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Income Tax Update 2021

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Presented by

Hartmuth van Alphen CA(Nam)/CA(SA)

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Hartmuth van Alphen CA(Nam)/CA(SA)
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1. Definition of Namibia in the IT Act

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Income Tax - Namibia defined (s 1)

- Namibia includes the territorial sea as well as the exclusive economic zone (EEZ) and the continental shelf over which Namibia exercises sovereign rights concerning the exploration and exploitation of the natural resources of the sea bed and its subsoil and the superjacent waters.
- The territorial sea extends 12 nautical miles out from the low water line.
- The EEZ is the part of the ocean that extends beyond the territorial sea for a distance of 200 nautical miles out from the low water line. In this zone, Namibia has the sole right to exploit the natural resources (mining, fishing, oil and gas).

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Namibia defined….(contd)

- All income derived from any trade carried on in the EEZ is from a source within Namibia and therefore taxable in Namibia.
- The continental shelf is not a fixed geographical area. It is defined as the area which extends not further than 350 nautical miles from the low water line, irrespective of the depth of the superjacent waters, <u>but limited to</u>
- the area which extends not more than 100 nautical miles beyond the 2 500 meter isobath (the line connecting the underwater depth of 2 500 meters).

Namibia defined….(contd)

- Where the EEZ extends beyond the continental shelf, the EEZ defines Namibia.
- Any income derived from the exploration and exploitation of the natural resources of the sea-bed and its subsoil which is part of the geographical area of the continental shelf, is taxable in Namibia.
- Any fishing, employment or other trading activities in the waters above the continental shelf (the superjacent waters) are also taking place within Namibia and the income derived therefrom is taxable in Namibia.

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2. Namibia Source-based Tax System

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Income Tax base - Source of income

- Namibia taxes income based on source or deemed source, not the place of residence of the taxpayer.
- When establishing the source of income, it is necessary to apply a two-tier test -
    - firstly it is necessary to establish the originating cause of the income, i. e. the reason why the income accrued to the taxpayer, and
    - secondly, the problem of locating the originating cause must be solved.
    - locating, in a geographical sense, the originating cause of the income is often a difficult task.

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Source of income….(contd)

- The originating cause usually is –
  - ➢ some personal activity of the taxpayer - rendering of services to another person, either as employee or as independent contractor.
  - ➢ some property over which the taxpayer has rights – transferring ownership of property or granting the right of use to another person, be it an immovable, movable or intangible asset.
  - ➢ a combination of both – carries on profit-producing activities involving the transfer of ownership of property or the grant of its use and the rendering of services.

Source of income….(contd)

- Income earned by non-residents employed or trading in Namibia is taxable in Namibia.
- In the case of individuals who work in Namibia for foreign employers for very short periods of time, it is likely that the work done in Namibia is so incidental to the individual's services elsewhere in the world that no attribution to Namibian source can be made.
- It is unlikely that this will be the case if the individual is present in Namibia for more than four continuous weeks or cumulatively for six weeks made up of a number of short periods.

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Source of income….(contd)

- Where services are rendered outside Namibia by a professional person who has an established practice in Namibia (eg engineering services) the income derived from rendering these services outside Namibia will only <u>not</u> be of a Namibian source if it can be demonstrated that the link between the services rendered in Namibia and those rendered outside Namibia is so tenuous that the services rendered abroad cannot be said to have been rendered in the carrying on in Namibia of the taxpayer's profession (s 15(1)(e)).
- Services, in this context, include the exercise of a person's skills, wit, personality, connections and intellect.

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Source of income….(contd)

- Where an employee, who is ordinarily resident in Namibia, renders services during any temporary absence from Namibia and such services are rendered for or on behalf of his employer in Namibia, the originating cause (the source) of income is deemed to be within Namibia (s 15(1)(f)).
- The reason for this is that the services rendered outside Namibia under these circumstances are merely incidental to the services normally rendered in Namibia.
- 'Temporary' means irregular or unscheduled, as opposed to a systematic absence from Namibia. A systematic absence is planned for and not incidental to the employee's normal duties in Namibia.

Source of income….(contd)

- An apportionment of the income is permissible where services are rendered partly within and partly outside Namibia, unless it can be proved that the work done or the services rendered in a country other than Namibia where the work is ordinarily done or the services are ordinarily rendered, are merely incidental (*ITC* 1104)*.*
- The above will apply in particular where the person is paid separately for these extraneous duties.
- A director’s services in his capacity as member of a board of directors are treated as being rendered at the head office of the company where the board ordinarily transacts it’s business.

