Tax Exemptions and Tax Expenditures

Corporate Taxation in Zambia

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Acronyms

7NDP	Seventh National Development Plan
BOZ	Bank of Zambia
COMESA	Common Market for Eastern and Southern Africa
CTPD	Centre for Trade Policy and Development
DTA	Double Taxation Agreement
DTTs	Double Taxation Treaties
EITI	Extractive Industry Transparency Initiative
FDI	Foreign Direct Investment
FIC	Financial Intelligence Centre
FSRP	Food Security Research Project
GDP	Gross Domestic Product
GRZ	Government of the Republic of Zambia
IFFs	Illicit Financial Flows
IMF	International Monetary Fund
MFEZ	Multi Facility Economic Zones
ML/TF	Money Laundering and Terrorist Financing
MNCs	Multi-national Corporations
MoF	Ministry of Finance
MSMEs	Micro, Small, and Medium Enterprises
OECD	Organisation for Economic Co-operation and Development
PACRA	Patents and Companies Registration Agency
PEPs	Politically Exposed Persons
PRA	Pharmaceutical Regulatory Authority
SADC	Southern African Development Community
STRs	Suspicious Transaction Reports
VAT	Value Added Tax
ZDA	Zambia Development Agency
ZEMA	Zambia Environmental Management Agency
ZICTA	Zambia Information and Communications Technology Authority
ZRA	Zambia Revenue Authority

Abstract

Zambia, like most African countries, is extremely rich in natural wealth. Corporate entities extract these resources and make huge profits on their investments. Ironically, Zambia does not get a fair share from its natural wealth, and is currently classified as a poor country despite being very rich in natural wealth. This paper conveys findings from a desk study undertaken in January-February 2019 to understand Zambia's tax regime (incentives /exemptions) available to corporate entities operating or intending to set up business in Zambia. Findings indicate that Zambia is very generous in its tax exemptions, which highly favours big companies. The tax regime offers a 5 years tax free period supposedly to allow a company sufficient time to set up and stabilize its operations. Thereafter, tax payment is staggered in percentages up to 10 years, provided a company made profits in that fiscal year. In year 6 to 8 only 50 percent of profits are taxable while 75 percent of profits are taxable in year 9 and 10. Because of weak institutional capacity (for monitoring and policy/law enforcement), coupled with widespread corruption, this tax landscape leaves Zambia at the mercy or good will of corporate entities to truthfully declare their production and profits, upon which the tax regime is based. It is estimated that Zambia loses over US$4.5 billion annually through tax evasion and tax avoidance. The sad reality is that this situation is unlikely to change anytime soon, and there is very little hope to curb illicit financial flows as long as the current tax regime and institutional roles remain as stipulated in national laws.

1. Background

It is a well known fact that governments need money to govern and, therefore, have to raise funds to deliver public goods and services. Although government revenue may come from sell of goods and services (charge fees), borrowing and even grants, the biggest financial resources come from taxation which is important for both economic growth and balancing national budgets. Consequently, collecting sufficient revenues to finance their national budgets stands as a biggest challenge. When less revenue is collected because of too many tax concessions and tax breaks, public service delivery is compromised.

Taxes can both be an incentive or a disincentive. High tax levels can discourage foreign investors from going to invest in a country, or encourage domestic firms to relocate abroad. For this and other reasons, designing a tax regime that works for everyone becomes an important facet of public governance. Hence, the need to carefully consider tax incentives offered to ensure optimal benefits accrue to the nation. It is against this background that Jesuits Conference of Africa and Madagascar found it imperative to discuss how to improve domestic resource mobilization and explore ways to stem illicit financial flows from African countries. This paper presents a Zambian case study on tax incentives in Zambia and illicit financial flows.

2. Introduction

The Zambian government remains committed to pursue sustainable economic development and equitable growth. And this responds to its Seventh National Development Plan (7NDP, 2017-2021) whose core theme takes an integrated multi-sectoral development approach and focuses on "accelerating development efforts towards Vision 2030 without leaving anyone behind" (GRZ, 2016).

From time immemorial, Zambia has pursued a very generous tax regime which allows companies to operate for up to ten years at minimal tax contributions on their profits. And depending on how other agreements specify, e.g. some double taxation agreements (DTAs) Zambia has signed with other countries, tax exemption remains at zero in perpetuity. For instance, Irish companies operating in Zambia are not taxed at all because they derive additional benefits from Ireland-Zambia DTA which provides for zero taxation under a source country clause. This type of generosity does not only allow companies to extract Zambia's wealth free, but more importantly it robs Zambia of revenue needed to run government operations and create opportunities for its people to generate wealth. Due to this mammoth loss, Zambia remains a poor country despite being so rich in natural wealth both up and below ground.

Amidst this background, Zambia is unable to collect in full even the little tax the country is entitled to because of corruption and other illicit financial out flows. Until all forms of illicit financial out flows are addressed, Zambia will continue to face serious budget deficits and consequently forced to depend on borrowing. Furthermore, many studies have shown that tax incentives do not play a major role in investors' decisions regarding where to invest. Instead, investors look at other factors such as political stability, security of their investment, infrastructure, etc. Therefore, since tax incentives are not a major consideration for investment, a paradigm shift is urgently needed on Zambia's tax regime for the country to start getting real value from its national wealth. Zambia should offer lower tax bands and shorter concession periods. It is unlikely that many business entities will keep their doors open for 10 years while making losses! This is what the Zambian tax regime assumes; to "baby sit" these companies for 10 years without getting much from them.

3. Tax Incentives

Tax incentives are financial portfolios used to attract businesses to invest in a particular country (or location of that country) to boost economic growth. These may be tax breaks, subsidies (tax deductions or credits), exemptions, etc. Tax incentives are designed to assist companies to be profitable and create jobs, and ultimately bring economic benefits to the larger community. Governments consider themselves to be key beneficiaries in that as companies create wealth (profits and jobs), government will collect revenue through corporate income tax, individual employees (payroll income tax), property tax and several other sources connected to business operations. Zambia taps its revenue from various tax sources: income tax (pay roll tax; corporate income tax); customs and excise tax; loyalty tax; mineral tax; and value added tax. Among these tax sources, the easiest to collect has been payroll tax.

Zambia's corporate tax regime enforces provisions of the Zambia Development Agency (ZDA) Act, No. 11 of 2006, a principal law that gives investment incentives to corporate entities planning to invest or expanding their businesses in Zambia. The primary purpose of tax incentives is to attract investors, considered to be partners in the nation's development agenda, for jobs and wealth creation. Various investment incentives are offered in different sectors. This paper looks at different tax incentives offered and how the same impacts domestic resource mobilization, *vis-à-vis* government revenue collection. Are these tax incentives yielding the intended purposes or have they become a sink hole?

Since 2006 until last year (2018) when the tax incentives were slightly revised, companies registered under the Zambia Development Agency benefited greatly from Zambia's generous tax regime articulated in the Zambia Development Act of 2006, which offered 5 years tax free; and thereafter different tax percentages applied (below 100%), provided that company made profit. This paper reflects on this tax regime because it has implications on what happened over the last decade and counting.

The ZDA Act, No. 11 of 2006 offers a wide range of incentives in form of exemptions and concessions. From 2006-2017, the ZDA Act recognized and offered tax incentives to **five categories of investors**[2] as follows:

First category: business entities with more than US$10 million to invest in any sector or product. These companies are entitled to negotiate with government for additional incentives other than what they already qualify for under the ZDA Act.
Second category: corporate entities who invest not less than US$500,000 in a Multi Facility Economic Zones (MFEZ) and or in a sector or product classified as a priority sector or product under the ZDA Act.[3] In addition to general incentives, these investors are also entitled to the following incentives:

- Zero percent tax rate on dividends for 5 years from year of first declaration of dividends.
- Zero percent tax on profits for 5 years from first year profits are made; for year 6 to 8 only 50 percent of profits are taxable and in year 9 and 10, 75 percent of profits are taxable.
- Zero percent import duty rate on raw materials, capital goods, machinery including trucks and specialized motor vehicles for five years.
- VAT deferment on machinery and equipment, including trucks and specialized motor vehicles.

Third category: investors designated as micro or small business enterprises[4] under the ZDA Act. This group of investors is also, in addition to applicable general incentives, entitled to the following incentives:

- Income tax exemption for the first three (3) years, for an urban area[5] based enterprise.
- Income tax exemption for the first five (5) years, for a rural-based enterprise.

