STRATEGIC VAT PLANNING AS A SUSTAINABLE SOURCE OF INCOME FOR MUNICIPALITIES DURING 2017-2021

PLANIFICACIÓN ESTRATÉGICA DEL IVA COMO FUENTE SOSTENIBLE DE INGRESOS PARA LOS MUNICIPIOS DURANTE 2017-2021

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Abstract: *Nowadays, the value added tax system plays a significant role in satisfaction of social, economic and budget related goals especially in terms of satisfaction of sustainable income sources for municipalities. With respect to lack of coherence, lack of autocorrelation and also normality of the population and consistence of the standard deviation, the present research has incorporated the linear regression model in addition to the ARMA time series. In addition, for the purpose of estimation of tax efforts and tax capacities the OLS method has been used. According to the results of the study, in spite of increase in the value added of products, consumer services and the per capita income; in contrast to the Caldor's and Salvatore's theories and as a result of the improper execution and improper distribution of the income of various sectors, the overall tax income of the province and the sustainable income sources of municipalities will not increase parallel to the mentioned rate. The following recommendations are aimed at moderation of the problem at hand: 1- value added tax should be received from the final consumer; 2- in order to increase the efficiency of resources and help with implementation of the article 44 of the constitution, the task of collection of taxes must be assigned to municipalities; 3- electronic commerce systems must be developed by the help of municipalities and guilds so that tax evasion and tax rent are avoided, resources are distributed in a more efficient manner and, tax payers are identified properly.*
Keywords: *tax income, strategic planning, tax capacity, regression model, ARMA model*

Abstracto: *Hoy en día, el sistema de impuesto al valor agregado juega un papel importante en la satisfacción de los objetivos sociales, económicos y relacionados con el presupuesto, especialmente en términos de la satisfacción de las fuentes de ingresos sostenibles para los municipios. Con respecto a la falta de coherencia, la falta de autocorrelación y también la normalidad de la población y la consistencia de la desviación estándar, la presente investigación ha incorporado el modelo de regresión lineal además de la serie temporal ARMA. Además, a los efectos de la estimación de los esfuerzos tributarios y las capacidades impositivas, se ha utilizado el método OLS. De acuerdo con los resultados del estudio, a pesar del aumento en el valor agregado de los productos, los servicios al consumidor y el ingreso per cápita; en contraste con las teorías de Caldor y Salvatore y como resultado de la ejecución inadecuada y la distribución inadecuada de los ingresos de varios sectores, el ingreso fiscal general de la provincia y las fuentes de ingresos sostenibles de los municipios no aumentarán paralelamente a la tasa mencionada. Las siguientes recomendaciones apuntan a la moderación del problema en cuestión: 1- se debe recibir el impuesto al valor agregado del consumidor final; 2- Para aumentar la eficiencia de los recursos y ayudar con la implementación del artículo 44 de la constitución, la tarea de recaudación de impuestos debe asignarse a los municipios; 3- Los sistemas de comercio electrónico deben desarrollarse con la ayuda de los municipios y gremios para evitar la evasión de impuestos y el alquiler de impuestos, distribuir los recursos de una manera más eficiente y los contribuyentes se identifican adecuadamente.*
Palabras clave: *ingresos fiscales, planificación estratégica, capacidad tributaria, modelo de regresión, modelo ARMA*

