THE IMPACT OF PRESUMPTIVE TAX ON HOUSEHOLD INCOME DISTRIBUTION AND POVERTY ALLEVIATION IN TANZANIA: TAZMOD APPLICATION

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Abstract

The government of the United Republic of Tanzania (URT) has managed to improve domestic revenue mobilization in recent years in order to increase tax revenues in comparison to GDP. This increase also affects presumptive tax positively. This paper analyzes the impacts of social benefit policy reforms, with a focus on presumptive tax effects on government revenue, household income distribution, and poverty in Tanzania. The study uses a static microsimulation model for Tanzania: TAZMOD v2.4. TAZMOD is based on EUROMOD software, and concepts and variables are implemented in a similar way to those used in the SOUTHMOD project. The simulation model was based on amending the upper presumptive tax policy turnover threshold from TSh100,000,000 to TSh50,000,001 (a 50% decrease) and imposing a 7% marginal rate. The sources of the data are the Tanzanian mainland's 2011/2012 and 2017/2018 household budget surveys. The results reveal that the reforms would have a positive effect on presumptive tax on government tax revenue, household income distribution, and poverty. Likewise, the findings reveal a significant relationship between presumptive tax and the reduction of household poverty.

Keywords: Presumptive Tax, Microsimulation, Poverty, Tax-Benefit Reforms.

1.   INTRODUCTION

Taxation policies are used by the government to mobilize resources for development, but they have an impact on income distribution. It is in the interests of researchers to understand how taxation policies affect income distribution and the reduction of poverty among different segments of the population in the economy. Micro-simulation models, such as EUROMOD, were developed to simulate taxation policy outcomes for European countries. However, due to their flexibility in terms of functionalities, these have been modified so that they can be used in other countries. According to information provided in Leyaro et al.'s (2019) report:

> SOUTHMOD is a joint project between the United Nations University World Institute for Development Economics Research (UNU-WIDER), the European Union Tax–Benefit Microsimulation Model (EUROMOD) team at the Institute for Social and Economic Research (ISER) at the University of Essex, and Southern African Social Policy Research Insights (SASPRI) in which tax–benefit microsimulation models for selected developing countries are being built. (p. ii)

Leyaro et al. (2019) note that "these models enable researchers and policy analysts to calculate, in a comparable manner, the effects of taxes and benefits on household incomes and work incentives for the population of each country" (p. ii). Their report discusses TAZMOD, the

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SOUTHMOD model developed in respect of Tanzania (Leyaro et al., 2019)[2]. In addition, they state that:

> The TAZMOD model and its documentation in this country report has been prepared within the UNU-WIDER project on 'SOUTHMOD—simulating tax and benefit policies for development', which is part of a larger research project on 'The economics and politics of taxation and social protection'. (Leyaro et al., 2019, p. ii)

They also note that:

> As Tanzania's financial year runs from 1 July to 30 June, it has been decided that TAZMOD's systems for each year should reflect the position as at 1 July in each year, rather than selecting a time point in June. So, for example, TAZMOD's 2015 system refers to the arrangements that were applicable from 1 July 2015. (Leyaro et al., 2019, p. 4)

Like other developing countries, Tanzania is reliant on taxes as a source of revenue (Osoro, 2010). Evidence shows that domestic resource collection in Tanzania has resulted in a significant increase in local government revenues. According to J. Semboja and Msafiri (2022), Tanzania's tax structure is divided into "five major categories of tax revenue, namely income tax, value-added tax (VAT), excise duties, import duties, and others" (p. 1). They note that, "from the tax revenue growth perspective, the performance during 1999/00-2020/21 is considered to be good" (J. Semboja, & Msafiri, 2022, p. 1). Tax collection increased by 2.429 percent (rising from TZS685 billion to TZS17,318 billion) while GDP increased by 1.937 percent (J. Semboja & Msafiri, 2022, p. 1). J. Semboja and Msafiri also note that "the best performer was income tax whose collections rose by 2,773 percent, followed by excise tax by 2, 773 percent and VAT by 2,248 percent. Import duty collection also grew by 1,406 per cent" (p. 1).