The ZDA Act is rather vague on its definition of a micro or small business enterprise; it does not assign any numerical investment threshold. However, a *Micro, Small, and Medium Enterprises Policy* provides more explicit definitions with investment thresholds (p5-6),[6] which are subsequently adopted in this paper.

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[2] Special thanks to Centre for Trade Policy & Development (CTPD) for permission to utilize material from its 2015 report on *Tax Incentives in Zambia;* a study undertaken by this same author.
[3] Refer to the Second Schedule of the ZDA Act of 2006.
[4] The ZDA Act defines a micro or small business enterprise (*Section 3*) as "any business enterprise whose total investment, excluding land and buildings, and annual turnover investment and the number of persons employed by the enterprise does not exceed the numerical value or number prescribed."
[5] The ZDA Act does not define "urban" and "rural area" leaving their interpretation open, which can be problematic.
[6] Ministry of Trade, Commerce and Industry (2009), *Micro, Small, and Medium Enterprise Development Policy of 2009*

Fourth category: those who invest less than US$500,000 in a sector or product classified as a priority sector or product under the ZDA Act. This category is only entitled to general incentives.

Fifth and last category: caters for people who invest any amount in a sector or product not classified as a priority sector or product under the ZDA Act. This category of investors is only entitled to general incentives provided under other various pieces of legislation.

New Incentives (since 2018)

Since 2018 revision to Procedures and Guidelines for Certificate of Registration/MFEZ Permit, the ZDA now offers essentially similar incentives, both fiscal and non-fiscal incentives, but at a reduced investment level. These incentives now only apply to companies investing in two categories: i) Manufacturing and ii) Priority sectors. Certificate of registration is valid for 10 years from time of issue, and subject for renewal before expiry date.

i) Manufacturing

Companies who invest more than US$500,000.00 in a Multi-Facility Economic Zone, Industrial Park, or Rural area are entitled to the following fiscal incentives:

a) Accelerated depreciation on capital equipment and machinery (fixed assets).
b) Zero percent import duty rate for five (5) years on capital equipment and machinery.
c) Investment guarantees and protection against state nationalization
d) Free facilitation on applications for immigration permits, secondary licenses[7], land acquisition and utilities.

ii) Priority sectors

Companies who invest not less than US$500,000.00 in a priority sector are entitled to:

a) Zero percent import duty rate for five (5) years on capital equipment and machinery.
b) Investment guarantees and protection against state nationalization
c) Free facilitation on applications for immigration permits, secondary licenses, land acquisition and utilities.

Priority sectors with respective eligible activities for tax incentives purposes are specified in *Table 1* below.

[7] Examples of secondary certificates include: environmental impact assessments from Zambia Environmental Management Agency (ZEMA); telecommunications license from Zambia Information and Communications Technology Authority (ZICTA); medical facility licenses (e.g. hospitals, clinics, drug companies, etc.) from Pharmaceutical Regulatory Authority (PRA); manufacturing licenses from local authority; financial institution license from Bank of Zambia; stock broker license from Securities and Exchange Commission; etc.

Table 1: Priority Sectors and Eligible Activity for Tax Incentives

Investment	Sector	Eligible Activity
1. Construction of Infrastructure, excluding renovation, expansion, and refurbishment	a) Education	Construction of education & skills training institutions.
	b) Health	Construction of health centres as specified under the Health Professions Act 2009.
	c) Tourism	Construction and establishment of hotels; convention centres; exhibitions centres; museums; theme parks; art galleries; theatres; large retail complex (containing ten or more stores, restaurants, or other business establishments housed in a series of connected or adjacent buildings or in a single large building).
	d) Housing	Develop fifty (50) or more houses maintained under one management control, and provides roads and other essential services to use such houses.
	e) Agriculture	Construction of crop and grain storage facilities.
2. Energy and Water Development	a) Fuel	Building and installation of processing and refinery plants for bio-fuel.
		Construction of petroleum refineries; pipelines; and rural (gas) filling stations.

Non-fiscal Incentives

Under the ZDA Act, people who invest not less than US$250,000.00 in any sector or product are now only entitled to non-fiscal incentives listed below.

a) Investment guarantees and protection against state nationalization
b) Free facilitation on applications for immigration permits, secondary licenses, land acquisition and utilities.

Government also introduced amendments to the Income Tax as well Value Added Tax. For instance, Amendment 16 of 2017 on Income Tax introduced accelerated depreciation on equipment and machinery, which essentially makes companies to pay less tax. This provision was effective 2018.

In December 2018, government again made revisions to the Income Tax and VAT, and both amendments came into effect on 1st January, 2019. Among other things, revisions on income tax provided for computation of business gains, profits, and interest (including disallowed interest) (Section 2 of the Amendment), in accordance with Section 82A of the principal Act. Furthermore, the revision provides guidance on computation of indexed losses (Section 3) and indexed capital allowances (Section 4). In short, government gave more tax concessions to investors.

On VAT, the amendment introduced and demanded use of "electronic fiscal devices" (instead of a "fiscal cash register") to improve efficiency and effectiveness in capturing information at point of sale "for tax purposes and printing invoices" (Section 2).

Economic Indicators

Economic indicators helps to understand how well an economy is performing – is there growth or stagnation? Zambia's economic indicators show a stable but not glamorous outlook. Except for total exports which seem to have recorded some growth between 2010 and 2013, there is a downward spiral in almost all indicators (*Table 2*) suggesting the need to arrest problems contributing to this scenario. One area that comes to mind is the generous tax incentives that government offers (e.g. 5 years at zero tax) which in a way keeps substantial amounts of tax revenue from being collected and ploughed back into the economy. With such a generous tax incentive regime, one would expect reciprocal tax compliance from companies who have been helped to set up business tax free for the first five years and more tax breaks thereafter up to 10 years. But this does seem to be the situation. Instead, companies continue to engage in activities that take money out of Zambia rather than getting injected in the same economy. Furthermore, assuming that tax incentives lead to increase in FDI inflow, one would expect high industry, more employment levels and subsequently lower poverty levels. However, poverty is still a huge challenge in Zambia; many people are struggling to have a decent livelihood. An analysis by Zambia Food Security Research Project (FSRP) showed 89.6% as poor rural households, while the national extreme poverty stood at 42.3%. With respect to income and wealth distribution, Zambia's Gini Index[8] stands at 57.1, indicating that economic inequality is quite high. Such economic imbalance should be an area of concern bcause it might be an indicator of government's inability to collect revenue or mismanagement of the same and therefore unable to create tangible benefits to society.

Table 2: Selected Macro-economic Performance Indicators, 2010-2017.

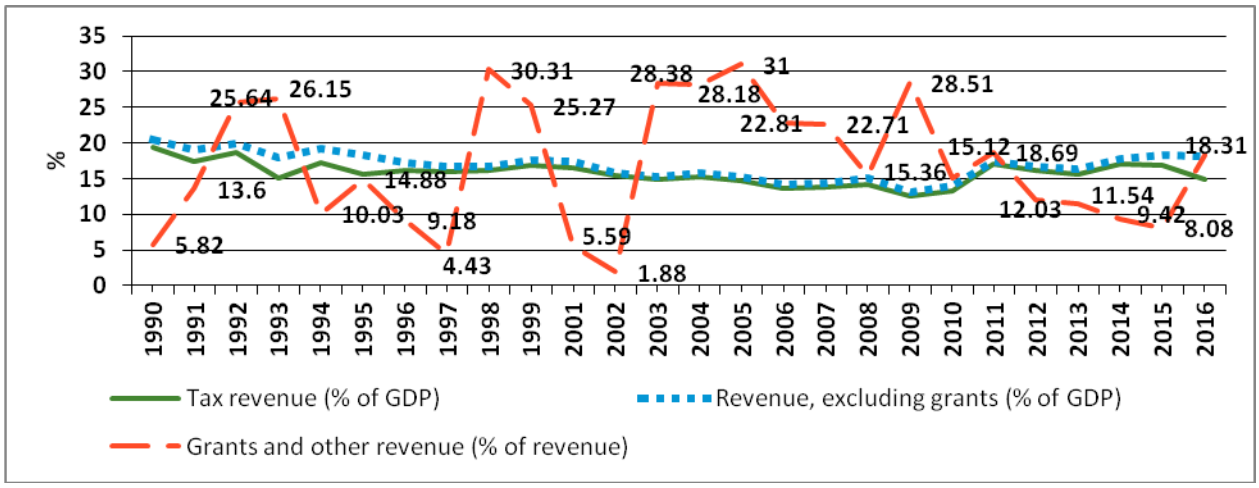
Year	2010	2011	2012	2013	2014	2015	2016	2017
Real GDP Growth, 2010-2018 (end year %)	10.30	5.56	7.60	5.06	4.70	2.92	3.76	4.08
GDP per capita (end year, US$)	1,236.0	1,732.0	1,814.0	1,897.0	1,886.0	1,376.0	1,322.3	
Annual Inflation Rate (end-period %)	7.9	7.2	7.3	7.1	7.9	21.1	7.5	
Exchange Rate (annual average)[9]	4,797.0	4,860.5	5,142.0	5.4	6.2	8.6	10.3	
Non-traditional exports [fob], (US$ million)	1,259.9	1,690.3	2,851.7	3,558.4	2,272.0	1,848.6	1,748.9	
Total Exports [fob] (US $ million)	7,483.5	8,753.6	9,520.8	10,843.4	10,220.2	7,362.0	6,513.5	
Imports [fob] (US $ millions)	4,709.9	6,454.2	7,925.5	9,195.4	8,594.8	7,436.2	6,538.5	
GINI Index[10]	55.6	n/a	n/a	n/a	n/a	57.1	n/a	n/a

