

SME TAXATION IN ZAMBIA

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INTRODUCTION

This paper discusses:

- **The current situation of the informal sector in Zambia;**
- **Some key tax compliance challenges; and**
- **Strategies to address these challenges.**



INFORMAL SECTOR DEFINITION (S)

Defined differently by different stakeholders.

Popular Definition:

- Anyone earning an income outside a formal Job.



DEFINITION (S)....(CONT)

Definitions include:

- Small or medium sized businesses.
- Suppliers to the final consumers.
- Businesses operating at subsistence level.
- Businesses not registered with government authorities e.g. Patents and Company Registration Agency, Local and labour authorities.



Other characteristics

1. Businesses register-able in the light of their size but deliberately avoid inclusion in the formal tax and levy systems;
2. Medium of exchange is predominantly on cash basis;
3. Do not usually keep accounting record or have poor records.



Size of the informal sector

- Despite the rapid growth of this sector in Zambia, it's contribution to GRZ's revenue has been insignificant.
- In 1991 about 74% of labour force was employed in the informal sector.
- By 2005, it rose to 88% of labour force.



TAX REVENUE CONTRIBUTION

- Medium Taxpayer Office (MTO) – Contribution 18-23%
- Small Taxpayer Office (STO) – Contribution 2%
 - (1) annual turnover of less than K200m
 - (2) Turnover Tax (TOT), Presumptive and Base Tax
 - (3) Local Offices of NGOs, Government Agencies (i.e. ZANIS, PACRO, RTSA etc)



Revenue Challenges of the informal sector

- High level of cash transactions and related 'poor' record keeping.
- Wide geographical distribution of SMEs and varying levels of infrastructure development (banking services, e-filing and e-payment etc).
 - 10 districts out 72 still un-banked.
 - ZRA offices in 35 districts out 72 districts



ZRA POINTS OF PRESENCE

- 752,614 sq.km
- 72 Districts
- 11 Domestic tax offices
- 24 Customs offices



Revenue Challenges of the informal sector

- Varying levels of literacy and diversity of languages (about 70 dialects in Zambia – about seven major ones).



Challenges....(cont)

- 'Poor' or 'low' understanding of different SMEs businesses (varying factors affect cost of compliance for different SMEs). *One-size fits all SME taxation may not be appropriate.*
- Low perception of the 'benefits of paying tax' among SMEs. In addition most 'tax incentives' appear to favour the LTOs and Multi-national Investor.
- *Tax allowance/credits only for formal employment?*



Challenges....(cont)

- Unfavorable ratio of revenue to tax administration costs compared to large firms.
- Large taxpayer office (LTO)
 - Revenue Contribution 75 – 80% (Staff numbers: 36)
- Medium Taxpayer Office (MTO)
 - Revenue Contribution 18-23% (Staff numbers: 113)
- Small Taxpayer Office (STO)
 - Contribution 2% (Staff numbers: 155)



Challenges....(cont)

- Social/political conflict of taxing SMEs vs poverty reduction!!
- large share of the population/electorate are employed in the informal sector.
- Revenue potential over the short run is limited.
- Is the trouble worth it?



Need for SME Taxation

- **Recognition that SME taxation promotes equity in taxation** (*There was and there still is a strong public demand (from Persons in formal employment, unions, NGOs, Members of parliament) on Government to “broaden tax base”*)
- **Most small firms are perceived as ‘de-facto exempt’ from taxation arising from widespread non compliance.**
- **Need to build culture of compliance among ‘future LTOs’**
- **Zambian Government’s SNDP calls for a** *“comprehensive reform of the present tax system aimed at broadening the tax base and increasing revenue yield, while at the same time improving efficiency and equity”.*



STRATEGIES TO ADDRESS THE CHALLENGES

The interventions have involved Legislative and administrative.



Pre-2004 generic approach

From 1995 to 2005:

- **Conventional Compliance approach i.e. compliance tax audits and other quantitative methods of estimating under-declarations.**



Pre-2004 generic approach (Continued)

Disadvantage:

- Did not acknowledge the major challenges of the informal sector such as high cash transactions with inadequate or incomplete records, varying cost of compliance.



Post 2004 specific approaches

For VAT, the following are the specific interventions:

1. Invigilation of randomly selected VAT registered cash traders;
2. Introduction of legislation on use of cash Registers and Invoicing
3. Establishment of cash audit teams to enforce use of cash registers;
4. Obtain supply chain information of predominantly cash based businesses



Post 2004 specific approaches (Continued)

5. Raising public awareness through media on need to improve tax compliance (e.g Demanding an Invoice on purchase);
6. The use of the investigation wing, to investigate and prosecute tax evaders;
7. Adoption of International best practice in audit techniques



Post 2004 specific approaches (Continued)

8. Introduction of Presumptive Tax on minibuses (2003), and Turnover Tax (2004) and Advance Income Tax (2007) to address the problems of the cost of becoming formalised and tax compliance for small businesses operating in the informal sector.



Other interventions of ZRA (continued)

Presumptive tax regime :

- Aims to deal with factors hindering the participation of the informal sector in taxation.
- Levied on all unincorporated passenger transport operators. The rates are based on bus sitting capacity.



Other interventions of ZRA (continued)

Turn Over Tax

- Levied on the total sales of the company or individuals at a 3 % (of the total sales).
- Applicable for firms that have an annual turnover of ZMK200 million and below.



Other interventions of ZRA (continued)

Advance Income Tax (AIT):

- Collected on every importation from traders deemed not compliant on Domestic taxes.
- A type of WHT at 6% of VDP.



Other interventions of ZRA (continued)

Base tax:

This is tax that is normally paid by taxpayers that do not keep books of accounts and normally operate as individual persons - mainly these are marketers and small grocery shops in markets (K450/per day or us10c)



Other interventions of ZRA (continued)

1. Contracting 3rd parties to collect Presumptive Taxes and base tax from small traders.
2. Introduction of a call center facility easily accessed by taxpayers.
3. Working to increase filling and payment points and options.



Other interventions of ZRA (continued)

- Post 2008: Move from tax type focus to taxpayer focus/segmentation of administration
 - Large taxpayer office (LTO)
 - Small and Medium Taxpayer office (SMTO)
 - Design and Monitoring (D&M – HQ)



Conclusion

Despite the main efforts made by ZRA to address the revenue risks posed by the informal sector, much still needs to be done to improve the revenue uptakes in this sector.



Conclusion (continued)

Lessons learnt that may be used for future interventions:

1. Intervention policies should be based on results of comprehensive studies of the compliance challenges of the sector.
2. Any intervention will have to take into consideration the lack of audit trails in the sector and be innovative enough to overcome it.
3. The need to change the mind set of players in this sector to appreciate the benefits of paying tax.



Conclusion (continued)

4. Prosecute tax offender as a deterrence to others.
5. Increase financial and human resources for the authority to effectively carry out audits.
6. The government should show political will to broaden the tax base and include the informal sector for an equitable fair tax system **Zambian Government's SNDP calls for a *"comprehensive reform of the present tax system aimed at broadening the tax base and increasing revenue yield, while at the same time improving efficiency and equity"*.**



Thank You



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