ADMINISTRATIVE IMPLICATIONS OF EXTENDING VALUE ADDED TAX (VAT) TO WHOLESALE AND RETAIL STAGES IN MALAWI

MASTERS IN BUSINESS ADMINISTRATION

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THE POLYTECHNIC

JULY 2008

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by

SUNGANI MWALE

A dissertation submitted to the Faculty of Commerce, The Malawi Polytechnic, in partial fulfilment of the requirements for the degree of Master of Business Administration.

JULY 2008

DECLARATION

I declare that this research report is my own, unaided work, except where acknowledged in the text and references. It has not been submitted before for any degree or examination in any other university. Where work of others has been used, acknowledgements have been given.

Candidate ____

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Date____

CERTIFICATE OF APPROVAL

We declare that this dissertation is from the student's own work and effort. Where he has used other sources of information, it has been acknowledged. This dissertation is submitted with our approval.

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DEDICATION

To my beloved mama, Betty Nyamwanza, my son Mthuthuzeli and my lovely wife Debbie. Mama you are ceaselessly inspirational, your mama Emelia Nabanda taught me that where there is a will there will always be a way. Deborah and Thuthu your love never fails.

ACKNOWLEDGEMENTS

With pleasure, many thanks should go to my family for their support and encouragement. These are people who have been there for me at all times more especially when things appeared hazy.

My gratitude should also go to Mr Bentry Mkwara who always found time for me in his supervisory role in spite of the ever heavy load on his desk. Sincere thanks should also go to Professor P. Simukonda, Mrs N.A. Katenje and all the other Lecturers who took me through in this MBA program. The rigour of the program adds the flavour.

I would also like to thank management and staff of MRA for the endearing support showed in various ways. And without being exhaustive my sincere appreciation should specifically go to Dr. Khwima Nthara, Economist for World Bank Malawi office and MBA group 5.

Above all, praised be the Lord for it is only through His will that anything becomes possible. Lord you give me the strength, guidance and I am always grateful to you for the smile that you put on my face in many ways.

ABSTRACT

Value added tax (VAT) in Malawi has recently been extended from the manufacturing stage to wholesale and retail stages and seems to become the mainstay of the tax revenue. This study was carried out to investigate the administrative implications of this extension.

To determine the administrative feasibility of the extension, this study examined the effectiveness of the current administrative provisions, and semi structured questionnaires were designed and administered to a probability systematic sample of 102 major stakeholders of VAT in Malawi comprising VAT registered taxpayers, and tax administration officials directly involved with the operation of VAT. The purpose was to ascertain their attitudes toward the current administrative provisions and the resultant implications. The data collected were analyzed using SPSS, Microsoft Excel, and Decisional Analyst.

The results of the research were tabulated and groups of responses were analyzed using descriptive statistics. The Chi - Square test was used to provide a statistical foundation to accepting or rejecting the null hypotheses. The study found statistically significant differences ($p < 0.05$) in the attitudes observed and those expected regarding the two null hypotheses about the feasibility of the current VAT administrative provisions, and whether the extension of VAT to wholesale and retail stages has contributed to the administrative implications. Both of the null hypotheses were rejected.

It is therefore concluded that the current administrative provisions are feasible for effective management of an extended VAT scope in Malawi. Secondly, it is also concluded that the extension of VAT to wholesale and retail stages in Malawi has contributed to administrative implications. These findings suggest that there is more work to be done to improve VAT administration. The results have led to recommendations for a staged approach to improve systematic information management and review the minimum turnover limit for registration for VAT.

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LIST OF ABREVIATIONS

CTL	Commercial Transaction Levy
DFID	Department for International Development
DTE	Developing and Transitional Economies
EC	European Community
EU	European Union
GDP	Gross Domestic Product
FAD	Fiscal Affairs Department
FBT	Fringe Benefit Tax
IMF	International Monetary Fund
MRA	Malawi Revenue Authority
NTA	National Tax Agency
OECD	Organization of Economic Corporation and Development
PAYE	Pay As You Earn
SADC	Southern Africa Development Community
SARS	South African Revenue Services
SATI	Southern Africa Tax Institute
TPIN	Taxpayer Personal Identification Number
UNISA	University of South Africa
VAT	Value Added Tax
WHT	Withholding Tax
WTO	World Trade Organization

CHAPTER 1

INTRODUCTION

1.1 BACKGROUND

The importance of increasing public revenues effectively in most developing countries cannot be overemphasized. Given the significance of public investment in enhancing economic growth and meeting other social goals, and the need for fiscal sustainability, it is absolutely critical for governments to focus on methods of raising revenues effectively.

In view of the problems such as inflationary effects and political conditions associated with foreign loans, it is considered that the main obligation for raising additional revenue must rest with taxation apart from the other sources of funds such as public enterprises and user charge (Chipeta and Chulu, 2000). As such, to improve tax administration, in developing countries, the more specific issues of taxation have been examined in various tax jurisdictions. As Kusi (1998) has pointed out, among the more specific tax issues, attention needs to be given to the composition of the tax structure as well as to the design of its major components. As such many countries have resorted to reforming their tax regimes by introducing new tax and/ or improving the tax administration.

Basically, taxes can be divided into two broad categories namely, direct taxes on individuals and corporations, and indirect taxes on a variety of goods and services. In Malawi examples of direct taxes are income taxes such as corporation tax, fringe benefit tax (FBT), with holding tax (WHT) and pay as you earn (PAYE), and indirect taxes include excise, import duties and value added tax (VAT).

One of the most prevalent indirect taxes in the previous half a century in the World is the VAT. VAT is rapidly becoming the pivotal component of most of the tax systems in more than 120 nations around the world and seems to be carrying the increased weight being placed on the many developing and transitional economies (DTE) under pressure for new fiscal revenues for example to offset revenue losses from tariff reductions needed to accord with regional, continental trade agreements as well as the World Trade Organisation (WTO) requirements. To that effect the International Monetary Fund (IMF) has been very instrumental in the implementation of VAT in Malawi and so many other countries and attaches so much importance to its design and implementation.

The design of a particular tax seeks to address particular objectives such as revenue generation and improvement in administration. For revenue generation purposes, many stakeholders look at tax requirements in terms of the potential to raise a certain percentage of Gross Domestic Product (GDP) and that is of striking. For administrative purposes, this requires a great deal of understanding because the cost of collection should be kept as low as possible since every single amount spent on collecting revenue reduces the net contribution to the national revenue. Nonetheless, to date surprisingly little effort appears to have been made to help those engaged in such tasks to deal with some of the important questions. The problem is not simply to determine what would be desirable but also to assess what is administratively practicable within the specific country feasibility. Administrative simplicity is one of the general principles governments look into when deciding how best to raise the revenue they require (Stiglitz, 2000). For example one of the questions to ask might be: is the extension of VAT, in Malawi in tandem with this spirit?

The concept of VAT was developed to overcome the difficulties in conventional system of commodity taxation. This concept was developed particularly in West European countries where they have a common market of all Western Europe (Wang, 2001). The countries making up the then European Community (EC) found that if the goods were taxed on the basis of sale price, the idea of the European Common market would not be successful, as people would be discouraged to buy goods from other countries. The idea of VAT was evolved to overcome this difficulty. As a result of its perceived advantages, presently VAT has been introduced in over 120 countries including those in Africa, Asia, Europe, Middle East, South America and China.

Amongst the advantages advanced by proponents of VAT is that exports can be freed from domestic trade taxes, and that it provides an instrument of taxing consumption of goods and services, minimizes interference in market forces, and aids enforcement by providing audit trail through different stages of production and trade. Thus it acts as a self-policing mechanism.

1.2 TAX STRUCTURE IN MALAWI

When Malawi gained independence in the mid 1960s, it inherited a tax system based on that of the United Kingdom. This tax system has been characterized by Thirsk and Shalizi

(1990) to be a pattern more reminiscent of a developed country than that of a Sub-Saharan country because of heavy reliance on direct taxes. As much as 50 percent of total tax revenue was collected through personal and company taxes despite Malawi being a developing country, particularly one with little or no mineral wealth.

Since then the tax system has undergone through various changes as the country progressed through various economic situations. Malawi had embarked on a comprehensive tax reform in the mid to late 1980s with World Bank assistance. A pressing need for more revenue was created due to fiscal pressure resulting from a decline in foreign trade due to the closure of the rail lines in Mozambique and a drop in foreign aid. Government raised the rates on those tax bases that were administratively the easiest such as trade and income taxes. In 1984 the company tax rate had reached as high as 50 percent. However it became apparent that the hiking of the rates was not the ultimate solution hence it led to the reexamination of the tax system as a whole.

It was then decided that the reform should create a tax system that is not only revenue productive but at least as equitable as possible. This necessitated the shift of the base of taxation from production and trade towards consumption. Generally the proposed reform for VAT comes with a view that VAT is to operate side by side with the income tax, and that would take some of the weight off the income tax without imposing an excessive administrative burden (Kaldor, 1965). For equity purposes the idea is that taxation of individuals should be based on the expenditure, and not on their income. This overall approach was complemented with changes aimed at simplifying the administration such as improvement of procedures and eventually computerizing the tax administration and creating a tax analysis unit in the Ministry of Finance.

1.3 EVOLUTION OF VAT IN MALAWI

VAT is an indirect tax levied on consumption expenditure. In Malawi, VAT originates from what used to be called surtax. Government through the Ministry of Finance levies the tax and it is administered by an agency, Malawi Revenue Authority (MRA). Since April 1970 surtax (VAT) was levied up to the manufacturing stage on selected goods and services and importations when it was introduced under the Customs and Excise Act. Since then it has gone through a number of administrative transformations.

Initially, in the 1970s, a ring system was put in place to facilitate the administering of surtax in Malawi. The system allowed those registered for surtax an exemption using certificates. But this contributed to the heightened administrative demand of the tax. Shalizi and Thirsk (1990) assert that the system was sound in principle but problematic in practice because substantial administrative resources were required to administer the tax. To improve tax administration, Government as part of its tax reform programmes, replaced the ring system in the late 1980s, with a crediting mechanism, which in principle makes use of the VAT although it was not termed as such. Apparently Malawi was deemed to have VAT by 1994 by the Fiscal Affairs Department (FAD) of the IMF (Ebrill et al, 2001). The adoption of VAT, meaning extension to the retail stage – was then part of the IMF conditionality in 1996.

The Surtax Act (2001) in November 2002 permitted the imposition of surtax to be extended from the manufacturing stage to various distribution stages of wholesalers and retailers. In spite of the extension, the name surtax was maintained. Eventually the main law of VAT has been consolidated in the VAT Act that was effected in July 2005. The tax still operates on the same principles as an indirect tax levied on consumption. The term surtax should therefore not be confused with VAT. Since the time the extension was effected, the name remained surtax until recently when the new term was adopted.

According to IMF reports based on data available in 1999 in Malawi VAT (surtax) contributed about 36.2% of the total tax revenue or in other words the VAT raised accounted for about 5.7% of the GDP at a standard rate of 20% and other rates averaged at 10% (Ebrill et al, 2001). In 1979/80 surtax (VAT) was the largest source of revenue amongst all the other taxes forming the Malawi tax structure (Chipeta, 1998). This signifies that the tax is making a significant contribution. However, with the emerging problems that have rapidly grown with the extension it is worthwhile to consider the contribution specifically coming from the extended group.

1.4 PROBLEM STATEMENT

Even though it is generally believed that wholesalers and retailers contribute little to the total amount of net VAT revenue collected and that the revenue cost of excluding the sector from the VAT is thus not great, it appears to be difficult to exclude this particular sector in a VAT system. It has been stated that a very crucial objective in most transitional and developing jurisdictions adopting VAT is to limit the number of taxpayers to a figure that can be competently administered by revenue authorities (Krever, 2005).

The extension of VAT in Malawi intends to increase the revenue generation but at the same time maintaining the equity and efficiency characteristics of the tax. In terms of revenue generation VAT collection has progressively increased since the extension. According to MRA records, VAT revenue has increased by 198 percent in the years beginning from 2002 to 2006. More importantly the extension has also increased and continuously aims at increasing the number of taxpayers registered for VAT which since November 2002 to 2006 has increased by 246 percent. However, numerous problems have also been borne which compromise the other objectives.

The extension of VAT to the wholesale and retail trade sectors is part of the Government's reform strategy aimed at spreading out the tax net to the informal sector thereby relieving excess burden on the already highly taxed formal sector. Government through the Ministry of Finance suggests that widening of a tax base would help to reduce the tax burden (Malawi Government, 2005). The tax authority is faced not only with a challenge to register as many taxpayers for VAT as possible, but also to ensure that the tax administration is effective. Any amount of money spent on collection significantly reduces the contribution to revenue. Consequently widening the tax base without considering effective methods of administering the taxpayers will render the whole exercise less meaningful and hence the reduction of the VAT rate will remain a far-fetched dream.

Besides the challenge to register as many taxpayers and at the same time trying to control the cost of collection, VAT administration in Developing and transitional economy (DTE) has also been a great challenge in itself. For instance other tax experts and academicians have raised serious concerns over the VAT system adopted and its suitability in the DTE. One such concern is echoed by two authors Bird and Gendron (2005) who have expressed their concern in that the major question for DTE that already have a VAT of some sort is; how can they make a tax like VAT, which to work properly relies essentially on self assessment, function adequately in countries that often fail to meet what most would consider the necessary preconditions for self assessment systems?

In light of this, it is imperative to assess the current administrative provisions and examine the implications of the extension.

1.5 HYPOTHESES

In view of the problem statement presented above this study has tested the following null hypotheses:

a. The current administrative provisions are not feasible for effective management of an extended VAT scope.

b. Extension of VAT to wholesale and retail stages in Malawi has not contributed to administrative implications.

1.6 OBJECTIVES OF THE RESEARCH

The general objective of the research is to determine the administrative feasibility of extending the scope of VAT to wholesale and retail stages in Malawi.

The following were the specific objectives:

a. To investigate the feasibility of the current administrative provisions for effective management of an extended VAT base.

b. To investigate the administrative implications of extending VAT to wholesalers and retailers in Malawi.

1.7 SIGNIFICANCE OF THE RESEARCH

Experience shows that most specialists tend to ignore the importance of tax administration. Most literature on Malawi taxation contains the observation that a major principle or desirable characteristic of its tax system is that it should have minimum costs of collection and compliance consistent with effective enforcement. However, apart from a general statement of this type, which amounts to little more than a self-evident dictum, little research has been undertaken on problems of tax administration as distinct from tax policy.

A good tax system depends largely on two things: good tax policy and a good tax administration to implement this tax policy. This study concentrates on tax administration noting that while, the majority view the success of a tax in terms of the overall collection for effective administration it is important to realise that measuring the performance of VAT should not be restricted to revenue figures only. The cost equation of administering the tax should also be taken into account.

