Zambia Institute of Chartered Accountants

ZiCA

Competence, Integrity and Virtue

Comments on the Budget Estimates for the 2020 Fiscal Year

INTRODUCTION

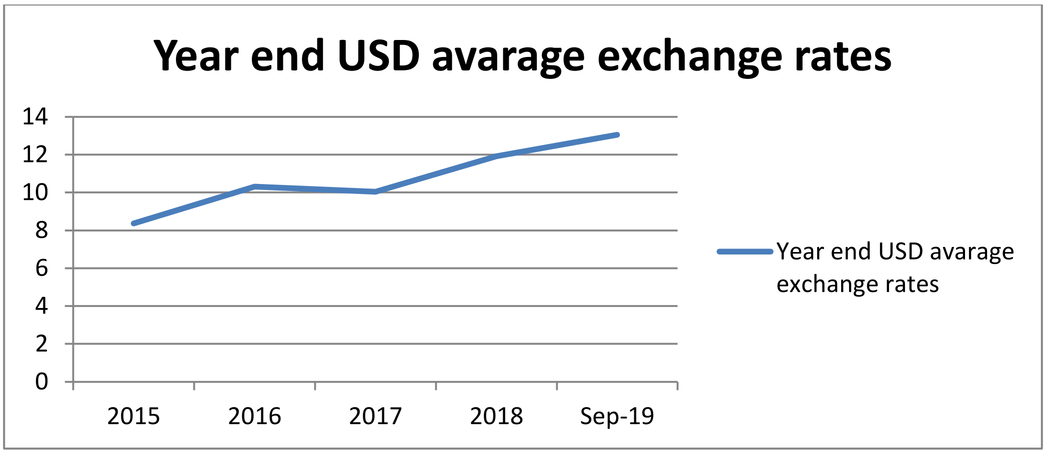
The Zambia Institute of Chartered Accountants is a professional membership body whose function among others is to advise government on matters of economic and national development. As requested, the Institute wishes to submit its overall comments on the 2020 National Budget presented to the Parliament on Friday, 27th September, 2019 by the Minister of Finance, *Hon. Dr. Bwalya Ng'andu*, *MP*, under the theme **"*Focusing national priorities towards stimulating the domestic economy*".**

1.1 As directed by the Clerk of the National Assembly, the thrust of our comments is on the ramifications of the macroeconomic framework and the social protection in the Budget. What we are presenting are our views on the proposed changes to the Tax system and also commentary on the economic aspiration of the budget.

1.2 We are happy with the budget, considering that the Minister had very tight budgetary constraints to deal with, but subject to a few areas that need improvement. We are also pleased with the decision to cancel plans to introduce GST and continue with a modified VAT system. The success will depend on the housekeeping measures that ZRA proposes and the quality of implementation.

2.0 Overview of the Global and Domestic Economies

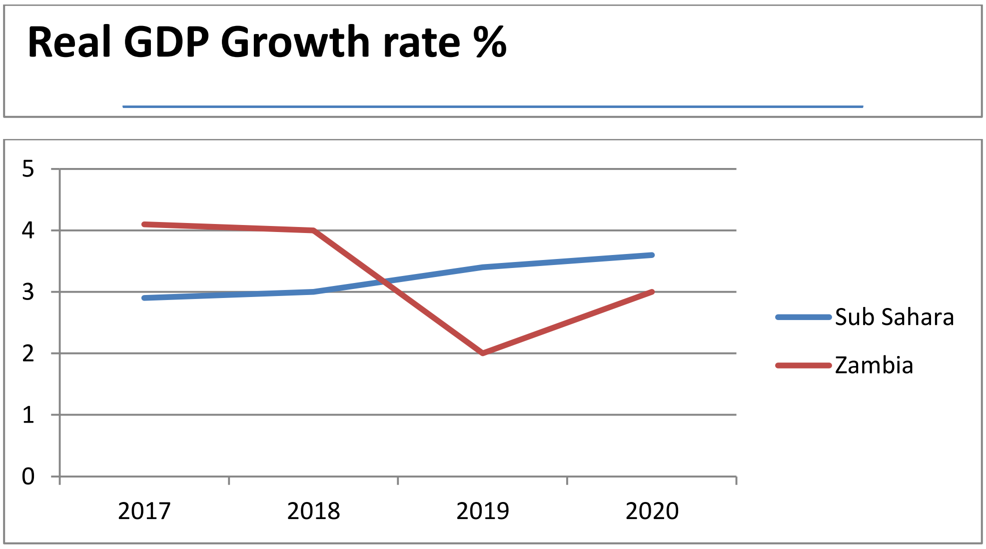
The 2020 National Budget was presented against the backdrop of growing concerns about the sustainability of the country's debt and negative sentiments of the country's possibility of falling into high risk of debt distress. The economic growth is expected to slow down to 2% by the end of 2019 which is 50% of the targeted 4% and growth of 3.7% in 2018. The slowdown in growth is primarily attributed to the impact of climate change, debt servicing and the escalating trade war between the US and China. On the foreign exchange market, the Kwacha depreciated by 9.4% to an average of K13.03 to 1 USD by August 2019 since December 2018, when the Kwacha stood at K11.91 to the USD. The depreciation was largely due to the increased demand for energy imports, debt servicing, and strengthening of the USD.



