THE KINGDOM OF LESOTHO

INCOME TAX ORDER 1993

EXPLANATORY MEMORANDUM

This section-by-section Commentary provides a detailed explanation of the Order entitled the Income Tax Order 1993.

1. Short Title

The Income Tax Order 1993 supersedes the Income Tax Act 1981 (referred to in this Commentary as the "1981 Act"). The Order follows the general structure of the income tax system established under the former Act and its predecessors but the substance has been reorganised and revised in many particulars.

2. Commencement

Apart from section 36(2), the Order shall come into operation on 1 April 1993. Section 36(2) empowers the Commissioner to deny interest deductions where a resident company exceeds a 3:1 debt-to-equity ratio. Subsection (2) of section 2 provides that section 36(2) does not come into operation until 1 April 1994. This gives resident companies a twelve-month period to comply with the debt-to-equity in section 36(2).

The Order applies for years of assessment commencing on or after 1 April 1993. Under the Order, the year of assessment continues to be the twelve-month period commencing on 1 April, unless the Commissioner has granted permission to use a substituted accounting period. For most taxpayers, this means that the new law will first apply to the year of assessment commencing on 1 April 1993. Under section 213, a company which has been granted permission to use a substituted accounting period under section 40 of the 1981 Act may continue to use that period under the Order until the Commissioner decides otherwise. For those taxpayers, the new law will apply to the first year of assessment commencing on or after 1 April 1993. If, for example, the substituted accounting period is the calendar year, then the new law will apply to the year of assessment commencing on 1 January 1994.

3. Interpretation

This section provides definitions of commonly used terms in the Order. The definitions in section 3 apply unless the context otherwise requires. The discussion below refers to the more important definitions, the other definitions being self-explanatory.

"adjusted cost base": the adjusted cost base of an asset takes as its starting point the cost base of the asset as determined under section 60. In most cases, this will be the purchase price of the asset. The following adjustments are made to the cost base so as to arrive at the adjusted cost base of the asset -

(a) the cost base is reduced by -

  (i) any part of the cost base allowed as a depreciation or amortisation deduction under the Order; and

(ii) any other item of reduction properly chargeable to capital account; and

(b) the cost base is increased by -

(i) the cost of improvements to the asset; and

(ii) any other costs properly added to capital account.

The intention with (a) is that the cost base is reduced by any part of it, which is recovered by the taxpayer, either by way of tax deductions (such as depreciation or amortisation deductions), or by way of refund or reimbursement. The intention with (b) is that the cost base of the asset is increased by the amount of any non-deductible costs of acquiring, holding, improving, or disposing of the asset.

The main provisions in the Order under which the cost base or a part of the cost base of an asset is allowed as a depreciation or amortisation deduction are -

* section 41 - depreciation of premises and equipment;
* section 43 - amortisation of expenditure incurred in acquiring mining rights;
* section 44 - amortisation of intangible assets; and
* section 45 - amortisation of start-up expenses to the extent that those expenses are reflected in the value of an asset (such as goodwill).

The reference in the definition to "other items of reduction properly chargeable to capital account" is intended to include any other tax deduction for the cost base of an asset (for example, an outright deduction under section 42(2) for small value depreciable assets), and any refund or reimbursement of part of the purchase price of the asset (for example, due to a defect in the asset).

The adjusted cost base of an asset is increased by the cost of any capital improvements made to the asset. A capital improvement is to be distinguished from a repair, which is allowed as a deduction under section 42. There is a well developed body of judicial decisions in both the United Kingdom and the Republic of South Africa as to the difference between a repair and a capital improvement. Those decisions are relevant in determining whether a particular expenditure is a capital improvement or a repair for the purposes of this definition (see also the Commentary to section 42).

The reference in the definition to "other costs properly added to capital account" is intended to include non-deductible costs of acquiring, holding, or disposing of the asset. Examples of acquisition and disposal costs include -

* fees, commissions, or remuneration for the professional services of a surveyor, valuer, auctioneer, accountant, broker, agent, or legal adviser;
* costs of transfer, such as stamp duty; and
* costs of advertising to find a seller or buyer.

Examples of holding costs include interest on a loan financing the acquisition of the asset, rates, insurance premiums, maintenance costs, and legal costs incurred defending the taxpayer's title to the asset. These costs are only added to the cost base, however, if they are non-deductible. Generally, where the asset is income-producing holding costs will be allowed as a deduction under section 33.

The definition of adjusted cost base is relevant to the determination of the amount of any gain or loss on disposal of a business or investment asset. It is noted that the definition of adjusted cost base is not relevant to a depreciable asset for which an election under section 41(5) has been made (that is, an election for pooling to apply). Gains and losses on disposal of assets to which pooling applies are dealt with through the pooling mechanism (see section 59(5)).

"associate": this term is defined in broad and general terms, rather than seeking to specify every relationship which will give rise to persons being associates for the purposes of the Order. It is common, particularly in tax avoidance activities, for associates to consort together. Accordingly, the Order in many situations treats the acts of an associate of the taxpayer as the acts of the taxpayer.

The definition makes it clear that it is not necessary for a person to be obliged to act in accordance with the directions of the taxpayer in order to be an associate. Merely acting on the taxpayer's suggestions will suffice. Moreover it is not necessary for the taxpayer to actually communicate with another person before that person can be an associate. Associates often have implicit understanding of each other's wishes, and therefore, do not need to communicate.

Generally, it can be expected that a taxpayer's spouse, children, parents, and siblings will be regarded as associates of the taxpayer, as will be companies and trusts controlled by the taxpayer.

"branch": this term is defined to mean any place where a person carries on business. It specifically includes a place where the person carries on business through an agent other than an agent of independent status acting in the ordinary course of business. Whether an agent is independent of the person represented depends on the extent of the agent's obligations as regards the person represented. For example, an agent will not be regarded as being of independent status if the agent's commercial activities for the person represented are subject to detailed instructions or to comprehensive control by the person represented. The agent of independent status exclusion is commonly used in the definition of "permanent establishment" in double tax treaties and it is intended to adopt the meaning under such treaties for the purposes of this definition.

The definition of branch also specifically includes a place where a person has, is using, or is installing substantial equipment or substantial machinery; and a place where a person is engaged in a construction, assembly, or installation project. These are expressly included to avoid any argument, particularly where the activities are of a temporary nature, that they are not a branch under general principles. The term "construction, assembly, or installation project" is intended to be of broad import. It would include, for example, the construction of buildings, roads, bridges, dams, the laying of pipe-lines, and excavating or dredging. A person is regarded as being engaged in a construction, assembly, or installation project if the person is engaged in supervisory activities in relation to such a project.

The definition is relevant to the taxation of non-residents. For all purposes of this Order, the Lesotho branch of a non-resident company is treated as a separate taxpayer which is a resident of Lesotho (see Commentary to section 6(2)).

"business": is defined to include any trade, profession or vocation. Consequently, the activity of providing services (other than pursuant to an employment) is treated as a business for the purposes of this Order. Business is defined inclusively to ensure that the well developed body of judicial decisions in the United Kingdom and the Republic of South Africa on the meaning of "business" give content to the term. While there is no rule of law as to what is a business, these decisions have identified a number of factors, which have been taken into account in determining whether the particular activities of a taxpayer constitute a business. The main factors identified are: profit motive, scale of activity, repetition and continuity of activity, commercial character, and system and organisation. The judicial decisions have emphasised that the existence or absence of any one particular factor will not be decisive.

While repetition of activity is an important indicator of the carrying on of a business, the judicial decisions have recognised that an isolated activity can, in certain situations, constitute a business. The express inclusion of "an isolated transaction with a business character" is intended to ensure that the judicial concept of an adventure in the nature of trade is included as a business for the purposes of the Order.

The definition is primarily relevant to the determination of what is business income, and is relevant to the definition of "business asset" and "business debt".

"business asset": this term is defined to mean an asset which produces income subject to Lesotho income tax, including withholding tax under section 107 or 108, being an asset used in a business or which is held for the purposes of sale in a business. While there is no separate definition of the term "asset", it is intended to include anything which may be turned to account. The term "asset" has been used in preference to the term "property" which, if read narrowly, would unduly limit the scope of the definition of business asset.

Whether an asset is a business asset depends on the characterisation of the taxpayer's activities as a business (see Commentary on the definition of "business"). If the taxpayer's activities amount to a business, then every asset used in that business (regardless of whether it is revenue or capital in nature) is a business asset. This includes, for example, land and buildings, plant and equipment, and fixtures and fittings. The definition of business asset also includes an asset held for sale in a business, such as trading stock.

The definition of business asset is primarily relevant to the taxation of gains and losses on disposal of assets. For the purposes of the Order, assets are divided into three categories: business, investment and other assets. Other assets are basically personal-use assets. The tax treatment of gains and losses from the disposal of assets depends on the character of the asset. Any gain on disposal of a business asset is taxed as ordinary income (section 19), while a loss is allowed as a deduction (section 48).

"business debt": this term is defined to mean a debt the proceeds of which are used to incur a business expense deductible under Division IV of Part IV of Chapter II or to acquire a business asset (separately defined in section 3(1)). This term is primarily relevant to the application of section 19 to gains on the satisfaction of a business debt. The fact that a debt is considered a business debt does not necessarily mean that interest expense on the debt is fully deductible (see section 36 and regulations to be promulgated thereunder).

"company": this term means a body corporate or unincorporate, whether created or recognised under laws of Lesotho or elsewhere. This includes a statutory corporation, and any other body owned or controlled by a government (including a foreign government) or statutory corporation. Company also includes an unincorporated association, for example, a social club; but does not include a partnership or trust. It is intended that the characterisation of an entity as a partnership, trust or company will be mutually exclusive. Consequently, an entity which is a partnership under general principles cannot at the same time be a company or trust. Similarly, an entity which is a trust for tax purposes (separately defined in section 3(1)), cannot be a partnership or company. A company can be a trustee of a trust, but in respect of its activities as trustee it will be taxed as a trustee rather than a company.

"contractor": this term means a person who is in the business of providing leasing, construction, transportation, or any other service prescribed by regulations under a contract where the primary purpose of the contract is the performance of services. By virtue of the definition of "person", an individual, partnership, or company may be a contractor.

The requirement that the person be in the "business" of providing the relevant services is intended to exclude employees from the definition of contractor. For the distinction between employee and independent contractor, see the Commentary to the definition of "employment".

The fact that goods are also provided under the contract of service does not of itself preclude a person from being a contractor, provided the provision of goods is ancillary to the provision of services. For example, while a builder in the construction industry will provide materials for the erection of a building, the primary purpose of a person who contracts with the builder is to obtain the builder's services and not the goods which the builder supplies. In the ordinary course, therefore, a builder will be a contractor. On the other hand, the supplier of materials to the builder ordinarily will not be a contractor even if the supplier transports the materials to the building site, the primary purpose of the contract being the supply of goods rather than transportation services. If the supplier of materials contracts with a person to transport the materials to the building site, then that person will be a contractor being the provider of transportation services.

This term is relevant to the obligation to withhold tax at source under section 157.

"debt obligation": this term means a right to receive a repayment of money or property from another person. The definition specifically includes deposits in banks and other financial institutions, accounts receivable, notes, bills of exchange, and bonds. This term is relevant to the definitions of "interest", "foreign currency gain", and "foreign currency loss" in section 3(1), and to section 57 which provides a tax accounting rule for discount or premiums on a debt obligation.

"depreciable asset": this term means any tangible movable property or an industrial building used wholly or partly in the production of income subject to tax, being property or an industrial building which is likely to lose value because of wear or tear, or obsolescence. An industrial building is separately defined in section 3(1). Whether movable property or a building is likely to lose value is determined at the time of first use by the taxpayer in the production of income subject to tax.

Property or an industrial building which is only partly used in the production of income subject to tax is still treated as a depreciable asset, although pooling does not apply to such an asset (see section 41(6)(a)). Property or an industrial building wholly used to produce exempt income is not a depreciable asset.

This term is relevant to section 41 which allows a deduction for depreciation of a taxpayer's depreciable assets, and to section 42 which allows an outright deduction for minor capital equipment.

"disposal": this term is defined in relation to an asset. The definition is broad and extends beyond the ordinary meaning of the term.
Under general principles, a disposal of an asset involves a change in ownership whereby one person loses title in the asset and another gains it. Consequently, the definition includes a sale or exchange of an asset, the transfer of an asset by way of gift, and the distribution of an asset in specie by a company.

A disposal also occurs in situations where no person acquires the asset; in particular, the redemption of an asset (for example, shares in a company or units in a unit trust), and the destruction, loss, or extinction of an asset. A disposal also occurs where a trustee makes an in specie distribution to a beneficiary, even though there is no change in beneficial ownership of the asset in this situation.

A disposal includes a disposal of part of an asset. For example, a single block of land which is subdivided into two blocks one of which is sold constitutes a disposal of part of the land. The creation of a lesser interest in an asset, particularly, land (for example, a lease, easement, profit a prendre or life estate) would not be a disposal; although any amount received for the creation of the lesser interest would be treated as property income under section 20.

The death of a taxpayer does not give rise to a disposal of the assets of the taxpayer. Consequently, the passing of an asset to the personal representative of the deceased or to a beneficiary (either directly or through the deceased's personal representative) does not give rise to a disposal of the asset by the deceased. There is, however, a disposal of the asset by the personal representative or the beneficiary of the deceased if they dispose of the asset to a third party. The cost base of the asset to the personal representative or the beneficiary is determined under section 60 and regulations to be promulgated under that section.

This term is primarily relevant to the taxation of gains and losses in relation to business and investment assets.

"dividend": this term is defined broadly to include any distribution (in money or money's worth) by a company to a member of the company. The definition is intended to extend beyond the general law notion of a dividend as being a flow or liberation of profits from the capital of the company. Distribution is intended to be interpreted broadly and includes an amount paid as a return of capital (other than on a complete liquidation of the company), although this would constitute an item of reduction in calculating the adjusted cost base of the membership interest in the company. An issue of bonus shares, however, which does not change the participation rights of the members is not intended to be a dividend for the purposes of the Order. The cost base of the bonus shares is determined under section 60.

To be a dividend, a distribution must be made to the taxpayer as a member of the company; a distribution made in some other capacity, for example, as a creditor of the company would not be a dividend.

The definition does not include a distribution on complete liquidation of the company. This is treated as a disposal of the membership interest in the company (see section 90). The tax treatment of a liquidator's distribution depends on whether the membership interest is a business or investment asset of the member, and on whether the disposal gives rise to a gain or loss.

This term is primarily relevant to the imposition of advance corporation tax under section 87, and to the imposition of withholding tax under section 107.

"employment": this term is defined broadly to mean employment as that term is generally understood and to the holding of any office or appointment. An employment relationship will not exist where a person is genuinely engaged as an independent contractor. The determination of whether a person is an employee or independent contractor involves looking at a number of factors, including whether the hirer has the legal right to control the manner in which the work is to be performed, and the degree of integration of the service provider within the hirer's business. This latter point will depend on such things as -

* whether the service provider is engaged on a continuous basis;

* where the services are performed;

* whether the hirer controls the timing and scheduling of work; and

* whether the hirer provides the working tools, plant, and other relevant facilities.

This term is relevant to identifying who is an employee or employer, both of which terms are separately defined in section 3(1). It is also relevant to the determination of what is employment income, the application of the fringe benefits tax, and the application of pay-as-you-earn withholding.

"expatriate taxpayer": this term is defined to mean a resident individual (other than a citizen or permanent resident of Lesotho) who is employed or engaged under a technical services contract. A person is a resident individual if he or she satisfies one of the residence tests in section 5. The reference to "employed or engaged" is intended to include both employees and independent contractors as expatriate taxpayers. "Permanent resident" and "technical services contract" are separately defined in section 3(1).

This term is relevant to the application of sections 9(3), 24, and 97 each of which provides concessional treatment for certain expatriate taxpayers.

"foreign currency gain": this term is defined to mean a gain attributable to currency exchange rate fluctuations in respect of a holding of foreign currency or a debt obligation denominated in a foreign currency. For example, a Lesotho resident may have borrowed $US1m from a United States bank repayable in two years time, and at the time of making the loan the exchange rate was M3:$US1 (ie. the resident borrowed M3m). At the time the principal is repaid, the exchange rate is M2.5:$US1 which means that the cost of repaying the US loan is M2.5m. In this case, the Lesotho resident has made an exchange gain of M500,000 in respect of a debt obligation denominated in a foreign currency. "Foreign currency loss" is similarly defined in section 3(1).

The definitions are relevant to section 58 which treats foreign currency gains or losses as interest income or expense, respectively, and which provides a tax accounting rule for such gains or losses.

"industrial building": this term is defined to mean a building wholly or principally used for the purposes of carrying on manufacturing operations. "Manufacturing" is separately defined in section 3. A building will qualify as an industrial building even though some ancillary non-manufacturing functions (such as clerical or other administrative functions, or warehousing of finished goods) are carried on in the building. The definition of industrial building also specifically includes a research facility wholly or principally used for the development of improved or new methods of manufacture.

The definition is relevant to section 41, which provides for the depreciation of industrial buildings.

"interest": this definition is intended to expand upon the ordinary meaning of interest. According to general principles, interest means an amount paid by a debtor to a creditor in respect of moneys owing by the debtor to the creditor as consideration for the loan of the monies or for the forbearance to sue for credit provided in the form of goods or services.

The definition expressly includes a discount, premium, or swap payment as interest. This reflects the fact that, particularly in international transactions, these payments are functionally equivalent to interest. A loan is made at a "discount" where the creditor lends less money than the nominal principal that is required to be repaid, the discount representing the difference between the amount lent and the nominal principal. A loan is made at a "premium" where the holder of debt is required to pay an additional amount on issuance above the nominal principal.

Interest swaps occur where a party which has borrowed under a floating interest rate seeks to limit its exposure to interest rate fluctuations by swapping interest obligations with another party (usually a financial institution) which has borrowed an equivalent amount at fixed interest rates. Payments made between the parties in satisfaction of offset arrangements pursuant to the swap are within the definition of interest for the purposes of the Order.

The definition is primarily relevant to sections 20 (inclusion of property income in gross income), 36 (deductibility of interest expense), and 107 (withholding tax on interest paid to a non-resident).

"investment asset": this term is defined to mean all assets of a taxpayer, other than -

(a) a business asset; or

(b) an asset that does not produce income subject to Lesotho income tax (including withholding tax under section 107 or 108) and that is held primarily for personal use by the taxpayer.

As to the meaning of "asset" see the Commentary on the definition of "business asset". The first exclusion ensures that gains on disposal of business assets are treated as business income; while losses are allowed as a deduction. The second exclusion ensures that there are no tax consequences on the disposal of personal-use assets. An asset will only be a personal-use asset if it does not produce income and is held by the taxpayer primarily for personal use. It follows that an income-producing asset is treated as an investment asset. This includes, for example, shares, debt obligations, and rental properties. It also follows that a non-income producing asset (for example, vacant land or a piece of art) which is held for resale at a profit is an investment asset. Where a non-income producing asset is held for personal and some other use, it will not be an investment asset if it is primarily held for personal use. Whether a non-income producing asset is held primarily for personal use is a question of fact and degree to be determined having regard to all the circumstances.

The definition is primarily relevant to the taxation of gains or losses on disposal of assets.

"manufacturing": this term is defined to mean the substantial transformation of tangible movable property which definition largely restates the meaning of "manufacture" under general principles. The definition specifically excludes construction, installation, assembly, transportation, power generation, or the provision of public utility services. These activities would not be regarded as within the ordinary meaning of manufacture, and their specific exclusion is out of abundant caution.

"member": this term is defined in relation to a company to mean a shareholder or other holder of an equity interest in the company. This would include, for example, the member of a company limited by guarantee where there are no shares as such.

"membership interest": this term is defined in relation to a company to include a share in a company. The definition is inclusive only, and therefore, will include any other equity interest in a company (for example, a member's interest in a company limited by guarantee).

"natural resource payment": this term is broadly defined and would include an amount which would be a royalty under ordinary concepts for the taking of natural resources. This would cover, for example, a payment made for the right to enter and remove minerals or timber. It would also cover, for example, a payment to a geologist who provided information as to where minerals may be found in exchange for payments based on the amount of minerals recovered from the site indicated. The payment made to the geologist in these circumstances would be a natural resource payment even though the geologist has no interest in the natural resources taken. The term is relevant to withholding tax under section 107.

"non-resident": this term is defined to mean a person who is not resident in Lesotho, and in relation to individuals, partnerships, and companies this means a person who is not a resident individual under section 5, a resident company under section 6, or a resident partnership under section 7, respectively. The residence of other persons (such as governments or public international organisations) is determined according to general principles. For example, the Government of Lesotho would be a resident, while a foreign government would be a non-resident of Lesotho.

"paid": this term is defined inclusively to ensure that paid includes an amount credited in favour of a person. This means, for example, that an amount credited in the accounts of a debtor is regarded as paid to the debtor, at least where the crediting is with the express or implied consent of the creditor.

This term is particularly relevant for the timing of the liability to advance corporation tax under section 87, and withholding tax under section 107 or 108. A special meaning of "paid" for purposes of section 107(1) is provided in section 107(4).

"payment": this term is defined broadly to cover any means of conferring value on a person. The definition is intended to eliminate any argument that "payment" is confined to a payment of money. It includes the transfer of property and any other means of conferring value or benefit on a person. The definition also includes an "amount payable". This is to ensure that the definition is also operative where the relevant event for tax purposes is an amount being payable rather than actual payment (such as a taxpayer accounting on an accrual basis for tax purposes).

"permanent resident": this term means a resident individual who has been present in Lesotho for a total of seven years or more. The seven-year presence test may be satisfied by a continuous period of presence or by the aggregation of more than one period of presence in Lesotho.

The term is primarily relevant to the definition of "expatriate taxpayer" in section 3(1).

"person": this term is defined to include a partnership, company, a government or political subdivision of a government, and a public international organisation. While a body corporate is clearly a separate legal person, the specific inclusion of a company in the definition ensures that unincorporated bodies, which are treated as companies for the purposes of this Order, are also treated as persons. The definition also specifically includes a government, a political subdivision of a government (for example, a local council), and a public international organisation. The reference to a government includes both the Lesotho Government and a foreign government.

The term is only defined inclusively so that it otherwise has its ordinary meaning. This means, for example, that it includes an individual. While the definition does not include a trust, it will include the trustee of a trust.

"royalty": this term is intended to be broadly defined extending beyond payments made for the use of industrial or intellectual property rights. In particular, it includes an amount paid for the use of, or right to use, industrial, commercial, or scientific equipment (for example, rental payments made under chattel leases of such equipment); or for the supply of know-how (i.e. the supply of systematic existing information). The definition also includes payments for technical assistance which is ancillary to the use of industrial or intellectual rights; industrial, commercial, or scientific equipment; or know-how. Where a person has a right to use industrial or intellectual property, industrial, commercial or scientific equipment, or know-how, or a right to receive ancillary assistance in relation to the foregoing, a payment received as consideration for agreeing not to use that right is also treated as a royalty.

"standard rate of tax": this term is defined to mean a rate of tax of 25%. This rate is relevant to the taxation of non-residents (see sections 12 and 107), and to the taxation of lump sum payouts from complying superannuation funds (see section 99).

"taxpayer": this term is defined to mean a person subject to a tax imposed by this Order. In relation to income tax, a taxpayer is an individual, trustee, company, or non-resident person who has chargeable income (section 4).

In relation to fringe benefits tax, a taxpayer is an employer who has a fringe benefits taxable amount (section 117). "Employer" is defined in section 3(1) to mean a person who employs or remunerates an employee (see the related definitions of "employee" and "employment"). By virtue of the definition of "person", the Lesotho Government and a foreign government, and any political subdivision thereof may be an employer and, therefore, a taxpayer in respect of fringe benefits tax.

"underlying ownership or control": this phrase is used in Part VIII of Chapter II to identify the ultimate owners of a company being either individuals, or entities that are not ultimately owned by individuals such as charitable trusts or governments. It is necessary to have such a concept to prevent groups of companies being used for tax avoidance purposes and to identify cases where the economic substance of ownership does not change for the purposes of granting roll-over relief.

Subsection (2) provides that in interpreting the Income Tax Order, regard is to be had to this document. This is intended to overrule the general principle that legislation is to be interpreted by reference to the words of the statute only. The drafting of the new legislation has focussed on stating broad principles which are elaborated in this document. This document, however, is intended to be used only as an aid in interpretation. Thus, for example, in the case of inconsistency between language in this document and the statute, the statute must prevail. Similarly, where regulations are issued under the authority of section 212, these prevail over language in this document.

As there have been no judicial decisions in Lesotho on taxation matters, it is intended that judicial decisions of other jurisdictions of the Commonwealth, particularly the United Kingdom and the Republic of South Africa, be referred to in interpreting the Order where relevant. Moreover, it is intended that to the extent that the tax laws of the Republic of South Africa are consistent with the Order, the regulations and administrative practice of the Republic of South Africa be referred to on an interim basis in applying this Order, pending regulations or other notices (such as rulings of the Commissioner) in Lesotho.

4. Income Tax Imposed

This section imposes income tax on every individual, trustee, company, and non-resident person who has chargeable income for a year of assessment. "Chargeable income" is defined in section 13 to mean gross income less allowable deductions. The use of the word "has" is intended to be neutral allowing the tax accounting rules in Division V of Part IV of Chapter II to apply. Income tax continues to be imposed periodically by reference to the year of assessment, being the twelve-month period from 1 April to 31 March or such substituted period as may be allowed by the Commissioner under section 49.

Income tax is expressly imposed on "every individual, trustee, company, and non-resident" who has chargeable income. The reference to "company" means that income tax is imposed on unincorporated associations (subject to the application of section 25 where the association is an "exempt organisation"), and on statutory corporations, and other bodies owned or controlled by a government (including the Government of Lesotho) or other statutory corporation. While section 4 imposes income tax on a trustee, this must be read subject to Part VII of Chapter II which limits the circumstances in which a trustee is liable to tax on trust income. The reference to "non-resident" is of residual application (as the general reference to individuals and companies covers non-residents), and would include, for example, a foreign government or a political subdivision of a foreign government, unless exempt by virtue of section 112. While a public international organisation is a non-resident for the purposes of the Order, it is exempted from liability for income tax under section 21. Further, while subsection (1) imposes income tax on a non-resident partnership (by virtue of the definition of "person"), subsection (3) ensures that tax is imposed on the partners and not the partnership. This is consistent with the principle of taxation of partnership income in Part VI of Chapter II.

Subsection (2) provides the rule for calculating the amount of tax payable. This is calculated by applying the relevant rates of tax as determined under Part III of Chapter II to chargeable income and then subtracting any tax credits allowed under this Order (for example, a foreign tax credit allowed under section 105).

The imposition of income tax under this section is broadly consistent with current law, although the concept of "taxable income" has been deleted from the taxing formula. While under current law "taxable income" is intended to mean that part of gross income which is "taxable", the combined use of "taxable income" and "chargeable income" can lead to confusion. For example, Item 2 of the Third Schedule of the 1981 Act imposes a 25% rate of tax on the "taxable income" (that is, gross income less exempt income) of a non-resident, rather than on chargeable income as was intended. Internationally, chargeable income and taxable income are generally used to mean the same thing, namely the amount against which tax is levied. It is for this reason that the term "taxable income" is no longer used, with "chargeable income" being the amount against which the rates of tax are applied.

5. Resident Individual

Section 5 provides rules for determining whether an individual is a resident of Lesotho. Subsection (1) provides for four alternative tests of residence: normal place of abode; 182 day; Lesotho Government official; and the common law test. An individual who does not satisfy any of these tests is a non-resident for the purposes of this Order (see definition of "non-resident" in section 3(1)). The operation of each test is outlined below.

An individual with a normal place of abode in Lesotho who is present in Lesotho for part of the year of assessment is a resident individual under section 5(1)(a). There is no minimum period of presence under this test. This means, for example, that a person posted overseas for, say, eighteen months who maintains a home in Lesotho and who returns to Lesotho during the year of assessment for a holiday will be a resident for the whole of the year of assessment. While the individual may be a resident in these circumstances, he or she may be exempt from Lesotho income tax on overseas employment income under section 104.

An individual who is present in Lesotho for more than 182 days during any consecutive period of twelve months is a resident individual under section 5(1)(b). The individual is treated as a resident under this rule for the year of assessment coinciding with this twelve-month period, or, where two years of assessment each fall partly within this twelve-month period, for both years of assessment. This test may be satisfied by a single period of presence in Lesotho, or by the aggregation of two or more periods within the period of twelve months. Presence in Lesotho for a part of a day will count as a whole day for the purposes of applying this test. This means, for example, that an individual living in the Republic of South Africa but who is employed in Lesotho, or who runs a business in Lesotho will satisfy this test if present in Lesotho for at least some part of 183 days of the year of assessment. The 183 days is not measured by reference to a year of assessment but by any consecutive period of twelve months. This means, for example, that a person who is present in Lesotho for the duration of an eight-month contract commencing on 1 November 1993 is a resident for both the 1993/94 and 1994/95 years of assessment. This is because the person is present in Lesotho for more than 182 days during the twelve month period 1 November 1993 - 31 October 1994. Whether a person is a resident for the whole of the year of assessment will depend on the application of subsections (2) and (3).

An individual who is an official of the Lesotho Government posted overseas during the year of assessment is a resident individual under section 5(1)(c). It is the individual's status as an official of the Lesotho Government which determines residence under this test. Consequently, this test is satisfied regardless of whether or not the person is present in Lesotho for any part of the year of assessment.

An individual who is otherwise a resident of Lesotho is a resident individual under section 5(1)(d). The reference to a person who is "otherwise a resident of Lesotho" means a person who is a resident of Lesotho according to ordinary concepts. This is determined according to the general principles established by United Kingdom judicial decisions. Whether a person is a resident according to ordinary concepts is a question of fact and degree involving consideration of a number of factors, none of which is decisive. These factors include -

* physical presence in Lesotho during the year of assessment;
* frequency, regularity, and duration of visits to Lesotho;
* maintenance of a place of abode within Lesotho during a period of absence;
* family and business ties in Lesotho;
* life-style; and
* nationality.

An individual who satisfies one of these tests is treated as a resident individual for the entire year of assessment, unless subsection (2) or (3) applies. Subsections (2) and (3) provide part year residence rules for the first and last year of an individual's residence in Lesotho. Under subsection (2), an individual who was not a resident individual at any time during the preceding year of assessment is only a resident from the date of first presence in Lesotho in the current year of assessment. Similarly, under subsection (3), an individual who is not a resident individual at any time in the following year of assessment is only treated as a resident up until the last day of presence in Lesotho in the current year. The rule in subsection (3) only applies if the individual had a closer connection to a foreign country than to Lesotho for the period after the last day of presence in Lesotho. The question of whether an individual had a closer connection with a foreign country during this period is a question of fact and degree determined having regard to the individual's personal and economic relations. The factors to be taken into account include the individual's -

* family and social relations;
* occupation;
* political, cultural and other activities;
* place of business; and
* property.

6. Resident Company

Section 6 provides rules for determining whether a company is a resident of Lesotho. Subsection (1) provides three alternative tests of residence: place of incorporation; place of management and control; and place of majority of operations. Subject to subsection (2), a company, which does not satisfy any of these tests, is a non-resident person for the year of assessment. The operation of each test is outlined below.

A company which is incorporated or formed under the laws of Lesotho is a resident company under section 6(1)(a). The reference to a company being "formed" under the laws of Lesotho ensures that this test applies to entities within the expanded definition of "company" in section 3(1) such as unincorporated associations.

A company which has its management and control in Lesotho is a resident company under section 6(1)(b). The reference to the management and control of a company is intended to adopt the test of corporate residence in United Kingdom judicial decisions. According to these decisions, the management and control of a company is regarded as being in the hands of the directors rather than the shareholders. Consequently, the management and control of a company is usually located at the place where the directors exercise their powers of management. In this regard, the focus is on the location of the superior and directing authority of the company and not the place of day-to- day operations.

A company which undertakes a majority of its operations in Lesotho is a resident company under section 6(1)(c). This test is intended to overcome tax avoidance practices whereby it is ensured that the place of incorporation, and management and control of a company is located outside Lesotho even though the majority of the company's operations occur in Lesotho.

Subsection (2) provides that a branch in Lesotho of a non-resident company is treated as a separate person which is a resident company for the purposes of the Order. "Branch" is defined in section 3(1). Subsection (2) has two effects. First, it gives separate legal personality for tax purposes to a branch of a non-resident company. Consequently, wherever the Order refers to a person this will include the branch of a non-resident company. Secondly, the branch as a separate person is treated as a resident company. This means, for example, that a non-resident company with a Lesotho branch is subject to Lesotho income tax (at the rate applicable to resident companies) on the worldwide income of the branch, and that payments to the branch are considered payments to a resident person for the purposes of the withholding rules.

7. Resident Partnership

A partnership is a resident partnership for a year of assessment if at any time during the year of assessment the partnership has a resident of Lesotho as a partner. The residence of the partners is determined in accordance with this Part. The test is satisfied if only one partner is a resident of Lesotho, and this is the case regardless of the level of the interest of that partner in the partnership, and regardless of the residence of the other partners. Further, the test is satisfied if "at any time" during the year of assessment a partner was a resident. In other words, it is not necessary for the partner to be a resident of Lesotho for the whole of the year of assessment. Where the test is satisfied the partnership is treated as a resident of Lesotho for the whole of the year of assessment.

The test is primarily relevant to the withholding of tax at source provisions. For example, a partnership being a person for the purposes of the Order can be a "contractor" within the section 3 definition. Consequently, payments made to the partnership as contractor are subject to withholding of tax at source. The rate of withholding depends on whether the partnership is a resident or non-resident (see sections 108 and 157).

8. Resident Fund

Section 8 provides rules for determining the residence of a superannuation fund. A superannuation fund is a resident fund if it -

(a) is organised in Lesotho and operated for the principal purpose of providing superannuation benefits to resident individuals; and

(b) has its management and control in Lesotho.

For a superannuation fund to be a resident fund, it must satisfy both requirements. A superannuation fund is organised in Lesotho if the trust deed is executed and registered in Lesotho. To qualify as a resident fund it must be operated for the principal purpose of providing superannuation benefits to resident individuals (defined in section 5). This means, for example, that the fact that there are a small number of non-resident members of a fund will not necessarily preclude the fund from being a resident fund. Even if a fund is established in Lesotho for the principal purpose of providing superannuation benefits, it is only a resident fund if it has its management and control in Lesotho. As with companies, the management and control of a fund is located at the place of the superior and directing authority of the fund. This involves looking to see where the decisions as to overall investment policy (rather than day to day portfolio management decisions) are taken.

A resident fund, which is an employer superannuation fund or a self-provided superannuation fund, is entitled to certain tax concessions in Part IX of Chapter II.

9. Rate of Income Tax for Resident Individuals

The chargeable income of a resident individual is subject to the progressive rate scale in the Second Schedule to the Order. An individual is a resident individual if he or she satisfies one of the tests of residence in section 5(1). The Second Schedule provides for three rate bands (25%, 35%, and 40%) with a maximum marginal rate cutting in at M40,000 of chargeable income. This compares to the five bands under current law with the highest rate (48%) cutting in at M34,000 of chargeable income. The reduction in marginal rates under the new law will be financed by the base broadening measures included in the new law. The new rate scale does, however, involve an increase in the lowest marginal rate from 15% to 25%. To compensate low income earners for this increase, a resident individual is entitled to a non-refundable rebate of M600 reduced by 10 lisente for each Maloti of chargeable income above M14,000. This is provided for in item 2 of the Second Schedule.

As an anti-avoidance measure, a special rate applies to property income derived by a minor resident in Lesotho. This measure is designed to prevent income splitting between parents and children under a tax system which adopts the individual as the tax unit. Under subsection (2), the chargeable property income of a resident minor is subject to the rate of tax specified in the Fourth Schedule. This rate equates to the maximum marginal rate, which at the time of enactment is 40%. "Minor" is defined in section 3(1) to mean an individual who is under 18 years of age at the end of the year of assessment. The normal marginal rates in the Second Schedule apply to any other income (such as employment income) of the minor. The "chargeable property income" of a minor is determined in accordance with section 14.

