



Vat Compliance Cost for SMEs in Algeria: Burden, Complexity and Business Factors

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Abstract: This study investigates the cost of compliance for VAT in Algeria. Specifically, it examines the burden of VAT compliance cost by the small and medium enterprises (SMEs) in Algeria, the complexity of the VAT law and its compliance, and the business factors affecting VAT compliance cost. This study used questionnaire survey to collect data from the respondents for the purpose of investigating the VAT compliance cost. This study focuses on the SME operators within Adrar State in Algeria. The results of the study show that majority of the respondents think that VAT compliance cost is a burden to their company and VAT law is complex and costly for them. The high cost of compliance can discourage voluntarily compliance among owners of the SMEs. This study also reveals that business location of the SMEs does not affect their compliance cost. On the other hand, business size, business type and external advisors affect the compliance cost of the SMEs. In Algeria, SMEs are the backbone of the economy. However, the high compliance cost for this sector can discourage investors to invest in SMEs. Therefore, the government needs to review the tax policy, structure and legislation, and tax administration with a view to reduce the tax compliance cost for VAT specifically for the SMEs in Algeria.

Keywords: VAT, compliance cost, SMEs, Algeria

I. INTRODUCTION

Tax compliance is a topical policy issue especially in developing countries. This is important since governments across different countries are continuously trying to improve their tax and revenue collection process for the purpose of financing their budgets. Since the compliance cost constitutes an additional cost to taxpayers over and above the actual amount due to the government, it is likely that it is a burden and that taxpayers want to evade tax by not declaring their true financial position and revenue (Faridy, 2014). Compliance cost for small and medium enterprises (SMEs) is particularly important as SMEs in most developing countries constitute the bulk of business taxpayers. As such, their compliance levels have significant influence on government tax revenue collection (Maseko, 2013). In Algeria for example, SMEs constitute 94% of nationwide businesses network; and more importantly, generate 52% of the total production of the non-oil private sector and nearly 35% of the VAT of the economy (MISMEPI, 2012). Between 2002 and 2012, SMEs accounted for 99% of all declared investment projects in Algeria (NOS, 2012). Furthermore, the SMEs engaged over 1.8 million people in 2012, recording a 6% increase in the employment rate against 2011, averaging 2.61 jobs per SME in 2012 (MISMEPI, 2012). Consequently, SMEs have helped in the financing of public infrastructure, especially that its per sector share of private investment revealed that 17% was from the manufacturing sector; 46% from transportation; 35% from building and public works; while fishing and agriculture generated 2% taxes (MISMEPI, 2012). Alink (2010) emphasizes that the refusal of SMEs to comply with tax regulations, especially in the form of non-registration for tax, improper filing of returns, under-reporting of sales and profit, improper or poor record-keeping, etc., constitute major threats to revenue generation efforts of the government.

Value Added Tax (VAT) compliance cost specifically for SMEs is an important element that remains under-analyzed (Lucie et al., 2008). In Algeria, VAT is charged on all economic activities, such as commercial and industrial handicraft and other professional activities. Based on this, its compliance with respect to cost-related factors has become an important issue for the SMEs. Broadly, two different types of VAT rates are often applied in Algeria. The first rate is 7% and is applicable to commodities, products, wares, operations and

merchandise which are related to materials for agriculture, plants and domestic buildings, printing, plants and domestic animals, products of traditional crafts, etc. The second rate is 17% and is meant for operations that are related to goods and services that are covered or subjected to another rate. Registration generally is required for entities that have an annual turnover of Algerian dinar DZD100,000. Given the important position that SMEs occupy in the Algerian economy, its failure to comply with VAT regulations could cause a great economic distortion as it concerns decision-making for the optimal allocation of resources. For instance, the increased burden on SMEs may discourage new startup businesses, which in turn, can reduce tax revenue (Djankov et al., 2000). Therefore, investors may avoid starting a new business, thus adversely affecting the growth of SMEs.

Even though many studies have been undertaken in both developed and developing countries with respect to tax compliance cost (see for example Evans, 2008; Yesegat, 2009; Hansford&Hasseldine, 2012); very limited published studies are available in the context of Algeria. Therefore, the objective of this study is to investigate the cost of compliance for VAT in Algeria.

