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CONTENTS

Effectiveness of Electronic Fiscal Devices System in Improving VAT Compliance in Morogoro Municipal Council, Tanzania

Jaraj S. Kikula[1]

Abstract

This paper assessed the effectiveness of Electronic Fiscal Devices (EFD) system in improved VAT compliance in Tanzania Revenue Authority, taking Morogoro Municipality as a case study. The research used a cross-sectional research design whereby ten per cent (10%) of the target population was used as the sample size for the study. Using simple random sampling technique, 39 VAT registered traders were selected from a population of 387 VAT registered traders. Moreover, 11 Tanzania Revenue Authority (TRA) officers, who were the key informants for the study, were selected from a total population of 109 TRA officers working at Morogoro Regional Office. Both primary and secondary data were used. The former were collected using questionnaires and a key informant interview guide, and the latter were collected by reviewing various performance documents obtained from the study area. Analysis of the primary data was done using descriptive statistics generated in the Statistical Package for Social Sciences (SPSS) software. Empirical findings revealed that the EFD system assisted in improvement of VAT compliance. Based on the research findings, the study concludes that use of the EFD system has a substantial impact on the improvement of VAT compliance. The article offers several recommendations to various actors.

Keywords: Electronic Fiscal Devices, Value Added Tax, VAT registered traders.

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Introduction

Revenue collection is an integral component of fiscal policy and administration(Gideon & Alouis, 2013). In order to improve revenue collection, the Government emphasises on payment of taxes, levies,

duties and various licenses by citizens and other members of community. Tax revenue is one of the most important sources of Government income (Mohammed & Gela, 2014). In supporting this view, the International Monetary Fund (IMF) in 1989 reported that taxation is the major source of Government revenue that contributes close to 80% of total Government revenue in most of the least developing countries (Siriak, 2010). Many countries in the world improve tax collection in order to support the Government operations ranging from administrative activities, infrastructure constructions and service provision. Therefore, an effective and efficient tax collection system improves the economic growth of any country because it yields revenue to finance expenditure of the public sector.

One of the victims of numerous economic crises that have plagued developing countries since the first oil shock in 1973 has been the tax system (Osoro, 1993). This apparent failure of the tax system led to most of the developing countries to have huge fiscal deficits in both the current and overall Government budget, particularly since the fiscal year 1978/9. Consequently, bank borrowing and external finance were sought as temporary measures to finance the deficits (*ibid*). According to Webb (1992) in Petro (2006), more than 50% of all adjustment loans agreed for developing economies between 1979 and 1989 included conditions relating to Government finances which had tax reform elements. Furthermore, Ranker (2001) in Petro (2006) argued that, under pressure from International Finance Institutions, many developing countries are currently reforming their tax systems to extract more revenues from citizens as aid transfers are in rapid decline.

The study on which this research is based was stimulated by the fact that, since the introduction of EFD system in Tanzania, the business atmosphere and the tax system have been disturbed by a lot of national wide strike of business community, a lot of complaints from traders about the use of EFD machines and many conflicts between the government through TRA and the traders which led the national leader of traders' community to be kept in remand. Tanzania, as one of the victims of this problem, underwent various tax reforms in the 1980s that were promoted by IMF and World Bank (WB) in order to design a tax system that is viable and able to support Government services without depending on external funds (Jörgen, 2001). According to Gideon and Alouis (2013), these reform measures sought to revamp and strengthen revenue administration, enhance voluntary compliance, expand the tax base and address corruption-induced revenue leakage. Notable among these were the creation of Revenue Authorities, adoption of Value Added Tax (VAT) systems, shifting from Income Tax Returns to Final Deduction Systems and segmentation of the taxpayer population by treating them as distinct revenue possibilities comprising large, medium, small, and micro tax payers (*ibid*).

