

**IMPACT OF AUDITING ON VAT COMPLIANCE: A CASE
STUDY OF SMALL VAT OPERATORS IN BLANTYRE CITY
OF MALAWI**

MASTER OF BUSINESS ADMINISTRATION DISSERTATION

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**UNIVERSITY OF MALAWI
THE POLYTECHNIC**

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BY

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Bachelor of Business Administration - University of Malawi

**Submitted to the Department of Management Studies, Faculty of Commerce, in partial
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**University of Malawi
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DECLARATION

I declare that this dissertation is my own work and does not contain any previously published work accepted for an award of any degree. Other people's work has been properly acknowledged, hence making the work very original.

Name: Lovemore George Mwanandi

Signed: _____

Dated: _____

CERTIFICATE OF APPROVAL

We, the undersigned, certify that we have read and hereby recommend for acceptance by the University of Malawi a thesis titled '*Impact of auditing on VAT compliance: A case study of small VAT operations in Blantyre City of Malawi*'.

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DEDICATION

To my mother, who did not live long enough to witness the fruits of her hands and also my family for their understanding, patience and unlimited support rendered to me during my study period.

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Finally, I thank small VAT operators in the City of Blantyre for their participation in the study as respondents.

ABSTRACT

The perception of many tax professionals and other scholars is that VAT auditing has a positive effect on compliance of VAT operators and the study was carried to assess that belief. Quantitative data was collected from a sample of 353 respondents using probability sampling technique and 101 respondents responded positively representing a 29% response rate. The study established that religion, ethical behaviour, patriotism, morale, personal qualification, age, marital status, legality of business entities, business turnover and nature of business activities were some characteristics that affect VAT operators' compliance. Furthermore, the outcome has also shown that there was a weak insignificant negative relationship between VAT compliance and audit and that only 1 % of VAT operator's compliance is explained by VAT audits. In that case, the study informed that VAT audits do not make a substantial impact on VAT compliance in Malawi. Meaning that VAT compliance cannot in any way be affected by audit rates in Malawi and that audit productivity and effectiveness does not add much value to compliance and revenue. However, the study established tools and strategies that can be used to supplement the already existing ones to improve VAT.

Therefore, in order to achieve high levels of compliance, it was recommended that Malawi Revenue Authority should combine audit with other enforcement tools such as civic education in order to stimulate compliance, engage government to devise tax policies that promote compliance and devise pragmatic, practical and effective operation plans that enhance the impact of VAT audits in order to consolidate VAT compliance and revenue.

KEYWORDS

Value Added Tax, VAT compliance, VAT returns filing, Small VAT operators, Taxable person and VAT auditing.

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LIST OF ABBREVIATIONS AND ACRONYMS

COMESA	Common Market for Eastern and Southern Africa
DIF	Discriminant Index Function
EFD	Electronic Fiscal Device
EFDMS	Electronic Fiscal Devices Management Systems
ESCOM	Electricity Supply Commission of Malawi
IID	Investigation and Intelligence Department
IMF	International Monetary Fund
IRS	Internal Revenue Service
LTO	Large Tax Office
MK	Malawi Kwacha
MSCE	Malawi School Certificate of Education
MRA	Malawi Revenue Authority
MTO	Medium Tax Office
OECD	Organization for Economic Cooperation and Development
PAYE	Pay As You Earn
PSLC	Primary School Leaving Certificate
RPP	Return Payment Processing
SACU	Southern Africa Customs Union
SADC	Southern African Development Community
STO	Small Tax Office
TCMP	Tax Compliance Measurement Program
TSU	Taxpayers Service Unit
USA	United States of America
VAT	Value Added Tax
VCW	Voluntary Compliance Window
WB	World Bank
WHT	Withholding Tax

OPERATIONAL DEFINITIONS

Value Added Tax:

It is a general tax on consumption expenditure that is levied on value added created at various stages in the production and distribution chain of any product or service.

VAT compliance:

It is a voluntary activity of any VAT operator to register, file VAT returns and pay VAT to a tax authority and more also the degree to which a VAT administration system effectively and efficiently functions in collecting the tax.

VAT returns filing:

It is the preparation and submission of VAT returns, on a monthly basis, to a tax authority by a VAT operator.

Small VAT operators:

They are registered VAT operators whose turnover is in between MK10 million and MK100 million. This classification is according to Malawi Revenue Authority as at 30th July, 2015.

Taxable persons:

It is a business, sole trader or any professional who are responsible for charging, collecting and paying VAT to a tax authority. The term is synonymous to VAT operators and is used interchangeably.

Deterrent effect:

It is a preventive effect on audited VAT operators. It is the use of punishment as a threat to deter people from not paying taxes. In this case VAT auditing is used as a tool for the threat.

VAT auditing:

It is the examination of source documents in order to verify the correct tax position of a VAT operator. The activity helps to identify all or part of the under declared tax. According to OECD (2006), a tax audit is an examination of whether a taxpayer has correctly assessed and reported their tax liability and fulfilled other obligations

Malawi Kwacha (MK)

It is a unit of exchange in Malawi. All goods and services including tax are transacted in this currency. At the time of this research, it was being exchanged at MK 750 to 1 USD

CHAPTER 1

INTRODUCTION

1.1 Background

It has become increasingly demanding for governments all over the world to devise means of generating adequate revenues to finance their expenditures (Patrick & Stone, 2009). The expenditure rates continue to soar as a result of growth in population with its demand for infrastructure, social-political and economic investments (Patrick & Stone, 2009). It is against this background that taxation remains a legally accepted means of generating revenue all over the world and there are different kinds of taxes that governments levy (Williams, 2011). Taxation dates back to biblical times where citizens were made to pay tax towards the construction of structures such as tower of Babel. The researcher also notes from the Bible in Matthew, Chapter 22 Verse 21, where it reads “He said unto them, therefore render to Caesar the things that are Caesar's, and to God the things that are God's.”

Global economic turmoil such as recession have created financial problems amongst many countries in the world and more also has created gaps in their budgets. For example, latest recession in the United States of America (USA) has caused serious budgetary deficits (International Monetary Fund [IMF], 2010). To circumvent these problems, governments keep on reducing expenditure lines thereby negatively affecting service delivery to the citizenry or alternatively, raising the tax rates. These recessions have now offered opportunities for underground economic activities to few individuals whose proceeds cannot be declared for tax purposes hence becoming noncompliant (IMF, 2010). Compliance, as viewed by James and Alley (2004) is a voluntary activity and degree to which a tax system effectively and efficiently boosts revenue collection which is grossly affected by factors such as knowledge, financial soundness, moral and legal responsibility. In-sufficient revenues that government are collecting have forced some countries such as United Kingdom to ease the tax burden on the citizenry by cutting down their budgetary lines and alternatively increasing efficiencies in the administration of taxes in order to achieve high compliance rates.

Africa continent and particularly Southern African Development Community (SADC) region countries including Malawi are not exceptional to the revenue in-sufficiency and noncompliance problems. All the countries are experiencing challenges in one way or another,

for example, shortage of money that could be used in the provision of social services, development projects and economic growth. The yearly budgets are always in deficit as revenues do not match their proposed expenditures. There has been a large increase in fiscal deficit that has been attributed to the rapid expansion in expenditure and low revenue collection, thus making fiscal deficit the core issue of most of the developing countries like Malawi over the past decades (Qasi & Sulaiman, 2010). The fiscal deficit is a recurring feature of the public sector financing (Omojimate & Iboma, 2012). Aizenman and Jinjark (2005) noted that trade integration has greatly impacted on tariffs thereby reducing the performance of custom and excise duty. These problems have further been compounded by the freezing of donor aid by cooperating partners in most countries because of governance issues such as corruption commonly known in Malawi as cash gate. A working definition of corruption by World Bank is abuse of public power for private benefit (World Bank, 2012). Thompson and Shah (2005) describes corruption as the behaviour of officials in public sector, where they improperly and unlawfully get government money to enrich themselves or those close to them, by misusing public power entrusted to them. Macrae (1982) describes cashgate as a form of corruption where there is an arrangement that involves a private exchange of money between two parties where one has an influence on the allocation of resources either immediately or in the future, and use or abuse public or collective responsibility for private ends.

In Malawi, the cashgate scandal exposed very serious weaknesses in terms of governance and public financial management to the extent that government was plundered of more than MK13 billion in 2013/2014 fiscal year and has un-necessarily made Malawi government very bankrupt. It has so far failed to repay about MK200 billion and MK80 billion it owed several banks and suppliers of goods and services respectively (Malawi Government, Budget Paper, 2013). Almost all development partners, providing budgetary support, have suspended their support arguing that unless public finance management is tightened, they are not going to provide any budgetary support. The stoppage of budgetary support leaves Malawi with no choice but to rely solely on domestic revenue for the provision of social services and development projects. As a result, Malawi government through Malawi Revenue Authority aims to strengthen tax administration to improve VAT operators' compliance and bring efficiencies that maximize tax collections. Myles (2000) noted that any government's financial capacity depends on how well it collects taxes. This proposition is also true for Malawi because taxes are the main stay and number one source of revenue.

Tax administration activities in Malawi are delegated to Malawi Revenue Authority (MRA), a government agent responsible for assessment, collection and accounting for all direct and indirect taxes. Taxation is a wide field of study and covers taxes such Income Tax, Custom Duty, Excise Tax, Sales Tax, Value Added Tax (VAT) and many others. As such, this study only focused on VAT for a number of reasons. Leach (2003) notes that VAT is a relatively new tax that has a wider coverage whose adverse variances, if adequately controlled under proper administration, can help generate more revenues. Whenkroff (2003) also alludes that VAT has become a verifiable source of revenue in many developing countries. A report published by the International Monetary Fund (2012) also notes that VAT is the most reliable, stable and efficient source of revenue in Malawi after customs duty whose performance has grossly been affected by trade agreements entered into by regional blocks and countries. Examples of such agreements are Common Market for Eastern and Southern Africa (COMESA), Southern African Development Community (SADC), Southern Africa Customs Union (SACU), Malawi-South Africa, Malawi-Zimbabwe, Malawi-Mozambique and Malawi-Zambia. IMF (2012) also observed that domestic VAT alone contributes over 30 % to Malawi government account number one and is a very important and dependable source of revenue such that it is slowly becoming the main stay. However, it has been observed by the (2014) that performance of VAT is declining and requires safeguarding against the evading behaviour of VAT operators by auditing (Appendix 2).

1.2 Administration of VAT in Malawi

Legal basis for VAT administration in Malawi is provided by the VAT Act of 2005. A definitive statement made by Bird, (2005, p.8) defines VAT as a broad tax that is levied and collected at every stage of production, distribution and consumption using a credit system. Also Bird and Gendron (2007, p.10) defines VAT as a general tax on consumption expenditure that is levied on the value added, created at various stages in the production and distribution chain. VAT audit manual, a guide for tax auditors in Domestic Taxes Division in MRA, defines VAT auditing as an activity or set of activities that are performed by a tax auditor to determine a taxpayer's correct tax liability for a particular accounting tax period. The taxpayer's financial affair is examined in order to assess compliance and verify return's accuracy, completeness and correctness. Organization for Economic Cooperation and Development (OECD) (2006) describes tax audit as an examination on whether a taxpayer has correctly assessed, reported tax liability and fulfilled other obligations.

Value added is explained by Jones, (2003) as a difference between the business's purchase of inputs and sale of output. For example, a business produced a carton of soap from inputs such as soda and oil. It spent MK 180 and sold it for MK 200. The value added in the transaction is MK 20 and VAT would be charged on the twenty kwacha at a standard rate of 16.5 % applicable in Malawi. Similarly, if a sugar distributor sold one ton of sugar at MK 200, 000 from a factory price of MK160, 000 including all relevant expenses, the value added to this transaction is MK 40,000. Therefore, VAT would be chargeable on the MK 40,000 at a standard rate of 16.5 %. This means that VAT on input is credited against VAT on output as observed by Adesola, (2000).

MRA collects VAT through registered individuals and businesses in the production, distribution and consumption chain known as VAT operators or taxable persons as defined in Section 10 of the VAT Act (2005). They include manufacturers, wholesalers, retailers and service providers, such as those in carriage and haulage, accommodation and hospitality and construction businesses. Section 11 of the VAT Act (2005) requires any person supplying taxable goods and services whose turnover exceeds ten million kwachas per year to register for the operation of VAT and get a registration certificate, which must be displayed at the principal place of business. Section 19 of the VAT Act (2005) stipulates that any business that qualifies as a taxable person or has grounds to believe that it will qualify as a taxable person must apply for registration within 30 days of becoming liable and should immediately start keeping business records of all purchases and sales. Above all, VAT operators are required to remit VAT to MRA by 25th day of the preceding month to which the VAT relates according to Section 25 of the VAT Act (2005).

VAT operators are segmented into three distinct groups, namely; large, medium and small using their sales turnover. The segmentation has been done following the Pareto principle, commonly referred to as the 80-20 rule because MRA believes that 80 % of revenue is collected from 20 % of registered VAT operators and in that case MRA structured its offices into Large Tax Office (LTO), Medium Tax Office (MTO) and Small Tax Office (STO) in order to serve its clientele better (see Appendix 1).

1.2.1 Tax Compliance

Marti (2010) states that compliance is a complex term to define. Simply put, tax compliance refers to the fulfilment of all tax obligations as specified by the law freely and completely. It

has been observed that regulatory burdens fall disproportionately on small VAT operators internationally (Pope & Abdul-Jabbar, 2008). Their size and nature makes the issue of tax compliance one of the important aspects because smallest VAT operators have access to limited resources and inadequate expertise to comply with the VAT. Kasipillai and Abdul-Jabbar (2006) explains that non-compliance could either be failure to submit a tax return within the stipulated period or non-submission, understatement of income, overstatement of deductions and failure to pay assessed taxes by due date. In some cases, non-compliance may mean an outright failure to pay levied taxes. Studies done by Kasipillai and Abdul-Jabbar, (2006) have revealed and showed that the problem of tax evasion is a widespread one in many countries. Additionally, Fagbemi, Uadile and Noah (2010) observed that the problem is predominant in developing countries as is the case with Malawi and therefore is hindering development hence causing economic stagnation and other socio-economic problems. Non-compliance falls under four domains namely registration, filing, underpayment and payments as key risk areas and are further explained as follows:

Registration which is covered in Section 11 of the VAT Act (2005) stipulates that any person who makes taxable supplies of goods or services, whose business turnover is estimated or exceeds ten million per year, is obliged to register for VAT and be given a registration certificate. However, some businesses do not register for VAT and so do not operate VAT. This is non-compliance and is a punishable offence. Any business entity that does not register upon reaching the required threshold is liable to a penalty of five hundred thousand kwacha and a five-year jail term upon conviction for deliberate or reckless failure to register or two hundred-thousand-kwacha penalty for any other reason. In addition, non-compliant business is liable to pay the amount of tax not collected on taxable supplies from the date the registration was due. This is in accordance with Section 45 of the VAT Act of 2005.

Return filing is covered in Section 35 of the VAT Act of 2005 and requires any registered VAT operators to keep business records of input and output VAT from the day it got registered. They are further required to file and submit VAT returns on a monthly basis. Currently, the last day to submit a return is the 25th day of the month immediately following the month to which the return relates. However, VAT operators who fail to file their returns contravene Section 49 of the VAT Act of 2005 and it is evidence of non-compliance.

VAT requires any registered VAT operators to remit VAT on or before the due date. Failure to pay VAT is a form of non-compliance. This scenario arises when a VAT operator collects VAT on taxable goods or services but fails to remit it to MRA by the 25th day of the month to which the return relates. This is done deliberately in order for them to keep the money for tax and use it for their own business activities, which is contrary to Section 34 of the VAT Act of 2005. This is a serious offence and is punishable with heavy fines and interests. Non-compliance under this sub-heading could be in the following ways:

Non-issuance of tax invoices is where VAT operators deliberately do not issue EFD receipts to customers in order to conceal sales so that they do not pay the correct VAT. Others conceal their accounting trail by having parallel books. Some operators ask customers whether they want to be issued with an EFD receipt or not and if they demand it they are told a different price to accommodate the VAT. For fear of being charged VAT, most customers do not demand tax receipts, this is a serious and punishable offence.

