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Global Tax Alert

Zambian Government issues 2020 Tax Amendment Acts

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Executive summary

On 1 January 2020, various Tax Amendment Acts came into effect in line with the pronouncements made in Zambia's 2020 National Budget. The Minister of Finance had announced that the Government would be working on broader reforms aimed at increasing tax revenue and improving compliance. The 2020 Amendment Acts are as follows:

- *Income Tax (Amendment) Act No. 15 of 2019*
- *Value Added Tax (Amendment) Act No. 14 of 2019*
- *Value Added Tax (Zero-Rating) (Amendment) Order No. 88 of 2019*
- *Value Added Tax (General) (Amendment) Regulations No. 90 of 2019*
- *Property Transfer Tax (Amendment) Act No. 13 of 2019*
- *Customs and Excise (Amendment) Act No. 16 of 2019*

The tax amendments address key areas in the mining industry as well as introduce cross-industry tax measures. The amendments also reflect the Zambian Government's commitment to mitigate the impact of climate change by encouraging sustainable energy usage.

Detailed discussion

The key provisions of the amendment legislation focus on improving revenue collection through better enforcement, raising additional revenue particularly from the mining industry and encouraging the use of alternative energy sources as detailed below.

Business Tax

Corporate Income Tax

Change introduced: Section 2 of the *Income Tax Act* (ITA) was amended to redefine the word "farming" to mean "the cultivation of crops and plants, raising of livestock or poultry, beekeeping and rearing fish but excludes the letting of any property or provision of a service ancillary to farming."

"Farming" in section 2 of the Act was previously defined to include "agricultural activity." An enterprise that qualifies as a farming business is entitled to a reduced tax rate of 10%. 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 are now excluded in the amended definition.

Change introduced: Section 78(1) of the ITA was amended to provide for the charging of penalties and interest on taxes payable under Sections 81, 81A, 82, 82 to impose interest and penalties on overdue payments to all transactions subject to withholding tax.

The penalty regime in the Act previously excluded penalties and interest on overdue payments for withholding tax on dividends, payments to nonresident contractors, interest, royalties, rent, commissions, management and consultancy fees and public entertainment fee. The amendment now extends the penalty regime to these types of payments.

Change introduced: Section 82A (1) (b) of the ITA to provides an exemption from withholding tax on interest paid to banks and other non-banking financial institutions licensed under the *Banking and Financial Services Act 2017*.

There has been confusion among taxpayers with respect to the treatment of withholding tax on interest payable to banks and financial institutions. In many if not all instances, the interest is deducted directly in full, from the borrowers account. As such, it would be a significant administrative burden to expect the borrower to account for withholding tax.

International Tax

Change Introduced: Section 97A of the ITA has been restructured to introduce definitions for:

- Actual conditions
- Arm's-length conditions
- Equity holder
- Fixed rate performance shares
- Loan creditor
- Normal commercial loan
- Ordinary share
- Reference price
- Related or associated persons
- Relative
- Security
- Subsidiary

This was done with the intention of clarifying key transfer pricing definitions as well as aligning the Act with definitions provided in other Acts including the *Companies Act of 2017* and the *Anti-Corruption Act of 2012*. The introduction of new definitions further aligns the Act with the Organisation for Economic Co-operation and Development (OECD) and seeks to eliminate any possibilities that may arise from controversies. However, the use of local legislation such as the *Anti-Corruption Act*, which is a criminal focused Act, may be inconsistent with OECD definitions.

Change Introduced: Section 97A (11) of the ITA amended to clarify the eligibility of a taxpayer to claim a tax credit or adjustments in relation to transactions with both resident and nonresident related persons.

The amendment provides much needed guidance on relief for taxpayers where transactions with related parties have been subject to transfer pricing adjustments. However, this relief is limited to related-party transactions where a double taxation treaty exits between Zambia and the relevant jurisdiction(s). No relief will be available where no treaty exists. The amended provision also prescribes arm's length as the basis to determine the income on which the tax credit or corresponding adjustment has been claimed.

Further, the introduction of section 97A (11A) limits the claim or adjustment to within a period of 12 months from the date of assessment in the other jurisdiction.

Change introduced: The amendment of the transfer pricing provisions under Sections 97A (13), (14), (15), (16) and (17).

The amended transfer pricing legislation and regulations provide for the determination of arm's-length pricing on the sale of base and precious metals between related parties using a reference price. Entities may adjust the quoted reference price to account for exigencies such as poor quality or low grade. There is, however, no mechanism to determine how these adjustments must be made. Furthermore, there is no provision to account for circumstances where a higher-grade metal is sold and the parties agree on a premium above the reference price. The Commissioner General will be able to capture premium adjustments and provide guidance on any pricing adjustments. The information that the Commissioner General will be entitled to request for the purpose will include third-party sale prices for benchmarking.

Property Transfer Tax (PTT)

Change introduced: Section 2 of the Act was amended to redefine the word "share" to include "any stock, any certificate, warrant or equivalent rights."

This amendment applies to indirect share transfers and expands the definition of shares to include transfer of rights that are equivalent to shares. The transfer of such equivalent rights is now within the scope of PTT.

