

**AN ASSESSMENT OF THE EFFECTIVENESS OF  
INTEGRATED TAX AUDIT ADMINISTRATION AMONG  
LARGE TAXPAYERS IN MALAWI: A CASE OF BREWERY  
INDUSTRY**

**MASTER OF BUSINESS ADMINISTRATION DISSERTATION**

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**UNIVERSITY OF MALAWI  
THE POLYTECHNIC**

**July, 2017**

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

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**July, 2017**

## **DECLARATION**

I declare that this dissertation is my own unaided work. It is being submitted in partial fulfilment of the requirements for the degree of Master of Business Administration in the University of Malawi and has not been submitted before for any degree or examination in any other university.

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## CERTIFICATE OF APPROVAL

We, the undersigned, certify that we have read and hereby recommend for acceptance by the University of Malawi a thesis titled, *'An Assessment of the Effectiveness of Integrated Tax Audit Administration among Large Taxpayers in Malawi: A Case of Brewery Industry.'*

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## **DEDICATION**

I dedicate this thesis to my late mother, Flossie Sauti –Phiri.

## **ACKNOWLEDGEMENTS**

This study would not have been possible without the valuable assistance from individuals, who tirelessly provided their contributions, support and value towards this work. I would like to take this opportunity to express my sincere gratitude to them.

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## **ABSTRACT**

Integration of tax audit systems becomes effective if all stakeholders are collaborating. This will ensure an effective tax administration which maximizes revenue mobilisation and enhances voluntary compliance. Around the world, effective integrated tax administration system has seen countries collecting more tax revenues for the betterment of their socio economic growth. In Malawi, little is known despite the country introducing the integrated tax audit system in 2007. The knowledge of an effective integrated audit system is paramount to a country like Malawi which, for almost five years now after donor freeze, is grossly dependent on its domestic revenues to support its recurrent budget. This knowledge will help Malawi to understand the bottlenecks related to revenue collection and taxpayer compliance as well as draw lessons on how to improving its revenue mobilization strategies and promote voluntary compliance.

It is against this background that the study objected to explore the effectiveness of integrated tax audit systems among large tax payers in Malawi.

The study collected a sample of 40 internal tax auditors' respondents and 5 tax representatives that were randomly selected from Malawi Revenue Authority and selected large tax payers in the brewery industries in the country respectively. The large taxpayers are; Carlsberg Malawi Limited, Chibuku Product Limited, Malawi Distillers Limited, Bowler Beverages Limited and Shine Beverages Limited. Thereafter, descriptive statistics in which frequencies, percentages and charts/ tables were used to test the study objectives. Furthermore, t-student test was used to test the statistical significance of the factors influencing the effectiveness of the integrated audit systems along the sampled companies.

The study found that current tax payments, tax debts payments (timeliness of the tax debts payments) and tax return (correctness and timeliness of return filing) improved after the implementation of the integrated tax audit system in Malawi. Furthermore, it was observed that the audit findings with regards to the trends of appeals and objections after implementation of the integrated tax audit systems, as there were fewer appeals and objections.

Therefore based on these findings, the study concludes that the rolling out of the integrated tax audit system to some extent promoted voluntary tax compliance among large tax payers firms in the country.

There is therefore need to promote the usage of more integrated tax systems, processes, procedures and encourage execution of more integrated audits among all taxpayers. This will assist in enhancing voluntary compliance in form of tax payments, return filing, tax debt payments as well as minimize audit objections and appeals in the course of the tax payers dealing with tax matters. Over and above, there will be improvements in tax revenue collections which will result in rapid socioeconomic development of the country.



## TABLE OF CONTENTS

DECLARATION .....	i
CERTIFICATE OF APPROVAL.....	ii
DEDICATION .....	iii
ACKNOWLEDGEMENTS .....	iv
ABSTRACT.....	v
LIST OF TABLES .....	x
LIST OF FIGURES .....	xi
ABBREVIATIONS AND ACRONYMS .....	xii
CHAPTER 1 .....	1
INTRODUCTION .....	1
1.1 Background of the study .....	1
1.2 Problem statement .....	3
1.3 Study objectives .....	3
1.3.1 <i>Main objectives</i> .....	3
1.3.2 <i>Specific objectives</i> .....	4
1.4 Research questions .....	4
1.5 Research hypothesis .....	4
1.7 Organisation of the study .....	5
Chapter 2.....	6
LITERATURE REVIEW .....	6
2.1 Introduction .....	6
2.2 Tax audit effectiveness – A global, African and Malawi perspective .....	6
2.2.1 Tax administration, tax compliance and tax reform .....	6
2.2.2 Tax audit and its effectiveness .....	10
2.3 Tax compliance factors of an effective integrated tax audit .....	15
2.4 Components determining an effective integrated tax audit.....	16
2.4.2 Ease of use of the integrated tax audit system .....	16
2.4.3 Usefulness of the integrated tax audit system.....	16
2.4.4 Reliability of the integrated tax audit system .....	17
2.4.5 Cost of the integrated tax audit system .....	17
2.4.6 Compatibility of the integrated tax audit system to existing systems.....	17
2.6 Theories associated with tax audit .....	17
2.6.1 The economic model of compliance .....	17
2.6.2 Behavioural compliance models .....	20

2.6.3 Australian tax office (ATO) compliance model .....	22
2.7 Conceptual framework .....	30
2.8 Chapter summary .....	32
CHAPTER 3 .....	32
RESEARCH METHODOLOGY .....	33
3.1 Introduction .....	33
3.2 Research philosophy .....	33
3.3 Research strategy (approach) – Deductive.....	33
3.3.1 Research design and methods .....	34
3.3.2 Sample size and sampling techniques.....	35
3.3.3 Data collection tools .....	36
3.4 Data collection.....	38
3.4.1 Sources of data.....	38
3.5 Data analysis .....	38
3.6 Research ethics.....	39
3.7 Chapter summary .....	39
CHAPTER 4 .....	40
RESULTS AND DISCUSSIONS.....	40
4.1 Introduction .....	40
4.2 Tax compliance factors of an effective integrated tax audit.....	40
4.2.1 Frequency of audit objections and appeals .....	41
4.2.2 Timeliness of tax payments .....	42
4.2.3 Timeliness of tax debt payment .....	43
4.2.4 Correctness and timeliness of tax return filing .....	44
4.3 Components determining an effective integrated tax audit.....	45
4.3.1 Usefulness of the integrated tax audit system.....	45
4.3.2 Ease of use of the integrated tax audit system .....	45
4.3.3 Compatibility of the integrated tax audit system .....	46
4.3.5 Reliability of integrated tax audit system .....	46
4.3.7 Cost of the integrated tax audit system .....	46
4.4 Chapter summary .....	47
CHAPTER 5 .....	48
CONCLUSIONS AND RECOMMENDATIONS .....	48
5.1 Introduction .....	48
5.2 Conclusion.....	48

5.3	Recommendations .....	50
5.4	Areas for further research.....	51
5.5	Chapter summary .....	51
REFERENCES .....		52
APPENDICES .....		61
Appendix 1: Questionnaire for tax auditor .....		61
Appendix 2: Questionnaire for taxpayer.....		63

## **LIST OF TABLES**

Table 1: Characteristics of Quantitative Research Method .....	35
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## LIST OF FIGURES

Figure 1: Conceptual Framework .....	31
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## **ABBREVIATIONS AND ACRONYMS**

AFRITAC	:	African Tax Centre
ATAF	:	African Tax Administrators Forum
ATO	:	Australian Tax Office
CSF	:	Critical Success Factor
CRM	:	Customer Relationship Management
DTD	:	Domestic Taxes Division
EFD	:	Electronic Fiscal Device
EFDMS	:	Electronic Fiscal Data Management System
ERCA	:	Ethiopian Revenues and Customs Authority
GoM	:	Government of Malawi
GDP	:	Gross Domestic Product
IBRD	:	International Bank of Reconstruction and Development
IDA	:	International Development Association
IMF	:	International Monetary Fund
IRS	:	Internal Revenue Services
LCD	:	Least Developed Country
LTO	:	Large Taxpayers Office
NAP	:	National Audit Plan
MRA	:	Malawi Revenue Authority
OECD	:	Organisation of Economic Cooperation and Development
RA	:	Revenue Authority
TAAD	:	Tax Audit and Assessment Department
UN	:	United Nations
VAT	:	Value Added Tax
WB	:	The World Bank

# CHAPTER 1

## INTRODUCTION

### 1.1 Background of the study

Taxation systems and tax revenues are fundamental components of any attempts to build nations through the provision of social services by Governments to its citizenry. Tax administration is very crucial to the economic development of nations and Malawi is no exception. However, the design of the tax administration matters if meaningful economic development is to be attained. To support this, McKerchar and Evans (2009), states that a key component of any tax system is the manner in which it is administered.

Since the inception of the Malawi Revenue Authority (MRA) in 2000, several reform initiatives have been implemented. The reform initiatives include the merging of Income Tax and Value Added Tax (VAT) divisions into Domestic Taxes Division (DTD), introduction of electronic fiscal devices for VAT administration and automation of various tax and procedures including the tax database and payment systems just to mention but a few.

The MRA Modernization Programme Report (2014), states that despite the rolling out of the tax reforms aimed at improving the tax administration, there are still inefficiencies, ineffectiveness and revenue gaps in Malawi. In this case, the shortfalls associated with tax administration significant to reduced tax non-compliance and subsequent increased cost of collection and compliance were not well articulated. For instance, one report regarding assessment of effectiveness of tax administration design reiterates that Malawi's taxation framework is not fully designed to cater for more revenue mobilization with minimal or no collection and compliance challenges (International Monetary Fund [IMF], 2016).

Apart from relying on other traditional revenue mobilization enhancement strategies, another critical compliance improvement tool is a robust tax audit programme. Such a programme will ensure recovery of the otherwise lost tax revenues from the non – compliant taxpayers as well as enhance voluntary tax compliance as audits have a deterrent effect. African Tax Administration Forum [ATAF] (2017) reports that generally, revenue authorities have had gaps in the way tax audit systems are framed in the areas of risk-based auditing, adopted audit procedures and

methodologies, and inadequate skills among the tax auditors to acquire better capacities and competences to undertake complex audit practices.

In recent years, the extent of tax revenue losses due to tax evasion and/ or tax fraud has attracted considerable attention in many countries. In order to reduce the tax gap (the difference between tax that is owed to Government and the taxes paid on time) and increase the degree to which taxpayers comply with the tax rules compliance and reduce cost of compliance, tax audit is one function used by tax authorities as an effective way of deterring and detecting tax evasion and tax fraud.

According to the Taxation and Value Added Tax (VAT) Acts (Government of Malawi [GoM], 2006), MRA has powers to inspect business records to ascertain correctness of taxes paid and tax declarations made. Under section 54 of the Taxation Act and sections 35 and 36 of the VAT Act, taxpayers are mandated to keep business records for audit and inspection. At the beginning of each fiscal year, the Audit Department within the Domestic Taxes Division draws a National Audit Plan (NAP) which highlights the audit programme scope by sector or industry; by taxpayer segment and by tax audit type (GoM, 2006). The NAP also cites audit coverage targets for each tax office.

To support the idea of audit programmes, different tax audits techniques are executed using risk-based approaches (Walker, Shenkir & Barton, 2003), due to limited human personnel's to undertake the taxation processes (Romney & Steinbart, 2012). However, inadequate education and audit systems are key to revenue losses as inadequate detection towards malpractices related to revenue collection practices are undermined substantially (Walker et al., 2003). A robust audit system is therefore vital to seal revenue leakages.

In Malawi, the Integrated Tax Audit System was adopted in 2007 when VAT and Income Tax divisions merged to become the Domestic Taxes division (GoM, 2007). According to an integrated tax audit administration mandate, an execution and verification of audits on functional basis in relation to tax type, audit type and risks using a risk based approach was adopted. It is worth noting that an integrated tax audit provides tax custodians mandates to conduct an audit to



a business's wholesomely. Despite this development, there have been scanty researches exploring the effectiveness of the integrated tax audit among large scale stakeholders in Malawi. As such the study of the effectiveness of an integrated tax audit administration cannot be overstated.

The Malawi Revenue Authority has segmented taxpayers into categories using their periodic tax contribution, revenues realized, specific industries such as excise operators and financial firms among other criteria. One of the categories is the large taxpayers who contribute about 70% of total domestic revenues. The five taxpayers (Carlsberg Breweries, Chibuku Products, Malawi Distilleries, Shine Beverages and Bowler Beverages) study belongs to the large taxpayer category by virtue of them being excise operators by being alcoholic and non- alcoholic beverage manufacturers.

