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Of tax-free allowances and inequality – Klaus Schade

Sometimes, well-meant interventions have unintended consequences. One case in point are tax-free allowances, such as tax-free housing allowances, tax-free car allowances, tax-free pension fund contributions, etc. Namibia has a progressive income tax system with marginal tax rates rising with increased taxable income. This, however, results in tax-free allowances being regressive meaning that the better off benefit more than low-income earners.

The Government intends to increase the pension fund contribution that can be deducted from the taxable income to NAD150,000 or 27.5% of the income, whichever amount is lower. First, an employee earning less than NAD145,000 per annum will be worse off with the new regulations, since they can only deduct less than the current maximum amount of NAD40,000 per annum. Moreover, someone earning an income of more than NAD1.5 million per annum and deducting the maximum amount of NAD150,000 from the taxable income will have a tax saving of NAD55,500 – that is the equivalent a domestic workers employed at the minimum wage earns in three years. It is also more than ten times the amount someone who is earning NAD100,000 per annum will save in income tax.

While the increase in the amount deductible from the taxable income is meant to enable formal sector employees and self-employed to save for the retirement age, it disadvantages those who need the support most – the low income earners – and it increases income inequality. The same applies to the tax-free pension fund payout that benefit those who could save more – usually the better off – more through higher tax savings.

In order to address income inequality, tax-free housing, car and other allowances should be terminated and the allowance should be included in the salary, which would increase the transparency of salary packages in addition. Tax-free pension fund contributions could be replaced with tax credits with an equal amount for all income tax payers that contribute to a pension fund. Even those employees who earn below the tax threshold and therefore do not benefit at all from any tax-free allowances will benefit from tax credits, since they would receive an EFT from the Receiver of Revenue at the end of the financial year. Such a progressive tax system will not only boost the disposable income of low-income earners, but will benefit the economy as well. High income earners save a higher share of their income and spend a higher share of their expenditure on imported goods and services than low-income earners. Strengthening the income of low-income earners will therefore support the domestic economy, since the savings from tax credits will certainly flow immediately back into the economy. And, it will contribute to reducing income inequality.

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