CONTENTS

FOUDATIONS IN TAXATION (LSO)

This is the new edition of the CAT Study Text for paper FTX- Foundation in Taxation (Lesotho variant paper-LSO). This book has been written specifically for CAT students. It entails plenty of self test questions to enable students to practice for CAT examinations.

Aims

To develop the ability to prepare computations of tax liability for both individuals and businesses resident in Lesotho for the purposes of income tax, corporation tax and value added tax. In addition, to develop knowledge and understanding of the manner in which dealings must be conducted with the Lesotho Revenue Authority, including knowledge of the statutory timescales for the submission of claims and returns and the due dates for the payment of tax liabilities.

Objectives

On completion of this paper, candidates should be able to:

- Calculate chargeable income and income tax liability for the different taxpayer
- Calculate an individual's income from employment
- Prepare computations of the chargeable gains arising on disposals by both individuals and companies
- Prepare corporation tax computations
- Complete and submit Value Added Tax calculations using data from the appropriate recording systems
- Identify the due dates for submission of returns and the payment of tax liabilities
- Conduct dealings with the Lesotho Revenue Authorities and with clients in an appropriate manner.

POSITION OF THE PAPER IN THE OVERALL SYLLABUS

An understanding of the formats of accounts used for sole traders, partnerships and companies from paper FFA (F3) Foundation in Financial Accounting is assumed. There is no substantial integration with other papers. The coverage in Paper FTX (LSO) will provide the grounding for the study of Paper F6 Taxation (LSO).

SYLLABUS CONTENT

1. Chargeable income and income tax liability for different tax payers

- (a) calculation of chargeable income
- (b) Depreciations allowances – single asset method and pooling method
- (c) Minimum chargeable income
- (d) Assessments for individual, partnerships and compamies
- (e) Relief for losses

2. Income from employment

- (a) Computing taxable emoluments from employment
  - (i) Basis of assessment
  - (ii) Employment of self-employment
- (b) Allowable deductions
- (c) Fringe benefits and fringe benefits tax.

3. Income tax computations

- (a) Income from property, including from investments and chargeable gains/losses
- (b) Computing taxable income
  - (i) Gross income
  - (ii) Allowable deductions
  - (iii) Allocation of tax rates

(iv) Personal tax credit

(v) Minimum chargeable income

4 Chargeable gain computations (individuals and companies)

(a) Chargeable persons, disposals and assets

(b) Computing gains and losses

(i) basic computation

(ii) valuing assets

(c) Relief for allowable losses.

5 Administration of income tax

(a) Assessment System

(b) Payment of income tax, including payments on account

(c) Dealing with the Lesotho Revenue Authority.

6 Corporation tax computations

(a) Accounting periods

(b) Company profits chargeable to corporation tax

(c) Chargeable gains/losses

(d) Computing corporation tax liability

(e) Relief for losses.

7 Administration of corporation tax

(a) corporation tax assessment

(b) The payment of corporation tax (including ACT quarterly payments)

(c) Dealing with the Lesotho Revenue Authority.

8. **Value Added Tax (VAT)**

(a) Scope of VAT

(b) Basic principles of VAT

(i) Types of supply

(ii) Computing VAT due

(iii) Accounting for VAT

(iv) The time for supply

(v) VAT invoices and records

(vi) Registration

(vii) Administration of VAT.

EXCLUDED TOPICS

The following topics are specifically excluded from Paper FTX (LSO)

Prepare chargeable income for clubs and associations:

- Badges of trade
- Successions
- Long life assets
- Depreciation allowances on hotels and intangible assets
- Change of accounting date
- Limited liability partnerships
- Foreign income of partnerships and companies
- Double tax relief
- Formation, reconstitution or dissolution of a partnership
- Determination of adjusted cost base of partner's interest

Income from employment:

- Detailed operation of the PAYE system
- Share incentive schemes

Income tax computations:

- Foreign income and double tax relief

Corporation tax:

- Anti-avoidance
- Personal service companies
- Share incentive schemes
- Mergers & acquisitions
- Incorporation and liquidation roll over
- Reconstructions
- Long term contracts
- Change in control of companies
- Double taxation agreements and treaties
- Foreign income of companies
- Reinvestment relief
- Negligible value claims
- Wasting assets and leases
- Incorporation relief
- Change of accounting date

Value added tax:

- Group registration
- Secondhand goods scheme
- Partial exemption
- Special schemes for retailers
- The capital goods scheme
- Serious misdeclaration penalty
- Default interest

KEY AREAS OF THE SYLLABUS

The key topic areas are as follows:

- Computations of chargeable income / losses for tax payers
- Calculating an individual `s income from employment
- Assessment of profits / losses from trades or professions
- Basic income tax computations
- Computing profits chargeable to corporation tax
- Computing corporation tax payable

- Basic Value Added Tax computations

APPROACH TO EXAMINING THE SYLLABUS

Paper FTX (LSO) is a two-hour written paper.

The examination will predominantly computational and will comprise two compulsory sections. Section A 10 multiple choice questions for ***20 Marks*** and section B nine long questions for ***80 marks***, which will add up to a total of ***100 marks.***

Section B of the paper

Question 1 will relates to chargeable income and tax payable for an individual taxpayer for 15 marks

Question 2 relates to corporation tax and also for 15 marks.

Question 3 relates to Value Added Tax (VAT) and will amount to 10 marks.

Question 4 to question 9 may include topics from any area of the syllabus not examined elsewhere in the paper. Question 4 accounts for 10 marks and Questions 5 to 9 amounts to 6 marks each.

ADDITIONAL INFORMATION

ACCA applies a six-month rule in that questions requiring an understanding of new legislation will not be set until at least six calendar months after the last month in which the legislation came into use.

The cutoff date for the June examinations is 30 November preceding the June examinations. The cutoff date for the December examinations is 31 May preceding the December examinations.

Tax rates and allowance tables will be provided at the front of the examination paper. Calculations should be made to the nearest month and the nearest M.

Knowledge of section numbers will not be needed to understand questions in this paper, nor will students be expected to use them in their answers. If students wish to refer to section numbers in their answers they may do so and will not be penalized if not, or even incorrect, section numbers are used.

RELEVANT TEXTS

There are a number of sources from which you can obtain materials relevant to the ACCA CAT examinations. These are listed below:

Lesotho Income Tax Act 1993

Lesotho income Tax Act Explanatory memorandum

Lesotho Value Added Tax Act 2001 (as amended)

Candidates should also read any relevant articles published in student accountant magazine.

STUDY SESSIONS

1 Introduction to the Lesotho tax system

(a) Identify the main sources of Lesotho tax legislation

(b) Describe the organization of Lesotho Revenue Authority and its terms of reference including the appeal system

(c) Describe the objections and appeals process.

2 Introduction to personal taxation

(a) Identify the fiscal year

(b) Explain the scope of income tax with regard to chargeable persons and chargeable income

(c) Distinguish between income and capital profits/losses

(d) Outline the key elements of personal tax computation including gross income and exempt income.

3 Income tax – basic computation

(a) Explain the entitlement to and the amount of the personal tax credit

(b) Property income

(i) Identify the categories of property income

(ii) Calculate taxable income from dividends, interests, rents and royalties

(c) Prepare examples of income tax computations using standard layout

(d) Explain and illustrate the treatment of gains/losses on the disposal of assets

(e) Explain and illustrate the differences between total tax liabilities

(f) Explain and calculate the minimum chargeable income.

4 Income tax – income from employment

(a) Explain the difference employment and self employment and its implications

(b) Identify principal categories of deductions and illustrate their scope

(c) Identify and calculate the fringe benefits and fringe benefits tax.

5 Income tax – income from trades and profession

(a) Explain the principles of deductible and non-deductible expenditure

(b) Prepare chargeable income computations

(c) Explain and apply relief of losses

6 Depreciation allowances

(a) Explain the principles relating to depreciation allowances and ensure that assets are correctly grouped / classified

(b) Prepare depreciation allowance computations using both pooling method and the single asset method

(c) Illustrate the difference between the pooling method and the single asset method.

7 Partnership

(a) Explain the principles of taxation of partnership

(b) Determine partnership residence

(c) Calculate partnership income / loss

(d) Calculate the individual partners' tax

(e) Demonstrate the effect of changes in partnerships.

8 Superannuation contributions

(a) Explain and calculate the reliefs available for contributions to an employer's superannuation fund for both the employer and the employee

(b) Explain and calculate the reliefs available for contributions to a self-provided superannuation fund

(c) Explain and calculate the reliefs available for contributions to a non-resident superannuation fund

(d) Describe the treatment of a complying superannuation fund.

9 Income tax administration

(a) Describe the administrative procedures relating to returns of income, including the filing of returns and cases where returns are not required

(b) Describe the administrative procedures relating to assessments including deemed assessments, default, special and amended assessments

(c) Outline the processes for the collection and refund of tax

(d) Identify the due dates for the payment of income tax

(e) Explain the processes for paying tax by instalments and calculate instalments due

(f) Explain how a repayment of overpaid tax can be obtained.

10 Chargeable gains/losses (individuals and companies)

(a) Identify chargeable persons, chargeable assets and chargeable disposals

(b) Explain the circumstances in which market value will be used as either the transfer value or the base cost

(c) Explain and calculate exemptions and reliefs

(d) Prepare basic computation of chargeable gain/loss

(e) Explain and illustrate how relief for losses is given.

11 Corporation tax – compute the profits liable to corporation tax

(a) Explain the scope of corporation tax including the concepts of residence and source

(b) Identify chargeable accounting periods

(c) Identify the different classes of income

(d) Explain and illustrate the treatment of gain/losses on the disposal of business assets

(e) Compute profits chargeable to corporation tax for Lesotho resident companies.

12 Corporation tax – computation of tax liability

(a) Identify the rates of corporation tax to be applied

(b) Identify the financial year(s) relevant to chargeable accounting period

(c) Calculate the corporation tax liability for Lesotho resident companies

(d) Calculate the corporation tax payable for periods longer and shorter than 12 months

(e) Explain and apply relief for losses.

13 Corporation tax - administration

(a) Outline the corporation tax assessment rules including return and filing dates, the processes relating to amendments and enquiries

(b) Explain the processes for the payment of tax, including advanced corporation tax and the quarterly payments system.

14 Value added tax

(a) Explain the scope of Value added tax

(b) Illustrate the need for registration – compulsory, voluntary, exemption and deregistration

(c) Explain and contrast the types of supply – standard, zero rated and exempt

(d) Compute VAT liability – input tax, output tax, bad debts, discounts and irrecoverable VAT

(e) Explain the time of supply/tax point for inputs and outputs

(f) Outline the process of accounting for VAT, including return periods and VAT returns

(g) Explain the detail required on VAT invoices

(h) Detail the basic VAT administration requirements – records

(i) Explain the treatment of imports and exports.

15 Revision of Income tax.

16 Revision of taxation of chargeable gains.

17 Revision of corporation tax.

18 Revision of VAT.

Assumptions and abbreviations

Unless otherwise stated, the following assumptions must be made when interpreting the examples and questions in this tax manual:

- References to the Act are to the Income Tax Act 1993 as amended, Income Tax Order 1993 Explanatory memorandum and Value Added Tax Act 2001.
- All individuals are residents

- There is a double tax agreements between Lesotho and other countries
- Enterprises are registered as vendors for Value-Added Tax
- The cost price of all purchases made by registered vendors for VAT purposes do not include vat.
- In the case of an individual the year of assessment ends on 31st March each year.
- All calculations are in Maloti.

Abbreviations used in this manual:

▪ Lesotho Revenue Authority	LRA
▪ Pay-as-you-earn	PAYE
▪ Value Added Tax	VAT
▪ Fringe Benefit Tax	FBT
▪ Advance Corporation TAX	ACT

Chapter 1

INTERPRETATION OF 1993 INCOME TAX ACT (AS AMENDED)

The emphasis in this chapter is on providing a fuller explanation of the definitions contained in S.3 of the Income Tax Act and the entire terminology used in the Income Tax Act.

An understanding of these sections is essential for the proper interpretation of the underlying provisions of the Act.

LESOTHO GOVERNMENT

This includes a statutory corporation (e.g LNDC, LEC) and any other body in which the Government or a statutory corporation has a controlling interest.

MINISTER

This means the Minister of Finance

COMMISSIONER

This refers to the Commissioner of Income Tax appointed under the Act.

TRIBUNAL

This means the Administrative Tribunal for Tax Appeals established by S.203.

YEAR OF ASSESSMENT

This means the period of 12 months ending on 31 March, or, with a company, such other period as the Commissioner may allow. This may normally be based on the company ` s financial year.

PERSON

This includes

i) A partnership
ii) A company
iii) A government
iv) A political subdivision of government (e.g. local authority)
v) A public International Organisation

TAX PAYER

The tem refer to a person subject to tax imposed by the Act.

EXPATRIATE TAXPAYER

This term is defined to a 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 S.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 S.3 (1).

TECHNICAL SERVICES CONTRACT

This means a contract under which accounting, auditing, economic, financial, legal, management, engineering, architectural, or other similar professional service is performed.

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.

NON – RESIDENT

It means a person who not a resident in Lesotho

RESIDENT NON RESIDENT

A resident of another country who works in Lesotho.

MINOR

This means an individual who is under 18 years of age at the end of a year of assessment.

CONTRACTOR

It means a person who is engaged in business of:

(i) Leasing vehicles, plant or equipment
(ii) Providing construction, transportation or any other service prescribed by the regulations
(iii) Where the primary purpose of the contract is the performance of the service whether goods are also provided or not under the contract

PUBLIC INTERNATIONAL ORGANISATION

This means an organization listed in the First Schedule of the Act.

SUPERANNUATION FUND

This means

i) A pension fund, or

ii) A provident fund, or

iii) A retirement annuity fund, or

iv) Group Life Assurance

TAX RATES:

(i) Standard rate of tax
This is 25%

(ii) Special rate
This is 10%

(iii) Marginal rates
These are 20% and 30% accompanied by personal tax credit

PERSONAL TAX CREDIT

This is the personal credit allowed to individuals under S.73. It is M6, 466.00 per annum with effect from 1 April 2015.

PAID

This term is defined inclusively to ensure that 'paid' included 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.

COST BASE

The cost base of an asset is the starting point in deciding the adjusted cost base of an asset.

The general principle is that the cost base of an asset is its tax cost. Usually, this will be the actual purchase price of the asset. However, S.60 provides rules designed to cover most circumstances.

i) Purchased Asset

The tax cost of an asset purchased is the amount paid for the asset, including the market value of any considerations in kind given for the asset.

ii) Asset Produced or Constructed by Taxpayer

The tax cost is the amount incurred in producing or constructing the asset, including any non-deductible expenses such as interest or taxes incurred during the construction period.

iii) Assets Acquired in Non-Arms-Length Transaction

The tax cost is the market value at the date of acquisition.

iv) Assets Acquired by Way of Gift

The tax cost is the greater of

a) the transferor `s adjusted cost base

or

b) the market value of the asset at the date of transfer

v) Cost of Asset Acquired in Transaction in which a gain is not taken into account

The following examples of such circumstances:-

a) The passing of an asset to a personal representative or beneficiary on the death of a taxpayer

b) The passing of an asset at a loss between associates

c) The transfer of assets between spouses

d) The contribution of asset to a partnership

The general rule is that the tax cost to the transferee is the adjusted cost base of the transferor at the date of transfer. With transfer on death it is the adjusted cost to the deceased at the date of death.

Where the transfer involves an asset swap the cost base of the asset received is the adjusted cost of the asset given in exchange at the date of transfer.

v) Part Disposal

Where there has been a partial disposal of an asset the cost base must be apportioned between the part disposed and the part retained based on their market values at the time the asset was acquired.

For example – a property developer purchases 20 hectares of land for M100, 000. 10 hectares have development potential and are worth M75, 000, with the remaining valued at M25, 000. On disposal of the development land the cost is apportioned based on these values and not on the basis of average cost per hectare that would give a value of M5, 000 per hectare, irrespective of its potential.

vii) Asset purchased before 1 April 1993

It is the higher of:

a) its market value at that date

or

b) its adjusted cost base at that date

viii) **Investment Assets**

Investments Assets being interest in immovable property held by the taxpayer for more than 12 months have a Tax cost that is the adjusted cost base of the asset increased for the effects of inflation as prescribed in regulations.

ADJUSTED COST BASE

The adjusted cost base of an asset is the cost base

a) Reduced by:-

i) Any depreciation or amortization allowance

ii) Any refund or reimbursement (for example, a refund arising from a defect in asset)

b) Increased by:-

i) the cost of improvements (but not repairs) to the asset

ii) Any other capital costs relating to the asset. This is intended to include non-deductible costs of acquiring, holding or disposing of the asset.

Examples of acquisitions and disposal costs include

- fees, commissions etc to a valuer, broker, legal adviser etc
- advertising costs
- transfer costs, such as stamp duty

Holding costs relate to items such as rates, insurance etc., though these are usually deductible against income and, as such, would not be added to the cost of the asset.

BUSINESS

This 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 the Act. 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" gives content to the term. While there is no rule of law about what is a business, these decisions have identified several factors which have been considered 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 organization

The judicial decisions have emphasized that the existence or absence of 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 recognized that an isolated activity can, in certain situations, constitute a business. The express inclusion of "an adventure an isolated transaction with a business character" is intended to ensure that the judicial concept of in the nature of trade is included as a business for the purposes of the Act.

BUSINESS ASSET

This is defined to mean an asset that produces income subject to Lesotho Income Tax and is used in a business or is held for sale in a business.

While there is no separate definition of the term "asset", it is intended to include anything that be turned to account. The term "asset" has been used instead of the term "property" which, if read narrowly, would unduly limit the scope of the definition of business asset.

BUSINESS DEBT

This is defined to mean a debt the proceeds of which are used to incur a deductible business expense or to acquire a business asset. Its most common application is to loans that are raised by the business for the purposes of either acquiring a business asset or incurring a business expense.

BUSINESS INCOME

Business income means the profits or gains arising from a business. Thus, the distinction between gains of a capital nature is not relevant.

The Act specifically included the following items as forming part of Business Income:-

1. Gains on:-
   - i) disposal of business assets

     Or
   - ii) satisfaction of business debts

   whether or not the asset was on capital or revenue account.

2 A payment received as consideration for accepting a restriction on the capacity to carry on a business.

CHARGEABLE INCOME

This is the Gross Income of the taxpayer reduced by any deductions allowed under the Act.

CONSIDERATION RECEIVED

The consideration received on the disposal of an asset includes the market value of any consideration in kind. Usually this will be the cash received. However, there will be circumstances where cash in not the consideration for a disposal, e.g. a swap or barter arrangement, therefore the need to create a fair market value rule.

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. An office building, being immovable property does not qualify.

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, although there in 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 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 or a 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 S20.

The death of 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 the dispose of the asset to a third party. The cost base of the asset to the personal representative or the beneficiary is its adjusted cost base in the hands of the deceased at the date of death of the deceased.

EMPLOYEE

This means an individual who is in employment.

EMPLOYER

This means a person who employs or remunerates an employee.

EMPLOYMENT

This term is defined broadly to mean employment at 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 and independent contractor. The determination of whether a person is an employee or independent contractor involves looking at several 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 provided within the hire's business. This latter point will depend on such things as-

- Whether the service provider is engaged on a continuous basis
- 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 tax.

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 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 that 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 Act.

INVESTMENT ASSET

This term is defined to mean all assets of a taxpayer, other than:-

a) A business asset

Or

c) Any asset that does not produce income subject to Lesotho Income tax (including withholding tax under S.107 or S.108) and held primarily for personnel use by the taxpayer.

As to the meaning of "asset" see 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 ensured that there are no tax consequences on the disposal of personal use assets if it does not produce income and is held by the taxpayer primarily for personal use. It follows than 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 another 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 to have regard to all the circumstances.

Chapter 2

INTRODUCTION TO TAXATION

The following study sessions are covered in this chapter

		Syllabus reference
a)	Describe the overall structure of Lesotho tax system	A1a
b)	Identify the main sources of Lesotho tax legislation	A1b
c)	Describe the organization of the Lesotho Revenue Authority And its terms of reference including the appeals system	A1c
d)	Identify the different types of taxes	A2a
e)	Explain the difference between direct and indirect taxation	A2b

INTRODUCTION

Most people who enter the workplace are amazed to see the amount of tax that is deducted from their monthly salary. Most people `s first reaction is that there must be a mistake. "I am paying too much tax". After consultation with the salary department it is usually confirmed that the correct amount was deducted. The reality of tax is something that most people have to face whether you are employed or operating your own business.

CRITICAL QUESTIONS

When dealing with taxation a person is normally confronted with the following questions:

- How is the tax rate determined?
- Do the taxation rules stay the same every year?
- What kinds of taxes are levied in Lesotho?
- What does the Government do with the tax levied?
- How is a person `s taxable income for the year calculated?
- How do I know how much tax I should pay?
- How does Government collect the tax due

THE NATURE AND PURPOSE OF TAXATION

In modern economies taxes are the most important source of governmental revenue. They are compulsory levies that are regularly imposed and, as a rule, designated for no special purpose; they are regarded as a contribution to the general revenue pool from which most government expenditure are financed. Taxes differ from other sources or revenue in that they are unrequited i.e. they are not paid in exchange for some specific thing, such as the sale of public property or the issue of public debt. While taxes are presumably collected for the sake of the welfare of the taxpayers as a whole, the liability of the individual taxpayer is independent of any benefit received.

Tax legislation customarily distinguishes between the tax object and the tax base. The tax object may consist of goods, transactions. (e.g. income, net wealth, inheritances). The tax base is the physical unit or monetary amount to which the tax rate is applied. For example, a levy on automobiles (the tax object) may use as the tax base the weight of the automobile, its horsepower, its age, its value etc. Similarly, a property tax may be based on gross value of rental; an excise duty on sugar may be levied as a percentage of the retail price or as a fixed sum per ton of the finished product, etc.

During the 19th century, the prevalent idea was that taxes should serve mainly to finance the government. In earlier times, and again today, governments have used taxation for other than merely fiscal purposes. Current theories suggest that governments should not use the tax instrument as revenue – raising device exclusively. Taxes are considered to have three functions:

1. **Fiscal or budgetary**: to cover government expenditure as far as they are not financed from other sources (fees, profits from public enterprises, the issue of public debt, and the creation of money);

2 **Economic:** to lessen inequalities in the distribution of income and wealth to the extent they are considered excessive and unjust.

3 **Social:** Besides its main function, taxation has many purposes. Certain consumption goods considered undesirable, such as alcoholic beverages and cigarettes, may be taxed heavily on the grounds of national health (though more

often than not this justification has been put forward to conceal the purely fiscal desire for more revenue).

THE FUNCTIONS AND RESPONSIBILITIES OF LESOTHO REVENUE AUTHORITY

The LRA is the organization principally responsible for the collection, assessment and remittance to the Government of public revenues in Lesotho. It became operational in 2003 after it was established by the Act of Parliament in 2001. Prior to 2003, the Ministry of Finance and Planning was responsible for collection of Taxes through three departments being Sales Tax, Income Tax and Customs Excise.

The functions and responsibilities of the LRA are reflected in its vision and mission statements. LRA is specifically created to:

- Administer the three legislations which are Income Tax Act, Customs Excise Act and Value Added Tax Act.
- To collect all taxes and duties due to Lesotho Government
- To provide the conducive environment to all taxpayers and treat them equally
- To raise assessments against taxpayers who engage in under declaration of taxes
- To impose additional taxes to late payments and late filing of Tax returns

That is, the LRA collects taxes on behalf of the Government and it remits the money to the Lesotho Government. The LRA acts as the tax collecting agent of the Government and it is normally paid commission on an annual basis, which is a percentage fixed on the taxes collected.

CLASSES OF TAXES

In the literate of public finance, taxes have been classified in various ways according to who pays them, who bears the ultimate burden of them, the extent of which the burden can be shifted, and various other criteria. The most common distinction is between direct and indirect taxes, an example of the former being the income tax and the latter Value Added Tax. There is much disagreement among economists as to the criteria for distinguishing between direct and indirect; it is usually said that a direct tax in one that cannot be shifted by the taxpayer to someone else.

Some theorists have attempted to show that in principle any tax may be shifted, in whole or in part, depending on the condition under which the tax is levied. Nevertheless, it conceded that some taxes are more likely to be shifted than others.

Classifying taxes according to the extent of which the burden can be shifted

Direct Taxes

The direct taxes are primarily taxed on persons; they are aimed at the individual `s ability to pay as measured by their income or net wealth. The main types of direct taxes are the following:

1. Individual Income Taxes

   These are taxes levied on the total personal net income usually over some stipulated minimum. They are normally adjusted to take into account the circumstances influencing the ability to pay by the individual, such as family status, the number and age of children, financial burdens resulting from illness, etc.

