

**ARE ZAMBIA'S TAX LAWS ADEQUATE AND EFFECTIVELY APPLIED  
IN RAISING REVENUE FOR THE GOVERNMENT TO REDUCE  
POVERTY?**

**BY**

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IN RAISING REVENUE FOR THE GOVERNMENT TO REDUCE  
PORVERTY?**

**BY**

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Being a paper presented in partial fulfillment of the examination requirements for the degree of Bachelor of Laws degree (LL.B) of the University of Zambia.


**UNZA**

**2011**

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**L410-DIRECTED RESEARCH**

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IN RAISING REVENUE FOR THE GOVERNMENT TO REDUCE  
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## **ABSTRACT**

Economies across the world depend on resources collected from both direct (Income Tax and Company Tax) and indirect taxes (Value Added Tax, Excise and Customs Duties) to finance Government activities. No Government can be sustained without mechanisms for generating domestic revenue. It is a trite observation that taxation is the only rational means of raising revenue to finance Government spending on goods and services and in the redistribution of wealth or income. Taxation also plays a pivotal role in encouraging economic growth and reducing disparities between the rich and the poor, and reducing poverty.

This obligatory essay examined as to whether or not the existing tax laws are adequate and effectively applied in raising revenue for the Government of the Republic of Zambia to reduce poverty. Further, the essay examined and considered whether the establishment of Zambia Revenue Authority (ZRA) has yielded its intended purpose and whether the enforcement of the tax laws by ZRA was a reality or mere fallacy. Furthermore, the dissertation attempted to examine whether Government was allocating enough resources towards poverty reduction. In addition, the research examined and considered whether or not it was necessary under the circumstances to broaden the tax base by reforming the existing tax policy in order to enhance revenue collection.

The study discovered that, most tax laws in Zambia do not satisfy the principle of adequacy and are not fairly applied to all the eligible tax payers. Further the study established that, in its quest to generate sufficient revenue, ZRA is on the right track in so far as realizing its intended purpose is concerned. However the enforcement of the tax laws has not been satisfactorily done owing to the inadequate legal framework under which ZRA operates. Furthermore, the essay also discovered that Government's resource allocation towards the priority sectors of fell below the Fifth National Development Plan FNDP set targets. Therefore the study recommends that Government should take significant steps to strengthen the legal framework for sound fiscal policies particularly on tax reforms which constitute the major policy instruments needed to accelerate growth and eliminate poverty and promoting a better tax system to mobilize more revenue.

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In the first place, I would like to thank Jehovah God almighty for having given me the gift of life and for being the source of my strength. I thank you GOD for your continued protection since I came into this world and your abundant goodness. *The fear of the LORD is the beginning of wisdom; and all who follow his precepts have good understanding. To him belongs eternal praise.* **Psalms 111 vs10**

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My special thanks go to my wife Pamela and children Natasha, Mwenya, Fred junior and Chansa for the unwavering encouragement, patience and understanding during the course of this research. They keenly accepted and endure long hours and days of my absence throughout the period of my study. I have set an example for you my children that with determination you can achieve your dream. I also thank my sister in law Esther for taking care of the young ones escorting them to and from Little Hearts School, without her life would have been unbearable.

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## **DEDICATION**

I dedicate this paper to my late Father and Mother, Mr. Metson .C. Nsama and Mrs. Jennipher Mowa Nsama who are not going to see me being awarded with the Bachelor of Laws degree (LL.B) of the University of Zambia. You were really a source of my inspiration. You inculcated into me a rare quality of being resolute, firm in purpose, hard work and discipline in order for me to accomplish my dream.

And

To my late son Bupe Kings Nsama you inspired me to continue working hard in my life. To me your memories are still fresh. I will forever cherish you all through out the rest of my life until we meet again on the other side of life.

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Property Transfer Tax Act, Chapter 340 of the Laws of Zambia

Value Added Tax Act, Chapter 331 of the Laws of Zambia

Zambia Revenue Authority Act, Chapter 321 of the Laws of Zambia.

## **LIST OF ACRONYMS**

AIDS	Acquired Immuno Deficiency Syndrome
BSACo	British South Africa Company
COMESA	Common Market for Eastern and Southern Africa
CPs	Cooperating Partners
CSO	Central Statistics Office
ECCDE	Early Childhood Care Development and Education
FDI	Foreign Direct Investment
FISP	Farmer Input Support Programme
FNDP	Fifth National Development Plan
FRA	Food Reserve Agency
GDP	Gross Domestic Product
GRZ	Government of the Republic of Zambia
HIPC	Highly Indebted Poor Country
MDGs	Millennium Development Goals
MNFP	Ministry of Finance and National Planning
PAYE	Pay As You Earn
PEAP	Poverty Eradication Action Plan
PRSP	Poverty Reduction Strategy Paper
SADC	Southern Africa Development Community
SNDP	Sixth National Development Plan
RTSA	Road Transport and Safety Agency
VAT	Value Added Tax
WTO	World Trade Organisation
ZRA	Zambia Revenue Authority

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## CHAPTER ONE

### 1.0 GENERAL INTRODUCTION AND BACKGROUND

This chapter covers the basic aspects of the research. These being the introduction, statement of the problem, definition of concepts, objectives of the research, significance of the study, specific research questions, research methodology, organization of the study and the conclusion.

### 1.1 INTRODUCTION

Many developing countries including Zambia attained their independence around the same period. Some of these countries have made, since then giant leaps and bounds in their national development. Other countries have on the other hand, fallen far behind, even losing the small development gains made few years following the advent of their independence. Due to high levels of poverty, absence of employment, lack of educational opportunities, absence of good health care, an abundance of hunger and lack of good infrastructure, these countries have become harbingers of diseases such as; malaria, tuberculosis, measles and HIV/ AIDS. Yet some of these diseases are preventable or even curable, but thousands of people die each year due to lack of good health care and other associated problems.<sup>1</sup>

How can these countries Zambia in particular defeat poverty and be on the road to national development? What tools does Zambia need to use in order to have enough resources and be able to overcome the challenge of poverty? Can Zambia's tax laws play a significant role in the fight against poverty? In reality, it is a fact as Father Pete Henriot of the Jesuit Center for theological Reflections (JCTR) rightly pointed out that, Zambia is one of the richest countries on the continent of Africa. It has rich mineral deposits, plenty of arable land, abundant water, agriculture and tourism. However, despite such a rich background in terms of the natural resources, Zambia is one of the poorest countries in the world today. It ranks 166 out of 177 on the United Nations Development Programme "*Human Development Index*."<sup>2</sup> One may argue that if Zambia has all these natural resources in abundance why should poverty be a topical issue?

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<sup>1</sup> Foreword: By Dr. Mpazi Sinjela in; Kanja G.M. Intellectual Property Law, UNZA Press, Lusaka, 2006 page 1

<sup>2</sup> The Post Newspaper No. 5031- Tuesday July 27, 2010.

In the recent past, the Government of the Republic of Zambia officially launched its second Poverty Reduction Strategy Plan (PRSP), known as the Fifth National Development Plan (FNDP) for the period 2006 to 2010.<sup>3</sup> Zambia's first PRSP covered the period 2002- 2004 but it was later extended to include 2005.<sup>4</sup> The FNDP is guided by the National Vision 2030 (NV2030) which has its goal to transform Zambia into a prosperous middle income country by the year 2030. The FNDP acknowledges that despite the implementation of the PRSP and the positive economic growth since 1999, national poverty levels remain high.<sup>5</sup> The FNDP also acknowledges that the degree of poverty and its severity is more pronounced in the rural areas than the urban areas. Further, the FNDP observes that; Zambia's income distribution inequality and the gender gap still remain significant.<sup>6</sup>

In their joint Press Release the Civil Society for Poverty Reduction (CSPR), Jesuits Center for Theological Reflections (JCTR) and Caritas Zambia observed that the end of 2008 and the first half of 2009 was full of challenges that saw gains in poverty reduction swept by the global economic crises and falling copper prices which were not helped by the already existing impediments to development.<sup>7</sup> The World Bank placed Zambia in the "*Highly exposed*" countries due to its high poverty levels and slowed growth.<sup>8</sup> The findings of the ongoing current review of the budget from 2006 – 2010 whose aim is to build capacity among the non-governmental organizations and the public on the budget awareness indicate that the fiscal policy currently being used in implementing the budget is not effective. The findings revealed that; poverty levels in the country have continued to rise under the current budgetary implementation framework.<sup>9</sup>

From the foregoing poverty analysis, it is evident that Zambia's poverty levels and its severity are still high and as such poverty remains one of the greatest challenges for the Government of the Republic of Zambia which needs practical and relatively permanent solutions.

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<sup>3</sup> The Joint International Development Association (IDA)-International Monetary Fund (IMF) Staff Advisory Note on the PRSP (Fifth National Development Plan- FNDP) 2007 p.2-6

<sup>4</sup> The Joint International Development Association IDA- IMF Staff Advisory Note on PRSP, FNDP 2007 page 2

<sup>5</sup> The Joint International Development Association IDA- IMF Staff Advisory Note on PRSP, FNDP 2007 page 2

<sup>6</sup> The Joint International Development Association IDA- IMF Staff Advisory Note on PRSP, FNDP 2007 page 2-3

<sup>7</sup> Press Release by CSPR-JCTR and Caritas Zambia: Pre- 2010 Budget under the Theme: "Economic growth with Equity; Investing in the dignity of the people." August 5, 2009.

<sup>8</sup> Press Release by CSPR- JCTR and Caritas Zambia; 2010 Budget: "Economic growth with equity: Investing in the dignity of the people" August 5, 2009.

<sup>9</sup> Poverty levels in Zambia are still on the increase- CSPR | Lusaka times.com (Wednesday, March 31, 2010)

## 1.2 STATEMENT OF THE PROBLEM

From time immemorial, taxation has been a source of revenue for the state to provide for social goals for use by the entire citizenry. Different countries have used various tax systems in order to meet their revenue needs.<sup>10</sup> Taxation constitutes a major fiscal tool in the development strategy of any nation. Its uses are multi-faceted. A country's economic and social progress largely depends on its ability to generate sufficient revenues to finance a host of essential non-revenue yielding public services such as poverty reduction, education, health, communication, transport and national security.<sup>11</sup>

Some developing countries have through taxation been able to realize enough revenue which in turn they channel into other sectors of their economies and have ultimately lowered the levels of poverty to sustainable levels. In Uganda for example, the Government has used tax policies in line with Poverty Eradication Action Plan (PEAP) objectives through supporting increased production, minimizing distortions, promoting human development and generally exempting the poor from paying certain taxes. Headcount poverty as percentage of the total population has reduced significantly from 56 percent in 1992 to 31 percent in 2006. Income per capita increased from US\$ 285, 860 in 1995/96 to US\$ 824,742 in 2006. The impressive growth in GDP appears to have benefited the masses translating into significant reduction in poverty levels.<sup>12</sup>

Whereas Zambia which is equally a developing country, the levels of poverty are still soaring high as can be seen by the current poverty analysis done by the various Non-Governmental Organizations (NGOs).<sup>13</sup> The researcher acknowledges that; indeed considerable literature has been written on taxation in Zambia. Notwithstanding this fact, most of the literature centers on securing an efficient tax system, broadening the tax base and the realization that taxation is today the most effective Government fiscal instrument of raising revenue. Thus, in 1993 Zambia Revenue Authority was established following the enactment of the ZRA Act.<sup>14</sup>

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<sup>10</sup> J. M. Sakala's Obligatory Essay: Zambia's Tax Legislation vis-à-vis The Shadow Economy; UNZA: (2004)

<sup>11</sup> R. N. Simbyakula, Taxation and Economic Development in Zambia; (Ph.D. Thesis, Wisconsin, 1990)

<sup>12</sup> Uganda's Taxation Policy: Implications for Poverty Reduction and Economic Growth. Review Report 2008, p.7

<sup>13</sup> Poverty levels in Zambia are still on the Increase- CSPR|Lusaka times.com Wednesday, March 31<sup>st</sup> 2010 p. 2 - 5

<sup>14</sup> ZRA was created under an Act of Parliament; Act No- 28 of 1993



ZRA is responsible for assessing, levying, collecting and accounting for public revenue in the form of direct taxes, duties, sales tax and other statutory charges on behalf of the Government of the Republic of Zambia.<sup>15</sup> The setting up of ZRA came as a result of Governments' deep concern for sharp decline in the ratio of tax revenue to Gross Domestic Product (GDP).<sup>16</sup>

Economies across the world depend on resources collected from both direct taxes (income tax and company tax) and indirect taxes (value added tax (VAT), excise and customs duties) to finance Government activities. No Government can be sustained without mechanisms for generating domestic revenue.<sup>17</sup> Taxation as a source of Government revenue in Zambia is reported to have performed well up to target in the last few years. As at end –September 2010, domestic revenue had performed well within target for the year and was expected to over perform by 12% by the end of the year. This performance was attributed to higher collections under Income tax and VAT arising from the collection of tax arrears.<sup>18</sup>

Whilst this is a welcome development, attention still needs to be raised to the fact that the tax burden distribution is heavily skewed towards direct taxes. Particularly troubling is the disproportionate burden that continues to fall on the individuals working in the formal employment sector. Pay as You Earn (P.A.Y.E) is yet again expected to be the largest contributor to tax revenue in 2011 at K3, 710.6 billion more than company tax at K1, 337. 1 billion and mining at K1, 858.4 billion respectively.<sup>19</sup>

Although, taxation as source of revenue in Zambia is reported to have performed well up to target in the last few years, there has been an observed decline in the share of tax revenue to Gross Domestic Product (GDP) and contribution of domestic consumption taxes and decline in revenue from trade taxes attributed to trade liberalization in regional groupings such as Southern Africa Development Community (SADC) and Common Market for Eastern and Southern Africa

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<sup>15</sup> See ZRA Act no 23 of 1993.

