

Lab of Tomorrow

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Challenge: Improvement of collection of revenues for Zambia from small and medium enterprises (SME)

Background paper: Taxation and SMEs in Zambia

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List of Abbreviations

CIT	Company Income Tax
GRZ	Government of the Republic of Zambia
LTO	Large Taxpayer Office
MOF	Ministry of Finance
MSME	Micro, Small and Medium Enterprises
MTO	Medium Taxpayer Office
PAYE	Pay As You Earn
PIT	Personal Income Tax
SME	Small and Medium-sized Enterprises
STO	Small Taxpayer Office
VAT	Value Added Tax
ZBS	Zambian Business Service
ZMK	Zambian Kwacha
ZRA	Zambia Revenue Agency

1. Zambia - Country Profile

Overview

The Republic of Zambia gained its independence in 1964 after decades of colonial rule by the British. The country is located in Southern Africa and borders Angola, the Democratic Republic of Congo, Tanzania, Malawi, Mozambique, Zimbabwe, Botswana and Namibia. It covers an area of 752,618 sq km.

Population

Zambia has a population of approximately 15 million people and is said to have over 70 different languages, while almost 33 % of the population speak Bemba. Almost half of the population are aged below 0 and 14 years old while only 5 % are older than 55 years old. In 2015 nearly 40% of the population was urbanized. More than 60% live beyond the poverty line.

Economy

Zambia has had one of the world's fastest growing economies for the past ten years, with real GDP growth averaging roughly 6.7% per annum. Privatization of government-owned copper mines in the 1990s increased copper mining output and profitability, spurring economic growth. Copper output increased steadily from 2004, due to higher copper prices and foreign investment, but weakened in 2014 when Zambia was overtaken by the Democratic Republic of Congo as Africa's largest copper producer. Despite strong economic growth and its status as a lower middle-income country, widespread and extreme rural poverty and high unemployment levels remain significant problems, made worse by a high birth rate, a relatively high HIV/AIDS burden, and by market-distorting agricultural policies.

2. The Tax System

The Zambian tax system broadly comprises income taxes (which include Company Income Tax (CIT), Pay As You Earn (PAYE) and Personal Income Tax (PIT)), Property transfer tax, Value Added Tax (VAT) and Customs and Excise taxes. These taxes are collected by the Zambia Revenue Authority (ZRA) which is the corporate body mandated to collect all taxes. The table below gives the broad tax categories in Zambia, the laws underpinning tax collections and the types of taxes under each category.

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Table 1: Tax Category, Legal framework and Tax type

Tax category	Tax Law	Type of tax
Income taxes	<ul style="list-style-type: none"> ➤ The Income Tax Act, Chapter 323 of the Laws of Zambia • Subsidiary Legislation - 	<ul style="list-style-type: none"> • CIT • PIT • PAYE • Withholding tax • Mineral royalty • Presumptive Tax • Turnover Tax • Base Tax
Value Added Tax	<ul style="list-style-type: none"> ➤ Value Added Tax Act, Chapter 331 of the Laws of Zambia • Subsidiary Legislation <ul style="list-style-type: none"> - The VAT (General) Regulations - The Commissioner General's Rules 	<ul style="list-style-type: none"> • Import Value Added Tax • Domestic VAT
Property taxes	<ul style="list-style-type: none"> ➤ Property Transfer Tax, Cap 340 of the Laws of Zambia • Subsidiary Legislation <ul style="list-style-type: none"> - Property Transfer Tax (Exemption) Order 	<ul style="list-style-type: none"> • Property Transfer Tax
Customs, Excise and other duties	<ul style="list-style-type: none"> ➤ Customs and Excise Act • Subsidiary Legislation <ul style="list-style-type: none"> - Customs and Excise (General) Regulations - Commissioner General Rules 	<ul style="list-style-type: none"> - Customs duty - Excise Duty • Export duty - Carbon Emission Surtax

Source: ZRA

For tax types and applicable rates, see Annex I

From a macroeconomic perspective, tax policy in Zambia has been comparably effective at raising revenues, as measured by tax/GDP ratios. Tax revenue in Zambia is the biggest source of budget financing and accounts for about 70% of the total budget. The 18 percent tax/GDP ratio, which had been maintained throughout the first decade of the new millennium, had since declined to 15%. Currently, the ratio is showing an increasing trend again. VAT, which is taxation on every value added to a taxable service or product and thus provides the government's second largest source of tax revenue after income taxes, was a central component of the tax reform process unveiled in the early 1990s and became operational in 1995 through the Value added tax act. **Generally, 70% of the VAT revenues comes from 1% of the enterprises while only 5-10% of the revenue comes from 90% of the SMEs.** According to estimates, SMEs generate up to between 40 – 60% of GDP in Zambia. (ZBS, 2010).