Source: Bank Zambia (2010, p.12), *FDI Report*; World Bank (2018), *World Economic Indicators*[11]

[8] Developed by Corrado Gini in 1912, Gini index (also called Gini coefficient) is used to measure inequality on income or wealth distribution across a nation's population. It reflects economic inequality.
[9] Zambian Kwacha was rebased in 2013.
[10] Measured out of 100 units, where 1 represents perfect equality
[11] For more details, visit: http://zambia.opendataforafrica.org/WBWDI2018Jul/world-development-indicators-wdi

A long view on Zambia's revenue collection indicates a systematically weak position in that tax revenues are noticeably below 20% of gross domestic product (GDP). Even revenue from other sources (excluding grants) is equally below 20% of GDP. But Zambia has been fortunate to receive substantial amounts of grants, which in certain time slots account over 30% plus of revenue (*Figure 1*). This is a worrisome picture because what this means is that Zambia possibly relies on loans to reduce its budget deficit.

Figure 1: Revenue, Tax Revenues and Grants



Source: World Bank (http://zambia.opendataforafrica.org/WBWDI2018Jul/world-development-indicators-wdi)

Economic performance in selected sectors for 2016 and 2017 indicate that main drivers of economic growth came from Wholesale and retail trade, Construction, and Mining and Quarrying which contributed 21.3%, 11% and 10.5% share to GDP, respectively (ZRA, 2018). This raises a question whether mining is still Zambia's economic main artery, as it is generally portrayed. Other sectors whose individual GDP share was above 5% include: Agriculture, forestry and fishing; Manufacturing; Education; Public administration and defense; compulsory social security (*Table 3*) (ZRA 2018, p.27).

Table 3: Real GDP Growth and Share in Selected Sectors, 2016-2017

ECONOMIC ACTIVITY	REAL GDP GROWTH (%)		REAL GDP SHARE (%)	
	2017	2016	2017	2016
Agriculture, forestry and fishing	16.6	3.7	8.2	7.3
Mining and quarrying	3.0	7.3	**10.4**	**10.5**
Manufacturing	4.4	1.9	8.0	8.0
Electricity generation and supply	18.5	(13.6)	1.6	1.4
Construction	6.4	10.2	11.0	10.7
Wholesale and retail trade; repair of motor vehicles and motor cycles	0.7	(0.1)	**21.3**	**22.1**
Transportation and storage	7.8	2.2	3.4	3.3
Accommodation and food services	6.0	1.3	1.9	1.8
Information and communication	(13.2)	17.4	3.3	3.9
Financial and insurance services	0.7	(2.4)	3.5	3.7
Real estate	2.9	3.2	3.4	3.4

ECONOMIC ACTIVITY	REAL GDP GROWTH (%)		REAL GDP SHARE (%)	
	2017	2016	2017	2016
Professional, scientific and technical services	7.3	6.4	1.9	1.8
Administrative and support services	6.0	5.3	0.9	0.9
Public administration and defense; compulsory social security	2.8	9.7	5.2	5.2
Education	6.7	4.7	7.7	7.5
Human health and social work services	17.4	1.6	1.5	1.3
Water supply; sewerage, waste management, and remediation activities	(3.7)	3.4)	0.2	0.3
Arts, entertainment and recreation	(4.0)	0.5	0.4	0.4
Other service activities				
Real GDP Growth	**4.1**	**3.8**		

Source: ZRA (2018, p.27), *2017 Annual Report*

4. Financial Flows

Although tax revenue is a major financial source of government income, government also generate money from other sources such as from sale of goods and services (charges/fees), foreign direct investment (FDI), grants, and loans (domestic and external). Though the latter has to be repaid, it does help government to balance its budget. However, a loan portfolio is also an indicator of government's financial status to raise its own revenue. When government raises sufficient revenue, there is no need to borrow. *Table 4* shows annual total revenue collected (2011-2017), grants received and loans contracted while presents annual FDI receipts (2009-2018). Although FDI is not money in government hands, however, when well invested it may cause positive trickle down effects in the economy as companies who bring in FDI create jobs and other business opportunities connected to their operations (e.g. raw material and equipment suppliers, transporters, professional service providers, etc.). *Table 6* shows type of tax and how much each contributed to total revenue collected from 2011-2017.

Table 4: Total Revenue Collected, Total Expenditure and other Selected Variables.

Year	Revenue		Expenditure		Grants Received	Loans	Fiscal Balance
	K' million	% of GDP	K' million	% of GDP	K' million	US$' million	K' million
2018[12]	34,795		48,998.0				
2017	39,149.7	16.7	60,013.5	23.4	466.62	8,790.28	(14,693,245)
2016	39,400.0	18.5	58,500.0	27.4	545.91	6,947.1	(7,756.98)
2015	34, 420.6	18.7	51, 385.0	28.1	1,213.59	6,704.37	(9,451.22)
2014	30,558.1	18.3	37,595.0	22.6	2,626.62	4,729.60	(8,884.24)
2013	26,635.2	21.1	36,144.6	28.7	1,525.52	3,512.9	(5,413.88)
2012	23,134.6	21.8	26,152.2	24.7	762.4	3,179.6	
2011	20,233.0	21.5	22,385.3	32.8	714.0	1,980.0	

Source: BOZ Annual Reports (2014, p.27-28; 2015, p27; 2017, p.17); ZRA (2018), *2017 Annual Report, p.33-36;* World Bank *2017, p.13*

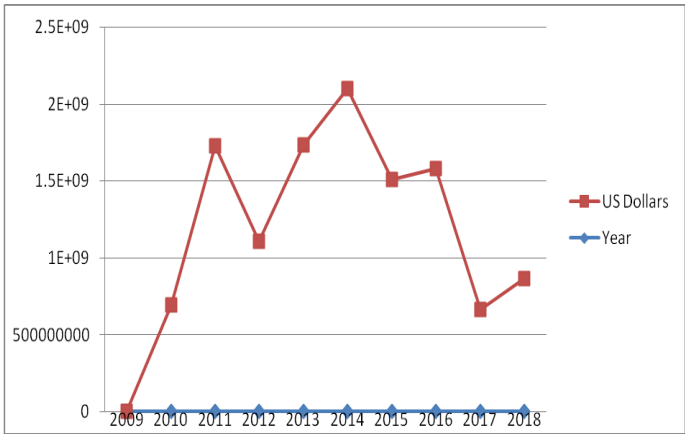
[12] Figures for 2018 only cover up to Sept 2018, the third quarter of the year. For details refer to 2018 *Quarterly Economic Review* reports.

Annual injection of grants received to supplement government's annual budget presents a worrisome trend of dependency on external financing to deal with budget deficits. This external dependency has most likely contributed to Zambia's unsustainable situation of being unable to fully finance its annual budget. All financial reports point in one direction: budget deficits. As a result, the Zambian government is left with no other option but to contract loans, most of which is used to finance social consumption.