Change introduced: Section 5 (2A) of the Act was amended to broaden the definition of realized value and exclude from exemption, intra-group transfers where a company has only been a member of the group for a limited period of three years.

The amendment addresses a number of key matters relating to indirect share transfers. First, the amendment introduces nominal value and actual consideration as methods used to determine realized value, in addition to the current method based on the proportionate value of the Zambian entity. Previously, the realized value of shares subject to indirect transfer was calculated using the proportion of the Zambian company to the value of the transferred shares, irrespective of the actual consideration paid for the transferred shares or the nominal value. Section 5 (2A) now aligns the valuation methods close to the methods used for direct transfers by providing that the realized value shall be, whichever is greater of the:"(a) Proportion that the value of the Zambian company bears to the value of the transferred shares (b) Consideration for the share being transferred (c) Nominal value"

It is not clear if the "consideration of the shares transferred" refers to the full value of the indirect transfer. Clarification is expected in this regard as it is unlikely that the amendment was intended to have that effect.

The amendment also allows for the determination of a nil value for a transfer where the Commissioner General is satisfied that such a transfer with a realized value is made for the purposes of group re-organization and that there is no change in the effective shareholding of the Zambian company. Further, the relief available for intragroup share transfers (both direct and indirect) excludes transfers to companies that have been members of the same group for less than three years. This is an anti-avoidance provision to ensure that transfers are not staged to take advantage of the relief.

Indirect Tax

Value Added Tax (VAT)

Change introduced: Subsidiary legislation was amended including the VAT (Zero Rating) Order and VAT (General) Regulations.[1]

VAT Zero Rating

Pursuant to the powers provided under the principal Act and by means of Statutory Instrument, the Minister of Finance has issued amendments to the VAT (Zero) Rating Order to introduce new items to be zero rated. This includes:

- The supply of selected capital equipment and machinery for the mining sector
- Selected capital equipment and machinery for the mining sector
- Liquefied Petroleum Gas (LPG)
- Appliances that use gas fuel

The Government has proposed to zero rate selected capital equipment and machinery for the mining sector in a bid to improve cash flow within the sector. Previously, the mining industry imported equipment that is standard rated while making zero rated supplies (exports). In the absence of VAT deferment, this generated refunds and contributed to the build-up of VAT refund arrears. By zero rating capital equipment and machinery in this this sector, it is anticipated that the accumulation of refunds will slow down.

LPG is an eco-friendly alternative source of energy and will help ease pressure on the country's electricity grid. The amendment reflects the Government's efforts to encourage sustainable energy usage.

VAT General Regulations

Pursuant to the powers provided under the principal Act and by means of Statutory Instrument, the Minister of Finance has issued amendments to the VAT (General) Regulations to:

- Remove input VAT claims on consumables and spare parts except when they are a stock in trade
- Limit the claim of input VAT on the supply of electricity to 80% from 100% for mining companies.

The removal of input VAT on consumables is a revenue raising measure and is part of the Government's efforts to improve domestic revenue. Further, regulations to the Act are expected prior to its effective date.

Other VAT administrative measures

Change introduced: Section 2 of the VAT Act was amended to introduce definitions for various electronic commerce terms as follows:

- Electronic commerce means buying, selling, advertising or marketing of goods and services using the internet, mobile telecommunication networks and other electronic infrastructure.
- Electronic service means a service capable of delivery of data across multiple electronic commerce platforms.
- Electronic payment machine means a payment terminal used by a taxable supplier to receive a payment.

The changes reflect an effort to keep tax legislation current and abreast with emerging technologies and electronic commercial activity. It further enables the Act to reflect a more information technology-driven approach to governing compliance.

Change introduced: Section 7A was introduced to the VAT Act making it mandatory to use Electronic Fiscal Devices (EFDs) for VAT and other types of taxes.

The introduction of the mandatory use of EFDs is to enhance data matching and analysis thereby enabling 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 while ensuring that non-compliance is detected early and dealt with. However, the provision allows for the Commissioner General to approve the use of a document, device or equipment other than an EFD for a certain category of taxpayers.

Change introduced: Section 8A was introduced to the Act for the taxation of electronic services.

In line with the recognition of electronic commerce, the new provision renders taxable, the provision of an electronic service in Zambia, where that service is performed, undertaken or utilized in the country or the benefit of the supply is for a recipient in Zambia regardless of whether the provider of the service has a place of business in Zambia or the service is paid for outside Zambia.

Customs and Excise Tax

Change introduced: The First Schedule of the *Customs and Excise Act* (section 72) was amended to provide for a higher customs duty rate of 10% for selected capital equipment and machinery imported by mining and mineral processing companies.

Previously, equipment and machinery imported by mining and processing companies was either duty free or attracted customs duty at the rate of 5%. This increase in duty rate is seen a revenue raising measure by the Government.

Change introduced: The First Schedule of the *Customs and Excise Act* (section 72) was amended to remove customs duty on the importation of LPG.

This measure is introduced to further reduce the cost of LPG and make it more affordable for consumers to use gas powered appliances.

Endnote

1. See EY Global Tax Alert, *Zambia amends VAT legislation*, dated 13 January 2020.

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