## **1.2 Problem statement**

Malawi Revenue Authority has undergone various policy and administrative reforms. However, failure to empirically assess effects of some of the tax reform initiative remains a challenge for MRA. It is always important to evaluate the effectiveness on any initiative introduced in an institution. The evaluation results pave way for redesigning of the reforms. Since rolling out the integrated tax audit system in 2007 as a tax administration approach, MRA has not assessed its effectiveness. According to Ayalew (2004), tax audits help revenue authority achieve its objectives, and ensure the fiscal health by means of indirectly drive voluntary compliance, (directly generate additional tax collections) and reduce cost of compliance. It is therefore vital to assess effectiveness of tax audit systems as failure to do so as failure may lead to inadequate collection of taxes by the revenue body. This has dire consequences not only towards socio-economic development of the country, but also slows economic growth. Such circumstances may eventually result in increasing poverty levels among the people in the country.

## **1.3 Study objectives**

### **1.3.1 Main objectives**

The main objective of this study was to assess effectiveness of an integrated tax audit administration amongst the brewing industry of large corporate taxpayers.

### **1.3.2 Specific objectives**

Based on the main objective stated above, the study addresses the following specific objectives:

- a) To identify components determining effectiveness of an integrated tax audit system.
- b) To identify tax compliance behaviour trends through tax obligations that show effectiveness of integrated tax audit system.

### **1.4 Research questions**

This research identified and attempted to answer the following questions;

- a) What are the components that determine effectiveness of the integrated tax audit system?
- b) What are the taxpayers' obligations and compliance behaviour trends that are determinants of an effectiveness of an integrated tax audit system?

### **1.5 Research hypothesis**

Several statement of supposition can be made in view of the factors affecting effectiveness of integrated tax audit. The hypotheses for this study were:

**H1:** The integrated tax audit approach, *ceteris paribus*, will not enhance tax audit effectiveness amongst large taxpayers in the brewing industry.

**H2:** There is a negative or no relationship, *ceteris paribus*, between integrated tax audit approach and tax audit effectiveness for large taxpayers.

### **1.6 Significance of the study**

Despite numerous empirical studies published that have explored the role of audit on taxpayer compliance behaviour, no such study has been undertaken in Malawi. The results of this study are expected to be significant in various aspects. This study therefore narrowed this research gap in the literature by assessing the effectiveness of an integrated tax audit system as a tax administration tool among large taxpayers in the brewing industry in Malawi.

On the global spectrum, this study contributed to the existing literature on tax audit systems, audit effectiveness and tax compliance by adding findings made from the Malawian tax

spectrum, which have different tax cultural values and attitudes. In the local context, this study will assist in building tax reform initiatives that promote tax administration. The findings will further assist MRA in designing tax administration systems that will result in improved efficiency and effectiveness as well as growing compliance levels.

The findings from this research have also provided information to the tax authorities that can enable them to identify the critical success factors (CSFs) of the integrated tax audit system and can further help to effectively design audit policies and tools that best suit the needs of the taxpayers across the country. In addition, it helps the revenue office tax auditors to know their role in the tax system. Moreover, it may serve as a source of reference and give some highlights for others who would like to know more about the issue and interested in undertaking further and detail studies in tax audit effectiveness as a research title.

## **1.7 Organisation of the study**

Chapter One: Introduction; introduces the topic and cites definition of the study problem, the objectives, significance and limitations of the study.

Chapter Two: Literature review; which discussed previous studies on the effectiveness of tax audit and some theories related to tax revenue mobilisation by nations and its significant towards socio-economic development.

Chapter Three: Research Methodology; this present information concerning data , the study's design, analytical procedures used, among others that was used to analyse data in order to achieve the study objectives.

Chapter Four: Results and discussion; which discusses the results of the study in line with study objectives. The significance of the results is weighed.

Chapter Five: Conclusion; concludes the study findings and presents the recommendations and areas of further study.

## **CHAPTER 2**

### **LITERATURE REVIEW**

#### **2.1 Introduction**

This study explored different schools of thought of tax compliance and tax auditing. The study also highlights empirical works that have been influenced by such theories and the new empirical findings and emergence of new theories out of previous studies. As such the chapter defines the concepts of tax administration, tax audit, tax compliance and specifically integrated tax audit system. Additionally theories and their relation to the study are discussed.

#### **2.2 Tax audit effectiveness – A global, African and Malawi perspective**

##### **2.2.1 Tax administration, tax compliance and tax reform**

A well renowned scholar, Adam Smith once said “Two things are certain in life, death and tax, the only sad thing is that they do not happen in that order.” This is a clear indication that the subject of taxation is inevitable. A research by Bird and Zolt (2003) reveal that ‘No one likes taxes. People do not like to pay them. Governments do not like to impose them’.

Taxation has a key role in a modern economy. Governments make use of taxation as a tool to generate revenue, discourage undesirable behaviour, reduce inequality, distribute resources and protect local industries. In addition, governments perform a number of activities in order to maintain law and order, satisfy the requirement of basic needs, public utilities and various development programmes. In order to carry out all these activities and discharge its overall responsibilities towards the people, governments need sufficient revenues. Such sources of revenues are taxes, fees and charges, fines and penalties and foreign grants. Among these sources, tax is the main source of collecting the government revenue. Malawi is no exception. According to Plant (2011), there are limits to how much a government can receive as grants from donors or borrow from donors or the private sector. So raising tax revenues is a necessary element for governments to spend on essential services and, in turn, reduce poverty. According to Drummond, Daal, Srivastava & Oliveira, (2012), raising more domestic revenue is a priority for most Sub-Saharan African countries. Tax regimes vary from country to country but form an integral part of most governments.

To stress on the importance of taxes and tax systems, Johannson, Engen & Skinner (2008) states that tax systems are primarily aimed at financing public expenditures. Tax systems need to be set up to minimise taxpayers' compliance costs and government's administrative cost, while also discouraging tax avoidance and evasion. Johannson et al. (2008) further states that what matters for these decisions is not only the level of taxes but also the way in which different tax instruments are designed and combined to generate revenues. In support of taxes, Cheeseman and Griffith (2005) reiterate many reasons why the focus on tax is to be supported and because of the perceived benefits related to comprehensive collection of tax revenue that is essential and attributive towards development.

The Organisation of Economic Cooperation and Development [OECD] report on Revenue Statistics for Africa (2016) states that tax revenues in African countries are rising as a proportion of national incomes. According to Sarfo (2015), the ability of developing nations to increase domestic revenue is a very reliable means of escaping the economic control that is tied to donor funds. Thus the improvement of revenue collection has always been high on national agenda. According to Fossat and Bua (2013), since the early 1990s, major tax administration reforms have been implemented in the Francophone countries of sub-Saharan Africa. While the reforms have contributed to an increase in revenues, attention is still needed to address a number of weaknesses in these countries' tax administrations. Such over dependency of sub-Saharan Africa on donor aid can be backed by this data. Data reports show that, as of March 2017, the Bank approved \$5.9 billion for the region for 83 IBRD/IDA projects this fiscal year 17/18, including \$1.2 billion in IBRD loans and \$4.7 billion in IDA commitments, of which \$975 million was from the IDA Scale-up Facility. (World Bank, April, 2017). This data backs the idea of over-dependency of sub-Saharan Africa on donor aid due to lack of robust revenue mobilisation strategies.

In the Malawi context, according to Chipeta (1998), since independence 30 years ago, the tax system has undergone a number of reforms and individual tax adjustments in response to the need for more revenue and for improving fiscal incentives for economic development. Although several tax reforms have been undertaken, especially since the 1983/84 fiscal year, taxation has failed to generate sufficient revenue to meet the needs of the government. Chipeta (1998) further

states that the tax burden measured by the ratio of tax revenue to GDP averaged 17.6% over the period 1980-1989. The tax ratio exhibited no upward trend over this period, suggesting that tax reforms did not increase the tax burden. In addition, Chipeta (1998) states that internal borrowing, mainly from the banking system, and external loans can be used to finance the overall budget deficit. But because these two sources of finance are not sustainable in the medium and long terms, every effort must be made to design a tax system that is viable and that can support government expenditure without recourse to deficit financing and foreign credit and aid.

Mohamad, Ahmad & Deris (2003) define tax compliance as the degree to which a taxpayer complies or fails to comply with the tax rules. According to Bird (2008), in an ideal, law-abiding society, people would pay the taxes they owe, and tax administration would amount to little more than the provision of facilities for citizens to discharge this responsibility. No such country exists, or is likely ever to exist. To concur with Bird (2008), Mohamad et al. (2003) states that the problem of tax compliance is as old as the taxes themselves and that today's tax agencies typically lose significant per cent of total revenues to tax evasion and other types of non-compliance. Alm (2004) takes tax evasion and avoidance as a universal phenomenon. In view of this, Bird (2008) says that compliance with tax laws must be created, cultivated, monitored and enforced in all countries. In their study, Mas'ud, Aliyu & Gambo (2014) state that in developing African countries, there is no obtainable statistics on tax evasion scores. However, there exist some statistics such as tax collection as a percentage of GDP. According to Kim (2008), in comparing these tax evasion scores of developing African countries with that of developed and transition countries, it is evident that tax evasion is worst in African developing States. McGee and Tyler (2006) laments that the problem is especially acute in developing economies since governments do not have appropriate infrastructure in place to collect taxes.

By looking at compliance, Tait (1995) states that the basic objective of any tax administration is to maximise voluntary compliance whilst Mohamad et al. (2003) cements this that the goal of an efficient tax administration is one to foster voluntary tax compliance using all possible methods including penalties. According to Bird (2008), the objective of tax administration may be constant — optimising collections under the law and increasing the levels of voluntary

compliance in ways that sustains community confidence — but the means to achieving it are not. To back Bird's stance, Jacobs (2013) further states that a high degree of voluntary compliance among all taxpayers does not just simply "happen." Therefore this means that there has to be a conduit such as the integrated tax audit system.

To enhance compliance and attain the means as such, tax administrations are always evolving and bringing on board reform initiatives. The OECD (2004) states that revenue administrations face different environments in administering taxation systems. To cement the OECD position, Alink and Van Kommer (2003) state that tax administrations operate in societies that are rapidly changing and have to fulfill increasing demands and growing expectations from their stakeholders, including new demands from taxpayers for sophisticated government services. As such, a standard approach to tax administration may be neither practical nor desirable in a particular instance. This is the sole reason MRA introduced the integrated tax audit system as one of tax administration reforms aimed at improving efficiency and effectiveness in tax auditing.

Apart from rolling out the integrated tax audit system, its effectiveness and simplicity to the Authority and taxpayers is what matters most. Bird (2008) suggested that the best tax policy in the world is worth little if it cannot be implemented effectively. Bird (2008) further states that one of the most important lessons emerging from experience in various countries is that an essential precondition for the reform of tax administration is to simplify the tax system in order to ensure that it can be applied effectively in the generally low-compliance contexts of developing and transitional countries.

However, despite coming up with the simplified approach to tax auditing aimed at attaining high degree of compliance, taxpayers at the same time strive to pay minimal taxes through tax evasion and / or tax fraud. This antagonism breeds tension and friction between tax administrations and taxpayers. To avoid such frictions, Alink and Van Kommer (2003) state that it is essential that a tax administration carries out its responsibilities in a manner which warrants the highest degree of public confidence in the organisation's efficiency, integrity and fairness. To cement this,

Cowell (1992) found out that the public acceptance depends critically on how the public and business communities ‘see the tax administration’.

It is said that one can only govern fairly with the consent of the governed. In taxation, it is equally true that fair taxation requires the consent of the taxed. Taxpayers will always have high positive expectations from revenue authority. To highlight the Malawian perspective, Kaluluma (2007) cited the concerns that taxpayers in Malawi have against the revenue authority. The concerns include that:

- There is a general feeling that tax rates are too high;
- It is further felt that the tax system is unfair;
- Tax officials are viewed as harsh;
- Tax officials are further accused of corruption and inefficiency; and
- Due to failure by Government to show clearly to what use taxes have been put, taxpayers do not see the justification why they should be asked to pay taxes;

The study by Kaluluma (2007) concludes that unless these concerns are addressed, taxpayers do not see the justification for paying taxes. This also backs the rationale behind the Malawi Revenue Authority embarking on tax reform initiatives including the integrated tax audit system aimed at addressing taxpayers’ concerns.