The new law recognises Lesotho's reliance on the assistance of overseas technical personnel in a number of key areas of economic development. While such personnel are likely to satisfy one of the tests of residence in section 5, it may work hardship to apply the full progressive rate structure to such persons as typically they only come to Lesotho for a fixed term. For this reason, subsection (3) applies a concessional rate of tax to certain expatriate taxpayers. The chargeable income of an expatriate taxpayer, which represents compensation for services rendered under an aid project, is subject to tax at the standard rate of tax, which at the time of enactment is 25%.

"Expatriate taxpayer" is defined in section 3(1) to mean a resident individual (other than a citizen or permanent resident of Lesotho) who is employed or engaged under a technical services contract. "Technical services contract" is also defined in section 3(1). While the concession is available to both employees and independent contractors, it is required in subsection (3) that the services be provided under an "aid project". This is defined in subsection (4) to mean a project financed by a foreign government or public international organisation through a grant or loan. While it is not necessary that the taxpayer be in a direct contractual relationship with the foreign government or public international organisation, such a person must be the original source of the funding for the project. However, if the expatriate taxpayer is employed by a person whose income from the project is exempt from tax (for example, under an international agreement), then subsection (5) denies the benefit of the concessional rate.

The concessional rate is only available to a resident individual who is not a citizen or permanent resident of Lesotho. "Permanent resident" is defined in section 3(1) to mean a resident individual who has been present in Lesotho for a total of seven years (see the Commentary to that definition). The effect of the definition of "permanent resident", therefore, is that the concessional rate applies for a total period of seven years. To qualify for the concessional rate, the services do not have to be provided under the same contract or aid project during that period. A person who has been present in Lesotho for a total period of seven or more years is considered to have a sufficiently strong enough connection with the country to justify being subject to full marginal rates.

The concessional rate is applied against that part of the chargeable income of the expatriate taxpayer which represents compensation for services provided under an aid project. In calculating chargeable income, deductions (including the abatement under section 73) are allowed in accordance with the Order. Where the taxpayer has other income subject to tax in Lesotho, that income is charged to tax at normal marginal rates. In this situation, deductions which relate to both the services and other income must be apportioned in accordance with section 46(1). The personal deduction (referred to in this Commentary as the "abatement") allowed under section 73 is prorated between the two chargeable incomes in proportion to total gross income in accordance with section 46(2).

10. Rate of Income Tax for Resident Companies

The chargeable income of a resident company is subject to income tax at the rates set out in the Third Schedule. Under the Third Schedule, all income of a resident company (other than manufacturing income) is subject to tax at the rate of 40%. The manufacturing income of a resident company is subject to tax at the concessional rate of 15%.

According to subsection (2), the concessional rate in the Third Schedule applies to chargeable income which is Lesotho-source derived from manufacturing (see section 3(1) definition of "manufacturing"). Where a company has both manufacturing and other income, deductions relating to the production of both classes of income must be apportioned in accordance with section 46. It is intended that the allocation of deductions between manufacturing and other income will be closely monitored to ensure that deductions are not unreasonably allocated to non-manufacturing income to reduce the amount of chargeable income subject to the normal corporate rate.

By virtue of subsection (3), the concessional rate for manufacturing income does not apply to a Lesotho branch of a non-resident company despite the branch being treated as a resident company for the purposes of the Order. This means that the 40% rate applies to all the chargeable income of the branch.

11. Rate of Income Tax for Trustees

The chargeable trust income of a trustee is subject to tax at the rate specified in the Fourth Schedule. This rate is set to equate to the maximum marginal rate and is designed to ensure that trusts are not used as a means of tax avoidance.

The rate in the Fourth Schedule does not apply to the chargeable trust income of a trustee of an estate of a deceased taxpayer who was a resident individual at the date of death during the first two years of administration of the estate. Instead the marginal rates in the Second Schedule apply to the year of assessment in which the individual dies and the following year. If the administration of the estate extends beyond this period, then the chargeable trust income is subject to tax at the Fourth Schedule rate in any subsequent year.

12. Rate of Income Tax for Non-Residents

The chargeable income of a non-resident taxpayer is subject to tax at the standard rate of tax (25%). A non-resident taxpayer is a person who is subject to income tax under the Order but who is not a resident of Lesotho. This would include, for example, an individual who is not a resident under section 5 and a company that is not a resident under section 6. This section does not apply to the chargeable income of a Lesotho branch of a non-resident company as this is subject to the rate of tax prescribed in the Third Schedule (see section 10(1)). This section also does not apply to a non-resident individual or company acting in the capacity of trustee. The liability of a trustee depends on whether there is chargeable trust income. If there is, then it is subject to the rate of tax prescribed in the Fourth Schedule. Finally, this section does not apply to a non-resident partnership, as such a partnership is not a taxpayer for the purposes of the Order (see section 75), although it will apply to non-resident partners liable under section 77.

13. Chargeable Income

Under section 4, income tax is imposed on every individual, trustee, company, or non-resident person who has chargeable income for a year of assessment. The persons upon whom tax is imposed under section 4 are taxpayers for the purposes of the income tax (see section 3(1) definition of "taxpayer"). Section 13 states the formula for calculating the chargeable income of a taxpayer for a year of assessment as -

gross income - allowable deductions.

The gross income of a taxpayer is determined in accordance with section 17. From gross income are subtracted all deductions allowed under the Order. Most deductions are allowed under Division IV of Part IV of Chapter II, although the abatement deduction is allowed under Part V of Chapter II.

Subsection (2) of section 13 makes it clear that for a non-resident taxpayer, no deduction is allowed in calculating the amount of income subject to withholding tax under section 107 or 108. A non-resident who elects to be taxed by assessment in respect of income subject to withholding tax under those sections is allowed a deduction for expenses or losses incurred in deriving that income but subject to the limitations in section 109.

14. Chargeable Property Income of Minors

Under section 9(2), the chargeable property income of a resident minor is subject to tax at the rate of 40%. Section 14 provides that the chargeable property income of a resident minor is the property income of the minor (see section 20) less any deduction allowed under Division IV of Part IV of Chapter II relating to the production of that income, and further reduced by a personal deduction. The confining of deductions allowable in this way means that the abatement in section 73 is not taken into account in calculating chargeable property income, the special personal deduction of M1,000 being in lieu of the abatement in section 73. However, if the minor has other income (for example, from an employment or business), then the full abatement would be taken into account in calculating the amount of chargeable income in relation to that other income.

For example, if a minor has interest income of M2,500 and employment income of M6,000, then the chargeable property income subject to a 40-percent tax will be M1,500. The balance of the interest income (M1,000) plus the employment income (total of M7,000), reduced by the abatement of M6,240 under section 73, will be subject to tax at the rates specified in the Second Schedule (in this case, 25%). Thus, the tax will be M790:

M1,500 times 40% = M600
M760 times 25% = M190.

15. Chargeable Trust Income

The chargeable trust income of a trustee (other than the trustee of certain deceased estates) is subject to tax at the rate of 40% (see section 11). Section 15 provides that the chargeable trust income of a trustee is calculated in accordance with Part VII of Chapter II.

16. Minimum Chargeable Income

Section 16 provides an alternative method of calculating the chargeable income of those taxpayers with low reported chargeable income but visible signs of substantial wealth. Under section 16, a taxpayer's minimum chargeable income is calculated on a presumptive basis having regard to visible signs of wealth to which objective values are assigned. The indicators of wealth used in determining minimum chargeable income are: air travel; electricity consumption; value of the taxpayer's principal residence; school fees; the value of a secondary residence; and the value of the taxpayer's motor vehicle.

If the chargeable income of a resident individual calculated under section 13 is less than the minimum chargeable income calculated under section 16, then under subsection (1) the individual's chargeable income is the minimum chargeable income. The inclusion in the new law of this method of taxation is in response to the low level of compliance which has been detected among some wealthy taxpayers. The calculation of minimum chargeable income is designed in such a way as to have no application to most resident individuals. Under subsection (4)(a), this section does not apply to a resident individual whose income (other than income subject to a final withholding tax such as interest, see section 158(2)) consists solely of employment or pension income. Further, under subsection (4)(b), this section does not apply to a resident in receipt of employment or services income which is entitled to diplomatic or similar exemption (see section 22) or which is exempt under a treaty or other international agreement (see section 112). In the case of a husband and wife where neither spouse is excluded by subsection (4), this section applies to the spouse with the greater chargeable income calculated under section 13. Finally, each of the indicators of wealth is only taken into account if it exceeds the threshold prescribed in the Fifth Schedule (see subsection (7)). Most taxpayers will not have amounts that exceed the thresholds. Even where a taxpayer does have amounts that exceed the threshold for one or more indicators of wealth, the presumptive calculation will have no effect on tax liability where it is less than the taxpayer's normal chargeable income calculated under section 13.

A taxpayer's minimum chargeable income is the sum of the amounts calculated under each of the paragraphs in subsection (2). No deductions are allowed in calculating the minimum chargeable income of a taxpayer. This means, for example, that the abatement allowed under section 73, or a loss carry forward deduction under section 47 are not taken into account in calculating minimum chargeable income.

The first component of minimum chargeable income is the air travel amount. Under subsection (6), the air travel amount of a taxpayer is the total cost of air or sea travel of the taxpayer, the taxpayer's spouse, and the taxpayer's minor children. The air travel amount does not include travel on the taxpayer's employer's business, but does include travel on the taxpayer's own business. By virtue of subsection (7) and item 2 of the Fifth Schedule, the air travel amount is only taken into account if it exceeds M2,500 for the year of assessment. Where it exceeds this threshold, the whole amount is taken into account under subsection (2).

The second component of minimum chargeable income is the electricity amount. Under subsection (6), the electricity amount is the value of electricity consumed in the taxpayer's principal residence and secondary home. A secondary home is a residence available for the use of the taxpayer's spouse or minor children. If there is more than one secondary home, then the electricity amount includes the value of electricity consumed in each home. The electricity amount is determined by reference to accounts rendered for electricity consumption during the year of assessment. By virtue of subsection (7) and item 2 of the Fifth Schedule, the electricity amount is only taken into account if it exceeds M3,000 for the year of assessment. Where it does exceed this threshold, the whole of the amount is taken into account under subsection (2).

The third component of minimum chargeable income is the principal-residence amount. The principal residence of a taxpayer is the residence (whether in Lesotho or elsewhere) at which the taxpayer spends most of his or her time during the year of assessment. The calculation of the principal-residence amount depends on whether the principal residence is owned or rented by the taxpayer or the taxpayer's spouse. If it is owned, then the principal-residence amount is the greater of the adjusted cost base of the residence or the value of the residence for the purposes of property rates. The "adjusted cost base" of a residence is determined in accordance with the definition in section 3(1) (see also section 60 and the regulations thereunder for the meaning of "cost base"). Where the residence is rented, the principal-residence amount is the greater of eight times the actual annual rental or eight times the annual fair market rental for the year of assessment. By virtue of subsection (7) and item 2 of the Fifth Schedule, the principal-residence amount is only taken into account if it exceeds M150,000. Where it does exceed this threshold, only 5% of the principal-residence amount is included in minimum chargeable income under subsection (2).

The fourth component of minimum chargeable income is the schooling amount. Under subsection (6), this is the tuition and related fees incurred in respect of the taxpayer's minor children during the year of assessment. "Related fees" includes, for example, the cost of books, excursions, and after-hours tutoring. By virtue of subsection (7) and item 2 of the Fifth Schedule, the schooling amount is only taken into account if it exceeds M1,000 per child. Where it does exceed this threshold, the whole of the amount is included in minimum chargeable income under subsection (2).

The fifth component of minimum chargeable income is the secondary home amount. The secondary home of a taxpayer is a residence (whether in Lesotho or elsewhere) available for use by the taxpayer, or the taxpayer's spouse or minor children. A secondary home is taken into account even if the taxpayer's spouse or minor children pay rent to the taxpayer for the use of the home. If the taxpayer has more than one secondary home, then each is taken into account under this head. The secondary home amount is calculated in accordance with the same principles as for the calculation of the principal-residence amount, and is only taken into account if it exceeds M20,000. Where it does exceed this threshold, only 5% of the amount is included in minimum chargeable income under subsection (2).

The final component of minimum chargeable income is the vehicle amount. Under subsection (6), this is the value of a motor vehicle or vehicles owned or used by the taxpayer, the taxpayer's spouse, or the taxpayer's minor children. It does not include, however, the value of a vehicle which is wholly used for business purposes. The value of a motor vehicle is determined in accordance with tables which are to be published by the Commissioner, and, by virtue of item 2 of the Fifth Schedule, is only taken into account if it exceeds M20,000. Where it does exceed this threshold, only 25% of the amount is included in minimum chargeable income.

The application of section 16 is illustrated by the following example -

Taxpayer is married with a spouse who does not derive any income and a ten year old child. He receives a salary of M60,000 and rental income of M15,000, and has M10,000 in deductions for the year of assessment (including the abatement allowed under section 73). Taxpayer, therefore, has a chargeable income under section 13 of M65,000.

During the year of assessment, Taxpayer -

* spends M10,000 in private air travel to Mauritius for his wife and child;

* consumes electricity in the family home to the value of M2,500;

* has only one family home with an adjusted cost base of M200,000 (this is higher than the value for the purposes of property rates);

* incurs school fees of M15,000 for his child;

* has a vehicle available for private use with a value of M25,000.

As taxpayer derives rental income in addition to his salary, he is subject to section 16. Had the other income been interest subject to a final withholding tax under section 158 and not rental income, then section 16 would not apply.

For the purposes of calculating minimum chargeable income, Taxpayer has an air travel, principal-residence, schooling, and vehicle amount. As the value of electricity consumed is less than M3,000 (the threshold set out in the Fifth Schedule), no electricity amount is taken into account in calculating minimum chargeable income. Taxpayer's minimum chargeable income for the year of assessment is M40,000 (being M10,000 + (5% x M200,000) + M15,000 + (25% x M25,000)). As this is less than the chargeable income calculated under section 13, section 16 does not apply to Taxpayer.

17. Gross Income

This section defines gross income being the first component in the calculation of the chargeable income of a taxpayer. The section also sets out the jurisdictional extent of income taxation in Lesotho.

Subsection (1) provides that the gross income of a taxpayer for a year of assessment is the total of the employment income, business income, property income, and any other income or gains derived by the taxpayer during the year of assessment. Gross income, however, does not include amounts which are exempt from income tax. These are mainly set out in Division III of Part IV of Chapter II, and in treaties or international agreements referred to section 112 of the Order. The rules for determining when income is "derived" are set out in Division V of Part IV of Chapter II.

The definition of the tax base in subsection (1) differs significantly from that under section 7 of the <u>1981 Act</u>. Under that section, gross income is largely confined to income according to ordinary concepts, there being a specific statutory exclusion for "receipts of a capital nature". What is income according to ordinary concepts is determined according to the vast body of United Kingdom and South African judicial decisions. While section 7 does specifically include certain amounts in gross income (whether or not of a capital nature), the inclusions are largely declaratory of the ordinary meaning of income.

It is the intention of the new law to define the tax base comprehensively, so that it is not confined to income according to ordinary concepts. This is primarily achieved through the definitions of employment, business, and property income in the following sections. Further, the reference to "any other gains" is not intended to be confined to income according to ordinary concepts.

The broadening of the income tax base under the new law ensures that the burden of tax is shared more equitably among taxpayers than under current law. Further, it is the broadening of the tax base which will allow for significant reductions in income tax rates without an overall reduction in Government revenue from income tax. It is expected that a broader tax base with significant reductions in rates will lead to greater compliance by taxpayers. In other words, there is likely to be a further fiscal dividend from a more equitable tax system.

Subsections (2) and (3) set out the jurisdictional extent of income taxation in Lesotho. The gross income of a resident taxpayer includes income from all sources, while a non-resident taxpayer is subject to tax only on Lesotho-source income. A comprehensive set of source rules is provided in section 103. Separate jurisdictional rules apply to the taxation of income derived through a partnership or trust, see Parts VI and VII of Chapter II respectively.

The new law extends Lesotho's jurisdiction to tax the foreign-source income of residents. Under section 11 of the <u>1981 Act</u>, Lesotho asserts jurisdiction to tax citizens, permanent residents, and resident companies on their worldwide income, and other residents on foreign income which is received in the jurisdiction (ie. a remittance basis of taxation).

Under the new law, Lesotho asserts jurisdiction to tax all residents on their worldwide income with relief from international tax generally provided by way of a foreign tax credit (see section 105). Consequently, the new law removes the remittance basis of taxation. While the remittance basis of taxation may be justified for those residents who have a less permanent connection with Lesotho (particularly, overseas technical personnel), the experience of other countries with such taxation is that it is easily avoided. Taxpayers have been able to structure their transactions so as to obtain the benefit of the income in the jurisdiction without there technically being a remittance of the income. In particular, techniques have been adopted to convert income into capital before remittance (for example, by using the income to purchase equipment outside the jurisdiction), or through set-off arrangements with foreign banks.

Relief from worldwide taxation is provided for some "short-term" residents in section 24. Under that section, the foreign property income of an expatriate taxpayer (see section 3(1) definition) is exempt from income tax. In this way, exemption from worldwide taxation is confined to those residents for whom it is justified, rather than being generally available as under current law. Indeed, expatriate taxpayers may be better off under the new law as the exemption is available regardless of whether or not the foreign income is brought into Lesotho.

18. Employment Income

Employment income is included in gross income under section 17(1)(a). "Employment income" is defined in section 18 to mean a payment or benefit arising from an employment (defined in section 3(1)). The use of the word "arising" to define the nexus between the payment or benefit and the employment is intended to ensure that employment income is broadly defined. It is intended that employment income include all gains (regardless of their nature) arising from the employment relationship. Examples of employment income include wages, salary, overtime pay, leave pay, payment in lieu of leave, sick pay, strike pay, a return to work payment, commission, bonus, gratuity (including a contract gratuity), allowances (including responsibility, recruitment, and retention allowances), stipend, pension, retirement allowance, a payment in return for a restrictive covenant given by a former employee, or benefit (whether or not convertible into money or money's worth). This list is not exhaustive and is provided for guidance only. It includes amounts which clearly satisfy the "arising" test. By virtue of section 31(3), employment income includes a gift (including a testamentary gift) made to, or for the benefit, of an employee. The effect of section 31(3) is that the mere fact of employment alone supports the characterisation of the gift as employment income. Consequently, for example, a wedding present given by an employer to an employee is included in gross income as employment income.

Certain amounts are not included in employment income. First, employment income does not include a benefit included in the fringe benefits taxable amount of the taxpayer's employer under section 117. This exclusion from employment income is by way of reconciliation with the fringe benefits tax ("FBT"). It ensures that benefits, which are subject to fringe benefits tax in the hands of the employer, are not taxed again in the hands of the employee. Where the employer providing a fringe benefit is not a taxpayer for the purposes of fringe benefits tax (such as a public international organisation - see section 21), the employer will not have a fringe benefits taxable amount, and therefore, the value of the benefits is required to be included in the employment income of the employee (unless exempt under section 22 or by virtue of a treaty or international agreement referred to in section 112). Where an employee is required to include the value of a fringe benefit in gross income under this section, subsection (2) provides that the FBT valuation rules in Chapter III apply in calculating the value of the benefit.

Secondly, employment income does not include an exempt fringe benefit. Section 118 exempts certain benefits from fringe benefits tax either for policy reasons or on the grounds of administrative convenience. The effect of paragraph (b) of section 18(1) is to carry those exemptions through to the income tax.

Thirdly, employment income does not include a reimbursement of expenditure incurred by an employee on behalf of the employer for which the employer would have been entitled to a deduction under Division IV if the expenditure had been incurred directly by the employer. This ensures that an employee is not taxed on the reimbursement of genuine business expenses incurred on behalf of his or her employer.

Fourthly, employment income does not include passage granted to an employee at the commencement or termination of employment. This exemption is provided for on policy grounds and in recognition of Lesotho's reliance on overseas technical personnel in key economic areas.

The new law does not differ significantly from the taxation of employment income provided for in section 7 of the 1981 Act. The jurisdiction asserted in section 7 of the 1981 Act, however, has been undermined by exemptions elsewhere in the Act, particularly for contract gratuities, and certain public service responsibility, recruitment, and retention allowances. The new law removes these exemptions. The withdrawal of the exemption for contract gratuities is one of the key base broadening measures in the new law. In most cases though, employees will not pay any more tax because of the significant reduction in marginal rates, particularly the maximum marginal rate which has been reduced from 53% to 40% as part of the reform process. Further, a deduction is allowed for contributions made by an employee to a complying superannuation fund for up to 20% of the employment income of the employee. Consequently, the combined effect of lower marginal rates and the deduction for superannuation contributions will mean that many higher income earners will be better off under the new law.

19. Business Income

"Business income" is defined in section 19 to mean the profits or gains "arising" from a business. As with employment income in section 18, the use of the word "arising" to define the nexus between the profit or gain and business is intended to ensure that business income is broadly defined. It is intended that all profits or gains, regardless of whether they are revenue or capital in nature, be included in business income. "Business" is defined in section 3(1) and includes the provision of services other than as an employee. As outlined in the Commentary to the definition of "business", whether a particular activity constitutes a business is a question of fact and degree to be determined having regard to all the circumstances.

Subsection (2) specifically includes certain amounts in business income. Under paragraph (a), business income includes a gain on the disposal of a business asset or on the satisfaction of a business debt whether or not the asset or debt was on revenue or capital account. "Business asset" and "business debts" are defined in section 3(1). The effect of paragraph (a) is that gains on the disposal of all business assets or the satisfaction of all business debts are included in business income regardless of whether, under general principles, the gain would be classified as a capital gain. Under section 48, losses on the disposal of a business asset are allowed as a deduction. Paragraph (b) specifically includes in business income a payment received by a person carrying on business as consideration for the person accepting a restriction on the capacity to carry on the business.

As stated above, the new law removes the distinction between income and capital gains in the business context, so that all gains of a business are included in gross income. The distinction between income and capital gains is often a difficult one to make, there being no clear guidelines in the case-law or the legislation. The cases have drawn a distinction between "fixed" and "circulating capital", between "profit yielding structure" and that which gets turned over in the ordinary course of business, and between revenue and capital account. The cases do not give content to these distinctions as they inevitably involve a judgement made on the basis of the facts of each case. An examination of the cases, therefore, reveals many fine distinctions being made which has made administration of the Act difficult. Further, and more importantly, the distinction between income and capital gains has encouraged businesses wherever possible to characterise their transactions as giving rise to (tax-free) capital gains.

20. Property Income

This section defines property income to include the income or gains specifically listed. "Dividends", "interest", "natural resource payments", and "royalties" are specifically defined in section 3. The definition is inclusive only, and therefore, is intended to include any other returns on capital or payments for the right to use, or for possession of, property or money, including any premium or like consideration. Property income, however, does not include business or employment income. For example, the rental income derived by a person who is in the business of renting properties will be treated as business income rather than property income.

Property income specifically includes gains on disposal of investment assets (such as rental properties, stocks and shares, and financial assets) as calculated in accordance with section 59. This means that the new law introduces a limited capital gains tax. Capital gains from the disposal of personal assets, such as the taxpayer's private residence, vehicle or personal effects will not be property income. The inclusion of gains on investment assets in the tax base is justified on equity grounds. Under current law, taxpayers with the same capacity to pay tax face different tax burdens depending on whether they earn income or capital gains. Generally, it is high-income earners who are in a position to derive substantial capital gains. Further, even outside the business context, the distinction between income and capital gains is often artificial.

21. Public International Organisations

Section 21 exempts a public international organisation from both income and fringe benefits tax. An organisation is a public international organisation if it is listed in the First Schedule to the Order. This section expands the existing exemption in section 22(1)(ra) of the 1981 Act to include fringe benefits tax.

22. Diplomatic and Similar Privileges

The exemptions in section 22(a) and (b) are largely a re-enactment of the exemption in section 22(1)(e) of 1981 Act, and give force of law to Lesotho's obligations under Articles 34 and 37 of Vienna Convention on Diplomatic Relations.

The official employment income of a diplomatic officer, consular officer, administrative or technical employee of a diplomatic mission, member of the service staff of a diplomatic mission or consular post, or private servant is exempt from income tax in Lesotho under section 22(a). A fringe benefit (as defined in section 115) provided in relation to such persons as part of their official remuneration is an exempt fringe benefit for the purposes of fringe benefits tax (see section 118(b)). The exemption does not apply to any other Lesotho-source income of the person (for example, interest income). Further, the exemption does not apply to any person who is a citizen or permanent resident of Lesotho.

Paragraph (b) expands on the exemptions provided under section 22(1)(k) of the 1981 Act. Generally, the exemptions under section 22(1)(k) continue to be available under section 112 of the Order. Section 22(b) of the Order is a general exemption applying to the official employment income of a person in the public service of a foreign government where that person is resident in Lesotho solely for the purposes of performing the duties of office. This would cover, for example, a person in the public service of a foreign government who is an adviser to the Lesotho Government for a fixed period. The exemption is only available if the Lesotho-source employment income is subject to income tax in the foreign country. The exemption does not apply to any other Lesotho-source income of the person.

Under paragraph (c), the exemption is extended to foreign-source income (see section 103) derived by a person referred to in paragraph (a) or (b) or by a member of the family of such person. Family members will be liable for tax on Lesotho-source income.

23. Foreign Service Allowance

A foreign service allowance paid to a person serving in a Lesotho foreign mission is exempt from income tax to the extent declared by the Minister by notice in writing in the Gazette. This section re-enacts the exemption in section 22(1)(l)(i) of the 1981 Act.

24. Property Income of Expatriate Taxpayers

This section recognises that Lesotho relies on the assistance of overseas technical personnel in a number of key economic areas. Under section 5, these persons will be resident individuals if they are present in Lesotho for more than 182 days. As residents, they will be liable for Lesotho income tax on their worldwide income (see Commentary to section 17). As these persons are generally only in Lesotho for a fixed term for the purpose of providing technical assistance, it would be unfair to subject them to Lesotho income tax on worldwide income. Consequently, this section exempts from income tax the foreign property income derived from a foreign source or from the disposal of an investment asset generating foreign income by an expatriate taxpayer. "Expatriate taxpayer" is defined in section 3 to mean a resident individual (other than a citizen or permanent resident) who is employed or engaged under a "technical services contract" (separately defined in section 3(1)). When combined with the definition of "permanent resident" in section 3(1), this section effectively exempts from Lesotho income tax the foreign property income of most overseas technical personnel for a period of seven years. An ancillary effect of this exemption is that the exempt income is subtracted in making the calculation under section 16(2).

This exemption replaces the remittance basis of taxation which applies under section 11 of the 1981 Act to all resident individuals (other than citizens and permanent residents). See the Commentary to section 17 for a discussion of the reasons for removal of the remittance basis of taxation.

25. Exempt Organisations

This section exempts the income of a religious or charitable organisation, an amateur sporting association, or a trade union or like organisation (such as an employer association) from income tax. The exemption largely re-enacts the exemptions in section 22(1)(b), (c), and (d) of the 1981 Act, while removing some of the anomalies and inconsistencies which exist under those exemptions. The exemption covers, for example, donations and receipts from fund-raising activities such as dinners, fetes and jumble sales. The exemption is only available where the organisation has a ruling from the Commissioner confirming its exempt status, and none of its income or assets confers, or may confer, a private benefit on any person. In this context, a private benefit is in distinction to a benefit that may be conferred on a member of a charitable class as a consequence of an organisation's charitable activities, or a benefit ancillary to those activities. A private benefit also would not be considered as arising from an arm's-length payment to a provider of property or services to an exempt organisation.

It is generally regarded as inappropriate for the tax-exempt status of such organisations to extend to commercial activities carried on in direct competition with the private sector. Consequently, under subsection (3), income from commercial activity is exempt only if that activity is ancillary to the organisation's charitable or non-profit function. For example, income from the sale of religious literature would generally be regarded as ancillary to the exempt function of a church; whereas income from a general bookshop or a printing press operated by a church in a commercial manner would not normally be regarded as ancillary to the church's exempt function.

It is also usual to deny the exemption for property income, as such income is generally untaxed at the level of the payer. If property income is exempt, then there is an incentive to convert taxable business income into untaxed property income, particularly through related party transactions. Consequently, the exemption in section 25 does not apply to property income (see section 20); although interest income from which tax has been withheld under section 158 is not included in the gross income of an exempt organisation (section 158(2)).

An organisation, which is exempt from income tax under section 25, is still liable for fringe benefits tax on fringe benefits provided to employees. Fringe benefits tax is a surrogate for income tax on the employee, and therefore, should be paid by exempt organisations.

26. War Pensions

War pensions and gratuities paid by the Lesotho Government in respect of persons who retired before the date of enactment of this Order are exempt from income tax. This basically re-enacts the exemption in section 22(1)(f) of the 1981 Act, although the exemption is only available to persons who retired before the date of enactment of the Order (that is, to persons currently receiving the benefit of the exemption). In other words, the exemption is to be phased out with the introduction of the new law. Section 26 also makes it clear that the exemption is only available for pensions or gratuities paid by the Lesotho Government.

27. Interest

This section exempts the first M500 of interest derived from a single savings account by a resident individual from income tax. The exemption is only available in respect of savings accounts with a registered financial institution resident in Lesotho. As the Lesotho branch of a non-resident financial institution is deemed to be a resident company under section 6(2), an account held with such a branch qualifies for the exemption. An account held with a foreign branch of a non-resident financial institution does not qualify for exemption, and the interest paid on such an account is fully taxable with a credit for any foreign tax (such as withholding tax) paid on the interest.

The exemption is only available in respect of a single savings account. It is not possible to aggregate the interest earned on several accounts to reach the M500 limit. An individual with more than one account must nominate the account to which the exemption applies. The nomination must be made to the financial institution with whom the account is held and must include the individual's taxpayer identification number. This allows the financial institution to take the exemption into account in calculating the amount of tax (if any) withheld from interest paid on the account under section 158.

The exemption is not available to a resident minor. This is consistent with section 9(2) which imposes tax at the maximum marginal rate on the chargeable property income of resident minors.

This section rationalises the exemptions for interest income in section 22(1)(h) of the 1981 Act into a single exemption. While the aggregate exemption under the sub-paragraphs of section 22(1)(h) of 1981 Act is more than the M500 exemption under the new law, it is considered that making the withholding tax on interest under section 158 a final tax sufficiently compensates for the lower aggregate exemption.

28. Scholarships

This section exempts a scholarship payable for tuition or fees for full-time instruction at an educational institution from income tax. The exemption is confined to scholarships payable in respect of tuition or fees, and does not include scholarships or a part of a scholarship for living expenses.

29. Farming

This section exempts from income tax the income derived by a resident individual from farming carried on in Lesotho. The exemption is only available for primary farming operations, whether pastoral or agricultural. It is not available for secondary operations such as processing of harvested crop. The exemption is not available for farming operations carried on by a company, nor for farming operations carried on outside Lesotho (for example, in the Republic of South Africa). As income derived through a partnership retains its character in the hands of the partners (see section 77(5)), a resident individual's share of partnership income represented by farming income which otherwise satisfies section 29 is exempt.

This section largely re-enacts the exemption in section 22(1)(m) of the 1981 Act, although confines it to resident individuals and to income from farming operations in Lesotho.

30. Maintenance and Child Support

Under current law, alimony or maintenance payments or child support payments are taxed in the hands of the recipient (section 7(b) of 1981 Act) without a deduction to the payer. This has the effect of taxing the income represented by the alimony or maintenance payment twice. Section 30 exempts maintenance and child support payments from income tax. Consequently, the income represented by the payment is taxed to the payer only (as the payer is not allowed a deduction for the maintenance or child support payment).

31. Gifts

This section provides that the value of any property acquired by way of a gift, bequest, devise, or inheritance (compendiously referred to below as a "gift") is exempt from income tax. Subsection (2) makes it clear that the exemption does not extend to any income derived from the property which is the subject of the gift. Subsection (2) also provides that the exemption does not apply where the gift is itself income, such as a gift of an annuity or a life interest in a trust estate. Subsection (3) provides that the exemption does not apply to a gift made by an employer to an employee. The effect of subsection (3) is that regardless of the reason for the gift (it may be a bonus based on performance or a wedding present), all gifts made by an employer to an employee are employment income of the employee.

32. Exemption Under Other Laws

Section 32 is declaratory of general principles of statutory interpretation. An example is the income of the King and Regent of Lesotho, which is exempt from income tax under the Office of King Order 1990.

33. Expenses of Deriving Income

The chargeable income of a taxpayer is calculated by deducting from the gross income of the taxpayer all allowable deductions. Generally, allowable deductions are specified in Division IV of Part IV of Chapter II, although some deductions are provided elsewhere in the Order (for example, the personal deduction under section 73, and a partner's share in a partnership loss under section 77).

This section provides the basic principles for determining whether an amount is an allowable deduction under Division IV of Part IV of Chapter II. The general rule is that a deduction is allowed for any expense or loss (including a depreciation, amortisation, or other deduction allowed under a specific section in Division IV), but only to the extent incurred by the taxpayer during the year of assessment in the production of income subject to tax under the Order. Consequently, for example, no deduction is allowed for expenses incurred in deriving exempt income or for the application or appropriation of income after it has been derived (such as the carrying of amounts to reserve funds). The requirement that the expense or loss be incurred in the production of income subject to Lesotho income tax applies to all deductions (including depreciation and amortisation deductions) allowed under Division IV. Where an expense or loss has been incurred both in the production of income and for some other end, a deduction is only allowed to the extent to which the expense or loss is incurred in the production of income.

A deduction is only allowed for an expense or loss "incurred" in the year of assessment. The timing of the recognition of deductions is determined according to the rules in Division IV and Division V of Part IV of Chapter II.

The availability of deductions under the new law is broader than under current law in two important respects. First, under the new law, the general deduction provision applies to all income producing activity; while under section 26(a) of the 1981 Act, the general deduction provision only applies to a taxpayer carrying on trade in Lesotho. While trade is broadly defined, it does not cover all income producing activities, particularly those generating property income. In relation to those activities, unless a specific provision applies, no deductions are allowed for expenditure or losses incurred in earning the income. Secondly, the new law specifically provides for apportionment of deductions which relate both to income producing and other activities; while under section 34(i) of the 1981 Act, a deduction is only allowed for "moneys...wholly or exclusively laid out or expended for the purposes of trade".

Subsection (2) of section 33 provides that an employee will only be allowed deductions in relation to employment income to the extent prescribed by regulations. This is consistent with the overall policy of limiting the number of returns filed by employees.

Subsection (3) lists a number of expenses or losses which are not allowed as a deduction under subsection (1). As subsection (1) is of general operation, these exclusions are also of general operation, applying unless the contrary intention is expressed. Paragraph (a) provides that to the extent that an expense or loss is of a personal nature it is not deductible, and is largely a re-enactment of section 34(a) and (b) of the 1981 Act. Subsection (4) provides a non-exhaustive list of expenses considered to be of a personal nature.

Paragraph (b) provides that deductions are not available for income tax, and is a re-enactment of section 34(d) of the 1981 Act. If the tax in question is a foreign income tax, it may qualify for a foreign tax credit under section 105 of the Order.

Paragraph (c) provides that no deduction is allowed for the cost of acquiring, producing, or improving property or for other expenses chargeable to capital account, including indirect expenses such as depreciation, interest, or taxes incurred during the construction period. This limitation applies regardless of whether the property is a business asset (including trading stock) or an investment asset. There is a substantial body of case law in the United Kingdom and the Republic of South Africa on the distinction between revenue and capital account in the context of deductions. By using the expression "capital account" it is intended that that body of case law apply for the purposes of paragraph (c), except to the extent that regulations deal with the matter.

The "construction period" is the period from the commencement of construction of income-producing property to the time that the property is first used in the production of income subject to Lesotho income tax. It is not until the time of first use in the production of income that depreciation and holding expenses are allowed as a deduction. For depreciation deductions, this is confirmed by the definition of "depreciable asset" in section 3(1) under which an asset is not regarded as depreciable until it is used in the production of income; it is only at that point that the property is taken into account under section 41.

While a deduction is not allowed for expenditure referred to in paragraph (c), it is included in the cost base of the property (where that property is a business or investment asset) under section 60(3). In other words, the cost is taken into account on disposal of the property. Paragraph (c) does not apply to research and development expenditure deductible under section 40.