Introduction

Collecting VAT (value added tax) is a solution towards independence from exogenous, uncontrollable, fluctuating and untrustworthy incomes from selling density and parking lots and, fines relating to article 100. In addition, VAT can be considered as a sustainable source of income for both municipalities and states (Kane and Luck Wood, 2015). Strategic planning, futurism, and estimation of resources in case of occurrence of probable crises and creating a suitable structure for states' and municipalities' budget financing through strategic planning of tax incomes is one of the key goals of policy makers (Mozafari et al., 2016). During the past few decades, the system of strategic VAT planning towards creating sustainable sources of income for municipalities has been implemented in more than 50% of the countries around the globe (Jim, 2014). This tax which is collected from the added value of corporations during various phases of production, distribution and or consumption is accompanied by several benefits such as low tax rates, reduced incentives for tax evasion and providing a reliable source of sustainable income for states and municipalities (Abrishami & Mehrara, 2015). Countries that have yet failed to apply strategic planning in their tax systems and those that do not fully obey the laws are faced with problems such as improper distribution networks, increased prices after putting VAT into effect, negative inflation related effects such as reduced purchasing power and improper income distribution, and reduced load capacity and reduced public co0llaboration in maintenance of the country and resultantly, deterioration of municipalities' sustainable sources of income (Danesh Jafari et al., 2015). During 2015-2016, 82% of the income of the municipality of the city of Malayer came from selling density, parking lots, changing building usages, issuance of building certificates and etc. According to the elite theory 56, all these items are unstable and have caused lack of stability in the income of municipalities in addition to piling of debts of municipalities. Actual tax receipts on the one hand and the necessity of having access to stable income sources for municipalities on the other hand have made it crucial to review the current tax systems and to develop a strategic high efficiency VAT planning for municipalities (Aimer, 2015). One of the most important challenges faced by state policy makers and municipalities is to pay attention to the significant effects of VAT on economic variables and adoption of a tax policy with suitable rates and bases aiming to satisfy the income sources of municipalities and the state. On the other hand, taxation should be of the least interference with the overall economy and the country's development process (Arshadi et al., 2015). Taxes are considered as the most important financial sources for satisfaction of public and sustainable income of municipalities. In addition, taxes are the most efficient and effective financial policy tools throughout the world. In fact through the development of a strategic planning and through avoidance of inconsistencies in goals, governments and municipalities can make the best and yet the most efficient use of these sources that are dependent on controlled and endogenous factors. Nevertheless, by the use of the tool of tax, governments can orient various activities and economic and social flows (Afshari, 2015). The point that is usually subjected to less attention is that high amount of income resulting from sales of oil and fines relating to the article 100, building usage change, parking lots and selling density have undesirable consequences such as dependence of national income on exports of a single product (oil) and sales of properties of cities by the municipalities (Eric and Joseph, 2013). In this regard, the primary question considered by policy makers is: what would be the future shape of tax incomes considering the current economic statuses and laws? How can an individual identify the opportunities and strengths and forecast external threats and weaknesses through making use of previous experiences, real-time decision making and estimation of the future? How can one provide his community with the highest level of welfare through estimation of demands for public products? (Pajooyan, 2015); When an economic model is successful in terms of explanation relationships between the variables, it would be capable to forecast the future in a proper way (Guajarati, 2014). Precise identification of the potential tax income provides the policy makers and city managers with a clear horizon for strategic planning. Scientific forecasting of sustainable tax income of municipalities results in creation of a suitable perspective in addition to enhancement of strategic thinking in municipalities. It also improves the precision of urban developers and tax collectors (Monavarian et al., 2016). On this basis, a tax system is described as an efficient system only when the society has met its tax limits. Some of the most important factors effective on tax capacity of a society are the value added in various economic