Studies by various researchers of VAT in low to medium income countries indicate that the implementation of VAT has been faced with administrative challenges. For example, Ebril et al (2001) found that although VAT can facilitate substantial improvements in overall tax administration, there have been some significant weaknesses in the VATs implemented in DTE in that there is a difficulty in coming up with workable self assessment systems. Another study by Glenday (2005) assessed the administrative capacities and implementation of VAT in SADC member countries. Glenday concluded that while some member countries have achieved a high level of sophistication and efficiency in tax administration, no country can claim to have achieved and implemented "best practices" in all areas of tax administration. Klun (2004) also examined performance measurements for tax administration in DTE. From his assessment, he discovered that a common problem with measurements in DTE, demonstrates that the tax administration is only weak in areas assessed using indicators derived from data it collects itself. This neglects soft indicators and work assessments assisted by taxpayers. The assessment of the administrative capacities in view of the implemented VATs are of fiscal, economic and social interest, given that they contribute to the development of the tax structures of the countries adopting the tax. It is therefore important to carry out more focussed studies on specific country VATs. At the same time focussed studies may serve two additional purposes: to identify those areas requiring specific country adjustments and provide detailed information on the specific country VAT.

This research questions further the administrative aspects of a broader VAT. The study focuses on administrative implications of the extension of VAT to wholesale and retail stages in Malawi. Because of its focussed approach the study includes data from the primary source of the taxpayer. Even though most illustrations for the suggested recommendations are drawn from the context of a VAT system, there are a lot more emerging issues that can provide solutions to the overall tax administration in Malawi.

From observations, the wholesale and retail taxpayers contribute to a good part of the issues aggravating the problems faced in revenue production of the VAT. According to Malawi Revenue Authority (MRA) management reports, the greatest concern in terms of administration is that this problem threatens the growth of VAT in the country. Given this background, the study will help MRA improve the effectiveness of administering VAT.

1.8 LIMITATIONS OF THE STUDY

Tax studies in developing countries are known to be very difficult because of restricted data (Ebrill et al, 2001). Most of the people have resentment towards taxation. Some of the respondents were hesitant to attend to the questionnaires for fear that the information might be used for tax assessments. Convincing the subjects of the reasons for the primary data was a major concern for this study especially the third group of respondents constituted of VAT registered taxpayers. As such, to overcome this limitation data collection was done in person by the researcher to persuade response to attain a more than fifty percent response rate.

1.9 ORGANISATION OF THE THESIS

The rest of the study is organised as follows: Chapter 2 is a review of the literature concerning the study. The chapter has focussed on establishing the context of the VAT administration in view of the inclusion of wholesalers and retailers by referencing to previous work. Chapter 3 focuses on the methodology used in conducting this study. The chapter highlights the data collection methods and the instruments used in collecting and analyzing data. Chapter 4 presents the results of the survey of the VAT administration structures and capacity to administer an extended VAT scope in Malawi. Chapter 5 discusses the outcome of administrable instruments. Finally, chapter 6 draws the conclusions and recommendations arising from the study including suggestions for future research.

CHAPTER 2

LITERATURE REVIEW

2.0 INTRODUCTION

This chapter provides the principles of VAT and approaches to VAT administration, both generally and in the context of the extension of the VAT system in Malawi. To understand the principles and approaches, a brief review of some of the pertinent characteristics of VAT that provide clues to the theoretical underpinnings and the conceptual framework of administering VAT are discussed. The discussion then proceeds to examining the extension of VAT to wholesale and retail stages in Malawi. More importantly this review is a prelude to trying to answer whether the VAT in place in the country is as good as it could be in administrative terms or that there could be a better way of adjusting it to suit the situation in Malawi. The discussion ends with an attempt to evaluate the impact of the extension in perspective of administration.

2.1 VAT DEFINED

As alluded to in the introduction chapter, as a result of the rapid and widespread adoption of VAT, the laws implementing the tax have adopted different terms and forms in different countries. Nonetheless, despite varying names and terminology, the VAT has a common core throughout the world (Thuronyi, 1996). It is a tax levied on all sales of commodities at every stage of production. To be more particular, it is an indirect tax aimed at taxing consumption at various stages of the economy.

VAT as an indirect tax is based on the view that it is a consumption tax imposed on firms but borne by consumers (Taylor, 1970). According to Taylor, the ultimate distinction is made between households and firms, products and buyers, in terms of indirect taxes in that households sell factors and buy products while firms sell products and buy factors. But the firms are the ones used as taxpayers by collecting VAT on behalf of Government. Similarly, Williams and Mendes (1975) define VAT as a consumer tax on the supply of goods and services by way of business. Mc Lure (2004) simply defines VAT as an indirect tax imposed on the value added of each stage of production and distribution until it reaches the final consumer.

However it is also argued that despite its name, VAT is not generally intended to be a tax on value added as such; rather it is intended as a tax on consumption (Ebrill et al, 2001). The essence of VAT is that it is charged at all stages of production, but with the provision of some mechanism enabling firms to offset the tax they charge on their sales of goods and services. It is a tax on consumer expenditure (Cnossen, 1996) therefore businesses (where they are registered and fully taxable) do not bear the final costs of VAT. They are able to charge VAT on the supplies that they make (output VAT) and recover VAT on purchases that they have made (input VAT). If at any stage in this process the VAT paid on supplies exceeds the VAT collected from sales, the excess is refunded to the trader concerned (Bertram and Edwards, 1986).

Therefore, one element of VAT is for a business to be registered having fulfilled some requirements imposed by the particular VAT system. This implies that only supplies (goods and services) by registered persons are able to claim deductions for input tax imposed on their acquisitions. As it is noted, it is unusual for VAT systems to apply to all businesses in the economy. In practice almost all the VATs in the world today follow the European Union (EU) model in that they are, at least in principle, intended to tax consumption on a destination basis (import taxed, exports zero rated) and are applied on a transaction basis using the invoice-credit (output tax less input method) (Bird, 2005). Regardless of the basic model from which they may have started, however, as time passed, and circumstances changed, many countries introduced home grown variations into whatever VAT design they initially adopted (Mathis, 2004).

As a tax on consumption, the VAT is a multi – point sales tax with set off mechanism for the tax paid on purchases. It implies VAT causes nil effective tax burden of purchases because tax does not become cost of doing business but borne on consumption expenditure.

2.2 VAT CHARACTERISTICS AND THE DISTRIBUTION STAGES

One important conceptual characteristic of VAT is that it is regarded as a better tax by avoiding the cascading effect. Thus, output of the first manufacturer becomes input for the second manufacturer, who carries out further processing and supplies it to the third manufacturer. This process continues till a final product emerges. This product then goes to the distributor/ wholesaler, who sells it to the retailer and then it, reaches the ultimate consumer. On the other hand, if a tax is merely based on the selling price of a product, the tax burden goes on increasing as raw materials and final product pass from one stage to the other (Ajakaiye, 2000). This is called cascading effect. Nonetheless, besides VAT being conceptually ideal, a question that arises is, has it been the desirable solution in totality, or is it in the same spirit of simplicity and does it suit the specific country situation?

In recent years the adoption of VAT has become attractive as perceived means to broaden the tax bases in most of the otherwise narrow tax based Southern Saharan countries apart from other low and medium income countries (Jenkins and Khadka, 2000). For example, when in 1996, Uganda introduced VAT to replace commercial transaction levy (CTL) and sales tax it was stated that VAT was considered necessary for broadening the tax base (Kangave, 2005).

Indeed broad based taxes such as VAT certainly do play an important role in raising revenue as well as the coverage. Since it is consumption based it is applied to large sections of the population. VAT that is applied fairly to both imports and exports provides neutrality and at the same time raises more revenue. Burgess and Stern (1993) along with other academics have characterized it as a pragmatic response to the difficulties of raising revenue in economies with large informal sectors and fairly narrow tax bases. Also, while neutrality and revenue purpose are considered to be central to the design of the VAT, the simplicity to administer this tax is also considered important. VAT is known to be self enforcing. To this end, countries have introduced a VAT to replace other forms of distortionary indirect taxes such as sales and turnover taxes. For example, in 1977 Korea introduced VAT in place of eight different taxes in order to simplify the indirect tax system and its administration (Jenkins and Khadka, ibid). Similarly, a number of the Sub Saharan countries, including Tanzania, Kenya, Zambia, Zimbabwe, Mauritius, Namibia, Lesotho and Ghana have introduced this tax to replace the other distortionary taxes. It has been introduced with either a single rate or fewer rates than the other rates it replaced. Another example is taken from SADC member countries where as of 2004 out of the thirteen member countries in SADC, all of the ten that have introduced VAT are using a simple single VAT rate (Glenday, 2005).

Notwithstanding these conceptual characteristics, some economists and writers (OECD, 2006) have commented that even when modern broad based taxes are used, the evidence suggests that in practice, once introduced, they have been subsequently ineffective, becoming in effect almost a self-assessment system without the necessary administrative systems and safeguards to support such a system.

2.3 OVERVIEW OF ADMINISTRATION OF VAT

According to Betts (1977), administration is concerned with the communication of information, through procedures, the handling of paperwork involving data capture, information retrieval, processing and recording data, and the proper utilization of the staff involved in these activities throughout the organization. Gill (2003) points out that a revenue administration should be treated as an open system based on the congruence model. Thus it consists of an interrelated set of components that interact within its environment. It takes inputs, puts that through a transformation process and produces output.

Administrative reforms are increasingly stressed as key elements for tax reforms. There are various reasons why tax administration reform may be needed in a country. Inspired by new public management paradigms, effectiveness and efficiency concerns are typical reasons for establishing autonomous revenue administering bodies. First, while tax policy and tax laws create the potential for raising revenue, the actual amount of taxes flowing into Government treasury, to a large extent, depends on the efficiency and effectiveness of the revenue administration (Woolf, et al 1985). Weaknesses in tax administration leads to less cost effective revenue raising. Without a matching proactive administrative capacity of the tax administration, its chances of monitoring taxable activity and countering tax evasion are seriously reduced (Gill, 2003). Thirsk (1991) in a World Bank research project involving ten countries including Malawi described weak tax administration as a characteristic of the developing countries. Further to that Thirsk noted that inability to collect accurate and timely information on taxpayers' circumstances, to determine who has paid tax and who has not, to check the accuracy of taxpayers' declarations, to detect the presence of fraud and to collect taxes already assessed as typical administrative shortcomings.

Basically the aim of an administrative machine is to give management an efficient communication network, which provides sufficient information to conduct the undertaking successfully towards stated objectives. Just like in any other tax to strengthen the performance of the VAT, the basic reform strategy identifies major issues to be encapsulated in VAT administration. There are functions such as taxpayers' registration and education, audit, collection and enforcement of VAT arrears that form the core functions of VAT administration. This is the formal structure that has been adopted in most of the African jurisdictions as well as in other countries (Riswold, 2004). These functions are facilitated by a number of very broad principles that should apply in each administrative rule, such as fairness and efficiency. In some ways, VAT administration is constituted by a number of rules, some related, some not very closely related, some expressing clear policy, and some based rather largely on arbitrary considerations (Thuronyi, 1996). Nevertheless, the final incidence, or burden of tax administration will depend on how it is imposed by the national authority, what rate structure is used, how the base is defined, and how general is the coverage (Osoro, 1993). However, this is only the beginning. In the end, effective management of a VAT base will depend on the practicality of the administrative provisions and adjustments that have recognition for importance of country specific circumstances (Aujean et al, 1999). Still more, some features are pertinent, as outlined in the next sub-section.

For the purpose of this paper tax administration will adopt the model presented by Das - Gupta and Mookherjee (1998). These authors look at tax administration as being comprised of three interrelated activities. These are identification of tax liabilities based on tax legislation; the assessment of taxes to determine if the taxes actually paid are smaller (or larger) than tax liabilities; and the collection, prosecution and penalty activities that impose sanctions on tax evaders and ensure that taxes and penalties due from taxpayers are actually collected. On the other hand a deficiency of these activities will reflect administrative tax gaps. There are four key administrative tax gaps quite commonly recognized in taxation literature as described in appendix 1.

Given this background, the task of VAT administrative machinery, is to use processes and capacity building measures that develop the administration's ability to detect and penalize evasive behavior through audit and effective recovery. These are the main modes of control on which VAT systems are built. Nevertheless the taxpayer service, which has the task of taxpayer education, should not be neglected. Adequate effort should be produced in the direction of taxpayer education and it should be recognized as a key function within the administration.

2.3.1 Administrative Provisions and Appropriate Features of a VAT Design

Research at the IMF on VAT in the early 1990s viewed the concept of self-assessment as core to the recommended strategy for implementing a VAT (Grandcolas, 2005). The principle of self-assessment entails effective detection of non-filers, broad audit coverage, enhanced taxpayer education, enforcement of arrears and application of appropriate sanctions (Keen and Mintz, 2004). Out of over 120 countries that have adopted VAT only in sixteen countries VAT is administered without self-assessment procedures (Ebrill et al 2001).

Additionally, this study takes into account what IMF experts have identified in a frequently quoted article as the prerequisites for a sound VAT administration founded on self-assessment system. These are the conditions that provide the basis for the administrative provisions. For a recent exposition Ebrill et al (ibid) has listed the seven conditions that should be included which have been summarised and presented in appendix 2.

A basic inference that may be drawn from these conditions is that they include not only collection prerequisites but also conditions of easiness of administration. In actuality the main objective of self-assessment system is to efficiently raise revenue. And the main aim of the system of any tax administration is to collect the revenue with minimum administration and compliance costs (Australian Government, 2004). However a growing concern of tax administrations throughout the world is on how to simplify the tax assessment system to encourage voluntary compliance (Sarker, 2003).

2.3.2 Collection of VAT and the Self-assessment System

VAT is believed to play a pivotal role in developing modern methods of tax administration based on effectively monitored voluntary compliance (Osei and Quartey, 2005). Under this system called self-assessment, taxpayers comply with their basic tax obligations without the intervention of a tax official. Essentially, self-assessment requires taxpayers to perform certain functions and exercise some responsibilities that might otherwise be undertaken by the tax office. That is, taxpayers calculate and pay their own tax liabilities. They must complete their returns and submit them with their payments to the tax administration. If they do not, the tax administration detects this failure and takes appropriate enforcement actions, including applying the penalties specified in the law. Returns are then subject to the possibility of audit. Under this system, the taxpayer must in fact be put in a position to recognize that the tax administration is efficient (Toby, 1978).

For VAT registrants to carry out proper self assessment they first need accurate accounts. Guidance on book keeping is another area of focus to enhance the standard of collection, especially in small and medium businesses. Activities aimed at elevating the moral duty to pay tax, include calling on taxpayers to file their returns on time and tax education.

It is the procedures put in place that are of central value to the success of the self-assessment system, let alone the overall administration. The self-assessment stipulates collection procedures using filing and payment forms, which vary from different jurisdiction according to their complexity. To ensure the practicality of administering and proper coordination, the self-assessment system consequently relies primarily on the four major functions of registration and taxpayer education, audit, collection and enforcement.

