AN EVALUATION OF THE IMPACT OF INCOME TAXATION ON THE GROWTH OF SMALL AND MEDIUM Sized ENTERPRISES IN ZAMBIA

By

MWANDU NSAMA

(27006786)

Being a Directed Research essay submitted to the University of Zambia Law Faculty in Partial fulfillment of the requirements for the Award of the Bachelor of Laws (LLB) Degree.

UNZA 2012
DECLARATION

I, MWANDU NSAMA, computer number 27006786, do hereby declare that this Directed Research Essay is my genuine work and to the best of my knowledge, information and belief, no similar piece of work has previously been produced at the University of Zambia or any other Institution for the award of Bachelor of Laws Degree. All other works in this essay have been duly acknowledged. No part of this work may be reproduced or copied in any manner without the prior authorization in writing of the author.

..................................................

MWANDU NSAMA
I Recommend that the Directed Research Essay under my supervision by:

MWANDU NSAMA

(Computer No. 27006786)

Entitled:

AN EVALUATION OF THE IMPACT OF INCOME TAXATION ON THE GROWTH OF SMALL AND MEDIUM SIZED ENTERPRISES IN ZAMBIA

Be accepted for examination. I have checked it carefully and I am satisfied that it fulfills the requirements pertaining to format as laid down in the regulations governing Directed Research Essays.

MR. FREDERICK S. MUDENDA

Date 14/05/17
ABSTRACT

The purpose of this dissertation was to evaluate the impact of income taxation on the growth of Small and Medium Enterprises in Zambia. It made an attempt to establish the effectiveness of maintaining compliance to the current tax policy by SMEs in Zambia. Furthermore, the research sought to establish whether the laws and the policies governing the regulation of Small business enterprises encourage them to formalize. The essay also sought to establish the impact of regional and international aspects of income taxation on SME regulation and development in Zambia.

Through research, it was found that the majority of SMEs in Zambia are informal and many have maintained the status quo arguing that the tax system creates an unnecessary burden on their operations. Furthermore, it was found through research that there is need for income taxation to be imposed so as to encourage SMEs to formalize. It was also found that there are other non-tax barriers to the growth of SMEs which are connected or incidental to income taxation. Furthermore, it was also established that there is need to strengthen the formulation and implementation of the Micro, Small and Medium Enterprise Development Policy in Zambia so that it is in line with regional and international standards.

Considering the fact that SMEs make up a considerable portion of the private sector the dissertation recommends that the sector needs to be encouraged to grow and the various policies and pieces of legislation that affect the regulation of SMEs must be reviewed to ensure that they adequately promote the growth of SMEs. This is because SMEs have a number of advantages to the national and global economy which include job creation, poverty reduction and the equitable access and distribution of social goods.
ACKNOWLEDGEMENTS

First and foremost am grateful to the Almighty God for making the successful completion of this dissertation possible. The trajectory through Law school has not been easy, but through his grace, I have had the strength to keep going.

I sincerely thank Mr. Fredrick Mudenda, my supervisor for his patience, understanding and guidance throughout the period of the research. It was a great honour and privilege to have been taught and supervised by you, sir and may the good Lord continue blessing you in your current and future endeavors.

I am grateful to my parents Mr. and Mrs. Nsama for their financial and moral support. You have always encouraged me to lead my siblings by example through hard work and perseverance. Thank you very much for always being there for me. I will remain forever indebted to you.

I would like to express my sincere gratitude to my good friends, Chilwana Iliamupu, Saidi Patrick, Florence Kafwimbi, and the entire Law School 4th year Class of 2012. Thank you very much and may God richly bless you, aluta continua!
DEDICATION

This paper is dedicated to my parents Mrs. K.C Nsama and Mr. G. Nsama, my brothers Ng’onga, Chileshe and Bupe and to the memories of J.B.

Mum and Dad, I would like to express my sincere gratitude for the sacrifice, guidance and care that you have given me since my coming into this world. You have always encouraged me to work hard even when the going gets tough. I thank you for the financial and moral support that you have always given me whenever I need it. Without you I would not have reached this far. You are my inspiration and may the good lord continue to bless you.

Ng’onga, Chileshe and Bupe, you always remind me of how proud you are of me and this has pushed me to work even harder every day. I would like to take this point in time to thank you and to encourage you to work hard in everything you do.

J.B, I thank God for your love, dedication and affection. Though I was very young when you answered God’s call, the vivid memories of you that I have always remind me of how special you are and will always be to me. May Your Soul Rest In Eternal Peace
TABLE OF STATUTES

Banking and Financial Services Act, Cap 387 of the laws of Zambia

Federation of Rhodesia and Nyasaland (Dissolution) Order in Council, 1963

Information and Communication Technologies Act No. 15 of 2009

Local Government Act, Cap 281 of the laws of Zambia

The Companies Act, Cap 388 of the Laws of Zambia


The Income Tax (Amendment) Act No. 49 of 2010

The Income Tax Act, Cap 323 of the Laws of Zambia

Zambia Development Agency Act No 11 of 2006
TABLE OF CONTENTS

Research Topic .................................................................................................i
Declaration........................................................................................................ii
Supervisor’s Approval......................................................................................iii
Abstract ............................................................................................................iv
Acknowledgements..........................................................................................v
Dedication.........................................................................................................vi
Table of Statutes..............................................................................................vii
Table of Contents............................................................................................viii
List of Abbreviations.........................................................................................xi

CHAPTER ONE
INTRODUCTORY CHAPTER

1.0 Introduction..................................................................................................1
1.1 Income Taxation and growth of SMEs in Zambia.......................................1
1.2 Statement of the Problem.........................................................................4
1.3 Objectives of the Study...........................................................................4
  1.3.1 General Objective...........................................................................4
  1.3.2 Specific Objectives........................................................................5
  1.3.3 Research Questions addressed.......................................................5
1.4 Significance of the Study........................................................................6
1.5 Methodology..............................................................................................6
1.6 Conclusion.................................................................................................6
CHAPTER TWO
HISTORICAL DEVELOPMENT OF INCOME TAX LEGISLATION AND SMALL AND MEDIUM ENTERPRISES IN ZAMBIA

2.1 Introduction.................................................................8

2.2 Historical Development of Income Tax Legislation in Zambia............................8

2.3 Historical Development of SMEs in Zambia.................................................10

2.4 The Nexus between Income Tax Legislation and SME regulation in Zambia........16

2.5 Conclusion...........................................................................18

CHAPTER THREE
THE LEGAL AND POLICY FRAMEWORK OF INCOME TAXATION AND SMALL AND MEDIUM ENTERPRISE DEVELOPMENT IN ZAMBIA

3.1 Introduction...........................................................................19

3.2 Review of the Micro, Small and Medium Enterprise Development Policy.........21

3.3 Income Taxation, Incentive or Barrier to SME Growth in Zambia....................25

3.4 Future prospects for SME Growth in Zambia..............................................30

3.5 Conclusion...........................................................................30
CHAPTER FOUR
COMPARATIVE ANALYSIS OF THE LEGAL AND POLICY FRAMEWORK OF INCOME TAXATION AND SMALL AND MEDIUM ENTERPRISE DEVELOPMENT: A REGIONAL AND INTERNATIONAL PERSPECTIVE

4.1 Introduction..................................................................................................................32

4.1.2 The role of COMESA in Income Taxation and SME Development.......................34

4.2 The Regional and International analysis of the taxation of SMEs.........................36

4.3 Lessons from the Regional and International Community on SME taxation and Development.................................................................................................................40

4.4 Conclusion....................................................................................................................43

CHAPTER FIVE
CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction..................................................................................................................44

5.2 General Conclusions....................................................................................................46

5.3 Recommendations.........................................................................................................48

5.4 Conclusion....................................................................................................................51

Bibliography.....................................................................................................................52
# LIST OF ABBREVIATIONS

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
</tr>
</thead>
<tbody>
<tr>
<td>CEEC</td>
<td>Citizens Economic Empowerment Commission</td>
</tr>
<tr>
<td>COMESA</td>
<td>Common Market for Eastern and Southern Africa</td>
</tr>
<tr>
<td>MCTI</td>
<td>Ministry of Commerce Trade and Industry</td>
</tr>
<tr>
<td>MSMEs</td>
<td>Micro, Small and Medium Enterprises</td>
</tr>
<tr>
<td>PACRA</td>
<td>Patents and Companies Registration Agency</td>
</tr>
<tr>
<td>SADC</td>
<td>Southern African Development Community</td>
</tr>
<tr>
<td>SME</td>
<td>Small and Medium Enterprises</td>
</tr>
<tr>
<td>UN</td>
<td>United Nations</td>
</tr>
<tr>
<td>UNZA</td>
<td>University of Zambia</td>
</tr>
<tr>
<td>ZCSMBA</td>
<td>Zambia Chamber for Small and Medium Business Associations</td>
</tr>
<tr>
<td>ZDA</td>
<td>Zambia Development Agency</td>
</tr>
<tr>
<td>ZRA</td>
<td>Zambia Revenue Authority</td>
</tr>
</tbody>
</table>
CHAPTER ONE

INTRODUCTORY CHAPTER

1.0 INTRODUCTION
This chapter gives an introduction and an outline of the research. The chapter looks at the following; the research topic, the statement of the problem, the objectives of the research, the significance of the study, and the methodology of the study. The chapter also contains a conclusion of the issues discussed herein.

