

**BROADENING THE TAX BASE: A CASE FOR THE
INFORMAL REAL ESTATE SECTOR IN ZAMBIA**

THESIS

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ABSTRACT

The main objective of the study was to analyze the potential tax collection from the informal rental housing market in Zambia, using household level rental housing data collected for the Lusaka Urban District by the Central Statistical Office (CSO) as a basis for computation and extrapolation to the national level. This data was used to analyze household monthly expenditure on housing (rent), the total number of households in rented accommodation, and the tax regime applicable on rental income, to estimate the potential tax revenue that could be realized from this emerging sector. The estimates indicate that about K9.7 billion revenue could be collected on income from rental housing in Lusaka Urban District alone and a total of K83 billion nationally per annum. This represents about 0.4 percent of the country's GDP in 2007. Compliance needs to be improved and legislation revised to ensure that the landlords are compelled to remit tax to the Zambia Revenue Authority. The current legislation makes enforcement and compliance difficult as it places the statutory tax burden on tenants, who are very mobile. It is, therefore, recommended that the landlord is made responsible for the payment of taxes due on rental income and that any compliance requirements be enforced against the real estate/property that is generating the income.

This study also examines the performance of the presumptive taxation regime in Zambia. The study uses data from the Zambia Revenue Authority on revenue collection from presumptive taxes which were introduced to capture income from the informal sectors. The presumptive taxes already introduced in Zambia include: base tax, advance income tax and turnover tax for minibuses and taxi operators. To analyze the performance of the presumptive tax regime, the study utilizes data on imports made by those not registered for taxes, to estimate how much revenue could be generated by imposing a 3 percent turnover tax on the value of their imports at importation. The analysis shows that the Zambia Revenue Authority increased revenue collection from K5.3 billion in 2004 to K33.5 billion in 2007. This improvement in revenue collection is far below the potential, however, which is estimated at over K501 billion on imports of unregistered traders alone. To collect this revenue and expand the tax base, the tax authority needs to improve the administration of advance income tax on unregistered importers, and raise the advance income tax rate to a level where the importer is indifferent between paying the advance tax at the border and paying turnover tax inland.

TABLE OF CONTENTS

DEDICATION	VII
LIST OF FIGURES AND TABLES.....	VIII
CHAPTER ONE	1
CONTEXT OF THE RESEARCH.....	1
1.1 Introduction.....	1
1.2 Statement of the Research Problem.....	2
1.3 Objectives of the Study.....	8
1.3.2 Specific objectives.....	8
1.4 Research Design.....	8
1.5 Structure of the Thesis	9
ZAMBIA’S ECONOMIC AND FISCAL PERFORMANCE	10
2.1 Introduction.....	10
2.2 Macro-economic Overview.....	10
2.3 Revenue Performance against Targets.....	12
2.5 Declining Trend in Tax Revenue to GDP.....	19
2.6 Is the Zambian Tax System Responsive?	20
2.8 Taxation of the Informal Sector in Zambia.....	25
LITERATURE REVIEW	28
3.1 Introduction.....	28

3.2	<i>Examples from other Developing Countries</i>	28
3.3	<i>Presumptive Taxes</i>	33
3.4	<i>Informal Rental Income</i>	36
3.5	<i>Institutional Framework for Property Tax Administration</i>	38
	METHODOLOGY.....	45
4.1	<i>Introduction</i>	45
4.2	<i>Data Sources</i>	45
4.2.1	<i>Central Statistical Office and Zambia Revenue Authority</i>	45
4.3	<i>Data analysis</i>	46
4.3.1	<i>Analysing Data from the CSO for Potential Tax Revenue</i> ...	46
4.3.2	<i>Analysing Data from ZRA for Potential Revenue from the Informal Sector</i>	47
	CHAPTER FIVE.....	49
	APPLICATION OF THE PRESUMPTIVE TAXATION TECHNIQUES TO THE INFORMAL REAL ESTATE HOUSING SECTOR IN ZAMBIA	49
5.1	<i>Introduction</i>	49
5.2	<i>Tax Collection from Informal Sector Businesses</i>	49
5.3	<i>Presumptive tax on Taxi and Minibus Operators</i>	49
5.4	<i>Advance Income Tax</i>	50
5.5	<i>Turnover Tax</i>	51
5.6	<i>Base Tax</i>	51
5.7	<i>Estimating Potential Revenue from an Advance Tax on Importations</i>	52

5.8	<i>Advance Tax and Tax Administration</i>	53
5.9	<i>Non-Compliant Taxpayers</i>	53
5.10	<i>Potential Revenue from Advance Income Tax</i>	54
5.11	<i>Potential Revenue from the Informal Real Estate Sector in Lusaka</i>	55
5.12	<i>Potential National Real Estate Tax Income</i>	57
	REFLECTIONS, CONCLUSIONS AND RECOMMENDATIONS	60
6.1	<i>Introduction</i>	60
6.2	<i>Reflections</i>	60
5.3	<i>Conclusion</i>	62
5.4	<i>Recommendations</i>	62

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Finally I wish to state that all errors of interpretation and weakness of analysis in this work are entirely mine.

DEDICATION

To the almighty God, for the grace and the gift of life and the opportunity to undertake a Master of Business Administration at Rhodes University in South Africa.

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LIST OF FIGURES AND TABLES

Tables

Table 1	Selected Macroeconomic Indicators (1999—2005)
Table 2	ZRA Revenue Performance against Targets (2000-2005 K'billions)
Table 3	The Responsiveness of the Overall Tax System (1973—2005)
Table 4:	Tax Paid By Minibus Operators per Annum
Table 5	Trend in Revenue Collections from Informal sector
Table 6	Estimated Annual Income and Potential Tax Revenue for Lusaka urban
Table 7	Potential Rental Revenue from All Rented Housing Units in Zambia

Figures

Figure 1:	Revenue Contribution by Tax type
Figure 2:	The Share of Tax Revenue in the GDP (1995 – 2000)
Figure 3:	Growth in Nominal GDP and Tax Revenue (1995- 2000)

CHAPTER ONE

CONTEXT OF THE RESEARCH

1.1 Introduction

The development of any country lies in its ability to mobilize resources to finance development programs. This is especially important for developing countries in Africa. However, most countries in Africa have faced challenges in generating adequate revenue domestically. This has led to heavy reliance on aid and foreign borrowing to finance development that has yielded limited prospects for sustainable growth. The over-dependence on foreign aid has brought about the realization that has led to a shift in the development paradigm that now emphasizes the need to identify sustainable internal resource mobilization instruments to finance development programmes (Zambia Revenue Authority: 2003).

The major emphasis for reform has included strategies to strengthen tax policy and tax administration. There has been increased pressure to expand the tax base by capturing activities that are currently not contributing to tax revenue. These efforts are being complemented by strategies to improve compliance among those already registered for tax purposes. Compliance and enforcement activities need to be strengthened, not only for small and medium companies, but also for large companies including mining conglomerates and other multinational corporations.

Measures to improve revenue collection from the informal sector are hindered by a lack of statistical information regarding the scope, extent and potential for revenue from this sector. The extent to which the informal real estate housing sector can contribute to expanding tax revenue is one of the cases in point. (Zambia Revenue Authority: 2003). The inefficiency and ineffectiveness of overall tax administration is another critical area that requires to be reviewed to curtail revenue leakages and ultimately enhance and sustain government revenue generation and collection (Zambia Revenue Authority: 2003).

Although there seemed to be limited political support for enforcing tax compliance in the informal sector, the Zambia Revenue Authority collects taxes in this sector using two tax

instruments: the presumptive tax regime for transport operators and a turnover tax for other small and medium enterprises. (Zambia Revenue Authority: 2003).

It should be emphasized that Zambia pursued an ambitious liberalization cum privatization programme, starting in 1991. The key objective of privatization was to allow the private sector to be the engine of economic development in Zambia. Thousands of housing units that were previously owned by privatized companies were sold to employees who were retrenched. These houses are part of the real estate housing sector that have been made available to the rental market in Zambia and may be considered for rental income taxation. Though privatization was a challenging policy initiative, government recorded significant success in this area. However, challenges have been recorded in other areas. For instance, liberalization and privatization led to redundancies and redeployment of skills that were no longer relevant. Most of the labour off-loaded from privatized companies found employment in the informal sector, which is challenging to tax (Nanyangwe, Ndovi, Klepp & Olapade: 2004).

The potential to improve the contribution of the informal sector remains largely untapped. If accurate data was captured on the real estate housing sector in Zambia, significant revenues could be collected from this sector. Interventions need to be implemented by relevant government agencies to spearhead, among other things, formalization of the informal sector businesses, thereby making it easier for the Tax Authority to enforce tax compliance (Nanyangwe et al: 2004).

1.2 Statement of the Research Problem

The need to have the tax system raise additional tax revenue to match the ever-increasing budgetary pressures as well as to assist the nation to move away from perpetual crippling fiscal deficits has been one of the greatest challenges to tax management in Zambia. The Zambia Revenue Authority's Unit on Research and Business Development recognizes that the revenue yield of the Zambian tax system has been rather low (Zambia Revenue Authority: 2003). This has been due to, among other factors:

- declining economic performance,
- a declining formal sector resulting in growth in the informal sector in general,

- poor tax enforcement strategies, and
- weak tax legislation.

Conversely, the real estate (housing) sector has been growing (Central Statistical Office: 2004; Central Statistical Office: 2005; Zambia Revenue Authority: 2003), albeit without a corresponding increase in tax revenues from this sector.

The economic performance of Zambia has not been favourable since 1970 when growth in real gross domestic product (GDP) began to register an average annual decline of 0.1 percent through to 1984. The trend in the real growth rate in GDP fell from 19 percent in 1969 to 1.3 percent in 1984 against a backdrop of a population growth rate of 3 percent per annum. Real per capita income declined by 10.4 percent in the same year (Central Statistical Office: 2000).

Addison and Osei (2001), in their research on taxation and fiscal reform in Ghana, however, caution that harsh tax enforcement strategies combined with poor service delivery contributes to undermining the legitimacy of government strategies and only increases non-compliance with tax. This is a valid precautionary measure for this research and serves as a good lesson to Zambia.

The budget report of 2006 indicated that Zambia has a narrow tax base and that there is a great need to broaden the tax base. Current statistics indicate that the Zambian budget is internally financed by only 50 percent as at 2005, 54 percent in 2006 and 67 percent in 2008. Although there is an upward trend in internal financing of the budget, the current scenario requires that more domestic tax revenue should be collected to reduce continued dependence on foreign financing of the budget (Ministry of Finance and National Planning: 2006).

On the other hand, Zambia has experienced the expansion of the informal sector and shrinkage in formal sector employment. Furthermore, trade liberalization has led to a reduction in trade taxes (tariffs) and subsequently trade tax revenue (Zambia Revenue Authority: 2002). Compulsory measures should, therefore, focus on internal revenue sources. One of such sectors with the greatest potential to contribute to government revenue is the informal real estate sector.

This sector currently contributes a meagre 3 percent to the total tax revenue envelope. However, there is significant potential revenue that can be generated in the sector through house rentals and sales. This revenue is not captured because of the lack of statistics, legislation and policy to bring income from the real estate sector into the country's tax net. The potential for raising revenue in this sector has, to the knowledge of this researcher, never been analyzed and estimated (Ministry of Finance and National Planning: 2005).

The Central Statistical Office's report of 2006 contends that the growth in unemployment pushed a large segment of skilled people in society into the informal sector. The report also indicates that between 1993 and 1996 the proportion of households working in the informal sector rose from 59 percent to 61 percent. The Incomes and Prices Commission (1989) estimated that eighty percent of the Zambian labour force was employed in the informal sector.

Conspicuous in the rise of the informal sector has been the rapid expansion in the construction industry. The National Income Statistics indicate that the construction industry is one of the fastest growing sectors in the economy, with a projected annual growth of 15 percent in 2004 (Central Statistical Office: 1997; Central Statistical Office: 2005). Much of this growth is recorded in the housing sector and commercial construction sector (Bank of Zambia: 2006; Ministry of Finance and National Planning: 2005). In addition, a lot of emphasis has been placed on developing the residential housing sector through targeted fiscal incentives proposed in the 2006 budget. Ironically little effort has been made by the Zambian government to turn the sector into a viable source of tax revenue.

This is partly because there is a tendency to associate informal activities only with poor women and children selling vegetables on the street, or small-scale marketers in high-density areas. However, these people represent the very lowest end of the informal sector. It can be demonstrated that there is a healthy stock of traders and business people engaged in activities that are potentially taxable.

Among the business people are landlords who own properties from which they receive rentals; real estate agents who lease, buy and sell houses, buildings and land on behalf of

their clients; and entrepreneurs involved in the import and export trade who supply medium to high quality products; manufacturing, mining and trading houses. Other categories of business people whose operations await taxation include importers of second hand vehicles from Japan as well as South Africa; commodity brokers engaged in buying and selling agricultural products in rural areas for resale in towns and cities; trade brokers involved in buying and selling products for other people in return for a commission; suppliers of goods and services to government and parastatal organisations and, finally, consultants undertaking research on behalf of the government ministries and international organisations such as United States of America International Development Agency and the Norwegian Aid Agency (Central Statistical Office: 1997; Central Statistical Office: 2005).

Many of these people earn well in excess of the threshold for paying income taxes but fail to make the required contributions for various reasons ranging from limited knowledge on the need to pay their tax obligations or outright evasion of tax. This category of taxpayers should pay personal income tax or company tax, withholding taxes and/or presumptive taxes (Central Statistical Office: 1997).

Zambia faces challenges in mobilizing domestic financial resources to finance development programs in the country. Domestic financial resources are critical inputs into the development process and have several proven positive attributes. It is a sustainable non-debt source of development finance that is especially important to Zambia, which only recently had its foreign debt forgiven under the Highly Indebted Poor Countries initiative. In addition, Zambia's experience with foreign debt and official development assistance has not been impressive especially in terms of stimulating economic growth, development and in poverty reduction. It is important that Zambia continues to strengthen its fiscal management to ensure that it does not slip back into unsustainable foreign debt. Fiscal prudence is not sufficient, it should be accompanied by strong fiscal policies that can stimulate domestic savings, raise the performance of tax and non-tax revenues as well as attract remittances, whilst limiting capital flight out of the country (Central Statistical Office: 1997; Central Statistical Office: 2005).

