



BRIEF ON DOMESTIC RESOURCE MOBILISATION: THE CASE OF VALUE ADDED TAX

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1. INTRODUCTION

Domestic Resource Mobilisation (DRM) is crucial to addressing Zambia's economic and social challenges, fostering sustainable growth and enhancing fiscal resilience. The Government is committed to strengthening DRM through robust fiscal policies, with a particular focus on tax reforms. Enhancing DRM is essential for financing national priorities, reducing dependence on external borrowing, and improving fiscal stability. This brief focuses on DRM with a specific focus on Value Added Tax (VAT) administration highlighting key challenges and success in its implementation.

2. MEASURES TO ENHANCE DOMESTIC MOBILISATION

The Government is implementing various measures to enhance domestic revenue collection in the medium term. Below are notable measures to enhance resource mobilisation.

- 1) **Indexing Excise Duties** – Adjusting specific excise duties on selected goods such as fuel, alcohol and tobacco and tobacco products to maintain their revenue value amid inflation.
- 2) **Smart Invoicing System** – Continuing the implementation of the system (launched on April 1, 2024) to improve tax invoice monitoring and verification.
- 3) **VAT Registration Review** – Assessing the VAT registration threshold and promoting voluntary registration to reduce compliance costs for small businesses.
- 4) **Tax Expenditure Framework** – Evaluating tax incentives to ensure they are well-targeted and aligned with government policy. Tax expenditures encompass any deviation from the standard rate or baseline regime with the aim to stimulate economic growth by encouraging investment in¹ key sectors, attracting both domestic and foreign investment, promoting social equity and supporting emerging industries.

¹Tax Expenditure Report for the 2023 Fiscal Year

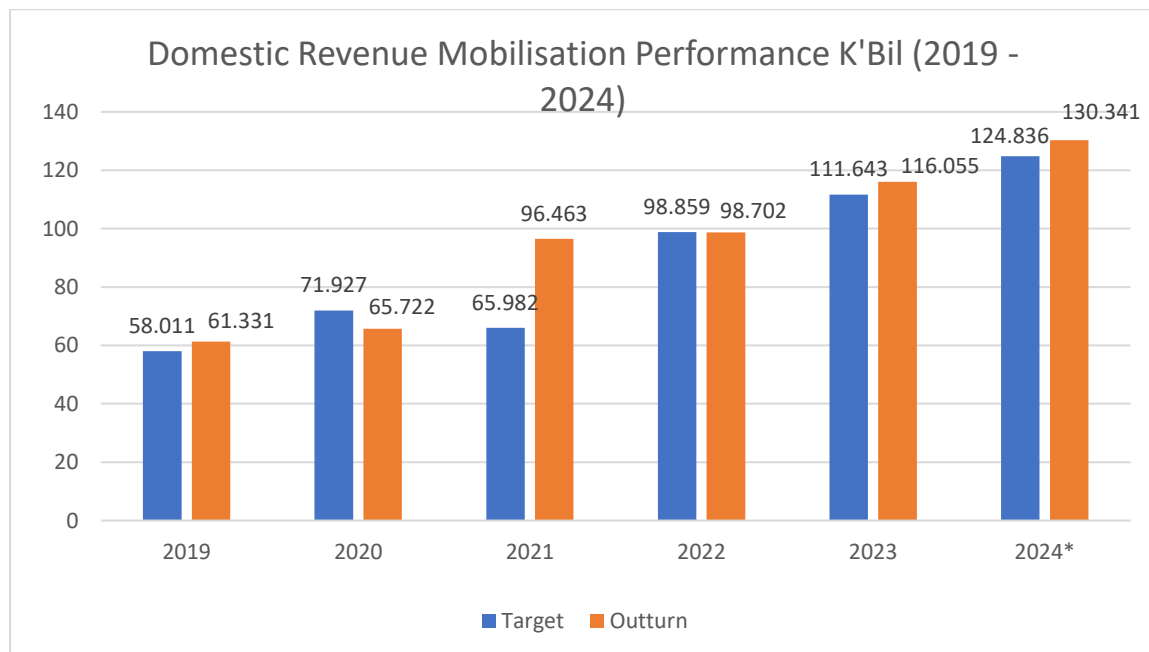
- 5) **Two-Pillar Solution** – Finalising options to address tax challenges arising from digitalisation and prevent tax base erosion.
- 6) **Tax Policy Certainty and Services** – Maintaining stable tax policies and enhancing taxpayer services to improve compliance.
- 7) **Mass Property Valuation** – Expediting property valuation for accurate billing and improved property tax collection, supporting decentralisation efforts.

Implementing the measures mentioned above is crucial, as inefficient DRM leads to persistent budget deficits, high debt servicing costs, and excessive reliance on external financing. These challenges, in turn, constrain fiscal space for development priorities and pose risks to long-term economic stability.

2.1 Domestic Revenue Performance

Domestic Revenue Mobilisation efforts are highlighted below.

