NEB
NAMIBIA EQUITY BROKERS

the ECONOMIST
20 September 2018

2569
CIRRUS

Income Tax Amendment Act, 2018

Macro and Micro Implications

Table of Contents

Macro Background ***2***

Background **2**

Impact on growth **3**

Budget deficit and fiscal consolidation **4**

Impact on employment **5**

Impact on foreign currency flows **5**

Conclusions **6**

Specifics of the Bill ***7***

New personal income tax scales **12**

Macro Background

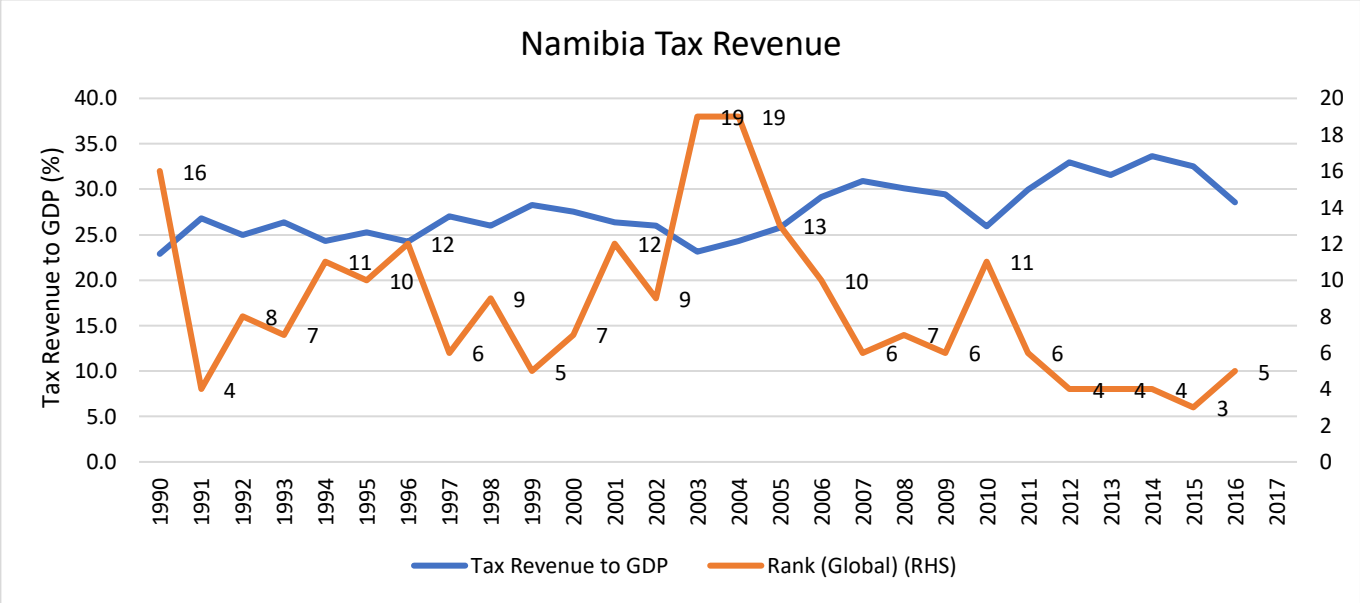
During his budget speech earlier this year, Hon. C Schlettwein announced that certain areas will be targeted for tax reform, including the abolishment of manufacturing incentives, repeal of export processing zones, introduction of a dividends tax on local dividends, taxing of commercial activities of charitable institutions, taxation of trusts, providing for the taxation of foreign income and increasing of individual tax rates.

True to his word, an income tax amendment bill has been circulated which aims to amend the definition of "gross income" with regard to the specific inclusion of foreign income, to provide for specific taxation of trusts, phase out existing preferential treatment granted to only certain traders; deleting certain exemptions, limit losses carried forward to 5 years, introduce withholding tax on dividends paid to Namibian residents, provide for thin capitalization rules, reduce the tax rates of low income earners, provide for penalties for tax evasion and to provide for incidental matters.

