Zimbabwean Government Initiatives for Widening Revenue Base: A Comparison of the Existing and Proposed Income Tax Act

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Abstract
The existing legislation is based on geographical boundaries within or outside Zimbabwe (source based). The proposed Income Tax Act Chapter23:13 intends to widen the tax base by adopting the residence based tax system. This paper highlights the changes proposed in the new Income Tax Act, such as the inclusion of items of a capital nature into gross income, shrinking of the allowable deductions and anti-avoidance measures. In analysing the differences between the two, the implications, challenges and recommendations were also discussed. Students, employees, tax consultants and organisations will benefit from this discussion. The study was mainly a desk research of a thorough analysis to polarise the differences of the two Acts in light of the government objective to maximise revenue (wealth creation).

Keywords: Income Tax Act, Proposed Income Tax Act, Challenges, Implications

1. Introduction

According to the Zimbabwe national budget statements (2009-2012) the existing sources of revenue for the nation are tax revenue and non tax revenue. Non tax revenue in 2009 was derived from fees, charges and fines, pension contributions and revenue from investment properties. From 2010 to date the non tax revenue base was increased by an additional source i.e. diamonds. The table below shows revenue and debt statistics for the nation (2009-2012):

<table>
<thead>
<tr>
<th>Revenue source</th>
<th>2009 Millions</th>
<th>2010 Billions</th>
<th>2011 Billions</th>
<th>2012 Billions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax revenue</td>
<td>685,02</td>
<td>1,762,5</td>
<td>1,877,8</td>
<td>3,233,2</td>
</tr>
<tr>
<td>Non tax revenue</td>
<td>38,9</td>
<td>0,1368</td>
<td>0,1223</td>
<td>0,406</td>
</tr>
<tr>
<td>Total revenue</td>
<td>723,92</td>
<td>1,899,3</td>
<td>2,1</td>
<td>3,6</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Debt statistics</th>
<th>2009 Billions</th>
<th>2010 Billions</th>
<th>2011 Billions</th>
<th>2012 Billions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Principal amount</td>
<td>1.6</td>
<td>2.1</td>
<td>2.9</td>
<td>3.9</td>
</tr>
<tr>
<td>arrears</td>
<td>3.8</td>
<td>4.8</td>
<td>5.1</td>
<td>6.1</td>
</tr>
<tr>
<td>Total debt</td>
<td>5.4</td>
<td>6.9</td>
<td>8.0</td>
<td>10</td>
</tr>
</tbody>
</table>

Source: Zimbabwe budget statements various years (2009-2012)

The table shows that tax revenue from 2009 to 2012 accounted for 94, 6%, 92, 8%, 89, 43% and 87, 3% of the total revenue, respectively. Looking at the debt statistics arrears also account for a larger chunk of the total debt as witnessed by the following arrears to total debt percentages; 70.3%, 69.7%, 64% and 61%. According to an IMF Report (2011 ) Zimbabwe has not been able to pay its debt obligations as they fell due

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since 2006 which resulted in no debt advances from the major players i.e.(World Bank, IMF and International Financial Institutions). Zimbabwe is operating on a “manage within your means approach”. The revenue collections are all consumed in expenditures hence debt arrears escalate. The existing scenario supports Finance Minister’s ongoing plea for a widening of Zimbabwe’s revenue base.

Although the current source based tax system is generating revenues for the government there are leakages of collectable revenue that are being employed by taxpayers to evade taxation or reduce their actual tax burden. According to Mangoro (2013) these tax evasion schemes by taxpayer include international investment, e-commerce transactions, offshore accounts, capital nature receipts discrimination by current legislation. According to (Boven Berg et al.,1997)international integration of financial markets directly influences macroeconomics either by affecting domestic savings or domestic investment, in source based taxation the integration of financial markets implies that taxpayers would rather invest in foreign companies than save domestically hence international transactions would be hard to find if the taxpayer does not disclose them.

According to Mangoro (2013) the use of e-commerce to transact does not leave paper trail in the taxpayer’s revenue which can be assessed by the tax authorities hence revenue collectability is affected. The use of e-transactions also gives rise to the use of offshore accounts to hide revenues and cash streams by the taxpayers. Taxpayers are willing to hide their revenue streams and their net worth to reduce their tax burdens and the source based tax system foster this behaviour if a taxpayer could prove that the money is not of a Zimbabwean source.

The current legislature is that if the taxpayer can prove that the revenue is of a capital nature then it is not levied income tax act according to Income Tax Act Chapter 24:03 section 8 if a taxpayer can justify the substance of a transaction to be of a capital nature hence there are countless leakages of collectable revenue due to this scapegoat that taxpayers use.

2. Literature Review

Introduction

National revenue diversification refers to the concept of utilising different revenue streams in a bid to widen the national revenue base (Braun et al., 1998). Increasing levels of both recurrent and capital expenditure, debt and arrear levels and dwindling tax income in struggling economies are a great advocacy for revenue diversification (Sjoquist, 2004). Revenue diversification is actually seen as a vital way for governments to cope with fiscal stress and continue in operation (Carol, 2005). The current paper looks at the alternative sources of national non tax revenue the nation could employ (e.g. public private partnerships, earmarking, and commercialisation of public entities) and a comparison of the current tax policy (source based) and the new tax bill (residence based) as a way of broadening the revenue base in the Zimbabwean arena.