Public finances such as tax revenue provide the most sustainable source of revenue to finance government operations and the provision of public goods and services that support sustainable growth and development. Thus, the prospect for rapid economic growth and welfare depends on the ability of the country to put in place a robust and buoyant revenue system that is capable of generating sufficient public revenues to finance the country's development programmes. While the Zambian revenue system has made important strides in increasing revenue collection through tax policy and administration reforms undertaken in 1994 (Ministry of Finance and National Planning: 2005), there is need to further improve revenue collection through wealth taxation. At present, tax revenue largely comes from taxation of income and very little revenue is collected from taxation of wealth, the main tax being levied on real estate.

This study seeks to explore and estimate the amount of revenue that can be collected from the housing real estate sector under the current tax regime, assuming firstly full compliance and, secondly, when compliance is only 50 percent. The study also analyzes the total tax collected from the informal sector and examines the potential to boost collections of taxes from informal sector operators. This involves analyzing the performance of turnover tax, presumptive tax for minibuses, and the recently introduced advance income tax on imports of unregistered taxpayers. This analysis assists in estimating the potential tax that can be mobilized by strengthening compliance and enforcement strategies to capture informal income, including incomes in the predominately informal rental housing market. Knowing the potential revenue, compared with the revenue forgone, the government, through the Zambia Revenue Authority, will be able to enhance its efforts to improve the tax regime and administration for informal business, to improve revenue collection and reduce fiscal dependence on foreign grants and loans.

Further justification of the need to understand the revenue potential arises from the fact that government is committed not to slip back into unsustainable debt after benefiting from the highly indebted poor country debt reduction initiative and identifying new revenue sources is critical in this regard. There is a need to have the tax system generate more revenue to reduce fiscal dependence on donor financing and to improve fiscal sustainability and macroeconomic stability.

In recent years, the Tax to Gross Domestic Product ratio, which measures the overall productivity of the tax system, has improved substantially from 13 percent to about 19 percent of Gross Domestic Product since the creation of the semi-autonomous tax authority. However, since 2005, performance significantly declined from 18.7 percent in 1994 to 16.2 percent in 2006 (Bwalya & Sigande: 2007). This trend needs to be reversed to ensure fiscal independence and macroeconomic stability and it augurs well that revenue from the informal sector has increased since the advent of market liberalization in 1991 (Nanyangwe et al: 2004).

1.3 Significance of the Study

The study seeks to explore how wealth taxation, such as taxation on real estate, can contribute to tax revenue and promote tax equity. Thus the relevance of this study lies in providing evidence on how the presumptive tax regime can be extended to capture tax revenue from the informal rental housing sector. The estimates of potential and actual revenue provide relevant information that would help to design appropriate tax policy instruments and enforcement strategies to increase the contribution to tax revenue. The results also provide general insights into how to strengthen and administer taxes on wealth (real estate tax) and capture the informal sector in the tax net.

The informal sector in Zambia is currently estimated at 80 percent of the total economy and, therefore, can contribute significantly to tax revenue. The study also provides insights into issues of efficient and effective management strategies that can be utilized to promote voluntary tax compliance among those enterprises operating in the informal sector. Further, the study recommends the need for the Zambia Revenue Authority to develop and manage effective tax information systems on informal real estate housing sector transactions and actors. This is important to capture housing units and rental prices in the informal real estate sector (Central Statistical Office: 2004; Central Statistical Office: 2006; Chirwa: 2000).

It would appear that this research is the first of its kind to attempt to estimate the potential tax revenue that could be raised from the informal rental housing sector in Zambia. Thus, the findings make a contribution to existing literature on this subject, and on taxation of the informal sector income in general.

1.3 Objectives of the Study

1.3.1 Overall objective

The overall objective of this study is to estimate the potential revenue that could be collected from the informal sector, including the rental housing sector, and to analyze tax administration measures that could enable effective administration of taxes in the informal sector in Zambia. This overall objective will be accomplished by addressing the following specific objectives:

1.3.2 Specific objectives

- To analyze the actual and potential revenues that can be collected from the informal sector businesses and particularly from the rental housing sector in Zambia;
- To review the performance of a presumptive tax regime for the informal sector and estimate the potential revenue that can be collected by streamlining the administration of presumptive taxes by reviewing the performance of the recently introduced advance income tax for unregistered taxpayers; and
- To recommend policy and administrative measures that can improve revenue collection from the informal sector, particularly the rental housing sector in Zambia.

1.4 Research Design

This study utilizes housing census data collected by the Central Statistic Office to estimate the number of housing units in rural and urban areas in Zambia, and in particular in the capital city, Lusaka. Information is also collected on housing units that are owner occupied and those that are rented out, and the average rent is computed for three residential categories namely: high density, medium density and low density. Using this information, it is possible to compute the average rental price for each residential class and the potential revenue that could be collected from rental income in total, assuming full compliance with the tax legislation governing the taxation of rental income. Further, data was obtained from the Zambia Revenue Authority on actual collections of taxes from the informal businesses and the number of registered but non-complaint taxpayers.

This data is used to estimate the potential income from the informal sector, and to compare it with what is actually collected.

The findings in the present study are based on secondary data on the informal real estate (housing) sector computed from the Central Statistical Office and Zambia Revenue Authority annual tax reports.

1.5 Structure of the Thesis

This thesis is organized as follows: Chapter one introduces the study's purpose and objectives. It also provides insights into the research process and methodological considerations. Chapter two discusses the context of the study by examining the revenue collection performance and highlights the major successes and challenges for increasing revenue collection in Zambia. Chapter three reviews existing literature on the topic of study. Then Chapter four discusses the research design and methodology and key data sources. Chapter five analyses the empirical results, including the estimation of the potential and actual revenue from the informal real estate housing sector in Zambia. Chapter six presents the key findings of the study, concludes the study and presents some recommendations.

CHAPTER TWO

ZAMBIA'S ECONOMIC AND FISCAL PERFORMANCE

2.1 Introduction

This chapter highlights Zambia's economic and fiscal performance trends since independence and highlights the difficulty of taxing the informal sector, of which the real estate housing sector is part. Taxing the real estate housing sector is by no way an easy task because the sector itself is very complicated and it is characterized by low literacy levels that may render voluntary compliance difficult. There is also a lack of tax education awareness within the sector of the benefits and effects of paying tax on housing rentals to government. The informal sector is generally difficult to tax due to lack of permanent commercial structures, relatively low levels of income and the fact that players in the sector seldom maintain books of account (Nanyangwe et al: 2004).

2.2 Macro-economic Overview

At independence in 1964, Zambia was one of the strongest and most prosperous economies in Sub-Saharan Africa with real per-capita income of just above \$1,200, a real growth rate of 5.2 percent, external debt of US \$155 million dollars and inflation was in single digits at (8.2 percent in 1965) (Mwanawina & Mulungushi: 2002). The prospects for rapid economic growth depended to a great extent on favourable international copper prices as the rest of the sectors of the economy were small, less diversified and uncompetitive, and government revenues were largely dependent on copper export revenues.

The prospects for economic growth started to deteriorate after a precipitous decline in copper prices in the mid-seventies. Typical of less diversified and inflexible economies, government's failure to restructure its pre-recession consumption and investment patterns led to significant deterioration in the country's fiscal position (high budget deficits) and a rapid buildup of external debt, which rose from US\$ 250 million in 1970 to US\$ 4,639 million in 1985. (Mwanawina & Mulungushi: 2002).

Table 1 - Selected Macroeconomic Indicators (1999—2005) (Bank of Zambia: 2006)

Year	1999	2000	2001	2002	2003	2004	2005
Population (millions)	10.2	10.3	10.5	10.8	11.1	11.1	11.1
Real GDP growth rate, percent	4.9	3.7	4.9	3.3	5.1	5.4	5.0
GDP per capita, USD	307.1	314.5	346.7	349.6	389	490.8	654.9
Private Consumption as percent of GDP	81.4	87.4	87.1	86.8	81.1	63.8	68.7
FDI as percent of GDP	5.2	3.8	2.0	8.0	8.0	6.7	6.6
Inflation rate, percent	20.6	30.1	18.8	26.7	17.2	17.5	15.9
Avg. exchange rate: ZMK to USD	2388	3111	3608	4307	4743	4772	4464
Terms of Trade (percent change)	-7.9	-4.3	-1.3	-7.3	4.4	21.4	5.5
Overall balance US million	-334	-418	-289	-331	-275	-343	70

Source: (Governor's Economic Review Report; Bank of Zambia, 2006)

An increase in money supply mainly to finance government budget deficits increased inflationary pressures pushing the rate of inflation to 37.6 percent in 1985. Gross domestic investment fell from about 40 percent of GDP in 1974 to 18.6 percent in 1986 and real economic growth averaged 1.2 percent between 1972 and 1985 while per-capita income dropped to US\$260 by 1986. Zambia, which at independence was a middle income country, slipped into economic malaise and became one of the poorest and most heavily indebted countries in the world (Mwanawina & Mulungushi: 2002).

As the economic crises deepened, the country acceded to World Bank and International Monetary Fund inspired economic reforms in an effort to stabilize and restructure the economy. These efforts did not provide immediate solutions to the country's economic problems. Economic growth continued to be depressed, with consecutive negative growth

rates from 1989 to 1995, averaging negative 1.3 percent¹. Similarly, macroeconomic fundamentals continued to deteriorate, with inflation reaching its record high of 128.7 percent in 1989, before starting to gradually fall in response to the structural adjustment and stabilization policies implemented after 1991. By 1999, inflation had fallen to 20.6 percent and the exchange rate, which was artificially overvalued, depreciated to K2,388 from K66.9 in 1989 (Mwanawina & Mulungushi: 2002). Prospects for real economic growth started to improve, with intermittent real positive growth rates throughout the nineties. Real economic recovery only started to be experienced later at the turn of the century when real Gross Domestic Product (GDP) growth rates rose from 3.7 percent in 2000 to an average of 5.3 percent between 2001 and 2006, with per-capita incomes projected to recover to pre-1965 level of about \$1,200 by the year 2010 (Bwalya & Sigande: 2007). Again, these impressive growth rates have been bolstered by a recovery in copper prices on the international market and by a stable and conducive macroeconomic and investment environment. To sustain these positive growth rates, government should remain fiscally prudent and consistently implement economic and investment policies that promote domestic financial resource mobilization and intermediation, and inspire private sector confidence in the economy.

2.3 Revenue Performance against Targets

The Zambia Revenue Authority implements a comprehensive revenue administration system, which has progressively and consistently delivered tax revenue to support government operations. The Authority's performance, as measured by its ability to meet tax revenue targets set by government, has been impressive from its inception. It has consistently met its parliamentary tax revenue targets, even under difficult economic and administrative conditions.

Table 2 below shows revenue performance against targets since 2000. Parliament and the International Monetary Fund (IMF) (operational) targets are given in columns two and three and actual tax revenue in column four. The fifth column shows the variance

¹ Except in 1993 when real GDP grew by 6.3 %.

between parliament and International Monetary Fund revenue targets, and the last two columns show variances between actual revenue and parliament and International Monetary Fund targets respectively.

Table 2 - ZRA Revenue performance against targets (2000-2005 K'billions)

Year	Parliament Revenue Target (a)	IMF Revenue target (b)	ZRA Actual Revenue Outturn (c)	Variance IMF vs. Parliament target (a-b)	Variance Revenue vs. Parliament target (a-c)	Variance Revenue vs. IMF target (b-c)
2006	6627.2*	6348.4		(278.8)		
2005	5,511.5	5,582.8	5,521.8	(71.3)	10.3	(61)
2004	4,536.6	4,498.2	4,554.3	38.4	17.7	56.1
2003	3,522.0	3,468.2	3,549.5	53.8	27.5	(81.3)
2002	2,818.0	2,774.7	2,848.8	43.3	30.8	(74.1)
2001	2,325.4	2,288.4	2,448.6	37.0	123.2	(160.2)
2000	1,600.0	1,841.6	1,739.5	(241.6)	139.5	(102.1)

Note:* After dropping VAT measures amounting to K45 billion, and K63 billion on account of the suspension of duty on importations of petroleum up until November 2006.

Clearly, the International Monetary Fund targets tend to be more stringent than parliamentary targets, except in 2001, 2005 and 2006 when parliament targets fell below the International Monetary Fund operational targets. The Authority has consistently delivered revenue to government in excess of the parliamentary target, but rarely meets the International Monetary Fund target. It is important also to note that the amount by which revenue out-turn exceeds the Parliamentary target has been falling, from K139.5 billion in 2000 to K10.3 billion in 2005 (Zambia Revenue Authority, 2003; Bwalya & Sigande: 2007). Several factors may have contributed to this outcome; for example, an improvement in revenue forecasting would tend to improve revenue target setting and thereby reducing revenue forecast errors or variances.

A fall in revenue performance below target and a recent decrease in tax revenue to GDP ratio appear to coincide with declining government funding to the Authority as illustrated in *Figure 2* below (Zambia Revenue Authority Annual Report: 2007). This is compounded by an increase in tax concessions provided for in the budget and the effect of this decline in government support to the Zambia Revenue Authority was exacerbated by a dismal performance of the domestic Value-Added Tax (VAT) regime in recent years. These factors are all inter-linked and suggest that funding of revenue administration systems and infrastructure have reached such critical levels that efficiencies in tax administration attained after the establishment of the Authority can no longer be sustained or leveraged. While the Authority has recognized and undertaken efforts to streamline tax administration, government through the Ministry of Finance and National Planning should review and implement a robust and incentive-compatible mechanism for financing revenue administration in the country. Such a mechanism should be tailored towards reversing the recent declining trend in revenue productivity and performance, and contribute to the attainment of the country's medium term objectives as set out in the macro-economic framework and the Fifth National Development Plan (Bwalya & Sigande: 2007).