Table 5: Foreign Direct Investment (FDI), net inflow

Year	US$
2018	
2017	865,903,085.19
2016	662,813,935.42
2015	1,582,666,666.67
2014	1,507,800,000.00
2013	2,099,800,000.00
2012	1,731,500,000.00
2011	1,108,500,000.00
2010	1,729,300,000.00
2009	694,800,000.00

Figure 2: FDI net inflow, 2009-2018



Source: World Bank (http://zambia.opendataforafrica.org/WBWDI2018Jul/world-development-indicators-wdi)

Table 6: Proportion of Tax Type to Total Revenue, 2013-2017

Year	Income Tax		Value-added Tax (VAT)		Excise Tax[13]		Customs & Export Duty	
	K'million[14]	*% of GDP*	*K'million[15]*	*% of GDP*	*K'million*	*% of GDP*	*K'million[16]*	*% of GDP*
2017	18,830	48.5	13,887	35.8	3,170.3	8.1	2,544.4	7.6
2016	17,991	57.7	7,940	25.5	3,250.7	10.4	1,956.0	6.3
2015	16,508	55.2	8.217	27.5	3,253.9	10.9	1,929.4	6.4
2014	13,225	47.9	9,554	34.6	2,854.0	1.7	1,911.5	7.1
2013	11,411	50.2	7,364	31.8	2,339.5	1.9	1,810.8	7.9
2012[17]	11,733.8	10.6	(297.2)	(0.3)	2,198.1	10.6	2,035.8	1.8

Source: ZRA (2018), *2017 Annual Report, p.33-36*; BOZ Annual Report (2015, p.27)

It is important to note that FDI inflow is not an end itself but a means develop new businesses, to increase employment and growth, as well as tax base and subsequently tax revenue. Hence, if tax incentives and double taxation agreements (DTAs), also called double taxation treaties

[13] This includes: Import Excise Duty; Local Excise Duty; Rural Electrification Levy; Import Fuel Levy; Local Fuel Levy; and Carbon Tax.
[14] ZRA (2018), p35
[15] ZRA (2018), p35
[16] ZRA (2018), p36
[17] 2012 entries are in billions of Kwacha; this was before the currency was rebased in 2013. All figures from 2013 onwards are in millions of Kwacha.

(DTTs) do not deliver these fundamental benefits, they should be renegotiated and ensure such reforms yield a win-win situation.

Against this background of collecting low tax revenues, Zambia is forced to incur debt to balance its budget and finance other critical areas of its developmental agenda. As *Table 7* indicates Zambia's debt stock has continued to increase, with external debt alone standing at US$37,220.17 million in 2017. Compare this debt to K39,149.70 million (equiv. to US$3,858.51 million[18]) collected as revenue in 2017. With such a low level of revenue, this raises concerns on the country's ability to pay this debt without sacrificing critical social services such as health and education. And signs are already clear on the wall. On 24th December 2018, *Diggers! Newspaper* (No. 115, p.1) carried a front page article where Minister of Higher Education, Prof. Nkandu Luo, announced that starting 2019 government will no longer pay meal allowances (part of a government scholarship) to students in eligible colleges (Funga, 2018). Instead, government will share responsibility on education with parents/guardians. While this may not be a big problem for parents who can afford, for the vulnerable in society it means the very end of their educational empowerment because they cannot afford to pay university fees. And this means pushing on the streets people who would otherwise be educated and in future become government's source of revenue from payroll tax and possibly from companies these future citizens might create.

Table 7: Zambia's External Debt Burden (US$' million), 2012-2017

	2012		2013		2014		2015		2016		2017	
CREDITOR	**Loan**	**Debt Share %**	**Loan**	**Debt Share %**	**Loan**	**Debt Share %**	**Loan**	**Debt Share %**	**Loan**	**Debt Share %**	**Loan**	**Debt Share %**
Bilateral loans[19]	239.0	7.5	183.8	5.2	199.4	4.2	450.00	6.7	458.7	6.6	373.82	4.2
Multi-lateral[20]	1,382.8	43.5	1,452.7	41.3	1,493.6	31.60	1,503.97	22.4	1,560.4	22.5	1,614.85	18.4
Others	166.1	5.3	172.9	4.9	167.5	3.5	199.50	3.0	254.4	3.7	373.82	4.2
Export / Suppliers / Commercial debt	565.8	17.5	904.9	25.8	3,035.7	64.2	4,750.40	70.9	4,928.0	70.9	6,801.61	77.4
Private Banks[21]	992.1	31.2	971.5	27.7	2,022.9	42.4	-	-	-	-	-	-
Total Debt	**3,345.8**		**3,685.8**		**6,919.10**		**6,903.87**		**7,201.5**		**9,164.1**	

Source: Bank of Zambia Annual Reports, (2014, p.25; 2016, p.23; 2017, p.17)

Government's withdrawal of students' meal allowance seems to be part of a fiscal austerity measure being applied to reduce government expenditure in order to attend to other obligations such as debt payments. While reducing public expenditure is a good intervention, however, the biggest concern this measure raises is that it will cause terrible ripple consequences in the long run. Government's withdrawal of educational support will negatively

[18] Calculated at 1US$ = K9.89 exchange rate at the time.

[19] Includes: Paris Club (US$195.32 million); Non-Paris Club (US$254.68 million)

[20] Covers: IMF (US$256.82 million); World Bank Group (US$695.79 million); and African Development Group (US$351.86 million).

[21] From 2015 onwards, debt from Private Banks seems to have been included in the Export/Supplier/ Commercial Debt sub-heading.

affect Zambia's human development agenda as some of the brightest children from poor families will not go beyond Grade 12 because their parents / guardians cannot afford to pay university fees. It reduces the quantity and quality of a human resource needed to manage national affairs. Many uneducated folks will find themselves in the informal and unlikely to earn a decent income to support themselves and their families. Through this measure, government is essentially reducing future tax revenues from payroll taxes which ride on decent jobs. Because most uneducated folks operate in the informal sector, consequently they do not pay income tax. Zambia has not yet found a way on how to collect tax from the informal sector. Ultimately, government is contributing to deepening the poverty trap instead of reducing poverty.

In 2017, government external debt service stood at US$666.7 million, a 14% increase from 2016 where it paid out US$585.0 million. Debt service constituted US$162.3 million in principal maturities while interest and other charges were US$504.4 million (BOZ, 2018, p.17) (*Table 8*). No data available yet on debt stock for 2018.

Table 8: Zambia's Official External Debt Service by Creditor (US$' million), 2014 - 2017

	2012	2013	2014	2015	2016	2017
CREDITOR	**US$'million**	**US$'million**	**US$'million**	**US$'million**	**US$'million**	**US$'million**
Bilateral loans	**76.3**	**132.8**	**16.5**	**-**	**39.7**	**65.1**
Paris Club	56.7	114.9	0.0	-	1.0	6.5
Other	19.6	17.9	0.0	-	38.7	58.6
Multi-lateral	**36.2**	**35.6**	**49.2**	**92.5**	**102.9**	**100.1**
IDA	7.8	9.1	8.5	-	-	-
IMF	12.0	17.9	29.4	52.8	69.1	69.2
World Bank Group	-	-	-	3.2	7.6	14.0
ECU/EIB	9.8	0.0	0.0	-	0.4	1.5
Others	6.6	8.6	11.3	36.5	25.8	15.4
Suppliers/Bank (Commercial)/ Export	**173.9**	**70.2**	**199.3**	**289.2**	**442.4**	**501.5**
TOTAL DEBT	**286.4**	**238.6**	**265.0**	**381.7**	**585.0**	**666.7**

Source: Bank of Zambia Annual Reports (2017, p.17; 2014, p.25)

Financial Out Flows

There are various areas of financial outflows, major ones being: tax refunds, tax exemptions, and double taxation agreements. In between there are also numerous other illicit channels that people use to evade or and avoid paying tax. And that robs government millions of tax revenue. Because of weak institutional capacity which hinders effective monitoring of business operations, quantifying loss of tax revenue is still a big challenge in Zambia.

On illicit financial flows, the Global Financial Integrity Report 2015 estimates that Zambia is "losing an average of US$2.8 billion per year, through financial flows", which are often concealed or disguised in various ways before the same is brought back into the financial system (FIC 2016, p.16). Later in 2017, FIC estimated this loss to be around K4.5 billion (USD 450 million) (FIC 2017, p.8).

4.1 Tax Refunds

Tax refunds constitute a loss to government because this money is paid out to consumers. In a situation where revenue is as low as what Zambia collects (refer to *Table 4* above), a tax refund adds pressure to budgetary obligations which government has to meet. This case was particularly evident in 2017 where the Zambian government owed companies millions in VAT refunds. Unfortunately, data was not easily available in this area. Records indicate that government paid out the following in tax refunds: K6,718.50 million in 2017; K7,974.75 million in 2016; K11,772.00 in 2012; and K51.6 billion in 2009 (*Table 9*).

