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Why prepaid expenses are tax-deductible in Botswana

If you're running a business, you're probably well aware of the importance of keeping your finances in order. One way to optimise your tax efficiency is by deducting prepayments from your taxable income. But what exactly are prepayments, and why are they tax deductible for income tax purposes? In essence, prepayments refer to any payments made for goods or services in advance or in respect of future periods. This could include rent, insurance premiums, or even prepaid utility bills. So why are prepayments tax deductible? Keep reading and we will answer you. In this article, words importing the masculine shall be deemed to include the feminine.

Enter prepayments

Basically, from an accounting perspective, a prepaid expense refers to a cost that is incurred in one financial year in respect of a service/goods that will only be consumed during one or more subsequent financial years. It is disclosed as an asset on the balance sheet during the financial year in which it is incurred and it is only expensed to the income statement in subsequent financial years to the extent that it is consumed in or applies to such years.

Enter tax

Per the Income Tax Act, allowable or deductible expenditures are expenses permitted to be deducted from gross income before the net amount is subjected to tax. Therefore, the said Act prescribes that 'in ascertaining the chargeable income of any person for any tax year there shall, upon due claim and subject to such evidence as the Commissioner General may require, be deducted from the assessable income of such person all expenditure wholly, exclusively and necessarily incurred by that person during the tax year in the production of his or her assessable income.' The quoted extract is what is referred to as the general deduction formula which lays the foundation upon which expenditures are deducted for tax purposes.

The answer

The reason for allowing prepaid expenses to be deducted for income tax purposes when they would have been posted to the Balance Sheet is that the person would have obtained an unconditional liability to pay the expense at year-end. For example, if a company in its December 2023 year prepays insurance up to 31 July 2024, the accountants will only expense say P2m of it in the income statement whilst say P2.8m is posted as an asset in the Balance Sheet. However, the reality of the matter is that the impacted company would have had a legal liability to pay for the full insurance bill as at 31 December 2023. The amount in the Balance Sheet (P2.8m) must then be deducted for tax purposes in the 2023 financial year's tax computation. Since the prepaid expense is picked from the Balance Sheet, it must then be added back in the subsequent year on the face of the tax computation and the succeeding year's Balance Sheet figure gets deducted for tax purposes. This allows the taxpayer maximum tax deductions for expenses incurred in each year.

Conclusion

In conclusion, prepayments can be a useful tool for managing your tax obligations. By deducting prepayments from your taxable income, you can reduce your overall tax liability and potentially save money on your taxes. However, it's important to be aware of the rules and regulations surrounding prepayments and to consult with a tax professional if you have any questions or concerns.

Well folks, we hope that was insightful. As us the two Yours Truly say goodbye, remember to pay to Caesar what belongs to him. If you want to consult, join our free Tax WhatsApp group or to know about our 9 Tax e-books, send a text to +267 7181 5836 or email us at jhore@aupracontax.co.bw. You can read more tax articles on our website, www.aupracontax.co.bw under the 'Tax articles' tab.