Alternative Revenue diversification strategies

Earmarking

Earmarking is assigning revenue from specific sources to specific purposes. Some economists argue that a government can ease agreement about increasing both revenue and expenditure by earmarking especially where there will be disagreements. Earmarking may have merits such as protecting high-priority programs from shifting majorities, inefficiency, and corruption. However, most economists have been sceptical about it since in practice, it is difficult to achieve pricing and taxation arrangements that will allocate resources appropriately for the service in question (McCleary,1991). In addition, this practise may also overburden taxpayers.
Donations

Donations are also another way of financing government projects; however, they have their own shortcomings. Cheslock & Gianneschi (2008) found that the use of private donations to replace state appropriations substantially increases resource disparity among public institutions of higher education. They also found that an individual public institution generates slightly fewer gift dollars when receiving relatively lower levels of state appropriations.

Public Private Partnerships (PPPs)

According to Muchemwa (2012) a PPP is a contract between a public sector entity and a private sector entity, where the later performs a public entity function per outcome based specifications, for a fee and for a specific period of time. PPPs are an arrangement between a government and the Private sector in which public activities are performed by the private sector. They offer an opportunity for improved transparency through project formulation, design, implementation and evaluation (BPRA, 2012). The successful implementation of PPPs depends greatly on sound legal procedures, and contracts that show the relationship between government agencies and private firms (Nsasira et al., 2013). However, Sabau & Liviu (2012) argue that PPPs have a major risk of the temptation to use them as a means of avoiding budgeting which may then lead to their under-utilisation.

Commercialisation and Privatisation

According to Muchemwa (2012) full privatisation is when the public entity sells off the facility to the private sector to continue operating as it sees fit or even to discontinue the operation. According to Livingston & Charlton (2001) decentralisation in an effort to raise revenue has its own shortcomings and tax raising potential may not match with the requirements that come with it. According to Gono (2009) parastatals are operating under capacity currently at 10%, this retards economic growth and reduces the government revenue base. Privatisation can increase the tax revenue base of the economy and help the ailing parastatals to operate more efficiently. The Zimbabwean portfolio has 78 parastatals, according to Zhou (2012) only three parastals i.e Dariboard Zimbabwe Ltd, COTCO and Zisco Steel have been privatised the rest have gone through a process of unbundling but no efficiency has been injected into the parastatals. Moreover the privatisation process has been slowed by the new Indigenisation Act which seems to have repelled investors rather than increase investments.

Diamond Revenue

Over the years 2010 to 2012 diamond revenue has contributed a large share to the non tax revenue of the nation. There is need for transparency in diamond accounting and the tax authorities should take part in the value chain of the diamonds. (National budget statements, 2011)

Some of the above non tax revenue sources are already being utilised in the nation with just a few in need of being fully implemented e.g. the commercialisation of public entities and public private partnerships (Zhou, 2012). This invariably implies that the non tax revenue bases though of paramount importance to the nation are inadequate. Greater reliance is still placed on tax revenue which in the wake of economic distress in the industrial and agricultural sectors is insufficient (National budget statement, 2012).

Tax Revenue

Many developing and emerging market economies continue to rely heavily on trade taxes as a source of government revenue (Baunsgaard, no date). It is imperative to distinguish between tax revenue and tax rates. Tax revenue may influence economic activity through an income effect while tax rates operate through a substitution effect (Laffer, 1981).

Devereaux, , Griffith, & Klemm (2004) argue that changes in the tax law, such as base-broadening measures through reductions in capital allowances, can lead to high revenues and revenues will continue to be so strong.
Countries can also make use of property taxes or tax products/ activities that have social costs such as tobacco in a bid to increase national revenue. (Lorde et al., 1990) echoed that pollution taxes can play a useful role in holding down the costs of maintaining and improving environmental. However, this has not yet been introduced in Zimbabwe.

Above all, nation-wide multi-stakeholder consultations are necessary, argues Asfaha (2007). The study added that, the multi-stakeholder consultations should target three issues: establishing a national revenue management law which is acceptable to all stakeholders; establishing a multi-stakeholder independent oversight and monitoring committee and compliance with the national revenue law; and giving the law constitutional status. Zimbabwe has proposed a new tax policy i.e. the residence tax policy instead of the source based tax.

3. **Comparison of the Current Income Tax Act and the Proposed Income Tax Bill**

   Apparently, Zimbabwe is using the Income Tax Act [Chapter 23:06], which was first enacted in 1967 and is still operating to date. Below are the main differences in the two documents.

