

**AN ASSESSMENT OF THE IMPACT OF THE VAT AND REVENUE  
COLLECTION ON GDP: THE CASE OF ZANZIBAR REVENUE BOARD**

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REQUIREMENTS FOR THE DEGREE OF MASTER OF BUSINESS  
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**2015**

**CERTIFICATION**

The undersigned certifies that he has read and hereby recommend for acceptance by the Open University of Tanzania (OUT), a dissertation entitled, **An assessment of the Impact of the VAT and Revenue Collection on GDP: The Case of Zanzibar Revenue Board**, in partial fulfillment of the requirements for the degree of the Master of Business Administration (MBA-Finance) of the Open University of Tanzania.

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**DEDICATION**

This work is dedicated to my family and all those who truly care for me for their efforts, understanding and encouragement. Their support has led the successful accomplishment of my study.

## **ACKNOWLEDGEMENT**

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## ABSTRACT

This research work studied the assessment of the impact of the VAT and revenue collection on GDP -ZRB. It attempted to examine the contribution of VAT on revenue collection in ZRB, the extent to which VAT has contributed to the steady growth in Gross Domestic Product in Zanzibar and also assessed the challenges of revenue Collection in ZRB. To attain that above, VAT inflows, revenue collection and GDP data from 2002 to 2012 are collected from public publications which are stored both in hard copy and softy copy and 20 questionnaires were distributed and administered effectively. For this study data and information base, was built from both primary which was obtained from interviewing 20 respondents of ZRBs' staff, and secondary sources which was obtained from annually report on economic growth, publication from economic survey published by Government of Zanzibar and National Bureau of Statistics (NBS) data sources were consulted. The study employed the Ordinary least Square method to analyze the contribution of VAT on revenue collection in ZRB and the extent to which VAT has contributed to the steady growth in Zanzibar economy. Also used SPSS to analyze the challenges facing ZRBs' staff on revenue Collection. The result of the study revealed that value added tax is beneficial to the Zanzibar economy. The behavior shows that value added tax is statistically significant to revenue generated by ZRB in Zanzibar. From the findings, for Zanzibar to attain its economic growth and development, she must be able to generate enough revenue meet up with the challenges of her expenditures in term of provision of social facilities and the running costs of the Government.

**Key words:** GDP, VAT, Revenue Zanzibar

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**LIST OF ABBREVIATIONS**

BOT	Bank of Tanzania
CIT	Corporate Income Tax
DC	Deputy Commissioner
DRD	Domestic Revenue Department
EAC	East Africa community
EPZ	Export Processing Zone
FDI	Foreign Direct Investment
GURT	Government of United Republic of Tanzania
GDP	Gross Domestic Product
ICT	Information, Communication and Technology
IMF	International Monetary Fund
ITD	International Tax Dialogue
LGAs	Local Government Authorities
PAYE	Pay As You Earn
PIT	Personal Income Tax
RGZ	Revolutionary Government of Zanzibar
OECD	Organization of European Cooperation Development
SADC	Southern African Development community
SDL	Skill Development Levy
SME	Small and Medium Enterprises
SSA	Sub-Sahara Africa
TAPA	Tax Administration Procedure Act



TIC	Tanzania Investment Centre
TRA	Tanzania Revenue Authority
URT	United Republic of Tanzania
USA	United States of America
VAT	Value Added Tax
ZIPA	Zanzibar Investment Promotion Act
ZRB	Zanzibar Revenue Board

## **CHAPTER ONE**

### **INTRODUCTION**

#### **1.1 Back ground of the Study**

All civilized countries need to collect taxes for several reasons, such as to finance developmental activities, to meet their day-to-day expenses related to maintenance of a free and fair society, to control the economy through fiscal measures, and to a certain extent, to change the economic behavior of people. This authority of national governments to collect monies from taxpayers must recognize a balance between the nations' authority to tax and taxpayers' rights.

Thus, the real challenge for nations is to ensure that taxpayers are treated with fairness, justice, and equity, while national governments assert their jurisdiction as taxing authorities. Ideally this tax collection can be analogized to the extraction of honey from the abode of honeybees where honey bees are not disturbed and careful extraction of the honey results in a circular process where more honey is deposited by honeybees giving better opportunity to the extractor to get the honey in perpetuity.

A sound tax system should identify surpluses in the economy and should tax it in such a fashion as to cause minimal damage to productive activity. Tax collection should act as a catalyst for economic growth. Ideally a tax system should be neutral with respect to its effect on economic behavior. In the real world, however, it is impossible to achieve neutrality. Administrative feasibility and practicability are two important constraints on tax policy. These are also matters of convenience to varying

degrees. A tax policy is administratively feasible when its enforcement does not cost too much. At the same time administrative feasibility should not be an excuse to compromise the original objective. Further, a tax structure should treat equally those individuals who are approximately in the same situation and account for differences among people who are in dissimilar situations. Finally, every tax should be collected at the time or in the manner in which it is the most convenient for the contributor to pay it, and every tax should be so contrived as both to take out and keep out of the pockets of people as little as possible over and above what it brings to the public treasury David G. Davies, *United States Taxes and Tax Policy*, 17-19 (1986).

Sneed, commenting on American tax policy, has suggested that while designing a tax system, the government must answer certain questions<sup>3</sup>. Does the tax base consist of stable and easily identifiable features of the social and economic order? Does the tax system cause substantial distortion of the base? Does allocation of the tax burden reflect the political, social, and ethical aspirations of dominant groups? Finally, does the tax system try to achieve some or all of the following purposes?

- (i) To supply adequate revenue,
- (ii) To achieve a practical and workable tax system,
- (iii) To establish horizontal and vertical equity,
- (iv) To achieve economic stability,
- (v) To reduce economic inequality,
- (vi) To avoid impairment of the market-oriented economy, and
- (vii) To accomplish a high degree of harmony between the tax and the intended political order?

By and large, taxpayers of all countries do not want to pay taxes unless:

Compelled by a situation where they are left with no option other than to pay the taxes. Therefore, for better tax compliance, a system should be designed that automatically extracts taxes rather than leaves the payment of taxes to the voluntary choice and morality of taxpayers. Penal provisions making tax evasion a costly affair should supplement this automatic extraction of taxes.

The tax administrators of developing countries face many challenges in the massive task of tax collection. Nevertheless the problem of tax evasion bothers tax administrators of developing countries and developed countries alike. In the real world, those who wish to reduce their tax liability have more choices than just tax evasion. Smarter and more sophisticated taxpayers, who find the cost/risk of evasion greater than the benefit, practice risk free legal ways of non-payment of taxes rather than blatant tax evasion, which is popularly known as tax avoidance.

In many countries, there are perfectly legal tax avoidance strategies for minimizing tax liabilities. For the government, the results of tax evasion and tax avoidance are the same; for the taxpayer, however, tax avoidance is preferable because there are less or no chances of getting caught and prosecuted. It is also believed that relatively less wealthy and consequently less well-advised people engage in tax evasion whereas relatively wealthier and better-advised people practice tax avoidance.

Therefore, the loss to government revenue on account of tax avoidance is much greater compared to tax evasion. For effective revenue collection, governments need to curb not only the tax evasion but also the tax avoidance. The tax collection system

should be designed in such a way that not only the tax evasion but also the tax avoidance becomes difficult for the taxpayer.

In December 1991 the Tax Commission, appointed by the Government of Tanzania, offered a proposal for reform of the Tanzanian tax system. The replacement of the current sales tax by a value-added tax (VAT) is the Tax Commission's central recommendation in the domain of indirect taxation (URT, 1991a: chapter 12). With sales and excise taxes on domestic goods and services being the largest single source of tax revenue (Fjeldstad, 1995b), this proposal implies that VAT is regarded as the mainstay of Tanzania's future revenue system.

The Government announced in the 1992 (June) Budget Speech its intention to introduce VAT in January 1994. To this day, however, little progress has been made in this area. It is not entirely clear how the introduction of a value-added tax became an issue in the Tax Commission's report. It appears that the Government and its representatives in the Commission were committed to the introduction of VAT, apparently with the argument that a VAT would contribute to an over-all increase in tax revenue for the state. Basu and Morrissey (1993) report that it is "clear that the International Monetary Fund (IMF) to some degree supported, if they did not actually initiate, this policy objective". Although several members of the Commission were opposed to introducing a VAT, largely because it was seen as administratively difficult to implement and no obvious improvement of the existing system, these reservations were not explicitly expressed in the report.

Value Added Tax is seen as a major source of economic efficiency gains in Revenue Collection as a substitute for trade tax on final consumption goods, VAT will therefore have significant impact on effectiveness to raise revenue, VAT may well struggle to replace foregone revenue (Crahan Glendday, 2005). Expanding scope of VAT shall be charged on any supply of goods or services in mainland Tanzania where taxable supply made by a taxable in the course of any business carried on by him. The importation of taxable goods or services from any place outside Tanzania shall be charged VAT and procedures applicable under Custom laws for imported goods shall apply in respect of VAT on import. VAT ignored area for performance measure in citizen at least developed countries; therefore the study will assess the contribution of the VAT on revenue collection in Zanzibar Revenue board.

### **1.1.1 Establishment and Mandates of the Tax Administration Bodies**

Tax System under the current set up in Zanzibar consists of three administrative organs namely the Tanzania Revenue Authority (TRA), Zanzibar Revenue Board (ZRB) and Municipal and District Councils (sometimes referred as Local Governments Tax Administration). According to the Act No. 11 of 1995 passed by the Union Parliament; TRA was established to serve as a central body for the assessment and collection of specified revenue, to administer and enforce the laws relating to such revenue and to provide for related matters for the Union taxes in the URT. Thus in that regard, TRA in Zanzibar deals with Union taxes as stipulated in the First Schedule of the URT Constitution<sup>1</sup>.

Essentially TRA administers Central Government taxes in Mainland as well as Union taxes in Zanzibar. ZRB that was established under the ZRB Act No. 7 of 1996 is

responsible for administering revenue collection from inland resources other than customs, excise and income taxes on behalf of the Government of Zanzibar. While TRA became operational in July 1996, ZRB became operational two years later (in July 1998). Municipal, Town and District Councils classified as Local Governments Authority in Zanzibar has empowered to collect local taxes by the House of the Representatives through the Zanzibar Municipal Council Act, No 3 of 1995 and Districts and Towns Councils Act, No 4 of 1995.

### **1.1.2 Taxes Administered by the Tax Administration Bodies**

Zanzibar, as noted above, has a three tier tax system whose tax authorities operate independently as per their legislative jurisdictions governing their main function of revenue mobilization. Although these tax authorities operate independently but their base for taxation purposes is the same, implying the existence of competition in the course of revenue collection.

### **1.1.3 Taxes Administered by TRA**

The taxes administered by TRA in Zanzibar are those that fall under Union Matters as stipulated in the First Schedule of the URT Constitution. The TRA has been given mandate to collect and account these taxes on behalf of the Revolutionary Government of Zanzibar (RGZ) and remit the same to the Government through Bank of Tanzania (BOT), Zanzibar Branch. TRA performs this function through its offices in Unguja and Pemba. The main office for TRA in Zanzibar is based in Unguja Island under the leadership of the Deputy Commissioner (DC). The DC is assisted by Managers in the Customs and Excise Department and Domestic Revenue Department (DRD) in Unguja and the Manager In-charge for Pemba. There is also

Tax Investigation unit that works in collaboration with the Revenue departments to fight against malicious practices in the process of revenue mobilization.

Similarly there are sections that render support services to the Authority such as Human Resources and Administration, Finance, Information, Communication and Technology (ICT) and Taxpayers Services and Education. The TRA in Zanzibar administers both direct and indirect taxes falling under the union taxes category. The direct taxes are administered by using Income Act cap 332 which was passed by the Parliament by virtual of Article 138 of the URT Constitution.

The indirect taxes are administered by the East African Customs Management Act, 2004 and Excise duty Tariff Act. The direct taxes include employment taxes (Pay As You Earn (PAYE) and Skills Development Levy (SDL)), Corporate, Individuals and withholding taxes while indirect taxes consists of taxes on international trade such as import duty, Excise and VAT, non tax revenue administered by the Customs and Excise department.

#### **1.1.4 Taxes Administered by the Zanzibar Revenue Board**

The ZRB is responsible for collecting internal revenues on behalf of RGZ. Structurally, ZRB operates under the leadership of a Commissioner who is assisted by deputy Commissioner. For effective execution of its duties and responsibilities, ZRB has been organized into 13 departments in which 6 of them deal with revenue collection either directly or indirectly and the remaining 7 render support services to the organization. These departments are headed by managers. As per the current set up, these departments are tax-type based as opposed to functionally based with one



stop centre where all taxpayer services are rendered for tax payment purposes. As pointed out earlier, ZRB administers and collects inland taxes (non union) from both tax and non-tax sources within Zanzibar Islands. The main taxes collected by ZRB include Value Added Tax (VAT), Excise Duty Local, Hotel Levy, Hotel Levy, Restaurant Levy, Tour Operation Levy, Stamp Duty, Airport Service Charge, Seaport Service Charge, Road Dev. Fund, Petroleum Levy, Fuel Sector Dev. Fund, Road License Fees, Motor Vehicle Registration fees, Driving license fees, Ministry Collections and Parastatal Contributions.

#### 1.1.5 Human resources Status in the ZRB

The status of the human resources adequacy and capacity in the ZRB was based on the report for Capacity Determination of TRA and ZRB in collecting domestic union taxes in Zanzibar in 2010 as shown in Table 1.1.

**Table 2.1 Distribution of ZRB employees by Departments**

Department	Number of Staff		
	Professionals	Non-Professionals	Total
Tax Audit and Investigation	4	2	6
Finance and Accounts	4	3	7
Research Policy and Dev.	2	0	2
Administration	3	24	27
VAT	6	5	11
Internal Audit	2	0	2
ICT	2	5	7
Large Taxpayers Office	11	4	15
Tax Payers Education	2	0	2
Other Taxes	8	11	19
ZRB Pemba Office	9	11	20
Ministries Collections	0	8	8
Legal service Department	3	0	3
<b>Total</b>	<b>56</b>	<b>73</b>	<b>129</b>

Source: Capacity Determination report, (2010)

According to that report, ‘the analysis of the ZRB staff by their college training and current position/rank for each department indicated that about 43 percent of the ZRB employees do not have school training beyond secondary education. Many of them have attended tertiary short term training on tax collection, investigation, auditing, VAT, customer care. It has 42 well-trained and competent senior tax officers constituting about 32 percent of the total staff of the ZRB. The classification of staff on professional basis however indicates that 43.4 percent of the employees are professionals.

