Deloitte.

Namibian Mid-Term Budget Review 2018/19

Summary of Namibian Mid-Year Budget Review

Tabled in the National Assembly on 24 October 2018

Index

"'*If everyone is moving forward together, then success takes care of itself.'* This quote by Henry Ford says it all."

Minister of Finance, Mid-Year Budget Review, October 2018

Introduction

In his 2018/2019 mid-year budget review speech, the Minister confirmed that, against a complex set of external shocks to the Namibian economy and domestic structural constraints, a responsive macro-fiscal policy framework was adopted. The Minister listed a number of achievements since 2016 including:-

- A rebalance of the macro-fiscal framework;
- Improvement in the framework for long-term sustainable fiscal operations;
- Improvement in nominal GDP numbers for 2017 (2.7% better than projected), thus cushioning fiscal ratios against overshoots;
- Improvement in revenue (3.7% better than projected) due to efforts to collect tax arrears. However, a principle amount of N$3 billion remains outstanding;
- Alignment of expenditure to budget revenue;
- Reduction of budget deficit by a cumulative 3.8% of GDP over the past three years (from 8.1% in FY2015/16 to about 4.4% this year);
- Reduction of spending as a proportion of GDP from a high of 40.2% percent in FY2015/16 to an estimated 34.6% this year;
- Improvement in external trade deficit - narrowed by 34.9% with the current account deficit improving to 4.9% of GDP in 2017 and 1.3% during the second quarter of 2018; and
- A rise of foreign reserves to 5.2 months of import cover in September 2018, as imports slowed due to a depressed domestic economy.

Despite these listed achievements the Minister also acknowledged that high financing needs and liquidity constraints in the domestic economy have hindered the implementation of a steadier and growth friendly fiscal stance.

In the light of this, the Minister has recommended savings from non-core operational spending lines and development projects with a low budget implementation rate and reallocation of resources to areas that will make a difference. Further, targeted allocations were made to address immediate priorities.

For FY2018/2019 revenue was revised upward by a 1 percentage point to N$56.7 billion and expenditure to N$66.5 billion. The projected budget deficit for 2018/19 has therefore been revised from 3.6% of GDP to 5.3% of GDP.

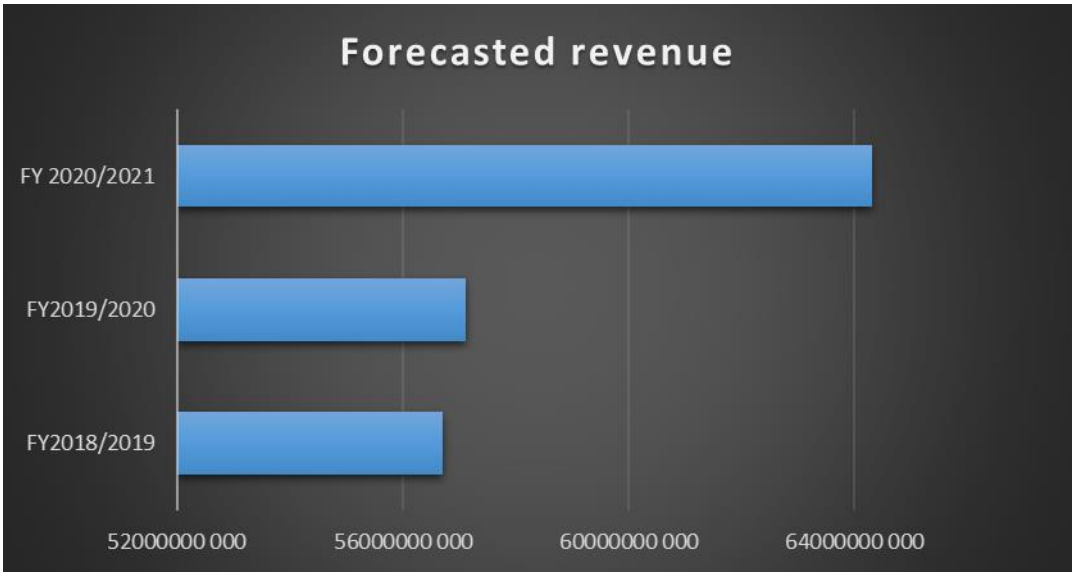
This result is a reversal of the initial progress made on fiscal consolidation. It also triggered a credit rating downgrade to sub-investment grade by credit rating agencies. More concerning is the total debt stock that increased by 3.6% to N$74.2 billion.