### **2.2.2. Tax audit and its effectiveness**

According to Ethiopian Revenues and Customs Authority (ERCA) (2010), a tax audit is defined as an activity or a set of activities performed by tax auditors to determine a taxpayer’s correct tax liabilities for a particular accounting or tax period, by examine of a taxpayer’s organisation products and financial records in order to assess compliance to tax laws and verifying the true, fair, reliable, and accuracy of tax returns and financial statements.

Ayalew (2014) cites that the role of a tax audit goes beyond verifying a taxpayer’s reported obligations and detection of discrepancies between a taxpayer’s declaration and supporting documentation. Audit also plays a major role in improving tax administration and overall



taxpayer compliance by impacting on taxpayer behaviour. In addition, Abdi (2010) states that one important tool for improving efficiency and effectiveness of a tax system is to use appropriate tax audit methods. There are different tax audit systems and the integrated tax audit system is one such system.

A well - managed tax audit plays a major role in managing compliance and will have significantly wider impacts than just raising revenue directly from audit activities. Grandcolas (2005) is of the view that a good audit program employs strategies to optimize both the direct and the deterrent effect of audits. IMF (2010) agrees with Grandcolas (2005) that a well - structured audit program plays an important part in improving the effectiveness of tax administration as well as detecting and addressing non-compliance. Grandcolas (2005) further states that an effective audit should be seen in terms of the following effects:

- Corrective – making adjustments to rectify instances of non- compliance;
- Deterrent – influencing the behavior of the audited taxpayer or group of taxpayers to be compliant in future; and
- Preventative – persuading the broader taxpaying community to comply.

Alink and Van Kommer (2016) defines tax integration as the constitution of one process, system or resource to be applied in different tax applications, instead of every application having its own. Tax integration is never a goal in itself; however, it can be an instrument to help achieving one or more of the following objectives; *effectiveness*: implementation of the political goals to an optimal extent; *efficiency*: execute the tasks with maximum result at minimum cost; and – *serviceability*: obtaining a high level of client’s satisfaction will increase the compliance of the client.

Before the introduction of the integrated tax audit by MRA in 2007, audits were executed on one tax type using only a single audit type. This approach meant that separate audit teams would visit a taxpayer to only audit, for instance VAT and leave out the other taxes for a different audit team which would come at another scheduled audit date and time. This proved costly for the Authority in terms of time and other resources. Taxpayers’ cost of compliance was also high as it meant

more time was spent attending to various audit teams instead of the taxpayers' core business activities. This approach was also costly to taxpayers as it meant raising numerous audit objections and appeals, if any, at different times instead of once. This generally brought conflict between the revenue authority and taxpayers and was a catalyst for non-compliance. This kind of approach ensures that taxpayers as well as auditors view tax issues with the 'one stop shop' perception. An effective audit program will lead to prompt detection of taxpayers who fail to submit tax returns, and / or pay tax due, and this is critical to improving tax compliance.

There are various measurable parameters that can be used when conducting an assessment of the effectiveness of an integrated tax audit system. Some of the parameters are; timely payment of taxes due, timely payment of tax arrears arising from audits (if any), number of objections and appeals, number of correct returns filed; number of timely return filing and number of audit queries.

Taxpayers will raise an objection and / or lodge an appeal against the revenue authority if not satisfied with tax audit results. Effective tax audits in terms of audit quality have minimal or no objections and / or appeals. Number of objections and appeals is an indicator of effectiveness of any tax audit system.

Timely payment of different taxes and timely payment of tax arrears entail that the taxpayer is compliant as this is an indicator of several factors; that the taxpayer has knowledge of the taxes operating; that the taxpayer understands and appreciates the anomalies leading to audit assessments; that the taxpayer knows the tax obligations attached to individual taxes being operated. It is assumed that once an integrated tax administration puts in place all the necessary elements, taxpayers are expected to make their tax payments on time. This is also the case with taxpayers who have tax arrears raised from audit assessments.

Timely filing of tax returns and submission of correct tax returns are also indicators of an effective tax audit system.

In a study about the effectiveness of integrated tax audit, Barrand, Harrison & Ross (2004) found out that the integration is expected to improve the level of collections and general compliance levels, provides for a more consistent treatment of taxpayers, reduces costs to government through the achievement of economies of scale, and reduces administrative burden on taxpayers. In aggregate, these represent significant potential benefits.

To support the notion that the impact of an effective tax system should not only be measured by revenue yield, Tait (1991) suggests that the effectiveness of audit should not be measured in terms of its direct revenue yield (that is the amount of additional tax assessed) but the extent to which audit contributes to better tax compliance. This notion supports the idea that the core objective of tax audits is also to enhance tax compliance apart from direct additional revenue yield.

IMF (2010) further backs Tait (1991) by stating that tax audit can also provide valuable support in these four areas: firstly, it provides information and intelligence; secondly, it helps to address deficiencies in the law; thirdly, if auditors observe recurring patterns of tax avoidance, audits may indicate inappropriate penalty provisions that may need to be amended to provide an adequate deterrent and lastly, audits also help in law clarification and education.

On the global arena, the effectiveness of tax audit systems can be cited using country case studies. Scandinavia is one region with the most efficient and effective tax administrations resulting in one of the highest compliance rates in the world. In a study case of Denmark, estimates of personal income tax evasion against the fraction of income that is self-reported (self-employment income, foreign income, and so on). The estimates are taken from the Danish tax audit field experiment in Kleven, Klusden, Kreiner, Pedersen & Saez, (2011). In this study, according to Kleven (2014), throughout the distribution of self-reported income shares, individuals are near-perfect compliers on third-party reported income and at the same time large evaders on self-reported income. However, in Kleven et al. (2011), the overall evasion rate in Denmark is extremely low (2.2 percent of income), because almost all income (about 95 percent) is subject to third-party information reporting where tax evasion is virtually nil. Denmark uses the data matching techniques of auditing.

Furthermore, according to Kleven (2014), the evidence from Denmark is qualitatively consistent with evidence from the United States of America. The most recent tax compliance study by the US Internal Revenue Service in 2012 estimates that the tax evasion rate is 56 percent for income with little or no information reporting, 8 percent for income with substantial information reporting, and 1 percent when there is both substantial information reporting and withholding. While the differences in tax evasion between income categories are therefore just as stark in the United States as in Denmark, the average tax evasion level across all categories is larger in the United States.

Another country case study is Bolivia. The experience of Bolivia, which introduced a major simplification of its tax audit system in 1986, is instructive in this respect. According to Thirsk (1997), much of the initial success achieved in reforming the tax administration in Bolivia was clearly attributable to the extensive simplifications made in the tax audit system. It is in the same vein that the integrated tax audit system was developed to simplify tax audit approach in Malawi. As part of measuring the audit effectiveness in sub-Saharan Africa, the GDP to tax revenue ratio can also speak volumes. According to Keen and Mansour (2009), in sub-Saharan Africa, there has clearly been an increase in the average tax ratios (total taxes as a share of GDP) since the 1990s. Over this period, an increase of 7.7 points was largely due to revenues from natural resources. In contrast, however, for non-resource related revenues, there has been no change over the same period – from an average 13% of GDP to 14% 25 years later.

However, measuring the extent of tax evasion and / or tax fraud in sub-Saharan Africa is hard due to sketchy data.

The effectiveness of tax audit in Malawi can also be measured by the revenue yield apart from the trends in taxpayer behavioural change in terms of income declarations, tax payments, filing of tax returns just to mention but a few. For instance, according to the DTD annual report (2012-2013), a total of 377 completed audits contributed MK 8.867 billion to total tax liabilities out of which MK 6.149 billion from 70 finalised audits was quantified from large taxpayers. This was a 212% increase from the previous year's audit performance. This represents that 69.3% of total Domestic taxes audit liabilities were raised from audits conducted with large taxpayers. This is a

clear indication of the significance of tax audits to revenue generation and particularly large taxpayer audits.

There are several studies that have looked at the effectiveness of tax audits. Palil and Mustapha (2011) argued that audits rates and the thoroughness of the audits could encourage taxpayers to be more prudent in completing their tax returns, report all income and claim the correct deductions to ascertain their tax liability. According to Alm, Jackson & McKee (2004), audits are thought to have a *direct* deterrent effect on the individuals actually audited as well as an *indirect* deterrent effect on individuals not audited.

The findings on the effects of tax audit by Biber (2010) are also supported by other research studies. Allingham and Sandmo (1972), McCaleb (1973), Sandmo (1981) illustrated that the effect of high probability of detection leads to an increase in the income declared, thereby reducing tax evasion. On the other hand, Ebrill, Keen & Summers, (2001) carried out a research on tax audit and compliance with emphasis on probability of fraud detection through tax audits. The study indicated that lack of an effective audit program undermines the functioning of the entire tax operations and that the most obvious consequences of ineffective audits are the deterioration of compliance and loss of credibility of the tax administration.

On a related note, there are also studies which have revealed the consequences of ineffective tax audit systems. One research by Ebrill et al. (2001) indicates that the most obvious consequences of ineffective audits are the deterioration of compliance and a loss of credibility of the tax administration. Even if sufficient penalties are provided for in the law, taxpayers will not be deterred from minimising their tax liabilities if they believe that there is little chance of being audited.

### **2.3 Tax compliance factors of an effective integrated tax audit**

The dependent variables in this study as earlier stated are timely filing of returns, correct filing of returns, timely payment of taxes, timely payment of tax arrears and number of audit queries, objections and appeals.

It can be emphasised that one of the measures of effectiveness of the integrated audit approach is tax return filing both in terms of the time of filing and correctness of the return. A taxpayer is therefore taken to be compliant if he or she files returns on time and that the declarations on the returns are correct in terms of the mathematical calculations and other declarations.

The other measure of compliance is how the taxpayer is making payments of the various taxes being operated. This is especially linked to the dates due for the payments. If a taxpayer is remitting the payments by the due dates then he or she is deemed compliant. This also applies to the payments of the tax arrears accrued to tax evasion. This is a form of penalties and interests.

The other dependent variable is the number of audit queries, objections and appeals. If the magnitude of these elements is high, it means the audit approach is less effective as more often than not, taxpayers raise queries if the audit findings are not satisfactory.

All these variables are assumed to be dependent on the design of the integrated tax audit administration hence this study was meant to find out if this has an impact (positive or negative) on audit effectiveness having in mind the independent variables discussed earlier in the paper.

## **2.4 Components determining an effective integrated tax audit**

There are components that determine an effective tax audit system.

### **2.4.2 Ease of use of the integrated tax audit system**

The effectiveness of any new product or system can be measured by its simplicity to embrace and use. The easiness to use will make the attainment of intended objectives easy, in this case, enhancing voluntary compliance through the integrated tax audit system. This study therefore intended to study the effectiveness of the audit system through its simplicity to use by tax auditors and taxpayers.

### **2.4.3 Usefulness of the integrated tax audit system**

The study intended to investigate the effectiveness of the integrated tax audit system through its usefulness to tax auditors as well as taxpayers. The usefulness will impact on the compliance levels of taxpayers. In this study, the usefulness of the integrated tax audit approach is vital to

ensure its desired effectiveness. If taxpayers and tax auditors are properly oriented about the benefits of an audit approach, such an approach is easily embraced.

#### **2.4.4 Reliability of the integrated tax audit system**

Reliability and credibility can be key components of business continuity. In this case, the level of credibility of the integrated tax audit system would affect the effectiveness of the system by looking at its expected outcomes.

#### **2.4.5 Cost of the integrated tax audit system**

Innovation is always associated with cost. The rolling out of any system, change of process and procedures has an attached cost to it. The study therefore measured the effectiveness of an integrated tax audit system by looking at the cost of compliance (from the taxpayer's spectrum) as well as cost of collection by the revenue administration. Every entity strives to minimise its operational costs.

#### **2.4.6 Compatibility of the integrated tax audit system to existing systems**

One measure of effectiveness of any system can be its compatibility to existing systems, processes and procedures. This study looked at the compatibility of the integrated tax audit system to audit policies, processes and procedures for both the tax authority and taxpayers. This compatibility of the audit system will have a bearing on the level of tax compliance.

### **2.6 Theories associated with tax audit**

#### **2.6.1 The economic model of compliance**

According to Slemrod (2000), the Economic model looks at economists approaching the question of why people fail to comply with the law. This began by constructing a theory based upon the assumption about human behaviour that underlies all economics; namely that individuals generally act rationally in evaluating the cost and benefit of any chosen activity. Consequently, this basic model assumes that people would evade tax when the expected utility of their criminal act exceeds its expected disutility.