Figure 1: Domestic Revenue Mobilisation 2019 - 2023

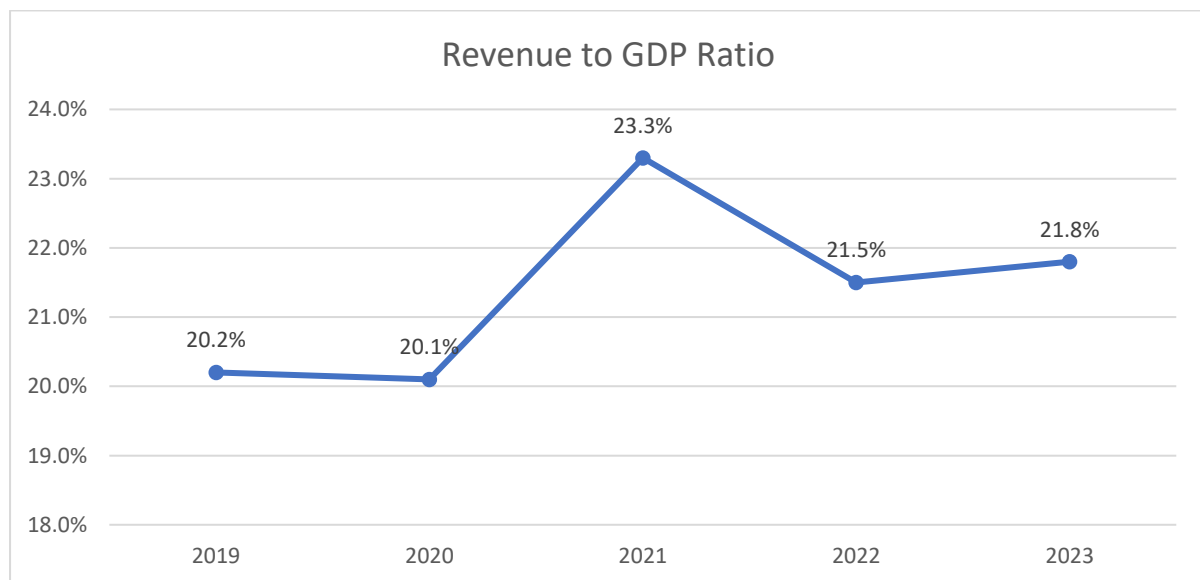


* 2024 figures are preliminary figures

Source: PBO Construction from Annual Economic Reports

As shown in Figure 1, revenue mobilisation has demonstrated consistent growth over the years in both targets and actual collections. Between 2019 and 2024, revenue targets increased from K58.01 billion to K124.84 billion, while actual collections rose from K61.33 billion to K130.43 billion. The highest revenue over performance occurred in 2021, due to post-COVID-19 economic recovery, improved tax compliance, and the introduction of new tax measures. The only revenue shortfall recorded was in 2020, attributed to the economic impact of the COVID-19 pandemic. Revenue performance in 2022 and 2024 remained strong, with actual collections closely matching or exceeding targets, reflecting improved forecasting and tax administration. The steady growth in revenue mobilisation suggests significant progress in domestic resource mobilisation efforts.

Figure 2: Domestic Revenue to GDP Ratio



Source: PBO Computation using fiscal Tables

The Revenue to GDP Ratio measures the proportion of a country's total revenue relative to its Gross Domestic Product (GDP). The ratio shows the country's ability to generate revenue from its domestic economy. A higher Domestic Revenue to GDP ratio is considered desirable, as it indicates a country's ability to fund its public expenditures and development programmes from its own resources.

As shown in Figure 2, the Revenue to GDP ratio remained relatively stable, declining slightly from 20.2 percent to 20.1 percent in 2020. There was a significant spike to

23.3 percent in 2021. A sharp decline to 21.5 percent was then recorded in 2022, indicating potential revenue collection challenges or stronger GDP growth relative to revenue. There was a modest rebound to 21.8 percent in 2023, showing some stabilisation but still below the 2021 peak. 2024 ratio predicted to be at 20.9 percent. A fluctuating revenue-to-GDP ratio suggests instability in revenue collection, which may affect budget planning and execution.

Tax revenues constitute the majority of domestic revenues (approximately 80 percent), with Value Added Tax (VAT) contributing a substantial share—about 31 percent of tax revenues in 2023 (see Figure 3). However, despite its significance, VAT administration in Zambia faces persistent challenges, including inefficiencies, tax evasion, and a substantial backlog of VAT refund claims.

Figure 3: Revenue Performance 2023

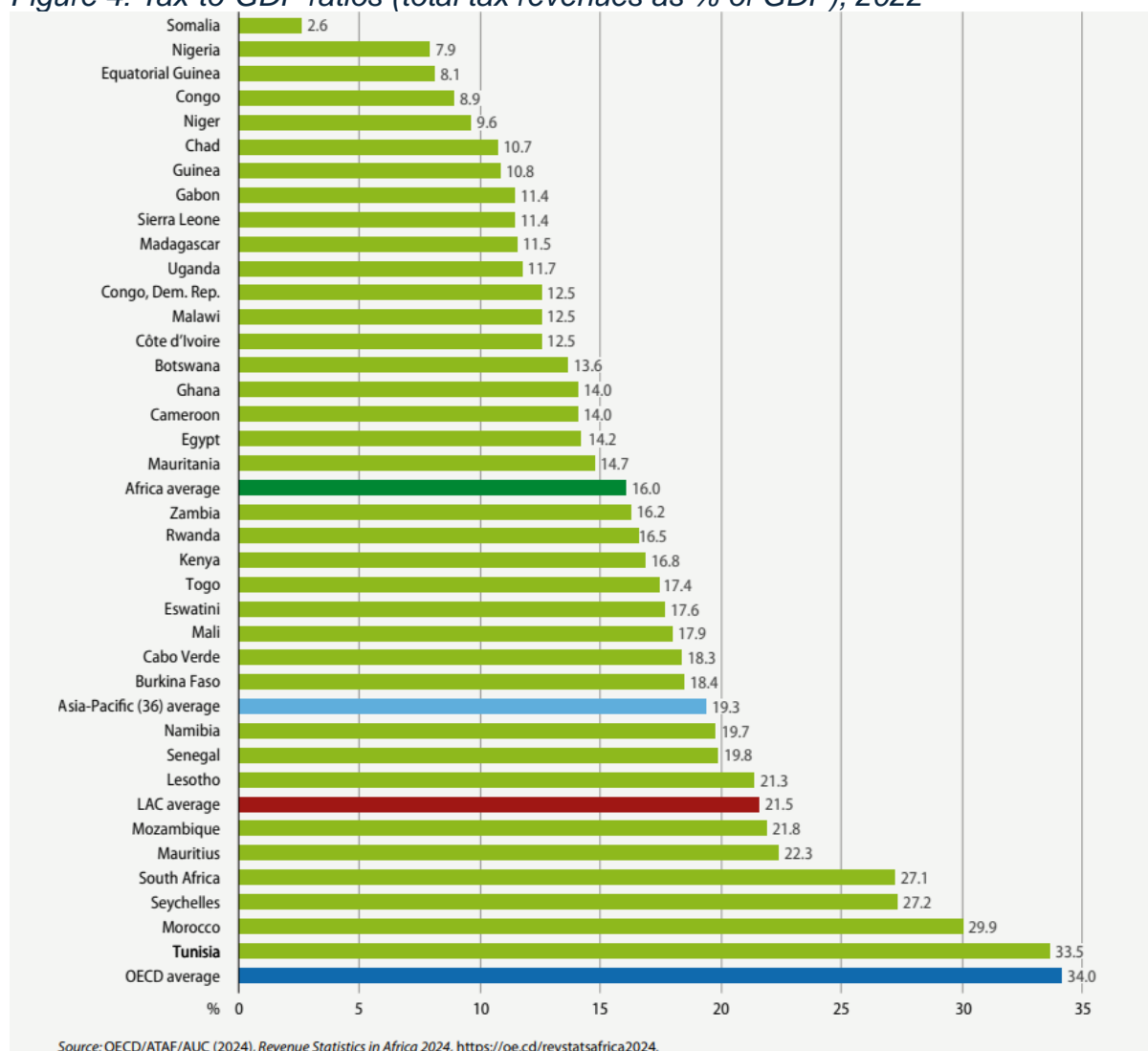
2023 FISCAL TABLE APPROVED BUDGET					
	2023 Approved Budget	Outturn	Outturn Var (Budget)	Outturn Var %	% of GDP
TOTAL REVENUE AND GRANTS	113,348,736	122,103,910	8,755,174	7.7%	22.9%
TOTAL REVENUE	111,643,321	116,055,320	4,411,999	4.0%	21.8%
Tax Revenue	93,767,023	92,380,958	(1,386,066)	-1.5%	17.3%
a. Income Taxes	50,427,135	45,144,653	(5,282,482)	-10.5%	8.5%
Company Tax	21,195,997	14,912,618	(6,283,379)	-29.6%	2.8%
o/w Mining	12,849,660	5,352,508	(7,497,151)	-58.3%	1.0%
Non-Mining	8,346,338	9,560,109	1,213,772	14.5%	1.8%
Pay As You Earn (PAYE)	19,319,235	19,446,821	127,586	0.7%	3.6%
Other Income tax - Withholding Tax	9,911,902	10,785,214	873,312	8.8%	2.0%
b. VAT	29,209,212	32,907,647	3,698,434	12.7%	6.2%
o/w Domestic VAT	9,795,240	9,865,321	70,081	0.7%	1.8%
Import VAT	19,413,973	23,042,326	3,628,353	18.7%	4.3%
c. Customs and Excise Duties	13,810,456	13,916,942	106,487	0.8%	2.6%
Customs Duty	6,879,990	6,369,361	(510,630)	-7.4%	1.2%
Excise Duties	6,930,465	7,547,582	617,116	8.9%	1.4%
o/w Fuel Levy	1,128,201	1,448,707	320,506	28.4%	0.3%
Carbon	302,040	117,929	(184,112)	-61.0%	0.0%
Rural Electrification Fund	374,815	421,670	46,856	12.5%	0.1%
Cement Levy	73,835	56,004	(17,830)	-24.1%	0.0%
d. Insurance Premium	210,720	301,528	90,809	43.1%	0.1%
e. Export Duties	109,501	110,187	686	0.6%	0.0%
Non-Tax Revenue	17,876,298	23,674,363	2,667,238	14.9%	4.4%
a. Total User fees, fines and Charges	7,098,291	8,693,520	1,595,229	22.5%	1.6%
o/w fees and fines, charges and GAI's	4,088,872	3,983,386	(105,486)	-2.6%	0.7%
Exceptional Revenue (TAZAMA & Atlas mara)		3,130,827	3,130,827		0.6%
Road user Charges and fees (RTSA)	685,772	1,000,536	314,763	45.9%	0.2%
RDA (Tolls)	2,323,646	3,709,598	1,385,952	59.6%	0.7%
b. Interest from On-lending/Dividends	1,418,991	3,613,388	2,194,397	154.6%	0.7%
c. Mineral Royalty	8,986,242	7,708,995	(1,277,247)	-14.2%	1.4%
d. Motor Vehicle Fees	127,299	187,083	59,784	47.0%	0.0%
e. Tourism Levy	24,644	45,723	21,079	85.5%	0.0%
f. Skills Development Levy	220,830	294,826	73,996	33.5%	0.1%
GRANTS	1,705,414	6,048,590	4,343,175	254.7%	1.1%
Project	1,705,414	6,048,590	4,343,175	254.7%	1.1%