Table 9: Tax Refunds, 2009-2018

Year	K'million
2017	6,718.5
2016	7,974.75
2012	11,772.0
2009	51,600.00

These tax refunds are substantial amounts, which can be utilized in some critical sectors and help improve people's well being. Zambia's current tax regime works against the poor. For instance, there is no provision for individuals to claim tax refunds, yet companies who already receive numerous tax exemptions and a generous package of tax incentives are also entitled to tax refunds! This is day light robbery from the treasury. Government should seriously consider reforming its tax regime, which currently favours companies, and work out something that will protect the most vulnerable in society.

4.2 Tax exemptions

Though not usually quantified (and there is no data available), tax exemptions are a major source of foregone revenue. For every tax incentive offered, there is an opportunity cost embedded in it. Yet, none of the three key agencies (ZDA, ZRA nor Ministry of finance) has data on revenue forgone from Zambia's generous tax regime. One wonders, how do they arrive at incentives to offer without calculating how much government will forgo and how much it will start collecting when the tax break period ends? Low tax collection is always an area of concern because it affects service delivery negatively. The problem becomes deeper when companies become dishonest in their business dealings – most companies under declare their production levels and subsequently their profits. For example, it has been noted that key industry players such as Lawyers, Banks, Accountants and Audit Companies are all guilty of helping their corporate clients to lie about their production figures and profits accrued. Lawyers 'educate' their clients on how to manipulate certain portions of the law, while Banks play a major role in administering secret jurisdictions, commonly referred to as safe havens, where individuals and corporate entities hide (bank) their ill gotten wealth. This helps their clients to avoid paying tax and conceal billions of dollars in save haven accounts available across the globe e.g. in Switzerland, Cayman Islands, etc. Corrupt individuals and companies also usually set up trusts, charitable organisations or multi-national companies which are then used to evade tax.

In March 2011, a workshop held in Maputo noted similar concerns. According to Fjeldstad (2011, p3), tax policy is a major obstacle for developing an effective tax systems in Mozambique, Tanzania and Zambia. For many years tax incentives in the form of exemptions and tax holidays have made it easier for a number of firms to escape taxation altogether, notably in extractive industries, manufacturing and processing, and even hotels and lodges. Fjeldstad (2011) further argued that without substantial reforms on tax exemptions and the tax system for natural resources it is unlikely fiscal self-reliance will be attained in the foreseeable future.

4.3 Double taxation agreements (usually bilateral in nature)

In Zambia, Double Taxation Agreements (DTAs) are provided for in the Income Tax Act of 1966, and subsequent amendments to this same principal law. Currently, the Zambian government has twenty-two (22) DTAs in effect (*Table 10*), the oldest being with South Africa since 22nd May, 1956 (CTPD 2017, p.7) and most recent with Botswana, signed on 9th March 2015 and became effective 1st April, 2016 (in Zambia) and 1st July, 2016 (in Botswana) (GRZ, 2015).
DTAs are bilateral agreements where countries prescribe rules on how to avoid taxing the same incomes twice and, or assist each other in tax collection based on income tax laws of a cooperating country. One key motivation for developing countries like Zambia to engage in DTAs is to signal to investors that their income will not be overtaxed, and also to assure them that their investments will be legally protected under international law in case of political turmoil. However, despite DTAs' good intentions, unfortunately, this is another area being abused by corporate entities to evade tax.

DTAs' role in attracting foreign direct investment (FDI) in low-income countries is quite questionable. A study by OECD (2000) on the role of tax in attracting investments revealed that tax treaties signed between countries or tax incentives are not among the top five factors that motivate people to invest in a particular country. Another study by Sauvant and Sachs (2009) gave same findings. Five years later, the International Monetary Fund (2014) who undertook a similar study on the role of tax incentives for attracting investments arrived at the observations.

A study by Makano and Imakando (2015) revealed the same scenario; tax incentives are not a primary factor for deciding where to invest. Investors consider political stability, security, infrastructure, educated workforce and decent healthcare – the same things that tax revenues pay for in the first place – as important factors when exploring a place to invest in. In terms of how much FDI comes through DTAs, Cheelo and Kaela (2015) noted that the direction of the relationship between FDI and DTAs cannot easily be determined, and currently there is no data to show that connection.

Table 10: Zambia's DTAs and their Negotiated Provisions.

	Country	Type of Agreement	Dividends (%) Qualifying Companies	Interest (%)	Royalties (%)	Management qualifying consultancy / company technical fees	Date signed
1	Botswana[22]	Income	5%	10%	10%	10%	9 March, 2015
2	Canada	Income & Capital	15%	15%	15%	None	16 February, 1984
3	China	Income	5%	10%	5%	15%	26 July, 2010
4	Denmark	Income & Capital	15%	10%	15%	15%	13 September, 1973
5	Finland	Income & Capital	5%	15%	5/15%	None	3 November, 1978
6	France	Income & Capital				None	5 November, 1963
	Germany	Income & Capital	5%	10%	10%	None	13 May, 1973
8	India	Income & Capital	5%	10%	10%	None	5 June 1981
9	Ireland	Income & Capital	None	None	None	None	29 March, 1971
10	Italy	Income & Capital	5%	10%	10%	None	27 October, 1972
11	Japan	Income & Capital	None	10%	10%	None	19 February, 1970
12	Kenya	Income & Capital	None	None	none	None	27 August, 1968
13	Mauritius	Income					26 January, 2011
14	Netherlands	Income & Capital	5%	10%	10%	None	19 December, 1977
15	Norway	Income & Capital	15%	10%	15%	15%	14 July, 1971
16	Poland	Income & Capital					19 May, 1995
17	South Africa	Income & Capital	15%	15%	15%	15%	22 May, 1956
18	Sweden	Income & Capital	10%	10%	10%	15%	18 March, 1974
19	Switzerland	Income & Capital	-	-	-	-	30 May, 1961
20	Tanzania	Income & Capital	20%	20%	20%	20%	2 March, 1968
21	Uganda	Income & Capital	20%	20%	15%	15%	24 August, 1972
22	United Kingdom	Income & Capital	5%	10%	10%	None	22 March, 1972 **Renewed 2014**

Source: CTPD (2017, p.7), *Policy Brief on Double Taxation Agreements*

In the Zambian case, some DTAs were signed well before massive investments occurred, while in other cases FDI inflow prompted countries to negotiate for a fair share of tax revenue from their investments in Zambia. In other words, after companies set up business, their FDI inflow necessitates and influences promulgation of DTAs and not the other way around (p24). However, this ambiguous evidence does not mean DTAs are not useful in attracting FDI but suggests that this outcome is not automatic and guaranteed. What this means is that there are other critical factors that determine outcomes from DTAs and these vary from one DTA to another.

Due to such concerns, double taxation treaties have attracted international, regional and national institutions' attention, prompting United Nations, OECD, COMESA, and SADC each issuing guidelines on double taxation treaties, while various governments are tightening their legal and policy frameworks and re-negotiating old DTAs to prevent loss of tax revenue through transfer mispricing and other avenues that companies may take advantage of DTAs to repatriate profits and avoid taxes (CTPD, 2015). Many developing countries are pushing for a review of their outdated DTAs to minimize tax revenue losses from foreign owned

[22] See details in *Statutory Instrument No. 19 of 2015*.

multinational corporations who go to exploit natural wealth in developing countries. Poorly negotiated DTAs have contributed to lower corporate tax rates and helped companies to externalize their profits from poor countries to tax havens resulting into net loss to poor countries. Realising that existing DTAs have been unfavourable, some countries (e.g. Uganda) have suspended DTAs until they put in place a legal and policy framework that promotes a win-win situation from DTAs.

Zambia too is not an exception in this regard, and has been losing substantial amounts through DTAs. For example, when an Irish company makes money in Zambia, both Zambia and Ireland would legitimately want to tax that income but the Ireland-Zambia DTA, signed in 1971, does not permit any domestic taxation hence, Zambia foregoes all its taxes from that DTA (*Table 10*). A point to note is that in a trade relationship between developing and developed countries, cross border income generally flows in one direction towards developed countries (and tax havens) because developing countries, like Zambia, are notably importers of goods and services from developed countries.

