Zimbabwe Coalition on Debt and Development

Investing in People for Social and Economic Justice in Zimbabwe

TAX ANALYSIS REPORT

2016 First Quarter

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1. Introduction

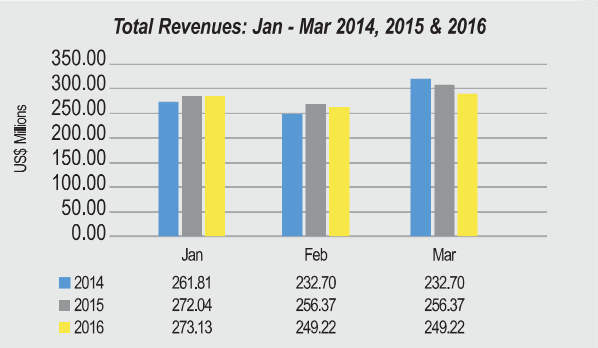
Tax is a critical source of revenue in Zimbabwe. It is an important primary domestic resource that is sustainable, provides the impetus to fairly distribute income and offer policy space for government to respond to the needs of the citizens. It acts as a social and economic instrument for addressing national objectives. The Government of Zimbabwe is constrained in mobilizing resources from the traditional sources such as money printing, aid and debt thereby the growing importance of tax revenue. In 2015 fiscal year, 93% of the total revenue was generated from taxation. This report provides in-depth tax information through scrutiny of Zimbabwe's tax administration, major revenue heads, trends and distributional implications for purposes of informing and defending public interests.

2. Analysis of the 2016 First Quarter Revenues

2.1 Total Revenue Analysis

The 2016 National Budget provided for US$3.85 billion revenues and US$4 billion expenditures. The bulk of the budgeted revenue was tax revenue. For the first three month, about US$808.4 million in revenues was collected against the targeted US$920.7 million resulting in about 12% negative variance. First quarter revenues are 21 % of the budgeted revenues. During the first quarter in 2015, a total of US$832.77 million was collected; hence the 2016 first quarter revenues have declined by 3% from the 2015 collections. As shown in the figure 1 below, first quarter revenues performed well in January and deteriorated in February and March.

Figure 1: Total Revenues ***2014 - 2016 (Jan - Mar)***



Source: Ministry of Finance and Economic Development

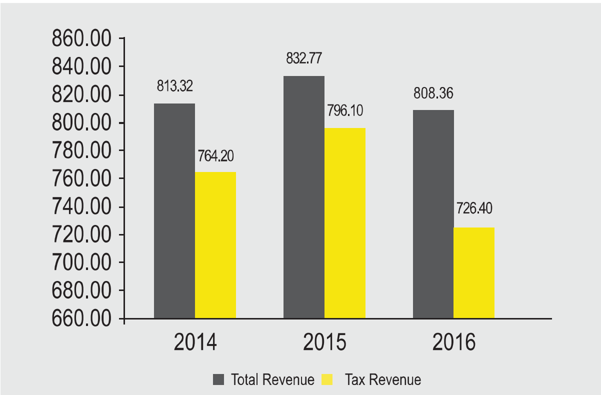
During the first quarter of 2016, tax revenues collected were US$726.4 million against a target US$861.8 million resulting in a 16% negative variance. Non-tax revenues collected of US$81.95 million exceeded the targeted US$58.86 million by 39%. Tax revenues accounted for 90% of government revenues while non-tax revenues accounted for the remainder 10%. Table below shows revenue performance for the 2016 first quarter.

Table 1: Tax and Non-Tax Revenues US$ ***(Jan-Mar 2016)***

	TAX	NON-TAX
January	238,312,476.0	34,817,212.7
February	230,464,081.8	18,754,929.6
March	257,628,152.4	28,379,370.6
Total	**726,404,710.3**	**81,951,512.9**