They state that "the more appropriate tax revenue performance criterion is to compare the tax revenue collected with the performance of the economy or the respective tax base" (J. Semboja & Msafiri, 2022, p. 2). Their research reveals that "the total tax to GDP ratio rose slowly from 8.9% in 1999/00 to 11.5% in 2008/09 but fluctuated between 10.6% and 12.5 % during 2008/09-2020/21" (J. Semboja & Msafiri, 2022, p. 2). They add that:

> The best performer has been income tax, whose ratio increased from 2.2% in 2000/01 to 5.0% in 2013/14 but declined gradually to 3.8% in 2020/21. VAT, whose ratio rose gradually but consistently from 2.9% in 1999/00 to 4.1% in 2004/5, fluctuated thereafter between 2.9% and 4%. The other tax categories either showed fluctuating or declining performance (J. Semboja & Msafiri, 2022, p. 2)

Similarly, Local Government Authorities (LGAs) set a collection target of TZS687 billion for the year 2017/2018 but were only able to collect 41 percent of that amount (TZS281 billion) (URT, 2020). However, in most cases, tax was collected unwillingly, as armed police officers

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[2] SOUTHMOD models are currently available for Ecuador (ECUAMOD), Ethiopia (ETMOD), Ghana (GHAMOD), Mozambique (MOZMOD), Namibia (NAMOD), Vietnam (VNMOD), South Africa (SAMOD), Tanzania (TAZMOD), Uganda (UGAMOD), and Zambia (MicroZAMOD). The models are updated to recent policy systems using national household survey data.

staying at roadblocks were observed assisting local government tax collectors who were collecting taxes (Fjeldstad, 2001).

Presumptive tax is tax that is collected from individuals based on their annual turnover rather than their profit. H. Semboja (2015) states that:

> presumptive income taxation, therefore, seemed to be a very appropriate method of tax administration for a specific relatively low income group of people earning less than TZS20m; especially those in semi-informal firms who do not keep records and do not qualify for VAT registration. (p. 75)

Income taxpayers within this system are not required to prepare and submit audited accounts to the Tanzania Revenue Authority (TRA). However, they may opt not to apply the system, and to prepare audited accounts and pay taxes based on profits instead. Conditions that qualify a taxpayer for inclusion in the presumptive tax system are as follows: the taxpayer must be a resident individual; the annual turnover of their business must not exceed the threshold (TSh100 million); and they must only derive their income for the year from business sources within the URT and not be engaged in any other activities, such as employment or investments (TRA, n.d.).

The term "individual" refers to sole traders and people on salaries who are subject to a progressive individual income tax rate. This rate can vary from 9% to 30%. However, non-resident individuals pay 20%, charged on their total income. The other method of tax administration requires sole traders, by law, to file an income estimate within three months of the start of the accounting year. According to Thuronyi (1996), "the best remedy is to bring inflation under control; when this is not possible, it is often desirable to adjust the tax system to inflation in some manner" (p. 434). Likewise, taxpayers need to complete a tax return even though tax evasion and avoidance are still quite widespread (H. Semboja, 2015). H. Semboja (2015) notes that "Tanzania uses turnover-based presumptive taxation as an effective domestic finance resource policy instrument for reducing SME [small and medium-sized enterprises]'s compliance burden and bringing informal SMEs into the tax net" (p. 87). H. Semboja (2015) also states that "the total presumptive income tax in Tanzania has been very small (about 0.4 percent between 2008/9-2014/15) compared with other forms of income taxes, number of taxable entities and desired tax transformation targets" (p. 73).

The TRA initially designed a presumptive scheme that would only apply to small business individuals who did not maintain sets of business accounts. However, it decided to extend the scheme's application to similar small businesses keeping complete records as a mechanism by which to promote, formalize, or induce the former to emulate the latter. The presumptive tax was designed to serve two functions. Firstly, it was designed to reach those who were not reachable through the formal Personal Income Tax (PIT) and ensure an equitable tax system. Secondly, it aimed to institute in-built attributes in order to motivate operators under the presumptive scheme to graduate into the preferred tax system. When the scheme was introduced in Tanzania, it was meant to cover all taxpayers not registered under the VAT scheme. In July 2004, a dual reform was undertaken to revise the VAT threshold from the annual turnover of TSh20 million to TSh40 million per annum and merge the presumptive income tax and the receipt-based stamp duty schemes (H. Semboja, 2015).

