



THE 7 INSTITUTE
FOR RESEARCH AND DEVELOPMENT

The Multi-Dimensional Analysis of VAT in Mogadishu: Effects on Households and Businesses



Table of Contents

Executive Summary.....	4
1.0 Introduction.....	6
1.1 Research Questions.....	7
1.2 Objectives of the Study.....	7
1.3 Significance of Study.....	7
1.4 Scope and Limitations.....	7
2.0 Literature.....	8
2.1 Background.....	8
2.2 VAT Design and Implementation.....	9
2.3 Economic Impacts of VAT.....	9
2.4 Social and Household Effects of VAT.....	10
2.5 Business Adaptation to VAT.....	10
2.6 Payment Method Considerations in VAT Systems.....	11
2.7 Behavioral Economics and Tax Compliance.....	11
2.8 Informal Economy Theory and VAT.....	12
2.9 Tax Wedge Theory.....	12
2.10 Progressive Taxation in VAT Systems.....	12
3. Methodology.....	13
4.0 Data Analysis.....	14
4.1 Revenue Performance Report from August to December 2024 (FGS).....	14
4.2 Analysis of the Impact of VAT Implementation in Mogadishu.....	15
4.2.1 Awareness and Understanding of VAT.....	15
4.2.2 Public Perception of VAT Fairness and Purpose.....	15
4.2.3 Economic Impact on Households.....	16
4.2.4 Consumer Behavior and Business Adaptations.....	16
4.2.5 VAT and Payment Methods.....	17
4.2.6 VAT Compliance.....	17
5.0 Discussion.....	18
5.1 The Flawed Implementation of Automatic VAT Deductions in Somalia: Lessons Unlearned and the Need for Reform.....	18
5.2 The Unintended Consequences of Mogadishu's VAT Policy: Economic Strains, Compliance Challenges, and the Growth of the Informal Sector.....	20
5.3 Causes of Poor Revenue Projection.....	23
5.3.1 Inadequate Market Research & Data Limitations.....	23
5.3.2 Low Compliance & Weak Enforcement.....	23
5.3.3 Institutional & Capacity Constraints.....	24
5.3.4 Technological Gaps.....	24
6.1 Conclusion.....	25
References.....	33



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Executive Summary

Somalia's fiscal landscape has undergone significant changes over the past decade as it strives to rebuild its economy following decades of political instability and economic fragmentation. One of the most critical steps in this process was introducing the value-added tax (VAT) system in Mogadishu in August 2024. The primary motivation behind the VAT policy was to enhance domestic revenue mobilization, reduce reliance on external aid, and create a sustainable funding source for public services and infrastructure development. However, implementing VAT in the fragile state of Somalia presents unique challenges, given the dominance of the informal economy, weak institutional capacity, and widespread poverty. Despite its potential to boost government revenue, the VAT system in Mogadishu has faced significant hurdles, including low compliance rates, widespread informality, and a lack of public trust in the tax system. This study examines the multi-dimensional impact of VAT on households and businesses in Mogadishu six months after its introduction. Using a mixed-methods approach, the research combines empirical surveys, secondary data analysis, and qualitative interviews with key stakeholders to assess the effects of VAT on household spending, business operations, compliance behavior, public perceptions, and the role of payment methods in tax avoidance.

The findings reveal that VAT has disproportionately affected low-income households due to its regressive nature, with 92% of surveyed households reporting increased spending on essential goods such as food. Despite an official VAT exemption on healthcare services, many hospitals continue to charge VAT due to the misclassification of their merchant accounts, placing additional financial strain on vulnerable populations. VAT has also reduced disposable income and household savings, with 47% of respondents reporting slight reductions in savings and 18% experiencing significant declines. Furthermore, 52% of consumers have shifted their purchases from formal to informal businesses to avoid VAT, undermining the government's revenue collection efforts. On the business side, 86% of businesses have raised prices in response to VAT implementation, leading to inflationary pressures. SMEs face higher administrative burdens and shrinking profit margins, prompting some to transition into informal market participation. VAT compliance varies, with larger businesses more likely to comply due to formal banking structures, while smaller businesses avoid VAT registration by operating in cash-based transactions. The selective taxation of merchant account transactions has created market distortions, incentivizing businesses to use untaxed payment methods such as mobile money and cash, further eroding VAT compliance. In an ideal VAT framework, taxation should be based on the nature of goods and services being purchased, not the payment method used.

Additionally, weak enforcement mechanisms, and a lack of digital tax monitoring systems contribute to VAT evasion. Although 97% of respondents are aware of VAT implementation, only 40% perceive it as fair, while a significant portion remains skeptical about government transparency and the equitable allocation of tax revenues. Many respondents see VAT as primarily a revenue-generating tool (54%) rather than a policy to improve public services (29%). The public's opposition to

VAT on merchant accounts is also notable, with 59% believing it should not apply selectively to one payment method. The study further identifies weaknesses in revenue projection, where initial VAT estimates underestimated actual collections due to insufficient market studies and outdated economic assessments.

While VAT can potentially increase government revenue and modernize Somalia's tax system, its effectiveness is undermined by selective enforcement, public distrust, and socio-economic inequities. The tax has contributed to higher household costs, business adaptations encouraging informality, and revenue losses due to avoidance behaviors. Strengthening administrative capacity, broadening VAT enforcement across all payment methods, and ensuring social equity through exemptions for essential goods are critical for improving VAT effectiveness in Somalia. Successful VAT collection relies on a business registration system. Businesses are the primary collectors, charging VAT on taxable goods and services and remitting it to the government. This research underscores the need for data-driven tax policy, enhanced digital tax monitoring, improved public engagement, and targeted reforms to ensure VAT contributes to Somalia's long-term economic stabilization and development.

This study contributes to the growing body of literature on tax reform in fragile states by providing empirical evidence on the socio-economic impact of VAT in Mogadishu. The findings highlight the critical need for aligning VAT policies with local economic conditions, enhancing public awareness, and strengthening enforcement mechanisms. The study also offers valuable insights for policymakers to refine VAT administration, promote equitable revenue generation, and address structural weaknesses in Somalia's tax system. By balancing revenue generation with social equity, the government can improve VAT effectiveness while protecting vulnerable populations from undue financial burdens. The study's recommendations underscore the importance of phased implementation, simplification of tax procedures, and broader application of VAT across all payment methods to enhance compliance and fairness. These insights will inform future tax reforms and contribute to Somalia's economic stabilization and development agenda.



1.0 Introduction

Implementing Value-Added Tax (VAT) in Mogadishu, introduced in August 2024, represents a pivotal milestone in Somalia's ongoing fiscal reform agenda. As the country emerges from decades of political instability and economic fragmentation, the introduction of VAT aims to enhance domestic revenue mobilization, reduce dependency on external aid, and promote long-term economic self-sufficiency. This tax system is designed to broaden the tax base, foster transparency, and provide a sustainable funding source for public services and infrastructure development. However, the effectiveness of VAT in Mogadishu is contingent upon addressing significant challenges, including low compliance rates, widespread informality, and the socio-economic impact on vulnerable populations.

