LRA PRACTICE NOTES

TAXATION OF FOREIGN NATIONALS

[Operations Support Division]

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1.0 Definitions and Acronyms

The following definitions of words as used in this Practice Note shall have the same meanings as contemplated in the Income Tax Act no.9 of 1993:

"the Act or Income Tax Act"	means Income Tax Act No. 9 of 1993;
"DTA"	Double Taxation Agreement for the avoidance and prevention of fiscal evasion with respect to taxes on income;
"Diplomat	refers to an individual who is not a citizen or permanent resident of Lesotho and who is a diplomatic officer, consular officer, administrative or technical employee of a diplomatic mission or consulate, consular employee, member of the service staff of a diplomatic mission or consular post, or a private servant of a member of a diplomatic mission;
"Foreign national"	is a person who is not a citizen of the host country in which he or she is residing or temporarily sojourning[1]
"LRA or the Authority"	Lesotho Revenue Authority;

[1] https://en.wikipedia.org/wiki/Foreign_national

“Public International Organization”	means an organization listed in the First Schedule of the Income Tax Act”;

2.0 Background

Taxation of foreign nationals, especially on employment income, has been a debatable issue between LRA and foreign nationals over the years. The debate has always been around the question of which country has taxing rights between Lesotho and the country of residence of the foreign national. That is not surprising considering the fact that income taxation may have similar principles but different jurisdictions on the other hand may have different tax systems. For instance, some countries use residence based method of taxation while some use source based method.

3.0 Objective

This practice note seeks to define and simplify the taxation treatment of Lesotho source income earned by foreign nationals in Lesotho and of particular relevance will be the explanation of statutory test of residence. It primarily focuses on the employment income that foreign nationals earn in Lesotho.

4.0 The Law and its application

The provisions of Income Tax Act govern the taxation of income in Lesotho and in terms of Section 103 therein, Lesotho source income received or accrued to foreign nationals and worldwide income received by Lesotho residents is subject to Lesotho income tax system. It is worth noting that a person can be a foreign national in general terms but through passing certain tests under the Income Tax Act be deemed a resident for income tax purposes. In making that determination, section 5 (1) of the Act provides for four (4) alternative tests under residency test. If an individual satisfies any of these tests he/she is taken to be a resident of Lesotho for tax purposes. The tests are listed and defined as follows:

4.0.1 Normal place of abode:

An individual who has a permanent place of abode in Lesotho and is present in Lesotho for part of a year is considered a resident of Lesotho for income tax purposes. There is no time limit within which she/he should have been in Lesotho. This means that an individual who has a normal place readily and regularly available (dwelling) in Lesotho whether or not such individual only has occasional visits in Lesotho for a holiday in the year of assessment is regarded as a resident for the whole year.

4.0.2 The physical presence test (182 day test):

An individual who has been present in Lesotho for more than 182 days, for any consecutive period of 12 months is regarded as a resident of Lesotho for tax purposes. It is to be noted that a day includes part of a day which simply means that a period of 4 hours for instance, is equivalent to a day.

4.0.3 Lesotho Government Official:

An individual who is a citizen of Lesotho and is deployed in a foreign country for an assignment remains a resident of Lesotho for tax purposes. It is therefore expected that such individual files the income tax return in Lesotho and the individual's employer remits pay-as -you-earn (PAYE) on behalf of the individual in Lesotho.

It should be noted that foreign nationals paid out of Government of Lesotho counterpart contribution where Lesotho has entered into an international agreement with another country/government are treated as Lesotho government officials for the purposes of this practice note hence are residents of Lesotho for tax purposes.

4.0.4 Otherwise a Resident of Lesotho (Common Law Test):

An individual is a resident of Lesotho in accordance with ordinary tests of residency. This involves an inquiry into facts and other essential considerations none of which is decisive, including;

(i) Physical presence in Lesotho during the year of assessment
(ii) Frequency, regularity , and duration of visits to Lesotho
(iii) Maintenance of a place of abode within Lesotho during a period of absence i.e. has a home in Lesotho.
(iv) Family and business ties in Lesotho
(v) Life style
(vi) Nationality
(vii) Location of personal belongings.