While the reduction of tax rates for low income earners is applauded, the majority of the remainder of these developments are highly concerning from a micro and macro-economic perspective.

Background

Namibia currently has one of the highest tax revenue to GDP ratios in the world, having held ranks between third and fifth globally in the past five years. At present, the country's tax revenue to GDP ratio, as calculated by the World Bank, stands at 28.5%, and ranks 5th highest in the world.

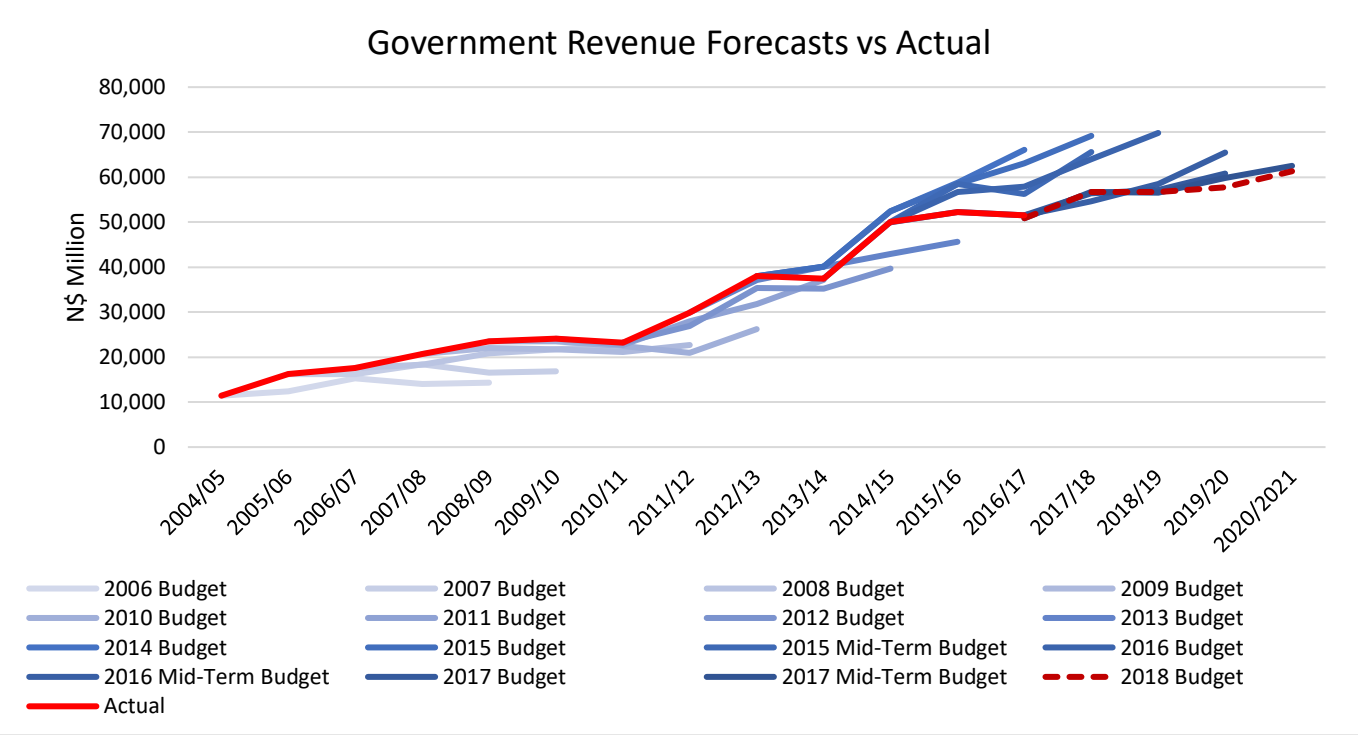


Despite this, the Government has been running substantial budget deficits for a number of years, albeit that it is now embarking on a process of "fiscal consolidation" aimed at reducing these deficits to more sustainable long-term levels.