2.3.3 Success of VAT Administration

Apparently, an important concern with tax administration borders on how substantively tax laws should be implemented to further compliance goals, and then addressing the question of taxpayer sanction, how they work and what is required to make them effective (Musgrave and Musgrave, 1989). Tax administration is much more a question of designing acceptable answers for myriad practical bureaucratic problems. It is in this respect that Tait (1988) considers tax administrators to be concerned with the nuts and bolts of taxation, meaning they are responsible for implementing the rules. Ideally, tax administrators ensure the practicality of the particular tax by looking at problems and options in theory and their different impacts, while keeping an eye firmly on the ball of practical implementation. The administrative provisions spelt out by the particular legislation facilitate this. On the contrary, tax policy is more theoretical in nature and tends to address in most cases long-term goals such as fiscal stabilization (Lent et al, 1973).

The success of a VAT will therefore largely depend on the structure, operations and how practically inherent problems in the tax base can be tackled. This means the taxpayer's involvement in aspects of VAT administration, which can largely be described by his/her interaction with different sections of the VAT authority, is important. That is determined by how well the rules are understood by both the taxpayers and VAT staff; how cumbersome are the filing obligations, audit procedures and the control of numbers of VAT registrants permitted by the threshold level (Frontline, 2006). Hamilton (2005) concluded from his study that complexity may induce irrational behavior in taxpayers. For those who file themselves, complexity may cause them to intentionally take a reluctant approach when faced with VAT obligations that seem to offer no answers. Therefore, sound VAT administration involves general principles governing the VAT and better understanding of rules and processes by the taxpayer, which in turn will influence the collection costs. Thus, elements of administrative provisions have an important bearing on collection costs (ITD, 2005) because they will command how enormous administrative resources may be needed to continually administer the tax.

2.4 MONITORING VAT AND TAXPAYER SERVICE

A study by Otts (1988) concluded that modern tax administrations are more concerned with a stronger focus on taxpayers, specialization of personnel and independence from the Ministries of Finance. Having gone through general perspectives in theory and practice of VAT administration with special emphasis on the principles and concepts, appropriate features and a descriptive importance of a self assessment system in VAT, it is also inferred that successful VAT administration is a strong focus on taxpayers interaction with the tax authority and emphasis on more cost effective strategies, such as the control of the VAT population.

Administrative controls are necessary in a VAT system and are exercised through a number of means, including sanctions and monitoring. Sanctions entail interest and penalties charged in an effort to shape the taxpayers' behaviour in a certain way or rather to deter him or her from doing the unnecessary. It is a way of enforcing compliance. Monitoring whereby the VAT administration ensures that the laid down procedures are followed facilitates this. The imposition of sanctions is a significant feature of the cost equation to the taxpayer, and the revenue administration focuses on the success to collect them. However critical to administration is the service. Taxpayer service can be a very important tool (OECD, 2007).

Admittedly, much of the monitoring is generally implemented to benefit the VAT system. Even World Bank (2005) asserts that VAT requires a more sophisticated tax administration to monitor and tackle fraud. VAT being a self-assessed tax relies heavily on sound books and records of business activity. This in turn requires good literacy and numeracy levels, ability to maintain books and records of business activities and breadth of accounting profession. It is believed that effective taxpayer monitoring requires gaining knowledge of taxpayers, recognition of the diversity of taxpayers in terms of their size, complexity and sectors (Fjeldstad and Rakner, 2003). Providing services that are user-friendly, in the sense of being accessible and understandable for all, helps to maintain and strengthen the taxpayer's willingness to comply voluntarily thereby contribute to improvements in overall levels of compliance with the laws (OECD, ibid). Fjestald and Rakner (ibid) have also remarked that the challenge for taxation is to raise domestic revenue from consenting citizens in poor and increasingly open economies as such elected governments in Africa are faced with hard choices about taxation.

For instance, Osei and Quartey (2005) argue that inadequate taxpayers' education was probably the most instrumental factor that worked against VAT's effective implementation in Ghana in 1995.

Tax experts recommend that a proactive approach to informing taxpayers and traders about the tax system and their obligations and implementing a range of taxpayer communication and education initiative will ease the revenue administration (Barrand, 2006). However this has not been the case in most of the Sub-Saharan African countries. A study by Fjeldstad and Rakner (2003) has revealed that in spite of the recent reforms in the region, many of these countries have no tax manuals to consult. Another research by South African Revenue Services (SARS) (2005) indicates that only about a quarter of the taxpayers in that country are well informed and knowledgeable about their responsibilities, a significant number of the population remain unsure about their responsibility.

2.5 WHOLESALERS AND RETAILERS AND THE ADMINISTRATIVE CHALLENGES

It is argued in a number of papers that, while the VAT imposition offers considerable potential, the preliminary evidence in Sub-Saharan African countries to date is not encouraging and that a systematic assessment of administering wholesalers and retailers under a VAT system is needed.

As earlier alluded to, in recent years the adoption of VAT has become attractive as perceived means to broaden the tax bases in most of the otherwise narrow tax based countries. However it has been remarked by Fjeldstad and Rakner (2003) that the development of this tax has been faced with a lot of challenges inconsistent with the capability of tax administrations in most of the DTE. Many explanations can be given for the challenges. Top on the problems is the large informal sector characterizing these Sub Saharan countries (Bird and Gendron, 2005).

An informal sector consists of employed workers and self employed persons producing and distributing goods and services on a small scale and the transactions and income concerned are not officially recorded. Different writers have used different definitions for this sector. Chipeta (2002) for example, said that an approximate definition in the Malawian context is the one used in a World Bank (1990) study. The report considered all small scale enterprises, which are registered businesses owned by Malawians and employing up to 20 persons, as being part of the informal sector. It then goes on to say that it includes large numbers of unregistered businesses and part time marginal activities using very little capital, most being one person operations. But Chipeta (ibid) did not confine the informal sector to Malawian or to enterprises employing up to 20 persons. Therefore in this case the informal sector can be registered or not and can be owned by Malawians or not.

One feature of an economy that affects the potential effectiveness of tax administration is the size of the informal sector. For one thing a large informal sector means that a large part of the population is difficult to monitor. Indeed Malawi is typically characterized by a large informal sector. This sector is estimated to contribute significant shares of GDP and continues to grow. Estimates show that in between 1994 – 2003 the informal sector in Malawi has grown from 18.5 percent to 27.4 percent (Glenday, 2005). As described in the background paper, the large proportion of the informal sector, which is dominated by the wholesalers and retailers, has not been part of the VAT system (Shalizi et al, 1990). While the above factor may be responsible for Malawi's VAT challenges, these are the same problems faced by many developing countries.

The central theme of concern that induced the VAT shift from the formal sector activities to include informal activities was the need for more revenue. It was argued in a concept paper presented to the Ministry of Finance by Chipeta and Chulu (2000), that the then VAT regime was imperfect. The authors point out that under the system some revenue was forgone directly due to the exclusion of these trade sectors, and indirectly because the tax lost on commodities that somehow manage to enter the country free of tax cannot be recovered by taking the output out of traders who subsequently sell those imports. The argument has been stated more formally by Keen and Schenk (1999) who recommended the adoption of a modern consumption tax with special features to include wholesalers and retailers at the threshold of annual turnover of MK 2 million. In considering this, it should be borne in mind that the main reason for adopting the extension was the intractability of the revenue that would be lost. As long as the revenue at risk was taken care of it would not seem necessary that the VAT scope be extended to all the wholesalers and retailers in the threshold of MK 2 million per year.

Evidence from a recent study has shown that in spite of the increased revenue amounts the performance of VAT has relatively declined in comparison with the two pre-extension VAT systems relating to the period using the suspension system and the period VAT was restricted to the manufacturing stage. The percentage performance during the former was at 80, and during the latter it was at 103, whilst the present one is rated at 64 (Chibowa, 2006). The contributing factor cited in Chibowa's (ibid) study report is low compliance. This suggests that the current system fails to address the objectives in the self-assessment VAT systems, which are aimed at enhancing efficient revenue raising.

Fjeldstad and Rakner (2003) found that in Tanzania and Uganda tax administration reforms in the 1990s resulted in short term revenue increases but the achievements proved to be difficult to sustain in the long run. In Uganda, a large agro based economy was attributed as one of the reasons for its stalling revenue performance (Kangave, 2005).

The extension of VAT in Malawi has been no exception, judging from numerous MRA Management reports of administrative chaos attributing to this factor.

Finally, since administrative costs largely depend on the number of taxpayers and the feasibility of audit controls (Cnossen, 2002), it must be noted that, as Lent et al (1975) once stated, in developing countries the problem of increasing the number of taxpayers should be viewed with caution, especially if only a small percentage of the new taxpayers will affect the revenue significantly because even though the control and audit of small taxpayers may be kept at a minimum, the number alone may pose problems of registration, filing returns, and tax collection that could impede the efficient administration of the entire VAT system. In addition to that, conclusions gathered from international experience (Cnossen, 1998; Mann, 2002) suggest that the administrative costs of collecting tax from small and medium businesses is deemed to be relatively high in relation to the additional revenue (net of the VAT on inputs, which is paid anyway) raised from them.

2.6 IMPACT OF EXTENSION OF VAT ON ADMINISTRATION

Over the years, various studies have cited a variety of factors affecting the level of VAT administration e.g. threshold level, literacy, industrial concentration and, of course, administrative resources. Presumably, many of the same factors have a role to play in determining the level of VAT administration in Malawi. Apparently, it has been commented that one of the main taxation problems in underdeveloped countries is in fact the designing of a set of taxes, which will satisfy the equity criteria and yet also be acceptable in light of the other considerations, particularly from the view point of cost of collection (Cnossen, 2005). Nowhere, however, can one find a clear basis for assessing the manner or extent to which the choice of particular threshold level may affect the administration or a clear picture of relationship between the cost of collection and the number of VAT registrants (Glenday, 2005). Nor do we really attempt to provide such a picture in the present research, which is essentially aimed at looking at the implications rather than an empirical analysis.

Nevertheless the administrative resources incurred by the tax administration are of fiscal, economic and social interest, given that they represent a deduction in the gross yield of the tax structure.

2.6.1 Administrative Resources

Apart from revenue, one other factor in efficient administration of any tax is the collection costs. Collection costs consist of administrative and compliance costs. In this context, administrative costs include the full resource cost to the public sector of operating the VAT. In essence, administrative costs are costs, incurred in an effort to collect the VAT, which consist of budgeted costs of both the primary and secondary activities (Taylor, 1970). Primary activities in this case refer to all requirements directly related to VAT generation i.e. registration, audit, collection and enforcement. Secondary functions on the other hand refer to all other functions apart from the primary ones that ease the generation of VAT i.e. training, investigations, publicity and a few other administrative requirements. The administrative costs include not only the wages and salaries of staff, and the full cost of the accommodation and materials used by the staff, but also the services received and paid for from other departments. The most useful way of representing these costs is in the form of a percentage of the revenue collected (James and Nobes, 1983). Therefore, all costs incurred by the VAT administration for activities related to revenue should be consolidated. It is then possible to see how these costs would affect the revenue collected.

On their part, compliance costs are more difficult to calculate. James and Nobes (ibid) suggest that compliance requirements of a tax not only include that money spent on accounts and tax guides but also tax payers' time spent and anxiety suffered in completing the tax returns. That is true but it is rather difficult to quantify the intangible part. As such the compliance costs are restricted to the tangible share.

Administrative costs are met out of general tax revenue in line with government's tax policy. Compliance costs on the other hand, fall evenly on private taxpayers. The underlying fact is that regardless of which side of the two collection costs eat up part of the revenue. To what extent, that is what matters. A decrease in the cost of collecting taxes is desirable with respect to the efficiency of tax administration (Malawi Government, 2005). However, since the expenditure for tax collection, at the same time, represents the cost of fair taxation, it cannot be regarded in isolation as being an indicator of performance of tax authority (Japan National Tax Agency (NTA), 2000). The effectiveness of administration will therefore be reflected by this variable and possibly by how well the administrative provisions are capable of meeting their objectives. There do not exists any absolute quantitative criteria regarding this variable, but in general if the cost is greater than a certain percentage of yield it becomes worthwhile to analyse the administrative procedures and systems supporting the tax. If the proportions further exceeds that percentage both the administrative procedures and the structure should be analysed and if it gets even higher then the very existence of the tax must be questioned (Mann, 2002).

As a general rule, the ratio of total administrative costs to total gross revenues in developed countries with many years of administrative experience and stable tax structures fluctuates between one and two percent; in less developed countries having achieved a certain level of administrative efficiency, this ratio varies between two and three percent (Mann, ibid). For example in Malawi the retention for the revenue authority is currently at 2.5 percent (MRA, 2006 a). The cost/gross revenue criterion can possibly be used to label the unproductive taxes. In this instance the unproductive tax is defined as any tax that combines relatively low revenue with proportionally high administrative costs.

Basically the reform for VAT in Malawi came with a view that VAT is to operate side by side with the income tax, without imposing an excessive administrative burden (Shalizi and Thirsk, 1990). As a matter of fact, it is not uncommon that modern taxation advocates for simple but effective taxes. However, having introduced this tax is not adequate in itself. The question to ask might be that, has the VAT lived up to its early promise as an efficient, fair source of revenue? Answering this question is not easy. There are numerous challenges that might face administration of VAT. One of such is maintaining a broadened scope of taxpayers that can at the same time be effectively managed. Going by Adam Smith's fourth canon of taxation that "every tax ought to be so contrived as both to take out and keep out of the people as little as possible, over and above what it brings into the treasury of the state" (James and Nobes, 1983). Surely this is too significant a challenge to ignore under a broad based tax. Nonetheless as much as the goal of tax administration varies widely from country to country, Shoup (1975) suggests that at one extreme the goal is simple “maximize tax revenue with the given administrative resources”.

It has been commented that, in many developing countries, a simple VAT with a high registration threshold, the turnover level at which the tax is charged would clearly be simpler to administer than the taxes that such a VAT would replace (Ebrill, et al 2002). However a very crucial objective in most transitional and developing jurisdictions adopting VAT is to limit the number of taxpayers to a figure that can be competently administered by revenue authorities (Krever, 2005).

2.6.2 Threshold Level for Registration

The threshold issue is of great practical importance, given that the low initial threshold in several countries has been cited as VAT’s key weakness. The threshold level implies allowing small businesses to exempt their supplies on the condition that they do not deduct input tax. The consequences of such exemptions amount to treating small businesses as non-taxable persons or non-registered taxpayers and therefore, those exemptions are presented as registration threshold in the overview (Annacondia and van der Corput, 2003). Paraphrasing Ebrill et al (2002), a low registration threshold level is considered a prime reason why Ghana’s VAT failed when first introduced in 1995 (a registration level of $20,000.00 compared with $75,000.00 on its successful reintroduction in 1999). It is also one of the reasons Uganda’s VAT nearly failed when it was introduced in 1996 (at $20,000.00) later raised to $50,000.00. Even in Sierra Leone, where they are preparing for the introduction of VAT on June 1, 2007, the threshold is one of the crucial issues that have been earmarked for a detailed understanding of its impact, both financial and economic (Department For International Development (DFID), 2004). A simple rule of thumb though is to set the threshold at the point where the collection costs saved are balanced against the revenue lost (Ebrill et al, ibid).