2.4 The Structure and Performance of the Zambian Tax System

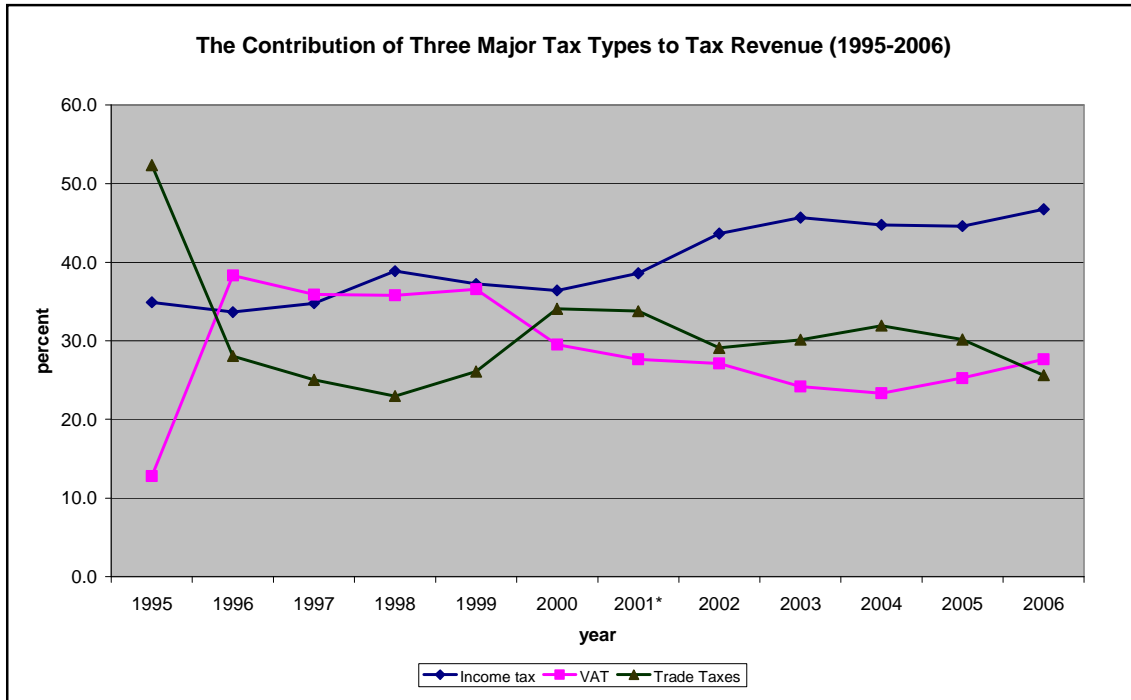
Initially, as shown in *Figure 1*, trade taxes were the major sources of tax revenue for government and accounted for 50.6 percent of the total tax revenue in 1994. Income tax and sales taxes accounted for 31.4 percent and 18.1 percent respectively.² Following administrative and tax reforms of 1995, and the subsequent introduction of value-added tax (VAT) to replace sales taxes, the contribution of VAT to total tax revenue increased from 12.8 percent in 1995 to 38.3 percent in 1996, maintaining an average contribution of about 36 percent throughout the late 1990s. In 2000, the domestic VAT contribution started to decline reaching its record low of 23.3 percent in 2004, but increased marginally to 25.3 percent in 2005. This decline resulted, in part, from a proportionate reduction in both domestic VAT and excise duty which, respectively, declined from about 20 percent and 18 percent in 1995 to 11 percent and 14 percent in 2005 (Zambia Revenue Authority: 2003; Bwalya & Sigande: 2007).

In terms of trade taxes, trend analyses suggest an initial drop in contribution of trade taxes to revenue falling from 52.3 percent in 1995 to 28.1 percent in 1996 and reaching its record low of 23 percent in 1998. Thereafter, trade taxes gradually increased, averaging about 30 percent of total taxes between 2000 and 2005 (Zambia Revenue Authority: 2003; Zambia Revenue Authority: 2007).

Import VAT contributes over 60 percent of total trade taxes and import duty and trade excise account for the rest. Depending on the import and the importer, much of the import VAT collected at the border is actually refunded under domestic VAT. However, import VAT plays an important role in the performance of domestic VAT as it tends to secure domestic VAT by encouraging importers to file a claim on purchases against their vatiable supplies. Import duty is expected to continue to decline as tariffs continue to be reduced under the various regional trade protocols that Zambia has ratified.

² With the advent of multilateral and regional trade liberalization initiatives the role and importance of trade taxes as a source of revenue is expected to diminish.

Figure 1: Revenue Contribution by Tax Type



Source: (Zambia Revenue Authority: 2007)

Direct taxes have shown the greatest improvement since 1995, consistently increasing from 31.4 percent of total tax revenue in 1995 to 35 percent in 1996 and thereafter maintaining a steady increase throughout the period. By 1995, income tax contributed the largest percentage (44.6 percent) to total tax revenue and was forecasted to reach 47 percent in 2006. This performance suggests that income taxes have been particularly more responsive to economic growth compared to commodity taxes (VAT) and efforts to sustain this growth trend is recommended to secure government revenue by further broadening the tax base. Current efforts in this direction include the recent introduction of several presumptive tax regimes aimed at capturing incomes in the informal sector.

The major driver of income tax is Pay-As-You-Earn (PAYE), accounting for over 65 percent of total income taxes in 2007, 2008 and 2009. The contribution of PAYE to the total tax revenue recorded the highest growth rate since 1995, increasing from 16 percent in 1996 to 32.6 percent in 2004, before declining to 31.2 percent in 2005 (Zambia Revenue Authority: 2007; Bwalya & Sigande: 2007). In comparison, company tax only grew from 6.2 percent in 1995 to 8.2 percent in 2005, and mineral royalties showed a

marked decline in their contribution to tax revenue, steadily declining from 5.2 percent in 1995 to 2.3 percent and 1 percent in 1996 and 1999 respectively. Between 2000 and 2004, the average contribution of mineral royalties to tax revenue was only 0.2 percent. It only increased marginally to 0.7 percent in 2005, following a rebound in production and metal prices on the international market. This decline is also explained by a significant reduction in the royalty rate on mineral extraction, which decreased from about 3 percent before privatization to a meager 0.6 percent after privatization (Zambia Revenue Authority: 2007). The mineral royalty currently provides a cash flow advantage to government as it is a deductible expense for income tax purposes of mining companies. It enables government to receive some revenue from mining companies even when they are not in a profitable situation.

There is an opportunity to capture additional revenue from the mining sector by scaling up efforts to renegotiate for an upward adjustment of the mineral royalty rate and to further bring all base metals jointly produced with copper into the tax base and to implement a separate royalty regime and license for each base metal jointly produced with another. Stream-lining the mineral licensing system and revising the fiscal regime for the mining sector to international standards would significantly contribute to base broadening and subsequently to government revenue and to social welfare of the Zambian people by increasing government capacity to fund the provision of public services.

In summary, this trend analysis of revenue contribution to total tax revenue provides useful insights for long term tax planning for Zambia. It reviews an interesting pattern of our revenue system that is heavily dependent on income taxes and trade taxes.³ This pattern may not be sustainable in the long-term, especially with the ongoing progressive reduction in import tariffs inspired by regional and multilateral trade agreements. Given

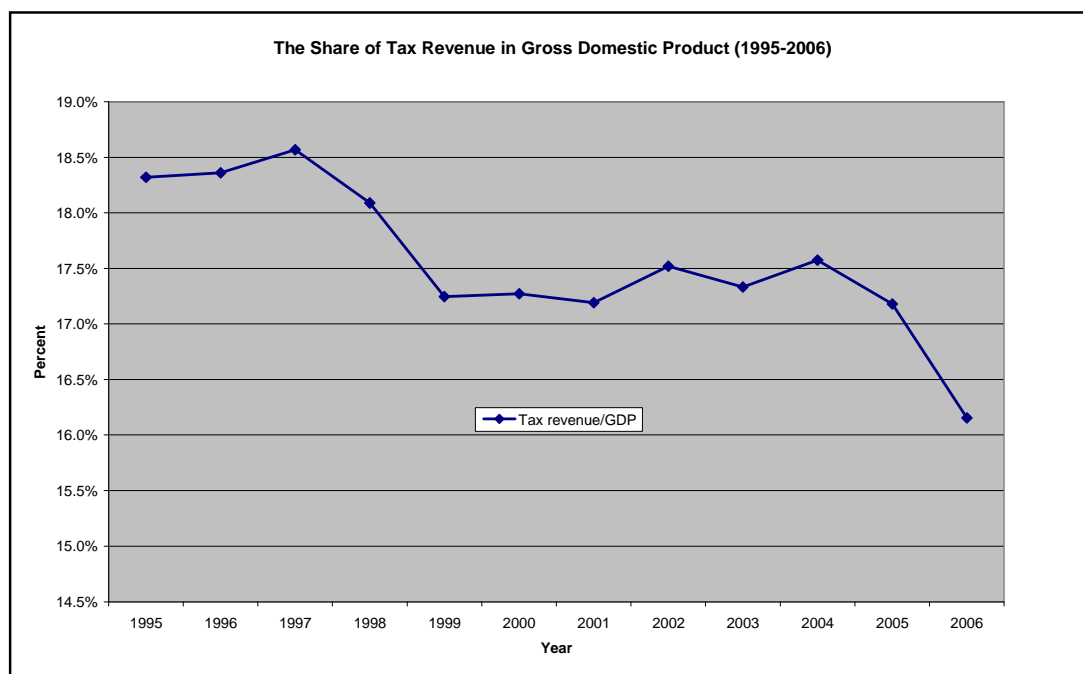
³ In most countries, consumption taxes tend to be the major sources of revenue. For instance in 2001, consumption taxes contributed 32.6% to tax revenue in the OECD countries, (but only 16.1% in the USA) and most developing countries are much more dependant on consumption taxes. For instance, in Mexico, consumption taxes contribute 73.5% to total tax revenue in 2001 (Bwalya & Sigande: 2007).

the continuous reduction in trade taxes, the country must escalate its efforts to reverse the declining trend in consumption taxes (VAT) and implement measures to step up the contribution of VAT to total tax revenue. This calls for both a tax policy review of the VAT regime as well as initiatives aimed at promoting compliance. There is a need to broaden its application in terms of the number of commodities on which consumption taxes are payable as well as raising compliance and taxpayer education campaigns.

2.5 Declining Trend in Tax Revenue to GDP

Figure 2 below shows the trend in tax revenue to GDP. Although the revenue system was more productive at the inception of the Authority, with revenues of over 18 percent to GDP, the ratio fell from 18.5 percent in 1997 to 17.2 percent in 1996. In subsequent years, revenues continued to fluctuate between 17.5 percent and 17% up until 2004. After 2004, the revenue to GDP ratio started to fall, reaching a projected level of 16.2 percent in 2006, but this performance in the last two years is not indicative of the optimal performance of the country’s revenue system (Zambia Revenue Authority: 2007).

Figure 2: The Share of Tax Revenue in the Gross Domestic Product (1995—2005)



Source: (Zambia Revenue Authority Annual Tax Reports, 2007)

It is, however, worrisome to government which needs to scale up its expenditures to promote rapid economic growth and reduce the incidence and severity of poverty in the country. Sustaining a declining trend in revenue has much wider implications as it fails to meet projected revenue that forms the basis for the country's medium term economic development program (Fifth National Development Plan) and the medium term macro-economic framework targets. It is, therefore, imperative that this trend is reversed to levels consistent with the country's development plan and macro-economic framework. But to reverse this revenue trend, detailed analyses of factors underlying the recent dismal performance should be documented and should form the basis for tax planning and administration. Interestingly, the below average performance in the last two years coincides and is consistent with quite impressive average economic growth rates of 5 percent. It is, however, unexpected for a responsive tax system to record a revenue decline when the economy is actually growing (Bwalya & Sigande: 2007).

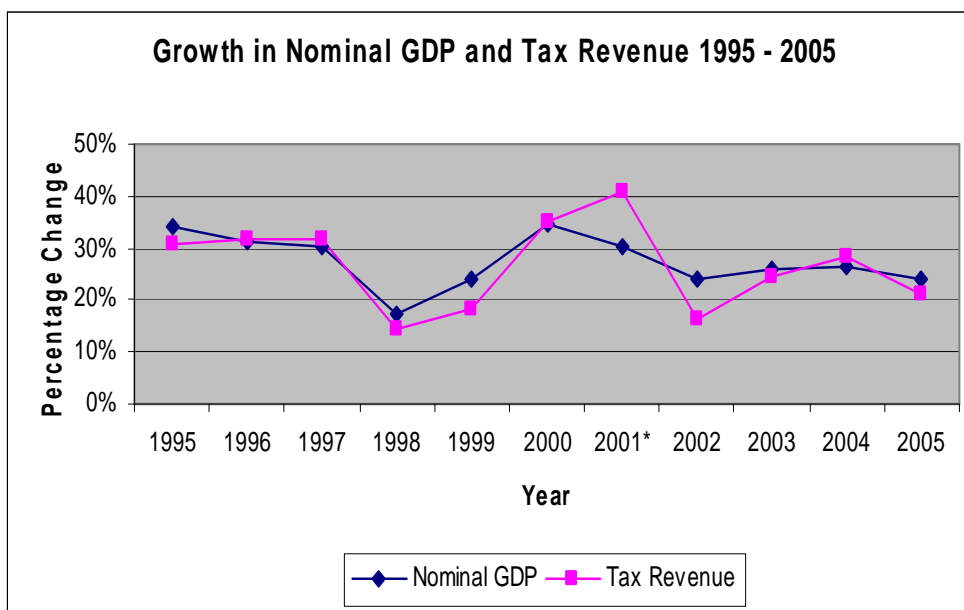
It is, therefore, important to conduct a diagnosis, not comprehensive but indicative of the revenue structure in terms of its responsiveness to changes in income (economic growth). This analysis is extended to cover the major tax types for which data is readily available.