Source: Ministry of Finance and Economic Development

Figure 2: First Quarter Total & Tax Revenues ***(2014 - 2016)***



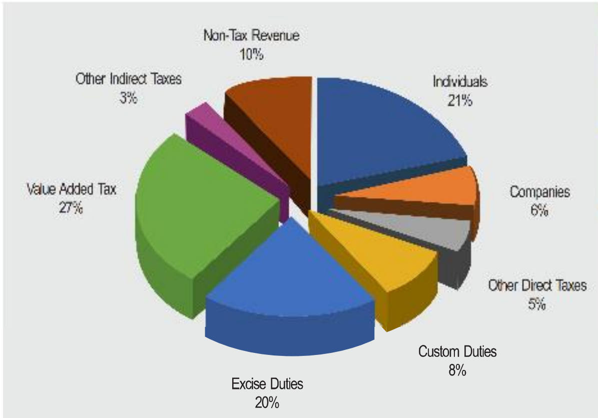
Source: Ministry of Finance and Economic Development

In relation to the same quarter in 2014 and 2015, the 2016 first quarter revenues compare unfavorably as shown in Figure 2 below. Tax revenues declined by a larger proportion of 9% from US$796.1 million in 2015 first quarter to US$726.4 million during the first quarter of 2016. The declining performance in both total and tax revenues is indicative of the general economic slowdown and underlying tax inefficiencies.

2.2 Contributions of Revenue Head

In terms of contribution by revenue heads to total revenues, V.A.T, individual tax and excise duty contributed the bulk of the revenues in the first quarter of 2016 as presented in the graph below. The pattern presented in the figure has been consistent since 2009 despite marginal changes as V.A.T, excise duty and individual tax heads accounted the bulk of revenues.

Figure 3: 2016 First Quarter Revenue Contribution



Source: Ministry of Finance and Economic Development

2.3 Tax Heads Analysis

2.3.1 Value Added Tax (V.A.T)

V.A.T contributed 27% of the gross revenue collections in the quarter under review compared to 26% contributed during the same quarter in 2015. An amount of US$214.6 million was collected against a target of US$236 million hence a negative variance of 9%. In 2015, US$213.3 million was collected against a target of US$254 million resulting in a negative variance of 19%. V.A.T collected in 2016 was marginally, 1%, higher than in 2015. Thus, despite the negative variation, V.A.T collected in the first quarter of 2016 compares favorably, in both amount and proportional contribution to total revenues, to 2015 first quarter.

Value added tax, which is a tax on consumption of goods and services, was first introduced in Zimbabwe in January 2004 to replace the sales tax. The decision to replace the sales tax with V.A.T was influenced by the fact that V.A.T is applied on a broader range of goods and services (including those that were exempted from sales tax), so V.A.T broadened government's tax revenue base.

Currently, V.A.T is charged at a rate of 15% on all goods and services. Goods that are subject to V.A.T include among others food, household appliances, electricity, water, land and buildings, computers, stationery etc. During the first quarter, Statutory Instrument (SI) 9 of 2016 (Value Added Tax [Amendment] Regulations, 2016 [No. 40]) streamlined and reduced zero-rated items effective 1 February 2016. Protective clothing, milk, eggs, vegetables, fruits, rice, cereals and margarine were exempted from V.A.T. However, the same SI repealed zero-rating of nearly 40 imported basic commodities and goods meant for use or consumption for agricultural purposes. Given that the majority of basic goods consumed in Zimbabwe are imports of agricultural nature, the new V.A.T regulations are likely to push up the cost of food and other basic necessities.

V.A.T revenues continue to be undermined by leakages and corruption as government lags in operationalizing use of electronic fiscal devices meant to provide real time monitoring of transactions for V.A.T purposes. The dominance of V.A.T, is neither socially desirable nor economically sustainable. The high consumption tax essentially reduces real income; hence lower household consumption and this has adverse consequences on the ability of households to purchase nutritious food, education and health among other critical social services.

2.3.2 Company Tax

The contribution of corporate tax has been consistently deteriorating since 2013. In the first quarter of 2016, a total of US$52 million was collected against a target of US$76 million resulting in a negative variance of 32%. In the same quarter of 2015 a total of US$71.6 million was collected against a target of US$81 million resulting in negative variance of 12%. Company tax revenues declined by 27% in the first quarter of 2016 compared to same quarter in 2015. The 2016 contributions to total revenue fell from 9% in 2015 to 6% in 2016.