As we argue throughout, much more work needs to be done before we could achieve a full understanding of the implications, possibilities and limitations of the value added tax as a fiscal tool for developing and transitional economies (DTE) including Malawi. There might be numerous problems but the hot problems at the forefront of the VAT list in Sub-Saharan and other DTE countries with huge informal sectors, is limited administrative resources and, in many cases, little apparent political will to support effective tax administration. The problems are both much more fundamental and generally a lot more difficult to resolve in practice (Bird and Gendron, 2005).

2.7 CHAPTER SUMMARY

This chapter has discussed the definition of VAT, its conceptual characteristics and the framework for administering VAT. The discussion has also tried to describe the wholesale and retail stages in relation to the informal sectors of an economy. It has been shown in the foregoing discussion that the success of VAT is dependent on the effectiveness of a self assessment system. Additionally the chapter has illustrated that monitoring and taxpayer services are an important component of VAT administration.

However the general perspective in this review is that a VAT system is, of course, not supposed to be a “rigid model” of the initial VAT adopted from the EU. Like most structural adjustment programs, VAT is neither perfect nor perfectible. Experience has shown that in spite of revenue potentials there are administrative challenges associated with administering a VAT characterized by a large informal sector that might outweigh the revenue gains made. Nonetheless, some form of VAT almost certainly constitutes a critical ingredient in the answer for DTEs that are dominated by the informal sector although even the best possible VAT will not solve all the administrative problems inherent in their tax systems. In many instances, administration of VAT will be more effective in the face of controllable number in terms of registrants permissible by the threshold level.

CHAPTER 3

RESEARCH METHODOLOGY

3.1 INTRODUCTION

This chapter outlines the methods used in conducting the study. It discusses the research strategy and a number of techniques used. Broadly, it presents a descriptive picture of the research design highlighting the data collection and analysis methods.

3.2 RESEARCH APPROACH AND STRATEGY

The research uses a deductive approach and relies on quantifiable data. This is both an exploratory as well as a descriptive study that seeks to draw its conclusions based on a statistical analysis of a set of observed variables dealt with in the study, such as VAT administrative obligations. These administrative obligations refer to activities bordering the primary functions of VAT generation i.e. visits to taxpayers for enforcement requirements of registration, collection and audits, and filing of returns. A desk research as part of the study has been used to analyze the activities underlying the VAT administration in terms of expansion of the number of registrants, workforce, management structure, tax base and the applicable rates. The research uses the objectives of the research as the guiding lines to ensure track of the strategy for both primary and archival data collection.

3.3 DATA COLLECTION

This study required an integration of primary and secondary data. Primary data was sourced through questionnaires distributed to three population samples hence three sets of structured questionnaires were designed. Methodical triangulation was found to be necessary to strengthen the validity of results (Kane, 1991), hence the use of three sets of questionnaires. The researcher was personally responsible for distribution and collection of questionnaires. For ethical purposes the questionnaires were treated with confidentiality without necessarily seeking names of respondents. Private details of the respondents were avoided. For example in the case of taxpayers, details like taxpayer's identification number (TPIN), addresses, and for officers like employment numbers and staffing grades were not part of the data collected.

Official secondary data, in form of published summaries, were collected from Malawi Revenue Authority (MRA) as an internal source, and the Treasury Department of the Ministry of Finance. Such secondary data sources include annual reports, management reports, and administrative and public records. Other documentary data were gathered from institutional publications such as journals, research papers, electronic journals and articles. For example, study reports done by the International Monetary Fund (IMF), World Bank, Southern Africa Tax Institute (SATI) and Southern Africa Development Community (SADC).

3.4 SAMPLING TECHNIQUES AND SAMPLE SIZE

The target population for this study was VAT taxpayers and MRA staff dealing with VAT. The total population was 2016 made up of 1943 taxpayers and 73 MRA staff. These are the major stakeholders of VAT.

Selection of respondents of the study was done using probability systematic sampling technique. To ensure the chance of each case being selected from the population, three subgroups were drawn from the population. These subgroups comprise sampling frames of the VAT registrant population that is maintained in a database within the VAT Division of the MRA, officers involved in the day-to-day activity of the VAT administration who also form an interface between management and the registrants, and officials holding middle to senior managerial positions in the VAT Division of the MRA. A total of 102 respondents were selected comprising three sub groups, being 62 VAT registrants, 32 MRA VAT frontline officers and 8 MRA VAT managerial staff.

The study was carried out in Blantyre. This was purposefully chosen because the major VAT activity in terms of revenue contribution, taxpayer population and even the workforce is clustered within Blantyre. The Blantyre area generates over 80 percent of the total national VAT collection, holds about 60 percent of the VAT taxpayer population (1943 out of a total 3,374) and over 50 percent of VAT staff (MRA, 2006 b).

3.4.1 Determining The Sample Size

It was found imperative to draw out the respondents from a cross section of VAT stakeholders, mostly those who are directly involved with the generation of the tax in order to come up with an appropriate sample size which would give acceptable outcomes of the study. To accomplish this, the aggregate sample size was made up as follows:

i. *Sampling frame 1*.

This comprised VAT registered taxpayers, and the sample drawn from this frame is referred to as Sample A. The sample size was calculated using the 'adjusted minimum size method' based on a formula adopted from Saunders et al (2003) as explained below. It is reaffirmed by Saunders et al that where a population is less than 10, 000, a smaller sample size can be derived using this formula without affecting the accuracy. In addition, to obtain the required adjusted sample size, it was required to calculate the minimum sample size that can be used provided one knows the level of confidence and margin of error and the estimated proportion of response expected on a particular attribute.

Therefore to estimate the proportion of a particular variable a pilot sample of 15 observations was collected to infer the likely estimation of the main survey. In this case, the variable used was taxpayers' educational visits due to the great variability of the responses on this aspect as compared to the other variables. Proportion of those who have received educational visits was 62 percent and those who did not were 38 percen†.

To find minimum sample size required (n):

$$n = p\% \times q\% \times [z/e\%]^2$$

Where p% is the proportion belonging to those who had received educational visits.

q% is the proportion not belonging to those who had received educational visits.

z is the level of confidence corresponding to z value in the standard normal table.

e% is the margin of error.

Substituting the specified categories with the proportions given above, z value of confidence level of 90%, which is 1.65 and margin of error (e) of 10%, will give:

$$= 62\% \times 38\% \times [1.65/10]^2$$

$$= 64$$

Therefore to find adjusted minimum size,

$$\mathbf{n' = \frac{n}{1 + (n/N)}}$$

Where **N** is the total population, which is the total number of current VAT, registered taxpayers (excluding those deregistered) in Blantyre jurisdictions.

$$N = 1943$$

$$n' = \mathbf{62}$$

ii. Sampling frame 2

This comprised VAT frontline staff within the MRA grading range of 10 to 7. The number of VAT frontline staff was 30 because the total population is 120 and below 1000, then the minimum recommended number of sample size was used (Saunders et al, ibid). The sample drawn from this frame will be referred to as sample B.

iii. Sampling frame 3

This comprised VAT managers. There are a total of 9 VAT middle and senior managers (MRA Grades 6 – 3) in MRA apart from the office of the Commissioner of VAT (which was vacant at the time of the study). All but one are based in Blantyre hence this sample was composed of all the 8 Blantyre based MRA VAT managers. Henry (1990) quoted by Saunders et al (2003) recommends collecting data from the entire population rather than by probability sampling. The sample drawn from this frame will be referred to as sample C.

3.4.2 Selecting The Respondents

Samples A and B were drawn randomly. The systematic samples were random because each of the first respondents from each one of the two groups was randomly drawn.

True (1983) suggests that a systematic sample is random as long as the first case is randomly drawn. This was deliberately opted for mostly because of the characteristics of the sampling frames involved. Firstly, the frame did not have relevant clusters or strata nor did it contain periodic patterns. Secondly, categorising the frames was next to impossible.

Therefore sample A was obtained by picking randomly one of the first thirty cases in the frame. Then the rest followed by consecutively picking every thirtieth case from the one picked first. Dividing the total cases in the frame by the required sample size derived this sample. Similarly picking every second name from a randomly organized staff list produced sample B.

3.5 ADMINISTERING THE QUESTIONNAIRES AND ETHICAL ISSUES

Three sets of structured questionnaires were personally administered to collect primary data. The questionnaires were personally administered to ensure strictest adherence to ethical requirements (see appendices 3 and 4) and gaining acquaintance with the respondents to persuade response without coercing them in order to overcome the problem of low response rates associated with taxation studies (Cnossen, 1998). All requirements on administration level for the operation of VAT from the taxpayers' and tax officials' point of view were included in these questionnaires. Pretesting of the questionnaires was done to allow an opportunity for correction and possibly rephrasing some of the questions that appeared to be vague to the respondents. The final draft versions of these questionnaires are attached in appendices 5, 6 and 7.

The first questionnaire (Appendix 5) targeted for sample A sought experiences, perceptions and opinions about the administration of VAT and its applicable provisions in view of the extension from the taxpayers as well as suggestions on what can be done to improve VAT administration. Similarly the second questionnaire (Appendix 6) targeted at sample B, sought similar perspectives but from an operational point of view. Whilst the third set was for the managers as the ones behind the strategies and ensuring that they are successfully implemented (Appendix 7).

For ethical purposes, at all times during the distribution a deliberate effort was being taken to emphasize the confidentiality attached to the study as well as voluntary compliance in spite of an introductory note attached to the questionnaire (Appendix 2) addressing the same issues. Further to that the questionnaires were administered upon formally seeking consent form MRA management (Appendix 1). In other cases, for example, when seeking data from government departments such as the Office of the Auditor General, and the National Statistics Office as well as from the World Bank (Malawi country office) a letter of introduction from the Head of Management Studies, University of Malawi, was used.

3.6 DATA ANALYSIS

Initially the filled questionnaires were all coded in order of collection and erratic data were cleaned before the actual data entry. All primary and secondary data collection involved some numerical data or data that was usefully quantified to meet the objectives of the research. Quantitative analysis techniques were used. Statistical Package for Social Sciences (SPSS) was used to capture and analyze all the primary data. Microsoft Excel was used for reprocessing the primary data for tabulation. Decision Analyst (Stats) was used to calculate the Chi Square statistic to test the null hypotheses.

Data obtained through triangulation has been used as one way of strengthening the validity of the results; views were being sought differently from the taxpayers and frontline officers' perspective. For instance, opinion on the effectiveness of the administrative provisions was based on the responses given by all the three groups of the respondents.

Compilations of data at a primary level give an overall picture at taxpayers' and VAT officials' level. These primary data were used to provide descriptive strings for various variables.

3.6.1 Analysis of Factors Determining Visits to Taxpayers

Since there are several factors such as size of business, or function based activities such as audits, collection or tax education influencing frontline officers to visit taxpayers, inferential statistic was used to determine the level of significance. Using the SPSS a cross tabulation of frontline officers' period of service in VAT against the determining factors was used to detect the association between the two variables. With the use of nominal data and a lot of variables, derivation of Cramer's V was an appropriate inferential statistic to be used in this case.

3.6.2 Testing of the Null Hypotheses

Chi square test was done using Decision Analyst (Stats 1.1) software to determine if the observed frequency distributions of the feasibility of various administrative provisions are unlikely to have been caused by chance. Similarly to determine the administrative implications of the extension of VAT the same chi square was used. Since the variables used give data on a nominal scale, a Chi square test has been found to be the appropriate test. This helps in deciding whether the observed frequency distribution could be a result of definite cause or just pure chance. If the difference between the observed results and expected results is small, say less than the critical value of 5 percent then perhaps chance is the only factor. On the other hand, if the difference between observed and expected results is large then the difference is said to be significant and we expect that something is causing it and the null hypothesis is rejected.

3.7 CHAPTER SUMMARY

This chapter has explicitly indicated that primary data was extensively collected from the major stakeholders of VAT using structured questionnaires. The researcher had to choose a population and select the sample to collect the data from with utmost care bearing in mind the study involved a population that was neither homogeneous nor uniform. Being methodical was also very important and, at the same time, more desirable than simply picking the sample at random. Courtesy and respect paid to the respondents and the untiring persistence to visit the respondents has significantly contributed to the high response rate. The data collected were analyzed using SPSS, Excel and Decisional

Analyst. Finally, the acceptance or rejection of the null hypotheses was on Chi square statistical foundation.

CHAPTER 4

RESEARCH RESULTS

4.0 INTRODUCTION

This chapter presents the findings of the study from the analysis of the data (as explained in section 3.6) that was collected using semi structured questionnaires. The findings have been presented in three parts. Firstly outlined, are the results from the VAT registered taxpayers, followed by those from MRA VAT frontline staff and the last part comprises results from the managers, as outlined in subsection 3.4.1.

4.1 CHARACTERISTICS OF TAXPAYERS IN THE VAT NET

4.1.1 Business Entities, And Period Operating VAT.

Tables 1 a and b below show a cross section of respondents from the group of VAT taxpayers. It indicates the diversity of characteristics of the respondents in terms of the business entities, and period the taxpayer was registered for VAT. This is particularly important because it signifies that the findings are based on a diversified group of taxpayers.

Table 1a: VAT Taxpayer Respondents in Categories of Business Entity

Business entity	Frequency	Percent
Sole proprietorship	26	43
Partnership	12	20
Limited	22	37
Total	60	100

The results in Table 1a show that 43 percent of the respondents were sole proprietors, 20 percent were partnerships and 37 percent were limited liability firms.

Table 1b: Period of Registration for the VAT Taxpayers

Period Registered	Frequency	Percent
Before Nov, 2002	37	62
2002 – 2003	15	25
2003 – 2004	5	8
2005 – 2006	3	5
Total	60	100

Table 1b shows that most of the taxpayers comprising the VAT net were registered in 2002 when VAT was being extended to wholesale and retail stages. The data are positively skewed (see appendix 8) which agrees with the overwhelming response at the time of the extension.

4.1.2 Self Assessment System Compliance

VAT being a self assessed tax, requires a well documented system that starts at the point of sale. Various methods are used but it appears that manual receipts are dominant as reflected in Table 2.

Table 2: Proportions of taxpayers according to method of sale documentation

Sale Documentation Method	Frequency	Percent
Till Machines	5	8
Manual receipts	40	67
Till and manual receipts	9	15
Gross Takings	2	3
Other	4	7
Total	60	100

The results in Table 2 above show that 67 percent of the respondents use manual receipts, 8 percent use till machines, 15 percent combine both manual receipts and till machines, 3 percent do not issue out any receipts, they simply take the gross takings and 7 percent use other methods, for example computer generated receipts.

4.1.3 VAT Monitoring and Taxpayer Service

Service to taxpayers to assist them meeting their obligations means good mechanisms of disseminating information through taxpayers' education. It appears a significant proportion of the taxpayers have not received an educational visit and some have not even had an access to the short VAT explanatory booklets as observed from the table below.

