

SC REVENUE ADVISORY BULLETIN #00-07

SUBJECT: Bad Debts
(Sales Tax)

EFFECTIVE DATE: January 1, 2000

SUPERSEDES: All previous advisory opinions and any oral directives in conflict herewith.

REFERENCES: S. C. Code Ann. Section 12-36-90 (Supp. 1999)
S. C. Code Ann. Section 12-36-2540 (Supp. 1999)
S. C. Code Ann. Section 12-54-85 (Supp. 1999)

AUTHORITY: S. C. Code Ann. Section 12-4-320 (Supp. 1999)
S. C. Code Ann. Section 1-23-10(4) (Supp. 1999)
SC Revenue Procedure #99-4

SCOPE: The purpose of a Revenue Advisory Bulletin is to provide guidance to the public and to Department personnel. It is a written statement issued to apply principles of tax law to a specific set of facts or a general category of taxpayers. **A Revenue Advisory Bulletin does not have the force or effect of law, and is not binding on the public.** It is, however, the Department's position and is binding on agency personnel until superseded or modified by a change in statute, regulation, court decision, or advisory opinion.

LAW:

Effective for debts incurred after 1999, Code Section 12-36-90(2) has been amended to exclude from "gross proceeds of sales:"

(h) the sales price, not including sales tax, of property on sales which are actually charged off as bad debts or uncollectible accounts for state income tax purposes. A taxpayer who pays the tax on the unpaid balance of an account which has been found to be worthless and is actually charged off for state income tax purposes may take credit for the tax paid on a return filed pursuant to this chapter, except that if an amount charged off is later paid in whole or part to the taxpayer, the amount paid must be included in the first return filed after the collection and the tax paid.

QUESTIONS AND ANSWERS:

1. Does the exclusion for bad debts found in Code Section 12-36-90(2)(h) apply to sales which took place prior to January 1, 2000?

No. The exclusion for bad debts found in Code Section 12-36-90(2)(h) only applies to “debts incurred after 1999.” The unpaid balance due the retailer constitutes a debt to the retailer. This debt is incurred at the time of the sale; therefore, the sale must take place after the calendar year 1999 in order for the exclusion to be applicable. The exclusion does not apply to sales which occurred prior to January 1, 2000 even if it is determined to be a bad debt or uncollectible account on or after January 1, 2000.

2. What is a “bad debt” or “uncollectible account?”

A “bad debt” or “uncollectible account” is any debt or account receivable arising from the sale of tangible personal property by the retailer on which sales tax has been reported and paid in a prior reporting period which later becomes worthless or uncollectible for state income tax purposes. Since the state income tax law is based on the federal income tax law, the debt or uncollectible account must be of a type that is properly deductible under Internal Revenue Code Section 166.

3. How does a retailer report a bad debt or uncollectible account?

A retailer reports a bad debt or an uncollectible account by taking a deduction on the sales tax return for the sales price of the property the sale of which is actually charged off as a bad debt or uncollectible account for state income tax purposes. This deduction should be listed on Line #4 of the “Worksheet” on the back of the sales tax return.

The deduction is limited to the sales price of the tangible personal property that is worthless or uncollectible. The following are not deductible as a bad debt or uncollectible account:

interest or finance charges,

sales tax on the sales price,

uncollectible amounts on property that remains in the possession of the retailer until the full sales price is paid,

expenses incurred in attempting to collect or collecting any part of the debt,

any portion of the debt that is actually collected,

any debt sold to a third party for collection,

any uncollectible amount on property repossessed by or on behalf of the retailer; or

any portion of the debt upon which tax was not paid.

Note: The deductions for a bad debt should not create a “negative” sales tax return. If your deductions reduce your tax liability for a particular month below zero, show the tax liability as zero for that return and take any excess bad debt deductions on the next month’s sales tax return.

4. Is a taxpayer who files his income tax return on the cash basis but who accrues and remits the sales tax in accordance with Code Section 12-36-910 (on the accrual basis) entitled to a bad debt deduction since the sales price of property will not be charged off as a bad debt or uncollectible account for state income tax purposes?

Yes. The retailer may take a deduction for a bad debt provided he otherwise meets the requirements for a deduction for a bad debt under the state income tax code.

5. Are there any time limitations as to when the deduction may be taken on the retailer’s sales tax return?

The debt or account receivable arising from the sale of tangible personal property by the retailer on which sales tax has been reported and paid in a prior reporting period must become worthless or uncollectible for state income tax purposes before the deduction can be taken on the retailer’s sales tax return. Once a debt is determined to be worthless or uncollectible for income tax purposes, it should be deducted on the sales tax return for the month it became worthless or uncollectible.

If the return for the month in which the debt became worthless or uncollectible has already been filed with the department, then the retailer, in order to take the deduction for the bad debt, should file a claim for refund (with supporting documentation) for the month in which the debt became worthless or uncollectible. A claim for refund must be filed within the statute of limitations set forth in Code Section 12-54-85.

6. If a retailer files sales tax returns with the department, but is not required to file state income tax returns, is the retailer allowed to take a deduction for a bad debt or uncollectible account?

Yes. Since the state income tax law is based on the federal income tax law, a retailer who is not required to file a state income tax return takes a deduction for a bad debt or an uncollectible account when the sale is actually charged off as a bad debt or uncollectible account for federal income tax purposes.

If the retailer is not required to file a state income tax return and is also not required to file a federal income tax return, the retailer may take a deduction for a bad debt provided he otherwise meets the requirements for a deduction for a bad debt for South Carolina income tax purposes.

7. What documentation and records must a retailer maintain to substantiate a deduction for a bad debt or uncollectible account?