II. LITERATURE REVIEW

Tax compliance costs have been extensively studied globally. Researchers have been explaining and reviewing the evolution of tax compliance costs over the last six decades (Sandford, Godwin and Hardwick, 1989). Vaillancourt et al. (2008), for instance, carried out a study on tax compliance cost in Canada and argue that more research needs to be conducted for the purpose of curbing the problems that are associated with government revenue generation. In addition, extensive reviews of tax compliance costs have also been conducted by Rametse (2006), Yesegat (2009) and Abdul-Jabbar (2009) for the purpose of reviewing and specifying the importance and burdensomeness of tax compliance costs. Evans (2008) also carried out an overview of administrative and tax compliance costs. His study revealed three important findings that arise from the literature: compliance costs are regressive; compliance costs are high and significant; and compliance costs are not reduced over time. Furthermore, the findings of Pope (2009) are also aligned with Evans's (2008) first two conclusions. In addition, Pope (2009) emphasizes the political sensitivity of tax compliance costs and asserts that many governments of the world do not give serious commitment to the efficiency and simplicity of tax policy and do their best to minimize research and/or publicity on the topic.

As for studies on VAT compliance cost, a study by Brunton (2005) in New Zealand found that VAT (or GST in the case of New Zealand) is the most time consuming of all taxes surveyed. The mean for the internal compliance costs of the GST were estimated at NZ\$1,852. Similarly, a study by the Inland Revenue of New Zealand (2010) found GST to be the most time consuming of all taxes surveyed. Mean GST compliance costs are estimated to be \$2,185. In a UK study carried out by Hansford & Hasseldine (2012), the outcome with respect to the VAT division reveals that 219 hours on average is spent annually on VAT compliance. This equates to more than half of the in-house time spent on tax compliance. On average, VAT compliance costs are approximated to be £6,062, representing more than 40% of the internal tax compliance costs.

In the Netherlands, VAT is found to be the second most expensive tax to comply with, with its costs of compliance is estimated at 6% of VAT revenue (Allers, 1994). A high costs-revenue ratio for VAT is also reported by Malmer (1995). In Sweden, the Swedish VAT compliance costs are estimated at 2.5% of the VAT revenue. Moreover, the average costs of handling VAT are found to be more than twice the costs of complying with preliminary taxes and payroll charges and are also highly regressive (Malmer, 1995).

In a major Australian study on GST start-up compliance costs for small businesses conducted by Rametse and Pope (2002), the mean gross start-up compliance costs for small businesses was estimated at A\$7,600. Glover and Tran-Nam (2005) estimated the GST recurrent compliance costs/benefits for small businesses in Australia and found that the average gross recurrent compliance costs of GST are AU\$2,481, while the average net costs amounted to AU\$1,244. More recently, Lignier and Evans (2012) conducted an electronic survey of a sample of 3,500 small businesses and GST was found to be the most time consuming of all taxes. A total of 287 hours were estimated as internal GST compliance time and this is estimated to be equivalent to AU\$11,950.

The VAT in Ukraine appears to be the most time consuming when compared to other countries. Companies in Ukraine spent, on average, 650 person-hours on VAT functions in 2007 (IFC, 2009a). In Uzbekistan, the average time spent on preparing VAT invoices amounts to 94 man-hours per year, which represents a burden of approximately UZ\$28 billion in terms of labor cost for all legal entities in Uzbekistan (IFC, 2010b).

VAT is also found to be the most time consuming of all taxes paid in Armenia, with record-keeping being the most onerous VAT activity. An interesting finding is that large companies spent, on average, 108 hours searching, studying and analysing VAT legislation in 2009 (IFC, 2011a). This shows that VAT can be very complex. In Nepal, tax compliance costs are found to be high for VAT. Overall, average VAT compliance costs are estimated at Nepalese rupees 14,756 (IFC, 2011a). Furthermore, VAT compliance costs are found to be high for businesses that partially outsource tax compliance services.

Generally, the outcomes of the VAT compliance costs researches from developed nations reveal that tax compliance cost is regressive in nature and it is more burdensome than other taxes. Furthermore, when VAT compliance services are outsourced, it tends to lead to higher compliance cost. Overall, VAT compliance costs are high (whether incurred internally or externally) and more burdensome for smaller businesses. Based on the extensive review of VAT literature across the countries, it is discovered that published studies which investigate VAT compliance cost are very limited in Algeria. It is in this regard that this study intends to fill the gap as its findings shall help to improve VAT administration particularly in Algeria.

