



Taxing the informal sector in Nigeria: Prospects and challenges

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Abstract

In Nigeria, the informal sector accounts for a significant economic activity, yet it remains largely untaxed and unregulated. The informal sector is a segment of the economy, comprising of unregulated, unregistered and unmonitored economic activities that operates outside the formal sector. This sector will include among others, small-scale traders, artisans, transport workers and other non-registered businesses. This sector contributes meaningfully, but absence of proper record-keeping, and cash-based transactions has made it difficult for tax authorities to effectively capture or regulate this sector. The problems associated with the informal sector go beyond revenue loss. Its continued exclusion from the tax net undermines the principle of fairness in taxation and places a heavier burden on the already taxed formal sector. There is, therefore, a growing need to find workable legal solutions that can integrate informal economic actors into the formal tax system without jeopardizing their survival. This research aims to examine the taxation of the informal sector in Nigeria, while analyzing the challenges which have hindered effective tax administration of this sector of the economy and explore practical prospects for reform. The research adopted a doctrinal method, while sources of data included both primary and secondary. These were reviewed to provide clearer pictures of the existing legal scope and their limitations. Findings reveal that complex taxation procedures, inflexible compliance mechanisms as well as legal issues are some of the bane to the successful taxation of the informal sector in Nigeria. It is therefore recommended that simplifying tax procedures, introduction of flexible compliance mechanisms and tailoring legal reforms to reflect the realities of informal sectors would help in actualizing the goal of the taxation of the informal sector in Nigeria.

Keywords: Taxation, informal, economy, policies, Nigeria

Introduction

Nigeria operates a federal system of government with a tripartite tax structure shared among the federal, state, and local governments pursuant to the provisions of the Constitution of the Federal Republic of Nigeria 1999 ^[1]. Over the years, the country's tax system has undergone several reforms aimed at enhancing revenue generation, improving tax administration, and promoting voluntary compliance ^[2]. Nevertheless, one of the persistent challenges confronting Nigeria's tax regime is the effective taxation of the informal sector.

The informal sector is predominantly characterised by unregistered businesses, absence of accounting records, irregular income flows, and a general lack of structured operations ^[3]. These problems are similar to the ones bedeviling the digital sector of the economy ^[4]. These make it difficult for tax authorities to identify, assess, and collect taxes from operators within the sector. Moreover, cultural perceptions, mistrust of government, weak enforcement mechanisms, and inadequate tax education contribute to widespread non-compliance ^[5].

Statutorily, tax laws in Nigeria—such as the Personal Income Tax Act (PITA) ^[6], Companies Income Tax Act (CITA) ^[7], and various State tax laws—provide a legal basis for taxing individuals and corporate entities, including those in the informal sector. However, these laws are often ineffectively applied to informal businesses due to poor documentation, low institutional capacity, and the voluntary nature of compliance in many informal enterprises.

Judicial authority has reinforced the notion that all taxable persons, regardless of business structure, are liable to taxation. In *FBIR v. Halliburton (WA) Ltd* ^[8], the court held that once a person derives income from a source within

Nigeria, liability to tax arises unless expressly exempted. Similarly, in *Shell Petroleum Dev. Co. v. FBIR* ^[9], the court affirmed the principle that tax obligations are grounded in statutory provisions and not dependent on business size or level of formality.

The growing consensus among policymakers is that excluding the informal sector from the tax net undermines fiscal sustainability and creates an unfair burden on the formal sector. This has led to various attempts to integrate the informal economy into the mainstream tax framework, including presumptive tax schemes, simplified compliance procedures, and taxpayer education campaigns. Yet, the success of these efforts has been limited.

This paper, thus, seeks to examine the legal and institutional challenges associated with taxing the informal sector in Nigeria and to evaluate the prospects for reforming the system in a manner that ensures equity, efficiency, and sustainability.

Conceptual Framework

1. Taxation is the system of imposing tax

The Black's law dictionary has defined tax as a charge usually monetary, imposed by the government on persons, entities, transactions or property to yield public revenue ^[10]. Tax, according to Umenweke ^[11], is a compulsory contribution towards a country's expenses raised by the government from peoples' salaries, properties, and from the sale of goods and services. The word tax was further judicially defined in the Australian case of *Matthew's v Chicory Marketing Board* ^[12] as 'a compulsory exaction of money by a public authority for public purpose or raising money for the purpose of government by means of contributions from individual persons'

Taxation is the imposition of a compulsory financial levy by the government on individuals, corporations, property, or transactions for the purpose of raising revenue to fund public expenditure and promote economic stability^[13]. It is a central feature of sovereign power, enabling the state to maintain institutions, provide infrastructure, and perform redistributive functions essential for societal development.

In Nigeria, the power to tax is derived from the Constitution, which allocates taxing responsibilities across the federal, state, and local governments^[14]. This distribution is reflected in various enabling legislations, including the Personal Income Tax Act, Companies Income Tax Act, Value Added Tax Act and the Federal Inland Revenue Service (Establishment) Act.

Taxation serves multiple functions beyond revenue generation, it is used as a tool for regulating consumption (through excise duties), correcting externalities (e.g., environmental taxes), and ensuring social justice through progressive tax policies. A well-structured tax system should therefore reflect the principles of equity, certainty, convenience, and efficiency as enunciated by Adam Smith^[15].

