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Modelling the Implementation of General Sales Tax System from the Current Vat Tax System to Increase Domestic Revenue and Economic Recovery in Zambia

Paul Bernandicto Ngosa

Zcas University

Zambia

ABSTRACT

The significance and value of this study are to remind and alert the government of the republic of Zambia the potential of the sale tax system in comparison to the current value-added tax system in revenue generation which will stimulate economic development, capacity, ability, and self-sustenance of the nation and reduce over-dependence on debt financing. The usage of General Sales Tax framework from the current Value Added Tax System enhances Government revenue and exhort the policymakers that the general sales tax generously influence the monetary development and could fundamentally raise enough income for reimbursement of obligations and add to economic development in Zambia. However (Abdul-Khaliq 2017). The other finding is that VAT enlisted powers business incorporate VAT on every one of the sales. Therefore, the products and services seem progressively costly to customers and for that business who are not VAT enlisted, this expansion might be unwelcomed clients which sway government revenue contrarily. The VAT would support the advancement of a huge underground economy. Evading the VAT is a piece of the way of life. In many cases, residents sidestepping the VAT are not in any case mindful that they are getting away tax collection in light of the fact that their avoidance strategies have moved toward becoming a piece of their regular daily existences. It also consists of businesses engaging in schemes to secure larger refunds than those to which they are entitled, rather than evading it outright like in an underground economy. Regardless of how very much built, VATs are constantly powerless to tricks that enable organizations to guarantee bigger discounts than they are entitled.

KEY WORDS: *General Sales Tax System, Value Added Tax System, Government Domestic Revenue, Economic Recovery.*

1.0 Background

The introduction of general sales tax system to replace the value added tax (VAT) system in Zambia has attracted a lot of arguments from various stakeholders which includes the tax payers, academicians, professionals and foreign envoys, on how the sales tax system will affect prices of goods and services, foreign investments, cost of basic needs (food Basket) and economic growth of the country.

The economy of the Republic of Zambia continued to recover in 2017 from the global economic slowdown which has had a negative impact on the country's historically strong minerals sector. The falling commodity prices and decreasing demand in destination markets have hurt the foreign direct investment and highlighted the need to diversify the economy (ZDA 2018). The rise of the digital economy has forced policymakers to grapple with the fundamental issues of taxation and how best to raise revenue to fund government expenditure in a more challenging context.

Governments have doubted the adequacy of existing tax regimes to continue to raise sufficient revenue. The European Commission has expressed concerns about the ability of existing corporate tax rules (Pwc 2018).

Zambia's external debt stood at USD9.4 billion at the end of June, up from USD8.7 billion in December 2017, while Government guaranteed debt wasUSD1.2 billion. Meanwhile, domestic debt in the form of government securities was K51.9 billion at the end of June 2018, representing 19.2%of GDP. The total domestic arrears amounted to K13.9billion at the end of 2018 easily surpassing in relative terms the debt levels that qualified Zambia for the Highly Indebted Poor Countries debt relief scheme in 2005.Atthat time, Zambia's external debt stood at USD7billion, while its domestic debt was around USD1.7 billion (Pwc 2019)

Countries such as Zambia have announced they want to address the issue of transfer pricing (Financial Times, 2013). Mining companies are accused of selling copper at artificially low prices to other parts of the same conglomerate so that taxable profits in Zambia are low, while profits are reportedly high in the buyer's country, which may have low taxes. There are accounting standards for developed countries to address transfer pricing concerns, but how can developing countries with fewer capacities to assess adherence to such standards minimize transfer pricing.

1.1 Introduction

The effective tax systems are central for sustainable development because they can mobilize domestic tax base as a key mechanism in economic development and reinforce government legitimacy through promoting accountability (Heggstad 2011).The country cannot continue raising debts to finance its deficits, that's why the government has resolved to put up mechanisms that can trim its persistent financial deficit s and rising in debt burden to hunt for that elusive surplus and builds up its savings to stimulate and develop the domestic economy in the present and future (Ibrahim 2011).

