
State of South Carolina
Department of Revenue
300A Outlet Point Blvd., P. O. Box 12265, Columbia, South Carolina 29211
Website Address: <http://www.sctax.org>

SC REVENUE RULING #13-4

SUBJECT: Bad Debt Deductions by Retailers
(Sales and Use Tax)

EFFECTIVE DATE: Applies to all periods open under the statute.

SUPERSEDES: S.C. Advisory Bulletin #02-1 and all previous advisory opinions and any oral directives in conflict herewith.

REFERENCES: S.C. Code Ann. Section 12-36-90 (2000, Supp. 2012)
S.C. Code Ann. Section 12-36-130 (2000, Supp. 2012)
S.C. Code Ann. Section 12-6-40 (Supp. 2012)
S.C. Code Ann. Section 12-6-50 (Supp. 2012)
S.C. Code Ann. Section 12-36-2560 (2000)
S.C. Code Ann. Section 12-36-2110(A) (2000, Supp. 2012)
S.C. Code Ann. Section 12-36-1110 (Supp. 2012)
S.C. Code Ann. Section 12-36-30 (2000)
S.C. Code Ann. Section 12-60-470 (Supp. 2012)
S.C. Code Ann. Section 12-36-2540 (2000)
S.C. Code Ann. Section 12-54-85 (2000, Supp. 2012)
S.C. Code Ann. Reg. 117-313.3 (Supp. 2012)

AUTHORITY: S.C. Code Ann. Section 12-4-320 (2000)
S.C. Code Ann. Section 1-23-10(4) (2005)
SC Revenue Procedure #09-3

SCOPE: The purpose of a Revenue Ruling is to provide guidance to the public and to Department personnel. It is an advisory opinion issued to apply principles of tax law to a set of facts or general category of taxpayers. It is the Department's position until superseded or modified by a change in statute, regulation, court decision, or another Departmental advisory opinion.

LAW:

For purposes of the sales tax, Code Section 12-36-90(2)(h) excludes from "gross proceeds of sales":

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 a deduction for the sales price charged off as a bad debt or uncollectible account on a return filed pursuant to this chapter, except that if an amount charged off is later paid in whole or in part to the taxpayer, the amount paid must be included in the first return filed after the collection and the tax paid. The deduction allowed by this provision must be taken within one year of the month the amount was determined to be a bad debt or uncollectible account.

For purposes of the use tax, Code Section 12-36-130 reads in part:

The term ‘sales price’ as defined in this section, also does not include the sales price, not including 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 a deduction for the sales price charged off as a bad debt or uncollectible account on a return filed pursuant to this chapter, except that if an amount charged off is later paid in whole or in part to the taxpayer, the amount paid must be included in the first return filed after the collection and the tax paid. The deduction allowed by this paragraph must be taken within one year of the month the amount was determined to be a bad debt or uncollectible account.

QUESTIONS AND ANSWERS:

1. 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 South Carolina income tax law adopts the federal income tax law for bad debt deductions,¹ the debt or uncollectible account must be of a type that is properly deductible under Internal Revenue Code Section 166.

2. 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, or the portion of the sales price, subject to sales or use tax which is actually charged off as a bad debt or uncollectible account for state income tax purposes.² This amount should be listed as a deduction on the worksheet on the back of the applicable sales tax return.

¹ Code Sections 12-6-40 and 12-6-50.

² In limited circumstances, the bad debt does not have to actually be deducted for South Carolina income tax purposes for the retailer to take a bad debt deduction for sales tax purposes. See questions #3, #5, and #6 for these situations.

The deduction is limited to the sales price of the tangible personal property on which sales tax was previously paid that is worthless or uncollectible. As a result, the following are not deductible as a bad debt or uncollectible account for sales and use tax purposes:

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, including repossession costs;³

any portion of the debt that is actually collected;

any debt sold to a third party for collection;

any amount recovered through repossession of the property as calculated in accordance with Questions #12 and #13: or

any portion of the debt upon which tax was not paid including the sales price amount which is in excess of the price subject to tax for items which have a maximum sales tax. See Questions #8 (Example 2) and #13.