Commenting on the model, Webley, Robben, Elffers & Hessing (2002) indicated that economic models clearly predict that higher penalties and audit probabilities should discourage non-compliance. Even if both have some deterrence effect, higher audit probabilities probably have more impact than higher penalties. Whilst Batrachea, Ross & Harrison (2012) state that for a long time, economists have disregarded ‘crime’ from their analyses, although it has always been of substantial practical interest. The reason behind this disregard might have been the opinion that illegal activities are too immoral to deserve a special scientific consideration. Nobel Prize winner Gary Becker (1968) used economic analysis as a tool for designing optimal public and private policies that fight against illegal behavior. He defined optimal policies as those decisions that reduce the social loss in income caused by ‘offenses’ (i.e., crimes). The loss is considered to be the sum of injuries, costs of apprehension, conviction and imprisonment. Becker’s study integrated the behavioral components which link the costs implied by crime eradication. These components are: (1) the number of offenses and their costs; (2) the number of offenses and the corresponding punishments; (3) the number of offenses and the public outlays on police and the judicial system; (4) the number of sentences and the expenditures with incarceration and other types of punishments; and (5) the number of offenses and the money spent for protection and arrests. The model attempts to cover all sorts of violations, ranging from felonies like murder, assault, robbery etc., to tax evasion, collusive business arrangements, white-collar crimes, traffic etc. Starting from Becker’s insights on crime and punishment, the literature on tax evasion flourished both in the economic and behavioral direction.

Batrachea et al. (2012), further narrates that the economic model of criminal activity proposed by Becker (1968), the article of Tulkens and Jacquemin (1971) on delinquency cost and the optimal allocation of private and public expenditure along with studies regarding the analysis of optimal portfolio and insurance policies under uncertainty (Arrow, 1970; Mossin, 1968) were the starting point in Allingham and Sandmo’s model of income tax evasion. The aim of their study was to analyze taxpayers’ propensity towards avoiding taxes by underreporting income and the degree in which taxpayers display this type of economic behavior. Roughly in the same time with Allingham and Sandmo (1972) and independently of them, Srinivasan (1973) also proposed a theoretical model that yields the same predictions.



According to Batrachea et al. (2012), although the standard tax evasion model of Allingham and Sandmo and other similar economic models capture some important aspects of tax compliance (i.e., taxpayers' response to increases in tax rate, audit probability, penalty rate), they do not suffice the need for an accurate prediction of taxpayers' behavior. The reason is that they do not offer a comprehensive perspective on the sociological and psychological factors which shape compliance (i.e., attitudes, beliefs, norms, perceptions, motivations).

However, the economic model showed some empirical shortfalls necessary to accurately predict taxpayers' behavior. The model fell short of explanations as to why it is necessary for tax authorities to also take into account behavioral factors when designing fiscal policies. Therefore, the researchers have considered examining taxpayers' inner motivations, beliefs, perceptions, attitudes in order to accurately predict taxpayers' behavior. Other scholars embarked on new studies in a quest to find answers to the shortfalls of the Economic model. As a result behavioral models on tax compliance emerged. There is therefore need for tax compliance models which incorporate both economic and behavioral features so that governments and tax authorities should consider when designing fiscal policies. Among the sociological and psychological factors which shape tax compliance, the 'slippery slope' framework singles out trust in authorities and the perception of the power of authorities.

In the study by Batrachea et al. (2012), the model of Allingham and Sandmo (1972) constituted the starting point for a massive stream of tax evasion theoretical models that took into account different variables (i.e., audit probability, social stigma, and information uncertainty) and economic choices (i.e., allocation of work time, high expenses employed to hide evaded taxes). Besides causing an important stir among theoreticians, the classical model of tax evasion has left its mark also on the empiricists who used it to study the firm's decision-making process relative to evading different taxes (i.e., income tax, profit tax) or to design financial policies based on enforcement. Batrachea et al. (2012) states that nearly all studies published after Allingham and Sandmo have incorporated Yitzhaki's recommendation of applying the penalty to the evaded tax and not to the undeclared income. Even if his suggestion solves the major inconsistencies of the classical model, it still generates a counterintuitive result (compliance level rises with the

increase of the income tax rate) which is not in line with empirical results (Clotfelter, 1983).

Similarly, Spicer (1986) enriched further the works of earlier writers by incorporating the impact of social norms supportive of tax compliance in the Economic model of tax evasion. Spicer achieved this by introducing the psychic cost of evasion in the taxpayer's objective function. Psychic costs were postulated to depend on the evasion behavior of other taxpayers, the perceived equity of the tax system, informal sanctions, attitude towards risk and so on. In this model, an act of evasion is committed only when the expected gains from taxes evaded exceed expected losses from tax assessments imposed through audits and psychic cost. The results of the formal economic analysis of Allingham, Sandmo, and others are consistent with the empirical evidence based on survey studies by Mason and Calvin (1984), Clotfelter (1983) and Manasan, (1988) that established that fear of sanctions deter evasion and that increased opportunities for evasion increase the incidence of evasion.

### **2.6.2 Behavioural compliance models**

The shortfalls of the economic models led to the birth of behavioral models. The economic models of tax compliance have been subject to harsh criticism. The first reason for this criticism was that they assume taxpayers to be fully rational utility maximizers whose behavior is interpreted as a reaction to different financial benefits and losses. The second reason was that the predictions of the economic models were invalidated by a bevy of empirical studies.

In these behavioral models, built on the grounds of sociological and psychological determinants, taxpayers are seen no longer as selfish utility maximizers but as human beings motivated to pay taxes on the basis of different attitudes, norms, beliefs, perceptions, feelings, social characteristics, cultural background like age, gender, race, religion, etc.

Slemrod (2000) discusses the Psychological model. Psychologists tend to model human behaviour in much more complex terms than economists. They might be interested, (as key independent variables), in tax evasion decision in factors such as: the individuals as moral beings with ideas and values of their own that commands and their own impulses filter through and are

affected by this moral screen. Beron (2002) is of the view that social scientists from almost every discipline have turned their attention to tax evasion as a social phenomenon.

According to Slemrod (2000), under the Sociological theory, sociologists tend to see the cause of variation in human behaviour in the structure of the social system. Thus the theory explains people's actions by examining the forces that impinge on the position that they occupy within the system. Taxpayers live and work in society. They have families, friends and co-workers who are sources of reward or punishment. These social forces shape behaviour just as effectively as the reward and punishments administered by the state. Given their basic assumptions about human behaviour, sociologists are also likely to look to attitudes towards government views relating to the enforcement of tax laws, views about the fairness of the tax system, contact with the tax department and demographic characteristics as independent variables.

In his study, Bird (2008) established that developing and transitional countries exhibit a wide variety of tax compliance levels, reflecting not only the effectiveness of their tax administrations but also taxpayer attitudes toward taxation and toward government in general. Attitudes affect intentions and intentions affect behaviour. Attitudes are formed in a social context by such factors as the perceived level of evasion, the perceived fairness of the tax structure, its complexity and stability, how it is administered, value attached to government activities, and the legitimacy of government.

The other behavioral model of tax compliance which encompasses these socio-psychological determinants is the 'slippery slope' framework proposed by Kirchler, Hoelzl & Wahl in 2008. According to Kirchler, Wahl & Kastlunger (2010), the 'slippery slope' framework, trust in authorities and power of authorities are two main dimensions shaping tax compliance. *Trust in authorities* is defined as 'the general opinion of individuals and social groups that the tax authorities are benevolent and work beneficially for the common good' and *power of authorities* is defined as 'taxpayers' perception of the potential of tax officers to detect illegal tax evasion and to punish tax evasion' (Kirchler et al., 2008). Both trust in authorities and power of authorities increase tax compliance, but the quality of compliance differs: *voluntary tax compliance* is achieved by increasing levels of trust; *enforced tax compliance* is achieved by

increasing levels of power. The study tested these main assumptions of the slippery slope framework in four European countries differing in terms of cultural and economic settings (Austria, Hungary, Romania and Russia) by presenting participants with different scenarios of trust and power. As predicted, the highest level of intended tax compliance and the lowest level of tax evasion were found in conditions of high trust and high power. In addition, participants in conditions of high trust indicated more voluntary compliance just as participants in conditions of high power indicated higher enforced compliance. Kirchler et al. (2010) further state that the results support the assumptions of the slippery slope framework and confirm the role of trust and power as important determinants of tax compliance. When talking about tax behavior, the attitude towards taxpayers is of great importance as it can enhance either compliance or non-compliance. A 'service and client' climate between tax authorities and taxpayers is meant to foster trust in authorities and stimulate taxpaying behavior. Alternatively, a 'cops and robbers' climate breeds distrust and resistance, giving birth to cheating behavior. In the light of these realities, a huge merit of the 'slippery slope' framework is that it promotes a more 'service and client' approach of tax authorities towards taxpayers.

The two models (economic and behavioural) have shown that tax compliance is related not only to economic, but also to behavioral issues that impact tax revenue collections.

### **2.6.3 Australian tax office (ATO) compliance model**

Another behavioural model that is being used is the pyramidal Compliance model which was developed by the Cash Economy Task Force in the Australian Tax office (ATO) in 1997. This compliance model is a structured way of understanding and improving taxpayer compliance. The model helps us to understand the factors that influence taxpayer behaviour and to apply the most appropriate compliance strategy.

According to ATO (1997), the Compliance theory states that taxpayer compliance behaviour is influenced by many factors thus - business, industry, sociological, economic and psychological. The theory shows a continuum of taxpayer attitudes towards compliance. At the base of the continuum, taxpayers have the desired attitude of being 'willing to do the right thing'. At the other extreme, taxpayers have decided not to comply - choosing to evade or opt out of the tax

system. The theory also summarizes the different sorts of support and intervention that tax administrations may need to provide to collect the required revenue. The model suggests that tax administrations have the ability to influence taxpayer behaviour through their response and interaction.

The responsive regulation approach is based on the proposition that effective enforcement requires a dynamic and gradual application of less to more severe sanctions and regulatory interventions (Braithwaite 1985). This range of sanctions and interventions balances traditional authoritarian deterrence with strategies that rely on persuasion and encouragement through three states of communication – cooperation, toughness, and forgiveness (Ayres & Braithwaite 1992). The Australian approach also advocates a deeper understanding of the motives, circumstances, and characteristics of taxpayers, so tax authorities can tailor enforcement to effectively deliver compliance (ATO 1997, 1998).

There are several studies and literature that have followed the inception of the ATO Compliance model. Several revenue authorities have also adopted the principles of this model. In a survey study of Australian taxpayers, Wenzel (2002) found that taxpayers were more compliant when they thought that they had been treated fairly and respectfully by the Australian Tax Office. On the same topic, Lind and Tyler, (1988); Murphy, (2002) and Tyler and DeGoey, (1996) conducted studies where there is evidence to show that people who feel they have been treated fairly by an organisation will be more likely to trust that organisation and be inclined to accept its decisions and follow its directions. According to other researchers, Sour, (2002); Keller, (1997); Trivedi, (1997); Hamm, (1995); Chang et al. (1987) in Ahmad, Pall & Akir, (2003), enforcement elements such as audit, penalty and tax rates have a great influence on tax compliance behaviours.

In a separate study, Braithwaite (2009) used the ATO Compliance model to further understand taxpayer behaviour and the elements that influence such behaviour. According to Braithwaite, two decades of empirical work on tax compliance has produced awareness of the complexity of tax compliant and non-compliant behaviour. Tax compliance itself is now recognized as a multi-faceted construct (Webley, Robben, Elffers, & Helsing, 1991) Braithwaite found out that in the

midst of enormous diversity, a notably consistent theme over the past two decades of tax research has been deterrence. A vast body of research has focused on identifying the costs, be they material, social or psychological, which would deter would-be tax evaders, and counter the lure of the benefits of evasion.

This study by Braithwaite (2009) questioned the assumption that the most effective management strategy is consistent punishment, i.e. increasing costs to the non-complier and reducing benefits, in the hope that the offence will not be repeated. Braithwaite (2009) describes a different approach that has been borrowed from the regulatory literature. This approach encourages non-compliers to cooperate with tax officers in paying the taxes they owe, with prospects of punishment and loss placed in the background, only to enter into the compliance game when cooperation fails.

Braithwaite (2009) further used the ATO model to state that tax enforcement is an area where the effects of deterrence and compliance approaches are unknown (Andreotti, Erard & Feinstein, 1998). When taxpayers are audited, for example, and a penalty imposed, it is unclear whether they learn that they got away with a lot of things that the audit did not detect. The deterrence sign will be positive if this is the bigger lesson than the lesson that cheating will be punished. Sometimes an audit succeeds in deterring cheating in the long run, but in the year or two after audit taxpayers believe they are unlikely to be audited, and this has a dramatic negative effect on compliance in those two years. Braithwaite (2009) concludes that this and other kinds of complexity have moved the compliance literature over the past decade away from a crude contest between punishment and persuasion. Rather the debate has been about how to get the right mix of the two.

