UNITED NATIONS DEVELOPMENT ACCOUNT PROJECT

COVID-19 RESPONSE

JUNE 2022

COVID-19
Response and Recovery
Mobilizing financial resources for development

DA-COVID-19 project led by Debt and Development Finance Branch, Division on Globalization and Development Strategies (DDFB/DGDS)

ECA

JUNE 2022

Zambia
Response and Recovery:
Mobilising financial resources for development in the time of COVID-19

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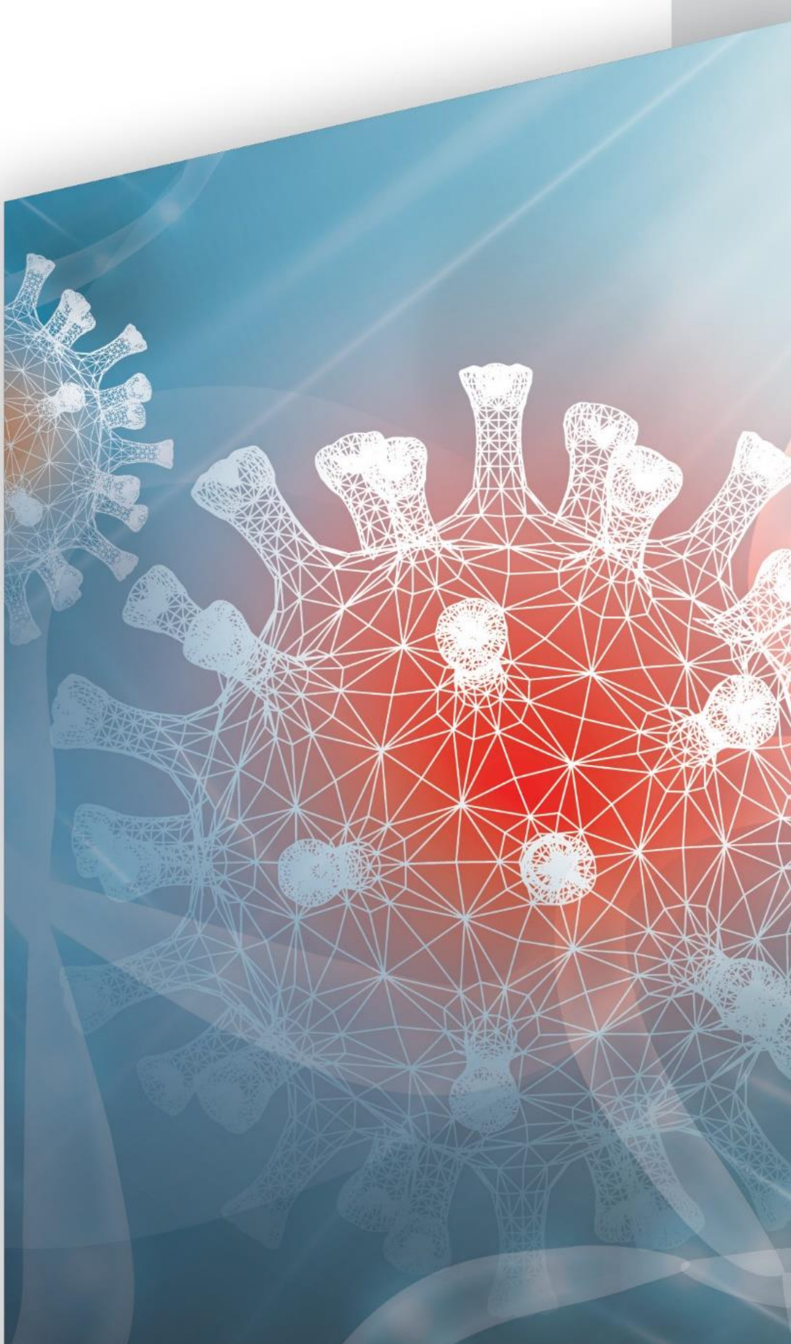

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About the COVID-19 Response and Recovery project

This paper is an output from the project “Response and Recovery: Mobilising financial resources for development in the time of COVID-19”, which is co-ordinated by the Debt and Development Finance Branch of UNCTAD and jointly implemented with ECA, ECLAC and ESCAP. This project is one of the five UN Development Account short-term projects launched in May 2020 in response to the COVID-19 crisis.

The project aims to enable low-income and middle-income developing countries (LICs and MICs) from Africa, Asia-Pacific, and Latin America and the Caribbean to diagnose their macro-financial, fiscal, external financial and debt fragilities in the global context and design appropriate and innovative policy responses to the COVID-19 pandemic leading toward recoveries aligned with the achievement of the Sustainable Development Goals (SDGs).

Acknowledgements

The analytical framework document was produced by the Macroeconomic Analysis Section of the Macroeconomics and Governance Division of ECA, under the overall guidance of the Director a.i. of the Division, Batholomew Armah, and the team was led by Hopestone Kayiska Chavula. The background paper for the report was commissioned from Mr Shebo Nalishebo an expert on taxation policy issues.

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ACRONYMS AND ABBREVATIONS

CIT	Company Income Tax
COVID-19	Corona Virus Disease
GDP	Gross Domestic Product
ITA	Income Tax Act
OLS	Ordinary Least Squares
PAYE	Pay As You Earn
PTT	Property Transfer Tax
SADC	Southern African Development Community
UNCTAD	United Nations Conference on Trade and Development
UNECA	United Nations Economic Commission for Africa
UNUWIDER	United Nations University World Institute of Development Economics and Research
VAT	Value Added Tax
WHT	Withholding Tax
ZIPAR	Zambia Institute for Policy Analysis and Research
ZRA	Zambia Revenue Authority

EXECUTIVE SUMMARY

Zambia is presently beset with fiscal and debt challenges which require fiscal adjustments to make an economic turnaround. To bring the country back on the path of fiscal and debt sustainability, the government would have to frontload fiscal adjustment measures in the coming few years. With the fiscal framework having already having been weakened even before the COVID-19 pandemic, Zambia’s public finances face a number of structural challenges, including lower levels of economic growth, with limited growth in tax revenues, and an already high and unsustainable public debt. The issues are compounded by the fact that a number of loans, including the US$3 billion Eurobonds, will fall due within the next five years. Further, with COVID-19 still here, it makes the fiscal adjustment ever more challenging. And having lost access to international capital markets following its default on several loans in 2020, Zambia would have to look within itself to generate enough resources to bring public finances on a more sustainable trajectory.

The need for higher public revenues to fund basic services, counter the massive impact of the COVID-19 pandemic and pay off the debt presents an opportunity for Zambia to make its tax system more efficient and equitable. The Zambian government plans to increase domestic revenue to no less than 21.2 per cent of GDP in the medium term while ensuring fairness and equity in the tax system[1]. This study therefore undertakes a comprehensive and detailed review of Zambia’s income tax regime. It is largely guided by UNECA’s analytical framework for direct tax system. In order to inform how the tax system may realistically be reformed, it was necessary to go back to the basics by assessing the base upon which the tax system is premised. By assessing the personal income tax, corporate income tax and mineral royalties, we make a distinction between what the tax base ought to be, what the tax law says about how the taxes should be collected and how they are actually collected. The study also provides the required and necessary reform proposals that would not only increase revenues but reduce the efficiency costs of the tax system, improve progressivity and ensure fairness.

In terms of design, the Zambian income tax system is designed on a global basis. But it is administered similarly to a schedular tax with heavy reliance on withholding and a few taxpayers being assessed on global income. It broadly consists of personal and corporate income taxes.

Zambia’s income tax system is principally governed by one law - the Income Tax Act Chapter 323 of the Laws of Zambia. All income taxes, whether for individuals,

[1] Ministry of Finance (2022). Medium Term Budget Plan 2022-2024.

companies and other taxable entities, are under this single law. The act helps determine a taxpayer's taxable income, charging provisions, tax liability, deductions, returns and assessments, double taxation relief, appeals, offences and penalties, and prosecution.

The Mines and Minerals Development Act guides the collection of mineral royalty.

Personal Income Tax

An individual, whether resident or non-resident, is subject to tax on income within or deemed to be from a source within Zambia. Foreign source dividends and interest for individual residents are subject to tax.

Zambia adopts a narrow definition of gross income for estimating personal income tax. The base of the personal income tax defined in the Income Tax Act falls short of the Haig-Simons comprehensive income notion, as several components of income are not included in the concept of gross income for the purpose of estimating the taxable income. These include capital gains, in-kind income (e.g., net imputed rental income for those in free housing provided by the employer or owner-occupied housing). There are also numerous exemptions, deductions and allowances which are made based on political, social and other considerations. However, exemptions not only erode the already narrow tax base but also introduce inefficiencies and inequities in the system.

Administratively, withholding on wages and salaries as well as on interest and dividends represent major sources of revenue in Zambia. The withholding system is applied in the form of pay-as-you-earn (PAYE). The PAYE system, generally applied on wage income and partnerships, is a final tax, thereby freeing taxpayers from filing an annual tax return and minimizing the tax administration burden of processing a large number of returns with little revenue prospects. Despite the advantages, compliance rates remain low, with the biggest non-compliant employers being the government itself. Further, the marginal rates and tax-exempt thresholds are not changed regularly, thereby introducing "bracket creep" particularly for low-income earners who are just above the exempt threshold and subjected to a steep rise in the marginal rate – from being exempt to paying 25 per cent. This compromises the fairness and progressivity of the system.

Given the dual structure of the economy in which there is a significant representation of the informal sector, presumptive taxes are used as a proxy for an income tax to taxpayers in this hard-to-tax part of the economy. This leads to greater horizontal equity and efficiency gains, increasing the tax base and helping to reduce tax evasion. However, horizontal equity is compromised as they are only applied to marketeers and small business owners in the transport sector.

Recommendations

- Consider broadening the tax base by limiting deductions, exemptions and other tax preferences.This includes reducing the value of fringe benefits for personal-to-holder vehicles which are not progressive as they are generally disproportionately provided to highly compensated employees. Also, taxing the 1,858 elected councillors on their allowances will also increase equity and increase the tax base.
- Reduce the graduation of the marginal rate schedule as it is presently too steep. A less steep rate after the exempt bracket, such as 15 per cent, will minimize the tax burden faced by low-income earners who are most prone to bracket creep.
- Along with the change in the rate structure, the government should possibly index the threshold to inflation to minimize bracket creep.
- Extend the scope of presumptive taxes to other sectors other than transporters and traders with substantial informal sector activity. These include: agriculture, forestry and fishing; construction; real estate activities; and activities of households as employers.
- Reduce the top marginal rate of 37.5 per cent so as to align it more closely with the standard corporate tax rate, thereby reducing the disincentive effects and the associated scope for tax avoidance.

Corporate Income Tax

The corporate income tax, specifically referred to as “company income tax” in Zambia, is levied on business profits. Curiously, the income tax law includes hedging as a business to prevent companies, especially those in mining, from adopting hedging strategies deliberately designed to reduce taxable profits in Zambia. As with personal income tax, Zambia principally operates a source-based system for the taxation of business income, with income from or deemed to be from a Zambian source generally being subject to income tax. Residency also widens the scope of taxation as a resident company will be charged income tax on interest and dividends from a source outside Zambia on a worldwide basis.

As with taxable personal income, taxable business income is defined on a net basis. However, the long list of deductions allowed in ascertaining the gains or profits of a business adds to the eroding of the tax base. It places the tax system further away from the notion of a comprehensive income. Some incentives may also be given based on the lobbying prowess of the intended beneficiary. With limited monitoring capacity by the Zambia Development Agency (ZDA), maintaining incentives which appears to disproportionately favour a particular sector at the expense of tax revenue deters tax morality in the rest of the sectors and therefore may encourage tax evasion.

Many sectors have income tax rates below the standard rate of 30 per cent. The multiplicity of tax rates not only erodes the tax base, but it adds to the complexity of administering the taxes, and undermines the sense of fairness as a disproportionately heavier tax burden is placed on the non-priority sectors to collect the same revenue.

The design of tax incentives – particularly the ZDA tax holidays – seem largely ineffective, given the short time period for the holiday (5 years). It also increases monitoring costs for the already resource-constrained ZDA unnecessarily. It also causes serious distortions and inequities in corporate taxation. Further, the recent reduction of the corporate tax rate for the tourism sector from the standard rate to 15 per cent, due to the industry being adversely hit by the COVID-19 pandemic, does little to address the plight of tourism businesses given that they have generally been making losses. It would be more effective on firms already making profits.

Recommendations

- Government should broaden the base of the corporate income tax by, among other things, eliminating sector- or activity-specific tax incentives.
- Government should adopt a single proportional rate of the corporate income tax to enhance the efficient allocation of capital. Government should consider setting the rate at 15-25 per cent to minimise tax avoidance and evasion practices.
- Government should rethink the reduction of corporate income tax on the tourism sector and instead devise alternative measures to revive the sector.
- ZDA tax holidays incentives have to be redesigned to take into consideration the policy rationale for giving the tax breaks.

Mining fiscal regime

The mining sector plays a key role in Zambia as a source of export earnings, investment, employment, and government revenue. Mining activities contribute significant government revenue mainly from royalty and Corporate Income Tax. Nonetheless, there continues to be concerns about revenue leakages affecting all fiscal instruments in the sector. There is also a perception among many policymakers that the government share from mining is ‘low and unfair’ and that profit shifting undermines the potential revenue from the Corporate Income Tax.

Development agreements, instituted in the 1990s when the Government privatised the mines, were meant to guarantee a more cordial relationship between the government and investors. The agreements, which had stability periods ranging from 15 to 20 years, embodied highly generous tax and other concessions. Cutting across these development agreements was a ‘stabilisation clause’ binding the Government not to make alterations either to the magnitude or structure of any of the incentive provisions. However, they were abolished in 2008, thus contributing to the instability of the mining fiscal regime since then. The resulting volatile tax regime has unduly increased the mines' tax burden and discouraged long-term investments in the sector, leading to constraints in revenue generation and more suspicions.

Clearly, it has not been easy to determine an optimal fiscal regime. To ensure that the government receives at least a minimum payment for the exploitation of the country's natural resources and to safeguard against unplanned changes, the Government uses multiple fiscal instruments to exercise the resource ownership and its sovereign taxing power.

In exercising its ownership power, the government levies royalties on the value of resources extracted. The estimation of mineral royalty is based on gross value or norm value of the minerals. The gross value is applicable on industrial minerals, energy minerals and gemstones, while norm values are applicable on base metals (including copper) and precious metals. Zambia applies a sliding-scale mineral royalty regime for copper. However, applying the variable royalty rate for copper on an aggregate basis increases the distortive impact and adds significant uncertainty to taxpayers.

In exercising its taxing power, the government levies a corporate tax on all mining companies, as it does with the non-mining companies but with some nuances unique to the mining sector. However, with multinationals dominating the extractive industries, they can potentially devise numerous ways to shift profits abroad by payments for goods and services obtained abroad from related parties. So, a number of safeguards have been devised which include the following:

- Given the capital-intensive nature of mining, the Income Tax Act permits a 10-year carrying forward of tax losses for mining compared to 5 years for non-mining businesses. To protect Zambia's tax base, there is an additional restriction on mining whereby the loss carry-forward in any year is capped at 50 per cent of the taxable income in that year.
- Further, in 2019, Government introduced a limitation on interest deductibility to 30 per cent of earnings before interest, tax, depreciation and amortization (EBITDA). This applies to all companies, except companies in the insurance, banking, and financial services industry.

These limitations notwithstanding, all other cross-border payments – except for dividends and interest due to the EBITDA rule –are not subject to any limitation on deductibility.

Recommendations

- Government should consider bringing back development agreements in a different form to guarantee sustainable mining activity. The development agreements could include a clause on amending the stabilization mechanisms to ensure more flexibility.

- With regard to the sliding scale of the mineral royalty regime, Government should consider applying the variable royalty rate on the incremental rather than aggregate value in each price band which will help to reduce the average effective tax rate for mining companies.
- Zambia should extend the limitations on deductibility to other cross-border payments on investment income such as management and consultancy services.

I INTRODUCTION

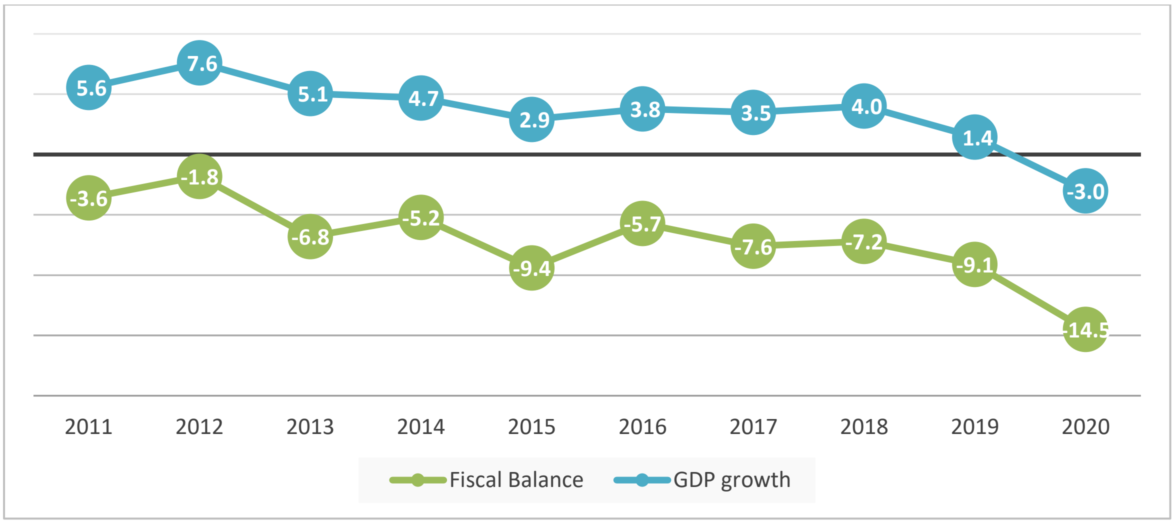
In 2020, Zambia became the first African country to default on its debt in the COVID-19 era. The default came after its private creditors refused to grant the country a six-months principal and interest payments moratorium. Prior to this default, the southern African country had been experiencing a challenging fiscal situation resulting in its first recession in two decades. The reduced economic activity resulted in total revenues and grants being below target by 10.1 per cent, and total expenditure (including amortization) being 14.3 per cent above target. Given this revenue underperformance and above-target expenditure, the fiscal deficit on a cash basis was at 14.4 per cent of GDP against a target of 5.5 per cent in 2020[2]. The fiscal deficit on a commitment basis (which includes domestic arrears) exceeded 23 per cent of GDP.

Over the last decade, fiscal deficits averaged 7.1 per cent of GDP and have been widening. The fiscal deficit which was just 1.8 per cent of GDP in 2011 soared to 9.4 per cent of GDP by 2016. After reducing in the next four years, it then increased to 14.4 per cent in 2020. The International Monetary Fund attributed the huge rise in the fiscal deficit to "excessive spending in the face of relatively low and flat revenues"[3]. The deficits created an annual average revenue gap of more than K15 billion. The rising deficit was also consistent with the declining economic growth over the period (Figure 1).

[2] Ministry of Finance (2021). Annual Economic Report 2020. Ministry of Finance, Lusaka, Zambia.

[3] International Monetary Fund (2017). Zambia – Selected Issues. IMF Country Report No. 17/328. October 2017.

Figure 1: Fiscal Balance, % of GDP, 2011 - 2020



Source: Author's calculation using Ministry of Finance Annual Economic Reports for 2011-2020

The persistently widening deficit spending and low economic growth led to an unsustainable stock of public debt. As at end-December 2020, the stock of public debt amounted to US$19.8 billion representing an increase of 2 per cent from the stock of US$19.4 billion recorded at the end of 2019. By composition, public external debt amounted to US$12.7 billion while public domestic debt amounted to US$7.1 billion. A recent report shows that public debt as at end-June 2021 rose to US$27.0 billion, consisting of US$16.9 billion external debt and US$10.1 billion domestic debt[4]. This is an increase of 36 per cent in barely 6 months. The increase was due to continued disbursements on already contracted public external loans and an increase in domestic debt through issuance of Government securities for direct budget support.

To mitigate the effects of the COVID-19 pandemic, the Government instituted a number of spending measures, which further widened the deficit. The Government, among other things, issued an K8 billion "COVID Bond" (equivalent to 2.4 per cent of GDP) to finance COVID-related expenses, including health-related spending, arrears clearance (including fuel arrears), and grain purchases to ensure food security. This expenditure resulted in higher than planned expenditure. Other measures included reallocation of the health budget from primary health care to purchase medical supplies and equipment in response to the need to procure COVID-19-related supplies. The Government also scaled up social protection programmes to protect lives and livelihoods of the most vulnerable people.

To cushion businesses and individuals, the Government has had to forego some revenue as it constituted measures to cushion the health and economic effects of

[4] Ministry of Finance (2021). Public Debt Summary as at end-June 2021: Ministry of Finance, Lusaka, Zambia.

COVID-19. Measures instituted included suspending import duties on mineral concentrate and export duties on precious metals to support the mining sector; waiving tax penalties and fees on outstanding tax liabilities resulting from COVID-19; suspending customs duties and Value Added Tax (VAT) on some medical supplies and medical-related commodities; removing the provisions related to claiming VAT on imported spare parts, lubricants, and stationery to ease pressure on companies; zero-rating VAT for equipment used for full-body sanitization; and giving a tax break for the tourism industry, which was one of the most affected by COVID-19, including reducing the Corporate Income Tax rate to 15 per cent, instead of the standard 35 per cent[5], and suspension of import duties and fees[6]. These concessional measures to mitigate the effects of the pandemic resulted in increased revenue losses.

To bring the country back on the path of fiscal and debt sustainability, the government would have to frontload fiscal adjustment measures in the coming few years. With the fiscal framework already weak even before the pandemic, Zambia's public finances face a number of structural challenges, including lower levels of economic growth, with limited growth in tax revenues, and an already high public debt. The issues are compounded by the fact that a number of loans, including the US$3 billion Eurobonds, will fall due within the next five years. Further, with COVID-19 still here, it makes the fiscal adjustment more challenging. And having lost access to international capital markets following its default on several private loans, Zambia would have to look within itself to generate enough resources to bring public finances on a more sustainable trajectory.

The need for higher public revenues to fund basic services, counter the massive impact of the COVID-19 pandemic and pay off the debt presents an opportunity for Zambia to make its tax system more efficient and equitable. The Zambian government plans to increase domestic revenue to no less than 21.2 per cent of GDP in the medium term while ensuring fairness and equity in the tax system[7], according to the 2022-2024 Medium Term Budget Plan. In order to inform how the tax system may realistically be reformed, it was necessary to go back to the basics by assessing the base upon which the tax system is premised. This was then compared to the characteristics of the current tax system, including the legislation governing the tax system, and how the taxes are actually administered.

This study therefore undertakes a comprehensive and detailed review of Zambia's income tax regime, guided by, but not limited to, the United Nations Economic Commission for Africa's analytical framework for assessing the

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[5] The standard corporate income tax rate has been reduced to 30 per cent starting in 2022.

[6] Ministry of Finance (2020). National Budget Address: Ministry of Finance, Lusaka, Zambia.

[7] Ministry of Finance (2022). Medium Term Budget Plan.

direct tax system. It makes a distinction between what the tax base ought to be including what the measure of income on which personal and corporate taxes are levied, what the tax law says about how the taxes should be collected and how they are actually collected. The study also provides the required and necessary reform proposals that would not only increase revenues but reduce the efficiency costs of the tax system.

The remainder of the report is structured as follows; a brief overview of Zambia's tax system (both direct and indirect taxes) is presented in Chapter 2. In Chapter 3, the analytical framework is presented. Chapter 4 deal with the Personal Income Tax, while the Corporate Income Tax is analysed in Chapter 5. The mining fiscal regime is analysed in Chapter 6. Chapter 7 discusses the main findings and offers some recommendations.

