



EXAMINING SOMALIA'S NEW SALES TAX

Somali Public Agenda Policy Paper No. 08



Farhia Mohamud & Ibrahim Jibril
November 2024

EXAMINING SOMALIA'S NEW SALES TAX

Somali Public Agenda Policy Paper No. 08

Farhia Mohamud & Ibrahim Jibril
November 2024



Somali Public Agenda
Mogadishu
Somalia
Tel: +252(0)85 8358
Email: info@somalipublicagenda.org
Website: <https://www.somalipublicagenda.org>

© Somali Public Agenda 2024

Somali Public Agenda is a non-profit public policy and administration research organization based in Mogadishu, Somalia. Its aim is to advance understanding and improvement of public administration and public services in Somalia through evidence-based research and analysis.



With the exception of any third-party images and photos, the electronic version of this publication is available under a Creative Commons Attribution-NonCommercial-ShareAlike 3.0 (CC BY-NC-SA 3.0) licence. You are free to copy, distribute and transmit the publication as well as to remix and adapt it, provided it is only for non-commercial purposes, that you appropriately attribute the publication, and that you distribute it under an identical licence. For more information visit the Creative Commons website: <http://creativecommons.org/licenses/by-nc-sa/3.0/>.

Somali Public Agenda

Mogadishu

Somalia

Tel: +252(0)85 8358

Email: info@somalipublicagenda.org

Website: <https://www.somalipublicagenda.org>

Design and layout: Somali Public Agenda

Copyeditor: Peter Chonka

Acknowledgments

This policy paper was produced as part of a series of ad hoc research and analysis on relevant issues related to fiscal governance and federalism for our EU-funded project titled, “Increased Opportunities for Somali Citizens’ Scrutiny of Fiscal and Financial Governance.”

The report was edited by Peter Chonka, Senior Lecturer at King’s College London and Fellow at Somali Public Agenda.

About the Authors

Farhia Mohamud Hassan is a researcher at Somali Public Agenda (SPA). Her work focuses on developmental economics, peace and reconciliation, and governance studies. She holds a Higher Diploma in Security Studies from the Higher Institute for Security Studies and a bachelor’s degree in Economics from SIMAD University. Farhia is actively involved in various research projects on transitional justice, durable solutions, and fiscal accountability. She regularly authors reviews and analyses of Somalia’s national budget and its fiscal implications. Her publications cover diverse topics, including safety and security, regional integration, transitional justice, and financial governance. In addition to her research, Farhia is an avid blogger. She writes about Somalia’s landscapes to portray a narrative of hope, and her work has been featured by the United Nations Mission in Somalia (UNSOM) and the Nation.

Ibrahim Jibril is a researcher at Somali Public Agenda, where he has worked on and contributed to numerous research outputs addressing key social and political issues. Ibrahim holds a bachelor’s degree in public administration from Mogadishu University. Ibrahim’s research interests focus broadly on public policy, accountability, transparency, e-governance, youth empowerment, development policy, and the Sustainable Development Goals (SDGs).

Contents

Acknowledgments	III
About the Authors	III
Executive summary	1
A brief background	2
The introduction of the sales tax	5
The 5% Sales Tax in effect	7
Sales tax tech-collection process	10
Challenges to the implementation of the 5% sales tax	12
Policy recommendations	15
Develop the capacity to implement more sophisticated tax regimes	15
Strengthen transparency and accountability to build public trust	16
Prioritize intergovernmental fiscal relations	16
References	17
About Somali Public Agenda	18

EXECUTIVE SUMMARY

On August 18 2024, the federal government launched a new 5% sales tax in Mogadishu. The sales tax was incorporated into the 2024 budget appropriation act the parliament approved in December 2023. This inclusion provided the new sales tax a legal mandate to expand the scope of the 1984 Sales Tax Act, which was limited to imported goods, wholesale trade, hotels, and products manufactured by factories, and did not allow expanding the sales tax to retail consumers.

To monitor the implementation of the 5% sales tax, all businesses were mandated to use mobile money merchant accounts, which allows the government to deduct 5% of every transaction automatically. Major markets and businesses in the central business districts largely complied with the new sales tax. On the other hand, businesses in the peripheral districts and small shops in neighborhoods have been less compliant and used other means of payment.

About the technology used, we found that the system doesn't always notify businesses following the five percent tax deduction from their merchant accounts after every transaction. Moreover, businesses face challenges when they make refunds to customers who want to return taxed goods or services. Businesses don't have access to the system to request refunds on the 5% sales tax the system deducted from their merchant accounts, and they continue to bear this burden even after a return and refund of a purchase by a customer. While the Ministry of Finance told us that they are ready to collaborate with businesses and address these matters, the system doesn't offer a clear channel of communication.

