Tax First Namibia
July 2021 Newsletter

A monthly newsletter published by PwC Namibia providing informed commentary on current developments in the local tax arena.

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Also in this issue:

Transfer Pricing: Staying on track with the arm's length principle

The term “transfer pricing” (or “TP” for short) is on everybody’s lips these days. It generally refers to the rules and methods applied for pricing transactions between related entities under common ownership or control. Based on general TP rules, entities within the same group operating from more than one country (also known as “connected persons”) will be required to ensure that transactions between them are carried out at arm’s length.

In terms of a Practice Note issued by the Ministry of Finance in 2006, the arm’s length principle is based on standards applied internationally. For a transaction to be classified as having been carried out at arm’s length, it “should have the substantive financial characteristics of a transaction between independent parties, where each party will strive to get the utmost possible benefit from the transaction”.

Guidance in the Practice Note also includes a list of five methods that are considered acceptable for determining an arm’s length price. These are:

(a) Comparable Uncontrolled Price (“CUP”) Method
(b) Resale Price Method
(c) Cost Plus Method
(d) Transactional Net Margin Method (“TNMM”)
(e) Profit Split Method

No prescription is given by the Namibian Tax Authorities on which method is preferred or which must be used. However, it is evident that some methods may provide more reliable results than others. Choosing the most appropriate method will depend on various factors, such as the availability of comparative data, the quality of such data and the taxpayer’s specific circumstances.

The onus remains on the taxpayer to prove that transactions are carried out at arm’s length. This is not only important from an income tax perspective but may also be relevant in the event of a Customs inquiry.

Therefore, it is imperative that whatever pricing method is chosen, it must be documented and fully explained in the transfer pricing documentation. Lack of adequate documentation and/or policies applied creates an unnecessary risk of adjustments to income tax or values for Customs purposes, which in turn, may result in further tax payments, penalties and interest.

For more information, please feel free to contact our PwC Transfer Pricing team.

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PwC’s Namibian Income Tax Handbook

PwC Namibia is excited to announce that our second edition of the Namibian Income Tax Handbook has been launched. This handbook was produced by the Income Tax team at PwC Namibia, and is based on published legislation and regulations as at 31 March 2021.

Orders can be placed with the PwC Business School via email at: na_busschool@pwc.com
Cost per copy is N$350 (VAT inclusive)

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Income Tax View: Deductibility of Expenses

Most taxpayers usually struggle to determine whether the expenses they incur as part of their trade or business, are deductible for income tax purposes. In addition, taxpayers may be unsure of which type costs incurred are not allowed as deduction in calculating their taxable income. This article highlights the criteria for general deductions, as well as, prohibited deductions as contained in the Income Tax Act of Namibia.

General Deductions

The general deduction formula contained in Section 17(1)(a) of the Namibian Income Tax Act, serves as a guideline for taxpayers in determining the deductibility of their expenses for income tax purposes. All of the following requirements must be satisfied, in order for an amount to be deemed deductible.

The amount must:

- Be as a result from carrying on a ‘trade’;
- Constitute expenditure or losses;
- Actually be incurred (during the year of assessment);
- Be in the production of (taxable) income; and
- Not be of a capital nature.

The term ‘trade’ is defined under Section 1 of the Namibian Income Tax Act. Although the definition is wide, it may be misinterpreted by many. The basic principle is to determine if an activity is a trade or not. This can be established by asking yourself: (a) is there continuity of these activities?; and (b) is there a long-term objective or reasonable possibility of the trade to generate profits?

Although the terms ‘expenditure’ and ‘losses’ are not specifically defined in the Namibia Income Tax Act, former court cases such as Joffe & Co (Pty) Ltd v CIR (1946 AD) provides some guidance on the meaning. An extract from the case indicated that “*... in relation to trading operations, the word ‘losses’ is sometimes used to signify a deprivation suffered by the loser, usually an involuntary deprivation, where expenditure usually means a voluntary deprivation*”.

The term ‘actually incurred’ is also not specifically defined in the Namibia Income Tax Act. The general interpretation is that ‘incurred’ does not necessarily mean ‘paid’. Basically, if an unconditional liability exists to pay the expense at a future date, the expenditure has been incurred and it is deductible. Based on previous court cases (such as Edgars Stores Ltd v CIR 50 SATC 81 (A)), it is clear that you cannot deduct contingent liabilities for tax purposes.