III. RESEARCH METHODOLOGY

This study used questionnaire survey to collect data from the respondents for the purpose of investigating the VAT compliance cost for SMEs in Algeria. The questionnaire in this study is adapted from Faridy (2014). This research focuses on the SME operators within Adrar State in Algeria. Adrar is the second largest province in Algeria and it is a large administrative region. The SMEs were identified by the number of employees (not more than 250 employees) and their fixed capital which ranges between DZD 200 million to 2 billion ((MISMEPI, 2012).

For this study, the populations consists of 2,164 private sector SMEs (MISMEPI, 2012). Based on Sekaran (2013), the appropriate sample size for this study is 338. The sampling process of this study is based on simple random sampling technique. The SMEs were randomly selected from the registered taxpayers in the database of the Adrar State tax department. The employees of the tax department in Adrar State were requested to distribute and collect the questionnaires from the selected sample as the SMEs have to visit the tax department for tax payment purposes on a regular basis of at least once in a month. The researcher managed to obtain 327 completed questionnaires from the sample which represented 96.7% response rate.

IV. RESULT OF THE STUDY

4.1 Burden of VAT Compliance

In Table 1, Question 1 shows that about 96.9% of the respondents think that VAT compliance cost is a burden to their company, while 3.1% oppose this opinion. Result of Question 2 shows that 53.2% of SMEs reflect that VAT compliance cost is between 21% to 30% burden for them; 40.7% say it is between 31% to 40% burden; while 6.1% state that it is between 10% to 20% burden to them.

Result for Question 3 indicates that 46.5% of SMEs think that VAT law complexity is the reason for burden in VAT compliance; 30.3% blame it on VAT compliance taking more time than other taxes; and 23.2% say that VAT is a monthly tax to pay, hence takes more time and frequency to comply.

Table 1: Burden of VAT compliance

Q 1: Is VAT compliance a burden to your company?		
Response	Frequency	Percentage
Yes	316	96.9
No	11	3.1
Total	327	100
Q 2: Percentage of burden for VAT compliance:		
Percentage of burden	Frequency	Percentage
10% - 20%	20	6.1
21% - 30%	174	53.2
31% - 40%	133	40.7
41% - 50%	0	0
More than 50%	0	0
Total	327	100
Q 3: Reasons of burden for VAT compliance:		
Reasons of burden	Frequency	Percentage
VAT law is complex	151	46.5%
VAT is a monthly tax to pay	75	23.2%
VAT takes more time than other taxes	101	30.3%
Total	327	100

4.2 VAT Complexity and Compliance

Table 2 shows the complexity of VAT law and VAT compliance. The statement that other taxes are less complex than VAT is strongly agree by 45.2% of the respondents; 41.2% agree with the statement; and 13.6% remain neutral. The mean value for response is 64.5 and standard deviation is 0.71.

In response to the question whether VAT complexity is insignificant to their businesses, only 0.5% of the respondents strongly agree; 1% agree; 10.5% neutral; 59% disagree; and 28% strongly disagree. The mean value for response is 64.5 and standard deviation value is 0.81.

A total of 41% of the respondents strongly agree that simplified VAT law would increase voluntary compliance, 53% of the respondents agree; 5.7% remain neutral; and only 0.3% disagree with the statement. The mean value for response is 64.5 and standard deviation value is 0.82.

Responses to the statement that compliance with VAT law is excessively complex and costly for taxpayers show that 50% of the respondents strongly agree; 48.5% agree; 1% remains neutral; and 0.5% disagrees with this statement. The mean value for response is 64.5 and standard deviation value is 0.87.

In response to the statement that complexity of VAT compliance discourages them to fulfill VAT obligations, 29% of the respondents strongly agree; 68% agree; 2.6% remain neutral; and 0.3% disagrees with this statement. The mean value for the response is 64.5 and standard deviation value is 0.96.