The 2017 budget and 'Zambia Plus' economic recovery program have put an emphasis on the need to improve domestic revenue collection. Repeat and large fiscal deficits have led to rising debt levels and put pressure on this fiscal stance. Both spending and revenues have grown considerably since 2010, but in the recent years the pace of expenditure has exceeded revenue. Zambia needs to calibrate carefully how much revenue is required for its development goals and to ensure this analysis feeds into the revenue policy and the administration of taxation. One of the main gripes liberals have with VAT is that it affects the poor and rich equally. Those with higher incomes do not have to pay more into the system than those who can barely afford a loaf of bread. The ethics of what's exactly fair is completely debatable, but when it comes down to it, a VAT makes the biggest impact on the lowest earners. Whether this is one of the advantages or disadvantages of VAT depends on where you fall on the socioeconomic scale. The current system of taxation (VAT) has resulted in the country owing the mining companies and outstanding amount of US$ 600Millions in unpaid VAT refunds. The VAT rule 18 draws its legality from section 15 of the VAT Act. Under this law all exports including the mining companies are indirectly exempt from paying VAT which is zero rated which means that though they have registered as suppliers of goods and services on which VAT has to be deducted they charge VAT at zero percentage.as a results interims of VAT, they don't owe government anything since they don't collect VAT output but claims from the government but could claim all the input VAT each month. It is against this background that the government want to implements generals' sales tax system in order to migrate from Value Added Tax to general sales tax.

A sales tax system is believed to help in broadening tax base and increase revenue contributions by all sectors and individual in the entire value chain. The increase in internal revenue generation from taxes by changing the tax collection system from value added tax to sales tax will help government to develop all sectors of the economy and operate a surplus budget and repay its debts. However, the success of this system needs interactions and coordination between tax payers and tax collector (Irawati 2019).

Economic growth is one of the most important determinants of economic welfare. The relationship between tax revenue and economic growth is a frequent topic of discussion. Also, tax is a sustainable source of revenue for government and a tool for fiscal policy and macro-economic management. It is a potential tool for economic and social reform as it pervades all aspect of the economy, individual, companies, citizens and foreigners (Abdul-Khaliq 2017).

In 1934, New York City became the first local government to adopt a local sales tax. Use of local sales taxes spread, and as of 2008, local sales taxes were used in 33 states (David and Rayna 2017) .A diverse revenue system reduces the

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likelihood that beneficiaries can avoid paying a fair share of the cost of public services and a diversified revenue structure is likely to add to the stability of total revenue over the business cycle as well as financing local public services through user charges and fees promotes a more efficient level of public services. However, for this system to succeed there must be high levels of compliance. Tax compliance is defined as the ideal condition of taxpayers who meet tax regulations and report their income accurately and honestly. From these ideal conditions, tax compliance is defined as a state of taxpayers who fulfill all tax obligations and carry out their taxation rights in the form of formal and material compliance (Alm et al 1990)

1.3. Statement of the Problem

Zambia has continued to experience difficulties in managing and servicing its relatively huge stocks of external debt. The relatively high level of Zambians' external indebtedness, rising debt burden and inability to source sufficient external finance at favorable terms and conditions has serious implications on the country's economic performance. The relationship between public debt and economic growth is a major concern for policy makers. This is because a debt is supposed to replace by internal revenue generation which are existing resources in an economy which should lead to greater economic performance and development. But this is not always the case in Zambia as internal revenue generation tools are under-utilized and even the current system of revenue collection could have failed.

