

S C H O O L O F

A C C O U N T A N C Y

University of the Witwatersrand, Johannesburg

A research report submitted to the Faculty of Commerce, Law, and Management, University of the Witwatersrand, Johannesburg, partial fulfilment of the requirements for the degree of Master of Commerce (specialising in taxation)

WHAT ARE THE CHALLENGES IN TAXING THE INFORMAL ECONOMY AND POSSIBLE WAYS TO OVERCOME THEM?

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Declaration

I declare that this report is my unaided work. It is submitted for the degree of Master of Commerce at the University of the Witwatersrand, Johannesburg. It has not been submitted before for any other degree or examination in any other university.

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Noluvuyo Mbedu

Abstract

Recent years have witnessed increased attention towards the challenges of taxing the informal economy (Joshi, Prichard & Heady 2012:1). However, this research report aimed to argue whether informal economy businesses in South Africa should be included in the tax system, given that the challenges of taxing the informal economy will need to be overcome. Other African countries such as Nigeria, Uganda, Cameroon and Ethiopia have attempted to tax the informal sector directly, and some businesses are bribing tax officers to reduce their company's tax payments. If the marginal bribe rate is lower than the statutory marginal tax rate, the company's tax payments will be reduced. (Kundt: 2017:6). Prichard (2012:16) has mentioned that the policy makers focus on the cost and benefits of taxing the informal economy. This research report also aimed to argue about the analysis that is needed to overcome the challenges of taxing the informal economy.

'Encouraging tax compliance is also important, not only in reducing costs but also in strengthening the potential benefits of formalisation' (Joshi, Prichard & Heady, 2013:16).

Keywords: informal sector; taxation; developing countries; informal economy; hard-to-tax.

Table of Contents

Declaration	2
Acknowledgements	3
Abstract	4
CHAPTER 1: INTRODUCTION	6
1.1 Background of the study	6
1.2 Research question.....	8
1.3 Research methodology	8
1.4 Significance of the study	9
CHAPTER 2: WHAT IS THE INFORMAL ECONOMY?	10
2.1 Defining the Informal economy.....	10
2.2 Characteristics of the informal economy.....	11
CHAPTER 3: WHAT ARE THE CHALLENGES OF TAXING THE INFORMAL SECTOR?.....	16
3.1 Challenges experienced in other African countries.....	16
CHAPTER 4: WHAT ARE THE DIRECT WAYS OF TAXING THE INFORMAL ECONOMY?	26
4.1 Indirect taxation of the informal economy.....	26
4.2 Presumptive taxes.....	28
4.3 Support incentives for the informal economy.....	31
CHAPTER 5: CONCLUSION	35
5.1 Conclusion.....	35
5.2 Recommendations for future research	36
REFERENCES	37

CHAPTER 1: INTRODUCTION

1.1 Background of the study

The proposed study aimed to consider how the informal economy in South Africa can become active players in the tax system. Hence, this study proposed to find the challenges of taxing the informal economy and possible solutions to overcome these challenges. Also, this research aimed to identify the existing tax system to tax the informal economy that Nigeria, Uganda, Cameroon and Ethiopia are using and possible ways to implement a similar system in South Africa. I have chosen these countries because there has been sufficient research on them.

It is important for the taxpayers to comply with the regulations that are attached to the Value-Added Tax Act (VAT) 89 of 1991, referred to as the Income Tax Act and VAT Act. The main enforcing state enterprise in South Africa is the South African Revenue Service (SARS). The informal economy significantly contributes to reducing unemployment by allowing people to make a living outside of the formal employment system and to the Gross Domestic Product (GDP) of the country (Ali, Fjeldstad & Sjørusen, 2014).

The term informal economy traditionally refers to the group of people with different occupations who engage in small-scale, informal street trading, primarily on street pavements, offering a wide range of items and necessary services to prospective customers (Joshi, Prichard & Heady, 2014:3). The majority of the informal sector in South Africa is made up of black women who deal in a variety of commodities such as candies, cigarettes, clothes, and, most prominently, fruit and vegetables that are typically produced or supplied by someone else (McLaren, 2014:8). The informal economy provides a livelihood and income to approximately 2.5 million people in South Africa (Fourie, 2018:2). The informal sector represents a large portion of the South African economy (Etim, 2020:22). In recent years, the South African government has encouraged the establishment of new businesses as a means to create job opportunities and accelerate economic growth (2014 NTE Report:3). For example, according to OECD (2017:11), the government has taken measures to reduce the restrictions for starting and launching a business, diversifying the sources of funding, and guaranteeing that government policies provide both financial and non-financial assistance for entrepreneurs and small companies. The steps taken by the government

has increased the number of informal traders in South Africa, which has grown significantly (Horn 2011:11). Consequently, the informal economy has heightened importance in the growth and development of the broader economy (Acs, Arenius, Hay & Minniti, 2005:102).

Despite the size of the informal economy, policy debates on employment and framework documents, such as the National Development Plan (NDP), tend to focus more on the formal economy (Fourie, 2018: 13). The NDP's focus on the economy and employment ignores informal sector enterprises and their unusual needs and constraints (Fourie, 2018: 15). These requirements include a good inclusive growth plan that actively engages the poor in developing economic processes, creating production, and earning a fair wage through employment. (OECD, 2017:3). For example, these informal sectors provide jobs, although the salaries are not decent (Fourie, 2018:6). Other restrictions include a lack of adequate and safe buildings in excellent locations, little or no bookkeeping skills, a lack of money, credit and insurance, as well as becoming the target of crime and harassment by local governments (Fourie, 2018:9). Several structural restrictions are inherent in the concentrated form of the economy (Fourie 2019:4). These also make it difficult for informal economy business owners to expand outside local markets, advance to the sector's top levels or move up to higher-value markets and formal sector value chains. (Etim, 2020:16).

It should be noted that much of the existing data relating to the informal economy does not provide a complete picture of the sector, revealing the government's miscomprehension of the informal economy (Etim, 2020:21). There are significant discrepancies between the numbers presented by Statistics South Africa (StatsSA) and the SARS in their assessments of the number of income taxpayers across different income brackets. If the informal traders are willing or accept enforcement or register their business, they could find themselves paying less tax; for example, their businesses might not be making the turnover of R1 000 000, therefore, they might be charged less tax. The current research has some information although more research is certainly required in this area to fully understand the potential outcomes of taxing the informal economy.