Graph 1: Source Ministry of Finance

At a global perspective, growth remains subdued. The trade war between the United States of America and China as well as uncertainty regarding trade agreements post BREXIT contributed to a decline in GDP growth from 3.8% in 2018 to 3.2% in first half of 2019. Europe and Asia experienced the sharpest declines. Forecast growth in 2020 is 3.5% based on stabilisation of conditions in the EU area and emerging markets, the ongoing build-up of economic stimulus in China and recent improvements in global financial markets. The growth across emerging markets and developing economies is projected to be 4.1% in 2019 and 4.7% in 2020.

GDP growth in Sub Sahara Africa was 3% in 2018 compared to 2.9% in 2017. It is expected to reach 3.4% in 2019 than 3.6% in 2020. This is on account of increased investment in larger economies in SSA together with growth in non-resource intensive countries.



Graph 2: Source Ministry of Finance

3.0 Macroeconomic Framework and Social Protection Issues

3.1 Social Protection Issues

Considering the tight budgetary constraints, we are of the view that the amount budgeted for social protection (K2.58 bn representing a 17% increase to address increased poverty challenges due to drought, hunger, unemployment etc.) is reasonable.

Sector	**2019** %	**2020** %	**Monetary** 2019 @ K80.6B	**Monetary** 2020 @ K106B	**Monetary Variance**	**Increase**
Economic affairs	23.79	20.6	20.651	21.836	1.185	Yes
Education	15.29	12.38	13.274	13.122	-0.152	No
Health	9.3	8.84	8.069	9.366	1.297	Yes
Social protection	2.52	2.43	2.187	2.58	0.393	Yes
Environmental Protection	1.01	0.58	0.875	0.611	-0.264	No

However, we think the Government needs to improve internal controls and monitoring of social protection programs for them to have impact and avoid wastage and fraud (as was experienced in the social cash transfer scheme in 2018). It should consider introducing half yearly and random operational audits of these programs (Women and youth empowerment, SCT etc.) in addition to the annual audits. This will be a deterrent to Fraud and improve performance and impact.

However, it should be noted that these grant aided programs are not sustainable in the long term and the Government should shift focus to economic empowerment programs at community level gradually.

3.2 Factors that will influence the Macro economic objectives

The mounting trade tension between the United States and China coupled with the buoyant United States dollar are increasingly contributing to the depreciation of currencies for emerging and developing economies. Compounded by the deterioration in the budget deficit and current account deficit, the Kwacha has been a subject of foreign exchange exposure. In the final analysis these factors are likely to impact negatively on the economic projections in the Budget.

The country's economy is still heavily reliant on the mining operations for most of its economic output and accounts for 70% of Zambia's export of goods. However, the sector is dominantly led by a few major mining players and is highly susceptible to fluctuations in commodity prices and global economic conditions. Given the circumstances, it is a risky undertaking to place so much reliance in the Budget on the sector for part of the resource envelop.

In our view other challenges that are expected to have adverse impact on the 2020 Budget are:

a) Volatility in foreign exchange rates;
b) Cost of importing Electricity
c) Drought caused by low rainfall experienced in the country
d) The rising cost in the petroleum sector;
e) The rising budget deficit;
f) The ballooning public expenditure;
g) The cost of borrowing remains significantly high despite several interventions; and
h) Escalating interest payments on public debt;

3.3 Fiscal Framework

The Minister proposes to raise a total of K106 billion in 2020, representing 32.4 percent of GDP of this amount, K72.0 billion, representing 22.0 percent of GDP will come from domestic revenues, while the balance will be raised through domestic and external financing.

4.0 Indirect Taxes

4.1 Value Added Tax

Under Value Added Tax ("VAT"), in our view the measures proposed fall into three (3) broad categories as follows:

(1) Measures aimed at reducing the accumulation of VAT refunds and expand VAT base ;
(2) Measures aimed at encouraging households to use alternative sources of energy; and
(3) House- keeping measures.

We consider each of these below.

4.1.1 Measures aimed at reducing the accumulation of VAT refunds and expanding the VAT base

a) Zero rate capital equipment and machinery for the mining sector

The objective of the proposed measure is to improve cash flow for the mining sector and reduce VAT refund claims.

Commentary

We welcome this move because currently, mining capital equipment and machinery are generally standard rated. However, VAT on certain qualifying mining equipment is deferred under the VAT deferment scheme. From the National Budget pronouncements, it is not clear whether this measure will complement the VAT deferment scheme or the deferment scheme will be abolished and all mining equipment (including equipment currently on the deferment scheme) will then become zero rated. We therefore look forward to clarifications in the amendment Act or subsidiary legislation.

b) Zero rate Copper cathodes for VAT purposes

The Hon. Minister proposes to zero rate the local supply of copper cathodes for VAT purposes.