There are several challenges to the implementation of the sales tax. These include a limited administrative and institutional capability; insecurity and instability preventing the broader implementation of the 5% sales tax in Mogadishu and beyond; low public trust in government institutions that fuels opposition to tax; and the implementation of the sales tax limited only to Mogadishu. Moreover, citizens and businesses feel they are already paying many other informal taxes, even though the federal government has recently abolished some of these ad hoc payments to increase sales tax compliance.

This policy paper presents several policy considerations. These include the necessary development of the capacity to implement more sophisticated tax regimes through the exemption of the sales tax from essential goods and services, building tax administration capacity, & exploring alternative revenue streams; to strengthen transparency and accountability to build public trust through increased transparency and improving public service delivery, closing the public trust deficit gap, & increasing public awareness, education and stakeholder engagement; and prioritizing intergovernmental fiscal relations through equal implementation of the sales tax.

A BRIEF BACKGROUND

Following Somalia's independence in 1960, the government's budget was often supported through foreign aid as domestic revenue remained insufficient to cover core government expenditures. Somalia's state institutions collapsed in 1991 when clan militias toppled the military regime that ruled Somalia for close to 21 years. When the first non-transitional federal government was (s)elected in Mogadishu in 2012, efforts began to collect domestic revenue, particularly indirect taxes. However, these initiatives were hampered by a variety of factors, including an active conflict, weak public institutions, inadequate infrastructure, and a narrow revenue base as the government's writ did not reach beyond certain districts in Mogadishu.

The formal approval of the government budget by the parliament in late 2012, reflects Somalia's initial efforts to rebuild state institutions and improve fiscal management. The 2013 budget of \$114 million marked a significant milestone in this process (Somali Public Agenda, 2018). The Federal Government of Somalia's (FGS) budget has steadily increased throughout the years, as shown in Table 1.1. International trade taxes through Mogadishu seaport and airport and the government regaining the management of the Somalia's aviation and licensing fishing companies has played a key role in increasing domestic revenue.

Concession agreements, particularly on the Mogadishu seaport and airport with the Albayrak Group and Favori LLC—Turkish-owned companies—were also part of efforts to raise domestic revenue sources as non-tax revenues in 2014-16 (Abshir, et al., 2020). Moreover, in March 2023, the FGS has also reached a fiscal federalism agreement with four Federal Member States (FMSs) in Baidoa as part of the National Consultative Council (NCC)'s efforts to agree on contentious constitutional issues. Members of the NCC who met in Baidoa [agreed](#) to establishing a National Revenue Authority and the Committee of Appropriations and Revenue Acceleration. These two institutions have not yet been established.

Although the recurring theme of recent years has been 'A Reliance on Domestic Revenue', this has, in some cases, covered about half of the total budget, but more recently, this has only accounted for about a third of the total budget since 2019, as shown by Table 1.2. The total amount of projected domestic revenue has gradually increased, but its coverage within the total budget in percentage has decreased since 2016. This has related to increasing government expenditure, which has outpaced increases in domestic revenue generation, and is also partly due to increased budgetary support from international donors.

Table 1.1: FGS Annual Budget and Change in Domestic Revenue 2016-2024

Year	Projected Domestic Revenue	Total Projected Budget	Domestic Revenue % of Total Budget	% increase/decrease in domestic revenue
2016	\$139 million	\$246 million	56%	(↔)
2017	\$164 million	\$267 million	61%	18% ↑
2018	\$156 million	\$274 million	56.9%	4.9% ↓
2019	\$189 million	\$344 million	54.9%	21.2% ↑
2020	\$234 million	\$476 million	49%	23.8% ↑
2021	\$260 million	\$671 million	38%	11.1% ↑
2022	\$250 million	\$929 million	26%	3.8% ↓
2023	\$283 million	\$977 million	29%	13.2% ↑
2024	\$346 million	\$1 billion	33%	22.3% ↑

Two factors have driven the recent push to increase domestic revenue. The first is external debt relief, supported by the International Monetary Fund (IMF) and the World Bank. Reforms to increase domestic revenue were partly a prerequisite for the completion of the Heavily Indebted Poor Countries (HIPC) initiative, which included the imposition of levies such as the new sales tax.

The second is the inherent domestic need for economic stabilization and a desired shift away from reliance on foreign aid to domestic revenue production. Increasing taxation and exploring alternative ways to increase domestic revenue is needed to put Somalia's government on a sustainable footing, and this should not be entirely seen as an externally imposed initiative (driven by HIPC). For instance, Somalia's tax-to-GDP ratio is extremely low and remains among the lowest in Africa. Even Somalia's existing taxes on trade are low when compared, for instance, with the tax rates of other countries in the East African Community (EAC). This highlights the importance of domestic revenue mobilization for economic stabilization and increased fiscal responsibility, with the sales tax as one part of that strategy. The discussion among Somali stakeholders should focus on the efficiency, fairness, and transparency of different revenue generation mechanisms, with these shared fiscal sustainability goals in mind.