Table 3: Educational Visits and Access to Short VAT Explanatory Booklets

	Percent		
	Yes	**No**	**Total**
Educational Visit	65	35	100
Access to booklets	63	37	100

Results from Table 3 show that as much as 35 percent of the VAT taxpayers have not received an educational visit while 65 percent are the ones who have received an educational visit either before or after registration for VAT. Thirty seven percent of the taxpayers have not had an access to short explanatory booklet while 63 percent have.

4.1.4 Audit Visits And Irregularities Detected

Comparatively, unlike educational visits, audits appear to be so widely covered. Audits are carried out as part of administrative controls necessary for monitoring a VAT system. However the frequency of audits also contributes to the administrative costs.

Table 4: Frequency of Audit Visits As Experienced By VAT Taxpayers

Frequency of audits	Frequency	Percent
None	1	2
Once	16	27
Less than 4 times	35	58
4 times	3	5
More than 4 times	5	8
Total	60	100

Table 4 shows the frequency of audit visits received from VAT officers by a taxpayer in a period of twelve months. Only 2 percent of the taxpayers have not received an audit visit in the period of 12 months, 58 percent of the taxpayers have received between two to four visits in the same number of months, 27 percent have been visited once and 8 percent more than four times.

Audits assist to detect non compliance amongst taxpayers. It is through these exercises that shortfalls and weaknesses of the taxpayers such as irregularities of VAT returns are usually discovered. Table 5 shows the frequency of taxpayers based on a number of times there has been occurrence of irregularities.

Table 5: Occurrence of Irregularities

Occurrence of Irregularities	Frequency	Percent
None	26	43
Once	22	37
Twice	6	10
More than twice	6	10
Total	60	100

Table 5 above shows that about 57 percent of the respondents have been found with an irregularity of some sort either on one visit or more. And Table 6 below shows that of those found with irregularities 20 percent were found with technical errors 22 percent with arithmetic errors and 16 percent with understatement of sales or purchases. But appendix 9 illustrates that even though the prevalence of arithmetic error type of irregularities are relatively high in magnitude, technical errors have been detected on most of the visits. It implies technical errors can occur again and again. This simply illustrates low comprehensibility of VAT requirements on the part of the taxpayer.

Table 6: Irregularity Type

Irregularity type	**Frequency**	**Percent**
Understatement of sales	7	12
Understatement of purchases	2	3
Arithmetic errors	13	22
Technical errors	12	20
Total	34	57
None	26	43
Total	60	100

4.1.5 Taxpayers' Opinion On The Effectiveness Of Current VAT Administrative Provisions

Taxpayers were asked to comment on the current administrative provisions in view of the extension of VAT to wholesalers and retailers.

Table 7: Taxpayers' Opinion on the Effectiveness of VAT Administrative Provisions

Opinion	Frequency	Percent
Very effective	6	10
Effective	16	27
Less effective	33	55
Don't know	5	8
Total	60	100

As indicated in Table 7 fifty five percent of taxpayers believe that the current administrative provisions are less effective while 37 percent believe that they are effective (27 percent, effective and 10 percent, very effective) and 8 percent of the respondents are not sure on how these provisions are fairing.

4.2 RESULTS FROM FRONTLINE OFFICERS

This section presents results from questionnaires directed at VAT frontline staff respondents. The results show that the respondents have been working directly with VAT taxpayers from one to over five years.

Table 8: Period Of Service For VAT Frontline Respondents

Period of service	Frequency	Percent
Less than a year	4	13
1 - 2 years	8	25
2 - 3 years	5	16
3 - 4 years	6	19
Over 5 years	9	28
Total	32	100

As table 8 indicates most of the respondents have been dealing with VAT for more than a year. Only 13 percent have worked for less than a year. The respondents were therefore able to understand and respond to questions related to administration of VAT without difficulty.

4.2.1 VAT Monitoring and Taxpayer Service

The results presented below reflect monitoring and taxpayer service activities, particularly the level of visits to taxpayers from the perspective of VAT frontline staff. Results from Table 9 shows that 28 percent of the frontline staff visit taxpayers for more than 16 times a month which means going out to taxpayers on every working weekday while 25 percent go out at least 8 to 16 times translating to two to four times a week.

Table 9: Frequency of Visits by VAT Frontline Officers to Taxpayers

Frequency of visits to taxpayers	Frequency	Percent
Once a month	6	19
2 - 4 times a month	6	19
8 - 16 times a month	11	34
More than 16 times a month	9	28
Total	32	100

The duration of stay at taxpayers' premises varies according to various purposes of visits. But as Table 10 below, indicates most often frontline officers spend more than 3 hours at a taxpayer's premise.

Table 10: Time Spent By Officers at the Taxpayers' Premises

Time spent at taxpayers premises	Frequency	Percent
0 - 30 minutes	4	13
30 - 60 minutes	5	16
1 - 2 hours	5	16
2 - 3 hours	2	6
More than 3 hours	16	50
Total	32	100

As observed that the amount of time spent by an officer at the taxpayer's premise varies most often officers are driven by some factors that can either be function related or based on the taxpayers' characteristics.

4.2.2 Determining Factors for Visits to Taxpayers

The study looked at a number of factors as determinants for frontline officers' visits to taxpayers. The factors looked at were size of business, type of business, persistent default of payments, late submission of returns, submission of erratic returns and education of taxpayers. Cross tabulation to obtain Cramer's V was used to analyze factors influencing frontline officers' visits to taxpayers.

From inferential statistics, all years of experience showed that a follow up for late submission of returns was a significant factor in determining visits made to taxpayers. Level of significance for Cramer's V obtained is 0.025. As shown in Table 11, 72 percent of the frontline officers find follow up for late returns as an important factor in influencing their visits.

Table 11: Importance of Late Returns as a Determining Factor for Visits

Perception	Frequency	Percent
Very important	13	41
Important	12	38
Less Important	4	13
Not important	3	9
Total	32	100

Another key factor revealed from the inferential analysis was the size of business. There is a strong association between officers of 1 – 4 years and the importance of the size of business when it comes to deciding visits to taxpayers. Level of significance for Cramer's V obtained is 0.054. It is therefore concluded that frontline officers of 1 – 4 years experience find the size of business as an influencing factor on the choice of taxpayers to visit.

As shown in Table 12 on the overall, 50 percent of the frontline officers find the size of business as a very important factor while 25 percent find it important.

Table 12: Size of Business as a Deciding Factor for Visits by Frontline Officers to Taxpayers

Perception	Frequency	Percent
Very important	16	50
Important	8	25
Less Important	3	9
Not important	5	16
Total	32	100

4.2.3 Feasibility Of Administrative Provisions

Frontline office respondents were also asked to give their views on the feasibility of the following VAT administrative provisions; the invoice credit method, exemptions for health, education and health services, MK 2,000,000.00 threshold for compulsory registration, single positive standard VAT rate, VAT calculated on accrual basis (tax payable when effective delivery or transfer of ownership occurs), staffing and training, and procedures for payment of monthly VAT due, collection of VAT arrears, audit and registration.

Table 13a: Perception of VAT Frontline Staff on the Feasibility of Current VAT Administrative Provisions Governing a Self Assessment System.

Feasibility of	Feasible	Averagely feasible	Less feasible	Not feasible
Invoice credit method	47	34	6	13
Exemption of services	78	6	16	0
threshold level of MK 2 million	25	9	25	41
Single rate	56	28	6	10
Accrual basis	47	25	25	3
Staffing and training	41	41	9	9
Payment procedures	38	31	31	0
Arrears collection Procedures	75	9	6	10
Audit procedures	56	22	18	4
Registration procedures	44	28	28	0

Results presented in Table 13a show that frontline officers find that all of these provisions are feasible except for the threshold level for registration.

Table 13b: Chi – Square Statistic for Variables in Table 12.

Chi – Square Statistic	Degrees of freedom	Probability that the observed values are different from the expected
339.0831	30	99.999 %

The Chi – Square obtained in Table 13b, gives a difference that is too large to have been caused by chance variations. Therefore the observed perception towards the feasibility of current VAT administrative provisions is significant and unlikely to have been caused by chance.

The threshold level for registration for VAT is critical in a VAT system. Table 14 shows that 41 percent of the officers currently find this provision not feasible and 25 percent find it less feasible. This illustrates how doubtful the operators of VAT are about the feasibility of the current threshold level.

Table 14: Perception on the Feasibility of the Current Threshold Level for Registration for VAT

	Frequency	Percent
Feasible	8	25
Averagely feasible	3	9
Less feasible	8	25
Not feasible	13	41
Total	32	100

4.2.4 Implication Of The Extension Of VAT To Wholesale And Retail Stages On Administration

The extension has resulted in some changes in administrative procedures and way of operation. This section shows the results obtained on the perception of the implications as a result of the extension.

Table 15a: Implication of the Extension on Administration

	Percent				
	Strongly agree	**Agree**	**Mildly agree**	**Mildly disagree**	**Disagree**
Increased substantial paperwork in processing of returns	41	34	13	6	6
Increased substantial paperwork in issuing payments notices	16	50	21	6	6
Increased substantial paperwork in and reconciling liabilities and payments for taxpayers	28	28	19	9	16
More effort on enforcement	56	22	13	3	6
More audit exercises	69	19	6	6	0
Increased number of nil returns being detected each month	18	25	9	28	19
Increased number of non filers being detected each month	22	25	25	16	12

Table 15b: Chi – Square Statistic for Table 12

Chi – Square Statistic	**Degrees of freedom**	**Probability that the observed values are different from the expected**
182.5416	24	99.999 %

As can be seen in table 15b there is an overall Chi square value of 182.5416 with 24 degrees of freedom which is giving 99.999 percent as the probability that the observed values are different from the expected. This means that the probability of the values in table 12 occurring by chance alone is less than 0.001. Therefore the proportion of people agreeing or disagreeing with the statements is extremely unlikely to be explained by chance factors alone.

In view of the implications the study in general sought the views of the respondents on what they think would happen in the face of a controllable of taxpayers permissible by the threshold level.

Table 16: Administrative Costs and Problems

	Frequency	Percent
Remain same	4	13
Decrease	21	65
Increase	7	22
Total	32	100

Table 16 indicates that 65 percent of the VAT frontline staff have a view that restricting the number of wholesalers and retailers would make a difference in such a way that administrative costs and problems in the VAT system would be reduced.

Respondents were also asked whether the inclusion of wholesalers and retailers in the VAT system has increased the burdensomeness of the workload of a VAT administration and if at all the machinery is effective. Table 17 shows that over 53 percent believe that the burden of the workload has increased.

Table 17: Burdensomeness of the Workload.

	Frequency	Percent
Absolutely yes	17	53
Yes	5	16
Not really	10	31
Total	32	100

Table 18: Effectiveness of the VAT Administration from the Perspective of Frontline Officers

Effectiveness	Frequency	Percent
Very effective	1	3
Effective	11	34
Less effective	20	63
Total	32	100

On the overall, frontline officers are of the opinion that the current VAT administrative machinery is less effective. As observed from Table 18, 63 percent of the officers find the current administrative machinery to be less effective.

4.3 RESULTS FROM VAT MANAGERS

This section presents results from the managers' point of view. The section looks at strategic as well as operational characteristics of VAT administration including relative cost of administration, critical success factors and key functions of VAT administration.

4.3.1 Strategic Issues

From the results it is revealed that 100 percent of the mangers feel that VAT administration is facing systems improvement rather than fundamental reversal. The mangers have cited skilled officers and taxpayer service as some of the critical success factors.

Views were also sought as to how the managers look at the various functions of VAT administration. Table 19 shows managers' views on the processes governing the four primary functions of VAT administration.

Table 19: Managers' Views on Reliability of Processes of Four Primary Functions of VAT Administration

	Percent			
Reliabibility of :	**Very reliable**	**Reliable**	**Averagely Reliable**	**Not reliable**
Collection processes	12	12	38	38
Registration processes	38	12	0	50
Audit	38	12	0	50
Enforcement	13	18	25	25

Although there are views that the processes are reliable, a significant proportion of the managers still feel that the processes in some way are not reliable. For instance, as Table 19 shows, 50 percent of the managers feel that registration and audit processes are not reliable.

4.3.2 Operational Issues

Operations are at the core of VAT administration because they involve the day to day activities for the generation of VAT. Apparently operational activities of a VAT system dictate the administrative costs. Results show that 62 percent of the managers agree that their operations have been affected substantially by the extension and 88 percent of them believe that the relative administrative cost has increased while 12 percent conversely think that it has fallen.

In view of the increase in administrative costs, respondents were asked to rank the components of their operations on VAT administration according to their significance as a contributor to the total cost. Table 20 shows the results found.

Table 20: Operational Activities and Their Contributions to the Budgetary Costs

	Percent		
Operational Activity	**Very Significant**	**Significant**	**Not significant**
Follow up of returns	38	50	12
Collection of arrears	50	38	12
Audits	62	38	0
Identification of new registrants	25	62	13
Actual Registration	12	75	13
Processing of returns	13	62	25
Taxpayers education	12	38	50

All but one of the listed activities significantly contributes to the total administrative cost. However, high on these activities are audits and collection of arrears, for which 62 and 50 percent of managers, respectively believe that are very significant contributors to the total cost. And contrary to these two activities is the taxpayers' education activity that is being viewed as something that does not contribute to the cost significantly. Table 20 shows that 50 percent of the managers find this activity not significant when it comes to their budgetary costs.

4.4 CHAPTER SUMMARY

This chapter has presented the findings of the study capturing the most essential characteristics with the derived data presented in tabular form.

The findings encapsulate different issues regarding the administration of VAT and its extension to wholesalers and retailers from both the taxpayer's and tax authority's point of view. The VAT taxpayers highlighted different aspects experienced in the course of interactions with VAT officers. Frontline VAT staff also highlighted experiences encountered and their perceptions on VAT administration, while VAT managers' perceptions on strategic and operational issues were also covered. It has been observed that there are different attitudes towards the feasibility of current VAT administrative provisions. This chapter has also shown that the extension has substantially increased the burdensomeness of administering the tax.

CHAPTER 5

DISCUSSION OF RESULTS

5.1 INTRODUCTION

This chapter discusses the results of the study presented as a summary of findings in the previous chapter. The discussion is focused on the results with particular attention to the literature reviewed.

5.2 CHARACTERISTICS OF THE EXTENDED VAT SCOPE AND TAXPAYER SERVICE

5.2.1 The Extension and Record Keeping

Presumably the extension has allowed various businesses to be registered for VAT. The extension, which meant the inclusion of even small and medium businesses, has taken on board even those businesses to which record keeping might be a tall order. Under the VAT which is a self assessed tax, the bulk of the burden of administration of the tax is put on the registered taxpayers in terms of appropriately issuing VAT invoices and maintaining the records.

