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## An Analysis into the Implementation of Presumptive Tax Legislation in Zimbabwe

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### **Abstract:**

*The first decade of the new millenium for Zimbabwe was characterized by worst economic performance since its independence in 1980 giving rise to the informal sector due to the high unemployment levels in the country. Companies have been closing down leading to reduced revenue collections from the corporate sector hence government has resorted to presumptive. The study aimed to identify the adoption of the presumptive tax legislation in Zimbabwe, to understand the current state on the implementation of the presumptive tax legislation in Zimbabwe and to obtain an understanding over whether the informal traders are knowledgable about the presumptive tax legislation and how they prefer to be taxed. It adopted the descriptive study approach as it sets out to collect, organize and summarize information about the matter that was under study, that is, presumptive tax legislation. Desk research was carried out to gather data on the presumptive tax legislation as well as literature on the subject through secondary data. The study realised that the presumptive tax legislation in Zimbabwe is mainly industry specific wher the tax is charged based on the profession or trade of the individual. There is a possibility that the presumptive tax legislation can overcharge new companies whist charging less existing companies hence it should be factored in upon implementation. The study suggests for the method to be fair, the tax should be charged on gross receipts, so that the presumptive tax payer identifies the need to register for tax where compliance is monitored as well as enforcement.*

**Keywords:** Presumptive tax, ZIMRA, informal sector, Zimbabwe

## 1. Introduction

### 1.1. Background of Study

The first decade of the new millenium for Zimbabwe was characterized by worst economic performance since its independence in 1980. Capacity utilization shrank to 10% and unemployment was above 80% by end of 2008 as the private and public sector unleashed massive retrenchments. Due to lack of employment opportunities in the public sector and in the private formal sector, many people were forced to join the informal sector to earn a living. Although their earnings remained low and a large number were classified as poor, without the informal sector, their earnings would be negligible, and as a result, the intensity of their poverty would be even more severe. Even in the aftermath of a decade long economic downturn, Zimbabwe's formal sector is downsizing due to some socio economic factors that hinder full capacity utilization. The retrenched are actively participating in the informal sector in the form of SMEs (Chidoko & Makuyana, 2012).

The informal sector has been growing due to the high unemployment levels in the country. The sector comprises of small players who lack financial and managerial skills to enable them to maintain proper books of accounts. It was against this background that the government has now changed strategy by widening presumptive taxes in order to tax the "hard to tax" taxpayers (Tagara, 2005). Companies have been closing down leading to reduced revenue collections from the corporate sector. Further, companies have been retrenching employees due to the harsh economic climate in the country. As such, the tax collections from employment income have been shrinking and government has resorted to presumptive taxes to ensure that income earners contribute their quota to the fiscus (Tagara, 2005).

The survey carried out by ZIMSTATS in 2004 (ZIMSTATS, 2006) revealed that the employed population aged 15 years and above was estimated to be 5.1 million and of these 681 000 were considered to be in the informal sector. The informal sector absorbed 31 000 persons from the population ever-retrenched between January 1995 and May 2004, 80 percent of them males. 63% of the males then employed in the informal sector were retrenched between 1997 and 2000 whilst 69 percent of females were retrenched between 1999 and 2001. The same survey carried out in 2011 revealed that the employed population aged 15 years and above, was estimated to be 5, 4 million. Of these, 84% were considered to be in informal

employment, 11% were in formal employment and 5% were in employment not classifiable. Experts say Zimbabwe’s high unemployment rate, pegged at well above 80% due to the sustained decline in economic production levels, has been cited as one of the key underlying reasons behind spiralling informal sector activity (The Standard, 2012).