2.6 Is the Zambian Tax System Responsive?

Revenue performance is often analyzed with reference to its base. Economic growth tends to be the best proxy for overall revenue base and this base is used to examine the responsiveness of the tax system to changes in national income. The expectation is that when the revenue system is responsive (buoyant), there is a tendency for revenue to drift with Gross Domestic Product (GDP) in the long term. *Figure 3* below plots growth rates in GDP and total tax revenue. The figure shows that the tax system is fairly responsive, meaning that the revenue system is capable of capturing more revenue when the economy is doing well and similarly records a revenue decline during bad times when the economy is in a recession. With the exception of 2001, when revenue growth was significantly above the growth rate of the economy mainly on account of the Parastatal Debt Swap Initiative, the growth in tax revenue shows a high correlation with economic growth over the period (Zambia Revenue Authority: 2003; Zambia Revenue Authority: 2005). The observed discrepancies arise from discretionary measures (mostly budgetary measures

and tax concessions), which tend to vary from year to year. They may also reflect the enforcement effort exerted by the Authority to raise compliance and prevent tax fraud and tax evasion.

Figure 3 - Growth in Nominal GDP and Tax Revenue 1995-2005 Figure (Zambia Revenue Authority: 2007)



Source: Zambia Revenue Authority – 2005 Annual Report

This trend analysis seems to suggest that the tax system is quite responsive to changes in aggregate income (GDP). More detailed analysis of the responsiveness of the tax system is presented below and statistical econometric procedures are used to estimate the overall responsiveness of the tax system (referred to as buoyancy) and further split buoyancy into two more specific measures—the effects of discretionary tax measures and the actual elasticity of the tax system (in-built flexibility). Firstly, estimates for the overall tax system are presented, and then disaggregated by looking at specific tax types.

Table 3 provides summary estimates of buoyancy, elasticity and discretionary measures before and after the establishment of the Zambia Revenue Authority. The idea is to gauge how the tax system has changed after the reform and to see how any progress made so far can be leveraged for even further improvements. The evidence suggests significant improvement in the responsiveness of the tax system, with buoyancy increasing from

0.78 before Zambia Revenue Authority reform to 2.91 after reform. The automatic responsiveness of the tax system also improved, from what was previously an inelastic tax system (elasticity 0.85) to one that is now fairly elastic (1.25). This implies that if incomes increase by 1 percent, revenue increases by 1.25 percent. This suggests that the tax system is capable of capturing a large percentage of taxes from an increase in income (GDP). In addition, revenue collection is affected by efficiencies in tax administration, by the effects of discretionary tax measures (tax concessions, holidays, etc.) and other tax administrative measures. These measures either increase or erode the tax base and affect the responsiveness of the tax system.

Table 3 - The Responsiveness of the Overall Tax System (1973—2005)

Overall tax system	Pre-ZRA Reform	Post ZRA Reform	1973--2005
Buoyancy	0.78	2.91	1.19
Elasticity	0.85	1.25	1.62
Discretionary measures	0.82	0.87	0.84

Source: (Phiri: 2006)

The estimated effect on the tax system of these discretionary measures shows great improvement in post-Zambia Revenue Authority period compared to the pre-reform period. The evidence suggests that the creation of Zambia Revenue Authority has helped to improve tax administration and that discretionary measures on the overall have had a positive effect (elasticity = 0.87) on revenue performance (Phiri: 2006). However, the effect of discretionary measures on tax revenue is lower than expected and there exists substantial scope to limit certain discretionary measures that erode the tax base and reduce the responsiveness of the tax system to changes in Gross Domestic Product. Limiting discretionary (budgetary) measures that erode the tax base has become even more important in recent years when the ratio of taxes to Gross Domestic Product has been falling (*Figure2*).

2.7 Role of the Informal Sector in the National Economy

In the context of the severe contraction in formal sector employment during the past decade of rigorous economic reform implementation, the informal sector employment has increased, growing at approximately 5 percent per annum, and now employs 80 percent of over 4.4 million labor force compared to 43 percent of total urban labor in 1985 (Seshamani: 1999)⁴. However, the capacity for the informal sector to absorb the ever-growing labor force and new entrants (mostly the youth) seeking sustainable employment is being exhausted and deliberate measures to expand livelihood options need to be identified and implemented. As in many developing countries in Sub-Saharan Africa, the informal sector in Zambia is highly heterogeneous and sometimes over-lapping with the formal sector. It embraces the most dynamic and highly productive activities and less productive ones. According to Seshamani (1999), the informal sector in Zambia can loosely be subdivided into three sectors. The micro-enterprise sector has considerable potential for growth and is perhaps the most dynamic aspect of the informal sector in Zambia. The micro-enterprises are predominately in manufacturing and high value wholesale and retail activities. The enterprises tend to have close, but highly beneficial business links with the formal sector. For instance, micro-enterprises in furniture and textiles receive contracts to produce and supply their produce to formally incorporated enterprises. Those in large maize marketing often supply to milling and brewery companies. It is in this context that these micro-enterprises operating in the informal sector are being regarded as the most dynamic aspects of the informal sector and often seen as an extension of the formal sector.

⁴ The informal sector is mainly defined by stating the characteristics of its businesses. Various definitions of the informal sector exist. However, the following United Nations International Labour Organization's definition of the informal sector is pertinent to this study; Small units of production, independent self employed producers, a predominance of family labour, little capital, low technology, low productivity, irregular incomes, etc. (International Labour Organization: 1994).

The second category comprises the household or family sector employing unpaid family labour. This category dominates the subsistence agriculture and low-value trading (retailing and vending) and restaurants. These livelihood activities are less diverse and with limited capacity for growth. The third category essentially includes independent service sector activities and embraces domestic workers, helpers, street vendors, and cleaners. Women and the youth dominate this form of informal sector employment. (Central Statistical Office: 2006).

In the context of the above categorization, the informal sector can be seen to play two distinct roles in the national economy, depending on the nature and scope of activities people engage in (Seshamani: 1999). On one hand, those who look at the informal sector as a transitory and residual economy, contend that the informal sector plays a minimal and transitory role in providing sustainable livelihoods and poverty reduction options, and makes a marginal contribution to national development. The basic premise is that people enter into the informal sector on a temporary basis while waiting for opportunities in the formal sector to unfold. This is because the informal sector only provides fixed income opportunities that people compete for, resulting in an involuntary growth of the informal sector. This growth further makes entrepreneurs compete for fixed income opportunities, which is eventually exhausted, subsequently engulfing people in poverty. Moreover, due to technical and inefficiencies associated with micro-enterprises in the informal sector, households and individuals fail to rejuvenate or diversify their income generating activities and as such get permanently trapped into poverty (Seshamani: 1999).

On the other hand, the opponents of the transitory notion put forward the argument that the informal sector plays an important role in people's livelihoods and national development in several ways: firstly, the informal sector is critical in human capital formation, for instance through apprenticeship and learning by doing, it acts as an incubator for entrepreneurship and enterprise development in the economy; secondly, the informal sector provides employment and income generation. Despite involuntary growth, it provides self-employment, although without social security. Thirdly, where a niche is established in the market, the informal sector can provide sustainable employment and income to a majority of the people both in the formal and the informal

sector. In fact, evidence suggests that in Zambia, informal sector income in some cases is higher than formal sector income. Finally, the informal sector plays a cardinal role in the distribution chain for most goods and services, especially in the rural areas of Zambia. (Simbyakula: 1990).

2.8 Taxation of the Informal Sector in Zambia

The informal sector is mainly defined by stating the characteristics of its businesses. Various definitions of the informal sector exist. However, the following United Nations International Labour Organization's definition of the sector is pertinent to this study: Small units of production, independent self-employed producers, a predominance of family labour, little capital, low technology, low productivity and irregular incomes, among others (Simbyakula: 1990).

Other notable characteristics of the informal sector include the ease of entry and the freedom from bureaucratic regulation. It is important to note that this definition makes no definite mention of income levels earned in the informal sector. It should also be noted that the informal sector comprises many other sub-sectors such as the informal real estate housing sector, real estate properties, transporters, farmers, cross-border traders, and marketers, among others. The informal sector is primarily small scale, uses little capital and in Zambia is not fully exploited as a source of tax revenue.

According to Simbyakula (1990), many people in developing countries are involved in subsistence production of goods and services. He questions whether or not such people should be subjected to personal income tax. In addition, Simbyakula argues that if the aim of an income tax is to help collect as much revenue as possible, it is, therefore, prudent that institutions responsible for revenue collection cast a wide tax net. This entails that economic activities that earn substantial income within the informal sector must be captured in the tax net. Simbyakula states that the requirement to pay tax will provide an incentive to the informal sector to enhance productivity. He insists that "ability to pay" among the informal sector players would necessitate exempting a lot of people from this sector for the reason that they produce only enough to sustain themselves.

In considering how the informal sector should be taxed, Simbyakula (1990) postulates that it is critical to bear in mind fundamental principles based on income tax guidelines as suggested as far back as 1951. Among such principles are the existence of a predominantly monetized economy, a high level of literacy, the prevalence of reliable accounting records to determine income, a large degree of voluntary compliance, an appropriate political environment and an honest, efficient and effective tax administration.

Though there is a need to reform tax laws, this does not necessarily result in efficient and effective tax collection. There are certain taxation principles that ought to be given special attention in an effort to capture tax revenue from the informal sector (Simbyakula: 1990; Atkinson & Stiglitz: 1976). Several approaches have been experimented on in different countries with respect to cost-effective taxation of the informal sector. For instance, Ghana tried to implement taxation through standard assessments, via the leadership of the groups and associations in the informal sector (the bus operators' association), and daily income tax rates for specified informal sector groups such as commercial taxi drivers (Addison & Osei: 2001; Addison & Levin: 2005). However, the large number of operators in the informal sector makes the cost of effectively collecting taxes from the sector uneconomical. On the other hand, the number of participants in and the size of the informal sector makes it an attractive sector for revenue collection and if not targeted would compromise tax compliance among medium and large income taxpayers who would seek to hide their operations in the informal sector to evade taxes.

From the foregoing, there is little doubt that Zambia's economic performance has recorded little significant growth in the last few years. This assertion is corroborated by data from the Central Statistics Office (Central Statistical Office: 2006). Such performance may, however, be further enhanced by subjecting business people in the real estate sector to taxation. Lessons drawn from Ghana show that it is feasible to do so even when taxing the sector suffers from such drawbacks as poor record keeping arising from illiteracy, the high cost of taxing the sector in question and the lack of political will. To overcome these problems requires espousing unorthodox, versatile and diligently designed tax collection methods, to collect as much tax revenue as possible from the informal sector in general and the informal real estate housing sector in particular.

Moreover, it may be necessary to carry out reforms in the tax laws and/or policies and solicit support from the government to tax the sector.

CHAPTER THREE

LITERATURE REVIEW

3.1 Introduction

This chapter reviews the body of existing literature pertinent to this study, on Zambia's need to broaden its tax base. It discusses contemporary research and debates relevant to this study. The chapter conceptualizes the research topic in the light of ongoing debates on taxation in Africa, identifies research gaps, strategically positions the study within the research conversation and seeks to contribute to the existing body of knowledge on enhancing tax revenue collection. Due to limited scholarly work on the subject matter in Zambia, the study draws on literature from similar studies undertaken in other third world countries.

3.2 Examples from other Developing Countries

Addison and Osei (2001) argue that a number of developing countries have now successfully stabilized their economies and are proceeding towards the adoption of sustainable pro-poor-growth-oriented strategies. Addison and Osei (2001) in their study on taxation and fiscal reforms in Ghana argue that the provision of public services in many countries is constrained by low levels of public revenues, which could, in principle, be addressed by higher levels of taxation. In addition, Addison and Levin (2005) postulate that taxes should be increased when they are so low that the government is unable to finance essential public spending. In many poor developing countries, a low tax revenue/GDP ratio prevents these countries from undertaking ambitious expenditure programs in health and education (Addison & Levin: 2005).

Addison (2001) and Karingi and Wanjala (2005) contend that a rapid increase in domestic revenue and a corresponding increase in public services should be a policy priority. However, one needs to be cautious about increased public spending and increased taxation as taxes begin to reduce growth when pushed beyond certain levels (Bashir & Darrt: 1994; Berry & Kaserman: 1993). This implies that very high taxes may eat into the revenue of taxpayers, which in turn would hinder the growth of businesses

and rob them of the capacity to make more taxable income. Addison and Levin (2001) also assert that increased taxation may have adverse supply side effects by constraining already low private investment. This is a more fundamental problem in most African countries. In addition, taxes also affect the microeconomic channels of uncertainty where risk aversion and irreversibility of investment projects may affect growth. Low-income countries often face unusually high resource volatility, both in the domestic revenue component and in the net aid inflow, which indicates that it is important to embark on serious diversification of the tax revenue structure (Addison & Osei: 2001).

Significantly, Addison and Osei (2001) reveal that most developing countries are still predominantly rural and income bases are notoriously difficult to tax. The difficulty in taxing economic activities in rural areas arises from institutional limitations. As Addison and Osei (2001) show, developing countries tend to have archaic tax administrations which make the assessment of tax liabilities problematic. This is compounded by the tendency of the underpaid tax administrators to be corrupt and the tendency of taxpayers to evade taxes, resulting in sub-optimal revenue collection (Addison & Levin: 2005; Graetz, Reinganum & Wilde: 1986). There are also political economic aspects involved, where those who should be taxed are exempted from taxation because of the political protection they enjoy from institutions and powerful politicians (Addison & Osei: 2001).

Addison and Osei (2001) also contend that some local government taxes are rather unpleasant and impact heavily on poorer households. The problem is not only that those taxes reduce incomes of poor household, they also impact on how these taxes are collected. Harsh tax enforcement strategies combined with poor service delivery undermine the legitimacy of the local government and tend to increase tax resistance (Fjeldstad: 2001; Addison & Levin: 2005). Even if there are improvements in the enforcement mechanism, it is unlikely to compensate for bad tax design. Attempts to squeeze additional revenues from poorly designed taxes may only exacerbate the negative effects on the economy and society in general.

