Jesuit Centre for Theological Reflection

JCTR

Promoting Faith and Justice

"THE TAXATION SYSTEM IN ZAMBIA"

FINAL REPORT

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1.0 INTRODUCTION

Primarily a country's tax system must provide sufficient funds for government expenditure programs. However, the means of attaining this basic requirement to get a sufficient level of taxation matters a lot. This mainly relates to the structure and productivity of the tax system. A productive and well-structured tax system should espouse two basic principles. It should:

- minimize the distortion caused by taxation as economic agents attempt to limit their tax liability (the principle of 'efficiency'); and
- extract tax without disadvantaging or discriminating against any taxpayer (the principle of 'equity').

In addition to the main objective, taxes can also be used to redistribute income in the economy to reduce inequality or as a tool for regulation to encourage or dissuade particular activities in order to enhance social welfare. For example, imposition of excise taxes on cigarettes and alcohol could be aimed at reducing the incidence of diseases associated with the consumption of these products. Taxation can also be used to achieve certain macroeconomic objectives such as low inflation by increasing levels of taxation in general or to stimulate economic activity by offering tax incentives in certain sectors of the economy. However, the achievement of these secondary aims should not compromise the core tenets of efficiency and equity.

Developing countries like Zambia face impediments to achieving key objectives of taxation. These objectives are universal, but countries endeavor to achieve them in very different environments. Developing countries, in particular, face great obstacles in achieving these aims. In fact, the need for high government expenditure is even greater in developing countries where the capital stock (e.g. schools, hospitals and roads) is low. In Zambia, tax revenues fund a lot, but not all of expenditure. The shortfall is mainly plugged by foreign aid from cooperating partners and by government borrowing, both locally and internationally.

2.0 THE TAX SYSTEM IN ZAMBIA

The Zambian tax system broadly comprises income taxes, consumption taxes and trade taxes. These taxes are collected by the Zambia Revenue Authority (ZRA) which is the corporate body mandated to collect all taxes.

Table 1: Broad tax categories in Zambia

Tax category	Type of tax
Income taxes	• Company income tax • Pay As You Earn (PAYE) • Withholding tax • Mineral royalty
Property taxes	• Property Transfer Tax
Consumption taxes	• Import and domestic VAT • Excise duties

Trade taxes	• Customs duty • Export duty

In addition, the tax system also comprises non-tax instruments, which includes royalties and fees. These include fuel or road levy, rural electrification fund levy, medical levy, Carbon Emission Surtax (CES) and motor vehicle licensing fees.

Box 1: Taxes collected, definitions and applicable rates

1.0 Income taxes and applicable rates		
Tax Types	**Definition**	**Applicable Rates**
Company Tax	❖ A tax on all incorporated businesses on their profits from businesses. ❖ Company tax applies on companies whose turnover is above ZMW800, 000 per annum.	**Category** **Rate** • Companies generally 35% • Charitable organizations 15% • Farming 15% • Non – traditional exports 15% • Manufacture of fertilizer 15% • Mobile telecommunication sector First ZMW250,00 Profit 35% Above ZMW250,000 Profit 40%
PAYE	❖ PAYE is tax charged on income from employment. ❖ Income from Employment includes: Salaries and wages; Overtime and bonuses, Gratuities and allowances, cash benefits and commissions. ❖ All cash benefits paid in form of allowances are taxable under PAYE, such, as education, housing and utility. ❖ However, the following Benefits are not subjected to PAYE: Labor day awards;	**Current PAYE Regime (2014)** **Income Bands(Monthly)** – **Rates** 0 – K3,000 – 0% K3,001 - K3,800 – 25% K3,801 - K5,900 – 30% Above K5,900 – 35% **Previous PAYE Regime (2013)** **Income Bands(Monthly)** – **Rates** 0 – K2,200 – 0%

	Ex-Gratis Payments, Medical Expenses; and Funeral Expenses.	K2,201 - K3,000 — 25% K3,001 - K5,900 — 30% Above K5,900 — 35%
Self Employed Individual (SEI) tax	❖ Tax is paid for annual turnover above ZMW 800,000 and is charged under the PAYE rates. ❖ For annual turnover below ZMW 800,000, tax paid is at 3% of turnover.	• PAYE rates apply for annual turnover above ZMW 800,000. • Tax paid is at 3% of turnover for turnover below ZMW 800,000.
Withholding Tax	❖ Is tax collected at source from some payments like dividends, interest, rent, commissions, management and consultancy fees.	**Category** **Rate** • Dividends(final tax) 15% • Interest (Companies) 15% • Interest(Individual) final tax 25% • Rent final tax 10% • Commissions 15% • Management & Consultancy fees 15%
Mineral Royalty	❖ Mineral royalty is the compensation to the government for extracting minerals from the earth. ❖ Mineral royalty on base metals and precious metals is based on norm value. ❖ Norm Value means the monthly average London Metal Exchange (LME) Cash price per metric ton multiplied by the quantity of the metal or recoverable metal sold. ❖ Mineral royalty rate of energy minerals, industrial minerals and gemstones is calculated on gross value. ❖ Gross value means the realized price for a sale free	• The mineral royalty rate for base metals is at 6% • The rate for precious metals is at 6% • The rate for industrial minerals is at 6% • The rate for gemstones is at 6% • The rate for energy minerals is at 6%

	on board, at the point of export from Zambia or point of delivery within Zambia.	
Property Transfer Tax	❖ Tax levied on transfer of land and buildings and is paid by the seller. It is also paid on transfer of shares. ❖ Where a person transfers property to a member of his immediate family, the transfer will be treated as a gift and transfers will go at nil value. No property tax will be paid. Immediate family means a spouse, child adopted child or stepchild. ❖ Exempt Organizations from the tax include: The Government; Foreign Governments; Approved International organizations; Political Parties; Cooperative societies; Local authorities; Registered Trade Union Clubs or societies; and approved pension funds or Medical aid societies. ❖ Other exemptions include transactions as a result of a sale or other disposal of any stock or share listed on Lusaka Stock Exchange.	• Tax rate is at 10% of the Realizable value. • Realizable value is price at the time of transfer, at which it could be reasonably sold on open market.

Tax on Individual Minibus and Taxi Operators.	❖ A predetermined amount is paid by the individual public transport operators.	• Rates range from ZMW 600 per annum for a less than 12-seater bus to ZMW 7,200 per annum for a 64-seater and above.
Turnover Tax	❖ Tax on businesses for both companies and individuals whose turnover is below ZMW 800,000 per annum	• Applicable tax rate is 3% of the turnover.
Advance Income Tax (AIT)	❖ This is the tax charged on importers that are either not registered with Zambia Revenue Authority or are registered but are not compliant.	• The tax is computed at 6% of Value for Duty Purposes (VDP) but is not a final tax.
Base Tax	❖ Base Tax is a tax on small businesses and marketers that are difficult to assess.	• The current amount of base tax is ZMW 150.00 per annum.
Fuel or Road Levy	❖ Levy charged on all imports of Petroleum products such as diesel and petrol. This Levy is meant for the maintenance and construction of roads in the country.	• The levy rate is up to a maximum of 15%.

2.0 Customs and Excise taxes and applicable rates		
Tax types	**Main features**	**Rates**
Customs Duty	❖ This is a tax levied on all goods imported into the country. Duties are based on the CIF (cost, insurance and freight) value.	**Category Rate** • Raw materials 0% • Capital goods 5% • Intermediate 15% • Finished goods 25%
Excise Duty	❖ Taxation on a range of selected products whether produced locally or imported, determined by government policy.	**Product (some examples) Rate** • Petroleum Products 7% - 36% • Wines and Spirits 125%

		• Motor Vehicles 5% - 30% • Perfumes and Body lotions 25% • Clear Beer 35% - 75% • Talk time and mineral water 10%
Import VAT	This a tax charged on imports.	Standard rate of 16%.
Export Duties	This is a duty charged on specific exported goods. This duty is meant to encourage further processing of locally produced goods and is charged on Copper concentrates, Scrap Metal and Cottonseed.	**Product Rate** • Copper concentrates at 15% • Scrap Metal at 15%-25% • Cotton seed at 15%
Carbon Emission Surtax (CES)	This is a tax charged on motor vehicles based on the engine capacity.	**Engine Capacity in CC (ZMW)** • 1500 and below 50.00 • 1501 – 2000 100.00 • 2001 – 3000 150.00
Motor Vehicle licensing Fee	❖ This fee is charged on imported motor vehicles and covers the registration costs.	The fee is ZMW 163.00

3.0 VAT and applicable rates.	
Tax types	**Definition**
Domestic VAT	❖ This is taxation on every value added to a taxable service or product. The tax is borne by the consumer. For VAT purposes, sale or disposal of goods or rendering of services is called **supplies**. ❖ **Taxable supplies** are taxed at either 16% (standard rate) or 0% (zero-rated). Zero-rated supplies include Exports, Energy Saving appliances, Equipment and machinery, medical supplies and schoolbooks. ❖ **Exempt supplies** are items specifically excluded by law from liability to VAT, (i.e., no VAT is charged) even if supplied by a registered business. Examples of exempt supplies include:

	❖ Only registered businesses can charge and claim VAT. There are two types of VAT registrations: ❖ **Statutory registration** – annual taxable turnover in excess of ZMW 800,000. ❖ **Voluntary registration** – where the turnover of a business is below ZMW 800,000 per annum but the business has fulfilled all the requirements for VAT registration. ❖ A registered business charges and collects VAT on its supply of goods and services to customers. VAT so charged is called **output tax.** On the other hand, registered businesses claim the VAT that they pay on purchases of taxable goods and services for their businesses. The tax so claimed is referred to as **input tax.** The net of output and input tax is paid to ZRA or refunded to the taxpayer as the case may be. Therefore, a business dealing in taxable supplies can claim input tax, while a business dealing in exempt supplies will not be required to register for VAT and therefore cannot claim the input tax. For example, educational services from Nursery to secondary school are exempt, therefore, a primary school will not register for VAT and will not claim any input tax.

