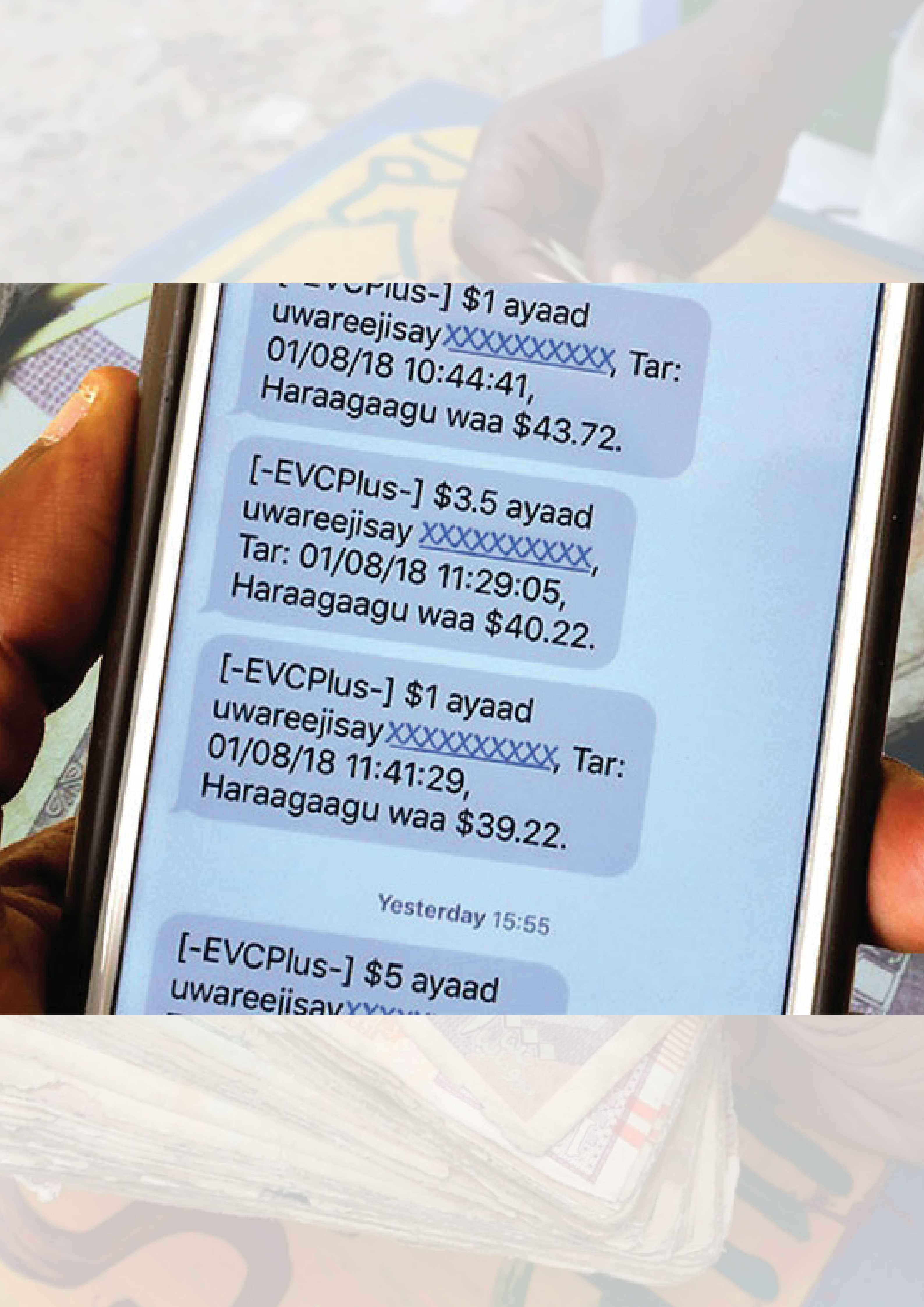
Baraaro Center
FOR SOCIOECONOMIC AND DEVELOPMENT RESEARCH

Policy Brief

Mobile Money Taxation in Somalia:

An Opportunity to Increase Domestic Revenue

April, 2024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Executive Summary

Somalia is going through two pivotal transitions in the security and economic spheres and will soon live in two new eras: post-Al-Shabab and post-HIPC. Both eras are rapidly unfolding, and the government will soon be the principal custodian of all Somali nationals, with many liberated communities seeking development. Fiscal sustainability and autonomy as domestic revenue mobilization and expenditure control are key to success in these new eras.

Given the numerous socioeconomic and environmental challenges ranging from taxpayer awareness, economic informality, and other institutional barriers, The Federal Government of Somalia (FGS) will need cheap and easy ways to propel domestic revenue. The FGS should consider mobile money taxation to raise revenue and prepare for the post-HIPC economy, in which Somalia covers all of its budgetary expenditures.

