# REPORT OF THE COMMITTEE ON ESTIMATES FOR THE FIFTH SESSION OF THE TENTH NATIONAL ASSEMBLY APPOINTED ON 23<sup>RD</sup> SEPTEMBER, 2010

### Consisting of:

Mr H H Hamududu, MP; Mr E M Hachipuka, MP; Mr G Lubinda, MP; Mr C L Milupi, MP; Mrs S T Masebo, MP; Mr J L P Mulenga, MP; Mr P Sichamba, MP; Mr L Ngoma, MP and Mr E M Sing'ombe, MP.

The Honourable Mr Speaker National Assembly Parliament Buildings LUSAKA

Sir,

Your Committee has the honour to present its report on its deliberations for the year 2011.

#### **Functions of the Committee**

- 2.0 The functions of your Committee are as follows:
- (a) to examine the Estimates and Excess Expenditure Appropriation Bill;
- (b) to report on the economies, improvement in organisation, efficiency or administrative reform, consistent with the policy underlying the estimates, examine whether the money is well laid out within the limits of the policy implied in the estimates;
- (c) to suggest alternative policies in order to bring about efficiency and economy in administration:
- (d) to carry out regular examination and scrutiny on budgets, estimates and management thereof, and conduct budget hearings; and
- (e) to make recommendations in a report to the House for consideration and implementation in future budget estimates.

### Meetings and Programme of Work of your Committee

3.0 Your Committee held ten meetings during the period under review.

In line with its programmes of work, your Committee considered Zambia's tax system and the review of Governments' budgetary performance for the 2010 fiscal year.

#### **Report of your Committee**

4.0 The Report is in four parts. Part I deals with Zambia's tax system while Part II provides the review of the second and third quarter of the 2010 budget. Part III details the findings arising from a Foreign Tour and Part IV is the Conclusion.

#### **PART I**

#### ZAMBIA'S TAX SYSTEM

5.0 Your Committee was concerned that the bigger portion of Zambia's domestic taxes continued to be Pay As You Earn (PAYE). For example, in the 2011 budget, PAYE was expected to account for twenty-four percent of the domestic tax revenue while company tax only accounted for nine percent. This meant that only a few Zambians in the formal sector are paying taxes while much of the informal sector continues to be excluded. Further, corporate tax contributions normally paid by large Multi-national Companies (MNCs) continued to be lower than PAYE. Furthermore, Multinational Companies enjoy generous incentives which erode the tax base.

According to the Zambia Business Survey (ZBS) of June 2010, conducted by the Government in collaboration with the World Bank, 88 percent of the workers in Zambia are in the informal sector while the remaining 12 percent are in the formal sector. With the exclusion of the informal sector from the tax net, only 12 percent of the total workforce would bear the 24 percent of the domestic revenue of the 2011 budget.

In this respect, your Committee resolved to study in detail, Zambia's tax system. The objectives of the study are as follows:

- (a) to appreciate Zambia's tax structure;
- (b) ascertain the effectiveness of Zambia's tax system;
- (c) investigate the challenges of tax administration in Zambia; and
- (d) recommend possible measures to improve tax administration in Zambia.

In order to gather enough information on this subject, written memoranda and oral submissions were sought from the Zambia Business Forum (ZBF); Jesuit Centre for Theological Reflection (JCTR); Caritas Zambia; Zambia Association of Chambers of Commerce and Industry (ZACCI); Chambers of Mines of Zambia (CMZ); Zambia Association of Manufactures (ZAM); Zambia Institute of Chartered Accountants (ZICA); Zambia Revenue Authority (ZRA); and the Ministry of Finance and National Planning (MOFNP). The summary of the findings of your Committee is set out below.

#### Zambia's Tax Structure

5.1 The structure of the tax system in Zambia has been demonstrated by using cumulative data for the period 2003 to 2010 (Table 1).