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Source of income….(contd)

- If the head office is situated in Namibia the fees are derived from a Namibian source, irrespective of the place where the director resides or performs the services (*ITC* 250).
- Regardless of the actual source, s 15(1)(a) deems the source of income derived from any contract entered into in Namibia for the sale of goods (<u>not services</u>) to accrue from a source within Namibia; no matter where the goods originate from or are delivered to.
- Certain other income (s 15) is also deemed to be from a source within Namibia – such as royalty income on the use or right to use in Namibia a patent or trade mark, wheresoever the right to use the IP has been granted.

Source of income….(contd)

- Section 15(2) deems <u>any</u> interest which has been received by or accrued to any domestic company or any person who is ordinarily resident in Namibia to be from a source within Namibia, <u>regardless of where the interest originates from</u>.
- <u>All</u> interest received by or accrued to persons mentioned above, is therefore included in “gross income”.
- Interest is exempt from tax if the capital on which it is earned is held outside Namibia for the purpose of any business carried on by the taxpayer outside Namibia <u>and</u> the interest is subject to income tax under the laws of the country in which it is earned; <u>or</u> the full capital from which the interest is derived was obtained from a source outside Namibia (s 16(1)(r)).

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3. Gross income

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Income – The principle

- In 1901 Lord Macnaghten, in *London CC v AG,* remarked – 'Income tax, if I may be pardoned for saying so, is a tax on income'.
- In other words, the most fundamental issue in income tax is the question – what constitutes "income"?
- In *Delfos,* Wessels CJ stated – "The tax is to be assessed in money on all receipts or accruals having a money value. If it is something which is not money's worth or cannot be turned into money, it is not to be regarded as income".
- The *Brummeria* case in 2007 overturned the 'convertibility' principle and ruled that – "it does not follow that if a receipt or accrual cannot be turned into money, it has no money value".

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Gross income, income and taxable income

- The definition of 'gross income' forms the basis of the entire tax assessment procedure.
- **"Gross income"** (the general provision)
  - **in relation to any year of assessment**
  - **means the total amount, in cash or otherwise,**
  - **received by (<u>on his own behalf for his own benefit</u>) or accrued to (<u>unconditionally entitled</u>) or in favour of a 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.**
- Where an amount is included under a specific provision, it can not also be taxed under the general provision.

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Gross income….(contd)

- Including, without in any way limiting the scope of this definition, such amounts (whether of a capital nature or not) so received or accrued as are described in paras (a) to (q) of the definition of gross income (the specific provisions override the general provision).
- "Income" is the amount left after the deduction of exempt income from gross income.
- "Taxable income" is the amount left after the deduction of all allowable expenditure and losses, including assessed losses brought forward from the prior year.
- "Tax payable" is the amount after applying the tax rate to the taxable income.

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Gross income….(contd)

Payments in advance/borrowed money

- Advance payments are taxable in the year of their receipt even if they only accrue in the sense of legal entitlement in a later year.
- The recipient usually intended that the money 'should be his to do with it as he liked'.
- While payments in advance may be repayable if the services are not in fact performed, they are nevertheless receipts connected with the revenue-earning operations of the business and therefore included in gross income.
- In *CIR v Genn & Co (Pty) Ltd,* Schreiner JA held that borrowed money is not '<u>received for his own benefit</u>' for the purpose of gross income. The same moment as possession of the funds is given, the borrower falls under an obligation to repay the loan amount – <u>this corroborates its capital nature</u>.

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Gross income….(contd)

Deposits received

- In *Greases (SA) Ltd v CIR* the court held that "for a deposit amount to be excluded from gross income, it must be received and held in trust. The money should not be allowed to freely mix with the business money and used as deemed fit, but rather kept separate to earn interest for the benefit of the person to be refunded".
- An important consideration is whether the deposit is refundable; if so the money should be kept in a separate banking account controlled by trustees.
- Where the money is deposited in the trading account and the taxpayer uses it as he deems fit, the amount is likely to fall within gross income of the recipient.
- In my view, a *bona fide* deposit received is in the nature of a loan which must be repaid. The receipt is of a capital nature.

Trade and capital/revenue nature of income

Trade is defined as every profession, trade, business, employment, calling, occupation or venture, including the letting of any property

- Income derived from trade from a source within or deemed to be within Namibia is taxable unless it is of a capital nature.
- Income which is capital in the hands of one taxpayer may be revenue in the hands of another.
- Where there is a sale of an asset it must be determined whether the asset constitutes part of the taxpayer's capital structure which he uses to generate income, or is it held with an intention of generating income through its re-sale.

Trade….(contd)

- The courts have recognised that the *ipse dixit* (the taxpayer's word) as to his intention, being a purely subjective test, is not the final determinant and that the actual activities and conduct of the taxpayer when purchasing an asset, during the period he held the asset and at the time he sold it, is the objective test to be applied when deciding what the real intention of the taxpayer was.
- An example of assets held to generate income is a building rented out to tenants or a truck owned and operated by a provider of transport services.
- An asset held as trading stock on the other hand, is held with an intention of generating income through its re-sale.