Between 2006 and 2011, 440 000 small-enterprise ‘closures’¹ occurred, according to StatsSA's Quarterly Labour Force Survey (2017), while the number of new company start-ups fell to a record low in 2017.

These enterprises probably re-emerged in the informal sector, where compliance with income tax laws is patchy (Pillay, 2018:11). It is important to note that SARS's tax amnesty for small businesses and sole proprietors between 2003 and 2010 netted approximately 385 000 additional income taxpayers (SAIT, 2003). According to ILO 2003, it is probable that while South Africa's informal sector consists primarily of hawkers, a growing number of moderately high-income individuals who own their own businesses constitute a growing percentage of the informal sector which provides them with the opportunity to evade income tax.

1.2 Research question

- What are the challenges in taxing the informal economy and possible ways to overcome these?

Research sub-questions:

- What is the informal economy?
- What are the challenges of taxing the informal economy?
- What are the possible ways of overcoming the challenges of taxing the informal economy?

1.3 Research methodology

The study was qualitative research in the form of other people's studies and different sources of secondary data that includes articles, books and possible legislation.

¹ The term ‘closures’ is in inverted commas because many of these firms are expected to continue to exist and function but no longer declare their operations to the authorities.

1.4 Significance of the study

Policymakers overlook the informal economy's potential, as well as the constraints it faces, its unique vulnerability, and policy support that may help it become more sustainable and self-sustaining (Fourie, 2018:6). Despite estimates that the informal sector would develop and provide almost two million new jobs by 2030, the informal sector is not addressed in the NDP's analysis and policy initiatives for small companies and employment (Fourie, 2018:10).

The government could consider supporting the majority of the informal sectors where small, medium and micro enterprise (SMME) owners or managers who have no basic information with regards to taxation and its benefits by offering training and seminars to broaden their knowledge about taxation.

More research towards the informal economy is required and will be important to the other students or other researchers because it will further establish whether there is a need for taxing the informal economy. This is so because, for example, in South Africa, the informal economy is diverse and comprises different industries, not just trade. Most of the multi-person, employing enterprises are in construction, retail trade and services, but also in manufacturing and communication. The informal industry has the capacity to employ, and the informal sector is not static either hence this study will shed light for the policy makers about the importance of taxing such a big informal economy (Skinner 2019:24).

CHAPTER 2: WHAT IS THE INFORMAL ECONOMY?

2.1 Defining the Informal economy

Before exploring the informal economy, it is important to understand the informal economy or sector definition. The term informal economy can be described as a diverse range of economic activities, including employment and employees that are not regulated or protected by the state. The term informal sector was originally proposed by Keith Hart (1973) and is described as employment that is outside of formal labour markets. Its further elaboration and elucidation were made by the International Labour Organisation's (ILO's) Employment Mission to Kenya under the auspices of the World Employment Programme in 1972. The definition of informal economy employed in the ILO's study is, therefore, broader as the term is meant to include the more substantial small businesses that have merged into the informal sector after abandoning the confines of the formalised small business sector. The informal economy can be found anywhere in the world. Compliance is mostly the reason why informal businesses are not operating formally.

The term informal economy refers to economic activities that occur mostly outside of the formal labour market. Also, the informal economy can be described as a diversified set of economic activities such as selling, mechanic, jobs outside the formal market (WIEGO, 2014). The informal economy has expanded due to unemployment, and people are not able to survive with one source of income in their households. They are appearing in new places and new ideas of adding income to support their families (WIEGO, 2014). Most importantly, the informal economy contributes significantly to the global economy by reducing poverty.

Over the years, the informal economy has increased and involved more services than selling fruits and vegetables on the street. The face of the informal economy is increasing, especially for those who are not running illegal businesses; for example, during the COVID-19 lockdown in South Africa, some citizens started selling their products on social media such as Facebook and WhatsApp. The lockdown has affected many lives where many people had their salaries reduced, and some lost their jobs; hence competition within the informal economy has increased. The government has advised the nation that the citizens should start businesses to increase the

employment rate, and some businesses might be successful. Most of these businesses transact in cash, and that makes it difficult to audit such businesses.

The informal economy can be defined as unstructured economic activities that do not comply with government laws but contribute to household income. In many industrialised and developing nations, the informal sector helps to create jobs and reduce poverty. The informal economy also employs a large number of people and contributes to the economy's social welfare (GDP) (Ligthelm, 2006:12).

2.2 Characteristics of the informal economy

The informal economy is characterised by a significant number of traders, most of whom are breadwinners, who engage in a wide range of legal and illicit operations outside of the formal economy (Fundie, 2020:12). Those who are unable to find employment in the formal sector can turn to the informal economy as a primary or secondary source of income. Some of the characteristics of the informal economy include easy access to the business sector, such as small-scale processing of products and educational skills that are not available in the formal economy, such as tutoring. The informal sector has high development potential and can be viewed as a convenient way to start a small business.

The main characteristic of the informal economy is the challenges associated with implementing the informal economy tax policies directly (Etim, 2020:13). Informal economy businesses assume that choosing to participate in the formal economy will require compliance with tax legislations and obligations. Compliance with tax laws and obligations might bring some important benefits for informal economy businesses and positively trigger growth and productivity (Joshi, 2014:22). The benefits include stable work environments because, as an informal employee, you are not being taxed and UIF (Unemployment Insurance Fund) does not apply on wages or salaries (Joshi, Prichard and Heady, 2014:6). Further benefits include quality work environments, the expansion of customer bases by providing formal tax receipts (rather than informal paper receipts with a stamp as proof of purchase), exposure to police and municipal officers for security and infrastructure, rather than worrying about trading informally providing access to capacity-building and training (Joshi, Prichard & Heady, 2014:9).

The informal economy already pays a range of taxes, penalties and licensing fees, primarily imposed on local governments. These fees are paid by the informal economy because they can stimulate business growth, improve market conditions and contribute to the development of a tax-enforcement culture (Joshi, Prichard & Heady, 2014:14). According to economic modelling research, fully enforcing taxation on the informal economy would increase labour productivity and output (Ordóez, 2014). Informal businesses pay a wide range of fees that, once they register for taxation, become deductible in taxable income calculations. Therefore, if they formalise, their tax liability would be reduced, and they would still be able to receive the benefits that accompany taxation. An example of such benefits is getting COVID-19 provisional tax relief whereby businesses received support from the government to keep their businesses going and be able to pay their employees half salary, and then they received the other portion from UIF.