As Meade (2001) indicates, the introduction of value-added tax (VAT) in a number of developing countries has been successful with regard to revenue generation. However, it is important to complement VAT with either exemptions and/or excise duties to make it

less regressive (Addison & Levin: 2005). Meade (2001) rightly argues that if a country decides to exempt a number of goods, a careful analysis would be required as there is no guarantee that the tax exemption will be targeted to benefit the poor, as is the case in Zambia where multi-national mining corporations are given tax holidays which do not benefit the majority of the poor people in the country.

Literature on taxation reveals that excise duties have received less attention in the reform agenda compared to other tax instruments. Yet excise duties may raise substantial revenue and at the same time be distributionally friendly (Muriithi & Moyi: 2003). However, one needs to have realistic rates to enhance tax compliance and a corruption-free tax system. These rates should be seen as a long-term opportunity of raising revenue as the economy develops and consumers switch from basic commodities to luxurious commodities.

Meade (2001) also argues that broadening the VAT base should be a low priority and if implemented, it should only be in those countries where the net fiscal incidence is favourable to the poor. Prior actions, particularly in sub-Saharan African countries, need to be concerned about the wide divergence between the effective and statutory tax rates. Equally vital is the need to raise tax revenue without increasing tax rates, through reinforcing tax and customs enforcement strategies such as those targeting smugglers of cigarettes, and other high value goods, reducing tax exemptions and fighting fraud and corruption. Meade, however, contends that the fight against corruption takes time, as it has to be undertaken on several fronts, including tax evasion by some compromised officers within the tax authorities themselves.

Addison and Osei (2001) further state that increased efforts are needed to improve revenue collection of direct taxes. As these authors show in the case of Ghana, moving away from indirect taxation towards direct taxation can be a distributionally friendly strategy. Shende (2002) also places emphasis on building the institutional capacity to reduce tax evasion. He stresses that in order to protect the poorer households, it is important to set the income tax threshold fairly high (Shende: 2002; Schill: 1994). In Kenya there has been a deliberate policy towards protecting the poor via personal income

taxation as the Personal Income Tax threshold was consistently raised compared to the per capita income (Addison & Levin: 2005).

Meade (2001) postulates that if the informal sector is very large and increasing over time, tax policy must attempt to bring the informal sector into the tax base and/or attempt to contain its growth. Possible policy measures will depend on the cause of changes in the relative size of the informal economy. He argues that in some countries it might be necessary to develop specific regulations on how to tax the informal sector. However, this would probably jeopardize poverty reduction objectives, which most developing countries have embarked on.

Addison and Levin (2005) contend that governments should first provide a governance framework within which revenue authorities can perform effectively without continual compromise. According to these scholars, governments must not only respect the independence of the revenue authority, but also address the need to maintain incentives for staff within such service. They should also recognize that weaknesses in budgetary and expenditure management systems would undermine the potential economic and political returns on investment in the revenue services.

Equally significant is the need to address institutional biases towards organizational overall performance, such as information technology related procedures (e.g. data integrity and security) and manpower capacity building across tax type as well as sufficient attention to fiscal accountability. The integrity of the institution as well as its corporate image should be enhanced through anti-corruption crusades and awareness (Addison & Levin: 2005)

As observed by a Central Statistical Office survey (2006), entry into the formal sector labour market has become very competitive. Consequently, most of the unemployed people have found their own ways of working and sustaining their livelihood as their only alternative to evading the poverty trap; hence the development of the informal sector (Eggenberger-Argote: 2005).

The informal sector should therefore be viewed as an added ingredient to the overall national development process (Tendler: 2002; Nanyangwe et al: 2004). It is no longer

just a labour market phenomenon resulting from an excess supply of labour, but a viable alternative to formal sector employment. Most of the informal activities are taking place in the trade and agricultural sectors of the economy (Central Statistical Office: 1997). Capturing this growing sector into the tax net would help broaden the tax base. It would be detrimental to disregard this sector for tax purposes (Gërkhani: 2004). Tax revenues will continuously face mounting pressure as the formal sector contracts while the growing informal sector has hardly been taxed in the last few years. It is for these reasons that the Zambia Revenue Authority has over the last three years put a lot of effort into bringing the informal sector into the tax net. Even though the results have not been phenomenal the drive continues and new lessons are being learnt at each turn.

Thomas (1992) argues that despite the diversified set of definitions of informal economies, there is general consensus on the main divisions of economic activity, which occur within its borders. He states that the irregular sector economic activities do not only involve some degree of illegality in the production or distribution or exchange of products, but also of the products themselves. Some irregular activities include tax evasion, social security fraud, and avoidance of regulations of business. Though this activity occurs in developing and transition countries, institutions and governments of the First World predominantly measure informal economies, reprimand violators, and collect lost income from taxes or fees from business people in the sector who fail to obey regulations (Thomas: 1992).

Thomas (1992) also points out that the informal sector may be spoken of as an amalgam of various sectors, all of which are unregulated or excluded from the formal sector. Generally speaking, the informal sector involves the activities of mostly self-employed or micro-scale businesses working in the production of goods, as well as those involved in the exchange of these goods. Selling on the streets of a wide range of goods or services often by women is a conspicuous example of the informal sector.

In addition, Portes (1989) argues that the distinction between the formal and informal sectors, though blurred, lies not so much in the product but in the production and exchange of the product. He also argues that the International Labour Organization adopted the first institutional definition of informal economy, stemming from Hart's

research, in 1973, which was organized around the concept of poverty and unemployment conditions.

In addition, Eggenberger-Argote (2005) states that the informal sector consists of entrepreneurs who produce legitimate products without proper permits and legal status because they lack the resources and/or the incentives to comply with the excessive rules and regulations necessary to become part of the formal economy. In other words, informal sector activities are extra-legal in the regulatory, but not in the criminal sense. Hence the informal sector is a very heterogeneous and complex phenomenon. It includes not only the urban poor who depend on informal subsistence activities for their livelihood, but also high income people entering the informal economy as a way of supplementing declining formal sector incomes or increasing profit margins. Understanding the complexity and heterogeneity of the informal sector has significant implications for any strategy and policy interventions trying to alleviate poverty in this sector and to formalize the informal economy.

3.3 Presumptive Taxes

As the International Monetary Fund suggests, presumptive taxes may offer a solution to taxing the informal sector. Presumptive taxation has been used successfully in many countries to raise revenue from hard-to-tax groups and reduce tax evasion. Presumptive taxation is useful when a country has a weak tax administrative system and offers possible equity and efficiency gains (McCarten: 2004). It is usually used as a proxy for income taxation on small businesses and sometimes farmers outside the regular tax framework.

As McCarten (2004) observes, presumptive taxation offers the possibility of reducing tax evasion at low cost and broadening the tax base. Even though revenue per taxpayer may be low, there are potentially large spillover effects. Presumptive taxation may be the only means to tax small businesses in developing countries. Small businesses are likely to comprise the vast bulk of corporate taxpayers, and may prove effective at cutting audit time and cost, especially where accounting literacy is low (Slemrod & Yitzhaki: 1994).

As a first step, the tax collection authorities must conduct a census of taxpayers recording the sales volume for each business. The second step is to determine the profit margin for each type of business based on factors such as location and floor space. Professional income in European Union countries is occasionally taxed on the basis of location (Fjeldstad & Rakner: 2003) and in this connection market traders could be taxed based on the average income traders presumably earn.

Introducing a system of presumptive taxation may not be without problems. Firstly, it may give profitable firms an incentive not to keep records so that they can be eligible to be taxed at an average level (Fjeldstad & Rakner: 2003). Secondly presumptive taxation may in practice turn into a tax on the proxy factor used to measure income e.g. on floor space or number of seats in a restaurant. Moreover, as presumptive taxation is usually set at a deliberately punitive level in order to force firms into self-assessment, it might backfire and push firms underground rather than into the formal sector. In addition, presumptive taxation allows tax collection authorities a large amount of discretion in estimating tax assessments. This may lead to collusion with tax authorities by individuals seeking a lower assessment. Unless the process is transparent (backed by adequate access to court and perceived to be fair), there may be problems of implied harassment, extortion and arbitrary assessments. In this regard, taxpayer education becomes crucially significant.

If the underlying assumptions behind the structure of presumptive taxation are not updated regularly, there may be unintended burdens. For example, when profits fall during an economic downturn, the burden of presumptive taxation may increase unless such macro-developments are reflected in the determination of presumptive taxes (Fjeldstad & Rakner: 2003). Presumptive taxes can be efficient. As a flat tax, presumptive taxes impose no burden on marginal increments in income or profit; the marginal tax rate is zero. However, they may impose a barrier to the entry of new firms who will have to start paying taxes based on average incomes of already established firms (Fjeldstad & Rakner: 2003).

Presumptive taxation, as any tax system, cannot yield dividends unless effective prosecution and fines back it for non-payers. There is thus an imperative need for easy

access to the court for those disputing decisions of the revenue collection authority. The Zambian Revenue Appeals Tribunal might end up being over-stretched by tax appeals from dissatisfied taxpayers.

An additional tax that might be ideal for generating revenue from the informal sector is the base tax. This is a tax levied on small-scale businesses unable to maintain business records. In Zambia, the base tax for 1998 was fixed at 266 penalty units or an equivalent of K47, 880 per year (Zambia Revenue Authority: 2002).

Imposing presumptive and base taxes on the informal sector can by itself not enhance the collection of tax revenue from the sector unless the would-be taxpayers comply with the law. Scholz and Piney (1995) note that to achieve this goal requires staging an effective education campaign aimed at raising tax awareness among taxpayers. They argue that this is all the more essential in the informal sector where literacy levels are too low. Some scholars have observed that illiteracy is a major source of non-compliance among taxpayers (Nanyangwe et al: 2004; Scholz & Piney: 1995).

It is worth noting here that the general levels of illiteracy are not as bad as the levels of 'tax illiteracy' as even people who are quite fairly well educated seem to know very little about their tax obligations. Therefore, taxpayer education needs to be included in the national educational curriculum in order to provide an early exposure to tax issues.

It should be underscored that rental income is an income just like any other form of taxable income. However, it is not subject to tax in Zambia, as in other sub-Saharan African countries where governments collect property tax (Franzsen: 2002), Simbyakula (1990) argues that property tax is an appropriate indicator of the ability to pay in that wealth is usually found to be more unequally distributed than income.

That there is need to subject rental income to taxation cannot be disputed. Property is a manifestation of wealth and therefore a source of income. Its taxation is justified on the grounds that property owners have the ability to pay tax and it may enhance the re-allocation of resources. Moreover, property may be acquired with funds that may not have been taxed (Landes: 1999).

Property tax is a fiscal tool that may be utilized to adhere to certain focal points such as land reform, either in rural or urban areas. Thus, depending on the design and extent of application, property tax can exert a greater influence on the way in which land is used or the types of structures built and the locality, than income or consumption taxes having an equal yield in revenue (Hunt: 2004).

When properly administered, property tax can be a very valuable source of tax revenue for government either at the central level or local level (Frank & Bahigwa: 2003). The revenue generated from this source may be used to finance local authorities' developmental programmes. If revenues from this source are reasonable, the burden of income taxes can also be reduced by keeping income tax rates low, thereby having the effect of redistributing wealth.

Despite the fact that property tax offers an opportunity to collect more revenue for the local government on sites and improvements in Southern and Eastern Africa, not much revenue is collected due to a lack of properly qualified and skilled valuers (Fanzsen: 2002). It is noteworthy that property assessment should be an integral part of a well-administered property tax system. Unfortunately, municipal valuers do not work independently of others. They are team players whose performance depends on other players responsible for accurate property records and those responsible for tax collection and enforcement. Thus, it is imperative to build capacity in areas of professional, technical and management skills, training, computerization and collection and enforcement procedure in order to have an efficient property tax system.

3.4 Informal Rental Income

According to the Income Tax Act CAP 323 of the Republic of Zambia, rental income simply relates to the income derived from the letting of real estate property. The term 'rent' is not defined in the Income Tax Act. However, it can be construed as any form of payment made for the use or occupation of real estate property (Feldstein: 1977). The Income Tax Act recognizes that income arises in various ways and as such, the classification of income in section 17 of the Income Tax Act is meant to enumerate the different types of income and income sources for assessing purposes.

According to Franzsen (2002), property tax is an annual tax levied on the ownership (occupation) of immovable property, which includes land, buildings or houses. Property tax therefore, has been an important source of local government revenue. However, before dealing with property taxes, or rates as it is often known in most of these countries, in its narrow sense, it should be noted that in most of the sub-Saharan countries, the income from the use, acquisition and or alienation of immovable property is generally taxed by means of other property-related taxes. It is noteworthy that different countries utilize a variety of tax bases to determine the annual property tax: land value, value of improvements on the land or both (Nsamba-Gayiiya: 2001).

It is evident that Zambia can learn from how other countries have endeavoured to raise government revenues from the informal real estate sector. However, it has been observed that most Sub-Saharan countries (e.g. Kenya, South Africa, Tanzania, Uganda and Namibia) have made attempts to capture the informal real estate housing sector indirectly through property tax (Franzsen: 2002) which does not precisely or necessarily capture tax from the income earned by landlords. It should be noted that property tax in Zambia is purely based on land (site value) as opposed to improvements made on the land (Chirwa: 2000).

Franzsen (2002) also states that even if property-related taxes are levied on all urban properties in sub-Saharan Africa, there are only a few countries (Namibia and South Africa for instance) which already have tax legislation on land value and property improvement value, and the rest (including Tanzania, Uganda and Kenya) are still struggling to formulate property tax legislation.

In other words, it is clear that all efforts are directed towards taxing property as well as legislating for property taxes. However, with property tax being difficult to assess and value, it is imperative that housing rental income serve as a source of revenue to the treasury through withholding or presumptive tax levies. The difficulty in assessing and valuing property is exacerbated by the problem of the shortage of qualified and skilled manpower to survey land, keep good records and maintain an accurate deeds register (proper cadastral information) (Franzsen: 2002). And where property evaluators are available, they lack the capacity to assess property and prepare proper valuation rolls. In

addition, they fail to undertake interim valuations and regular general revaluations, all of which are a prerequisite for a legitimate and efficient property tax system (Chirwa: 2000). This scenario and challenge apply to most countries in Southern Africa, including Zambia.