This policy paper draws from a forum held by Somali Public Agenda (SPA) on September 3 2024 following the introduction of the new sales tax, as well as, existing literature, and interviews with businesspeople, FGS Ministry of Finance, and the public. It seeks to provide an analysis of Somalia's newly implemented 5% sales tax and its economic, fiscal, and social implications. It explores the problems that may impede its successful implementation and investigates the public response to the tax from various socioeconomic viewpoints. Finally, the paper informs policymakers, stakeholders, and the general public by identifying opportunities

and challenges and presents practical suggestions for balancing budgetary goals with economic stability and social welfare.

THE INTRODUCTION OF THE SALES TAX

Law No. 2, issued January 7, 1984, which amended the law of November 5 1966, has been, until recently, the legal base for the sales tax. However, the new 5% sales tax was incorporated in the 2024 budget appropriation act, in line with fiscal reform pledges made during the HIPC process. Chapter Four of the Appropriation Act for the 2024 Budget was dedicated to a discussion of the expansion of the scope of the 1984 Sales Tax Act. The primary reason was that the scope of the 1984 sales only extended to imported goods, wholesale trade, hotel invoices, and products manufactured by factories, and did not allow for the expansion of the sales tax to final consumers.¹ The new sales tax, which the parliament gave a legal base as part of the 2024 budget appropriation act, covers a larger range of goods. These include electricity, televisions, water, professional services (including those provided by lawyers, notaries, accountants, and agents of shipping companies), private security services and other similar providers, communications, publications, retail, restaurants, insurance, health services, transportation services, banks and remittances, and any other business not listed above but selling a service or product.² This increase in taxed products has intensified public criticism since it directly impacts everyday essentials such as food and utilities, which are crucial for low-income families (Ahmed & Nur, 2024).

Table 1.2: Difference Between VAT and Sales Tax

Feature	Value-Added Tax (VAT)	Sales Tax
Definition	A tax levied on the value added at each stage of production or distribution.	A tax imposed on the final sale of goods or services to the consumer.
Application	Charged at every stage of the supply chain (manufacturers, wholesalers, retailers).	Charged only at the point of sale to the final consumer.
Tax Base	Covers both goods and services, ensuring broader revenue collection.	Typically limited to goods, with services often excluded.
Transparency	Provides detailed records at each stage, aiding in tracking tax compliance.	Simpler but less transparent as it focuses solely on the final transaction, leaving the earlier stages unaccounted for.

¹ You can access and read the 1984 Sales Tax Act here: <https://revenueauthority.gov.so/sites/default/files/Darman%20Income%20tax%20and%20sales%20tax.pdf>.

² You can read the appropriation act for the 2024 federal government budget here <https://mof.gov.so/publications/appropriation-act-2024-budget>.

Feature	Value-Added Tax (VAT)	Sales Tax
Revenue Potential	Generates higher and more consistent revenue due to broader coverage.	Generates less revenue due to limited application to final sales.
Compliance Requirements	Requires proper bookkeeping and reporting at all stages of the supply chain.	Less complex compliance since it only applies at the retail level.
Adoption in Somalia	Somalia is considering VAT as part of tax reform efforts to boost revenue.	Sales tax is currently more common but has limitations in collection.

While the general public doesn't oppose the levied tax, it complains about its broader scope and inadequate service compensation. The 5% rate of the new tax was also a hotspot for debate. The President of Somalia, Hassan Sheikh Mohamud, has highlighted that according to the East African Community countries, Somalia imposes the lowest sales tax rate on its citizens. EAC member states, particularly Uganda, have a higher rate of 18% but don't levy this on essential commodities (Ali, 2024). Businesspeople, in particular, are concerned about arbitrary taxes imposed at checkpoints and customs compounded by overlapping regional and federal taxation.³

Prime Minister, Hamze Abdi Barre, and Minister of Finance, Bihi Iman, had met with the businesspeople to discuss the challenges they face and the newly imposed tax. The Prime Minister and his cabinet then passed a resolution aimed at eradicating all unlawful payments and guaranteeing that government money is received solely through the Single Treasury Account (TSA). The resolution demanded actions to simplify operations, reduce arbitrary charges, and resolve concerns from merchants and enterprises, as well as, considerable reductions in customs costs, especially those at the Mogadishu seaport and Afgoye Road.⁴ Critics pointed out that those businesspeople were from the elite and could not speak for the medium and small business owners who weren't at the table.

The 5% sales tax has received resistance from a wider spectrum of stakeholders, including businesspeople, political elites, and some lawmakers. Business owners claimed that the sales tax would increase operating costs, raise prices, and reduce consumer demand. Even though parliament had already approved the expansion of the scope of the sales tax as part of the 2024 FGS budget. Meanwhile, some MPs have accused the government of increasing the financial strain of already struggling citizens. This opposition reflects a common cynicism about the government's capacity to successfully handle the imposed tax, as well as a concern that the new tax may exacerbate economic hardships for ordinary people.