Source: Ministry of Finance and National Planning

Tax to GDP Ratio

The tax-to-GDP ratio is a gauge of a nation's tax revenue relative to the size of its economy as measured by Gross Domestic Product (GDP). The ratio provides a useful look at a country's tax revenue because it reveals potential taxation relative to the economy. It also enables a view of the overall direction of a nation's tax policy and international comparisons between the tax revenues of different countries.

Figure 4: Tax-to-GDP ratios (total tax revenues as % of GDP), 2022



Zambia's tax-to-GDP ratio stands at 16.2 percent, slightly above the African average of 16.0 percent but lower than the regional averages for Asia-Pacific (19.3 percent), Latin America and the Caribbean (21.5 percent), and OECD countries (34.0 percent).

Compared to countries like Mauritius (22.3 percent), South Africa (27.1 percent), Seychelles (27.2 percent), Morocco (29.9 percent), and Tunisia (33.5 percent), Zambia's tax-to-GDP ratio is relatively low. This suggests that these nations may have more effective tax administration, broader tax bases, and fewer exemptions. However, Zambia performs better than Nigeria (7.9 percent), Uganda (11.7 percent), Malawi (12.5 percent), and Côte d'Ivoire (12.5 percent), indicating a relatively stronger tax collection system than several Sub-Saharan African countries.

Although Zambia's tax-to-GDP ratio exceeds the African average, the difference is not substantial, highlighting the need for further improvements in domestic revenue mobilisation. The current ratio reflects ongoing challenges in expanding the tax base, reducing tax evasion, and enhancing compliance. A lower tax-to-GDP ratio restricts the government's ability to fund infrastructure, social services, and debt repayment. To boost revenue collection, Zambia may need to reform VAT administration, reduce tax exemptions, and enhance tax collection efficiency.

3. BACKGROUND TO VALUE ADDED TAX

Introduced in 1995 to replace Sales Tax, VAT is a consumption-based tax levied at every stage of the production and distribution chain. VAT is administered by the Zambia Revenue Authority (ZRA) under the *Value Added Tax Act*, Chapter 331 of the Laws of Zambia. It is applied at a standard rate of 16 percent on most goods and services and imports, with certain items zero-rated or exempted. The VAT system operates on an invoice-based mechanism, allowing businesses to recover input VAT and preventing the cascading "tax-on-tax" effect. For zero-rated VAT supplies, businesses can claim back input VAT (the VAT paid on purchases). For VAT exempted supplies, businesses cannot reclaim input VAT on purchases.

While this system, fosters compliance through its self-policing mechanism and enhances trade efficiency, VAT administration faces challenges, including balancing short-term revenue maximisation with the long-term goals of predictability and revenue growth. Complexities such as the reverse-charge mechanism for imported

services and broader constraints experienced by other African countries highlight the need for continuous reforms to strengthen VAT administration in Zambia.

As of 2023, VAT was the second-largest contributor to tax revenue, accounting for 31 percent of the total, second only to Income Tax (54 percent). Over the past five years (2019 –2023), VAT has consistently contributed approximately 30 percent to total tax revenue. Despite its substantial contribution, VAT administration in Zambia faces notable challenges as detailed below.

