Highlights from The Zambia Fair Tax Monitor (FTM) Report

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Introduction

Zambia's fiscal performance remains a challenge as debt levels were recorded at over 70 percent of GDP in 2019, increasing from 20.8 percent of GDP over the past 10 years while tax to GDP is only of 19% and has barely improved significantly over the same period. Zambia's limited domestic revenue sources is a critical problem. As the country's debt has continued to escalate, Domestic Resource Mobilisation (DRM) has become a top Government agenda to ensure that Zambia is better placed to fund its development.

In a Ministerial statement by Hon Bwalya Ngandu, Minister of Finance, on July 12, 2020, he indicated that prior to the onset of Covid-19, overall budget performance as measured at end December 2019, remained relatively fair despite the fiscal challenges. Total revenues and grants were above target by 5.7 percent. The current Covid-19 has however brought a new reality for the government when rethinking their DRM agenda. the current Covid-19 pandemic has put an extra pressure on government spending according to Hon Bwalya Ngandu, Government spending in 2020 is expected to increase by an estimated K9.7 billion. While the economic downturn, with a projected negative growth of around minus 4.2 percent, has affected the levels of resource mobilization by a revenue reduction of K12.8 billion. In addition to this, the debt levels have been increasingly worrying as the fluctuating Kwacha exacerbates the burden of external debt servicing for the Zambian government and shrinking their fiscal space. As seen all over the world the Covid-19 crises and related responses have mainly exacerbated already existing inequalities and therefore it is timely to look at how the Zambia tax and spending is organised and what can be done to increase the fairness and sufficiency of the revenues.

Zambia has faced this crisis with deep previous fiscal weaknesses and that will limit its capacity to recover in future. Domestic Revenue Mobilisation (DRM) in Zambia comes in different forms including various taxes, levies, and fees. Efficient and effective tax collection is important to a country like Zambia because it is the biggest source of long-term financing for sustainable development and the determinant of good governance in terms of high-quality service provision; holding the Government to account; and citizens participation in the management of public funds. Efficient and effective tax collection coupled with economic growth is the remedy to long term aid and debt dependency and increased policy space to implement strategies that reflect the country's development plans. In the current COVID19 context this is achievable by stimulating growth in priority sectors as identified by the 7th National Development Plan.

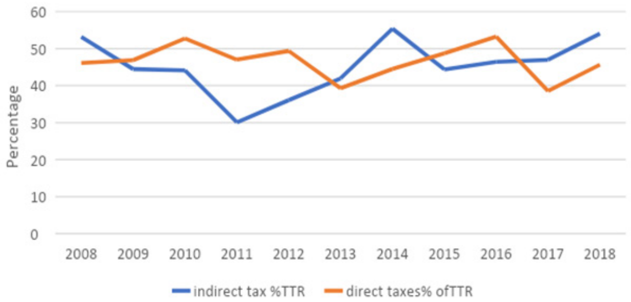
The report initially looks at previous fragilities and gives a brief description of the Zambian tax system. It further analyses the pre-Covid tax regime following the 6 clusters of topics: (i) Distribution of the tax burden and progressivity; (ii) Revenue sufficiency and illicit financial flows; (iii) Tax competition & corporate incentives; (iv) Effectiveness of the tax administration; (v) Government spending; and (vi) Transparency and accountability. While doing so, the study encompasses relevant data from the last 10 years and challenges tax policies and offers recommendations accordingly for a future that is bringing even more uncertainty. In Covid-19 context, Zambia's government can't build recovery without addressing fairer taxation and understanding the challenges of the past that will only be amplified now.

It must be noted however that this report was prepared on the backdrop of COVID-19 becoming a global pandemic which has caused various unprecedented economic strains. It is too soon to reflect all the implications of these developments and related policy priorities in Zambia in this document. However, the relevance of Zambia's first FTM report still stands as it provides the and analysis of the system and policies on which the current Covid measures build and is key in speaking to the importance of strengthening the tax base to be able to respond to economic shocks such as the one brought about by the COVID-19 pandemic. It is expected that the findings of this study will go a long way in influencing tax policy formulation and evaluation in Zambia to make the tax system more equitable and progressive. Distribution of the tax burden and progressivity.

Zambia's main revenue sources can be divided into three categories, namely: (i) total domestic revenue; (ii) domestic financing; and (iii) total foreign financing and grants. Total domestic revenue represents the largest share of these sources and includes tax and non-tax revenue.

