

Tax First

Newsletter August 2011



Tax planning on leasehold improvements – The lessor's side

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In our February issue of Tax 1st, we discussed the implications for the lessee when leasehold improvements are effected to leasehold property.

In this issue we will look at the tax implications for the lessor who owns the property where these improvements are effected.

Specific inclusion in Gross Income

The gross income definition specifically includes certain capital amounts in taxable income.

Paragraph (l) of the definition of gross income is a specific provision that includes the value of improvements made to land or building leasehold property, that were specifically agreed on in the lease agreement, in a taxpayers gross income.

Legal obligation under the lease agreement to improve the property

Based on this paragraph in the Income Tax Act, where the leasehold improvements are required in terms of the lease agreement, the value of the leasehold improvements should be included in the taxable income of the lessor. The value that needs to be included is discussed below.

Voluntary leasehold improvements

It often happens that a lease agreement does not stipulate an obligation to effect leasehold improvements, but the lessee effects certain improvements to the property voluntarily. Would this amount be taxable in the hands of the lessor?

Gross income is defined in the Income Tax Act as follows:

*“in relation to any year or period of assessment, means, in the case of any person, the total amount, in **cash or otherwise**, received by or accrued to or in favour of such person during such year or period of assessment from a source within or deemed to be within Namibia, **excluding receipts or accruals of a capital nature**”*

Although leasehold improvements effected to property is not in the form of cash, the definition of gross income specifically includes amounts in cash or otherwise and improvements would fall into this category.

In the case of *Geldenhuys v CIR*, it was held that something is “received” when it is received by the taxpayer on his own behalf and for his own benefit. The improvements effected on a property would generally meet this criteria as the improvements would benefit the lessor in future.

Where amounts are received that are capital in nature, the amounts fall outside the definition of gross income.

The key question is whether leasehold improvements will qualify as receipts of a **capital nature**.

The Act does not contain a definition of capital nature and the matter is normally decided with reference to case law. Over the years the courts have dealt with many cases in this regard and have set some guidelines to determine whether an amount is of a capital or income nature.

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Winds of change—Namibian tax amendments

The last two months saw significant changes in the Namibian taxation system.

The Ministry of Finance announced held two press conferences during which it announced various proposed tax amendments to current revenue legislation. This included their intention to implement an additional tax in the form of export levies to be levied on certain products.

After various consultations between the Ministry of Finance and some affected industry groups, these proposed amendments, some of the proposals were amended.

The announcement on 17 August 2011 covered the following:

Income Tax

- The tax rate for mining companies other than diamond mining will remain at 37,5% (instead of 44% previously proposed).

The Ministry of Finance is however considering a formula-based surcharge that will levy higher taxes for mining companies during economic upturn.

Value Added Tax

- VAT Refunds will continue to be allowed to non-resident persons for VAT paid on the acquisition of Namibian goods exported to other countries.
- Exports by registered persons in Namibia will remain zero-rated.

Export Levy

- The basis of the proposed export levy will be determined for specific industries and products.

The proposed levies will range between 0% and 2% and will mainly have an influence on exporters of raw minerals, unprocessed fish, game, crude oil and gas.

Other proposals (as per press release on 21 July)

The remaining proposals should still be introduced as legislation.

Proposed implementation date

The press release indicated that the proposals are envisaged to be implemented by 2012/13.

The possible tax effect of some of the amendments may be as follows:

Non-resident shareholder's tax payable on dividends ("NRST")

In terms of the proposed amendment NRTS will increase from 10% to 20%, where the shareholder holds less than 25% of the share capital of the Namibian company paying the dividend. Where the shareholder holds more than 25% of the Namibian company's share capital the NRST rate will remain at 10%.

The implication of this would be that Namibian companies declaring a dividend to a non-resident owning less than 25% of the Namibian share capital will be liable to withhold 20%, instead of the current 10% NRST. A double tax treaty may reduce this rate to 15%.

Increase of the VAT registration threshold and abolishment of voluntary VAT registration

The threshold for VAT registration will increase from N\$ 200,000 to N\$ 500,000. In terms of this proposed amendment VAT registration will only be allowed when a taxpayer's turnover from taxable supplies exceed N\$ 500,000 in any 12 month period.

Persons currently voluntarily registered will be granted a 6 month period (subject to the effective date of the legislation) to settle outstanding VAT, penalties and interest and to de-register for VAT purposes. This will also affect companies such as exploration companies which will not be allowed to voluntarily register for VAT purposes and will have to capitalise or expense all input VAT and import VAT costs.

15% VAT on the supply of livestock

The supply of livestock will become subject to 15% VAT which is aimed at bringing the supply of livestock in line with the supply of game. This proposed amendment may require suppliers of live stock to register for and administer VAT.

Stamp Duties on immovable property

Immovable property transferred to a natural person with a value less than N\$ 400,000, will be exempt from stamp duties when the amendment to the Stamp Duties Act takes effect. Immovable property sold for more than N\$ 400,000, will be subject to stamp duties of N\$ 10 for every N\$ 1 000 or part thereof.

