

**TAX BRIEFING:** Monthly Insight

# Bad Debt Provision, Business Profits and Income Tax Rates, Filing of Legal Entities' Income Tax Return

*The Ministry of Finance issued Ministerial Circular POL. 1056/2015 pertaining to the formation of bad debt provisions. The concept of profits deriving from business activities, the liquidation procedure and the applicable tax rate on legal entities were clarified by way of Ministerial Circular POL. 1059/2015. Finally, guidance on the filing of annual income tax returns by legal entities was provided by Ministerial Circular POL. 1060/2015.*

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### **A. Formation of Bad Debt Provision for the 2014 Tax Year and onwards**

#### **I. Overview**

According to Article 26 of the Income Tax Code (Law 4172/2013), individuals engaging in business activities, legal persons and legal entities may form bad debt provisions for any claim which has not been paid or set off, for example claims arising from retail sales or the provision of services to individuals, claims against customers in Greece and abroad and so on, on condition that they have taken **appropriate actions**

for ensuring the right to collect such claims.

The question whether an action is deemed appropriate to ensure the right to collect the claims is assessed on a case by case basis at the discretion of the tax authorities taking into account, among other factors, the amount of the claim and the solvency of the debtor.

The filing of a legal action, submission of an application for interim or compulsory measures, sealing of a cheque by the issuing bank and submission of all necessary documentation for the issuance of a payment order, are some of the actions that may be deemed appropriate to ensure the right to collect claims.

The delegation of the collection of a claim to a third party (e.g. to a company providing collection services) and the interruption of the provision of mobile phone services do not ensure the right to collect the relevant claims.

Where businesses have not taken appropriate actions, the relevant bad debt provisions are not recognized and respective tax adjustments are made. The amount of bad debt provisions which may be formed for tax purposes depends on the amount of the respective due and payable claims and the period of time during which such claims have remained unpaid. In particular, for due and payable claims:

- a.** not exceeding €1,000 each and remaining unpaid for over 12 months, the taxpayer may form a bad debt provision equal to 100% of the claim;

- b. exceeding €1,000 each and remaining unpaid for over 12 months, the taxpayer may form a bad debt provision equal to 50% of the claim;
- c. exceeding €1,000 each and remaining unpaid for over 18 months, the taxpayer may form a bad debt provision equal to 75% of the claim; and
- d. exceeding €1,000 each and remaining unpaid for over 24 months, the taxpayer may form a bad debt provision equal to 100% of the claim.

Due and payable claims are calculated on the basis of the unpaid amount of each transaction with a customer or debtor and not on the aggregate outstanding balance for a customer or debtor. Due and payable claims are claims for which the payment date has passed and a claim is considered due and payable:

- a. after the lapse of the agreed credit period provided under an agreement or other arrangement with the customer;
- b. in the case of absence of an agreement or other arrangement, from the date of issuance of the invoice (or other record); or
- c. in the case of promissory notes, from their expiration date and in the case of cheques, from the date of issuance of the cheque.

The value of the claim does not include VAT, however discounts and returns are taken into account.

## 2. Bad Debts Formed Before 1st January 2014

The above applies to bad debt provisions formed in the financial years starting from 1st January 2014 onwards. Bad debts existing before 1st January 2014 which have not been written off by 31st December 2013 are also taken into account for the formation of bad debt provisions.

Any outstanding balance of Account no. 44.II (Bad Debt Provisions) as at 31st December 2014, reflecting bad debt provisions formed in the 2010, 2011, 2012 and 2013 tax years, must be carried forward to the gross income of the 2015 tax year and reduced by any bad debts written off in 2014 which refer to the fiscal years prior to 31st December 2013. Any bad debt provisions exceeding 1% or 0,5%, formed in 2013 or before in accordance with the previous Income Tax Code (Law 2238/1994), and not deducted at the time of their formation, will not be taxed again.

## 3. Written Off Claims

If a claim becomes payable or is written off, recovery of the bad debt provision to which it relates is effected directly by transferring the provision to the business profits. A claim may be written-off for tax purposes only if:

- a. an amount corresponding to the debt had been previously registered as income;
- b. it is previously deleted from the taxpayer's books; and
- c. all appropriate actions for the collection of the claim have been taken in accordance with the law.

