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RENTAL TAXATION:
CURBING NON-COMPLIANCE AND IMPROVING ADMINISTRATION

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"Every tax ought to be so contrived as both to take out and keep out of the pockets of the people as little as possible, over and above what it brings into the public treasury of the state" - Adam Smith (1774, p311)

Executive Summary

Since 2013, the Zambian economy has grappled with a high fiscal deficit. Many stakeholders continue to implore the Government to take measures to ensure that the tax base is broadened, voluntary compliance improved and domestic resource mobilisation enhanced to reduce the deficit. Consequently, there has been a call on the tax administration authority to rethink its tax collection strategies and bring more individuals and firms into the tax net. Recently, the Government reiterated its commitment to enhance resource mobilisation in the 2019 Budget Speech. Improved administration of taxation in the housing sector, particularly rental properties, offers a promise as one of the options to increase tax revenues especially if more tax payers are captured under this tax net. However, the administration of individual rental income tax faces many challenges.

The tax is highly evaded – registration is a paltry 5%. Using the Living Conditions Monitoring Survey of 2015, approximately 600,000 dwellings were being rented in that year. Out of these, only 32,719 houses, or 5%, were registered for withholding tax on rental income. This is despite an average of 20,000 new rented dwellings being added to the total housing stock every year between 2010 and 2015. This implies that very few of the new rented stock were being registered for payment of the tax.

Potentially, K394 million could have been collected as rental tax revenue from individuals for 2015, if the policy of 10% withholding had been effectively enforced. Over 30 times more than the actual 2015 revenue collections of only K12.3 million could have been collected in that year, unlike the 3.1% of the probable nationwide tax that was garnered from individuals. The potential collection is also much higher than the K10.5 million that was mobilised from this tax in 2016. Had the K394 million been collected, it would have been sufficient to pay for the labour costs of constructing primary school infrastructure development in Lusaka Province for the whole 2015[1].

A legislative change mandating tenants to withhold and pay the tax was one of the major drivers of the reduced total collections from rental income tax. Previously, landlords would self-withhold the tax. But in 2015, tenants were expected to withhold and pay the tax on behalf of their landlords. However, this policy change did not work as expected. Total collections from the rental tax *including* those from companies, shrunk to K291 million in 2015 from K472 million in 2014. They plunged further to K282 million in 2016, and by October 2017 only K215 million had been collected from this tax. Clearly, tax collection is worsening and not improving.

Other reasons for underperformance stem from low compliance and enforcement levels, mainly driven by high evasion and low tax morality. It was also established during a survey conducted in Lusaka, Kitwe and Ndola that there was poor awareness and inadequate knowledge of the tax. Additionally, administrative hurdles were observed in form of inefficient tax collection systems that made it difficult to make payment, such as few tax pay points and the resultant long queues. Additionally, most defaulters got away with non-payment because of the weak capacity in detecting evasion and poor enforcement of the tax exhibited by the tax authority.

Narrowing the Gap

The large gap observed between potential and actual rental income tax collections obtained from individuals, justifies the need for attention from policy makers and implementers and calls for reorganisation of the tax. In pursuing this reform, the challenges affecting compliance and administration must be borne in mind and must be at the centre of the design of the individual rental income tax regime. Once these problems are addressed, they will ultimately lead to increased revenue and narrow the deficit of K382.5 million[2] recorded in 2015.

In anticipation of improved revenue collections we make the following recommendations:

- ***Revert to landlords paying the tax:*** The use of tenants as withholding agents has not achieved the

1 Government Estimates of Expenditure (Yellow Book), 2015

2 The deficit is calculated as the difference between the estimated potential tax and the actual collection in 2015

intended purpose. Tenants have been evading payment of this tax and tax payments have worsened between 2015 and 2017. Reverting to landlords self-withholding the tax will increase administrative feasibility as landlords are easier to locate and follow up. Moreover, other strategies can be employed on landlords to strengthen enforcement, such as the use of third party information. ZRA can leverage on information from commercial banks, including the mandatory Tax Payer Identification Number (TPIN) registration for all bank account holders, to identify landlords and enforce registration of these TPINs for payment of withholding tax on rental income. This will increase the number of taxpayers registered and aid voluntary compliance as well as enforcement.

- ***Introduce a tax waiver**:* This is meant to further entice landlords to register for the tax and voluntarily comply, especially those that may be willing to pay the tax but may be deterred by the requirement to pay outstanding tax obligations, interest and penalties accrued by their tenants. ZRA could declare a tax waiver and amnesty for a specified period in which landlords can be forgiven these outstanding tax liabilities and aid them start on a clean slate. The objective would be to get more landlords registered for easy follow up and audits.

- ***Increase work scope of tax collection agents**:* Withholding tax agents should be assigned to defined geographic locations called blocks. In these blocks, agents will systematically manage tax compliance of each landlord. Landlords who may have houses in multiple locations will pay the rental income tax within the respective block where the house is located. For this to work, ZRA will have to leverage on information technology for tax payments. The appointed agent should have up-to-date information on the payment status of each landlord in their assigned block and should only follow up on those who have not registered and not paid. For these, a commission agreed by ZRA and agents can be charged to act as remuneration for agents as is the case in Kenya where 2% is collected as commission by appointed agents.

- ***Create a mobile registration and payment application:*** ZRA should ensure that a tax registration and payment mobile application is created for landlords to sign up to. Such an application will easily cover those without bank accounts but with basic mobile phones. In addition, for those without bank accounts, a payment platform such as *Zoona* which is located almost everywhere can be used from which their cash payments can be sent directly to a ZRA account. For those with bank accounts, ZRA can work in hand with commercial banks to establish a channel from which mobile banking can include an option for tax payments on the menu of bill payments. Taxpayers will have the convenience to pay their dues from any area.

- ***Concentrate registration and enforcement efforts in Lusaka, Copperbelt and Southern Provinces:*** The strategy requiring landlords to self-withhold and pay the tax can easily be implemented in these three provinces as they have the highest potential for tax. The three provinces combined capture 85% of the rented housing stock within the country but have very low rental tax registration rates averaging 5%. Starting with these provinces provides an opportunity for ZRA to efficiently collect over three quarters of the potential tax. Thereafter, ZRA could gradually expand enforcement to other provinces.

- ***Landlords should be compelled to register their properties whenever they are commencing a rent-out***. A certificate of registration, issued by the local authority, for rented property at point of first occupancy should be a requirement. This provision can also be linked within the proposed mobile application for new registrations to be able to capture all new rented properties on the market. Agents can be used to follow up new rental developments as they are likely to know the happenings within their blocks.

Improvements such as these as well as improvements in record keeping are essential for proper management of the tax to increase revenue collections from the tax. This will make it hard to evade the tax and encourage voluntary compliance in taxpayers once registered**.**

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Acronyms

CG	Commissioner General
CIT	Company Income Tax
GDP	Gross Domestic Product
GIS	Geographic Information System
HMCR	Her Majesty Customs and Revenue
KRA	Kenya Revenue Authority
LCMS	Living Conditions Monitoring Survey
MTEF	Medium Term Expenditure Framework
MoF	Ministry of Finance
PAYE	Pay As You Earn
PIT	Personal Income Tax
ToT	Turnover Tax
UK	United Kingdom
VAT	Value Added Tax
WHT	Withholding Tax
ZDA	Zambia Development Agency
ZRA	Zambia Revenue Authority

1 Overview

In the wake of macroeconomic instabilities that occurred in Zambia during 2015 and the increasing fiscal deficit since 2013, the focus of Government shifted towards the much needed fiscal consolidation of public revenues and expenditures in the medium term (Ministry of Finance 2017). In 2017, an economic recovery plan called the Economic Stabilisation and Growth Programme also dubbed Zambia Plus was drafted and launched. The 2017-2019 Plan is anchored on *fiscal consolidation* and aims to accomplish a number of things. Among them is to reduce the fiscal deficit as well as debt accumulation through increase in tax collection and cuts on expenditure.

Economic recovery requires frugality. Thus to protect as many areas of expenditure as possible, raising more domestic revenue remains particularly important to increase fiscal space from which to operate. The Zambia Revenue Authority (ZRA) is key to fiscal consolidation. Their task, among other things, is to increase revenue collections by K6.1 billion in 2018 and increase the contribution of tax revenue to Gross Domestic Product (GDP) from a ratio of 13.3% in 2016 to 15.6% by 2020 (Ministry of Finance 2017). In order to achieve this, ZRA has embarked on programmes strategically aimed at increasing voluntary tax compliance and optimise revenue collection. One such programme was the 2015 awareness campaign on withholding tax on rental income, aimed at improving collections under this tax.

Before 2015, rental income tax was a major contributor to total withholding taxes in Zambia; for instance it contributed 60% in 2014. With the aim to increase rental tax contributions, a policy change mandating tenants to withhold the tax instead of landlords was introduced in 2015. ZRA also undertook a number of taxpayer education activities targeted at tenants which included sending text messages to mobile phone users with the aim of encouraging tenants to pay the tax. However, this strategy did not go according to plan as rental tax collections markedly reduced to a share of 15%. The policy change happened at a time when there was a significant slowdown in economic activity which thwarted tax collection in general.

1.1 Low rental tax collections

The appeal to focus on withholding tax on rental income came from an observed growth in rented dwellings[3]. The 2010 and 2015 Living Conditions Monitoring Surveys (LCMS) show that the total number of rented housing units increased from 20% in 2010 to 24% of total housing in 2015 as shown in Table 1-1.

