5% of the turnover in excess of TSHS11,500,000
Where turnover exceeds TSHS 16,000,000 but does not exceed TSHS 20,000,000	TSHS 862,499	TSHS 487,000+5.3% of the turnover in excess of TSHS 16,000,000

Source: **TRA, 2017**

Under this system, tax payable is established based annual turnover shown by taxpayer's records. In absence of complete records, annual turnover will be estimated based on the best judgment of the commissioner. The turnover bands and their tax rates are as stipulated by table 3.1:

b) Many taxable categories for the individuals who prepare audited accounts

This is a group of taxpayers whose annual turnover is above TSHS 20,000,000 and are required to prepare audited accounts/financial statements in respect of their business. Taxpayers under this category are taxed basing on their profits. The rates applicable for this category are as follows in table 3.2.:

Table 3.2: Rates of Tax for Individuals Who Prepare Audited Accounts

Annual Taxable Income	Tax Rate	
	Tanzania mainland	Zanzibar
Where Total Income does not exceed TSHS 2,040,000	NILL	NIL
Where Total Income exceeds TSHS 2,040,000 but does not exceed TSHS 4,320,000	9% of the amount in excess of TSHS 2,040,000	13% of the amount in excess of TSHS. 1,800,000
Where Total Income exceeds TSHS 4,320,000 but does not exceed TSHS 6,480,000	TSHS 205,200 plus 20% of the amount in excess of TSHS 4,320,000	TSHS. 327,600 plus 20% of the amount in excess of TSHS. 4,320,000
Where Total Income exceeds TSHS 6,480,000 but does not exceed TSHS 8,640,000	TSHS 637,200 plus 25% of the amount in excess of TSHS 6,480,000	TSHS. 759,600 plus 25% of the amount in excess of TSHS. 6,480,000
Where Total Income exceeds TSHS 8,640,000	TSHS 1,177,200 plus 30% of the amount in excess of TSHS 8,640,000	TSHS. 1,299,600 plus 30% of the amount in excess of TSHS. 8,640,000

Source: **TRA, 2017**

3.3. Various Advantages and Disadvantages of Presumptive Tax System

Table 3.3 presents various 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, (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 SMEs with very high profit margins, (Jaramillo, 2004).

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 Treasury.

Table 3.3: Presumptive Taxes System: Advantages and Disadvantages

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

Source: **TRA, 2017**

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 SME profit margins is required before setting the rate.

3.4. Significant Impact of Presumptive Income Tax

We will now examine how the tax system in Tanzania has influenced the ways in which the informal sector entrepreneurs behaved. Conventional objectives and expected impacts for taxation of presumptive income tax for small and medium scale firms include raising revenue for the government budget. Given that small and medium scale businesses generally do not generate substantial levels of income/consumption tax, most TRA devotes its scarce resources to large taxpayers. This section asserts that the presumptive income tax has a strong impact on a SME-firm's decision to enter the formal sector and thus grow. To this end, the section sets the following national development objectives for the presumptive income tax;

- ➢ To create a "culture of taxation" and the regularization of the rule of law,

- ➢ To provide education and training on how to monitor business activities,

- ➢ To increase the size of the formal sector, *and*

- ➢ To promote growth.

The achievement of these national development goals suggests a different type of tax system from a large taxpayer scheme, and a slightly enhanced role for the revenue authority to include outreach and education.

3.5. Performance of Presumptive Income Tax

The performance of presumptive income tax which reflect the tax from informal sector is the key variable to consider in order to describe the performance or contribution of informal sector into the total revenue collection. Table 3.4 presents the basic tax statistics including the targeted and actual tax revenue collection, presumptive taxes, total tax revenue, number of taxpayers and other indicators in the country from 2010/11 to 2016/17.

In respect to table 3.4, the total number of registered tax payers has been increasing yearly from 845,737 in year 2010/11 to about 2,500,727 in year 2016/17 and presumptive income tax payers also increased from 414,395 in year 2010/11 to about 678,125 in year 2016/17. This increase is reflected by their respective growth rates where the number of taxpayers on average has the growth rate of 196 percent and presumptive tax payers with the growth rate of 64 percent between the two periods (2010/11 and 2016/17). However, the total number of presumptive income tax payers as percent of total TRA tax payers decreased from 49 percent in year 2010/11 to about 27.1 percent in year 2016/17. This trend is also portrayed in figure 3.1 and 3.2.

Such increase in the number of tax payers implies that, more people are contributing to the national income out of their activities, however the number seems to be still low when comparing to the working population. Also, data on table 3.4 shows that, both presumptive income taxes for individual with accounts and individuals with no accounts have been increasing during the sample period.

The reported performance results from many interacting factors including improvement of presumptive scheme system where more SMEs comply with tax payment and other tax administrative measures have largely contributed to this achievement. Also, Block Tax Management System, tax survey and patrols, tax severance and tax audits surely have reported their contributions to this achievement. With the intention of the authority and the government to increase the revenue collection, these factors have in one way or another contributed to the performance of tax revenue and increase in number of tax payers in the country.

When comparing the number of taxpayers with other East African countries there is no much difference in the number of tax payers especially the Small and Medium Enterprises whereby for Kenya the number of active taxpayers largely the SMEs reported to be about 2 million in 2016/17 while in Tanzania it is about 2.5 million SMEs.

Table 3.4: Presumptive Income Tax Basic Statistics from 2010/11 to 2016/17

	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
Targeted tax revenue collection	5,652,589.63	6,228,832.56	7,871,430.33	10,374,937.57	11,318,221.90	12,362,957.98	15,105,100.05
Total TRA Net Collections	5,315,147.57	6502599.16	7739298.48	9383046.94	9908996.35	12525377.55	14126590.01
Total TRA Net Domestic Collections (Including Domestic Excise Duty, Excluding Customs & Excise) (Mil. TShs.)	2,988,665.81	3910763.23	4747921.39	5778289.15	5918638.58	7326729.78	8499620.01
Individual tax revenue (Account cases) (Mil. TShs.)	28,858.98	37,115.23	39,844.02	49,506.49	54,792.54	76,261.34	96,087.57
Non Account Cases (Presumptive) (Mil. TShs.)	20158.08	28653.10	30064.96	37902.79	47089.34	65539.87	82578.76
Individual Tax Revenue (Account cases + presumptive) (Mil. TShs.)	49,017.06	65,768.33	69,908.98	87,409.28	101,881.88	141,801.21	178,666.33
Presumptive taxpayers	414,395	459,674	498,442	538,317	581,383	627,893	678,125
Total number of TRA taxpayers	845,737	1,035,281	1,609,420	1,783,511	1,990,032	2,199,360	2,500,727
% of presumptive taxpayers to total TRA taxpayers	49%	44.4%	31.0%	30.2%	29.2%	28.5%	27.1%
Growth rate of Presumptive Taxpayers		10.9%	8.4%	8.0%	8.0%	8.0%	8.0%
Growth rate of Total TRA Taxpayers		22.4%	55.5%	10.8%	11.6%	10.5%	13.7%
% of Presumptive to Total Individual Revenue Collections	41%	44%	43%	43%	46%	46%	46%
% of Total Individual (Account & Non Account Case) Revenues to Total TRA Net	0.9%	1.0%	0.9%	0.9%	1.0%	1.1%	1.3%
% of Presumptive Revenues to Total TRA Net	0.4%	0.4%	0.4%	0.4%	0.5%	0.5%	0.6%
% of Total Individual (Account & Non Account Case) Revenues to Total TRA Net Domestic	1.6%	1.7%	1.5%	1.5%	1.7%	1.9%	2.1%
% of Presumptive Revenues to Total TRA Net Domestic	0.7%	0.7%	0.6%	0.7%	0.8%	0.9%	1.0%

Source: TRA, 2017

The Nexus between Taxation of the Informal Sector and Inequality in Tanzania

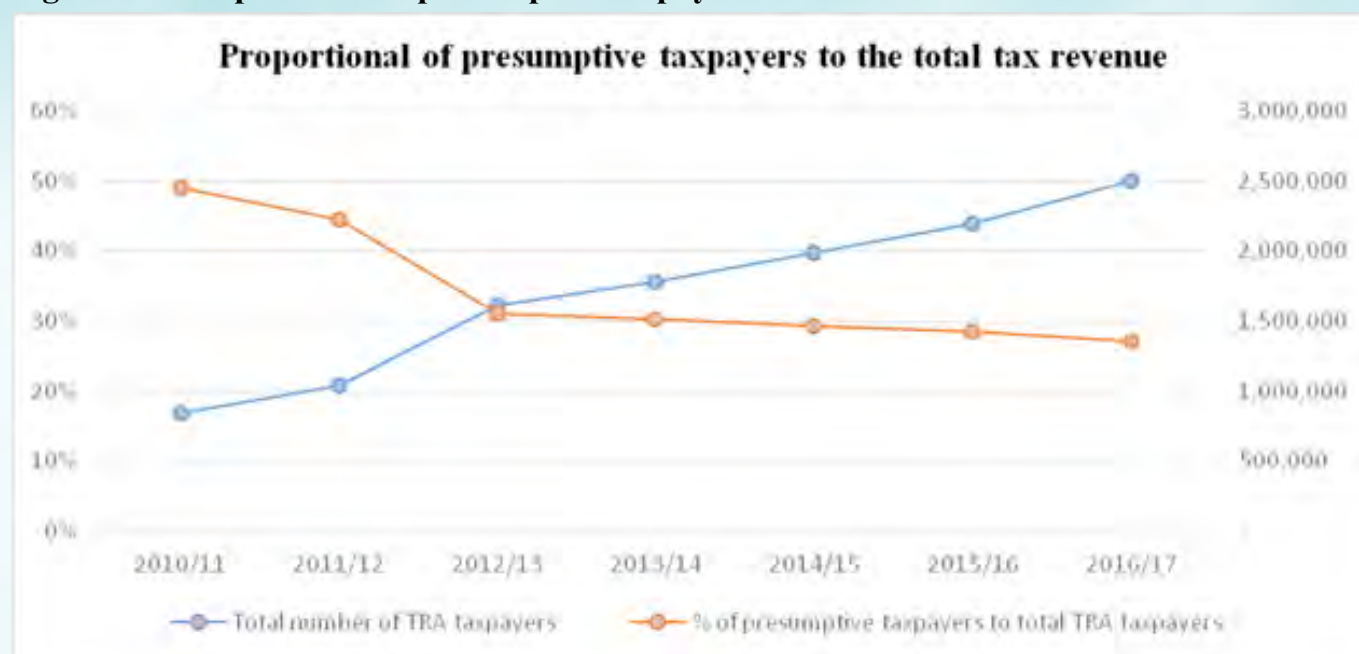**Figure 3.1: Trend of Total and Presumptive Income Tax Payers**

Source: **TRA, 2017**

Figure 3.1 portrays the trend of income tax payers both presumptive and total revenue tax payers whereby both are progressive as the information indicating that, both total and presumptive income tax payers have been increasing during the period under consideration. The result has revealed that, significantly improvement in the domestic revenue mobilization, introduction of some tax incentives, increase accounts preparation awareness among the informal sectors and rewards to the large tax payers and improvement of tax collection strategies has contributed to the persistent increase in both kinds of tax payers (TRA, 2011 and Semboja, 2015). According to Semboja, 2015, the tax revenue as percent of total GDP increased from 15.3 percent in the year 2008/2009, to about 18.5 percent in the year 2014/2015. Also, this observed increased was hand in hand with the increasing of presumptive income taxes during the same sample period.