Paragraph (d) provides that no deduction is allowed for the cost of a gift to an individual if the gift is not included in the gross income of the recipient. Where the gift is included in the gross income of the recipient, the cost of providing the gift must still satisfy subsection (1). The purpose of paragraph (d) is to ensure that there is symmetrical treatment on the income and deduction sides in relation to gifts.

Paragraph (e) provides that no deduction is allowed for a fine or other similar penalty paid to a government for breach of any law. This includes, for example, fines for traffic infringements, or for breach of regulatory laws (such as liquor licensing laws).

Paragraph (f) provides that an insurance premium paid to a non-resident insurer in respect of an asset or risk in Lesotho is nondeductible. It is illegal under the Insurance Act for such assets or risks to be insured with a non-resident insurer, and therefore, paragraph (d) is intended to ensure that no deduction is allowed for expenditure arising from an illegal act.

34. Compensation Expense

Apart from related party transactions, which are dealt with under section 113, it is not for the Commissioner of Taxation to decide whether or not a particular expenditure should have been incurred. Provided the expenditure is incurred in the production of income subject to tax under the Order, it is deductible unless it runs a foul of a provision such as those of section 33(3). For example, the fact that the incurring of the expense involved a bad business decision is irrelevant in determining deductibility. The treatment of compensation payments represents an exception to this principle. Under section 34 no deduction is allowed for compensation payments to the extent to which they exceed a reasonable amount. A taxpayer who agrees to an unreasonably high compensation amount may do so for purposes other than the production of income. For example, a company facing a take-over bid may agree to pay its executives and other key personnel substantial amounts should their service agreements be terminated, the purpose of such agreements being to increase the cost of the take-over so as to discourage the take-over. Excessive compensation may also be in the nature of a disguised dividend.

35. Limitation on Entertainment Expenses

Under the 1981 Act, most entertainment expenses are deductible. The deductibility of entertainment expenses is usually justified on the basis that the expenses are incurred to provide the setting for business discussions, or because they generate customer goodwill. There are, however, good reasons for limiting the availability of deductions for entertainment expenses. Because of the difficulties faced by the Commissioner in policing the availability of such deductions, they are invariably obtained for entertainment expenditure incurred solely or mainly for private purposes. Further, a high level of personal enjoyment is often associated with entertainment, even where the entertainment is indisputably related to business. This type of enjoyment also tends to accrue disproportionally to high income earners. For these reasons, the new law limits the availability of deductions for entertainment expenses to 50% of the expense incurred.

Under subsection (1), only 50% of entertainment or meal expenses are allowed as a deduction. Subsection (1) only applies to expenses which otherwise satisfy section 33. The limitation in subsection (1) also applies to depreciation expenses. For example, an employer who acquires a leisure facility (such as sporting equipment) for the benefit of employees will only be entitled to 50% of the depreciation deduction otherwise available under section 41.

"Entertainment" is intended to include recreational activities such as sporting or other leisure pursuits, and travel in relation to such activities. Section 34 is intended to apply to entertainment and meal expenses regardless of whether -

* business discussions or transactions occur;

* the expenses were incurred for the purposes of promotion or advertising; or

* the expenses were incurred in respect of a conference, convention, or similar event.

The limit in subsection (1) does not apply where the cost of providing the entertainment or meal is subject to fringe benefits tax to the provider or is an exempt fringe benefit under section 123(3). Under section 123, the provision of a meal or refreshment by an employer to an employee is a fringe benefit and subject to fringe benefits tax. If the provision of the benefit were not fully deductible, then the non-deductible part of the benefit would effectively be taxed twice. Subsection (3) of section 123 exempts from fringe benefits tax a meal or refreshment provided by an employer to an employee in an in-house dining facility provided the benefit is available to all employees on equal terms. As an incentive to employers to provide such benefits to employees, the entire cost is deductible provided the general rule in section 33 is otherwise satisfied.

The limit in subsection (1) is not intended to apply to the cost of meals or entertainment furnished as part of a business of furnishing meals or entertainment. For example, if the taxpayer operates a restaurant, subsection (1) does not deny a deduction for the cost of meals furnished to patrons; however, subsection (1) would apply to the restaurateur's costs of entertaining business associates in the restaurant.

36. Interest Deduction

This section provides for the deductibility of interest expense. Subsection (1) states a general principle which is inherent in section 33 that interest incurred on a borrowing used by the taxpayer in the production of income subject to Lesotho income tax is allowed as a deduction. The deductibility of interest, therefore, depends on how the taxpayer has used the borrowed funds. If, for example, the taxpayer has used the borrowed funds for the acquisition of new plant, then the interest expense on the borrowing is deductible. On the other hand, if a business taxpayer uses the borrowed funds partly to acquire new plant, and partly to acquire a new car to be used for private purposes, then the interest expense must be apportioned between the two uses and a deduction is only allowed for that part of the interest expense related to the acquisition of the new plant.

In determining how a borrowing has been used, it is intended that regard would also be had to the general asset and liability position of the taxpayer. For example, a taxpayer may use M20,000 of self-generated funds to buy a car to be used for private purposes while at the same time borrowing M20,000 for use in the taxpayer's business. In this situation, it would be reasonable to conclude that only half of the interest expense on the borrowing is deductible because the taxpayer could equally have used his or her own funds in the business and borrowed to acquire the car. It is intended that specific rules for determining how a borrowing is considered to be used for income tax purposes be provided in regulations.

Subsection (2) provides a thin capitalisation rule to ensure that foreign owners of resident companies do not use excessive related party debt (referred to as "in-house debt") as a means of repatriating profits instead of paying dividends on equity. For the foreign controllers of a Lesotho resident company, there is little practical difference between in-house debt or equity; however, there are significant tax differences depending on whether a dividend or interest is paid to a non-resident controller. Where a dividend is paid, the resident company is liable for advance corporation tax ("ACT") in respect of the dividend and withholding tax is payable under section 107. This means that the profits out of which the dividends are paid are effectively subject to 40% tax through the ACT mechanism and the dividend is subject to 25% withholding tax. On the other hand, if interest is paid, there is no ACT liability and the payer company is entitled to a deduction for the amount of the interest, although withholding tax is payable under section 107. This means that the profits out of which the interest is paid are only subject to the 25% withholding tax (or any lesser rate provided by treaty). The thin capitalisation rule is intended to limit the tax advantages available for in-house debt.

Under subsection (2), the Commissioner may disallow interest deductions where the debt-to-equity ratio of a resident company exceeds 3:1. For example, assume a company has a share capital of M100 and in-house borrowings of M500. In this case, the Commissioner may only allow deductions for interest expense on borrowings up to M300, with interest on the other M200 disallowed. The interest paid on the other M200 is still characterised as interest, and therefore, is subject to withholding tax under section 107. The rule in subsection (2) does not apply to a resident company, which is principally engaged in the business of money-lending.

The calculation of the debt-to-equity ratio of a resident company will be made in accordance with regulations. Any attempt by a resident company to increase the level of in-house debt up to the 3:1 ratio level may, in appropriate cases, be attacked under the anti-avoidance provisions in Part XI of Chapter II.

37. Bad Debts

Section 37 allows a deduction for a bad debt incurred in a business-giving rise to income subject to tax when the debt is written off in the taxpayer's accounts as bad. The section applies both to accrual-basis and cash-basis taxpayers. The intention with section 37 is to allow the generally accepted accounting principles as to the writing off of bad debts to apply. In particular, it is not necessary that the debt be proved to be legally irrecoverable before being written off. A debt may be written off as bad where, having regard to all the circumstances, a reasonable businessperson would consider that there is little likelihood that the debt would be repaid.

The amount of any bad debt for which a deduction is allowed under section 37, which is subsequently recovered by a taxpayer, must be included in gross income under section 71.

The new law makes two changes of substance to the treatment of bad debts under section 26(j) and (k) of the 1981 Act. First, it removes the Commissioner's discretion to allow taxpayers a deduction for doubtful debts. Any allowance of a deduction for doubtful debts imposes severe burdens on the tax administration to prevent abuse. Secondly, the new law removes the requirement that it be proved to the satisfaction of the Commissioner that a debt is bad before it is allowed as a deduction. Under a system of self-assessment, routine deductions such as bad debts must be allowed according to specified criteria rather than at the Commissioner's discretion.

38. Annuities Paid to Former Employees

Subsection (1) allows a deduction for an annuity paid to a former employee of the taxpayer or to a dependant of a former employee. The annuity will be taxable to the recipient as income according to ordinary concepts. The section is largely a re-enactment of section 26(g) of the 1981 Act, although the requirement that the former employee have retired on the grounds of old age, ill-health or infirmity has been removed as has the monetary limit on the amount of the deduction where the annuity is paid to a dependant. While, in some cases, such a payment may be deductible under section 33 as being incurred in the production of income subject to tax under the Order (for example, where the annuity is negotiated by the former employee as part of his or her remuneration package), this may not always be the case. Section 38, therefore, ensures that all such payments are deductible.

The amount of the annuity allowed as a deduction is determined in accordance with the Regulations. This is to ensure that section 38 is not used as a means of avoiding the reasonable benefit limits applicable in determining whether an employer-sponsored superannuation fund is a complying fund for the purposes of Part IX of Chapter II. This will also ensure that the expressed limit in section 34 will apply to such payments.

Under subsection (2), a deduction is only allowed under subsection (1) where the former employee to whom the annuity relates worked in a business of the taxpayer the income of which was subject to tax in Lesotho. This ensures that there is a sufficient nexus between the annuity paid and the taxable activities of the taxpayer. Where the former employee worked in the manufacturing business of a resident company, subsection (3) provides that the deduction allowed under subsection (1) may only be deducted against manufacturing income. The effect of subsection (3) is to give the deduction allowed under subsection (1) the character of a manufacturing deduction for the purposes of quarantining such deductions against manufacturing income.

"Annuity" is intended to have its ordinary meaning, namely a sum of money of definite amount payable annually either in perpetuity, or for the life of the recipient, or for a term of years, or for the life of another under a contract, will, or settlement. An annuity is deductible if it is paid to a former employee of the taxpayer or a dependant of a former employee. "Employee" has the meaning in section 3(1) and, therefore, includes a director or other holder of an office. An annuity paid to an independent contractor will not qualify for a deduction under section 38. A dependant of a former employee includes a spouse or child under the age of 18 of the former employee, or any other person who at the time of the employee's death depended on the employee for their maintenance (for example, elderly parents of the employee). A person of full capacity over the age of 18 would not normally be regarded as a dependant of another person.

39. Approved Training Expenditure

Section 39 provides a tax concession for those employees who incur certain approved training expenditure. A taxpayer carrying on business in Lesotho may deduct 125% of expenditures incurred for training or tertiary education of a citizen of Lesotho employed in that business. While the deduction is available to a non-resident taxpayer, it only applies to expenditure incurred in relation to a citizen of Lesotho who is employed by the taxpayer in a business the income from which is subject to Lesotho income tax. To qualify for the deduction, the Commissioner must approve the expenditure. It is expected that the Commissioner will issue a list of approved training and tertiary education courses for the purposes of this section. This section largely re-enacts section 30 of the 1981 Act.

40. Research and Experimental Costs

This section allows a deduction for research and development expenditure incurred in the production of income subject to tax under the Order. It broadens the scope of deductions allowed for such expenditure under section 26(m) of the 1981 Act.

An activity is regarded as research and development if it involves the application of scientific method in a systematic progression of work from hypothesis to experiment, observation and evaluation, followed by logical conclusions. The work must pertain to, or be predicated upon, principles of physical sciences, biological sciences, chemical sciences, engineering, or computer sciences. Research and development also includes other activities related to such work, such as industrial or engineering design; production engineering; operations research; mathematical modelling and analysis; psychological research; design, construction, and operation of prototypes; computer software development; and commercial, legal and administrative aspects of patenting technology developed as a result of the research.

Examples of activities that are not regarded as research and development include market research, testing or development, or sales promotion; quality control; cosmetic modifications or stylistic changes to existing products or technology; management or efficiency surveys; preparation for teaching; and donations to research institutions.

Subsection (2) provides that no deduction is allowed under this section for the acquisition of a depreciable asset or land, even though the asset or land may be solely or principally used in research and development. A taxpayer is entitled to deductions under section 41 for depreciable assets. Further, subsection (3) expressly provides that expenditure incurred for the purpose of ascertaining the existence, location, extent, or quality of a natural resource deposit is not deductible under subsection (1). Such expenditure may be deductible under section 43.

41. Depreciation of Premises and Equipment

A deduction is allowed under section 41 for depreciation of a taxpayer's depreciable assets (defined in section 3(1)). Single asset depreciation applies unless the taxpayer elects for the pooling system to apply. If an election is made, then pooling applies to all the assets of the taxpayer (including future acquisitions) other than assets which are partly used in the production of income subject to tax. The election must be made by the due date for the return of income for the year of assessment in which it was made, and once made is irrevocable.

For the purposes of both single asset depreciation and the pooling system, depreciable assets are classified into four groups with depreciation rates set out in the Sixth Schedule. Group 3 covers assets which are not specifically included in any of the other groups.

Single asset depreciation applies where a taxpayer has not elected for pooling to apply. Regardless of whether a pooling election has been made, single asset depreciation applies to depreciable assets that are only partly used in the production of income subject to tax, and to assets in group 4. The operation of single asset depreciation is illustrated by the following example.

Taxpayer has acquired a new computer for use in its business. The computer was acquired on 1 September 1993 for M15,000, and was sold on 31 December 1996 for M12,000.

A computer is a group 2 asset and, therefore, has a declining balance depreciation rate of 20%. The depreciation deduction for the 1993/94 year of assessment is -

20% x M15,000 x 212/365 = M1,742.

The adjusted cost base of the computer at the end of the 1993/94 year of assessment is M13,258 (M15,000 - M1,742). The depreciation deduction for the 1994/95 year of assessment is -

20% x M13,258 x 365/365 = M2,651.

The adjusted cost base of the computer at the end of the 1994/95 year of assessment is M10,607 (M13,258 - M2,651). The depreciation deduction for the 1995/96 year of assessment is -

20% x M10,607 x 275/365 = M1,598.

The adjusted cost base of the computer at the date of disposal is M9,009. As the computer is a business asset, the difference between the consideration received on disposal and the ajusted cost base is included in the gross income of Taxpayer as business income. The amount included in gross income is -

M12,000 - M9,009 = M2,991.

If Taxpayer had disposed of the computer for M5,000, then the difference between the adjusted cost base of the computer and the consideration received on disposal (M4,009) is allowed as a deduction under section 48.

Where pooling applies, the depreciation deduction is calculated separately for each pool by applying the rate of depreciation for the pool against the balance of the pool at the end of the year of assessment. The closing balance of the pool is calculated by adding to the opening balance of the pool half the cost of acquisitions in the current year and half the cost of acquisitions in the previous year, and then subtracting the consideration received on disposal of assets in the pool during the year of assessment.

Where the consideration received on disposal of assets in the pool during the year of assessment exceeds the closing balance (before reduction of the disposal consideration), the excess is included in gross income under subsection (9). This would be characterised as business income.

If no assets have been added to the pool during the year of assessment, and the closing balance of the pool is less than M500, the taxpayer is permitted to write off the balance of the pool as a deduction. This rule is provided for administrative convenience, so that taxpayers do not have to carry forward small amounts. The balance of the pool may also be deducted if all the assets in a pool are disposed of.

The operation of pooling is illustrated by the following example.

Taxpayer commenced carrying on a construction business on 1 April 1993 and elects for pooling to apply. Taxpayer acquires the following group 2 assets during the 1993/94 year of assessment (total cost of M835,500) -

*	construction equipment (3 items)	M200,000 each
*	computer system	M20,000
*	2 heavy general purpose trucks	M100,000 each
*	10 office chairs	M500 each
*	10 desks	M750 each
*	3 filing cabinets	M1,000 each

In 1994/95, Taxpayer acquired another item of construction equipment for M250,000. In 1995/96, Taxpayer sold one of the trucks for M50,000.

The closing balance of the group 2 pool for the 1993/94 year of assessment is equal to half the cost of all assets acquired in that year, namely M417,750 (M835,000 x 50%). The depreciation deduction for assets in group 2 for the 1993/94 year of assessment is -

20% x M417,750 = M83,550.

The closing balance for the 1994/95 year of assessment is the sum of the closing balance for the 1993/94 year of assessment less depreciation (M334,200) plus half the cost of the 1993/94 acquisitions (M417,750) and half the cost of the 1994/95 acquisitions (M125,000), namely M876,950. The depreciation deduction for assets in group 2 for the 1994/95 year of assessment is -

20% x M876,950 = M175,390.

The closing balance for the 1995/96 year of assessment is the sum of the closing balance for the 1994/95 year of assessment less depreciation (M701,560) plus half the cost of the 1994/95 acquisitions (M125,000) less the consideration received on disposal of one of the trucks (M50,000), namely M776,560. The depreciation deduction for the assets in group 2 for the 1995/96 year of assessment is -

20% x M776,540 = M155,312.

The pooling system provided for in the new law does not differ significantly from that applicable under section 26(c) of the 1981 Act. The new law limits the number of pools to three (pooling not being applicable to assets in group 4). It also introduces the "half-year" convention in relation to additions to the pool during the year of assessment. Under section 26(c) of the 1981 Act, additions obtain the benefit of a full year's depreciation, and this is the case even if acquired in March. The new law adopts the half-year convention whereby a taxpayer receives half a full year's depreciation in the year of acquisition regardless of when the asset was acquired, and the other half in the following year of assessment. This is to prevent taxpayers loading depreciation deductions in the year of assessment in which the asset was acquired by purchasing late in that year and claiming a full year's depreciation deductions.

42. Repairs, Spare Parts, and Minor Capital Equipment

Subsection (1) provides for a deduction for repairs to assets used in the production of income subject to Lesotho income tax. No deduction is allowed under this subsection for capital improvements made to such assets, although a deduction may be allowed under section 41. There is a well-developed body of judicial decisions in both the United Kingdom and the Republic of South Africa as to the difference between a repair and a capital improvement. It is intended that that body of case-law give content to this section. Broadly, according to those cases, a repair involves the restoration or replacement of the subsidiary parts of an asset (particularly where those parts have become broken or worn out). The reconstruction of an entire asset is not regarded as a repair. The essence of a repair is the restoration of an income-producing asset to its former condition without improving its function or efficiency. The fact that different or modern materials are used does not preclude the restoration being a repair provided the new materials do not significantly improve the asset's function or efficiency.

Subsection (2) provides for an outright deduction for the acquisition of a depreciable asset with a cost of less than M50. "Depreciable asset" is defined in section 3(1).

43. Mineral Extraction

This section provides for a ten-year write-off period for mineral extraction expenditures incurred in the production of income subject to income tax. "Mineral extraction expenditures" means expenditure incurred for exploration, drilling, development, or acquisition of mining rights. Section 43 does not apply to capital equipment used in mining operations, although deductions may be allowed under section 41 if such equipment is a depreciable asset.

This section replaces the five-year write-off period in section 28 of the 1981 Act. The five-year write-off period is short compared to the average mine life, and therefore, the new law adopts an amortisation regime which is more reflective of the real situation.

44. Amortisation of Intangible Assets

This section provides for the amortisation of the cost of acquiring an intangible asset over the useful life of the asset on a straight-line basis. A deduction is only available if the intangible asset has an ascertainable useful life and is used in the production of income subject to income tax. Section 44 applies to the cost of acquiring industrial or intellectual property rights (such as copyrights, patents, trade-marks, and designs), and to premiums previously deductible under section 26(h) of the 1981 Act. It also applies to amounts paid to secure contractual rights (for example, an agency or supply contract), or a franchise. Under subsection (2), the regulations may provide fixed write-off periods in the interest of administrative simplicity. In the absence of such regulatory provisions, the deduction under section 44 must be based on the actual estimated useful life of the particular asset.

This provision is intended to ensure that there is consistent treatment between tangible and intangible assets acquired by a taxpayer, and significantly expands on the amortisation provision in section 26(h) of the 1981 Act.

45. Start-up Costs

This section provides for a four-year write-off period for expenditure incurred in starting up a business to produce income subject to income tax. Such expenditure is of two broad categories: it may be incurred in acquiring intangible assets essential to the carrying on of a business, such as goodwill, intellectual or industrial property rights, or contractual rights; or it may involve an intangible advantage which does not manifest itself in any particular asset, such as the cost of feasibility studies, large-scale advertising, and initial transactional expenses, such as stamp duties, or professional fees. The second category is intended to cover expenditure which is not deductible under general principles because it is incurred preliminary to the derivation of income from the business.

46. Apportionment of Deductions

This provision requires that deductions which relate to more than one class of income are to be apportioned between those classes. This is necessary, for example, because of quarantining of deductions in relation to some classes of income under section 47, or because of the exemption from income tax of some items of income.

The classes into which income is divided differ depending on the nature of the taxpayer concerned. The classes of income that can be derived by an individual taxpayer include -

* exempt income;
* Lesotho-source business income;
* Lesotho-source property income;
* Lesotho-source other income;
* foreign-source business income;

* foreign-source property income; and
* foreign-source other income.

The classes of income that can be derived by a corporate taxpayer include -

* exempt income;
* Lesotho-source manufacturing income;
* Lesotho-source other income; and
* foreign-source income.

No specific basis of apportionment is provided, thereby allowing the appropriate method to be determined having regard to all the circumstances, except to the extent that regulations specify rules in this regard.

47. Losses Carried Forward

Section 47 provides for the quarantining of deductions and carry forward of losses. Separate rules apply for individual and corporate taxpayers. For the purposes of carrying forward losses, income derived by an individual taxpayer is divided into the following classes -

* Lesotho-source business income;
* Lesotho-source property income;
* Lesotho-source other income;
* foreign-source business income;
* foreign-source property income; and
* foreign-source other income.

This is the effect of subsections (1), (2), and (5). Under subsection (1), an individual taxpayer whose business income is exceeded by the deductions relating to that income may not deduct the excess against other income but may carry the excess forward as a loss for deduction against chargeable business income derived in a subsequent year of assessment. This permits the loss to be carried forward indefinitely. The deductions, which relate to business income are those which solely relate to that income (such as the rent of business premises) and those which have been allocated to business income in accordance with section 46.

Subsection (2) provides a similar quarantining and loss carry forward rule in relation to the property income of an individual taxpayer. Consequently, an individual taxpayer who has negatively geared investment assets (under which the interest expense incurred during the year of assessment in respect of the acquisition of the asset exceeds the property income from the asset) will not be able to deduct the excess interest against employment or business income.

There is no provision for an individual taxpayer to carry forward a loss in relation to other income. The main type of other income is employment income and it is not expected that a taxpayer would incur a loss with respect to such income.

The effect of subsection (5) is to apply the quarantining and loss carry forward rules in subsections (1) and (2) separately to Lesotho-source and foreign-source income. This means, for example, that an overall loss on foreign business operations cannot be deducted against domestic business income, domestic property income, or foreign property income; rather, the foreign business loss must be carried forward for deduction against foreign-source business income derived in a subsequent year of assessment. Where the taxpayer has more than one foreign business operation, the calculation of whether there is an overall foreign loss is made on a global basis (that is, after adding foreign business income from all foreign operations and subtracting business deductions relating to that income).

For the purposes of carrying forward losses, the income of a corporate taxpayer is divided into three classes -

* Lesotho-source manufacturing income;
* Lesotho-source other income; and
* foreign-source income.

Subject to the separate quarantining and carry forward rule for manufacturing income, subsection (3) provides that corporate losses are to be carried forward on a global basis. Under subsection (5) the rule in subsection (3) applies separately to Lesotho-source income and foreign-source income. The effect of subsection (5) is that an overall foreign loss may not be deducted against domestic income, but must be carried forward for deduction against foreign-source income derived in subsequent years of assessment.

Subsection (4) provides that deductions relating to the production of manufacturing income (hereinafter referred to as "manufacturing deductions") by a resident company may only be deducted from such income. If manufacturing deductions exceed manufacturing income, then the amount of the excess is carried forward for deduction against manufacturing income derived in subsequent years. The quarantining of manufacturing deductions in this way is necessary because of the concessional rate of tax applicable to chargeable manufacturing income derived by a resident company from a Lesotho source. Where a taxpayer derives both manufacturing and other income, deductions are considered to relate to manufacturing income if they exclusively relate to that income (such as depreciation of plant and equipment, and wages paid to manufacturing labour), or partly relate to that income (such as general overhead expenses) allocated in accordance with section 46.

There are some further specific quarantining and carry forward rules provided for in other sections. For example, the effect of section 62 is that losses on the disposal of investment assets may only be deducted against gains from such disposals, with any excess loss carried forward to the next year of assessment. Under section 69(2), the deductions attributable to the supply of goods or services to members by a social club or other membership organisation may only be deducted against income derived from members.

48. Losses on Disposal of Business Assets

A deduction is allowed for a loss arising on the disposal of a business asset. This is the case regardless of whether the asset is on revenue or capital account. This section is the deduction equivalent to section 19(2)(a) which includes gains on business assets in gross income, and is consistent with the policy under the new law of removing in the business context the often artificial distinction between income and capital. "Business asset" is defined in section 3(1).

49. Substituted Accounting Period for Tax Purposes

This section gives the Commissioner a discretion to allow a company to use a period other than the twelve-month period ending on 31 March as the year of assessment. A company wishing to use a substituted accounting period must make an application in writing to the Commissioner showing compelling need. Compelling need may be demonstrated in some cases where the company is a subsidiary of a foreign company which has a balance date other than 31 March. However, permission will not be automatically granted in such cases, with each application depending on its facts.

Where permission is granted, the Commissioner may impose conditions on the use of the substituted accounting period. This is to ensure that there is no loss or deferral of tax as a result of the company using the substituted period. For example, a company which derives most of its income in March, may apply for a substituted accounting period ending on 28 February. This would result in a twelve-month deferral of tax for income derived in March in the year of the changeover. In this case, the Commissioner may impose a condition that all March income be treated as derived in February of the year of change-over.

Because of the administrative difficulties involved with substituted accounting periods and the potential for abuse, the new law more strictly regulates their use. Under section 40 of the 1981 Act, a person who carries on business and who regularly makes up accounts for a twelve-month period ending on a date other than 31 March may calculate chargeable income on the basis of that other period. Under the new law, the use of a substituted accounting period is not automatic, and permission to use such a period may only be given to a company.

As a transitional measure (see section 214), a company using a substituted accounting period pursuant to section 40 of the 1981 Act is permitted to continue to use that period until the Commissioner decides otherwise. Further, those taxpayers currently using a substituted accounting period who are not entitled to do so under the new law will be subject to a transitional measure requiring preparation of a return for a short period so as to commence using the twelve-month period ending on 31 March as the year of assessment, commencing with the period ending on 31 March 1994.

50. Method of Accounting

Subsection (1) states the general rule that a taxpayer's method of accounting for tax purposes must clearly reflect the taxpayer's income for the year of assessment. Special rules for accounting for the income of an insurance business will be specified in Regulations. These rules will largely conform with the existing tax accounting treatment of such income under the Fourth Schedule to the 1981 Act.

Under subsection (2) and subject to subsection (4), a taxpayer is given the option to use either the cash or the accrual method of accounting for particular items of income or deduction (see sections 51 and 52). Where, however, a taxpayer's gross income for a year of assessment exceeds M150,000, the taxpayer must use the accrual method for all classes of income for that year of assessment and all succeeding years of assessment. In the case of a trustee liable under section 83 or 84, the threshold is determined by reference to the gross income included in the calculation of chargeable trust income. Under subsection (3), a taxpayer who is an individual or a trustee and who satisfies the threshold in subsection (2) is only required to use the accrual method for business income, with all other classes of income accounted for on a cash or accrual method at the taxpayer's option. While the accrual method only applies to business income in this situation, the threshold under subsection (2) is calculated by reference to the taxpayer's total gross income.

Except where a taxpayer is required to use the accrual method by virtue of subsection (2), subsection (4) only permits a taxpayer to change its method of accounting with the prior written permission of the Commissioner. Where a taxpayer's method of accounting is changed, subsection (5) requires that adjustments be made to items of income, deduction, or credit, or other items to ensure that no item is omitted as a result of the change or included twice. For example, in the absence of subsection (5), where a taxpayer changes from cash to accrual as may be required under subsection (2), amounts billed in the previous year of assessment but received in the year of changeover will escape taxation altogether. This is because no amount has been received in the year of billing under the cash method, and no amount has accrued in the year of receipt under the accrual method. In this situation, subsection (5) requires the taxpayer to include in gross income for the year of changeover amounts received as a result of bills issued in the previous year of assessment. The opposite situation arises where a taxpayer changes from accrual to cash, so that subsection (5) would apply to avoid double taxation of amounts received in the year of changeover taxed under the cash method which were billed in the previous year and taxed under the accrual method.

The new law differs from the position under the 1981 Act. The combined operation of sections 2(3) and 7 of the 1981 Act is that an amount is included in gross income when "received" or "accrued". Judicial decisions on similar wording in the Income Tax Act 1962 (RSA) indicate that a taxpayer may be taxed on both receipts and accruals during the year of assessment, although the same amount may not be taxed twice. In providing for a single method of accounting (cash or accrual) in relation to each class of income derived, or deduction incurred, by a taxpayer, the new law provides for greater certainty as to the method of tax accounting.

51. Cash-Basis Accounting

This section specifies when a cash-basis taxpayer includes amounts in gross income or claims expenses as deductions. Income is taken into account when received by, or made available to, the taxpayer; and expenses are allowed as deductions when paid by the taxpayer. Section 51 applies regardless of whether a receipt or payment is in cash or kind. Where a payment is treated as income of a taxpayer under section 67(1), it is regarded as received when the taxpayer benefits from it, or when it is dealt with as the taxpayer directs. Similarly, a payment treated as made by a taxpayer under section 67(2) is regarded as made when paid.

An amount paid by cheque is regarded as paid and received at the time of tender, subject to the condition that the cheque is met on presentation. Consequently, a cash-basis taxpayer cannot avoid deriving income in a particular year of assessment simply by not banking the cheque until the next year.

While section 51 refers to a cash-basis taxpayer, it only applies to those classes of income and deduction for which a taxpayer is required to account on a cash basis under section 50. For example, as a result of section 50, an individual may be required to account for business income on an accrual basis and property income on a cash basis, in which case section 51 only applies to property income.

52. Accrual-Basis Accounting

Subsection (1) states the general principle that an accrual-basis taxpayer must take income and deductions into account when payable. Subsection (2) provides the rule for determining when income is payable to the taxpayer; and subsection (3) provides the rule for determining when an amount is treated as payable by the taxpayer. Both these subsections are expressed to be subject to the Order, and therefore, give way to any specific tax accounting rule elsewhere in the Order, particularly those in the other provisions of Part V of Chapter II.

Under subsection (2), an amount is treated as payable to the taxpayer when the taxpayer becomes entitled to receive it. A taxpayer is entitled to an amount when it becomes recoverable as a debt. This depends on the terms of any agreement to which the taxpayer is a party, and on general law. Subsection (2) specifically provides, however, that a taxpayer is treated as entitled to an amount even though it may be payable to the taxpayer in the future or by instalments.

Under subsection (3), an amount is treated as payable by a taxpayer when all the events that determine liability have occurred and the amount of the liability can be ascertained with reasonable accuracy. The focus under the accrual method, therefore, is on the fixing of the liability and the determination of the amount of the liability with reasonable accuracy. This may be compared with the cash method, where actual payment of the liability determines the timing of the deduction. The test in subsection (3) does not require absolute certainty as to both the fact, and the amount, of the liability. For example, the supply of trading stock would be treated as satisfying the test even though there is a residual possibility that the liability may be cancelled because the supplier has breached the contract of supply. Nevertheless, a liability, which is in some way contingent on future events, will not satisfy the test in subsection (3).

Under the accrual method, there is an incentive for taxpayers to fix a liability as soon as possible while delaying the date for payment as long as possible. Indeed, if there is a sufficiently long delay, the value of the deduction for an accrued liability may exceed the present value of the future payment. For this reason, subsection (3) contains the additional qualification that an amount is not treated as payable before "economic performance" with respect to the amount occurs. Subsection (4) provides the rules for determining when economic performance occurs.

Under paragraph (a) of subsection (4), economic performance in respect of the acquisition of goods or services occurs at the time the goods or services are provided. This means, for example, that if an accrual-basis taxpayer contracts to purchase trading stock in year 1 with delivery and payment in year 2, the deduction for the trading stock will not arise until year 2. While the fact of liability and the amount of the liability are fixed in year 1, economic performance does not occur until the stock is supplied in year 2. In the case of the use of property, paragraph (b) provides that economic performance occurs at the time the property is used. This means, for example, that a deduction for rent cannot be claimed until the taxpayer uses the immovable property to which the rent relates in the production of income subject to tax. Paragraph (c) provides that, in all other cases, economic performance occurs when the taxpayer makes payment in satisfaction of the liability to which the claim relates.

53. Claim of Right

Taxpayers often receive or pay amounts which are disputed. For example, a taxpayer may receive an amount which the taxpayer is subsequently required to repay in whole or part because, for example, the amount was paid by mistake, or was erroneously calculated, or was the subject of a dispute which was decided against the taxpayer. Alternatively, a taxpayer may make a payment in similar circumstances. In these situations, section 53 provides for a claim of right doctrine, that is, the taxpayer is treated for tax purposes as having made the payment or received the payment although not obliged to make it or entitled to receive it.

In the case of a cash-basis taxpayer, an adjustment is made to eliminate the payment for tax purposes when it is refunded. In the case of an accrual-basis taxpayer, the adjustment is made when the claim of right is given up, even if the amount has not been paid. If the amount has been paid by an accrual-basis taxpayer and is refunded, the act of refund will amount to a cessation of the claim of right and will give rise to an adjustment at that time. This section generally eliminates arguments by taxpayers that the tax status of the payment is unclear because its legal status is unclear.

54. Prepayments

The rules in sections 51 and 52 would produce the result that a payment relating to services or other benefits which are received by a taxpayer over more than one year of assessment would be immediately deductible. Section 54 provides for the spreading of the deduction over the years of assessment to which it relates where the service or other benefit extends for a period of more than three months after the end of the year of assessment. For example, if a taxpayer makes a single payment of five years' rent on a building used in a business, the deduction for the rent is spread over the five year period to which it relates. Examples of other payments to which this section will apply include prepayments of interest, long-term service contracts, long-term insurance and long-term management fees.

It is to be noted, however, that this section does not create deductibility of payments. It simply spreads the timing of an otherwise allowable deduction. The question whether a payment is deductible will be tested in accordance with the principles set out in Division IV of Part IV of the Order.

55. Long-Term Contracts

This section provides a tax accounting rule for the recognition of profit arising under a long-term contract. Two of the more commonly used accounting methods used for long-term contracts are the percentage-of-completion method and the completed-contract method. Under the percentage-of-completion method, profit is recognised in proportion to the progress made on the contract during the relevant accounting period. In other words, the profit is recognised as it "emerges" over the life of the contract. Under the completed-contract method, profit is not recognised until the contract is substantially performed. Accounting standards now clearly favour the percentage-of-completion method as a better measure of "periodic accomplishment" over the life of the contract. From a tax perspective, the completed-contract method gives rise to an unwarranted deferral of tax.

Section 55 requires recognition of income arising under a long-term contract on the basis of the percentage-of-completion method. The intention in subsection (1) is that the estimated profit on the contract is brought to account as income on the basis of the percentage of the contract completed during the year of assessment. The reference in subsection (1) to "income" and "deductions" is intended to ensure that only those amounts which are included in gross income or allowed as a deduction under the Order are taken into account in calculating the estimated profit under the contract. Under subsection (2), the percentage of completion for a year of assessment is based on the ratio of contract costs incurred during the year of assessment to estimated total contract costs.

Subsections (3) and (4) recognise that due to, for example, cost overruns, some long-term contracts actually give rise to an overall loss. Generally, this will not be known until the last year of the contract, and in the meantime the taxpayer has returned the expected profit under the contract as income over the life of the contract in accordance with subsection (1). Subsection (3) provides for a limited loss carry-back where a long-term contract gives rise to an overall loss. According to subsection (5), an overall loss occurs where the deductions, which would otherwise be allowed under this Order in respect of expenses incurred under the contract, exceed the gross income arising under the contract.