2. Taxes on net worth

   These are levied on the total net worth of a person – that is, the value of his assets minus his liabilities. As with the income tax the personal circumstances of the individual are considered. Very often there is a double taxation when net worth tax falls upon both corporation and individuals. No such tax is levied in Lesotho, however.

3. Death duties

Taxes at death can take two forms; inheritance tax, where the tax object is the bequest received by the person inheriting, or estate tax, where the object is the total estate left by the deceased. Inheritance taxes usually allow for personal circumstances of the taxpayer, including his net worth before receiving the bequest and his relation to the donor.

Estate taxes are generally graduated according to the size of the estate, although in some countries they make allowance for the number of children involved. To prevent the death duties from being circumvented, a rational and efficient system has to include a tax on gifts between living persons, particularly those that are made in anticipation of death. (Donations Mortis Causa)

Indirect Taxes

Indirect taxes include taxes on sales of consumer goods in the process of production, on legal transactions, etc., where the assumption (sometimes erroneous) is that the tax will be shifted in whole or in part to the ultimate consumer of the goods, who presumably has the ability to pay. The following are the main types of indirect taxes-

1 Value Added taxes and customs duties

The sales objects in these instances are commodities or services. They are levied on almost everything, from necessities such as coffee, tea, to luxuries such as jewels and furs. Taxes on specific commodities are called excises, as distinguished from sales taxes.

2. Taxes on legal transactions

Examples of these are taxes on the issue of shares, on the sale of house and land, and on stock exchange transactions. They are frequently levied in the form of stamp duties.

Some taxes cannot be said with certainty to be either direct or indirect. This is because they may, under certain assumptions, be shifted by the taxpayer to someone else. The current prevailing opinion is that corporation income taxes are partially or wholly shifted, although the results of some empirical studies are not altogether convincing on this point. (When the corporation income tax is accompanied by personal income tax, it can also involve double taxation of the divided element in profits).

One can also distinguish between taxes based on the effect they have on the distribution of income and wealth.

A proportional tax

Is the one that imposes the same relative burden on all taxpayers – i.e where tax liability and tax base grow in equal proportion. Taxes that are nominally proportional include as a rule, the corporation tax.

A progressive tax

It is characterized by a more than proportional rise in the relative burden. Examples of these taxes are income taxes, expenditure taxes, and death duties.

Regressive tax

Is one which is paid in equal amount by all taxpayers e.g Value Added Tax. The various taxes on elements of income or net worth, and ad valorem excises of cigarettes or sugar that is nominally proportional will turn out to be decidedly regressive in practice, because the proportion of personal income spent on cigarettes and sugar declines as level of personal income rises.

Pool taxes, levied as a fixed amount per capita, obviously are regressive. Even income taxes that are nominally progressive may become less so in the upper income categories, when it is possible to reduce the tax base by means of deductions or by the lower income categories to which a proportional tax rate applies, some progression is introduced through personal exemptions.

There are other ways of classifying taxes. Some taxes are specific- i.e they are levied based on weight, length, volume, and other specific characteristics of the tax object. Other taxes are ad valorem – levied on the value of the goods as measured by the price.

HOW ARE TAXES IMPOSED?

Generally speaking there are two methods of imposing taxes known as "indirect" and "direct".

Indirect Taxation

This is taxation which is imposed in an impersonal way through a levy on goods or services. This is typified by customs duties which may be levied on both imports and exports. These have been modified over time in response to pleas that they should not be levied on goods regardless as being necessities for people as a whole. Another modification in customs duties over time has been their use in the development of protection by means of import duties, of manufacturing industries faced with overseas competition.

Excise duty is another form of indirect taxation whereby tax is levied upon a wide range of goods. Its development has been basically in two directions. The first has been the high rates imposed on a narrow range of goods such as tobacco, alcohol and fuel. The second is the use of value added tax on all items sold. Therefore indirect taxation involves taxes which are not paid directly to the state by the person who ultimately bears the cost.

Direct Taxation

Direct taxes are those taxes which fall to be paid directly to the state by the taxpayer. In the past the problem that dominated direct taxation was the way in which it could be levied to reflect a man ` s wealth. Tax was applied to a man ` s conspicuous wealth initially, due to the lack of developed accounting records. Therefore, land tax was the backbone of direct taxation for centuries, but this became less satisfactory when wealth took different forms due to commercial development. At various times tax was therefore applied to other objects of the wealthy such as carriages, servants, hair powder and dogs. The tax on windows resulted in avoidance by taxpayers who bricked up windows or made two windows into one.

These taxes, although useless in the long term, resulted in two developments:-

(i) they required some form of local inspection and collection thus resulting in an administrative machine

(ii) A relieving provision was created which limited the total tax payable by an individual to 10% of his income.

PROPORTIONAL, REGRESSIVE AND PROGRESSIVE TAXES

Ultimately all taxes involve a loss of spending power by people and it therefore becomes important to know who is bearing the burden and in what proportions. This is not just a question of fairness; a tax on the rich has a different economic effect and significance compared to a tax on the poor.

<u>Proportional Tax</u>

Initially all income taxes were proportional whereby all individuals paid the same rate regardless of earnings. Nowadays an example of a proportional tax is Corporation Tax whereby all companies pay tax on profits at rate of 10% or 25%.

<u>Regressive Tax</u>

A regressive tax is one which is paid in equal amount by all taxpayers e.g Value Added Tax. Therefore, the higher the income, the lower the proportion of it which is paid in tax. Such taxes are called regressive because of their diminishing marginal utility. i.e they fall on persons with small incomes with greater effect than on those with large incomes. Similarly a sales tax will affect the larger family more than the small one.

<u>Progressive Tax</u>

Most countries nowadays use a progressive income tax system whereby, after an exemption for low income, the rate of tax increases in stages so that the proportion of total income taken in tax rises as income rises. On considerations of fairness it seems that the progressive tax is most suitable. This is based upon the premise that the loss of M1 to a rich man is of less consequence than a similar loss to a poor man whom it is assumed requires such money for the purchase of necessities.

Another argument in favour of progressive taxation is that it helps to reduce inequalities of wealth thus resulting in long-term stability in a capitalist society.

What are the economic effects of progressive taxes?

In a progressive system a higher proportion of tax is taken from the rich communities but this may have little effect upon their actual consumption of goods and services. Hence, savings may reduce. A tax on the poor, however will remove spending power on personal consumption.

A second effect is that high marginal rates of tax may result in an individual choosing between more income or more leisure, generally the latter therefore reducing the activity level and gross output of the workforce.

However, it may also be argued that due to high marginal rates of tax, individuals may work longer to maintain a certain standard of living.

THE ROLE OF TAXATION IN THE ECONOMY

Taxation is used by governments as a tool of economic policy and therefore its ultimate aim should be to provide the greatest advantage it can for the country as a whole. In this respect taxation can be used to influence the disposition and availability of real resources. It is not just coincidence that increased prosperity and social stability has normally been accompanied by increased taxation which usually results in improvement of the economic and social infrastructure of a country.

The primary role of taxation can therefore be to enable the government to command the real resources it requires in order to perform certain functions on behalf of the country as a whole e.g. national defence, roads, electrification etc.

A second purpose of taxation may be to transfer purchasing power from one section of the community to another. Thus, for example, unemployment benefit may be provided for individuals who are made redundant. Lesotho has not yet advanced to the degree where it can afford such social intervention.

Another role of taxation is its use as an economic tool of government to improve the performance of the economy by altering the balance between current consumption and capital investment. Current consumption can also be altered by applying taxation on goods which are not considered socially desirable, such as tobacco and alcohol.

EFFECTS OF TAXATION ON THE ECONOMY

The immediate effect of taxation can usually be clearly identified to the individual who pays it, but it may become more difficult to determine its ancillary effects on other sectors of the community.

For example, if tax is imposed upon a manufacturer based upon the number of units sold, this may result in him reacting by raising the sales price per unit, thus effectively attempting to pass the tax burden on to the consumer.

This may produce two further effects. The customer may not have sufficient income to continue purchasing the product, or alternatively he may substitute his purchase with another similar but cheaper product. These are called the “income and substitution” effects respectively.

A chain reaction could therefore result whereby the manufacturer may decrease his output, thus affecting other factors of production such as the labour force.

WHY TAX ON INCOME?

Adam Smith propounded the following four “canons” of taxation which have been applied, with modification naturally, to systems of taxation:

a) Taxation should be equitable
b) There should be certainty with regard to the amount to be paid
c) There should be convenience regarding payment and collections and
d) There should be economy of collection.

A tax on incomes has, over the years, been regarded as that which best fulfils the above Canons and provides the necessary money to the state, because:

a) practically everybody has an income and thus practically everybody pays tax – this is regarded as being equitable
b) Income measurement commonly provides thorny problems, especially when accounting conventions are so diverse, but has been found that by legally defining what income is, the uncertainty regarding income measurement is reduced and, therefore, there is a reasonable certainty of what tax would be paid. (The idea here is that the taxpayer should be aware of his potential tax liability).
c) Systems of PAYE (Pay As You Earn) on salaries and wages make it easy for tax to be collected and paid. It is clearly convenient to tax to be paid out of income, since ‘income’ assumes that funds are available.
d) Again, PAYE system reduce Government` s collection costs. The accounting system as a whole provides a means whereby income can be conveniently ascertained, (e.g. the published accounts of companies). The local tax office has informally indicated that of the revenues collected approximately 1, 5% is spent on collection.

QUIZZ

1. Indicate whether the following taxes are proportional, progressive or regressive.
   i) Value Added Tax
   ii) Personal Income Tax
   iii) Corporate Income Tax

2 What are the four canons of taxations as propounded by Adam Smith?

3 Define the two main types of tax and give two examples of each

4 What is meant by
   (i) Proportional Tax?
   (ii) Progressive Tax?
   (iii) Regressive Tax?

5 What is the role of tax in the economy

ANSWERS TO A QUIZZ

1 i) Regressive
  ii) Progressive
  iii) Proportional

2 i) Equity
  ii) Certainty
  iii) Convenience of Payment and Collection
  iv) Economy of Collection

3 i) Direct Taxes

Taxes that can neither be shifted in whole or in part but falls to be paid directly to the State by the taxpayer

(a) Individual income taxes
(b) Death duties

ii) Indirect Taxes

Tax that can be shifted in whole or in part to the ultimate consumer of goods or services who presumably has the ability to pay

(a) Consumer taxes and customs duties (VAT and Excise Duties)
(b) Tax on legal transactions (Stamp Duties)

4 i) Tax where all individuals pay the same rate of tax regardless of their earnings e.g. Corporate Tax.

ii) Tax where there is more than proportional rise in the tax liability relative to the increase in the tax base eg personal income tax

iii) Tax where there is less than proportional rise in the tax liability relative to the increase in the tax base e.g GST

5 i) Fiscal/Budgetary
ii) Equity
iii) Economic Role

CHAPTER 3

GROSS INCOME

The following study sessions are covered in this chapter

		Syllabus reference
a)	Explain the scope of tax with regard to chargeable income for individuals and business	B1a
b)	Outline the key elements of a personal tax computations Including gross income and exempt income	B1c
c)	Explain the difference between employment and self-Employment and its implications	B2a
d)	Compute employment income	B2c
e)	Calculate termination payments	B2d

INTRODUCTION

Gross income is one of the main building blocks of taxation. If you are given a pile of documents relating to a taxpayer `s income you will have to understand the concept of "gross income" to be able to decide which of the amounts constitutes gross income and therefore subject to tax. An amount must be included in gross income before it can be subject to tax. The determination of gross income is the starting point of the tax calculation of a taxpayer.

An amount can be included in gross income either by complying with the general definition in the Act or by being included in gross income by means of one of the specific inclusions, also included in the definition.

This chapter will discuss the different components of the gross income definition as well as the special inclusions listed as part of taxpayer `s gross income.

CRICTICAL QUESTIONS

When a person deals with the concept of gross income, the following questions arise:

- What is meant by gross income?
- Does the definition of gross income apply to all persons whether you are in Lesotho or out of Lesotho?
- When is an amount included in gross income?
- Can the taxpayer decide when such an amount may be included?
- What if the amount does not fall within the definition of gross income?
- Which amounts are specifically included in gross income?

CLASSES OF INCOME

The Gross Income of a taxpayer for a year of assessment is the sum of

a) Employment Income

And

b) Business Income

And

c) Property Income

And

d) Any other income or gain

But does not include amount exempt from income tax S17 (1).

Gross Income of a Resident taxpayer includes income from all geographical sources S17 (2).

S.17 of the Act defines four separate classes of income in respect of which further detail is provided in the Explanatory Memorandum to the Income Tax Act- Employment income, Business Income and Property Income are detailed hereunder. No definition is provided in relation to the category "any other income or gain". This is designed as a "catch all" section to ensure that income or gains not included in other classes of income do not escape the tax net.

EMPLOYMENT INCOME (S.18)

Employment income is included in gross income under S17 (1)(1). "Employment income" is defined in S.18 to mean a payment or benefit arising from employment (defined in S.3 (1)). The use of the word "arising" to define the nexus or link between the payment or benefit and the employment is intended to ensure that employment income is broadly defined, It is intended that employment incomes include all gains (whatever 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 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 that clearly satisfy the "arising" test.

By virtue of S31 (3), employment income includes a gift, including a testamentary gift, made to, or for the benefit, of an employee. The effect of S31(3) is that the mere fact of employment alone supports the characterization of the gift as employment income. Consequently, for example, a wedding present given by an employer to an employee in included in gross income as employment income.

AMOUNTS EXCLUDED FROM EMPLOYMENT INCOME

Four items specifically excluded from employment income-

1 Employment income does not include a benefit included in the fringe benefits taxable amount of the taxpayer `s employer under S.117. This exclusion from employment income is by way of reconciliation with the fringe benefits tax ("FBT"). It ensures that benefits that 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 public international organization – see S21), the employer will not have a fringe benefit taxable amount, and therefore, the value of the benefits is required to be included in the employment income of the employee (unless exempt und S.22 or by virtue of a treaty or international agreement referred to in S.112).

2 Employment income does not include an exempt fringe benefit S118 exempts certain benefits from fringe benefits tax either for policy reasons or on the grounds of administrative convenience. The effect of S18 (1)(b) is to carry those exemptions through to income tax.

3 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, 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.

4 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.

There are deductions available to employees in determining their chargeable income and these deductions are covered in full in the next chapter.

Payment of tax on employment income

The responsibility of collecting tax lies with the employer through the Pay as You Earn System (PAYE) therefore it is important to establish whether an individual is employed or self-employed.

IMPORTANT CASE LAW DECISIONS RELATING TO EMPLOYMENT INCOME

During the last few years there have been several important case-law decisions relating to the taxation of employment income.

The distinction between being employed and being self- employed is important in several respects. The self-employed can claim a wider range of deductions and are also excluded from the Pay As You Earn System.

EMPLOYED OR SELF-EMPLOYED

The UK Inland Revenue in their leaflet IR56 suggests that positive answers to the following questions usually mean that someone is self- employed.

- Are you ultimately responsible for how the business is run?
- Do you risk your own capital in the business?
- Are you responsible for bearing losses and profits?
- Do you yourself control what you do, and whether you do it, how you do it and when and where you do it?
- Do you provide the major items of equipment needed to the job?
- Are you free to hire other people, on terms of your own choice, to do the work?
- Do you have to correct unsatisfactory work at your own expense?

The background to these questions is several case-law decisions in the UK which are outline hereunder.

1 FALL V HITCHEN (1973)

A dancer was employed by Saddler Wells, a ballet dancing company, under a contract which specified-

i) He should work full time
ii) During specified hours
iii) For a regular salary
iv) With a minimum initial period

i) followed by possible termination by a fortnights notice on either side
ii) He was prohibited from undertaking outside work without permission.

It was held that the degree of CONTROL exercised over the job was such that he was an employee and this case was used by the Inland Revenue as authority for treating all actors and others engaged under a standard Equity (Actor `s trade union) contract as employees.

2. MARKET INVESTIGATIONS LTD V MINISTER OF SOCIAL SECURITY (1968)

This case centred on the test for INTEGRATION and consideration whether an individual was fully integrated into and formed part of an employer `s organization, rather than standing separate from it as an independent contractor, even though his precise actions may not be tightly controlled. The judge in this case commented that the following factors may be of importance in determining the level of integration.

i) whether the man provides his own equipment
ii) whether he hires his own people
iii) what financial risk he takes
iv) what degree of responsibility for investment he has

v) whether and how far he has an opportunity of profiting from sound management

3. HALL V LORIMER (1992)

Mr. Lorimer was a vision-maker who worked with several television companies and he failed several tests regarding control and integration. However, it was held that **considering the facts as a whole** he was in business on his own account and consequently was self- employed.

The importance of the case lies in the stress upon viewing the facts as a whole and adopting a common-sense approach, rather than singling out a particular factor or factors (such a control or integration) and regarding that as decisive.

BUSINESS INCOME (S.19)

Business income is defined in S.19 to mean profits or gains 'arising from a business". As with employment income in S.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 S.31 (1) and includes the provision of services other than as an employee. As outlined in 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.

In considering whether a taxpayer is carrying on business the following factors have to be borne in mind:-

i) the motives of the taxpayer and whether there is an intention to make a profit
ii) the frequency of the action that caused the income and whether the earning of the income includes the conduct of a series of actions

Some guidelines have been laid down by the Courts as to what constitutes a business.

1. SMITH v ANDERSON

Business means anything that occupies the time and attention and labours of a man for profit.

2 MODDERFONTEIN DEEP LEVELS v FEINSTEIN

This involved a mining company that from time to time bought clothing for resale to its employees at cost. Though there was no profit involved the company was still held to be carrying on a separate trade.

3 CIR v SCOTT

Carrying on a business normally involves a series of actions. Although generally speaking one or two isolated transactions cannot be regarded as the carrying on of a business, a single transaction may be carried out so that it might be regarded as carrying on a business, Thus in Stephen v CIR the salvaging of a single ship `s cargo was considered a business because the salvage operations which were managed by the staff of the appellants business, and which necessitated so many ordinary business acts such as the engaging of services of men, hiring apparatus, purchasing equipment, the transport of cargo to Cape Town and the like.

4 CIR v LYNDENBURG PLATINUM LTD

Again the importance of continuity and repetition was stressed as a necessary element in the carrying on of a business for an individual but not for a company. Thus, an isolated transaction could be considered a business in a company but not in an individual.

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 the asset or debt was on revenue or capital account. "Business Asset" and "Business Debt" are defined in S.31 (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 S.48, losses on the disposal of a business asset are allowed as a deduction. Paragraph (b) specifically includes in business income any payment received by a person carrying on business as consideration for the person accepting a restriction on the capacity to carry on the business.

The Act 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 judgment made based on 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 what is more important, the distinction between income and capital gains has encouraged businesses wherever possible to characterize their transactions as giving rise to (tax-free) capital gains.

PROPERTY INCOME (S.20)

This section defines property income to include the income or gains specifically listed. "Dividends", "interest", "natural resource payments", and "royalties" are specifically defined in S.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 a rental properties, stocks and shares, and financial assets) as calculated in accordance with S.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 the old Act, taxpayers with the same capacity to pay tax faced different tax burdens depending on whether they earned income or capital gains. Generally, it is high income earners who can derive substantial capital gains. Further, even outside the business context, the distinction between income and capital gains is often artificial.

ANY OTHER INCOME OR GAIN (S.17.1)

There is no elaboration in the Act on what is intended to be covered by this subsection. However, the Explanatory Memorandum states that it is not intended to be confined to income according to ordinary concepts which suggests it is very much a "catchall" section to prevent avoidance. A question it raised, for example, is:-

"Does this section bring into the tax net winning in a Casino?', as these would certainly fit into classification."

The answer to this question is **NO** as such a gain is entirely fortuitous and does not have any of the characteristics of income in that it is not designedly sought and worked for. Fortuitous gains are therefore excluded from Gross Income. However, a professional gambler, however, would be subject to tax on gains from carrying on a business of gambling. Equally, an author who wins a prize in literary contest would have the prize-money treated as part of Business Income.

EXEMPTIONS AND EXCLUSIONS

Before establishing Gross Income it is essential to be aware of the amounts exempted from Income Tax and amounts excluded from Gross Income as these are not included in the calculation of Gross Income.

DIPLOMATIC AND SIMILAR PRIVILEGES (S.22)

The exemptions in this section are designed to give force of law to Lesotho `s obligations under the Vienna Convention on Diplomatic Relations.

The employment income of any employee of a diplomatic mission, provided such person is not a citizen or permanent resident of Lesotho, is exempt from tax.

This exemption, however, does not apply to other Lesotho source income, but does apply to non-Lesotho source income. Similar exemptions apply to members of the diplomatic officer `s family.

Several foreign personnel who are not diplomatic personnel but are in the public service of a foreign government providing services as advisors to the Lesotho Government form another category. The employment income of such Resident individuals is exempt from tax provided that income is subject to tax in a foreign country. They are also exempt from tax on no-Lesotho source income as are members of their family.

DOUBLE TAXATION AGREEMENTS (S.112)

This section provides a reconciliation rule to resolve any inconsistencies between the terms of the Act and the terms of Double Taxation Agreements to which Lesotho is a party. Under this section, in case of inconsistency, the terms of the double taxation treaty prevail over the Act apart from the application of the general anti-avoidance provisions in Part XI of Chapter II.

The practical effect of this is of direct relevance to a substantial number of resident expatriate technical personnel providing services in Lesotho. Under S.22 detailed above, such personnel would be obliged to pay tax in Lesotho if not paying tax in a foreign country on the Lesotho source income. However, many contracts for technical assistance to Lesotho provide for an exemption from income tax for foreign personnel providing such technical assistance. The purpose of this section is to give legal effect to such agreements and mitigates in a substantial way the effect of S.22

FOREIGN SERVICE ALLOWANCE (S.23)

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 the Gazette.

This is the usual practice internationally in that diplomats serving abroad in a foreign mission receive a tax-free allowance instead of a taxable salary.

PROPERTY INCOME OF EXPATRIATE TAXPAYERS (S.24)

The property income derived-

a) From a foreign source, or
b) From the disposal of an investment asset generating foreign-source income, by an expatriate taxpayer is exempt from income tax

Several important definitions are required to understand this section fully.

i) property Income – see above

ii) Investment Asset – covered in detail later

iii) Expatriate Taxpayer- is defined to mean a Resident individual (other than a permanent Resident or citizen of Lesotho) who is employed or engaged under a technical services contract.

iv) A technical services contract means a contract under which accounting, architectural, surveying, or other similar service is performed

v) A permanent resident means a Resident individual who has been present in Lesotho for a period or periods in total of seven years or more.

WAR PENSIONS (S.26)

War pensions and gratuities paid by the Lesotho Government in respect of persons who retired before 1st April 1993 are exempt from income tax.

INTEREST (S.27)

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 saving 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 S.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 which 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 S.158.

The exemption is not available to a resident minor or a trust.

SCHOLARSHIPS (S.28)

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.

SUBSISTENCE FARMING (S.29)

This section exempts from income tax the income derived by a resident individual from subsistence farming carried on in Lesotho.

The exemption is only available for primary farming operations, whether pastoral or agricultural. There is a further requirement that the output from the farm must be used primarily for own consumption. The fact that some sales of produce are made will not preclude the application of the exemption. This provision came into effect on 1 April 1996. Prior to this date all farming operations in Lesotho were exempt from tax, provided they were carried out by an individual. Once there is the appearance of any substantial level of commercial activity then the exemption will not apply. It is not available for secondary operations such as processing of harvest 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).

GIFTS (S.31)

This section provides that the value of any property acquired by way of 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 live 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 whatever 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.

DIVIDENDS PAID BY RESIDENT COMPANIES (S.87.6)

S. 87(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 despite whether ACT (covered in Chapter 8) was payable in respect of the dividend. The effect of subsection (6) is that the maximum rate of tax on the non-manufacturing income of a resident company distributed to a resident individual is 25%, and on manufacturing income is 10%. 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 S.109, unless the non-resident makes an election under that section.

LUMP SUM PAYMENTS

(TAXATION OF TERMINATION BENEFITS) (Sec. 99 & 159 as amended)

These may include the following:

(i) Provident fund
(ii) Severance pay
(iii) Pension etc

1. A lump sum payment from a complying superannuation fund is excluded from Gross Income but is subject to tax at the Standard Rate of tax unless the recipient elects for the payment to be included in Gross Income.
2. The amount equal to the first 25% of basic salary is exempt, the remaining balance is then taxed at standard rate.

   The obligation to deduct tax lies with the trustee or fund manager of the superannuation fund.

EXAMPLE:

Molefe received the following terminal benefits (all stated gross) when he left his employment. Molefe's gross annual salary was M560, 000. The related income tax has been withheld and remitted to Lesotho Revenue Authority by his employer.