2.1. Formal and Informal Sector

What constitutes the formal and informal sector depends on the stakeholder employing the terms and is therefore subject to different contextual definitions.

According to the ZRA the informal sector consists of businesses not registered with government authorities, businesses operating at subsistence level, suppliers to the final consumers, and small and medium-sized enterprises (SME). Further characteristics include the predominant reliance on cash as the medium of exchange and a lack of accounting records and poor bookkeeping.

As of 2005, 88% of the labor force was employed in the informal sector compared to 74% in 1991. Despite the rapid growth of the informal sector, its tax contributions to the GRZ (Government of the Republic of Zambia) has been insignificant.

2.2. Small and Medium-sized Enterprises

In a political context, SMEs are broadly understood as synonymous with the informal sector in Zambia. Along these lines, all business entities outside the large, tax-paying enterprises are described as SMEs regardless of revenue scale or other perimeters. In this sense, SMEs usually have a workforce of less than 10 employees and that 52% of all SMEs business activities are based in rural areas. Within the MSME sector, manufacturing activities account for 41% while trading account for 49%. Services accounted for only 10%. Due to this broad, unspecific yet commonly used definition, SMEs also include the many small and micro businesses remaining under the poverty line despite their operations. Consequently, the debate about expanding the SME tax base is often conflated with the social/political conflict of (extreme) poverty and therefore often portrayed as counterintuitive to efforts of poverty reduction.

2.3. ZRA definition of SME

From an administrative point of view, however, SMEs can be delineated through size of business turnover. The Zambian Business Survey (ZBS) defines an SME as a firm with 50 employees or less. The ZRA defines as small any taxpayer with a turnover of less than ZMK 200 million per annum (1 US Dollar being approximately equal to ZMK 10,000) and a medium taxpayer as one with an annual turnover of between ZMK 200 million and ZMK 20 billion. **Only medium businesses are subjected to the normal income tax regime.** (The Citizen Empowerment Commission, Commercial Banks and other stakeholders use their own, deviating definitions.)

Following the definition by the ZRA, the following facts about SMEs in Zambia hold:

- According to ZBS, there are 2.94 million SMEs in Zambia, with the majority operating in agriculture; Other common sectors among SMEs include wholesale and retail, manufacturing, hotels and lodges, catering and food.
- The distribution of SMEs by sector is highly skewed, with about 72.6% of all firms having only one employee
- The Transport sector has many SMEs as well but the share of firms with one employee is surprisingly low in this sector, with a relatively high proportion of firms having 2 to 6 employees.

3. Institutions

The Government and Ministry of Finance

Zambia is a presidential representative democratic republic with Edgar Lungu elected as president in 2015. Commissioner General who is appointed by the President, is the chief executive of the ZRA, and is responsible for the execution of functions as directed by the Board. Key institutions involved in tax policy formulation are commonly the policy analysis department in the Ministry of Finance (MOF).

