SECTION 2

INCOME TAX PRACTICE NOTES

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2000

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30 October 2000
Effective date: 1 January 2000

DUE DATE FOR PAYMENT OR SUBMISSION OF A RETURN

Where the due date for any payment or submission of any return in terms of the Income Tax Act, 1981 (Act 24 of 1981) (as amended) falls on a Saturday, Sunday or Public Holiday, the due date shall be the first following working day.

ISSUED BY THE COMMISSIONER OF INLAND REVENUE

2001

No 1

17 January 2001
Effective date: 17 January 2001

ABOLISHMENT OF LIVESTOCK VALUES FOR TAX PURPOSES

As from the 2001-year of assessment farmers will no longer be obliged to include the value of livestock on hand in the determination of taxable income. The standard values of livestock on hand at the end of the 2000-year of assessment must be claimed as a deduction in the 2001-year of assessment.

Farmers are still obliged to complete the relevant schedule with regard to livestock on hand at the end of the year of assessment.

ISSUED BY THE COMMISSIONER OF INLAND REVENUE

No 2

17 January 2001
Effective date: 17 January 2001

DUE DATE FOR SUBMISSION OF RETURNS OF INCOME AND DATE FOR PAYMENT OF ANY INCOME TAX DUE

In anticipation of proposed amendments to the Income Tax Act, 24 of 1981, Inland Revenue Directorate confirms the following arrangements.

Individual taxpayers who derive income wholly or partly from farming and/or business as well as companies must render returns of income before the first working day of the month following the expiry of 7 months after the end of the year of assessment and pay any income tax due in respect of that year of assessment. In the case of companies this arrangement will apply to years of assessment commencing on or after 1 January 2000. In the case of individual taxpayers who derive income from farming and or business the arrangement will apply to years of assessment commencing on or after 1 March 2000.

It should be noted that the letting of property is regarded as income derived from business for the purposes of this practice note.

All other individual taxpayers (those who do not derive income from farming or business), who are required to render returns of income and pay income tax must still render returns not later than the last day of June following on the end of a year of assessment.

ISSUED BY THE COMMISSIONER OF INLAND REVENUE

No 3

31 March 2001
Effective date: 1 March 2001

TAX TREATMENT OF ALLOWANCES TO EMPLOYEES – GUIDELINES TO BE FOLLOWED BY EMPLOYERS

Allowances

Any cash allowance is taxable in full, except allowances paid to an employee in defrayal of cost incurred on behalf of the employer and certain housing allowances.

Travel allowances

So much of any amount paid to an employee by way of allowance for business travelling which was not actually expended for that purpose, will be included in a taxpayer's income. In order to prove the actual costs of business travel the recipient must be able to furnish accurate records, both of costs and distances travelled for business purposes in his/her private car.

The appropriate portion of the expenses rank for deduction from a travel allowance namely: Fuel and oil, maintenance and repair, insurance, license fees, lease costs or capital write-off allowance.

The capital write-off allowance of one-third per annum must be calculated on the total cost of the vehicle comprising the cash cost, value-added tax and any finance charges.

If the employee's travel allowance provides for running expenditure and the acquisition of a vehicle, the employee may also approach the Receiver to obtain a directive with regard to the portion of the allowance, which relates to the acquisition of a vehicle. The employee will be required to submit proof with regard to the date of purchase, cost of vehicle, information on business/private trips, agreement concluded between employer/employee and proof that the travelling cost to be incurred is a condition of employment.

PAYE need not be withheld by the employer in the case of a *bona fide* travel allowance for business purposes.

The gross allowance must be reflected on the employee's PAYE 5 certificate. The employee's claim of the related expenditure must be detailed in his return.

A reimbursement of actual expenditure incurred for business travel do not need to be reflected on the PAYE 5 certificate.

If an employee is paid a rate per kilometer for business travel, the total amount must be reflected on the PAYE 5, and the appropriate proportion of costs will be allowed as a deduction. PAYE need not be deducted. If the amounts are insignificant a deduction equal to the income will normally be accepted.

NB Please note:

Where the claimable portion of expenses represents a low percentage of the allowance, the taxable portion of the allowance could be substantial and result in a large amount of tax payable at the end of the year of assessment. To reduce such large shortfalls, which has to be paid at the end of the tax year, it is recommended that employers be requested to deduct a larger monthly PAYE amount in such cases.

Entertainment allowance

The full amount of an entertainment allowance must be reflected on the employee's PAYE 5 certificate but a deduction may be claimed in respect of expenses incurred, upon submitting a tax

return. The deductions are limited to the amount of the allowance received. The allowance is not subject to PAYE.

The employee should retain vouchers as he may be asked to substantiate expenses. He will be required to furnish a statement in support of his claim giving the following information:

Position held by employee, eg. marketing director

Who was entertained

Nature of entertainment

Purpose of entertainment

Cost thereof

Copy of service contract if entertainment is a condition of employment

Only expenses incurred in the production of income can be claimed.

Reimbursement of entertainment expenditure actually incurred on the instruction of the employer, and accounted for to him does not give rise to a taxable benefit.

Personal subsistence allowance

A personal subsistence allowance is one paid to an employee when he is obliged to spend time away from his usual place of residence. The gross amount must be reflected on the employee's PAYE 5 form. He is entitled to deduct his actual expenditure in his income tax return and will therefore only be taxable on the unexpended portion. The allowance is not subject to PAYE.

An employee receiving a field living allowance will be exempt from tax on the amount, provided that he has a permanent home, in addition to his field accommodation and actually expended it on food or accommodation.

ISSUED BY THE COMMISSIONER OF INLAND REVENUE

No 4 **27 July 2001**
Effective date: 1 March 2001

CANCELLATION OF RETIREMENT ANNUITY POLICY CONTRACT

Directorate: Inland Revenue received a number of requests from both retirement annuity fund members and administrators for the cancellation of retirement annuity fund contracts.

The Commissioner of Inland Revenue has no authority to grant approval. However, should a retirement annuity contract be regarded as void *ab initio* in terms of the law of contract, this office will have no objection to the refund of contributions to members and a return to the position of the parties on the day before the contract was entered into. Please note that it is a requirement that this office be advised of all such refunds and furnished with the following information:

- Full details of the member of the fund
- The income tax reference number of the member
- Confirmation that the contract is void *ab initio* in terms of the law of contract and the reason(s) for the decision
- The *quantum* of the amount to be refunded
- Whether the taxpayer enjoyed any deduction in respect of his contribution to the fund.

Inland Revenue Directorate is very concerned by the number of cases where members have been led to believe that their investment will be accessible in times of need prior to becoming

entitled to any benefit as contemplated by the definition of "retirement annuity fund" in section 1 of the Income Tax Act. Insurance agents, brokers and others involved in the marketing of retirement annuities should emphasise the provisions of the definition to clients when marketing and selling the product.

ISSUED BY THE COMMISSIONER OF INLAND REVENUE

No 5 **16 November 2001**
Effective date: 16 November 2001

CHANGE OF COMPANY YEAR-ENDS

The Income Tax Act, 1981, provides for the change of financial year-ends subject to approval by the Minister. To change a company's year-end application is to be made to the Office of the Commissioner (Head Office). The application is to be accompanied by the company form CM 32. An application may be refused if it is clear that the taxpayer is busy with a scheme to obtain a benefit to which it is not entitled.

The date on which the Registrar of Companies approves a request for a change in year-end will determine the year of assessment of such company that will be affected.

Three possible effects can result from a change in a company's year-end (assume that the year of assessment is 1998):

1. **Where the year-end date is moved to a later date (lengthening of a financial year):**

   A year-end may be moved to a later date by not more than 6 months, which will result in the year of assessment being extended.

   1.1 If the new date still falls in the same year of assessment (say 1998), the period of assessment is just extended and only one assessment is raised for that year of assessment (1998). Any capital allowances will only be allowed for one period.

   1.2 If the new date falls in the next year of assessment (1999), the period of assessment is just extended and no assessment will be raised for 1998 and one will be raised for 1999. Any capital allowances will only be allowed for one period.

2. **Where the year-end date is moved to an earlier date (shortening of a financial year):**

   A year-end may be moved to an earlier date by not more than 6 months, which will result in the year of assessment being shortened.

   1.1 If the new date still falls in the same year of assessment (say 1998), the period of assessment is just shortened and only one assessment is raised for that year of assessment (1998). Any capital allowances will only be allowed for one period.

   1.2 If the new date falls in the previous year of assessment (1997), another period of assessment is created in that year of assessment (1997).

   In this case, eg. the 1998 year end is brought forward from 28 February 1998 to 31 December 1997: (assume that 1997 has been assessed). This means that there is an extra 10 month period in the 1997 year of assessment which will have to be assessed. This can only be done by issuing a revised assessment which includes the income and expenditure for the 10 month period (capital write-offs claimed are to be accepted as expenditure in addition to such amounts claimed for the original 1997 financial year).

   The 1998 year of assessment will be assessed on the basis of the company's new financial year.

The above procedures are to be applied with immediate effect and to all changes of year-ends that still have to be implemented.