VAT refund is an aspect where some VAT operators understate sales and inflate purchases so that they are in excess situation where MRA must refund them. In that regard, VAT auditing is conducted for these operators before they get their refund in order to ascertain the correct tax position to avoid over claiming VAT. A report published by the International Monetary Fund (2012) indicates that there was reduction of VAT in 2012 and 2013 tax years because most VAT operators were in refund situation. This has been a pointer to VAT challenges currently facing MRA (Appendix 2).

1.3 The Role of VAT Audit as a Tool for Enhancing Compliance

Tax audit is an examination of whether VAT operators have correctly assessed and reported their tax liability and fulfilled other obligations. It is further said that tax audits are often more detailed and extensive than other types of examination such as general desk checks, compliance visits and document matching programmes (OECD, 2006). Generally, an audit examines issues seen as most significant to achieve an accurate assessment of a taxpayer's tax liability. Typically, it includes issues or indications of significant unreported VAT input or output. Normally, the Companies Act of Malawi requires incorporated businesses to obey bookkeeping and accounting standards to allow transparency, accountability and governance. Auditing businesses involve physical enquiries such as inspection and examination of goods in stock and on the business premises. The audit programme of a revenue body performs a

number of important roles that when effectively carried out, can provide significant contribution to the improved administration of the tax system (OECD, 2006). These roles are described briefly as follows:

1.3.1 Promote Voluntary Compliance

The primary role of the VAT audit programme is to promote voluntary compliance by all VAT operators with the VAT law. It seeks to achieve this by reminding VAT operators of the risks of noncompliance and by generating confidence in the broader community that serious abuse of the VAT law shall be detected and appropriately be penalized by a tax administration (OECD, 2006).

1.3.2 Detect Noncompliance at the Individual Taxpayer Level

By concentrating on major areas of risk such as claiming more input VAT, on the part of VAT operators, where it clearly shows that they are evading tax, audits may bring to light significant understatements of tax liabilities (OECD, 2006).

1.3.3 Gather Information on the “Health” Of the Tax System and VAT Operators’ Compliance

Results of a normal audit process may offer information on the general well-being of the tax system. In the overall, all audits conducted on a random basis can assist a revenue authority by gathering very critical information to inform judgments on the levels of VAT compliance. Over time, it can be used to identify trends in the overall organizational effectiveness and also gather more precise information that can be used to inform decision making in future compliance improvement strategies, for example, in refining an automated risk-based case selection processes and supporting changes to tax legislation (OECD, 2006).

1.3.4 Gather Intelligence

Audits may expose and bring to light information regarding tax evasions and avoidance schemes involving large numbers of VAT operators and the information can be used to unlock major projects abuse (OECD, 2006).

1.3.5 Educate VAT Operators

Audits can assist in clarifying the application of the VAT law, to identify improvements required to recordkeeping for individual VAT operators and thus may contribute to improved compliance in the future (OECD, 2006).

1.3.6 Identify Areas of the Law That Require Clarification

Audits may bring to light areas of the tax law that are causing confusion and problems to large numbers of VAT operators and thus require further efforts by the revenue administration to clarify the laws' requirements and provide civic education to the VAT operators on what they must do to comply with taxes into the future (OECD, 2006).

1.4 Types of Audits

Audits vary in their scope and level of intensity to which they are conducted in a revenue administration. For this reason, there are various types of audit as follows:

1.4.1 Full Audits

It typically entails a comprehensive examination of all information relevant to the calculation of a taxpayer's tax liability for a given period. The scope of a full audit is all encompassing and its objective is to determine the correct tax liability for VAT operators. Given their broad scope, full audits are typically costly to undertake because they always require considerable resources. As a result, they reduce the rate of coverage that could otherwise be achieved by a more varied mix of audit types (OECD, 2006).

1.4.2 Limited Scope Audits

Limited scope audits are confined to specific issues such as non-submission of a VAT return and on a particular tax scheme arrangement employed by the taxpayer. The objective is to examine key potential risk areas of noncompliance. These audits consume relatively fewer resources than full audits and allow for an increased coverage of the taxpayer population (OECD, 2006).

1.4.3 Single Issue Audits

Single issue audits are confined to a particular item of potential noncompliance that may be apparent from examination of a VAT operator's return. Given their narrow scope, single issue audits typically take less time to perform and can be used to review very large numbers of

VAT operators involved in similar schemes to conceal noncompliance. Therefore, VAT audits provides a window for Malawi Revenue Authority to review books and source documents of a VAT operator in order to close gaps between VAT declared and VAT legally due. VAT auditing exercise fulfils the dual purpose of firstly maximizing revenue collection and secondly ensuring voluntary compliance. The process provides a chance to identify defaulters so that undeclared VAT is enforced and collected.

Therefore, VAT audit is an integral part of VAT compliance amongst the VAT operators and for its effectiveness, VAT audit relies on a number of integrated components such as proper maintenance of books of accounts, source documents and taxpayer education campaigns. If properly administered, VAT operators become aware of their obligations such as return filing and remittance. In practice, the scope and nature of any audit programme undertaken for particular VAT operators depends on the available evidence that points to the likely risks of noncompliance and a taxpayer's prior history. Extensive audit inquiries may also be justified simply because a VAT operator's financial and or business activities are unusually complex (OECD, 2006).

1.5 Statement of the Problem

International Monetary Fund and World Bank are international organisations that foster global monetary cooperation, secure financial stability, facilitate international trade and promote high employment, sustainable economic growth and reduction of poverty around the world. These two institutions have observed that global tax compliance rates are steadily nose diving amongst VAT operators (IMF, 2014). The declining trend is regardless of interventions put in place by revenue authorities in most countries such as tip off anonymous, public sensitizations, voluntary compliance window (VCW) and use of electronic fiscal devises (EFD) that are aimed to revitalize the performance of VAT. The nose diving trend as observed globally is also evident and applicable to Malawi (IMF, 2014). The above stated interventions could also be factors that affect the performance of VAT; however, the study only focused on VAT audit because of limitations in resource availability and therefore could be areas for further research in future.

The declining trend in the performance of VAT is a problem thought to be caused by tax evasion, which is a deliberate refusal to pay taxes. Therefore, to fight this phenomenon various countries including Malawi are using VAT audit as an enforcement tool in their tax

administration systems to improve VAT compliance (Modugu & Anyaduba, 2014). The declining trend is cause for worry in Malawi by MRA management, government and all stakeholders who have the view that VAT audits are not being performed adequately yet they are central to the voluntary compliance framework of VAT operators (International Monetary Fund, 2012). Audits are said to have a direct deterrent or rather preventive effect on audited VAT operators. For instance, in a study done by Alm and McKee (2004), it was found that 1% increase in audit volume directly increased revenue. This means that a high volume of successfully completed audits bring positive impact on tax compliance and indeed revenue (Andeoni, Erand & Feinstein, 1998).

VAT audits are regarded as very important tax tool for enforcing highest possible levels of voluntary compliance yet they are not adequately performed on all VAT operators in Malawi. It is a legal requirement to conduct VAT audits on all VAT operators on quarterly basis but most of them have taken more than two years without being audited. Blantyre station's annual audit report reveals that the station audited only 177 out of an average of 6,000 VAT operators in 2015 fiscal year, representing audit coverage of only 3%. This clearly indicates an audit cycle of approximately 34 years, meaning that at this rate it shall take Blantyre station, 34 years to conduct and conclude audits on all registered VAT operators. This is a very magnitude problem and perhaps, it is the more reason why Malawi Revenue Authority experienced low VAT performance in 2015 fiscal year (MRA, Revenue outturn report, February, 2016). VAT audits are an important aspect for boosting revenue for cash strapped government of Malawi, yet they are not being undertaken frequently while there is low VAT compliance amongst the small VAT operators.

1.6 Purpose of the Study

The purpose of the study is to examine and understand the effectiveness of VAT auditing on small VAT operators' compliance and other qualitative attributes on the tax compliance level in Blantyre city. More also, to come up with solutions that should improve compliance of small VAT operators. This would in return improve VAT performance and contribute to the achievement of targets in Malawi Revenue Authority.

1.7 Specific Objectives

1. Identify characteristics of non-compliant VAT operators.
2. Assess the relationship of factors that influence VAT operators' compliance.

3. Examine the factors influencing VAT operators' compliance.
4. Determine strategies for improving VAT operators' compliance.

1.8 Research Questions

In order to examine and understand the impact of VAT auditing on small operators' compliance, four research questions have been formulated to guide the study:

1. What are the characteristics of non-compliant VAT operator?
2. What is the relationship of factors influencing VAT operators' compliance?
3. What is the extent of factors influencing VAT operators' compliance?
4. What are the strategies for improving VAT audits and compliance?

1.9 Research Hypothesis

A hypothesis is a formal statement that presents the expected relationship between an independent and dependent variable (Creswell, 1994). It is a tentative explanation that accounts for a set of facts and can be tested by further investigation. Therefore, this study hypothesized that there is a positive relationship between VAT operators' compliance and VAT auditing where VAT auditing is considered as a factor that influences the VAT operators' compliance. This position is also taken by Davis, Hecht and Perkins, (2003) who in their study found that tax audits are an effective and deterrent instrument for achieving high compliance levels amongst VAT operators. Engel et al., (2001) also, in another study, found that additional marginal audits and tax enforcement efforts produces high compliance rates. A procedure on how the null hypothesis was tested was formulated (see Appendix 3).

1.10 Significance of the Study

The study is very important because it has enhanced an understanding of factors that encourage non-compliance with a VAT obligation by small VAT operators in as far as VAT auditing is concerned. Furthermore, the study has provided suggested solutions and recommendations which when implemented by relevant stakeholders shall enhance VAT collections. In return, MRA shall be able to meet its revenue targets and more revenue shall be available to government coffers for the provision of services and development projects. It is indeed imperative to increase tax compliance because the tax collected serve many purposes such as paying for the goods and services it provides on schools, roads, law enforcement and military protection. More also, taxes also stabilize the economy and redistribution of wealth

in a country and ensure that government has a steady stream of revenue throughout the year (Mill, 2009).

Furthermore, the study is beneficial to both tax literature and practicing VAT professionals in the performance of their work. In terms of tax literature, the information shall add to the limited literature available in the region. Also, researchers may use the identified characteristics regarding non-compliance to examine the significant association between them in their future research. More also, the study has helped in building capacity because it has brought on board new knowledge. The knowledge gained from the study has helped in improving professional competence and human resource development. The study, from policy makers' perspectives, shall assist tax authorities in the formulation of appropriate strategies. Examples being tax education and tax simplification programmes in order to improve compliance among VAT operators such that the administration of VAT auditing in MRA shall be according to best practice. In so doing, cost of collecting VAT shall be very low. It is believed that high compliance costs result in tax avoidance, tax fraud, and inhibit investment by way of diminishing competitiveness of businesses and taxation attractiveness.

Summarily, information obtained from this study shall be beneficial to both tax literature and practice. In terms of tax literature, it shall add new knowledge to the limited literature that is available in the region. More also, researchers shall use the identified non-compliance variables to examine the significant association of the variables in their future researches. Specifically, the information shall assist Malawi Revenue Authority and other tax authorities in developing appropriate strategies such as tax education and tax simplification programmes in order to improve compliance among VAT operators.

1.10.1 Importance of VAT Compliance

VAT compliance is a very important aspect because high VAT compliance levels unlock revenues that would otherwise be lost by way of tax evasion. Governments all over the world spend public money on behalf of their people in providing development amenities and other social services. Therefore, in order to catch up with these responsibilities, governments need to put in place effective and efficient tax policies that propel voluntary compliance so that more revenue is generated and collected. In emerging economies, such as Malawi, taxes are the major, most important and reliable source of revenue but one major problem inhibiting the effective tax administration is the deliberate refusal to pay taxes (tax evasion). The study

therefore has helped in pointing out areas that need to be addressed in order to have effective and efficient tax policies that encourage VAT compliance so that VAT operators pay their tax obligations willingly. For example, Nigeria has devised a self-assessment tax policy that allows people to establish their own tax instead of government determining how much tax to pay. Using this policy, tax payers are now required to file their tax returns and remit payment voluntarily (Atawodi & Ojeka, 2012). Resultantly, the practice has informed the need for VAT auditing. This development ensures that VAT operators file accurate information and VAT payment that reflect the true state of affairs in terms of their output and input VAT. Thus, the primary purpose of tax audit is to ascertain the extent to which tax payers may have complied with the relevant statutory provisions of the VAT Act regarding their statements of financial position and other tax-related returns.

1.10.2 Significance of Designing Effective and Efficient Tax Policies

Consumers who are the payers of VAT are discriminated against under the regular taxation system because of compliance requirements, compliance costs and uniform VAT rates for small, medium and large consumers and enterprises. Therefore, the design of efficient and effective tax policies would motivate and encourage small VAT operators to pay their tax obligations. Policies that aim at reducing compliance costs and low tax rates encourage small consumers and enterprises to comply with taxes and in doing so allowing governments to increase tax revenue. Additionally, simplified tax provisions for small and medium enterprises reduce size of the informal economy and the number of non-complying VAT operators (Vasak, 2008). An overly and complex tax regime makes tax compliance unduly burdensome and often have a distortionary effect on the development of the small consumers and businesses. As such they are tempted to morph into forms that offer a lower tax burden or no tax burden at all (Masato, 2009). This results into a tax system that imposes high expenses on the general public and society at large. Besides, a poorly designed and executed tax system leads to low efficiencies, high collection charges, waste of time operators and revenue administrations, low tax revenue and deviation of optimum allocation of resources (Farzbod, 2000). Existing empirical evidence clearly indicates that small VAT operators are affected dis-proportionately by these costs so much that when they are scaled by sales or assets, their compliance costs become higher than for large businesses (Weichenrieder, 2007). Thus Shahroodi (2010) stated that for a tax system to be efficient; the tax policy needs to be designed in such a way that the tax rates are appropriate and rational; the exemptions are lower in amounts; the revenue administrations are more efficient; the tax burden of the indigent

people should be lighter and the fight against corruption and tax evasion should be much more intense.

Tax policies should therefore be designed in such a way that they do not only directly affect small business operators but also indirectly push for voluntary compliance and their growth. Yaobin (2007) emphasised and declared that special tax regimes for small business operators might be an appropriate policy instruments for minimising the cost of revenue collection. Dangers for having inadequate taxation measures for small VAT operators have been on the rise because of the potential of uneven tax enforcement thereby causing distortions in competition, voluntary compliance by larger enterprises and by wage earners (Koranteng et al., 2017). Therefore, government intervention should help maintain a balance while ensuring that countries exploit the social benefits from greater competition and entrepreneurship.

Tax regimes and enforcement measures should therefore be simple, consistent and predictable. This shall encourage VAT compliance while lowering compliance and administrative costs. Thereby reducing uncertainty that is faced by small VAT operators as well as improve their levels of voluntary compliance (Kasipillai, 2005).

1.11 Limitations and Delimitations

Tax affairs are confidential matters and are not discussed or shared anyhow. In view of this, sensitive information involving VAT operators were handled in a professional manner while adhering to the oath of allegiance the researcher undertook before being employed by the Malawi Revenue Authority. Business information was not disclosed to business competitors and a strict code of conduct was observed before, during and after questionnaire administration to avoid un-necessary reprisals. Due to budgetary resource constraints, the study was undertaken in Limbe and Blantyre business areas involving small VAT operators. The small VAT operators were targeted because they are riskier than the large and medium VAT operators.

1.12 Thesis Organization

The study is organised in six chapters and the first chapter has provided background and discussed the administration of VAT, provided a brief discussion of non-compliance and the role of audit in the administration of VAT in Malawi, statement of the study problem, its purpose, specific objectives, study questions, study hypothesis and significance of the study.

The researcher is well aware that every study has its own problems and therefore limitations and delimitations have been outlined in this chapter. Chapters 2 - 4 has also explained the conceptual framework and literature review in order to understand what other researchers have done on this topic to avoid re-invention of wheels, also the study methodology, data analysis, its finding and their discussion have been made. Chapter 5 has finally discussed the conclusion and provided recommendations.