Presumptive Tax legislation was introduced by ZIMRA to broaden the revenue base in view of the increase in informal business activities. Selected sectors of the economy were targeted to ensure the participation of informal businesses in tax payment in line with experiences of other developing countries (ZIMRA, 2014). The first presumptive tax was introduced in Zimbabwe by way of an informal trader’s tax in 1998 as an attempt to tax the “hard to tax” taxpayers. Small traders such as flea market operators and hawkers were liable to a tax of 10% on rentals payable by them to the landlord. This was additional to the rental and was to be withheld and paid by the landlord to the Revenue Authority. The tax was allowed as a credit against income tax chargeable.

he first Finance Bill for the financial year 2005 introduced changes to tax legislation including the widening of presumptive taxes as the country’s economy has been characterized by hyperinflation, leading to the review the budget midterm. The mid-term fiscal policy review presented was aimed at expanding the tax base thereby raising additional revenue for the government.

Non-compliance would result in penalties. The maximum penalty for failure to collect the tax was an amount equal to the tax not collected. The collections effected by the payer who must deduct the tax from the debt. The penalty would be sourced from the payer’s own resources.

1.2. Statement of the Problem

The level of SMEs is increasing in the informal sector which is also contributing to the increase in the presumptive tax revenue collected by ZIMRA. However, this is being met by resentment from the operators in the informal sector who feel that ZIMRA is being unfair to their operations. This triggered the cause for the research to be carried out.

1.3. Research Objectives

To identify the adoption of the presumptive tax legislation in Zimbabwe To understand the current state on the implementation of the presumptive tax legislation in Zimbabwe To obtain an understanding over whether the informal traders are knowledgeable about the presumptive tax legislation and how they prefer to be taxed

2. Literature Review

Smatrakalev (2006) highlighted that presumptive tax is replacement for standard personal or corporate income tax. It is implemented in cases when the tax base is too small or hard to verify or there are improper accounting practices. The term presumptive taxation covers a number of procedures under which the ‘desired’ base for taxation (direct or indirect) is not itself measured, but is inferred from some simple indicators which are more easily measured than the base itself.

Alm et al (1992) defines presumptive tax as a method which involves the use of indirect means to ascertain tax liability, which differ from the usual rules based on the taxpayer’s accounts. The concept covers a variety of means of determining the tax base, reconstructing income based on administrative practice, to true minimum taxes with tax bases specified in legislation.

2.1. Purpose of Presumptive Taxation

There are various reasons why countries have engaged in presumptive tax. A research carried out by Thuronyi (1996) on presumptive tax identifies a number of these and these are reflected in the diagram below:

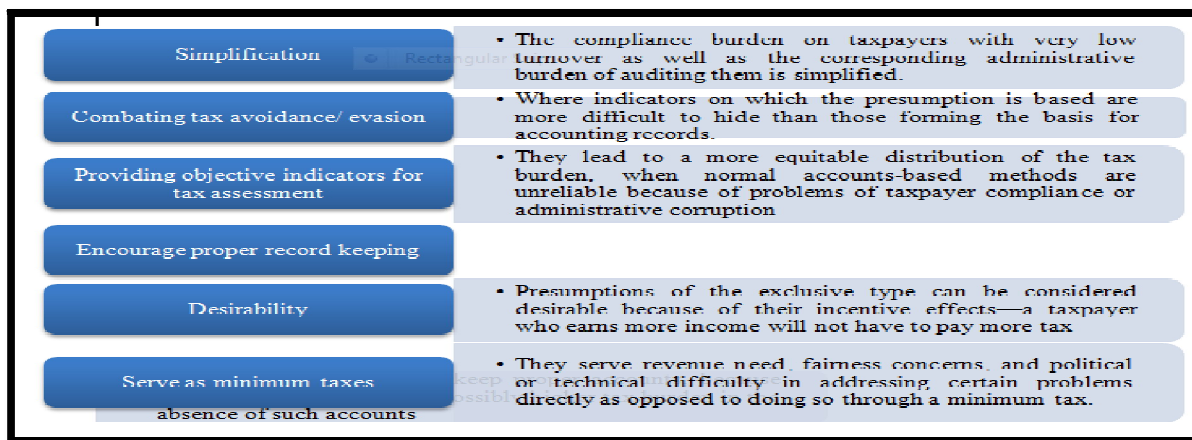


Figure 1: Reasons for Presumptive Tax  
Source: Thuronyi (1996)