3 Watch this Daauus Media video <https://youtu.be/X4VeQsZ9VV0?si=bQzvryh3AMxzCN2->

4 Read the resolution here <https://www.facebook.com/share/p/15Uwbh4swM/?mibextid=CTbP7E>

THE 5% SALES TAX IN EFFECT

On August 18 2024, the five percent (5%) sales tax was set in motion. The implementation and the adoption of this new sales tax is limited to Mogadishu due to the lack of a functioning and agreed upon fiscal federalism arrangement and limited tax harmonization among the federal government and Federal Member States (FMSs).

Although the sales tax is imposed on all businesses in Mogadishu, different districts of the city vary in terms of business compliance and the government's capacity to enforce implementation. There is a widespread public tendency to avoid the five percent sales tax. Some businesses themselves evade adding the sales tax to bills due to fear of losing customers. They evade the tax by not using the merchant accounts but instead unregistered mobile-based money wallets or accepting cash for high-priced items (even though it's rare to carry cash, and there are shortages of physical banknotes). Major markets and businesses in the central business districts comply mostly with the new sales tax due to strong government enforcement capacity. On the other hand, businesses in the peripheral districts and small shops in neighborhoods are the least compliant. This disparity in compliance could be attributed to retaining customers who are sensitive to price increases. This concern is common in lower-income areas where price hikes can significantly affect demand.

The 5% sales tax is not a new tax form, as the previous government attempted to implement it particularly in hotels as one of the components of 1984 sales tax. However, enforcement was limited due to its inability to effectively monitor the compliance of the sales tax. This re-introduction of sales tax, using merchant accounts and collaboration with commercial banks, enables the government to monitor businesses' bank and merchant accounts and automatically transfer the 5% tax to its central account. Currently, the levying of the sales tax depends on the mobile money merchant account system, and there is no mechanism for the payment of the tax on cash transactions. This tax is also not collected on account-account transfers, which are commonly used for large USD purchases.

Officials from the Ministry of Finance participated in several public forums, addressing people's questions on the tax. It also engaged some businesses on tax calculations in the first weeks of its collection in Mogadishu. The government then started to hold businesses accountable for tax evasion. The awareness-raising efforts weren't widespread enough to communicate the government's message effectively among public, and there was a short period between the imposition of the tax and punishment for those who tried to avoid it. The Ministry of Finance further attempted to enforce compliance through representatives in the district administrations. They served letters to some businesses by hand requesting bank

account statements, Enterprise Resource Planning (ERP)⁵ System Statements and mobile money merchant account statements between August 18 – October 30. This is to cross-check information from each document and look for discrepancies.

The government has attempted to play an active role in enforcing tax compliance on businesses but this has varied significantly between different parts of the city. Major markets and companies in central business districts generate significant income, which translates to higher tax and are more easily accessible than businesses in peripheral districts and small shops, which generate less income due to fewer and smaller transactions. With limited government staffing for tax compliance at every business in the city, it has prioritized major markets and businesses in central districts, at least for the early phase. They may also go and check businesses in the peripheral districts, although limited due to the uncertain security conditions in these areas.

The 5% sales tax has noticeably affected the public, particularly consumers who purchase goods and services. It has introduced an additional five percent on almost everything they purchase. This value mounts up in their daily purchases, from monthly groceries to additional needs and wants. The new sales tax covers virtually all goods and services, including necessities such as staple foodstuffs, health care, water, and electricity. Some people claimed that the price of goods has increased not only by the five percent, but by additional amounts that businesses have added to goods. This further burdens low-income households which struggle afford essential goods and services.

The sales tax has become a new source of government revenue and contributes to the coverage of some of the FGS' budgetary obligations. It has allowed the government to generate 550,000 USD in 10 days.⁶ With a proper enforcement and increased awareness and compliance, the sales tax revenue could increase, and this is what is projected by the Revenue Directorate of the Ministry of Finance in their Medium-Term Revenue Roadmap 2024 – 2027. It is expected that the growth will continue in the next three years as illustrated at Table 1.3.7

5 An ERP is a software system that businesses use to manage and integrate the important parts of their businesses, including, planning, purchasing inventory, sales, finance, human resources, and more.

6 See the remarks of the Director of the Directorate of Revenue on the amount of money collected in the first 10 days of the tax <https://youtu.be/ZqonVbXMs64?si=EUaoMfrhXpoy9rmF>

7 You can access the Ministry of Finance Somali Medium-Term Revenue Road Map 2024–27 here <https://www.mof.gov.so/publications/somali-medium-term-revenu-road-map-2024-27>.