2.0 LITERATURE REVIEWS

2.1. Sales taxes

General sales tax is a consumption tax imposed on the sale of goods and services. It is a new tax system the government of republic of Zambia want to implement in the second quarter of 2019 to replace the current value added tax. In 2014, United States of America collected $412 billion from sales tax, which accounted for around 35 percent of their general revenue. Most of this cash is put in a state fund that pays for things like Medicine, education, public pensions, prisons, police and foster care. If the U.S. repealed its current tax system and replaced it with an equivalent VAT, these states would see little or no impact to the general fund that finances all these important programs (Thompson 2018).There has been an increasing reliance on sales taxation in both the Canada and in the United States (Yang 2015) and (Fisher 2007) notes that sales taxes are an important source of revenue for state governments the way that property taxes have always been an important source of revenue for local governments .State governments are also increasingly using state sales taxes to redistribute funds to local governments (Fox, 2003). sales tax competition does not only involve the state sales tax, but the total effective sales tax rate, which would include all jurisdictions and other local sales taxes(Agrawal 2014) , and political involvement in attracting businesses could impact an economy in such a way that sales tax rates could have a positive association with business activity (Burnes, Neumark and White, 2012) .Due and Mikesell 1994 study gives an exhaustive look into the history of the sales tax, noting that while it was used in response to the revenue issues, Efforts to optimize tax revenues are by increasing taxpayer compliance and the factors that influence taxpayer compliance is the government's authority in taxation and the trust of taxpayers to the government (Irawati 2019).However, there are many issues outside a government's control with regard to raising revenues from sales taxation (Rogers 2004). Sale tax are Consumption taxes and Consumption taxes increases the prices of consumer goods and so reduce the real reward for working. Therefore, it can affect labor supply. However, they do not discourage saving and investment provided that they are expected to be constant over time (Jens Matthias Arnold 2011)

Mikesell (2012) recently covered varying cultures and policies of sales taxation at the state level, including inconsistencies in implementation and exemptions, which causes a large concern for government revenue-raising. The literature on lower-level local sales taxes has been focused on cross-border effects.(PWC 2019) which includes the decline in food purchases as a result of a tax increase was markedly larger at the border of the state rather than elsewhere (Tosun and Skidmore 2007) .

2.20 Value Added Tax

Value added tax (VAT) is a type of indirect tax that is imposed on goods and services. Sometimes, when the government operates on a budget surplus or wants to increase its revenue in order to finance its budget deficit. VAT is a tax, which is imposed at every stage of production i.e., from production level to retail level. Under VAT tax is calculated on value Added where value added is the difference between sales value and purchase value. VAT does not boost exports, we should reconsider the adoption of VAT when there is a lot of subsidy of which in Zambia subsidy

