AFRICA FOR RESULTS INITIATIVE

DOMESTIC RESOURCE MOBILIZATION IN AFRICA: AN OVERVIEW OF THE USE OF ELECTRONIC FISCAL DEVICE IN VAT COLLECTION IN MALAWI

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SYNOPSIS

The bulk of domestic revenues for Malawi come from tax revenue, which are divided into direct and indirect taxes. Tax performance determines government day-to-day operational functions and efforts to strengthen the same cannot be overemphasized. Some studies have concluded that the primary obstacle to revenue mobilization is weak administration. Indirect taxes are the main contributors of the Malawi central government revenue. Malawi Revenue Authority (MRA) piloted the use of Electronic Fiscal Devices (EFD), a new system for collecting Value Added Tax (VAT) in March 2014 to strengthen tax administration. Since inception, VAT there has been an increase in total and average VAT compared to the months before the EFD's. However, the initiative has countered some challenges, including traders giving customers the option, whether or not to get a receipt. There is need for improved tax education, policy coordination, inclusive decision-making and incorporation of the informal sector in VAT and generally tax revenue policy.

1. Introduction

Domestic revenues in Malawi include tax and domestic non-tax revenues, with the bulk of domestic revenue coming from tax revenue. Total budgeted tax revenues have averaged 90 percent of domestic resource envelope between the 2011/12 and 2016/17 fiscal years in Malawi. Tax performance therefore determines government day-to-day operational functions in Malawi and efforts to strengthen the same cannot be overemphasized. Without adequate taxes, government may continuously record large budget deficits, and resort to unsustainable debt levels, in order to finance recurrent expenditures (Chipeta, 2002). This case study will focus on taxes as a source of revenue for the Malawi government.

Tax revenues are divided into direct and indirect taxes. A direct tax is one paid directly to the government and cannot be shifted by the taxpayer to someone else, whereas an indirect tax can. Examples of the former include employment income tax (PAYE in Malawi), business profit tax, capital income tax and some passive income tax. In general, direct tax is levied on income and is charged at source (Magalasi, 2009). An indirect tax is a tax on expenditure or consumption such as customs and excise duties and Value Added Tax (VAT). These are normally levied on traders such as importers and exporters, wholesalers and retailers on whom the liability of the tax falls. The trader can transfer this tax to the final consumer, by simply recovering the tax paid in the form of customs and excise duty or VAT from the consumer by increasing the commodity price to include such duty or Value Added Tax.

Domestic revenue can be increased through increase non-tax revenue and/or increasing tax rates, broadening the tax base, improving compliance, and reviewing polies related to tax incentives. With increasing liberalization and regional integration agenda, governments in Africa have to rely on

domestic direct and indirect taxes, as opposed to trade taxes. Yet some studies have concluded that the primary obstacle to revenue mobilization is weak administration and that some African countries collect as little tax as half of what is expected.

Malawi's tax rates are already comparatively high, and this is partially a result of a small tax base. Like majority of African countries, Malawi's sources of collecting taxes is very limited. The tax burden falls excessively on the small formal sector of the economy, which in Malawi it is less than 10 percent of the adult population receiving a regular salary (FinMark, 2014). Thus because there are very few people that pay tax, the rates remain very high. The situation is further heightened by evasion and avoidance. Indirect taxes are the main contributors of the Malawi central government revenue. The Value Added Tax (previously surtax) is an important part of the revenue base for Malawi.

The Malawi government introduced the Surtax sales tax in 1970/71, to broaden the tax base and increase tax revenue (Chipeta, 2002). In the 1971/72 fiscal year, the government raised the surtax rate from the initial 5% to 10% of the normal ex-factory selling price. The standard surtax rate on goods and services further rose to 25% of producer prices for domestically produced goods and 30% of the c.i.f. prices plus duties for imports as of 1984. Surtax became the single largest source of tax revenue in Malawi, accounting for 34.95% of the total in 1993 (Chipeta, 1998), and having the same average of 35 percent of total revenue from 1980 to 2014. Other sources also record VAT as the single biggest source of revenue for government (Magalasi, 2009).

Several reforms in revenue mobilization have been undertaken in Malawi. In 1989/1990, government shifted taxes from income towards consumption taxes, with an aim of reducing direct taxes and increasing indirect taxes. The revenue base was re-oriented from trade taxes towards VAT. In 2000, the Malawi Revenue Authority (MRA) was opened, having been established by an Act of Parliament in 1998. Since the inception of MRA, major efforts have been made towards modernizing the tax system and procedures. In 2002 Surtax (later, VAT) was extended to wholesalers and retailers which widened the tax base.