Trade….(contd)

- Undeveloped land where no activity with the aim to develop the land for the purpose to earn income from the capital structure developed takes place; the inference being that land of this nature cannot readily produce income and hence is held as trading stock.
- Assets such as Krugerrands or diamonds, which normally cannot be used to produce income.
- The holding of mineral rights and claims, or the options to such rights or claims, without any realistic hope of raising the large amount of financing required to exploit these rights by mining, will normally give rise to an inference that the rights are held as trading stock to be resold at a profit.

Trade….(contd)

- Are the proceeds arising from the sale of shares, other than sales by share dealers, always income of a capital nature?
- In order to be successful in arguing the capital nature of such proceeds, the taxpayer should be able to prove his intention that the shares were held to derive dividend income and, preferably, show that dividend income has in fact been derived over an extensive period of time.
- The courts have in the past ruled that the sale of shares in a property owning company (fixed or any other property such as mineral rights), rather than the company selling the property outright, have merely been an alternative method of employing one and the same profit-making scheme.

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Trade….(contd)

- When a taxpayer disposes of an asset held as an investment, the mere decision to dispose of this asset does not *per se* subject the resultant profit to tax. The difficulty lies in determining whether the taxpayer merely sold the asset to his best advantage or whether he has crossed the *rubicon* and embarked on a scheme of profit-making when selling the asset. In that case, the proceeds derived from the sale will be revenue in nature (*Natal Estates Ltd v SIR*).
- Irrespective of the number of transactions taking place, whether the receipts that flow from the carrying on of a business are income depends on whether the business constituted a 'scheme of profit-making' *(CIR v Pick 'n Pay Employee Share Purchase Trust)*.

Trade….(contd)

- Where a taxpayer, in the ordinary course of carrying on a business, receives an interest-free loan, the monetary value of the <u>interest-free use of the money</u> (as distinct from the capital amount of the loan itself) will be included in the borrower's gross income *(CSARS v Brummeria Renaissance (Pty) Ltd).*
- This only applies to interest-free loans granted as *quid pro quo* (in exchange) for goods supplied, services rendered or any other benefit granted by the borrower, provided the benefit granted is not capital in nature.
- More likely to be the case with interest-free loans between non-related parties than between related parties.

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Trade….(contd)

- Does the earning of interest income constitute the carrying on of a trade although the taxpayer is not a money lender?
- In *CSARS v Scribante Construction (Pty) Ltd* it was held at [11] "Borrowing money and re-lending it at a higher rate of interest, thereby making a profit, constitutes the carrying on of a trade".
- However, when interest is earned on surplus funds invested (passive income), this does not constitute the carrying on of a trade (*CSARS v Megs Investments (Pty) Ltd*). The taxpayer will not be allowed the deduction from this income of any expenditure under s 17(1)(a).

Export of manufactured goods

- Taxable income derived from the export of goods manufactured in Namibia is reduced by an allowance of 80%, excluding income derived from the export of manufactured fish and meat products (s 17C)). In this context, the words "taxable income" mean the profits derived from this trade.
- Where the taxable income of the taxpayer has not been wholly derived from the export of goods manufactured in Namibia, the amount attributable to the export must be calculated in order to reflect the true taxable income (profit) derived from such exports.
- For this allowance to apply, the taxpayer is not required to be a registered manufacturer, nor is he required to have manufactured the goods himself.
- The repeal of s 17C comes into operation at the end of five years commencing on 31 December 2020.

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Registration as manufacturer

- Section 5A was repealed by section 1(1) of the Income Tax Amendment Act No. 2 of 2020 and has come into operation on 31 December 2020.
- From that date onwards, the registration of a taxpayer as manufacturer is no longer possible.

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4. Deductible expenditure

Hartmuth van Alphen CA(Nam)/CA(SA)

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Deductible expenditure and losses

- No deduction of expenditure under any of the subsections of s 17(1) is allowed if the taxpayer is not <u>carrying on a trade within Namibia</u>.
- **S 17(1)(a) – (general deduction formula)**
  - ➢ In determining the taxable income of any person
  - ➢ from carrying on any trade within Namibia,
  - ➢ there shall be allowed as deduction from the income,
  - ➢ expenditure and losses actually incurred in Namibia
  - ➢ <u>during the year of assessment (case law, not s 17(1)(a))</u>
  - ➢ in the production of the income,
  - ➢ provided that they are not of a capital nature.