Based on the above background, the idea of establishing a semi-autonomous tax administration was conceived by the Government, and the Tanzania Revenue Authority (TRA) was born on July 1, 1996. One of the major reforms made by the Government and the TRA after its establishment was the introduction of VAT as it was recommended by IMF, WB and the Tanzania Tax Commission that was appointed by the Government of Tanzania in 1991. Based on the view of the Tax Commission Report of 1991, VAT was recommended to be the type of tax which would bring more businesses into the tax system unlike sales tax, stamp duty and entertainment tax which brought into a tax system for only manufacturers and importers, leaving a large portion of the Gross Domestic Product untaxed. Also, the report argued that VAT would reduce the economic distortion because it would ensure that the decisions made by the producer as well as by the consumer in the allocation of limited/scarce resources would be based on the economic situation and not tax consideration (*ibid*). Doubts came up on whether this kind of tax would work in Tanzania, given the Tanzania's economy that is mainly based on the agricultural sector and the attitudes of non-compliance amongst most of the business community body in Tanzania. Despite that, the Government of Tanzania accepted the recommendation and in May 1992 formally reached a decision to introduce VAT in Tanzania (Petro, 2006).

In the 1996/1997 Budget session, the Government announced its intention to introduce VAT in Tanzania(Emmanuel, 2009). The VAT bill was gazetted on March 14, 1997 and was presented to the Parliament for first reading during the April 1997 session. The VAT was introduced in Mainland Tanzania on 1st July, 1998 in order to replace sales tax which was introduced in 1969. The sales tax was the most important source of income for the Government in the 1980s, but became less important in the 1990s (Jörgen, 2001). VAT also replaced Hotel Levy, entertainment tax and stamp duty. It was anticipated that more revenue would be generated with VAT, as the VAT base is significantly broader than the sales tax (*ibid*). The main reason for introducing VAT was to expand the tax base in order to enhance revenue collection, to attain economic neutrality, to promote export, to attain its administrative advantages, and reduce tax evasion and avoidance among the tax payers. Tanzania opted for single rate of VAT that is 20% form when VAT was introduced in July 1998 to June 2009, but the rate was reduced to 18% with effect from July 2009(Siriak, 2010).

Godwin (2003) in Petro (2006) and Marandu (2004) pointed out that the performance of VAT in the first six months after its introduction was very encouraging, basing on a comparison of actual collection against estimated, and comparison with collections from replaced taxes during the similar periods in the previous years. The VAT collection suddenly dropped during the third year of its implementation as shown in Table 1. TRA reviewed the performance of VAT and the proposed strategies, one of which was the introduction of VAT in petroleum products which made the tax to

increase from the fiscal year 2001/02. Table 1 indicates the trend value added tax over years with respective total VAT revenue.

Table 1: Value Added Tax performance, 1998/99-2002/03 (In millions of TZS)

VAT trend	1998/99	1999/00	2000/01	2001/02	2002/03
Total VAT Revenue	234,605.4	254,181.2	231,120.9	339,950.5	431,237.0

Source: Marandu, 2004; Petro, 2006; TRA Monthly Revenue Report

Table 1 shows the value Added Tax (VAT) perforance from 1998/99 to 2002/03. Needless to say, the trend has been increasing since then, except in 2000/01 when there was a slight decrease of the performance. This because there was some laxity in the supervision and follow up by TRA officials.

Emmanuel (2009) attested that VAT performance is analyzed by looking at its target and actual performance. The VAT Department was able to achieve its target during the year 2001/02 since TRA was established. Furthermore, a report of Curtis*et al.* (2012) indicates that, in the period between the fiscal years 2004/05-2009/10, VAT contributed the highest share of total tax revenue collected (above 30%). However, the trend of contribution tended to decline over the period between 2004/05 and 2009/10 as shown in Table 2.

Table 2: Composition of Various Government Tax Revenues, 2004/05 - 2009/10

Year	VAT (%)	Income Tax (%)	Excise Duty (%)	Import Duty (%)	Other Taxes (%)	Total (%)
2004/05	42.2	27.7	14.7	6.4	9.0	100
2005/06	41.3	28.5	13.4	9.8	7.0	100
2006/07	32.9	28.3	20.6	9.6	8.6	100
2007/08	31.0	29.3	19.7	8.6	11.4	100
2008/09	30.5	30.4	18.8	8.9	11.4	100
2009/10	30.5	29.5	20.1	8.5	11.4	100

Source: Curtis *et al.* (2012); Ministry of Finance (Field data, 2010/11

Also, from a study conducted by Bevan (2012) based on the TRA's own computation, and looking at the average over 2006/07 - 2009/10, the overwhelming bulk of the tax revenue losses were on VAT (57%) and Import Duty (41%). This shows that the Government of Tanzania was losing a lot of revenue from VAT due to incompetent methods of VAT collection. According toBird and Zolt (2008), poor technology in taxation is one of the major causes of tax revenue loss in developing countries, Tanzania included. Also a study by Kerver (2008) indicated that having modern VAT collection and revenue regulations via technology will increase VAT collection in African countries, Tanzania included.

