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Submission File

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South African Revenue Service
Private Bag X923
Pretoria
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BY E-MAIL: policycomments@sars.gov.za

Dear SARS

COMMENTS ON THE DRAFT INTERPRETATION NOTE ON DOUBTFUL DEBTS

1. We herewith take an opportunity to present our comments on behalf of the South African Institute of Chartered Accountants (SAICA) on the draft Interpretation Note (IN) providing guidance on calculating the doubtful debts allowance as contained in section 11(j) of the Income Tax Act, No 58 of 1962 (the Act).

COMMENTS

Information required for an increased allowance rate directive

2. In terms of section 11(j) a taxpayer may apply to the Commissioner to have the 40% allowance (section 11(j)(i)(aa) and section 11(j)(ii)(aa)) increased to a percentage not exceeding 85% (hereinafter referred to as 'the Directive'). It is submitted that the information required as set out in the Request for Information (RFI) template provided by SARS, together with the excel models to be completed, are too cumbersome to compile.

3. For instance, the RFI requires a list of each debtor in the drop list provided which is not how IFRS 9 works and is the reason it was decided to move away from specific debtor provisions.

4. The benefit of an increased allowance does not seem to justify the effort required and not many taxpayers will have resources to comply with the amount of information required.

5. This is especially burdensome given the proposed annual request process which we comment on further below.

6. Submission: It is recommended that the level of detail required is reconsidered, especially where IFRS 9 is applied. In such an instance most of the information should be obtainable from the taxpayer's Annual Financial Statements.

7. In addition, whatever allowance is claimed in year one, has to be added back in the next year, i.e. *'the allowance granted in a particular year of assessment must be included in the taxpayer's income in the following year of assessment'* (at para 5.1 of the draft IN).

8. It is further doubtful whether SARS will have the required resources to review and process these directive applications.

Period of validity of an increased allowance rate directive

9. An application to rely on an increased allowance percentage has to be submitted annually (para 5.7 of the draft IN) and even though the RFI document does not have to be completed annually, the excel models have to be completed again. In the event of changes to the model applied for IFRS 9 purposes as set out in para 5.7 of the draft IN, the directive will become invalid and a taxpayer will have to re-apply. Such a re-application requires explanations as to the reasons for the change, in addition to the standard RFI and excel model that have to be resubmitted.

10. The requirement to submit such an application on an annual basis means that SARS could decline it, which brings about significant, unnecessary, uncertainty for taxpayers.

11. Submission: It is recommended that the Directive applies for a period of 5 years along with a written undertaking from the taxpayer that should a circumstance arise which will have a material impact on the model and percentage arrived at, the taxpayer will inform SARS and submit a revised information pack.

12. This will also motivate taxpayers to complete and submit all the information required, even though cumbersome, because taxpayers will be able to rely on the approved, increased allowance for a period exceeding one year. The benefit of a period of certainty of 5 years outweighs the effort required in terms of application processes. This will also alleviate any resource constraints that could potentially be experienced by SARS in this regard.

13. As an anti-avoidance measure, penalties and interest could be imposed should the taxpayers fail to report any material changes.

Applications for directive to be made before provisional payments due

14. The draft IN determines that '*model or methodology changes could potentially impact on a taxpayer's estimates for provisional payments and as such the application should be made before the date on which such provisional payments become due*' (at para 5.7).

15. Taxpayers' tax positions can change significantly between payment of its first and second provisional tax liability. It would therefore not be feasible to have such a directive application completed before calculation and payment of a taxpayer's first provisional tax liability.

16. Submission: It is recommended that a directive application be required to be completed prior to the calculation of a taxpayer's second provisional tax obligation and associated payment.

Difference between tax and accounting treatment

17. Section 11(j)(i)(aa)(B) and Example 1 of the draft IN refer.

18. It is uncertain under what circumstances a debt will be written off for accounting purposes, will not qualifying for a section 11(i) deduction.

19. <u>Submission</u>: It would appear from the discussion document that bad debts which have been handed over to a third party for collection will be written off for accounting purposes but will not qualify for deduction under section 11(i).

20. We would appreciate a reason why this would not qualify for a tax deduction as this is not our understanding of the section as some creditors hand over *prescribed debts* for instance. It is not the handing over of the debt that should be considered but the intention and view of taxpayer on collectability that should be compared for mismatch between accounting and tax treatment.

21. We would appreciate other examples on this matter to understand if there are other scenario's where the accounting and tax treatments are not aligned.

22. It is also respectfully submitted that the divergence between accounting and tax creates an unnecessary administrative burden of having to track bad debts separately for tax and accounting purposes and that an alignment between tax and accounting is unlikely to result in a loss to the fiscus.

23. Paragraph 5.6.5 reads as follows –

    'A taxpayer should write off non-performing debt at the point in time when there is no reasonable expectation of further material recoveries. <u>SARS does not accept that a debt is bad for tax purposes if</u>, notwithstanding that the debt has been written off as bad for accounting purposes under either IFRS 9 or not, <u>the taxpayer still pursues its recovery through alternative processes</u>, for example, the appointment of a debt collection agency to recover the debt on behalf of the taxpayer. The criteria applied by a taxpayer in classifying a debt as bad for tax purposes could be expressed as <u>the period that debt and its associated provision are held on balance sheet before the entity believes that no further material recoveries would be collected</u>. Taxpayers are required to provide full details of all the factors it takes into account before classifying a debt as bad.

24. From the comments made by SARS in this paragraph (pertaining to the write off of debts when they become bad), it appears that debts that are handed over to a debt collection agency are not perceived to be written off from a tax point of view.

25. We do not agree with this interpretation and it appears to be inconsistent with SARS' current practice of permitting a deduction under section 11(i) if the amount is written off for financial reporting purposes. A debt is bad if it is more likely than not to be irrecoverable, not when there is no legal remedy to recover the amount.

26. The views expressed in par 5.6.5 will equally not make sense in respect of debts that are removed from the taxpayer's balance sheet once it is handed over to a collection agent.

Important to note here is that once such debt is handed over, the taxpayer does not keep track of payments received, ongoing aging of the debt etc. The subsequent tracking of the debt is now done by the collection agency as the debt sits in their books.

27. Submission: As stated above, we disagree with the interpretation provided in this paragraph and in many cases the taxpayer will no longer have all the necessary information to claim the section 11(j) allowance as is required in the draft Interpretation Note. We kindly request SARS to reconsider the views expressed in the draft IN and provide clarity on when a debt would be considered 'bad' for purposes of section 11(i).

Lease receivables and partial write off

28. The third paragraph on page 8 reads as follows –

> *'No doubtful debt allowance will be granted in respect of lease receivables. As indicated under 3.6 IFRS 9 allows for debt to be partially written off for financial reporting purposes. Such debt that has been partially written off for financial reporting purposes will generally not be deductible as it is not yet considered bad for tax purposes and should be included in the debt to which the provisions to section 11(j) apply".*

29. The above paragraph creates confusion as it appears that the entire paragraph relates to lease receivables, which it does not.

30. Submission: To make it clear that the first sentence is not related to the following sentences in the paragraph, it is suggested that a new paragraph begins after the first sentence.

Should you wish to clarify any of the above matters please do not hesitate to contact us.

Yours sincerely

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The South African Institute of Chartered Accountants