Table 1-1: Percentage distribution of households by tenancy status, 2010 and 2015, Zambia

Basis of Occupation	Owner Occupied Housing		Rented Housing		Other Housing		Total Housing Units (000)	
Province	2010	2015	2010	2015	2010	2015	2010	2015
Central	86%	84%	13%	15%	1%	1%	250	238
Copperbelt	64%	62%	35%	37%	1%	1%	369	410
Eastern	95%	92%	5%	8%	0%	0%	342	323
Luapula	92%	89%	7%	11%	1%	0%	191	198
Lusaka	46%	41%	54%	57%	0%	2%	366	494
Muchinga	-	88%	-	12%	-	0%	-	129
Northern	92%	91%	8%	9%	0%	0%	318	202
North-Western	90%	93%	10%	7%	0%	0%	138	170
Southern	83%	80%	16%	19%	1%	1%	311	293
Western	96%	94%	4%	5%	0%	1%	205	158
Total Zambia	**80%**	**76%**	**20%**	**24%**	**0%**	**0%**	**2,491**	**2,615**

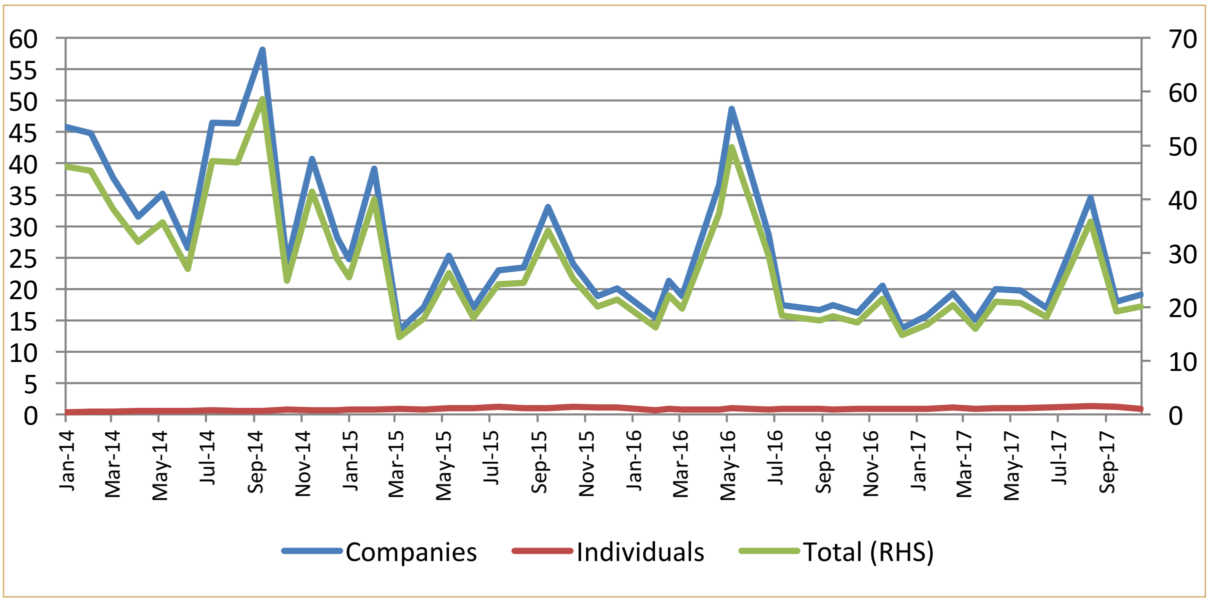
Source: Constructed from the Living Conditions Monitoring Surveys 2010 and 2015

3 Rental Income tax is charged on rent by both corporates and individuals, in this study we focus on individuals.

While there were 498,000 rented units in 2010, the number increased to 600,478 in 2015, with over 100,000 new rented houses added to the housing stock in the period. The proportion of houses on rent generally increased in all provinces except in North-Western Province. In 2015, Lusaka and Copperbelt provinces had the highest proportion of houses on rent at 57% and 37%, respectively. Almost two thirds (57%) of the additions to the rented housing stock in 2015 were in urban areas, increasing from 49% in 2010. The increased number of rented houses shows that the net from which to collect rental tax widened especially in the urban areas and presented an opportunity for more rental tax revenue.

Despite this rapid growth in the housing stock, tax collections from the individual taxpayers segment remained low. In Figure 1-1, the performance of withholding tax on rent exhibited a declining trend between January 2014 and October 2017, with some revenue spikes in certain months. The average monthly collections reduced from K39 million in 2014 to K21.5 million in 2017. Collections from individuals or households were especially dismal, averaging 2% of the total collections on rental income tax per month unlike the company (or firm) registered properties that contributed the larger share. The maximum amount raised from household collections in a month was about K1.3 million; while the monthly average over the period January 2014 to October 2017 was less than K1 million.

Figure 1-1: Withholding tax on rent collections – Individuals against Company collections, Jan 2014-Oct 2017 (K million)



Source: Zambia Revenue Authority Tax-online Records

In 2015, revenue from the individual segment amounted to K12.3 million. Collections further worsened in 2016 with the total individual tax collected amounting to K10.5 million and only showed slight signs of improvement in 2017, as K10.8 million was collected up to October 2017. Moreover, out of an eligible 600,478 rented houses in 2015, only 32,719 were registered for rental tax payment, representing 5% of would-be taxpayers in that year. This low number of registrations made the tax one of the highly contravened taxes despite the taxpayer awareness campaign that was dedicated to the tax in that year. Clearly, tax payment has not improved after 2015 and tax evasion remains rife on rental income. Total collections from this tax were below target in all of the months further demonstrating the high non-compliance levels, the rife evasion as well as poor enforcement of the tax.

1.2 Purpose of the study

To successfully improve administration and increase rental income tax collections, the Government will be required to undertake reforms to the tax. This study aims to provide evidence that should influence the transformation of rental income taxation in Zambia. The methodology used is presented in Text Box I in pursuit of the following specific objectives:

- Understand the rental setting for households and the income derived from it in Zambia;
- Ascertain the factors that affect compliance to rental income tax in Zambia;
- Estimate the potential household tax revenue from rental income; and
- Offer policy recommendations aimed at improving administration and curbing non-compliance in implementing the tax.

Text Box I: Study Approach

A mixed approach was used for analysis: desk analysis, key informant interviews and a household survey were undertaken. During the desk analysis, data from the nationally representative 2015 LCMS was used to estimate how many households are rented in Zambia and the possible rental tax that can be collected from individuals. This was compared with data from ZRA's Tax-Online system to inform the levels of payment of the rental income tax. Only the information for household taxpayers was used.

To synthesise key policy advice and ensure better strategies in the administration of the tax, key informant interviews were conducted with experts from Ministry of Finance (MoF) and ZRA. Also, a survey on rental income taxation collected responses in Lusaka, Kitwe and Ndola from 640 households to understand perceptions towards taxation of rental income in Zambia.

1.3 Outline of the report

In Section 2, the study presents the theoretical underpinnings of rental taxation and gives a background of the tax in Zambia. This is followed by a synopsis of the rental income tax landscape in Zambia. History of its setup and the policy changes over the years as well as the compliance levels and revenues realised, using the LCMS data and ZRA Tax-online data are all relayed in Section 3. The section also presents the challenges faced as per the survey findings and ends with experiences of other countries. Finally, the study gives conclusions and recommendations that can be employed to improve administration, voluntary compliance and collections from rental income tax in Zambia.

2 Conceptual Framework

Rental income denotes earnings obtained from the letting out of immovable or real property. The income is usually referred to as rent and is paid by a user of the property (tenant) to the owner or supplier of the property (landlord).

2.1 Rental tax designs

Income earned from immovable property is taxed in most countries albeit differently, as shown in Text Box II. The main objective of the tax remains revenue collection, and may also be viewed as an instrument of reducing income inequality.

Rental income may be subject to a global or a schedular taxation system. A global tax system is one in which incomes received from various sources including rent are aggregated and allowed expenses deducted. The profit or remaining income is then taxed in bands at different tax rates. This is also referred to as a Personal Income Tax (PIT) system. On the other hand, schedular systems subject specific sources of income to different tax rates (Lee and Krever 1998).

The global system is desirable from economic and equity points of view, as income from all sources is taxed in a similar manner and tax payers are deterred from abusing loopholes in the tax laws (Khadka 2015). The fact that net income is treated the same makes the tax system equitable as those with less net income pay less tax.

However, ensuring global treatment of income is largely difficult. Challenges, including ineffective tax administration and tax evasion, have led to the introduction of schedular taxes. Examples of schedular taxes are presumptive and withholding taxes.

Withholding tax is a requirement for the payer of an item of income (e.g., the tenant in paying rent) to deduct tax from the payment and remit to the tax authority.

Text Box II: Rental income tax: a subset of property tax

While property taxes are mostly charged on the value of land and property, income from the property may be taxed instead. If taxation of rental income is to be preferred, theory dictates that the value of property should be estimated by the net rental value. The rationale for using net rental value is that taxes are paid from income (a flow) rather than from wealth (a stock) (Bird & Slack, 2002). These taxes produce an important source of finance that is perceived to be consistent and non-distortionary to economic growth (Hodge, 2012). Property taxes have historically been associated with local government on the pretext that real property is immovable and it is unable to shift location in response to the tax.

However, taxing property is one area that is very dependent on organised and dependable administration (Gayer & Mourre, 2012). Regrettably in most countries, weak local administration is an impediment to implementing the property tax. Most local government authorities do not have the capacity to administer the tax, resulting into a lower revenue base, lower collections, and non-existent enforcement (Bird R. , 2008). This has led some countries to shift the responsibility of tax collection from local governments to central authorities. To also counter difficulties faced with data capture and a lack of up-to-date valuation rolls, these countries have changed the revenue base from wealth to income earned from rent and/or from sales (capital gains tax).

In Zambia, the rental income tax is charged on income from property wealth. Though property taxes in form of rates are levied on buildings by local councils, and land rents charged on land by the Ministry of Lands, these routes are peppered with complications. Zambia has thus taken the path to tax incomes from rent using a withholding system and capital gains from sale of property using a property transfer tax. In taxing rental income, the Zambian practice, however, uses gross rental values as the base of the tax, as opposed to the economically relevant “net” rents that build in an allowance for deduction of allowable expenses. It has been argued that using net rentals is tedious and as such the simplified gross value is preferred.

Zambia currently uses schedular taxation on rental income in the form of a withholding tax. The advantages of using a withholding tax system are that the tenant helps police tax collection on behalf of government immediately after payment - this may be monthly or as frequently as the rent is paid. Conversely, the disadvantage of the withholding tax system is that the administrative burden is shifted to the tenant who may not comply.