- 1) **VAT Refund Backlog:** Between 2021 and 2024, VAT refund claims increased from K3.6 billion to K13.7 billion. As of September 30, 2024, outstanding VAT refunds amounted to K55.75 billion, equivalent to 31 percent of the national budget for 2024. This backlog adversely affects business liquidity and erodes confidence in the tax system.
- 2) **Tax Evasion and Compliance Issues:** VAT evasion and under reporting by businesses and informal suppliers remains a significant challenge for the Zambia Revenue Authority (ZRA)². These issues are exacerbated by limited enforcement and weak penalties.
- 3) **VAT Fraud:** Fraudulent activities, including misreporting and false refund claims, undermines Zambia’s revenue mobilisation efforts and further complicate VAT administration.

Given the critical role of VAT in Zambia’s fiscal policy, addressing these challenges is imperative to achieving fiscal sustainability and DRM goals.

3.1 VAT Performance

Total VAT collections grew significantly from K16.7 billion in 2019 to K32.9 billion in 2023, representing a nearly 97 percent increase over five years.

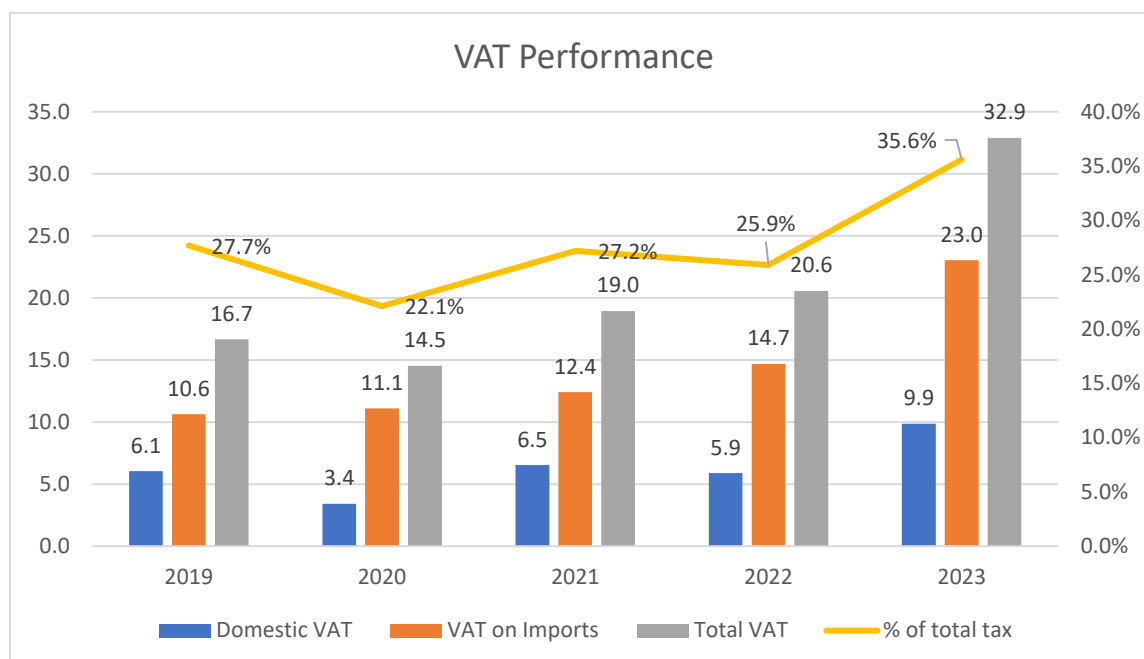
Table 1: VAT Performance (K'Bil) 2019 - 2023

Year	2019	2020	2021	2022
Domestic VAT	6.1	3.4	6.5	5.9
VAT on Imports	10.6	11.1	12.4	14.7
Total VAT	16.7	14.5	19.0	20.6
% of total tax	27.7%	22.1%	27.2%	25.9%

Source: PBO Computation using ZRA data

²An Analysis of the Zambian Taxation System – Action Aid, 2022

Figure 5: VAT Performance (K'Bil) 2019 - 2023



Source: PBO Computation using ZRA Data

The most substantial annual growth occurred between 2022 and 2023, with VAT revenue surging by 59.7 percent, largely on account of a positive performance of VAT imports. This positive performance is attributed to increased importation of petrol, diesel and other vatable goods. The depreciation of the kwacha drove up the taxable base and collection of outstanding import VAT liabilities amounting to K759.2 million³.

4. POLICY FRAMEWORK

The VAT legal and regulatory framework supports revenue generation, economic growth, and equity through a number of initiatives as set out below.

(1) Supporting Export Competitiveness

Zero-rating exports incentivises trade and enhances Zambia’s export-oriented sectors, such as mining and agriculture.

³ZRA 2023 Annual report

(2) Promoting Equity

Exemptions for essential goods like food, medical supplies, and educational materials are for public benefit and protect vulnerable populations.

(3) Align with Global Practices

The destination principle ensures VAT is applied where goods and services are consumed. While globally accepted, this principle limits revenue from Zambia's raw material exports.

(4) Revenue Mobilisation

VAT contributes significantly to government revenue, but a VAT gap (estimated at 30–39 percent due to evasion and non-compliance) constrains its full potential⁴.

5. LEGAL AND REGULATORY FRAMEWORK

The main pieces of legislation for the administration of the VAT are the Zambia Revenue Act and the Value Added Tax Act. They are supported by various Statutory Instruments as set out below.

5.1 Legal Framework

(1) Zambia Revenue Act, Cap 321

The *Zambia Revenue Act, Cap 321* of the Laws of Zambia establishes the ZRA under Section 9 and provides for its mandate. The mandate of the Authority includes, but not limited to, assessment and collection of taxes and duties, enforcement of relevant statutory provisions, facilitation of international trade, and advisory on aspects of tax policy.

(2) Value Added Tax Act, Chapter 331

Value Added Tax Act, Chapter 331 of the Laws of Zambia is the principal legislation governing VAT administration. The legislation, which came into operation in 1995, imposes a tax on the supply of goods and services in Zambia and importation of goods. The VAT Act, 1995 repealed the Sales Tax Act and the Insurance Levies, Cap 55663 and Act No.25 of 1990.

⁴An Analysis of the Value Added Tax (VAT) Gap in Zambia, 2023

(3) Value Added Tax (General) Regulations Statutory Instrument No. 88 of 2010

The VAT Regulations provide guidelines for the enforcement of the VAT principal legislation. Section 51 empowers the Minister to make regulations for or with respect to any matters as required by the VAT Act. Value Added Tax (General) Regulations Statutory Instrument No. 88 of 2010 revoked the S.I. No. 78 of 1995. The Regulations prescribe enforcement of provisions on supply of goods, input tax and general provisions of the VAT Act.