ISSUED BY THE COMMISSIONER OF INLAND REVENUE

No 6

27 November 2001
Effective date: 27 November 2001

PENSION AND RETIREMENT ANNUITY LUMP SUM PAYMENTS ON DEATH AND RETIREMENT

The purpose of this practice note is to replace all earlier rulings in this regard.

The Directorate Inland Revenue hereby confirms the position with regard to the above:

- Fund administrators do not need to apply for a directive on lump sum payments resulting from death before or after retirement or at retirement;
- If the total value of the annuity or annuities from retirement funds exceeds N$20 000 (a pension fund) or N$10 000 (a retirement annuity fund) not more than one third of such annuities may be commuted for a single payment and if the total value does not exceed N$20 000 (a pension fund) or N$10 000 (a retirement annuity fund) the total amount may be commuted for a single payment.

  NOTE: It is expected that the amount of N$10 000 referred to in the preceding paragraph with regard to retirement annuities will be increased during 2002.

  The single payments referred to above are excluded from the definition of gross income in section 1 of the Income Tax Act and are therefore not subject to income tax.

  NOTE: If a lesser amount is commuted, such amount will also be excluded from gross income but any balance will be regarded as an annuity and therefore taxable.

The above will be strictly applied with immediate effect.

ISSUED BY THE COMMISSIONER OF INLAND REVENUE

2002

No 1

14 November 2002
Effective date: 14 November 2002

ESTIMATION OF PROVISIONAL TAX

Paragraphs 17, 19, 22, 23 and 24 of Schedule 2 to the Income Tax Act

1. Companies

The practice to base a company's provisional tax payments on the latest assessment received must be stopped with immediate effect.

Paragraphs 17, 19 and 24 of Schedule 2 to the Income Tax Act prescribe the manner in which a company shall estimate its total taxable income, calculate the provisional tax payable and pay such provisional tax.

Future estimates of taxable income for a specific year must be based on particulars of income and expenditure for that year and may not be based on taxable income as assessed for the latest year of assessment. This concession only relates to taxpayers other than companies in respect of the first payment.

2. Taxpayers other than companies

Paragraphs 17, 19, and 22 of Schedule 2 to the Income Tax Act prescribe the manner in which a taxpayer other than a company shall estimate its total taxable income, calculate the provisional tax payable and pay such provisional tax.

Estimates for the first period may be based on taxable income as assessed for the latest year of assessment. Future estimates of taxable income for the second period must be based on particulars of income and expenditure for that year and may not be based on taxable income as assessed for the latest year of assessment.

3. **Farmers**

Paragraphs 17, 19, and 23 of Schedule 2 to the Income Tax Act prescribe the manner in which a taxpayer (other than a company) who derive income from farming shall estimate its total taxable income, calculate the provisional tax payable and pay such provisional tax.

Future estimates of taxable income for a specific year must be based on particulars of income and expenditure for that year and may not be based on taxable income as assessed for the latest year of assessment.

Note:

In terms of paragraph 19(3) of the Schedule to the Act, the Minister may call upon a taxpayer to justify any estimate and may increase the amount thereof to an amount, which the Minister considers to be reasonable.

ISSUED BY THE COMMISSIONER OF INLAND REVENUE

No 2 **13 December 2002**
Effective date: 1 January 2003

CALCULATION OF TAX PAYABLE BY REGISTERED MANUFACTURING ENTERPRISES

Section 7(1) and (2) of the Income Tax Amendment Act, 2002)

Background

Section 17D of the Income Tax Act was amended by section 7 of the Income Tax Amendment Act, 2002. The effect of the amendment was to withdraw the special deduction registered manufacturers were entitled to in terms of the section 17D.

Section 7 of the Income Tax Amendment Act, 2002 introduced a new allowance in respect of land-based transportation costs to replace the special deduction for registered manufacturers. In addition to this amendment, the income tax rate for registered manufacturers has been reduced to 18% for the first ten years of manufacturing status in terms of Schedule 4 paragraph 3(2) of the Income Tax Act.

The purposes of this practice note is to provide guidance in respect of the allowances claimable by registered manufacturers as a result of the amendment made to section 17D of the Income Tax Act.

Revenue practice

The following practice will be applied by revenue when assessing taxpayers who are registered manufacturers with immediate effect.

1. The special deduction for registered manufacturers may be claimed by all registered manufacturers in respect of any year of assessment commencing on or before 1 January 2003.
2. That the allowance for land-based transportation costs may be claimed by any registered manufacturer for all tax years commencing on or after 1 January 2003 for a period of ten years if such taxpayer's manufacturing status was approved by Revenue on or after 1 January 2003.

3. For those taxpayers who had obtained manufacturing status approval from Revenue prior to 1 January 2003, the land-based transportation costs allowance can be claimed for any tax year commencing after 1 January 2003 for the remaining number of years of a ten year period commencing from the date manufacturing status was granted to the taxpayer.

The following examples illustrate Revenue's practice in this regard:

1. Company A has a December year end and will be entitled to the following allowances:
   (*a*) The special deduction for registered manufacturers can be claimed for the tax year ending 31 December 2002 for the last time.
   (*b*) On the assumption that the company was registered during the year of assessment ending 31 December 1998, the land-based transportation costs allowance may be claimed for the first time in the tax year ending 31 December 2003 and for each of the following tax years up to 31 December 2007.
   (*c*) The 18% tax rate will apply for the first time to the tax year ending 31 December 2003.
2. Company B has a June year end and will be entitled to the following allowances:
   (*a*) The special deduction for registered manufacturers can be claimed for the tax year ending 30 June 2003 for the last time.
   (*b*) On the assumption that the company was registered during the year of assessment ending 30 June 1998, the land-based transportation costs allowance may be claimed for the first time in the tax year ending 30 June 2004 and for each of the following tax years up to 30 June 2007.
   (*c*) The 18% tax rate will apply for the first time to the tax year ending 30 June 2004.

Taxpayers are not required to apportion the special deduction for registered manufacturers based on the wording of section 7(2) of the Income Tax Amendment Act that repeals this deduction with effect from 1 January 2003.

ISSUED BY THE COMMISSIONER OF INLAND REVENUE

2003

No 1 **27 February 2003**
Effective date: 1 March 2003

TAXATION OF TRUSTS

This practice note serves to clarify the taxation of trusts.

The Income Tax Act will be amended to include in the definition of a "person" a trust. The current practice of the Directorate is to regard trusts as persons for income tax purposes.

It was held in cases such as *SIR v Rosen* 1971 (1) SA (A) and *Armstrong v CIR* 1938 AD 343 that the conduit principle applies to trusts.

Inland Revenue Directorate hereby, in view of the preceding paragraph, confirms the following with regard to trusts:

Trusts with vested beneficiaries

- The nature of income derived by a trust retains its character in the hands of a beneficiary.
- The net income or loss of a trust (being income less expenditure and less allowances) shall be taxed or allowed as a loss in the hands of the beneficiaries.

Discretionary trusts

- The nature of income derived by a trust retains its character in the hands of a beneficiary.
- The net income (income less expenditure less allowances) received by discretionary trusts, where no discretion had been exercised at the end of the year of assessment, shall be taxed in the hands of the trust.
- Losses of a trust shall be carried forward by the trust to a subsequent year of assessment. Losses from a trade shall be set off against income from another trade carried on by the trust.
- Where a trust is taxed on income derived and such income is subsequently distributed to beneficiaries it will constitute income of a capital nature in the hands of a beneficiary. The distribution will not be allowed as a deduction in arriving at the taxable income of the trust.
- Where the beneficiaries are ecclesiastical, charitable and educational institutions of a public character, and the trustees do not distribute any amount of the trust income, the trust itself will be regarded as an "institution" for the purposes of the exemption from income tax as conferred by section 16(1)(*j*) of the Income Tax Act. In other words, the same exemption that applies to such "institutions" will apply to the trust.

Mixed vested beneficiary/discretionary trusts

An apportionment has to be done based on the principles as set out above.

ISSUED BY THE COMMISSIONER OF INLAND REVENUE

No 2 **30 July 2003**
Effective date: 27 June 2003

TAXATION OF COMPANY (EMPLOYER) OWNED POLICIES

This practice note serves to clarify the taxation of company owned policies, especially with regard to the deductibility for tax purposes of premiums contributed towards such policies, tax implications when zero rate interest loans are made against such policies and the substitution of a life covered on such policies.

Paragraph (*m*) of the definition of "gross income" in section 1 of the Income Tax Act 24 of 1981, (the "Act") provides as follows:

> '"**gross income**" . . . namely –
>
> (*m*) any amount received or accrued under or upon the surrender or disposal of any policy of insurance upon the life of any person who, at any time while the policy was in force, was an employee of the taxpayer, or where the taxpayer is a company, was a director or employee of such company;'

Paragraph (*m*) of the definition of "gross income " explicitly refers to the proceeds of company (employer) owned policies and therefore render it taxable.

Section 17(1)(*a*) of the Act provides for a deduction on premiums contributed towards company (employer) owned policies.

