An Income Tax take on bad debts in the era of COVID-19

December 2020

Abeku Gyan-Quansah is a Partner in PwC Ghana and the PwC West Africa Indirect Tax Leader. He is a regular speaker on tax matters and the faculty lead of the Tax Centre of the PwC Business School in Ghana.

As the world is still reeling from the impact of COVID-19, businesses have been forced to adjust how work is done, amend revenue projections and consider staff strength as many businesses have had to lay-off staff or adopt a staff rotation policy. In these very abnormal times, one area that a business may have to pay close attention to is its receivables/ debtors' portfolio. With businesses folding up and revenues not coming in as expected, there is a likelihood that debtors may not be able to settle their debts. Such debts are already a headache for most businesses in the commercial sense and will likely create a major tax concern for any taxpayer especially under current market circumstances. Do the tax laws give some respite when it comes to bad debts that you may have to provide for or write off from your books? The answer is **Yes**, if certain conditions are met. So, under what conditions will the law consider those debts as being bad for tax purposes and what evidence should be in place for the respite to apply? This article gives some insights on the tax treatment of bad debts.

Bad Debt Under Ghana's Income Tax Laws

In general, the income tax laws allow a person to deduct non-capital expenses that are wholly, exclusively and necessarily incurred by that person in the production of the income from the investment or business during the year.

The income tax laws allow a person to deduct bad debts as an expense in determining the amount of income to be taxed if certain conditions are fulfilled. A bad debt considered allowable as a business expense reduces the chargeable income/taxable profits (a basis for tax charge) of a person for tax purposes. On the contrary, where it is not allowed, the amount would increase the amount to be taxed.

In order to pay lower income taxes by making a claim for bad debts, the person needs to demonstrate to the Commissioner-General ("C-G") of the Ghana Revenue Authority ("GRA") that reasonable steps have been taken to pursue the debt and the entitlement or debt claim cannot be satisfied by the debtor. There has been some level of ambiguity on what the C-G may consider as "reasonable steps" as this opens the door for subjectivity. The C-G , in a bid to give some guidance on this matter issued Practice Note- DT/2020/02 ("PN") dated 28 April 2020 to bring some clarity to taxpayers to avoid disputes with the GRA on bad debts.

What Constitutes Reasonable Steps?

To have some level of certainty that the bad debts will be allowable for income tax purposes, taxpayers should have taken reasonable steps to recover these debts. Reasonable steps as described in the PN include demonstrating the following:

- Complied with the taxpayer's credit policy;
- Issued reminder notices to the debtor regarding the debt;
- Resorted to debt collecting agencies;
- Renegotiated the terms of the debts for the debtor;
- Took steps to resolve disputes with the debtor including by arbitration.

In addition to the above, the debt can be considered bad if the debtor has died, is bankrupt, in liquidation or cannot be traced despite various attempts and there are no known assets from which the debt can be recovered.

Also, where attempts at negotiation or arbitration have failed and the anticipated cost of litigation is prohibitive with no other circumstance presenting a cost-effective recovery approach, the debt can be written off and a deduction allowed for income tax purposes.

Bad Debts Under a Banking Business

The requirements and conditions stated earlier in this article relate to non-banking businesses. Due to the unique nature of the banking business, additional requirements must be fulfilled before a debt can be written off.

To begin, the C-G will only allow a bad debt deduction where the banking business makes a specific provision for a debt claim for an amount which was previously included in calculating the income of the business or the amount is an outstanding loan and the C-G is convinced that the debt is now bad.

As a condition precedent to considering the specific provision for write-off, the bad debt write-off should have been sanctioned by the Board of Directors of the bank and the Bank of Ghana. Furthermore, the business should have taken one or more of the reasonable steps indicated earlier based on sound commercial considerations to recover the debt.

As is the case for non-banking businesses, evidence of efforts made to collect the debt must be clearly documented. In addition, the following conditions must be met;

- Due process for granting the loan should be followed between the bank and the borrower;
- Details of collateral should be provided in addition to the checks made to ensure the collateral was not encumbered;
- The business should indicate whether a valuation has been made of any security held against the debt;
- The bank should also show the sale of any seized or repossessed assets to cover the debt in part;
- There should be an indication from the bank on whether the borrower can be traced and whether there is any insurance cover for the recovery of the loan; and
- The age analysis of the loan must be available.

The securitization of the loan also affects its deductibility for income tax purposes. A loan could either be fully collateralized, partly or not collateralised at all.

Bad debts arising from a fully collateralized loan will not be deductible for income tax purposes. This is because it is expected that the bank would have liquidated the security in full settlement of the debt. For a partially collateralized loan, only the residual outstanding amount after liquidating the security can be written off provided it satisfies the conditions given. In the case of a non- collateralised loan, the conditions earlier indicated would have to be fulfilled before the debt can be written off.

Conclusion

As a taxpayer, a debt written off signifies lost income. It is a cost of doing business and getting an income tax deduction will effectively reduce a company's income that is taxed and paid. It is therefore imperative that all the efforts that were taken in a bid to recover the debt is clearly documented in order to serve as evidence and provide a basis for the write-off to protect shareholder value.

Want to know more? Let's talk.

You can contact us by sending an email to abeku.gyan-quansah@pwc.com and copying in Benjamin Agyare at benjamin.kojo.agyare@pwc.com

At PwC, our purpose is to build trust in society and solve important problems. We're a network of firms in 155 countries with over 284,000 people who are committed to delivering quality in assurance, advisory and tax services. Find out more and tell us what matters to you by visiting us at www.pwc.com.

PwC refers to the PwC network and/or one or more of its member firms, each of which is a separate legal entity. Please see www.pwc.com/structure for further details.