



TAX

# CARIBBEAN REGIONAL CAPACITY BUILDING WORKSHOP ON FACTORING / RECEIVABLES DISCOUNTING

TAX IMPLICATIONS ON FACTORING RECEIVABLES

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# Tax Implications on Factoring Receivables

## Factoring Receivables

Factoring receivables may be defined as a financial transaction whereby an enterprise sells its debt claims to a third party in order to obtain cash (usually less than the full amount of the debt). The third party then assumes responsibility for the administration and collection of the debt on the due date for its own account.



# Tax Implications on Factoring Receivables

## Receipts

The receipts or takings, or cash inflow from the sale of goods and services, of a business or profession may sometimes form the basis for taxation. The option of paying tax upon receipts rather than sales may also be allowed for sales tax purposes under certain sales tax regimes. Receipts, in the sense of a document acknowledging that money has been received in return for goods or services, is relevant for purposes of tax authorities in that some countries require receipts of some form to be given for all transactions.



# Why does it work?

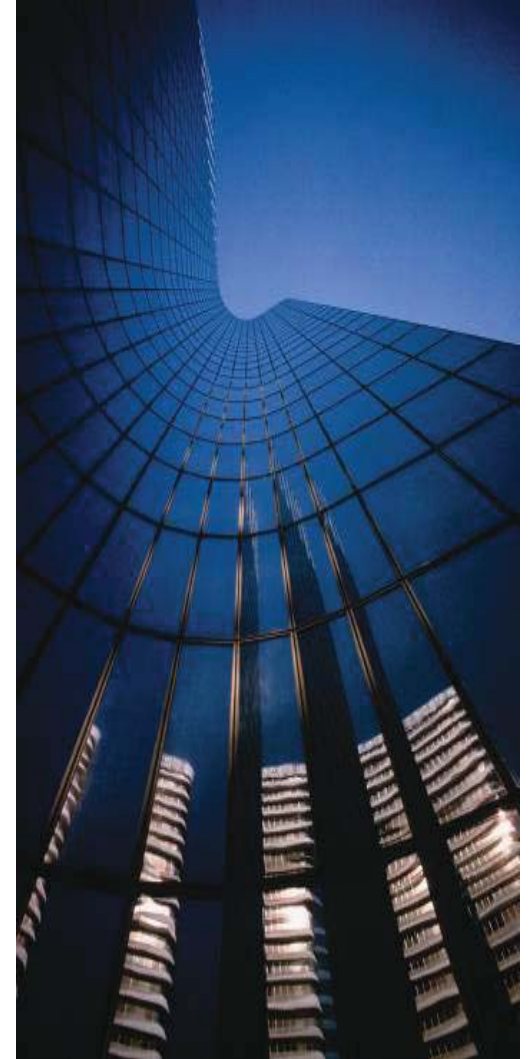
The manufacturer or producer of the goods is skilled at making and producing. Over the years it has been recognised that the collection of monies from sales also requires some skill and expertise. The producer or manufacturer is then able to use his labour force solely in the production and manufacture of the goods and be able to manage his cash better.



# Status of Taxpayer

Producers may carry on their undertaking as self employed persons, partners in a joint venture, registered businesses or companies. Whatever the circumstances, the producers will have revenues and expenditures, and tax exposure. Ordinarily income tax rates for individuals are higher than rates for companies; moreover a company offers greater flexibility in terms of being able to utilize various tax rates e.g. individual, company and withholding tax rates, as well as a means of separating and segregating personal assets from business assets in the event of litigation.