Source: ZRA

3.0 ASSESSMENT OF TAX REVENUE PERFORMANCE

An assessment of the performance of the Zambian tax system between 2010 and 2013 reflects an increase in tax revenues in nominal terms, with tax collections increasing from ZMW13, 125.5 million in 2010 to ZMW 23,154.8 million in 2013, representing an increase of 76.4% (See Table2). This performance is attributed to higher than projected collections in most tax types, especially income taxes, excise taxes and trade taxes.

Table 2: Tax Revenue Performance (ZMW millions)

	2010	**2011**	**2012**	**2013**
Total Revenue	**13,161.4**	**18,928.0**	**20,807.0**	**23,190.8**
Tax Revenue	**13,125.5**	**18,889.0**	**20,719.1**	**23,154.8**
Income Tax	**7,350.6**	**9,766.9**	**11,733.8**	**11,630.6**
Company Tax	2,421.7	3,643.6	4,402.4	2,852.3
Non Mining Company Tax	1,176.5	1,169.7	1,701.9	1,767.5
Mining Company Tax	1,245.2	2,473.9	2,610.3	1,084.7
PAYE	3,866.3	4,519.3	4,934.0	5,738.7
Withholding Taxes & Others	626.3	736.0	938.9	1,278.9

Mineral Royalty	412.0	868.0	1,458.6	1,760.7
Mining Tax Arrears	-	1,752.6	-	-
Excise Taxes	**1,372.4**	**1,662.5**	**2,198.1**	**2,339.5**
Excise Duties		1,110.8	1,531.5	1,546.9
Rural Electrification Levy		30.1	30.6	35.0
Fuel levy		504.5	613.8	731.5
Carbon Tax		17.1	22.1	26.1
VAT on domestic goods	**515.0**	**(32.8)**	**(279.2)**	**1,185.5**
Trade Taxes	**3,911.8**	**5,739.7**	**7,066.5**	**7,999.1**
VAT on imports	2,644.6	3.997.3	5,030.8	6,178.3
Custom Duty	1.262.6	1,737.8	2,032.2	1,808.4
Export Duties	4.7	4.5	3.6	12.4
Export Duty on Scrap metals	-	2.6	0.0	0.0
Export Duty on Cotton seed	-	-	0.1	0.3
Export Duty on Copper Concentrate	-	1.9	3.5	12.2
Non Tax Revenue	**35.9**	**39.0**	**87.8**	**36.0**
Medical Levy	24.3	18.4	27.1	2.5
Motor Vehicle Fees	11.6	20.6	60.7	33.5

Source: ZRA

3.1 Income Taxes

Income taxes have increased from K7,350.6 million in 2010 to K11,630.6 million in 2013 representing an increase of 58.2 per centum. This growth is driven by all the tax types, except for mining company tax, which have registered positive growth in line with the growth in the economy. Mining company tax though showing growth in the first three years, declined in 2013 due to negative factors in production levels and commodity prices.

3.1.1. Excise Taxes

Excise taxes have increased from K1,372.4 million in 2010 to K2,339.5 million in 2013 representing an increase of 70.5 per centum. This growth is driven by all the tax types which have registered positive growth in line with the growth in the economy.

3.1.2 Domestic VAT

Domestic Vat has recorded negative collections for the years of 2011 and 2012 and then increased to K1,185.5 million in 2013. This performance in 2011 and 2012 is attributed to tax avoidance and evasion by some sectors of the economy.

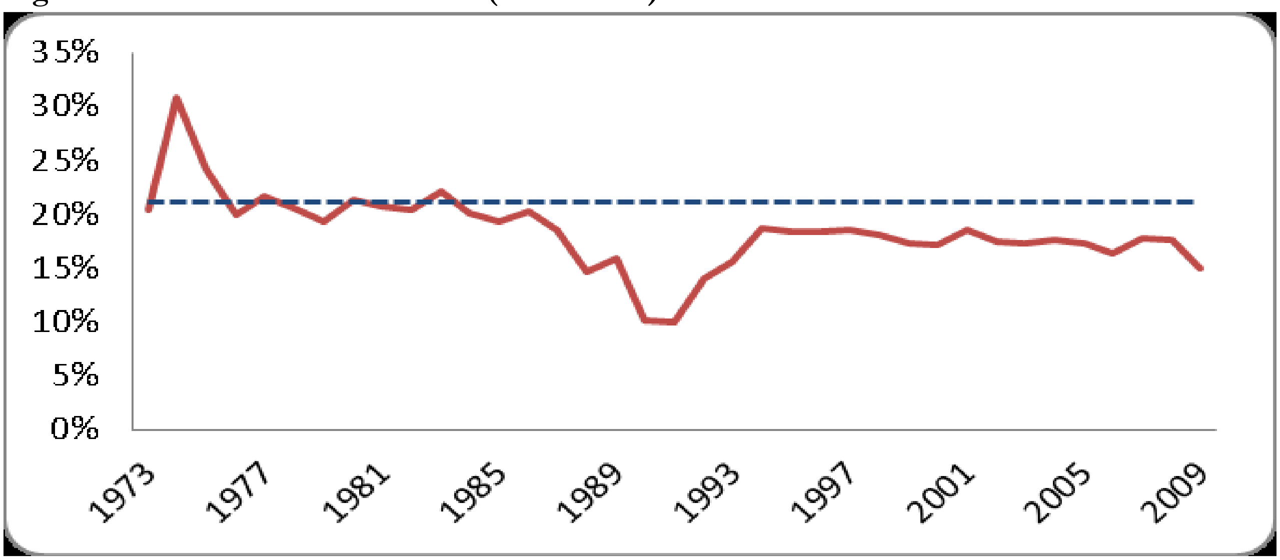
3.1.3 Trade Taxes

Trade taxes have increased from 3,911.8 million in 2010 to 7,999.1 million in 2013 representing an increase of 104.5 per centum. This growth is driven by all the tax types, especially import VAT, which have registered positive growth in line with the growth in the economy through increased imports of capital and consumption goods.

4.0 TAX REVENUE TO GDP RATIO

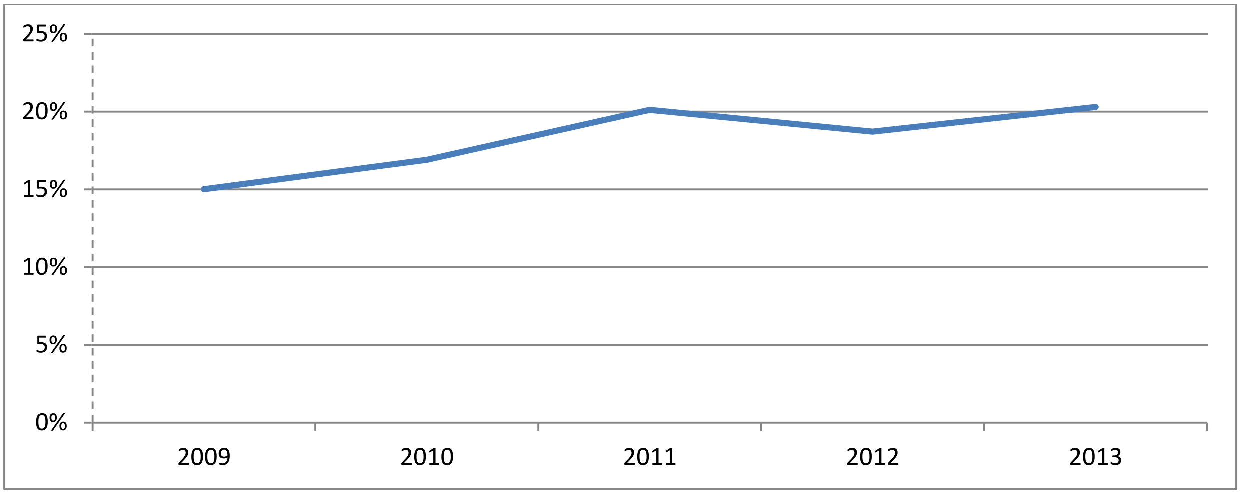
In general, a tax system should be responsive to the growth of the economy. As economic activity grows, tax revenues should also increase, as the country's tax base often closely follows GDP. A simple way to measure this is to look at the ratio of total tax revenues to GDP. For Zambia, the share of total tax revenue as a percentage of GDP has averaged 18 percent in the last decade after falling precipitously to 13 percent just before the reform period (see Figure 3.10). However, since the reforms, the ratio has declined steadily, reaching 15 percent in 2009. This was considered too low and Government and other stakeholders like the IMF and the World Bank believed that it should be raised to at least 20 percent to enable Zambia to meet its development goals (MTEF 2011 – 2013).