2. Informal Sector

The informal sector plays an important role in the development of many nations. The informal sector refers to economic activities undertaken outside government registration, regulation and extant laws^[16]. Transactions within this sector are predominantly carried out in cash with less accounting records and bookkeeping of the daily economic activities or transactions^[17]. The profits from this sector contribute substantially to the GDP of the nation yet it has been of great difficulty for tax administrators to tax this sector. Despite the potential revenue that could be generated from this sector, there is still a knowledge gap about its character and role which results in large scale tax evasion.

The informal sector is comprised of legitimate and illegitimate activities. Legitimate activities include primary and secondary activities such as farming and shoe-making, tertiary activities with relatively large capital like housing and transport, small scale distribution such as street hawkers and roadside food sellers, other groups like musicians, artists and photographers^[18]. Transfer of money as a result of borrowing, begging or even as a gift would also come under this grouping in the sector.

Informal sector activities could also be illegitimate in sense of money or property gotten from theft, embezzlement, prostitution, drug-pushing and the likes^[19]. It would seem that the illegitimate part of this sector holds even more funds than the legitimate part. The fact that illegitimate activities cannot be taxed poses a challenge as the nation's revenue seems locked in these activities. The government would have to do more in terms of fighting these activities so the funds can be released to legitimate operators that can then be taxed. Generally, the informal sector is usually characterized by small scale of operation, family ownership, reliance on indigenous resources, labor intensive activity, use of skills acquired outside the formal school system, ease of entry into the sector and operation in unregulated markets.

The informal sector can also be classified in terms of those who are genuinely in the sector because of the poor economic environment where earning opportunities are scarce and those entrepreneurs whose objective or rational behavior is to escape state regulations in the operations of their business activities^[20].

This means that their business is not strictly informal but they have chosen to group themselves as such because of the benefits they stand to gain if they do so. This latter category would include underground crime activities, and businesses that evade tax and avoid institutional or government regulations or avoid even being registered at all. This gives credence to the definition of the ILO of the informal sector as those enterprises that are not captured by the regulation or taxation imposed by the government^[21]. The informal sector has been described as unregulated, non-structured, unmeasured, unofficial, irregular or shadow economy^[22]. The fact that the informal sector accounts for about 85.8 percent of the employment in Africa^[23] leaves room for wonder.

Nigeria, being a developing country has a major part of its population operating in the informal sector. The Nigerian informal sector constitutes approximately 60-65 percent of its economic activities and accounts for about 80.4 percent of the total workforce in Nigeria^[24]. It can then be said that the sustenance of most persons in Nigeria is from the informal sector making it the major source of economic growth, productivity and competitiveness. The informal sector contributes largely to the economy in terms of employment. Nigeria has consistently led the continent in the ratio of informal sector contribution to total GDP since 2010 with MSMEs making up about 50 percent of the nation's GDP^[25].

3. The Formal Sector

The formal sector refers to the segment of the economy that operates within the legal and regulatory framework established by the state. It includes registered businesses, government institutions, and corporate organisations that comply with statutory obligations such as business registration, taxation, labour laws, and financial reporting^[26].

Entities within the formal sector are typically subject to structured taxation, including the payment of corporate income tax, personal income tax (for employees), value-added tax (VAT), and other sector-specific levies^[27]. Their activities are monitored by regulatory agencies such as the Corporate Affairs Commission (CAC), the Federal Inland Revenue Service (FIRS), and relevant state tax authorities^[28]. These businesses also have access to formal credit systems, government incentives, legal protections, and dispute resolution mechanisms.

The formal sector plays a pivotal role in national development, providing employment, infrastructure investment, and reliable tax revenue^[29]. In Nigeria, however, the size of the formal sector is significantly smaller than that of the informal sector, with formal enterprises accounting for only a fraction of total economic activity^[30]. The limited scope of the formal economy increases pressure on compliant taxpayers, widens inequality in tax burden distribution, and challenges the sustainability of public finance. From a legal standpoint, the distinction between the formal and informal sectors is critical in assessing the effectiveness of tax policies. While formal sector entities are easily identifiable and subject to routine enforcement, the informal sector often escapes regulatory reach, resulting in gaps in the tax system^[31].

Legal and Institutional Framework for Taxing the Informal Sector in Nigeria

1. Legal Framework

1.1 Constitution of the Federal Republic of Nigeria (as amended) ^[32]

The Nigerian Constitution is the supreme law of the land in Nigeria, and it provides for the legal framework for all other laws and regulations in the taxation industry. Currently, the Constitution of Nigeria does not have a specific provision that explicitly states that the informal sector should pay taxes. However, Section 24 ^[33] states that: "It shall be the duty of every citizen to declare his income honestly and pay taxes in accordance with the law." This provision applies to all citizens, including those in the informal sector. Also, Section 15 ^[34] mandates that taxes, duties and levies be uniformly applicable throughout Nigeria, promoting consistency in tax enforcement across the Country.

These sections and provisions of the Nigerian Constitution establish the foundational principles and legal framework for taxation in Nigeria. Pursuant to the constitution, the federal, state and local governments have enacted various laws, regulations and policies on taxation.