1.13 Chapter Summary

The foregoing chapter has provided the research context and has also provided the study's problem statement, purpose and objective, research questions, hypothesis, significance, limitations and delimitations. The next chapter shall discuss the conceptual framework and a review of literature according to the purpose, objective and questions of the study in order to avoid re-inventing the wheel.

CHAPTER 2

LITERATURE REVIEW

2.1 Introduction

This chapter reviewed work done by other researchers who have helped decipher the effect of VAT auditing on small VAT operators' compliance. The study basically intended to provide answers between effects of VAT auditing and small VAT operators' compliance in the administration of VAT in Malawi. It was felt that the study would bring some solutions to the research problem and questions so that audits are carried out according to best practice in order for MRA to maximise revenue. Studies that have been done on this topic present two schools of thought. The first school presents evidence that audits have a deterrence and reciprocity effects on tax compliance. The second school presents a contrary view and emphatically argues that auditing does not have a deterrence and reciprocity effect on tax compliance (Ortega & Sanguinetti, 2013).

2.2 Deterrence effect on VAT Compliance

People and businesses pay taxes because they are afraid of enforcement mechanisms such as fines and penalties put in place by government. This deterrence approach to tax compliance was first formally analysed in the work of Allingham and Sandmo (1972). In the model, tax payers decided on whether and how much to evade taxes in the same way they would approach any risky decision or gamble, that is, by maximizing expected utility (Slemrod, 2007). Under this framework, tax evasion was negatively associated with the probability to detection and the severity of punishment. Nonetheless, the deterrence alone couldn't explain the level of tax compliance that was actually observed in most countries (Alm et al., 1992; Frey & Feld, 2002; Graetz & Wilde, 1985) because the level of detection probabilities and fines were too low to explain the low levels of tax evasion as observed in developed economies (Andreoni, Erard & Feinstein, 1998).

2.3 Theoretical Grounding of the Study

Tax audits have been variously discussed in relation to tax compliance by many researchers. Such studies observed that audits have a positive impact on tax evasion (Dubin, 2004; Jackson & Jaouen, 1989; Palil & Mustapha, 2011; Shanmugam, 2003). The researchers have further claimed that in self-assessment systems, tax audit play a very important role whose central role is to increase voluntary compliance. Further, Palil and Mustapha (2011) have argued that

audit rates and the thoroughness of the audits encourages VAT operators to be more prudent in completing their VAT returns, report all sales and claim correct input VAT and deductions in ascertaining their tax liability. However, they also observed in contrast that, VAT operators who have never been audited before that they were tempted to under report their actual sales and claim false deductions.

Palil and Mustapha (2011) also found that tax audits can change compliance behaviour of small VAT operators from negative to positive. This notion complemented findings in the study of Witte and Woodbury (1985) and also in the study of Beron, Tauchen and Witte (1988). Typically, Witte and Woodbury, in their study of small business proprietors, established that tax audits have a significant role in tax compliance framework of VAT operators. However, Beron, et al. (1988) found a contradictory result that reported that audits did not significantly correlate with evasion for all groups they studied. Tax audits were found to be more effective in inducing VAT operators to over claim deductions rather than encouraging them to correctly report their actual income. Evans, Carlon and Massey (2005) studied the tax compliance of small and medium size enterprises (SME) in Australia from another point of view whose objective was to examine the relationship between record keeping practices of SMEs and the potential exposure to tax compliance problems. The study found that audit history, including frequency, audit outcome and the type of audit on small business owners had a very significant indirect impact on tax compliance. The result also evidenced that the primary objective of the small business owners doing their record keeping is tax compliance were related rather than being part of their business management. Russel (2010) in his theory regarded tax compliance as a model synonymous to looking at a coin. The head side reflected factors that influence taxpayer's behaviour. These were business, industry, economic and psychological factors. These factors influenced VAT operators' when making decisions regarding VAT submission. The tail side reflected different taxpayer attitudes to compliance and their corresponding compliance strategies that best responds to each particular attitude. The model advocates for a deeper understanding of issues such as motivation, circumstances and characteristics of VAT operators so that tax enforcement and other actions should be specifically tailored to promote compliance. Consequently, with the right responses and interventions revenue authorities can influence taxpayer behaviour in a positive way to achieve high compliance rates amongst tax payers.

The conceptual framework of this study originates from the theory and work of Allingham and Sandmo (1972) who observed that tax declaration decisions are made under uncertainty situation where failure to report one's full income does not automatically provoke a penalty. The study further stated that the taxpayer has two options, that is, whether to declare his actual income or cheat and declare less income, if they choose the latter strategy, their pay off will depend on whether or not they are investigated by the tax authority, if they are not, they are clearly better off than under the former strategy. If they are, then they are worse off. The choice of a strategy is therefore a non-trivial one. The ideology is based on the actual income that is exogenously given and known by the taxpayer and not the tax collector. Tax is levied at a constant rate on the declared income which is the taxpayer's decision variable. However, with some probability, the taxpayer will be subjected to investigation by the tax authority, which will then get to know the exact amount of his actual income. If this happens the taxpayer will have to pay additional tax on the under declared amount, at a high penalty rate.

It is therefore established from the literature review that there is evidence indicating that indeed tax audits play an important role in increasing voluntary compliance. Additionally, there are various opinions that exist for best ways of improving tax compliance. However, given the chance, a lot of businesses cannot pay their taxes unless there is motivation to do so. Some other people believe that the best way to provide motivation is to increase incentives while others believe that the best way is to increase penalties (Feld & Frey, 2007). Theories informing this study are broadly classified into economics and psychology based theories:

2.3.1 Economical Based Theories

These theories are also known as deterrence theories and place their emphasis on tax incentives. They suggest that VAT operators are amoral utility maximisers because they are influenced by economic motives such as maximisation of profits and probability to detection. As such, VAT operators analyse alternative compliance paths, for instance, whether or not to evade tax, the likelihood of being detected and the resulting repercussions. Then they choose the alternative that maximises their expected output after evaluating returns and adjusting risk. This process is referred to as "playing the audit lottery" by Trivedi and Shehata (2005).

2.3.2 Psychology Based Theories

These theories on the other hand postulate that VAT operators are motivated to comply with their tax obligations by psychological factors and focus on their morals and ethics. The

theories suggest that some VAT operators may comply even when the probability of detection is so low. As opposed to the economic theories that emphasize on increased audits and penalties as solutions to compliance issues, psychology based theories lay their emphasis on changing individual attitudes towards tax compliance.

Therefore, the study combined use of these theories because the reviews have demonstrated that tax audits play a significant role in increasing voluntary compliance because high audits rates and their thoroughness potentially encourage VAT operators to be more prudent in completing their VAT returns. More also in order to improve compliance, audits should be used as deterrence and enforcement tool by invoking penalties for noncompliance.

2.4 Characteristics of Non-Compliant Small VAT Operators

In trying to identify characteristics of non-compliant VAT operators, the researcher reviewed various literatures. Generally, it was observed that small VAT operators are relative and dynamic and often characterized by uncertainty, innovativeness and evolution (Olorunshola, 2003). In Nigeria, Aderemi (2003) observed that small VAT operators are usually small, owner or family managed businesses offering basic goods and services, which tend to lack organisational and management structures with the urban ones tending to be more structural than their rural counterparts. These are some of the most generic features of small VAT operators in Nigeria. Udechukwu (2003) went on to say that small VAT operators are mostly sole proprietorships and very few are partnership as such they are not separate legal entities. According to Olorunshola (2003), this ownership style has led small and medium enterprises to have a simple management structure. Factors also contributing to the reasons why small and medium enterprises have a simple management structure are few numbers of employees and the owners' low level of education. Since there is no legal personality between the small and medium enterprise and its owners, it means the lifespan of the enterprise is dependent on the lifespan of its owners i.e. there is no perpetual continuity. Further, Hanefah, Ariff and Kasipillai (2002), posit that production processes of small VAT operators are usually labour intensive and they usually serve as suppliers for the larger manufacturing firms with their operations being highly dependent on raw materials sourced locally. They also require a lower start-up capital than the larger companies (Akinsulire, 2010). The decisions of the managers have a higher tendency to be subjective given that they are managed and controlled by the same individual. The employee-employer relationship found in smallest VAT operators is predominantly informal. In Kenya, taxpayers exhibit varying levels of tax compliance and that

has caused compliance problems to the extent that there was a budget shortfall of Ksh. 3.4 billion in the 2005/2006 fiscal year. The extent of the budget short fall was poor service delivery to the citizens. The impact of attitudes and attitude change on tax compliance behaviour is so huge in Kenya (Marti, et al., 2010).

Another key feature of the small VAT operators is that they are heterogeneously varying in size from small retail outlets to highly paid professionals and substantial manufacturing enterprises. Small VAT operators are also likely to vary in organizational form from sole proprietorships (with or without employees), small corporations (public or private), professionals and partnerships. This feature usually results in different obligations for record keeping for the enterprise. A working paper produced by the OECD (2009) that was based on case studies was reviewed. The paper emphasised that audits are a critical and significant component of compliance activities of tax authorities in all OECD countries. It spells out that small VAT operators represent a high risk group because they are so numerous and their income is not fixed and often times very difficult to be verified against third party data. Their business set-ups do not have well-developed structures such as record keeping, internal auditing and cash handling. The riskiness of these entities comes in form of failure to register, file return and non-payment of taxes. Given the scarce resource problem and a relatively large number of VAT operators to administer, the study recommended that tax authorities should have an organised and systematic approach of selecting cases for audit because application of risk management techniques in effective audit case selection and management achieves better results. The displayed characteristics of non-compliant VAT operators in that study were size of VAT operators, non-fixed income and internal controls (OECD, 2009).

Another experimental study conducted by Alm and McKee (2006), tried to estimate the determinants of taxpayer compliance using subjects who received income. The subjects were required to declare income they received for tax purposes and faced a probability of being audited, pay penalty on the under declared income if they cheated and receive a public good that depended on their payment of tax. In the Alm and McKee (2006) study, a respondent was presumed to have a fixed endowment of income and must decide the amount to declare for tax purposes. However, the taxpayer could be audited with the probability of a fine for the untaxed income. An individual could choose not to maximise the expected utility of the tax evasion. Each respondent was given ten tokens and was told that further accumulation of tokens would be redeemed in cash at the end of the study period. In addition, they were given

freedom to decide much income to report to the researcher. The reported income was taxed while the unreported was not. Results indicated that tax compliance increases with income and audit rate. Compliance becomes greater when VAT operators perceive benefits in public good funded by their tax payments. The changes in fine rates appeared to have little impact on tax compliance behaviour. However, researchers were very careful in concluding the study by not generalizing their findings because data was based on laboratory experiments that used students whose behaviour was very different from that of actual tax payers. In summary, this sub-chapter has identified a number of characteristics such as size, income, business setup, knowledge, financial soundness, moral responsibility and legal responsibility. These were individual characteristics very unique to small VAT operators that were also established by other researchers in their studies on this topic.

2.5 Relationship Between Factors That Influence VAT Operators' Compliance

An economic and behavioural experiment done by Ritsema and Thomas (2003) studied the behaviour of non-compliant VAT operators by investigating factors such as age, education, marital status, income level and unpaid tax arrears. The study established that filing status, income and tax evading opportunities positively correlated to amounts of tax owed to tax authorities. Reasons advanced for these findings were lack of money by VAT operators to settle their tax obligations. This problem was common to VAT operators who owed higher tax amounts because they were not motivated by a sense of morality to pay tax arrears. The researcher's findings confirmed the view that VAT operators are very different in their motivation for failure to declare and pay taxes.

Alm and Michael (1992) used laboratory experiments to test compliance behaviour of different VAT operators. Tax returns were selected for audit process considering deviation of each taxpayer's tax return from the normal return. The results indicated that it was difficult for individual VAT operators to coordinate and collaborate on tax evasion. The study also discovered that most tax authorities can minimize tax evasion by using information disclosed by VAT operators such as income or sales reported on their tax returns to determine and decide small VAT operators to be audited. When tax variances are established, the tax payer is fined and asked to pay the additional tax. Probability was used to select VAT operators randomly for audit and each taxpayer had the chance of being picked for an audit exercise regardless of the status of tax returns. However, it was discovered that the method was weak as it was neither fixed nor constant. It became variable and endogenous, depending on the behaviour of

both the taxpayer and tax administration. To overcome this problem known individual malpractices such as deviations from industry norm regarding average tax returns were used. This method proved to be more effective in deterring tax evasions

In an experiment conducted by Alm et al. (1991) involved graduates from University of Colorado, the subjects were given money as income ranging from 25 cents to \$2 dollars and were required to decide how much they were supposed to declare and pay tax. Subjects were rewarded from group tax fund, money that was shared equally among them. Each respondent was guaranteed a minimum of \$5 for participating and additional earnings that ranged between \$15 and \$25. The study found that tax compliance occurs because some individuals are oversensitive or overweight to low probability of an audit exercise. In addition, it was observed that individuals do not behave as if their preferences are linear. They often remit tax issues because of their expected utility as it can be seen that an increase in money respondents received as rewards, also increased their compliance level. These results suggest that compliance increase when taxpayer's value public goods financed tax payments most. It was therefore concluded that individuals pay taxes in order to receive public services even when there is no probability of being detected and punished. However, the study has been criticized for example by the Australian Tax Office because it was in form of an experiment and used students than the actual VAT operators. It has further been established that behaviour is dynamic and is bound to provide different results because thinking and reasoning are not linear.

Lastly, a review on the study by Internal Revenue Service (IRS) conducted in April 1990 in the United States of America was made. The study used previous audits results to come up with a formula they called Discriminant Index Function (DIF) to determine tax returns to be subjected to an audit based on issues identified in taxpayer's returns. A high DIF score was an indicator for selecting a tax return for audit. It was observed from the outcome of the study that audits that were done using DIF scores as a selection criterion generated additional revenues than those that were randomly selected. It was therefore concluded that DIF rule was able to achieve high levels of compliance because VAT operators found it difficult to coordinate their behaviour. However, as evidenced from cheap talk session, information sharing influence tax evasion thereby making tax authorities achieve low compliance. Therefore, the study recommended use of additional methods to improve compliance management. In conclusion, it has been determined that age, education, marital status, income

levels and collaboration are some of the factors that affect non-compliance. The picture that is coming out of the literature review is that there are relationships between the factors that affect the compliance of VAT operators.

2.6 Factors Influencing Small VAT Operators' Compliance

In trying to examine the factors influencing VAT operators' compliance many studies were reviewed and those that were relevant to this study were work done by Alm and McKee (2004). In the study, the researchers noted that several factors such as age and audits for example influenced compliance of VAT operators. It was found out that audits are a central feature to voluntary compliance framework in United States of America. Audits were said to have a direct deterrent effect on audited VAT operators and at the same time they have an indirect deterrent effect on VAT operators who have not been audited.

Empirical findings on an econometric study done by Dubin, Gractz and Wilde (1990) also established that a dollar (\$) of revenue collected by the tax authority was a result of taxpayer audits and a further additional six dollars collected was as a result of the indirect effect. The most interesting breakthrough was that previous official communication pertaining to audit results announced by the tax authority brought negative impact on subsequent compliance of the VAT operators while un-official communication of audit results made by VAT operators themselves increased tax compliance. The study was however considered weak because the depth of data analysis was very limited and shallow despite having adequate sample size because it was an experiment.

The researcher also reviewed work of Birskyle (2013), a study that was conducted in the United States of America. It was established that a volume of audits that were successfully completed had a positive and significant impact on tax compliance. It was further established that one per cent increase in audit volume directly increased state revenue by approximately two dollars. The study provided empirical evidence to the fact that audits have a deterrent effect on tax payer compliance. Other important milestones that were observed were that opportunities to evade tax are provided by weak tax systems and educational qualification of tax payers. These factors correlated to tax compliance levels of VAT operators. It was concluded therefore that there was positive correlation between auditing and compliance levels and any increase in audit coverage meant a substantial increase in dollar revenue. The

study recommended an increase of resources to audit function in tax authorities to enhance high levels of compliance.