This policy brief proposes two primary ways to tax the enormous mobile money industry and presents a theoretical argument on the feasibility of mobile money taxation in Somalia. First, this policy brief advocates for a corporate-level sales tax on all goods and services provided by telecom companies (i.e., sim card, airtime, and internet data). This shall be achieved by deploying high-capacity point of sales machines that can trace corporate sales and automatically levy taxes. Second, this policy brief advocates mobile money (MM) tax on the total value of every transaction (i.e., nonmerchant) completed by Somali MM users. A rate of 0.5%, which can be negotiated with the telecom companies, shall be levied on person-to-person MM transactions.

The MM taxation, in the two forms proposed here, will approximately enhance the domestic revenue $150+ million annually. This is an opportunity for the FGS to penetrate deeply into the informal economy, bypass security and other institutional challenges, and broaden its revenue base. Unlike many Sub-Saharan African and EAC countries, imposing MM tax in the proposed form will not be of any detriment to financial inclusion. Although it will exert a tax burden on MM users, this burden will not result in any economic distress because Somalia has one of the lowest tax burdens in Africa.

1. Introduction

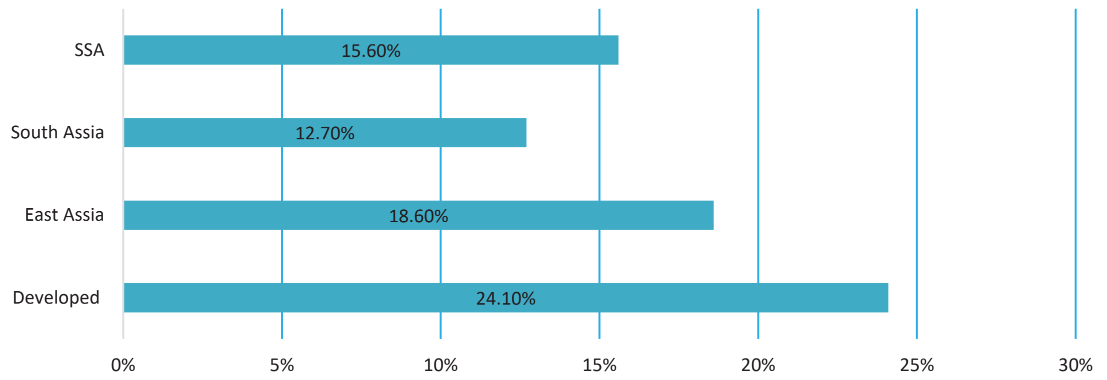
The COVID-19 pandemic and other economic challenges in the African continent result in large gaps in revenues—with several countries like Somalia facing institutional challenges to collect taxes for financing the budgetary expenditures—Mobile money (MM) taxation is becoming a lazy option to broaden the tax base and delve deep into the informal economy[1]. The Sub-Saharan African (SSA) region has struggled to implement efficient tax administration and policy systems and keep up with the rapid pace of technological change, making it a region with one of the lowest tax-to-GDP ratio worldwide. Governments in SSA lack a formalized business environment where they can easily implement tax policies and prevent tax evasion. As of 2017, the SSA is ranked second, with the lowest tax-to-GDP ratio of 15.5%, slightly higher than South Asia[2]. This gap in the domestic revenue mobilization (DRM) capacity is causing a notable and narrow bottleneck for governments in the SSA region in terms of delivering services and meeting the sustainable development goals.

[1]https://restofworld.org/2022/how-mobile-money-became-the-new-cash-cow-for-african-governments-but-at-a-cost/

[2]Figure 1 shows the data.

To address the revenue gaps, many SSA governments have imposed levies and taxes on MM, which has become ubiquitous in these countries in the past 5 years. MM taxation is largely driven by the increased pressure on governments of these countries to enhance revenue in the face of increasing national debt, waning economic activities, increasing digitalization of business activities, informality, and low capacity of revenue units.

Figure 1: Regional Tax-to-GDP ratio (as of 2017)



Source: The Mobile Economy 2020, GSMA (2020)