The Zambia Revenue Agency

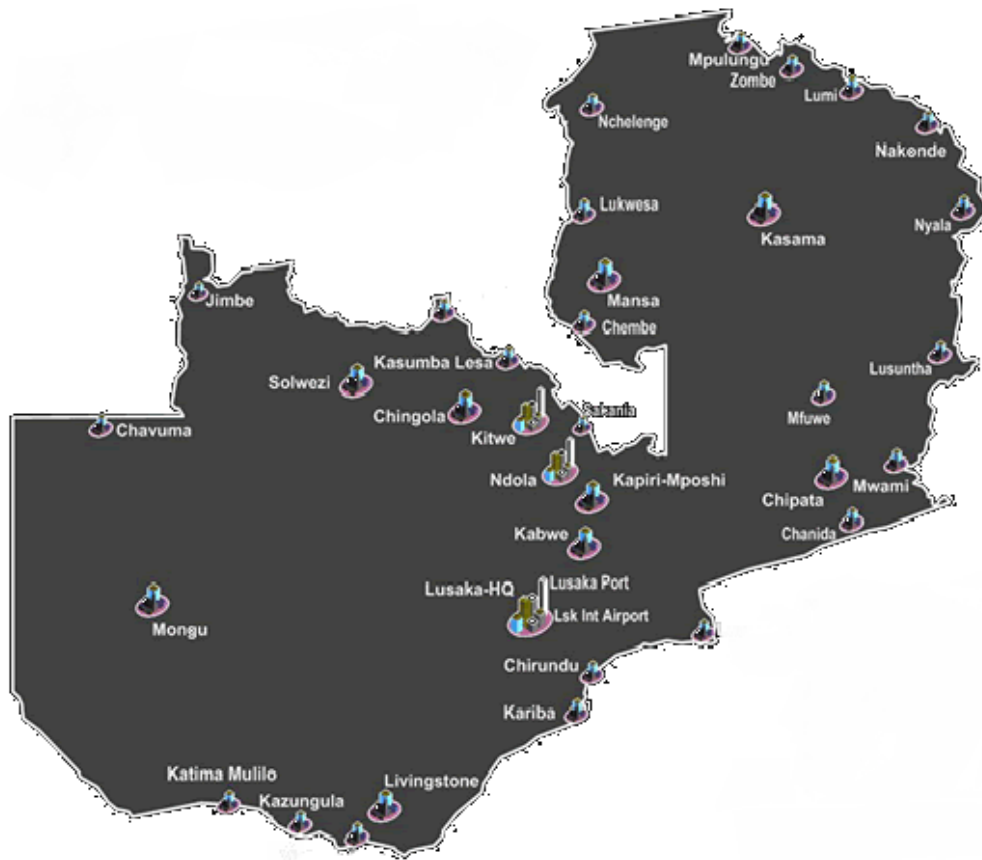
Established in 1994, the official mission statement of the Zambia Revenue Agency is “To maximize and sustain revenue collections through the integrated, efficient, cost effective and transparent systems, professionally managed to meet expectations of all stakeholders” (ZRA, 2010b).

The ZRA is represented through 11 domestic tax offices and 24 customs offices in 35 of the 72 districts of Zambia.

Approaches adopted by the ZRA to improve efficacy and equity and to expand the tax base include:

- Invigilation of randomly selected VAT registered cash traders
- Introduction of legislation on use of cash registers and invoicing
- Establishment of cash audit teams to enforce the use of cash registers
- Obtaining supply chain information of predominantly cash based businesses
- Introduction of Presumptive Tax on minibuses (2003), and Turnover Tax (2004) and Advance Income Tax (2007) to address the problems of the cost of becoming formalized and tax compliance for small businesses operating in the informal sector.
- Contracting third parties to collect presumptive taxes and base tax from small traders.
- Introduction of a call center facility accessible to taxpayers.
- Working to increase payment points and options.
- Post 2008: segmentation of administration to focus on taxpayers instead of tax types:
 - Large taxpayer Office (LTO),
 - Medium Taxpayer Office (MTO) responsible for businesses with an annual turnover between ZMK 200million and ZMK 20billion
 - Small Taxpayer Office (STO) responsible for businesses with an annual turnover smaller than ZMK 200 million,
 - Design and Monitoring (D&M – HQ)

Figure 1: ZRA Operational Stations



4. Challenges in the informal/SME sector

Infrastructural and Operational Challenges

- High level of cash transactions and related 'poor' record keeping.
- Poor tax literacy due to lack of tax education/information and lack of general literacy.
- Linguistic diversity of Zambia (about 70 dialects in Zambia – about seven major ones)
- Wide geographical distribution of SMEs and varying levels of infrastructure development (banking services, e-filing and e-payment etc).
- 10 districts out 72 still unbanked.
- ZRA offices in 35 districts out 72 districts
- ZRA only has 1380 staff members; staff available for every 1000 citizens is 0.095.
- Payment methods
- Discrepancy between tax deductions stated by the SME and respective tax collection stated by the ZRA.
- Unfavorable ratio of revenue to tax administration costs compared to large firms.