1.2 Personal Income Tax (Amendment) Act 2011 ^[35]

The Personal Income Tax is the tax levied on the total income of an individual, group of individuals, proprietors, corporation sole, communities, families, trustees and executors who are resident in a State. All the States' Internal Revenue Service administer PITA for residents of their respective States and every individual who earns income in Nigeria either from employment or from doing business is subject to tax under the Personal Income Tax Act (PITA). This Act governs tax that is imposed on income of individuals, corporate sole or body of individuals, communities, families and trustees or executors of any settlement ^[36]. This includes both those in the formal and informal sector. This Act provides for taxing the informal sector in various provisions. Section 3(1) ^[37] defines "income" to include "any amount derived from or received in or outside Nigeria", which includes income earned by individuals in the informal sector. Section 10(1) ^[38] states that "every person shall be taxed on their income", which includes individuals in the informal sector. Section 12(1) ^[39] provides for the taxation of self-employed individuals, including those in the informal sector, at a rate of 15% on their net profits. Section 27(1) ^[40] introduces the concept of "Presumptive Taxation", which allows the tax authority to estimate the income of individuals in the informal sector based on certain criteria. Section 19 of the Act provides for the income exempted ^[41]. Section 33(1) ^[42] provides for the taxation of income earned by individuals in the informal sector through the "Informal Sector Tax" at a rate of 2% on their turnover. Section 23(3) ^[43] provides a legal basis for the tax authorities to tax the informal sector using a Best of judgment approach especially when the taxpayer does not have information that will assist the tax authority in calculating tax payable. These provisions demonstrate the intention of the Nigerian Government to bring the informal sector into the tax net and ensure that individuals in this sector contribute to the tax revenue.

1.3 Presumptive Tax Regulations (2018) ^[44]

The Presumptive Tax Regulations 2018 of Nigeria provides for taxing the informal sector in the following provisions:

- Regulation 3(1) defines "informal sector" to include "small-scale businesses, artisans, traders, and other self-employed individuals" who are not registered for Value Added Tax (VAT).
- Regulation 4(1) introduces the concept of "Presumptive Tax" which allows the tax authority to estimate the income of individuals in the informal sector based on certain criteria such as: Turnover, Number of employees, Business location, Type of Business.
- Regulation 5(1) provides for the taxation of individuals in the informal sector at a rate of 3 percent of their estimated turnover.
- Regulation 6(1) provides for the payment of presumptive tax by individuals in the informal sector on a quarterly basis.
- Regulation 8(1) provides for the tax authority to review and adjust the estimated income and tax liability of individuals in the informal sector.

These regulations provide a framework for taxing the informal sector in Nigeria, aiming to bring more individuals and businesses into the tax net and increase revenue generation.

1.4 National Tax Policy 2017 ^[45]

The NTP provides that the ministry of finance should take appropriate steps to ensure that the legislature reviews the income tax rate for small businesses in line with current economic realities so as to be an incentive to encourage compliance and promote Micro, Small and Medium Enterprises (MSMEs). The NTP also provides that there should be a minimum threshold for VAT registration and compliance in order to protect micro-businesses. The NTP recognizes the importance of the informal sector and the need to bring it into the tax net and emphasizes on simplified tax compliance procedures. It provides that the government will provide education and awareness programs to informal sector operators to help them understand their tax obligations.

2. Institutional Framework

2.1 Federal Inland Revenue Service ^[46]

The Federal Inland Revenue Service (FIRS) plays a crucial role in taxing the informal sector in Nigeria, including:

- **Tax Identification:** FIRS identify and registers informal sector operators, issuing them with Tax Identification Number (TINs) ^[47]. It does this in collaboration with States Board of Internal Revenue and Local Government Councils.
- **Tax Education:** FIRS educate informal sector operators on their tax obligations, providing guidance on tax compliance.
- **Tax Collection:** FIRS collect taxes from informal sector operators within their jurisdiction ^[48].
- **Enforcement:** FIRS enforces tax compliance in the informal sector, conducting audits and investigations ^[49].
- **Data Collection:** FIRS collect data on informal sector operators, improving tax compliance and policy development ^[50].
- **Simplified Tax Regimes:** FIRS design and implements simplified tax regimes, easing tax compliance for informal sector operators.
- **Tax Amnesty:** FIRS implement tax amnesty programs, encouraging voluntary compliance from informal sector operators.

- **Collaboration:** FIRS collaborates with other government agencies, state governments, and local authorities to tax the informal sector ^[51].
- **Capacity Building:** FIRS builds its capacity to effectively tax the informal sector, including training staff and leveraging technology ^[52].
- **Public Awareness:** FIRS raises public awareness of tax obligations and the importance of tax compliance in the informal sector ^[53].
- **Policy development:** FIRS contributes to policy development providing insights on taxing the informal sector ^[54].

By performing these roles, FIRS play a vital part in bringing the informal sector into the tax net, generating revenue for the government, and promoting tax compliance in Nigeria.

2.2 State Inland Revenue Service

The operations of the informal sector in Nigeria are largely regulated by state governments. As a result, most laws, regulations and policies on informal sector taxation are state driven ^[55]. In the case of *Abia State Board of Internal Revenue v Okochyna* ^[56], the Court ruled that the state government had the power to tax informal sector businesses, but emphasized the need for proper registration and assessment. Also, in the case of *Federal Inland Revenue Service (FIRS) v Rivers State Board of Internal Revenue Service* ^[57], the Court ruled that the constitution does not allow the Federal Government to make tax laws outside the taxation of incomes, profits and capital gains. The Board primarily administers the Personal Income Tax Act and are responsible for accounting to the state government for all revenue collected ^[58]. This paper will therefore examine the policies and legal framework on informal sector taxation using three States as model.