2. Purpose of the Policy Brief

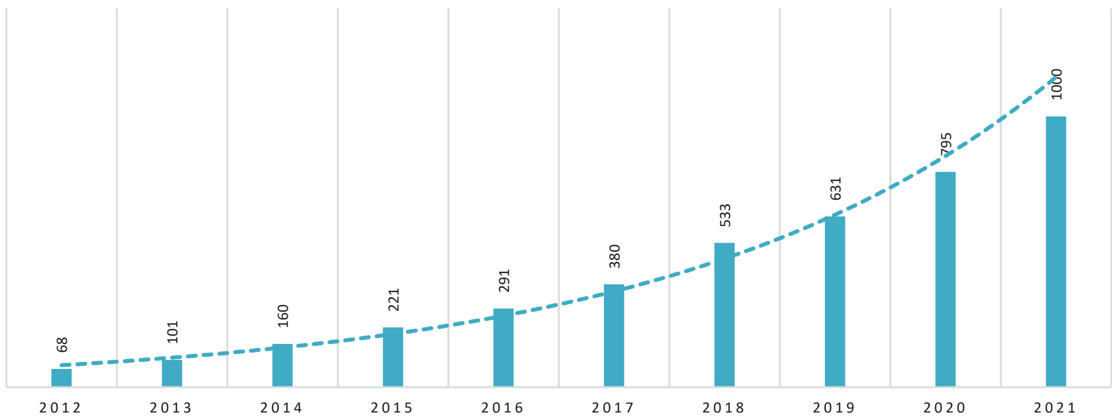
This policy brief advocates imposing taxes on three types of MM categories: Airtime, Internet Data, and Transactions. The policy brief will initially present evidence of how other SSA countries are imposing such taxes to enlarge their tax base and reach the informal economy. This section will then discuss the necessity of taxing MM in Somalia and how The Federal Government of Somalia (FGS) can easily partner MM providers to tax one of the most informal economies in the world. The study also theoretically discusses the potential impact of MM taxation on financial inclusion in Somalia. Finally, this policy brief presents a suitable earmarking strategy that will help the FGS tailor MM tax revenues to beneficial public programs in the social and security sectors.

3. MM Taxation in the EAC region

MM services have become ubiquitous since 2012. More than 1.35 billion MM accounts were registered as of 2021—a 10-fold increase from the 2012 levels.[3] In the same year, the total value of MM transactions reached 1 trillion USD worldwide.

[3]State of the industry report on Mobile Money-GSMA

Figure 2: Total MM Transaction Value (blns)



Source: GSMA 2021

The SSA has been one of the main forces behind the growing trend in the MM industry, with >600 million MM accounts and transactions valued at >$600 billion in 2022[4]. MM services have created unprecedented opportunities for unbanked communities in the SSA regions and have tremendously improved financial inclusion. This also presents an opportunity for governments in the region to penetrate the informal economy and tax it.

The member government of the East African Community (EAC) follows three different methods of taxing the MM industry[5].

a- Value added tax (VAT) and excise duties levied on transaction (service) fees charged by MM providers

b- Specific taxes on the underlying value of MM transactions

c- Consumer taxes on Telecom services and goods

Table 1: International Center for Tax and Development

Country	Taxation of MM service Charges	Taxation of Transaction Values	Taxation of Telecom Services (Goods & Services)
Burundi	--	--	VAT (18%)
DRC	--	--	VAT (16%), Excise (10%)
Kenya	Excise (12%)	--	VAT (16%) Excise (20%)
Rwanda	VAT (18%)	--	VAT (18%) Excise (10%)
Tanzania	VAT (18%) Excise (10%)	TZS 10 to ZS 4,000 on MM transfers and Withdrawals	VAT (18%) Excise (17%)
Uganda	Excise (15%)	0.5% of withdrawals	VAT (18%) Excise (17%)
South Sudan	--	--	VAT (18%) Excise (15%)

[4] The Normalization of Mobile Money in Sub-Saharan African

Notably, the EAC nations see the growth of the MM industry as an opportunity to fill in the revenue gaps caused by rising debt and the shrinking export sector worsened by COVID-19. The national taxation policies of the sector are not cohesive and somewhat tailored to the nature of the national telecommunications and banking industries, in addition to the specific needs of the government.

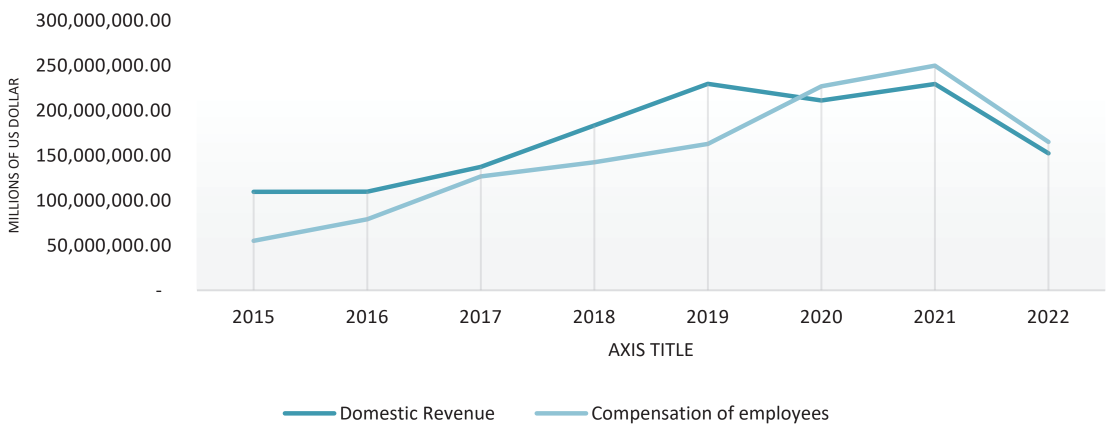
4. Somalia's case

Somalia, ranking among the lowest in the SSA regarding institutional strength, business formalization, production capacity, and exports, faces an even greater challenge in raising its domestic revenues and collecting taxes to fund government operations and respond to recurrent security crises and draughts. As of 2021, Somalia's tax-to-GDP ratio was approximately 2.1%, and the country is highly reliant on budget support and external grants. Due to the outbreak of the COVID-19 pandemic, ensuing political crises, and raging war on terror, Somalia's government has been struggling to finance the compensation and other operating costs domestically.