Table 1.3: Sales Tax Trends and 2021-2027 Estimates (Figures in Millions)

Description	2021 Actual	2022 Actual	2023 Actual	2024 Estimate	2025 Fore-cast	2026 Fore-cast	2027 Fore-cast
Domestic Revenue	\$229.4	\$262.9	\$329.5	\$357.4	\$423.5	\$513.4	\$602.0
Tax Revenue	\$162.6	\$182.1	\$227.8	\$253.4	\$295.3	\$369.9	\$435.7
Sales Tax	\$23.4	\$25.8	\$34.9	\$47.2	\$50.6	\$64.3	\$78.8

The revenue from the existing and more limited sales tax was already gradually increasing over the last 3 years from 2021 to 2023, alongside domestic revenue and the broader government tax receipt. It's estimated that this year (2024) will also witness a significant increase. In 2023 and 2024 the sales tax increased by 35.3% and 35.2% respectively, considering that the increase this year can be partly attributed to the introduction of the expanded 5% sales tax imposed in the previous three months starting from August 18.

Over recent years, sales tax revenue's role within the total tax receipt of the government has significantly increased, from 14.4% in 2021 to 18.6% estimated for the end of 2024. It's projected that the sales tax revenue share within the tax revenue will stabilize around 17% & 18% of the total over the next three years 2025 – 2027. Furthermore, the sales tax revenue will account for 13.2% of the total government's domestic revenue generation, an increase from 10.2% in 2021.

The increasing role of the sales tax indicates a growing reliance of the government on consumer-driven revenue. This suggests that government revenue will be more sensitive to changes in consumer behavior. As sales tax becomes a more prominent revenue source, it will be essential for the government to carefully assess how fluctuations in consumer spending, influenced by broader economic factors, may affect financial stability. This necessitates the implementation of adaptive fiscal strategies. One such challenge will be the public demand for a zero-rate tax on essential goods and services, such as hospitals, which is crucial considering the high unemployment rate and prevalence of low-income households.

To sustain the growth to reach the projected government income, the federal government should ensure a wider implementation and compliance with the new 5% sales tax across Mogadishu and expansion into the FMSs. More importantly, the new sales tax can further open up discussions around accountability considering the fact that the 5% sales tax paid by citizens in Mogadishu will create a heightened sense of awareness around demands for public services and questions about state expenditure.

SALES TAX TECH-COLLECTION PROCESS

One of the things that has allowed the government to implement and “efficiently” collect the new sales tax, is the use of digital technology. In this regard, the government has established a system facilitating tax collection processes. Every business in Mogadishu uses mobile money or e-wallets to pay and receive money as the main method of transactions. This is partly because of the limited availability of the older, non-divisible, and increasingly worn-out 1,000 Somali Shilling notes in Mogadishu. A couple of years ago, telecommunications companies and banks (which are often interlinked) encouraged all businesses to open merchant accounts connected to mobile numbers and business bank accounts, instead of regular accounts that were only linked to a specific phone number. This step would later become crucial for the sales tax collection as the government has continued on this path and ordered all the remaining businesses to open merchant accounts.

Telecommunications companies and banks provide these merchant accounts to businesses. The government, with the help of these companies, has integrated and connected its tax collection system to the merchant accounts of every registered business. The system connects the business merchant accounts to the government’s single-treasury account. The system in place is programmed to automatically and immediately deduct the five percent sales tax from every business transaction that the business’s merchant account receives and sends the amount to the government’s single treasury account, ensuring immediate tax collection at every transaction.

However, business owners have expressed concerns about the accuracy and reliability of the system at the early stages of the new sales tax collection. They told Somali Public Agenda researchers that the system was deducting more than five percent that was due to a single transaction. They believed the system was double taxing the full amount with the five percent tax instead of separating the original price and the five percent tax and then deducting only the five percent. Nonetheless, this problem was not evident after our researchers tested this with the help of a businessperson’s merchant account.⁸

Although our researchers verified that the system didn’t double tax, some business owners stated that they were adding more than the imposed five percent on every transaction based on their perception of this (nonexistent) problem. This may also be attributed to business people’s desire to look for excuses that would help them increase their profit, taking advantage of public confusion about the newly introduced tax. Regardless of the exact reasons, it is quite evident that there has been a widespread increase in the prices of goods in Mogadishu.

Nevertheless, businesses also face genuine issues with the new sales tax

8 A SPA researcher together with a businessperson monitored the merchant account for one day’s transactions. This was done by checking the merchant account balance in advance and immediately after a sales transaction with the 5% sales tax included.

collection system. Firstly, there are problems when they refund customers when they return goods or when services were incomplete. Businesses don't have access to the system to request the refund on the 5% sales tax that the system deducted automatically from their merchant accounts. They currently have no way to recover this amount. Our researchers communicated this issue with officers from the FGS Ministry of Finance who stated that businesses can reach out to them in those situations to solve this issue. However, the system designed to collect the sales tax doesn't offer a clear channel of communication and there does not seem to be a standardized process for refunds.

