



Department of Taxes, Government of Botswana

**DEPARTMENTAL GUIDANCE NOTE ON TERMINAL EXPENSES
PAYABLE UNDER EMPLOYMENT CONTRACTS.**

Part VI (Ascertainment of Chargeable Income) of the Income Tax Act 1995*.

1. Introduction

The purpose of this Note is to advise practices which will be followed with regard to deductions which will be allowed in respect of various contractual terminal payments to employees in determining business chargeable income of the employer. To the extent that such payments are made to expatriate employees the guidelines which follow do no more than confirm what has been Departmental practice for very many years. Over recent years however regard has been had to similar payments made to citizen employees, in particular, Approved Service Gratuities (Section 32* of the Income Tax Act) and Severance Benefits (Section 28 of the Employment Act). The various amendments to the Income Tax Act have made provision for the income tax treatment of such payments in the hands of the employee but as far as employers are concerned the deductions allowable in respect of all terminal expenses, relating to employees, must be considered within Part VI (Ascertainment of Chargeable Income) of the Income Tax Act. This Note attempts to cover acceptable bases for deductions of all such payments whether made to citizen or expatriate employees.

The terms of the Note have no force in law and do not restrict any taxpayer's rights under the Income Tax Act, in particular, the rights of objection or appeal.

2. General

Payments covered under the terms of this Note are those which are to be met by an employer, out of his own funds, in terms of a contract or

* All references to the provisions of the Income Tax Act are based on the latest edition of Laws of Botswana published in 2002.

general conditions of service, when an employee's engagement terminates. In this regard termination of a fixed period contract is seen as termination of an agreement. The particular payments, which are covered here, are:

- (a) To expatriate employees – gratuities, leave pay, passages and related costs;
- (b) To citizen employees - service gratuities, whether or not approved Under section 32 (8) of the Act; and
- (c) Severance benefits payable in terms of the Employment Act.

Due to the differing methods of calculation of the various terminal payments, it is necessary to set out slightly varying guidelines for each of the above categories of payments. Also some qualifications will be needed in the case of employees who are participators in close companies (i.e. terminal payments which are treated as dividends under section 133).

3. Bases for deduction

Two alternative bases for deduction are provided either of which, if consistently used by an employer, will be accepted. But the same basis must be used for all employees who may receive terminal payments.

The two bases are:-

- (a) year of payment of the expense; and
- (b) annual provision during contract period, calculated by reference to the expenditure incurred in respect of each specific employee during the accounting period.

No other basis of deduction will be permitted for tax purposes.

No general or arbitrary provisions will be allowed.

A change from basis (a) to basis (b) or vice-versa will be permitted but one change only will be accepted. A subsequent reversion to the previous basis will not be accepted.

4. Year of Payment basis

Where an employer chooses to claim a deduction for the year in which the amounts become due and payable, the deduction, if related to specific

employees and otherwise in order, will be allowed. This will apply to all such payments mentioned in paragraph 2.

If an annual provision has been claimed and allowed for an earlier year it will be assumed that the employer has changed from basis (b) to basis (a) and the Commissioner will retain the right to either, as he sees fit :

- (i) re-open earlier years to disallow the provisions previously allowed or,
- (ii) restrict the deduction in the year of claim to the excess over the provisions previously allowed.

No further annual provisions will be allowed.

5. Annual provision basis

5.1. Expatriates employees

Where an employer chooses to claim a deduction annually, by provision in his accounts or otherwise, this will be allowed subject to the amounts claimed being related to specific employees and for each:

- (a) a gratuity deduction being the contractual percentage of salary on base remuneration for the year;
- (b) a leave pay deduction being the amount due for leave accrued to the accounting date at the latest known leave pay rate less any amount deducted in an earlier year; and
- (c) a deduction for passages and related costs

being the estimated future cost apportioned to the expired period of the employment less any amount deducted in earlier years.

5.2. Service Gratuities – Citizen employees

Where an employer has a scheme which provides for or the written conditions of employment provide for payments of gratuities to citizen employees either on termination of employment after a minimum period of employment or at periodic intervals during the course of employment the annual provision method of deduction will be permitted. It is not necessary that the gratuity be an "Approved Service Gratuity" within the provisions of section 32(8) of the Act – the subsection only sets out conditions that must be met if an employee is

to be exempted wholly or partially. It is expected that the calculation of the provision for the gratuity will be calculated by reference to the employee's basic rate of pay at the time he becomes entitled to payment of the gratuity.

The provision method is thus acceptable provided it is applied consistently and subject to the following:-

- (a) provision must be made for all relevant employees;
- (b) the provision must be specific to each of those employees;
- (c) the provision is no more than the gratuity accrued to each employee during the accounting period;
- (d) the provision is calculated by reference to each employee's basic pay at the end of the accounting period;
- (e) the provision made for any particular accounting period does not contain any under-provision for an earlier accounting period except where a recalculation of the provision becomes necessary by reason of an increase in the basic pay of any employee;
- (f) provisions made in earlier accounting periods in respect of employees who by reason of termination of their employment, or for any other reason, have lost their entitlement to any gratuity are brought back into credit against other provisions; and
- (g) no provision is made in respect of any other terminal benefit in respect of any particular employee.

5.3. Severance Benefits

A severance Benefit is a payment, which an employer may have a statutory obligation to make to an employee under section 28 of the Employment Act. By virtue of section 2(3) of that Act an employee for this purpose does not include "an employee who falls into a category of persons commonly known as managers, administrators or executives or as professional staff or into some other category of persons of the same or a similar status".

The provision basis of deduction will be permitted for eligible employees who may become entitled to such a benefit and the guidelines, as set out in the previous paragraph, in respect of Service Gratuities should be followed. In particular, attention is drawn to the following :-

- (a) an employee may cease to be entitled to a Severance Benefit because he moves into one of the non-eligible categories, and
- (b) no provisions in respect of any other terminal benefit will be permitted as section 28 of the Employment Act relieves the employer of the obligation to make any other terminal benefits if an employee requires payment of a Severance Benefit.

6. Participatory Payments

6.1. Year of payment basis

If this basis is adopted and a payment is made to an employee which falls to be treated as a dividend in the hands of a participator, deduction will not be allowed from assessable income but from chargeable income in ascertaining taxable income in terms of section 50.

6.2. Annual provision basis

If this basis is adopted and a payment is made to an employee which falls to be treated as a dividend in the hands of a participator, the related provisions for years prior to the year of payment will be allowed as a deduction from assessable income in ascertaining chargeable income. In the year of payment, the provisions for the prior years will be added back to chargeable income as "provisions no longer required". There will also be added back in the year of payment, any balances of the payments made which have been deducted in ascertaining chargeable income. The total payments will then be deducted from chargeable income, in terms of section 50, in ascertaining taxable income.

IF however a taxpayer requires adjustments made in the tax years in which the provisions were made this will be permitted. The Commissioner will also make similar adjustments, if he is required to do so to avoid loss of tax.

7. Conclusion

As indicated earlier the contents of this Note are without prejudice to the rights of objection and appeal of any aggrieved taxpayer.