Like many Sub-Saharan African countries, relative efficiency of tax collection in Tanzania has improved. Both presumptive income taxes for individuals with accounts and individuals with no accounts have been increasing during the last eight years. The total number 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 tax regimes, their outcomes have not been significant in pulling the informal and semi-informal sector operators into formal and, hence, bringing them in the TRA tax net. However, while 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, it is true for the second category that the presumptive tax system has not been very effective and significant enough to change the behavior of the informal sector.

Figure 3.2: Proportional of presumptive taxpayers to the total tax revenue

Proportional of presumptive taxpayers to the total tax revenue

Source: **TRA, 2017**

Figure 3.2 suggests that, since 2010/11 the number of total income tax payers have been increasing faster than the number of presumptive income tax payers. This is shown by the declining trend of proportion of presumptive tax payers to the total taxpayers. 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.

The total presumptive income tax in Tanzania has been very small (about 0.4 percent during the period of 2008/9-2014/15) compared with other forms of income taxes, number of taxable entities and desired tax transformation targets (TRA, 2011). Obviously, the short-term effect of taxing small and medium scale enterprises is the possibility of increased revenue for fiscal expenditures. The medium and long-term effects are that by legitimizing more private enterprises, the country can provide greater access to business/vocational education and skills training for these small and medium scale firm's workers and micro business owners.

For many micro and small entrepreneurs in developing economies, the choice to pay tax or remain in the informal sector is a socio-economic complex decision. Most firms will choose to stay in the non-tax paying informal sector by default since the perceived short-term and temporary benefits outweigh the perceived immediate costs (Joel & Shlomo, 1994; Ofori, 2009; Marti, 2010; Nakiwala, 2010). If compliance costs both financial and time are added into a firm's cost-benefit analysis of paying taxes, the disincentive to comply with tax requirements becomes even stronger. On local government authorities too, there is also a strong disincentive to collect taxes from small businesses.

3.6. Increasing of informality in the SMEs sector

The term tax refers to a mandatory financial charge or other type of levy usually imposed by authority on person's activities or property in terms of money so as to finance various public expenditures. Any failure to pay, or evasion of or resistance to taxation, is punishable by country's law. Taxes consists of direct or indirect under a certain tax system. This part investigates the relationship between business license (formality Indicator) and response to the tax payment.

Tables 3.5a and 3.5b show that large number of SMEs, i.e., about 77.70 percent in year 2016/17 and about 100 percent in year 2010/11 have had business licenses and they are paying taxes means they are formal, but tables 3.5a and 3.5.b show that few SME firms i.e., about 22.30 percent in year 2016/17 and 0 percent in year 2010/11 had no business licenses but they pay taxes. This suggest that significant number of SMEs firms are entering into the tax network. These may be paying other local government taxes and levies while tables 3.5a and 3.5.b show that majority of SMEs at about 93.18 percent in year 2016/17 and about 87.5 percent in year 2010/11 have had no business licenses and they did not pay taxes. These are classical informal sector firms. These are outside government network.

The increase in their number suggest an increasing informality in the SMEs sector and tables 3.5a and 3.5.b show few of SMEs, i.e., about 6.82 percent in year 2016/17 and about 12.5 percent in year 2010/11 have business licenses but they do not pay taxes. This decrease in their number suggest a decrease on SMEs tax evasion. However, the revenue foregone from licensed informal sector firms have insignificant impact in the total revenue since it's from very small population but there is a possibility of large number of tax payer being operating freely under the umbrella of those SMEs who claim to legal operation without business license. In this case, the Government should investigate clearly the validation of large number of SMEs at about 93.18 percent to operate without business license.

Table3.5a: Informal sectors/SMEs Paying Tax with Business License 2016/2017

		Paying of taxes		Total
		Yes	No	
		%	%	%
Business license	Yes	77.7	6.82	60.49
	No	22.3	93.18	39.51
Total		100	100	100

Source: **Policy Forum Survey, 2017**

Some informal sectors did not comply with the tax system even if they have business license due to limited tax knowledge; inadequate benefits of paying tax; cumbersome procedures, bureaucracy and corruption; high cost of registration; unaware of tax authorities and procedures. small capital turnover, immature business, and economic hardship; absence of proper business premises avoiding tax payment, high taxes, levies, running from government; failure of the system as well as nature of business.

Revenue foregone influence decrease in production, low provision of social patterns; increase of poverty and increase of income inequality among the people, (Kowalski, 2005). According to Hollingshead, 2010 the average tax revenue loss to all developing countries was between $98 billion and $106 billion annually during the years 2002 through 2006. This figure represents an average loss of about 4.4 percent of the entire developing world's government revenue. Many small businesses in the country have been confirmed to run and operated by people informally while others escape tax payment system.

Table3.5b: Informal sectors/SMEs Paying Tax with Business License 2010/11

		Paying of taxes		Total
		Yes	No	
		%	%	%
Business license	Yes	100.0	12.5	82.0
	No	0.0	87.5	18.0
Total		100.0	100.0	100.0

3.7. Delays in Starting Paying Taxes

Taxation provides a predictable and stable flow of revenue to finance development objectives of the country. This is important in a country like Tanzania that has serious challenges with meeting its development objectives. Small and medium enterprises (SMES) are significant for economic growth in the country and contributing as much of the gross domestic product while generating taxable incomes (Beck, *et al,* 2005). In Tanzania, when a business or firm complete legal requirements such as registration and start operation, it needs to comply with tax systems including paying the required taxes.

Table 3.6 presents the view of SMEs respondents on the period of starting paying tax. Table 3.6 suggests that very few, that is about 13.87 percent of respondents have the view that it takes less than 7 months to start paying taxes after starting business operations. These start paying taxes on time and no delays. Paying early can reduce interest and penalties on the tax dues also encourages a tax planning lifestyle, so that SME firms can be proactive about their financial future.

Table 3.6: The Period When the Business/Firm Start Paying Tax

	Frequency	Percent
Less Than 7 months	96	13.87
7 months - 2years	179	25.87
3 - 5years	252	36.42
Above 5 years	165	23.84
Total	**692**	**100**

Source: **Policy Forum Survey, 2017**

In the country there is no tax holiday for the new local entrance in the business activities that is why there is no specific time given to the business operators for the maturity, (URT, 2003 and Consultation with TRA staffs, 2017). This is one of the major reasons why most of the informal sector/SMEs in the country have low life span even though their entrance into business activities is high. Low experience in the business is accompanied with lack of enough tax system, low level of sales turnover and limited innovative skills which force them to increase the profits through underground activities operation and escaping payment of taxes to the Government. This situation drags the government to the high level of revenue foregone although the activities which aiming at avoiding taxes are also done by formal sectors.

3.8. Various Forms of Taxes and Levies Paid by The Businesses

In mobilizing tax revenue various types of taxes can be applied so as to cover the diversity of sources of income in the economy and ensure inclusiveness of all activities in the economy. For the firms or business operators, the key types of taxes include market levy, Value Added Tax, License tax, and Presumptive tax. Table 3.7 presents the views of the respondents on the type of tax the businesses/firms are paying.

Table 3.7: Type Of Tax Paid By The Business/Firm

	Frequency	Percent
Market levy	138	19.9
Value added tax	2	0.3
Business License/Fees	110	15.9
Presumptive tax	7	1.0
Both license and presumptive tax	435	62.9
Total	**692**	**100**

Source: **Policy Forum Survey, 2017**

Table 3.7 shows that, many i.e., about 62.9 percent pay both license and presumptive taxes. Few of them equivalent to 19.9 percent pays the market levy and 15.9 percent paying the license fees This indicates that, to operate a business in Tanzania, one has to pay the taxes based on the laws and regulations and thus many are obligated to pay both license fees to have business registration and the presumptive tax which is the income tax out of the annual turnover of the business/firm. On the other hand, the result suggests that, the informal sectors/SMEs are operating in multiple number of taxes.

Many of the respondent contributing to the tax revenue by paying both presumptive and license tax due to the following reasons; to abide the laws and regulations of the country, to avoid disturbances of conducting business which may result from follow up by the tax authority and to contribute to the government revenue which facilitate the provision of public goods and social services in the country. However, despite many of the business operators paying taxes, those who do not pay taxes exist and the reasons for not paying includes; oppressive tax enforcement, harassment of taxpayers, and discontent with public service delivery seem to increase tax resistance and may explain widespread tax evasion, (Fjeldstad, and Semboja, 2001).

The impact of many business operators paying tax is increase government revenue associated by the informal sector contribution which can nourish the ability of the government to provide for the economy. Also, the tax payment helps in redistribution of income in the sense that income earners are contributing to the government which provide services to the society and hence redistribute income and reduce the level of inequality in the society. On the other hand, tax can be coercive, it can be accompanied with corruption, and it can be excessive to the payers thus undermines the business performance and hence results to income inequality among payee and non-payee of the tax, (TJNA, 2011). The situation is similar to other East African countries whereby for the business firms to operate obtaining license is key requirement and the business have to contribute to the tax revenue. A common technique employed is the use of presumptive taxation system where the SMEs contribute to the tax revenue out of their annual turnover (annual turnover base tax system).

3.9. Relatively High Amount of Taxes Paid by These SMEs Business

The amount of taxes to be paid to the Government through its agencies relay on the rates planned by the Government itself under the responsible entities. The amount is based on the type of taxes and other criteria's like level of returns as well as nature of the business or activities. Since the payment of taxes is compulsory, tax evasion and deliberately failure to comply with the planned amount of tax is a crime which is punished by law. In Tanzania, the task of collecting taxes is authorized under TRA and ZRB, (URT, 2010).