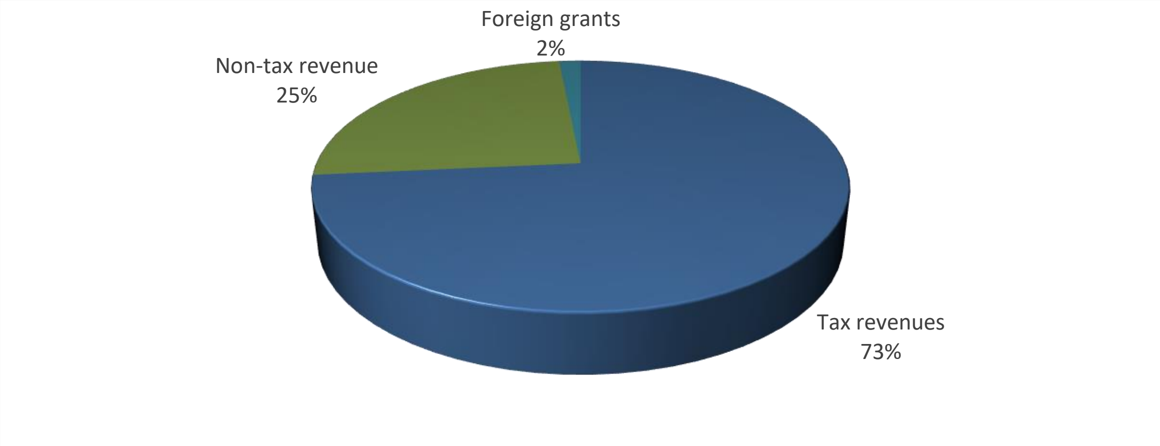
II OVERVIEW OF ZAMBIA'S TAX SYSTEM

Before delving into design issues of the direct tax system in Chapter 3, this chapter considers a high-level overview of tax revenue trends and the tax mix in Zambia over the last 25 years. Also considered are some of the key changes to the economic environment, the tax mix and the legal and institutional framework in which the tax system has had to operate.

2.1 General tax revenue trends

Nearly three-quarters of revenues and grants in Zambia come from tax revenues. In 2021, the total government revenue and grants was forecast to be K97.5 billion (Zambian Kwacha), or 27 per cent of gross domestic product (GDP). The primary source of revenue is taxation, which was forecast to raise K71.7 billion in 2021, or 20 per cent of GDP and 74 per cent of total revenues and grants – equivalent to K8,120 for each adult aged 18 and above living in Zambia. Figure 2 shows the composition of total government revenues and grants in 2021, with tax revenues taking up about three-quarters of the total government revenues and grants.

Figure 2: Composition of total government revenues and grants, 2021 forecast



Source: Compiled from Ministry of Finance Fiscal Tables, 2021

Typically, tax revenues[8] in Zambia have hovered around 15 per cent of GDP[9] and have been sensitive to economic cycles. Figure 3 shows that the tax-to-GDP ratio in Zambia has been lower than the Southern African Development Community (SADC) average of 21 per cent. Zambia's tax revenues are closer to the lowest levels found in SADC. Broadly, the tax-to-GDP ratio averaged around 16 per cent between 1996 and 2004. This was the time the country faced significant challenges in the mining sector and was faced with a public debt of over 130 per cent of GDP in 2004[10]. During 2005-2012 following the attainment of the Highly Indebted Poor Countries (HIPC) Completion Point, the tax-to-GDP ratio dropped below 15 per cent, reaching as low as 11.7 per cent in 2009 at the time of the Global Financial Crisis. Ironically, this was the period when growth was at its peak, averaging over 7 per cent. Following some gains during 2013-2015, the taxes dropped again in 2016 when the country experienced a mini-economic crisis brought about by a combination of adverse factors, including low copper prices and adverse weather conditions which led to electricity supply constraints as the bulk of Zambia's electricity supply is generated from hydropower. In 2018 and 2019, the tax revenues rose to about 16 per cent before plunging to less than 15 per cent in 2020 when the COVID-19 pandemic struck (2020 figure not shown in chart as data for the SADC comparison is only available up to 2019).

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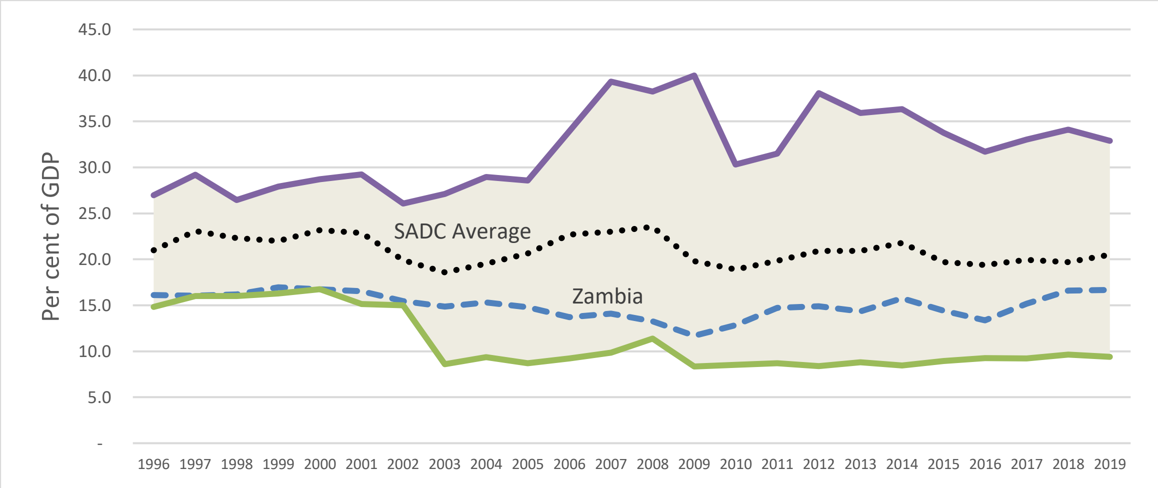
[8] It should be noted from the onset that tax revenues, unless explicitly stated, do not include mineral royalties (referred to as "mineral royalty tax" in Zambia) as they are not taxes per se; instead, mineral royalties are classified as non-tax revenue.

[9] However, 2021 was an exceptional year in terms of tax revenue receipts. Estimated at 19.4 per cent of GDP, the higher tax receipts were due to higher collections from corporate income tax from mining firms, primarily due to higher copper prices and the depreciation of the Kwacha against the United States Dollar.

[10] International Monetary Fund Fiscal Monitor.

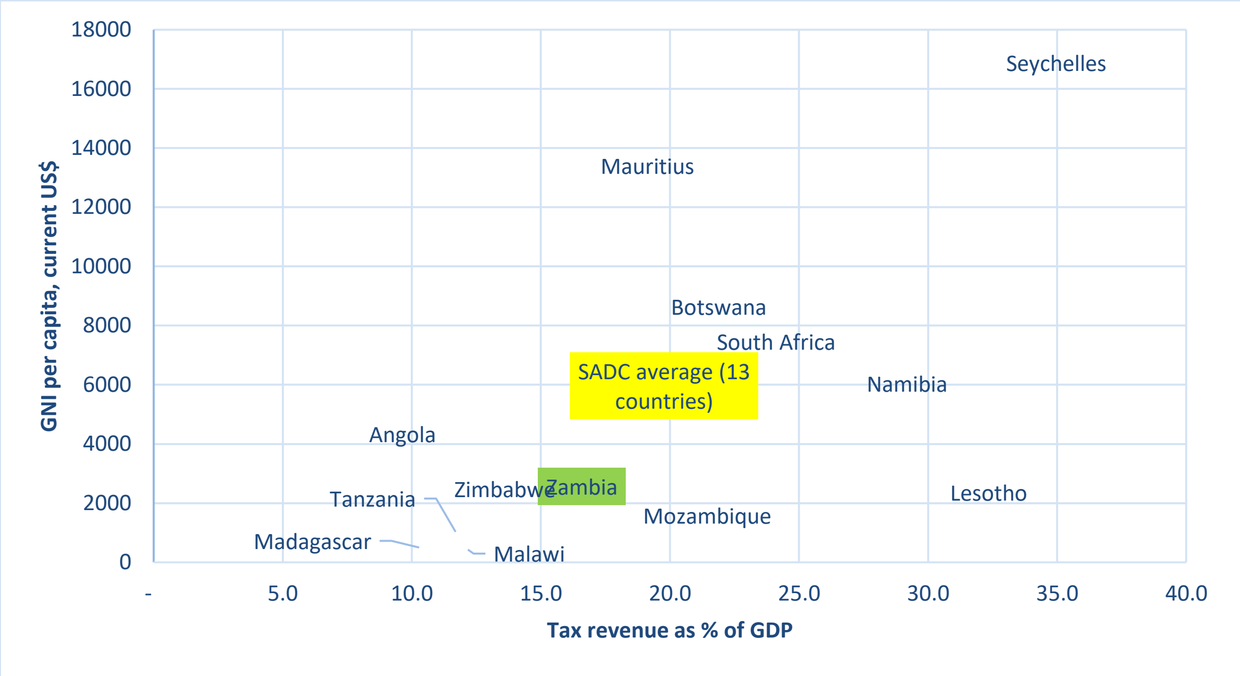
Figure 3: Total tax revenue as a % of GDP in Zambia and SADC, 1996 - 2019



Note: The shaded area shows the tax revenue as a per centage of GDP range among SADC countries (i.e. the maximum and minimum) in a given year.
Source: World Development Indicators, downloaded 30 Nov. 2021

Zambia's tax-to-GDP ratio in relation to per capita income is significantly lower than the average for SADC countries. The country's tax revenue adjusted for GNI per capita was lower than the unweighted average for 13 SADC countries in 2018 where data was available. It was lower than that of Seychelles, Lesotho, Namibia, South Africa, Botswana, and Mauritius; but higher than those of Madagascar, Tanzania, Malawi and Zimbabwe. This performance typifies the level of tax revenue collections over the years. Significant tax exemptions, large thresholds, and a multiplicity of tax rates explain the large gap in the tax ratio between Zambia and SADC countries (International Monetary Fund, 2017). Figure 4 shows the average tax-to-GDP ratio for Zambia in relation to other SADC countries.

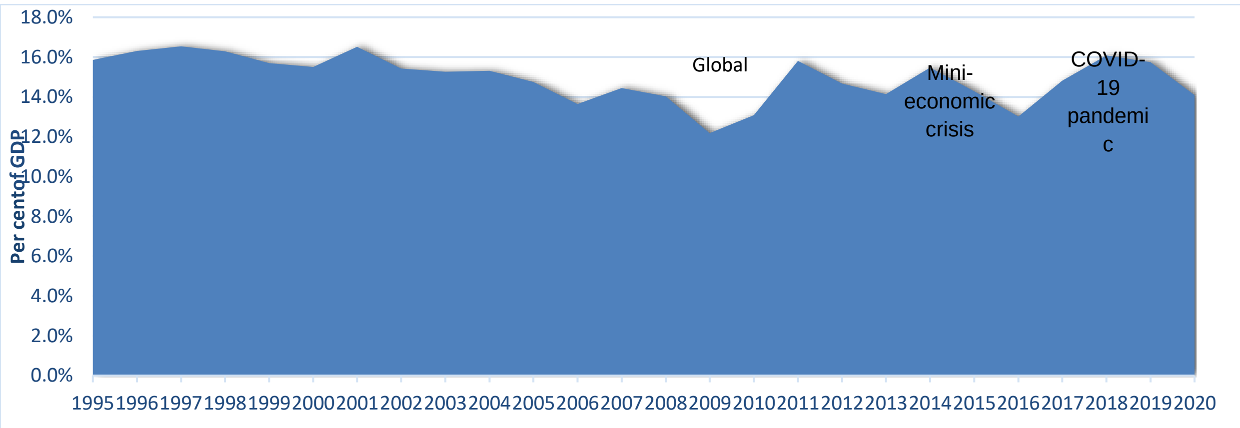
Figure 4: Tax revenue as % of GDP adjusted for GNI per capita (in current US$), 2018



Source: Constructed from World Development Indicators, downloaded 30 March, 2022

Since 1995, there have been three periods during which tax revenues recorded significant declines. These are in 2009 (due to global economic crisis), 2016 (due to national mini-economic crisis as a result of a slump in copper prices and adverse weather conditions which resulted in, among other things, low agriculture output and electricity supply constraints) and 2020 (due to COVID-19 pandemic). During the three periods, there was significant decline in tax revenue as shown in Figure 5.

Figure 5: Trends in total tax revenues, per cent of GDP, 1995-2020

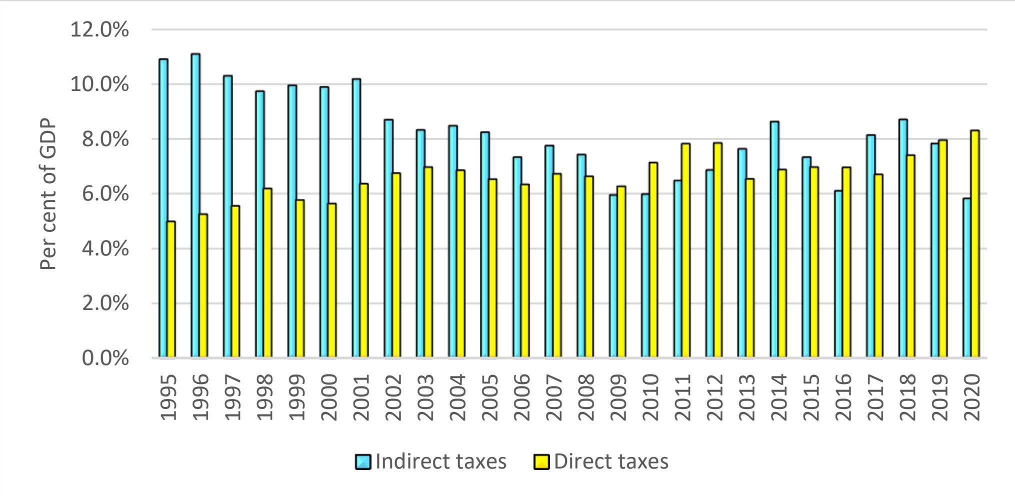


Source: Elaborated using data from Ministry of Finance, Zambia

The declines in overall tax revenues were largely driven by relatively poor

performance in indirect taxes. Direct taxes[11], on the other hand, showed resilience and instead seem to have been unaffected by these external shocks. Clearly, direct taxes have served as a buffer during times of economic downturns and show a relatively higher potential to increase domestic revenues (Figure 6). However, while revenue is generally measured on an accrual basis, delays in assessments and final payments, particularly for business taxes, are likely to have caused lags in collections. Average processing times for income tax refunds was 52 days in 2020 instead of the stipulated 45 days, while processing times for VAT refunds averaged 306 days instead of the Charter standard of 30 days[12]. Given this state of affairs, the conclusions proffered above may not be entirely accurate.

Figure 6: Trends in total tax, direct and indirect tax revenues, per cent of GDP, 1995-2020



Source: Elaborated using data from Ministry of Finance, Zambia

2.2 The tax mix

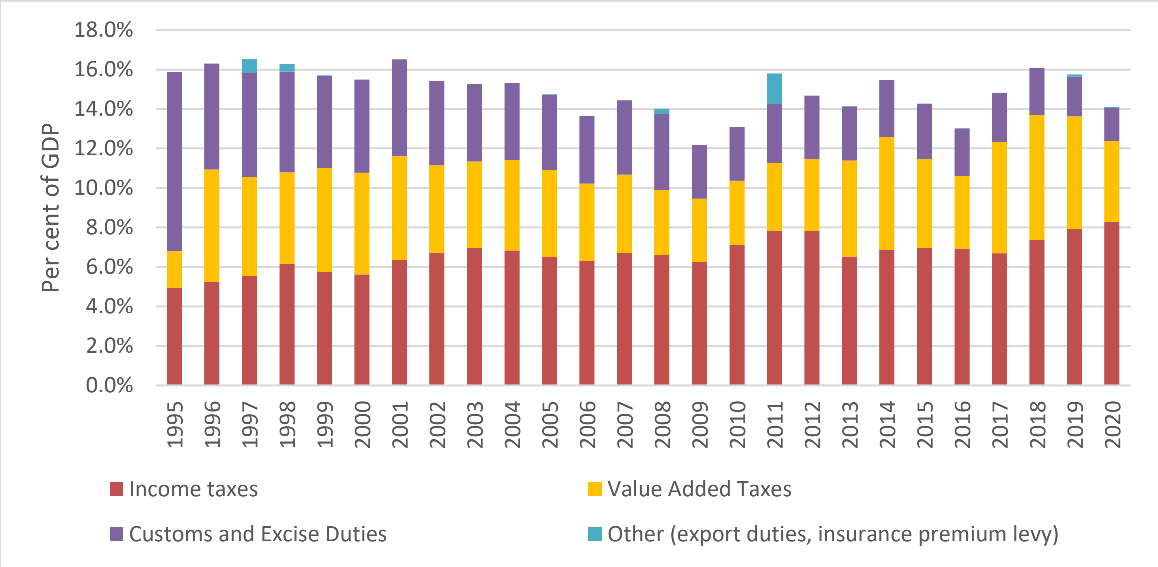
The Zambian tax system broadly consists of three categories: (i) Income taxes (ii) Value Added Tax (VAT) and (iii) Customs and Excise taxes. Others are insurance premiums and export duties. Of these, i**ncome taxes are the most dominant tax type**. Indirect taxes dominated between 1995 and the global financial crisis. Since then, direct taxes have had a relatively larger share. Averaging 6.6 per cent of GDP during 1995-2020, income taxes accounted for nearly half (45 per cent) of the total tax revenues (Figures 7 and 8). This was followed by Value Added Tax (4.5 per cent of GDP; 30 per cent of total tax revenues) and Customs and Excise Duties (3.7 per cent

[11] Since 2014, mineral royalties, which hitherto were under direct taxes, were reclassified as non-tax revenues. The series used in this report from 1995 to 2020 excludes mineral royalties from direct taxes.

[12] Zambia Revenue Authority (2021). Annual Report 2020.

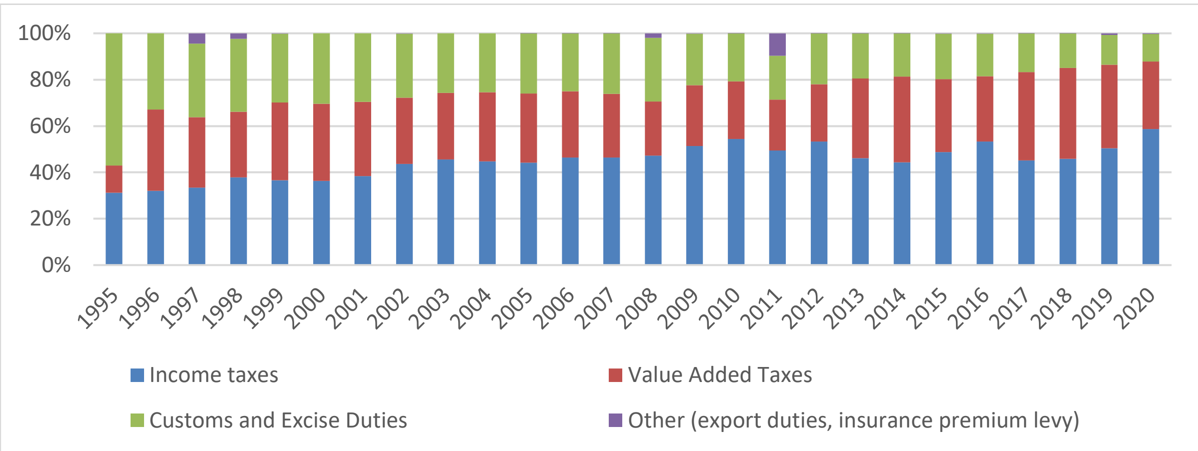
of GDP and 25 per cent of total tax revenues).

Figure 7: Tax revenue collections by type, as a per centage of GDP, 1995-2020



Source: Elaborated using data from Ministry of Finance, Zambia

Figure 8: Tax revenue collections by type, as a per centage of total revenue, 1995-2020

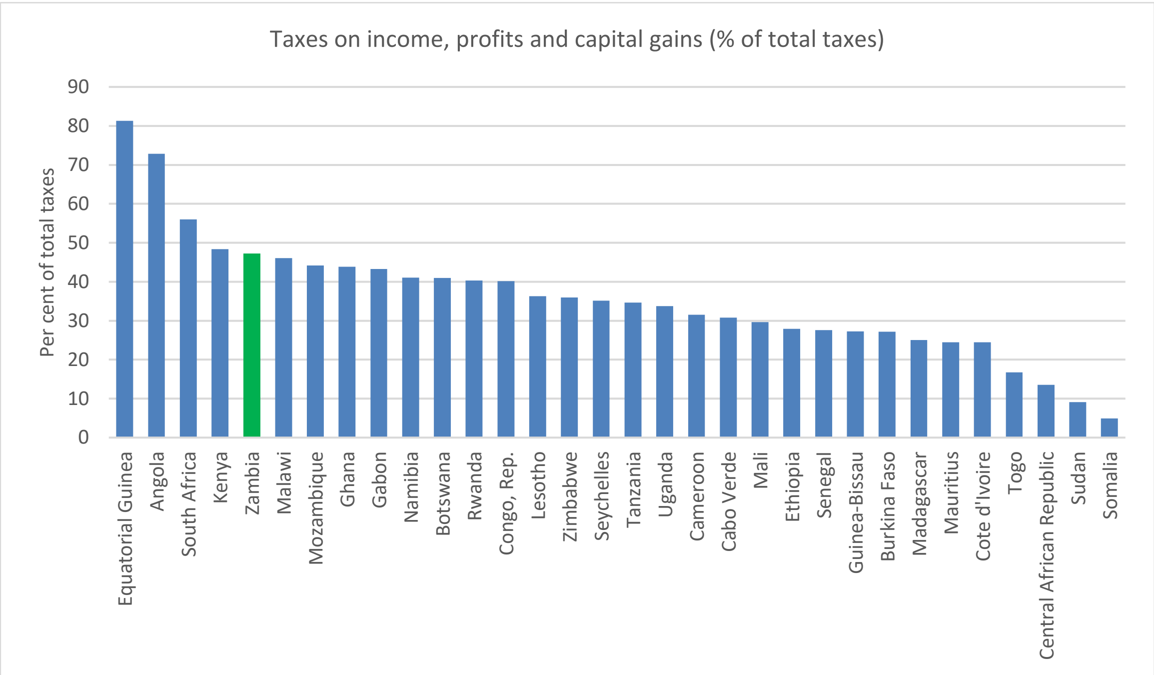


Source: Elaborated using data from Ministry of Finance, Zambia

Income taxes have been holding the fort for general tax collections. Despite declining economic growth, income taxes were on the increase. According to the 2020 Annual Report of the ZRA, income tax collections have doubled between 2016 and 2020 from K17,991 million in 2016 to K34, 584 million in 2020. The positive performance, at least for corporate income tax, is driven by improved copper prices on the international market and the non-deductibility of mineral royalties for company income tax purposes introduced in the 2019 mining tax regime. While the motivation for removing deductibility was the desire to increase the effective tax rate paid by mining companies, the lack of tax deductibility of mineral royalty payments violated common international practice where mineral royalty payments are typically treated as deductible expenses for income tax purposes similar to most other indirect taxes. This led to reduced exploration and postponement of new investments such as First Quantum Minerals' "S3" expansion project at Kansanshi mine. The Government has since reintroduced the deductibility of mineral royalties from 2022.

Unlike most other African countries where indirect taxes dominate, there is an almost equal split between direct and indirect taxes in Zambia. Other countries with a similar direct tax system structure include Angola, Botswana, Republic of Congo, Equatorial Guinea, Gabon, Ghana, Kenya, Malawi, Mozambique, Namibia, Rwanda and South Africa. All, except Malawi and Rwanda, are considered resource-rich countries (Figure 9).

Figure 9: Average taxes on income, profits and capital gains (% of total taxes), 2010-2019, Zambia compared to selected African countries



Source: World Development Indicators, 26 October 2021

2.3 General overview of legal and institutional framework

Taxes are collected by the Zambia Revenue Authority (ZRA), a semi-autonomous agency created under the Zambia Revenue Authority Act, Chapter 321 of the Laws of Zambia mandated to collect all national taxes. The tax types are governed by primary tax legislation, subsidiary legislation and annual practice notes which detail the ZRA's interpretation of changes in tax laws. These include direct taxes, indirect taxes and customs and excise taxes.

Direct Taxes: The Direct Taxes Division of the ZRA is mandated to administer and collect income taxes as provided for under the Income Tax Act, Chapter 323 of the Laws of Zambia; and the Property Transfer Tax Act, Chapter 340 of the Laws of Zambia. The Division also administers Mineral Royalty, as provided for under the Mines and Minerals Development Act No. 11 of 2015, Tourism Levy pursuant to the Tourism and Hospitality Act No. 13 of 2015 and Skills Development Levy pursuant to the Skills Development Levy Act No. 46 of 2016.

Domestic Indirect Taxes: The Indirect Taxes and Excise Division of the ZRA is responsible for administering inland consumption taxes as provided for under the Value Added Tax Act, Chapter 331 of the Laws of Zambia; the Insurance Premium Levy Act No. 21 of 2015; and the Customs and Excise Act Chapter 322 of the Laws of Zambia to administer Local Excise.

