Title	**TAX DEDUCTIBILITY FOR BAD AND DOUBTFUL DEBTS** Section 30 of Income Tax Act 1967 **TREATMENT OF RECOVERIES** Section 30 of Income Tax Act 1967 **DEDUCTION FOR BAD AND DOUBTFUL DEBTS AND TREATMENT OF RECOVERIES** Public Ruling No. 1/2002
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TAX DEDUCTIBILITY FOR BAD AND DOUBTFUL DEBTS
Section 30 of Income Tax Act 1967

DEDUCTION FOR BAD AND DOUBTFUL DEBTS AND TREATMENT OF RECOVERIES
Public Ruling No. 1/2002

Bad Debts	Doubtful Debts
▪ Amount of trade debt that has been clearly identified as not being collectible. ▪ These amounts have been recorded in the Accounts for a long period of time. ▪ The amount of trade debt is definitely and confirmed as irrecoverable.	▪ Amount of trade debt that is unlikely to be collectible or company is not sure whether it will receive the payment or not. ▪ It is not the actual amount but rather the estimate of accounts receivable or trade debt that is likely to be bad debt or irrecoverable.

There are four common accounting treatments for bad and doubtful debts and their respective treatment on tax deductibility are further explained.

1 Writing-Off Bad Debts

Bad debts are written-off in a particular year in relation to trade debts which can be proved, by the taxpayer, to be irrecoverable. Trade debts written-off as bad are generally allowable as deduction against gross income in computing adjusted income.

The actions that should be taken before the debts are written-off depend on the size of the debt and the anticipated cost effectiveness of each action. If the taxpayer decides not to take further action to pursue a debt, the reasons should be documented. There should also be evidence to show that each debt has been evaluated separately and what information was used in the evaluation.

All reasonable steps based on sound commercial considerations should be taken to recover the debt. To support a claim for tax deduction of a bad debt written-off, one or more of the following actions should be taken:

- reminder notices to be sent
- debt restructuring scheme to be proposed
- debt settlement to be rescheduled
- negotiation or arbitration of a disputed debt
- legal action (filing of civil suit, obtaining of judgment from the court and execution of the judgment) to be taken

The following circumstances could justify the writing-off of a bad debt:

- The debtor has died without leaving any assets or estate, from which the debt can be recovered.
- The debtor is bankrupt or in liquidation and there are no assets from which the debt can be recovered.
- The debt is statute barred.
- The debtor cannot be traced despite various attempts.
- Attempts at negotiation or arbitration of a disputed debt have failed and the anticipated cost of litigation is prohibitive.
- Any other circumstances where there is no likelihood of cost effective recovery.

2 Specific Provision For Bad Debts

Provisions for specific debts which are estimated to be irrecoverable are allowable as tax deduction provided they arise from credit sales (trade debts) and the taxpayer can prove that there are commercial reasons for such provisions.

Only trading debts which are written-off or specifically provided for, would qualify for tax deduction. The examples of specific bad debts that are not tax deductible include:

- Bad debts arising from sales of fixed assets to other debtors.
- Bad debts arising from non-trade debts, such as inter-company advances and loans given to employees.
- Bad debts arising from taking over or acquiring trade debtors from another company are not tax deductible when the transferred trade debts turn bad.

When making the specific provision for specific debts, the taxpayer will need to :

- Evaluate or determine the likelihood of recovery of each debt, at the end of the particular accounting period.
- Compile evidence to show that evaluation has been done. Each debt should have been evaluated separately, evaluation of the extent of each debt's doubtfulness, when and by whom the evaluation was done and specific information used for the evaluation.

Circumstances for evaluation to determine the specific proportion of doubtful debts:

- the age-analysis of the debts or the period over which the debt has been outstanding
- current financial status of the debtor
- credit record of the debtor or history of bed debts
- the experience for the particular trade or industry

3 General Provision For Bad Debts

General provision for bad debts which is based on a percentage of total sales or outstanding debts, is not tax deductible even though the taxpayer may be required to do so under law and accounting convention. An adjustment should be made in the tax computation for any such general provision in the Income Statement.

4 Forgiving Or Waiving Payments Of Debts

Forgiving or waiving payments of trade debts (either wholly or in part), is not tax deductible. Such a decision by the taxpayer is not regarded as a valid business or commercial consideration. The amount written-off should not be allowed a deduction as the decision is made for reasons other than in the ordinary course of business and on the basis of considerations other than the likelihood of recovery.

TREATMENT OF RECOVERIES OF BAD DEBTS
Section 30 of Income Tax Act 1967

Any recovery of a trade debt, previously written-off as bad or specific provision for bad debt has been made, should be shown as income in the Income Statement for the period in which it is received. No tax adjustment is required as the amount is already shown as income in the Income Statement. Tax adjustment is required for the amount of trade debts recovered if the recovery is not credited into the Income Statement.

Any recovery of a non-trade debt, previously written-off as bad or specific provision for bad debt has been made, should be shown as income in the Income Statement for the period in which it is received. Such recovery would be capital receipts and are not taxable. Therefore, tax adjustment is required to exclude the amount from the tax computation.

SETTLEMENT WITH ASSETS
Public Ruling No. 1/2002

A trade debt may be settled with the assets held as security or given in exchange for the debt. For example, a debt may be settled by the foreclosure of an asset held as security for the debt or by an asset (such as a property or shares in a company) given in exchange for the debt. In such a case, the net proceeds from the sale of the asset or the market value of the asset given in exchange is the value to be taken as settlement for the debt.

After settlement of the trade debt with assets, any balance of the debt still outstanding can be claimed as a bad debt if one of the following circumstances is satisfied:

- The debtor has died without leaving any assets or estate, from which the debt can be recovered.
- The debtor is bankrupt or in liquidation and there are no assets from which the debt can be recovered.
- The debt is statute barred.
- The debtor cannot be traced despite various attempts.
- Attempts at negotiation or arbitration of a disputed debt have failed and the anticipated cost of litigation is prohibitive.
- Any other circumstances where there is no likelihood of cost effective recovery.

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