sectors, number of tax payers, number of employed people and etc. (Danesh Jafari et al., 2015). The significance of doing research in municipalities lies in the fact that according to current investigations, no previous studies have used the present study's statistical methods for anticipation of the potential capacity of VAT which is a reliable and sustainable source of income for municipalities. Since the capacity of tax load is not clear, therefore it is readily subjected to various fluctuations and resultantly, the yielded incomes are not reliable. Considering this content, policy makers must seek changes and try to introduce new and more reliable and yet sustainable sources of income for municipalities. However, in terms of anticipation of tax incomes of value added, the method of adaptive expectations is used which has no scientific basis (Tafazoli, 2014). There are many previous studies that have elaborated on strategic planning for income sources of municipalities and anticipation of tax incomes and also estimation of tax capacities. In most of these studies regarding strategic planning for tax incomes usually the time series models of the first order including the self-explaining models, moving average models and, self-explaining moving average models are used. Falahati et al., (2014) carried out a study and elaborated on strategic planning of sustainable state income sources and proposed a model of estimation of tax capacity using neural networks. Arab Mazar & Ayat (2014) wrote a paper titled as "Strategic tax planning in Iran" and elaborated on investigation of the potential tax capacity of Iran. In this paper, they tried to propose a clear definition of potential economic capacity of taxation in order to investigate the factors effective on it from different perspectives. Upon reviewing the literature of the subject matter, the Iran's potential economic tax capacity has been estimated for the period of 1998-2014 in form of a panel model and according to the information from 20 countries. Results of this model have shown that during the aforementioned period, the average potential economic capacity of Iran's taxation is equal to 12.3% which is a high value compared to the average performance of the taxation system of Iran in the same period. In addition, other results of this study have shown that Iran's tax efforts index during the same period was approximately 58%. In 2015, in a paper titled as "principal features of VAT as a reliable source of income for municipalities", Afshari has counted the important features of VAT as low rates, spread of coverage of VAT, simplicity of identification and collection, desirability, continuity and low fluctuations. Lithold (2014) wrote an article titled as "tax efforts in China" and stated that measurement of tax efforts is done as a goal in policy making and identification of taxes towards satisfaction of required credits for public expenses. He has made use of variables such as tax income, gross per capita domestic production, the share of the agriculture sector from value added and, the shares exports and imports from GDP (gross domestic production) and, the rate of growth of population. He concluded that China's tax efforts are equal to 43 percent which is lower than the average standard tax effort index. Castles et al., (2015) elaborated on estimation of tax capacity of Spain's local governments. This research has made use of data belonging to the period of 1993-2014. Through estimation of tax capacities of local governments of Spain and through using the econometric methods of square of errors, the authors concluded that in return for reduced tax capacity, 35% of the shock is covered by reduced public expenses, 25% is covered by increased tax levels and the remaining is covered by the increase in the level of debts. Altony (2014) carried out a study and made use of the statistics of time series of 16 Arab countries during 1994-2014 and stated that many Arabian governments are faced with problems in the context of production of sufficient income for satisfaction of their public expenses. The purpose of this study was to compare the tax efforts of Arabian countries. The most important factors in determination of the share of tax income in GDP has been stated as the per capita income, the share of agriculture sector and the share of mining sector in GDP.

Method

In the present study, the author has tried to estimate the function of tax capacity through using previous data and the econometrics method of square of errors. In addition, the ARMA method has been incorporated for anticipation of provincial tax income through the application of the E-views software. In many developing countries, the low levels of tax income are associated with lack of proper and complete execution of tax regulations which in turn, is usually resulted from unsuitability of bureaucratic systems and executive methods of responsible devices in terms

of identification and collection of taxes. In order to estimate the function of tax capacity, usually the external-organizational structural factors are considered. This is because the other effective factors are qualitative and are not considered for in the econometrics model. Estimation of Iran's tax capacity in addition to introduction of Iran's tax capacity contributes increased municipalities' income in a significant way. In this regard, the present research tries to investigate the elements effective on VAT income in the province of Hamadan and also tries to estimate the Hamadan province's tax capacity. Value added in sections including industry and mining, services, investment in industrial units and the per capita income of households are considered as the most important factors effective on VAT and the tax capacity of the Hamadan province. As it was mentioned previously, different studies have estimated tax capacity indifferent ways. The present research incorporates the OLS method for estimation of tax capacity of the province of Hamadan. The model is as follows:

TT= B1 DI + B2 TI + B3 DS + B4 PI + D

In the upper relation, TT stands for the amount of VAT income; DI stands for added value of the industry and mining sector; DS stands for added value of services sector; TI stands for investment in industrial units; PI stands for per capita income and; D stands for other factors effective on VAT.

