

TRANSFER PRICING: LESOTHO HIGH COURT CONFIRMS LIMIT TO REVENUE SERVICES LESOTHO'S POWER TO IMPUTE INCOME UNDER SECTION 113

The High Court held that section 113 of the Income Tax Act does not authorise the Commissioner General to impute notional interest on an interest-free intercompany loan by applying an arm's-length standard that the provision does not contain.

On 6 August 2026, the Commercial Court Division of the High Court delivered judgment in *AfriSam (Lesotho) Pty Ltd v Lesotho Revenue Authority* and another.

Mathaba J accepted that the balances in issue were loans between associated companies. The Court nevertheless held that section 113 of the Income Tax Act 1993 did not empower the Commissioner General to impute market-related interest on those interest-free loans. It set aside the order of the Revenue Appeals Tribunal, expunged the imputed interest income and reduced the resulting tax liability to zero.

The judgment provides important guidance on the scope of Lesotho's transfer-pricing legislation. It also identifies a statutory gap that Parliament may wish to address.

Background

AfriSam Lesotho supplied cement in the local market, purchasing it from its South African affiliate. For administrative convenience, some of AfriSam Lesotho's customers paid amounts into AfriSam South Africa's bank account.

After amounts owing between the companies were set off, balances remained due to AfriSam Lesotho. Those balances fluctuated as the companies continued trading. It was common cause that they did not bear interest.

Following an audit, the then Lesotho Revenue Authority, now Revenue Services Lesotho ("**RSL**"), treated the balances as intercompany loans. It then applied a deemed interest rate of 10%, resulting in additional taxable income for AfriSam Lesotho.

The Revenue Appeals Tribunal held that the Commissioner General was entitled to treat the balances as loans and to impute interest under section 113. It nevertheless found that the 10% rate had not been adequately substantiated and remitted the matter to the Commissioner General to determine an appropriate rate.

AfriSam Lesotho appealed to the High Court, challenging the Commissioner General's statutory power to impute the interest income at all.

What does section 113 say?

Section 113(1) permits the Commissioner General, in a transaction between associated taxpayers, to distribute, apportion or allocate gross income, deductions or credits between them where necessary to prevent tax evasion or clearly reflect their income.

The section also contains more specific powers concerning intangible property, the recharacterisation of the source of income and the nature of a payment or loss, and certain instalment sales.

It does not, however, state generally that transactions between associated taxpayers must be adjusted to an arm's-length price. Nor does it expressly authorise the Commissioner General to create income that was neither paid nor accrued.

The High Court's decision

The Court agreed with the Tribunal that the residual balances were loans and that the underlying arrangement was a transaction between associated companies. The characterisation of the balances as loans did not, however, determine whether the Commissioner General could impute interest on them.

The central statutory question was whether the power to distribute, apportion or allocate gross income implicitly included a power to create market-related interest income by applying the arm's-length principle. The Court held that it did not.

Although section 113 has an anti-avoidance purpose, the Court found that a purposive interpretation could not be used to insert a conventional transfer-pricing mechanism that was absent from the statutory text. Doing so would cross the boundary between interpreting legislation and making legislation.

The Court distinguished the South African and Mauritian authorities considered in support of the assessment. The legislation applied in those jurisdictions expressly incorporated an arm's-length standard. Their courts were therefore applying a principle already enacted in domestic law. Section 113 contains no equivalent general language.

The Court also considered the development of comparable United States legislation. Earlier legislation containing language similar to section 113 had been interpreted as permitting the allocation of existing income, but not the creation of notional interest income. The position changed after regulations expressly incorporating an arm's-length standard were introduced.

The Court concluded that section 113 did not authorise the Commissioner General to create or impute gross income where none had been realised. The Commissioner General had therefore acted outside the powers conferred by the section.

Once the Court reached that conclusion, the question whether the 10% rate was appropriate became moot.

The importance of actual income

A significant aspect of the judgment is the distinction between allocating existing income and creating notional income.

The Court noted that the LRA's case did not involve tracing how AfriSam South Africa had used the funds or reallocating income actually generated from them. The assessment was confined to interest deemed to have arisen through the application of the arm's-length principle. The Court expressly left other potential reallocation issues outside the scope of its judgment.

The decision should therefore not be read as invalidating every transfer-pricing adjustment under section 113. The section may still permit RSL to distribute, apportion or allocate existing gross income, deductions or credits between associates where its requirements are met. The case also did not concern interest that was actually paid or accrued.

Its clearest effect is that section 113 cannot be used to create an arm's-length return where no such income arose.

The Court's reasoning may also be relevant where an assessment rests solely on RSL substituting a preferred arm's-length price, fee, mark-up or result by reference to international transfer-pricing principles. Whether the judgment applies will depend on the precise nature of the adjustment and the statutory basis stated in the assessment and objection decision.

A legislative gap

The Court expressly identified the absence of a codified arm's-length standard as a gap in Lesotho's tax legislation. It observed that Parliament may wish to modernise the Income Tax Act by formally incorporating contemporary transfer-pricing principles.

Any amendment would require careful attention to its commencement and transitional effect. Unless and until the legislation changes, section 113 must be applied according to its text and the interpretation given to it by the High Court.

Conclusion

The judgment confirms an important principle of tax law: an anti-avoidance purpose does not, by itself, create a taxing power that Parliament did not confer.

RSL retains the powers expressly granted by section 113, including the allocation of existing gross income, deductions and credits between associates. It may not, however, use the section to import a general arm's-length standard and create income that was not realised.

Taxpayers affected by section 113 assessments should review the precise statutory basis and calculation of those assessments in light of the judgment.

This article is intended for general information only and does not constitute legal or tax advice. It reflects the judgment as at the date it was issued. If your business is subject to an RSL audit or assessment involving section 113, our tax and dispute resolution team can assist with reviewing the statutory and factual basis of the adjustment, advising on objections and appeals, and assessing related-party arrangements and supporting documentation.

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