2.2. Legal Characteristics Of Presumptive Tax Methods

The appropriate policy of presumptive taxation will usually depend on the particular challenges it is seeking to address. The legal characteristics of presumptive tax methods are shown in the table below:

Characteristic
Rebuttable vs Irrebuttable
Minimum tax vs Exclusive tax
Mechanical vs Discretionary
Scope of application
Taxpayers targeted

Table 1: Legal Characteristics of Presumptive Tax Methods  
Source: Thuronyi (1996)

Rebuttable methods are administrative approaches, which may or may not be specifically described in the statute, that are used to reconstruct the taxpayer's income whilst irrebuttable presumptive assessments are specified in the statute or legislation hence they are legally binding. The rebuttable presumptive assessments are usually required in cases where taxpayers do not fully divulge their financial situations on their returns or are unable to file a tax return (Iordachi & Tirlea, 2016).

The irrebuttable method can either further be categorized into minimum tax or exclusive tax. The minimum tax method is where the tax liability is not less than that which is determined under the presumptive rules whilst the exclusive method is where the tax liability is established or calculated under the presumption alone, regardless of the fact that regular rules might lead to a greater liability (Iordachi & Tirlea, 2016).

The mechanical method allow no discretion to the revenue authorities, it can either be rebuttable or irrebuttable. The discretionary method is hugely rebuttable and involves applying a huge measure of discretion. Examples of the mechanical methods include the gross receipts or company's assets method. Factors to consider in deciding on which method to apply, either the mechanical or discretionary method, include whether it is a corruption conducive environment, the reduced administrative resources that come with applying mechanical rules, the rigidity of mechanical rules, amongst others (Thuronyi, Presumptive Taxation of the Hard-To-Tax, 2003).

Presumptive taxation can also be categorized in the scope of its application, such as the income tax. It can also be categorized according to the types of taxpayers who are targeted. In general terms, these were basically classified into three, noncompliance by small businesses and professionals; noncompliance by individuals and businesses as a whole, including large companies (Thuronyi, Presumptive Taxation, 1996).

2.2. Methods Of Charging Presumptive Tax

They are various methods that are used to charge presumptive tax to taxpayers. These are reflected in the diagram below:

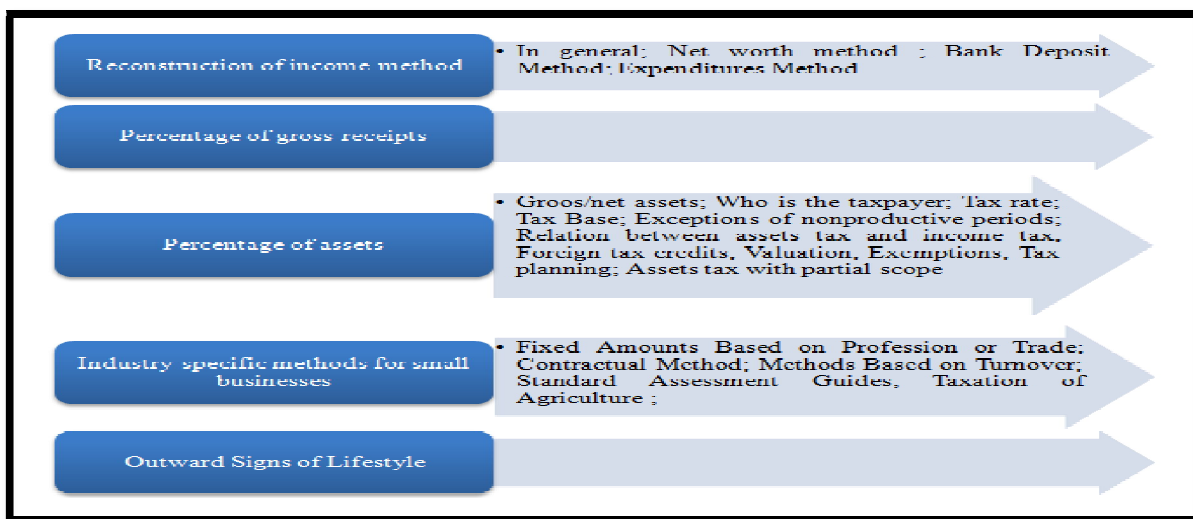


Figure 2: Methods of Charging Presumptive Tax  
Source: Thuronyi (1996)