1.1 INCOME TAXATION AND THE GROWTH OF MICRO, SMALL AND MEDIUM ENTERPRISES IN ZAMBIA

In any economic dispensation there are a number of key players which includes both large multinational corporations (MNCs) which are mostly owned by foreigners but run by locals and small business enterprises (hereinafter referred to as SMEs) which are usually owned and operated by locals. Zambia like any other country is no exception to this reality as the economic structure comprises of small enterprises in both rural and urban areas to large corporations like the mines on the Copperbelt and North Western provinces. The research herein is devoted to the small business sector of the economy which despite its size and magnitude cannot go unnoticed for its actual and potential contribution to the national treasury insofar as income tax, Value Added Tax and other forms of taxes are concerned.
Small businesses in their operations are subject to pay income tax. Income tax is defined as a duty or tax on income or profits.\(^1\) The Zambia Revenue Authority defines income tax as the tax on profits made by limited companies and self employed individuals as well as emoluments earned by employees.\(^2\) Micro, Small and Medium sized Enterprises (MSMEs) are defined according to a number of variables which include the following; total fixed investments, sales turnovers, number of employees and legal status.\(^3\) Micro Enterprises are classified as any business enterprise registered with the Registrar of Companies whose total investment excluding land and buildings is up to K80 million and whose annual turnover is up to K150 million.\(^4\) Furthermore, the business should be employing up to 10 persons.\(^5\)

Small Enterprises are classified as any business enterprise registered with the Registrar of Companies whose total investment, excluding land and building in the case of manufacturing and processing enterprises is between K81 million and K200 million in plant and machinery. In the case of trading and service providing enterprises total investment excluding land and building must be up to K150 million with an annual turnover between K151 million and K300 million.\(^6\) Furthermore, the business should be employing between 11 and 50 persons.\(^7\) The topology of small businesses has changed with time to include enterprises which are informal. An informal enterprise is one which is not registered with registrar of companies whose total investment excluding land and investment is up to K50 million and employing up to 10 individuals.\(^8\)

---

\(^1\) Mick Woodley ed., *Osborne's Concise Law Dictionary* (London: Sweet and Maxwell, 2005), 215
\(^4\) *The Micro, Small and Medium Enterprise Development Policy*, 5-6
\(^5\) *The Micro, Small and Medium Enterprise Development Policy*, 5-6
\(^6\) *The Micro, Small and Medium Enterprise Development Policy*, 6
\(^7\) *The Micro, Small and Medium Enterprise Development Policy*, 6
\(^8\) *The Micro, Small and Medium Enterprise Development Policy*, 6
Small businesses are under an obligation to pay income tax and it is the duty of the government to formulate and implement a policy that encourages small businesses to grow. One scholar a few years ago observed that the tax policy does not encourage more small businesses to enter into the formal sector, whilst those already in the formal sector tend to shun the culture of compliance with tax authorities. Furthermore, he observed that; Small businesses complain that the threshold level for Value Added Tax (hereinafter referred to as VAT) registration is too high. Pitched at K200 million (US $40,000), when per capita income is only K 1.75 million (US $375), is a formidable barrier for firms to enter the formal sector (defined in Zambia as a firm with a VAT registration number) and thus encourages even medium-sized firms to remain outside the tax net and avoid even the 3% turnover tax.

Despite the aforementioned, the importance of SMEs to economic growth and national development cannot be overlooked or ignored because it is evident from the growth of economies of countries in East Asia, particularly the tiger nations. Harvey notes that SMEs have played and are continuing to play an important role in the economic development of East Asia and this development is evident from the raise in employment opportunities. Developing countries like Zambia can learn from Asian nations like Singapore and Malaysia on how entrepreneurship through small business firms has transformed not only individually run households but countries as a whole. This concept of entrepreneurship is undeniably the driving force behind many SMEs and the tax policy in Zambia needs to encourage more small

---

10 Richard, Designing a Small Business Tax System that Enhances Growth: Lessons from Africa, 7
11 Charles Harvey, Boon-Chye Lee, The role of SMEs in national economies in East Asia (Massachusetts: Edgar Elgar Publishing Inc, 2002), 3
businesses to flourish in order to reduce poverty and improve the standards of living of the general populous.

1.2 STATEMENT OF THE PROBLEM

One impediment to the growth of SMEs in Zambia observed during preliminary investigations is the fact that most of them are not formalized or have remained in the informal sector. This is due to factors such as being made to meet a high threshold in terms of VAT registration among others. Furthermore, this lack of formalization has cost a number of SMEs in their efforts to access loans, grants, bailouts and other forms of financial assistance and have lead in some severe cases to their down fall. This problem is further exacerbated by other social, political and economic considerations such as poverty, lack of political will on the part of government, low income per capita but to list a few.\textsuperscript{12} The research is focused on addressing the legal and institutional impediments to the growth of SMEs in the country and thereafter making recommendations on how best the law can be fine tuned to bring about the much needed change to the operations of SMEs in the Country.

1.3 OBJECTIVES OF THE STUDY

1.3.1 GENERAL OBJECTIVE

The general objective is to evaluate the impact of income taxation on the growth of Small and medium sized Enterprises in Zambia as per the research topic title hereto.

1.3.2 SPECIFIC OBJECTIVES

a) To find out the rationale behind the categorization and percentage of income tax paid by Small and Medium sized Enterprises in Zambia.

b) To find out the effectiveness of maintaining compliance to the current tax policy by Small and Medium sized Enterprises in Zambia.

c) To find out whether the current tax policy on small businesses is in line with international and regional systems of taxation of small businesses.

1.3.3 RESEARCH QUESTIONS ADDRESSED

The research questions which were addressed in an effort to arrive at a conclusion on whether the law on income taxation in Zambia hinders the growth of small and medium sized enterprises are the following:

1. Is the current legal regime facilitative of the operations of Small and Medium sized Enterprises?

2. Is there need to reduce the percentage of income tax that is paid by Small and Medium sized Enterprises in Zambia insofar as encouraging them to grow?

3. Is the current policy framework in the country of taxing income of Small and Medium sized enterprises in line with international standards of taxation?

4. Apart from legal provisions what other measures can the government put in place to promote the growth of SMEs?
1.4 SIGNIFICANCE OF THE STUDY

The study is aimed at analyzing the possible benefits that would accrue to proprietors and would be proprietors of Small and Medium sized Enterprises in the event that the general law and policy framework on income taxation is revised. The practical importance of this research is to make recommendations to the government on the importance of encouraging the growth of SMEs in the country in order to realize more benefits from their operations.

1.5 METHODOLOGY

This research was a qualitative one. It embraced both desk research and field investigations. In this regard the desk research was carried out through the collection of secondary data in the form of Law reports, books, journals, dissertations as well as the internet. Field investigations were in the form of open ended interviews conducted with key stakeholders such as the relevant officials from the Zambia Development Agency (ZDA), Zambia Revenue Authority (ZRA), The Zambia Chamber for Small and Medium Business Associations (ZCSMBA), The Citizens Economic Empowerment Commission (CEEC) as well as some proprietors of selected SME's but to mention a few.

1.6 CONCLUSION

This Chapter has dealt with the basic aspects of the research and has given a prelude to the subject. It has also highlighted the salient features of the research topic as contained herein. Furthermore, the chapter has briefly looked at the tax policy issues concerning SMEs and the benefits that the latter can bring to society. The next chapter gives a historical background to the
development and relationship between income tax legislation and SME operations and regulation in Zambia.
CHAPTER TWO

2.0 HISTORICAL DEVELOPMENT OF INCOME TAX LEGISLATION AND SMALL AND MEDIUM ENTERPRISES IN ZAMBIA

2.1 INTRODUCTION

This chapter will give an account of the historical development of income tax legislation and SME operation and regulation in Zambia. Furthermore, the chapter will discuss the nexus between income taxation and SME regulation in Zambia. Finally, a conclusion will be drawn from the matters discussed hereunder.

2.2 HISTORICAL DEVELOPMENT OF INCOME TAX LEGISLATION IN ZAMBIA

In order to give a good account of the historical development of Income Tax Legislation in Zambia there is need to trace briefly the colonial and post-independence eras of the country. For as Banda\(^1\) observed the history of income tax in Zambia goes back to the earlier days when the country was known as Northern Rhodesia. The starting point of this synopsis is the period when the county was under the rule of the British South African Company (hereinafter referred to as the BSA co) which in 1920 published a draft proclamation in the Northern Rhodesia Gazette by way of notice\(^2\) (Notice No. 91 of 1920) for the imposition of direct taxation on European inhabitants in the territory. The effect of the proclamation was that it provided for the raising of revenue by the imposition of a tax on income that was derived in the territory. Thus, all income that was received by a person was taxable and for the purposes of determining the taxable

---

\(^1\) Banda, R. *Taxation Law in Zambia*, School of Law Obligatory Essay, 1988, 1.

\(^2\) Banda, *Taxation Law in Zambia*, 1
amount of any person other than companies there were abatements or an allowance granted on
the proposed taxable amount. Furthermore, hut tax was imposed on all the natives that were
living in the territory.

It should be noted that income taxation has continuously been in force since 1921. In 1924 the
British government took over the administration of the territory from the BSA Co however, the
income tax policy of the former did not differ much with that of the latter for example, the
ordinary income tax and hut tax continued to be levied throughout the territory. \(^3\) By this time the
two territories of North Western Rhodesia and North Eastern Rhodesia had amalgamated into
one territory called Northern Rhodesia later known as the republic of Zambia.

In 1953 the Federation of Rhodesia and Nyasaland was formed and it became necessary to
integrate the taxation laws of the Southern Rhodesia, Northern Rhodesia and Nyasaland. \(^4\) The
laws become merged or integrated for the proper functioning of the federation. Previous
legislation, rules and proclamations concerning income taxation of the three territories were
incorporated into a new Federal Income Tax Act \(^5\) of 1954. Taxes were levied and collected
annually throughout the territory pursuant to Section 6 of the Act. Furthermore, Section 78 sub-
section (1) of the Constitution of the Federation provided for the keeping of all revenues or other
money raised or received by the Federation. Such revenues included all tax on income and
profits and territorial surcharges under Article 82 of the Federal Constitution. After the Unilateral

observed that the imposition of taxation by the colonial authorities brought about a lot of discontent. Furthermore, he
also observed that the imposition of taxation was in fact felt in villages where certain people had no money to pay it
apart from paying it in the form of prison sentence.

\(^4\) A.S Silke, *Income Taxation in the Central African Federation* (Cape Town: Juta and Co Ltd, 1954) as cited by
Banda, R. *Taxation law in Zambia*, School of Law Obligatory Essay, 1988, 2

\(^5\) This Act was promulgated and incorporated on 26th March 1954.
Declaration of Independence by the Southern Rhodesia government and the dissolution\(^6\) of the Federation each territory adopted its own policy on taxation vis-à-vis income taxation.