Where it is determined that a long-term contract has given rise to an overall loss, subsection (3) permits the Commissioner to allow the loss to be carried back to the preceding year of assessment and applied against the amount included in gross income under subsection (1) for that year. The loss may not be applied against any other income of the taxpayer for that preceding year of assessment. The application of subsection (3) will require a limited re-opening of the taxpayer's assessment for the preceding year of assessment.

Under subsection (4), a loss may only be carried back under subsection (3) where the Commissioner is satisfied that the taxpayer is unable to carry the loss forward under section 47 of the Order. This could occur, for example, where the taxpayer is not a citizen or permanent resident of Lesotho and the completed long-term contract is the taxpayer's only income-producing activity in Lesotho with the taxpayer satisfying the Commissioner that no new contract in Lesotho has been or will be entered into. Further, the Commissioner must be satisfied that the taxpayer will not obtain the benefit of the loss in another jurisdiction. For example, the taxpayer may still be a resident for tax purposes in the taxpayer's country of citizenship during the term of the contract, and as such, may be able to claim the loss as a deduction in that jurisdiction. In this situation, a loss carry-back under subsection (3) would not be permitted.

"Long-term contract" is broadly defined in subsection (5). In particular, it is not confined to contracts in relation to immovable property transactions. It includes any contract for the manufacture, installation, or construction of movable property (including a contract for the performance of services related to such a contract) provided the term of the contract extends over more than one year of assessment. This includes, for example, the construction of buildings, bridges, dams, pipelines, tunnels, and other civil engineering projects; construction management contracts in relation to such projects; the construction of major items of plant; and contracts for the refurbishing of hotels and other business premises.

The transitional measure in section 11B of the 1981 Act inserted by the Income Tax (Amendment) Order 1992 will continue to apply under the new law (see section 207).

56. Trading Stock

Profits and losses on disposal of trading stock are to be brought to account on disposal. Under subsection (2), the deduction for the cost of goods sold during the year of assessment is determined according to the following formula -

(opening trading stock + cost of goods acquired) - closing trading stock.

The opening trading stock for a year of assessment is the closing trading stock at the end of the preceding year of assessment. Subsection (4) provides that the value of closing trading stock is the lower of its cost base or market value at the end of the year of assessment. Where the market value of trading stock is lower than cost, the valuation rule in subsection (4) allows a taxpayer to advance the recognition of a loss on trading stock before the time of disposal. Subject to the specific valuation rules provided in section 56, the cost base of trading stock is determined in accordance with the rules in section 60. For example, section 60(6) gives the cost base of trading stock to which roll-over relief under section 91 or 92 applies.

Section 56 contains a number of specific valuation rules applicable to trading stock. Subsection (3) gives a cash-basis taxpayer an option to determine the cost base of trading stock on either the prime cost method (in which only direct costs are brought to account as part of the cost of trading stock) or the absorption cost method (where indirect costs are also treated as part of the cost of trading stock). An accrual-basis taxpayer must use the absorption cost method. Under section 50(2), a taxpayer whose gross income for a year of assessment is M150,000 is an accrual-basis taxpayer. Section 50(5) applies where a taxpayer's method of accounting for trading stock is changed. This may occur, for example, where a taxpayer changes from a cash- to accrual-basis taxpayer.

In the case of generic items of trading stock where it is not possible to identify costs with particular units of stock, the taxpayer may use the first-in-first-out or average cost conventions for determining the cost of inventory in calculating the cost base of closing trading stock. A taxpayer will not be permitted to use the last-in-first-out convention for valuing trading stock.

57. Annuities and Debt Obligations with Discount

Subsection (1) states a rule of tax accounting whereby a discount or premium on a debt obligation is taken into account for tax purposes as it accrues. This is a rule of tax accounting only; subsection (1) does not provide for the taxability or deductibility of discounts or premiums. This is determined under the general provisions of the Order. The effect of subsection (1) is that a discount or premium is treated as accruing over the term of the borrowing, rather than being treated as derived or incurred when paid (usually at the end of the term of the loan).

Subsection (2) provides a tax accounting rule for annuity income. It is to be treated as accruing over the term of the annuity.

58. Foreign Currency Gains and Losses

Subsection (1) requires an accrual-basis taxpayer to bring to account for tax purposes unrealised foreign currency gains and losses at the end of the year of assessment.

Subsection (2) provides a characterisation rule under which foreign currency gains and losses for all taxpayers are treated as interest income and expense, respectively. This means that foreign currency gains will generally be treated as property income; while a foreign currency loss will be allowed as a deduction if the foreign currency holding, or foreign borrowing or debt to which it relates is used in the production of income, subject to the limitations of section 36.

59. Gains and Losses on Disposal of Assets

Subsection (1) states the general principle that the gain or loss on disposal of a business or investment asset is to be taken into account in determining chargeable income. Under subsection (6), the gain or loss on disposal of an asset, which is not a business or investment asset (for example, the family home) is not taken into account for tax purposes.

The extent to which gains or losses on disposal of business or investment assets are taken into account depend on the nature of the asset disposed of and the circumstances of the disposal. A gain on the disposal of a business asset is included in gross income under section 19; while a loss is allowed as a deduction under section 48. A gain on the disposal of an investment asset is included in gross income as property income under section 20; while a loss is allowed as a deduction, but only to the extent of any gains on the disposal of such assets (see section 62). The excess of losses over gains on the disposal of investment assets may be carried forward indefinitely.

Under subsection (4), a loss on the disposal of a business or investment asset is not taken into account for tax purposes where the asset is disposed of directly or indirectly to an associate. This is to prevent the selective realisation of losses through related party transactions to offset gains. Subsection (4) is only relevant to an asset which has actually lost in value, as section 61(2) will apply where an asset is transferred to an associate at an undervalue.

Subsections (2) and (3) provide tax accounting rules for the calculation of the gain or loss on the disposal of business or investment assets. A gain on the disposal of a business or investment asset is the excess of the consideration received over the adjusted cost base of the asset at the date of disposal. Similarly, a loss on disposal of a business or investment asset is the excess of the adjusted cost base of the asset at the date of disposal over the consideration received. The two components of the formula for calculating the gain or loss on disposal of an asset, therefore, are the "adjusted cost base" of the asset and the "consideration received" on disposal. The amount of the "adjusted cost base" is the "cost base" of the asset determined under section 60 adjusted in accordance with the definition of "adjusted cost base" in section 3; and the amount of the "consideration received" on disposal is determined in accordance with section 61.

Subsection (5) is necessary to prevent double counting in relation to gains or losses on disposal of depreciable assets to which pooling applies. Such gains or losses are effectively taken into account in the pooling calculation through the reduction of the balance of the pool by the proceeds of sale under section 41(8) (or inclusion in income under section 41(9)). As depreciable assets are business assets, the gain or loss on disposal would also be taken into account under section 19 or 48, respectively. The effect of subsection (5) is to exclude the operation of sections 19 and 48 to depreciable assets to which pooling applies.

60. Cost Base

The cost base of an asset is the starting point in determining the adjusted cost base of the asset which is the first component in the formula for determining whether there has been a gain or loss on disposal of the asset. It is also relevant to the determination of closing trading stock for the purposes of section 56 and to the depreciation provisions in section 41.

Subsection (1) states the general principle that the cost base of an asset is the asset's "tax cost" which is generally determined in accordance with the rules in subsections (3)-(9). The rules in section 60 cover the majority of cases, although it is anticipated that regulations will be required to deal with some specialised cases.

The basic rules for determining the cost base of an asset are set out in subsection (3). The tax cost of an asset purchased is the amount paid for the asset, including the market value of any consideration in kind given for the asset. The tax cost of an asset produced or constructed by the taxpayer is the amount incurred in producing or constructing the asset, including any non-deductible indirect expenses referred to in section 33(3)(c).

Where an asset has been acquired in a non-arm's length transaction (otherwise than by way of gift), subsection (4) provides that the tax cost is the market value of the asset at the date of acquisition. Subsection (5) provides that the tax cost of an asset, which has been transferred to the taxpayer by way of gift, is the greater of the transferor's adjusted cost base or the market value of the asset at the date of transfer.

Subsection (6) deals with the situation where a taxpayer disposes of an asset to another person, but the taxpayer's gain or loss on disposal is not recognised for tax purposes. Examples of this include the passing of an asset to a personal representative or beneficiary on the death of the taxpayer; the disposal of an asset to an associate in circumstances where section 59(4) applies, the transfer of assets between spouses (section 63(1)), and the contribution of an asset to a partnership where section 78(2) applies. In this situation, the tax cost of the transferee depends on the circumstances of the transfer. Where the transfer involves an asset swap, the adjusted cost base of the asset received by the transferee is the adjusted cost base at the date of the transfer of the asset which the transferee has given in exchange. In other cases, the tax cost of the transferee is the adjusted cost base of the transferor at the date of the transfer.

A part disposal of an asset is treated as a disposal for the purposes of the Order (see the definition of "disposal" in section (3)). Where there is a part disposal of an asset, subsection (7) requires the cost base of the asset to be apportioned between the part of the asset retained and the part disposed of. The basis of apportionment is the market values of the respective parts of the asset at the time the asset was acquired.

The new law applies to all business and investment assets regardless of when they were acquired. Consequently, the gain on disposal of a business or investment asset acquired before 1 April 1993 will be subject to tax under the new law. To prevent the retrospective operation of the new law, subsection (8) provides that the tax cost of assets acquired before 1 April 1993 is the greater of the market value of the asset at that date or the adjusted cost base indexed for inflation during the period of ownership to 1 April 1993. Allowing the taxpayer to use the higher of the two figures as the tax cost maximises the adjusted cost base of pre-1 April 1993 assets. This will be particularly favourable for those taxpayers with assets having a market value at 1 April 1993 which is lower than the indexed adjusted cost base at that date as it means that when the asset is disposed of not all the increase in market value after 1 April 1993 will be taxed. The indexed adjusted cost base will be determined in accordance with the formula prescribed in the regulations.

Subsection (9) provides that the step-up in the cost base under subsection (8) does not apply where the gain or loss on disposal of the asset would have been recognised for tax purposes under the 1981 Act. The tax cost of such assets is determined in accordance with the general principles in this section. Further, section 62(3) provides that neither the step-up in cost base in subsection (8) nor the indexation of immovable assets in subsection (10) apply in calculating a loss on disposal of a pre-1 April 1993 asset. The tax cost of such an asset will be determined in accordance with the other provisions in section 60. For example, if the asset was purchased by the taxpayer, then the tax cost will be the price paid in accordance with subsection (3). This also means that neither a gain or a loss will be recognised where the consideration received on disposal of a pre-1 April 1993 asset is greater than the adjusted cost base but lower than the adjusted cost base resulting from the application of subsection (10).

The application of these principles is illustrated by the following example -

> Taxpayer acquires shares in 1990 for M100,000. On 1 April 1993, the market value of the shares is M130,000 and the indexed adjusted cost base is M125,000. Consider the tax position of Taxpayer if the shares are disposed of on 31 March 1995 for M200,000, M90,000, or M120,000.
>
> Where the shares are sold for M200,000, the cost base of the shares under section 60(8) is M130,000 (being the greater of the market value or adjusted cost base at 1 April 1993). As there are no items of addition or reduction to the cost base, the adjusted cost base is also M130,000 giving rise to a gain of M70,000.
>
> If Taxpayer had disposed of the shares for M90,000, section 60(8) does not apply (section 62(3)) and the cost base of the shares is M100,000 being the original purchase price determined in accordance with section 60(3). As there are no items of addition or reduction to the cost base, the adjusted cost base is also M90,000 giving rise to a loss of M10,000.

Where the shares are sold for M120,000, there will be neither gain nor loss on disposal. There will be no gain because the consideration received is less than M130,000 being the adjusted cost base determined in accordance with section 60(8) for the purposes of calculating a gain. On the other hand, there will be no loss because the consideration received is greater than M100,000 being the adjusted cost base of the shares for the purposes of calculating a loss.

Under subsection (10), the adjusted cost base of an investment asset being an interest in immovable property which is held for more than 12 months is indexed for inflation during the period of ownership. The method of indexation will be prescribed in the regulations. The indexation of the adjusted cost base under subsection (10) does not apply in calculating a capital loss on disposal of an interest in immovable property (section 62(3)). This means that a gain will only be recognised on disposal of an interest in immovable property held for more than twelve months where the consideration received exceeds the indexed adjusted cost base; and a loss will only be recognised where the consideration received is less than the unindexed adjusted cost base. Neither a gain or loss will be recognised where the consideration received is less than the indexed adjusted cost base but greater than the unindexed adjusted cost base. In this situation, the taxpayer has only made a nominal gain which is protected by indexation.

61. Consideration Received

The other component of the formula for calculating the gain or loss on disposal of an asset is the consideration received by the taxpayer for the disposal. In most cases, the amount of consideration received on disposal of an asset will be clear, being the cash proceeds of a sale. Section 61 provides special rules for other cases. Under subsection (1), the consideration received includes the market value of consideration furnished in kind. Subsection (2) deems the disposer to have received consideration equal to the fair market value of the asset when an asset is disposed of in a non-arm's length transaction (for example, to a related party). Under subsection (3), where an asset is disposed of by gift, the disposer is deemed to have received consideration equal to the greater of the adjusted cost base or the fair market value of the asset. Finally, subsection (4) requires the cost base of an asset to be apportioned in the case of a part disposal of an asset. For example, if a taxpayer conveys an easement in land, a portion of the cost base of the land is apportioned to the easement in determining the gain on the conveyance.

62. Losses on Disposal of Investment Assets

Subsection (1) provides a quarantining rule for the allowance of a deduction for losses on the disposal of investment assets incurred during the year of assessment. A deduction is only allowed for such losses to the extent of gains derived by the taxpayer from the disposal of investment assets during the year of assessment. Any loss or part of a loss disallowed as a deduction under subsection (1) is carried forward to the next year of assessment under subsection (2) and is treated as a loss on the disposal of investment assets in that year for the purposes of applying subsection (1) in that subsequent year of assessment. Through this carry-forward mechanism, a loss or part of a loss disallowed under subsection (1) may be carried forward indefinitely.

Subsection (3) provides that sections 60(8) and (10) do not apply in calculating the amount of a loss on disposal of an investment asset (see Commentary to section 60).

63. Nonrecognition of Gain or Loss

Subsection (1) provides three situations where gains or losses on the disposal of an asset are not recognised for tax purposes. Under paragraphs (a) and (b) the transfer of an asset between spouses, or between ex-spouses as part of a divorce settlement, is not recognised for tax purposes. "Spouse" is intended to have its normal meaning under the written or customary law of Lesotho. Under section 60(6), the transferee spouse takes the adjusted cost base of the transferor at the date of the transfer. Consequently, the whole of the gain or loss accruing since the date of acquisition by the transferor spouse will be derived or incurred by the transferee spouse on a subsequent disposal of the asset.

Paragraph (c) deals with the involuntary conversion of an asset where a replacement asset is acquired. For the purposes of paragraph (c), an involuntary conversion of an asset includes the destruction, theft, or compulsory acquisition of the asset. Such a conversion is treated as a disposal for tax purposes under the definition in section 3. Where some compensation is received (for example, an insurance or damages payout), that compensation is the consideration received on disposal of the asset for the purposes of section 61. Whether or not a loss or gain occurs depends on whether the compensation is greater or less than the adjusted cost base of the asset disposed of. Paragraph (c) defers the recognition of the gain or loss where the compensation received is used to acquire a replacement asset of a like kind to that disposed of. An asset may be of a like kind where it performs a similar function to that performed by the asset replaced, or is the same type of property.

Where paragraph (c) applies, subsection (2) provides that the starting point in determining the tax cost of the replacement asset is the adjusted cost base of the involuntarily disposed of asset. For example, if an office building with an adjusted cost base of M100,000 is destroyed by fire, and the taxpayer receives M150,000 under an insurance policy which is wholly used to acquire a replacement building, the tax cost of the replacement building is M100,000 being the adjusted cost base of the destroyed building at the date of the destruction. Recognition of the M50,000 gain made by the taxpayer on disposal of the building is deferred until the taxpayer disposes of the replacement building. If the replacement building had cost M140,000, then the tax cost of the replacement building would still be M100,000, but the difference between the insurance proceeds and the cost of the replacement building would be included in gross income. Recognition of the other M40,000 of gain on receipt of the insurance proceeds would be deferred until the taxpayer disposes of the replacement building.

64. Income of Joint Owners

Under section 64, the basis of apportionment of income and deductions relating to jointly owned property is the respective interests of the joint owners in the property. The general principles of property law apply in determining the interests of joint owners in income-producing property.

65. Valuation

This section provides a fair market value test where it is necessary to bring into the calculation of chargeable income property, services or any other benefit received or given.

Where the property is transferred to an employee or other provider of services, subsection (2) provides that the fair market value of the property is determined without reference to any restriction on the subsequent transfer of the asset. The valuation rule established by judicial decisions in the absence of such a provision is that the amount of income is the amount for which the asset can be converted for cash, with the result that a condition attached to the property that it cannot be disposed of by the recipient results in a nil valuation.

66. Currency Conversion

Chargeable income is to be calculated in Maloti, and to this end a taxpayer must keep books of account in Maloti. Under subsection (4), however, the Commissioner has a discretion to allow a taxpayer to keep books of account in a currency other than Maloti.

Where the calculation of chargeable income involves foreign currencies, subsection (2) sets out the basic rule that conversion to Maloti is to be made at the exchange rate prevailing on the date the amount is taken into account for tax purposes. For example, income derived by a cash-basis taxpayer in a foreign currency must be converted on the date received; similarly, an expense incurred by such a taxpayer in a foreign currency must be converted on the date paid.

Subsection (3) permits a taxpayer to use the average rate of exchange between Maloti and a foreign currency during the year of assessment where this does not give a result which is substantially different from that arising under subsection (2). This is intended as a rule of convenience for those taxpayers who have multiple transactions in the same foreign currencies during the year of assessment. Under this rule, a taxpayer would generally not be permitted to use an average rate of exchange where the actual rate of exchange has fluctuated widely during the year of assessment.

67. Indirect Payments and Benefits

Section 67 enacts a doctrine of constructive receipt and a doctrine of constructive payment. The doctrine of constructive receipt (subsection (1)) applies in two broad classes of case. First, under paragraph (a), a payment which directly or indirectly benefits a taxpayer and which would have been income of the taxpayer if the payment had been made directly to the taxpayer is treated as income of the taxpayer. For example, an employer's payment of an outgoing of an employee, such as the school fees of the employee's children, is treated as income of the employee as the employee directly benefits from the payment through the savings resulting from not having to pay the fees. Even if payment of the fees is normally the responsibility of the employee's spouse, paragraph (a) still applies as the employee indirectly benefits from the payment by the employer.

Secondly, under paragraph (b), a payment dealt with as the taxpayer directs and which would have been income of the taxpayer if the payment had been made directly to the taxpayer is income of the taxpayer. This would cover, for example, a situation where an employee directs his or her employer to pay some part of his or her salary or wages directly to a third party. One situation where this could occur is where an employee's contributions to a superannuation fund are paid directly to the fund by the employer.

Subsection (2) provides for a corresponding rule where a payment is made on the taxpayer's behalf or as the taxpayer directs.

68. Finance Leases

This section provides that a finance lease is to be treated as a purchase of the leased asset by the lessee financed by a loan to the lessee by the lessor. A lease is a finance lease if it comes within one of the paragraphs of subsection 2. The section applies to leases of tangible property, whether movable or immovable.

Where a lease is a finance lease, the lessee is treated as the owner of the leased property for income tax purposes. More particularly, -

* the lessor is not entitled to deductions (such as depreciation deductions) for the cost of the leased asset, these being allowed to the lessee;

* the principal at the commencement of the "loan" will be the present value of the payments to be made under the lease.

* the lease payments will be dissected into the two components, one being the repayment of "principal" and the other being "interest";

* the interest component of each lease payment will be calculated, according to actuarial methods, on the principal outstanding at the commencement of each payment period, with the balance of the payment treated as repayment of principal; and

* the interest component of the lease payment is included in gross income of the lessor and allowed as a deduction to the lessee.

69. Exclusion of Doctrine of Mutuality

This section abolishes the doctrine of mutuality established by the judicial decisions of the United Kingdom and RSA courts whereby certain transactions are not treated as giving rise to income even though apart from the doctrine they would be seen as involving income. This applies particularly to social clubs, mutual insurance companies, or other similar membership organisations. The intention is that under the new law, such bodies will be taxed as companies (see the extended definition of "company" in section 3) and to the extent that they derive income in excess of deductions, they will be liable for tax at the company rate.

Income of such bodies will include, for example, membership dues, dining room and bar receipts, fees for the use of facilities (for example, sporting facilities) and investment income. If the body is an exempt organisation (for example, an amateur sporting association), then section 25 will exempt some income from tax. Deductions will be allowed in accordance with the Order for expenses or losses incurred in producing income subject to tax.

Where such bodies are run on an annual break-even basis, this change in tax law should not create any significant tax problems as deductions incurred will largely offset income derived. Subsection (2), however, only allows expenses or losses attributable to the supply of goods or services to members to be deducted to the extent of income derived from members. Any excess could not be deducted, for example, from property income derived by the club. This is an anti-avoidance measure designed to prevent the supply of goods or services to members at an undervalue giving rise to deductions which could be used to protect from tax income derived otherwise than from members.

70. Compensation Receipts

This section provides a characterisation rule for compensation receipts. A compensation receipt is to take the character for tax purposes of the thing that is compensated. This statement is largely declaratory of general principles. The characterisation of a compensation receipt according to this principle determines whether the receipt is chargeable to tax, and if so, in what manner. For example, a payment to an individual as compensation for the loss of employment income resulting from accident caused by another's negligence is characterised as employment income, and therefore, included in gross income under section 18.

71. Recouped Deductions

This section provides that an amount allowed as a deduction, which is subsequently recovered by the taxpayer, is included in gross income in the year of assessment in which the amount is recovered. Under subsection (2), an amount is considered recovered upon the occurrence of an event, which is inconsistent with the basis for the deduction. An example of such an event is a decision of a court or tribunal in the taxpayer's favour. The amount would be considered recovered when the decision is handed down and not when the actual repayment is received.

An amount included in gross income as a result of the operation of this section takes the character of the income to which the recovered deduction relates. This is relevant, for example, for the purposes of the quarantining of deductions under section 47.

72. Individual as Tax Unit

Subject to sections 73 and 74, which take account of the marital and family status of taxpayers, the Order adopts the individual as the tax unit. Consequently, each spouse is required to calculate chargeable income separately.

73. Abatements

Every resident individual is entitled to a personal deduction referred to as an "abatement". The amount of the deduction depends on the marital status of the taxpayer, and if married, the income derived by the taxpayer's spouse. For an unmarried taxpayer or a taxpayer whose spouse earns more than M500 in gross income, subsection (1) provides that the abatement is M6,240. In the case of two working spouses, both are entitled to claim this amount as their abatement. For a married spouse whose gross income is M500 or less, subsection (2) provides that the abatement is M7,992. Where both spouses earn income, the determination of whether the single or married abatement applies is based on the gross income and not chargeable income of the spouse. The abatement effectively operates as a tax-free threshold for resident individual taxpayers.

Where a spouse dies, subsection (3) allows the surviving spouse to claim the married abatement in subsection (2) until the surviving spouse remarries. The amount of the abatement allowed to the deceased and the surviving spouse is calculated in accordance with subsection (4).

Under subsection (4), an individual who qualifies for an abatement under subsection (1) or (2) for a period of less than twelve months must apportion the abatement. For example, an unmarried individual who becomes a resident of Lesotho on 1 July would be entitled to an abatement of M4,680 being 3/4 x M6,240. If the individual is married, then the determination of whether the single or married abatement applies is based on the spouse's gross income after becoming a Lesotho resident. This subsection is also intended to apply where two working resident individuals marry during the year of assessment and one ceases to be employed after the marriage. In this situation, both individuals are entitled to the single abatement prorated for that part of the year of assessment prior to the marriage. After the marriage, the employed spouse is entitled to the married abatement prorated for that part of the year of assessment after the marriage.

74. Income Splitting

This section gives the Commissioner power to adjust the chargeable income of taxpayers where income splitting is attempted. Subsection (1) contains a non-exhaustive list of arrangements, which commonly involve income splitting. The reference to a spouse or child of the taxpayer is not intended to limit the general application of the definition of "associate" in section 3, but merely to indicate the kind of cases where the section is likely to be applied.

The reference in paragraph (a) to a stated interest rate below the open market value is intended to include a zero rate of interest. For example, a taxpayer on the highest marginal rate with M50,000 to invest and an adult child to support may loan the amount to the child at a zero interest rate, thereby allowing that child to invest the amount at market rates. The effect of this transaction is that the interest is derived by the child and as such is subject to a lower marginal rate of tax than if derived by the taxpayer. In this situation, the Commissioner may treat the interest as having been derived by the taxpayer, including it in the taxpayer's chargeable income and excluding it from the chargeable income of the child.

An example of a situation covered by paragraph (b) is where a professional taxpayer on the highest marginal rate pays a salary to his or her spouse as an administrative assistant where no actual services are rendered or the salary paid substantially exceeds the market rate for the services rendered. The taxpayer claims a deduction for the salary paid, and therefore, the income represented by the salary is taxed to the spouse at a lower marginal rate. In this situation, the Commissioner may treat the taxpayer as having only paid a salary equivalent to the market salary having regard to the services rendered and adjust the chargeable income of the taxpayer and spouse accordingly.

An example of an assignment intended to be covered by paragraph (c) is where an investment asset is transferred by a taxpayer on a high marginal rate to a related party on a low marginal rate under a condition whereby the taxpayer retains control of the asset. Paragraph (d) applies where a taxpayer assigns a right to receive income, for example, an assignment of a royalty stream, rather than making an outright transfer of the income-producing property. This section may only be applied to an assignment of a right to receive income where income splitting is involved. It is not intended to apply to ordinary commercial transactions which may involve assignments of income streams.

It is common for business taxpayers, particularly professional taxpayers, to derive income through a partnership or family discretionary trust the partners or discretionary beneficiaries of which are members of the taxpayer's family on low rates of tax. For example, a consulting engineer may carry on business through a family trust with the engineer's spouse and adult children as beneficiaries. The trust employs the engineer and enters into a contract with a third party for the provision of engineering services. The amount paid by the third party to the trust is less than the salary paid to the engineer with the excess being distributed to the beneficiaries of the trust. In this situation, the Commissioner may ignore the trust structure and treat the entire amount paid by the third party as income of the engineer. In determining whether the trust or partnership structure is intended to split income, subsection (2) requires that regard be had to the consideration given by the other party for the interest in the partnership or trust. Generally, income splitting will not be regarded as involved where full value is given by the person receiving an interest in the partnership or trust.

75. Principle of Taxation for Partnerships

A partnership is not treated as a separate taxpayer under the Order, with partnership income taxed to the partners in accordance with the rules in section 77. This is consistent with the treatment of partnerships under section 21 of 1981 Act. A partnership is obliged to file a return of partnership income and the responsibility for this rests with the nominated officer of the partnership (see sections 128 and 211). Further, a partnership is also obliged to file any election, notice, or statement required to be filed under the Order in relation to the partnership's activities. An example would be an election under section 41(5) for pooling to apply to the partnership's depreciable assets. It is intended that such elections, notices, or statements be filed by the nominated officer.

76. Calculation of Partnership Income or Loss

While a partnership is not taxed as a separate taxpayer, a notional calculation is made under this section of the chargeable income of the partnership for the purposes of allocating liability to tax on that income among the partners. This calculation involves a notional application of the terms of the Order relevant to the calculation of chargeable income to the partnership on the assumption that the partnership is a resident individual taxpayer. This means that the calculation is based on the worldwide income of the partnership. Where the notional chargeable income of the partnership is positive, it is referred to as "partnership income"; and where it is negative, it is referred to as "partnership loss".

Partnership income or loss is calculated without regard to -

(1) the deduction allowed under section 73;

(2) interest exempt under section 27 or excluded from gross income under section 158(2); or

(3) the carry forward of any loss, deduction, or credit.

The deductions, losses, and credits referred to in (1) and (3) are excluded from the calculation of partnership income or loss as they are taken into account at the level of the partners. The deduction under section 73 is only available to those partners who are resident individual taxpayers, and the amount of the deduction depends on the individual partner's personal circumstances.

As partnership losses are passed through to the partners on a current year basis (see sections 77(3) and (4)), the carry forward of a loss or deduction is taken into account at the partner level. This means that section 47 (including the quarantining of deductions) has no application in the calculation of partnership income or loss. Section 47 does apply, however, at the partner level which means that the quarantining of deductions provided for in that section will depend on the status of each partner (see commentary to section 77).

Credits are not taken into account in calculating partnership income or loss. As stated above, the calculation under this section is a notional calculation of the chargeable income of the partnership, and it is this calculation which forms the basis of the allocation of income or loss to partners under section 77. The claiming of credits is an event, which occurs after the calculation of chargeable income, and therefore in the partnership context, occurs after the section 77 allocation. This means that credits arising in relation to partnership income are claimed by the partners in accordance with their distributive shares in the income to which the credit relates and in accordance with their particular circumstances. For example, any foreign tax credit arising in respect of foreign-source income derived by the partnership is claimed by the partners in accordance with their distributive shares in the foreign-source income, and provided that the circumstances of each partner otherwise satisfy the requirements for claiming the credit under section 105, in particular that the partner is a resident.

The exemption of interest under section 27 and the exclusion of interest from gross income under section 158(2) are intended to apply only to interest derived directly by an individual resident taxpayer. Consequently, those provisions do not apply to the calculation of partnership income or loss, and are not intended to apply to interest derived through a partnership even where a partner of the partnership is a resident individual.

77. Taxation of Partners

Section 77 provides for the allocation of partnership income or loss (as calculated under section 76) among the partners. The basis of the allocation is the partner's distributive share of partnership income or loss, as defined in subsection (6).

As discussed in the Commentary to section 76, the calculation of partnership income or loss is based on the worldwide income of the partnership. The general jurisdictional rules of the Order are then applied at the partner level in the allocation of partnership income or loss. As residents are taxed on worldwide income, subsection (1) includes in the gross income of a resident partner that partner's distributive share of partnership income. As non-residents are only taxed on Lesotho-source income, subsection (2) includes in the gross income of a non-resident partner that partner's distributive share of partnership income, which is Lesotho-source income. A non-resident partner, therefore, is not subject to Lesotho tax on his or her distributive share of foreign-source income of the partnership. The source of partnership income is determined in accordance with the rules in section 103, and under subsection (5), income retains its geographic source in the hands of the partners.

Similarly, subsection (3) provides that a resident partner is allowed a deduction for the partner's distributive share of partnership loss. For a non-resident partner, subsection (4) only allows a deduction for the partner's distributive share of partnership loss to the extent that the activity giving rise to the loss would have given rise to Lesotho-source income if a loss had not been incurred. There is a limitation on a partner claiming a deduction for his or her distributive share of partnership loss. Under subsection (7), a partner is only allowed a deduction to the extent of the adjusted cost base of the partner's interest in the partnership determined at the end of the year of assessment in which the loss occurred. Where the loss exceeds the partner's adjusted cost base, the excess may be carried forward to the next year of assessment. A partner's adjusted cost base in respect of an interest in a partnership is calculated in accordance with section 79.

As section 47 does not apply in calculating partnership loss, such a loss is calculated on a global basis. As income and deductions retain their character in the hands of the partners (subsection (5)), the intention is that a partner's distributive share in the items of income and deduction which comprise partnership income or loss are taken into account (together with the partner's other income and deductions) in applying section 47 at the level of the partners. Consequently, for example, an individual partner's distributive share of property income and deductions relating to that income included in partnership income or loss is taken into account in determining whether the partner has an overall property loss which is quarantined and carried forward under section 47(2). While the general quarantining and loss carry forward provision in section 47 does not apply in calculating partnership income or loss, specific quarantining rules do apply. For example, if there is an excess of losses on disposal of investment assets by the partnership over gains from such disposals, then the excess constitutes a loss, which is allocated to the partners according to the rules in subsections (3) and (4).

Under subsection (5), income, expenses, and losses taken into account in calculating partnership income and loss retain their character both as to nature and geographic source in the hands of the partners. Consequently, for example, foreign-source property income included in partnership income is similarly characterised in the hands of the partners. This means that the income retains its character as property income for the purposes of applying section 47 to the partner and as foreign-source income for the purposes of the partner claiming credit for any foreign tax paid by the partnership in respect of the income. This subsection also ensures that the characterisation of partnership assets as business or investment assets is carried through to the partners. This may be relevant, for example, to the application of section 62 to the partner where a share of an overall loss on the disposal of investment assets by the partnership has been allocated to the partner.

As indicated in the example in the previous paragraph, subsection (5) is relevant to the claiming of credits in respect of partnership income, particularly in relation to withholding taxes. Circumstances will arise where income from which tax has been withheld at source has been paid to a partnership. In some cases, the treatment of such income will depend on whether the partnership is a resident or non-resident (see section 7). For example, interest paid by a financial institution resident in Lesotho to a non-resident partnership will be subject to withholding tax under section 107 (the interest being Lesotho-source under section 103(1)(i)). In calculating partnership income, the interest will be exempt income unless the partnership makes an election under section 109 in which case credit for the withholding tax would be allocated to the partners in accordance with their distributive shares in the interest income. If the partnership is a resident partnership, then tax is withheld under section 158(1) and not section 107. The interest is included in partnership income and as such is fully taxed to the partners (regardless of residence) with a credit allowed for the withholding tax in accordance with the partner's distributive shares in the interest income. The same situation arises with payments for services rendered by a partnership from which tax is withheld under section 108 or 157.

Partnership income or loss is allocated to partners under subsections (1)-(4) on the basis of each partner's "distributive share" of the income or loss. This is defined in subsection (6) to mean the partner's percentage interest in the partnership. A partner's percentage interest in a partnership is determined with reference to the partner's economic interest in the items of income or loss subject to allocation determined having regard to all the facts and circumstances of the partnership, including the terms of the partnership deed. Under this rule, each item of income and deduction must be divided on the same percentage basis for income tax purposes. For example, if A and B each contribute M100,000 to the AB Partnership and agree to share income and losses equally, then each has a distributive share of 50% in each item of income or deduction taken into account in calculating partnership income or loss.

The regulations may provide for circumstances under which different partnership items may be allocated in different proportions among the partners. Departures from allocation of each item according to the partner's interest in the partnership will only be accepted for tax purposes if they have substantial economic effect. For example, a partnership with both resident and non-resident partners may agree that Lesotho-source income be allocated to the resident partners and foreign-source income to the non-resident partners thereby minimising the overall Lesotho tax on partnership income as non-resident partners are not liable for Lesotho tax on foreign-source partnership income. The regulations may allow such an allocation to be accepted for tax purposes, but only if it is consistent with the economic reality of the partnership. Important in this regard will be whether the non-resident partners also bear all foreign losses, or whether they are shared among all partners.

78. Formation, Reconstitution, or Dissolution of a Partnership

The intention is that business and investment assets of a partnership are treated for tax purposes as owned by the partnership. Consequently, the gain or loss on disposal of such assets by the partnership to third parties is included in the calculation of partnership income or loss under section 76 and is allocated to the partners in accordance with their distributive shares in partnership income or loss determined in accordance with section 77. Section 78 deals with certain internal transactions involving partnership assets, namely, the contribution of assets to the partnership, changes in the constitution of the partnership, and the transfer of assets to partners on dissolution of the partnership. The effect of section 78 is that, in most cases, the contribution, change in composition, or transfer on dissolution is treated as a complete disposal of the asset by the contributing partner or partnership respectively, with the gain or loss being taken into account in the calculation of partnership income. The intention is that, despite the continuing interests of some partners in the asset, the gain or loss accruing up to the time of contribution, change in composition, or transfer on dissolution is taxed to the partner or partners who held an interest in the asset during that period.