#### **1.1.6 Taxes Administered by Municipal, Town and District Councils**

Municipal and Town/District Councils under the Ministry of Local Governments and Regional Administration administer and collect tax revenue for the local systems including trade licenses, crop cess, rents, fees, and fines and penalties within their area of jurisdiction. In particular, the Municipal taxes include levies and charges mainly in the following areas; market locations, trading, commercial advertisement, rents, parking, sewage, environment, construction, bus conductors, etc.

For the case of Town and District councils, the taxes in the form of levies and charges cover mainly in the following areas: Trading licenses, commercial advertisements, town cleaning, construction, transfer ownership (house), vehicle routing, etc. All these taxes are administered and collected by using respective Acts of the LGAs as legal authorities. In most cases, by-laws are used to set tariff rates in the LGAs. One of the lessons from the study of Tax and Management Consultancy Bureau (2008) recommended that there is necessity for simplification and

harmonization of various state and local government laws related to tax, property and business asset ownership as a means to encouraging and facilitating formalization.

## **1.2 Background to the Problem**

Fiscal Policy refers to that part of the government policy measures concerned with the raising of revenue through taxation and other means, and deciding on the level and pattern of expenditure for the purpose of influencing economic activities or attaining some desired economic goals (Anyanwu and Oaikhenan, 1995). In Tanzania, the major Fiscal Policy instrument includes changes in rates of taxes on Personal Income Tax (PIT), Company Income Tax (CIT), Customs & Excise Duties (CET), as well as, Mining rents and Royalties. These taxes along with interest and repayments, licenses, fines and fees constitute government revenue. Such taxes are imposed not only to generate revenue, but also to provide incentives or disincentives in certain specific socio-economic activities.

Value added tax was introduced by Von Siemens in 1951, it was designed in order to solve the financial problem of German Government. Revenue is defined in International Financial Reporting Standards (IFRS) as the gross inflow of economic benefits during the period arising in the course of the ordinary activities of an entity when those inflows result in increases in equity, other than increases relating to contributions from equity participants (IASB, 2012). The VAT is a consumption tax charged on taxable goods and services whenever value is added at each stage of production and at final stage of sale, VAT is charged by business register for VAT only.

As VAT is less distortive, It has been spreading world on to about 130 country adopted (study material view, 10076). VAT is not collected in full from the final seller of the product, the seller deduct from its Vat liability the amount of tax it has paid to other Vat registered business further up chain VAT therefore collected fractionally from different business. (BBC article explain the impact). As assessment of the impact of VAT on revenue collection. In the case of revenue board, VAT refers to the extent to which revenue board collect to provide services for Government obligation since established. Some of the observable measures such as VAT help to secure future revenues reduce the costs of future transactions and reduces costs associated with defective goods and services such as field services and managing complaints (Anderson *et al.*, 2001).

The value-added tax is, according to Goode (1984: 157), "the most important tax innovation of the second half of the twentieth century". The speed with which the value-added-tax system has spread around the world is unmatched by any other tax in modern times. 30 years ago there was no comprehensive V AT anywhere (Shoup, 1990). In Japan, immediately after the Second World War, a short-lived V AT was implemented. In 1954 France introduced a limited V AT in the form of a wholesale-level V AT to replace a multi-stage production tax (Metcalf, 1995: 127). A comprehensive value-added tax first appeared in Brazil in 1967.

This tax was designed to overcome the defects of turnover taxation and to secure a greater degree of tax coordination among the states of the Brazilian Federation (Shoup, 1990: 4). Later in 1967 Denmark became the first country to introduce a comprehensive VAT at the national level. In 1968 France merged the restricted VAT

with the existing turnover tax on services and a local tax on retail sales into a single, comprehensive levy extending through the retail stage. In the following years, the VAT was adopted by the other member states of the European Community to replace their turnover taxes. Sweden, in 1969, and Norway, in 1970, enacted a VAT to replace a retail sales tax.

For today, VAT is found in more than 90 countries. Of the Organization for Economic Co-operation and Development (OECD) countries, only Australia and the US do not use value-added taxes. All Latin American countries now have VAT, as do several of the ex-communist countries of Eastern Europe (e.g., Bulgaria, the Czech Republic, Estonia, Hungary, Poland, Russia and the Slovak Republic). A number of African and Asian countries have introduced or plan to introduce VAT, including Côte d'Ivoire, Indonesia, Kenya, Malawi, Mali, Niger, Senegal and South Korea (IMF, 1992).

### **1.3 Statement of the Problem**

Collection of revenue is not enough unless combined with high respect for taxpayers as a drive towards encouraging them to pay more taxes voluntarily because it is the taxpayer who has the monetary power that can change profits or loss figures in the agency's annual reports (Ambali, 2011) VAT which in turn means collection of revenue increasingly. Zanzibar Revenue Board (ZRB) has largely met its goal of promoting tax compliance through a fair, equitable and transparent application of tax laws. An increasing number of developing countries have converted their sales taxes to value-added taxes (IMF, 1992, OECD, 1995). From an economic point of view, there is, in principle, little difference between VAT and the retail sales tax (RST).

Levied at the same rates and covering the same number of goods and services, both taxes should raise the same amount of revenues increase revenue or to allow lower rates of tax on commodities.

Both consumer services, e.g., restaurants, hotels and theatres, and business services (excluding financial services) can be included in the VAT base. Some concessions must, however, be made for social policy considerations or on administrative grounds. It would, for instance, be difficult to defend and, in the absence of a charge, to administer the taxation of health, education, social and religious services. These public services are exempted in the OECD countries.

A second group of activities often exempted includes (i) financial services, e.g., dealings in money, shares, bonds, lending money, operating bank accounts and advancing credit, (ii) insurance and (iii) gambling. These are usually exempted because of the difficulty of isolating and measuring the service element (Gilis, 1990). Exemption rather than zero-rating are chosen, principally for revenue reasons. Zero-rating would ensure equal taxation of closely-competing businesses in a way that exemption does not. Exemption, however, means that some tax is embodied in the price of the services sold to businesses.

Implementation Completion Report (ICR) is silent on performance of ZRB in this area. The absence of evidence with regard this intermediate outcome indicator affects IEG's assessment. (World Bank-Independent Evaluation Group, 2012). Therefore, this study sought to assess the impact of the VAT and GDP on revenue collection in Zanzibar Revenue Board.

## **1.4 Objectives of the Study**

### **1.4.1 General Objective**

The study sought to assess the impact of the VAT and revenue collection on GDP - ZRB.

### **1.4.2 Specific Objectives**

In order to alleviate the above problems, this study was designed to accomplish the following Specific objectives in attempt to achieve the major objective outlined above:

- (i) To examine the contribution of VAT on revenue collection in ZRB.
- (ii) To examine the extent to which VAT has contributed to the steady growth in Gross Domestic Product in Zanzibar.
- (iii) To assess the challenges of revenue Collection in ZRB.

### **1.4.3 Research Questions**

- (i) To what extent has VAT contributed on revenue Collection in ZRB?
- (ii) To what extent has VAT contributed to the steady growth in Gross Domestic Product in Zanzibar?
- (iii) What are the challenges of revenue Collection in ZRB?

## **1.5 Significance of the Study**

Findings of this study may be useful in the following ways:

Firstly, Completion for the research is one among the requirement for the award of MBA degree of Open University of Tanzania.

Secondly, the study might help to add knowledge to our understanding of the VAT toward revenue authorities in Zanzibar, hence is useful for VAT decision making process.

Thirdly, the results of the study might be used by the Zanzibar Revenue Board (ZRB) in order to enhance Government obligation such as delivering of social services.

Fourthly, the study may also be of immense benefit for future users as well as other researchers, scholars and students.

Fifthly, the study may also provide members of the public knowledge on the importance of VAT in Tanzania and on the effective utilization of taxation to promote fiscal redistribution of income.

Sixthly, the study may explore the challenges facing ZRB in VAT collections and provides the ways to address them.

Finally, the results can also be used by the policy makers, planners and other stakeholders to develop programs and policies for better provision of services in the ZRB.

## **1.6 Scope of the Study**

The scope of the study was limited to quantitative data of VAT, total Revenue collected by ZRB and Gross Domestic Product of Zanzibar covering the period 2002-2012 to evaluate the extent that VAT has contributed to the steady growth in Gross Domestic Product in Zanzibar and to examine the contribution of VAT on revenue collection in ZRB.



## **1.7 Study Limitations and Delimitations**

The researcher of this study faced a number of limitations when conducting this study. These limitations are:

Financial and budgetary constraints, this limitation was due to the fact that the researcher was self-sponsored and the process of conducting research required a lot of financial resources to carry out various activities, such as to develop and distribute questionnaires for respondents and other stationary services which are more expensive as compared to researcher's ability to afford them effectively. Also another obstacle of the study was the tight schedule of the respondents who are ZRB's tax official.

In additionally, Time schedule by the university management was limited which affected the research contents. However, efforts were put in place to mitigate the impacts of these challenges on the result of the study. Also the study was faced by the following delimitations: these are only the study used quantitative data of VAT, total Revenue collected by ZRB and Gross Domestic Product of Zanzibar covering the period 2002-2012. When assessing the challenges of VAT collection in ZRB, the study interviewed only twenty (20) respondents of ZRB's staff.

## **1.8 Organization of the Study**

This chapter presented the introduction of the study, background of the problem, statement of the problem, General objective of the study, specific objectives, Research Questions, Study Limitations and Delimitations, significances of the study and scope of the study.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 Overview**

This chapter presents theoretical and empirical reviews of the study. Thus the key terms and concepts of the study will be defined and various theories related to revenue collection will be discussed. Also literature analysis will be made to show the knowledge gap and the relevant of the study. Furthermore, a conceptual framework for addressing the research problem will be presented as well as various lessons that will be learnt from the literature.

#### **2.2 Conceptual Definitions**

##### **2.2.1 Value Added Tax**

The VAT is a consumption tax charged on taxable goods and services whenever value is added at each stage of production and at final stage of sale, VAT is charged by business register for VAT only. (*www.tra.go.tz*).

Also Bird (2005) defined value added tax as a multi stage tax imposed on the value added to goods and services as they proceed through various stages of production and distribution and to services as they are rendered” which is eventually borne by the final consumer but collected at each stage of production and contribution chain. The United Kingdom Statement of Standard Accounting Practice (SSAP) No 5, defines Value Added Tax as “a tax on the supply of goods and services which are eventually borne by the final consumer but collected at each stage of production and

distribution chain”. This definition of (SSAP) expresses three essential characteristics of VAT. These are:

That the tax is a consumption tax.

The burden of VAT is multi-stage.

The value added is an important feature to VAT because the determination of value added is central to the calculation and computation of VAT.

Value added is described as the increase in the value of goods and services in the process of production or delivery.

### **2.2.2 Revenue**

All governments undertake activities which are economic in nature and are either transfers or exhaustive, which may lead to the output of goods and services. Whichever way government requires financial resources on a regular and steady basis to achieve their objectives (Ogiji, 2004) Public revenue according to Nnadi and Falodun (2003) is a term used to describe all the income expected by the government within the budget period. It consists of recurrent and capital revenue. Recurrent revenue is the money received regularly every year by way of taxes, fees, fines and so on. Capital revenue consists of all bulk loans and grants received by the government from within the economy, or from abroad.

Revenue is the income accruing from taxation to a government during a specified period of time, usually a year. or revenue is the gross income from a business enterprise, investment, property, etc or something that yields a regular financial return. (www.dictionary.com).

### **2.2.3 Gross Domestic Product - GDP**

The GDP is a numerical metric that measures all the finished products and services produced by a particular population, usually a single nation or collection of nations, such as the European Union. The GDP is calculated by adding the sum of all consumer spending, government spending, business spending and total imports less total exports for the time period in question. This metric is used to assess many aspects of a nation's economic health, including general growth patterns and standard of living. In years when the GDP is at an increase, the economy is understood to be growing, unemployment tends to be down and exports tend to be up. (www.investopedia.com).

### **2.2.4 Features of the VAT**

The reasons why so many countries have adopted the VAT are usually connected with the following assumed features of the tax; neutrality, stability and flexibility, in addition to its revenue potential:

VAT is considered to be neutral with respect to foreign trade, and does not distort domestic production and distribution.

VAT is considered to be neutral regarding the production technique that a business adopts. In other words, it makes no difference for the tax liability whether a product is manufactured with a capital- or labor-intensive technology.

VAT is considered not to be influenced by the forms or methods by which business is conducted.

VAT is considered to be a relatively stable source of government revenue.

Since consumption as a share of GDP fluctuates little, by implication the VAT is a stable source of revenue.

VAT is a relatively flexible tax instrument; a change in the rate translates immediately into more or less revenue. This is partly because the consumption as a share of GDP in general fluctuates little, and partly because the VAT is collected on a current terms.

In addition to the points made above, consumption taxes are often considered as an efficient means of taxation, since it is less likely to distort economic behavior than income taxes (see Atkinson and Stiglitz, 1980; and Kay, 1990). With high marginal rates of income tax, individuals may have less incentive to work hard.

With a consumption tax, the extra income is not taxed until it is spent. Consumption taxes can also be levied on a wide base. The wider the tax base, the lower rate is needed to raise a given amount of revenue. In theory, people should be taxed on everything they buy; in practice, many countries have numerous exemptions from VAT while others tax some goods at lower rates.

A VAT taxes the value-added in production through the various stages of production. Value added is simply the difference between the value of the goods and services sold and the value of goods and services purchased as intermediate inputs.

Under a VAT, the sum of purchases (i.e. the value added at earlier stages) and value added by the firm itself equals (by definition) the value of the inputs (which have a

full tax credit attached to them) of the next firm in the production distribution process. As a result, the same value-added is never taxed twice; that is, cumulative effects do not occur. Moreover, at the final retail stage the sum of all values added throughout the process and, by the same token, the sum of all the differences between sales and purchases equal the consumer price, excluding tax.