Note: The deductions for a bad debt allowed pursuant to Section 12-36-90 or 12-36-130 must not create a “negative” sales tax return. Even though the statute allows the bad debt deduction to be taken within one year of the month the amount was determined to be a bad debt or uncollectible account, it is recommended that a deduction for a bad debt be taken on the first sales tax return after the amount was determined to be a bad debt or uncollectible account. If this reduces your sales or use tax liability for that 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.

3. Is a retailer who files his income tax return on the cash basis but who accrues and remits the sales and use taxes on an accrual basis in accordance with South Carolina sales and use tax law entitled to a bad debt deduction for sales and use tax purposes since the sales price of property will not be charged off as a bad debt or uncollectible account for South Carolina income tax purposes?

Yes. The retailer may take a deduction for a bad debt for sales and use tax purposes provided he otherwise meets the requirements for a deduction for a bad debt for South Carolina income taxes.

³ Although repossession costs are used to calculate the bad deduction for federal and South Carolina income tax purposes, these costs are not deductible for the sales and use tax bad debt deduction since these costs were not part of the sales price subject to sales tax.

4. Is a retailer 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 retailer is only remitting the sales tax as each installment portion of the sales price is received, the sales and use tax would not have been paid for any unpaid amounts, and therefore, the bad debt deduction is not applicable.

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

Yes. Since South Carolina has adopted the federal method of calculating bad debts for income tax purposes, a retailer who is not required to file a state income tax return (e.g., an out-of-state corporation that has nexus for sales and use tax purposes but does not have nexus for income tax purposes) may take a deduction for a bad debt or an uncollectible account when the sale is charged off as a bad debt or uncollectible account for federal income tax purposes.

If the retailer is not required to file a South Carolina 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 for sales and use tax purposes provided he otherwise meets the requirements for a deduction for a bad debt for South Carolina income tax purposes.

6. If a retailer maintains a reserve for bad debts for income tax purposes, can 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 as bad debts for sales and use tax purposes.

7. If a retailer receives a partial payment with respect to a sale, is the retailer allowed a bad debt deduction if the unpaid balance is later determined to be worthless or uncollectible?

Yes. If the entire sales or use tax was previously remitted on the total sale's price, 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 South Carolina income tax law have been met.

8. 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 sales or use tax?

Only the portion subject to the tax and on which sales or use tax was remitted to the department may be taken as a bad debt deduction.

Example 1: An auto repair shop sells a part for \$100, installs the part for \$50, and separately states the installation labor on the bill to the purchaser.⁴ The retailer remits to the department the \$6 sales tax on the \$100 charged for the parts. If the purchaser fails to make any payments and the amount is written off as a bad debt, then the auto repair shop may only deduct \$100 as a bad debt deduction. (See also, Question #9 relating to partial payments.)

Example 2: A retailer sells a car for \$16,000. The buyer pays \$2,000 down and finances the remaining \$14,000 purchase price with the retailer. The retailer remits the maximum sales tax of \$300 (for sales of motor vehicles) to the department.⁵ The buyer makes principal payments of \$3,000 and then defaults on the remaining amount of the loan. The retailer is only allowed a bad debt deduction of \$1,000⁶ (\$6,000⁷ sales price subject to the tax – \$3,000 principal payments - \$2,000 down payment) = \$1,000).

Note: See also, Questions #10 related to selling financing contracts to third parties and #12 and #13 related to the treatment of repossessed property.

9. 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 or use 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 or use tax and how much applies to amounts not subject to the sales or use tax.