Meanwhile, Somalia's long-term pursuit of the debt-relief program under the HIPC Initiative will soon be completed. The debt-relief program, facilitated and supervised by the IMF, is considered a huge economic achievement for Somalia because it wipes out $5 billion of debt from the country records. However, after completion in late 2023, the grants—which now cover a huge portion of the budgetary expenditures will lapse and be replaced by concessional loans[6].

Thus, the FGS is facing substantial pressure to enhance domestic revenue for covering the compensation and operational costs after the HIPC completion point. Thus, similar to several SSA and EAC nations, Somalia has the opportunity to consider MM taxation as a lazy option to enhance government revenues.

Figure 3: Domestic Revenue Vs. Compensations



Source: Ministry of Finance

5. Nature of Somalia's fiscal challenges

The fiscal challenges faced by the FGS can be attributed to intrinsic and extrinsic factors. Intrinsic factors relate to the FGS' revenue authority and Ministry of Finance. Extrinsic factors, however, are external factors from the wider economy, security, and social environment.

[6]IMF Staff Concluding Statement, 2022

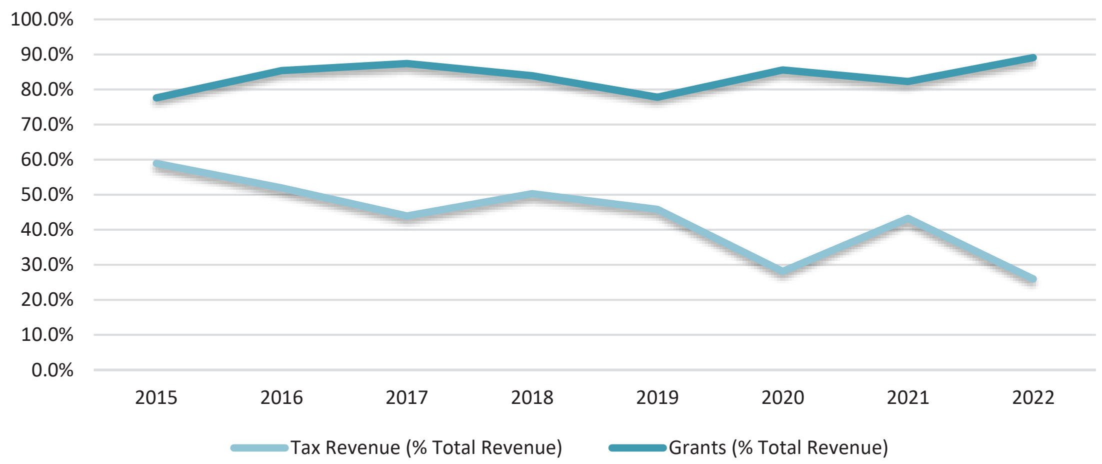
5.1. Intrinsic Factors

First, Somalia does not have a national revenue authority with the mandate to devise and implement tax policies. At present, the FGS relies on the revenue department of the Ministry of Finance. The revenue department has long failed to mobilize domestic revenue because of structural weaknesses and knowledge and capacity gaps. A notable structural flaw is the absence of division between the tax policy and tax administration departments. Theoretically, tax authorities can establish revenue targets and rarely raise the revenue threshold.

Second, the staff of the in-land revenue and customs departments are unequipped with policy making and implementation capacity.

Third, the influx of grants led to total negligence by revenue authorities in setting up key procedures for collecting sales, personal, and profit income taxes. Overreliance on grants is visible in the nature of tax revenues and grant trends. As in Figure 3, the tax revenues seem to decline as grants increase, indicating that tax policies are loose and inconsistent.