The final price, that is the price paid by consumers, has therefore to cover all the values added at the successive stages. VAT thus provides a systematic mechanism for taxing final consumption while relieving transactions in intermediate goods. In comparison, the retail sale tax is levied only at the time of sale to the consumer. The total tax collected piecemeal under the VAT from all stages of production and distribution is equal to a tax collected on the sale from retailer to the final consumer or user, that is, a retailer-sales-tax. This equivalence has sometimes led to a VAT being termed a national sales tax (Metcalf, 1995).

### **2.2.5 Comparing VAT and Sales Tax**

An increasing number of developing countries have converted their sales taxes to value-added taxes (IMF, 1992, OECD, 1995). From an economic point of view, there is, in principle, little differences between VAT and the retail sales tax (RST). Levied at the same rates and covering the same number of goods and services, both taxes should raise the same amount of revenues. If VAT is identical to a retail sales tax, why not collect the full tax at the retail stage through a RST.

While the economic effects of the two taxes would be the same, the design and administration of the taxes differ. VAT is usually preferred for four reasons:

The potential coverage of the tax;

Its ability to distinguish producer goods from consumer goods;

Its ability to (effectively) correct border tax adjustments; and Its administrative feasibility

It is sometimes argued that the different ways in which a VAT and a retail sales tax are collected may make enforcement of VAT more efficient.<sup>6</sup> Under a retailer sales tax system, producers, wholesalers and retailers do not pay tax when they buy or sell from one another. VAT in contrast, is paid throughout the production chain. Registered intermediaries, but not the final consumer, reclaim VAT by presenting a set of invoices to the tax authorities.

This may make VAT harder to avoid. While a good is being produced, sellers have an interest in proving that they have paid the tax on their inputs in order to reduce the tax liability on their sales. With a retail sales tax system, in contrast, the burden of collecting the tax lies entirely with the final seller of the good. If (s) he fails to charge it, the tax on the whole value-added is lost. As the tax rises, the incentive to avoid it increases.

By limiting such incentives governments can set VAT at higher rates than they could with retail sales tax. It is probably no coincidence that sales tax in the United States are 8 percent, on average, compared with a total OECD average for consumption taxes (including VAT) of nearer 20 percent (Economist, 1995). As a rule of thumb, it is often reckoned that 10 percent is the highest level at which a sales tax can be set without large-scale attempts at evasion.

### 2.2.6 Alternative Types of VAT

There are three broad types of VAT:

The consumption VAT

The income VAT

The gross product VAT

The gross domestic product (GDP) can be used as a starting point for illustrating the bases of the three VAT variants, and the relationship among them, since it represents the total sum of the value added in the domestic production of goods and services (Zee, 1995: 86). For illustrative purposes, I consider a two-factor (labor and capital), two-sector (private and public), open economy, where  $C$  is private consumption,  $I$  is gross investment,  $G_c$  is public expenditure on goods and services,  $G_w$  is public expenditure on wages and salaries, and  $(X-M)$  is the trade balance measured as the value of exported ( $X$ ) less imported ( $M$ ) goods and nonfactor services. Gross domestic product then equals:

$$GDP = C + I + G_c + G_w + (X-M)$$

Gross domestic income (GDI) is the sum of factor income payments (i.e. wages for labor; and interest, profits, etc., to capital) - often referred to as the value added ( $V$ ) - and depreciation ( $D$ ):

$$GNI = V + D$$

The basic national accounting identity is given by:

$$GDP = GNI$$



This last equation can be stated in terms of either factor cost (i.e., exclusive of indirect taxes net of subsidies), or market prices (i.e., inclusive of indirect taxes net of subsidies). The gross product VAT (P- VAT) has the broadest base of the three VAT types. It taxes all expenditures (except public sector wage expenditure, which is not taxed under any variant of VAT), on GDP if implemented on the origin principle, and on GDP adjusted for the trade balance if implemented on the destination principle.

Assuming that the origin principle is used, then the base of p- VAT can be expressed as  $P\text{-VAT base} = \text{GDP} - G_w = C + I + G_c + (X-M)$

The tax is computed by subtracting from a firm's sales only purchases of goods that are used up currently, not purchases of machinery or other capital goods. This type of VAT is in restricted use, probably because it disallows deduction of both purchases of capital goods and depreciation, and, thus, strongly discourages investment by discriminating the use of capital goods.

The second main form of VAT is the income type VAT (I- VAT). Gross investment Expenditure of the economy reflects the actual aggregate expenditure on capital goods in a given period. However, part of this expenditure is used to compensate for capital goods that have been consumed or depreciated. While depreciation as such is simply a bookkeeping entry and does not represent an actual economic transaction, it does affect the computation of profitability, and therefore the value added, of firms (Zee, 1995: 87). The aggregate tax base is equivalent to that for a comprehensive income tax, excluding depreciation from its base:

$$i\text{-V AT base} = \text{GDP} - G_w - D = C + (I - D) + G_c + (X-M) = V - G_w$$

The last equality in this equation indicates that the base of an I-V AT is the sum of factor income payments (net of government wage expenditure). Hence, it relies on understanding the general cash flow for a firm. This type of V AT is used, for example, by Argentina and Peru.

The consumption VAT (C-VAT) is the most common type. The tax is levied on the total value of sales at each stage of production and allows a credit for any V AT paid on inputs in production. Thus, in addition to depreciation, expenditures on capital goods which contribute to a net augmentation of the capital stock are not taxed. Thus, the entire gross investment expenditure is excluded from the tax base:

$$\text{C-VAT base} = \text{GDP} - G_w - I = C + G_c + (X-M)$$

The C- V AT is the most neutral of the three VAT types since it does not generate distortion in the production process between capital and other inputs. It can be considered a general tax on consumption (inclusive of net exports if implemented on the origin principle, as shown above). Providing the narrowest base of the three VAT variants, C-VAT requires the highest rate to achieve a given revenue yield.

If the trade balances (X-M) is removed from each of the three VAT bases, the V AT variants would be converted to the destination principle. In this case, the C- VAT base becomes:  $\text{C-VAT base} = C + G_c$

This relation corresponds to the total sales tax at the retail level. Hence, a C- VAT implemented under the destination principle is equivalent to a retail-sales tax.

However, the administration and collection mechanisms of the two taxes are quite different.

### **2.2.7 Principles of Implementing VAT**

Each of the three variants of V AT can be implemented under two principles - the origin and destination principles; and by using two main methods of computation - the credit-invoice and subtraction methods (OECD, 1995; and Zee, 1995).

Under the origin principle the V AT is imposed on the value added of all taxable products that are produced domestically. Under the destination principle the V AT is imposed on the value added of all taxable products that are consumed domestically (Zee, 1995: 88). The distinctions between the two principles are based on the location of production and consumption, and not the type of products being produced or consumed. The two principles are identical in a closed economy. In an open economy, the differences between them lie in the treatment of exports and imports. Under the origin principle, exports are taxed but imports are not, while the converse is the case under the destination principle.

Most countries that have a VAT have implemented it on the destination principle.

This is due to two main reasons (Zee, 1995). First, the destination principle is regarded as effective in ensuring that traded products contain no V AT elements of the exporting countries. The origin principle, in contrast, which allows imports entering a country to bear the VAT burdens of exporting countries most likely, will lead to undesirable tax competition, implicating that flexible prices and exchange

rates are not being viewed as adequate mechanisms for alleviating such behavior among trading countries.

Second, although the destination principle requires border tax adjustments, such adjustments can be carried out with relative ease. In any case, they seem to be a small price for circumventing the potential valuation problems associated with the origin principle

### **2.2.8 Tax Enforcement**

The tax enforcement unit in TRA which is under Debt Management is comprised of three functions including collection, examination and investigation. Each function is separate yet interrelated so as to instill voluntary compliance with the tax laws. In the case of ZRB, it is under Tax Investigation and Audit department. The enforcement exercise in both cases (TRA and ZRB) insists on continued effort to effectively administer and collect while affording the best service possible in order to maintain fairness to all taxpayers. In support of the overall tax administration missions in Zanzibar, tax enforcement serves the purposes to discover potential tax law violations in a manner that fosters confidence in the tax system and compliance with the law.

Despite the efforts made, tax enforcement represents a significant problem for the tax systems in Zanzibar because they do not have necessary resources or the know how to discover dishonesty, tax evasion or to handle complicated tax issues. In that regard, the effort made by the staff to perform major enforcement activities including

provision of urgent notice, close up of accounts and businesses, write offs, follow up of arrears, etc. is being jeopardized.

### **2.3 Theoretical Literature Review**

The theoretical basis for the research work is revenue productivity theory (Frank, 1984) because the importance of taxation in revenue generation cannot be overemphasized. Authorities on finance based their arguments principally on this as an important criterion used to judge a good tax. The two aspects of revenue productivity agree that the tax base must be large enough and that the cost of operating the tax system must be below the revenue it generates.

Adam Smith also argued that it made little sense to institute a tax system in which the cost of collecting the tax is higher than the realized tax revenue. Others like, David Ricardo and J.S Mills (1970) emphasized this prominence by putting revenue first in their division of public finance into three namely; “revenue, expenditure and public debt”. The major essence of introducing VAT was to raise revenue; the law setting up VAT affirms this position. (Ndukwe, 1991) called it the look-inward approach.

This is another important criterion used to judge a good tax. The two aspects of revenue productivity agree that the tax base must be large enough and that the cost of operating the tax system must be low. In furtherance of the economy principle, the revenue productivity theory agrees that it makes little sense to institute a tax system for which the cost of collection is higher than the realized tax revenue.

The theory further emphasizes the aspects of having a large enough tax base to cover at minimum cost and stresses an efficient tax administration so as to enforce compliance. As earlier referred to, Adam Smith's *Wealth of Nations* published in 1776 provide the theoretical basis for taxation emphasizing equality, certainty, convenience and economy.

Again, as seen earlier, other economists like J.M. Keynes believe that these are not sufficient to meet all the purposes of modern economic policy which are partly achieved through the budget. These are the allocation, distribution and standardization functions. As a result, they have proposed five broader criteria of taxation. These are the principles of equity, efficiency, simplicity, neutrality and revenue: Canon of Equality, Canon of Convenience, and Canon of Economy. Also other theories based on this study are as follow:

### **2.3.1 Socio Political Theory**

This theory of taxation states that social and political objectives should be the major factors in selecting taxes. The theory advocated that a tax system should not be designed to serve individuals, but should be used to cure the ills of society as a whole.

### **2.3.2 Expediency Theory**

This theory asserts that every tax proposal must pass the test of practicality. It must be the only consideration weighing with the authorities in choosing a tax proposal. Economic and social objectives of the state.

### **2.3.3 Benefit Received Theory**

This theory proceeds on the assumption that there is basically an exchange relationship between tax-payers and the state. The state provides certain goods and services to these members of the society and they contribute to the cost of these supplies in proportion to the benefits Received (Bhartia, 2009). Anyanfo (1996) argues that taxes should be allocated on the basis of benefits received from government expenditure.

### **2.3.4 Faculty Theory**

According to Anyanfo (1996), this theory states that one should be taxed according to the ability to pay. It is simply an attempt to maximize an explicit value judgment about the distributive effects of taxes. Bhartia (2009) argue that a citizen is to pay taxes just because he can, and his relative share in the total tax burden is to be determined by his relative paying capacity.

### **2.3.5 Theory of Laffer Curve**

This theory was propounded by Professor Arthrun Latter; the theory explains the theoretical representation of the relationship between government revenue raised by taxation and all possible rates of taxation. The theory demonstrated with a curve (i.e. the laffer curve) which was constructed by through experiment. It considers the amount of tax revenue raised at the extreme tax rate of 0% and 100%, he concluded that a 100% tax rate raises no revenue in the same way that a 0% tax rate raises no revenue. This is because, at 100% rate, there is no longer incentive for a rational taxpayer to earn ay income, thus, the revenue raised will be 100% of nothing. It follows that there must exist at least one rate in between where tax revenue would be

a\ maximum. Laffer attributes the concept to Ibn Khaldun and Keynes J.M. one potential result of this theory is that, increasing tax rate beyond a certain point will become counter-productive for raising further tax revenue because of diminishing returns (Laffer 2004).

### **2.3.6 Ibn Khaldun's Theory of Taxation**

His theory was explained in term of two different effects, the arithmetic effect and the economic effect which the VAT rate have on revenue. The two effects have opposite result on revenue in case the VAT rate are increased or decreased. According to the Arithmetic effect, if VAT rates are lowered, the VAT revenue will be lowered by the amount of the decrease in the rate. The reverse is the case for an increase in VAT rates (Ishlahi, 2006).

The economic effect however, recognized the positive impact that lower VAT rate have on work, output and employment and thereby the tax base by providing incentives to increase these activities whereas raising VAT rate has the opposite economic effect by penalizing participation in the taxed activities. At a very high VAT rate, negative economic effect dominates positive arithmetic effect, thereby, the VAT revenue declines (Ishlahi, 2006).

## **2.4 The Impact of VAT and Revenue Collection**

The VAT started to be implemented internationally in the 1960, it use has grown rapidly in the world (Craham Glendday, 2005). The value added tax system was introduced by Von Siemens in 1951. In fact it was designed in order to solve the financial problem of German government (Iranian national tax INTA). European



was introduced Vat in 1967 these was taxation and custom,(European commission In south Africa VAT was introduced in1991 to replace general sales tax (GST) Initially there was some problem on the ability of VAT replace GST of revenue source for Government (Dolfin S.Go The World Bank).

The 1991 The Government of Tanzania offered a proposal for reform of Tanzania tax system. The replacement of the current sale tax by value added (VAT). The government of Tanzania announced in the 1992 June Budget speech its intention to introduce VAT In January 1994 (Chr. Michelsen Institute (1995) VAT has financial impact by using different metrics for financial performance such as profit, stock price, Tobin's q (ratio of market value of a firm to the replacement cost of its tangible assets), return on assets (ROA), and return on investment, (ROI), abnormal earnings, and cash flows. Many studies have shown a strong link between Vat and revenue collection and firm profitability (Rust *et al.*, 2004). Some studies explicitly consider the impact of VAT on revenue collection while ZRB and financial performance of a firm reveals that, observed metrics lead to improved financial performance (Gupta and Zeithaml, 2005).

## **2.5 Relationship between Vat and Revenue Collection**

The ability to collect revenue and vat of ZRB is vital for a number of reasons. It has been shown that government lead to achieve obligation. One of the recurrent vat and revenue ties structure of the government of Zanzibar is dwindling revenue generation as characterized by budget Vat in the developing countries emphasize effects on income distribution, administrative complex tax collection as well as possible inflationary cost (IMF 1992).