Example: An auto repair shop sells a part for \$100, installs the part for \$50, and separately states the installation labor on the bill to the purchaser. The retailer remits the \$6 sales tax, and receives a partial payment of \$40 before the unpaid balance was determined to be worthless or uncollectible. The auto repair shop should take a bad debt deduction of \$73.33 on the deduction line 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 Not Including the Sales Tax) multiplied by Payment Received - $(\$100/150) \times \$40 = \$26.67$

Step 2 - Taxable Portion of Total Bill minus Answer from Step1 = Bad Debt Deduction
 $(\$100 - \$26.67 = \$73.33)$

⁴ S.C. Regulation 117-313.3 (Installation charges incident to the sale of tangible personal property are not subject to sales and use tax when the charges are separately stated from the sales price of the property on billing to customers and provided the seller's books and records of account show the reasonableness of such labor in relation to the sales price of the property.)

⁵ Code Section 12-36-2110(A)(2).

⁶ The bad debt is only allowed in this example if the retailer is handling the financing. If the retailer sold the account to another person, e.g., a finance company, the bad debt deduction is not allowed. See Question #10.

⁷ Since the retailer paid the maximum tax of \$300, the bad debt is limited to the gross proceeds associated with that maximum tax. The sales tax rate for maximum sales tax items, including motor vehicles, is 5% under Code Section 12-36-1110. As a result, the gross proceeds derived from that \$300 maximum tax is \$6,000 ($\$6,000 \times .05 = \300).

10. If a retailer sells tangible personal property to a purchaser under a financing arrangement, sells or assigns the purchaser's financing contract to another person (e.g. finance company) for an agreed upon consideration, and remits the sales tax on the full purchase price to the department, is the retailer or the person who purchased the financing contract entitled to a bad debt deduction if the purchaser fails to pay under the terms of the financing arrangement?

No. Neither the retailer nor the purchaser of the financing agreement is entitled to the bad debt deduction in the above situation. Only the taxpayer who paid the sales tax is entitled to the bad debt deduction for sales tax; therefore, the finance company cannot claim a sales tax refund for the bad debt if the customer fails to make the required payments. Since the taxpayer (the retailer) no longer owns the financing contract at the time of the bad debt, the retailer cannot claim a bad debt deduction.

In *South Carolina Department of Revenue v. Anonymous Company A et al.*, 678 S.E.2d 255 (2009), Company A (retailer) and Company B (finance company) were separate corporations with the same owners. The retailer sold used cars using installment contracts for financing and then sold the installment contracts to the finance company. The retailer paid the sales tax on the full purchase price of the car (as limited by the \$300 sales tax cap on motor vehicle sales). A number of purchasers failed to make all of their payments and the remaining principal was written off as a bad debt by the finance company for State income tax purposes. The companies sought a refund of sales taxes for installment contracts which became uncollectible after the retailer sold them to the finance company. The companies argued (1) that the two companies acted as a single unit and as a result were a single taxpayer and, therefore, were entitled to the bad debt deduction under Code Section 12-36-90(2)(h); (2) that the finance company was entitled to the bad debt deduction based on an assignment of a refund claim from the retailer; or (3) that the retailer was entitled to the bad debt deduction. The South Carolina Supreme Court rejected each of these arguments and found that neither the retailer nor the finance company was entitled to the bad debt deduction.

In reaching its conclusion, the Court found that under Code Section 12-36-90(2)(h) the taxpayer who paid the sales tax must be the same taxpayer that is entitled to the bad debt deduction for income tax purposes in order to claim the sales tax bad debt deduction. Code Section 12-36-30 defines person as "any individual, firm, partnership, limited liability company, association, corporation, receiver, trustee, any group or combination acting as a unit...." The companies maintained they were acting as a "unit" and were, therefore, a single taxpayer entitled to the deduction under Code Section 12-36-90(2)(h). The Court found that each corporation was a separate person for purposes of the sales tax and only the retailer could take the bad debt deduction if the retailer owned the installment agreements. The Court also found that the retailer could not assign a refund based on bad debts to the finance company.⁸ Finally, the Court found that since retailer sold the contract to the finance company, the retailer did not suffer a bad debt and was not entitled to a bad debt deduction.