Somalia's fiscal landscape has undergone profound transformations since the re-establishment of the Federal Government in 2012. Efforts to rebuild the tax system included reintroducing customs duties, sales taxes, and business levies. However, the introduction of VAT marked a significant shift toward modernizing the tax administration. Despite the government's objective to increase revenue generation, the selective application of VAT to merchant account transactions has created loopholes, incentivizing businesses and consumers to shift toward informal payment methods such as cash and mobile money. This shift has exacerbated the dominance of the informal economy, making tax enforcement more difficult and undermining the intended objectives of the VAT system.

The introduction of VAT in Mogadishu has presented unique challenges in a fragile state economy characterized by weak institutional capacity, widespread informality, and poverty. One of the key issues is the selective application of VAT to merchant account transactions, which has incentivized tax avoidance and driven consumers toward informal markets. Additionally, VAT's regressive nature disproportionately affects low-income households, increasing the cost of essential goods and services while offering few protections for vulnerable populations. The lack of clear enforcement mechanisms and public trust in the tax system further complicates compliance efforts. This study addresses the critical need to evaluate the socio-economic impact of VAT, assess compliance behaviors, and propose strategies to improve VAT administration in Mogadishu.

1.1 Research Questions

1. What is the level of public awareness regarding VAT implementation?
2. What are the socio-economic impacts of VAT implementation on household spending patterns in Mogadishu?
3. How does VAT impact business performance?
4. What factors drive tax avoidance behaviors among businesses and consumers?

1.2 Objectives of the Study

1. To assess public awareness regarding VAT implementation in Mogadishu.
2. To examine the socio-economic impacts of VAT implementation on household spending patterns.
3. To analyze the effects of VAT on business performance.
4. To evaluate VAT compliance levels among businesses and consumers.
5. To propose policy recommendations for improving VAT administration and promoting social equity.

1.3 Significance of Study

This study contributes to the existing body of literature on tax reform in fragile states by providing empirical evidence on the socio-economic impact of VAT in Mogadishu. The findings offer valuable insights for policymakers to refine VAT administration, align tax policies with local economic conditions, and enhance public trust in the tax system. The study's recommendations will help shape future tax reforms, promote equitable revenue generation, and support Somalia's broader economic stabilization and development agenda.

1.4 Scope and Limitations

The study focuses on the impact of VAT implementation in Mogadishu, covering both household and business sectors. The geographical scope is limited to Mogadishu due to its status as the pilot location for VAT introduction. The research period spans six months following the implementation of VAT, capturing the immediate effects of the tax system. Limitations include the potential underrepresentation of certain population groups and the difficulty obtaining reliable data from informal businesses. Despite these constraints, the study comprehensively analyzes VAT's impact and offers actionable recommendations for policymakers.

2.0 Literature

2.1 Background

Somalia has undergone significant fiscal and economic transformations over the past decade, aiming to enhance domestic revenue generation and reduce reliance on foreign aid. One of the most critical steps in this process is implementing a Value-Added Tax (VAT) system, introduced in Mogadishu in August 2024. The government seeks to establish a sustainable revenue model to support public services, infrastructure, and long-term economic stability.

Following the collapse of the central government in 1991, Somalia faced a prolonged period of political instability, economic fragmentation, and weak institutional governance. The absence of a unified government led to the breakdown of formal tax collection systems, leaving revenue generation largely dependent on informal trade and external aid. During this period, taxation was primarily enforced by local authorities, regional administrations, and business communities, often ad hoc and uncoordinatedly.

In subsequent years, Somalia, with support from international financial institutions such as the International Monetary Fund (IMF) and the World Bank, began implementing tax reforms aimed at enhancing domestic revenue mobilization. By the early 2020s, discussions around VAT introduction gained momentum as a strategy to broaden the tax base, reduce dependency on external aid, and promote fiscal self-sufficiency. The VAT system was formally introduced in August 2024 in Mogadishu as part of the government's broader economic reform agenda.

Despite its formal introduction, VAT implementation has faced significant challenges, including limited compliance, widespread informality, and weak enforcement mechanisms. The selective application of VAT to merchant accounts has further complicated its effectiveness, leading to tax avoidance and potential distortions in the market. The government continues to refine tax policies and enforcement strategies to address these challenges and ensure VAT contributes meaningfully to Somalia's economic stability. Furthermore, VAT's selective application to merchant account transactions has created tax avoidance loopholes, enabling businesses and consumers to bypass taxation by using alternative payment methods such as cash and mobile money. This has led to distortions in the economic landscape, where formal businesses bear a heavier tax burden while informal businesses continue to operate tax-free.

The socio-economic implications of VAT are also significant. Households, particularly low-income families, experience increased financial strain as VAT raises the cost of essential goods and services. On the other hand, businesses struggle with adapting to new compliance requirements, leading to increased operational costs and potential shifts toward informal market participation.

Given these challenges, there is a need for an in-depth analysis of VAT implementation in Mogadishu. This study explores the effects of VAT on households and businesses, assesses compliance and evasion behaviors, and

identifies strategies for improving tax administration. By understanding the multi-dimensional impact of VAT, policymakers can develop effective solutions to enhance compliance, promote fairness, and optimize revenue collection in Somalia.

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2.2 VAT Design and Implementation

The success of VAT depends on its alignment with local conditions, including institutional capacity, levels of informality, and public trust (Keen & Smith, 2017). Various African countries, such as Kenya and Nigeria, have introduced simplified VAT regimes designed to facilitate compliance, particularly for small businesses (Mburu et al., 2019).

A key aspect of VAT design is determining tax rates and exemptions. Research suggests that while standard VAT rates maximize revenue, zero-rated or reduced rates on essential goods can mitigate VAT's regressive effects (Atkinson & Morelli, 2014). Countries such as South Africa have successfully implemented exemptions for food and healthcare to protect low-income households (South African Revenue Service, 2022). The World Bank (2020) recommends that VAT systems balance simplicity and inclusivity to enhance compliance and reduce evasion.

Phased implementation has also proven beneficial. For example, Afghanistan introduced a simplified VAT system in 2005, gradually expanding its scope over time (World Bank, 2017). This approach helped mitigate resistance from stakeholders and improved overall acceptance. Digital technologies have transformed VAT administration, making tax collection more efficient. Electronic filing systems and real-time monitoring tools have significantly reduced evasion in countries like Kenya and Rwanda (IMF, 2020). These innovations are particularly relevant in fragile states with weak administrative capacities.

2.3 Economic Impacts of VAT

The economic effects of VAT vary depending on its implementation. VAT can significantly boost government revenue if robust enforcement mechanisms are in place (Torgler & Schneider, 2009). In Nigeria, VAT contributed approximately 10% of total tax revenue by 2020 (Federal Inland Revenue Service, 2021). However, this percentage could be higher if informal sector operators were incorporated into the tax system.

One challenge in developing economies is that VAT may incentivize informal trading, particularly where high levels of informality already exist (Moore, 2012).

This risk is especially pronounced in Somalia given the dominance of informal markets. Studies by UNCTAD (2018) indicate that informal traders often evade VAT due to the perceived complexity and lack of awareness about compliance requirements.

A well-structured VAT system can encourage business formalization, thereby expanding the tax base (Keen & Smith, 2017). In Kenya, the introduction of e-filing systems simplified VAT registration and compliance for small enterprises (Kenya Revenue Authority, 2020). VAT also enhances fiscal sustainability by increasing domestic resource mobilization, reducing reliance on external aid, and enabling investment in long-term development projects (OECD, 2019).