It is clear that the lack of skilled manpower to properly assess and value property results in low tax receipts, which in turn is gravely compounded by poor administration (Dillinger: 1996). It should be recognized that there are also political liabilities inherent in property tax that cripple the implementation of property tax laws and impair the collection of property tax. This is because politicians at district level fear tax revolts so much that they would rather see property tax go uncollected. However, in a situation like Zambia where poverty levels and unemployment levels are high, government has a challenge to collect more tax revenue and use it for developmental projects and in turn reverse the trend. As a result, it is prudent to capture tax revenue on rental income directly to enhance tax revenue collection and in turn finance most of the developmental projects internally.

3.5 Institutional Framework for Property Tax Administration

It is unnecessary to emphasize that the existence of well-defined tax laws alone cannot guarantee the success of the tax collection effort. There must be a supplementation of tax incentives with wider reforms in the internal organization of revenue collecting authorities, such as reforms in information systems, organizational structure, budgeting and accounting systems, task assignments and other staffing policies (Mookherjee: 1997). An efficient and effective tax administration must also exist to implement such laws. An efficient and effective tax administration is therefore essential to successful domestic resource mobilization. This is in line with Surrey's observation (cited in Mookherjee, 1997:36):

It is increasingly apparent that tax administration must receive far greater attention if the goals of tax policy are to be attained. Much of tax policy is being directed to obtaining increased revenues to enable governments to carry out their economic planning. The search is for additional taxes, for new sources of revenue. Yet it is true in many countries that the successful administration of some of the existing taxes

would provide a considerable part of the needed additional revenue. The diligent execution of existing taxes may well make unnecessary, or at least reduce, the multiplication of taxes in search of revenue.

As defined by the Inter-American Centre for Tax Administrators, the term “efficiency” means the level of performance of a tax administration’s activities in terms of costs and productivity, while the term “effectiveness” signifies the level of taxpayer compliance with the revenue administration’s objectives (Serra: 2005; Manasan: 2003). The advantages that derive from effective and efficient revenue administration are threefold (Serra: 2005; Manasan: 2003): firstly effective administration is crucial to generating more tax revenue, enabling governments to achieve greater financial acumen and facilitating growth oriented programmes and the creation of the desired infrastructure for economic expansion. Secondly, this obviates the need to introduce higher tax rates and/or new taxes, a development that reduces the burden on existing taxpayers. Finally, efficient tax administration eases the adoption of simple and admissible tax laws, thereby undermining non-compliance.

It should be noted that to achieve effective and efficient revenue administration, there is need to control fiscal corruption. According to Chand and Moene (1999), fiscal corruption can be controlled through reforming the design of taxes and their administration and the control of expenditure, waste and fraud. However, it is difficult to obtain adequate information on perceived fiscal corruption because, more often than not, parties involved naturally strive for concealment.

It should be underscored that the extent of corruption in most revenue authorities can be obtained by comparing the theoretical yield of tax revenue and actual tax revenue collections (Chand & Moene: 1999). However, the shortfall in the tax revenue yield could be also attributed to other factors such as poor organization and administration of departments. The authors noted that it is also difficult to establish how much corruption adds to government expenditure, as standards for comparison are not readily available, particularly for government and quasi-government departments. In addition, they stated that corruption can be controlled by reducing the discretionary powers of tax administration officers, lowering tax rates to foster compliance, and having a standard or

good tax audit trail. Furthermore, Blackburn, Forgues-Puccio and Gonzalo (2005) state that corruption is reflected in bribery and tax evasion as bureaucrats conspire with the rich in providing false information to the government.

An equally important advantage to be derived by governments from the existence of an efficient tax administration is that it enhances their ability to effectively enforce taxes with potentially high revenue yields such as income tax and its complex variations like excess profits tax or expenditure tax which demand precision and sophistication in their application (Serra: 2005; Mookherjee: 1997; Braithwaite & Braithwaite: 2000).

An efficient tax administration can further devise means to tax the informal and the agricultural sectors of the economies of such countries that remain largely untaxed in spite of their inherent potential to provide a substantial portion of the revenues needed by such governments to carry out the social overhead projects necessary for economic development (Manasan: 2003).

One easily noticeable feature of developing countries is their low tax effort. While the overall average tax effort level of these countries is estimated at about 18 percent of Gross Domestic Product (GDP), the average for industrialized countries is around 38 percent (Tanzi & Zee: 2001). The disparity in the tax effort levels of these two groups of countries is therefore significant. The low tax effort levels of developing countries simply mean that the ability of such countries to collect tax revenue through voluntary compliance by taxpayers is severely restricted. There is therefore the need to increase the tax effort levels of the developing countries.

The low tax efforts of these countries, which to some degree are a reflection of the weak tax administrations, have produced certain undesirable results in these countries (Caulfield: 2006; Fjeldstad: 2003; Graetz, Reinganum, & Wilde: 1986). Among such undesirable consequences are that the governments of such countries are usually forced to adopt taxes which are easy to administer, even if their revenue yields are low. This results in failure to institute sophisticated taxes whose implementation requires high levels of sophistication in tax administration. The choice of such easy-to-administer taxes not only leads to distortions in the country's tax structure but also affects its ability to provide the necessary incentives for economic growth.

A weak tax administration also limits governments in their choice of tax options, making it difficult for them to undertake a comprehensive review of their tax laws in order to make them simpler, clearer, more equitable and neutral. The important thing, however, is that the difference between the taxable capacity of a country and the tax effort levels can and should be reduced by improved tax administration (Fjeldstad & Rakner: 2003).

The institutional framework within which the revenue administration operates impacts directly on the effectiveness and efficiency of the overall tax management. However, Devas, Delay and Hubbard (2001) in their study on effectiveness and efficiency in Kenya, Tanzania, Zambia and South Africa argue that both tax administration reforms and tax policy reforms must be implemented concurrently in order to have an effective and efficient fiscal management system which is prudent, transparent and accountable. This implies that tax administration reforms are not the only vehicle that can solve all problems, there is need to espouse wider reforms that touch on all institutions, policies and tax laws that affect efficiency and effectiveness in tax collection.

With tax administration being one of the key components of reform, it is imperative that the institutional framework is chosen appropriately. The institutional frameworks in operation in developing countries are many and varied. The general trend, however, is to have separate administrations for internal taxes and customs duties as is the case in such countries as Barbados, Ghana, Nigeria, Sierra Leone and Zimbabwe (Fjeldstad & Rakner: 2003). In some other countries, such as Brazil, Mexico, the Netherlands Antilles and Suriname, there are joint administrations of these taxes. Another common feature is that most of these administrations are part of the Civil Service machinery of the countries (Taliercio: 2004). Yet another feature is the location of the assessment and collection functions within the tax administration. The exceptions are Chile, Costa Rica, El Salvador and Peru, where the collection function is performed by a unit separate from the tax administration (Devas et al: 2001).

When it comes to the provision of support services for the tax administration, the institutional arrangements with regard to tax administration are by no means uniform. While in Ghana, India, Chile and Colombia legal services are incorporated within the tax administration itself, in some other countries they are provided by the Ministry of Justice

(Taliercio: 2004). In some countries, personnel development and training are the responsibility of units within the tax administration. In others, however, they are performed by units outside the tax administration (Devas et al: 2001). Similarly, in many countries responsibility for the provision of other support services such as taxpayer services, internal audit functions, tax processing, data processing and management units for controlling, evaluating and coordinating plans and programmes is located in units and departments outside the tax administrations (Mookherjee: 1997).

Even though, as indicated, the institutional frameworks of revenue administrations in developing countries differ from country to country, they appear to have some common problems, which need to be addressed (Fjeldstad & Rakner: 2003). The first of these is again described by Surrey (1958:96) as follows:

Many countries really possess no such clear picture of their tax systems. Instead, there often exists a bewildering array of overlapping and contradictory taxes. Many of these taxes overlap so that a single commodity or transaction may be subject to a number of taxes, imposed at different or supplementary rates involving different tax bases with different times of payment, different returns and separate administrative and judicial procedures. Some of these taxes are obsolete yielding only small revenue or sometimes nothing at all, but remain on the books to complicate the tax structure.

Other tax administrations are so riddled with exemptions as to be scarcely applicable to anyone (Tanzi & Zee: 2001). Moreover many tax measures are simply charges and fees for government concessions or services. Often the administrative provisions and judicial procedures of an existing tax are applied without change to new taxes because they are enacted without any examination of the differing requirements that the new taxes may warrant. In addition, the same words will be used in various tax laws but with different definitions or without definitions at all, so that only confusion in application can result. Further, the controlling laws themselves may be extremely difficult to locate. Very often there is a tangled mass of laws, regulations, decrees and the like reaching far into the past, jumbled together with amendments and modifications. When the statutory picture is so confused, it is extremely difficult for the government to know what it must administer and the taxpayers do not know what laws they must comply with (Aprill: 2001).

One solution to the problem presented by this “tangled mass of laws” is to have the various laws codified. This can be based on an orderly statutory rearrangement of the entire tax system in accordance with a definite outline (Central Statistical Office: 2003; Aprill: 2001). The various taxes should be classified as income taxes, succession taxes, property taxes, excise and sales taxes, and so on. Each in turn should be sub-divided so that each tax is separately identified. Overlapping between the taxes should be eliminated, with the various taxes applicable to a single article or transaction consolidated into one tax. Moreover, the substantive provisions describing the articles or persons taxed and fixing the rate and base of the tax should be separated from the administrative provisions. The latter should be divided functionally, as respects the returns to be filed, the time for payment, the other duties of the taxpayer, the powers of the administrator, the penalties imposed, among others (Thuronyi: 1996; Steuerle: 2004).

Tax laws by their very nature are subject to frequent changes. Every year the annual budget statement introduces new measures and procedures, amends, or cancels existing ones. These frequent changes can make the law confusing as well as complicate the tax structure (Manasan: 2003). After a few years, these changes and amendments become so many that the taxpayer finds it difficult to know which laws are applicable. As Talierco (2004) suggests there is a need therefore for the tax administration to undertake periodic consolidation of the tax laws so that it can have all the amendments and changes compiled into one statute to which both taxpayers and tax administration can have easy and ready access. Another institutional arrangement that seems to impede the efficiency and effectiveness of tax administrations in some of these countries is the linkage of the revenue administration with the Civil Service (Taliercio:2004). The revenue administration, therefore, reflects the weaknesses and structural defects existing within the Civil Service organization, especially excessive bureaucracy, low morale and the inadequacy of resources.

In the light of these problems, many developing countries have now embarked on a restructuring programme of their revenue administrations (Fjeldstad & Rakner: 2003). This exercise has resulted in the adoption of an institutional framework within which the revenue administrations have been made semi-autonomous and excised from the Civil Service, thus freeing them from the problems that plague the Civil Service. One of the

pioneers in this restructuring exercise in Africa, whose results have been adopted in other countries in Africa, albeit with slight modifications, is Ghana (Addison et al: 2001).

3.6 Conclusion

It can be said that tax revenue can only be enhanced if tax administration is efficient and effective and serious efforts are made to broaden the tax base through policy strategies such as capturing the informal real estate (housing) sector among others. In light of Zambia's need to broaden its tax base and of recently scholarly debates on related topics, this chapter has sought to highlight the current thinking which indicates how to accomplish this goal. Drawing lessons from some developing countries such as Ghana, South Africa and Kenya, Zambia needs to introduce or strengthen such taxes as the base, withholding and presumptive taxes. Introducing or consolidating these taxes would be meaningless unless tax administration in Zambia is made efficient through legal reforms.

This chapter demonstrates that there are different strategies that countries are using to capture the informal sector into the national tax net. These strategies form the basis upon which this study has drawn to explore ways in which Zambia can broaden its tax net, by bringing the informal real estate housing sector into the national economy. The chapter also illuminates the fact that the informal real estate housing sector has the potential to contribute to the tax revenue of any nation. However, it is clear from the literature reviewed in this chapter that bringing the informal sector into the tax net is complex and needs well thought through policies and strategies. For example, the chapter provides evidence that there is substantial income that can be generated from the informal real estate housing sector. But because of the fears of tax revolts if this tax was collected directly, district councils opt to engage an indirect way of collecting it through property taxes. It is evident that substantial revenue could be raised through taxing the informal real estate housing sector by targeting the high-density, medium-density and low-density residential categories. The next chapter discusses the methodology used in this study. The chapter provides a situational analysis of each residential category discussed above and how much tax revenue could be collected from each category in the Lusaka Urban District in comparison with the actual revenue collected by the Zambia Revenue Authority, to determine the potential tax revenue gap.

CHAPTER FOUR

METHODOLOGY

4.1 Introduction

This chapter describes the research methodology that was used to estimate tax revenue that can be collected from the informal house rental market in the Lusaka Urban District of Zambia. Kerlinger (1970) defines research as the systematic, controlled, empirical and critical investigation of hypothetical propositions about the presumed relationships among natural phenomena. Lusaka was purposively picked from a number of major cities and towns with developed rental markets. During the research process, it became evident that Lusaka Urban District has statistics of rented accommodation or rather houses where tenants pay rent (Central Statistics Office: 2006). These statistics have been used in a mathematical model to estimate the potential tax revenue that can be collected from the informal real estate housing sector in the Lusaka Urban District. The research also demonstrates that a similar approach can be used to estimate the potential tax revenue that can be collected from the informal real estate housing sector in the whole country.

This section of the study also explains the research methods, data sources, data collection techniques, data organization, and data analysis. It also explains how other taxes on the informal sector business can be computed and estimated, with the focus on the recently introduced advance income tax enforced on imports by unregistered taxpayers or importers. These estimates of potential revenue from turnover taxes are compared with actual revenue collected. These estimates are then consolidated to show the extent of revenue that can be collected from informal sector business in Zambia.

