

Loans forgiven trigger tax to debtors

In some cases, people resolve to cancel or to write off a debt due to financial challenges or default by debtors. This practice is not only applicable to individuals, but it also applies to companies. However, it is imperative that we understand that the tax laws equally regard forgiving an interest-free loan as making a donation which may actually trigger tax in the hands of the debtor.

As alluded to above, the tax laws regard the act of forgiving a loan as making an actual cash donation. Primarily, the tax law prescribes that donations tax is levied on the value of 'any gratuitous waiver or renunciation of a right.' To put this into perspective, where a loan is forgiven, technically, a right to receive cash is waived, accordingly giving rise to donations tax. In essence, the act of forgiving or giving up anything valuable to any person for free may trigger donations tax. Put differently, the rationale giving rise to such tax is based on the fact that one gives up a right to receive cash whereas the other is granted with an opportunity to enjoy the benefit of not paying back the debt. Therefore, the tax laws consider that act of forgiving a loan to be fundamentally similar to making a cash donation. In this regard, a cancellation of a loan is assessable for donations tax. The tax is payable by the beneficiary of the forgiven loan, in this case the debtor. However, the tax will not apply to loans below the value of P25,000.

In essence, loans forgiven are equally considered as a donation, hence liable to donations tax. However, it is key to note that the tax is applicable on loans which are interest-free and not subjected to income tax upon the time of forgiveness. You can read more tax articles on our website, www.aupracontax.co.bw under the 'Tax Articles' tab.

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