Generally under the reconstruction of income, tax authorities are normally authorized to evaluate income on their best judgment in circumstances when the taxpayer has failed to file a return and substantially understated their income. This is

usually provided in general terms in the statute. (Thuronyi , Presumptive Taxation , 1996). The net worth method is applied in the absence of substantial information about the taxpayer's actual income by determining the change in the taxpayer's net worth over the time. The estimated personal consumption expenses, usually determined by inspecting the taxpayer's lifestyle are added to this amount. The bank deposit method secures records of deposits into the taxpayer's bank accounts, foreign and domestic, and to presume that they constitute income. This can only be reversed unless the taxpayer can prove otherwise. The expenditures method works similarly to the bank deposit method where income can be presumed on the grounds of total cash expenditures in the absence evidence of the taxpayer's net worth (Thuronyi , Presumptive Taxation , 1996).

The percentage of gross receipts method is where the taxable income of a business cannot be below a specified percentage of the gross receipts of the business. However if the taxpayers fail to declare their gross receipts, they can evade the presumption hence when drafting policies for such a minimum tax, it is essential to stipulate which taxpayers are subject to the tax and what objects are included in gross receipts (Pashev , 2005).

The percentage of assets method is a presumptive tax method, which is taxable on the value of assets an individual has. The rationale behind such method of taxation is that investors can expect to earn a specified average rate of return on their assets. This type of tax method is also encouraged where it can help address challenges with the administration of the income tax that are problematic to address directly (Pashev , 2005).

The outward signs of lifestyle method calculate tax based on certain outward signs of visible personal consumption as specified in the statute. The signs of lifestyle of the taxpayer's family are aggregated. This does not entail ownership of assets only, but enjoyment vacation home is taken into account (Thuronyi, Presumptive Taxation of the Hard-To-Tax, 2003). In drafting requirements for such a system to apply in a certain country, attention should be given to how wealthy individuals in that country spend.

The operation of a simplified presumptive tax system is the most frequent and popular approach in taxing SMEs and can be found in a large number of developed and developing countries worldwide. These systems vary considerably in their scope of application, the criteria used to determine the tax liability of the SME, and their performance. There is neither a standard principle nor is there uniform experience with the design and application of presumptive systems.

Presumptive taxation has become an increasingly popular instrument for reducing the SME compliance burden and bringing informal SMEs into the tax net but this system should be limited to small businesses having difficulty in keeping proper books and records (Engelschalk, 2007). However, a good presumptive tax system must be designed to facilitate ease migration into the standard tax system (Bodin & Koukpaizan, 2008). Stern & Barbour (2005) however argued that presumptive tax systems should not act as simplified alternative tax regimes for SMEs because presumptive tax systems can cause significant cash flow problems especially for new small businesses and for SMEs in sectors with variable output, for example, agricultural producers.

Contrary to the view expressed sometimes by tax policymakers in developing countries, presumptive tax systems are not easy to design and require substantial preparatory work. In particular, the risks are high of arbitrary features of presumptive taxation, with an excessive tax burden on some groups of small taxpayers and under-taxation of others, and of an excessive gap between the standard and the presumptive tax regimes, causing severe problems of migration into the standard regime for successfully operating and expanding SMEs.

### 3. Methodology

The researcher used the descriptive study approach as it sets out to collect, organize and summarize information about the matter that was under study, that is, presumptive tax legislation. Desk research was carried out to gather data on the presumptive tax legislation as well as literature on the subject through secondary data. Data was also gathered from primary sources who were informal traders in Bindura in order to identify gaps and achieve the research objectives. The convenient sampling method was applied as it was based on the availability of the respondents. Questionnaires were distributed to a population of 150 people and of these 56 were returned and non were spoiled. Focus group discussions were also carried out with informal traders in Bindura.