George and Olan'g's (2020) study of Dar es Salaam street vendors reveals "that TRA has set the lowest rate for presumptive income tax (Tshs. 100,000 per annum) payable in four

installments" in order to simplify the registration, formalization and taxpaying processes (p. 3). They note that "this rate applies to businesses with an annual turnover of more than Tshs. 4,000,000 but less than Tshs. 7,000,000" that "do not have complete records" (George & Olan'g, 2020, p. 3)

According to H. Semboja (2015), "the current Tanzanian presumptive income tax is rationalized and/or based on solid sector and fiscal policy foundations" (p. 74). Likewise, H. Semboja (2015) notes, in July 2004, the government of Tanzania, through the Income Tax Act 2004, later amended in 2006, "formalized the presumptive scheme by introducing a new simplified taxation schedule for small business taxpayers as part of a drive to make it easier for informal sector operators (including start-up businesses) to register, formalize and start paying taxes" (p. 75; see also George and Olan'g, 2020). H. Semboja (2015) adds that "the rationalization of the presumptive scheme has been in line with the National Small and Medium Enterprise Sector Policy of 2003", noting that "the policy has the objectives of enhancing business registration and simplifying the tax system" (p. 74). According to H. Semboja (2015), the 2003 policy, the first Five Year Development Plans, FYDP I and II (URT, 2016; URT, 2021), and annual budgets "seek to simplify the tax system and introduce tax incentives" for the benefit of SMEs (p. 74).

Mas-Montserrat et al. (2023) state that presumptive tax regimes (also known as simplified tax regimes) simplify the tax compliance process for micro and small businesses. They note that these regimes "aim at encouraging tax compliance and business formalization by reducing tax compliance costs and by levying lower tax rates as compared to the standard system" (Mas-Montserrat et al., 2023, p. 3).

2.   METHODOLOGY

2.1.   TAZMOD

The study uses a static microsimulation model for Tanzania (TAZMOD) to simulate the effect of indirect tax-benefits on poverty and income distribution. TAZMOD is based on EUROMOD software, and concepts and variables are implemented in a comparable way to the SOUTHMOD modeling conventions in order to provide an overview of EUROMOD's status in European nations (Decoster et al., 2019). TAZMOD collects information about income taxes, social security contributions, turnover taxes, VAT and excise taxes, and other taxes and benefits to the extent that the underlying data permits this. The TAZMOD model uses data from the 2011/2012 and 2017/2018 Tanzanian mainland household budget surveys produced by the National Bureau of Statistics (NBS) (NBS, 2014, 2020), which is based on probabilistic sampling. TAZMOD utilizes data relating to 10,186 households containing a total of 46,593 individuals. Policies were simulated for the years 2012, 2015, 2016, 2017, and 2018 by updating household-level data from the year 2011/2012 (Wright et al., 2019). Consumption was used when calculating and estimating indicators of poverty and income distribution over income, which is underreported in the household budget surveys, and this can affect the interpretations. Additionally, in Tanzania's economy, household consumption is viewed as a better measure of poverty than income. The scale of this study is consistent with similar poverty and income distribution-related studies conducted in Tanzania.

Tax-benefit policies usually contain the description of one tax or benefit, where this description is made up of functions. The functions used here are as follows: *Elig* determines eligibility/liability for benefits/taxes; *BenCalc* calculates the benefit/tax amount for all eligible

units; *ArithOp* is a simple calculator, allowing for the most common arithmetical operations; *SchedCalc* allows for the implementation of the most common (tax) schedules; *Allocate* allows for the (re)allocation of amounts (incomes, benefits, and taxes) between members of assessment units; and *Min* and *Max* are simply minimum and maximum functions.

In addition, *ils_dispy* describes one of the most important EUROMOD concepts: standard disposable income. In general, the following components make up disposable income in EUROMOD: original income (essentially employment and self-employment income; capital, property, and investment income; and private pensions and transfers), plus benefits (cash transfers, i.e., unemployment benefits, public pensions, family benefits, social transfers, and other country-specific cash transfers), minus direct taxes (income tax, turnover tax, and other country-specific taxes, as well as social insurance contributions, which are paid by employees and the self-employed).

2.2.   Data Sources

The data sources used are the 2011/12 and 2017/18 Tanzanian mainland household budget surveys produced by the NBS (NBS, 2014, 2020). In the analysis, the baseline system uses the 2017 tax-benefit calculation rules and upgrading factors are applied to update revenue components for the 2017 policy year. The tax and benefit policies that are simulated in TAZMOD version 2.4's 2021 system use 1 July 2021 as the time point. This is later than the time point for the 2017/18 NBS household budget survey data (NBS, 2020). The study adopted EUROMOD and TAZMOD v2.4. They provide the simulation with indirect tax-benefit analysis, while the Gini coefficient provides us with income inequality information.