4.1 Income tax treatment of foreign nationals:

The income tax treatment of a foreign national who passes any one of the above explained residency tests and consequently attains "a Lesotho resident status for income tax purposes" is different from that of a foreign national who remains a non-resident even after the application of a residency tests.

4.1.1 Tax treatment where a foreign national becomes a resident for income tax purposes:

A foreign national who is a resident of Lesotho for income tax purposes will pay income tax at the same rate as an ordinary Lesotho resident and is liable for tax in Lesotho on the worldwide income received. It should however be noted that, the Lesotho source property income of an expatriate taxpayer is taxable in Lesotho while the foreign source property income is not taxable in Lesotho. Property income is composed of dividends, interest, natural resource payments, rent, royalties, and gains on the disposal of investment assets. There are certain exceptions and exemptions that also apply to ordinary residents. For instance, where dividend is paid out of manufacturing income, no withholding tax is payable while 15% withholding tax is applied on royalties paid for the use of technology that produces manufacturing income subject to tax in Lesotho.

A foreign national who receives employment income such as salaries, wages, bonuses, overtime pay and leave pay pays income tax at marginal rates if the income exceeds a certain threshold[2] amount in the year of assessment.

The foreign national is also generally entitled to the same deductions and rebates as an ordinary Lesotho resident. The deductions allowable in this regard are those of expenses incurred directly in the generation of employment income and have certain conditions and requirements as elaborated in the Income Tax Regulations No. 23 of 1994. These include education expenses to improve work knowledge or skills, expenses for technical and trade books and journals and association subscriptions, motor vehicle expenses incurred for work, contributions made to a complying superannuation fund and donations paid to the Lesotho Sports and Recreation Commission.

Foreign nationals (who do not enjoy diplomatic and similar privileges) employed by public international organization[3] and diplomatic and consular missions at an office in Lesotho who are paid out of income sourced from outside Lesotho fall under this category as long as they pass any of the residency tests discussed above.

The Income Tax Act requires employers to deduct/withhold, on a monthly basis, an amount due for tax from the employee's income as part-payment of that employee's annual tax liability and to remit same to Lesotho Revenue Authority. This is done through the operation of the pay-as-you-earn (PAYE) system.

[2] The threshold amount may be changed by the Minister through publication of notice in a gazette.
[3] as defined in the Income Tax Act

There are certain non-cash benefits that are received or due to an employee by virtue of an employment relationship with the employer. These non-monetary benefits derived from employment may not form part of an employee's normal salary or wage but that does not make them tax-free remuneration. Sections 119 through to 127 of the Act govern the taxation of these benefits referred to as fringe benefits and further prescribes the valuation methodology that should be used by the employer to determine the cash equivalent (taxable) value of the fringe benefits. This FBT system is operated separately from the PAYE system[4].

The Act further requires that the taxable income from each source within Lesotho must be assessed separately. This means that all expenses relating to a specific source of income must be deducted from that source, for example, expenses from employment cannot be deducted from property income but have to be deducted from employment income exclusively.

The foreign national, just like any other resident taxpayer is obliged to observe his/her tax obligations including (1) completing and filing his/her return of total Lesotho source income,(2) calculating taxes due[5] and (3) remitting taxes due when they become payable to Lesotho Revenue Authority, and (4) keeping the records of income and deductions.

4.1.2 Tax treatment where a foreign national fails all the residency tests

If the foreign national does not pass any of the residency tests it means such an individual remains a non-resident and will be taxed as such. The law through the Income Tax Act states that the gross income of a non-resident taxpayer includes only Lesotho-source income. This means that non-residents are liable for tax only on the Lesotho source income that they received.

[4] For a detailed and a fully comprehensive guide on the taxation of Fringe Benefits, refer to the Income Tax Public Ruling on Fringe Benefits Tax issue 2 published in February 2011 accessible at www.lra.org.ls website.