- Large taxpayer office (LTO) Revenue Contribution 75 – 80% (Staff: 36)
- Medium Taxpayer Office (MTO) Revenue Contribution 18-23% (Staff: 113)
- Small Taxpayer Office (STO) Revenue Contribution 2% (Staff: 155)
- Poor coordination between the central and local government levels leads to an increasing number of local taxes, which are difficult for taxpayers to understand.
- Rate of medium-sized businesses voluntarily registering for VAT is very low
- Cost of compliance is usually higher amongst SMEs
- The separation between personal activities and business is not clear as most SMEs are unincorporated sole traders. This sector is also mostly unbanked.
- Tax evasion collusions and cartels are common among SMEs making third party checks unreliable and facilitating suppression of purchases.
- Only 50% of surveyed businesses report having a computer, only 46% have internet access -> SMEs have limited abilities to use e-resources for communication, payment systems etc. provided by ZRA. (ZRA Taxpayers Perception Survey Report, 2015)
- Perception challenges
 - Low perception of the ‘benefits of paying tax’ among SMEs. In addition, most ‘tax incentives’ appear to favour the LTOs and Multi-national Investors
 - Most small firms are perceived as ‘de-facto exempt’ from taxation arising from widespread non-compliance.
 - Non-uniform recognition that SME taxation promotes equity in taxation (strong public demand from persons in formal employment, unions, NGOs, Members of Parliament) on Government to broaden tax base. Opposition by small businesses)
 - Majority of SMEs does not perceive non-filing and non-tax payment as an offense
 - Majority of SMEs deem accessibility of ZRA Information as insufficient

Annex I - Tax Types and Applicable Rates

Tax Types	Definition	Applicable Rates
Company Income Tax	<ul style="list-style-type: none"> ❖ A tax on all incorporated businesses on their profits from businesses. ❖ Company tax applies on companies whose turnover is above ZMW800, 000 per annum. 	<ul style="list-style-type: none"> • Companies generally - 35% • Charitable organizations - 15% • Farming - 15% • Non – traditional exports - 15% • Manufacture of fertilizer - 15% • Mobile telecommunication Sector First ZMW250,00 Profit - 35% , Above ZMW250,000 Profit -40%
PAYE	<ul style="list-style-type: none"> ❖ PAYE is tax charged on income from employment. ❖ Income from Employment includes: Salaries and wages; Overtime and bonuses, Gratuities and allowances, cash benefits and commissions. ❖ All cash benefits paid in form of allowances are taxable under PAYE, such, as education, housing and utility. ❖ However, the following Benefits are not subjected to PAYE: Labour day awards, Ex-Gratis Payments, Medical Expenses; and Funeral Expenses. 	Income Bands(Monthly) & applicable Rates 0 – K3,000 - 0% K3,001 - K3,800 - 25% K3,801 - K5,900 - 30% Above K5,900 - 35%
Self Employed Individual (SEI) tax	<ul style="list-style-type: none"> ❖ Tax is paid for annual turnover above ZMW 800,000 and is charged under the PAYE rates. ❖ For annual turnover below ZMW 800,000, tax paid is at 3% of turnover. 	<ul style="list-style-type: none"> • PAYE rates apply for annual turnover above ZMW 800,000. • Tax paid is at 3% of turnover for turnover below ZMW 800,000.
Withholding Tax	<ul style="list-style-type: none"> ❖ Is tax collected at source from some payments like dividends, interest, rent, commissions, management and consultancy fees. 	Category and Rate <ul style="list-style-type: none"> • Dividends(final tax) - 15% • Interest (Companies) - 15% • Interest(Individual) - final tax 25% • Rent final tax - 10%

