PRACTICE
STATEMENT No. 57
Issue Date: 10/05/2017

SUBJECT	FIJI REVENUE & CUSTOMS AUTHORITY: BAD DEBTS DEDUCTION
DATE OF EFFECT	1 January 2016
CONFIDENTIALITY STATUS	May be released to the public
LEGISLATIVE REFERENCES	Income Tax Act 2015 - Sections 26, 27, 37, 39
PRACTICE CO-ORDINATOR	Deputy Director Revenue Management

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INTRODUCTION

1. The purpose of this Practice Statement is to provide information on bad debts written off for tax purposes. It is issued with the authority of the Chief Executive Officer of the Fiji Revenue & Customs Authority (FRCA).

2. A bad debt is an allowable deduction for tax purposes when the amount has become uncollectible and is written off in the person's financial accounts during the year.

3. It applies to persons who use the accrual basis of accounting, which requires that all income be included in gross income, whether received or not. The amount must have been included in the person's gross income previously.

4. It also applies to those in the money lending business.

5. If the amount allowed as a deduction is recovered, the amount must be included in the person's gross income in the year of receipt. This amount is referred to as bad debts recovered.

LEGISLATIVE BASIS

6. Section 26 of the *Income Tax Act 2015* (ITA) allows a deduction for bad debts. It provides the conditions that must be satisfied before a deduction is allowed.

7. Section 27 provides for the inclusion of amounts in gross income that have been previously allowed as a bad debt deduction. The recovered amount is income and is included in gross income in the year of receipt.

8. Section 37 provides for the Methods of Income Tax Accounting and Section 39 provides for the Accrual Basis of Accounting. Both these sections are important as bad debts applies to a person who accounts for income tax on an accrual basis.

9. Extracts of the law are in the Attachment and further guidance is given in the following paragraphs.

APPLICATION

10. Section 26 (1) provides the conditions that must be satisfied before a taxpayer is allowed a bad debt deduction for a tax year. The conditions are as follows:

(*a*) the amount of the debt—

(i) must have been previously included in the person's gross income; or

(ii) is money lent in the person's normal money lending business;

(b) the debt or part of it must be written off in the person's financial accounts during the year;
(c) the person must have reasonable grounds for believing that the amount will not be recovered; e.g. bankruptcy cases, debtor untraceable.

11. A bad debt deduction can be claimed by a person who accounts for income tax on an accruals basis and who had previously included the debt amount in gross income.

12. The basic principle under the Accrual basis of accounting is that the income that has not been received by a person is included in gross income. Therefore, the effect of bad debt deduction is to rewrite the amount previously included in gross income.

Example 1

ABC Ltd sells goods on cash and credit basis.
The credit sales for January 2017 was $ 10,000.
Debtors must pay ABC Ltd within 60 days.

Cyclone Z hits Fiji and by 2018, most debtors accounts remained unpaid.

*ABC Ltd believes that half of its customers affected by Cyclone Z will not be able to pay their debts, As a result, ABC Ltd **writes off 50%** of the debt in its accounts for the current tax year.*

Bad Debts Deduction for 2018 = 50% x $10,000 = $5,000.

If the CEO is satisfied that ABC Ltd had reasonable grounds to write off the debt the deduction will be allowed.

Example 2

A local supermarket (Lee & Sons) supplied $1500 worth of goods to Ms. Kesa on credit in 2016. Ms Kesa used to visit the shop regularly but has not been seen for the last 2 months.

The shop owner found out that Ms Kesa had migrated.

On this basis, it is likely that money owed cannot be recovered. It is also reasonable for Lee to make no further enquiries. The amount can be claimed as a deduction in 2017 if –

- *it was included in Lee's 2016 tax return; and*
- *is actually written off in Lee's books of accounts in 2017.*

13. A bad debt deduction can be claimed by a person whose normal business is lending money (such as a bank, financial institution) and where the amount lent cannot be recovered by the person.

14. Since the debt is on revenue account, there is no requirement for the debt amount to have been previously included in gross income. Therefore, the bad debt deduction in this case is effectively a timing rule for revenue losses of banks and other financial institutions.

Example 3

Bank of Fiji lent $10 million as loans to customers in 2017. During the year some of its debtors defaulted and subsequently the bank has reasonable grounds for believing that 5% of the debt cannot be recovered. For those that were confirmed to have migrated, become bankrupt or ceased business, the amounts owing were written off.

Bank of Fiji writes off 5% of the debt in its accounts for the current tax year. Assume Bank of Fiji's fiscal year ends on 31 December 2017.

Bad Debts Deduction for 2017 is = 5% x $10,000,000 = $500,000.

15. Section 26 (2) states that the amount allowed as a bad deduction for a tax year must not exceed the amount written off in the person's financial accounts as a bad debt.