Non-compliance is especially true where the tenant is not incentive compatible. Incentive compatibility is a characteristic of a mechanism where each agent knows that his best strategy is to follow the rules, no matter what other agents will do. In this case for example, the landlord and tenant need to work together to ensure that rental tax is paid. The landlord's role is to monitor that the tenant deducts the tax whilst the tenant's role is to deduct the tax and make payment to ZRA. If this is achieved from both parties, then tax payment occurs and increased collection from withholding of rental tax is achieved.

On the other hand, the advantage of the global or profit system is that it is not discriminatory and recognises costs incurred on the relevant property before taxable income is determined. Yet the profit tax system may suffer disadvantage in that it is difficult for landlords who are individuals to willingly come forward and register for their obligations. Therefore, payments lag or don't come forth, thus denying the treasury timely income.

The withholding system may also suffer other limitations as recorded in Khadka (2015), which may include: revenue loss; non-registration; complicated tax administration as they increase the number of tax schedules which administrations have to check; and of course these systems do not take into account progressivity and are regressive in nature. Some countries have used the withholding system successfully while others have used it in combination with the profit system.

The choice of a withholding system in Zambia was based on the fact that it is easier to implement, as it is assumed the landlord and tenant will work together. Previously an attempt to collect the rental tax was made using the Personal Income Tax (PIT) system. However this was abandoned as it was considered cumbersome as will be shown in the next section. The argument that a schedular tax helps curb tax evasion, by levying tax at source or by use of a simple flat rate makes such taxes, including withholding tax on rental income instead of the profit tax, more popular.

3 Rental Taxation Landscape in Zambia

3.1 Background to rental income taxation in Zambia

In Zambia, all forms of rented property are subject to withholding tax (WHT) on rent. They include apartments, flats, houses irrespective of the material used (logs, bricks, blocks, mud, sheet, iron, prefabricated, etc.). The tax is also extended to rented office space and rented trading space. Other forms of tenancy are also liable to the tax such as boarding houses, sublet rooms in a house or office. However, there are exemptions for landlords with valid Zambia Development Agency (ZDA) incentives and those landlords approved by the ZRA Commissioner General in line with the provisions effected in January 2016.

Text Box III: Chronology of rental tax

1970's	Introduction of WHT Tax on Interest, Management and Consultancy Fees, Royalties
1990's	Introduction of WHT on Rent as an advance tax
2004	Introduction of ToT regime for small taxpayers, landlords with other businesses could declare at 3% those without paid WHT at 15%
2015	WHT made final tax at 10%, tenants required to withhold and remit on behalf of landlord
2016	Landlords with special circumstances exempted from the tenants withholding if permission is granted by CG

The WHT was first introduced on interest, management and consultancy fees, royalties and public entertainment fees in 1971, and was extended to dividends, rent, commissions and payments to non–resident contractors. It was particularly introduced on rental income in 1984. The tax is administered under the Income Tax Act in which Section 82A defines rent as: "a payment in any form, including a fine, premium or any like amount, made as a consideration for the use or occupation of the right to occupy any real property including personal property directly connected with the use or occupation of, or the right to use or occupy such real property" (Zambia Revenue Authority 2015).

In the early years of administering the rental income tax the tax rate fluctuated between 10% – 35%. From 1996 up to 2004, landlords were required to pay 15% of the gross rental income as a withholding tax. This tax was however treated as an advance tax or a tax credit that would be discounted from the taxpayers' obligations under either the PIT or Company Income Tax (CIT). The landlords, who bore the tax liability, were required to be registered for either PIT or CIT as the case would be and the rental income tax payment would act as a cushion of the taxpayer's PIT/CIT obligations. Once a PIT or CIT return was submitted, a taxpayer would either pay additional tax, or claim a refund depending on how much of their tax obligation would have been covered by the withholding tax on rental income payments.

When the Turnover Tax (ToT) regime was introduced in 2004, individuals or businesses within the small taxpayers' segment earning income below the segmentation threshold of K 200,000 then, were required to pay a 3% tax on their annual gross turnover. For those that owned rented property, the 15% withholding tax also acted as an advance payment as was the case in the previous regimes for PIT and CIT. Thus, businesses and persons were required to be registered for ToT, PIT or CIT and the withholding tax would then be treated as an advance payment towards their tax obligations as required by the law. This regime was deemed cumbersome and tedious for many tax payers as well as ZRA. Many taxpayers complained that the WHT rate was too high and implored the Government to reduce it to a more manageable rate.

Therefore, in the 2015 Budget Speech the Government reduced the rental income withholding tax rate from 15% to 10%. The 2015 budget also disallowed rental income to be remitted as turnover tax or under the PIT or CIT and instead made it payable as WHT at 10% and as a final tax. Under this system, the tenant (payer) was made solely responsible for deducting WHT from gross rentals on the date of accrual of the rental amount; the tenant was also to file returns for relevant tax periods and make payments. The landlord's responsibility was to submit an annual income tax return making full declaration of rental income and other income received during the year. This was meant to double check that the tax had been paid.

The implementation of the above amendment gave rise to some compliance challenges for individual landlords with special circumstances. Examples of these special circumstances included multiple tenants in a room such as boarding houses, rooms of one house rented out separately, or having tenants with special privileges such as diplomats who are not required to register for the tax. Thus, the 2016 National Budget Address introduced an alternative option in which the landlord could apply for approval to receive gross rentals and pay tax on behalf of the tenant and file returns for the relevant tax period.

As a final tax, withholding tax does not give tax credits. As a compensation for the non-deduction of allowed expenses, a lower tax rate is applied (10% of gross rentals in comparison to 35% on corporate income tax profits). A flat rate is applied irrespective of the annual income value collected, whether a taxpayer is resident or non-resident, regardless of the type of property being charged or whether the taxpayer is an individual or not. This reflects the adoption of a schedular rental tax system and the intention to simplify tax administration. However, such a system does not take the equity aspects into consideration and there is still room for improving efficiency in collection.

3.2 Taxpayer eligibility

Taking into consideration that withholding of the tax is only undertaken on rented housing units, and that some rented stock are exempt from the tax, the 2015 LCMS data shows that out of the total housing units, close to a quarter of dwellings in Zambia (24%) were rented in 2015. The houses that were most eligible for payment of the tax were those in urban areas as 56% of urban dwellers were tenants.

Table 3-1 demonstrates that in 2015, 600,478[4] houses were eligible for withholding tax on rent and formed the approximate base for the tax. From the table, low cost residential housing comprised 73% - the larger proportion - of the total rented housing. The base included the whole span of houses such as mud houses, those with grass thatched roofing, etc., whose value in terms of the rentals could be as low as K50 per month. For such type of housing, the costs of compliance and enforcement would be higher than the tax to be paid. Though medium and high cost residential areas only accounted for 21% of the rented housing, tax on rentals from these areas constitutes a good portion with reasonable amounts of tax worth pursuing.

Table 3-1: Distribution of households by stratum, tenancy status and tax eligibility 2015, Zambia

	Owner Occupied Housing	Rented Housing	Free Housing	Total Housing Units	Exempt from Rental tax	Eligible for Rental Tax	Percentage
Small Scale	1,241,895	28,906	56,217	1,327,017	7,630	21,276	4%
Medium Scale	45,148	772	1,824	47,744	313	459	0%
Large Scale	2,318	27	54	2,400	-	27	0%
Non Agric	50,713	16,391	30,640	97,744	1,553	14,838	2%
Low Cost	377,960	447,394	52,145	877,499	10,724	436,669	73%
Medium Cost	61,658	76,097	8,111	145,867	1,520	74,577	12%
High Cost	37,567	58,759	19,980	116,306	6,127	52,632	9%
Total	1,817,259	628,346	168,971	2,614,576	27,868	600,478	100%

Source: Living Conditions Monitoring Survey 2015

4 This number was as presented by the 2015 LCMS, going forward it may not include housing units rented out by statutory bodies as the 2017 national budget address removed their eligibility for exemption from the tax.

3.3 Compliance rates: reflections of a lowly performing tax

Tax compliance entails that one fulfils all their tax obligations as required by law. These obligations include registration as a taxpayer, filing of tax returns on time and making timely and correct payments. To assess the level of registration for withholding tax on rental income, data was obtained from ZRA's returns and payments for the period January 2014 to December 2015[5] and compared with the 2015 LCMS data.

As at 2015, a total of 32,719 houses were registered for withholding tax on rental income out of the 600,478 eligible houses, translating into a registration rate of 5%. The total count of individual registrations improved from 10,341 in 2014 to 22,378 in 2015 as indicated in Table 3-2. The improvement was driven by increased registrations in Central and Copperbelt Provinces both by 2%, whereas declines in registrations between 2014 and 2015 were recorded in Lusaka Province by 8% and 1% in Southern Province.

Though Lusaka Province recorded a percentage decline in registrations in 2015 compared to 2014, it still had the largest percentage of registered taxpayers at 50% of the total registrations. Copperbelt Province had the second largest percentage of rental taxpayers at 23% of the total, however, both Lusaka's and Copperbelt's registration rates were relatively low with only 6% and 5% of the eligible households registered for the tax in 2015, respectively.