3.   RESULTS AND DISCUSSIONS

The study of microsimulation uses the effects of the presumptive tax on poverty. It is divided into three parts: the budgetary influence, the household income disparity effect, and the effect of poverty. To illustrate the types of results and analysis that can be provided, two hypothetical policy reforms are considered. As indicated in the previous section, TAZMOD refers to 2021.

The simulation results discussed here focus on the fiscal implications for the government budget, as well as the impact of amending presumptive tax on the Tanzanian mainland on poverty and inequality. 2021 was selected as the time point (the baseline time point), because it matches the date of the survey. For the 2012, 2015, 2016, 2017, and 2018 simulations, variables in the 2011/12 and 2017/18 were uprated to a 2012, 2015, 2016, 2017, and 2018 time point respectively, using the Consumer Price Index for food and non-food items.

Proposed Reform Used in Microsimulation

It was assumed that the Tanzanian government had amended the presumptive tax policy, reducing the upper presumptive tax turnover threshold from TSh100,000,000 to TSh50,000,001, and imposing a 7% marginal rate.

The above reform was used to demonstrate the effect that such a policy amendment might have on government revenue and expenditure, income distribution, and poverty. The baseline microsimulation system used for the analysis of the study was for 2017.

3.2.   Budgetary Effect

According to the reform imagined above, the Tanzanian government amended the presumptive tax policy, reducing the upper presumptive tax turnover threshold from TSh100,000,000 to TSh50,000,001, and imposing a 7% marginal rate. The microsimulation results reveal that government revenue through taxes, social security contributions (SSCs), and indirect taxes would increase by 5.33 percent (from TSh8,870,422.74 to TSh9,370,185.65) as a result of this reform. The direct taxes would decrease by 6.04 percent. Cognizant, indirect taxes would increase by 9.88 percent. Social security contributions (employer, employee, and self-employed) would increase by ten percent and social assistance would surge to 31.87 percent. This contradicts the findings of H. Semboja (2015), who suggests that "the total presumptive income tax has been very small when compared with other forms of income taxes, the number of taxable entities and desired tax transformation targets" (p. 81). In the short term, taxing SMEs could result in the receipt of increased revenue for fiscal expenditures. Tax education is expected to help taxpayers to understand tax laws and procedures, and to contribute to the creation of a positive tax compliance attitude (Sheikh Obid, 2007).

Table 1: Tax Benefit Policy Yearly (TSh)

	tz_2018 (base)	tz_2021_reform_1	Difference to base	Percentage change
Government revenue through taxes, SSCs, and indirect taxes	8,870,422.74	9,370,185.65	499,762.91	5.33
... direct taxes	2,881,905.38	2,717,637.92	-164,267.47	-6.04
... indirect taxes	3,433,457.72	3,810,020.04	376,562.33	9.88
... SSCs (employer, employee and self-employed)	2,555,059.64	2,842,527.69	287,468.05	10.11
Government expenditure on social transfers	175,559.09	257,683.87	82,124.78	31.87
... child benefits	0.00	0.00	0.00	-
... social assistance	175,559.09	257,683.87	82,124.78	31.87

3.3.   Poverty Effect

The findings show that when the upper turnover threshold for presumptive tax is reduced from TSh100,000,000 to TSh50,000,001, and a 7% marginal rate is imposed, poverty decreases by 0.55 percent. Poverty in male-headed households decreases by 0.68 percent while poverty in female-headed households decreases by 0.16 percent. Poverty in households with children decreases by 0.56 percent. The average normalized poverty gap decreases to -4.38 percent, while the poverty gaps for male-headed households and female-headed households are reduced to -4.31 percent and -4.61 percent respectively.

