Appendix 1

Background Information

Macro-Economic Overview

Macro-Economic Structure

The structure of the Namibian economy is still characterized by a relatively high share of primary production (especially mining), although that share has decreased substantially since independence. A rough picture of the country's production structure is provided by the contributions of the main sectors to GDP (Table 4 below).

Table 4: Percentage Contributions to GDP in Current Prices

	1985	1990	1995	2001
Primary sector	33.9	27.1	19.1	21.7
Of which: mining	25.7	16.4	8.3	13.0
Secondary sector	13.5	15.7	16.4	14.2
Of which: manufacturing	9.5	11.5	11.5	9.1
Tertiary sector	46.9	50.6	54.0	54.8
Of which: government serv.	17.5	19.3	21.9	21.0

During the first half of the 1990's, Namibia experienced real GDP growth of close to 5 percent per year. Production increased strongly in the secondary and tertiary (services) sectors. Dependence on the primary sector (mining, fishing and farming), which had accounted for more than 30 percent of the total in the 1980's, was brought down to less than 20 percent of GDP. To some extent the decreasing share of primary production had to do with relatively slow growth in output. The main factor, however, was lower export prices for diamonds and other minerals.

Growth has slowed considerably since 1995, and especially during the last two years. The average growth rate for the period 1995-2001 is only 3.1 percent as against 4.8 percent for 1990-1995. At the same time, the trends in the production structure appear to have been reversed to some extent, most notably with a strong increase for the mining sector's share in total production. Growth rates in volume terms and in current prices for the two periods are compared in Table 5 below.

Table 5: Production Growth in Constant and in Current Prices

Average yearly growth rates in percent	1990 – 1995		1995 – 2001	
	Constant prices	Current prices	Constant prices	Current prices
Primary sector	3.8	6.9	1.1	15.9
Of which: Mining	3.7	0.3	0.9	21.8
Secondary sector	4.3	15.5	3.0	10.9
Of which: Manufacturing	3.8	14.6	2.2	8.9
Tertiary sector	5.7	16.2	3.5	12.8
Of which: Government services	5.9	17.4	2.9	12.6
Gross Domestic Product (GDP)	**4.8**	**14.1**	**3.1**	**13.2**

Production growth in real (constant prices) terms has decreased substantially in all sectors after 1995. Primary industries, however, show the lowest average growth rate – around 1 percent per year. In spite of its low volume growth, this sector of the economy, and especially the mining sub-sector, now has by far the highest growth rate in monetary (current prices) terms. Substantial price increases, especially for diamonds, have made the primary industries the fastest growing sector in monetary terms over the last few years. This price trend also explains the rising share of the primary sector in total GDP as registered in Table 1 above.

The fact that export prices for primary products have increased considerably faster than the domestic price level has partly compensated for the effect on incomes and purchasing power of low production growth. It also has had a favourable impact on government revenue. At the same time, it has to be noted that such reliance on a high price level for

raw materials makes both purchasing power and government revenues highly vulnerable to fluctuations in international markets.

Changing structural trends are also evident in the growth pattern, as seen from the demand or expenditure side. Private consumption increased more slowly than GDP between 1990 and 1995 but has increased considerably faster after 1995. Government consumption shows the opposite pattern – strong growth in the first phase after independence has changed into more moderate growth after 1995. Fixed investment has increased strongly over the whole period, but it can still be argued that the investment share of GDP (22 percent in 2001) is not very high.

Exports have shown an unstable pattern, where price changes have, to a large extent, compensated for dramatic fluctuations in volume growth. Between 1990 and 1995, the export volume increased by close to 10 percent per year, but its share of GDP did not increase due to unfavourable development in international prices. Namibia's terms of trade deteriorated by almost 6 percent per year on average during this period. After 1995, volume growth has been close to zero or even negative, but rapidly rising export prices and improving terms of trade have eliminated most of the effect on incomes and the balance of trade. Namibia's external transactions still register a surplus on current account, but this surplus has shown a tendency to decrease in recent years.

Savings

Gross domestic savings expressed as a percentage of GDP have increased somewhat, from 18-19 percent in the mid 1990's to 20 percent as an average for the last three years. At the same time, the trend has been downward for gross national savings (which includes Namibians' savings outside Namibia, but excludes savings of foreigners in Namibia). From around 27 percent of GDP in the mid 1990's it has declined to 22.5 percent as an average for the last three years.

The higher percentages for gross national savings reflect the fact that much of the savings made by Namibians have found their way to other countries. Namibia is a capital

exporting country, whose economic problems have less to do with lack of savings than with insufficient investment and job creation within the country.

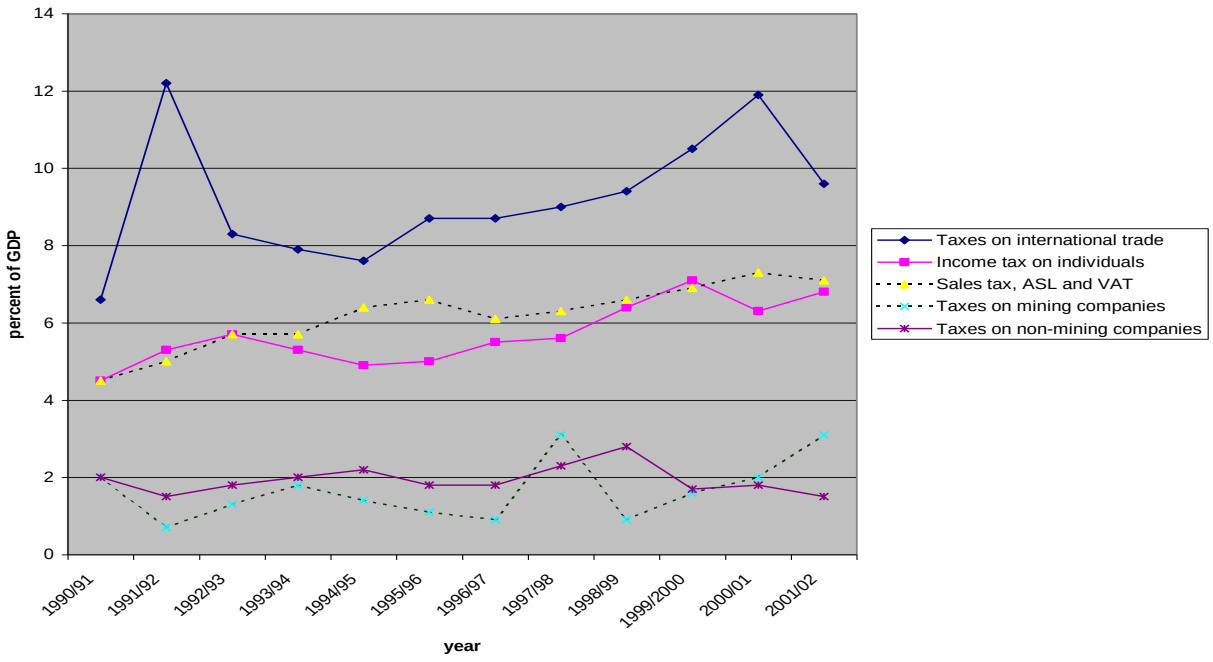
Tax Revenue

The Namibian tax system has been kept relatively unchanged over the last five years, except for two major reforms:

1. Value Added Tax (VAT) was introduced towards the end of 2000, replacing the earlier Sales Tax and Additional Sales Levy;
2. The major part of the fuel levy was taken out of the tax system in fiscal year 2000/01 and is now a levy paid into the Road Fund.

In addition to customs and excise revenue from the South African Customs Union (SACU) pool, the major components in the tax system are income tax on individuals, company taxes and VAT. Those tax and customs categories together account for approximately 95 percent of total tax revenue. Other items such as non–resident shareholders tax and taxes on property (transfer duty), play a limited role. Figure 1 below shows the development since 1990 of the major tax categories.

Figure 1: Tax Revenue (Percentage of GDP)



As shares of GDP, most of the major items have shown a rising trend over the period under review. Total tax revenue has increased from less than 25% of GDP in 1990/91 to 30.5 % as an average for the last three years. It has also considerably increased its share of total government revenue – from around 80 percent in the early 1990's to more than 90 percent in recent fiscal years. Non-tax revenue and grants have decreased considerably in real (constant prices) terms and as a share of GDP.

Customs and Excise Duties (termed taxes on international trade in diagram 1 above) represent Namibia's share of the SACU pool and have accounted for the largest share of revenue. They have shown a rising trend in percent of GDP during most of the period. Present projections, however, point to declining revenue in real terms from this source over the next few years. Negotiations have been going on for a number of years between SACU member countries with the aim to reform the formula for dividing customs and excise revenue between the countries. An amended agreement has recently been signed. While it does provide Namibia with some discretion to protect infant industries, it does not allow Namibia to autonomously amend excise duties, or vary its share of customs duties which are shared on a formula basis.

Income tax on individuals accounts for almost a quarter of total tax revenue. It has shown a rising trend as a share of GDP, especially between 1994 and 1999. The tendencies for the last two years appear somewhat ambiguous, but together with preliminary figures for the first part of 2002/03 they seem to indicate stabilization at a GDP-share around 7 percent.

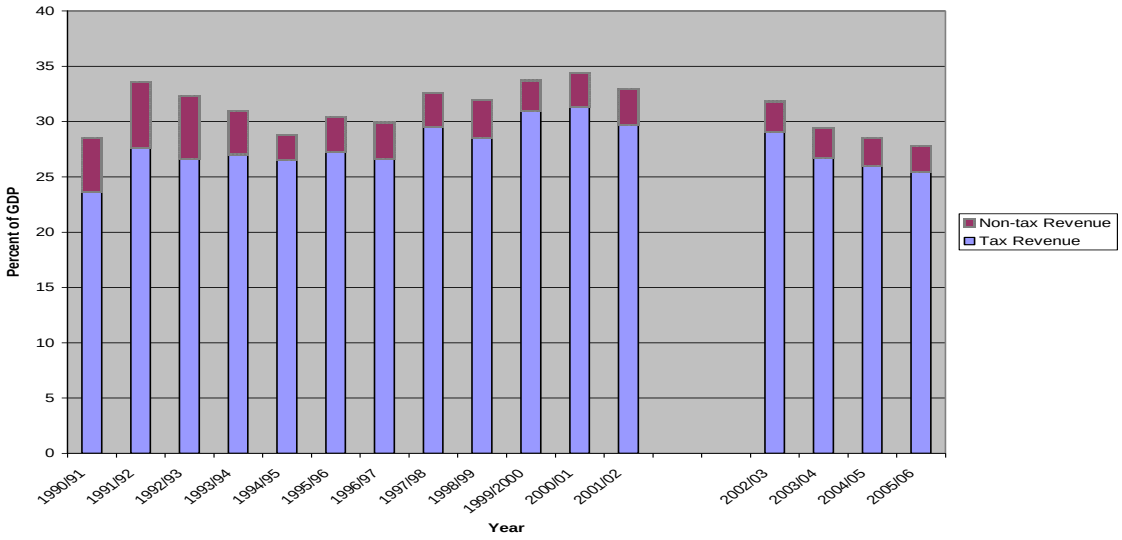
Sales taxes and VAT also account for almost a quarter of total tax revenue and have registered very steady growth over the whole period, from 4.5 to 7 percent of GDP. Due to the relatively stable development of its tax base (consumption expenditure), VAT can be regarded as the most reliable and predictable of the major tax items.

Company taxes exhibit a considerably more volatile pattern. Tax on non-mining companies is the only tax item that shows a decrease as a percentage of GDP over the

period under review. This tendency has been most notable over the last few years. At the same time, tax revenue from mining companies (especially diamond mining companies) has increased strongly, and that tendency appears to persist in the current financial year. As pointed out earlier, however, these taxes are a volatile and unreliable revenue source in the medium term, as they are strongly exposed to international price fluctuations.

As already mentioned, total tax revenue has been relatively high over the last three years – close to or above 30 percent of GDP. Temporary factors, such as high export prices for diamonds and other minerals as well as high revenue from the SACU pool, have contributed to this. It is projected that tax revenue as a share of GDP will decrease over the next few years (see Figure 2 below). These projections are those supplied by government based upon the existing tax legislation.

Figure 2: Government Revenue from Own Sources (% of GDP)



Government Expenditure

Commenting on government expenditure is outside of the Terms of Reference of this report. However, without a brief synopsis of the current expenditure breakdown, the macro-economic overview would be incomplete.

Government expenditure, as a share of GDP, has increased steadily – from 31% in 1990/91 to 38% percent in 2001/02. The projected downturn in revenue, described in Figure 2 above, strongly affects the scope for future expenditure growth, and this is further aggravated by a decreasing tendency in international donor support. As a consequence, Cabinet has decided that total government expenditure should be reduced gradually to 30 percent of GDP. This will make it possible to stabilize the budget deficit at a sustainable level of close to or below 3 percent of GDP.

In a function-oriented classification of government expenditure, the high share for education in Namibia is probably the most striking feature. Expenditure shares for some major sectors in the budget for 2002/03 are presented in the following table.

Table 6: The Composition of Government Expenditure 2002/03

	% of total exp.	**% of GDP**
Operational expenditure		
Social services	36.0	12
Of which: Basic Education, Culture and Sport	19.1	6.6
Higher Education, Training and Employment	3.6	1.2
Health and Social Services	12.7	4.4
Administration	21.0	7.0
Of which: Finance	11.2	3.9
Public safety	15.0	5.0
Of which: Defence	7.1	2.5
Police	5.6	1.9
Economic services	7.0	2.0
Infrastructure	3.0	1.0
Development Budget	11.0	4.0
Statutory expenditure	7.0	2.0
Total Expenditure	**100**	**34.5**

Personnel expenditure shows a strong increase over the whole period. The same holds for subsidies and transfers, which include transfers to households, but also the rapidly increasing financial support to State-Owned Enterprises. Interest payments for the servicing of government debt have been steadily increasing. Government debt now stands at 26 percent of GDP – up from around 20 percent in the mid 1990's.

Evolution of the Post-Independence Tax System

The main characteristics of the Namibian tax system that were inherited from South Africa at independence are:

- An income tax levied almost exclusively on labour
- A source (and deemed source) based income tax
- A substantial body of decided (mostly S.A.) tax cases
- A heavy reliance on the SACU pool
- The inability of Namibia to autonomously adjust customs duties and excise taxes

The evolution of Namibia's post-independence tax system has been subject to the incremental adjustment of various taxes, without a comprehensive and coordinated reform of the whole system being conducted.

The *1990/91 Budget* acknowledged the country's budget constraints and the fact that people were already heavily taxed in Namibia:

> *"The question may be asked why at this stage increases in the rates of taxation have not been suggested for the financing of budget deficit. In the first place, Namibia is already heavily taxed. International experts maintain that our taxation level compares with that of a developed country. Sales tax increases have been suggested, but as sales tax is regressive and affects the poorer sector more than the wealthier, it appears not to be the ideal tool for raising revenue. Company tax is at present already at a high level and increases at this stage would not be conducive to economic development and the investment climate that the government is trying to create and would, in any case, be counter-productive. Personal tax is also very high and the problem of 'fiscal drag' is making life*

difficult as it is. On the other hand, our public finance position does not allow us to decrease taxation as is so often suggested. Increased demands for finance by the new requirements of a (newly) independent country are difficult to reconcile with reduced revenues from taxation."

The *1991/92 Budget* addressed two important questions: (a) was the tax system that the new government of Namibia inherited adequate? and (b) if changes were needed in the tax system, what forms should such changes take? The Budget acknowledged the fact that piecemeal adjustment of single tax instruments could not create the additional revenue that was needed to address the budget deficit. What was required was a comprehensive and coordinated set of tax measures, which included adjustments in the tax instruments and their administration.

Measures that were introduced in the interim years included:

- Reduction of marginal tax rates and simplification of the tax scales, in an effort to counter *fiscal drag*.
- The threshold for the payment of income tax has been increased, first from N$ 5 000 to N$ 10 000 and then to N$ 20 000.
- Making premiums paid towards educational insurance policies tax-deductible up to a total of N$30 000 per annum for such premiums together with life insurance premiums.
- Easing of tax on housing fringe benefits, as part of a strategy to address the problem of home ownership.
- Exemption from income tax of dividends accruing to individuals. This proposal was aimed at creating an incentive to invest locally rather than on foreign stock exchanges.
- Reduction of the company tax rate from 42 percent to 35 percent.
- Abolition of the *undistributed profits tax,* which was considered misdirected and unproductive of revenue.

- Phasing in of write-off provisions over a period of three consecutive years, instead of complete write-offs in one year.
- Definition and implementation of tax rates for different categories of mining activities.
- The putting in place of a number of tax incentives for manufacturing enterprises, to promote manufacturing in the economy.
- Exempting from tax 80 percent of profits arising from the export of manufactured goods (excluding manufactured fish and meat products). This provision is in addition to the existing package of incentives for manufacturing and it applies also to re-exports,
- Removal of the exemption of parastatals from income tax, to broaden the tax base.
- Introduction of new livestock values for the purpose of taxing farm income more accurately.
- Reduction of non-resident shareholder's tax rate from 15 percent to 10 percent, to attract foreign investment.
- An increase in the rate of sales tax to 11 percent, with maize-meal and *mahangu* exempted to protect poorer sectors of population.
- The *1993/94 Budget* introduced an additional sales levy (ASL) on identified non-essential (luxury) goods. The ASL was to be levied in addition to the sales tax already being levied. This allowed a reduction of the rate of sales tax, from 11 percent to 8 percent. (Since ASL rate ranged between 0 percent and 15 percent, for most luxury items the effective sales tax was (8 + 15 = 23 percent).
- Substituting Value Added Tax (VAT) to replace the GST/ASL.
- Introduction of an additional tax on fuel, earmarked for the road fund.
- An increase in the rate of interest charged on outstanding tax, from 15 percent to 20 percent, to discourage delays in payments.
- An increase in the tax administration budget, to ensure that taxes were correctly charged and collected.

Appendix 2

Principles Relating To Tax Policy Design

Objectives of and Reasons for Taxation

Public commitment by a government has two fundamental purposes: *first,* to provide for collective services and *second,* to create a redistribution of income as a counterweight to the uneven distribution in a free market economy. Economic policies in developed countries concentrate on the two concepts of efficiency and equity. Differences with regard to actual policies have their origin in diversity in political values, traditions and probably also institutions, resulting in different ways of balancing these two concepts.

It is also possible to recognize a tension between efficiency and equality. In a given society there exists a point beyond which the demand for equality cannot move without consequences in the form of economic losses due to diminished efficiency. In some instances there exists a positive correlation between equality and the rate of economic growth. This correlation is most obvious in developing countries with great differences in income and wealth. An equalization of living conditions could result in more people participating in the development of the society. An extremely high concentration of wealth tends to lead to nepotism and corruption, which do not favour development of efficiency in a society.

The tax system normally has four main purposes:

- Funding of public expenditure
- Stabilisation of the economy
- Redistribution of income
- Influencing the allocation of resources.

Principles Related to Tax Policy Design

Most taxes influence the choice of alternatives that exist for households and businesses and thereby affect the efficiency of the economy. In some cases these effects are intended – e.g. fuel and energy taxes that limit emission of greenhouse gases. But taxes may also result in unintended consequences and efficiency losses, and that is the basis for the idea of *Optimum Taxation*, a tax system constructed in a way to minimise such losses. According to this theory, taxes should be imposed on those objects which are the least affected by changes in prices. For instance, the tax rate should be higher on necessity consumption such as food and clothing and lower on tourism and entertainment.

A tax with the purpose of redistributing income should – contrary to the idea of Optimum Taxation – result in lower tax rates on goods primarily consumed by individuals with low income than on goods primarily consumed by those with high income. The purpose of redistribution is most prominent within taxation of income from employment and capital.

The principle of *Uniform Taxation* aims at taxing alternative sources of income as uniformly as possible. High tax rates on salary income and low taxes on capital income may induce individuals to try to transform income from employment into income from capital and vice versa. The Swedish Tax Reform in 1990 represents an effort in this direction. The tax rates on ordinary income from employment, income from capital and corporate income were set at the uniform level of 30 per cent.

Adam Smith's canons of taxation form the foundation of a good tax system since they are still widely accepted as providing a good basis on which to judge taxes.

According to Adam Smith, a good tax should meet four standards: **equality, certainty, convenience and economy**. These four standards or canons together with a number of later additions by modern economists form the basis of what is considered to be a good tax system for Namibia.

Modern economists have added the following three more canons to those of Adam Smith:

- A tax must not hinder efficiency or should involve the least loss of efficiency
- A tax should be compatible with foreign tax systems (in Namibia's case, with those of other SADC countries)
- Tax should automatically adjust to changes in the rate of inflation (particularly important in high inflation economies)

Equity

The *first* canon of **equality or equity** has been stated by Adam Smith as "the subjects of every State ought to contribute towards the support of the government, as nearly as possible, in proportion to the revenue which they respectively enjoy under the protection of the State. In the observation or neglect of the maxim consists what is called the equality or inequality of taxation." This means that the tax paid should be a fixed proportion of the income which a person enjoys under the protection of the State. However, he points out that richer citizens should not pay taxes in proportion to their wealth, but more than in proportion, which means progressive taxation. Modern economists tend to agree with this latter view that the canon of equality calls for progressive taxation.

According to Smith, horizontal equity and vertical equity respectively require the equal treatment of similar incomes and an appropriate degree of inequality in the treatment of different incomes.

Vertical equity reflects the notion that individuals with more tax paying ability should pay more tax than those with less. The concept is uncontroversial as a generalisation. However, the ideal degree of progressivity of the tax system is subject to diverse views. As a taxpayer's ability to pay increases, whether evaluated on an income or consumption basis, graduated tax rates result in a tax liability that rises in percentage terms as income rises. This shift distorts resource allocation and lowers economic efficiency, forcing a trade-off between vertical equity and the efficiency / growth criteria for an economy. No such conflict arises between horizontal equity and economic performance. The tension between these two objectives should therefore be carefully managed.

Horizontal equity refers to the extent to which individuals with similar resources and ability to pay taxes, bear the same taxes. If one sees two individuals' identical lifetime labour earnings as making them similar in ability to pay, then the pursuit of horizontal equity requires that they bear the same total tax burdens over their lives. The relative stability over time of individuals' incomes affects the horizontal equity of different tax bases. If two individuals have the same average income over a period longer than a year, their exact annual patterns should not matter. Over the longer period, they have the same tax paying ability and should bear the same total taxes. However, a progressive tax rate schedule applied on an annual basis, without provision for averaging, penalises those with fluctuating incomes relative to others with a more stable pattern. This outcome is inequitable and discourages individuals from choosing occupations or activities with variable income, such as entrepreneurship and self-employment.

There are differences of opinion among economists as to whether consumption or income should be the index of equality. However, there seems to be agreement among economists that, if income is selected, the concept of income should cover total accretions to wealth, meaning income in the ordinary sense and any kind of windfall.

The *second* canon put forth by Adam Smith is the canon of **certainty**. According to Adam Smith "the tax, which each individual is bound to pay, ought to be certain and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person. The certainty of what each individual ought to pay is, in taxation, a matter of so great importance that a very considerable degree of inequality, it appears, I believe from the experience of all nations, is not near so great an evil as a very small degree of uncertainty." Certainty is achieved by formulating rules indicating the method and manner in which tax is to be collected.

The *third* canon of Adam Smith is that of **convenience**. According to this canon "every tax ought to be so levied at the time or in the manner in which it is most likely to be convenient for the contributor to pay it." It implies that taxes should be imposed in such

a manner and at the time which is most convenient for the taxpayer, for example, the best time for the collection of taxes on consumable goods is at the point of purchase of such goods by the consumer.