As a result of the extension the VAT system is characterized by a variety of registrants ranging from sole proprietors, partnerships to limited liability firm (see Table 1a). Even though VAT taxpayer population is known, in terms of number registered, there is no information in terms of size distribution of various categories. As observed from the results (Table 1b and appendix 8) there were a lot of taxpayers who got registered at the time of the extension. These taxpayers include a large number of part time marginal activities using very little capital, most of them one person or family operations running as wholesalers and retailers.

Since the start of the extension in November 2002, the total number of VAT registrants has increased from 975 to 3,374 as end of 2006 (MRA, 2006 b). Presumably a lot of wholesalers and retailers have been added to the list. Though there is no precision, the wholesalers and retailers in the extended VAT scope are more or less similar in their operation of credit mechanism. It is not uncommon that most of the wholesalers' supplies go directly to unregistered consumers. As such this (wholesale) conspicuously resemble retail sales that end up with final unregistered consumers (public) who are not entitled to claim any credit for the VAT on their purchases. In essence there is a possibility that the extension has increased the number of retailers not necessarily wholesalers. This shows how challenging administering the extended scope is meant to be. Apparently there is no sector of economy activity where close monitoring is more desirable than at the retail stage. Consequently the system requires control in some form or another over retail sales.

One of the crucial objectives of the VAT administration in Malawi has been the enforcement of issuance of tax invoices (receipts). Issuance of receipts is regarded as the bedrock of the self enforcing aspect of the credit method. As observed from the results (Table 2) the extended VAT system is characterized by the abundance of taxpayers using manual receipts as part of a self enforcing aspect. Manual receipts are the dominant mode of documentation for a sale. This correlates with the inclusion of small and medium businesses who, most of them, would not afford a till machine despite having an incentive provision in the VAT Act. The incentive which is a deliberate policy is there to promote the use of till machines for more formal receipts. Manual receipts unlike till receipts are easily manipulated. This is in contrast with the self – enforcing aspect of the credit method where the buyer requires a VAT invoice from the seller in order to obtain the input VAT deduction or credit. This creates a paper trail and enhances compliance with the VAT. A break in the self enforcing chain has a revenue consequence such as loss of tax revenue through suppression of sales and hence the difficulties in administering the tax.

5.2.2 Inadequate Taxpayers' Education

Guidance on operation of the tax to the operators is another key area of focus to enhance the standard of collection. Guidance and activities aimed at elevating the moral duty to pay tax include calling on taxpayers to file their returns on time and tax education. Although a considerable effort has been made in the area of taxpayers' education and sensitization as it is required in a self assessment system there is need to reduce the proportion of those who have not received the service. A big gap in this area is likely to affect the operation of VAT.

Even though about 60 percent of the taxpayers indicate that they have received an educational visit (see Table 3), there is still a gap in adequacy of effort applied in this direction. As noted from the results obtained from frontline officers as well as managers, taxpayers' education is not regarded as one of the priorities of the administrative machinery. Results from frontline officers (as hinted in subsection 4.2.2), fail to indicate that taxpayers' education was a significant factor for their visits to taxpayers. Similarly, this inadequacy is evidenced from the managers who do not take this as one of their budgetary priorities as observed in Table 20.

It is imperative that adequate effort in the direction of taxpayers' education should be recognized as a key function of VAT administration. Apart from the taxpayer's own capacity to comply with the law, the tax administration has an obligation to assist the taxpayer to comply with the law. This includes facilitating taxpayers' accessibility to short explanatory booklets, filing forms and changes to the law.

Unless taxpayers know the rules of the game under which their economic activities will be taxed, they will not be able to operate the VAT effectively. Explanatory materials should be prepared by the tax administration and it should be made sure that they are kept up to date. To this end, the materials the tax administration uses in applying the tax laws (e.g. copies of the legislation act and regulations) should be publicly available and there should be a mechanism in place whereby taxpayers can have their queries answered.

A tax system can only minimize costs if both sides are well versed in the underlying rules.

5.3 VAT MONITORING

5.3.1 Emphasis on Audit and Failure to Utilize other Functions

VAT requires a more sophisticated tax administration to monitor and tackle fraud. As such, control visits meant to ensure, primarily, that the statutory provisions for VAT are being complied with, are part and parcel of administering the system. Auditing is the universal method for the control of VAT and the prevention of tax evasion. However, it is important that tax administration should administer the substantive VAT regime in a manner that is no more complicated than necessary to assess and collect VAT.

As evidenced by the results, there is a reflection that the stakeholders of VAT admit that audit is a prioritized function. The study revealed that the frequency of audit visits received by taxpayers is quite high (Table 4). In addition the managers find audit as a very significant function in their budgetary allocation (Table 20). On the overall there is an emphasis on audits as compared to the other functions.

While audits offer considerable control the present trend is not encouraging. The observation is that, often when taxpayers have been audited, irregularities are detected. Judging from the numerous occurrences of irregularities of various kinds, management is eventually aroused by a breakthrough in the non compliance. But a closer analysis indicates that a significant proportion, in terms of frequency rather than magnitude (illustrated in appendix 9), of the irregularities are technical in nature which suggests inadequate comprehensibility on the part of the taxpayers.

There seem to be two main problem areas. Firstly, concentrating on one facet of the key functions, that is audit at the expense of another equally important facet that is taxpayer education, which has resulted in failure to facilitate voluntary compliance. Secondly, concentrating too much on audit, without having due regard for the vital need to apply a balanced approach when allocating administrative resources.

These problems come in the sense that, some otherwise what would have been avoidable technical irregularities arise due to a lessened effort towards taxpayer service. Nonetheless it is important that the taxpayer must be informed of prefiling obligations and made to understand and comply with the laws. As earlier suggested, taxpayer service through a proactive approach to informing taxpayers and traders about the tax system and their obligations and implementing a range of taxpayer communication and education initiative will ease the revenue administration (Barrand, 2006).

A reduction in the time frontline officers go out and conduct compliance audits would be a considerable cost savings.

Frontline officers should strive to have effective audits. Audit visits should not be made to the same taxpayers. If an audit detects irregularities taxpayers should be made to understand them and how they might avoid them in future. The audit plan should primarily focus on issue orientation covering a limited period. Similarly, identification of cases should be monitored to provide for a good coverage of taxpayers each year.

5.3.2 Frequency of Visits and Administrative Resources

The tax authority must assess and collect sufficient VAT revenue to meet their goals and obligations. However, it is important that the costs of compliance and administration for taxpayers and VAT administration be reduced wherever possible. The questionnaire requested information on the frequency of visits by frontline officers to taxpayers and the time they spend at the premises in order to determine the effectiveness of VAT administration and potential use of time and administrative resources associated with the operations.

The results show that frontline officers frequently visit taxpayers and spend a lot of time with them. The majority of the officers go out almost everyday for various functions (Table 9). This has an impact on the operating expenses because it entails high transport costs. The visits which are not well regulated are also at a disadvantage because there is no proper guidance on the characteristics of the client population and whether the information can be used to direct administrative resources to improve efficiency.

While it is accepted that there must be interaction between tax officials and taxpayers, the visits have to be well coordinated. As observed (in Table 10) that most of the visits take a lot of time (about more than three hours), this has a bearing on compliance and administrative costs. Administrative costs are costs incurred in an effort to collect the VAT, and consist of budgeted costs of both the primary and secondary activities. Whilst compliance costs, the taxpayer incurs them in order to meet the tax obligations. Such costs are like stationery costs and labour costs. And compliance costs of a tax not only include that money spent on accounts but also tax payers' time spent and anxiety suffered in attending to tax officials.

It is also possible that, with high figures of revenue, the importance of analyzing such operational implications might be overlooked. In tax matters, the majority view the success in terms of the overall collection. But for effective administration it is important to realize that measuring the performance of VAT should not be restricted to revenue figures only. In addition it is important to realize the impact one function i.e. frequent and long visits, may cause on some of the subsequent components of the VAT system, such as collection costs.

High collection costs are not necessarily a result of a bad tax but may simply reflect inefficiency. Not even low administrative costs are necessarily good operational wise because it may implore inadequate monitoring. There is, however some substantial sense in the way the VAT is to be operated. Proper set up of functional teams that are well coordinated facilitate effective monitoring. It is important that the visits should be issue oriented.

5.3.3 Factors Determining Visits to Taxpayers

There are several factors prompting officers to visit taxpayers in varying degrees. First, function based factors, influence officers to visit taxpayers to carry out their routine tasks. Such visits typically emanate from the primary functions of audits, collection, and enforcement for filing of returns and taxpayers education. Secondly, the characteristics of taxpayers may also influence officers to visit them. These include characteristics such as compliance, size of business, industry and even location.

However while these general reasons cannot be ignored, the research data point to more specific factors that also influence visits. As observed in Tables 11 and 12 in chapter 4, late returns and size of business are the major influencing factors for visits. It means that more often tax officers go out to taxpayers for a reason of following up on unsubmitted returns. Secondly, officers often times visit taxpayers because of the size of their business. This means large businesses are likely to be visited more frequently than others. As such, there is no apparent set up of monitoring visits to taxpayers.

Although visits to taxpayers are an integral part of administering and very important we must do all it can be done to lower the cost and the burden to businesses. If an unreasonable burden is placed on businesses, it will cause unjustifiable problems to the economic and social environment of the tax regime. Additionally if the registered taxpayers are subjected to unnecessary burden, it gives rise to administering and compliance problems.

Administrative and compliance costs should be guarded at all costs. Given a particular targeted level of tax revenue, a tax system that requires fewer resources to administer and to comply with is better than a tax system that costs more. It is important that tax administration should view itself similar to business that provide services to customers and should constantly strive to improve the manner in which they provide such services.

5.4 FEASIBILITY OF ADMINISTRATIVE PROVISIONS

On the whole VAT administration, as exercised by the tax authority is governed by administrative provisions, which are spelt out by the particular legislation. Of course, to a certain extent as alluded to in chapter 2, the VAT label has necessarily adopted the EU model, although some important differences remain within VATs in different jurisdictions. Since the context within which they must operate differs significantly from country to country, it is only to be expected that different adjustments to the provisions may be best for different countries such as a single positive rate and exemption of some services to make them feasible. There are several such provisions but this study only looked at the feasibility of ten major and more prominent ones.

As evidenced by the results, there are varied perceptions on the feasibility of the current VAT administrative provisions. The study revealed that most frontline officers are contented with the feasibility of these provisions (Table 13a). For example, about 78 percent of frontline staff are contented with the provisions that allow the exemption of services such as education and financial. It means the idea of exempting certain businesses from being registered is supported.

In addition over 56 percent of them find the provision of a single rate as desirable. This can be explained by the fact that it is easier to administer a single rate VAT than a multiple rate one. Although one school of thought encourages the differentiation of VAT rates in the sense that lower rates should be applied on commodities for which the demand is more elastic and higher rates for which the demand is inelastic so as to minimize the impact of taxation on the pattern of consumption. In Malawi the multiple rates of VAT would not help matters. Thus, the differentiated non zero rates of a VAT were redesigned to a single rate to address specific problems built on simplicity needs. Whatever other effects it might have as by-products would be compared to this principal role.

As earlier alluded to in Chapter 2, there are several provisions governing a VAT system. It is appreciated that at no point is there one correct answer to a problem. All of the provisions listed in Table 13a are reform principles to improve the performance of an extended VAT scope in Malawi. This study has made it possible to explore instruments that initially might not have been considered either feasible or not feasible.

Despite having most of the provisions considered feasible, the study has revealed that there is a concern on the feasibility of the threshold level. Thus, the majority of frontline officers find this not feasible. The observation made (in Table 14) suggests that MK 2 million minimum turnover is not nearly high enough to have a good and even effectively managed VAT system. The number of VAT taxpayers to be registered must, for better or worse be controlled to matching with the administrative capacity by the threshold level. A threshold level too low is perceived to cause problems.

On the overall the instruments in place are specifically designed to be administrable and to promote institutional changes that would improve the quality of VAT administration. As such to overcome these deficiencies that might be caused by this major weakness a re-look at the design of the threshold level is implored.

5.5 ADMINISTRATIVE IMPLICATIONS OF THE EXTENSION

According to the study results, on the whole, it is believed that the extension has heightened up the administrative burden of VAT (see Table 17). Despite the continued need for more administrative simplicity of VAT, part of the reform process is aimed at the effectiveness of administering the tax. Surely, the extension of the VAT attempts to balance any revenue losses with offsetting revenue gains. However, weak areas have been identified in the area of generating and utilizing information on taxpayers and their payments. As a result, deficiencies in the administrative system have become major obstacles for effective operation of the VAT and may lead to inefficiencies.

Through this statement on deficiencies in the extended VAT administrative system, this study highlights the weakness leading to these deficiencies. The most striking weakness diagnosed by this study is that the information system is not effectively managed. In particular there is no proper set up of functional control system and the system also fails to identify trends and patterns of various operational tasks so as to allow a proper allocation of resources. By having such a weakness in place there would be no increase in ease and speed at which management would be able to analyze changing conditions and react to them appropriately.

It appears from the results that most of the provisions (in Table 13a), which are adopted from the universally acclaimed EU model, are feasible. However, from the overall analysis it appears that the VAT population cannot be effectively managed with the current administrative provisions. The threshold is too low to control the population. Of course this is a population that has significant levels of small to medium businesses which do not easily cope up with the self assessment.

On the other hand, it appears there is no systematic information management. As a result there are no proper grounds on which decisions are based.

As observed from the results (Table 15a) everyone strongly agrees that the extension has substantially increased the paperwork for various tasks. Conversely everyone thinks that restricting the number of registrants would make a difference by reducing the relative administrative cost (Table 16). The questionnaire had also sought views from the managers on the impact of the extension on their budgetary costs. Apparently, the majority of them agree that the extension has increased their budgetary costs.

Everything being equal, simplification should result in lower costs of the tax administration and the taxpayer because: Tax administrators should accept that they cannot capture absolutely all of the taxable economic activity. The increased costs associated with a complex administrative tax regime may outweigh the additional tax revenue collected, thereby suggesting a need for balance.

Although there was an indication from a managerial perspective that VAT administration is facing systems improvement, a significant proportion of the managers are not confident on the reliability of processes involved with the primary functions. Similarly, frontline officers feel that the overall VAT administration is less effective (Table 18). This can be a true manifestation of the deficiencies in the administrative system.

5.6 CHAPTER SUMMARY

To sum up, this chapter has discussed the findings of the study as presented in Chapter 4. The chapter holistically looked at all the findings from the three groups of respondents and their views on the different aspects of VAT administration in Malawi. The discussion centred on the characteristics, trends and issues of the current extended VAT system in Malawi, and its resulting implications as portrayed by the research findings. From the discussion it has been established that taxpayers' experiences and views are hardly any different from the tax administrators' perspective. There is an overemphasis on one aspect while leaving out equally important aspects of the administrative functions. Particularly, the evidence points that an audit function is given particularly high attention by the tax administration than the other aspects. Otherwise, the administrative provisions on the whole are said to be feasible but are found to be practically deficient due to the low threshold level permitting those taxpayers liable for registration. It has been further argued, in the discussion that there is no systematic information management. On the whole, the discussion has highlighted the major weakness of the VAT administration as reflected by the analysis of the findings.