The measurement of VAT and Revenue collection has increasing number of developing have converted their sales tax to value added taxes (IMF,1992 O E CD,1995).such as banking and financial sector requires special consideration due to difficulties of finding accurate measurement parameters (Saifuddin and Zaman, 2011).

## **2.6 Tax Evasion and Tax Avoidance**

Two major problems are discussed: Tax evasion and tax avoidance. Tax evasion and taxpayer can achieve the same goal of reducing his tax liability while tax evasion is considered illegal; by nature all taxes exert an income in that they compulsorily withdraw revenue from the private sector. Also as indirect taxes are levied on goods, people tend to shift from the purchase of one goods to another this is the substitution effect to a tax.

A good tax system is one, which does not result in either income effect or substitution effect. However, this is not attainable in the real word, hence the application of this rule is to achieve the highest possible neutrality from the imposition of tax system.

**Tax Avoidance:** this is defined as tax payer effort to avoid paying tax by finding a legal hook hole in the tax. Is a deliberate legal act and one of the ways of doing it is by taking more life assurance policies.

**Tax Evasion:** This is an illegal attempt by tax payer not to pay tax. One of the methods is by not declaring all of one's earnings and under estimation of earning.

## **2.7 Empirical Literature Review**

Although very few literatures exists on the subject of VAT in less developing countries, extensive studies have nevertheless been done on the alternation prominence of Indirect Tax in developing countries in general and Tanzania in particular.

The core function of VAT as a revenue collection tool in developing countries has been studied by eminent scholars. Naiyeju (1996) argued that the positive result received from any tax depends on the extent of how it is properly managed. The extent of how the tax law is interpreted and implemented as well as the publicity brought into it will determine how a particular tax is able to meet its objectives.

Ariyo (1997) in his study on productivity of the Nigerian tax system reported a satisfactory level of productivity of the tax system before the oil boom. The report underscored the urgent need for the improvement of the tax information system to enhance the evaluation of the performance of the tax system and facilitate adequate macroeconomic planning and implementation.

Ajakaiye (2000) worked on the impact of VAT on key sectorial and macroeconomic aggregates, using a Computable General Equilibrium (CGE) model considered suitable for Nigeria. The study developed three scenarios. In order to approximate the presumed Nigerian situation, the study assumed that government pursued an active fiscal policy involving the re-injection of the VAT via increases in government final consumption expenditure in combination with a presumed non-cascading treatment of the VAT.

Two other simulations considered an active fiscal policy combined with a cascading treatment of VAT and a passive fiscal policy combined with a non-cascading treatment. As it turned out, the scenario of a cascading treatment of VAT with an active fiscal policy not only had the most deleterious effects on the economy, it was also the one that most closely approximated the situation in Nigeria. VAT revenues under this scenario are more than 3% lower than the first scenario, the general price index increases by 12%, and wage and profit incomes fall by 8.54% and 12.27% respectively. Overall, the GDP declines by 11.34%. Such a situation, as observed by the researcher, poses a great threat to the sustainability of VAT.

Different scholars have used different explanatory variables to attempt some empirical measurements of tax efforts in various countries. Such variables included agricultural output-GDP ratio, per capita income, mineral exports-GDP ratio, the degree of openness of the economy, money-GDP ratio, etc. Using mining-GDP ratio, agricultural output-GDP ratio, and export-GDP ratio as determinants of tax share in GDP to measure tax efforts.

Chelliah, Bass and Kell (1975) show that agriculture share is negative while the mining share is positively related to tax share, and the export ratio is not significant. Tait and Gratz (1979) later updated the work of Chelliah, Baas and Kelly (1975) using the same sample of developing countries for the period 1972-1976. However, they did not find the agric-GDP ratio to be significant but their measure of tax effort indices yielded similar results to the initial study. Using panel data on 43 Sub-Saharan African Countries for the period 1990-1995 to measure the determinants of the tax-GDP ratio to construct an index of tax effort for these countries, Stotsky and

Woldemariam (1977) found that the countries with a relatively high tax-GDP ratio tended to have a relatively high index of tax effort, although the results varied across the countries.

Conversely, the results suggested that the determinants of tax share were the agricultural output-GDP and mining-GDP ratios respectively. They also found the impacts of export-GDP ratio and, in some specifications, per capita income or imports, to be positive significant and positively related to the tax share. Eltony (2002) used time-series and cross-sectional country data for the period 1994-2000 for 16 Arab countries to examine the determinants of tax effort.

The results showed that the main determinants of tax revenue share in GDP were per capita income, agricultural output-GDP ratio and mining-GDP ratio. The share of exports, imports and outstanding foreign debts were other variables found to be important. Also, country-specific factors such as the political system, attitudes toward government, the quality of tax administration and other institutions of government appeared to be important determinants of tax-GDP ratio.

In a recent study, Teera (2003) attempted an assessment of Uganda's tax performance relative to 18 other Sub-Saharan countries aimed at evaluating the feasibility of raising tax revenues in Uganda. The study used pooled data to construct an index of tax effort for these countries, and also applied the model to individual tax shares to pinpoint the source of high and low effort. By extension, the model must have incorporated value added tax. The result showed that Uganda's tax effort index for total taxes on income were less than unity, while the indices for international

trade taxes and taxes on goods and services exceeded unity. One may be tempted to consider this as defining a place for value added tax.

In their study, Bird, Vazquez and Torgler (2007) concentrated on the relevance of demand factors such as corruption, voice and accountability. They opined that not only supply factors matter, but that demand factors matter quite significantly in the determination of tax effort. They concluded that a more legitimate and responsive state is likely an essential precondition for a more adequate level of tax effort in developing countries. This calls for attention to countries' specific factors.

Tanz and Davoodi (1997) also found empirical support for the relevance of demand factors. Thus, they argued that the quality of institutions and governance influence tax revenue through their contribution to tax evasion, improper tax exemption and weak administration. This study observes that in Nigeria or Lagos State, the institutions and governance may not likely influence VAT revenue through these outlets but rather through corruption, voice and accountability. Though, the Nigerian experience demonstrates the relevance of some of the above propositions.

Adegbie and Fakile (2011) worked on company income tax and Nigeria's economic development. They used the GDP to capture the Nigerian economy and Petroleum Profit Tax (PPT), Company Income Tax (CIT), Customs and Excise Duties and VAT to measure Company Income Tax. Findings revealed that there is a significant relationship between company income tax and Nigerian economic development and that tax evasion and avoidance are the major hindrances to revenue generation.

Owolabi and Okwu (2011) empirically evaluated the contribution of VAT to the development of Lagos State economy. Development aspects considered included infrastructural development, environmental management, education sector development, youth and social development, agricultural sector development, health sector development and transportation sector development.

Result showed that VAT revenue contributed positively to the development of the respective sectors. However, the positive contribution was statistically significant only in agricultural sector development. Owolabi and Okwu (2011) examined the contribution of Value Added Tax to Development of Lagos State Economy, using simple regression models as abstractions of the respective sectors considered in the study. The study considered a vector of development indicators as dependent variables and regressed each on VAT revenue proceeds to Lagos State for the study period. Development aspects considered included infrastructural development, environmental management, education sector development, youth and social development, agricultural sector development, health sector development and transportation sector development. The results showed that VAT revenue contributed positively to the development of the respective sectors.

However, the positive contribution was statistically significant only in agricultural sector development. On the aggregate, the analysis showed that VAT revenue had a considerable contribution to development of the economy during the study period. Also Unegbu and Irefin (2011) in their paper, the impact of value added tax (VAT) on economic and human developments of emerging Nations from 2001 to 2009,

using regression, discriminant analysis and ANOVA, found out that VAT allocations have a very significant impact on expenditure pattern of the state during the same period. Also observed that, the perceptions by the citizenry across the administrative areas of the state suggest that VAT has minimum impact level on the economic and human developments of Adamawa State from 2001 to 2009.

Adegbe and Fakile (2011) concentrated on the Company Income Tax and Nigeria Economic Development relationship. Using Chi-square and Multiple Linear Regression analysis in analyzing the primary and secondary data respectively and concluded that there is a significant relationship between company income tax and Nigerian economic development. And that tax evasion and avoidance are major hindrances to revenue generation.

Lee and Gordon (2004) in their paper, Tax structure and economic growth, explore how tax policies affect a country's growth rate, using cross-country data during 1970–1997. Their findings revealed that statutory corporate tax rates are significantly negatively correlated with cross-sectional differences in average economic growth.

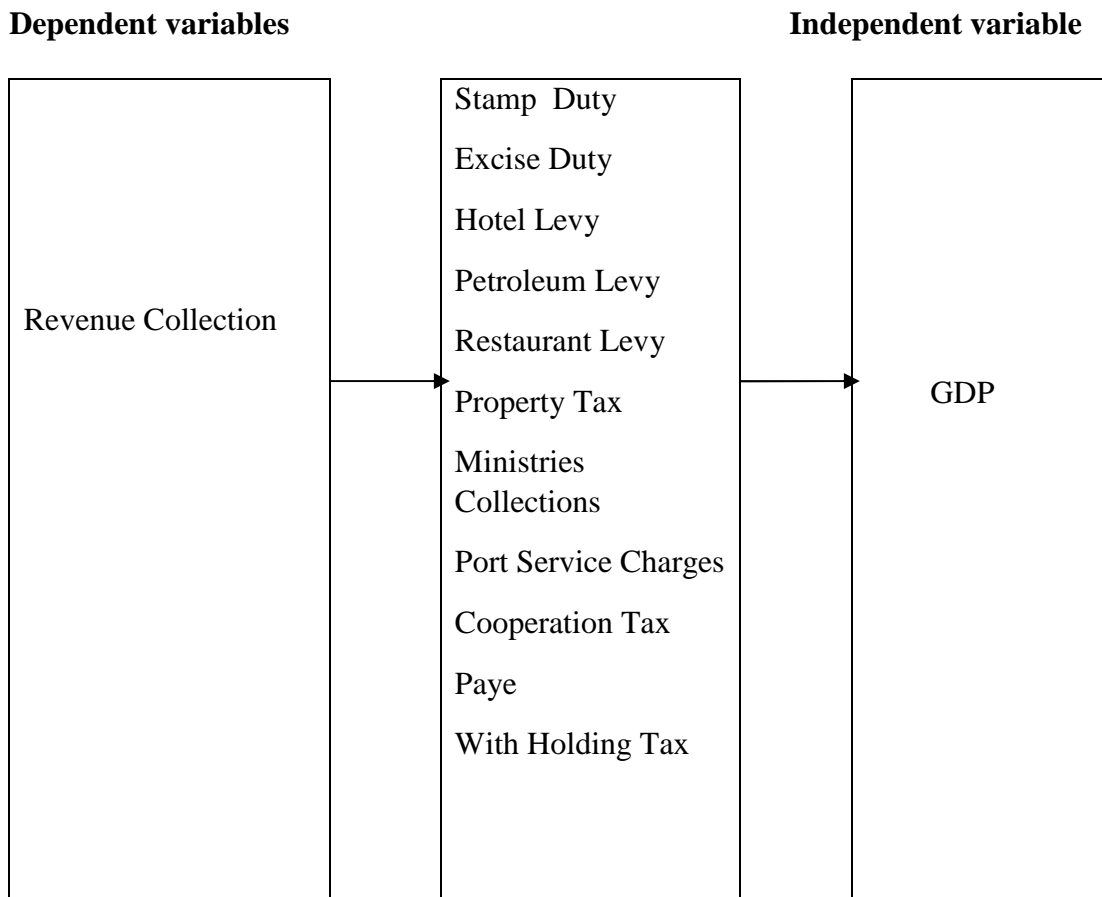
## **2.8 Synthesis and Knowledge Gaps**

ZRB has largely met its goal of promoting tax compliance through a fair, equitable and transparent application of tax laws. Implementation Completion Report (ICR) is silent on performance of ZRB in this area. The absence of evidence with regard this intermediate outcome indicator affects IEG's assessment. (World Bank-Independent Evaluation Group, 2012). Therefore, this study sought to assess the contribution of the VAT and GDP on revenue collection in Zanzibar Revenue Board.



## 2.9 Conceptual Framework

The model consists of two variables that are Revenue collections which are dependent variable and independent variable which is GDP.



**Figure 2.1 Conceptual Framework**

Source: Own work (2014)

## 1.1 Chapter summary

This chapter presents critical literature analysis that shows the knowledge gap and the relevant of the study. Also it shows a conceptual framework for addressing the research problem. The following Table 2.2 presents the summary of empirical literature review of this research.

**Table 2.2: Summary of Empirical Literature Review**

<b>Variab le</b>	<b>Country</b>	<b>Findings</b>	<b>Author and year</b>
VAT	NIGERIA	Value Added Tax has statistically significant effect on revenue generation in Nigeria. The study recommends that there should be dedication and apparent honest on the parts of all agents of VAT with respect to the collection and payment and that government should try as much as possible to improve on the way of collecting value added tax.	Aworemi, Remi Joshua (2013)
VAT	NIGERIA	<p>i The Nigerian VAT has potential for revenue generation, but it is inelastic to GDP</p> <p>ii VAT has no proper threshold in Nigeria</p> <p>iii Waivers, exemptions, concessions, evasion are the major threat to VAT revenue generation in Nigeria</p>	Okwori Joseph (2014)
VAT	TANZANIA	There is no a prior reason for proclaiming that the value-added tax is better or worse than a retail sales tax.	Bergen(1995)

		<p>Conventional wisdom indicates that a V A T is preferable if the rate is high but that the sales tax is preferable if the rate is to be Low (Sandford and Godwin, 1990:214). The unique features of the VAT, ie., the multistage collection and the rebate system, may, despite increasing administrative and compliance costs compared to a sales tax, provide a more accurate and reliable mechanism for excluding tax from business costs and export prices</p>	
VAT	UGANDA	<p>The result showed that Uganda's tax effort index for total taxes on income were less than unity, while the indices for international trade taxes and taxes on goods and services exceeded unity, The result showed that Uganda's tax effort index for total taxes on income were less than unity. One may be tempted to consider this as defining a place for value added tax.</p>	Teera (2013)

## **CCHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

The study employed the quantitative as well as qualitative research approach. A quantitative approach is one in which the researcher primarily uses postpositive claims for developing knowledge (i.e., cause and effect thinking, reduction to specific variables and hypotheses and questions, use of measurement and observation), employs strategies of inquiry such as experiments and surveys, and collect data on predetermined instruments that yield statistics data. And qualitative research approach is aimed at gaining a deep understanding of a specific organization or event, rather than surface description of a large sample of a population. It aims to provide an explicit rendering of the structure, order, and broad patterns found among a group of participants (Kothari, 2004).