This poor performance is consistent with the sluggish economic growth characterized by company closures. The Zimbabwean economic growth averaged 7.2% in the period 2009-2015. The economy registered strong growth between 2010-2012, with real economic growth averaging 11.3%, before slowing down to an average of 3.1% between 2013 and 2015. Notable economic stagnation has been experienced in the most recent years, with the economy estimated to have grown by 1.1% in 2015 and projected to grow by 1.4% in 2016.

Despite poor performance of the economy, closure of industries and rising informalisation; company tax revenues are further undermined by tax holidays, corruption and non-compliance. Corporate tax is charged at 25%. The Zimbabwe Revenue Authority (ZIMRA) offers tax holiday to licensed investors and investors under the Built Own Operate and Transfer (BOOT) and Built Operate and Transfer (BOT) for the first 5 years of operation. Under the BOOT and BOT arrangements special tax rate of 15% is applied in the second five years of operation. Manufacturing companies exporting more than 50% of output are taxed at a special rate of 20%.

Mining companies enjoy tax incentives that include special tax rate of 15% for holders of special mining license, fully or wholly allowed to deduct as tax allowance capital expenditure on exploration, development and operating in mining, and there is no restriction on the carryover of tax losses. Farmers also enjoy incentives in allowed special deductions in the form of expenditure on fencing, clearing and stamping land, sinking boreholes, etc.

Corruption, political connections and a culture of patronage have ensured that not all companies are fully taxed hence poor company income tax revenue. Lack of legitimacy, transparency and accountability, on the part of companies and government, undermine residents' willingness to pay taxes hence low tax revenues. Illicit financial activities are undermining tax revenues as they distort tax liabilities by the companies. Companies misreport transactional values, quantity and composition of goods, and misinvoice to evade and avoid customs duties, V.AT., incomes taxes and other taxes. In 2015, Zimbabwe lost an estimated US$684 million through illicit financial flows hence reduced tax revenues. Illicit financials flows could have continued in the first quarter of 2016 due to lack of strong legal and institutional mechanisms to combat such activities.

2.3.3 Individual Tax

The revenue head contributed US$166.4 million compared to a target of US$196 million hence a negative variance of 15%. In the same quarter in 2015, US$200.18 million was collected against a target of US$192 resulting in a positive variance of 4%. The proportional contribution of individual tax to total revenues declined from 24% in 2015 to 21% in 2016. Individual tax revenues collected in the first quarter of 2016 were 17% lower than the same quarter in 2015. The revenue head therefore declined in amount collected and contribution to total revenues. This is a resemblance of the dwindling and low individual incomes due to high unemployment that was exacerbated by massive retrenchments in 2015 and low levels of wage incomes.

The tax threshold for the first quarter was US$300 (the same as in 2015) lower than the Poverty Datum Line (PDL) estimated at US$483 in February 2016. Individual income above the tax threshold attract tax rate of between 20% and 50%. Generally, the individual tax rate is above the corporate tax rate and the tax threshold falls below the PDL which is socially undesirable.

2.3.4 Excise Duty

A total of US$160.4 million was collected against a target of US$179.08 million resulting in 10% negative variance. This is an unfavorable comparison to the first quarter of 2015 when US$165 was collected against a target of US$139 million and a positive variance of 19%. During the quarter under review, excise duty collections were 3% lower than the same quarter in 2015.

Excise duty was collected on beer, wines and spirits, tobacco, second hand motor vehicles, fuels, electric lamps and airtime. Fuels, Beer and airtime are the largest contributors to the revenue head contributing 80%, 9% and 6% respectively. Tobacco, and wines and spirits contributed 3% and 2% respectively while second hand motor vehicles and electric lamps' contributions were close to zero.

During the period under review there was change on the mechanism for calculating excise tax on the change of ownership of second hand motor vehicles aimed at improving transparency and easing the tax head administration. The tax that was previously calculated based on ZIMRA's assessment of the agreement of sale has been changed to a fixed fee schedule based on the years from manufacture and engine capacity. This is a positive development as it reduces previous leakages posed by the subjective and variations in the assessment of distinct agreements of sale.