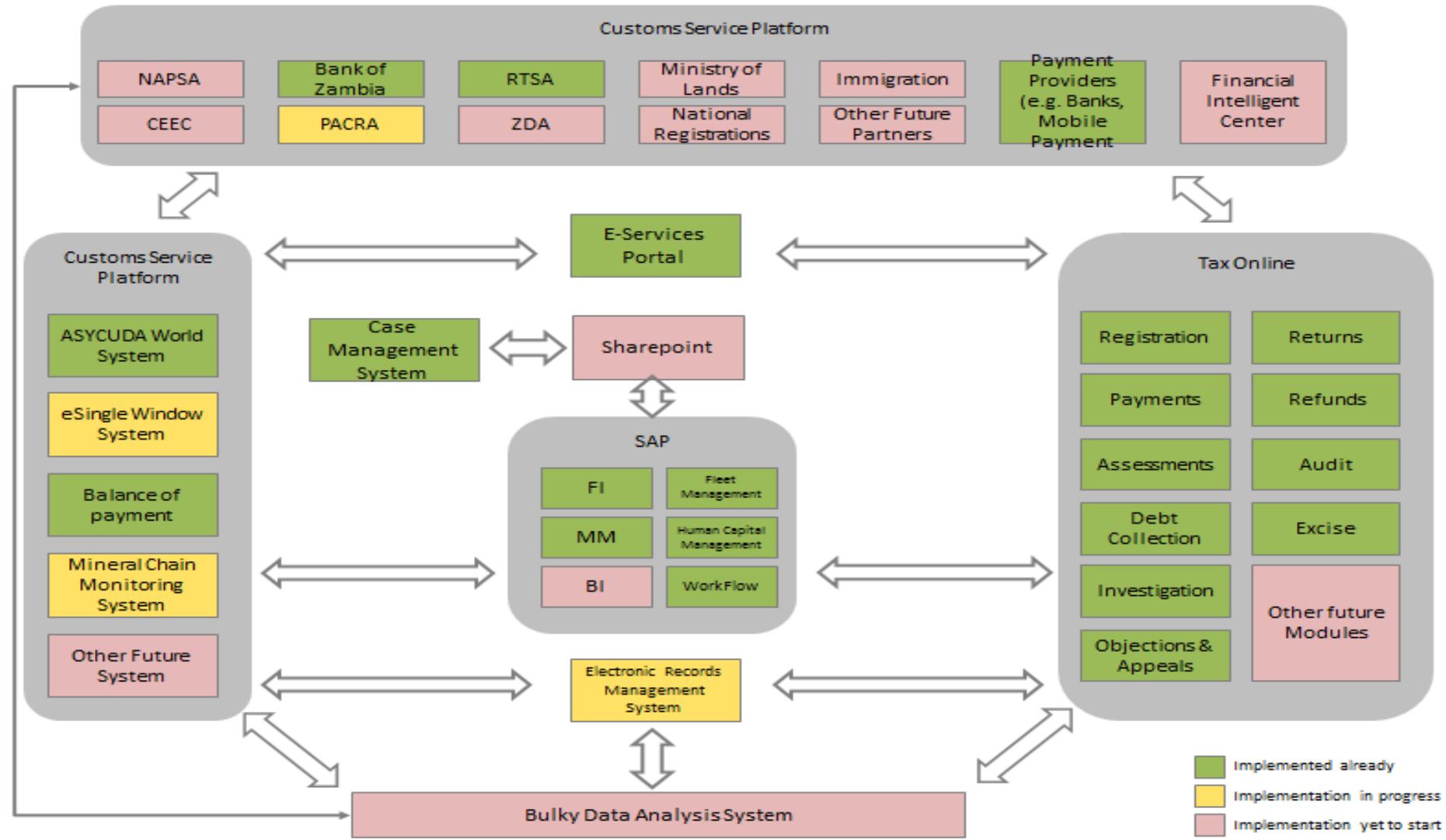
		<ul style="list-style-type: none"> • Commissions - 15% • Management & Consultancy fees - 15%
Mineral Royalty	<ul style="list-style-type: none"> ❖ Mineral royalty is the compensation to the government for extracting minerals from the earth. ❖ Mineral royalty on base metals and precious metals is based on norm value. ❖ Norm Value means the monthly average London Metal Exchange (LME) Cash price per metric ton multiplied by the quantity of the metal or recoverable metal sold. ❖ Mineral royalty rate of energy minerals, industrial minerals and gemstones is calculated on gross value. ❖ Gross value means the realized price for a sale free on board, at the point of export from Zambia or point of delivery within Zambia 	<ul style="list-style-type: none"> • The mineral royalty rate for base metals is at 6% • The rate for precious metals is at 6% • The rate for industrial minerals is at 6% • The rate for gemstones is at 6% • The rate for energy minerals is at 6%
Property Transfer Tax	<ul style="list-style-type: none"> ❖ Tax levied on transfer of land and buildings and is paid by the seller. It is also paid on transfer of shares. ❖ Where a person transfers property to a member of his immediate family, the transfer will be treated as a gift and transfers will go at nil value. No property tax will be paid. Immediate family means a spouse, child adopted child or stepchild. ❖ Exempt Organizations from the tax include: The Government; Foreign Governments; Approved International organizations; Political Parties; Cooperative societies; Local authorities; Registered Trade Union Clubs or societies; and approved pension funds or Medical aid societies. ❖ Other exemptions include transactions as a result of a sale or other disposal of any stock or share listed on Lusaka Stock Exchange. 	<ul style="list-style-type: none"> • Tax rate is at 10% of the Realizable value. • Realizable value is price at the time of transfer, at which it could be reasonably sold on open market.