Prior to 2019, the Zambian economy has largely been dependent on revenue collected through direct taxes. Between 2008 and 2018, direct taxes as a percentage of total tax revenue ranged between 46 and 55 percent. However, as illustrated in Figure 1, the last two years have seen Zambia increase its reliance on indirect taxes largely due to improved Value Added Tax (VAT) collection which has risen as a result of the enhancement of information technology solutions, particularly the use of electronic fiscal devices amidst VAT refund accumulation. In the past two years, therefore, indirect taxes have exceeded direct taxes – this risks the tax system being less progressive because indirect taxes are non-discriminatory in nature (meaning the poor and the rich are taxed at the same rates) and the burden heavily falls on the poor when broken down into proportions of their income.

Figure 1: Direct and Indirect Taxes (2008-2018)



Source: Ministry of Finance

Personal income tax (PIT) has been the largest contributor to Zambia's direct taxes with a larger contribution than Corporate Income Tax. PIT has consistently contributed more to the government treasury than Corporate Income Tax (CIT) over the past ten years period due to challenges the Zambia Revenue Authority (ZRA) has faced in allowing too many exemptions as well as its inability to effectively curb corporate tax dodging. An assessment of financial transactions between January 01, 2018, and September 30, 2018 suggested that Zambia had lost ZMW 1 billion (equivalent of US$82mn) in tax evasions while the Financial Intelligence Centre (FIC) analysed multiple cases where many Small and Medium Enterprises (SMEs) were found not to be registered for tax and lacked compliance.

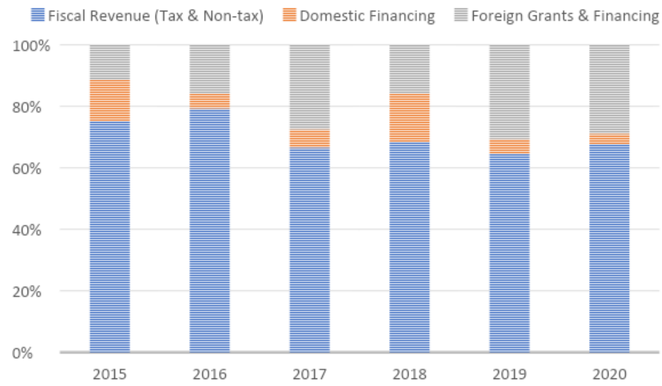
One major oversight that needs to be addressed and could contribute to a more equitable increase in revenue collection is the introduction of wealth taxes. To do so the ZRA could benefit from having a specific unit that deals with the High Net Worth Individuals (HNWIs).

Lastly, the lack of gender-responsive policies on taxation renders the regime regressive. This is exacerbated by the lack of gender dis-aggregated tax data. Extensive gender needs assessments, as well as incidence analysis of the impact of certain tax policies and related measures (including tax incentives) must be carried out by the Government to help target interventions.

Revenue Sufficiency

In terms of revenue sufficiency, the Zambian Government has seen an increase in its annual budget over the years. Zambia's national budget has grown from ZMW16.7 billion (US$3.3bn) in 2010 to ZMW106 billion (US$8.2bn) in 2020. The increases in domestic revenue have largely been attributed to the adoption of new technologies that have improved the efficiency and compliance of tax collection, however, although domestic revenue has been increasing in recent years and is expected to continue increasing, the proportion of domestic sources of revenue in comparison with foreign sources of revenue has been decreasing (from 81.3 percent in 2010 to 71.1 percent in 2020). We can expect to see this trend continue beyond the year of 2020 as the slow economic growth and subdued domestic resource mobilisation resulting from the COVID-19 pandemic will increase the need for financing.

Figure 2: Percentage Share of Domestic and Foreign Revenue



Source: Ministry of Finance

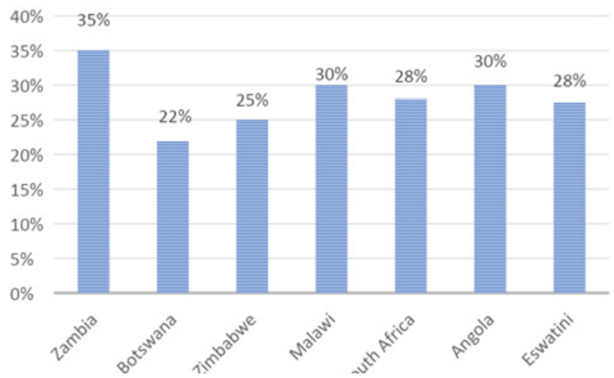
Over the past decade Zambia has seen a significant increase in infrastructure spending. Foreign financing and grants as a source of Government revenue have increased by 10 percent from 2010 and make up about 28.9 percent of the 2020 budget. The share of revenue sources for the national budgets has been illustrated above in Figure 2.

