

# INCOME TAX SECOND AMENDMENT ACT, 1999 ( ACT NO 21 OF 1999)

## OVERVIEW AND COMMENTARY

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### 1. Introduction

The Income Tax Second Amendment Act, 1999 (Act no 21 of 1999) was published on 3 December 1999 in Government Gazette no 2240. Unless otherwise stated amendments came into effect on 1 March 1999 for individuals and on or after 1 January 1999 for companies.

This overview and commentary deals only with aspects which impact upon retirement funding arrangements or related aspects.

### 2. Definition of “gross income”

#### 2.1 Overview

Paragraph (d) of this definition, which deals with receipts or accruals from a pension fund, now specifically excludes from its ambit the receipt or accrual of an annuity. Amounts specifically not to be included as gross income are any lump sum upon

- death;
- superannuation, ill-health or infirmity proven to the satisfaction of the Minister; or
- retirement.

This amendment is effective from 1 March 1998.

A new paragraph (dD) is inserted in this definition as from 1 March 1999 to include amounts received from a preservation fund upon

- withdrawal of any portion of the benefit;
- retirement or death in case of a provident preservation fund; or
- the cessation of a preservation fund.

#### 2.2 Commentary

This section aims to include in gross income all benefits received from a pension fund other than annuities (annuities are specifically identified as gross income in terms of paragraph (a) of this definition), and lump-sums referred to in 2.1 above. Section 5 (3), which applies the averaging formula to any income included in taxable income in terms of paragraph (d) of the definition of “gross income”, can clearly no longer be applied to an annuity received by or accrued to the taxpayer, as could have previously been argued.

The reference to provident preservation fund in paragraph (dD) specifically, by implication means that a lump-sum benefit received from a pension preservation

fund upon death or disablement is excluded from gross income and is therefore not taxable (this tax regime is in line with that applicable to pension funds). It would also exclude a lump-sum from a provident preservation fund upon disablement or ill-health from gross income which would similarly not be taxable (if derived from a provident fund, only one-third of the amount would be tax-free).

It is quite interesting that paragraph (c) of this definition, which deals with employment related receipts and awards, specifically excludes from its ambit any lump-sum award from a pension fund, retirement annuity fund and benefit fund. The newly introduced preservation fund, addressed below in greater detail, and the provident fund are not referred to. By implication, lump sum awards from preservation funds and provident funds are in the first instance gross income in terms of this definition and would enjoy the tax concession (of now N\$ 100,000, previously N\$ 50,000) applicable to gratuities contained in section 16 (1) (o), which is referred to in paragraph 8.1 below. The apparent overlap between paragraph (d) and paragraph (c) of the definition of “gross income” could make the interpretation of the Act quite interesting, in this regard.

We do not believe that this can be the intention of the legislator and that an amendment is likely to be introduced in due course to clarify the existing ambiguities.

### **3. Definition of “pension fund”**

#### **3.1 Overview**

A minor change to this definition now requires funds which are established by any law, to also obtain approval from the Minister, unless the rules of such fund are set out in the relevant law. The new definition now also excludes the newly introduced preservation fund from its ambit. The effective date is 1 March 1999.

The maximum annuity which may be commuted for a cash lump-sum was increased from N\$ 10,000 to N\$ 20,000 as from 1 March 1999. Furthermore, where the value of an annuity does not exceed N\$ 20,000 as at 1 March 1999, such annuity may be commuted for a cash lump-sum.

Local authorities are as from 1 March 1999 precluded from controlling the management or assets of the fund, as has been the case with all other employers before.

#### **3.2 Commentary**

A number of funds have been established under separate legislation, such as the ‘Members of Parliament and Other Office-bearers Pension Fund’, which was promulgated recently, and, we believe, the Government Institutions Pension Fund.

Previously there was some argument whether such funds were subject to the control of the Minister. The amendment now clarifies the position.

The amendment to the maximum annuity which may be commuted for a cash lump-sum is now also applied as a once-off concession to all existing pensioners and annuitants. This commutation is not tax-free, however, since the relevant tax concession only applies to the lump-sum paid in the event of death, superannuation, ill-health or infirmity. It is interesting to note that this once-off concession has no expiry date.