### 4. Findings

#### 4.1. Presumptive Tax Legislation in Zimbabwe

##### 4.1.1. Transport Operators' Presumptive Tax

The full presumptive tax for transport operators should have been paid by the 20<sup>th</sup> day after the end of each quarter or on a monthly basis. The Zimbabwe National Road Administration (ZINARA) was appointed as an agent of ZIMRA for the collection of presumptive taxes in respect of transport operators, taxicabs and driving schools with effect from 1 January 2015. ZINARA acts as a withholding tax collection agent on behalf of ZIMRA for presumptive tax, implying that they are empowered to turn down vehicle licence renewals for transport operators who fail to issue a tax clearance certificate (Mhlanga, 2018).

The Table below shows the amount to be paid by the various classes of transport operators.

Operators of:	Description	Presumptive Tax (US\$ per quarter for each vehicle)	Presumptive (US\$ per month with effect from 1/01/2017)
Omnibuses	8 to 14 passengers	150	40
	15 to 24 passengers	175	45
	25 to 36 passengers	300	70
	From 37 passengers and above	450	100
Taxi-Cabs	All	100	25
Driving Schools	Class 4 vehicles	500	100
	Class 1 and 2 vehicles	600	130
Goods Vehicles	More than 10 tonnes but less than 20 tonnes	1000	200
	More than 20 tonnes	2500	500
	10 tonnes or less but with combination of truck and trailers of more than 15 but less than 20 tonnes	2500	500

Table 2: Transport Operators' Presumptive Tax

The presumptive tax method legislation for transport operators is industry specific of fixed amounts based on profession or trade (Thuronyi, Presumptive Taxation, 1996). Despite of income the taxpayers pay the amount charged by the tax authorities were individuals do not want to divulge their income.

#### 4.1.2. Hairdressing Salon Operators' Presumptive Tax

ZIMRA requires each operator of a hairdressing salon to pay presumptive tax amounting to US\$10.00 for each chair every month. This amount, like the transport operators' presumptive tax, should be paid by the 20<sup>th</sup> day after the end of the quarter. Failure to pay the presumptive tax will attract interest charges. The presumptive tax method legislation for hairdressing salon operators is refutative in nature which is a method identified by Iordachi & Tirllea (2016).

#### 4.1.3. Informal Traders' Presumptive Tax

The presumptive tax for informal traders is paid through the landlords of the premises the operators will be using. As such all individuals receiving rental income from informal traders in respect of either premises, residential accommodation, or a place on which trade is carried on, amongst others, are required to recoup an extra amount in the form of presumptive tax. The amount should be equivalent to 10% of the rental and this should be paid to ZIMRA on behalf of the informal traders. This is also applicable to local authorities. Unlike in the case of transport operators and hair salon operators, the amount equivalent to the presumptive tax should be paid within 30 days from the date the amount is claimed. If the lessor fails to retrieve the amount from the informal trader or rather fails to pay it to ZIMRA, he/she will be liable for the payment of a penalty of 100% of the amount due in addition to the presumptive tax in their personal capacity. The lessor is allowed to terminate the lease without notice in the event that the informal trader refuses or fails to pay the presumptive tax, as this equally constitutes a breach of the lease. This method can be related to the contractual method as the tax is charged on 10% of the rentals paid by the informal trader.

#### 4.1.4. Small-Scale Miners' Presumptive Tax

Small Scale Miners are not liable to pay any presumptive tax as this was reduced from 2% of the gross amount payable to 0%. This legislation came into effect on 1 October 2014. The taxation of small-scale miners can be related to that of the industry specific method based on profession or trade (Thuronyi, Presumptive Taxation, 1996).