In 1964 Northern Rhodesia attained independence and the new government took it upon itself the task of enacting or modifying already existing legislation for the territory. One of the many statutes that were enacted is the Income Tax Act of 1966 which provided for the imposition of taxation on all income that was earned in the new republic of Zambia. The Act provided for a unitary system of income taxation, new procedures and penalties and also introduced the concept of Pay As You Earn (PAYE) thereby doing away with the previous system of taxation based on arrears but rather on available disposable income. The Act has through the many years it has been on the statute books undergone several amendments and the recent amendment being the Income Tax (Amendment) Act No 49 of 2010 which repeals and replaces a number of provisions in the Income Tax Act.\(^7\)

### 2.3 HISTORICAL DEVELOPMENT OF SMALL AND MEDIUM ENTERPRISES IN ZAMBIA

In Zambia like many other countries across the world small and medium enterprises or small business enterprises (hereinafter referred to as SME’s or MSMEs) are most often associated with the concept of entrepreneurship, for example in 2004 it was discovered through a survey that at least 58% of the MSME sector comprised of entrepreneurs.\(^8\) The word entrepreneurship is not susceptible to precise definition but in ordinary parlance can be understood as the art or science of applying entrepreneurial skills, by taking risks and initiatives in organizing resources to make

\(^6\) Federation of Rhodesia and Nyasaland (Dissolution) Order in Council, 1963

\(^7\) CAP 323 of the revised edition of the Laws of Zambia.

a profit or money or an advantage. The word entrepreneurship is derived from the French word 'entrepreneur' which in ordinary parlance means one who takes in between. Richard Cantillon an 18\textsuperscript{th} century economist defined an entrepreneur as a risk taker describing the activity of entrepreneurship as buying at a certain price and selling at uncertain price.\footnote{Elliot Mumba, \textit{Entrepreneurship and Small Business Management: Concepts and Practices 2\textsuperscript{nd} Edition} (Lusaka: Lativia Limited, 2011), 8}

In the twenty first century we have come to understand an entrepreneur as an innovator and can be defined as a person who is able to identify business opportunities and organize the resources necessary to initiate a successful business activity.\footnote{David Deakins and Mark Freel, \textit{Entrepreneurship and Small Firms 3\textsuperscript{rd} edition} (Berkshire: McGraw Hill, 2003), 3} Entrepreneurship and small business play a vital role in the economic development of countries and regions. The American and Australian economies are examples of economies that have developed by encouraging entrepreneurship.\footnote{Elliot Mumba, \textit{Entrepreneurship and Small Business Management}, 2011, 17}

The development of SME's in Zambia can be traced back as far as the advent of colonialism. During the colonial era most businesses whether large (the mines and commercial farms) or small like grocery stores, saloons, bookshops, butcheries but to mention a few were wholly owned or operated by Europeans, for example, Saasa observed that Zambia's large scale farmers were exclusively of European origin\footnote{Oliver S. Saasa, \textit{Zambia's Policies towards Foreign Investment: The case of the Mining and Non Mining Sectors.} Scandinavian Institute of African Studies, Uppala (1987), 14} even after independence. Furthermore, he noted that to take the construction industry as an illustration, it was reported that out of the 200 contracting companies that existed at independence, only one was Zambian owned.\footnote{Oliver, \textit{Zambia's Policies towards Foreign Investment}, 17}
One can observe that is disparity is because Africans were confined to the role of providing a reserve for cheap labour\textsuperscript{14} for the European owned businesses like the mines and commercial farms thereby making it difficult for Africans to engage in any meaningful and profitable entrepreneurship activity. Furthermore, one can note that the situation was further exacerbated by the fact that the line of rail which was used for the transportation of goods within the major economic hubs of the territory was also located in Crown land which was the exclusive reserve for Europeans. This unfortunate revelation was a result of the colonial policy of discrimination in land and resource distribution which regarded the natives as inferior to the Europeans.\textsuperscript{15}

After independence the government of Dr Kaunda was faced with the need to empower citizens and enhance socio-economic development. This was in order to negative the social and economic ills that were created by the colonial government and its policies of discrimination and euro centralism. The preferred policy by the government for achieving economic growth was socialism in light of the philosophy of humanism. It has been observed that prior to the introduction of multi-party democracy and the adoption of free market policies in 1991, Zambia was a one-party State with a socialist-oriented economy.\textsuperscript{16} The Public sector was the preferred engine of growth and the business environment was characterized by price controls, administratively determined exchange rates, a variety of subsidies for consumer goods and services, negative real interest rates and high rates of inflation.\textsuperscript{17}

\textsuperscript{14} Oliver, Zambia’s Policies towards Foreign Investment, 11

\textsuperscript{15} Mudenda observed in his seminal book on land law that the territory of Northern Rhodesia was divided into Crown land, native reserves and native trust lands by the colonial authorities. Fredrick S. Mudenda, Land Law in Zambia: Cases and Materials (Lusaka: Unza Press, 2007)

\textsuperscript{16} UNCTAD Report on Growing micro and small enterprises in LDC’s The “missing middle” in LDCs: why micro and small enterprises are not growing, 70

\textsuperscript{17} Growing micro and small enterprises in LDC’s the “missing middle” in LDCs: why micro and small enterprises are not growing, 70
Hence from the factors adumbrated above it was very difficult for private enterprises to thrive yet alone grow into viable entities. Enterprises in the private sector thrived only if they had access to foreign currency.\textsuperscript{18} To have access to foreign exchange, enterprises had to be well connected to the bureaucrats or the Establishment.\textsuperscript{19} Small enterprises like most of the private sector also had difficulty in securing raw material inputs and equipment and furthermore, borrowing was also very difficult for business people as real interest rates, which were administratively determined, were negative and hence most commercial institutions had very little incentive to lend.\textsuperscript{20}

Furthermore, the country had no special legal framework promoting SMEs since the economy was enjoying the high prices of copper hence ignoring the SME sector. The country depended much on mining copper and only the public sector was visible by then\textsuperscript{21} however, in the 1970’s it become apparent that there was need to encourage small businesses as the mines which were the major employers could not absorb all those in need of employment and furthermore the country also faced the problem of people migrating from the countryside to the urban areas in search of formal employment.\textsuperscript{22} In order to reverse this trend the government started by creating the Village Industry Service (VIS) in 1978, which was meant to encourage as well as provide

\textsuperscript{18} Growing micro and small enterprises in LDC’s the “missing middle” in LDCs: why micro and small enterprises are not growing, 70.

\textsuperscript{19} Growing micro and small enterprises in LDC’s The “missing middle” in LDCs: why micro and small enterprises are not growing, 70

\textsuperscript{20} Growing micro and small enterprises in LDC’s The “missing middle” in LDCs: why micro and small enterprises are not growing, 70


\textsuperscript{22} Chibwe, Unlocking the Potential of Zambian Micro, Small and Medium Enterprises, 7
support to rural communities to develop and utilise artisan craft skills and thereby produce crafts that could be sold in exchange for money.\textsuperscript{23}

As early as 1981, the Zambian government had recognized the importance of the MSME sector and its contribution to economic development.\textsuperscript{24} At the same time, the government recognized the challenges that the industry was facing and through the Small Industries Development (SID) Act of 1981 made an attempt to enhance the effectiveness of the sector’s Development to the national economy by establishing the Small Industries Development Organization (SIDO).\textsuperscript{25} The SID Act was later supplemented by the provisions of the Fourth National Development Plan of 1989.\textsuperscript{26} Provisions were made in the latter to provide infrastructure for operations of MSMEs, promote access to credit by MSMEs with growth potential and improve production capacities of MSMEs with a view to increase incomes and employment.\textsuperscript{27}

Furthermore, the government provided financial resources to MSMEs through the Development Bank of Zambia (DBZ), Village Industries Services (VIS) and the Small Industries Development Organization (SID).\textsuperscript{28} Despite the above developments and measures there was not much growth in the MSME sector. This was due to the following factors; specified targets to be achieved were not set and strategies to be employed to achieve the targets were not well defined, MSME

\textsuperscript{23} D.M Mauzu, SMME Policy in Zambia, under http://library.fes.de (accessed on 13\textsuperscript{th} March, 2012)


\textsuperscript{25} Ministry of Commerce Trade and Industry, The Micro, Small and Medium Enterprise Development Policy, (2009), 1

\textsuperscript{26} The Micro, Small and Medium Enterprise Development Policy, 2009, 1

\textsuperscript{27} The Micro, Small and Medium Enterprise Development Policy, 2009, 1

\textsuperscript{28} The 2003-2004 Zambia Small and Medium Enterprises Survey Final Report, 2007, 1
support institutions suffered from inadequate funding and poor management, and Private enterprise to which the MSME sector belongs was not proactively encouraged by the state.29

In 1991 the new government under Dr. Chiluba liberalized the economy and encouraged more private enterprises to flourish. The government established the Commercial Trade and Industrial (CIT) Policy in 1994 with pronouncements that the government would devise a strategy to encourage the growth of small enterprises.30 Furthermore, the local authorities were to review their infrastructure services and licensing regulations so as make the registration and operations of small enterprises easier. The government also committed itself to enact legislation and provide incentives that promote the rapid growth of the MSME sector. The government also made it a priority to decentralize business registration.31

In 1996 the government revised the SID Act and replaced it with the Small Enterprises Development (SED) Act.32 It should be noted that most of the incentives provisions under the Act were never implemented as the systems for their implementation were never put in place.33 Chisala observed that the policies under the Small Industries Development Act of 1981 and the Small Enterprises Development (SED) Act of 1996 had a negligible impact on the development of SMEs as they were just merely public pronouncements with little effort to implement them.34

31 The Micro, Small and Medium Enterprise Development Policy, 2009, 2
32 The Micro, Small and Medium Enterprise Development Policy, 2009, 2
33 The Micro, Small and Medium Enterprise Development Policy, 2009, 2
Despite the aforementioned constraint the government did not stop its efforts of encouraging the growth of MSMEs. In 2006 parliament through the enactment of the Zambia Development Agency Act No. 11 dissolved the Small Industries Development Board and all its activities were incorporated into the Zambia Development Agency (ZDA) under the MSE Division. The Zambia Development Agency is an institution that works in liaison with the Ministry of Commerce Trade and Industry (MCTI) in trade and investment promotion and it is also responsible for regulating the MSME sector and its various implementing organizations and structures and ensuring that all MSME development activities create synergy and are directed at achieving set national goals and objectives.35