Second, the system doesn't notify businesses after the five percent tax deduction has been taken from every transaction. Businesses receive a message following every sale that displays receipt of the full amount - including the five percent sales tax and stating that this has been added to his/her merchant account balance. However, the five percent sales tax is immediately deducted from their accounts but without notification or message indicating that this has taken place. This could be one of the reasons why business owners believed that the system was deducting more than five percent. The majority of businesses in Mogadishu don't have professional accountants or systems. They rely on the messages and account balances for accounting and when they receive a message showing them an amount higher than the one in their balance, it may create confusion for people with limited understanding and awareness on how the tax deduction works.

CHALLENGES TO THE IMPLEMENTATION OF THE 5% SALES TAX

There are several challenges to the implementation of the sales tax. First, there is limited administrative and institutional capability. While the flat, uniform sales tax has been designed to be simple to implement, the method of taxing merchant mobile money accounts comes with drawbacks, including the fact that vendors in the informal economy often do not have merchant accounts, allowing them to avoid the tax altogether. The informal economy – comprising sectors such as retail, food markets, and services – accounts for a sizable share of the Somali market. This creates a considerable hurdle to the sales tax compliance since informal sellers are now unlikely to register a merchant account for tax purposes. Importantly, the size of the informal economy and the scope of tax avoidance that is likely to occur as a result is unknown. This is exacerbated by the lack of enforceable telecommunications regulation where – in the absence of a national ID system – sellers can have multiple Sim cards for storing non-taxed revenues. It is also unclear how effectively the government will be able to compel merchants to use their merchant accounts instead of shifting transactions through their personal accounts. Furthermore, all cash sales are effectively untaxed, as are account-account transfers.

Second, insecurity and instability remain challenges that prevent the wider implementation of the 5% sales tax in Mogadishu and potentially in the Federal Member States (FMSs) in the future. It hinders government access to businesses in Mogadishu's peripheral districts and settlements, such as Heliwa, Daynile, Yaqshid, Garasbaley, and Suuqa-Xoolaha. In these locations, the government is currently unable to enforce the use of merchant accounts that incur the sales tax instead of their regular mobile phone numbers. This is because the tax collecting officers can't often go to these areas due to real security concerns. A similar case can be seen in the recent federal government efforts to mandate the installation of CCTV cameras at all businesses in Mogadishu. This left many business owners in fear as al-Shabaab had been threatening them not to install the CCTV cameras (particularly in the Mogadishu periphery districts) and the government has limited capacity to protect them from retaliatory violence.

Third, cultural factors also contribute to the tendency of tax avoidance. Somali citizens pay contributions through a religious practice known as Zakat, which is an annual payment of 2.5% on accumulated wealth that is given to support the impoverished. They also pay qaaraan (fundraising contribution) through trusted clan elders. Standardized taxation by the government is almost an alien concept, particularly when it hasn't been delivering essential services to its citizens. Bad governance and abuse of power by government officials (such as soldiers) exacerbate this tendency. Soldiers collect money (informal taxation) at checkpoints and business stores. This creates a negative perception of government and significant public resentment (Abshir, et al., 2020). Although tax avoidance is

a global phenomenon, the 5% sales tax imposition on all goods and services has spurred anti-government sentiments.

Fourth, public mistrust and resistance also presents a huge obstacle. The public trust in government institutions remains low, fuelling opposition to the newly implemented sales tax. Years of political instability, poor administration, and Somalia's poor status in the global corruption perception index and good governance indices have raised legitimate concerns about whether the new 5% sales tax would be used to benefit the public or merely further burden ordinary citizens.

The low public trust is partially caused by the limited public awareness and tax literacy. A lack of public knowledge and comprehension of how the sales tax works is another important impediment. Many companies and customers lack sufficient awareness about the sales tax procedures, compliance requirements, and how the tax will affect them. Without awareness-raising campaigns and technical assistance, there is a risk of noncompliance. This impact was seen as some sellers have taken advantage of the lack of information by overcharging customers for their own benefit.

Fifth, the sales tax is only effective and implemented in Mogadishu. The government's capacity to apply the sales tax is centered in Mogadishu, and this causes opposition and concerns that citizens in Mogadishu alone pay the sales tax burden as people and businesses in the FMSs aren't included. If this concentration of taxation in Mogadishu persists, it could potentially lead to revenue decline in the future as businesses and enterprises might relocate to the FMSs – as happened when income tax collection from nongovernmental organizations started in Mogadishu in 2018. On the other hand, expanding the sales tax to other regions will necessitate firm agreement on revenue allocation across levels of government, which remains a contentious issue.