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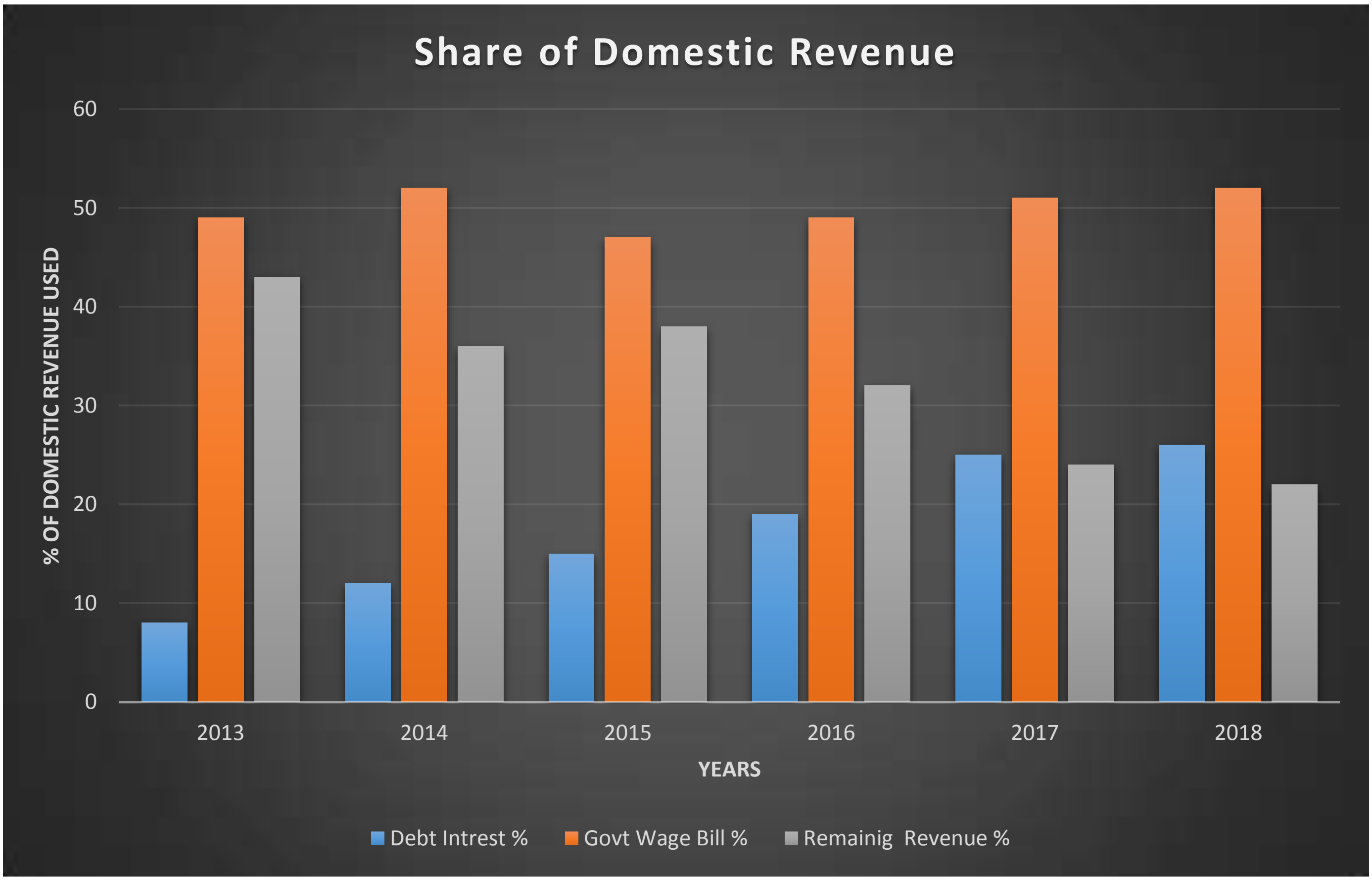
are discouraged (Sukumar Mukhopadhyay 2001). Although Sukumar Mukhopadhyay (2003) reviewed that VAT is not the best form of contention tax, especially in a development economy. The VAT system of taxation does not encourage vertical integration of firms as it is independent of number of stages in the production and distribution channel (Narayana 2005) and it's not a burden to the manufacturer but transfer all the burden to the consumer (Akash and Harish Kumar 2006) .Some argue that a VAT would encourage saving because it would raise the prices of everything we buy. In this line of thinking, Americans would buy fewer goods and services and therefore save money that they formerly spent. A VAT would undoubtedly raise the prices of everything that consumers buy, but this would not increase the savings rate. The low savings rate is not the result of low prices, but of the current tax code that discourages savings by taxing returns of investment through taxes on capital gains, dividends, and interest (Dubay 2010). Few economists argue that tax hikes encourage economic growth. Yet some argue that a VAT would improve economic growth because it would tax consumption instead of income tax. The income taxes highly progressive structure and the double taxation of capital income and capital gains strongly discourage working, saving, and investing, which are essential to economic growth

3.0 METHODOLOGY

The mixed method strategy. Mixed method strategies explore is an approach for leading research that includes gathering, examining and incorporating quantitative and qualitative research (McKim 2017).The inductive methodology of this study was finished by dissecting data drawn from actualities dependent on the theory and research destinations. The inductive certainties were drawn from input review and whole investigation. The deductive actualities were drawn from existing literature looking at connections between. The method of data collection was self-administered questionnaires which were distributed to various institutions (Scratch and Lee 2008).

4.0 Data Analysis and Findings

Figure 1:Percentage share of Domestic Revenue Used



The external debt stock stands at USD9.97 billion, domestic debt stock stands at K52.86 billion, domestic arrears stands at K14.01 billion .The total public debt and arrears is USD15.95 billion representing 57%of GDP. While the Guaranteed debt was USD2.7 billion of which USD1.21 billion had been drawn against the principal amount (PWC 2019). Tax revenues remain the largest contributor to the government income and the move to a Sales Tax regime is