The contribution of an asset to a partnership is treated under subsection (1) as if the partner disposed of the asset to the partnership. This is despite the fact that under partnership law the partner may retain an interest in the asset. If the asset is a business or investment asset of the partner, the gain or loss to the partner on disposal of the asset is recognised for tax purposes. The consideration received by the partner and the cost base for the partnership is determined in accordance with the principles in sections 61 and 60 respectively. The effect of subsection (1) is that the gain or loss on the asset accruing up to the date of contribution is taxed to the contributing partners. The contributed asset is then treated as a business or investment asset in accordance with the circumstances of the partnership. The gain or loss on a subsequent disposal of the asset by the partnership is taken into account in calculating the partnership income or loss for the year of assessment in which the disposal occurred. Consequently, the partner who originally contributed the asset will only be liable for his or her share of the gain or loss accruing after the contribution.

Subsection (2) provides that the gain or loss on contribution of an asset to a partnership is not recognised for tax purposes where the partner's interest in the partnership immediately after the contribution of the asset is 50% or more. Where subsection (2) applies, section 60(6) provides that the tax cost to the partnership of the asset contributed is the adjusted cost base of the contributing partner immediately before the contribution. This means that recognition for tax purposes of any gain or loss, which has accrued in respect of the asset prior to the contribution, is deferred until the year of assessment in which the partnership subsequently disposes of the asset. On a subsequent disposal of the asset, the entire gain or loss which has accrued since the contributing partner owned the asset is included in the calculation of partnership income or loss and is allocated according the partners' distributive shares.

Under paragraph (a) of subsection (3), a change in the constitution of a partnership (for example, the admission of a new partner) is treated for tax purposes as a disposal of all the assets of the old partnership to the reconstituted partnership. This means that the gain or loss, which has accrued during the period the asset was held by the old partnership, is taxed to the partners of the old partnership in accordance with their distributive shares of partnership income. There is an exception to this in subsection (4) where there is a continuity of 50% or more of the interests in the partnership after the change in composition. In this situation, the adjusted cost base of the asset to the old partnership is rolled-over to the new partnership in accordance with the application of section 60(6) in calculating the partnership income or loss of the new partnership in the year of assessment in which the asset is subsequently disposed of. For subsection (4) to apply, the required continuity of ownership must be maintained for at least 12 months after the change in composition of the partnership.

Under paragraph (b) of subsection (4), a transfer of a partnership asset to a partner on dissolution of a partnership is treated as a disposal of the assets by the partnership to the partner for the purposes of calculating the partnership income or loss for the year of assessment in which the partnership is dissolved.

79. Determination of Adjusted Cost Base of Partner's Interest

This section provides for the calculation of the adjusted cost base of a partner's interest in the partnership. A partner's interest in the partnership is a business or investment asset depending on the circumstances. The gain or loss on disposal of the interest must be taken into account for tax purposes. In calculating the gain or loss, the adjusted cost base of the interest in the partnership is the cost base of the interest calculated in accordance with section 60 (in most cases, the capital contribution of the partner) increased by the partner's distributive share of partnership income and exempt income, and decreased by the partner's distributive share of partnership losses and non-deductible expenses (for example, expenses incurred in deriving exempt income of the partnership). The reduction for losses and non-deductible expenses is not to decrease the adjusted cost base below zero.

The adjusted cost base is relevant to a partner's ability to claim a deduction under section 77(3) or (4) for the partner's distributive share of partnership loss. A deduction is only allowed under those subsections to the extent of the adjusted cost base of the partner's interest in the partnership as of the end of the year of assessment. If the amount of the deduction exceeds the adjusted cost base, then the excess may be carried forward for deduction in a subsequent year. The intention is that the loss may be carried forward indefinitely.

80. Interpretation

This section defines three terms used Part VII of Chapter II which provides for the taxation of income derived through a trust.

"grantor": a grantor is a person who transfers property to, or confers a benefit on, a trust for no consideration or for a consideration which is less than market value. The transfer or conferral may be by way of settlement of the trust or to an already established trust. The definition is relevant to the taxation of grantor trusts under section 81(2).

"grantor trust": broadly a grantor trust is a trust in which the grantor has retained control over the whole or a part of the corpus or income of the trust.

A trust is a grantor trust if the grantor has a power to revoke the trust so as to acquire a beneficial interest in the corpus or income of the trust which power is exercisable at any time. The power may be expressly provided in the trust deed or arise by operation of the law, and a grantor is considered to have a power to revoke the trust if the power is exercisable by an associate of the grantor. A grantor is considered to have a power to revoke the trust where the grantor has a power which is functionally equivalent to a power to revoke the trust, such as an unrestricted power to have the corpus or part of the corpus paid for the benefit of the grantor (for example, a power to have the corpus paid for the "comfort or maintenance" of the grantor). Where the power to revoke the trust is contingent on the occurrence of an event which is uncertain (such as the marriage or divorce of a beneficiary), the trust will not be considered to be a grantor trust until the year of assessment in which the event occurs.

A trust is a grantor trust if the grantor has a power to alter the trust so as to acquire a beneficial interest in the corpus or income of the trust. This would include, for example, a power to add beneficiaries including the grantor. As with the power to revoke, the power to alter may be expressly provided in the trust deed, arise by operation of the law, or be exercisable by an associate of the grantor.

Finally, a trust is a grantor trust if the grantor has a reversionary interest in the corpus or income of the trust. The interest in the corpus or income of the trust may revert to the grantor at the end of a fixed period or on the occurrence of a particular event.

"qualified beneficiary trust": this is a trust in relation to which a person has a power solely exercisable by that person to vest the corpus or income of the trust in that person. It also includes a trust whose sole beneficiaries are any combination of: an individual, the individual's estate, and the individual's appointees. A trust is a qualified beneficiary trust in these circumstances even though the beneficiary is under a legal disability. For purposes of section 80, the term "appointees" means appointees under a general power of appointment.

81. Principles of Taxation for Trusts

Income derived through a trust is taxed to the trustee or beneficiary as provided for in Part VII. Unlike partnerships, therefore, trusts are not ignored for tax purposes and the trustee may be subject to tax in certain circumstances. Broadly, a beneficiary is taxed on trust income if he or she is presently entitled to the income, while income, which is accumulated in the trust, is taxed to the trustee. It is important to determine who is the taxpayer in respect of trust income because of the different rates which may apply. A resident individual beneficiary (other than a minor) is taxed on trust income at normal marginal rates, while a trustee is generally taxed at a flat rate equal to the maximum marginal rate (an exception being the first two years of assessment of the execution of a deceased estate). A trust is required to file a return of trust income (see Commentary to section 128).

There are two exceptions to the general scheme of taxation of trust income outlined above. Under subsection (2), a grantor trust is not treated as an entity separate from the grantor. Consequently, the income of such a trust is treated as being derived by the grantor and transactions between the grantor and the trust are ignored for income tax purposes. This is the case regardless of whether there is a beneficiary presently entitled to the income. In this case, the beneficiary is not taxed on the income. Subsection (2) also provides that a qualified beneficiary trust is not treated as an entity separate from the beneficiary. This means that the income of the trust is taxed to the beneficiary regardless of whether the beneficiary is presently entitled to the income.

The basic structure for the taxation of trust income is similar to that applicable to partnerships, although there are some important differences. A notional calculation is made of the chargeable income of the trust for the purposes of allocating liability to tax on that income between the beneficiaries and the trustee. This calculation involves a notional application of the terms of the Order relevant to the calculation of chargeable income to the trust on the assumption that the trust is a resident individual taxpayer. This means that the calculation is based on the worldwide income of the trust. Where the notional chargeable income of the trust is positive, it is referred to as "trust income"; and where it is negative, it is referred to as trust loss.

Trust income or loss is calculated without regard to -

(1) the deduction allowed under section 73; or

(2) interest exempt under section 27 or excluded from gross income under section 158(2).

The deduction allowed under section 73 is excluded from the calculation of trust income or loss as it is taken into account at the level of the beneficiaries, depending on their particular circumstances. No deduction is allowed under section 73 in calculating chargeable trust income on which a trustee is liable under section 83 or 84, except pursuant to section 84(2). The exemption of interest under section 27 and the exclusion of interest from gross income under section 158(2) are intended to apply only to interest derived directly by an individual resident taxpayer. Consequently, those sections do not apply in the calculation of trust income or loss. Further, they do not apply in calculating chargeable trust income on which a trustee is liable under section 83 or 84.

An important difference between the taxation of partnerships and trusts is that trust losses are not allocated to beneficiaries; instead they may be carried forward to the next year of assessment as a deduction in calculating trust income or loss for that year. For this reason, section 47 which provides for the quarantining of deductions and carry forward of losses applies in calculating trust income or loss. As the trust is treated as a resident individual taxpayer for the purposes of calculating trust income or loss, the quarantining of business and property losses in section 47 applies in that calculation. This means that, for any year of assessment, a trust may have both trust income and trust loss for different classes of income.

Any monetary amounts relevant to the trust's activities are taken into account in the calculation of trust income or loss. This means, for example, that the M150,000 threshold for the use of accrual-basis accounting is calculated by reference to the trust's activities regardless of the gross income of the beneficiary.

Income, expenses, or losses derived or incurred by the trust retain their character both as to nature and geographic source. This is particularly important in relation to tax credits attaching to income (for example, foreign source income) passing through the trust. See the discussion on this point in relation to partnerships in the Commentary to sections 76 and 77.

The calculation of trust income or loss is made separately for each trust, even though trusts may have a common trustee.

82. Taxation of Beneficiaries

The income of trusts is taxable to beneficiaries to the extent that beneficiaries are presently entitled to that income. Present entitlement is to be determined in accordance with trust law principles. Broadly, a beneficiary will be regarded as presently entitled to a share of trust income where the beneficiary -

(1) has an absolute and indefeasible vested interest in possession in a share of income; and

(2) has an immediate right to demand payment of that share of income.

It is intended that a beneficiary who is under a legal disability (such as a minor or a person with a mental disability) will satisfy the second part of the test if that person would have an immediate right to demand payment but for the disability. Section 67 applies in determining whether or not a beneficiary is presently entitled to a share of trust income.

As discussed in the Commentary to section 81, the calculation of trust income or loss is based on the worldwide income of the trust. The general jurisdictional rules in the Order are then applied at the level of the beneficiary in the allocation of trust income. As residents are taxed on worldwide income, subsection (1) includes in the gross income of a resident beneficiary the share of trust income to which the beneficiary is entitled. As non-residents are only taxed on Lesotho-source income, subsection (2) includes in the gross income of a non-resident beneficiary that part of the share of trust income which is Lesotho-source income to which the beneficiary is presently entitled. The source of income is determined in accordance with the rules in section 103, and under section 81(6) income retains its geographic source in the hands of the beneficiary.

Subsection (3) makes it clear that beneficiaries are not allowed a deduction for their share of trust losses. As stated in the Commentary to section 81, trust losses are not passed through to beneficiaries but may be carried forward in the trust in accordance with section 47.

83. Taxation of Trustees

This section effectively taxes the trustee on trust income to which no beneficiary is presently entitled. Such income is referred to in this section as chargeable trust income. As stated in the Commentary to section 81, trust income is calculated on the assumption that the trust is a resident individual taxpayer, and therefore, trust income includes the worldwide income of the trust. Applying the normal jurisdictional rules of the Order to chargeable trust income, under subsection 1(a), the trustee is liable for tax on that part of chargeable trust income which is Lesotho-source income.

The taxation of that part of chargeable trust income which is foreign-source income should not depend upon the residence of the trustee as the trustee has no entitlement in a personal sense to the income. On the other hand, to confine tax at the level of the trustee to Lesotho-source income opens the way for tax avoidance by the use of offshore trusts deriving foreign source income even though the ultimate beneficiaries of that income will be persons resident in Lesotho. Accordingly, paragraph (b) of subsection (1) provides that the trustee is subject to tax on foreign-source chargeable trust income where one of three tests is satisfied. First, where the grantor was resident of Lesotho at the time of making a transfer to the trustee. Secondly, where the grantor was a resident of Lesotho in the relevant year of assessment. Thirdly, where a resident person may ultimately benefit from the income. Whether this third test is satisfied depends on an analysis of all the facts and circumstances of the trust. Where foreign-source income is included in chargeable trust income, the trustee is allowed a credit for any foreign taxes paid in respect of that income.

Chargeable trust income is defined in subsection (2) to mean the trust income for the year of assessment less that part of trust income to which beneficiaries are presently entitled (including in the case of a non-resident, foreign-source income which would have been included in gross income under section 82 if the beneficiary were a resident).

Subsection (4) provides that the application of section 83 is subject to section 84, which specifically deals with decedents' estates.

84. Taxation of Estates of Deceased Persons

This section provides special rules for the taxation of income in the year of assessment in which the death of a taxpayer occurs. The rules only apply to income accruing or arising from an income-producing activity carried on by the taxpayer before the taxpayer's death, and provide for the taxation of such income on the basis that no beneficiary is presently entitled to the income. If a beneficiary is presently entitled to all or some part of the income, the beneficiary is not subject to tax on that income. The income is subject to tax at the rates specified in section 11(2). Where the deceased was a resident individual at the date of death, the marginal rates in the Second Schedule apply.

Subsection (1) applies to income derived by the taxpayer before the death of the taxpayer. Such income (other than income, which is not subject to tax, for example interest income subject to a final withholding tax under section 158(2),) is taxed to the executor or administrator of the deceased's estate as chargeable trust income. In calculating the amount of chargeable trust income, a deduction is made for the abatement which would have been allowed to the taxpayer if he or she were still alive. The amount of the abatement is prorated under section 73(4). Subsection (3) applies to income which has been derived by the executor or administrator after the death of the taxpayer. Such income (other than income, which is not subject to tax,) is taxed to the executor or administrator as chargeable trust income. In this situation, no deduction is allowed under section 73 in calculating chargeable trust income. Sections 82 and 83 apply to income derived by the executor or administrator of the estate of a deceased taxpayer from income-producing activity carried on after the taxpayer's death.

Subsection (5) makes the trustee liable for tax liabilities of the deceased arising prior to death, but this is not intended to impose any personal liability on the trustee beyond the assets of the estate of the deceased.

85. Interpretation

This section defines "qualified income" being an expression used only in Part VIII of Chapter II of the new law. "Qualified income" is defined to mean Lesotho-source manufacturing income derived by a resident company to which the concessional rate of 15% applies under section 10(2), and intercorporate dividends paid by a resident company.

The definition is primarily relevant to the imposition of ACT under section 87, but is also relevant to the dividend stripping provision in section 89.

86. Principles of Taxation for Companies

This section states the broad principles applicable to the taxation of companies and their shareholders. A Company is liable for income tax on its chargeable income. In relation to distributed profits this liability is collected through the advance corporation tax ("ACT") mechanism in section 87. A member is only taxable on dividends to the extent provided for in the Order. Dividends paid to a resident member are not subject to income tax. This is provided for in section 87(6) and means that the ACT paid by the company in respect of the dividends is a final tax. Dividends paid to a non-resident member are subject to withholding tax under section 107, although no withholding tax is payable if the dividends are paid out of manufacturing income to which the concessional rate provided for in the Third Schedule has applied pursuant to section 10(2).

The exemption of dividends paid to resident members removes the double taxation of dividends, which applies under the terms of the 1981 Act. Under the 1981 Act, companies are taxed on their chargeable income, while members being individual taxpayers are taxed on dividends received subject to a deduction under section 31(3). The amount of the deduction for individual taxpayers is calculated according to the sliding scale in the Fifth Schedule to the 1981 Act which is based on the taxable income of the member. As the monetary amounts in the Fifth Schedule have not been up-dated for some time, all members are likely to be taxed on 66 2/3% of the dividend received. Even with the dividend deduction, the two tiers of tax on distributed profits under current law gives rise to an effective rate of tax of 65% on distributed profits of the company (based on 1991/92 rates of tax). This is illustrated by the following example -

Company Level M

Company profits	100	
Tax (45%)		45
After tax profits	55	
Dividend		55

Member Level

Chargeable income (M55 x 2/3)		37
Tax (53%)		20
Total corporate and member tax	65	

Under the new law, a company will continue to pay tax on its chargeable income, although at the lower rate of 40%. A resident company will be liable for advance corporation tax ("ACT") on dividends paid to members at the rate of 66 2/3% of the dividend which equates to a rate of 40% on the pre-income tax profits of the company (the payment of a dividend being an after-tax event). The company is entitled to credit the ACT against its liability for income tax including instalments of tax. A dividend paid to a resident member will be exempt from Lesotho tax. The example above is reproduced below under the new law -

Company Level		M
Company profits	100	
Tax (40%)		40
After tax profits	60	
Dividend		60
ACT (66 2/3%)		40
Net income tax paid by company (M40-M40)	0	
Total tax paid by company (ACT only)	40	

Member Level

Dividend exempt at the member level

As the ACT is fully creditable against the income tax of the company, the maximum rate of tax paid on distributed profits is 40%.

87. Advance Corporation Tax

This section provides for the imposition of ACT on a dividend paid by a resident company. The residence of a company is determined under section 6, and a payment to a member is a "dividend" if it comes within the definition in section 3(1) as expanded by section 88. No ACT is payable to the extent that the dividend is paid out of "qualified income". This is defined in section 85 to mean manufacturing income concessionally taxed under section 10 and dividends received from another resident company. No ACT is payable on dividends paid out of manufacturing income because the company is taxed at the rate of 15% rather than 40% on such income. ACT is not payable on dividends paid out of income represented by dividends received from another resident company because ACT would have been paid by that other resident company or some other resident company higher up in the corporate chain. This prevents multiple tiers of ACT being payable as dividends pass through a corporate group. Where a company has both qualified and other income, subsection (3) treats a dividend as being first paid out of the qualified income. In other words, subsection (2) is a dividend-ordering rule under which it is assumed that a resident company distributes its qualified income first.

The rate of ACT is set out in subsection (2). As dividends are paid out of after-tax profits, the rate of ACT is designed to equate to the company income tax rate (40%) on the profits out of which the dividend has been paid. This is illustrated in the example to the Commentary to section 86.

ACT is an advance payment of the company's income tax liability on its distributed profits and is not a tax liability in addition to income tax. A Company may credit ACT against its income tax liability, including instalments of income tax. This is the purpose of subsections (4) and (5). Under subsection (4), a liability for ACT may be satisfied by an instalment of tax provided the instalment has not previously been taken into account under that subsection. As a transitional measure, where a dividend is paid out of pre-1 April 1993 profits, ACT on the dividend may be satisfied by income tax paid on those profits. Under subsection (5), ACT paid may be set off against an instalment of tax or a final liability (net of instalments) paid after the dividend is paid. This is not confined to an instalment or final liability in relation to the year of assessment in which the profits out of which the dividend was paid were derived. The instalment or final liability may relate to any subsequent year of assessment and, in this way, ACT credit can be carried forward indefinitely.

The application of subsections (4) and (5) is illustrated by the following example -

> Taxpayer Pty Ltd has chargeable income of M500,000 for the 1993/94 year of assessment on which M200,000 of income tax is payable. It has paid instalments of tax for that year of M20,000 each on 30 September 1993, 31 December 1993, and 31 March 1994. The balance of income tax for that year (M140,000) is due on 30 June 1994. On 1 May 1994, Taxpayer pays a dividend of M60,000. Taxpayer has no qualified income, so the dividend is fully subject to ACT.

> ACT payable on the dividend is M40,000 (M60,000 x 66 2/3%). Under subsection (4)(a), the ACT payable is satisfied by the instalments of tax paid on 30 September 1993 and 31 December 1993 . This means that no amount of ACT is actually paid to the Commissioner. As ACT has been satisfied by the instalments of tax, it is not also creditable against the income tax assessed to Taxpayer for the 1993/94 year of assessment. The instalments, however, remain creditable against Taxpayer's final liability (section 150(6)).
>
> If Taxpayer had paid a dividend of M120,000, then the ACT payable is M80,000 (M120,000 x 66 2/3%). In this situation, M60,000 of the ACT liability is satisfied by the three instalments of tax with a balance of M20,000 payable. The three instalments of tax remain creditable against Taxpayer's final liability which leaves a net amount payable of M140,000 (section 150(6)). The M20,000 of ACT paid is credited against that liability under subsection (5)(b).
>
> If Taxpayer had paid a dividend of M300,000, then the ACT payable is M200,000 (M300,000 x 66 2/3%). In this situation, M60,000 of the ACT liability is satisfied by the three instalments of tax with a balance of M140,000 payable. Taxpayer has a final liability for the year of assessment, after credit for instalments paid, of M140,000. This liability is fully satisfied by the credit for ACT of M140,000 paid.
>
> Suppose that Taxpayer's chargeable income is M400,000, although its accounting profit is M500,000 (the difference resulting, for example, from a loss carry forward deduction). Tax payable on the chargeable income is M160,000. Taxpayer pays a dividend of M300,000 giving rise to an ACT liability of M200,000. As discussed in the previous paragraph, after set off of instalments of tax paid, there is a net ACT liability of M140,000. The net income tax payable for the 1993/94 year of assessment after set off of instalments is M100,000. The ACT paid is credited against this liability so that no further income tax is paid. The M40,000 excess ACT is creditable against the first instalment of tax for the 1994/95 year of assessment due on 30 September 1994.

Subsection (6) provides that a dividend paid by a resident company is not included in the gross income of a resident member. This is the case regardless of whether or not ACT was payable in respect of the dividend. The effect of subsection (6) is that the maximum rate of tax (both shareholder and individual) on the non-manufacturing income of a resident company distributed to a resident individual shareholder is 40%, and on manufacturing income is 15%. Subsection (6) also prevents multiple taxation of company profits where dividends are paid from one resident company to another before passing to individual shareholders. Subsection (6) does not apply to dividends paid to a non-resident, although as these are subject to withholding tax, they will not be included in gross income by virtue of section 109, unless the non-resident makes an election under that section.

Where a company redeems a portion of its shares, the distribution made in redemption is treated as a dividend subject to ACT. To complete the picture, subsection 7 treats such a transaction as if the redemption had taken the form of a dividend to all the shareholders on a pro rata basis, and a use of the proceeds of the dividend by the shareholders whose proportionate interest in the company increased to purchase shares from the redeeming shareholders.

88. Disguised Dividends

This section treats a number of transactions between a company and a member of the company or an associate of a member, which are in substance a distribution, as a dividend for the purposes of the Order. Where the transaction is with an associate of a member, the dividend is treated as having been paid to the member and not the associate.

The amount of a loan made by a company to a member or an associate of a member which in substance is a distribution is treated as a dividend. An example of this may be an interest-free loan, although it will depend on all the circumstances. An excessive payment made by a company for property or services provided by a member or associate may be treated as a dividend. In this situation, the amount of the dividend would be the excess over the market value of the property or services. The treatment of the excess as a dividend in this situation would have to be reconciled with the member's tax position where the full amount of the payment is taxable. Similarly, where a company provides property or services to a member or associate of a member at an undervalue, the excess may be treated as a dividend. The fact that the company is deemed to have received market value on the disposal does not affect the treatment of the transaction as giving rise to a dividend in the hands of the member. Finally, the release by a company of a liability owed by a member or an associate of a member to the company may be treated as a dividend. This may apply, for example, where a company forgives a debt owing to it by a member, and this is the case regardless of whether market interest rates are payable in respect of the debt.

An amount to which this section applies is deemed to be a dividend for all the purposes of the Order. This means, for example, that ACT is payable on the amount of the deemed dividend.

89. Dividend Stripping

Section 89 grants a discretion to the Commissioner to treat a dividend paid as part of a dividend stripping transaction as not paid out of qualified income and, hence, as causing the payor to become liable to ACT in respect of the dividend. An example of such a transaction would be where the shares of a company about to pay a substantial dividend were purchased by another company, and sold shortly after payment of the dividend at a loss.

90. Liquidations

Where a company is liquidated either formally by a winding up under the Companies Act 1967 or informally such as the members of the company simply appropriating its assets to themselves, the distributions received are treated as a disposal by the members of their membership interests in the company. The definition of "dividend" in section 3(1) specifically excludes a liquidation distribution.

The tax treatment of the gain or loss on disposal of the membership interest by way of liquidation will depend on whether that interest is a business or investment asset of the member. Except where the interest forms part of the trading portfolio of a share-trader, the interest will be an investment asset so that any loss on disposal will only be taken into account to the extent of the member's gains on disposal of other investment assets (see section 62).

91. Incorporation and Liquidation Roll-Overs

This section identifies two situations in the corporate context where a disposal of an asset is not recognised for tax purposes. Both situations involve transfers where there is no substantial change in the ownership of the asset. The first situation is where a person transfers an asset to a company in exchange for a membership interest in the company and after the transfer the person has a 50% or greater membership interest in the company. In this situation, the transfer is not treated as a disposal of the asset for the purposes of the Order, and the company takes over the adjusted cost base of the transferor for the purposes of calculating any gain or loss to the company on a subsequent disposal of the asset. The cost base of the membership interest received in return is the adjusted cost base of the asset transferred less any liability transferred. The effect of section 91 is that the adjusted cost base of the asset is rolled over to the company and taxation of the gain or loss on the asset which has accrued prior to the transfer to the company is deferred until the company subsequently disposes of the asset. The application of section 91 in this situation is illustrated by the following example.

> Taxpayer who carries on business as a sole trader decides to incorporate the business. Taxpayer transfers a business asset with an adjusted cost base of M100,000 and a market value of M200,000 to X Pty Ltd in exchange for shares in the company. X Pty Ltd is wholly owned by Taxpayer.
>
> In the absence of this section, the transfer would give rise to business income includable in the gross income of Taxpayer under section 19. Under subsection (1), the transfer is not recognised for tax purposes. Subsection (2) provides that the company's cost base for the asset is Taxpayer's adjusted cost base of the asset at the time of the transfer, namely M100,000. If the company subsequently disposes of the asset for M300,000, then a gain of M200,000 is included in the business income of the company for the year of assessment in which the disposal occurs. The effect of subsections (1) and (2) is that taxation of the increase in value in the asset prior to the transfer to the company is deferred until the

company subsequently disposes of the asset. Under subsection (3), the shares received by Taxpayer in return for the transfer are given a cost base equal to the adjusted cost base of the asset transferred at the time of the transfer, namely M100,000.

The second situation to which this section applies is where a company is liquidated and an asset is transferred to a corporate member of the company which held a 50% or more interest in the company immediately prior to its liquidation. In this situation, the transaction will not amount to a disposal of the asset and the transfer is ignored in calculating the effects of the liquidation under section 90. The cost of the asset transferred is then carried over to the shareholder together with its business character.

Both roll-over provisions apply where a person has a 50% or more membership interest in the company at the relevant point in time. This 50-percent membership interest is satisfied through the ownership of membership interests possessing 50% of the total voting power of all classes of membership interests entitled to vote and at least 50 percent of the total number of membership interests of all other classes of membership interests in the company.

92. Reconstruction Roll-Over

In addition to the specific situations dealt with in the previous section, there are many variations on the theme and it is not possible to cover them all with specific legislation. Accordingly, this section provides a general roll-over relief for companies where reconstruction occurs without any significant change in the underlying ownership of the assets concerned. The regulations may provide for specific circumstances in which the requirements of this section are considered to have been met and for a procedure by which companies may obtain a ruling from the Commissioner that relief under this section is available.

93. Change in Control of Companies

A common form of tax avoidance involving companies is the transfer of tax losses or credits (for example, for ACT) through the medium of the sale of a company. The new owners being able to divert activity to the company the income from which is sheltered by the tax losses or credits. In order to prevent this avoidance, section 93 denies the carry forward of a loss, deduction, or credit by a corporate taxpayer where there has been a change of 50% or more in the underlying ownership or control of the company. An exception is provided where the company continues in the same business and does not engage in any new business or investment except with the permission of the Commissioner. The same-business exception must be satisfied for a period of three years after the change in majority underlying interests. This exception is common to many countries and is based on the view that a person who purchases a company and continues to conduct the same business has purchased the company for its business rather than for any existing or potential tax losses in the company.

94. Interpretation

This section defines "employer superannuation fund" and "self-provided superannuation fund", two terms used in Part IX of Chapter II in relation to the taxation of long-term savings. An "employer superannuation fund" is a resident superannuation fund established and maintained by an employer, which satisfies the conditions prescribed in the regulations. An employer superannuation fund is a fund established by an employer for the benefit of employees and their dependents. A "self-provided superannuation fund" is a resident superannuation fund, which satisfies the conditions prescribed in the regulations. In both cases, the superannuation fund must be a resident superannuation fund, that is, it must come within the definition of "resident fund" in section 8.

95. Contributions to an Employer Superannuation Fund

This section provides for deductions for employer and employee contributions to an employer superannuation fund. No deductions are allowed in respect of contributions made to a superannuation fund, which is not an employer superannuation fund, except for contributions which come within section 96 or 97.

Under subsection (1), an employer is entitled to a deduction for a contribution made to an employer superannuation fund in respect of a resident employee. A resident employee is entitled to a deduction under subsection (2) for contributions made to an employer superannuation fund. No deductions are allowed for employer contributions in respect of non-resident employees even if made to an employer superannuation fund, or for contributions made by non-resident employees to an employer superannuation fund. "Employer" and "employee" have their meanings in section 3(1). The residence of employees is determined in accordance with the tests in section 5.

The deductions allowed under subsections (1) and (2) are subject to the ceiling in subsection (3). The total amount allowed as a deduction under subsection (1) and (2) in respect of the same employee is 20% of the employment income paid by the employer to the employee during the year of assessment. Where the combined deductions exceed the ceiling in subsection (3), subsection (4) effectively provides that the employee's deduction under subsection (2) is allowed first in determining which deductions are denied as a result of the application of subsection (3). For example, suppose Employer pays Employee employment income of M100,000. Employer makes contributions to an employer superannuation fund of M15,000, and Employee makes contributions of M10,000. The combined contributions (M25,000) exceed 20% of Employee's employment income (M20,000). The effect of subsection (4) is that Employee is permitted a deduction for the whole of her contributions (M10,000), while Employer is only permitted a deduction for M10,000 of its contributions in respect of Employee. The other M5,000 of Employer contributions is non-deductible. If in this example, Employee had contributed M20,000 to the fund, then that would be fully deductible to Employee and Employer would be denied a deduction for the whole of its contributions.

96. Contributions to a Self-Provided Superannuation Fund

This section allows a resident individual a deduction for a contribution made to a self-provided superannuation fund during the year of assessment. As with section 95, a ceiling is imposed on the amount of the deduction allowed. A deduction is only allowed for contributions up to 20% of the individual's gross income for the year of assessment.

This section will mainly apply to resident individuals who are either self-employed or employees for whom no employer superannuation is available. The application of this section, however, is not confined to such persons and may also apply to resident individuals who provide for their own superannuation to "top-up" employer and/or own contributions made to an employer superannuation fund. In this situation, though, the ceiling for the deduction allowed under this section is reduced by any amount contributed with respect to the individual for which a deduction was obtained under section 95. This is intended to prevent employees avoiding the 20% ceiling in section 95 through the use of self-provided superannuation.

97. Contributions to Non-Resident Funds

The deductions allowed under sections 95 and 96 are only allowed for contributions to resident superannuation funds. This section provides deductions for contributions made to non-resident funds. By virtue of the definition of "non-resident" in section 3(1), a non-resident superannuation fund is a fund, which is not a resident fund within the definition in section 8.

Subsection (1) applies to contributions made to a non-resident superannuation fund by, or in respect of, of a resident of Lesotho (other than an expatriate taxpayer). Where the non-resident fund is an employer-based superannuation fund, deductions are allowed for employer and employee contributions in accordance with section 95. Consequently, the 20% ceiling applies to deductions for contributions made by, or in respect of, an employee. Where the fund is self-provided, deductions are allowed for contributions in accordance with section 96, subject to the 20% ceiling. A deduction is only allowed under subsection (1) if the trustee or fund manager has given the Commissioner an undertaking in writing that it will withhold tax at the rate specified by the Commissioner from any payments (periodic or lump sum) made to the resident individual (or dependents) in respect of whom the deductible contributions were made. Further, the fund must comply with the conditions prescribed in the regulations. These will largely be the conditions applicable to employer and self-provided superannuation funds modified to take account of the fact that the fund is non-resident.

Subsection (2) provides that sections 95 and 96 apply to contributions made to a non-resident superannuation fund by, or on behalf of, an expatriate taxpayer. An expatriate taxpayer is defined in section 3(1) to mean a resident individual (other than a citizen or permanent resident of Lesotho) who is employed or engaged under a technical services contract. There is no requirement that the trustee or fund manager give an undertaking to withhold tax in this situation.

98. Income of a Complying Superannuation Fund

This section provides that the income of a complying superannuation fund is exempt from Lesotho income tax. By virtue of the section 3(1) definition, a complying superannuation fund is an employer superannuation fund or a self-provided superannuation fund as defined in section 94. As both employer and self-provided superannuation funds are resident funds, the exemption in this section does not apply to Lesotho-source income derived by a non-resident fund.

99. Lump Sum Payments Made by a Superannuation Fund

This section provides that a lump sum payment made by a complying superannuation fund is subject to a flat rate of tax of 25% on the gross amount of the payment. This tax is collected by withholding under section 159, and the lump sum payment is not included in gross income. A lump sum payment made by a complying superannuation fund is exempt from income tax if it is rolled over into another complying superannuation fund (for example, from an employer superannuation fund to a self-provided fund on retirement from employment). In this situation, the tax payable under this section is deferred until a subsequent payout (lump sum or periodic) by the other complying superannuation fund). Similarly, a lump sum payment made by a complying superannuation fund is exempt from income tax if it is used to purchase an annuity. In this situation, the amount of each annuity payment is included in gross income under section 17. For tax to be deferred, the lump sum must be rolled over into another complying superannuation fund or used to purchase an annuity within 90 days of the payment being made.

A lump sum payment made by any other superannuation fund, including a non-resident fund, is included in the gross income of the recipient and taxed at normal marginal rates.

100. Income of Life Assurance Business

This section provides that the income of the life assurance business of a taxpayer is exempt from income tax. The amount of the income exempt under this section is to be calculated in accordance with the regulations. The treatment of income of life assurance businesses is largely unchanged from that applicable under the 1981 Act.

101. Proceeds of a Life Assurance Policy

This section exempts from income tax the proceeds of a life assurance policy paid by a life assurance company. The exemption is only available to the extent that the proceeds are attributable to premiums for which a deduction was not allowed. Generally, deductions are not available for premiums paid under life assurance policies. Deductions may be obtained, though, where the policy is taken out by an employer over an employee. In this situation, the proceeds are taxable to the recipient under section 19.

102. Compulsory Savings

Subsection (1) preserves the existing exemption for amounts deducted from salary or wages under section 3 of the Compulsory Savings Act. This exemption is consistent with the deduction for contributions to superannuation funds under sections 95 and 96.

Subsection (2) preserves the existing exemption for amounts paid under section 5 of the Compulsory Savings Act, but only for payments made before 1 April 1994. After that date, payments made under section 5 of the Compulsory Savings Act are included in gross income and subject to tax at the usual marginal rates.

103. Source of Income

This section provides a comprehensive set of source rules. Paragraphs (a)-(m) of subsection (1) provide rules for identifying whether income is Lesotho-source income. This is particularly relevant for the taxation of non-residents, as only Lesotho-source income is included in the gross income of a non-resident taxpayer under section 17(3), or subject to withholding tax under section 107. The basic rule is in paragraph (a), which provides that income derived from an activity, which occurs in Lesotho, is Lesotho-source income. For example, income from an employment exercised, or business carried on (including services rendered), in Lesotho is Lesotho-source income. It is intended that the rule in paragraph (a) applies unless a more specific rule in one of the other paragraphs applies. Any income, which is not Lesotho-source income, is treated as foreign-source income under subsection (2). This is particularly relevant to the foreign tax credit allowed to residents under section 105, as credit is only allowed for foreign tax paid in respect of foreign-source income.

There are very few source rules in the 1981 Act. In most cases under that Act, source is determined according to general principles as developed in decisions of the courts of the United Kingdom and the Republic of South Africa. The problem with relying on judicial rules is that they often focus on formal acts, and, therefore, tend to be easily manipulated by taxpayers. It is particularly important that Lesotho, as a capital-importing country, have clearly defined source rules, which are designed to protect the tax base Lesotho asserts over non-residents. It is for this reason that the new law contains a comprehensive set of source rules.