In 2005, the law changed to recognize VAT as a tax and this further widened the tax base. Several automations to aspects of revenue collection were introduced over the past decade, including the Automated Systems for Customs Data in 2008. From 2009 to 2011, there was the introduction of VAT machinery, banking services and some basic commodities. These factors present a challenge in growing business by making business operations very expensive and access to finances even more expensive. Introduction of VAT on inputs of VAT exempt products means that the VAT is built into the cost of production e.g. bread and milk. This has led to increasing consumer costs. The result is a shrinking market because of lack of affordability by the consumers.

In 2012, in order to encourage compliance and develop the private sector, there was a removal of various taxes including the minimum tax based on turn over, taxes on gains from sale of shares and the removal of VAT on a number of services (African Development Bank Group, n.d). In 2007/8, VAT was reduced from 17.5% to 16.5%. Government has introduced a standard rate of 16.5 percent VAT on Internet services in order to allow Internet service providers claim input VAT and this will in turn reduce costs associated with the provision of internet services thereby making internet services relatively cheaper and accessible to users.

Generally, compliance level to tax payment by the small-scale business has been very low due to lack of mechanisms by MRA to collect taxes from this sector. From time to time VAT officers visit registered people to examine their books and records to verify the accuracy of Value Added Tax returns and to see that the books etc. are being properly maintained. Some shop owners, however, ask customers whether they want a receipt, such that if the customer requires one, they would be charged VAT. This means customers opt to buy without a receipt, in order to pay lesser amount.

What it also means, is that the traders are evading tax and not emitting VAT and other taxes to MRA. In addition, it means the traders do not declare all the income / profit that they make.

Some have insisted that the high tax rates in Malawi have largely contributed to the growth of the informal sector and non-compliance (Chipeta, 2002; Magalasi, 2009). Still others contest that tax education plays an important role in bringing about tax awareness and a vibrant tax culture, and a lack thereof may increase evasion (Chiumya, 2006). The prevalence of a large informal sector that is outside the tax system, under declarations and evasion are challenges that commonly arise in the discussions on majority of African countries' tax system, and Malawi is no exception.

Thus to address these challenges, MRA rolled out the EFDs in March 2014. This is the initiative being discussed in the case study, with a focus on VAT revenue performance pre-and post implementation, challenges faced, lessons learnt and possible policy implications.

2. Presentation of the case study

Electronic Fiscal Device (EFD) describes a wide variety of technological devices that revenue administrations can use to help monitor business transactions. Similar to Casy and Castro (2015) in this case study, the term EFDs will refer to devices used by tax administrations to monitor business-to-consumer and business-to-business transactions that create a fiscal obligation for the sales tax or the value-added tax (VAT). The devices have a "fiscal memory," which is a tamper-proof receipt certified by a relevant government authority, in this case the Malawi Revenue Authority. The use of technology is an important tool to lessen administrative and compliance costs and efforts, from the perspectives of both tax administrations and taxpayers (Casy and Castro, 2015).

Malawi Revenue Authority (MRA) piloted the use of Electronic Fiscal Devices (EFD), a new system for collecting Value Added Tax (VAT) in March 2014. According to MRA (2016), this was done mainly to curb VAT administration challenges including tax evasion by non-issuance of tax invoices especially by small to medium taxpayers. This will be through the ability to monitor sales transactions electronically, through a GPRS modem to the MRA central server. "To further ensure compliance, the buyer will be encouraged to demand a tax invoice that will be generated by the EFDs as this is the only way a taxable transaction will be captured" (MRA, 2016). The Introduction of the EFDs were a result of amendments made to the Malawi VAT Act in July 2011. The amendments authorize the MRA to introduce the fiscal devices. The amendments make it mandatory for all VAT operators to acquire and use these machines for each sale transaction.

EFD, is a device that records all sales transactions and provides evidence of such transactions in a technically easy and undisputed way. The initiative replaces manually generated receipts, invoices and ordinary electronic cash register. To verify reports submitted and ensure efficiency in tax collection, there are machines at MRA's offices connected to EFDs, which store every sales transaction while receipts, that have a life span of five years, are being issued to buyers. The types of the EFDs rolled out are electronic tax register (ETR), electronic signature device (ESD) and electronic fiscal printer (EFP).The ETR has nonerasable inbuilt fiscal 'read only' memory that stores business and tax data at the time of sale. The memory is nor wiped or reset by loss of power and can be accessed only by an appropriately authorized person with the relevant electronic key to download data.