Income tax relief: depreciation

Informal economy businesses are not insured, and if they comply with the tax regulations, they will be able to form a tax deduction on the assets in terms of Section 11(e). Section 11(e) also allows for a depreciation deduction on the wear and tear for machinery, plant, implements, utensils and articles. However, the assets must be held by the taxpayer or bought under an instalment credit agreement (Smulders, Di Maria & Van der Wer, 2017:9).

Income tax relief: reduced tax rate for SMMEs

The informal business may benefit from this tax relief as different tax rates are applied to different types of entities and sizes. As a micro-business expands and its taxable turnover increases, the tax rate increases to encourage the micro-business to keep appropriate records to transition to the normal income tax system and not remain in the turnover tax system. (SARS, 2019a:10).

Taxable income (R)	Rates of tax (R)
1 – 195 850	18% of taxable income
195 851 – 305 850	35 253 + 26% of taxable income above 195 850
305 851 – 423 300	63 853 + 31% of taxable income above 305 850
423 301 – 555 600	100 263 + 36% of taxable income above 423 300

Skills development levy relief

Section 3 of the Skills Development Levies Act Act 9 of 1999 mandates that all organisations pay a 1% skills development levy on their total salary to their employees. For example, companies with a maximum annual payroll expenditure of R500 000 are exempt from paying the Skills Development Levies Act's Section 4(b). (Smulders, Di Maria & Van der Wer 2017:6).

According to WIEGO (2014), the average nominal daily wage for the informal economy employee is approximately R50. The regular income of various informal labour markets in South Africa is estimated by the SARS to be less than R79 000 annually. The informal economy may include vendors, such as people who sell various commodities such as vegetables and mechanics. There are also hawkers, advertisers, artisans, small veranda businesses and cross-border traders among the workers in this industry. The black market (shadow economy, underground economy) can include other concepts, which can be defined as the informal economy. Moreover, Buss (2018) states that informal sector means the part of the economy that involves financial transactions that are not registered for tax and record-keeping purposes but are not inherently illegal or at least unlikely to be associated with law enforcement and government regulation. Examples of activities in this sector include people selling things from their home, sometimes called garage/yard sales, paying a friend or neighbour to mow grass, shovel the snow from your driveway, walk and/or otherwise take care of your dog when you are on vacation or sick. The

informal economy's income is small compared to formal traders; hence the informal economy revenues are low, and future tax rates are correspondingly low based on their estimated daily earnings. At the same time, the collection of taxes in the informal economy is very high, and tracking the informal economy is very difficult. Displacement as a result of building beautification initiatives in public spaces and urban improvements such as public transport creates market uncertainty for informal traders, which makes it difficult to monitor the informal economy.

Nonetheless, as discussed, it can be understood that the informal economy contains a wider variety of profiles than historically thought. The informal economy includes a variety of economic units that are mostly owned and operated by individuals in urban areas, either alone or in collaboration with other members of the same household. According to the African Newsletter on Occupational Health and Safety (2012:32), informal sector units can employ one or more workers on a continuous basis in addition to unpaid family worker's and or casual employees. Such small-scale organisations usually have a low organisational level and little to no distinction between labour and capital. They are engaged in the production and distribution of goods and services with the main goal of creating jobs and providing a minimum wage for the individuals involved.

According to the Western Cape Provincial Economic Review & Outlook (2017), an informal economy has no more than four regular workers, a small firm has no more than 20 regular employees, and a small business has no more than 50 employees. Medium-sized businesses employ up to 200 people. Micro-businesses can be classified as survivalists or non-survivalists. Survivalist businesses employ no one, and examples include hawkers, vendors and spaza shop owners. Non-survivalist businesses employ no more than four people on a daily basis. All of these activities are typically associated with the informal economy (Western Cape Provincial Economic Review & Outlook; 2007:132). They usually do not pay taxes and are not registered. Small businesses, on the other hand, have access to new technologies and operate in the formal economy (Western Cape Provincial Economic Review & Outlook; 2007:160).

As the informal economy is already paying fines and licences, formalisation will provide more benefits; they might be aware of these benefits but have no knowledge on how to get them.

Their businesses might fall in a certain category where they might not even pay anything, but they will have the opportunity to be engaged with big businesses and help to expand their businesses. If the informal economy is able to comply with the tax rules and regulations, more jobs will be created, and that will reduce poverty. Further research is still required in this section as compliance need to be implemented to reduce poverty and increase the country's revenue.

CHAPTER 3: WHAT ARE THE CHALLENGES OF TAXING THE INFORMAL SECTOR?

3.1 Challenges experienced in other African countries

This research report sought to determine whether the informal economy in South Africa should be engaged in the formal tax system, analysed the possible benefits for the country as a whole and the informal economy, which may receive benefits. Such benefits include being able to get credit from suppliers or banks, applying for input tax/VAT return, and businesses could grow as all the VAT registration documents will be in place. Further, I discuss experiences from other African countries such as Nigeria, Ghana, Cameroon and Ethiopia.

Joshi, Prichard and Heady (2014:4) debated the costs and benefits of taxing the informal sector, with a focus on direct revenue and equity. When evaluating the policies that could be implemented to tax the informal sector, it is first of all important to address whether the tax revenue generated from this effort is adequate to justify the costs of introducing and enforcing taxation in the informal economy. Tax revenue from the informal economy should provide sufficient revenue for the government in the near future to cover the operating costs and fulfil its other revenues. However, the decision to tax the informal economy may not be a prudent one if the system continues to operate untrustworthily. This could provide preliminary indications of potential benefits to taxing the informal economy.

This chapter will explore the challenges that other African countries have experienced in taxing the informal economy and the possible ways that these challenges can be overcome.

Taxing the informal economy can be challenging, but the simple way to do so is to indirectly tax the goods and services that they buy and sell (Joshi, 2014:10). Tax compliance can take the form of enforcement or voluntary compliance. Penalty and detection rules can be used to achieve enforcement compliance, whereas voluntary compliance can be achieved if there is a willingness to comply with the appropriate tax rules without harassment or pressure from the tax authorities. Based on the existing tax system used in Nigeria, Uganda, Cameroon and Ethiopia to

tax the informal economy, I have suggested ways to implement taxing the informal economy in South Africa.