CHAPTER 6

CONCLUSIONS AND RECOMMENDATIONS

6.0 INTRODUCTION

This chapter states the conclusions of the study drawn from the research findings. The chapter also suggests key recommendations to enhance the effectiveness of administering an extended VAT scope in Malawi.

6.1 CONCLUSIONS

Given the focus in this study on administering the extended VAT scope, it is noted that there is unanimous acceptance that the extension of VAT to wholesale and retail stages in Malawi has its own administrative implications. The single most telling indicator over the years of the extension has been the high incidence of pervasive administrative challenges. This study has helped to clarify the matters as observed from the conclusions. The conclusions are being drawn based on the null hypotheses that were tested by this study.

The Chi – Square statistic obtained for the null hypotheses has led to the rejection of both of them because in both cases the probability that the responses are caused by chance variations is extremely low. Firstly, the study has revealed that the current administrative provisions of the VAT system in Malawi are feasible. The probability that the observed values are different form the expected is 99.999 percent which gives 0.001 as the probability that the observed perception is caused by chance variations. Therefore, it is concluded that the observed perception on the feasibility of current VAT administrative provisions is unlikely to have been caused by chance. Similarly the second null hypothesis that the extension of VAT to wholesale and retail stages in Malawi has not contributed to administrative implications is also rejected. The Chi Square statistic obtained from the test gives 0.001 percent as the probability of the responses occurring by chance factors alone.

However the analysis shows that although the provisions in place are sound in design, the low threshold level has been a significant source of potential administrative instability and burden that has adversely affected the effectiveness of administering the VAT system in Malawi. This agrees with the VAT administration paradigms, as some recent literature (Annacondia and van der Corput, 2003) suggests that low threshold levels are a cause for administrative problems in a VAT system, particularly those characterized by a high incidence of informal economic activities.

Apparently, the study indicates that variations on inefficient, risky and largely unmanaged life of VAT activities occur again and again in this VAT system, not just with audits but with every type of function. By and by it has become a system of uncontrolled replication of visits to taxpayers, unmanaged retention of taxpayers and unwieldy volumes of paperwork. And ever increasing challenges due for the need to control all the taxable activity do not seem to end.

In light of these revelations the study has also implicitly highlighted the following emerging administrative implications:

6.1.1 Administrative Implications of the Extension

a. Increased administrative demands

The extension has heightened up the administrative demands of administering the VAT system. As noted from the results, it has given rise to paperwork involved to procedures and processes. Similarly, the workload involving the primary functions of audits, collection and enforcement of arrears has also been substantially increased.

b. Challenges owing to the self assessment system

The inclusion of wholesalers and retailers in itself is a challenge to the self assessment system. The success of a self assessment system is, of course, intimately related to the ability of the tax administration either to enforce or assist the taxpayers to comply with the needed conditions. Or, perhaps most fundamentally, the degree of existing trust between officials and taxpayers and how quickly (and in what ways) that trust can be built up to support a self assessment system? An issue that itself requires much closer examination than it seems to have received.

c. High collection costs

The extension has also caused high collection costs. Here two corollaries may be suggested. First, as already mentioned, one implication is simply that by sequencing increased paper work and the increase of interaction points with the taxpayers a lot of resources are incurred. This study notes that the exact level of additional administrative costs suffered due to the implications is difficult to quantify. Nevertheless all the three major stakeholders have admitted that the relative administrative costs of administering VAT in Malawi have risen. Secondly, on the part of the taxpayer, as more effort and time is needed to attend to VAT officers his/her compliance costs are also increased.

d. Poor coordination of the primary functions

VAT administration seem to put much emphasis on certain aspects of administration than others, perhaps because they give higher priority to other, more pressing needs or, perhaps less understandably, because of the almost certainly mistaken belief that the presumed "best administrative practices" observed elsewhere can and should simply be copied. Instead there is lack of a balanced approach towards the primary functions in pursuit of the goals and objectives of tax administration. It is neither the emphasis on enforcement nor, it seems, the desire to check on how taxpayers are complying that can solely yield the results. Any good revenue administration needs good controls. Yet not only audits avail in such situations, but even taxpayers education and assistance to the taxpayers on how to comply with the obligations do assist.

e. ***Low compliance due to insufficient taxpayers' education.***

As observed from the results, technical irregularities have been detected on more than one visit to a taxpayer as opposed to the other irregularities such as arithmetic errors. This simply reflects inadequate understanding of the operation of a VAT on the part of a taxpayer and inadequate provision of taxpayer education on the part of the tax administration.

6.1.2 Factors Contributing to the Administrative Implications

Generally, there are deficiencies in the VAT administrative system. This comes as a result of major weaknesses of the systems reform. Mostly, the weaknesses have come in threefold through:

a. Lack of systematic information management to cater for the coordination of the primary activities of administering VAT such as audits, taxpayers' education, collection and enforcement efforts.
b. Relatively low effort in the direction of taxpayers' education and service which has limited taxpayers' ability to understand their obligations fully.
c. Low threshold level for registration which has unnecessarily increased the taxpayer population.

6.2 RECOMMENDATIONS

This study recommends a staged approach to develop an effective VAT administrative structure over a medium term. Effectiveness of VAT administration can be enhanced without making drastic changes to the system as long as the threshold level is increased and information is managed effectively. This study recommends that there should be a fundamental reform of the functions of the VAT themselves, effectively involving the systematic management of information. The early stages would involve the gradual reform of the systems. This could be initially tested either within or across a subset of functional sections of the VAT administration such as audit, taxpayers' education or enforcement of arrears. This structure could then be rolled out to larger scale knowledge management software, intranets and other data bases concerning the whole VAT system. Eventually a review of the threshold level for VAT registration could follow. This could solve the VAT administration's information access, sharing and management. As a matter of fact, this would enhance the efficient allocation of resources and long term decline in the cost of administering the taxpayers.

More specific recommendations that would both enhance the administering of VAT and also improve coordination of the functionary activities, as just described above are as follows:

6.2.1 It is recommended that an early initiative be undertaken by VAT administration to reform information management systems. Information in the VAT system is present in two forms, namely structured and unstructured information. Structured information is stored in databases with a predefined structure to cater for the predictable information needs. This information can be compiled, collated and analyzed to make meaningful decisions.

However unstructured information is present as detailed textural reports usually written and does not conform to easy data collation. Unstructured information in the VAT system has always been stored on an ongoing basis and spans many individual taxpayers' hard copy files. A significant majority of the VAT's information system, over 50 percent is in this form and it is hardly used. Most of the information that individuals in the VAT administration are looking for is buried within the organization in this form. As such, enormous information of strategic value is lost due to a lack of systematic information management. This information can however be evolved with the strategic direction that the system wishes to take. A set of automated processes and workflows must be implemented to normalize this information into a structure and enable access to this information for the operation of the system. The typical structured information that can be used is:

a. The dates of visits to taxpayers and functions carried out.
b. Taxpayer's details, in terms of nature of business, industry and size.
c. Minutes of important issues.

The end result of this will be a systematic, robust, scalable architecture for providing easier, faster access to the information that an individual is looking for.

6.2.2 It is recommended that an early initiative be undertaken to scale up taxpayers education and service. The cost effective education and service of taxpayers can lower the costs of compliance and improve the quality of compliance. The scope to increase this can be yielded through:

a. Increased educational visits to taxpayers, particularly upon registration or audit,
b. introduction of informational help desks at tax administration offices, and
c. central information (telephone) call centres.

And increase the access to information through a range of distribution channels including:

a. short explanatory booklets and guides,
b. special tax newspapers, and
c. use of internet.

6.2.3 It is recommended that the threshold level for registration, that is the minimum turnover limit of taxable sales should be reviewed. Consideration should be in the direction of increasing it in order to control the number of small and medium businesses being registered. There is a possibility that a lot of revenue collected from such traders is not remitted because most of them seldomly keep records as required by a self assessment system. Thus, it has been noted that most of the retailers more frequently resort to practices designed to evade VAT, particularly because the large numbers and small volumes of their transactions make it difficult for the revenue authority to detect their strategies.

The exemption level should be set at a level that excludes traders that cost more to administer than the revenue they produce. This would make VAT collections to be more cost effective by reducing administrative and compliance costs incurred due to replication of largely unmanaged VAT activities.

6.3 AREA FOR FURTHER RESEARCH

This study has looked at the administrative implications of the extension of VAT and suggests the raising of the minimum turnover for registration. The approach of raising the minimum turnover for registration may be taken as a medium term target, but may not be an absolute panacea given the significance of the proportion of businesses to be excluded. Assuming that this sector, which is already big, as alluded to in chapter 2, keeps on growing, it means the economic activity to be excluded is also likely to become significant. Arguably, it is claimed that the extension is there to broaden the tax base. Then the next question might be how would the additional tax revenue meant to come from this economic sector be recouped? This study cannot however, provide an outright answer.

This study has focused on making VAT collection more cost-effective. However, it should not be misconstrued that it does not appreciate that building better performance indicators, which would benefit design, implementation and evaluation of the VAT system, includes coverage of the output measures. Hence to safeguard the short to medium term gains in effective administration, it is therefore recommended that further studies be conducted to see what taxation potential the excluded economic activity has and how effectively it can be taxed. Possibly, the research should look at how indirect tax can be collected from these small taxpayers without the higher compliance and administrative costs associated with VAT.

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Appendix 1

Key Administrative Tax Gaps

The following are the four key administrative gaps commonly recognized in tax literature.

a) **The identification gap**: The percentage of the base that is outside the tax net. This captures the tax administration's inability in expanding the base.

b) **The filing gap**: The shortfall owing to non-filing defined as the number of non-filers as a percentage of the total registered persons. This reflects the tax administration's inability to monitor and enforce compliance with respect to filing.

c) **The audit gap**: The loss due to under-reporting of net tax liability. This reflects ineffectiveness of the administration's effort to raise the probability of detection that would be negatively correlated with a low degree of under-reporting.

d) **The recovery gap**: The fraction of the adjudged principal amount, penalties and additional tax that remain uncollected. This reflects the ineffectiveness of recoveries.

Appendix 2

Prerequisites for an Effective Self Assessed VAT System

Based on a research at the IMF on the VAT in the early 1990s, the conditions for the successful implementation of self assessment are summarized below (Ebril et al, 2001).

i. Simple VAT law that would provide for limited exemptions, a single positive rate, a zero rate limited to exports, and a high threshold.

ii. Service to taxpayers to assist them meeting their obligations; good mechanisms of disseminating information – taxpayers need to be informed of changes to the law and should have easy access to information and tax forms.

iii. Simple registration procedures, availability of tax forms and easiness of procedures to comply with.

iv. Collection enforcement – Prompt detection of taxpayers failing to submit VAT returns and / or pay tax due is critical to VAT administration.

v. Audit – the VAT administration should have a proper set up of audit teams that effectively detect non-compliance.

vi. Penalties – Non-compliance should be deterred with appropriate penalties. Tax fraud should not be condoned but prosecuted through the criminal justice system.

vii. Access to review of decisions – there should be a provision allowing settlement of dispute as well as a mechanism for access to appeal.

Appendix 3: Letter for seeking consent

Deputy Commissioner General
Malawi Revenue Authority
Chayamba Building
Private Bag 247
Blantyre

Dear Sir:

REQUEST TO ADMINISTER A STUDY QUESTIONAIRE

I am currently researching on value added tax (VAT) administration, in order to determine and share effective practices of this topical and important issue. I am pursuing a course in Business Administration with the University of Malawi, The Polytechnic.

VAT, which is a relatively new tax, is one of the taxes that has swept the world over the last few decades and poses so many challenges. It is with this perspective that I find it interesting to know more about experiences of introducing and implementing an extended VAT base.

I am now arranging a further insight with targeted representative sample of VAT divisional participants to be selected randomly who can give personal insights into specific practical administrative aspects. The questionnaires are expected to be administered early March 2007 and it is envisaged that a single questionnaire can only take up to 15 minutes.

My major intended output will be a report summarizing the findings and I will be sending a copy of this to MRA.

I hope you are able to help me and should be grateful if you would provide the feedback.

If you require any further information I shall be prepared to call upon you at any time to you're your convenience.

Sincerely,

Appendix 4: Introductory note attached to the Questionnaire

ADMINISTRATIVE IMPLICATIONS OF EXTENDING VAT TO WHOLESALE AND RETAIL STAGES IN MALAWI.

A student who is pursuing a Masters Degree in Business Administration with the University of Malawi, The Polytechnic, is undertaking a study to gather information on administrative aspects of the extension of VAT in Malawi.

You have been selected as one of the respondent through a systematic random sampling, and therefore you are requested to assist by completing the attached questionnaire. To ensure strictest confidence, you are not obliged to disclose your name on the questionnaire. And to take up as little of your time as possible the questionnaire has been made simple to complete.

Since the questionnaire is for academic purposes, some questions may appear elementary and /or sentimental.

Thank you for your cooperation.

Appendix 5

STUDY QUESTIONAIRE FOR VAT REGISTERED TAXPAYERS

ADMINISTRATIVE IMPLICATIONS OF EXTENDING VALUE ADDED TAX (VAT) TO WHOLESALE AND RETAIL STAGES IN MALAWI.

Unless otherwise indicated, please tick in the space provided next to the answer you choose. Please answer all questions.

1. **Please indicate the following**:

A. Your business entity

a) Sole proprietorship ( )
b) Partnership ( )
c) Limited ( )
d) Other (specify)

____

B. Status of respondent

____

(e.g. taxpayer or representative)

C. Nature of business

a) Agriculture ( )
b) Manufacturing ( )
c) Mining ( )
d) Construction ( )
e) Utilities ( )
f) Transport ( )
g) Wholesale trade ( )
h) Retail trade ( )
i) Other __________________________________

(Please indicate)

D. When were you registered for VAT?

a) Before November 1, 2002. ( )

b) 2002 – 2003 ( )

c) 2003 – 2004 ( )

d) 2004 – 2005 ( )

e) 2005 – 2006 ( )

E. Please indicate your documentation method for a sale

a) Use of till machines ( )

b) Manual receipts ( )

c) Both (a) and (b) ( )

d) Gross takings ( )

e) None of the above ( )

f) Other ______________________________

2. Is each and every sale documented? (Please tick)

Yes ( )

No ( )

3. Do you have a mechanism to differentiate sales by VAT rates?

Yes ( )

No ( )

4. Have you received an educational visit from VAT officials?

Yes ( )

No ( )

5. If the above answer is yes, when was (were) the visit (s)?

a) Prior to registration ( )

b) After registration ( )

c) Prior and after ( )

6. Have you had an access to short explanatory booklets of VAT?

Yes ( )

No ( )

7. If the above answer is yes, is the language used in the booklet understandable as to what you must do?

Yes ( )

No ( )

8. Has the introduction of VAT led to a review of your accounting system?

Yes ( )

No ( )

9. Are you able to calculate your compliance costs?

Yes ( )

No ( )

10. Please rate the easiness of doing the following tasks as a VAT registrant (fill in the appropriate number according to your answer in the parentheses provided).