#### 4.1.5. Cross-Border Traders' Presumptive Tax

Individuals who engage in cross border trading, importing goods for commercial purposes into Zimbabwe are legible to pay a presumptive tax amount equivalent to 10% of the value for duty purposes (VDP) of the imported commercial goods. However, there are exceptions where the trader is registered for Income Tax purposes with ZIMRA and their tax returns are submitted up to date as well as payment of all taxes due. The taxation of cross-border traders' presumptive tax is classified under the industry specific methods based on the amount of imports.

#### 4.1.6. Operators of Restaurants Or Bottle-Stores

The presumptive tax for every restaurant or bottle store operator is required to pay amounts to US\$70 per month which should be remitted by the 10<sup>th</sup> day after the end of each quarter. If the amount is not paid by the due date, it attracts interest. The taxation of operators of restaurants or bottle-stores can be related to that of the industry specific method that is fixed (Thuronyi , Presumptive Taxation , 1996).

#### 4.1.7. Cottage Industry Operators

Operators of cottage industry include persons in the metal fabrication, furniture production or upholstery business, or any other business that the Minister may prescribe via a notice in a statutory instrument. Such operators who owns or are in charge of a cottage industry are liable to pay an amount of US\$70 per month as presumptive tax, regardless of it being licensed, or not. Similarly to the operators of restaurants and bottle stores, failure to pay the tax by the 10<sup>th</sup> day after the end of the quarter attracts an interest charge. The taxation of cottage industry operators can be related to that of the industry specific method that is fixed (Thuronyi , Presumptive Taxation , 1996).

#### 4.1.8. Commercial Waterborne Vessels

Operators of waterborne vessels that are used for the carriage of passengers for profit and fishing for commercial purposes are also charged presumptive tax whose full amount of presumptive tax shall be paid by the 10<sup>th</sup> day after the end of each quarter. However, such operators have an option to pay on a monthly basis. The rates are shown in the Table 2 below.

Operator of:	Carrying capacity inclusive of cabin crew/description	Presumptive tax per quarter per vessel in US\$ with effect from 1 January 2012	Presumptive tax per month per vessel in US\$ with effect from 1 January 2017
Waterborne Vessel	Up to 5 passengers	250	60
	6 to 15 passengers	500	100
	16 to 25 passengers	1 000	200
	26 to 49 passengers	1 500	350
	50 passengers and above	2 000	450
Waterborne Vessel	Fishing rigs	350	80

Table 3: Commercial Waterborne Vessels Operators' Presumptive Tax

The presumptive tax method legislation for commercial waterborne vessels operators is industry specific of fixed amounts based on profession or trade (Thuronyi , Presumptive Taxation , 1996).

This section deals with the analysis and interpretation of data obtained from the respondents in the study area through self-administered questionnaires. Each section and question in the questionnaire will be discussed individually.

#### 4.2. Analysis of Empirical Results

This section analyses the response from the questionnaires administered to the SMEs. The 56 questionnaires that were returned were considered complete and usable for the purpose of data analysis, giving a response rate of 37%. All returned questionnaires were usable because the respondents comprised of literate business people. Of the respondents, only 7 were above 45 whilst the remainder was between the age ranges of 18-45. In terms of gender, 8 out of 56 respondents who returned the questionnaires were women whilst 38 were men. More than 50% of the respondents had the necessary knowledge to fill in the questionnaires as they were above 0 levels.

Of the respondents, 11 were from the transport sector; 5 from hairdressing salons; 12 from informal traders; 3 from small-scale miners were; 11 from cross-border traders; 6 from restaurants and the cottage industry operators were 8. Operators with a period less than 1 year were 6, 2-3 years were 11 and those more than 3 years were 34. The majority (27), was motivated to start business as a result of retrenchments; 7 as a result of unemployment; 5 by the indigenization and empowerment policy; 4 from savings and 6 as a result of retirement.