Table 3.8 summarizes respondent's views on the amount of the taxes they pay through their business for years 2014 and 2017, shows that, many i.e., about 51.3 percent rates the amount of taxes they pay to be high in year 2014. This number increased about 78.9 percent in 2017. This suggests that, the informal sectors especially those within tax net are operating in the environment of relatively high taxes compared to their sizes and capacities. The SMEs is complaining about high taxes.

Table 3.8: The Amount Of Taxes Paid By The Business/Firm

	2014	2017
	Percent	Percent
Very high	8.4	55.2
High	42.9	23.7
Moderate	46.1	19.4
Low	1.3	0.6
Very low	1.3	1.2
Total	**100**	**100**

Source: **Poverty and Social Impact Analysis of Proposed Presumptive Tax in Tanzania Study, 2014 & Policy Forum Survey, 2017**

In spite of other harsh environment of Informal Sectors/SMEs operation in the country, tax regime is also unfavorable for SMEs development as taxes are many, rather high and collected by various authorities including Tanzania Revenue Authority and the Local Government Authorities. Furthermore, entrepreneurs are ignorant of tax matters and the cost of complying with tax regulations is considered high, (URT, 2003). In addition, SMEs are further constrained in this environment in comparison to larger businesses due to the disproportionately heavy costs of compliance arising from their size.

According to Mwangi, (2014), 47 percent of the SMEs incurs more than Kshs. 50,000 monthlies which is equivalent to 1,800,963.87 TSHS, as costs of tax compliance. This situation is far better for Kenya SMEs taxes compliance compared to that of Tanzania. In Kenya, some of these costs include bookkeeping, installation of software and internet costs, additional cost of hiring professional staff such as auditors and tax experts, accounting for the largest proportion of these costs while in Tanzania. Despite of such greater achievements of Tax systems in Kenya, most of Kenyan SMEs do feel and strongly agree that the taxation system in Kenya is in great need of improvement so as to improve taxpayers' tax compliance level, with the end result being increased government revenues.

3.10. Limited Influence Of Tax System To The Performance Of The Informal Sector

There are various tax related factors that constrain the growth of SMEs such as: tax categories, taxation policies and the regulatory environment. Stagnation of the growth of SMEs may be as a result of non-supportive tax laws, systems and administration. SMEs may also face a disproportionately high tax compliance cost burden compared to larger businesses, calling for adjustments to administrative approaches and/or policy to address impediments to SMEs posed by tax compliance cost considerations.

Table 3.9 revealed that many that is, about 49.13 percent argued that, the current taxation system has little influence or impact to the day to day operations of SMEs activities. However, significant number i.e. about 29.48 percent argued that, tax system has high influence to the performance of the informal sectors.

Table 3.9: The Impact of Tax System to The Informal Sector

	Frequency	Percent
Very high	107	15.46
High	97	14.02
Moderate	148	21.39
Little	162	23.41
Very little	178	25.72
Total	**692**	**100**

Source: **Policy Forum Survey, 2017**

Consultations suggest that there are other important factors influencing performances of informal sector in Tanzania. Other factors include limited financial systems, insufficient funds to expand business operations; unstable economy, limited freedom of conducting businesses and also different charges that are imposed to the informal sectors leads to the increase or decrease of the informal sectors. Joshi, *et al, (*2012) and Kuehn, (2014) show that there is a positive relationship between tax and the size of the informal sectors. Most of the developing countries such as Kenya, India and Indonesia shows that, there is positive relationship between tax and size of the informal sectors, the increase in the tax rates influences the greater increasing rate of the size of informal sectors, and the decrease in tax will reduce number of the informal sectors, (Loayza, 1996).

3.11. Very Few Informal Sectors Use EFD Machine

The use of EFDs has been adopted in many African countries. Recently Revenue Authority (TRA), body responsible for tax collection is Tanzania, launched the use of Electronic Fiscal Devices (EFDs) in tax collection (TRA, 2013) with the aim of increasing efficiency in tax collection. The system is being implemented in two phases, with the first phase planned to cover all VAT registered taxpayer's country wide, and the second phase is intended to cover Non-VAT registered traders with turnover ranging firm TSHS 14 million and above per annual.

Table 3.10: The Use of EFD Machine in The Business/Firm

	Frequency	Percent
Yes	100	14.45
No	592	85.55
Total	**692**	**100**

Source: **Policy Forum Survey, 2017**

Table 3.10 indicates that, large number of respondents, i.e., about 85.55 percent of the informal sector do not use EFD while very small number at about 14.45 percent use EFDs. This result implies that, the compliance of tax paying through the use of modern technology (EFD) machine is very small due to high costs of obtaining and operating them; insecurity which leads to the lack of trust and other financial reasons; limited networks as well as absence of the room for correction when a mistake occurs accompanied with long process of compensation. Also it was insisted that tax payers resisted the use of EFDs machines due to misunderstanding on modern technology and disturbance of the routine systems outage. The complaints of these business operators may hinder voluntary tax compliance and may result in to a decrease of tax collection, (Mbilinyi and Mutalemwa, 2010, Mutalemwa, 2014).

The need for effectiveness in tax administration operations is often annoying when dealing with hard-to-tax groups of the economy. For example, small businesses, farmers, and self-employed individuals who represent a large number of taxpayers (Andreoni, *et al,* 1998). These groups

usually lack the appropriate bookkeeping and accounting records to determine and assess their tax liabilities (Feinstein, 2008). It is very hard and expensive for the tax administrators to assess and collect taxes from these groups. Consequently, many small businesses especially in the informal economy of developing countries simply escape the tax net and are not taxed at all, (Agola, 2010).

From the tax administration's perspective, it's expected that, the use of EFDs could lead to an improvement in audit outcomes, with the same number or even a lower number of auditors. However, according to the survey responses, some administrations have actually increased their audit resources as a consequence of introducing EFDs.

3.12. Moderate performance of the EFD machine in the SMEs business/firm

The major aim of the Government introducing this device was to simplify the collection revenue by minimizing collection costs and time consuming by the business operators. Table 3.11 presents views of respondents the level of satisfaction of the EFD devices on the performance in the business/firm.

Table 3.11: Level of satisfaction on the EFD machine performance in the business

	Percent
Very high	14
High	14
Moderate	56
Low	7
Very low	9
Total	**100**

Source: **Policy Forum Survey, 2017**

Table 3.11 indicate that many i.e., about 56 percent are somehow satisfied when using an EFDs devices. Significant i.e., about 28 percent are highly satisfied with the use of EFD machines. The newly introduced EFDs devices have moderate impact on informal sector's operation (regardless of significant number of the informal sectors/SMEs being moderately satisfied.

Electronic device processing method is less time consuming, less costly, more accurate and faster as compared to the manual data processing method. Cascio, (1986) argues that electronic device method is more reliable and fast as compared to the manual data processing method. Liden and Adams, (1992) evidenced that older employees usually favor the use of manual methods in determining the value of tax while the younger employees usually favor the use of electronic devices citing the above benefits.

In Zimbabwe and Kenya, the level of EFDs satisfaction is also positive as reported by Nyasha *et al.*, (2013) that fiscal electronic devices had positively impacted on the motor industry through improvements in tax collection, saves time in tax collection, reduces direct contact between tax collectors and hence minimizes corruption.

3.13. Limited Effects of EFD Machine onto the Performance of SMEs

Importance and contribution of using EFDs to the side of government is to increase revenue collection. The use of EFDs machines reduces the operation cost of the government that was incurred to collect VAT as well as improve the business income of taxpayers. Moreover, it improves the efficiency and effectiveness of government operations provides timely and accurate tax information to businesses and increases the availability of electronic tax filing. The study of (Yalemtesfa, 2011) report that introduction of EFDs helped to decreases tax evasions and need to create enough awareness and strong regular audit follow up to get those fruit full benefit of using EFDs.

Table 3.12: Contribution of EFD Machine to the Performance Of Business

	Percent
Very high	2
High	10
Moderate	47
Low	23
Very low	18
Total	**100**

Source: **Policy Forum Survey, 2017**

Table 3.12 presents views of the respondents on the contribution of EFD machine to performance of business. Table 3.12 shows that, very few, that is about 12 percent of the respondents had the view that EFD machines have high /positive contributions to the SMEs performance. Many, that is, about 47 have the view that EFD machines have moderate impact and significant i.e., about 41 percent have the view that EFD machines have low impact.

There are various factors contributing to these moderate perceptions on the use of EFD machines. EFD devices are new technologies and many SMEs operators have limited education and information on these devices. Other reasons include weak network system in some places; high buying and operation costs; limited knowledge's to large number of users and limited room for correction once mistake occurs. Many SMEs users complained that the training they received did not give them a sound knowledge in effectively using the machines, (TCCIA, 2012).

Comparing with other developing countries, (Nyasha, *et. al*, 2012) conducted a study to find out the attitudes of employees towards the use of EFDs in calculating value added tax (VAT) in Zimbabwe and revealed that EFDs had positively impacted on the business sector through improvements in tax collection, saves time in tax collection, reduces direct contact between tax collectors and hence minimize corruption and also Naibei, *et al*, (2011) revealed that effective and regular use of ETR/ EFD machine has a significant impact on the business performance and Value Added Tax (VAT) compliance in Kenya.

3.14. Low Satisfaction of the SMEs On the Tax Systems Used in Their Business

The development of small and medium enterprises is greatly affected by the level of taxation, its administration and compliance regardless of being government revenue. The higher is the share of small and medium businesses is in an economy, the higher the productivity that can be potentially realized with the SME sector. Table 3.13 presents views of respondents on levels of acceptability of the system of taxes used by the business/firm for years 2014 and 2017. On average, majority that is about 59.7 percent in year 2014 and about 94.1 percent in year 2017 had the view that the tax system is unsatisfactory and unacceptable for the SMEs in Tanzania. The level of unacceptability increased from 59.7 percent in year 2014 to about 94.1 percent in year 2017. This may suggest that the Tax system is getting tougher and strict to the SMEs operations in Tanzania.

Taxpayers face a whole series of explicit or implicit costs and other limitations such as large amount and number of taxes; limited tax education; mistrust between tax authorities/agencies and business operators and the nature of tax being imposed on the sales amount and not on the profit which makes them loose trust on the system since it undermines their business performance, (Jousten, 2007). The major outcome of this situation is the business operators prevaricate their tax obligation through provision of wrong business/firm information, getting out of the tax system by turning themselves into very small business or turning themselves into underground business operators.