2.4 THE NEXUS BETWEEN INCOME TAX LEGISLATION AND SMALL AND MEDIUM ENTERPRISE REGULATION IN ZAMBIA

A nexus in ordinary parlance is simply a connection between two or more similar or different entities. The nexus in question is the relationship between Income Taxation and SME regulation. The starting point is to recognize the fact that for anything to have the force of law it has to be recognized or provided for by a piece of legislation. In this regard the Income Tax Act36 provides for the imposition of tax on income that is earned in the republic by individuals and entities other than individuals i.e. companies. Taxable income is defined under Section 17 of the ITA. Taxable income is that income which is liable to tax.37 Furthermore, section 2 of the Income tax Act defines ‘assessable income’ as the amount of a person’s income liable to tax which may be included in an assessment and which remains after allowing the deductions, to which that person

35 The Micro, Small and Medium Enterprise Development Policy, 2009, 22
36 Cap 323 of the laws of Zambia
37 Misheck Table, Understanding the Tax System in Zambia, 2008/2009, 24
is entitled under the provisions of the Act. The assessable income is returned in an annual Income tax return in accordance with section 46(1), 46(2) and 46(3) of the Income tax Act.\textsuperscript{38}

The provisions of the Act dealing with returns (in particular Sections 46 and 47) do not apply to taxpayers covered by Section 64A (2). Section 64A (2) excludes from Income tax, persons with turnover of ZMK200 Million and below. These have an obligation of paying turnover tax monthly at the rate of 3\% of their gross turnover.\textsuperscript{39} The majority of small businesses in Zambia are not capable of making an annual turnover of ZMK200 million hence they pay the 3\% income tax. The threshold of ZMK200 million appears to be a huge stumbling block for formalization of small businesses into the formal tax system and furthermore has created more problems in so far as redemption of costs incurred on Value Added Tax on items that are purchased by producers and traders thereby increasing the cost of production to the ultimate consumer. It should also be noted that most private companies want to trade with Value Added Tax registered companies.

Notwithstanding the aforementioned the Act is one of the many pieces of legislation that applies to SMEs. The main piece of legislation currently for the development of the MSME sector in the country is the Zambia Development Agency Act number 11 of 2006 and it is also the principle legislation under which the MSME Development Policy operates. Other pieces of legislation include the Companies Act\textsuperscript{40} which provides for the legalization of business operations in Zambia through registration of companies, trademarks, industrial designs and patents, the Citizens Economic Empowerment Commission Act\textsuperscript{41} which provides for economic

\textsuperscript{38}Zambia Revenue Authority, Income Tax, under http://www.zra.org (accessed on 1\textsuperscript{st} February, 2012)
\textsuperscript{39}Zambia Revenue Authority, Income Tax, under http://www.zra.org (accessed on 1\textsuperscript{st} February, 2012)
\textsuperscript{40}Cap 388 of the laws of Zambia
\textsuperscript{41}The Micro, Small and Medium Enterprise Development Policy, 2009, 23
empowerment of citizens through the practice of enterprise and provision of empowerment fund, the Banking and Financial Services Act\textsuperscript{42}, which regulates the provision of banking and financial services but to mention a few.\textsuperscript{43} However, there are a number of other licensing and regulatory requirements that need to be adhered to by SMEs and this generally depends on the nature of business of the SME in question.

2.5 CONCLUSION

This chapter has made an attempt to give an account of the historical development of both Income Tax legislation and SMEs in Zambia. The Chapter also discussed the nexus between income tax legislation and SME regulation in Zambia. The next chapter will look at the legal and policy framework of income taxation and SME development in Zambia and will briefly comment on the recent developments in Income Tax legislation with emphasis on the Income Tax (Amendment) Act No. 49 of 2010. Thereafter, the Chapter will give a review of the Micro, Small and Medium Enterprise Development Policy of 2009 and will evaluate whether income taxation is an incentive or barrier to SME growth in Zambia. Finally, the Chapter will look at the future prospects for SME growth in Zambia.

\textsuperscript{42} Cap 387 of the laws of Zambia
\textsuperscript{43} The Micro, Small and Medium Enterprise Development Policy, 2009, 23
CHAPTER THREE

3.0 THE LEGAL AND POLICY FRAMEWORK OF INCOME TAXATION AND SMALL AND MEDIUM ENTERPRISE DEVELOPMENT IN ZAMBIA

3.1 INTRODUCTION

This chapter focuses on the legal and policy framework of income taxation and Small and Medium Enterprise development in Zambia. It also gives a review of the Micro, Small and Medium Enterprise Development Policy of 2009 and also evaluates how income taxation is an incentive or barrier to SME growth in Zambia. Finally, the chapter looks at the future prospects for SME growth in the country.

Economies across the world depend on resources collected from both direct taxes (Personal income tax and company tax) and indirect taxes (value added tax - VAT, excise and customs duties) to finance government activities.\(^1\) In this respect each country has the duty to formulate and implement policies and put in place legal and institutional frameworks that regulate how the foregoing resources are collected and managed. Flowing from the foregoing it is trite to assert that no government can be sustained without mechanisms for generating domestic revenue.\(^2\) Taxes are therefore a major way for countries to raise revenue to meet social and developmental needs of the people and they also assist in redistribution of wealth or income and can also be used to encourage or discourage certain activities.\(^3\)

---

\(^1\) Sydney Mwansa and Chilufya Chileshe, *JCTR: Zambia’s Tax System ‘Need for Equity and Efficiency*, Lusaka, 1 http://www.jctr.org (accessed on 10\(^{th}\) April, 2012)


\(^3\) Mwansa and Chileshe, *JCTR: Zambia’s Tax System ‘Need for Equity and Efficiency*, under http://www.jctr.org (accessed on 10\(^{th}\) April, 2012)
The legislative framework for income taxation in Zambia is provided for by the Income Tax Act\(^4\) which is an Act to provide for the taxation of incomes and matters connected therewith. The Ministry of Finance and National Planning makes tax policy and the Zambia Revenue Authority\(^5\) (hereinafter referred to as ZRA) is mandated by law to implement the policy, for example one of the major functions of the governing board of the ZRA is to assess, charge, levy and collect all revenue due to the Government under such laws as the Minister may, by statutory instrument, specify.\(^6\) The tax system in Zambia generally consists of three categories of taxes namely;

Income taxes (Pay as You Earn, Company Tax), Consumption taxes (domestic Value Added Tax, Import Value Added Tax and Excise Duty) and Trade taxes (Customs and export Duty). And of the three categories of taxes, income taxes are the largest contributors to the tax revenue base followed by consumption taxes and then trade taxes.\(^7\)

It is no wonder that this research was devoted at evaluating the impact of Income taxation on the growth of Small and Medium Enterprises in the country.

In Zambia there is a general corporate tax rate of 35 percent, however, there are sector-specific multiple tax rates. Some of these sector-specific rates are 15% for agriculture, 30% for mining, 15% for manufacturing of fertiliser, 15% for non-traditional exports, and 15% for charitable organisations carrying on business.\(^8\) Small business enterprises which are mostly informal are taxed on their monthly turnover at the rate of 3%\(^9\) but however enterprises which make in excess of ZMK200 million pay the general corporate tax rate. Insofar as the legal and policy framework

\(^4\) Cap 323 of the Laws of Zambia
\(^5\) Created by Cap 321 of the Laws of Zambia
\(^6\) Sec 11 (1) (a) of Cap 321 of the Laws of Zambia
\(^7\) Mwansa and Chileshe, JCTR: Zambia’s Tax System ‘Need for Equity and Efficiency, 1
\(^8\) Background document for the 5th NEPAD-OECD Ministerial Conference: Highlights of the Policy Framework for Investment in Zambia Dakar, (26-27 April 2011), 12
\(^9\) This type of tax is paid by businesses that have a turnover of less than ZMK200 million. Misheck Table, Understanding the Tax System in Zambia 2008/2009, 41

20
for the development of SME’s is concerned the Ministry of Commerce, Trade and Industry makes the appropriate policies and the Zambia Development Agency has the mandate of implementing the policies through its SME Division.10

Notwithstanding the above the Income Tax Act11 (hereinafter referred to as the Act) has been amended on several occasions since its first enactment in 196612 by the Parliament of the Republic of Zambia. The most recent amendment being the Income Tax (Amendment) Act No. 49 of 2010 which has brought the following changes; it has introduced new definitions, introduced specific penalties for the submission of incorrect returns and other documents, it has increased income tax bands taxable at the rates of 0%, 25% and 35%, it has reduced income tax bands at the rate of 30%, it has introduced a tax rate of 40% on income in excess of K250,000,000 per annum for the telecommunications sector 13 but to mention a few. Even though the changes that have been brought by the amendment Act do not have a direct impact on SME regulation the point to bear is that it is the genesis of the amendment Act that the topic of the research was formulated hence the changes to the Act could not go unnoticed.

3.2 REVIEW OF THE MICRO, SMALL AND MEDIUM ENTERPRISE DEVELOPMENT POLICY (2009) OF ZAMBIA

One of the characteristic elements of the Zambian economy at present is the existence and mushrooming of SME activities since the reintroduction of multi-party politics and the liberalization of the economy. One can note that the third republic ushered in a new focus to

11 Cap 323 of the laws of Zambia.
12 Act came into operation on the 1st April, 1966
13 Zambia Revenue Authority, Domestic Taxes Division Practice Note No. 1/2011, 3
economic development based on the equitable contribution of the private sector to the national economy. According to Chisala;

The private sector has become the centre of concern in today’s globalised world and hence a number of African countries have withdrawn from running the nation’s economic activities and have moved to a more competitive market economy where a sizeable portion of the nation’s economy is being run by the private sector.\(^{14}\)

In Zambia however SMEs have, struggled to graduate and have remained stagnant. Even after the expiry of the Poverty Reduction Strategy Paper (PRSP) (2000 – 2004) (which ran in tandem with the Transitional National Development Plan, 2002 – 2005) that placed the SMEs as one of the instruments to economic recovery, employment creation and poverty reduction, the SMEs sector has remained marginalized and poverty levels are still high.\(^{15}\) The question then remains whether we have put in place effective policies to address this problem as a country.