	M
Pension	102,000
Severance pay	60,000
Provident fund	20,000

Required;
Calculate tax payable by Molefe on terminal benefits.

SOLUTION

25% of annual gross salary (M560, 000) = M 140,000

	M
Terminal benefits:	
Pension	102,000
Severance pay	60,000
Provident fund	20,000
	182,000
Less: exempt portion	(140,000)
Chargeable terminal benefits	42,000

Tax payable 25% x 42,000 = M10, 500

Superannuation funds fall into two categories as outlined in S.94.

This sections defines "employer superannuation fund" and "self- provided superannuation fund". An "employer superannuation fund" is a resident superannuation fund established and maintained by an employer that 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 that satisfies the conditions prescribed in the regulations. The regulations with which the funds are supposed to comply are outside the scope of this syllabus. In both cases, the superannuation fund must be a resident superannuation fund, that is, it must come within the definition of "resident fund" in S.8.

This is further defined as a result of S.8

(a) is organized 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 organized 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 S.5). This means, for example, that the fact that there is 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 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.

Early Withdrawal:

The Superannuation Regulations published under the Income Tax Act specify that early payments can be made from a superannuation fund in case of personal hardship and the Commissioner has made a ruling as to what constitutes personal hardship as follows:

The Commissioner will treat the following circumstances as amounting to severe personal hardship of a fund member:-

(a) where the member is unable to find replacement employment within four months of the member `s involuntary redundancy;

(b) Where the member is forced to retire from employment on the grounds of ill health and is unable to find replacement employment within four months of retirement. For purposes of (a) above "Replacement employment" includes a business activity.

All withdrawals made in the circumstances specified above are, of course, subject to tax in accordance with S.99 of the Act.

Pre 1993 Contributions

The Income Tax Act, 1993 substantially increased the amount that may be deducted for tax purposes in respect of contributions to fund. S.99 of the Act specifies that a lump sum payment from a fund is subject to tax at the standard rate of tax, currently 25%. However, no tax was payable on a lump sum paid under S.22 (1)(p) of the Income Tax Act, 1981. Regulations have been created regarding the tax treatment of lump sum paid after 1 April 1993 from a fund in respect of contributions made prior to 1 April 1993.

In this regulation:

"Capital value" means the value as at 1 April 1993 of the sum of vested employer and employee contributions and the vested income that arose before 1 April 1993 on those contributions.

The regulation is made subject to the condition that the trustee or fund managers obtain prior tax clearance from the Commissioner before a tax-free amount is paid to a member of a fund.

FOREIGN EMPLOYMENT INCOME OF RESIDENTS (S.104)

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 exception is not available where the income is Lesotho-source income. For example, under the source rule in S.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 S.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 although some part of the service is performed outside Lesotho. Such income would not qualify for exemption under S.104.

The exemption in S.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 the country of service, then Lesotho asserts full jurisdiction to tax the income. Income that is untaxed in the country of source because it falls below the tax-free threshold (as may be the case with some Lesotho mineworkers in South Africa) is regarded as being chargeable to tax in the foreign country of source.

Under S.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 S.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. S.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.

PROCEEDS OF LIFE ASSURANCE POLICY (S.101)

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 through where the policy is taken out by an employer on an employee. In this situation, the proceeds are taxable to the recipient.

INCOME OF LIFE ASSURANCE BUSINESS (S.100)

The income of the life assurance business of a taxpayer, calculated in accordance with the regulations, is exempt from tax. This does not include the income from funeral insurance business of group life assurance.

INTEREST RECEIVABLE (S.158)

Interest payable to a resident of Lesotho by a resident of Lesotho, other than an individual, is subject to a withholding tax of 10%.

EXEMPT ORGANISATIONS (S.25)

The income of the following organizations is exempt from income tax:-

a) Religious or Charitable

b) Amateur Sporting Association

c) Trade Union or similar organization

The exemption does not apply to the property or business income that is not related to the function constituting the basis for the organization `s exemption.

The exemption is only available where:

a) An organization has a ruling from the commissioner confirming its exempt status,

b) None of the organization's income or assets confers, or may confer, a private benefit on any person.

INCOME OF COMPLYING SUPERANNUATION FUND (S.98)

The income of a complying superannuation fund is exempt from tax.

QUIZZ

1 Are the following receipts exempt from income tax?

 i) Traveling expenses under a scholarship

 ii) Maintenance from a former spouse

2 When are the proceeds of a life insurance policy subject to income tax?

3 What Lesotho source income of a foreign diplomat in Lesotho is exempt from tax?

4 What element of income of a Lesotho diplomat serving abroad is exempt from tax?

5 What foreign source income of an expatriate taxpayer is exempt from Lesotho income tax?

6 Are war pensions and gratuities paid by the Lesotho Government exempt from tax?

7 Detail the taxation position regarding interest received by a resident of Lesotho.

8 What resident individual is not entitled to exemption on the first M500 interest received from a S.27 account?

9 Thabiso Moshoeshoe, a resident of Lesotho operates a farm in Ficksburg. Is this farming income exempt from income tax in Lesotho?

10 When is the value of gift not exempt from income tax?

11 Is a dividend from a South African Company exempt from tax?

12 What is the taxation position regarding a lump sum payment from a complying superannuation fund?

13 What are the requirements for a superannuation fund to be a resident fund?

ANSWERS TO A QUIZZ

1. (i) No

   (ii) Yes

2 They are liable to the extent that a deduction has been allowed for the premium

3 Lesotho source employment income

4 Foreign service allowance

5 The income derived from the disposal of an investment asset generating foreign source income.

6 Yes, provided the person retired before 1 April 1993.

7 Interest received can be divided into 3 categories.

   (i) Interest from a Non-Resident – fully taxable

   (ii) Interest from a Resident Individual- fully taxable

   (iii) Interest from a Resident other than an individual

Such interest is subject to withholding tax of 10% on gross amount. This is a final tax and the net amount received is excluded when computing Gross Income. The first M500 of such interest is exempt from the 10% withholding tax provided the following conditions are met:

(i) It is derived from one savings account

(ii) By a Resident individual

(iii) Who is not a minor

(iv) The account must have been nominated by the individual as the one to which the exemptions applies

(v) The account must bear the taxpayer `s identification number (TIN).

(vi) The account must be with a financial institution Resident in Lesotho which is registered under the Financial Institutions Act 1973.

The relief of 3(b) above is not available to a trust.

8. A minor
9. No
10. when it is between an employer and an employee
11. No
12. It is subject to 25% unless:-

(i) It is to an expatriate taxpayer who either

a) Rolls it into any superannuation fund within 90 days

or

b) Uses it to purchase an annuity within 90 days

or

(ii) In any other case it is either

(a) Rolled into a complying fund within 90 days or

(b) Is used to purchase an annuity from a resident within 90 days

Or

(iii) It represents the capital value of contributions made prior to 1 April 1993 to a fund the lump sum from which would have exempt under the 1982 Act.

13 Its purpose must be that of providing superannuation benefits to resident individual.

- its management control must be located in Lesotho.

CHAPTER 4

GENERAL DEDUCTION FORMULA

<u>The following study sessions are covered in this chapter</u>

	Syllabus reference
a) Explain the principle of deductible and non-deductible expenditure	B3b
b) Identify the principal categories of deductions and illustrate their scope	B2b
c) Describe the treatment of superannuation contributions	

INTRODUCTION

In the process of determining the taxable income, the allowable deductions are deducted from income. If you are in the process of calculating a taxpayer `s taxable income, you will have to know which amounts of expenditure may be deducted, as any taxpayer would like to be able to deduct as much of his expensed as possible. If there is no specific deduction in the Act, the general deduction formula may apply.

The governing principle in relation to deductions is contained in S.33 of the Act that deals with allowable and disallowable deductions.

CRITICAL QUESTIONS

When a person deals with allowable deductions, the following questions arise:

- When is an expense deductible for tax purposes?
- May the taxpayer decide when such an amount can be deducted?
- In which circumstances is an expense of a capital nature?
- What happens if the amount is not deductible in terms of the general deduction formula?
- Are there expenses that may never be deducted for tax purposes?

ALLOWABLE DEDUCTIONS

A deduction is allowed for:-

i) Any expense
ii) Or loss
iii) To the extent incurred
iv) By the taxpayer
v) During the year of assessment
vi) In the production of income
vii) Subject to tax

Remember

- All components must be present for an expense to be deductible.

CASE LAW IN RELATION TO ALLOWABLE DEDUCTIONS

A substantial body of case law exists which can be relied on to provide a broader interpretation of the general deduction formula set out in S.33(1) and a summary of the more important cases is given below.

Expense or Loss

The distinction between expenditure and a loss is not of major significance. In an English Case, ALLEN v FARQHUARSON the distinction between expenditure and loss was discussed as follows:-

"Expenditure means something or other which the trader pays out; I think some sort of volition is indicated. He chooses to payout some disbursement; it is an expense; it is something that comes out of his pocket. A loss is something different. That is not a thing that he expends or disburses. That is a thing which, so to speak, comes upon him "ab extra".

Expenditure and losses refer not only to cash outflows, but to liabilities, which may be settled in cash or otherwise. An example of expenditure in a form other than cash would be payment made by means of shares or land, in which case, the cash equivalent of the value of the asset disposed of would represent the expenditure. An example of a loss is the theft of goods form a shop by a customer or a bad debt, (which is a loss that is specifically allowed).

Incurred by the Taxpayer

In deciding whether expenditure has been incurred, it is not for the tax authorities to decide whether the expenditure was prudent or otherwise, the mere fact that it is actually incurred means that passes this test. The deductibility of expenditure is not determined on a cash basis, (except for taxpayers who account on a cash basis), that is, it is not necessary to have actually paid the expenses before the deduction can be claimed. As long as the liability has been incurred, an expenditure, which may be claimed, has arisen.

In CALTEX OIL (SA) LTD v CIR, Botha JA stated:

The expression 'expenditure actually incurred" means all expenditure for which the liability has been incurred during the year whether the liability has been discharged during that year or not.

Because the Act refers to expenses incurred, the deduction of accounting provisions for future expenditure will not be allowed until the liability has actually arisen. So, for example, a provision created for the repair of a machine will not be allowed, because at the time at which the provision is made, no actual liability has arisen.

During the Year of Assessment

This requirement is specifically mentioned in S.33, but the courts have held that the expenditure that the taxpayer claims as a deduction, must be incurred during the year in which it is claimed. This means that the accounting principles of matching do not apply in the case of tax and that the expenditure must be claimed in the year in which it is incurred. So, for example, in the case CONCENTRA (PTY) LTD v CIR, the company claimed as a deduction certain expenditure should have been claimed in the years in which it arose, and that, by not doing so, the company had forfeited its right to claim a deduction.

In the case SUB NIGEL LTD v CIR it was said:-

For the scheme of the Act shows that, as the taxpayer is assessed for income tax for a period of one year no expenditure incurred in a year before the particular tax year can be deducted. In the CALTEX case, Botha J.A. in his judgment made the following statement:
It is only at the end of the year of assessment that it is possible, and then it is imperative, to determine the amount received or accrued on the one hand and the expenditure actually incurred on the other during the year of assessment.

Here again, we see the principle that all expenditure incurred during the year must be quantified and claimed by the end of the year.

In the Production of Income

This is probably the most onerous requirement of S.33. In terms of this requirement, any expenditure that has not been incurred for the purpose of producing income will not be allowed as a deduction. It is important to note that expenditure in itself does not produce income. Normally, it is actions that produce income and expenditure is merely a consequence of such actions. The expenditure attendant upon such actions is expenditure incurred in the production of income.

The term “in the production of income” has been the subject of several court cases that have attempted to define its meaning. In PORT ELIZABETH ELECTRIC TRAMWAY CO. LTD v CIR, the court was called upon to decide whether certain expenditure incurred by the company, as a result of an accident, was properly deductible, being “expenditure in the production of income”. A vehicle belonging to the company had been involved in an accident, as a result of which the driver (an employee of the company) had been fatally injured. The company was obliged to pay compensation to the family of the deceased and it was this expenditure that formed the subject matter of the case. The commissioner for Inland Revenue considered the expenditure not to be in the production of income. In his judgment, Watermeyer A.J. said:

"The purpose of the act entailing expenditure must be looked to. If it is performed for the purpose of earning income, then the expenditure attendant upon it is deductible; ….

The other question is what attendant expenses can be deducted? How closely must they be linked to the business operation? Here, in my opinion, all expenses attached to the performance of a business operation bona fide performed for the purpose of earning income are deductible whether such expenses are necessary for its performance or attached to it by chance or are bona fide incurred for the more efficient performance of such operation provided they are so closely connected with it that they may be regarded as part of the cost of performing it."

The judge allowed the compensation as a deduction but disallowed the legal expenses incurred in defending the claim for compensation.

The decision of the court effectively comes down to establishing three items:

i) The business operation must be bona fide performed
ii) The particular act must be identified and a decision made as to whether or not it was performed for the purpose of producing income
iii) The expenditure which it is sought to deduct must be closely linked to the act identified

In other words, the expenditure must be an inevitable concomitant of the income-producing operations.

Thus, in the case Joffe & co. (Pty) LTD v CIR the existence of negligence in a compensation claim gave rise to the deduction for compensation being disallowed. The court came to the conclusion that as the compensation arose from negligence, such negligence was not an inevitable concomitant of the income-producing operations.

The restrictive nature of these tests results in the disallowance of most expense that are necessarily incurred in the carrying on of a business but fail to satisfy the requirement that they be laid out for the purpose of earning income, as the following examples illustrate:-

1. A farmer who had let land to a tenant was required to compulsory destroy a swarm of locusts on the property was refused a deduction for the expense as it was in no way related to the trade of letting.
2. In a case involving a jockey who took Turkish baths for purposes of keeping his weight down before a race, it was held that the expenditure was deductible.
3. It should be noted that the term "in the production of income", does not mean that the expenditure may only be deducted once the income has been produced. In SUB-NIGEL LTD v CIR it was held that all that was necessary was that the expenditure was incurred for the purpose of producing income and that, the mere fact that income was not produced, did not preclude the deductibility of the expense. The case involved the deduction of a premium on a loss of profits insurance policy. The court found that the fact that no income had actually been produced was irrelevant and that the expenditure had been incurred for the purpose of producing income and was, therefore, deductible.

   In the case involving CIR v PICK `n PAY WHOLESALERS (PTY) LTD., one of the judges, had the following to say about the words" incurred in the production of income".

   It is, of course, clear that the words "incurred in the production of income" do not mean that, before a particular item of expenditure may be deducted; it must be shown that it produced income the particular year of assessment. The income may be earned only in a future year and I shall assume that the same principle applies to justify the deduction of expenditure relating to the income of a previous year. There must, however, be a sufficiently distinct and direct relationship or link between the expenditure incurred and the earning of the income.

> It is submitted that where an expense is incurred after the income is earned, that it will be more difficult for the taxpayer to show that the expense was instrumental in producing the income if he were not bound to incur the expense after the income was earned. The commissioner could argue that, where the expense if voluntary, the taxpayer need not incur it, and this would not affect the production of the income, as it had already been earned.

In the PORT ELIZABETH ELECTRIC TRAMWAY COMPANY case, Watermeyer A.J.P had this to say on the matter:

There is certainly one type of expenditure that must be excluded, and that is expenditure payable out of income after it has been earned, … In a sense such expenditure might be said to be attendant upon business profits, but there is a real distinction between 'charge against profits and an appropriation of profits after they have been earned'.

Subject to Tax

It follows from this requirement that no deduction can be claimed in respect of expenditure or losses connected to exempt income.

EXPENSES CHARGEABLE TO CAPITAL ACCOUNT

S.33 (1)(c) specifically disallows deductions for expenses properly chargeable to capital account (however, depreciation and amortization allowances are permitted in respect of certain expenditures and these are covered in Chapter 8)
Once again, it is necessary to seek guidance from judicial decisions in deciding whether expenditure is of a revenue or capital nature.

One of the leading cases in this area is that of NEW STATE AREAS LTD. v CIR. In this case a distinction was made between that which is changing its form from money to goods and vice versa and is therefore of a revenue nature. Fixed capital on the other hand refers to the means of production, such as property, plant tools e.t.c. and expenditure on these or for their expansion and improvement is expenditure of a capital nature.

Each case must therefore be judged on its own facts, and, based on this judgment; a decision must be made as to whether the expenditure was made to acquire or create on income-producing asset or whether the expenditure was incurred in actually working the producing asset i.e. producing income.

Cases involving intangibles, however, create greater problems. A useful guide that has been established by the English courts is:- Has the expenditure created an enduring benefit? If it has, then it is capital, if not it is revenue. The decision as to the enduring nature of the benefit unfortunately is also subjective, for while a benefit of five years may be considered to be enduring in the case of one taxpayer it may not be in the case of another. It is apparent then, that an expense is capital if it is part of the cost of acquiring an asset or a right that forms part of the taxpayer `s income earning structure, or if it creates an enduring benefit for the taxpayer. If the expense is not capital, it must be revenue. There is no halfway house between capital and revenue.

It should be noted that while it is true that there is no halfway house between capital and revenue it is nevertheless permissible to apportion an expense into its capital and revenue component. In the Appellate Division case CIR v GUARDIAN ASSURANCE HOLDINGS (SA) LTD., the court sanctioned such an appointment. The company, which had originally decided to issue shares by means of a private placing, changed it mind in favour of a public placing in the belief that it could earn substantial interest by investing oversubscriptions. As it happened, the issue was heavily oversubscribed, resulting in interest income of R616, 049. Of the total flotation expenses incurred<R226, 755> the taxpayer estimated that R98, 085 was additional cost incurred as a result of the decision to have a public issue. In the taxpayer `s view, this amount was expended in order to earn the interest income of R616, 049 and was therefore deductible. Inland Revenue disallowed the deduction on the grounds that the R226, 755 expenditure was indivisible and was an expense of a capital nature and, therefore, not deductible. Inland Revenue were of the view that where expenditure is incurred for different purposes such expenditure cannot be dissected and allocated to the different objects. The court rejected this contention and held that the expenditure could be apportioned and that the R98, 085 portion relating to the earning of interest was not of a capital nature, In the words of Muller J.A:

"In the absence of any prohibition or direction in the Act itself, I can see no reason why, in principle, an apportionment should not be applied in the present case. It is of course true, as contended by counsel for the appellant, that all the expenditure in the present case was incurred for a dual purpose and that it is physically impossible to dissect the various items of expenditure for allocation to the different objects. But I cannot agree with counsel `s further contention that, for that reason, the expenditure as a whole must, for the purpose of the Income Tax Act, be regarded as expenditure of a capital nature within the meaning of S.11 (a) of the Act".

Examples of capital expenditure, which will not be deductible in terms of S.33 (3)(c) are:

1 Money spent in acquiring fixed capital assets for use in a business, e.g. factory premises and plant and machinery. This would include all expenditure connected with or attached to the acquisition of capital assets, e.g. transfer duty on factory premises acquired, railage paid on plant acquired for use in business, installation costs, e.t.c

2 Expenditure designed to extend the scope of a business or to secure an enduring advantage or benefit for the trade carried on.

3 Money spent in order to create a source of income, for example, the purchase price of the goodwill of a business, the purchase price of an annuity, the purchase price of a lease of premises on which to conduct trading or in respect of which income is receivable.

4 Expenditure incurred by company in obtaining share capital, for example, by way of underwriting commission and advertising and legal costs in connection with an offer of shares to the public.

5 Transfer fees paid on the transfer of a liquor license from one set of premises to another.

6 The cost of erecting a model house on a rented site for the exhibition of the goods of a furniture dealer. Although the purpose of the erection is to advertise the dealer `s products, the advertising is of a permanent nature and result in the creation of a capital asset. The same principle applies to installation of window lighting and permanent signs on trading premises.

7 Cost of erections of partition in leased premises.

8 The cost of improving or adding to capital assets (as distinct from repairs), e.g. initial rat-proofing of business premises. Expenditure incurred in moving business to new premises and in adapting new premises. The cost of removing stock-in-trade is, however, deductible.

9 Amounts paid by an oil company to ensure that garage proprietors sell only the products of the company.

10 Expenditure on improvements and alterations (as distinct from repairs) to income-producing assets or properties or for the substantial development or extension of a trade or business.

11 Outlay incurred in devising permanent method of disposal of waste effluent in the case of a chemical-manufacturing firm.

12 Architect `s fee in connection with the erection of new factory premises by manufacturer. (Architect `s fee in connection with erection of property by a dealer in landed property constitutes revenue expenditure and is deductible).

13 Consideration paid to acquire interest in trade contracts of other dealers.

14 Sum of money paid for the exclusive sole right to become agent in respect of a certain commodity.

15 Expenditure incurred on the incorporation of a company.

16 Expenditure incurred on the alteration of the memorandum and articles of association of a company.

17 Legal expenses incurred in obtaining new trading licenses.

DEDUCTIONS FOR EXPENSES INCURRED IN PRODUCING EMPLOYMENT INCOME

The Income Tax Regulations provide for deductions for expenses incurred in producing employment income. A taxpayer is entitled to these deductions only:-

a) To the extent to which it is reasonable and necessary

And

b) Which the taxpayer can substantiate.

Expenses incurred by a taxpayer to maintain or improve skills and knowledge which the taxpayer requires in his or her current employment are an allowable deduction provided that the sum of the expenses incurred by the taxpayer in a year of assessment exceeds M1, 000.

The only expenses that are deductible are

a) Enrolment and tuition fees

b) Examination fees

c) Cost of books, stationery etc. related to study

OTHER EXPENSES

(i) Travel Expenses
(ii) Motor Vehicle Expenses
(iii) Technical and Trade Books
(iv) Subscriptions to Associations
(v) Home Office Expenses

Deductions are also permitted for the above expenses provided they exceed:-

a) M2, 500 and

b) In aggregate 5% of taxpayers gross income

Travel Expenses

Travel expenses incurred by a taxpayer in the course of his or her employment are an allowable deduction. In this regard travel expenses means:

a) Fares

b) Registration fee for conference etc.

c) Accommodation, meals and incidental expenses

All of which must be attributable to the taxpayer.

The total expenses are apportionable in proportion to the total time spent primarily on the employment activities and otherwise.

Motor Vehicle Expenses

The following motor expenses incurred by a taxpayer in the course of employment are an allowable deduction;-

a) Operation, maintenance and repair
b) Interest on borrowed money
c) Leasing payments
d) Depreciation of a vehicle owned

Where the motor vehicle is not used exclusively for the production of employment income the expenses are apportioned in proportion to total mileage **or** an allowance is granted of one (1) loti for each Kilometre relating to employment.

Technical and Trade Books and Journals

Expenses incurred by a taxpayer for books, journals and other publications on topics relevant to the taxpayer ` s current employment and used by the taxpayer in his or her employment are an allowable deduction.

Subscriptions to Associations

Expenses incurred by a taxpayer for subscriptions to any trade or professional association, including a trade union, are an allowable deduction.

Home Office Expenses

A home office is a portion of a taxpayer `s residence which the taxpayer uses:-

a) Exclusively and on a regular basis as his or her principal place of work and

b) For the convenience and at the request of the taxpayer ` s employer

It includes all borrowing, maintenance, and running costs. The amount allowed by way of deduction is the proportion of the entire house occupied as the home office.

DISALLOWED DEDUCTIONS

The following deductions are specifically disallowed:-
Any expense or loss to the extent that it is of a personal nature. Examples of such expenses that are inclusive and not exhaustive are:-

a) The costs of commuting between taxpayer` s residence and work
b) The cost of clothing worn at work, except for the clothing that is not suitable for wearing outside work
c) The cost of caring for dependents
d) The cost of education leading to a degree or diploma (however, see regulations regarding employment income deductions)

Income Tax (NB Fringe Benefits Tax is a separate tax from Income Tax and is an allowable deduction)

Expenses for acquiring, producing or improving property or for other expenses properly chargeable to capital account

Cost of a gift where the value is not included in the recipient `s gross income

Fines or Penalties paid to a Government for breach of any law

Insurance premiums paid to non-resident insurers in respect of an asset or risk located in Lesotho.

RESTRICTED DEDUCTIONS

1. Compensation is not deductible to the extent that it exceeds a reasonable amount (S.34)
2. Only 50% of an otherwise allowable deduction for expenses of entertainment or meals is allowed. This does not apply to a fringe benefit or an exempt fringe benefit (S.35). Consequently, meals provided to staff in a canteen would not be a restricted deduction.
3. Where a resident company not principally engaged in a money lending business has a debt to equity ratio in excess of three to one, the Commissioner may disallow deduction for the interest paid on that part of the debt in excess of the three to one ratio (S.36.2)
4. An otherwise allowable deduction for an expense that is not a capital nature that relates to a service or other benefit that extends beyond three months after the end of the year of assessment to which the service or other benefits relates. Such an expense is allowed proportionately over the years of assessment to which the service or benefit relates (S.54). In effect this requires individuals who account on a cash basis to account on an accrual basis for prepayments that extend more than three months into the next year of assessment.