Another study based on the ATO compliance model was conducted by Leviner in 2014. Recent developments in regulation and tax administration in Australia inspired this study on tax compliance and responsive regulation. This study analyses the economics of crime and compliance as the dominant approach to tax enforcement of the past three and a half decades. It evaluates the key advantages and disadvantages of the economic approach as well as its application to tax. According to Leviner (2014), preserving the integrity of the tax system has

challenged societies throughout history. Tax noncompliance is a serious problem that fosters a climate of disrespect, antagonism, and selfishness in the relationships among citizens and between them and the government and distorts the distribution of the tax burden and wealth in society (Carroll 1989; Cowell 1990; Kaplow 1996; Slemrod 1992).

Furthermore, in his study, Leviner (2014) explores one alternative solution to the problem of noncompliance. It suggests that expansion of the traditional tax compliance analysis to include responsive elements of regulation, as illustrated in the Australian Tax Office's (ATO) approach to tax enforcement, may yield a more useful and forward-looking approach to tax compliance and enforcement than those available under other systems. Leviner (2014) cites that like other tax administrations in the industrialized world, over the years using the ATO compliance model, the Internal Revenue Service (IRS) has taken a number of steps to ease the tax gap including substantially enhancing enforcement efforts and resources (IRS 2004, 2006). Unfortunately, despite some increases in enforcement revenue, the net difference between taxes owed and taxes collected in the US remains close to \$300 billion per tax year. This raises the question whether the steps taken thus far are sufficient to alleviate the problem of tax noncompliance. If not sufficient, what alternatives are available to government agencies and other regulatory institutions?

Leviner (2014) further suggests that responsive regulation goes a step further, however, and also considers other parameters, including the way society, morality, and ethics affect taxpaying behavior and, particularly, the manner in which the taxpayer-tax administration relationship shapes compliance. Specifically, evidence on tax enforcement generally confirms the conclusion that taxpayers are highly responsive to the perceived or actual risk of detection. According to IRS estimates, compliance is most likely where the risk of detection is significant, such as when third-party reporting or withholding takes place. Taxpayers misreport a mere 1% of all wages, salary, and tip income contributing approximately \$10 billion to the US tax gap (IRS 2006).

In conclusion, Leviner (2014) states that it becomes clear, therefore, that taxpaying behavior is not merely the result of isolated calculations of the monetary costs and benefits taxpayers expect to incur from compliance and noncompliance. Taxpaying behavior is also a social process where

taxpayers share information, experiences, attitudes, and patterns of behavior that affect their assessments of costs and benefits and, consequently, their actual compliance with the tax law (Schwartz & Orleans 1967; Roth & Scholz 1989; Carroll 1992; Lederman 2003; Kirchler 2007; Torgler 2007). One may even go so far as to argue that moral, ethical, and social factors play a more important role in compliance than the threat of legal punishment (Kahan 2001; Scholz et al, 1992; Steenbergen, Scholz & McGraw, 1992).

This study links the principles of all the compliance models cited in this paper to this study's objectives. MRA draws lessons from the models in understanding taxpayer behaviour and in the subsequent designing of compliance enhancement strategies. The integrated tax audit system just like the economic model strives to enhance compliance by understanding taxpayer behaviour. The effectiveness of the integrated tax audit system will be a reflection of the level of compliance through the parameters discussed in the paper as dependent variables. The design of an audit system will entail the probability of detection and subsequent penalties. The effectiveness of the integrated tax audit system will be measured through trends in timely tax and tax debts payments; levels of filing correct and timely returns; number of appeals and objections against the expected penalties; perceived equity of the tax system; and probability of detection.

The study's perceived factors associated with the effectiveness of integrated tax audit system link with the principles of the behavioural models which use taxpayers' perceptions about tax systems as one of the determinants of tax compliance. In view of this, perceptions about the integrated tax audit system by the taxpayers of the audit tax system determine level of compliance. Tax administrations use the 'deterrent effect' by tax audits.

Further to this, the behavioural models cite socio – psychological factors such as socio norms, attitudes, perceptions as determinants of taxpayer behaviour. In this study, the taxpayers' perceptions on integrated tax audit (the system's ease of use, credibility, usefulness, cost, reward, compatibility) determined the effectiveness of the integrated tax audit system. Just like the 'slippery slope framework' by Kirchler, trust in MRA's integrate audit system affected compliance. Tax authorities should therefore strive to have their systems positively perceived by



taxpayers. This can draw the equation: Level of Taxpayer Perceptions = Level of Tax Compliance.

On the other hand, the challenges associated with ineffectiveness of the integrated tax audit system in a bid to promote voluntary compliance link with the shortfalls highlighted in each of the compliance models. Lessons learnt are used to redesign tax policies, systems and processes to best suit the expectations of the taxpayers.

The ATO model helps in addressing the objectives of this study as it looks at factors that influence taxpayer behaviour (in this case the perceived factors of effectiveness of integrated tax audit system and factors that determine effectiveness of the tax system). By looking at a combination of factors, the model shows a continuum of taxpayer attitudes towards tax compliance. This will grossly address the challenges associated with ineffectiveness of integrated tax audit system. Redesigning of tax audit systems will have to take into consideration taxpayer attitudes towards complying with the law.

The integrated tax audit system is a reform initiative which was designed around addressing concerns of taxpayers. One lesson learnt from ATO Model is the 'responsive regulation' approach. This study learns that once the other persuasive strategies of enforcing compliance fail, audit is used as one of the compliance enforcement strategies. On top of this, the effectiveness of the tax audit system is a benchmark as the ATO model suggests that tax administrations influence taxpayer behaviour through their response and interaction. A deeper understanding of the perception factors of effectiveness of tax audit system helps MRA to tailor enforcement strategies including tax audit to effectively deliver compliance.

In view of this, Malawi revenue authority through the integrated tax audit system has taken the path of persuasion than an enforcement pyramid approach to regulation. This means MRA prefers the low-cost option of persuasion first and escalate to more deterrence-oriented options (and ultimately to incapacitation) as less interventionist strategies successively fail.

ATO makes it as easy as possible for taxpayers to do the right thing by providing the information and tools they need to meet their tax obligations as conveniently and inexpensively as possible. (Braithwaite, 2009) It is also in the same spirit that MRA designed the integrated tax audit. In Malawi, the ATO model is being used as the belief is that detecting and dealing appropriately with non-compliance deters others. In the event that a taxpayer chooses not to comply, MRA takes more stringent action including integrated tax audits. In Malawi, the principles of the ATO model (from enhanced taxpayer service to heavy enforcement measures) are used. For instance the large taxpayer office (LTO) has the Customer relationship management model which assigns dedicated tax officials to handle specific taxpayers' tax matters. This is a persuasive approach. On the other hand, LTO also has the Compliance Enforcement strategy which prescribes integrated tax audits, assessments, penalties to tax offenders. This is the punitive approach to compliance management.

The adoption of the integrated tax audit system has demonstrated positive results in tax administration on the world scene, in Africa and Malawi in particular. According to Fischer, Wartick & Mark (1992) different noneconomic factors such as demographic; non-compliance opportunity; tax payers' attitude and perceptions of tax system fairness; and various features of the tax system fairness have been proposed to affect tax compliance. Following the lead of Fischer et al., (1992), the Inland Revenue Service of USA outlined 64 factors that are related with tax compliance by taxpayers or companies. To concur with Fischer et al. (1992), Alm, Jackson & McKee (2004) state that the extent which the tax payers perceive a tax system to be fair influences their attitude to pay their taxes Alabede, Pall & Akir (2011) further postulated that, a tax payer whose motive is to demonstrate his beliefs in a system will evaluate the fairness of the systems with objectivity whereas the taxpayer whose attitude is motivated by what benefit to derive from the system may label the tax system fair only if he is benefiting from it. This sums up that the perceptions of the integrated tax audit system affects compliance.

According to Munyurwa (2013), it was found out in a study amongst large taxpayers in Rwanda that tax audit contributes to the effectiveness of tax collection and improvement of fiscal revenue. It is confirmed that tax audit had a positive impact on tax revenue collection. Tax audit is one of the most powerful revenue administration tools that can ensure that tax payers pay their

tax liability with very little room for evasion. Therefore, the tax audit function should be strengthened to minimize both deliberate and innocence tax evasion made by many tax payers.

Adediran, Alade & Oshode (2013) conducted a study in Nigeria to determine if integrated tax audit can actually increase the revenue base of Nigerian government and if it can stamp out the incidence of tax evasion. The study found out that the attitudes of taxpayers were not encouraging and that tax evasion had done more harm than good to the tax system. The study further found out that, to a greater extent, tax audits led to increased revenues and help curb tax evasion and tax fraud.

The advent of the effective tax audit system in Malawi brought positive results including:

- Prevention of more tax evasion and tax fraud. This will protect the much needed tax revenues for the Government. Steady flow of domestic revenues is needed now more than ever when there has been a dry spell of donor inflows for some four years as well as in the wake of the ‘cash gate’ scandals;
- The additional revenues generated through tax audit assessments will be used to finance, apart from the current budget, additional huge expenditures needed due to cushion the food shortage;
- The integrated tax audit system plays a ‘deterrent effect’ for potential future offenders.

In the countries and regions where the integrated tax audit system has not been adopted, there have been such challenges as increasing cases of tax evasion and tax fraud will rob the Government of tax revenues. According to Fossat and Bua (2013), despite encouraging progress, tax audit results in most of the African countries still fall short of what is needed, especially in the following area: Audit coverage is inadequate: less than 1 percent of large and medium-sized businesses are audited annually; desk audit programs need improvements and the use of issue-oriented audit methods is still inadequate in several countries, where the most frequent practice is still to conduct a full audit for all taxes due by of a given taxpayer and for several years; collection of additional taxes due after an audit is inadequate, especially for the additional taxes due after a full audit (between 10 and 30 percent) and the most serious cases of tax fraud and

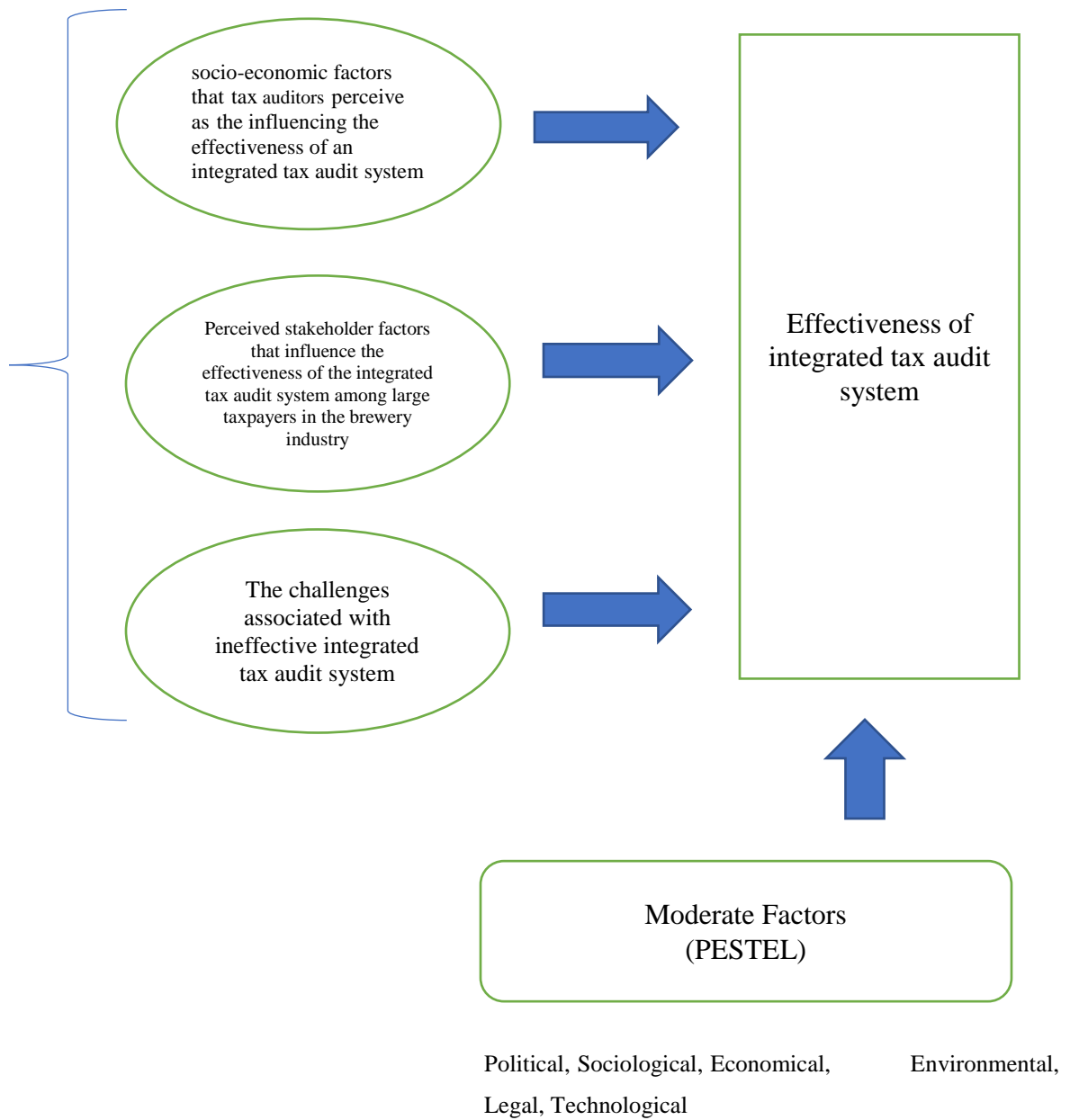
evasion are usually not prosecuted. Furthermore, Fossat and Bua (2013) lament that despite significant assistance provided, over several years, in the areas of audit training and audit policy design, significant progress is still needed in many tax administrations of Africa to develop an audit strategy suitable for the needs of a modern tax system.