The Ministry of Commerce Trade and Industry (MCTI) came up with the Micro, Small and Medium Enterprise Development Policy (hereinafter referred to as the MSME Development Policy) of 2009\(^ {16}\) in order to address a number of grey areas in the growth of SMEs. The policy was aligned with the Fifth National Development Plan as well as various government policies and development initiatives that have a bearing on the development of MSMEs.\(^ {17}\) The rationale behind the MSME Development Policy of 2009 is to create a national vision and leadership for deliberate development of the MSME sector and to facilitate creation and implementation of


\(^{15}\) Chibwe, Unlocking the Potential of Zambian Micro, Small and Medium Enterprises, 2008, 8


\(^{17}\) *The Micro, Small and Medium Enterprise Development Policy*, 2009, 21
relevant and effective sector legislation and regulatory framework.\textsuperscript{18} The vision of the policy is to create a vibrant, dynamic sector that contributes 20\% of Gross Domestic Product and 30\% annually to the creation of decent employment by the year 2015.\textsuperscript{19}

The objectives of the policy include the following:

[i] To facilitate creation and development of viable MSMEs that contribute 30\% towards annual employment and 20\% towards GDP by the year 2018;
[ii] To facilitate an increase of the 10\% towards utilization and value addition of local raw materials in identified regional areas by the year 2018;
[iii] To strengthen forward linkages between MSMEs and large scale companies by facilitating an annual increase of 10\% in subcontracting of MSMEs by large scale companies,
[iv] To improve productivity in the MSME sector by 10\% by the year 2018; and
[v] To enhance local economic development thereby stimulating broad based economic growth by establishing five (5) business incubators and five (5) industrial parks in identified locations by the year 2018.\textsuperscript{20}

Notwithstanding the above policy position, Zambia has not yet effectively implemented the policy. SMEs still face the following barriers; limited access to markets\textsuperscript{21}, limited access to appropriate technology, machinery and equipment, limited access to suitable business financing solutions; and inadequate infrastructure such as roads and telecommunications facilities.\textsuperscript{22} Thus, it is imperative that the country can effectively implement the policy in order to encourage SME growth. Zambia ought to learn from countries that have implemented very effective and

\textsuperscript{18} The Micro, Small and Medium Enterprise Development Policy, 2009, 7
\textsuperscript{19} The Micro, Small and Medium Enterprise Development Policy, 2009, 7
\textsuperscript{20} The Micro, Small and Medium Enterprise Development Policy, 2009, 7 - 8
\textsuperscript{21} Richard Stern et al., Small Business Taxation: Is this the Key to Formalization? Evidence from Africa and Possible Solutions, FIAS Tax Team World Bank Group (4 September, 2007), 4
\textsuperscript{22} The Micro, Small and Medium Enterprise Development Policy, 2009, 4 - 5
successful MSME development policies such as India were MSMEs are said to contribute at least 70% of the Gross Domestic product\textsuperscript{23} and have thus contributed significantly to poverty reduction, employment, economic and social development.

Jahanshahi acknowledges the fact that the number of people employed in the SME sector has increased significantly.\textsuperscript{24} Furthermore, he notes that Micro, Small and Medium Enterprises are a critical economic factor in India. They make up a majority of the domestic business transactions and at the same time play an important role in international trade. He also notes that the manufacturing sector especially has experienced the greatest amount of growth in India.\textsuperscript{25}

The importance of the private sector and SMEs in economic development cannot be overlooked because they are the engine of every nation’s economy as they occupy a prominent position in the development of many countries in the world be it least developed, developing and developed countries.\textsuperscript{26} China which has a history of state owned enterprises has seen the rise of entrepreneur activities which account for the country’s recent good economic performance on the world market. The remarkable growth of China has been driven by various engines. The most notable is the development of the non-state sector, fuelled by the desire of millions of Chinese people to seek a better life.\textsuperscript{27} Hence, it is prudent to note that there is a strong correlation between government support, enterprise growth and economic development as shown herein.

\textsuperscript{23} The Micro, Small and Medium Enterprise Development Policy, 2009, 1
\textsuperscript{25} Jahanshahi, The Relationship between Government Policy and the Growth of Entrepreneurship in the Micro, Small & Medium Enterprises of India, 74
\textsuperscript{26} Chibwe, Unlocking the Potential of Zambian Micro, Small and Medium Enterprises, 8
\textsuperscript{27} Linda Yueh, China's Entrepreneurs, under http://www.economics.ox.ac.uk (accessed on 23th march, 2012)
3.3 INCOME TAXATION, INCENTIVE OR BARRIER TO SMALL AND MEDIUM ENTERPRISE GROWTH IN ZAMBIA

The word growth in ordinary parlance simply means the increase in the value or quantity of a particular subject matter. The establishment, growth and sustenance of any business is dependent on a number of factors which are not limited to tax policy considerations only. In order to ascertain the impact of income taxation on the growth of SMEs in the country, a number of growth performance measures were employed during the research. These measures include the rate of employment in enterprises, formalization and access to financing, use of technology and proper management of enterprises.

The growth rate of employment is based on the number of new employees that are hired or new jobs that are created by small businesses since they provide the main source of jobs and income for Africans after subsistence agriculture. The importance of SMEs in the creation of jobs was emphasized by Albaladejo who observed that through the expansion of existing firms and the creation of new start-ups, SMEs in Africa account for most of the private sector jobs available. Formalization and financing is based on whether a business is registered with the relevant authorities like Patents and Companies Registration Agency (PACRA) and whether the business is able to easily access financing with banks and other lending institutions. The use of

29 According to The Ministry of Commerce Trade and Industry, SMEs are faced with a plethora of challenges and constraints which include limited access to markets, technology, business financing but to mention a few. The Micro, Small and Medium Enterprise Development Policy, 2009, 4
32 The functions of the agency are to administer the Companies Act, the Registration of Business Names Act, the Patents Act, the Trade Marks Act, the Registered Designs Act, and the Companies (Certificates Validation) Act as per Section 5 (1) (a) of the Patents and Company Registration Agency Act NO 15 of 2010
Notwithstanding the above, MSMEs have an obligation to pay income taxation depending on whether the business is run as a sole business, partnership under the Business Name Registration setup, a limited company formed pursuant to the provisions of the Companies Act\textsuperscript{38}, or otherwise not formalised. The question that needs to be addressed is whether income taxation is an incentive or barrier to the growth of SMEs in Zambia. In order to address this question regard will be had to the provisions of the Act\textsuperscript{39}. The Act provides a number of incentives to firms that engage in specialized sectors which are designated under the Act. Paragraph 5 of the charging schedule provides the following;

5. notwithstanding the provisions of paragraphs 1 and 4-

(a) the tax chargeable on income received from a rural enterprise shall be reduced, for each of the first five charge years for which that business is carried on, by such amount as equal to one -seventh of the tax which would otherwise be chargeable on that income;
(b) the maximum rate for income received from farming shall be fifteen per centum per annum;
(c) the maximum rate of tax on that portion of income which is determined by the Commissioner-General as originating from the export of non-traditional products shall be fifteen per centum per annum;
(d) the maximum rate of tax for income received from the chemical manufacture of fertilizer shall be fifteen per centum per annum.

Paragraph 5 part (a) provides for an incentive to companies (SMEs inclusive) that are designated as rural enterprises. Rural enterprises\textsuperscript{40} are defined as any company that is either a manufacturing company or a hospitality company which meets certain conditions outlined in the relevant laws.\textsuperscript{41} SMEs that meet the above criteria enjoy the benefit of paying 6/7 of the tax rate for the first five

\textsuperscript{38} Cap 388 of the laws of Zambia
\textsuperscript{39} Cap 323 of the laws of Zambia
\textsuperscript{40} A rural area is defined as provided for under the Local Government Act, CAP 281. Misheck Table, \textit{Understanding the Tax System in Zambia}, 2008/2009, 116
\textsuperscript{41} Misheck Table, \textit{Understanding the Tax System in Zambia}, 2008/2009, 179
years. Furthermore, SMEs that are into farming enjoy the benefit of paying income tax at the rate of 15% despite meeting the threshold of ZMK 200 million. Hence, SMEs that are into farming enjoy a reduced rate of income tax of 15% instead of paying 35% company income tax. Income from non-traditional exports, chemical fertilizer manufacturing and tourism activities is also subject to a tax rate of 15%.

The income tax system is not entirely immune from barriers to the growth of SMEs. For example the income tax threshold of ZMK200 million has proved to be a barrier to the formalization of Small and Medium enterprises in the country than an incentive for their entry into the formal tax system. It has been observed that;

Small businesses complain that the threshold level for VAT registration is too high. Pitched at K200 million (US $40,000), when per capita income is only K1.75 million (US $375), is a formidable barrier for firms to enter the formal sector (defined in Zambia as a firm with a VAT registration number) and thus encourages even medium-sized firms to remain outside the tax net and avoid even the 3% turnover tax.

Thus, many businesses remain informal and avoid paying any tax at all. The informal sector cannot be ignored because most of the SMEs in Zambia are in an informal sector and hence are not captured by the Central Statistics Office therefore, their contribution and also the national GDP may somewhat be underestimated. This has in return denied government the much needed

---

43 Paragraph 5 part (b) of charging schedule
44 Paragraph 5 of charging schedule
revenue as most of the SMEs do not remit taxes. Furthermore, it has been noted that the informal sector is growing but its contribution to tax revenue has remained poor. In order to meet the ever-growing demand for social services and development there is need to extend taxation to the informal sector. This will enhance tax revenue productivity and attain equity in bearing the tax burden. Being outside the tax net prevents the bulk of Africa’s small business community, (vital for growth and innovation) from accessing formal business funding and credit schemes. Taxation is efficient if it can fuel the provision of public infrastructure for business development in exchange for formalization. For small businesses, the choice of whether or not they pay taxes (and hence whether they remain in the informal sector) is thus driven by a simple-cost benefit analysis.