(4) Commissioner General's Rules

The Commissioner General is empowered to issue administrative rules under Section 52 of the VAT Act to provide practical instructions on implementing specific provisions under the Act.

5.2 Key Regulatory Provisions

Below are some key regulatory provisions as contained in Statutory Instruments on VAT.

(1) Registration Requirements (Statutory Instrument No. 91 of 2012)

Businesses with an annual taxable turnover exceeding K800,000 or K200,000 over three consecutive months are required to register for VAT. Voluntary registration is available for entities below the statutory threshold, subject to specific conditions.

(2) Tax Provisions

Rates and Exemptions: Statutory Instruments (SIs) such as SI68 and SI69 of 2014 outline exempt and zero-rated goods and services.

Cross-border Taxation: SI No. 18 of 2024 introduced a 16 percent VAT on cross-border electronic services to address taxation in the digital economy.

(3) Technological Adaptations

SI No. 58 of 2023 mandated the adoption of a VAT electronic invoicing system, promoting transparency and efficiency.

(4) Compliance Mechanisms (VAT Act)

Non-compliance penalties include fines for late registration, delayed returns, and failure to issue tax invoices. Interest on overdue taxes is set at the Bank of Zambia's discount rate plus 2 percent per month, incentivising timely compliance.

6. EFFECTIVENESS OF VAT ADMINISTRATION IN CONTRIBUTING TO SUSTAINABLE DOMESTIC REVENUE MOBILISATION IN ZAMBIA

The effectiveness of VAT administration significantly impacts the Government's ability to generate sustainable domestic revenue. This section focuses on two key aspects: collection efficiency and compliance, which are essential indicators of the performance of VAT administration in Zambia.

6.1 Collection Efficiency

VAT collection efficiency measures the government's ability to collect revenue as a percentage of potential VAT collections. The effectiveness of collection mechanisms, such as automated systems, enforcement strategies, and tax audits, directly influences revenue mobilisation. Effectiveness of VAT system is measured by, among other metrics, revenue impact of zero rating or exemption of goods and services. Regrettably, tax expenditures in the 2023 financial year were not costed due to complexities in administration of the tax type and the requirement for more information on full value chain to be able to determine the aggregate revenue impact.⁵

6.1.1 Challenges to Collection Efficiency

Tax Evasion and Avoidance: High levels of informal economic activity and underreporting by registered taxpayers reduce VAT collection efficiency. For instance, estimates suggest that the informal sector in Zambia accounts for over 40 percent of economic activity, creating gaps in the tax net⁶.

Refund Delays: Delayed VAT refunds negatively impact the cash flow of businesses, reducing compliance and trust in the tax system. VAT refunds were one

⁵Tax Expenditure Report, 2023 Fiscal Year

⁶World Bank, 2023

of the drivers for the decline in the projected primary fiscal balance from 2.9 to 2.5 percent during Third and Fourth Review of the IMF Extended Credit, respectively. This was mainly due to refunds accumulating at a higher pace than repayments by the State.

Frequent Policy Changes: Regular amendments to VAT legislation create uncertainty and hinder long-term business planning.

6.2 Compliance

Tax compliance reflects the willingness of taxpayers to fulfil their VAT obligations. Low compliance rates often stem from complex registration processes, lack of awareness, and high compliance costs. Current payments compliance in Zambia stands at 73 percent⁷.

6.2.1 Challenges to Compliance

Two major identified challenges to compliance are:

- (1) **complex tax processes:** businesses, particularly small and medium enterprises, face difficulties understanding and navigating VAT regulations; and
- (2) **compliance costs:** high administrative costs, such as record-keeping and filing requirements, discourage compliance among small and medium enterprises (SMEs).

6.3 Audit Queries Relating to VAT Administration

The Auditor General regularly reports on matters relating to the administration of VAT. Table 2 below summaries audit queries on VAT administration from 2019 to 2023. Detailed information on the queries are as at Appendix 1.

⁷ZRA 2023 Annual Report

Table 2: Summary of Queries on VAT

Audit Query	Financial Year Relating to the Query				
	2019	2020	2021	2022	2023
Loss of Revenue to Government – Domestic VAT	√				
Failure to Collect withheld VAT		√			√
Irregular Refund of VAT			√		
Failure to Update VAT Account Statements			√		
Failure to Act against Taxpayers who Abused the VAT Deferment Scheme					√
Failure to Collect VAT Withheld by Oil Marketing Companies					√
Reverse VAT Withheld but not Paid to ZRA					
Failure to Automate Refunds of VAT and Customs Taxes					√

Source: PBO Construction from Auditor Generals Reports

Failure to collect withheld VAT appears to be a more persistent query during the period having been reported in 2020 and more recently in 2023. The Audit Report for the financial year 2023 revealed more queries which include non automation of the VAT refund process which may not only be contributing to the delays in repayments by the State, but also the accuracy of the refund amounts.

6.4 Reforms to Improve Efficiency and Compliance

Over the years, the ZRA has implemented several measures aimed at improving VAT compliance, reducing revenue leakages, and modernising tax administration. These initiatives include administrative restructuring, technological advancements, and policy reforms, as detailed below.

(1) Introduction of VAT Collection at Source

The VAT withholding mechanism introduced in 2017 tasked designated agents with deducting VAT from supplier payments and remitting it directly to the ZRA. This

measure aimed to reduce revenue leakages and improve compliance, particularly in high-risk sectors. The withholding system led to a significant increase in VAT revenue. For instance, VAT revenue in 2017 was at least 13 percent higher compared to 2016⁸. Despite its effectiveness, issues such as non-remittance by agents and cash flow challenges for suppliers emerged, necessitating continuous monitoring and adjustments.

(2) Electronic Fiscal Devices

The ZRA introduced Electronic Fiscal Devices (EFDs) in 2018 through the enactment of the Value Added Tax (Amendment) Act No. 15 of 2018 to combat tax evasion, enhance transparency, improve compliance and curb underreporting among businesses. EFDs are electronic devices used to record sales transactions and automatically generate fiscal invoices.

Documented effectiveness of the introduction of EFDs include:

- a) **Real-Time Data Capture:** EFDs transmit sales data to the ZRA in real time, enabling better monitoring of business transactions and detection of discrepancies between reported sales and VAT remittances;
- b) **Enhanced Transparency:** fiscal invoices improve sales reporting accuracy and reduce opportunities for tax evasion; and
- c) **Improved Compliance Rates:** businesses using EFDs have shown higher compliance rates due to automated reporting.