Sixth, efforts to reduce the impact of the tax on the poorest citizens will be hampered by the efficient, but blunt, collection system. One way to make the sales tax less regressive is to establish exceptions for basic goods, such as food and medicine. However, transactions through merchant accounts do not include detailed information on the goods being sold, making it impossible to allow exceptions to the tax under the current system. The current limitation of sales tax to mobile money merchant accounts may insulate some of the poorest consumers (who work and buy goods in the large informal economy) from price increases, although this would require further research.

Seventh, the implementation of the sales tax is projected to have a mixed economic impact. On the one hand, the tax might provide much-needed funding for government services, infrastructure, and social initiatives. On the other side, it may lead to inflation, particularly in vital products such as food and basic services such as health, which are already prone to price instability. As consumer purchasing power diminishes, demand for goods and services may fall, limiting economic growth and worsening poverty.

Finally, the mobile money sales tax could also reduce the incentive for the government to print new physical cash (a promise the FGS has been making for many years). In fact, the government may want to discourage cash use altogether in order to maximize tax revenues and enhance digital financial governance. While mobile money is hugely useful for marginalized populations, research suggests that when this is the only option for transactions (in the absence of cash), it can cause issues for the poorest segments of society (Chonka & Bakonyi 2021; Chonka, Sahgal & Wasuge forthcoming).

POLICY RECOMMENDATIONS

Develop the capacity to implement more sophisticated tax regimes

- **Exploring the possibility of exempting the sales tax from essential goods and services:** the federal government could exempt essential goods and services from the sales tax, for example, food items, healthcare services, and utilities such as water and electricity. The exemption of these and related essential goods and services could reduce the financial burden on low-income families. However, any exemption may open up the possibilities of abuse, and require efforts to verify compliance. One starting point could be to work with the mobile money operators to create an additional ‘tax free merchant account’ that could be given to, e.g., public health facilities. If this works, it could then be replicated for other essential goods and services.
- **Investigating other methods for reducing regressive taxation:** because sales tax exemptions increase the administrative burden of monitoring and enforcement, the government could consider maintaining the flat, uniform tax rate but look for other methods to reduce the prices and tax burden on food and other basic goods. This could include targeting these goods for reduction of taxes charged at internal ports of entry (e.g., between Afgoye and Mogadishu) and reduction of duties for imported food or medicines.
- **Building tax administration capacity:** even with an automated tax collection method, improving the efficiency and openness of tax administration such as enhancing digital system accuracy and transparency is critical to effective implementation of the sales taxes. To ensure a seamless implementation, tax officers will need training programs on digital system operation, data analysis, system updates, and so on. Training the tax collectors and supervisors also needs to include the upholding of citizens’ rights and avoidance of any sort of harassment. Issues with tax evasion or fraud must be dealt with according to proper legal processes.
- **Exploring alternative revenue streams:** while the 5% sales tax can provide a consistent and reliable domestic revenue, the federal government should look at additional revenue streams to diversify its economic basis. The sales tax, similar to VAT, is quite regressive and disproportionately shifts the tax burden onto the poorest in society. Other sources of revenue may be less regressive and counterbalance this. Increasing tariffs on luxury items, extending property taxes, payroll tax, and digitalizing customs revenue collection are all potential options to supplement the sales tax. A diverse revenue approach reduces reliance on a single tax instrument, improving budgetary sustainability.

Strengthen transparency and accountability to build public trust

- **Increased transparency and improving public service delivery:** the government should publish comprehensive information on sales tax revenues and their expenditure, as well as, create independent supervision to ensure tax collection. Moreover, since the sales tax is now collected only in Mogadishu, the federal government should allocate a portion of this revenue to the provision of key public services such as roads, clean water, security, education and healthcare to citizens in Mogadishu. This will reduce the increasing feeling in Mogadishu that the federal government is only interested in collecting money and is not willing to provide public services in return. These efforts will increase public trust and compliance with the tax regulations.
- **Closing the public trust deficit gap:** strengthening the governance and transparency around already-collected revenues would increase the trust and the legitimacy that the citizens would give their government. For instance, the Auditor General's Office has highlighted that five separate investigations have disclosed serious misconduct by Albayrak Group and Favori LLC, citing that the necessary documents for audit review weren't made available (Mustaqbal Media, 2024). Similarly, there is a concern that public property, primarily land, has been auctioned in recent months without following proper legal procedures. Citizens will be more likely comply with taxation requirements others when the federal government demonstrates good governance.
- **Increasing public awareness, education, and stakeholder engagement:** to increase public trust and compliance, the federal government must conduct comprehensive public awareness efforts and inform citizens. These efforts should clarify the sales tax's objectives, how it will be implemented, and how the funds will be utilized to benefit the general population. Engaging with important players, such as corporations, civic society, and community leaders will promote collaboration and reduce opposition.