However, this study emphasises the importance of further research as well as the challenges posed by the overall vulnerability of many informal economy businesses as a result of unequal power dynamics, particularly corruption (Joshi 2014:13).

Taxation of the informal economy can represent not only a form of revenue for the government but also a form of investment in its people. However, the informal economy could benefit greatly from economic stimulation as some businesses cannot afford to expand and require support from the government. There are many possible drawbacks and obstacles to the success of a formalisation policy, but finding possible ways will be a great help. For instance, a particular challenge to the formalisation process would be educating the informal economy members on the benefits of formalisation. Formalisation can only succeed with a high rate of conformity; the country needs to be comfortable with change and the policies that will come with the enforcement. The extent of agreement with formalisation correlates with the education provided to informal economy members (Nguyen 2017: 12). It would be necessary to weigh these obstacles against the benefits to fully understand the potential implications of a policy.

Cameroon

In Cameroon, for example, there has recently been a debate about delegating responsibility for collecting taxes from micro-businesses. The national revenue authority lacks both the ability and the desire to participate significantly in this market, which is largely unorganised and offers little potential revenue. Some local mayors are requesting these responsibilities. Unlike local governments, national tax authorities require revenue sources for service provision and have the opportunity to use such revenue to improve services to informal firms, increasing the likelihood of compliance. Furthermore, local governments have better information about the size, location and profitability of informal businesses, as well as greater capacity to monitor and enforce tax payments. The possibility that local governments lack the resources to collect such taxes in an efficient and reasonable manner has increased opposition to its implementation. The possibility

of receiving budget administration assistance from the local office has been considered (an offshoot of the treasury that helps to manage accounts). There is currently little cooperation at the local level between tax administration and budget administration, and the budget administration office will be well-positioned from some perspectives. What this would require, however, is the coordination of tax policy between local and national governments to avoid both tax evasion and double taxation, as well as to encourage firms to graduate out of the informal taxation regime as they grow (Loeprick, 2009:11).

Ethiopia

Ethiopia's experience has followed a similar path to that of Cameroon, indicating the feasibility of decentralised small company taxes. Ethiopia is a federal republic with the regional government in charge of small company taxation. Businesses in Ethiopia are divided into three categories depending on turnover starting in 2008, with firms having a turnover comparable to R1 000 000 being subject to the normal tax regime. The two smallest groupings of businesses are not required to keep proper financial records. Instead of paying income tax and VAT, these businesses must pay a per cent turnover tax and a provisional income tax (Prichard, 2010b:27). Despite the reality that capacity constraints are likely to be less severe at the regional level than at the local level, the Ethiopian experience highlights some of the perceived advantages of subnational selection.

Most importantly, although these firms' tax revenue constitutes only a comparatively small proportion, it is a critical component of national tax revenue. It has thus provided decentralisation initiatives more successful significance. While central control remains substantial, the importance of this revenue implies that more emphasis has been paid on good implementation. Similarly, the proximity of the regional tax authorities to the impacted companies appears to have resulted in a wider debate over the tax architecture. Authorities acted in response to public dissatisfaction with the tax that took members of industry groups and companies around the board to business owners responsible for calculating small business turnover, thus improving the perceived scheme credibility and fairness. Finally, there is evidence that small business taxes have contributed to increased corporate public involvement, with small

business taxation emerging as a key concern in the aftermath of the 2005 election (Prichard, 2010b:6).

Ghana

Ghana's experience with Identifiable Grouping Taxation (IGT) and the following transition to assumed normal taxes is instructive in exposing a variety of difficulties. For starters, the prospect for taxing the informal economy does not appear to be as grim as it appears, and governments concerned about a tax backlash may discover that the informal economy is not as hostile to taxes as one might think. Second, a careful analysis of the political situation in individual nations may identify possible tax entry sites that run counter to current state-society ties. Furthermore, while IGT is not an ideal tax, it does provide a potential route to taxing the informal economy to create more accountable and equitable states when viewed in a broader, long-term context.

Furthermore, because people are constantly concerned about their money, Ghana should prioritise budget transparency and the actual expenditure of tax revenue on local development. Transparency is crucial because it reduces concerns about taxation and the level of corruption among government officials while simultaneously improving compliance. Everyone who pays taxes will be able to claim and maintain receipts, which can help hold municipal authorities responsible for how the money is used.

Ghana has focused on a strategy that will seek an alternative approach to aggressively attempting to resolve the importance of attempts to tax the informal economy. A policy of this type entails concerted measures to encourage effective collective action within the informal sector, as well as the establishment of institutional mechanisms to facilitate dialogue and collaboration between informal sector associations and the state. Joshi and Ayee (2008) conducted research on this topic, focusing specifically on the growth of Ghana's association taxation system. Between 1987 and 2003, the Ghanaian Internal Revenue Service delegated income tax collection from the informal sector to informal economy associations through IGT. The system arose from the corporatist partnership politics of the largest passenger transport group, the Ghana Private Road Transport Group and the Rawlings regime from 1981 to 2000, and it has persisted since the

opposition's electoral victory. Following its early success, the arrangement was expanded to include associations in thirty-two other informal sector activities. Rising informal sector revenues have been attributed to IGT (Joshi & Ayee, 2008:15).

The system solves some of the problems associated with micro-business tax collection. In terms of tax administration, IGT reduced the cost of collection to a fixed 2.5 per cent, which was paid to associations for their collection work. The organisations were in charge of recognising members and ensuring their compliance. From the perspective of the associations, becoming tax-compliant gave them legitimacy and helped protect them from more arbitrary public and police harassment. Micropayments were made possible by the system (the system initially collected taxes from transport employees on a regular basis but moved to weekly payments). It had adjusted to the volatility of the sector's earnings and had become a minor burden. Compliance with the tax payments, on the other hand, did not make the operators personally accountable to the state, shielding them from certain, even more burdensome, laws being imposed. The disadvantage was that many informal associations were not fully accountable, and member revenue was collected without being automatically transferred to the tax authority.

Another issue was that partnerships and their associated taxation were viewed as tax havens for larger corporations. These disadvantages have become more apparent over time. Despite this, one of the system's main achievements was instilling a tradition of tax-paying in the informal economy within businesses. This was crucial when the government decided to transition to a more common presumptive tax regime, known as the Tax Stamp and Vehicle Income Tax, in response to growing problems with the IGT system. These new regimes called for the informal sector and private transportation operators to purchase tax enforcement stickers annually from the tax authorities. They were also to be plainly shown. It offered a fairly straightforward form of tax enforcement, which was adopted without any serious opposition, perhaps most notably. For these businesses, small tax payments had become a daily expectation, many of which in reality welcomed a change from the once common, but increasingly problematic, IGT regime (Prichard; 2010b).