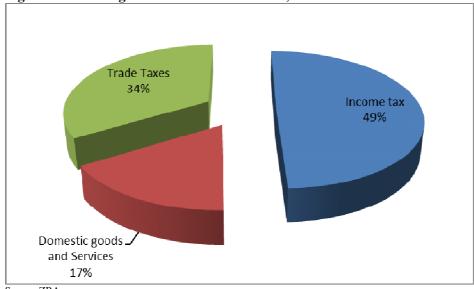
**Table 1: Structure of the Taxes in Zambia** 

	CUMULATIVE ACTUAL OUTTURN (2003-	CUMULATIVE	
TAX TYPE	2010)	TARGET (2003-2010)	VARIANCE
	K' billion	K' billion	K' billion
TAX REVENUE	60,603.9	58,605.7	1,998.2
Income Tax	30,019.4	26,771.5	3,247.9
Company tax	8,270.5	6,355.0	1,915.5
PAYE	17,796.6	16,635.8	1,160.8
WHT	2,889.4	3,174.1	(284.7)
Extraction Royalty	1,062.9	606.6	456.3
<b>Domestic Goods and Services</b>	10,103.4	11,354.1	(1,250.7)
Excise Duties	7,677.1	8,295.6	(618.5)
Domestic VAT	2,426.3	3,058.5	(632.2)
Trade Taxes	20,481.1	20,480.1	1.0
VAT imports	13,458.1	13,207.8	250.3
Import Tariffs	6,799.0	6,941.9	(142.9)
Export duty	224.0	330.4	(106.4)

Source: ZRA

In terms of contribution to the total revenue, your Committee was informed that income taxes (Company tax, PAYE, withholding taxes and mineral royalty) have been the highest contributors at 49 percent followed by trade taxes which contributed 34 percent while taxes on domestic goods and services contributed 17 percent. (See Figure 1)

Figure 1: Percentage of Contribution of Taxes, 2003 to 2010



Source: ZRA

#### Effectiveness of Zambia's Tax System

5.2 Your Committee was informed that the key objective of Zambia's tax system is to raise adequate revenues to fund public expenditure. Public expenditure includes spending on the social sectors such as health, education, infrastructure, social protection and agriculture. Therefore, the effectiveness of Zambia's tax system should be measured in relation to the extent to which it provides resources to meet these obligations. In this regard, the ratios set out hereunder provide a good measure of the extent to which Zambia's taxes provide adequate resources to meet the needs of the country:

# (a) Total Revenue Collection Against Total Expenditure

Your Committee was informed that the share of the tax revenues to total expenditures gives the extent to which the tax system is able to generate resources for public expenditure. It measures the adequacy of own revenue sources for the Government and the level of dependency on other sources. Table 2 below highlights the ratio of total tax revenue to actual expenditure by the Government from 2005 to 2009.

**Table 2: Revenue to Expenditure Ratio** 

Year	2005	2006	2007	2008	2009
Total tax Revenue	5,522,000	6,329,000	8,164,000	9,670,000	9,660,000
Total expenditure	7,268,854	7,729,459	9,798,711	12,348,786	13,872,822
Revenue/Expenditure	76.0%	81.9%	83.3%	78.3%	69.6%

Source: Ministry of Finance and National Planning

Table 2 explains that between 2005 and 2007, the ratio of the total tax revenue to expenditure increased from 76 percent to 83 percent. This means that the Government was increasingly using more of its local resources to finance its programmes. However, the trend changed as the ratio declined in 2008. This was mainly attributed to the impact of the global economic crisis, resulting in the fall in import volumes thereby affecting the performance of the tax system. With the rebound in the world economy, the forecast for 2011, shows that taxes will contribute more resources to the Government revenue.