4.2 Data Sources

4.2.1 Central Statistical Office and Zambia Revenue Authority

Data needed to estimate the potential tax from the real estate housing informal sector are available at the Central Statistical Office (CSO) and the Zambia Revenue Authority. Data was collected from the CSO housing census survey of 2004 and 2005 for Lusaka, to

determine the number of housing units, which include data on whether a housing unit is rented out or not. The data also contains basic housing attributes such as number of rooms, location, whether electrified or not and whether it is connected to regular municipal water supply or not. These attributes and other neighborhood attributes influence rental prices. It is, however, not the objective of this study to establish what attributes influence rental prices, although it is an interesting area for future research. Tax information was collected from the Zambia Revenue Authority database, including tax rates and actual tax revenue.

4.3 Data analysis

4.3.1 Analysing Data from the CSO for Potential Tax Revenue from the Informal Housing Sector

The approach used to estimate the total withholding tax on informal housing rental income was developed as follows: first it was assumed that a standard housing unit with a set of physical and neighborhood attributes (j), attracts a rental price r_{ij} . It is also assumed that there are k landlords in the study area (City of Lusaka) with h_{ij} residential housing units of different attributes on rent (k and i denote the k th and i th landlord and housing units respectively). Further, it was assumed that landlords are not registered for withholding tax and hence do not pay any tax on rental income, but that it is the tenant's responsibility to withhold the tax component on his rent and remit it to the Zambia Revenue Authority. The research interest was not to compute the tax payable to the Zambia Revenue Authority from rental income appropriated by the landlord, but the tax that was collectable on rent that the tenant should have withheld and remitted to the Zambia Revenue Authority.

The annual rental income per housing unit is denoted with y_{ij} and attributes by y_{ij} . Then the landlord's gross rental income per annum is calculated by multiplying rental price by the number of housing units owned. This is formally stated as:

$$\sum_{i=1}^n y_{ij} = \sum_{i=1}^n (r_{ij} \times h_{ij}) \quad (1)$$

Total rental income is multiplied by the withholding tax rate of t^* to obtain the total tax revenue from the informal housing real estate sector in Lusaka urban area. This can be stated as:

$$Tax = t^* \sum_{i=1}^n y_{ij} \quad (2)$$

Equation (2) shows the total potential tax revenue that government can collect from the informal housing rental market, assuming costless enforcement and full compliance. In other words, it gives the potential tax revenue that can be collected, assuming 100 percent enforcement, and this is then compared to the actual revenue that the tax authority collected in 2005.

4.3.2 Analysing Data from ZRA for Potential Revenue from the Informal Sector

This section presents an approach used to measure the potential income and the tax that can be collected from those involved in cross-border trading who are not registered for taxes and those who have not been compliant with income tax in the previous year, that is, for 2006 and 2007. An analysis was made of the recently introduced advance income tax collected at the border on imports by unregistered and non-compliant traders. These traders pay 3 percent advance income tax on the total landed value of their imports, but can claim the full amount of advance income tax paid on their imports when they file their income tax returns with the domestic taxes division. Those not registered cannot claim the advance income tax, in which case this tax becomes a final tax to government. Since the advance income tax is levied on imports of unregistered traders, data on imports into the country is used for this group of importers for the period of one year to compute the amount of turnover tax expected (potential) to be collected inland if all unregistered importers were to truthfully declare their local sales and pay 3 percent turnover tax on sales. This value represents the minimum turnover tax that would have been collected if the advance tax was collected at the border; the value is expected to be larger if unregistered traders paid tax on turnover tax locally since 3 percent on the total cost of goods is less than 3 percent on total sales. It is also important to note that this

estimate only applies to cross-border trading by unregistered traders. Those who are registered are captured either in company tax or turnover taxes.

CHAPTER FIVE

APPLICATION OF THE PRESUMPTIVE TAXATION TECHNIQUES TO THE INFORMAL REAL ESTATE HOUSING SECTOR IN ZAMBIA

5.1 Introduction

Chapter 4 discussed the research process and methodology. It also introduced a mathematical model upon which the computation of the potential tax income from real estate was based. Drawing on the mathematical model and statistical data from the Central Statistical Office, this chapter discusses the potential income that the Zambia Revenue Authority could capture by taxing real estate housing sector. The chapter also discusses some of the taxes that have been introduced to capture income from the informal sector.

5.2 Tax Collection from Informal Sector Businesses

There are a number of strategies that the government has put in place to bring income from the informal sector into the Treasury through the tax system. The performance of different taxes that have been introduced to capture the informal sector into the tax net is set out below and in the last section a summary of the overall performance of these taxes between 2004 and 2007 is provided.

5.3 Presumptive tax on Taxi and Minibus Operators

The presumptive tax regime was introduced to capture public transport operators (minibuses and taxis) who are not registered under company tax. Transport operators in this category pay a daily fee or tax based on minibus seating capacity as shown in Table 5.1 below. The Zambia Revenue Authority has increased collections from this tax from this section of the economy from K1.0 billion in 2004 to K1.85 billion in 2006 and 2007 respectively.

Table 4 - Tax Paid By Minibus Operators per annum

Type Of Vehicle	Amount Of Tax Per Vehicle Per Year*
64 seater and above	K7,200,000
50-63 seater	K6,000,000
36-49 seater	K4,800,000
22-35 seater	K3,600,000
18-21 seater	K2,400,000
12-17 seater	K1,200,000
below 12 seater (include taxis)	K600,000

Note: * The amounts payable are broken down into daily tickets to make the amounts more affordable.

5.4 Advance Income Tax

Advance Income Tax is a tax withheld in respect of imported goods for commercial purposes. This means that goods imported for personal use are excluded from this tax (Zambia Revenue Authority, 2007).

The purpose of introducing the Advance Income Tax in 2007 was to broaden the tax base by targeting more profitable sections of the informal and unregistered enterprises which are engaged in cross-border trading. Advance Income Tax is computed at the point of entry at the rate of 3 percent on the value of imports for unregistered importers and non-compliant taxpayers. Advance Income Tax is not a final tax. The initial objectives of this tax were to encourage non-registered businesses to register for taxes and also to make enforcement of compliance on traders more cost effective.

The impact of the introduction of advance tax both on registration of businesses in the informal sector and enforcing compliance on small scale enterprises and self employed

individuals has been impressive. Upon its introduction in April 2007, the Zambia Revenue Authority collected about K13 billion from unregistered importers in 2007.

This tax has helped to increase tax collection from more profitable informal sector activities and is expected to improve compliance on turnover tax and help to capture the informal sector into the tax net. With increased compliance strategies implemented in 2008, monthly tax collection on advance income tax has increased from K526 million in January 2007 to K4.2 billion in April 2007, raising K8.1 billion from this tax type alone between January and April 2008 (Bwalya & Sigande: 2007).

5.5 Turnover Tax

Turnover tax is a tax on gross sales/turnover, that is, earnings, income, revenue, takings, yield and proceeds (Zambia Revenue Authority: 2003). Turnover tax is collected from businesses whose turnover is less than K200 million and hence not eligible to register for company tax. This tax is directed at any person whose business earnings are subject to Withholding Tax and such Withholding Tax is not the final tax. This includes businesses and individuals earning rental income, commissions, interest and royalties. This tax has been quite productive, increasing its contribution to revenue from K4.3 billion in 2004 to K18.7 billion in 2007 (Bwalya & Sigande: 2007) It is expected that the productivity of this tax will continue to grow as new and more cost-effective compliance strategies are implemented.

5.6 Base Tax

The base tax is a tax mainly collected from market places. The tax is collected in partnership with the local authorities and is a major source of revenue in most rural and provincial centres. Base tax is currently applied in those towns where it is easy and practical to collect. It is not administered in major towns. Base tax is levied on small-businesses that cannot maintain adequate records on which to base a correct tax assessment at the end of the charge year. In 2007 the base tax rate was increased to K150, 000 from K50, 000 per charge year. The mechanisms for collecting this tax are more challenging and expensive, but new strategies are being worked out to engage with local councils to help in the administration of this tax. Collections from base tax are recorded under turnover tax.

Table 5 - Trend in revenue collections from informal sector (K' billion)

Tax Type	2004	2005	2006	2007
Presumptive Tax	1.0	1.05	1.85	1.82
Turnover tax	4.3	9.8	13	18.7
Advance Income Tax	-	-	-	13.0
Total	5.3	10.85	14.85	33.52

*Advance tax was introduced in April 2007.

(Source: Zambia Revenue Annual Report, 2007)

Table 5 above summarizes the performance of taxes that target informal or small businesses and self-employed individuals. All tax types have more than doubled their contribution between 2004 and 2007, while the Advance Income Tax, which was only introduced in 2007, has made a significant contribution to revenue from the informal sector. The total collections from these taxes increased from K5.3 billion in 2004 to K33.54 billion in 2007 (Bwalya & Sigande: 2007; Phiri: 2007). This is a substantial contribution to the Treasury by this sector.

5.7 Estimating Potential Revenue from an Advance Tax on Importations

This section of the present study analyzes the impact of introducing an advance tax on importations by unregistered traders as a means to promote tax registration, and indirectly assesses how this measure can be used to improve compliance under the turnover tax. In other words, how much revenue would be collected from advance tax and how the established database of traders can be used, is examined to estimate the possibility to enforce compliance and improve revenue collection from small businesses operating informally (unregistered for taxes).

The major objective for introducing an Advance Tax was initially to encourage individual businesses to register for taxes as those not registered would suffer an advance tax of 3 percent at time of importation. This tax is not a final tax; it can be claimed back when the

taxpayer files an income tax return with the Domestic Taxes Division. While increasing tax registration was the rationale used to have this measure passed, the measure had the potential to raise revenue in 2007 estimated at K20 billion, and is important to the Zambia Revenue Authority because it can be used to promote compliance among importers registered under the turnover tax. This is possible because the Zambia Revenue Authority now has a database on the Automated System of Customs Data (Asycuda) against which to estimate the minimum tax payable by those involved in cross border trade.

5.8 Advance Tax and Tax Administration

By the end of 2007, the Zambia Revenue Authority collected about K13 billion in advance tax revenue, which is assumed to be net as advance tax claims are negligible, if not zero. It is difficult to ascertain the impact of advance tax on income tax registration recorded in 2007. The trends in tax registration indicate that the total number of taxpayers registered for income tax increased from 44,490 in 2006 to about 54,419 in December 2007 (Zambia Revenue Authority: 2007). But this increase is not remarkably different from that recorded between 2005 and 2006, when registrations increased by 13,757 (Zambia Revenue Authority, 2007). It is therefore difficult to attribute the increase in income tax registrations solely to the introduction of advance tax; at most the impact is likely to be marginal (Bwalya & Sigande: 2007).

5.9 Non-Compliant Taxpayers

The present study has extracted from the Integrated Tax Administration System (ITAS), the number of firms that did not file their income returns in the charge year ending September 2007. This is after taking into account multiple account numbers on the system to remove duplications. The data indicates that there are about 51,190 taxpayers registered for income tax. Of these, 18 percent (9,164) filed their income returns in 2006 and 2007 and 82 percent did not. Of these only 24 are registered as government departments and 330 as non-governmental organizations. What is important is to examine how many of these made importations in 2007 because, for these, a more effective compliance strategy can be configured in the Automated System Customs Data

(Asycuda) to ensure that in future they pay advance tax on their importations, and possibly recover any advance outstanding tax obligations from the past (Phiri: 2007).

Of the total number of taxpayers who did not file income tax returns (41,696), only 5 percent made importations in 2007, amounting K16, 718 billion in terms of value for duty purposes. Importations by non-compliant taxpayers account for 99.9 percent of this value and the rest (0.1percent) is accounted for by importations by the government, agencies and non-governmental organisations. Since these traders were registered by taxpayer identification number and for income tax, the advance tax of 3 percent was not charged on their importations in 2007, with the hope that they would declare their income tax when they do their turnover tax returns. The present study therefore attempts to calculate the minimum tax that would have been collected if these firms had paid a 3 percent advance tax at the time of making an importation.

5.10 Potential Revenue from Advance Income Tax

The Advance Tax has been calculated that would have been collected from these non-compliant firms if they had been made to pay tax at the border. This value represents the minimum turnover tax that would have been collected if the advance tax was collected at the border; the value is expected to be larger if taxpayers paid tax on turnover. The total value of importations obtained from the Asycuda database for those taxpayers who did not file an income tax return in the charge year ending September 2007 was multiplied by the advance tax of 3 percent as legislated in 2007. The value of the duty for the purpose of importations by non-compliant taxpayers is estimated at K 16,717 billion. Applying a 3 percent advance tax on this figure would have raised K501.5 billion in advance tax revenue in 2007 (Bwalya & Sigande: 2007).

The key policy question is how to ensure that this amount is collected from non-compliant traders at the lowest cost to the Authority. The compliance and revenue recovery strategy as set out below, was proposed. Since it is known that at best K501.5 billion in advance tax would have been collected on importers who fail to comply with tax payments, it is recommended that Domestic Taxes enforce compliance on these firms through customs clearance by reconfiguring the database on Asycuda. Removing non-compliant taxpayers from the Asycuda database has the effect that when these non-

compliant businesses in future make importations, advance tax can automatically be levied and collected right at the port of entry. This measure will not recover the estimated revenue but will raise significant revenue at almost zero enforcement cost to the Authority. Once the non-compliant importers have paid 3 percent advance tax on their current importations, they should further be required or at least advised to settle any advance unpaid tax on their imports in earlier years.

For those taxpayers who did not import anything but who are non-compliant because they did not file their income tax returns in the charge year 2006 and 2007, these should also be removed from the Asycuda database so that should they decide to import in future, advance income tax can be charged and collected on all their imports until when they are cleared by Domestic Taxes as compliant.

In addition to these measures, Domestic Taxes should use this information to enforce compliance on these taxpayers inland.

5.11 Potential Revenue from the Informal Real Estate Sector in Lusaka

The principle objective of this study was to estimate the amount of tax revenue that can be collected from the rental from the real estate informal housing sector in Zambia, using the town of Lusaka as a case study. This town, which is also the capital city of Zambia, was chosen because more accurate data is available and it also has the largest informal rental housing sector in the country.