The Namibian Long Term Insurance Act, 1998, does not prescribe a maximum term for a life insurance policy.

It came to the attention of the Directorate Inland Revenue that it is possible to indefinitely postpone the maturity of a company (employer) owned policy by continuously substituting/adding to the life covered on such policies, resulting in an indefinite postponement of the tax liability on the proceeds of such policies upon maturity.

As from 27 June 2003 the Directorate Inland Revenue has decided that company (employer) owned policies will be dealt with for tax purposes as follows:

- The amount of any loan (for example a zero interest loan) made against a company owned policy **will become taxable in the tax year the loan is made**; and
- The substitution or addition of life covered on any company owned policy will not be allowed as it may have the effect of indefinitely postponing the tax liability of the proceeds on such policy upon maturity. In other words, the **policy must mature upon the death of the last original life assured on such policy.**

Should the need arise to add an additional life assured on a company (employer) owned policy for a valid reason other than the postponement of tax, the Directorate of Inland Revenue must be approached for a directive in this regard. Failure to obtain a directive may lead to Inland Revenue Directorate invoking the provisions of section 95 of the Act, thereby effectively rendering the substitution of the life assured a scheme for the avoidance of tax.

ISSUED BY THE COMMISSIONER OF INLAND REVENUE

No 3 **11 September 2003**
Effective date: 5 August 2003

FINANCIAL YEAR-ENDS OF PARTNERSHIPS

This practice note serves to clarify the inclusion of income in the tax returns of persons who conduct a business through a partnership.

A partnership is not recognised as a "person" for the purposes of the Income Tax Act, 1981, ("the Act") and therefore not a taxable entity as such. The net profit or loss of a partnership is taxable in the hands of the individual partners. Section 56(15) of the Act, 1981 provides that persons who conduct a business in the form of a partnership shall furnish separate returns of income and computations as contemplated in subsection (1)(*a*), but every person shall in his or her return include a copy of the joint financial statements of such partnership, together with such other or further particulars as may from time to time be prescribed.

In *Sacks v CIR* (1946 AD 31, 13 SATC 343), it was held that the partner's share of profits only accrue to him at the year-end of the partnership. There is no obligation upon the partners to continue to hold the receipts and accruals of the partnership business in common, subject to an obligation to bring them into account at the end of each fixed period for the purposes of ascertaining the profit or loss for the accounting period. When the time arrives then, for the first time under the partnership agreement, a partner becomes entitled to claim a separate determinable share of the partnership profits and then, for the first time under the partnership agreement, that determinable share accrues to him as gross income.

The right to profit is quite distinct from the actual profits earned. The actual profits simply mean the excess of receipts over expenditure over a given period. The right, however, exist throughout. It is merely the value of the right, which remains uncertain until eventually ascertained. (The Law of Partnerships and Voluntary Associations in South Africa, B. R. Bamford; *Sacks v CIR*, 1946 AD 31, 13 SATC 343).

In *ITC 1042* (1964) 26 SATC 189, the court confirmed the ruling in the Sacks case and restated the general principle that a taxpayer is not required to bring to account in any year amounts that have not been received or accrued to the taxpayer. In this case the partnership agreement provided that the accounts of the partnership would be brought into account on a date later than the individual partner's tax return was due. The court held that the partnership income had not been received or accrued to the taxpayer and thus did not form part of his gross income.

The Directorate Inland Revenue herewith confirms that a partnership may determine the annual financial year-end date of the partnership as it deems fit. The Act, as it stands, does not stipulate the date upon which the partnership should bring into account its business for the purposes of Article 56(15). It is, however, important that each partner should attach the joint financial statements of the partnership with the submission of their income tax returns and income received or accrued should be correctly accounted for.

ISSUED BY THE COMMISSIONER OF INLAND REVENUE

No 4 **28 August 2003**
Effective date: 27 July 2003

NON-RESIDENT SHAREHOLDERS' TAX ("NRST")

NRST is generally applied when a company managed and controlled in Namibia distributes a dividend to a non-resident. An exception to this general rule is contained in section 42(1)(iv) of the Income Tax Act ("the Act") which levies NRST at an intermediary level when a dividend is distributed by a Namibian company to another Namibian company. This practice note serves to clarify the application of section 42(1)(iv) of the Act.

Section 42(1)(iv) of the Act provides that NRST is payable on the amount of any dividend (including an interim dividend) which has been declared by any company if the shareholder to whom the dividend or interim dividend has been paid or is payable is a company (whether or not managed and controlled in Namibia) more than fifty percent of the issued share capital or equity share capital (as defined in section 1 of the Companies Act, 1973,) of which is held, either directly or through a nominee or some other company or companies, for the direct or indirect benefit of one or more companies neither managed nor controlled in Namibia.

The Commissioner of Inland Revenue has until now levied NRST on dividends paid by a Namibian company to another Namibian company where more than 50% of the issued share capital or equity share capital is held by non-residents.

It has now been decided that no NRST will be levied on dividends paid by a Namibian company to another Namibian company where more than 50% of the issued share capital or equity share capital is held by non-residents, which are resident in countries that concluded treaties for the avoidance of double taxation with Namibia. NRST will thus be levied on treaty country residents only when the Namibian company declares a dividend to a non-resident.

Section 42(1)(iv) will therefore only apply to dividends paid by a Namibian company to another Namibian company where more than 50% of the issued share capital or equity share capital is held by non-residents, which are resident in countries that have not concluded treaties for the avoidance of double taxation with Namibia. In terms of section 46(2) of the Act NRST will not be imposed on so much of the dividend declared by a Namibian company to a non-resident that is attributable to income which has been subjected to NRST in terms of section 42(1)(iv) of the Act at an intermediary level.

The decision has been taken in terms of the non-discrimination clause contained in the existing double taxation treaties between Namibia and the other countries.

No 5

17 September 2003
Effective date: 17 September 2003

TAXATION OF DEATH BENEFITS DERIVED FROM PENSION FUNDS

This practice note serves to clarify the taxation of death benefits derived from pension funds in instances where it solely provides for the pay-out of a death benefit and no annuities.

Paragraph (*a*) of the definition of a pension fund in section 1 of the Income Tax Act provides the following requirement, namely:

> '. . . that the fund is a permanent fund bona fide established for the purpose of providing annuities for employees on retirement from employment or for widows, children, dependants or nominees of deceased employees, or mainly for the said purpose and also for the purpose of providing benefits other than annuities for the persons aforesaid;' . . . (Underlined for emphasis).

The definition explicitly requires that:

- The fund should provide for annuities for employees on retirement or for widows, children, dependants or nominees of deceased employees; or
- The fund should provide mainly for annuities *and* also for the provision of a benefit other than annuities. The annuities to be paid out in terms of the rules of the fund to the member, his or her widow/widower, dependants or nominees should therefore represent more than 50 percent of the total proceeds available to the member.

For the purposes of the definition of a pension fund, the word mainly is not defined in the Act. However, courts decided in various cases that "mainly" means more than 50 percent.

It has come to the attention of the Directorate Inland Revenue that the rules of quite a number of funds provide for a single payment (lump sum) in the event of death of the member of the fund. It is noted that Inland Revenue Directorate erroneously approved some of these funds for tax purposes.

Inland Revenue Directorate will cancel the approval of all these funds and adjust taxpayers' assessments where contributions to the funds were allowed as a deduction for tax purposes. However, administrators of these funds will be allowed to amend the rules of the funds in accordance with the provisions of the Act. Such amendments must take place on or before 28 February 2004.

Until the approval of these funds are cancelled or the rules are amended, and in order not to affect the members who contributed towards such funds, it has been decided to tax the lump sum death benefit paid by the funds in full on death of the member.

Administrators of funds, referred to above, should apply for tax deduction directives in all cases where lump sum death benefits are to be paid out.

ISSUED BY THE COMMISSIONER OF INLAND REVENUE

No 6

17 September 2003
Effective date: 1 October 2003

TAXATION OF FRINGE BENEFITS – LOANS

The Directorate is aware of the recent decrease in interest rates charged by financial institutions and it was therefore decided to adjust the interest rate which has to be used to determine the value of the fringe benefit. The practice note serves to adjust the interest rate to be used to determine the value.

Paragraphs 6 and 8 of The Schedule to Income Tax Tables in respect of fringe benefits for use by employers are herewith amended as follows as long as the official interest rates charged by financial institutions remain below 15%.

6. Housing loans and mortgage subsidies

   (*a*) If no interest is payable, 1% per month of the outstanding amount of loan or subsidy;

   (*b*) If nominal interest is payable, 1% per month less nominal monthly interest on outstanding amount.

In the event of the above being impracticable, the average monthly equivalent may be converted by dividing the annual benefit at 12% per year (or 12% less the interest paid), by 12.

The value of the benefit determined under this item should be reduced by an exemption of one third of the calculated amount if such benefit was granted in accordance with an approved housing scheme.

8. Loans (other than housing loans or mortgage subsidies)

   (*a*) If no interest is payable, 1% per month of the outstanding amount of loan or subsidy;

   (*b*) If nominal interest is payable, 1% per month less nominal monthly interest on outstanding amount.

