



<b>SUBJECT</b>	<b>FIJI REVENUE &amp; CUSTOMS AUTHORITY</b>  <b>COMMERCIAL DEBT FORGIVEN</b>
<b>DATE OF EFFECT</b>	1 January 2016
<b>CONFIDENTIALITY STATUS</b>	May be released to the public
<b>LEGISLATIVE REFERENCE</b>	<i>Income Tax Act 2015, Section 17 (1) (f), Section 2 definition of dividend</i>  <i>Tax Administration Act , 2009</i>
<b>PRACTICE COORDINATOR</b>	National Manager Revenue Collection

INDEX	
Introduction .....	2
Legislative Basis .....	2
Application.....	3
Process.....	7

## **INTRODUCTION**

1. The purpose of this Practice Statement is to provide guidance on the taxation of commercial debts that are forgiven. It is issued with the authority of the Chief Executive Officer of the Fiji Revenue and Customs Authority (FRCA).
2. This applies to a situation where a person forgives, after 31 July 2016, a debt owed by an associate of the person.
3. A 'commercial debt' is a debt where the interest on that debt, if it was paid or payable, would be a deductible expense for the borrower. If the debt is interest-free, it is still a commercial debt if interest charged would have been deductible. In other words, it applies to all or part of the principal amount of a commercial loan that is forgiven, whether interest was charged or not.
4. The amount of the forgiven debt is included in the borrower's gross income. It is therefore important to recognise when a forgiven debt becomes taxable income. The following checklist can be used as a guide-
  - the debt is in respect of a business loan or advance;
  - the lender and buyer are associates for tax purposes;
  - all or part of the debt has been forgiven.

## **LEGISLATIVE BASIS**

5. Section 17 (1) (f) of the *Income Tax Act 2015* (ITA) includes in business income, the amount of a commercial debt forgiven, if the parties to the transaction are associates. It states:

*"17.—(1) The following are included in the business income of a person conducting a business—...*  
*(f) any commercial debt between associates that is forgiven;"*

6. The debt forgiveness rules only applies if the lender and borrower are associates.
7. 'Associate' is defined in Section 4 of the ITA. In general, two persons are associates if they have family or business connections and the relationship puts one in a position of influence over the other or both can be influenced by a third person. Some of the specific relationships covered in the ITA are (i) individuals and a relative of the individual (ii) a partner in a partnership and the partnership (iii) a trust and a beneficiary (iv) a member of a company and the company (v) and two companies. For

partnerships and companies, an associate is a person who has controlling interests (more than 50%) such as in rights to dividends, income, capital, voting rights etc.

8. "Commercial debt" is defined in Section 17 (1) (f) and means a debt in respect of which interest (whether payable or not) is or would have been a deductible business expense for the borrower.
9. Forgiven, in the case of a commercial debt, means a debt where the borrower's obligation to pay it is waived or the time frame for legal recovery in the Limitation Act (Cap 35) has expired.
10. A debt is also forgiven if under an arrangement made by the parties, the borrower is no longer required to pay all or part of it. In such cases, the debt is treated as forgiven at the time the agreement is made. Further guidance is given in paragraph 13.

## **APPLICATION**

11. A debt forgiven is only taxable where a person (lender) forgives a commercial debt owed by an associate (borrower), after 31 July 2016.

**Example 1** - Commercial debt forgiven where the borrower is a company and an "associate" of the lender

*RCo is a shareholder in XCo with 51% shareholding interest.*

*In 2009, XCo lent RCo \$60000 for repayable in 5 years with interest. \$3000 remained unpaid for a number of years and this amount was forgiven by XCo in October 2016.*

*Tax implications for RCo*

*RCo is an 'associate' of XCo, for tax purposes and the loan was for a business purposes. Since it is a commercial debt, \$3000 is treated as business income under section 17 (1) (f) and will be included in RCo's gross income for the tax year 2016.*

**Example 2** - Commercial debt forgiven where the borrower is a company and "not an associate" of the lender

*MCo is a shareholder in XCo with 49% shareholding interest.*

*XCo loaned MCo \$10,000 in 2014, \$2000 remained unpaid on 31 December 2015 and the amount was forgiven by XCo in October 2016.*

Tax implications for MCo

*MCo is a minority shareholder and therefore not an associate of XCo. The amount forgiven is not treated as business income under Section 17 (1) (f).*

*The forgiven debt may be a deemed dividend (as defined in paragraph (f) of the definition of dividend in section 2 of the ITA). However, intercompany dividends (paid by a resident company to another resident company) are exempt from income tax and this taxing rule also applies to deemed dividend.*

**Example 3** - Commercial debt forgiven where the borrower is an individual and an “associate” of the lender

*John is a resident shareholder of JMCo with 51% shareholding. John owes JMCo \$3000. It is a commercial debt which was forgiven by JMCo in October 2016.*

Tax implications for John

*John is the majority shareholder in JMCo, therefore is an associate of the Company for tax purposes. \$3000 will be included in his business income under Section 17 (1) (f).*