It is also essential to ensure that any informal taxation reform aims to improve compliance. It can be achieved by having clear information and coordination on informal taxes intent and collecting it for citizens required to pay the tax. Informal traders need to understand why it is important to pay tax and who will collect and how; the information must be transparent.

Jallow (2017:2) believes that numerous attempts have been made. Taxes on the informal economy have historically been difficult for both the taxpayer and the tax collector. In Zambia, for example, a flat three per cent tax was implemented in 2004 to tax the large informal economy, which only made the poorest people of society poorer since they could not afford to comply with the adverse incorporation.

Nigeria

The low level of tax compliance in Nigeria's informal economy can be attributed to a variety of issues. A lack of understanding of tax rules, a lack of understanding of the primary rationale for paying tax, a lack of adequate knowledge and keeping of accounting records, and a culture of tax evasion and avoidance are all factors contributing to Nigeria's informal economy's poor level of tax compliance (Jallow, 2017:10). Taxing the informal economy is necessary and equitable for all. Taxation is critical in assisting in the formation of a social contract that is necessary for the establishment of the state and the advancement of human advancement. When this connection is established between the government and informal workers, they will be included in the service provision and regulatory frameworks.

It is important to find a possible way to overcome these challenges or future recommendations that can assist in improving the successful tax base for the informal economy. Tax education and awareness are important in human nature because they influence how citizens understand, react and respond to the reality of tax payment. Tax education and public awareness may lead to a willingness to pay tax without being forced. As a result, the level of compliance to tax in the informal economy is determined by the citizens' level of tax education and awareness. (Kasum, Kasum & Osemen, 2013:9).

According to Lateef, Saheed and Onipe (2015:17), Nigeria has a low level of tax knowledge due to a lack of tax publicity and education by the tax authorities. Gasch (2014:2) recommended that tax authorities maintain regular tax education programmes and public enlightenment for taxpayers on the principles of tax laws and the benefits of tax payment to overcome this problem in Nigeria's informal sector. This initiative is meant to improve civic responsibilities and to ensure continuing voluntary tax compliance.

Corruption control

The control of corruption can also improve tax compliance. Political influence also leads to tax administration corruption, resulting in a loss of emphasis on the critical goal of revenue collection (SAIPA, 2019:6). The influence of corruption on tax administration and South Africa's revenue collection authority, the SARS, has received less attention (SARS 2021).

A recent article by Visser mentioned that strict rules and consequences on SARS employees who are corrupt could improve compliance. For instance, a former SARS employee submitted a false VAT input claim. Other SARS employees had approved his request, which is why the trust and safety of the citizen against corruption are important. Another recent article (Visser, 2021) describes how SARS is launching a major recruitment drive that will be targeting highly skilled workers to assist in building a data-driven smart tax authority and will be tackling wealthy taxpayers who may be avoiding tax obligation. However, the upgrade of the administration will increase compliance. The corruption has an impact on tax administration and SARS has received less attention. In South Africa, revenue collection has been falling short of budgeted revenue for several years. 'While there is no empirical evidence linking under collection to corruption, it is reasonable to assume that corruption played a significant role(Visser, 2021).

Voluntary tax compliance

Voluntary tax disclosures have been one method used by SARS to encourage non-compliant taxpayers to disclose their tax conditions truthfully. The willingness of a taxpayer to prepare and file tax returns without being harassed or pressured by the tax authority is referred to as voluntary tax compliance. It has been noted that the SARS is working hard to improve the tax

base. A smart modern SARS with unquestionable integrity, trusted and admired by all, has been established. Their mandate is to ensure optimal compliance with tax legislation, with the goal of promoting a culture of voluntary compliance and making it easier for taxpayers and traders to comply with the law. SARS has developed a future strategy to improve service delivery, which includes providing citizens with clarity and certainty about their tax obligations, as they frequently do have doubts and questions regarding tax administration. It is critical to make it simple for taxpayers and traders to comply and fulfil their obligations, as well as to implement a system capable of detecting taxpayers and traders who do not comply or collaborate with banks. Taxpayers become hesitant to visit the SARS offices because of the long queues. Modernising the systems to provide digital and streamlined services may increase compliance, as call centres also take a long time to respond. SARS are collaborating with stakeholders to strengthen the tax system and increase public trust in the tax administration system.

If the above strategy is implemented to ensure that citizens follow tax rules and regulations, and those who are evading taxes come forward and register their businesses, it is possible to receive a large number of voluntary taxpayers through the Voluntary Disclosure Programme. South Africa has implemented a Voluntary Disclosure Programme to contact those who are aware that they owe tax. According to SARS, over 3000 taxpayers have responded to the Voluntary Disclosure Programme since its inception. It is worth noting that not everyone who is not paying taxes is unaware, but some are evading taxes.

Revenue

The fundamental advantage of taxing the informal economy is that it creates revenue. Taxing the informal economy will help increase government revenue, which is based on its size and positive contribution to the country's GDP (Schneider & Klinglmair, 2004:9). According to Keen (2012:15), taxing the informal economy should have less emphasis because the informal sector tax revenue is low with the high cost of administration, it has regressive tax incidence, and tax enforcement, if necessary, may result in various forms of harassment. However, taxing the informal economy will benefit both the government and its citizens because it will increase the country's revenue while also improving infrastructure and creating jobs. However, the economy's initial revenues

are expected to be minimal, as tax receipts and tax rates will be very low, but the cost of collection will be high due to logistic and administrative costs such as monitoring, assessment and collection. The low revenues at the start will propel some benefits, such as bringing informal economy participants into the tax net, ensuring excellent data for tax purposes, increasing transparency by ensuring good data for tax purposes and increasing the level of tax compliance in the future.