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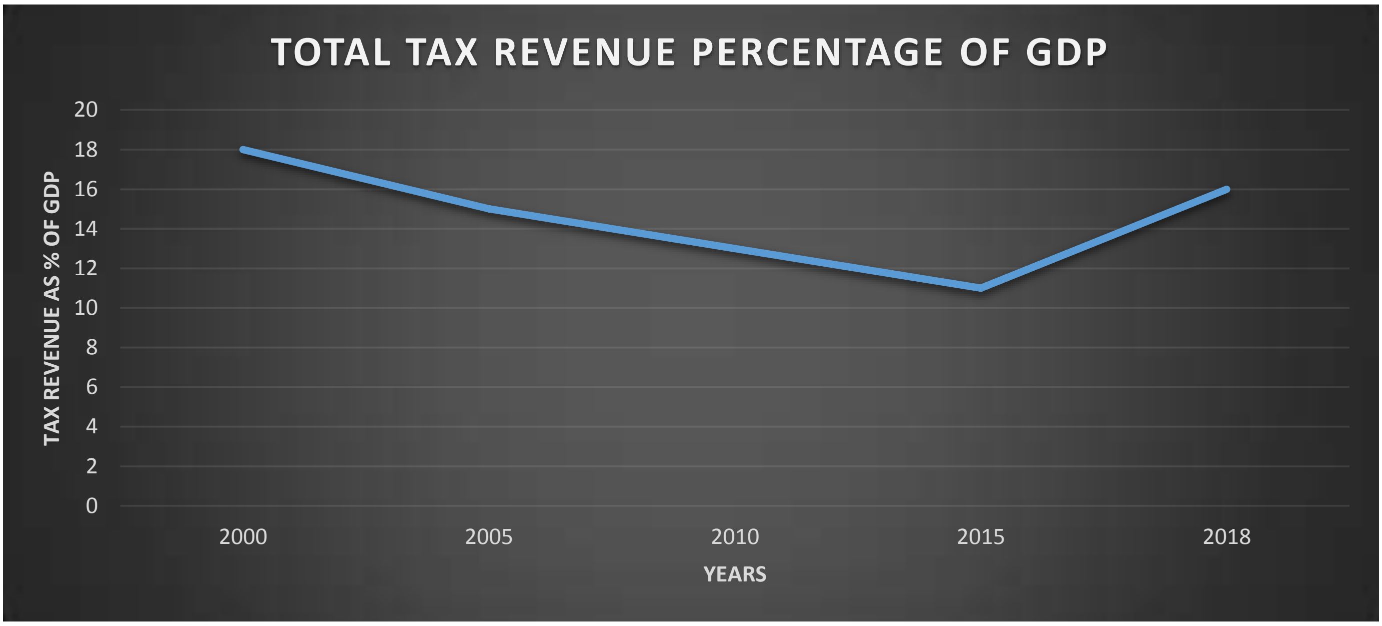
expected to result in an easier collection and administration process and consequently add a further K4.2 billion to the revenue treasury. From the analysis, it is obvious that the domestic revenue raised can only finance the debt interest and government wage bill and the balance is below 15% on average. This translate into government failing paying back the debts, the only thing government is able to do is to pay interest without the principle.it is an indication that the current taxation system of value added tax(VAT) is not well managed to raise enough revenue for government and it has a lot of weaknesses.

Figure 2: Total Revenue as the Percentage of GDP



Zambia's GDP has remained relatively stable over the last three years. The GDP Growth rates ranges from 3% to 5.5% (Medium Term Expenditure Framework, 2018). The Wholesale and Retail industry makes up a significant share of Zambia's GDP contributing about 18% on average (CSO 2017). Government of the republic of Zambia need to encourage foreign direct investment to boost domestic revenue and sustain the achieved Gross Domestic Product growth rate which is expected to increase to 6%. Complete diversification of the economy to Agriculture industry to improve food security as well as improve oversight and accountability would all have tremendous long-run implications for addressing fragility and creating stability in Zambia (Hopkins 2018).