<sup>16</sup> F. Mudenda, Zambia Revenue Authority: "Towards Enhancing Effectiveness In Tax Administration," Obligatory Essay, University of Zambia: 1994

<sup>17</sup> Jesuit Centre for Theological Reflections, "Analysis of the 2011 Budget- Financing for 2011," Lusaka, 2010

<sup>18</sup> Budget Speech for 2011- Paragraph 42 as presented by Minister of Finance and National Planning Mr. Situmbeko Musokotwane

<sup>19</sup> Jesuit Centre for Theological Reflections (JCTR), "Zambia's Tax System: Need for Equity and Efficiency," A draft Report Submitted to the Parliamentary Committee on Estimates, Lusaka, 2010. Page 5

(COMESA). Legislated trade tax concessions and tariff reductions due to SADC and COMESA trade protocols have been eroding the tax base.<sup>20</sup>

Performance of the mining sector taxes has equally not been impressive. Many stake holders have been calling on the Zambian Government to reintroduce the windfall tax to help the country benefit from the current surge in international copper price nearly an all-time high of over US\$9,000 per tone. However such repeated calls have fallen on the deaf ears of the Government who have opted to use the variable tax on the mines.<sup>21</sup>

The writers' humble research revealed that considering the fact that ZRA has now been in existence for about 16 years and a number of amendments made to the current tax laws, the writer was unable to find any literature which has analyzed the adequacy and the effective application of the current tax laws in so far as raising sufficient revenue for the Government to reduce poverty is concerned. Accordingly, it is the objective of this study to analyze the adequacy and the effective application of the current tax laws in raising revenue for sustaining poverty reduction by the Government of the Republic of Zambia. It is a trite observation that; taxation is the only rational means of raising revenue to finance Government spending on goods and services and in assisting the redistribution of wealth or income and can be used to encourage or discourage certain activities. Taxation also plays a critical role in encouraging economic growth and reducing disparities between the rich and the poor; and reducing poverty.<sup>22</sup>

The researcher was inspired to undertake this study in view of the high poverty levels in Zambia and to determine whether the Government is allocating enough resources towards poverty reduction activities or not. In most cases inadequacy of resources or lack of it by the Government has been cited to be the reason why the challenges of poverty, lack of good health care and lack of good infrastructure are still in our midst today.

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<sup>20</sup> Jesuit Centre for Theological Reflections, "Zambia's Tax System: Need for Equity and efficiency," 2010. page 4

<sup>21</sup> The Sunday Post 2<sup>nd</sup> January 2011

<sup>22</sup> Uganda's Taxation Policy: Implications for Poverty Reduction and Economic Growth. 2008 .Page 9

### 1.3 DEFINITION OF CONCEPTS

**Gross Domestic Product (G.D.P)**, is the total output of an economy and consists of all the goods and services that have been produced in the course of a year.<sup>23</sup>

**Poverty:** Poverty is a deprivation of minimum essential assets and opportunities to which every human being is entitled. Poverty is thus better measured in terms of basic education, health care, nutrition, water and sanitation, in addition to income, employment and wages.<sup>24</sup>

**Tax:** is money paid to the Government; it is an amount of money levied by a government on its citizens and used to run the government, the country, a state, or a municipality.<sup>25</sup>

### 1.4 OBJECTIVES OF THE RESEARCH

The fundamental objective of this study is to explore the extent to which the effective use of taxation might be of use in sustaining poverty reduction in Zambia. The following are the specific objectives of the study;

1. To give a brief historical background of the concept of taxation and its contribution in sustaining poverty reduction during the colonial era, post-colonial era up to the establishment of the Zambia Revenue Authority (ZRA).
2. To highlight the extent to which Z.R.A has been realistic in its attempt to realize its core objectives which include assessing, charging, levying, collecting and accounting for public revenue in the form of trade taxes, duties, sales tax and other statutory charges on behalf of the Government.
3. To give an analysis of the current tax laws by assessing their strengths and weaknesses in so far as revenue collection is concerned.
4. To make a comparative analysis between the Zambia Revenue Authority and the Revenue Authority of Uganda another African developing country. This is in order to see as to what extent is taxation is being utilized as a tool for poverty reduction in that jurisdiction.

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<sup>23</sup> Sean Nagle, Introduction to Macro Economics, Higher Education for Development Cooperation (HEDCO), Dublin-Ireland, 1992. Page 6

<sup>24</sup> G, Sugiyarto Poverty Impact Analysis-Selected Tools and Applications: Asian Development Bank (ADB) - 6 ADB Avenue, Mandaluyong City 1550 Metro Manila, Philippines, 2007. Page 39

<sup>25</sup> [www.bing.com.Dictionary.Search](http://www.bing.com.Dictionary.Search)

5. To consider whether the Government is allocating sufficient funds towards sustaining poverty reduction.
6. To determine whether or not the Government should broaden the current tax base through tax policy reforms.

## 1.5 SIGNIFICANCE OF THE STUDY

The pertinence of this study cannot be over emphasized. Generally speaking the study has come at the right time in view of the escalating poverty levels in Zambia. About two-thirds of Zambians live in abject poverty.<sup>26</sup> Zambia's economy has withered the effects of the global economic recession and a subsequent fall in the world copper prices. For instance, copper prices fell from a record high of US\$ 9,000 in 2006 to US\$3,900 in March 2009 as a result of the 2008/9 economic and financial crisis.<sup>27</sup> Some mining companies abandoned their operations; some placed their mines under care and maintenance, while others postponed their investment in the mine operations. It is estimated that over 14,000 jobs were lost in the mines owing to the tumbling copper prices resulting from the global financial crisis.<sup>28</sup>

High inflation, currency volatility, rising unemployment and restricted access to capital dampened Zambia's economic performance in the early 2009, however copper prices have nearly returned to more stable and profit yielding levels.<sup>29</sup> But we are yet to see the trickle down effects of the current trends in that respect. The findings of the ongoing current review of the budget from 2006 to 2010 whose aim is to build capacity among the public and the NGOs on the budget awareness, indicate that the fiscal policy being used in implementing the budget is not effective. The reason given for inefficiency being that; the poverty levels in the country have continued to rise under the current budgetary implementation framework.<sup>30</sup>

The writer was prompted to choose this area of study in view of the fact that Government revenue finances the operations of Government and its developmental projects; poverty reduction inclusive. Government revenue comes from trade taxes, personal income taxes and

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<sup>26</sup> United States of America Bureau Of African Affairs: "Zambia's Poverty Levels" 10<sup>th</sup> September 2010. page 1

<sup>27</sup> Sixth National Development Plan (SNDP): A Civil Society Perspective-March 2010, page. 30

<sup>28</sup> Sixth National Development Plan (SNDP): A Civil Society Perspective-March 2010, page. 33

<sup>29</sup> Sixth National Development Plan (SNDP): A Civil Society Perspective-March 2010, page. 35

<sup>30</sup> Interview with Mr. Patrick Nshindano, Information and Programmes officer-Civil Society for Poverty Reduction (CSPR), 11<sup>th</sup> January, 2011

corporate taxes.<sup>31</sup> The question one may ask is; why is it that some developing countries have managed to reduce poverty by the contribution of their tax regimes whereas Zambia a developing country as well with all the peace and the resources available continue to experience high levels of poverty, hunger and disease, lack of good health care and lack of good infrastructure? The researcher considers such and other similar questions to be the cause of the study.

Further, the study is justified on the basis that ZRA has been in existence for 16 years and yet it seems that something more needs to be done, perhaps expanding the tax base, decentralization and increased awareness on the concept of taxation. The study aims at making useful suggestions and recommendations to that effect.

## **1.6 SPECIFIC RESEARCH QUESTIONS**

1. Has the establishment of ZRA yielded its intended purposes?
2. Are the current substantive tax laws adequate and effectively applied to all the taxpayers?
3. Is the current revenue raised by ZRA sufficient to help Government in effectively sustaining poverty reduction?
4. Is the enforcement of the tax laws a reality or a mere fallacy?
5. Is there a necessity to reform the current tax policy to maximize revenue collection?
6. Is the Government allocating enough resources towards sustaining poverty reduction?

## **1.7 RESEARCH METHODOLOGY**

This study will be based on both primary and secondary information. The primary information will include interviews with some officials from the Ministry of Finance, Zambia Revenue Authority (ZRA), Bank of Zambia (BOZ), the Central Statistics Office (CSO) and the various Non- Governmental Organizations (NGOs) such as the Civil Society for Poverty Reduction (CSPR) and the Jesuit Center for Theological Reflections (JCTR) where necessary. Questionnaires will be used sparingly, and only where this is absolutely necessary. Secondary sources will include statutes, textbooks, journals, judicial decisions, articles and reports. Certain data will be analyzed by using tables and pie charts where this would be unquestionably required.

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<sup>31</sup> Fred Mutesa's Paper presented on: "Impact on Zambia of the Global Financial Crisis: The social and Poverty Dimensions" at Taj. Pamodzi Hotel, Lusaka: 23, October 2008.

## **1.8 CONCLUSION**

There is no doubt that effective poverty reduction remains the most fundamental challenge for the Government of the republic of Zambia. Economies across the world depend on resources collected from both direct taxes (Income tax and Corporate tax) and indirect taxes (VAT and Excise and Customs Duties) to finance a great number of essential non- yielding public services such as education, health, transport, communication, water and sanitation, energy, national security and poverty reduction respectively. A country's economic and social advancement depends on its ability to generate sufficient revenues to finance all these government activities.

## **CHAPTER TWO**

### **TAXATION IN ZAMBIA BEFORE AND AFTER THE INTRODUCTION OF ZAMBIA REVENUE AUTHORITY**

#### **2.0 INTRODUCTION**

This chapter looks in brief at the historical perspective of taxation law in Zambia. It examines taxation before and after the establishment of the Zambia Revenue Authority and its impact in sustaining poverty reduction in Zambia. The period covered under this chapter runs from pre-colonial, colonial era under the administration of the British South African Company (B.S.A Co), beginning in 1889 through to independence in 1964 up to the creation of Zambia Revenue Authority in 1994.

#### **2.1 TAXATION DURING THE COLONIAL DAYS AND ITS IMPACT IN SUSTAINING POVERTY REDUCTION IN ZAMBIA.**

Long before the advent of colonial domination, a form of taxation existed in Zambia. It was in the form of tribute paid in kind and according to one's ability by the inhabitants of the chiefdoms to their ruler. Each head of a household voluntarily contributed a portion of his harvest to the ruler who in turn placed it in some form of a cess-pool. The chief could use the surplus accruing to him to distribute among his subjects in times of shortages, war effort, festivals or to cater for special needs of particular individuals in society. There were no enforcement mechanisms apart from the moral and perhaps social pressure.<sup>1</sup>

From the foregoing, it is clear that; in pre-colonial times taxation impacted positively on the welfare of the people in their respective chiefdoms in the sense that, whenever there was a shortage of food due to bad harvest for example, festivals and the like, the chief could use part of the tributes given to him to help meet the needs of the vulnerable in society. It was some sort of Social welfare scheme. In addition this form of tax was usually paid without any compulsion; it was willingly and voluntarily contributed. This meant that people never left their homes and

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<sup>1</sup> R.N. Simbyakula, Taxation and Economic Development in Zambia (PhD Thesis, Wisconsin: 1990 ) Page 60

were able to attend to agricultural, hunting and cattle rearing activities and produced enough food for their families.

Colonial taxation on the other hand; took the place of tributes given to the chiefs and demonstrated the power of the new rulers. From 1890 when Zambia effectively came under colonial rule to 1924, a commercial company the British South African Company (B.S.A Co.) administered the territory on behalf of the British Government. As a commercial undertaking the B.S.A Co. expected to show profits to its shareholders. Hence the company needed to exploit every possible kind of revenue.<sup>2</sup>

One of the obvious means of obtaining more revenue was the imposition of the *hut tax* which was brought into force by the tax regulations of 1900.<sup>3</sup> Under this law every adult male of the age of 18 and above had to pay 3 Shillings. The new monetary tax could not be easily met from the local resources, payment in kind was therefore, theoretically legal but the tax payer was responsible for transporting the goods to usually non-existent markets. By 1905, a Native tax came into force in North Western Rhodesia through a proclamation<sup>4</sup>. The Native Tax Proclamation provided that every male of 18 years and above had to pay 10 Shillings and every adult male of 18 years and above who had more than one wife was liable to a further 10 Shillings in respect of each additional wife.<sup>5</sup> In some special instances such as old age, chronic illnesses or infirmity of body where by a native could not afford to pay, a certificate of tax exemption could be issued by the Colonial Administration.<sup>6</sup>

The basis of taxation in Northern Rhodesia was different for indigenous people from the settlers. Every indigenous male over the age of 18 was liable to tax which was collected in the province where he worked but at the rate of the province from which he came from. Like in other African countries, the position in Zambia was that there was no readymade army of unemployed persons looking for employment because the inhabitants were largely self-sufficient landed proprietors. Thus one of the aims of the British South African company was to create such an army, to turn

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<sup>2</sup> R.N. Simbyakula.; Taxation and Economic Development in Zambia (PhD Thesis, Wisconsin: 1990) page 63

<sup>3</sup> See the Government Notice No.9 of 1900 – British Central Africa Gazette: December, 1900.