Whichever type of taxpayer shows up the following is applicable:



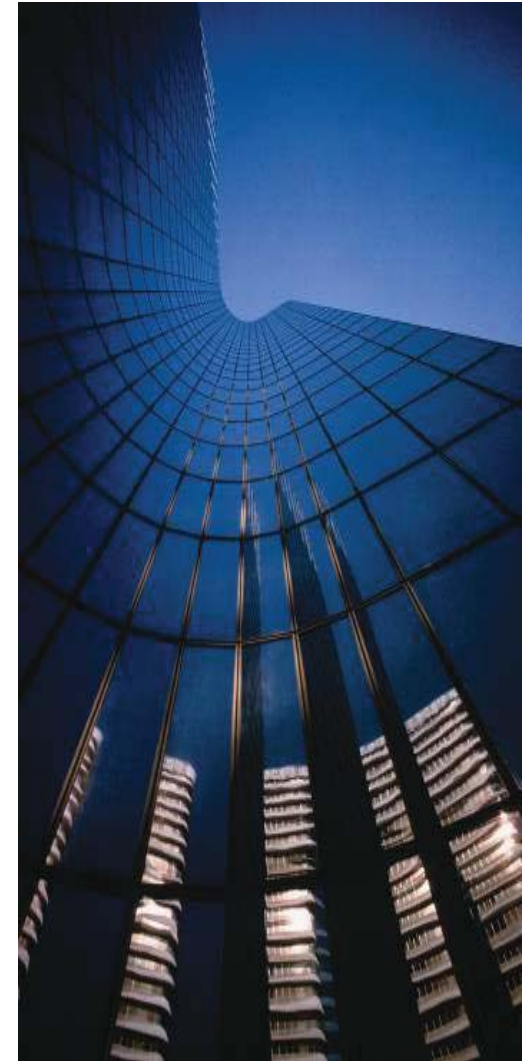
# Income Tax Implications

We consider the example where a producer sells \$20,000 of produce and receives \$14,000 cash with \$6,000 owing

(a) From an accounting perspective we have

<u>Balance Sheet</u>		<u>Profit &amp; Loss</u>	
DR	CR	DR	CR
Cash	-		Revenue –
14,000			20,000
Accounts -	6,000		
Receivable			

If there are no other transactions his tax payable will be based on revenue of \$20,000 although he has only received \$14,000. Most likely he will be unable to meet his tax liability because he did not receive the \$20,000.



# Income Tax Implications

(b) Consider now that the \$6,000 receivables are sold for \$5,000

<u>Balance Sheet</u>		<u>Profit &amp; Loss</u>	
DR	CR	DR	CR
Cash	-		Revenue –
14,000			20,000
5,000			
Accounts - 6,000	5,000	Write Off	1,000
Receivable	1,000		



# Income Tax Implications

(c) Is the write-off receivable of \$1,000 deductible for tax purposes?

Most tax jurisdictions do not allow deductions for general provisions. Write-offs of specific accounts are allowable. Under these circumstances a case can be made for this treatment to be deemed a write-off of specific accounts and therefore tax deductible. However, taxpayers should seek confirmation from Revenue Authorities.

## **NB**

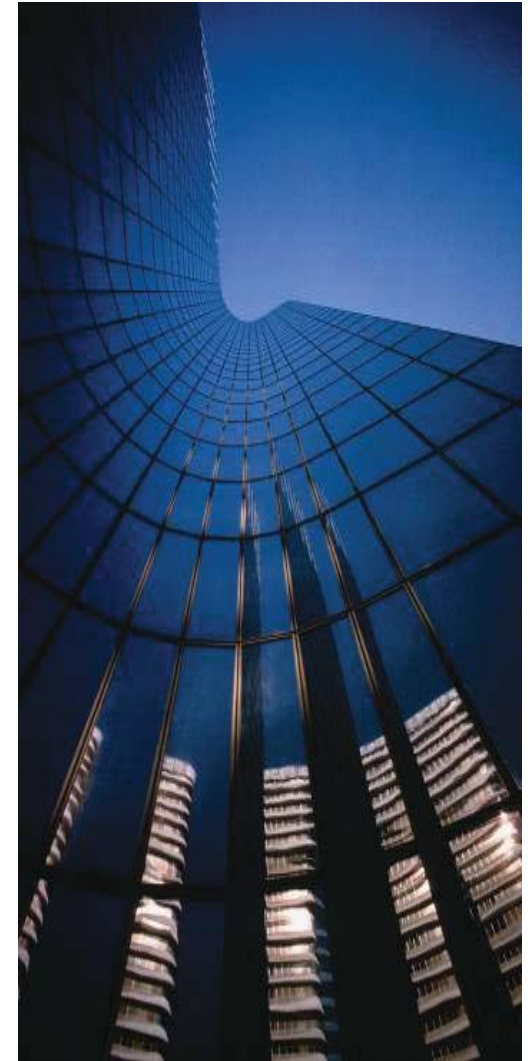
The tax payer would have recorded a sale of \$19,000 and would have received cash of \$19,000. There is therefore no excuse for settling his obligation with Revenue Authorities.