The *fourth* canon of Adam Smith is that of **economy**. According to this canon "every tax ought to be so contrived as both to take out and keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the State." This canon aims at keeping the administrative cost of tax collection minimum, that is, the difference between the money, which comes out of the pockets of people and that which is deposited in the public treasury should be as small as possible.

Appendix 3

Tax Bases

World-Wide (Residence) or Source

Namibia levies income tax on income and profits derived from a Namibian source, and on certain other income deemed to be from such a source. Namibia's major trading partner, South Africa, has recently moved to a residence based system.

Many of the factors considered in South Africa, when that country changed from source to residence, confront Namibia too. Some of them are listed below:

Recent South African History of Investigations

In 1986/87 the Margo Commission[1] recommended that the source basis should be retained, with some broadening of the deeming provisions. It mentioned two factors that might in the future tip the balance towards a residence basis:

- The lifting of exchange controls
- The "independent national states", and to some extent the existence of other countries in the rand monetary area, exposed the system to schemes of avoidance.

On the other hand, in favour of retaining the source basis were:

- The complexity of a residence system
- In terms of Double Taxation Agreements and international convention, credits would in any case need to be granted for foreign taxes already paid on income that was flowing into South Africa from off-shore.
- The yield on the "foreign take" would be reduced as and when South Africa reduced its tax rates so as to align itself with its trading partners.

[1] *Report of the Commission of Inquiry into the Tax Structure of the Republic of South Africa* (The Margo Report), RP34/1987 (Pretoria: The Government Printer 1987), para. 26-3.

The factors that the Katz Commission took into consideration in its 1997 Fifth Interim Report as having a bearing on an appropriate system for South Africa included the following:

- An open economy – integration of the economy with the global economy
- Protection of financial capital and human skills
- Exchange controls
- Capital flows – regardless of short-term flows induced by a relaxation of exchange controls, South Africa, as a developing country was likely to remain a net capital importer. However, it will be subject to the international phenomenon of the increased mobility of capital.
- Regional headquarters base - the source based system positioned the country well as a head office, finance or management company location for investment into Africa, north of the country's borders.
- Treaty network – the nature and extent of the treaty network have an important impact.

The Commission recommended that that the source system be maintained, but that the deeming provisions be widened.

Policy Issues for Consideration in Namibia

Generally, investor countries tax on a worldwide basis whereas an investee country, which is still developing, uses the source or territorial basis of taxation. No country in fact has a pure source or residence system. Countries with a source based system tend to deem certain categories of income as being sourced in their jurisdiction. Countries with residence based systems in turn exclude certain categories of the income of their residents.

From the perspective of *revenue collection*, adopting a residence or source based system will probably make little difference as regards direct investment in Namibia, but as regards *passive* investment income, will bring a revenue collection advantage (initially

anyway). This benefit has already been achieved by the use of a deeming provision in Section 16(1) (r) of the Namibian Income Tax Act No 24 of 1981.

With regard to *active* business income, it must be questioned whether the relaxation of exchange controls has or will cause tax-opportunistic export of capital. South Africa has seen and is lamenting the relocation of some of its large companies to foreign bourses, for competitive and investment reasons. It is not seen as a risk to the Namibian economy that Namibian companies will seek to list on foreign bourses.

With Namibian exchange control regulations following South Africa's, it must be asked what the appropriate response is to the relaxation of controls? South Africa has opted for a residence based system. Relaxation of exchange controls does leave Namibia vulnerable if its residents end up having large sources of foreign income in years to come. However, Namibia has, as mentioned above, used deeming provisions in the case of foreign interest income for domestic companies and resident individuals.

One of the objectives that are sought in tax policy formulation is neutrality. Neutrality refers to the absence of unfair advantage of foreign businesses operating in Namibia and Namibian business operating abroad. Pursuit of this neutrality within a residence system is complex, onerous to achieve and therefore fails the simplicity test. South Africa has experienced this first hand in seeking to draft legislation that ensures South African companies competitive neutrality. A source-based system on the other hand leaves the international flow of commerce and capital unaffected and favours developing nations in their pursuit of investment.

Examples of some of the legislative *complexities* that face the architects of a residence system include:

- Exempting Namibian companies operating abroad from Namibian tax if they pay foreign tax of a roughly equivalent amount in their country of operation so as not to penalise them in the pursuit of their trade.

- Trying to account for the tax liability arising from indirect foreign income of their residents via foreign entities – usually non-resident companies, partnerships or trusts.
- Distinguishing the above from portfolio holdings.
- Limiting transfer-pricing activities between residents and foreign entities that they might control.
- Monitoring (and, if necessary, challenging) financial reporting of foreign entities.
- Administering rebates for foreign income taxes paid by residents

From the perspective of *protecting the Namibian capital base* it has to be stressed that moving to a residence system places the taxing country in a far more competitive tax policy framework than remaining with a source base. Said differently, it exposes the country to competitive influences far more ruthless with regard to tax rates, and even neighbours who may use a source basis. This is mitigated by the fact that personal income tax levels are lower in Namibia (max. marginal rate 36%) than South Africa (max 40%). Internationally mobile individuals are far more likely to feel comfortable with exposing themselves to a source-based system. Rather than concern itself with the competitiveness with respect to a residence system, it may be more effective for Namibia to remain with a source-based approach in order to protect its capital base. Deeming provisions where necessary could be expanded.

A source based system favours Namibia as a base for investment into the rest of Africa. South Africa's move to a residence-based system further improves these prospects from a competitive perspective. South Africa's more ambitious, world-wide system was phased in by first taxing all passive income and later switching to a full residence system. It has, we believe, placed Namibia in a strong competitive position. The advantages of being seen as non-aggressive towards foreign income can have marked advantages for foreigners considering becoming resident in Southern Africa. It is foreseeable that South African entrepreneurs might be attracted to settle in Namibia if certainty is seen to exist surrounding this policy issue.

We therefore recommend that the source-based income tax system be retained on the following grounds:

- It is simple to administer and holds no justifiable *revenue advantage* for Namibia in the foreseeable future.
- Namibia is free to expand its deeming provisions in the future and in any case has a *hybrid system at present*. A "source-plus" system therefore need hold no disadvantage over a "residence-minus" system.
- *Policing* the payment of taxes on foreign income that a Namibian company may generate abroad is complex and we believe beyond the scope of what IRD should be focusing on in the medium term.
- *Policing* the indirect foreign income of residents is complex and of questionable advantage relative to this complexity.
- It is *investor friendly* and competitively attractive.

Estate Duty and Donations Tax

Despite the arguments that can be made against having another tax to administer, we recommend that in the absence of a Capital Gains Tax, an Estate Duty be introduced to help improve vertical equity in the Namibian tax system.

The mechanism should be kept simple, being levied at a flat rate of say 20% - 25% on the dutiable estates of ordinary residents. The dutiable estate of the deceased would be defined as follows:

The sum of:

- All property of the deceased at the date of death; and
- All property deemed to be property of the deceased at the date of death

Less:

- Deductions allowed, e.g. funeral costs, debts, approved charitable bequests

Less:

- An abatement in order to arrive at the dutiable amount.

The detailed structure concerning inclusions, exclusions and deductions should be set out in a separate paper if this proposal is accepted. However, we do recommend that in the interests of limiting the impact of this tax on the workload of I.R.D, a relatively high abatement on the net assets of the estate be set at say N$1,5m to N$2 million.

The administrative impact on IRD of Estate Duty should be minimal as the winding-up of estates is subject to supervision by the Master. It is estimated that (assuming an appropriate abatement), the administration of Estate Duty should require at most one or two individuals in the Windhoek Office of IRD.

Donations Tax

A donation is the obvious method of shifting wealth from one person to another, or from one generation to another, and thereby reducing the dutiable amount of one's estate. It is therefore recommended that if Estate Duty is introduced, a provision be made in the Income Tax Act for the levying of donations tax on donations made by persons ordinarily resident in Namibia or by domestic private companies. A donation can be defined as "any gratuitous disposal of property including any gratuitous waiver or renunciation of a right". The legislative amendments required for a Donations Tax should, upon acceptance of the Estate Duty recommendation, be introduced promptly in order to discourage opportunistic estate planning.

Appendix 4

Income Redistribution and Poverty Relief - A Universal Income Grant Combined with Indirect Tax Increases

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Proposal for a Development Grant to the Poor Financed out of a Progressive Expenditure Tax on the Affluent

Introduction

This appendix contains the Consortium's tax proposal to address the serious problem of poverty and income inequality in Namibia.

Following an extensive review of the relevant literature and an analysis of possible alternative strategies, we found that by far the best method of addressing poverty and inequality would be a universal income grant of at least N$70 per month to all Namibians of six years and older. This grant is to be financed out of an increase in indirect taxes earmarked for a universal income grant.

Provided that an effective delivery system can be implemented, such a grant funded by an increase in indirect taxes will:

- Significantly reduce absolute poverty levels
- Significantly reduce the degree of inequality, bringing the Gini coefficient down from 0.68 to 0.60
- Target those most in need without requiring a complex administrative system
- Be sustainable and affordable without retarding economic growth
- Avoid the negative consequences of alternative strategies to transfer income from the rich to the poor.

We found that a universal income grant financed out of indirect taxes will effectively offer a progressive anti-poverty grant to the poor, and impose a progressive expenditure tax on the affluent.

The Problem

In terms of income distribution, Namibia is one of the most unequal societies in the world. Nambia's Gini Coefficient (a measure of inequality), is about 0.68. Income inequality is thus worse in Nambia than it is in Brazil and South Africa - two countries infamous for their high Gini coefficients of just above and just below 0.60. Namibia's Gini coefficient is thus the highest measured Gini coefficient in the world

The Gini Coefficient measures a society's ratio of income inequality on a scale between 0 - 1. If all the country's income were earned by only one person, the Gini-coefficient of the country would be 1. If all income were equally distributed, the Gini co-efficient would be 0. The higher the coefficient between 0 and 1, the more unequally the society's income is distributed. With a Gini coefficient of 0.68 and a per person annual expenditure of N$9,735 it can be shown that the expected difference between the annual expenditure of any two randomly drawn individuals would be as much N$13,240.

In addition to the extreme disparities in income distribution, Namibia has a very serious problem of poverty. It is obviously important for a government to try to address this problem in a way that is sustainable, encourages investment and economic growth, and avoids the poor becoming dependent on the state (rather than seeking ways to become self-supporting).

Various countries have tried to reduce income inequalities through the tax system, but these attempts have often failed. Sometimes this is because the system enables the more affluent to pass the real burden of the increased taxes on to the poor. Sometimes the system encourages people to move their income generating assets into investments (or foreign countries) to avoid the increased taxes. Often the increased revenue does not result in increased benefits to those most in need because the additional revenue is spent on creating a new bureaucracy to administer the distribution of grants. This usually means that very little reaches the poor, for whom the money was intended.

We have devised our tax proposal to fund the universal income grant in a way that will avoid these negative consequences.

The Proposal

We recommend a grant of N$70 per month to every Namibian of 6 years and older, to be funded by increases in Value Added Tax (VAT) and preferably also increases in excise tax[2] and possibly also the institution of a bed tax or tourist levy. Every Nambian would receive such a grant until s/he becomes eligible for a state pension at 60 years.[3] In the case of children aged 17 or younger, the care-giver would receive the grant on behalf of the child.

Financing this grant will require an increase in VAT of about 6 ½% . It should be possible to also fund the grant through a proportional increase in excise taxes (eg on alcohol, tobacco, luxury motor vehicles etc.), and if some of it is funded out of a tourism levy, the VAT increase could be kept down to about 4 ½ %.

If every Namibian gets a state grant of N$70 per month and every Namibian pays an additional 6,7% in indirect taxes, it follows that every Namibian benefits from the grant, and every Namibian contributes to it. However, they do not do so in the same proportion. Those who spend more, contribute more through indirect taxes to the funding of the grant and benefit less from receiving the grant. Those who spend less, contribute less to the funding of the grant, but benefit more from receiving the grant. Our funding model

[2] Increases in excise taxes could, however, only be made with the agreement of the other SACU members.

[3] We recommend that the existing pension of N$250 be retained, and not, as has been argued in some quarters, replaced by a "means tested" pension. A means test is extremely difficult and costly to administer efficiently. If the recommendations of this report are accepted, the pensioners with a high per person expenditure will in any case be worse off, because of the increase in the indirect taxes. The pensioners with a low per person expenditure will probably be better off if our recommendations are implemented, because the other members of the household who at present also live off the pension, will then be receiving a grant.

shows that the wealthier will subsidise the poor to a very significant extent. Our model also shows that about 85% of Namibians will receive a grant that is worth more than the additional amount they pay in indirect taxes to fund it. Those who benefit the most will be the poorest 40% of the population. Furthermore the grant will target and benefit the poor, effectively transferring a larger nett benefit the poorer one is, without requiring the cumbersome bureaucratic application of a means tests.

If a person spends exactly N$1,040 per month (in an average expenditure pattern), the 6,7% increase in indirect tax is exactly equal to the N$70 received in a grant from the state. This person will neither gain nor lose from the grant or the tax. This is the break-even point. In a household of four with an average expenditure pattern, the break-even point, where the household gains as much from the grant as it contributes in tax, will be N$4,160.

Individuals who spend less than N$1,040 per month (in an average expenditure pattern) will gain more from the grant than they contribute in additional VAT. Those who spend more than N$1,040 per month will gain less from the grant than they pay in additional taxes to fund the grant. This form of tax is called a negative expenditure tax because below the break-even point, the person receives more back than s/he pays. A negative expenditure tax is, in fact, a grant to the poor. The lower the person's expenditure, the higher the grant will be. The higher a person's expenditure, the larger the additional tax burden both in absolute terms and as proportion of expenditure.

If the grant is also funded by increased excise taxes (on alcohol and tobacco and cars) those who spend a lot on these products will subsidise the grant to a greater extent. (This is difficult in Namibia's case, because excise taxes are determined by the SACU arrangement).

For example, a person who neither drinks, smokes nor drives expensive cars, will have a far lower "break-even" point of approximately N$580. When he spends more than this

amount, he will contribute more to funding the grant through additional taxes than the monthly benefit of N$70 he receives through the grant.

Conversely, a person who neither drinks alcohol nor smokes, will have a far higher "break-even" point of about N$1,460. Such persons will benefit more from the grant than they contribute towards funding it, if they spend less than N$1,460 per month.

The Assumptions

The funding model rests on the following assumptions:

- The poor, who receive a benefit from the grant, will spend the additional money they receive. This is very likely to happen as poor people generally use increases in their disposable income to fund their daily cost of living.

- Those who receive less from the grant than they contribute in VAT to the grant will maintain their existing expenditure levels. (Very similar results to those reported here will, however, be obtained even if the expenditure is cut back by half or by the full amount of the indirect tax increase)[4] The assumption that expenditure levels of the affluent will not be too dramatically reduced is only likely to hold if the increases in indirect taxes are not too high. The higher the grant, the higher the tax required to fund it, and the more this assumption will be open to question. For this reason we have proposed that the grant be limited to N$70 per month. If increased excise taxes are also used to fund the grant, it is easier to assume that people will not reduce their levels of expenditure significantly, because people using alcohol and tobacco products generally do not reduce their consumption because of increased costs.

[4] If the expenditure level increases with the full amount of the indirect tax increase, in other words, if expenditure is not cut back at all because of the tax increases, the increase in indirect taxes required to finance the grant is 6.7%. If, on the other hand, the affluent cut back on their expenditure levels by the amount that tax increases, so that the overall expenditure remains the same, then the increase in indirect taxes required will be about 7.1%. Assuming that the expenditure of the affluent increases by half the increase in indirect taxes, an increase of 6.9% in indirect taxes is required.

- The reduction in savings will not influence the rate of investment in Namibia. This is also a reasonable assumption to make, given the nature of existing savings and investments.

The system we propose can only be implemented successfully if three administrative conditions are met:

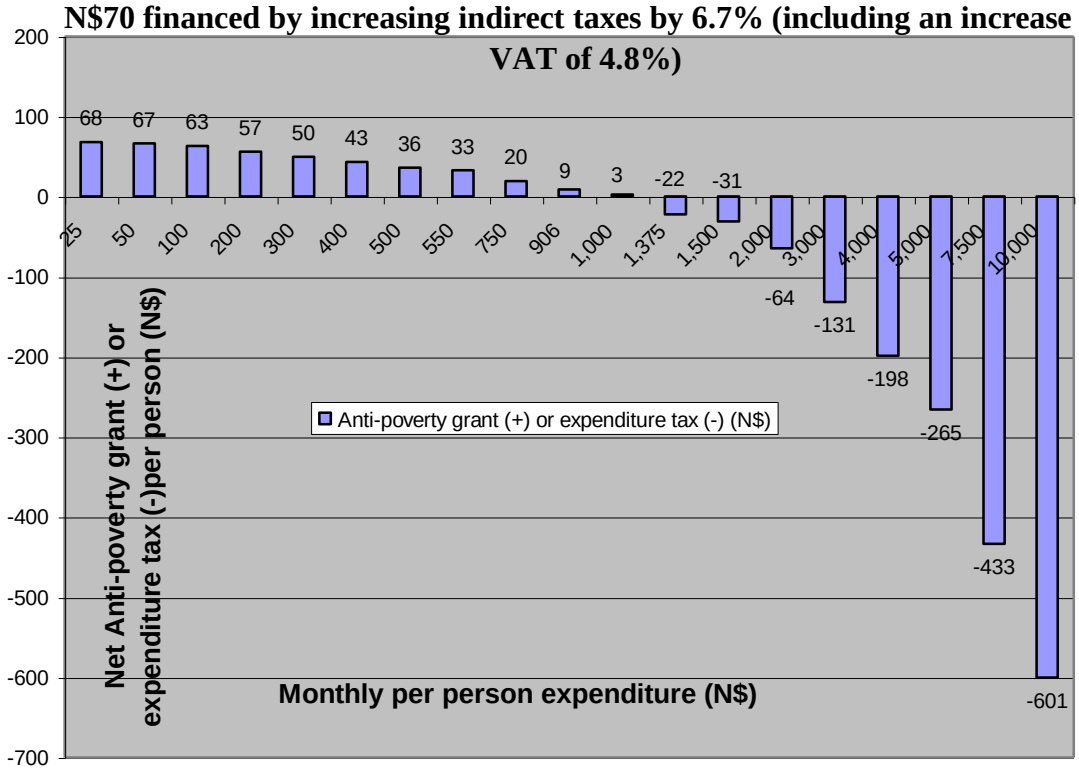
- The efficiency of the existing indirect tax system must be maintained or improved
- Every Namibian citizen must be capable of unique identification, preferably biometrically (by finger print or eye pupil)
- An efficient and cost effective delivery system must be established.

Despite the challenges posed by the above conditions, we believe it is possible for Namibia to develop the institutional capacity to fulfill them. The biggest challenge that must be met is the establishment of an efficient and cost effective delivery system. Unless this condition is met, the universal income grant cannot be implemented. The development of an appropriate delivery system will take at least four years and require substantial donor assistance.

The Nett Impact of a Grant Combined with an Increase in Indirect Taxes

Figure 3 illustrates this very clearly:

Figure 3
Nett anti-poverty grant received or progressive expenditure tax paid with grant of N$70 financed by increasing indirect taxes by 6.7% (including an increase in VAT of 4.8%)



The Actual Fiscal Burden Imposed by a Universal Grant

Paying a monthly N$70 grant to every Namibian between ages 6 to 60 yrs will cost N$1,156-million per year. This *gross* additional tax burden appears extremely high and could lead people to conclude that the proposed universal grant is unaffordable for the Namibian economy. However, this is a misleading conclusion. According to the fiscal model, everyone will pay taxes to fund the grant - but everyone will benefit from it in return. About 85% of Namibians will get back more than they pay. The total value of the amount they receive over and above the amount they contribute is N$522mil.[5] This

[5]If one assumes that the rich cut their expenditure back by half of the indirect tax increase (which means that indirect taxes have to be increased by 6.9%), this amount will by N$516 million, and if the rich cut back their expenditure by the full amount, they will contribute only N$509. The higher the required tax rate, the lower the net benefit and the net burden. The more the affluent

amount comes from the 15% of people with the highest monthly expenditure who will contribute a total of N$522 mil more than they get back in return. This nett tax burden of N$522 mil per year is the real measure of the tax burden, and falls on the 15% of the wealthiest Namibians. This nett burden in this redistributive model, falls only on those who spend more than the "break-even" point of R1040 per person each month. This nett tax burden represents the real cost of the universal grant, and brings it well within the realm of affordability for Namibia.

It is easier to understand the argument regarding the difference between a nett and gross burden by assuming a hypothetical situation in which all income and expenditure in Namibia were completely equally distributed (i.e. a Gini Coefficient of 0). Under such circumstances everyone would pay N$70 through VAT increases to fund the grant, and everyone would get back N$70 in return (assuming no cost of collection and delivery). The state would raise N$1,156-million and pay back N$1,156-million to the same people. Thus the nett tax burden on each individual would be nil. This is the tax burden that counts. In this case it obviously makes no sense to argue that this is unaffordable to the society, based on the gross tax value of N$1,156-m.

It would, however, make no sense to introduce a universal income grant if everyone had the same income and expenditure. It only makes sense to offer such a grant because there is such disparity in incomes. The greater the inequality in a society, the greater the nett gain of the income grant will be to the poor, and the greater the nett burden in taxes for individuals with a high level of expenditure. In Namibia, which has one of the most unequal distributions of income in the world, the nett tax burden is close to half the gross amount paid out.

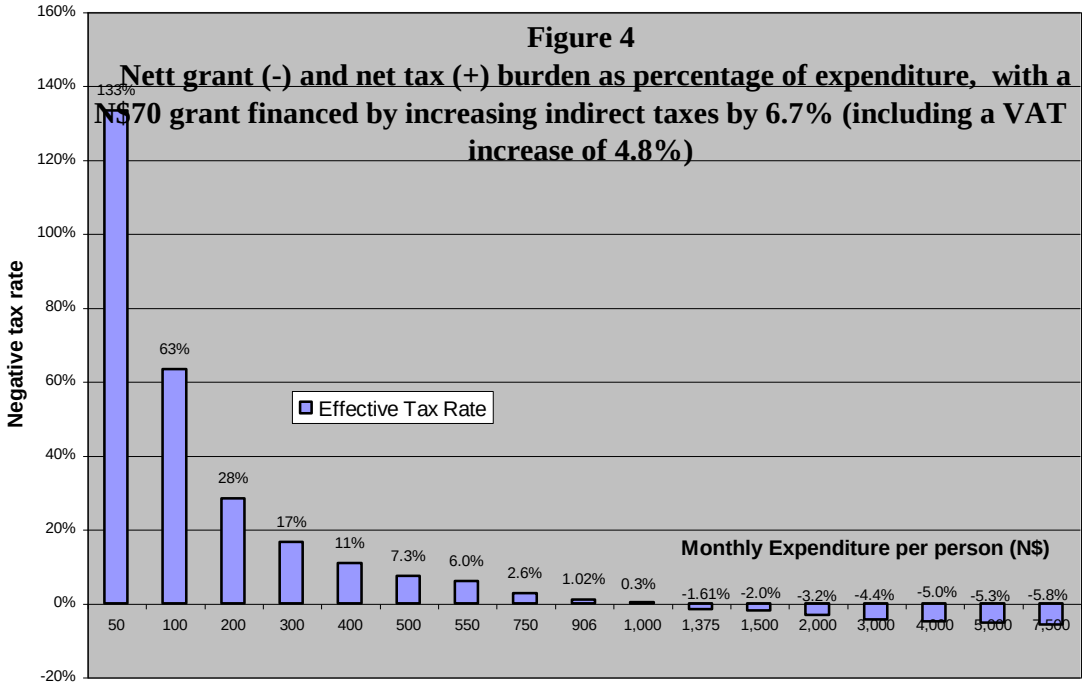
Although an increase in indirect taxes is usually regressive because the poor spend a larger proportion of their income than the rich, the nett impact of a grant combined with an increase in indirect taxes is clearly progressive. 85% of the population will be better

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cut back their expenditure because of the tax increases, the less the actual additional tax burden is, even though the indirect tax increase is higher.

off if indirect taxes are raised and an income grant is paid out to everyone above five years of age. Those who benefit most will be the poorest four or five deciles of the population, with a low monthly per person expenditure. Those with a N$200 per month expenditure will be able to increase their expenditure by at least a third. Those with an expenditure of N$100 per month will be able to increase their expenditure by two thirds. This makes a significant difference to the poorest of the poor.