Figure 4: Tax Revenue Vs. Grants (% of total Rev)



Source: Ministry of Finance

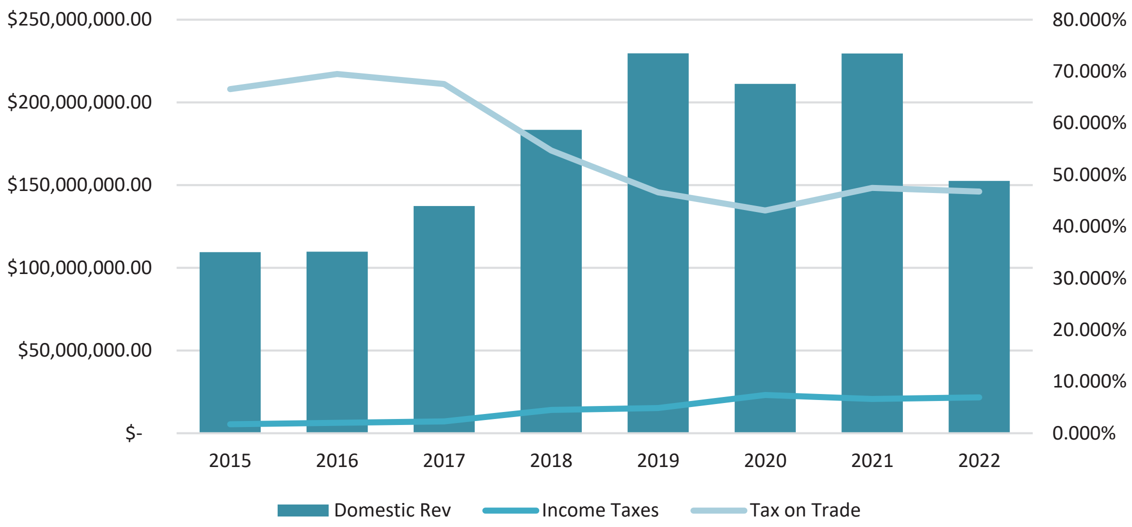
Another profound fiscal challenge is the tax structure, which is highly concentrated on trade. The absurd notion that customs are the only source of tax revenue for the government is widely accepted by the Somali public. Revenue officials and other government financial institutions are succumbed to the same notion and make almost no effort to activate other sources of tax revenues. Eventually, almost all domestic revenue comes from the trade tax; however, revenue from the trade tax has gradually declined since 2018. The income tax on government employees, corporations, and some private sector employees (NGOs staff included) makes up <10% of domestic revenue as of 2022. Sales and other taxes on goods, services, and properties rarely exist. This makes revenue sources less diversified and more vulnerable to global trade shocks.

The income tax revenue from big businesses categorized as corporations in the government records was lower than the income tax revenue streams from private and public sector employees. This is not because employees in the public and private sectors earn more money than companies, but companies do not produce accurate financial reports on their gains and losses; additionally, the government has made no effort to create frameworks for accurate reporting requirements. Therefore, the "corporations" pay lump sums only based on gentlemen agreements and informal negotiations.

Despite an increase in government employees, public sector tax revenues have decreased strangely since 2017. Meanwhile, since 2017, tax revenue from private sector employees, the bulk of which are foreign and NGO employees, has increased. Employees working for telecommunication companies, banks, merchandise companies, universities and hospitals are not effectively charged any personal income tax. This violates the principle of *Equity* in our taxation system, under which all taxpayers with equal ability shall be taxed equally and any differential in ability are accounted for.

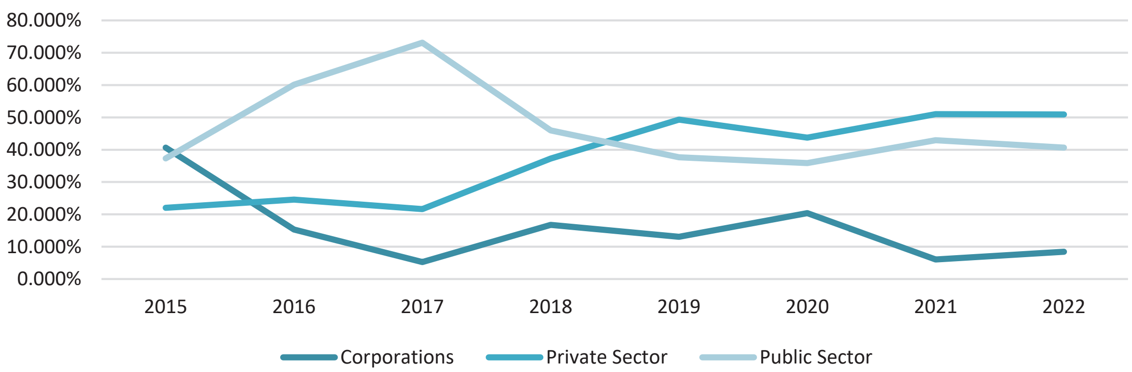
With the necessary improvement measures, the FGS could generate considerable revenue from personal income tax, which currently accounts for <10% of domestic revenue. It could also realize considerable revenue from sales, corporate income, and turnover taxes. However, owing to the limited institutional and technical capacity of the FGS and its member states, in addition to the pervasive informality in the Somali economy, such improvements cannot be easily implemented.