*The debt forgiven may be a deemed dividend (as defined in paragraph (f) of the definition of dividend in section 2 of the ITA). However JMCo will not be required to account for dividend tax if the amount is included in John’s gross income.*

**Example 4** - Commercial debt forgiven where the borrower is an individual and “not an associate” of the lender

*Mary is a resident shareholder of JMCo with 49% shareholding. Mary owes JMCo \$3000. It is a commercial debt which was forgiven by JMCo in October 2016.*

Tax implications for Mary

*Mary is a minority shareholder in JMCo therefore is not an associate of the Company for tax purposes. The debt forgiven, \$2000 will not be included in her business income.*

*However, the amount forgiven may be a deemed dividend (as defined in paragraph (f) of the definition of dividend in section 2 of the ITA) which is subject to dividend tax.*

*JMCo will pay \$90 dividend tax (\$3000 x 3%)*

*If Mary is a non- resident, dividend tax payable by JMCo is \$270 (\$3000 x 9%)*

12. A commercial debt forgiven by an unrelated party is not taxable.

**Example 5** - Commercial debt forgiven where the borrower is “not an associate” of the lender

*SCo owes MCo \$3000. It is a commercial debt and was forgiven in October 2017.*

*Tax implications for SCo*

*Since SCo is not an associate or member of MCo, Section 17(1) (f) does not apply and the amount forgiven is not included in SCo's business income.*

13. Where the lender and borrower are “associates” and have an arrangement for waiver of the debt at a future date, the amount of debt forgiven will be treated as forgiven at the time the agreement was made.

**Example 6** - Commercial debt forgiven when agreement for waiver exists

*J&S Partnership lends \$6,000 to an associate of the partnership, Joe on 20th December 2016. Joe used the loan for business purposes.*

*Under the terms of the agreement, the loan is interest free, repayment is \$1000 a month from January 2017 and after 3 months, and the balance will be waived.*

*Since an agreement for waiver of the debt balance exists and the debt that will be forgiven is a commercial debt, \$3000 (\$6000-\$3000) will be treated as Joe's business income for the tax year 2016.*

14. A debt forgiven because the creditor cannot sue the debtor due to the expiry of the 6-year period for legal action under the Limitation Act, is an amount to be included in business income.

**Example 7**- Commercial debt forgiven where the borrower is an “associate” and has been declared bankrupt

*JCo loaned \$10,000 to an associate of the Company, Ben in 2013. It was a commercial debt and Ben paid \$7000. In 2017, Ben was declared bankrupt.*

*\$3000 (\$10,000 - \$7000) will be included in Ben's business income for 2017 as it is treated as forgiven in 2017.*

*If JCo is unable to sue and \$3000 remains unpaid within 6 years from 2013 (i.e. by 2019), the debt is treated as forgiven in 2019 and included in Ben's business income.*

*The debt forgiven may be a deemed dividend (as defined in paragraph (f) of the definition of dividend in section 2 of the ITA). If the amount is treated as a deemed dividend before the events above takes place, JCo will be required to pay \$90 dividend tax (3% x \$3000) and the debt forgiveness rules in Section 17 (1) (f) will not apply.*

**Example 8** - Non-commercial debt forgiven where the borrower is an “associate” and has been declared bankrupt

*JCo lent \$10,000 to Len, an associate of the Company, in 2013. Len used the funds to buy his personal car. In 2016, JCo sued Len for the amount unpaid (\$4000.) and Len was declared bankrupt. The amount is treated as forgiven in 2016.*

*The provisions of Section 17 (1) (f) will not apply as the debt was not a 'commercial debt'. However the debt forgiven may be a deemed dividend (as defined in paragraph (f) of the definition of dividend in section 2 of the ITA) in which case JCo will be required to pay \$120 dividend tax (\$4000 x 3%).*

**Example 9** - Commercial debt forgiven where borrower is an employee

*JCo lends \$4,000 to Sera an employee*

*The loan was for her small business. She retires 3 years later and the remaining debt is forgiven. Although the debt forgiven is a 'commercial debt, Sera is not an associate of JCo therefore the provisions of Section 17 (1) (f) does not apply.*

*The amount forgiven is an employee benefit and will be subject to Fringe Benefit Tax which is payable by JCo.*

## **PROCESS**

15. Companies and other entities that have forgiven a debt or remaining debt in respect of a loan given to an associate will be required to report this information in income tax returns.
16. A person who has 'forgiven debt income' must also report the amount in the tax return for the year in which the debt was forgiven.

17. The record keeping requirements and penalties in the *Tax Administration Act, 2009*, apply.

18. Persons who have forgiven a debt or who have gained from a forgiven debt can write to us directly for clarification on how this law applies to them. For comments and enquiries please e-mail: [tepu@frca.org.fj](mailto:tepu@frca.org.fj) or [info@frca.org.fj](mailto:info@frca.org.fj)

***End of PS***

=====