Since the regulation of VAT was executed in 2008, therefore it would not be suitable to use econometrics methods such as VAR and or ARDL as a result of insufficiency of observations and years. Therefore the ordinary least squares method has been used. Undoubtedly, there are far more independent variables that are effective on tax income of the province of Hamadan, however since the time period is short, increasing the number of independent variables results in lack of estimation of model using the OLS method. In addition, the authors of the present study have tried to rate the shares of tax payers in form of size as large, medium and small, but since there were no statistics available for the shares of tax payers, it was not possible to do so. Ultimately, it was decided to select variables such as added value of the sector of industry and mining, level of industrial investments and the per capita income of households of the province of Hamadan as the factors effective on VAT. Each of the selected independent variables will be discussed in the following.

As it was mentioned in the upper model, the tax income related to value added of the sector of industry and mining, the value added of the sector of services, investment in industrial units and the per capita income of the province of Hamadan have been selected as the independent variables.

Results

Several estimations were made using the ordinary least squares method. The following equation has been selected as the best equation using the AIC and DW criteria:

TT= 0.1008TI + 0.073DI - 0.0112DS + 0.394PI (2) + 953582

D.W =2.03

R2 =%99

Hypotheses testing

As you can see in the correlation matrix, the correlation between variables is too low and this validates the lack of coherence. Another classic assumption is that the average of equation residuals must be equal to zero. Therefore in our estimation, we have elaborated on the test of average disruption. The observed t statistic is located between critical distribution points of t with an error value of 5%. Therefore it is accepted that the average of equation residuals is zero. Another classic assumption regarding sum of squares models is lack of autocorrelation between residuals. If the Durbin-Watson statistic is located between 1.5 and 2.5, the assumption of lack of autocorrelation is accepted. However, when the Durbin-Watson statistic is smaller than 1.5 or larger than 2.5, it is concluded that there is an autocorrelation between the residuals. The Durbin-Watson statistic of the present study's model has been calculated as 2.03 and since it is a number between 1.5 and 2.5, it is concluded that there is no autocorrelation. Similarity of the variances of residuals is also another classic assumption; however, as a result of shortness of the period of study, it was not possible to calculate it. The upper model shows that investment in industrial units is effective on

Vat income of the province of Hamadan with a coefficient of 10% in a way that one unit increase in the investments in Hamadan province's industrial units results in a one percent increase in the amount of collected VAT. Table 1 shows the Hamadan province's average tax income, tax capacity and tax efforts.

Table 1, average tax income, tax capacity and tax efforts

Average provincial tax income (2008-2015)	Average tax capacity	Tax efforts
316328	773.737	40.0%

As you can see in the above table, a significant gap can be seen between the capacity of VAT and tax income in a way that tax efforts has been estimated as 40 percent. According to the estimated model, a tax effort of 40 percent is too low for the province of Hamadan and it shows that 60% of the potential tax capacity is left uncollected. This process can be shown in form of the following equation:

(3) $Yt = P1\ Yt\text{-}1 + P2\ Yt\text{-}2 + \ldots\ldots + Pp\ Yt\text{-}p + Ut$

When YT is a function of interruptions of the unbreakable disturbance sentences, it creates a moving average process. A moving average process from level Q is defined in form of the following equation:

(4) $Y = Ut + A1\ Ut\text{-}1 + A2\ Ut\text{-}2 + \ldots . Aq\ Ut\text{-}q$

In general, the ARMA is the most flexible type of uni-variate time series models which in fact is a combination of self-explanatory and moving average processes. In general, it is written in form of the following equation:

(5) $Y = P1\ Yt\text{-}1 + \ldots . + Pp\ Yt\text{-}p + Ut + A1\ Ut\text{-}1 + \ldots + Aq\ Ut\text{-}q$

Equation 5 is shown in form of ARMA (p, q). If the primary time series in form of the model of ARMA (p, q) required d times of subtraction in order to become reliable, then the mentioned series will have a self-explanatory moving average process from the level d and it would be written as ARIMA (p, d, q)1.