Table 3.13: Acceptability Of The System Of Taxes Used By The Business/Firm

	2014	2017
	Percent	Percent
Not at all satisfactory and unacceptable	37.1	58.8
Somehow unsatisfactory and unacceptable	22.6	35.3
Satisfactory and acceptable	39.5	5.4
Highly satisfactory and acceptable	0.8	0.4
Very high satisfactory and acceptable	0.0	0.1
Total	100	100

Source: Source: **Poverty and Social Impact Analysis of Proposed Presumptive Tax in Tanzania Study, 2014 & Policy Forum Survey, 2017**

Most of countries like the East African once are complying with no exception since the challenges of the informal sectors tax system are common. In Ukraine, the SME sector are in greater position to equivocate SMEs taxation system and go to the shadow economic activities due to unfavorable government tax policies and administration. According to expert evaluations, between 50 and 80 percent of Ukraine's economy is in the shadow sector as a tax system impacts (Barriers to the Development of Small and Medium Business in Ukraine 1998 7). Development of small and medium enterprises is heavily influenced by the level and nature of taxation, its administration and compliance. The higher the tax rate is, or the greater the efforts to fulfill taxation requirements are, as well as to check how those requirements are met, the lower the initiatives are for SMEs to perform well, (Yadviga, 1999).

3.15. Complicity of Tax System Reduces Income of the Informal Sectors

Taxpayers appear to face a number of common costs of having to obey 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. Agreement cost can impact submission behavior as it can affect SME profitability depending on the magnitude of the cost in terms of low efficiency, high collection charges, waste of time for SMEs which affect SMEs too relative to larger firms, (Weichenrieder, 2007; Atawodi and Ojeka, 2012). Table 3.14, presents perceived views of surveyed SMEs firms on the positive impact gained from the taxation system.

Table 3.14: The (Positive) Impact of Tax System On Income

	2010/11	2016/17
	Percent	Percent
None	25.25	33.43
Very Little	23.28	39.82
Moderate	44.92	23.92
High	5.57	2.08
Very High	0.98	0.74
Total	**100**	**100**

Source: **Policy Forum Survey, 2017**

Table 3.14 suggests that many that is about 48.5 percent in year 2014 and about 73.25 in year 2017 had the view that tax system has little or no impact the SMEs incomes. This negative perception on the importance of tax on incomes increased from 48.5 in year 2014 to about 73.25 percent in year 2017. On one hand this may suggest that tax system is not very important factor determining performances of SMEs incomes. On the other hand, SMEs tax payers are not satisfied with the way taxes a taxed among them, since the taxes are collected with no regards on how the business performed, tax collectors while collecting taxes they are not well aware about how does firm gets out of the expenses for the whole year.

The income affected with the system of paying taxes, may lead to the increase of the non-tax payers or the increase of informal sectors. These informal are those who a not regally supposed to be informal but the system encourage them to act informal so as to avoid the cost of tax, (Lema, 2013). From the respondents, they are mostly preferred to act informal so as they can avoid tax payment of which they are currently cannot afford since its highly affects their income due to small business cycle, especially the growing informal

Moreover, many of the developing Nations looks forward to improve the taxation systems for the informal sectors, to make them formal so that there could be a better revenue collection, since formalization can encourage business growth, create a better business environment, and help build a culture of tax compliance, (Joshi, *et al*, 2014).

3.16. Decline contribution of the tax system on the effectiveness of product/ service or competitiveness

Tax system involves the choice of taxes to be levied, who should pay what, what should be the rates and how should tax be collected based on the tax policy, laws, regulations as well as form of administration, (Makundi, 2017). Effective competitiveness according is the situation in which two or more independent competitors acting on their own not in collusion contest the same piece of business, (John, 1940). This situation tries as a workable alternative to the economic theory of perfect competition since perfect competition is seldom observed in the real world. Table 3.17 covers views on the impacts of tax system on the effectiveness of competitiveness in their business.

Table 3.15: The impacts of tax system on the effectiveness of product/service or competeveness

	2010/11	2016/17
	Percent	Percent
None	29.41	34.79
Very Little	21.57	38.14
Moderate	40.2	22.13
High	7.52	2.91
Very High	1.31	2.04
Total	**100**	**100**

Source: **Policy Forum Survey, 2017**

Table 3.14 suggests that many that is about 50.98 percent in year 2014 and about 72.93 in year 2017 had the view that tax system has little or no impact of the SMEs effectiveness of product/ service or competitiveness. This negative perception on the importance of tax on incomes increased from 50.98 in year 2014 to about 72.93 percent in year 2017. Like Tanzania, other East African Countries and Nigeria, the nature of tax system is facing with similar problems. Because the business environment and products requirements keep changing, the requirements imposed on suppliers and the process of supply chain building and integration are also changing.

3.17. Many reasons for informal sectors/SMEs not paying taxes

Tax is an important stream of revenue for government's development projects, however, tax compliance among SMEs in most of the developing nations is poor as an outcomes of unfavorable tax systems that plays a dual role as it attacks direct the mentioned factors, (Burçin, 2016). Similar to Nigeria, the rate of tax evasion is high due to various factors like high tax rates; complex filing procedures; multiple taxation; lack of proper enlightenment affect tax compliance among the SMEs surveyed only to a lesser extent, (Atawodi, *et al,* 2012).

The Government of Tanzania through ministry of SMEs policy of 2013 realized that, the informal sector is still facing various constraints including bureaucratic, high costs and centralized of the legal and regulatory framework. Also, the sector is operating the harsh conditions of many taxes, rather high and collected by various authorizes including TRA and LGAs; education concerning tax matters and the cost of complying with tax regulations is considered high.

Table 3.17 presents respondent's views on the reasons for why Informal Sectors/SMEs avoid paying taxes. The table suggests that majority that have the view small capital turnover, immature business and economic hardship (83.9 percent); inadequate benefits of paying tax, (79.7 percent); Nature of business (75.9 percent) and absence of proper business premises (64.6 percent) are reasons for the informal sector not paying taxes

Table 3.17: Reasons for SMEs not paying taxes

Reasons	Percentage
Limited Tax Knowledge	60.1
Inadequate benefits of paying tax	79.7
Cumbersome procedures, bureaucracy and corruption	55.9
High cost of registration	51.5
Unaware of Tax authorities and procedures	54.1
Small capital turnover, immature business and economic hardship	83.9
Absence of proper business premises	64.6
Avoiding tax payment, high taxes, levies, running from government	53.5
Nature of business (very small business especially agricultural business	75.9
Average	**64.4**

Source: **Policy Forum Survey, 2017**

3.18. Significant Government Revenue Forgone

Tax revenue foregone as a result of the "shadow economy" represents a very significant component of the total tax gap that is the difference between actual and potential tax revenues. Definitions of the "shadow economy" vary widely, but it may generally be taken to describe a situation where businesses operating outside the tax system and registered businesses conceal transactions to avoid paying taxes or social security charges, or to avoid the costs associated with legislation on safe working conditions or protection of consumers' rights, (Russell, 2010). Sometimes the transactions are only partly concealed and maybe reported to the revenue agency or to the government statistical office at lower than true values so as to reduce rather than entirely eliminate taxes.

In estimating the revenue forgone from informal sector, the measure employed is the difference between the planned and the actual revenue collected from the informal sector in Tanzania for the year 2010/11 to 2016/17. Table 3.18 summarizes the figures for targeted and actual tax revenue collected form year 2010/11 to 2016/17 whereby the difference between the two variables indicates

the revenue forgone which is the gap between the potential revenue to be collected and what has actually collected.

Table 3.18 shows that both planned and actual tax revenue rises each year whereby planned tax revenue rises from 5,652,589.63 million in year 2010/11 to 15,105,100.05 million in year 2016/17. This indicates that there is potential of increasing the tax revenue collection if all sources are harnessed well. While the planned revenue increases, the net TRA collections increases too each year. This is indicated by the increase of revenue from 5,315,147.57 in year 2010/11 to 1,4126,590.01 in year 2016/17. These trends have been depicted by figure 3.5 whereby both targeted and actual revenue collection increases overtime. On the other hand, the difference between the two produces the revenue forgone implying that it is the amount missed while collecting the tax revenue and largely due to presence of informal sector.

Table 3.18: Targeted and actual tax revenue collection from 2010/11 to 2016/17 in Mill Tsh

| Year	Targeted Tax Revenue	Total TRA Net Collections	Revenue forgone
2010/11	5652589.63	5,315,147.57	337,442.06
2011/12	6228832.56	6502599.16	-273,766.60
2012/13	7871430.33	7739298.48	132,131.85
2013/14	10374937.57	9383046.94	991,890.63
2014/15	11318221.90	9908996.35	1,409,225.55
2015/16	12362957.98	12525377.55	-162,419.57
2016/17	15105100.05	14126590.01	978,510.04

Source: **TRA, 2017**

Table 3.18 reveals that, the revenue forgone has been maximum in year 2014/15 where it was 1,409,225.55 million Tanzanian shillings. In years 2011/12 and 2015/16 tax revenue collection surpassed the targeted collection and thus there was no revenue forgone where by the collection surpass the target by 273,766.60 and 162,419.57 respectively. Based on Table 3.18, figure 3.3 summarizes the trend of revenue foregone for the period of seven financial years.

With regards to the information in figure 3.4, there is revenue foregone since in seven (7) financial years, only two (2) years the planned revenue targets were met and surpassed while other five (5) years experienced under collection whereby the targeted revenue is higher than the actual collection even though the revenue collection trend has been increasing yearly.

It is true that, the informal sector in Tanzania is among the toughest sectors and contributes marginally to tax revenue generation, (World Bank, 2010). Despite of the sector being the second main employing sector after agriculture by employing about 10.1 percent of the employed persons, the sector is not yet stable enough for the Government to depend on for its revenue.