Figure 5: Tax Structure



Source: Ministry of Finance

Figure 6: Income Tax Structure



Source: Ministry of Finance

5.2. Extrinsic Factors

The informality of the economy is the biggest extrinsic factor that challenges revenue mobilization in Africa, whose economic activities are 85% informalized.[7] This informality is even higher in Somalia's private sector, accounting for approximately 90% of all economic activities in the country. As a result, even though billions of dollars of economic transactions occur every day, the FGS is unable to tax the private sector regularly and effectively.

As stated previously, the Somali economy is dominated by informality, and the business community has never been properly taxed. The country lacks standardized accounting standards, and small and medium enterprises hardly ever record their business transactions. The business community is thus unaware of their obligation to pay taxes, such that the government can provide essential services, making the awareness another challenging extrinsic issue.

The Somali business community has spoken out on numerous occasions over the oppressive and illegal taxes and Zakat levied by Al-Shabab. Reportedly, Al-Shabab has been expanding financially due to its effective infiltration of the financial institutions controlled by the government until the government started its financial war against the group in late 2022. The business community has a strong case for the government to intervene and stop Al-Shabab from intimidating them and forcibly taking a large portion of their revenues for the business community to pay taxes. Al-Shabab's security threats and its taxes are another difficult extrinsic challenge to revenue mobilization, although the FGS has made remarkable progress in reducing this burden.

6. MM Taxation: An Easy DRM Option

Internal and external challenges impede the FGS from enhancing domestic revenue in the short term, resolving long-standing fiscal difficulties before the HIPC CP, and funding the fight against terrorism.

The FGS can easily and quickly expand its revenue base and overcome intrinsic and extrinsic obstacles by levying a tax on MM. Somalia is already a global leader in MM, and Somalis are poised to become the first cashless global society. With approximately 73%[8] of the population aged U16 years using MM services, almost all business transactions are carried out using MM transfers mainly provided by telecommunication companies. The combined services of the major MM providers in the country result in millions of transactions, with an estimated value of $2.7 billion per month[9]. Taxing the MM sector is an easy and immediate option for the FGS to mobilize much-needed revenue because it does not demand major institutional /or procedural adjustments. Tax collections, as in many African countries, are made by MM providers, and the FGS sets up an effective monitoring system. Taxation of the MM sector can thus be an immediate alternative to various taxes that the FGS cannot levy in the near term because of intrinsic and extrinsic challenges and reach the massive informal economy of the country.

[7] GSMA 2020

[8] This estimation was provided by World Bank Group as of 2017, and the number may have increased thereafter. The penetration rate of MM is higher in urban areas than in rural areas, with penetration rates of 83% and 73%, respectively.

[9] This estimation was provided by the World Bank in its Multi-Partner Fund Progress Report (2017).

Table 2: Major MM Providers in Somalia

MM Provider	Service Name	Presumptive Ranking
Hormuud Telecom	EVC+	Most used programs in the south-central regions
Dahabshil Bank	E-Dahab	The second most used program in the south-central regions
Golis Telecom	Sahal	Most used program in the Puntland State
Premier Bank	Premier Wallet	The third most used program in the south-central regions
Amal Bank	M-Tell	The fourth most used program in the south-central regions

Source: Author

7. MM Taxation: The Proposed Procedure

Most SSA countries impose sector-specific taxes on telecommunication companies. In the early stages of the sector, taxes were imposed as an excise duty on transaction fees charged by telecommunications companies. However, with the decline in voice and data traffic and the desire of governments to tax the informal sectors, many other forms of MM tax have emerged, such as a tax on total MM revenue and a tax on total transaction value.[10] As mentioned before, African nations, especially EAC-member countries, also tax goods and services. Herein, the most appropriate forms of taxation of the Somali MM sector are discussed.

At present, the FGS does not have any form of sector-specific MM taxation; the government does not tax MM revenues generated by telecom operators via airtime and internet data. Moreover, the government does not tax the value of the underlying transactions carried out with MM services by mobile users. MM providers do not charge any fees from the users for transactions; thus, the FGS cannot levy any taxes on the service charges. Therefore, the FGS has an unprecedented opportunity to tax this untapped sector in two ways:

1- The FGS shall tax the total value of each transaction completed by MM users. This tax shall be limited to nonmerchant transactions (person to person). Because the merchant-type transactions will be subject to sales tax soon as the FGS deploys the Point of Sales Machines (PoS).

2- The FGS will tax airtime and internet data, the two biggest direct services provided by MM. The normal sales tax rate shall be subject to a normal sales tax rate. The PoS machine systems shall be enhanced to capture, trace, and tax these transactions. The same taxation policy will apply to all other transactions made using other digital tools, such as Master and VISA cards.