Anambra State

Anambra State established an online registration platform for businesses in the State, including those in the informal sector. This platform is called 'Anambra Social Service Identity Number' (ANSSID). This registration was made compulsory and was a requisite for accessing and paying for government service in the state. Community Revenue State Officers (CROs) were deployed in the informal sector for the registration of the businesses. In 2022, a new tax regime was introduced by the new government to simplify the tax regime in the informal sector and eliminate illegal taxation. The rates and time of payment for the transportation sector was changed. The new rates were reached after consultations with the stakeholders in the sector and series of protests by the players in the informal sector.

The weekly rates are as follows: 1,000 naira for motorcyclists, 2,500 naira for tricycle riders, 3,000 naira for taxi drivers and shuttle buses and 3,750 naira for mini trucks. Taxes for heavy duty vehicle operators were suspended. For market traders, the tax and levies are to be paid annually and was divided into two: 7,400 naira for private traders and 12,200 naira for government market. The new regime also exempted petty traders, wheelbarrow pushers and vulcanizers from paying any tax. This new regime introduced digital collection of taxes as opposed to proxy collection by agents of the government and thus mandated all taxpayers in the Informal sector to do biometrics capturing and registration.

It is hoped that the new reviewed rates go down well with operators in the informal sector. It is advised that the government should further look into the matter of violent enforcement of these taxes as complained by businesses in the sector and should ensure that going forward, matters of taxation and its administration should take due consideration of the nature of the informal sector in terms of the rates to be imposed and the time and mode of implementation.

However, the Anambra State Presumptive and Miscellaneous Tax Law, 2025, represents a progressive attempt to formalize and tax the informal sector through a structured, simplified, and digitized approach. This law is directly relevant to the study of taxing the informal sector in Nigeria, as it tackles many of the longstanding challenges such as informality, lack of records, multiple taxation, and revenue leakages that have historically undermined effective taxation of small businesses. By introducing a presumptive tax model, the law provides a fixed or turnover-based tax framework for informal traders, artisans, transport operators, and other small-scale businesses that lack proper financial records. This aligns with international best practices for taxing hard-to-tax populations in developing economies.

Crucially, the law mandates non-cash, digital payment systems such as Transpay and mobile e-ticketing designed to eliminate extortion and reduce cash leakages, a major barrier to trust in the tax system. This helps improve transparency, accountability, and voluntary compliance, while protecting taxpayers from arbitrary levies.

Furthermore, the law promotes uniform tax schedules, published publicly to avoid double taxation and informal collection by touts or non-state actors—one of the core administrative problems in Nigeria's tax structure.

From a broader perspective, Anambra's legal and policy shift illustrates one of the key prospects of taxing the informal sector: that with political will, technological innovation, and clear legislation, informal taxation can be efficient, fair, and development-oriented ^[59].

Lagos State

Tax is administered by the Lagos State Inland Revenue Service (LIRS) through various trade unions and the Presumptive tax income assessment. LIRS categorized the taxpayers in the informal sector into Market men/women and artisans; micro, small and medium scale enterprises (including professionals) and household domestic staff. The minimum tax payable under the presumptive tax is 8,100 annually which is 675 naira a month. There is also room for additional assessment where such taxpayer deserves to pay more and self-assessment. Payment of tax is made directly to the government account with a tax card. Taxpayers can opt to pay their tax from their shops/businesses through an electronic means called IBILE Hub. Commercial motorists also pay a distinct type of tax called the 'Consolidated Informal Tax Sector Transport Levy.' The levy is paid daily at a fixed price of 800 naira. The Lagos State government has also organized public enlightenment programs, and provided social services for the informal sector through some of its ministries to ensure voluntary compliance of taxpayers and attract unregistered businesses into the tax net.

The efforts made by the Lagos State Government towards taxing the informal sector are commendable. They are on the vanguard of generating substantial percentage of its Internally Generated Revenue (IGR) from taxation.

However, it is imperative for the State to work towards curtailing the issue of illegal and multiple taxes suffered by those in the sector as it would in the long run affect such businesses negatively, which may lead to lower tax returns.

Kogi State

In response to the longstanding difficulties associated with taxing the informal sector, the Kogi State Internal Revenue Service (KGIRS) introduced a presumptive tax framework in 2023. This initiative formed part of the state's broader efforts to widen the tax net, improve internally generated revenue (IGR), and curtail informal and illegal tax collection practices. The presumptive tax system, as applied in Kogi State, targets small-scale and informal businesses that typically operate outside the formal economy and often lack the capacity to maintain accurate financial records or fulfill conventional tax obligations.

The core feature of the 2023 reform was the implementation of a simplified, flat-rate tax structure for various categories of informal sector operators, such as petty traders, market women, artisans, transport workers, and small mining operators. This was designed to ease the compliance burden on taxpayers and to address the chronic under-taxation of the informal economy. In addition, KGIRS made a significant policy shift by enforcing a cashless revenue collection policy, requiring that all tax payments be made through electronic channels such as POS machines, bank transfers, or verified digital platforms. This measure was introduced to minimize revenue leakages and eliminate the widespread practice of unofficial, cash-based collection by unauthorized agents.