Growth

Growth will be accelerated by formalising an informal business into a formal one. When the informal economy avoids paying fees and taxes, it may be denied access to specific opportunities such as credit, government contracts, tax holidays and incentives, modern technology acquisition, training, and government contracts grants and technical support that would otherwise be available to formal businesses (Lagthelm, 2006:16). According to Basley and Persson (2014), small businesses in the informal economy suffer challenges with economies of scale and exportation prospects because they are not regulated by legislation. Lagthelm (2016:4) agreed that formalising the informal economy will increase informal economy productivity, resulting in growth and increased revenue generation. According to Joshi, Prichard and Heady (2014), however, as the informal sector increases, business growth will be realised by adequate rules and the formalisation of the informal economy (Wingender, Gasper & Jaramillo, 2014:30). When the benefits of formalisation outweigh the costs of formalisation, which include registration fees, regulations and the cost of compliance, informal sector businesses will formalise.

Furthermore, Rand and Torm (2012) affirmed that the formalisation of SMMEs into formal settings in Vietnam had a positive impact on the profits, investment and growth of those firms. Likewise, McKenzie and Sakho (2010 :3) agreed that informal economy formalisation could hinder growth and profitability. Taking the growth expectation from formalisation into consideration, McKenzie and Sakho (2010:16) argued that the benefit derivable from formalisation is minimal, which might not be enough of a reason for informal formalisation. Combining the experiences from Ghana, Ethiopia, Cameroon and Nigeria, the aim of this study

was to find ways to tax the informal economy in South Africa. More research is required to find a possible policy that will improve the compliance of the informal economy.

CHAPTER 4: WHAT ARE THE DIRECT WAYS OF TAXING THE INFORMAL ECONOMY?

Taxation is a critical tool for developing a country's economy and ensuring long-term development. Taxation is a type of fiscal, social contract between citizens and the government in which citizens pay tax to the government in exchange for infrastructure development, economic and social services, law and order enforcement, and other administrative services provided by the government for the citizens' benefit. In this section, I discuss a few possible methods for indirectly taxing the informal economy. Many researchers, including Dube and Casale, have suggested that indirect taxation and presumptive taxation could be used to tax the informal economy; I will therefore explain how presumptive taxes have been a direct source for taxing informal economy entities for most African governments (Dube & Casale 2016:15). Dube and Casale (2016:21) provided some evidence that presumptive taxation is the most common way of taxing the informal economy in four Sub-Saharan countries: Zambia, Zimbabwe, Ghana and Cameroon.

4.1 Indirect taxation of the informal economy

Taxing the informal economy can be difficult, but the most straightforward technique is to tax the goods and services that they buy and sell. According to the SARS, VAT is an indirect tax on the consumption of goods and services in the economy (SARS, n.d.). VAT is not reimbursed to companies that are not VAT registered (McLaren, 2014:4). The term indirect refers to the fact that informal sector businesses are not registered as taxpayers but are still taxed as a result of taxes paid on goods and services higher up and lower down the value chain (McLaren, 2014:7).

According to McLaren (2014:4), direct implementation of informal economy tax policies is difficult, as it has been researched that some developed countries are increasingly trying to figure out the simple way of taxing the informal economy.

Another way to attract the informal economy into taxation is to implement incentive measures, a policy option that has proved highly successful in other African countries that have implemented the taxation of the informal economy. For example, Nigeria, Kenya and Morocco introduced tax incentive measures through legislation, budget speeches, official notices/directives, signed agreements and Memorandums of Understanding between the

government and corporations (Nlerum, 2011:8). Because the costs and benefits of tax incentives vary by country, the impact of tax incentives on economic growth and the expansion of the tax base is not uniform, though it is possible. While tax incentives may certainly play a key role in attracting new investments that contribute to the country's major economic growth and development in some circumstances, in others, a particular tax incentive scheme may result in few new investments and a significant cost to the government. Therefore, if the government can introduce incentives, informal traders may gain; for example, workers' rights, which are not enforced in the informal economy, the option to apply for and receive business loans, and safer business premises that are subject to health and safety regulations. According to the Survey of Employers and Self-Employed (SESE, 2017:11), there are about 1.8 million individuals in South Africa who own and operate non-VAT registered enterprises with no additional employees. About 67 per cent of individuals who operate such non-registered businesses do so because they are unemployed or have recently been retrenched, with plus or minus 28 per cent of young people running such businesses (mostly youth below 35 years own salons). According to StatsSA (2017:17), approximately 10 724 000 South Africans work as employees or entrepreneurs in the informal sector, 70 per cent of who deal with food products.

Street traders are typically underprivileged, unskilled citizens. Tax structures and tax policies can also be used as effective tools to tackle gender disparities and to help combat perceived social inequalities (Economic and Social Council; 2019:2). Countries at all levels of development are encouraged to assess the impact of their fiscal systems on gender equality in terms of both taxation and expenditure. It could also be achieved by changes that evaluate and amend tax laws as well as revising tax collection procedures, tax administration and allocation of expenditure by gender-sensitive budgeting (Economic and Social Council; 2019:2). The informal economy has been the government's emphasis for tax revenues, as seen by recent news from the SARS Commissioner, who mentioned that renewed administrative actions had increased compliance while also bringing some success. However, the SARS Commissioner declared that it is still early to declare the victory of the 3 000 taxpayers that have responded to the Voluntary Disclosure Programme. SARS was able to identify a ten per cent offshore asset collecting to around R4

billion. SARS has improved administration, which has expanded the tax base by R1.6 million for newly registered taxpayers.

According to Visser (2021, Pay-As-You-Earn (PAYE), VAT and personal income tax, which had previously contributed little tax revenue to the government due to economic depression and tax equity problems, have all improved. Furthermore, as government expenditures rise, it is necessary to consider informal economy taxation to enhance government revenues, address tax justice issues, and improve tax compliance in emerging nations, particularly Nigeria and including South Africa. In recent years, taxing the informal economy to enhance tax compliance and income has been a hot topic. The informal sector appears to be difficult to tax due to administrative issues, a lack of tax experience or employees, the nature of the economic activity involved and the financial implications. Informal economy taxation benefits a country and its economy in three ways: it generates income, enhances economic growth and provides a channel for good governance.

4.2 Presumptive taxes

Presumptive Income Tax Assessment is one of the measures identified in the National Tax Policy for developing a tax system that encourages compliance with tax laws. Presumptive would enable tax authorities to deal efficiently with taxable individuals who have previously failed to comply with tax regulations because of their size or lack of business address, according to the National Tax Policy. A strategy to encourage voluntary compliance among taxable individuals in the informal economy, resulting in an increase in tax collections (Revenue trends tax proposal: 2021).