2.4 Social and Household Effects of VAT

The social impact of VAT is a critical consideration in developing economies. Due to its regressive nature, VAT can disproportionately affect lower-income groups (Atkinson & Morelli, 2014). In South Sudan, the absence of exemptions for essential goods led to widespread dissatisfaction among low-income households (Ministry of Finance, 2019).

Research suggests that VAT increases household spending, particularly on essentials like food and utilities (Adegbeie & Adeyeye, 2018). In Nigeria, many households experienced reduced disposable income after VAT implementation, leading to a decrease in non-essential spending. Similarly, VAT can negatively impact household savings (Besley & Persson, 2014), particularly in fragile states where financial literacy is low.

Public perception of VAT plays a crucial role in compliance. If taxpayers perceive the system as fair and transparent, they are more likely to comply (Torgler & Schneider, 2009). Kenya, for example, has successfully improved taxpayer trust by allocating VAT revenues to infrastructure projects, thereby demonstrating tangible benefits (Kenya Revenue Authority, 2020).

2.5 Business Adaptation to VAT

Businesses face significant challenges in adapting to VAT systems, particularly in fragile and developing states. One major issue is the increased operational costs associated with VAT compliance. Small and medium enterprises (SMEs) often struggle with the administrative burden, record-keeping, and financial implications of VAT, which can reduce their profit margins (Mburu et al., 2019; Joshi et al., 2014). In Nigeria, SMEs cited VAT as a significant barrier to growth, prompting many to shift to informal operations (Federal Inland Revenue Service, 2021).

Several governments have introduced incentives and simplifications to mitigate these challenges to ease VAT compliance. Rwanda's "One Stop Shop" initiative provides SMEs with a streamlined VAT registration and filing process, reducing administrative burdens (Rwanda Revenue Authority, 2022). Similarly, Kenya offers reduced compliance requirements for micro-enterprises, enabling them to participate in the formal economy with minimal tax obligations (Kenya Revenue

Authority, 2020).

Another key challenge is price adjustments. Many businesses pass VAT costs onto consumers by increasing prices, which can reduce consumer purchasing power and shift demand toward informal markets. Studies have shown that inflationary pressures following VAT implementation have led to consumer resistance and policy backlash in countries like South Sudan and Zimbabwe (Ministry of Finance, 2019; Mzumara et al., 2021). To balance business sustainability and consumer welfare, governments must establish mechanisms that prevent excessive price hikes while ensuring businesses can recover their costs effectively.

2.6 Payment Method Considerations in VAT Systems

The selective application of VAT on specific payment methods, such as merchant accounts, remains a contentious issue. Differential treatment of payment methods can create inequities and reduce public trust in the tax system (Bird & Gendron, 2015; de la Feria & Walpole, 2018). In Mogadishu, the exclusive taxation of merchant account transactions has prompted businesses and consumers to shift toward alternative, untaxed payment methods like cash and mobile money, effectively undermining VAT revenue collection.

Aligning VAT policies with consumer payment preferences is essential to ensuring compliance and efficiency. In economies where digital payments are rapidly growing, selective VAT application may discourage financial inclusion and drive users back to cash transactions. Studies show that Kenya and Ghana have successfully encouraged VAT compliance by offering digital payment incentives, such as tax discounts for businesses that adopt electronic transactions (Kenya Revenue Authority, 2020; Ghana Revenue Authority, 2021). Implementing similar strategies in Mogadishu could enhance VAT collection while promoting financial transparency.

2.7 Behavioral Economics and Tax Compliance

Behavioral economics examines how psychological factors influence taxpayer behavior and compliance. Research suggests that individuals and businesses are more likely to comply with taxes when they perceive the system as fair, transparent, and easy to follow (Besley & Persson, 2014; Alm & Martinez-Vazquez, 2003). Conversely, complex tax systems with high administrative burdens and perceived injustices often drive avoidance and evasion behaviors.

In Mogadishu, the selective application of VAT has led to perceived inequities, where consumers and businesses question the fairness of being taxed based on payment methods rather than transaction value. Studies from Uganda and South Africa indicate that simplifying tax regulations, increasing public awareness, and demonstrating tangible tax revenue benefits can significantly enhance compliance rates (Torgler & Schneider, 2009; OECD, 2019). Governments can leverage behavioral insights by implementing nudges, such as SMS reminders, simplified registration processes, and public service improvements funded by VAT revenue, to boost compliance in Somalia.

2.8 Informal Economy Theory and VAT

The informal economic theory suggests that high compliance costs and regulatory burdens push businesses into informal operations, where they can avoid taxes and administrative requirements (Moore, 2012; Schneider & Enste, 2000). In fragile states like Somalia, the informal sector dominates economic activity, challenging VAT enforcement. The Somali economy is heavily informal, with a large proportion of businesses operating outside the formal tax system. This informality challenges VAT enforcement and compliance, as many transactions occur without proper documentation.

Evidence from Ethiopia and Tanzania indicates that complex tax registration processes and high VAT rates discourage businesses from formalizing (World Bank, 2018; IMF, 2021). To counter this, countries have introduced tax amnesty, simplified VAT regimes, and incentive-based formalization programs to encourage voluntary compliance. Rwanda, for example, introduced a tiered VAT system that reduces tax rates for micro-enterprises while gradually integrating them into the formal sector (Rwanda Revenue Authority, 2022). Somalia could benefit from similar reforms by offering reduced VAT rates or exemptions for small businesses transitioning from informality to legality.

2.9 Tax Wedge Theory

The tax wedge theory explains the difference between employers' total labor costs and workers' net take-home pay due to taxation. This concept is particularly relevant for VAT, as it illustrates how taxes distort economic behavior. When VAT increases the cost of goods and services, consumers may shift to substitutes or informal markets to minimize their tax burden (Atkinson & Morelli, 2014). The selective application of VAT on merchant accounts in Mogadishu creates a "wedge" that incentivizes consumers to use alternative payment methods such as cash and mobile money to avoid taxation. This leads to inefficiencies and potential revenue losses for the government. Expanding VAT coverage to include all payment methods could reduce this disparity and encourage formal transactions.

2.10 Progressive Taxation in VAT Systems

Progressive taxation seeks to reduce economic inequality by taxing higher-income groups at higher rates while offering relief to lower-income populations. While VAT is inherently regressive since it imposes a uniform tax rate on all consumers regardless of income—progressive elements can mitigate its adverse effects (Torgler & Schneider, 2009; Bird & Zolt, 2005).

Several African nations have introduced tiered VAT rates or exemptions for essential goods to protect low-income households. For example, South Africa zero-rates staple foods, healthcare, and public transportation services to alleviate the tax burden on vulnerable populations (South African Revenue Service, 2022). Kenya and Uganda have adopted similar measures to ensure that VAT policies do not disproportionately impact lower-income groups (Kenya Revenue Authority, 2020; Uganda Revenue Authority, 2021). In Mogadishu, policymakers could consider

adopting a mixed VAT approach, where essential goods are zero-rated or taxed at a lower rate. In contrast, luxury goods and services face standard or higher VAT rates. Additionally, direct cash transfers or VAT refunds for low-income consumers could be explored to enhance the system's progressivity and fairness.