"This Budget review is presented against the backdrop of the progress we have made as a nation, the challenges we face and the opportunities which we should seize."

Minister of Finance, Mid-Year Budget Review, October 2018

Revenue

In the mid-term budget speech, the Minister announced a decrease in revenue for the current, 2018/19 financial year by approximately N$ 100 million (estimated revenue N$ 56.7 billion), with a moderate increase in the 2019/20 year by N$ 400 million (estimated revenue N$ 57.1 billion) and by N$7.2 billion in 2020/21 (estimated revenue N$ 64.3 billion) financial year.



Revenue outturn – 2017/2018

Some contributing factors for the revenue outturn are:

- All identified spending arrears were settled;
- Total revenue of N$ 58.8 billion was collected - 4.3% better than the original budget and 3.5% better than the revised budget revenue due to targeted collection efforts by Inland Revenue.

Revenue forecasts – 2018/2019

Total revenue is projected to slow to 30.2% in FY2018/19 and to average 28.5% of GDP over the medium term.

Some contributing factors for the revenue forecast are:

- the Mid-Year revenue outturn amounted to N$28.8 billion a 50.8% of the budgeted revenue of N$56.7 billion;
- Current collection rate is on par with the previous corresponding period and the recent historical six-month average collection - thus revenue collection is expected to be in line with budget expectations;

- Weak outlook on revenue is mainly stemming from continued decline in SACU revenue as a result of the subdued economic growth for especially the South African economy;

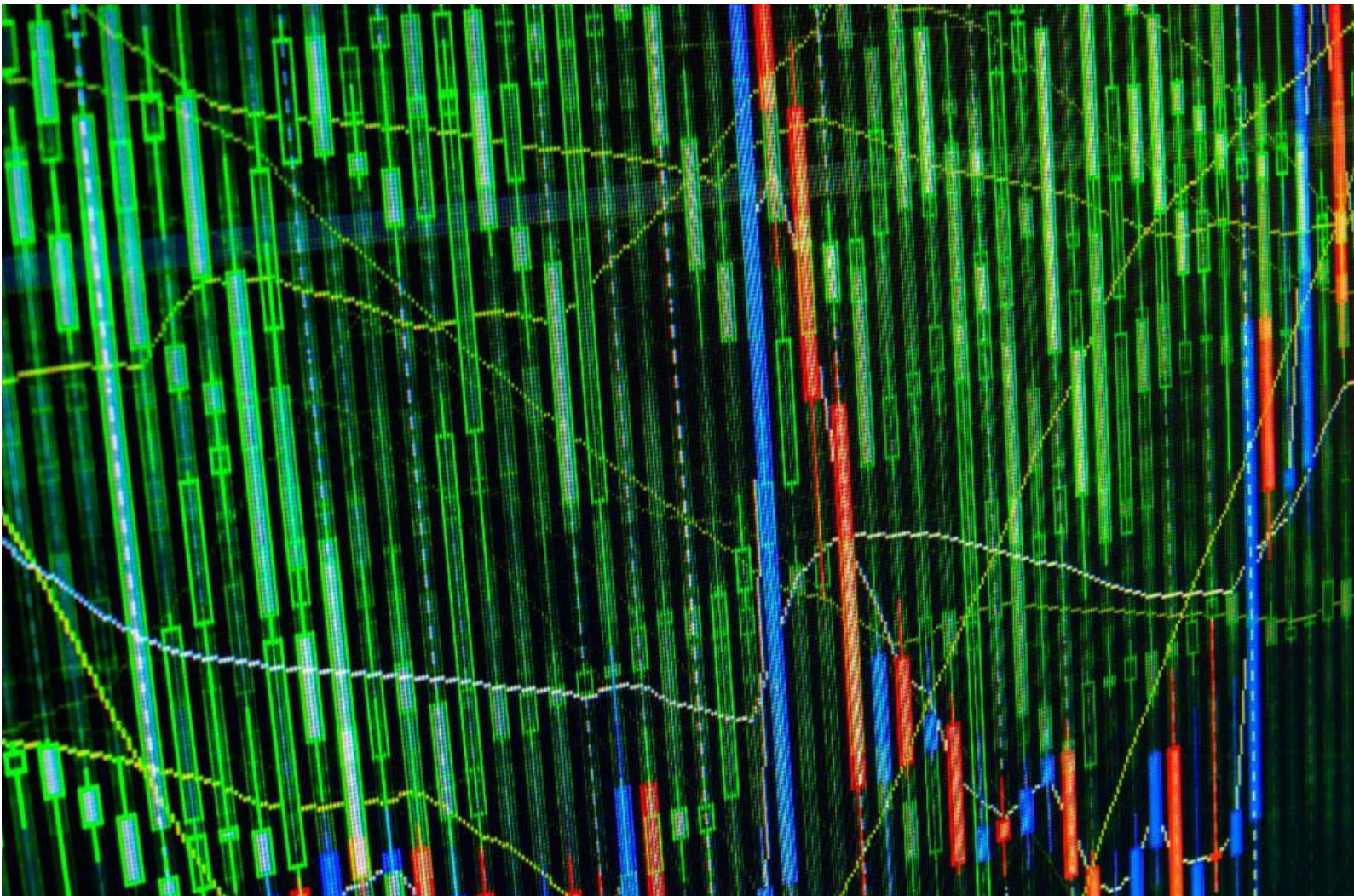
- Accumulating arears and lower than projected VAT arears to the decline of the domestic economy;