Commentary

We welcome this measure as this will encourage local value addition, ease cash flow challenges by manufacturers and reduce input VAT claims due to exporters of products manufactured from copper cathodes.

c) Disallow input VAT claims on consumables such as stationery, lubricants and spare parts for all entities, except where these products are stock in trade

The Hon. Minister proposes to disallow input VAT on consumables except where such consumables are stock in trade. The Hon. Minister provides examples of consumables that are likely to be affected by this measure to include stationery, lubricants and spare parts.

Commentary

We would like to highlight that the budget so far does not provide much guidance on what would constitute a consumable or stock in trade. We look forward to clarifications in the amendment Act or subsidiary legislation.

As a result we can only speculate as to the definitions of these terms at this stage. In view of this our subsequent comments are based on general definitions of consumables.
As a starting point, the VAT Act does not define consumables and stock in trade.

Definition of consumables
However the Customs and Excise (General) Regulations 2000 defines consumables as:
"Consumables" means items that are utilized by an organization and are depleted on a regular basis, and includes fuel, lubricants, spare parts and tyres.

Further, the Oxford Dictionary defines consumables as:
A commodity that is intended to be used up relatively quickly.

Based on the general definitions, where a business uses goods in its production process and these goods do not form part of the finished products, then the goods may be considered to be consumables.

Taking the above into account, the measure may result in significant cost escalation for businesses.
For example, manufacturers of cement, detergent paste and lime use coal in processing their raw materials. As the coal does not form part of the final product, does it mean that it will be treated as a consumable?

Similarly with regard to the Mining sector, there are spares and consumables that are critical to the mining operations. Examples of critical consumables include:

i. Pump spares;
ii. Metallurgical / smelting reagents;
iii. Mill balls and grinding media;
iv. Tyres and tubes for loaders, surface dump and haulage trucks and drill rigs; and
v. Explosives.

In the same manner that the Ministry of Finance consulted with various stake holders when deciding on whether to proceed with sales tax, we would recommend that similar consultations are held on what consumables to disallow for VAT purposes to avoid crippling some sectors of the economy.

d) Limiting input VAT claims on diesel from 90% to 70%

The Hon. Minister proposes to limit input VAT claims on diesel by mining and mineral processing companies from 90% to 70%.

Our Commentary

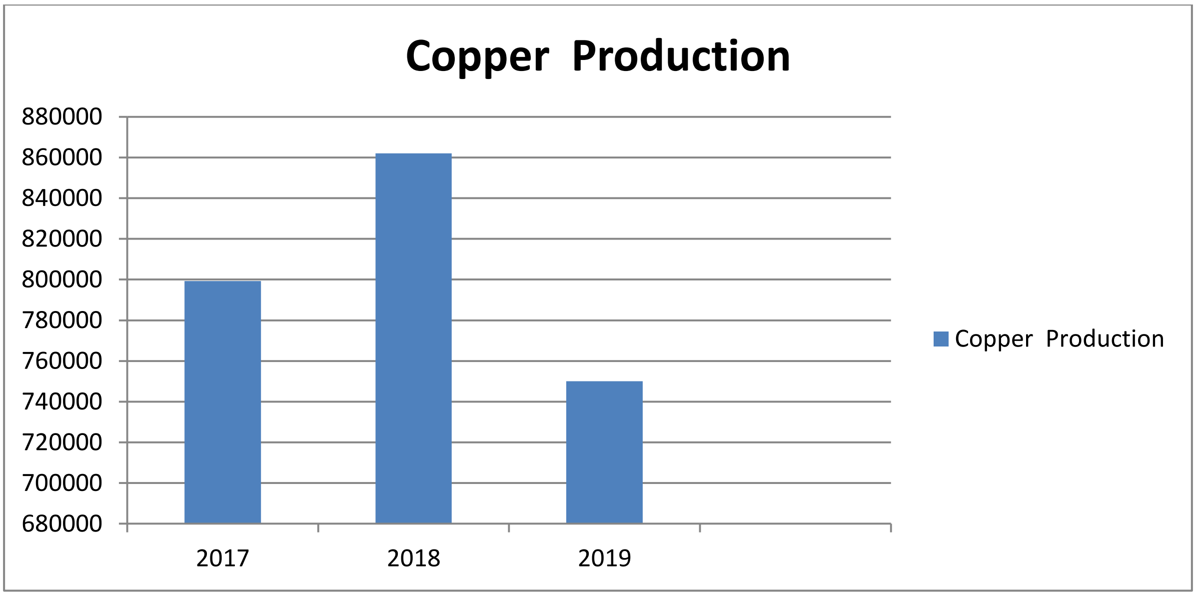
We welcome the measure as it will help increase the revenue for the Government.

e) Limiting input VAT claims on electricity from 100% to 80%

The Hon. Minister proposes to limit input VAT claims on electricity by mining and mineral processing companies from 100% to 80%.