The progressive benefit and burden imposed by a combination of a universal grant and an indirect tax increase is shown in Figure 4. This diagram shows that although the indirect tax has to be increased by 6.7% to finance a grant of N$70 per person, all those with a per person expenditure of less than N$1040 a month are better off, and it is only when the monthly per person expenditure exceeds N$4,000 that the tax rate creeps up to above 5%.



Targeting the Grant, while Avoiding Poverty Traps and Dependency

The approach we suggest avoids all the problems associated with means tests, which are often applied in industrialised countries to target state assistance to the poor. In some countries, such as the German Federal Republic, the state's assistance to the poor is cut

back by 1 Euro, for every Euro the family earns itself. This amounts to a 100% marginal tax and serves as a serious disincentive to a poor family to earn additional income. Furthermore in such countries the state can afford to adopt a high poverty line. In Germany, for example, a family of four in certain circumstances can receive as much as E1500 (equivalent to N$15,000) per month. This approach inevitably creates a poverty trap because unskilled people can earn as much by relying on a state grant as they can by going out to work. There is therefore no incentive to work, and under these circumstances the grant creates dependency.

Apart from this very negative aspect, the implementation of a means test requires a sophisticated and extensive bureaucracy. Some times this can cost as much as the savings achieved by introducing a means test to prevent those who do not qualify from getting the grant.

The consortium's proposal of a universal grant funded by increases in indirect taxes also targets the poor, but without the negative consequences of a means test.

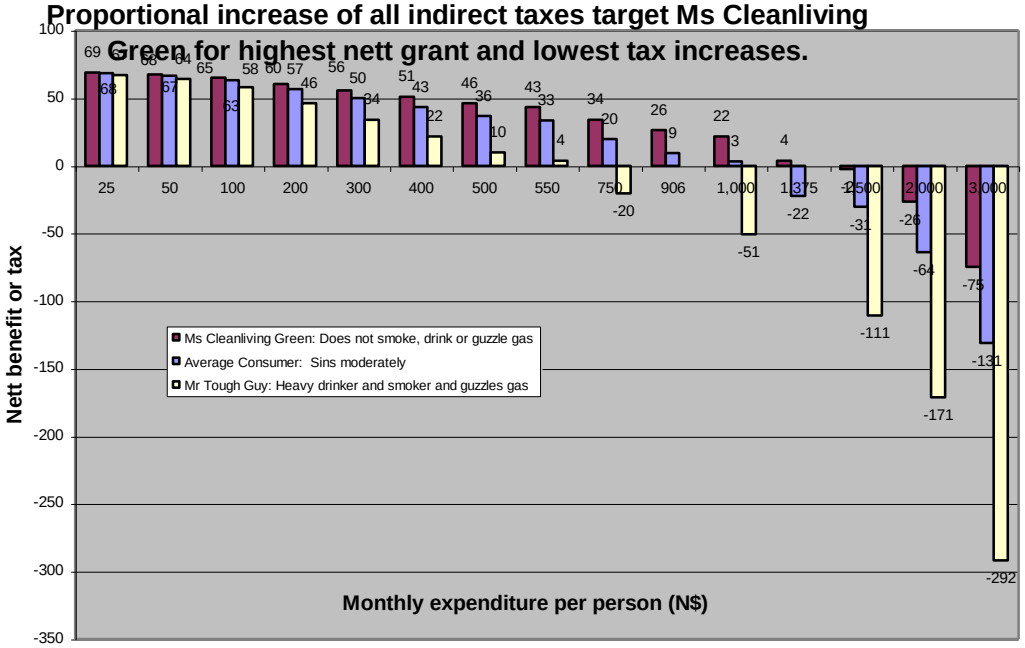
If Namibia were to introduce a N$70 monthly grant financed by an increase in indirect taxes, a poor person would lose only N$6,70 for every N$100 by which the person's expenditure increases. This is a marginal tax rate of 6,7% compared to the 100% rate in the German example used above. Because everyone gets a grant, which is funded by the wealthier who spend more, the grant is perfectly targeted without requiring an expensive bureaucracy. A small grant of $N70 is very unlikely to create dependency. On the contrary, it is far more likely to offer opportunity to the poor to improve the opportunities of earning additional income. Children can be better nourished, youth can pay for additional training opportunities or transport costs in looking for work. The poorer one is, the more support one gets from the grant.

The grant will be a very effective way of targeting households for support in which the breadwinner has become unemployed because of ill health, e.g. because of AIDS.

Another great advantage of paying out the grant to individuals, or in the case of children, to the caregiver, is that it enables the grant to reach the needy within households.

For example, if a husband earns N$1,900 a month and keeps N$1,100 for himself and gives the rest to his wife and three children, he himself will pay as much in tax as he receives from the grant. However, his wife and three children, with a per person expenditure of N$200 per month, will benefit by N$56 per person per month (or N$224 together) from their grant. This system, in contrast to any other system, has the great advantage of being able to address inequality in power relationships within households by automatically targeting those who get the least, to benefit most from the grant. This would be greatly assisted if the grant could be delivered in the form of electronic money to a smart card which can only be accessed by the caregiver and if it is possible to store the money on the card if required.

Figure 5
Proportional increase of all indirect taxes target Ms Cleanliving
Green for highest nett grant and lowest tax increases.



Another advantage is that the system distinguishes between people on the basis of how they spend their money. If it should be possible to get agreement form SACU to fund the grant by proportional increases in excise levies on tobacco and alcohol, those who

purchase these items will subsidise the grant to a greater extent than people who do not. (See Figure 5) This supports the case for levying increased excise taxes to fund the grant. However, it must be borne in mind that excise taxes are levied within SACU, and cannot be unilaterally altered by individual countries.

The Dynamic Economic Consequences of a Grant

For the purpose of alleviating poverty, a N$100 per month grant would be preferable to a N$70 amount. However, the macro-economic consequences of the larger amount are more difficult to predict because of the higher tax burden on the affluent. If implemented today, it would be more prudent to start with a lower monthly grant and evaluate the macro-economic impact over a reasonable period. If there is no reason for concern, the grant can be increased. If a grant is only implemented in three to four years' time, it would be possible to start with N$100 per month. The real cost of such a grant then would be much lower and would be similar to the cost of a N$70 monthly grant in 2002.

There is also a case to be made for extending the grant to Namibians five years and younger. However, this may be administratively very difficult to implement. The biometric identification system foreseen for Namibia, similar to the HANIS system implemented in South Africa, should be used for every Namibian that receives the grant. This will prevent fraud. However, if one uses fingerprints, such an identification system cannot be implemented in the case of younger children. The grant could well, as is the case with the existing targeted poverty grant in Brazil, only be paid in the cases where children attend school to ensure school attendance and to monitor via the school who the care-giver is.

Another reason some may put forward for restricting the grant to children six years and older is that a grant for small kids may in some cases create a perverse incentive to have children.

The effects of the expenditure tax the consortium proposes to fund this grant will have much less of a distorting influence on the economy than an increase in income tax would

have. We consider the expenditure tax the ideal method of raising taxes and supporting the poor. By adopting these measures, Namibia can succeed in implementing, by an indirect method, a direct and progressive expenditure tax.

It would, of course, be essential to earmark the additional amount thus raised for the grant. If the increased funds were spent elsewhere, the taxpayers would not get a direct repayment, and this would wipe out the advantage achieved by the difference between the gross and the nett tax burden. In fact, if the increased revenues raised in indirect taxes were not spent on the grant, the nett tax burden would be as high as the gross tax burden.

The nett impact of the grant will be to create more demand in rural areas. This should stimulate economic development in parts of the economy that have been marginalised.

Should a grant of N$70 be paid out today, it would bring down the Namibian Gini codfficient from 0.68 to about 0.60. Namibia would no longer have the dubious distinction of having the highest measured Gini coefficient in the world.[6]

[6] Countries such as Brazil and Guatemala have Gini coefficients of higher than 0,6.

Appendix 5

Income Tax on Individuals

Introduction

All persons other than companies are taxed as individuals in Namibia.

The threshold for rendering returns is N$20 000 per annum for all taxpayers. However, a taxpayer has to pay provisional tax if he earns:

a) N$5000 or more in addition to salary income;
b) only income from which no withholding tax has been deducted, once he exceeds the threshold of N$ 20 000 per annum.

Personal income tax comprises some 57% of taxes on income and profits in Namibia and about 24% of total tax revenue. Excluding SACU revenue, the percentage rises to 35%.

In Pursuit of Simplification

IRD have asked us to consider a proposal to simplify the PAYE system by means of a *final withholding schedular tax for salaried employees*. This implies that those who earn an income through employment will be subject to a tax that is final in nature, that is, not subject to assessment and not requiring rendering of a personal income tax return. This would entail ignoring certain of the features that influence an individual's ability to pay.

"Ability to pay" is not a clear-cut concept. Attempts at achieving it by allowing an individual taxpayer's liability to be determined by age, marital status, medical expenses, provision for retirement, family size and income net of certain expenses incurred in earning it, are at best likely to result in a rough approximation. "Ability to pay" is also influenced by factors such as individual needs, debt, past losses, future prospects and

changes in current asset values. No tax system can capture all these factors. It stands to reason that these individual circumstances introduce complexity for IRD and the taxpayer who has to account for them, thereby driving up compliance costs. For this reason public support may be forthcoming for reforms that simplify both administration and tax compliance, especially if accompanied by an appropriate adjustment in tax rates in order to accommodate the lack of sensitivity to individual circumstances.

Schedular taxation, in the context of the personal income tax, refers to the practice of taxing different categories of income separately, often according different rules and at different rates, and sometimes by means of final withholding taxes. It has a respectable ancestry, dating back to at least 1803 in the United Kingdom and is used by a number of OECD countries. [7]It is interesting to note that the advice given by tax advisers in the last ten years to countries in transition (e.g. Czech Republic, Estonia, Hungary, Latvia, and Poland) has been to delay the introduction of a western-style global income tax on individuals. Furthermore, for individual income taxation, the advice was to continue using schedular taxes and to introduce or expand withholding at source. A final withholding tax for salaried employees with no other source of income is the norm and a good share of these countries also use final withholding schedular taxes for several forms of capital income (interest, rent and dividends).

There is however a danger associated with the level of the rate of final withholding taxes on salary as high rates tend to make the country concerned uncompetitive, push enterprises underground and introduce anti-labour biases.

Sensibly designed however, schedular taxation with final withholding taxes can simplify both administration and compliance, leading to significant cost savings for both tax-gatherers and taxpayers. The cost however is clear – a diminution of equity, both horizontal and vertical.

[7] Martinez-Vazquez, J. and R.M. McNab. 2000. “The Tax Reform Experiment in Transitional Countries”.

Final Tax on Employment Income

The number of returns issued for 2002 gives an indication of the major administrative burden on I.R.D. and where simplification benefits can most easily be achieved:

Table 7: Income Tax Returns Issued by IRD (2002)

	2002
Forms to self-employed taxpayers	17 649
Salary returns	91 263
Non-filer returns	99 235
Sub-total	**208 147**
Companies	21 711
Total	**229 858**

Based upon the numbers reflected above, in excess of 191 000 taxpayers can be removed from the assessment system by moving to a final withholding schedular tax for employees, allowing I.R.D. to focus on the self-employed and company taxpayer collections, audits and taxpayer services. Because of the cost savings and efficiency gains that this could mean for I.R.D., we have given favourable consideration to the proposal.

Current PAYE System

The current system for the rendering of income tax returns by individuals can be considered a hybrid in that it requires tax returns from all salaried individuals above the minimum threshold of N$20 000, but absolves over 50% of these taxpayers from submitting income tax returns based upon certain requirements, namely:

- Having been in the employ of the same employer for a full year of assessment.
- If the whole income for the year of assessment consists solely of remuneration as defined, and interest not exceeding the exemption for interest income of N$500.
- If not entitled to deductions from income (as provided in the Act) other than those taken into account by the employer for the purposes of employees' tax.

In the above circumstances the person concerned is assessed on a copy of the employees' tax certificate, typically rendered with the return required from the employer.

It stands to reason that whilst the above does provide administrative simplification for I.R.D., it also leads to instability in the system. Resignation or increased interest income, due say to rising interest rates, may suddenly trigger the need for a tax return by the employee. The employee however, may not always be cognisant thereof, having become accustomed to non-filing. This re-categorisation of taxpayers from non-filers to filers and then back to non-filers results in inefficiencies within the assessment system at IRD.

The various elements of the existing income tax system are set-out below as well as the consequences of having to transform the system to that of a final withholding tax for salaried employees.

Features of the System

Collection method

The deduction for PAYE will be made by the employer as is currently the case, but for all salaried taxpayers will be final.

Period of Assessment and Rates of Taxation

The period of assessment is currently 1 March to 28 February. In view of the fact that employees resign from the services of one employer and move to another, it becomes very difficult to assess the tax liability on an annual basis, without transgressing the taxpayer's right to confidentiality, as the old employer would have to supply the new employer with earnings and deductions for the year-to-date.

It is therefore proposed that the assessment period be changed from twelve months to a month or part thereof. The annual threshold and the tax brackets would be converted to monthly earnings.

Returns by Employer

Currently the employer provides I.R.D with monthly declarations and the employee's tax is deducted monthly. This will remain unchanged.

An annual reconciliation of PAYE paid to actual amounts deducted is then performed. In the proposed system, an annual listing will be provided by the employer reflecting detail currently incorporated on the PAYE certificates so as to enable IRD to verify the accuracy of deductions and tie the amounts back to the monthly payments made to IRD. The PAYE certificates currently being issued by employers will therefore no longer be needed. The annual listing will augment the audit process which is critical to the success of the system and which currently is not satisfactory.

Salary Income

Salary income is currently added to other income and taxed annually. In the proposed system it will be added to other income (as defined below) and taxed monthly.

Other Income:

Directors Fees, Bonuses, Leave Pay and other Non-Monthly Income

It is proposed that rather than use average rates which provide opportunities for income manipulation, that these amounts be taxed on receipt and not on accrual. This will provide the employee with the option of having his or her bonus spread over a period of months. The maximum period allowed for payments should be limited to twelve months. In the case of leave pay paid out upon retirement, the taxable amount should be determined in the month of receipt after deducting the N$100 000 allowance currently in place.

Commissions

Commission income is currently added to other income and taxed annually. In terms of this proposal, commissions will simply form part of the monthly computation of tax. However, individuals earning purely commission will be dealt with on the same basis as self-employed taxpayers in terms of the existing basis of assessment.

Retrenchment Compensation

Retrenchment compensation is currently subject to an exemption of N$100 000. Whereas an employee who receives a lump-sum payment could probably arrange to have the amount paid out over a period of months, it may be more difficult for retrenched individuals to negotiate the same treatment. However, it is felt that the N$100 000 exemption is sufficient to provide relief for most employees who might be retrenched. The balance of any retrenchment lump-sum would be taxable at the normal rates.

Qualification for the retrenchment exemption is made subject to the approval of the Minister in s 16(o)(iv). This should continue to be the case. The Minister or Commissioner should be satisfied that the termination or impending termination of the taxpayer's services is due to his employer's having ceased or his intention to cease to carry on trade in respect of which the taxpayer was employed, or when the taxpayer has become redundant in consequence of a general reduction in personnel of a particular class by his employer. The Commissioner should be satisfied that the circumstances warrant the concession, so that the exemption serves its true purpose, namely that of hardship relief. We do not believe it is practical to define the word "retrenchment" in the Act – it should remain subject to interpretation.

Housing

Housing allowances, free housing and subsidised housing should be treated as is currently the case, but the assessment frequency will change to monthly, together with other income.

Other Fringe Benefits

Subsidised or interest free loans, free use of employer's assets, such as a company car should be added to other income and taxed monthly.

Allowances Excluding Reimbursive Allowances

Allowances are currently added to other income and taxed annually. In terms of this proposal they will be added to other income, but taxed monthly.

Antedated Salaries

Where a salary or pension increase is made with retrospective effect, the resulting lump sum may be taxed over the period retrospectively, but not exceeding three years. It is proposed that antedated salaries be taxed in the month of receipt in terms of the normal tax tables.

Annuities from Pensions Funds and Retirement Annuity Funds

Annuities from Namibian Funds and those funds that deduct PAYE for Namibia are currently added to the taxpayers other income and taxed annually. It is proposed that the same income tax rates and table be used by administrators of funds as will be applicable to employees when having their tax deducted by their employer. The fund administrator will withhold the tax on a PAYE basis and pay it over to IRD. Those pensioners who receive income that is subject to tax in Namibia and yet not subject to a withholding tax (such as interest) would be required to file an income tax return where the non-pension income exceeds N$ 20 000. Those taxpayers who therefore only receive pension payments become "non-filers". Those individuals who receive annuities from retirement funds in another country that does not deduct PAYE, will be taxed after annual assessment. If the individual has Namibian pension income in addition to the foreign

pension annuity, such pensions/annuities to be taxed as if they were the only income from that source.

Lump Sums Paid by Pension, Provident and Retirement Annuity Funds

Usually up to one third of the pensioner's entitlement in the fund upon retirement is tax free. It is proposed that the balance be taxed in the month of receipt. This will no doubt encourage the payment of the lump-sum by way of an annuity which could be seen as being in the interests of the pensioner in the long run.

Deductions Against Allowances

Currently the actual expenditure is allowed for example in the case of motor vehicles, after apportionment between private and business travel, but limited to the amount of the allowance. The calculation of deductions against car allowances, as an example, consumes vast quantities of administrative time.

In order to simplify the treatment of expenditures incurred by the employee in pursuit of his employer's business, it is proposed that no deductions be allowed by the employee. Employers should rather be encouraged to reimburse employees directly for expenses, and to claim a deduction when computing the tax liability of the business.

Expenses Related to Home Offices

The proposed system does not lend itself to the claiming of expenses for home offices, which if allowed, could lead to large scale abuse. We therefore propose that only self-employed taxpayers be allowed to claim expenses and that salaried employees be encouraged to negotiate compensation from the employer for out-of-pocket expenses.

Deduction for Business Use of Private Assets

It is proposed that deductions for the use of a private car, cell phone or private phone be disallowed in the hands of the employee and that employees consequently be encouraged to claim the direct expenses from the employer on either a rate per kilometre basis or phone rental plus calls or percentage of calls. These expenses will be deductible in the employer's calculation of tax liability.

Pension or Provident Funds Contributions

Currently, the contributions are deducted from salary in the determination of PAYE, limited to N$30000 per annum. Included in this limit are contributions to Retirement Annuities and study policies. This should remain as is, but the limit becomes a monthly amount, namely N$2500.

Retirement Annuity Fund Contributions

Contributions to retirement annuity funds are currently limited together with retirement funding to a maximum of N$30000 annually. We propose that this, as is the case above, be reduced to a monthly limit, which together with pension or provident fund contributions may not exceed the monthly equivalent of the N$30 000 exemption limit. The employer should take this into account when calculating PAYE, if requested by the employee and proof of payment is submitted.

Study Policies

Premiums paid on study policies are currently allowed as a deduction subject to the same aggregate limit for retirement funds and retirement annuity funds, namely N$30000 on an annual basis. The employer takes this into account when calculating PAYE if requested to do so by the employee and proof is submitted. There is no difficulty in dealing with this on a monthly basis, the limit simply being divisible by twelve. However, IRD are experiencing administrative difficulties with the treatment of payouts from such policies. It is therefore recommended that study policy proceeds have to be made payable to a recognised educational institution in order to enjoy tax exemption. If received by an

individual, it should be taxable in full. Furthermore the policy will have to be endorsed by the insurance company reflecting that it is a study policy and a schedule of study policies maturing each year submitted to IRD.

Impact of the Salary Tax Proposal

We have considered the impact of the above-mentioned proposals on employers, employees and IRD.

Much of the simplification is achieved by reducing taxable employment income to basic elements. The *employer* is therefore impacted upon by additional administration currently not contained in the PAYE system, but this is mainly the additional administration in the handling of expense claims by employees. It is however felt that these claims are in any event incurred in the operation of the business and should therefore not belong in the domain of IRD in the first place. Much of the frustration experienced by assessors in dealing with expense claims by taxpayers is due to the fact that IRD are placed in the position of having to judge whether expenses claimed against allowances are in fact legitimate business expenditure. Employers themselves are in a better position to assess what constitutes legitimate expenditure.

Employees should not suffer penalty if expenses are claimed from their employers. Furthermore, they are relieved of the duty to submit annual income tax returns if they have no other income exceeding N$5000 per annum. The tightening of the latitude for abuse in this area of tax collection should provide scope for a reduction in tax rates for individuals in addition to those proposed in this report.

The success of the above system is dependent upon *IRD's* ability to ensure compliance on the part of the employer. IRD are of the view that at least 10 of its existing assessors could be released to perform field audits of employers.

Personal Tax Rates

We have reviewed the effectiveness of the current tax scale in the light of the above proposals and the generally accepted principle that the scale should by nature of its progressive design, contribute to a more equal distribution of after-tax incomes.

Figures 6 and 7 illustrate the maximum marginal income tax rates in OECD and SADC countries.