- Non-diamond mining company tax and withholding taxes on individuals (e.g. PAYE) are expected to perform better than the estimate in the main budget. This potential over-performance will be counterbalanced by downward revisions on VAT and non-mining company tax on account of slackness in consumption demand and subdued economic activity;

- The domestic economy continues to be subdued with the economy in recession for the last ten-quarters from the middle of 2016;

- Weak growth in neighbouring trading partners adversely impacting on the domestic economy and will continue to do so;

- Volatility in the global capital and financial markets as it impact negatively on the exchange rates and domestic policy responsiveness



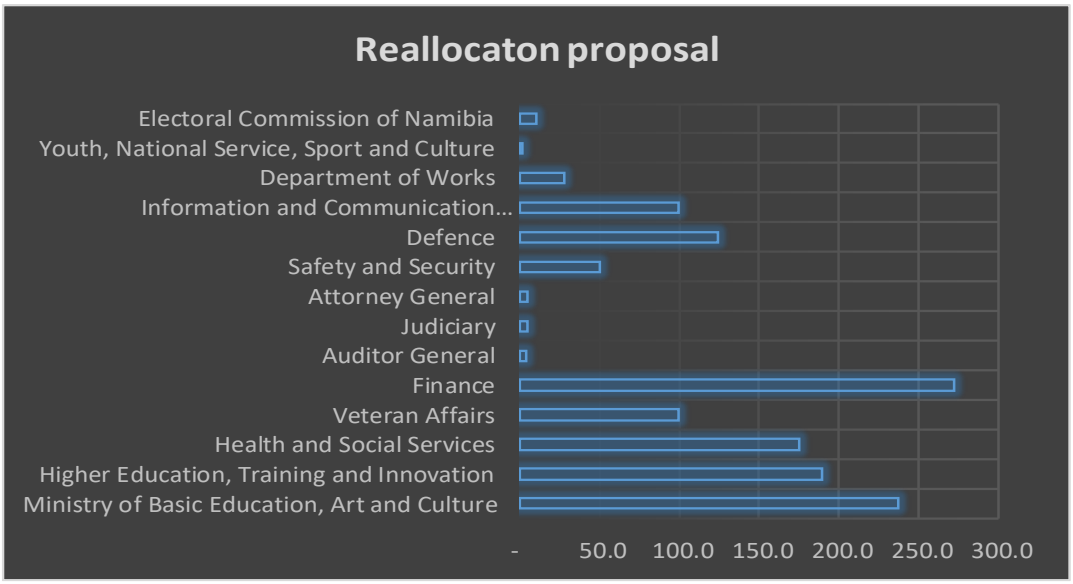
Expenditure

The overall outcome of the mid-term budget review was limited to reallocations within and between votes, without any additional expenditure in the overall non-statutory expenditure ceiling, which remains at N$58.5 billion.

