

Are grossed-up expenses tax deductible?

Grossed-up expenses are often used by employers or trading partners to cushion employees or suppliers from suffering taxes. For employers, grossing up is often implemented to offer employees additional benefits, such as bonuses, allowances, or company cars without passing the PAYE cost to the impacted employees. For withholding taxes, grossing-up is done when the supplier doesn't want to suffer Botswana withholding taxes, i.e., the payer pays them without deducting such taxes. This technically inflates the costs of the employer or payer, as applicable. But are these expenses tax deductible? The answer is not as simple as yes or no. Keep on reading and allow us to demystify this tax entanglement. In this article, words importing the masculine shall be deemed to include the feminine.

Enter grossing-up

Regarding employer-employee transactions, grossed-up expenses are additional costs that an employer pays on behalf of an employee, which are then added to the employee's taxable income. These expenses are 'grossed up' to cover the tax that the employee will have to pay on the benefits they receive. For example, if an employer provides a car for an employee's use, they may gross up the car benefit taxable value to cover the tax that the employee would have to pay. This is done to ensure that the employee receives the full value of the benefit without having to pay any additional tax. Grossed-up expenses can be a great way for employers to reward their employees, but they can also have tax implications.

On the other hand, the grossing-up concept is adopted when negotiating or concluding trading contracts. As an example, a South African service provider may dictate that they require a payment for say, consultancy services ordinarily chargeable to withholding tax at 10% to be paid without the tax. As an example, if a Botswana client has to pay the said South African trader P1m, they would ordinarily deduct 10% as withholding tax, paying the net of P900 000 to the payee. However, if the payee doesn't want to suffer Botswana taxes, the payer ends up paying the P1m without deducting taxes and he bears tax of P111 111 (being $10\% * P1m / 0.9$), which increases total expenses from P1 to P1.11m for the Botswana entity due to grossing-up.

The law

It is crucial to note that an expense can only be deductible for tax purposes if specified by the Income Tax Act or if it fits in the ambit of the prescribed general deduction formula. Accordingly, the said Act prescribes that expenses are tax deductible if they are, 'incurred by that person during the tax year in the production of his or her assessable income.'

In this regard, the key component to note when determining whether grossed-up expenses can be deducted for tax purposes is to ascertain whether such expenses have been 'incurred.' In general, this technically means that the taxpayers do not necessarily need to have paid for the expenditure, but the simple fact that a liability to pay arose is sufficient. Now, if we have

a second glance at the grossed-up expenses it suffices to state that the taxpayer would have a liability to pay such an expense due to the agreement (whether written or verbal) that the payee bears the taxes, thus fulfilling the incurred test. Simply put, such expenditures are tax deductible.

Tax hint: If you have never had a tax audit/review conducted by a tax consultancy firm to check whether you are tax compliant or should it be apparent that you are not certain that your tax affairs are in good order, then don't wait for the taxman to pounce on you as that can be very costly. Contact us today so we can help you fix your tax affairs whilst you still have time.

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