Figure 1: Tax revenue to GDP ratio (1973 – 2009)



The tax to GDP ratio reached 20.1 percent and 20.3 percent in 2011and 2013 respectively. However, in 2012 it declined to 18.7 percent (see Figure 3.10A). The increase in 2010 through to 2011 was due to an improvement in the economic growth of key sectors of the economy, especially in mining, construction, transport, storage and communication sectors (See Table); as well as improvements in taxpayer compliance. In 2011 the achievement of a tax to GDP ratio of 20.1 percent was due to the collection of mining tax arrears. If mining tax arrears are removed, the tax to GDP ratio is 18.2 percent. The fluctuation in the ratio is a sign that the tax system is robust and responding to certain factors in the economy. In 2013 tax revenues were mainly driven by PAYE and trade taxes.

Figure 2: Tax revenue to GDP ratio (2009 – 2013)



Source: ZRA

On the basis of the tax to GDP ratio achieved in 2011, it is clear that the collection of arrears can ensure that revenue collections are increased especially if this is targeted at key sectors of the economy like mining. The positive performance of tax revenues continue to be driven by PAYE and trade taxes, tax types that cannot be fully relied for the long term sustainability of revenue flows.

Table 3: Growth and share of GDP

	Percentage growth		Percentage share	
KIND OF ECONOMIC ACTIVITY	2011	2010	2011	2010
Agriculture, Forestry and Fishing	7.7	6.6	12.6	12.5
Mining and Quarrying	1.3	15.2	9.4	9.9
Manufacturing	5.0	4.2	9.1	9.2
Electricity, Gas and Water	7.9	7.4	2.4	2.4
Construction	7.2	8.1	11.8	11.8
Wholesale and Retail trade	5.3	4.2	15.1	15.3
Restaurants, Bars and Hotels	5.0	10.2	2.3	2.4
Transport, Storage and Communications	12.3	14.9	10.4	9.9
Financial institutions and Insurance	6.0	6.0	7.1	7.1
Real Estate and Business services	2.9	3.0	7.5	7.7
Community, Social and Personal	8.5	5.3	8.7	8.6

Services					
TOTAL		6.5	7.6	100.0	100.0

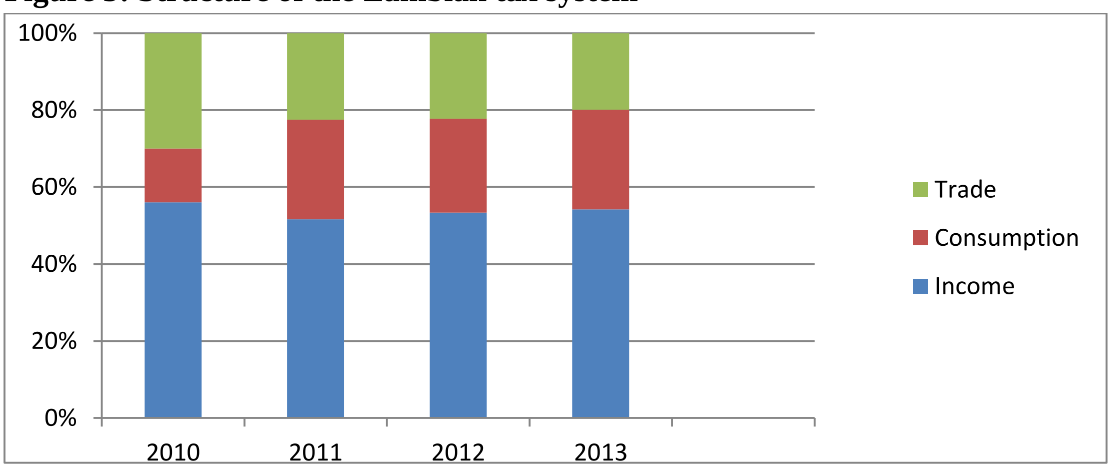
Source: CSO

5.0 ASSESSMENT OF TAX CATEGORIES

Structure of the Zambian system

Income taxes continued to be the major source of revenue accounting for more than 50 percent of the total tax collections in the last four years. The trend analysis of tax type contributions to total tax revenue is a useful tool for long term tax planning. The dependence on income taxes to provide most of the revenues needs to be assessed for long term sustainability of revenue flows. It is better to rely more on consumption taxes as these are more broad - based. Consumption taxes like VAT and Excise are paid by almost the entire population as they consume various goods and utilize certain services. The tax base of the consumption taxes are therefore much broader than income taxes like PAYE and company tax, which are paid by a limited section of the population. External shocks have less impact on a broader base compared to a narrower base.

Figure 3: Structure of the Zambian tax system



Source: ZRA

5.1 Income tax performance

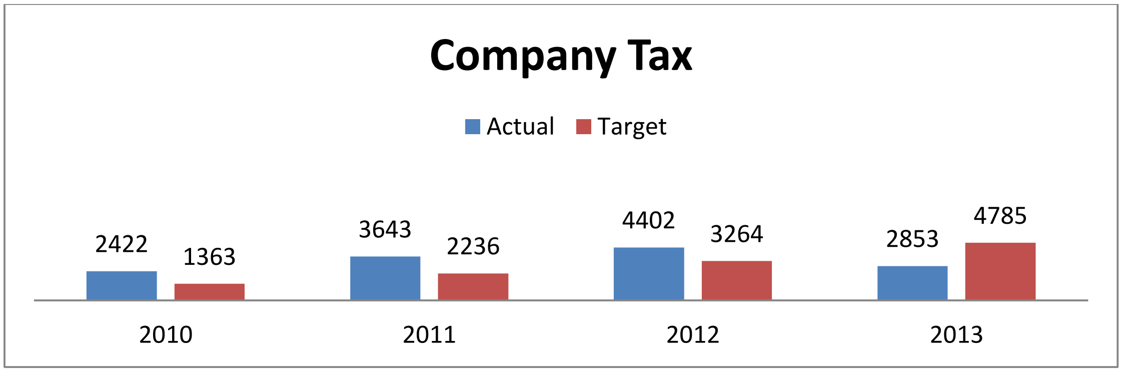
Income taxes have shown an upward trend over the last 4 years in nominal terms, rising from ZMW 6,914 in 2010 to ZMW 9,812 in 2013. This represents an increase of 29.5% which is attributed to increased economic activity. The increase in income taxes was mainly driven by PAYE and company tax. PAYE has consistently increased in line with increased wages over the same period, especially in the public sector. The increase of wages in the public sector also triggered increases in wages in the private sector. Company tax has increased from ZMW 2,422 million in 2010 to ZMW 4,402 million in 2012 due to increased payments of mining company tax, which increased from ZMW 1,245.2 in 2010 to ZMW 2,610.3 in 2012.(See Table) However in 2013 company tax did not meet its target due to a reduction in mining company tax. This is attributed to the reduction of copper prices and copper production in 2012. Withholding taxes also increased over the same period as a result of increases in rental income and dividends.

