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FISCAL INCENTIVES FOR GOOD ENVIRONMENTAL MANAGEMENT IN ZIMBABWE

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ABSTRACT

Tax incentives are rarely considered in discussions on environmental protection, yet well structured incentives can be of critical importance in contributing to good environmental management. For tax incentives to contribute maximally to sound environmental management, their various objectives, e.g., curing market failure, influencing economic behaviour and raising revenue for environmental protection must be well balanced. This balance becomes even more difficult to achieve when account is taken that the objectives must be pursued in the light of the general principles of taxation—equity, certainty, efficiency, etc. — and specific principles of environmental taxation, like the polluter pays principle. Inevitable inconsistencies are bound to occur, but the framework of objectives and principles allows for clearer thinking in the design and implementation of specific environmental tax incentives.

In Zimbabwe, no *general* tax incentives for good environmental management are currently in place. However, by examining, in the light of the above scheme, those few environmental incentives that exist, this article seeks to open the vista for the systematic introduction of more incentives for environmental protection in Zimbabwe.

INTRODUCTION

There are only a few fiscal incentives for the protection and management of the environment in Zimbabwe and, needless to say, hardly any conceptual framework for such incentives has evolved. This is in direct contrast to North America and Europe where the subject of fiscal incentives for environmental protection has generated a considerable degree of interest. Therefore, this presentation adopts a robust approach of utilising, 'ready made', the framework developed in those countries of the North and to some extent in South Africa, in order to locate the existing fiscal incentives in Zimbabwe and to argue for a systematic introduction of additional ones.

OBJECTIVES, PRINCIPLES AND CLASSIFICATIONS

The objectives for implementing fiscal incentives for environmental protection are generally considered to be:

- curing market failure,
- influencing economic behaviour, and
- raising revenue for environmental protection.

By "curing market failure" is meant the "internalisation of " (making enterprises pay for) environmental costs which would otherwise have remained "externalised", that is, transferred to the various segments of the community in the form of damage costs to human

health, property and ecosystems.¹ Fiscal incentives could also have the objective of “influencing the economic behaviour” of enterprises and individuals who may be encouraged to invest in preventive, restorative or compensatory measures to protect the environment. Finally, the objective of “raising revenue” could be achieved through imposing an environmental tax or charge or by denying a deduction for an environmentally hazardous activity and using the revenue for protecting or restoring the environment.

These objectives must be pursued in the light of general principles, or canons, of taxation and specific principles of environmental taxation, as discussed below.

Within this general framework, environmental fiscal incentives can be classified as either negative or positive.

THE POLLUTER PAYS PRINCIPLE

This approach provides that environmental policies should be based on the Polluter Pays Principles (PPP). Adopted in 1972 by member countries of the Organisation for Economic Co-operation and Development (OECD), PPP is intended to encourage industries to internalise environmental costs and reflect them in the prices of products. Further, in the case of OECD, the guidelines on PPP were intended to discourage subsidies that could lead to distortions in international trade.

In developing countries, however, the costs of environmental damage in the processing of “pollution-intensive” goods — pulp and paper, oil, aluminium, chrome, for example — are passed on in the form of higher prices, but continue to be borne entirely domestically in the form of damage costs to human health, property and ecosystems. In this regard it has been observed as follows:

Many Third World policy makers see this as beneficial in that it gives developing countries a comparative advantage in “Pollution-intensive” goods that should be exploited. They also see that passing along more of the real costs could reduce the competitive position of their country in some markets and thus regard any pressure in this direction as a form of disguised protectionism from established producers. Yet it is in developing countries’ own long-term interests that more of the environmental and resource costs associated with production be reflected in prices. Such chances must come from developing countries themselves.²

It is encouraging to note that environmental protection is one of the conditions that must be met by applicants for licences to operate in export processing zones (EPZs) in Zimbabwe — where they enjoy a lot of tax advantages including a five-year tax holiday. Section 25 of the Export Processing Zones Act, 1994, requires that in the consideration of applications for investment licences, regard must be had to, among other things, “the impact the proposed investments is likely to have on the environment and, where necessary, the measures proposed to deal with any adverse environmental consequences”. Under such provisions transnational corporations (TNCs), for example, could be encouraged to adhere to environmental standards operative in their home countries and to transfer to developing countries eco-friendly technologies. It is too early to say whether in practice the recently appointed Export Processing Zones Authority would use these provisions to ensure good

1 *Our Common future: The World commission on Environment and Development*, Oxford University Press, 1987 p.220.