2.3.5 Customs Duty

Customs duty collected in the quarter amounted to US$67.8 million against target of US$90.3 million, hence a negative variance of 25%. In the first quarter of 2015, US$78.3 million was collected against a target of US$84 million; hence a negative variance of 9% was recorded. Customs duty revenues collected in 2016 were 13% lower than in 2015. The contribution of the revenue head to total revenues marginally declined from 9% in the same quarter in 2015 to 8% in 2016.

During this quarter, the travelers' rebate was struck down from US$300 to US$200 effective 1 January. Travelers transported by service vehicles (goods carrying vehicle, omnibus, vehicle drawing a trailer (excluding those for tourists on an organised tour or safari), and vehicles hired for a reward for the transportation of passengers and/or goods) no longer qualify for travellers' rebate. Similarly, daily remission of duty was reviewed downwards from a free on board value of US$50 to US$10 on a single consignment in the first quarter.

Old vehicles attract more duty than the new ones, hence constraining the poor who cannot afford to buy new vehicles. However, clothing manufacturers, bakeries and tourist operators among other corporate continue to receive rebate on specific inputs and imports of capital nature. Indications are that custom duty for corporate is less severe than to individuals.

2.3.6 Other Direct Taxes

This revenue head includes sub-heads that are domestic dividend interest, tobacco levy, royalties, other income taxes and vehicle carbon tax. A total of US$41.2 million was collected against a revenue target of US$57.5 million hence a negative variance of 28%. The contribution of other direct taxes to total revenue remained consistent at 5% in both 2015 and 2016. These other indirect taxes are examined below.

2.3.6.1 Domestic Dividend and Interest

The amount of domestic dividends and interest collected in the first quarter of 2016 were US$14.6 million against a target of US$16.1 million hence a negative variance of 9%. Similarly, in 2015, an amount of US$12.1 million was collected against a target of US$13.1 million hence negative variance of 8%. Domestic dividend and interest collections improved by 21% between 2015 and 2016.

2.3.6.2 Royalties

During the first quarter of 2016, royalties of US$13.4 million were collected against a target of US$24.5 million hence a negative variance of 45%. In 2015, royalties of US$19.6 million were collected against a target of US$32.5 million resulting in a negative variance of 40%. Comparing 2016 and 2015, royalties collected have declined by about 32%. The amount of royalties collected does not signify the importance of the mining industry neither the vastness in natural resources Zimbabwe is bestowed with.

2.3.6.3 Tobacco Levy

Tobacco levy has poorly performed during the first quarter of 2016. A total of US$0.4 million was collected against a revenue target of US$2.1 million hence a variance of 79%. Similarly, in 2015, a total of US$0.6 million was collected against a target of US$3.2 million, hence a variance of 81%. Tobacco levy collections have declined by 33% between 2015 and 2016 mainly due to the lowering of the levy from 1.5% to 0.75%, lower tobacco prices and the late start of the tobacco selling season caused by the El-Nino induced drought.

2.3.6.4 Other Income Taxes

During the quarter under review, US$4.8 million was collected against a revenue target of US$5.8 million hence a revenue variance of 16%. In 2015, for the comparable quarter, US$4.5 million was collected against target of US$11.7 million hence a revenue variance of 62%. Other income tax revenues collected in 2016 first quarter have improved by 7% compared to 2015.

2.3.6.5 Vehicle Carbon Tax

Carbon tax revenue collected in 2016 first quarter was US$8.1 million against a target of US$9.1 million hence a negative variance of 11%. In the same period of 2015, US$8.4 million was collected against a target of US$7.6 million resulting in a positive variance of 11%. Comparing 2015 and 2016, carbon tax revenue declined by 4%.

2.3.7 Other Indirect Taxes

Other indirect taxes contributed US$23.9 million compared to a target of US$27 million; hence a negative variance of 12%. In the same quarter of 2015, US$21.8 million was collected against a target of US$30 million; hence a variance of 27%. The contribution of other indirect taxes to total revenues remained constant at 3% in 2015 and 2016.