Previously immovable property transferred to natural person with a value less than N\$20,000 were exempt from stamp duty and stamp duty on immovable property sold for more than N\$ 20,000 were subject to stamp duties of N\$ 100 plus N\$10 for every N\$ 1 000 or part thereof.

The effect of this amendment on the stamp duty payable will be as follows:

Value of immovable property transferred to a natural person	Existing legislation	Proposed amendment
	N\$	N\$
N\$ 20,000	0	0
N\$ 400,000	3,900	0
N\$ 950000	9,400	5,500

Juristic persons and trusts will pay a flat rate of N\$ 12 for every N\$ 1 000 or part thereof with no exemption applicable for the first N\$ 400 000.

Government Gazettes

Government Gazettes for the period 21 July 2011 until 19 August 2011 was included in this edition. This is not an exhaustive list of Acts/Notices/Proclamations published.

Acts

8 of 2011 Employment Service Act, 2011

This Act provides for the establishment of the National Employment Service, to impose reporting and other obligations on certain employers and institutions, to provide for the licensure and regulation of private employment agencies and to deal with matters incidental thereto.

9 of 2011 Statistics Act

Government Notice

124-2011 Tariff of fees chargeable by professional land surveyors: Professional Land Surveyors', Technical Surveyors' and Survey Technicians Act, 1993

144-2011 Regulations relating to controlled wildlife products and trade: Controlled Wildlife Products and Trade Act, 2008

146-2011 National Planning Commission: Determination of date for taking of population and housing census: Statistics Act, 1976

147-2011 National Planning Commission : Population and housing census regulations: Statistics Act, 1976

General Notice

271-2011 Amendment to the Municipality of Windhoek building regulations: Local Authorities Act, 1992

Bills in progress*

- B 6-2008 National Youth Service Bill
- B1-2010 Industrial Property Bill
- B7-2010 Namibian Planning and Construction Council Bill
- B 18-2010 Architectural and Quantity Surveying Bill
- B26-2010 Statistics Bill
- B1-2011 Unit trust control Amendment Bill
- B3-2011 Pension Fund Amendment Bill
- B4-2011 Inspection of Financial Institutions
- B6-2011 Appropriation Bill
- B7-2011 Conferment of National Honours Bill

Source: Parliament of Namibia www.parliament.gov.na/bills

Tax Calender—September 2011

Monday	Tuesday	Wednesday	Thursday	Friday
12	13	14	15	16
19	20 • Import VAT return • PAYE return	21	22	23
26 • VAT return (Category B)	27	28	29	30 • Social Security payment • Tax return - companies with 28 February year ends • Business Individuals tax returns

Mining Royalties

Royalties are levied in terms of the Prospecting and Mining Act as a percentage of the market value of the minerals extracted by licence holders in the course of finding or mining any mineral or group of minerals. The rates are determined as follows:

Group of Minerals	Royalty Percentage
Precious metals/ Base and rare metals	3%
Semi-precious stones/Industrial metals/ Non-Nuclear fuel minerals	2%
Nuclear fuel minerals	3% - 6%



Tax planning on leasehold improvements – The lessor's side (Continues from page 1)

In general one would distinguish between capital and income by the rule that capital produces income.

Therefore where there is no obligation on the lessee to effect improvements to the lessor's property, the value of the leasehold improvements will most likely not be included in the gross income of the lessor as it would fall outside the definition of gross income.

This is in line with the treatment for lessees, where the lessee is not allowed to claim a deduction for leasehold improvements effected where there was no obligation to do so (S17(1)(h)).

Value

A further aspect to consider is the value that will need to be included in the gross income of the lessor.

The Act addresses two scenarios:

- a) The value of improvements is stipulated in the lease agreement; and
- a) No value is stipulated

In the case of (a) the amount to be included in gross income would be the amount that was stipulated in the agreement.

In the case of (b) the fair and reasonable amount in the opinion of the Minister will need to be included in the gross income of the lessor.

To avoid any uncertainty in tax planning, it is advisable to specify improvement obligations clearly in the lease agreement. This will eliminate the uncertainty of leaving the value to be established by the Minister.

More or less expenditure than specified in the contract

If a lease specifies an amount for improvements that need to be effected, that amount would be included in the lessor's taxable income. Where the actual costs of the improvements exceed the amount stipulated in the agreement, the lessor should generally not be taxable on this amount.

However, if the amounts spent on the improvements are less than the amount in the agreement, the lessor will still be taxed on the full amount as specified in the agreement. Therefore it is important to ensure that from a tax planning point of view for the lessor, that the amount specified in the contract should be used in full for the related improvements. Where the amounts specified in the contract is not spent in full, the lessor will have the burden of tax on the full amount specified without the related benefit in the form of improvements.

Capital allowances

It should be noted that the lessor who includes the value of the improvements into his gross income, may be entitled to certain capital allowances. For example, where buildings were erected on the lessor's property, the value thereof will be included in his taxable income. S17(1)(f) allows a deduction in respect of buildings used by the taxpayer for the purposes his/her trade.

Conclusion

Careful planning can be crucial in determining the taxability of leasehold improvements. Lessors should therefore pay special attention to contract wording in order to avoid any unpleasant tax surprises on assessment of their returns.

Should you have any queries in this regard please feel free to contact one of our tax specialists.

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