The bulk of Government expenditure focuses on the civil service wage bill, with personnel and salaries making up over 50% of total revenue, giving Namibia the status of the country with the fifth highest

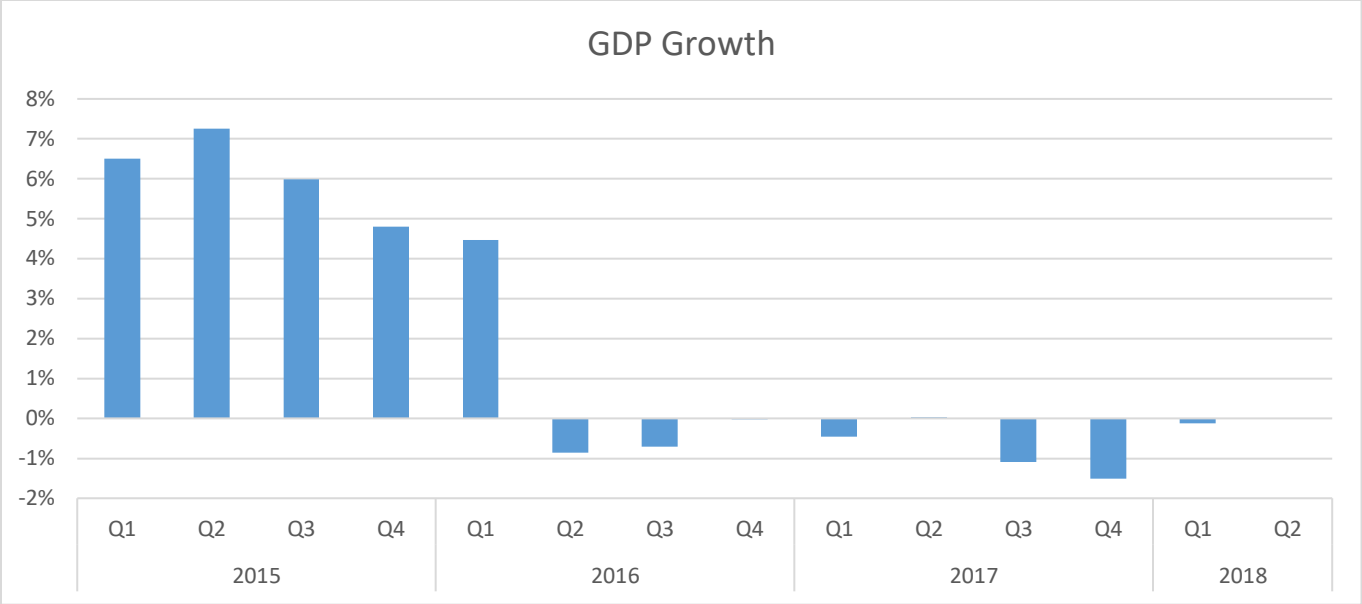
civil service wage bill to GDP in the world. Moreover, transfers to SOEs for operating expenses represent a further indirect contribution to wages and salaries in the country, while the various additional costs of employing people, including office floor space, utilities, transport and similar, push this total up to well over 65% of total revenue.

Over recent years, revenue growth has slowed, following a number of years of aggressive expansion driven by investment into the mining industry, low interest rates and rampant government spending and borrowing. In recent years, the economy has slowed and the outlook for revenue growth, much like and correlated to the outlook for GDP growth, is tenuous at best.



Impact on growth

Following a contraction in 2Q2018 and revisions to previous releases, Namibia's economy has now contracted for nine consecutive quarters. The bulk of this contraction is derived from a slowdown in private sector activities, at least in part due to an increasingly inhospitable business environment and climate. In this climate, increasing tax rates on businesses, trusts and individuals can have but one implication on growth – less of it.



A low growth environment already weakens investor returns on capital deployed in the country, thus creating an incentive to look for better returns elsewhere. The addition of more tax simply further reduces the return available to investors, and further encourages such investors to seek alternative jurisdictions in which to do business.

As investment is one of the foundational components of GDP, the less hospitable business environment created by increased taxes will undoubtedly result in lower growth. It is our view that the magnitude of the changes, coupled with the plethora of other anti-business developments seen over recent years, will result in a substantial withdrawal of investment from the economy, a sustained contraction and a substantial uptick in unemployment.