## **2.7 Conceptual framework**

This research is performed within the framework of assessing the effectiveness of integrated audit tax system in Malawi. The conceptual framework draws the golden thread amongst the various factors involved in this study. From Figure 1, it can be seen that the combination of determinants of the effectiveness of the integrated tax audit system are: the compliance indicators/ socio-economic factors (tax payments, timeliness and correctness of filed returns, tax debts payment, number of objections and appeals); the qualities of the integrated tax audit system (ease of use, cost, compatibility, usefulness and credibility).

There are also other moderate peripheral factors that indirectly influence the effectiveness of the integrated tax audit system. The factors are political, economic, social, legal, environmental and technological (PESTEL). Some factors would be lending and inflation rates, currency stability, tax legislation provisions, climate change, political stability.

According to Pickens (2005), the willingness to pay taxes or comply with the tax laws or to engage in the given behaviour in general terms is informed by the overall attitude of the individual given certain operant factors. Thus the factors forming the basis of this study have been considered as antecedents of an individual's taxpaying attitude.



**Figure 1: Conceptual framework**

## **2.8 Chapter summary**

The literature review shows that there are indeed various factors that influence the adoption of integrated tax audit approach. The topic about tax audit system has been widely discussed and most theories and concepts have been developed.

The literature review has outlined and discussed the basic concepts or theories and identified some of the factors that influence the effectiveness of the integrated tax audit system. The literature has also revealed findings in both developed and developing countries. The key important factors have been discussed such as the tax audit concepts, the critical success factors have also been looked into with the benefit of tax audit to the Authority and taxpayers. Equally, previous and existing theories of innovation of adoption have been presented which is used as a basis for our research framework.

## **CHAPTER 3**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

This chapter discusses the research philosophy, methodology that was used to conduct the study including the type of data collected and the sources of the collected data. The sample technique, sample population and data analysis tool is also discussed. This chapter further describes and justifies the chosen research design.

#### **3.2 Research philosophy**

This study dwells on the philosophy of Positivism. Saunders (2003) argues that positivism philosophy is based upon the highly structured methodology to enable generalization and quantifiable observations and evaluate the result with the help of statistical methods. With the help of positivism philosophy, researcher can collect all the facts and figures that are associated with the research issue through general sources. In this research philosophy, the researcher plays the role of an objective analyst to evaluate the collected data and produces an appropriate result in order to achieve research aims and objectives.

#### **3.3 Research strategy (approach) – Deductive**

This study used the Deductive research approach using ‘formal logic’. This approach is associated with the positivism paradigm. Deductive research approach allows the research to establish a hypothesis by using theory. A variety of data and information is collected by the researcher to confirm or reject the hypothesis to resolve the issue (Gill & Johnson, 2010). This approach is based on the general idea to reach at the specific situation and is linked with the positivism philosophy, which include hypothesis to prove assumptions.

This research approach uses objectivity and causation by using pre-specified questions which are outcome oriented. There were numerical estimates as well as statistical inferences.

In this study, deductive approach was favoured over inductive because it offers the following advantages; the approach has the possibility to explain causal relationships between concepts and variables; deductive approach also has the possibility to measure concepts quantitatively and can

generalise research findings to a certain extent. This approach therefore befits the study as it looks at frequencies of filing, objections and appeals and tax payments as one variable.

### **3.3.1 Research design and methods**

According to Blaxter, Hughes & Tight (2006), methodology is the overall approach which underpins the research process. Research methodology is defined as a method or way to systematically solve the research problem. This study used a quantitative research technique. Frankel and Devers (2000) state that quantitative research is deductive and that quantitative research methods measure the value and the way statistical inferences are expected, with the help of mathematical techniques for processing the data. Kane (1991) describes further that quantitative data therefore is numerical and answers such questions as what, when, who, which, how many and how often.

This study preferred quantitative design because it allows the results to be generalised from a sample to an entire population of interest. In this case, the results of the brewery industry and large taxpayers and tax auditors would be generalised to the entire taxpayer and auditor populations. Furthermore, this research design allows the measurement of the incidence of various views and opinions in a given sample (thus large taxpayers and auditors. The factors that led to quantitative method being preferred over qualitative method have been highlighted.



**Table 1: Characteristics of quantitative research method**

<b>Research aspect</b>	<b>Quantitative research</b>
Approach to research enquiry	Structured/rigid/determined methodology
Main Purpose of investigation	To quantify extent of variation in a phenomenon, situation, issues, etc.
Sample size	Greater emphasis on sample size
Analysis of data	Subjective variables to frequency distributions, cross-tabulations or other statistical procedures.
Communication of findings	Organisation more analytical in nature, drawing inferences and conclusions, and testing magnitude and strength of a relationship

*Source: Kothari (2006)*

### **3.3.2 Sample size and sampling techniques**

This study has a sample population. This is to follow what Crask, Fox & Stout, (1995) state that defining the target population is an important step in designing the research project. In Malawi, the brewery industry is one sector that is relatively small but easily comparable for tax purposes hence the sample of five. In addition, this is one sector where all firms are categorised into the large taxpayer grouping because they operate excise tax. A total of five interviews were conducted with tax representatives for the brewery industry.

A sample of forty (40) auditors was chosen because it represents 60 per cent of the total pool of auditors in Domestic Taxes Division responded to a questionnaire. The 60% representation was believed to be a fair representation of all the auditors.

Thomas (2004) cites that given our limited resources, we can never study the whole world but only parts of it. Therefore, this study sampled five large taxpayers from the brewery industry

namely; Carlsberg Breweries, Chibuku Products, Bowler Beverages, Shine Beverages and Malawi Distilleries to come up with respondents for the study. These taxpayers operate all domestic tax types from VAT, corporate tax, Excise tax, Pay As You Earn, Fringe Benefits Tax, Withholding Tax, Dividends tax. Four of the targeted respondents are Blantyre based whilst the fifth one is Lilongwe based. The general aim of sampling is to obtain a subset of a population that is representative of the target population. Cooper and Schindler, (2003) illustrate that there are several compelling reasons for sampling, including lower costs, greater accuracy of results, greater speed of data collection and availability of population elements.

The study used stratified sampling because MRA categorises taxpayers in strata (large, medium and small). The tax audit topic is specialised and the only relevant respondents were the tax auditors in MRA as well as tax representatives from the 5 large taxpayers in the brewery industry. The brewery industry and tax auditors were selected as both are specialised industries and professions respectively. Since this study is to do with effectiveness of tax audit system, auditors are best place to assess. However, each of the 40 respondents had been sampled using the simple random system. At the time of the study, the Domestic Taxes Division had a total of sixty (60) auditors of different ranks (senior and junior). Again the five tax representatives had been sampled using the simple random system from a pool of about twenty five (25) tax professionals from all of the five large taxpayers. The 40 respondents represent a good sample population from the auditors' pool at MRA. The 5 tax representatives also represent a fair population as large taxpayers usually have a one contact person for tax matters with MRA.

### **3.3.3 Data collection tools**

Kane (1991) states that there are different ways of collecting data and the main ones are focus groups, secondary sources and data reviews, observations and interviews. Secondary sources and data reviews are the act of collecting data from existing records.

Walsh (1999) defines a questionnaire as simply lists of pre-written questions with or without standardized answers. According to Brynard and Hanekom (1999), one of the advantages of using questionnaires is that respondents have time to think about the answers to the questions in

the questionnaire. A questionnaire therefore can also be semi-structured thus containing both closed and open-ended questions.

This study conducted interviews using semi structured questionnaires which allowed the respondents to freely express themselves when responding. This would not be the case if the questionnaires were closed. Walsh (1999) points out that, semi-structured questions allow for the development of a guided conversation, which answers such questions as how and why.

The pilot study involved five tax auditors who are station at MRA Head office in the Audit section. The semi – structured questions were distributed to the respondents by hand. One taxpayer in the brewery industry was used as a pilot respondent. The questionnaire was hand delivered as well.

The pilot results showed that the tax auditors indicated that the integrated tax audit system is effective by looking at the trends of the tax obligations of filing, payments and appeals. The taxpayer cited that the system was effective by mentioning the reduced time taken to finalise the audits and how easy it was to use.

The results of pilot helped the researcher to polish up the questionnaires for both the tax auditor and tax representative.

The final questionnaires were administered to be respondents by hand delivering them to the respondents. The tax auditors were stationed in the same office block as the researcher so it was easy to administer the questionnaire. All questionnaires to the taxpayer were also hand delivered by the researcher personally as the four firms are Blantyre based and the fifth taxpayer was based in Lilongwe.

### ***3.3.3.1 Desk surveys***

One tool used for data collection is desk survey. The survey has involved extracting on line literature using search engines such as Google scholar, science direct and Sci-hub. In addition, data has also been collected from internal MRA reports such as tax audit reports, compliance

reports, revenue collection reports and other automatically generated information systems reports from SAS. On top of this, financial statements and tax remittance reports from the five large taxpayers were also studied.

The desk surveys have been done to gather specific data on; type of taxes registered for, number of audits conducted, hard copies of tax returns, amount of additional taxes quantified if any), tax anomalies / queries identified and amount of tax liabilities (if any) out of audits.

### **3.4 Data collection**

#### **3.4.1 Sources of data**

Secondary data has been obtained from the questionnaires, physical individual taxpayer files as well as the TACS and SAS tax systems currently being used by the Domestic Taxes division. Data collected from the various respondents also encompasses socio – economic characteristics of large taxpayers, compliance costs and constraints associated with tax auditing and compliance in the study area.

The study had to use secondary data as this data just like primary data sources are important in research because the sources provide valid and reliable information, which strengthens study findings. To back this data source choice, Churchill (1995) indicates that the main advantage of secondary data is that it saves administrative time and costs. Another advantage is that secondary data may be less biased than perceptions and opinions (Kane, 1991). Secondary data also provides a source of data, which is both permanent and available in a form that can be easily checked and verified by others (Denscombe, 1998). Some data for this research was collected from books, journals, previous studies and also from websites.

### **3.5 Data analysis**

Statistical Package (SPSS) and Microsoft Excel: Content analysis has been used to analyse open-ended questions used to reveal intents, motivations and behaviour of people in the sample. Content analysis is a technique for gathering and analysing the content of text. The content can be words, phrases, sentences, paragraphs, pictures, symbols or ideas. It can be done

quantitatively as well as qualitatively, and computer programs can be used to assist the researcher (Miles & Huberman, 1994).

### **3.6 Research ethics**

There are four overarching ethical requirements for researchers: reliability, validity, honesty and confidentiality (Brynard & Hanekom, 1999). Reliability is the degree to which an assessment tool produces stable and consistent results. Validity is an indication of how sound a research is. Validity applies to both the design and research methodology. Confidentiality on the other hand is guaranteeing anonymity or secrecy on a respondent's identity and information while honesty is the ability to tell the truth about research findings and avoiding cheating. All these requirements were observed strictly during the research. Prospective research participants must be fully informed about the procedures and risks involved in research and must give their consent to participate (Trochim, 2006). In this case, the respondents were informed of the academic objectives of the study in advance and were assured of confidentiality. For the same reason of observing privacy, the respondents were not forced to disclose their names on the questionnaires. The questionnaires and the interviews were straight to the point to avoid wasting respondents' time.