Prioritize intergovernmental fiscal relations

- **Equal implementation of the sales tax:** the federal government should increase its efforts to ensure comprehensive compliance with the sales tax equally across the whole of Mogadishu, particularly through education, support and engagement with businesses in the peripheral districts and nearby neighbourhoods. This would increase the sales tax revenue, generate more public responsibility over the long-term, and pave the way for wider expansion of the sales tax in the FMSs (although this will require tax harmonization and implementation of the agreed-upon points of fiscal federalism).

REFERENCES

- Chonka, P. and Bakonyi, J. (2021) 'Precarious technoscapes: forced mobility and mobile connections at the urban margins'. *Journal of the British Academy*, 9(S (11)), pp.67-91.
- Chonka, P., Sahgal, G. and Wasuge, M. (forthcoming) 'Mobile money, (dis)empowerment and state-reconstruction in Somalia's conflicted digital economy' accepted/in press for *International Affairs*
- Somali Public Agenda, 2018. Review of Somalia's 2018 budget for public services and economic development. [Online] Available at: <https://somalipublicagenda.org/review-of-somalias-2018-budget-for-public-services-and-economic-development/>
- Abshir, S., Abdirahman, K. & Stogdon, H., 2020. Tax and State in Somalia: Understanding Domestic Revenue Mobilization. [Online] Available at: <https://riftvalley.net/publication/tax-and-state-somalia-understanding-domestic-revenue-mobilization/>.
- Mustaqbal Media, 2024. Somalia's Auditor General Exposes Major Scandal Involving Turkish Firms Managing Mogadishu's Airport and Port. [Online] Available at: <https://mustaqbalmedia.net/en/somalias-auditor-general-exposes-major-scandal-involving-turkish-firms-managing-mogadishus-airport-and-port/>
- Ahmed, M. O. & Nur, M. S., 2024. Somalia Traders Shut Businesses to Protest Sales Tax. [Online] Available at: <https://www.bloomberg.com/news/articles/2024-08-19/somalia-traders-shut-businesses-to-protest-imf-backed-sales-tax>
- Ali, A., 2024. Canshuurta iibka ee lagu soo rogay Soomaaliya ma ka culays yar tahay tan dalalka Bariga Afrika?. [Online] Available at: <https://www.bbc.com/somali/articles/cm2nkvxyx250>

ABOUT SOMALI PUBLIC AGENDA

Somali Public Agenda is a non-profit public policy and administration research organization based in Mogadishu. Its aim is to advance understanding and improvement of public administration and public services in Somalia through evidence-based research and analysis. At Somali Public Agenda, we believe that all Somalis deserve better public services including access to affordable education, healthcare, housing, security and justice delivered via transparent and accountable authorities.

What We Do

Research: Somali Public Agenda contributes to the understanding and improvement of public administration in Somalia through research and analysis on various issues that affect public policies and the provision of public services. SPA regularly publishes research reports, governance briefs, and commentaries (always in both the Somali and English languages) on decentralization, public bureaucracy, and local administration; democratization and elections; financial governance; security, justice, and rule of law; urban planning and land administration; employment; and, education system and health services. These publications often inform citizens, policymakers, practitioners, and international actors on governance and public service issues in Somalia.

Dialogue: Public Agenda Forum is a platform and space for discussions on governance and public service issues in Somalia. The Forum (including Gaxwo & Gorfeyn monthly meet-ups) serves as an avenue for critical examinations of issues of public priorities. Different segments of society including researchers, policy-makers, and practitioners are invited to meet and discuss issues on equal terms. The Public Agenda Forum convenes dialogue with policy-makers and public figures and organizes workshops, policy design sessions, seminars, and book/report launches. Often the findings of the Forum discussions help inform Somali Public Agenda's governance briefs.

Public Service Design: Based on the findings and policy recommendations of our studies, we design public policies, programmes, and projects with the relevant authorities through our SPA Policy Lab. In collaboration with policymakers, public administrators, and the community, we design knowledge-based public services. Before the government invests resources in the policies, programmes, and projects designed, we envisage experimenting with the public service at a small-scale level to test the efficacy of the services designed.

Training: Based on the findings of our research and our co-designing work, Somali Public Agenda through its Center for Learning and Development offers short training courses to contribute to the building of administrative cadres that can deliver public policies and programmes to the community. The Center for Learning and Development's aim is to connect the civil servants, policymakers, and non-profit sector workers with communities and provide administrations with the technical skills necessary to formulate and implement solutions for public service challenges. Moreover, the center offers training to Somali professionals who have the desire and passion to join the public sector as well as professionals engaged in the civil service and non-profit sectors.

Somali Public Agenda

Mogadishu
Somalia

Tel: +252(0)85 8358

Email: info@somalipublicagenda.org

Website: <https://www.somalipublicagenda.org>