In March 2018 the development budget for 2018/19 was increased by 30% relative to the revised allocation from the previous year to support economic growth. Despite this increased budget, execution remains low, thus the Minister himself notes that this part of the budget did not have the positive economic impact expected. We suspect that one of the reasons for the low execution rate could be inefficiencies within the current public procurement regime and the Public Procurement Act.

In line with the budget priorities of protecting expenditure in the social sectors of education, health and skills development the main considerations in the 2018/19 budget review were the potential resource shortfalls in critical services, especially in the social services sector. These were considered against potential savings and projected underspending on programs and projects which have not yet commenced or with low implementation rate.

The total assessed critical funding for the remainder of the financial year amounts to N$1.8 billion and will be availed through reallocations between votes.



The operational budget execution rate stood at 51% while the development budget outturn was estimated at 27% by the end of September 2018.

The ratio of operational to development expenditure is illustrative of government's priorities and fiscal consolidation comes at the expense of developmental projects.

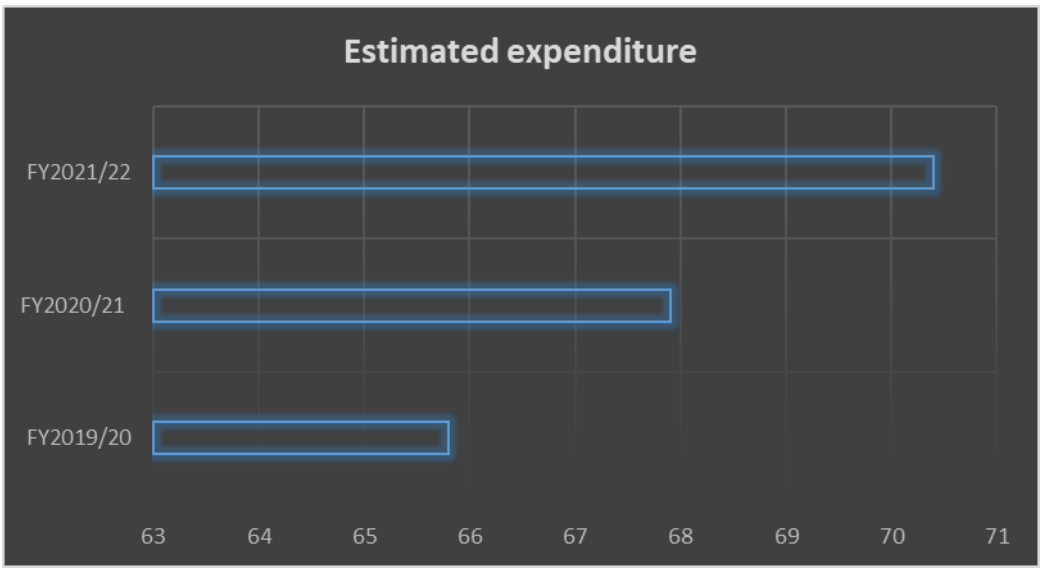
Due to the 27% implementation rate of the development budget by September 2018, an amount of N$1.79 billion was realized from the development budget, mainly from projects with zero implementation rate and those with a low implementation rate.

The reallocation included: -

- N$ 180 million to the Contingency Fund, mainly for funding priority needs arising from the 2018 Land Conference Resolutions and drought relief commitments. The resolutions from the Land Conference are the priorities for more serviced land in urban and peri-urban areas, delivery of low cost housing, improving animal health and processing facilities in communal areas and resettlement and post-resettlement support program;
- N$ 236.9 million for the continued implementation of the new curriculum and recruitment of teachers;
- N$ 124.5 million was allocated to Defence for utilities and transport related expenses;
- N$ 99.7 million for NBC operational expenses.