Figure 6

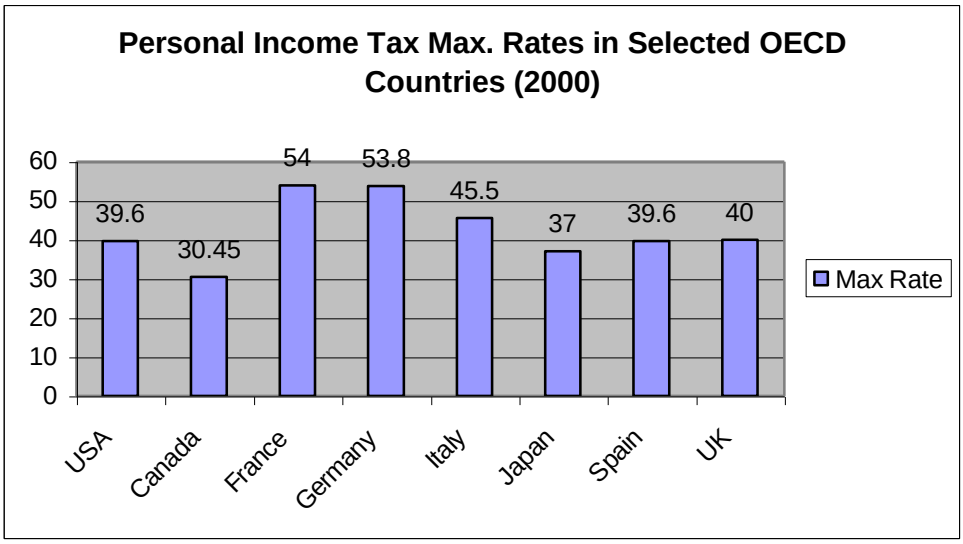


Figure 7

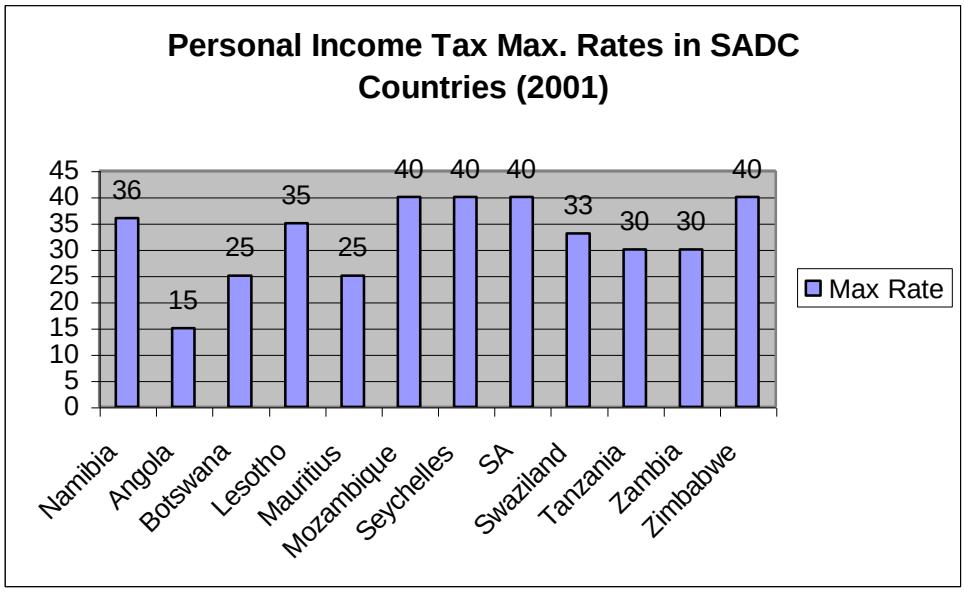


Table 8: Tax Scales for Individuals in Namibia and South Africa 2002/03

Namibia	**SA**	**Namibia**	**SA**
Up to N$20 000	R27 000	NIL	NIL
N$20 001 to N$40 000	R27 001 to R40 000	18%	18%
N$40 001 to N$80 000	R40 001 to R80 000	30%	25%
N$80 001 to N$200 000	R80 001 to R110 000	35%	30%
	R110 001 to R170 000		35%
N$200 000			36%
	R170 001 to R240 000		38%
	R240 000 +		40%

As can be seen, South Africa provides greater relief in the lower and middle brackets, while Namibia is more competitive in the top bracket. The cost of introducing some relief in the lower brackets needs to be considered. This would improve the re-distributive effects of the tax. However, care must be exercised when considering the maximum

marginal rate as it impacts upon the attraction of skilled labour and needs to be considered in tandem with the corporate rate, which will be discussed later.

The trend internationally is to limit the number of tax bands on the income tax scale. Ignoring the initial threshold, Namibia has four tax bands. This is on the low end of the spectrum when compared with SADC and OECD countries.
Fewer bands tend to function better in economies where there is less income inequality. Furthermore, the gap between the top rate and middle rates provides a strong incentive to split income.

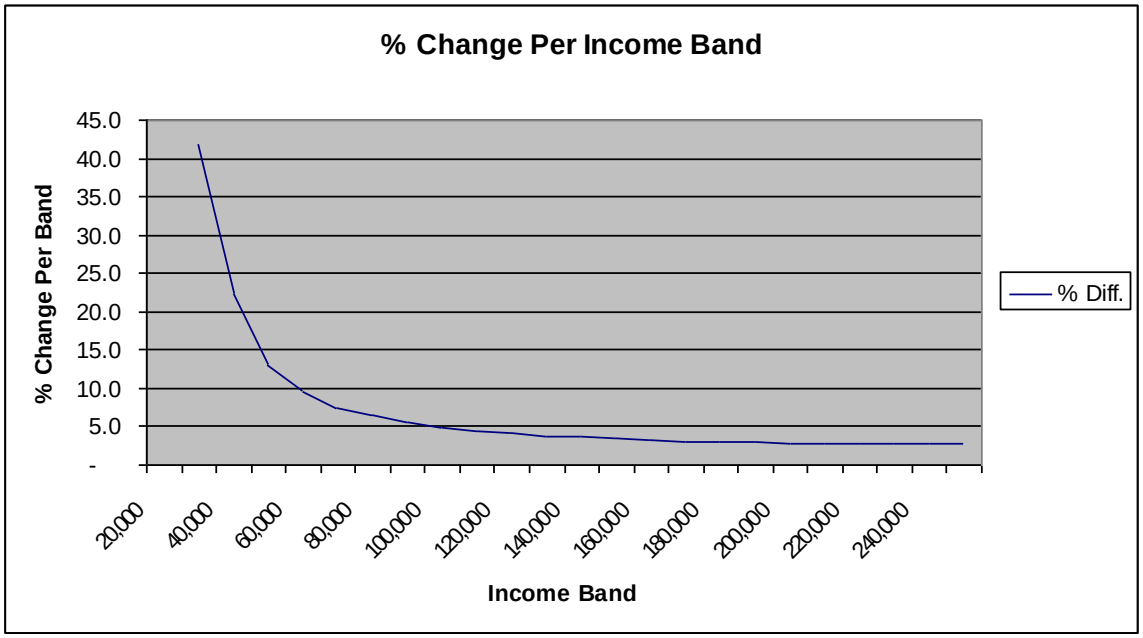
We propose the following revision of the existing tax table:

Table 9

TAX RATES: 2002/2003			
-	20,000	-	-
20,000	40,000	-	18.0%
40,000	80,000	3,600	30.0%
80,000	200,000	15,600	35.0%
200,000		57,600	36.0%
TAX RATES: 2003/2004			
-	24,000	-	0.0%
24,000	40,000	-	17.5%
40,000	80,000	2,800	29.5%
80,000	200,000	14,600	34.5%
200,000		56,000	35.0%

The graph in figure 8 below illustrates the percentage difference in tax payable by a person in the respective income bands, if the above proposal is implemented.

Figure 8



The above adjustment raises the threshold from N$20 000 to N$24 000 and provides significant relief in the lower tax brackets. The maximum marginal rate has been adjusted to match the nominal company tax rate of 35%.

Table 10 below illustrates the change in the effective tax paid by an individual at a specific income level.

Table 10: Proposed Change in Effective Tax Paid by Individuals for 2003/04

Tax inc	Tax: 02/03	Eff. %	Tax: 03/04	Eff. %	Diff.	% Diff.
20,000	-	-	-	-	-	
30,000	1,800	6.0	1,050	3.5	750	41.7
40,000	3,600	9.0	2,800	7.0	800	22.2
50,000	6,600	13.2	5,750	11.5	850	12.9
60,000	9,600	16.0	8,700	14.5	900	9.4
70,000	12,600	18.0	11,650	16.6	950	7.5
80,000	15,600	19.5	14,600	18.3	1,000	6.4
90,000	19,100	21.2	18,050	20.1	1,050	5.5
100,000	22,600	22.6	21,500	21.5	1,100	4.9
110,000	26,100	23.7	24,950	22.7	1,150	4.4
120,000	29,600	24.7	28,400	23.7	1,200	4.1
130,000	33,100	25.5	31,850	24.5	1,250	3.8
140,000	36,600	26.1	35,300	25.2	1,300	3.6
150,000	40,100	26.7	38,750	25.8	1,350	3.4
160,000	43,600	27.3	42,200	26.4	1,400	3.2
170,000	47,100	27.7	45,650	26.9	1,450	3.1
180,000	50,600	28.1	49,100	27.3	1,500	3.0
190,000	54,100	28.5	52,550	27.7	1,550	2.9
200,000	57,600	28.8	56,000	28.0	1,600	2.8
210,000	61,200	29.1	59,500	28.3	1,700	2.8
220,000	64,800	29.5	63,000	28.6	1,800	2.8
230,000	68,400	29.7	66,500	28.9	1,900	2.8
240,000	72,000	30.0	70,000	29.2	2,000	2.8
250,000	75,600	30.2	73,500	29.4	2,100	2.8
300,000	93,600	31.2	91,000	30.3	2,600	2.8
350,000	111,600	31.9	108,500	31.0	3,100	2.8
400,000	129,600	32.4	126,000	31.5	3,600	2.8
450,000	147,600	32.8	143,500	31.9	4,100	2.8
500,000	165,600	33.1	161,000	32.2	4,600	2.8

Conclusion

There is no such thing as a perfect tax scale; all scales involve value judgments and trade-offs among simplicity, revenue, marginal rates and redistribution. Namibia is not out of line with its regional neighbours. However, it can be said that there may be scope to reduce rates further when compliance improves. The salary proposals should achieve this with improved audit and allow Namibia to become more competitive relative to countries like Botswana, Tanzania and Zambia. Ideally, the changes in the tax scale should be introduced so as to coincide with the change to the salary tax proposal. However, the latter will take some time to implement.

Provisional Taxpayers

Provisional taxpayers should include any person who derives/receives/accrues income of more than the minimum threshold (currently N$20 000 per annum), other than remuneration, interest and dividends. We recommend that executive directors of all Namibian companies earning salaries be required to pay tax in line with the above schedular system. At present only public company directors are subject to PAYE.

It is also recommended that the first payment in the provisional tax cycle should be made six months after the beginning of the year of assessment. This payment should be based on the estimated taxable income for the relevant six months, but it should not be less than half of the previous year's final assessment. A penalty of 20% on the shortfall and, in the case of late payment, 10% of the provisional tax payable, should apply.

The second payment should be made twelve months after the beginning of the year of assessment. This payment should be based upon the estimated taxable income for the relevant year of assessment, but it should not be less than the previous years final assessment. A penalty of 20% on the shortfall and, in the case of late payment, 10% of the provisional tax payable should apply.

Taxation of Passive Income – Withholding Taxes

Factors to Consider

Namibia has existing withholding taxes in place, most notably Non-Resident Shareholders Tax, albeit it not a final tax - due to foreign credits granted in terms of DTA's. However, before we discuss specific withholding taxes it may be worth discussing withholding taxes conceptually and especially with regard to cross-border capital flows.

Most of the challenges facing tax authorities with cross border flows these days relate not so much to foreign direct investment, but portfolio investment flows, whether by institutions or individuals. While the mechanisms that are used for the former are established, the taxation of passive income as a result of globalisation is of a recent vintage. Not only have the flows increased significantly in recent years, but also the identity of the foreign (non-institutional) portfolio investors in most cases remains quite opaque to national tax authorities. This makes capturing these amounts in local tax nets all but impossible.

The existing international tax regime is a mixed system of residence and source-based taxation. The rights to tax *active* income at source are almost universally granted when such income is attributable to the permanent establishment of a foreign enterprise in the source country. On the other hand, the rights to tax *passive* income are generally shared between the source and residence countries – with severe restrictions placed on the rights being granted to the former. The OECD Model Tax Convention, for example, imposes a maximum tax rate of 10% on interest and of 15% on dividends in the source country.

When discussing the role of withholding taxes on cross-border income flows from portfolio investment, the focus has usually been on interest rather than on dividends. This is because most dividends are paid out of corporate profits that have already been taxed in the source country, rendering the likelihood of escaping taxation small.

In summary, the benefits of a withholding tax methodology are:

- It is administratively fairly simple as it enables Revenue to capture interest at source, as most of it is paid by easily identifiable entities, such as financial institutions.
- Withholding tax deducted by the source country is normally allowed as a credit via double taxation agreements in the resident country and is therefore not a disincentive for investment.

  However,

- Withholding taxes that are too high will depress the inflow of foreign savings. If institutions face foreign tax credit limitations in their home countries, such taxes would also effectively become final.

Interest Income

In a global context it may be worth mentioning that the EU, for example, considered the imposition of an EU-wide minimum withholding tax on interest payments from certain saving instruments at 15% to residents of member states as early as 1989 in order to address tax evasion problems. This was ultimately abandoned due to the lack of unanimous agreement, leaving Austria, Belgium and Luxembourg implementing a pure withholding system and the balance of the nations implementing an information sharing system, which the former will adopt after an interim period.

Closer to home, Botswana applies a 15% withholding tax on interest payable on offshore foreign loans and Zimbabwe withholds interest received by residents from Zimbabwean financial institutions and building societies at a final rate of 20%. Similarly, a final tax is imposed on the yield of Treasury Bills purchased by residents and is payable at the time of purchase of the bills.

Introducing a withholding tax on passive interest income would be a simple way for Namibia to deal with a challenge that causes the most sophisticated tax authorities trouble. Furthermore, IRD are ill equipped to deal with the vast number of returns financial institutions submit, detailing the interest income of investors. It is possible therefore, that many taxpayers escape the payment of tax on interest by simple non-disclosure.

A withholding tax on interest could skew portfolio shifts towards Treasury Bonds and NamPost Savings Bank deposits, if the above assumption on the reliance on non-disclosure is correct. Investors could move funds out of the banks, thereby driving up the cost of money to the institutions, which increases the price of borrowed funds, and hence discourages investment.

Nampost Savings Bank, however, invests its deposits with the local banks and makes its profit on the margin between the wholesale and retail rate on investment funds. This means that the banks will still receive the deposits, but initially there may be slight margin pressure on the banks for funds that do find their way to this institution. Nampost is providing a valuable service to the un-banked with its 94 branches, a large percentage of which would be unaffordable without the favourable tax treatment. We would like to see this exemption maintained. The choices are to allow the economic adjustment to work its way through the system, or to impose a cap on deposits per individual so that the wealthy in effect do not stand to benefit.

We propose a withholding tax on interest paid to individuals at a rate of 10 %. This rate should be low enough to stimulate savings and yet improve the tax yield. This implies a scrapping of the N$500 annual interest exemption. This measure should raise approximately N$60 million in tax revenue per annum. The direct annual cost of the exemption of Nampost deposits will be N$ 1,9 million based on current deposits.

Unit Trusts

Unit trusts are defined as companies for income tax purposes. The income of unit trusts was not subject to tax for the three years of assessment commencing on or after 1 January 1995, 1996 and 1997 and the exemption has now been extended indefinitely with effect from any year of assessment commencing on or after 1 January 1998. Distributions by a unit trust are dividends in their entirety and residents are therefore not taxable on such income. Non-residents are however subject to NRST at 10% on distributions.

The above reflects considerable leniency towards unit trusts, no doubt to encourage discretionary savings on the Namibian Stock Exchange (NSE). It can be argued that the unit trust industry with N$3,1 billion under management still has much development potential in Namibia, we are of the view that the treatment of unit portfolios for tax purposes should be normalised vis-à-vis other investments. Interest should therefore be taxed. We are concerned about the skewing that occurs in financial markets when certain

products or instruments are given preferential tax treatment. This inevitably leads to distortions in portfolio flows and falsely favours one industry over another.

I.R.D have asked the Consortium to consider the merits of a withholding tax mechanism, should interest from unit portfolios become taxable. Unit trusts in South Africa and Namibia, as in the UK, follow the "quasi-conduit" principle for taxation. This means that although they are deemed to be companies for tax purposes, the tax treatment acknowledges the flow-through principle established in law for trusts. Hence, as long as the income is distributed to unit-holders, the income is treated as accruing in the unit-holder's hands, and taxed accordingly.

We do not believe that the conduit principle should be disturbed. However, that does not mean that a withholding tax cannot be levied. Rather than being a charge in the fund however, the withholding tax should be levied at unit-holder account level, and accounted for in the unit trust management company's unit holder accounting system. This would enable I.R.D. to rely on management companies to collect the tax and submit an electronic return annually of all the amounts per account holder. As unit trusts distribute income bi-annually, the withholding tax should be paid over to IRD on the month-end following the lapse of 30 days of the date of distribution.

Eighty five percent of funds under management in Namibia are non-equity (cash and bonds). This no doubt reflects that the industry has grown due to the interest exemption. Bulk funds from products that are subject to their own tax treatment, such as life products and retirement funds incorporated in the N$3 billion under management do not represent a taxable base. However, even if 30% of the funds are considered as being attributable to individuals (+/- 65% in S.A.), the withholding tax would amount to N$ 85 million.

Trusts

The taxation of trusts is dealt with in Appendix 8, however with regard to the withholding of interest from trusts, we recommend that trust administrators be responsible for the collection of a 10% withholding tax on interest, subject to the normal tax principles

applicable to trusts. Therefore, if the income accrues in the hands of the trust, the tax on the interest should be withheld on behalf of the trust. If however, the income is distributed to a beneficiary, the tax should be withheld on behalf of the beneficiary.

Non-Resident Shareholders Tax

The above measures are an expansion of the withholding tax methodology, already reflected in a Non-Resident Shareholders Tax (NRST). We do not consider NRST to be detrimental to investment in Namibia. Many countries provide a tax credit for NRST paid in other jurisdictions and it can therefore not be considered a final tax. NRST generated N$ 105 million in revenue for the fisc in 2001/2002. We therefore recommend that NRST be retained at a rate of 10%.

Appendix 6

Companies and Close Corporations – Income Tax

Corporate tax as a percentage of taxes on income and profits in Namibia has varied considerably (within the range 28 to 48 percent) between individual years over the last decade. However, there now seems to be a tendency for the share of company taxes to be decreasing from the high levels reached in the mid 1990's.

Tax collections from the mining sector account for a very high share of corporate tax in Namibia – 45 percent as an average over the last 12 years. The development over the period of the three components is illustrated in Table 11 below. The sector share of total taxes on income and profits is presented as three-year averages.

Table 11: Company Taxes in Percent of Total Tax on Income and Profits.

	1990/91-1992/03	**1993/94-1995/96**	**1996/97-1998/99**	**1999/00 2001/02**
Diamond mining	9.2	13.2	13.3	15.2
Other mining	5.4	3.4	1.9	4.7
Non-mining	20.0	22.9	22.6	14.9
Total company tax	**34.6**	**39.5**	**37.9**	**34.9**

It is evident that the declining contribution from company taxes in recent years is a result of declining tax revenue from non-mining companies.

In South Africa corporate taxes up until 1999/2000 contributed in the region of 25-27% of taxes on income and profits. Compared to Namibia, this displays relatively less dependency, but SA revenue was skewed by what SARS believed to be underpayment by companies. The drive to raise this revenue has resulted in an increase of its share to 34 percent for 2001/02.

As a percentage of total taxes, corporate taxation in Namibia amounts to around 17 percent (of which more than half comes from diamond mining companies).

Namibia's non-diamond mining percentage can be considered to be at the low end of the spectrum internationally. This is not so when diamond mining is included. However, with an economy so heavily weighted by one form of mining, the comparison must indicate that corporate collections on a relative scale are too low. It has to be considered whether this is a consequence of extensive tax incentives to manufacturing companies in combination with a relatively high nominal tax rate.

What must also be considered, is that the trend internationally for corporate tax rates is downward. The low contribution from corporate taxes to total tax revenue in Namibia is considered to be primarily due to inefficiencies in IRD tax administration in the area of audit and a lack of competence and confidence on the part of assessors to challenge returns submitted by corporate taxpayers.

An argument in favour of a fully integrated personal and corporate tax system is that it can achieve neutrality regarding the allocation of profits. The treatment of dividends is therefore crucial as it influences whether owners of businesses will distribute company profits or retain them. Taxation also affects the choice of finance (equity versus debt). However, the incongruencies of applying a progressive system on retained earnings within a company, has hindered the implementation of a general system of full integration of corporate and personal taxation. Trying to impute profits to shareholders is likewise fraught with practical difficulties. It therefore seems a given that corporate taxes will remain a component of the Namibian tax structure.

The equivalence of the corporate tax rate and the top marginal rate of personal income tax is an important requirement for a neutral, efficient and equitable tax system. This is necessary to avoid creating an incentive to switch income. Introducing a final withholding tax on salaried income does not interfere with this equilibrium, as it is final.

Companies and close corporations are subject to normal tax at the rate of 35% for the years of assessment commencing on or after 1 January 1999. Special rates of tax apply to mining, long-term insurance business and petroleum companies and will be dealt with separately below. Invariably however, the question is asked what the ideal tax rate should be, not only in terms of neutrality within a country between individuals and corporates, but also between nations competing for capital. A comparison of nominal corporate tax rates between countries can be made, but this is fraught with complexities of which a few are mentioned below:

- It does not take account of the effective rates actually paid, or of the legal definition of the tax base on which they are assessed.
- International competitiveness with regard to foreign investment is also influenced by political-economic stability. It could therefore be argued that a tax rate should include a sovereign risk discount or premium. Furthermore, double taxation agreements often negate the regional benefits afforded corporates.
- The redistributive effects of changes in the corporate rate need to be borne in mind, particularly in a developing country, where portions of any increased burden may be shifted to consumers, stakeholders and finally owners of capital.

Namibia in respect of geography and convenience must be affected by investor decisions which compare South Africa to itself. The fact that South Africa has a nominal corporate tax rate of 30% is noted. However, the imposition of STC on dividends distributed raises the effective rates to 37,7 % when there is a full distribution. We do not therefore consider Namibia to be out of line with S.A.

When compared to Angola, Mozambique and Ghana, Namibia's rate is on par. However, its main competitors other than S.A., such as Botswana (15%), Tanzania (30%), Mauritius (25%) or Zimbabwe (30%), all have lower rates. The potential for revision of the tax rate is therefore downwards, when all the regional comparisons have been made, but the corporate share of tax revenue should preferably be increased by a careful review of transfer pricing practices and the curtailment of incentives.

It is however debatable, with the existence of the EPZ's and tax incentives applicable to manufacturing, whether any downward revision would not simply result in loss of revenue to the state. We therefore do not recommend a reduction in the nominal corporate rate at this stage.

Manufacturers

Specific tax incentives have been developed for the manufacturing sector. During 2002. Government brought about significant changes in the law as applied to manufacturing companies in order to streamline the special tax dispensation for the manufacturing sector. Any new manufacturing company, and any existing company increasing its production, can now apply to be registered as a manufacturing company, thus reducing the tax rate it pays from 35% to 18%. In addition, capital depreciation and costs incurred in promoting exports and training will also receive special dispensation.

In the last 10 years the non-government services sector has grown about 50% faster than the manufacturing sector throughout the decade, even though it was not given any special tax dispensation. There is an economic argument to be made that employment and income in Namibia would grow faster if the overall rate of company tax were brought down to 30% or 25% instead of concentrating benefits on a struggling manufacturing sector. Tourism may hold far more promise for Namibia than textiles, for example.

The dominant view in the economic literature is that one should not target specific sectors at the cost of others. This, it is argued, simply causes economic distortions. In addition, to the extent that the decision on whether a company is entitled to the tax reductions is arbitrary, the discretion given to bureaucrats again puts the system at risk to attempts at corruption (See Morriset & Pirnia, 2000). However, there is the example of countries such as South Korea where the government's policy of favouring certain sectors of the economy in the end paid very handsome dividends.

Appendix 7

Special Classes of Taxpayers – Income Tax

Long Term Life Assurance Companies

Section 29A of the South African Income Tax Act makes provision for a *"Four-Funds Approach"* for taxing long-term life assurance companies. In terms of this approach, the insurer is required to establish and maintain four separate funds, known as the Untaxed Policyholder Fund, the Individual Policyholder Fund, the Company Policyholder Fund and the Corporate Fund.

The Four-Funds Approach is based on the recognition that insurers hold and administer certain of their assets on behalf of various categories of policyholders. The balance of their assets represent, in the case of proprietary insurers, shareholders equity, and in the case of the mutual insurers, funds to which current policyholders are not entitled and which should thus be treated as corporate funds. The application of this approach requires that insurers allocate their assets and liabilities to separate funds representative of the various policyholder or corporate interests, and that each fund be taxed as a separate entity in accordance with the applicable taxation principles.