Kinsey (1992), using an experiment, also found out that compliance increases greater with perceived probability of being audited. In that study it was established that a 10 % increase in the audit rate increased compliance by 2 %. However, the experiment was said to be weak and limited because it was difficult to create a real world situation and that subjects were not representative of the population because of recollection bias, reluctance to report past behaviour and not to appear dishonest. Again, it was hard to distinguish whether VAT operators remitted taxes because they had a social duty or fear of an audit. In a survey done by the Internal Revenue Service Oversight Board, it was reported that 96 % pay taxes because of their civic duty and 62 % pay for fear of an audit. However, the problem was that the relationship between audit coverage and compliance are not linear and therefore impact of an audit cannot be uniform to all VAT operators because income levels come into play. Dubin, et al. (1990) also discovered that a decline of audit rates from 2.5 % in 1977 to 1 % in 1986 reduced income tax collection by \$41 billion. Another study done by Plumley (1996) confirms that audits significantly increase reported income. As a result, there are some auditing programmes that are more effective in encouraging compliance than others. For example, performing comprehensive audits deter evasion while issue oriented audits encourage evasion. The argument is that VAT operators are more likely to evade a single tax because they know that it takes time for a tax authority to make another set of audit round as it is very costly and time consuming for tax authorities to conduct these audits.

In the studies conducted by Blumenthal and Christian (2001), Alm and McKee (2006), Ebimobowei and Eze (2013) the results showed that a positive relationship between tax audit and tax compliance was established. This means that the compliance rate rises if the tendency of being tax-audited is high. If the tax payers are informed that their fillings will be closely examined, there is a tendency for the tax payers' behaviour to change in response to an increased probability of being tax audited. They found also that penalties and interest as enforcement tool had a significant inverse relationship with tax compliance which implied that an increase in penalty had a tendency to decrease tax compliance. This finding is congruent with the Marrelli (1984), Marrelli and Martina (1988), Alm, Jackson and Gordon (1990), McKee (1992), who found that penalty rates had a negative association with tax compliance. For example, In Nigeria, Ebimobowei and Eze (2013) found that despite the

penalties taxpayers still did not fully comply with taxes because the penalties were either weak or poorly enforced. This meant that penalties did not deter tax evasion. The findings were that the relationship between penalties and tax compliance was inversely significant. The result further revealed that there was a significant positive relationship between government spending and tax compliance. This connotes that an increase in government spending on the social and welfare needs of its citizens has a tendency to positively influence tax compliance. The study established that in Nigeria there was a causality effect between tax audit and tax compliance. Again in Marti (2010) and Marti, et al., (2010 studies performed in Kenya on taxpayers' attitudes and tax compliance behaviour, it was established that there was relationship between attitude and tax compliance.

However, it is evident from the reviews that not all studies agreed to the fact that audits have a deterrent effect on compliance. For example, Bergman and Nevarez (2006) conducted a research whose data was generated from Chile and Argentina and discovered that audits do not affect future individual compliance and that the gap between pre and post audit compliance rates widened. VAT operators that were not audited had a better compliance rate than those audited. It was further discovered that compliance levels slightly increased during audits and worsened after concluding audits. These results were against what tax officials believed because they contended that VAT operators' refrained from under-declaring or miss-reporting sales during audits. It was therefore concluded that audited VAT operators consistently decreased their payments to tax authorities more than those not audited. They illegally reduce their tax obligations by manipulating sales in order to decrease output VAT and fake purchases to artificially increase input VAT. The use of fake invoices was the most popular strategy for evading VAT in both countries. Martinez-Vazquez and Rider (2003) also established that VAT operators take advantage of loopholes available in tax authorities to escape compliance. They established that there was a 50 % VAT reduction and noncompliance on audited VAT operators because they wanted to recover the additional tax and penalties they suffered at close of the audit. The additional taxes compensated future noncompliance thereby forcing tax authorities to under collect VAT. Therefore, the study provided evidence for rejecting claims that tax audit directly increases individual compliance among operators and that penalties and other sanctions have a positive effect on tax evasion.

Therefore, the literature review has established that tax audits are a central feature to voluntary compliance framework and they have a direct deterrent effect on audited VAT operators. In

contrast, they have an indirect deterrent effect on VAT operators who have not been audited. Dubin, Gractz and Wilde (1990) established that a dollar of revenue collected by the tax authority was a result of audits and any additional six dollar collected was a result of the indirect VAT auditing. Birskyle (2013) also established that the volume of audits that were successfully completed had a positive and significant impact on tax compliance. These studies further provided strong evidence that audits have a deterrent effect on tax payers' compliance and that there is positive correlation of audit to compliance levels. Ebimobowei and Eze (2013) also established in their study that they performed in Nigeria that there is a causality effect between tax audit and tax compliance. Again in Marti (2010) and Marti, et al. (2010) studies on taxpayers' attitudes and tax compliance behaviour they performed in Kenya established that there is relationship between attitude and tax compliance.

On the contrary, Bergman and Nevarez (2006) and other cited researchers disagree that audits directly affect compliance. They emphatically concluded that audited VAT operators consistently decrease net tax payable to tax authorities. Also, Martinez-Vazquez and Rider (2003) rejects the claim that tax audit directly increase individual tax compliance. It is also clear that most of these studies were done in developed countries with very few studies in developing countries such as Malawi evidenced through limited literature compared with the developed countries. A study conducted by Mazzolini et al. (2016) tested for heterogeneous effects of audits depending on its outcome. The study found that the audit's target effect was in place only when evasion was detected or when it was likely to be detected. This implied that it was not the audit alone that has positive effects on individual compliance behaviour, but the change in taxpayers' beliefs relative to IRA's ability to detect evasion that induced a higher post-audit tax compliance.

2.7 Strategies for Improving VAT Audits and VAT Operators' Compliance

In determining strategies that can be used to improve small VAT operators' compliance, various literature was reviewed. Russell, (2010) in Brazil established that there are other tools and strategies that can be used to improve compliance. Further, Russel found that noncompliance behaviour involved schemes such as tax avoidance using transfer pricing, triangular operations through tax havens and offshore arrangements. The study was executed during a time when profits realised by Brazilian companies abroad were not being taxed at home and companies used this strategy to avoid tax payment. A number of strategies and tools were introduced to deter tax avoidance. For instance, improvement on tax policy and adoption

of new legislation that specifically dealt with transfer pricing rules were announced. This worldwide taxation criterion was introduced to strengthen tax institutions operations. The revenue agency created specialized units within its organizational structure that were responsible for administering and auditing multinational corporations. Investigation and Intelligence Department (IID) was instituted to be responsible for investigating and detecting tax crimes that were related to international financing and money laundering. New Information Systems that became new sources of information on international transactions and integrated information on foreign trade were developed. For example, SISCOMEX provided a global view of taxpayer's operations and networks.

IMF policy paper (2015) indicates that tools for improving compliance are third party reporting. It adds that extensive use of financial institutions is an important source of information for revenue authorities and therefore information provided by financial institutions was exchanged with tax authorities. Third party information emerged to be a principle weapon for addressing cross-border evasion because it reduced the probability of false reporting and also increased chances of being detected. However, dependence on third party information had its own disadvantages. VAT operators focused their evasion by not reporting certain income in their financial transactions (OECD, 2006).

Another strategy was the introduction of withholding tax on all foreign transactions. The strategy worked in USA and Denmark such that there was only about 0.2% underreporting on employment income because information was provided to the tax authority by employers. Segmenting VAT operators into distinct groups is also another tool for improving compliance. This strategy enables distinct compliance risks they pose to be addressed differently. Compliance risks vary systematically with size of tax payers. For example, failure to register is likely to be a greater issue with small VAT operators than larger VAT operators; while ensuring prompt payment and monitoring avoidance is a greater issue with the latter.

It has been noted that there are many tools and strategies that can be used to improve compliance among VAT operators such as tax policy improvements, investigation and intelligence gathering. These tools and strategies help in curbing international financing and money laundering. Development of new information systems become sources of information gathering on international transactions and foreign trade. The policy paper (IMF, 2015) mentions third party reporting and withholding tax as tools for improving compliance.

2.8 Chapter Summary

The chapter reviewed studies done related to VAT compliance. Key issues that came out clearly were that many studies have been conducted in developed countries with very few in developing countries because there is not much literature on developing countries. The studies have presented two schools of thoughts whereby the first school stated and presented evidence that tax audits have deterrence and reciprocity effects on tax compliance while the second school is of the contrary view and has argued that tax audits do not have a deterrence and reciprocity effect on tax compliance. These studies have informed this study by pointing out that tax audits play a significant role in encouraging and increasing voluntary compliance and changes compliance behaviour from negative to positive. However, some researchers had opposing views and argued that audits did not significantly correlate with tax evasions. They indicated that there was potential exposure to compliance problems to the extent that audit history, frequency, outcome and audit type of small business owners had significantly and indirectly impacted on compliance. The chapter presented factors that influenced taxpayer's behaviour and VAT compliance. These included size of the business, type of industry, economic and psychological factors and taxpayer attitudes. Economics and psychology based theories are the theories that have informed the study. It has also been noted that small VAT operators are relative and dynamic, characterized by uncertainty, innovativeness and evolution. They are small in size; owner or family managed and require lower start-up capital. They are mostly sole proprietorships as such are not separate legal entities and have a short lifespan with no perpetual continuity. They are usually labour intensive and usually serve larger manufacturing firms. As such, they represent a high risk group in the tax administration and can only be encouraged to pay tax by conducting tax audits frequently. The next chapter will look at the research design, ethical considerations, research reliability, validity and study diagnostics tests.

CHAPTER 3

RESEARCH METHODOLOGY

3.1 Chapter Overview

This chapter discusses the methodology used to collect data and states the research philosophy, research approach, research design, sample selection and size, data collection and analysis, limitations and duration of the study period. The methodology established a research paradigm and how data were collected using quantitative techniques. Both primary and secondary data were collected and analysed to draw conclusions and recommendations on auditing and VAT operators' compliance.

3.2 Research Philosophy and Approach

Philosophy of the study was premised on an onion as provided by Saunders et al. (2009, p.106), where it is stated that data collection techniques and analysis procedures are very important for any study. It is a step by step process that is synonymous to peeling off an onion and one starts by peeling off or taking out the outer layer before reaching into the inner layer. The methodology was handled in a similar fashion in order to collect relevant data. Positivism philosophy was chosen and used in this study because it assumes an objective world that can be measured by scientific methods where researchers can predict and explain causal relations among key variables (Chikhwenda, 2005). This philosophy focuses on the study objectives and advocates a stance of a natural scientist. Utilising positivism was important to this study because it emphasised quantifiable observations and statistical data analysis. These clarifications were in agreement to the preference of the researcher where wanted to work with quantifiable observations and data whose outcome or results would be used to make generalizations similar to those made by physical and natural scientists (Saunders et al., 2009).

A deductive or top-down approach of handling matters was used in the study because the researcher intended to work from a broader and general perspective picture that generalized issues to finer and specific issues. This approach was also elaborated by Yin, (2003) who stated that an existing theory can be used to formulate objectives, research questions and more theoretical propositions that can be used as a platform for organizing and analysing data. It can be seen that the study hypothesised that VAT auditing affects compliance amongst small VAT operators. This assumption led to the development of the main objective first and thereafter specific objectives.

3.3 Research Strategy

A cross sectional survey research design was used to observe and collect data from subset of a population at a specific time. Data was collected using questionnaires that were administered to the targeted respondents. It was quantitatively processed and analysed using descriptive and inferential statistics modes of the SPSS. In this case, the cross sectional survey was very advantageous over other strategies because the researcher was on top of the affairs and in control of the data collection process. In this case, the survey was able to generate data whose findings were representative and the data collection process was cost effective. Easterby-Smith et al. (2008) agree and recommend that cross-sectional studies should often employ surveys as their strategies (see Appendix 5). In order to generate relevant and meaningful data, the researcher was cautious and careful in sample selection and questionnaire design together in its piloting so that the data was representative, reliable and ethical so that results that reflected a true representation of the population were achieved.

3.3.1 Population

Saunders, et al. (2009, p. 212) defines population as “a set of cases from which a sample is selected and is a complete set of items that share similar characteristics selected for statistical analysis”. In that regard, the study determined its sample from a population of 4339 small VAT operators that were found in a VAT register maintained by MRA as at 30th June, 2015 in Blantyre city.

3.3.2 Sampling

Sampling is the process of selecting a group of people or events with which to conduct a study (Saunders, et al., 2009). Probability sampling technique was used to identify the respondents from the population because it provided a chance for each respondent to be selected and that the chance was calculated and known in advance. Furthermore, it increased the sample’s representativeness, decreased sampling error and bias. Sampling is often associated with surveys and experimental research strategies (Saunders, et al., 2009).

3.3.3 Sampling Frame

Sampling frame was an important aspect of the study and constituted a complete list of all elements in the population from which the sample was drawn. It constituted all registered small VAT operators in Blantyre City. However, as highlighted by Saunders, et al. (2009), the researcher ensured that the sampling frame was complete, accurate and up to date because

incomplete and inaccurate list of VAT operators would have left out some respondents thereby reducing their chance of being selected for the study. This would have been the basis for criticizing the findings. Therefore; the researcher made sure that the sampling frame was valid and reliable by cleaning the register to get rid of those that passed on, changed location and closed their businesses before sampling was done.

3.3.4 Sampling Technique

In determining the most appropriate sampling technique in order to obtain a representative sample, five sampling techniques were assessed one by one from simple random, systematic random, stratified random, cluster random and multi-stage random. Simple random technique was chosen and used considering factors such as geographical area over which the population was spread, nature of sampling frame which further influenced the probability of the sampling technique, structure of the sampling frame, the required sample size, and ease of the technique.

Simple random sampling was used for selecting the respondents randomly from the sampling frame. A computer was used to generate random numbers and each of the cases was numbered in the sampling frame using a randomizer in an excel spreadsheet. The list of registered VAT operators was copied and pasted into columns of an excel sheet and a function (= RAND ()) was created to generate the random numbers. The lists were sorted and re-arranged in order from highest to lowest random numbers. This technique offered simplicity in assembling respondents in a fair way from the population of small VAT operators. It was felt that using random sampling, a reasonable generalisation was established and achieved.

Furthermore, in determining the sample size using a simple random technique, the researcher, pegged the margin of error at 5 % in order to achieve a high level of accuracy. This is a statistic expression of the amount of sampling error where the results would be close to characteristics of the population. Secondly, the confidence level was pegged at 95 per cent because a high level of certainty was desired and was achieved meaning that the sample really represented the population.

3.3.5 Sample Size

Statisticians have proved that when the sample size of a study is large, the distribution curve is somehow close to normal. Thus, the larger the sample size the more robust it will be and a relationship called a central limit theorem occurs. Stutely (2003, p. 40) states that statisticians

have shown that a sample size of more than thirty respondents result into a sampling distribution whose mean is close to a normal distribution curve and therefore makes generalisation possible.

Rao application software was used to select the sample size and a 5 % margin of error and 95 % level of confidence were inserted in the appropriate fields. The result was a sample size of three hundred and fifty-three (353) respondents. An excel spreadsheet was also used to arrange the names of small VAT operators into a frame and to generate random numbers in order to get a list of respondents (see Appendix 6).

3.3.6 Data Collection Methods and Instruments

Since the use of positivism philosophy focuses on quantitative data and assumes an objective world that can be measured scientifically the study was quantitative in approach. Such being the case, quantitative methods of data collection were used because positivism philosophy is more of quantitative and tend to generalize results. This approach, though, is contrary to Howe who recommends the use of mixed methods together because they generate quantitative and qualitative (Howe, 1992). Howe's argument offers advantages to a study such as collaboration of findings through triangulation and filling of gaps created by the other method.