The amendment affecting local authorities is of no consequence to most local authorities, since their funds already comply with this requirement through equal representation of employer and employees on the board of trustees.

#### 4. Definition of ‘preservation fund’

##### 4.1 Overview

As from 1 March 1998, a new type of fund has been introduced through this definition, being a preservation fund. The amendment refers to a pension - and a provident preservation fund. The **sole purpose** of such fund shall be

- 4.1.1 preserving any amount derived from a pension or provident fund, pending transfer to another approved fund or withdrawal, and
- 4.1.2 where any amount is still in the fund at retirement, for the purpose of providing annuities or lump-sum benefits for members, widows, children, dependents or nominees of deceased members, **or mainly for such purposes**, and also for providing benefits other than annuities or lump-sums.

Contributions are to be by way of transfer within the year of assessment or three months thereafter. As for a pension fund, not more than one-third of any annuity may be commuted for a cash lump-sum, unless the value of the annuity was less than N\$ 20,000.

Once the annuitant or pensioner dies, no further benefit other than annuity shall be payable.

A member may only withdraw capital within three years of the transfer of capital into the preservation fund.

The capital may be transferred from the preservation fund to any one or more pension -, provident – or retirement annuity fund.

Retirement shall not be prior to age 55 or after age 70, unless in the event of ill-health/infirmity.

The board of trustees is to be appointed by the fund’s administrator .

The rules of the fund must be complied with and the fund must be registered under the Pension Funds Act.

## 4.2 Commentary

Since a preservation fund was previously not recognized by the Income Tax Act, all preservation funds were approved for tax purposes either as a pension – or as a provident fund. The relevant rules would therefore have had to comply with the appropriate definition in the Income Tax Act. A pension preservation fund could thus offer payment of the balance of a pensioner’s capital in the event of death of the pensioner or annuitant. The new definition now makes it quite clear that only an annuity can be paid from the balance of the capital in the event of the death of a pensioner or annuitant. Where a pensioner or annuitant leaves neither a spouse nor a dependant nor a nominee, any pension still payable would have to be paid to the estate. If no pension is payable but a balance of the original capital is still available, there is no provision that this balance can be paid out. Again this is an anomaly which will hopefully be addressed by Inland Revenue. Preservation funds no longer require participation of an employer, as would have previously been required, which brings an administrative relief.

As pointed out earlier, paragraph ( c ) of the definition of “gross income” includes any benefit from a provident fund and from a preservation fund (be it a provident – or a pension preservation fund) in gross income. The definition of “preservation fund” allows a maximum commutation at retirement (be it ill-health/infirmity -, early-, normal – or late retirement) of the larger of one-third of the value of the annuity or N\$ 20,000. (Although not specifically stated, as a result of the combination of the definition of the two different types of fund within a single definition, the legislator’s intention is presumably that the restriction on the commutation of an annuity would only apply with regard to the pension preservation fund and not the provident preservation fund. This can probably be challenged based on the definition as it currently stands). In terms of paragraph (c) of the definition of “gross income”, the commutation of an annuity from a preservation fund and all other benefits are taxable unless specifically exempted by the Act elsewhere. This could be withdrawal benefits, death benefits, disability benefits, or retirement benefits paid by a provident preservation fund. In terms of paragraph (dD) referred to in paragraph 2.1 above, however, only certain amounts are to be included as “gross income”. Turning to section 16 (1)(z), it becomes evident that the following amounts are exempted, all other amounts thus being taxable

- One-third of any lump-sum derived from a provident fund upon retirement, death or disablement (or as specifically stated by the act, “...other than upon resignation, dismissal or dissolution of the fund.”).
- One-third of any lump-sum derived from a provident preservation fund upon retirement or death (interestingly, the exempt amounts are specifically identified in this case and do not have to be arrived at by deduction). Therefore, unlike the case of a provident fund and as pointed out in paragraph 2.2 above, lump-sums derived from a provident preservation fund upon disablement would not be taxable.