1	**2**	**3**	**4**	**5**
Very difficult	**Difficult**	**Average**	**Easy**	**Very easy**

a) Completing the monthly returns ( )

b) Issuing VAT invoices ( )

c) Keeping the records ( )

d) Submitting monthly returns ( )

e) Understanding VAT regulations ( )

f) Attending to VAT officers ( )

g) Understanding the various categories of supplies (taxable and exempt)( )

h) Splitting the taxable sales between those liable of to zero and the ones at 17.5% rates. ( )

i) Keeping records of gross takings ( )

j) Calculating the tax due ( )

11. How many times have you been audited (VAT) in the past 12 months?

a) None ( )

b) Once ( )

c) Less than 4 times ( )

d) 4 times ( )

e) More than 4 times ( )

12. How many times has there been occurrence of irregularities?

a) None ( )

b) One visit only ( )

c) Twice ( )

d) More than 2 (specify) ____________________

13. What type of irregularities have you experienced?

a) Understatement of sales ( )

b) Understatement of purchases ( )

c) Arithmetic errors ( )

d) Technical errors ( )

14. How many times have you had visits for a reminder of assessments in the past 12 months?

a) None ( )

b) Less than four times ( )

c) Four times ( )

d) More than four times ( )

15. How many times have you had visits for a reminder of monthly returns in the last 12 months?

a) None ( )

b) Every month ( )

c) Once inn a quarter ( )

d) Over 4 times a year ( )

16. What is your opinion about the current administrative provisions in view of the extension of VAT to wholesalers and retailers?

……………………………………………………………………………………

……………………………………………………………………………………

17. Suggest what should be done to improve or enhance VAT administration

……………………………………………………………………………………

……………………………………………………………………………………

……………………………………………………………………………………

Thank you for filling this questionnaire

Appendix 6

STUDY QUESTIONAIRE FOR VAT TECHNICAL OFFICERS

ADMINISTRATIVE IMPLICATIONS OF EXTENDING VAT TO WHOLESALE AND RETAIL STAGES IN MALAWI.

Unless otherwise indicated, please tick in the space provided next to the answer you choose. Please answer all questions.

1. **Please indicate the following**

Your work station ___________________________________

For how long have you worked at this station?

a) Less than 1 year ( )
b) 1-2 years ( )
c) 2-3 years ( )
d) 3-4 years ( )
e) Over 5 years ( )

2. **How often do you visit the traders?**

a) Once a month ( )
b) 2-4 times a month ( )
c) 8-16 times a month ( )
d) More than 16 times months ( )

3. **How long do your visits take?**

a) 0-30 minutes ( )
b) 30-60 minutes ( )
c) 1-2 hours ( )
d) 2-3 hours ( )
e) More than 3 hours. ( )

4. **If you decide to visit certain taxpayers more frequently than others what are the determining factors for your visits to taxpayers?** (Please rank your response on the basis of importance)

1	2	3	4
Very important	Important	Less Important	Not important

a) Size of business ( )

b) Type of business ( )

c) Persistent default ( )

d) Late returns ( )

e) Errors in returns ( )

f) Education ( )

g) Other (specify) ____________________

5. **How would you rate yourself in terms of the following attributes?**

1	2	3	4
Very Good	Good	Average	Poor

a) Cooperation with taxpayers ( )

b) Understanding of the VAT legislation ( )

c) Understanding of basic principles of VAT ( )

d) Understanding of basic principles of tax ( )

e) Understanding of tax rates ( )

f) Understanding of business practices ( )

g) Conducting audits ( )

h) Providing taxpayers education ( )

6. **How would you rate other VAT frontline staff in terms of the following attributes?**

1	2	3	4
Very Good	Good	Average	Poor

i) Cooperation with taxpayers ( )

j) Understanding of the VAT legislation ( )

k) Understanding of basic principles of VAT ( )
l) Understanding of basic principles of tax ( )
m) Understanding of tax rates ( )
n) Understanding of business practices ( )
o) Conducting audits ( )
p) Providing taxpayers education ( )

7. **The extension of VAT to wholesale and retail stages has been associated with a number of administrative changes. These changes constitute the current administrative provisions. From your experience how feasible are provisions listed below (a to p)?** (Please enter the number corresponding to your choice)

1 If you think they are feasible
2 If you think they are averagely feasible
3 If you think they are less feasible
4 If you think they are not feasible

a) The invoice credit method ( )
b) Inclusion of services in the base of VAT ( )
c) Exemptions for health, education and health services ( )
d) Establishment of a large taxpayer’s unit ( )
e) MK 2,000,000.00 threshold for compulsory registration ( )
f) Zero rating of exports (with trade being taxed on destination basis) ( )
g) Input credits for capital goods ( )
h) Single positive standard VAT rate ( )
i) VAT calculated on accrual basis (tax payable when effective delivery or transfer of ownership occurs) ( )
j) Staffing and training ( )
k) Procedures for payment of monthly VAT due ( )
l) Procedures for collection of VAT arrears ( )
m) Procedures for audit exercises ( )
n) Procedures for identification of new registrants ( )
o) Procedures for detection of delinquent taxpayers ( )

p) Interest and penalties imposed on defaulters ( )

8. **The VAT system in Malawi employs a self-assessment approach: that is, taxpayers calculate and pay their own tax liabilities. The conditions that support a self-assessed tax system include services to taxpayers. To what extent do you think the VAT administration assist taxpayers in meeting the following obligations?** (Please enter the number corresponding your choice in the space provide)

1	2	3	4
Large	Average	Minimal	Not at all

a) Clarity of information describing taxpayers' obligation ( )
b) Informing taxpayers of changes in the law ( )
c) Accessibility to information and VAT forms ( )
d) Access of taxpayers to an appeal process ( )

9. **To improve the effectiveness of VAT administration, more procedures have gradually been introduced and these have an impact on some of the following tasks, do you agree or disagree?**

1	2	3	4	5
Strongly agree	Agree	Mildly agree	Mildly disagree	Disagree

a) Increased substantial paperwork in processing of returns,
b) Increased substantial paperwork in issuing payments notices
c) Increased substantial paperwork in and reconciling liabilities and payments for taxpayers) ( )
d) More effort on enforcement ( )
e) More audit exercises ( )
f) Increased number of nil returns being detected each month ( )
g) Increased number of non filers being detected each month ( )

10. **Does the inclusion of wholesalers and retailers in the VAT system increase the burdensome workload of the VAT Administration?**

(Please tick)

a) Absolutely yes ( )
b) Yes ( )
c) Not really ( )
d) Don't know ( )

11. What is your opinion about the current administrative provisions in view of the extension?

a) Very effective ( )
b) Effective ( )
c) Less effective ( )
d) Don't know ( )

12. In your view, how would restricting the number of wholesalers and retailers make a difference? (Please tick your choice(s) below)

a) Administrative costs will remain the same ( )
b) Administrative costs will decrease ( )
c) Administrative costs will increase ( )
d) Administrative problems will remain the same ( )
e) Administrative problems will decrease ( )
f) Administrative problems will increase ( )

13. Please comment in the space provided how you feel the VAT administration can be improved.

____

____

____

____.

Thank you for filling this questionnaire.

Appendix 7

STUDY QUESTIONAIRE FOR VAT MANAGEMENT

ADMINISTRATIVE IMPLICATIONS OF EXTENDING VAT TO WHOLESALE AND RETAIL STAGES IN MALAWI.

Unless otherwise indicated, please fill in the space provided next to the answer you choose. Please answer all questions.

1. **Is the VAT administration facing systems improvement or fundamental reversal?**

   ____

2. **What do you think are the critical success factors for accomplishing systems improvement?**

   ____

   ____

   ____

   ____

3. **How well are these factors understood across the organization?**
   a) Very well understood ( )
   b) Well understood ( )
   c) Partially understood ( )
   d) Not understood ( )
   e) Don't know ( )

4. **How influential are they in guiding the day-to-day actions of the people?**
   a) Very influential ( )
   b) Influential ( )
   c) Partially influential ( )
   d) Not influential ( )
   e) Don't know ( )

5. How reliably do the existing processes deliver on the critical functions of:

1	2	3	4
Very reliable	Averagely reliable	Reliable	Not reliable

a) Collection ( )

b) Registration ( )

c) Audit ( )

d) Enforcement ( )

6. How well do the division's support systems facilitate:

1	**2**	**3**	**4**
Very well	**Well**	**Averagely well**	**Not well**

a) Maintaining the clarity of purpose and alignment with the environment ( )

b) The information flow ( )

c) Communications and coordination to plans ( )

d) Controlling core processes and deal effectively with the VAT environment ( )

e) Supporting personal needs of the VAT registrants ( )

7. Are your support systems built to support VAT core processes or do they seem to have a life of their own?

____

8. What is your opinion about the current provisions in view of the extended VAT base?

a) Very effective ( )

b) Effective ( )

c) Less effective ( )

d) Don't know ( )

9. Has the operation of VAT been substantially affected due to the extension?

Yes ( )

No ( )

10. If the answer to question 9 is 'yes' how has VAT operations affected your budgetary costs?

a) Relative cost of administration has increased ( )

b) Relative cost of administration has decreased ( )

c) Relative cost of administration has remained the same ( )

11. If the administrative costs have increased, please rank the following components of your operation on VAT administration according to their significance as contributor to your cost. (Tick as appropriate)

Component	Very significant	Significant	Not significant
a) Follow up of returns	___	____	____
b) Collection of arrears	___	____	____
c) Audits	___	____	____
d) Identification of new registrants	___	____	____
e) Registration	___	____	____
f) Processing of returns	___	____	____
g) Taxpayers education	___	____	____

15. **In your view do you think restricting the number of wholesalers and retailers would make a difference?**

a) No, administrative costs will remain the same ( )

b) Yes, administrative costs will decrease ( )

c) Yes, administrative costs will increase ( )

d) No, administrative problems will remain the same ( )

e) Yes, administrative problems will decrease ( )

f) Yes, administrative problems will increase ( )

16. Please comment in the space provided how you feel VAT administration can be made more effective.

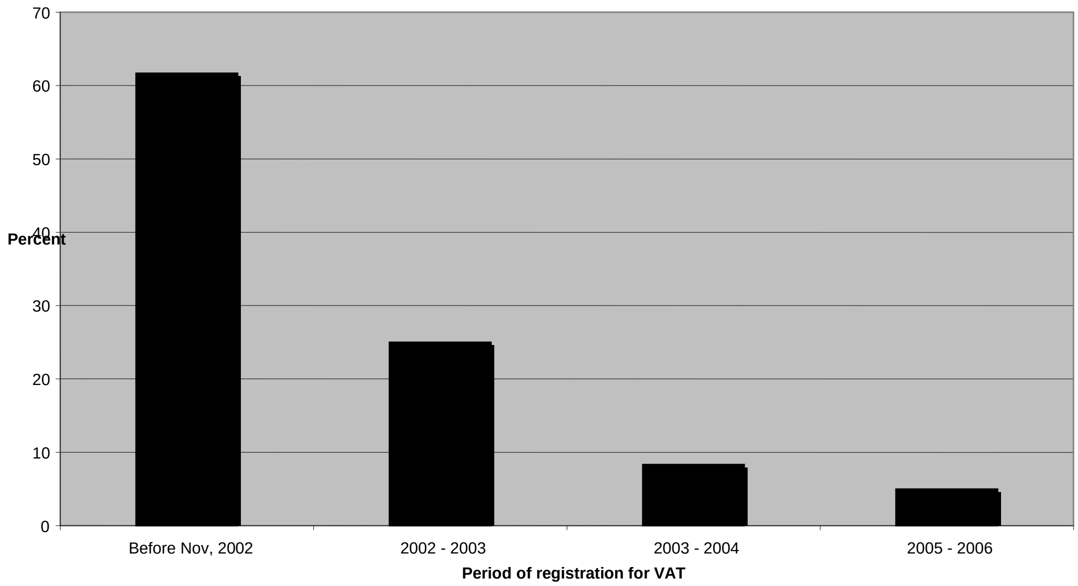
____

____

Thank you for filling this questionnaire

Appendix 8

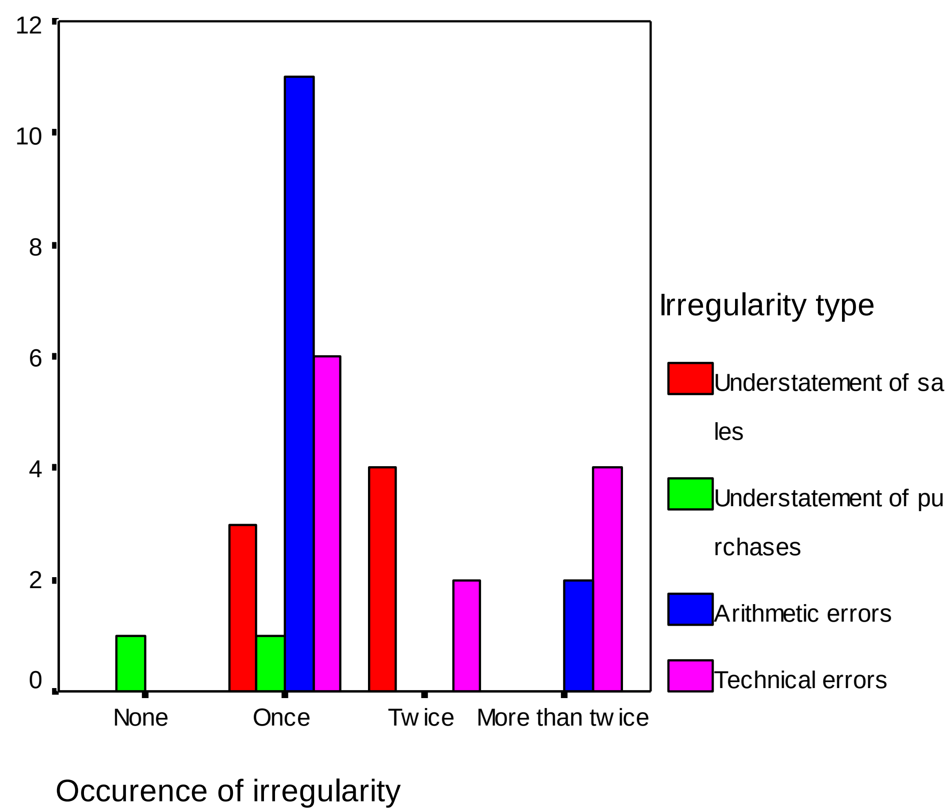
Distribution of VAT Taxpayer Respondents according to year of Registration



A figure illustrating the proportions of VAT taxpayer respondents according to the period they were registered based on results presented in Table 1b.

Appendix 9

Prevalence and magnitude of VAT Irregularities amongst taxpayers.



A figure illustrating occurrence of irregularities and on how many visits the particular type of irregularity has been detected amongst taxpayers.