The generalized Dickey Fuller test:

Table 2, shows the results of the generalized Dickey-Fuller test for the variables of study.

Table 2, results of the generalized Dickey-Fuller test

variable	T statistic	Critical value
Tc	-5.250	-3.632
Tt	-6.210	-3.632
Tw	-5.260	-3.632
Tr	-4.420	-3.632
Ts	-7.145	-3.632

Estimation of the ARMA model

According to the Box-Jenkins method, in order to determine p and q in the ARIMA model one can use the ACF and or PACF autocorrelation functions of the time series sample. Since the series in the present study are procedural, they should be first dissolved. In this case, the ACF and PACF of the residuals of each of the models will be dissolved and then used for the ARIMA model. Results of ultimate estimation of all of the models are summarized in table 3.

Table 3, ultimate results of model estimation

Rejection probability	T statistic	coefficient	variable	Investigated factor
0.009	0.11	983582	C	Estimation of y-intercept of VAT income
0.04	0.81	0.89	AR(1)	
0.03	-1.07	-17.4	MA(1)	
0.00	28.5	1.18	AR(1)	Estimation of the model of VAT income in consumption
0.02	1.6	6	MA(1)	
0.029	6.3	-8.93	MA(2)	
0.009	1.84	1.18	AR(1)	Estimation of the model of VAT income in services
0.006	-3.53	-0.84	MA(1)	
0.008	0.35	4.7	AR(1)	Estimation of the model of VAT income in industry
0.0001	2.97	0.91	MA(1)	
0.000	24.9	1.10	AR(1)	Estimation of the model of VAT income in wealth and properties
0.000	-4.31	0.99	MA(1)	

Anticipation of VAT income of the province of Hamadan until 2021

Anticipation of tax incomes in the method of time series is in form of internal sample and is shown in table 4.

(6) $Yt+1 = Yt + d (Yi – Yt)$

In the upper equation, Yt+1 stands for the anticipated income of the year and Yt stands for the income of the previous period which has been calculated using the regression model. Also d stands for the final adjustment coefficient and the realized and actual income of the previous period is also shown with Yi.

For the first year of the program, d= 0.5 is anticipated

For the second year of the program, d= 0.25 is anticipated

For the third year of the program, d= 0.125 is anticipated

For the fourth year of the program, d= 0.0625 is anticipated

For the fifth year of the program, d= 0.03125 is anticipated

After calculation and substitution, the anticipated model of VAT income is as summarized in table 4.

Table 4, anticipated income of VAT

Income of tax on wealth and properties		**Income of tax on industries**		**Income of tax on services**		**Income of tax on consumption**		**Tax income**		**year**
anticipated	**real**	**anticipated**	**real**	**anticipated**	**real**	**anticipated**	**real**	**anticipated**	**real**	
10	9	137	104	79	191	64	45	377	349	2010
11	11	167	181	87	167	76	37	443	397	2011
14	16	195	199	96	192	90	95	501	502	2012
16	124	220	226	106	76	107	88	552	514	2013
19	17	243	190	116	109	126	148	614	534	2014
23	153	264	256	128	93	150	131	641	653	2015
36	175	293	221	151	106	198	166	678	668	2016
32	-	321	-	156	-	211	-	731	-	2017
38	-	316	-	188	-	283	-	790	-	2018

45	-	331	-	239	-	346	-	866	-	2019
63	-	364	-	278	-	451	-	990	-	2020
92	-	386	-	330	-	517	-	1166	-	2021