Example 4

Debtor owes Taxpayer $100.

Subsequently, Debtor is in financial difficulties and Taxpayer has reasonable grounds for believing that only 50% of the debt will be recovered.

As a result, Taxpayer writes off 50% of the debt in its accounts for the current tax year.

The effect of Section 26(2) is that the amount of the bad debt deduction is limited to the amount actually written off in the Taxpayer's accounts. This is the case even if there is some doubt about the recoverability of the entire debt.

16. Section 27 provides the rules when bad debts are recovered. The amounts previously written off as a bad debt is included in gross income in the tax year in which it is received.

Example 5

Bank of Fiji wrote off $500,000 as bad debt in 2017 which was allowed as a deduction for tax purposes. *Assume that Bank of Fiji's fiscal year ends on 31 December.* *After taking action through the courts, the Bank was able to recover $200,000 in the year 2020. The $200,000 bad debts recovered will be included as income in the return for the tax year 2020 (the year of receipt).*

PROCESS

17. Business taxpayers can claim bad debts deduction in the income tax returns for a tax year. They must also declare bad debts recovered as income in the return.

18. To support a claim for deduction for tax purposes, there should be sufficient evidence of steps taken to recover the debt, including one or more of the following:
    a. issuing of reminder notices;
    b. legal action (filing of civil suit, obtaining of judgement from the court or execution of the judgement);
    c. information relating to a debtor that has migrated or is untraceable;
    d. information on a debtor that has been declared bankrupt

19. For enquiries, please contact Taxpayer Education & Publicity Unit (TEPU) team on: Email: info@frca.org.fj or call on telephone number 3243000.

ATTACHMENT

Bad debts

26.— (1) A person is allowed a deduction for a tax year for a bad debt if the following conditions are satisfied—

(a) the amount of the debt—

(i) was previously included in the gross income of the person; or

(ii) is money lent by the person in the normal course of carrying on a business of money lending to derive taxable business income;

(b) the debt or part of the debt is written off in the person's financial accounts for the tax year;

(c) there are reasonable grounds for believing that the debt is irrecoverable.

(2) The amount of the deduction allowed to a person under this section for a tax year must not exceed the amount of the debt written off in the person's financial accounts for that year.

Recouped deductions

27. If a person has been allowed a deduction for any expenditure or loss incurred, or bad debt written off, in a tax year in the computation of the chargeable income of the person for the year and, subsequently, the person has received, in cash or in kind, any amount as a reimbursement or recovery of, or an indemnity for the expenditure or loss, or debt, the amount received is—

(a) income included in the gross income of the person in the tax year in which it is received; and

(b) treated as income of the same character as the income to which the deduction is related.

Method of Income Tax accounting

37.— (1) An employee must account for employment income on a cash basis.

(2) Subject to subsection (4), the following persons must account for gross income, and expenditures and losses on an accrual basis—

(a) a company;

(b) a partnership; and

(c) a person required to account for valued added tax on an invoice basis under section 36 of the Value Added Tax Decree 1991.

(3) Subject to subsections (1) and (4), a person to whom subsection (2) does not apply may account for gross income, and expenditures and losses on a cash or accrual basis, provided that the same basis is used for determining both gross income, and expenditures and losses.

(4) The CEO may specify that any class of persons must account for Income Tax purposes on a cash or accrual basis.

(5) A person may apply, in writing, for a change in the person's method of accounting for Income Tax and the CEO may, by notice in writing, approve the application but only if he or she is satisfied that the change is necessary to properly compute the chargeable income of the person.

(6) If a person's method of accounting for Income Tax changes, the person must make adjustments in the tax year of change to items of income, deduction or credit, or to any other items affected by the change so that no item is omitted and no item is taken into account more than once.

Accrual-basis accounting

39.— (1) A person accounting for Income Tax on an accrual basis derives an amount when it is due to the person and incurs expenditure when it is payable by the person.

(2) Subject to this Act, an amount is due to a person at the time the person becomes entitled to receive it even if the time for discharge of the liability is postponed or the amount is payable by instalments.

(3) If—

(a) a person has been allowed a deduction for any expenditure incurred in deriving gross income; and

(b) the person has not paid the liability or a part of the liability to which the deduction relates within one year after the end of the tax year in which the deduction was allowed,

the unpaid amount of the liability is income included in the gross income of the person for the first tax year following the end of the one-year period.

(4) An amount to which subsection (3) applies has the same character as the income to which the deduction relates.

(5) If the amount of an unpaid liability is included in gross income under subsection (3) and the person subsequently pays the liability or a part of the liability, the person is allowed a deduction for the amount paid in the tax year in which the payment is made.

=========End of Practice Statement=========