The EFD program was implemented in phases based on the category of the VAT operators. The initial phase began 6 March 2014. Twenty VAT operators were involved in the pilot phase (Fiscal Blackbox, 2016). VAT operators issuing manual receipts or using ordinary cash registers were now required to acquire and use the EFDs- ETR's. Ordinary cash registers are cash registers not attached to any computer system or Point of Sale (POS) devices. The first phase deadline for VAT operators to acquire the devices was 30 June 2014. After this date, it was an offense to issue a "non-fiscal-receipt" and the MRA

would take strict action against traders issuing such receipts.

The two categories to follow were those that use POS systems requiring Electronic Fiscal Printers (EFP) followed by those that issue business to business (B to B) invoices required to use Electronic Signature Devices (ESD). EFPs work in conjunction with other types of sales recording device and connect to that existing electronic cash register. These are normally for larger retail institutions that already operate some form of POS. The EFPs work in conjunction with the POS system to capture fiscal information. The printers have a fiscal memory that exhibits the same characteristics and security features as ETRs.

An Electronic Signature Devices (ESD) is a device that provides a unique “signature” to an invoice which appears a hexadecimal (that is, base16) “hash” on a printed invoice/receipt (Casy and Castro, 2015). ESDs are mostly used where a computerized sales and invoicing solution is in place. The ESD is plugged into the computer network, and any request to generate a receipt or invoice results in the ESD generating a hash key that is printed to the document. No signature is ever the same and any change to the invoice after it is generated results in a different hash key. The ESD itself does not record detailed transaction data and would usually be implemented in conjunction with a fiscal printer.

By the end of all the phases, it would be mandatory for every VAT registered operator to use an EFD. This includes any new business that has registered for VAT as of 6 March 2014. A shop is registered to collect VAT if it makes sales of up to 10 million kwacha (approx USD14 throusand) per year. Companies would purchase the machines through local suppliers: Gestetner, Business Machines Limited (BML), Canotech and Xerographics. As way of making the landing cost cheaper, Government put a duty waiver on the machines (EY, 2014). VAT operators who procure the requisite EFDs within four months from the commencement of each phase shall recover the entire cost of the EFD from the MRA through the following month's VAT return. VAT operators who procure the EFDs outside the prescribed time frame will not recover the cost of their purchases.

3. Outcomes and overall assessment

Prior to the EFD’s, MRA had to do some of the following, to curb non-compliance. One way was test-buying, where MRA officials impersonate customers and check for anomalies. Second were sit-Ins, where MRA officials sit and watch transactions in chosen shops from opening to closing times and later compare opening balances with closing balances to estimate the taxes due for that day and previous days. Thirdly, were comparisons, where businesses of similar nature and/or in same location are compared; and finally Public education, to inform the public on the unwanted behaviour and encourage them to report to MRA any incidence of tax evasion that they suspect. These methods are clearly quite expensive. Although comparisons and public education remain necessary and ongoing, EFD’s reduce the necessity of the first two methods of test-buying and sit in’s. Table 1 shows percentage of VAT of GDP from 2013 to 2015.

Table 1: VAT as a percent of GDP

2013	2014	2015
4.3%	4.0%	5.5%

Source: World Bank, MRA, Author computations

There is a notable increase in 2015, of 5.5 percent, compared to 3.4 percentage in 2013, and this may be attributed to the EFD’s which made administration easier. More specifically, VAT on average increased, and were at an average of $12.27 million, a month in the 17 months post EFD’s compared to $11.19 million in the 18 months before EFD’s (Chart 1; Table 2).

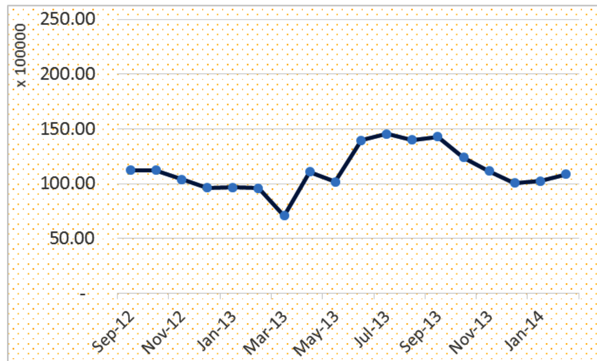
Table 2: Monthly Total and Average Pre-EFD and Post EFD in Millions of USD

In USD	Pre-EFD's	Post EFD's
Total	201.47	220.8
VAT Monthly Average	11.19	12.27

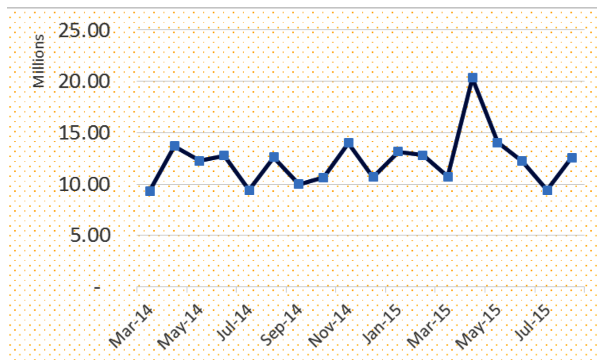
Source: MRA Statistics; Author computations

Chart 1 below shows VAT in the 18 months before and after March 2014 when the EFD's were rolled out. Figures are in millions of USD in order to account for currency movements vis-a-vis the US dollar which has a direct impact on proces and thus VAT charged on products.