For example, a sole trader `s year end is 31 March and he prepares his accounts on a cash basis. On 1 January, he pays his insurance premiums for the year to 31 December for M2, 800.

Cash basis taxpayers normally claim a deduction for an expense when it has been paid. However, in this case, the value of the benefit extends nine months into the next financial year. The value of this nine-month benefit is disallowed in the current year but will be an allowable deduction in the following year.

The disallowed amount is (9/12 *M2, 800) = M2, 100

5. A deduction is allowed for an annuity paid to a former employee of the taxpayer or to a dependent of a former employee. The deduction is restricted to M1, 200 p.a. (S.38)

This deduction is only allowed where the employee worked in a business of the taxpayer the income from which was subject to tax in Lesotho.

Furthermore, if the employee worked in a manufacturing business of a company, then the deduction may only be applied against the company `s manufacturing income.

SPECIAL ALLOWABLE DEDUCTIONS

1. Bad Debts (S.37)

   A deduction is allowed for a bad debt incurred on revenue account in a business giving rise to income subject to tax when the debt is written-off into the taxpayer `s accounts. Consequently, no deduction is available for a provision for bad debts.

2. Training (S.39)

A taxpayer carrying on business in Lesotho is allowed to deduct 125% of expenditure incurred for training or tertiary education of a citizen of Lesotho who is employed by the taxpayer in a business the income from which is subject to tax in Lesotho.

3. Research and Development (S.40)

A deduction is allowed for Research and Development expenditure incurred in the production of income subject to tax.

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; design; construction; and operations 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 modifications or stylistic changes to existing products or technology; management of 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, although the asset or land may be solely or principally used in research and development. A taxpayer is entitled to deductions under S.41 for depreciable assets. Further, subsection (3) expressly provides that expenditure incurred to ascertain the existence, location, deductible under subsection (1).

Such expenditure may be deductible under S.43.

Repairs, Spare Parts, and Minor Capital Equipment (S.42)

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 S.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 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.

The Act does not define a repair but the following guidelines have been laid down by court decisions:-

CIR v AFRICAN PRODUCTS

The following principles were outlined in this RSA case:-

1. Repair is restoration by renewal or replacement of subsidiary parts of the whole. Renewal as distinguished from repair is reconstruction of the entirety, meaning by the entirety not necessarily the whole but substantially the whole subject matter under discussion.
2. In the case of repairs effected by renewal it is not necessary that the materials used should be identical with the materials replaced.
3. Repairs are to be distinguished from improvements. The test for the purpose is – has a new asset been created resulting in an increase in the income-earning capacity or does the work undertaken merely represent the cost of restoring the asset to a state in which it will continue to earn income as before.

It follows; from the use of the words "Restoration by Renewal or Replacement" it is a necessary implication that the original structure must have been damaged in some way.

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

Amortization of Intangible Assets (S.44)

This section provides for the amortization 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. S.4 applies to the cost of acquiring industrial or intellectual property rights such as copyright, patents, trade-marks and designs, and to premiums previously deductible under S.26 (h) of the 1981 Act. S.26 (h) of the 1981 Act allows for a premium on a lease to be apportioned over the period of the lease or 25 years whichever period is the lesser. 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-offs periods in the interest of administrative simplicity. In the absence of such regulatory provisions, the deductions under S.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 amortization provision is S.26 (h) of the 1981 Act.

Start-up Costs (S.45)

This section provides for amortization @ 20% reducing balance for expenditure incurred in starting 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 rights, or contractual rights; or it may involve and intangible advantage which does not manifest itself in any particular asset, such as the cost of feasibility studies, large-scale advertising, and initial transitional expenses, such as stamp duties, or professional fees. The second category is intended to cover expenditure that is not deductible under general principles because it is incurred preliminary to the derivation of income from the business.

Losses on Disposal of Business Assets (S.48)

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 S.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 S.3 (1).

It should be noted that losses on disposal of Investment Assets can only be offset against gains on disposal of Investment Assets.

Superannuation Contributions (Ss. 95, 96, 97)

Provision is made to allow as a deduction payment by a resident individuals to pension funds.

1. A resident fund i.e. one resident and managed in Lesotho with object of providing pension benefits for residents of Lesotho.
2. A non-resident fund that is not managed in Lesotho and whose primary objective is not the provision of pension benefits for residents of Lesotho.

In addition, funds can be either complying or non-complying.

1. Complying funds – these are funds that have undertaken in writing to deduct tax from both lump sums and pension payment to residents of Lesotho and to pay these taxes to the Government of Lesotho.
2. Non-complying funds – these are funds that have not given the relevant undertaking in writing.

Employers, employees and the self-employed are entitled to a deduction for contributions to complying resident funds and complying non-resident funds.

The permissible deduction is as follows:

1. For employers and Employees – A maximum of 20% of Employment Income of the employee. The deduction can be claimed by the employer and employee, subject to the upper limit of 20% in aggregate. In determining deductibility, the employee `s contributions, are taken into account first.

2. For self-employed – A maximum of 20% of Gross Income less any amount allowed by way of deductions against employment income.

APPORTIONMENT OF DEDUCTIONS

This provision requires that deductions that 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 S.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 employment income
- Lesotho-source business income
- Lesotho-source property income
- Lesotho-source other income
- Lesotho-source farming income
- Non-Lesotho-source employment income
- Non-Lesotho-source business income
- Non-Lesotho-source property income
- Non-Lesotho-source other income
- Non-Lesotho-source farming income.

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

- Exempt income
- Lesotho-source manufacturing income
- Lesotho-source other income
- 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.

QUIZZ

1 Detail the requirements of the general deduction formula

2 What are the 6 deductions specifically prohibited in arriving at chargeable income?

3 What is the position regarding the deductibility of prepayments for a taxpayer who prepares accounts on a cash basis?

4. Thabang Molise pays an annuity of M3,000 per annum to the wife of his former employee. Is this an allowable deduction?

5. Is an increase in bad debt provision an allowable deduction?

6. Is market research an allowable deduction?

7. The South African case CIR v African Products outlined a number of principles as to what constitutes a repair. What are they?

8. In what circumstances can a deduction be claimed for the full cost of a depreciable asset?

9. Over what period can intangible assets be depreciated?

10. What is the maximum allowable deduction in respect of superannuation contributions by the self-employed?

ANSWERS TO A QUIZZ

1. Any expense or loss to the extent incurred by the taxpayer during the year of assessment in the production of income subject to tax.
2. Expenses of personal nature

   Income tax

   Capital expenses

   Cost of a gift not included in recipient's income

   Fines or penalties paid to a government for breach of any law

   Insurance premiums paid to non-resident insurers in respect of an asset or risk located in Lesotho.

3. Where the benefit extends for a period exceeding three (3) months after the end of the year of assessment then it must be time-apportioned between the relevant years of assessment.
4. Yes, but only to the extent of M1200.00
5. No.
6. If it is aimed at improving sales of an existing product, **YES**. **NO,** if it relates to a product not yet being sold.
7. Repairs implies that there must have been a damage

   It is not necessary that the materials used should be identical with the materials replaced

   Repair is restoration by renewal or replacement of subsidiary parts of the whole.
8. When it cost less than M50.00
9. Over its useful life
10. 20% of **gross income** less any amount allowed as a deduction against employment income.

CHAPTER 5

CAPITAL ALLOWANCES

<u>The following study sessions are covered in this chapter</u>

	Syllabus reference
a) Explain the principles relating to depreciation allowances and ensure that assets are correctly classified	B3d
b) Prepare depreciation allowance computations using both pooling and single asset methods	B3d
c) Illustrate the difference between pooling method and single asset method.	B3d

INTRODUCTION

From the previous chapter, capital expenditure is a disallowed expense. But the cost of the asset used to generate income meets the definition of the general deduction formula.

Now, what makes it disallowed is the fact that the asset is going to be used for more than one year of assessment.

It follows, therefore, that in determining the allowable deduction, the cost base of the asset has to be spread over its useful life.

DEPRECIATION OF ASSETS AND INCOME TAX (S.41)

From accounting point of view, capital expenditure is taken to the profit and loss account in the form of depreciation. For Income Tax purposes depreciation as included in the profit and loss account does not automatically qualify as an allowable deduction. The part of capital expenditure which qualifies for deduction is specifically computed using any of the two methods available. The two alternative methods available for claiming depreciation allowance on the capital cost of premises (normally limited to industrial premises) and equipment including those for non subsistence farming are:

- Single Asset Method
- Pooling Method

For the purposes of both single asset and pooling method, depreciable assets are classified into four groups and depreciation is calculated on a **declining balance method:-**

Declining Balance Depreciation Rates
Assets

Group	**Included**	**Rate**
1	Automobiles; Taxis; Light General Purpose Trucks; Tractors for use	25%

	Over-the-road; Special Tools and Devices.	
2	Office furniture; Fixtures, and Equipment Computers and Peripheral Equipment and Data Handling Equipment; Buses; Heavy General Purpose Trucks; Trailers and Trailer Mounted Containers; Construction Equipment	20%
3	Any depreciable asset not included in another Group	10%
4	Railroad Cars and Locomotives and Railroad equipment; Vessels, Barges, Tugs and Similar Water Transportation Equipment; Industrial Buildings; Engines and Turbines; Public Utility Plant.	5%

SINGLE ASSET DEPRECIATION

Single Asset Method is similar to Reducing Balance Method of accounting.

It applies where a taxpayer has not elected for pooling to apply.

No matter whether a pooling election has been made, single asset depreciation will apply to depreciable assets that are only partly used in the production of income that is 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 2014 for M15,000 and was sold on 31 December 2017 for M12,000.

A computer is a group 2 asset and, therefore, has a declining balance depreciation rate of 20%.

The following is the depreciation schedule for the period of ownership of the asset:-

	M
1 September 2014 Bought	15,000
Depreciation Allowance for year 31 March 2015 (7 months)	(1,750)
Adjusted cost base 31 March 2015	13,250
Depreciation allowance for year 31 March 2016	(2,650)
Adjusted cost base 31 March 2016	10,600
Depreciation allowance for year ended 31 March 2017 (9 months)	(1,590)
Adjusted cost base at date of disposal	9,010
Proceeds	(12,000)
Gain on disposal of business asset	2,990

The gain would be included in Business Income through the application of S.19. If the 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 (M4,010) would be an allowable deductions – loss on disposal under S.48.

Note: The answer would be different if days were used other than months; the examiner normally gives additional instructions requiring the use of months in all apportionments.

POOLING OF ASSETS

Where pooling of assets applies, the depreciation allowance 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 year of assessment. The closing balance of the pool is calculated by:

i) adding to opening balance of the pool half the cost of acquisition in the current year and half the cost of acquisition in the previous year,

and

ii) 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, the excess which is a gain on disposal of fixed assets is included in gross income under subsection (9). This would be characterized 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 2013 and elects for pooling to apply. Taxpayer acquires the following group 2 assets during the 2013\14 year of assessment (total cost of M835, 500).

- Construction equipment each M600,000
- 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 2014/15 Taxpayer acquired another item of construction equipment of M250, 000. In 2015/16, Taxpayer sold one of the trucks for M50,000.

The following summarizes the position:-

	Acquisitions	**Disposals**
Year ended 31 March 2014	M835, 500	NIL
Year ended 31 March 2015	M250, 000	NIL
Year ended 31 March 2016	NIL	M50,000

2013/14 ½ current year acquisitions	417,750
+ ½ previous year acquisitions	NIL
- disposal proceeds	NIL

Balance at end of year	417, 750
Depreciation allowance @20%	(83,550)

2014/15 Balance at beginning of year	334,200
+ ½ current year acquisitions	125,000
+ ½ previous year acquisitions	417,750
- disposal proceeds	NIL

Balance at end of year	876,950
Depreciation allowance @ 20%	(175,390)

2015/16 Balance at beginning of year	701,560
+ ½ current year acquisitions	NIL
+ ½ previous year acquisitions	125,000
- disposal proceeds	(50,000)

Balance at end of year	776, 560
Depreciation allowance @ 20%	(155,312)

Balance at end of year	621,248
	=======

SUMMARY OF DIFFERENCES BETWEEN THE TWO METHODS

SINGLE ASSET METHOD	POOLING METHOD
1. Depreciation allowance is granted for the period during the year that the asset is	1. the assets are depreciated on the basis that they were acquired exactly half way through the year.

in use. i.e. dates when the fixed assets were purchased and disposed of must be kept.	
2. This method is always applicable to Group 4 assets and to all other assets when pooling has not been elected for.	2. It only applies when it is elected for. Once elected for, the election is irrevocable. It cannot be applied to Group 4 Assets.
3. When the asset is disposed of, a gain or loss may occur which will form part of Business Income or, in the case of a loss, will be an allowable deduction against Business Income.	3. Gains or losses do not arise on disposal as the proceeds are deducted from the balance of the pool. However, where all the assets are disposed of and a balance remains, then that balance is an allowable deduction. If the balance of the pool is a credit, then that balance forms part of Business Income in the year that it arises.
4. It requires the maintenance of detailed asset registers	4. It does not require the maintenance of detailed asset registers.
5. It can be applied to assets both fully and partially used in the production of Income, subject to an apportionment of the amount attributable to the production of Income.	5. It cannot be applied to assets partially used in the production of Income.

FARMING ASSETS

The amendment of Section 29 means that depreciation allowance on assets of non-exempt farming activities could now be claimed. The problem, however, is which cost base should be used when computing such depreciation allowances.

The amount of any depreciation allowance of farming assets would be calculated on the assumption that single asset method depreciation had applied to the assets during the period before the amendment.

In other words, for example, depreciation for the first year of assessment, in this case, 1996/97, would be based on the adjusted cost base of the asset at the start of the year i.e 1st April 1996 calculated on the assumption that single asset depreciation method had applied to the asset from the date of acquisition (before 1st April 1996) up to 1st 1996 when the amendment was effected. Thereafter the method of computing depreciation allowances shall depend on the election made by the taxpayer with exception to possible farm buildings.

Example

An estate owner acquired office furniture on 1 September 1994 for M15, 000. Show what would be the depreciation allowable now that commercial farming is no longer exempt from income tax.

Solution

Office furniture is a group 2 asset depreciable at the rate of 20%. Assumed depreciation allowance would be the following before and up to 31st March 1996:

Notional Allowances

	M	1995	1996
1st September 1994 Cost	15,000		
1994/95 20%(15000x212/365)	1,742	1,742	

Tax written down value 31.03.95	13,258		
1995/96 20%	2,651		2,651

Tax written down value 31.03.96	10,607		
	=====		

PRACTICE QUESTION

Thabo Molapo owns a business in Maseru and his year end is 31 March.

The following is a list of business asset disposals and acquisitions. You are required to calculate his depreciation allowance for each of the years ended 31 March 2015, 2016, 2017, using both the Pooling and Single Asset Method.

1 April 2014	Bought	Industrial Building	M200, 000
1 June 2014	Bought	Motor Vehicle A	M75, 000
1 June 2014	Bought	Motor Vehicle B	M60, 000

1 September 2014	Bought	Computer	M40, 000
1 December 2014	Bought	Office Equipment	M20, 000
1 June 2015	Sold	Motor Vehicle A	M30, 000
1 September 2015	Sold	Computer	M35, 000
1 December 2015	Bought	Furniture	M20, 000

CHAPTER 6

INDIVIDUALS

The following study sessions are covered in this chapter

	Syllabus reference
a) Explain the scope of income tax with regard to chargeable persons chargeable income.	B1a
b) Outline the key elements of a personal income tax computation including gross income and exempt income and deductions	B1c,&B5b
c) Explain the entitlement to and the amount of the personal tax credit	B5c

INTRODUCTION

After a person starts working they eventually start saving money. This money can then be invested in different assets, for example shares, fixed deposits or even business ventures. The aim of these ventures is to generate additional income. It must be remembered that the gross income definition of taxes all income received by residents of Lesotho.

CRITICAL QUESTIONS

When dealing with specific income and deductions, the following questions normally arise:

- What are the bases for collection of tax?
- Which portion of investment income must be included in gross income?
- How much of investment income is exempt from tax?
- Which cost must I claim first?

Individual `s Residence (Section 5)

There are two main bases for collection of tax. The first is RESIDENCE and the second is SOURCE.

Using RESIDENCE as the basis for tax collection is based on the principle that one should pay tax on all income in the country they reside.

Using SOURCE as a basis for tax collection is based on the principle that one should only pay tax in country on income arising in that country.

Income tax in Lesotho is based primarily on RESIDENCE but there are also rules in relation to SOURCE.

Resident individuals are defined in S.5 of the Act. An individual is a Resident individual for the entire year of assessment if that individual:-

Case one

a) Has a normal place of abode in Lesotho and is present in Lesotho for part of the year of assessment. There is no minimum period of presence under this test of residence. Once you have a home in Lesotho, it does not matter whether you spend part of the year abroad, you are the resident for the whole year for income tax purposes.

Or

b) Is present in Lesotho on more than 182 days in any consecutive period of 12 months that includes all or part of the year of assessment. The test may be satisfied by a single period of presence in Lesotho or by aggregation of two or more periods within the period of twelve months

Or

c) Is an official of the Lesotho Government posted overseas during the year of assessment. It is the individual `s status as an official of Lesotho Government that determines residence under this test.

Or

d) Is otherwise a resident of Lesotho

Parts (a), (b) and (c) are clear in respect of the requirements. Part (d) means a person who is resident according to ordinary concepts. Whether a person is a resident according to concepts is a question of fact and degree involving several factors. No single factor is decisive, and the emphasis lies on viewing the individual factors as a whole. The factors include:-

- Physical presence in Lesotho during the year of assessment
- Frequency, regularity and duration of visits to Lesotho

- Maintenance of place of abode within Lesotho during a period of absence
- Family and business ties in Lesotho
- Life style
- Nationality

An individual who satisfies any one of the tests; (a) to (d) above is treated as a resident individual for the entire year of assessment unless subsection (2) or (3) applies.

Case two

An individual who was not a resident individual any time during the preceding year of assessment is only a resident from the date of his first presence in Lesotho in the current year of assessment.

Case three

An individual who is not a resident individual any time in the following year of assessment is only treated as a resident individual until the last day of presence in Lesotho in the current year. This rule only applies if the individual has a closer connection to a foreign country after the last day of presence in Lesotho. This is similar to the concept of a domicile, namely, where is the individual `s real home deemed to be. The question as to whether an individual has a closer connection with a foreign country is a question of fact and degree determined by having regard to his personal and economic relations such as:

- Family and social relations
- Occupation
- Political, cultural and other activities
- Place of business
- Property

The 1993 Income Tax Act defines different classes of resident and sets out rules regarding what elements for their income are subject to tax in Lesotho. The table below gives an analysis of these groups and the relevant types of income that are subject to tax in Lesotho.

	Employment Income	**Business Income**	**Property Income**	**Other Income or Gain**
Resident Citizen and permanent Resident	Worldwide (except if sourced and taxed abroad)	World wide	Worldwide	Worldwide
Diplomatic Resident	Exempt source	Lesotho source only	Lesotho source only	Lesotho source only
Lesotho Diplomat	Foreign Service Allowance is exempt	Worldwide	Worldwide	Worldwide
Expatriate	Worldwide	Worldwide	Lesotho source only	Worldwide except for gain on disposal of Foreign Investment Asset

Non- Resident	Lesotho source only	Lesotho source only	Lesotho source only	Lesotho source only

The exception provided for employment income at 1, above, has been designed largely with Basotho mineworkers in South Africa in mind.

Several examples are given below to illustrate how the rules can be applied

1. Molibeli Matsoso is a Mosotho working in Johannesburg and owns a house in Maseru where his wife and children reside, During the year ended 31st March 2016 he makes five visits to Lesotho for periods totaling 20 days.
   Is he a resident individual for the year ended 31st March 2016?

   YES. The maintenance of an abode and a single presence in the country is sufficient to make him a resident.

2. Thabo Letsie spends the following periods in Lesotho

   1st January 2016 to 15th March 2016 (74 days)
   1st July 2016 to 30th October 2016 (122 days)

   Is he a resident of Lesotho, and, if so, for what years of assessment?

   YES. He has spent more than 182 days in Lesotho in a consecutive period of 12 months.

He is a resident individual for both assessment years ending 31st March 2016 and 2017.

4. Mike Musasa first came to Lesotho on 1st August 2015 and remained. For what period is he a resident?

He is a resident for the year ended 31st March 2016 but only with effect from 1st August 2015. He is not deemed to be a resident for the full year of assessment.

5 Ts`epang Seko has lived in Lesotho for almost 20 years. On 1st September 2015 he immigrated permanently to Canada.

What is his position regarding residence?

He is a resident up to the year ended 31st March 2016 but only up to 1st September 2015 when his residence terminates.

SOURCE OF INCOME (Section 103)

The residential status of an individual determines what income is subject to taxation in Lesotho. Broadly speaking income can be derived from either a Lesotho source or a foreign source.

S.103 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 S.17 (3), or subject to withholding tax under S.107

The basic rule is in paragraph (a) which provides that income derived from an activity that 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 more specific rule in one of the other paragraphs applies.

Any income that 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 S.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, can be easily manipulated by taxpayers. It is particularly important that Lesotho, as a capital-importing country, has clearly defined source rules 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.

The full section is reproduced hereunder:-

1. Income is Lesotho-source if it is

    (a) Derived from an activity which occurs in Lesotho

        Or

(b) Derived from services performed under a contract entered into with the Lesotho Government

Or

(c) Derived by a resident of Lesotho from services performed as a driver of a vehicle, or an officer or member of the crew of any vehicle or aircraft, where the services are performed both in and out of Lesotho

Or

(d) Derived from immovable property located in Lesotho, including gains from the disposal of an interest in immovable property and form the property of which consists directly or indirectly principally of interests in immovable property located in Lesotho.

Or

(e) Derived by a resident of Lesotho from the disposal of movable property, other than business income derived from a business conducted outside of Lesotho

Or

(f) Derived from the disposal of a membership interest in a resident company

Or

(g) Derived from the rental of movable property used in Lesotho

Or

(h) Derived from the sale or license of industrial or intellectual property used in Lesotho

Or

(i) Interest where the debt is secured by immovable property located in Lesotho, where the borrower is a resident of Lesotho, or where the borrowing relates to a business carried on in Lesotho

Or

(j) a dividend, management fee, or director` s fee paid by a resident company

Or

(k) A pension or annuity where-

i) the pension or annuity is paid by the Lesotho Government or a resident of Lesotho
ii) The services or employment in respect of which the pension or annuity was granted were rendered or exercised in Lesotho.

Or

(l) a natural resource payment for a natural resource taken from Lesotho

Or

(m) Derived by a resident of Lesotho in carrying on a business as owner or chatterer of a vehicle, vessel, or aircraft

Or

(n) Taxable in Lesotho under an international agreement

2. Any income which is not Lesotho-source is foreign-source income.

TAXATION RATES AND PERSONAL CREDITS

A resident individual other than a resident minor is allowed a non-refundable personal credit of **M6, 732** against full income tax liability in the year of assessment. In addition to being non-refundable, it cannot be carried forward or backwards, i.e. non- utilized part is lost forever.

APPORTIONMENT OF PERSONAL CREDIT

Where an individual qualifies for personal credit in the year of assessment for a period which is less than twelve months, the personal credit must be time apportioned.

TAXATION RATES

Resident individual Tax Rates on Chargeable Income

Post 1 April 2017	**Rate**
First M56, 964	20%
Over M56, 964	30%
Personal tax credit	M6, 732

Note: The minister of Finance reviews these rates annually, students are advised to check the latest rates from the latest budget speech. However ACCA applies a six-month rule in that questions requiring an understanding of new legislation will not be set until at least six calendar months after the last month in which the legislation came into use.

The above rates are therefore valid for up to June 2017 examinations. Rates are always provided in the exam, please use the rates given.

EXPATRIATES

The tax rates for an expatriate tax payer from 1st April 2017 are the same as those of any other resident individual.

Non- residents

Rate of tax – 25%

Resident Non Resident

Arising from the new Double Taxation Agreement between Lesotho and South Africa, an amendment was made to Section 12 of the 1993 Income Tax Act. The Double Taxation Agreement with South Africa states that where an individual is resident in both Lesotho and South Africa, he will be deemed to be resident in the country in which he physically resides during the year of assessment. The effect of this amendment is that individuals who work full time in business or employment in Lesotho but who reside outside Lesotho are now deemed to be non-residents. This class of non-residents, however, does not benefit from the non-residents tax rate of **25%** but taxed at full rate as stated in the second schedule.