Code Section 12-36-2540 states:

(A) Every person engaging in any business, for which a privilege or excise tax is imposed by this chapter, shall keep and preserve suitable records of the business, as considered necessary by the commission, to determine the amount of tax due under this chapter. The taxpayer shall keep and preserve records, such as purchase invoices, for three years. Invoices must bear the name and address of the vendor.

(B) Any person selling both at wholesale and at retail shall keep books which separately show the gross proceeds of wholesale sales and the gross proceeds of retail sales. If the records are not separately kept, all sales must be considered retail sales.

(C) Every seller and every person storing, using, or otherwise consuming, in this State, tangible personal property purchased from a retailer shall keep records, receipts, invoices, and other pertinent papers in the form the commission requires.

Based on the above, the department recommends that a retailer taking a deduction for a bad debt or an uncollectible account maintain the following with respect to bad debts and uncollectible accounts:

The name of the purchaser;

The original date of the sale giving rise to the bad debt or uncollectible account;

The original taxable amount of the transaction;

The amount of tax remitted to the South Carolina Department of Revenue on the original transaction;

The amount of interest, finance or service charges incorporated into the debt;

All payments or other credits applied to the account of the purchaser;

The portion of the debt or account representing a charge that was not subject to sales tax on the original transaction;

The date the bad debt or uncollectible account was charged off for state income tax purposes or, if the retailer is not required to file state income tax returns, the date the bad debt or uncollectible account was charged off for federal income tax purposes;

The amount of the bad debt or uncollectible account charged off for state income tax purposes or, if the retailer is not required to file state income tax returns, the amount of the bad debt or uncollectible account charged off for federal income tax purposes;

The amount of the sales price deducted on the sales tax return as a bad debt or uncollectible account;

Evidence that the bad debt or uncollectible account was actually charged off for state income tax purposes or, if the retailer is not required to file state income tax returns, evidence that the bad debt or uncollectible account was charged off for federal income tax purposes. If the retailer is not required to file a state income tax return and is also not required to file a federal income tax return, the retailer must maintain evidence that the deduction for the bad debt otherwise meets the requirements for a deduction for a bad debt for South Carolina income tax purposes.

8. Are there any time limitations as to when the department may assess taxes due if the department determines that a retailer claimed a bad debt deduction on his sales tax return in error?

Yes. In accordance with Code Section 12-54-85(A), the department must assess any taxes due with respect to a bad debt deduction the department believes was taken in error within thirty-six months from the date the sales tax return on which the bad debt deduction was taken was filed or due to be filed, whichever is later.

Note: Taxes may be determined after the thirty-six month limitation if any of the circumstances listed in Code Section 12-54-85(C) apply.

9. If a retailer maintains a reserve for bad debts, may the retailer take a deduction on his sales tax return for contributions to the reserve account?

No. Only actual charges against the reserve account representing uncollectible debts and accounts may be deducted for sales tax bad debt purposes.

10. If a retailer receives a payment on a bad debt after the deduction is taken on a sales tax return, is the retailer required to remit tax on the payment?

Yes. If an amount charged off and deducted on a sales tax return is later paid in whole or part to the taxpayer, the amount paid must be included "gross proceeds" on the first return filed after the collection and the tax paid.

11. If a retailer receives a partial payment with respect to a sale, is the retailer allowed a bad debt deduction (if the tax was remitted on the sale) if the unpaid balance is later determined to be worthless or uncollectible?

Yes. A deduction is allowed for the portion of the sales price that is determined to be worthless or uncollectible provided the requirements for a deduction for a partial bad debt under the state income tax code have been met.

12. If a retailer determines that a sale is worthless or uncollectible, how is the deduction determined if a portion of the sale was not subject to the tax?

Only the portion subject to the tax and on which sales tax was remitted to the department may be taken as a bad debt deduction. For example, if an auto repair shop sells a part for \$100, installs the part for \$50, separately states the installation labor on the bill to the customer, and collects and remits to the department the \$5 sales tax, then the auto repair shop may only deduct \$100 as a bad debt deduction.

Note: See also Question 13.

13. If a retailer receives a partial payment with respect to a sale and subsequently determines that the unpaid balance is worthless or uncollectible, how is the deduction determined if a portion of the sale was not subject to the tax?

Only the portion subject to the tax and on which sales tax was remitted to the department may be taken as a bad debt deduction. Therefore, the retailer must allocate the payment to determine how much of the payment applies to amounts subject to the sales tax and how much applies to amounts not subject to the sales tax. For example, if an auto repair shop sells a part for \$100, installs the part for \$50, separately states the installation labor on the bill to the customer, collects and remits to the department the \$5 sales tax, and receives a partial payment of \$40 before the unpaid balance was determined to be worthless or uncollectible, then the auto repair shop should take a bad debt deduction of \$74.19 on Line #4 of the "Worksheet" on the back of the sales tax return. The bad debt deduction should be determined as follows:

Step 1 - (Taxable Portion of Total Bill divided by the Total Bill) times Payment Received
 $(\$100/\$155) \times \$40 = \25.81

Step 2 - Taxable Portion of Total Bill minus Answer from Step1 = Bad Debt Deduction
 $\$100 - \$25.81 = \$74.19$

14. Is a taxpayer who has elected to report installment sales on a cash basis in accordance with Code Section 12-36-2560 entitled to a bad debt deduction?

No. Since the taxpayer is only remitting the tax as each installment portion of the sales price is received, the bad debt deduction is not applicable.

SOUTH CAROLINA DEPARTMENT OF REVENUE

s/Elizabeth A. Carpentier
Elizabeth A. Carpentier, Director

November 6 _____, 2000
Columbia, South Carolina