#### **3.2 Research Design**

The research design is the conceptual practices and structure within which a research is conducted; it gives the awareness for the collections, measurement and analysis of data. This study is descriptive and exploratory type of research design, based on both quantitative and qualitative approach. It is descriptive because it determines relationship between variables i.e. dependent variables which are revenue collection and GDP, and independent variable which is VAT with related to the different research analysis. Thus it includes related information based on numerical data to justify the study.

And also it exploratory research design because it explore the challenges facing ZRB's staff on revenue collections.

### 3.3 Study Area

The study was conducted in Urban and West region of Zanzibar. The selection of the study area is attributed by the fact that the area is the commercial headquarter of the country, where several ZRB tax payers are available; also it is the area where the head office of ZRB is located.

### 3.4 Population of the study

A population is a group of individual, persons, objects, or items from which sample are taken from measurement (lapin, 1987). The population of the study of the assessment of the impact of the VAT and GDP on revenue collection -ZRB is the totality of Zanzibar economy and the total number of staff of ZRB which is 129 staff.

### 3.5 The Study Sampling Design and Procedures

Sampling is the process of choosing some elements from a large group in order to get information from them (Longman, 2010).

**Table 3.1: Sample Distribution Table**

<b>Respondents</b>	<b>Total</b>	<b>Percentage (%)</b>
VAT	5	25
Large Taxpayers Office	5	25
Other Taxes	4	20
Ministries Collections	5	25
Legal service Department	1	5
<b>Total</b>	<b>20</b>	<b>100</b>

Therefore the sample of this study is the Revenue collected by ZRB, Gross Domestic Product of Zanzibar and VAT, covering the period 2002-2012 to examine the contribution of VAT and ZRB collection and to Zanzibar GDP. And in assessing the challenges facing staff of ZRB on VAT collection, the study interviewed only twenty (20) respondents of ZRB's staff out of 129 staff. The table below shows the distribution of the respondents.

### **3.5.1 Sample Selection**

The sample was selected using stratified sampling procedure. Stratified random sampling is a sampling technique whereby the total population is divided into different groups or layers before selection of the representatives (Adam, J & Kamuzora, F. 2008). This helped to ensure that every item in the population has an equal chance of inclusion in the sample since the population did not constitute a homogeneous group. Thus, this design contributed to obtain a representative sample. The main advantage of this method is that, it gives appropriate weighing to particular groups which is small but more important to the study. The strata were formed on the basis of common characteristics, which is on department basis. In each stratum, items were selected through simple random sampling so as to avoid biasness by the researcher.

### **3.6 Sources of Data**

These days, data from modern experiment are often stored automatically and only a small particular aspect of that stored information may be interest to the theorists and experimenters (Penrose, 20004). VAT inflows and revenue collection and GDP data are obtained from public publication which is stored both in hard copy and softy

copy. For this study data and information base, was built from both secondary and primary data. The secondary sources are annually report on economic growth, publication from economic survey published by Government of Zanzibar and National Bureau of Statistics (NBS) data sources will be consulted. Documentation method used to collect secondary data by reading different available documents such as ZRB books which are the major source for this study, news paper and different websites including Africa and European development VAT websites.

Primary data refers to the first hand information obtained directly from the field (Salant and Dilman, 1994). The primary data obtained through field study which involved visiting the study area, interviews, and discussions with the staff of ZRB. When requesting access, established credibility with intended participants, overcome the organizations' concerns on time and resources, and provided clear assurance about confidentiality and anonymity of the organization as well as individual participants.

### **3.6.1 Data Collection Methods and Instruments**

The study employed field observation, focus group discussions, and analysis of documents structure interview and questionnaires to acquire relevant information.

### **3.6.2 Focus group discussion**

This enabled the researcher to get deep information and perceptions from various groups of people by sharing ideas within the group. The groups were important as they played different roles as far as development of training programs in public sectors is concerned. A part from questionnaire tool the researcher had a group

discussion with the trainees and tutors of the institute pertaining to the contribution of training programs to the work efficiency in public sector.

### **3.6.3 Analysis of Documents**

Published and unpublished documents were analyzed through references abstract guides and contents analysis techniques.

### **3.6.4 Structured Interview**

Structured interviews refer to interviews that involve the use of a set of predetermined questions and of highly standardized techniques of recording (Kothari, 2004). They were used through interview guides and questionnaire techniques. The decision to use interview guides became relevant so as to maintain vigor in the questions to be asked.

### **3.6.5 Questionnaires**

Questionnaires were used to other remaining staff of ZRB mostly dealing with revenue collections. This was because it facilitated the process of collecting large amount of data at a minimal cost and time. This method was relatively cheap to distribute. Questionnaires also minimized interview's biasness and thus created openness and readiness in answering question.

## **3.7 Variables**

These variables that are selected for the study were dependent variables (revenue collection and GDP) and independent variable (VAT). The independent variable (VAT) is expected to have a positive relationship with the dependent variables



(revenue collection and GDP) in ZRB. This means that an increasing of VAT results in increasing of revenue collection and GDP and decreasing of VAT results in decreasing of revenue collection and GDP in Zanzibar.

### **3.7.1 Intervene Variables**

The variables that explain a relation or provide a causal link between other variables. Also called by some authors “mediating variable” or “intermediary variable.” So intervene variables of Revenue Collection and GDP with VAT are Stamp duty, Excise duty, Hotel levy, Petroleum levy, Restaurant levy, Property tax, Ministries collections, Port service charges, Cooperation tax, Paye and Withholding tax.

### **3.8 Data Processing, Analysis and Presentation**

The study employed the Ordinary least Square in analyzing the impact of the VAT and GDP on revenue collection -ZRB. Usage of regression equations on macroeconomic variables estimation began way back in 1936. Jan Tinbergen developed a macro economic model for the Dutch economy containing twenty-four equations, and in 1939 he developed forty macroeconomic models for U.S.A., particularly regression equations. These equations describe the key macroeconomic relationship of the Dutch economy and U.S.A alike. Also in many cases lag regression equations were introduced on consumption in comparison with income (Press man, 2004).

Tzouvelekas et al. (2002) applied stochastic regression model to estimate technical efficiency in organic and conventional wheat farming in Greece. Assaf and Matawie (2009) used stochastic frontier model to analyze Technical efficiency and impact in

the hospital food service sector. They estimate technical efficiency and impact coefficient by using Ordinary least squares.

Ensrom (2005) applied standard log linear to transaction data to estimate direct impact and elasticity on Swedish property crisis of 1990s. The study fit the regression which is appropriate in this case, and it fits well based on a strong a priori expectation (Damodar and Porter, 2009). Also Theil (1978) suggest that if intercept is absent in some cases, the slope coefficient may be estimated with far greater precision. In doing so the study is divided into two layers:

The first layer was to examine the contribution of VAT on revenue collection in ZRB. So in analyzing this specific objective, the researcher employed the Ordinary least Square. This has expressed in the following format:

$$RC_t = B_0 + BVAT_t$$

Where by  $RC_t$  = ZRB Collections at any time  $t$

$B_0$  = Constant factor of ZRB Collections

$B$  = is a slop

$VAT$  = VAT at any time  $t$

$t$  = Time in year

The second layer is to examine the extent to which VAT has contributed to the steady growth in Gross Domestic Product in Zanzibar. Also in this second specific objective, the researcher employed the Ordinary least Square. This has expressed in the following format:

$$\mathbf{GDP}_t = \mathbf{B}_0 + \mathbf{B}\mathbf{VAT}_t$$

Where by  $\mathbf{GDP}_t$  = GDP at any time  $t$

$\mathbf{B}_0$  = Constant factor of ZRB Collections

$\mathbf{B}$  = is a slop

$\mathbf{VAT}_t$  = VAT at any time  $t$

$t$  = Time in year

The reduced form coefficients (**B**) of these structural equations are also known as impact propensity or impact multipliers because they measured the immediate impact on the endogenous variable for of unit change in value of the exogenous variable. Refer to computation of certain measures along with searching relationship patterns existing among data groups (Kothari, 2004). Veal (1997) explains that, data analysis is done to sort and evaluate gathered information in relation to posed questions and identified concepts.

Moreover, in assessing the challenges facing the staff of ZRB in VAT collection, the study used Statistical Package for Social Sciences (SPSS) Version 16.0 so as to increase accuracy as well as save time for the researcher. Qualitative data that were obtained from the interview and questionnaires were coded before carrying out statistical analysis and later decoded for interpretation. Then, the coded data were tabulated by counting the number of cases falling in different categories of variables. The data were processed to get frequencies and percentages that were used for inferences. Table, charts and graphs together with description was used to present some data that were collected in the field.

### **3.9 Ethical Considerations**

The researcher applied for the research clearance letter from the University and from other relevant offices on the study areas. The researcher also ensured that there is informed consent from the study participants, as well as ensuring them of privacy and anonymity

## **CHAPTER FOUR**

### **FINDINGS, DATA ANALYSIS AND DISCUSSION**

#### **4.1 Introduction**

In this section the study presents data in tabular form as in appendix 1, 11.and III, after which methods of analysis i.e. reduced form regression equation and Package for Social Sciences (SPSS) Version 16.0 were applied. After a tabular presentation of data, summary of results were presented and analyzed thereafter.

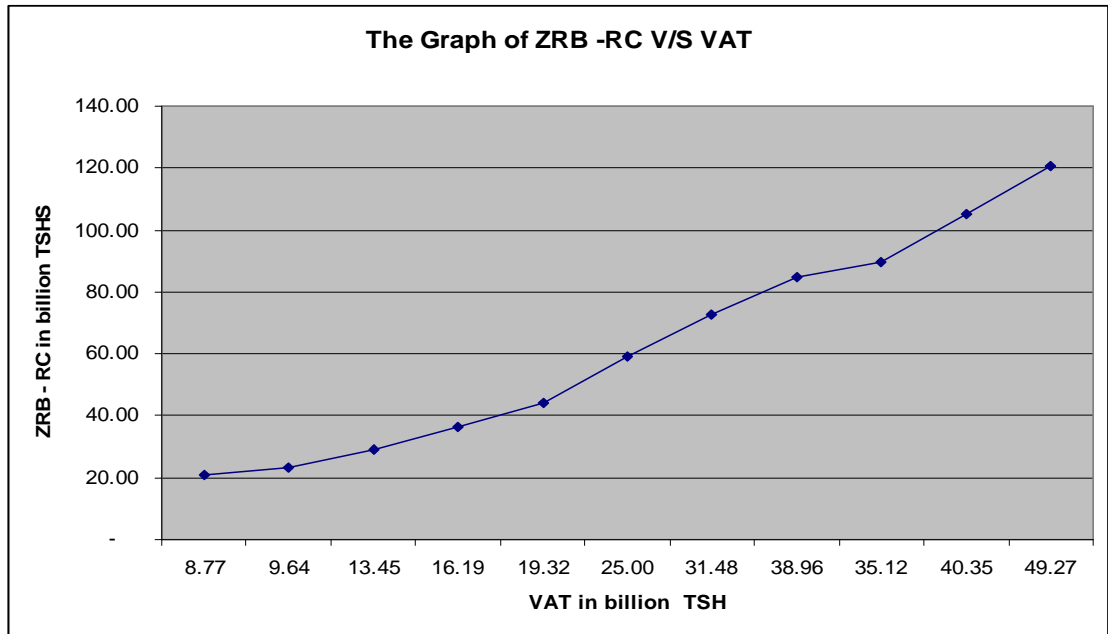
Interpretation, analysis and discussion of the results are divided into three parts. Part A looks into whether VAT has contributed significantly on revenue collection in ZRB, using linear reduced form regression equation, part B examine the extent to which VAT has contributed to Zanzibar GDP, using the same linear reduced form regression equation and part C the assessment of the challenges facing ZRB's staff on VAT Collection in ZRB.

The main purpose of doing this is to get insight on the intertwinement of VAT, ZRB-RC and GDP. Application of simple linear reduced form regression equation warranty more insight and understanding. Again for each analysis of the results, graphical presentation nourishes visual perception. Among benefit of graphical presentation is quick and fast reference of the tendency or outside appearance of variables.

#### **4.2 Empirical Analysis of the Contribution of VAT on ZRB-Revenue Collection**

Empirical analysis on ZRB-Revenue Collection is done at two layers. First layer provides graphical presentation of VAT and ZRB-Revenue Collection for the period

of the study. The second layer estimates regression equation for which contribution coefficient is provided. Figure 4.1 plot relationship between VAT and ZRB Revenue Collection from 2002-2012.



**Figure 4.1: VAT and ZRB Revenue Collection from 2002- 2012**

Source: Research study, (2015)

Graphical presentation of VAT on the vertical axis and ZRB Revenue Collection on the horizontal axis. Graph suggests that, the graph exhibits the upward sloping tendency. The upward sloping of the curve shows that VAT and ZRB Revenue Collection upward movement is steady, through not smooth. Upward movement has fluctuations particularly in 2009 n which VAT inflows was 38.96 billion TSHS plummeted to 49.27 billion TSHS in 2012.