<sup>4</sup> See Native Tax Proclamation No.16 of 1905.

<sup>5</sup> See S. 3 (1) of the Native Tax Proclamation, NO.16 of 1905.

<sup>6</sup> S.5(2) of the Native Tax Proclamation No. 16 of 1905



villagers into wage earners, separate men from their wives, families, fields, cattle and hunting grounds.

Company officials backed by army units or the police, moved from village to village registering families and collecting taxes in tours that brought them face to face with the local people, many of whom had never before set the eyes on the white man.<sup>7</sup>

The enforcement process was carried out with such ruthless efficiency that by 1930, 113,000 Zambians had left their villages to enter the labor market with 35,000 trekking to find jobs in the Sothorn Rhodesia (Zimbabwe) and South Africa. In the fiscal year 1931 to 1932, African taxation yielded 148,000 pounds more than was paid in income tax by settlers, and formed one sixth of Government's Gross Domestic Product from all sources.<sup>8</sup> But a settler paid no tax what so ever on earned income of less than 96 pounds a month if he had a wife and two children.<sup>9</sup>

The tax may have been a small part of the villagers cash needs, but it remained a compulsory factor that made wage labor unavoidable for many thousands of men. Needless to say it was viewed as an instrument of oppression and was deeply resented. This culminated in six deaths in 1935 when Copper belt miners reacting to reports of a tax increase went on strike for the first time and the police opened fire. The inquiry setup to look into the 1935 Copper belt disturbances revealed that; miners were lowly paid and taxes were beyond the earning capacity of many Africans and there was lack of social service delivery.<sup>10</sup> The *Poll tax* and *Hut tax* as they were known were subsequently abolished in January 1964 when the African majority in Parliament formed Government.<sup>11</sup> The methods of collection and enforcement that were used against the poor subsistence farmers, though efficient, were highly coercive and cannot be justified in any country with democratic pretentions.<sup>12</sup>

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<sup>7</sup> H. J. Simons, "Zambia's Urban Situation" in Turok, B (ed.), Development in Zambia (Zambia Press, London, 1979) page.7

<sup>8</sup> H. J. Simons, "Zambia's Urban Situation" in Turok, B (ed.), Development in Zambia Page.8

<sup>9</sup> R.N. Simbyakula, Taxation and Economic Development in Zambia (PhD Thesis, Wisconsin: 1990) page 62

<sup>10</sup> F. Mudenda, Zambia Revenue Authority: Towards enhancing effectiveness in tax administration (Obligatory Essay, University of Zambia: 1994). Page 11

<sup>11</sup> R.N. Simbyakula, Taxation and Economic Development in Zambia( PhD Thesis Wisconsin 1990 ) page 66

<sup>12</sup> R.N. Simbyakula, Taxation and Economic Development in Zambia (PhD Thesis, Wisconsin: 1990 )Page 66

## **2.2 THE INTRODUCTION OF THE ZAMBIA REVENUE AUTHORITY AND ITS IMPACT ON REVENUE COLLECTION AS WELL AS POVERTY REDUCTION**

Prior to the establishment of ZRA in 1994, all taxes were collected by the two departments under the Ministry of Finance and National Planning. These were; Customs and Excise department and the Income Tax department. During that time, the growth in revenue collections lagged far behind the growth in expenditure. This meant that expenditure was rising at a very faster rate than growth in revenue. In the end the Government of the republic of Zambia started experiencing huge budget deficits. Normally these were financed through borrowing and printing money. These modes of raising revenue have consequences of high inflation.<sup>13</sup>

Before 1990, the tax as a percentage of Growth Domestic Product (GDP) was around 18.6 percent<sup>14</sup>. By 1993, taxes as a percentage of Growth Domestic Product fell to around 13 % that is about a reduction of 5.6 percent points. Meanwhile expenditures increased by more than 10 percent points. The methods of collection of the taxes could not match the challenges that had come with technological development.<sup>15</sup> The setting up of ZRA came as result of the Government's deep concern for the sharp decline in the ratio of tax revenue to G.D.P in the period between 1980 through to 1993. The principle factor responsible for the decline was the decline in tax compliance which increased to unprecedented levels. However several other factors such as corruption and bribery; and inflation equally contributed to this decline in the tax ratio to GDP. <sup>16</sup> This decline in the tax ratio led to a serious shortfall in the funding available to Government to maintain and develop public services such health, education and physical infrastructure like roads, schools and hospitals. As a result, the country became increasingly dependent on donor funding to support even the most basic areas of essential public spending.<sup>17</sup>

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<sup>13</sup> Ministry of Finance and National Planning- Budget Office: Mr. M.Masiya's Interview, 20<sup>th</sup> January 2011.

<sup>14</sup> Ministry of Finance and National Planning- Budget Office: Mr. M.Masiya's interview, 20<sup>th</sup> January 2011.

<sup>15</sup> Ministry of Finance and National Planning- Budget Office: Mr. M.Masiya's interview, 20<sup>th</sup> January 2011.

<sup>16</sup> F. Mudenda, ZRA- Towards enhancing effectiveness in Tax administration.(Obligatory Essay, Unza: 1994) Page 15

<sup>17</sup> F. Mudenda, ZRA- Towards enhancing effectiveness in Tax administration. Page 16

Table 1 showing the Tax ratio to Gross Domestic Product: 1980-1993

Year	Tax Revenue as a% of GDP
1980 – 1985	21.2
1985 – 1990	18.1
1991	17
1992	15.5
1993	12.2

Source: Ministry of Finance Budget Office- 1991 and 1992

From the above table, it is evident that tax ration to the Gross Domestic Product had a downward trend for the period under review. It was therefore, necessary for the Government to see to it that the situation was put under control and as such, ZRA was established with the objective of maintaining the key principles of efficiency, equity through a broadened tax base and simplicity of tax administration.<sup>18</sup> From the foregoing, it is evident that, Zambia Revenue Authority was created in order to redress the serious shortfall in revenues available to the Government and the increasing dependency on donor funding to support the basic necessities such health, education and physical infrastructure.<sup>19</sup>

After 30 years of relatively dismal performance, Zambia's macroeconomic situation has changed in the last 10 years with GDP at an unprecedented average of 4.8% between 1999 and 2009. Growth continues to be driven by the output in the construction, mining and agriculture sectors.<sup>20</sup> GDP growth for 2009 was estimated at 6.1, a relatively small dip from 6.3 in 2008, and the 2010 and 2011 GDP growth forecasts stand at 5.5% and 5.7% respectively. The tax share of all revenues has stood at 75% average, increasing in recent years to 80%. The total revenue covers on average, 90% of public expenditure<sup>21</sup>. The major challenge to tax administration remains the large size of the informal sector.<sup>22</sup>

<sup>18</sup> ZRA website-www.zra.org.zm

<sup>19</sup> F. Mudenda, ZRA- Towards Enhancing Effectiveness in Tax Administration. (Obligatory Essay, Unza:1994) page 16

<sup>20</sup> African Economic Outlook 2011- (the site was last visited on 16<sup>th</sup> March 2011 )

<sup>21</sup> African Economic Outlook 2011- (the site was last visited on 16<sup>th</sup> March 2011)

<sup>22</sup> African Economic Outlook 2011 -(the site was last visited on 16<sup>th</sup> March 2011)

Table 2: Showing Macroeconomic Indicators

	2008	2009	2010	2011
Real GDP growth	5.7	6.1	5.8	5.9
CPI inflation	12.4	13.4	10.0	7.4
Budget balance% GDP	-2.2	-2.7	-2.7	-1.9
Budget account % GDP	-7.1	-4.0	-1.9	-1.5

Source: Central Statistics Office: estimates and predictions based on the authors' calculations. Figures for 2009 are estimates; for 2010 and later are projections.

The above table indicates that Zambia's domestic revenue has in the recent years increased proportionately compared to external financing. It is acknowledged that during the period of the Fifth National Development Plan (FNDP) Government made substantial efforts in a number of fields.<sup>23</sup> However, Civil Society is concerned that while this is a welcome development, it appears that the tax burden distribution is still heavily slanted towards the few eligible and potential tax payers in the country. It is argued that the current strategy followed by the Government may fall short to attain the goals set under the macroeconomic sector, including the reduction of poverty.<sup>24</sup>

Suffice to say that; the establishment of ZRA by and large, has positively impacted on the revenue collection in the country given the current statistics on the tax ratio to the GDP compared to the period before it was established. From the ratio of 13% as a percentage of GDP in 1993, we witnessed a tremendous increase of up to 19% by 2000. So between 1994 and 2000 there was an increase of 6% points in taxes as a percentage of GDP.<sup>25</sup> For the reasons given above, it can safely be stated that ZRA is on the right track in so far as realizing its intended purpose is concerned.

<sup>23</sup> Sixth National Development Plan [SNDP]: A Civil Society Perspective: "Economic Growth with Equity: Investing in the Dignity of the People" By the Civil Society for Poverty Reduction. Page21

<sup>24</sup> Sixth National Development Plan (SNDP): A Civil Society Perspective. March 2010. Page 21

<sup>25</sup> Ministry of Finance and National Planning (MFNP)-Tax Policy Officer, Mr.M.Masiya's Interview -20<sup>th</sup> January 2011

### 2.3. GOVERNMENT'S RESPONSE TO THE CHALLENGES OF POVERTY.

According to the Poverty Impact Analysis report done by the Asian Development Bank,<sup>26</sup> poverty is deprivation of minimum essential assets and opportunities to which every human being is entitled. Everyone should have access to basic education and primary health care services. Poor households have got the right to sustain themselves by their labour, and be reasonably rewarded and be afforded some protection from external shocks. Beyond income and basic services, individuals and societies are also poor and tend to remain so if they are not empowered to participate in making the decisions that shape their lives. Poverty is thus better measured in terms of basic education, healthcare, nutrition, water and sanitation, in addition to income, employment and wages.<sup>27</sup> In view of this definition of poverty, it would only be proper that Government's response towards poverty reduction be determined in terms of basic education, healthcare, nutrition, water and sanitation, agriculture, in addition to income, employment and wages. This will be done by assessing generally, the growth performance of some of these key sectors of the economy in relation to poverty.

The performance of the health and education sectors – sectors that are key contributors to human development has not been sufficiently impressive.<sup>28</sup> Zambians are still riddled with high rates of mortality with life expectancy at 40 years. This is one of the lowest in the world. HIV and AIDS mitigation and prevention as well as Malaria programmes are still largely financed by external donors. Services such as the Voluntary Counseling and Testing (VCT) and Anti-retroviral Treatment (ART) centers are still not readily available in the rural areas of Zambia and yet, it is common knowledge that HIV and AIDS has become one of the greatest challenges faced by rural communities. Child and maternal mortalities are still serious of concern in the health sector.<sup>29</sup> Overall, as indicated by the satellite home interviews conducted by the Jesuit Center for Theological Reflections, the public has very little confidence in the public health care system. This is largely because the quality of health care provided falls short of the expected standards to achieve a health nation.<sup>30</sup> The role of the health sector in poverty reduction cannot be overemphasized. A healthy population is a prerequisite to wealth creation; economic growth and

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<sup>26</sup> Poverty Impact Analysis: Selected Tools and Applications –( Asian Development Bank 2007 ) page 98

<sup>27</sup> Poverty Impact Analysis: Selected Tools and Applications –( Asian Development Bank 2007 ) page 101

<sup>28</sup> United Nations Development Programme – UNDP 2009

<sup>29</sup> Sixth National Development Plan (SNDP): A Civil Society Perspective. March 2010 page 81

<sup>30</sup> Sixth National Development Plan (SNDP): A Civil Society Perspective. March 2010 page 82

well-being of a nation. Wealth creation and economic growth are tools for fighting poverty.<sup>31</sup> In terms of sanitation, Zambia has vast water resources in form of rivers, streams, lakes and ground water. However, access to clean water and good sanitation remains a huge challenge in Zambia. This is evidenced by incidences of cholera in most urban areas, lack of toilet facilities in both urban and rural areas, the challenge of garbage disposal in urban areas and water pollution.<sup>32</sup>