Figure 3.3: Trend Of Revenue Forgone In Tanzania From 2010/11 To 2016/17

TREND OF REVENUE FORGONE

337,442.06
-273,766.60
132,131.85
991,890.63
1,409,225.55
-162,419.57
978,510.04
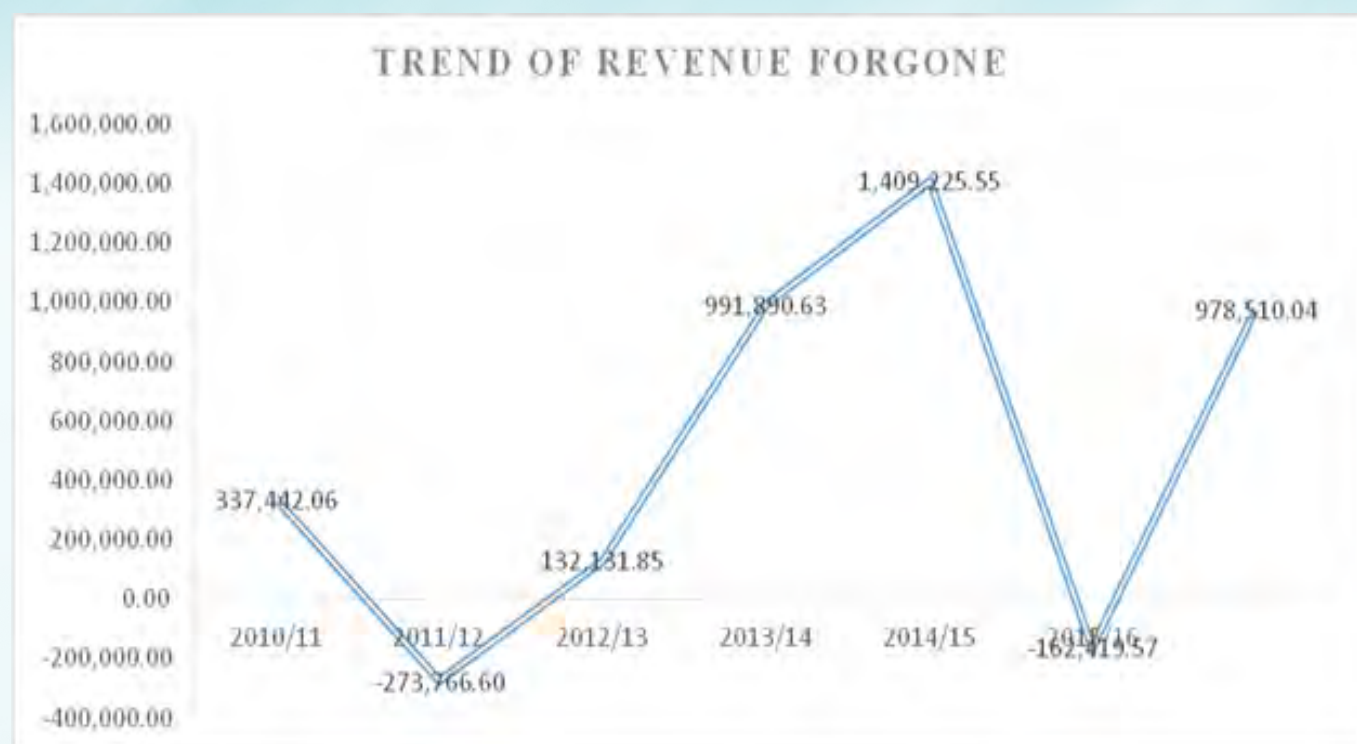
Source: **TRA, 2017**

The existence of large amount of revenue forgone with unstable trend in the country has been a result of many interrelating complex factors. These include presence of large unstable informal sector in the country characterized by inadequate information, knowledge and education on tax paying advantages, whereby non-taxation or under taxation of some informal sector have contributed largely on the widened gap between planned and actual revenue collected and hence revenue forgone. On the other hand, the gap between planned and actual revenue collected has been narrowed in some years due the application and enhancement of block management system to categorize taxpayers in order to facilitate their monitoring process so as to facilitate collection of arrears and proper assessment while enabling them pay tax in a cost effective way, (Meena, 2013).

In comparison with other countries as it is for Tanzania that tax revenue forms the major component in the total revenue portfolio in Kenya the situation is the same whereby tax revenue is the base of the major source of government revenue, (ICPAK, 2016). Also the proportion of revenue from informal sector to the total tax revenue has been declined overtime suggesting there is increased reliance on other income tax as the source of tax revenue despite the increased number of informal activities in Kenya, (Masinde, 2010). Likewise, in Uganda the revenue foregone is larger and over the last eight financial years the amount is estimated to be nearly half of the budget needed to finance the next financial year's budget. This shows that more efforts are needed to curb the gap between the potential revenue and what actually collected.

Despite all social economic policies, legal and institutional reforms, there are number of businesses which are not registered or captured in the government systems. There are some reasons for informal sector to escape paying taxes in Tanzania. These includes; inadequate knowledge and education on tax paying advantages, registration and business management practices, lack of proper business premises and cumbersome procedure, bureaucracy and corruption, by the tax revenue collection units.

3.19. Dynamic and Increasing Potential Revenue Foregone

The chapter analyzed revenue foregone from the informal sector over the years 2010/11 to 2016/17. Presumptive tax system in operation is a special designed tax measures or *tax preferences*" and pervasive element in the income tax system of most economies, in particular, the case of Tanzania. There are various advantages and disadvantages of the presumptive taxes system. System generally favours businesses with high profit margins, thus creating an avenue for revenue losses for the government

However, two significant impacts of presumptive income tax have been a creation of a "culture of taxation" and the regularization of the rule of law and has been tactful in expanding the size of the formal sector. There has been an increase in the number of tax payers including the presumptive tax payers in the country. This has largely resulted to more revenue collection by the revenue authority and promote formalisation of the informal sector. But also there has been increasing in their number of non-paying and unregistered SMSs suggest an increasing informality in the SMEs sector and *thus increasing revenue foregone by the government*. Majority SMEs start paying taxes later and some take over five years. These do not advantage of "the early bird catches the worm"? and too increases revenue foregone.

The government has introduced use of EFD to circumvents the SMEs taxation problems. Currently, year 2017 large number of classical informal sector firms do not use EFD. The newly introduced EFDs devices have moderate impact on informal sector's operation (regardless of significant number of the informal sectors/SMEs being moderately satisfied. Many have the view that EFD machines have moderate impact and that the reformed tax system is not at all satisfactory and acceptable. Also, the tax system has little or no *impact the SMEs incomes foregone, SMEs effectiveness of product/service or competitiveness*.

There are various reasons as to why informal sectors avoid paying taxes. These small capital turnover, immature business and economic hardship; inadequate benefits of paying tax; Nature of business and absence of proper business premises. This suggests that revenue forgone by all parties are potential significant. The estimated revenue forgone has been the gap between the potential revenue to be collected and what has actually collected. These have been increasing revenue foregone by all parties over time.

Chapter Four

4.0.   Level of Inequality Due to Taxation or No-Taxation of Informal Sector

This chapter analyzes the level of inequality arise due to taxation or non-taxation of the informal sector in the country for the period between 2010/11 and 2016/17. The chapter has nine sections examining the *nexus between taxation of the informal sector and inequality in Tanzania*. Section 4.1 presents the views on the awareness of inequality in relation to the major policy issues in Tanzania. Section 4.2 analyzes the level of equity, equality of outcome and equality of opportunity in while section 4.3 presents the factors that contributes to the existence of inequality in the country. Section 4.5 discusses the contribution (effects) of Presumptive Income Tax System in income inequality and informal sector activities. Further, section 4.6 analyzes the impacts of increasing inequality in the society and section 4.7 presents the effect of the size of informal sector on revenue collection. Section 4.8 examines the contribution on increased inequality to the size of informal.

4.1.   Inequality is a critical policy issue in Tanzania

The concept of economic inequality comprises disparities in the distribution of economic assets (wealth) and income within or between populations or individuals. Table 4.1 shows that, most i.e., about 89.8 percent of respondents are aware of inequality being one of the critical policy issue in Tanzania. These results revealed that, inequality is the major policy issue in Tanzania.

Table 4.1: Awareness Of Inequality As A Critical Policy Issue In Tanzania

	Frequency	Percent
Yes	814	89.8
No	89	9.8
I do not know	3	0.3
Total	**906**	**100**

Source: **Policy Forum Survey, 2017**

Inequality is viewed as the critical policy issue due to its consequences to the people and the economy. These includes; it undermines the tax system such that few small enterprises are taxed heavily thing which reduces the revenue collected, since there are those who pay fewer taxes than they are required based on their sales while there are those who do not pay tax at all while they are required to pay, contributes to increased size of the informal sector which leads to the increase of small enterprises firm who do not pay tax which undermine and discourage SMEs who pays taxes. Also inequality in its broader context influences decline and collapse of SMEs performance in business which hinders development of business in the country.

For many sub-Saharan countries inequality issues have been mainstreamed in their policies and in most cases the gender aspect is prioritized. However, inequality can be viewed in other forms such as income and thus affects the economy when not given careful attention. Most of the respondents proposes that inequality should be a critical policy issue so as to ensure favorable business environment in the country. Likewise, in other East Africa countries like Kenya inequality issues have been prioritized in many of the government activities and reduction of the variability in income, gender and education have been the major concern of the country, (Diego, 2005).

4.2. Dynamism in the level of equity, equality of outcome and equality of opportunity in Tanzania

Equity, equality of outcome and equality of opportunity are the key characteristics of ensuring inclusive growth and advantage to majority of the citizens. The table 4.2 shows the respondents views concerning the level of equity, equality of outcome and equality of opportunity in Tanzania for the years 2010/11 and 2016/17.

Table 4.2: Level Of Equity, Equality Of Outcome and Equality of Opportunity

Years	2010/11	2016/17
	Percent	Percent
Very good	3	3
Good	8	15
Satisfactory	47	34
Bad	34	39
Very Bad	8	10
Total	**100**	**100**

Source: **Policy Forum Survey, 2017**

Table 4.2 suggests that significant number, that about 42 percent in year 2010/11 and increased to 49 percent in year 2016/17 had the view that the level equity, equality of outcome and equality of opportunity in Tanzania between rich and poor has worsened. The increasing level of inequity, inequality of outcome and inequality of opportunity in the informal sectors have been complex function of various factors. These include bad income and employment policies, limited entrepreneurial skills and knowledge. (Harris-Todaro, 1970, Mishra and Ray, 2014). In spite of many other contributive factors, Inequality of "outcomes" and inequality of "opportunities" have long been associated with very different views on social justice, in the literature on economic inequality for different developing and developed countries. These results to increase dependency, level of poverty, decline of other business, and decrease Government revenue which cause economic stagnation, (Francois, 2003).

4.3. Factors Contributing to Inequality Among Informal Sectors

Table 4.3 suggests that majority, that is 81.6 percent had the view that income levels as first important factor contributing to the existence of inequality among informal sectors in Tanzania. The second important factor is tax levels (74.6 percent) and third factor is the size of the informal sector (61.2) percent.