Furthermore, KGIRS intensified its enforcement efforts in 2023 by launching crackdowns on fake and illegal tax collectors operating across the state. These efforts were aimed at restoring public trust in the formal tax system and ensuring that only designated revenue officers were authorized to collect levies from informal operators. These policy actions align with national and global calls for greater accountability, transparency, and efficiency in informal sector taxation.

Despite these commendable strides, significant challenges remain. One of the key limitations of the presumptive tax approach in Kogi State is the lack of publicly accessible information regarding the actual tax rates and the criteria used for classifying different business categories. This opacity raises concerns about the fairness and equity of the system, particularly in determining whether the tax burdens imposed are proportionate to the earning capacities of informal operators.

Another critical challenge is the limited stakeholder engagement during the design and rollout of the presumptive tax policy. While some consultative meetings were reportedly held with market unions and transport associations, there is little evidence of sustained dialogue with a broad range of informal sector actors. Without meaningful inclusion of the target population in the policy-making process, compliance may remain low and resistance high.

Additionally, the state's push for digital-only tax payments, though well-intentioned, presents a digital access challenge for many informal workers. A significant number of these operators, particularly in rural and semi-urban areas, do not have access to smartphones, bank accounts, or reliable network infrastructure. This digital divide risks excluding or

further marginalizing vulnerable groups within the informal sector.

Moreover, there is a lack of robust data and performance evaluation mechanisms to assess the impact of the presumptive tax regime in Kogi State. While anecdotal reports suggest an increase in IGR, there is a need for transparent reporting on the actual contribution of the informal sector to state revenue, compliance rates, and the socio-economic impacts of the new tax policies on micro-enterprises ^[60].

2.3 Small and Medium Enterprises Development Agency (SMEDAN) ^[61]

SMEDAN plays a role in taxing the informal sector in Nigeria. SMEDAN educates informal sector operators about their tax obligations and the benefits of taxation. They help informal sector operators to formalize their businesses and register with relevant tax authorities. They support tax policies that encourage informal sector operators to comply with tax laws and regulations ^[62]. SMEDAN builds the capacity of informal sector operators to manage their tax affairs effectively. SMEDAN provides training and education on tax matters, while advocating for policies that support the informal sector and reduce tax burdens. They also collect data on informal sector operators to help tax authorities understand the dynamics. Furthermore, they partner with tax authorities to provide a platform for informal sector operators to comply with tax laws. Importantly, the agency provides access to finance for informal sector operators to help them meet their tax obligations. By playing these roles, SMEDAN helps to bring the informal sector into the tax net, promoting a more inclusive and equitable tax system in Nigeria.

Prospects of Taxing the Informal Sector

The informal sector, often described as economic activities that operate outside the purview of government regulation and taxation, represents a significant portion of the Nigerian economy. The International Monetary Fund (IMF) estimates that Nigeria's informal economy accounts for approximately 65% of the country's Gross Domestic Product (GDP), making it one of the largest informal sectors in Sub-Saharan Africa ^[63]. The potential of taxing this sector, therefore, lies not only in broadening the tax base but also in achieving fiscal sustainability, enhancing social equity, and stimulating formal economic participation.

One major prospect is the expansion of government revenue. With formal sources of taxation, such as petroleum revenues, proving increasingly unstable due to global price volatility and energy transition pressures, taxing the informal economy presents an opportunity to diversify Nigeria's fiscal base. As observed by Umenweke, broadening the tax base through informal sector taxation can significantly improve Internally Generated Revenue (IGR) at both the federal and sub-national levels, especially when presumptive tax regimes are employed ^[64].

Another key prospect is the integration of informal enterprises into the formal economy. Effective taxation mechanisms when accompanied by regulatory support and access to credit may incentivise informal businesses to formalise. This transition would not only increase compliance but also improve access to legal protections, social welfare schemes, and infrastructural benefits. According to Akanle, formalisation through taxation

strengthens the state's capacity to implement economic policy and ensures the legal recognition of micro-enterprises^[65].

Additionally, taxation of the informal sector offers a tool for enhancing social justice and equity. The existing system, heavily dependent on Pay-As-You-Earn (PAYE) taxes and Value-Added Tax (VAT), disproportionately burdens salaried workers and consumers, while informal actors often escape fiscal responsibility. A well-structured informal tax policy could correct this asymmetry. The Supreme Court in *Aderawos Trading Co Ltd v Federal Board of Inland Revenue*^[66] recognised the principle that taxation should be based on the capacity to pay, thereby underscoring the importance of equity in tax administration.

Moreover, the use of technology and digital identification systems, such as the Bank Verification Number (BVN) and National Identification Number (NIN), creates new avenues for identifying and taxing informal actors. When integrated with mobile money systems and simplified registration platforms, these tools enable tax authorities to administer presumptive and turnover-based tax regimes without heavy administrative costs.

Finally, taxing the informal sector could enhance state legitimacy and public trust, provided revenues are transparently utilised. Empirical research has demonstrated a positive correlation between tax compliance and citizens' perceptions of public service delivery^[67]. Thus, effective utilisation of tax proceeds from the informal economy could reinforce the social contract between citizens and the state.

It is worth noting, however, that these prospects must be pursued with sensitivity to the peculiar characteristics of the informal sector. Many participants are low-income earners and subsistence operators. As such, the design of the tax system must ensure that it does not stifle productivity or deepen poverty. In this regard, a context-sensitive presumptive tax framework, complemented by taxpayer education and incentives for voluntary compliance, remains crucial. These prospects among others include;

Revenue Mobilisation and Fiscal Expansion

The most immediate and obvious benefit of informal sector taxation is increased government revenue. Studies show that Nigeria loses trillions of naira annually to tax evasion and non-enrolment by informal businesses^[68]. Taxing this sector would expand the tax base, reduce dependency on oil revenues, and enable better budgetary planning.