104. Foreign Employment Income of Residents

Income from employment exercised in a foreign country by a resident individual is exempt from income tax where the income is chargeable to tax in the foreign country. The exemption is not available where the income is Lesotho-source income. For example, under the source rule in section 103(1)(b), income from an employment exercised in a foreign country under a contract with the Lesotho Government is Lesotho-source income. Similarly, under the source rule in section 103(1)(c), income derived by a resident of Lesotho from services performed as a member of a crew of an aircraft is Lesotho-source income even though some part of the service is performed outside Lesotho. Such income would not qualify for exemption under section 104.

The exemption in section 104 is only available in respect of employment income. Income derived in a foreign country, as an independent contractor will not qualify for exemption.

The exemption is conditional on the overseas employment income being chargeable to tax in the foreign country of service. If the income is exempt in the country of service, then Lesotho asserts full jurisdiction to tax the income. Income which is untaxed in the country of source because it falls below the tax-free threshold (as may be the case with some Lesotho mine-workers in South Africa) is regarded as being chargeable to tax in the foreign country of source.

Under section 11(2) of the 1981 Act, Lesotho asserts jurisdiction to tax citizens and permanent residents on worldwide income, subject to a foreign tax credit under section 11(4). This means, for example, that the income of Lesotho citizens working in the mines in South Africa is subject to Lesotho tax under current law. For administrative and policy reasons, though, this liability is not enforced. Section 104 gives legislative force to the current practice in relation to Lesotho residents working in South African mines. While these persons will be the main beneficiaries of the exemption, it is not confined to mine-workers. Nevertheless, the policy of the exemption has been developed largely with such workers in mind.

105. Foreign Tax Credit

A simple foreign tax credit system calculated on a global basis is provided for in section 105 as the general method of relief from international double taxation. The calculation of the foreign tax credit is made in Maloti, which requires application of the currency exchange rules in section 66. Under subsection (1), a resident taxpayer is entitled to a foreign tax credit against liability to Lesotho income tax for foreign income tax borne by the resident on foreign income subject to Lesotho income tax.

The credit is only available in respect of foreign tax borne by a resident taxpayer on foreign income subject to Lesotho income tax. No credit is allowed, therefore, for foreign taxes paid in respect of foreign-source income, which is exempt from Lesotho income tax (for example, overseas employment income exempt under section 104, and the foreign property income of expatriate taxpayers exempt under section 24).

Whether or not income is "foreign-source income", is determined under section 103(2). The fact that the income is regarded as sourced in a foreign country under the tax law of that country is irrelevant in determining whether income is foreign-source income.

Credit is only allowed for "foreign income tax". It is intended that the list of creditable foreign taxes published by the United Kingdom Inland Revenue for the purposes of the foreign tax credit of that country apply for the purposes of this section. This list is not intended to be exhaustive and particular taxes will be looked at on a case-by-case basis. To be considered an "income tax" the tax base must be net income or gain, although credit will be allowed in respect of a foreign withholding tax (subsection (6)). A foreign tax levied in circumstances where the foreign country increases the rate of tax to "soak-up" Lesotho income tax is expressly excluded by subsection (6) from being a foreign income tax.

A credit is only allowed for those foreign taxes "directly borne" by the resident taxpayer. This is generally a reference to the legal incidence of the foreign tax. Under paragraph (a) of subsection (4), any foreign income tax borne by a partnership is treated as borne by the partners. This is consistent with the general principle that partnership income is taxed to the partners. The amount of the credit allowed to each partner depends on the application of section 77 (see the Commentary to that section). Under paragraph (b), any foreign income tax borne by a trustee in respect of foreign-source income included in the gross income of a resident beneficiary is treated as borne by the beneficiary; and similarly under paragraph (c), any foreign income tax borne by a beneficiary in respect of foreign-source income included in the chargeable trust income of a trustee is treated as borne by the trustee.

Subsection (2) limits the amount of the foreign tax credit to the Lesotho income tax on the foreign-source income. This is calculated by applying the average rate of Lesotho income tax to the foreign-source income reduced by any deduction properly allocated to the income. The average rate of Lesotho income tax is the Lesotho income tax on the taxpayer's chargeable income (before allowance of the foreign tax credit) as a percentage of that income.

The calculation of the foreign tax credit limit is made on a global basis, although under subsection (3) separate limits apply to foreign business and other income of the taxpayer. This is to ensure that low-taxed foreign income (particularly property income) is not used to average down high rates of tax on foreign business income.

The Commissioner will use Part XI of Chapter II against a taxpayer who has entered into a transaction which has the effect of maximising the foreign tax credits and minimising Lesotho income tax, particularly through manipulation of source rules and the allocation of deductions.

A resident taxpayer with an excess foreign tax credit for a year of assessment is not allowed to carry the excess forward. The calculation of the credit limit on a worldwide basis and the current rates of tax in Lesotho are such that it is unlikely that many taxpayers would find themselves in an excess credit situation. Where a taxpayer is allowed both a foreign tax credit and a credit for advance corporation tax, the foreign tax credit is allowed first (as excess ACT credits can be carried forward). This should further ensure that there is little wastage of foreign tax credits.

The operation of the foreign tax credit and the need for separate credit limits for business and property income is illustrated by the following example.

> Lesotho Traders Pty Ltd operates a wholesaling business in Lesotho with branches in Zimbabwe and Namibia. For the 1993/94 year of assessment, Lesotho Traders had a chargeable income of M1,000,000, of which M200,00 was derived from sales through the Zimbabwe branch (on which Zimbabwe tax of M85,000 was paid) and M100,000 from sales through the Namibian branch (on which M42,000 in Namibian tax was paid). Lesotho tax on chargeable income is M400,000, and the issue is the amount of the foreign tax credit allowed for the Zimbabwe and Namibian taxes.
>
> The amount of foreign tax credit allowed is limited to the Lesotho tax on foreign income which is M120,000 (M300,000 x 40%). The total foreign tax paid is M127,000, and therefore, M7,000 of foreign tax goes uncredited. The total Lesotho tax paid is M280,000, and the total foreign tax paid is M127,000 giving a total tax payment of M407,000.
>
> Assume that M50,000 of Lesotho-source income was interest on deposits with the Lesotho Bank. If the deposits were with a bank in the United Kingdom, then the M50,000 of interest would be foreign income and subject to UK tax of M12,500. Total foreign income is now M350,000 on which total foreign tax of M139,500 has been paid. In the absence of a separate limit for business and other income, the foreign tax credit allowed would be M140,000. Consequently, all the foreign tax would be creditable with the high rates of foreign tax on branch profits being averaged down by the low rate of tax on the interest income. Total Lesotho tax paid is M260,500, and total foreign tax paid is M139,500, giving a total tax of M400,000. By moving the source of the interest income (a highly mobile class of income) offshore, Lesotho Traders has managed to reduce both its overall tax liability and its Lesotho liability.
>
> To avoid such manipulation of the foreign tax credit limit, foreign income is put into two baskets: business income and other income; and a separate calculation of the credit limit is made for each. The credit limit for the foreign business income of Lesotho Traders is M120,000 with M7,000 of foreign tax uncredited as outlined above; while the credit limit for other foreign income is M20,000 (M50,000 x 40%) with the full amount of UK tax being creditable. The overall position is the same as above where the interest income had been derived in Lesotho.

106. Tax Havens

Where a resident of Lesotho has entered into a transaction which has the direct or indirect effect of arranging that income which would otherwise have been derived by the resident is derived as foreign-source income of a non-resident company which is connected with a tax haven, this section gives the Commissioner power to make any adjustment to the income and foreign tax credit position of the resident so as to reverse the effect of the transaction. In particular, the Commissioner could "look through" the tax haven company and treat its income as that of the resident controller.

Under subsection (2), a foreign country may be treated by the Commissioner as a tax haven if the country has effective rates of tax significantly lower than those in Lesotho, or bank and commercial secrecy laws which conceal the identity of the real owner of any asset or income. Subsection (3) provides that a country will not be regarded as a tax haven if Lesotho has entered into a double tax treaty with the country. Currently, Lesotho has entered into double tax treaties with the United Kingdom and the Republic of South Africa. Some countries (such as the UK) have published lists of tax havens and it is intended that the Commissioner will have regard to those lists when exercising the power under this section.

107. Withholding Tax on International Transactions

It is common practice internationally for source countries to levy withholding tax on most types of property income paid to non-residents. Taxation by withholding is necessary because of the difficulties which source countries experience in enforcing tax liabilities once the income has left the jurisdiction. Under the 1981 Act, withholding tax is only levied on dividends and interest paid or credited to non-residents, and therefore, no withholding tax is levied on royalties or management fees. While Lesotho-source royalties and management fees are subject to tax by assessment under current law, the source rules relevant to such income have been easily manipulated. Consequently, there is a clear incentive under current law to structure related party transactions so that what is derived by the non-resident is foreign source royalties or management fees. The use of management fees has been a particularly effective means for non-resident parent companies to get profits out of Lesotho subsidiaries free of Lesotho tax. The new law extends the classes of income to which withholding tax applies to royalties, natural resource payments, and management fees. This will eliminate the use of royalties and management fees as a means of avoiding Lesotho tax.

Under subsection (1), withholding tax at the standard rate of tax (25%) is imposed on the gross amount of a Lesotho-source dividend, interest, royalty, natural resource payment and management charge (each of which is defined in section 3(1)) paid to a non-resident. A lower rate of withholding may apply under a double tax treaty entered into by the Government of Lesotho. Withholding tax is payable when the relevant income is paid to the non-resident. Under the definition of "paid" in section 3(1), this includes an amount credited to the non-resident. Further, where the income is interest in the form of a discount or premium, subsection (4) provides that the liability for withholding tax arises at the time the discount or premium accrues. This is consistent with the tax accounting rule in section 57.

A person is a non-resident if the person is not a resident under Part II of Chapter II. A payment made to a non-resident partnership is subject to withholding tax under this section. A payment made to a trust to which a non-resident beneficiary is presently entitled is subject to withholding tax. The source of income is determined according to the rules in section 103. While withholding tax under this section is imposed on the non-resident payee, section 161 provides for collection of the tax from the payer of the income.

As under current law, the liability for withholding tax arises regardless of whether the income is paid by a resident or a non-resident. The key requirement is that Lesotho-source income of the type listed is paid to a non-resident. It is noted that under section 6(2), the Lesotho branch of a non-resident company is treated as a separate taxpayer being a resident company for the purposes of Lesotho income tax.

Subsection (1) is expressed to be subject to the rest of the section. Subsection (2) provides that no withholding tax is payable on Lesotho-source dividends paid out of manufacturing income to which the concessional rate in section 10(2) applies. Where the company paying the dividend has both manufacturing and other income, it is intended that the company be treated as having paid the dividend out of the manufacturing income first. This is consistent with the dividend-ordering rule applicable to the ACT provisions in section 87(3).

Subsection (3) provides for a lower rate of withholding (15% of the gross payment) on royalties paid in respect of technology used by the paying company in the production of manufacturing income to which the concessional rate of income tax applies. This only applies to royalties paid in respect of rights to use the actual manufacturing process. It does not apply, for example, to royalties paid for use of brand names or for marketing intangibles related to manufactured goods.

The effect of subsection (5) is that no withholding tax is payable in respect of a dividend, interest, royalty, natural resource payment or management charge paid to a trustee where no beneficiary is presently entitled to the income. This is because such a payment (being Lesotho-source income) is included in chargeable trust income under section 83 or 84 and is taxed to the trustee.

The Minister of Finance has power under subsection (6) to exempt interest from withholding tax where it is in the public interest to do so. In determining whether to give a notice under this subsection, the Minister must have regard to the economic and other benefits likely to accrue to Lesotho from the exemption and to the recommendation of the Commissioner. The power to exempt interest under subsection (6) applies to a single payment of interest, a payment of interest under a transaction, and a payment of interest under a series of transactions.

108. Services Income Paid to a Non-Resident

This section imposes withholding tax at the rate of 10% on the gross amount of a payment made to a non-resident under a Lesotho-source services contract. Withholding tax is payable when the relevant income is paid to the non-resident. Under the definition of "paid" in section 3(1), this includes an amount credited to the non-resident. A non-resident is any person who is not a resident of Lesotho under Part II of Chapter II, and includes a payment made to a non-resident partnership.

For withholding tax to be payable, the payment must be made under a "Lesotho-source services contract". This is defined to mean a contract (other than an employment contract) under which the primary purpose is the performance of services giving rise to Lesotho-source income. Services income is Lesotho-source if -

(1) the services are performed in Lesotho (section 103(1)(a));

(2) the services are performed under a contract entered into with the Lesotho Government as defined in section 3(1) (section 103(1)(b)); or

(3) the services are transportation services within section 103(1)(c) (this will include, for example, services performed by contract drivers who are residents of Lesotho in transporting goods between Lesotho and the Republic of South Africa).

This section does not apply to a Lesotho-source management charge. It is intended that these be subject to withholding tax at the higher rate of 25% under section 107.

Withholding tax imposed under this section is on the gross amount of the payment. No deduction is allowed for expenses or losses incurred in deriving the services income, unless the non-resident elects to be taxed by assessment under section 109.

While the tax is imposed on the non-resident payee, section 161 provides for collection of the tax from the payer.

109. Nature of Tax Imposed

This section provides that withholding tax imposed under section 107 or 108 is a final tax unless the non-resident files a return and elects to be taxed by assessment. If an election to be taxed by assessment is made, the non-resident may claim deductions for expenses and losses incurred in deriving the income subject to withholding tax but, in the case of expenses, only if the expense is Lesotho-source income in the hands of the person to whom it is paid. A non-resident who elects to be taxed by assessment is entitled to a credit for the withholding tax paid. The rate of tax applicable to a non-resident electing to be taxed by assessment is that specified in the Fourth Schedule, namely 40%.

110. Agents for Non-Residents

This section provides for a mechanism for collection of tax at source in relation to payments of Lesotho-source income made to a non-resident which are not covered by section 107 or 108. Prior to a person making such a payment, the person is required to give notice to the Commissioner of the circumstances and amount of the payment and withhold an amount from the payment representing tax due, or which may become due, by the non-resident, as advised by the Commissioner.

111. Taxation of Branch Profits

Where a foreign parent company has a subsidiary in Lesotho, income tax is levied on the worldwide profits of the subsidiary, and withholding tax is levied on any dividends paid by the subsidiary. To equate the tax treatment of subsidiaries and branches operated by non-resident companies in Lesotho, a branch is taxed as if it is a separate person which is a resident company (that is, on worldwide income); and under this section, the branch is subject to tax at the standard rate of tax (25%) on repatriated income. This is defined in subsection (2) to mean the chargeable income of the branch less Lesotho income tax paid on that chargeable income and less any profits reinvested in Lesotho. A repatriation of money by a branch is treated for tax purposes as having been made first out of branch income regardless of how it may be treated in the records of the branch.

112. International Agreements

This section provides a reconciliation rule to resolve any inconsistencies between the terms of the Order and the terms of any treaty (such as a double tax treaty) or international agreement to which Lesotho is a party. Under this section, in the event of inconsistency, the terms of the treaty or international agreement prevail over the Order apart from the application of the general anti-avoidance provisions in Part XI of Chapter II.

113. Transfer Pricing

Transfer pricing is used (most commonly in the international context) to shift tax liabilities among associated taxpayers to obtain the best overall tax outcome. This section gives the Commissioner broad powers to distribute, apportion, or allocate income, deductions, or credits between associated taxpayers to prevent the evasion of Lesotho tax or to clearly reflect the income of such taxpayers. This includes adjusting the income arising from the transfer of intangible property between associates so that it is commensurate with the income attributable to the intangible.

As transfer pricing often involves the recharacterisation of income or manipulation of source rules, this section gives the Commissioner power to recharacterise the source and nature of any income or loss.

114. Recharacterisation of Income and Deductions and Reimbursement Agreements

This section gives the Commissioner broad powers to recharacterise elements of transactions entered into as part of a tax avoidance scheme, to disregard for tax purposes a transaction which does not have substantial economic effect, and recharacterise a transaction where the form does not reflect the substance.

115. Interpretation

This section provides definitions of the main terms used in Chapter III. Those definitions that are not self-explanatory are discussed below.

"Employee": this term includes an associate of an employee but does not include a domestic assistant. As the term is defined inclusively, the general definition of "employee" in section 3 is intended to apply for the purposes of FBT. The definition is central to the operation of FBT as only fringe benefits provided to an employee are subject to FBT.

The inclusion of associates ensures that fringe benefits provided by an employer directly to, for example, the spouse, children, or family company or trust of an employee will be subject to FBT. The definition specifically excludes a domestic assistant from being an employee for the purposes of FBT. While such a person is an employee of the family he or she works for under the general definition in section 3, it is not intended to impose the compliance burden of FBT on such employers. This is consistent with the exemption of such employers from making PAYE deductions under section 156(1). Any fringe benefits provided to a domestic assistant are included in that person's employment income under section 18, although such a person may not be required to file a return under section 129(a).

"employer": this term includes an associate of an employer. As with the definition of employee, "employer" is defined inclusively with the intention that the general definition in section 3 apply for the purposes of FBT. The inclusion of associates ensures that fringe benefits provided by an associate of an employer (for example, a related company) to an employee of the employer are subject to FBT in the hands of the employer. This rule is only relevant where the benefit provided by the associate is not a reward for services rendered by the employee to the associate.

"medical expenditure": this term is defined to include a premium or other amount paid for medical insurance. As the term is defined inclusively, it will have its ordinary meaning, namely an amount paid for medical treatment both preventative and curative. It is intended that "medical" be interpreted broadly and would include dental treatment. The definition is relevant to the identification of medical fringe benefits.

"tax-exempt employer: this term is defined to mean an employer whose income is not subject to tax. This includes the Lesotho Government (other than statutory corporations subject to tax) and exempt organisations. An exempt organisation is still considered a tax-exempt employer even though it may be liable for income tax under section 25 on some part of its income. The definition specifically excludes a public international organisation exempt from income tax under section 21, and an employer exempt from income tax under a treaty or international agreement pursuant to section 112. The definition is relevant to FBT payable in respect of excessive superannuation benefits.

116. Fringe Benefits Tax Imposed

Subsection (1) imposes FBT on every employer who has a fringe benefits taxable amount. The "fringe benefits taxable amount" of an employer is determined under section 117.

As stated above, it is intended that the definition of "employer" in section 3(1) apply for the purposes of FBT. Consequently, every person who employs or remunerates an employee is liable for FBT. Through the definitions of "employee" and "employment" (referred to in the definition of "employee"), FBT will apply to a person who remunerates an office holder (for example, a director) where that remuneration includes fringe benefits. FBT, however, will not apply to a services relationship which is properly characterised as that of independent contractor.

Through the definition of "person" in section 3(1), a partnership, government, or political subdivision of a government (such as a local council) may be an employer for the purposes of FBT. While these bodies are not taxpayers for the purposes of income tax, they may be taxpayers for the purposes of FBT. This is consistent with their obligations under the PAYE provisions. In the case of a partnership, it will be liable for FBT on benefits provided to employees, but not on benefits enjoyed by the partners. While a public international organisation is also a person for the purposes of the Order, it is exempt from FBT under section 21. Subject to section 22, fringe benefits provided to employees of a public international organisation will be subject to section 18 of the Order.

A person is an employer for the purposes of FBT regardless of the person's residence, although under section 118(b) no FBT is payable on benefits provided in respect of employment income which is not subject to tax in Lesotho.

Subsection (2) provides that the amount of FBT payable by an employer is determined by applying the FBT rate (40%) to the fringe benefits taxable amount of the employer.

117. Fringe Benefits Taxable Amount

This section defines "fringe benefits taxable amount" to mean the amount calculated in accordance with the following formula -

$$\mathbf{A \times \frac{1}{1 - B},}$$

where A is the sum of the taxable values of all fringe benefits (other than exempt fringe benefits) provided by the employer to all employees during the year of assessment and B is the rate of FBT provided for in the Fourth Schedule, namely 40%. Sections 119-127 identify the fringe benefits to which FBT applies, and for each benefit a valuation rule is provided for determining the taxable value of the benefit.

The effect of this formula is to gross-up the taxable value of fringe benefits by the amount of FBT so that the FBT rate is levied against the grossed-up amount. The employer is then allowed a deduction for FBT paid. In this way, fringe benefits are taxed in the same way as employment income under the PAYE provisions. For example, assume that the sum of the taxable values of all fringe benefits provided by Employer during the year of assessment is M100,000. The fringe benefit taxable amount is -

$$\text{M}100{,}000 \times \frac{1}{1 - 0.4} = \text{M}166{,}666.$$

FBT payable is M66,666 (M166,666 x 40%) and this amount is fully deductible to Employer.

118. Exempt Fringe Benefits

This section identifies three classes of exempt fringe benefit. First, paragraph (a) refers to those fringe benefits specifically exempt under sections 123(3) and 124(3). These benefits are exempted from FBT as they are considered to be socially desirable.

Secondly, paragraph (b) refers to a fringe benefit, which relates to exempt employment income. This would cover, for example, a benefit provided to a resident employee in respect of foreign employment the income from which is exempt under section 104, and a benefit provided to an employee whose employment income is exempt under a treaty or other international agreement referred to in section 112.

Thirdly, paragraph (c) refers to de minimis benefits, that is, benefits whose value is so small as to make it unreasonable or administratively impracticable to account for them for tax purposes. In determining whether it is unreasonable or impracticable to account for the benefit, regard must be had to the frequency with which the benefit is provided to the particular employee and to other employees. A small value fringe benefit provided to an employee regularly (for example, every week) would not normally be considered an exempt fringe benefit under paragraph (c), nor would a small value fringe benefit provided to a large number of employees (where it is not unreasonable to account for it). Examples of fringe benefits which may qualify for exemption under paragraph (c) include occasional departmental or celebratory lunches or dinners, occasional cocktail parties or firm picnics, birthday cakes for employees, or one-off private use of a car.

The exemption from FBT is carried through to the income tax under section 18(b). Consequently, an employee in receipt of an exempt fringe benefit will not be required to include the value of the benefit in employment income.

119. Car Fringe Benefit

Under subsection (1), a motor vehicle which is provided by an employer for the private use of an employee or which is available to the employee for private use is a car fringe benefit. The reference to "motor vehicle" is intended to cover a motor car, station wagon, panel van, utility, or similar vehicle. Private use includes any use, which is not exclusively for the business purposes of the employer. For example, the use of a motor vehicle to travel to and from the employee's place of work would be regarded as private use. An employee does not actually have to use the motor vehicle for private purposes for there to be a car fringe benefit, the availability of the vehicle for private use being enough. A motor vehicle is considered to be available for private use, for example, if the employee is entitled to use the vehicle for private use, it is kept or garaged at or near the employee's place of residence, or the employee has custody or control of the vehicle while not performing his or her duties of employment. Where an employer places a prohibition on an employee's private use of a motor vehicle but that prohibition is not consistently enforced by the employer, the vehicle may still be treated as being used for private purposes despite the prohibition.

The taxable value of a car fringe benefit is provided by the statutory formula in subsection (2). Broadly, the taxable value is 15% of the market value of the car at the date it was first provided for private use. This is the case regardless of whether the vehicle is owned or leased by, or otherwise available to, the employer. It is intended that the market value of second-hand cars will be determined having regard to valuation books published by motor vehicle traders associations. This amount is prorated where the vehicle is not used for private purposes or available for such use on some part of every day of the year of assessment. For example, if a vehicle is only used or available for private use on weekends, the fraction for proration is 104/365. If the motor vehicle is used or available for private use on some part of day, then the whole of the day counts as a day of private use. The taxable value is reduced by any payment made by the employee to the employer for private use of the car, such as rent.

120. Housing Fringe Benefit

Under subsection (1), the provision of accommodation or housing by an employer to an employee is a housing fringe benefit. This is intended to cover a lease or licence granted by an employer to an employee to occupy or use a house, flat, unit, caravan, mobile home, bunkhouse or living quarters. It also includes the payment or reimbursement by an employer of hotel, guesthouse, or hostel accommodation for an employee.

The taxable value of a housing fringe benefit is provided in subsection (2) as the open market rent of the accommodation or housing. In the case of hotel or similar accommodation, the tariff charged by the hotel for the room occupied by the employee would normally be treated as the open market rent of the accommodation. The taxable value is reduced by any payment made by the employee (such as rent) for the benefit.

Subsection (3) provides a ceiling on the taxable value of a housing fringe benefit. The taxable value is not to exceed 20% of the remuneration paid by the employer to the employee for the year of assessment in which the benefit is provided. The reference to "remuneration" rather than employment income is intended to ensure that the value (as determined under the FBT provisions) of fringe benefits provided to the employee is taken into account in applying the ceiling.

121. Utilities Fringe Benefit

Under subsection (1), the reimbursement or discharge by the employer of an employee's utilities expenditure is a utilities fringe benefit. "Utilities expenditure" is defined in section 115. The taxable value of a utilities fringe benefit is provided in subsection (2) as the amount of such expenditure which is reimbursed or discharged by the employer.

122. Domestic Assistance Fringe Benefit

Under subsection (1), the provision by an employer to an employee of a housekeeper, chauffeur, gardener, or other domestic assistant (other than a security guard) is a domestic assistance fringe benefit. An employer may provide such benefit either by meeting the cost of the domestic assistant directly or reimbursing the employee for such cost. The taxable value of a domestic assistance fringe benefit is the total remuneration paid to the domestic assistant for services rendered to the employee. The reference to "remuneration" rather than employment income is intended to ensure that the value (as determined under the FBT provisions) of fringe benefits provided to the domestic assistant are taken into account in calculating the taxable value of such benefit. The taxable value is reduced by any payment made by the employee for the benefit.

123. Meal or Refreshment Fringe Benefit

Under subsection (1), the provision by an employer to an employee of a meal or refreshment is a meal or refreshment fringe benefit. This is intended to cover a meal or refreshment provided either at the employee's place of work (for example, in an executive dining room), or at a restaurant or cafe. "Refreshment" is intended to be interpreted broadly and would include the provision of drinks. A meal or refreshment is provided by an employer where the employer meets the cost of the meal or refreshment, or reimburses an employee for costs incurred by the employee for a meal or refreshment.

Although all fringe benefits are subject to the de minimis exception in section 118(c), it is expected that it will most commonly apply to meal or refreshment fringe benefits. Refer to the Commentary to section 118 for examples of situations where the de minimis exception may apply in relation to the provision of a meal or refreshment.

Subsection (1) is expressed to be subject to subsection (3) which treats as an exempt fringe benefit a meal or refreshment provided in a canteen, cafeteria, or dining room (referred to below as a "facility") operated by or on behalf of an employer solely for the benefit of employees and which is available to all non-casual employees on equal terms. "Canteen", "cafeteria", and "dining room" are intended to have their ordinary meaning and, in particular, "canteen" is intended to include a bar operated by an employer. It is not necessary that the facility be on the employer's business premises provided it is operated by or on behalf of the employer. The reference to "operated...on behalf of the employer" is intended to cover, for example, a facility operated by an associate company of the employer, which is available to all employees of the corporate group. To qualify for the exemption, the facility must be available to all non-casual employees of the employer on equal terms. Consequently, a facility which is only available to senior employees will not qualify for the exemption, nor will a facility available to all non-casual employees but with entitlements depending on seniority. Rules for determining who is a non-casual employee will be provided in regulations.

Where a meal or refreshment fringe benefit is provided, subsection (2) provides that the taxable value of the benefit is the cost to the employer of providing the meal or refreshment less any payment made by the employee for the meal or refreshment.

124. Medical Fringe Benefit

Under subsection (1), the reimbursement or discharge by an employer of an employee's medical expenses is a medical fringe benefit. "Medical expenditure" is defined in section 115. Where a medical fringe benefit is available to all non-casual employees on equal terms, the benefit is treated as an exempt fringe benefit. Rules for determining who is a non-casual employee will be provided in regulations. The taxable value of a medical fringe benefit is provided in subsection (2) as the amount of the reimbursement or discharge.

125. Loan Fringe Benefit

Under subsection (1), a loan provided by an employer to an employee at an interest rate, which is below the Central Bank of Lesotho discount rate, is a loan fringe benefit. "Loan" is intended to be interpreted broadly covering an advance of money, provision of credit or other financial accommodation, or any transaction which in substance effects a loan of money.

The taxable value of a loan fringe benefit is provided in subsection (2) as the difference between the actual interest paid by the employee during the year of assessment and the interest which would have been paid had the interest rate been equivalent to the Central Bank of Lesotho discount rate.

126. Debt Waiver Fringe Benefit

Under subsection (1), the waiver of an obligation of an employee to pay or repay an amount owing to the employer or a third party is a debt waiver fringe benefit. The reference to the waiver of employee debts to third parties is intended to cover a situation where the employer discharges the employee's obligation to a third party with no obligation for the employee to reimburse the employer.

The taxable value of a debt waiver fringe benefit is provided in subsection (2) as the amount of the payment or repayment waived.

127. Excessive Superannuation Contributions

Under subsection (1), superannuation contributions made by a tax-exempt employer (as defined in section 115) which, if the employer were taxable, would not be allowed as a deduction as a result of the application of the ceiling in section 95(3) are an excessive superannuation contributions fringe benefit. The taxable value of such benefit is the amount of the contribution which would not have been allowed as a deduction if section 95 applied.

128. Filing of Return of Income

Subsection (1) obliges every taxpayer and every nominated officer of a partnership or trust to file a return of income for each year of assessment. Under the section 3(1) definition of "taxpayer", every person who is subject to income tax in Lesotho is a taxpayer for the purposes of this section. By virtue of section 4, this means an individual, trustee, company, or non-resident who has chargeable income for the year of assessment. For a trustee with chargeable trust income, this will be a separate return from the trust return unless the whole of the trust income is chargeable trust income. In the case of an individual, the obligation to file a return is subject to section 129, which identifies certain resident individuals who are not obliged to file a return. The obligation to file a partnership, trust, or company return falls on the nominated officer of the relevant entity as determined in accordance with section 211.

While partnerships and trusts are not separate taxpaying entities, partnership and trust returns are necessary for the purposes of auditing the separate returns of the partners or beneficiaries. In particular, these returns identify income and deductions taken into account in calculating partnership or trust income or loss. This is important, for example, in calculating the amount of any tax credits attaching to income passed through to partners or beneficiaries, and for the application of section 47 to partners or beneficiaries. Generally, elections, notices, or statements required to be filed in respect of the activities of a partnership or trust would be included in the partnership or trust return.

The obligation to file a partnership or trust return arises where the partnership or trust derives Lesotho-source income and/or has Lesotho resident partners or beneficiaries. Where the Lesotho resident partners of a partnership have minority interests and the partnership only derives foreign source income, the Commissioner may regard the returns of the Lesotho resident partners as satisfying the obligation to file a partnership return. Similarly, where the Lesotho-resident beneficiaries have only small fixed interests in the trust and the trust only derives foreign source income, the Commissioner may regard the returns of the Lesotho resident beneficiaries as satisfying the obligation to file a trust return.

A return required to be filed under subsection (1) must be filed no later than the last day of the third month following the end of the year of assessment, which for most taxpayers is 30 June. Where a corporate taxpayer has permission to use a substituted accounting period, then that period is the taxpayer's year of assessment for the purposes of the Order (section 49). Consequently, such a taxpayer is obliged to file a return by the last day of the third month following the end of the substituted accounting period. The Commissioner may extend the due date for filing a return of income under section 131. A person who fails to file a return of income as required by subsection (1) is guilty of an offence under section 175 and is liable for additional tax under section 193.

As section 128 fixes the same date each year for the filing of returns, it will no longer be necessary for the Commissioner to publish a notice each year calling for the filing of returns. While the Commissioner may continue this practice, the notice has no legal effect and the absence of such a notice being published will not be an excuse for failing to file a return by the due date.

The Commissioner is empowered under subsection (3) to require a taxpayer to file a return for a period which is less than the year of assessment in the circumstances set out in that subsection.

Subsections (2), and (4)-(6) set out the formal requirements as to contents and place of filing of returns.

129. Cases Where Return Not Required

This section describes those taxpayers who are not obliged to file a return. Under paragraph (a), a resident individual whose gross income for the year of assessment is less than the amount of the abatement allowed to the individual under section 73 is not obliged to file a return. This applies to a resident individual entitled to the single abatement with a gross income of less than M6,240 and a resident individual entitled to a married abatement with a gross income of less than M7,992. This paragraph will also apply to a resident individual whose only income for the year of assessment is subject to a final withholding tax as such income is not included in gross income. This would include, for example, an individual whose sole income is interest paid by a Lesotho-resident financial institution to which section 158(2) applies.

Under paragraph (b), a resident individual is not obliged to file a return where the gross income for the year of assessment of the individual (other than income subject to a final withholding tax) consists exclusively of -

(i) employment income of less than M50,000 derived from a single employer from which tax has been withheld by the employer under section 156; or

(ii) a pension from which tax has been withheld by the trustee or fund manager under section 159.

In these classes of case, the tax withheld at source will be largely equal to the final liability of the employee or pensioner. It is for this reason that paragraph (b) excuses a resident individual in receipt of such income from the obligation to file a return.

This section only applies where the taxpayer's employment income is less than M50,000 and has been derived from a single employer. A taxpayer's employment income for the purposes of applying this threshold is determined in accordance with section 18, and therefore, does not include fringe benefits subject to FBT as these are separately taxed to the employer. Where a resident individual derives employment income from more than one employer during the year of assessment (for example, the taxpayer has a second job or changes jobs during the year of assessment), it is not certain that the total amount of tax withheld will equal the taxpayer's total liability for the year, and therefore, the taxpayer is obliged to file a return and pay any additional tax due or seek a refund of tax overpaid. For the same reasons, this section does not apply to a taxpayer in receipt of more than one pension during the year of assessment.

There is one situation where this section will apply even though the taxpayer has derived income other than employment or pension income, namely where that other income is subject to a withholding tax which is a final tax. As the income to which the final withholding tax applies does not affect the liability on the taxpayer's other income, this section continues to apply to such a taxpayer. Under the Order, there are two classes of income for which tax withheld is a final tax for resident individuals, namely interest income paid by a resident financial institution (section 158) and a lump sum superannuation payment from a complying superannuation fund (section 159). This means, for example, that a resident individual whose only income for the year of assessment consists of employment income of less than M50,000 and interest paid by a resident financial institution is not obliged to file a return for that year of assessment.

130. Information Returns

This section imposes an obligation on every company or partnership making payments of Lesotho-source interest, dividends, royalties, management fees, rent, or other income specified by the Commissioner to file a return of those payments (referred to as an "information return") within 28 days of the end of the year of assessment in which the payments were made. The source of income is determined according to the rules in section 103. By virtue of section 211(6), the information return is required to be filed by the nominated officer of a company or the nominated partner of a partnership. The Commissioner may extend the due date for filing an information return under section 131. A person who fails to file an information return as required by subsection (1) is guilty of an offence under section 175.

The information returns required by this section will be matched against the returns of income of the payees of the relevant income.

131. Extension of Time to File Returns

A person who fails to file a return (income or information) by the due date is guilty of an offence under section 175 and, in the case of a return of income, liable for additional tax under section 193. To avoid these penalties, a taxpayer may apply to the Commissioner under this section for an extension of time to file an income or information return. Where an extension is granted, the extended due date becomes the due date for the purposes of the application of sections 175 and 193.

An application for an extension of time should be filed with the Commissioner before the due date for the return (particularly, if the taxpayer wishes to avoid the penalties in sections 175 and 193) and state the reason why the return cannot be filed by the due date. A taxpayer liable for instalments of tax under section 150 will only be granted an extension if the taxpayer has paid the instalments due for the year of assessment to which the return relates.

The granting of an extension to file a return of income does not alter the due date for payment of income tax for the year of assessment to which the return relates. By virtue of sections 128 and 143, income tax is due and payable on the last day of the third month after the end of the year of assessment. A taxpayer who has been granted an extension of time to file a return of income is required to make an estimate of the tax payable (net of instalments paid) for the year of assessment to which the return relates and to pay the estimated liability on the original due date (namely, on the last day of the third month after the end of the year of assessment). In the absence of special circumstances, it is intended that the estimate be based on the taxpayer's actual liability for the previous year of assessment. Where the taxpayer's estimate is more than 10% below the taxpayer's actual liability (net of instalments paid), the taxpayer is liable for additional tax under section 195.

132. Free Postage for Returns

To facilitate the filing of returns, this section exempts returns from postal charges. It is intended that this section apply to all returns required to be filed under the Order, namely returns of income, fringe benefits, and advance corporation tax, and information returns.