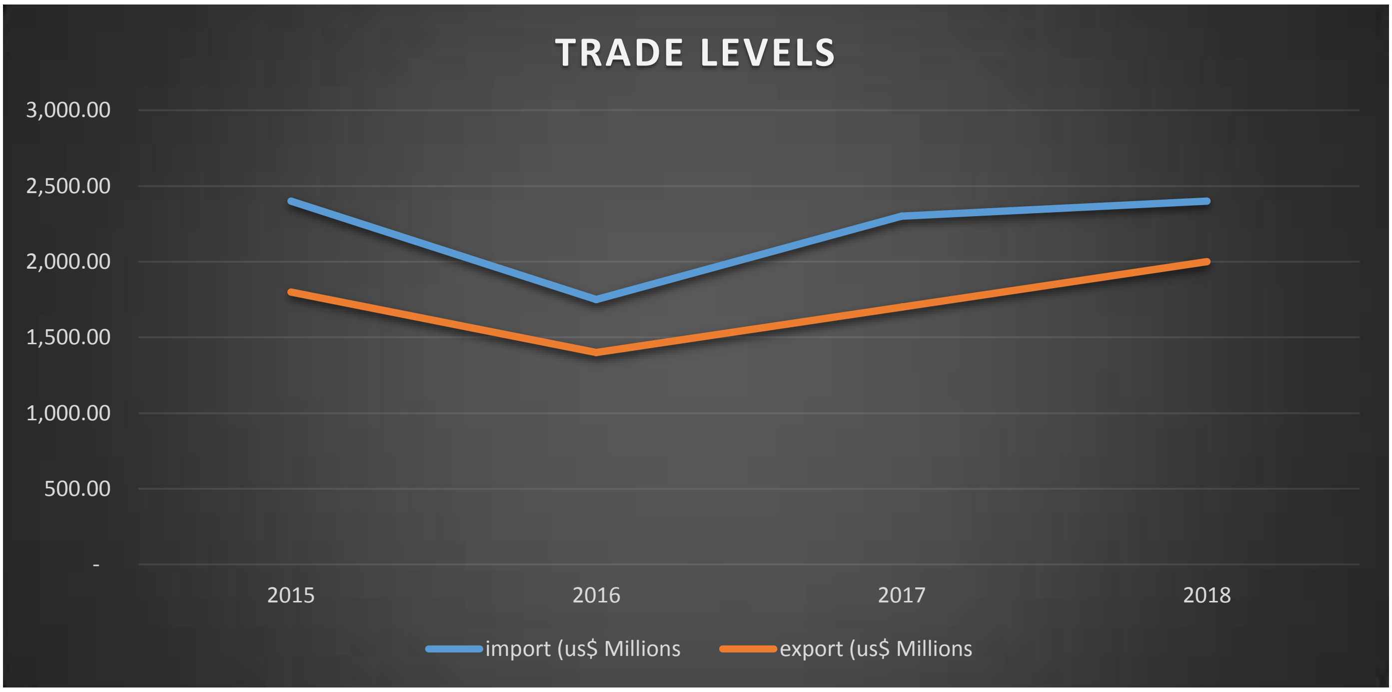


Figure 3: The Trade Levels of Imports and Exports

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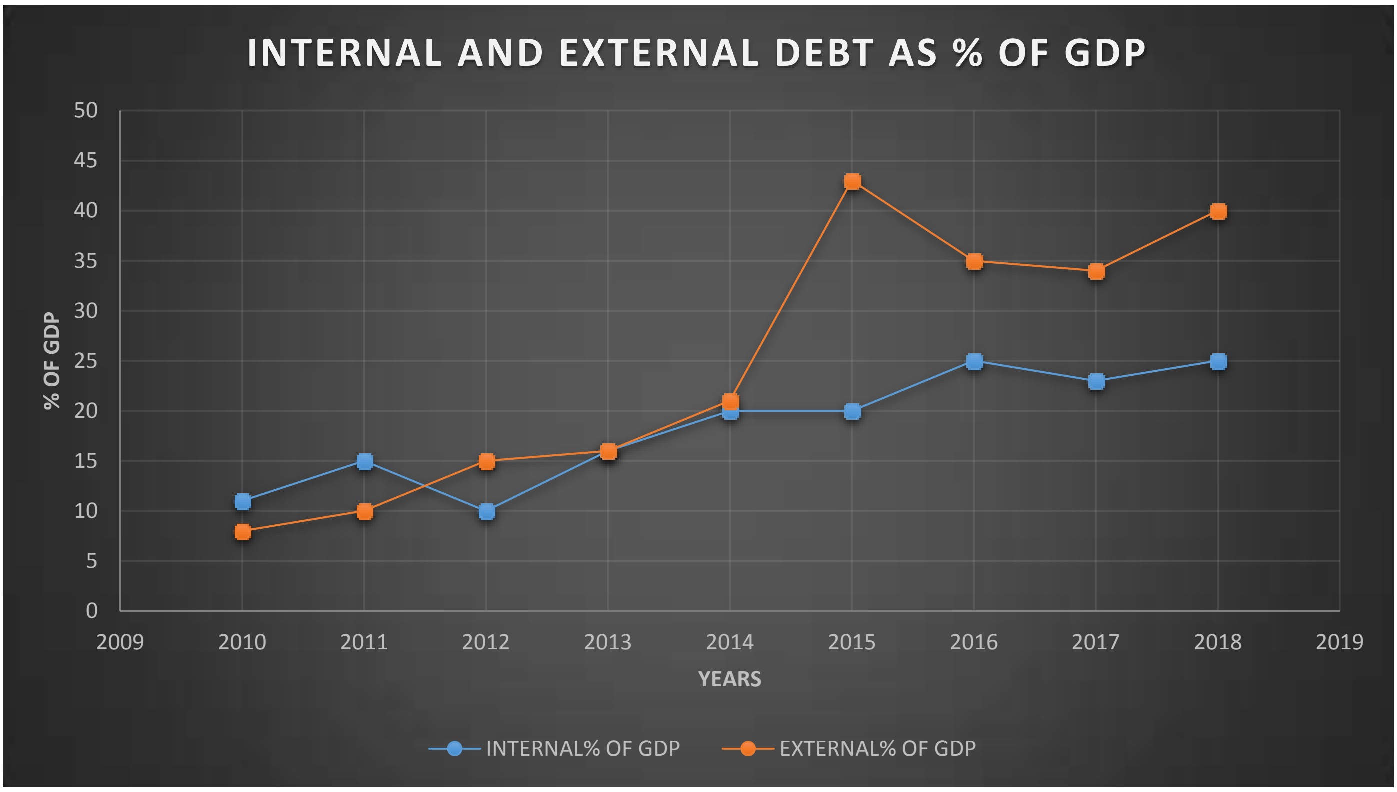
Zambia's tax regime for mining post-privatization has been volatile, inconsistent (exemptions and concessions), and severe with post hoc charges after exogenous market shocks. These influences result in the loss of much needed revenue, increase unemployment, aggravate inflation and elicit capital flight.

Figure 4: Internal and External Debt as Percentage of GDP



The impact of this significant rise in debt is that debt service costs now account for 27% of the 2019 expenditure budget from 20% in 2018. This increase in debt servicing commitment is likely to reach 30% by the 2010 especially that the local currency has continued to depreciate.

The Zambian Government is projected to spend about 47.1% (2017:53%) of the total budget on its wage bill. The Government has set itself a target keeping the public sector wage bill within a target of 40% of domestic revenues by 2021. This will be achieved by restricting recruitment to only frontline personnel and ensuring that annual wage adjustments are made in the context of the resource envelope and to maintain this government need to constantly enhance domestic revenue collection. Failure to contain this will constrain Government's ability to undertake other developmental activities.