As the Act now reads, following the amendment under discussion, the pension preservation fund is at a significant disadvantage from the tax point of view, since all benefits are fully taxable, except to the extent that they do not exceed N\$ 100,000 under circumstances where the taxpayer is entitled to the tax-free gratuity in terms of section 16 (1 )(o). The provident preservation fund now appears to offer an exemption in terms of section 16 (1)(z) (i.e. one-third of certain lump-sums), set out above, as well as in terms of section 16 (1)(o) (i.e. the tax-free gratuity of now N\$ 100,000), under certain circumstances. We have pointed out earlier that this aspect is likely to be addressed by the Receiver of Revenue, probably by the addition of ‘provident’ and ‘preservation fund’ to the proviso of paragraph (c ) to the definition of “gross income”, which should then remove most of the anomalies referred to above.

In terms of the new definition, a member may, within the first three years of transfer of the capital to a preservation fund, withdraw as often and as much of the capital in the preservation fund as he/she likes. No further withdrawals are allowed thereafter. Such withdrawal benefit will be taxable in the year of assessment in which the capital was transferred, at the rate of tax which would have then been applicable.

## **5 Levy of normal tax for the benefit of the State Revenue Fund**

### 5.1 Overview

Section 5 (3), commonly referred to as the averaging formula, was amended as from 1 March 1998 to apply the average, rather than the marginal rate of tax, also to withdrawal benefits derived from a preservation fund and to benefits derived from a preservation fund upon dissolution of the preservation fund.

### 5.2 Commentary

All other lump-sum benefits not exempt from income tax upon death, disablement and retirement (refer to paragraph 4 above) and any annuities or pensions are thus taxed at the marginal rate of tax. While benefits derived from a provident fund are treated in the same fashion, any lump-sum derived from a pension fund upon death or disablement is still fully tax-free.

## **6 Certain amounts to be included in income or taxable income**

### 6.1 Overview

A new subsection (6) was introduced to section 14 of the Act as from 1 March 1999 in terms of which any amount withdrawn from a preservation fund and not transferred to a pension -, provident – or retirement annuity fund, will be included in taxable income in the year in which the original benefit was exempted from tax on the grounds of its transfer to the preservation fund.

## 6.2 Commentary

The intention of this section appears to be to prevent the taxpayer from using a preservation fund to manipulate his/her effective rate of tax through the temporary transfer of the benefit to the preservation fund. As pointed out in 4 above a taxpayer can only withdraw funds from a preservation fund within the first 3 years.

## **7 Circumstances in which amounts deemed to have accrued from sources within Namibia**

### 7.1 Overview

A new subsection (3) has been added to section 15 as from 1 March 1999, in terms of which any annuity voluntarily purchased by a person ordinarily resident in Namibia, from an insurer in terms of section 16.B, will be taxable in Namibia, wherever such annuity contract was entered into and wherever the annuity is payable.

### 7.2 Commentary

With the promulgation of the Long-term Insurance Act 1998, all insurers operating in Namibia were required to separate their Namibian business from the other business on a prescribed basis. Essentially, policyholders were under certain circumstances given a choice as to where their policies were to be domiciled. This amendment is presumably aimed at preventing such policyholder to evade tax in Namibia on the grounds of the source thereof being in South Africa. However, as will be referred to in paragraph 10 below, section 16 (1)(z)(ad) offers an exemption where it can be proven that the capital invested in the annuity in fact came from outside Namibia.

## **8 Exemptions – Lump-sum received from termination of office or employment**

### 8.1 Overview

The maximum tax-free, once-in-a-lifetime gratuity a taxpayer is entitled to claim in terms of section 16 (1)(o), has been increased from N\$ 50,000 to N\$ 100,000 as from 1 March 1999.

### 8.2 Commentary

The amounts in respect of which this concession is granted are reflected in paragraph (c) of the definition of “gross income”. As pointed out earlier, this by implication includes any amount received from any provident fund or preservation fund, besides those amounts specifically referred to in the definition.