133. Deemed Assessments

The new law introduces a system of self assessment under which taxpayers calculate their chargeable income and the income tax payable thereon for a year of assessment, and pay the tax due on filing the return for that year. The move to self-assessment is consistent with international trends, as the traditional assessing function (which is provided for under the 1981 Act) is now viewed as an inefficient use a tax administration's scarce resources. The information necessary to make a correct assessment of a taxpayer's liability is generally within the taxpayer's own knowledge, and therefore, whether or not a correct assessment of a taxpayer's liability is made depends on the level of voluntary compliance achieved by the tax system. Traditionally, the expectation that the taxpayer's return will be closely scrutinised by a taxation officer before an assessment is raised has been seen as the main incentive to encourage compliance with taxation laws. The experience of other countries, however, is that the assessment function has been fairly ineffective in achieving high levels of compliance simply because of the enormity of the task of closely scrutinising every return filed. Greater levels of compliance have been achieved in other countries through the threat of post-assessment checking accompanied by high penalties for non-compliance. To this end, the introduction of self-assessment in Lesotho will be accompanied by a substantial increase in the level of audit activity undertaken by the Department of Income Tax, and the new law incorporates the increase in penalties provided for in the Income Tax (Amendment) Order 1992.

Section 133 is central to the operation of the system of self-assessment, which applies under the new law. It applies to all taxpayers, including those who are not obliged to file a return under section 129.

Where a taxpayer has filed a return of income for a year of assessment, the Commissioner is deemed to have made an assessment of the chargeable income and income tax payable for the year of assessment being those respective amounts as specified by the taxpayer in the return. The assessment of income tax payable is after taking into account any credits claimed by the taxpayer (such as a foreign tax credit, or a credit for instalments of tax paid or ACT). For all purposes of the Order, the taxpayer's return is deemed to be a notice of the assessment served on the taxpayer on the later of the due date for filing or the actual date the return was filed. This is particularly relevant to time limits in section 135 for the amendment of an assessment.

Where a taxpayer does not file a return pursuant to section 129 for a year of assessment, the Commissioner is deemed to have made an assessment of the taxpayer's chargeable income and tax payable thereon being the respective amounts shown on the taxpayer's tax withholding certificate (as required by section 163), or the total of those amounts where the taxpayer has more than one certificate. For all purposes of the Order, the tax withholding certificate(s) is deemed to be a notice of the assessment served on the taxpayer on the date that the taxpayer would otherwise have had to file a return for the year of assessment. This deeming is particularly necessary should there be a dispute as to the application of section 129 and the Commissioner subsequently wishes to raise an assessment on the taxpayer. The deeming means that this may be done through the amendment of assessment procedures in section 135.

134. Default and Special Assessments

While self-assessment will apply to all taxpayers, the new law preserves the Commissioner's power to raise an assessment on a taxpayer in appropriate cases, for example where a taxpayer fails to file a return, or is about to leave Lesotho without any prospect of returning.

Where a taxpayer defaults in filing a return for a year of assessment, the Commissioner may make an assessment of the taxpayer's chargeable income and tax payable thereon. This is referred to as a "default assessment". It is not intended that this section apply to taxpayers who self-assess themselves as not being required to file a return under section 129. Such taxpayers are specifically dealt with in section 133 (see the Commentary to that section).

The Commissioner may also raise an assessment of a taxpayer as an alternative to requiring the taxpayer to file a return under section 128(3). This is referred to as a "special assessment". It is expected that this would only be done in cases of urgency (for example, where the taxpayer is threatening immediate departure from the jurisdiction), or where the Commissioner is satisfied that there is sufficient information available to make a reasonably accurate assessment of the taxpayer's liability.

Notice of a default or special assessment must be served on the taxpayer in the form specified in subsection (3).

135. Amended Assessments

This section empowers the Commissioner to amend an assessment by making such alterations or additions to the assessment, as the Commissioner considers necessary to make a correct assessment of the taxpayer's liability. Under self-assessment, it is expected that an amended assessment will most commonly arise as a result of an audit of the taxpayer's activities, or in response to an application by a taxpayer for an amendment to an assessment under subsection (4) (see below). An amended assessment may increase or decrease a taxpayer's tax liability. The Commissioner is obliged to serve a notice of an amended assessment on the taxpayer, and it is treated in all respects as an assessment for the purposes of the Order.

The only limit on the Commissioner's power to amend an assessment is the time limit set out in subsection (2). Under paragraph (a), where the need to amend the assessment has arisen as a result of any fraud, or gross or wilful neglect committed by or on behalf of the taxpayer, the Commissioner is empowered to amend the taxpayer's assessment at any time. "Fraud", "gross neglect", and "wilful neglect" are intended to have their general law meaning. In the present context, they would include a deliberate understatement of income or overstatement of deductions in a return, a deliberate omission of income from a return, or a deliberate or reckless failure to ascertain the truth of a particular statement in, or omission from, a return. The fraud or neglect must be made by the taxpayer or on the taxpayer's behalf (for example, by the taxpayer's agent for preparation of the taxpayer's return). Paragraph (b) provides that, in any other case, an assessment may only be amended within four years of service of notice of the assessment. For deemed assessments, the date of service of the notice of assessment is determined in accordance with section 133(4), and for default, special, or amended assessments, it is the actual date of service.

This means that, in the ordinary case of deemed assessment under section 133(1) not involving any fraud or gross or wilful neglect on the part of the taxpayer, the assessment may be amended within four years from the due date for filing the return to which the assessment relates (namely, the last day of the third month after the end of the relevant year of assessment) or, if later, the actual date the return was filed.

Subsections (4)-(8) provide for a procedure whereby a taxpayer can apply for an amendment of what is in effect their own self-assessed liability. An application for an amendment to an assessment may only be made in respect of a deemed assessment under section 133. A taxpayer who wishes to challenge a default or special assessment, or an amended assessment is confined to the objection and appeal procedure in Part III of Chapter IV. An application for an amendment to a deemed assessment specifying in detail the grounds upon which it is made, must be filed with the Commissioner within four years after service of the notice of assessment as determined under section 133(4). The Commissioner is obliged to consider the application and may decide to amend the assessment, or disallow the application, and must serve notice of the decision in writing on the taxpayer. If a decision on the application is not made within 90 days of the application being filed with the Commissioner, then the Commissioner is deemed to have disallowed the application and to have served notice of this decision on the taxpayer on the ninetieth day after the application was filed. This is intended to ensure that applications are considered promptly by the Commissioner. The Commissioner's decision on the application is to be treated for all the purposes of the Order as an objection decision. This is intended to allow the taxpayer to appeal the Commissioner's decision on the application to the Administrative Tribunal for Tax Appeals and to the Courts in accordance with sections 138-140.

136. General Provisions in Relation to Assessments

The effect of this section is to ensure that the only avenue available to a taxpayer to challenge an assessment is by way of an objection or appeal under Part III of Chapter IV of the Order. If, for example, a taxpayer is sued under section 144 for recovery of the income tax assessed, the taxpayer cannot raise as a defence that the assessment is excessive. This can only be raised through the objection and appeal procedure.

137. Objection to Assessment

This section provides for the first step in the procedure for challenging an assessment, namely filing with the Commissioner an objection to the assessment. Except where the taxpayer has applied for an amendment to an assessment under section 135(4), the filing of an objection under this section is a pre-requisite for review of an assessment by the Administrative Tribunal for Tax Appeals (the "Tribunal") and the courts.

It is intended that this section will only apply to default, special, and amended assessments, as taxpayers dissatisfied with their own self-assessed liability may apply for an amendment to the assessment under section 135(4).

An objection to an assessment (other than an amended assessment) must be filed with the Commissioner within four years after service of notice of the assessment. Where the assessment is an amended assessment, an objection must be filed with the Commissioner within four years after service of notice of the original assessment, or within 60 days after service of notice of the amended assessment, whichever is the later. There is no provision for an extension of time for filing an objection and, therefore, the time limits in section 137 must be strictly observed by taxpayers if they wish to preserve their appeal rights.

An objection must be in writing and specify in detail the grounds upon which it is made. The statement of the grounds of the objection must be sufficiently explicit as to alert the Commissioner to the particular aspects of the assessment, which the taxpayer considers erroneous, and the reasons for the taxpayer's view. A statement of vague grounds, such as the assessment is "excessive" or "arbitrary", is not sufficient to amount to a valid objection.

The Commissioner is obliged to consider the objection and may either allow the objection in whole or part, or disallow it. The Commissioner's decision on the objection is referred to as an objection decision and written notice of it must be served on the taxpayer. While no time limit is specified within which the Commissioner must consider an objection, the Commissioner's failure to make an objection decision within 90 days of the objection being filed by the taxpayer is deemed to be a decision to disallow the objection and that decision is treated as served on the taxpayer on the ninetieth day after the objection was filed. As access to the Tax Tribunal and the courts depends on the making of an objection decision by the Commissioner, this protects the taxpayer from undue delay by the Commissioner in considering an objection. This is particularly important given that income tax is still payable even though the assessment is disputed by the taxpayer.

138. Appeal to Administrative Tribunal for Tax Appeals

This section provides that a taxpayer dissatisfied with an objection decision may appeal the decision to the Administrative Tribunal for Tax Appeals ("the Tribunal"). By virtue of section 135(8), the Commissioner's decision on a taxpayer's application to amend a self-assessed liability is deemed to be an objection decision, and therefore, a taxpayer can also appeal that decision to the Tribunal under this section.

The Tribunal is an independent administrative body established under section 203 specifically for the purpose of hearing appeals on objection decisions. The Tribunal is empowered to undertake a full merits review of the taxpayer's objection to, or application for amendment of, an assessment. The role of the Tribunal is to satisfy itself as to whether the objection decision of the Commissioner is correct. In other words, the Tribunal reviews the merits rather than the legality of the decision, and for this purpose the Tribunal has all the powers of the Commissioner. In particular, the Tribunal may review the exercise of discretions granted to the Commissioner relevant to the assessment under appeal.

A taxpayer appealing to the Tribunal must file a notice of appeal with the Tribunal within 60 days after being served with notice of the objection decision, and a copy of the notice must be served on the Commissioner. As a result of section 207(5), the notice of appeal must be filed with the Registry of the High Court. There is no provision for an extension of time for filing a notice of appeal to the Tribunal, and therefore, the time limit in this section must be strictly observed by taxpayers if they wish to preserve their rights of appeal to the courts.

A taxpayer's appeal to the Tribunal is limited by subsection (2) to the grounds of objection set out in the taxpayer's notice of objection or application for amendment. The Tribunal, however, is given a discretion to grant the taxpayer leave to add new grounds. It is not intended that there be any limit on the type of grounds, which may be added to the taxpayer's objection in exercise of this discretion. The Tribunal may permit a taxpayer to add entirely new grounds for arguing that an assessment is excessive, and this is the case even if the Tribunal is required to consider matters not considered by the Commissioner in making the original assessment or the objection decision. This ensures that the Tribunal focusses on issues of substance relating to the assessment in dispute. While the power to permit a taxpayer to add new grounds is discretionary, it is intended that generally the discretion will be exercised in the taxpayer's favour. Examples of situations where the Tax Tribunal may refuse to exercise the discretion include a case where the taxpayer has acted in bad faith, the adding of the new grounds will prejudice the Commissioner in some way which cannot be adequately compensated for by an order of costs, or the grounds sought to be added are clearly futile or pointless.

The Tribunal has broad powers as to the form its order may take. It may either affirm or amend the assessment under appeal. Consequently, where the Tribunal wholly or partly agrees with the taxpayer's objection, it has the power to amend the assessment itself and it does not have to refer the assessment back to the Commissioner. By virtue of section 135(3), an assessment amended by the Tax Tribunal is treated for all purposes of the Order as an assessment. Alternatively, the Tribunal may remit the assessment back to the Commissioner for reconsideration in accordance with its directions and recommendations.

139. Appeal to High Court of Lesotho

This section provides for an appeal from the decision of the Administrative Tribunal for Tax Appeals (the "Tribunal") to the High Court of Lesotho. An appeal to the High Court may be made by either the taxpayer or the Commissioner. Notice of the appeal must be filed with the Chief Registrar of the High Court within 60 days of the parties being notified of the decision of the Tax Tribunal, and a copy of the notice of appeal must be served on the other party.

An appeal from a decision of the Tribunal to the High Court may only be made on a question of law. The party appealing must state the question of law on the notice of appeal. While the distinction between questions of law and questions of fact may not always be easy to draw in particular cases, some broad principles may be stated. First, the question of what actually happened is a question of fact. For example, the question of whether the taxpayer actually incurred M10,000 of travel expenses is a question of fact. This question may only be decided by the Commissioner (as decision-maker) and the Tribunal (as reviewer of the merits of the Commissioner's decision). The decision of the Tribunal on this issue cannot be appealed to the High Court. Secondly, the interpretation of a particular section in the Order is regarded as a question of law, and therefore, the decision of the Tribunal on such a question may be appealed to the Courts. Thirdly, a question of whether particular facts ascertained fall within a particular section of the Order is regarded as a question of law. For example, whether the M10,000 of travel expenses of a taxpayer are deductible under section 33 is regarded as a question of law, and therefore, the decision of the Tribunal on this question may be appealed to the High Court.

As the High Court only reviews the legal correctness of the Tribunal's decision (rather than the merits of the decision), an appeal to the High Court will only be successful if the Tribunal is found to have made an error of law which resulted in a decision different to that which would have been made if the error had not been made. Generally, the High Court will make its decision based on the findings of fact, and the inferences drawn from those facts, by the Tribunal.

The High Court is permitted to make such orders as it considers appropriate by reason of its decision. Where the taxpayer's appeal is wholly or partly allowed, the High Court may either remit the matter to the Tribunal or finally dispose of the matter itself. As the appeal to the High Court is from the decision of the Tribunal, it may be appropriate in some cases to remit the matter to the Tribunal for further consideration. For example, the High Court may consider that further findings of fact are necessary before a correct decision on the objection can be made. Where the matter is remitted to the Tribunal, it would ordinarily be remitted to a Tribunal constituted by the same member(s) as heard the original appeal. On the other hand, the High Court may make a decision which finally disposes of the matter, for example, it may order that the assessment be amended. This is likely to occur in a case where all the facts necessary to enable a decision to be made by the Court have been found by the Tribunal.

140. Appeal to Court of Appeal

This section provides for an appeal from the decision of the High Court to the Court of Appeal of Lesotho. An appeal under this section is not automatic, but requires special leave of the Court of Appeal. It is expected that special leave will only be granted in those cases where the issues raised are of sufficient importance to warrant consideration by the Court of Appeal.

The party appealing to the Court of Appeal must file a notice of appeal with the Chief Registrar of the Court of Appeal within 60 days of the parties being notified of the decision of the High Court of Lesotho, and a copy of the notice of appeal must be served on the other party. The Court of Appeal has inherent jurisdiction to consider applications for an extension of time to file a notice of appeal.

The Court of Appeal is permitted to make such order as it considers appropriate by reason of its decision. See the Commentary on section 139 for a discussion of the types of orders the Court may make.

141. General Provisions in Relation to Objections and Appeals

Subsection (1) provides that the burden of proving that an assessment is excessive is on the taxpayer. Consequently, unless the taxpayer is able to establish positively that the assessment is excessive, the assessment stands irrespective of whether or not there are any facts which would give prima facie support to the assessment. In other words, there is no obligation on the Commissioner to prove that the assessment is correct. The taxpayer must prove his or her case on the balance of probabilities, that is, the taxpayer must establish that it is more likely than not that the position is as he or she alleges.

Appeals before the Administrative Tribunal for Tax Appeals will be conducted in accordance with the procedural rules adopted by the Tribunal pursuant to section 207. The conduct of an appeal to the High Court and the Court of Appeal will be governed by the procedural rules applicable to those Courts. In addition to these procedural rules, the Minister may make regulations to specifically govern an appeal against an objection decision.

142. Powers of the Commissioner after Appeal

The fact that an appeal in relation to an assessment has been decided does not preclude the Commissioner from further amending the assessment, but such an amendment cannot re-open any matter determined on the appeal unless there was fraud, or gross or wilful neglect on the part of the taxpayer which was only discovered after the determination of the appeal. This section applies to an amendment initiated by the Commissioner or as a result of an application by the taxpayer under section 135(4). An amendment, however, may only be made within the time limits specified in section 135.

143. Due Date for Payment of Income Tax

Income tax assessed pursuant to a deemed assessment under section 133 is due and payable on the date on which the return of income is due, namely the last day of the third month following the end of the year of assessment. For most taxpayers, this means that income tax is due on 30 June. Income tax assessed under a default, special, or amended assessment is due and payable 30 days after the taxpayer is served with notice of the assessment or amended assessment, although the Commissioner may demand payment under a default or special assessment issued under section 134(2) immediately after the taxpayer is served with notice of the assessment.

The due date for payment of income tax is not affected by the fact that the taxpayer has challenged the assessment through the objection and appeal procedures, or has applied for an amendment to the assessment under section 135(4). The Commissioner, however, has power to extend the due date for payment of tax, or to make any other appropriate arrangements for payment of tax due (such as the payment of tax by instalments with interest). This power may only be exercised where good cause is demonstrated by the taxpayer. An example of a situation where the Commissioner may grant an extension of time is where there is a genuine dispute as to the taxpayer's liability. In this case, the Commissioner may extend the time for payment of, say, half the disputed tax until after the taxpayer's appeal has been finally resolved. The granting of an extension of time does not prevent the liability for additional tax under section 194 running from the original due date.

Subsections (6) and (7) give the immigration authorities power to prevent a person leaving Lesotho where any liability arising as a result of the filing of a section 128(3) return or the raising of a special assessment under section 134(2) has not been paid by the due date. The power is to be exercised until the taxpayer makes payment in full or makes an arrangement to the satisfaction of the Commissioner for payment of the tax.

144. Income Tax as a Debt Due to the Lesotho Government

This section provides that income tax which is due and payable is a debt owed by the taxpayer to the Lesotho Government and is payable to the Commissioner. Where income tax is not paid on the due date, subsection (2) provides that the Commissioner may file a certified statement setting out the amount of tax owing with the clerk of any court of competent jurisdiction and that statement is treated as a civil judgment of that court in favour of the Commissioner for the amount of the debt set out in the judgment. The judgment may be used by the Commissioner to recover the amount owing in any court in Lesotho that has jurisdiction over the taxpayer. Subsection (3) provides that this is the case notwithstanding anything to the contrary in the Subordinate Courts Order 1988.

This section is largely a re-enactment of section 63(1) and (2) of the 1981 Act which provides for the recovery of tax due.

145. Recovery From Assets of Taxpayer

This section is a re-enactment of section 65 of the 1981 Act which gives the Commissioner a preferential claim on the assets of a taxpayer from the date that income tax becomes due and payable.

146. Recovery From Spouse of Taxpayer

This section is a re-enactment of section 63(3) of the 1981 Act which gives the Commissioner power to recover income tax due and payable by a taxpayer who is married within community of property from the assets or income of the taxpayer's spouse.

147. Distress Proceedings

This section is a re-enactment of section 64 of the 1981 Act which provides for distress proceedings against the property of the taxpayer as a means of recovering income tax which has not been paid on the due date. While this is an alternative to the method of recovery of unpaid tax provided for in section 144(2) and (3), it does not prevent the Commissioner from also using the judgment debt procedure to collect any excess tax owing after the execution of distress against the property of the taxpayer.

148. Recovery of Tax From Person Owing Money to the Taxpayer

Where a taxpayer has not paid income tax by the due date, this section empowers the Commissioner to recover the tax indirectly by requiring a third party who owes money to, or holds money for, the taxpayer to pay that money, or a specified part of it, to the Commissioner in satisfaction of the taxpayer's liability. This section is activated by the Commissioner serving a notice in writing on the third party requiring that person to pay the amount set out in the notice on the date specified, and a copy of the notice must be sent to the taxpayer. Where a section 148 notice is validly served, the Commissioner obtains a statutory right to payment which cannot be defeated by any subsequent dealing with, or action taken in respect of, moneys referred to in the notice.

The amount which may be required to be paid to the Commissioner under a section 148 notice must not exceed the amount of income tax due and payable by the taxpayer. A section 148 notice may only be served on a third party where the taxpayer has failed to pay income tax on the due date; it cannot be used in anticipation of such a failure. Where the third party is obliged to make a series of payments to the taxpayer (for example, salary or wages), a section 148 notice may specify that a set amount be deducted from each payment and paid to the Commissioner until the tax debt is satisfied. A section 148 notice may be served on any person within the class of persons specified in the section. A section 148 notice may be served on any "person" within the section 3(1) definition, including for example, a partnership, or the Lesotho Government.

There are three classes of person on whom a section 148 notice may be served. First, a notice may be served on a person who owes, or may owe, money to the taxpayer. This allows the Commissioner to recover tax owing by a taxpayer from the debtors of that taxpayer, including persons who may become debtors of the taxpayer in the future. For example, the Commissioner could use a section 148 notice to require a financial institution to pay to the Commissioner an amount standing to the credit of the taxpayer in an account with the financial institution. The notice, however, must not specify a date for payment to the Commissioner, which is before the date the amount, becomes due to the taxpayer. In the above example, if the amount is a term deposit, then the notice could not require the financial institution to pay the amount over to the Commissioner until the deposit matures.

Secondly, a notice may also be served on a person who holds, or who may hold, money on behalf of the taxpayer. This would include, for example, a real estate agent who holds the proceeds of sale of immovable property on behalf of the taxpayer, or a lawyer or accountant who may hold money on trust for the taxpayer as client. The notice, however, must not specify a date for payment to the Commissioner, which is before the date it is held by the third party on behalf of the taxpayer.

Thirdly, a notice may be served on a person having the authority of some other person to pay money to the taxpayer. This is intended to prevent this section being avoided by a person owing money to, or on behalf of, the taxpayer directing another person to pay the amount to the taxpayer.

A person who complies with a section 148 notice is deemed to have been acting under the authority of the taxpayer and any other person concerned, and is thereby protected from any liability to the taxpayer in respect of the payment (for example, for breach of contract). A person who fails to comply with a section 148 notice is guilty of an offence under section 177, and the Court before which the person is convicted is empowered to order the person to pay all or a part of the amount specified in the notice despite the person's conviction.

149. Duties of Receivers

This section provides a procedure for the collection of income tax where a taxpayer is in financial difficulties such that a liquidator, receiver, trustee of an unrehabilitated insolvent, or mortgagee in possession (collectively referred to in the section as a "receiver") has control of the taxpayer's assets. A receiver is required to give notice to the Commissioner within 14 days of the earlier of being appointed to the position or of taking possession of the taxpayer's assets. The Commissioner then notifies the receiver of the amount necessary to cover present and future tax liabilities of the taxpayer. The receiver is obliged to set aside out of the proceeds of sale of an asset or assets sufficient funds to meet the liability notified by the Commissioner, and is liable to the Commissioner for the amount so set aside. This obligation is subject to any debts, which have priority over the Commissioner's claim of income tax owing. A receiver must not part with any of the assets in question without the prior written permission of the Commissioner, and is personally liable for the amount required to be set aside where the receiver fails to comply with the requirements of this section. Further, a receiver who fails to comply with the requirements of this section is guilty of an offence under section 190.

150. Instalments of Income Tax

This section provides for a system of quarterly instalments of income tax on income, which is not otherwise subject to withholding of tax at source. The section is particularly relevant to companies and individuals carrying on business. Instalments are payable on the last day of the sixth, ninth, and twelfth months of the year of assessment with the balance payable on filing of the return for the year of assessment pursuant to section 143. For most taxpayers, this means that instalments of tax are due on 30 September, 31 December, and 31 March.

The amount of each instalment is 30% of the amount of income tax levied on income not subject to withholding of tax at source in the previous year of assessment. The amount of income tax for the previous year of assessment taken into account for the purposes of this section is the total liability (net of foreign tax credits but before set off of instalments of tax or ACT). The figure of 30%, rather than 25%, is adopted on the assumption that the taxpayer's income in the current year of assessment will be higher than in the prior year. The Commissioner, however, has a discretion to reduce the amount of an instalment where the

Commissioner is satisfied that there will be a reduction in the current year of assessment in the amount of the taxpayer's income which is not subject to withholding of tax at source.

Divisions I and II of Part IV of Chapter IV relating to the collection and recovery of income tax apply equally to the collection and recovery of an instalment of income tax. Consequently, an instalment of tax which is due and payable is a debt owed to the Lesotho Government and is payable to the Commissioner. The priority rule in section 145 applies to an instalment of tax. The Commissioner may recover the amount of an instalment through the judgment debt procedure in section 144, from the spouse of the taxpayer (in the case of individuals) under section 146, through distress proceedings against the property of the taxpayer under section 147, from a third party under section 148, or from a receiver under section 149.

Each instalment of tax is credited against the income tax liability of the taxpayer for the year of assessment to which the instalment relates. The full amount of the instalment is credited against the income tax liability regardless of whether a liability for advance corporation tax has been set off against the instalment. Where the instalments exceed the income tax liability for the year of assessment to which they relate, the excess is applied against any other tax liability of the taxpayer with any further excess being refunded. The liability may be for the current year of assessment or for any other year of assessment, such as a previous year of assessment. By virtue of the definition of "tax" in section 3, this allows excess instalments to be applied against any outstanding FBT liability of the taxpayer. It is also intended that this allows excess instalments to be credited against any instalment which may already be due for the next year of assessment.

The instalment system is illustrated by the following examples.

<u>Example 1</u>

Taxpayer had a chargeable income of M100,000 on which tax of M36,000 was paid for the 1993/4 year of assessment. M12,000 of the tax was collected by withholding at source under section 157. The amount of each instalment of tax for the 1994/95 year of assessment is -

30% x (M36,000 - M12,000) = M7,200.

The taxpayer's chargeable income for the 1994/95 year of assessment is M120,000 on which tax of M44,000 is payable (M14,000 of which being collected by withholding at source). During that year of assessment, the taxpayer has paid M21,600 (M7,200 x 3) in instalments of tax. This, along with the tax withheld at source, is credited against the final liability for the year, leaving a net liability of M8,400 payable by Taxpayer.

<u>Example 2</u>

Sellers Pty Ltd had a chargeable income of M500,000 on which tax of M200,000 (before foreign tax credit or advance corporation tax set off) was payable for the 1993/94 year of assessment. M100,000 of the chargeable income was derived from foreign sources in relation to which Sellers was entitled to a foreign tax credit of M25,000; and M50,000 of the chargeable income was interest on which tax of M5,000 was withheld at source. Sellers also paid a dividend during the year of assessment on which M30,000 advance corporation tax was paid. The amount of each instalment for the 1994/95 year of assessment is -

30% x (M200,000 - M25,000 - M5,000) = M51,000.

The amount of 1993/94 liability taken into account in calculating the amount of each instalment is before set off of ACT.

Sellers' chargeable income for the 1994/95 year of assessment is M750,000 on which M300,000 of tax is payable. It is entitled to a foreign tax credit of M40,000 and a credit for tax withheld from interest of M7,500. During the year, Sellers has paid M50,000 of advance corporation tax which was set off against instalments of tax. Sellers, however, is entitled to credit the full amount of instalments payable (that is M153,000 before set off against ACT). Sellers' net liability for the year is -

M300,000 - (M40,000 + M7,500 + M153,000) = M99,500.

151. Repayment of Overpaid Tax

Where tax has been paid for a year of assessment in excess of the taxpayer's liability for that year, the taxpayer is entitled to a refund of the excess. This provision is subject to the other provisions of the Order, such as section 150(6) which permits excess instalments of income tax to be set off against any other tax liability of the taxpayer (including FBT) for the year of assessment or for any other year of assessment, and section 168(3) which permits excess withholding tax to be set off against any other tax liability of the taxpayer.

A taxpayer claiming a refund of tax must file the claim with the Commissioner within 4 years after service of the notice of assessment for the year of assessment to which the claim relates. For deemed assessments, the date of service of the notice of assessment is determined in accordance with section 133(4), and for default, special, or amended assessments, it is the actual date of service. Where the tax is a final withholding tax, the claim for a refund must be made within four years after the date on which the payment from which the tax was withheld was made. This would apply, for example, to withholding tax imposed under section 107 or 108.

152. Return of Fringe Benefits

This section obliges every employer to file quarterly returns of fringe benefits provided to employees. The quarterly periods for which returns are required are 1 April-30 June, 1 July-30 September, 1 October-31 December, and 1 January-31 March. Fringe benefits returns are required for these periods regardless of whether the employer is entitled to use a substituted accounting period as the year of assessment for income tax purposes. The return must be filed within 14 days of the end of the period to which it relates. An employer who fails to file a return as required by this section is guilty of an offence under section 175, and is liable for additional tax under section 193. A fringe benefits return must show the employer's fringe benefits taxable amount and the FBT payable for the quarter.

Sections 128(3), 131, and 132 apply with the necessary changes made to the filing of fringe benefits returns. Consequently, the Commissioner may require a fringe benefits return for a period of less than three months in the circumstances set out in section 128(3) (see the Commentary to section 128). Upon application by an employer in writing, the Commissioner may grant an extension of time for the filing of a fringe benefits return (section 131). Any extension of time granted does not affect the due date for payment of FBT under section 153, being the date the return is due. Where an extension of time has been granted, the employer is required to estimate the amount of FBT payable for the quarter and pay that amount on the due date. It is intended that the estimate be determined having regard to the previous quarter's liability and the liability for the equivalent quarter of the previous year (to take account of any seasonal factors). Where the employer's estimate is more than 10% below the employer's actual liability for the quarter, the employer is liable for additional tax under section 195. Finally, a fringe benefits return is exempt from postal charges if marked "Fringe Benefits Tax" and "on Government service".

153. Assessment, Appeals, and Collection - Fringe Benefits Tax

This section provides the procedural rules for the assessment, challenging of an assessment, and collection of fringe benefits tax ("FBT"). For this purpose, Parts II and III, and Divisions I, II, and IV of Part IV of Chapter IV apply, with any necessary changes made, to FBT.

The application of Part II of Chapter IV means that FBT is largely self-assessed by employers. The statement of the fringe benefits taxable amount and the FBT payable in the employer's fringe benefits return is deemed to be an assessment of those amounts by virtue of section 133. Further, the fringe benefits return is deemed to be notice of the assessment served on the employer on the later of the due date for filing the return or the actual date the return was filed. Through the operation of section 134, the Commissioner may raise a default assessment where no fringe benefits return is filed, or a special assessment in the circumstances set out in section 128(3). An FBT assessment may be amended by the Commissioner in accordance with section 135(1) and (2), and an employer may apply under section 135(4) for an amendment of a self-assessed liability. By virtue of section 136, an FBT assessment may only be challenged through the objection and appeal procedure in Part III of Chapter IV.

The application of Part III of Chapter IV means that a liability for FBT may be challenged through the objection and appeal procedures in that Part. As most FBT assessments will be deemed assessments, it is expected that appeals will generally relate to decisions by the Commissioner on applications by employers for an amendment to their self-assessed liability.

The application of Divisions I, II, and IV of Part IV of Chapter IV means that FBT is collected in the same way as income tax, although the instalment of tax provisions do not apply as FBT is collected through quarterly returns. In the ordinary case, FBT is due and payable on the date on which the return is due (namely, 14 July, 14 October, 14 January, and 14 April) (through section 143(1)). Where the Commissioner has raised a default, special, or amended assessment, FBT is due and payable 30 days after service of notice of the assessment or amended assessment (through section 143(2). The fact that the employer may dispute an FBT liability does not prevent the tax from being due and payable (through section 143(3)). An employer may seek an extension of time to pay (through section 143(4)). The departure prohibition procedure in section 143(6) may be applied against an employer who is an individual.

FBT that is due and payable is a debt owed to the Lesotho Government and is payable to the Commissioner (through section 144), and the priority rule in section 145 applies to the recovery of FBT. The Commissioner may recover FBT through the judgment debt procedure in section 144, from the spouse of the taxpayer (in the case of individuals) through section 146, through distress proceedings against the property of the taxpayer through section 147, from a third party through section 148, or from a receiver through section 149. An amount paid in excess of the employer's FBT liability may be refunded in accordance with section 151.

154. Return of Advance Corporation Tax

This section obliges a resident company to file a return of advance corporation tax ("ACT return") within seven days of paying a dividend. The definition of "paid" in section 3(1) as including credited applies for the purposes of determining when the ACT return is due. The return must contain the information specified in paragraphs (a)-(d). A company which fails to file an ACT return as required by this section is guilty of an offence under section 175, and is liable for additional tax under section 193. An ACT return is exempt from postal charges if marked "Advance Corporation Tax" and "on Government service".

There is no provision for an extension of time in relation to the filing of an ACT return as the tax obligation to file a return is based on the occurrence of a single event, namely the paying of a dividend.

155. Assessments, Appeals, and Collection - Advance Corporation Tax

This section provides the procedural rules for the assessment, challenging of an assessment, and collection of advance corporation tax ("ACT"). For this purpose, Parts II and III, and Divisions I, II, and IV of Part IV of Chapter IV apply, with any necessary changes made, to ACT.

The application of Part II of Chapter IV means that ACT is largely self-assessed by companies. The statement of the ACT payable in the company's ACT return is deemed to be an assessment of that amount through the operation of section 133. Further, the ACT return is deemed to be a notice of the assessment served on the company on the later of the due date for filing of the return or the actual date of filing. The Commissioner may raise a default assessment where no ACT return is filed through the operation of section 134. An ACT assessment may be amended by the Commissioner in accordance with section 135(1) and (2), and the company may apply under section 135(4) for an amendment of its self-assessed liability. Through section 136, an ACT assessment may only be challenged through the objection and appeal procedure in Part III of Chapter IV.

The application of Divisions I, II, and IV of Part IV of Chapter IV means that ACT is collected in the same way as any other income tax liability. In the ordinary case, ACT is due and payable on the date on which the return is due, being seven days after the dividend is paid (through section 143(1)). Where the Commissioner has raised a default or amended assessment, ACT is due and payable 30 days after service of notice of the assessment or amended assessment (through section 143(2). The fact that the company may dispute an ACT liability does not prevent the tax from being due and payable (through section 143(3)). A company may seek an extension of time to pay (through section 143(4)).

ACT that is due and payable is a debt owed to the Lesotho Government and is payable to the Commissioner (through section 144), and the priority rule in section 145 applies to the recovery of ACT. The Commissioner may recover ACT through the judgment debt procedure in section 144, through distress proceedings against the property of the company under section 147, from a third party under section 148, or from a receiver under section 149. An amount paid in excess of the company's liability for ACT may be refunded in accordance with section 151.

156. Withholding of Tax by Employers

This section obliges an employer to withhold tax from a payment of employment income to an employee. This is referred to as pay-as-you-earn ("PAYE") withholding. The definitions of "employer" and "employee" in section 3 apply for the purposes of this section, so that PAYE withholding applies, for example, to payments to directors and other office-holders. It is specifically provided that the obligation to withhold does not apply to the employment income of a domestic assistant. This is to prevent the obligations of this section falling on ordinary householders. It is intended that a domestic assistant for the purposes of this section include a housekeeper, chauffeur, gardener, or security guard.

PAYE withholding applies to any payment of "employment income" by an employer to an employee. By virtue of the definition in section 3, "employment income" has the meaning in section 18. This means, for example, that PAYE withholding will apply to wages, salary, overtime pay, leave pay, payment in lieu of leave, sick pay, strike pay, a return to work payment, commission, bonus, gratuity (including a contract gratuity), or allowance (including a retirement allowance) paid by an employer to an employee. It will not apply, however, to any fringe benefits provided to an employee which have been subject to FBT in the hands of the employer, nor to any fringe benefits which are exempt from FBT. It will apply, however, to the value of any other fringe benefits provided to an employee.

The rate of PAYE withholding will be prescribed in the regulations. As stated in the Commentary to section 129, in the ordinary case of an employee receiving salary or wages from a single employer during the year of income, the cumulative amount withheld for the year of assessment should equal the employer's liability for that year assuming that the employee has no other income includable in gross income.

The obligation to withhold under this section overrides any law which forbids the reduction or attachment of employment income, and applies notwithstanding an obligation on the employer to withhold for any other purpose (for example, pursuant to a garnishee order).