Table 4.3: Factors contributes to the existence of inequality among Informal Sectors

	Percent
Tax	74.6
Size of Informal Sector	61.2
Education	31.4
Gender	10.6
Income	81.6
Organization	29.1
Average	**48.08**

Source: **Policy Forum Survey, 2017**

Informal sector exists in all economies in varied sizes, but its size and determinants are of particular interest in the context of developing economies only if all of them are operating under the tax net. With regards with their limited education in both operational and tax systems large number of informal sector evade tax obligation thus transfer tax burden to the commitments once. Existence of inequality in the society has its impacts which cut across social and economic aspects. Inequality undermines the performance of some business as others may fail to venture into the business or other business collapse and also reduces the competitiveness of doing business

4.4. Presumptive Tax System Contributes to the income inequality

One cause of inequality is the rate at which income is taxed coupled with the progressivity of the tax system. The current Presumptive Income Tax System for most SMEs is articulated in the Finance Act 2012 as revised version of the Income Tax Act 2006 is specific form of progressive tax system. In a progressive tax system, the level of the top tax rate will have a direct impact on the level of inequality within a society, either increasing it or decreasing it. Additionally, a steeper progressivity results in a more equal distribution of income across the board. Table 4.4 presents respondent's views on the contribution of presumptive income tax system to the income inequality in Tanzania. Table 4.4 suggests that majority, that is about 74.6 percent argued that, the current presumptive tax system contributes to increasing income inequality in Tanzania. The results advocates that, presumptive tax system is contributing greatly to the income inequality in the country.

The contribution of presumptive income tax to the existence of income inequality has been a result of factors such as; increased size of the informal sector and impose stiff competition among the business operators, thus some of the firms tends to evade the tax by lowering their scale of business operation or hiding some information and hence increases the size of informal sector in the country.

The increasing of income inequality in the country has its effects increased social economic classes between have and have not such that the disparity between richer and poor will increase and thus put pressure on the economy to grow due to increased dependency however inequality can also spur economic growth especially when it is not extreme.

Table 4.4: Contribution Of Presumptive Tax System In Income Inequality

	Frequency	Percent
Yes	676	74.6
No	131	14.5
I do not know	99	10.9
Total	**906**	**100**

Source: **Policy Forum Survey, 2017**

Also, increased level of inequality may spur the increase of social crimes in the society as resources will be skewed to few richer than for the poor one and in some cases income inequality can fuel political instability and may be the cause of lack of desirable social services (Furman, and Stieglitz, 1998). Although there is no guideline for the determination of the tax rate high turnover may result SMEs to move out of the system. Thus, extensive analysis into average SMEs profit margins is required before setting the rate, (World Bank, 2014).

Presumptive Income Tax Leads To The Increasing Informal Sector Activities

Table 4.5 presents respondent's views on the contribution of the current presumptive system to the increase of informal sector activities in the country. Table 4.5 suggests that many that about 66.7 percent agreed that, the current presumptive system contributes to the increase of informal sector activities in the country.

Table 4.5: Contribution of Presumptive Income Tax to increasing informal sector activities

	Frequency	Percent
Yes	604	66.7
No	215	23.7
I do not know	87	9.6
Total	**906**	**100**

Source: **Policy Forum Survey, 2017**

The current presumptive tax system is nursing level and behaviour of informal sector. The progressive nature of this tax has hindered the development of some small business due to non-affordability of these taxes especially to the small business operators in the country, thus, forces others to continue being in the informal environment. The desire to become small is fueled by presence of high taxes thus other splits their business into small firms so as to avoid paying of taxes and hence stimulating the increasing of informal sector in the country.

On the other hand, the increasing of informal sector has its impacts across all sectors of the economy. The informal sector exhibits a high degree of job creation in Tanzania. However, it is faced with a number of constraints and suffers from low labor productivity and use of low technology or elementary tools. Thus expansion of informal sector may hamper revenue collection targets in one end but also it provides an alternative way to employ more of the working population as well as presumptive income tax on one way help to distribute the burden of tax revenue to many participants and it is a good strategy for enhancing revenue collection.

4.5.   Increasing level of inequality within the society

Table 4.6 suggests that significant number that is about 39.5 percent have the view that the increase level of poverty as the major impacts of increasing level of inequality within a society.

The reason behind this perception is that inequality is a broader concept and its impacts are not seen directly, thus from different condition one can relate the current practice and the inequality as the reason for these impacts to cover the whole economy in general. On top of that, the long-run increase in income inequality not only raises social and political concerns, but also economic once. It tends to push up the level of poverty through dragging down the GDP growth. Lower income people (informal sectors operators) in the society have been prevented from realizing their human capital potential, which is not good for the economy as a whole, (OECD, 2017).

Table 4.6: The Major Impacts Of Increasing Level Of Inequality Within A Society

	Percent
Increased level of poverty	39.5
Increased level of classes	21.3
Failure of other business	16.3
Decline of the economy	22.8
Average	**25.0**

Source: **Policy Forum Survey, 2017**

4.6. Increase Size of Informal Sector Contributes Largely to The Revenue Foregone

Table 4.7 shows the respondent's views on the effect of revenue collection based on the size of the informal sectors. The table suggests that large number of the study population at about 69.1 percent argue for the large size of informal sector does have direct side effects on the government revenue collection. The results vetoes that, large number /size of informal sectors in the country is attributing to the government loosing revenue needed to finance public services.

Studies suggest that about 40 percent of all households in Tanzania Mainland (excluding agriculture) were in the informal sector activities as compared to 35 percent in 2001. When including agriculture, ILFS 2006 reported that 94.1 per cent of Tanzania's population were working in the informal sector of which the agriculture sector was by far the main sector of employment with a share of 74.2 per cent of total employment. In Tanzania Mainland, 91 per cent of all employed (including agriculture) work in the informal economy and only 3 per cent work in the formal sector, that shows that there is a lot of revenue lost from the informal sector since they are many, and it is difficult to tax the informal sectors, if they will manage to charge all these informal sectors, they must be collecting a lot from them.

Table 4.7: Size of Informal Sector Affect Revenue Collection

	Frequency	Percent
Yes	626	69.1
No	173	19.1
I do not know	107	11.8
Total	**906**	**100**

Source: **Policy Forum Survey, 2017**

Size of the informal sector also imposing a problem to the government for the case of revenue collections. Joshi and Ayee (2008) shows that government efforts in Ghana to tax informal sector firms resulted in at least some degree of bargaining between informal sector associations and the government, (Prichard, 2009). In a similar vein, Prichard (2010b) finds that expanded taxation of small firms in Ethiopia prior to elections in 2005 triggered some public mobilization and prompted the government to include greater business involvement in overseeing the presumptive tax regime. Finally, de Mel *et al*. (2012) find that in Sri Lanka the formalization of firms, including entrance into the tax net, fostered expanded trust in the state, though they do not explore any broader governance implications. As such, these issues remain a potentially powerful argument for taxing informal sector operators,

Therefore, developing economies like Tanzania needs to further the development of its private sector by creating an environment favorable to the growth of SMEs, introduction of group registration of the SMEs, permanent business areas, freedom of conducting their business strengthening the factors that lead to business success, and addressing the problems threatening the existence and advancement of small and medium enterprises, so they can adequately play the role expected of them in economic transformation. Such role includes mobilization of domestic savings for investment, appreciable contribution to gross domestic product, increased harnessing of local raw materials, employment generation, and significant contribution of poverty reduction efforts through sustainable livelihoods and enhancement in personnel income, technological development and export diversification, (Atawodi, 2006).

4.7. Increase level of inequality contributes to the increasing dynamism of the informal sector in Tanzania

It is apparent there are high levels of inequalities within informal sector and those inequalities have been growing over time. Table 4.8 presents views of respondents on the impact of increasing level of inequality to the informal sector in the country.

Table 4.8 suggests that many respondents i.e., about 56.7 percent had the view that the increase level of inequality can lead to the increase in the informal sectors in the country. Also, we noted that increasing size of the informal sector is the result of the increasing level of inequality since most of the big business men and women tends to operates informally after the business crises occurs.

Table 4.8: The Increase Level of Inequality Lead to The Increasing Informal Sector

	Frequency	Percent
Yes	514	56.7
No	250	27.6
I do not know	142	15.7
Total	**906**	**100**

Source: **Policy Forum Survey, 2017**

In the world of inequality, unfavorable public policy and corruption is likely to cause the existence of the informal economy, (Loayza, 1996; Johnson *et al*, 1997 and Johnson *et al*, 1998). This situation has no difference to the once revealed in the study and the main results is either stimulation or determination of the national economic growth depends to the available policies and strategies for making sure the business ventures are operating progressively while obeying Government rules and regulations.

Power inequities between the state and informal sectors generally, imply that while formalization may offer protection and predictability to some firms, it may equally make firms vulnerable to unequal treatment and harassment by making them more visible to state authorities. In many countries, especially poor countries like those found in African continent, a heavy burden of taxes, bribes, and bureaucratic hassles drives many producers into the informal sector. Producers and suppliers in the informal sector avoid much of this burden, but they must produce with less assistance from public services than is available to producers in the formal sector. These public services include the protection of property rights by the police and the courts as well as public utilities, such as roads, electric service, potable water, and sewage disposal, (Yoshiaki and Herschel, 2002).

4.8. Nexus Between Taxation of the Informal Sector and Inequality in Tanzania

This chapter analyzed the level of inequality arise due to taxation or non-taxation of the informal sector in the country for the period between 2010/11 and 2016/17. The chapter found that increasing inequality is a critical policy issue in Tanzania. The levels equity, equality of outcome and equality of opportunity in Tanzania between rich and poor has worsened. We noted that income levels, tax and size of the informal sector as important factor contributing to the existence of inequality among informal sectors in Tanzania. The current presumptive tax system contributes to increasing income inequality in Tanzania and increase of informal sector activities in the country. The increase level of poverty as the major impacts of increasing level of inequality within a society. The large size of informal sector does have direct side effects on the government revenue collection. In the literature, a growing informal sector is generally regarded a response to an increased burden of taxation, social security contributions and labor market regulations, (Sophie, 2011). Further increases in taxes are expected to induce informal sector growth, eroding the tax base, such that tax revenue may in fact fall with higher tax rates.

Chapter Five

5.0. Conclusion

Chapter Five presents the conclusion. Specifically, the chapter is divided into three sections. Section 5.1 summarizes the major findings from the study and Section 5.2 presents the policy implications of the findings. Section 5.3 analyzes the specific recommendations from the respondents on the way to improve tax revenue collection from informal sector in the country and reducing the level of inequality in Tanzania.