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Deductible expenditure and losses….(contd)

- The terms <u>expenditure</u> and <u>loss</u> are not defined in the IT Act. Therefore, their ordinary meaning must be attributed to these terms.
- <u>Expenditure</u> is ‘the total amount of money that is spent on something’ and <u>loss</u> is ‘the fact of no longer having something or of having less of it than you had before’.
- For expenditure to be deductible, it must be incurred for the purpose of earning income and it must be a necessary concomitant of the business operation. No causal link need be shown between a particular item of expenditure and any income produced in that or any other year of assessment.
- Expenditure deducted from income in compliance with the requirements of ss 17 and 18 (except ss 17(1)(a)–(c)) is allowed, even if it is capital in nature (the specific provisions).

Deductible expenditure and losses….(contd)

- When determining whether an expense or loss is capital or revenue in nature, the test is whether the expense or loss incurred is more closely linked to a capital asset or a revenue asset.
- Where expenditure is incurred with an intention to bringing into existence an asset or advantage for the enduring benefit of the trade, such expenditure is closely linked to creating, expanding or preserving the income-earning structure of the taxpayer and its ability to generate profits in the future (capital in nature).
- *New State Areas Ltd v CIR* is the leading case where the principles in deciding whether an expense or loss is capital or revenue in nature have been laid down.
- Section 17(1)(a) provides positively for what may be deducted and ss 24(f) & 24(g) (counterparts to s 17(1)(a)) provide negatively for what may not be deducted in the determination of a taxpayer's taxable income.

Deductible expenditure and losses….(contd)

- S 24(f) – prohibits the deduction of any expenses incurred in respect of any amounts received or accrued which do not constitute income as defined in s 1.
- Generally, receipts and accruals of a capital nature do not form part of 'income' as defined, as such receipts and accruals are not included in the general provision of the definition of 'gross income'. Thus, the deduction of expenditure incurred in respect of such receipts and accruals is not allowed.
- This section also disallows the deduction of expenses incurred in the production of exempt income (like dividends), as exempt income is not included in 'income' as defined.

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Deductible expenditure and losses….(contd)

- Expenditure is sufficiently closely linked to the ordinary income-earning operations if it would be proper, natural or reasonable to regard the expenses as part of the cost of performing these operations, having regard both to the purpose of the expenditure and to what it actually effects.
- The decision in *Port Elizabeth Electric Tramway Co v CIR* still is the *locus classicus* on the interpretation of the phrase '<u>in the production of income</u>' in s 17(1)(a).
- The required tests must be applied to each expense incurred by the taxpayer. A deduction claimed must satisfy the requirements of both, s 17(1)(a) <u>and</u> s 24(g).
- Excessive expenditure – is the expenditure motivated by benevolence rather that sound business principles?

Deductible expenditure and losses….(contd)

- Where the remuneration paid to an employee (often the sole member of a CC or his close relative) bears little or no relationship to the true worth of the services rendered by the employee (devoid of commercial rationality), the deduction by the employer of this expense is disallowed because it was not incurred in the production of its income (s 17(1)(a)) or to the extent to which it was not expended for the purposes of its trade (s 24(g)).
- The amount will nevertheless be taxable, as it is revenue in nature and beneficially received, whether for services rendered or not. It does not follow that, because an amount is not allowed as a deduction from income, it is not taxable in the hands of the recipient (*WF Johnstone & Co Ltd v CIR*).

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Deductible expenditure and losses….(contd)

- Interest is a periodic charge for the use of money and therefore deductible under the general principles as long as it is incurred for the purpose of earning income. Where the expenditure being financed is incurred prior to the commencement of trade, the interest expense is not incurred while carrying on a trade and is therefore, not deductible.
- Interest paid on shareholders' loan accounts created by crediting dividends declared but not paid, is only deductible if the company clearly had surplus funds available at the time the dividends where declared; the company could thus continue to utilise these funds in its ordinary income producing activities.

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Deductible expenditure and losses….(contd)

- The argument is that where a company does not have surplus cash available to enable it to actually pay the dividends declared, then the intention of the company when declaring the dividends is questionable.
- Under these circumstances, where the shareholder makes the dividends available to the company as an interest-bearing loan, then the declaration of dividends is regarded as a simulated transaction, instituted merely to pay the interest.
- In *Scribante Construction,* SARS lost this argument on the grounds that the company actually had cash, surplus to its operating requirements, available to pay the dividends.

Deductible expenditure and losses….(contd)

- The rules governing the deductibility of expenditure equally apply to employees, as employment is a trade.
- Any employee who incurs expenditure of a revenue nature for the purpose of earning income, is entitled to deduct that expenditure, irrespective of whether he earns fixed or performance based income *(KBI v Van der Walt).*
- Often the deduction of expenditure by an employee is denied, as the expenditure incurred is directed at producing income for his employer, not for himself.
- Under these circumstances, the employee would have earned his salary without spending a cent.

