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Recovered bad debts trigger VAT & CIT in Botswana

If you've been fortunate enough to recover a bad debt that you had written off as non-recoverable; well, congratulations! But beware, this good fortune may come with a tax consequence. Keep on reading and allow us to enlighten you as to why you need to be on the lookout when bad debts previously written off are eventually recovered. In this article, words importing the masculine shall be deemed to include the feminine.

Enter bad debts

Bad debts are basically an expense or a loss to the business. They generally arise when a receivable is no longer collectable which may be due to bankruptcy or other challenges. This is commonly experienced by business operators who extend credit facilities to their customers. Accordingly, when a customer fails to pay, a business operator will ultimately write off the debt in the books of accounts. In this case the taxman may allow a deduction of such an expense as it is revenue in nature because it would have occurred as a direct consequence of running a business. However, it is vital to understand that the tax man will only allow the bad debt to be deducted if it was previously included in gross income for tax purposes. This technically disqualifies non-income generating debts like those which arise from interest-free loans from allowable deductions. This is based on the fact that no income would have been previously included in the gross income of that taxpayer. Put differently, bad debts are only deductible if they arise from taxable revenue previously assessed for tax.

Enter CIT

As alluded to above, a bad debt is only allowable as a deduction when it was previously included in gross income. In other words, a bad debt is only deductible if it was previously taxed. The principle here is that when one makes a sale on credit such a sale is included in the taxable income even when the actual cash has not been received. So, when the customer fails to pay later on the taxman allows you to claim a deduction to the extent of the amount previously taxed i.e., for Corporate Income Tax (CIT) purposes. Looking at this closely, this adjustment has a reversing effect. Eventually, when the same debt is recovered it should be included in the gross income effectively resulting in the resurgence of the tax that was previously reversed by the deduction of the bad debt.

Enter VAT

When a VAT-registered person suffers a bad debt on an amount on which VAT was charged, an input tax credit calculated based on the tax fraction of the irrecoverable amount is permitted. Technically, the principle is the same. The input tax is permitted to reverse the output tax previously paid on the credit sale. Thereafter, a recovered bad debt may be likened to cash received on sale. Consequently, this results in an output tax that was previously reversed by an input tax deduction.

Conclusion
To conclude, the recovery of a previously written-off bad debt can trigger a tax liability for the taxpayer. Business operators are therefore urged to correctly account for bad debts recoveries for tax purposes to avoid unnecessary interest and penalties should the taxman knock on their doors.

Well, folks, we hope that was insightful. As us the two Yours Truly say goodbye, remember to pay Caesar what belongs to him. If you want to consult, join our free Tax WhatsApp group or to know about our 9 Tax e-books, send a text to +267 7181 5836 or email us at jhore@aupracontax.co.bw. You can read more tax articles on our website, www.aupracontax.co.bw under the 'Tax articles' tab.