2 *Our Common Future*, *op.cit.* (fn.1) p.84.

environmental management in EPZs.³ All that can be said now is that the opportunities for doing so do exist.

PRINCIPLES OF TAXATION

The generally accepted principles of taxation as articulated by Adam Smith and added to by modern day economists underlie any system of taxation. These canons include equity, simplicity, certainty, convenience, administrative efficiency, flexibility, stability and neutrality. In the design and implementation of environmental fiscal incentives, these canons must be adhered to as much as possible. However, some of them, like neutrality, have to be limited or abandoned since the objective of imposing fiscal incentives for the environment is specifically to influence behaviour and the market.⁴

Other principles with direct relevance to the environment have been suggested.⁵ They include:

- the principle of efficacy, i.e., the tax should be effective at working the intended change;
- environmental effectiveness, and
- the principle of compatibility with existing institutional framework.

CLASSIFICATION OF INCENTIVES

Classified according to their impact on behaviour, incentives may either be negative or positive, and avoidable or incapable of being avoided.

A negative incentive may be defined as "one that through the application of a fiscal measure, a taxpayer is discouraged from embarking on or continuing with an act that has unfavourable environmental consequences".⁶

A positive incentive may be defined as "one that through the application of a fiscal measure a taxpayer is persuaded to adopt a particular act that has favourable consequences".⁷

Incentives can also be divided into general incentives and incentives granted under special incentive laws. For general incentives, no special approval is required to qualify, as in accelerated depreciation of capital goods to promote industrialisation, for example. Special incentive laws, like Zimbabwe's EPZ regulations "required that the taxpayer obtain approval from the government — or from an investment board operating under authority delegated by government — in order to be eligible for the incentives".⁸

Negative Incentives

Environmental Taxes

Environmental Taxes designed to discourage particular forms of behaviour or activities have traditionally been imposed on mass consumption goods such as tobacco, beer and petroleum products.

3 A nine-member board of the Export Processing Zone Authority was appointed on 23rd February, 1996.

4 Henderson, P. G. W., "Fiscal Incentives for Environmental Protection — Conceptual Framework" *South African Journal of Environmental Law and Policy* Vol 2, No.1, 1995 (hereinafter referred to for short as "Conceptual Framework") pp. 61 -2.

5 *Ibid.*

6 Henderson, P. G. W., "Conceptual Framework" *op. cit.* (fn.3) p.67.

7 Henderson, P. G. W., "Conceptual Framework" p.68.

8 *Taxation in Sub-Saharan Africa*, IMF, Washington D.C., 1981 Occasional Paper No.8 p. 33.

The first problem pollution taxes suffer from is that of ambiguity about their objectives. Are they designed to compensate for environmental damage, to encourage polluters to reduce their pollution, or to raise revenue for environmental protection? Clearer articulation of the objective of the pollution taxes would greatly assist in the proper design and efficacy of the taxes.

A second problem with environmental taxes, as with all consumption taxes, is the question of its incidence. Consumption taxes are generally regressive in nature and accordingly environmental tax could fall disproportionately on the poor. Steps to mitigate this regressivity could include designing the rates of the tax in such a way as to differentiate appropriately among products consumed relatively more by the rich than by the poor, e.g., having higher rates for gasoline than for kerosene.