Deductible expenditure and losses….(contd)

- Expenditure and losses incurred by a taxpayer before the commencement of trade do not qualify for deduction under s 17(1)(a), as the taxpayer is not yet carrying on a trade. A deduction may be allowed where trade has commenced but no income has yet been produced, due to the nature of the taxpayers trade; for example crop farming.
- In *ITC 697* Price J stated: "If a taxpayer has no asset with which he can trade then he cannot be trading".
- Repairs (often an expense of a capital nature) are deductible under s 17(1)(d). A repair is the renewal or replacement of something that has become defaced or worn out by use (ITC 491). Replacing something for aesthetic reasons or to improve an asset does not constitute a repair.

Deductible expenditure and losses….(contd)

- Where major renovations to a building are undertaken, the work done will normally be a combination of repairs and improvements.
- If a taxpayer intends modernising a building, two contracts should be entered into: - one contract for legitimate repairs and the other contract for improvements or renewals.
- <u>Improvement</u> can be defined as ‘an addition or alteration which increases the quality or value of something’.
- This is the test to be applied for distinguishing repairs from improvements (*CIR v African Products Manufacturing Co Ltd*), the latter being a capital expense and therefore, also not deductible under s 17(1)(a).

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Deductible expenditure and losses….(contd)

- Realised foreign exchange gains/losses on loans raised for the financing of both working capital and fixed capital requirements are taxable/deductible.
- Unrealised foreign exchange gains and losses arising at the end of the fiscal year are not taxable/deductible if they relate to a foreign currency loan of the taxpayer.
- The position is different if a liability in a foreign currency is incurred for the acquisition of goods and services and the amount is unpaid at the end of the year. In these circumstances, unrealised gains or losses are taxable or deductible as long as the obligation to pay is unconditional. The expense has actually been incurred.

Deductible expenditure and losses….(contd)

Wear and tear allowance

- Expenditure in respect of implements, machinery, vehicles, aircraft, sea-going craft, utensils and articles used for the purposes of the taxpayer's trade is deductible over three years, commencing in the year the expenditure is incurred.
- The allowance is not apportioned if the asset is used for less than the full year of assessment.
- No deduction for wear and tear is allowed in the year during which the asset is disposed of or withdrawn from trade.
- Be aware that the so called 'scrapping' allowance in s 17(1)(u) is only available if the taxpayer, after scrapping the asset, also discards or disposes of it.

Deductible expenditure and losses….(contd)

Building allowances

- The cost of erection of buildings is allowed by deducting a 20% initial allowance in the year the building is first brought into use and 4% annual allowances during the following 20 years. No initial allowance is available to a purchaser of a <u>used</u> building and the annual allowance is only claimable by the purchaser for those years remaining of the 20 years, calculated from the year subsequent to the year the building was brought into use.
- Section 17(1)(f) does not require the taxpayer to actually have incurred the cost of erection, for him to be allowed the deductions under that section. Thus, a lessee could claim the building allowances.

Deductible expenditure and losses….(contd)

Building allowances….(contd)

- The cost of erecting a building excludes the erf and all earth works. Included are, inter alia, the builder's costs, plumbing, electrical works and professional fees (architects, engineers etc). The developer manages the construction of the building and all related matters. His reward in the form of the profit he realises on the sale of the building is also part of the cost of erecting the building.
- The erection of a building commences on the date when the laying of its foundations commences.
- Interest incurred on project financing must be considered when planning a construction project.

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Deductible expenditure and losses….(contd)

- Be aware that the owner of the property who is not constructing himself, may not deduct interest expenditure incurred during the construction phase of the building.
- This is so as the owner does not yet carry on a trade; thus s 17(1) prohibits the deduction of the interest expense as it is pre-production expenditure.
- The situation is different for the builder or construction company. The interest expense is deductible as these entities are carrying on a trade.
- For this reason, the builder or construction company should incur the interest expense as part of the cost of erecting the building.

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Deductible expenditure and losses….(contd)

Registered manufacturers (s 5A)

- An additional allowance of 25% of salaries, wages and training costs of employees who are directly engaged in the manufacturing process (s 17A).
- An additional allowance of 25% of marketing and related costs incurred in respect of manufactured goods exported (s 17B).
- An additional allowance of 25% in respect of inward transportation costs by road or rail of material, components and equipment imported for use directly in the manufacturing activity for which the company is registered (s 17D).
- Annual building allowance (8%) may be claimed by owners or lessees of factory buildings (first proviso to s 17(1)(f)).

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Deductible expenditure and losses….(contd)

Registered manufacturers (s 5A)….(contd)

- The taxable income derived from the manufacturing activity in respect of which the taxpayer is registered, is taxed at 18% (para 3(2) of Schedule 4).
- The deduction of the allowances in ss 17A, 17B and 17D may not create or increase an assessed loss.
- These incentives shall continue to apply until the end of the first tax year after the 31 December 2020.
- My view is that this means '<u>the end of the first tax year commencing on or after 1 January 2021</u>'.
- I believe that my view is supported by the *contra fiscum* rule.