The education sector is equally faced with significant bottlenecks. For instance the persistence of high levels of illiteracy is a good indication of the challenge of the education sector in Zambia. In Zambia, the education sector is composed of four inter-linked layers shaped in a pyramid, with Early Childhood Care Development and Education (ECCDE) as foundation stage, followed by the basic education, then high school and tertiary level, as the final stage.<sup>33</sup> The pyramidal shape of the education system having a wide base at basic school level, but with a very weak ECCDE foundation level; makes the entire system unstable, as more than 80% of the children are not ready to copy with school pressure owing to their lack of ECCDE exposure. However at basic school stage, there has been a lot of political will from cooperating agencies as well as Government, resulting in increased gross enrolment rates of 130.98% for grades 1 – 7 in 2008, but only 28.71 progressing to grade 10 – 12 level.<sup>34</sup> This could be attributed to external financial resources meant to support the realization of the Millennium Development Goal number 2 on basic education at the exclusion of other levels of education.<sup>35</sup>

According to the Ministry of Finance and National Planning (MFNP)<sup>36</sup>, the allocation of funds to University Education is woefully insufficient to meet qualitative and quantitative improvements especially in light of the reluctance on the part of Government to transfer a significant amount of the cost of delivery to the users of university services.<sup>37</sup> Generally the low quality state of education and skills training environment has left many young people unemployed and lacking in basic skills training contributing to high poverty levels that affect over 80% of the population. This means that the youth and children who constitute over 60% of the country's population

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<sup>31</sup> Office of the High Commissioner for Human Rights; Draft Guidelines; "A Human Rights Approach to Poverty Reduction Strategies" (2002) page 5

<sup>32</sup> Sixth National Development Plan (SNDP): A Civil Society Perspective- March 2010 page xxviii

<sup>33</sup> Sixth National Development Plan (SNDP): A Civil Society Perspective- March 2010 page 83

<sup>34</sup> Ministry of Education Report; 2008

<sup>35</sup> Sixth National Development Plan (SNDP): A Civil Society Perspective. March 2010 page 134

<sup>36</sup> Sixth National Development Plan (SNDP): A Civil Society Perspective-March 2010 page 83

<sup>37</sup> Sixth National Development Plan (SNDP): A Civil Society Perspective- March 2010 page 83

suffer from high poverty levels and unemployment. This poses a great challenge to the educational rights of the children and youths enshrined in the MDGs and EFA goals<sup>38</sup>

In terms of agriculture , in the past few years Government has endeavored to develop the sector; mainly by recognizing the importance of diversifying this sector and by providing some subsidies mainly for those that grow maize ( Farmer Input Support Programme - FISP). This is one of the major poverty reducing programmes by the Government. However, it has been argued that the Government has focused on one crop only and leaving some other helpful crops like cassava and groundnuts. Government has equally neglected to some extent some other agricultural areas; like live stock and fisheries agriculture<sup>39</sup>

**2.4 CONCLUSION**

This chapter looked at the historical perspective of taxation in Zambia. It has examined taxation before and after the establishment of Zambia Revenue Authority (ZRA) and considered its impact in sustaining poverty reduction for the period under review. Long before the advent of colonial domination, a form of taxation existed in Zambia. It was in the form of tribute paid in kind and according to ones’ ability. Each head of a household voluntarily contributed a portion of his harvest to their ruler who in turn placed it in some form of a cesspool. In times of shortages, war effort or festivals, the Chief could use the surplus accruing to him to distribute among his subjects or to cater for special needs of particular individuals in society. It was some sort of a welfare scheme. In addition tax was voluntarily paid and in kind without any compulsion, this meant that people never left their homes in search of cash wage but attended to agricultural, hunting and cattle rearing activities and produced enough food for their families. In all pre-colonial form of tax impacted positively in sustaining poverty reduction.

Colonial taxation on the other hand, took the place of tributes given to the chiefs and demonstrated the power of the new rulers the BSACo who administered the territory on behalf of the British Government. As a commercial undertaking the BSACo expected to show profits to its share holders. One of the obvious means of obtaining revenue was by the imposition of the hut

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<sup>38</sup> Sixth National Development Plan (SNDP): A Civil Society Perspective- March 2010 page 83

<sup>39</sup> Sixth National Development Plan (SNDP): A Civil Society Perspective- March 2010 page.85

tax brought into force by the tax regulations of 1900. The colonial tax was viewed as an instrument of oppression and was deeply resented as it mainly benefited the whites. This culminated in six deaths in 1935 on the Copper belt when the miners reacting to the reports of tax increase went on strike for the first time and Police opened fire. *Pole tax* and *hut tax* were subsequently abolished in 1964 when the African majority in parliament formed Government. The methods of tax collection and enforcement that were used against the poor subsistence farmers though efficient were highly coercive and cannot be justified in any country with democratic pretensions. Hence colonial taxation contributed to the deterioration of the quality of human life especially in the rural agricultural communities and ultimately, impacted negatively in terms of poverty reduction.

The establishment of ZRA in 1994, by and large has impacted positively on revenue collection. Taxation as a source of Government revenue is reported to have performed well up to target in the last few years and is expected to over perform by over 12% by the end of the year 2011. This performance is attributed to ZRA's higher collections under Income tax and VAT arising from the collection of tax arrears.

The chapter has further examined Government's response to the challenges of poverty reduction. This was done by looking at the growth performance of the various key sectors of the economy. The performance of the health and education sectors -sectors that are key contributors to human development has not been sufficiently impressive. Access to clean water and good sanitation remains a huge challenge in Zambia. This is evidence by incidences of cholera outbreaks and uncollected garbage in most urban areas. The performance of the agriculture sector has been mixed. However the Government has endeavoured to develop the sector mainly by providing some subsidies in form of fertiliser for those that grow maize through the Farmer Input Support Programme (FISP). This is one of the major poverty reducing programmes being used by the Government. However it has been argued that Government has focused on crop only at the expense of other equally helpful crops like cassava, rice and groundnuts. However, in as much as taxation has performed well, and all the efforts put in place by the Government, the rate at which poverty is being reduced is quite low.



## **CHAPTER THREE**

### **A COMPARATIVE ANALYSIS BETWEEN THE ZAMBIAN AND THE UGANDAN TAX SYSTEMS**

#### **3.0 INTRODUCTION**

This chapter attempts to make a comparative analysis between the Zambian tax system and other developing African countries. To this effect an analysis of Zambia's main tax laws will be done to determine their adequacy in so far as tax collection is concerned. Further, the chapter will go on and make a comparative analysis between Zambia's tax regime and that of Uganda respectively. The writer chose Uganda because of its peculiar similarities with Zambia. In the first place, both Uganda and Zambia are developing African countries. Secondly, Uganda and Zambia got their independence at almost the same time in 1963 and 1964 respectively. Thirdly, Uganda is a member country to the Common Market for Eastern and Southern Africa (COMESA), whereas Zambia is also a member country to this regional grouping and as such they share a lot in common together. On the other hand, Ugandan Revenue Authority Statute of 1991 is to a large extent a replica of the Zambia Revenue Authority Act<sup>1</sup>. On the other hand, these countries established their autonomous revenue authorities as a perceived means to sustained revenue improvement.<sup>2</sup>

The analysis will be based on the aspect of adequacy of the tax laws, efficiency, performance and tax policy formulation of these respective countries in relation to the domestic resource mobilization for poverty reduction. However, it must be mentioned that; an analysis of the tax system of these countries is a complex one; hence it cannot be comprehensively covered in a piece of work of this nature due to resources and time limitations. Therefore, only a number of the main features of these tax systems will be analysed for the purposes of comparisons. Then finally a conclusion will be given at the end of this chapter.

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1 F. Mudenda., Zambia Revenue Authority Towards Enhancing effectiveness in tax administration Obligatory Essay University of Zambia 1994

2 S.C. Hadler, "Improving Tax Administration in Sub-Saharan Africa". Harvard Law School: USA. (2000) page 3

### 3.1 AN ANALYSIS OF THE CURRENT TAX SYSTEM IN ZAMBIA

The tax system in Zambia is broad and has a wide range of taxes from which revenue could be collected. Zambia has the potential to equitably and efficiently raise more tax revenue by employing policies and practices that improve tax revenue administration.<sup>3</sup> Zambia's tax system is currently the only reliable source of Government revenue whilst other sources exist, such as Foreign Direct Investment (FDI), remittances and printing of the money, these are not reliable as they are unpredictable and can be unsustainable.<sup>4</sup> The Zambian tax system offers a wide base and alternative source of revenue, and therefore has the potential to contribute even more than is currently the case. Therefore tax administration needs to be supported in order to keep it abreast with the growth of the economy.<sup>5</sup> Taxation in Zambia is implemented through direct and indirect tax laws. This segment aims at examining the adequacy and effectiveness of some of these tax laws.

#### 3.1.0 DIRECT TAXES

The Zambian **Income Tax Act**<sup>6</sup> is the principal Act for taxation. It is based on the source principle. This means that any income generated in Zambia or any income whose source is deemed to be from Zambia is liable to taxation.<sup>7</sup> The Income Tax Act applies to both individuals and companies. All individuals and companies are liable to the Zambian tax on income that springs or deemed to spring from a Zambian source. Resident individuals are also liable on a part of their foreign source income.<sup>8</sup> Income includes: business profits and emoluments i.e. salaries, wages, overtime or leave pay, commission, fees, bonuses, gratuities (inducements) allowances and pensions or annuities.<sup>9</sup>

There are however, exemptions for foreign source dividends, for farming dividends, for income of any persons designated as an enterprise under the, Zambia Development Act.<sup>10</sup> Furthermore,

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<sup>3</sup> Zambia's Tax System – Need for Equity and Efficiency -Submitted to the Parliamentary Committee on Estimates: By Jesuit Centre for Theological Reflection (JCTR). 13 December 2010. p.2

<sup>4</sup> Zambia's Tax System- Need for Equity and Efficiency- Submitted to Parliamentary Committee, 2010, page 2

<sup>5</sup> Zambia's Tax System - Need for Equity and Efficiency- Submitted to Parliamentary Committee, page 3

<sup>6</sup> Chapter 323 of the Laws of Zambia

<sup>7</sup> See section 14(1) (a) of Income Tax Act; Chapter 323 of the Laws of Zambia.

<sup>8</sup> Income Tax Act, Chapter 323 of the Laws of Zambia. Section 14 (1)( b)

<sup>9</sup> Income Tax Act, Chapter 323 of the Laws of Zambia. Section 17

<sup>10</sup> See Part 4 of the Second Schedule of the Income Tax Act for the tabulation of exemptions

other exemptions under the Income Tax Act include, for civic society, registered trade unions, approved fund for medical aid societies, approved savings schemes for political parties. The Income Tax law also provides for the exemption of charitable organisations involved in humanitarian work and for emolument of office holders such as the President and recognized chiefs, for entertainment and other allowances paid to certain members of the judiciary and other officials.<sup>11</sup>

The Income Tax Act encompasses the following taxes: Company Income Tax; Pay As You Earn (P.A.Y.E);<sup>12</sup> Withholding tax on interest, dividends, management fees, payments to foreign contractors, rentals.<sup>13</sup> Turn over tax – this tax is paid by businesses whose annual turnover is two hundred million kwacha (K2, 000,000.00) or less.<sup>14</sup> What happens in this case is that if you are a business entity, and you make K200 million or less per annum, you do not qualify to pay company income tax, instead you are expected to pay a presumptive tax at a rate of 3% of your turn over.<sup>15</sup> The other form of presumptive tax– is being tax charged on passenger transport, taxis, minibuses, buses and coaches whose rate is based on the capacity of the vehicle per day.<sup>16</sup> The policy or the guiding principle behind the Income Tax Act is that: taxes must be collected from all business enterprises and persons who are earning an income including the difficult to tax who are mainly in the informal sector. Owing to this wide coverage, the Income tax law is adequate.<sup>17</sup>

### **3.1.1 INDIRECT TAXES**

#### **Value Added Tax**

Zambia introduced the Value Added Tax (VAT) law on 1<sup>st</sup> July 1995 under the VAT Act.<sup>18</sup> The VAT Act replaced the Sales Tax Act. VAT law is based on the destination principle.<sup>19</sup> That is to say the tax is paid in the jurisdiction where consumption takes place. For example all goods

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<sup>11</sup> See Part 1 of the Second Schedule s.1 and section 41 of the Income Tax Act

<sup>12</sup> Income Tax Act, Section 71(1)

<sup>13</sup> Income Tax Act, Section 83 (A) 1 C

<sup>14</sup> Income Tax Act, Section 64 (A) 1

<sup>15</sup> Income Tax Act, Section 64 (A) 2

<sup>16</sup> See Income Tax (Amendment) Act Number 1 of 2003

<sup>17</sup> Interview with Mr. M Masiya, Tax Policy Officer, Ministry of Finance and National Planning, 20<sup>th</sup> January 2011

<sup>18</sup> Chapter 331 of the Laws of Zambia

<sup>19</sup> See section 7( 1) of the Value Added Tax Act

and services consumed in Zambia should be VAT-able or VAT law applies. The majority of goods and services are taxed at the standard rate of 17.5%.<sup>20</sup> A number of goods and services are however, zero rated.<sup>21</sup> Their producers do not charge VAT on their output, and are entitled to claim VAT paid over their input.<sup>22</sup> The list of zero rated goods and services include items within the groups such as food and agriculture, exports, supplies to privileged persons and medical supplies and drugs. Some other goods and services are exempt and their producers do not charge on their output, but are not entitled to claim VAT paid over their input. These goods and services include; water supply services, health supplies services, books and newspapers, transport services, conveyance of real property, financial services, metals, funeral services, gaming and betting, relief at importation, kerosene paraffin and trade union subscriptions.<sup>23</sup>

Domestic VAT continues to under perform. Ineffective revenue policy and inefficient collection practice is preventing it from maximizing the resources that can be collected from VAT. The VAT base has been eroding and has reduced from a rate of 20% in 1995 to 16% in 2009.<sup>24</sup> This could be largely attributed to inefficient and incomprehensive ways of VAT collection. Many basic measures to ensure maximization of monies collected through VAT are not adhered to by many commercial entities and there is no notable commitment to enforce them. There is still a large section of businesses that goes on with no record of sale because of lack of simple measures such as cash registers this often affects how much money can be collected by the ZRA.<sup>25</sup>

This is one of the taxes that have been reducing instead of increasing. There are a number of tax leakages and ZRA lacks the means of collecting VAT, administrative costs and procedures are also a challenge.<sup>26</sup> The VAT tax law in its current form whereby many goods and services consumed in Zambia is zero-rated and exempt does not satisfy the principle of adequacy because not so much revenue is realized due to these exemptions and zero-ratings.