Despite the above-mentioned progress in revenue collection, Zambia suffers from a severe problem of Illicit Financial Flows (IFFs). IFFs are a major problem for many African countries particularly those heavily dependent on extractive industries. This is more so in Zambia as it accounts for 65 percent of the continent's IFFs in copper which indicates the vast scale of the problem. The establishment of the Financial Intelligence Centre (FIC) in 2013 was a domestic effort to investigate, follow up, and expose misconduct in financial transactions, hence identifying and combating tax leakages.

Tax Competition & Corporate Incentives

Zambia offers a wide range of incentives in the form of allowances, exemptions, and concessions for companies that can be a drain on the economy's resources in terms of revenue foregone. The Zambia Development Agency (ZDA) Act of 2006 provides for specific investment thresholds for companies to qualify for fiscal and non-fiscal incentives. This is despite the lack of evidence to show that tax incentives are not the most important factor in attracting investment. As such, due to Zambia's significant tax exemptions, large thresholds, and a multiplicity of tax rates there exists a large gap in Zambia's tax to GDP ratio and that of other Southern African Development Community (SADC) countries.

Figure 3: Comparative CIT Rates (Southern Africa)



The Figure 3 above shows that in the Southern African region, Zambia's CIT rate is among the highest standing at 35 percent. Despite the high rate, Zambia offers a system of multiple CIT rates (nineteen CIT rate possibilities ranging from 0 to 40 percent) rather than a consolidated tax rate. According to the International Growth Centre (IGC), a country should offer a consolidated tax rate as that offers investors simplicity, predictability, and certainty without having to apply for discretionary tax incentives

With regards to Zambia's Special Economic Zones (SEZs), the report shows that despite the high investment pledges that are made, actualising these investments have proven to be a challenge due to various reasons such as a limited number of staff and resources for monitoring and evaluation. Since the start of the Covid-19 pandemic the range/intensity of tax competition/incentives has increased. For instance, the suspension of import duties on the importation of concentrates in the mining sector to ease pressure on the sector

Effectiveness of the Tax Administration

The ZRA forecasts revenues taking into account various indicators including previous trends, macroeconomic variables and others, presenting its targets to Parliament. In recent years the ZRA has been exceeding its stated objectives. In 2018, this performance was overwhelming as a result of favourable outturn in the three revenue categories; direct taxes, local indirect taxes, and trade taxes.

A 2006 assessment of Zambia's tax system using the Tax Administration Diagnostic Assessment Tool (TADAT) found that Zambia has a sound tax administration structure, with several systems that encourage taxpayer compliance.

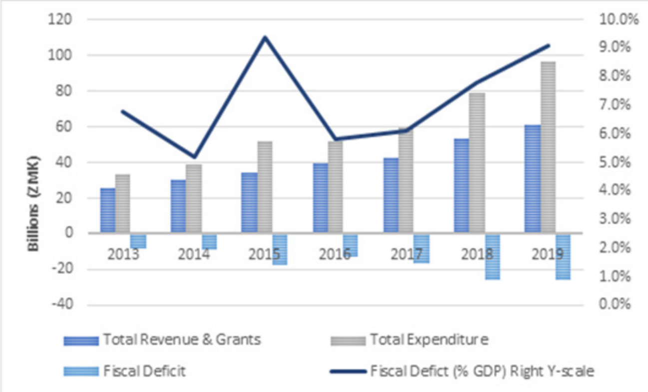
The study also listed several areas where reform should be targeted. The assessment cites very low rate of online filing, very high rates of tax arrears, and a backlog of VAT refund claims. They also found that the database of registered taxpayers contained inaccuracies, including a large number of inactive taxpayers.