To anchor fiscal sustainability, the Minister is not expecting expenditure to increase significantly over the medium term.

Aggregate expenditure are estimated to be N$65.8 billion in FY2019/20, N$67.9 billion in FY2020/21 and N$70.4 billion in FY2021/22.



Tax

Tax policy

Due to the continued declines in SACU revenue, various tax policy proposals have been announced during the FY2018/19 Budget with the objective of partially generating replacement revenue. In addition, such proposed tax policies also sought to strengthen the equity and progressivity of the tax system.

It is encouraging to note that since the announcement of the proposed tax policies, there has been various stakeholder consultations and the concerns raised thus far have been considered. It is equally encouraging to note that the Minister re-iterated that adequate consultation time and further input from stakeholders will be provided.

In line with the spirit of having an equitable and progressive tax system, the Minister stressed the continuance of bringing all potential taxpayers in the tax net. In the same vain, improvement in tax administration, compliance and revenue collection will remain high priorities.

Tax relief for individuals

In an effort to encourage contractual savings, the Minister announced that the tax deductible amount in respect of pension and annuity contributions made by individual taxpayers will be increased to an amount yet to be determined. The current tax deductible amount is N$ 40 000 per year (i.e. N$ 3 333 per month) and has last been adjusted in 2011. This proposal is most welcomed and will incentivise a pension saving culture. However, it may only benefit your middle and higher income earners.

Furthermore, the Minister also announced that unsustainable increases in income tax collected from individual taxpayers will be avoided. We assume the Minister referred to the current tax tables and the changes proposed earlier in the year. In past budget speeches the Minister also voiced his concern of disproportionate contributions made to revenue by individual taxpayers. As the individual tax tables have last been changed in 2013 we note that the final tables would need to take into account fiscal drag to be truly impactful for individual taxpayers.

Other proposals to be scrutinised

In line with the objective of an equitable and progressive tax system, the Minister announced that the current loss provisions will be maintained. In essence this means that trading losses can be carried forward indefinitely for as long as trading continues. However, we are yet to see the final version of this proposal.

Furthermore, the Minister mentioned that unintended consequences on the proposed withholding tax on local dividends will be avoided. Again, this is a welcomed announcement as the proposed amendments raised some concerns regarding the definition of dividends and the avoidance of double taxing of the same dividend income flow.

Tax proposals

The following tax proposals will be refined before been tabled and before they become effective.

- ***Taxation of foreign income derived by Namibian residents***
  In the draft amendment bill it is proposed that Namibia moves from a source basis of taxation to a residency basis of taxation. The matter has been under discussion with the Ministry and the Minister's comment today may mean that this amendment will remain on the table or that the deemed source provisions are expanded. In the current Namibian environment we question whether a residency basis of taxation is appropriate if one considers revenue collection against costs of such collections.

- ***Change in the taxation of trusts***
  In the draft amendment bill it is proposed that trusts be taxed, irrespective of the nature of the trusts. A number of unintended consequences could flow form the proposals and were discussed with the Ministry. The Minster confirmed that further consideration are being given to this amendment.

- ***Phasing out of ineffective tax incentives***
  We assume the Minister referred to manufacturing tax incentives – if so we would hope that the Minister would consider less generous incentive as opposed to a complete phase out of these incentives – mainly due to the potential impact a total phase out may have on foreign investments.

- ***Thin capitalization***
  The introduction of a specified debt to equity ratio in the current thin capitalization rules that are aimed at combating transfer pricing issues on interest paid on foreign loans are proposed in the draft amendment bill. Although thin capitalisation provisions have been law since 2005, the provisions do not provide for a so called 'safe harbor' ratio. The amendment bill aims to bring that ratio into the law.

- ***Charities, religious and educational institutions***
  The amendment bill currently has a number of unintended consequences with regards to the taxation of charitable, religious and educational institutions which were discussed with the Ministry. The Minister's comments today seem to indicate that further consideration will being given to this amendment so that only the commercial income from such institutions are subjected to tax.

"… The intent of our tax proposals must remain to improve and stabilize our revenue base, while at the same time ensuring that the Namibian economy remains an attractive and competitive investment home."