### **3.7 Chapter summary**

This chapter discusses the research methodology that has been used in this study, the study design, sampling technique used, the data collection tools, the data analysis techniques as well as the research ethics.

## **CHAPTER 4**

### **RESULTS AND DISCUSSIONS**

#### **4.1 Introduction**

This chapter presents the findings of the study and a discussion of results of the study that investigates the effectiveness of an integrated tax audit approach for large taxpayers (the brewery industry in Malawi).

The researcher used the Statistical Package for Social Sciences (SPSS) to analyse the quantitative data. The qualitative data were analysed using content analysis which is defined as a systematic, replicable technique for compressing many words of text into fewer content categories based on explicit rules of coding (Weber, 1990).

The study highlighted factors that were conceptualized in line with the research questions. The measurable factors that indicated the effectiveness of the integrated tax audit approach are; timely payment of taxes due and tax arrears arising from audits, correct and timely return filing and reduced number of audit queries and objections by the large taxpayers.

#### **4.2 Tax compliance factors of an effective integrated tax audit**

Tax administrations including MRA operate in a dynamic and complex environment where the PESTEL framework is active. There are political, economic, social, technological, environmental and legal factors that may affect the core objectives for which the revenue authority exists include the effectiveness of the integrated tax audit system.

The political environment in Malawi has some influence on the compliance level of the taxpayers in different segments and sectors of the economy. These factors may include foreign trade policy, tax policy, government policy and political stability. On the other hand, economic factors have a significant impact on how an organisation does business and also how profitable they are. The factors such as economic growth, interest rates, exchange rates, inflation, disposable income of consumers and businesses play a major role in behaviour of taxpayers.

The socio economic also known as socio-cultural factors are the areas that involve the shared belief in tax and attitudes of the taxpayer population. These factors include – population growth, age distribution, tax consciousness.

The technological landscape is changing fast and this has not spared the tax administration. These changes have affected the modes of paying taxes, tax data management and many other ways. Tax compliance will be affected by such changes.

The other factor to take into consideration is the environment. These factors have become important due to the increasing scarcity of raw materials, policies about pollution, doing business as an ethical. Tax compliance and behaviour can be affected by this.

It is very clear that taxpayers abide to various Malawi tax laws including the tax laws that hinge on tax auditing. The very existence of the tax legislation has a deterrent effect on non-compliance.

The effects of PESTEL factors cannot be undermined in determining taxpayer behavioural patterns including how they react to the tax audit system.

#### **4.2.1 Frequency of audit objections and appeals**

Respondents (taxpayers) were asked in the questionnaire about the level of satisfaction of the audit findings which came out of the various audits conducted before and after the inception of the integrated tax audit system. This was in line with the audit performance indicator that the number of objections and appeals reveals effectiveness of the integrated tax audit system through the quality of audit and level of satisfaction of the audit findings by the taxpayer.

A total of nineteen (19) tax audits were conducted on Carlsberg Malawi, Chibuku Breweries, Malawi Distilleries, Bowler Beverages and Shine Beverages five years before the introduction of the integrated tax audit system. An aggregate of ten objections were raised (Carlsberg – 2, Malawi Distilleries – 2, Chibuku – 2, Bowler – 3 and Shine -1) as well as six appeals (Carlsberg – 1, Malawi Distilleries – 1, Chibuku – 1, Bowler – 2 and Shine -1) were lodged on the same audits

after the objections were quashed by the Revenue Authority. The results meant that 53% of the audits conducted had objections and 32% of the same audits went up to the appeals stage.

The increase in the number of objections and appeals is an indication that taxpayers were not satisfied with the outcome of the audit findings. This number of objections is a clear indicator of the quality of audit and audit approach deployed during the nineteen audits.

In order to measure the effectiveness of the integrated tax audit system on appeals and objections, the study also investigated the tax audits conducted after the introduction of the integrated tax audit approach. The eleven audits conducted on Carlsberg Malawi, Chibuku Breweries, Malawi Distilleries, Bowler Beverages and Shine Beverages led to two objections (by Carlsberg and Malawi Distilleries) and one appeal (by Chibuku Breweries) case arose. This represents that 18% of the audits had objections and the appeal lodged represents 9% of all audits executed.

The results showed that audits conducted after the introduction of the integrated tax audit approach saw a reduction in objections and appeal cases. This reduction in number of objections and appeals is a clear indication of improvement in audit quality as well as audit approach.

#### **4.2.2 Timeliness of tax payments**

A question was put to respondents to investigate if the introduction of the integrated tax audit system had an influence on the timeliness of the tax payment obligations.

The results of the study showed that there were Value Added Tax and Income tax payments for Carlsberg Malawi, Chibuku Breweries, Malawi Distilleries, Bowler Beverages and Shine Beverages that were used to check the timeliness of tax payments. For the period (2004 to 2007) and (2009 to 2013) which are pre and post integrated tax audits respectively, there was an aggregated total of two hundred different tax payments in each period under study for Carlsberg Malawi, Chibuku Breweries, Malawi Distilleries, Bowler Beverages and Shine Beverages.

The pre- integrated tax audit system period showed that there were an aggregate twelve (12) late VAT payments for Carlsberg Malawi, Chibuku Breweries, Malawi Distilleries (1), Bowler



Beverages (5) and Shine Beverages (6). This represented a 20% late payment rate out of sixty (60) VAT payments. There was also an aggregate of twenty – two (22) late payments out of 140 income tax payments made in total by Carlsberg Malawi (1), Chibuku Breweries (1), Malawi Distilleries (3), Bowler Beverages (6) and Shine Beverages (11). This represented a 16% late income tax payments rate.

After the introduction of integrated tax audit system, the study sampled a total of 200 tax payments from Carlsberg Malawi, Chibuku Breweries, Malawi Distilleries, Bowler Beverages and Shine Beverages. The results showed that there were two late VAT payments by Bowler Beverage and Shine Beverage against a total of sixty (60). This represents a 3% late payment rate. There were also five late income tax payments (Malawi Distilleries- 1, Bowler Beverages – 3 and Shine Beverages – 1) out of the total 140 payments made. This represented a 4% late payment rate.

These results therefore showed significant improvement in timely tax payments for Carlsberg Malawi, Chibuku Breweries, Malawi Distilleries, Bowler Beverages and Shine Beverages significantly dropped in the post- tax integrated audit system (VAT from 20% to 3% and Income tax from 16% to 4%) The reduction in late tax payment shows the effectiveness of the integrated tax audit system.

#### **4.2.3 Timeliness of tax debt payment**

In the study, another question was posed to the taxpayers to find out if tax compliance (in this case timeliness of payment of tax debts) had been affected positively or negatively by the integrated tax audits.

Tax audits generate tax debts. As such the study also looked at the way the tax arrears for the brewing industry were being paid to the tax authority.

The data shows that seven (7) tax assessments that created debts were raised from the nineteen (19) audits executed at Carlsberg Malawi, Chibuku Breweries, Malawi Distilleries, Bowler Beverages and Shine Beverages before the roll out of the integrated tax audit approach were paid

on time. This translates to a 37% tax debt payment compliance rate. On the other hand, out of the six audits conducted (that raised six different tax debts), five tax debts were paid on time except one by Shine Beverages. This translates into 83% compliance rate in terms of tax arrears for Carlsberg Malawi, Chibuku Breweries, Malawi Distilleries, Bowler Beverages and Shine Beverages.

The results showed that the debt payment rate significantly improved after the integrated tax audit system was introduced. The increase in debt payment rate meant that the large taxpayers in the study were satisfied with audit findings, the penalties attached to the audits are willingly paid.

#### **4.2.4 Correctness and timeliness of tax return filing**

The respondents (taxpayers) were also asked if their filing compliance (correctness of the tax returns and timely filing of the tax returns) had in any way been enhanced or reduced with the introduction of the integrated tax audit system.

As audits are known to have a deterrent effect, tax filing (in terms of correctness and timeliness) is one element that was investigated to measure the effectiveness of integrated tax audit. The study showed that there were 186 and 197 correct tax returns in the pre and post integrated tax audit period. The record also showed that there were 166 returns filed on time in the pre integrated tax audit period against 193 in the post integrated tax audit period. There were differences in the rate of return correctness and timely returns filed between the pre and post- tax integrated audit system by Carlsberg Malawi, Chibuku Breweries, Malawi Distilleries, Bowler Beverages and Shine Beverages. The number of correct and timely returns increased by 6% and 14% respectively for Carlsberg Malawi, Chibuku Breweries, Malawi Distilleries, Bowler Beverages and Shine Beverages after the introduction of the integrated tax audit system.

In addition, there were also other factors that impacted on the effectiveness of the integrated tax audit approach and these are; usefulness of the audit tool by auditors and taxpayers; ease of execution of this approach; conformity to existing MRA business processes by auditors; cost of

doing business (compliance); reliability of the audit approach. The respondents expressed and highlighted their points of view on all the variables and analyses made.

### **4.3 Components determining an effective integrated tax audit**

#### **4.3.1 Usefulness of the integrated tax audit system**

Auditors and taxpayers were investigated on how useful the integrated tax auditing system is when planning, executing and working with tax officials on tax audits. The usefulness of the system meant that the system was aiding in verifying tax issues from various tax types from a single window and helping completion of the audits faster, and reduces cases of objections and appeals.

Ninety six (96%) of the tax auditors responded that the integrated audit system has proved effective since its adoption. The case was the same with the taxpayers where 80% demonstrated the effectiveness of the integrated audit system (in terms of reducing cost of compliance through shortened audit time cycles, reduced audit queries / objections and appeals and simplified audit handling in liaison with the tax auditors) The results showed that an audit system is considered useful if it reduces cost of operations.

#### **4.3.2 Ease of use of the integrated tax audit system**

Respondents were also asked if the system was easy to use. On the perception of ease of use, 80% of the tax auditors showed that the integrated tax audit system was easy to use. The effectiveness of the system was demonstrated by the facts that the audit planning cycle is simplified, the audit time cycle was shortened as the audit looks at more than one tax type.

All five taxpayers (Carlsberg Malawi, Chibuku Breweries, Malawi Distilleries, Bowler Beverages and Shine Beverages) acknowledged that the easiness of use of this audit approach. The respondents indicated that once MRA dispatches letter of audit appointment, the audit usually covers more than one tax type thereby reducing the time the taxpayers will be audited. This approach also allows the tax representatives to easily and swiftly prepare documentation for the auditors to verify. This spares the taxpayers time to concentrate on their core business. This showed that, when an innovation is easy to use, it works out to be effective.

### **4.3.3 Compatibility of the integrated tax audit system**

Both tax auditors and taxpayers' representatives were asked if the compatibility of the system made it effective through realization of effective audits, reduced cost of collection and compliance.

Results of the study show that ninety – two (92) % of the tax auditors responded that the effectiveness of the integrated tax audit system was considered with its compability with the existing audit processes and procedures and the general Domestic taxes division business environment. The audit system did not require a great deal of business process re-engineering. Notably, 80% of the large taxpayers indicated that the audit system was effective in the sense that it did not require an overhaul of the way they do business. It was just the few changes to the procedures that were redesigned. This meant no or little cost attached to the changes.

### **4.3.5 Reliability of integrated tax audit system**

In the study, the respondents were asked if the reliability of the audit system meant that it was effective. The areas of focus in determining effectiveness included systems security, privacy and confidentiality issues. In the study, 92% of tax auditors found the system effective due to its reliability on taxpayer data security and privacy approach while the remainder saw the system not reliable hence not very effective. On the other hand, 80% of the taxpayers replied that the integrated tax audit system was effective as it protected their position on tax matters after the tax audits. Gaining the confidence of customers (taxpayers in this case) is of paramount importance to revenue administrations and if not well managed could discourage potential users (taxpayers). User trust, privacy and security cannot be overemphasized to ensure confidence in the auditing systems provided by the revenue authority.

### **4.3.7 Cost of the integrated tax audit system**

Introduction of a new product, system or process is is always associated with cost. In the questionnaires, the respondents were asked if the audit system was effective using the cost attached as a measure of effectiveness. Cost effectiveness is an expected outcome for every corporate, profit or non – profit oriented.