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<sup>20</sup> Jesuit Centre for Theological Reflections (JCTR), "Zambia's Tax System: Need for Equity and Efficiency", Submitted to Parliamentary Committee on Estimates: By December, Lusaka, 2010. page 6

<sup>21</sup> See Section 15 of the Value Added Tax Act

<sup>22</sup> Value Added Tax (Zero Rating) Order 1996

<sup>23</sup> Value Added Tax Act Section 15 which provides for goods and services that are exempt from taxation

<sup>24</sup> Jesuit centre for Theological Reflections, "Zambia's Tax System: Need for Equity and Efficiency," page 5

<sup>25</sup> Jesuit Centre for Theological Reflections, "Zambia's Tax System: Need for Equity and Efficiency," page 8

<sup>26</sup> Interview with Mrs. C. Chilufya, Programme Officer- Jesuit Centre for Theological reflections, 20<sup>th</sup> Dec 2010

## Customs and Excise Duty

Historically, customs and excise duties constituted a large portion of government revenue. Over the years, these tax laws have been reduced in line with the global trends of facilitating trade and fulfilling the commitments that the government of the Republic of Zambia has signed up to under the various international and regional groupings such as Common Market for Eastern and Southern Africa (COMESA), Southern Africa Development Community (SADC) and the World Trade Organization (WTO).<sup>27</sup> It has been shown that the SADC trade protocol has contributed to loss of revenue for Zambia. Mostly this is due to lower customs duty collections, but also to some extent lower VAT and Excise.<sup>28</sup> The Customs and Excise Act,<sup>29</sup> provides for the imposition, collection and management of customs, excise and other duties, the licensing and control of warehouses and of premises for the manufacturer of certain goods, the regulating, controlling and prohibiting of imports and exports, the conclusion of customs and trade agreements with other countries.<sup>30</sup>

It has been observed that, there is a continued proliferation of tax exemptions to companies under the Customs and Excise Act law. These exemptions are facilitated by Section 69 of the Customs and Excise Tax Act, which empowers the Minister of Finance to grant exemptions without recourse to Parliament. These exemptions constitute huge tax revenue losses to the country. What is worse is that there is no sufficient evidence to prove the real value of the tax exemptions to the increase in Foreign Direct Investment (FDI) that Zambia is witnessing. While tax incentives to foreign investors have the potential to promote investment, they tend to deprive Government of essential resources for delivering to the public, social services promised in the National Development Plan.<sup>31</sup>

However, there are certain categories of imports which are classified as sensitive to the economy and on these goods duty still applies these include; motor vehicles, beer or alcohol, cigarettes and petroleum products, and many more. These products have remained as a major source of

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<sup>27</sup> Interview with Mr. Masiya, Tax Policy Officer, Ministry of Finance and National Planning (MFNP) 20<sup>th</sup> Jan. 2011

<sup>28</sup> Peter L., et al, Tax Policy Issues in Zambia: Selected Papers, Langmead and Baker Limited, Lusaka, 2006. Page 8

<sup>29</sup> Chapter 322 of the Laws of Zambia

<sup>30</sup> See the Preamble to the Customs and Excise Tax Act.

<sup>31</sup> Sixth National Development Plan (SNDP): A Civil Society Perspective, March 2010, page.5

revenue under these categories of tax law.<sup>32</sup> Hence, for the Customs and Excise Act, the principle of adequacy is only satisfied to the extent that they contribute to meeting the commitments of trade facilitation but not for the revenue satisfaction.

### **3.2 THE UGANDAN TAX SYSTEM AND ITS EFFICIENCY IN DOMESTIC REVENUE MOBILISATION**

The Ugandan Revenue Authority like Zambia Revenue Authority was set up to maximize revenue collection by removing the Revenue Collection System from the deficiency and ineffective Government departments of Customs, Income Tax and Inland Revenue. These former departments faced similar problems as the former departments of Taxes, Customs and Excise in Zambia. These problems included, underfunding, corruption, smuggling, tax frauds and evasions, low levels of compliance and low degree of probity by officers due to poor civil service conditions.<sup>33</sup>

The Ugandan national planning framework which guides public action to reduce poverty is contained in the Poverty Eradication Action Plan (PEAP) which was formulated in 1997 aimed at reducing the population living in absolute poverty by to 10% by 2017.<sup>34</sup> Tax policies in Uganda support poverty reduction through creating more growth and reducing the cost of goods mainly consumed by the poor.

Tax policy actions have been in line with the PEAP objectives through supporting increased production, minimizing distortions, promoting human development and generally exempting the poor from paying certain taxes.<sup>35</sup> Head count poverty as a percentage of the total population has reduced significantly from 56% in 1992 to 31% in 2006. The Impressive growth in GDP appears to have benefited the masses through translating into a significant reduction in head count

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<sup>32</sup> Interview with Mr. Masiya, Tax Policy Officer, Ministry of Finance and National Planning 20<sup>th</sup> Jan 2011

<sup>33</sup> F. Mudenda; Zambia Revenue Authority: Towards enhancing effectiveness in tax administration, Obligatory Essay, UNZA (1994). Page 15

<sup>34</sup> Uganda's Taxation Policy: Implications for Poverty Reduction and Economic Growth. (2008) page 17

<sup>35</sup> Uganda's Taxation Policy: Implications for Poverty Reduction and Economic Growth. (2008 ) page 18

poverty. Yet the dramatic decline in coffee prices partly reversed the positive poverty reduction trends until 2000.<sup>36</sup>

On moving in and out of poverty, one of the factors underlying the improvements has been the recovery of coffee prices at the international markets in 2006. Similarly, in Zambia we are coming from a situation where copper prices were low, but since 2006, the copper prices have been on the upsurge on the international market however, the Zambian Government has not seized the opportunity to get the maximum and much needed revenue for poverty reduction by re-introducing the windfall tax,<sup>37</sup> instead they opted for preferential tax negotiated for and agreed to by the foreign mining companies and the Government which most critics argue is not benefiting the majority poor Zambians.<sup>38</sup> As a result, tax revenue collection has not kept the pace with GDP, one reason being that the copper boom is generating little direct tax revenue.<sup>39</sup> This poor tax buoyancy is a concern from a poverty reduction perspective, because collecting tax revenues and using them for poverty reducing expenditures would be one way of the many ways to channel the resources from the copper boom to the poor.<sup>40</sup>

The Value Added Tax law is an important component of Uganda's tax system contributing around 36 of the total domestic revenue.<sup>41</sup> A recent survey on VAT found that increasing VAT while other taxes remained constant would increase the tax burden of the poor but the non poor households would continue paying more taxes relative to their expenditures than the poorhouse holds.<sup>42</sup> In Uganda tax policies that affect the livelihoods of the poor directly like agricultural inputs and outputs, health and education materials have remained exempt. However commodities like sugar, soap, and matches consumed by the poor are vat-able.<sup>43</sup>

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<sup>36</sup> Uganda's Taxation Policy: Implications for poverty reduction and Economic Growth. Review Report 2008 p.37

<sup>37</sup> See Post Newspaper February 14, 2011(The windfall tax is calculated using the selling price, tonnage exported and the applicable tax rate) page 19

<sup>38</sup> Ngambi, S.P. "Stabilization Clauses and the Zambian Windfall Tax" 1 *Zambia Social Science Journal*, Aquila Printers Lusaka Zambia, 2004. pp 107

<sup>39</sup> Bigsten. A and Sven Tengstan "Renewed Growth and Poverty Reduction in Zambia" *Zambia Social Science Journal*, Aquila Printers, Lusaka, 2010 pp. 1-28

<sup>40</sup> Bigsten. A, and Sven Tengstan, "Renewed Growth and Poverty Reduction in Zambia", page10

<sup>41</sup> Uganda's Taxation Policy Implications for poverty Reduction and Economic Growth Review Report 2008 p.12

<sup>42</sup> Ssewanyana, S.N and Okidi, J. A micro-simulation of the Ugandan Tax system and the poor, Economic Policy Research Center, Kampala, 2009. Page 39

<sup>43</sup> Uganda's Taxation Policy: Implications for Poverty Reduction and Economic Growth. Review Report 2008 p .39

In terms of revenue performance, Uganda's tax reforms have had a marginal increase in revenue collection as a percentage of GDP (i.e. from 11.3% of GDP in 1995/96 to 13.1% of GDP in 2007/08) and they have not widened the tax base. Uganda's revenue collection is among the lowest in the East African region.<sup>44</sup> The low revenue performance has been attributed to the structure of Uganda's economy. Uganda has a significantly large agricultural sector accounting for 21.4% of GDP in 2007/09. Uganda's tax system is dominated by indirect taxes which depend on goods and services consumed. Direct domestic sources of Uganda's tax policy contributed 29% in 2005/06 while indirect taxes accounted for 71%. The share of international trade taxes in total domestic revenue has declined from 61% in 1996/97 to 51% in 2007/08. While, Pay As You Earn (PAYE) has had the highest increase from one percent of total revenue in 1988/89 to 14% in 2007/08. Non-tax revenue has almost remained constant at around 3% or less since the early 1990s.<sup>45</sup>

As any other developing country, Uganda faces formidable challenges in generating revenue because most of the workers in the country are typically employed in agriculture or in small and informal enterprises.<sup>46</sup> Hence the modern means of raising revenue such as Income taxes and consumption taxes play a diminished role in Uganda's economy. There is also a problem of revenue fraud in the form of smuggling, under valuation, under declaration of income and taxable goods and misclassification of good. There is also a problem of tax evasion and avoidance.<sup>47</sup> The low revenue collections in Uganda are also attributed to low compliance levels, difficulties in enforcement, political interference, poor revenue management and administration.<sup>48</sup>

Consequently, Uganda's tax system does not meet or satisfy the principles of certainty, simplicity and neutrality.<sup>49</sup> The tax laws are not simple so that tax payers understand the rules and effect on tax payers understand the rules and effect on tax payers decisions as to how to

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<sup>44</sup> Uganda's Taxation Policy: Implications for Poverty Reduction and Economic Growth. Review Report 2008. Page 3

<sup>45</sup> Uganda's Taxation Policy: Implications for poverty Reduction and Economic Growth. Review Report 2008 page 7

<sup>46</sup> Uganda's Taxation Policy: Implications for poverty Reduction and Economic Growth. Review Report 2008 page 9

<sup>47</sup> Ugandan Auditor General's Report for the Year Ending June, 2006

<sup>48</sup> Ugandan Auditor Generals Report for the year ending June, 2006

<sup>49</sup> Tanzi, V and Zee H (2009): Tax policy for Developing Countries- international Monetary Fund, Oxford press, London. page 20



carry out particular transactions have not been kept to a minimum.<sup>50</sup> The tax rules are also not clearly specified for an ordinary tax payer to know when the tax is to be paid, how it is to be paid and how the amount to be paid is to be determined. In addition there are normally many annual tax changes which create uncertainty.<sup>51</sup> The tax system does not adequately satisfy the principle of appropriate Government revenues<sup>52</sup>.

