

## **Statement of Practice (SP 3/09)**

### **Claims for Bad Debts**

A deduction for bad debts is governed by section 21 of the Income Tax Act (the Act). A debt may be deducted as bad by an individual carrying on a business on condition that the debt is proved to have become bad and to have been actually written off as a bad debt.

A similar provision in relation to companies is made in section 60 of the Act. In the case of banks, the law allows also the deduction of any irrecoverable loan due by a company in liquidation in respect of which winding up procedures have started.

2. The term “bad debt” is not defined in the Act. It should therefore be given the normal commercial meaning.

Although much is left to the taxpayer to decide when a debt can be considered bad, there is also the need for the taxpayer to show reasonableness in his decision to consider a debt to have become bad. MRA would also need to be satisfied that the debt is irrecoverable.

Where a debt has been written off as bad but is subsequently recovered in whole or in part, the Act requires that the amount recovered be reported as income in the year the debt is paid.

3. For the purposes of considering to what extent debts may be allowed as bad under the Act, they are grouped under the following categories –

(i) *Small amounts*

It is quite reasonable not to expect a taxpayer to have recourse to legal action to recover small amounts of debts. What is “small” is not always easy to define; it depends on each case and is related largely to the size of business transactions.

However, for banks a debt not exceeding Rs100,000 may be considered as “small”. For others, the threshold is Rs 25,000.

A debt not exceeding Rs100,000 owed to banks and not exceeding Rs 25,000 in other cases may be allowed as bad, whether or not legal action has been taken to recover the debt.

(ii) *Debts owed by companies in liquidation or receivership*

In the case of banks, the law allows any irrecoverable loan due by a company in liquidation or receivership to be considered as bad. This

rationale may be extended to debts owed by any person in bankruptcy or in the process of being wound up.

Debts owed to banks and to any other person by the above mentioned companies may be allowed as bad even where the outcome of any recovery action is not finalized at the time the debt is written off as bad by the taxpayer. Cases where a debt is written-off in a year but the debtor goes into liquidation or receivership in subsequent years may also be allowed without further investigation.

- (iii) *Debts owed by persons who are deceased, are untraceable or have left the country and have no assets*

Where MRA is satisfied that a debt meets any of these characteristics, it may be allowed as bad even if the taxpayer has not taken any legal action to recover the debt.

- (iv) *Proceedings pending before the court*

Proceedings against debtors usually take long to finalise before the court.

Debts which are pending before the court may be allowed provided that there were no chances of recovery. Any debt written off as bad but is subsequently recovered on the order of the court will have in any case to be written back as income in the year in which the payment is received.

- (v) *Loans with or without security or with inadequate security*

A debt with the above characteristics which does not fall under any of the above 4 categories may be allowed provided that the taxpayer proves that legal action has been taken to recover the debt.

- (vi) *Debts owed on credit cards*

Unless a debt owed on credit card falls under category (i) or (iii), the bank should show that legal action has been taken to recover the debt for that debt to be allowed as bad.

- (vii) *General provision established by Bank of Mauritius*

The Bank of Mauritius has issued guidelines to banks to require the establishment of a general provision to ensure the adequacy of the overall allowance for credit losses. The general provision is over and above the provision made on loans assessed individually.

The general provision is clearly a provision that is not allowable for tax purposes. It should therefore be added back to the profit of the bank.

4. The above guidelines do in no way debar the MRA from investigating further into a claim for bad debts where there is strong reason to doubt the genuineness of the claim. Special attention will be given to debts arising from transactions between related parties.

16 December 2009