#### **4.2.1 Estimation of Regression Equation of VAT and ZRB Revenue Collection for which Contribution Coefficient is provided**

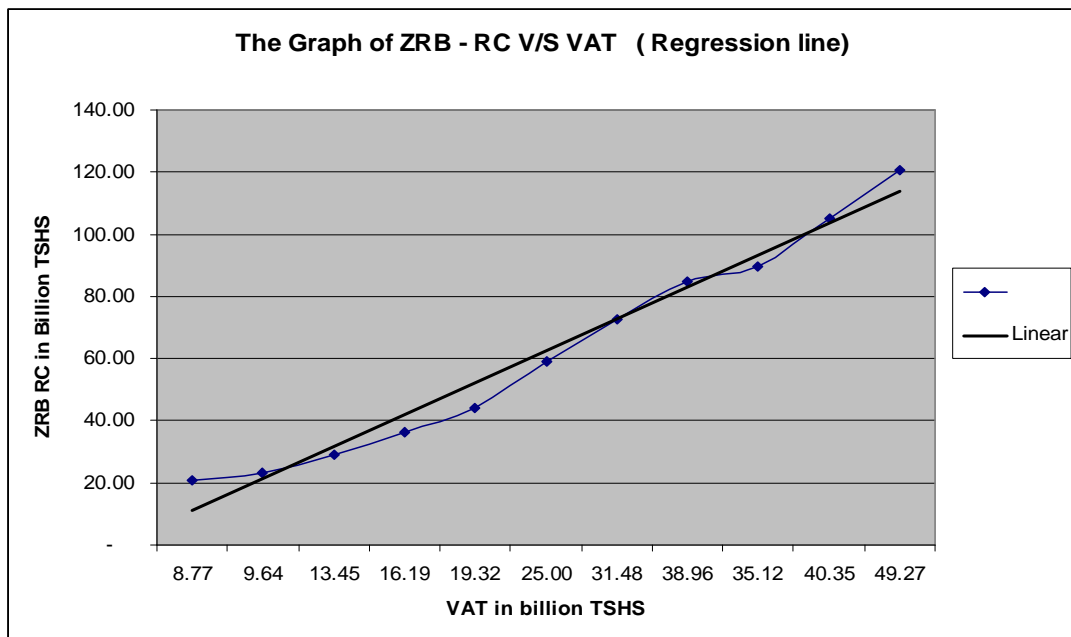
To get the more different results of these variables the researcher analyzed the same data applying regression equation and coefficient of determination below.

Result of linear reduced form of regression equation estimating contribution of VAT on ZRB Revenue Collection (RC) the study used data in appendix 1. Summary results of the estimated Ordinary Least Square regression equation are provided bellow:

$$RC_t = -2.72\text{billion} + 2.49VAT_t$$

$$r^2 = 0.99$$

The estimated equation above reveals that the contribution of VAT on ZRB Revenue Collection is one unit of VAT brings about 2.49 units of ZRB Revenue Collection. This estimated result leads the study to accept that VAT has impact on ZRB Revenue Collection. Substantiated by  $r^2 = 0.99$  which is strong goodness fit claims to agree with the results that VAT has strong contribution to ZRB Revenue Collection. The following graph shows the above regression equation.



**Figure 4.2: The regression Equation Graph of VAT and RC (ZRB Revenue Collection)**

Source: Research study, 2015

This information should be born in mind that ZRB received VAT amounting from 42.04 percentage of ZRB Revenue Collection in 2002 to 40.87 percent in 2012 in relation to output. Table 4.1 shows that trend.

**Table 4.1: Percentage of VAT in ZRB Revenue Collection**

S/N	YEAR	TSH BILLION		
		ZRB -RC	VAT	VAT/RC %
1	2002	20.86	8.77	42.04
2	2003	23.36	9.64	41.27
3	2004	29.29	13.45	45.92
4	2005	36.30	16.19	44.60
5	2006	44.29	19.32	43.62
6	2007	59.21	25.00	42.22
7	2008	72.45	31.48	43.45
8	2009	84.96	38.96	45.86
9	2010	89.41	35.12	39.28
10	2011	105.08	40.35	38.40
11	2012	120.56	49.27	40.87
<b>TOTAL</b>		<b>685.77</b>	<b>287.55</b>	<b>41.93</b>

Source: Research study (2015)

Much as the results is statistically as provided by the test, results are practically significant. But, the researcher does not imply that it is only VAT that contributes ZRB Revenue collection. A lot of factors contribute to ZRB Revenue collection these are Stamp duty, Excise duty, and Hotel levy, Petroleum levy, Restaurant levy, Property tax, Ministries collections, and Port service charges.

### **4.3 Empirical Analysis of the Contribution of VAT on Zanzibar GDP**

Empirical analysis on Zanzibar GDP is also done at two layers. First layer provides graphical presentation of VAT and Zanzibar - GDP for the period of the study. The second layer estimates regression equation for which contribution coefficient is provided.



### 4.3.1 Graphical Presentation of VAT on Zanzibar GDP

Figure 4.3: Plots relationship between VAT and Zanzibar GDP from 2002-2012.

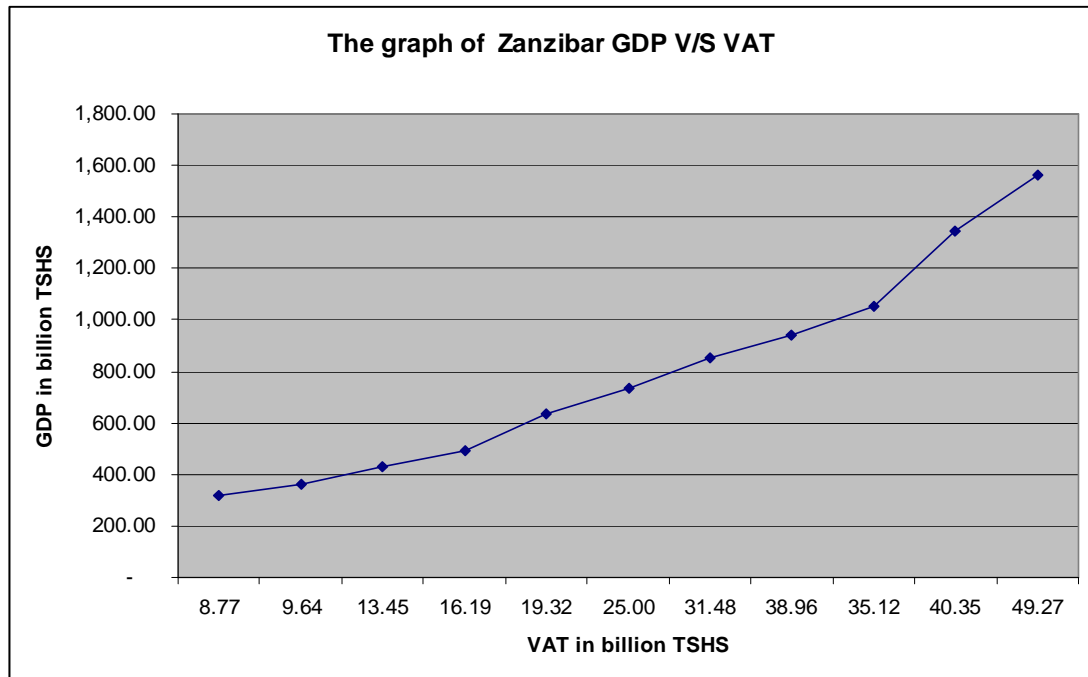


Figure 4.3: VAT and GDP of Zanzibar Economy from 2002-2012

Source: Research study, 2015

Graphical presentation above of GDP on the vertical axis and VAT on the horizontal axis. Graph suggests that, the graph exhibits the upward sloping tendency. The upward sloping of the curve shows that VAT and GDP upward movement is steady, through not smooth. Upward movement has fluctuations particularly in 2001 in which VAT inflows was 40.35 billion TSHS plummeted to 49.2735 billion TSHS in 2002.

### 4.3.3 Estimation of Regression Equation of VAT and GDP for which

**Contribution Coefficient is provided**

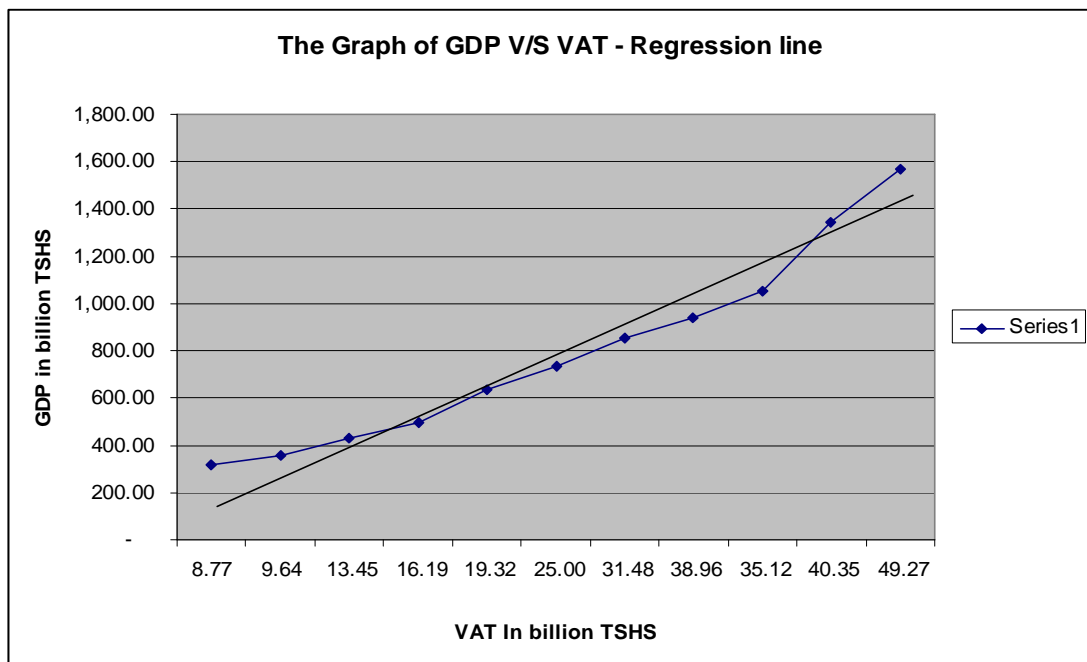
To get the more different results of these variables the researcher analyzed the same data applying regression equation and coefficient of determination below.

Result of linear reduced form of regression equation estimating contribution of VAT on Zanzibar economy the study used data in appendix 2. Summary results of the estimated Ordinary Least Square regression equation are provided bellow:

$$\text{GDP}_t = 43.65\text{billion} + 28.68\text{VAT}_t$$

$$r^2 = 0.97$$

The estimated equation above reveals that the contribution of VAT on Zanzibar economy is one unit of VAT brings about 28.68 units of Zanzibar GDP. This estimated result leads the study to accept that VAT has impact on Zanzibar economy. Substantiated by  $r^2 = 0.97$  which is strong goodness fit claims to agree with the results that VAT has strong contribution to Zanzibar economy. The table bellow shows the graph of regression equation



**Figure 4.4: The Regression Equation Graph of VAT V/S GDP**

Source: Research study, 2015

This information should be born in mind that ZRB received VAT amounting from 2.74 percentage of ZRB Revenue Collection in 2002 to 3.15 percent in 2012 in

relation to output. Table bellow shows that trend. Smith, Islam, and Moniruzzaman, (2011) shows that the performance of VAT was quite satisfactory in the initial years; afterwards, VAT collection remained stagnant at a certain level. the stagnation happened as a result of relatively small number of VAT tax-payers, a general lack of awareness, and a weak monitoring system. Samimi, and Abdolahi, (2011) Scan the impact of implementing Value Added Tax on Export of goods and services found that, the impact of VAT on export is positive.

**Table 4.2: Percentage of VAT in Zanzibar GDP**

<b>TSH BILLION</b>				
<b>S/N</b>	<b>YEAR</b>	<b>GDP</b>	<b>VAT</b>	<b>VAT/GDP %</b>
1	2002	320.22	8.77	2.74
2	2003	358.60	9.64	2.69
3	2004	430.78	13.45	3.12
4	2005	493.99	16.19	3.28
5	2006	638.02	19.32	3.03
6	2007	734.80	25.00	3.40
7	2008	851.15	31.48	3.70
8	2009	939.37	38.96	4.15
9	2010	1,050.77	35.12	3.34
10	2011	1,344.15	40.35	3.00
11	2012	1,565.19	49.27	3.15
<b>TOTAL</b>		<b>8,727.05</b>	<b>287.55</b>	<b>3.29</b>

Source: Research study, 2015

Much as the results is statistically as provided by the test, results are practically significant. But, the researcher does not imply that it is only VAT that contributes

Economic growth of Zanzibar. A lot of factors contribute to the growth of Economy of Zanzibar such as FDI and TRA- Zanzibar collections.

#### 4.4 Profile of the Respondents

The profile of respondents of the challenges facing ZRB's staff on VAT Collection in ZRB involved 5 (25%) VAT officials of which 3 are male and 2 are female, 5 (25%) Large Taxpayers officials of which 3 are male and 2 are female, 4(20%) other Taxes officials of which 2 are male and 2 are female, 5 (25%) Ministries Collection officials of which 2 are male and 3 are female and 1(5%) legal Service official which is male. Therefore the male responds are 11 (55%) and female respondents are 9(45%), this shows that the researcher had considered the gender issue.

By considering the above involvement, the researcher was able to obtain different perspectives of employees from different sections concerning the challenges facing ZRB's staff on VAT Collection. The following table illustrates the fact in hand.

**Table 4.3: The Profile of Respondents of the Challenges Facing ZRB's Staff on VAT Collection in ZRB**

<b>Respondents</b>	<b>Male</b>	<b>Female</b>	<b>Total</b>	<b>Percentage (%)</b>
VAT	3	2	5	25
Large Taxpayers Office	3	2	5	25
Other Taxes	2	2	4	20
Ministries Collections	2	3	5	25
Legal service Department	1	0	1	5
<b>Total</b>	<b>11</b>	<b>9</b>	<b>20</b>	<b>100</b>

Source: Field Survey (2015)

On the part the number of respondents according to the age group were; 10 (45.8%) of the respondents varied from (20 - 30), 7(33.4%) of the respondents varied from (31 - 41) and 3 (20.5%) of the respondents varied from (42 - 52), there was no respondent who was above (53 -60) age group. This implies that, ZRB is heavily accommodated with young employees than old employees; this is probably due to increasing number of skilled and qualified youths and also due to rapid increase in number of senior employees' retirement. So this could minimize the challenges facing ZRB on revenue Collection. The tables below illustrate this fact.

**Table 4.4: Age of Respondents of ZRB's Staff**

		<b>Frequency</b>	<b>Percent</b>	<b>Valid Percent</b>	<b>Cumulative Percent</b>
Valid	20- 30	10	50.0	50.0	50.0
	31-41	7	35.0	35.0	85.0
	42 -53	3	15.0	15.0	100.0
	<b>Total</b>	<b>20</b>	<b>100.0</b>	<b>100.0</b>	

Source: Field Survey (2015)

The number of respondents according to designations were; 1(5%) of the respondents was from upper level class, 15 (75%) of the respondents were from middle level class and 4 (20%) of the respondents were from lower level class. The table below illustrates this fact.