Results and recommendations

Results of the upper test show that a direct relationship exists between investment in the sector of industry and mining and, value added of this section and the total provincial Vat income. Industry owners pay their taxes and this can be considered as a suitable and yet reliable and sustainable source of income for municipalities. This is because the tax burden of the Vat is totally on the final consumer and it has no effects on the profits obtained by the producer (Khaloorzadeh et al, 2014). On the other hand, it has been shown that a negative relationship exists between the value added of the services sector and people's per capita income and the provincial VAT income. Here the Calder's theory stating a direct relationship between consumption and tax income is rejected and therefore, this income cannot be considered as a sustainable source of income for municipalities. This also shows the lack of efficiency of the tax system in terms of identification and collection of taxes in the sectors of services and consumption. According to the article 8 of the regulation of value added tax, tax payers are distributors, suppliers and providers and or importers of goods and services (Sharzhay et al., 2015). This is while that the tax burden is completely transferred to the customers some of whom are the buyers of the materials of production companies and they are charged with higher prices. This is while the purpose of introducing VAT is to reduce the taxes and support producers (Hung et al, 2014). However, due to improper execution of laws and regulations, the rate of taxes and rates of inflation have increased and resulted in increase of the cost of materials and the finished product prices. Since most of the primary producers and even service providing companies are located in large cities and special cities (industrially known and reputable cities), therefore Iran lacks a proper and just distribution of resources and facilities (according to reports published by the Central Bank of Iran, 8 of 1128 cities of Iran receive more than 82% of the value added of the section of industry and mining. Afterwards, peasants and citizens who live in non-industrial cities and towns tend to purchase goods and services from tax payers who are located in large cities and are considered as the main tax payers. As the tax is paid by the final consumers, industrial cities will be more developed and as a result, economic gaps between the cities become wider. Now that the tax per capita income in Iran is determined disregard of the economic status of cities, according to the laws of the fifth development program of Iran, the excess tax income of every province is allocated to the provincial planning committee and also 45% of VAT is paid to the municipalities of the cities where the producers, distributers and service providers are located in (Pajooyan, 2015). On this basis, all these factors together result in economic reinforcement of industrial cities and growth of economic gaps between industrial cities and cities that lack industries. Lack of proper distribution of resources and, increased rate of efficiency of sources such as capital, work force and suitable services for human forces in large cities; result in removal of resources from small cities. As a result tax capacity in these cities is increased, per capita income of the citizens of these cities is increased and municipalities of these cities will be able to provide the citizens with better services. This results in improper distribution of services and welfare and creation of economic gaps between cities. Ultimately, it may result in increased rate of immigration from non-industrial cities to more industrially developed areas which is in contrast with the goals and policies of Iran's state in terms of just distribution of facilities and state income (David Fardar, 2015). On the other hand, due to low purchasing power of people in non-industrial cities the inflation related effects of VAT results in decreased popularity of the latest currencies. In addition, when the products' finished price is higher, the prices of exported goods are also increased while the tariff rate of imported goods reduces and as a result the domestically made and exported goods will lose their competitiveness against foreign and imported goods. This may result in reduction of rate of growth of the incomes of the industry sector and VAT. In addition, according to the appendix 1 of the article 38 of the VAT regulation makes industry owners pay the taxes of environmental contaminations. Therefore, with respect to the contamination taxes paid by the producers is somehow the compensation for damages done to the living environment

of consumers (Tayebnia, 2015). Regarding the optimist and idealist paradigms the following are recommended: 1- VAT should be collected from the final consumers so that the inflation related effects and tax rents and tax evasions are decreased. 2- The taxes collected from final consumers must be allocated to the tax domains of the corresponding cities so that the collected taxes are spent in the same location where they are collected so that the economic gap and the economic dichotomy are diminished and levels of public services are improved and the goals of tax equality are realized. 3- Through the collaboration of different guilds, there should be electronic commerce systems created with encouraging policies so that tax evasion, tax rent and etc. are clarified and tax payers are identified properly. 4- in order to improve the efficiency of resources in the tax system and better execution of the article 44 of the constitution and the law of manner of transfer of state sectors to municipalities, the task of collection of taxes should be assigned to municipalities.

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