3. Methodology

This study adopts a mixed-methods approach to comprehensively assess the socio-economic impact of Value-Added Tax (VAT) implementation in Mogadishu. The research combines quantitative and qualitative methods to capture diverse perspectives from households, businesses, and key stakeholders. The primary data collection method is a questionnaire survey targeting businesses and households. The survey employed a non-random sampling technique, selecting participants based on their involvement in economic activities and their likelihood of being affected by VAT. This method ensures that the study reaches respondents directly impacted by VAT policies, allowing for more targeted insights. A total of 250 respondents were surveyed, including 150 households and 100 business representatives, to provide a balanced view of VAT's impact on different segments of society.

The questionnaire was designed to collect data on several key aspects, including awareness of VAT policies, spending patterns, business pricing strategies, compliance behaviors, and public perceptions of VAT fairness. Household surveys focused on the financial burden of VAT on essential goods, while business surveys explored operational challenges, price adjustments, and strategies to circumvent VAT through informal market participation.

In addition to the quantitative survey, the study incorporates qualitative interviews with academic experts, revenue administrators, and business owners to understand VAT implementation challenges and policy design better. These interviews provided in-depth insights into the regulatory framework, enforcement mechanisms, and the broader socio-economic implications of VAT. Including expert opinions helped contextualize the survey findings, ensuring that both macro and micro perspectives were considered.

By integrating quantitative and qualitative methods, the study offers a comprehensive analysis of VAT implementation, identifying compliance patterns, evasion, and the tax system's socio-economic consequences. This methodological approach enhances the reliability and depth of the findings, making them more relevant for policymakers seeking to refine VAT policies and improve tax administration in fragile economic contexts.

4.0 Data Analysis

4.1 Revenue Performance Report from August to December 2024 (FGS)

Somalia does not have a VAT law. The current tax system is based on Sales Tax Law No. 2 of 1984, which applies to a 5% tax rate on various goods and services. The revenue performance report reveals significant gaps between projected estimates and actual collections, reflecting structural weaknesses in the country's tax administration. Despite widespread VAT avoidance by businesses and buyers, the YTD VAT collections significantly exceeded the original estimate, showing a tremendous variance. This sharp rise indicates that the government expanded the tax base but failed to project its impact accurately, likely due to poor market studies or expectations of the new tax system's impact.

This sharp increase was predictable even before the VAT implementation because the introduction of VAT automatically expanded the tax base by including more goods and services under the taxable bracket. The discrepancy between the estimated and actual revenue collections indicates that the revenue projection was either based on insufficient market study or poor expectations of the new tax system's impact. Nevertheless, despite the expansion of the taxable base under the indirect taxation system, overall revenue collection remained far below expectations, indicating widespread non-compliance and weak enforcement, because the estimation was carried out without conducting a comprehensive market assessment, and accurate data on the volume of taxable transactions and business activities. Moreover, the Ministry of Finance underestimated the taxable economy's size and the potential revenue impact of VAT.

The analysis highlights that Somalia's tax revenue collection remains unpredictable due to poor estimation methods, low compliance rates, and weak enforcement mechanisms. While the revenue performance signals progress in tax collection, the absence of a VAT law remains a critical gap in Somalia's fiscal policy framework. The overall analysis highlights that the revenue projection methods lack sufficient market data, updated economic assessments, and proper forecasting models, which undermines fiscal planning. To bridge this gap, the Ministry of Finance must adopt data-driven forecasting models, conduct regular market studies, and strengthen compliance enforcement mechanisms to improve future revenue projections and collection efficiency.

4.2 Analysis of the Impact of VAT Implementation in Mogadishu

4.2.1 Awareness and Understanding of VAT

The survey conducted among households and businesses in Mogadishu provides a comprehensive assessment of the impact of VAT six months after its implementation. The findings reflect the population's awareness, perception of fairness, economic consequences, and business adaptations in response to the tax.

The survey reveals that 97% of respondents are aware of the VAT implementation in Somalia, with only 3% indicating a lack of awareness. This high awareness suggests that the government's communication efforts have been relatively effective. However, the depth of understanding varies: 32% claim to have a very good understanding of VAT policies, 41% rate their knowledge as good, 15% consider it average, and 12% admit to having poor comprehension. While general awareness is strong, further education may be required to ensure businesses and consumers fully grasp the implications of VAT.

The high awareness level indicates that the government's communication efforts have effectively reached the public. However, only 73% of respondents (Very Good + Good) demonstrate a solid understanding of VAT policies. This suggests a need for further education campaigns targeting the remaining 27% who have an average or poor understanding. Policymakers should focus on simplifying complex aspects of VAT and providing clear explanations of how it works, its purpose, and its benefits to both individuals and businesses. Educational programs could include workshops, infographics, and community outreach initiatives to ensure all stakeholders fully grasp the implications of VAT.

4.2.2 Public Perception of VAT Fairness and Purpose

The fairness of VAT policies remains a divisive issue. While 40% of respondents believe VAT policies are fair, 34% disagree, and 26% are unsure. When asked about the main goals of VAT, 54% identified increasing government revenue, 29% cited improving public services, and 11% viewed it as ensuring fairness. However, a small fraction of respondents (6%) expressed skepticism, associating VAT with looting, theft, or personal gain.

The mixed perception of VAT fairness highlights the importance of addressing public skepticism. To improve acceptance, the government must transparently communicate how VAT revenues will be allocated toward public services and infrastructure development. The dominant belief that VAT's primary goal is to increase government revenue (54%) underscores the need to demonstrate tangible improvements in public services due to VAT collections. Addressing concerns about corruption (6% associating VAT with looting or personal gain) requires strengthening accountability mechanisms and ensuring visible progress in healthcare, education, and security. Building trust could involve regular updates on VAT revenue usage and measurable outcomes tied to specific projects.

4.2.3 Economic Impact on Households

The introduction of VAT has had a noticeable financial impact on households. A significant 92% of respondents reported increased household spending due to VAT. The main areas affected include food (42%), utilities (25%), healthcare (21%), and education (12%). Additionally, VAT has influenced household savings: 47% reported a slight reduction in savings, 18% experienced a significant decrease, and 34% noted no impact.

Furthermore, the percentage of income allocated to VAT-inclusive goods varies, with 53% of households spending less than 5%, 31% spending between 5% and 10%, 9% allocating 10% to 15%, and 6% exceeding 15%. Despite these financial pressures, 90% of respondents expressed willingness to pay VAT if it improves public services. The significant increase in household spending indicates that VAT has placed a financial burden on families, particularly affecting essential goods like food and utilities. To mitigate these effects, policymakers should consider introducing zero-rated or reduced VAT rates for necessities such as food, healthcare, and education. This approach can protect vulnerable populations from the regressive nature of VAT. Measures to address reduced savings (47% slightly reduced, 18% significantly reduced) could include subsidies for low-income households or tax credits for essential expenses. Monitoring the percentage of income spent on VAT-inclusive goods can help identify segments of the population disproportionately affected by the tax and inform targeted interventions.