8 Transaction Value Taxation: The Proposed Rate

The MM tax rates initiated in the SSA region vary with countries. Countries such as Malawi, Côte d'Ivoire, and Cameroon had the lowest transaction tax rates, with a maximum rate of 0.5%. Because of the unfavorable public response to transaction tax rates, some nations, including Uganda, were forced to reconsider the rates, while others turned to earmarking strategies that specifically matched transaction tax revenues to important development spending.

The higher tax burden on taxpayers in these nations, who were already subject to various MM tax types, was the main cause of the public outrage and rebuke toward transaction taxes. For instance, Kenyan MM users faced three main tax types as of 2020 (Table 3). The SSA

[10] GSMA 2020

countries were introducing the MM tax in an economic environment where consumers have already been bearing a huge tax burden; thus, their transaction tax proposals, at least initially, were rebuked and resisted by the public.

Table 3: Key Taxes on Kenyan Users of MM

Type	Rate	
Value Added Tax (VAT)	16% on the value of mobile services (including excise taxes), handsets and SIM cards. Mobile money is exempt	
Excise Duties	Mobile Services	15% on mobile service costs
	Mobile Money	12% for transaction fees
Customs Duty	SIM Cards	25% of the cost, insurance, and freight (CIF) value
	Railway Development Levy (RDL)	2% of the CIF value
	Import Declaration Fee	3.5% of the CIF value
	Merchant superintendent shipping levy	Various rates

Source: EY GLOBAL, 2019

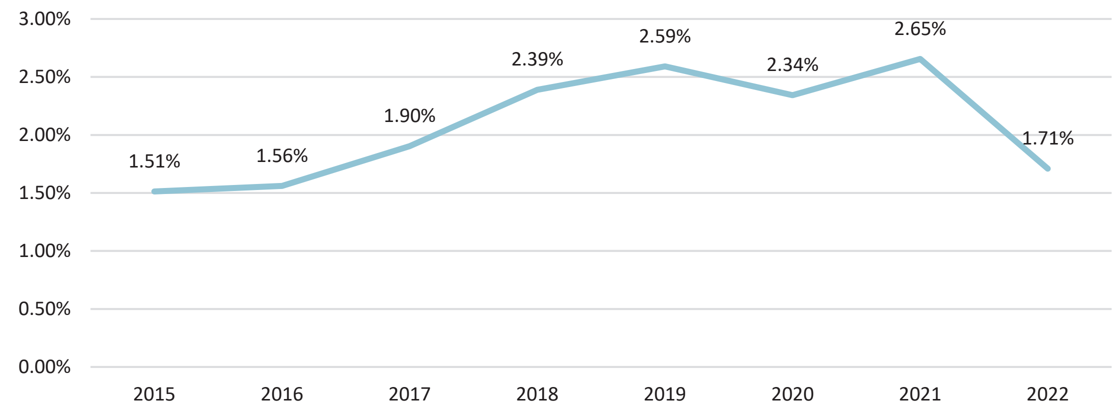
For Somalia, the tax burden is not a major challenge. Somalia's economy is highly informalized, and consumers seldom ever pay any systematic taxes. However, consumers pay indirect taxes arising from the unregulated business environment, such as bribes, Al-Shabab's tax, and other security-related transaction costs from curfews and road closures. However, with Al-Shabab's threat abating and institutional strengthening continuing, such indirect costs will soon be minimized to insignificance. Thus, FGS charges **0.4%** of the total transaction value completed by MM users in Somalia. This rate is less than the lowest rate in Africa and only applies to person-to-person transfers. Taxing the total transaction value, which is approximately **$2.7 billion,** at this rate, the FGS potentially increases domestic revenue by approximately **$98 million** annually.

9. MM taxation: Implications for Financial Inclusion in Somalia

Although SSA policymakers consider MM taxation as inevitable, experts are concerned that it may reverse the huge gains made in financial inclusion in recent decades. Many poor and nomadic communities are already protesting the MM taxation, and some governments like that of Uganda were forced to reconsider transaction tax rates. The outcry against MM taxation in many SSA nations is due to the tax burden on consumers in these countries.