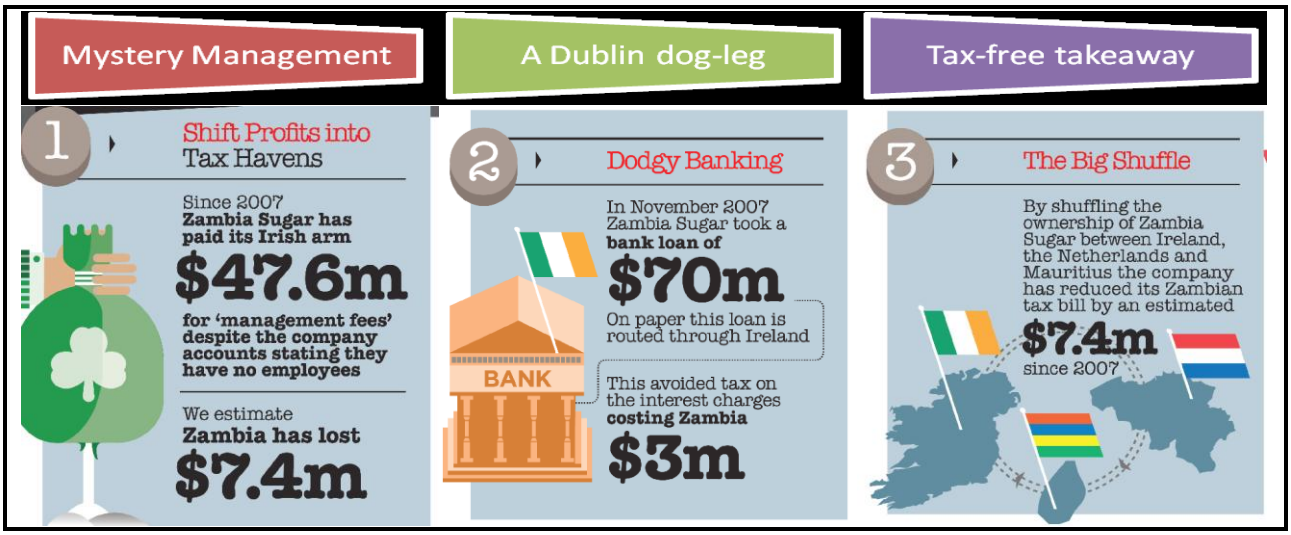
Thus, when a developed country negotiates a tax treaty with a developing country like Zambia, its primary interest is to try and limit or better still cancel taxation rights of the 'source' country, which will generally reserve more taxation rights to itself. It may sound strange that the Zambian government is not free to decide how much tax it levies on income generated from within its own boarders due to DTA. Generally, DTAs work on the principle that a cooperating country would limit taxing its partners' companies in its jurisdiction. It works on the assumption that both countries anticipate having companies from their jurisdictions to operate in another country. Hence they foresee benefits in having a DTA. But as noted earlier, the real problem is that cross border trade and income between a developed and developing country predominantly flows in one direction in favour of developed countries. In this case, what it means is that taxable cross-border income generally flows away from Zambia to investors and companies based in wealthy countries or tax havens.

Being a potential source of investment for a developing country, the developed country will often have the economic and political muscle to get its way. The Ireland-Zambia DTA, signed over 40 years ago, is a good example of such trade imbalance. It is one of two tax treaties Zambia has signed that denies it the right to tax any financial outflows from cross border income, which would normally be subject to withholding taxes. Not only does this DTA openly rob Zambia and boost Irish revenues at Zambia's expense, ironically it also gives multinational companies a huge loophole to 'treaty shop' and use Ireland as a tax-free conduit for transactions between Zambia and other countries. While Ireland gives aid to Zambia with one hand, huge amounts of Zambian government revenues is taken out easily using another hand, through this Ireland-Zambia DTA.

In a 2015 study, the Centre for Trade Policy and Development estimated that since 2007 Zambia lost about US$18 million from Zambia Sugar Company (trading abroad as Illovo)

under the Zambia-Irish DTA. This occurred through dodgy banking, shifting profits and shuffling the company's ownership in different countries (CTPD 2015, p.9). *Figure 3* shows a summary of how Zambia Sugar and Illovo underpaid Zambia in taxes using underhand methods.

Figure 3: DTAs Financial Loopholes



Source: CTPD (2015, p.9), *Policy Brief on Double Tax Agreements*

In such a situation, one wonders if there is hope for Zambia to accrue any benefits from such an imbalanced tax agreement. For now, the only solution lies in renegotiating some of these "outdated" treaties to make "source and residence more balance as shown by a re-negotiated Zambia-UK treaty signed on February 4, 2014 (CTPD 2015, p.9).

Drivers of Illicit Financial Out Flows

Corruption

Corruption is noted as a major constraint not only in tax collection efforts but also in how the same little revenue collected is eventually utilized in the public service. Government loses substantial amounts of its revenue through corrupt practices, especially in the public sector procurement processes (FIC 2014, p.13-17), and many such cases have been recorded in Zambia. FIC notes that amounts involved have been increasing since 2014. For instance, although suspected corruption cases reported in 2016 represented only 6% of total number of reports received, the value of transactions was very high, accounted for 76% (over K3 billion) of all cases analyzed (FIC 2016, p.15). And many of these were linked to public procurement contracts, often perpetuated by people with political connections and their associates. FIC further noted use of proxies in business transactions and people avoiding to transact through banks, but instead preferred third party cash payments. In particular, law firms were used to

facilitate or receive questionable remittances (in or out) which in "some cases originated from high risk jurisdictions" (FIC 2016, p.15). The primary purpose is to conceal identity of final beneficiaries.

In a survey undertaken by Transparent International, Zambia scored 38 out of 100 on the corruption perception index (CPI) and is ranked number 105 out of 180 countries surveyed (*Table 11*). CPI gives a relative degree of corruption in the public sector of a particular country or region. In this case, Zambia's score and ranking indicates a high degree of corruption and that is problematic. Because of a high degree of corruption, the country is unable to collect sufficient revenue because some of its revenue leaks through corruption and does not get into government coffers. And even when revenue has been collected, corruption noted in procurement of public contracts points to theft and abuse of public resources. For instance, forty-two (42) fire tenders bought at a cost of one million US dollars (US$1 million) each (42for42), instead of their real value of two hundred fifty US dollars (US$250), a latter value which these fire tenders were eventually insured at, is a case pointing to grand corruption and still a hot topic in the court of public opinion.

Table 11: Zambia's ranking on the Corruption Perception Index, 2015-2018

Rank	Country	Year & Score (out of 100)			
		2015	*2016*	*2017*	*2018*
1	Denmark	91	90	88	88
2	New Zealand	91	90	89	87
3	Finland	90	89	85	85
3	Switzerland	86	86	85	85
3	Singapore	85	84	84	85
7	Norway	88	85	85	84
8	Netherlands	82	83	84	
9	Luxembourg	82	81	86	
105	**Zambia**	**38**	**38**	**37**	**35**

Source: Transparency International (https://www.transparency.org/cpi2018#results)

Since 2014, the Financial Intelligence Centre (FIC) records cases of suspicious transaction reports (STRs) on all clients as part of its efforts to identify potential money laundering or illicit financial flow transactions. The nature of suspicions relate to large or unusual cash deposits; activity inconsistent with customer profile; and large and unusual inward and outward remittances. FIC notes that use of personal accounts to route funds is widespread from business in order to evade tax, which eventually is remitted outside the country. In order to curb this problem, FIC advises that government should consider making use of personal accounts for business transactions a criminal offense as this might help to understand what is happening with such businesses (p.6).

Most STRs processed emanated from retail, construction, and mining sectors (FIC 2014, p.5-6). This is not surprising because these three sectors handle huge sums of money and have several

layers of suppliers in the value chain of their businesses. FIC identified seven (7) major trends: i) illicit flow of funds, ii) tax evasion, iii) procurement fraud, iv) bribery and corruption, v) accounting fraud, vi) cyber crime, and vii) money laundering (*Ibid*,p5-6). Two years later (in 2016), FIC reported that Zambia lost approximately over K4 billion through suspicious transactions (*Table 12*).

Table 12: Potential Loss in 2016 from Suspicious Transactions, Zambia Kwacha (ZMW).