Presumptive Tax	<ul style="list-style-type: none"> ❖ A predetermined amount is paid by the individual public Transport operators. ❖ It applies to Individual Minibus and Taxi Operators 	<ul style="list-style-type: none"> • Rates range from ZMW 600 per annum for a less than 12-seater bus to ZMW 7,200 per annum for a 64-seater and above
Turnover Tax	<ul style="list-style-type: none"> ❖ Tax on businesses for both companies and individuals whose turnover is below ZMW 800,000 per annum 	<ul style="list-style-type: none"> • Applicable tax rate is 3% of the turnover.
Advance Income Tax (AIT)	<ul style="list-style-type: none"> ❖ This is the tax charged on importers that are either not registered with ZRA or are registered but are not compliant. 	<ul style="list-style-type: none"> • The tax is computed at 6% of Value for Duty Purposes (VDP) but is not a final tax.
Base Tax	<ul style="list-style-type: none"> ❖ Base Tax is a tax on small businesses and marketers that are difficult to assess. 	The current amount of base tax is ZMW 150.00 per annum
Customs Duty	<ul style="list-style-type: none"> ❖ This is a tax levied on all goods imported into the country. Duties are based on the CIF (cost, insurance and freight) value. 	Category & Rate <ul style="list-style-type: none"> • Raw materials - 0% • Capital goods - 5% • Intermediate - 15% • Finished goods - 25%
Excise Duty	<ul style="list-style-type: none"> ❖ Taxation on a range of selected products whether produced locally or imported, determined by government policy 	Product (some examples) Rate <ul style="list-style-type: none"> • Petroleum Products (7% - 36%) • Wines and Spirits - 125% • Motor Vehicles (5% - 30%) • Perfumes and Body lotions - 25% • Clear Beer (35% - 75%) • Talk time and mineral water - 10%
Export Duties	<ul style="list-style-type: none"> ❖ This is a duty charged on specific exported goods. This duty is meant to encourage further processing of locally produced goods and is charged on Copper concentrates, Scrap Metal and Cotton seed. 	Product & Rate <ul style="list-style-type: none"> • Copper concentrates at - 15% • Scrap Metal at 15% - 25% • Cotton seed - 15%
Carbon Emission	<ul style="list-style-type: none"> ❖ This is a tax charged on motor vehicles based on the engine capacity. 	Engine Capacity in CC <ul style="list-style-type: none"> • 1500 and below, ZMW 50.00 • 1501 – 2000, ZMW 100.00

Surtax (CES)		• 2001 – 3000, ZMW150.00
VAT	<ul style="list-style-type: none"> ❖ This is taxation on every value added to a taxable service or product. The tax is borne by the consumer. For VAT purposes, sale or disposal of goods or rendering of services is called supplies. ❖ Taxable supplies are taxed at either 16% (standard rate) or 0% (zero-rated). Zero-rated supplies include Exports, Energy Saving appliances, Equipment and machinery, medical supplies and schoolbooks. ❖ Exempt supplies are items specifically excluded by law from liability to VAT, (i.e., no VAT is charged) even if supplied by a registered business. For example, educational services from Nursery to secondary school are exempt, therefore, a primary school will not register for VAT and will not claim any input tax. 	Taxable Supplies are taxed either at 16% for standard rated supplies or 0% for Zero rated supplies

