LOANS FORGIVEN TRIGGER DONATIONS TAX: By Jonathan Hore

They say, 'forgiveness is the key to freedom, it liberates you from the past.' Well, in as much as such sentiments may actually liberate one from their past, freedom on the other hand is not entirely guaranteed in the tax realm, especially where the forgiveness is punctuated in Pulas. I want to show you how loans forgiven can trigger donations tax in the hands of the debtor. In this article, words including the masculine shall be deemed to import the feminine.

The concept

Technically, loan forgiveness occurs when a creditor relieves a debtor from a debt obligation. Such arrangements maybe a result of trade negotiations between companies or simply between individuals who may unanimously forgive or relieve the other party from the repayment obligation. I am sure you will agree with me that in such instances, the creditor would have surrendered or disregarded his or her right to receive money whereas the debtor would have, for one reason or the other, benefited from such. If we look at this transaction closely, I am sure we can all decipher the obvious i.e., one party giving the other party money for free. Before I get into deeper aspects of this matter, let me state that the donations tax is only payable where the debt is not interest-bearing and where it wouldn't have been subjected to income tax. In other words, no donations tax arises on loans forgiven if such loans carried an interest element. Let's now have a look at how the taxman interprets such arrangements.

Enter tax

Loans forgiven are by no means different from donated cash in as far as tax is concerned. Consequently, cancellation of interest-free debts triggers donations tax. The tax is payable by the donee or beneficiary, in this case the debtor. Technically, the tax is called Capital Transfer Tax. The term donations tax is derived from the terms prescribed by the Act being, 'donee' and 'donor' to mean 'any beneficiary' and any person giving away property, respectively.

The key aspect is that the tax is levied on the value of 'any gratuitous waiver or renunciation of a right,' technically referred to as a chargeable disposal by the Act. The term gratuitous means to give away freely without any charge or any recompense. As you can see, if you ought to forgive someone a loan you are construed to have gratuitously waived a right to receive money. As such, that act of forgiving someone something with monetary value falls in the ambit of a chargeable disposal of property subject to Capital Transfer Tax, in other words Donations Tax.

Why are we now referring to a disposal of property when we are discussing loans? Well, the Act brings another interesting aspect to this tax. In terms of the Capital Transfer Tax Act the term property is defined as 'any right in or to movable or immovable, corporeal or incorporeal property wherever situated.' This definition is wide and encompasses almost anything that has a monetary value. Technically, a loan is construed to be a property which triggers tax if a debtor is forgiven in as far as the donations tax is concerned.

Enter exemption

It would obviously be onerous for the taxman to try and collect tax from each and every Pula that people exchange almost on a daily basis and actually pardon each other. That would be a sheer waste of resources isn't it. The tax is only applicable where the value of the loan or debt forgiven is more than P25,000. This minimum threshold applies to both

companies and individual taxpayers. However, for a person in business or a company only non-interest-bearing debts written off trigger donations tax. Officially, this means that if anyone has their interest-bearing debt or loan forgiven, it is subjected to business income tax. This explains why I stated that the loan must be interest-free if donations tax is to be triggered.

Well folks, I hope that was insightful. As Yours Truly says goodbye, remember to pay to Caesar what belongs to him. If you want to join our Tax WhatsApp group or to know about our 9 Tax e-books, send me a text on the cell number below.