To avoid reinventing the wheel, secondary data was collected. This process involved reviewing of various documents in order to get a profile of registered VAT operators. This type of data was sourced from various offices within MRA structure such as Taxpayer Service Unit (TSU), Return Processing (RPP), Audit and Inspection and Computer Unit. These documents were VAT register, emails, letters, memos, websites, monthly reports, VAT returns, import and exports summaries, payroll details and accounts of sales of goods or services. The rationale was to get information from readily existing sources on this subject. It was evident from the reviews that there were there indications that there was a link between audits and compliance. However, the secondary data had limitations because it was collected for other purposes and, as a result, it was not a useful resource in answering the research questions and achieving the study objectives. These limitations provided justification for the need and collection of primary data.

Primary data was collected using a questionnaire that was carefully developed in order to get vital information from the respondents. In designing it, attention was put on issues such as

clarity, use of clear language and expressions. A combination of measuring scales such as nominal, ordinal and rating were used. Nominal scales were used to collect bio data of the respondents as it served as a label in gender identification and other parameters that often do not require calculations. Ordinal scales were used to collect and arrange respondents' preferences according to their magnitude while rating scales were used to collect information relating to respondents' attitude that required them to estimate magnitude of characteristics of a compliant VAT operator, effects of VAT auditing and VAT operators' compliance and strategies for improving VAT operators' compliance.

The questionnaire was pilot tested on five small VAT operators selected randomly in order to understand how respondents answered the questions in order to make the necessary adjustments to the questionnaire from a different site. Pre-testing was an essential step in the questionnaire designing process and it helped to evaluate on how respondents generally responded to the questions. Closed questions with yes or no answers, multiple choice questions that required respondents to tick their favoured answers and spaces to fill in reasons for their choices were asked. Likert scales were used to determine the extent of attitudes on compliance. The questionnaire was personally distributed to the respondents. Qualitative and quantitative data was prepared, mathematically captured and computed on the SPSS using different measuring scales classified into nominal, ordinal, interval and ratio scales

3.4 Ethical Considerations

Love (2012) describes ethics are principles and guidelines that help people to uphold beliefs they value and it deals with values and morals. It is the application of moral principles and professional codes in collecting, analysing, reporting, and communicating research results from respondents. Ethics are based on people's personal values i.e. what one person or group considers to be good or right might be considered bad or wrong by another person or group. Again, considering what Cohen, Manion and Morrison (2004, p. 58) stated that "it is important to observe rights of respondents as human beings and should be respected at all times during studies". This implies that decisions regarding completion of questionnaires remain entirely in respondents' hands. Therefore, in this study, respondents were given a chance to withdraw from the study any time they felt doing so. They were not coerced to provide information which they felt was sensitive and or discriminating. They were provided with assurance that their responses shall remain anonymous and confidential. They were assured that their information would not be used in a way that adversely affected them and no financial rewards

were made available for responding to the questionnaire. A statement to that effect was included on the questionnaire.

3.5 Research Reliability and Validity

Easterby-Smith et al. (2008, p. 109) defines reliability as “the extent to which data collection techniques and analysis procedures yield consistent findings”. Reliability can be checked if same measures yield same results on all other occasions and similar observations are achieved. In this study, reliability was defined as the degree to which tools produced consistent results. Validity is defined as stance that findings are really about what they appear to be (Saunders et al., 2009, p.157). It means how well tests measure what ought to be measured and was necessary in this study in order to convince the stakeholders to make them believe the findings. The type of validity used in the study is formative because it ascertained the provision of information and made sure that measures covered a broad range of areas within the study.

3.6 Diagnostics Tests

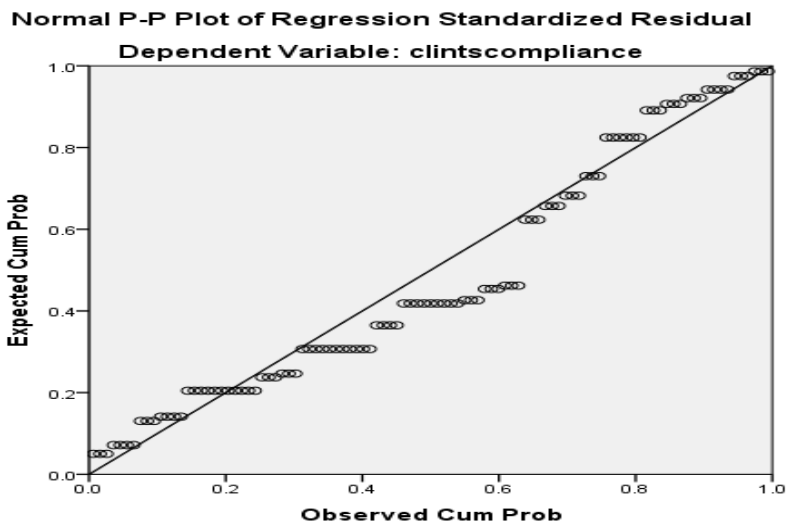
To ensure reliability and validity, diagnostic tests were made using Statistical Package for Social Sciences (SPSS). The type of reliability used was Cronbach’s alpha coefficient and was chosen because of its versatility (see Table 1).

Table 1: Reliability Statistics

Cronbach's Alpha	Cronbach's Alpha Based on Standardized Items	N
0.512	0.654	101

Source: Field Survey Data, 2016

The normality test produced a scatterplot and regression line that met the quantitative data analysis assumptions. The test used a Listwise deletion on all variables in the procedure for the presence of autocorrelation. The results indicated that data was good and normal because the dependent variable “VAT operator’s compliance” was normally distributed. This was because the significant value of Cronbach's Alpha based on standardized items was more than 0.05 and is normally distribution because the data clustered almost close to the regression line (Figure 1 & 2).



1: Reliability Statistics

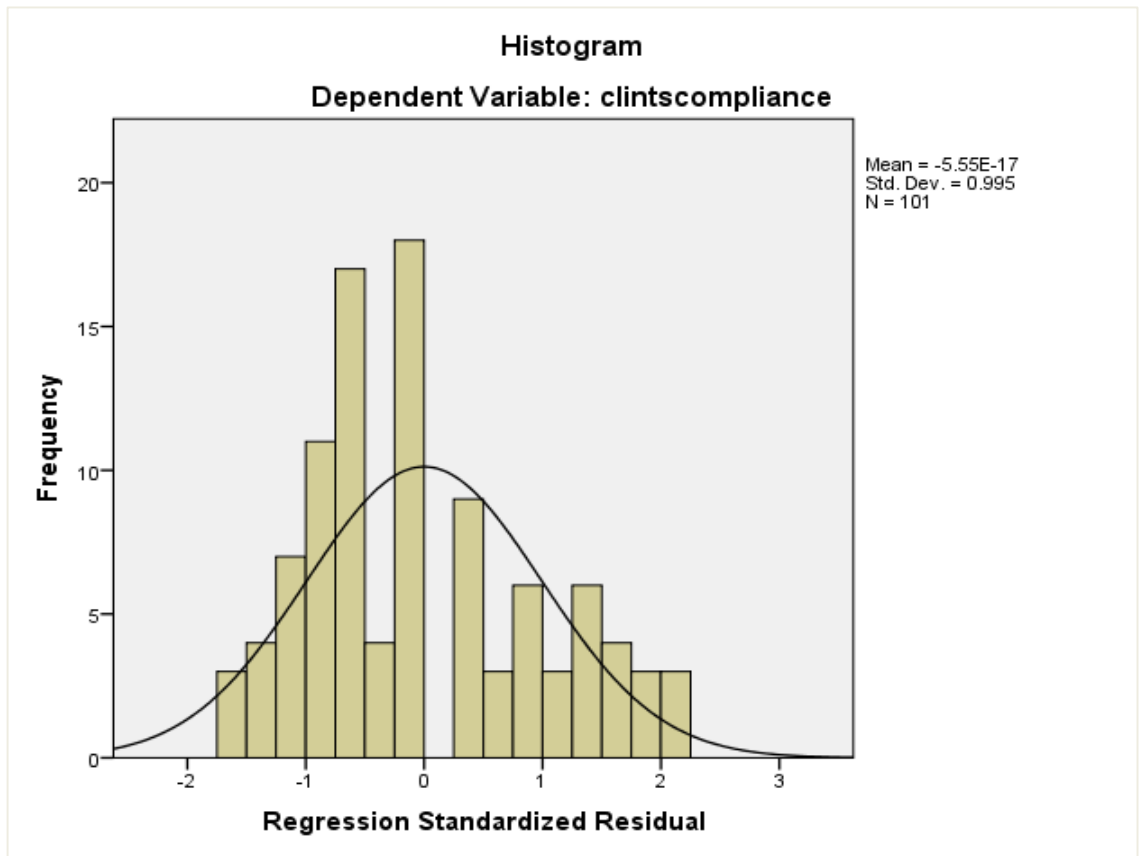


Figure 2: Reliability Statistics

Source: Field Survey Data, 2016

3.7 Chapter Summary

This chapter presented the methodology used in this study. The positivistic philosophy and cross sectional survey strategy were selected and justified for collecting primary and secondary data, analysis of data and presentation of findings. Probability sampling technique or rather simple random was used to identify the sample from a population of 4339 small VAT operators bearing in mind their geographical location. These respondents were identified considering the fact that small VAT operators were the riskiest group than medium and large VAT operators. Additionally, tax evasion is rife amongst this group because their payment of VAT depends on many attributes considering that VAT is a self-assessment tax. Quantitative data was collected, prepared and processed using SPSS from 101 questionnaires that were received from a sample of 353 respondents representing 29 % response rate. Ethically, respondents were allowed to withdraw from the study any time they felt doing so and were assured that their information shall remain confidential. A statement to that effect was disclosed on the questionnaire. A diagnostic test was made to assess the reliability of data using Cronbach's Alpha coefficient and it confirmed that the data was good and normal. The next chapter shall look at data analysis, findings and their discussion.

CHAPTER 4

DATA ANALYSIS, FINDINGS AND DISCUSSION

4.1 Introduction

Raw data does not convey any meaning to its users until it is processed and turned into information that can be used to make judgements, interpretations, conclusions and recommendations. Miles, Huberman and Saldana (2013, p. 69) define data analysis as “the process of inspecting, cleaning, transforming and modeling data with the goal of discovering useful information, suggesting conclusions and supporting decision-making”. Data analysis consists of actions such as examination, categorization, tabulation, and re-combination of data. In that regard, the researcher categorized data into various groups and made sure that statistical techniques were fully utilised so that findings made sense.

Data analysis in this study was based on responses from small VAT operators using survey questionnaires. There were three hundred and fifty-three (353) questionnaires that were distributed to respondents in Blantyre and Limbe areas and out of the total questionnaires, the researcher, only received 101 questionnaires. This represented 29 % response rate and was significant representation of the sampled population. However, it failed to achieve the desired 50 % response rate because some respondents willingly pulled out from the study. It was noted during the field visits that most respondents were reluctant to divulge their tax affairs despite assurances that their information would not in any way be disclosed to business competitors and tax authority. The respondents still felt that the researcher would disclose their information to Malawi Revenue Authority and more also to the general public, some of whom are business competitors who may likely gain a competitive advantage.

The collected data was organised and captured in variable and data panes of the Statistical Package for Social Sciences (SPSS). This software was used to analyse descriptive statistics into frequencies, graphs and tables. Pearson correlation was used because the data was parametric (continuous variables) in nature. Furthermore, multiple linear regression was used to analyse the data in order to assess the relationships between factors and VAT compliance and more also examine the factors influencing the VAT operators' compliance.

4.2 Demographic Data of Respondents

Respondents' demographic data segmented their composition into males and females and the result indicated that 80% were male while 20% were female. They were further segmented into attributes such as age, ethnicity, education qualification and marital status. Their ages ranged between 25 and 70 years and this signified that issues of VAT auditing and compliance involves people of various age groups. However, the study revealed that out of 101 respondents that answered the questionnaire, those that were aged between 45 and 54 years were most observed. This trend suggests that issues of VAT compliance among small VAT operators and more also small businesses were frequently performed by respondents of this age group, perhaps because they are mature and responsible in their conduct of small business management. Furthermore, the results revealed that 88% of the 101 respondents were blacks while those of Asian origin were only 6.9%. This outcome indicated that VAT activities among small VAT operators and most small businesses were being performed by local Malawians, perhaps because they are now locally empowered financially by the organisations that provide capital in form of small loans. The individual respondents were either owners of these businesses or employees and so they transacted VAT activities on their own or on behalf of the owners. Their educational qualifications ranged from Primary School Leaving Certificate (PSLC) to doctorate degree and the outcome indicated that most of them (28.7%) were those with diplomas and were seconded by those with Malawi School Certificate of Education (MSCE) (27.7 %). Respondents qualified to diploma level and above were mostly from accountancy background and accountancy was also the most popular qualification amongst the respondents. The explanation for this trend could be that VAT activities are mostly performed by individuals with accounting knowledge and skills. The results indicated that 82.2 % of the respondents were married while 11.9 % were single and 5.9 % of the respondents did not reveal their marital status. This result suggested that most respondents performing VAT activities are performed by married people who tend to be stable, mature and responsible. Table 2 below provides the summary of the demographic results.

Table 2: Demographic Data of Respondents

	Category	Frequency (N=101)	Percentage (%)
	Male	81	80.2
	Female	20	19.8
Age	25 – 34	16	15.8

	35 – 44	32	31.7
	45 – 54	38	37.6
	55 – 64	12	11.9
	65 – 74	3	3.0
Ethnicity	Black	89	88.1
	White	4	4.0
	Coloured	1	1.0
	Asian	7	6.9
Qualification	PSLC	11	10.9
	MSCE	28	27.7
	Diploma	29	28.7
	Degree	18	17.8
	Masters	12	11.9
	Doctorate(PhD)	3	3.0
Marital Status	Single	12	11.9
	Married	83	82.2
	Other	6	5.9

Source: Field Survey Data, 2016

The findings were also compared to the sample frame considering that only 29 % of the total sampled respondents are the ones that provided feedback while 71% did not respond to the questionnaire. The outcome of such a comparison indicated that the demographic results provided a true representation of issues on the ground.

4.3 Characteristics of Non-Compliant VAT Operators

All the sampled respondents were asked if they had ever submitted their returns and their payment late or not at all to Malawi Revenue Authority. The outcome showed that 62 (62%) of the respondents did not submit their returns and made their payment late or not at all to the revenue authority and as such they were non-compliant VAT operators while 39 (38 %) of the respondents indicated that they were compliant. Those that were compliant meant that they had submitted VAT returns and VAT payments on time without fail and cheating. Both groups were further asked questions in regard to their frequency of attendance to religious activities, type of their business legal entity, annual business turnover and industry of their business in order to isolate characteristic that are unique to non-compliant VAT operators.

4.3.1 Non-Compliant Respondents' Attendance to Religious Activities, Legal Entity, Business Turnover and Business Industry

Table 3 indicates that 39 (38%) of the compliant VAT operators attended religious activities once a week 21 (54%), their entities were mostly sole proprietors (54%), their business turnover was more than MK 90 million 15 (39%) and their industry type were retail and wholesale, combined 15 (39%) and service 15 (39%). This implied that attendance to religious activities, type of business entity, turnover and industry type influenced VAT compliance and are characteristics that VAT operators must possess for them not to be compliant to VAT obligations.

Table 3: Attendance to Religious Activities, Legal Entity, Turnover and Industry of Business of Non-Compliant Respondents

	Category	Frequency (N=39)	Percentage (%)
Attendance to religious activities	more than once a week	12	30.8
	once a week	21	53.8
	once a month	3	7.7
	once a year	3	7.7
Legal Entity	Sole trader	21	53.8
	Partnership	6	15.4
	Limited	9	23.1
	Other	3	7.7
Turnover (Malawi Kwacha)	10,000,001 - 30,000,000	3	7.7
	30,000,001 - 50,000,000	6	15.4
	50,000,001 - 70,000,000	3	7.7
	70,000,001 - 90,000,000	12	30.8
	≥ 90,000,000	15	38.5
Nature of Business	Retail and Wholesale	15	38.5
	Carriage and Haulage	3	7.7
	Hospitality	3	7.7
	Construction and Building	3	7.7
	Service	15	38.5

Source: Field Survey Data, 2016

4.3.2 Compliant Respondents' Attendance to Religious Activities, Legal Entity, Turnover and Type of Business

There were 62 respondents (62%) that were non-compliant and a summary is shown in Table 4. The table indicates that a majority of respondents attended religious activities more than once a week (58%), their entities were mostly sole proprietorship (48%), their business turnover was more than MK 90 million (37%) and industry type was also service (53%). The findings implied that attendance to religious activities, type of business entity, turnover and industry type have some effect in influencing VAT compliance and are characteristics that VAT operators must possess for them to be compliant to VAT obligations.