In addition, though they qualify for personal tax credit by virtue of Section 73, they do not benefit from the following:

(i) Superannuation contribution deduction
(ii) the 1st M500 interest exemption as per Section 27
(iii) relief from further tax on interest on which 10% withholding tax has been levied i.e the withholding tax does not become a final tax

(iv) Exemption for Lesotho-source subsistence farming income as per Section 29.

The amendment of Section 12 has the likelihood of increasing significantly the tax liability of resident non-resident taxpayers.

Example 1:

An individual works full time in Lesotho earning M100, 000 per annum. His contribution to a superannuation fund is 20%. What would be his tax liability if he were residing in:

a) Lesotho?

b) Ladybrand?

Solution

	Lesotho	**Ladybrand**
Employment Income	100, 000	100, 000
Superannuation deduction	(20,000)	Nil
	-----------	------------
Chargeable Income	80,000	100,000
	======	=======
Tax payable on:		
First M56, 964 @ 20%	11,393	11,393
Over M56, 964 @ 30%	6, 911	12,911
	--------	---------
Tax Liability	18,304	24,304

Less: Personal Credit	(6, 732)	(6, 732)
	---------	---------
Total tax payable	11, 572	17,572
	=====	=====

Example 2:

The same information as in example 1 except that the taxpayer received M10,000 as net interest on his deposits with Standard Lesotho Bank. What is the tax liability:

Solution

	Lesotho	**Ladybrand**
Employment income	100,000	100,000
Bank Interest	(excluded)	10,000
	-----------	-----------
	100,000	110,000
Superannuation deduction	(20,000)	NIL
	-------------	------------
Chargeable Income	80,000	110,000
	========	=======
Tax Payable on:		
First M56, 964 @ 20%	11,393	11, 393
Over M56, 964 @ 30%	6, 911	15,911
	--------	---------
Tax Liability	18,304	27,304
Less: Personal Credit	(6, 732)	(6, 732)
	---------	---------

Total tax payable	11,572	20,572
	=====	=====

From these two examples, it is clear that the decision to live in Ladybrand will cost the taxpayer and extra M6, 000 and M9, 000 respectively.

PRACTICE QUESTION

Mr Molapo Majara is a Lesotho resident who resides in Mafeteng. Mr Majara has commercial properties from which he collects rental income. Some of the properties are located in Bloemfontein in the Republic of South Africa, whereas some are located in Maseru, Lesotho.

During the year ended 31 March 2016, Mr Majara's rental records revealed the following:

	South African property	Lesotho property
Rental income	35,000	79,000
Expenses:		
Ground rent	1,200	1,500
Water and electricity	5,000	1,200
Cleaning and maintenance	1,000	3,500
Security	500	950
General repairs	7,000	19,000
Depreciation (allowable)	1,750	3,900
Total expenses	16,450	30,050
Net rental profit	18,550	48,950

Additional information:

(1) The exchange rate between the Lesotho Loti and South African Rand was M1 to R1 during the period.

(2) No tax was deducted in South Africa from the property rental income paid to Mr Majara.

(3) Mr Majara also earned net transport income of M12,500 from his minibus during the year to 31 March 2016.

(4) Mr Majara received net interest income of M5,000 from a savings account during the year to 31 March 2016. Withholding tax was deducted by Nedbank (Lesotho) and remitted to the Lesotho Revenue Authority.

(5) During the same year, Mr Majara received dividends amounting to M35,000 from shares he holds in a South African company operating in South Africa.

(6) He is employed at a salary of M3,500 per month as a technician by a Lesotho company, Bataung(pty) Ltd. In addition to his salary in the year to 31 March 2016, he received a monthly cash allowance of M350 and the full use of a company car, which was purchased by the company in January 2015 at a cost of M290,000.

Required:

(i) Explain the tax treatment of the interest received from Ned bank (Lesotho).

(ii) Compute the amount of tax payable by Mr. Majara for the year ended 31 March 2016.

CHAPTER 7

FRINGE BENEFIT TAX

<u>The following study sessions are covered in this chapter</u>

Syllabus reference

a)	Describe the scope of fringe benefit tax (FBT)	E1
b)	Identify and calculate the taxable value and taxable amount Of fringe benefits	E2a
c)	Calculate the fringe benefit tax liability	E2b
d)	Identify the due date of payment of FBT	E2c
e)	Explain the process of filing a return on FBT	E2d

INTRODUCTION

Theko has just started to work for the first time in his life at Mohloli Chambers. In addition to his salary every month he is entitled to use one of the company's vehicles. He can take the vehicle home and use it over weekends for his own private purposes. On resigning from the company he will have to return the vehicle to the company.

On his salary slip, at the end of the first month, he was surprised to see that there was no entry "fringe benefit – company Vehicle", because he was of the opinion that any benefit arising from employment is treated as employment income.

In this chapter we are going to deal with benefits that are not taxable in the hands of the employee and how the taxable value of such benefit is determined.

CRITICAL QUESTION

In this chapter the following questions will be discussed:

- When will a benefit be a fringe benefit?
- How will the value of such benefit be calculated?
- Will there be any exemptions from tax in an employer/employee relationship?

FRINGE BENEFITS TAX

Tax imposed on employers who provide their employees with fringe benefits. The Income tax Act specifically identifies fringe benefits as, car, housing, utilities, domestic assistance, meal or refreshment, medical, loan, debt waiver and excessive superannuation contributions. All other benefits will then fall under the definition of employment income hence taxable to employees.

Exempt Fringe Benefits

- Meals or refreshments provided in a canteen, cafeteria, or dining room operated by or on behalf of the employer solely for the benefit of the employees and which is available to all non-casual employees on equal terms.
- Medical fringe benefit available to all non-casual employees on equal terms.
- A fringe benefit relating to exempt employment income.
- A fringe benefit, the value of which is so small as to make accounting for it unreasonable or administratively impractical.
- Provision of a security guard
- Housing fringe benefit to the extend it is in excess of 20% of an employee's remuneration for the year of assessment in which the benefit is provided.
- Fringe benefits provided to a domestic assistant.

For the purpose of meals and refreshments and medical fringe benefits, a non-casual employee is defined as an employee who does not meet any of the following two conditions:

1. An employee who is employed under a single contract, arrangement or understanding which is for a fixed period of less than one month. However, if the contract is subsequently renewed, such that one has been employed for more than one month from the commencement of the original contract, that person is a non-casual employee. Or
2. An employee who works for less than 15 hours per week over the course of a month.

Fringe Benefit Tax Payable

The total of all taxable values provided to an employee in the year of assessment is divided by 70% to gross it up to a taxable amount. FBT is 30% of the taxable amount. FBT is an allowable deduction to the employer.

Car Fringe Benefit

This is a benefit consisting of the use, or the availability for use, of a motor vehicle wholly or partly for private purposes by the employee.

The taxable value is calculated as follows:

(15% x A x B/C) – D

Where

A – is the market value of the motor vehicle when first provided
B – Number of days the motor vehicle was available for use
C – Number of days in a year of assessment
D – Payment made by the employee

Example:
Molise received a new car from his employer for both business and personal use. The cost of the car was M180, 000. He pays the employer M300 per month for the use of the car.

Solution:

Taxable Value: (15% x 180,000) – (300 x12)	=	23,400
Taxable Amount 23,400/0.7	=	33, 429
FBT 33, 429 x 30%	=	**10, 029**

Housing Fringe Benefit

This arises when an employer provides housing or accommodation to an employee. The taxable Value is the open market rent of the accommodation less any payment made by the employee but cannot exceed 20% of total remuneration.

Example:

Paul Mohau receives a salary of M130, 000 and a bonus of M20, 000 from his employer. The employer also pays M3, 500 of rent per month on his behalf. Calculate Fringe benefit tax for the year.

Solution:

Taxable value 3500 x12 = 42,000

Total Remuneration

Salary	M130, 000
Bonus	20,000
Housing	42,000

192,000 x 20% = 38,400

Taxable amount, 38400/0.7 = 54,857

FBT, 54,857 x 30% = **16, 457**

Utilities Fringe Benefit

This consists of reimbursement or discharge of an employee's utilities by the employer such as water, electricity and telephone. The taxable value is the amount of reimbursement or discharge.

Meal or Refreshment Fringe Benefit

Provision of any meal or refreshment by the employer to the employee is a fringe benefit. This is subject to the above exemption. The taxable value is the cost of the benefit less any payment made by the employee.

Domestic Assistance Fringe Benefit

This consists of the provision of a domestic assistant to an employee. Provision of a security guard is exempt. The taxable value is the total employment income paid by the employer less any payment made by the employee for the benefit.

Medical Fringe Benefit

Subject to the exemption above, reimbursement or discharge of an employee's medical expenses, including premiums to a medical insurance company is a fringe benefit. The taxable value is the amount of reimbursement or discharge.

Debt Waiver Fringe Benefit

This consists of the waiver of an employee's obligation to the employer or other third parties by the employer. The taxable value is the amount of payment waived

Loan Fringe Benefit

This consists of the provision of a loan to an employee at a rate below two thirds of Central Bank of Lesotho's discount rate. The taxable value is the difference between the interest paid by the employee and the interest that would have been paid, had the interest been at two thirds of CBL discount rate.

Example:

During the year, the company advanced Puleng a personal loan of M100, 000 for a period of two years on which they charged an interest rate of 2% per annum. The Central Bank of Lesotho discount rate averaged 13·5% during this period.
Calculate Fringe benefit tax payable in the first year of assessment.

Solution:
Taxable value, (2/3 x 13.5) – 2 =7 %(100,000)
Taxable amount, 7,000/0.7 = 10,000
FBT, 10,700 x 30%= 3,000

Excessive Superannuation Contributions Fringe Benefit

This is a fringe benefit applicable to tax-exempt employers only. It consists of contributions paid by the employer in excess of the allowable 20% of the employee's employment income. The taxable value is the excessive contribution.

Fringe Benefit Tax Returns

Employers are required to make returns and payments of FBT within 14 days after every quarter.

Practice Question

Mr. Moloi Moloi, a resident taxpayer, is employed by Maputsoe Motors, a resident employer, as a manager. During the year ended 31 March 2017, he received the following benefits from his employer, in addition to his basic salary of M120, 000.

(1) A motor vehicle was provided for both personal and business use. However, Mr. Moloi is only allowed to use the vehicle from Monday to Friday; he is not allowed to use the vehicle over the weekends. Mr. Moloi pays M500 per month to Maputsoe Motors towards his personal use of the car. The vehicle's adjusted cost base on 31 March 2016 was M142, 000. The vehicle was first provided to Mr. Moloi on 1 April 2015.

(2) Maputsoe Motors pays rent of M8, 200 per month for a town house at Lower Thetsane for Mr. Moloi. Mr. Moloi reimburses the company 20% of the rental amount.

(3) Mr. Moloi is reimbursed the following amounts per month.

Water	M400
Electricity	M700
Telephone	M1, 200
Security guard	M1, 748
Domestic assistant	M600

(4) Maputsoe Motors contributes M1, 595 per month towards Mr. Moloi's medical aid. This represents 50% of the total contribution payable to the medical aid provider. All employees of Maputsoe Motors receive this 50% medical aid subsidy.

(5) Maputsoe Motors waived repayment of a loan of M8, 500 by Mr. Moloi, which had been made to him by the company for his father's funeral preparations. The loan was made in December 2014 at no interest.

Required:

(a) Calculate the total fringe benefit tax payable by Maputsoe Motors in respect of Mr Moloi for the year ended 31 March 2017. (21 marks)

(b) State by when the fringe benefit tax due on 31 March 2017 is payable. (1 mark)

CHAPTER 8

PARTNERSHIP

<u>The following study sessions are covered in this chapter</u>

Syllabus reference

a) Explain the principles of taxation for partnerships	B3g
b) Determine partnership residence	B3g
c) Calculate partnership income / loss	B3g
d) Calculate the individual partners' tax	B3g
e) Demonstrate the effect of changes in partnerships	B3g

<u>Introduction to taxation of partnership</u>

The main important principle is that partnership is not treated as a separate taxpayer from the partners. The accounting concept of separate entity does not apply. The partnership is at liberty to file the information relating to its activities and elect whether the pooling method can apply on depreciable assets. The partnership must file the return of income on or before 30th June each year. The filing must be done by the nominated partner\officer but if the partnership fails to nominate the representative, the commissioner shall nominate one of the resident partners.

A partnership is a resident of Lesotho for the year of assessment so long as there is a resident partner regardless of whether his interest is significant or not. Even if the resident partner was part of the partnership for a certain portion of the year, the partnership becomes a resident for the whole year of assessment.

<u>Partnership Income\ loss (S.76)</u>

When calculating partnership income or loss, one must consider that what is calculated is a notional income or loss. That is; the tax rate shall not be applied on the partnership chargeable income. When calculating the chargeable income of the partnership, the following deductions or credits are disregarded;

- the personal tax credit under section 73,
- interest exemption under section 27,
- interest exclusion under section 158
- and the carry forward of any loss.

The reason for disregarding these is that they are taken into consideration at partner level when dealing with tax liability of individuals.

Taxation of individual partner (S.77)

Resident partners are taxed on worldwide income of the partnership while non-resident partners are only taxed on Lesotho source income. That is; each partner is charged tax on his distributive share of partnership income. Therefore, the non-resident partner will be charged tax on his distributive share which relates to Lesotho source income. At this individual level the exemption of M500 as per section 27 is not considered and 10% withholding tax is not the final tax because the income was generated by partnership. Each partner tax liability is determined using the same rates as applicable to individuals in Chapter 5.

Changes in partnership (S.78)

The contribution of assets to a partnership is treated as though the partner has disposed the asset to a partnership. If the asset is a business or investment asset of the partner, the gain or loss to a partner is recognized for tax purposes. The contribution of assets to partnership does not result in accounting for any gain or loss.

A gain or loss where a partner contributes an asset to the extent that his interest is 50% or more after contributing the asset is not recognized for tax purpose.

The change in partnership constitution is treated as a disposal of all assets in the old partnership to the new partnership. The change in constitution may arise as a result of admitting new partner or when another partner retires. The gain shall therefore be taxed in the hands of the partners from the old partnership. There is exception where there is continuity of 50% or more in a partnership; the adjusted cost base of assets in the old partnership is rolled over into the new partnership.

When a partnership is dissolved, a transfer of assets to the partner or partners is treated as a disposal by partnership and hence it is a partnership gain or loss.

PRACTICE QUESTION

KCM is a partnership trading in Lesotho. The following are the partners:

- Mr Khothatso who has been living in Maputsoe since birth.
- Miss Mohlomi who works in Maputsoe but lives in Ficksburg, RSA.
- Mrs Christopher, born in Ficksburg and living there.

They share profits and losses equally.

For the year ended 31 March 2017, the partners had the following assets:
A light delivery vehicle which was purchased on 1 July 2015 for M135,000 and office equipment purchased on 1 December 2015 for M90,000.
On 1 June 2016, they bought a computer for M25,000.
The partnership uses the single asset method of depreciation.

Other income and expenses were:

- Gross profit from the Maputsoe office M400,000
- Gross profit from the Ficksburg office M250,000
- The delivery van and computers are used in Maputsoe while the two offices share the office equipment.
- Repair and running costs of the delivery van M6,000
- Salaries and wages: Maputsoe M54,000
  Ficksburg M30,000

Requirement:

Calculate the income tax payable in Lesotho by each of the partners for the year ended 31 March 2017. State clearly in the case of each partner the tax residence basis which you have applied.

CHAPTER 9
COMPANIES

<u>The following study sessions are covered in this chapter</u>

Syllabus reference

a) Explain the scope of corporation tax including the concept of residence and source. C1a

b) Identify the financial year(s) relevant to a chargeable accounting period. C1b

c) Identify different classes of income C2a

d) Calculate the corporation tax liability for Lesotho resident companies at appropriates C2f & C3a

e) Explain and apply relief for losses C2e

f) Explain the processes for the payment of tax, including advanced corporation tax and the quarterly payments system and withholding taxes C3b

INTRODUCTION TO COMPANY TAX

Companies have to pay tax on their profits. Company is regarded as legal person and it can therefore owe tax or be owed tax refund. As much as it has to pay tax on its profit, it also qualifies for certain deductions against the income. The tax payable by companies is called corporation tax.

In this chapter, we will know more about relevant corporation tax to both manufacturing and non-manufacturing companies. In addition to that, advanced corporation tax and payment of tax installments will be covered.

DEFINITION (S.3)

A company is defined as a body corporate or unincorporated, whether created or recognized under the law in force in Lesotho or elsewhere, but does not include partnership or trust.

Residence: (S.6)

A company is a resident company if it satisfies any one of the following three conditions:

1. It is incorporated or formed under the laws of Lesotho or
2. It has its management and control in Lesotho. The management and control of a company is regarded as being in the hands of directors rather than 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, or
3. It undertakes the majority of its operations in Lesotho. This test is intended to overcome tax avoidance practices whereby is ensured that the place of incorporation, and management and control of a company is located outside Lesotho, even though the majority of operations occur in Lesotho.

A branch in Lesotho of a non-resident company is treated as a separate person which is a resident company. This type of a branch does not qualify for the 10% special rate.

RATE OF TAX (S.10)

The chargeable income of a resident company is subject to tax at a rate of 25% for non-manufacturing companies.
A special rate of 10% applies to the Lesotho-source manufacturing income of a company. This rate does not apply to a Lesotho branch of a non-resident company.

MANUFACTURING (S.3)

This term is defined to mean the substantial transformation of tangible movable property, but does not include construction, installation, assembly, transportation, power generation or the provision of public utility services.

From the perspective of a small country like Lesotho that is endeavoring to develop a manufacturing industry to create employment the definition is possibly a little restrictive in the exclusion of assembly. There is a conflict between the Income Tax Act and industrial policy on this particular issue. An assembly project would qualify for a manufacturing rate of tax. The continuance of such an anomaly seems inappropriate.

In determining whether there has been a substantial transformation of tangible movable property, reliance would need to be placed on judicial decisions in both RSA and UK. However, a useful guide in this area is the list of processes regarded as being processes of manufacturing in RSA. The construction of roads and buildings which is regarded as manufacturing is RSA is not so regarded in Lesotho.

ACCOUNTING PERIODS FOR COMPANIES

Companies, unlike individuals, have the option of either having accounting period which ends on 31st March or any other date. However, the substitution of accounting period for tax purposes is only possible on being granted permission by the commissioner, S.49.

INCOME TAX PAYMENTS BY COMPANIES

A taxpayer who derives income in the year of assessment is liable to pay installments of tax due on 30 September, 31 December and 31 March, S.150 (1). However, for the companies whose accounting date has been substituted, they are liable to pay the three installments of tax due on the last day of the sixth, ninth and twelfth months after the date on which the accounting period commences.

The amount of each installment is 30% (A – B) where:

A – is the taxpayer's liability for the preceding year of assessment after any foreign tax credit but before set off of advance corporation tax.

B – is so much of A as paid in the preceding year of assessment by amounts of withholding tax.

Each installment made is credited against the income tax assessed to the taxpayer for the year of assessment. However, where the installment exceeds the total income tax liability for the year of assessment, the excess could be used to reduce any other taxes due from the taxpayer extending to Value Added Tax and the remainder could be refunded.

ADVANCE COPORATION TAX (S.87)

A resident company which pays a dividend is liable to pay advance corporation tax at the rate of **25/75** of the dividend payment except to the extent that the distribution is made out of qualified income.

Qualified income is defined in S.85 as consisting of:

- Manufacturing Income subject to 10% special rate and
- Dividends received from another resident company

A dividend is treated as paid first out of qualified income and then out of other income. A company may pay advance corporation tax by a credit against the installment of tax already paid but not yet set off against the final tax liability or by cash.

CALCULATION OF ADVANCE CORPORATION TAX

Example

Thamae Traders Ltd has the following income:

Manufacturing Income (after tax) M150, 000

Non- Manufacturing Income	M800, 000
Lesotho Source dividends	M20, 000
Foreign source dividends	M11, 000

The company has decided to pay dividends of M350, 000 to its shareholders. Calculate the ACT payable thereon.

Solution

Dividends paid	M350,000
Less: Qualified income:	
Manufacturing Income	(150,000)
Lesotho source dividends	(20,000)
Non- qualified element	180, 000
ACT payable thereon (25/75)	M60,000

SETTLEMENT OF ADVANCE CORPORATION TAX

ACT is an advance payment of the company's income tax liability on its distributed profits and is not an additional tax. A company may credit ACT against its income tax liability, including installments of income tax. This is for the purpose of subsections (4) and (5).

Under subsection (4), a liability for ACT may be satisfied by an installment of tax provided the installment has not previously been taken into account under that subsection.

Under subsection (5), ACT paid may be set off against an installment of tax or a final liability (net of installments) paid after the dividend is paid. This is not confined to an installment of tax or a final liability in relation to the year of assessment in which the profits out of which the dividend was paid was derived.

The installment 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) are illustrated by the following example:

Example

Taxpayer Pty Ltd has chargeable income of M500, 000 for the 2016/2017 year of assessment on which M125,000 of income tax is liability.

It has paid installments of tax for the year of M16, 153 each on 30 September 2016, 31 December 2016 and 31 March 2017. The balance of income tax for the year, M76,541, is due on 30 June 2017.

a) Where total installments equal ACT payable

On 1 May 2017, taxpayer pays a dividend of M60, 000. The taxpayer has no qualified income, so the dividend is fully subject to ACT.

ACT payable on the dividends is M20, 000 (M60, 000 x 25/75)

Under subsection (4) (a), the ACT payable is satisfied by the installments of tax paid on 30 September 19X6 and 31 December 2016. This means that no amount of ACT is actually paid to the Commissioner.

As ACT has been satisfied by the installments of tax, it is not also creditable against the income tax assessed to taxpayer for the 2016/7 year of assessment. The installments, however, remain creditable against the taxpayer's final liability (S.150 (6)).

b) Where total installments are less than ACT payable, and ACT is less than the total tax liability for the year of assessment

If the taxpayer had paid a dividend of M300, 000, then the ACT payable is M100, 000 (M300, 000 x 25/75).

In this situation, M48, 459 of ACT liability is satisfied by the three installments of tax with a balance of M51, 541 payable. Taxpayer has a final liability for the year of assessment, after credit for installments paid, of M76, 541. This liability is satisfied by the credit for ACT of M51, 541 paid, leaving a balance of M25, 000 of final corporation tax payable.

c) Where total installments are less than ACT payable but ACT is more than total tax liability for the year of assessment, i.e. Surplus ACT

Suppose that taxpayer's chargeable income is M400, 000. Tax liability on the chargeable income is M100, 000 (400,000 x 25%). Total installments paid are M48, 459.

If dividends of M315, 000 were paid, ACT would be M105, 000 (315,000 x 25/75).

In this situation, M48, 459 of ACT liability is satisfied by the three installments of tax with a balance of M56, 541 payable. Taxpayer has a final liability for the year of assessment, after credit for installments paid, of M51, 541. This liability is satisfied by the credit for ACT of M51, 541 paid, leaving a surplus ACT of M5, 000 which is creditable against the first installment of tax for the 2017/8 year of assessment due on 30 September 19X7.

TAXATION OF DIVIDENDS IN THE HANDS OF MEMBERS

Subsection (6) provides that a dividend paid by a resident company is not included in the gross income of a resident individual. This in effect means that the maximum rate of tax on a manufacturing dividend is 10% and on a non-manufacturing dividend is 25%. It also permits passage of dividends between resident companies without any further liability to taxation.

REDEMPTION OF SHARES (S.87 (7))

On redemption of shares, a company may purchase a certain proportion of shares from each shareholder or from certain number of shareholders. If the former approach is adopted then the redemption is on pro-rata basis otherwise not on pro-rata basis.

Where the redemption is on pro-rata basis, the gains or losses are treated normally. However, where the redemption is not on pro-rata basis, the gain is treated as distribution to the shareholders and therefore the company has to account for ACT like on ordinary dividends.

DISGUISED DIVIDENDS (S.88)

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 purpose of ACT. 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.

Examples of transactions which may amount to disguised dividends:

(a) Where a company makes an interest free loan to a member or an associate of a member, it may be in substance a distribution (but it depends on the circumstances). The likely dividend would be the market interest.

(b) An excessive payment made by a company for property or services provided by a member or associate. The amount of disguised dividends would be the excess over the market value of the property or services.

(c) Where a company provides property or services to a member or associate of a member at undervalue, dividend would be the difference between the market value and the under value.

(d) Where the company releases a liability owed by a member or associate of the member, the liability would become dividend.

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

DIVIDEND STRIPPING (S.89)

Remember that dividends are paid out of qualified income and no ACT is payable on such distribution.

Dividend stripping occurs where a company, just before it is to pay dividends out of its qualified income (no ACT would be payable), is bought by another company. The acquiring company would receive the dividends but sell the acquired company thereafter at a loss.