This trend of VAT contribution as well as the tax revenue loss is worrying and requires a serious intervention reform. The Tanzanian Government, through TRA, became aware that using technology for collection of tax will enhance the Government's revenue position as well as reducing the degree of tax evasion, and it started by making laws and regulations concerning Electronic Fiscal Devices (EFDs) in the year 2009. TRA has since introduced several reforms in order to improve revenue collection including the introduction of EFD to the VAT registered traders in July 2010.

The EFDs have been introduced to VAT registered traders under the "The Value Added Tax (Electronic Fiscal Device) Regulation, 2010" - Subsidiary Legislation, Government Notice No. 192 published on May 28, 2010, and enshrined in the Finance Act 2010 with the main aim of enhancing VAT compliance in Tanzania. TRA's new EFD system became effective on July 1, 2010 (Dickroman, 2013). The success of EFDs in Tanzania was questioned during the initial stage of implementation. This is because the use of EFD machines received wide spread rejection by traders country wide (Mbago, 2014). Most of the businesses were closed to protest against the use of EFDs. The EFD system is fully funded and facilitated by TRA. The TRA finances the purchase of EFD machines and other fiscal devices. However, taxpayers were required to install the machines and claim these machines as the input tax. The refund or claim was restricted to the EFDs installed or interfaced with the existing systems. A taxpayer with more than one point of sale, for example branches, was refunded for all the machines and devices purchased for use in the business.

One of the strategies deployed by TRA to implement EFD project was to make registration of all devices before they were put into use by VAT registered traders (Pandu, 2012). The registration procedures involved the application for registration to TRA offices by approved suppliers for every device sold. Upon satisfaction by the content of the application a User Identification Number (UIN) is issued by TRA (*ibid*).

Currently, the use of EFDs across the country is increasing and TRA is on the second phase of implementation to cover Non-VAT registered traders with a turnover ranging from TZS 14 million and above per annum (Mbago&Lisley, 2014). The growing willingness of businesses to use EFDs is a direct result of awareness campaigns along with enforcement efforts conducted by TRA throughout the country. The TRA Director for Tax Service and Education, Richard Kayombo, said that traders are better informed and that response to the use of the machine by the business community is very positive (Mbago, 2014).

Considering the significance of VAT administration in developing countries, previous literatures on VAT administration focuses on the VAT administration tasks and its problems (Abraham, 2003; Kerver, 2008; Taye, 2011).Other studies put their attention on the laws and practices used in administration of VAT exemption (Nkane, 2010), factors influencing compliance to VAT payment (Siriak, 2010), and the management of VAT in Tanzania (Petro, 2006).It must be acknowledged, however, that Tanzania has undertaken major efforts to enhance VAT collection by providing education to taxpayers inorder to improve voluntary VAT compliance and making several reforms on the laws gorverning the issues of VAT in Tanzania (Machogu & Amayi, 2013). Horn (2003), Mmanda (2010), Clive (2011) and Fuke (2013) in the study of Ikasu (2014) who have done a similar study on EFD machines have tried to describe the principles, benefits, advantages and disadvantages as well as strategies of implementing the use of EFD machines. Therefore, there is a necessity to research on the influence of EFDs on VAT collection so as to ensure EFD system achieves the objectives intended by the government of Tanzania.