157. Payments to Resident Contractors

This section provides for withholding of tax at source from payments to independent contractors resident in Lesotho. Under this section, a person who contracts with a resident contractor is obliged to withhold tax at the rate of 5% of the gross of amount of any payment made to the contractor under the contract. To ensure that the section only applies to substantial contracts, the obligation to withhold commences with the first month in which the aggregate of payments made under the contract for the month exceed M3,000. The obligation then continues until the contract is complete regardless of the monthly aggregate of payments made under the contract.

The obligation to withhold is imposed on every "person" who makes a payment to a resident contractor. "Person" for this purpose has the meaning in section 3, and therefore, the obligation to withhold applies to an individual, partnership, company, government or political subdivision of a government, and to a public international organisation. The obligation to withhold, however, does not apply to payments made by an individual for the erection or improvement of the individual's principal residence. This is intended to prevent the obligations of this section falling on ordinary householders.

For the section to apply, the payment must be made to a "resident contractor". The definition of "contractor" in section 3 applies for the purposes of this section (see the Commentary to the definition), and therefore, an individual, partnership, or company may be a contractor for the purposes of this section. Whether a contractor is a resident depends on the application of the residence tests in Part II of Chapter II. While this section does not apply to payments made to a non-resident contractor, such payments may be subject to withholding tax under section 108.

The amount of tax to be withheld is 5% of the gross payment made under the contract, including the cost of any materials supplied by the contractor. The tax withheld is set off against the contractor's final liability for the year of assessment under section 168. Where the contractor is liable for instalments of tax, the amounts withheld under this section may not be set off against those instalments as the calculation of the instalments takes into account the fact that the taxpayer is liable for withholding of tax at source. A contractor, which is a company, is not permitted to set off tax withheld under this section against any advance corporation tax liability for the year of assessment.

158. Payments of Interest

This section provides for withholding of tax at source from interest paid by a resident of Lesotho to another resident of Lesotho. The rate of withholding is 10% of the gross amount of the interest. The definition of "interest" in section 3 applies for the purposes of this section. By virtue of the extended definition of "paid" in section 3, the obligation to withhold applies to the crediting of an amount of interest in favour of a resident. Where the interest is paid in respect of the account of the taxpayer designated for the purposes of section 27, the amount withheld is to take into account the exemption of the first M500 of interest income under that section.

The obligation to withhold tax under this section applies to every person resident in Lesotho making a payment of interest to another resident. Consequently, the obligation is not confined to interest paid by financial institutions, but applies to interest paid by a resident partnership, resident company, the Lesotho Government, and local councils. The obligation to withhold, however, does not apply to interest paid by individuals. This means, for example, that an individual will not be required to withhold tax on interest paid on a home mortgage loan.

The obligation to withhold under this section only applies to interest paid to a person resident in Lesotho. The residence of a person is determined in accordance with the tests in Part II of Chapter II. If the payee is a non-resident, then the interest may be subject to withholding tax under section 107. Section 158 does not apply, however, to interest income which is exempt from income tax (for example, under section 102).

Tax withheld under this section is a final tax where the payee is a resident individual (other than in the capacity of trustee) or an exempt organisation under section 25. For these persons, interest to which section 158 applies is not included in their gross income for the year of assessment in which the interest was paid.

159. Payments by a Superannuation Fund

This section provides for withholding of tax at source from payments made by a superannuation fund. The obligation to withhold applies to both lump sum and periodic payments (such as pensions or annuities) made by the fund. As with PAYE withholding, the rate of withholding will be prescribed in the regulations.

The obligation to withhold applies to all resident superannuation funds whether complying or non-complying. A lump sum payment made by a complying superannuation fund is subject to a flat rate of tax of 25% of the amount of the payment under section 99. Where that tax has been withheld under subsection (1) of this section, subsection (2) provides that the tax withheld is a final tax and the lump sum payment is not included in the gross income of the recipient.

160. Payments by a Liquidator

This section obliges a liquidator making a payment to a member of a company to withhold tax at the rate of 10% of the gross amount of the payment. The cancellation of the shares of a company on liquidation amounts to a disposal by the members of their shares in the company. The shares will be a business or investment asset of the member depending on the member's particular circumstances, and therefore, the disposal of the shares on liquidation may give rise to a gain includable in the gross income of the member. The tax withheld under this section is not a final tax and may be credited against the member's final liability for the relevant year of assessment.

161. International Payments

This section is linked to the withholding obligations imposed by sections 107 and 108 in relation to international transactions. While those sections impose tax on the non-resident recipient, this section provides for the collection of the tax by withholding at source. Consequently, the person making the payment to which section 107 or 108 applies is obliged to withhold tax from the payment. For payments to which section 107 applies other than royalties covered by section 107(3) ("manufacturing royalties"), the rate of withholding is 25% of the gross amount of the payment. For manufacturing royalties, the rate of withholding is 15% of the gross royalty paid. In both cases, the rate of withholding is subject to a lower rate applying as a result of the operation of any double tax treaty to which Lesotho is a party. For payments to which section 108 applies, the rate of withholding is 10% of the gross amount of the payment.

Where a payment to which this section applies is made to a trust, it is difficult for the payer to know whether the payment falls within section 107 or 108, as the payer may not know of the residence status of the beneficiaries of the trust or whether any beneficiary is presently entitled to the income of the trust (if there is no beneficiary presently entitled, then no liability to tax arises under section 107 or 108 as the trustee is liable under section 83 or 84). Accordingly, subsection (2) of this section provides a procedure whereby the payer may withhold tax at the rate specified in the relevant section and pay it to the Commissioner thereby relieving the payer from the liability to pay the amount of tax withheld to the person entitled to it. It is then for the trustee or beneficiaries to demonstrate to the Commissioner that the payment was not subject to withholding tax under section 107 or 108, in which case, the Commissioner is obliged to refund the tax withheld to the person entitled to it.

Under subsection (4), a payer of interest to a non-resident is not obliged to withhold tax under this section if the Minister has published a notice in the Gazette under section 107(6) to the effect that the interest is exempt from tax.

Subsection (5) of this section obliges a person making a payment to a non-resident to which section 110 applies, to withhold tax in accordance with the notice issued to the person by the Commissioner under that section. This ensures that such a person is a withholding agent for the purposes of the Order and, in particular, that Division II of Part VII of Chapter IV applies to the collection and recovery of such tax and that the penalties in Part XI of Chapter IV apply to a failure to comply with the section 110 notice.

162. Interpretation

This section provides that the reference to "payee" as used in Division II of Part VII of Chapter IV means a person receiving payments from which tax has been withheld as a result of the operation of one of sections 156-161.

163. Tax Withholding Certificates

This section obliges a person required to withhold tax under Division I of Part VII of Chapter IV (referred to as a "withholding agent") to deliver to the payee a tax withholding certificate setting out the amount of payments made and tax withheld therefrom during the year of assessment. Failure to do so is an offence under section 178.

In the case of a payee who is an employee, the employer must deliver a certificate of tax withheld under section 156 to the employee within 28 days after the end of the year of assessment. Where an employee changes employment, the former employer must deliver the certificate within 7 days of the employee leaving employment. In all other cases, the certificate must be given on the date of payment. This means, for example, that a person obliged to withhold tax under section 157 from payments made to a resident contractor must give a separate tax withholding certificate with each payment made.

As a tax withholding certificate records tax credits available to the payee, it must be attached to the return of the payee for the year of assessment to which the certificate relates. This does not apply to a payee who is not obliged to file a return, such as a payee to which section 129 applies or a non-resident for whom withholding tax is a final tax.

164. Record of Payments and Tax Withheld

This section obliges a withholding agent to keep records of payments made to payees and the amount of tax withheld therefrom, which records are to be available for inspection, by the Commissioner. Within 28 days after the end of the year of assessment, the withholding agent is required to file a statement in the prescribed form setting out the matters listed in subsection (2). Where the employer is a company entitled to use a substituted accounting period, the reference in subsection (2) to "year of assessment" in this section is intended to mean the period 1 April to 31 March rather than the substituted period. This is because the statement filed under subsection (2) is intended to be matched against the return of the payee, which return will generally relate to the period 1 April to 31 March, particularly in the case of individuals. The Commissioner is given a discretion to grant an extension of time for the filing of a statement under subsection (2).

165. Failure to Withhold Tax

A withholding agent who fails to withhold tax as required by Part VII of Chapter IV is personally liable for the tax, which has not been withheld. The recovery provisions in Division II of Part IV of Chapter IV apply to this liability. A withholding agent obliged to make a payment under this section is entitled to recover the amount from the payee.

A withholding agent who fails to withhold tax as required by Part VII is guilty of an offence under section 178 and is liable for additional tax under section 196.

166. Payment of Tax Withheld

This section obliges a withholding agent who has withheld tax in accordance with Part VII of Chapter IV to pay the tax withheld to the Commissioner within the time prescribed in regulations. The Commissioner may use the recovery provisions in Division II of Part IV of Chapter IV to recover withholding tax, which has been withheld but not remitted within the time prescribed. A withholding agent who fails to remit the tax withheld within the time prescribed is liable for additional tax under section 196.

167. Priority of Tax Withheld

This section provides that amounts withheld under Part VII of Chapter IV are deemed to be held by the withholding agent in trust for the Lesotho Government with the result that in the insolvency or liquidation of the withholding agent, the tax withheld is not treated as part of the estate of the company or unrehabilitated insolvent and the Lesotho Government has first priority in distributions by the liquidator or trustee in insolvency. Similarly, where the withholding agent has received notice of some other claim upon the money to be paid to the payee (for example, a garnishee in relation to a judgment debt), the obligation to withhold takes primacy over the other claims to the money.

168. Adjustment on Assessment

This section specifies the treatment of the tax withheld so far as the payee is concerned. The payee is treated as having received the amount of tax withheld so that it forms part of the income of the payee. Similarly, the tax withheld is treated as tax paid by the payee, and therefore, is available for set off against the tax liability of the payee arising under any assessment. No set off is allowed for withholding tax, which is a final tax. This applies, for example, to withholding tax paid in respect of international payments to which section 107 or 108 applies (unless the non-resident has made an election under section 109).

Where the tax withheld exceeds the income tax liability of the payee for the relevant year of assessment, the excess is applied against any other tax liability of the payee (for example, FBT or an instalment of tax under section 150), with any further excess refunded to the payee.

169. Accounts and Records

This section obliges a taxpayer to maintain in Lesotho and in the Sesotho or English languages such records as may be necessary for the accurate determination of the taxpayer's tax liability, including a liability for FBT. "Records" is intended to be interpreted broadly covering all written documents which record and explain the transactions and other acts of the taxpayer that are relevant to the determination of the taxpayer's liability. This not only includes records relevant to the ascertainment of the taxpayer's chargeable income and tax credits, but also records relating to any election, estimate, determination, or calculation made by the taxpayer for the purposes of the Order. The records must be kept in a manner, which is sufficiently detailed and logically consistent so as to enable a person of reasonable competence to ascertain the taxpayer's liability promptly, easily and quickly.

The records must be maintained by the taxpayer in Lesotho. They do not, however, have to be located at the taxpayer's business or other premises, rather they may be located, for example, at the business premises of the taxpayer's accountant provided that it is in Lesotho. The requirement that the records be kept in Lesotho is intended to ensure that they are readily accessible to the Commissioner, particularly having regard to the investigations powers in section 170 and 171.

The Commissioner is given a discretion in subsection (2) to disallow a deduction which cannot be substantiated without reasonable excuse by the taxpayer. A deduction may be substantiated by a receipt or other record of the transaction, or by any other evidence of the circumstances giving rise to the claim for the deduction. The deductions to which the obligation to substantiate applies includes the abatement allowed under section 73. This means, for example, that a resident individual must prove that his or her personal circumstances support the claim for either the single or married abatement.

A taxpayer is obliged to keep the records or evidence referred to in subsections (1) and (2) for as long as they remain material in the administration of the Order. This is primarily determined by reference to the time limit in which the Commissioner can amend an assessment (see section 135).

The obligation to keep records is particularly important under self-assessment where a taxpayer may not be obliged to file a return at all, or may only be required to file a simplified return. Consequently, substantial penalties are imposed on a taxpayer who fails to comply with this section. Such a taxpayer is guilty of an offence under section 176 with the level of penalty depending on the degree of culpability of the taxpayer in relation to the particular failure. Alternatively, the taxpayer may be liable for additional tax under section 197. Further, a person who fails to maintain proper records but who wishes to challenge an assessment may not be able to satisfy the burden of proving that an assessment is excessive as required by section 141.

This section does not give the Commissioner any investigatory powers, but it is intended to ensure there is created and retained by the taxpayer a minimum pool of information which may be accessed under the Commissioner's investigation powers in sections 170 and 171.

170. Access to Books, Records, and Computers

This section provides the Commissioner with broad powers of investigation. The powers in subsection (1) may be exercised by either the Commissioner or an officer authorised by the Commissioner for the purpose of this section (referred to as an "investigator"). It is intended that an officer may be authorised generally to exercise the powers in section 170, rather than being authorised specifically for each exercise of the power. While the power may be exercised for the purpose of enforcing the provisions of the Order (including FBT), it is expected that the main purpose for which the power will be exercised is the determination of a taxpayer's income tax liability, and in this regard the power is drafted broadly. The only limit on the exercise of the power is that it be exercised in good faith. It is intended that this power will be the main power relied upon as the legal basis for the conduct of field audits of taxpayers by the Department of Income Tax.

Paragraph (a) of subsection (1) provides that an investigator is to have full and free access to any premises, place, book, record, or computer. The premises, place, book, record, or computer does not have to be that of the taxpayer. For example, the power in paragraph (a) may be used to gain access to books or records kept by the taxpayer's accountant or in a bank safety deposit box. The investigator is not required to give advance warning that access will be sought. Further, it is intended that paragraph (a) authorises a "roving enquiry", that is, where the investigator merely suspects that the access may provide relevant information. It is not necessary for the investigator to specify in advance the books or records sought.

Paragraph (b) provides the investigator with power to make an extract or copy from any book, record, or computer-stored information to which access is sought under paragraph (a); and under paragraph (c), the investigator is authorised to seize any book or record that, in the investigator's opinion, affords evidence which may be material in assessing the liability of any person liable to tax under the Order. The power of seizure, therefore, is more specific than the paragraph (b) access power in that it may only be exercised in relation to the determination of the liability of a person under the Order, rather than being exercised for all the purposes of the Order. A book or record seized by an investigator may not be retained indefinitely, but only for so long as required for determining the liability of a person under the Order or for any proceedings under the Order. Paragraph (e) empowers the Commissioner to seize a computer where a hard copy or computer disk of information stored on the computer is not provided. In this case, the computer can only be retained for as long as it takes to copy the information required. Subsection (4) entitles the owner of a book, record or computer seized under paragraphs (c) and (e) to have access to them while they are in the custody of the Income Tax Department.

Subsection (1) provides a statutory right of access to an investigator. Subsection (2) provides that a failure by an investigator to produce a written authorisation when requested by the occupier of the premises or place to do so removes the statutory right of access. The officer, however, may still be entitled to remain on the premises pursuant to some other right, for example, at the invitation of the occupier. If there is no other right of access, then the officer may not enter, or must leave, the premises.

Under subsection (3), the owner, manager or any other person on the premises or place (including an employee) to which access is sought must provide all reasonable facilities and assistance for the effective exercise of the access power. This would include, for example, indicating the location of books or records, opening locked storage facilities (or at least providing the key), and providing adequate lighting, power, work space, telephone and photocopying facilities. Subsection (3) does not require a person to answer questions concerning a taxpayer's affairs, as this requires a section 171 notice. A person who fails to provide all reasonable facilities and assistance as required by subsection (3) is guilty of an offence under section 182.

171. Notice to Obtain Information or Evidence

This section provides the Commissioner with a general power to obtain information from any person. To properly exercise the power, the Commissioner must give the person notice in writing of the information required, but having done so the person receiving the notice is required to comply with it. This section also provides that the Commissioner may give a notice requiring any person to attend and give evidence regarding the tax affairs (income tax or FBT) of that person or of any other person. The notice may require that the person produce any book, record, or computer-stored information in their control as specified in the notice. It is not necessary that the books, documents, or computer-stored information be described with complete accuracy, rather it is sufficient if they are described with reasonable certainty. It is intended that such notices be drafted quite broadly, and therefore, for example, a notice which requires the production of "all books, papers and documents in the control of [the recipient of the notice] relating to the income of a [nominated person]" is considered to be sufficiently certain as to be a valid notice under this section. Books, records, or computer-stored information are regarded as in the control of a person if that person either has physical possession of them (for example, accounts with the taxpayer's accountant) or, while lacking physical possession, has the right or power to require another person to produce them.

For a notice under this section to be effective, the Commissioner must comply with the service requirements in subsection (4). A person who fails to comply with a notice under this section is guilty of an offence under section 179.

172. Books and Records not in Sesotho or English Language

This section provides the Commissioner with a procedure whereby books and records in relation to which the Commissioner seeks access under section 170, or production under section 171, which are not in the Sesotho or English language must be translated at the expense of the taxpayer to whom the books and records relate. The translator must be approved by the Commissioner.

It is noted that records required to be maintained by section 169 must be kept in the Sesotho or English language, and that failure to do so is an offence under section 176 or may give rise to a liability for additional tax under section 193.

173. Tax Clearance Certificate

This section obliges a taxpayer, if required by regulations, who wishes to transfer funds out of Lesotho to obtain a tax clearance certificate from the Commissioner before making the transfer. The regulations could specify the transactions for which a certificate is required, and could provide that a tax clearance certificate will only be issued if the Commissioner is satisfied that all the tax liabilities of the taxpayer relating to the funds to be transferred have been complied with by the taxpayer. The section becomes operative only after regulations are issued.

A person who fails to comply with this section is guilty of an offence under section 184.

174. Taxpayer Identification Number

In due course, the Commissioner will issue taxpayers with a taxpayer identification number. This section provides that the Commissioner may require a taxpayer to include the taxpayer identification number in any return, notice, or other document required for the purposes of the Order. For example, taxpayer identification numbers of payees are required to be included in an information return filed by a company or partnership under section 130. This will allow the Commissioner to match the information in that return with that contained in the payee's return of income.

175. Offences Related to Returns

The failure to file a return or document as required under the Order is an offence under subsection (1). The reference to a "return" includes a return of income required by section 128, an information return required by section 130, a fringe benefits return required by section 152, and an ACT return required by section 154. "Document" is intended to be interpreted broadly so that it covers any statement, notice, or record required to be filed with the Commissioner. For example, subsection (1) will apply to a failure to file a section 164 statement with the Commissioner concerning payments subject to withholding tax made by the taxpayer during the year of assessment.

The failure to file a return or document does not have to be the result of deliberate or reckless conduct for there to be an offence committed under this section. The offence is committed when, as a matter of fact, a person omits to file a return or document required by the Order to be filed with the Commissioner regardless of the reason for the omission. It is not intended, however, to apply this section where the failure is due to impossibility of performance beyond the control of the person required to file the return or document. An example of this may be where the document to be filed depends on information to be supplied by a third party, which has not been supplied, and cannot otherwise be obtained.

A person convicted under this section who continues to fail to file the return or document as required by the Commissioner is guilty of a further offence under subsection (2). The penalty for this offence is M1,000 for each day the person fails to file the return or document and imprisonment for three months. To emphasise the seriousness of a continuing failure to file a return or document, there is no option for a fine in lieu of imprisonment.

176. Offences Related to the Maintenance of Proper Records

The failure to maintain proper records as required by the Order is an offence under this section. The main section imposing an obligation to keep records is 169. Examples of offences in relation to this section include: a failure to keep records necessary for the accurate determination of the taxpayer's income tax, FBT, or ACT liability, a failure to keep such records in Lesotho, a failure to keep such records in the English or Sesotho languages, and a failure to keep such records for the time limit set out in section 169(3).

The failure to maintain proper records does not have to be the result of deliberate or reckless conduct for there to be an offence committed under this section, although a failure which results from deliberate or reckless conduct is subject to a higher penalty under subsection (2). An offence is committed under subsection (1) when, as a matter of fact, a person fails to keep proper records regardless of the reason for the failure. It is not intended, however, to apply this section where the failure is due to impossibility of performance beyond the control of the person required to maintain the records. For example, a person would not be guilty of an offence for failing to keep records for the requisite time-limit where the records have been destroyed in circumstances which were beyond the control of the person (such as an accidental fire on the business premises).

177. Offences Related to Failure to Comply with a Section 148 Notice

Section 148 empowers the Commissioner to serve notice on certain persons owing money to, or holding money on behalf of, a defaulting taxpayer requiring them to pay the amount specified in the notice to the Commissioner. This section makes it an offence for a person to fail to comply with the notice. A mere omission to comply with a section 148 notice amounts to a failure to comply unless the recipient of the notice can establish that it was impossible to comply with it.

Failure to comply with a section 148 notice is viewed as a serious offence, as recovering the tax owing from a third party may be the only avenue open to the Commissioner. Under subsection (2), a person convicted of an offence under this section may be ordered by the Court to pay the amount or a part of the amount specified in the section 148 notice to the Commissioner in addition to the penalty imposed under subsection (1).

178. Offences Related to Failure to Withhold Tax

A person required to withhold tax at source under Part VII of Chapter IV but who fails to do so is guilty of an offence under this section. Similarly, a person who fails to provide the payee with a tax withholding certificate is also guilty of an offence under this section. These are viewed as serious offences as the collection of tax by withholding at source is central to the administration of the income tax system under the new law, and giving the payee a tax withholding certificate is essential to the payee claiming credit for tax withheld.

179. Offences Related to Failure to Give a Statement Required by Section 110

A person liable to make a payment to a non-resident that is likely to give rise to Lesotho-source income in the hands of the payee is required to give the Commissioner a statement in writing setting out the amount of the payment. A failure to give the Commissioner such a statement as required is an offence under this section. It is regarded as a serious offence because the section 110 procedure may be the only way in which the Commissioner can recover tax owing by a non-resident.

180. Offences Related to Failure to Remit Amounts Withheld under Part VII

A person who withholds tax at source as required under Part VII of Chapter IV but who fails to remit the withheld tax to the Commissioner within the time limit prescribed in the regulations (see section 166) is guilty of an offence under this section. It is regarded as a serious offence because the amounts withheld represent another person's tax.

181. Offences Related to Tax Withholding Certificates

This section prescribes a number of deliberate acts in relation to tax withholding certificates as giving rise to an offence. Because of the tax credits which attach to tax withholding certificates, this is viewed as a serious offence.

182. Offences Related to Failure to Provide Reasonable Assistance

This section provides that it is an offence for a person to fail to provide the Commissioner or an authorised officer with all reasonable facilities and assistance in the exercise of the investigations powers in section 170.

183. Offences Related to Failure to Comply with a Section 171 Notice

This section provides that the failure to comply with a section 171 notice is an offence. An offence under this section may be committed where a person fails to provide information required by the Commissioner under a section 171(1) notice, where a person fails to attend and give evidence as required by a section 171(2) notice, or where a person fails to produce any book, record, or computer-stored information within their control as required by a section 171(2) notice.

184. Offences Related to Tax Clearance Certificates

A person who transfers funds out of Lesotho without complying with section 173 is guilty of an offence under this section. This is viewed as a serious offence because once the funds are transferred out of Lesotho, it may not be possible for the Commissioner to recover any tax liabilities in relation to those funds.

185. Offences Related to Taxpayer Identification Numbers

This section provides that it is an offence for a person to knowingly use a false taxpayer identification number, including the taxpayer identification number of another person. No offence is committed where the person has used the taxpayer identification number of another person with the permission of the other person on a document relating to the tax affairs of the other person. This would cover, for example, an accountant who uses the taxpayer identification number of a client in completing the return of the client. The misuse of taxpayer identification numbers is viewed as a serious offence because of the importance of such numbers in the matching of information returns and other statements required to be filed by third parties to income returns.

186. Offences Related to Secrecy

This section provides for an offence where a person contravenes the secrecy provision in section 202.

187. Offences Related to Contempt of the Tribunal

This section provides for an offence where a person contravenes section 207(7).

188. False or Misleading Statements

This section provides for an offence where a person makes a statement to a taxation officer which is false or misleading in a material particular. It is also an offence under this section to omit from a statement to a taxation officer any matter or thing without which the statement is misleading in a material particular. Whether a statement is false is a question of fact. A statement or omission is misleading if it is reasonably likely to mislead a typical person belonging to the class of persons to whom it is directed. It is not necessary that the statement or omission be knowingly or recklessly made for there to be an offence under this section, although it is a defence to a prosecution under this section that the person did not know (subjectively determined) and could not reasonably be expected to have known (objectively determined) that the statement or omission was false or misleading. A more severe penalty is imposed under subsection (2) if the statement or omission is made knowingly or recklessly. Subsection (4) sets out the circumstances where a statement is regarded as being made by a person to a taxation officer. The list, however, is not exhaustive.

The application of this section is not confined to false or misleading statements or omissions relating to the tax affairs of the person making the statement or omission. It is also intended to apply to statements and omissions made by a person concerning the tax affairs of another person. This would include, for example, statements or omissions made by a taxpayer's adviser, although the adviser may be able to rely on the defence in subsection (3).

189. Obstructing Taxation Officers

This section provides for an offence where a person obstructs the Commissioner or an authorised officer in the performance of duties under the Order. Examples of actions which may constitute obstruction include physical obstruction, such as failing to permit the Commissioner or a properly authorised officer access under section 170, locking a room or cabinet and hiding the key, or otherwise hiding or destroying documents relevant to the investigation of a taxpayer's affairs.

190. Offices Related to Failure to Comply with Section 149

This section provides for an offence where a receiver fails to comply with the requirements of section 149.

191. Offences by Corporate Bodies

This section provides that persons involved in the management of a corporate body are deemed to have committed a tax offence committed by that body. This section only applies to companies which are corporate bodies (not all companies are corporate bodies within the broad definition of company in section 3(1)), although this will include statutory corporations. It is a defence to a prosecution of a person under this section if the person proves that he or she did not consent to, or know of, the commission of the offence (subjectively determined) and that he or she exercised reasonable diligence to prevent the commission of the offence. Whether reasonable diligence has been exercised is objectively determined having regard to the nature of the person's functions and to all the circumstances of the offence.

192. Interpretation

This section defines "specified rate" for the purposes of Division II of Part XI of Chapter IV. The specified rate is the basic rate of additional tax and is based on normal commercial lending rates in Lesotho. It is intended that the specified rate will normally be set at a level above commercial rates (for example, 5% higher) so that the Commissioner is not used as a creditor by taxpayers.

193. Additional Tax for Failure to File Returns

This section imposes additional tax at the specified rate on a taxpayer who fails to file a return within the time required under the Order. A return for the purposes of this section includes an income, fringe benefits, and ACT return, but does not include an information return under section 130. Additional tax is imposed on the tax payable for the year of assessment (net of instalments paid under section 150 and estimated tax paid under section 131(4) at the date the return was due) for the period from the due date of the return until the return is properly filed. Additional tax being by way of compensation for the Commissioner not receiving tax payable on the due date is in addition to any penalty resulting from a conviction under section 175 (see section 199(3)).

194. Additional Tax for Failure to Pay Tax When Due

This section imposes additional tax at the specified rate on a person who fails to pay tax imposed under the Order on or before the due date. This applies to income tax (including estimated tax under section 131(4) and an instalment of income tax under section 150), fringe benefits tax, and ACT. Additional tax is imposed on the amount of the outstanding tax for the period in which it is unpaid. Where a person pays additional tax under this section and it is subsequently determined that the whole or a part of the tax to which it relates was not payable, then the Commissioner is obliged to refund the additional tax relating to the tax found not to be payable.

195. Additional Tax for Under-Estimation of Tax Payable

A taxpayer who has been granted an extension of time to file a return under section 131 is required to estimate the amount of tax due for the year of assessment (net of instalments and ACT paid) and pay the estimated tax on the due date for filing the return. This section imposes additional tax at the specified rate where the taxpayer's estimated tax is more than 10% below the taxpayer's actual liability (net of instalments and ACT paid). Additional tax is imposed on the whole of the difference between the estimated tax paid and the actual tax payable for the period from the original due date of the return to the date on which the final liability was satisfied. Additional tax under this section is in addition to additional tax under section 194 as it represents a penalty for under-estimating tax payable.

196. Additional tax in Relation to Tax Withheld Under Part VII

This section imposes additional tax at the specified rate on a withholding agent who fails to withhold tax as required under Part VII of Chapter II. Additional tax is imposed on the amount of tax not withheld as required for the period from the date the tax should have been withheld to the date that the tax is paid by the withholding agent.

This section also imposes additional tax at the specified rate on a withholding agent who fails to remit tax withheld to the Commissioner by the due date. Additional tax is imposed on the amount of tax not remitted for the period from the due date for payment of the tax to the date the tax is paid by the withholding agent.

Additional tax imposed by this section is in addition to the penalties resulting from conviction of the withholding agent of an offence under section 178 or 180 (see section 199(3)). This is because additional tax is by way of compensation for the Commissioner not receiving the tax payable on the due date. Further, additional tax imposed under this section is the personal liability of the withholding agent, and no part of the additional tax may be recovered from the payee or credited against any assessment.

197. Additional Tax in Relation to Records

This section imposes additional tax on a taxpayer who fails to maintain proper records as required by the Order for a year of assessment. The amount of additional tax imposed under this section is double the amount of tax payable for the year of assessment in which proper records were not maintained. Additional tax imposed under this section is an alternative to prosecution of the taxpayer under section 176 (see section 199(4)).

198. Additional Tax in Relation to False or Misleading Statements

This section imposes additional tax on a taxpayer who knowingly or recklessly makes a statement to a taxation officer that is false or misleading in a material particular or omits from a statement made to a taxation officer any matter or thing without which the statement is misleading in a material particular. Additional tax is only imposed under this section where the tax properly payable by the taxpayer exceeds the tax that would have been payable if tax had been assessed on the basis that the statement or omission was not false or misleading. The amount of additional tax imposed under this section is double the amount of the excess tax payable. Additional tax imposed under this section is an alternative to prosecution of the taxpayer under section 188(2) (see section 199(4)).

199. Recovery of Additional Tax

Additional tax is imposed automatically under Division II of Part XI of Chapter IV and is due from the date the proscribed activity is committed. This section provides that the normal rules for collection and recovery of income tax apply to additional tax. The Commissioner is given a discretion to remit in whole or in part any additional tax payable. It is intended that the Commissioner will publish guidelines indicating the circumstances in which the power of remission may be exercised.

Additional tax imposed under sections 193 and 196 is in addition to any penalty which the taxpayer or withholding agent may be liable for on conviction of an offence under Division I of Part XI of Chapter IV. Additional tax imposed under section 197 or 198 is an alternative to prosecution under section 176 or 188, respectively. If additional tax has been paid under section 197 or 198 and the Commissioner commences prosecution under section 176 or 188 for the same act or omission, then the additional tax must be refunded.

200. Appointment of Commissioner and Deputy Commissioner of Income Tax

This section provides for the appointment of the Commissioner of Income Tax and a Deputy Commissioner of Income Tax. The Commissioner has the general administration of this Order.

201. Delegation

This section empowers the Commissioner to delegate to any officer of the Income Tax Department any power or duty conferred or imposed on the Commissioner under the Order, other than this power of delegation.

202. Secrecy

This section provides that a person appointed under, or employed in the carrying out of, the provisions of the Order must preserve secrecy with regard to all information or documents which come to his or her knowledge in an official capacity in performing duties under the Order. A person who fails to comply with this section is guilty of an offence under section 186.

203. Establishment

This section provides for the establishment of the Administrative Tribunal for Tax Appeals (the "Tribunal"). This is an administrative body specifically established for the purpose of hearing appeals from taxpayers in relation to objection decisions of the Commissioner. An appeal to the Tribunal involves a full merits review of the objection decision made by the Commissioner. The Tribunal is to consist of a President and such other members as may be appointed by the Minister.

204. Membership

This section sets out the qualifications required of persons to be appointed to the Tribunal. The President must be a Judge of the High Court of Lesotho. A person may only be appointed as a member if they come within one of the categories in subsection (2). The reference to "significant experience in taxation matters" is intended to refer to experience in a wide range of taxation matters at a high level of practice. A person who is currently an officer of the Income Tax Department may not be appointed as a member, although a former officer may be appointed to the Tribunal. This section also sets out the term of office of the Presidential and other members of the Tribunal.

No member of the tribunal may hear a case in which that member has a material, pecuniary, or other interest, unless both parties agree to the member taking part. Possible conflicts of interest include a case concerning an associate (including a current or former business partner) of the member, the member has a similar dispute with the Department of Income Tax, the member advised on the facts giving rise to the dispute, or the member was a taxation officer concerned in the case before being appointed to the Tribunal.

205. Responsibility

This section provides that the Tribunal shall hear appeals from taxpayers with respect to objection decisions of the Commissioner. The orders, which may be made by the Tribunal, are set out in section 138(3). See generally the Commentary to section 138.

206. Organisation

It is the responsibility of the President of the Tribunal to assign members to hearings. The Tribunal for a particular hearing may be constituted by one or three members at the discretion of the President. It is intended that the Tribunal will be constituted by three members in cases involving a significant issue of principle, particularly if the result affects the tax position of a number of other taxpayers. Hearings, which largely involve disputes over questions of fact, should be heard by a single member.

207. Administration and Procedure

This section specifies the basic procedural rules applicable to hearings of the Tribunal. Importantly, the Tribunal is to conduct its hearings with as little formality as possible, although proceedings are to comply with procedural rules as specified by the President. The normal rules of evidence applicable to judicial hearings do not apply to the Tribunal.

208. Hearings and Decisions

Hearings before the Tribunal are open to the public, although the taxpayer may request that they be closed to the public. The Tribunal must publish its decisions, although taxpayers may request that their identity or affairs be concealed and steps must be taken to preserve trade secrets and the like.

209. Forms and Notices; Authentication of Documents

A number of sections in the Order refer to notices, returns, statements, and other documents being filed with the Commissioner. This section provides the power to prescribe forms for the purposes of the Order.

210. Service of Notice and Other Documents

This section provides the rules for determining whether a notice or other document required to be served on a person for the purposes of the Order has been validly served.

211. Notification of Nominated Officers

This section provides the rules for appointment and notification of nominated officers of partnerships, trusts, superannuation funds, or companies for the purposes of the Order.

212. Regulations and Amendment of Schedules

This section provides the Minister with a general power to make regulations for the better administration of the Order. The regulations are not confined to interpreting the meaning of provisions of the Order. The authorisation of regulations "for the better carrying into effect of the purposes of this Order" means that, where rules necessary to carry out a particular section of the Order are not contained in the Order itself, they may be prescribed by regulations. Under subsection (2), it is intended that transitional provisions will be made by way of regulations. Under subsection (1)(b), the Minister is given power to amend by way of regulations the First, Fifth, Sixth, and Seventh Schedules to the Order and any monetary amounts in the Order (for example, the level of the abatements in section 73).

213. Repeal

This section repeals the Income Tax Act 1981 and the Amending Acts and Orders thereto.

214. Transitional Provisions

This section provides for certain transitional measures, although it is intended that most transitional measures will be included in regulations made by the Minister.

SCHEDULES

First Schedule

This lists the organisations, which are public international organisations for the purposes of the Order within the definition in section 3(1).

Second Schedule

This sets out the resident individual income tax rate scale. It also allows a resident individual a non-refundable rebate of M600 reduced by 10 lisente for each Maloti of chargeable income above M14,000. The rebate is to ensure that no resident individual is worse off as a result of the increase in the lowest marginal rate to 25%.

Third schedule

This sets out the resident company tax rate scale.

Fourth Schedule

This sets out the rate of income tax applicable to a trustee, minor, and a non-resident who elects to be taxed by assessment in relation to income subject to withholding tax. In each case the rate is 40% and applies as a flat rate against the relevant chargeable income. This schedule also sets out the rate of fringe benefits. The rate is 40%, which equates to the general rate of corporate tax and the maximum marginal rate on resident individuals.

Fifth Schedule

This sets out the multiplication factors and the thresholds applicable in relation to the calculation of minimum chargeable income under section 16.

Sixth Schedule

This divides depreciable assets into four groups and provides the relevant declining balance depreciation rate for assets in each group.

Seventh Schedule

This sets out the repealed legislation for the purposes of section 213.