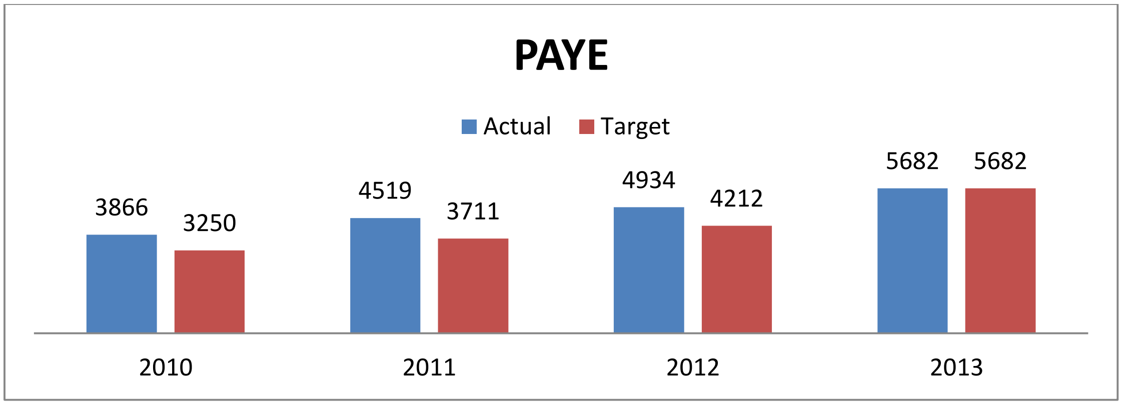
Table 4: Income Tax Revenue Performance (ZMW million)

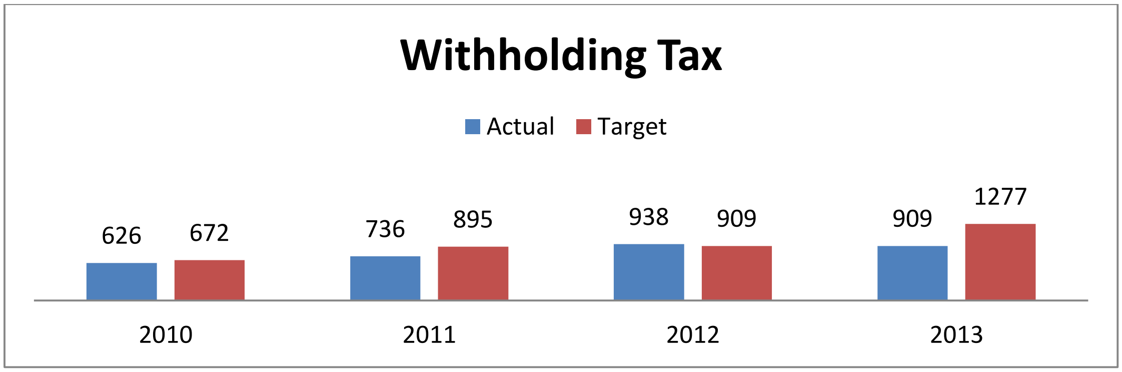
	2010		2011		2012		2013	
	Actual	**Target**	**Actual**	**Target**	**Actual**	**Target**	**Actual**	**Target**
Company Tax	2,422	1,363	3,643	2,236	4,402	3,264	2,853	4,785
PAYE	3,866	3,250	4,519	3,711	4,934	4,212	5,682	5,682
Withholding Tax	626	672	736	895	938	909	1,277	1,080
TOTAL	6,914	5,285	8,898	6,842	10,274	8,385	9,812	11,547

Source: Zambia Revenue Authority

Figure 4:Income Tax Revenue Performance (ZMW million)







Source: Zambia Revenue Authority

PAYE continues to be the biggest contributor to income taxes (56% in 2010 and 58% in 2013) and is contributed by the working population, who form a small percentage of the total population (less than 20%). There is therefore need to review the contribution of other taxes like company tax and withholding taxes to ensure that issues of equity are adequately addressed. The contribution of PAYE to GDP has remained constant at an average of 4.7% for the period 2010 to 2013 as depicted in Table 5.

Table 5 : PAYE to GDP ratio **ZMW billion**

	2010	2011	2012	2013
GDP	77.7	93.4	106.0	125.9
PAYE	3.8	4.5	4.9	5.7
Ratio	4.8%	4.8%	4.6%	4.5%

Source: Zambia Revenue Authority

5.1.1 Value Added Tax (VAT) Performance.

Net Domestic VAT collections have shown a fluctuating trend over the last 4 years in nominal terms, moving from ZMW 515 million in 2010, posting negative collections of ZMW 32.8 million and ZMW 279.2 million in 2011 and 2012 respectively, and then posting a positive collection of ZMW 1, 198.3 million in 2013. In terms of performance against targets, collections fell short in 2011 and 2012. (See Table 6). Generally over the years, the performance of VAT has been below expectation and has tended to weaken the performance of consumption taxes. The performance is attributed to compliance and enforcement challenges faced by the ZRA. The enforcement challenges are slowly being addressed by ZRA with the introduction of the new computerized platform, known as Taxonline.

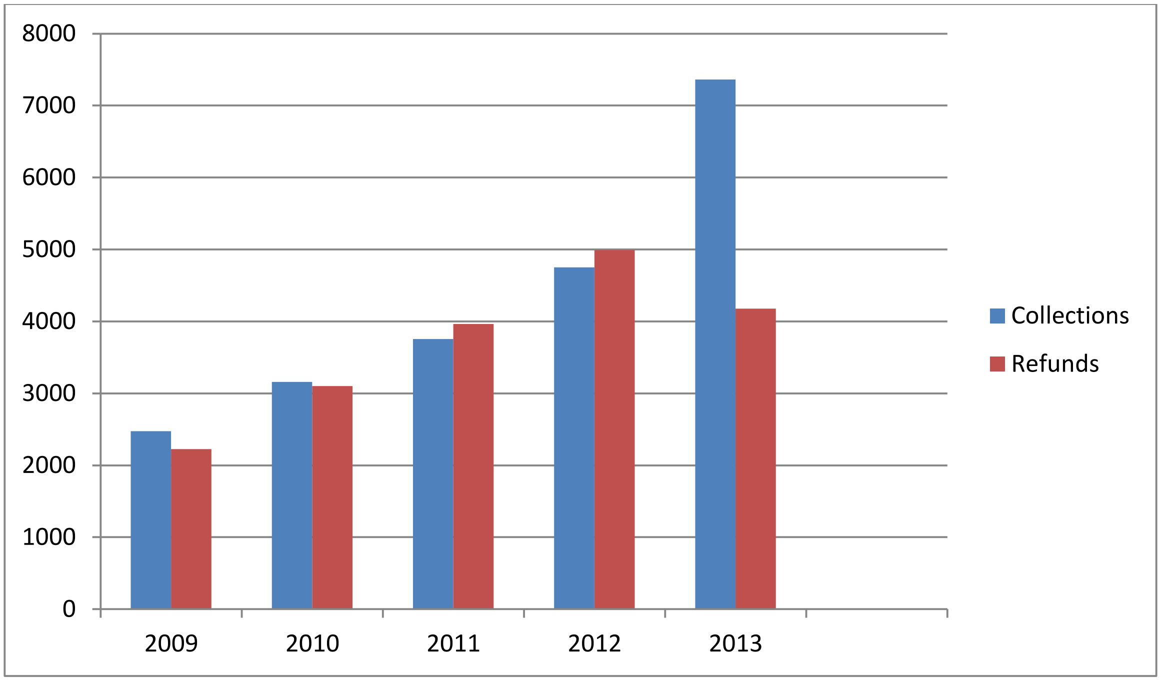
Table 6 : Net Domestic Vat Collections

K million	2010		2011		2012		2013	
	Actual	**Target**	**Actual**	**Target**	**Actual**	**Target**	**Actual**	**Target**
Domestic VAT	515.0	500.3	(32.8)	828.5	(279.2)	392.0	1,198.3	500.6

Source: ZRA

It is important to note that all VAT refunds are paid out of domestic VAT. This practice tends to, at times, adversely affect the performance of this tax type. The performance of Domestic VAT and the associated refunds over the period of 2009 to 2013 is shown in the figure below.

Figure 5 : VAT Collections and Refunds



Source: Zambia Revenue Authority

The performance of VAT can also be analyzed from the perspective of VAT productivity. For each year, VAT productivity can be calculated as:

VAT productivity = (Net VAT collections/GDP)*(1/Statutory VAT rate)

Analyzing VAT productivity eliminates the effect of rate changes. Another measure is the C-efficiency which uses the same principle, but uses the value of total Consumption in the economy and not GDP.

C-efficiency = (Net VAT collections/Total Consumption)*(1/Statutory VAT rate)

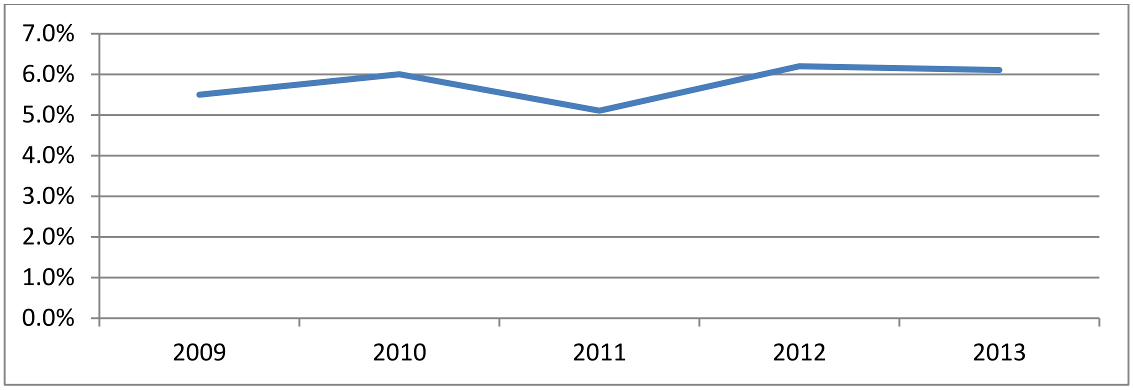
Since VAT is a tax on consumption, rather than all economic activity, in principle, the C-efficiency can give more accurate measurement of VAT performance.