According to the Federal Inland Revenue Service (FIRS), informal economic activities contribute up to 57% of Nigeria's GDP but less than 10% of tax revenue^[69]. If properly harnessed, this untapped source could fund infrastructure, healthcare, and education, thereby accelerating national development. Moreover, the World Bank projects that integrating informal operators into the tax net could increase sub-Saharan Africa's tax-to-GDP ratio by up to 4% within a decade^[70].

Formalisation and Business Legitimacy

The act of taxing the informal sector often initiates a transition toward formalisation. When small businesses register for tax purposes, they gain access to credit facilities, government procurement opportunities, and legal protection. This encourages enterprise growth and reduces their exposure to extortion by non-state actors^[71]. In Ghana, for instance, those under the Tax Stamp regime receive formal

identification and are allowed to bid for municipal contracts^[72]. Nigeria can adopt a similar approach to encourage participation. Scholars argue that "taxation becomes a gateway to broader inclusion in the formal economy, particularly for women and youth entrepreneurs"^[73].

Social Equity and Redistribution

Equitable taxation is a cornerstone of distributive justice. Taxing only the formal sector fosters resentment, inefficiency, and systemic inequality. By drawing informal operators into the tax net, Nigeria would create a more progressive and inclusive system, ensuring that all economic agents contribute to public goods.

A study by the International Monetary Fund (IMF) notes that informal taxation reduces the perceived fairness of tax systems, especially when informal businesses directly compete with formal ones but escape tax liabilities^[74]. Eliminating such disparities promotes horizontal equity. Furthermore, increased revenue from informal taxation allows for targeted subsidies and social spending, thereby reinforcing the social contract between the state and citizens^[75].

Improved Statistical and Economic Planning

Registering and taxing informal businesses enables the government to collect reliable data for planning and policymaking. With access to business locations, turnover rates, employment levels, and trade sectors, agencies like the National Bureau of Statistics (NBS) can develop more tailored policies. As tax compliance increases, Nigeria can transition from informal guesswork to evidence-based development strategies, especially in urban renewal, transportation planning, and health financing^[76].

Digitisation and Innovation Opportunities

Efforts to tax the informal sector often drive technological innovation within public administration. Nigeria's recent attempts to implement e-taxation for small businesses have spurred reforms in biometric registration, e-invoicing, and digital payment platforms^[77]. Ghana's use of mobile money to collect informal taxes has not only increased compliance but also stimulated fintech development^[78]. By investing in such digital infrastructure, Nigeria can build administrative systems that are both transparent and scalable.

Challenges in Taxing the Informal Sector in Nigeria

While the potential benefits of taxing the informal sector in Nigeria are significant, the process is fraught with complex legal, administrative, socio-economic, and political challenges. These challenges have, over the years, undermined the capacity of tax authorities to effectively bring informal actors into the tax net. This section discusses these challenges extensively.

Lack of Reliable Data and Taxpayer Identification

One of the foremost challenges is the absence of accurate data on the size, composition, and income levels of the informal sector. Most participants in the informal economy operate without formal business names, addresses, or registration documents. This anonymity complicates efforts by tax authorities to identify, assess, and monitor potential taxpayers. As noted by Umenweke, tax administration in Nigeria suffers from "a severe dearth of baseline data and record-keeping frameworks", which makes it difficult to develop targeted tax policies for informal enterprises^[79].

The failure to integrate the informal sector into systems such as the Taxpayer Identification Number (TIN), National Identification Number (NIN), and the Corporate Affairs Commission (CAC) database hampers tax tracking and enforcement. Although some progress has been made through mobile technology and banking infrastructure, such tools are yet to be optimally deployed for taxation purposes.

Weak Institutional Capacity and Administrative Inefficiency

Tax authorities in Nigeria, particularly at the state and local government levels, often lack the institutional capacity to design and implement effective informal sector taxation strategies. Issues such as inadequate funding, shortage of trained personnel, corruption, outdated technology, and poor inter-agency coordination plague the tax system. As observed by Akanle, “the machinery for tax enforcement remains grossly inadequate, especially in rural and peri-urban areas where most informal businesses operate”^[80]. Furthermore, the tax-to-GDP ratio in Nigeria remains one of the lowest in the world, at approximately 6–8%, largely due to inefficiencies in tax administration and enforcement in the informal sector. This is in stark contrast to the African average of about 17%^[81].

Low Tax Morale and Public Distrust

Tax morale the intrinsic willingness of citizens to pay taxes is notably low in Nigeria. This is due in large part to widespread perceptions of government corruption, mismanagement of public funds, and poor service delivery. Informal sector participants often question the legitimacy of the tax system, viewing it as exploitative rather than contributory. The decision of the Supreme Court in *FBIR v Integrated Data Services Ltd*^[82] reaffirmed the need for transparency and accountability in the administration of tax laws. However, in practice, government agencies have failed to engender sufficient public confidence to elicit voluntary compliance from informal actors.