Customs Services: The Customs Services Division is responsible for administering trade taxes, fees and charges as mandated under the Customs and Excise Act, Chapter 322 of the Laws of Zambia. The Division also protects society through enforcement of regulatory controls on imports, exports and goods in transit as well as by contributing to the security and control of international supply chains. The Division is also responsible for supporting industrial growth by facilitating legitimate international trade[13]. Table 1 gives the broad tax categories in Zambia, the laws underpinning tax collections and the types of taxes under each category.

Table 1: Tax Category, Legal framework and Tax type

Broad Category	Category	Primary Legislation	Subsidiary Legislation	Type
Direct Taxes	Income taxes	Income Tax Act Chapter 323 of the Laws of Zambia		Company Income Tax Personal Income Tax
	Property Taxes	Property Transfer Tax Chapter 340 of the Laws of Zambia		Property Transfer Tax
Indirect Taxes	Value Added Tax	Value Added Tax Act Chapter 331 of the Laws of Zambia		Domestic VAT Import VAT
	Customs, excises and other duties	Customs and Excise Act Chapter 322 of the Laws of Zambia		Customs Duty Excise Duty Export Duty

[13] Zambia Revenue Authority (2021). Annual Report 2020.

Non-tax Revenue	Mineral Royalties	Mines and Minerals Development Act, 2015	Income Tax Act Chapter 323 of the Laws of Zambia	Mineral Royalties

Source: Zambia Revenue Authority

III ANALYTICAL FRAMEWORK

This study employs the analytical framework developed by UNECA's Macroeconomics and Governance Division to assess the Zambian income tax system. This was enriched by key informant interviews with key policy makers in the design and implementation of direct taxes in the countries (See Annex I and II). The framework could be used in assessing countries' direct tax policies with the aim of identifying opportunities and challenges aimed at strengthening the countries' domestic resource mobilization as they transition through and out of the COVID-19 pandemic.

The analytical framework has three main components:

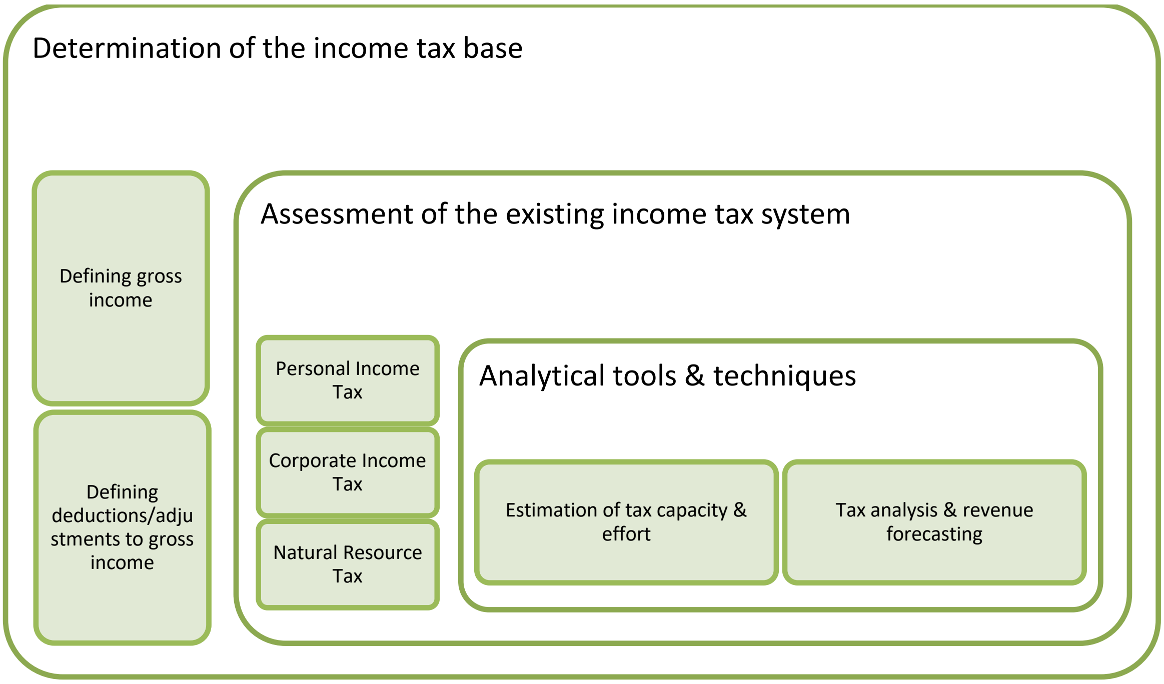
(a) An empirical determination of the base that is subject to income tax. This determination is important given the numerous changes that have been made to the income tax base over the years which may have eroded the base.

(b) The comprehensive assessment of existing direct tax system and how it relates to the income tax base. The assessment is made with regard to how well the tax law is designed to capture the tax base, as well as the actual administration of the taxes.

(c) Applying tools and techniques to estimate the tax capacity and effort, as well as the tax analysis and revenue forecasting. The tax analysis also includes ex-ante impact analysis of the proposed reform options.

Figure 10 is a graphical illustration and summary of the analytical framework that has been applied.

Figure 10: Overview of the analytical framework for assessing Zambia's direct tax system

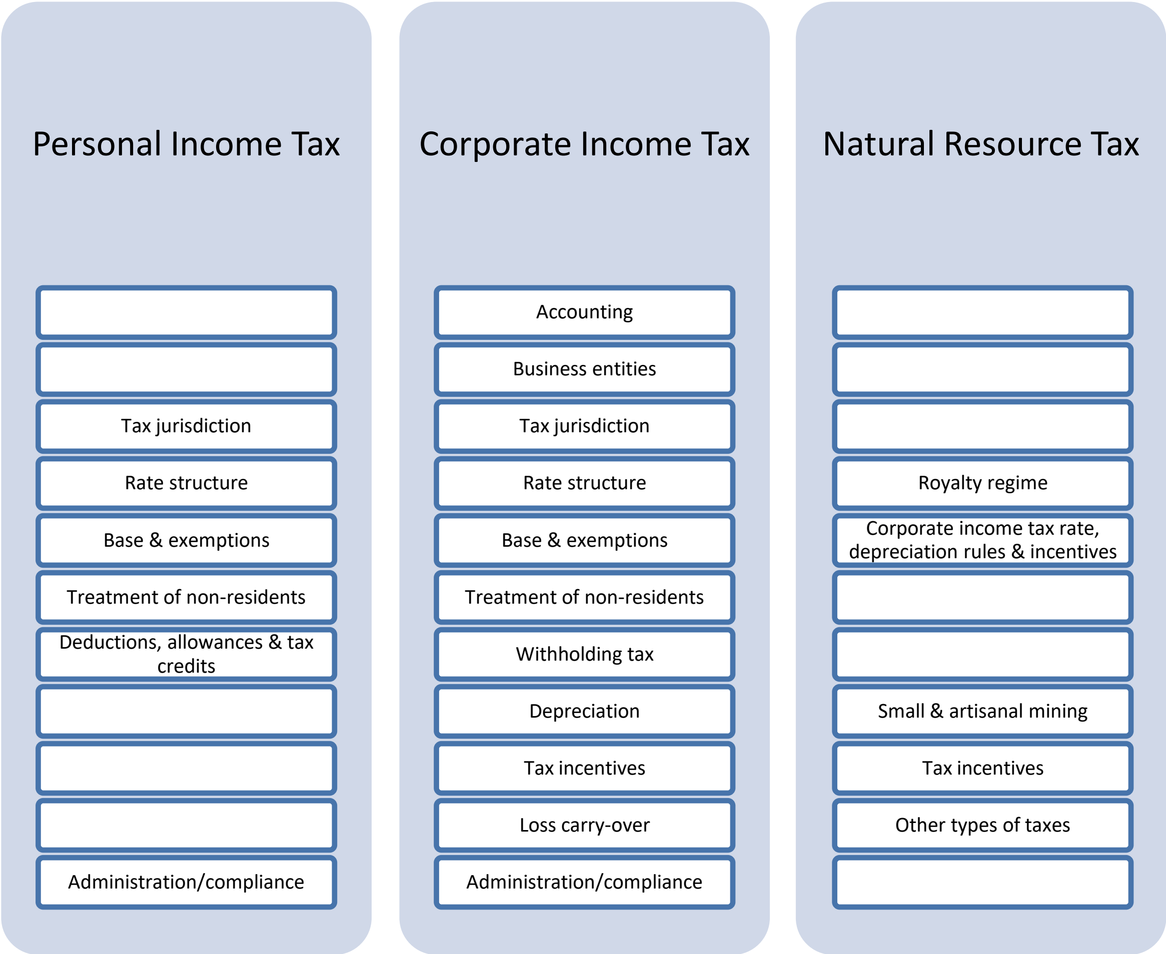


Source: Author's own elaboration from the proposed UNECA Analytical Framework on Direct Tax Policies for African Countries.

After bringing out key considerations for determining the income tax base, we then compare the base to the legislative provisions that define Zambia's existing income tax system. Zambia's income tax system is principally governed by the Income Tax Act Chapter 323 of the Laws of Zambia. All income taxes, whether for individuals, companies and other taxable entities, are under this single law. The act helps determine a taxpayer's taxable income, charging provisions, tax liability, deductions, returns and assessments, double taxation relief, appeals, offences and penalties, and prosecution. Over the years, numerous amendments have been made to the act. Other pieces of legislation governing the income tax administration system are the Skills Development Levy Act and the Mines and Minerals Development Act.

The module for the assessment of the existing direct tax system is divided into personal income tax, corporate income tax and natural resource taxes (Figure 11). There is a separate natural resource tax from corporate income tax given the importance of natural resources to the country. Being a resource-rich country, the case for special resource taxes in Zambia is to tax resource rents over and above the levies implicit in general income taxes. There is an efficiency and an equity argument for taxing natural resources – the efficiency argument is that a tax on resource rents is non-distorting and complementary; while the equity argument is that the property rights to resources ought to accrue to the public at large rather than to private citizens since the rents represent the bounty that nature has bestowed on the economy rather than a reward for economic efforts[14]. Annex I presents the set of questions that were asked to develop the baseline information for Zambia.

Figure 11: Module for assessing the existing direct tax system



Source: Consultant's own elaboration from the proposed UNECA analytical framework on direct tax policies for African countries

IV ASSESSMENT AND ANALYSIS OF DIRECT TAX SYSTEM

4.1 PERSONAL INCOME TAX

The concept of "comprehensive" income is considered the gold standard for determining the personal income tax base. The Haig-Simons definition of comprehensive income tax base forms the basis for the analysis of the Zambian

[14] Robin Broadway and Frank Flatters (1993). The Taxation of Natural Resources: Principles and Policy Issues. Public Economics Division, Policy Research Department, The World Bank, October 1993, WPS 1210.

personal income tax regime. The Haig-Simons concept of income stipulates that income tax base is equal to the sum of consumption and change in net worth. In this concept, all inflows and outflows of resources are considered taxable income in a broad sense, including donations and windfall gains.

The following components of income are included in the Haig–Simons comprehensive definition of income: wages and salaries, commissions, profits of privately–owned businesses, dividends, interest income from securities and bank accounts, tips, rental income, transfer payments (such as employment insurance benefits), gifts or inheritances received, income in kind such as the value of free (or subsidized) parking provided by an employer, the value of driving a company car for personal use, frequent flyer miles earned from taking business trips, the value of accommodation in owner–occupied housing, and the net increase in the real value of a person's assets.

The concept of taxable income effectively defines the income tax base. The taxable income of a person for a tax period is commonly defined as the gross income of the person for the period less the total deductions allowed to the person for the period[15]. The gross income of a person for a tax period is the total of the amounts derived by the person during the periods that are subject to tax. The gross income of a person, therefore, excludes amounts that are exempt from tax. The total deductions of a person for a tax period are the total expenses incurred by the person during the period in deriving amounts subject to tax plus any capital allowances and other amounts allowed as a deduction (e.g., charitable donations).

Consequently, there are three key elements in the definition of the tax base: first, the inclusion of amounts in gross income; second, the identification of amounts that are exempt income; and third, the allowance of amounts as deductions[16].

4.1.1 Key considerations for determining the personal income tax base

We empirically define the base of the income that is subject to individual tax by considering a hypothetical example.

[15] Lee Burns and Richard Krever (1998). Individual Income Tax. International Monetary Fund; https://doi.org/10.5089/9781557756336.071.
[16] Victor T. Thuronyi (1996). Tax Law Designing and Drafting. International Monetary Fund, August 23, 1996.

Example 1: Suppose a 45-year-old individual is married with 2 biological children and a niece (one of his children and his niece are of school-going age, while his second child is an infant). He lives in a house provided by his employers. He is employed in a permanent and pensionable job and is entitled to health insurance paid for by his employers. His 40-year-old wife runs a small business on her own selling fruits and vegetables at a nearby food market. The couple has jointly invested in a 5-year Government Bond. This middle-class family also gets dividend income from their joint investment in the wife's brother's company based in South Africa.

The above hypothetical illustration identifies a number of income categories: employment for the man, small business for the woman, investment income (interest and dividend income for both). There are also fringe benefits such as free housing provided by the employer and health insurance (See Table 2).

Table 2: Determining the categories of income from the hypothetical example

Income type	Description from hypothetical example
Employment	Salary of man
Business	Small business income from wife
Investment	Interest income from government bond; dividends from equity holding in foreign company
Miscellaneous receipts	Company housing; pension contribution

We first have to establish where the source(s) of income lies as well as where the taxpayers are resident. The *Source Principle* asserts the prior, and even sole, claim of the source country, or country in which the income arises to natural persons, to tax such income without reference to other criteria or physical presence or legal residence. Clearly, taxing income on a source basis amounts to a tax on the location of capital, or investment, because it disregards the status of the investor in favour of the siting of the investment. The *Residence Principle* asserts that individuals are taxable in the country or tax jurisdiction in which they establish their residence or domicile, regardless of the sources of income. In a nutshell, the residence principle taxes residents' worldwide income and the source principle taxes all income produced by domestic factors irrespective of their owners' residence. We assume that the family are Zambian resident based on the residency criteria established. So, their income will be taxable within Zambia. Furthermore, we assume that their income was sourced from within Zambia, they received dividend income from South Africa.

We are also faced with the complexity of determining the joint interest and dividend income between the man and his wife. So, before estimating taxable income, a key consideration is the unit of taxation – are we going to measure their income as a family or separately for each individual?

4.1.1.1 Unit of taxation

In seeking to determine if the tax will be collected at family or individual level, it immediately brings in the complexity of defining a family. With the tradition of extended families, we have to ensure that we confine the family to a household. While in this example the members are all related, it is not often the case that people in a household are related. Defining a household also brings to the fore complexities of usual residency, common provisions for food, and other such considerations that go with defining households.

If the family is the unit of taxation, the incomes of all members of the family will be aggregated, and the income tax is then imposed on total family income. If the unit of taxation is the individual, each individual is taxed only on his or her own individual income. We take the traditional view that the personal income tax system should be designed primarily to distribute tax burdens in a way that is fair to all individuals, irrespective of their family circumstances. At the same time, a tax system cannot be fair to individuals unless it takes into account the differences in ability to pay that result from the way that resources are shared within families of different sizes and types[17]. However, given the shared interest and dividend income in this example, the choice between the family and individual as the unit of taxation involves certain judgments and is therefore not that clear-cut.

A tax system based on individual taxation is neutral with respect to marital status and avoids the efficiency problems that result from joint taxation. It does, however, result in different treatment of married couples with the same income, depending on the distribution of earnings between spouses. On the other hand, tax systems that are based on joint taxation, while achieving equal treatment of married couples with the same income, regardless of the distribution of earnings between the spouses, create inequalities in taxation between married and unmarried couples and individuals with the same income.

If the unit of taxation is the family, the gross income would include earnings from wages for the man (including fringe benefits, i.e., employer-provided housing), and earnings from self-employment for the woman; as well as interest and dividend income.

If the unit of taxation is the individual, the income of the man and that of his wife

[17] C. Eugene Steuerle (1997). Taxation of the Family – Testimony Before the Ways and Means Committee. Urban Institute, April 15, 1997.

would be determined separately. Starting with the man, his gross income is the sum of his wage earnings from his job (including the health insurance benefits), part of the interest income from investing in a government bond, and part of the dividend income from the family equity holding in his brother-in-law's foreign-based company. For his wife, her gross income would be estimated as the earnings from her small business and part of the interest income from the bond and dividend income from the joint investment in her brother's company (See Table 3).

Exemptions

Some components of this family's income may be excluded from gross income. It may be the case that one or both of the school-going children are eligible for a scholarship or bursary. If that is the case, the scholarship or bursary may be exempt from the income assessment. Exempt income will be excluded from the definition of gross income and thus excluded from the calculation of taxable income.

Deductions

Because taxable income includes net amounts, there is need to recognise expenses incurred to derive gross employment income. However, determining employee expenses could be a complex issue, particularly with regard to borderline expenses that have elements of both employment expenses and personal consumption such as commuting, travel and entertainment. For the small business, expenses could have been incurred. If the business is unincorporated, this brings in another complexity as there is no distinction in the expenses of the individual and the business. It would become even more complicated if the woman does not keep records, as is the case with most small businesses in the country.

Tax allowances and credits

Any tax offsets that may be available to the taxpayer are then subtracted. There are two types of subtractions that are relevant to the calculation of the actual tax payable by a taxpayer. First, an amount may be subtracted from gross income in the calculation of the taxable income of the taxpayer, commonly referred to as "allowances". Second, an amount may be subtracted from the tax payable, referred to as a "tax credit". Therefore, the key difference between tax allowances and credits is that tax allowances are deducted from gross income to arrive at taxable income, while tax credits are deducted from gross tax liability to arrive at final tax liability[18].

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[18] Parthasarathi Shome, ed. (1995). Tax Policy Handbook, Fiscal Affairs Department, International Monetary Fund, https://doi.org/10.5089/9781557754905.071.

Allowances in our example would include the free housing provided by the employer and health insurance cover. With dividend income obtained from shareholding in a South African based company, there is a possibility of a tax relief on the dividends received if there is a double taxation treaty between Zambia and South Africa. This will form part of the tax credit. Another possible credit could be child support given that the couple has 3 children under their care.

Table 3: Estimation of taxable income and tax payable

Income type	Unit of taxation		
	Individual 1 (man)	**Individual 2 (woman)**	**Family**
Gross income	Employment income, including fringe benefits Part of interest income	Business income Part of interest income	Both employment & business income; interest income
Less: exemptions	Scholarship or bursary		Scholarship or bursary
Less: deductions	Employee expenses, if any	Business expenses	Employee and business expenses
Less: Allowances	Free housing from employer; health insurance		Free housing from employer; health insurance
Less: Credits	Part of dividend income; child support	Part of dividend income	Total dividend income

This example illustrates the complexities encountered in determining taxable income. Key considerations include the unit of taxation, which income type goes into which income category, apportionment of some income, if individual taxation is preferred. It is by no means exhaustive as it highlights a few selected income types. Other decisions that have to be made include whether deductions accrue to particular income types or have to be aggregated and deducted from gross income.

This brings to the fore another issue that ought to be considered: whether gross income and deductible expenses have to be determined separately for each type of income, or if all income and expenses should be considered together to arrive at a single net gain that is subject to tax – that is, schedular or global income tax structures, respectively.

Sources of income can be designed on either a global or schedular basis. However, this is easier said than done as, in practice, most global income tax systems have schedular features, and some schedular income tax systems have global features. A global income tax aggregates all sources of income while a schedular income tax imposes tax on each source of income separately. Most countries that have adopted global income taxes are in form only as they are often administered similarly to a schedular tax with heavy reliance on withholding and a few taxpayers filing final returns or being assessed on global income.

There are several advantages and disadvantages of either system. A schedular income tax system is more easily administered in countries without a sophisticated tax administration. Tax is generally collected by withholding, significantly reducing the number of taxpayers who must file returns. An additional advantage is that a schedular tax allows for different treatment of different types of income if a country wants to tax either labour income, capital income, or certain kinds of capital income more lightly. This differential treatment, however, can be obtained under a global income tax with schedules for particular kinds of income, as is typical. The main advantage of a global income tax is that goals of vertical equity can be achieved more easily since the tax is based on an aggregate measure of income. It may also have administrative advantages if there are many taxpayers with multiple sources of income, because only one return is filed for each taxpayer. Schedular systems often end up with a patchwork of overlapping schedules, multiple exemptions for the same income, and high marginal tax rates.

4.1.2 Assessment of the existing legislation for personal income tax

Jurisdiction

A person's liability for tax in Zambia is determined by the source of the person's income as well as their residency status. Section 14(1)(a) of the Income Tax Act specifies that an individual, whether resident or non-resident, is subject to tax on income within or deemed to be from within Zambia. Section 4 of the Income Tax Act defines a resident. An individual is treated as a resident if they reside in Zambia. It includes an individual who is physically present or who exercises an employment in Zambia for 183 days or more in any charge year, that is, the period of twelve months ending on the 31st December, and each succeeding such year. A non-resident of Zambia is generally someone who spends less than 183 days in Zambia during the charge year preceding the year of assessment.

The Zambian income taxation system is territorial as only income accrued or derived within Zambia is chargeable to income tax. Put differently, all non-Zambian source income are outside the scope of income tax. However, there are exceptions: Firstly, foreign-sourced income received by a resident individual is subject to income tax on interest and dividends, as specified in Section 14(1) (b). Suffice to say that where a Double Taxation Treaty exists between Zambia and other jurisdictions, the interest and dividends are subject to the provisions of the treaty. Secondly, Section 18 of the Income Tax Act specifies income that is deemed to be within Zambia. These are:

- any individual ordinarily resident in Zambia who carries out business partly within and partly outside Zambia, is taxed on his/her total income accrued in and derived from both within and outside Zambia;
- income earned by a person resident in Zambia from shipments of persons, mail, livestock or any other goods shipped or loaded outside Zambia;
- remuneration for services rendered outside Zambia to the Government or any statutory corporation if that person rendering the services is resident outside the Republic solely for that purpose.

Treatment of non-residents

Non-residents are treated differently from residents for tax purposes. For the purposes of the Income Tax Act, an individual is treated as a non-resident if he/she is in Zambia for some temporary purpose only and not with any view or intent of establishing his/her residence in the country. He/she has not actually resided in Zambia at one or several times for a period equal to 183 days in any charge year.

Non-resident beneficiaries are taxable only on income sourced within Zambia. A distinction is made between residents and non-residents with regard to personal capital income (dividends, payments to non-resident contractors, management and consultancy fees, interest, royalties, rentals, and commissions). Non-residents are charged at 20 per cent and it is the final tax.

With the global travel restrictions put in place by national governments to contain the spread of the COVID-19 pandemic, non-resident individuals would have unintentionally found themselves tax resident in Zambia. The plain reading of the legislation means that if they clock 183 days or more in a charge year, their income would become chargeable under the Zambian Income Tax Act. The Zambia Revenue Authority issued no guidance with regard to the special circumstances of the COVID-19 pandemic.

Determining taxable income

Gross Income

Tax on personal or individual income is defined as the taxes levied on the net income (gross income minus allowable tax reliefs) on individuals. Section 2(1) of the Income Tax Act defines an individual as a “natural person”. Section 17 of the Income Tax Act defines what income is included for tax purposes, though it does not explicitly call it “gross income”. These include emoluments; annuities; dividends;

interest, charges and discounts; royalties; and income from letting of property. The First Schedule further specifies additional income that is subject to tax. This includes income from maintenance under any court order or decree following matrimonial proceedings or a written separation agreement; amount stipulated for the improvements to land and buildings; commencement and cessation of employment, including compensation for loss of employment; lump sum payments; capital recoveries; the market value of exotic timber when land is disposed of for valuable consideration; farm stock (including all livestock, produce, and crops which have been harvested) and share options. Tax relief can take the form of exemptions, deductions, allowances and credits.

Exemptions

The Income Tax Act specifies persons and personal income that are exempted from personal income tax. Section 15 of the Income Tax act empowers the minister responsible for finance, by statutory order, to make exemptions. The Second Schedule lists the persons and personal income exempted from the tax. Amounts defined as "exempt income" are excluded from the definition of gross income and thus from the calculation of taxable income.