The agricultural, non-monetised and informal sectors combined re-enforce each other to limit the amount of revenue generated. About 70% of Uganda's working population employed in the agricultural and those in the service sector who earn Uganda Shs50, 000 cannot pay any form of income tax.<sup>53</sup> Therefore direct taxes in Uganda do not directly affect the poor because of their low levels of income. The tax threshold for PAYE is above the poverty datum line and the other direct taxes are not paid by the poor. Low levels of revenue collections by Uganda Revenue Authority are also attributed to low levels of compliance, difficulties in enforcement, political interference, poor revenue management and administration.<sup>54</sup>

Tax policy in Uganda, has implications on the poor through the principles of fairness and equity; economic growth and efficiency, and raising appropriate government revenues.<sup>55</sup> Taxes consistently found to be regressive or at least not progressive are those on exports and on kerosene. However, most of the commodities consumed by the poor in Uganda are taxed; i.e. sugar, soap, matchboxes and paraffin attract different taxes. Import and VAT/Sales taxes in Uganda have also been found to be progressive.<sup>56</sup> Value Added Tax (VAT) is an important component of Uganda's tax system contributing around 36% of the total domestic revenue.<sup>57</sup>

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<sup>50</sup> V. Tanzi and Zee. H, Tax Policy for Developing countries: International Monetary Fund, Oxford Press, London, 2009. page 23

<sup>51</sup> V. Tanzi and Zee. H, Tax Policy for Developing Countries page 27

<sup>52</sup> Uganda's Tax Policy: Implications for poverty Reduction and Economic Growth. Revenue Report, 2008 page 44

<sup>53</sup> Uganda's Tax Policy: Implications for poverty Reduction and Economic Growth. Revenue Report, 2008 Page 45

<sup>54</sup> Uganda's Tax Policy: Implications for poverty Reduction and Economic Growth. Review Report, 2008 page 47

<sup>55</sup> Uganda's Tax Policy: Implications for Poverty Reduction and Economic Growth. Review Report, 2008 page 47

<sup>56</sup> Uganda's Tax Policy: Implications for Poverty Reduction and Economic Growth. 2008. Page 48

<sup>57</sup> Uganda's Tax Policy: Implications for Poverty Reduction and Economic Growth. 2008. Page 49

### 3.3 CONCLUSION

This chapter has examined and considered the adequacy of the Zambian tax laws in so far as revenue collection is concerned. The Income Tax Act is the principle Act for taxation and it is based on the source principle. It encompasses a number of taxes such as the Company Income Tax, Pay As You Earn (PAYE). The principle behind the Income Tax law is to ensure that taxes must be collected from all business enterprises and persons who earn an income, including the difficult to tax.<sup>58</sup> This means that any income generated in Zambia or any income whose source is deemed to be from Zambia is liable to tax. In terms of section 17 of the Income Tax Act, income includes business profits and emoluments i.e. salaries, wages, overtime or leave pay, commission, fees, bonuses, gratuities (inducements) allowances and pensions or annuities. It is argued that, owing to this wide coverage, the Income tax law is adequate in so far as revenue collection is concerned.

The VAT law on the other hand, is based on the destination principle which implies that to all goods and services consumed in Zambia, VAT law applies. However, goods and services which are not consumed in Zambia are taxed at zero percent or what is called zero rating. Domestic VAT continues to under perform, its base has been eroding and it has reduced from a rate of 20% in 1995 to 16% in 2009.<sup>59</sup> This largely attributed to the inefficient and incomprehensive methods of VAT collection. Many basic measures to ensure maximization of revenue collected through VAT law are not adhered to by many commercial entities.<sup>60</sup> There is still a large section of businesses that goes on with no records of sale because of lack of simple measures such as cash registers. This often affects how revenue can be collected by ZRA. The VAT law in its current form whereby many goods and services consumed in Zambia are zero rated and exempt from VAT, does not satisfy the principle of adequacy<sup>61</sup>.

The Customs and Excise Act constituted a large portion of Government revenue in the past.<sup>62</sup> However, under the Customs and Excise Act there is continued proliferation of tax

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<sup>58</sup> Interview with Mr. M Masiya, Tax Policy Officer, Ministry of Finance and National Planning, 20<sup>th</sup> Jan 2011

<sup>59</sup> Zambia's Tax System Need for Equity and Efficiency Draft Report Submitted to the Parliamentary Committee on Estimates, by Jesuit Center for Theological Reflections (JCTR) Olympia Park Lusaka, 3<sup>rd</sup> December 2011. Page 8

<sup>60</sup> Jesuit Centre for Theological Reflections (JCTR), "Zambia's Tax System: Need for Equity and Efficiency", Submitted to Parliamentary Committee on Estimates: By December, Lusaka, 2010. page 9

<sup>61</sup> Jesuit Centre for Theological Reflections (JCTR), "Zambia's Tax System: Need for Equity and Efficiency", Page 10

<sup>62</sup> Interview with Mr. Masiya, Tax Policy Officer Ministry of Finance and National Planning 20<sup>th</sup> Jan 2011

exemptions to companies. These exemptions are being facilitated by section 69 of the Customs and Excise tax Act, which empowers the Minister of finance to grant exemptions without recourse to Parliament. Whilst incentives have the potential to promote investment they tend to deprive Government of the essential revenue for delivering to the public, social services. For the Customs and Excise Tax law, the principle of adequacy is only satisfied to extent that it contributes to meeting commitments by the Government of trade facilitation with various international and regional groupings such COMESA and SADC, but not for revenue satisfaction.

Further, the chapter made a comparative analysis between Zambia's tax system and that of Uganda, in terms of efficiency, performance and tax policy formulation in relation to domestic revenue mobilization for poverty reduction. In terms of efficiency, the Zambian tax system has been fluctuating. In Zambia as in Uganda, the overall incidence of the tax system has been critically affected by the limitations on the effective scope of the main tax instruments due to exemptions on almost all agricultural activities and goods from direct tax and VAT and the effective exclusion of the informal sector which occupies a large part of the economy. In terms of performance, the Ugandan tax has had a marginal impact in revenue collection as a percentage of GDP where as Zambia's tax system as a source of revenue is reported to have performed well up to target in the last few years. However, there has been an insignificant impact on reducing the poverty rate in Zambia whereas in Uganda poverty reduction has significantly reduced despite the marginal impact in revenue collection.

## **CHAPTER FOUR**

### **TAXATION AS TOOL FOR POVERTY REDUCTION**

#### **4.0 INTRODUCTION**

This Chapter sets out to discuss how taxation can be utilized as a tool for sustaining poverty reduction through tax policy formulation. The chapter will then consider whether the Government of the Republic of Zambia is allocating sufficient funds towards poverty alleviation programmes. Furthermore, the chapter will determine whether the Government should broaden the current tax base in order to enhance revenue collection. Then finally, a conclusion will be given.

#### **4.1 TAXATION POLICY AND POVERTY REDUCTION**

Tax policy refers to the choice of tax instruments, the rates at which taxes are set, the nature of exemptions and the assignment of taxes to different levels of government.<sup>1</sup> A good tax system should be defined so as to meet the requirements of equity in burden distribution, efficiency in resource use, the goal of macro-economic policy and easy administration<sup>2</sup> Tax policy has implications on the poor through the principles of fairness and equity, economic growth and efficiency, and raising appropriate government revenues. Introduction of broad based taxes, zero rating of education and health services and taxes on consumption are characteristics of a pro-poor tax system. However, low domestic revenue generation, high exemptions and imposing taxes on goods consumed by the poor do not support the notion of pro-poor growth.<sup>3</sup>

A broadened tax base through tax policy reforms and mobilizing domestic resources is absolutely essential for sustaining poverty reduction over the longer run. The informal sector being effectively immune from taxation, governments of developing countries have fewer tax instruments than rich countries. By imposing taxes on some branches of the economy and not on others they create a high economic distortion.<sup>4</sup> Economic growth is not a guarantee of poverty reduction, unless we have a well designed pro-poor tax policy in place which helps to generate

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<sup>1</sup> R. A Musgrave, Public Finance in theory and Practice, 5<sup>th</sup> edition, Tata McGraw, London, 2004. Page 10

<sup>2</sup> R. A Musgrave, Public Finance in theory and Practice, 5<sup>th</sup> edition, Tata McGraw, London, 2004. Page 10

<sup>3</sup> John Gray and Emma Chapman, Evaluation of Revenue Projects, Synthesis Report, Copenhagen, 2009. Page 19

<sup>4</sup> T. Ghirmai Kefela, Reforming Tax Policies and Revenue Mobilization Promotes a fiscal Responsibility, Journal of Law and Conflict Resolution Volume 15 San Jose, CA 95110 USA, 2009 .page 98

more income earning opportunities so that poor people can engage in productive and well-paid work.<sup>5</sup> The average taxation ratio of developed countries as a proportion of GDP lay between 29% and 32%, whereas the corresponding range for developing countries in the medium-income category was from 17% to 32%. The average taxation ratio in the poorest countries lies between 13% and 16% respectively. The problem is a vast gap that exists between the tax payments required by law and those actually surrendered to the state.<sup>6</sup>

The Governments of developing countries should take significant steps to strengthen the framework for sound fiscal policies particularly on tax reforms which constitute the major policy instrument needed to accelerate growth and eliminate poverty and promoting a better tax system to mobilize more revenue.<sup>7</sup> Reducing the number of income tax deductions for instance, permitted in some of these countries to eliminate filing requirements for most wage earners, thus greatly reducing the administrative burden, since withholding alone then will be sufficient to enable most income tax payers to fulfill their obligations.<sup>8</sup>

In the wake of fiscal crises of the states in the sub-Saharan Africa, designing a tax system that can provide incentives for growth, meet distributional demands and increase revenue collection is central to a Revenue Authority's viability and effectiveness.<sup>9</sup> It is undoubtedly the case that inappropriate taxation policies can have a quantitatively significant impact on poverty levels, possibly negating the benefits gained by the poor from other aspects of the government's expenditure programme.<sup>10</sup>

## **4.2 GOVERNMENT'S RESOURCE ALLOCATIONS TOWARDS POVERTY REDUCTION AND OTHER CHALLENGES**

Zambia launched the Fifth National Development Plan (FNDP) in 2006. This followed a long spell following the adoption of structural adjustment programme (SAP) in the mid-1980s. The

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<sup>5</sup>T. Ghirmai Kefela, *Reforming Tax Policies and Revenue Mobilization Promotes fiscal responsibility*, Page 99

<sup>6</sup> T. Ghirmai Kefela, *Reforming Tax Policies and Revenue Mobilization Promotes fiscal responsibility*, page 100

<sup>7</sup> Department for International Development (DFID) "Evaluation of Revenue Projects" EV 636, Oxford University Press, London, 2001. page 12

<sup>8</sup> T. Ghirmai Kefela, *Reforming Tax Policies and Revenue Mobilization Promotes a fiscal responsibility*, page 100

<sup>9</sup> P. Langmead et al, *Tax Policy Issues in Zambia*, Langmead & Bake, Lusaka, 2006. Page 8

<sup>10</sup> P. Langmead et al, *Tax Policy Issues in Zambia*, Langmead & Bake, Lusaka, 2006. Page 9

return to national planning in 2006 followed the realization that even in a liberalized economy, development planning is necessary for guiding priority setting and resource allocation.<sup>11</sup> In this regard, the FNDP has since 2006, remained Zambia's development planning and resource programming tool. While the FNDP has provided the overall framework and specific programmes within the context of the projected resource envelop, the annual government budget remains the primary instrument for implementing the FNDP.<sup>12</sup>

The FNDP recognized the challenge of high poverty levels in the country and planned to reduce these levels. This is envisaged to be achieved through increased investment in the key priority growth sectors of the economy.<sup>13</sup> The priority focus was on achieving broad-based wealth and job creation through enhanced pro-poor spending in areas that included rural development, agriculture and manufacturing.<sup>14</sup> Poverty levels in Zambia have generally remained high at 64% of the total population.<sup>15</sup> This has been mostly due to increase in the incidence of poverty in the rural population where levels rose from 78% in 2004 to 80% in 2006.<sup>16</sup> In order to determine the government's resource allocation towards the challenges of poverty, an assessment of the FNDP's set expenditure targets for priority sectors of agriculture, health, infrastructure, education and skills development, water supply and sanitation will be crucial.