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 payer to become liable to ACT in respect of the dividends.

Example:

Where the shares of a company about to pay a substantial dividend were purchased by another company, and sold shortly after the payment of the dividend at a loss.

Maluti Ltd is a manufacturing company and its financial affairs are as follows:

Net Assets	**1,500,000**
Share Capital	100,000
Distributable reserves	1,400,000
	1,500,000

Metolong Ltd has bought X Ltd for M1,300,000 and has received dividends M1,300,000. Now Metolong Ltd is to sell Maluti Ltd for M500,000 thereby creating M800,000 loss.

Therefore there would be no ACT on dividend of M1,300,000 as it would have been from qualified income and no income tax on sale of the company at a loss.

In this case the Commissioner would demand that ACT be paid on the dividends as this transaction amount to dividend stripping.

RETURN OF ADVANCE CORPORATION TAX (S.154)

A resident company must, within seven days of paying dividends, file a return of ACT stating:

a) The amount of dividends paid,
b) ACT payable,
c) The amount of ACT which has been satisfied by way of set-off in accordance with S.87

PAYMENT OF ACT

Where there has been no set-off of ACT it must be paid within seven days of the dividend payment. This payment can be carried forward indefinitely for set-off against future tax liability.

Practice Question

Toy (Pty) Limited had the following Lesotho sourced income for the year ended 31 March 2016:

Manufacturing income	M500,000
Non-manufacturing income	M950,000
Dividends received	M50,000

On 20 May 2016 the company paid a dividend of M600,000 to its shareholders, all of whom are Lesotho residents for tax purposes.

Required:

(i) Calculate Toy (Pty) Limited's final tax liability for the year ended 31 March 2016 and state by when it must be paid. (7 marks)

(ii) Calculate the instalments of tax payable by Toy (Pty) Limited for the year ended 31 March 2017 and state on which dates these instalments will be payable. (3 marks)

CHAPTER 10

WITHHOLDING TAXES

The following study sessions are covered in this chapter

		Syllabus reference
a)	Understand and explain withholding tax obligations	B5g
b)	State and describe the general provisions relating to Withholding tax at source	B5h

WITHHOLDING TAXES

Withholding tax, in simple terms, means a way of collection of tax at the source of taxable income i.e. before income is actually paid to the taxpayer; a certain amount is deducted based on Income Tax regulations contained in Ss 156 to 168. However, in some instances withholding tax becomes the final tax in which case it is both the way of collection of tax and the form of tax.

a) Payment of Employment Income (S.156)

An employer must withhold tax from payment of employment income to an employee who is not a domestic assistant. This is normally referred to as PAYE (Pay as You Earn) form of tax.

b) Payments to Resident Contractors

A person who makes a payment to a resident contractor must withhold tax at the rate of 5% of the gross amount of the payment.

Exception to this general rule

i) Where payment is made by an individual for erection or improvement of his private residence, no withholding tax should be deducted from the gross payment.

i) Where total payments under a contract for any month are less than M3,000, no withholding tax should be deducted from the gross payment. It is very important to note that payments are evaluated separately for each contract for the purpose of this exception.

Obligation to withhold tax remains until the contract is completed.

Where a contractor is liable for instalments of tax, the amount withheld may not be offset against the instalments because instalments would have taken account that the taxpayer is liable for withholding tax at-source. Again the contractor who is a company may not offset the withholding tax against advance corporation tax.

The tax withheld is set off against the contractor `s final liability for the year of assessment under S168.

ii) Where payment is made to the complying contractor no withholding tax should be deducted from the gross payment. The contractor would have had a certificate of exemption, which is normally valid for two years, issued by the Commissioner of Taxes.

c) Interest Payments (S158)

First M500 of interest earned on a nominated account is exempt from income tax (as already seen – S.27). However, 10% withholding tax is levied on any payment of interest made by a resident person, who is not an individual or natural person, to a resident of Lesotho. The withholding tax so deducted becomes the final tax. For this reason any interest on which withholding tax has been deducted is not included in the computation of gross income.

d) Payments from Superannuation Fund (S.159)

A trustee or a manager of a superannuation fund must withhold tax at the rate of 25% on any lump sum payment and periodic payment made to any beneficiary.

Where tax has been withheld as stated above on the lump sum or periodic payment from a complying superannuation fund and the beneficiary has made no election under Section 99(1), the withholding tax is the final tax and therefore not included in the computation of gross income.

The regulations, however, provide that tax may be withheld from periodic payments in the same way tax is deducted from employment income i.e salary.

e) Payments by a Liquidator (S160)

A liquidator making payment to a member of a company must withhold tax at the rate of 10% on the gross amount of payment. This is not a final tax and it may be credited against the members` final tax liability for the year of assessment.

Withholding Tax on Non Residents

Tax at standard Rate

Withholding tax at 25% is payable on Lesotho source property income provided it is not related to manufacturing or is otherwise exempt.

Tax at 10%

Withholding on interest paid in respect of loan used in the production of manufacturing income; royalties paid in respect of technology used for manufacturing and management charges paid in respect of services provided for manufacturing are subject to tax at 10%.

Non Resident contractors are also taxable at 10%

Exemptions from withholding tax

No withholding tax is payable on Lesotho source dividends paid out of manufacturing income.

GENERAL PROVISIONS FOR WITHHOLDING TAXES (S.163 – 166)

a) Tax Withholding Certificates (S.163)

Withholding agents are obliged to deliver to payee a tax withholding certificate setting out the amount of payments made and tax withheld during the year of assessment within the following time frame:

i) in case of an employee or recipient of pension, within 28days after the end of year of assessment

i) Where the employee has ceased employment during the year of assessment within 7 days of termination of employment.

ii) In any other case on the date of payment.

b) Record of payments and tax withheld (S.164)

A withholding agent is obliged to maintain records of all taxes and must within 28 days after the end of the year of assessment; file a detailed return to the Commissioner.

c) Failure to withhold tax (S165)

A withholding agent who fails to withhold tax is personally liable to pay the amount of tax that should have been withheld. However, it may still be recovered from the payee.

d) Payment of tax withheld (S.166)

Taxes withheld must be paid to the Commissioner within the following time limits:

i) in respect of withholding tax:

- by employers
- from resident contractors and
- on periodic payments form superannuation funds;
    - **Within 15 days of the end of the month in which tax was withheld.**

iii) In all other cases immediately after payment.

Tutorial Note:

It is important to know which withholding taxes become final tax and therefore to exclude from gross income or non-final tax which is set off against final tax liability in the year of assessment.

PRACTICE QUESTION

The following information relates to Basotho (Pty) Limited and its activities.

(i) The shares in Basotho (Pty) Limited are held as follows:

	%
Companies resident in Lesotho	20
Individuals resident in Lesotho	60
Individuals resident outside Lesotho (overseas)	20
	100

(ii) The payments made by the company in the year to 31 March 2017 included the following:

Interest (net) paid to a non-resident in respect of a five year loan agreement M360,000

Contractors' fees (net) payable under service contracts:

– to residents M200,000

– to non-residents M400,000

Dividends paid to shareholders as in (i) above:

– final dividend for 2016 M300,000

– interim dividend for 2017 M700,000

(iii) The final dividend for 2017 of M500,000 was paid on 10 July 2017.

Required:

Calculate the withholding taxes payable by Basotho (Pty) Limited for the year ended 31 March 2017.

CHAPTER 11

ASSET DISPOSALS

The following study sessions are covered in this chapter

		Syllabus reference
a)	Identify chargeable assets, chargeable disposal and exempt disposals	D1a
b)	Distinguish between income and gains/losses on the Disposal of business and investment assets	B1b
c)	Calculate gain/loss on disposal on business and Investments assets	D2b
d)	Explain and illustrate the treatment of gains/losses on the disposal of assets	B4d
e)	Explain the circumstances in which market value will be used as the cost base	D1b
f)	Calculate disposal for post 1993 assets taking into consideration Indexation for the effect of inflation	D2c
g)	Explain and illustrate how relief for losses is given	D2d
h)	Prepare a basic computation of chargeable gain/loss	

ASSET DISPOSAL AND INCOME TAX

The basic principle in calculating gain or loss on disposal of assets is to subtract adjusted cost base of the asset from the proceeds. The adjusted cost base of an asset depends on the nature of the asset and its date of acquisition. Different rules apply to different assets.

Depreciable Business Assets

The adjusted cost base of these assets is the tax written down value on the date of disposal. Where the proceeds are less than the tax written down value, then that loss is allowable deduction against Business Income.

In other words, the treatment of disposal is the same as for assets purchased before 1st April, 1993 except that Section 60(8) does not apply.

BUSINESS ASSETS – NON-DEPRECIABLE

Non- depreciable business assets fall into two categories. This may include office building.

Non- depreciable Business Assets Held at 1st April 1993

The adjusted cost base of the asset is deducted from the proceeds. In the case of such assets, the adjusted cost base is the higher of original cost or market value as at 1st April 1993. Section 60(8)

Where the proceeds exceed the adjusted cost base, then the gain forms part of Business Income.

Where the proceeds are less than the adjusted cost base, then, the loss is an allowable deduction. However, the loss is only allowable to the extent that there is an actual loss. Thus, if the proceeds exceed the original cost but not the value as at 1st April 1993, the loss is not allowable deduction. This is a no gain, no loss situation.

Example

Tsotang has disposed of non-depreciable business asset for M26, 000. The original cost of the asset when it was purchased in 1992 was M25, 000. The improvements made to the asset were valued at M500 while the market value as at 1st April 1993 stood at M27, 000. Compute the gains, if any, which would be included under business income.

Solution

Asset adjusted cost base:-	Original cost	25,000
	Improvements	500
	Total	25,500
		======

Proceeds	26,000
Less: adjusted cost base	25,500

Gain	500
	======

Proceeds	26,000
Less: Market value	27,500

Loss	1,500
	======

In this case the loss is not an allowable deduction, it is a no gain no loss situation.

Non- depreciable Assets Acquired After 1st April 1993

The adjusted cost base of the asset is deducted from the proceeds. The only adjustments to cost base are capital improvements.

Where the proceeds exceed adjusted cost base, then that gain forms part of Business Income.

Where the proceeds are less than the adjusted cost base, then that loss is an allowable deduction against Business Income.

FARMING ASSETS – DEPRECIABLE AND NON-DEPRECIABLE

The amendment of Section 29 which has brought about the difference between commercial farming (not exempt from income tax) and subsistence farming (exempt from income tax) has implications on the disposal of assets as well.

The treatment of such disposals would be like other assets however, with the following transitional provisions. The cost base of any disposed of farming asset which was purchased before 31st March 1996 is equal to its market value on 31st March 1996. This applies to trading stock and other assets. This is to ensure that the individual will only be taxed in respect of the gain or loss accruing after the removal of the exemption i.e from 31 March 1996.

It is important to note that while the market value as at 31st March 1996 is taken as the cost base for disposals of commercial farming assets, the adjusted cost base at 31st March 1996, arrived at by assuming that the single asset method of depreciation has been applied since acquisition of the asset, is what is taken for depreciation purposes. (You may refer back to Chapter 4, if you are not sure of yourself).

Now, for the purposed of disposal, the cost base would again depend on whether the asset is depreciable or not.

For depreciation assets, gains should be proceeds less tax written down value taking account of notional allowances for pre 1st April 1996 assets and S60(8) has to take effect.

For non- depreciable assets, the higher of market value as at 1st April 1996 and original cost would be used as cost base for disposal purpose.

The treatment of assets is similar to business assets except that 1st April 1993 is substituted for 1st April 1996.

Non- depreciable Farming Assets:

Example:

1st May 1992	Cost	M25, 000
1st April 1993	MV	M25, 500
1st April 1996	MV	M25, 400
1st May 1996	Sales proceeds	M26, 000

Solution

Sale Proceeds	M26, 000
ACB	<u>M25, 400</u>
Taxable Gain	600
	=======

Example

1st April 1993	Cost	M25, 500
1st April 1996	MV	M26, 000

1st May 1996	Sale Proceeds	M27, 000

Solution

Sale Proceeds	M27, 000
ACB	(M26, 000)

Taxable Gain	1,000
	========

Example

1st April 1993	Cost	M25, 500
1st April 1996	MV	M26, 000
1st May 1996	Sale proceeds	M25, 800

Solution

Sale Proceeds	M25, 800
ACB	M26, 000

Notional loss (Not Allowable)	200
	=======

Depreciable Farming Assets:

Example:

1st April 1992	Cost	M25, 000	
1st April 1993	TWDV		M20, 000
1st April 1993	MV	M25, 500	
1st April 1996	TWDV		M10, 240
2nd April 1996	Sale Proceeds	M26, 000	

1st April 1996	MV	M25, 400

Solution

Sale Proceeds	M26, 000
TWDV	(M10, 240)

	M15, 760
	========

Example

1st April 1993	Cost	M25, 500
1st April 1996	TWDV	M13, 056
1st April 1996	MV	M26, 000
3rd April 1996	Sale Proceeds	M27, 000

Solution

Sale Proceeds	M27, 000
TWDV	(M13, 056)

	M13, 944
	=======

INVESTMENT ASSETS – IMMOVABLE PROPERTY

Such investment assets fall into two categories:

- Land and Building giving rise to Rental Income
- Shares in companies whose primary assets consist of investments in immovable properties.

Determining whether land or buildings are investment assets or business assets depend on whether rental income is being derived from the asset.

These assets are grouped into two categories.

Immovable Investment Assets Held at 1st April 1993

The adjusted cost base of the asset is deducted from the proceeds. In this case, the adjusted cost base is determined in a two-step process

i) The adjusted cost base at 1st April 1993 is firstly established. This is the higher of the original cost of the asset or its market value at 1st April 1993.

ii) If the asset has been held for more than twelve months, then the adjusted cost of the assets at (i) above, can be increased for the effects of inflation between 1st April 1993 and the date of disposal.

Where the proceeds exceed the adjusted cost base, then there is an allowable loss. Such loss can be off-set against any gains arising from the disposal of any investment asset (movable or immovable). Any unutilized loss can be carried forward for set-off against future gains.

However, the amount of the loss that is allowed is restricted to the extent that the loss is an actual loss. It is therefore necessary to make a comparison between the proceeds and the original cost. If, on this basis, there is a profit, then the loss is not allowable.

If there is a loss, only the actual will be allowable.

Examples:

Immovable Investment Assets Held at 1st April 1993

1st January 1993	Cost	M26, 000
1st April 1993	Market Value	M27, 000
13th October 1993	Sale Proceeds	M28, 000

Solution

Sale Proceeds	M28, 000
ACB	M27, 000
Taxable Gain	M1, 000

1st January 1993	Cost	M26, 000
1st April 1993	Market Value	M27, 000
13th October 1993	Sale Proceeds	M26, 700

Solution

Sale Proceeds	M26, 700	M26, 700
ACB		M27, 000
Original Cost	26,000	
	---------	------------
Actual Profit	700	
Notional Loss		(300)
	======	=======

Therefore: No gain no loss situation

Example (continued):

1st January 1993	Cost	M26, 000
1st April 1993	Market Value	M27, 000
13th October 1993	Sale Proceeds	M25, 900

Solution:

Sale Proceeds	M25, 900	M25, 900
ACB		M27, 000
Original cost	M26, 000	
	-----------	------------
Actual Loss	(100)	
Notional loss		1,100

IMMOVABLE PROPERTY AND INDEXATION FOR EFFECT OF INFLATION S 60(10)

Where the asset is an investment asset which is an immovable property and has been held by the taxpayer for more than twelve months, the adjusted cost base must be indexed for inflation.

This adjustment is done through increasing the cost base of the asset by the rate of inflation measured by consumer price indices between the date of acquisition and the date of disposal.

It is important to note that it is only interests in immovable property that can be indexed for the effects of inflation. Essentially immovable property is land and buildings and sometimes shares in an immovable property company.

Example

Asset purchased	1 July 1993	M100, 000
CPI	stood on	105
Asset disposed	1 September 1994	M120, 000
CPI	Stood on	118

Solution

Adjusted cost base M100, 000 /105x118 = M112, 381

Cost	M100, 000	Indexed cost	M112, 381
Proceeds	M120, 000	Proceeds	M120, 000
	-------------		--------------
Actual gain	M20, 000		M 7, 619
	=======		=========

The taxable gain is M7, 619 as the taxpayer is allowed to increase the cost base of the asset for the effects of inflation.

However, there are restrictions on the use of indexation.

1. Indexation cannot be used to create an allowable loss. In a situation where an actual gain arises and the application of indexation creates a notional loss, then that loss is not allowable.

Example

Asset purchased	1 July 1993	M100, 000
CPI	was 105	
Asset disposed	1 September 1994	M110, 000

CPI was 118

Solution

Adjusted cost base M100, 000/105x118 = M12, 381

Cost	M100, 000	Indexed cost	M112, 381
Proceeds	M110, 000	Proceeds	M110, 000
	-------------		--------------
Actual gain	M10, 000	Notional loss	(M2, 381)
	=======		========

As indexation has given rise to a notional loss and an actual gain has arisen, neither a gain nor a loss is deemed to have arisen for tax purposes.

2. Indexation can only be applied where the asset has been held for more than 12 months. Therefore the cost base of an asset cannot be indexed when the asset has been held for a year of less.

INVESTMENT ASSETS – NOT IMMOVABLE PROPERTY

For purposed of calculating the tax implications of disposal of these assets, they are divided again into two categories.

Investment Assets Held at 1st April 1993

The adjusted cost base of the asset is deducted from the proceeds. In the case of such assets, the adjusted cost base is the higher of original cost or market value as at 1st April 1993.

Where the proceeds exceed the adjusted cost base, then the gain forms part of Property Income.

Where the proceeds are less than the adjusted cost base, then there is an allowable loss. Such loss can be off-set against any gains arising from the disposal of any investment asset (movable or immovable). Any unutilized loss can be carried forward for set-off against future gains.

However, the amount of the loss that is allowed is restricted to the extent that the loss is an actual loss. It is therefore necessary to make a comparison between the proceeds and the original cost. If on this basis there is a profit, then the loss is not allowable.

Example

Taxpayer acquired shares in De Beers on 1st April 1984 for M5, 000. These shares were worth M45, 000 on 1st April 1993 and were disposed of in October 1993 for M60, 000.

Solution:

	M		M
Cost	5,000	April 1993 value	45, 000
Proceeds	60, 000	Proceeds	60, 000
	--------		----------
Actual gain	55, 000	Notional gain	15,000
	=====		======

The gain that is taken into account for tax purposed is M15, 000 because in calculating the adjusted cost base we use the higher of adjusted cost or market value as at 1 April 1993.

Also market values on 1st April 1993 cannot be used to establish or augment a loss.

Example

An investment asset was purchased on 1st January 1992 for M50, 000. The Market value at 1st April 1993 was M60, 000. The asset has eventually been sold for M55, 000. Compute gains or loss.

Solution

	Original cost		Market Value
	M		M
Proceeds	55, 000		55, 000
Cost	50, 000		60, 000
	---------		----------
Actual Gain	5,000	Notional Loss	5000
	====		======

Example

As in (5) above but the original cost was M108, 000. The market value at 1st April 1993 was M127, 000. The asset has eventually been sold for M100, 000. Compute gain or loss.

Solution

	Original cost		Market Value
	M		M
Proceeds	100, 000		100, 000
Cost	108, 000		127, 000
	-----------		-----------
Actual Loss	8, 000	Notional Loss	27, 000
	------------		------------

As market value cannot be used to augment a loss, the actual loss in this case is limited to M8, 000, the actual loss.

2. **Investment Assets Acquired After 1st April 1993**

The treatment of such disposals is straight- forward.

Where the proceeds are less than the original cost then the loss is an allowable loss. Such loss can be off-set against any gains arising from the disposal of any investment asset (movable or immovable). Any unutilized loss can be carried forward for set-off against future gains.

PERSONAL ASSETS

No tax implication arises from the disposal of assets, such as a private residence or motor vehicle, provided they are not used in the production of income subject to tax.

SPECIAL SITUATIONS

A number of special situations are identified in the Act in respect of which special rules apply.
These are as follows:

1. **Loss on Disposal to an Associate**

Where an asset is disposed of at a loss to an associate, then the loss is not recognized for tax purposes. In such a situation, the asset is deemed to have been sold by the disposer and acquired by the buyer for its adjusted cost base at the date of disposal.

2. Asset Depreciation under the Pooling Method

Gains and losses do not normally arise where assets are depreciated using the pooling method. However, there is a required treatment for three particular situations.

i) Where, after disposal, there is a credit balance on the pool, then that credit balance is treated as a gain and forms part of Business Income.

ii) Where, after all the assets in a pool have been disposed of, a debit balance remains, then that debit balance is treated as a loss and is an allowable deduction against Business Income.

iii) Where the balance in a pool is less than M500 and there have been no additions to the pool during the year, then that balance is an allowable deduction against Business Income.

3. Transfer between Spouses and Former Spouses

Where an asset is transferred between spouses or between former spouses as part of a divorce settlement, a taxable disposal has not arisen.

In such cases the (former) spouse is deemed to have acquired the asset at its adjusted cost base to the other (former) spouse as at the date of transfer. Correspondingly, the (former) spouse transferring the asset is deemed to have disposed of it for its adjusted cost base at the date of transfer.

4 Involuntary Conversion and Re-investment

Special treatment is available for situations when an asset is involuntarily disposed of and a similar asset is acquired. Such situations cover, for example, compensation under an insurance policy for the destruction of an asset or a payment for the compulsory acquisition of an asset.

Where payment has been received for the involuntary conversion of an asset and the proceeds are re-invested in a similar asset, then the following rules apply:-

i. If the proceeds are less than the adjusted cost base, then the loss is allowable. The new asset is deemed to have been acquired at its actual cost.

ii. If the proceeds are greater than the adjusted cost base then the following applies:-

a) If the full amount of the proceeds is re-invested in a new asset, no chargeable gain arises and the new asset is deemed to have been acquired for the adjusted cost base of the asset disposed of.

b) If the full amount of the proceeds are not re-invested in a similar asset then uninvested proceeds will form part of taxable gain. The newly acquired asset is deemed to have been acquired at the adjusted cost base of the asset disposed of.

c) If the amount re-invested in a new asset exceeds the proceeds, then any gain is not taxable and the new asset is deemed to have caused the adjusted cost base of the old asset plus the excess investment over and above the proceeds received.

Example

The taxpayer received compensation from an insurance company for the office equipment which was destroyed by fire. At the time of fire the adjusted cost base of the equipment was M12, 000.

What would be the taxable gain and cost at which the new asset would be deemed to be acquired if the taxpayer received compensations as follows?

a) M10, 000 and used it to buy a new and similar equipment for M13, 000?
b) M15, 000 and used it to buy a new and similar equipment for M13, 000?
c) M15, 000 and used it to buy a new but dissimilar equipment for M10, 000?
d) M15, 000 and used it to buy a new equipment for M16,000?

Solution:

Gain or Loss = Proceeds less adjusted cost base

a) M10, 000- M12, 000 = (M2000) loss, this is allowable
New asset therefore is deemed acquired at actual cost M13, 000 not M10,000.

b) M15, 000 – 12, 000 = M3, 000 gain
This gain is not taxable because all the proceeds have been used to replace the asset destroyed by fire. However, the new asset is deemed to have been acquired for adjusted cost base of the asset replaced i.e M2, 000 not M15, 000.

c) M15, 000 – M12, 000 = 3, 000 gain
Uninvested proceeds = M15, 000 – M10, 000 = M5, 000
Gains not taxable would be (10,000/15, 000)x 3,000 = 2000
The adjusted cost base would be M12, 000.

d) M15, 000 – M12, 000 = M3,000 gain not taxable
The adjusted cost base = adjusted cost base of old asset M12, 000

Plus excess investment over and above the proceeds received

(M16, 000 – M15, 000) M1, 000 i.e M13, 000.

5 Transfer of Assets on Death

Where an asset is transferred to a personal representative or beneficiary on the death of a taxpayer a disposal for tax purposed is not dement to have arisen.

In such a situation, the personal representative or beneficiary is deemed to have acquired the asset for its market value at the date of death or its adjusted cost at the date of deat if that is higher.

6 Contribution of Asset to Partnership

Where a taxpayer transfers an asset to a partnership a part of the contribution of capital to the partnership and the taxpayer `s interest in the partnership exceeds 50% after the contribution of the asset then no gain or loss is deemed to have arisen on the disposal of the asset.

The taxpayer is deemed to have disposed of the asset for its adjusted cost base at the date of transfer and the partnership is deemed to have acquired it for that amount.

UNUTILISED LOSSES ON DISPOSAL OF INVESTMENT ASSETS

Losses on disposal of investment assets are only allowed to the extent of gains derived by the taxpayer from the disposal of investment assets by the taxpayer. Any unutilized losses in a year of assessment can be carried forward indefinitely for future set-off against chargeable gains arising on disposal of investment assets.