   Exemptions:

   (*a*) casual loans obtained, of which the aggregate of all the loan amounts at no time exceeded N$3 000;

   (*b*) any loan made by the employer to an employee for own further studies.

ISSUED BY THE COMMISSIONER OF INLAND REVENUE

2006

No 1 **5 September 2006**

DETERMINATION OF TAXABLE INCOME OF LONG-TERM INSURANCE ENTERPRISES

Section 32 of the Income Tax Act

The purpose of this Practice Note is to clarify the misconceptions in the market regarding the determination of taxable income of long-term insurance enterprises.

Section 32(1) of the Income Tax Act prescribes the basis for calculating the taxable income of a long-term insurance business that carries on such business in Namibia. Section 32(1) refers to the gross amounts derived from the investment of funds by a long-term insurance business. The term gross amounts must therefore be interpreted as income before the deduction of interest, salaries, property expenses or any other expenses such a company may incur.

The taxable income of a long-term insurance business is deemed to be an amount equal to 40% of the sum of the gross amounts derived by a long-term insurance business as set out below.

1. The following amounts form part of the gross amounts (referred to above), namely:

(*a*) Interest received or accrued on funds invested in any interest bearing security or similar financial instrument within or outside Namibia relating to long-term insurance business carried on in Namibia.

(*b*) Interest received or accrued on funds invested in any interest bearing security or similar financial instrument within Namibia relating to long-term insurance business carried on outside Namibia.

(*c*) Dividends as defined in section 1 of the Income Tax Act received or accrued on funds invested in any shares in companies incorporated within or outside Namibia relating to long-term insurance business carried on in Namibia.

(*d*) Dividends as defined in section 1 of the Income Tax Act received or accrued on funds invested in any shares in companies incorporated within Namibia relating to long-term insurance business carried on outside Namibia.

(*e*) Rent received or accrued from the letting of property within Namibia by a long-term insurance business carried on in Namibia.

(*f*) Rent received or accrued from the letting of property within Namibia relating to long-term insurance business carried on outside Namibia.

(*g*) Management fees received or accrued from any company in which the long-term insurance company has a beneficial interest of at least 10% of the issued share capital of such company. Management fees will include any fees for services provided to such a company including fees of a managerial or secretarial nature. However, such amount will not be included if the sole or principal function of the company is, in the option of the Permanent Secretary, the rendering of services.

(*h*) Any other amount received from the investment of so much of the funds that are invested within or outside Namibia in respect of any long-term insurance business carried on in Namibia and of so much of the funds that are invested in Namibia in respect of any long-term insurance business carried on outside Namibia, which are not covered by points (*a*) to (*g*) above.

Note must be taken that income sources included in the gross amounts loose their identity and as such do not qualify for any deduction or exemption (e.g. dividends) other than the deduction in terms of section 20(4) of the Income Tax Act, which is applicable on a company which carries on a long-term insurance business in Namibia, and the reduction in terms of section 32(1) of 40% to arrive at the taxable income.

2. Deduction from dividend income

Section 20(4) of the Act provides for the calculation of an amount that can be deducted from the income derived from dividends in carrying on long-term insurance business to determine taxable income.

The amount is determined by using the following formula:

$$Y = A \times B/C$$

Y in the formula represents the amount that is deductible from taxable income derived from dividends.

A in the formula represents the taxable income derived by the company from dividends before any deduction is made in terms of section 20(4) of the Act.

B in the formula represents the amount of dividend income that is included in the amount to determine the taxable income of the company for the year of assessment.

C in the formula represents the total dividend income of the company for the year of assessment in question.

Example:

Gross amounts:		
Interest	:	N$ 1000.00
Dividends	:	N$ 1000.00
Total gross amounts	:	N$ 2000.00
Less: Section 20(4) – Dividends deduction – Formula calculation	:	(N$ 160.00)*
Total gross amounts after section 20(4) deduction	:	N$ 1840.00
Less: 40% deduction i.t.o section 32(1) – Taxable income	:	**N$ 736.00**

*** Formula calculation**

$Y = A \times B/C$
Y= 40% of N$ 1000.00/1 × 40% of N$ 1000.00/N$ 1000.00
Y = N$ 160.00

3. The following amounts will not form part of the gross amounts (referred to above), namely:

(*a*) Amounts that have been derived by the taxpayer from the investment of funds attributable to any long-term insurance business carried on by him or her in Namibia with any pension fund, provident fund or retirement annuity fund.

(*b*) Amounts that have been derived by the taxpayer from the investment of funds attributable to individual annuity contracts entered into by him or her in respect of which annuities are being paid and which are not connected with any business carried on by him or her in Namibia with any fund referred to in (*a*).

(*c*) Interest on the loan portion of the normal tax imposed under any income tax law.

4. Other income from insurance business

Any other amounts not referred to in the preceding paragraphs received by or accrued to a long-term insurance company in the ordinary course of carrying on the business of a long-term insurer will not be included in the gross amounts of such company. Those amounts will be regarded as non-insurance income and taxed as such. This will include foreign exchange gains or losses in respect of loans, advances and debts in terms of section 25A of the Income Tax Act.

5. Non-insurance business

If a long-term insurance company carries on any business other than that prescribed by the Long-term Insurance Act, the income or expenditure of such business will be taxed in terms of the general provisions of the Act and not in accordance with section 32 of the Act. This will include the Item under point 4.

Any loss on non-insurance business may in terms of section 21 of the Income Tax Act be set off against taxable income of long-term insurance business.

ISSUED BY THE DIRECTOR: INLAND REVENUE

No 2

5 September 2006
Effective Date: 5 September 2006

DETERMINATION OF THE TAXABLE INCOME OF CERTAIN PERSONS FROM INTERNATIONAL TRANSACTIONS: TRANSFER PRICING

Section 95A of the Income Tax Act

(This Practice Note is mainly based on the OECD Guidelines and the South African Practice Note.)

1. Definitions and terminology

1.1 The concepts below are defined in section 95A of the Act:

1.1.1 Goods;

1.1.2 international transaction;

1.1.3 resident; and

1.1.4 services.

1.2 For purposes of this Practice Note, the words below are defined as follows:

1.2.1 **Advance pricing arrangement ("APA")**: An APA is an arrangement that determines, in advance of controlled transactions, an appropriate set of criteria for the determination of the transfer pricing for those transactions over a fixed period of time.

1.2.2 **Connected person**: A "connected person" is defined in relation to each of the following categories of persons.

1.2.2.1 In relation to a natural person:

(i) any relative of such person (including by adoption), i.e. children and parents, grandchildren, grandparents, brothers and sisters, great-grandchildren, great-grandparents, uncles and aunts, nephews and nieces, the person's spouse and any person who is a relative of the spouse, the spouse of any of the above-mentioned relatives; and

(ii) any trust of which such natural person or any relative or spouse referred to above is a beneficiary. A beneficiary means any person named, in the will, trust deed or letter of wishes, as a beneficiary or as a person upon whom the trustee or the trust has a power to confer a benefit from the trust.

1.2.2.2 In relation to a trust:

(i) any beneficiary of such trust, i.e. any person named as a beneficiary in the trust deed or letter of wishes, or any other person in favour of whom the trustee of the trust exercises the trustee's discretion; and

(ii) any connected person in relation to such beneficiary, for example any of the beneficiary's relatives and any trust of which a relative may be a beneficiary. A trust and connected persons in relation to the beneficiaries of the trust, are connected persons.

1.2.2.3 In relation to a connected person in relation to a trust (other than a unit trust scheme in property shares, as authorised under the Unit Trust Control Act, 1981 (Act No. 54 of 1981)), any other person who is a connected person in relation to such trust.

All persons who are connected persons in relation to a trust are connected persons in relation to each other.

1.2.2.4 In relation to a member of any partnership:

(i) any other member of such partnership; and

(ii) any connected person in relation to any member of such partnership, for example any of that member's relatives and any trust in which a relative may be a beneficiary.

1.2.2.5 In relation to a company:

(i) its holding company, as defined in section 1 of the Companies Act, 1973 (Act No. 61 of 1973) (the Companies Act);

(ii) its subsidiary, as defined in section 1 of the Companies Act;

(iii) any other company, where both such companies are subsidiaries (as defined) of the same holding company;

(iv) any person, other than a company as defined in section 1 of the Companies Act, who individually or jointly with any connected person in relation to such person, holds (directly or indirectly) at least 20 per cent of the company's equity share capital or voting rights. The person so contemplated, could be a natural person, trust, close corporation or any entity which is not a company for purposes of the Companies Act;

(v) any other company, if at least 20 per cent of the equity share capital of such company is held by such other company, and no shareholder holds the majority voting rights of such company. This will be the case where companies B and C each hold 50 per cent of the equity share capital of company A; both companies, B and C, will be connected persons in relation to company A;

(vi) any other company, if such other company is managed or controlled by:

(*aa*) any person (A) who or which is a connected person in relation to such company; or

(*bb*) any person who or which is a connected person in relation to A.