# Income Tax Implications

(d) Is the sale of the receivable taxable to the vendor / to the purchaser?

	<b>Vendor</b>	<b>Purchaser</b>
Corporate Tax	NO	NO
Business Tax (Belize)	NO	NO
Annual Tax (Grenada)	YES	NO
Withholding Tax (Sale to non-resident)	YES	Required to withhold



# Income Tax Implications

Regarding Corporate Tax the vendor is selling an asset and the purchaser is purchasing an asset. There should be no income tax on this transaction.

Business Tax (Belize) is levied on all receipts of every individual, self employed person, professional, firm, partnership or company. Receipts mean revenues, whether in cash or kind received or accrued, of a person or entity carrying on a trade or business or practicing a profession or vocation in Belize, without any deduction. The rate is usually 1.75% but varies between 0.75% and 25% depending on the type of receipt.

Since the vendor should have paid Business Tax on his revenue the sale of the receivable should not attract further Business Tax.

Note, any revenue derived by the purchaser on the receivables will be subject to Business Tax.

Annual Stamp Tax (Grenada) is similar to Business Tax in Belize but at a rate of 0.5%. Treatment should be the same also.



# Income Tax Implications

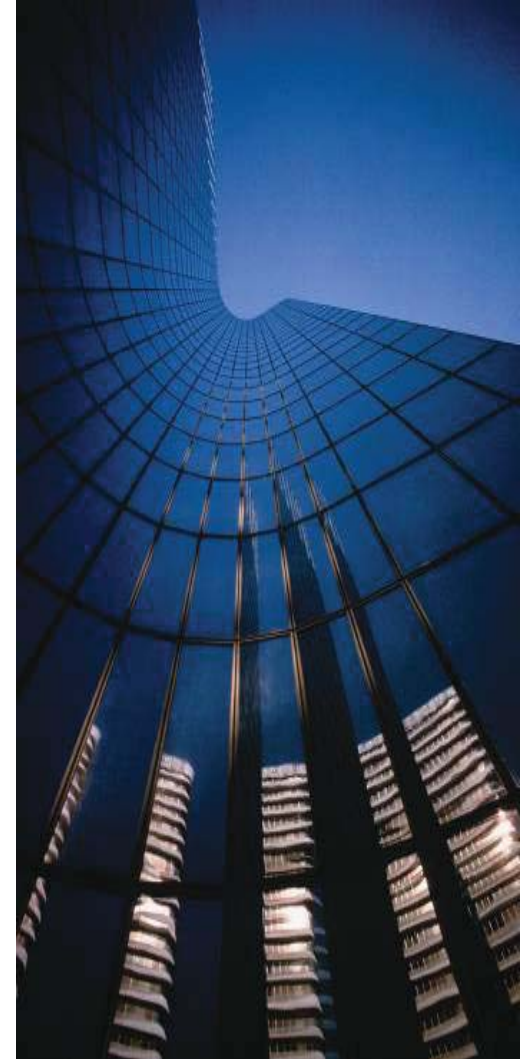
## (e) Sale to non-residents – withholding tax

In the circumstance where the transaction involves non-residents care must be taken. Ordinarily payments made to non-residents attract withholding tax on the basis that the recipient of the funds has derived income from the paying jurisdiction. Revenue authorities are constantly on the lookout for these transactions and utilize various methods to capture tax revenues. Such methods include tax audits and exchange control requirements. However the following should be noted



# Income Tax Implications

- the sale of the receivable represents the sale of an asset and is not a transaction of an income nature
- vendors should avoid the notion that they are earning income from selling the receivable
- all countries here are Member States of CARICOM and signatories to the CARICOM Treaty. The treaty is based on the source principle, that is, income is taxed at source only, with no relief from double taxation; rather the exemption method is used. The emphasis is on income and parties to such transactions should be prepared to resist any attempts at withholding tax on the basis that no income is derived from the transaction.