Source: JCTR Report on “Taxation System in Zambia” by Wisdom Nhekairo, Former Commissioner General - ZRA

ANNEX II - ZRA IT Systems



Annex III - ZRA IT Systems Glossary/ Q+A

- How does the registration of companies look like? Which systems are involved? With which systems does the tax-payer get in touch while paying his taxes? (frontend)
 - The Tax-payers get in touch with Asycuda World & TaxOnline
 - For the process of interactions with taxonline there is a manual
- [Can businesses pay taxes by themselves over internet?](#)
 - Yes they can process their taxes online and pay through online banking
- **E-Payment**
 - middleware platform for tax payments for **TaxOnline** and **ASYCUDA World System**
- **CEEC**
 - The Coalition for Eco-Efficient Commintion (CEEC) has been established and is supported by a broad range of mining sector companies keen to accelerate awareness, knowledge transfer and, by implication, improve energy and cost outcomes in the substantive area of commintion.
- **NAPSA**
 - NAPSA was formed to provide income security against the risk arising from retirement (old age), death and invariability with a focus on adequacy of benefits and monthly receipt of pension in a better way than the repealed ZNPF. This is achieved trough the payment of different kinds of benefits to its
- **ZDA** = Zambia Development Agency
- **PACRA** = Patents and Companies Registration Agency
 - The registration of companies is done through this agency and not through the ZRA
- **RTSA** = Road, Tranpsort and Safety Agency
- **eSingle Window System**
 - The single-window system is a [trade facilitation](#) idea. As such, the implementation of a single window system enables international (cross-border) traders to submit regulatory documents at a single location and/or single entity. Such documents are typically customs declarations, applications for import/export permits, and other supporting documents such as certificates of origin and trading invoices.
 - The main value proposition for having a single window for a country or economy is to increase the efficiency through time and cost savings for traders in their dealings with government authorities for obtaining the relevant clearance and permit(s) for moving cargoes across national or economic borders. In a traditional pre-single-window environment, traders may have had to contend with visits and dealings with multiple government agencies in multiple locations to obtain the necessary papers, permits, and clearances to complete their import or export processes.

- **ASYCUDA World System**

- a web based collaborative system for trade facilitation
- The Automated System for Customs Data is a [computerized](#) system designed by the [United Nations Conference on Trade and Development](#) (UNCTAD) to administer a country's customs. In 2004 there were more than 50 operational projects with expenditures exceeding US\$7 million. It is the largest [technical cooperation](#) programme of the UNCTAD, covering over 80 countries and 4 regional projects.
- UNCTAD's aim was to build a computer system to assist customs authorities (or their local equivalents) all over the world to automate and control their core processes and obtain timely, accurate and valuable information to support government projections and planning.

- **TaxOnline:**

- TCS (TATA) has a framework which is customized according to the requirements for a given country
- e-Services like e-Registration, e>Returns, e-Amendment, e-Communication, e-Payment and also other e-Services for Motor Vehicle Registration, Driving Permit, Stamp Duty
- News, updates, circulars and notifications
- 'search' functionality
- Tracking the status of various applications on-line
- Logging in using digital certificate
- Using virtual keyboard for entering passwords
- FAQs, Query posting and replying
- subscribe/view RSS feeds

- **Case Management**

- a system for managing staff integrity related matters

- **Electronic Record Management System**

- An Electronic Document and Records Management System (EDRM) is a computer program (or set of programs) used to track and store records. The term is distinguished from imaging and document management systems that specialize in paper capture and document management respectively. ERM systems commonly provide specialized security and auditing functionality tailored to the needs of records managers.

- **Cargo Transit Monitoring system** – a web based system for monitoring the movement of cargo to reduce transit fraud
- **SharePoint** (under development) – to manage the intranet and process workflows that are currently manual
- **Mineral Value Chain** – an integrated platform for monitoring mineral related transactions

Further Comments:

- There is no asylum for companies who did not pay taxes in the past and voluntarily admit their misbehaviour to the ZRA
- Companies have to be registered and when they do so, they receive a certificate which has to be displayed visible at their office