Two companies will be connected persons in the event of one company being managed or controlled by a connected person in relation to the other company, as well as where the companies are managed or controlled by persons who are connected persons in relation to each other. For example, two companies, one whose shares are held by a trust and the other, whose shares are held by the beneficiary of such trust, will be connected persons in relation to each other.

Company in the definition are not limited to a company, as defined in section 1 of the Act. Company also refers to entities which are companies or corporations according to the ordinary meaning of the word. For example, a company incorporated under the law of any country other than the Republic of Namibia, which does not carry on business in the Republic of Namibia and which is not a shareholder of a Namibian company could also be a connected person, for the purposes of the application of the connected person provisions.

1.2.2.6 In relation to a close corporation:

(i) any member of such close corporation;

(ii) any relative of such member, or any trust which is a connected person in relation to such member; and

(iii) any other close corporation or company which is a connected person in relation to any member or relative or trust contemplated in (i) and (ii) above.

12.2.7 In relation to a person who is a connected person in relation to any other person in terms of the foregoing provisions of this definition, such other person.

1.2.3 **Controlled transaction**: A controlled transaction will be any transaction between connected persons.

1.2.4 **Uncontrolled transaction**: A transaction which is concluded at arm's-length between enterprises that are not connected persons in relation to each other.

1.2.5 **Multinational**: The term multinational is used to refer to any group of connected persons with members (including natural persons) or business activities in more than one country. The term "members" refers to constituent parts (including natural persons) of that multinational, each having a separate legal existence.

1.2.6 **OECD Guidelines**: The Organisation for Economic Co-operation and Development (OECD) Report on Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, published in July 1995 and supplemented with additional chapters and revisions to the contents thereof.

1.2.7 **Transfer prices**: Transfer prices are the prices at which an entity transfers goods and services to connected persons.

2. Introduction

2.1 Namibia use a source-based tax system, which means that Namibia will only include in its tax base income arising within the Namibian tax jurisdiction. The residence of the tax payer will therefore be irrelevant.

2.2 The Namibian Income Tax Act has been amended with an effective date of 14 May 2005 to make provision for the determination of taxable income of certain persons in respect of international transactions. This was necessitated by the current practices in the market to shift taxable income from one entity to another to take advantage of the lower tax rates in a certain tax jurisdiction and financial assistance abuses. Rules of allocation have been identified and are predominantly based on the OECD Guidelines.

2.3 Transfer pricing describes the process by which entities set the prices at which they transfer goods or services between each other.

2.4 The transfer prices adopted by a multinational have a direct bearing on the proportional profit it derives in each country in which it operates. If a non-market value (inadequate or excessive consideration) is paid for the transfer of goods or services between the members of a multinational, the income calculated for each of those members will be inconsistent with their relative economic contributions. This distortion will impact on the tax revenues of the relevant tax jurisdictions in which they operate.

2.5 Section 95A provides that the Minister may, in determination of the taxable income of either the acquirer or the supplier, adjust the consideration in respect of the international transaction to reflect an arm's-length price for the goods or services. This is based on the international taxation principles that serve a dual purpose of securing the appropriate tax base in Namibia and to avoid double taxation.

2.6 Although the Income Tax Act grants the Minister the power to adjust the consideration in respect of a transaction, the reality is that numerous transactions in respect of the same goods or services are entered into between the connected persons. In practice the Minister will exercise his discretion in respect of all transactions entered into in respect of a product or service during any period.

2.7 The OECD has continuously worked to build a consensus on international taxation principles to contribute to the expansion of world trade on a multilateral,

non-discriminatory basis and to achieve the highest sustainable economic growth in Member countries.

2.8 The objective of this Practice Note is to provide tax payers with guidelines about the procedures to be followed in the determination of arm's-length prices, taking into account the Namibian business environment. It also sets out the Minister's views on documentation and other practical issues that are relevant in setting and reviewing transfer pricing in international agreements.

3. The Minister's approach to the Practice Note

3.1 This Practice Note has been drafted as a practical guide and is not intended to be a prescriptive or an exhaustive discussion of every transfer pricing issue that might arise. Each case will be decided on its own merits, taking into account the taxpayer's business strategies and commercial judgement.

3.2 Status of the OECD Guidelines

This Practice Note is based on and acknowledges the principles of the OECD Guidelines. Nothing in this Practice Note is intended to be contradictory to the OECD Guidelines and in cases where there is conflict, the provisions of the OECD Guidelines will prevail in resolving any dispute.

Any amendments made to the OECD Guidelines will be deemed to be incorporated into this Practice Note.

4. Tax treaties

4.1 Article 7 of the OECD "Model Tax Convention on Income and on Capital" provides inter alia for the attribution of profits to a permanent establishment of an enterprise. Furthermore, Article 9 of the OECD Model Tax Convention stipulates that the arm's-length principle must be applied to commercial and financial relations between associated companies residing in the contracting states. These principles are embodied in each of Namibia's tax treaties.

4.2 The "business profits" and "associated enterprises" articles in the tax treaties do not indicate priorities as to the methods to be used to determine the attribution of profits or an arm's-length price. Therefore, the Minister holds the view that no inconsistency exists between domestic law and the tax treaties, as both embody the arm's-length principle as set out in the OECD Guidelines.

4.3 The Minister acknowledges that paragraph 2 of Article 9 of the OECD Model Tax Convention provides that a contracting state must make an appropriate adjustment to the amount of tax it levies on profits, if the other contracting state has made an adjustment to the profits of a related enterprise.

The concept of corresponding adjustments for transfer pricing purposes is therefore encompassed within the scope of this Practice Note.

4.4 Even though it is accepted that section 95A by definition can only apply between separate legal entities, the contents of this Practice Note will also apply to transactions between –

- a person's head office with the branch of such person; or
- a person's branch with another branch of such person.

This is by virtue of the fact that the Practice Note encompasses and accepts the provisions of Article 7 of the OECD Model Tax Convention applicable to the above transactions and will consider the abovementioned transactions in terms of the OECD principles stipulated in Article 7.

5. The arm's-length principle

5.1 The arm's-length principle is the international transfer pricing standard that OECD Member countries have agreed to be used for tax purposes by multinational enterprises and tax enterprises. This means that transactions between connected persons are to be conducted at arm's-length. In other words, transaction 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. The OECD Guidelines interpretation of arm's-length will be followed in the application of this Practice Note.

5.2 The Ministry of Finance has adopted a policy that it will not be automatically assumed that connected persons under a controlled transaction have sought to manipulate their profits. The Minister will take cognisance of the genuine difficulties to accurately determine a market price in the absence of market forces or when a particular commercial strategy has been adopted.

5.3 Other than tax considerations, factors such as governmental regulations (for example price or exchange controls) may also distort the prices charged between connected persons. These factors are recognised by the OECD Guidelines and the Minister.

5.4 The determination of an arm's-length consideration is not an exact science but requires judgement on the part of both the taxpayer and the Minister. Accordingly, taxpayers and the Minister need to approach each case, having due regard for the unique business and market realities applicable to each individual case.

5.5 An arm's-length price does not necessarily constitute a single price, but a range of prices and the facts of each case will determine where, within that range, a specific arm's-length price will lie.

5.6 Arm's-length prices may vary across different markets, even for transactions involving the same product or service. To achieve comparability, it is important to ensure that the markets in which the parties operate are comparable. Any differences must either not have a material effect on price, or be differences for which appropriate adjustments can be made.

6. Guidance for applying the arm's-length principle

6.1 Principles of comparability

6.1.1 The application of the arm's-length principle is generally based on a comparison of conditions in a controlled transaction with the conditions in transactions between independent enterprises. The preferred arm's-length methods are based on the concept of comparing the prices/margins achieved by connected persons in their dealings to those achieved by independent entities for the same or similar dealings. In order for such comparisons to be useful, the economically relevant characteristics of the situations being compared must be highly comparable.

6.1.2 To be comparable means that none of the differences (if any) between the situations being compared could materially affect the condition being examined in the method (e.g. price or margin), or that reasonably accurate adjustments can be made to eliminate the effect of any such differences. If suitable adjustments cannot be made, then the dealings cannot be considered comparable.

6.1.3 Factors determining comparability:

(*a*) Characteristics of goods and services;

(*b*) functional analysis;

(*c*) terms and conditions of relevant agreements;

(*d*) relative risk assumed by the taxpayer, connected enterprises and any independent party where such party is considered as a possible comparable;

(*e*) economic and market conditions; and

(*f*) business strategies.

Characteristics of goods and services

The OECD Guidelines, at paragraph 1.19, mention a non-exhaustive list of features that may be relevant in comparing two products:

(i) In the case of transfers of tangible goods, the physical features of the goods, its quality and reliability, and the availability and volume of supply; and

(ii) in the case of intangible goods, the form of the transaction, the type of property, the duration and degree of protection, and the anticipated benefits from the use of the goods.

Functional analysis

The compensation for the transfer of property or services between two independent enterprises will usually reflect the functions that each enterprise performs, taking into account the risks assumed and the assets used. In determining whether two transactions are comparable, the functions and risks undertaken by the independent parties should be compared to those undertaken by the connected persons.