As part of Section 17(1)(a), an expense must be incurred ‘in the production of taxable income’ in order to be deductible. An expense must thus be connected to the income-earning activities. Random expenditure which has no correlation with the income of a business may not be set off against or be deducted from business income.

The last requirement is ‘Not of a capital nature’. ‘Capital’ is not specifically defined within the Namibian Income Tax Act. Reference is once again made to case law. Based on the case of New State Areas Ltd v CIR (1946 AD), the following guidelines may aid you in determining whether expenses are capital or revenue in nature: (1) Does the expenditure form part of the costs to perform the income-earning operations? (2) Does the expenditure form part of the cost to establish, improve or add to the income earning structure? (3) Does the expenditure fall under fixed (non-deductible expenditure) or floating (deductible expenditure) capital?

Prohibited Deductions

Section 24 governs amounts which are not deductible for income tax purposes, irrespective of whether they satisfy the general deduction framework discussed above. Prohibited deductions under this provision of the Namibian Income Tax Act include:

- Maintenance of any taxpayer
- Domestic and private expenses
- Recoverable losses and expenses
- Taxation levied on income
- Transfers to reserves
- Expenses incurred in the production of exempt income
- Non-trade expenses
- Notional interest
- Land tax

Income Tax View: Deductibility of Expenses (Cont'd)

Special Deductions

In addition to general deductions, special deductions are also contained in the Namibian Income Tax Act. Although we will not provide an in-depth explanation thereon in this article, they are listed below for ease of reference. It is important for taxpayers to take note of the income tax treatment towards these special deductions, which include:

- Legal Expenses (Sec17(1)(c))
- Repairs and Maintenance (Sec17(1)(d))
- Bad Debts (Sec17(1)(l))
- Doubtful Debt Allowance (Sec17(1)(m))
- Employer Contributions to Pension, Provident & Benefit Funds (Sec17(1)(o))
- Annuities paid to former employees (Sec17(1)(p))
- Scientific Research Allowance (Sec17(1)(r))
- Donations (Sec17(1)(s))
- Restraint of Trade Payment (Sec17(1)(x))
- Contributions towards Company-Owned Policies (Sec17(1)(w))
- Manufacturers Allowances (Sec17A to 17D - phasing out)
- Assessed Losses (Sec21)

With this article we have dealt with the general deduction framework, prohibited deductions and touched on special deductions all contained within the Namibian Income Tax Act. This allows taxpayers to be better geared towards the understanding of the deductibility of expenses when performing their income tax calculations. It is important to remember that when in doubt, to rather consult a trusted and professional tax advisor in making informed decisions.

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New Tax Legislation Tracker

This diagram tracks the progress of proposed tax legislation. The following is a status of proposed legislative changes up to 30 June 2021. Based on the Minister of Finance, Hon. Ipumbu Shiimi's 2021/22 Annual Budget Speech in March 2021, majority of these proposals will come into effect during the 2022/23 fiscal year.

- Introduction of **Special Economic Zones** (with sunset clause).
- Introduce VAT on management fees of **listed asset managers**
- Reduction in the corporate tax rate of **non-mining companies**
- VAT zero-rating on **sanitary products**
- Review withholding tax on interest from unit trusts relating to **Namibian companies**
- Increase tax deductibility of **pension, retirement fund & edu policy contributions** from N$40,000 to N$150,000 p.a.
- Introduce a 10% **dividend withholding tax** for dividends paid to residents.

Tax Calendar | July 2021

Important Submission dates for July 2021

Tuesday, 20th of July

- VET Levy return;
- Import VAT return;
- PAYE return;
- Withholding Tax returns: Services, Royalties, Interest; NRST

Monday, 26th of July

- Value Added Tax Return

Monday, 2nd of August

- Social Security return
- 1st provisional for taxpayers with a January 2022 year-end;
- 2nd provisional for taxpayers with a July 2021 year-end;
- Tax return for companies with a December 2020 year-end;

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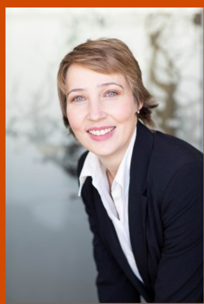

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