5.1. Main findings from the study

Building the national capacity to mobilize more tax revenues is now at the top of the worldwide development policy agenda. The need for many developing countries is to be able to finance increased public spending on activities for poverty reduction as well as on public goods that are critical to economic development has sparked the interest widening tax base for improved tax revenue collection, (Levin, 2004). Thus the expansion of public in public services and a corresponding increase in tax revenue is now a priority in many developing nations. Currently, domestic revenue mobilized together with aid inflows provide much needed funding, for social economic activities financing in Tanzania. However, rising the domestic revenue to sustain social economic activities is more important than depending on the foreign aid.

Enhancing domestic revenue requires careful design tax reforms in ways that take proper account of their distributional impact, in particular their impact on the poor, (Levin, 2004). Since tax-policies have redistributive impacts, of a size comparable to the effects of social sector expenditures and since a pro-poor expenditure strategy takes time to implement it is important to understand the distributional consequences of tax policies, (Sahn and Younger, 2002).

The increase in tax may have the following impacts if not carefully undertaken; adverse supply side effects by constraining already low private investment, thus undermining growth and the prospects for increasing tax revenues sustainably, taxation also generally affects the composition of investment, which may be a more fundamental problem for economic growth, particularly in developing countries, than the level of overall investment itself, (Devarajan, *et al*., 2002) and tax increases generate uncertainty about what the tax-structure will be in the future.

With growing informal sector in many developing countries, tax revenue mobilization has been a challenge especially from this sector. The tax-system fails to capture potential revenues from economic activities due to the size and fast growth of the informal sector, and in addition, tax collection is inefficient. Various ways have been employed to raise tax revenue from this sector although the potential have not yet optimized. These include; enhancing voluntary tax compliance among SMEs, and strengthening the potential benefits of formalization which on one way or another have contributed to the performance of revenue collection from the informal sector.

5.1.1. Large dynamic of the informal sector growth lead to the low performance of the sector

The informal sector in Tanzania is large and dynamic in the sense that the rate of entry for new entrants is high and the life span for many entrants into the sector is low (approximately less than

five years) thus rate of exit is also high. Also, there is dominance of traditional business, mostly with youth and adult operators characterized with basic education conducting mainly trade as the dominance activity in the sector. This implies that the trend of the informal sector is unstable though it's getting larger overtime.

The dynamism of the sector is also associated with the nature of the participants whereby most of the sector operators have basic education with limited further entrepreneurial education, training, workshops and other skills, and the nature of economic situation prevailing such that low effective demand which affect the business cycle has been mentioned as among the reasons for short survival of many of informal sector operators. With presence of many small businesses which are not registered, low capital equipment and machinery usage and lack of permanent sites of business operation difficult the formalization process and tax collection into the informal sector. This behavior rises concern about the potential of the informal sector to be depended as the source of government revenue.

This confirms the characteristics of informal sector in many developing nations. Grimm, *et al,* in 2011 found that, informal sector growth is mainly through the creation of new firms instead of the expansion of existing ones, which is consistent with much higher returns at very low levels of capital. Also Russell, in 2010 in his writing on managing the shadow economy, postulates the nature of the informal sector as a major and enduring revenue risk, by its very nature the size of the shadow economy is difficult to measure.

5.1.2. Unstable informal sector and taxation system lead to large revenue foregone

Informal sector exhibits an unstable pattern in contributing to the government revenue and thus revenue foregone from the sector get larger overtime. Despite presence of presumptive tax and increased contributors to the tax net, still the informal sector has not contributed substantially to the total revenue such that, there is large dependency on large tax payers group. This is because most of the operators in the sector have no business license and do not pay tax which cause large untapped potential of taxation in informal sector and hence increases the revenue foregone. With this, the burden of tax increases to the few payees while there is many of untaxed group thus causing the rising of inequality in income among the operators of the sector and between the formal and informal sector.

This implies that despite the growth of the sector, still the sector has not exploited to its fullest in terms of the potential tax revenue to be harnessed. The finding has been observed in some other countries like in Zambia where it has been found that the tax revenues forgone due to tax evasion by the informal economy is large and increasing due to difficulties of incorporating informal sector activities into tax net (Phiri, 2012). Also Russell, in 2010 in his writing on managing the shadow economy, postulates that tax revenue foregone as a result of shadow economy represents a significant larger share of the tax gap components. This shows that the efforts to deal with the informal sector so as to raise revenue need to be enhanced as the potential is growing unexploited to its optimal level.

The use of presumptive income tax has contributed to the improvement of tax revenue as it registers a positive growth of the amount collected each year. This implies that the instituted mechanisms to bring informal sector into the tax bracket are working and thus need to be enhanced and promoted. On the other hand, the increase of revenue foregone is associated with the difficulties of taxing the informal sector due to limited information about the business operators. there are some reasons

for informal sector to escape paying taxes in Tanzania. these includes; small capital turnover, immature business and economic hardship, inadequate benefits of paying tax, nature of business and absence of proper business premises are the major factors for the SMEs not paying taxes. Also, inadequate knowledge and education on tax paying advantages, registration and business management practices, cumbersome procedure, bureaucracy and corruption, by the tax revenue collection units, have their contribution, (Aikaeli, and Mkenda, 2014).

5.1.3. Inappropriate Taxation Systems of the Informal Sector Leads to High Inequality

Presumptive income tax system works better in attempting to collect revenue from the informal sector however, it may infringe few who are small and are not in the position to pay the taxes or tax less some who are supposed to be in higher category of tax. This leads to the rise of Inequality which has been viewed as the major policy issue in the country in many sectors. The existence of inequality among the informal sector in the country has been mainly contributed by Taxes, size of the informal sector, and Income distribution. This is also reported in different part of the world by different authors like, (Diego, 2005; and Ela, 2013) that high inequality in education, taxes and level of income leads to an increase of informal sector.

The concern on the tax system particularly the Presumptive tax system is that, many presumptive regimes are deliberately designed to reduce the tax payments of smaller firms. Thus, this fuels the problem of firms not wishing to graduate onto the standard regime when they are able to, and large firms making themselves appear small, and hence leads to inequality. The increasing level of inequality in the society has direct influence in the increase level of poverty, increased level of classes, failure of other business as well as decline of the economy. This is not only in Tanzania but also in other countries in the world like India whereby (Romero, 2007 and Cashin, 2016) revealed that gender inequality, education inequality, and income inequality increase poverty, classes and decline of the economy.

5.2. Policy Implication and Recommendations

This section provides the policy implication of the findings derived from the study and the recommendations of the implications and findings. These are as follows;

5.2.1. Enhanced formalization of informal sector in the country

The size of informal sector in the country is growing overtime and it is owned by mostly youths and adult groups. This implies that, government revenue collection base gets narrowed hence increase the burden of tax to the formal sector and government itself to cover the provision of public services. Also, this situation characterizes the high level of unemployment among youth and adult's population thus, most of them engaged themselves in the informal activities. Thus, the government should strengthen the formalization process of informal sector in the country as the way of increasing the tax base, and initiatives to revamp the economy need to be undertaken so as to enhance the capacity of formal sector to absorb the abundant unemployed labor force.

Also, the government and other stakeholders should invest in the provision of business education to the business operators; education system and curriculum should be improved by giving room for job creators and not seekers graduates; encourage people with middle and higher education to participate in business activities as well as improve the provision of further entrepreneurial education, skills, seminars and workshops to the business operators so as to increase efficiency, effectiveness and innovation in their business. This will be in line with improvement in the entrepreneurial education,

and other skills; strengthen affordable financial supports; creating reliable market for the emerging industries and other conducive business environment in those industries.

The government, through the small and medium industries should continue to promote SMEs development through the provision of advisory services, infrastructure facilities, market access, financial support and many other supporting services. This may help number of SMEs programs to develop with the vision of improving the competitiveness at the market and at the end be formal business. Furthermore, it is upon the government to revise the business registration processes by reducing the cost of registration imposed by BRELA and smoothen the registration requirements so as to attract more informal business to register their business. This will improve processes of registration and incentivize entrepreneurs and business operators to register their business and enhance formalization.

5.2.2. Widened tax base in the country

With unstable contribution of informal sector to the total revenue, which result large revenue foregone indicates that the informal sector is not so stable sector for the government to depend on it for its revenue. Therefore, this calls for the enhancement of the instituted mechanisms to bring informal sector into the tax bracket. On top of that, provision of tax education to the informal sector should be conducted frequently in order to strengthen tax awareness and compliance to the SMEs. Moreover, beyond facilitating business registration authorities must go an extra mile by continuous monitoring performances of such business that they pay tax. So, the Government should play the role of turning the informal sector to be the dependable tax revenue base entity by formalizing them while supporting them to grow through improving their business environment, giving them affordable financial support, business education so as enabling their ability to explore other part of the sector as well as stimulating customer effective demand through economic improvement and stabilization.

Moreover, efforts should be done on the financial management awareness creation, simplification and provision of soft loans and provision of business registration education based on its benefits especially during provision of financial or capital investment support from either Government or non-Government entities. The Government should create favorable legal and regulatory framework, improve infrastructures, business development services, access of affordable SMEs financial support and improve coordinated institutional support framework. Also, the Government should simplify tax system; impose tax amounts based on the profit level of the business; and introduce tax incentives and holidays to the new SMEs so as to give them room for growth and prosper. The following are specific recommendations from the Bagamoyo Validation Workshop;

I. Ensure machingas are registered by giving them identity cards and making them pay a small "membership fee"
II. Tax knowledge should be a cultural shift – this means introducing the importance of paying tax into our education system (from primary school national curriculum)
III. Tax education should also be reformed within government tax bodies to emphasize that we are trying to tax the informal sector to help them grow, not just to eat away from their profits
IV. There should be a department within Tanzania Revenue Authority (TRA) that deals specifically with SMEs and the informal sector
V. There needs to be a compliance department at the local government level that links with this SMEs department at TRA. This compliance department will serve as a certification method for local enterprises

VI. Build infrastructure for market segmentation of informal activities taking place in the same geographical area/location

5.2.3. Optimal tax system to the informal sector

The study found that, the existence of inequality among the informal sector in the country has been mainly contributed by Taxes, size of the sector, and Income distribution. This indicates that, there is high level of inequality in the country which should be minimized or eliminated by reducing the size of informal sector through formalizing them and improve their general business environments; application of re-distribution income strategies for the country so as revamping the customer's effective demands as well as improving the education system as the means of creating jobs creators and not seekers while preparing the large unemployed work group to exploit the unexploited business areas. Also the Government should improve the tax systems by consortium all kinds of taxes, levies and other business charges and bills into a single unit or specific payment door so as reducing time consuming by business operators when it comes into tax compliance.