In this regard the situation is exacerbated by the fact that tax compliance costs on SMEs are relatively higher compared to larger firms. According to a report based on a project called National Policies and Measures for Growing Micro and Small Enterprises in LDCs, it was observed that apart from their disadvantage of generally having a low level of education, setting up and maintaining a sophisticated system of accounts is also costly for these small entrepreneurs. By reducing tax compliance costs and thereby lowering the overall tax burden on small businesses, simplification provisions help achieve more neutral tax treatment of firms of varying sizes, implying efficiency gains, and encourages compliance with (adherence to) the tax

47 Chibwe, *Unlocking the Potential of Zambian Micro, Small and Medium Enterprises*, 9
48 Alfred Mwila et al., *A report prepared for the Jesuit Center for Theological Reflection: The Taxation System in Zambia*, (January 2011), 8
49 Mwila et al., *The Taxation System in Zambia*, (January 2011), 8
50 Mike Pfister, *Taxation For Investment And Development: An overview of policy challenges in Africa*, (2009), 13
51 UNCTAD Report on *Growing micro and small enterprises in LDCs: The “missing middle” in LDCs: why micro and small enterprises are not growing based on a project titled National Policies and Measures for Growing Micro and Small Enterprises in LDCs, funded by the Government of the Netherlands*, 78
laws of a country, including operating in the formal rather than informal (underground) economy, and full reporting of all amounts required to determine the true tax base.\textsuperscript{52}

3.4 FUTURE PROSPECTS FOR SMALL AND MEDIUM ENTERPRISE GROWTH IN ZAMBIA

The future prospects for SME growth in Zambia are bright as long as the government continues to make an effort to achieve the policy objectives under the MSME Development policy. This should be coupled with other measures that seek to counter the various challenges that small business enterprises face especially those in the informal sector.\textsuperscript{53} Thus, there is need for example to enhance the taxation of small enterprises in order to encourage their formalization because a key component of a capable state is the existence of an efficient and effective tax administration. A solid taxation system also encourages good governance.\textsuperscript{54}

3.5 CONCLUSION

The chapter has made an attempt to discuss the legal and policy framework of income taxation and SME development in Zambia. The Chapter also gave a review of the MSME Development Policy of 2009 and noted that income taxation is more of a barrier to SME growth in Zambia because the majority of small businesses have remained informal so as to avoid paying the 3% turnover tax. It was also noted that Zambia needs to learn from countries like India that have implemented successful SME development policies. Finally, the Chapter looked at the future

\textsuperscript{52} SME Tax Compliance and Simplification Background note prepared by the OECD Centre for Tax Policy and Administration for a Roundtable Discussion at the 1st Meeting of the Working Group on Taxation of the SEE Investment Committee, 3.

\textsuperscript{53} Such as limited business financing, technology, equipment and machinery but to mention a few.

\textsuperscript{54} Mike Pfister, Taxation for Investment and Development: An overview of policy challenges in Africa, Ministerial Meeting and Expert Roundtable of the NEPAD-OECD Africa Investment Initiative, (11-12 November, 2009), 14
prospects for SME growth in Zambia and noted that the situation can only improve when there is proper implementation of the MSME Development Policy of 2009 and the current tax policy is reviewed. The next chapter looks at the regional and international analysis of income tax legislation as well as the lessons that Zambia can learn in order to spur the growth of SMEs.
CHAPTER FOUR

4.0 COMPARATIVE ANALYSIS OF THE LEGAL AND POLICY FRAMEWORK OF INCOME TAXATION AND SMALL AND MEDIUM ENTERPRISE DEVELOPMENT: A REGIONAL AND INTERNATIONAL PERSPECTIVE

4.1 INTRODUCTION

This Chapter gives a comparative analysis of the legal and policy framework of income taxation and Small and Medium Enterprise development from a regional and international perspective and how this affects the legal and policy framework of income taxation and SME development in Zambia. In the analysis of the legal and policy framework of income taxation and Small and Medium Enterprise development from the regional and international perspective we shall address the role of the Common Market for Eastern and Southern Africa (hereinafter referred to as COMESA) and look at the systems that different countries have put in place in the taxation of Small and Medium enterprises.

To begin with it is trite to note that as the world continuously becomes a global village, Zambia is also being increasingly influenced by the regional and international aspects of trade, investment and taxation. The increased influence is largely because the country is a member of a number of regional and international blocs or organisations such as COMESA, Southern African Development Community (SADC) and the United Nations (UN) which deal in matters of social-economic and political development but to mention a few. It was noted in the previous chapter that the impact of income tax on the growth of SMEs in Zambia is that it has been more of a barrier than an incentive because of the fact that many small businesses are informal and have chosen to remain so. This situation presents a serious hurdle in the formulation and
implementation of any meaningful policy on Small and Medium Enterprise development in the Country. Richard Stern notes that finding an “optimal tax regime” for small businesses is challenging from both the standpoint of the revenue authority and the taxpayer in any type of country.\textsuperscript{1} From a design perspective, it is particularly difficult in developing countries due to the character of small firms and the economic environment.\textsuperscript{2}

He attributes the difficult in designing an optimal tax regime for small businesses because the majority of economic output in most Sub-Saharan African countries is produced by the informal sector (in which firms operate under the tax radar); thus the tax base is constantly shifting. He also notes that small firms perceive the tax system as incurring large time and financial cost and thus do not see any incentive to join the tax net even if they could. Small firms face an ‘inverse economies of scale’ impact of paperwork and procedures required for tax authorities.\textsuperscript{3}

Furthermore, he notes that;

Many small firms in developing countries lack the capacity and training to be able to undertake monitoring for tax compliance. Owners and operators of small businesses are more likely to be poorly educated and therefore do not have the accounts and records necessary for many tax systems.\textsuperscript{4}

Finally, from the perspective of revenue authorities, small businesses generate a disproportionately low amount of revenue, relative to large enterprises. He also notes that given both the number of firms and the difficulty in finding them, it is not perceived as cost effective to monitor small enterprises especially given limited resources to administer the standard tax

\begin{footnotesize}
\begin{itemize}
\item[3] The underlying causes of informality are numerous and range from a conscious decision to avoid detection through registration in order to avoid paying tax, to the lack of information on how to register or what advantages are gained by formalizing. Richard, \textit{Designing a Small Business Tax System that Enhances Growth: Lessons from Africa}, 3.
\end{itemize}
\end{footnotesize}
system. In light of the aforementioned we shall now analyse the role of COMESA in income taxation and Small and Medium Enterprise development and how this affects the legal and policy framework of income taxation and Small and Medium Enterprise development in Zambia.

4.1.2 The role of the Common Market for Eastern and Southern Africa in Income Taxation and Small and Medium Enterprise Development

COMESA was founded in 1994 as a successor to the Preferential Trade Area (PTA) for Eastern and Southern Africa, which was established in 1981. COMESA (as defined by its Treaty) was established as an organisation of free independent sovereign states which have agreed to cooperate in developing their natural and human resources for the good of all their people and as such it has a wide-ranging series of objectives which necessarily include in its priorities the promotion of peace and security in the region. However, due to COMESA's economic history and background its main focus is on the formation of a large economic and trading unit that is capable of overcoming some of the barriers that are faced by individual states in trade and investment by creating an enabling environment and legal framework which encourages the growth of the private sector, the establishment of a secure investment environment, and the adoption of common sets of standards.

6 COMESA, History of COMESA, under http://www.comesa.int (accessed on 10th April, 2012)
7 COMESA, History of COMESA, under http://www.comesa.int (accessed on 10th April, 2012)
8 COMESA, History of COMESA, under http://www.comesa.int (accessed on 10th April, 2012)
COMESA seeks to foster trade liberalisation and Customs co-operation in the region. The net effect of the foregoing on member states of the COMESA union is trade creation. COMESA also aims at improving the administration of transport and communications to ease the movement of goods, services and people among the member states. COMESA also aims at creating an enabling environment and legal framework which encourages the growth of the private sector (SME sector inclusive), the establishment of a secure investment environment, and the adoption of common sets of standards. Furthermore, COMESA seeks to harmonise macro-economic and monetary policies throughout the region.

COMESA recognises the fact that SMEs are the backbone of industrialisation, and make up a large part of Africa’s largely informal economy and have some of the most enterprising and innovative entrepreneurs. Hence, COMESA helps member states in formulating and implementing income taxation and Small and Medium Enterprise Development policies through institutions like the COMESA Regional Investment Agency which aims to achieve sustainable economic and social progress in all Member States.

This is done through increased co-operation and integration in all fields of development, particularly in trade, customs and monetary affairs; transport, communication and information; technology, industry and energy; gender, agriculture, environment and natural resources.

---


Therefore, member states of COMESA have agreed to adhere to principles such as inter-State co-operation, harmonisation of policies and integration of programmes among the member States.\textsuperscript{14} It is trite to note that COMESA ensures that SMEs are effectively and efficiently taxed so as to encourage their growth by creating equilibrium between income taxation and SME development.

\textbf{4.2 THE REGIONAL AND INTERNATIONAL ANALYSIS OF TAXATION OF SMALL AND MEDIUM ENTERPRISES}

Different countries across the world use various methods to tax SMEs. However, there are two sets of decisions to be made in designing any tax regime for SMEs which include a partitioning of the set of taxpayers into groups for distinct treatment, generally by the use of thresholds specified in terms of some notion of size; and determining what form of special tax regime—if any—should be applied to each of size categories of taxpayer thus identified.\textsuperscript{15} It has been observed that the aforementioned decisions need to be made, it should be stressed, in respect of each of the taxes levied under the ‘normal’ regime on larger taxpayers, most notably the VAT, income tax (corporate and personal) on owners of the enterprise and the withholding from employees’ wages of income tax and social contributions.\textsuperscript{16}

\textsuperscript{14} ACTRAV, \textit{Priorities and Objectives according to the Treaty}, under \url{http://actray.ilo.org/actray-english/teleavour/global/ilo/blokit/comesa.htm} (accessed on 10\textsuperscript{th} April, 2012)

\textsuperscript{15} Background paper for the International Tax Dialogue Conference, \textit{Taxation of Small and Medium Enterprises}, Buenos Aires (October 2007), 21

\textsuperscript{16} International Tax Dialogue Conference, \textit{Taxation of Small and Medium Enterprises}, Buenos Aires (October 2007), 21
In the taxation of Small and Medium Enterprises many countries across the globe use special regimes. For example a number of countries in Latin America\(^{17}\) and Sub-Saharan Africa\(^{18}\) use special regimes (presumptive regimes) based on a standard rate of tax on monthly turnover or based on some other criteria such as physical area, electricity bills, number of employees, or the number of vehicles as the main qualification.\(^{19}\) Furthermore, the main argument for using special regimes based on turnover is that it seeks to simplify the tax regime for Small and Medium enterprises. It has been noted that turnover is almost universally used as a qualification criteria, with the special regime generally linked explicitly to the VAT threshold.\(^{20}\)

For example in Zambia small firms are not registered in the general tax system and therefore are not liable to VAT and corporate income tax; instead small businesses are liable to pay a blanket 3% turnover tax. This scheme was designed to simplify the tax rules for small businesses in order to increase compliance and encouraging business to acquire enough scale to take advantage of the benefits of graduating to the formal sector.\(^{21}\)

