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The tax treatment of IFRS 16 adjustments in Botswana

As the International Financial Reporting Standards (IFRS) are becoming increasingly adopted by countries around the world, understanding the tax treatment of IFRS 16 adjustments is crucial for companies. IFRS 16 was introduced to replace IAS 17 and requires companies to account for all leases in their Balance Sheets, rather than only finance leases as was previously required. Technically, IFRS 16 requires companies to recognise some assets acquired under leases as Right-of-Use (ROU) assets in their Balance Sheets, depreciate them and recognise a notional finance cost.

On the other hand, actual rental payments are no longer regarded as expenses, but they are used to reduce the Balance Sheet lease liability. These changes have a significant impact on the taxation of companies. In this article, words importing the masculine shall be deemed to include the feminine.

Tax principles

In general, tax expenses must be those which an entity can prove beyond doubt that it has a legal liability to pay for at year-end such as a rental amount already invoiced but not paid. Expenditure which would have already been paid for a year-end is obviously tax deductible if related to the running of the business. Revenue on the other hand is only taxed if it has unconditionally accrued to a business. With this in mind, we shall now proceed to analyse how IFRS 16 affects corporate tax computations

Interest expense

This refers to the interest expense on the lease liability recognized under IFRS 16 and is usually reported as lease finance costs in accounts. The finance cost is a notional or imputed finance cost which doesn't result in an actual cash outflow for a business and is added back when computing corporate tax. Only real interest expenses are allowed for tax purposes.

ROU depreciation

The above stands for IFRS 16 Right-of-use asset depreciation, which is basically the depreciation of the ROU asset recognised as part of the company's assets. Since companies are now required to recognise some assets which they lease such as commercial or residential buildings as part of their assets, these are separately classified as ROU assets in the books of accounts. From that angle, the assets are then depreciated and this increases the impacted entity's depreciation costs, reducing net profits. For corporate tax purposes, this is added back to net profits as it is a capital expense.

IFRS 16 rental payments

These are accounted for in the Balance Sheet because IFRS 16 introduced a new lease accounting model that recognizes lease assets and lease liabilities in the Balance Sheet. This model aims to provide a more transparent view of a company's leasing activities and their impact on the financial position of the impacted entity. Under the previous lease accounting standard, IAS 17, operating lease payments were generally recognized as an expense in the income statement and did not impact the Balance Sheet. The non-recognition of the lease payments actually incurred as an expense means that IFRS 16 results in understatement of lease expenses. The correct tax treatment of the payments is to deduct the said lease outgoings from net profits as the payments are a real expense deductible for tax purposes.

Well, folks, we hope that was insightful. As us the two Yours Truly say goodbye, remember to pay 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.