Deductible expenditure and losses….(contd)

Mining operations (s 18 and s 36)

- Exploration expenditure is carried forward to the year in which a mine commences production and is then fully deducted in that year. This means that an exploration company does not create an assessed loss as long as mining operations have not commenced.
- Development expenditure is carried forward until the year in which a mine commences production and is then claimed in three equal instalments, commencing in the first year of production and the two subsequent years.
- Mining operations may not claim any expenditure or a provision for future expenditure in respect of environmental rehabilitation costs.

Non-deductible expenditure

Deductions not allowed in terms of s 24

- Expenses incurred in the maintenance of any taxpayer and his family (s 24(a)).
- Domestic or private expenses (s24(b), like travelling between the place of residence and the place of business (includes travelling to/form the farm by a part-time farmer), or expenditure incurred to maintain a taxpayer's health or well-being.
- S 24(b) also prohibits the deduction of expenses incurred while being on leave, even if taken while on an overseas business trip.
- Any loss or expense which is recoverable under any contract of insurance (s 24(c)). <u>Only the portion of the loss not recoverable may be deducted</u>.
- Income allocated to any reserve fund (provisions) (s24(e)).
- Land tax paid in terms of s 76 of the Agricultural (Commercial) Land Reform Act, 1995 (s 24(i)).

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5. Farming operations

Hartmuth van Alphen CA(Nam)/CA(SA)

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Farming operations (Schedule 1)

- Farming operations are carried on where there is a genuine intention to farm land, linked with a reasonable prospect that ultimately a profit will be derived from that operation; regardless of the size or extent of the land occupied or the amount of the income earned.
- The term ‘farming operations’, on a restrictive interpretation, includes only those activities carried on by a farmer on his own land and from which he derives income. In these circumstances, he need not be the owner of the land but he must have a right thereto and to its yield.
- Taxpayers conducting the business of a nursery in the course of which plants are grown from seeds are regarded as carrying on farming operations.

Farming operations….(contd)

- In *CIR v Smith* the court pointed out that the IT Act is directed to the taxation of profit-making activities and that the legislature did not intend that a person who farms as a hobby, or who dabbles in farming for his own personal satisfaction, should receive the benefits of the First Schedule to the IT Act.
- It is important to note that in terms of this decision, the question whether the farming activities under scrutiny have, objectively, a reasonable prospect of profit is always relevant.
- This is authority for the application of the 'facts and circumstances' test, as required in section 21A.

Farming operations….(contd)

In principle farming operations are taxed on the same basis as any other business or profession with the exception of –

- Section 22(1) (value of closing stock), which does not apply to a taxpayer carrying on farming operations.
- The value of livestock and game on hand at year end is not included in the income of a farmer as no value is attributed to these animals. This is so, regardless whether the livestock represents an asset of a revenue nature (Cattle held for meat production) or an asset of a capital nature (breeding stock).
- The total selling price of breeding stock is income.
- Standing corps, harvested produce, seed, fertiliser and spare parts do not constitute trading stock when utilised in the carrying on of farming operations.

Farming operations….(contd)

- The deduction of infrastructural development expenditure is effectively ring-fenced, as it is only allowed against taxable income derived from farming operations and cannot be deducted against income from other trades. The term 'taxable income' used in para 10(6) of Schedule 1 must be read in the context of that Schedule and means <u>profits</u> derived from farming operations *(CIR v Zamoyski).*

- The deduction of this expenditure may not result in a loss from farming operations. 'Surplus' expenditure is carried forward to the next year.

- Income derived from game farming qualifies as income from farming operations. <u>Activities which do not qualify as farming operations are:</u> - the occasional hunting of game, accommodating and entertaining tourists, the sale of sand, the lease of land for a fixed rental or speculating in cattle.

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Farming operations….(contd)

- Where a deduction in respect of an asset acquired by a farmer has been allowed under para (10)(1) of Schedule I and the asset is disposed of by the farmer, the amount received which does not exceed the expenditure in respect of that asset, must be included in the income of the farmer (recoupment).
- This applies only to such assets which are or have become movable assets, like wind mills, pumping plants or drinking troughs when dismantled.
- Where the farmland is sold, the amounts received for dams, roads or other infrastructure affixed to the land are not recouped by the farmer for tax purposes, although a deduction was allowed in the past.
- Like any other taxpayer, a farmer is prohibited from claiming a deduction for his personal or domestic expenditure (s 24(a) and (b)), such as the cost of repairs to his private homestead or the wages and rations of his domestic servants.