# VAT / GCT / ABST Implications

## Time of supply

This tax is applicable to a supply of goods or services and takes place at the earliest of

- an invoice for the supply is issued,
- payment is received for the supply, or
- the goods are made available to the recipient or the services are performed, as the case may be

Thus a VAT liability may be triggered notwithstanding no money has been received

## Cash flow implications

E.g. where VAT is 15% and \$10,000 of produce is sold. There is a VAT payable of \$1,500. The producer anticipates collecting \$11,500



# VAT / GCT / ABST Implications

<u>Balance Sheet</u>		<u>Profit &amp; Loss</u>	
DR	CR	DR	CR
Accounts Receivable - 11,500	VAT Payable 1,500		Revenue 10,000

If received cash of \$9,200, \$8,000 is the producer's amount and \$1,200 is the VAT.

<u>Balance Sheet</u>		
DR	CR	
Accounts Receivable -	11,500	9,200
Cash -	9,200	



# VAT / GCT / ABST Implications

There is a receivable of \$2,300 remaining including \$300 VAT. Please note that the producers would have paid in the VAT of \$1,500 and will most likely be experiencing severe cash flow problems.

## (a) *Value of receivable for sale*

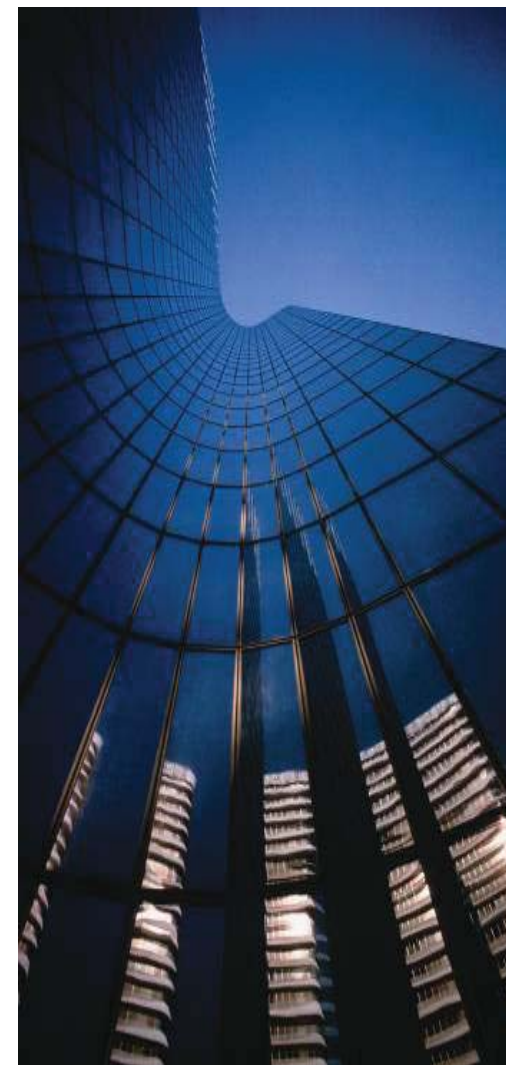
Although the receivable to the producer is \$2,000, the receivable to be factored is \$2,300, the VAT inclusive amount.

If this is sold for \$1,800 the VAT portion is  $15/115$  OR  $3/23$  of the sale, i.e. \$235 of the remaining VAT of \$300 which was to be collected.

The amount not collected \$500 consists of:

VAT portion $3/23$ of \$500	-	\$ 65
Producers Receivable	-	\$ 435

The \$65 not collected is the VAT on the bad debt of \$435 and is deductible from the payment of output tax in the taxable period that the bad debt is written off or subsequent period.



