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Postal: P O Box 504899, Gaborone
Physical: Office 15, 2nd floor. Plot 50667, Left Block at Medical Mews, Fairgrounds, opp BancABC
Telephone: +267 393 9435 /+267 71 81 58 36
Website: www.aupracontax.co.bw

CORONA, DEBTOR DEFAULTS & TAX: CRUNCH TIME: By Jonathan Hore

Some of you may know that the taxman is owed over P3bn by taxpayers. The coronavirus is likely to worsen the situation due to strained cashflows. A lot of tourists have cancelled bookings, events have been postponed and a number of projects have been rescheduled. All this has been done to try and contain the most menacing virus most of us have ever witnessed in our lives. So, the biggest question is whether the virus will lead to more tax defaulters and the answer to that is almost certain. I will analyse the impact of the virus on business as well as the related tax implications. In this article, words importing the masculine shall be deemed to include the feminine.

BURS OWED P3BN ALREADY

It has been reported that the 2018 BURS financial report indicated tax debts of about P3bn, some of which have been owing for years. I must remind you that this debt arose before the coronavirus and it is about 7.5% of BURS annual tax collection of roughly P40bn. The Minister of Finance & Economic Development categorically emphasized the need to achieve tax collection efficiencies. The biggest challenge with tax debts is that interest continues to accumulate until the debt is cleared, which tends to make them spike in a short time.

The common law principle referred to as the *in duplum rule* which prescribes that interest cannot exceed the principal debt does not apply to taxes, since tax is statutory. The said rule applies to contractual agreements. No-one signs a contract with BURS that they will pay tax; tax is imposed by the tax laws and its payment is non-negotiable. However, as the figures already tell us, some taxpayers are not meeting their obligations for various reasons. This debt is likely to increase due to the virus especially that South Africa is already under lockdown. I now turn to the tax treatment of tax debts, i.e. the VAT and corporate tax effects.

TAX, DEBTS AND CORONA

The tax treatment of debts is already catered for in the tax laws. If a taxpayer defaults in paying tax, BURS will charge monthly compound interest of 1.5%, which comes to a good 18.96% per annum. To put things into perspective, if one owes P1m in January 2020, the debt grows to P1.19m by December 2020 and that's a massive rise, considering that tax interest is non-productive. Let me now expand on the VAT and income tax treatment of debts:

- **VAT & bad debts written off:** If your debtor defaults, which is most likely to happen this year due to the virus, you can claim back the VAT that you would have paid to BURS, if any. The VAT Act requires that you raise a credit note, which technically reverses the VAT due to BURS in the respective tax period. So, the virus will not really prejudice you from a VAT angle although you may suffer from a cashflow perspective.
- **VAT & bad debts you owe:** If your business fails to honor a debt whether due to the virus or for any other reason, you are expected to pay tax to BURS if your creditor writes off the debt. In reality, you may never pay this tax as creditors usually write off the debts, claim their VAT from BURS but never send you the credit note as they want to continue chasing you for their money.
- **Income tax and bad debts:** A taxpayer who is not a bank can make provisions for bad debts and claim a tax deduction provided the debt was initially recognized as income and that it is not general such as 5% of debtors. When the debt actually becomes bad, no additional deduction can be claimed as that will be a double

deduction. However, taxpayers who write-off a debt without making a provision can also claim the bad debts written off as a tax deduction.

- **Banks and provision for bad debts:** Banks are allowed to claim a provision for bad debts provided that the provision does not exceed 1.5% of the total loan book before impairments. So, whilst every other taxpayer can only claim provisions which are specific and not general, banks do not have to worry about whether their provisions are specific or general. They are allowed to claim on both as long as the income statement provision does not exceed the stated 1.5% limit.

Well folks, I hope that was insightful. As Yours Truly says goodbye, remember to pay to Caesar what belongs to him. If you want to join our Tax Whatsapp group, send me a text on the cell number below.