# (b) Tax Revenue as a Ratio of GDP

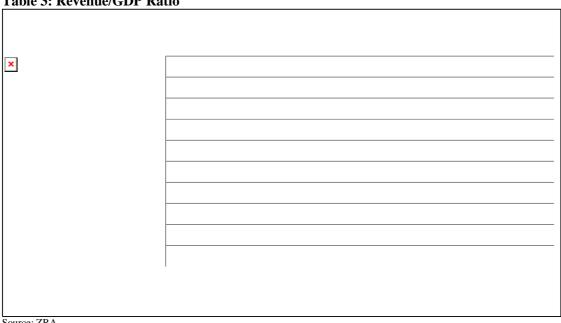
Your Committee was informed that the ratio of tax revenue to GDP shows the proportionate increase in the Government revenues to economic growth. Ideally, tax revenue is supposed to increase with the growth in the economy. In Zambia, tax revenue as a share of GDP increased from an average of 13 percent before the reforms of 1992, to an average of 17 percent during the post reform period.

Table 3 below shows that tax revenue to GDP ratio has fallen from a high of 18.6 percent in 2001, to about 15 percent in 2009. The fall in the ratio in 2009 was mainly attributed to the impact of the lagged effects of the global financial crisis which depressed demand for consumption of goods and services.

Apart from the years 2006 and 2009, the performance of the Tax-to-GDP ratio had been very strong. This ratio compares favorably with several African countries such as, Ghana (16.3 percent), Kenya (18.2 percent), Malawi (16.9 percent), Tanzania (12.4 percent), Uganda (12.6 percent) and Ethiopia (13.1 percent). It was argued that though the Tax-to-

GDP ratio compares favorably with other countries in the region, the economy had potential to sustain a much higher ratio of about 20 percent.

Table 3: Revenue/GDP Ratio



Source: ZRA

#### (c) Cost-to-Collection Ratio

The cost to collection ratio shows the cost associated with the collection of Government revenues. One of the canons of taxation is that it must be cost effective, that is, it must cost less to collect the taxes than the tax revenue. In this regard, table 4 highlights the extent to which it costs to collect tax in Zambia.

**Table 4: Cost to Revenue Ratio** 

Year	Releases	Collections	Cost-to-collection ratio
1 ear	K' bn	K' bn	Cost-to-conection ratio
2005	127	5,522	2.30%
2006	<b>06</b> 132 6,329		2.09%
2007	197	8,164	2.41%
2008	210.7	9,670	2.18%
2009	210.9	9,660	2.18%

Source: Ministry of Finance and National Planning

From the table 4 above, it can be deduced that the cost of collecting revenue as a percentage of tax revenues collected between 2005 and 2009, averaged 2.23 percent. This is above the average cost for countries in the Organisation for Economic Cooperation and Development (OECD) of 0.98 percent and slightly above non-OECD countries which is around 1.46 percent as of 2007. This explains that Zambia's tax system is not in keeping with this important tenet of a good tax system.

#### **Mining Taxation in Relation to High Metal Prices**

5.3 Your Committee is alert to the debate on the windfall tax on mining activities in view of the high metal prices on the international market. It is also aware that the Government has refused to restore the windfall tax despite repeated appeals by various stakeholders including your Committee to do so. Nonetheless, your Committee was encouraged to note that most of the mining companies enjoying various tax exemptions would be in the tax paying position earlier than projected as a result of high copper prices.

## Challenges Associated with Zambia's Tax System

5.4 The issues set out below were identified as challenges associated with Zambia's tax system.

### (a) Taxation of the Informal Sector

Your Committee was informed that taxation of the growing informal sector has remained a major challenge. In-spite of the effort made in taxpayer identification and registration activities throughout the years, many potential taxpayers still remain outside the tax net.

# (b) Taxpayer Compliance

Tax compliance was another challenge to the successful operation of the revenue system in Zambia. It was noted that some taxpayers find keeping books of accounts challenging and this adversely impacted on the collection of taxes.