Budget deficit and fiscal consolidation

More aggressive tax policy, in stark contrast to the on-going efforts to bring about fiscal consolidation, will likely prove disastrous for the fiscus. Namibia is already a high-tax jurisdiction (far too high for a developing country looking to attract investment), as evidenced by the high tax-to-GDP ratio. Increasing the tax burden on the corporates and the public will be unlikely to generate additional revenue, and is highly likely to cause revenue to fall.

The obvious sanity check associated with this point is to say: what will be the impact on revenue if the tax rate is increased to 100%? It would, presumably, fall to zero. At 99%, would it be much better? How about 80%? In this regard, there is a clear point of optimality. It appears highly unlikely that this point will be reached with more and higher taxes, given the current large revenues relative to GDP, and the already languishing economy.

Moreover, the overall impact of throttling the private sector with further taxes will likely have a double-whammy effect on fiscal consolidation, as lower revenue collection will result in a wider budget deficit, thus debt uptake, on a lower GDP number. A large amount of the fall in revenue is

likely to stem from reduced employment as a result of the proposals, as marginal businesses will likely have little choice but to close their doors or cut back on costs – often labour.

One final consideration worth bearing in mind, is whether indeed it is the revenue side of the "income statement" of Government which requires attention, rather than the expenditure side. Given the country's tax-to-GDP ratio, it seems implausible that the problems pertain to revenue.

However, on the expenditure side, frequent reports detailing waste, corruption and mis-prioritisation of public funds are the norm rather than the exception. Thus, we believe that one cannot justify trying to increase revenue, at very least until expenditure issues and leakages have been resolved.

Impact on employment

One of the most blatant tell-tale signs of a sub-optimal economy, is its employment rate. At present, Namibia has the 7th highest youth unemployment rate in the world, according to the World Bank. This is a blatant illustration of the fact that the economy is performing sub-optimally.

This view can be supported by the fact that one in three people are unemployed, every second person is un-or-under-employed (i.e. in subsistence agriculture or unemployed) and every second young person is unemployed. This is not the sign of a healthy economy, and a likely reason for it is that we chase away job-creators (investors) with uncompetitive tax rates and a restrictive investment climate.

At present, private sector creates approximately 80% of the jobs in Namibia, however as money is syphoned from private sector to public sector, this percentage can be expected to fall. The concern in this regard is that further pressure on private sector will likely result in substantially greater numbers of jobs being lost, than Government will be able to create. This is particularly true given our expectation that revenue will actually fall, not rise, as a result of these proposals.

The second, third (and similar) round effects of reduced employment are clear to be seen. Households have less money, which results in less consumption and investment, which results in less revenue for government (which, if these tax proposals are anything to go by, results in higher taxes, and the circle continues).

Impact on foreign currency flows

In addition to the economic implications mentioned above, there are substantial risks around the outflow of capital from the country, and the resultant implications thereof.

Over the past five years, Namibia has imported some N$155 billion more goods and services than she has exported. In order to plug this gap, from a balance of payments perspective, the country has been highly reliant on foreign direct investment, and when that fell in 2016 (and continued to remain weak in 2017), portfolio flows from pension fund assets invested outside of the country. The current tax proposals will undoubtedly not only result in a reduction in foreign direct investment inflows, but will likely spark substantial outflows to jurisdictions where rates are more favourable.

This process runs the risk of destabilising the country's external position through depleting foreign exchange reserves. If left unchecked for a period of time, this may well put the country's currency peg with the South African Rand under pressure.

Conclusions

All in all, the current income tax proposals join a host of economically detrimental policies/laws proposed by the Government over the past three years. Many of these policies are crafted under the guise of "helping the poor" and "improving equality". However, like many such feel-good policies, the proposals defy basic economic principles and will, undoubtedly, do enormous harm to the already struggling economy.