The increasing level of inequality in the society has direct influence in the increase level of Poverty, Increased level of classes, failure of other business as well as decline of the economy. This suggests that, Inequality has direct impacts into the National growth and development. Hence the Government and other responsible stakeholders should play an animated role to minimize the quintessence of all kinds of inequalities through formulation of different ant-inequality policies, programmes, strategies, seminars and workshops.

It is imperative for the policy makers to manifest the inequality issues in its policies regarding business operation in the country as it impacts the business operation to these small and medium enterprises in the country. Further, there is a need to conduct studies on better ways to ensure equity in various government policies and interventions so as to improve equity but also efficiency of these interventions.

5.3. Specific recommendations on how to improve revenue collections from the informal sector

Budget financing has been a major problem in many of the developing countries in attaining their desired goals. Several techniques have been employed in these countries to ensure financing of their budgets. Among the key strategies employed is domestic revenue mobilization which depend largely on tax revenue. Focusing on domestic revenue, taxation is viewed as the major source of revenue to many countries as it accounts for the larger share of the net domestic revenue. In Tanzania tax revenue is a very important contributor of this revenue.

There are several techniques of improving the ways of collecting tax from informal sector. As the best practice, presumptive income tax has been employed as the tax which covers the informal sector activities, unfortunately it has not sufficiently cover all the informal sector. This section presents the ways of improving revenue collection from informal sector based on the views of the respondents in this study. Table 5.1 shows opinions on the ways to improve tax revenue collection from the informal sector from the respondents.

Table 5.1: Ways to be done to Improve Tax Revenue from Informal Sector

	Percent
Increase/expedite EFD machine usage	30
To restructure the tax collection system	53
To register permanent areas for street vendors to conduct their business	17
Total	**100**

Source: **Policy Forum Survey, 2017**

Table 5.1 present major policy strategies suggested by respondent concerning ways to improve tax revenue collection from informal sector in Tanzania. These are; to increase EFD machine usage, restructure the tax collection system and to register permanent areas for street vendors to conduct their business.

5.3.1. Increase/expedite EFD machine usage.

Tanzania Revenue Authority started implementing the Electronic Fiscal Devise (EFD) system in 2013. The system is being implemented in two phases, with the first phase planned to cover all VAT registered taxpayer's country wide, and the second phase was intended to cover Non-VAT registered traders with turnover ranging firm TSH 14 million and above per year, (TRA, 2014). In essence, Tanzania Revenue Authority (TRA) introduced the use of EFD as a way of increasing tax collection from SMEs with an automated device to keep records. Automated devices enhance revenue collection from SMEs because they reduce the human element in tax collection that increases effectiveness and correctness of the information recorded.

Usage of the EFD machine can be increased through improving provision systems of these machines to business operators, by reducing the cost of acquiring them to easier financial constrain of accessing EFD and raise the morale for the need of these machines to the business operators or traders. Also, provision of education and raising of awareness on the use of EFD machine and its advantages to business operators should be enhanced by educating them to be aware of the machine system on how it works, how it helps both collectors and SMEs when they use the machines.

The use of EFDs machines reduce the operation cost of the government that was incurred to collect VAT as well as improve the business income of tax payers. Also the study indicated that while EFDs improving the efficiency and effectiveness of government operations also provides timely and accurate tax information to businesses and increases the availability of electronic tax filing. The impact of introduction of EFD to the tax revenue has been observed as Tanzania Revenue Authority (TRA) recorded an increase in Value Added Tax (VAT) under the use of EFD when comparing the periods before and after introduction of EFD, (TRA, 2013).

5.3.2. Restructure of the tax collection systems

Taxation is a very important source of income of any government for its development and provision of social services. Hence it is compulsory for every working person and the society in general to pay a true tax on the right time to enable the government meet the cost of providing social services, (Samson, 2012). Taxation of the informal economy appears to be a potentially important source of government revenue, as the informal sector comprises a large, and in many countries growing, share of GDP, (Schneider and Klinglmair 2004, Schneider *et al*, 2010).

The government of Tanzania introduced presumptive tax as a need for effectiveness in tax administration when dealing with hard-to-tax groups of the economy. For example, small businesses, farmers, and self-employed individuals who represent a large number of taxpayers. These groups usually lack the appropriate bookkeeping and accounting records to determine and assess their tax liabilities, (Feinstein, 2008). It is very hard and expensive for the tax administrators to assess and collect taxes from these groups. Consequently, many small businesses especially in the informal economy of developing countries simply elude the tax net and are not taxed at all, (Agola, 2010).

Enhancement of the ways used to collect tax from the informal sectors has been viewed as another way of improving tax revenue collection from informal sector. Based on the results in table 5.1, about 53 percent of the respondents which is average suggested that the government should restructure the tax collection system to be friendly to the business operators, reduce bureaucracy on tax payment and also to have a uniform tax collection system that will collect all forms of taxes at once and to reconsider the progressivity of presumptive tax to rely on the business circulation. Also, there should be tax holiday to new firms once they start business to promote development of these business.

This will help to reduce disturbances of tax collection from different authorities in different time which compromises the comfortability of the firms to conduct their business, the system will promote growth and development of newly entering firms in the market by providing tax holiday at the beginning of the business and tax amount will consider the business conditions prevailing during the particular time. Also this will build confidence to the business operators and hence improves compliance to tax payment and hence improves tax revenue collection.

Joshi and Ayee (2008) show that government efforts in Ghana to tax informal sector firms resulted in at least some degree of bargaining between informal sector associations and the government. This shows that a better improvement of the informal sectors taxation will increase the revenue to the nation. In a similar vein, Prichard (2010b) finds that expanded taxation of small firms in Ethiopia prior to elections in 2005 triggered some public mobilization and prompted the government to include greater business involvement in overseeing the presumptive tax regime. Finally, Mel, *et al*, (2012) find that in Sri Lanka the formalization of firms, including entrance into the tax net, fostered expanded trust in the state, though they do not explore any broader governance implications.

5.3.3. Registration of Permanent Areas for Street Vendors to Conduct their Business

Registration of permanent sites for small business operators'/street vendors has also raised as the specific recommendation of improving tax revenue collection from informal sector. The act involves allocating and designating specific areas around towns and cities with which small business like street vendors' business will be conducted and each premise within the designated area will be known and contributes to the revenue in form of taxes. Practically, this is not a new idea as it has been applied in some places but its effectiveness was not as good as expected mainly due to political agendas of the government, low enforcement of the bi-laws and few areas were designated to not enough cover the demand of these business operators who are mainly informal.

It is suggested that permanent areas around the cities and towns should be registered and designated special for small business operations like street vendors whereby only on these areas small business will be conducted. Further allocating areas based with type of business will do well in controlling and monitoring informal sector activities. These areas need to be favorable for the operation of the type of business, and should be available in every municipal/town where the operators in the areas will contribute to the tax revenue.

Allocating permanent areas for small business operation will clearly classify the informality, and reduce the disturbances of the tax collection from informal sector and hence street vendors will be controlled and that they will be more comfortable to conduct their businesses in their legal areas of operations. This will also improve the competitiveness of business operation for both formal and informal sectors.

For the better and improved revenue collection from informal sector, there is a need to identify potential areas for small business operation designate them and register as market areas for small business operations largely the informal sector activities. This will induce the informal sector to register themselves so as to access the market areas and hence widened the base of informal sector contributing to the tax revenue of the country. Also, the government should concentrate on these group formulations among the informal sectors (people with the same interest) so that they can register to the revenue authorities as one among the tax payers thing which help in administration of these informal sectors.

5.4. Ways to be done to reduce inequality in informal sector

The informal sector is a prominent characteristic of many developing countries. In recent years, there has been a large body of empirical work that tries to understand what determines the size of the informal. Nonetheless, we are still far from understanding the relationship between the informal sector and the stage of economic development (La Porta and Shleifer, 2008). Some authors have argued that firms operating in the informal sector are less regulated and less taxed than firms in the formal sector, which allows them to operate more efficiently. This, represents a positive force for development, (Schneider and Ernste, 2002). The concept of economic inequality (also known as the gap between rich and poor, income inequality, wealth disparity, or wealth and income differences) comprises disparities in the distribution of economic assets (wealth) and income within or between populations or individuals. The term typically refers to inequality among individuals and groups within a society. Table 5.2: shows the ways in which level of inequality among the informal sectors can be reduced, views are according to how the respondents responded.

Table 5.2: Ways to be done to reduce inequality in informal sector

	Percent
To stabilize the economic condition	34.9
Provision of business education	23.1
Provision of loans	18.9
Participatory approach in business decision making	23.2
Total	**25**

Source: **Policy Forum Survey, 2017**

The results in table 5.2 show that, significant number i.e., about 34.9 percent recommended for stable economic condition as the major way of reducing inequality in the informal sector/SMEs. Also few. i.e., about 23.1 percent suggests on the provision of business education to the informal sectors is a key factor for reducing inequality, similarly few respondents of about 23.2 percent argued that there should be participatory approach in business decision making and very few of them tallying 18.9 percent suggesting provision of loans will reduce the inequality among informal sector.

Consequently, once these things are clearly done there would be some impacts to the informal systems such as; there would be an increase of the money flows and business circulation among the firms which would make sufficient profit to the firms and that makes them comfortable with the tax payment, increase awareness to the firms about the ongoing market so that they can cop and plan their businesses according to the economic situations, then accessibility of loans will help to expand their businesses and introduction of new techniques in business, but also for the firms participation in decision making will make reliable rules and conditions for the business firms (informal sectors) .

The report by OECD (2006) on removing barriers to formalization, discovered various ways that tries to reduce informality these includes, supporting broad programs of regulatory reform, introduce regulatory impact assessments, and institute programs of reform that examine regulatory burdens from the enterprise point of view, design measures to create a business-friendly culture in government and to improve service provision to local tax payers. Also ILO study (2002) on informal sector in Mainland Tanzania, found that government ceases to play the role of economic operator, but moved to play a more critical role as creator of the conditions within which enterprises in the emerging private sector can successfully supply the goods and services needed, while creating jobs and incomes at a pace keeping up with population growth.

Therefore, from the country's policies concerning the informal sectors, there is a need to insist and make serious follow up on these ways of solving the inequality level, since they are there for better implications. Better implication of these way will reduce the level inequality to informal sectors, hence government need to insist and make efforts on the improvement and implementation of these ways.

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