Arowolo and Folarin (2020:1) mentioned that Nigeria is currently operating a self-assessment system in which taxpayers review their books. The taxpayers pay based on the outcome after reviewing the calculations. However, by doing this, the taxpayer would usually prepare and submit an analysed account, tax calculations, completed assessment forms and evidence of tax payments. Therefore, the tax authorities are empowered to review these returns and either accept or reject them. South Africa can also implement such a system. South Africa can consider a similar voluntary tax system as the issue around increasing tax revenues from the informal economy is not caused by a lack of the tools that will subject them to be taxed, but the inability

to identify the taxable persons in this sector. However, it is important to acknowledge how to assess a taxable person that you do not know?

Taxing the informal economy will usually also make the informal economy vulnerable to coercion. Jallow (2017:2) also found that that a poor tax administration has led to violence and harassment, such as police chasing informal operators who are selling on the street and tax raids on those not paying licences. The Uganda Revenue Authority, for example, has implemented a more open, accountable and business-friendly tax regime in accordance with its computerised Integrated Tax Administration Programme and training from the World Bank and the International Monetary Fund, but issues remain. Emran and Stiglitz (2014:601) suggest prioritising other revenue streams as a result of these issues, as governments typically receive very little revenue from taxing informal activity, and in certain circumstances, the expenses of collecting these taxes are higher than the revenue obtained.

This has provided some evidence in a recent publication on presumptive taxation that the most common way of taxing the informal economy is through presumptive taxation, for instance, in Ethiopia, Ghana, Nigeria and Cameroon (Dube & Casale, 2016:13). While the presumptive taxes differ greatly with respect to their nature, scope and execution, there are some common observations about their efficiency and effectiveness. Some tax administrations found it challenging to implement the presumptive taxes due to severe capacity limitations concerning an adequate workforce. Administrative constraints also sometimes lead to a lack of monitoring and enforcement, so that taxpayers fail to pay.

A more drastic alternative for reorganising tax administration in the informal economy is to improve government's responsibility to provide a possible way to tax the informal economy. The South African government is already levying significant taxes such as trading licences for certain businesses (for example, selling alcohol in the locations, allowing them to trade in certain areas and avoiding being chased by the police because they have their municipal rental receipt or certificate) and extending their obligations, to promote voluntary enforcement and enhance small business taxation. According to Boudin and Koukpaizan (2008), there are three potential benefits to such a strategy: (a) local governments need more money, so they may have more

reasons to follow the taxation of informal firms; (b) local governments may be better positioned to negotiate productively with informal economy operators, and respond by providing relevant services to informal economy operators; and (c) there are significant risks which include the possibility that local governments may lack the necessary capacity; there is a risk of wasteful tax competition between localities; local government may be particularly arbitrary and coercive in some cases and disconnecting local taxes from national level may, in fact, lead to more double taxation and complicate taxation (Fjeldstad & Therkildsen, 2008).

Taxation policies are frequently viewed from the perspective that their sole purpose is to collect revenue; however, well-legislated and progressive tax rates can be applied. Progressive tax policies may be effective in assisting business owners in growing their businesses and encouraging investors to fund new small businesses in South Africa. According to the ILO, governments must create appropriate macroeconomic, social, legal and political frameworks for large-scale job creation and business prospects (ILO, 2014:32). Governments should adopt a proactive approach on placing decent employment that respects fundamental human rights, as well as workers' rights in terms of workplace health and safety and remuneration, at the centre of economic and social development policies, and to promote well-functioning labour markets and labour market institutions. Greater focus should be given to investing in people, including education, skill training, lifelong learning, health and safety and promoting entrepreneurial initiatives to enhance the amount and quality of jobs.

When implemented successfully, taxation can encourage business growth by allowing informal businesses to approach formal businesses because they will be able to provide bank statements, be VAT registered, and with all the necessary information for a registered business, create a better business environment and help build a culture of tax compliance. Furthermore, when implemented successfully, taxation can assist employees by allowing them access to credit, reducing harassment by police and government officials, and improving access to training and support programmes (Joshi, Prichard & Heady, 2014:12).

4.3 Support incentives for the informal economy

Technology improvements will be able to make tax collections easier and cheaper for the government or SARS. For example, as a result of recently introduced automated tax systems, the Uganda Revenue Authority has seen an increase in tax collection as well as higher transparency and compliance. In 2017, 400 000 new informal registrants were found to be successful in the voluntary system of registration for taxpayers (Jallow, 2017:3). In short, both the state and the informal economy have vested interest in developing a strong and sustainable tax and social contract, which will increase accountability and transparency and increase the informal businesses. When trust is built between the two bodies and the integrity and rights of informal actors are secured, it will benefit all stakeholders.

The promotion of fiscal compliance is based on policy transparency and accountability. Governments must be more up-to-date and reliable in the matter of how much money is raised or invested, where and for what reasons, and what potential responsibilities they have when the annual budget is presented to Parliament. The tax system reforms include creating a key link between tax payments and service delivery. When citizens see services improving, they should also increase their support for the tax system. This, in effect, would help to fund further improvements to citizens' programmes.

Making the tax-paying culture successful requires a high level of trust. Where there is a lack of confidence between residents and the government, citizens tend to avoid or evade taxes. One technique for building and maintaining trust between the government and the governed is to have constant confidence between taxpayers in the informal economy and the government. There have been substantial contradictions and anti-private-sector rhetoric from the administration. This developed an environment of distrust between the government and the corporate sector. In Kenya, the mistrust between the government and the informal economy has been compounded by the government's incapacity to address pervasive corruption, notably the use of government monies to divert economic resources to political supporters. Corruption has considerably degraded citizens' trust and contributed significantly to the prevalent atmosphere of democratic scepticism that makes it impossible for a tax-paying society to grow (Oken &

Benjamin, 2012:8). Similarly, corruption has eroded the requisite trust that needs to be built in South Africa to develop a culture of tax enforcement. The prevailing feeling is that the money that has been collected as taxes ends up in private or individual pockets. For instance, the tax that has been collected should be used to support the country's infrastructure. Tax officials don't report the correct amount that has been collected from the citizens, and they take funds for themselves. It is, therefore, easier to keep one's money and use it to obtain certain services that the government has failed to include in its responsibility. Confidence can be established by ensuring that revenue received from taxes is channelled into provisions of tangible services and infrastructures, which the people can see and connect with.