The majority, 60.7%, of the SMEs had between 5 to 10 full-time employees, including the owners; 21.4% of the respondents employed less than five full-time people including the owners, 14.3% of the respondents employed between 10 to 20 people including the owners and with 3.6% of the respondents employing more than 20 people. Those registered for income tax purposes were 3.6% with the other 19.6% registered for presumptive tax, whilst the remainder was not registered for any forms of tax. These results reveal that most (76.8%) of the SMEs that participated in the study were not registered in the formal tax system and thus did not file returns to ZIMRA as only 19.6% were paying presumptive tax.

The study revealed that the majority of respondents, 22, agreeing that poor record keeping makes assessment of revenue performance difficult. Only 2/56 (3.6%) of the respondents had tax clearance certificates for the previous year whilst the remainder of 54/56 (96.4%) did not. This implies that the majority (96.4%) of the respondents were not formally

registered for tax.54/56 (96.4%) of the respondents did not submit tax returns whilst 1/56 (1.8%) submitted on time and 1/56 (1.8%) submitted late.

The majority of the respondents, 73.2% has never been penalized by ZIMRA for any reason, whilst 26.8% have been penalized for not paying tax at all and 1.8% had been penalized for late payment of tax. A greater share of the respondents, 41.1%, indicated that they do not agree that the presumptive tax legislation is transparent to all taxpayers in the same business implying that the majority of the SMEs were of the view that the presumptive tax system was not transparent. Of the respondents, 53.6% disagree that the presumptive tax system is fair and the tax burden reasonable implying that the majority of the SMEs felt that the tax system is not fair and tax burden unbearable. The majority, 58.9%, also disagreed that the presumptive tax administration is efficient.

The research captured information on whether presumptive tax education being carried out efficiently and the findings were that 2/56 of the respondents strongly agreed that presumptive tax education is carried out efficiently, 3/56 agreed, 33/56 were not sure, 17/56 disagreed and 1/56 strongly disagreed. This implies that the majority (54%) of the respondents were not in a position to assess the presumptive tax education. Some of the respondents, 23.2%, did not register for tax as they felt that ZIMRA was not tolerant towards SMEs whilst 30.4% felt that their business income is too small for them to pay tax, 12.5% felt that they might incur additional costs in managing their tax affairs, 16.1% highlighted that lack of knowledge made them not register for tax and 17.9% were of the notion that the tax returns forms of ZIMRA are not easy to fill. A majority of the respondents, 51.8% strongly agreed that amendments in the current presumptive tax law are necessary to improve revenue performance of small business and their tax compliance. This implies that amendments in the current presumptive tax law are necessary to improve revenue performance of small business as well as their tax compliance.

## 5. Conclusions and Recommendations

The presumptive tax legislation was introduced in Zimbabwe as a means of taxing the informal traders who dodged paying tax to the government or taxing those individuals who could not register for tax purposes because of the compliance costs. The study realised that the presumptive tax legislation in Zimbabwe is mainly industry specific where the tax is charged based on the profession or trade of the individual. However, for some of the informal traders it is advantageous as they can pay less than they should whilst for some it can be costly, especially when income generation is not guaranteed.

The Zimbabwean experience indicates that a presumptive tax may not necessarily be the best means of taxing the informal traders, especially micro, small and medium enterprises as the amounts charged may not be best compared to standard taxation. However, for the purposes of taxing the informal sector, the presumptive tax legislation is serving its purpose as it is helping the tax administration (ZIMRA).

There is a possible risk that the presumptive tax legislation can overcharge tax for new companies whilst charging less to those companies that are already in existence regardless of the fact that its aim is to promote registration for tax purposes. Therefore, this should be addressed when implementing the legislation hence it should differ for start-up companies and those that are already in existence so as to promote the collection efficiency at the same time reducing tax evasion, therefore distributing the tax burden more fairly.

Finally, this study suggests for the method to be fair, the tax should be charged on gross receipts, so that the presumptive tax payer identifies the need to register for tax where compliance is monitored as well as enforcement. This is done through more efficient measures, such as withholding tax at source and third party reporting, improvement on the efficiency of tax audits, an improvement on the taxpayer services and optimizing the rate schedule.

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