Table 4: Persons and personal income exempted

Category	Description
Persons	• emoluments of the President, the income of the Litunga of Western Province and income of any chief received as a chief from government • emoluments for officials of any foreign government, any international organisation, any foreign foundation or organisation as approved by the Minister by order in the Gazette.
Exempt income	• lump sum payments withdrawn from an approved fund at retirement age, death, or permanent incapacity • approved payments for injury or sickness • a scholarship, bursary, or maintenance for education • alimony, maintenance, or matrimonial allowance • a pension received from an approved fund • ex-gratia payments to a spouse, child, or dependant on the death of an employee • lump sum payments paid to an employee on loss of office on medical grounds certain payments to government employees, members of the armed forces, etc. pension benefit as defined by the Constitution to include pension, compensation, gratuity, redundancy, or similar allowance in respect of a person's service capital gains non-monetary fringe benefits

Treatment of pension

Zambia has payroll taxes generally applied at a flat per centage of an employee's gross wages and used to fund social security schemes and health insurance. Both employers and employees make statutory payments. Those in the formal sector are obliged to make non-deductible contributions to one of three public schemes: the Public Service Pension Fund (PSPF), the National Pension Scheme managed by National Pension Scheme Authority (NAPSA), and the Local Authority Superannuation Fund (LASF). In addition, some quasi-government and private sector institutions offer occupational pension schemes which are managed by private pension providers regulated and supervised by the Pensions and Insurance Authority. Other Social Security services include the Medical Schemes and the Worker's Compensation Fund that compensates an employee when they stop working because of work-related injury and the National Health Insurance Scheme.

In the last few years, there have been quite a number of new developments in both pension and health insurance. These include the NAPSA change of the retirement age to 60 from 55 years, the introduction of early retirement at age 55 and late retirement at age 65 in 2015; the definition of pension benefits in the amended Constitution of 2016. Further, the National Health Insurance Scheme was launched in 2018.

Section 88 (2) of the Constitution exempts pension benefits from tax. Following this amendment, pension contribution payments to an approved fund are no longer deductible for income tax purposes. Since the Constitution does not provide a threshold of when the pension benefit should be paid, the Zambia Revenue Authority has guided that pension payments for people opting for early retirement or normal retirement should be exempted from tax.

Deductions

Deductions available to individuals are specified in Sections 29-44 of the Income Tax Act. These include: non-capital expenditure incurred wholly and exclusively in the production of the income from that source; interest on money borrowed by any person where the Commissioner-General is satisfied that the loan or advance was obtained for capital employed wholly and exclusively in the production of income.

Allowances

All allowances and payments are taxable unless specifically exempted by legislation. Part V of the Second Schedule lists the exempt income which include:

- ex-gratia payments made to a spouse, or dependent on the death of an employee;
- refunds of actual medical expenses incurred by an employee;

- accommodation provided by employer[19].
- personal-to-holder vehicles. This is a vehicle means a vehicle provided to an employee for both business and personal use and usually involves payment by the employer of all the expenses associated with the running and maintenance of the vehicle;
- emoluments of former Presidents of the Republic;
- funeral expenses paid or incurred by an employer on behalf of an employee are exempt (Statutory Instrument #104 of 1996);
- sitting allowances for Councillors in Local Authorities (paragraph 7(s) Second Schedule, Income Tax Act);
- Labour Day Awards paid to employees either in cash or in kind are non-taxable.

Rate structure

Part II of the Charging Schedule of the Income Tax Act specifies the rate structure for personal income tax. Personal income tax was levied on most forms of personal income, with a tax-free allowance of K4,000 in 2021. With inflation averaging 22.1 per cent in 2021, the tax-exempt threshold has been increased by 12.5 per cent to K4,500. There are four tax bands for personal income tax in Zambia ranging from 0 per cent to 37.5 per cent. Above the personal allowance, income is split into 3 other bands that are taxed at different rates. The rates of income tax applicable to an individual for the 2021 charge year are as shown in Table 5.

Table 5: Personal taxable income bands and rates, 2021

Band	Taxable Income (ZMW) per month	Rate of Income Tax (%)
Band 1	0 – 4,000 (2021); {0-4,500 (2022)}	0
Band 2	4,001 – 4,800 (2021); (4,501-4,800 [2022])	25
Band 3	4,801 – 6,900	30
Band 4	Above 6,900	37.5

Source: Ministry of Finance, 2021 National Budget Address, September 2020

With different tax bands depending on the level of income, personal income tax

[19] However, payments for utilities such as electricity, telephones, water bills, security and similar payments are not included in the meaning of free residential accommodation.

is considered a progressive tax type. Firstly, it is not charged on every person, but on persons with taxable income for the relevant tax period. It puts a higher proportional burden on wealthier individuals, leading to an equitable payment of the tax, at least vertical equity.

Tax Credits

Applicable tax credits are specified in the Charging Schedule. Persons in employment and are differently abled are entitled to a **Disability Credit** which is a tax credit of K500 per month or K6,000 for 2021 charge year. In order to qualify for the tax credit, the individual should be a member of the Zambia Agency for Persons with Disabilities. This is specified in Section 1(1) of the Charging Schedule. With regard to tax credits available on taxes paid in a foreign jurisdiction, the Income Tax Act provides for unilateral relief where there is no tax treaty. In cases where a tax treaty exists, the taxing rights are stipulated in the treaty.

4.1.3 Administration of the personal income tax

The Zambia Revenue Authority applies several methods of collecting personal income taxes to make income tax more effective as a fiscal policy instrument. The two main techniques used are: (1) withholding on wages and salaries, and on interest and dividends; and (2) estimated tax payments for hard-to-tax self-employment incomes.

Tax withholding on wages and salaries

Withholding on wages and salaries represents a major source of revenue in Zambia. The withholding system is applied in the form of pay-as-you-earn (PAYE). Under the PAYE system, withholding of the tax is made in a cumulative manner from one pay period to the next. The employer determines the cumulative totals of wages paid and of tax withheld for each employee in each pay period. The difference between the tax due on total wages paid-to-date and total tax withheld-to-date gives the amount of withholding required; total withholding for the year gets very close to the actual liability of employees. The PAYE system is used as a final tax. This has two main advantages: (1) This frees taxpayers from filing an annual tax return; and (2) it minimizes the tax administration burden of processing a large number of returns with little revenue prospects, thus reducing administrative and compliance costs.

The majority of individual taxpayers are below the tax-exempt threshold. As at 30th November 2021, there were 717,926 employees registered for PAYE. Of these, 440,302 (or 61 per cent) were below the personal income tax threshold of K4,000 per month. This left only 277,624 employees (or 39 per cent) that had monthly incomes of above K4,000. Additionally, there were 14,605 individuals registered for self-employed income tax (Table 6).

Table 6: Number and share of the labour force paying PIT, 2021

Monthly Income	Count of Employees in PAYE return	% of Total
a. K4,000 and below	440,302	61%
b. Above K4,000	277,624	39%
Total	**717,926**	**100%**

Source: Zambia Revenue Authority

Despite the advantages, compliance rates for PAYE are generally low in Zambia. The Zambia Revenue Authority reports three types of compliance rates: (a) on-time filing compliance (which is filing up to the due date); (b) filing compliance (which is filing up to the end of the month of the due month); and (c) on-time payment compliance (which is payment on or before the due date). Table 7 shows the compliance rates for the period January to November 2021. On-time filing was reported at 47 per cent, end-of-the-month filing was reported at 54 per cent, while on-time payments were at 65 per cent.

Table 7: PAYE compliance rates, 2021

Jan-Nov 2021	(%)
On-time filing	47
End-of-the-month filing	54
On-time payment	65

Source: Zambia Revenue Authority

Periodic payments (such as the 13th cheque) and other bonuses/allowances are all taxable. There are tax avoidance practices such as removing transport and entertainment allowances from taxable personal income tax. It is, however, difficult to determine how widespread this practice is. A key informant from the private sector intimated that it is mostly practiced in large companies[20].

It is difficult to ascertain the time-lag between withholding and transfer by the employer to ZRA. The due date for employers to file in their payments is the 10th of every month. Different employers have different dates on which they withhold PAYE from their employees (different dates of salary payments and processing of salaries),

[20] Key informant interview with a member of the Zambia Association of Manufacturers.

but they are expected to make the PAYE payment to ZRA by the 10th of every month. Late submissions (i.e., payments done after the 10th of the month following deduction) attract a penalty of 5 per cent of tax unpaid for each month under the provisions of Section 71(3) of the Income Tax Act. In addition, interest under Section 78A of the Income Tax Act is payable from the due date to the date of payment and is charged at the Bank of Zambia discount rate plus 2 per cent.

ZRA periodically carries out income assessments for employers through PAYE audits which are conducted each year on selected employers to make income assessments and minimize the abuse of the PAYE system. Section 56 of the Income Tax Act empowers the Commissioner-General to access any type of information required for tax purposes held by legal practitioners, accountants, and financial institutions.

Tax withholding on interest and dividends

Withholding is also used for taxation of dividends, payments to non-resident contractors, management and consultancy fees, interest, royalties, rentals, and commissions (Table 8). Section 81 of the Income Tax Act requires all companies registered in Zambia to withhold tax from payments of dividends other than dividends paid to the Government of the Republic of Zambia or dividends paid to individuals by a company listed on the Lusaka Securities Exchange (LuSE).

- Tax withholding on dividends is charged at the rate of 20 per cent and is a final tax for both residents and non-residents.
- Tax withholding for payments to non-resident contractors is charged at 20 per cent and it is a final tax. However, the exemption schedule or a Double Taxation Agreement could be applied where deemed necessary.
- For interest income, no tax is paid on interest earned by individuals from savings or deposit accounts held with financial institutions
- Royalties and commissions are charged at 15 per cent for residents and 20 per cent for non-residents. It is the final tax for non-residents.
- Public entertainment fees are charged at 20 per cent for both resident and non-resident taxpayers and it is the final tax.

Table 8: Tax withholding on individuals and applicable rates for residents and non-residents

Income type	Resident	Non-resident	Comment
Dividends	20% (Final tax)	20% (Final tax)	Except for dividends paid to GRZ or dividends paid by a listed company on the LuSE
Payments to non-resident contractors		20% (Final tax)	Commissioner General could apply the exemption schedule or the Double Taxation Agreement
Management & consultancy fees	15%	20% (Final tax)	
Interest			No tax paid paid on interest earned by individuals from savings or deposit accounts held with financial institutions.
Royalties	15%	20% (Final tax)	
Commission	15%	20% (Final tax)	
Rentals	10% (Final Tax)		
Public entertainment fees	20% (Final tax)	20% (Final tax)	

The differences in the marginal rates between employment income and personal capital income may create some economic distortions. In the case of management and consultancy fees, this may create an incentive for businesses to pay consultancy fees charged at 15 or 20 per cent depending on whether the payee is resident or non-resident, instead of hiring workers to do the same job. In the case of interest, a business may make interest-free loans to employees as opposed to paying wages.

Presumptive taxation

Given the large size of the informal sector, there are inherent deficiencies in the administration of personal income tax. To counter these deficiencies, presumptive methods of taxation are used as a proxy for an income tax on often hard-to-tax small, largely informal sector businesses. Individuals and partnerships operating buses, minibuses and taxis who are not limited companies are also charged a lumpsum payment based on the capacity of the motor vehicle they operate. This is called "presumptive tax on passenger transport" and is stipulated in the Ninth Schedule of the Income Tax Act. Another presumptive tax, stipulated in Section 64(2) of the Income Tax Act allows the Commissioner General to charge a *base tax* of K365 per charge year (or K1 per day) on persons who are not in a position to determine their income but do earn an income, and for which there is insufficient information to make an assessment. This is generally levied on small traders, especially marketeers.

Presumptive taxation is only applied to traders and passenger transport in the country. According to the Zambia Statistics Agency, the following industries have substantial informal sector activity (i.e., more than 50 per cent of value added): agriculture, forestry and fishing; construction; wholesale and retail trade; real estate activities; and activities of households as employers[21]. So, besides traders and transporters, presumptive taxation can potentially be expanded to income obtained from these other industries.

Presumptive taxes may lead to certain efficiency and equity gains. Taxpayers in the informal sector often find the tax procedures onerous, have low levels of tax literacy, and cannot afford the high cost of hiring professional accountants to prepare accounts and handle tax matters. Presumptive taxes help to alleviate these challenges. Since they take the form of a tax on average income, the marginal tax rate on income above this average income is zero. This avoids the negative incentives associated with high marginal tax rates. In addition, by facilitating more effective taxation of hard-to-tax groups, presumptive taxation may lead to greater horizontal equity in the tax system.

Inflation adjustments

National average incomes have been on the rise. The Zambia Statistics Agency estimates the National Average Earnings on an annual basis. This is used to, among other things, revise the contribution ceilings and pension payments for the National Pension Scheme Authority. As money income rises, even if real income remains unchanged, tax payers are moved upwards in the tax schedule and are thus subject to a higher marginal rate of tax. Furthermore, those who were below the taxation threshold may become liable to taxation as a result of the general rise in money incomes.

To minimize incomes creeping into higher tax brackets, the Government has operated an *ad hoc* inflation adjustment to provide relief to households. There have been numerous changes in the personal income tax brackets in the last decade. The tax-exempt threshold has increased from K600 in 2008 to K4,500 in 2022. After that, tax brackets were adjusted again in 2017, 2021 and, most recently, for 2022. In 2017, the top tax rate was increased from 35 per cent to 37.5 per cent. Table 9 shows the changes in the personal income tax bands and the period average inflation rates over the period 2010-2022.

[21] Central Statistical Office (2014). Gross Domestic Product 2010 Benchmark Estimates Summary Report: Central Statistical Office, April 2014.

Table 9: Changes in personal income tax bands (in Zambian Kwacha) and rates, 2010-2022

Charge year	Income Bands					Exempt threshold adjustment	Period average inflation rate
	0%	25%	30%	Top rate (35%)	Top rate (37.5%)		
2010	<=800	>800-1,335	>1,335-4,100	>4,100		14.3%	8.2%
2011	<=1,000	>1,000-1,735	>1,735-4,200	>4,200		25.0%	5.9%
2012	<=2,000	>2,000-2,800	>2,800-5,700	>5,700		100%	6.6%
2013	<=2,200	>2,200-3000	>3,000-5,900	>5,900		10%	7.0%
2014	<=3,000	>3,000-3,800	>3,800-5,900	>5,900		36%	7.8%
2015	<=3,000	>3,000-3,800	>3,800-5,900	>5,900		0%	10.0%
2016	<=3,000	>3,000-3,800	>3,800-5,900	>5,900		0%	18.2%
2017	<=3,300	>3,300-4,100	>4,100-6,200	>6,200		10.0%	6.6%
2018	<=3,300	>3,300-4,100	>4,100-6,200		>6,200	0.0%	7.5%
2019	<=3,300	>3,300-4,100	>4,100-6,200		>6,200	0.0%	9.1%
2020	<=3,300	>3,300-4,100	>4,100-6,200		>6,200	0.0%	15.7%
2021	<=4,000	>4,000-4,800	>4,800-6,900		>6,900	21.2%	22.1%
2022	<=4,500	>4,500-4,800	>4,800-6,900		>6,900	12.5%	13.2%*

Source: Budget Speeches (Ministry of Finance), Practice Notes (Zambia Revenue Authority)

*Projected inflation by the Bank of Zambia[22]

Aggregate statistics likely show evidence of bracket creep, a situation where income growth causes individuals to pay higher average income tax rates each year. There was a marked increase in the number of taxpayers in the bracket just above the exempt threshold and the top marginal rate bracket, particularly in 2020. While it is not immediately clear what led to this increase, it should be noted that there had been no adjustment in the tax brackets during 2017-2020 period. The effect is largest for individuals earning just above a tax threshold. The number of taxpayers in that band grew by 81 per cent over the period 2016-2020 (Table 10). This suggests evidence of 'bracket creep'. Further, this group is subjected to a steep rise in the marginal tax rate, i.e., from 0 per cent to 25 per cent.

[22] Source: Bank of Zambia (2022). Monetary Policy Committee Statement, February 2022.

Table 10: Number and per centage share of taxpayers by PIT band, 2016-2020

Band		2016		2017		2018		2019		2020	
		Number	Per cent	Number	Per cent	Number	Per cent	Number	Per cent	Number	Per cent
Band 1: 0%	**0 – 3,000**	**354,647**	66.7								
	3,001 – 3,800	**21,268**	4.0								
	3,801 – 5,900	**37,751**	7.1								
	Above 5,900	**118,039**	22.2								
	0 – 4,000			**456,558**	72.0	**440,074**	68.5	**439,726**	66.0	**498,959**	66.2
	4,001 – 4,800			**20,926**	3.3	**23,770**	3.7	**29,315**	4.4	**38,439**	5.1
	4,801 – 6,900			**38,681**	6.1	**40,474**	6.3	**45,971**	6.9	**49,745**	6.6
	Above 6,900			**117,944**	18.6	**138,125**	21.5	**151,239**	22.7	**166,571**	22.1
	Total number of taxpayers	**531,705**	**100.0**	**634,109**	**100.0**	**642,444**	**100.0**	**666,252**	**100.0**	**753,714**	**100.0**

Source: Zambia Revenue Authority

4.1.4 Key take-aways

The review of the income tax regime reveals that several components of income are excluded from the base due to numerous exemptions. These include capital gains, in-kind income (e.g., net imputed rental income for those in free housing provided by the employer or owner-occupied housing). Therefore, the base of the income tax defined in the Act falls short of the Haig-Simons comprehensive income notion.

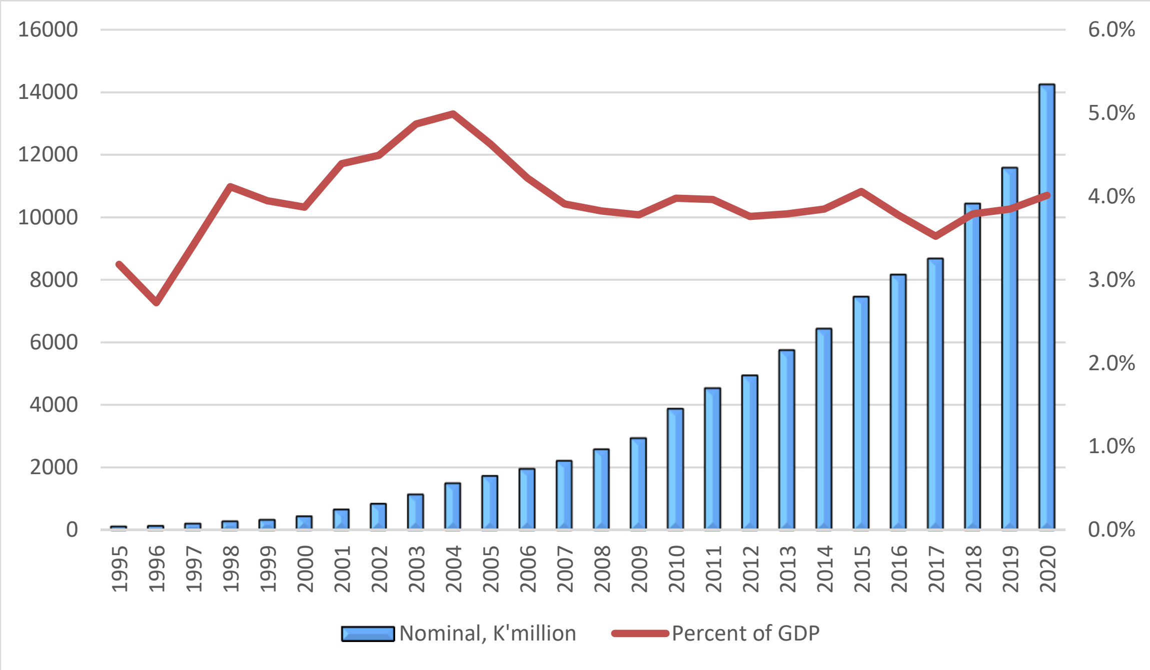
It is also observed that exemptions not only erode the tax base but also introduce inefficiencies and inequities. Fringe benefits deserve special mention as they are commonplace. On paper, full taxation of fringe benefits seems like the logical thing to do as it is a prerequisite to horizontal equity between taxpayers who are wholly remunerated in cash and taxpayers remunerated partly through fringe benefits. It also makes sense for vertical equity as the incidence of fringe benefits tends to rise with taxpayers' income and employment status. The full taxation of benefits would also help to achieve an economically efficient tax system. It ensures that the tax system will be neutral between those employers able to provide fringe benefits and those not able to do so and removes the distortion in favour of providing goods and services that are not taxed. Finally, taxation of fringe benefits is important to protect the revenue base. However, the complexities of market valuation of non-money benefits as well as difficulty in distinguishing genuine benefits from benefits that are consumed in the course of employment or that are a necessary condition of employment make it a challenge to administer.

There seem to be several reasons for the exemption of certain incomes or income types that lead to a significant loss in revenues. First, the exemption of the President and traditional leaders (under Zambian customary law) seems purely based on political considerations. Second, the exemption of diplomats is as a result of international convention or practice as specified in the Vienna Convention on Diplomatic Relations[23]. Third, some personal incomes are exempt purely from a social welfare point of view. These include pension, compensation payments, scholarships and bursaries. Fourth, some exemptions are made due to the considerable complexity of determining the tax payable. This is the case for capital gains and non-money fringe benefits such as personal-to-holder vehicles and employer-provided housing. However, this introduces inequities as the tax burdens of higher-income taxpayers who earn most of the capital income are reduced at the expense of others. Fifth, difficulties in valuation, as well as administration, makes it challenging to determine the valuation of non-monetary fringe benefits such as personal-to-holder vehicles and employer-provided housing. While its exclusion may encourage home ownership, the exclusion of imputed rent creates inefficiencies and inequities.

Leaving the tax rates and thresholds unchanged for a number of years, as was the case during 2017-2020, results in bracket creep. It could well be that the 0.5 per centage-point increase in the personal income tax revenues that are collected through the PAYE system shown in Figure 12 during 2017-2020 was due to bracket creep. While the income growth is good for the government’s revenue raising measures, it reduces the progressivity of the personal income tax system. This not only affects the low-income earners, but it also subjects them to a steep increase in the marginal tax rate – from being exempt to paying 25 per cent.

[23] https://legal.un.org/ilc/texts/instruments/english/conventions/9_1_1961.pdf .

Figure 12: Trends in nominal PIT (K'million) and as per centage of GDP, 1995-2020



Source: Author's own elaboration from Ministry of Finance data

The study reveals very low compliance rates for the PAYE system. Given that PAYE can easily be withheld from the source, it is surprising that the compliance rates are below 65 per cent, and most non-compliant employers are Government ministries and agencies.

4.2 CORPORATE INCOME TAX

The corporate income tax, specifically referred to as "company income tax" in Zambia, is levied by the ZRA on business profits. Due to the importance of mining to the Zambian economy, mining corporate income taxes are distinguished from other corporate income taxes. In the period 2016-2020, mining corporate income taxes accounted for an average of 34 per cent of the total corporate income taxes.

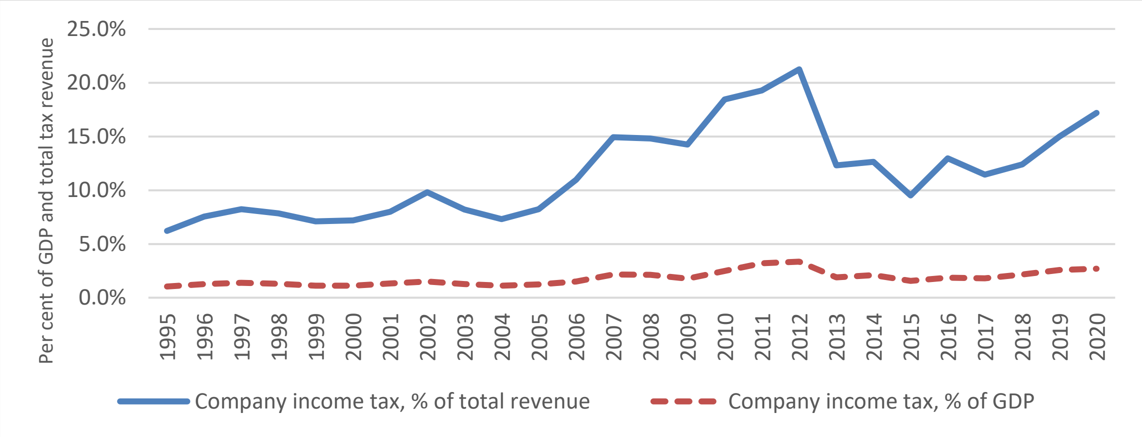
After significant increases during 1995-2012, corporate income taxes plunged as a share of total tax revenues. As a share of total tax revenues, Company Income Tax steadily increased from 6 per cent in 1995 to 21 per cent in 2012. It then plunged to below 13 per cent in 2013 and 2014 largely due to the underperformance in the mining sector[24]. Having bottomed-out at 9.5 per cent in 2015, it has been on the rise

[24] Annual Economic Reports, 2013 and 2014.

again, reaching 17 per cent share of total tax revenues in 2020 (Figure 13).