3. Implications of Tax Revenue Performance

During the first quarter, poor revenue collections persisted as revenue declined from the 2015 first quarter level while set targets were not achieved. This performance undermines funding of socio-economic goals that include social protection, key infrastructure financing and provision of basic services in education and health. The cash strapped government is more likely to push for engagement with International Financial Institutions (IFIs) to unlock financial assistance which undermines independence and has a negative effect of deteriorating the debt situation. Zimbabwe's total debt is estimated at $8.368 billion and engagement with IFIs is meant to repay the debt by further borrowings.

Crucial government expenditure such as infrastructure expenditure and social spending in health and education are likely to be suspended due to revenue deficit. Declining tax revenue and failure to meet revenue targets entails that there is no likelihood for reducing tax rates which are generally high. Prospects are high that non-tax revenue charges will be heightened as the Zimbabwean government pursues stringent measures to raise revenue.

V.A.T dominated tax revenue collections imply that the tax system is less redistributive and is inefficient. Companies continue to receive incentives meant to boost their recovery, promote export and increase output in mining despite existing evidence suggesting that such incentives have yielded less economic benefits to Zimbabwe. Coupled with tax evasion and avoidance, the fiscal measures are undermining company tax revenue and shifting the tax burden to individuals and few companies.

More revenue contributions from V.A.T (a non redistributive tax) than individual tax (redistributive tax) implies that the tax system is short to achieve the equity objective. Poor households consume a larger proportion of their income; hence they are taxed more through V.A.T than the rich. Growing contribution of V.A.T means that the rich are proportionally paying less tax from their incomes making the overall tax system regressive.

Individual tax rate generally exceeds the corporate tax rate and is inflexible. The tax free threshold is below the Poverty Datum Line (PDL) estimated at US$483 in February 2016. This tax pattern shows that government is more concerned with attracting investors at the cost of individuals. The tax threshold below the PDL means that the government is concerned with raising revenue at the detriment of poverty alleviation. Less revenue generated from individual tax entails that the tax system is less redistributive.

4. Conclusion

The 2016 first quarter government revenues underperformed as shown by a general decline of 3% from the 2015 revenues and a negative variance from the target of 12%. Tax revenues were 16% short of the target and declined by 9% from the 2015 first quarter level. V.A.T, individual tax and excise duties contribute the bulk of tax revenues. Tax revenues are undermined by leakages, abuse of tax incentives, company closures, hard to tax informal sector, tax incentives offered to corporate, corruption by ZIMRA officers and political patronage.

The tax system is generally favorable to companies than individuals. However, heightened informalisation implies that most individuals in the informal sector are not taxed. Given the revenue performance, government is constrained in financing social-economic goals and is likely to intensify borrowing which has negative implications to financial independence and sustainability, and will deteriorate Zimbabwe's debt situation.

Attempts to improve tax revenue mobilization should consider that the current tax system is regressive as the majority of Zimbabweans languishing in poverty are contributing more tax revenue to government through V.A.T and Individual tax than the rich. V.A.T and Individual tax revenue heads contributed more to the total revenues as they are inflexible than the company taxes overshadowed with a number of exemptions and incentives. In addition, corporate tax is charged on net income while individual tax is charged on gross income. Individuals and workers are double taxed; when they earn income and when they spend, whereas companies are taxed only on consumption. The tax system is inequitable and unfair as the poor are subsidizing the rich. Tax incentives should be streamlined as they are benefitting the companies at the expense of government revenues for social and economic development in the country. The tax system is a barrier to social confidence and dignity; poverty reduction; self sufficiency; safe and secured community; healthy and active living; and quality life in Zimbabwe. Effort is therefore required in improving tax revenue performance through tax justice in Zimbabwe by redressing inequities and leakages in the current tax system.

Government of Zimbabwe should improve tax collection efficiency to narrow the wide social and infrastructural development financing gaps being created by tax revenue underperformance. Maximizing tax revenue for sustainable social and economic development requires the government to ensure that tax payers benefit from their tax money, address the underlying political problems, streamline tax incentives to companies, improve transparency and accountability on tax revenue, streamline revenue collecting agents, implement punitive measures on tax avoidance and evasion, and effect effective oversight on ZIMRA among other things.