Table 4: Attendance to Religious Activities, Legal Entity, Turnover and Type of Business of Compliant Respondents

	Category	Frequency (N=62)	Percentage (%)
Attendance to religious activities	More than once a week	36	58.1
	once a week	25	40.3
	once a month	1	1.6
Legal Entity	Sole trader	30	48.4
	Partnership	18	29.0
	Limited	13	21.0
	Other	1	1.6
Turnover (Malawi Kwacha)	10,000,001 - 30,000,000	18	29.0
	30,000,001 - 50,000,000	5	8.1
	50,000,001 - 70,000,000	5	8.1
	70,000,001 - 90, 000, 000	11	17.7
	≥ 90,000,000	23	37.1
Nature of Business	Retail and Wholesale	6	9.6
	Carriage and Haulage	17	27.4
	Hospitality	5	8.1
	Construction and Building	1	1.6
	Service	33	53.2

Source: Field Survey Data, 2016

A comparison between compliant and non-complaint respondents was done by looking at the Table 3 and 4. It was established that non-compliant respondents attended religious activities

only once a week (54%) while compliant ones attended more than once a week (58%), sole proprietors were both compliance and noncompliance, with a business turnover of more than a MK 90 million trading in service industry. The only difference was in the level of intensity as can be seen from the actual percentages. The results confirmed that clients who frequented religious activities were compliant than those that were not. This was evidenced through attendance to religious activities implying that such activities may be playing a role in influencing compliance to VAT obligations. The findings are consistent to studies done by Torgler (2006/2007), Torgler and Schneider (2007), Torgler et al., (2008) and Torgler (2012) who claimed and supported the notion that religiosity was an important factor that influences voluntary tax compliance. The findings have shown that religiosity plays a vital role in fostering voluntary tax compliance in Malawi.

4.4 Relationship of Factors that Influence VAT Operators' Compliance

An assessment on the relationship of factors that influence VAT operators' compliance was performed using a Pearson correlation analysis to determine whether there is a relationship between VAT compliance and VAT audit. The result showed that there was no significant relationship between VAT compliance and VAT audit ($r = -0.093, p = 0.356$) (Table 5).

Table 5: Pearson Correlation Analysis between Compliance and VAT Audit

		VAT compliance	VAT audit
VAT compliance	Pearson Correlation	1	-.093
	P-value		.356
VAT audit	Pearson Correlation	-.093	1
	P-value	.356	

Source: Field Survey Data, 2016

Therefore, the alternative hypothesis (H_1) that there is a relationship between VAT audit and small VAT operators' compliance is rejected. As such the null hypothesis (H_0) was accepted concluding that there is no relationship between VAT compliance and VAT audit. These findings are consistent with Bergman and Nevarez (2006), Modugu and Anyaduba (2014), Manhire (2015), Martinez-Vazquez and Rider (2003) who found that tax audit did not directly increase tax compliance. Contrary to these researchers and findings are Alm and McKee (2004), Dubin, Gractz and Wilde (1990) and Birskyle (2013) who established that taxpayer audits were a central feature to the voluntary compliance framework and had a direct and deterrent effect on all audited VAT operators. Specific to African experiences, Modugu and

Anyaduba (2014) discovered that tax audits did not make any substantial impact on the low tax compliance in Nigeria. Therefore, the findings of this study have suggested that noncompliance of VAT operators in Malawi is unaffected by the audit rates. This is an indication to Malawi Revenue Authority that VAT audit alone is not a tool for the enhancement of VAT operators' compliance in Malawi.

A further analysis using Eta correlation was performed in order to determine other factors that are associated to VAT operator's compliance. The analysis was between VAT operator's compliance and attributes such as religion, ethical behaviour, patriotism, VAT morale, honesty, personal qualification, marital status, economic necessity, government wastefulness, pride in development and penalties and interest. The study used Eta correlation for this analysis because it is the most appropriate tool in the examination of relationships between an interval variable and categorical (Table 6). Results of Eta correlation analysis showed that there was significant relationships between VAT compliance and ethical ($r = 0.215, p = 0.030$), education ($r = 0.460, p = 0.000$) and marital status ($r = 0.245, p = 0.049$), economic necessity ($r = 0.334, p = 0.001$), penalties and interest ($r = 0.596, p = 0.000$). These findings are similar to what other researchers found. For example, the study done by Alm and McKee (2004) indicated that compliance levels were high amongst VAT operators and they paid their taxes on time and without defaulting for fear of being charged penalties and fines. It is also noted that there was positive relationship between VAT operators' compliance and economic necessity because the compliance of VAT operators was affected by lack of money to pay their tax obligations to the tax administration as VAT operators opt to keep and use the money in the business than paying tax.

Table 6: Eta Correlation Analysis between VAT Compliance and Other Factors Influencing VAT Operators' Compliance

	N	Eta Correlation	P-Value
Religion	101	0.148	0.141
Ethical	101	0.215	0.030**
Patriotic	101	0.106	0.293
VAT morale	101	0.039	0.699
Honesty	101	0.065	0.516
Education	101	0.460	0.000**

Marital status	101	0.245	0.049**
Economic necessity	101	0.334	0.001**
Government wastefulness	101	0.114	0.258
Pride in development	101	0.161	0.107
Penalties and interests	101	0.596	0.000**

** indicates p-value < 0.05 (significant)

Source: Field Survey Data, 2016

This scenario is very common to VAT operators who owe tax authorities higher tax amounts because they are not motivated by any sense of morality to pay tax arrears (Ritsema & Thomas, 2003). VAT operators also get motivated to pay taxes when they see public goods such as hospitals and school projects that government provides in their communities using tax revenues (Alm et al., 1991). The differences in VAT compliances by operators is dynamic and bound to behave differently at times and situations considering that their thinking and reasoning is not linear.

A study conducted by Ritsema and Thomas (2003) found that older aged VAT operators who were highly educated, married and high income earners were more compliant to taxes. The current study indicates that compliance of VAT operators in Malawi is not strongly influenced by auditing alone but probably by other factors that are more influential in encouraging their willingness to voluntarily comply with the VAT obligations. Recent studies on tax compliance emphasises on the importance of exploring the impact of non-economic factors from a number of perspectives such as individual VAT operators' internal values that derive their values, culture and religion towards tax obligations. Religious values held by most individuals are generally expected to effectively prevent negative attitudes and encourage positive attitudes in an individual's daily life and, hence, religiosity is presumed to positively motivate VAT operators to voluntarily comply with tax laws (Mohdali, 2016).

4.5 Factors Influencing Small VAT Operators' Compliance

This sub section of the study was aimed at examining the factors that influence VAT operators' compliance. To achieve this objective, respondents were asked to respond by taking one option (yes or no) to the questions. This was done to see if they considered factors such as VAT audit, ethical, education, marital status, economic necessity, government

wastefulness, pride in development and afraid of penalties and interest as reasons for paying tax. A multiple linear regression analysis was performed and results are reported (Table 7).

The results of multiple regression analysis showed that VAT audit ($t = 9.698, p = 0.004$), pride in development ($t = -4.140, p = 0.000$) and being afraid of penalties or interests ($t = -6.646, p = 0.000$) were statistically significant factors for explaining VAT operators compliance. The results also showed that although factors such as government wastefulness, economic necessity, marital status, education and ethical are related to VAT operators' compliance they are not statistically significant factors for explaining VAT operators' compliance. Furthermore, the results showed that the model is statistically significant ($F = 13.649, p = 0.000$) and 50% of the variation in VAT operators compliance is being explained by VAT audits, pride in development and afraid of penalties or interest. However, when the model with only VAT audits was fit to the data, the results showed that only 1 % of VAT operator's compliance is explained by VAT audits. Therefore, findings of the study have informed that VAT audits do not make any substantial impact on VAT compliance in Malawi. The results have proved beyond any reasonable doubt that audit productivity and effectiveness does not add much value to Malawi Revenue Authority.

Table 7: Regression Analysis of the Factors Influencing VAT Operators' Compliance

Variable	Unstandardized Coefficients		T	P-value
	B	Std. Error		
(Constant)	33.338	3.438	9.698	.00**
VAT audit	-1.098	.371	-2.956	.004**
Ethical				
Yes	2.010	1.062	1.892	.062
No (reference category)				
Education				
Yes	.264	1.253	.211	.833
No (reference category)				
Marital status				
Yes	4.569	2.577	1.773	.080
No (reference category)				
Economic necessity				
Yes	-.483	1.398	-.345	.731
No (reference category)				
Government wastefulness				
Yes	1.897	1.438	1.320	.190

No (reference category)				
Pride in development				
Yes	-5.401	1.305	-4.140	.000**
No (reference category)				
Penalties and interest				
Yes	-8.364	1.259	-6.646	.000**
No (reference category)				
<i>AdjustedR</i> ² = 0.503, <i>F</i> = 13.649, <i>P</i> = 0.000				

** indicates p-value < 0.05 (significant)

Source: Field Survey Data, 2016

The results of multiple linear regression analysis showed that VAT audit ($t = 9.698, p = 0.004$), pride in development ($t = -4.140, p = 0.000$) and being afraid of penalties or interests ($t = -6.646, p = 0.000$) were statistically significant factors for explaining VAT operators' compliance. The results also showed that although factors such as government wastefulness, economic necessity, marital status, ethics and education are related to VAT operators' compliance, they are not statistically significant factors for explaining VAT operators' compliance. Furthermore, the results showed that the model is statistically significant ($F = 13.649, p = 0.000$) and 50% of the variation in VAT operators compliance is being explained by VAT audits, pride in development and afraid of penalties or interest. However, when the model with only VAT audits was fit to the data, the results showed that only 1 % of VAT operator's compliance is explained by VAT audits. Therefore, findings of the study have informed that VAT audits alone do not make any substantial impact on VAT compliance in Malawi. The results have proved beyond any reasonable doubt that audit productivity and effectiveness does not add much value to Malawi Revenue Authority.

4.6 Tools and Strategies for Improving VAT Operators' Compliance

The researcher wanted to identify tools and strategies that can be employed to supplement the already existing ones to improve VAT compliance. Therefore, respondents were asked 'yes and no' questions on issues such as taxpayer education, whistle blowing (tip -offs anonymous), electronic filing and electronic banking in order to determine their level of attitudes on the attributes. The researcher also requested respondents to suggest any new tools and strategies that can be used to further improve VAT compliance. Table 8 presents results of the identified tools for compliance enhancement.

4.6.1 Compliance Enhancement Tools

Taxpayer education: The study revealed that 96 % of the respondents considered civic education as the most important tool for improving VAT compliance. They felt that MRA has the duty to inform and educate its clientele through programmes such as taxpayer education. It was indicated that taxpayer education was one of the most important programmes for the dissemination of new tax measures and also a way of promoting voluntary compliance.

Table 8: Responses on Whistle Blowing, E-Filing, E-Banking and Taxpayer Education

	Response	Frequency (N=101)	Percentage (%)
Taxpayer education	Yes	97	96.0
	No	4	4.0
Tip off anonymous	Yes	51	50.5
	No	50	49.5
Electronic bank payment	Yes	68	67.3
	No	33	32.7
Electronic filing	Yes	81	80.2
	No	20	19.8

Source: Field Survey Data, 2016

Whistle blowing:

The study showed that 50.5 % of the respondents agreed that whistle blowing, also known as tip-offs anonymous, should be used as a tool for improving voluntary compliance. It is an independent and confidential way for reporting fraud and un-ethical behaviour taking place in an organisation such as Malawi Revenue Authority. Any person can report using a hotline telephone service operating 24-hours a day, 7 days a week and 365 days using toll free numbers. It does not matter whether one is an employee, customer, supplier, manager or shareholder. Anyone can report through e-mail, web, text message, fax and post office mail. This facility is being used by MRA and uses Deloitte as its agent (see table 8).

Electronic Filing and Banking:

The study showed that 80 % of the respondents suggested that electronic filing should also be used as a tool for improving compliance. This is an automated service that allows VAT operators to prepare and file their VAT returns electronically. The returns are directly sent to a revenue authority from their preparation points. They are very advantages because they build a strong client relationship and improve business processes since VAT operators electronically file and lodge their returns fast and with minimal errors. If used properly clients

are able to save money on printing costs, mailing and records management. The service also helps in keeping client information in a more robust, organised and centralised manner. More also, the method can readily be accessed and available when needed.

Further, sixty-seven (67 %) of the respondents suggested that e-banking should be used to improve compliance. Electronic payment system offers a range of benefits as money transfers between virtual accounts and usually takes few minutes and one does not spend and waste time queuing on lines in a cash office, bank or post office. Virtual accounts maintain history of all transactions indicating pay point and amounts which can be checked and verified any time using real time. It also offers security as it cannot be taken and used by any one including robbers, although there might be issues of scammers. Electronic payment system is cost effective because low commissions are paid to service providers. It is again user friendly and convenient because money transfers occur anytime and anywhere.

4.6.2 Suggested Tools and Strategies for Compliance Enhancement

Furthermore, the study solicited suggestions from the respondents on the strategies that could improve VAT compliance if implemented by Malawi Revenue Authority and respondents' responses mentioned the following strategies that have been analysed and shown in Table 9.

Taxpayer education:

It is the tool to enable the taxpayer to understand the tax laws, making easy for them to comply with the obligations such as accurate preparations of returns, timely submission of the returns and payment of taxes. The study observed again that 36 % of the respondents named civic education as the most important tool for enhancing compliance. According to Norwahi and Dhami (2005) taxpayer education is a tool to enable taxpayers to comply with the self-assessment system. Taxpayer education provide the necessary tax knowledge to taxpayers to comply with the tax matters and allows change in the perceptions and attitudes towards tax compliance by creating more positive attitudes. In a study done by Kassipillai (2003) it was also confirmed that an attitude towards the tax compliance was increased soon respondents were provided education in the study that was carried in Malaysia that tested the compliance attitudes.

Table 9: Respondents Suggestions on Tools and Strategies for Improving VAT Operators' Compliance

	Frequency (N=101)	Percentage (%)
No suggestions	19	18.8
Taxpayer education	36	35.6
Superior taxpayer care	17	16.8
MRA to reduce rates	10	9.9
Improve workability of EFD machines	7	6.9
Open new MRA offices in Limbe and Blantyre	3	3
Government to be transparent	3	3
MRA to open VCW	3	3
Timely Auditing	3	3
Total	101	100

Source: Field Survey Data, 2016

Superior Taxpayer Service:

It is the work of looking after taxpayers as customers and ensuring their satisfaction with MRA's business and services. Taxpayers as clients must be aware of their rights in order to seek a high standard of service from the revenue body. The study observed that 17 % of the respondents mentioned that MRA should improve and start providing superior taxpayer service. It has been witnessed recently that major reforms in public sector administration strive to improve the efficiency and effectiveness of their operations and central to these reforms it's the use of modern technologies in delivering information and transaction services. Taxpayer service delivery function plays a crucial role in the administration of tax legislation in all countries because it encourages return visits by tax payers (OECD, 2007). Provision of services that are user-friendly and accessible to all, helps to maintain and strengthen the taxpayers' willingness to comply voluntarily and thereby contribute to improvements in overall levels of compliance with the laws.

Reduction of VAT and Interest Rate:

Ten percent (10 %) of the respondents suggested that government should reduce VAT rate to around 10 % in order to offshoot the economic hurdles they are currently facing so that VAT operators are not tempted to evade tax in order to use the collected VAT in the business but rather declare all to Caesar as commanded in the book of Matthew, Chapter 22 Verse 21. The

advantage of VAT rate cut is solution to the problem of externality, because any increase of indirect taxation pushes prices up, decreases consumption and hence reduce the effects of negative externalities such as damage to the environment, for example. However, for the policy to be economically effective, government should be prepared to forego much of the lost VAT revenue over a period longer than one year. In general, economic benefits will be partially compromised whilst the financial repercussions to the government will remain relatively high.