Namibia does not have a *"Four-Funds Approach"*. Section 32(1) of the Namibian Act provides for the taxation of the taxable income derived from the carrying on of a long-term insurance business by a taxpayer in Namibia.

The Consortium invited representation from the life industry in order to present their views on the merits and de-merits of the two tax dispensations from a client and corporate perspective, bearing in mind that the Namibian legislation is the old South African legislation prior to the introduction of the "Four-Funds Approach". The Life Assurance Association of Namibia "LAAN" listed their main views as the following:

- This has caused product disparity, which has limited the launch of certain specialist products in the Namibian market.

- Single premium endowments are treated more favourably in South Africa with a five year minimum term as opposed to Namibia, where the term has remained at ten years.

- The existing tax structure is easy for the industry to understand and easy for I.R.D. to apply, yet contains certain inconsistencies in the treatment of taxable income in the hands of the life company. For example, there is an incentive for individuals to receive dividend income in their own hands. A similar problem arises with the inclusion of tax exempt government treasury bills in client portfolios, as they are all "on-balance sheet" in a life company, meaning that the client's assets are treated as those of the insurance company.

The Consortium is of the view that from a purist perspective, it is preferable that the legislation for life assurers be reviewed. However, we do not regard this as urgent, nor is it a simple matter. It should therefore be a subject for further consultation in the future.

Mining

The Consortium has done a comparative review of the industry and is of the view that Namibian treatment of mining operations including the petroleum industry is not in need of revision. Special projects receive individual attention from government and we do not therefore believe that there are adverse conditions discouraging these operations. In fact, the deduction of capital expenditure is more limited in South Africa than in Namibia. However, we recommend that there needs to be a definition included in the Petroleum Taxation Act defining the territorial boundaries of Namibia, for example, the Continental Shelf.

Farming

There seems to be broad based concern amongst staff and management within I.R.D. that there is substantial loss of revenue to the fiscus in the current comprehensive income tax system, due to the ability of individuals to set-off employment income against farming losses. In principle there is nothing wrong with this, as it is the individual who is taxed and if he or she decides to invest earnings in farming operations, thereby increasing employment and development, there should be no cause for complaint. However, farming allowances do provide a means of tax planning and do cause a loss of revenue to the fisc in the short-term. The practice also discourages farming from being self-funding or being funded out of capital as opposed to income. However, if capital is scarce, the policy becomes one of choice and need not be discussed further.

The introduction of a schedular tax on salaried income will put an end to the practice of offsetting salaried income and farming losses, but it will not impact those generating income from trade in their own names or via partnerships. This disturbs horizontal equity in the system and is part of the price paid for simplicity in the tax system. However, it is a matter of choice and can be seen as favouring entrepreneurial style employment.

We do not recommend any specific changes to the treatment of farmers, other than that the deduction allowed for the erection of employee dwellings be updated from N$15 000 to N$50 000.

Trusts

The Consortium wishes to recommend a number of changes to the taxation of trusts which will require amendments of the law. This may become particularly relevant if trusts gain wider recognition, as they will if Estate Duty is introduced in Namibia.

The Namibian Income Tax Act contains no definition of a trust. Therefore, as the Act reads now, the common law meaning of a trust is ascribed to it. In the South African case

of CIR v Friedman and others NNO[8] the majority of the court found that a trust was not a person for income tax purposes and that therefore its trustee could not be its representative taxpayer. This necessitates the amendment of the definition of "person" in the Act to include a trust in order to correct the irregularity.

We recommend that trusts should be taxed at a flat rate, set at the maximum marginal tax rate in Namibia. This will help to discourage a burgeoning of trusts, as these vehicles are normally used for estate planning. South Africa applies the same principle, but the flat rate is 40%. The lower rate and absence of capital gains tax in Namibia will hopefully result in Namibians relocating trusts resident in South Africa to Namibia and broaden the tax base. The flat rate will make the tax system more progressive, without being damaging.

It is further recommended that a definition of "**special trusts**" be included in the Act. "Special trusts" are created solely for the benefit of a person suffering from a serious medical condition which incapacitates such a person and prohibits the individual from earning sufficient income for his or her maintenance or from being able to manage his or her own financial affairs. However, "Special trusts" should be taxed as ordinary persons, not at a flat rate.

[8] 1993 (1) SA 353 (A) 55 SATC 39, at SATC 61

Appendix 8

Tax Avoidance and Tax Evasion

Background

All tax systems are based on what is usually designated “mass loyalty”. This is founded on legislation relating to taxes being arrived at by normal democratic means. The rules of democracy require the minority to accept the decision of the majority. The citizens of a country have in this way decided how the common needs of the population are to be financed. The result is that the overwhelming majority of the people can be expected to comply with the rules of the tax system. The disloyal are then a small minority.

This being the actual situation, it may seem enough to restrict tax control to those supposed to be disloyal. However, that cannot be the perfect solution. A lot of mistakes are made out of misunderstanding due to the complex nature of tax rules. Furthermore, the tax system may have effects that were not intended. As a consequence, control is needed to make sure that the tax system operates in accordance with the intentions of the legislator.

If the number of the disloyal increases, the situation can be dealt with by increased and intensified tax control directed towards these categories. By doing so, the tax control contributes to increased overall loyalty to the tax system. But the success of this approach will decrease as the number of the disloyal increases. For several reasons, a situation where a majority of the taxpayers is disloyal cannot be handled through increased control. First, in a democracy there is a limit beyond which the control will constitute a threat to the integrity of individual taxpayers. Second, it might be difficult to fund such an increase of resources. Therefore the conclusion is – in a situation where the majority of the population does not comply with the tax system – that the legislator must move back to the starting point and try to create a system that a majority will accept.

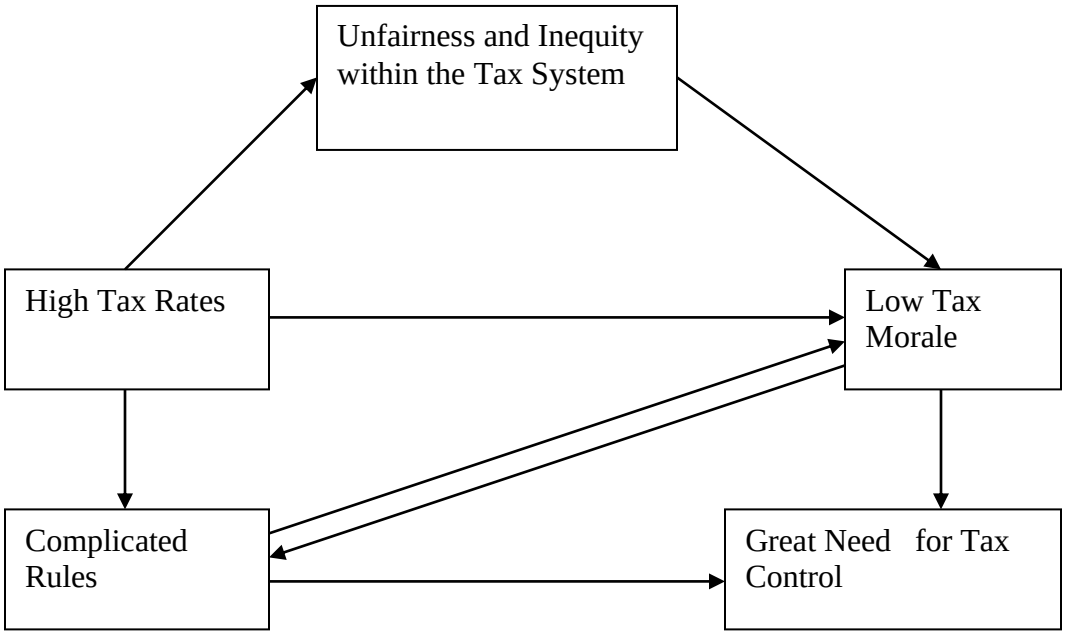
In a global economy, this problem has other dimensions. If a failing faith in the tax system is the result of taxation becoming less effective under the influence of new global communication systems, global finance and capital markets and a greater amount of free trade and free movement of goods, services, capital and personnel, the legislator will be faced with a completely different situation. If a majority of citizens in a country does not approve of those with financial capital being able to invest this abroad, and in this way avoid paying tax in the home country, but the legislator cannot change the taxation system so that such transactions are stopped, there is a risk that taxpayer compliance will decline. In a similar way, if the majority of citizens do not approve of the lowering of company tax but the legislator feels forced to do so to avoid the company moving to a country with lower company taxes, the non-compliance problem can be exacerbated. The citizens permanently resident in a country will have difficulty in understanding that their income from personal exertion should be taxed more severely than income from capital – but globalisation forces such a development. It will no longer be possible to adapt the system to the people and the system will no longer be based on mass loyalty.

Basic Relationships

In our opinion there exists a connection between high tax pressure, complicated tax rules, low degree of compliance, and great demand for tax control. High tax pressure is bound to lead to a low degree of compliance and complicated rules. One reason for this is that the unfairness and inequity that are incorporated in every tax system will be accentuated by increasing tax pressure and high tax rates. There is a need for complicated rules because tax avoidance becomes more profitable when the tax rates are high. The consequence of this is more complicated rules and a greater demand for tax control. The conclusion is that it is difficult to simplify tax rules if tax pressure and tax rates are high.

This can be illustrated in the following way[9]:

Figure 9: Interdependence of Factors Affecting Tax Compliance



The point made by this model is that the various factors influence and reinforce one another. This makes it difficult to do something about the complexity of the system without lowering tax rates. But tax rates are partly based upon the concept of vertical equity. At the same time, simplification tends to lead to greater horizontal inequity. These effects are easier to accept when the tax rates are low. Therefore, the consequence is that an urgent demand for simplicity will at the same time ask for a partly new definition of equity.

[9] RSV Rapport 2000:9: Vår förvaltningår 2010 – i globaliseringens spår.

The Underground Economy

There exist at least two ways to determine the extent of non-compliance. One is the macro-way, i.e. to use National Accounts. The other is the micro-way, i.e. calculations based on results of tax audits.

The Consortium has considered both ways. However, it does not seem possible to use the National Accounts. The reason is that the situation in a developing country like Namibia is so different, that experience derived from developing countries is inapplicable. At the same time it is not possible to use audits as a basis of estimation, as the number carried out is too low to be used to calculate the size of the underground economy. According to the Taxpayer Charter of Namibia, the Inland Revenue will give top priority to encouragement of voluntary compliance and to determine the extent of compliance and non-compliance. But up to now it has not been possible to come up with any figure based on Namibian statistics.

However, there are statistics available describing the estimated size of the underground economy. The figures below have reference to EU-countries.

Table 12: The Underground Economy as a Percentage of GDP.[10]

Country	**Percentage Underground Economy**
Greece	29-35%
Italy	26%
Spain	19-23%
Belgium	20%
Germany	14%
France	14%
The Netherlands	14%
Great Britain	13%
Ireland	10%

[10] Why millions of moonlighting to make ends meet. The European, 6-12 April 1998.

Denmark	7%
Austria	7%
Sweden	7%
Finland	4%

There is no reason to believe that the situation in Namibia is better than in those EU-countries where the underground economy is comparatively large. One reason for this conclusion is the insufficient audit capacity of IRD. The number of audits carried out each year is very limited. In addition to this, large companies have never been audited. In such a situation, there is a very high probability that compliance is relatively low due to the fact that the risk of disclosure is almost negligible. This is particularly applicable to tax avoidance and advanced tax-planning procedures.

Appendix 9

Dispute Resolution

It is understood that the existing system of objection and appeal for resolving disputes between the taxpayer and IRD has not at all times run smoothly. While it is recommended that no change be made to the existing remedies of objection and appeal available to the taxpayer, the Consortium considers that some speedier and less formal method of dispute resolution would be advantageous in the case of disputes involving smaller amounts of taxation.

It is recommended that a tribunal to be known as the Special Board for Hearing Tax Appeals be constituted to sit in cases involving smaller amounts of taxation. A panel of practicing legal practitioners willing to hear tax appeals for nominal remuneration could be appointed by the Minister of Justice and utilised to hear and pronounce upon such appeals, subject to an automatic right of appeal to the existing Special Court, which can hear the matter *de novo* if it is referred from the Special Board.

If possible, it is desirable for the Revenue officials actually involved in the dispute to present the Revenue case at such a hearing, which will have the salutary effect of encouraging officials to consider whether what they do will be sustainable in the Board at the times when they take action. The knowledge that they might personally have to defend what they have done in an independent tribunal will encourage good administrative practice.

This is likely to provide a swift remedy which will, at least in certain cases, filter out those disputes where it is not necessary to go to Court, which clog up the system, and where what is wanted by the taxpayer is some legally trained person who is independent of the Revenue Department to express a view on the merits of his or her case.

It must be noted that certain minimum administrative facilities will have to be made available to enable such a Board to function, as it will still be necessary to prepare a dossier setting out the documentary background to the dispute, and to have a registrar and a venue to enable the hearings to operate smoothly.

It is recommended that the monetary amount up to which the envisaged Special Board would have jurisdiction be left to the Revenue to determine.

Settlement of Disputes

It is further recommended that consideration be given to the enactment of legislation empowering senior Revenue officials to settle tax disputes, if necessary by waiving in part a claim for tax, *where it is in the interests of the fiscus to do so*. This would facilitate the sensible resolution of tax disputes where a justifiable basis for settlement on a purely economic basis exists.

Appendix 10

Export Processing Zones (EPZ's)

Over the past three to four decades EPZ's have become popular instruments of trade policy, offering firms located in them free trade conditions and a liberal regulatory environment. In 1970 only a handful of countries permitted such zones, but by 1996 there were more than 500 zones in 73 countries. (Madani, 1998).

The law allowing for the establishment of EPZ's in Namibia was passed in April 1996. Export Processing Zones can be established anywhere in the country and in any economic activity, not just in manufacturing, although exemptions have predominantly been given in the case of manufacturing industries. Originally strikes and lock-outs were illegal in EPZ's, but this provision was later dropped. Zone firms are exempt from corporate taxes, custom duties, value added tax, and transfer and stamp duties forever. In addition, in some cases local government has paid for the development of infrastructure. (In the case of Ramatex alone this cost was reported to exceed N$100 million).

The literature is generally critical of EPZ's under circumstances such as those in which Namibia finds itself (See, for example, Madani, 1998a & 1999b; Tanzi & Zee, 2000). The argument is that EPZ's are a second best choice that can be justified only where a very illiberal economic dispensation is being maintained. In addition, various authors have been very critical of permanent tax breaks and argue strongly that infrastructure cost should be privately financed and not subsidized by government. Concerns are raised that the forward and backward linkages of EPZ companies are often very limited, that the companies attracted are often foot-loose and ready to move on when another country offers better incentives. Other countries in the region may resent what they consider to be unfair competition. Furthermore, EPZ preferences may come into conflict with WTO commitments.

There is, in addition to all this, clearly a risk that companies will illegally shift activities or products to companies in EPZ's in order to gain tax advantages, or use these companies as conduits for tax free inputs in companies outside the area. Given the big potential benefits of being declared an export processing company it is inevitable that some companies will attempt to gain this status through bribery.

In spite of all these objections to EPZ's there are a number of countries that have clearly benefited from the introduction of such zones. Mauritius, for example, has experienced a very significant growth of a variety of industries.

Namibia recently had much publicized success in attracting big companies under the EPZ scheme. Since some of the companies attracted are footloose, these gains may not be sustainable. Not studies seems to have been done to determine the potential benefits if the funds spent on the EPZ's were employed elsewhere. It may well be that such an investigation would give a less favourable picture of the benefits of EPZ's. The consortium wishes to recommend that the Department of Trade and Industries should annually make a careful evaluation of all the direct and indirect costs and benefits of the EPZ projects. The impact on gross and net exports, the employment impact, the backward and forward linkages, the skills transfer benefits, government revenue foregone, and the environmental costs, etc. are all factors which need to be considered in these annual audits. Given the *a* priori case against EPZ's, it is essential that government regularly provides clear justification for its EPZ policy.

Mandani, Dorsati, 1998a, "A Review of the Role and Impact of Export Processing Zones", World Bank, Development Research Group, Trade, Washington, DC.

Mandani, Dorsati, 1998b, "Export Processing Zones" **Prenotes,** no 11, December, Worldbank, Washington, DC.

Tanzi, Vito, & Zee, Howell, H (2000) "Tax Policy for Emerging Markets: Developing Countries", **IMF Working Papers**, WP/00/35, International Monetary Fund, Washington.

Appendix 11

Land Taxation

"The land tax enjoys a distinguished pedigree in the theoretical literature on tax efficiency: (Skinner, 1991, p.1)., yet it is rarely used either as a serious revenue source or as an instrument for land reform (Also see Newbery, 1987, Lewis, 1984). Namibia has opted to use it as a land reform measure, but it is not meant to replace the other agricultural taxes as a serious source of revenue.

The land reform function of a Land Tax was first discussed in a Southern African context by the Transvaal Indigency Commission of 1908, when it was proposed that an annual tax should be levied on all holders of land as an alternative for tax derived from income on farming. This tax, it was proposed, should be at such a level that the efficient farmer would carry a somewhat lower tax burden than when he paid a tax on his income from farming. However the absentee landlords who in those days were primarily mining companies, that had bought up land for speculative purposes (holding the land in case gold should be discovered), would be punished for letting the land lie fallow, and would be encouraged to rather sell it, than hold on to it for ever.

The soon to be implemented Land Tax in Namibia has primarily a redistributive goal. It increases the tax rate from 0.75 % to 1.25% of valuation for each additional farm an individual owns, and it raises money that will be earmarked for the acquisition of farms to be redistributed to those previously excluded from farm ownership. It is not a tax instead of income earned from agricultural or other activities related to the farm ownership. In view hereof, the Consortium recommends that this tax cannot be used as a credit against other taxes.

Lewis, Stephen R, (1984) **Taxation for Development),** Oxford University Press, New York.

Newbery, David, (1987) “Agriculture Taxation, The Main Issues” in Newberry, David & Stern, Nocholas (eds) **The Theory of Taxation for Developing Countries,** Oxford University Press, New York.

Skinner, Jonathan, (1991), “If Agriculture Land Taxation Is So Efficient, Why Is It So Rarely Used”, **The World Bank Economic Review,** Vol 5(1), pp 113-133.

Appendix 12

Stamp Duty Act

The Consortium recommends that the Stamp Duty Act be amended to provide for:

Tariffs

A decrease in the number of tariffs to reduce the denominations of stamps to be printed and stocked by IRD.

Marketable Securities

A decrease in the various items included in the schedules, to clarify and simplify calculations.

Exemptions

The elimination of exemptions, to simplify the Act.

Appendix 13

Transfer Duty Act

The Consortium recommends that the Transfer Duty Act be amended as follows:

The different rates of tax in respect of Improved Land, Unimproved Land and Agricultural Land financed by the Agricultural Bank should be consolidated into one rate scale as follows:

Table 13:

Value of Unimproved or Improved Land	Rates of Tax
Does not exceed N$100 0000	N$ 0
Exceeds N$100 000 but not N$200 000	N$ 0 + 1% of each N$1 of the amount over N$100 000
Exceeds N$200 000 but not N$400 000	N$1000 + 5% of the amount over N$200 000
Exceeds N$400 000	N$11 000 + 10% of the amount over N$400 000

Appendix 14

Income Tax Administration

Background

During the last decade, the Namibian Tax Administration has taken significant steps towards becoming as a modern revenue authority. One such step is the computerisation of most of the workflow. A second step was the introduction of VAT in November 2000. The Taxpayer Charter represents a third step with a focus on customer service and taxpayer compliance. The document is well aligned with the principles published by the OECD. However, even if the developmental efforts have been successful, substantial work remains to be done before Namibia might claim a status as a country with a top revenue authority.

There are a number of areas where IRD have been less successful. One is audit. The Annual Report mentions as a constraint "the shortage of skilled auditors to audit taxpayers". According to the Consortium, this represents a very serious weakness. The Annual Report also mentions lack of independence when confronting tax offence cases and the lack of autonomy. Examples of the latter are restrictions regarding the payment of competitive remuneration to attract suitable personnel, the recruitment of staff and the disciplining and dismissal of poor performers. These are limitations on efficient human resource management. Other limitations include insufficient operational management with no or few management instruments such as planning and follow-up.

General Administrative Principles according to the OECD

The OECD has presented a number of documents dealing with General Administrative Principles. Of course, each Revenue Authority faces a different environment in which it has to operate, and has different administrative practices. A standard approach to tax

administration may be neither practical nor desirable in a particular instance. Bearing this in mind, it is the opinion of the Consortium that comments and recommendations concerning the desired future character of the Namibian administration should use the OECD principles as a point of reference.

In short, the OECD encourages the revenue authorities to

- make it their role to ensure compliance with tax laws
- promote voluntary compliance
- identify and address risk associated with non-compliance
- address the opportunities and challenges associated with globalisation
- make good tax treaty partners
- establish good relations with taxpayers, which means applying tax laws in a fair manner, delivering quality information, communicating to taxpayers theirs rights and obligations
- develop with employees relations promoting high ethical standards, recruitment based on merit and equal opportunities, high professional standards, remuneration sufficient to attract and retain competent individuals
- apply the provisions of tax treaties in a fair and consistent manner
- facilitate an active exchange of information with treaty partners in a timely fashion
- review administrative practices on an on-going bases due to changes in the environment
- utilise performance measurement approaches in the administration
- conduct and report on compliance measurement
- use appropriate risk management approaches in the administration.

It is primarily in the area of voluntary compliance that the Namibian tax administration has developed a document that is in line with these ideas. The Namibian Taxpayer Charter is an impressive step in the direction of modern tax administration. Nevertheless, much remains to be achieved in other areas.

Comments and Recommendations

It is essential to place comments and recommendation's in a proper perspective. IRD is by international comparison, a small governmental body with less than 400 employees. At the same time Namibia is a vast country. To some extent these circumstances require solutions that are typically Namibian.

The recommendations presented in this paper cover a lot of different areas. It is the opinion of the Consortium that they are all essential in order to transform the Namibian Tax Administration into a modern and efficient organisation. But all changes cannot and must not take place simultaneously. The transition must take considerable time and will require for prioritisation and a timetable.

Decentralization and Organizational Principles

It is not only possible, but also necessary, both to decentralize and to define responsibilities clearly within the entire administration.

The keyword for a decentralized organisation is accountability. The operational level is made fully responsible for the results achieved. Given a specific budget, the mission and the objectives of Head Office (HO), a performance plan is produced and results are offered. A follow-up system will prove if results are in accordance with the plan, i.e. whether management is made accountable. Having produced plans that have been accepted by HO, the management of the operational level should be independent, e.g. free to decide on employment of personnel, training of personnel, remuneration, expenditure, investment etc without approval from HO.

It is universally accepted that people produce more effectively if they are accountable, i.e. trusted to decide independently on basic operational matters and to be responsible for the results of their performance. Therefore, we strongly recommend that the organisation is reviewed taking this as well as decentralization into consideration.

The corollary of decentralisation is centralising what you cannot decentralise. The functions which must reside within the responsibility of HO are: legislation, mission and overall objectives, systems administration and IT, human resources, planning and follow-up, distribution of funds, economy and accounting. There is one more function – internal audit – that should be centralized in a way to be explained later in this paper. One way of transferring this into an organisation is to establish the following HO-entities:

- Legislation
- Operations
- Systems administration and IT
- Human Resources
- Economy

The legislative section of IRD is primarily responsible for the interpretation of law by rulings and legal advice. Due to the specific circumstances in Namibia, the legislative function within IRD should also be made responsible for litigation. Legislation will also participate in the follow-up of operations and investigate if decisions in tax matters are in accordance with the law.