The third problem is that of contradiction within the same tax system. For example, in Zimbabwe there are excise duties levied on petroleum products with the objective of conservation of energy. At the same time the Income Tax Act imposes too lenient a burden on fringe benefits for use of company vehicles for private purposes (section 8 (1) (f) Income Tax Act, Chapter 181), thus encouraging private motoring. For example, the deemed benefit for the use of a motor vehicle for a full year for private purposes is Z\$1 500.00 for a car whose engine capacity is 1 500cc or less, Z\$ 2000. 00 for a car between 1 500cc and 2 000cc, and Z\$3 000.00 in the case of a motor vehicle whose engine capacity exceeds 2 000cc. The petrol costs of running a 1 500cc motor vehicle at 40 litres a week at the current full price of \$3.64 per litre is \$6 988.80 per year, i.e., the fuel cost alone, excluding other lubricants, maintenance and depreciation, is almost 5 times more than the deemed benefit for the use of the car! Further, the same tax laws exempt completely senior civil servants from tax on their private use of government motor vehicles.

Prohibited write-off of expenditures which are contrary to environmental policy

Where the carrying out of an activity or acquisition of the asset is undesirable from an environmental point of view, depreciation on such expenditure could either be prohibited or retarded. For example in Zimbabwe, the depletion allowance of 5% based on the value of minerals produced by the miner was repealed with effect from 1 April 1995.

Linked to this would be prohibition of deductibility of damages and fines for violating environmental regulations.

Payment into statutory funds

According to Henderson¹⁰ a trust fund system imposes a tax or fee on a particular activity in order to create a fund dedicated to an environmental undertaking. The revenue realised then goes into an account that defrays or substitutes for the individual legal liability of one or more taxpayers.

Such a fund could be set up with contributions coming from the "pollution intensive" industries like mining and forestry. The revenue collected could then be used to support and promote, for example, indigenous knowledge systems or environmental protection and rehabilitation. In Zimbabwe, there are currently no dedicated statutory funds for such

9 Henderson, P. G. W., "Fiscal Incentives for Environmental Protection — The Way Forward", 1995 SAJELP Vol. 2 No.2 (hereinafter referred to for short as "The Way Forward") p.153.

10 "The Way Forward" p. 158.

purposes. The closest to such a fund is the Natural Resources Board which, however, is not only funded differently for the manner suggested above, but has very limited funds, of a few hundred dollars per each of the 57 Rural District Councils and which allocations are dedicated to environmental indigenous knowledge systems.

Positive Incentives

Double deduction of revenue expenditure

In taxation, generally, any outright deduction of a qualifying, *revenue* expenditure is a simple recognition of the economic expenses incurred in the production of the income in question. However, where a double deduction is granted, this becomes a very powerful tool for promoting the favoured expenditure. A good example is the proposed double deduction for export promotion expenditure, effective 1 April, 1996. No similar double deduction is currently available for environmental expenditure. It is submitted that much gain could be made if such a deduction were introduced, for example, for research and experimentation into eco-friendly production.

Currently, in terms of paragraphs (n), (o) and (p) of section 15(2) of the Income Tax Act, a taxpayer may claim expenditure incurred during the year in carrying out experiments and research relating to their trade, other than expenditure of a capital nature incurred on plant, machinery, land or premises or on the acquisition of rights, such as patents. These restrictions do not bode well for environmental research and experimentation whose very essence includes expenditures of a capital nature on plant, equipment and machinery including acquisition of patents and similar rights. The requirement that the expenditure should relate to the taxpayer's trade is also unduly restrictive and could even be harsh when subjected to strict interpretation by the courts.¹¹ All these restrictions underlie the urgent need for the introduction of separate deductions for environmental expenditures of both a revenue and a capital nature.

It is suggested that environmental revenue expenditure deductions be in the nature of a double deduction and not be restricted to the trade of the taxpayer as such in order to allow, for example, a city hotelier who contributes to a research project into maintaining safe air pollution levels in the city to benefit from the deduction.