Multiplicity of Taxes and Uncoordinated Tax Structures

The Nigerian tax system is characterised by an uncoordinated and burdensome multiplicity of taxes imposed by federal, state, and local governments. Informal sector operators are often subject to levies from multiple authorities ranging from market dues, signage fees, environmental levies, to development charges all of which may not be backed by proper legal frameworks. This creates confusion, administrative duplication, and tax fatigue among small-scale operators. According to Abdulrazaq, this fragmented structure leads to “arbitrary assessments, extortion, and harassment of informal traders, particularly women and youth”^[83].

Prevalence of Cash-Based Transactions and Absence of Financial Records

Most informal sector transactions in Nigeria are cash-based, undocumented, and outside the formal banking system. The lack of financial statements or audit records makes it difficult for tax authorities to estimate incomes or apply appropriate tax rates.

This scenario is compounded by the low level of financial literacy among informal operators. As a result, conventional taxation models such as income tax or VAT are difficult to apply, and the adoption of presumptive tax regimes remains limited due to legislative and technical constraints.

Legal and Regulatory Gaps

There exists a noticeable lack of comprehensive legislation tailored specifically for the taxation of the informal sector. While the Personal Income Tax Act (PITA) empowers state boards of internal revenue to tax individuals and unincorporated entities, there are no standardized procedures or guidelines for assessing informal sector incomes. In *Shell Petroleum Dev. Co v FBIR* (1996) 8^[84], the Court recognised the obligation of every taxable person to be subject to the law. However, in the context of the informal sector, the absence of legal clarity and enforcement mechanisms results in widespread non-compliance.

Analysis of The Taxation of the Informal Sector in Some Selected jurisdictions and lessons for Nigeria.

Government Policies for Taxation of the Informal Sector in the United States of America.

In the United States, the informal economy often labelled the “underground” or “shadow economy” is systematically addressed through a robust legal framework, surveillance-based compliance measures, and sophisticated technological infrastructure. The Internal Revenue Code (IRC), particularly section 61, mandates the declaration of all income, whether derived from legal or illegal sources, thus placing even informal income under the tax net^[85].

The U.S. Internal Revenue Service (IRS) implements an advanced information-matching system, where third-party reports from banks, employers, and digital platforms are cross-checked with individual filings. The growing digitalisation of the economy has enabled the IRS to trace informal financial flows, especially through platforms like PayPal, Venmo, and CashApp^[86]. A 2021 amendment to the American Rescue Plan Act mandated platforms to report transactions above \$600, tightening tax surveillance on informal operators.

Additionally, the IRS adopts the Voluntary Disclosure Program, allowing informal earners to self-report undeclared income to avoid criminal prosecution^[87]. For micro-enterprises, the IRS has developed simplified filing tools such as the “Schedule C-EZ” and free file systems to reduce compliance burden. Taxpayer education and audit triggers further reinforce voluntary compliance.

In contrast, Nigeria lacks a strong digital reporting system or comprehensive third-party data exchange mechanisms. As Umenweke observes, Nigeria’s informal taxation remains “fragmented, under-resourced, and poorly integrated with financial and digital infrastructure”^[88].

Government Policies for Taxation of the Informal Sector in Ghana

Ghana’s approach to informal sector taxation is particularly instructive for Nigeria due to their economic and cultural similarities. The Ghana Revenue Authority (GRA) has instituted a Tax Stamp Regime and Presumptive Taxation System, both of which have proven effective in widening the tax net. These are legally grounded in the Income Tax Act, 2015 (Act 896) and its subsidiary regulations^[89].

The Tax Stamp system applies to self-employed persons engaged in activities such as hairdressing, trading, transport services, and mechanics. Tax is calculated on the basis of turnover, location, and business type, with fixed amounts payable quarterly or annually. This model reduces the administrative burden of income assessment and enhances predictability^[90].

Additionally, the GRA has partnered with informal trade associations (e.g., drivers' unions, market women associations) to aid in taxpayer identification, collection, and compliance monitoring. Ghana also employs mobile revenue collectors, equipped with e-taxation tools to collect taxes on the spot in marketplaces^[91].

Moreover, Ghana integrates the Taxpayer Identification Number (TIN) into almost all public transactions, including vehicle registration, land transfers, and opening bank accounts. This makes participation in the formal economy contingent on being tax-registered.

Compared to Ghana, Nigeria's presumptive tax frameworks—such as those outlined under the Personal Income Tax Act (PITA)^[92], are poorly enforced and often arbitrary in assessment. As Akanle points out, “presumptive taxation in Nigeria lacks the institutional support and transparency seen in Ghana, and this undermines its legitimacy and effectiveness”^[93].

Government Policies for Taxation of the Informal Sector in the Netherlands

The Netherlands provides a unique example of a high-trust, compliance-driven tax system. Informality exists mostly in the form of gig work, undeclared domestic labour, and small-scale trade. The Dutch Tax and Customs Administration (Belastingdienst) manages informal taxation through the principles of compliance by design, institutional trust, and simplicity of processes^[94].

All self-employed individuals, including freelancers and micro-entrepreneurs, are required to register with the Chamber of Commerce (Kamer van Koophandel), which automatically links them to the tax system. The Dutch model simplifies Value Added Tax (VAT) and income tax declarations through a digital portal, allowing even small operators to comply with ease.

Further, the small business scheme (kleineondernemersregeling) exempts businesses earning below €20,000 annually from VAT filing, thereby encouraging compliance and formalisation. The country also integrates taxation with social benefits, such that those who pay taxes are eligible for public subsidies, pensions, and healthcare creating a “fiscal citizenship” model that motivates voluntary compliance^[95].