Import VAT

The performance of import VAT was positive and depicted an increase in nominal terms from ZMW 2,645 million in 2010 to ZMW 5,030million in 2012. This is attributed to the continued increase in the Value for Duty Purposes (VDP) on taxable transactions, as a result of increased imports. In 2012, the number of import entries increased by 20.7 percent compared to 2011, while VDP increased by 14.3 percent over the same period.

When domestic VAT is combined with import VAT and calculated as a percentage of GDP it reflects a fluctuating trend as depicted in the table below.

Figure 6 :Net VAT (Domestic and Import) to GDP, 2009 to 2013

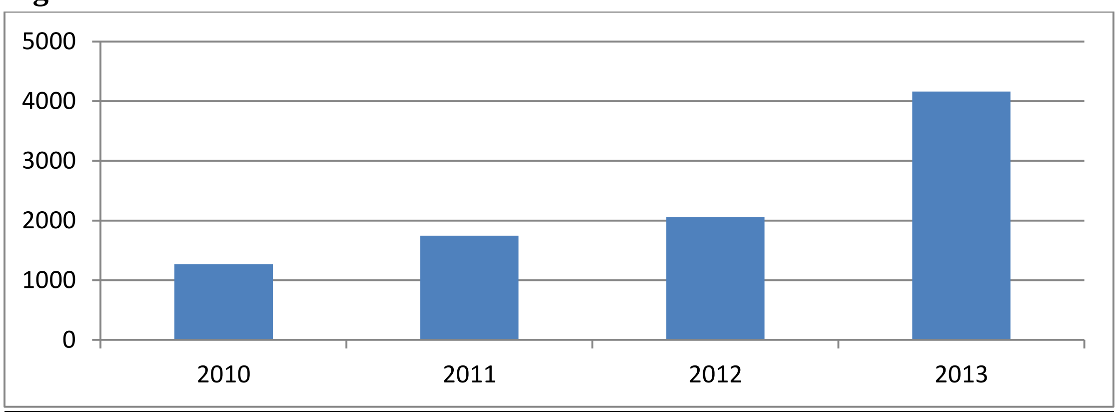


Source: Zambia Revenue Authority

5.1.2 Trade Taxes Performance

After the global economic crisis in 2008 when trade taxes experienced a downward trend, the situation has changed and trade taxes started showing an upward trend from 2010 onwards. During the period 2010 to 2013 most of the revenue collected from trade taxes was from import VAT. The other tax types under trade taxes, import duty and export duty continue to be adversely affected by the loss in revenue under the SADC and COMESA protocols.

Figure 7 : Performance of Customs and Excise 2010 -2013



Source: Zambia Revenue Authority

6.0 EVALUATION OF CONTRIBUTION OF MINING SECTOR

Mining Sector Taxes

International experience has demonstrated that a properly structured and administered minerals industry has potential to generate substantial benefits to individual economies and regions. Apart from being a direct source of foreign exchange, mining generates substantial direct revenues to government through corporate taxes, royalties and employee taxes from miners. In addition, the exploitation of minerals can lead to regional development and can facilitate diffusion of technology and be pivotal to skills training in mining areas.

Tax revenue from the mining sector has over the last 5 years shown an upward trend due to increased mining activities, increased production and favorable metal prices. These revenues represent a growing share of total tax revenue from 0.06 percent in 2005, to 12.6 percent in 2010 and 19.7 percent in 2012. Of the tax types, company tax has contributed the highest in most years, followed by mineral royalty. Revenue from exports of copper concentrate is also showing an upward trend.

Table 7:Performance of mining taxes

Mining taxes (ZMW '000)	2008	2009	2010	2011	2012	2013
Company Tax	464	401	1245	2474	2613	1084
Mineral Royalty	238	235	412	868	1486	1760
Export Duty	178	25	24	19	35	12
Windfall	126	-	-	-	-	-
PAYE	596	582	615	623	752	796
Total Mining Revenue	1602	1243	2296	3984	4886	3652
Total Revenue	9670	9660	13161	18928	20807	23190
As % of total revenues (PAYE included)	17%	13%	17%	21%	23%	16%
As % of total revenues (PAYE excluded)	8.2%	4.8%	13.%	18%	20%	12%

Source: Zambia Revenue Authority

The increase in tax revenue is mainly a result of high mineral prices, increased output, and an increase in the mineral royalty rate following policy changes in 2008. Much of the industry is still recouping investment costs and when these losses are finally recouped, there is expectation of a much larger share of revenue collection. Given that world demand for commodities is unlikely to fall substantially in the medium term, the expectations are that the mining sector will contribute around 30 percent of total revenues by 2013 (MTEF, 2010 -2013).

Between 2010 and 2012 the contribution of the mining sector averaged 17% this is an increase over the previous period of 2006 to 2009 which averaged 7%. It was however still way below the expected figure of 30% in 2013. This performance is what has led the general public to continue to call on the government to review the mining tax regime and to question the capacity of the tax administration to effectively counter any tax avoidance schemes by the mining companies.

Like any other large and specialized operations, mining operations are very complex and provides taxation challenges. In the current tax regime there has been a lot of debate on the appropriate tax instrument to use for the mining sector. ZRA recognizes this and established a dedicated Mining Tax Unit (MTU) to ensure efficient and effective taxation of the mining sector. To ensure that there is continued support both financial and human resource capacity, the ZRA received support from the Norwegian Tax Authority who financed a project to develop capacity in natural resource taxation, specifically the mining sector. The ZRA also received support from the IMF on the same project. This is to enable the tax authority to keep pace with the complexities associated with mining taxation, such as counteracting transfer pricing and tax avoidances by mining firms.

Despite the efforts that are being made at ZRA, the level of contribution of the mines in Zambia remains at a level that does not satisfy the general public. A review of the current mining tax regime in comparison to previous regimes does not show major differences except for the change that took place in 2008 when the windfall tax on revenue was introduced and its subsequent removal in 2009. The impact of this change has not been fully analyzed in terms of revenue gain or loss but has had widespread publicity and public debate. This is due to the political connotations that have characterized the introduction and removal of the windfall tax on revenues. There is need for a comprehensive analysis of the revenue impact and economic and social impact on the mining sector of reintroducing a windfall tax on revenue as opposed to maintaining the current mining tax regime which has a windfall tax on profits in the form of a Variable Profit Tax.

Table 8: Outline of tax regimes for 'large-scale license holders'

Tax regime	**DA**	**2008 Reforms**	**2009 Reforms**	**Existing Regime**	**Non Mining Regimes**
Income tax types					
Company Income Tax	25%	30% -	30%	30%	15% – 40%
Variable Profit Tax (Windfall Tax on Profit)	No	Yes	Yes	Yes	Yes
Windfall Tax on Revenue	No	Yes	No	No	No
Withholding Tax	No	Yes	Yes	Yes	Yes
Mineral Royalty	0.6%	3.0%	3.0%	6.0%	N/A
Mineral royalty based on official prices	No	Yes	Yes	yes	N/A
Trade and domestic tax types					
Export duty on copper ore and concentrates					
Import duty, Excise duty on imports.	Yes	Yes	Yes	Yes	Yes
Tax exemptions					
Loss carry forward (in years)	15 to 20	10	10	10	5 - 10
Capital Allowance (Depreciation)	100%	25%	100%	25%	25% – 100%

2008 Regime

The company income tax rate was increased from 25% to 30%. Deductions also changed:

- **Depreciation** allowance was cut from 100% to 25%. This meant that only a quarter of the value of a company's capital expenditure (investment) could be charged to depreciation each year, instead of the full amount. In other words, tax payments would be brought forward and it would take longer for companies to recoup investment expenditure.

- **Losses could be carried forward** for a maximum of 10 years, instead of 10 to 20 years. Again, this would have the effect of bringing forward income tax payments.
- **Hedging** operations were to be taxed separately from mining operations. Losses from hedging could no longer be used to reduce taxable profits from operations. This was intended to prevent companies from adopting hedging strategies deliberately designed to reduce taxable profits in Zambia.
- The **Mineral Royalty** rate for copper and cobalt was increased from 0.6% to 3%. In addition, henceforth it was to be based solely on gross sales value using the LME price instead of the price claimed by the mining companies. This ensured that mines could not avoid taxes by understating the realized sales price, or over-stating the costs of transport, etc. As before, royalty payments could be deducted from taxable income for the purposes of calculating income tax.
- A **Windfall tax** was introduced and operated like a variable rate royalty. It was calculated each month from the gross sales revenue of the taxpayer (in the same manner as the Mineral Royalty), using a tax rate that increased with the average London Metal Exchange (LME) cash price (for copper) or the Metal Bulletin price (for cobalt).
- A **Variable Profits Tax** (VPT) was also introduced at the same time. It was intended to make the tax regime more progressive by collecting a higher proportion of revenue when profits were high than when profits were low. VPT allows mining companies to earn profits equivalent to 8% of their gross sales revenue before the tax kicks in.

