Corporate tax treatment of bad debt incurred before 2018 (1/24/18)

This article offers an interpretation of the Corporate Income Tax (CIT) Act stating that where a bad debt incurred before 2018 is written off and deducted from taxable income, the company should meet requirements laid down by section 9 of the CIT Act. However, those requirements don't apply to bad debts incurred before 2018 that are written off without reducing the company's tax base.

On 25 May the State Revenue Service published an advance ruling on how to correctly write off prior-period debts in 2018.

Before the ruling was published

If a receivable that arose before 2018 is recognised as a bad debt in 2018 or later, the company can write it off and reduce taxable income using a coefficient of 0.75. In that case the debt should meet a number of statutory requirements, for example:

- The company has taken all reasonable steps to recover it;
- The debtor resides in the EEA or a country that has an effective double tax treaty with Latvia;
- The debtor's trade has been suspended by the tax authority's decision, and he has been deregistered as a trader.

This debt should also be deducted from profits earned before 2018 that can be distributed in dividends without applying the rules of the new CIT Act.

However, if a debt arose before 2018 and is covered by a bad debt provision recorded separately from any provisions made after 2017, the company can reduce its tax base by writing off the debt against that separate provision. This course of action is allowed only if the debt meets the requirements of the CIT Act. A coefficient of 0.75 should also be applied. Unlike the previous situation, no reduction is required in retained earnings for 2017 that can be distributed free of CIT after 2017.

After the ruling was published

The advance ruling states that where a debt incurred before 2018 is written off in 2018, the section 9 requirements don't apply and the debt doesn't need adding back to taxable income.

Provisions for bad debts incurred before 2018 that are written off without reducing taxable income escape the 36-month time limit and other section 9 requirements because otherwise the CIT Act would be applied retrospectively.