	REASON FOR SUSPICION	POTENTIAL LOSS AMOUNT (ZMW)	PERCENTAGE (%)
1	Large or unusual cash deposits	269,439,304.00	6
2	Activity inconsistent with customer profile	167,443,954.00	3.6
3	Large or unusual inward remittances	151,750,036.00	3.3
4	Unusually large foreign currency transactions	55,686,058.00	1.2
5	Large outward or inward transfers	800,000.00	0
6	Fraud	92,756,443.00	2.0
7	Large or unusual cash withdrawals	7,442,063.00	0.2
8	Suspected corruption/theft	3,518,300,000.00	76.3
9	Large or unusual outward remittances	48,306,012.00	1.0
10	Unusual business practices	121,822,253.00	2.6
11	Other	171,435,039.00	3.7
12	**TOTAL**	**4,605,181,162.00**	**100**

Source: FIC (2016, p.11), *Trends Report 2016*

All these cases point to the fact that ethics and morality in the public service is at their lowest level and continues sliding downwards. The Zambian government should urgently address this scourge and let ethics and professionalism rule over all processes.

Zambia also suffers from illegal immigration challenges. Due to its geographical location, coupled to being a peaceful nation, Zambia has generally been a preferred destination or transit country for people running away from war torn zones. With increase in economic activity in the mines, the country has also attracted workers from Asia and South America. Because not all labour is skilled, some have difficulty getting work permits hence stay in Zambia as visitors. According to FIC, this category of workers has no Bank accounts; they transfer money to home countries using their compatriots or their employers send it to their off shore accounts. Sadly, their emoluments are not taxed, and some of these expatriates are on a salary as low as K3,000.00 (equiv. to US$305.50)[23] per month.

In some cases, foreign nationals issued with either employment or temporary permits engage in business activities and set up companies in Zambia without investment permits. These suspects, especially Asian nationals, transfer the proceeds of these business activities using personal accounts to their countries of origin. The practice of using personal accounts for business

[23] At an exchange rate of 1US$ = K9.82 in 2016.

continues to be a method for facilitating illicit financial flows. Zambia recorded the highest FDI out flow in COMESA region from assets in parent companies by resident companies, mainly in the mining sector, with a total of US$1.1150 billion out of the region's total of US$2,266.9 billion. This situation is worrying because this might indicate an illicit flow of funds away from the location it is supposed to be invested in.

Tax Evasion

Tax evasion is committed in various ways by both small and very big multi-national companies. This crime may take the form of group company loans; use of personal accounts for business; false accounting, transfer pricing; and under valuing exports. In fact, it has been noted that in the mining sector, not only are mine companies at the centre of committing these crime but sadly, companies contracted by the mines are mines to repatriate their earnings (FIC 2014, p.7). FIC notes several emerging trends (in addition to existing trends) how companies are evading and avoiding paying tax (p.10-11). In 2014, FIC noted that use of personal accounts for business transactions had become pervasive and required urgent attention to stop it. Second, companies and individuals borrowing money from safe haven locations at very high interest rates, which is then used as a reason for externalizing money earned in Zambia purportedly to pay off loans. FIC further explained that "it is difficult to authenticate the loans contracted because of the opaque nature of jurisdictions in which the liabilities are contracted" (FIC 2014, p11).

Another bad development was observed in the Real Estate sector which involved deceptive transactions on land or property, as well as money laundering activities by both foreign and Zambian nationals. Proxies for politically exposed persons (PEPs) invested funds illegally obtained from government contracts into assets and properties (FIC 2016, p13-15). This is essentially a form of money laundering, but one with an ugly face in that land acquisition is creating fertile ground for forced evictions which may render many poor Zambians landless.

Other common means used to evade tax is through: i) falsifying import voices; ii) foreign loans /offshore centres; iii) transfer pricing; iv) false financial statements and v) unregistered company (FIC, 2014, p.8-9).

i) **Falsifying import voices**

Companies launder money by over- or under-invoicing products and services, especially sourced foreign suppliers who are usually preferred against local companies. Over- or under-invoicing misrepresents the true value of cost incurred and income earned, therefore, enabling the company to pay less or no tax at all.

ii) **Foreign loans /offshore centres**

Loans primarily used to increase cost to the company so that less or no profit is declared.

iii) Transfer pricing

This uses over- or under-pricing technique (within company units) to eventually avoid or evade tax.

iv) Falsified financial statements

This rides on the official authority given to alter company books to give an impress the company is not doing well. Usually two books are maintained: one for in-house use and the other for the tax man

v) Unregistered company

These are cases where the business is not registered neither with the ZRA of Zambia Patents and Companies Registration Agency (PACRA).

Zambia has lost billions of Kwacha through these violations.

Table 13: Estimated Financial Loss in 2017

	Suspected Offense	Estimated Loss
1	Tax Evasion	K3.9 billion
2	Corruption	K500 million
3	Money Laundering	K90.5 million
4	Fraud	K3 million
	TOTAL	**K4.5 Billion**

In 2017, FIC estimated losses from the above violations to be around K4.5 billion (USD450 million), as *Table 13* indicates.

The following two case studies from FIC (2014) illustrate the seriousness of these transactions and potential tax revenue loses to Zambia. It was estimated that Zambia lost well over K145 million[24] in 2014 alone.

Case Study on Tax Evasion in the Mining Sector

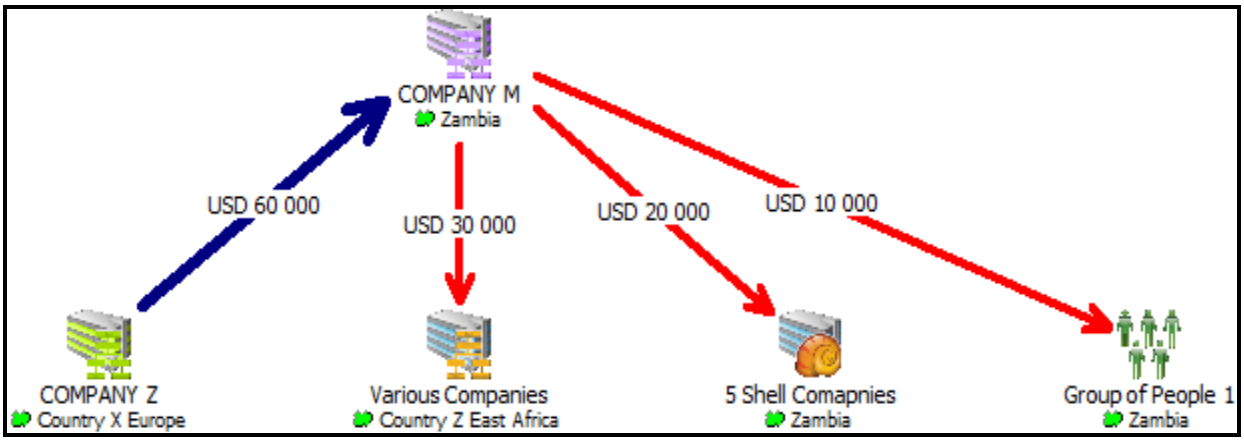
Incorporated in Zambia, Company "M" received various international transfers in dollars from Country "X" in Europe, ordered by a parent company to one of the mines in Zambia. This money was then transferred to Country "Z" in east Africa. Company "M" shareholders had strong links with fund recipients in Country "Z" in east Africa. This involved about US$60 million.

Company "M's" registered business was agriculture, forestry, fishing and construction. But in practice, Company "M" was in logistics management for mining companies. Company "M" was incorporated by two foreigners in east Africa, and suspicious transactions into the company accounts commenced immediately it was incorporated. Company "M" was not tax compliant.

[24] This figure is based on two case studies FIC explained it its *2014 Trends Report (p.13-17).*

One of the funds recipients in Zambia worked for a law enforcement agency. Both nationals were Directors on Company "M" and also established their own companies who were sub-contracted to provided security and clearance services, respectively. This case suggests suspected transfer pricing between the mine, parent company and the logistics company. The gap between market price and non-arms length price was US$300 per tonne.