⁸ Code Section 12-60-470(C)(2) provides that a taxpayer legally liable for the tax may assign a refund to another person "only after the taxpayer's claim is allowed, the amount of the refund is finally decided, and the department has approved the refund." The Court found that any assignment would have taken place before the bad debt occurred and, therefore, the finance company was not entitled to an assignment of a refund claim from the retailer.

11. 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 as a bad debt is later paid in whole or part to the taxpayer, under Code Sections 12-36-90(2)(h) and 12-36-130, the amount paid must be included in “gross proceeds” or “sales price” on the first return filed after the collection.

Example: A retailer sells merchandise with a sales price of \$1,000 to a purchaser on store credit and remits the sales tax on the total purchase price to the department. The purchaser fails to pay the retailer and the retailer writes-off the \$1,000 as a bad debt for both sales tax and South Carolina income tax purposes. Later the purchaser pays the retailer the full \$1,000. The retailer must remit the sales tax for the \$1,000 payment on the first sales tax return remitted to the department following the payment.

12. How are repossessions treated for purposes of calculating bad debts?

In each of these examples, the retailer has not elected to report installment sales on a cash basis in accordance with Code Section 12-36-2560. The retailer is reporting the full sales price and paying the full sales tax at the time of the sale.

Example 1: A retailer sells furniture for \$5,000 under an installment agreement. The retailer reports the full sales price of \$5,000 and pays the full 6% sales tax of \$300 on its sales tax return. The purchaser defaults and the remaining principal under the installment agreement at the time of default is \$4,000. The retailer repossesses the furniture. The fair market value of the furniture at the time of repossession is \$2,000. The bad debt deduction is calculated as follows:

Fair market value of furniture at repossession	\$2,000
Less: Basis of installment agreement at default	<u>(4,000)</u>
Bad Debt Deduction for sales tax purposes	<u>(\$2,000)</u>

The retailer is entitled to a bad debt deduction for sales and use tax purposes of \$2,000.

Example 2: A retailer sells furniture for \$5,000 under an installment agreement. The retailer reports the full sales price of \$5,000 and pays the full sales tax of \$300 on its sales tax return. The purchaser defaults and the remaining principal under the installment agreement at the time of the default is \$2,500. The retailer repossesses the furniture. The fair market value of the furniture at the time of repossession is \$3,000. The bad debt deduction is calculated as follows:

Fair market value of furniture at repossession	\$3,000
Basis of installment agreement at default	\$2,500

Since the fair market value of the furniture at repossession is greater than the basis in the installment agreement, there is no bad debt deduction for sales and use tax purposes.

13. How are repossessions treated for purposes of calculating bad debts for maximum tax items?

In each of these examples, the retailer has not elected to report installment sales on a cash basis in accordance with Code Section 12-36-2560. The retailer is reporting the full sales price and paying the full sales tax at the time of the sale.

For sales subject to a maximum tax, the bad debt must be calculated based only on the amount of the purchase that is subject to the sales tax. The examples below use motor vehicles which are subject to a 5% sales tax rate and a maximum tax of \$300.⁹ The maximum amount of the purchase price which is subject to sales tax is \$6,000 ($\$6,000 \times 5\% = \300). In each of these examples, there is an installment sale, but the retailer pays the sales tax on the entire transaction as the time of sale. The sales tax is imposed on the first \$6,000 of principal paid as a down payment and through an installment agreement. As a result, if a purchaser has paid more than \$6,000 in a down payment and principal, there is no bad debt.

A worksheet with each of these examples is provided at the end of this document, which may assist in calculating bad debts for maximum tax sales.