Workability of EFD Machines:

MRA has implemented a number of innovations such as Electronic Fiscal Devices (EFD) in order to improve issuance of VAT invoices and receipts. These are machines designed for use in business for efficient management controls in areas of sales analysis and stock control system and conforms to the requirements VAT laws. These gadgets are interconnected to a MRA server maintained at the Head office for monitoring sales using an Electronic Fiscal Devices Management System (EFDMS). However, it has been observed that the network is sometimes poor or down and therefore VAT operators requested an immediate improvement on the workability of these EFD gadgets so that they can avoid penalties and improve compliance. 7 % of the respondents suggested that MRA should improve on the workability of EFD machines. The introduction of EFDs should be considered as part of a comprehensive compliance improvement strategy that clearly identifies risks for different segments of taxpayers and should not be construed as the “silver bullet” for improving tax compliance. This innovation is consistent to Russell (2010)’s research where amongst the many reforms, the researcher suggested usage of information systems in the administration of tax.

Establishment of MRA Offices in Limbe and Blantyre:

Three percent (3%) of the respondents suggested that MRA should open new offices in Limbe and Blantyre so that they and other clients can access quality services close to their business locations in order to save time.

Government to be Transparent:

Three percent (3%) of the respondents also wanted government to be transparent in its dealings when using public money for development projects so that everybody knows how the taxes are being used so that they can be encouraged to even pay more. Openness, accountability and honesty define government transparency and in a free society such as

Malawi, it is government's obligation to share information with citizens. Governments exist to serve the people and information on how officials conduct the public business and spend taxpayers' money should be readily available and easily understood. This transparency allows good and just governance.

Voluntary Compliance Window (VCW):

Three percent (3%) of the respondents requested for the establishment of voluntary compliance window (VCW). This is a program that helps businesses and individuals who owe Malawi Revenue Authority, different taxes from previous tax periods to come forward and settle their obligations in compliance with the Taxation and VAT laws. If one decides to participate in the program, the taxpayer avails himself or applies in writing stating his offence. The participating individuals and organisations achieve a full and immediate compliance of taxes while being allowed to settle their arrears in instalments and penalties are waived depending on specific circumstances. They also complement the rapid improvement in exchange of information and the ability of governments to detect offshore evasion and are an integral part of a broader compliance strategy. They should be considered as part of a variety of compliance actions that tax administrations and governments take in order to encourage all taxpayers to meet their obligations.

Timely VAT Audits:

Three percent (3%) of the respondents suggested that MRA should conduct timely VAT audits in accordance to VAT Act that recommends quarterly audits for all VAT operators. Therefore, in order to deliver quality outcomes, auditors require access to improved and approved procedures, policies and tools. Obviously, such products vary considerably with the variety and complexity of the regimes administered by individual tax administrations. Nevertheless, it is possible to identify certain pre-requisites that must be in place if auditors are to be able to carry out their work effectively and efficiently. As such tax authorities should develop methodologies that ensure timely completion of audits

In addition to tools and strategies that have been elaborated above the researcher also found from various literatures that there are other strategies that can be used to enhance compliance among VAT operators such as tax policy improvements, investigation intelligence gathering and development of new information systems. These are important tools that can help in curbing tax evasion. Use of third party information gathered through intelligence and

information exchange from fellow revenue administrations and financial institutions is a practical way of strengthening audits. Most countries have legal provisions that support the VAT auditor in circumstances where the VAT operator does not provide satisfactory information. The auditor, therefore, should verify VAT operator's information using an independent or third party source. The study indicates that if these interventions are used objectively they can be weapons for addressing tax evasion within particular countries and across the borders because they reduce the probability of false reporting and also increases chances of perpetrators being detected. Large number of tax treaties are in existence and this reflect that there is a fundamental importance in accepting rules for exchange of information between countries for verification purposes. For many revenue administrations, the exchange of information is organised through liaison units. These units process the requests of foreign tax authorities; supervise the restrictions on the kinds of information that may be exchanged. The nature of audit activities is changing from working exclusively in the domestic arena to doing audits on international issues. One means of verifying information involving other countries is through simultaneous bilateral or multilateral audits. The number of these audits varies from one to ten per annum in the revenue administrations that employ them (OECD, 2006). Another important and essential tool is a comprehensive audit manual. Such a tool can help in achieving consistent results when dealing with VAT operators, the proper interpretation of legislation and the correct use of VAT audit operational procedures. It can also assist in the interpretation of information in responding to queries and request for information by external bodies such auditing firms, arbitrators and court of law.

New tax policies can as well be used as a tool for improving compliance. The primary goal of a revenue administration's compliance activity is to improve overall compliance with the tax laws and in the process instilling confidence in the VAT operators and the community at large. Instances of failure to comply with the VAT Act are inevitable either due to VAT operators' ignorance, carelessness, recklessness and deliberate evasion, or weaknesses in its administration. Historically, most VAT operators-driven failures or compliance risks have been addressed nearly exclusively by revising and devising new tax policies that help regulate VAT enforcement through an audit-based approach. In more recent times, revenue administrations have come to realise that the factors underlying VAT operators' compliance behaviour in any specific risk area are varied and often complex. As such, it is unlikely for them to be treated successfully with a 'single action' strategy, for example, a tax policy that reduces tax rates and bands is appropriate and rational. A tax policy such as introduction of

Withholding tax on all foreign transactions can as well be used as a tool for improving compliance. This policy worked in U.S.A and Denmark such that there was only about 0.2 % underreporting on employment income because information was provided to the tax authority by employers.

New information systems that support the publication of audit manuals in an electronic format are very important. This ensures ease of updating and also their availability to staff via the revenue authority's intranet. Additionally, relevant information is made available to the general public by revenue administration in order to provide transparency around the administration's procedures, uniform and standard interpretations of tax matters. Furthermore, it is becoming increasingly important so far that information technologies are used to support audit teams in the performance of their work. These tools are now being used to transform, organize and review business information. Generally, they fall into categories that support audit planning and processes including online guidance, access to data and tools with which to test business records and VAT returns during the audit process and computer based tools that meet operational requirements of auditors while not in office but in the field. For example, New Zealand Inland Revenue authority has recently introduced a compliance based auditing framework to assist auditors in conducting risk analysis before opening potential cases. As a result, tasks involved with audit case selection have tremendously been reduced because the template in use is able to automatically transfer data to appropriate plans and work schedules. The software package also facilitates information sharing among auditors, investigators and other stakeholders. In the same New Zealand Inland Revenue authority, a data warehouse tool is used to mine data from the central database and then imported into a tax audit selection system [TASS] tool (OECD, 2006).

Business and industry profiles are also important tools that bring awareness on how particular industries and businesses are conducted and the likely level of profitability. Their use facilitates timely audit completion because auditors are able to prepare their audit plans with some awareness on how particular industries and businesses are conducted and their likely level of profitability and expected expenses from a business of a particular size located in a particular region, city and district. To this end, some revenue authorities have developed business profiles and industry benchmarks using data from various sources to help in the conduct of VAT audits.

4.7 Chapter Summary

This section presented data analysis, findings and discussion based on the responses from VAT operators. It is established from the study that compliant and non-compliant VAT operators depicted similarities and differences in characteristics such as attendance to religious activities, legal entities, business nature and turnover. The chapter also outlined factors that influence VAT compliance. Finally, the chapter presented tools for enhancement of compliance such as tax payer education, tip-off anonymous, electronic bank payment and electronic filing. Additionally, the study has identified tools and strategies that can improve VAT compliance when properly used. The next chapter discusses the conclusion and suggests recommendations.

CHAPTER 5

CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

The study considered tax compliance as synonymous to looking at a coin that has two sides and further advocated for a deeper understanding of issues such as motivation, circumstances and characteristics that can achieve high compliance rates amongst small VAT operators. The findings have provided insights in the area of VAT auditing and compliance of small VAT operators. For example, it has been noticed that VAT declaration decisions are made in uncertainty situations where small VAT operators have two options, that is, whether to declare the actual output and input VAT or cheat to declare less output VAT or vice versa. It has also been observed that some respondents have not been compliant at one point or another.

5.2 Conclusions

Small VAT operators by virtue of their size and structure, comprise a very risky group and are somehow influenced by characteristics such religion, ethics, patriotism, personal qualification, age and marital status in making compliance decisions. The influencing characteristics are not static in nature but are rather dynamic as time and environment changes. The study established that certain characteristics are unique to both compliant and non-compliant VAT operators. In regard to the relationship of factors that influence VAT operators' compliance, the study established that audits are not a very important feature to voluntary compliance framework of VAT operators even when they make their own self assessments. It has been noted that audits do not cause a significant impact on the compliance of VAT operators. As such, under normal circumstances, some VAT operators shall remain non-compliant because tax compliance decisions are made unitary and in uncertainty situations and failure to declare one's true tax liability does not automatically provoke a penalty or fine. An attempt has been made to present a comprehensive analysis of the responses the VAT operators made particularly in regard to VAT audits and compliance. Subsequently, following an extensive review of relevant literature relating to tax audits and VAT operators' compliance in other climes and results of the study, it is therefore concluded that audits do not make any substantial impact on compliance of VAT operators in Malawi. It therefore behoves on the Malawi Revenue Authority to pursue more pragmatic and effective means of enhancing compliance in Malawi in order to consolidate and improve the performance of VAT and government's revenue.

5.3 Recommendations

In order for Malawi Revenue Authority to promote high VAT compliance rates among VAT operators in Malawi the following measures are recommended:

- i. MRA should combine audit with other enforcement tools such as civic education in order to stimulate compliance.
- ii. MRA should engage government to devise tax policies that promote compliance. For example, putting in place low tax rates.
- iii. MRA should devise pragmatic, practical and effective operation plans that enhance the impact of VAT audits in order to consolidate VAT compliance and revenue.

5.4 Contribution of the Study

5.4.1 Body of Knowledge

The study has empirically and significantly contributed knowledge and enriched the world of education especially in the field of Value Added Tax. It remains an additional insight for anyone who may wish to read further on the topic to the extent that that researchers may use the identified characteristics for further and future studies. The knowledge and information gained from this study shall help in the human development and empowerment of tax professionals in their day to day performance of their work. It has also added new knowledge to the limited literature available in the region.

5.4.2 Tax Policy

The study has shed light on matters of tax policy and in that context government shall come up with efficient and effective policies that motivate and encourage small VAT operators to voluntarily pay their tax obligations. Tax policies that lessen the burden of the indigent people are appropriate and should be designed in order to close the gap between the poor and the rich. Poorly designed tax system leads to low efficiencies, high collection charges, waste of time among operators and revenue administrations, low tax revenue and deviation of optimum allocation of resources. Yaobin, (2007) emphasised the formulation of special tax regimes for small business operators and are appropriate policy instruments for minimising cost of revenue collection. In so doing, government shall help maintain a balance between large,

medium and small VAT operators and reduce uncertainties faced by small VAT operators as well as improve their levels of voluntary compliance (Kasipillai, 2005). A good tax policy stabilizes the economy and redistribution of wealth of people in a country and more also ensures government to have a steady stream of revenue throughout the year (Mill, 2009).

5.4.3 VAT Compliance

VAT is the most important and reliable source of revenue for government and the study has pointed out areas that need to be addressed in order to have effective and efficient tax system that encourages VAT compliance so that VAT operators pay their tax obligations willingly. This development shall ensure VAT operators file correct and accurate information on returns and VAT payment. Thus, the primary purpose of tax audit is to ascertain the extent to which VAT operators comply with the relevant statutory provisions of the VAT Act compared to their statements of financial position and other tax-related returns. Once this is established, Malawi Revenue Authority shall assess VAT operators using best audit practices. VAT audits once mixed with other strategies such as tax education, superior customer service and tax simplification programmes shall improve compliance of VAT operators.

5.5 Areas for Further Study

Malawi like most African countries has the need to increase its tax revenues to finance human and economic development. As such, VAT which is a general consumption tax was the preferred instrument to achieve that goal because it's less detrimental to growth than Income taxes. Currently, its performance is not encouraging and pleasing. Yet, it has been noted from the study that VAT auditing does not affect the compliance of VAT operators in Malawi. Therefore, a study on the concept of VAT operators' attitudes towards compliance should be undertaken in order to fully understand the real causes of high levels of noncompliance among VAT operators in Malawi. There is need to investigate on the factors that influence taxpayers' attitudes and its relationship between attitudes and tax compliance behaviour among small VAT operators. This subject has received a lot of debate in most forums and the outcome of such a study would lead into the development of necessary action plans that can be implemented by the Malawi Revenue Authority in order to improve on the VAT compliance and revenue collection for a better Malawi.

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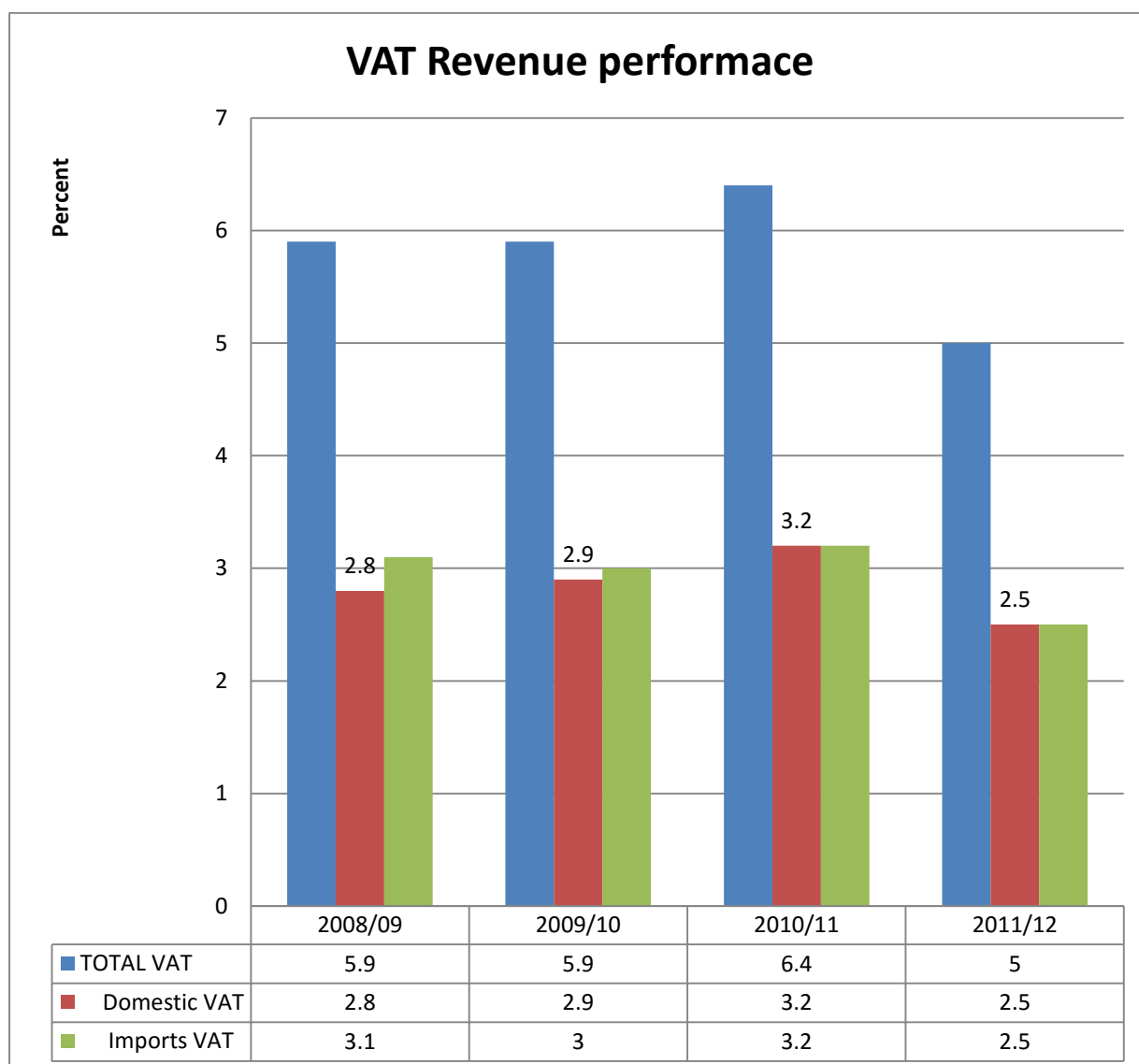
APPENDICES