As a share of GDP, corporate taxes have generally been stable, hovering in the 1-3 per cent range between 1995 and 2020. As with the share of total tax revenues, corporate taxes as a share of GDP reduced by 1.5 per centage-points from 3.4 per cent of GDP in 2012 to 1.9 per cent of GDP in 2013, reached a low of 1.6 per cent of GDP in 2015, before slowly rising to 2.7 per cent of GDP by 2020.

Figure 13: Company income tax as a per centage of total tax revenue and GDP, 1995-2020



Source: Elaborated from Ministry of Finance data

4.2.1 Key considerations for determining the corporate income tax base

In order to evaluate the existing system of corporate income tax and suggest improvements, we first determine the rationale for levying a corporate income tax. While the Haig-Simons notion of comprehensive income has provided the standard against which to gauge the personal income tax system, no consensus exists as to what the corporate income tax base ought to be. Using Example 2, we illustrate the key considerations in determining the corporate tax base.

Example 2. Jacob is the founder and majority shareholder in a company based in Lusaka offering cleaning services and employs 10 people. With a reported turnover of K5 million in 2021, the firm is incorporated in accordance with the 2017 Companies Act. The firm was badly hit by the COVID-19 restrictions instituted by the government in the second quarter of 2020 resulting into losses for the business during the 2020 financial year. The COVID-19 pandemic increased demand for cleaning and sanitary services. The firm planned to recapitalize by buying new equipment and expanding the offices, as well as hiring 5 more workers in order to cope with increased demand.

Jacob’s company went on to get a credit facility from a commercial bank, which was part of on-lending from the Bank of Zambia’s Targeted Medium Term Refinancing Facility. Due to the constraints brought about by the COVID-19 pandemic, some clients did not pay for the cleaning services at the time the services were rendered. As a result of the ensuing minor cash flow issues, the company only paid for the new equipment 3 months after delivery, while the construction of a new warehouse, which commenced in August 2021, was still ongoing. Business improved in 2021 and the company was able to regularly service its loan, declare after-tax profits in 2021 and pay off dividends to its resident and non-resident shareholders. With a positive business outlook, it has since opened a branch in Lubumbashi, Democratic Republic of Congo (DRC).

In this example, the determination of the corporate income tax base is instructive. Just like in the personal income tax base we have to determine the unit of taxation. We therefore have to separate Jacob, the individual, from the company, the legal person or entity. In personal income taxation, we defined personal income and treated it as a net concept; this also applies in corporate income taxation, where business income is also a net concept. We then have to define what a business is, what business income is, and thereafter determine the profits or taxable income. In determining the taxable income, we have to recognize some business expenses and deduct them. We also have to take note of investment income which may be deducted from taxable income.

4.2.1.1 Determination of taxable business income

A key purpose of the definition of business income is to broaden the income tax base. The starting point in determining whether an item or income is business income is to determine whether the activity giving rise to the income is properly characterized as a business. In broad terms, a business is defined as a commercial or industrial activity of an independent nature undertaken for profit. We therefore characterize Jacob’s cleaning service company as a business.

Being a limited company incorporated under the Companies Act, it is assumed that the company complies with the law and keeps books of accounts. Business accounting systems are constructed around two principal summary statements of the financial position of the business: balance sheet and income statement. The balance sheet shows the company’s assets and liabilities at a given point in time, usually the end of the accounting period. The income statement (or "profit and loss account") shows its revenues and expenditures for a particular period of time, between two balance sheet dates.

The balance sheet classifies assets and liabilities into monetary and non-monetary assets and liabilities. Monetary assets and liabilities include cash and the borrowing that the company made. Non-monetary assets include land and buildings, plant and equipment, inventories, and investments in the subsidiary company in DRC or the shares of other companies (as it is established that Jacob is just the majority shareholder, implying there are other persons, whether natural or legal persons, who have shares in the company). The net worth of the business is the difference between the balance sheet value of its assets (plus dividends distributed by the taxpayer during the year) and of its liabilities. A positive difference constitutes taxable business income, while a negative difference is a business loss.

The changes in the net worth of the business between two balance sheet dates are equal to the amount of profit earned in that period, as shown in the profit and loss account. The determination of taxable business income in the profit and loss account is based on the calculation of all recognized income amounts derived by a taxpayer in the tax period and all deductible expenses incurred by the taxpayer in the tax period. Zambia uses the profit and loss method to determine taxable income.

A key consideration when constructing the accounts is the timing of recognition of revenues and expenditures in the income statement. Income is generally measured on accrual or cash basis. The *accrual basis* is an accounting method under which you report your income when you earn it, whether or not you have received it. Generally, expenses are deducted when a liability is incurred for them, rather than when you pay them. In our example, this means the sales revenue for the cleaning services were recorded when the cleaning services were supplied, and not when the recipients of the services made the payment. The expenses incurred for the purchase of new equipment are attributed to the period in which the transaction took place. The capital expenditure is spread over the period from August to December 2021 and January to March 2022. Under the *cash-basis* system, income is derived when it is actually received by, or made available to, or applied to the benefit of, the taxpayer, and expenses are incurred when they are paid. Whatever practice is adopted, salary and wage earners would normally account for income and deductions on a cash basis, and businesses account for income and deductions on an accrual basis. Individuals conducting business typically enjoy some flexibility. In particular, it may be appropriate and simpler for smaller businesses to use cash-basis accounting.

Another principle that needs special consideration is the valuation of assets in the balance sheet. Assets are generally valued at historical value or current market prices. In practice, most firms value most assets on the basis of their original historical cost, after adjusting, where appropriate, for past depreciation that has been charged to the profit and loss account. Historical costs typically provide a more objective standard than other valuation bases. When assets are valued at historical cost, no capital gain or loss will be recorded in the income statement unless and until an asset is disposed of and the gain is "realized" and recognized. With valuation at current market prices, however, such gains or losses need to be brought into the accounts in each period, either by means of an entry in the income statement, or by a change to a "capital reserve" liability in the balance sheet.

4.2.1.2 Deduction of business expenses

In principle, all costs incurred to derive business income should be recognized for the purpose of determining net income. In our example, these include labour expenses, including new hires; capital expenditure (purchase of new equipment, construction of new warehouse for storage of inventories). But not all expenses are deductible. Further, distinctions have to be made on whether or not the asset is “wasting”, that is, declining in value through usage over time. Examples are buildings, plant, machinery and patents. For such assets, the cost could be recognized by way of depreciation or amortization deductions allowed over the life of the assets. Non-wasting assets include land and shares. For such assets, the cost of acquisition should be recognized upon disposal of the asset, through provisions that allow the cost base of the asset to be deducted in computing gain or loss on the disposal.

It is administratively impossible to monitor and impractical to design a depreciation system that will track over time the real economic depreciation charges for each asset group to allow the real yearly decline in each asset value to be written off as revenue. As a result, a set of arbitrary rules is generally applied. These rules become applicable when an asset is acquired, and are consistently applied to the asset in subsequent years until it is retired or sold. A well-known and commonly adopted depreciation rule is the Straight-Line Method where the historic cost of the depreciating asset is apportioned in equal amounts for deduction over a period of its estimated economic life.

4.2.1.3 Investment income

Typically, taxpayers owe tax on investment income net of costs incurred in earning it while the costs of services not related to investment income are not deductible from income. However, due to the challenges of separating the two cost components, withholding taxes are extended to investment income as final taxes.

In thinking about investment income, there are two broad approaches to its inclusion in gross income. First, the inclusion rule could refer to investment income, which is then separately defined by reference to specific categories or sources of income, such dividends in our example, as well as annuities, interest, rent, and royalties. If capital gains on the disposal of investment assets are included in the income tax base, investment income may also be defined to include such gains. Alternatively, the inclusion rule may refer to specific categories of investment income rather than to a collective notion of investment income.

It may be necessary to have supplementary definitions of the specific categories of investment income. Investment income include annuities, dividends, interest, royalties and rent. The supplementary definitions will be relevant to the income inclusion rules, as well as other aspects of the income tax such as withholding on payments such as interest, royalties or rent.

4.2.1.4 Loss carryforward and loss carrybackward

The tax law may provide for a net loss to be carried forward and allowed as a deduction in a subsequent tax year or carried back and allowed as an additional deduction in a previous tax year. Ideally, a well-designed tax system should not discriminate against enterprises that may end up making losses. Operational losses incurred by a firm should ideally be treated symmetrically with profits. That is, given that a profitable firm pays taxes, a loss-making firm should receive a tax refund. Although most corporate tax systems recognize the need to provide some tax relief to firms that report tax losses, a perfect loss-offsetting mechanism that treats positive and negative tax liabilities symmetrically remains elusive.

In practice, tax laws provide less than full loss offset for loss-making firms. The tax system should permit tax losses to be carried forward either indefinitely or over a fixed period of time. Such losses, however, are carried forward without interest. Loss carry backwards could also be permitted. This is usually restricted to those tax-loss firms which have paid some taxes during the years prior to incurring a loss. Provided that the current year tax loss is not greater than the sum of taxes paid in earlier years, a firm could be permitted to carry back its losses and receive a tax refund from the tax authority.

4.2.1.5 Treatment of subsidiaries and branches

The tax treatment of branches and subsidiaries has many facets that need to be considered. A foreign-based enterprise which carries on business operations in a host country, but has not incorporated itself in the host country, has established a branch. The Zambian cleaning service company establishing a branch in Lubumbashi faces unlimited liability for the debts and other legal obligations of its branch in Lubumbashi. In contrast, if the company had incorporated its business in DRC, then the DRC company would be a subsidiary. Under the subsidiary, liability is limited to the assets of the subsidiary in DRC.

In terms of attribution of profit, an important related concept is that of a Permanent Establishment (PE) defined in Article 5 of the Organisation of Economic Cooperation and Development (OECD) Model Tax Treaty. A permanent establishment, is a fixed place of business through which the business of an enterprise is wholly or partly carried out. Once a foreign person acquires a fixed place of business or employs resident individuals, the enterprise is deemed to have set up a permanent establishment. The income producing activities of a business are generally taxable once that business sets up a permanent establishment in a tax jurisdiction. Conversely, foreign persons should not be subject to branch taxation if they have not engaged in activity giving rise to a permanent establishment. In general, international conventions and bilateral treaties take the view that the profits to be attributed to a permanent establishment are those it would have made had it not been dealing with its own head office, but with an entirely separate enterprise under arms-length conditions. If separate accounts do not exist, then revenue authorities will apply the arm's-length principle in ascribing a profit to the establishment.

There are many advantages of a branch operation. (i) In terms of profits, the Lubumbashi branch can repatriate after-tax profits to the parent company in Zambia without further taxation; (ii) The Zambian company can also deduct fully the losses incurred abroad by the branch in Lubumbashi against its tax liability in Zambia; (iii) The parent company in Zambia can transfer property to its branch without incurring taxation in Zambia. The branch can also enjoy tax incentives from its parent company.

That said, there are also many disadvantages of a branch operation. For example, (i) a parent company cannot defer home country taxation on branch income that is not remitted to the home country. By contrast, a subsidiary has the opportunity to defer taxation in the home tax jurisdiction on income which is not remitted. (ii) Host countries typically grant more generous tax options to subsidiaries than to branches, such as for loss carried forward or backward, or deductions. (iii) Furthermore, limitations on deductions are often more restrictive for branches than for subsidiaries. Such restrictions are usually inspired by the desire to deter transfer-pricing abuses[25].

4.2.1.6 Tax incentives

Tax incentives form part of companies' decision to invest in a particular area or country. Like other countries, Zambia uses incentives, including various forms of tax

[25] Parthasarathi Shome, ed. (1995). Tax Policy Handbook, Fiscal Affairs Department, International Monetary Fund, https://doi.org/10.5089/9781557754905.071.

incentives, to stimulate investment and attract foreign direct investment (FDI) in preferred economic activities. Various types of tax incentives have been put in place including tax rate reductions for priority sectors, tax holidays for a certain number of years, and allowances such as accelerated depreciation or investment tax credits that allow an investment expense to reduce tax liability.

However, tax incentives add to the complexity of the tax system, given the high degree of selectivity, discretion, and control in granting of incentives. From an economic efficiency perspective, by favouring one form of economic activity over another, tax incentives distort relative prices, and therefore misallocate resources. And by singling out a particular sector for preferential treatment, tax incentives may be viewed as inequitable. They also undermine the sense of fairness, because a heavier tax burden must be placed on other sectors to raise a given amount of tax revenue. Moreover, the allocation of resources is distorted further since nonpreferred sectors must pay even higher taxes so that some activities may enjoy a lower tax liability. They also undermine the simplicity of tax administration by increasing monitoring costs, both by the tax administration and the investment agency which, as is the case in Zambia, is a separate entity responsible for promoting investment.

A special form of incentive is a tax holiday. An enterprise receiving the tax holiday is partially or fully exempt from the payment of the corporate tax over the period for which the tax holiday applies, usually in the early years of its operation. To illustrate the issues associated with tax holidays, we give a real-life example of an enterprise that was given a tax holiday in Zambia (names and regions changed to protect confidentiality).

Example 3. Zed Corporation is a subsidiary of a British multinational enterprise that commenced its operations in Zambia by opening a subsidiary in 2015 in a multi-facility economic zone and accessed a 10-year tax holiday. In 2021, the firm applied to the Minister of Finance through the Zambia Development Agency (ZDA) to have their income tax holiday commencement date varied from 2016 to 2020 as they faced delays to get to full production due to electricity supply constraints.

It should be pointed out that a tax holiday as an incentive depends largely on how profitable the recipient firm is. For Zed Corporation, it is clear that it may only have started full commercial production in 2020, four years after the tax holiday kicked in, and may not have been yet profitable at the time it applied for a renewal of its tax holiday. From this illustration, a number of issues arise. These include the date of commencement of the tax holiday, the definition and administration of the holiday, the filing of tax returns, to whom they are applicable and most importantly, the erosion of the tax base.

a) **Commencement date of the tax holiday**. Should the tax holiday start immediately after the holiday has been granted? Or should there be an allowance for an investment period before the holiday kicks in? Or should it start only when the firm commences full commercial production as Zed Corporation was requesting for? Added to this is whether or not the tax holiday should be renewable?

b) **Definition and administration.** Another issue that needs to be borne in mind is how the tax holiday will be defined and, more importantly, how it would be administered?

c) **Filing of returns.** Related to the issue of administration is that of filing of tax returns. Does the company file a tax return every year or they have to wait until the tax holiday elapses? Does it make sense from an economic efficiency perspective for the tax authority to continue assessing the tax returns from a firm that will not pay taxes for the duration of the tax holiday?

d) **Eligibility.** Who can apply for these incentives? There is often a widely held notion that tax holidays only apply to foreign companies. This is usually perpetuated by the high monetary threshold required for firms to qualify for incentives.

e) **Eroding the tax base**. The issue of base erosion could potentially be more serious than simply the direct revenue forgone. If a tax-exempt enterprise is part of a larger holding of non-tax-exempt companies, it is easy to shift income from profitable but taxable companies in the group to the tax-exempt enterprise through the transfer pricing of intercompany transactions. Hence, awarding tax-exempt status to a single firm may erode the tax base more than initially thought, since such abuses are generally difficult to police.

Answering these questions would help to think about and evaluate if tax incentives, and particularly tax holidays, are an effective tool for attracting investments. The fact that they erode the tax base, create opportunities for tax planning, increase in administration and monitoring costs should make us question their value as a policy option to encourage investment.

4.2.2 Assessment of existing legislation for corporate income tax

As with the personal income tax, the legislation for taxing corporate income is the Income Tax Act, Chapter 323 of the Laws of Zambia.

Defining Business entities

The Income Tax Act defines a business in terms of the scope of economic

activities involved in. As per Section 2(1) of the Income Tax Act, the term 'business' includes any profession, vocation or trade, any adventure or concern in the nature of trade whether singular or otherwise, manufacturing, farming, agro-processing and hedging. Curiously, hedging, a risk management strategy employed to offset losses in investments by taking an opposite position in a related asset, has been included as a business. This was apparently intended to prevent companies, especially those in mining, from adopting hedging strategies deliberately designed to reduce taxable profits in Zambia. A "company" means any business incorporated or registered under any law in force in Zambia or elsewhere.

Companies liable for Corporate Income Tax are those with an annual turnover of above K800,000. This also includes those carrying on mining operations, providing consultancy or under voluntary registration for Value Added Tax. Companies with an annual turnover of K800,000 or above are subject to a tax on turnover. Small businesses that are not capable of keeping records to enable effective tax assessment are subject to a base tax, levied at ZMW 365 per annum. This typically applies to small traders in markets.

The Income Tax Act does not recognize a partnership as a distinct taxable person. While a partnership is a business, it is not a company as it is not incorporated. For this reason, a partnership is not chargeable to tax but each partner is taxed individually. Nevertheless, the Income Tax Act provides that persons carrying on business in partnership are required to make a joint return as partners in respect of such a business. So, if there are two partners, the expected number of income returns will be three; one return for each partner, making it two returns for the two partners and one return for the partnership, bringing the number to three. Each partner declares income and taxes according to all business income they received eligible for tax, and the partnership constitutes all incomes received in the respective partnership but the tax liability for the partnership is nil since the tax is declared under the partners. Each partner will be taxed using the prevailing annual PAYE bands and rates for employed individuals in the charge year.

Jurisdictional basis

Zambia principally operates a source-based system for the taxation of business income – hence it is deemed a territorial system of taxation. Income deemed to be from a Zambian source is generally subject to income tax. However, the residence of the entity in Zambia will widen the scope of taxation. A resident company will be charged income tax on interest and dividends from a source outside Zambia on a worldwide basis.

Determining taxable business income

To estimate taxable business income in Zambia, the income statement is employed. As earlier alluded to, the determination of taxable business income in the profit and loss account is based on the calculation of all recognized income amounts derived by a taxpayer in the tax period and all deductible expenses incurred by the taxpayer in the tax period.

Definition of Business Income

Section 17 of the Income Tax Act defines the type of income that is included for business tax purposes. These are gains or profits from any business for whatever period of time carried on. It should be noted that where a business is carried on or exercised partly within and partly outside Zambia by a resident person, the whole of the gains or profits from such business shall be deemed to have accrued in or to have been derived from Zambia.

Deduction of Business Expenses

The Income Tax Act recognizes a long list of deductions that are allowed in ascertaining the gains or profits of a business. These are shown in Table 11 below.

Table 11: Allowable deductions for ascertaining the gains and profits of a business

Item	Comments/reasons for deduction
Mineral royalty for assessing income tax liability	Payable and paid for a charge year in pursuance of the Mines and Minerals Development Act, 2015
Bad and doubtful debts of financial institutions under certain conditions	Given their potentially larger destabilizing effect than capital losses in other industries,
Employing a disabled person	A deduction of K2,000 in each charge year for each person with a disability employed on a full-time basis
Expenditure incurred for the "skills development levy	
Losses and expenditures incurred in a charge year	Not of capital nature, incurred exclusively for business purposes
Interest on money borrowed by any person	This is provided that the tax authorities are satisfied that the loan or advance was obtained for capital directly employed for business purposes or in the production of income;
Any expenditure incurred within 18 months before the commencement of the business	This is provided the deduction would have been allowed as a deduction after the business commences its operations;

Item	Comments/reasons for deduction
Capital allowances for buildings, implements, machinery and plant, and premiums	
Capital allowances for capital expenditure in relation to mining operations	
"Investment allowance" of 10 per cent	when a person incurs capital expenditure on the construction of, or additions to, or alterations of any industrial buildings that are used for the purposes of his business as a manufacturer.
"Development allowance" of 10 per cent	for a business that incurs expenditure on growing of rose flowers, tea, coffee, or banana plant or citrus fruit trees or other similar trees
"Local content allowance" of 2 per cent	for expenditure of agro-processing or manufacturing businesses, other than expenditure of capital nature on the growing or purchase of a prescribed agricultural product within Zambia. the local content allowance shall be claimed in each year that the expenditure is incurred but not exceeding three charge years.
Contribution to an approved pension fund established on behalf of employees	
The establishment or in the administration of an approved share option scheme	
Any payment made for the purposes of technical education	relating to that business or for the purposes of obtaining further experience, training or qualifications relating to that business
Any subscription paid by a person in respect of his membership of a trade, technical or professional association	related to his business, employment or office.
Subject to the other provisions, an amount paid to an organisation exclusively providing public benefit activity	if the payment is in money or money's worth and is made for no consideration
Expenditure not being of a capital nature, incurred by the business during a charge year on experiments or research relating to the business.	

Investment Income

Section 17 of the Income Tax Act specifies the investment income included as part of the gross income. These are annuities; dividends; interest charges and discounts; royalties; and income from letting of property and the income as further classified in the First Schedule, which includes capital recoveries and share options. Capital gains on the disposal of investment assets are not included in the income tax base.

In order to limit the deductibility of certain cross-border payments, in 2020, Zambia amended the Income Tax Act to provide for the limitation of the deductibility of gross interest on borrowings to 30 per cent of Earnings Before Interest, Tax, Depreciation and Amortization (EBITDA). The 2021 amendment clarifies that the limitation applies to gross interest arising from loans that are both revenue and capital in nature. This provision is found in Section 29 (1B) of the Income Tax Act.

Rate structure

Once the business taxable income has been determined, various tax rates are applied (Table 12). Until 2021, the standard rate for Company Income Tax was 35 per cent. Effective 1st January 2022, the standard rate has been revised downwards to 30 per cent. However, many sectors enjoy tax rates below the standard rate, while companies in telecommunications with annual income exceeding K250,000 are taxed at 40 per cent. In the 2022 fiscal year, the Government has reduced the standard Company Income Tax rate to 30 per cent but maintained the 40 per cent for telecommunication companies. Part II of the Charging Schedule of the Income Tax Act specifies the rates of tax.

Table 12: Company Income Tax rate structure, 2021

Source of income	CIT rate (%)
Standard rate	35
Electronic communications networks or service licensees (income in excess of ZMW 250,000)	40
Mineral processing	35
Mining	30
Manufacturing of products using copper cathodes	15
Approved Public Benefit Organisations (on income from business)	15
Agro-processing	10
Farming	10
Non-traditional exports – agro-processing and farming	10
Non-traditional exports – other	15
Chemical manufacture of fertilizer	15
Organic manufacture of fertilizer	15

Source of income	CIT rate (%)
Trusts, deceased's or bankrupt's estates	30
Accommodation & food service activities	15

Source: Elaborated from the Zambia Revenue Authority

There are various reasons for the differentiated rates applied to the different economic activities. These include the following:

- Given the economic significance of the agricultural sector and the high contribution to employment in Zambia, farming agro-processing are taxed at the preferential rate of 10 per cent to help accelerate agricultural investment and productivity.
- In order to promote non-traditional (mostly non-mining) exports, corporate taxes are levied at 10 per cent for agro-processing and farming enterprises that are exporters, while the rest of the non-traditional exporters are levied at 15 per cent.
- The tourism sector was perhaps the most adversely affected by the COVID-19 pandemic after the Government ordered the closure of tourism establishments as part of the containment measures in 2020. In order to resuscitate the tourism sector and promote local tourism, the corporate income tax rate was reduced from the standard 35 per cent in 2020 to 15 per cent in 2021. This has since been maintained in 2022. This is according to Income Tax Act No. 20 of 2020 and amended by Act No. 43 of 2021.

The multiple CIT rates generate distortions and are prone to arbitrage, avoidance, and revenue leakage. The lower CIT rates are permanent and distortionary, eroding the overall tax base, and making already profitable companies even more so. The multiple rates, narrow tax bases, avoidance opportunities, and large informal sector have led to low CIT revenue productivity. Although Zambia has one of the highest standard CIT rates among SADC members (35 per cent), the revenue yields only 1.9 per cent of GDP, which is lower than other SADC countries.

4.2.3 Administration of the corporate income tax

Several methods of collecting business income taxes are employed to make income tax more effective as a fiscal policy instrument. The main techniques used are: (i) the timing of recognition of income and expenses; (ii) treatment of non-resident companies or branches; (iii) tax withholding; (iv) depreciation; (v) tax incentives (vi) loss carryforward.

Accounting

- **The timing of recognition of income and expenses is crucial to the calculation of taxable income.** The choice between cash basis accounting or accrual basis accounting will have a significant effect on the measurement of taxable income. There is no general rule of the Income Tax Act that requires that income or expenses must be accounted for using the cash or accrual basis. Section 5 of the Income Tax Act states the conditions when income is received. It states that income is received by a person when (i) it is paid, (ii) given or granted to him, (iii) it accrues to him or in his favour, (iv) it is in any way due to him or held to his order or on his behalf, (v) it is in any way disposed of according to his order or in his favour. A 'person' in the Act means an individual or natural person or a corporation. Basically, different rules will apply depending on the circumstances. For example, salary and wage earners typically account for income and deductions on a cash basis, while business tax payers above a certain size account for income and deductions on an accrual basis. Some examples of special rules are outlined below:
- Foreign currency exchange gains or losses "shall be assessable or deductible … in the charge year in which such gains or losses are realized". In this respect, foreign currency exchange gains or losses are recognized on an accrual basis, except for foreign currency gains or losses of a bank of a capital nature (Section 29A of the Income Tax Act)
- Where a bad debt has been allowed and the taxpayer subsequently recovers all or part of the debt, the amount recovered, which may ultimately be reincluded in gross income, is assessable in the charge year in which the recovery is received (Section 43A (2) of the Income Tax Act).