Such appropriate actions must prove that the claim cannot be collected, in other words, that the debtor is insolvent, which may be evidenced by:

- a. a final Court decision by virtue of which the debtor is obliged to pay;
- b. a certificate from the Land Registry certifying the debtor's property assets and any encumbrances thereon, or the absence of property assets;
- c. in the case of failure to achieve a bankruptcy arrangement or in the case of compulsory execution which results in an auction of the debtor's property, a copy of the table for the distribution of the auction proceeds proving that the claim in question may not be satisfied;
- d. the agreement for the restructuring of the debtor which is accepted by the Bankruptcy Court and reduces the creditors' claims;
- e. where the debtor is declared bankrupt, its financial statements showing that the property assets are not sufficient for the satisfaction of creditors; or
- f. the cessation of business activities of a corporation.

Certifications or letters drafted by attorneys do not constitute proof of the insolvency of the debtor. The same applies for the issuance of a bounced cheque or a conviction for issuing a bounced cheque.

## 4. Sale of Movable Assets by Way of Retention of Ownership Clause

With regard to the sale of movable assets by way of a retention of ownership clause, deletion of the claim may not be effected before completion of the procedure for the return of the asset or completion of judicial enforcement.

## 5. Cases Where Bad Debt Provision is Not Permitted

Formation of a bad debt provision is not permitted where the claims are:

- a. against shareholders or partners of the business or subsidiaries with a participation of at least 10% (unless legal proceedings are pending, the debtor has applied for bankruptcy or restructuring, or compulsory enforcement against the debtor is pending);
- b. covered by security (contractual or in rem); or
- c. against or guaranteed by the State or the regional and local authorities (OTA), although this does not apply to claims against or guaranteed by public law legal persons (NPDD), public businesses or organizations, social security organizations and so on.

## 6. Banks

Banks (including cooperative banks) may deduct bad debt provisions for 1% of the annual average of loans granted according to their monthly accounting statements. Examples of such credit

are claims for capital and registered interest (with the exception of irrecoverable or bad debt interest or non-productive claims which banks are entitled not to register in their books), claims arising from corporate bond loans covered in whole or part, or the acquisition of shares upon establishment of a company or share capital increase (as long as the share or bond titles form part of the bank's portfolio). Loans granted to the State and public law legal persons, loans guaranteed by the State, as well as deposits in other banks, are not taken into consideration for the deduction. For the purposes of determination of their annual results, banks (including cooperative banks) may also make special bad debt provisions for claims against their clients for which interest is no longer computed.

## 7. Financial Leasing Companies

Financial Leasing companies may deduct bad debt provisions for up to 2% of the total amount of rentals arising from leasing agreements concluded within the tax year. The total amount of bad debt provisions appearing in the businesses' accounts, including bad debt provisions for previous tax years, may not exceed 25% of the paid up share capital.

## 8. Factoring Companies

Factoring companies may deduct up to 1.5% of the annual average of any discounted claims from export activity without a right of recourse and up to 1% on the annual average of any discounted claims with a right of recourse.

**Ministerial Circular No. 1059/18.03.2015 provides Clarification on the Profits from Business Activities, the Liquidation Procedure and the Tax Rate Applicable to Legal Persons and Entities (Articles 47, 57 and 58 of the Income Tax Code respectively). In particular:**

### I. Capitalized or Distributed Profits

The capitalized or distributed profits of legal persons and entities, which have not been subject to income tax, are included in business profits. Such profits are notably reserves and profits generated in the previous fiscal year.

a. reserves include:

- i. any distributed or capitalized reserves (specific exceptions and existing special provisions regarding the tax treatment of distribution or capitalization of reserves remain in force); or
- ii. any distributed or capitalized reserves which are formed according to the provisions of the Income Tax Code and are exempted from income tax.

Ministerial Circular No. 1039/26.01.2015 is applicable to reserves arising from dividends paid to legal persons by Greek or non-

Greek affiliated companies and exempted from tax.