Apart from providing excellent goods and services to encourage citizens to pay taxes, incentives in the form of a national award for tax enforcement should be established for those in the informal economy who have proven to be faithful in paying their taxes. For example, in Nigeria, there is a culture of punishing informal sector tax defaulters while rewarding those who have met their commitments. The establishment of award institutions will go a long way toward persuading individuals and organisations in the informal economy to comply with their tax duties. Furthermore, under the various tax rules, there should be tax incentives and allowances for the informal economy. Tax exemptions and tax rebates would also be open to the informal sector for voluntary tax enforcement.

However, Meagher (2016) noticed that because the state ignores the realities of power relations between formal and informal economic actors, these arguments are devoid of historical context and virtually totally theoretical. Evidence from Meagher (2016:12) demonstrates how informal actors are not automatically gaining a political voice, especially women, immigrants and minority groups. Despite a contract formed between the state and its citizens, governments can still manipulate power imbalances. For example, parliamentarians in Uganda's ruling National Resistance Movement party are politically pressuring the Uganda Revenue Authority to avoid taxing certain areas, sectors or ethnic groups to gain support.

The necessary immediate revenue implications of informal economy taxation are the implications of expanded tax for small firms' growth. The support towards the informal economy

to comply with government rules and regulations will provide job creation and poverty reduction among lower-income groups, long-term economic development, and the development of a more extensive tax base within a period of time (Lagthelm, 2006:12). Also, it is notable that increasing the tax base towards small firms may hinder their growth, as some businesses do not consider formalising their business based on the current tax base when they think they pay more than they get. Although the findings are that informality carries various costs to firms, and it also precludes access to specific opportunities that are available to formal sectors.

The issue of taxation of the informal economy in developing countries has received increasing attention in recent years (Prichard, 2009:11). Prichard (2009:21) reviewed the existing debates and drew attention to new thinking about whether to and how to strengthen informal economy taxation. The informal economy has increased due to a low employment rate and vast numbers of foreigners who come illegally to the country to earn a living but fail to comply with tax legislation (Adams, 2020:17). In practice, most countries, particularly those in the developing world, confront difficulties in establishing efficient tax systems; the key question is whether to tax the informal economy directly or indirectly (Joshi, 2014). The tax revenue-to-GDP ratio is a useful measure of direct taxing efficiency, and it is often higher in developed countries than in emerging countries (McLaren, 2014:14). The primary difference between formal and informal economies is one of taxation, with the informal sector being viewed as the tax-free choice (Badaoui & Magnani, 2014:3). The informal economy has a direct influence on public revenues (Maiti, 2020:9).

Taxing the informal economy may be necessary to maintain tax morale and compliance among larger corporations (Alm, Martinez-Vazquez & Schneider, 2010:16). There is some evidence that formalisation may increase growth in some informal economies while also benefiting current formal sector businesses (de Mel, McKenzie & Woodruff, 2012:20). In terms of governance, various arguments have been advanced that taxation by the informal sector may be a strategy of engaging businesses with the state, so increasing legitimacy and good governance (Prichard, 2009:4).

The advantages of formality may include greater access to credit facilities and possibilities to interface with large corporations and the government. Formality will also improve their safety and prevent harassment from police and municipal officials, as well as provide them with access to broader training and support programmes that will benefit their businesses. If the informal economy taxation can be implemented successfully, it may provide benefits for the informal economy. More stable work environments will be created because income is not taxed, and there is no UIF requirement. Furthermore, the quality of work locations could improve.

CHAPTER 5: CONCLUSION

5.1 Conclusion

It is important to find a way to tax the South African informal economy as it is growing due to a lack of employment opportunities and salaries being insufficient to support families. Therefore, creating a policy that will improve compliance should be a priority as this will increase the country's revenue. SARS and the government should work together to reduce corruption and able to build trust with the taxpayer. The citizens of South Africa require support; the youth are in need of bursaries, the pensioners and child support grants need to be increased annually. Without the revenue increase, the country will be bankrupt. The expansion of the tax base has to be considered as that will hinder growth for small businesses that are willing to comply with South African tax rules and regulations.

Given the criticisms of existing taxation procedures for the informal economy, there is a need for a new strategy that does not ignore the power relationships between the different parties concerned. Policymakers will do well to pay attention to a variety of positive programmes and innovative strategies. For example, when informal workers organise themselves in alliances, such organisations will resolve power imbalances between the tax collector and the informal economy, benefiting both parties at least in part. Agarwala (2015:12) states that thanks to the work of SEWA (Self Employed Women's Association), informal workers in India 'managed to obtain certain employment rights and benefits from the state'. However, opponents of this approach claim that interactions of these workers are frequently seized by the state and de-legitimised in the eyes of its members.

The study aimed to understand future initiatives that can be implemented to formalise and assist the informal economy. The exploration included determining if South African informal traders should be included in the formal tax system for acknowledgement of income tax reform and other benefits related to formalisation. Taxation policies are often viewed from the point of view that their primary emphasis is on raising revenue; however, well-legislated and progressive taxation policies have specific aims, including supporting society or a business. Progressive

policies may help business owners grow their businesses and encourage investors to fund new small businesses in South Africa's townships.

Although Fourie (2018) probed the informal economy taxation, there is still a need for further research in this sector. The findings also suggest that a marginal expansion of the formal tax system through expansion of VAT could substantially increase the overall progressivity of the tax system. Tax rules should be simplified for taxpayers' knowledge and understanding to enhance voluntary tax compliance. Professionals should be recruited and trained in tax administration. The government should demonstrate a higher level of accountability, trust, and transparency in the application of tax revenue.

5.2 Recommendations for future research

This section provides recommendations from two perspectives. There is a need for the government and SARS to improve their support for the informal economy, as well as for the informal economy to adopt open innovation for economic growth. The sections that follow present these two points of view. Increasing the informal economy's support in agreement with the observations of various other authors, we would like to propose the following suggestions to strengthen the need for additional support for South Africa's informal economy, which will facilitate technology adoption: However, the COVID-19 issue has emphasised the necessity for informal business owners to utilise more web/mobile technology, such as social media, for business operations. This will enable them to access a bigger market and enhance their profits. Many businesses utilise social media to promote free internet hotspots in areas/communities where informal sector providers are concentrated, zero-rated websites where individuals can buy and sell informally, and a variety of other efforts. All of this will lay the groundwork for informal company operators to increase productivity, thereby contributing to South Africa's economic growth. (Etim 2020).

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