2009 Regime

- Windfall tax was abolished.
- Tax depreciation reverted to 100%.
- Mines were again allowed to combine hedging and operating income for income tax purposes.

Current Regime

- The mineral royalty rate for copper and cobalt was doubled from 3% to 6%.
- Tax depreciation reduced to 25%.
- Hedging and operating income were again to be treated separately for income tax purposes.

6.1 Comparative Analysis of Mining Taxation

The minerals industry has been the nucleus for the growth of many towns and cities within the sub-region. Most rail and road infrastructure was developed to serve the movement of material inputs to and outputs from the mines to local, regional and external markets. Similarly, since the mining sector uses substantial quantities of electric power, many generating units were constructed to service the sector. The infrastructure built from the development of the region's mineral resources has had spin-off benefits to the rest of the economy. The sector therefore has the potential to contribute to increased economic growth and job opportunities as further exploration and mineral development takes place and further mineral processing occurs within the regional boundaries. In addition to these forward and backward linkages, the minerals industry is a source of rent for use in other economic and social sectors and many countries in the region have been able to develop infrastructure and improve human capital using rent from the sector. However the contribution of the mining sector in terms of taxes to the national treasury has continued to be a source of concern to most countries within the region. The level of contribution has not been at the desired level by the majority of the population. The table below shows the contribution of mining taxes to total tax revenues for selected countries in the region. Apart from Botswana the rest of the countries are below the 30% mark which is what prevails in developed countries. Compared to some countries like South Africa, Namibia and Tanzania, Zambia is not doing too badly at 20%. However as stated earlier this performance falls below the desired level of 30%.

Table 9:Ratio of Mining Revenue to Total Tax Revenue

Country	2012
South Africa	9%
Botswana	34.7%
DRC	20%
Namibia	8%
Tanzania	5%
Zambia	20%
SADC Average	16.1%

Source: SADC Tax database

Box 2 :Comparative Analysis on Mining Taxation for Countries in SADC Region

Country	Tax Rates	Incentives	Mining Revenue Contribution/GDP (%)	Fiscal Stability Agreements
Botswana	CIT – 25% Mining Royalty: 3%-10% (Mining Royalty deductible in CIT) WHT on dividends/royalties – 15% Rates of tax amortization 2%-25% Average time for VAT refund < 6 months	Mining capital expenditure is claimable in the tax year in which such expenditure is incurred with unlimited carry forward of losses. Mining losses for any year can be carried forward indefinitely and be set off against the profits from the mining business in the subsequent years.	34.7%	No fiscal agreements with diamond mining company. Social contributions are required.
DR Congo	CIT – 30%/40% Mining Royalty: 0.5%-2% (Mining Royalty	CIT rate of 30% if mining operation in exploitation phase.	20%	Yes and Social Contributions are mandatory

	deductible in CIT) WHT on dividends/royalties – 10%/14% Rates of tax amortization 2%-25% Average time for VAT refund > 1 year	Mining companies allowed to book tax deductible reserves for site restoration up to 5% of their taxable profits. Transportation, analysis, insurance and marketing costs are deductible from taxable basis. 1/3 of the Mining Royalty is considered as a tax credit if related to mining products sold to a resident for transformation purpose.		
Namibia	CIT – 35%/55% Effective tax rate for diamond mining companies is 55% Mining Royalty: 0.5%-2% (Mining Royalty deductible in CIT) WHT on dividends/royalties – 10%/10.5% Rates of tax amortization 2%-25% Average time for VAT refund < 6 months		8%	No fiscal agreements
South Africa	CIT – 28% Mining Royalty: 0.5%-7% (Mining Royalty deductible in CIT) WHT on dividends/royalties – 10%/12% Rates of tax amortization: Specific legislation on exploration, development and production on mining assets. Average time for VAT	Certain incentives are permitted in specific legislation on mining exploration, development and production on mining assets of a company.	9%	No and Social Contributions are required

	refund < 3 months			
Tanzania	CIT – 30% Mining Royalty: 3%-4% (Mining Royalty deductible in CIT) WHT on dividends/royalties – 10%/15% Rates of tax amortization 2%-25% Average time for VAT refund > 1 year	No special incentives given to mining sector	5%	Yes and Social Contributions are voluntary

Source: SADC Tax database; PWC Global Mining Industry Update Report (2012); KPMG Namibia Country Profile; Mining.com

An analysis of the mining tax regimes in selected countries in the region shows an almost similar pattern in terms of tax rates and incentives. The fact that investments into this sector are significant and can have a major impact on the future development of an economy tends to force governments to be more liberal with incentives to ensure that the investment takes place.

The focus should not be so much on the incentives given but rather to evaluate the attainment or fulfillment of the benefits of that investment, that were envisaged when the incentives were granted. Based on the results of the evaluation, then the appropriate course of action can be taken.

7.0 EVALUATE INFORMAL SECTOR CONTRIBUTION

The size of the informal sector in Zambia, according to the findings of the Zambia Business Survey of 2010, has been growing and it is said to account for about 40% to 60% of total GDP.

"*The important contribution made by MSMEs in the development of any economy cannot be overlooked. In Zambia, MSMEs contribute about 56% of the total number of jobs and account for over 80% of the number of businesses registered at the Patents and Companies Registration Agency. MSMEs also present an avenue for transforming the economy away from its dependence on mining to high value addition and other sectors which could enhance the economy's resilience and increase its sources of economic growth.*" – Zipar, 2014

The sector's importance to the economy can be seen not only in terms of its ability to address some of the pressing social economic problems of unemployment and poverty reduction, but also as a nursery from which taxpayers generally can graduate into mainstream tax system. In view of this, Zambia introduced presumptive taxes; namely base tax, turnover tax and presumptive motor vehicle tax specifically for this sector of the economy.

Presumptive taxes have been administered in Zambia since 2003. The taxes were introduced to bring into the tax-net sectors of the economy which proved to be costly to administer conventional income taxes on earned income due to information asymmetry, compliance and administrative costs associated with taxing the sectors. It was the desire of government that the informal sector contributes to tax revenue. The primary sub-sectors of the economy targeted for these taxes were public transport i.e. bus and taxi operators, the marketers, and the small and medium enterprises in the informal sector. Four types of presumptive taxes are administered by the Zambia Revenue Authority (ZRA) namely;

Base tax - It is an assessed lump-sum tax of K150 per annum for traders in markets whose collection is by agency.

Presumptive motor vehicle tax - standard assessment tax for public service vehicle based on sitting capacity and the tax is collected by appointed agents.

Turnover tax - based on turnover of below K800, 000 as of 1st January, 2013 (increased from K200, 000 in 2012) and taxed at 3%. This tax is administered by ZRA.

Advance Income tax – levied on imports of unregistered or non-compliant taxpayers. This is credited to income tax for registered taxpayers when so established.

PERFORMANCE OF PRESUMPTIVE TAXES

As a percentage of total income tax revenue, presumptive taxes contributed less than 1% to total collections between 2004 and 2007. The share increased to above 1% in 2008-2010 before declining to 0.5% in 2012.

Table 10: OVERALL PRESUMPTIVE TAX REVENUE PERFORMANCE 2008–2012 (K Million)

	2008	2009	2010	2011	2012
Total Presumptive Tax	86.2	90.9	83.3	83.2	61.7
Total Income Tax	4,699	5,073	7,326	9,767	11,734
% share of Total Income Tax	1.8%	1.8%	1.1%	0.9%	0.5%

Source: Zambia Revenue Authority

The major contributor has been turnover tax which has shown some growth over the years. An increase in terms of the total contribution to income tax was registered between 2008 and 2010. Presumptive tax on public service vehicles on the other hand has not performed as well. It recorded a steady increase between 2004 and 2009 but has been on the decline thereafter. In 2009, K2.15 million was collected but this reduced to K1.5 million in 2010. In the last two years, no significant growth has been recorded as collections have stagnated at K1.9 million for both years. There has not been any significant revenue collected from base tax. Between 2005 and 2006 average collections were K80, 000 and fell drastically to a low of K30, 000 in 2009. In fact, no collections were made for 2012. Base tax has been the most difficult tax to collect due to the political sensitivities surrounding the operations in the markets. Turnover tax has recorded positive growth since inception to date. In 2004, K4.40 million was collected from this tax and it rose to K24.5 million in 2010. As a percentage of total income tax collections, TOT contributions have been fluctuating between 0.2% and 0.5%; with a low of 0.22% recorded in 2004 % followed by a steady increase to 0.51% 2008 before sliding to 0.33% in 2010. Of the presumptive taxes under study, TOT has been the biggest contributor.