**Table 4.5: Designation of ZRB Respondents**

<b>Designation of Respondents</b>					
		<b>Frequency</b>	<b>Percent</b>	<b>Valid Percent</b>	<b>Cumulative Percent</b>
Valid	Upper Level Personnel	1	5.0	5.0	5.0
	Middle Level Personnel	15	75.0	75.0	80.0
	Lower Level Personnel	4	20.0	20.0	100.0
	<b>Total</b>	<b>20</b>	<b>100.0</b>	<b>100.0</b>	

Source: Field Survey (2015)

This implies that the ZRB has many Middle level personnel than Upper level personnel and lower level personnel. In this regard, many of the Middle level personnel are directly concerned with the revenue collection than any other level, this is because the revenue collection is a key goal of ZRB, so it should allocate skilled and enough personnel so as to reach its goal easily and to overcome the challenges that might face them.

#### **4.5 Objective Three: The assessment of the Challenges of Revenue Collection in ZRB**

##### **4.5.1 To find, Whether if they have Been Faced by any Challenges During Their Work**

This section addresses the third objective of the study which assessment of the challenges of revenue Collection in ZRB. In the study, 20 respondents from ZRB staff were asked whether they have been faced by any challenges during their work.

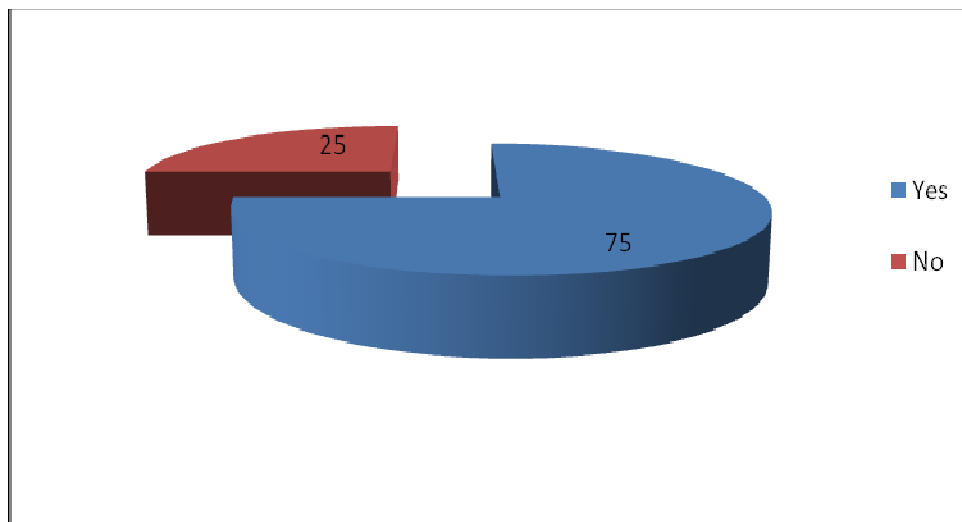
**Table 4.6: ZRB Staff Responses on whether if they have been Faced by any Challenges During their Work**

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Yes	15	75.0	75.0	75.0
	No	5	25.0	25.0	100.0
	<b>Total</b>	<b>20</b>	<b>100.0</b>	<b>100.0</b>	

**Source: Field Survey (2015)**

Table 4.6 depicts that in ZRB 15 (75%) of the respondents agreed that they have been faced by challenges during their work, whereas 5(25%) of the respondents have not ever been faced by any challenges during their work. Figure 4.5 illustrate the

fact. This implies that, there are still challenges of revenue collection in ZRB and high percentage of staff are faced with. Pramod Kumar (2004) found that tax administrators of developing countries face many challenges in the massive task of tax collection. Nevertheless the problem of tax evasion bothers tax administrators of developing countries and developed countries alike. In the real world, those who wish to reduce their tax liability have more choices than just tax evasion.



**Figure 4.5: ZRB Staff Responses on whether if they have been Faced by any Challenges During their Work**

**Source:** Research study, 2015

#### **4.5.2 The kind of challenges that face ZRB's staff on revenue collection**

This section also addresses the third objective of the study which assessment of the challenges of revenue Collection in ZRB. Question aimed at finding out the kind of challenges that face ZRB's staff on revenue collection. 20 respondents were asked the Table 4.7 shows the weight of respondents with respective to challenges that they face.

**Table 4.7: ZRB Staff Responses on Kind of Challenges that face them on Revenue Collection**

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Abundance of Exemptions for Political Reasons	4	20.0	20.0	20.0
	Ambiguous Exemptions on Commodities under VAT System	3	15.0	15.0	35.0
	Under invoicing of goods and services to avoid commodity taxes	3	15.0	15.0	50.0
	Ineffective enforcement of tax laws	1	5.0	5.0	55.0
	Tax officials do not have the political support to deal with tax evaders and the black economy	1	5.0	5.0	60.0
	Very Low Percentage of GDP is collected in Taxes	1	5.0	5.0	65.0
	How do we make things easier for the taxpayers	3	15.0	15.0	80.0
	How do we improve collections and compliance	4	20.0	20.0	100.0
	<b>Total</b>	<b>20</b>	<b>100.0</b>	<b>100.0</b>	

Source: Research study, 2015

Also responses were obtained from questionnaires that were distributed to 20 ZRB's staff. On the interview responses 4(20%) of the respondents indicated that, the main challenges that they face on revenue collection is Abundance of Exemptions for Political Reasons, 3(15%) of the respondents indicated the Ambiguous Exemptions on Commodities under VAT System, 3(15%) of the respondents indicated Under invoicing of goods and services to avoid commodity taxes, 1(5%) of the respondents indicated, ineffective enforcement of tax laws, 1(5%) of the respondents indicated,

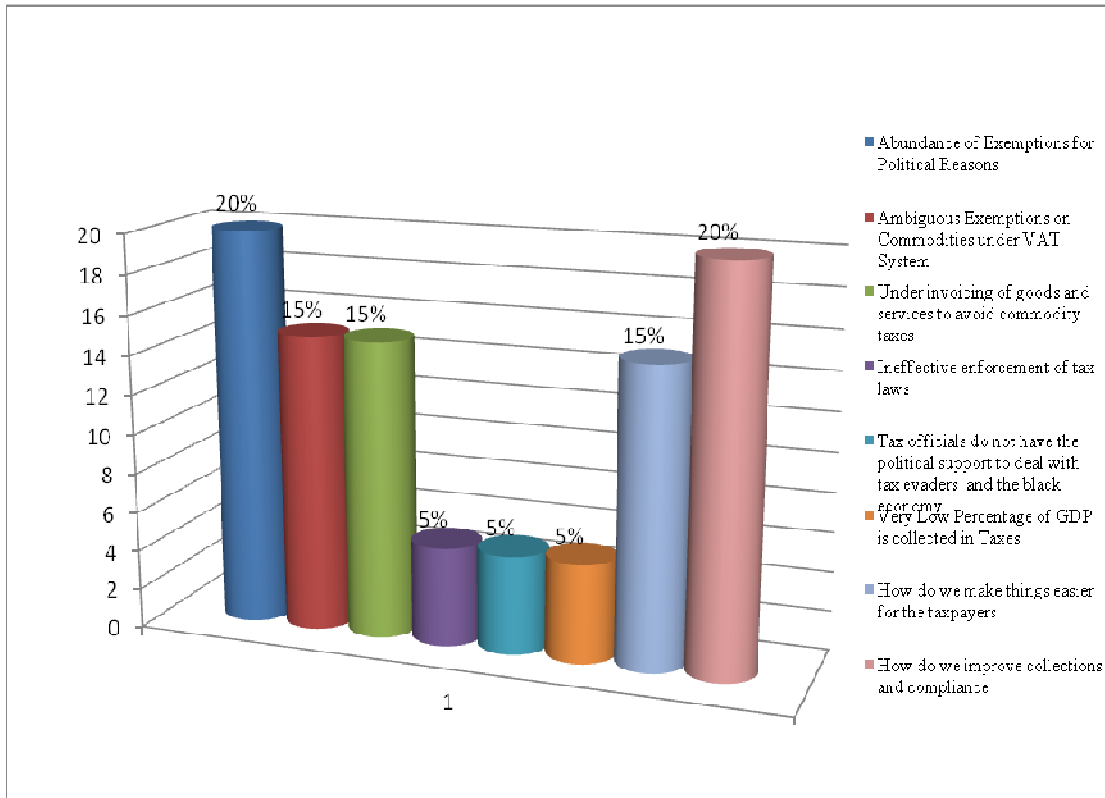


the tax officials do not have the political support to deal with tax evaders and the black economy, 1(5%) of the respondents indicated, very low percentage of GDP is collected in Taxes, 3(15%) of the respondents indicated, how to make things easier for the taxpayers, and, 4(20%) of the respondents indicated that, the main challenges that they face on revenue collection is How do we improve collections and compliance. Figure 4.6 clarifies the fact.

This implies that, ZRB staff still are faced by many challenges but the ones that dominant are Abundance of Exemptions for Political Reasons and How to improve collections and compliance. In the OECD countries, farmers are either taxed or exempted (Due, 1990; Cnossen, 1992). New Zealand, Sweden, and the United Kingdom treat farmers in the same manner as any other producers of taxable products; that is, they have to comply with the same requirements for furnishing returns and making payments.

Other OECD countries do not require farmers to register and compensate them for the tax borne on their purchases of VAT-liable inputs. Inclusion of small farmers in the VAT system in developing countries would most likely pose serious problems for taxpayers compliance, due to low levels of literacy and accounting skills. Small farmers may also withdraw from the market and into subsistence farming when taxed or controlled by the state in other ways. But probably more serious is the severe limitations on administrative resources, and lack of legal and economic sophistication, which at present makes it unrealistic to include small farmers in the V A T net. Due (1990) suggests that one alternative may be to exempt small farmers

from the registration requirement while zero-rating major farm-inputs, such as seed, fertilizer, pesticides, livestock, etc., and place a VAT on minor farm inputs.



**Figure 4.6: ZRB Staff Responses on Kind of Challenges that Face them on Revenue Collection**

Source: Research study (2015)

#### 4.5.2 Different ways that can be used to Reduce Challenges to a Minimum Level

This section continues to address the third objective of the study which is an assessment of the challenges of revenue collection in ZRB. The question aimed at finding out the different ways that can be used to reduce challenges to a minimum level. 20 respondents were asked the Table 4.8 shows the weight of respondents with their respective recommendations about the ways that can be used to reduce challenges to a minimum level.

**Table 4 8: ZRB Staff Responses on Deferent ways that can be used to reduce challenges to a Minimum Level**

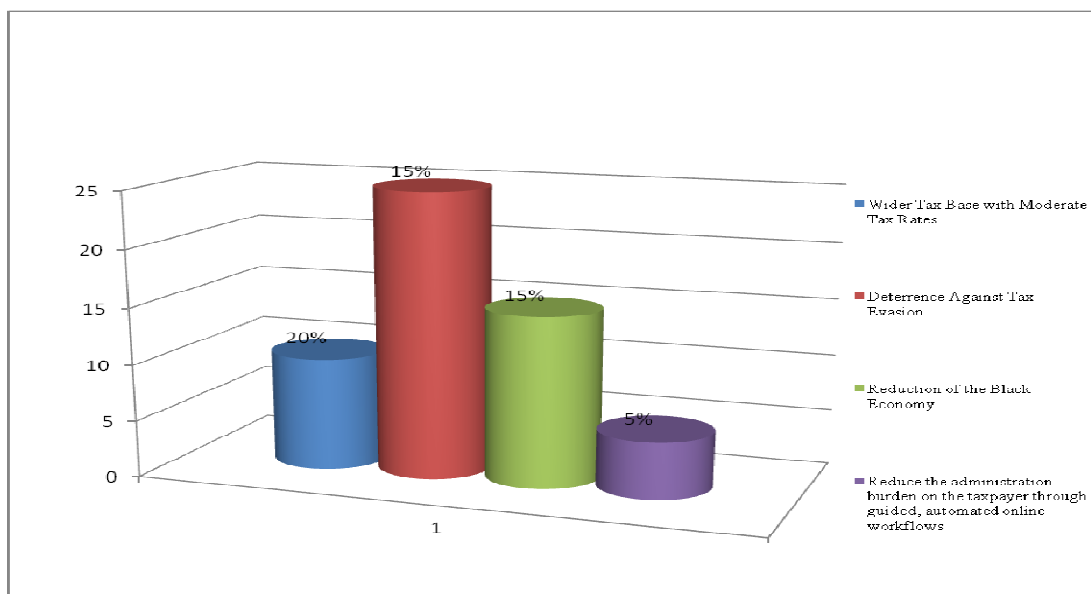
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Wider Tax Base with Moderate Tax Rates	2	10.0	10.0	10.0
	Deterrence Against Tax Evasion	5	25.0	25.0	35.0
	Reduction of the Black Economy	3	15.0	15.0	50.0
	Reduce the administration burden on the taxpayer through guided, automated online workflows	1	5.0	5.0	55.0
	Setting Large Taxpayer Units	3	15.0	15.0	70.0
	Deploy high performance analytics to uncover, track, analyze, and address non-compliance quickly and effectively	6	30.0	30.0	100.0
	<b>Total</b>	<b>20</b>	<b>100.0</b>	<b>100.0</b>	

Source: Research study, 2015

The responses were obtained from questionnaires that were distributed to 20 ZRB's staff. On the interview responses 2(10%) of the respondents indicated that, the proper way that can be used to reduce challenges to a minimum level is to Wider Tax Base with Moderate Tax Rates, 5(25%) of the respondents indicated that, the proper way that can be used to reduce challenges to a minimum level is the Deterrence Against Tax Evasion, 3(15%) of the respondents indicated that, the proper way that can be used to reduce challenges to a minimum level is the Reduction of the Black Economy, 1(5%) of the respondents indicated that, the proper way that can be used

to reduce challenges to a minimum level is Reduce the administration burden on the taxpayer through guided, automated online workflows , 3(15%) of the respondents indicated that, the proper way that can be used to reduce challenges to a minimum level is Setting Large Taxpayer Units, 6(30%) of the respondents indicated that, the proper way that can be used to reduce challenges to a minimum level is to deploy high performance analytics to uncover, track, analyze, and address non-compliance quickly and effectively. Figure 4.7 illustrates the fact.