Table 2: Poverty Effect

	tz_2018 (base)	tz_2021_reform_1	Difference to base	Percentage change in 2021
Poverty				
All	26.38	26.24	-0.14	-0.55
... male-headed households	26.06	25.89	-0.18	-0.68
... female-headed households	27.39	27.34	-0.04	-0.16
... households with children	28.01	27.86	-0.16	-0.56
... households with older persons	30.36	30.31	-0.06	-0.19
Poverty Gap				
All	6.16	5.90	-0.26	-4.38
... male-headed households	6.17	5.91	-0.25	-4.31
... female-headed households	6.14	5.87	-0.27	-4.61
... households with children	6.57	6.30	-0.28	-4.42
... households with older persons	7.14	6.84	-0.30	-4.35
Absolute national poverty line, in national currency, yearly	591,842	658,429	66,588	10.11

3.4.   Household Income Inequality Effect

The data reveals that households in the 20th to 80th quintiles would have benefited slightly more in 2021 than in the baseline year. The remaining groups of households would have been affected more: for example, the income of households in the 40th quintile would have increased by TSh84,135.95 billion, while the income of households in the 50th quintile would have increased by TSh96,629.73 billion. The income of households in the 60th quintile would have increased by TSh114,565.78 billion and the income of households in the 80th quintile would have increased by TSh185,289.65 billion. Thus, the results show that the reform would have a more positive impact on consumption-based income distribution as it relates to poor households. Furthermore, they indicate that the consumption-based distribution of income for poor households would have a positive effect.

Table 3: Annual Consumption-Based Income Distribution after Taxes and Transfers

	tz_2018 (base)	tz_2021_reform_1	Difference to base	Percentage change in 2021
Gini coefficient (household income)	0.3800	0.3811	0.0010	0.27
P80/P20 ratio	2.68	2.72	0.04	1.36
20th quintile	533,349.29	594,293.73	60,944.44	10.25
40th quintile	719,147.78	803,283.73	84,135.95	10.47
50th quintile	836,192.64	932,822.37	96,629.73	10.36
60th quintile	966,720.45	1,081,286.23	114,565.78	10.60
80th quintile	1,428,841.91	1,614,131.57	185,289.65	11.48
The absolute national poverty line in the national currency (annual)	591,842	658,429	66,588	10.11

In this case, we equate the Gini coefficient and the P80/P20 ratio of equivalent disposable earnings. The results suggest that the reform would boost inequality by 0.27 percent. Overall, the P80/P20 ratio would increase by 1.36 percent as household income inequality expanded, hence income inequality in society would increase slightly (Table 4). Overall, as household income inequality increases, the P80/P20 ratio also rises by 0.5 percent, and therefore income inequality in society slightly increases. The study is in line with Jara & Varela (2017)'s research relating to Ecuador, which shows that "direct taxes (social insurance contributions) reduce inequality, as measured by the Gini coefficient, by only 0.1 (0.9) points based on" data from Encuesta Nacional de Ingresos y Gastos de Hogares Urbanos y Rurales, that is the National Survey of Income and Expenditures of Urban and Rural Households, or ENIGHUR, 2011-2012, "whereas the effect is 0.9 (1.5) points based on ECUAMOD simulations" (p. 2). They "discuss possible reasons for the observed discrepancies and highlight the advantages offered by ECUAMOD for distributional analysis and ex-ante policy evaluation" (Jara & Varela, p. 2).

Table 4: Annual Household Inequality after Taxes and Transfers

	tz_2018 (base)	*tz_2021_reform_1*	*Difference to base*	*Percentage change in 2021*
Gini (household income)	0.3800	0.3811	0.0010	0.27
P80/P20	2.68	2.72	0.04	1.36

4.   CONCLUSION

This study used a microsimulation model based on amending the upper presumptive tax turnover threshold from TSh100,000,000 to TSh50,000,001 (a 50% decrease) and imposing a 7% marginal rate. The data obtained from the microsimulation revealed that a government revenue increase of 5.33 percent (from TSh8,870,422.74 to TSh9,370,185.65) would occur as a result of this reform. In the microsimulation, poverty decreased by 0.55 percent, with poverty within male-headed households decreasing by 0.68 percent and poverty within female-headed households decreasing by 0.16 percent. There was also a decrease in poverty within households with children. Moreover, the poverty gap decreased. It was further noted that the poverty gaps for male-headed households and female-headed households were reduced. The effects of the Gini coefficient in relation to income disparities and the P80/P20 equivalent disposable income ratio have been calculated. The results indicate that the reform would increase inequality by 0.27 percent. Overall, the P80/P20 ratio would increase by 1.36 percent, with household income inequality and thus income inequality in society slightly increasing. The improvement in human capital behavior would have far-reaching, long-term macroeconomic effects, with increases in productivity and improved national competitiveness.

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