4.2.4 Consumer Behavior and Business Adaptations

VAT has influenced purchasing behaviors, with 52% of respondents opting to switch from formal to informal businesses to avoid the tax burden, while 48% continue purchasing from formal businesses. This shift indicates a possible unintended consequence of VAT, as businesses may lose customers to untaxed informal markets.

Businesses also report significant operational challenges due to VAT. The majority (86%) have raised prices in response, 37% cited reduced profits, 33% noted a drop in customer demand, and 27% faced higher operational costs. Only 3% of businesses reported no impact. When assessing fairness, 52% of businesses find the VAT policy equitable, while 48% believe it unfairly affects specific business segments.

The shift to informal markets (52%) highlights the unintended consequences of selective VAT applications, which undermines the intended revenue generation goals. Encouraging formalization through simplified registration processes and incentives for compliance could reduce this trend. The price rise (86%) reflects businesses passing VAT costs onto consumers, potentially reducing purchasing power. Policymakers should explore measures to balance cost recovery with consumer protection, such as price caps on essential goods. Supporting small and medium enterprises (SMEs), which face challenges like reduced profits (37%) and lower customer demand (33%), is critical. Options include offering temporary relief measures, streamlined compliance procedures, or training programs to enhance efficiency.

4.2.5 VAT and Payment Methods

The government's selective application of VAT on merchant accounts has led businesses to adopt multiple payment methods. Among respondents, 42% use merchant accounts, 28% rely on mobile money, 16% use bank accounts, and 14% prefer cash transactions. The ability to offer multiple payment options is evident, as 71% of businesses permit customers to choose alternatives to merchant accounts, while 29% restrict payments to tax methods. This selective taxation leaves loopholes for customers and businesses to avoid VAT. The fairness of VAT on merchant accounts remains contested: 44% agree it is fair, 33% disagree, and 23% remain neutral. Moreover, 59% of respondents oppose applying VAT to all payment methods, while 41% support a uniform tax system.

The selective application of VAT to merchant accounts creates loopholes, enabling avoidance through alternative payment methods. Expanding VAT coverage to include all payment modes could enhance compliance and reduce evasion. The majority opposition (59%) to equal application across payment methods suggests resistance to broader taxation. Policymakers must carefully communicate the rationale behind such changes and address administrative complexity or burden concerns. Promoting digital payments through incentives or subsidies could encourage formal transactions while improving tax collection efficiency.

4.2.6 VAT Compliance

Compliance with VAT regulations in Mogadishu remains a critical challenge. Many businesses, particularly in the informal sector, evade taxation by avoiding merchant accounts and opting for cash transactions. Low enforcement capacity, limited government oversight, and a lack of digital tracking mechanisms contribute to these compliance gaps. Additionally, some businesses intentionally misreport sales or fail to register for VAT to reduce their tax obligations.

Consumers also engage in avoidance strategies, such as purchasing from informal vendors that do not charge VAT. This trend reduces government revenue and creates an uneven playing field for businesses that comply with VAT regulations. Strengthening compliance efforts through better enforcement, enhanced digital monitoring, and incentivizing formal business registration will improve VAT effectiveness.

Strengthening enforcement mechanisms, including digital monitoring tools and penalties for non-compliance, is essential to close existing loopholes. Incentivizing formal business registration through simplified procedures, tax credits, or access to credit facilities could promote compliance. Raising awareness about the negative impacts of tax evasion on public services and economic development could foster greater responsibility among businesses and consumers. Collaborating with financial institutions and mobile payment providers to track transactions and ensure VAT compliance can enhance revenue collection.

5.0 Discussion

5.1 The Flawed Implementation of Automatic VAT Deductions in Somalia: Lessons Unlearned and the Need for Reform

The Somali government's implementation of automatic VAT deductions on merchant account transactions has introduced significant flaws in the taxation system. Instead of taxing the actual value of goods and services, the government deducts a flat 5% VAT at the point of payment, regardless of the nature of the transaction. This approach disregards fundamental VAT principles, leading to inefficiencies and distortions in tax collection. One major issue is the taxation of overpayments when a buyer mistakenly transfers excess funds, VAT is still deducted, even if the seller later refunds the difference. Since no refund mechanism exists, businesses and individuals face permanent financial losses due to wrongful tax deductions. This blanket taxation method also imposes incorrect tax liabilities on sellers, making them accountable for VAT on amounts they never actually earned. Moreover, businesses might avoid using merchant accounts to escape unfair taxation, opting for cash transactions, which undermines transparency and tax compliance.

Another critical failure of this system is that it eliminates the need for businesses to report VAT, as the tax is deducted automatically. In a functional VAT system, businesses collect tax on sales, report their transactions, and remit the net amount to the government. However, in Somalia, businesses are excluded from this process, removing a key enforcement tool for tax authorities. Without tax reports, the government loses an essential audit trail, making it impossible to track taxable revenue, verify deductions, or identify fraud. This weakens overall compliance and allows unregistered businesses to operate outside the formal economy, further reducing tax collection efficiency. Additionally, businesses are unable to claim VAT refunds on purchases, leading to an excessive tax burden and higher operational costs. Over time, this discourages businesses from formalizing and registering with tax authorities, worsening an already weak compliance rate.

The deep distrust between the government and the business community is at the heart of this flawed system. Instead of investing in a tax policy encouraging voluntary compliance, the government installed a digital watchdog that enforces taxation without business participation. This implies that trust in businesses and individuals is not a priority, reinforcing a cycle where businesses avoid tax obligations, and the government responds with more rigid and forceful collection methods. However, such an approach is counterproductive, businesses that feel unfairly targeted will resort to informal transactions, reducing the taxable base and making VAT enforcement even more difficult. The automatic deduction system also contradicts Somalia's broader goal of financial sector development, as it discourages the use of digital payments and formal banking channels. This, in turn, limits the country's ability to modernize its economy and attract investment.

After more than six months of implementing the automatic VAT deduction system on merchant account transactions, the Somali government has yet to assess its

flaws or take corrective measures. Given that this is the first time such a program has been introduced, it would have been prudent for the government to adopt a phased or pilot-based approach before full implementation. In most well-structured tax reforms, governments test policies on a smaller scale, gather data, and identify potential inefficiencies before rolling them out nationwide. However, Somalia's approach lacked this critical step, leading to widespread unaddressed practical failures.

One of the major flaws of this system is that it automatically taxes transactions without distinguishing between taxable and non-taxable payments. Businesses and individuals have raised concerns about wrongful deductions, and the absence of a refund mechanism. Yet, the government has not conducted any public review or adjustment to address these issues. A pilot phase could have helped policymakers identify unintended consequences, such as businesses avoiding merchant accounts to escape unfair taxation, the risk of double taxation, and the lack of a dispute resolution process for incorrect deductions. Instead, the system was implemented in full force without a clear monitoring and evaluation framework, leaving businesses struggling with an untested and flawed mechanism.

Moreover, failing to conduct a post-implementation review means the government operates blindly, without real-time data on whether the system meets its intended goals. VAT compliance should be measured not only by immediate tax collection but also by evaluating the long-term sustainability, business participation, and economic impact. Without an assessment, policymakers cannot determine whether businesses comply voluntarily or find ways to bypass the system through informal transactions. Ignoring the shortcomings of this program erodes trust between businesses and the government, reinforcing the belief that tax policies are imposed without stakeholder consultation or accountability.