Table 3-2: Households registered for withholding tax on rent against total households by province, 2014 and 2015

	Registered Households						Total number of households, 2015	Proportion registered
	2014		2015		Total			
Province	No. of hhds	Percent	No. of hhds	Percent	No. of hhds	Percent		
Central	408	4%	1,450	6%	1,858	6%	32,400	6%
Copperbelt	2,242	22%	5,396	24%	7,638	23%	147,194	5%
Eastern	534	5%	1,357	6%	1,891	6%	21,559	9%
Luapula	101	1%	334	1%	435	1%	20,966	2%
Lusaka	5,667	55%	10,711	48%	16,378	50%	281,233	6%
Muchinga	4	0%	61	0%	65	0%	12,704	1%
North Western	104	1%	171	1%	275	1%	16,670	2%
Northern	204	2%	666	3%	870	3%	10,996	8%
Southern	1,052	10%	2,094	9%	3,146	10%	49,424	6%
Western	25	0%	138	1%	163	0%	7,331	2%
Grand Total	**10,341**	**100%**	**22,378**	**100%**	**32,719**	**100%**	**600,478**	**5%**

Source: Constructed from Zambia Revenue Authority Tax-online Records and LCMS 2015

Comparisons of registered households for rental tax against the total number of households on rent showed that Eastern Province had the largest proportion of registered households at 9%, closely followed by Northern Province at 8%, while Muchinga, Luapula, North-Western and Western provinces had only 1-2% registered taxpayers. The rest of the provinces hovered around the overall country average of 5% of eligible households registered for the tax in 2015, a dismally low registration rate. We infer from this information that Lusaka and Copperbelt Provinces have the highest potential for enforcement of the tax, since the two provinces have the highest number of housing units but with poor registration rates.

5 Before the introduction of the Tax-online system, data on the withholding tax was not disaggregated by the income type, therefore information for the withholding tax on rental income tax could only be obtained for 2014 and 2015. We ended with 2015 as it coincided with data produced in the LCMS and could be compared.

Table 3-3 estimates the monthly withholding tax on rent that could have been collected in 2015; assuming that all households that rented paid the tax. Calculating the tax as 10% of the total rental value, tax collections from rental tax would have been K32.9 million per month resulting into K394 million for the year. however, only K12.3 million was collected from individuals in that year as demonstrated in Table 3-4. It implies that a deficit of K382.5 million was recorded on collections from withholding tax on rent in 2015. Based on these figures, if the Revenue authority's efforts were rammed up to collect this deficit on rental tax this year, a contribution of about 6% would be made to the K6 billion hike in tax collections expected in 2018 from the 2017 levels.

Table 3-3 also shows that urban areas had a considerably higher median rent value at K350 than the rural areas which were at K75 and therefore urban areas present a larger potential for the collection of the tax. If enforcement of the tax were to be undertaken in urban provinces, the proximate revenue from Lusaka Province would be at K20.6 million, while Copperbelt and Southern provinces would rake in K6.9 million and K1.5 million, respectively, in a month. These would collectively bring in more than 85% of the probable collections. Similarly, the lion's share of revenue collections of K14.3 million would come from low cost residential areas, followed by K10.8 million from the high cost areas and K7.5 million from medium cost units. Rural areas would only contribute a paltry 2% to the tax collections.

Table 3-3: Household monthly rental values and estimated tax from rent in Kwacha, 2015, Zambia

Basis of Occupation	Mean Rentals	Median Rentals	Total Rentals	Tax from Rentals	Total Housing Units ('000)	
Region	Rural	189	75	6,917,211	691,721	36,599
	Urban	571	350	321,974,338	32,197,434	563,878
Province	Central	312	150	10,108,800	1,010,880	32,400
	Copperbelt	475	300	69,917,150	6,991,715	147,194
	Eastern	296	200	6,381,464	638,146	21,559
	Luapula	197	30	4,130,302	413,030	20,966
	Lusaka	733	350	206,143,789	20,614,379	281,233
	Muchinga	252	160	3,201,408	320,141	12,704
	Northern	200	80	3,334,000	333,400	16,670
	North Western	563	450	6,190,748	619,075	10,996
	Southern	322	200	15,914,528	1,591,453	49,424
	Western	456	300	3,342,936	334,294	7,331
Stratum	Small Scale	132	50	2,808,432	280,843	21,276
	Medium Scale	258	40	118,422	11,842	459
	Large Scale	1,165	150	31,455	3,146	27
	Non Agric	267	180	3,961,746	396,175	14,838
	Low Cost	328	300	143,227,432	14,322,743	436,669
	Medium Cost	1,003	680	74,800,731	7,480,073	74,577
	High Cost	2,057	1,300	108,264,024	10,826,402	52,632
	Total Zambia	647	300	328,866,512	32,866,513	600,478

Source: Living Conditions and Monitoring Survey, 2015 (Tax from rentals calculated by authors)

But in 2015, revenue collections from this tax were way below the probable expectations of that year as shown in Table 3-4. Within the provinces, only Central, Southern and Eastern Provinces managed to post collection rates of close to 5%. Lusaka was close to the country average of 3.1% but while the probable amount that Lusaka Province alone would have raised stood at

K247.4 million, only K8.2 million or 3.3% of the potential 2015 tax was collected in that year. At national level, only K12.3 million was collected in the year, against a probable expectation of K394.4 million leading to an approximate deficit of K382.1 million. From this calculation, only 3.1% of the probable rental tax was collected in 2015.

Table 3-4: Comparison of ZRA payments and LCMS rental tax estimates by province in K'000, for the year 2015

Province	2014 Actual Collections '000	2015 Actual Collections '000	2015 LCMS Estimates '000	Deficit Amount	% of 2015 Actual over Estimate
Central	140.02	610.20	12,130.6	11520.4	5.0%
Copperbelt	1,149.50	1,990.41	83,900.6	81,910.19	2.4%
Eastern	199.34	361.75	7,657.8	7296.05	4.7%
Luapula	33.80	42.12	4,956.4	4914.28	0.8%
Lusaka	4,889.88	8,174.84	247,372.5	239,197.66	3.3%
Muchinga	2.44	10.77	3,841.7	3830.93	0.3%
North Western	40.54	59.53	4,000.8	3941.27	1.5%
Northern	51.86	93.28	7,428.9	7335.62	1.3%
Southern	592.21	921.49	19,097.4	18175.91	4.8%
Western	14.82	26.27	4,011.5	3985.23	0.7%
Grand Total	**7,114.41**	**12,290.66**	**394,398.2** [1]	**382,107.54**	**3.1%**

Source: Constructed from LCMS 2015 and Zambia Revenue Authority Tax-online data

Thus for this tax, the average tax collection rate in relation to potential individual rental income tax collections was meagre. Even though, Central, Southern and Eastern Province collection rates were above the country average, they were still below 5% of what was probable. Muchinga, Luapula and Western Provinces collected far less than was probable while Copperbelt Province collections were at 2.4% of what could have been collected. Therefore more voluntary compliance and enforcement strategies are needed to improve collections from the rental tax.

3.4 Challenges and reasons for underperformance

The poor performance of revenue collected from rental income tax demonstrates that managing this tax has not been easy. There have been a number of changes to the laws and regulations related to the tax over the years, all in a bid to improve the collections from this tax. The challenges that have been faced can be grouped into those being faced by households leading to non-compliance and those confronting the tax authority in its administration of the tax.

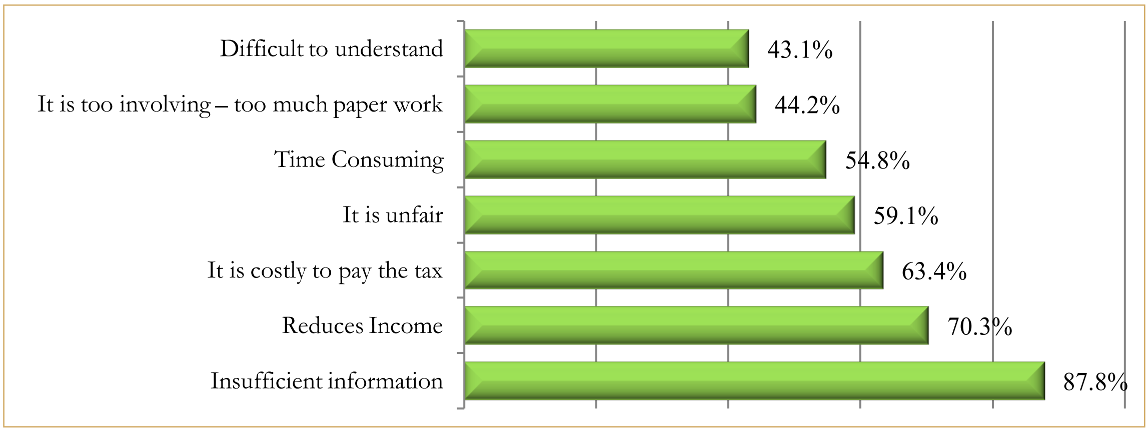
Non-compliance and evasion

The motives behind non-compliance by taxpayers are complex and have challenged tax authorities' world over. Evasion and avoidance are rife in this tax; the findings from the case study of Lusaka, Kitwe and Ndola are used to demonstrate these challenges:

a) *Limited knowledge of the tax:* tax knowledge, or lack of it, is indicated as one of the important factors influencing individual's tax attitudes. Literature confirms that a lack of knowledge remains a big impediment to tax compliance (Thananga, Wanyoike and Wagoki 2013). Despite the Tax Payer Education and Advisory Services programme by ZRA, its impact has been limited as the programme is based only at headquarters and Kitwe Office. Outreach to other areas only happens within special arrangements (ZRA 2016).