# VAT / GCT / ABST Implications

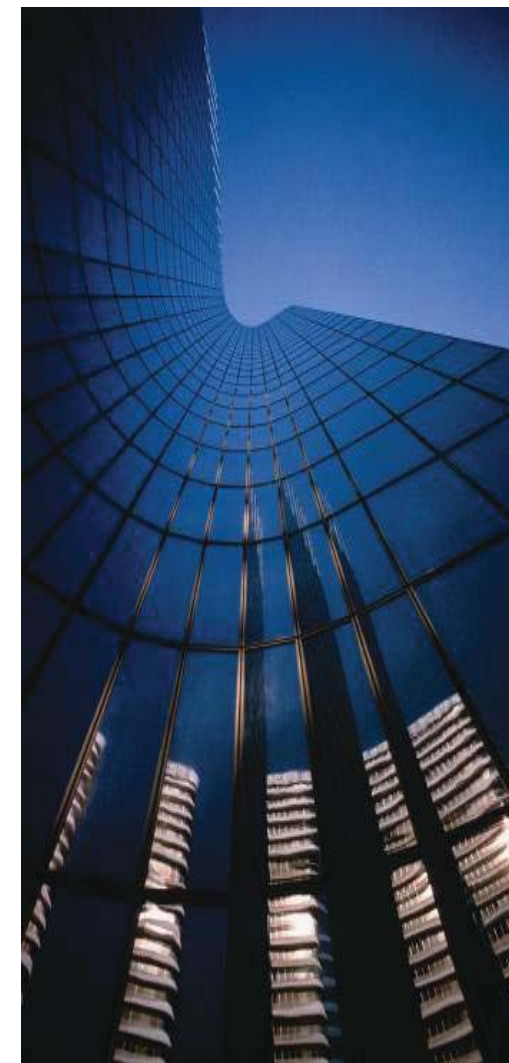
(b) Sale of receivables is a financial service

The sale of the receivable of \$2,300 for \$1,800 is a financial service. Under most VAT/ GCT/ ABST legislation this is an exempt supply and should not attract VAT. There should be no VAT on factoring receivables



# SUMMARY TABLE

TAX IMPLICATIONS OF FACTORING RECEIVABLES								
Factoring Receivables - where a company may sell its debt claims to a regional or non-regional person								
Country	Goods/ Service	Corporate Taxation		VAT/GCT/ABST		Transactions with Non-Residents		International Taxation
		Trading Income	Rate %	Taxable	Rate %	Withholding Tax	Rate %	Caricom Treaty
Barbados	Financial Instrument	No**	NA	Exempt	NA	No	NA	Yes
T&T	Financial Instrument	No**	NA	Exempt	N/A	No	N/A	Yes
Guyana	Financial Service	No**	NA	Exempt	N/A	No*****	N/A	Yes
Jamaica	Service*	No**	NA	Exempt***	NA	No	NA	Yes
St Vincent & Grenadines	Financial Service	No**	NA	Exempt	N/A	No*****	N/A	Yes
Antigua & Barbuda	Financial Service	No**	NA	Exempt****	NA	No	N/A	Yes
Belize	NA	NA	NA	N/A	N/A	NA	NA	Yes
Dominica	Financial Service	No	N/A	Exempt	N/A	No*****	N/A	Yes
Grenada	N/A	No**	NA	N/A	N/A	No*****	N/A	Yes
St Lucia	N/A	No**	NA	N/A	N/A	No	N/A	Yes
St Kitts Nevis	N/A	No**	NA	N/A	N/A	No*****	N/A	Yes
* Our view is that debts are intangibles and therefore choses in action. For GCT/VAT purposes it is not a good.								
** Our view is based on our understanding that the company generates the accounts receivables in the course of carrying on an agricultural business.								
*** We have an opinion from the TAAD stating that the sale of accounts receivables is a transfer of a debt security and therefore is an exempt service.								
**** In Antigua financial services includes transactions concerning money, deposits and current accounts, payments, transfers, debts, cheques or negotiable instruments, other than debt collection and factoring. We are of the view that this is an exempt supply.								
***** These jurisdictions seek to apply withholding taxes to payments of any kind. However the transaction should not attract withholding tax.								





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