Commentary

We welcome the measure as it is intended to generate more revenue for Government. However, we would have preferred a measure that cuts across all industries to avoid the perception that only one sector is targeted. We have taken note that copper production is projected to reduce to 750,000 mt in 2019 and that there is a general downward trend in copper prices on the international market.



Overall Commentary on measures aimed at reducing the accumulation of VAT refunds;

It is our considered view that these measures will help improve efficiency in the administration of the VAT, improve cash flow for local manufacturers who use the product like ZAMEFA as an input, reduce the VAT refund claims, promote the use of alternative sources of energy and thereby mitigating the effects of climate change and generate revenue for the Government.

However, we are concerned that The Hon. Minister also proposed that input VAT on consumables that are not stock in trade will be disallowed. Depending on the definition of consumables and stock in trade adopted by the tax authorities, this amendment could result in a significant increase in operating costs for the Mining Companies.

Hiking import duty on equipment's for the mining sector may seem to be good in the short term but it is likely to impact on the country's global competitiveness, and thus pose negative effect on the sector activity and in turn on employment. Mining companies carry out the various exploration and development activities prior to production over a long period of time, at high cost and in some cases with a high level of risk and uncertainty as to future commercial benefits. It is thus a unique industry that must be accorded special attention and requires stable fiscal policies.

We reiterate our proposal for engagement with the mining houses as a means of avoiding a slowdown in the sector. We further recommend building administrative capacity in the tax Authority and reviewing the tax regime to meet the best practice in revenue collection from the sector. In the long run the increases in the Mining tax will make the country very uncompetitive consequently forcing Mining companies to avoid investing in the country or put the mines on care and maintenance.

While the motive to increase tax collection from the mining sector is welcome, we would prefer a gradual and phased approach to changes to the mining tax regime to enable the affected parties to prepare and plan. We are of the view that the persistent changes to the mining tax regime will affect long-term investment, job creation and investor confidence in the sector.

On a positive side, the Minister is proposing a Zero rating of capital equipment and machinery for the mining sector, Reduction of capital allowances and Zero rate copper cathodes for VAT purposes to encourage local value addition, ease cash flow challenges by manufacturers and reduce input VAT claims due to exporters of products manufactured from copper cathodes and employment creation in the copper sub-sector. This is a very welcome move and it is our hope that Government will create an enabling environment to create corresponding industry to support this measure.

4.1.2 Measures aimed at encouraging households to use alternative sources of energy

The Hon. Minister proposes to zero rate:
•Gas stoves and other gas cookers;
•Gas boilers;
•Other appliances that use gas; and
•Liquefied Petroleum Gas.

Commentary

This measure will encourage the use of gas appliances and is intended to mitigate the effects of climate change by reducing reliance on electricity and charcoal for energy. We welcome the measure.

4.1.3 Housekeeping Measures on VAT

The following are the House Keeping measures proposed in respect of VAT

(a) Make it mandatory to use Electronic Fiscal Devices (EFD) for VAT and other tax types and facilitate accreditation of EFD manufacturers, distributors and virtual EFD software suppliers and vendors.

The measure is intended to extend the mandatory use of EFDs to other tax types and provide for accreditation of manufacturers, distributors and vendors of EFDs.

(b) Make it mandatory for all taxable suppliers to use Point Of Sale (POS) machines (swiping machines)

The measure is intended to make it mandatory for all taxable suppliers to have a Point of Sale (POS) machine as one of the payment options.

(c) Make it mandatory to capture on the invoice, the Taxpayer Identification Number (TPIN) and Name of both the buyer and seller of goods and services in all Business to Business (B2B) and Business to Government (B2G) transactions.

The measure is intended to enhance tax compliance.

(d) Amend the VAT Act by standard rating ancillary services to transits

Ancillary services include handling, administrative services provided to ensure that the necessary procedures and certificates are obtained for the transiting goods.

The implementation of this proposal may be marred by ambiguity in the determination of "ancillary services". In addition to this, establishing the degree of remoteness between the goods in transit and the services to be taxed may prove challenging. Whilst there has been abuse of ancillary service to mask local supplies that are unrelated to transit goods, we are of the view that alternative compliance measure should have been considered. The imposition of VAT on ancillary services may also *discourage the use of Zambia as a staging base for transporters. For example, transporters use Zambia to break bulk cargo from larger trailers to smaller ones. Zambia is also used to stage the transition of goods from road to rail. This requires provision of significant services and the imposition of VAT may drive the search for alternative staging bases. The VAT imposed on transit shipped goods is often not recoverable as most customers are non-residents.*

(e) Delete the supply of an inclusive tour to a tourist by a tour operator or travel agent licensed as such under the Tourism and Hospitality Act, 2007, if the contract was entered into before 1st January, 2014, subject to such conditions as the Commissioner-General may require.

The measure is intended to remove the redundant provision

(f) Amend paragraph D of Group 2 to empower the Commissioner General to be the sole issuer of Local Purchase Order (LPO) for zero rating.

