

<b>DOCUMENT CONTROL</b>		
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## **Guideline on Bad Debts that are Allowable Deductions for Tax Purposes.**

### **Citation and Commencement**

This Notice shall be cited as the Guideline on Bad Debts that are Allowable Deductions for Tax Purposes, in terms of Section 14 of the Income Tax Order of 1975, as Amended (*hereinafter referred to as the Order*) and Section 48 of the Value Added Tax Act, 2011 (*hereinafter referred to as the Act*).

### **Purpose**

The guideline is meant to give guidance on the qualifying requirements for bad debts that are allowable as deductions for tax purposes. For tax purposes, as opposed to accounting purposes, bad debts have to satisfy certain factors for them to be allowable as deductions from taxable income or qualify for bad debts relief.

## **The Law**

### **Income Tax**

In terms of section 14(1) (q) of the Order for purpose of ascertaining the taxable income of any person: *"there shall be deducted from the income of such person the amount of any debts due to the taxpayer to the extent to which they are proved to the satisfaction of the Commissioner, to be bad, provided such amount is included in the current year of assessment or was included in previous years of assessment in the taxpayer's income"*.

In addition, section 7 (p) (ii) of the Order states that *"any amount received by or accrued to any person by way of recovery or reimbursement of any bad or doubtful debt which has been allowed as a deduction under section 14 must be included in the gross income on the recovery year of assessment"*.

## VAT

In terms of Section 48 of the Act, *“where a taxable person has supplied goods or services for a consideration in money and has paid full tax on the supply to the Commissioner General but has not received payment, in whole or in part, from the person to whom the goods or services are supplied; and has taken reasonable steps to the satisfaction of the Commissioner General, to pursue payment and reasonably believes that the person will not be paid, the taxable person may reduce the output of that tax paid for which payment has not been received”*.

### Definitions

For purposes of this guideline, the following terms shall, unless the context otherwise indicates, be defined as follows;

**Bad debt** - means money owed to a taxpayer that the taxpayer cannot collect.

**Doubtful debt** – means an amount of money that a taxpayer does not expect to collect from his/her customers.

**Business bad debt** – means a bad debt created as part of the ordinary course of trade or business or as something that was closely related to the trade or business.

**Personal bad debt** – means a bad debt loss suffered by a taxpayer which was not incurred in connection to trade or business.

**Bona fide debt** – means debt created where there was debtor-creditor relationship and a valid and enforceable obligation for repayment which may be a written agreement or any proof to show that the debt was to be repaid.

**Economic loss** – means money not recovered which was previously reported as business income, either the taxpayer paid out cash or made credit sales of inventory that were not paid for.

### **1. What constitutes Bad Debts?**

- i. money lent to a borrower; or
- ii. credit extended to a customer for the purchase of a product or service, but the recipient was unable for some reason to fully repay the liability.

### **2. Factors determining the deductibility of bad debts:**

- i. For Income Tax purposes the debt amount must have been included in the current year of assessment or was included in previous years of assessment in the taxpayer's income;
- ii. In the case of VAT the taxpayer should have waited for at least six months from the later of when the payment was due or the date of supply;
- iii. The debt must be related to the business activity and there was a bona fide debtor-creditor relationship;
- iv. The debt must have been incurred as a result of the taxpayer's trade or business;
- v. Taxpayer must have suffered an economic loss because of the debt;
- vi. It must be clear from the circumstances that there is diminutive chance to collect either a partial or a full amount; and
- vii. There was a reasonable effort to collect the debt.

### **3. What steps are considered as reasonable effort to collect?**

Such steps would include some or all of the following, depending upon the amount involved and the resources available to the creditor to pursue the debt:

- i. reminder notices issued and telephone/email contact is attempted;

- ii. a reasonable period of time has elapsed since the original due date for the payment of the debt (this will vary depending upon the amount of the debt outstanding and the taxpayer's credit arrangements);
- iii. a formal demand notice is served;
- iv. issue of and service of a summon;
- v. the calculation and charging of interest is ceased and the account is closed;
- vi. a valuation has been made of any security held against the debt; and
- vii. sale of any seized or repossessed assets.

However, a taxpayer is not limited to only the above steps, any pertinent effort and evidence in trying to collect the debt should be considered. The taxpayer is responsible for establishing that the debt is bad and bears the onus of proof in this regard.

#### **4. Information needed to support a bad debt claim**

The following information although not conclusive and exhaustive, may be submitted to support a claim that a debt is bad:

- i. The name of the debtor and the amount of the debt;
- ii. The date the debt was incurred;
- iii. The nature of the debt;
- iv. The reason why it was considered to have become bad during the period covered by the accounts;
- v. In the case of Income Tax, the year of assessment in which the debt was included in the client's income and for VAT, the VAT period in which the VAT was accounted for;

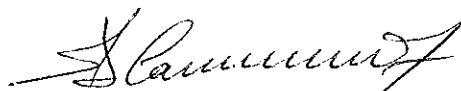
- vi. Any correspondence to the debtor including any responses/or failure to respond on the part of the debtor, which may include, reminder notices issued, formal demand notices, service summons, and proof of any other debt collection efforts; and
- vii. Judgment entered against the delinquent debtor.

**5. Where a bad debt has been recovered for Income Tax Purposes**

- i. If a taxpayer recovers a debt which had previously been deemed a bad debt and was allowed as a deduction for tax purposes, the taxpayer will be required to disclose this and include the whole amount recovered in taxable income in the year of recovery;
- ii. If a taxpayer has sold his business, including book debts, he may not claim any allowances for deduction as the debts are no longer due to him; and
- iii. Where a taxpayer has waived his rights to a debt, he is no longer entitled to claim for such debt as an allowable deduction for tax purposes.

**6. Where a bad debt has been recovered for VAT**

- i. If a taxpayer recovers a debt relief has been claimed and granted, the taxpayer should repay the Commissioner General the VAT element included in the payment.
- ii. The amount to be repaid should be included in the return as output tax for the period in which relief payment was received.



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