There have been challenges faced as well such as:

- a) **Non-Issuance of Fiscal Invoices:** some businesses opted to provide unofficial receipts, avoiding EFD-generated invoices;
- b) **Consumer Behaviour:** businesses sometimes offered discounts for non-receipted transactions or increase prices for official invoices, fostering non-compliance; and
- c) **Infrastructure Issues:** limited internet connectivity coupled with the extending load shedding hours hindered the effective use of EFDs.

⁸United Nations University, UNU – Wider, 2023

Due to these challenges, the ZRA has phased out the EFDs, replacing them with the Smart Invoicing System.

(3) Smart Invoicing System

The Smart Invoicing System (SIS) ensures that businesses issue VAT-compliant invoices while integrating directly with the ZRA database. This real-time connection enhances monitoring and helps mitigate invoice fraud. Under the VAT Electronic Invoicing System Regulations (SI No. 58 of 2023), all VAT-registered taxpayers are required to register for and exclusively issue invoices through SIS. Initially, businesses were expected to integrate their invoicing systems with SIS by 1st July, 2024; however, the deadline was later extended to 1st October 2024. From 2025 onward, VAT deductions will only be permitted for transactions involving SIS-issued invoices.

Achievements and other anticipated benefits of SIS include:

- a) **Automated Compliance Checks:** invoices are validated against VAT regulations, minimising errors and non-compliance;
- b) **Streamlined Record-Keeping:** digital invoices facilitate easier storage and retrieval, improving audit trails for businesses and tax authorities allowing for enhanced detection of false invoices and fraudulent claims, and improved data accuracy; and
- c) **Fraud Prevention:** fiscal signatures and QR Codes enhance data security and minimise fraudulent claims.

Challenges that may be faced include:

- a) **High Implementation Costs:** SMEs face difficulties due to the high initial cost of software installation and training;
- b) **Resistance to Change:** some businesses may resist adopting the system due to a lack of understanding or fear of increased scrutiny by tax authorities;
- c) **Infrastructure Limitations:** poor internet connectivity and unreliable electricity supply in some regions may limit the system's effectiveness;

furthermore, integration with existing accounting systems remains problematic for some businesses; and

- d) **Cybersecurity risk:** As smart invoicing is electronic, there is a heightened risk of cyber attacks.

The full impact of smart invoicing remains to be assessed, as its implementation was only completed in the second half of 2024.

(4) Tax Online 2 System

The Tax Online 2 platform simplifies tax administration by enabling electronic filing, payment, and tracking of VAT. This system was designed to improve efficiency, reduce administrative costs, and enhance taxpayer convenience.

7. PREVALENCE AND EFFECTS OF VAT EVASION ON REVENUE MOBILISATION

VAT evasion occurs through underreporting, false claims of input VAT, or the operation of informal businesses outside the tax net. Zambia's informal economy, which accounts for over 70 percent of the workforce⁹, intensifies VAT evasion as many transactions remain undocumented. Moreover, some registered businesses engage in fraudulent schemes, such as falsifying invoices to claim unwarranted refunds. As at November 2024, ZRA was handling over 320 suspected cases of VAT refund fraud estimated to be worth over K5 billion with over 140 cases concluded and 11 convictions in the Economic and Financial Crimes Court. Among them, was the recovery of over K4.4million that had been evaded in VAT¹⁰.

7.1 Impact on Revenue Mobilisation

The impact of VAT evasion is highlighted below.

- (1) **Revenue Loss:** VAT evasion deprives the Government of significant revenue considering that VAT accounts for 30 percent of total tax revenue.
- (2) **Fiscal Deficits:** Persistent revenue losses contribute to budget deficits, leading to increased borrowing.

⁹The Informal Sector in Zambia, 2024

¹⁰ZNBC, 2024

- (3) **Equity Issues:** Evasion shifts the tax burden to compliant taxpayers, eroding trust in the tax system. For example, the ZRA reported that only 6 out of the 6000 mining entities with mining licenses in the country contributed to revenue collection in 2023¹¹.
- (4) **Reduced Development Spending:** Revenue shortfalls limit the Government's ability to invest in priority areas such as health, education, and infrastructure. This hampers economic growth and exacerbates poverty levels in the country.

8. VAT REFUNDS AND IMPLICATIONS

The VAT refund system in Zambia is a critical mechanism designed to ensure businesses are not burdened with excess VAT costs. Refunds occur when the tax paid on inputs exceeds the tax collected on outputs, primarily benefiting businesses involved in exports and those purchasing capital goods. This system prevents a “tax-on-tax” effect, supports cash flow, and enhances export competitiveness. However, persistent inefficiencies in the refund process have led to significant backlogs, adversely impacting businesses and the economy.

ZRA has increased the pace of VAT refunds from K 1.4 billion in the first three quarters of 2024 to K1.7 billion per month in the last quarter of 2024. Currently the Authority employs a ‘First-in First-out’ approach but aims to adopt risk-based audits by end-2025¹².

8.1 Status of the VAT Refund Backlog

As of September 30, 2024, the backlog of VAT refunds claims amounted to K55.8 billion, with K17.8 billion audited and approved but pending payment. The breakdown of the audited refunds is as shown in Figure 5 below. The backlog has grown significantly, with refunds for mining companies accounting for the majority (K15.4 billion), followed by non-mining sectors (K2.3 billion) such as wholesale and

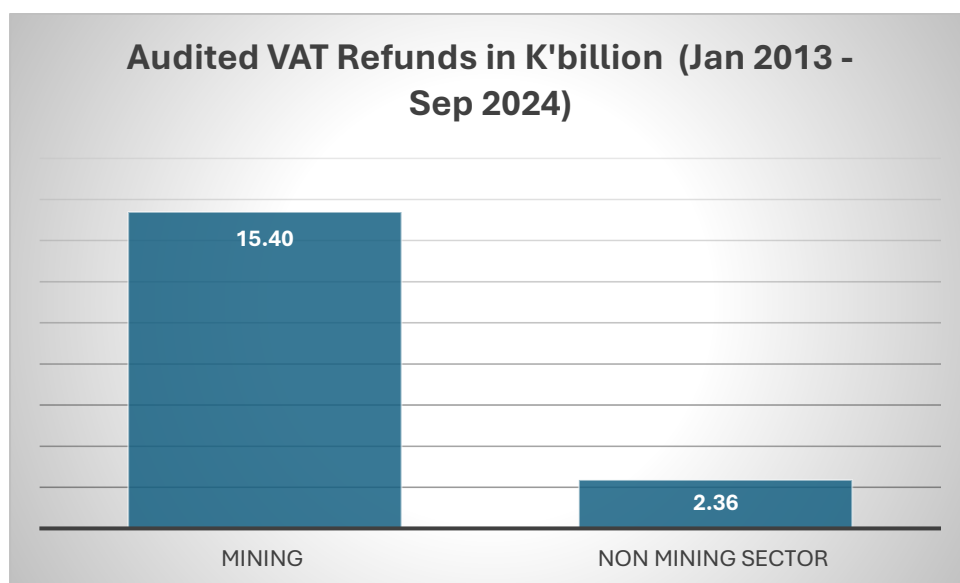
¹¹News Diggers, 2024

¹²Zambia: Third Review Under the Arrangement Under the Extended Credit Facility
<https://www.imf.org/en/Publications/CR/Issues/2024/12/17/Zambia-Fourth-Review-Under-the-Arrangement-Under-the-Extended-Credit-Facility-and-Financing-559680>

retail, manufacturing, and transportation. The distribution of pending VAT refunds for non-mining sectors is shown in Table 3.