[5] Taxpayers are required to complete their tax returns honestly and accurately. Certain penalties and criminal sanctions may be levied in full if accurate disclosures of all receipts, accruals and expenses are not made in the tax return.

To facilitate taxation of non-residents on the Lesotho-source income, withholding tax system is adopted. In terms of the withholding tax rules, the payer is required to deduct from the gross amount due to the payee, a percentage prescribed by the Act and subsequently pay the amount withheld to LRA within a stipulated time period as prescribed by the Act.

The withholding tax at standard rate is applicable on the gross amount of the Lesotho sourced income e.g. passive income. Passive income is income which is derived without active involvement in generating it and examples include: interest, dividends, royalties, management charge, patent fees, and trade mark fees. This standard rate is overwritten by the graduated rate as determined in a relevant treaty that Lesotho may have entered into with another country for the avoidance of double taxation or non-taxation. However, where dividend is paid out of manufacturing income, no withholding tax is payable. Also, where the royalty is paid for the use of technology that produces manufacturing income subject to tax in Lesotho the concessionary income tax rate is applied.

Service fees/income earned by a foreign national is taxed at a prescribed rate. Service fees/income relates to payment of fees made to a non-resident under a Lesotho source services contract. The contract referred to here is a contract of services that gives rise to Lesotho source income but it however excludes a contract of employment.

A foreign national may file a return of income in which case the individual will be electing to be taxed by assessment as opposed to withholding tax system. In this instance, a foreign national should first register with LRA by filling in and submitting the Registration form at any of the LRA Advice Centers[6]. In filing the return, the foreign national will be allowed deduction of expenses incurred in the generation of the taxable Lesotho source income and the losses on the other hand would be allowed as a deduction if they would otherwise have resulted in Lesotho sourced taxable gains.

[6] Registration forms are available at all LRA Advice Centres and on the website through the link http://www.lra.org.ls/forms.

4.3 Foreign Nationals exempted from Lesotho income tax:

Tax exemption on Lesotho sourced income of foreign nationals is usually provided for in international laws. There are cases where taxation of foreign national is determined by provisions of a treaty that Lesotho may have entered into with another country for the avoidance of double taxation or non-taxation or international laws such as the Vienna Convention as domesticated by the Diplomatic Immunities and Privileges Act of 1969.

4.3.1 Employees of Diplomatic Foreign Governments working in Lesotho:

Employment income of foreign nationals who enjoy diplomatic and similar privileges is not taxable in Lesotho. The exemption applies even where the foreign national becomes a resident of Lesotho through the application of residency test like physical presence test. This exemption also applies to an official employment income of a person who is in the public service of the government of a foreign country where:

(i) the person is resident in Lesotho solely for the purposes of performing the duties of his or her office; and

(ii) income is payable from the public funds of that country; and

(iii) the income is subject to income tax in that country.

In the event that the foreign national applies for and receives a permit for permanent residence in Lesotho, the exemption no longer applies and liability for normal tax arises from the date of issue of such permit. This is due to the fact that once the foreign national receives permanent resident status; he/she will be regarded as being ordinarily resident in Lesotho.

4.3.2 Relief under a tax treaty:

A foreign national who earns employment income from a source within Lesotho may be liable for income tax both in Lesotho and the foreign national's country of residence. In cases where there is a treaty entered into and between Lesotho and another country for the avoidance of double taxation or non-taxation, residence as defined therein will be applicable. If disputes arise between the two treaty parties around the issue of residency, tie breaker provisions as contained in the treaty are used to establish the residence. It follows therefore that while a person may pass the residency test, he/she will not be regarded as a resident for Lesotho tax purposes if that person can be deemed to be exclusively a resident of another country when applying provisions of a tax treaty.