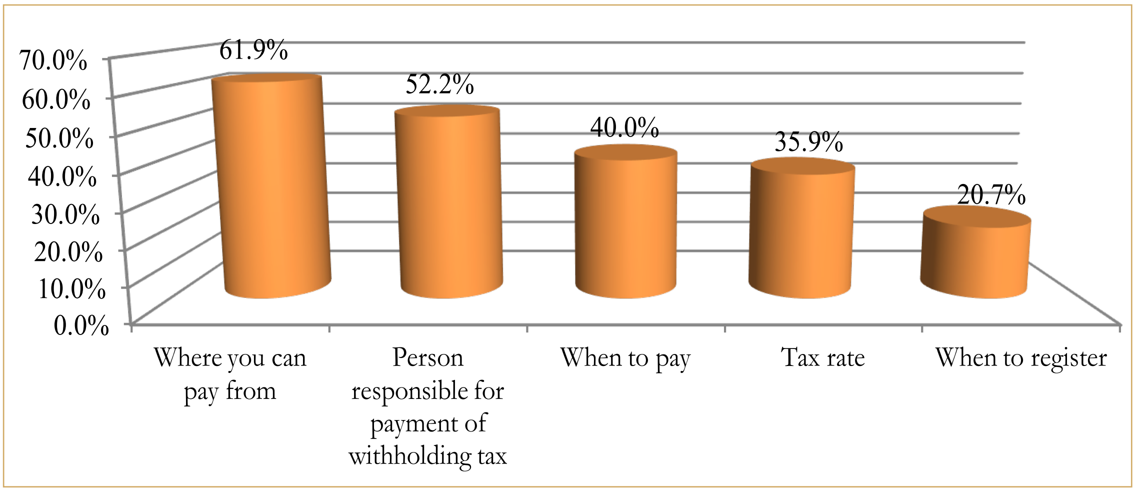
The survey on rental income taxation revealed that only one in five households were aware of withholding tax on rental income. Respondents aware of the tax were asked why people do not comply with paying withholding tax on rental income: 87.8% cited insufficient information as the leading cause for non-compliance – since the tax was not well advertised it made it less known. Other reasons cited were that the tax reduces income and it is costly to pay it.

Figure 3-1: Reasons people do not comply with paying withholding tax on rent



Respondents were asked to demonstrate their knowledge regarding the tax rate, who is responsible for withholding the tax, the pay points and when and where one could register for the tax. Only one in five people were aware of when to register for the rental income tax, 35.9% knew what the tax rate was and only two out of five were familiar with when to pay as shown in Figure 3-2. Further, the lack of knowledge on critical factors such as when to register for the tax by taxpayers made it very difficult for ZRA to capture would-be taxpayers, especially those who first put their houses on rent. Indeed, if many taxpayers do not know when to pay for the tax, then the revenue authority receives fewer payments especially where individuals do not feel obligated to register properties on rent, as there are no direct immediate sanctions for non-registration. Moreover, evasion of the tax is made easier because the probability to be caught is almost nil due to a lack of enforcement.

Figure 3-2: Knowledge on aspects of rental income tax



b) *Compliance and distortional costs:* relate to concerns over the costliness of a tax or extra expenses incurred by taxpayers or third party agents, in meeting the requirements laid on them by a given tax structure. These costs are also referred to in Rimmer (1996) as paper burden. For example, expenses for an agent to fill out tax forms and queue up to pay taxes (ZRA 2016). Without a doubt, transportation costs to the pay point also have a bearing on compliance, they were cited to at times exceed the amount paid in tax, particularly for those travelling long distances.

Further, taxes give rise to "distortional" costs as they alter decisions made by businesses and individuals when relative prices they face are changed (Bird & Zolt, 2003). For rental income, welfare losses occur when the tenant faces "grossed up" rentals (ZRA 2016) or where the incidence of the tax is shifted to the tenant. This in effect means that the landlord passes on the tax burden to the tenant who thus faces a higher cost[6]. Instead of, for example, paying rent of K2,000 the tenant pays K2,200 as they have to give K2,000 to the landlord and K200 to ZRA as 10% tax instead of K1,800 to the landlord and a withholding of K200 to total K2,000. Should a tenant face such a situation, they are likely to evade the tax on behalf of the landlord.

c) *Low incomes and taxpayer stress:* studies have shown that the financial condition of an individual might positively or negatively affect willingness to comply with provisions of tax law, irrespective of the relationship between non-compliance opportunity and compliance behaviour. Bloomquist, (2003) reports financial strain[7] as one of the sources of taxpayers stress. Financial strain refers to a deterioration of economic status, and individual taxpayers with meagre financial resources may be tempted to evade their tax payment if their household expenses exceed income. Faced with challenging economic times, 70.3% of those surveyed and who were aware of the rental income tax were of the view that the tax reduces their income, while just under two-thirds think it is costly and unfair. This may influence them to keep the tax deducted from rent to undertake other expenditures.

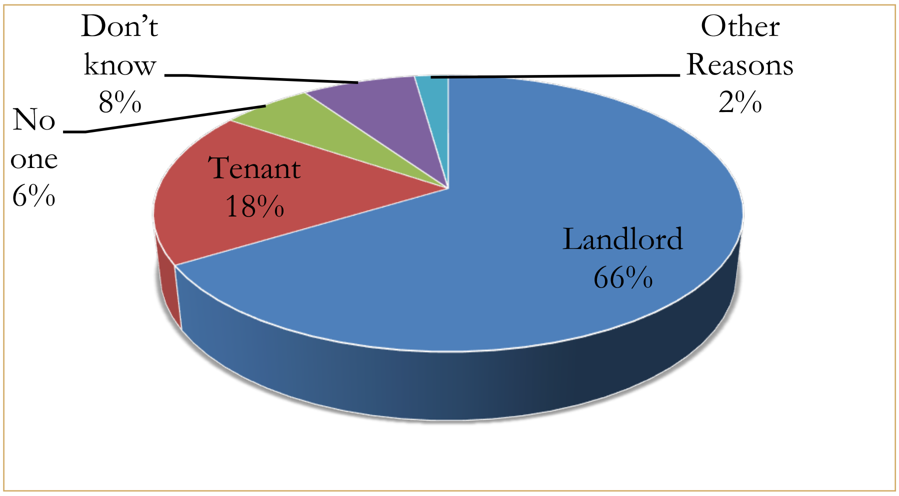
d) *Tenants not incentive compatible*: Incentive compatibility has been elusive in the implementation of withholding tax on rental income because opportunities exist for non-compliance. Firstly, a number of tenants may have knowledge that sanctions of non-compliance are charged on the landlord as per the Income Tax Act, such that if they do not pay, ZRA will pursue the landlord and not them. Therefore, tenants may have reason to evade the tax. Secondly, landlord and tenant may collude by agreement to evade the tax without consequence due to lack of enforcement by the tax authority. Moreover, the landlord may choose to give a blind eye to the payment of tax by declaring that their rental value is net of tax and as such it is up to the tenant to act as he chooses. On the other hand, tenants may be subjected to "grossed up" rentals, which include the tax component, resulting in higher rental burdens and this may result in evasion on behalf of the landlord by the tenant. This brings into question whether the tenant is a credible withholding agent since tenants are not incentive compatible.

About two-thirds of respondents from the household survey were of the view that landlords should bear the responsibility of self-withholding and paying the tax. The reasons cited were that landlords earn an income by virtue of being property owners on which the Government must earn tax, and as such should declare and pay the tax. Furthermore, the property bears the identity of the landlord and makes it easier for the tax authority to trace the landlord unlike the tenants who may change frequently. Additionally, others thought that since some landlords receive gross rentals then it is the duty of the landlord to remit the tax. Moreover it would be more correct for the landlord than the tenant to pay as they are obliged by law.

6 This is dependent on the rental price elasticity. For those houses where the tenant can leave the house to look for another because the tax burden has been shifted to them, the rental price is said to be elastic and the landlord may not have the ability to shift the burden (this may be observed mostly in high cost housing). Whereas in the case where the tenant stays and the tax burden shifts to them the price is said to be inelastic or it does not affect the decision to stay in the house and may mostly be observed in low cost housing.

7 This work was postulated in Elffers (1991), the two primary categories of taxpayer stress are financial strain and a growing dissatisfac tion with the tax system.

Figure 3-3: Who should bear the responsibility of remitting the rental income tax to ZRA?



Fewer than 20% of respondents argued that tenants should bear the administrative responsibility of paying the rental income tax in line with the current policy. They felt that this improves transparency as landlords risk not being honest. Tenants act as the check and balance and are most likely to pay the correct amount compared to the landlord. In like manner, it was perceived that if landlords were to pay, they would increase rentals. So, with tenants using the property, they remain the best option to withhold and pay the tax, especially when the landlord lives far away or abroad.

About 6% of the respondents were of the view that no one should pay this tax. They argued that Government plays no role when they build or buy the house. Therefore, Government is not entitled to demand any money in form of tax from them. Coupled with this, others felt that the tax should be removed as it takes away from the earnings acquired from the rental business and landlords pay other charges in form of land rents and rates.

e) *Grappling with paying a fair share:* according to Fjeldstad, Schultz-Herzenberg, & Sjursen (2012), addressing inequities in tax systems, procedures and enforcement would result in improved compliance. Where there are perceived inequities, individuals may shun the payment of tax. To exemplify this, Chibawe (2000) conducted research on the attitudinal factors that contributed to tax evasion in Zambia and concluded that 86% of tax payers in Zambia perceived the tax system as unfair and overburdening and hence justified their reasons for evading tax payment. There is no consideration of an exemption for low income earners within this tax and this may have played a role in low compliance.

To determine the levels of incomes and expenditures of would-be taxpayers, we analysed data as reported in the LCMS. Incomes were found to be higher for those households living in rented houses with a median income of K2,000 compared to those in owner occupied houses who had median incomes of K1,900. Those in high cost residential areas had about 8 times more income than those in the low cost areas. These and other findings are shown in Table 3-5.