The results show that only one tax auditor representing 4% responded that the audit system was not effective in terms of cost. The 24 tax auditors representing 96% responded by indicating that the integrated tax audit system was effective as the cost of doing business was minimized. The cost of business looked at elements such as time spent to plan audits, execute the actual audit and time spent to attend to objections and appeals audit. On the other hand, 80% of the taxpayers responded that the audit system was effective. The justification of their response was that the adoption did not require systems overhaul hence no cost; the time taken to attend to auditors had drastically reduced as this approach usually looks at more than one tax type audit and the time taken to raise objections and appeals with MRA had reduced.

In relation to the various literature reviewed in Chapter 2, the results of the study therefore indicate that the robust tax audit programme such as the integrated tax audit influenced tax compliance in form of the frequencies of correct and timely filing of tax returns, honouring of tax arrears, correct payments of taxes. The results of the study further showed that the integrated tax audit system was effective.

#### **4.4 Chapter summary**

This chapter presented data analysis and discussion of findings. All the respondents (tax auditors and taxpayers / taxpayer representatives) were aged above 25 years.

This chapter looks at parameters for measuring the effectiveness of the integrated tax audit system. Among other factors, the effectiveness of a tax audit system can be measured by; trends of total amount of tax payments; trends in tax debts payments; trends in timeliness of return filing and correctness of the filed returns; number of objections and appeals.

The study also identified components that determine and represent the effectiveness of integrated tax audit for brewery firms in Malawi. The factors were; usefulness of the system, ease of use of the system, compatibility of the system, system reliability and cost of the system.

From the overall findings, the assessed factors showed the effectiveness of the integrated tax audit system.

## **CHAPTER 5**

### **CONCLUSIONS AND RECOMMENDATIONS**

#### **5.1 Introduction**

This chapter presents a conclusion on the major findings of the study and make recommendations drawn from the study in relation to the factors that influence the effectiveness of integrated audit system. The two specific research objectives were to determine the effectiveness of integrated tax audit system in Malawi.

#### **5.2. Conclusion**

From the results of this study, a conclusion can be drawn that an assessment of the effectiveness of the integrated tax audit system was done and that the system's effectiveness can be proved by the trends in frequencies of the various tax obligations before and after the system was rolled out. Changes were noted in timeliness of tax payments, timeliness of tax arrears payments, correctness of tax returns, timeliness of tax return filing and number of audit objections and appeals lodged. Furthermore, the respondents alluded to the effectiveness of the system by pointing out factors that determine so. The factors pointed out included the easiness of using the audit approach, reliability of the audit system, how the system is compatible to existing procedures, cost of the system and how useful the system is to end users (tax auditors and taxpayers).

In a nutshell, the findings of the study indicate that the integrated tax audit system has a positive effect on tax compliance among the large taxpayers in the brewing industry.

The tax payments results show that the number of on time late tax payments significantly dropped in the post- tax integrated audit system.

The results of the study also show that after the introduction of the new audit approach, the taxpayers complied and paid the audit assessments (principal and penalties) on time. One reason would be that the taxpayers had no objections to the audit anomalies found during the audit. The willingness to pay the tax debts can be attributed to the fact that the audits findings and the audit approach were satisfactory to the taxpayers.

The study further reveals that there were lesser objections and appeals after the introduction of the integrated tax audit system than before the system was deployed. This is an indication that taxpayers were now more satisfied with the outcome of the audit findings as a result of high quality audits.

Extent of correctness of a tax return and time of filing are one of the key indicators of tax compliance level. The results of this study suggest that the extent of correctness of a return and the on time filing improved after 2007 (the year the integrated tax audit system commenced). This can be partly tied to the impact the audit approach has had on tax compliance.

The findings of the study further indicate that tax auditors observed that the integrated tax audit system does not have a significant cost to tax administration. The tax auditors were very confident that the system resulted in reduced cost of collection through more audit coverage, reduced time to complete audit cases and less audit queries and objections.

On the other hand, the findings of the study indicates that the taxpayers see the tax audit system as effective through the reduced cost of compliance (reduced time taken to attend to tax auditors and reduced audit queries and objections).

Further findings of the study reveal that many tax auditors and taxpayers find the integrated tax audit system effective as it is easy to use. It is believed that a user will deem effective an innovation or a particular system if it is easy to learn and use.

Compatibility is a determinant of behavioral intention to use any system. The results of this study show that compatibility of the system was taken as showing effectiveness of the audit system. The majority of the tax auditors realized that the system will fit in easily to the business processes.

Any useful product or system is an effective product. The study results revealed that both tax auditors and taxpayers accepted that the system was effective taking into consideration the usefulness of the integrated tax audit system before adopting it.

### **5.3 Recommendations**

Recommendations are being put across basing on the conclusions made and the results obtained from this study.

As the results indicate, tax audits have a deterrent effect that in the long run will enhance compliance. Despite having an effective audit system, the audit coverage is less than 2% of the taxpayer population meaning the huge chunk of taxpayers will go unaudited for ages. In view of this, there is need for improved taxpayer service delivery through the Customer Relationship Management (CRM). This will reach out to more taxpayer thereby further enhancing voluntary compliance from the majority of taxpayers.

The Malawi Revenue Authority should further embark on automation of its systems and procedures. The automation should however be reliable and credible. It has been learnt from the study that simplification of processes and procedures yield positive results in form of compliance. Taxpayers will easily comply with processes and procedures that have been simplified as the integrated tax audit system.

The spirit of taxpayers voluntarily declaring anomalies made in their business transactions should be promoted without waiting for tax audits. This will speed up time taken to close audit cases as well as reduce objections and appeals. The units responsible for taxpayer education including the audit section should work on encouraging voluntary disclosure and winning the confidence of taxpayers that they will not be penalised if such a disclosure is made.

However, the results should be read with caution due to the following limitations of the study:



The first limitation is that due to the fact that taxation is a sensitive subject, respondents (in this case the taxpayers) become sceptical about the study. The respondents may not respond openly for fear of repercussions. The data collection method of questionnaire would therefore jeopardise the results.

The other limitation was the sampling technique and sample size as the study only targeted one segment of the taxpayer population as well as only one industry. There are several industries as well as several tax segments. Results of other segments and industries could be different.

The fact that data collection was only for taxpayers in Blantyre and Lilongwe is also a limitation. There are sixteen tax offices in Malawi. The other areas would have different results.

The study's focus on taxpayers operating domestic taxes only was seen as another limitation. Examination of other levies and duties would have given a different result.

#### **5.4 Areas for further research**

This study set out to identify and analyse factors that determine the effectiveness on an integrated tax audit approach among large taxpayers. In the future, a similar study should be conducted to study the effectiveness of integrated tax audit among the medium and small taxpayers in Malawi.

#### **5.5 Chapter summary**

This research set out to investigate the factors that influence the effectiveness of the integrated tax audit approach in Malawi. The study has conclusively confirmed that the integrated audit approach has been effective to the Authority as well as to the taxpayers.

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## APPENDICES

### Appendix 1: Questionnaire for tax auditor

#### STRUCTURED QUESTIONNAIRE

on

#### **The Impact of An Integrated Tax Audit Administration as an Investigative / Compliance tool (The Case of Large Taxpayers in the Brewery Industry)**

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*You have been sampled from the Malawi Revenue Authority's large taxpayers' office pool of auditors. You are requested to participate in the study by responding to the questionnaire. This study is being conducted as part of an MBA Research to be submitted to the University of Malawi in partial fulfilment of the requirements for the award of the Master's Degree of Business Administration (MBA)*

*The general aim of this survey is to establish whether or not an integrated tax audit administration has an impact as an investigative / compliance tool. This is the case of large taxpayers in Malawi. This is specifically and taking into cognisance of the Brewery Industry in Malawi.*

---

**NB:** This questionnaire, though you have to fill it voluntarily, is an important research instrument for the study that I am currently conducting. Please try to respond to all questions/statements that have been formulated. For anonymity, please do not write your name or any of your identities on this paper. Note that your responses will strictly be confidential and will only be used for the purposes of this study and any publications that may arise.

**SECTION A: GENERAL PERSONAL INFORMATION**

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1. Name of Respondent (OPTIONAL)

\_\_\_\_\_.

2. Position of Respondent in the Organisation

\_\_\_\_\_

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**SECTION B: INTEGRATED TAX AUDIT SYSTEM**

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1. As a tax auditor, are you aware of all the processes and procedures involving the integrated tax audit system?

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

2 How do you perceive the integrated tax audit system. Is it useful to the Revenue Authority?

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

3. What is your perception of the integrated tax audit system in terms of easiness to use?

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

4. In your opinion, is the integrated tax audit system compatible to existing tax administration in general and audit processes in particular?

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5. What is your perception of the credibility of the integrated tax audit system?

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6. What do you think are the associated rewards of the integrated tax audit system to the Revenue Authority.

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7. Do you think the introduction of integrated tax audit system have enhanced tax compliance in the brewing industry? State reasons for your answer

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**Thank you very much for completing the questionnaire**

Send the same to:

Kondwani Sauti -Phiri,

Private Bag 247, BLANTYRE,

Cell: **0888 400 161 / 0999 936 606**

E-mail: [ksautiphiri@mra.mw](mailto:ksautiphiri@mra.mw)

[ksautiphiri@yahoo.com](mailto:ksautiphiri@yahoo.com)

**Appendix 2: Questionnaire for taxpayer**

## STRUCTURED QUESTIONNAIRE

on

### **The Impact of An Integrated Tax Audit Administration as an Investigative / Compliance tool (The Case of Large Taxpayers in the Brewery Industry)**

---

*Your organisation has been sampled from the Malawi Revenue Authority's large taxpayers' database. You are requested to participate in the study by responding to the questionnaire. This study is being conducted as part of an MBA Research to be submitted to the University of Malawi in partial fulfilment of the requirements for the award of the Master's Degree of Business Administration (MBA)*

*The general aim of this survey is to establish whether or not an integrated tax audit administration has an impact as an investigative / compliance tool. This is the case of large taxpayers in Malawi. This is specifically and taking into cognisance of the Brewery Industry in Malawi.*

---

**NB:** This questionnaire, though you have to fill it voluntarily, is an important research instrument for the study that I am currently conducting. Please try to respond to all questions/statements that have been formulated. For anonymity, please do not write your name or any of your identities on this paper. Note that your responses will strictly be confidential and will only be used for the purposes of this study and any publications that may arise.

### **SECTION A: GENERAL ORGANISATIONAL INFORMATION**

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3. Name of organisation / tax representative (OPTIONAL)

\_\_\_\_\_.

4. Position of Respondent in the Organisation \_\_\_\_\_

.

5. Type of Business. (Please circle)

a. Limited

b. Partnership

c. Sole Trader

d. Other

**6. Indicate total number of employees for your organisation (Please circle)**

a. Less than 100

b. From 101-500

c. From 501-1000

d. Over 1000

**7. Type of Accounting System (Please circle)**

a. Automated

b. Manual

c. Both

**8. Type of Taxes operating (Please circle)**

a. Corporate

b. PAYE

c. Withholding Tax

d. VAT

e. Fringe Benefit Tax

f. Other

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**SECTION B: INTEGRATED TAX AUDIT SYSTEM**

1. Are you aware of all the processes / procedures involving with the integrated tax audit system.

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2. How do you perceive the usefulness of the integrated tax audit system?

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3. What is your perception about the integrated tax audit system? Is it easy to use or adopt?

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4. Has the introduction of integrated tax audit administration reduced cost of compliance (what percentage? if any) and reduced time taken to conduct tax audits by tax official?

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5. In your opinion, is the integrated tax audit system compatible to the way you do business in of your organisation?

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6. In your opinion, how credible is the integrated tax audit system?

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7. What do you think are the associated rewards of the integrated tax audit system to your organisation.

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8. Has the adoption of the integrated tax audit system improved your tax compliance in terms of

(a) correctness of the tax return? Yes / No

(b) timeliness of tax return filing? Yes / No

9. Has the adoption of the integrated tax audit system improved your tax compliance in terms of;

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(a) payment of tax in time? State the reason if YES or NO

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10. Has the adoption of the integrated tax audit system improved your tax compliance in terms of;

(a) payment of tax debts in time? State the reason if YES or NO

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11. Have the audit findings been satisfactory? Any Objections and / appeal? State the reason if YES or NO

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Thank you very much for completing the questionnaire

Forward the same to:

Kondwani Sauti -Phiri,

Private Bag 247, BLANTYRE,

**Cell: 0888 400 161 / 0999 936 606**

**E-mail: [ksautiphiri@mra.mw](mailto:ksautiphiri@mra.mw)**

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