Tax treaties concluded between Lesotho and other states bear common criteria to be passed before a foreign national earning employment income in Lesotho could be exempt from income taxation. As a general guideline only, an exemption would apply if all three requirements listed below are met:

- The foreign national is physically present in Lesotho for a period or periods in aggregate not exceeding 182 days in any 12-month period commencing or ending during a year of assessment (not necessarily during a specific year of assessment).
- The remuneration is paid by, or on behalf of, an employer who is not a resident of Lesotho.
- The remuneration is not borne by a permanent establishment that the employer has in Lesotho.

4.3.4 Examples

Example 1

Mr. Shaw is ordinarily a resident of a foreign country who is employed in Lesotho by a company that is affiliated to a mother company in his country of residence. His salary is paid by the mother company. He spends all his weekdays in Lesotho and goes home at his country of residence over the weekends. His country of residence has an Agreement for the Avoidance of Double Taxation (DTA) with Lesotho.

Question

Where is Mr. Shaw's employment income taxable between Lesotho and his country of residence?

Answer

Mr. Shaw satisfies one of the residency tests as provided for in the Income Tax Act, specifically 4.0.2 above as he remains in Lesotho for more than 182 days in a year of assessment and his place of effective employment is Lesotho, making his employment income taxable in Lesotho. If when applying the relevant sections of the income tax law of his country of residence it is found that he also becomes a resident of his country of residence for tax purposes, then provisions of the DTA on residency determination will be considered.

Example 2

Ms. Fatzila lives across the borders of Lesotho but comes to work in Lesotho every week day. She is employed by Lesotho Cars (Pty) Ltd for a contract period of 2 years. Where should Ms. Fatzila's income be taxed?

Answer

Ms. Fatzila's income becomes taxable in Lesotho at marginal rates. This is because Ms. Fatzila is present in Lesotho for more than 182 days in the year of assessment hence becomes a resident for tax purposes in Lesotho as her place of effective employment is Lesotho. She will be allowed credits (including tax credit) and deductions similar to those of an ordinary resident.

Practically, she is in Lesotho for part of the day every week day as she goes back to her home outside Lesotho when she knocks off at the end of the day. But the reason that the Income Tax Act takes part of the day e.g. an hour to be equivalent to a full day, she is deemed to take 5 full days a week in Lesotho which makes it more than 182 days spent in Lesotho in the year of assessment.

Example 3

Mr. Osula is a foreign national who is employed by one public international organization in Lesotho and he does not have any Diplomatic immunities status.

Question

Is Mr. Osula's employment income exempt from tax in Lesotho?

Answer

No, Mr. Osula's income is taxable[7] in Lesotho at marginal rates and allowed credits (including tax credit) and deductions similar to those of an ordinary resident. This is because Mr. Osula is present in Lesotho for more than 182 days in the year of assessment hence becomes a resident for tax purposes in Lesotho as his place of effective employment is Lesotho.

Example 4

Mr. Schurma lives with his new wife and a daughter in Gauteng. He has just got a job as the managing Director of We Drive the Economy, a fleet service Lesotho resident company, on a three year contract. He spent the first 180 days of his contract in his office in Lesotho, and then took a month leave from work for a holiday in Mauritius. Before his leave, he had hired a personal assistant from Ladybrand temporarily for the 182 days he was in office. When he got back in office from his island holiday he had made sure that the same temporary personal assistant is back as well to continue with her good work.

Question

How is the employment income of the two employees taxed?

Answer

The income of the two employees is taxed at marginal rates from the first month of their engagement at the company. Mr. Schurma has a contract of employment with a resident company for a period exceeding 180 days which makes him a resident of Lesotho for tax purposes. His personal assistant on the other hand has been engaged by a company for a period exceeding 182 days hence she is also a resident for income tax purposes.

[7] The exemption granted to public international organizations is limited to the income of the organizations, it does not spill over to the employees.

Example 5

Mr. Makana is a regional manager of a Furniture chain stores in the Free State province of South Africa and branches in the whole of Lesotho. When in Lesotho, he works from his office at the main branch in Maseru town. He gets his monthly salary from the head office in Cape Town.

Question

Where is Manaka's employment income taxed?