Under the agriculture sector, funding levels were targeted to rise from 5% of the domestic budget in 2006 to 9% by 2010. By 2008, however, funding to agriculture stood at 5.8% of the domestic budget, representing only a miniscule increase of 0.8%.<sup>17</sup> This significantly explains the worsening poverty levels in rural areas that depend on this sector for much of their lively hoods.<sup>18</sup> During 2009/10 farming season total Government of the Republic of Zambia (GRZ) and Donor budget was K1, 074.4 billion against the FNDP projection of K1, 034.2 billion.<sup>19</sup> Of this, the GRZ budget amounted to K919.4 billion while the donor budget was about K155 billion. The total GRZ releases were K1, 149.4 billion representing 125%. Of this, 58.2% of the GRZ

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<sup>11</sup> Mid-Term Review of the Fifth National Development Plan (FNDP) 2006-2010. – Ministry of Finance and National Planning, Lusaka, Government of the Republic of Zambia (GRZ), Lusaka, October 2009, page 36

<sup>12</sup> Mid-Term Review of the Fifth National Development Plan(FNDP) page 37

<sup>13</sup> Mid Term Review of the Fifth National Development Plan, Page 38

<sup>14</sup> Mid-Term Review of the Fifth National Development Plan, Page 38

<sup>15</sup> Central Statistics Office (CSO) Report: 2006

<sup>16</sup> Mid-Term Review of the Fifth National Development Plan, Page 39

<sup>17</sup> Ministry of Finance and National Planning: Annual Progress Report (FNDP) 2009. Page8

<sup>18</sup> Mid-term Review of the Fifth National Development Plan, Page 41

<sup>19</sup> Mid Term Review of the Fifth National Development Plan 2006-2010 October 2009 Page 43

allocation and 66.4% of the releases went to the Farmer Input Support Programme (FISP) and Food Reserve Agency (FRA). Personal emoluments represented 14/3% and 13.2% of the GRZ budget and releases, respectively.<sup>20</sup>

Though the total budget and releases for the agricultural sector were above the FNDP projections, allocation to the core programmes continued to be low when compared to the FNDP projections.<sup>21</sup> By implication, the priority programmes in terms of funding to the agricultural sector were fertilizer support programmes and the Food Reserve Agency.<sup>22</sup> In addition, the releases of funds to the sector were not consistent and timely. This affected the implementation of planned programmes especially capital projects such as irrigation, infrastructure construction and rehabilitation works.<sup>23</sup> Market of inputs and outputs was affected by inadequate storage infrastructure especially in Luapula, Northern, Copperbelt and parts of Northern provinces. Some other areas, of agriculture, such as livestock and fisheries farming remains neglected in this sector.<sup>24</sup>

In terms of expenditure on infrastructure for the FNDP period (2006-2010), spending was to be raised to 5.3% of the budget by 2009 and maintained in 2010. However, during the review period, total releases of funds to the road sector amounted to K2, 130.5 billion, compared to the FNDP target of K2, 636.23billion.<sup>25</sup> In 2006 and 2007, the proportion of the domestic budget released to the road sector was 3.4%, while releases for 2008 accounted for 4.2%. The expenditures thus seem to be on the right track.<sup>26</sup>

In terms of spending on the health sector, the FNDP targeted to raise the health sector expenditures for both donors and government from 10.6% in 2006 to around 14.1% by 2010. During the same period the proportion of the domestic budget spent on health rose to 10.7 percent in 2007 and dropped to 9.7 percent in 2008 respectively. For 2007, this represented an

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<sup>20</sup> Ministry of Finance and National Planning: Annual Progress Report of the FNDP, Lusaka, 2009. Page 9

<sup>21</sup> Ministry of Finance and National Planning Annual Progress Report of the FNDP, Lusaka, 2009 Page 15

<sup>22</sup> Ministry of Finance and National Planning: Annual Progress Report of the FNDP, Lusaka, 2009. page 16

<sup>23</sup> Ministry of Finance and National Planning: Annual Progress Report of the FNDP, Lusaka, 2009. page 17

<sup>24</sup> Ministry of Finance and National Planning: 2009 Annual Progress Report page 16

<sup>25</sup> Mid-Term Review of the Fifth National Development Plan (FNDP) 2006-2010 page 41

<sup>26</sup> Mid-Term Review of the Fifth National Development Plan (FNDP) 2006-2010 page 42

increase of only 0.1% while the 2008 outturn was a decline on 0.9% over the 2006 figure. FNDP performance in the area of health during the review period has, thus been below target.<sup>27</sup>

The total health sector budget for 2009 was K1, 823.4billion, an increase of 12.6% from the K1, 586.6 billion allocations in 2008. These funds included Government and Cooperating Partners (CPs) contribution to the expanded human resource baskets. Out of the total sector budget 63% (K1, 133.9billion) was to be domestically funded. The share of the health budget in 2009 was 11.4% of the total national budget, which was less than the Abuja recommendation of 15%.<sup>28</sup> However, during the period under review, the sector was faced with a number of challenges among these was the withholding of funds by the Cooperating Partners (CPs), to expand human resource baskets resulting from the unresolved issues with its Cooperating Partners (CPs).<sup>29</sup>

Government through the FNDP, targeted to increase spending on education and skills development to 22.4 percent by 2010, from 16.3 achieved in 2006. The proportion of the domestic budget spending on education and skills development in 2007 and 2008 were 22.7% and 19% respectively. The outturn for 2007 was 0.3% above the end year while the 2008 achievement was a 2.7% increase over the 2006 figure. This was generally a positive performance for the education sector.<sup>30</sup>

The total education sector budget for 2009 stood at K2, 777 billion of which K2, 424 billion was from GRZ and K352/6 billion from Cooperating Partners (CPs).<sup>31</sup> This was an 11.4% increase over the 2008 budget of K2, 147billion; the bulk of the increase went towards Personal Emoluments, infrastructure development and education materials. Included in the Personal Emoluments (PEs) budget was an allocation of K45billion towards net recruitment of 4,777 teachers in 2009 to meet one of the sectors key targets of improving the quality of education provision.<sup>32</sup> In spite of the significant successes in the education sector that suggest the likelihood of the country attaining a good number of Millennium Development Goals (MDGs) in this area, the Mid-Term Review (MTR), identified several outstanding challenges such as

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<sup>27</sup> Mid-Term Review of the Fifth National Development Plan (FNDP): Lusaka, 2009. page 43

<sup>28</sup> Ministry of Finance and National Planning: Annual Progress Report on FNDP, Lusaka, 2009. page 82

<sup>29</sup> Ministry of Finance and National Planning: Annual Progress Report on FNDP, Lusaka 2009. page 83

<sup>30</sup> Zambia Millennium Development Goals: Progress Report, (MFNP) Lusaka, 2008. page 6

<sup>31</sup> Ministry of Finance and National Planning: Annual Progress Report on FNDP, 2009 Page 86

<sup>32</sup> Ministry of Finance and National Planning: Annual Progress Report on FNDP, 2009 page 87



disparities in the allocation of funding between core programmes in the education sector.<sup>33</sup> Management and Administration takes up a significantly large share of the education sector, a state of affairs that has serious implications for service delivery at the level of core business of the Ministry.<sup>34</sup>

Government spending on water supply and sanitation from the domestic budget was envisaged to increase to 0.6% of the domestic budget by 2010 from 0.2% in 2006. Actual releases of funds to the water supply and sanitation sector accounted for 0.5% of the domestic budget in 2007. From the foregoing, it can be concluded that the target of 0.6% in 2010 can be met if the current expenditure levels are sustained with only marginal improvements.<sup>35</sup> However, access to clean water supply and good sanitation remains a huge challenge in Zambia as evidenced by the incidences of cholera in most urban areas of Zambia, lack of toilet facilities in both urban areas, challenge of garbage disposal in urban areas and water pollution. It is recommended that government should increase resource allocation to this sector given its importance to national development.<sup>36</sup>

#### **4.3 BROADENING THE TAX BASE THROUGH TAX POLICY REFORMS**

This segment endeavours to answer the question as to whether or not; it is necessary to broaden the tax base given the current scenario whereby Government's resource allocation falls short of the set expenditure targets for most of the priority sectors of the economy. Clearly, this is a confirmation that Zambia's resource needs far much outweigh what ZRA currently raises in domestic revenue.

Starting at independence in 1964 as the second richest nation in sub-Saharan Africa, with per capital income of about 75% above the African average and about four times that of East Asia, per capita income is now below the African average and about a quarter of that in East Asia.<sup>37</sup> Zambia has over the past 40 years or so managed to become so impoverished that it is today one of the poorest countries in the world, and has been able to convince the international community

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<sup>33</sup> Ministry of Finance and National Planning Annual Progress Report on FNDP, Lusaka, 2009 page

<sup>34</sup> Mid-Term Review of the Fifth National Development Plan(FNDP) page 44

<sup>35</sup> Mid-Term Review of the Fifth National Development Plan (FNDP) page 86

<sup>36</sup> Sixth National Development Plan(SNDP): A Civil Society Perspective (2010) page74

<sup>37</sup> A. Bigsten and S. Tengstan, Renewed Growth and Poverty Reduction in Zambia, Zambia Social Science Journal, Volume 1, Aquila Printers , Lusaka, Zambia. 2010, page 2

that it had become so impoverished that it deserved to be classified as a Highly Indebted Poor Country (HIPC). This resulted in its accession to the HIPC initiative completion point and qualification under the Multilateral Debt Relief.<sup>38</sup>

The Zambian economy is reported to have been growing relatively fast over the last decade. Per capita incomes have been increasing after a long period of stagnation or decline.<sup>39</sup> Taxation as a source of government revenue in Zambia is reported to have performed well up to target in the last few years. As at end-September 2010, domestic revenues had performed well within target for the year and were expected to over perform by 12% by the end of 2010. This performance was attributed to higher collections under income tax and VAT arising from the collection of tax arrears.<sup>40</sup>

However, there has been an observed decline in the share of the tax revenue to Gross Domestic Product (GDP) and contribution of domestic taxes and decline in revenues from trade taxes attributed to trade liberalization in regional groupings.<sup>41</sup> The performance of the mining sector taxes has equally not been impressive. Another important aspect is the existence of a large informal sector in Zambia.<sup>42</sup> The Zambian tax system up until now, has only managed to capture, effectively tax revenue from the formal sector while the informal sector, remains minimally taxed. This keeps tax distribution heavily skewed towards direct taxes placing a disproportionate burden on formal sector workers.<sup>43</sup>

The government often has sensible private sector development policies, but according to several observers they are implemented poorly, slowly and reluctantly.<sup>44</sup> This is the classical Zambian problem of a disjoint between sensible policy analyses and the capacity and willingness to implement the policies. Policy is often inconsistent as to what to do with the informal economy; it seems as if the Government likes interventions rather than general.<sup>45</sup> The tax revenue collection has not kept the pace with the GDP growth, one reason being that the copper boom

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<sup>38</sup> Ministry of Finance and National Development, Zambia Millennium DGs Progress Report, Lusaka, 2008 Page 7

<sup>39</sup> Arne Bigsten and Sven Tengstan, Renewed Growth and Poverty Reduction in Zambia, 2010 Page 3

<sup>40</sup> See Paragraph 42 of the 2011 Budget Speech presented by the Minister of Finance. Mr. S. Musokotwane

<sup>41</sup> Jesuit Centre for Theological Reflection (JCTR), "Zambia's Tax System - Need for Equity and Efficiency," page3

<sup>42</sup> Jesuit Centre for Theological Reflections, "Zambia's Tax System- Need for Equity and Efficiency," Page4

<sup>43</sup> Jesuit Centre for Theological Reflections, "Zambia's Tax System-Need for Equity and Efficiency," Page 4

<sup>44</sup> Arne Bigsten and Sven Tengstan, Renewed Growth and Poverty Reduction in Zambia, Page 3

<sup>45</sup> Arne Bigsten and Sven Tengstan, Renewed Growth and Poverty Reduction in Zambia, Page 21

generates little direct tax revenue.<sup>46</sup> Another reason is that most employment is within the informal sector, where hardly any tax is collected. Hence this tax buoyancy is a concern from a poverty reduction perspective, because collecting tax revenues and using them for poverty reducing expenditures would be one of the main ways to channel resources from the copper boom to the poor.<sup>47</sup>

Zambia's economy is still very dependent on the mining Sector. In the recent past, the Ministry of Finance and National planning reported that Copper output will exceed 720,000 metric tons in 2010, the highest production since 1973 and the price of copper per metric ton is predicted to hit an all time high in 2011 of more than US\$11,000 per metric ton<sup>48</sup> Hence, the windfall tax which is meant to capture significant tax revenue during high mineral price periods should be considered for re-introduction in order to enhance revenue collection.<sup>49</sup> The windfall tax is effected (at graduated levels) only when the mining company's revenue becomes twice the cost of production.

The windfall tax has its own advantages and disadvantages. On the advantages side, the windfall tax once re- introduced will ensure that Government gets an equitable share in the proceeds from the copper exports which accounts for over 80% of Zambia's total exports but only contributes 2.2%.<sup>50</sup> Secondly, copper is a wasting asset, it is not going to grow in the ground again so Government should take this opportunity to pass on the benefits from the mines into the social economic system of the country.

Thirdly, the Government can not tax the mines when they have made losses or when the copper price falls below an agreed level.<sup>51</sup> Fourthly, once the windfall tax is imposed on the mines, Government will no longer heavily depend on VAT and PAYE. On the other hand, the main disadvantage of the windfall tax is that it hinders foreign direct investment (FDI). The re-

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<sup>46</sup> A. Bigsten and S. Tengstan, *Renewed Growth and Poverty Reduction in Zambia*, 2010.page 21

<sup>47</sup> A. Bigsten and S. Tengstan, *Renewed Growth and Poverty Reduction in Zambia*, 2010.page 22

<sup>48</sup> Jesuit Center for Theological Reflections (JCTR ), *Zambia's Tax System- Need for Equity and Efficiency*, Page 5

<sup>49</sup> Jesuit Center for Theological Reflections (JCTR), *Zambia's Tax System Need for Equity and Efficiency* : Page 9

<sup>50</sup> The Post Newspaper, Wednesday March 2, 2011. Page 4

<sup>51</sup> The Post Newspaper, Tuesday February 22, 2011. page5

introduction of the windfall tax can be seen by investors as an unstable tax regime and this could adversely affect the flow of FDI <sup>52</sup>

The current Pay As You Earn (PAYE) payments in the mines are relatively high but the distribution of income of mining staff is very unequal as there are a number of employees who are well paid, while a large number earn substantially less and are below the PAYE threshold.<sup>53</sup> 88% of Zambia's labour force is employed in the informal sector.<sup>54</sup> Despite the growing importance of the informal sector in Zambian economy, its contribution to tax revenue has been poor. Taxes aimed at the informal economy contributed less than 2% to total income tax collection.<sup>55</sup> There are a number of challenges attributed to tax collection from the informal economy. These include: most businesses transactions in the informal economy are done in cash and easy to conceal; most informal economy transactions are indifferent to proper record keeping; capacity of the revenue authority may be too low to match the growth of the information economy and informal economy taxation is sometimes prone to political interference.<sup>56</sup>

On the other hand, for a long time the few workers in the formal employment have been complaining that they were being over taxed. It could also be argued that in the quest to create an enabling environment to attract Foreign Direct Investment (FDI), the Government has lost revenue through granting of generous tax incentives, concessions, rebate, breaks, holidays exemptions.<sup>57</sup> In light of this outcry, about the over-taxation of the formal sector, some quarters have proposed that government should extend its tax net to the informal sector to capture some of the revenue that at present escapes collection.<sup>58</sup> This extension will ultimately broaden the tax base and enable government to reduce the tax burden being borne by formal economy employees and enterprises. From the foregoing it is clear that Government should seriously consider broadening the tax base or designing certain major taxes and must effectively and fairly apply tax law on investment especially on the mines in order to enhance revenue collection.