Methodology

The study was conducted in Morogoro Region, specifically in Morogoro Municipality in Tanzania. Morogoro Municipality is about 195 kilometres to the West of Dar es Salaam and is situated on the lower slopes of Uluguru Mountains whose peak is about 2,630 meters (8,629 feet) above sea level. Morogoro Municipality lies between latitudes 4.49 and 6.4 South of the Equator, and between longitudes37.0 East of the Greenwich, it covers an area of 531 square kilometres. The municipality is a fast growing business place due to the fact that it enjoys one peculiar advantage of being a hub whereby it links with a highway road to the Eastern, Western, Southern and Northern parts of the country to Dar es Salaam . Furthermore, it is among the regions in Tanzania where EFD machines received high resistance. The area was selected for this study because it has many cases related to Resistance to Change (RTC) (URT, 2015).

The study adopted a cross-sectional research design whereby data from respondents were collected once. Saunders*et al.* (2009) define a cross section as a strategy for doing research which involves an empirical investigation of a particular contemporary phenomenon within its real life context using multiple sources of evidence in the area chosen for the study. In addition, the research design was adopted because the approach allows the researchers to concentrate on a real scenario, thus proffering solutions to any business that may want to use the stated findings for improving the real situation (Nyasha *et al*., 2012). Moreover, cross-sectional design enables the researchers to give own judgments and opinions since they actually interact with the respondents under study. Furthermore, this approach enables the researcher to gather adequate and quality data that provide a great amount of description, detailed information about a particular scenario and comprehensive understanding of the context of the research and the processes being enacted.

The target population of the study Saunders*et al.* (2009) define population as a full set of cases from which a sample is taken. The study target population comprised a total of 387 VAT registered taxpayers drawn from the Morogoro Municipality registered as firms active from January 25, 2015 and 109 TRA officers who are the key informants of this study. The target population of the VAT registered trader was suitable due to the fact that the EFD project was first implemented to them and therefore most of the VAT tax payers have been registered with the machine for at least three years. The sample size for the study was thirty nine (39) VAT registered traders in Morogoro Municipality were used as the sample size and eleven (11) TRA officers from the TRA Morogoro Regional Headquarters were used as key informants for the study. Best and Kahn (2006) argue that a sample equal to or above 10% is valid to generalize results for the whole population. Ten per cent (10%) of the target population was used as a sample size of this study. This group of VAT registered traders is regarded to be small; therefore the researcher opted to a use a sample size of 10% so as to get enough number of VAT registered traders to represent the whole population.

The simple random sampling technique was used to select the sample of the study. According to Saunders *et al*. (2009) simple random sampling is the purest form of probability sampling. This technique assures that each element in the population has an equal chance of being included in the sample size. Simple random sampling allows the researchers to select the sample size without any bias. The sample selected can therefore be said to be representative of the whole population (*ibid*). The choice of this technique was due to the fact that, each target population has the same characteristics. The VAT registered traders use the same type of EFD machines and TRA officers perform almost the same duties on VAT collection. Both qualitative and quantitative data were collected descriptive statistics were

computed to find the distribution of the respondents, at times content analysis was applied, data analysis was effected using the Statistical Package for Social Sciences (SPSS).

Results and Discussion

Table 5 shows the responses with regard to effectiveness of EFD machines on improving VAT compliance.

Table 5: Effectiveness of EFD machines on improving VAT compliance (n=39)

Response	Frequency	Per cent
Yes	29	74.4
No	10	25.6
Total	**39**	**100**

Source: Field Data, April (2015)

The respondents were asked about the effectiveness of EFD machines on improving VAT compliance. Table 5 indicates that the majority 29 (74.4%) of the respondents were of the opinion that use of EFD machines is an effective way of improving VAT compliance among the VAT registered traders. Only 10 (25.6%) of the respondents said that use of the machines is not an effective way of improving VAT compliance. In order to strengthen the findings given in Table 5, the researcher interviewed 11 key informants to get their opinions about the effectiveness of EFD machines on improving VAT compliance. All the 11 (100%) key informants interviewed argued that EFD machines are an effective way of improving VAT compliance.

Level of VAT compliance attitude, Table 6 shows the responses on the level of VAT Compliance.