Analyst: Rowland Brown
Heinrich Jansen van Vuuren
Email: rowland@cirrus.com.na
heinrich@cronjelaw.com
Tel: +264 81 675 6401
+264 81 371 9204

Specifics of the Bill

While the macroeconomic implications of the proposed income tax changes are detailed in the earlier section of this document, a number of specific implications to the amendments are detailed below.

An explanatory memorandum to the income tax amendment bill as has been provided is annexed hereto for a full overview of the proposed amendments. Below we discuss some choice topics that may impact on the investment environment.

Amendment	***Implications***
DEFINITION OF "BENEFICIARY" A person who has a vested or contingent interest in all or a portion of the receipts or accruals or the assets of that trust	"Beneficiary" has been included in the definition of "shareholder" to broaden the scope of dividends tax.
DEFINITION OF "COMPANY" A trust has been included in the definition of a company.	By defining a trust as a company, the corporate tax regime will apply to trusts whereas trusts were previously taxed in a similar manner as individuals.
DEFINITION OF "DIVIDEND" Any amount declared, transferred or applied by a company for the benefit of any shareholder in relation to that company by virtue of any share held by that shareholder in that company, whether- (a) by way of a distribution or (b) as consideration for the acquisition of any share in that company; without taking into account any liability in respect of any loan, or any financial arrangement, as attributable to that share or interest.	The wide definition of a dividend tries to capture within the net of dividend withholding tax all dividends and share buy backs and seems to deem shareholders loans to fall within the definition. The implication is that the manner in which shareholders capitalize and withdraw capital from companies will come under scrutiny with the possible pressure of being subject to withholding tax on dividends where capital is returned to shareholders, whether by share buy backs, dividend distributions and possibly even repayment of shareholder loans. Incentives for shareholders to expose own funds to business ventures in Namibia are diminishing quickly which will certainly place another price premium on the cost of doing business in Namibia.

DEFINITION OF "GROSS INCOME"
(i) in the case of any resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such resident

Previously Namibia had a sourced based tax regime. This amendment aims to include the world-wide income of any resident into the Namibian tax net. This is in contrast with other countries seemingly moving away from residence-based tax regimes towards source-based systems makes one question the rationale.

The implication is that where residents earn income from sources that have no double taxation agreements in place with Namibia that determine the taxing rights of the jurisdictions, both jurisdictions will tax the income and the taxpayer will be left to try and claim a tax credit or rebate in respect of tax paid in foreign jurisdictions.

DEFINITION OF "PERSON"
An individual, a representative taxpayer as defined in this Act, a company, partnership and estate of a deceased person and such estate shall be deemed to have come into operation at the moment of death of the deceased person.

A partnership has been included as a person in terms of this definition, whereas partnerships were previously only deemed persons for purposes of withholding tax on interest.

The implication is that a partnership will presumably now be taxed as a person in its own right, whereas previously the partners distributed the taxable income between them and then were taxed in their personal capacities.However, no provision was made in terms of the definition of a dividend to attempt to tax the distribution of the post-tax profits.

Other provisions pertaining to partnerships have not been amended to align with the partnership now being deemed a person, such as deeming provisions between spouses in a partnership, and the provisions around the furnishing of tax returns and the calculation of tax, which are now presumably redundant.

As partnerships have not been included in the definition of a company, presumably they will not be taxed at corporate rates, but rather at individual rates, regardless of the partners being corporate entities. This can result in rate mismatches similar as is currently seen with trusts.

One must also consider the impact of this amendment where *en commandite* partnerships are used as investment vehicles, as returns will now be post tax returns with a possible upside of not being subject to dividends tax.

DEFINITION OF "SHAREHOLDER"

in relation to any close corporation, means a member of such corporation; or

in relation to a trust, means a beneficiary of a trust;

The relevance is that distributions to members of close corporations will be subject to dividend withholding tax.

Distributions to beneficiaries by trusts will also be seen as dividends. Refer to the discussion on disallowed deductions below.

CAPITAL ALLOWANCES

The amount of any such expenditure shall not be fully deductible in the same year of assessment, but shall be deducted, one – fifth for 5 years from the tax year it was acquired.