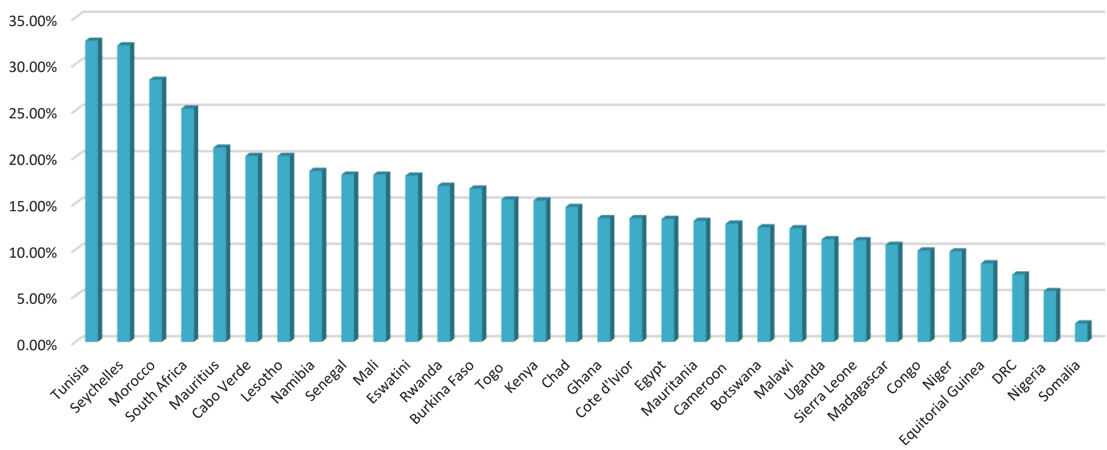
Arguably, the increased concentration of African governments on MM sectors and various imposed taxes can reverse the financial inclusion gains made over the past decades; this is mainly due to poorly designed tax policies driven solely by the mere desire to increase the government's revenue without considering the tax burden within the sector and the general economy. In Somalia, the tax burden is much lower than that of any other African economy. The tax burden in Somalia never reached 3%, whereas Kenya, Uganda, and Malawi have 15.6%, 12.7%, and 17.1% tax burdens, respectively.

Figure 7: Tax Burden in Somalia (2022)



Source: Ministry of Finance

Figure 8: Tax Burden in Africa (2022)



Source: OECD (2002)[11]

Thus, the proposed 0.4% rate, as a new cost for MM users, will have no financial implications. This is because the rate is very small compared with other SSA countries, or the tax burden in Somalia is low, and the alternative to MM is much more costly and inefficient. Somali Shilling is dominated by counterfeit notes, and its power as a medium of exchange and store of value has dramatically declined in recent decades. Therefore, although the proposed rate increases the cost of using MM, its impact on financial inclusion is minimal.

10. Immediate economic benefits

First, the Somali economy is highly informalized, and the FGS cannot tax its various sectors without considerable investments in formalization, institutional and business

[11]The OEC provides this statistic for 31 African countries, and the authors removed some regional figures and added Somalia

structuring, and technology. This investment cannot be undertaken quickly enough to address the FGS's immediate financial problems, especially the impending HIPC CP. With the proposed MM taxation, the FGS will tax the informal economy and increase the domestic revenue base by approximately 40% annually.

Second, taxing the MM could be a steppingstone to developing taxation models for the emerging digital economy in the country. The increasing digitalization of economic activities is already shifting international investment and traditional market accession, and many African nations are already preparing to cope with it. Taxation can also pave the way for a serious discussion of the regulation of MM.

Third, the security threat from Al-Shabab is expensive for the FGS because the FGS does not have the resources to reach the distant rural regions where most of the residents are under the control of Al-Shabab. Thus, MM taxation is a safe and effective option to reach these resources, which will help the government liberate these communities and provide the basic social services.

11. Conclusion

At present, Somalia has two pivotal transitions in the security and economic spheres and will soon live in two new eras: post-Al-Shabab and post-HIPC. The post-Al-Shabab security architecture and post-HIPC economic development are the challenging tasks that the current administration must deal with in the future. The two eras are quickly unfolding, and the government will soon be the primary custodian of all the affairs of the nation. Many liberated communities will look up to it for development. This calls for the government to invest in development initiatives and transform itself from a weak government into one that is self-sufficient.

DRM is the key to success in these new eras. This requires the FGS to complete fiscal federalism frameworks and resource-sharing agreements. The current administration has already taken steps to engage with the federal member states to complete such agreements. However, with the post-HIPC era beginning in 2023 and with most grants turning into concessional loans, the need to enhance domestic revenue is pressingly urgent. Thus, the FGS revenue authorities must identify new sources of revenue and improve public financial management systems and expenditure controls to widen fiscal space.

MM taxation is an immediate source of revenue enhancement and an easy option for the FGS to increase its domestic revenue by approximately 40% in the last quarter of 2023.

12 Recommendations

1- Engage and initiate immediate negotiations with telecom and banking leaders to discuss the possibility of transaction value taxes.

2- The FGS shall impose a 0.5% tax on the total value of each transaction completed by Somali MM users.

3- The FGS shall deploy point-of-sale machines with the capacity to trace the sales of key telecommunication services (i.e., Internet data and airtime) and impose a sales tax on these services.

4- The FGS shall begin working on a grand strategy to tax the digital economy and pass the necessary laws and acts to regulate and tax the digital economy.

Annex: Notes on Datasets

- **Note 1:** The dataset from the Ministry of Finance of Somalia for depicting revenues, expenditures, and grants is missing for 4 months (September–December) in FY2022.

- **Note 2:** Some data sets were converted into graphs by the authors along with additional adjustment (i.e., other variables or countries included) for the sake of better comparison, as in **Figure 7.**

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