The measure is intended to restrict the issuance of Local Purchase Orders to the Commissioner General only so as to curb the abuse of VAT zero-rating relief

Commentary

We are agreeable and support the house keeping measures proposed under VAT.

The proposed changes will enhance data matching and analysis to enable a more information technology driven approach to compliance. Emerging technologies such as data analytics can assist in a more risk-based approach to compliance monitoring that will cause the least disruption to compliant taxpayers whilst ensuring that non-compliance is detected early and dealt with.

Tax Online System ("TOS") for domestic taxes will be linked with the customs system making it possible to match profiles of customs importers with their VAT activities. It will be possible for example to match an importer of motor vehicles against their income tax and VAT profile to ascertain if their income supports the level of importation.

We note that the implementation of EFD's has been beset with significant challenges. These challenges need to be resolved to ensure that VAT performance is optimised. The accreditation of the value chain around EFD's (including virtual EFDs) must also be accelerated.

With increased integration of systems comes the potential for abuse. As such, we reiterate our call for comprehensive tax administration legislation that will ensure that the enhanced data collection capabilities are not used to the detriment of taxpayer rights.

4.2 Customs and Excise Tax

a) Remove customs duty on Liquefied Petroleum Gas.

This measure is intended to promote the use of alternative sources of energy and thereby mitigate the effects of climate change. We welcome this move and commend the government for this positive move.
This measure will further reduce the cost of LPG and make it more affordable for consumers to use gas powered appliances. However, other challenges remain that must be dealt with by regulation. These include the lack of interchangeability of gas cylinders that forces consumers to purchase or pay deposits for different types of cylinders at great cost. The Energy regulation Board has a significant role to play in ensuring that regulation is introduced to make cylinders interchangeable. This could be supported by introducing a cylinder exchange system for suppliers.

b) Amend the Customs and Excise Act to suspend customs duty for a period of three years, on selected equipment used in the aquaculture industry.

This measure is intended to promote the growth of the aquaculture industry in Zambia and hereby contribute to the economic diversification efforts of the country. We welcome this measure as it will help to promote the aquaculture sub sector and make community fish farming attractive, this measure is likely to increase investment in fish farming to increase fishery yield, reduce importation of fish and also reduce unemployment in the country. We would further encourage the Government to consider extending a moratorium to the entire value chain of the aquaculture industry.

c) Suspend customs duty for a period of three years, on machinery for processing of solid waste to generate electricity and produce organic fertilizers.

This measure is intended to promote the generation of electricity through Alternative means. The measure is also intended to promote the local Manufacturing of organic fertilisers. We welcome this positive move by Government because although this measure may lead to revenue loss in the short term, the future gains from this measure through increased electricity generation should reduce over dependence on hydropower and also compensate for the revenue loss.
Further, we are confident this measure will boost the local production of organic fertilisers to improve farming activities in Zambia.

d) Impose surtax on Flexible Intermediate Bulk Containers.

The Hon. Minister proposes to introduce a surtax at the rate of 5% on importation of flexible intermediate bulk containers. This measure is aimed at promoting local production of the containers (jumbo bags). We welcome this move. However, the purpose of introducing the surtax will only be achieved if there is local capacity to produce the containers and to achieve this objective, Government should assist local producers to scale up their capacity in the production of the containers.

e) Increase the specific excise duty rate on cigarettes to K265 per mille from K240 per mille

The measure is intended to maintain competitiveness of domestic producers of cigarettes and increase revenue collection for the Government.

4.3 The Mining Tax regime

a) 10% Import duty on importation of specified capital equipment

This measure is intended to raise revenue for Government and discourage transfer mis- pricing. We do not welcome the move to introduce 10% import duty on all mining inputs that attract 0% and 5% as it will not only increase the cost of doing business for the Mines but also discourage recapitalisation of the sector as well as Greenfield investments.

To the extent that the introduction of the import duty does not affect the appetite to import machinery and equipment (especially that Zambia does not manufacture such equipment), the measure should result in an increase in tax revenues.

Currently, most mining equipment critical to the sector is imported duty free and VAT deferred. The removal of VAT on imports of this critical equipment would not result in any benefit to the sector as the equipment did not attract VAT. We would therefore recommend that the sector be engaged by the ministry of Finance in arriving at the equipment that must be subjected to the 10% duty in order not to stifle investment in the sector.

b) Reduction of capital allowances

This measure is expected to reduce the amount of capital allowances claimable annually and extend the duration for claiming capital expenditure from 4 years to 5 years.

c) Pricing of base and precious metals between related parties

The proposed amendments include:

- Provide for price premium adjustments to be made to the reference price. In our understanding these premiums may be attributable to certain economically relevant characteristics;

Empower the Commissioner-General to issue specific guidelines on pricing of minerals.

- Use a price that is higher than the reference price in cases where a Zambia resident person or non-resident person has entered into a transaction with a third party in which the agreed price is higher than the reference price and the sale does not involve further milling, blending, treatment, refinement or transformation.