Furthermore, the purpose of any tax regime is one which creates equilibrium between formalization, the cost of compliance and revenue collection. For example Mike Pfister notes that African policymakers are challenged by the need to balance the following imperatives;

---

17 Latin American countries have adopted a wide range of simplified regimes for SMEs. Of 17 countries, 14 have adopted some type of simplified taxation (Argentina, Bolivia, Brazil, Colombia, Costa Rica, Chile, Dominican Republic, Ecuador, Mexico, Nicaragua, Honduras, Paraguay, Peru, and Uruguay). Exceptions are El Salvador, Panama and Venezuela. ITDC, *Taxation of Small and Medium Enterprises*, 27

18 25 out of 44 countries in the region for which data are available have special regimes for smaller enterprises (Benin, Burkina Faso, Burundi, Cameroon, Central African Republic, Chad, Comoros, Republic of Congo, Côte d’Ivoire, Gabon, Guinea, Kenya, Liberia, Mali, Mauritania, Niger, Rwanda, Senegal, Sierra Leone, Tanzania, Togo, Uganda, and Zambia). ITDC, *Taxation of Small and Medium Enterprises*, 27


(a) mobilising domestic resources and broadening the tax base to secure steady revenue streams for development financing and to diversify the revenue sources, especially in a context of tariff liberalisation that impacts strongly on tax revenue; (b) fighting tax evasion, spurred by tax havens, regulatory weaknesses, and some corporate practices; (c) improving the investment climate for enterprise development, largely shaped by the tax regime; and (d) promoting good governance, underpinned by effective taxation that promotes the accountability of governments to citizens and the investment community.\textsuperscript{22}

Thus, a country’s tax code for Small and Medium Enterprise development from the regional and international perspective postulates that taxation should not be used as an undue hindrance to the growth of Small and Medium Enterprises but should balance the aforementioned imperatives. For example, President Obama has noted that;

America’s small businesses face a tax code that is unduly complex. Often, these firms—unlike large businesses—are not engaged in complex transactions, and yet they must spend significant time and resources trying to comply with the tax code. Small businesses are disproportionately burdened with tax compliance, and the cost of this burden is substantial.\textsuperscript{23}

The president also noted that the high compliance cost for small businesses is a drag on innovation and entrepreneurship. He notes that the large outlays for tax preparer’s means that small business owners have less capital to reinvest in their companies. The large amount of time spent on recordkeeping and understanding tax provisions means that small business owners have less time and energy for innovation and business development. There are other costs to complexity as well. Frustration with the tax code may eventually lead to weakened compliance

\textsuperscript{22} Mike Pfister, \textit{Taxation For Investment And Development: An overview of policy challenges in Africa}, Ministerial Meeting and Expert Roundtable of the NEPAD-OECD Africa Investment Initiative (11-12 November, 2009), 8

\textsuperscript{23} The President’s Framework For Business Tax Reform, A Joint Report by The White House and the Department of the Treasury (February 2012), 16
and a higher gap between tax revenue owed and tax revenue paid. Moreover, complexity weakens the ability of tax policy to achieve its intended purpose.\textsuperscript{24}

Another important consideration to the legal and policy framework for the taxation of SMEs from the regional and international perspective is the prevention of double taxation of income derived by SMEs. Double taxation is defined by the UN Model Tax Convention as the imposition of similar taxes in two or more States on the same tax payer in respect of the same base. Double taxation is defined in the OECD Model as the imposition of comparable taxes in two (or more) States on the same tax payer in respect of the same subject-matter and for identical periods.\textsuperscript{25} The question is how does double taxation occur? The answer is that income tax is generally levied by a country on (1) the domestic and foreign income of its residents and (2) the domestic income of non residents. The foregoing rules are basically referred to as the residence and source principles of taxation.\textsuperscript{26}

The manner in which the aforementioned rules are applied by a country may result in double taxation or double non taxation of the income that is earned by a person (natural or juristic) in its jurisdiction or outside its jurisdiction. In this regard international taxation seeks to prevent double taxation or double non taxation of income that is to say one country may seek to tax without reference to tax levied in another country, or no country may tax (usually on the assumption that another country is taxing, although often it will be the result of the increased

\textsuperscript{24} The President's Framework For Business Tax Reform, (February 2012), 16
\textsuperscript{25} Asif Quresh, and A.R. Ziegler, International Economic law 2nd ed. (London: Sweet and Maxwell2007), 458
\textsuperscript{26} Victor Thuronyi, ed. Tax Law Design and Drafting Volume 2 (Washington D.C: IMF External Relations Department, Publication Services, 1998), 721
opportunities for tax planning or tax cheating on the part of the tax payer that international transactions offer).²⁷

It should be noted that double taxation is likely to act as a barrier to international transactions, and nations of the world are generally agreed on the desirability of removing such barriers as a means of increasing global welfare.²⁸ By similar reasoning double non taxation of international transactions will create a bias in favour of international over domestic transactions, leading to a loss of global (and national) welfare, not to mention tax revenue.²⁹ For tax policy makers at the regional and international forum, it is essential to strike the right balance between designing an attractive tax regime for investment and growth, and securing the necessary revenues for public spending. Tax policy is central to domestic resource mobilisation. When transparently and effectively designed and implemented, it provides an essential financial platform for sustainable development.

4.3 LESSONS FROM THE REGIONAL AND INTERNATIONAL COMMUNITY ON SMALL AND MEDIUM ENTERPRISE TAXATION AND DEVELOPMENT

It should be noted that the regional and international organisations have shaped and are continuingly shaping the way in which the country administers and implements income tax legislation. This is because the country has acceded to a number of international conventions and has signed double taxation treaties with at least 21 countries to avoid double taxation of

companies operating in other countries as well as Zambia.\textsuperscript{30} It should also be noted that in the development of a country’s tax laws, the international dimension plays an increasingly important role that significantly restricts the rules that might be adopted if regard were had to only domestic considerations.\textsuperscript{31}

Thus, in designing and drafting income tax laws in the country there is a need for the domestic laws to be continuously framed in a manner that takes into consideration rules of international practice such as those that are aimed at preventing double taxation or double non taxation of income and those that aim to address income characterization and timing rules but to mention a few. However, it should be borne in mind that the international challenge for taxation is the development of a system that does not act as an undue impediment to international transactions while protecting the revenue of each state.\textsuperscript{32} Hence, Zambia should continue to transform her tax system in a manner which reflects the regional and international aspirations and common purpose of organizations such as COMESA. This is because although Zambia is a sovereign state, and should assert this truth in regional and global trade, Zambia is, however, not an autarky.

Furthermore, the international best practice suggests that any special tax regime for small enterprises should offer reduced compliance costs and a reduction in the actual tax burden. This reduction in the actual tax burden is intended both to compensate, to some extent, for the particular difficulties that this sector faces in accessing capital and to act as an inducement to

\begin{flushright}

\textsuperscript{31} Thuronyi, V ed. \textit{Tax Law Design and Drafting Volume 2} (Washington D.C: IMF External Relations Department, Publication Services, 1998), 720

\textsuperscript{32} Thuronyi, V ed. \textit{Tax Law Design and Drafting Volume 2}, 1998,720
\end{flushright}
enter the formal sector. The main point behind small firms paying a blanket three per cent turnover tax was designed to simplify the tax rules for small businesses in order to increase compliance and encourage businesses to increase in order to take advantage of the benefits of graduating to the formal sector. The country should continue to simplify the tax system to encourage more businesses to register with the tax authorities however caution must be borne in mind so as not to create a too generous system that risks creating a system where collection and compliance costs exceed the amount of tax collected.

According to Richard Stern based on a study conducted by the World Bank in South Africa, Zambia, and Rwanda, the Zambian Small Business Taxation is the most business-unfriendly regime of the three countries studied. He notes that first, it is completely inflexible, in that it does not allow firms under the relatively high turnover threshold enter the general tax net under any circumstances. Furthermore, he notes that the turnover tax for small businesses is presumptive, which means that even new firms must pay a part of their estimated tax burden up front, even before sales.

He also notes that, this restriction, combined with a relatively high tax burden borne by small businesses because of the flat tax with no deductions places a high financial burden on firms in this system. In addition, even if a small firm participates in the Small Business Taxation, it is not considered tax registered (only those with a VAT number are) and thus does not have access to benefits such as government tenders and secured lending. Finally, given resource and “mandate”

34 Langmead, Tax Policy Issues in Zambia, 2006, 56
constraints, the ZRA does not engage in education and outreach activities to reduce the number of non-registered small business operators.36

4.4 CONCLUSION

In conclusion, this chapter has made an attempt to analyse the regional and international aspects of income taxation and Small and Medium Enterprise development. It was noted that organisations like COMESA help countries in the formulation and harmonisation of their legal and policy framework of income taxation and SME development. The chapter also looked at the lessons that Zambia can learn from the regional and international Community on taxation of Small and Medium Enterprises and it was noted that the tax system in the country needs to be reviewed so that it is more business friendly in order to encourage the growth of Small and Medium Enterprises. The next Chapter will give the conclusions and general recommendations of the research.

CHAPTER FIVE

5.0 CONCLUSIONS AND RECOMMENDATIONS

5.1 INTRODUCTION

This paper has made an attempt to evaluate the impact of income taxation on the growth of SMEs in Zambia. The main objective of the study was to establish the effectiveness of the current tax policy on SME growth in Zambia and it was established that income taxation been more of a barrier than an incentive to SME growth in the country. The first Chapter gave an introduction and general outline of the research. It was observed in the Chapter that the growth of SMEs has been impeded by the informality of the majority of enterprises in the country. Furthermore, it was also observed that the growth of SMEs in Zambia has also been impeded by social, economic and political factors such as poverty, the lack of political will on the part of the government, low income per capita but to mention a few.

The second Chapter gave a historical background to the development and relationship between income tax legislation and SME operations and regulation in Zambia. The Chapter established that the history of income tax legislation and SME operations and regulation in Zambia dates back to the colonial era. It was also observed in Chapter two that the colonial authorities were responsible for the introduction of income taxation in Northern Rhodesia. Insofar as SME activities are concerned it was noted that Europeans owned and operated most of the businesses in Northern Rhodesia even up to the time of independence. However, it was noted that after independence the government of Dr. Kaunda put in place measures to develop the small business
sector so as to empower the locals and that subsequent regimes continued to review the legal and policy framework of SME development in the country.