Some of the outstanding refunds amounting to K10.3 billion are VAT legacy arrears, having a cut-off date of 31st December, 2021. In response to the increase in domestic arrears including VAT, and as part of prudent efforts to dismantle the arrears, the Government is implementing the Revised Dismantling Arrears Strategy (DDAS) 2024 – 2029. The Strategy is aimed at clearing legacy arrears through a multi-year plan and through a central budget allocation under the Ministry of Finance and National Planning irrespective of which Ministry, Province or Spending Agency accrued the arrears. Out of K10.3 VAT legacy arrears, K3.5 billion had been paid as at 31st March, 2024.

Figure 6: Age Distribution of Approved VAT Refund Claims Pending Payment (January 2013 to September 2024)



Source: PBO Construction using data from ZRA

As shown in Table 3, out of the K2.40 billion VAT audited refunds for the non-mining sector, 77.6 percent is allocated to the top five sectors, with the Wholesale and Retail Trade sector receiving the largest share at 30 percent. The remaining 22.4 percent is earmarked for other broad non-mining sectors such as agriculture, finance and insurance and real estate, among others.

Table 3: Distribution of Audited and approved VAT Refunds (Jan - Sep 2024)

Broad Non - Mining Sector	Approved Amount (K)	Percentage (%)
Wholesale and retail trade; repair of motor vehicles and motorcycles	709,290,233.09	30
Manufacturing	377,998,990.08	16
Electricity, gas, steam and air conditioning supply	281,054,066.22	11.9
Transportation and storage	264,553,997.07	11.2
Professional, scientific and technical activities	199,758,045.62	8.5
Other Sectors	530,283,450.91	22.4
Total	2,362,938,782.99	100

8.2 The Current VAT Refund System

The refund system, administered by the ZRA, operates under the guidelines of the VAT Act. Businesses file refund claims, which undergo a rigorous verification process before approval. Once validated, payments are expected to be issued within 30 days for exporters and 60 days for other claimants. However, in practice, these timelines are rarely met, leading to growing backlogs.

The ZRA implements a “First-In, First-Out” approach in order to promote fairness in the processing of refunds. In 2025, VAT deductions will be restricted to transactions with SIS issued invoices and the ZRA has committed to establishing a compliance risk management unit by mid-2025 in order to adopt risk-based audits by end-2025¹³.

8.3 Factors Contributing to Backlogs

There are a numerous documented factors contributing to refund backlogs as summarised below.

¹³IMF ZAMBIA: FOURTH REVIEW UNDER THE ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY AND FINANCING ASSURANCES REVIEW

(1) Insufficient Budgetary Allocations

VAT refunds are financed from general government revenue, and inadequate allocations result in delays. The practice of considering input VAT as part of revenue further exacerbates the problem by creating fiscal pressure.

(2) High Volume of Claims from Export-Driven Sectors

Mining and agricultural sectors, with their zero-rated exports, generate substantial refund claims that overwhelm ZRA's processing capacity.

(3) Verification Bottlenecks

ZRA's stringent audit and verification procedures, aimed at curbing fraudulent claims, slow down the processing of refunds, particularly for high-value claims.

(4) Systemic and Technical Challenges

Inefficiencies in IT infrastructure, manual processes, and frequent system updates disrupt refund processing. According to the 2023 ZRA Annual Report, the refund process was negatively affected by manual processing of claims which included legacy refunds as they pose a risk of duplication, human error, loss of audit reports and omission from manual records. Although progress has been made in the automation of the system, the ZRA has stated that all refunds created before the automation will still need to be processed manually therefore still carrying the risks as stated¹⁴.

(5) Policy Ambiguity

Changes in refund policies, such as restrictions on diesel and electricity claims for mining firms, have created confusion and administrative hurdles.

8.4 Cascading Effects of Delayed VAT Refunds

Notably, delayed VAT refunds negatively impact business operations. Some of the effects are detailed below.

(1) Cash Flow Constraints

Delayed refunds reduce working capital, particularly for exporters and businesses reliant on high input VAT. This limits their ability to pay suppliers, meet payroll, expand their businesses and fund operations.

¹⁴2023 ZRA Annual Report

(2) Increased Cost of Doing Business

Businesses face higher financing costs to cover VAT payments, reducing profitability and competitiveness, especially in international markets.

(3) Tax Compliance Challenges

Cash flow pressures may force businesses to delay other tax payments, such as Corporate Income Tax and Pay-As-You-Earn, leading to penalties and reduced overall tax compliance.

(4) Erosion of Business Confidence

Persistent delays undermine trust in the VAT system, discouraging investments and prompting calls for VAT exemptions to bypass the refund process.

(5) Supply Chain Disruptions

Liquidity issues affect timely payments to suppliers, causing disruptions across entire supply chains.

(6) Impact on Exporters

Exporters, heavily reliant on timely refunds due to zero-rating, face liquidity challenges, reducing their competitiveness in global markets.

9. CONCLUSION

The effectiveness of VAT administration in Zambia plays a critical role in ensuring sustainable domestic revenue mobilisation. While various reforms, such as VAT collection at source, electronic fiscal devices, smart invoicing, and the Tax Online 2 system, have improved compliance and revenue collection, challenges remain. Key issues include tax evasion, refund backlogs, compliance costs, and infrastructure limitations, all of which hinder the full realisation of VAT's revenue potential.

Delayed VAT refunds continue to strain business cash flows, increase operational costs, and undermine confidence in the tax system. Additionally, VAT evasion, particularly within the informal sector and through fraudulent refund claims, significantly reduces government revenue, contributing to fiscal deficits and limiting funds available for essential public services.

