

TAX ALERT

AVC VACATION CLUB LIMITED V DIRECTOR-GENERAL, MRA (ARC/IT/343-21)

The Assessment Review Committee (“**ARC**”) recently published a ruling adjudicating over the disallowance of bad debts and more specifically what constitutes evidence of a debt proven to have become bad.

AVC Vacation Club Limited v Director-General, Mauritius Revenue Authority (ARC/IT/343-21)

FACTS

AVC Vacation Club Limited (“**Applicant**”) sells ‘Club Points’, i.e. intangible properties which are freely transferrable and can be assigned to any third party, entitling clients to enjoy holidays and other benefits based on their points.

An assessment was raised by the Mauritius Revenue Authority (“**MRA**” or “**Respondent**”) disallowing the Applicant’s claim for bad debts, having proceeded in an investigation from a sample of 20 debtors out of the approximate claimed 500 debtors. The Applicant’s internal procedure for debt recovery consists of making numerous phone calls over a certain period, attempting to reach clients by email, giving them time to pay and in case of no response, the Applicant issues a “Power of Sale’ letter to the client and the points are seized. Any defaulting clients cannot get any benefit and are no longer considered Club Points members.

ANALYSIS

After considering authorities from both sides and evidence on record, the ARC held that the MRA’s refusal to allow the claim for bad debt was right. While under the MRA’s Statement of Practice on bad debts (SP 9/11), any debt below Rs 50,000 or owed by persons who are deceased, untraceable or who may have left the country and have no assets may be allowed whether or not legal action was taken to recover the debt, the ARC held that taxpayers still needed to prove that reasonable steps have been taken to show that the debts were unrecoverable.

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ANALYSIS (Cont.)

The Applicant's failure to provide documents supporting its impossibility to trace its debtors or the debtors' financial hardship or lack of means was considered to be a valid justification for the MRA's decision not to consider the Applicant's bad debt claim, even if no legal action had been taken.

Consequently, the Applicant was unable to prove that the debts they claimed were irrecoverable, in contravention of section 60 of the Income Tax Act 1995, reproduced below:

“60. Bad debts and irrecoverable sums

(i) Subject to subsection (3), a company which derives gross income specified in section 10(1)(b) in an income year may deduct –

*(a) the amount of a debt or sum which is proved to have become bad and to have been actually written off as a bad debt by the company in that income year; and
(...)”*

Whether a debt is irrecoverable can only be reasonably assessed based on available facts.

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ANALYSIS (Cont.)

Essential features of the present case remain the Applicant's business model and internal debt recovery which provide the basis to consider the information available to the Applicant regarding its debtors. The Applicant's inability to properly demonstrate the reasonable steps that have been taken to prove that its debtors could not be retraced, were under financial hardship, and/or had no assets is to be considered in light of the Applicant's seizure of points belonging to debtors and the points' resale to third parties (sometimes at a higher price), while even refunding defaulting owners the cost of points at times.

The authors note that Mauritius is not the only jurisdiction that requires reasonable proof of the low recoverability of the debts for a deduction to be allowed.

For instance, the Australian Taxation Ruling (TR 92/18) on 'Income tax; bad debts', provides that, to obtain a bad debt deduction, taxpayers must have written off a debt as bad after an objective consideration of all relevant circumstances. However, the Australian Taxation Office ("**ATO**") declines a strict interpretation whereby a debt would not be considered bad until the debtor has died without assets, has become insolvent and his estate is distributed, or the debt is statute-barred or regarding a corporate debtor, the debtor is completely wound up or its liquidator has proceeded to a final distribution.

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ANALYSIS (Cont.)

The ATO nonetheless prescribes that the taxpayer, bearing the onus on establishing that a debt is bad, takes the appropriate steps in an attempt to recover the debt depending on the size of the debt and the resources available to the creditor, including the following:

- i. reminder notices issued and telephone/mail contact is attempted;*
- ii. a reasonable period of time has elapsed since the original due date for payment of the debt. This will of necessity vary depending upon the amount of the debt outstanding and the taxpayers' credit arrangements (e.g. 90, 120 or 150 days overdue)*
- iii. a formal demand notice is served;*
- iv. the issue of, and service of, a summons;*
- v. a judgment entered against the delinquent debtor;*
- vi. the execution proceedings to enforce judgment;*
- vii. the calculation and charging of interest are ceased and the account is closed, (a tracing file may be kept open; also, in the case of a partial debt write-off, the account may remain open);*
- viii. the valuation of any security held against the debt;*
- ix. the sale of any seized or repossessed assets.*

Similarly, in the UK, a deduction for a debt owed to a trader is only allowed if certain criteria are fulfilled.

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If HM Revenue & Customs deems that there is insufficient information available to determine whether a deduction for bad debt fulfils the above criteria, it would be important for the taxpayer to establish with respect to each debt the following:

- i. how the extent of its doubtfulness was evaluated,
- ii. when this was done;
- iii. by whom; and
- iv. what specific information was used in arriving at that evaluation.

CONCLUSION

It is clear that a debt written off as “bad” for accounting purposes will not automatically result in a deduction for bad debts being claimed for tax purposes. The burden of proof lies with the taxpayer (and is a rather high threshold), who will need to demonstrate that reasonable steps have been taken (including in certain circumstances, legal action taken against the debtor) to recover the debt.

[READ THE FULL RULING HERE](#)

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