Operations will be responsible for the planning and follow-up of the operational work carried out by operational entities. This includes setting operational targets, customer focus, compliance measurement, performance measurement and risk management. It is also the responsibility of operations to produce manuals for the operational work, e.g. an audit manual.

Systems administration and IT will administer the IT-support to the different activities of the IRA, not only operations. The majority of the activities of this entity will be directed towards operations. For this reason it could be argued that this entity should be merged with operations.

Human Resources will administer the principles for recruitment and dismissal, wage setting principles, training, code of conduct, relations with labour unions etc. Of course, it is an option to establish a separate entity for training, especially due to the great need for increased and improved training.

An autonomous Revenue Authority must also keep its own records, produce its own budgets and its own economic forecasts. This will require a separate entity.

The internal audit and controller functions we recommend become separate functions reporting to the Deputy Commissioner. The reason for this is that these functions are vital to the control the entire organisation, i.e. also the work carried out at head office.

The principle that no operational work should be carried out at head office unless absolutely necessary will require a separate entity for the assessment and audit of large companies, special entities (such as trusts and funds) as well as the audit of fraud cases.

Funding

Accountability and delegation of authority call for participation in the budget process. At the same time, the budget process cannot be separated from the planning process. The results promised in the performance plan must be dependent on the resources available, i.e. the budget received.

Our recommendation is that IRD should review its present system with the perspective of increased participation, consideration of the dependence on the planning process and the influence of the departmental funding principles.

Goals and Challenges

The overall objective proposed by the OECD reads: “the main role of the revenue authority is to ensure compliance with the tax laws”. The Namibian overall objective should be tested against the OECD proposal. Moreover, the present objectives have not

been made operational. There is no planning process that connects the objectives with the operational work of IRD.

The Namibian Taxpayer Charter emphasizes the importance of compliance. The Charter deals with both voluntary compliance and non-compliance. IRD have recently initiated efforts supporting voluntary compliance. Today there is a very strong focus on customer services. So far, no efforts have been made to try to determine the extent of compliance and non-compliance. There is an apparent shortage of audit capacity within the organisation.

The OECD also stresses the importance of addressing the opportunities and challenges associated with the globalisation of the world's economies and the necessity of co-operation and assistance between revenue authorities.

The recommendations of the Consortium are:

- to reconsider the Mission and the Objectives against the background of both the OECD principles and the comments of this report
- to make the objectives operational through a planning process
- to considerably strengthen the capacity in the audit field
- give priority to the international development in the area of globalisation.

Customer Service

IRD have developed a Taxpayer Charter that can be compared to that of any other country. It might even be ranked as one of the best in the world today. The Charter defines the role of IRD in a clear and precise way, a way that also represents a tough challenge to the staff of IRD. There is a will to encourage and achieve the highest possible degree of voluntary compliance.

One consequence of this document is that the focus of the entire organisation will be altered so that the relations to the taxpayer community become more important. This will ask for both a new attitude and a partly new competence. There is an apparent need that management strongly supports these changes, which will take considerable time to achieve. It is a matter of changing the perception that staff has in regard to the efficiency of their work.

Given this background, the following recommendations should be seen as further support to this important change of focus of the entire organisation:

- information campaigns directed towards the business community
- information meetings for training of newly registered vendors
- introduction of a new career e.g. called “service officer” or “information officer”
- establishment of new Service Centres
- “silent rooms” to guarantee privacy within Service Centres
- separation of incoming telephone calls from the attendance to visiting customers in Service Centres
- user-friendly information brochures regarding taxes other than VAT
- establishment of a follow-up system
- random inquiries about customer appreciation of the service behaviour of IRD.

Compliance and Non-Compliance

The overall objective of a tax administration must be to assess and collect taxes in accordance with the tax laws and by doing so, maximize State Revenue. But so far no tax administration in the world has been given enough resources to investigate every possible tax matter that might need to be looked into. At the same time, it is almost universally agreed, the most effective means a tax administration can use to promote voluntary compliance are service and control. Therefore, a tax administration has to rely upon service and control in order to move towards the ultimate target of compliance. By service we mean information activities directed towards the taxpayer community in order

to give the best possible assistance to those who are willing to comply. By control we mean audit activities performed in such a manner that non-compliance is minimized.

As a consequence, any tax administration must use its limited resources in such a way that service and control together produce optimum effect on the compliance of the taxpayer community. The weight that is given to service or control must depend on circumstances that can vary from year to year, but in our opinion a tax administration should have a specific strategy for service and a specific strategy for control. The Taxpayer Charter represents an excellent starting point for a Service Strategy. Therefore, we recommend that IRD develop a Service Strategy.

Of course, the result of service and control activities cannot be optimal if the activities are not supported by competent staff and by reliable systems for registration, assessment, collection and litigation. However, in our opinion, it is service and control that have the greatest effect on the compliance of taxpayers.

In this context, we recommend that IRD begin to try and determine the extent of compliance and non-compliance. This will be time consuming and difficult but necessary as a basis for the future work. There are at least two possible approaches. One is the macro-way, i.e. to use the national accounts of Namibia, the other is the micro-way, i.e. calculations based on results of tax audits. The OECD in the report on compliance management describes the micro way in detail.

Control

As mentioned earlier, it is the opinion of the Consortium, that the purpose of tax control or tax audits is to – as far as possible – guarantee that taxes are reported, assessed and paid in accordance with the tax laws.

The taxpayer community is not a homogeneous body. At one extreme there are salary-earning individuals with a fairly simple economy and at the other extreme there are large

companies with enormously complicated structures and economy. Somewhere in between, there are small and middle-sized enterprises whose economy often is intertwined with that of the owner. The different types of taxpayers require different approaches when it comes to control or audit.

Our recommendation is that IRD should issue an audit strategy that, on the basis of risk analysis, deals with:

- salary cases
- small and medium sized businesses
- tax fraud
- large enterprises

This recommendation necessitates the organisation developing a competent audit capacity. As mentioned before, there is a considerable shortage of skilled auditors. The present audit activity of IRD is by no means sufficient. The need is so urgent that the Consortium recommends that IRD make it a top priority to begin to recruit and train audit people. In this context, we also recommend that IRD produce a strategy for the recruitment and training of excellent auditors especially in the field of computerized audit.

Planning and follow-up

Planning represents a way to make the mission and the objectives operational. A starting point for the planning process could be to produce a paper describing the mission, the objectives, the different strategies and policies of IRD as well as the areas the HO wants to prioritise in the planning process. On the basis of the planning conditions given by the HO, each operational office starts its own planning process, considering both the operational intentions and the budget constraints. The result will be a performance plan describing the operations that each office undertakes to perform during next year given a specific budget.

Decentralization and accountability require a follow-up system. The follow-up system constitutes the basis for performance control both within the operational unit and from the HO. For this reason, the follow-up system must reflect the objectives put forward in the performance plan. In addition, the follow-up system should be a tool when it comes to measuring productivity and effectiveness. Therefore, the system must produce figures concerning number of taxpayers, number of specific tasks performed (e g VAT-refunds, outstanding cases, cleared cases, desk audits, field audits) as well as the cost of each specific task performed.

Management needs some sort of Management Information System that is not as detailed as the follow-up system, but that presents some key figures that will give management a glimpse of the present situation with respect to the workflow at the operational level.

Administering follow-up systems is a one major task for the HO. Most organisations have introduced a position as Controller, whom they make responsible for the follow-up system. The controller is responsible for both the system itself and the presentation of analysis to the management. The controller will also give support to the management when it comes to accountability, i.e. discussions with the heads of operational units concerning results versus performance plan.

A follow-up system – as described above – will be a basis for both quantity and quality control. In order to be complete, the quality control must also cover the quality of decisions made, reports presented etc. For this reason, these papers must be tested so that they are in accordance with the laws and the ethics of IRD and the country of Namibia. In order to be able to make a judgement in this context, the controller probably needs the assistance of the Legal Entity at the HO.

Still another aspect is the accuracy of the handling of payments. A tax authority handles a lot of money. The system in itself should have controls and measures that aim at securing that it is not misused. In addition to this, it is extremely important to have an internal

audit that both performs regular controls and investigates potential frauds. At present the MoF has a function for Internal Audit. It is essential that these audits are performed on a regular basis.

Consequently, the recommendations of the Consortium are that IRD should create:

- a planning system
- a follow-up system
- a Management Information System
- a controller function at the HO

Moreover, we recommend that IRD and the MoF contemplate how to strengthen the Internal Audit function.

Human Resources

The taxation officers – who represent 2/3rds of the staff – seem comparatively experienced, at least when the average time of employment – 7,5 years - is considered. 70% of these officers have been employed for more than 3 years and 40% more than 7 years. In our opinion, these figures indicate some sort of stability that can be extremely important to an administration undergoing great changes.

The changes that can be foreseen will put Human Resources under pressure. On the one hand, the present taxation officers must be trained to cope with the partly new situation. On the other hand, a large part of the present workload of the rest of the staff – presumably clerks – will disappear, sooner or later. Therefore, there will be an extreme need for training to transform these individuals to taxation officers. In fact, the training of employees might be even a greater challenge to IRD than the evolution of the operational work.

It is urgent to start promptly with the analysis needed to cope with the challenges in training and to produce a training strategy taking into consideration the entire scope of the future.

As pointed out by the OECD, skilled and committed employees who are valued and treated equitably are more likely to act fairly and professionally in all their dealing with taxpayers. In this context salary and benefits paid as well as career opportunities may create an attractive work environment. Skills also must be matched to tasks and effective training programs should create competent employees dealing with also the most complicated cases.

Codes of conduct are especially important as they define the behaviour and performance expected from public officials. This is especially important to an administration with a clear change of focus towards customer orientation. To most tax administrations, this change has taken considerable time, often more than 10 years. This fundamental change will be achieved sooner if it is supported by a code of conduct that explicitly sets the rules for the relationship between tax officers and taxpayers. Rules on conflicts of interest minimise the possibility of personal interest competing with public duties.

The recommendations of the Consortium are to:

- give priority to recruitment and training of employees
- produce Human Resources Policies that deal with remuneration, required qualifications, reasons for promotion, gratifications, reasons for dismissal, code of conduct and rules on conflicts of interest.

Operations

On the road towards a partly new identity, there are some areas that should be seriously looked into. First, the way in which taxes are paid. The present discussions with the banks should be concluded so that the banks accept payment on behalf IRD. Second, the

problems concerning the PAYE-system and reconciliation ask for a prompt solution. Third, the need for considerably increased audit capacity as well as an audit manual.

We have been told that IRD have extensive plans in the field of increased computerization e.g. electronic filing, electronic refunds and reception of returns on disc. This represents an even more dramatic change than the areas mentioned above. However, it is our firm belief that further development in the area of operations must be given less priority than the other changes proposed in this document. At this instance, our recommendations are:

- present the new focus of IRD to staff, taxpayers and stakeholders
- continue the efforts aiming at making the banks accept payment of taxes on behalf of IRD
- solve the problems caused by the PAYE-system
- increase the audit capacity and introduce an audit manual

Strategy for Change and Implementation Project

As mentioned, more than once in this document, it is not recommendable or even possible to try to address all these areas at the same time. Therefore, it is essential to create a strategy for change. Such a strategy must be based upon the circumstances within the MoF and IRD and take into consideration the overall Namibian situation and present a timetable for the different steps of change.

The most neglected areas are human resources (especially recruitment and training) and operational management. There is less need to prioritise operations and further computerisation of the workflow. If an efficient solution for these problems requires an autonomous revenue authority, the need to prioritise will be even stronger.

The strategy for change will ask for an implementation project headed by the top management of the future revenue authority.

Appendix 15

Independent Revenue Authority

Experiences in the Field of Autonomy

There are a number of documents – e.g. the Terms of Reference, the Government White Paper of August 1995 and the Annual Report 2000/2001 from the Ministry of Finance – that implicitly indicate that an autonomous revenue authority should be contemplated in Namibia. For this reason, the Consortium has decided to study the implications such a step might have in Namibia.

Some Sub-Saharan countries have had experiences of autonomous revenue authorities. These experiences have been analysed by or through the initiative of the Department for International Development (DFID) of the United Kingdom.

The arguments in favour autonomy relate primarily to effectiveness and efficiency

- A single purpose agency can focus its efforts
- When autonomous, it can manage its affairs in a businesslike way, free of political interference in day-to-day operations
- Freed from the civil service system, it can recruit, retain, or dismiss and motivate staff to a higher level of performance.

The success of the public sector depends to a large degree on effective and efficient revenue collection. Therefore, in most countries the driving force has been the need to increase tax revenue. In some cases, the aim has not been to increase tax revenues, but rather to improve effectiveness and efficiency of the tax system, potentially allowing reductions in taxes levied and thereby reduce the burden of the tax system on the economy.

The arguments against autonomy are mainly that it results in higher cost, that people in senior position might have a vested interest in securing higher rewards, and that it leads to fragmentation of the Public Service.

According to one British report, autonomy can be recommended in situations where civil service pay rates are a real obstacle to employing qualified staff and where civil service regulations are a hindrance to effective human resource management. In such cases, autonomy can provide managers with the necessary flexibility to perform. At the same time the reports emphasizes, a Revenue Authority is not a guarantee for insulation from political influence, nor from incompetence or malpractice.

The report suggests a number of factors likely to influence success with an Independent Revenue Authority (IRA) reform:

- An appropriate framework should be devised for regulation and accountability of the IRA to counterbalance its autonomy and to ensure that output and performance standards are achieved but without interfering with operational decisions and inputs.
- The Board should have clear terms of reference which prevent interference in day-to-day management.
- The Ministry of Finance needs to maintain a degree of independence from the Board so as to enable it to regulate the IRA. There is need for a clear division of responsibility between the IRA and the Ministry of Finance on tax policy.
- Time is needed to establish and consolidate an IRA: too many organisational changes (autonomy, integration, systems modernisation, decentralisation etc) at the same time can create management overload.
- Potential benefits from integration of tax departments are less quickly realised than those connected with human resources.
- Proper human resources management policies are essential, i.e. policies rewarding good performance and dealing with poor performance.

- Tough action is required at an early stage to weed out incompetent and corrupt staff and it is easier if all staff have to apply for their jobs at the outset (This requires political support).
- A funding package which involves an annually approved basic budget plus an additional amount based on a percentage of tax revenues above a specified target, probably provides the best balance between autonomy, accountability, predictability and incentives.
- Dynamic and honest leadership from the CE is crucial as well as good working relationships between the CE, the Board and the Ministry of Finance.
- The IRA needs to work at changing staff attitudes from hostile, reactive and bureaucratic, to customer-oriented, proactive and professional.

A later report from DFID contains findings and conclusions as to what has worked in the area of autonomy.

In a number of African countries, the evaluation concluded that the establishment of semi-autonomous revenue authorities was successful at quickly increasing revenue generated compared with what would have happened otherwise. The report also mentions that a plateauing in revenue/GDP ratios followed initial rapid increases.

The DFID concludes that initial gains may be significant, but second generation challenges in strengthening revenue administration are quickly manifested. First, gradual erosion has been observed of salary differentials between tax administration and other public service administrations. Second, Ministries of Finance have been consistent in maintaining control over the authorities' funding. Third, often externally imposed revenue targets make it difficult to achieve a productive balance between short-term revenue targets and the need to invest in developing the revenue base. Fourth, the indicators of performance commonly used have in practice been ineffective as tools for measuring, or managing, performance in the short to medium term. Fifth, the need to control corruption among staff should be embedded in national programmes to curb corruption.

In addition to this, the Consortium has drawn information from discussions and survey of some countries (i.e. Tanzania, Zimbabwe, Kenya, Zambia and Uganda). Most of our findings coincide with those of the DFID. Nevertheless, there are a number of observations that we would like to put forward as essential in the context of autonomy.

- If some of the present personnel of the Tax Departments are not to find careers in the future revenue authority, this must be clearly stated. Lack of decisive communication may result in problems and in some cases legal action.
- It may take time for some tax officers, for example those visiting taxpayers, to change their approach from a civil service to a business like way of dealing with the public. There is a specific need for training in this area.
- In spite of attractive incentives to the employees, Revenue Authorities have lost well-trained personnel to the private sector. One explanation is a lack of career development and succession planning. Another might be unjustifiably high expectations regarding remuneration.

Comments and Recommendation

Autonomy of a Revenue Authority is not a guarantee for a more efficient tax administration. On the other hand, the autonomy can be recommended in a situation where civil service pay rates are a real obstacle to employing qualified staff and where civil service regulations represent a hindrance to effective human resource management.

In Namibia, it has been argued that remuneration is a problem when it comes to recruitment of skilled staff. There is an obvious lack of progressive human resource management. Also, the operational management does not use modern management instruments. This could be a consequence of being too dependent on the Ministry.

Looking at Inland Revenue Department (IRD), the main impression is that it is a centralized entity. Moreover, the responsibility for such vital functions as Information Technology (IT) and Human Resources lies with the Ministry of Finance (MoF) and not

with IRD. Further, there exists no document that clearly defines the responsibility of different entities within IRD and between IRD and the MoF. The present management problems can partly be attributed to the centralisation of decisions and the lack of documents defining the responsibilities of different entities.

Against this background, it might seem natural to come to the conclusion that there exists in Namibia a clear case for the establishment of an autonomous revenue authority. At the same time, it should be kept in mind that this does not represent an easy policy route. The Consortium believes that autonomy should be seriously considered. In this context, a number of steps should be taken in consecutive order.

First, the content of autonomy must be defined. Second, the consequences for both the new authority and the ministry must be analysed. Third, there is an apparent need for new instruments supporting the efficiency of such a decision.

Autonomy may mean a right for the previously subordinate body to set wages, to recruit, train and dismiss employees, to set operational targets, to invest in equipment including IT, to hire or own the premises of the operations. Autonomy can also be more restricted. The point is that the actual content of the autonomy must be codified. Further the new relationship between the authority and the department must be documented. This will require a Revenue Authority Act that will be decided upon by the Parliament. Such an Act will take time to prepare and pass through Parliament.

A Revenue Authority Act would regulate the division of power between the Authority and the Ministry. It can also make clear in which way the Ministry should steer and control the new autonomous body.

The problem of funding should also be addressed at an early date. Performance indicators that can be used for follow-up and control must accompany the principles of funding. The more autonomy the revenue authority is given, the more effective the follow-up system must be.

Time is required time to establish and consolidate the new authority. Experience shows, that too many organisational changes can create management overload.

Further, autonomy must be accompanied by proper human resources policies, i e policies rewarding good performance and dealing with poor performance.
Last but not least, the autonomy requires a dynamic and honest leadership by the CE, as well as good working relationships between the CE, the Board and the MoF.

Even if there is evidence in Namibia of a clear case for an autonomous revenue authority, the Consortium is eager to emphasize the importance of thorough consideration of the above-mentioned areas, before making a decision on autonomy.

Any transition towards autonomy must occur step by step. Moreover, each step must be built on thorough analysis and be accompanied by a timetable. A very important part of the concept is to be aware that such a transition will and must take considerable time before it is completed.

Step 1: Decision

This step contains a number of different parts:

- A decision for or against autonomy. If the decision is no autonomy, it is still necessary to decide on what kind of reforms are needed in order to modernize the present administration.
- The content of the autonomy. It must be made clear, what kind of autonomy is to be introduced. One option is full autonomy with the right of the authority to - given a specific budget and specific targets – decide who to recruit and dismiss, what wages to set, what equipment to buy, what premises to hire etc. Another option is to limit the autonomy in one or other aspect. The point that must be stressed is that it is absolutely crucial that the degree of autonomy is made clear from the beginning.

- Objectives and targets explaining what performance the Government expects from the new authority. In this context, the existing Taxpayer Charter may constitute an excellent starting point.
- The way in which the new authority is to be funded. One-way is to start with the present budget (plus budget for IT and HRM in case of full autonomy) with additional budget for the transitional work. A second way is to try to develop a Fund Allocation System based on basic statistical information concerning the taxpayer community and performance indicators. This will take time – a couple of years – and for this reason the second step might be preceded by the "one way" described above. A third way is to connect the funding to the present and the expected total revenue. All three ways have their pros and cons. As mentioned earlier, the "third way" has been criticized by the ACED and the DFID.

Step 2: Revenue Authority Act

The creation of an autonomous revenue authority should be based on an Act of Parliament.

The minimum content of such an act is set out as follows:

- The decision on autonomy and the content of autonomy.
- Objectives and targets explaining what performance the Government expects from the new body.
- Funding
- The way in which Government intends to manage the IRA. The roles of the Ministry of Finance versus the IRA.
- The Board of the new IRA, its role and its relationship to the Commissioner and to the Ministry of Finance.
- The organisation of the IRA. We recommend deciding on basic principles such as the role of head office versus regional offices, i.e. whether the regional level is expected to be an integrated part of the IRA or autonomous bodies, principles for decentralization, compliance measurement, performance measurement, and risk management and also the role of Head Office versus Operational Offices. Then an

Organisation Committee is appointed with the assignment to come forward with a proposal for an organisation of the new IRA. This work might be used to get the necessary basic statistics needed for a decision on funding.

- How to deal with the personnel of the IRA. There are at least two alternatives. One way is to dismiss all personnel and to let them apply for the new positions created within the IRA. The alternative is to transfer all personnel to the new authority.
- A detailed and realistic timetable for the transition work.

Step 3: Organisation Committee

The Commissioner of the new IRA should head the Committee. The committee should have a steering-group consisting of representatives from the Ministry of Finance and the Taxpayer Community. The work of the Committee must cover at least the following aspects:

- Practical implications of the basic elements (decentralization, planning and follow-up, customer focus, compliance measurement, performance measurement and risk management) presented in the Revenue Authority Act.
- Funding principles within the IRA
- Accountability and responsibility of separate organisational entities.
- Division of work between Head Office and Operational entities.
- The IT-department
- The treatment of Big Enterprises
- The treatment of Fraud Cases
- The position of Customer Service Centres versus other operational entities
- The affirmation of qualified tax audit and especially computerized audit.
- The organisation of Head Office and the operational entities.
- Identification of different careers within the IRA and the qualifications needed for each career/position.

- Practical implications of the work needed to fill the organisation with employees
- Principles for remuneration
- Principles for recruitment and dismissal of personnel.
- Code of conduct
- Planning and follow-up principles
- Performance measurement
- Customer Service and compliance measurement
- Risk management
- Time-table for the transition

In the context of the recommended changes of the work of the Tax Administration we have emphasized the necessity of a strategy for change as well as an implementation project. If autonomy is seriously considered, it will make this necessity even greater. In fact, there will be such a great number of changes to implement that some ingredients will have to be given less priority. This will make the need for strategy even more crucial to the success of the transformation to a modern revenue authority.

In addition to this, there are a number of considerations that the Consortium would like to stress.

First, the number of changes and the scope of them will ask for a strong and competent leadership. Therefore, the transition work should be lead by the commissioner of the new IRA. It is essential that this leadership has a solid and evident support from the Government and that is based upon a genuine experience and a profound knowledge of both administrative and legal matters.

Second, the new authority will have to rely on the personnel of the present Inland Revenue. Of course, there might be a number of new recruitments, but the main body of the new authority must consist of personnel from the IR. The transition will require that employees will have to - at the same time - carry on the work of the old IRA and

participate in the preparations for the new authority. If this can be arranged in a smooth way, the personnel must be feeling that they have influence and trust; that they are participating in the building of a new and modern authority. This will place great stress on both the leadership and the Human Resource Management of the new authority.