Previously capital allowances were deductible over a 3-year period. This has been extended to 5 years, decreasing the benefit to the taxpayer to invest in capital assets used in the production of income.

The implication is that investors are dis-incentivised to make permanent investments.

ASSESSED LOSSES

No loss shall be carried forward for a period exceeding 5 years from the year the loss arises.

Previously tax losses could be carried forward indefinitely for as long as the person continued to trade.

This amendment once again dis-incentivises investment in longer term projects that may take more than 5 years to turn tax positive. The incentive is created not to commit permanent capital to a new venture during the initial phase so as to avoid accumulating large losses that will only be recouped later on, as the largest losses will be the first ones to lapse. This is certainly not positive for a country that is capital investment hungry and has an apparent desire to industrialise.

Read together with the abolishment of EPZ's and Manufacturing incentives and thin capitalization rules and watered down capital allowances, it concludes a story of Namibia's policy not being conducive to promote any form of permanent investment.

The provision further refers to when the losses arise and not the date on which this provision becomes effective, possibly resulting in retrospective application, wiping out old tax losses currently in existence. This will possibly penalise current investments and further incentivise disinvestment in favour of greener pastures elsewhere in developing economies that have favourable investment climates.

DISALLOWED DEDUCTIONS

Any tax, levy, royalty or similar charge other than municipal rates and taxes and Value Added Tax;	The inclusion of the word royalty is ominous and could be interpreted to be any form of royalty and not only those pertaining to public service.
In the case of a trust, any amount transferred or applied or distributed for the benefit of a beneficiary or on behalf of a beneficiary;	This is the attempt at abolishing the conduit principle whereby pre-tax profits could be distributed to beneficiaries to be taxed in their hands. The implication is that the trust will be taxed at the corporate rate and thereafter the distribution will be subject to withholding tax on dividends.
any foreign loss;	Only foreign income of residents will be considered in determining taxable income, but foreign losses are excluded. It is unclear whether the losses are simply ringfenced as pertaining to foreign income or whether the foreign loss cannot be applied to the foreign income in deterring the taxable amount.

WITHHOLDING TAX ON DIVIDENDS

10 percent of any amount of any dividend transferred or applied or declared or paid by a company for the benefit of any shareholder in relation to that company by virtue of any share held by that shareholder in that company on the earlier of the date on which the dividend is paid or when it accrues.	A 10% dividend withholding tax is introduced for residents. This is despite certain double taxation agreements with other jurisdictions providing for more favourable rates entrenched for non-residents with regards to non-resident shareholders tax. The effect may be that it becomes more tax effective to hold dividend earning portfolios offshore where DTA's provide relief. The disinvestment from Namibia that may result because of this is of great concern as it will place additional pressure on Namibia's balance of payments position.
Dividends to pension funds remain exempted.	Despite the pensions fund itself being exempted, the concerns below pertaining to dividend distributions in investment group structures will most probably result in significant dividend withholding tax leakage in respect of pension fund investments. It is also worth taking a moment to contemplate the effects hereof on security offered to debenture holders through debenture trusts. Should the trustee ever need to exercise his rights to protect debenture holders, this might trigger the dividend withholding tax provisions, resulting in a tax on an investor exercising his

security against a debtor. This is certainly of great concern to any investor.

So much of the amount of any dividend declared, paid, transferred or applied by any company as is proved to the satisfaction of the Minister to have been distributed out of dividends received by such company from any other company:
(i) of which all the issued shares of which are held for its own benefit by the first mentioned company to the extent that such dividends as is proved to the satisfaction of the Minister to have been distributed by such other company; and
(ii) Residents shareholder's tax was withheld and paid

This poorly drafted snippet of legislation leaves much to be desired and will cause immense confusion and possibly uproar.

Although somewhat uncertain from the wording, it seems to address the issue pertaining to taxing the same dividend several times as it is passed along through a group structure.

It is disconcerting that only wholly owned subsidiaries currently qualify for the exemption.

Any structure where only a percentage of the shares in a company is held by another company will not qualify on the current wording of the exemption and will therefore be liable to pay dividend withholding tax again when dividends received from an investment is distributed onwards in the group structure.