Government Spending

Governments are required to use the resources they have to provide public services, social protection, and infrastructure for its citizens. In previous years, however, Government expenditure has outpaced its resource mobilisation which has led to an increasing fiscal deficit which stood at 9.1 percent of GDP at the end of 2019 (Figure 4). This gap is likely to increase further as domestic resource mobilisation is expected to me much lower than anticipated in 2020 following the Covid-19 pandemic. To bridge the gap, the Government has turned to domestic and external financing. Additionally, Zambia's increasing debt payments have reduced the Government's budgetary commitments towards key developmental sectors such as healthcare, education, agriculture, and social protection. Since the start of the Covid-19 pandemic the government has responded by additional spending on COVID19 related interventions through the Ministry of Health and the Disaster Management and Mitigation Unit (DMMU) to face the pandemic head-on. As highlighted under the Revenue Sufficiency findings, the impact increased debt repayments has had in light of the COVID19 pandemic has left government in a tight fiscal space inadequate to respond to the economic shock seen in 2020.

According to Hon Ngandu, Government spending in 2020 is expected to increase by an estimated K9.7 billion. He explained that this is due to increased Government spending on Covid-19 related interventions and increased external debt payments and other foreign currency denominated expenditures affected by the depreciation of the kwacha. As highlighted under the Revenue Sufficiency findings, the impact increased debt repayments has had in light of the COVID19 pandemic has left government in a tight fiscal space inadequate to respond to the economic shock seen in 2020.

Figure 4: Total Expenditure and Fiscal Deficit (2013-2019)



Source: Ministry of Finance

Transparency and Accountability

In terms of transparency and accountability, a significant lacuna in Zambia's legislation is the lack of legislation guaranteeing access to information. The Companies Act of 2017 encourages companies to publish financial statements, but it is only mandatory for companies that are listed on the Lusaka Stock Exchange.

The revenue performance section of the Zambian budget provides detailed information regarding Zambia's revenue sources and the ZRA undergoes audits annually. In terms of the development of the budget, the Government allows for civil society to participate in shaping budget policies at both national and local levels, however there remains a need to enact the Planning and Budgeting Bill to strengthen the process.

Corruption remains a major impediment to Zambia's growth and development. In addressing it, the Government needs to embrace and act on reports generated by statutory bodies such as the Financial Intelligence Centre (FIC) and the Office of the Auditor-General, as well as interrogate tools such as the Corruption Perception Index (CPI) to strengthen and promote good governance. The table (Table 1) below indicates that Zambia's CPI score has been reducing over the years and lags behind other Sub-Saharan countries. Additionally, further enforcement of legislation such as the Public Finance Management Act of 2018 is imperative as efficient delivery of public services is key to poverty reduction and inequality.

Table 1: Zambia's Corruption Perception Index Score (2015-2019)

	Country	Score out of 100				
		2015	2016	2017	2018	2019
1	Denmark	91	90	88	88	87
2	Finland	90	89	85	85	86
3	Sweden	89	88	84	85	85
4	Botswana	63	60	61	61	61
5	Rwanda	54	54	55	56	53
6	Namibia	53	52	51	53	52
7	Ghana	47	43	40	41	41
8	Ethiopia	33	34	35	34	37
9	Zambia	38	38	37	35	34

Source: Transparency International

Key Recommendations

- In the quest to make the tax rates more progressive, the Government needs to continue to strengthen tax administration as well as design and implement strong tax policies focused on corporate tax evasion, avoidance, and overall compliance with regards to corporations – especially those in the mining industry.

- New legislation such as the yet to be enacted National Planning and Budgeting Act must be gender-sensitive at all levels of planning

- At 14 percent of GDP in 2015, Zambia's tax-to-GDP ratio is significantly lower than the unweighted average for SADC (23.7 percent of GDP) therefore Zambia needs to improve its collection by incentivizing tax compliance and the pressing on with the adoption of new technologies to improve efficiency. This would also reduce the country's increasing reliance on foreign debt.

- Zambia's tax incentives regime must be better targeted towards local businesses as an investment in the private sector would cushion the economy from external shocks and reduce the risks of IFF's. To realise this, there will be a need to review the CEEC Act and Companies Act to streamline characterisation and definitions of citizen-owned businesses (at present, the multiple categories in existence have created more loopholes than providing guidance that helps to targets incentive sand support to locally owned businesses.

- The recent Public Finance Management Act of 2018 had the objective to provide for oversight and accountability by detailing an institutional and regulatory framework for the management of public funds, including debt after its contraction. By ensuring the implementation of the progressive clauses of this Act, the Government can improve the usage of public resources in all sectors, enhance public debt management, and eliminate their fiscal deficit.

- There is a pressing need for the Government to provide a new strategy to curb corruption. The Government needs to begin to embrace reports by institutions such as the Financial Intelligence Centre or the Office of the Auditor-General, as well as interrogate tools such as the Corruption Perception Index to strengthen and promote good governance.

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