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<sup>52</sup> S.P. Ngambi, *Stabilization Clauses and the Zambian Windfall Tax*, 1 Zambia Social Science Journal Vol.1 Aquila Printers, Lusaka, 2010. Page 114

<sup>53</sup> Jesuit Center for Theological Reflections(JCTR), *Zambia's Tax System Need for Equity and Efficiency*, page 9

<sup>54</sup> Jesuit center for Theological reflections(JCTR), *Zambia's Tax System Need for Equity and Efficiency*, page10

<sup>55</sup> P. Langmead et al, *Tax Policy Issues in Zambia, Selected papers*, Langmead & Baker Ltd, Lusaka, 2006. Page 19

<sup>56</sup> P. Langmead et al, *Tax policy Issues in Zambia*, Page 24

<sup>57</sup> P. Langmead et al, *Tax Policy Issues in Zambia*, page 109

<sup>58</sup> P. Langmead et al, *Tax Policy issues in Zambia*, Page 109

#### 4.4 CONCLUSION

This chapter has examined and considered how taxation can be utilized as a tool for sustained poverty reduction through tax policy formulation. Tax policy has implications on the poor through the principles of fairness and equity, economic growth and efficiency, and raising appropriate government revenues. Introduction of broad based taxes, zero rating of education, and health services and taxes on consumption are characteristics of pro-poor tax system. A broadened tax base through tax policy reforms and mobilizing domestic resources is absolutely essential for sustaining poverty reduction over the longer run. It is undoubtedly that, inappropriate taxation policies can have quantitatively significant impact on the poverty levels, possibly negating the benefits gained by the poor from other aspects of the governments expenditure.

Further the chapter examined and considered whether Government has been allocating sufficient funds towards poverty reduction. Governments' resource allocation towards poverty reduction fell short of the Fifth National Development Plan (FNDP) set expenditure targets for the priority sectors of agriculture, clean water supply and sanitation, education and skills development for the period 2006-2010. This clearly demonstrates that Zambia's revenue needs far much outweigh what ZRA raises in domestic revenue. Furthermore, the chapter considered whether or not the Government should broaden the tax base. From the foregoing it is evident that Government would want to do a lot of things in order to reduce poverty what limits this is the amount of resources available and ZRA can only manage to collect revenue up to a certain amount, on that score one would argue that what ZRA collects is far from sufficient. It is therefore desirable that Government considers broadening the tax base through tax policy reforms or designs certain major taxes and mobilizes domestic resources which are essential for sustaining poverty reduction over the longer run.

## **CHAPTER FIVE**

### **CONCLUSION AND RECOMMENDATIONS**

#### **5.0 INTRODUCTION**

The general objective of the study was generally to demonstrate how the effective use of taxation might be of use in sustaining poverty reduction in Zambia and also to demonstrate that the current tax laws in Zambia as administered by the Zambia Revenue Authority (ZRA) are inadequate and are not effectively applied to all the tax payers. The study specifically demonstrated that economies across the world depend on resources collected from both the direct taxes and the indirect taxes to finance government activities. No government can be sustained without mechanisms for generating domestic revenue. Taxes play a critical role in encouraging economic growth, reducing disparity between the rich and the poor, and reducing poverty.

#### **5.1 OBJECTIVE OF THE STUDY**

To achieve the objective, the study attempted to answer the following questions:

1. Has the establishment of ZRA yielded its intended purpose?
2. Are the current substantive tax laws adequate and effectively applied to all the tax payers?
3. Is the enforcement of the tax laws a reality or a mere fallacy?
4. Is the current revenue raised by ZRA sufficient to help Government in effectively sustaining poverty reduction?
5. Is the Government allocating enough resources towards sustaining poverty reduction?
6. Is there a necessity for the Government to broaden the tax base to maximize revenue collection?

In attempting to answer questions one, chapter two endeavoured to demonstrate that, a country's economic and social progress largely depends on its ability to generate sufficient revenues to finance a host of essential non-revenue yielding public services such as education, health, communication, transport and national security and poverty reduction. Furthermore, it has been found that, the establishment of ZRA has had a positive impact on revenue collection given the

statistics on the tax ratio to the GDP compared to the period before it was established. Therefore, in its quest to generate sufficient revenues, ZRA is on the right track in so far as realizing its intended purpose is concerned.

In answering questions two and three, chapter three has attempted to examine and consider the adequacy of Zambia's tax laws and whether they are effectively applied to all the tax payers. It has been found that most tax laws do not satisfy the principle of adequacy and are not fairly applied to all the taxpayers. Overall, the incidence of the tax system has been critically affected by the limitations on the effective scope of the main tax laws due to exemptions on almost all agricultural activities and goods from direct taxes and VAT and the effective exclusion of the informal sector which occupies the large part of the economy. Over 80% of Zambia's labour force is employed in the informal sector. Taxes aimed at the informal sector contribute less than 2% to the total income tax collection.

Furthermore, it was found that, current mining tax revenue contribution of about 12.7% to GDP is insignificant when compared with the contribution mines made to Government in the 1960s of between 40% and 60% of the total tax revenue.<sup>1</sup> This loss of potential revenue from the mines reduces Governments fiscal space to finance social sector expenditure programmes such as education, health and infrastructure for poverty reduction. It was discovered that, the continued proliferation of tax exemptions to companies is facilitated by section 89 of the Customs and Excise Act which gives the Finance Minister Powers to grant exemptions without recourse to parliament. These exemptions constitute huge tax revenue losses to the country.

In attempting to answer question three, chapter three demonstrated that, the enforcement of the tax laws has not been satisfactory owing to the inadequate and old legal framework under which ZRA operates. It was found that, the current legal framework has been used for too long without fundamentally changing the basis upon which it operates and that there are in fact other administrative challenges like lack of use of forceful compliance methods, lack of adequate specialized tax officers to ensure full compliance, lack of adequate funding and also, the collection points are too far in between.<sup>2</sup>

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<sup>1</sup> Manenga Ndulo et al, Global Financial Crisis discussion Series. Paper 1. Zambia 2009. Page 5

<sup>2</sup> The Post Newspaper, Tuesday February 22, 2011. Page 6

In answering questions four, five, and six, chapter four has attempted to demonstrate that Government would want to do a lot of things in order to reduce poverty but, what limits this is the amount of resources available and ZRA can only manage to collect revenue up to a certain amount. On that score one would argue that what ZRA collects is far from sufficient. This is evidenced by Governments failure to meet the FNDP set expenditure targets for the priority sectors of agriculture, health, clean water supply and sanitation, education and training skills which are the key determinants for poverty reduction. Furthermore, in answering question six, it has been found that, the Zambian tax system up until now has only managed to tax revenue from the formal sector while the informal sector, remains minimally taxed. It has also been found that, although Zambia has experienced increased mining activities between 2000 and 2010, no significant increased Government revenue flowed from the mining sector.<sup>3</sup> It is therefore desirable that government consider broadening the tax base through tax policy reforms and mobilize resources which are essential for sustaining poverty reduction over the long run.

In light of the fore going, it has been found that, taxation as tool for poverty reduction has not been fully utilized to the extent where by the poverty levels can significantly be reduced. Although Zambia has had good growth during the past decade, achieving an average of 4.9% per annum, there has been an insignificant impact on reducing the overall poverty rate. The benefits of growth have been limited to urban areas, where there has been decline in poverty. Poverty in rural areas is still very high with 80% of people living below the poverty line. This is compared with the national of 64%. Poverty reduced by only 7% between 2000 and 2009.<sup>4</sup>

## **5.2 RECOMMENDATIONS**

To improve the adequacy and the effectiveness of the current tax laws so as to enhance revenue collection for poverty reduction, the author is of this research has made the following recommendations: Firstly, the Government should consider a comprehensive review of the following principle tax laws:

VAT Act: Section 15 of the Value Added Tax Act which deals with exemptions should be amended so that a number of exemptions should be considered for elimination. This will make as

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<sup>3</sup> Manenga Ndulo, et al Global Financial Crisis Discussion Series. Paper 10: Zambia, Overseas Development Institute (ODI) Westminster: London. 2009. Page 21

<sup>4</sup> Manenga Ndulo, et al Global Financial Crisis Discussion Series, paper 10. Page 22



many products and services taxable as much as possible. This should also apply to VAT treatment of agricultural products, Government should move from VAT exempt status to standard rating of all agricultural products with the exception of baby cereals, maize and maize flour. This will ensure that a wide range of agricultural and food products which comprises of a large portion of domestic production and consumption will be effectively inside the VAT system.<sup>5</sup>

Customs and Excise Act: - There is need to review the trade tax incentives and concessions under this law to ensure they are optimal, promote social welfare, and do not weaken the productivity of the revenue system. This should be done by specially amending section 69 of the Customs and Excise Act which empowers the minister of Finance to grant exemptions with out recourse to Parliament. It is recommended that these discretionary incentives issued by the minister must be done with the approval of Parliament and should be properly debated by the various stake holders. This will not only help in eliminating some of the unnecessary exemptions but also bring about transparency and accountability and ultimately enhance revenue collection.

Income Tax Act: - Even though the Income Tax Act has been found to satisfy the principle of adequacy owing to its wide coverage there are still a number of tax incentives such as tax holidays. This is a situation whereby a tax payer operating in a certain jurisdiction is granted a status not to pay tax on the profits he or she makes for a specified period. It is recommended that section 15(1) of the Income tax Act which provides for a wide range of exemptions found in the second schedule to the extent specified there in should be reviewed. It is hoped that once all these incentives are minimized there will be increased revenue coming from such measures.

Mining Tax Regime: - It is recommended that the Mines and Minerals Development Act of 2008, should be amended to facilitate the for the re- introduction of the windfall tax which will ensure that Government gets an equitable share in the proceeds from the copper exports. To this effect Government should engage the mining companies and renegotiate for new concessions considering the fact those conditions and circumstances under which the old concessions were negotiated and agreed for, have since changed. Copper prices have gone up and financial crisis has since subsided. During that time Government offered several concessions to the mining

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<sup>5</sup> Note that the 2006 Budget included a decision to move from VAT exempt status to standard rating of all agricultural products but was later reversed by the Minister of Finance in March 2006 cancelling out an estimated revenue gain of K40.5 billion (US\$12.3 million) that was expected from this measure.

sector in order to reduce the cost of production and to increase profitability. Government must effectively and fairly apply the tax laws on investment in Zambia especially in the mining industry in order to enhance revenue collection

Secondly, Government should broaden the tax base through tax policy reforms, zero rating of education and health services and taxes on consumption in order to come up with a pro-poor tax system that will help sustain the poverty levels in Zambia.

Thirdly, it is recommended that revenue collection in the informal economy be contracted to institutions that have some legitimacy and control, such as Councils and Road Transport and Safety Agency (RTSA) for Presumptive Tax and the Carbon Tax which was introduced in 2006 but has not yet fully been implemented. This is the case in Ghana where taxing the informal economy through various associations has been used with great success.<sup>6</sup>

Fourthly, a study must be commissioned to determine the optimal level of funding for ZRA and the impact of increased funding on revenue collection. Fifthly, ZRA must enhance its taxpayer education and taxpayer services to improve tax compliance and to reduce the cost of compliance.

Sixthly, Tax policy formulation should be enhanced to include much broader stakeholder participation beyond government and private sector. And a legal binding structure must be created that should formalize the participation of non state actors in the national budget process.

Finally, it is recommended that there is need to fully develop an effective and efficient enforcement and compliance mechanism in order to have an excellent and stable structure that has reliance on consumption taxes, like VAT and local excise duties and less on income taxes. like in Uganda where VAT has been found to be progressive and is a very important component of the tax system contributing around 36% of the total domestic revenue.<sup>7</sup>

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<sup>6</sup> Zambia's Tax System Need for Equity and Efficiency submitted to the Parliamentary Committee on Estimates by Jesuit Center for Theological Reflections, Olympia Park, Lusaka, 03 December 2010. Page 4

<sup>7</sup> Uganda's Taxation Policy: Implications for Poverty Reduction and Economic Growth. Review Report NO. 9 2008

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