# (c) Taxation of International Transactions

As the world becomes more globalised and technologically advanced, the Government through Zambia Revenue Authority (ZRA) continued to face the challenges of auditing computerised accounts, international transactions of multinational companies, taxation of services and electronic commercial transactions.

# (d) Lack of Major Reforms

Zambia's tax system has not undergone major reforms in a long time, except for additional forms taxes. This makes the whole tax system complex and lags behind the new developments in the economy.

### (e) Management of Tax Arrears and Traceability of Taxpayers

The accumulation of tax arrears is also a challenge for the Authority. Tax arrears have created an unpleasant impact on tax administration by distorting the revenue potential and collection capacities.

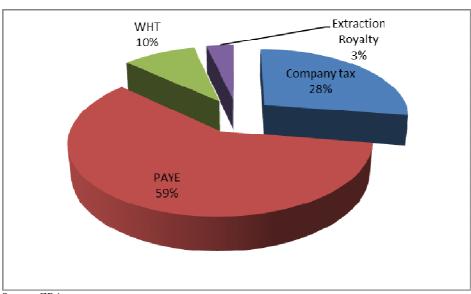
# (f) Smuggling and Tax Evasion

Zambia has long and porous borders making it easy to smuggle goods thereby undermining the revenue base. In addition, tax evasion tendencies such as non-issuance of invoices by most traders also undermines domestic revenue base. This situation is exacerbated by the existence of a huge cash economy which makes it difficult to maintain an accurate audit trail.

# (g) Narrow Tax Base

Zambia's taxes are excessively high with much of the burden being borne by a small tax base. This explains why the domestic tax revenue has continued to be skewed towards PAYE. The analysis of the cumulative data from 2003 to 2010, indicates that PAYE contributed 59 percent of total income tax while company tax was only 28 percent, withholding tax 10 percent and mineral royalty 3 percent. (See Figure 2)

Figure 2: Contribution of PAYE, Company Tax, Royalty and WHT to Income Tax, 2003 to 2010



Source: ZRA

### Spot Visit to ZRA Main Offices in Lusaka and Mwami Border in Chipata

5.5 In order to appreciate the situation on the ground with regard to the operations of the Zambia Revenue Authority (ZRA), your Committee undertook a spot check to the ZRA main offices in Lusaka and Mwami border in Chipata.

With regard to the tour of ZRA offices in Lusaka, your Committee was informed that since inception in 1994, the Zambia Revenue Authority has always exceeded the revenue targets except for the years 2006 and 2009, when the authority failed to meet the target by K296.9 billion and K531.2 billion, respectively. (See table 5). The positive performance for most of the years was largely attributed to the reform process in the Authority.

Table 5: Revenue Collection against Targets (1994 To 2011) in K' Billions

YEAR	TARGET	ACTUAL OUTTURN	VARIANCE			
1994 381		421	40			
1995	506	551	45			
1996	676	725	49			
1997	887	954	67			
1998	1,089	1,090	1			
1999	1,267	1,290	23			
2000	1,600	1,739	139			
2001	2,325	2,449	124			
2002	2,818	2,849	31			
2003	3,445	3,549	104			
2004	4,498	4,554	56			
2005	5,512	5,522	10			
2006	6,627	6,330	(297)			
2007	7,814	8,194	380			
2008	9,133	9,666	533			
2009	10,191	9,660	(531)			
2010 11,385		13,126	1,741			
2011 15,230		15,472	242			

Source: ZRA

Your Committee was informed that the under-performance in 2006, was attributed to lower collection of taxes during the period when INDENI Refinery was not operational, while in 2009 it was mainly because of the impact of the global financial crisis.

With regard to the tour of Mwami border, your Committee noted that the effective collection of taxes at the border did not only depend on the Zambia Revenue Authority, but a concerted effort of various government departments. Your Committee, therefore, commends the officers from various Government departments for their commitment to duty despite working under challenging conditions.

Below: MPs with officers at Mwami Border					
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