Treatment of non-resident companies or branches

The Income Tax Act basically lifts the definition of a *permanent establishment* from the OECD Model Tax Treaty. Section 81AA of the Income Tax Act defines a "permanent establishment" as a fixed place of business through which the business of an enterprise is wholly or partly carried on, and includes:

- a place of management;
- a branch;
- an office;
- a factory;
- a workshop;
- a mine, an oil or gas well, a quarry or any other place of extraction or exploitation of natural resources;

- a building site, a construction, assembly or installation project or any supervisory activity in connection with the site, project or activity, but only where that site, project or activity continues for a period of more than one hundred and eighty-three days;
- a place where an enterprise provides services, including consultancy services, through employees or other personnel engaged by the enterprise for that purpose within the Republic for a period or periods exceeding in the aggregate ninety days in any twelve-month period commencing or ending in the fiscal year concerned;
- in relation to an individual, a place where the individual performs services in Zambia for a period or periods aggregating more than ninety days within any twelve-month period commencing or ending in the fiscal year concerned; and
- an installation or structure continuously used for the exploration for natural resources for a period of not less than one hundred and eighty-three days.

If the conditions for a permanent establishment have been met, **then the income accruing to the permanent establishment will be subject to the corporate income taxation**. In the event that a permanent establishment is not present, then payments to the non-resident contractors will be subject to withholding tax. Where a relevant double tax treaty (DTT) is in force, the definition of a *permanent establishment* in the treaty should take precedence over Zambian domestic legislation where the non-Zambian resident enterprise does not have a permanent establishment under the treaty definition.

Zambia has in-force double tax treaties (DTTs) with the following 23 countries:

Botswana	Canada	China	Denmark
Kenya		India	Finland
Mauritius		Japan	France
Seychelles			Germany
South Africa			Ireland
Seychelles			Italy
Tanzania			Netherlands
Uganda			Norway
			Sweden
			Switzerland
			United Kingdom

Treatment of subsidiaries and branches

While there is no difference in the taxation treatment of the income of subsidiaries and branches, the distribution of profits is treated differently. Where profits of a branch of a foreign company derived from local operations are not re-invested in Zambia, they are subject to tax at 20 per cent. Subsidiaries on the other hand, will be required to account for taxes on the distribution of dividends using the withholding tax mechanism; the rate is 15 per cent for resident recipients and 20 per cent for foreign-based recipients.

Transfer pricing

The Income Tax Act has specific provisions on transfer pricing under Section 97. Accompanying this are the Income Tax (Transfer Pricing) Regulations, Statutory Instrument No. 20 of 2000. In 2018, the Government released new transfer pricing regulations to supplement the existing law and regulations through the Income Tax (Transfer Pricing) (Amendment) Regulations, Statutory Instrument No. 24 of 2018. There is also a Practice Note published by the Zambia Revenue Authority in 2018.

Zambia's Transfer Pricing Rules provide for the application of the 'arm's length principle' to controlled transactions. This means that the results of a controlled transaction should be consistent with the results that would have been realised in a comparable transaction between independent persons dealing under comparable conditions. Section 97A of the Income Tax Act and the Transfer Pricing Regulations require that assessable (taxable) income of a person is calculated on the basis that the arm's length principle is applied in relation to all controlled transactions. The Domestic and International Taxation Unit under the Budget Department under The Ministry of Finance and the Domestic Taxes Division of the Zambia Revenue Authority are the institutions that deal with transfer pricing issues in the country.

Tax withholding

The Income Tax Act contains also provisions for tax withholding on business income. Tax withholding on business income was first introduced in Zambia on Interest, management and consultancy fees, royalties and public entertainment fees in 1971. It has over the years been extended to dividends, rent, commissions and payments to non-resident contractors. The payments subjected to withholding are specified under Sections 81, 81A and 82A of the Income Tax Act. Table 13 is an excerpt of Part II of the Charging Schedule specifying the applicable rates.

Table 13: Part of the Charging Schedule showing Withholding Tax rates, 2021

Source of income	Withholding tax rate (%)
Dividends payable to residents	15
Dividends payable to non-residents	20
Payments to non-resident contractors	20
Dividends done by any person carrying on mining operations	0
Dividends paid by a company operating in a multi-facility economic zone or industrial park under the Zambia Development Agency Act, 2006, on profits made on exports	0
For a period of ten years from the time of commencement of works in the multi-facility economic zone or industrial park under the Zambia Development Agency Act, 2006	0
Branch profits[26]	20

Source: Elaborated from the Income Tax Act

Tax withholding is not the final tax for resident taxpayers. At the end of the charge year, the taxpayer will be required to submit an Income Tax Return containing all sources of income, including income from interest. The final tax will be determined through an assessment. The Withholding Tax deducted is taken into account before arriving at the final tax. However, where the payment is made to a resident of a country with which Zambia has a tax treaty, the rate may be reduced to what is prescribed in the treaty (if any), subject to the qualifying conditions being met.

Depreciation

Accounting depreciation, which is based on individual company policies, is a non-allowable deduction. However, for tax purposes, a deduction known as a 'capital allowance', which is predetermined in the tax code, is allowed on qualifying capital assets brought into use in the business. Part II of the Fifth Schedule of the Income Tax Act specifies that the wear and tear of any implement, plant or machinery shall be calculated on a straight-line basis of the original costs. The original cost shall be the current market value of such implements, machinery or plant as determined by the Commissioner-General in the charge year that they are first used for the purpose of a business.

[26] The Income Tax Act defines "*branch profits*" as the profits of a foreign company derived from the operation of its business within the Republic which are not re-invested in the Republic.

Accelerated depreciation is applicable to specified economic activities such as farming, agro-processing and businesses holding a Zambia Development Agency (ZDA) investment licence which can claim wear and tear allowance at 100 per cent, while businesses carrying on electricity generation, mineral processing, manufacturing and tourism can claim wear and tear allowance at 50 per cent of the cost.

Zambia does not tax capital gains, but levies in lieu a property transfer tax (PTT). Individuals, companies, and partnerships transferring land, shares, or intellectual property are subject to a 5 per cent tax, whereas the transfer of mining licenses is subject to a 10 per cent tax. The PTT is extended to share transfers outside Zambia if (a) the transferring person owns – directly or indirectly – at least 10 per cent of the Zambian company, and (b) in the preceding three years at least 10 per cent of the value of shares has been transferred.[27]

Tax incentives

The Direct Taxes Division of the ZRA administers tax incentives to both local and international investors. They can broadly be categorised into three groups (i) Zambia Development Agency (ZDA) incentives; (ii) Income Tax Act exemptions/reliefs; and (iii) Tax relief granted by way of Double Taxation Agreements. These **Income tax incentives are provided to businesses approved by the Zambia Development Agency (ZDA).** Specifically, these incentives are provided to businesses that have set up their business activity in a rural area, multi-facility economic zone or an industrial park. The incentives are also applicable to small and medium enterprises (SMEs) that are voluntarily registered for corporate income tax. The incentives are restricted to manufacturing and electricity generation activities. The incentives, charged at zero per cent for a period of five years from the year of commencement of operations, are effectively tax holidays.

Table 14: Tax incentives offered by the Zambia Development Agency

Activity	Description	Applicable rates/conditions
Business enterprise carrying on manufacturing activities in a rural area, multi-facility economic zone or industrial park (also applicable to SME's that have voluntarily registered for CIT)	Income	Zero per cent for a period of five years starting from the year of commencement of operations of the approved investment
	Tax to be deducted from any dividend declared	Zero per cent per annum for a period of five years starting from the year of commencement of operations of the approved investment.
Business enterprise carrying on electricity generation or	income	Zero per cent for a period of five years starting from the year of

[27] Section 4.1B of the Property Transfer Tax Act.

Activity	Description	Applicable rates/conditions
manufacturing activities in a rural area, multi-facility economic zone or industrial park (also applicable to SME's that have voluntarily registered for CIT)		commencement of operations of the approved investment
	Tax to be deducted from any dividend declared	Zero per centum per annum for a period of five years starting from the year of commencement of operations of the approved investment

Source: Zambia Revenue Authority

The duration of the incentives is five years starting from the year of commencement of operations, hence given the short time period for the holiday (5 years), the effectiveness of these incentives is questionable. According to the Régie de l'énergie, it takes 4 to 7 years to build a medium-sized hydroelectric power station, from the time the project initiator remits the Project Notification form to the government until the facility is up and running[28]. It may further take a couple more years for the investment to begin making profits. So, during the period of the tax holiday, it is unlikely that a power plant set up would declare any taxable income, and let alone any dividends. While it may take just several months to set up a medium-sized solar power plant, such a firm is unlikely to enjoy the benefits of the tax holiday either.

The singling out of manufacturing and electricity sectors for preferential treatment makes the incentives inequitable. While it is understandable that manufacturing and electricity are key sectors that need significant investments, a heavier tax burden is placed on nonpriority sectors, which undermines the sense of fairness. Further, the flawed design of the incentives is unlikely to yield the intended results, and complicates tax administration, especially that the ZDA approved firms are still required to file tax returns. It also increases monitoring costs by the already resource-constrained Zambia Development Agency[29].

Tax relief under the Income Tax Act

Tax reliefs provided in the Income Tax Act are provided in the Charging Schedule, an excerpt of which is shown in Table 15. There seems to be an overlap between ZDA incentives and those provided in the Income Tax Act. The incentives in the Income Tax Act for manufacturing firms seem better thought out as they give a longer tax holiday period and increased rates between years 11 and 15. However, it is unclear if a manufacturing firm could access either incentive or both, thereby adding to the administrative and monitoring costs.

[28] https://www.aqper.com/en/how-long-does-it-take-to-build-a-hydroelectric-power-station.

[29] Key informant interview with the Zambia Development Agency chief executive.

Table 15: Tax incentives rates, 2021

Category	Rate (%)
Manufacturing of products using copper cathodes	15
Approved Public Benefit Organisation (on income from business)	15
Agro-processing	10
Farming	10
Non-traditional exports – Agro-processing and Farming	10
Non-traditional exports – Others	15
Chemical manufacture of fertilizer	15
Organic manufacture of fertilizer	15
Rural enterprises	Tax chargeable reduced to 1/7 of the standard rate for 5 years
ZDA approved manufacturing firms in a rural area, multi-facility economic zone, or industrial park	0% for the first 10 years since the commencement of works, half of the standard income tax rate for years 11 to 13, and three-quarters of the standard income tax rate on business enterprise's profit earned in years 14 and 15 from the commencement of works.
Publicly-traded companies with one-third Zambian ownership	7

Source: Elaborated from the Income Tax Act

Double Taxation Agreements

Section 74 of the Income Tax Act authorizes the President to enter into double taxation agreements with other countries and territories, hence Zambia has double taxation agreements with 23 other jurisdictions. These are provided in the form of tax relief. A summary of the payments that are subject of these treaties and the applicable tax rates is presented in Table 16. The double taxation agreements aim to harmonise tax treatments between Zambia and other jurisdictions to prevent, mitigate or discontinue the levying, under the laws of Zambia and of such other country or territory, of taxes in respect of the same income. They also aid in the exchange of information on tax matters or for mutual assistance in tax matters with the objective of rendering reciprocal assistance.

Table 16: Zambia's Double Taxation Agreements with other countries

	Country	Applicable tax rates			
		Dividends	Interest	Royalties	Technical fees
1	Botswana	5% or 7%	10%	10%	10%
2	Canada	15%	15%	15%	0%
3	China	5%	10%	5%	0%
4	Denmark	15%	10%	15%	0%
5	Finland	5% or 15%	15%	5% or 15%	0%
6	France	20%	20%	0%	0%
7	Germany	5% or 15%	10%	10%	0%
8	India	5% or 15%	10%	10%	10%
9	Ireland	8%	10%	10%	0%
10	Ireland	0%	0%	0%	0%
11	Italy	5% or 15%	10%	10%	0%
12	Japan	0%	10%	10%	0%
13	Kenya	20%	20%	20%	0%
14	Mauritius*	5% or 15%	10%	5%	0%
15	Netherlands	5% or 15%	10%	8%	0%
16	Norway	15%	10%	15%	0%
17	South Africa	20%	20%	20%	20%
18	Seychelles	5% or 10%	5%	10%	0%
19	Sweden	5% or 15%	10%	10%	0%
20	Switzerland	0%	0%	0%	0%
21	Tanzania	20%	20%	20%	0%
22	Uganda	20%	20%	20%	0%
23	United Kingdom	5% or 15%	10%	10%	0%
24	United Kingdom	5% or 15%	10%	5%	0%

Source: Zambia Revenue Authority *Terminated in 2020

However, some of these double tax agreements tend to work to the disadvantage of Zambia due to the preference that these agreements have to the residency as opposed to the source principle. Zambia generally levies a 20 per cent withholding tax on interest payments made to non-residents. In its policy brief on Double Taxation Agreements, the Centre for Trade Policy and Development brings to the fore the Ireland-Zambia tax treaty which limits ‘source country’ tax on cross-border interest payments to zero. So, Zambia is not permitted to levy tax on interest payments from Zambian to Ireland companies. Given that taxable cross-border income generally flows outwards from Zambia to investors and companies based in wealth countries or tax havens, when a developed country or tax haven negotiates a tax treaty with a developing country like Zambia, it has a clear interest in trying to limit or even cancel the taxing rights of the source country. This will generally reserve more taxing rights to the developed country. And as a potential source of investment for the developing country, the developed country will often have the economic and political muscle to get its way.

The Ireland-Zambia tax treaty, signed over 40 years ago, is an example of such imbalance. It is one of only two tax treaties that Zambia has signed - the other being Switzerland - that deny the right to tax any of the outflows of cross border income normally subject to tax withholding. Not only does this tend to nakedly boost Irish revenues at the expense of Zambia, but it also allows multinational companies to ‘treaty shop’ using Ireland as a tax-free conduit for transactions between Zambia and other countries. While Ireland gives aid to the Zambian government with one hand, Zambian government revenues flow out again thanks to its Irish tax treaty[30].

Loss carry over

Losses can be carried forward to set against profits of the same source. A loss incurred by a person carrying on a mining operation or electricity generation can be carried forward for ten subsequent charge years after the charge year in which the loss is incurred. In all other cases, the loss can be carried up to five subsequent years after the charge year in which the loss was incurred. The longer period for mining and electricity projects is due to their typically longer investment recovery periods and larger initial tax losses.

However, there is an additional restriction on mining whereby the loss carry-forward in any year is capped at 50 per cent of the taxable income in that year. Given concerns about profit shifting, this cap provides a safeguard mechanism, albeit crude, and ensures that mining companies with current taxable income in a particular

[30] Centre for Trade Policy and Development (undated). Policy Brief on Double Taxation Agreements.

year will pay some corporate income tax even if carrying forward their tax losses. These provisions are in Section 30 of the Income Tax Act.

There are no loss carrybackward provisions in Zambia which avoids the need for the tax authority to pay refunds as a firm permitted to carry back its losses would receive a tax refund from the tax authority, thereby distorting revenue collection and the comprehensive income tax base.

4.2.4 Key take-aways

Many sectors enjoy income tax rates below the standard rate. The multiplicity of tax rates not only erodes the tax base but adds to the complexity of tax administering the taxes. It also undermines the sense of fairness as a disproportionately heavier tax burden is placed on the non-priority sectors to collect the same revenue.

The recent reduction of the corporate tax rate for the tourism sector due to it being adversely hit by the COVID-19 pandemic is flawed. Given that the tourism establishments have generally been making losses, the reduction of the corporate income tax rate – which is a tax on profits – is a wrong intervention, and has done little to alleviate their losses.

The long list of deductions allowed in ascertaining the gains or profits of a business adds to the eroding of the tax base, as it places the tax system further away from the notion of a comprehensive income.

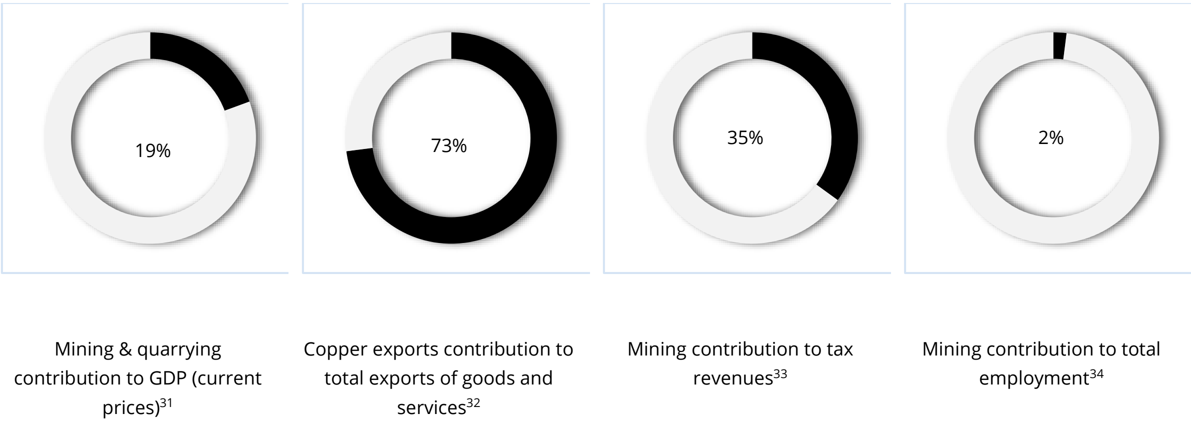
Some incentives may also be given based on the lobbying prowess of the intended beneficiary. With limited monitoring capacity by the ZDA, maintaining incentives which appear to disproportionately favour a particular sector at the expense of tax revenue deters tax morality in the rest of the sectors and therefore may encourage tax evasion.

The design of tax incentives – particularly the ZDA tax holidays – seem largely ineffective. Given the short time period for the holiday (5 years), the effectiveness of these incentives is questionable. It also increases monitoring costs for the already resource-constrained Zambia Development Agency unnecessarily. It also causes serious distortions and inequities in corporate taxation.

4.3 Mining Fiscal Regime

Mining is the mainstay of the Zambian economy. It is not only the largest contributor to GDP, but it is the largest foreign exchange earner, largest contributor to tax revenues and has a significant share of formal sector jobs. In 2021, mining contributed just under one-fifth of GDP, three-quarters of total exports, close to one third of tax revenues and one-fiftieth of the total employment. It also accounts for the largest inflows of foreign direct investments. Figure 14 shows selected indicators showing the economic contribution of the mining sector.

Figure 14: Economic contribution of the mining sector, 2021



There is a widely held view that the mines have not been contributing their fair share to Government revenue. This view is epitomised by the numerous changes in the mining fiscal regime in the last ten years, acquiring an unofficial record in mining tax instability[35]. Notable changes as follows:

- The 2008 regime which annulled the Mineral Development Agreements and introduced a windfall tax, but was scrapped a year later, following a drop in copper prices and opposition from mining houses. The Development Agreements between the Government of Zambia and the mining companies included Stabilisation clauses, which essentially constitute a promise on the part of the host government not to amend its laws in a way that adversely affects the economic rights of the investor contained within that particular concession agreement. In other words, even if the government amended its national laws, the new laws would not, in theory, apply to the concession agreements.
- In 2012, the government effected changes to the mining fiscal regime by, among other things, doubling the mineral royalty rate from 3 per cent to 6 per cent and treating hedging and operating income separately for income tax

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[31] Source: ZamStats, National Accounts Statistics, 2021.

[32] Source: Bank of Zambia, BoP Statistics, Q1-Q3 2021.

[33] Source: Ministry of Finance, Fiscal Tables, 2021, Corporate income tax & mineral royalty only.

[34] Source: ZamStats, 2020 Labour Force Survey.

[35] UNUWIDER (2018). Zambia's mining windfall tax. WIDER working paper 2018/51.

purposes, clearly violating the stabilization clauses in the Development Agreements. Hedging, as a risk management mechanism, was now treated as a separate activity, and was to be taxed separately from mining operations. Losses from hedging could no longer be used to reduce taxable income from operations. This was apparently intended to prevent companies from adopting hedging strategies deliberately designed to reduce taxable profits in Zambia[36].

- The 2015 regime reduced the mining corporate tax to zero per cent[37], effectively abolishing it, and royalty rates set at 8 per cent for underground mining and 20 per cent for open pit mining. This sparked fierce opposition and debate, resulting in the Government lowering the royalty rate to 6 per cent for underground mining and 9 per cent for open pit mining, and the reintroduction of variable profit tax and the corporate income tax at 30 per cent for mining operations and 35 per cent for processing.
- In 2016, the Government made three significant changes: the removal of the 9 per cent royalty on copper; the introduction of a "price-based royalty," the rate of which varies according to the copper price; and the removal of the variable profit tax. David Manley (2017) contended that the price-based royalty regime significantly relieved the burden of tax for mining companies, which was sensible at the time given the Government's short-term objective of keeping high-cost mines in operation, maintaining a steady revenue stream and jobs. However, in the long term, with copper prices sky-rocketing, the share of benefits taken by Government was much lower[38].
- In 2019, the Government removed the non-deductibility of mineral royalty for income tax purposes. It also increased mineral royalty rates by 1.5 per centage-points at all levels of the existing scale, and introduced a fourth-tier rate at 7.5 per cent when the copper price is between US$7,500 and US$9,000, and a fifth-tier rate at 10 per cent, when the copper price goes beyond US$9,000. Mineral royalty tax was also made non-deductible for income tax purposes. Perhaps the most fundamental proposed change, necessitated by the Value Added Tax refund problem especially in the mining sector, was the proposed abolishment of the VAT to replace it with a non-refundable General Sales Tax. But this was later abandoned after an uproar from the mining sector and other businesses.

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[36] Oliver S. Saasa & Shebo Nalishebo (2019). Assessment of the Mining Tax Regime in Zambia – 2000-2019. Premier Consult Ltd, 28 August 2019.

[37] Marriot Nyangu (2020). The Rise and Fall of the Mining Tax Regime in Zambia: Southern Africa Resource Watch (SARW).

[38] David Manley (2017). Ninth Time Lucky: Is Zambia's Mining Tax the Best Approach to an Uncertain Future? Natural Resource Governance Institute, Briefing October 2017.

- In 2022, mineral royalties are now deductible for income tax.

These frequent changes in the mining fiscal regime clearly show some possible issues in either the design, or the law or the administration of the law or in all these facets. While these changes to the mining fiscal regime resulted in more revenues for the government, it increased the mining companies' effective tax rates, thereby contributing to the drop in investment, growth and revenues. For example, First Quantum Mineral's Kansanshi mine halted their "S3" Expansion in 2013 citing "market conditions and a challenging fiscal environment". The US$650 million expansion was planned to increase the smelting capacity by at least 20 per cent and increase production[39]. Chambishi, whose core business is refining copper and cobalt mainly sourced from the Democratic Republic of the Congo (DRC), suspended its operations in February 2019 with 1,500 workers sent on forced leave, citing its inability to secure materials from DRC, thanks to a 5 per cent import duty on copper and cobalt concentrates[40]. In August 2019, Glencore's Mopani Copper Mines shut down the uneconomic Mindolo North and Central shafts in Kitwe, leading to a loss of over 1,400 jobs[41].

It is clear that the Government process of setting policy measures rarely drew on ex-ante impact analysis of possible effects of the measures, evidence from other countries, and genuine consultation with carefully selected key stakeholders. The instability in the mining sector has far-reaching consequences beyond mining due to its linkages with other sectors, thereby affecting tax earnings from not only the mining sector but the economy as a whole. Some analytical tools that could be used for impact analysis include input-output analysis as well as tax-benefit microsimulation models to measure the direct, indirect and induced effects.

4.3.1 Key considerations in the mining fiscal regime

In designing a mining fiscal regime, the government needs to be aware of its responsibilities as the sovereign tax power and as the resource owner. As the sovereign tax power, it has the responsibility to ensure that the resource sector makes its contribution to public revenues as do other industries. As the resource owner, it has to ensure that it gets an appropriate price for its resources in order to promote sustainable economic growth and intergenerational benefits for the people, who are the ultimate owners of the resources.