Unlike Nigeria, where the tax system is often viewed with suspicion and evasion is rife, the Netherlands achieves high compliance through legal predictability, social reciprocity, and simplified administrative procedures. As Devasia rightly notes, “institutional trust remains the most critical driver of informal sector taxation in advanced economies”^[96].

Conclusion

The informal sector remains a vital yet largely untapped component of Nigeria's economy. It constitutes a significant portion of the nation's labour force, contributes meaningfully to GDP, and sustains millions of livelihoods. Yet, paradoxically, it operates outside the formal tax net, resulting in substantial losses in government revenue and a skewed tax system where the burden rests disproportionately on the formal sector.

This study has examined the prospects, challenges, comparative approaches, benefits, and strategies for the taxation of the informal sector. It was revealed that while the informal sector offers immense potential for revenue mobilisation, poverty alleviation, and inclusive

development, a range of structural, institutional, legal, and socio-economic barriers hinder its effective taxation.

Key among these challenges are the absence of a clear legal framework for presumptive taxation, poor tax morale, inadequate taxpayer education, multiplicity of taxes, and the informal sector's deeply embedded distrust of government institutions. Moreover, inefficiencies in tax administration, lack of reliable data, and technological gaps continue to make tax enforcement difficult and regressive.

Comparative insights from countries like Ghana, the United States, and the Netherlands indicate that successful informal sector taxation hinges on simplicity, inclusivity, transparency, and reciprocity. These jurisdictions have adopted innovative presumptive tax models, digitised tax processes and introduced incentive-based systems that integrate taxation with tangible social and economic benefits.

In Nigeria's context, the benefits of taxing the informal sector extend beyond revenue generation. Properly executed, such a move can lead to increased state legitimacy, formalisation of economic activities, and promotion of equity, enhanced service delivery, and broader citizen participation in governance. Therefore, the issue is not whether to tax the informal sector, but how best to do so in a manner that is efficient, fair, and development-oriented.

Recommendations

In view of the findings and the complexities surrounding informal sector taxation, the following recommendations are proposed to improve policy, legislation, and administration in Nigeria:

Enact a Unified Legal Framework for Informal Sector Taxation

There is an urgent need for the National Assembly to enact a Presumptive Taxation Act that clearly defines assessment criteria, tax rates, and enforcement mechanisms applicable to informal businesses. This law should harmonise Federal and State powers, eliminate overlaps, and give legal backing to community-based taxation systems.

Simplify Tax Processes for Informal Operators

Taxation procedures should be simplified to reduce compliance costs. This includes introducing flat-rate taxes for specific income bands, removing bureaucratic bottlenecks in tax registration, and providing multi-channel payment platforms, including USSD, mobile apps, and scratch cards, especially in rural areas.

Strengthen Taxpayer Education and Sensitisation

Government must invest in continuous public enlightenment campaigns in local languages and through traditional and digital media. These campaigns should focus on the benefits of taxation, how to comply, and how tax revenues are utilised. Tax education should be embedded in the national curriculum and community outreach programmes.

Establish Transparent Linkages between Taxes and Public Services

Informal taxpayers are more likely to comply when they see tangible returns. Governments at all levels should directly invest informal sector tax revenues in visible community projects like market renovations, waste disposal, security, and health care facilities while communicating these efforts to the affected taxpayers.

Digitalise Tax Administration and Informal Sector Mapping

Leveraging technology is critical to tracking, assessing, and collecting taxes from informal enterprises. Tax authorities should invest in GIS mapping, mobile data collection tools, and artificial intelligence systems that can predict informal economic activity based on transaction footprints and behavioural data.

Integrate Taxation with Social Protection

Informal sector taxation should not be an extractive exercise. The government should design mechanisms that link tax compliance with access to social benefits such as micro-pensions, health insurance, skill development grants, and business loans. This approach will improve tax morale and promote voluntary compliance.

Engage Informal Sector Associations as Tax Partners

Market associations, cooperative groups, and unions should be formally recognised as stakeholders in tax administration. They can serve as intermediaries for taxpayer enumeration, information dissemination, dispute resolution, and collection support, subject to oversight and legal accountability.

Improve Administrative Capacity and Integrity

Capacity building for tax administrators especially at the local government level is crucial. Officers should be trained on community engagement, ethical tax collection, dispute resolution, and the use of digital tools. There should be robust monitoring and whistleblower mechanisms to check corruption and abuse.

Introduce Incentives for Voluntary Compliance

Incentives such as early payment discounts, tax amnesty periods, and public recognition of compliant informal businesses can drive behavioural change. Government may also offer legalisation and business registration support to informal operators that voluntarily register with the tax system.

Develop a National Informal Economy Strategy

Finally, Nigeria should adopt a national policy on the informal economy that outlines a clear vision for formalisation, taxation, empowerment, and social protection. This strategy should be driven by inter-agency collaboration involving the Ministry of Finance, FIRS, SMEDAN, NBS, NITDA, and relevant state actors.

By implementing these recommendations, Nigeria can evolve from a fragmented and punitive approach to informal sector taxation into one that is structured, inclusive, and socially productive. The path to a robust and equitable tax system lies not in coercion, but in strategic engagement, legal innovation, and the creation of mutual value between the government and its citizens.

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