Table 6 below shows estimates of potential income generated in the informal rental housing sector in Lusaka and the corresponding tax revenue that can be collected when full compliance is assumed. In the first column, three residential categories are reported. These are high density (low income), medium density (middle income) and low density (high income) residential categories. Column two shows the number of households in each residential category that live in rented accommodation. Column three shows the average rental price per housing unit and columns four and five show monthly rental income that accrues to landlords and the estimate of total monthly tax revenue per residential area respectively. The last column shows the total potential annual tax revenue

that would be collected if compliance was fully enforced. The withholding tax on rental income is set at 15 percent.

Table 6- Estimated Annual income and potential tax revenue for Lusaka urban district (K millions)

Residential Areas	Number of Households in Rented houses (h_{ij}) (a)	Rental Price Per month (K'000') (r_{ij}) (b)	Estimated rental Monthly Income $(y_{ij}) = (a * b)$	Tax revenue per month $tax = (r_{ij} * y_{ij})$	Potential Annual Tax Revenue Estimate $t * (12y_{ij})$
High density	177, 209	150.5	26,669.9	800	9,601
Medium-density	23, 052	450.5	10,385.0	0.311	3.74
Low-density	24, 243	2, 500	60,608	9.091	109. 1
Total	224,504	Na	26,740.95	809.40	9,713.8

Source: CSO (2000).

Note: Income from medium and high density housing units is taxed at a 3 percent turnover tax rate and low density housing units at a withholding tax rate of 15 percent.

Of the total housing units, about 78.9 percent of the housing units surveyed are located in high density residential areas and only 10.2 percent and 10.9 percent are in medium density and low density residential areas. As expected, there are significant differences in

rental rates, with housing units in the low density areas costing K2.5 million per month while those in medium and high density residential areas priced at K450, 500 and K150, 500 respectively. When the rental rate is multiplied by the number of rented housing units in each category, it is found that on aggregate, the largest rental income is appropriated by landlords with housing units in high density areas, followed by those with housing units in medium and high residential areas.

The total monthly rental income from high density housing units is estimated at K27 billion, K10.4 billion for medium density housing units, and K60.6 billion for low density housing units in Lusaka Urban. This means that the total annual rental income for all residential categories is K809.4 billion. The current tax regime imposes a 15 percent withholding tax for rental income above K200 million per annual, and a turnover tax of 3 percent on income below this threshold. These rates are applied to compute the potential tax revenue in each of the residential categories, with the medium and high density housing units being taxed at 3 percent and the low density housing units at 15percent. The estimated annual tax yield is specified in the last column of *Table 6*. The total potential tax revenue collectable is estimated at K9, 713 billion per annum for the Lusaka Urban Sector only. These estimates indicate that the greatest potential to capture revenue lies in the high density residential areas through turnover tax. Enforcing compliance in this market segment is costly and problematic, although not necessarily insurmountable. The challenge lies in formalizing property rights (title deeds) to landlords of these housing units. At present most of these units have no formal title deeds and are therefore difficult to capture in the tax net.

5.12 Potential National Real Estate Tax Income

In this section, the study extrapolates the Lusaka potential real estate tax income to the national level. There are 1,768,287 housing units in Zambia (Central Statistical Office: 2000). Of these, 1,170,781 (66.2 percent) are in rural areas and 597,506 (33.8 percent) in urban areas. 93 percent of housing units in rural areas are owner occupied and only 7 percent are rented. In the case of urban areas 46.6 percent of the housing units are rented. The information in column 1 of *Table 7* was used to estimate the distribution of housing units, which indicates that 78.9 percent, 10.2 percent and 10.9 percent of housing units

are in high, medium and low residential categories respectively. Rental rates vary by location and across towns, and specific information on average rental rates for the purpose of making accurate estimates is not available, except for Lusaka Urban. Therefore average rental prices for all towns in the country are estimated at 50 percent of rental prices in the Lusaka Urban District. This is close to the average rental price at national level.

Table 7: Potential rental revenue from all rented housing units in Zambia (K millions)

	housing categories	No. of rented housing units	of rented units	total rental income/m	rental income per yr	tax revenue per yr
All rural rental housing units	High density	923,746	64,662	4,865.8	58,389.9	1,751.7
	Medium density	119,420	8,359	1,883.0	22,595.4	677.9
	Low density	127,615	8,933	11,166.3	133,995.9	4,019.9
	Subtotal (rural)	1,170,781	81,955	17,915.1	214,981.3	6,449.4
All Urban rental housing units	High density	471,432	219,687	16,531.5	198,377.7	5,951.33
	Medium density	60,946	28,401	6,397.2	76,766.2	2,303.0
	Low density	65,128	30,350	37,937.2	455,245.8	68,286.9
	Subtotal (urban)			60,865.9		

		597,506	278,438		730,390.5	76,541.2
Total All	GRAND					
	TOTAL	1,768,287	360,392	78,780.9	945,371.8	82,990.6
At 50	Total					
percent tax		884,144	180,196	39,390.5	472,685.9	41,495.3
compliance						

Source: CSO: 2000 housing census report. Rental prices are K75, 000, K225, 000 and K1, 250,000 for high, medium and low residential housing units.

Rental income for all rural households is below the rental withholding income threshold and hence taxed under turnover tax at 3 percent. This is also the case for rental income in urban areas for high density and medium density housing units, but low density housing units are taxed at the withholding tax rate of 15 percent since income is above K200 million. With this assumption, the estimated national rental income per annum is K945.4 billion, of which 77 percent is from the urban rental housing sector and the remainder is from the rural sector (33 percent). Applying the appropriate tax rates yields a total potential revenue of K83 billion per annum, which is approximately 0.2 percent of projected Gross Domestic Product (GDP) in 2007. This would still make a significant contribution to the National Treasury even if this estimate had to scale down by 50 percent to take into account the low tax compliance levels in this sector.

CHAPTER SIX

REFLECTIONS, CONCLUSIONS AND RECOMMENDATIONS

6.1 Introduction

This chapter marks the end of the thesis with a reflection on the objectives and methodology in the light of the findings and insights of the study. It also discusses the recommendations and reflects on the lessons learnt.

6.2 Reflections

The principle objective of this study was to analyze the tax revenue that can be mobilized from the rental housing sector and to estimate the potential revenue that can be raised by putting in place a more efficient regime. Using data from the housing survey conducted by the Central Statistics Office and data on actual tax collections from the real estate sector, the findings show that there is great potential to mobilize substantial tax revenue to help finance the country's development program. The findings of the study demonstrate that the real estate sector, which in recent years has consistently posted high growth rates, can help to create substantial fiscal space by broadening the country's tax revenue base. But this can only be realized by undertaking tax policy and legislative changes aimed at encouraging voluntary compliance and enhancing revenue collection from this sector.

Critical to such reforms is the need to ensure that the compliance burden falls on the landlord and not the tenant as the case is now. This will ensure that tax liability on rental properties which has not been remitted to the Zambia Revenue Authority can be recovered from the physical asset generating that income stream on which the withholding tax is collected. The study found that at present the revenue laws place the compliance burden on the tenant to withhold and remit the 15 percent tax on rental income. In addition, the study findings reveal significant weaknesses in enforcement by the Zambia Revenue Authority and sustaining compliance and revenue productivity of the rental withholding tax on real estate.

In terms of estimates of potential revenue that can be collected, assuming costless enforcement or 100 percent self compliance, the study results show that rental income from high density housing units is estimated at K26.6 billion per annum and income from low and medium density housing units was estimated at K10.4 billion and K60.6 billion per annum respectively. The total potential tax revenue collectable was estimated at K9.7 billion per annum for Lusaka Urban district. These results indicate that the greatest potential to capture revenue lies in the high density residential areas. The challenge, however, lies in formalizing property rights (title deeds) to landlords as at present most of the housing units in medium and high density residential areas have no formal title deeds.

Further, the study finds that of the total 224,504 housing units surveyed in Lusaka urban, about 78.9 percent of the housing units are located in high density residential areas and only 10.2 percent and 10.9 percent are located in medium and low density residential areas. The analysis also reveals significant differences in rental rates, with rental rates on housing units in the low density areas on average K2.5 million per month while those in medium and high density residential areas are K450, 000 and K150, 000 respectively. This implies that those landlords with rental housing units in low density areas receive more income per month than those with housing units in medium and high residential areas, but it is not known whether this finding holds in net terms. The total tax revenue is estimated at K9.7 billion per annum. This figure is high on account of the large number of units compared to those in low and medium residential areas, but the major problem of capturing this revenue is that these housing units lack formal title deeds and the housing rental market operates informally. To achieve the revenue collections, the tax authority, the local councils and the ministry of land will have to work together and share information on the real estate sector to help better manage compliance.

In this context, the potential tax revenue that can be captured from informal housing rental market from the Lusaka Urban alone is quite significant and would represent 3 percent of collections from withholding taxes in 2007, of which rental withholding tax is just one of the taxes. The total revenue collection from all withholding taxes was K326 billion (Zambia Revenue Authority: 2007). The study estimates that at least K945.4 billion is earned from the rental housing sector per annum. Tax collections from this

source of revenue would have been K83 billion in tax revenue or 0.2 percent of Gross Domestic Product (GDP) in 2007. This is a significant contribution to National Treasury.

5.3 Conclusion

This study, in addition to capturing income from the real estate sector, demonstrates that there exists a great potential for expanding the tax net by innovatively applying and enforcing the presumptive tax regimes for informal sector businesses with an annual turnover below the threshold of K200 million. Study findings indicate that as much as K500 billion could be collected through the Advance Income Tax imposed on imports of unregistered importers and those not compliant with the turnover tax regime. Adding this estimate to the potential tax revenue from rental housing sector of K83 billion brings the total potential revenue to K583 billion. Over 90 percent of this revenue is currently not being collected.

One key research limitation is worth noting. Firstly, the study drew on secondary data on the number of housing units in various residential categories obtained by the Central Statistical Office in the 2000 National Census of Population and Housing. This data, however, lacks detail on rental prices of housing units across locations and towns. Thus estimates and the conclusions drawn in this study should be interpreted with caution. These results, despite the shortcoming, provide important insights about the rental housing sector and the potential to capture and mobilize government revenue from this sector that has had in excess of 6 percent growth rates since 2002. This information should prove valuable to future research on real estate in Zambia and other countries and indeed to policymakers concerned with improving revenue collections from this sector. Further, the analysis of the performance of presumptive tax regimes and how advance income tax can be applied to improve compliance with presumptive regimes shows some of the innovative approaches that can be designed and implemented to foster tax compliance among small and medium scale enterprises, including those operating informally.

5.4 Recommendations

Based on the findings of this research and the discussions herein, the study recommends that legislation should be reviewed to require that the landlord withholds the tax on rental

properties and remits it to the Revenue Authority and that enforcement of compliance be strengthened and penalties increased sufficiently so that the deterrence can be used to promote voluntary compliance and thereby lower the costs of collection. In order to promote compliance and increase revenue collection, efforts towards formalizing these transactions and assigning property rights (title deeds) should be expedited in order to bring these activities into the formal economy and the tax net. If rental income was to be subjected to presumptive tax regime at a flat rate of 3 percent, which is applicable to all businesses with annual turnover less than K200 million, the total tax that can be collected from the housing rental sector in Lusaka Urban is estimated at K9.7 billion. Households earning less than K200 million per annum from rental income should also be captured in the tax net. This will ensure that the application of the presumptive tax regime for the informal sector through turnover tax is equitable.

Government should revise the tax laws and ensure that landlords withhold and remit tax to Zambia Revenue Authority because enforcing compliance on landlords would be easier as their housing units can be held as security for unremitted taxes. Government should continue with the current tax threshold on rental income of K200 million but ensure that those whose rental income is below this threshold are taxed at the turnover tax rate of 3 percent. This will ensure equitable treatment of rental income with all other incomes in accordance with the Income Tax Act.

Government should simplify the taxpayer registration formalities. This entails the integration of registration for all tax types. The Taxpayer Identification Number (TPIN) should be used as a universal interface to give government access to all the tax types which are applicable to a particular taxpayer. This is in view of the fact that taxpayers, who are not registered for some taxes for which under the tax laws they are liable, may be eligible for a tax refund in other wing of the Zambia Revenue Authority.

Government should further streamline and enhance the institutional capability of the Zambia Revenue Authority to enforce the country's revenue laws including its capacity to investigate and prosecute tax evaders. This is critical in building voluntary compliance and sustaining a buoyant tax system. In addition the Zambia Revenue Authority should explore and establish effective partnerships with other government agencies and the

private sector, where for instance, the local councils may be subcontracted to collect some presumptive taxes in certain towns where collection by the Zambia Revenue Authority is not cost effective. It is important also to develop robust databases and share these with other government agencies to improve decision-making and tax compliance management.

The government and Zambia Revenue Authority should carry out educational campaigns programs to explain the importance of landlords paying tax on their rental income. In other words, in view of widespread apathy and political sensitivity towards the taxation of the informal estates housing sector, there is a need for government to own this campaign and provide the effective political will necessary to improve compliance and fair enforcement of tax laws. The government should adopt deliberate policies aimed at promoting formalization of the informal real estate housing sector and expedite the issuance of legal title to property. This will create the necessary database on housing units that can be used to enforce presumptive taxes and also help to better manage property taxes in the country.

Tax collection could also be enhanced if landlords are captured in the tax net through extensive use of utility companies such as Zambia Electricity and Supply Corporation (ZESCO), Zambia Telecommunications Limited (ZAMTEL) and Water and Sewerage companies, to the extent that when landlords are paying for their electricity, telephone and water services, details on whether they own or rent the houses with physical addresses for such properties should be indicated, which data could then be used by the Zambia Revenue Authority to ensure enhanced compliance by landlords.

Property assessment issues and tax issues should be kept apart. Valuations should not be manipulated or corrupted to attain equity. Equity is best attained through proper property categorization, adjustments to tax rates or the use of tax rebates.

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