Figure 4: Diagram illustrating Illicit Flow of Funds (Case Study 1), Zambia



From these transactions, FIC estimated that the Zambian government may have lost over US$15 million[25] in tax revenues, and concluded as follows: **Possible Offences:** Tax evasion and money laundering; **Indicators:** Illicit funds transfers, concealment of sources of funds; **Customer:** Corporations; **Industry:** Mining; **Jurisdiction**: Zambia

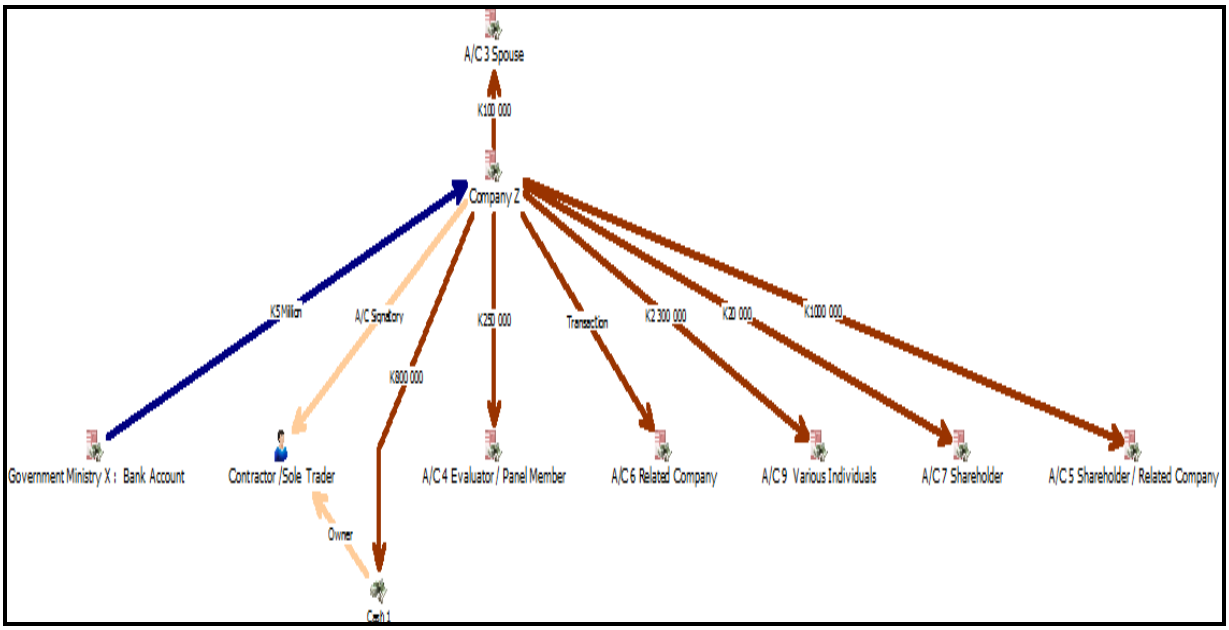
Case Study on Corruption in the Construction Industry

This case involved a K20 million contract from government Ministry "X" for construction of a training institute in town "Y". Company "Z" was awarded the contract though it didn't even meet minimum eligibility criteria. At time of bidding, it was not registered as a limited company by shares under the Companies Act, Chapter 388 of the Laws of Zambia, which was a bid requirement. Instead, it was registered as a sole trader under the Business Association Act, Chapter 389 of the laws of Zambia. Bidding instructions required those registered as a limited company. Second, company "Z" had no tax clearance, not compliant for tax purposes. Again tax compliance was a bid requirement. Company "Z" quoted the largest bid price (K17 million) and also offered longest completion period at 104 weeks compared to the two other bidders. For instance, company D quoted K12 million and to complete the works in 52 weeks. Nonetheless, the contract was awarded to company "Z" simply because bid evaluators in Ministry "X" were going to benefit from this deal. Bid evaluator "B" from Ministry "X" received a

[25] Equivalent to K138 million at an exchange rate of 1US$ = K9.2 in 2014.

ZMW250,000.00 gratification; spouse to Company "Z" owner was given ZMW100,000.00; and several other people were paid different amounts (*Figure 5*).

Figure 5: An Example of Corruption in the Construction Industry



In this case study, FIC (2014) estimated loss to government in excess of ZMW7 million, and summarized the case as follows: **Possible Offences:** Corruption and Money Laundering; **Indicators:** Bribery, fraud, illicit flow of funds, concealment of sources of funds; **Customer:** Corporations; **Industry:** Construction; **Jurisdiction**: Zambia (FIC 2014, p.16).

In 2017, FIC observed similar criminal behavior of tax evasion, corruption, etc. among corporations. Some of its key findings were that:

a) Nearly 50% of entities awarded contracts were not registered for tax purposes while some were non-tax compliant. A company should be tax compliant to be awarded a government contract.

b) Nearly 50% of cases had no capacity to execute contracts because some companies awarded were too young, operational for less than 12 months; unregistered; and companies with no financial base to execute the works.

c) Single sourcing awarded contracts to entities with no capacity to deliver. In fact, single sourcing simply killed benefits from competition.

d) Contract terms were varied, which compromised ethical behaviour and indirectly promoted fraud to favour friends and associates to those "connected."

e) Works were sub-standard and contractors abandoned project sites.

f) Ownership of some companies is problematic. In some cases politicians and their associates own the company but assign other people to be their fronts (FIC 2017, p.18).

4.4 Weak Institutional Capacity

All key institutions involved in managing tax processes indicated having weak institutional capacity as a major constraint to effectively delivering on their mandate. In particular, poor funding translate into weak capacity; agencies are unable to go monitor businesses and compel them to comply more. Weak institutional capacity contributes to lack of law enforcement, low tax collection and subsequently low taxes to support government programs.

5. Possible Interventions

To improve its tax revenue collection capacity the Zambian government should seriously consider reforming its tax regime by closing all potential loopholes which facilitates tax revenue leakages. And secondly,

5.1 Stump out Corruption

Corruption stands out as a major driver of illicit financial flows across the globe, and covers all sections of society. It is reflected as payments made to individuals to access a favour from key players such as the police, judges, politicians, government officials, and or even civil society. In Zambia, corruption extends to abuse of office and / or political power to induce government officials to perpetuate or ignore wrong doing such as promoting single sourcing, over pricing when buying government goods, etc. Because such monies are paid out to individuals, ultimately government loses out. Government should prescribe stiff punishment for all culprits to deter potential offenders. Stiff punishment will also send a clear message of government's zero tolerance to corruption.

5.2 Stop Illicit Financial Flows

Although there are numerous drivers to IFFs, it is possible to close all loopholes. Zambia should develop a simpler and predictable tax system. The current tax system is defeated by loop holes found in the global financial system which promotes tax avoidance and tax evasion. Indeed, stumping out illicit financial flows will not be an easy task as this usually involves several and powerful layers of actors. However, commitment from rich countries and safe havens to stop receiving IFFs from poor countries would help in resolving this problem.

5.3 Tax Regime Reforms

Numerous studies have shown that tax incentives are not among the top ten factors investors consider when deciding where to invest. Hence, it is ironic that government is still entangled in believing incentives are important and ought to be given. Zambia should consider taking a serious paradigm shift in its tax regime. All unnecessary incentives should be abolished.

5.4 Media Engagement

Media would be a good partner in the fight against theft of public resources. Because media has the power of the pen, it should be strategically used to can educate, inform and advocate for tax reforms. Media can serve as a powerful tool in behaviour change – to highlight wrong doing and inculcate honesty in industry and the larger society.

6. Conclusion

The foregoing discussion illustrates how Zambia loses tax revenues starting from its generous tax regime to criminal activities practiced by the same beneficiary companies to evade or and avoid paying tax. Zambia's tax regime and tax incentives are too generous; government essentially subsidizes companies to do business in Zambia for free. Investors are given 5 years tax free period and thereafter continue to enjoy tax breaks up to 10 years. And even then, companies only pay prescribed percentages of tax if they have made any profits. Knowing the greedy nature of business entities, as ably illustrated by some case studies, it is most likely that companies will explore this legal provision by declaring losses rather than profits. For this reason, the current tax regime leaves Zambia at the mercy or good will spirit of individual business owners to truthfully declare their production levels and profits. Due to a claw bar clause that expects companies to pay tax provided they have made profit, this provision leaves Zambia in a very precarious situation because it is not easily predictable to know if a company will pay tax or not.

It is estimated that Zambia loses well over US$4.5 billion annually through tax evasion and tax avoidance alone. If loses from other violations are added, this figure will be way higher than this. And if such monies were collected as revenue, this would make a huge difference to Zambia's fiscal situation. The country would most likely contract less loans and be sustained from locally generated revenue income. This should be a goal to work towards. To assist Zambia (and countries in a similar situation) get the best out of their natural wealth, government should reform its tax regime by removing some unproductive provisions (e.g. reduce the period of zero tax exemption from 5 years to 3 years). Strong advocacy is required from civil society to demand for development of a fair tax regime which engenders benefits to both government and the private sector. The current tax regime favours companies against government, a resource owner.

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