Economic theory predicts that when various functions are performed by a group of independent enterprises, the enterprise that provides most of the effort and, more particularly, the rare or unique functions, and assumes the most risk should earn a greater portion of the profit.

A practical way of evaluating functional comparability is to prepare a functional analysis. A functional analysis is a method of finding and organising facts about a business' functions, assets (including intangible property) and risks. It aims to determine how these are divided between the parties involved in the transaction under review.

A functional analysis should address all of the following:

(*a*) The functions and risks undertaken by the relevant members of the multinational.

(*b*) The relative contributions of various functions: The number of functions performed by a particular member of a multinational is not decisive in determining whether that member should derive the greater share of the profit. It is the relative importance of each function that is relevant.

(*c*) An appraisal of risk. In the open market, this assumption of increased risk will be compensated for by an increase in the expected return. The risks assumed should therefore be taken into account in the functional analysis.

(*d*) It must also be considered whether a purported allocation of risk is consistent with the economic substance of the transaction. In this regard, the parties' conduct should generally be taken as the best evidence concerning the true allocation of risk. The functions undertaken by an entity will, to some extent, determine the allocation of risks.

Business strategies

Business strategies are also relevant in determining comparability for transfer pricing purposes. Business strategies are a legitimate aspect of arm's-length operations. The arm's-length principle, therefore, acknowledges those strategies. Business strategies would take into account many aspects of an enterprise, such as innovation and new product development, degree of diversification, risk aversion and other factors which have bearing upon the daily conduct of business.

Business strategies could also include market penetration schemes. A taxpayer seeking to penetrate a new market or to expand (or defend) its market share might temporarily charge a lower price for its product than the price for otherwise comparable products in that market. Alternatively, it might temporarily incur higher costs (perhaps because of start-up costs or increased marketing efforts) and hence achieve lower profit levels than other taxpayers operating in the same market.

The Minister may consider a number of factors in evaluating a taxpayer's claim of following a strategy that temporarily reduces profits in return for higher long-term profits, for example, whether:

(*a*) the conduct of the parties is consistent with the professed business strategy;

(*b*) the nature of the relationship between the parties to the controlled transaction justifies that the taxpayer bears the costs of the business strategy;

(*c*) there is a plausible expectation that the business strategy will produce a return sufficient to justify its costs, within a period of time that would be acceptable in an arm's-length arrangement.

6.2 Recognition of the actual transactions undertaken

6.2.1 The Ministry of Finance's examination of a controlled transaction will be based on the transaction actually undertaken by connected enterprises as structured by them.

6.2.2 However, the Ministry of Finance will deviate from this approach in the following cases namely:

(*a*) Where the economic substance of a transaction differs from its form; and

(*b*) while the form and substance of the transaction are the same, the arrangements made in relation to the transaction, viewed in their totality, differ from those which would have been adopted by independent enterprises behaving in a commercially rational manner and the actual structure practically impedes the tax administration from determining an appropriate transfer price.

6.3 Evaluation of separate and combined transactions

6.3.1 The Ministry of Finance is aware that in certain cases separate transactions are so closely linked or continuous that it is difficult to evaluate it adequately on a separate basis. These transactions will therefore be evaluated together by making use of the most appropriate arm's-length method of methods.

6.3.2 However, the Ministry of Finance would still evaluate other transactions of such enterprises separately. In other words, while some separately contracted transactions between associated enterprises may need to be evaluated together in order to determine whether the conditions are arm's-length, other transactions contracted between such enterprises as a package may need to be evaluated separately.

6.4 Use of an arm's-length range

6.4.1 In some cases it will be possible to apply the arm's-length principle to arrive at a single figure (e.g. price or margin) that is the most reliable to establish whether the conditions of a transaction are arm's-length.

6.4.2 However, the Ministry is aware that there will also be many occasions when the application of the most appropriate method or methods produces a range of figures all of which are relatively equally reliable. In these cases, differences in the figures that compromise the range may be caused by the fact that in general the application of the arm's-length principle only produces an approximation of conditions that would have been established between independent enterprises.

6.4.3 The Ministry of Finance would therefore uses its own discretion and judgement to evaluate transactions. No general rule will be stated with respect to the use of ranges derived from the application of multiple methods because the conclusions to be drawn from their use will depend on the relative reliability of the methods employed to determine the ranges and the quality of the information used in applying the different methods.

6.4.4 In the event that the relevant conditions of the controlled transaction (e.g. price or margin) fall outside the arm's-length range asserted by the Ministry of Finance, the tax payer will be given an opportunity to present arguments that the conditions of the transaction satisfy the arm's-length principle.

6.4.5 Adjustments will be made if the tax payer cannot provide sufficient arguments. The adjustment will be made to the point within the range that best reflects the facts and circumstances of the particular controlled transaction.

6.5 Use of multiple year data

6.5.1 The Ministry of Finance may, in certain cases, examine the data of previous years, as well.

7. Acceptable methods for determining an arm's-length price

7.1 Introduction

7.1.1 Neither section 95A nor the tax treaties entered into by Namibia prescribe any particular methodology for the purpose of ascertaining an arm's-length consideration. Given that there is no prescribed legislative preference, the Minister would generally seek to use the methods that have been set out below.

7.1.2 The most appropriate method in a given case will depend on the facts and circumstances of the case and the extent and reliability of data on which to base a comparability analysis. It should always be the intention to select the method that produces the highest degree of comparability.

7.1.3 The choice of the most appropriate method should therefore be based on a practical weighting of the evidence, having regard to:

(*a*) the nature of the activities being examined;

(*b*) the availability, quality and reliability of the data; .

(*c*) the nature and extent of any assumptions; and

(*d*) the degree of comparability that exists between the controlled and uncontrolled transactions where the difference would affect conditions in the arm's-length dealings being examined.

7.1.4 In cases where there are no comparables or there is insufficient information to determine an arm's-length outcome, the method to be used should be a method that produces a reasonable estimate of an arm's-length outcome. Such estimate must be based on the facts in hand.

7.1.5 The application of the principles set out in this Practice Note may require the exercise of judgement. After the identification of an independent benchmark or benchmarks against which the pricing of a multinational is to be compared, it needs to be established to what extent the functions of the members of a multinational are similar to or differ from those of the independent benchmark(s). An element of judgement is required to determine the extent to which these similarities or differences have a material effect on the transfer price adopted by the multinational.

7.1.6 As a general rule, the most reliable method will be the one that requires fewer and more reliable adjustments to be made. Taxpayers will not be required to undertake an intricate analysis of all the methodologies, but should have a sound basis for using the selected methodology. This could entail providing reasons why secondary methods are not appropriate.

7.1.7 This section of the Practice Note considers the principles underlying each of the various transfer pricing methods. An understanding of these principles is useful for identifying the limitations of each method and applying the methods in practice.

7.2 The principle methods referred to in the OECD Guidelines

7.2.1 Several transfer pricing methods have been developed in international practice for determining and appraising a taxpayer's transfer prices. These methods are based on measuring a multinational's pricing strategies against a benchmark of the pricing behaviour of independent entities in uncontrolled transactions.

7.2.2 The standard transfer pricing methods recognised by the OECD Guidelines, are:

(*a*) The comparable uncontrolled price method (CUP method);

(*b*) the resale price method (RP method);

(*c*) the Cost plus method (CP method);

(*d*) the transactional net margin method (TNMM); and

(*e*) the profit split method.

7.2.3 The CUP, RP and CP methods are known as the traditional transaction methods and the TNMM and profit split method are referred to as transactional profit methods.

7.2.4 The Minister endorses the CUP, RP, CP, TNMM and profit split methods as acceptable transfer pricing methods, the most appropriate of these depending on the particular situation and the extent of reliable data to enable its proper application.

7.3 The hierarchy of methods

7.3.1 Section 95A does not impose a hierarchy for the transfer pricing methods. However, there is in effect a hierarchy, in that certain methods may provide a more reliable result than others, depending on the quality of available data and the taxpayer's circumstances.

7.3.2 The Minister acknowledges that the suitability and reliability of a method will depend on the facts and circumstances of each case. The most reliable method will be the one that requires fewer and more reliable adjustments.

7.3.3 It is essential to have an understanding of the commercial and economic reality underlying any particular transaction before beginning with a search for, and close examination of comparable transactions between unrelated enterprises in an application of the traditional arm's-length methods.

7.3.4 As a general rule, the traditional transaction-based methods are preferred. Of these methods the CUP method is preferred, as it looks directly to the product or service transferred and is relatively insensitive to the specific functions which are performed by the entities being compared.

7.3.5 The RP and CP methods look at valuing the functions performed. Because these methods examine gross margins, operating expenses are excluded and therefore the impact of relative cost structures should not be material.

7.3.6 In practice, the traditional methods may not be able to be applied, because of information constraints, particularly the lack of comparable uncontrolled transactions or published data on gross margins. Hence it may be necessary to resort to the transactional profits methods.

7.3.7 Of the transactional profits methods, the TNMM is reasonably objective because comparables are applied. Essentially, this is either the RP or CP with varying levels of operating expenses incorporated into the calculations.