The third chapter focused on the legal and policy framework of income taxation and SME development in Zambia. The Chapter also gave a review of the Micro, Small and Medium Enterprise Development Policy of 2009 and also discussed whether income taxation is an incentive or barrier to SME growth in Zambia. It was noted that the legal and policy framework of income taxation and SME development in Zambia needs to be reviewed or strengthened in order to encourage the growth of the small business sector in Zambia. Henceforth it was concluded that the government needs to put in place measures to create a more conducive business environment to encourage entrepreneurship in Zambia.

The fourth Chapter gave a comparative analysis of the legal and policy framework of income taxation and SME development from a regional and global perspective. The Chapter also looked at the lessons that Zambia can learn from the regional and international community in order to spur the growth of SMEs. The foregoing Chapter sought to give a regional and global perspective of income taxation and SME development and how this influences domestic legislation and policy formulation and implementation in Zambia. It was noted that organizations like COMESA help member countries like Zambia to formulate and harmonise their income taxation and SME development policies with those of the other member countries in the COMESA region. It was concluded that in designing and enacting domestic legislation the country needs to take the regional and international aspects of income taxation and SME development into account in order to development the SME sector in Zambia.
5.2 GENERAL CONCLUSIONS

The focus of this paper has been to evaluate the impact of income taxation on the growth of SMEs in Zambia. A general conclusion that can be drawn from this paper is that the imposition of income taxation on SMEs in Zambia has been more of a barrier than an incentive to their growth. This is because the majority of small business enterprises in the country are informal and as a result this has denied the government the much needed revenue from the small business sector for social and economic development. Therefore, there is need for the government to review the income tax laws and policy framework so as to create a balance between the equitable contribution of the private sector (SME sector) to the national treasury and SME formalization. This is because the private sector is the cornerstone of the free-market economic system which the country has been implementing since 1991.

The paper also revealed that initially there was little entrepreneurship activity during the colonial era and the early years after attaining independence especially among the indigenous Zambians. However, it was shown that most of the businesses were in control of Europeans. Furthermore, it was established that even after independence there was no special legal regime promoting SME development as the country depended on mining copper only and the public sector was more viable then. The research also revealed that it was only after the 1970’s and thereafter that the government of Dr. Kaunda made serious attempts to enhance the small business sector by creating specific institutions and enacting the Small Industries Development (SID) Act which established the Small Industries Development Organisation (SIDO). The research also revealed that the successive governments after Dr. Kaunda continued the commitment to enhance SME
development by continuously reviewing the legislative and policy framework of SME development.

The paper also discussed the current legal and policy framework of income taxation and small and medium enterprise development in Zambia. It was stated the Ministry of Finance and National Planning formulates tax policy and the Zambia Revenue Authority implements the said policy. It was also stated that the Ministry of Commerce, Trade and Industry formulates small business enterprise development policy and the Zambia Development Agency has the mandate to operationalise the said policy. A review was also given of the Micro, Small and Medium Enterprise Development policy of 2009 and it was stated that SME growth can only be enhanced if the country effectively implemented the policy and also looked to countries that have effectively implemented MSME development policies like India as acknowledged by the authorities cited in the paper.

Attention was also drawn to the fact the SMEs have an obligation to pay income taxes and the tax system provides that those businesses that make annual income of less than ZMK200 million have an obligation to pay turnover tax at the rate of 3%. However, it was noted that despite this many businesses have remained informal and avoid even paying the 3% turnover tax. The research also revealed that the threshold of ZMK 200 million is too high and has proven to be a hindrance to the formalization of SMEs in Zambia.

The paper also revealed that although the small business sector in Zambia has great potential for economic development, equitable wealth redistribution and poverty alleviation, it faces many
business challenges as established by the Ministry of Commerce, Trade and Industry Survey Report of 2003 and 2004 which include the following; limited access to markets, limited access to appropriate technology, machinery and equipment, limited access to suitable business financing solutions and inadequate business infrastructure such as roads and telecommunication facilities. Furthermore the sector also faces the following constraints; limited technical and management skills, inadequate and unsuitable operating premises that facilitate enterprise growth, inadequate regulatory systems and excessive competition from unregulated importation of cheap products. There is need for these challenges and constraints to be addressed.

The paper also revealed that although Zambia is an independent and sovereign state, the country is increasingly influenced by the regional and international aspects of trade, investment and taxation. In this respect the paper analysed the role of COMESA in the legal and policy formulation of income taxation and SME development and how this affects domestic legislation and policy formulation on SME development. It was stated that there is always need for domestic legislation of each state to take into account the regional and international aspects of trade, investment and taxation in framing any policy on the taxation and development of SMEs. It was stated that the factors that need to be taken into account when framing income tax policy and drafting legislation are the high informality of enterprises, compliance costs and double taxation or double non taxation of income.

5.3 RECOMMENDATIONS
Having discussed the impact of income taxation on the growth of small and medium enterprises in Zambia we shall now recommend the measures that can be put in place to spur the growth of SMEs in Zambia.
5.3.1 Creating a culture of compliance

It is recommended that the objectives of the small business tax regime in Zambia should create a culture of compliance and increase incentives for business formalization through the simplification of the tax system. The UK\(^1\) has recently announced measures to simplify the tax regime for small business enterprises. The UK has acknowledged and appreciated the fact that Small businesses make a vital contribution to the UK economy, both in terms of employment and growth.\(^2\) The purpose of this development is to create the most competitive tax system in the G20, and make the UK the best place in Europe to start, finance and grow a business. The aim behind the UK reforms is for SMEs to find tax easier to understand, and become more confident that they know what they need to do, when and how; and for it to be simpler and quicker for them to do what they need to do (register, keep records, file, pay), with greater certainty and accuracy.\(^3\)

5.3.2 Improving the capacity of Small enterprises to comply with the tax system

It is recommended that there is need to improve the capacity of small entrepreneurs to comply with the requirements of the tax system by providing or encouraging education and training and to promote economic growth through small business development. Thirdly, it is also recommended that the government should recognise and prioritise the role and contribution of the small business sector to the national economy. This will lead to the loosening of the tax system so as to encourage more SMEs to formalise. There should be a proper balance between taxation and formalisation as well as tax compliance costs. Hence the Ministry of Finance and National Planning should work in closer liaison with the Ministry of Commerce Trade and

\(^1\)HM Revenue and Customs, *Making tax easier, quicker and simpler for small business*, (March 2012), 2
\(^2\)HMRC, *Making tax easier, quicker and simpler for small business*, (March 2012), 2
\(^3\)HMRC, *Making tax easier, quicker and simpler for small business*, (March 2012), 2
Industry in order to formulate policies that create equilibrium between SME taxation and SME development in order to achieve the most appropriate results.

5.3.3 Creating a more conducive environment to do business

It is recommended that the government should take more effective steps to deal with the many market failures and imperfections that hinder SMEs from competing effectively with large-scale enterprises and imports from other countries. It is also recommended that the government should continue to work with the small business community, and their representatives (institutions like Zambia Chamber for Small and Medium Business Associations-ZCSMBA), in order to make any meaningful reforms that can positively impact the development of SMEs in Zambia.

5.3.4 Review of the MSME Development Policy

It is recommended that there is need to review or strengthen the Micro, Small and Medium Enterprise Development policy of 2009 as a matter of urgency in order to adequately address the regulatory as well as non-tax barriers to SME growth in Zambia. This will stimulate sustainable economic growth of the sector and will facilitate competition, cooperation and collaboration among MSMEs.

5.3.5 Holistic audit of the laws relating to small business taxation and development

It is recommended that the government should take a holistic audit of all pieces of legislation necessary to effectively regulate the MSME sector and synchronise and streamline them with the Zambia Development Agency Act No 11 of 2006.
5.3.6 Promote small business development in urban and rural areas

It is recommended that the government should not only promote SME growth in the urban areas alone but should encourage SME growth in the rural areas as well. This can be achieved through the strengthening of the functions of the Citizens Economic Empowerment Commission as well as the provision of other forms of loans and business grants. This will provide vital start-up capital for low income groups in society.

5.4 CONCLUSION

In conclusion, it is trite to note that SMEs have the potential to contribute to the socio-economic transformation and development of the country. This can only be possible if they are provided with an enabling environment through an appropriate legal and policy framework. The government needs to continuously play an active role in income tax policy formulation and implementation and this should include the participation of other key stakeholders. Furthermore, the aim of income tax policy should be to encourage more small business enterprises to formalise so as to contribute equitably to the national economy. The policy formulation and implementation of Income taxation and SME development in the country should be in line with regional and international aspects of trade, investment and taxation. This therefore calls for appropriate measures to be put in place, to ensure that small business enterprises are effectively and efficiently taxed.
BIBLIOGRAPHY

BOOKS


Table, Misheck Understanding the Tax System in Zambia. 2008/2009


ARTICLES

Alfred Mwila et al., A report prepared for the Jesuit Center for Theological Reflection: *The Taxation System in Zambia*, (January 2011)


Banda, R. *Taxation Law in Zambia*, School of Law Obligatory Essay, 1988

COMESA Regional Investment Agency, *COMESA Tax Guide 2009*


HM Revenue and Customs, *Making tax easier, quicker and simpler for small business*, (March 2012),


SME Tax Compliance and Simplification Background note prepared by the OECD Centre for Tax Policy and Administration for a Roundtable Discussion at the 1st Meeting of the Working Group on Taxation of the SEE Investment Committee.


The President’s Framework for Business Tax Reform, A Joint Report by The White House and the Department of the Treasury (February 2012)


UNCTAD Report on Growing micro and small enterprises in LDC’s the “missing middle” in LDCs: why micro and small enterprises are not growing

Zambia Revenue Authority, Domestic Taxes Division Practice Note No. 1/2011

POLICIES


WEBSITES


Linda Yueh, China’s Entrepreneurs, under http://www.economics.ox.ac.uk (accessed on 13th March, 2012)

COMESA, History of COMESA, under www.comesa.int (accessed on 10th April, 2012)
Godfrey Chitalu, *How to effectively tax SMEs*, under [www.daily-mail.co.zm](http://www.daily-mail.co.zm) (accessed on 23rd March, 2012)