Pre EFD



Post EFD



Source: MRA

These are in the 24 months. Prospects for the future look promising as far as VAT is concerned. VAT reached the highest monthly collection (K20.00 million) in April 2015.

Despite the current and potential success, the implementation of EFD's has several challenges as detailed below

I. Resistance from taxpayers upon implementation. Taxpayers took court order restraining MRA in 2014 (GOM, 2015).

II. Less taxpayers using the devices. They would give excuses that the machines have malfunctioned or when they have run out of paper for receipts they take too long to replenish (GOM, 2015).

III. amidst technical challenges with the devices, those entrusted with repairing would delay and thus most sales would be made without the devices

IV. Falsification of sales value. Some traders punch in K1,000 when a customer has bought goods worth K10,000.00. Since the receipt is so small, customers do not see, thereby the traders declare less to MRA.

V. Insufficient number of EFD's as MRA made a call for more suppliers and distributors for the same in December 2015

VI. ETRs cannot process refunds, or transactions for returned goods.

Other challenges include lack of information on the part of the public that evasion is illegal and a form of corruption. Further, methodologies of remitting the tax may be limiting as currently digital finance systems do not have the business-government component.

4. Lessons learned and Policy recommendations

Lessons learned

While several tax reforms have been undertaken in Malawi, taxation still fails to generate adequate revenue for the government, such that Malawi remains heavily aided. Although the EFD's have been operational for just over two years in Malawi, several lessons can be drawn to ensure better implementation in the future.

One key issue is that there is limited public awareness and tax education on the consumer side, to enforce the tax and to alert consumers so they are not "cheated" with false receipts. In addition, there is need to find better incentives for taxpayers to use the device. The introduction of the device is a potential win-win for both businesses and the revenue authority and this perspective is yet to be accepted by many. Another lesson is the requiring of

legislative support in the implementation and enforcement process.

Policy recommendations

Following the presented case study, several policy implications may be drawn.

First. there is need to encorporate the informal sector and perhaps reduce the rate in order to bring in businesses that may currently be evading the tax due to the perceived cost. This may address the challenges through undertaking an exercise to quantify the size of the informal economy. This may be facilitated by the introduction of national identification system, which is yet to be introduced in Malawi and several countries within Africa. Furthermore, it's important to incentivize tax payers through offering of basic business support and increasing of transparency and accountability on the part of government. In addition, institutions such as the judiciary and auditor general have to ensure access to information and clear channels for addressing grievances and exposing cases of corruption in tax authorities.

Secondly, enforcing compliance. In the 2015/16 budget statement, proposed amendments to the VAT Act which will, among others provide the underlisted:

I. the requirement for issuing only one type of an EFD invoice for VAT purposes;

II. Prescribing penalties for non-compliance with VAT operations, leading to closure of a business premise if necessary, with regard to the use of EFD machines; and

III. Sanctions that are effectively a deterrent to would-be offenders in VAT evasion, assault of VAT staff, and other malpractices.

Thirdly, the MRA may need stronger legal standing. This may minimise injunctions continually taken from the courts following evasion cases, and will allow MRA to prevail in its sytems. This will also enable more timely prosecutions. A good example is Kenya which prevailed through use of experienced legal counsels and strong government support amid similar challenges (AfDB, 2010).

Fourth, there is, the need to improve ICT infrastructure for the implemented technological solutions in order to minimize losses due to teething problems of implementation. This will also minimise excuses from traders who take long to have machines repaired or papers replenished.

The solution seems to have better the processes from government end but perhaps not from the taxpayer and general public need to understand how this helps them. Thus final policy recommendation is intense civic education to ensure taxes may are inclusive and pro-poor. Consumers should take VAT as their contribution to the society and thus sensitized to check receipts for correct input and be the eyes and ears for the MRA.

Finally, there is need for policy consistency to ensure both private sector development (which will in turn increase taxes), revenue mobilisation and formalisation of those in the informal sector can be pursued.

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