   - The major difference is that the bill proposes a shift from source based tax system to residence based tax system. The shift would bring a change from source-based (taxing income originated or deemed to have been from Zimbabwe) to a residence-based one, where under the taxable income of a taxpayer resident in Zimbabwe is the taxpayer’s income from all geographical sources within or outside Zimbabwe;
   - The existing Act has a lot of unfamiliar jargon making it difficult for users to understand, but the new income tax bill has simplified the language and brought a clearer distinction between the different types of income, that is, employment income, business income (previously called income from trade) and property income;
   - The current Act is ambiguous, clearer distinction is drawn in the new bill between deductions from income that are of a technical nature closely related to the production of the income in question and those that are “tax expenditures” (that is, deductions that are promotive of public policy objectives);
   - The taxation of certain amounts which, though strictly speaking are capital gains, relate to the disposal of certain property used primarily in the production of income, namely business property and investment property;
   - The removal from the body of the Act of prescribed amounts and formulas wherever possible to separate Schedules, namely the Fourth Schedule (“Miscellaneous Calculations”) and the Ninth Schedule (“Prescription of Various Amounts’)
   - Compared to the current Act, the new bill abolished the Special Court for Income Tax Appeals and retained the Fiscal Appeal Court, which is now the appellate court of first instance for income tax appeals.
   - The new bill resulted in the updating and modernising of outdated terms to take account of contemporary developments in the field of income taxation, such as the changeover to the accrual basis of accounting.
   - Unlike the current Act (which did not take into account amounts of a capital nature as these were being considered under the capital gains tax Act), the new bill now considers these
   - The current Act does not consider income from illegal activities, but the new bill proposes that income from these is taxed e.g. income from the disposal of marijuana
   - The current Act awards the SMEs allowances, but these have been disregarded in the new bill.
   - Currently, the motoring benefit was taxed according to engine capacity and apportioned according to use (i.e. for private or business purposes), but the new bill proposes that tax be levied according to
the cost of the vehicle and taxpayers are taxed for each private trip e.g. trip from work to home and from home to work.

4. Implications of the New Act

- Had it been that tax from the incomes (in pounds, pulas, USD, Rands) of the majority of Zimbabweans who were working abroad between 2007 and 2009 were returned home a lot of revenue would have been received. However, countries are unlikely to give up the right to collect tax from foreigners doing business within their economies.
- Although residence-based system provides a legal and broad base, it is subject to easy avoidance or and can raise the appetite to evade tax by channelling international investments through tax havens. The issue of dual residency may also make it difficult for tax authorities to determine the actual residence of a taxpayer and it also exposes taxpayers to the risk of double taxation
- A lot of ambiguities in the current Act are being addressed by the new Bill and as such, such clarity fosters a common understanding and similar interpretation and therefore same application
- General deductions formula looked at expenditure in the production of income and for purposes of trade but the new Bill disregards “Purposes of Trade”. This distinction will become a challenge to practitioners and may result in misinterpretation and wrong application. Expenses incurred for the protection of income such as insurance premiums are no longer deductible, bank charges and marketing costs are also not deductible. Are these not incurred in the production of income?
- The fact that some of the incomes that were taxed under the capital gains tax Act will now be taxed under the Income Tax Act effectively makes the Capital Gains Tax Act redundant. Although these two Acts are expected to work together, it may become a challenge to determine which Act will take precedence. For instance according to the new Income Tax Bill the cost base of any property is non-deductible, but such costs are deductible under the Capital Gains Tax Act. The bringing in of income of a capital nature that was being taxed under a separate Act without the other Act being repealed will attract different applications for the same type of income and therefore disparities. This will also make comparability a challenge
- The Capital Gains Tax Act does not recognise gains from a sale of a specified asset if the proceeds are used to replace the asset before the end of the next year of assessment from the date of disposal. The new Bill does not recognise gains from a transfer of property if the proceeds are used to replace the property within one year of disposal. Already there is disparity in the time period
- Proceeds of any crime or other unlawful activity will now form part of taxable income, but the expenses incurred in producing that income e.g bribes, illegal payments and fines are a prohibited deduction. This indirectly, may encourage crime and unscrupulous dealings
- The new Bill disqualifies capital allowances for commercial buildings erected before the new Bill becomes an Act, and this may not go well with taxpayers as there is no justification for this. The new Bill seems to advocate for a disappearance of SMEs allowances, it means SMEs are now taxed more.
- The new way of taxing of the motoring benefit according to the New Bill may ultimately discourage employees from accepting company vehicles.

5. Conclusions

- The new Bill is more user friendly than the previous one, with simple language coupled with clear terms
- Capital gains tax Act becoming redundant and not being repealed causes confusion and miscalculations due to different rates
Comparison between entities in the same industry becomes difficult as a result of applying different Acts for the same type of income

Taxing income from illegal trade promotes illegal transactions and fuel corruption and dubious activities

It can be argued that the new Bill penalised already over-burdened individual and corporate taxpayers e.g. on the taxation of motoring benefit

Ultimately, residence-based tax system broadens the tax base and increases revenue if well-administered

6. Recommendations

The tax authorities should provide a clear distinction between purposes of trade and production of income; The capital gains tax Act must be repealed to facilitate an efficient tax system; Government should also utilise PPPs fully and encourage commercialisation and privatisation.

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