Appendix 1: Categories of Registered VAT Operators

Type of Taxpayer	Turnover(MK million)	2014/15
Large VAT operators	Equal to or greater than MK750m	620
Medium VAT operators	Equal to or greater than MK500m but less MK750m	503
Small VAT operators	Equal to or greater than MK10m but less than MK500m	4339
Total		5462

Source: Malawi Revenue Authority, VAT Register

Appendix 2: VAT Collections in Percentages of Gross Domestic Product (GDP)

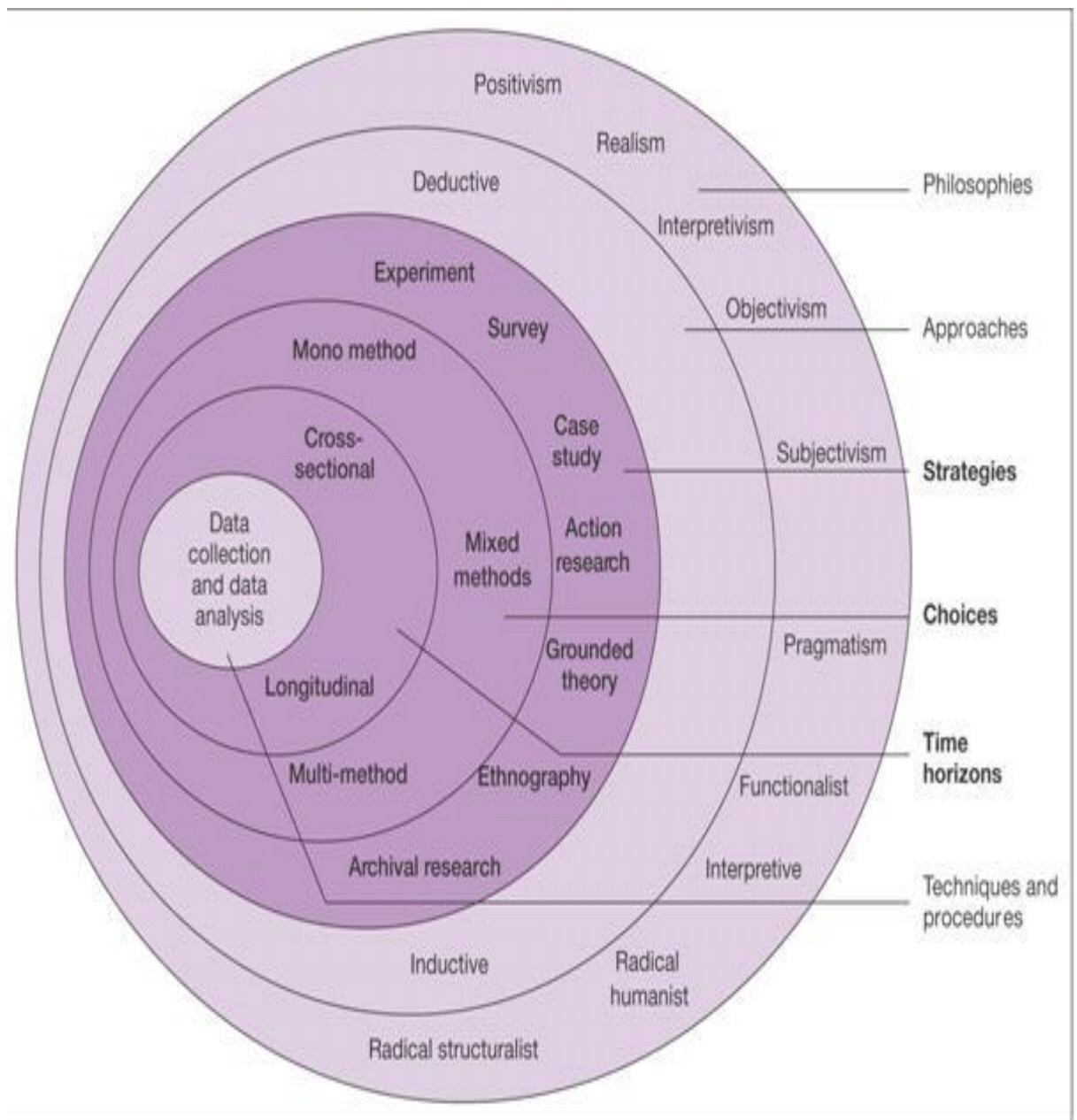


Source: IMF (2012) Report on MRA Revenue Performance

Appendix 3: Procedure for Testing Null Hypothesis

No	Null Hypothesis	Variable and Type	Nature of Variable	Statistical Analysis/ Test
1.	There is no statistical positive relationship between auditing and VAT compliance.	Dependable variable: VAT compliance Independent variable: Auditing.	Continuous variable	Pearson correlation coefficient
2.	Auditing does not influence VAT compliance amongst small VAT operators.	Dependable variable: Auditing Independent variable: VAT compliance amongst small VAT operators	Continuous variable	Pearson correlation coefficient
3.	There is no relationship of factors that influence VAT operators' compliance and VAT operators' compliance	There is no relationship of factors that influence VAT operators' compliance and VAT operators' compliance Dependable variable: Religion, ethical, Patriotic, VAT morale, honesty, education, marital status, Economic necessity, government wastefulness, pride in development and penalties and interests Independent variable: VAT operators'	Continuous variable	Eta correlation Coefficient

Appendix 4: Research Onion as Adapted from Saunders et al. (2009)



Appendix 5: Template for finding sample size

<p>What margin of error can you accept?</p> <p>5% is a common choice</p>	<input type="text" value="5"/> %	<p>The margin of error is the amount of error the study tolerates. If 90% of respondents answer <i>yes</i>, while 10% answer <i>no</i>, the researcher may be able to tolerate a larger amount of error than if the respondents are split 50-50 or 45-55. A lower margin of error requires a larger sample size.</p>
<p>What confidence level do you need?</p> <p>Typical choices are 90%, 95%, or 99%</p>	<input type="text" value="95"/> %	<p>The confidence level is the amount of uncertainty the study tolerates. Supposing that the researcher has 20 yes-no of questions in the study. With a confidence level of 95%, the researcher would expect that for one of the questions (1 in 20), the percentage of people who answer <i>yes</i> would be more than the margin of error away from the true answer. The true answer is the percentage you would get if you exhaustively interviewed everyone.</p> <p>Higher confidence level requires a larger sample size.</p>
<p>What is the population size?</p> <p>If you don't know, use 20000</p>	<input type="text" value="4339"/>	<p>How many people are there to choose your random sample from? The sample size doesn't change much for populations larger than 20,000.</p>
<p>What is the response distribution?</p> <p>Leave this as 50%</p>	<input type="text" value="50"/> %	<p>For each question, what do you expect the results will be? If the sample is skewed highly one way or the other, the population probably is, too. If you don't know, use 50%, which gives the largest sample size.</p>
<p>Your recommended sample size is</p>	<p>353</p>	<p>This is the minimum recommended size of your survey. If you create a sample of this many people and get responses from everyone, you're more likely to get a correct answer than you would from a large sample where only a small percentage of the sample responds to your survey.</p>

Alternate scenarios

<p>With a sample size of</p>	<input type="text" value="100"/>	<input type="text" value="200"/>	<input type="text" value="300"/>	<p>With a confidence level of</p>	<input type="text" value="90"/>	<input type="text" value="95"/>	<input type="text" value="99"/>
<p>Your margin of error would be</p> <p>%</p>	8.98	6.77%	5.46%	<p>Your sample size would need to be</p>	82	116	196

Appendix 6: Sample Questionnaire

QUESTIONNAIRE

Section One: Background Information

This section refers to background or biological information.

1. State your gender (*Tick one option only*):

Male	
Female	

2. State your age (*in complete years*):

3. State your ethnicity (*Tick one option only*):

Black	
White	
Coloured	
Indian or Asian	
Other (<i>specify</i>)	

4. Tick your highest educational qualification (*one option only*):

None	
PSLC	
MSCE	
Diploma	
Degree	
Masters	
Doctorate (PhD)	

5. Tick your marital status (*one option only*):

Single	
Married	
Other (<i>Specify</i>)	

Section Two: Characteristics, habits and preferences of VAT operators

This section explores the characteristics, habits and preferences of VAT operators towards VAT compliance.

6. How often do you attend religious activities or services?

1. More than once a week
2. once a week
3. once a month,
4. only on special occasions
5. once a year,
6. Never

7. What is the legal entity of your business?

1. Sole trader
2. Partnership
3. Limited,
4. Trust
5. Other (*specify*)

- 8 What is the level of your business turnover (annual business income)? *Check only one:*
1. MK 10,000,001 - 30,000,000
 2. MK 30,000,001 - 50,000,000
 3. MK 50,000,001 - 70,000,000
 4. MK70, 000,001 - 90,000,000
 5. More than MK90, 000,000

9 What is the nature of your business activities?

1. Retail
2. Wholesale
3. Manufacturing
4. Carriage and Haulage
5. Hospitality
6. Construction and Building
7. Service
8. Other (Specify).....

10 Have you ever submitted your VAT return late? *Please tick only one* Yes No

11 Have you been visited by an MRA auditor for VAT auditing?

1. Within three months this year?
2. Within six months this year?
3. Within nine months this year?
4. The past one year?
5. The past four years?
6. Never.

12 *This part deals with VAT Compliance, Penalty and Interest rates. Therefore, kindly tick the appropriate box to indicate whether you agree or disagree to the questions.*

Points of scale: 1 = Strongly Agree 2 = Agree, 3 = disagree, 4 = Strongly Disagree

a)	Do you agree that paying a small amount of penalty after VAT auditing would deter VAT operators from evading VAT if MRA detects evasion?			
b)	Do you agree that paying a high amount of fine after VAT auditing would deter VAT operators from evading VAT if MRA detects evasion?			
c)	Do you agree that VAT operators should be prosecuted in court if MRA detects their evasion?			
d)	You would remit VAT to MRA if you knew that once detected there is high penalty to pay			
e)	You would pay the collected VAT to MRA wilfully and without being forced			

13. Probability to detect VAT evasion by Malawi Revenue Authority auditors.

This part deals with probability to detect VAT evasion by Malawi Revenue Authority auditors. Therefore, kindly tick the appropriate box to indicate whether you agree or disagree to the questions.

Point scale: 1= Very High (VH), 2= High (H), 3=Low (L), 4= Very Low (VL)

a)	What is the possibility that a VAT operator who evades VAT gets caught?			
b)	What is the probability that MRA would detect VAT operators who claim or exaggerate non-deductible VAT?			
c)	Do you think VAT auditing has any VAT auditing and on your business as a VAT operators			

d) Do you agree that frequent auditing by MRA VAT auditors would deter VAT operators from evading VAT?				
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14 Means of VAT evasion and comprehensive VAT auditing

This part looks at the means for evading and the impact of VAT auditing on the compliance of VAT operators. Therefore, kindly tick the appropriate box to indicate whether you agree or disagree to the questions.

Point scale: 1= Strongly Agree, 2= Agree, 3= Disagree, 4= Strongly

Disagree

	1	2	3	4
a) Do you agree that non-issuance of VAT invoice or EFD receipts as a means of VAT evasion?				
b) Do you agree that understating of sales as a means of VAT evasion?				
c) Do you agree that inflating of input VAT and falsifying Sales in order to be in excess so that one claims a refund from MRA as a means of VAT evasion?				
d) Do you agree that categorizing taxable supplies into zero rated supplies as a means of VAT evasion?				

15 VAT operators' motivating factors in VAT declarations and Trust

This part deals with the motivating factors that influence VAT declarations among VAT operators and their trust to MRA. Therefore, kindly tick the appropriate box to indicate whether you agree or disagree to the questions.

	Yes	No
a) Do you agree that you declare VAT to MRA because you are God fearing person?		
b) Do you agree that you declare VAT to MRA because you are ethical?		
c) Do you agree that you declare VAT to MRA because you are afraid of penalties and interest		
d) Do you agree that you declare VAT to MRA because you are patriotic		
e) Do you agree that you declare VAT to MRA because you have a VAT morale		
f) Do you agree that you declare VAT to MRA because you have pride in developing Malawi		
g) Do you agree that government wastes a lot of money so no need to pay VAT?		
h) Do you agree that government is an untrustworthy so no need to pay VAT?		

16. Perspectives of VAT operators on VAT evasion

This parts deals with the perspectives of VAT operators on VAT evasion. Therefore, kindly tick the appropriate box to indicate whether you agree or disagree to the questions.

	Yes	No
a) Would you cheat on VAT if you happen to have a chance?		
b) Is it wrong to remit VAT to MRA?		
c) Is VAT evasion an economic necessity for your business survival and success?		
d) Do you consider yourself educated enough not to evade VAT?		
e) Do you consider that at your age you cannot evade VAT payment?		
f) Do you consider with your marital status you cannot evade VAT payment?		

17 Other alternative tools and strategies for improving VAT compliance amongst VAT operators in MRA

This part seeks to find other alternative tools and strategies for improving VAT compliance in MRA. Therefore, kindly tick the appropriate box to indicate whether you agree or disagree to the questions.

	Yes	No
a) Do you consider civic education as a means for improving VAT compliance		
b) Do you consider tip off anonymous as a means for improving VAT compliance		
c) Do you consider electronic filing or returns as a means for improving VAT compliance		
d) Do you consider electronic bank payment as a means for improving VAT compliance		

18. Provide suggestions for other tools and means to assist in improving VAT compliance

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Appendix 7: Letter Requesting Approval to Conduct a Research Using MRA Data and its VAT Operators

REF/ RES/P/1

c/o Malawi Revenue Authority,
P/Bag 247,
Blantyre.
22nd April, 2015.

The Commissioner General,
Malawi Revenue Authority
P/Bag 247,
Blantyre.

Dear Sir,

SEEKING APPROVAL TO CONDUCT A RESEARCH USING MRA DATA AND ITS CLIENTS

I would like to seek your approval to use MRA information it maintains such as monthly collection figures and other relevant data regarding small VAT operators.

I am an MBA student at the Malawi Polytechnic of the University of Malawi and I am on the verge of doing my dissertation and my topic is **“VAT auditing and of VAT auditing on clients’ compliance, a case of small VAT operators in Blantyre”**.

The purpose of this research is to verify if indeed VAT auditing has any bearing on clients’ compliance on tax. It is aimed at finding out any relationships that exist between tax audit and tax payers’ compliance.

I am stationed at Blantyre Domestic in audit and inspection section and it is my belief that the study will help build knowledge and competence in this area as I will be reviewing various literatures.

It is also my desire to share the findings and recommendations to MRA Management so that if used can help enhance VAT operators’ compliance so that revenues are maximized. It is my

hope that the research would come up with suggested tools that can help MRA meet its revenue targets.

I am looking forward to your considerate approval.

Yours faithfully,

Lovemore Mwanandi

Appendix 8: Research Budget

No	Item	Unit	Cost per unit	Total amount
1	Enumerators	116.00	500.00	58,000.00
2	Photocopying	130.00	90.00	11,700.00
3	Binding of final draft	3.00	1,500.00	4,500.00
4	Fuel for Supervising	50.00	1,000	50,000.00
5	Airtime	1.00	5,000.00	5,000.00
6	Refreshments	10.00	300.00	3,000.00
7	Contingency	1.00	2,800.00	2,800.00
				135,000.00

Appendix: 9. Fraction of Non-Filers against Filers