Table 6: Response on the level of VAT compliance attitude (n=36)

Response	Frequency	Per cent
Not wrong at all	5	13.9
Wrong and understandable	8	22.2
Wrong and punishable	23	63.9
Total	**36**	**100**

Source: Field Data, April (2015)

Through the questionnaire, the respondents were asked to state whether they thought that the actions of other people who do not pay VAT on their income is “not wrong at all”, “wrong but understandable” or “wrong and punishable”.Table6 indicates that out of the 39 respondents, only 36 respondents answered this question which made a response rate of 92.3%. As observed in Table 6, 23 (63.9%) of the respondents said that it is wrong and punishable; 8 (22.2%) of the respondents indicated that it is wrong and understandable and the remaining 5 (13.9%) of the respondents said it is not wrong at all. This means that23 (63.9%) had a VAT compliance attitude while 13 (36.1%) did not have a VAT

compliance attitude. Overall, the majority of VAT registered traders had a VAT compliance attitude. Table 7 shows the level of VAT compliance among VAT registered traders.

Table 7: Analysis of VAT compliance (n=39)

Year	**I declared an accurate VAT liability in a particular financial year**	**VAT liability contained error and therefore additional VAT was assessed through auditing.**	**Total**
	F (%)	**F (%)**	**F (%)**
2009/10	27 (69.2)	12 (30.8)	39(100)
2010/11	23 (59.0)	16 (41.0)	39(100)
2011/12	26 (66.7)	13 (33.3)	39(100)
2012/13	28 (71.8)	11 (28.2)	39(100)
2013/14	29 (74.4)	10 (25.6)	39(100)

Source: Field Data, April (2015).

Table 7 indicates a breakdown of responses according to the questions provided in the study instrument. The respondents were required to reveal whether they declared an accurate VAT liability in a particular financial year or their VAT liability contained errors and therefore additional VAT was assessed through auditing. The information needed was for the previous five years starting from the financial year 2009/2010 to 2013/2014. Overall, most traders declared accurate VAT liability compared to those who paid additional VAT after auditing. The above findings have been amplified by evidence supported by secondary data obtained at the TRA MorogoroRegional Office. On the basis of TRA office data the analysis of VAT has been effected. Table 8 shows the analysis of VAT compliance.

Table 8: Analysis of VAT compliance using the TRA office data

Year	**VAT traders who declared an accurate VAT liability in a particular financial year.**	**VAT traders whose VAT liability contained errors and therefore additional VAT was assessed through auditing.**	**Total**
	F (%)	**F (%)**	**F (%)**
2009/10	112 (56.6)	86 (43.4)	198(100)
2010/11	113 (50.7)	110 (49.3)	223(100)
2011/12	149 (55.2)	121 (44.8)	270(100)
2012/13	174 (55.9)	137 (44.1)	311(100)
2013/14	229 (59.2)	158 (40.8)	387(100)

Source: TRA Annual Reports, April (2015)

Table 8 shows the number of VAT registered traders in Morogoro region who declared an accurate VAT liability and those whose VAT liability contained errors and therefore the additional VAT was assessed through auditing. The information needed was from the financial year 2009/10 to 2013/14. The data show that the VAT registered traders who declared an accurate VAT liability were 112 (56.6) in 2009/10, 113 (50.7) in 2010/11, 149 (55.2) in 2011/12, 174 (55.9) in 2012/13 and 229 (59.2) in 2013/14. When comparing with the findings obtained in Table 8, the majority of VAT registered traders declared an accurate VAT liability in each financial year. This provides further supplementary evidence to the question raised in Table 4.3 that majority of respondents declared an accurate VAT liability in each fiscal year.

The status of EFD system on improving VAT compliance

From Table 8, the majority of VAT registered traders said that the EFD system improved VAT compliance. Five (50%) of the respondents who gave the reason said that, the correct amount of VAT will be paid to TRA if EFD machines will be effectively used, and the other 3 (30%) said that it is easy to keep the VAT records and save time when using the EFD machines. Weru *et al*. (2013) also found that, ETR system assisted in improvement of tax compliance in Kenya. Therefore this is an indication that EFD system has improved VAT compliance to the majority of VAT registered traders. Despite of that, 4 (57.1%) of those who said EFD system did not improve VAT compliance was due to the fact that VAT rate is too high and the other 2 (28.6%) said it is because of the challenges of using EFD machines. This shows that the EFD system did not improve VAT compliance to the minority of the respondents.