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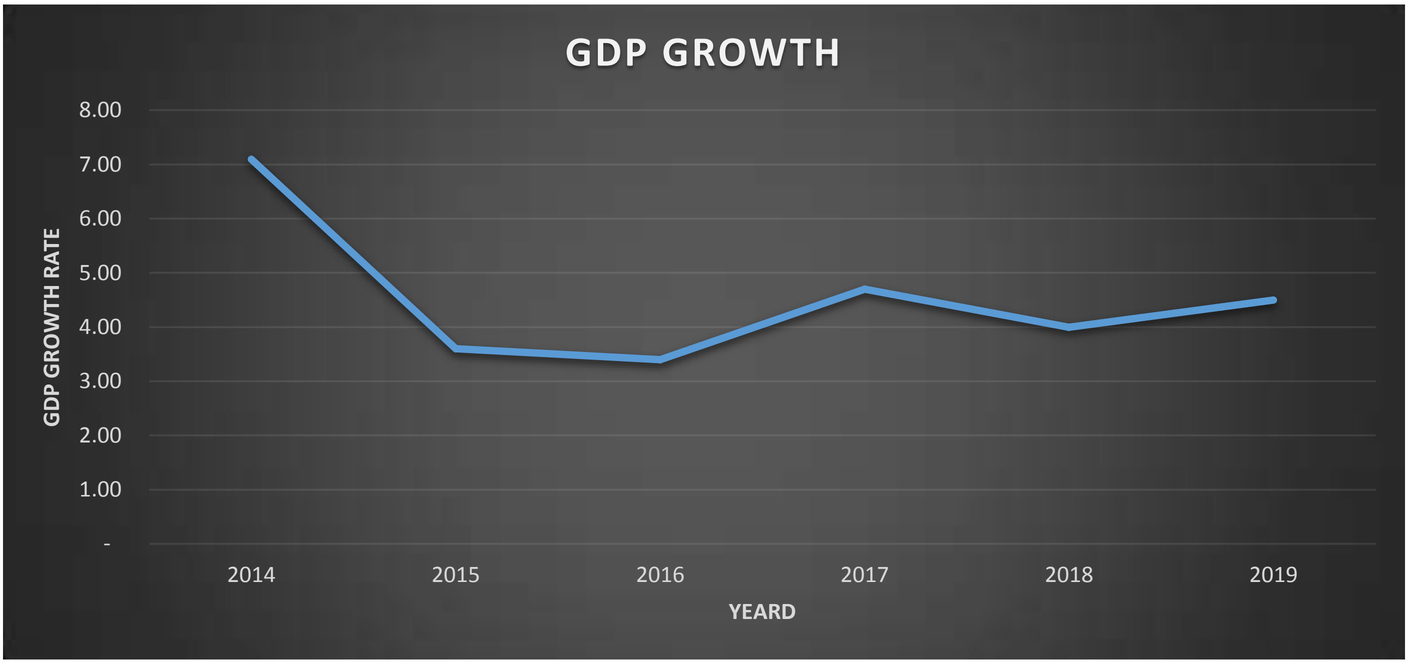

Figure 5: GDP Growth over Last Five Years

Zambia's real GDP growth is paged at 3.5 percent in 2018 and expected to grow to 4.5percent by the end of 2019 compared to 3.4 percent in 2017, indicating strong growth. Fiscal pressures remained high in 2018, caused by changes in capital spending and interest payments on debt. The fast accumulation of external non-concessional public debt continues to be a source of macroeconomic vulnerability.

5.0 Conclusion and Recommendation

Though the system of value added tax seem to be superior and adopted by many developing countries, it avoids the typical distortion to businesses production decisions caused by these tax instruments (Keen 2016)

The current taxation system of value added tax disproportionately hurts the poor because the tax eats already into their limited income, this system is very deceptive. The senior citizens and the Majority poor Zambians who lives on the fixed income are have adversely affected by the VAT and it discourages consumption. Since this tax system discourages consumption, then reduces spending which hurts businesses and workers. This system causes high employment levels if the businesses are unable to cover the cost of extra taxes passed to the consumers to cut costs.

The Zambian Revenue Authority under the current system have been facing numerous challenges of administrative costs and enforcing compliance by taxpayers among many small businesses. This system allows the businesses to more easily under report sales due to lack of paper trails of sales which potentially reduces mobilization and collection of revenue at the retail stage (Pomeranz 2015).

5.1 Policy Recommendation

Though VAT system is seemed to be favored by many developing countries, it is important to considers its weakness which include credit fraud and refund management which can be particularly challenging to address in circumstance where Zambia Revenue Authority have limited resources, recent happening in the mining industry where government is owning mining companies equivalent to US$600 Million as tax refunds. This situation can be solved by implementation of a general sales tax system which will stop government from losing revenue at the expense of national development.

Policy makers should consider the implementation of general sales tax which has no repercussions s along supply chain. The current system has been designed in such a way that certain businesses can receive VAT exemption. This exempting businesses are important trade partners for many taxpayer and may have implications for revenue mobilization and production efficiency which the general sales tax system can address.

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