Additionally, the selective taxation of merchant account transactions does not constitute a formal tax exemption but rather represents a distorted application of VAT that creates inequities in the tax system. In an ideal VAT framework, taxation should be based on the nature of goods and services being purchased, not the payment method used. However, in Mogadishu, VAT is applied exclusively to transactions processed through merchant accounts, while cash and mobile money transactions remain untaxed. Instead, it creates an uneven, loophole-ridden system where compliance depends on payment method rather than taxable value. This weakens VAT enforcement, reduces revenue, and distorts market behavior. A more effective approach would be to apply VAT uniformly across all transactions, regardless of payment method, while ensuring appropriate exemptions only for essential goods and services.

To address these shortcomings, the government must shift from a transaction-based VAT system to one that taxes actual sales values. VAT should be collected at the point of sale through proper invoicing instead of being automatically deducted from merchant accounts. A refund mechanism is crucial for correcting

overpayments and exempting non-taxable transactions from wrongful deductions. Furthermore, businesses should be reintegrated into the tax system via mandatory VAT reporting, allowing authorities to track compliance more effectively. Encouraging voluntary compliance through taxpayer education, formalization incentives, and tax administration transparency will help rebuild trust between the government and businesses. Without such reforms, Somalia's VAT system will continue discouraging digital transactions, weakening tax enforcement, and pushing businesses further into informality, ultimately harming economic growth and government revenue collection.

To ensure a fair and effective VAT system, the government should comprehensively review the automatic VAT deduction policy, collaborating with business owners, tax experts, and financial institutions to evaluate its true impact. A data-driven assessment should determine how many businesses have stopped using merchant accounts, how much unintended VAT has been deducted, and whether tax compliance has genuinely improved. Based on these findings, the government should implement corrective measures, including a VAT refund mechanism, exemptions for non-taxable transactions, and clear business tax reporting guidelines. Moving forward, any significant tax reform should undergo pilot testing before full implementation to ensure policies are refined based on actual data rather than imposed without adjustment. Without such corrective measures, the automatic VAT system will continue to harm buyers and businesses, diminish tax compliance, and drive more transactions into the informal economy, ultimately undermining the very tax revenue the government aims to increase.

5.2 The Unintended Consequences of Mogadishu's VAT Policy: Economic Strains, Compliance Challenges, and the Growth of the Informal Sector

Even when education and healthcare services are exempt from VAT, the tax still indirectly affects them by reducing household disposable income and increasing operational costs for institutions (Atkinson, 2019). Since VAT is applied to most goods and services, households must spend more on essential items such as food, transportation, and utilities, leaving them with less income to afford private education or out-of-pocket healthcare expenses. Additionally, while tuition fees and medical services may be VAT-exempt, schools and healthcare providers still incur VAT on operational costs like electricity, educational materials, medical supplies, and equipment (Stiglitz et al., 2017). Because they cannot reclaim this VAT, they often pass the additional costs onto students and patients through higher tuition fees and healthcare charges. This combination of reduced household purchasing power and rising service costs can make quality education and healthcare less accessible, particularly for low-income families. Furthermore, VAT can contribute to overall inflation, increasing the cost of living and further straining household budgets, forcing cutbacks in essential but non-mandatory expenses such as private tutoring, extracurricular activities, and preventive healthcare (WHO, 2021).

Although the government has recently announced a VAT exemption on

healthcare services, many hospitals continue to collect VAT from patients due to their reliance on Merchant Accounts that are subject to VAT (De Soto, 2000). A Merchant Account is a business banking account that allows hospitals to process electronic payments, but if the account is classified under a VAT-liable category, all transactions including patient payments automatically include VAT. As a result, despite the government's exemption, hospitals may still be charging VAT simply because their payment system is structured in a way that applies the tax by default. This creates an unfair situation where patients, particularly those in urgent medical need, are forced to bear an additional financial burden that should not exist under the new policy.

Beyond the technical issue, there is a significant ethical concern in hospitals continuing to collect VAT from injured and sick people. Healthcare is a fundamental human right, and adding unnecessary financial strain on patients, especially during medical emergencies—undermines the principles of equitable healthcare access (IMF, 2022). Many individuals and families already struggle with high medical costs and forcing them to pay VAT despite the exemption policy is not just an administrative failure but a moral injustice. Hospitals profiting from this loophole, whether intentionally or due to negligence, contradict their core mission of saving lives and providing care.

This issue also highlights a lack of proper enforcement and regulatory oversight. Patients continue to suffer financial harm if VAT exemptions are announced but not properly implemented at the transactional level. The government must ensure that hospitals update their payment systems, reclassify Merchant Accounts where necessary, and take firm action against non-compliant institutions (Atkinson, 2019). Public awareness campaigns should also educate patients about their rights so that they can demand VAT-free billing where applicable. Ultimately, benefiting financially from the suffering of the sick and injured is both immoral and shameful, and immediate corrective measures are needed to ensure hospitals uphold their duty to provide fair and transparent medical services.

In Mogadishu, many buyers are shifting their purchases from formal businesses to informal businesses, leading to a significant boom in the informal sector (De Soto, 2000). This shift is primarily driven by price sensitivity, as Somali consumers face numerous financial constraints, including limited income, high unemployment rates, large family sizes, and dependence on a single source of income. With many households struggling to meet their basic needs, even minor price differences influence purchasing decisions, making informal businesses—where VAT is not imposed—a more attractive option. Additionally, the Somali market is characterized by homogeneous products and services, meaning that the same goods are available from both formal and informal businesses. Since informal businesses do not charge VAT, they offer lower prices, drawing customers away from formal establishments obligated to include VAT in their pricing.

Another critical factor driving the shift to the informal sector is the flexibility of payment methods. Many informal and formal businesses allow customers to use cash, mobile money, or even informal credit arrangements. In contrast, formal

businesses may have stricter payment requirements, making transactions less convenient for low-income consumers. Some sellers also deliberately avoid VAT collection by allowing unregistered transactions, further reducing costs for buyers. This growing preference for informal businesses presents several challenges. While it helps consumers afford essential goods and services, it also weakens government tax revenues, reduces the competitiveness of formal businesses, and limits the ability of the state to invest in public services (Stiglitz et al., 2017).

The government could have strategically framed its VAT policy as a pilot project by initially imposing VAT only on merchant transactions while exempting other payment modes such as bank transfers, mobile money, and cash payments (IMF, 2022). This approach would have allowed the government to introduce VAT in a controlled and gradual manner, minimizing immediate financial strain on consumers while also assessing the policy's impact. However, the reality is that the government likely left these exemptions in place due to limited administrative capacity and enforcement challenges, rather than as a deliberate strategy to ease the tax burden on citizens.

A clear example of the government's lack of capacity is its inability to implement the VAT exemption for healthcare service providers using merchant accounts. Despite officially announcing that health services are VAT-exempt, many hospitals and clinics continue to charge VAT on patient payments simply because their merchant accounts are still categorized under VAT-liable businesses. This technical failure exposes the government's inability to enforce its own tax policies, leading to unjust financial burdens on patients (WHO, 2021). If the government had the capacity to implement VAT exemptions properly, it would have ensured that health service providers were reclassified to prevent unnecessary tax collection from vulnerable populations.