Example 1: A retailer sells a motor vehicle for \$7,000. The purchaser pays \$500 as a down payment and agrees to pay the remaining balance of \$6,500 under an installment agreement. The retailer reports and pays the maximum sales tax of \$300 on its sales tax return. Because the maximum tax applies to this sale, the purchase price of the vehicle that is subject to sales tax is \$6,000 ($\$6,000 \times 5\% = \300). The purchaser pays \$1,000 of principal under the installment agreement and then defaults. The remaining amount of the installment agreement that is subject to sales tax is \$4,500.¹⁰

The retailer repossesses the vehicle. The fair market value of the vehicle at the time of repossession is \$3,000. The bad debt deduction is calculated as follows:

Fair market value of vehicle at repossession	\$3,000
Less: Basis of installment agreement	(4,500)
Bad debt deduction for sales tax purposes	<u>(\$1,500)</u>

Example 2: The same facts as example 1, but the fair market value at repossession is \$5,000.

Fair market value of vehicle at repossession	\$5,000
Less: Basis of installment agreement	\$4,500

Because the fair market value of the vehicle at repossession is greater than the remaining principal of the installment agreement, there is no bad debt deduction for sales and use tax purposes.

⁹ Code Section 12-36-2110(A)(2).

¹⁰ Vehicle sales price subject to sales tax	\$6,000
Less: Down payment	(500)
Amount of installment agreement subject to sales tax	5,500
Principal payments made under installment agreement	(1,000)
Principal remaining at time of default	<u>\$4,500</u>

Example 3: A retailer sells a motor vehicle for \$17,000 under an installment agreement. The retailer reports and pays the maximum sales tax of \$300 on its sales tax return. The purchaser pays \$500 down and enters into a \$16,500 installment agreement. The purchaser pays \$10,000 of principal under the installment agreement and then defaults. The retailer repossesses the vehicle

Because the maximum tax applies to this sale, the purchase price of the vehicle that is subject to sales tax is \$6,000 ($\$6,000 \times 5\% = \300). Since the seller has already received more than \$6,000 for the motor vehicle with the down payment (\$500) and from principal payments (\$10,000) under the installment agreement, there is no bad debt for sales tax purposes.

14. 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 retailer is required to keep and preserve suitable records of the business. 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 South Carolina income tax returns, the date the bad debt or uncollectible account was 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 South Carolina income tax purposes or, if the retailer is not required to file South Carolina 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 South Carolina income tax return (e.g., an out-of-state corporation that has nexus for sales and use tax purposes but does not have nexus for income tax purposes) 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;

Fair market value of any repossessed property.

15. 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 must be deducted on the sales tax return within one year of the month the amount was determined to be a bad debt or uncollectible account.¹¹ This date would be when the amount was determined to be worthless, not the date the income tax return was filed claiming the bad debt deduction.

16. 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.

¹¹ Code Sections 12-36-90(2)(h) and 12-36-130

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.

SOUTH CAROLINA DEPARTMENT OF REVENUE

s/William M. Blume, Jr.

William M. Blume, Jr., Director

June 12, _____, 2013
Columbia, South Carolina

WORKSHEET FOR MAXIMUM TAX SALES OF MOTOR VEHICLE
EXAMPLES IN QUESTION #13 ON PAGES 7 AND 8

	<u>Example 1</u>	<u>Example 2</u>	<u>Example 3</u>
1. Sales Price	7,000	7,000	17,000
2. Sales Price Subject to Tax*	6,000	6,000	6,000
3. Down Payment + Principal Payments	1,500	1,500	10,500
4. If line 3 is greater than Line 2, STOP. YOU DO NOT HAVE A BAD DEBT DEDUCTION			STOP
5. If Line 3 is less than Line 2, subtract line 3 from Line 2	4,500	4,500	
6. Fair Market Value of Repossessed Property	3,000	5,000	
7. If line 6 is greater than Line 5, STOP. YOU DO NOT HAVE A BAD DEBT DEDUCTION		STOP	
Bad Debt Deduction	1,500	0	0

* The maximum sales tax on motor vehicles is \$300. The bad debt deduction is limited to the gross proceeds associated with that maximum tax. The sales tax rate for maximum sales tax items is 5%. As a result, the gross proceeds derived from the \$300 maximum tax is \$6,000 ($\$6,000 \times .05 = \300).