## **9 Exemptions – Lump-sum derived from an approved fund which was transferred to another fund**

### 9.1 Overview

Section 16 (1)(z) has been amended as from 1 March 1998 to firstly, also cover amounts received from a preservation fund or amounts transferred to a preservation fund, to secondly, remove the previous anomaly that this exemption only applied where the full benefit was transferred and to thirdly, clarify that this exemption does not apply where the amount can be claimed as a deduction of current contributions to a pension -, provident – or retirement annuity fund.

### 9.2 Commentary

The reference to preservation funds in this section is a logical outflow of the introduction of the new concept of a preservation fund. A major problem was often experienced in the past where an employee still owed the fund an amount in respect of a housing loan granted, upon his resignation from the fund and where his full benefit would have been taxed whether or not the employee intended to preserve the balance of his/her benefit in the fund. This problem has now been alleviated. The amendment also now prevents the taxpayer from claiming the same amount twice, i.e. as a transfer to another fund and as a current contribution.

## **10 Exemptions – Annuities paid by an insurer outside Namibia**

### 10.1 Overview

A new subsection (ad) was introduced to section (16) (1)(z) as from 1 March 1999, in terms of which a voluntary annuity purchased from an insurer outside Namibia and paid by the insurer outside Namibia will be tax exempt, if it can be proven that the capital originated from outside Namibia.

### 10.2 Commentary

A voluntary annuity is an annuity not purchased with capital derived from a pension -, retirement annuity – or pension preservation fund, the latter more commonly being referred to as ‘compulsory annuities’. However, if capital which was derived from a provident fund or a provident preservation fund and applied to purchase an annuity from an insurer, such annuity will be a ‘voluntary annuity’, since the capital is effectively an after tax receipt.

## **11 Exemptions – Receipts and accruals of foreign funds**

### 11.1 Overview

A new subsection (ae) was introduced to section (16) (1)(z) as from 1 March 1999, in terms of which receipts and accruals of pension -, provident -, preservation – and retirement annuity funds managed and controlled outside Namibia, are tax exempt, if such fund is substantially similar to a similar type of fund in Namibia and if there is a reciprocal arrangement in the legislation of the relevant country.

### 11.2 Commentary

This amendment was essentially in response to a similar clause having been introduced into the South African Income Tax Act, which would have affected Namibian funds investing in South Africa.

## **12 General deductions allowed in the determination of taxable income**

### 12.1 Overview

The aggregate that may be deducted by a taxpayer in respect of recurring contributions to a pension - , provident - , retirement annuity fund or ‘study policy’ has been increased from N\$ 20,000 to N\$ 30,000 as from 1 March 1999, through amendment of section 17 (2)

### 12.2 Commentary

The increase in the maximum tax deductible contribution will not doubt be welcomed.

## **13 Responsibility to submit income tax returns**

### 13.1 Overview

Section 56 (1) has been amended from 1 March 1998, whereby the due date for submission of income tax returns has been changed from 120 days to four months after the end of the year of assessment. In addition, section 56 (3) now provides that as from 1 March 1997 the Minister has the discretion to extend the due date for submission of returns or payment of any tax due.

Section 56 (5) was furthermore amended as from 1 March 1998, whereby employees who would have not been required to submit a return, will be assessed on the tax certificate issued by the employer.

## 13.2 Commentary

This amendment introduces a more practical due date and legislates past practice, although the discretion was applied rather hesitantly in the past and will hopefully be applied more freely in future.

As far as the previous final tax arrangement is concerned, the Receiver has now opened himself a back-door to raise additional tax and penalties where necessary, but has at the same time created the opportunity for taxpayers to have their tax liability recalculated.

## **14 Schedule 2 – Payment of provisional tax**

### 14.1 Overview

Section 18 of schedule 2 has been amended as from 1 March 1999 in terms of which any income subject to the payment of provisional tax will now be exempted from the payment of provisional tax, if the amount does not exceed N\$ 5,000.

### 14.2 Commentary

The previous limit of N\$ 1,000 has been in force for many years and created an unnecessary and increasing administrative burden on the taxpayer and the Receiver of Revenue.

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