Accelerated write-offs of capital expenditure

In terms of section 15(2)(c) of the Income Tax Act as read with the Fourth schedule thereof, accelerated write-offs of capital assets are allowed at various rates depending on the nature of the asset and generally ranging from 5% per year for commercial buildings to 25% per year for industrial buildings. For the purpose of this accelerated depreciation, "any works for the prevention of pollution" are classified together with industrial buildings and granted the higher depreciation rate of 25%. However, even more substantial, are the special deductions that farmers are entitled to. The Seventh schedule to the Income Tax Act contains provisions for the deduction of the following capital expenditures:

- water conservation works which are defined as meaning "any reservoir, weir, dam, embankment constructed for the impoundment of water";
- boreholes and wells;
- fencing which is used in the carrying on of farming operations, and
- works for the prevention of soil erosion, such as contour ridging.

11 See, *Van Lier Packaging Ltd. v. COT* (1971) 33 SATC 19.

The above expenditures by farmers rank for the deduction in full and are not liable for recoupment on subsequent disposal.

Allowances

Allowances could be granted for capital expenditure on pollution control equipment over and above the general capital allowances. Some tax jurisdictions, e.g., the USA do have such allowances. In Zimbabwe such allowances could be modelled along the lines of the training investment allowance which entitles a taxpayer to a deduction of 50% of the cost of the training building and training equipment. This allowance is granted over and above the other capital allowances for which the item may qualify, and any recovery on subsequent disposal, etc, is not subject to a recoupment.

Reduction in taxes for preferred items

Fiscal authorities could grant reductions in taxes for preferred items, e.g., exempt from sales tax any sale of pollution control equipment. This will have the effect of reducing the cost of complying with environmental standards. It is disappointing that there is currently no sales tax exemption for alternative energy equipment such as solar panels, appropriate and eco-friendly equipment such as *tsoiso* stoves, etc which are especially suitable for the rural areas and the promotion of whose use in these areas would go a long way in arresting deforestation and other environmentally destructive activities.

Recently, sales tax was hiked with the creation of a new "luxury" rate of 25%. Oddly included in the "luxuries" list and thus attracting sales tax at the punitive 25% rate are basic office furniture and equipment, which include metal filing cabinets, metal desks, wire baskets, but not oak ones!

NEGOTIABLE TAX CERTIFICATES

Henderson observes correctly that companies which are not in a tax paying position do not enjoy an immediate benefit from the right to deduct expenditure where there is no taxable income against which the expenditure may be deducted.¹² This problem is exacerbated in Zimbabwe by the fact that such deductions can often be lost because companies are allowed to carry forward their assessed losses for a maximum of six years, after which they can no longer use them to reduce their taxable income. Further, for those companies entitled to tax holidays, for example, EPZs investors who are entitled to a five year tax holiday, it would make good economic, but not environmental, sense to postpone expenditure, eg environment protection measures, qualifying for accelerated depreciation until the company is close to being in a tax paying position.

This problem can be solved by allowing the Commissioner of Taxes to issue the taxpayer a negotiable tax certificate for such an amount representing the deduction entitlement in the light of the tax that would have been payable had the taxpayer been in a tax paying position. This certificate could then be negotiated to any other taxpayer and utilised in the payment of any tax due. This would act as an incentive for taxpayers in a non-tax paying position to incur expenditure on environmentally favourable projects. It would also encourage companies to design and implement environmental protection measures right at the inception of their ventures when such measures are likely to contribute best than to wait until much later when sometimes irreparable harm would have been done.

¹² "The Way Forward" p. 166.

CONCLUSION

This article has identified a selection of both negative and positive incentives for good environmental management that currently obtain, or can be introduced, in Zimbabwe. Their weaknesses have been pointed out, not least of which is that the current incentives have developed in a haphazard manner and are contradicted by other fiscal measures in some instances. It is hoped that the theoretical framework that has been used to locate the existing incentives and to propose new ones will act as a vista for sustained and systematic utilisation of fiscal incentives to promote sound environmental management in Zimbabwe.



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