The above distributed or capitalized reserves are tax profits in the tax year during which distribution or capitalization was performed and are added to the results (profit or loss) from business activities and taxed according to the provisions of the Income Tax Code. Reserves formed from the added value of expropriated real estate property are tax exempted.

b. profits generated in the previous tax year include profits distributed by:

- i. Greek tax resident legal persons or entities which are exempted from income tax by virtue of the Income Tax Code or special laws, unless such persons are subject to tax by virtue of other special provisions; or
- ii. legal persons or entities and resulting from the IFRS, to the extent that they exceed tax profits, and in the case of tax losses;

Profits generated during the previous tax year which were not subject to income tax (e.g. profits of legal persons or entities exempted from income tax, interest from bonds issued by the National Financial Stability Fund (ETHS), capital gains from the transfer of Greek corporate bonds by virtue of Law 3156/2003, exempted income of corporations and General Government bodies), to the extent that the legal person or entity does not distribute such profits in the tax year in which they were created, are registered in a special reserve account. The above is applicable to legal persons and entities practicing double entry bookkeeping.

## 2. Clarifications Regarding Income from Business Activities

- a. Income from subscriptions, subsidies and compensations relating to the business activity of the legal persons or entities is deemed income from business activities. Income from subsidies received by virtue of laws providing investment incentives (e.g. Law 1892/1990 and Law 3299/2004) is subject to the special provisions provided in these laws. Subsidies granted in order to cover specific expenses do not increase the income from business activities and reduce the cost of the expense subsidized (e.g. subsidies provided by the Manpower Employment Organization (OAED)).
- b. Subscriptions, subsidies and so on provided to non-profit legal persons are tax exempted, unless certain conditions apply.
- c. Non-profit civil law companies are taxed only for income arising from business activities (e.g. income from public entertainment, issuance of newspaper, movies, rentals and interest from deposits). Any subscriptions and member registrations, as well as any subsidies or donations granted to them, are not considered gross income and therefore are not taxed. Subsidies granted to them for the performance of their activities reduce the cost of such activities. Added value relating to expropriated

real estate property is exempted from income tax.

- d. Income from the valuation of the real estate assets of legal persons and entities at fair value (according to Law 4308/2014) does not constitute income from business activities.

The above is applicable to legal persons which are non-Greek tax residents but have a permanent establishment in Greece and to foreign legal persons that are characterized as Greek tax residents. On receipt of income from dividends, interest and royalties in Greece (with the exception of intragroup payments of dividends, interest and royalties), foreign legal persons which are non-Greek tax residents and do not have a permanent establishment in Greece, are subject to withholding tax on such payments. Withholding tax exhausts their tax liability in Greece. The clarifications at 1 and 2 above are applicable to income acquired in the tax years starting from 1st January 2014 onwards. Any distribution or capitalization of reserves referring to fiscal years before 1st January 2014 which takes place in this fiscal year is subject to the provisions of the previous Income Tax Code (Law 2238/1994). Liquidation proceeds include any distribution of profit in the fiscal year during which the liquidation of the legal person or entity was completed, to the extent that such proceeds exceed the paid up share capital. Paid up share capital includes reserves formed by the issuance of par shares, corporate parts and so on. Liquidation proceeds exceeding the paid up share capital are treated as dividends and are subject to withholding tax. In the case of transfer of assets (e.g. reserves and titles) to the legal persons or members of the legal entities under liquidation, the commercial value of such assets or the value determined by any other appropriate means (e.g. an auditor's report), is taken into account in order to calculate the amount of the liquidation proceeds. Any difference between such value and the paid up share capital is not subject to withholding tax but is included in the annual tax return of the beneficiary and is taxed as dividend. Where reserves from profits which were not subject to income tax exist, such reserves will be taxed upon completion of the liquidation.

The above is applicable to liquidation proceeds acquired in the tax years starting from 1st January 2014 onwards. If before the issuance of the present Ministerial Circular, liquidation proceeds exceeding the paid up share capital were paid without withholding tax, the relevant amount will be included in the annual tax return of the beneficiary.

**Ministerial Circular No. 1060/19.03.2015 provides Clarification on the Filing of the Income Tax Return by Legal Persons and Entities, Payment of the Respective Tax and Application of the Credit Method.**

**1. Tax Returns of Legal Persons and Entities**

- a. Legal persons and entities subject to income tax are obliged

to file returns electronically, even if the income acquired is exempted from tax.

Foreign shipping companies' offices or branches located in Greece under Article 25 of Law 27/1975 are exempted from the obligation to file a return for any income exempted from tax in accordance with Law 27/1975. The above legal persons and entities are obliged to file an income tax return, even if they do not acquire any income.

