

ONLY REALISED FOREX LOSSES ARE TAX DEDUCTIBLE IN BOTSWANA

Most business operators who venture into cross-border trading or those who are involved with foreign currency dealings usually end up with an income statement reflecting either foreign exchange gains or losses. Today's article seeks to discuss the tax regulations and parameters around foreign exchange differences. As a tax firm, we intend to demystify the technical jargon applicable to the issue at hand and enhance your understanding of tax matters.

The concept

Well, in general a foreign exchange difference is simply a difference that results from translating one currency into another currency at different exchange rates. This usually occurs when a company buys or sells goods or services in foreign currency and that currency fluctuates relative to our Pula. The difference in the value of the foreign currency when converted to the Pula in the books of a local seller or buyer is recorded as "foreign exchange gain or loss". I am sure if we ask an accountant regarding this matter, we will be given much insight to the deeper accounting side of things.

Unrealised vs realised

The Income Tax Act provides specific provisions that must be adhered to in calculating tax. Firstly, the general deduction formular lays out the fundamentals upon which most of the expenditures incurred by a taxpayer are deducted. The key aspect provided by this formular to help us determine the tax treatment of losses arising from exchange differences is to test whether or not the loss have been 'incurred' and whether or not the loss is 'capital in nature'. In brief the word 'incurred' does not necessarily mean that the taxpayer should have paid for the expenditure, but the simple fact that a liability to pay arose is sufficient. Whereas the phrase 'capital in nature' technically means expenditure closely linked to the acquisition of assets or income earning machinery.

Enter tax

Let us now unfold the technicalities around unrealised and realised exchange differences. Unrealised gains or losses are a result of fluctuations in foreign currency exchange rates after a sales or purchase invoice has been issued or received. The subsequent actual receipt of the sales invoice or payment of the purchase invoice results in a realised gain or loss. Thus, unrealised gains or losses are mere currency valuations for reporting purposes. For example: XYZ (Pty) Ltd may record an exchange loss at the end of the year resulting from a credit purchase of consulting services from a South African supplier. Such an exchange loss is not deductible for tax purposes as it represents a valuation of liability in the books of XYZ.

One might argue that since the XYZ had 'incurred' the expense and does not necessarily need to have paid then he is entitled to deduct any exchange loss arising from the currency valuation. If this interpretation is adopted, it means XYZ would enjoy multiple deductions of the exchange loss if the liability remains unsettled for various years.

The correct interpretation would be to allow the deduction of the amount actually paid in BWP prior to the variation of the exchange rate. If the incurring of the liability and the payment occur in different years, then effect is given to the increase or decrease in the amount in the year it was paid. In essence an exchange loss is only deductible when the liability is actually paid or simply, when it is realised. Unrealised exchange losses are therefore added back in tax computations as they do not meet the 'incurred' test as stated above.

Tax hint & cheers!

If you have never had a tax audit conducted on your business by a tax firm, we highly recommend that you consider such so as to proactively reduce tax gaps. As we 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.