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[39] https://im-mining.com/2020/09/15/fqms-widened-kansanshi-s3-expansion-plan-includes-35-hitachi-eh4000ac3-trolley-trucks-seven-liebherr-r-9400-shovels/

[40] https://tiozambia.com/chambishi-metals-suspends-operations1500-workers-left-in-the-cold/

[41] https://www.africanews.com/2019/08/09/zambia-aksa-glencore-to-reverse-mine-shaft-closures/

As earlier pointed out, there is a fundamental conflict between mining companies and the government over the division of the risk and reward of resource development. Both parties want to maximize rewards and shift as much risk as possible to the other party. To ensure mutual benefits, the mining companies and the government enter into development agreements and the associated fiscal rules. The magnitude of revenues derived depend, to a large extent, on the design of the fiscal arrangements which should encourage a stable fiscal environment and efficient resource development.

In order to define stable relationships between the investors (often multinational enterprises) and the government, the development agreements are usually long term, over periods of 10 to 30 years. One reason mining projects are developed under long-term agreements is that the balance of power shifts over the life of a project. Before exploration begins or in its early stages, the power is with the mining companies due to the worldwide competition to attract potential investors. The power then shifts to the government, and political pressure for renegotiating the original agreement can become almost irresistible once a successful project has come on stream and is generating significant positive net cash flows, especially if there is a change in the political cycle. At the tail end of the project, when the resource deposit is almost depleted, the balance of power shifts again. The mining company can walk away from the project should it conclude that the government is making excessive demands.

It is not always easy to determine an optimal fiscal regime given the shifting balance of power over the life of a project. There always will be unavoidable trade-offs between revenue, risk and timing of the receipt of revenue. As a result, multiple fiscal instruments are needed to protect the interests of both parties over the life of the agreement. Product-based fiscal instruments can ensure that the government receives at least a minimum payment for the exploitation of natural resources of the country. Profit-based instruments reduce the likelihood of unplanned changes in resource contracts because they mean that the government shares in the returns from projects that turn out to be more profitable than expected. Therefore, a combination of royalties and corporate income tax are appropriate instruments.

Royalties are levied either on the volume or on the value of resources extracted. Royalties secure revenues as soon as production commences, and ensure that a minimum payment is made by the companies for the resources that they extract. They are also considerably easier to administer than most other fiscal instruments. The royalty should be based on a transparent price formula agreed upon as part of the mining agreement, and should be based on observable prices, necessitating the use of quoted reference prices such as the ones on the London Metal Exchange. The use of reference prices for the valuation of mineral sales for royalty purposes provides an effective safeguard against undervaluation. Further, royalties should be deductible for purposes of determining income tax liability because they are a cost of production. And depending on government perception of profitability, higher commodity prices could trigger higher royalty rates according to an agreed formula based on transparent market prices for the commodity.

In exercising its taxing power, the government should levy a corporate tax on all mining companies, as it does with the non-mining companies and regardless of whether the government owns the mine or not. Consequently, the design of income tax provisions specific to mining such as accelerated capital deductions is inappropriate. Instead, specific mining sector issues should be addressed by changing the price government charges for the use of its resource wealth using other fiscal instruments such as royalties.

As with income taxation of other industries, income taxation of the mining sector involves matching income and expenses. The particular features of the mining sector mean that some income tax issues are more important than in other industries. Due to the large initial capital investments incurred in exploration and development of mining projects, defining capital deductions and the permissible debt-equity ratio are important in maintaining the tax base, and to avoid earnings stripping through artificially high debt-equity ratios.

Being dominated by multinational companies increases the likelihood of transfer pricing. As a result, there ought to be provisions in the tax law enabling price adjustments to be made where under- or overpricing between associates has resulted in a lowering of taxable profit. To enforce such provisions, tax returns, at a minimum, should request for details of domestic or international transactions with related parties.

Given that foreign investment plays an important role in the mining sector, some countries tax the worldwide income of their companies and allow a foreign tax credit. So, investors from such countries will want to invest in a country with an income tax, so that they have a creditable tax in their home country.

4.3.2 Mining sector legislation and regulatory framework

Governed by the Income Tax Act and the Mines and Minerals Development Act, the mining fiscal regime encompasses both direct and indirect taxes, as well as mineral royalties, which are non-tax revenues. The Mines and Minerals Development Act is the primary legislation for the mining sector. The Act contains provisions for mineral royalty rates and associated provisions. The Income Tax Act specifies allowable deductions and revenues for determining the CIT tax base. The

VAT Act, Customs and Excise Act and the Property Transfer Tax Act also contain provisions for the mining sector.

Fiscal and regulatory responsibilities are allocated to ZRA and the Ministry of Mines and Minerals Development. ZRA collects all fiscal payments, while the Ministry of Mines and Minerals Development approves mining and non-mining rights, issues and administers all permits and rights and collects statistics related to the sector, maintains the registry of rights, undertakes resource mapping, and administers safety regulations.

Section 3 of the 2015 Mines and Minerals Development Act vests the ownership of the minerals located within the boundaries of Zambia in the President on behalf of the Zambian people. This is so notwithstanding any right of ownership or otherwise which a person may possess in or over the soil in, on or under which minerals are found. This means that the President, as the representative of the collective body of all Zambians, is symbolically given absolute ownership of minerals in the subsoil. Given that Section 3 of the Act does not categorise or specify any particular type of mineral, but simply refers to "minerals", this presumably includes all minerals, known and unknown[42].

4.3.3 Development Agreements

During the process of privatizing the mines in the 1990s, the sale of ZCCM assets was negotiated bilaterally between the Government and individual mining companies in contracts referred to as "Development Agreements." The agreements, which had stability periods ranging from 15 to 20 years, embodied highly generous tax and other concessions. The 1995 Mines and Minerals Development Act recognised the use of development agreements. Section 9 of the Act stated that:

- For the purpose of encouraging and protecting large-scale investments in the mining sector in Zambia, the Minister may, on behalf of the Republic, enter into an agreement relating to the grant of a large-scale mining licence.

Several issues were particularly noteworthy with respect to the Development Agreements. In particular, there was no VAT charge for mine products and capital expenditure had a deductible allowance of 100 per cent. Mining companies also benefited from excise duty rebates on electricity supplied by the state utility firm, ZESCO. It is worth noting that the first batch of privatised companies paid royalty rate of between 2 per cent to 3 per cent. But this rate was revised downwards following

[42] Ndulo, M. (1980). The ownership of base minerals in Zambia. The Comparative and International Law Journal of Southern Africa, 13(1), 78–85. http://www.jstor.org/stable/23245407.

negotiation of a generous rate of 0.6 per cent by Anglo American Corporation, which was subsequently applied uniformly across all mining firms.

The recovery in copper prices in the early 2000s prompted the Government to consider renegotiating the contracts and introduce significant policy changes to the fiscal regime in the mining sector. However, cutting across the Development Agreements was a ‘stabilisation clause’ binding the Government not to make alterations either to the magnitude or structure of any of the incentive provisions. Realising the difficulty to renegotiate the contracts individually, the Government annulled the 1995 Act and introduced a new legislation: the Mines and Minerals Act 2008 which effectively abolished the Development Agreements.

The abolishing of the Development Agreements has contributed to the instability of the mining fiscal regime.

4.3.4 Mineral royalties

Section 88 of the Mines and Minerals Development Act gives responsibility to the Commissioner General of the Zambia Revenue Authority to carry out the provisions of Part VII of the Act (Mineral Royalties and Charges).
For tax purposes, minerals are classified into the following broad categories:

- Copper
- Base metals other than copper: Iron, nickel, lead, zinc, cobalt, titanium, tin, aluminium, etc.
- Precious metals: gold, platinum, silver, palladium, selenium, etc.
- Energy minerals: Coal, uranium, oil, natural gas, etc.
- Gemstones: amethyst, aquamarine, beryl, corundum, diamond, emerald, etc.
- Industrial minerals: Limestone, sand, gravel, gypsum, talc, etc

Section 89 of the Mines and Minerals (Amendment) Act of 2018 read together with the Mines and Minerals Development Act of 2015 gives guidelines with regard to the estimation of mineral royalties and the applicable rates for the different types of minerals. The estimation of mineral royalty is based on gross value or norm value of the minerals. For purposes of computing mineral royalty, 'gross value' is defined as “the realised price for sale Free on Board at the point of export in Zambia or point of delivery within Zambia”. 'Norm Value' means (a) the monthly average London Metal Exchange cash price per tonne multiplied by the quantity of the metal or recoverable metal sold; (b) the monthly average Metal Bulletin cash price per tonne multiplied by the quantity of the metal sold or recoverable metal sold to the extent that the metal price is not quoted on the London Metal Exchange; or (c) the monthly average cash price per tonne, at any other exchange market approved by the Commissioner General, multiplied by the quantity of the metal sold or recoverable metal sold to the extent that the metal price is not quoted on the London Metal Exchange or in the Metal Bulletin.

Rate structure

The gross value is applicable on industrial minerals, energy minerals and gemstones, while norm values are applicable on base metals (including copper) and precious metals. The applicable royalty rates for minerals are shown in Table 17. Mineral royalties for holders of mining rights are payable at a rate of 5 per cent on base metals (except copper; 8 per cent for Cobalt) and energy and industrial minerals; and 6 per cent for gemstones and precious metals. Holders of large-scale, small-scale and artisanal mining licences and rights are liable to pay mineral royalties. All persons carrying out quarrying of industrial minerals, including the quarrying of gravel, clay and sand, are liable to mineral royalty (Part VI of the Mines and Minerals Development Act).

Table 17: Applicable mineral royalty rates

Type of mineral	Valuation	Applicable royalty rate
Base metals (other than Copper)	Norm value	5%; Cobalt (8%)
Precious metals	Norm value	6%
Energy minerals	Gross value	5%
Gemstones	Gross value	6%
Industrial minerals	Gross value	5%

Source: Zambia Revenue Authority

Zambia applies a sliding-scale mineral royalty regime for copper (Table 18). The base rate for copper is 5.5 per cent for prices below $4,500/metric ton (mt) increasing to 10 per cent when prices exceed $9,000/mt. The rate is applied stepwise to the aggregate value when the price crosses each threshold rather than to the incremental value in each price band. The mineral royalty is assessed on the gross value of commodity sales using norm values indexed to the quoted sales prices on the London Metal Exchange, and thus providing a safeguard against undervaluation.

Table 18: Mineral royalty sliding scale regime for Copper

Norm Price Range	Rate
Less than US$4,500	5.5%
US$4,500 but less than US$6,000	6.5%
US$6,000 but less than US$7,500	7.5%
US$7,500 but less than US$9,000	8.5%
US$9,000 and above	10%

Source: Zambia Revenue Authority

Applying the variable royalty rate for copper on an aggregate basis increases the distortive impact and adds significant uncertainty to taxpayers. Small differences in commodity prices can have significant threshold effects on revenue payments. It could provide incentives to mining companies to seek to circumvent a price threshold from being crossed. The use of norm prices for mineral royalty valuation reduces this risk.

Corporate income tax

Prior to 2022, mining operations were taxed under the Corporate Income Tax at a reduced rate of 30 per cent. Income from mineral processing was charged at the standard rate of 35 per cent while income from manufacturing of products made from copper cathodes benefits from a reduced rate of 15 per cent. There is no dividend withholding tax on distributions from mining activities[43]. Following the reduction in the standard rate in 2022, mining Corporate Income Tax is charged at the standard rate, as is income from mineral processing.

Expenditure deductions

Part VI of the Income Tax Act has provisions for the deduction of expenses in mining operations. These include the following:

(a) **Deductibility of mineral royalty:** Prior to 2019, the Government allowed the deduction of mineral royalties as an expense for income tax purposes. A non-deductibility of mineral royalties was effected during 2019-2021, contrary to common international practice. Following sustained opposition from the mining companies given that it increased their marginal costs, the government has allowed the deductibility of mineral royalties starting in 2022.

[43] https://www.zra.org.zm/wp-content/uploads/2020/01/Withholding-Taxes.pdf

(b) **Prospecting expenditure deduction:** There are special rules for prospecting expenditure in an area in Zambia over which a mining right has been granted. These enable the shareholders of the company undertaking the prospecting to claim a deduction for the prospecting expenditure, provided certain conditions are met.

(c) **Immediate capital expenditure on mining and prospecting:** 20 per cent of the original capital expenditure incurred on a mine which is in regular production in the charge year. Capital expenditure in relation to mining and prospecting includes expenditure on intangibles such as the purchase of or on the payment of a premium for the use of any patent, design, trademark, process or other expenditure of a similar nature;

(d) **Where separate and distinct mining operations are carried on in mines which are not contiguous, the deduction allowable shall be calculated separately according to the respective mines.** This measure prevents consolidation of income or losses between separate mines by the same owner Without the ring fence, an existing mining company could offset the development cost from a new mine investment against income from a producing mine, and hence defer consolidated income tax payments. This would provide an advantage relative to a new investor entering Zambia for the first time.

(e) **Restoration and rehabilitation works or amounts paid into the Environmental Protection Fund managed by the Ministry of Mines and Minerals Development**. While it is good practice to permit a tax deduction for any cash contributions to a mine-specific rehabilitation fund or expense provisioning, it is possible that this can be abused as a tax-delaying strategy.

Interest deductibility

Section 29 (1B) of the Income Tax Act was amended in 2019 and introduced a limit of 30 per cent on interest deductions as a per cent of earnings before income tax, depreciation and amortization (EBITDA). This interest-earning limitation applies to all interest expenses incurred with the raising of finance. The limit applies to all entities except for financial and insurance service activities. Prior to this change, there was a thin capitalization limit with a debt-equity ratio of 3:1, but it only applied to the mining sector. A key benefit of this move is that it effectively safeguards against transfer pricing through either the volume or price of debt, whereas the thin capitalisation rule only limits the volume. However, there may be practical challenges with an EBITDA limit if earnings are volatile, as is commonly the case for extractive industries.

Tax losses

Given the capital-intensive nature of mining, the Income Tax Act permits a longer period for carrying forward tax losses for mining than for businesses in other economic sectors. Section 30 of the Income Tax Act specifies the loss carry-forward period for mining operations as 10 years whereas it is five years for other businesses. However, there is an additional restriction on mining whereby the loss carry-forward in any year is capped at 50 per cent of the taxable income in that year, while losses are indexed to the US dollar exchange rate.

The 50 per cent limit ensures that a mining entity with current taxable income in a year will pay some CIT even if carrying forward tax losses. Given the general concerns about profit shifting, the cap does provide a crude safeguard mechanism.

Transfer pricing

Multinationals who dominate the extractive industries can potentially devise numerous ways to shift profits abroad by payments for goods and services obtained abroad from related parties. By making excessive cross-border payments, taxpayers are able to substantially erode the Zambian tax base. Applying transfer-pricing rules and the application of withholding taxes and/or denying deductibility of those expenses are some of the mechanisms used to limit such practices.

The government issued regulations implementing the transfer-pricing rule.[44] The Regulations were updated in 2018 with additional reporting requirements,[45] such as the preparation of a master and local file[46] for companies with annual turnover of above ZMW 50 million. The regulations were further updated with guidelines published in 2018,[47] which cover amongst others the use of various methods and finding appropriate comparables. Although these guidelines are geared to the Zambian situation, their appearance is very much in line with similar OECD Guidelines.[48] Most recently, rules were introduced to obtain country-by-country (CbC) reports from qualifying MNEs operating in Zambia.[49]

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[44] Statutory Instrument No.20 of 2000.

[45] Statutory Instrument No.24 of 2018.

[46] The master file provides a high-level overview in order to place the MNE group's transfer pricing practices in their global economic, legal, financial, and tax context. The local file provides more detailed information about the local company's intragroup transactions.

[47] Zambia Revenue Authority, Practice Note No. 2/2018.

[48] OECD (2017), OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017, OECD Publishing, Paris, https://doi.org/10.1787/tpg-2017-en.

[49] Statutory Instrument No. 117 of 2020.

Withholding Taxes and/or Limitation of Deductibility

Cross-border payments that are subject to the 20 per cent withholding tax are dividends (except for mining companies that enjoy an exemption), interest, royalties, branch profit transfers, commissions and management and consultancy fees. Rental payments are subject to a 10 per cent withholding tax and commodity royalties are subject to a 15 per cent withholding tax[50].

Withholding taxes provide a certain protection against base erosion. By allowing a full deduction of those cross-border payments from the income tax base the final tax burden in Zambia is reduced to the withholding tax (20 per cent).

However, this burden may be even further reduced by the application of Double Tax Agreements (DTA). Currently, Zambia has in force 22 DTAs that limit its ability to tax cross-border payments. Most DTAs, including those with some key investors such as Canada, China, the Netherlands and Switzerland, limit Zambia's right to tax cross-border interest and royalty payments to a maximum of 10 per cent. Only the DTA with Botswana and the new DTA with India allow a 10 per cent withholding tax on payments for management and consultancy services. Other DTAs omit such special provisions and rely on the existence of a permanent establishment in order for Zambia to execute its taxing right. Similarly, the withholding tax on branch profit transfers to countries that have concluded a DTA with Zambia is disallowed.

Tax incentives in the mining sector

In Zambia, there are two main types of tax incentives: (a) profit-based incentives – reduced tax rates; and (b) cost-based incentives – accelerated depreciation, investment deductions, and initial allowances. Profit-based incentives in the mining sector include the 30 per cent rate on income from mining operations and the 15 per cent rate on income from manufacturing products from copper cathodes. Profit-based tax incentives generally reduce the tax rate applicable to taxable income.

Cost-based tax incentives involve specific allowances linked to investment expenses, such as the accelerated depreciation, investment deductions, and initial allowances. They are targeted at lowering the cost of capital and so make a greater number of investment projects more profitable at the margin – that is, may generate investments that would not otherwise have been made.

Tax incentives that lower the cost of investment are often to be preferred over profit-

[50] Section 82A ITA lists the payments subject to withholding, whereas Section 7 of the Charging Schedule sets the rates.

based tax incentives.

Artisanal and small-scale Mining

Zambia has a large and growing artisanal and small-scale mining sector. Artisanal and small-scale mining principally includes gemstones – emerald, aquamarine, tourmaline, and amethyst. More recently, gold and manganese have become important. Further, a highly politicised group of artisanal and small-scale miners has emerged in the Copperbelt Province where the Government allowed youths to take control of what are known as 'black mountains', which are copper-rich slug dumps. The main fiscal contribution by the artisanal mining sector is through license payments and royalties. There are neither differentiated royalty rates for the artisanal and small-scale mining sector nor are there separate tax rates.

Other Types of Taxes

***Export duties:* export duties on copper ore and concentrate, gold and gemstones are generally applied at 10, 15 and 15 per cent, respectively.** To encourage local processing, import duty on copper ore and concentrate was removed in the 2021 Budget. The 10 per cent export duty on copper is intended to incentivize domestic processing and refining. However, given that the valuation for royalty is based on processed copper (i.e., at norm prices and norm values), there is already a strong incentive to process copper rather than exporting as concentrate.

4.3.5 Key takeaways

The mining sector plays a key role in Zambia as a source of export earnings, investment, employment, and government revenue. Mining activities contribute significant government revenue mainly from royalty and Corporate Income Tax. However, there continues to be a concern about revenue leakage affecting all fiscal instruments in the sector. There continues to be a perception among many policymakers that the government share from mining is 'unfair' and that profit shifting undermines the potential revenue from the Corporate Income Tax.

The mining sector fiscal regime is principally governed by the Mines and Minerals Development Act which sets out the provisions for mineral royalty, and the Corporate Income Tax. There have been numerous changes to the mining fiscal regime in the last decade and half. Following the abolishment of Development Agreements, stability of the fiscal regime is not guaranteed.
Mineral royalties are not sensitive to operational costs. The stepwise application of the rate to the aggregate value as opposed to the marginal value in each band

increases payment distortions. Small differences in copper prices can have a significant threshold effect on revenue payments.

The high export duty on gold and manganese (15 per cent) incentivizes smuggling by small-scale miners and under-declaration by large-scale mining companies. Further, it adds to the administrative burden of the tax authorities given the unorganized nature of the artisanal and small-scale mining.

V CONCLUSIONS AND RECOMMENDATIONS FOR REFORM

The tax system plays a very central role in Zambian economy. Taxes account for between 15 per cent and 20 per cent of GDP and accounts for three-quarters of the total domestic revenue of Zambia. The way in which these taxes are raised matters for economic efficiency and for fairness. As the country looks to address its fiscal deficit and debt challenges by raising more money through the tax system, the importance of getting the structure right for our tax system is cardinal.

As we look at the Zambian tax system, with a particular focus on the direct tax system, we seek to develop a clear vision of what the ideal system, devoid of unnecessary distortions, should be. In this final chapter of this report, we bring together the main lessons and conclusions of the whole assessment. We start by laying out the broad features of what a good direct tax system should look like. We then move on to look at the legislation and administration of the Zambian direct tax system in order to determine how it stacks up against the ideal. We then move on to the main recommendations for reform. The personal income tax, corporate income tax and mineral fiscal regime are considered in turn. In reviewing each of these taxes (using the term ‘taxes’ loosely as the mineral fiscal regime contains royalties which are not taxes per se), we consider the tenets of fairness, neutrality and efficiency.

5.1 Personal Income Tax key distinctive features

Feature	***Zambian tax system***
Jurisdiction	An individual, whether resident or non-resident, is subject to tax on income within or deemed to be from within Zambia
	Territorial system as only income accrued or derived within Zambia is chargeable to income tax
	Exceptions: foreign-sourced income received by a resident individual is subject to income tax on interest and dividends
Treatment of non-residents	Non-resident beneficiaries are taxable only on income sourced within Zambia
	For personal capital income, non-residents are charged at 20 per cent and it is the final tax.
	No guidance on residency status with regard to the special circumstances of the COVID-19 pandemic.

Feature	***Zambian tax system***
Gross income	emoluments; annuities; dividends; interest, charges and discounts; royalties; and income from letting of property. The First Schedule further specifies additional income that is subject to tax: income from maintenance under any court order or decree following matrimonial proceedings or a written separation agreement; amount stipulated for the improvements to land and buildings; commencement and cessation of employment, including compensation for loss of employment; lump sum payments; capital recoveries; the market value of exotic timber when land is disposed of for valuable consideration; farm stock (including all livestock, produce, and crops which have been harvested) and share options.
Exemptions	*Refer to Table 4*
Treatment of pensions	Section 88 (2) of the Constitution exempts pension benefits from tax.
	Pension contributions are non-deductible
Deductions	Non-capital expenditure incurred wholly and exclusively in the production of the income from that source; interest on money borrowed by any person where the Commissioner-General is satisfied that the loan or advance was obtained for capital employed wholly and exclusively in the production of income.
Allowances	• ex-gratia payments made to a spouse, or dependent on the death of an employee; • refunds of actual medical expenses incurred by an employee; • accommodation provided by employer[51]. • personal-to-holder vehicles. This is a vehicle means a vehicle provided to an employee for both business and personal use and usually involves payment by the employer of all the expenses associated with the running and maintenance of the vehicle; • emoluments of former Presidents of the Republic; • funeral expenses paid or incurred by an employer on behalf of an employee are exempt (Statutory Instrument # 104 of 1996); • sitting allowances for Councillors in Local Authorities (paragraph 7(s) Second Schedule, ITA); • Labour Day Awards paid to employees either in cash or in kind are non-taxable.
Rate structure	*See Table 5*
	It is not charged on every person, but on persons with taxable income for the relevant tax period.
	It puts a higher proportional burden on wealthier individuals, leading to an equitable payment of the tax, at least vertical equity.
Tax credits	Persons in employment and are differently abled are entitled to a Disability Credit which is a tax credit of K500 per month or K6,000 for 2021 charge year.
	Tax credits available on taxes paid in a foreign jurisdiction: unilateral relief where there is no tax treaty. In cases where a tax treaty exists, the taxing rights are stipulated in the treaty.
Tax withholding on wages and salaries	Withholding on wages and salaries is applied in the form of pay-as-you-earn (PAYE).
	The 61% of individual taxpayers are below the tax-exempt threshold
	Generally low compliance rates; see Table 7
	Periodic payments (such as the 13th cheque) and other bonuses/allowances are all taxable.
	It is difficult to ascertain the time-lag between withholding and transfer by the employer to ZRA. Late submissions (i.e., payments done after the 10th of the month following deduction) attract a penalty of 5 per cent of tax unpaid for each month
Tax withholding on interest and dividends	See Table 8
Presumptive taxation	Presumptive taxation is only applied to traders and passenger transport.
Inflation adjustments	Ad hoc adjustment mechanism in place;
	evidence of "bracket creep" due to non-adjustment during 2017-2020

51 However, payments for utilities such as electricity, telephones, water bills, security and similar payments are not included in the meaning of free residential accommodation.