Despite these challenges, the government could have politically and strategically reframed its limitations as a pro-people decision—one that demonstrates care and responsiveness to the financial struggles of its citizens. Instead of admitting that it lacked the infrastructure to impose VAT across all payment modes, it could have presented the exemptions as a well-thought-out policy choice aimed at protecting low-income individuals and businesses from excessive taxation. By doing so, the government could have gained public trust and softened the resistance to VAT, portraying itself as a progressive administration that prioritizes economic inclusivity and social welfare (Atkinson, 2019).

5.3 Causes of Poor Revenue Projection

Revenue projection is a fundamental aspect of fiscal planning, as it determines the government's ability to allocate resources efficiently and maintain economic stability. However, many developing economies experience significant gaps between projected and actual revenue due to systemic and structural factors. This discussion explores the causes of poor revenue projection, supported by relevant economic theories and literature.

5.3.1 Inadequate Market Research & Data Limitations

Accurate revenue projection requires a robust understanding of market dynamics and economic trends. However, many governments fail to conduct comprehensive market studies, leading to unrealistic revenue expectations. According to Musgrave and Musgrave (1989), revenue forecasting should be based on empirical economic analysis, as inaccurate data leads to fiscal imbalances.

Dependence on outdated data further exacerbates the problem. The Adaptive Expectations Hypothesis (Friedman, 1957) suggests that policymakers often rely on past data to predict future revenue, failing to account for evolving market conditions. Similarly, Friedman's Permanent Income Hypothesis (1957) posits that individuals and firms adjust their spending and tax compliance based on long-term expectations rather than past trends, indicating the need for real-time data integration in revenue estimation.

Additionally, the absence of a comprehensive taxpayer registration database results in a significant portion of unaccounted economic activities. Tanzi and Zee (2000) argue that weak taxpayer identification systems lead to substantial underestimation of revenue, as informal sector activities remain untaxed.

5.3.2 Low Compliance & Weak Enforcement

Tax compliance is a major determinant of revenue projection accuracy. The Laffer Curve Theory (Laffer, 1974) explains that excessively high tax rates discourage compliance and lead to lower revenue collection, often not reflected in government projections. Additionally, low expectations of taxpayer compliance result in conservative revenue forecasts, preventing governments from mobilizing their full revenue potential.

The issue of VAT non-compliance is particularly concerning. Due to weak enforcement mechanisms, Bird and Gendron (2007) highlight that VAT evasion is a common problem in developing economies. The Theory of Tax Morale (Torgler, 2007) suggests that taxpayer attitudes towards compliance are shaped by trust in government institutions and perceived fairness of taxation. Where tax morale is low, evasion rates tend to be high, causing discrepancies between projected and actual revenue.

The informal economy also significantly impacts revenue forecasts. The Dual Economy Theory (Lewis, 1954) explains that in many developing countries, a large workforce segment operates outside the formal tax system, making it difficult to

estimate taxable income. Schneider and Enste (2000) further argue that informal sector expansion reduces the effectiveness of tax policies, leading to inaccurate revenue projections.

5.3.3 Institutional & Capacity Constraints

Weak institutional capacity is another critical factor contributing to poor revenue projection. According to the Public Choice Theory (Buchanan & Tullock, 1962), inefficiencies in public institutions—such as lack of skilled personnel in tax administration—result in suboptimal policy implementation. Fjeldstad and Moore (2009) emphasize that governments with weak tax institutions struggle with revenue mobilization due to poor enforcement and lack of professional expertise. Moreover, inadequate enforcement mechanisms fail to ensure compliance, leading to revenue losses. Besley and Persson (2013) argue that state capacity plays a crucial role in tax collection, and countries with weak enforcement mechanisms experience lower revenue performance compared to those with stronger institutional frameworks.

5.3.4 Technological Gaps

Monitoring infrastructures play a crucial role in improving revenue forecasting accuracy. The Technology Acceptance Model (Davis, 1989) suggests that digital tax systems enhance efficiency, reduce errors, and improve compliance. However, in many developing economies, the absence of digital tax monitoring systems hinders accurate revenue tracking. Keen and Slemrod (2017) highlight that digital tax solutions, such as electronic invoicing and online tax filing, significantly enhance VAT compliance and reduce fraud. Countries like Rwanda and Estonia have successfully implemented digital tax systems, improving revenue collection and more accurate projections (Kiringai & West, 2018).

6.1 Conclusion

Implementing VAT in Mogadishu marks a significant milestone in Somalia's efforts to enhance domestic revenue mobilization and reduce reliance on external aid. However, this study has demonstrated that while VAT has the potential to broaden the tax base and generate government revenue, its application in Somalia has led to unintended socio-economic consequences. The research findings reveal that VAT's regressive nature has disproportionately affected low-income households, increasing financial strain and reducing access to essential services such as healthcare and education. Households have experienced rising costs of living, decreased savings, and a shift in spending behavior, with many opting for informal markets to escape the tax burden.

On the business side, VAT has led to higher operational costs, reduced profit margins, and declining consumer demand, forcing many businesses to adapt by either increasing prices or engaging in informal transactions to avoid compliance. The selective taxation of merchant account transactions has further complicated compliance efforts, incentivizing businesses and consumers to rely on untaxed payment methods like mobile money and cash. This has weakened government tax enforcement and reduced overall VAT efficiency, contradicting the intended goals of broadening the tax base and formalizing the economy. Moreover, weak institutional capacity, poor enforcement mechanisms, and a lack of public trust in tax authorities have exacerbated non-compliance and tax avoidance behaviors. A major challenge identified in this study is the flawed design of the automatic VAT deduction system, which indiscriminately taxes merchant account transactions without distinguishing between taxable and non-taxable payments. This has led to over-taxation, wrongful deductions, and a lack of refund mechanisms, creating an additional financial burden on businesses and consumers. The government's failure to conduct a post-implementation review or pilot test the VAT system before full enforcement has contributed to these structural weaknesses. Furthermore, the study highlights gaps in revenue projection, with the government underestimating VAT collections due to inadequate market studies and weak forecasting models. To improve VAT effectiveness in Somalia, policymakers must implement urgent reforms to align the tax system with economic realities and ensure fairness in its application. This includes standardizing VAT across all payment methods, implementing a clear refund mechanism, introducing tiered VAT rates for essential goods, and strengthening tax enforcement through digital monitoring systems. Additionally, the government must focus on building public trust in taxation, ensuring transparency in VAT revenue allocation, and improving taxpayer education. Without these reforms, Somalia's VAT system will continue to discourage formal business participation, weaken tax enforcement, and contribute to economic inequalities, ultimately undermining the long-term objectives of revenue mobilization and sustainable economic development.