Despite these challenges, ongoing digitalisation efforts, including smart invoicing and e-invoicing, show promise in improving compliance, reducing fraud, and broadening the tax base. However, their success depends on proper implementation, taxpayer education, and improvements in digital infrastructure. Strengthening enforcement mechanisms, streamlining VAT refund processes, and enhancing policy clarity will be crucial in ensuring that VAT administration effectively supports Zambia's fiscal stability and economic growth.

By addressing these structural inefficiencies and leveraging technology-driven solutions, Zambia can enhance VAT's contribution to domestic revenue mobilisation, reducing reliance on external borrowing and fostering long-term economic sustainability.

APPENDIX I

Audit Queries on VAT Collections

Irregular Refund of VAT – K3,562,136,950 (2021)

A review of records relating to VAT refunds revealed that amounts totalling K3,562,136,950 were irregularly refunded to various tax payers in that the invoices used to claim were expired as they had exceeded the three (3) months allowed for claiming as stipulated in the Value Added Tax Act, Cap 331 of the Laws of Zambia.

Failure to Update VAT Account Statements (2021)

Clause 24.2 of the ZRA Return and Payment Manual of 2020 stipulates that the process involves checking whether the returns and payments are sitting in the correct periods on the taxpayer's account statement. The process further involved requesting the taxpayer to submit missing returns and pay outstanding liabilities or reassigning the approved refunds to offset the outstanding liabilities in periods where the taxpayer owes.

A review of twenty-eight (28) taxpayers' statement of accounts revealed that although ZRA had made refunds in amounts totalling K881,931,955 to the respective companies, their account statements had not been updated as at 31st March 2022.

Failure to Collect withheld Value Added Tax (VAT) (2020)

According to the Value Added Tax General (Amendment) Rules, 2018 as prescribed in Government Gazette Notice No. 935 of 2016 6B (1) which states that except as otherwise allowed or directed by the Commissioner-General, an agent appointed in accordance with subsection 8A of Section 8 of the Value Added Tax Act shall withhold output tax on all the supplies of goods and services received in a particular month and remit the output tax to the Commissioner General within sixteen days following the end of the month in which the output tax is withheld.

A review of withholding VAT (WVAT) returns on Tax Online II revealed that amounts totalling K5,668,787,597 were withheld by six (6) institutions out of which

K3,728,375,925 was remitted to ZRA leaving a balance of K1,940,411,672 outstanding as at 31st August 2021.

Loss of Revenue to Government – Domestic VAT (2019)

During the period under review, thirty-three (33) suppliers supplied standard rated goods and services to two (2) companies and raised tax invoices in amounts totalling K61,205,219 which included output Value Added Tax (VAT) of K8,422,092.

However, it was observed that although the two (2) companies claimed input VAT of K8,422,092 on the procured goods and services, the thirty-three (33) suppliers filed in nil returns during the period under review thereby under declaring VAT by the same amount. In this regard, the Government lost revenue in amounts totalling K8,422,092.

Failure to Act against Taxpayers who Abused the VAT Deferment Scheme (2023)

Section 21 (2) of the Gazette Notice No. 310 of 2020 states, “where the supplier has deferred import VAT and does not use the imported item solely for making taxable supplies and not for resale that supplier shall be assessed the portion of such deferred import VAT and charged interest accordingly.”

In their report of July 2023 on VAT controls, the internal auditors reported that fourteen (14) taxpayers abused the VAT deferment scheme by reselling eligible goods such as trucks and trailers imported on VAT deferment resulting in revenue loss in amounts totalling K1,260,147. This was observed after motor vehicles cleared on VAT deferment were compared to the schedule of change of ownership in the same period. However, as at 31st August 2024, the Authority had not availed a report indicating that the suppliers were surcharged accordingly and cleared the VAT liability.

Failure to Collect VAT Withheld by Oil Marketing Companies (OMCs) – (2023)

Section 8.4.2 of the VAT Guide of 2021 states, “Except as otherwise allowed or directed by the Commissioner-General, a taxable supplier, being an OMC shall

withhold output tax on hydrocarbon oils and oil products supplied by TAZAMA Petroleum Limited and remit the output tax to the Commissioner-General within ten (10) days following the end of the accounting period in which the output tax is withheld.”

A review of VAT returns for the accounting periods ended 31st December 2023 revealed that twenty (20) OMCs withheld amounts totalling K2,799,007. However, a total of K383,515 was paid leaving a balance of K2,415,492 as at 31st August 2024.

Reverse VAT Withheld but not Paid to the Authority (2023)

Section 1.7.3 of the VAT Guide of 2021 states, “The recipient of an imported service raises a Tax Invoice based on the value of the service received from a non – resident supplier. The value of the service is the taxable value on which VAT at 16% is to be added and declared as output VAT on the return.”

A review of schedule of return amount and amounts remitted to the Authority revealed that the taxpayers filed in Reverse VAT returns in amounts totalling K1,032,315,228. However, an amount totalling K734,807,708 was paid to the Authority, resulting into a total of K297,507,521 withheld but not paid. As at 31st August 2024, the Authority had not received the reverse VAT payments and no demand notices were issued by the Authority.

Failure to Collect Withheld VAT from the Agents (2023)

Section 8 (8A) of the Value Added Tax (Amendment) Act No. 44 of 2016 states that the Commissioner-General may appoint a taxpayer as an agent to withhold tax on payments made to taxable suppliers of goods and services. In addition, Section 8.5 of the WVAT Guide of 2021 states, “the taxpayer shall make declarations (returns) on the invoices on which VAT was withheld and make full payment on or by the 16th day of the month following the end of the tax period.”

However, during the period under review VAT agents filed in Withheld VAT returns in amounts totalling K2,912,709,373 of which K472,610,643 was remitted to the Authority leaving a balance K2,440,098,730. Further, 5,281 Agents delayed

submitting VAT returns for period ranging between 18 to 2,259 days and penalties were not charged on the defaulting VAT agents.

Failure to Automate Refunds of VAT and Customs Taxes (2023)

In the report of the Auditor General on the Accounts of the Republic for the Financial year ended 31st December 2021 mention was made that on 5th February 2021, the Zambia Revenue Authority signed off a Certificate of Completion with a named University for the design, co-development, installation, testing and commissioning of a tax administration system. This was after the Project Management committee had accepted the fully developed components after testing it in July 2020. It was mentioned that despite the Authority paying the full contract sum of US\$3,595,351.91 the Authority had not been utilising critical developed modules such as audit, refunds, investigations and debt recovery.

It was observed that during period under review, the Authority processed tax refunds relating to VAT and Customs manually and all the records relating to refunds were maintained in excel spreadsheet. Consequently, there were inadequacies in the validation of claims which led to refunds being made to taxpayers with outstanding balances in other tax types. Further, tax refunds were paid to companies which had been deregistered from the tax register.