5.2 Corporate income tax key distinctive features

Feature	***Zambian tax system***
Definition of business	'business' includes any profession, vocation or trade, any adventure or concern in the nature of trade whether singular or otherwise, manufacturing, farming, agro-processing and hedging.
	Companies liable for Corporate Income Tax are those with an annual turnover of above K800,000.
	The Income Tax Act does not recognize a partnership as a distinct taxable person.
Jurisdiction	Zambia principally operates a source-based system for the taxation of business income – therefore deemed territorial system of taxation. Income deemed to be from a Zambian source is generally subject to income tax. However, the residence of the entity in Zambia will widen the scope of taxation. A resident company will be charged income tax on interest and dividends from a source outside Zambia on a worldwide basis
Definition of Business Income	These are gains or profits from any business for whatever period of time carried on.
	Where a business is carried on or exercised partly within and partly outside Zambia by a resident person, the whole of the gains or profits from such business shall be deemed to have accrued in or to have been derived from Zambia.
Allowable deductions for ascertaining the gains and profits of a business	*See Table 11*
Investment income	annuities; dividends; interest, charges and discounts; royalties; and income from letting of property and the income as further classified in the First Schedule, which includes capital recoveries and share options.
	Capital gains on the disposal of investment assets are not included in the income tax base.
	In order to limit the deductibility of certain cross-border payments, in 2020, Zambia amended the Income Tax Act to provide for the limitation of the deductibility of gross interest on borrowings to 30 per cent of EBITDA.
Rate structure	*See Table 12*
Accounting	There is no general rule of the Income Tax Act that requires that income or expenses must be accounted for using the cash or accrual basis.
Treatment of non-resident companies or branches	The Income Tax Act basically lifts the definition of a *permanent establishment* from the OECD Model Tax Treaty
	If the conditions for a permanent establishment have been met, then the income accruing to the permanent establishment will be subject to the corporate income taxation.
	In the event that a permanent establishment is not present, then payments to the non-resident contractors will be subject to withholding tax.
	Where a relevant double tax treaty (DTT) is in force, the definition of a *permanent establishment* in the treaty takes precedence over Zambian domestic legislation where the non-Zambian resident enterprise does not have a permanent establishment under the treaty definition.
	Zambia has in-force double tax treaties (DTTs) with 22 countries
	Where profits of a branch of a foreign company derived from local operations are not re-invested in Zambia, they are subject to tax at 20 per cent.
	Subsidiaries are required to account for taxes on the distribution of dividends using the withholding tax mechanism; the rate is 15 per cent for resident recipients and 20 per cent for foreign-based recipients.
	Zambia's Transfer Pricing Rules provide for the application of the 'arm's length principle' to controlled transactions.
	The Ministry of Finance under the Budget Department has a unit called "Domestic and International Taxation Unit" that deals with transfer pricing. The Domestic Taxes Division of the Zambia Revenue Authority also deals with transfer pricing issues.
Tax withholding rate schedule	*See Table 13*
	Tax withholding is not the final tax for resident taxpayers.
Depreciation	Depreciation is a non-allowable deduction
	Accelerated depreciation is applicable to farming, agro-processing and businesses holding a Zambia Development Agency (ZDA) investment licence can claim wear and tear allowance at 100 per cent. Businesses carrying on electricity generation, mineral processing, manufacturing and tourism can claim wear and tear allowance at 50 per cent of the cost.
	Zambia does not tax capital gains, but levies in lieu a property transfer tax (PTT).
Tax incentives	*Table 14 & 15*

Feature	*Zambian tax system*
Loss carryover	A loss incurred by a person carrying on a mining operation or electricity generation can be carried forward for ten subsequent charge years after the charge year in which the loss is incurred.
	In all other cases, the loss can be carried up to five subsequent years after the charge year in which the loss was incurred.

5.3 Proposals for reform

5.3.1 Personal income tax

The Government should consider broadening the tax base by limiting deductions, exemptions and other tax preferences. By its design, the personal income tax system has a standard deduction, i.e., the threshold for incurring a tax liability. This removes lower-income taxpayers from paying the tax and helps to enhance the progressivity of the tax with little loss in tax revenue. Therefore, additional deductions and deductions need to be rationalized. The government should limit deductible items such as sitting allowances for councillors. As at 2021, there were 1,858 wards each represented by an elected councillor. The rationale for singling out this particular group of elected officials is unclear.

Another candidate for removal from the exemption list are fringe benefits, specifically personal-to-holder vehicles which would be easy to determine the market value. The full taxation of personal-to-holder vehicles would help to achieve an economically efficient tax system by ensuring that the tax system will be neutral between those employers able to provide fringe benefits and those not able to do so and removes the distortion in favour of providing goods and services that are not taxed. A motor vehicle fringe benefit is when an employer provides a motor vehicle to an employee either wholly or partly for the private use of the employee. The value of motor vehicle benefits are shown in Table 19.

Table 19: Motor vehicle engine capacity and disallowed benefits

Motor vehicle engine capacity	**Value per annum (ZMW)**
2,800cc and above	40,000
Between 1,800cc and below 2,800cc	30,000
Below 1,800cc	18,000

Source: Zambia Revenue Authority

Personal-to-holder vehicles allowances are very widespread. In the public sector, over 500 senior government officials and institutional heads enjoy this

fringe benefit. Assuming these officers are entitled to an allowance of K40,000 per annum on their vehicles whose engine capacities are generally above 2,800cc, at the very minimum, over K21 million per annum is disallowed from taxable income. The number is even higher for the private sector which is much larger than the public sector in terms of the number employees. There are therefore, thousands of employees with access to personal-to-holder vehicles.

Figure 15: Number of senior government and parastatal officials likely to be entitled to persona-to-holder vehicles and estimates of forgone taxable income

	Agency	Ministers	Other senior officials	Statutory bodies/institutions/parastatals	Total	Disallowed benefits in employers' tax computation (>=2,800cc)	Amount p.a. (ZMW)
1	Office of the President		8	20	28	40,000	1,120,000
2	Office of the Vice President		2	3	5	40,000	200,000
3	Ministry of Defence	1	8	3	12	40,000	480,000
4	Ministry of Home Affairs & Internal Security	1	2	8	11	40,000	440,000
5	Ministry of Foreign Affairs & International Cooperation (v)	1	42	2	45	40,000	1,800,000
6	Ministry of Finance & National Planning	1	5	32	38	40,000	1,520,000
7	Ministry of Justice	1	2	7	10	40,000	400,000
8	Ministry of Agriculture	1	1	12	14	40,000	560,000
9	Ministry of Health	1	2	19	22	40,000	880,000
10	Ministry of Education(i)	1	2	135	138	40,000	5,520,000
11	Ministry of Local Government and Rural Development	1	1	6	8	40,000	320,000
12	Ministry of Energy	1	1	11	13	40,000	520,000
13	Ministry of Tourism	1	1	7	9	40,000	360,000
14	Ministry of Fisheries & Livestock(ii)	1	1	7	9	40,000	360,000
15	Ministry of Mines & Minerals Development	1	1	6	8	40,000	320,000
16	Ministry of Water Development & Sanitation(iii)	1	1	13	15	40,000	600,000
17	Ministry of Infrastructure, Housing & Urban Development	1	1	5	7	40,000	280,000
18	Ministry of Commerce, Trade & Industry	1	1	9	11	40,000	440,000
19	Ministry of Transport & Logistics	1	1	9	11	40,000	440,000
20	Ministry of Information & Media	1	1	7	9	40,000	360,000
21	Ministry of Lands & Natural Resources	1	1	5	7	40,000	280,000
22	Ministry of Labour & Social Security	1	1	5	7	40,000	280,000
23	Ministry of Community Development & Social Services	1	1	10	12	40,000	480,000
24	Ministry of Youth, Sport & Arts	1	1	6	8	40,000	320,000
25	Ministry of Green Economy & Environment	1	1	4	6	40,000	240,000
26	Ministry of Small & Medium Enterprise Development	1	1	2	4	40,000	160,000
27	Ministry of Technology & Science(iv)	1	1	43	45	40,000	1,800,000
28	Cabinet Office	0	10	1	11	40,000	440,000
29	Provinces	10	10		20	40,000	800,000
	TOTAL	**25**	**111**	**397**	533		21,720,000
	(i) Includes 116 district education boards						
	(ii) Includes 4 livestock training institutions						
	(iii) Includes 11 water utilities & sanitation companies						
	(iv) Includes 29 TEVET colleges						
	(v) Includes ambassadors & high commissioners						

In trying to ascertain the tax consequences associated with the receipt of these benefits, their respective business and personal uses should be considered separately. A portion of the benefit representing personal consumption should be taxed to the employee. Given that it would be hard to determine the portion due to the employee, that portion should be determined by applying a fixed ratio to the total cost of the service, So, given that the motor vehicle provided by the employer is used partly for private and partly for employment purpose, the value of the benefit should be reduced by, say, 50 per cent of the value of the benefit.

The Government should reduce the graduation of the marginal rate schedule as it is presently too steep. A less steep rate after the exempt bracket, such as 15 per cent, will minimize the tax burden faced by low-income earners who are most prone to bracket creep. Along with the change in the rate structure, the government should possibly index the threshold to inflation to minimize bracket creep. If it cannot be indexed to inflation, the changes to the exempt threshold should be better planned and done more frequently than the *ad hoc* system currently obtaining.

Along with the change in the rate structure, the government should possibly index the threshold to inflation to minimize bracket creep. Zambia adopts a narrow definition of gross income for estimating personal income tax. The base of the personal income tax defined in the Income Tax Act falls short of the Haig-Simons comprehensive income notion, as several components of income are not included in the concept of gross income for the purpose of estimating the taxable income. These include capital gains, in-kind income (e.g., net imputed rental income for those in free housing provided by the employer or owner-occupied housing). There are also numerous exemptions, deductions and allowances which are made based on political, social and other considerations. However, exemptions not only erode the already narrow tax base but also introduce inefficiencies and inequities in the system.

Broaden the scope of presumptive taxes in order to ensure horizontal equity. Given the dual structure of the economy in which there is a significant representation of the informal sector, presumptive taxes are used as a proxy for an income tax to taxpayers in this hard-to-tax part of the economy. This leads to greater horizontal equity and efficiency gains, increasing the tax base and helping to reduce tax evasion. However, horizontal equity is compromised as they are only applied to marketeers and small business owners in the transport sector. The presumptive taxes should be extended to other sectors other than transporters and traders with substantial informal sector activity. These include: agriculture, forestry and fishing; construction; real estate activities; and activities of households as employers.

5.3.2 Corporate income tax

Government should broaden the base of the corporate income tax by eliminating sector- or activity-specific tax incentives as well as minimize exemptions*.* The long list of deductions allowed in ascertaining the gains or profits of a business adds to the eroding of the tax base. It places the tax system further away from the notion of a comprehensive income. Some incentives may also be given based on the lobbying prowess of the intended beneficiary. With limited monitoring capacity by the ZDA, maintaining incentives which appears to disproportionately favour a particular sector at the expense of tax revenue deters tax morality in the rest of the sectors and therefore may encourage tax evasion.

Government should adopt a single proportional rate of the corporate income tax to enhance the efficient allocation of capital. As earlier established, although Zambia has one of the highest standard CIT rates among SADC members (35 per cent in 2021), the revenue yields only 1.9 per cent of GDP, which is lower than other SADC countries. This is because many sectors have income tax rates below the standard rate, while the Telecommunication sector has a rate of 40 per cent for those businesses with income of more than K250,000 per annum, while the standard rate applies to those with income of less than K250,000 per year. The multiplicity of tax rates erodes the tax base, adds to the complexity of administering the taxes, and undermines the sense of fairness as a disproportionately heavier tax burden is placed on the non-priority sectors to collect the same revenue. While reducing the rate for Telecommunications seems like the most logical thing to do, increasing the rate for agriculture, manufacturing and tourism, which enjoy rates of 10-15 per cent may not be optimal. A more acceptable rate would be 15-25 per cent, which is also the rate for withholding taxes on management and business consultancies, dividends and interest.

Government should rethink the reduction of corporate income tax on the tourism sector and instead devise alternative measures to revive the sector. The recent reduction of the corporate tax rate for the tourism sector due to it being adversely hit by the COVID-19 pandemic is flawed. Given that the tourism establishments have generally been making losses, the reduction of the corporate income tax rate – which is a tax on profits – is a wrong intervention, and has done little to alleviate their losses.

ZDA tax holidays incentives have to be redesigned to take into consideration the policy rationale for giving the tax breaks*.* The design of tax incentives – particularly the ZDA tax holidays – seem largely ineffective. Given the short time period for the holiday (5 years), the effectiveness of these incentives is questionable. It also increases monitoring costs for the already resource-constrained Zambia Development Agency unnecessarily. It also causes serious distortions and inequities in corporate taxation.

5.3.3 Mining fiscal regime

Government should consider bringing back development agreements in a different form to guarantee sustainable mining activity. The development

agreements could include a clause on amending the stabilization mechanisms to ensure more flexibility. The mining sector plays a key role in Zambia as a source of export earnings, investment, employment, and government revenue. Mining activities contribute significant government revenue mainly from royalty and CIT. Nonetheless, there continues to be concern about revenue leakage affecting all fiscal instruments in the sector. There continues to be a perception among many policymakers that the government share from mining is ‘unfair’ and that profit shifting undermines the potential revenue from the Corporate Income Tax. This mistrust contributed to the decision to abolish mining development agreements in 2008. The agreements, which had stability periods ranging from 15 to 20 years, embodied highly generous tax and other concessions. Cutting across the Development Agreements was a ‘stabilisation clause’ binding the Government not to make alterations either to the magnitude or structure of any of the incentive provisions. Their scrapping has contributed to the instability of the mining fiscal regime.

With regard to the sliding scale of the mineral royalty regime, Government should consider applying the variable royalty rate on the incremental rather than aggregate value in each price band with help to reduce the average effective tax rate for mining companies*.* The estimation of mineral royalty is based on gross value or norm value of the minerals. The gross value is applicable on industrial minerals, energy minerals and gemstones, while norm values are applicable on base metals (including copper) and precious metals. Zambia applies a sliding-scale mineral royalty regime for copper. However, applying the variable rate for copper on an aggregate basis increases the distortive impact and adds significant uncertainty to taxpayer.

Small differences in commodity prices can have significant threshold effects on revenue payments. For example, a US$1 price increase from US$7,499 to US$7,500 would result in the increase in the effective tax rate from 7.5 per cent to 8.5 per cent based on the current royalty regime. If a marginal royalty rate was applicable, the US$1 increase in the price would not distort the payments as the effective tax rate remains at 6.1 per cent (Table 20).

Table 20: Demonstrating the distortive nature of the current royalty regime and the progressivity of the marginal rate regime

			Price: Current royalty regime		Price: Marginal royalty regime	
Current rates	**Norm price band**	Band range	7,499	7,500	7,499	7,500
5.5%	0-4499	4,499			247.45	247
6.5%	4500-5999	5,999			97.50	97.50
7.5%	6000 - 7499	7,499	562.4		112.50	112.50
8.5%	7500 - 8999	7,500		637.5		0.09
10.0%	9000 plus					
Total Tax Payable			562.4	637.5	457.45	457.53
Effective Mining tax rate			**7.5%**	**8.5%**	**6.1%**	**6.1%**

Source: Author's own estimates

Zambia should extend the limitations on deductibility to other cross-border payments on investment income such as management and consultancy services. In exercising its taxing power, the government levies a corporate tax on all mining companies, as it does with the non-mining companies but with some nuances unique to the mining sector. However, with multinationals dominating the extractive industries, they can potentially devise numerous ways to shift profits abroad by payments for goods and services obtained abroad from related parties. So, a number of safeguards have been devised which include the following:

- Given the capital-intensive nature of mining, the Income Tax Act permits a 10-year carrying forward of tax losses for mining compared to 5 years for non-mining businesses. To protect Zambia's tax base, there is an additional restriction on mining whereby the loss carry-forward in any year is capped at 50 per cent of the taxable income in that year.
- Further, in 2019, Government introduced a limitation on interest deductibility to 30 per cent of earnings before interest, tax, depreciation and amortization (EBITDA). This applies to all companies, except companies in the insurance, banking, and financial services industry.

These limitations notwithstanding, all other cross-border payments – except for dividends and interest due to the EBITDA rule –are not subject to any limitation on deductibility.

ANNEX I: QUESTIONS FOR COMPARATIVE ANALYSIS OF PIT, CIT AND NATURAL RESOURCES TAX REGIMES

I.I Personal Income Tax

Tax regime feature	Information required	Information source
Jurisdiction basis	**Worldwide or territorial**	**Income Tax Act** **Regulations** **Practice notes**
Rate structure	1. Standard rates 2. Income brackets on which different rates apply 3. Number of income brackets 4. If there are scheduler tax rates, types of incomes on which they apply with the respective rates.	**Income Tax Act** **Regulations** **Practice notes**
Base and exemptions	1. Does the tax base include income from all sources: wage, bonus, overtime payment, rental income, interests, dividends, income from self-employment, business, commerce, agriculture, industry, transport; income from copyright, franchise, annuity, etc.; 2. List of exempt or excluded income with rationale for exemption 3. Treatment of pension. Is there a state pension system and how is it coordinated with personal tax? Is contribution to pension funds tax deductible? Is the distribution of income taxable? 4. What is the tax basis? Is the preferred tax basis net income (using the Haig-Simons definition) or consumption? How does the country's measurement of taxable income compare with the Haig–Simons comprehensive income definition? 5. What about income from capital gains? Are they treated as part of normal income or taxed separately? What is the basis for capital gains tax? 6. What per centage of labour force are paying PIT?	**Income Tax Act** **Regulations** **Practice notes** **National Pension Scheme Authority** **Public Service Pension Fund** **Labour Force Surveys**
Treatment of non-residents	1. Definition of resident 2. Does the same tax schedule apply to non-residents or there are differences in treatment? 3. What about tax on distributed dividends to non-residents?	**Income Tax Act** **Regulations** **Practice notes**
Deductions, allowances and tax credits	1. Standard and other deductions 2. List of allowances 3. Are tax credits available on taxes	**Income Tax Act** **Regulations**

Tax regime feature	Information required	Information source
	paid in a foreign jurisdiction? With treaty or without treaty?	**Practice notes**
Administration/compliance	Withholding methods and types, annual reporting requirements and anti-abuse rules. Filing Status (individual, joint, family, etc.).	**Income Tax Act** **Regulations** **Practice notes**

I.II Corporate Income Tax

Tax regime feature	Information required	Information source
Accounting	1. Cash or accrual basis? 2. Description of how one begins with gross income and derives taxable income regime	**Income Tax Act** **Regulations** **Practice notes**
Business entities	1. Types of entities subject to corporate tax 2. What taxes apply to agricultural activities, small businesses, property income etc?	**Income Tax Act** **Regulations** **Practice notes**
Jurisdiction basis	**Worldwide or territorial (including type of territorial)**	**Income Tax Act** **Regulations** **Practice notes**
Rate structure	1. Standard rate 2. Are there reduced rates on some industries by location or by sector? 3. Are natural resources e.g. minerals, oil and gas subject to higher tax rate?	**Income Tax Act** **Regulations** **Practice notes**
Base and exemptions	1. Does the tax base include income from all sources: business, trading as well as non-business income? 2. List of categories of incomes or businesses that are exempt for indefinite or given number of years 3. What per centage/number of businesses are in small and medium category (SME)? Any special provisions for SMEs? 4. Clarify the distinction between the tax base, which is comprehensive income, and withholding methods such as PAYE, border withholding, withholding on interest, and other advanced taxes. Can the withholding methods in combination approximate the comprehensive income tax base?	**Income Tax Act** **Regulations** **Practice notes** **Ministry of Commerce, Trade and Industry** **Ministry of Small and Medium Enterprises**

Tax regime feature	Information required	Information source
Treatment of non-residents	1. Permanent establishment rules. Definition of a domestic and foreign entity 2. Does the same tax regime apply to foreign enterprises or there are differences in treatment? Foreign Tax Credit allowed in general or by treaty. 3. Any differences in treatment of subsidiaries versus branches? 4. Does the law have clear provisions on transfer pricing? General description (e.g., OECD)? Any unit in Ministry of Finance (MoF) or revenue authority to deal with this?	**Income Tax Act** **Regulations** **Practice notes** **Double Taxation Agreements/Treaties** **Zambia Revenue Authority**
Withholding tax	1. Rate of withholding on dividends being repatriated? 2. Rate of withholding on interest or management fees to non-residents?	**Income Tax Act** **Regulations** **Practice notes** **Tax Treaties**
Depreciation	1. What are different depreciation rules for different asset groups? 2. What industries, sectors are given accelerated depreciation? 3. How is computation of capital gains done?	**Income Tax Act** **Regulations** **Practice notes**
Tax incentives	1. What kind of incentives are available and to which industries – lower tax rates, investment allowance, accelerated depreciation 2. Presence of tax holidays, investment incentives, investment tax credits? If yes, are those industries still required to submit their profit/loss account?	**Income Tax Act** **Regulations** **Practice notes** **Zambia Development Agency Act**
Loss carry-over	1. Loss carry forward rules for indefinite period or given number of years? 2. Any loss carry backward provisions?	**Income Tax Act** **Regulations** **Practice notes**
Administration/compliance	1. Type of advanced tax, treatment of flow through 2. Is there any provision for integrating PIT and CIT? 3. Provide clarity on the relationship between PIT and CIT as part of an integrated tax system. Discuss the double taxation of corporate income and the nature of flow-through applications (such as dividend exemptions and gross-up and credits) as applied 4. How to integrate the PIT and CIT system if integration is deemed reasonable.	**Income Tax Act** **Regulations** **Practice notes** **Zambia Chamber of Commerce & Industry** **Zambia Association of Manufacturers**

I.III Natural Resources Tax

Tax regime feature	Information required	Information source
Royalty Regime	1. Standard rate of royalty 2. Is there a sliding royalty regime where the rates may be indexed to the market price of the mineral, oil or gas? 3. Is royalty linked to revenue only or linked to profits? If it is profit linked how is profit determined for this purpose? 4. Distinction between contractual payments (royalties) and taxes (VAT and income tax).	**Mining and Minerals Development Act** **Income Tax Act** **Practice Notes** **Circulars issued from time to time**
Corporate income tax rate, depreciation rules and incentives	1. Income tax provisions related to natural resource sector. Tax rate applied to natural resource sector? Is it different from the normal CIT rate? 2. Are the same depreciation rules applied to this sector as the normal CIT? Are exploration costs amortized or expensed? 3. What per centage/number of businesses are in small and medium category (SME)? Any special provisions for mining SMEs? 4. Are there clear Transfer pricing laws and rules and the administration equipped to deal with it?	**Income Tax Act** **Regulations** **Practice notes** **Chamber of Mines**
Tax incentives	1. What kind of incentives are available to this sector – investment allowance, accelerated depreciation? 2. Any tax holidays? If yes, are the mines or oil wells still required to submit their profit/loss account?	**Income Tax Act** **Regulations** **Practice notes** **Chamber of Mines** **Zambia Development Agency Act**
Small and artisanal mining	1. Are there special royalty rate for this kind of mining 2. Are there special income tax provisions for this kind of mining	**Income Tax Act** **Mines and Minerals Development Act**
Other types of taxes	What other types of taxes or nontax fiscal instruments as applicable to extractive industry (e.g., land rent, application, registration fees and stamp duties, property taxes). What about contract terms such as stabilization clauses, among other provisions. ***Note:*** *The mineral contract analysis should be extended beyond the taxation of mineral enterprises.*	**Income Tax Act** **The Petroleum (Exploration and Production) (Amendment) Act, 2021** **Property Transfer Tax Act** **Regulations** **Practice notes**

ANNEX II: LIST OF INTERVIEWEES/KEY INFORMANTS

Institution	Department/Persons
Ministry of Finance	**Budget Office** Assistant Director, Revenue: Kayula Chimfwembe **Economic Management Department** Director, EMD: Maketo Mulele Assistant Director, Modelling & Forecasting: Dingiswayo Banda **Zambia Statistics Agency** Head, National Accounts: Litia Simbangala **Zambia Institute for Policy Analysis & Research** Executive Director: Dr Herrick Mpuku Senior Research Fellow (Research Director): Zali Chikuba Research Fellow: Public Finance, Mbewe Kalikeka
Zambia Revenue Authority	**Research and Planning Department** Director: Ezekiel Phiri Senior Economist: Yenda Shamabobo
Chamber of Mines	Chief Executive Officer: Sokwani Chilembo
Zambia Association of Manufacturers	Chief Executive Officer: Florence Muleya
Zambia Chamber of Commerce and Industry	Chief Executive Officer: Phil Daka
Zambia Development Agency	Acting Director General: Albert Halwampa