6.2 Policy Recommendations

Based on the findings of this study, it is evident that VAT implementation in Mogadishu has faced significant challenges related to compliance, enforcement, socio-economic impact, and public perception. To address these issues and improve VAT effectiveness while ensuring fairness and economic stability, the following contextualized and actionable recommendations are proposed:

1. Address VAT Compliance Gaps and Strengthen Enforcement Mechanisms

- **Standardize VAT across all payment methods:** The selective application of VAT to merchant account transactions has driven tax avoidance through mobile money and cash transactions. The government should implement VAT uniformly across all payment methods to reduce avoidance and ensure a level playing field for businesses.
- **Expand and digitize the taxpayer registration database:** A significant portion of businesses remain outside the formal tax system. The Ministry of Finance should conduct a business registration campaign, supported by digital records, to ensure more businesses comply with VAT requirements.
- **Enhance digital tax monitoring and reporting:** The absence of real-time transaction tracking has allowed VAT evasion to persist. The government should implement digital invoicing and an integrated electronic tax system to monitor sales and enhance enforcement.

2. Reduce the Financial Burden of VAT on Households

- **Expand VAT exemptions for essential goods and services:** While healthcare is officially VAT-exempt, improperly categorizing merchant accounts as liable has led to unnecessary taxation. The Ministry of Finance should urgently reclassify health service providers in tax records and ensure proper enforcement of exemptions to eliminate unjust financial burdens on patients.
- **Introduce a tiered VAT system for basic necessities:** Similar to international best practices, the government should zero-rate or apply a lower VAT rate to essential goods such as food, water, and electricity while maintaining higher rates on luxury goods and services.

3. Improve Business Adaptation and Support Compliance for SMEs

- Simplify VAT registration and filing procedures for SMEs: Many small businesses avoid VAT registration due to complex paperwork. The government should introduce a simplified VAT filing system, with reduced documentation and online submission options for SMEs.
- Provide financial and technical support to VAT-registered businesses: To ease the transition, the government should offer temporary tax incentives or reduced VAT rates for newly registered businesses, helping them integrate smoothly into the tax system.
- Phase in VAT enforcement for SMEs: Instead of imposing VAT abruptly, the government could implement a gradual enforcement approach, starting with larger businesses and progressively extending to SMEs while offering compliance training.

4. Build Public Trust in VAT and Improve Transparency

- Increase transparency in VAT revenue allocation: The government should publish quarterly reports on VAT collections and expenditures, showing how tax revenues are used for public services.
- Launch community engagement programs: The Ministry of Finance should hold regular public forums, media campaigns, and business consultations to clarify VAT policies, address grievances, and demonstrate the benefits of taxation.
- Strengthening tax education initiatives: Many businesses and consumers do not fully understand VAT regulations. The government should collaborate with trade unions, financial institutions, and civil society to run awareness programs that explain VAT obligations and benefits.

5. Improve Revenue Projection Accuracy and Fiscal Planning

- Adopt data-driven revenue projection models: The government should use real-time market data, business activity tracking, and economic indicators to estimate more accurate VAT revenue.
- Conduct regular economic assessments and market studies: The Ministry of Finance should conduct quarterly and semi-annual studies on VAT collection trends, business adaptation, and consumer behavior to refine tax policies based on actual market conditions.
- Enhance inter-agency coordination in fiscal planning: The Ministry of Finance, Central Bank, and tax authorities should collaborate more effectively to align VAT policies with broader economic strategies and ensure that projections are based on reliable economic indicators.

5. Correcting the Shortcomings of the Current VAT System and Enhancing Revenue Collection

- **Introduce a VAT Refund Mechanism:** Establish a clear refund process for overpayments and wrongful deductions while allowing businesses to offset mistakenly deducted VAT against future tax liabilities.
- **Differentiating Between Taxable and Non-Taxable Transactions:** Implement a smarter VAT system that distinguishes taxable sales from financial transactions, loan repayments, salary payments, and refunds, ensuring non-taxable transactions are exempt from automatic deductions.
- **Encourage Voluntary Compliance Through Incentives and Education:** Provide taxpayer education, formalization incentives, and transparent tax administration to build trust and increase compliance.
- **Promote Digital Payments Instead of Penalizing Them:** Ensure VAT policies do not discourage digital transactions, which are crucial for financial inclusion and economic modernization.

Appendix

General Awareness

1. Are you aware of the VAT implementation in Somalia?		
	Frequency	Percentage
Yes	242	97%
No	8	3%
Total	250	100%
2. How well do you understand VAT policies?		
	Frequency	Percentage
Very Good	80	32%
Good	102	41%
Average	38	15%
Poor	30	12%
Total	250	100%
3. Do you find VAT policies fair?		
	Frequency	Percentage
Yes	101	40%
No	85	34%
Not sure	64	26%
Total	250	100%
4. What are the main goals of VAT? (Select all that apply)		
	Frequency	Percentage
Increase government revenue	189	54%
Improve public services	104	29%
Ensure fairness	40	11%
Looting	3	1%
Theft	1	0%
Robbery	14	4%
Personal interest	2	1%
Total	353	100%

5. Is it the right time for the government to collect VAT?		
	Frequency	Percentage
Yes	122	49%
No	86	34%
Not sure	42	17%
Total	250	100%

Household Impact

6. Has VAT increased your household's spending?		
	Frequency	Percentage
Yes	231	92%
No	19	8%
Total	250	100%
7. Which expenses rose the most? (Select all that apply)		
	Frequency	Percentage
Food	241	42%
Utilities	143	25%
Healthcare	120	21%
Education	67	12%
Total	571	100%
8. How has VAT affected your savings?		
	Frequency	Percentage
No impact	86	34%
Slightly reduced	118	47%
Significantly reduced	46	18%
Total	250	100%
9. What percentage of your income goes to VAT-inclusive goods?		
	Frequency	Percentage
Less than 5%	133	53%
5-10%	78	31%
10-15%	23	9%
More than 15%	16	6%
Total	250	100%

10. Are you willing to pay VAT if it improves public services?		
	Frequency	Percentage
Yes	226	90%
No	24	10%
Total	250	100%
11. Do you switch from buying formal to informal business due to the VAT burden?		
	Frequency	Percentage
Yes	130	52%
No	120	48%
Total	250	100%

Business Impact

12. What is your business type?		
	Frequency	Percentage
Small	106	42%
Medium	118	47%
Large	26	10%
Total	250	100%
13. How has VAT affected your business? (Select all that apply)		
	Frequency	Percentage
Higher operational costs	118	27%
Lower customer demand	146	33%
Reduced profits	166	37%
No impact	13	3%
Total	443	100%
14. Have you raised prices due to VAT?		
	Frequency	Percentage
Yes	216	86%
No	34	14%
Total	250	100%

15. Is the VAT policy fair for all businesses?		
	Frequency	Percentage
Yes	130	52%
No	120	48%
Total	250	100%

Payment and Compliance

16. How do you process customer payments? (Select all that apply)		
	Frequency	Percentage
Merchant accounts	212	42%
Mobile money	141	28%
Bank accounts	80	16%
Cash	71	14%
Total	504	100%
17. Do you permit your customer to choose another payment mode rather than a merchant account?		
	Frequency	Percentage
Yes	178	71%
No	72	29%
Total	250	100%
18. Do you think VAT on merchant accounts is fair?		
	Frequency	Percentage
Yes	111	44%
No	82	33%
Neutral	57	23%
Total	250	100%
19. Should VAT apply to all payment methods equally?		
	Frequency	Percentage
Yes	103	41%
No	147	59%
Total	250	100%

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