- Extend the use of the reference pricing to adjust the pricing of purchases between related parties; and

- Empower the Commissioner-General to request a resident or non-resident person to provide, upon request third party Sales Agreements and third party invoices relating to the sale of the base or precious metals.

The objective of this measure is to ensure that premium adjustments are captured and that the Commissioner-General can also issue specific guidance on pricing of base metals and precious metals where appropriate and provide guidelines on determining discounts. Under current provisions the pricing of the sale of base or precious metals between related parties is the "reference price". The reference price is defined to include quoted prices for the minerals (e.g. quoted price on the London Metal Exchange, in the London Metal Bulletin, etc.). This is known as the Sixth Transfer Pricing method.

Commentary

Hiking import duty on equipment's for the mining sector may seem to be good in the short term but it is likely to impact on the country's global competitiveness, and thus pose negative effect on the sector activity and in turn on employment. Mining companies carry out the various exploration and development activities prior to production over a long period of time, at high cost and in some cases with a high level of risk and uncertainty as to future commercial benefits. It is thus a unique industry that must be accorded special attention and requires stable fiscal policies.

On a positive side, the Minister is proposing a Zero rating of capital equipment and machinery for the mining sector, Reduction of capital allowances and Zero rate copper cathodes for VAT purposes to encourage local value addition, ease cash flow challenges by manufacturers and reduce input VAT claims due to exporters of products manufactured from copper cathodes and employment creation in the copper sub-sector. This is a very welcome move and it is our hope that Government will create an enabling environment to create corresponding industry to support this measure.

4.4 Property Transfer Tax

a) Introduction of anti-avoidance provision on group relief provision

This measure proposes to exclude from PTT group relief provisions, transfers between Group Companies that have only been members of a Group for a period of 3 years or less. Currently there is no restriction on the length of time that a company must be a member of a group prior to the transfer of assets to the said company for the transfer to qualify for group relief.

b) Definition of “shares” to include equivalent rights

It is proposed that the definition of “shares” for PTT purposes be amended to include “Equivalent Rights” This broad definition is aimed at expanding the tax by aligning Zambia with other jurisdictions which commonly use the term ‘Equivalent Rights" in their tax legislation.

c) Removal of referenced income tax sections previously revoked

The Hon. Minister proposes to amend the PTT Act by removing references to provisions in the ITA relating to transfer pricing rules on loans (including thin capitalisation), which have since been repealed.

d) Exemption from PTT of certain indirect transfers within a group

It is proposed that the PTT Act be amended to allow the Commissioner –General (“CG”) of the ZRA to determine a nil realised value for certain indirect transfers of shares within a group of companies that do not lead to transfer of economic value where the transfer does not result in a change in the effective shareholding.

e) Determination of the “realisable value” in respect of the indirect transfer of ownership

The Hon. Minister proposes to amend the definition of “realisable value” used in computing the value of shares in an indirect transfer to include:

i. Nominal value of the shares being transferred ; and
ii. The direct consideration of the shares being transferred.

This is in addition to the current computation-based formula.
The realisable value will be the highest value determined based on the three methods.

Commentary

This is a welcome proposal as currently, there is no exemption from PTT for qualifying indirect transfers of shares within a group (reorganisation) as the definition of “group” for PTT purposes excludes non-resident entities. The lack of exemption for intragroup transfers leads to erosion of shareholder economic rights were no transfer has effectively taken place.

The three year limit is an anti-avoidance provision to ensure share transfers are not staged to take advantage of the relief provisions by creating a qualifying group first and then undertaking the share transfer. Whilst we agree with the necessity of this proposed amendment, we are of the view that the three-year cooling off period is too long and may deny relief for transaction that are not aimed at tax avoidance. Consideration should be given to reduce this to a maximum of two years.

4.5 Transfer Pricing

a) Alignment of definitions to the evolution of international trade

This measure intends to align these terms to the evolution of international trade in order that transfer pricing rules are appropriately applied to affected related party transactions. The measure also intends to introduce a definition for "Taxpayer" to achieve the same.

b) Amendment of the transfer pricing provisions

c) Clarification on corresponding adjustments

Commentary

We are agreeable with the amendment and clarification, in our view the previously revoked provision contained a number of useful definitions, the deletion of which may have caused avoidable confusion.

The amendment provides much needed guidance on relief for taxpayers where transactions with related parties have been subject to transfer pricing adjustments. However, this right is limited to transactions between treaty residents where the relating party is non-resident. No relief will be available if there is no double taxation agreement between the two countries. We foresee a number of challenges with this provision including:

- Zambia has a very limited treaty network, and, in many instances, the treaties are outdated and do not provide a mechanism for corresponding adjustments.
- States that are required to make corresponding adjustment may not reach agreement automatically. Our jurisdiction must agree that the adjustment it is required to make reflects the difference between the actual transaction amount and the arm's length transaction amount. The process of reaching agreement on this aspect requires that the "competent authorities" consult each other. The competent authority mechanism has not been properly defined in Zambia, leading to protracted delays in resolving disputes arising from treaty obligations.