All the key informants of the study argued that the EFD system has improved VAT compliance among the VAT registered traders because of the benefits of using the machines. This system assisted the VAT registered traders to update VAT records, save time during VAT remittance and produce both internal and external business reports which are very important in the operations of the business. In addition to that, the system is more accurate than the manual system as it has removed challenges and conflicts that occurred between the taxpayers and the TRA officers during the VAT remittance.

Newcomb (1943) and Cascio (1986) in Nyasha *et al.* (2012) mentioned the same benefits as explained by the key informants but more benefits such as control of file transfer, automation reconciliation of Tax returns declaration and compliance testing of bank files were added. Other benefits to customs automation include, it is easier to focus on inspecting high-risk consignments and possibility of submitting tax returns declarations on-line.

Table 4.4 shows the respondents with VAT compliance and non-VAT compliance attitude among the VAT registered traders. As observed in Table 4.4, the majority of VAT registered traders have a VAT compliant attitude. Razak and Adafula (2013) attested that there is a strong positive relationship between a taxpayer's compliance attitude and the level of tax compliance. This mean that the tax compliance attitude of the taxpayer has impact on the tax compliance of the taxpayer. If the compliance attitude is high then the compliance level is high, and vice versa is true. Based on this fact, the level on VAT compliance among the VAT registered traders is still high despite the introduction of EFD machines. This was also revealed in a study which was conducted in four selected countries namely Uganda, Kenya, South Africa and Tanzania. It was found that, only Tanzania and South Africa seems to have VAT compliant attitude (Ali *et al.*, 2012).

As observed in Table 4.5 and Table 4.6, VAT compliance among the VAT registered trader's declined in the financial year of 2010/11. This was the year in which EFD machines were firstly introduced in Tanzania. The decline of VAT compliance during the financial year 2010/11 was caused by resistance in the use of EFD machines by some of the taxpayers and at that time it was a new system. There was lack of knowledge concerning the EFD machines, and the VAT registered traders were not aware of the benefits of using the EFD machines.

From the interview with the key informants, VAT compliance started to increase from the financial year of 2011/12 because the traders were better informed and the response to the use of the machines by traders became positive and some of the traders learned from early adopters of the machines. A study by Gardner *et; al.* (1993) in Nyasha *et al.* (2012) also identified a positive correlation between experience with use of electronic devices and attitudes towards them. Results of an empirical study by Naibei *et al.* (2012) revealed that effective and regular use of ETR has a significant impact on the VAT compliance ($r = 0.622$, $p < 0.05$). This is in agreement with this study that there is a positive relationship between the use ofEFD machines and VAT compliance by the respondents.

Conclusion and Recommendations

TRA adopted the EFD automated system since 2010 for VAT registered traders. The use of EFDs in Tanzania has been increasing in the past 5 years. Based on the major findings of the research, the study concludes the following:

The EFD system has improved the VAT compliance among the VAT registered traders. The EFD system helps the VAT registered traders to update the records, save time during VAT remittances, improved sales audit and decrease the compliance costs. These four major reasons have improved VAT compliance among VAT registered traders in Morogoro Municipality, Tanzania. The EFD machines

were not effective in sealing the loopholes for VAT evasion. The reason for ineffectiveness was that some of the traders evade VAT by keeping two books one for EFD and the other one to provide receipts for customers without charging VAT. Many customers collaborated with traders due to hard economic situation and opted to buy goods/services without being issued the EFD receipt. In addition to that, if the trader is caught by the TRA officers that he/she did not issue the EFD receipts then the bribe is normally given to the TRA officers so that further legal action is not taken by the TRA officers. This is a way in which traders, customers and the TRA officers engage in corruption offences. Let the EDF machines be distributed to investors freely as will act as incentive to tax collections

Lastly, it is concluded that the training given by TRA through the suppliers and seminars increased the capacity of using the EFD machines. It is further concluded that TRA organized trainings for all the stakeholders, and it was after training that the attitudes towards EFD system changed and the system was gradually accepted by the VAT registered traders. The policy implication of this study is for the Government, through TRA, to come up with innovative strategies to increase tax collection, such a strategy can be equipping tax payers with free charge EFD machines this will act as an incentive to them.

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