This implies that, if ZRB deploys high performance analytics to uncover, track, analyze, and address non-compliance quickly and effectively, could reduce challenges that face it staff to a minimum level as indicated by 30% of the respondents. But shows also reduction of black economy could not affect much in reduction of challenges facing ZRB's staff in revenue collection, as indicated by 5% of the respondents.



**Figure 4.7: ZRB Staff Responses on Different Ways that can be used to Reduce Challenges to a Minimum Level**

Source: Research study (2015)

Pramod Kumar (2004) has emphasized that, the size of the black economy in developed Organization of Economic Co-operation and Development (OECD) countries is much smaller compared to the size of the black economy in developing countries. The amount of black money is growing not only in absolute terms but also in relative terms as a percentage of GNP.

#### **4.5.3 Measures that are Appropriate for Effective Collection of Revenue in ZRB**

This section also continues to address the third objective of the study which is an assessment of the challenges of revenue collection in ZRB. The question aimed at finding out the different ways that can be used to reduce challenges to a minimum level. 20 respondents were asked the Table 4.9 shows the weight of respondents with their respective recommendations about the ways that can be used to reduce challenges to a minimum level.

The responses were obtained from questionnaires that were distributed to 20 ZRB's staff. On the interview responses 7(35%) of the respondents indicated that, the appropriate measure for effective collection of revenue in ZRB is to improve taxpayer services through the proactive management of taxpayer or constituent relationships through e-reminders, notices and triggered alerts, 4(20%) of the respondents indicated to rationalize, decommission and upgrade outdated technology for better system efficiencies, enhanced workflow and a modernized technology infrastructure, 6(30%) of the respondents indicated to streamline, improve and automate tax collection and calculation processes whenever possible, 3(15%) of the respondents indicated to Leverage data for research and improve compliance measures and better customize taxpayer services Figure 4.8 illustrates the fact.

**Table 4.9: ZRB Staff Responses on Measure that are Appropriate for Effective Collection of Revenue in ZRB**

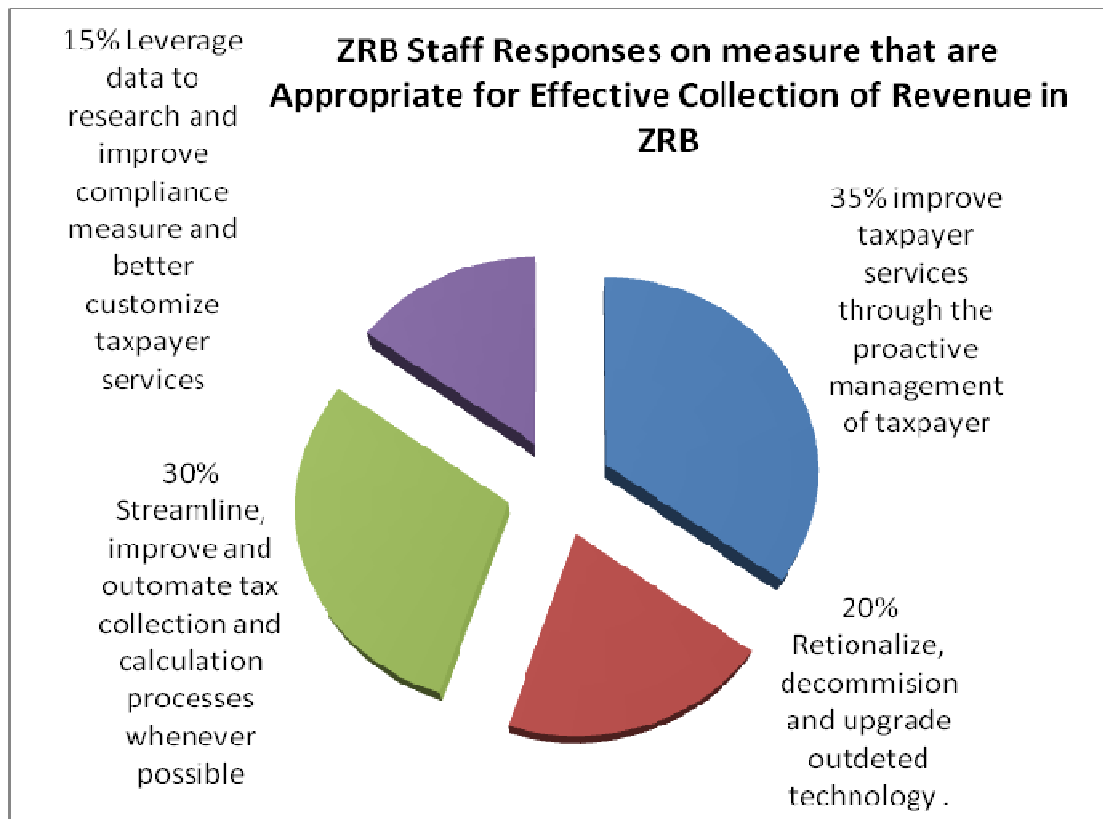
		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Improve taxpayer services through the proactive management of taxpayer or constituent relationships through e-reminders, notices and triggered alerts	7	35.0	35.0	35.0
	Rationalize, decommission and upgrade outdated technology for better system efficiencies, enhanced workflow and a modernized technology infrastructure	4	20.0	20.0	55.0
	Streamline, improve and automate tax collection and calculation processes whenever possible	6	30.0	30.0	85.0
	Leverage data to research and improve compliance measures and better customize taxpayer services	3	15.0	15.0	100.0
	<b>Total</b>	<b>20</b>	<b>100.0</b>	<b>100.0</b>	

**Source:** Research study (2015)

This implies that, ZRB should improve taxpayer services through the proactive management of taxpayer or constituent relationships through e-reminders, notices and triggered alerts for effective collection of revenue, as indicated by 35% respondents of ZRB staff. Also can, improve and automate tax collection and calculation processes whenever possible so as to increase the effectiveness of revenue collection, this also indicated by 30% of respondents.

The in effectiveness of revenue collection is caused by less development because of a paucity of funds with the government and corruption in higher places. also, the predominance of regressive indirect taxes, the poorer section of society has to

sacrifice a bigger share of income in taxes compared to richer persons of society. Further, taxpayers suffer greatly on account of absence of a fair dispute resolution system (Pramod Kumar, 2004).



**Figure 4.8: ZRB Staff Responses on measure that are Appropriate for Effective Collection of Revenue in ZRB**

Source: Research study, 2015

## **CCHAPTER FIVE**

### **CONCLUSION AND RECOMMENDATIONS**

#### **5.1 Introduction**

The upfront task of this paper was to assess the impact of the VAT on GDP and revenue collection -ZRB. The results reveals that the contribution of VAT on ZRB Revenue Collection is one unit of VAT brings about 2.49 units of ZRB Revenue Collection. This estimated result leads the study to accept that VAT has impact on ZRB Revenue Collection. Substantiated by  $r^2 = 0.99$  which is strong goodness fit claims to agree with the results that VAT has strong contribution to ZRB Revenue Collection.

Also it reveals that the contribution of VAT on Zanzibar economy is one unit of VAT brings about 28.68 units of Zanzibar GDP. This estimated result leads the study to accept that, VAT has impact on Zanzibar economy. Substantiated by  $r^2 = 0.97$  which is strong goodness fit claims to agree with the results that VAT has strong contribution to Zanzibar economy.

#### **5.2 Conclusion**

The result of the study revealed that value added tax is beneficial to the Zanzibar economy. This can be understood from the behavior of the variables in this research, which shows that value added tax is statistically significant to revenue generated by ZRB in Zanzibar. Furthermore there are still challenges facing ZRB in revenue collection the ones which are dominate are abundance of exemptions for political reasons and to improve collections and compliance.



### 5.3 Recommendation

From the findings, for Zanzibar to attain its economic growth and development, she must be able to generate enough revenue in order to meet up with the challenges of her expenditures in term of provision of social facilities and the running costs of the Government. The result of this study indicates that if more goods and services are taxed, the revenue base of the country will increase. We still recommend that the value added tax bases be widened to bring the informal sector into the value added tax net so as to stem possible evasion even by the so faithfully complying under the old rate.

Apart from that the study recommends the following:

VAT features are highly competent to allot benefit to the government. So, the channel of distribution and flow of VAT must be reformed.

A transparent approach to Rate of Tax, Refund Procedure, Maintaining and improving accounting procedure are the immediate need for an hour.

The uniform rate of VAT for all the products should be maintained throughout the country:

- (i) To improve taxpayer services through the proactive management of taxpayer or constituent relationships through e-reminders, notices and triggered alerts.
- (ii) To rationalize, decommission and upgrade outdated technology for better system efficiencies, enhanced workflow and a modernized technology infrastructure
- (iii) To streamline, improve and automate tax collection and calculation processes whenever possible

- (iv) To Leverage data for research and improve compliance measures and better customize taxpayer services

The government must take steps to widen their tax base and to reduce the black economy, thereby reducing tax avoidance and tax evasion. In order to reduce the black economy and tax evasion, all citizens must be issued a universal identification number, much like the United States social security number, to keep track of their transactions.

The officers of the tax department and other senior politicians and officials should be held to higher standards of tax compliance.

Codes and regulations must be simplified to permit better understanding and better tax compliance by taxpayers.

#### **5.4 Suggested Areas for Further Research**

There is a need to conduct further study on the assessment of the impact of the VAT on GDP and revenue collection in Tanzania which can be useful in comparative analysis between Tanzania and Zanzibar thus deviation and experience can be learnt. Further questions are posed by the issues of co linearity in the Simple regression model, and our own uncertainty of whether omitted variable bias could yet be involved. With these aspects of uncertainty, it seems that further investigation into this relationship is required, more comprehensive and longer term data will continue to become available, and with it a more thorough understanding of the relationship will be possible. The suggested topics for further research include:

- (i) The Challenges of Tax Collection in Zanzibar Economy.
- (ii) The assessment of the impact of the VAT and revenue collection on Tanzania economy.

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## APPENDICES

### Appendix I: VAT and ZRB Revenue Collection from 2002 to 2012

The Table Shows VAT and ZRB Revenue Collection from 2002 to 2012 that are used to Estimate the Regression Equation of VAT and RC

TSH BILLION					
S/N	YEAR	ZRB -RC	VAT	VAT2	RC*VAT
1	2002	20.86	8.77	76.91	182.94
2	2003	23.36	9.64	92.93	225.19
3	2004	29.29	13.45	180.90	393.95
4	2005	36.30	16.19	262.12	587.70
5	2006	44.29	19.32	373.26	855.68
6	2007	59.21	25.00	625.00	1,480.25
7	2008	72.45	31.48	990.99	2,280.73
8	2009	84.96	38.96	1,517.88	3,310.04
9	2010	89.41	35.12	1,233.41	3,140.08
10	2011	105.08	40.35	1,628.12	4,239.98
11	2012	120.56	49.27	2,427.53	5,939.99
<b>TOTAL</b>		<b>685.77</b>	<b>287.55</b>	<b>9,409.07</b>	<b>22,636.53</b>

Source: Research study, 2015

## Appendix II: VAT and Zanzibar GDP from 2002 to 2012

The Table Shows VAT and Zanzibar GDP from 2002 to 2012 that are used to Estimate the Regression Equation of VAT and GDP

S/N	YEAR	TSH BILLION			
		GDP	VAT	VAT2	GDP*VAT
1	2002	320.22	8.77	76.91	2,808.31
2	2003	358.60	9.64	92.93	3,456.91
3	2004	430.78	13.45	180.90	5,794.01
4	2005	493.99	16.19	262.12	7,997.76
5	2006	638.02	19.32	373.26	12,326.61
6	2007	734.80	25.00	625.00	18,370.01
7	2008	851.15	31.48	990.99	26,794.23
8	2009	939.37	38.96	1,517.88	36,597.95
9	2010	1,050.77	35.12	1,233.41	36,902.96
10	2011	1,344.15	40.35	1,628.12	54,236.43
11	2012	1,565.19	49.27	2,427.53	77,117.04
<b>TOTAL</b>		<b>8,727.05</b>	<b>287.55</b>	<b>9,409.07</b>	<b>282,402.22</b>

Source: Research study, 2015

### **Appendix III: Questionnaire For Staff of the Zanzibar Revenue Board (ZRB)**

#### **Introduction**

Dear respondent, this questionnaire intends to get information on the challenges on revenue collection faced by the staff of ZRB. This is for academic purposes in partial fulfillment of the requirement for the degree of Master of Business Administration (MBA-Finance) of Open University of Tanzania. Please fill this questionnaire in confidence and do not write your name in any part of this form. Please be assured that the information you provide on this questionnaire will be confidential. *(Please tick where appropriately).*

#### **A. Personal Particular.**

- (i) Name of work organization .....
- (ii) Designation.....
- (iii) Age .....
- (iv) Sex .....

#### **B: CHALLENGES ASSESSMENT**

*Please consider each of the following sentences and indicate the response that reflects your opinion about challenges on revenue collection that you face in ZRB.*

1. Have you ever been faced by any challenges during undertaking your responsibility?

Yes

No



2. If yes, what kind of challenges have you been faced with?
- (i) Abundance of Exemptions for Political Reasons
- (ii) Ambiguous Exemptions on Commodities under VAT System:
- (iii) Under invoicing of goods and services to avoid commodity taxes.
- (iv) Ineffective enforcement of tax laws.
- (v) Tax officials do not have the political support to deal with tax evaders and the black economy.
- (vi) Very Low Percentage of GDP is collected in Taxes
- (vii) How do we make things easier for the taxpayers?
3. Do you think can these challenges be reduced to minimum level?
- Yes
- No
4. If yes, please explain. (by choosing bellow:)
- a) Wider Tax Base with Moderate Tax Rates
- b) Deterrence Against Tax Evasion
- c) Reduction of the Black Economy
- d) Setting Large Taxpayer Units
- e) Reduce the administration burden on the taxpayer through guided, automated online workflows
- f) Deploy high performance analytics to uncover, track, analyze, and address non-compliance quickly and effectively

5. What measures do you think could be appropriate for effective collection of revenue in ZRB?

- a) Improve taxpayer services through the proactive management of taxpayer or constituent relationships through e-reminders, notices and triggered alerts
- b) Rationalize, decommission and upgrade outdated technology for better system efficiencies, enhanced workflow and a modernized technology infrastructure
- c) Streamline, improve and automate tax collection and calculation processes whenever possible
- d) Leverage data to research and improve compliance measures and better customize taxpayer services

**THANK YOU**