Consideration must be given to unilateral relief from transfer pricing adjustments by extending the unilateral credit provisions of Section 75. Currently, relief under Section 75 is only available on foreign income whereas corresponding adjustments may also be made to expenditure incurred by a Zambian resident.

4.6 Withholding Tax

a) Reduction of the Withholding Tax rate on interest payment on government securities to non-residents

The measure proposes to reduce the Withholding Tax ("WHT") rate on interest payments on Government securities to non-residents from 20% to 15%.

b) Exemption of Withholding Tax on interest payable to banks and financial institutions

The measure proposes to exempt from WHT, interest payable to local banks and financial institutions that hold a banking/ financial institution's licence granted under the Banking and Financial Services Act.

c) Provide for the appointment of withholding tax agents for excise duty

The Minister has proposed the amendment of Regulation 52 of the Customs and Excise (General) Regulations, SI No. 54 of 2000 to provide for the appointment of withholding tax agents for excise duty on manufactured oil products.

The appointment of withholding agents will enhance compliance with Excise Duty among manufacturers of oil products. However, mechanisms should be put in place to ensure that manufacturers are not exposed to penalties due to non-compliance by withholding agents, as has been the case with VAT withholding agents.

Commentary

We welcome the proposed amendments by the Hon. Minister as this proposed change now aims to formalise the limitation imposed by subsidiary legislation and the measure is aimed at reducing the administrative burden on taxpayers.

4.7 INCOME TAX

Amend Section 2 by redefining the word "farming".

"Farming" is defined in Section 2 to include "agricultural activity". An enterprise that qualifies as a farming business is entitled to a reduced tax rate of 10 percent. The Government is of the view that "agricultural activity" has been abused to include such activities as marketing, technical and management services or any other varying degrees of involvement in the agricultural process that are not part of farming. These activities will now be excluded in the amended definition.

Commentary

The classification of a business as a farming business largely depends on source rules, established through long standing case law. In determining the source of a taxpayers' income, consideration has to be given to the dominant source particularly where multiple sources of income can be identified. As such, this measure is likely to affect only those taxpayers whose dominant trade is largely services ancillary to agriculture, rather than those *whose source is dominantly agriculture in its common understanding, despite engaging in services ancillary to agriculture.*

4.8 Comments on other areas of the Budget

In the remainder of this section, we have provided commentary on areas which in our view requires urgent attention before Parliament approves the 2020 Budget. Our commentary in this respect is limited to areas where we want to draw the attention of the Minister of Finance and Parliament on the 2020 National Budget.

4.8.1 Fiscal deficit

The fiscal deficit which is the difference between government expenditure and revenue has been consistently high in the last few years 7.4 percent of GDP in 2018, estimated 6.5 percent in 2019 and projected 5.5 percent in 2020. It entails that domestic resources are insufficient to finance the expenditure. As such the deficit has been financed by both external and domestic borrowing.

4.8.2 Austerity Measures

Early this year, the Minister of Finance announced a series of measures to mitigate the threat on macroeconomic stability and attainment of development goals. There has been rising concern from stakeholders on the widening budget deficit and public debt coupled with increased public spending.

The Minister also announced a few other measures such as:

i. Indefinitely postpone the contraction of some pipeline debt until the debt is brought back to moderate risk of distress;
ii. Cancel some of the current contracted loans that are yet to be disbursed to reduce the debt service outlays;
iii. Undertake refinancing of selected bilateral loans, both local and external, to extend the maturity profile and attain lower costs on debt;
iv. Carry out an asset liability management exercise on the debt to ensure sustainability of cash flows;
v. Cease issuance of guarantees to commercially viable projects; and
vi. Cease the issuance of letters of credit and guarantees to state owned enterprises that are technically insolvent until their balance sheet challenges are resolved.

However we note that the Budget has not given specific details on the implementation of these measures. Instead the Minister has provided very limited initiatives in managing the ballooning public expenditure. Government urgently need to address the overpricing in public procurement as well as curtail spending in acquisition of unnecessary but luxury assets and also financing perquisites for Government officials. The 18% increase in the proposed public spending from K 86.8 billion in the 2019 Budget to K106 billion in 2020 does not give indication of good intention on spending cuts in several sectors. The public expenditure in the 2020 Budget represents 41.6 percent of GDP in 2020 from 28.9 percent in 2019. This has been the trend in the last six years where budget deficits mainly driven by the rapid rise in recurrent expenditures. Unplanned spending has been adding pressure to the country's meagre resources and mains an issue of great concern to the Institute. The increase in the 2020 Budget has been driven the following Expenditure Allocations:

Description	**2020 Budget**	**2019 Budget**	**2018 Budget**	**2017 Budget**
General Public Service	44,081	31,277	25,898	17,970
Local Govt Equalization Fund	2,278	1,165	1,078	888
Domestic Debt Payment	12,635	8,626	6,972	4,969
External Debt Interest Payment	21,091	14,947	7,269	4,697
Defense	6,526	5,072	3,498	3,204
Public Order and Safety	4,043	2,866	2,145	2,343
Economic Affairs	21,833	20,651	17,258	20,133
International Airports	1,823	1,593	941	0
Housing & Community Amenities	3,460	2,239	816	823
Health	9,367	8,069	6,782	5,762
Recreation & Culture	383	297	451	324
Education	13,122	13,275	11,562	10,642
Social Protection	2,580	2,187	2,301	2,693
Climate Change Resilience	222	213	458	348
Water Supply and Sanitation	4,381	3,150	801	392

Against this background, we expected the Minister to make policy announcements aimed at spending cuts in several sectors, including the complete halting of new infrastructure projects and, where possible, deferring other construction contracts as well as ban on non-essential foreign travel by Government officials and cutting of the presidential entourage when travelling.

4.9 Debt Position

During the Budget presentation the Minister announced that Government's External debt increased to USD10.23bn by June 2019 from USD 10.05bn at the end of December 2018. The stock of Government guarantees on a net basis is stated at USD1bn, and domestic arrears, excluding VAT refunds increased from K15.6bn (USD1.2bn) in December 2018 to

K20.2bn (USD1.57bn) at the end of June 2019. This amounts to a considerable total debt position of USD 12.8 bn -excluding VAT refunds.

However, the Government has not indicated the actual amount of VAT refunds they owe as at end of September though the Commissioner General has indicated that it is about K22bn cumulating from as far as 2009 and ZRA is making refunds of about K1.4bn monthly with about 70 percent of that being refunds to the mines. We urge the Government to ensure they urgently come up with a plan on how they will dismantle the VAT refunds arrears as this very key to smoothen the operations of the Mining Companies, improve the liquidity in the economy and help create jobs in the Country.

Measures Put in Place in handling the debt stock in the medium to long term

The 70% debt ratio stated in Ministry of Finance update on economic developments in May 2019 has raised alarm in the local and international markets because it is believed to be too high[1]. According to the EIU the debt/GDP ratio is forecasted to reach worrying high levels for a poor and commodity-dependent economy. The public debt/GDP ratio more than doubled from 30% in 2013 to 65% in 2017. This has also led to Zambia getting credit rating downgrades (Fitch's credit rating for Zambia was last reported at CCC with negative outlook).

In May 2019 the Government announced policy measures to manage this worrying debt burden by: planning to cancel some of the existing loan agreements, avoiding contracting new debt, introducing approval all new debt commitments by MOF and restricting payments by Ministries to only funded projects. According to the EIU's forecasts, which assume that Zambia avoids debt default, the public debt stabilises at around 90% until 2020 before falling slightly in 2020-21.

We have taken note of the measures put in place by the Minister in the 2020 budget.

Commentary

Domestic arrears repayments have increased by 46% from last year (compared to total domestic debt increasing by 31%). This amount is not adequate based on the total debt trend.

External debt repayments have increased by 41% and that is a welcome step as it reduces the foreign exchange risk exposure and it will contribute to reducing the fiscal deficit to 6.5% of GDP. This in turn should help improve Zambia’s credit rating and lead to reduction in interest rates.

While it is important for Zambia to reduce debt levels and the fiscal deficit, it cannot cancel new debt contraction completely because it needs to invest in some projects to meet its economic objectives in increasing energy supply and improving local economic activities. We are of the view that the newly created Public Investment Board could appraise project proposals and recommend projects which contribute to the GDP positively. A serious monitoring and evaluation of these projects should be put in place. This function could be done by the same body, although we have observed that it is currently at State House.

Reducing on budget wastage (as reported in the Auditor General and FIC report annually) and improving procurement standards is critical too to ensure that this measures have an impact.

4.10 Measures Put in Place in handling the economic growth, industrialization and job creation

The amount allocated for economic affairs is not adequate as it is just a 5% increase on the background of attaining 2% economic growth instead of 4% in 2019. One would expect more budget and measures to stimulate economic growth and to ensure that the SME sector starts growing.

We have taken note of some initiatives taken up in the agricultural sector (which accounts for about 50% of employment in Zambia according to the CSO). We are of the view that comprehensive programs like the Aquaculture transformation program are critical to build capacity and competitive advantage is selected sectors. We are of the view that two other sectors (for example cashew nuts, horticulture or other high value cash crops) in addition to Aquaculture which have ability to create jobs and create more tax revenue sources should have been targeted. This is a more sustainable way of providing social protection and creating wealth for Zambians.

4.11 Conclusion

We believe that the Budget is a necessary fiscal tool to create positive contribution to economic growth and poverty eradication. However, we note that Budget has not created a conducive environment for the private sector to thrive in employment creation and contribute to the growth of our economy. There is a contradiction in the sense that the country is in dire need of foreign exchange and desperately need to address the waning current account deficit but the Budget on the other hand is bent on introducing barriers to export growth. Finally we would like to thank the government for listening to the submissions from ZICA on maintaining VAT and discarding Sales Tax.