This is also possibly very troublesome where a trust distributes a dividend it received on which dividend withholding tax was withheld to a beneficiary which will again be subject to dividend withholding tax, as a trust is not wholly owned by the subsidiary.

In a sophisticated taxation system where government policy is aligned, one would expect an incentive for groups to invest in their beneficiary and to only trigger dividend withholding tax once profits are distributed to the beneficial owners.

THIN CAPITALIZATION

Where a resident company in which fifty percent or more of the underlying ownership or control is held by a non- resident and the resident company has a debt- to- equity ratio in excess of three- to- one at any time during a tax year, a deduction is disallowed:
a) for any interest paid to the non – resident in respect of any loan or financial arrangement; or
b) foreign currency exchange loss incurred;
by the resident company during that period on that part of the debt which exceeds the three – to – one ratio, being a portion of the interest or loss otherwise deductible but for this subsection.

Thin capitalisation relates only to companies with foreign ownership of 50% or more and were a debt-equity ratio of 3:1 is not maintained (at any point in time during a year). It is not certain how the receiver intends to gather the information regarding debt-equity ratios throughout the year.

The disallowance of interest deductions can be understood to a certain extent with regard to thin capitalisation by foreigners, but the disallowance of foreign exchange gains punishes investors for Namibia's economic situation.
This might serve to further disincentivise investment into Namibian companies.

New personal income tax scales

1. RATES OF NORMAL TAX

(Section 6)

Taxable amount	*Rates of tax*
Where the taxable amount -	
(a) does not exceed N$ 50 000	no tax payable
(b) exceeds N$ 50 000 but does not exceed N$ 100 000	17 per cent of the amount exceeds N$ 50 000
(c) exceeds N$ 100 000 but does not exceed N$ 150 000	N$ 8 500 plus 24 per cent of the amount by which the taxable amount exceeds N$ 100 000
(d) exceeds N$ 150 000 but does not of exceed N$ 300 000	N$ 20 500 plus 27 per cent of the amount by which the taxable amount exceeds N$ 150 000
(e) exceeds N$ 300 000 but does not exceed N$ 500 000	N$ 61 000 plus 30 per cent of the amount by which the taxable amount exceeds N$ 300 000
(f) exceeds N$ 500 000 but does not exceed N$ 800 000	N$ 121 000 plus 32 per cent of the amount by which the taxable amount exceeds N$ 500 000
(g) exceeds N$ 800 000 but does not exceed N$ 1 500 000	N$ 217 000 plus 34 per cent of the amount by which the taxable amount exceeds N$ 800 000
(h) exceeds N$ 1 500 000 but does not exceed N$ 2 500 000	N$ 455 000 plus 39 per cent of the amount by which the taxable amount exceeds N$ 1 500 000
(i) exceeds N$ 2 500 000	N$ 845 000 plus 40 per cent of the Amount by which the taxable amount exceeds N$ 2 500 000

Details as to the specifics of the bill were provided by Heinrich Jansen van Vuuren of Cronje and Company. For tax advice, please contact him at: heinrich@cronjelaw.com

Disclaimer: This publication has been issued by Namibia Equity Brokers (Pty) Limited. It is confidential and issued for the information of clients only. It shall not be reproduced in whole or in part without our permission. The information contained herein has been obtained from sources which and persons whom we believe to be reliable but is not guaranteed for accuracy, completeness or otherwise. All opinions expressed and recommendations made are subject to change without notice. No information contained herein, no opinion expressed and no recommendation made constitutes a representation by us or a solicitation for the purchase of securities mentioned herein and we have no responsibility whatsoever arising here from or in consequence hereof. Securities or financial instruments mentioned herein may not be suitable for all investors. Securities of emerging and mid-size growth companies typically involve a higher degree of risk and more volatility than the securities of more established companies. The recipient of this report must make its own independent decisions regarding any securities or financial instruments. Past performance is not indicative of future results, and investors may get back less than they invested. The inventories of Namibia Equity Brokers (Pty) Limited and its employees may from time to time include securities mentioned herein