Tutorial Note

Consideration Received (S.61)

1. This includes the market value of any consideration in kind.

2. Where an asset is disposed of in a non-arm's length transaction (e.g to an associate or related party) the disposer is treated as having received consideration equal to the fair market value of the asset at the date of disposal.

3. Where disposal is by way of gift, the disposer is treated as having received consideration equal to the greater of the adjusted cost base of the disposer or the fair market value of the asset at the date of disposal.

4. Where part of an asset is disposed of, the cost base is apportioned between the part disposed and the part retained.

The adjusted cost base of an asset is –

Cost
Plus capital improvements
Less depreciation allowance

QUESTIONS TO ASK REGARDING ASSET DISPOSALS

1. Is asset a personal asset? If so, no taxation implications
2. Is asset a depreciable business asset? If so, then

   a) is the pooling method used? If so, no taxable gain or loss as proceeds are off-set against balance of pool
   b) is the single asset method used? If so, then calculate gain or loss based on difference between proceeds and tax written down value.

3. Is the disposal as a result of an involuntary conversion or compulsory acquisition? If so, then the only taxable amount is the excess of proceeds over adjusted cost base to the extent that they are not reinvested in a similar asset.

4. Is it an investment asset purchased prior to April 1993? If so, then value at April 1993 becomes new cost base, provided it is higher than cost.

5. Is it an interest in immovable property disposed of subsequent to April 1994? If so, then check if asset has been held for period greater than 12 months. If so, then cost base can be adjusted for effects of inflation (but not deflation).

Practice Question

(a) Calculate any taxable gain/allowable loss on disposal of the following assets.

1. A non-depreciable business asset was disposed for M26, 000 in 2004. The original cost of the asset in 1992 was M26,200 and the market value as at 1st April 1993 was M27,000.
2. A non-depreciable farming asset disposed in 2007 for M 12,000. The cost in 1912 was M3,000. The market value in April 1993 was M10,000 and M11,000 in April 1996.
3. Immovable investment asset purchased in 1990 for M100,000 when CPI was 105. The market value as at 1st April 1993 was 105,000 and CPI was 107. It was disposed in 2001 for M114,000 when CPI was 115.

b) A taxpayer received compensation from an insurance company for office equipment destroyed by fire. At the time of the fire, the adjusted cost base of the asset was M12,000.

Calculate the taxable gain/loss and the cost of the new asset if he received compensation as follows:

(i) M10,000 and used it to buy a new similar asset for M13,000.
(ii) M15,000 and used it to buy a new similar asset for M 15,000.
(iii)M 15,000 and used it to buy a new similar asset for M 13,000.
(iv)M 15,000 and used it to buy a new similar asset for M17,000.

CHAPTER 12

ANTI-AVOIDANCE RULES

The following study sessions are covered in this chapter

	Syllabus reference
a) Explain and calculate minimum chargeable income	B3c

CHARGEABLE INCOME

The chargeable income of a taxpayer for a year of assessment is determined by subtracting from gross income of the taxpayer any deductions allowed under the Act (S.13.1).

A number of rules, mostly of an anti-avoidance nature are set out in the legislation for determining chargeable income.

MINIMUM CHARGEABLE INCOME

The minimum chargeable income provides a way of calculating chargeable income for taxpayers with low reported chargeable income while it is visible that they have so much wealth i.e. their lifestyle is inconsistent with the income that they indicate in their returns. In such circumstances the minimum chargeable income is arrived at by referring to indicators of wealth such as air travel, electricity consumption, value of the taxpayer's principal residence, school fees, the value of secondary residence, and the value of the taxpayer's motor vehicle. Therefore the minimum chargeable income is the sum of the following:

1. The full cost of travel by air or sea by the taxpayer, the taxpayer's spouse and the taxpayer's minor children, with the exception of travel on an employer's business and provided the amount exceeds M2, 500 in a year of assessment.

2. The full cost of electricity consumed in the taxpayer's principal residence and secondary home provided the amount exceeds M3, 000 per annum.

3. In relation to the taxpayer's principal residence (whether in Lesotho or elsewhere)

5% of the greater of the adjusted cost base of the principal residence or the value of that residence for purposes of property rates, where the principal residence is owned by the taxpayer or the taxpayer's spouse and the value of the house exceeds M150, 000.

5% of the greater of the eight times the actual annual rental or eight times the annual fair market rental where the principal residence is rented.

Effectively, this is 40% of the greater of the two figures above.

4. In relation to a secondary residence (in Lesotho or elsewhere and irrespectively of how many), 5% on the amount as calculated for the principal residence except that it applies where the value of the house exceeds M20, 000.

5. The full amount of school tuition and related fees incurred in respect of the taxpayer's minor children, provided the amount exceeds M1, 000 per annum in respect of each child.

6. 25% of the value of a vehicle available for personal use by the taxpayer, the taxpayer's spouse or the taxpayer's minor children, provided the value exceeds M20, 000.

The above section does not apply to

- A person whose gross income for the year of assessment (other than income subject to a final withholding tax) consists exclusively of employment income.

- A person whose income is exempt from tax.

No deductions are allowed in determining chargeable income.

Example

Minimum Chargeable Income

Moses Molupe has made a return of income for the year to 31st March 2007 showing a chargeable income of M 72, 000. The Commissioner of Taxes, aware of the flamboyant life style of Moses, believes the return understates his income and his investigations revealed the following:

During the year Moses paid M14, 500 in respect of a trip to Malawi for himself, his wife, his 24 year old daughter and his brother.

The cost of providing electricity to his principal residence was M4, 840 and to his secondary residence was M2, 900.

His principal residence owned by his spouse has an adjusted cost base of M179, 000 and is valued for purposes of property rates at M200, 000.

He has paid the following school fees;

2 daughters (aged 12 and 15)	M4, 900 each
1 son (24 years old)	M1,200
1 son (minor)	M 980

His secondary residence which he rents at M8,800 per annum has an adjusted cost base of M15,000 and is valued for property rates at M30,000.

The family vehicles are valued as follows:

Moses – M150, 000
Wife - M 80,000
Minor daughter - M 18,000

Required

Calculate his minimum chargeable income for the year of assessment.

Solution:

		M
1.	Air Travel (14500x2/4)	7,250
2.	Electricity (4850+2900)	7,750
3.	Principal Residence(200,000x5%)	10,000
4.	School Fees (4900x2)	9,800
5.	Secondary Residence (8800x40%)	3,520
6.	Motor Vehicles- Self (150000x25%)	37,500
	- Wife (80,000x25%)	20,000

		95,820

JOINT OWNERS (S.64)

Income or deductions relating to jointly owned property are apportioned among the joint owners in proportion to their respective interests in the property.

VALUATION (S.65)

Where the calculation of chargeable income involves a receipt, an outgoing or any other amount in the form of property, services, or other benefit, its fair market value on the date taken into account for tax purposes is used in determining chargeable income.

INDIRECT PAYMENTS AND BENEFITS (S.67)

The income of a taxpayer includes:

a) A payment that directly or indirectly benefits the taxpayer; and
b) A payment dealt with as the taxpayer directs which would have been income of the taxpayer if the payment had been made directly to the taxpayer.

The deductions of a taxpayer include a payment made on behalf of the taxpayer or as the taxpayer directs which would have been a deduction of the taxpayer if the payment had been made directly by the taxpayer.

INCOME SPLITTING (S.74)

When an individual taxpayer attempts to split income with a spouse, child, associate or other person, the Commissioner may adjust the chargeable income of the taxpayer and the other party to prevent income splitting.

Income splitting can substantially reduce the tax liability of an individual as each taxpayer would qualify for a personal credit and a lower rate on the first M54, 770

Practice Question

Mololi, a business man, is married to Mpho and they live with their ten year old child. He made profits of M90, 000, rental income of M15 000 and has M10, 000 in deductions for the year of assessment.

During the year of assessment, Mololi:

- Spent M10, 000 in private air travel to Cape Town with his wife and child.
- Consumed electricity in his principal and secondary residences to the value of M2, 500 and M200 respectively.
- His principal residence has an adjusted cost base of M200, 000 (This is higher than the value for the purposes of property rates).
- His secondary residence (which belongs to his brother) is valued at M50, 000 and he pays rent of M500 per month, the market rent is M650.
- Paid school fees of M15, 000 for his child.
- Has a vehicle available for private use with a value of M25,000

Required:

Calculate the minimum chargeable income, and tax payable.

CHAPTER 13

INCOME TAX ADMINISTRATION

The following study sessions are covered in this chapter

		Syllabus reference
a)	Describe the administrative procedures relating to returns of income and the corporation tax assessment rules, including the filing of returns and filing dates, and cases where returns are not required.	F1a
b)	Describe the administrative procedures relating to assessments including deemed assessments, default and special assessments, amended assessments and enquiries.	F1b
c)	Outline the process for the collection and refund of tax.	F1c
d)	Identify and recognise the due dates for the payment of income taxes.	F1d
e)	Explain the processes and outline the dates for the payment of tax, including tax by instalments, advance corporation tax and the quarterly payments system.	F1e
f)	Explain how a repayment of overpaid tax can be obtained.	F1f

Filling of Returns (Return of income)

All taxpayers, employees, sole traders, contractors, partnerships as well through their nominated partners and companies also, must file returns of income with the commissioner of taxes so to declare their incomes and make their tax settlements for the year of assessment on prescribed time periods or dates.

Every taxpayer must file a signed return not later than 3 months following the end of the year of assessment, the return may be signed by the representative of the taxpayer. The return may be accompanied by attachments such as the financial statements, or the accountant representation certifying the attachments/accounts. The return should contain a representation that it and any attached material are complete and accurate.

The commissioner may require the preparer of accounts or documents to certify that;

He has examined the books and accounts and other relevant documentation and;
The documents correctly reflect the data and transactions to which it relate

The commissioner may, by notice in writing require a return to be filed within less than 12 months when;

- the taxpayer is leaving Lesotho permanently or
- the taxpayer ceases to carry on business or
- the commissioner considers it expedient.

A return is not required to be filed:

- When the tax to be paid is less than the amount of the tax credit and;
- When gross income for the year exclusively consists of;
  Employment income less than M50 000 from a single employer and from which the tax had been withheld and;
- When the gross income consists exclusively of the pension from which tax has been withheld.

Assessments procedures
The responsibility to assess taxpayers lies with the Commissioner. Three ways in which the commissioner can carry out the assessments;

- Deemed or self-assessments

- Default and special assessments
- Amended assessments

Deemed assessment

Is whereby the return as filed by the taxpayer is deemed to be notice of assessment served on the taxpayer on the due date for filling or the actual date for filling.

The assessment states amount of chargeable Income and the tax payable thereon.

Where the taxpayer does not have to file a return of income, any withholding certificates issued are deemed to be notice of assessment served on the taxpayer three months after end of the year of assessment

Default and special assessment

There are two circumstances in which the commissioner can actually carry out the assessments himself other than the self-assessments made upon filling of returns. This is whereby the commissioner himself determines the chargeable income and tax thereon.

1. In situations where the taxpayer failed to file a return then the commissioner makes an assessment. (Default assessment)

2. In situations where the commissioner is entitled to seek a return in less than a period of 12 months he may instead may make an assessment (special assessment)

Amended assessment

There are two circumstances in which the commissioner may amend his assessments

1. When there had been fraud, gross or willful neglect the commissioner may amend an assessment of that year, at any time.

2. Whereas in other circumstances assessments may be amended within four years of the original assessment;

Application by the taxpayer for an amendment to an assessment

The taxpayer may within four years of the deemed assessment apply to the commissioner for an amended assessment, the grounds for the amendment of the assessment must be detailed.

The commissioner may allow or disallow the amendment by notice to the taxpayer in writing of his decision.

If no feedback has been received by the 90^{th} day of the application for the amendment it will be deemed that the commissioner had disallowed the amendment.

Objections and appeals to the assessments

Time limits for making an objection to the commissioner's assessment;

- In relation to the original assessment, within four years from the date of the assessment
- In relation to the amended assessment; within four years of the original assessment or within 60 days of the amended assessment, whichever is the latter.

The commissioner should serve the taxpayer with a notice in writing of his decision to the taxpayer's objection.

If no feedback has been received by the 90^{th} day it is deemed that the commissioner has disallowed any amendment caused by an objection.

Appeal to the Tribunal

A taxpayer dissatisfied with an objection decision may within 60 days lodge an appeal to the tribunal and serve the commissioner with a copy. The grounds for an appeal are restricted to those under an objection, unless the tribunal grants leave for the taxpayer to add other new grounds.

Appeal to the High Court

A decision of the Tribunal may be appealed to the High Court within 60 days of being notified of the decision.

Appeal to the Court of Appeal

An appeal from a decision of the High Court may be made to the Court of Appeal within 60 days of being notified of the High Court's decision.

CHAPTER 14

VALUE ADDED TAX

<u>The following learning objectives are covered in this chapter</u>

		Syllabus reference
a)	Explain the scope of value added tax	E1a
b)	Explain the VAT registrations requirements	E2a
c)	Explain when a business must register for VAT	E2b
d)	Outline the benefits of voluntary registration for VAT	E2c
e)	Explain when and why a business can apply for exemption from registration of VAT.	E2d
f)	Explain the circumstances under which a business can apply for deregistration for VAT.	E2e
g)	Explain and contrast the types of supply	E3a
h)	Explain the detail required on VAT invoices	E4a
i)	Outline the process for accounting for VAT	E4b
j)	Explain and outline the circumstances under which the business can account for VAT using the cash method	E4c
k)	Explain and outline the circumstances under which the business can account for VAT using the invoice method.	E4d
l)	Explain the treatment of imports and exports	E5a
m)	Recognise the time of supply/tax point for inputs and outputs	E6a
n)	Compute VAT liability	E6b
o)	Detail the basic VAT administration Requirements	E7a

Value Added Tax

Before July 2003, Lesotho had a Sales Tax which contributed to the Government Budget till 30th June 2003. The Minister of Finance announced in May 2003 that VAT would replace Sales Tax with effect from the 1st of July 2003. VAT was then introduced following the passing of VAT Act by Parliament in 2001. The LRA adopted the VAT system because of the problems in administering the Sales Tax system.

The advantages of VAT over Sales Tax are:

- It eliminates the concept of double taxation especially when one is buying a car that is already registered.
- Taxable goods and services may not be obtained without paying VAT as was the case with the use of Sales Tax exemption certificates (Misuse of exemption certificates to obtain supplies without paying tax is therefore solved).
- The input credit tax credit mechanism allows businesses to deduct tax paid on purchases and expenses used for making taxable supplies from tax collected and therefore solving the cash flow problems.
- The risk of not recovering VAT is reduced because it is recovered in stages.

What is VAT?

Value Added Tax is commonly known by its abbreviation VAT. This is a broad based tax levied on the supply or consumption of goods or services including supplies to Government. It is also levied on imported goods and services. It is also referred to as a destination based tax because it is levied at a place where the consumption of service occurs.

However, before a supply can be subject to tax, it must be made by a registered vendor and it must not be an exempt supply. It follows that small businesses not registered for VAT sell their supplies without charging VAT on final consumer.

VAT Registration

VAT can only be collected by registered vendors. Vendors are entrepreneurs who are registered for VAT. The entrepreneurs can register for VAT under compulsory, mandatory and voluntary registrations.

Compulsory Registration: the Act provides that a person conducting business in Lesotho is liable for compulsory registration within 14 days, once it is clear that the turnover of taxable supplies made by a person within 12 month period will exceed M850, 000.00 (M850, 000.00 is the VAT registration threshold). However, the following people and organization must register regardless of the threshold:

- National, regional or public authorities who carry on enterprises
- Auctioneers
- Persons carrying on an enterprise outside Lesotho whose goods or services are consumed in Lesotho.

Mandatory Registration: this is the registration whereby the Commissioner of VAT forces a person to register when his turnover exceeds the registration threshold. That means it is mandatory for him to register because the annual turnover is the determining factor.

Voluntary Registration: this is a registration that a person can apply for even if his turnover is less than the threshold amount. The Commissioner of VAT can approve such a registration at his discretion. The entrepreneurs opt for this registration because of the benefit for recovering the paid VAT.

The candidates must be aware that the suppliers of exempt services cannot register for VAT even if the annual turnover exceeds the threshold. The examples include the suppliers of banking services, educational services, water etc. If the supplier provides both the exempt and taxable services, the Commissioner will consider the taxable supplies.

Reasons that can lead to cancellation of VAT registration

The Commissioner may cancel the registration of a vendor through applying section 17(6) of the Vat Act. Section 17(6) lists the following circumstances which can lead to cancellation of vendor's VAT registration where a vendor:

- is in breach of the conditions or limitations attaching to the registration;
- has no fixed place of abode or business
- has not kept proper accounting records relating to any enterprise carried on by the vendor;
- has not submitted regular and reliable value added tax returns as required by section 27; or
- is not, in the opinion of the Commissioner, a fit and proper person to be registered.

Basic concepts

The most important aspects of the VAT system are discussed below. This is to provide students with the ideas relating to underlying concepts and how they are applied in the VAT system.

Taxable Supply means a supply of goods or services (other than an exempt supply) made in Lesotho by a vendor for consideration in the course or furtherance of an enterprise carried on by the vendor (VAT Act 2001 Sec 12(1).

A supply of goods or services can only be taxable if they meet the following requirements:

- It must be a supply
- The subjects of the supply must be goods or services
- The supply must be for a consideration
- It must be in the course of an enterprise

- It must not be an exempt supply
- It must be a connection with Lesotho in relation to place of supply
- The supplier must be a vendor, i.e. liable or registered for VAT registration.
- Furthermore the students must be aware that the exports are also taxable supplies while imports are taxable supplies so long as they are not exempt.

The legislation also provides for VAT to be charged when there is:

- A supply by auction
- A sale of goods by instalments
- Supply of goods or services by an agent on behalf of a principal(Vendor)
- Lay- bye sale.
- Any supply of goods or services which is incidental to the supply of goods and services is part of the supply
- A supply of taxable fringe benefits

Time of supply: it is vital to know the time when a taxable supply is made, because that will help the ministry or any organization to understand when Vat is payable to or claimable from the LRA. Time of supply is crucial as it assist a vendor to recognize the relevant tax period to which the taxable supplies relate. The VAT tax period is a one month and the VAT is payable or claimable on or within twenty days after the end of the month.

The general rules for goods and services supplies are as follows:

Goods: the earlier of:

- The time the goods are removed from the supplier's premises
- The time when the invoice is issued
- When payment is received
- When goods are made available to the person to whom they are supplied.

Services: the earlier of:

- The time when a payment is received
- Time when an invoice is issued
- When the services are actually rendered or performed

Value of supply

The taxable value of the taxable supply is the consideration of that supply. In this regard the consideration can be money or the fair market value of goods or services supplied. Both consideration and fair market value exclude Vat. Therefore this means that a rate of tax will be applied on consideration or fair market value.

In supermarkets, the customer normally pay the price reflected on shelves, thus the price you see is the price you pay. That is; the vat amount is already included on a selling price. Tax fraction is used to establish the amount of vat included in a selling price.

Tax fraction: $\dfrac{r}{100 + r}$

Where: r = the applicable rate of tax

Example;

The supermarket sells the groceries whose selling price is M5300.00 and we have to find the taxable value and the amount of Vat charged. The rate of Vat is 14%.

Solution: In order to establish the taxable value and vat charged we have to apply the tax fraction.

a. VAT charged:

$$M5300 \times \frac{14}{100 + 14} = M650.88$$

b. Taxable value:

Selling price: M5300.00

Vat charged: (M 650.88)

M4649.12

Note: If the question can show prices excluding vat, the applicable rate of tax is applied straight to the amount in order to get the vat amount.

Place of supply

Place of supply is very important because it determines whether the transaction can be taxed in Lesotho or not. The rules under the place of supply establish the origin of the supply and its destination. This concept is vital as it assist us to charge vat on imports and on consumption of goods or services in the country.

General rules:

- Where goods are delivered or made available and if it involves transportation, the place where the goods are when the transportation commences
- Services: the place of business from where the services are supplied
- Radio, television, telephone or other communication services, where the signal or service originates outside Lesotho, the place of supply will be where the recipients receive the service or signal.

Vat rates and exempt supplies

There are four VAT rates in Lesotho:

0% for exports of goods and services and on maize meal, maize (grain), bread, milk, beans, peas, agricultural inputs (fertilizers, seeds and livestock feed, unmalted sorghum), hens eggs and paraffin intended for use as fuel for cooking, illuminating or heating.

5%: utilities. E.g. telephone and electricity services

14%: other supplies of goods and services. E.g. groceries

15%: alcohol and tobacco products

Exempt supplies

These are the supplies of goods or services which do not attract the vat charge. Thus, unlike the taxable supplies the exempt supplies are not taxable.

Exempt supplies include the following goods or services:

- Supply of pipe water
- Supply of sport activities by an amateur sporting organization, but not including sporting goods
- Public postal services
- Passenger transport service
- Medical and dental services
- Financial services
- Insurance services
- Education services
- Supply of unimproved land
- A supply by way of lease or letting of immovable property, where the tenant is a manufacturer and the property is used by the manufacturer principally for carrying on a manufacturing enterprise
- Any other supply as prescribed by the Minister in regulations

Note: *Students must note that pipe water is exempt but if it is exported then it becomes a zero rated supply. A case in point is Lesotho Highlands Development Authority (LHDA) because it exports water to South Africa. It is for this reason that LHDA is registered under VAT system because it provides taxable supply.*

Example

Transaction	VAT Rate/ Exempt	Calculations	VAT (paid)/collected
Stock bought (raw materials for M120, 000	14%	120,000 * 14/114	(M14,737)
Public transport cost for delivering staff to rural areas for one month. Amount paid was M18000,00	exempt	n\a	n\a
Sales of M500,000 to Botswana Government			
Purchase of photocopier for M15,000			
Vacant land bought for M125, 000			
Rental income for M15,000 (tenant is a manufacturer)			
Sales of rain coats to Ministry of defence for M300,000			
Sales of blankets to individual customers for the month amounting to M22, 000.00			

Paid M2000.00 as financial charges to the bank.			
Purchased alcohol and tobacco worth M25, 000.00 for farewell party for one employee.			
Settled the water bill from water authority amounting to M500.00			
The amount paid for telephone bill was M18000.00			

Solution

Transaction	VAT Rate/ Exempt	VAT Calculations	VAT (paid)\ Collected
Stock bought (Raw materials for M120,000.00)	14 %	M120,000*14/114	(M14,737.00)
Public transport cost for delivering staff to rural areas for one month. Amount paid was M18,000.00	Exempt	N\a	N\a
Sales of M500, 000.00 to Botswana Government.	0%	M500,000* 0/100	0
Purchase of photocopier for M15,000.00	14%	M15,000* 14/114	(M1,842.00)
Vacant land bought for M125,000.00	Exempt	N\a	N\a
Rental income for M15,000.00 (tenant is a manufacturer)	Exempt	N\a	N\a
Sales of rain coats to ministry of defence for M300,000.00	14%	M300,000.00*14/114	M36, 842.00
Sales of blankets to individual customers for the month amounting to M22,000.00	14%	M22,000.00*14/114	M2, 702.00

Paid M2, 000.00 as financial charges to the bank	Exempt	N\a	N\ a
Purchased alcohol and tobacco worth M25, 000.00 for farewell party of one employee.	15%	M25,000.00*15/115	M 3, 261.00
Settled the water bill from water authority amounting to M500.00	Exempt	N\a	N\ a
The amount paid for telephone bill was M18, 000.00	5%	M18, 000.00*5/105	M 857.00

Vat invoices, credit and debit notes

This section will look at VAT invoices, credit and debit notes.

VAT invoices

An invoice is a document used to notify the customer about his obligation to pay. The vat invoice is also used for the same purpose but then it is rather more important to the registered vendor (customer) because it is an appropriate document when claiming the input tax (tax on purchases for business). In addition to that the registered vendor is supposed to issue Vat invoices as per the Vat Act requirement and the customer who is registered for vat must also demand a vat invoice when buying the inputs.

The requirements for vat invoice are shown in schedule iii section 24 of Vat Act and they are as follows:

- The words 'VAT invoice" in a prominent place.
- Name, address and Vat registration number of the supplier
- Name or business name and address of the recipient (customer)
- Serial number of invoice and date of issue
- The quantity or volume of the goods or services supplied

- A description of the goods or services supplied
- The selling price, excluding vat and any discount
- The total amount of the vat charged
- The selling price including vat or
- The total charge on the invoice inclusive of vat, any discount and the rate of tax

Credit and debit notes

Having issued the tax invoice and paying vat to LRA errors may have occurred which affect the calculated vat. Thus, for example the customer may return the goods or an inappropriate price may have been charged. As a result a credit note or a debit must be issued to correct the amounts reflected on the invoice which was issued earlier.