7.3.8 In theory the TNMM is inferior to the RP or CP methods where sufficient information is available to apply all three methods, because comparing operating expenses requires a similar structure of business to be truly reliable. This presents a more difficult threshold than functional comparability.

7.3.9 Where a taxpayer has considered a number of methods, it may be appropriate to document the reasons for discarding some of those methods. The availability of data is likely to be very important in a taxpayer's choice of method. Namibia is a small market and under certain circumstances this means reliable comparables may be difficult for taxpayers to locate.

7.4 The CUP method

7.4.1 Description

The CUP method compares the price charged for goods or services transferred in a controlled transaction to the price charged for goods and services transferred in a comparable uncontrolled transaction in comparable circumstances. If there is any difference between the two prices, this may indicate that the conditions of the commercial and financial relations of the associated enterprises are not arm's-length, and that the price in the controlled transaction may need to be substituted for the price in the uncontrolled transaction.

7.4.2 Application

The CUP method is the most direct and reliable way to apply the arm's-length principle where it is possible to locate comparable uncontrolled transactions. A comparable uncontrolled price can be determined by reference to similar products or services transferred under similar circumstances by the taxpayer to an independent party (internal comparable) or by reference to similar products or services transferred under similar circumstances by one independent party to another (external comparable).

The two transactions being compared will only be truly comparable if there are no differences between the two transactions that will have a material effect on the price, or if reasonably accurate adjustments can be made to eliminate the effect of differences that may materially affect the price.

It is important to keep in mind that two transactions will not be comparable merely because the product or service transferred is comparable. Regard should also be had to the effect on price of broader business functions and economic circumstances other than just the product comparability.

7.5 The resale price method

7.5.1 Description

The resale price method is based on the price at which a product, which has been purchased from a connected enterprise, is resold to an independent enterprise. The resale price is then reduced by an appropriate gross margin, to cover the reseller's selling and other operating costs, and to provide an appropriate profit, depending on functions performed, assets used and risks assumed by the reseller. The balance may be regarded as the arm's-length price before other adjustments in respect of, for example, customs duties.

7.5.2 Application

The resale price margin of the reseller in the controlled transaction may be determined by reference to the resale price margin that the entity obtains on items purchased and sold in comparable uncontrolled transactions, as well as by reference to the resale price margin obtained by one independent party selling to another. Functional comparability is very important and it is essential that the functions performed by the independent entity are comparable to the functions performed by the member of the multinational selling to an independent enterprise. There should be no differences, which have a material effect on the price, for which reasonably accurate adjustments cannot be made.

In applying the resale price method, fewer adjustments are normally required for product comparability than under the CUP method. Minor product differences are less likely to have an effect on profit margins than on prices, as profit margins for similar functions tend to be equal, but prices for different products will be equal only to the extent that products are substitutes for one another. For example, a distributor performs the same function to sell toasters

and blenders and is therefore likely to require the same profit margin, but blenders are not comparable in price to toasters.

Although broader product differences can be allowed in the resale price method, product similarity may still be important when applying this method, for example when high value intangibles are involved. All the other factors affecting comparability will have to be considered when applying the resale price method.

The resale price method focuses only on the external sale price to third parties and the gross margin required to reward the function performed by the reseller. These factors are not overly sensitive to differences between the cost structure of a member of a multinational and an independent firm. Thus, if the member of the multinational operates a more efficient distributorship than the independent firm, this will result in a higher net profit percentage when the resale price method is used, and will not influence the gross profit percentage.

The resale price method is most appropriate where the reseller does not add substantially to the value of the product or does not posses valuable marketing intangibles.

7.6 The cost plus method

7.6.1 Description

The cost plus method requires estimation of an arm's-length consideration, by adding an appropriate mark-up to the costs incurred by the supplier of goods or services in a controlled transaction. This mark-up should provide for an appropriate profit to the supplier, in the light of the functions performed, assets used and risks assumed.

7.6.2 Application

This method is best suited to situations where:

(*a*) services are provided;

(*b*) semi-finished goods are sold between connected parties;

(*c*) connected persons have concluded joint facility agreements or long-term buy-and-supply arrangements.

The mark-up should ideally be determined with reference to the mark-up earned by the same supplier in uncontrolled transactions. If this is not possible, the mark-up should be determined by using the mark-up earned in comparable transactions by an independent supplier performing comparable functions, bearing similar risks and employing similar assets to those of the taxpayer.

An uncontrolled transaction is comparable to a controlled transaction for purposes of the cost plus method if one of two conditions is met:

(*a*) none of the differences between the transactions being compared or between the enterprises undertaking those transactions materially affect the cost plus mark up in the open market; or

(*b*) reasonably accurate adjustments can be made to eliminate the material effects of such differences.

Fewer adjustments are needed for product comparability than under the CUP and the same comparability principles as discussed under the resale price method will apply to the cost plus method.

7.7 Transactional net margin method (TNMM)

7.7.1 Description

The TNMM examines the net profit margin that a taxpayer realises from a controlled transaction, relative to an appropriate base, for example cost, sales or assets. This ratio is referred to as a profit level indicator. The profit level

indicator of the tested party is compared to the profit level indicator(s) of comparable independent parties.

7.7.2 Application

Although the TNMM is classified as a transactional profit method, it is more closely aligned to the CP and RP methods than to the profit split method. As with the CP and RP methods, the TNMM focuses on the functions performed by an enterprise. The difference is that the TNMM compares net profit rather than gross profit.

The TNMM is, however, considered less reliable than the traditional transaction methods. This is because the net margins which are used in the TNMM are very sensitive to the relative cost structures of the entities being compared, as they include operating expenses in their calculations. For example, if a multinational operates a more efficient distributorship than the independent firm, the application of the TNMM would result in a lower net profit being determined for the distributorship than if the RP method were used. Thus, unless an adjustment could be made to reflect the relative efficiency of the firms being compared, use of the TNMM would not provide a reliable result.

In order to maximise the reliability of the TNMM, the member of the multinational and the independent firm being compared would need to be structurally similar. In practice, firms are structurally unique and comparisons of indicators between firms will tend to be less reliable than comparisons made at the gross margin level. For this reason the TNMM, along with the profit split method are considered to be methods of last resort in international practice. This observation does not preclude the TNMM from being used. It must be recognised that reliable information on gross margins may be difficult, if not impossible, to obtain. Thus information constraints may dictate the TNMM as the only practical approach in many cases.

The connected party (tested party) whose profit level will be compared to the profit level of the independent parties, will usually be the party for which reliable data on the most closely comparable transactions can be identified. It is also usually the enterprise that is the least complex and that does not own valuable intangible property.

7.8 The profit split method

7.8.1 Description

The first step in the profit split method is to identify the combined profit to be split between the connected parties in a controlled transaction. In general, combined operating profit is used, ensuring that both income and expenses of the multinational are attributed to the relevant connected person consistently.

That profit is then split between the parties according to an economically valid basis approximating the division of profits that would have been anticipated and reflected in an agreement made at arm's length.

7.8.2 Application

The profit split method is usually applied where transactions are so interrelated that they cannot be evaluated separately. Under similar circumstances, independent enterprises may decide to set up a form of partnership and agree to some form of profit split.

Two alternative approaches to the profit split method are outlined in the OECD Guidelines. Under both approaches, the first step is to determine the combined profit attributable to the parties to the transaction. The combined profit is then allocated as follows:

Under the residual profit split approach, each of the parties to the transaction is assigned a portion of profit according to the basic functions that it performs. The residual profit or loss is then allocated between the parties on the basis of their relative economic contribution in respect of the amount to be allocated.

Under the contribution analysis approach, it is generally the combined operating profit (profit before interest and tax) that is divided between the parties on the basis of the relative contribution of each party to that combined gross profit.

However, paragraph 3.15 of the OECD Guidelines notes that these approaches are not necessarily exhaustive or mutually exclusive. There may be alternative ways to split a profit to achieve a reliable arm's-length result.

As is explained in paragraph 3.17 of the OECD Guidelines it may, in some circumstances, be appropriate to split gross profits (as opposed to operating profits) between the connected parties and then deduct the operating expenses incurred by or attributable to each relevant enterprise. The example used in paragraph 3.17 of the OECD Guidelines is the case of a multinational that engages in highly integrated world-wide trading operations involving various types of property. It may be possible to determine the enterprises in which expenses are incurred or attributed, but not to accurately determine the particular trading activities to which those expenses relate. In such case it may be appropriate to split the gross profit from each trading activity and then deduct from the resulting overall gross profit the operating expenses incurred by or attributable to each enterprise.

The allocation of gross profit should be consistent with the location of activities and risks. Care must be taken to ensure that the expenses incurred by or attributable to each enterprise are consistent with the activities performed and risks assumed by the relevant entities.

(*a*) Residual profit split analysis

The residual profit split approach first provides both the parties to the transaction with a basic return, based on what independent firms would obtain for performing similar functions and undertaking similar risks. Applying other transfer pricing methods, such as a cost plus method or a resale price method, could also achieve this.