Third, the relationship between the Ministry of Finance and the IRA must be clear and well documented. The degree of autonomy must be made absolutely precise. The way the new authority will be funded and steered must also be well known beforehand as well as the way in which the MoF will follow-up the performance of the new authority. In this context, it is important to stress that the targets set up by the MoF should not be so detailed that the authority will not have freedom to choose the means to fulfill these targets.

Fourth, the funding of the new authority must provide realistic means for both transition and development of the performance. With the assistance of the Ministry of Finance, the Consortium has calculated a rough figure on the administrative cost of the Inland Revenue. Based upon the National Accounts of 1999, the administrative costs represent 0.8% of the total revenue. The actual figure should be somewhat higher – perhaps 1% - due to the fact that the cost of IT is paid for by the Ministry. In an international perspective, this represents a comparatively low figure, especially compared to developing countries. Against this background, there might be room for additional funding.

Fifth, there must be a realistic attitude to the content of this transition, that it will and must take time, that there must be room for mistakes as well as a capacity to make necessary adjustments to different transformation plans.

A Regional Perspective

Introduction

To date African Countries, which have set up Revenue Authorities are:

Ghana	1985
Uganda	1991
Zambia	1993
Kenya	1995
Tanzania	1996
Lesotho	2000
Malawi	2001
Zimbabwe	2001

Mauritius is discussing possibilities of setting up an IRA.

Other countries in the world that have IRA's are:

Jamaica	1981
Argentina	1985
Peru	1988
Colombia	1991
Spain	1991
Singapore	1992
Malaysia	1994
Bolivia	-
Mexico	-
Venezuela	-

Salient Features of Revenue Authorities

We summarise the salient features and practical experiences gathered in our regional visits.

Board of Directors

- All revenue authorities have a board of directors headed by a chairman
- The Boards are composed of members from both **private** and **public** sectors

- Ex-officio members from Ministries of Finance, Planning, Reserve/Central Banks, Commissioner General

Management

- As far as possible, professional managers appointed either from within the Tax Departments or from private or public sector
- Headed by a Commissioner General
- Assisted by a Deputy Commissioner General
- In some cases Direct and Indirect Taxes are separated, each headed by a Deputy Commissioner- General
- Commissioners of various Revenue Department
- Directors of various Directorates

Autonomy

Autonomous but within the overall supervision of the Ministry of Finance as specified in the Act.

Examples of Vision / Mission Statements

Zimbabwe

Vision

"Our vision is to provide a first class service in Zimbabwe and be a leader in the facilitation of trade, economic development and revenue generation in the region and beyond, through the efforts of professional and dedicated staff."

Mission

"Our mission is to facilitate economic development, trade and travel; revenue generation and collection to enforce compliance with revenue laws and to enforce regulatory controls with integrity, transparency and fairness."

Tanzania

Revenue Authority Mission and Statement

"To contribute to National Development through fair, efficient and effective tax administration, which provides high quality taxpayer or service through competent and motivated staff."

General Functions of a Revenue Authority

The functions of the Authorities are generally stated as follows:

- To act as an agent of the State in assessing, collecting and enforcing the payment of all revenues;
- To advise the Minister on matters relating to the raising and collection of revenues;
- To perform any other function that may be conferred or imposed on the Authority in terms of this Act or any other enactment;
- To assess, collect and account for all Central Government Revenue;
- To administer efficiently and effectively all the revenue laws of the Central Government;
- To advise the government on all matters related to fiscal policy;
- Promote voluntary tax compliance
- To improve the quality of services to the taxpayers;
- To counteract fraud and other forms of tax evasion;
- To produce trade statistics and publications etc;

Sample of Revenue Departments in IRA's

- Value Added Tax Department
- Income Tax Department
- Customs and Excise Department
- Large Tax Payers
- Vehicle Registration Department
- Tax Investigations etc

Support Departments

- Internal Audit
- Finance
- Human Resources & Administration
- Information systems
- Research & Policy
- Tax payer education
- Legal Affairs

Sample of Tax Laws Administered by IRA's (example from Tanzania)

- The Income Tax Act,
- The Customs Tariff Act,
- The East African Customs Management Act,
- The Value Added Tax Act,
- The Excise Tariff Ordinance
- The Stamp Duty Act,
- The Road and Fuel Toll Act,
- Car Benefit Act
- The Airport Service Charges Act,
- The Motor Vehicle (Tax Registration and Transfer) Act,
- The Port Service Charges Act,
- The Traffic (Foreign Vehicles Routes) Act,
- The Vocational Education and Training Act,
- The Customs and Excise Management Act,
- The Foreign Commercial Vehicles Licensing Act
- The East African Excise Management Act,
- The East African Community Mediation Agreement,
- The Pools and Lotteries Act

Repeatedly Stated Advantages Experienced

- Improved Revenue Collection
- Motivated and dedicated staff
- Improved working environment (computers, vehicles, office space etc.)
- Friendly relationship between taxpayers and the Authority because of :
    - Taxpayer education
    - Training of tax officers in customer care and change from civil service culture
- Improved and vigorous training of tax officers (both on job and professional courses)
- Donor confidence, hence immense support (e.g. Tanzania)

Stated Preconditions for Successful Implementation

- Government must be **clear** right from the beginning that IRA will have necessary autonomy and support from the highest echelons of the Government. (Uganda Revenue Authority currently facing a problem of MOF trying to control operations even though the Act is still intact)
- Recruitment and remuneration autonomy of the Board and professionally conducted interviews
- Targets should be set realistically by both MOF and IRA taking into account what is feasible to avoid disappointments where targets are not met or unnecessary optimism when targets are surpassed
- Transition process should be transparent, competitive and have integrity.
- Employees should be made aware of the employment conditions, and be allowed to make their choices clearly.
- Government should be prepared to allocate adequate budget so as to enable an efficient transformation process.
- The staff should be retrained before the effective date of changeover and be assured of continuous retraining.

Transitional Arrangements

Different countries have adopted different transitional arrangements. The list below samples some common arrangements:

- Appointing a Board after the Act is passed, which oversees the transition for a period of say one year before the different tax departments are merged into the IRA
- Requiring all the employees of the Tax Department to apply for the various positions
- Interviewing through private sector consultants
- Giving staff options to remain in civil service and be deployed to other departments
- All appointed staff to be on a probation period of at least one year when they are evaluated and assessed (Tanzania 1 year, Zimbabwe 6 months)
- After the probation period some are by implication dismissed (NB: A Zimbabwe experience shows that those who do not pass the probation should have the option to go back to the main Civil Service. They should all have been on secondment and only resign from Government once confirmed by the IRA)
- Employing everybody on a contract of 3-5 years
- Decision as to which assets are to be passed on from government to the IRA.

Appendix 16

Income Tax Administration – Implementation Strategy and Project Proposal

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Background

At our meeting with the Minister of Finance on 04 November 2002, he asked us to prepare a strategy for change.

The purpose of this paper is to present our proposals with regard to Tax Administration and Autonomy. The fact that the Minister is not prepared to create an autonomous Revenue Authority at this stage, he made very clear during the meeting. In our opinion, this is understandable. The experience of other countries with autonomy has not always been satisfactory. At the same time, an autonomous body must be managed and controlled.

Autonomy is not a goal in itself but one of several means that can contribute to the creation of a first class tax administration. With this paper, we convey that it might very well be possible to achieve this even without autonomy. Then as a consequence, a first class tax administration can – at this later stage – be given autonomy.

Desired Situation

The Namibian Tax Administration should be administering the tax system with effectiveness and efficiency with a focus on compliance and non-compliance using modern management instruments and promoting high professional and high ethical standards with respect to the employees.

The Present Situation

Today the IRD can be described as an administration with a high standard in the field of interpretation and administration of tax laws. The workflow has been computerized to a large degree and the VAT has been implemented successfully. In addition to this, the IRD have taken remarkable steps in the field of customer orientation based upon a Taxpayer Charter of very high standard even in an international context. However, there are a number of areas where IRD have been less successful. One is audit. The number of tax audits and the audit competence is very limited and there is no experience in the field of computerized audits. At the same time there is a lack of progressive Human Resources Management partly due to the restrictions regarding the payment of competitive remuneration in order to attract and keep qualified personnel. In addition to this there is insufficient use of modern operational management instruments, e.g. planning and follow-up, performance measurement and risk measurement.

The Solution

In order to promote development towards the Desired Situation considerable efforts must be taken primarily in the areas of

- Operational Management
- Tax Audits
- Human Resources Management (HRM).

There are other areas where there is a need for further improvement – e.g. operations and customer orientation – but these efforts appear to be rather limited compared to the need of improvement in the above mentioned areas.

The Challenges

IRD have developed competence (at top management level) in the field of the interpretation and administration of tax laws. At the same time, there is an apparent shortage of skill and experience with regard to modern management instruments both operational (Planning and Follow-up, Decentralisation and Accountability, Performance

Measurement etc) and non-operational (e.g. Human Resources Management). One challenge is to develop these modern instruments without loosing or dramatically reducing the present high competence described above.

At the same time, it will not be possible to have progress in the development of new instruments unless the present relationship between IRD and the MoF is changed in a number of ways. First, there should be a written document making the roles of the two entities very clear. Second, the new instruments require decentralisation of power so that IRD will be made accountable. This does not mean autonomy on the part of IRD but a considerable change in the present relationship between the two entities. This represents another challenge.

The present shortcomings in the field of tax audit can to some extent be explained by the absence of operational management instruments. However, a more obvious explanation is the lack of human resources management, primarily the inability to pay competitive remuneration in order to attract skilled employees. Therefore, a third challenge is to get the MoF to fund the necessary investments in both skilled expertise and equipment (primarily computers).

The effectiveness and the efficiency of an organisation cannot be achieved solely by improvements in management skills and through the acquisition of a few highly competent auditors. The operational result will primarily be dependent on the way employees are treated, i.e. trained, expected to participate in planning and follow-up, offered different careers and remunerated. The point is that a modern administration must rely on a number of HMR instruments, not only remuneration to be effective and efficient. The fourth challenge is to establish an HMR-policy of IRD that enables IRD to use and develop the entire capacity of the present employees. The employees must feel that they actually represent the most valuable asset of the organisation and that top management is prepared to invest in their future provided they are willing and capable of undergoing further training and meet new qualification demands.

Decision by the Government

The first step is to get the Government to decide to create:

A first class Tax Administration working effectively and efficiently on the basis of:

- Accountability
- Decentralisation
- Customer orientation
- Compliance and risk management
- Planning and follow-up
- Performance measurement
- Skilled and dedicated employees.

Accountability and decentralisation require on the one hand, the freedom to decide on matters within the own "jurisdiction", on the other hand the obligation to be made responsible for the effects of these decisions. If there is no freedom to decide on the means, you cannot be made fully responsible for the result. An organisation that is not free to decide on operational matters – interpretation of law and treatment of employees being examples of the extremes – will not be able to fully develop its own internal capacity in the context of effectiveness and efficiency. At the same time, decentralisation without steering and control is irresponsible. For this reason, the decision by the Government should be one of principle. The exact content and the actual future relationship between IRD and the MoF cannot be documented until there is a detailed proposal.

Furthermore, this development will necessitate stable and detailed principles for funding of IRD. Such a funding system should preferably be based upon basic statistics and performance indicators. However, it will take time to establish such a system. The decision of the Government should therefore be to accept the idea in principle and – until such a system is in place – to give IRD a budget based upon the present expenditures with additional fund necessary for the transition work building the new administration.

The most urgent need for development is in the area of tax audit. One reason is that at present the tax audit is undeveloped, to say the least. Another reason is that it will take a number of years to establish a competent tax audit capacity. As a matter of fact, it should be much easier to achieve quick results in the management field. The decision of the Government should therefore be to invest in tax audits. This decision must be made in principle and the actual funding be based upon needs presented to the Government at a later time.

One essential key to progress lies in the way the employees are treated. Bearing in mind that a salary increase is not a universal solution to every kind of problem, there is an urgent need for a Human Resources Policy that explains in detail the conditions for recruitment, dismissal, conduct, remuneration, career possibilities, participation in target-setting and planning etc. It is not possible to create an effective and efficient organisation without the active participation of the employee who must feel valuable and trusted in order to be able to participate and contribute to the success of the organisation. To achieve this, the Government should decide to create an HRM-policy applicable to IRD which should be presented to Government for approval.

The extent of the change and the complexity of the matter will require a specific Implementation Project headed by an Implementation Manager.

To summarize, the basis for the implementation work should encompass a number of decisions on the part of Government:

- To create an effective and efficient Tax Administration
- To build the new administration on the basis of accountability and decentralisation
- To establish a document describing the future relationship between the MoF and IRD
- To create a funding system and to give financial room for the implementation work

- To fund a substantially improved competence in the tax audit field
- To create an HRM-policy that supports these necessary improvements
- To establish an Implementation Project headed by an Implementation Manager.

Implementation Project

The project and its manager should work in accordance with specific Terms of Reference from the Government and should be supported by a Steering Group consisting of representatives of the MoF and the taxpayer community. It is advised to divide the project into at least three sub-projects dealing with

- Management
- Tax Audit
- Human Resources Management.

A manager reporting to the Implementation Manager should head each sub-project. It is important that the members of the sub-project are chosen both from IRD and among expertise outside the administration. The implementation work will to some extent interfere with the day-to-day work, but it is desirable to minimize this effect.

The Implementation Manager could be recruited from outside provided that this person has a sound knowledge and experience of legal and administrative matters. The success of the implementation will to a large degree be dependent on the quality of this recruitment.

The instructions of each project must include a timetable and if necessary dates for checkpoints.

Sub-Project 1: Management

This project is supposed to look into and analyse the following areas mentioned in our report:

- Decentralization and Organisational Principles
- Funding
- The new role of Head Office
- Organisation of Head Office and Operational Entities
- Goals and Challenges
- Compliance and non-compliance
- Planning and Follow-up
- Performance Measurement

The purpose of the project is to introduce and make operational the above mentioned new management instruments. The work will result in

- A reconsideration of Mission and Objectives
- A plan for decentralisation
- A documentation of IRD vs the MoF in the new decentralised environment
- A new role for Head Office
- A new organisation (Head Office and Operational Offices)
- An Operational Planning Process
- A Time Reporting System connected to the planning process and the follow-up system
- A Follow-up System based upon a detailed description of the workflow and the cost of every detail of the workflow
- A Performance Measurement System
- A Funding System based upon performance criterias
- A Management Information System
- A Controller Function within Head Office.

In order to decentralise there must be instruments in place that support this decision. Such instruments are preferably a planning system and a follow-up system but also objectives

and performance criteria. On the part of the MoF, this means specific if not detailed demands that are directed at IRD meaning that the MoF expects a specific performance from IRD and that the follow-up system makes it possible for the MoF to check if results are in accordance with demands. In this way IRD are made accountable. With such a system in operation, the MoF should try to decentralise, because decentralisation and accountability is a precondition for a development towards greater effectiveness and greater efficiency. Of course, the same discussion and the same conclusion are applicable within IRD.

All this work should not be carried out simultaneously. A Funding System based on performance criterias cannot be established until these criterias have been identified. The Management Information System should be put into full-scale operation until the other systems are in place.

The timetable for this sub-project must cover more than one year. During the first year it is realistic to demand rudimental results in connection with Mission and Objectives, Decentralisation, Head Office and Operational Entities, Planning Process and Follow-up system. These results could preferably be reported in a sub-report. It will take longer to create a Performance Measurement System and a detailed Follow-up System partly because these will depend on the Time Reporting System being put into action. This will ask for at least one more report.

It is advisable to seek support outside the organisation and learn from the experiences and mistakes made by others. In the basic report on Tax Administration, the Planning System of the Revenue Authority of Zimbabwe is presented as an Appendix. Benchmarking is strongly recommended, not least because of the risk of “reinventing the wheel”. The OECD has published a number of documents that could be of interest in this connection.

When the new organisation and these management systems are put into operation – even if not developed into perfection – the work of the sub-project is complete.

Sub-Project 2: Tax Audit

Background

As mentioned before, the number of tax audits and the audit competence are insufficient. During the period November 2000 – December 2001 the number of field tax audits amounted to 264. During the same period 16 cases of special investigation were concluded. These audits have not been directed towards big enterprises and there has been no computerized audit.

In Namibia – as in most other countries – the large companies represent the majority of the private sector economy and can be expected to pay considerable amounts in taxes. If these companies know that there is no tax control, there is a significant probability that they tend to minimize their taxes as much as possible. This has been proved to be the case in a number of countries. As a result, there will be no voluntary compliance but voluntary contribution. Without effective tax audits there will be very little compliance. Therefore, tax audits constitute one essential precondition for an efficient tax system. This makes the Namibian situation serious.

The fact that today the accounting of business enterprises is to a large degree computerized, constitutes another big problem. There is no way to audit these enterprises effectively without competence in the field of computerized audit. IRD lack such competence. This makes the Namibian situation even worse.

Partly as a consequence of globalisation, there is a tendency in the world of increasing economic crime. The most threatening pattern is the shift of focus within organised crime. Organised crime is more and more acting in the field of economic crime, buying companies and operating under the disguise of serious business. Taking this into consideration, the present status of special investigations in Namibia is insufficient, to say the least.

In our report, we have proposed a Schedular Taxation of salary income. As a consequence, the employees will no longer have to file an income tax return. The income tax is finally handled by the employer and paid to IRD monthly. At the end of each year, there will be a reconciliation - meaning that the twelve monthly payments are summarized and compared to a yearly report from each employer. The tax is a final monthly tax. The assessment work earlier performed by IRD will be the responsibility of the employers. The system must be supported by rigorous field audits. The number of employers will exceed 7 000. This final tax will represent more than 6 per cent of the GDP of Namibia and more than 20 per cent of the total tax revenue. From an IRD administrative point of view, it can be argued that it is more effective than the present system. However, with limited field audit capacity, a minimum field audit control will require field audit of all employers within a five-year period. Consequently, the field audit capacity of the IR must be substantially increased. As a matter of fact, it can be argued that the final tax should not be introduced unless IRD has a capacity to audit the employers.

Solution

Against this background, it should be obvious that the field audit capacity of IRD must be substantially increased. In this context, a number of problems must be emphasized. First, the present insufficiency cannot be effectively solved without input of external expertise. Second, it will take up to five year of training to get an auditor capable of approaching the challenges described in this paper. Third, it is realistic to come to the conclusion that the vast majority of the future auditors must be recruited from the present personnel of IRD. Fourth, the number of auditors will depend on the Audit Strategy. Today, there is no such strategy. Fifth, there must be an HRM-policy supporting this investment in increased audit capacity.

According to the Consortium, the investment in increased field audit capacity should be given higher priority than any other recommendation. It represents a way to secure the tax base and will most certainly result in substantially increased tax revenue. The increase

in revenue might even appear even before the capacity has been fully developed. The business community is supposed to realise that the audit capacity will constantly improve and that even returns filed earlier may be scrutinized. Given this priority, we recommend that the MoF decide on this investment as soon as possible.

Audit Strategy

An essential part of the work of this sub-project will be to prepare an Audit Strategy. The recommendation of the Consortium is to issue a strategy that, on the basis of risk analysis, deals with:

- Salary cases - employers
- Small and medium sized businesses
- Big enterprises
- Tax fraud
- Computerized audit.

One part of this work is to define what constitutes the parameters of each category and to calculate the number of objects in each category. Then the necessary audit frequency should be determined as well as the expected number of days each audit (on average) is expected to last. Finally, it will be possible to estimate the number of auditors needed to operate in accordance with the strategy.

Risk Analysis

It is realistic to come to the conclusion that IRD will never be given enough resources to be able to field audit every entity each year. For this reason, there will be a need to prioritise among the potential field audit cases. In this context, we recommend that IRD use Risk Management and Risk Analysis. The OECD has presented the principles for such analysis. These papers also give inputs to further work on audit selection techniques.

It must be an essential part of the work of this sub-project to develop a model for risk analysis and audit selection.

Audit Manual

In order to steer the audit fieldwork there is need for an Audit Manual. This is an audit programme that tells the auditor which steps to take and in which order. The programme should be seen as a guarantee for equality in treatment of taxpayers as well as a means to certify that each audit reaches minimum depth.

The manual should be in place as soon as possible.

Big Enterprises

Big enterprises represent a challenge to any tax administration.

It will be necessary to investigate the nature of the large enterprises of Namibia. The result of this work will have an influence upon the way IRD will best approach them for audit purposes.

It is realistic to conclude that it will take some years before IRD have improved the audit competence to such a degree that such audits are justified from the standpoint of effectiveness and efficiency. Nevertheless, the survey work should start as soon as possible.

Computerized Audit

As mentioned before, the accounting of the majority of businesses is computerized. The bigger the enterprise the more difficult it is to audit its accounts without computerized techniques. There exists equipment that makes it possible to copy the accounting – part of or even more – of an enterprise and to let it undergo tests constructed by a tax administration. There are also instruments that facilitate the audit work, i.e. some sort of computerized audit manual.

The Sub-project should investigate the need for computerized audit support.

Fraud Cases

In a globalised environment and with enterprises working across national borders, it is of crucial importance for a country to have a capacity to detect, and through enforcement, stop cases of economic crime. This requires two things. First, highly competent investigators, and second, rights to investigate and to detain people suspected of crime.

It should be a priority to try to quantify the necessary audit capacity and to analyse if the present legislation gives sufficient support to such investigations.

Recruitment

Based upon the Audit Strategy and other analysis presented in this paper, it should be possible to – at least roughly – determine the number of auditors needed. Of course, every auditor need not have top skills in every aspect of the audit work. There will be a great difference of required basic skills if you are supposed to audit small or medium size enterprises compared to the audit of big enterprises or fraud cases.

Then the competence of the present personnel must be investigated. In this context, it is essential to try to estimate their potential for successful training in the audit field.
The result of this investigation will have an influence upon the need for recruitment of new personnel. This will be a crucial part of the work of the sub-project. It is realistic to think that the judgement of the investigators will be questioned. At the same time, the present personnel – due to anticipated funding problems – will constitute a restriction to the audit investment.

This sub-project will have no chance of success if IRD is not able to attract external expertise. Today, there is an apparent internal lack of competence in the areas of

- Computerized audit
- Audit of big enterprises
- Investigation of fraud cases.

These experts must presumably be recruited from the private sector. We do not think there should be more than a small number – 3-5 persons. The natural procedure will be to recruit them on a contractual basis for a limited period of years. The immediate purpose of the recruitment will not be to perform a number of audits but, to take part in the Implementation Project and to train auditors to a greater degree of competence. In this context, it is realistic to estimate that they will participate in audit cases. It might also be possible to get support from overseas. There are a number of countries with a vast experience in these areas. This support might even be financed through Donor Programs.

A great challenge to this investment will occur if the remuneration of the employees trained in qualified audit appears to be too low to keep them within IRD. This will put HRM-policies under great pressure.

Sub-project 3: Human Resources Management

At present, IRD are a part of the public sector. This puts restrictions on the HRM of IRD. So far, IRD have no HRM-policy of its own. The success of the proposed transition to a modern tax administration will to a large degree be dependent on the way the qualified employees are treated.

As mentioned earlier in this paper, one essential key to progress lies within the HRM-policy. Bearing in mind that a salary increase is not a universal solution to every kind of problem, there is an urgent need for a HRM-policy that explains in detail the conditions for recruitment, dismissal, conduct, remuneration, career possibilities, participation in target-setting and planning etc. Today, it is not possible to create an effective and

efficient organisation without the active participation of the employee who must feel valuable, trusted to be able to participate and contribute to the success of the organisation.

Employees who undergo tough audit training will presumably want to know what they might expect in the form of future career and remuneration. Experience from abroad tells us that the remuneration must not necessarily be equal to that available in the market, but not considerably lower. To a tax administration, the challenge must be to compete with the private sector in the field of working environment, participation in work planning and work development. This requires an excellent HRM-policy.