6. Provisional tax & Obligation to register

Hartmuth van Alphen CA(Nam)/CA(SA)

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Provisional tax payments (Schedule 2 Part III)

- Any person (other than a company) who's annual taxable income exceeds N$ 5 000, other than remuneration, must register as provisional taxpayer (para 18(a) of Schedule 2).
- All provisional taxpayers must make provisional tax payments at the end of the first 6 months of the tax year and again on the last day of the year of assessment.
- A taxpayer (other than companies) who derives his income wholly or mainly from farming, only makes one provisional tax payment at the end of February (para 23 of Schedule 2).
- Payments must be based on the total estimated taxable income for the current tax year.

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Provisional tax….(contd)

- The first provisional payment must be accurate within 50% of 80% of the final taxable income assessed and the second payment within 80% of the final taxable income assessed.
- Where the taxpayer has paid less tax than the minimum payment required for either period, additional tax of up to 100% of the amount underpaid may be levied.
- Late lodgement of provisional tax returns is subject to an additional tax of N$ 100 per day; also applies to NIL returns.
- A final payment is due 7 months after the end of the financial year.

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7. Employees Tax & Fringe benefits

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Employee benefits and deductions

- The single most important characteristic of the regulations dealing with the taxation of employee benefits is that these depend upon the existence of an employer/employee link for activation.
- This employer/employee link does not exist in relation to the holder of an office, such as a non-executive director who only receives fees for attending board meetings.
- Where a non-executive director receives a company car for private use, the value will only be taxable if he receives it for services rendered or to be rendered. Where the car is given to him because he exercises control by virtue of his shareholding in the company, there is no taxable benefit.

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Employee benefits and deductions….(contd)

- Fringe benefits relate to the taxable value of any benefit a person receives in respect of his employment other than remuneration, such as the free use of an asset.
- Fringe benefit regulations do not apply to self employed persons.
- Taxable value calculated as follows:

Company car

- If all running, maintenance and insurance costs are borne by the employer the value is calculated at 1.5% per month of the cash value of the car.
- If the cost of fuel is borne by the employee, the rate is 1.4%.

Employee benefits and deductions….(contd)

Travel and car allowance

- The amount by which the allowance exceeds the expenditure related to business travel, is deemed to be taxable income of the recipient.
- Only employees who are obliged to use their cars for business purposes as a condition of their employment, are entitled to claim such expenses.
- The capital cost of a car is claimed over 3 years based on the ratio of business km to total km travelled.
- The proceeds received when selling the vehicle constitutes a recoupment, calculated on the same basis as the deduction previously claimed was calculated.

Employee benefits and deductions….(contd)

Entertainment and cell phone allowances

- Claim actual costs incurred by employee when entertaining or the use of the phone for business purposes.

Housing loan

- The taxable value arising from a loan received for the purchase or improvement of the employee's residence is calculated at 12% interest less the actual interest payable.

Free housing

- Taxable value is the rent paid by the employer.
- Employer owned houses are taxed based on tables issued by the IRD; value linked to the number of living rooms in the house and where in Namibia the house is situated.

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Employee benefits and deductions….(contd)

Approved housing scheme (s 16A)

- The amounts/values of loan repayments, free employer housing or rent paid is reduced by 1/3 if the benefit is granted in terms of an approved housing scheme. The employer's policy document setting out the details of the housing scheme must accompany the employer's application for approval to the IRD.
- An employee participating in the scheme may not sacrifice remuneration as a result. Thus, the only time an employee may participate in the scheme, is at the time his employment commences or his remuneration is increased by the value of the housing benefit.

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Employee benefits and deductions….(contd)

Approved housing scheme….(contd)

- Section 16A(4)(b) states that the Minister shall not approve any scheme where a housing benefit is granted in substitution for any reward for services rendered which would otherwise have been granted to such employee.
- My interpretation of s 16A(4)(b) is: - Where two employees perform identical services and one receives a housing benefit and the other not, the remuneration of the employee who receives the benefit must exceed the remuneration of the other employee by the amount of the benefit.
- It appears that the intention of the legislator was, that the housing benefit must always be granted in addition to the employee's normal remuneration.
- The opening words of subsection (4) prohibit the Minister from approving a scheme if this condition is not met.

Employee benefits and deductions….(contd)

- The value of car and travel allowances should be determined by taking the circumstances of the employee into account. It is important to make employees aware of the necessity to keep accurate vehicle log books and to retain all relevant expense vouchers.
- Where an employee plans to buy a new vehicle, it is advisable to effect that purchase as early as possible in the year of assessment so that the value of a full year's allowance is available against which the 1/3 wear and tear deduction on the new vehicle can be claimed.
- The value of all employee benefits must be disclosed separately on the annual PAYE 5 certificate and per the detailed payroll submitted monthly on ITAS.