Minister of Finance, Mid-Year Budget Review, October 2018

Transfer pricing

Base erosion and profit shifting ("BEPS") refers to corporate tax planning strategies employed by multi-national enterprises to shift profits from high tax jurisdictions to lower tax jurisdictions, thereby eroding the tax base of the higher tax jurisdiction.

In an effort to secure government revenues by ensuring that profits are taxed in the jurisdiction where the economic activities generating such profits are performed and where value is created, various BEPS action plans have been put in place by the Organisation for Economic Co-operation and Development.

The Minister highlighted the fact that Namibia supports such actions. He further highlighted the fact that the key success in the BEPS fight lies in tailored transfer pricing legislative measures and a developed transfer pricing audit capacity. Although Namibia still have a long way to go in transfer pricing matters, progress have been made with the set-up of the Larger Taxpayers and Investigation Unit of Inland Revenue aimed at dealing with transfer pricing audits.

We believe the enforcement of transfer pricing measures (introduced in 2005 already) is long overdue and will improve revenue collection and compliance with the legislation.

Namibia Revenue Agency (NAMRA) and system

Progress is being made with tax administration reforms and the Minister confirmed that the Namibia Revenue Agency will be operational by March 2019.

Skills audits for existing Inland Revenue staff are currently underway and is expected to be completed by mid-November 2018. The Minister will also announce the Board of Directors with recruitment process to follow from there.

The Minister unfortunately did not comment on the progress with the integrated tax administration system (ITAS).

Corporate tax rates and VAT rates

As expected, no changes were announced to any of the corporate tax rates or the VAT rate.

Other tax amendments proposed in March

The Minister did not comment on the VAT and additional customs & excise duty amendments that he announced with the March budget tabling.

Deficit, Debt and Funding

Sovereign Ratings Assessments

The Minister mentioned that the budget deficit has triggered a sovereign rating credit downgrade to sub-investment grade by credit rating agencies.

The latest rating of Fitch Credit Rating Agency, has reaffirmed the sovereign rating for Namibia at a sub-investment grade of BB+, with as stable outlook.

Rating agencies have also raised concerns on the public sector wage bill which absorbs about 50 percent of revenue.

By reducing growth in public debt and improvements in external balances, it will be key in addressing the ratings weaknesses.

Deficit and public debt

The budget deficit for FY2017/2018 was 5.0% of GDP. For FY2018/2019 the Minister is projected the deficit to be 4.5% of GDP.

Public debt as a ratio of GDP stood at 41.7% for FY2017/2018 - better than the estimated 42.1% and is expected to be 45.1% in FY2018/2019.

The Minister noted that the domestic market will remain the key source for financing supported by other measures like partial listing of some state assets and PPP formations.

Debt servicing stood at 8.9% of revenue in FY2017/2018, while guarantees accounted for 7.2% of GDP. The targeted levels were 10% of revenue and 10% of GDP respectively.

The key development projects to be funded under the Economic Governance and Competitiveness Support Program in collaboration with the African Development Bank are:

- the agricultural mechanization program,
- Walvis Bay-Kranzburg railway rehabilitation,
- Windhoek-Hosea Kutako International Airport road.

No mention was made to specific energy and solar projects.

"This budget review is consistent with this policy path. It contains current year spending within appropriated level and adopted fiscal adjustment path. It sets forth a medium-term policy stance which emphasizes inclusive growth and job creation objectives within a broadly balanced fiscal consolidation framework."

Minister of Finance, Mid-Year Budget Review, 24 October 2018

Contacts

Gerda Brand
Deloitte | Director| Taxation Services
Tel: + 264 285 5062
Mobile: + 264 811278987
Email: gbrand@deloitte.co.za

Olivia Nghaamwa
Deloitte | Senior Manager| Taxation Services
Tel: + 264 285 5159
Mobile: + 264 813650375
Email: onghaamwa@deloitte.co.za

Indileni Nambala
Deloitte | Manager| Taxation Services
Tel: + 264 285 5027
Mobile: + 264 814044722
Email: inambala@deloitte.co.za