Table11: OVERALL PRESUMPTIVE TAX REVENUE PERFORMANCE (ZMWMILLION)

	2005	2006	2007	2008	2009	2010	2011	2012
TOT	9.9	13.1	18.8	23.1	24.1	24.5	30.1	35.0
AIT	0	0	12.3	60.8	64.6	57.2	51.1	24.7
Base Tax	0.07	0.09	0.04	0.03	0.03	0.08	0.01	0
Presumptive on Transport	1.1	1.8	1.8	2.3	2.2	1.5	2.1	2.0
Total Presumptive	10.98	14.96	32.91	86.24	90.88	83.3	83.22	61.71
Total Income Tax	2,462	2,967	3,841	4,699	5,072	7,326	9,767	11,733
% share of Total Income Tax	0.45	0.50	0.86	1.84	1.79	1.14	0.85	0.52

Source: Zambia Revenue Authority

Despite the fact that presumptive income tax system has been in existence in Zambia for close to ten years now, its impact on revenue has been very meagre. ZRA collection figures confirm that less than 1% of revenue is contributed by the tax to total revenue.

Table 12: Informal sector taxes

Tax type	**Main features**
Turnover Tax	Turnover Tax is levied on the total sales of the company or individuals. The rate is 3 percent of the total sales of the firm or individual. This is applicable for firms that have an annual turnover of ZMK800 million and below.
Presumptive tax on minibuses/taxis	Is levied on all unincorporated transport operators. The rates apply as follows:

Sitting Capacity	Tax (Per Year)	Tax (Per Day)
64 – seater and above	K 7,200	K 19.70
50 – 63 seater	K 6,000	K 16.40
36 – 49 seater	K 4,800	K 13.20
22 – 35 seater	K 3,600	K 10.00
18 – 21seater	K 2,400	K 6.60
12 – 17 seater	K 1,200	K 3.30
Below 12 – seater (including Taxis)	K 600	K 1.60

	Source: ITA
Base tax	Base Tax is aimed at collecting taxes from the marketers. It is currently pegged at K500 per day for all those trading in markets.
Advance Income Tax (AIT).	Lastly, the country also has for the last three years implemented the advance income tax. The advance income tax is specifically targeted at the cross border traders and it is levied at 6 percent. It is a tax charged on all imports of unregistered or partially compliant with value exceeding US $500. The tax is designed in such a way that the individuals are given a leeway to claim the tax if they file in their annual returns or to consider it as a final tax.

Source: Zambia Revenue Authority

7.1 Zambian Tax Legislation

Presumptive taxes are an important alternative for Zambia due to the severe constraint that ZRA faces in terms of resources and skills, and the tradeoff that it has to make between pursuing large taxpayers as opposed to the small ones. There's however, growing evidence (revenue statistics) to support the notion that presumptive taxes especially base tax and presumptive taxes on motor vehicles are not yielding much revenue as anticipated. In this regard there is need to undertake a comprehensive study to critically evaluate the current tax legislations that mandate ZRA to administer and levy TOT, base tax and presumptive motor vehicle tax so as to establish the extent to which tax laws, compliance costs and administration issues contribute to their performance.

Zambia's current tax legislation dealing with presumptive taxes is similar to legislation that is found in most countries that have legislation that wants to tax the informal sector. The characteristics of the informal sector in most developing countries are similar and require legislation that usually departs from the norm in terms of equity and neutrality. In designing a good tax system, it is universally accepted that the tax system must be equitable and neutral.

Equitable and neutral in that it must be fair and it should not be discriminatory. It must not prescribe a different tax regime for one group of citizens and another regime for others. The tax system must also not unduly influence the consumption behavior of citizens. However when dealing with taxation of the informal sector, tax authorities are forced to depart from the norms of equity and neutrality because of the characteristics of the sector.

In Zambia the focus of the current legislation is to get the players in the informal sector to register. In the short term there will be no gain in terms of revenue so getting firms to register should not be simply a cost-benefit calculation involving a trade-off between enforcement costs and tax collection. Registration can also improve the attitude of small business owners towards the state and, more importantly, help stimulate economic growth. In the long term this increased economic growth can then translate into more revenues. There is therefore need to not just focus on the revenue performance but to measure the registrations and the expansion of the activities of these taxpayers and their graduation to medium and large taxpayers.

There is need for the government to introduce more reforms aimed at taxing the informal sector. The following are reforms that are working effectively in other African countries.

1. Tanzania – the use of Block Management System which segments SMMEs into "BLOCKS" –small manageable areas for easy and cost effective management of taxpayers
2. Burundi – establishment of Centers for servicing of Medium Enterprises – establishes centers all over the country to provide specialized and focused services to SMEs.
3. Ghana – introduce Tax Discs for public vehicles – require all public transporters to display Tax Discs alongside License Discs as evidence of having paid tax. Enforcement is done by the Road Traffic Authority and the Traffic Police.

7.1.2 Comparison of Informal Sector

The contribution of informal sectors to economic growth is significant in Zambia and other African countries, making taxation of SMEs, which form a significant part of the informal sector, an important issue for tax administrations. The vast number of SMEs and their economic nature (narrow taxable base, undocumented, cash-based business transactions, high mobility and activity in rural areas) in developing countries are the two reasons why tax administrations face difficulties in properly administering this group of taxpayers. This is even more pronounced in African countries where tax administrations encounter various capacity constraints in terms of skills and financial resources. Apart from the revenue generating potential of SMEs, broadening of the tax base through inclusion of all businesses into the tax net is also seen as critical for increasing the perceived fairness of the tax system among citizens.

The fact that the majority of the labor force in Africa, especially in rural areas, is employed in the informal sector (of which SMEs are a sizable component as mentioned above) makes SMEs an important player in a country's economic activities. The contribution of the informal sector to the GDP in SADC countries averages 43% of GDP, in 2012 (See Table).

Table 13 : Informal Sector contribution to GDP - 2012

Country	% GDP
Zimbabwe	62.75
Tanzania	52.52
Democratic Republic of Congo	46.56
Angola	41.09

Malawi	39.69
Botswana	31.85
South Africa	24.87
Zambia	42.08
SADC Average	**42.67**

Source: Elgin & Oztunali, 2012

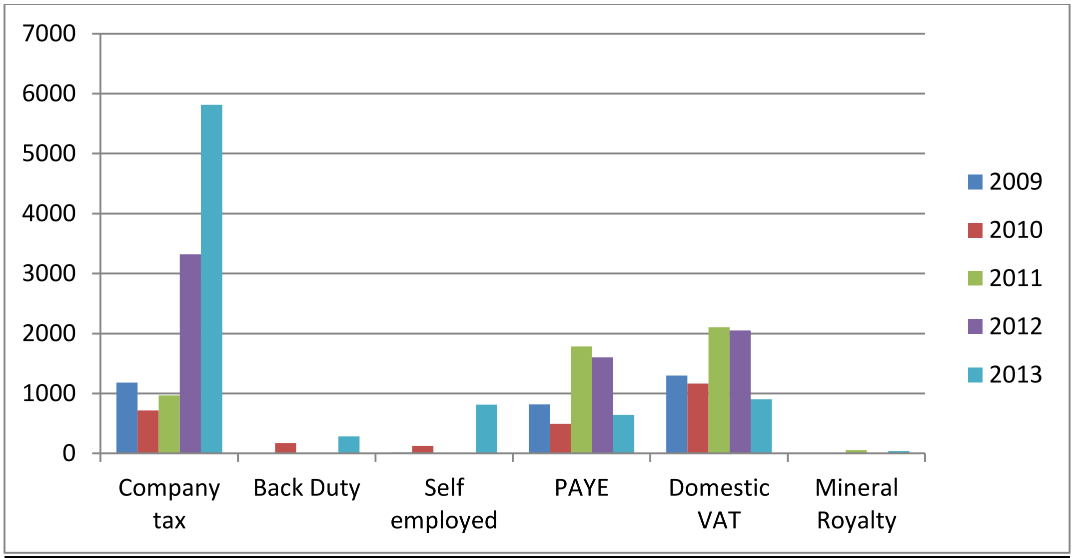
8.0 ASSESS EXTENT OF REVENUE LOSS

The accumulation of tax arrears due to non-compliance by taxpayers means less revenue to government. An analysis of the trend in domestic debt accumulation shows an increase in company tax debt increasing from ZMW 1,182 million in 2009 to ZMW 3,319 million in 2012. Increases have also been recorded in PAYE and Domestic VAT. A comparison of the performance of these tax types, with the exception of PAYE, shows them under performing against targets during the same period under review. This implies that a reduction in the accumulation of arrears would reduce the deficit and may result in the meeting of targets. There is therefore need for ZRA to put in place a deliberate strategy of dealing with tax arrears.