Employee benefits and deductions….(contd)

- Expenditure claimed against an allowance received may not exceed the amount of the allowance, except where the expenditure qualifies as a deduction under s 17(1)(a) read together with s 24(g); this applies whether an employee earns performance-based income or fixed income only *(CIR v Van der Walt)*.
- *Bona fide* allowances paid to employees are not subject to the employer withholding PAYE. This is so in terms of s 14(1) and confirmed in PN No. 3 of 2001.
- The portion of any allowance which exceeds the claimable expenditure, is deemed to be taxable income of the employee.

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Employee benefits and deductions….(contd)

- The benefit or advantage to be derived by an employee from being granted shares or a share option in his employer company or a company which is linked to his employer, is a taxable fringe benefit.
- Generally, the taxable benefit derived by the employee is the market value of the shares when awarded, less the cost to the employee of these shares.
- What is the position of the company as far as deductibility of the cost of the shares/share option granted is concerned?
- S 17(1)(a) requires that expenditure must have been actually incurred for the purpose of earning income before it ranks for deduction in terms of the section.

Employee benefits and deductions….(contd)

- Does a company incur expenditure within the meaning of s 17(1)(a) when it issues shares?
- In *CSARS v Labat Africa Ltd* it was held that the issue of shares does not involve a movement of assets of the person who expends, even though the value of the shares might be diluted or diminished in the hands of the shareholders and accordingly, the issue of shares does not qualify as expenditure.
- A safe way is to actually pay the employee the appropriate cash amount to induce him to leave his former employer or an incentive bonus in the case of an existing employee.
- On this basis the company has incurred expenditure which qualifies as a deduction, while the benefit to the employee (whether cash or shares) is in any event taxable under paragraph (b) of the definition of "gross income".

Employee benefits and deductions….(contd)

- Are contributions to a medical scheme taxable in the hands of the employee, if paid by the employer?
- Where the employee is contractually obliged to pay the contribution, but the employer makes the payment on behalf of the employee, this would constitute a benefit received by the employee in respect of employment, which must be included in his gross income (para (g) of the definition).
- Where an employer enters into a valid ‘salary sacrifice scheme’ with his employees, which has the effect that the employer assumes the obligation of contributing the employee’s share to a medical scheme, thereby reducing the taxable remuneration of the employee, the scheme should not fall foul of s 95(1) (*ITC 1663 & ITC 1682*).
- In *ITC* 1682 it was held that the implementation of a ‘salary sacrifice scheme’ was not abnormal in commercial practice.
- The employer’s contributions are subject to the limitation in s 17(1)(o)(ii).

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Employee benefits and deductions….(contd)

- Any amount received by an employee or the holder of an office because of the termination of his services is exempt from tax, up to a maximum of N$ 300 000 over the taxpayers lifetime (s 16(1)(o)).
- Any balance of the amount received is taxed in three equal instalments, beginning in the year the amount is received by or accrued to the taxpayer (s 13(3)).
- Only amounts paid which are directly linked to the termination of employment or loss of office, qualify for this exemption (para (c) of the definition of "gross income" and s 13(3)).
- Amounts which do not qualify are leave pay, performance bonusses or long-service awards (receipts in terms of para (b) of the definition of "gross income").

Employee benefits and deductions….(contd)

- In the case of retrenchment, the Labour Commissioner must be notified in terms of s 34(1)(a) of the Labour Act, 2007.
- The s 16(1)(o) exemption does not apply unless: -
  - ➢ the person has attained the age of 55 years; or
  - ➢ the Minister is satisfied that the person's services are terminated due to retirement, ill-health or other infirmity; or
  - ➢ the Minister is satisfied that the person's services are terminated due to the taxpayer becoming redundant because the employer is reducing personnel or has/intends to cease carrying on the trade in respect of which he was employed.
  - – The employer has to obtain a directive from the IRD.

Employee benefits and deductions….(contd)

- Any taxable portion of an amount received from a pension fund, provident fund or preservation fund is taxed at the <u>average</u> rate applicable to the taxpayer's income, excluding the amount received from the pension fund, but the rate shall not be less than the lowest rate at which tax becomes payable, currently 18% (s 5(3)).
- An employee may deduct up to N$ 40 000 per annum in respect of his total contributions to a pension fund, provident fund, retirement annuity fund or an education policy.
- The contributions by an employee to a medical aid scheme, are not deductible by the employee.

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Questions & Answers

Post your questions by selecting the link within the Q & A section between 23 Feb 2021 and 1 Mar 2021. The answers for the questions will be posted in the section by 4 Mar 2021.

Questions after this time frame can be send to
technical@saiba.org.za

Thank you for joining us for the event.

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