The importance of this is so great that it requires a specific Sub-Project with the objective to state policies concerning:

- Recruitment
- Qualifications for different types of work
- Remuneration
- Dismissal
- Careers
- Participation
- Code of Conduct.

If this is not possible to achieve within the Public Service Sector, the matter of Autonomy must be seriously considered.

Appendix 17

Customs and Excise Administration

Review of Customs Operations

Background

The Consortium appointed two auditors from Ernst and Young to conduct a review of Customs and Excise operations.

The review included the following:

- Interviews with various Officers within the divisions Administration, Operations and Legal & Technical Services.
- Revision of working documents.
- Revision of structures.
- Inspections of activities and premises.
- The following Customs and Excise offices formed part of the sample review:
    - Windhoek Head Office.
    - Windhoek Regional Office.
    - Hosea Kutako International Airport.
    - Buitepos Border Post (Trans Kalahari).
    - Walvis Bay Regional Office, including the harbour and the airport.

The Objectives

The objectives of the review were as follows:

- Evaluate the Directorate: Customs and Excise system from a management perspective.

- Review collection procedures and practices and benchmark them with reference to effectiveness and efficiency.
- Identify factors that may lead to tax evasion.
- Determine structural changes that may be required to improve the system.
- Assess the adequacy of the existing system.
- Assess management information and risk management.
- Determine whether there are adequate resources and the skill level of those resources.
- Recommend a plan of action for improvement.
- Assess the desirability of uniting Customs and Excise and Inland Revenue into one autonomous revenue authority.

The Directorate: Customs and Excise Mission Statement

"Our purpose in Customs and Excise is to protect society with respect to the international movement of goods and people, to collect and secure revenue, facilitate trade whilst exercising appropriate control, and to advance Namibia's interest regionally and internationally in these areas".

The Strategic Goals of the Directorate: Customs and Excise

The self stated strategic goals of the Directorate are as follows:

- Maximise voluntary compliance through clear Customs procedures.
- Optimise revenue collection through efficient controls.
- Deter tax evasion.
- Enhance staff development and performance.
- Improve the ability to gather and analyze trade statistics.
- Active participation in regional and international organizations.

Below are our findings following interviews/observations/inspections of the various sections within the Directorate: Customs and Excise.

Findings:

Public Relations

The Directorate are promoting a public awareness campaign in line with the WCO and SADC Protocol on Trade. The motto is "Happy to Serve". The goals of the awareness campaign are as follows:

- To inform the public in respect to its obligations under the law in order to achieve voluntary compliance.
- To foster progressive partnerships based on mutual trust.

We are of the opinion that the public awareness campaign promotes an approachable image and provides the public with general information and procedures on customs related matters. The awareness campaign should contribute to a positive image of Customs and Excise.

Technical services

The Controller, Technical Services, is responsible for four functional departments:

- Technical Control.
- Audit of enterprises.
- Classification/Valuation.
- Origin.

During our meetings it was observed that the ASYCUDA system has been introduced in Customs and Excise and is going to be upgraded. It will be known as the "ASYCUDA + +" system. The United Nations Conference on Trade and Development ("UNCTAD") has developed the computer system by using harmonized customs documents and codes, to enable the community to verify the application of preferential rates within the member countries. It was observed that various offices are not linked to the ASYCUDA system and many Officers have no computers at all.

The following other key issues were identified when interviewing staff:

- The Officers have expressed a concern with regards to the lack of training needed to enable sound interpretation of financial statements and audit procedures from a risk management perspective.
- The List of prohibited and restricted goods are not generally updated.
- The Officers have expressed a concern that expertise is required in the fields of customs valuation and tariff classification.
- The Officers have expressed a concern that there is a lack of transport in order to conduct inspections.
- The Officers have expressed a concern that there is a lack of computer equipment in order to profile companies.
- The IT system is only linked to Head Office and the border posts are not linked at all.
- Management Authority is centralized
- No specific performance targets are set.
- There is a shortage of manpower due to losses to the private sector.
- The Customs and Excise system is not integrated with Inland Revenue.

Regional Offices

The following issues were identified:

- Officers expressed a concern that there is lack of manpower and specialised skills in tariff classification and checking procedures.
- Lack of equipment, for example forklifts, scanners and manual scanning is required to scan passengers and baggage.
- Non-linkage to ASYCUDA at certain sites / warehouses.
- There is no mechanism in place in order to follow-up whether VAT is paid after having been deferred.
- Control mechanisms to deter corruption are inadequate and need reviewing.

- No validation of duty credit rebate certificates, which could lead to abuse of the rebate provision.

Functional Services

The Functional Services division consists of the following sections:

- Revenue Control
- Logistics

The Revenue Control section is responsible for refund and drawback applications. The Logistics section manages the pool of vehicles allocated to the Directorate.

Officers have expressed a concern that there is a lack of financial accounting skill amongst Officers and a shortage of computers. Officers interviewed expressed a concern that there are no VAT refund facilities available at exit points.

Human Resources

There seems to be a general shortage of manpower especially with financial skills. Of the total 440 posts in the directorate, we were informed that there are 40 positions vacant.

Training

The training division in the Directorate is responsible for all the relevant training of specific technical procedures within Customs and Excise. The training courses are conducted at Head Office in Windhoek and also in South Africa. The duration of the courses ranges between 3 to 30 days.

We were provided with an annual training plan for the period April 2002 to March 2003. However, there seems to be a failure on the part of management to adequately utilize the training available, as staff members are not being readily nominated for training.

We have reviewed the training materials and recommend that the material be improved in such a way that theory can better be related to practice. The implementation of a post evaluation system should greatly assist in improving the relevance of training material and the way it is presented. Furthermore, an evaluation system for the officers attending the training will facilitate managerial review of the effectiveness of the training.

There is a shortage of computers in the training centre as those installed are used for the administration of the centre.

Legal Services

The legal services division is divided into three sections:

- Preventative measures and investigations.
- Legislation and litigation.
- International matters.

Legal Services has no Officers with legal qualifications. Interpretation of the Act and litigation when necessary is therefore hampered. It is difficult to attract and retain people with legal qualification in the Directorate. This needs to be addressed so as to enable the department to have the resources necessary to fulfill its appointed role in the Directorate. The Regulations as well as the Customs Rules in force in Namibia (by virtue of Article 140(3)) of the Namibian Constitution need to be Namibianized and re-gazetted to avoid litigation. This is an arduous and time consuming task requiring liaison with the Ministry of Justice. This should be listed as one of the outputs of the project plan recommended by the Consortium.

Airports

The Hosea Kutako International Airport was visited and Officers interviewed. The following weaknesses were identified:

- Traders and clearing agents are complaining about the slow service which results from a shortage of manpower.
- Defective equipment is hampering work (X-Ray machines, cameras)
- There is a shortage of equipment (computers and screening machines)
- The Harmonized Customs Tariff book is not up to date.
- The trade statistics are done manually and sent to Head Office.
- The Officers have expressed a concern that there is a lack of customs knowledge on the part of the Officers, despite having attended the Customs courses.
- The Officers are experiencing problems applying the theoretical training in practice.
- There are no VAT refund facilities at the airport.
- Export verifications are not done because of a lack of facilities, manpower and room.

Places of Entry

As part of our assessment of the points of entry, an interview was conducted with the Acting Chief of Customs and Excise and two Customs and Excise Officers on site. Furthermore, the procedures used to clear goods and existing equipment were evaluated. Certain Officers were also questioned in order to assess their knowledge with regards to Customs and Excise matters.

The issues identified again include a shortage of skilled manpower and the lack of functioning equipment. Communication with Head Office seems poor as issues referred for attention do not receive prompt attention and Tariff amendments are not advised timeously. Trade statistics were done manually, thereby potentially undermining the reliability of statistics used to claim Namibia's share of the SACU pool.

The lack of systems is further evidenced by the handling of bonds which are lodged to secure the payment of deferred VAT. Places of entry are not linked with one another to ensure that the same bonds are not used elsewhere. Therefore, the amount deferred can exceed the bond amount.

We also observed that the examination of cargo is often not done.

Rebate Stores/Manufacturing Warehouses Inspections

In terms of the information provided to us the following numbers of rebate stores, ordinary warehouses, manufacturing warehouses and clearing agents are registered with Customs and Excise:

- Rebate stores – 27.
- Ordinary storage warehouse – 25.
- Manufacturing warehouse – 4.
- Clearing agents – 26.
- EPZ registrants – 7.

The action plan 2002/3, inspectorate section has only identified 10 rebate stores to be inspected for the period. Therefore only 37% of the rebate stores will be inspected. We, therefore recommend that a policy procedure be implemented to address this issue. We recommend that the inspection of the rebate stores/manufacturing warehouses should be conducted on an ad hoc basis throughout the year as identified by the Controller or Chief of Customs and Excise. In view of the large number of registrations, a period of three months will not be adequate to entertain a full inspection on all registrants, as set out in the department's year plan

The Customs State Warehouse ("CSW")

The record keeping of the CSW should be improved. A record should be kept of all goods entering the CSW.

Customs Warehouse Facility

We visited a warehouse and concluded that the registrant of the customs warehouse mentions effective records of goods that are cleared in and out of the warehouse. Customs and Excise has conducted reviews of this warehouse on a quarterly basis.

EPZ Registrant

We visited an EPZ registrant that manufactures automotive components for the export market. No appointment was made to review the registrant's records.

During our visit it was identified that the registrant is registered in terms of the Motor Industry Development Programme ("MIDP"). In terms of EPZ exemptions, no customs duty and VAT is payable on imported goods. The imported goods have to be used in the manufacturing of products for the export market.

The registrant keeps records of all the import and export documentation. Due to the nature of the business it is not always possible to prove that the imported goods were exported. According to the registrant, a Customs Officer paid them a visit the previous day regarding the record keeping. Balances should be kept of the imported goods that are used in the manufacturing process of exported goods.

It was furthermore noted that raw materials are scrapped and sold to the domestic market and faulty goods, not fit for the export market, are sold to the domestic market. The registrant was informed that permission has to be obtained from Customs and Excise before the goods are sold locally. Customs duty and VAT have to be accounted for when goods are then cleared for home consumption. The registrant has to keep records of goods sold to the domestic industry.

The registrant's export documentation was reviewed. In terms of the MIDP, all exports have to be under Customs supervision. If a Customs and Excise Officer is not available to do an inspection, a declaration has to be signed by the registrant that an Officer was contacted, the date of the call and a reference number has to be declared. It was found that no reference is made of an attempt to contact Customs and Excise for supervision. Customs and Excise only indicated on the declaration, "EPZ export". We therefore recommend that the correct procedures be followed.

In terms of the MIDP, it was observed that Customs and Excise has no copies of the information document on the MIDP. The requirements and procedures of the programme are indicated in the information document. Customs and Excise officials need to increase their knowledge on the MIDP in order to enforce the rules and requirements of the MIDP.

A stock list was prepared when the registrant initially applied for registration in the EPZ. Vehicles and machinery can be imported under the EPZ without paying customs duty and VAT. We recommend that Customs and Excise review the registrant's entire original stock list to ensure that it was not sold for domestic consumption. If a vehicle has to be replaced, Customs and Excise's permission has to be obtained and the customs duty and VAT has to be accounted for.

The Harbour

Oil Depots

During our visit there were no oil vessels in the harbour and therefore verification of the process was not possible.

We however understand that before gas oil is released from the tanker, a "dip" is taken of the specific container at the harbour to establish the balance in the container. After the gas oil has been transferred from the vessel to the tanker at the harbour another "dip" by Customs and Excise is taken in order to confirm the quantity transferred.

We were furthermore informed that a registrant accounts for their excise duty on a monthly basis at Customs and Excise Head Office in Windhoek.

We have not reviewed the registrant's record keeping with regards to their excise duty accounts and therefore cannot express our opinion on the correctness of it. In terms of interviews conducted with Customs and Excise Officers at Walvis Bay, specific training on excise duty was needed.

In terms of the risk management procedures, a verification process is required to verify that the correct excise duty is paid in Windhoek on the goods that are cleared in Walvis Bay. Communication (an audit trail) should be improved between the Head Office in Windhoek and the Walvis Bay Regional Office with regards to the excise duty accounts.

Containers In The Harbour

The Customs and Excise Officers have identified that the lack of equipment, for example, scanning machines and forklifts, are preventing them from examining the containers effectively.

Recommendations:

Human Resources

Suitably qualified staff need to be recruited and existing Customs Officers have to be trained properly on Customs and Excise related matters. In this regard, we recommend that external consultants with technical knowledge on Customs and Excise related matters be engaged to assist with the training and transferring of skills to Customs Officers in specialised customs areas.

The credentials of external consultants should be considered carefully and it should be based on practical experience.

We recommend that a survey of existing skills and a training needs assessment be conducted.

The training programme should be practical and various practical examples should be utilised in order to train Officers effectively.

Training is also required on general accounting procedures in order to equip Officers to understand financial statements, where applicable.

Areas of focus should be on tariff classification, customs valuation, checking procedures and specific excise duty.

The problem of retaining Officers once they have been trained in the specialised customs areas arises. Due to the costly investment involved in training specialised Officers, an appropriate salary policy needs to be implemented to prevent the movement of trained Officers to the private sector. A bonus structure based on performance should also be considered.

The recruitment of qualified Officers presents many problems. There are also no experienced Customs and Excise Officers available to recruit from outside Customs and Excise. Salary scales have to be sufficiently attractive to attract the calibre of qualified personnel necessary, for example in the legal section. This can, of course, be a source of conflict between the new staff and the existing staff and can have a negative effect on the morale of Officers.

In order to avoid conflict, we recommend that the salary scales of all Officers be revised in order to accommodate experienced professionally qualified Officers and recommend that a position be created in order to accommodate a professional qualified Officer. A formal qualification should be a requirement for the position. It will also encourage junior Officers to obtain formal qualifications on a part-time basis.

Information Technology ("IT")

During our review it was noted that the Directorate: Customs and Excise is in the process of upgrading the ASYCUDA system. Changes are time consuming and expensive. When change is spread over a long period of time, it can loose focus, funding and momentum. The system is effective as long as it can be implemented in such a way that it is tailored to meet the requirements of and address the problems of the existing system.

We therefore recommend that the newly established IT division within the Directorate should ensure that the system runs smoothly and that the infrastructures are serviced and maintained on a regular basis. This might eliminate some of the IT problems presently experienced, for example at one of the border posts where the computers have not been working since July 2002 and to date has not been fixed.

During our review we noted that a number of Customs and Excise Officers are not aware of the new system i.e. the ASYCUDA ++ system, which is in the process of being implemented. The ASYCUDA ++ system cannot be developed successfully, without the co-operation and goodwill of all the Customs and Excise Officers. When introducing any computer system, there is always the possibility of user resistance.

Effective Customs control in order to prevent customs duty/tax evasion; fraud or smuggling is one of the main functions of Customs. Due to the limitation of Customs and Excise resources it is not possible, or feasible, to examine every consignment that enters a country. Therefore in carrying out their control functions, a Customs and Excise Officer must be selective. Risk assessment and the selective criteria being used in order to identify consignments for examination of documents for checking purposes are currently done manually. If such processes are automated the selection process can be done on a much more informed and thorough basis.

Intelligence gathered by Customs and Excise Officers can be fed into the system and can be taken into account when the selection process is taking place. The probability of

uncovering fraudulent practices is therefore increased where selective files can be analysed more systemically, accurately and in a timelier manner.

Without over emphasising the benefits of utilising an automated Customs procedure, we observed during our review that information held manually is bulky and it is time consuming evaluating and organising it properly. It is almost impossible to extract meaningful and related data from a variety of files without a very labour intensive exercise in light of the limited resources available.

Again this could be eliminated by the automation of Customs procedures and systems. Furthermore, Customs and Excise has the responsibility of collecting trade statistics which play a vital role in revenue sharing between the South African Customs Union ("SACU") members. Data for the compilation of external trade statistics is generally extracted from import and export goods declarations. Where goods declarations are not processed by computer for clearance purposes, which is the case, the capture of the data takes place at a later time thereby delaying compilation of the statistics. If the declaration process is automated, the trade statistics will be structured in such a way that when the data is captured at the point of importation and exportation, the trade statistics are also compiled automatically.

The automation of Customs procedures will eliminate most of the problem areas experienced by Customs officers, for example, it will reduce congestion at border posts and airports, it will expedite the release of goods and more accurate and timely information will be available. It will furthermore strengthen resources and increase enforcement capabilities.

We furthermore recommend that the most labour intensive procedures be given first priority when the automation process takes place.

Evasion of Customs Duty and VAT

During the review we identified the following areas and factors that may or are leading to customs duty evasion.

- There are no effective control mechanisms in place at the airports. For example, at Walvis Bay International Airport, goods can enter into Namibia without the payment of Customs Duty and VAT.
- There is no equipment available, for example scanners to scan passenger's luggage on arrival at the international airports in Namibia. Forklift trucks are not available to remove goods from a container.
- The lack of necessary equipment will directly result in the evasion of customs duty and goods may therefore be smuggled.

We therefore recommend that an analysis should be undertaken at each airport, harbour and border post to establish the need for equipment in order to improve the control mechanisms utilised by Customs and Excise Officers.

- The knowledge on tariff classification and customs valuation is not sufficient and it therefore can lead to abuse by traders. We recommend that specialised training be conducted on custom valuation for Officers who assess entries in conjunction with on-the-job training.
- Vehicles are imported in transit for export and they could enter the country again without paying customs duty and VAT. The information regarding the engine numbers should be computerised and effective procedures should be in place to identify those vehicles that re-enter the border posts.

A concern has been expressed that Customs and Excise Officers are also experiencing problems when clearing imported motor vehicles. They indicated that most of the values are under declared and the customs officials do not have means or mechanism and

resources to confirm such values. We recommend that the standard uniform valuation of the motor vehicles be followed and in particular second-hand motor vehicles.

Illegal Transit of Goods into Namibia

Because of lack of examination equipment i.e. scanners, forklifts, x-ray machines, Customs and Excise officers are not able to examine the goods which are entering the country. For example, at the Hosea Kutako Airport there is no x-ray machine or any dogs available to assist Officers in examining the goods.

We therefore recommend that priority be given to equip the offices with the necessary equipment.

Inspection Of Bonded Warehouse Facilities

We have noted during our visit to the Windhoek Regional Office that they are experiencing problems with regards to the ratio of Customs Officers to the number of bonded warehouses which have to be inspected on a quarterly basis. The present ratio is 1:25. In most cases they are not able to inspect all the bonded warehouse facilities in one quarter and this could lead to goods going out of the bonded warehouse without customs duty being accounted for.

The payment of the excise duty on fuel in Windhoek and the actual quantities removed from the depots should be investigated in order to establish that the relevant excise duty is accounted for.

We recommend that manpower be increased and the quarterly inspection system be reviewed to address the issue.

Management Procedures And Processes

There is a lack of risk management conducted by senior management. For example, there is no monitoring and review of activities and processes at the border posts and ports to

determine the accuracy of planning assumptions and the effectiveness of the measures and procedures which have been implemented.

We have noted that there is no methodology applied by senior managers to use the available resources at their disposal. We recommend that measures should be taken to assist senior managers to match customs priorities to resources.

It is recommended that meetings with Senior Officers should take place on a weekly basis within the Regional Offices in order to discuss current issues that need attention and prioritise them, for example inspections of a bonded warehouse. Availability of human resources and training should also be discussed during the meeting.

The Controller of the Regional Office should then report to Head Office on a monthly basis with regards to the status of activities within that office.

It is furthermore recommended that Controllers be empowered to deal with immediate situations, while working within the set parameters and to approve procedures.

Controllers should develop action plans on measures to be taken to deal with issues of concern and problem areas, for example, deployment of resources and monitoring activities.

Management should improve the quality of Customs control in areas like information and accountability, for example, the valuation of data, compliance measures and regular audits.

Focus should be placed on high risk areas and deploying limited resources in those areas.

We evaluated current procedures and we have identified potential control weaknesses. The following areas need to be improved:

- The development of risk profiles.
- Company audits.
- Random examinations and inspections.
- Target selection (select transaction for specific checks according to trader, agent, origin of goods, tariff heading, duty rate and value).
- Physical examination (lack of equipment).

We recommend that Head Office introduce a policy document based on the requirements of the Act and Customs and Excise procedures. The Regional Offices should then follow these procedures.

The Desirability of Uniting the Directorate: Customs and Excise and Inland Revenue in a Single Revenue Authority

We have noted that all the Officers are accepting of the concept of uniting Customs and Excise and Income Tax into one Revenue Authority. We however believe that even if autonomy is the desired route generally for both IRD and Customs and Excise, their functions cannot be integrated within such an authority other than for the fact that they could report to a joint Commissioner – which they do in any case at present. We recommend that the autonomy of Customs and Excise and IRD need to be maintained no matter where they reside as their respective focus is different and specialised.

Appendix 18

Minority Report

The purpose of this section of the report is to express a dissenting view by one of the Consortium members in respect of one aspect of the recommendations on which it was not possible to reach unanimity. The issue is an important one, which lies at the heart of the Consortium's findings.

The minority finds itself unable to agree to the recommendation that the salary income of employees (including directors of companies) should be taxed on a schedular basis and, in effect, be subject to a final tax based on a monthly tax period irrespective of the individual taxpayer's other economic situation.

This will have the effect that an employee (as defined) who carries on another business as a sole trader and who incurs a loss in the other business will be unable to set off the loss incurred in that business against his income from employment and pay tax on his real, overall taxable income, as would be the case at present. Indeed, the employee may have made a loss overall, after taking into account his business as a sole trader, yet he will be taxed separately on his taxable income as if the trading loss did not exist. The trading loss would have to be carried forward, separately, to the following year.

The objection to this recommendation is based on one of the age-old canons of taxation, namely *equity*, which would in this instance be sacrificed in favour of simplicity and administrative convenience. Both horizontal and vertical equity (i.e. that persons in the same *overall* economic situation should be similarly taxed, and that persons in different *overall* economic situations should be differently taxed) are violated by a system that

simply taxes income from employment as a final tax and ignores the taxpayer's other sources of income.

This recommendation also offends the canon of neutrality, i.e. that one form of economic behaviour should not be dictated in preference to another by purely tax considerations. This is violated because persons who earn income as employees will be taxed on their income from employment irrespective of the fact that they may, for example, have incurred a loss from another trade carried on as a sole trader, while another person in the identical economic position except that he or she is not an employee but carries on both trades as a sole trader will be able to set off the loss from the one trade against the profit from the other in arriving at his or her taxable income.

This lack of neutrality will encourage people to trade as sole traders rather than as employees, which offends the canon of neutrality. While it might be considered to be a good thing to encourage persons to conduct business as sole traders, this should in the minority view not be the case *for purely tax reasons*.

While it is appreciated that the so-called canons of taxation should not be elevated to the status of inviolate principles which can never be compromised, it is nevertheless considered that in the context of the present issue the recommendation to isolate income from employment and subject it to a final tax irrespective of the taxpayer's other profits and losses would perpetrate an unacceptable inroad into equity and neutrality. It will perpetuate and indeed justify the perception that it is the middle class salary earners who bear the brunt of income tax, and that only the very poor and those who do not earn income from employment, often the rich, are able to mitigate their tax position.

In the minority view, the position could be remedied by affording all taxpayers the opportunity of submitting a tax return in which the income and losses from all sources of income can be disclosed and tax paid on the overall taxable income, or not paid on an overall assessed loss, as the case may be. This would be fair, and would afford the possibility of some relief to taxpayers who have incurred losses as sole traders as well as

earned income from employment. But this would, of course, strike at the very heart of what is sought to be achieved by the majority recommendation under consideration.