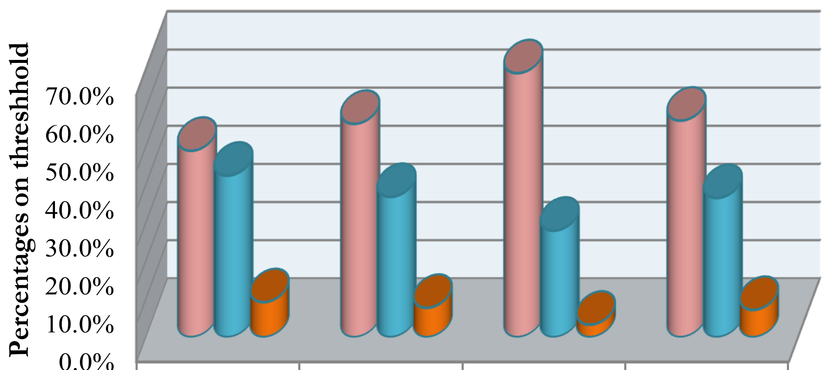
Table 3-5: Monthly average income and expenditure (in K) by district, stratum, tenancy status and type of housing

		District name							
		Kitwe		Ndola		Lusaka		Total	
		Income	Expenditure	Income	Expenditure	Income	Expenditure	Income	Expenditure
		Median	Median	Median	Median	Median	Median	Median	Median
Stratum	Low Cost	1,000	888	1,000	580	1,400	1,010	1,200	900
	Medium Cost	1,800	1,450	2,300	1,460	3,570	2,100	3,000	1,740
	High Cost	12,500	4,250	6,000	3,200	10,000	5,220	10,000	4,250
	Total	**1,500**	**1,173**	**2,000**	**1,403**	**1,800**	**1,260**	**1,800**	**1,260**
Tenancy Status	Rented	1,500	1,020	3,000	1,990	2,000	1,306	2,000	1,300
	Owned	1,500	1,238	2,000	1,200	1,900	1,305	1,900	1,300
	Company ownded	2,000	1,230					2,000	1,230
	Free (Owned by family or close friend)			500	1,180	700	635	700	635
	Total	**1,500**	**1,173**	**2,000**	**1,403**	**1,800**	**1,260**	**1,800**	**1,260**
Type of housing	Detached house	1,500	1,375	2,000	1,380	2,000	1,578	2,000	1,430
	Semi-detached	1,500	1,060	3,000	1,990	1,800	1,330	1,800	1,300
	Flat/ Apartment	1,800	882	5,000	2,750	1,500	1,227	1,500	1,227
	Cottage/ Servants Quaters	500	1,100	290	290	700	530	500	565
	Non-residential (e.g. Containers)					2,000	1,690	2,000	1,690
	Other					4,000	4,470	4,000	4,470
	Total	**1,500**	**1,173**	**2,000**	**1,403**	**1,800**	**1,260**	**1,800**	**1,260**

High cost and medium cost residential areas would be quick wins for this tax as the areas have residual income that would be paid in tax. The low cost residential areas though with more numbers, present low residual incomes. In the low cost residential areas, use of tenants to withhold the tax presents a steeper battle as tenants may not have an incentive to remit the tax as the cost of remitting may be higher than the amount to be paid in tax. This builds the case for introducing some progressive elements into the design of the tax. For those with low incomes, a more progressive taxation system would be ideal, however taking into consideration the aims of a schedular tax system, a threshold excluding certain types of low valued accommodation would suffice.

Results from the household survey also show that over half of the respondents advocated for the introduction of a threshold. A total of 69.1% of those in the high cost areas were for the idea of introducing a threshold followed by those in the medium cost areas (55.8%) and then those in the low cost areas (48.8%). However, over a third (36.3%) of respondents were not in support of an exemption threshold.

Figure 3-4: Do you think there should be a threshold income for rental taxation?



	Low Cost	Medium Cost	High Cost	Total
Yes	48.8%	55.8%	69.1%	56.6%
No	42.2%	36.6%	27.8%	36.3%
Don't know	9.0%	7.6%	3.1%	7.0%

Tax administrative hurdles

a) *Inefficiency in tax collection systems:* there are many factors that underpin a country's ability to collect enough tax revenue from domestic sources. Attoh & Awal, (2013) propose that one paramount influence is the efficiency of the tax administration institution. Conversely, the policy in Zambia that the tenant bears the responsibility of payment firstly means that the Tax Authority must come into contact with about 600,478 tenants (if all of them were to pay) unlike the fewer numbers of landlords. This increases the amount of work in registrations and audits.

   It also means that a different taxpayer registration must be done every time there is a new tenant even though the property is the same. In the absence of efficient registration systems, the task is daunting. For audits, it imposes a tax auditor visiting various residential units, owned by one person to undertake audits instead of seeing only the owner or property manager for one audit, which currently only happens if a landlord has been granted an exemption certificate by the CG.

b) *Revenue information services:* ZRA has made strides in introducing web-based interactive systems in form of ASYCUDA World for customs transactions and Tax Online for domestic taxes. Both systems allow taxpayers to undertake e-filing and e-payment functions (ZRA 2016). These have helped with reducing the costs of compliance. However, these require internet services that are almost out of reach for most small taxpayers.

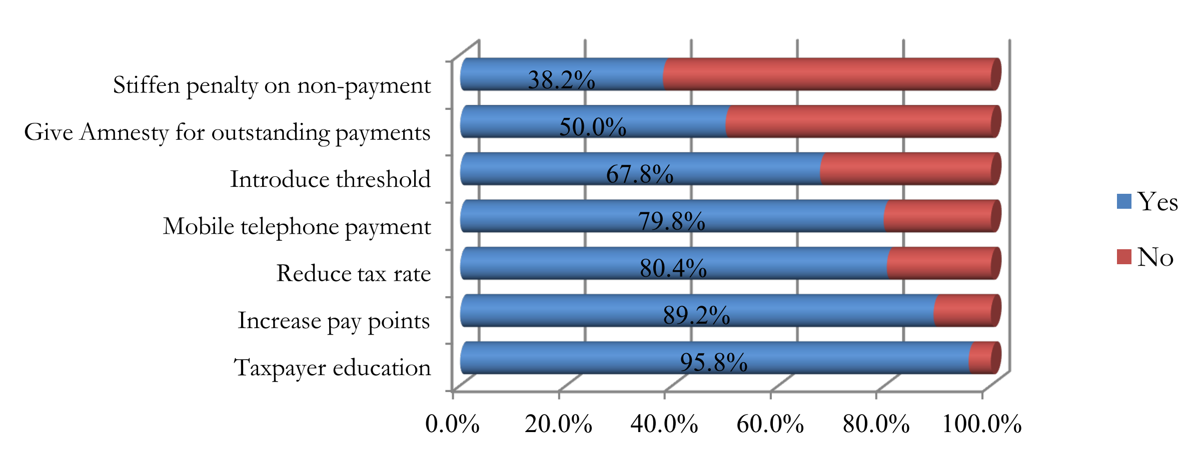
   According to the 2015 ICT Survey, there are only 12.7% of households that have access to internet services whereas mobile device services are being accessed by 64.5% of households (ZICTA 2015). The absence of robust mobile telephony solutions in tax payment hinders capturing those would be tax payers that may have mobile phones and not the internet.

c) *Weak capacity in detecting evasion:* the current law requires tenants to withhold and pay the tax, yet the same law holds the landlords accountable for non-payment should the tenant not comply. The landlords and not tenants will pay back taxes and penalties. This inconsistency implies that tenants may not feel compelled to pay withholding tax especially that sanctions are on the landlord. Moreover, it is difficult to detect the non-paying tenants as most properties are not captured on the registration system, since a tenant is the one who has to do the registration.

d) *Increased tax rate:* as the tax rate goes up, tax payers may evade payment and create a negative effect on the revenue (Friere-Seren and Panades 2013). A high tax rate is positively related to tax evasion and negatively related to tax compliance (Ali, Cecil and Knowblett 2001). This effect was observed in Zambia where collections reduced in 2015. Though the withholding rate on rental income was reduced from 15% to 10% and made a final tax, few rental tax payers were under this regime. Most tax payers previously paid the tax at 3% under the ToT regime and these now perceive the 10% final tax as an increment from a low of 3%. The high rate of "increase" from 3% to 10% may have had an effect of inducing evasion with taxpayers shunning the tax.

   Finding solutions to these challenges is important to establish a fair and efficient mechanism that achieves the objective of increasing revenue collections from this tax, improve equity and rid the administration of inefficiencies. Figure 3.5 represents the thoughts of survey respondents on how to improve compliance with the tax.

Figure 3-5: Options to increase compliance rates on rental tax



The majority of respondents proposed solutions that encouraged engagement with taxpayers such as taxpayer education. Increased payment points were also envisaged to be a solution especially if they included robust mobile telephony solutions in the absence of physical presence points. Respondents also expected that reducing the tax rate to levels closer to the TOT tax rate would increase compliance. About a third of respondents advocated for the introduction of a minimum exemption threshold and half the group perceived a tax amnesty and waiver on outstanding payments as the solution to voluntary compliance. Few interviewees were of the view that stiffer penalties could resolve non-compliance. The study adopts some of these options as part of its recommendations to improve rental tax administration and curtail non-compliance.

3.5 Experiences of other countries

A comparison of different ways rental income tax is administered shows that most countries in the developed world use the profit tax system while developing regions use schedular taxation. In the United Kingdom, France and India, the system followed is the personal income tax that applies different tax rates to different incomes in a global manner. The withholding system is used in East Timor with both landlords and tenants withholding tax depending on the type of person that the tenant is. In Africa, South Africa uses a PIT system whilst Uganda uses a schedular system. Summaries of the taxation systems are presented in Text Box IV.

Text Box IV: International experiences on rental taxation design

1. **The United Kingdom (UK): a mix of personal income tax and withholding tax**

   Rental taxation in the UK is charged using either the PIT system or the withholding tax system. According to Her Majesty's Revenue and Customs (HRMC) (2015), the PIT system is used for residents and is paid on profit left after adding together all rental income and deducting any expenses or allowances claimed. The rate of tax depends on total income for the year including any income from employment, self-employment or pensions, band rates may range from 0% to 45%. It is also charged on the use of furniture and additional services such as cleaning and repairs.

   A withholding system is used only for non-residents may elect to either pay income tax upfront using a withholding tax or receive untaxed income and pay tax later (Global Property Guide 2016) at a flat rate of 20%.A tax amnesty is given to those that declare unpaid tax by voluntarily telling the HMRC about rental income from previous years. If a penalty is charged, it will be lower than when the HMRC find out about the income through audit.

2. **France: separate regimes for income from land and unfurnished lettings and from furnished lettings**

   Like the UK, income collected per annum is captured into thresholds that are charged differently. Income is categorised to be either from land and unfurnished lettings or from furnished lettings. However, taxable income may be calculated under the Micro-BIC, a simplified deduction scheme that simply taxes 50% of the gross income and is automatically deducted and no separate tax forms for the business need be prepared (Blevins 2016).