Credit notes or debit notes must be issued in the following situations:

- When the supply of goods or services is cancelled
- When the nature of the supply of goods or services has been significantly altered
- Where part or all the goods or services have been returned to the supplier
- Vat invoice issued shows the incorrect vat charge
- The previously agreed selling price has been altered

Accounting basis

There are two methods of accounting for Vat in Lesotho which are *accrual* (or invoice method) and *cash* (or payment) method. The method used reflects the vat payable or claimable for a particular period.

Accrual method

This is the method whereby the vendor has to account for vat under the relevant time of supply. That is; the vendor must account for both credit and cash sales transactions which occurred under the tax period so that he pays vat collected and the one not yet received. In the same token, he must claim the vat paid and the one he is yet to pay so long as transactions are relevant to a related tax period. The vat taxpayers are registered under this method by default. Since the vendor pays LRA irrespective of whether he has received cash or not, *there is a possibility that some customers may be insolvent (bad debts), the amount paid can be claimed back subject to certain rules.*

Cash method

This method permits the vendor to account for both vats payable and claimable only when payments are received from customers or made to suppliers. There are conditions that must be satisfied by vendors before they can use this method and they are as follows:

- The vendor must apply in writing to the Commissioner of VAT
- The vendor can be also be granted to use this method where his 90% or more of total taxable supplies consists of supply of services
- All his vat returns must be up to date
- No vat owing (If not there is arrangement made to settle the arrears
- Not been involved in vat evasion

Practice Question

Thabo has a business printing and selling T-shirts. In May 2017 he makes the following purchases and sales.

Invoice date	Numbers bought/sold	Amount	Date paid

Purchases		M	
07.05. 17	20	100	01.06.17
Sales			
08.05. 17	4	40	01.06.17
12.05. 17	6	60	01.06.17
23.05. 17	10	100	01.07.17

For both cash and accrual methods

Calculate the vat that Thabo must collect on his sales

Calculate the vat that Thabo must pay on his purchases

SOLUTION

Cash method

1. Sales: 0
2. Purchases: 0

In this situation Thabo will only collect vat in June and May and therefore, he is not supposed to account for vat in May as he is neither receiving nor paying cash.

Accrual method

Vat on purchases: M100 x 14/114 = M12.28

M40 + M60 +M100 = M200

Vat on sales: M200 x 14/114 = M24.56

Under accrual method Thabo has to account for vat on sales and vat on purchases in the month of May 2017.

Returns and payment of Vat

Having done basic concepts of vat and understanding different rates of tax as well as appreciating the exceptions to taxable supply by means of exempt supplies, time is ripe to learn the output and input taxes. Output vat is a tax that a vendor charges on his sales while the input tax is charged on raw material or purchases of the vendor. Then when filling a vat return, one must deduct the input vat from output vat. The difference between output vat an input vat is vat payable or claimable from LRA. If input vat is higher than output tax in a particular period, then LRA is supposed to pay a refund to a vendor. However, there are restrictions on the input vat that can be claimed in order to protect revenue from inappropriate claims.

Most entities in Lesotho source their inputs from South Africa; therefore they normally pay input taxes to South African companies. Then, if they buy from a VAT registered companies, they are free to claim that input so long as proof of original tax invoice is submitted at the boarder post while the vendor keeps the LRA stamped copy of such an invoice. This process is facilitated by the double taxation agreement between the governments of Lesotho and South Africa. This agreement is vital for businesses and individuals because they do not pay vat on imports twice. LRA use the original invoices to claim VAT paid in South Africa.

Then when considering the example on accrual method above , the vat payable per return is calculated as follows:

Vat return for the tax period of May 2017

	Amount	**Vat rate**	**VAT**
	M	**%**	**M**
Taxable outputs (sales)	**200**	**14**	**24.56**

Taxable inputs (Purchases)	**100**	**14**	**<u>12.28</u>**
Vat payable/ (refundable)			**<u>12.28</u>**

(This is not a complete VAT return but an extract)

Payments: A vat return and payment for each period must be submitted to LRA *not later than 20 days after the end of a vat period.* For instance, a vat period starts on the 1st of December 2006 and end on the 31st of December 2006, the vat return must be filed on or before the 20th of January 2007. That means, a vat tax period is a month and the return must be rendered to LRA on or before the 20th of the month following the tax period. Vat payment must accompany the return and if its vat refundable then the return is still supposed to be filed on due date.

Denial of input tax

Input tax may be claimed in most circumstances where vat is incurred for purpose of making taxable supplies. However, there are instances where vat incurred will either be denied or there may be conditions relating to the extent of the claims. Restrictions to claim vat are on expenses such as:

- Expenses for private use
- Expenses incurred prior to two months before registering for vat
- Vendor on cash basis but who has not paid the expense
- Entertainment of customers and clients in restaurants, theatres and night clubs
- Staff refreshments such as coffee, tea and other snacks
- Catering services acquired for staff canteens and dining room
- Subscription fees for sporting or recreational clubs
- Christmas lunches and parties, including hire of venues
- On the first M5,000.00 of electricity and telephone consumptions

- for expenses relating to a non-commercial or passenger vehicle by a vendor, unless such person is in the business of dealing in, or hiring of, passenger vehicles and that vehicle was acquired for the purposes of that business;
- for input tax paid for a commercial vehicle with unladed mass of less than 3 500kg (3.5 tonnes)
- For expense relating to a vehicle constructed for a special purpose other than the carriage of passengers and having no accommodation of carrying persons
- Expense for a vehicle capable of accommodating only one person.
- Beverages, meals and other hospitality and entertainment supplied to customers and clients at product launches and other promotional events and etc

Exceptions: The input tax incurred in relation to the following entertainment expenses may be claimed:

- Vendors who are in the business of supplying entertainment
- Meals and refreshments for organizers of seminars and similar events

Penalties for non-compliance and fraud

There are two types of additional tax or fines for failing to make a return or to pay by due date as well as acts of fraud. There are fines which are imposed by Commissioner of Vat and those imposed by courts. Some penalties for non-compliance and fraud are shown below:

Infringement	Penalty / Additional tax
1.Late submission of a return	Additional tax of 22% per month or part thereof of the outstanding VAT amount
2. Late payment of VAT	Additional tax of 22% per month or part

	thereof of the outstanding VAT amount
3.Failure to file a return or pay	Additional tax of 22% per month or part thereof of the outstanding VAT amount
4.Incorrect or false return or other declaration	Criminal offence which is liable on conviction to a fine or up to 2 years in prison
5. Fraudulent evasion	Criminal offence which is liable on conviction to a heavy fine or up to six years in prison

PRACTICE QUESTION

1. What is VAT? Is it a direct or indirect form of taxation? Give reasons for your answer.

2. What are the four VAT rates in Lesotho and can you give examples of each one?

3. List 5 items that need to be shown on a VAT invoice?

4. In what circumstances can a vendor issue a credit note?

5. Mafafa Ltd is a Lesotho resident company and a local VAT registered vendor. The company is a general dealer. All figures are inclusive of VAT where appropriate. The Company's transactions pertaining to March 2007 are as follows:

6. Denvertech Limited of Ladybrand, Republic of South Africa (RSA), repaired company's computer. The repair cost amounted to M8, 000.00. The computer was taken to Ladybrand for repair. Denvertech is a registered vendor in RSA.

Purchases of merchandise for re-sale from Game wholesalers in Bloemfontein RSA. The goods cost M260, 000.00. The goods were delivered to the premises of Mafafa by Game wholesalers. A game wholesaler is RSA registered vendor.

Purchases of goods for re-sale from Glory wholesalers, in Ficksburg RSA. The goods which were collected by Mafafa from the warehouse of Glory wholesalers cost M320, 000.00. Glory wholesale is also a registered vendor in RSA.

Payment of a monthly rent amounting to M12, 000.00 for a factory building which is rented from Lesotho National Development Corporation (LNDC), a Lesotho registered vendor, Mafafa uses the building for manufacturing leather products for the Lesotho market.

Liquor sales amounting to M500, 000.00 made by Mafafa from its liquor off-sale department at Motimposo.

Notes: RSA exports are zero rated in Republic of South Africa and VAT rate in RSA is 14%

Required:
Explain the VAT effects of each of the above transactions numbered from a to e. Compute the VAT input or output if any.

CHAPTER 15

FINANCE LEASE

<u>The following learning objectives are covered in this chapter</u>

	Syllabus reference
a) Define the implications of acquiring assets under a finance lease or a hire purchase contract.	B3e
b) Define a finance lease for tax purposes	B3e
c) compute the allowable interest and depreciation allowances for assets acquired under both finance leases and hire purchase contracts.	B3e

Finance Lease

Section 68 of the of the income tax Act 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. This section applies to the leases of tangible property, whether movable or immovable.

A lease of property is said to be a "finance lease "if:

a) The lease term exceed 75% of the effective life of the asset
b) The lessee has the option to purchase the asset at the end of the lease term
c) The estimated residual value of the asset at the end of the term is less than 20% of its market value at the start of the lease term

For the purposes of subsection 2, the effective life of property, where the property is included in group of assets in the Six Schedule, is determined as follows:

Group 1	5 years
Group 2	7 years
Group 3	15 years
Group 4	30 years

Where the lease is a finance lease, the lessee is treated as the owner of the leased property for income tax purposes. As a result of this the following must be noted:

i. The lessee is entitled to deductions such as depreciations for the cost of the leased asset
ii. The principal amount at the beginning of the "loan" will be the present value of the payments to be made under the lease.
iii. The lease payments will be dissected into two components, one being the repayment of the principal amount and the other being interest
iv. The interest element of each lease payment will be calculated, according to actuarial methods and the remaining balance treated as the repayment of the principal
v. The so calculated interest element will be included in the gross income of the lessor and allowable deduction to the lessee.

Example

Calculations of Loan Amortisation Schedule using annuity table for the purposes of establishment of the interest element of the repayment.

Manufacture A leases a finance lease of an item of equipment for a period of five years. The annual lease payments are M75, 000 per annum and the effective rate of interest is 20% per annum.

Reguired:

a) Calculate the interest element of the payment for each year if payments are made in arrears

Solution

Firstly, it is necessary to calculate the capital value of the lease. This is arrived at by multiplying the annual instalments of M75, 000 by the annuity factor for the fifth year which is 2.991 by 20%. The resultant figure is M 244, 325. This is the amount on which the capital allowance will be based on.

Secondly, one can then calculate an amortization of that loan with annual payments of M75, 000 dividing the payment between capital and interest.

Year	opening Balance +	interest -	Repayment	=	Closing Balance
	M	M	M		M
1	224,325 +	44,865 -	75,000	=	194,190
2	194,190 +	38,838 -	75,000	=	158,028
3	158,028 +	31,606 -	75,000	=	114,634
4	114,634 +	22,927 -	75,000	=	62,561
5	62,561 +	12,439 -	75,000	=	NIL

b) Calculate the interest element of the payment for each year if payments are made in advance

Annuity factor = (2.589 + 1) 3.589

Capital value = (3.589 x 75,000) M269, 175

Year	opening Balance -	Repayment +	Interest	=	Closing Balance
	M	M	M		M
1	269,175 -	75,000 +	38,835	=	233,010
2	233,010 -	75,000 +	31,602	=	189,612
3	189,612 -	75,000 +	22,982	=	137,534
4	137,534 -	75,000 +	12,466	=	75,000
5	75,000 -	75,000 +	–	=	–

SOLUTIONS TO PRACTICE QUESTIONS

CHAPTER 5 – CAPITAL ALLOWANCE

POOLING METHOD

Make a summary of Yearly Acquisition and Disposals based on groups of fixed assets for depreciation allowance purpose.

	25%	**20%**	**5%**
YEAR ENDED 31 MARCH 2002	**GROU-P1**	**GROUP 2**	**GROUP 4**
Bought Industrial Building			200,000
Bought Motor Vehicle	75,000		
Bought Motor vehicle	60,000		
Bought Computer		40,000	
Bought Office Equipment		20.000	
	-----------	---------	---------

Acquisitions	135,000	60,000	200,000
	======	======	=========
YEAR ENDING 31 MARCH 2003			
Acquisitions	NIL	20,000	
	===	=====	
Sold Motor Vehicle	30,000		
Sold Computer		35,000	
	---------	--------	
Disposals	30,000	35,000	
	=====	=====	

	Group 1(25%)	**Group2(20%)**
Year ended 31 March 2015		

½ Acquisition in the current period	67,500	30,000
+ ½ acquisitions in the previous period	-	-
Less: Disposals	-	-
Capital Allowance - 2015	(16,875)	(6,000)
	50,625	24,000
Year ended 31 March 2016		
½ Acquisition in the current period	-	10,000
+ ½ acquisitions in the previous period	67,500	30,000
Less: Disposals	(30,000)	(35,000)
	88,125	29,000
Capital Allowance - 2016	(22,031)	(5,800)
	66,094	23,200
Year ended 31 March 2017		
½ Acquisition in the current period	-	-
+ ½ acquisitions in the previous period	-	10,000
Less: Disposals	-	-
Capital Allowance - 2017	(16,523)	(6,640)
	49,571	26,560

Group 4 Assets listed in the 6th schedule are not eligible for the pooling method (S.41.5). It is therefore necessary to calculate the depreciation allowance under the Pooling Method for Group 1 and Group 2 Assets and the single asset method for the Industrial Building.

Calculation of Depreciation Allowance – SINGLE ASSET METHOD

Industrial Building

1 April 2001 Bought	200,000
Allowance- 2015	(10,000)
	190,000
Allowance – 2016	(9,500)
	180,500
Allowance -2017	(9,025)
	171,475

Motor Vehicle A

1 June 2014 Bought	75,000
2015 -Allowance 10/12 x 25%	(15,625)
	59,375
2016-Allowance 2/12 x 25%	(2,474)
	56,901
Disposal proceeds	30,000
Loss on Disposal	26,901

Motor Vehicle B

1 June 2014 Bought	60,000
2015 Allowance 10/12 x 25%	(12,500)
	47,500
Allowance- 2016	(11,875)
	35,625
Allowance- 2017	(8,906)
	26,719

Computer

1 September 2014 Bought	40,000
2015-Allowance 7/12 x 20%	(4,667)
	35,333
2016-Allowance 5/12 x 20%	(2,944)
	32,389
Proceeds	35,000
Gain	2,611

Office Equipment

1 Dec 2014 Bought	20,000
2015 Allowance 4/12x20%	(1,333)
	18,667
Allowance- 2016	(3,733)
	14,934
Allowance- 2017	(2,987)
	11,947
	=====

Furniture

1 Dec 2015 Bought	20,000
2016 Allowance 4/12x20%	(1,333)
	18,667
Allowance - 2017	(3,733)
	14,934

Total Capital Allowances for each year.

	Pooling Method	**Single Asset**

2015	32,875	44,125
2016	37,331	53,205
2017	32,189	24,651
	102,395	121,981

CHAPTER 6 INDIVIDUALS

(i) Interest income is subject to withholding tax of 10%, however, the amount withheld will take into account the exemption of the first M500 of interest income under s.27. Since Mr Majara is a resident, the 10% withheld is a final tax.

(ii) Computation of tax payable by Mr. Molapo Majara for the year ended 31 March 2016

	M
Income:	
Net rental profit:	
Republic of South Africa property	18,550
Lesotho property	48,950
Net transport income (net)	12,500
Dividends received	35,000
Salary	42,000
Cash allowance	4,200
Car benefit (FBT only)	0
Total income	161,200

Tax payable: M54, 770 at 20% 10, 954

M106, 430 at 30%	31, 929
	42,883
Less personal tax credit	(6, 466)
Tax payable	36, 417

CHAPTER 7 FRINGE BENEFITS

Mr. Moloi and Maputsoe Motors

(a) 1. Car fringe benefit

Taxable value (142,000/0·75) 189,333

Taxable amount (189,333 x 15% x (365–104)/365) – (500 x 12) 14,308

Taxable amount (14,308/0·7) 20, 440

Fringe benefit tax at 30% =6,132

2. Housing fringe benefit

The maximum house benefit is the lower of the costs to the employer and 20% of remuneration

House benefit (8,200*12)	98,400
Employee contribution (98,400*20%)	(19,680)
House benefit based on rental costs	78,720

Salary	120,000
Car (as above)	14,308
Utilities ((400 + 700 + 1,200)*12)	27,600
Debt waiver 8,500	
Medical aid (1,595*12)	19,140

Security guard and domestic assistant (1,748 + 600)*12)	28,176
House (as above)	78,720
Total remuneration	296,444
20% maximum restriction	59,289

Taxable amount (59,289/0·7) 84,699

Fringe benefit tax at 30% = 25, 410

3. Utilities

Taxable amount (27,600/0·7) 39, 429

Fringe benefit tax at 30% =11, 829

Domestic assistance

Taxable amount ((600*12)/0·7) 10, 286

Fringe benefit tax at 30% =3,086

The provision of a security guard is an exempt fringe benefit

4. Medical aid

This is an exempt fringe benefit

5. Debt waiver fringe benefit

Taxable amount (8500/0·7) 12,143

Fringe benefit tax at 30% =3, 643

Total fringe benefit tax (6, 132 + 25, 410 + 11, 829 + 3, 086 + 3,643) = 50,103

(b) The fringe benefit tax due on 31 March 2017 is payable within 14 days after 31 March 2017 i.e. by 14 April 2008.

CHAPTER 8 PARTNERSHIP

<u>KCM Partnership</u>

<u>Taxable profit calculation for the year ended 31 March 2017</u>

	Lesotho	Foreign
	M	M
Income:		
Gross profit	400,000	250,000
Less: Depreciation:		
Delivery van	(27,422)	
Computer	(4,167)	
Office equipment	(8,400)	(8,400)
Repairs	(6,000)	
Salaries	<u>(54,000)</u>	<u>(30,000)</u>
Taxable profit	300,011	211,600

TAX PAYABLE:

1. Mr. Khothatso: Lesotho resident taxable at marginal rates on worldwide income

1/3 of 300,011 =	M100,004
1/3 of 211,600 =	<u>M 70,533</u>
	<u>170,537</u>
M54, 770 at 20%	10, 954
M115, 767 at 30%	34,730
Personal credit	<u>(6,466)</u>
	<u>**39,218**</u>

2. Miss Mohlomi: Resident non-resident taxable at marginal rates Lesotho source income only.

1/3 of 300,011 = M100,004

M54, 770 at 20% 10,954

M45, 234 at 30%	13, 570
Personal credit	(6, 466)
	18, 058

3. Mrs. Christopher: Non-resident: Only Lesotho source income at 25%

Thus M100,004 at 25% = 25,001

Workings:

Capital allowances:

1. Light delivery vehicle: 2006/2007 cost M135,000

Depreciation 9/12 * 25%	(25,312)
Tax written down value 1/4/2007	109,688
Depreciation for the year	**(27,422)**
	82,265

2. Office equipment: 2006/2007 cost M90,000

Depreciation allowance 4/12 * 20%	(6,000)
Tax written down value 1/4/2007	84,000
Depreciation for the year	**(16,800)**
	67,200

3. Computer: 2007/2008 Cost	M25,000
Depreciation allowance 10/12 * 20%	**(4,167)**
	20,833

CHAPTER 9 COMPANIES

Toy (Pty) Limited

Corporation income tax payable – year ended 31 March 2013

Manufacturing income at 10%		50,000
Non-manufacturing income at 25%		237,500
		287,500
Less: ACT paid		
Manufacturing income net of tax payable	450,000	
Dividends received	50,000	
	500,000	
Dividends paid	600,000	
Excess	100,000	
ACT at 25/75		33,334
Final liability due on 30 June 2013		**254,166**

(ii) Instalments due for 2014:

Three instalments of M86,250 (M287,500 at 30%) due on 30 September 2013, 31 December 2013 and 31 March 2014 respectively.

CHAPTER 10 WITHHOLDING TAX

Withholding taxes payable by Basotho (Pty) Ltd

Interest: paid out of non-manufacturing income, withholding tax rate of 25%

Withholding tax payable: 360,000 x 25/75 = M120, 000

Contractors' fees paid to **residents**: withholding tax rate of 5%

Withholding tax payable; 200,000 x 5/95 = M10, 526

Contractors' fees paid to **non-residents**: withholding tax rate of 10%

Withholding tax payable: 400,000 x 10/90 = M44,444

Dividends paid to **non-residents**; withholding tax rate of 25%

Withholding tax payable

Final dividend 2002: 300,000 x 20% x 25/75 = M20,000

Interim dividend 2003: 700,000 x 20% x 25/75 = M46,667

Total withholding tax payable: **M241,637**

CHAPTER 11 ASSET DISPOSAL

(a)

1. Proceeds 26,000

Less: ACB	(27,000)	
Notional Loss	1,000	(not allowable)

Actual Loss allowable is 200 (26,000 – 26,200)

2. Proceeds	12,000
Less: ACB	(11,000)
Taxable gain	1,000

3. Proceeds	114,000
Less: ACB (105,000x115/107)	(112,850)
Taxable gain	1,150

(b)	Gain/ (Loss)	Cost of new asset
(i)	allowable loss of 2,000	13,000
(ii)	no gain no loss	12,000
(iii)	taxable gain of 2,000	12,000
(iv)	no gain no loss	14,000 (12,000 + 2,000)

CHAPTER 12 ANTI AVOIDANCE RULES

Air travel (full cost)	10,000

Electricity (less than M3,000)	-
Principal residence (5%)	10,000
Secondary Residence (650x12)40%	3,120
School fees	15,000
Motor Vehicle (25%)	6,250
	44,370

Because his chargeable income of M95,000 (90,000 + 15,000 – 10,000) is higher than the minimum chargeable income, Mololi pays tax on the reported chargeable income of M95,000 as follows:

First 54,770 at 20%	=	10,954
40,230 at 30%	=	12,069
Personal credit		(6,466)
Tax Liability		16,557

CHAPTER 13

Feedback on Practice question

1. VAT is an abbreviation for Value Added Tax. It is a tax levied on the supply or consumption of goods or services including supplies to Lesotho Government and is also levied on imported goods or services. The supply is subjected to tax if it is not exempt and it is supplied by a VAT registered vendor. It is an indirect form of a tax because the burden of paying is shifted to the final customer.

2. Four VAT rates :

   0%: exports of goods and services and other basic food commodities like eggs, paraffin, animal manure, bread and etc.

5%: Electricity and telephone bills

14%: clothes, sweets, and other groceries

15%: Alcohol and tobacco products

3. a) The words ‘VAT invoice’ in a prominent place

   b) Name, address and Vat registration number of the supplier

   c) Name or business name, address and Vat registration number of the recipient (customer)

   d) Serial number of invoice and date of issue.

   e) Description of the goods or service supplied

   f) The selling price excluding Vat and any discount

   g) The total amount of Vat charged or

   h) The total charge on the invoice inclusive of vat, any discount and the rate of tax.

4. i) when the supply of goods or services is cancelled

   ii) When the nature of the supply of goods or services has been significantly altered

   iii) Where part or all goods or services have been returned to the supplier.

   iv) Vat invoice issued shows the incorrect vat charge

   v) The previously agreed selling price has been altered

5. a) Since Vat is also referred to as a destination based tax, in terms of services then Mafafa will pay the input tax of M982.00. However this will not be a claimable input tax by Mafafa Limited because the vat was paid for service rendered in Republic of South Africa. Also as a concept of place of supply vat is paid where the service is consumed.

   Vat paid by Mafafa: M8, 000.00*14/114 = M982.00

b) Direct delivery of goods into Lesotho and to premises of Mafafa Limited by Game wholesalers must be treated as an export from South Africa and therefore vat is charged at zero rate. However, Mafafa have to pay vat on imports at Lesotho boarder to Lesotho Revenue Authority officials when goods entered into Lesotho. This input vat is claimable and therefore is supposed to be deducted from vat collected by Mafafa. Input vat paid: M260, 000.00* 14/100= M36, 400.00

c) Where Mafafa Limited transported the goods purchased from Glory Wholesalers into Lesotho itself, and then the Lesotho/South Africa Double Taxation Agreement applies. That is, because Mafafa paid vat to Glory wholesalers in RSA, we assume Mafafa submitted proof (original invoice) of payment of the input vat to LRA which LRA will use to claim vat paid in RSA from South African Revenue Service (SARS). The input vat paid can then be claimed as a deductible input tax by Mafafa. Input vat paid: M320, 000.00* 14/114= M39, 298.00.

d) A rental paid by a tenant who is involved in manufacturing products is an exempt supply and therefore Mafafa has not paid vat on rent.

e) Output vat collected by Mafafa is M500, 000.00 * 14/114 = M61, 403.51