The residual profit remaining after the first stage division would be allocated among the parties, in accordance with the way in which this residual would have been divided between independent enterprises. Facts and circumstances that could influence the profit allocation in the second stage include the parties' contributions of intangible property and relative bargaining positions.

This requires a judgment about what factors contribute to the residual profit, and their relative contribution. For example, it may be determined that the process development and the marketing are the only relevant contributors to the residual profit and that each contributes 50 per cent to that profit. A 50:50 split of the residual profit between the manufacturer and the retailer would then be justified.

There is no definitive guide on how the relative contribution of the parties should be measured. It is quite likely that the transaction between the parties will be unique, so there will be no external benchmark against which to test the reliability of the assessment of relative contributions. In practice, the assessment of relative contribution may, of necessity, need to be a somewhat subjective measure, based on the facts and circumstances of each case.

(*b*) Contribution analysis

Multinationals are organisationally different from comparable domestic enterprises. Large integrated multinationals may have the benefit of cost savings attributable to the scale of their operations, otherwise known as economies of scale. Such savings are not necessarily available to independent enterprises. For example, the administration costs incurred by a multinational which both manufactures and retails toasters are likely to be less than the aggregated costs faced by two separate firms, one of which manufactures toasters, and the other of which retails them. In the absence of intangibles, the price determined under the cost plus method would then be higher than the price determined under the resale price method. This means that there would be a negative residual if the residual profit split approach were to be used.

Economies of scale are not an aspect which can readily be evaluated in a traditional arm's-length analysis. However, it is an important factor that needs to be addressed when determining whether a multinational's transfer prices are consistent with the arm's-length principle.

One approach to this problem may be to use the contribution analysis approach. Under this approach, the combined gross profit of the two parties to a transaction is allocated between them, on the basis of their relative contribution to that profit. This differs from the residual profit split approach, in that basic returns are not allocated to each of the parties to the transaction before the profit split is made.

8. Administration

8.1 Examination practices

The Ministry of Finance is aware that transfer pricing cases can present special challenges to the normal audit or examination practices. Transfer pricing cases are fact-insensitive and may involve difficult evaluations of comparability, markets, and financial or other industry information. However, the Ministry of Finance is in the process to set up a special unit that will specifically deal with transfer pricing. Technical assistance will also be provided to the Ministry of Finance by OECD and the South African Revenue Services.

8.2 Burden of proof

The burden of proof is on the tax payer. However, the tax payer could be assured that the burden of proof will not be misused by groundless or unverifiable assertions about transfer pricing.

8.3 The mutual agreement procedure

The Ministry of Finance is aware that double taxation may occur as a result of transfer pricing adjustments. The Ministry of Finance will, therefore, make use of mutual agreement procedures to endeavour to solve these issues with competent authorities but is not bound to reach an agreement or to resolve tax disputes. Both competent authorities will only endeavour to reach an agreement.

8.4 Corresponding and secondary adjustments

To eliminate double taxation in transfer pricing cases, the Ministry of Finance will consider requests for corresponding adjustments. However, secondary adjustments will not be considered at all.

8.5 Documentation

A taxpayer is required to be in possession of transfer pricing documentation. If the Minister, as a result of this examination, substitutes an alternative arm's-length amount for the one adopted by the taxpayer, the lack of adequate documentation will make it difficult for the taxpayer to rebut that substitution, either directly to the Minister or in the Courts.

A taxpayer needs to demonstrate that it has developed a sound transfer pricing policy in terms of which transfer prices are determined in accordance with the arm's-length principle by documenting the policies and procedures for determining those prices.

On the other hand, preparing documentation is time-consuming and expensive. It will therefore not be expected of taxpayers to go to such lengths that the compliance costs related to the preparation of documentation are disproportionate to the nature, scope and complexity of the international agreements entered into by taxpayers with connected persons. In these circumstances taxpayers would be required to submit abridged documentation identifying the relevant transactions and providing details of the methodologies applied. The taxpayer should use judgement to determine the level of documentation required.

The documentation guidelines set out below broadly follow Chapter V of the OECD Guidelines. According to paragraph 5.4 of the OECD Guidelines, the tax payer's process of considering whether transfer pricing is appropriate for tax purposes should be determined in accordance with same prudent business management principles that would govern the process of evaluating a business decision of a similar level of complexity and importance. The Minister would expect taxpayers to have created, referred to and retained documentation in accordance with this principle.

This Practice Note does not prescribe to tax payers what kind of documentation should be available because appropriate documentation depends on each tax payer's specific facts and circumstances.

In determining an arm's-length price, a tax payer would generally go through a process which will usually include some form of a functional analysis and information gathering on relevant comparables. Tax payers should therefore be able to justify why certain transfer prices are considered to be consistent with the arm's-length principle.

9. Advance pricing agreements (APAs)

Due to various factors, the APA process will not in the foreseeable future, be made available to Namibian taxpayers. This Practice Note will thus not deal with APAs.

ISSUED BY THE DIRECTOR: INLAND REVENUE

2011

No 1

24 February 2011

Effective date: (1) In the case of any taxpayer other than a company 1 March 2010; and

(2) In the case of any taxpayer which is a company, at the beginning of the financial year of such company on or after 1 January 2010

GAME FARMING

Section 27 of the Income Tax Act, 1981 (Act No. 24 of 1981) as amended ("the Act") read with Schedule 1 of the Act

1. The Directorate Inland Revenue felt it necessary, due to the rapid growth in game farming and organised hunting expeditions on game farms, to explain Inland Revenue's practice with regard to these activities.
2. It has come to the attention of the Directorate Inland Revenue that a large number of farmers are carrying on farming operations with game only or game farming in addition to other farming operations.
3. The same tests that are used to determine whether a person is carrying on ordinary farming operations are applicable to game farming. Game farmers should therefore be able to convince the Directorate Inland Revenue that game livestock ("game") is purchased, sold, bred, etc., on a regular basis before the activities can be regarded as *bona fide* farming operations. Where a person who owns land and occasionally allows hunters, for example, to cull the game thereon, such activities cannot, on that account alone, be accepted as constituting farming with game.
4. It will therefore be required:
   - 4.1 That game farmers should exercise proper control over their game on the farm and that the property is properly fenced on the outer perimeters;
   - 4.2 that game counts be performed and conducted on an annual basis by means of physical counts; and
   - 4.3 that game farmers keep proper records and/or registers in respect of the game counts and all permits issued by the Ministry of Environment and Tourism relating to the hunting of game or any product derived there from including any documents or permits relating to the sale, purchase, catch or translocation of game for audit purposes.
5. Game farming:
   - 5.1 Income:
     - 5.1.1 The fortuitous sale of game, game carcasses, game skins, etc., and/or the sale of any product derived there from or any income generated from or related to the hunting of game by a *bona fide* game farmer constitutes game farming income and is taxable. Income derived from persons to whom the right is granted to hunt game on the farm is also regarded as game farming income.
     - 5.1.2 Income solely derived from the following activities will not be regarded as farming income:
       - Accommodation and catering on the farm;
       - admission charged to persons for spending holidays on the farm; and
       - where the farmer, his or her employees or freelance tour guides act as guides for holidaymakers/hunters.
   - 5.2 Expenditure:

     A deduction for the acquisition of game will only be allowed to determine the taxable income from game farming if expenditure is actually incurred to acquire the game.

5.3 Stock:

5.3.1 Opening and Closing stock – Opening and closing stock should be excluded when calculating taxable income from game farming.

5.3.2 Every *bona fide* game farmer shall include in his or her return of income rendered for a tax year a reconciliation of game, which reconciliation should indicate:

5.3.2.1 The number of game sold and purchased;

5.3.2.2 the number of game hunted;

5.3.2.3 an estimate number of the net accruals after births and deaths have been taken into consideration;

5.3.2.4 the number of all game donated;

5.3.2.5 the opening and closing balances of game.

5.4 Paragraph 11 of Schedule I of the Act:

Game, as mentioned above, is regarded as livestock if a person is carrying on *bona fide* game farming. It is accepted that where a taxpayer carries on farming operations with game and game has been sold in the circumstances contemplated in paragraph 11 of Schedule 1 to the Act, the taxpayer will be entitled to the relief provided for in the said paragraph.

5.5 Improvements:

Capital improvements, as outlined in paragraph 10 of Schedule 1 of the Act, incurred during a year of assessment by a *bona fide* game farmer will be allowed as a deduction to determine the taxable income of such farmer if they are being used in connection with game farming operations.

5.6 Housing for safari-goers and hunters:

Expenditure incurred in respect of residential facilities such as bedrooms, dining rooms and sitting rooms that are made available to safari-goers and hunters by any farmer who is not a *bona fide* game farmer, is not farming expenditure and therefore not deductible in terms of paragraph 10 of Schedule 1 of the Act. Expenditure incurred during the year of assessment by a *bona fide* game farmer in respect of beds, furniture, refrigerators, stoves, etc., will be allowed as a deduction in terms of section 17(1)(*e*) of the Act against camping fees, accommodation fees and visitors fees.

ISSUED BY THE DIRECTOR: INLAND REVENUE