- b. Also subject to the above rules are legal persons and entities under liquidation, or for which no provision for a liquidation procedure exists, for example in the case of an offshore company with a registered seat abroad and a permanent establishment in Greece, acting exclusively through property located in Greece which decides to sell its real property in Greece.

Partnerships being dissolved without entering into liquidation are considered to have ceased activity on the date of their dissolution, for example, upon registration with the Commercial Registry (GEMI) of the decision of their members or partners for dissolution, or upon registration with GEMI of their Articles of Association providing for dissolution, or on a date determined by a Court decision as the date of dissolution. In the case of legal persons or entities registered with Registries other than GEMI (e.g. shipping companies and law firm partnerships), the cessation of activity is considered to take place on the date of their dissolution or on the date of the balance sheet for the end of their liquidation (where the dissolution follows the liquidation procedure), as the case may be. Where the deadline for filing of the tax return for cessation of activity or the end of the liquidation expires before the deadline for filing the return for the last tax year before cessation of activity or initiation of liquidation, the latter must be filed within the deadline provided for the filing of tax return for cessation of activity or end of the liquidation respectively.

- c. Income tax payable is calculated on the basis of the filed income tax return or following an administrative determination (Article 32 of the Income Tax Code) with the deduction of any tax withheld, paid in advance and paid abroad. Taxes already paid are deducted in the order mentioned above (first withholding tax, then tax paid in advance and finally tax paid abroad).
- d. With regard to tax paid abroad in a foreign currency, the exchange rate taken into account will be the rate that applied on the date of payment of the tax abroad. If after deduction of the tax paid abroad there is a credit balance, the respective amount is not returned.
- e. Any corporate or withholding tax on dividends paid to a

Greek parent company by a Greek or other EU member state subsidiary (on condition that the provisions of Article 48 of the Greek Income Tax Code on intragroup dividends do not apply) is deducted from the income tax which must be paid by the Greek parent company. Corporate tax on dividends is the tax on the taxable profits of the distributing legal person or entity which corresponds to the dividends and is reduced by any tax exemptions or deductions, other than deductions for any tax withheld, paid in advance and paid abroad.

The above is also applicable to the distribution of dividends of previous fiscal years.

## 2. Payment of Income Tax in Advance

a. Greek or non-Greek corporations, cooperatives and cooperative unions, joint ventures and so on, are obliged to pay in advance an amount equal to 80% of the tax imposed on their income for the current tax year. Greek banks in the form of societies anonymes and branches of non-Greek banks operating in Greece are obliged to pay in advance an amount equal to 100% of the tax imposed on their income for the current tax year. The percentage of advance tax payment is decreased to 55% in the case of:

- i. partnerships established in Greece or abroad having a permanent establishment or a branch in Greece;
- ii. non-profit legal persons established in Greece or abroad (including any kind of associations (somateia) and foundations); and
- iii. civil law societies (koinonies), civil law companies, holding companies (symmetochikes) or silent partnerships (afaneis etaireies) engaging in business activity and joint ventures of civil law companies.

A 50% discount on the amount of tax payable in advance is provided to newly established legal persons and entities (other than those arising from a transformation or merger) for the first three fiscal years of their operation. The tax which is payable in advance is reduced by any withholding tax deriving from a Greek source in accordance with Greek legislation. Tax on dividends, interest and so on withheld abroad is not deducted.

- b. If the taxable income is reduced by more than 25%, the tax paid in advance is reduced accordingly. In this respect, a relevant application must be filed by the legal person or entity within nine months from the beginning of the new tax year.
- c. No tax payment in advance is assessed in the following cases:
  - i. corporate restructurings (e.g. contribution of business, merger, fragmentation according to Articles 52 and 54 of the Income Tax Code and the provisions of Law Decree 1297/1972 and Law 2166/1993);
  - ii. mergers or fragmentations of Greek societies anonymes according to Articles 68, 80 and 81 of Law 2190/1920;
  - iii. mergers of limited liability companies according to Article 54 of Law 3190/1955;
  - iv. mergers of agricultural cooperative organizations, as well as transformations of agricultural cooperative organizations into societies anonymes or limited liability companies, according to Article 21 of Law 2810/2000;
  - v. transformations of legal persons according to special legal provisions; and
  - vi. distributions or capitalization of profits of societies anonymes, which are exempted from income according to special legal provisions (e.g. the Bank of Greece and the Hellenic Republic Asset Development Fund (TAIPED)).

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