3. **Timor Lesté (East Timor): either tenant or landlord can withhold tax**

   The definition of rent and the tax rate are similar to Zambia but the departure is that either the tenant or landlord can withhold tax from rental or lease payments. If the tenant is a legal person such as a non-individual enterprise, a partnership, company, unincorporated association, non-government organisation etc, then the tenant is required to withhold tax at the time of making the payment. If the tenant is a natural person - an individual, the landlord has to self-withhold tax from the payment when received. However, if the rent or lease payment is to a non-resident, then the tenant is required to withhold tax from the payment.

   For resident individual landlords and non-resident landlords whether individual or company, withholding tax on rental income is final. However for legal persons such as corporations the amount of rent received must be declared in their gross income in their annual income tax form. A credit will be allowed for amounts of withholding tax previously withheld. The tax laws require that the party who is liable to withhold tax must create and keep adequate records to prove that they withheld and paid the correct amount of tax. These records need to be kept for 5 years after the tax year in which the tax was withheld and remitted to National Directorate of Domestic Tax (Ministry of Finance - National Directorate of Domestic Tax (NDDT) 2012)

4. **India: taxpayer not liable to pay tax if the total taxable income does not exceed the maximum threshold**

   Rental income in India is considered as income accrued in India from property in India and is taxable irrespective of residential status. However, if total taxable income, (including rental income or any other source of income) does not exceed the maximum threshold amount then the taxpayer is not liable to pay tax on it (Parashar, 2015).

5. **South Africa: recurrent expenses deducted, security deposit excluded**

   Rental taxation is extended to holiday homes, bed-and-breakfast establishments, guesthouses, sub-renting part of your house for example, a room or a garden flat, dwelling houses and any other similar residential dwellings (South African Revenue Services (SARS) 2016). The rental base includes all amounts paid in addition to the monthly rental. A refundable deposit such as a security deposit paid by a tenant is not taxable provided it is kept separately in a trust account and is not used. But if it is forfeited by the tenant, then it is taxable. When it comes to VAT expense claims, the supply of a "dwelling" is an exempt supply for VAT purposes, and you cannot deduct VAT incurred on its expenses.

6. **Uganda: taxes individuals and companies differently**

   In Uganda, the administration of the rental income tax differentiates between residential properties and commercial properties. Mulondo (2014) states that the Ugandan Revenue Authority (URA) would tax all rented properties in the urban areas through the application of 20% rate for individual owned properties and 30% rate for company owned properties. The Ugandan system recognises landlords expenses incurred in keeping their property in good repair. The URA further recognises that companies and individuals should be taxed differently.

The choice of a withholding system in Zambia was driven by the fact that it is a simpler system to administer compared to the profit system. Developing countries have experienced difficulties in implementing the profit tax system. Kenya before the 2016 reforms, applied different tax rates to properties according to different income thresholds. This however proved challenging to administer and led to a change of the regime in 2016 and the use of a flat rate.

3.51. Kenya: undertook reforms and simplified a cumbersome tax regime

Rental income in Kenya is taxable under the Income Tax Act. Additionally rent on non-residential buildings (commercial) is taxable under the VAT Act. Rental income is defined as all rent, premium or any other consideration for use or occupation of property. In this Act all persons in receipt of rental income are liable to pay the tax unless exempted specifically under any laws (Kenya Revenue Authority (KRA) 2012). Kenya previously strictly followed the personal income tax system for landlords but have since undertaken changes to the rental income taxation regime in 2016 as discussed in Text Box V.

The PIT regime is basically for those exempted from the residential income tax and includes: commercial property, those that elect to use the PIT system, non-resident landlords and landlords earning more than 10 million Kenyan shillings[8] per year. In this regime allowable expenses incurred wholly and exclusively in the production of rental income can be included to arrive at the chargeable rent. All expenses are to be supported with documentary evidence. Landlords are therefore required to properly maintain records such as rent schedules – rental income (rent receipt books) and expenditure related to rental expenses in form of invoices and receipts.

Further, landlords are required to maintain other relevant documents including title deeds or land records, certificate of occupation showing when first let out, bills of quantity showing cost of construction or sale agreement. Landlords are also required to maintain building plans that show the number of rentable units and lease/tenancy agreements showing the rent per unit.

Before the introduction of the residential rental income tax regime, there were different rates of tax applicable to landlords. Kiema (2007), shows that the tax rates depended on the type of person. For natural persons, chargeable rental income was aggregated with other incomes of the person and taxed

Text Box V: Residential rental income tax in Kenya

KRA was experiencing challenges in administering and collecting tax on residential rental income. It revisited its process of collecting taxes from rent particularly from the untapped low end segment of the market. Commencing January 2016, the Finance Act of 2015 introduced Section 6A in the Income Tax Act Cap 470 Laws of Kenya, which provides for a simplified tax regime on residential rental income. The tax is payable by any resident landlord (Individual or Company) from income which accrued in or is derived from Kenya for the use or occupation of residential property.

A 10% flat tax rate on gross rental income is payable by a resident person for the use of residential property where the rent income does not exceed 10 million Kenyan shillings per annum and a further 2% to be collected only by appointed agents. However, landlords who wish to remain in the current tax regime can elect in writing to the Commissioner, to be taxed under the normal tax rates.

The new regime is intended to simplify the previous complex tax computation in tax bands where KRA had been charging a 10% tax on the lower band, 15%-25% on the mid-band, and 30% on the higher band. It does not require landlords to produce records to account for expenses as the residential rental tax will be a final tax which will be paid on monthly basis using a simplified online payment return. The tax will now be charged on the gross rent income from all properties and eligible landlords shall not be required to file annual returns unless one has other incomes for example commercial rent, business income, farm income, et cetera.

Source: KRA, Residential Rental Income Tax: What You Need to Know

8 This is approximately US$100,000 at an exchange rate of $1 to Ksh100 as at July 2017.

at the individuals' graduated scales, which ranged from 10% to 30% depending on the income. For corporate entities, taxable rental income was aggregated with other incomes albeit taxed at a single rate; that is, the corporate tax rate of that particular accounting year.

The chargeable income for partnerships, on the other hand, was shared among the partners according to their profit-sharing ratio; then each partner's portion taxed in combination with his or her other sources of income.

Withholding tax is applicable to rental income received by non-residents. In this method, the tenant is responsible for deducting tax at source from rent payments due to the non-resident landlord, and remitting the tax so deducted to the Commissioner of Taxes, on or before the 20th day of the following month.

This section is used to help draw on some of the policy experiences as lessons useful in thinking about implementing the necessary reforms. We make recommendations in line with some of them to make the withholding system work in taxing rental incomes and get more revenue out of the tax.

4. Conclusions and Policy Lessons

At the crossroads of low tax collections from rental income amidst increased rental housing stock. Into 2018, the revenue authority holds a tough task of raising K6 billion more than they did in 2017. One of the tax handles that can be used to contribute to this amount is withholding tax on rental income which is currently contributing dismal amounts. If the shortfall between the potential and actual collections in 2015 could be collected, over 6% of the K6 billion revenue increase targeted for 2018 could be raked in. Collections from this tax can be improved by reducing non-compliance and improving administrative efficiency.

This study has unearthed the realities in the implementation of the tax, including extremely low levels of registration hence low compliance. It has also unveiled other factors that affect the payment of and compliance with this tax type which include:

Paltry registration of taxpayers for withholding tax on rental income at 5%. The study established that withholding tax on rental income is highly evaded. Out of an approximate 600,000 households that formed the base for this tax in 2015, there were only 32,719 households registered for the tax, giving a registration rate of only 5%. This is despite an average of 20,000 new rented dwellings being added each year between 2010 and 2015 to the housing stock. The increment in the number of rented houses shows that the net from which this tax could be collected widened especially in the urban areas, with Lusaka and Copperbelt Provinces having the largest tenancy rates and as such more households need to be captured for payment targeted through increased registration of taxpayers.

Policy change reduced rental income tax collections between 2014 and 2015. After the budget change mandating tenants to withhold taxes and remit them on behalf of landlords was implemented in 2015, the performance of withholding tax on rent exhibited a declining trend between 2014 and 2017. This demonstrates that the use of tenants as withholding agents has not worked as expected to increase collections from this tax.

Little revenue has been realised from the tax on rental income. Out of an approximate K32.8 million per month, or K394 million per year, that could have been collected as estimated from the number of tenants in the 2015 LCMS, ZRA only managed to collect K12.3 million for the whole 2015. Lusaka Province collections were only at K8.1 million when K247 million could have been collected, Copperbelt and Southern Province collections stood at K1.9 million and K0.9 million out of K83.9 million and K19.1 million potential collections, respectively.

With less than 2% of the potential tax being collected, there is enough scope to increase tax revenue collections on rental income. Only 2% of the probable revenue was collected from Lusaka and on average only 1.8% of the probable tax was collected nationwide in 2015. This shows that there is a large gap between the probable revenue and actual collections. Efforts are required to improve compliance and vigilant enforcement.

There are many reasons for the underperformance of the tax. They include non-compliance in the form of evasion and low tax morality, poor awareness and low tax knowledge, high compliance and distortionary costs. Additionally, administrative hurdles in the form of inefficient tax collection systems, payment difficulties, weak capacity in detecting evasion and low enforcement were identified.

Given the large gap between the potential tax that can be collected and the current levels of revenue on this tax, it is clear that the rental income tax regime needs renewed attention and reorganisation from both the policy makers and the implementers. In order to reform the rental income tax regime, it is essential that these factors are borne in mind.

4.1 Policy recommendations

The low number of registrations at 5% of eligible taxpayers implies that ZRA can only enforce this tax on 32,719 registered houses from a pool of over 600,000 rented houses. Unless a reform is implemented collections will continue to be low. The low levels of registration stem from the fact that ZRA has no known way of tracing a tenant apart from basing it on the goodwill of the taxpayer. It is however known for a fact that for a tax to sufficiently raise resources, it should be made 'hard' for taxpayers to evade, whether effective tax enforcement is in place or not, and easy for those who would want to comply. To achieve this requires a combined number of strategies.

