

WAIVER OF A DEBT – TAX IMPLICATIONS

According to the Income Tax Act (the “**Act**”), a ‘disposal’ of assets includes the forfeiture, termination, redemption, cancellation, surrender, discharge, relinquishment, release, waiver, renunciation, expiry or abandonment of an asset.

For example, in the event that an amount owed by a debtor to a creditor is reduced or written-off, the reduction of the debt for inadequate consideration can result in either income tax (per section 19 of the **Act**), or to capital gains tax (CGT) (per paragraph 12A of the Eighth Schedule of the **Act**) implications in the hands of the debtor.

Where a debt is reduced, whether by way of waiver, forgiveness, compromise, or otherwise, the debtor who is afforded the relief could realize a recoupment in terms of the **Act**. In the case of capital assets, the reduction of debt could potentially result in a lower base cost in respect of the asset or a reduction in assessed capital losses in terms of the **Act**.

In general, the tax treatment of a debt reduction is linked to the type of asset associated with the incurral of the debt, in other words, the tax consequences depend on the nature of the asset acquired or funded by the original debt.

For the various scenarios, refer the table below:

<i>In terms of Section 19 of the Act</i>	
If the original amount of debt was applied to fund:	The amount of the debt reduction
the acquisition of trading stock, which is still held and not disposed of.	reduces the cost price - if reduced to zero, the balance represents a recoupment to the extent of any deduction or allowance granted.
the acquisition of trading stock, which is no longer held.	represents a recoupment (included as income) to the extent that the debt-funded expenditure was claimed as a deduction or an allowance.
expenditure (excluding expenditure relating to allowance assets).	represents a recoupment (added to gross income) to the extent that the debt-funded expenditure was claimed as a deduction or an allowance.
an allowance asset still on hand.	reduces the remaining base cost of the asset – any excess is a recoupment of the capital allowances.

an allowance asset no longer on hand.	may well give rise to a double recoupment, if the capital allowances were recouped in a previous year of assessment.
<i>In terms of Par. 12A of the Eighth Schedule of the Act</i>	
If the original amount of debt was applied to fund	The amount of the debt reduction
a capital asset (other than an allowance asset) still held at the date of the debt reduction.	will reduce the para-20 base cost expenditure – if reduced to zero, the balance of the reduction amount must be applied against any assessed capital loss.
a capital asset (other than allowance asset) no longer held or the reduction exceeds the base cost of the asset.	reduces any assessed capital loss of the debtor by the amount of the debt reduction after having been reduced by any previous base cost reduction.
an allowance asset still held at the date of the debt reduction.	will reduce the para-20 base cost expenditure – the balance of the reduction amount will give rise to normal (income) tax consequences in terms of section 19.
an allowance asset no longer held at the date of the debt reduction.	will be dealt with in terms of section 19.
to fund an asset in respect of which no allowances or deductions are claimed, for example, the acquisition of goodwill.	reduces the base cost of the asset for CGT purposes – if reduced to zero, the balance remaining will reduce the assessed capital loss.