Table 2: VAT complexity and compliance

Factors	Frequency					Total	Mean (S.D.)	Rank
	1	2	3	4	5			
	Strongly Disagree				Strongly Agree			
Others taxes are less complex than VAT	0 0%	0 0%	44 13.6%	135 41.2%	148 45.2%	327 100	64.5 (0.71)	1
VAT complexity is insignificant	92 28%	195 59%	35 10.5%	4 1%	1 0.5%	327 100	64.5 (0.81)	2
Simplified VAT law would increase voluntary compliance	0 0%	1 0.3%	17 5.7%	175 53%	134 41%	327 100	64.5 (0.82)	3
Compliance with VAT law is excessively complex and costly for taxpayers	0 0%	1 0.5%	4 1%	159 48.5%	163 50%	327 100	64.5 (0.87)	4
Complexity of compliance discourages taxpayers to fulfill VAT obligations	0 0%	1 0.3%	7 2.6%	223 68%	96 29%	327 100	64.5 (0.96)	5

4.3 Business Factors Affecting VAT Compliance

With regards to responses for the business factors affecting VAT compliance cost by the SMEs, Table 3 shows that 19% of the respondents think that business location does not have effect on tax compliance cost; 44% say that it has minor effect; 35% are neutral; 2% say it has moderate effect; and 1% say that business location has major effect on compliance cost. The mean score for the response is 65.4 and standard deviation is 0.64.

A total of 37% respondents think that business size has major effect on SMEs compliance cost for VAT; 54% say it has moderate effect; 4% seem neutral; 4% think it has minor effect; and 1% show that it has no effect on VAT compliance cost. The mean value for the response is 65.4% and standard deviation is 0.79.

For business type effect on cost of VAT compliance, 23% of respondents say that it has a major effect on VAT compliance cost; 54% say it has a moderate effect; 20% remain neutral; 2% say it has minor effect; and 1% says it has no effect on VAT compliance cost. The mean value for the response is 64.5 and standard deviation is 0.71.

A total of 30% respondents in this study say that external advisor can majorly affect VAT compliance cost of the SMEs; 53% say it has a moderate effect; 15% remain neutral; 1.5% say it has minor effect; and 0.5% say it has no effect on VAT compliance cost. The mean value for the response is 64.5 and standard deviation is 0.72.

Table 3:Business factors affecting VAT compliance cost

Factor affecting VAT compliance cost	Frequency					Total	Mean	Rank
	1 Major Effect	2 Moderate Effect	3 Neutral	4 Minor Effect	5 No Effect		(S.D.)	
Business location	2	5	113	145	62	327	65.4	1
	1%	2%	35%	44%	19%	100%	(0.64)	
Business size	121	177	12	14	3	327	65.4	2
	37%	54%	4%	4%	1%	100%	(0.79)	
Business type	75	177	67	6	2	327	64.5	3
	23%	54%	20%	2%	1%	100%	(0.71)	
External advisor	99	174	48	5	1	327	64.5	4
	30%	53%	15%	1.5%	0.5%	100%	(0.72)	

IV. CONCLUSION, LIMITATION AND FUTURE RESEARCH

This study aims to investigate the burden, complexity and business factors affecting compliance costs of VAT for SMEs in Algeria. SMEs play a vital role in the development of a country. For instance, in Algeria, the contribution of SMEs to GDP for 2012 was 60% and they employ approximately 1.86 million workers. SMEs are the majority business taxpayers in most developing countries and as such, their compliance levels directly influence government tax revenue collection.

Results of this study reveal that majority of the respondents think that VAT compliance cost is a burden to their company, which represents around 21% to 40% of the total tax compliance burden for the SMEs. They also think that VAT law is complex and costly for the taxpayers. This high cost of compliance can discourage voluntarily compliance among owners of the SMEs. This study also reveals that business location of the SMEs does not affect their compliance cost. On the other hand, business size, business type and external advisors affect the compliance cost of the SMEs.

SMEs in Algeria are the backbone of the Algerian economy, contributing almost 60% to GDP. However, the high compliance cost for this sector can discourage investors to invest in SMEs. Therefore, the government needs to review the tax policy, structure and legislation, and tax administration with a view to reduce the tax compliance cost for VAT specifically for the SMEs in Algeria.

There are two main limitations of this study that have to be acknowledged. First, the data was collected from only one state in Algeria while other states might differ in their business perspectives. Second, VAT compliance cost as a percentage of GDP or total tax compliance cost has not been considered in this study. Future studies can be conducted by making GDP as the base for the percentage of expenses incurred on compliance cost. Moreover, future studies can use different ways to collect data, including qualitative methods. Future studies can expand the sample to all Algerian states so that the result could be generalized to the whole of Algerian population.

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