Table 14 :Trend in Domestic Debt Accumulation (K Million)

Tax type	2009	2010	2011	2012	2013
Company tax	1182	717	969.4	3319	5813.0
Back Duty	8.0	170	-	-	287.2
Self employed	16	123	11	-	812.8
PAYE	819	490	1786	1605	641.4
Domestic VAT	1298	1167	2107	2049	901.9
Mineral Royalty		0.7	53	0.04	40.3
TOTAL	3192	3455	4849	5611	8496.6

Figure 8: Trend in Domestic Debt Accumulation (K Million)



Source: Zambia Revenue Authority

9.0 REPORT ON EMERGING ISSUES

Possibility of a financial transaction tax on copper

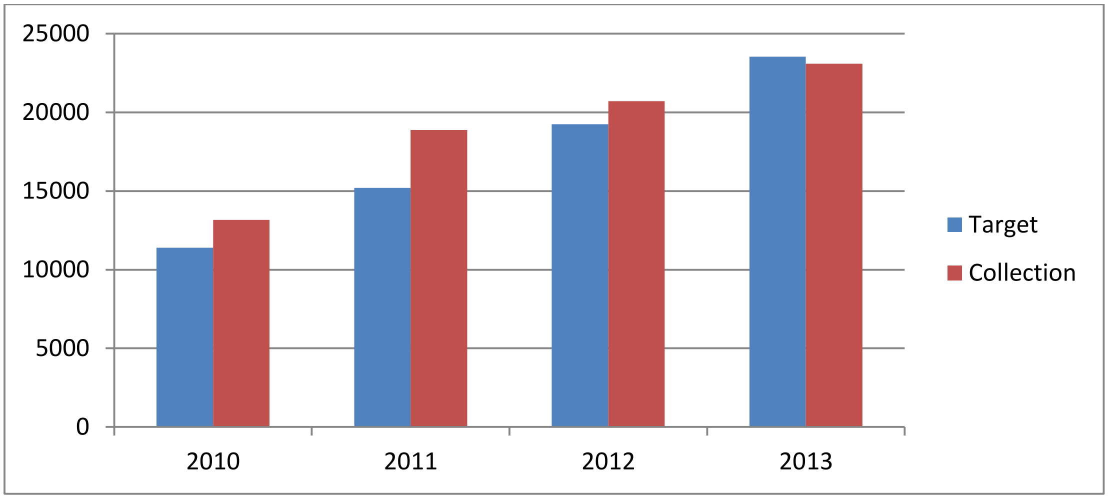
As this report explains, Zambia's mineral tax regime may still not be performing satisfactorily. There may be other innovative methods of capturing tax revenue from the mining sector. One possible innovation is the use of a Financial Transaction Tax on copper that is traded on the international market. The study evaluates the possibility of such a transaction tax – has not been tabled. It is unlikely that it can be in the near future because of its complexity and non-consensus on a global basis.

10.0 TREND ANALYSIS ON REVENUE COLLECTION VS, PARLIAMENT TARGETS

10.1 Tax revenue collection and set targets

Each year, the Government projects the amount of revenue that it intends to collect. The agreed targets are ratified by Parliament and are passed on to ZRA for implementation. Since 1994 when ZRA was created, collection of tax revenues has been above target for most years. Figure 3.7 demonstrates this using data for the period, 2010 to 2013.

Figure 9: Tax collection against set parliamentary targets (ZMK billions)



Source: Zambia Revenue Authority

11.0 ASSESS CAPACITY OF ZRA

The responsibility of ZRA, among others, is to:

a) Properly assess and collect taxes, duties, levies and fees at the right time.

In terms of collecting overall revenues against set parliamentary targets, ZRA has consistently managed to exceed the targets with one or two exceptional years. In those exceptional years it was not an issue of lack of internal capacity but as a result of external factors beyond the control of ZRA. Notwithstanding the foregoing, there is room for ZRA to improve its capacity in order to meet future challenges. ZRA recognizes this and is constantly looking at ways in which it can improve efficiency and effectiveness in order to increase the compliance of taxpayers. This is especially with regard to widening the tax base and combating tax avoidance and tax evasion schemes.

With regard to meeting targets for individual tax types, the result is somewhat varied. Some tax types continue to underperform as a result of the challenges faced by ZRA in managing compliance and enforcement. This is also linked to widening the tax base and combating tax avoidance and evasion.

b) **Properly enforce all relevant legislation and administrative procedures**.

ZRA has demonstrated that it has the capacity to enforce most of the relevant legislation and administrative procedures. However the capacity is inadequate when it comes to widening the tax base and combating tax avoidance and tax evasion schemes. The lack of capacity is both internal and external. Internal in terms of sufficient and skilled manpower constraints. External in terms of political and social constraints.

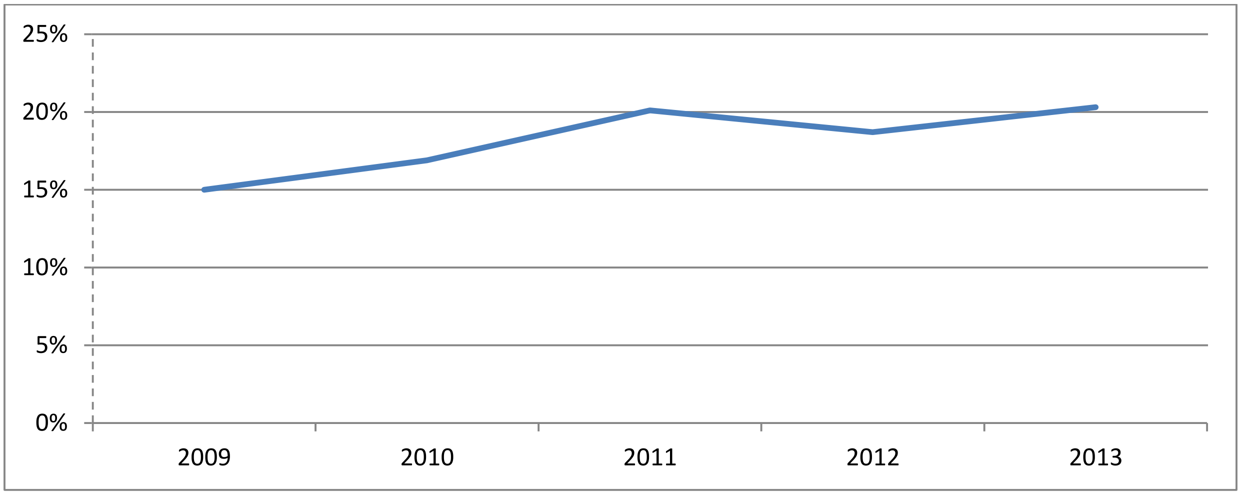
c) Propose adequate tax collection methods

The ZRA must continuously engage with the taxpayers in terms of taxpayer education, information dissemination and service provision. Tax payers must increasingly comply on their own by finding it easier and efficient to deal with ZRA. This involves creating an environment that allows the taxpayers to comply with their obligations without necessarily going to ZRA offices.

The government must ensure that all other departments that deal with taxpayers share this information with ZRA and vice versa so as to avoid taxpayers providing different information to ZRA and other government wings.

The government must increase the network of Double Taxation Agreements to enable ZRA exchange information with countries where multinationals operating in Zambia does business in and with. This is to assist ZRA have enough information to counter tax avoidance and evasion schemes like transfer pricing and thin capitalization.

Figure 2: Tax revenue to GDP ratio (2009 – 2013)



Source: ZRA

Table 2: Tax Revenue Performance (ZMW millions)

	2010	2011	2012	2013
Total Revenue	**13,161.4**	**18,928.0**	**20,807.0**	**23,190.8**
Tax Revenue	**13,125.5**	**18,889.0**	**20,719.1**	**23,154.8**
Income Tax	**7,350.6**	**9,766.9**	**11,733.8**	**11,630.6**
Company Tax	2,421.7	3,643.6	4,402.4	2,852.3
Non Mining Company Tax	1,176.5	1,169.7	1,701.9	1,767.5
Mining Company Tax	1,245.2	2,473.9	2,610.3	1,084.7
PAYE	3,866.3	4,519.3	4,934.0	5,738.7
Withholding Taxes & Others	626.3	736.0	938.9	1,278.9
Mineral Royalty	412.0	868.0	1,458.6	1,760.7
Mining Tax Arrears	-	1,752.6	-	-
Excise Taxes	**1,372.4**	**1,662.5**	**2,198.1**	**2,339.5**
Excise Duties		1,110.8	1,531.5	1,546.9
Rural Electrification Levy		30.1	30.6	35.0
Fuel levy		504.5	613.8	731.5
Carbon Tax		17.1	22.1	26.1
VAT on domestic goods	**515.0**	**(32.8)**	**(279.2)**	**1,185.5**
Trade Taxes	**3,911.8**	**5,739.7**	**7,066.5**	**7,999.1**
VAT on imports	2,644.6	3.997.3	5,030.8	6,178.3
Custom Duty	1.262.6	1,737.8	2,032.2	1,808.4
Export Duties	4.7	4.5	3.6	12.4
Export Duty on Scrap metals	-	2.6	0.0	0.0
Export Duty on Cotton seed	-	-	0.1	0.3
Export Duty on Copper	-	1.9	3.5	12.2

Concentrate				
Non Tax Revenue	**35.9**	**39.0**	**87.8**	**36.0**
Medical Levy	24.3	18.4	27.1	2.5
Motor Vehicle Fees	11.6	20.6	60.7	33.5

Source: ZRA