Recommendations are offered in light of improving administration and hence collections from the withholding tax on rental income thereby increasing voluntary compliance.

4.1.1 Who should pay the tax?

If Zambia is to improve the administration of rental income tax, consideration has to be made as to who withholds the tax.

a) ***Revert to Landlords paying the tax***

The use of a landlord as a tax point yielded better results as shown from 2014 revenue collections – the highest rental tax collections during the period 2014 to 2017. Lessons from East Timor show that the tenant is best used to withhold tax when they are a legal person such as a body corporate, partnership or association or when the landlord is non-resident. When the tenant is an individual it is best that the landlord self-withholds the tax payment. This was also seen in the case of Kenya – individual tenants only withhold the tax where the landlord is non-resident.

Moreover, requiring the tenant to bear the responsibility of payment increases the work of registrations and audits on the revenue authority as every new tenant is required to register anew unlike if a landlord registers the property, the change of tenants would not matter. In the absence of efficient registration systems, landlords simply created situations in which they evaded paying the tax through their tenants, in that, as long as they obtained their net rentals they did not insist on the tenant remitting the tax since they no longer felt obligation.

When the tenant is an individual it is best that the landlord self-withholds the tax payment. This was confirmed in the survey conducted, as most respondents were of the view that landlords should pay tax on the income earned from property owned. Enforcement of payment by the tax authority is made easier as property bears the identity of the landlord and the tax authority can therefore trace the landlord unlike the tenants who change frequently. Targeting the landlord means that those landlords that have more than one house on rent can be captured once and for all.

Zambia should therefore revert to landlords withholding the tax. The strategy of using landlords to pay the tax can also be combined with other strategies such as using third party information from places such as commercial banks. Given that all bank account holders are required to have TPIN registrations from 2018. ZRA can leverage on information obtained through this third party source to identify landlords and enforce registration of these TPINs on the system. This will help increase the number of taxpayers captured. Once done, follow-ups and enforcement can be conducted through different communication channels including letters and phone calls and thereafter audits can be intensified.

b) ***Introduce a tax amnesty and waiver***

For most taxpayers, fear to register as a taxpayer rides on knowledge that penalties and interest will ensue and be backdated if a house had been on rent for a number of years but registration was not done. To encourage landlords to register for the tax, especially those that may be willing to pay the tax but deterred by outstanding tax obligations, interest and penalties accrued by their tenants, ZRA should declare an amnesty and tax waiver for a specified period of time. In this period landlords can be forgiven the outstanding liabilities if they register for this tax and as such start on a clean slate.

Thereafter to encourage voluntary tax compliance, a continuous tax amnesty can be adopted as is done in the UK. Those who voluntarily choose to apply and pay for rental income tax for previous years are charged no penalty or a small penalty amount depending on the reason. Taxpayers are not penalised for the period before registration. This could help in Zambia in the sense that what is most important is for the taxpayer to be registered and enforcement can be assured going forward but stiff penalties could be used for those that do not make an effort to register and pay for the tax once found.

4.1.2 How should the tax be paid?

a) Increase the work scope of tax collection agents

Seeing that enforcement costs of the tax may be higher in certain locations than the actual amounts paid, ZRA should allocate the appointed WHT agents to defined geographic locations called blocks. In these blocks, agents could systematically be assigned to manage tax compliance of each landlord. Landlords who may have houses in multiple locations could pay the rental income tax within the respective block where the house is located. As an incentive to landlords to voluntarily comply, Agents that collect the tax on behalf of ZRA may collect the 10% withholding and an extra amount agreed by ZRA and the agents as their pay such that the effective tax rate will be greater than 10%. For instance, an extra 2% is charged by agents in Kenya and this acts as their remuneration. The appointed agent will be required to have up-to-date information on the payment status of each landlord in their assigned block and only follow up on those landlords not yet paid up. For this to work, ZRA will have to leverage on information technology for tax payments.

b) Create a mobile registration and payment application

The absence of robust mobile telephony solutions in tax payment hinders capturing those that may have mobile phones and not the internet. Since most banks have mobile telephony solutions in which bills such as water, electricity and pay television are paid from, the tax authority can leverage on such a system so as to ensure that tax payments are also included on the menu of options for this channel. ZRA should work in hand with commercial banks to establish a mobile telephony solution that channels tax payments through Mobile Banking. Banks can include a simple option from which taxpayers can pay rental tax.

Further, ZRA should ensure that a registration and payment mobile application is created and made mandatory for all landlords to sign up to. Such an application will cover those landlords that do not have bank accounts but have basic mobile phones. Agents can make use of this channel to follow up on a platform such as Zoona where those with cash payments can have their payment sent directly to a ZRA Account by Zoona. The Agents should only follow up on those who have not registered and not paid and this information can be updated an obtained from ZRA.

4.1.3 Where the tax should be paid

The findings that Lusaka, Copperbelt and Southern Provinces have the highest number of housing units and low registration rates for the tax means that the three provinces have the highest potential for enforcement of the tax. ZRA should therefore employ an urban area targeted strategy.

a) ***Concentrate on Urban Provinces***

The strategy requiring landlords to self-withhold and pay the tax can easily be implemented in the three urban provinces as they have the highest potential for tax. Lusaka, Copperbelt and Southern Provinces combined capture 85% of the rented housing stock within the country but have very low rental tax registration rates averaging 5%. Starting with these provinces would allow ZRA to efficiently collect over three quarters of the potential tax. Thereafter, ZRA could gradually expand enforcement to other provinces. Concentrating on these urban provinces has the potential of bringing in three times more than what is collected in a year, in one month.

b) ***Uphold the Ability to Pay Principle***

The *ability to pay principle* should be upheld in the design of a tax system. Ability to pay looks at both vertical and horizontal ability of taxpayers. In the case of rental tax, reducing the tax rate and providing differentiated tax rates would tackle vertical ability, while introducing a threshold would address the issues of horizontal ability.

Ability to pay builds a case for introducing progressive elements into the design of the rental tax. Due to low incomes among the majority of the population, a more progressive taxation system would be ideal, for example those in high cost residential areas could be charged higher tax while those in the low cost residential areas a lower tax or none at all. However, taking into consideration the aims of a schedular tax system – simplification - a threshold excluding certain types of low valued accommodation would suffice. In this case, houses with grass thatched roofing, mud floors and mud walls would be excluded, and the essence would be to allow for improvement to a decent standard of living.

Lessons can be learnt from other countries - there is a minimum threshold for a charge of rental income tax in India; this generally takes equity issues into consideration. Uganda applies the rental income tax only in urban areas and, further, properties owned by individuals are taxed at a lower rate compared to company-owned properties as they recognise that equity considerations should be made in designing tax systems.

c) ***Reduce Compliance Costs***

Concentrating on urban provinces would allow for the reduction of transport costs for most people travelling from far flung areas to ZRA offices to remit this tax. ZRA can appoint agents to go to these far flung locations on appointed dates since transport costs for individuals in these areas are usually higher than that of the tax payment. Eventually the solution to reducing this burden on the taxpayer would be to avail the robust mobile telephony solutions that do not require people to travel but finalise transactions from the comfort of their homes.

4.1.4 What else can be done?

There is little effort observed in deterrence of evasion and enforcement of the withholding tax on rental income. This emanates from the fact that there are no obligations to register properties on rent and there are no direct immediate sanctions on people who make no effort to register for the tax. Evasion on the tax is made easy as the probability to be caught is almost nil. Going forward and thinking long term ZRA has to improve its effectiveness and efficiency in its administration of the tax.

a) *Develop Geographical Information Systems*

To effectively manage this tax ZRA will require up to date information on properties in form of local council's valuation rolls, which are the most reliable sources of information on property. The rolls capture all developed properties in cities, towns as well as districts and indicate the property and rental market values. Secondly they capture developments of new properties as they are being added to the property stock on the market. The current biggest challenge however, is that it takes time for councils to update a valuation roll defeating the need of timely information for ZRA.

Advanced technology allows for cadastral, geographical databases which are comprehensive registers that map property in real time and include details of ownership, tenure, precise location, dimensions (area), and the value of individual parcels of land. By linking the graphic and literal information about taxpayers, the Geographical Information Systems (GIS) could be used to efficiently identify landlord taxpayers. Since property value information would be readily available, validation of properties and buildings would allow ZRA to get realistic information on house values and therefore rental values.

ZRA should work with the Municipal Councils to develop these registers. This effort is necessary to ensure that design, implementation and maintenance of the rental income tax regime remain valuable, timely and orderly. What is more, this is one of the fiscal handles that can then be decentralised to the local authorities in the aim to achieve fiscal decentralisation.

The absence of this data implies ZRA has no verifiable records to show which properties are rented out. Going forward would either require real time updating of the valuation rolls at the council's by empowering them with robust IT solutions or developing GIS registers that can pick information from documents such as building plan approvals and titling processes to show the period of development and automatically update the registers. It also requires that registrations occur by landlords whenever they are commencing a rent-out such that there is a certificate of registration at point of occupancy as it is done in Kenya. Improvements such as these in record keeping are essential for proper management of the tax.

b) *Improve awareness and knowledge*

The very low levels of awareness and knowledge on withholding tax on rental income call for consistent programmes on tax education. Apart from text messages sent by the authority to the general populous, the Revenue Authority should engage more in outreach programmes targeted at urban populations where there are more rented houses.

To help urban taxpayers from the medium and low cost residential areas, ZRA could target market campaigns, drama demonstrations, cultural dancing in local languages as a means to reach out the message of the need to register and pay withholding tax on rental income. For the readers and those that may be well versed with technology, ZRA would do well to make use of interactive websites, disseminate leaflets, enhance the call centres by ensuring be well trained people are based there and monthly adverts to remind taxpayers of their rental obligations.

To entrench the ideals of taxation, Zambia needs to begin to inform the populous about tax at an early age. This could be done through tax clubs and or tax education in secondary schools. This may increase the number of people that are aware about the tax and therefore increase the number of people who register for it.

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