Answer

Mr. Manaka's employment income is taxed in Lesotho for the reason that his company has a permanent establishment in Lesotho i.e. he has a physical office in Lesotho.

Example 6

Professor Knowslotsofstuff is engaged on sabbatical training of Doctors at the Faculty of Sciences at the Lesotho University from one South African University for 18 months. He does not engage in any other income earning activities in Lesotho, he spends his spare time either playing soccer with the University students or touring the highlands. The African University pays his monthly salary with the Lesotho University paying him a basic stipend.

Question

Who has the taxing rights between the two countries, Lesotho & South Africa?

Answer

South Africa has the right to tax professor's salary on the payment that comes from sources outside Lesotho as he is in Lesotho for purposes of the training only. That is, his part of income is exempt from tax in Lesotho in terms of the DTA between the two countries. However, the stipend earned from Lesotho University is taxable at marginal rates.

Example 7

Mr. Muhlakazo a civil engineer who has a three (3) year renewable contract with the Lesotho Water Authority and one of his duties involves monitoring the construction of the dam. He stays at his house in Pretoria and only comes to Lesotho every second month. In one of his flights from Johannesburg where he lives with his wife and five sons, he met his now friend Mr. Putthemintheirplace, a very South African prominent forensic attorney. Mr. Putthemintheirplace comes to Lesotho only as per the Lesotho High Court request which is usually twice in 6 months.

Question

What is the taxation of income paid to the gentlemen?

Answer

The income paid to both gentlemen as independent contractors in services provided in Lesotho is taxable in Lesotho through withholding tax system at the DTA tax rate.

Example 8

Mr. More holds South Africa and Lesotho dual citizenship. He lives with his wife in Pretoria and only flew into Lesotho this morning from the Durban July festivities just so he makes it to one of his meetings with the Revenue Authority. He has a 10 months contract with the Revenue Authority to provide its staff with identification cards. When he is in Lesotho, he stays at his old house at Ha Thetsane where his oldest daughter lives. He normally always comes to Lesotho during the holidays and some weekends to attend weddings and funerals.

Question

Which Jurisdiction, between South Africa and Lesotho, has the taxing rights over Mr. More's income including the one he earns from the Revenue Authority?

Answer

The DTA between the two countries gives residency of an individual to a State where (1) an individual has a permanent home available to him/her or (2) his/her center of vital interest can be determined or (3) he/she is a national, in that order. If the determination cannot be made the two countries should reach a mutual agreement.

Now in Mr. More's case, the determination cannot be made through the three attributes mentioned above with him having permanent homes in both countries (Thetsane & Pretoria), attending social ceremonies in both while on the other hand is a national of the two countries. Therefore the two State should reach a mutual agreement on the issue of Mr. More's residency for income tax purposes.

5.0 Conclusion

It is established that generally, foreign nationals are taxed in Lesotho through withholding tax system where the tax withheld becomes the final tax unless the person opts to file a return. In a case where a non-resident passes a residency test, such person it treated as a resident for income tax purposes in which case the person is taxed on the income earned globally with the exception of income earned from foreign property. The foreign national who is a resident for tax purposes as explained in 4.1.1 will enjoy similar deductions and exemptions to those afforded to a regular resident.

The domestic laws of Lesotho remain applicable where no tax treaty exists. Where a treaty exists, provisions therein take precedence. In some cases, exemptions are provided for under tax treaties and other international laws where income that would ordinarily be taxable is exempt.

Disclaimer

This Practice Note provides the general interpretation of the law and considers broad principles in guiding the taxation of foreign nationals on income earned in Lesotho. The Practice Note has no binding legal force and does not affect a taxpayer's right of objection and appeal to the Commissioner General, the Revenue Tribunal or the Courts of Law. This Practice Note shall not affect the taxpayer's right to argue for a different interpretation, where necessary, in any appeal process, as stipulated in the revenue laws. Neither is this Practice Note binding on the Commissioner General, should circumstances arise for deviation as necessary or as the Commissioner General may deem otherwise in his discretion.