



MAINE REVENUE SERVICES SALES, FUEL & SPECIAL TAX DIVISION INSTRUCTIONAL BULLETIN NO. 29

DEDUCTION FOR BAD DEBTS

This bulletin is intended solely as advice to assist persons in determining, exercising or complying with their legal rights, duties or privileges. It contains general and specific information of interest as well as interpretations and determinations by Maine Revenue Services regarding issues commonly faced by your business. Portions of the Sales and Use Tax Law referred to in this bulletin can be found at the end of the bulletin in Attachment #1. Also attached are applicable Sales and Use Tax Rules.

In most cases a retailer is required to report and remit sales tax on all taxable sales made during the reporting period on the Sales and Use Tax Return, whether or not payment has been received from the customer. If all or part of the amount owed by the customer is subsequently determined to be uncollectible and is charged off on the books of the retailer, the retailer may be entitled to a credit for the sales tax paid to the State with respect to the uncollectible amount.

1. REQUIREMENTS FOR DEDUCTION

- a. Deduction Must be Made within Three Years of Charge-off.** The amount must be deducted on a sales and use tax return filed within three years from the date the amount was actually charged off on the books of the retailer. Credit for charge-offs cannot be taken later than the 15th day of the 37th month after the uncollectible amount was charged off on the books of the retailer.
- b. No Deduction for Amounts Not Actually Charged Off.** The amount to be deducted must actually be charged off as uncollectible on the books of the retailer. On audit deductions for bad debts will be disallowed unless there is evidence that this has been done. No deduction is allowable for expenses incurred in attempting to collect any account receivable, or for that portion of a recovered amount that is retained by or paid to a third party as compensation for services rendered in collecting the account.
- c. Deduction is Allowable Only for Taxable Sales Previously Reported.** The deduction may be made only with respect to taxable sales which were originally reported as taxable by the retailer, and on which tax has been paid by the retailer to the State. If the sales tax rate in effect at the time of the sale is different from the rate in effect at the time that the credit is claimed, the deduction must be adjusted to reflect the rate that was in effect when the sale was made.

Determination of the amount to be deducted when the amount charged off represents both taxable and nontaxable items is discussed in Section 2 of this bulletin.

d. Information Must be Retained to Support Deduction. In support of deductions for uncollectible accounts retailers must maintain adequate and complete records showing:

- i. Date of the original sale.
- ii. Name and address of the purchaser.
- iii. Amount the purchaser contracted to pay.
- iv. Amount on which the retailer paid tax to the State.
- v. All payments and other credits applied to the account of the purchaser.
- vi. Evidence that the uncollectible amount on which tax was paid to the State actually has been charged off.

e. Tax is Due on Amounts Subsequently Collected. If a retailer subsequently collects any account which has been charged off as worthless, and for which credit has been taken, the amount collected must be included in the return filed for the period in which the collection occurred. The tax on that amount must be paid with that return, based on the tax rate that was in effect at the time of the original sale. If the tax rate in effect at the time of collection is different from the tax rate in effect at the time of the original sale, the amount of the collection and the date of the original sale should be noted on the back of the return.

f. Taking Credit on Return. When taking credit for an amount that has been charged off as uncollectible, the retailer must report the taxable amount charged off on Line 2c of the return and state on the back of the return (or on a sheet attached to the return) the date and amount of the accounts being deducted.

2. PARTIALLY TAXABLE ACCOUNTS

a. General. If the amount charged off includes the cost of property or services not subject to Maine sales tax as well as taxable receipts upon which tax was paid to the State, the deduction is limited to the taxable portion. In determining the taxable portion, all payments and credits to the account with the exception of certain trade-in allowances are applied ratably against the taxable and nontaxable portions of the account. Computation of the credit allowable for accounts that include trade-in allowances is discussed in Section 3 below.

b. Deductions by Holders of Classified Permits. When a deduction is made by a retailer for an uncollectible account originating in a period when the retailer held a classified permit, the portion of the account that may be deducted is based on the classified permit percentage that was in effect at the time of the sale. For example, if a retailer who held a permit indicating 82% exempt sales has charged off as uncollectible an account representing sales of \$200 made during the period this permit was in effect, the deduction would be \$36.

Uncollectible amount charged off:	\$200.00
Less: Uncollectible amount multiplied by exempt percentage (\$200.00 X 0.82)	<u>(164.00)</u>
Amount of sales adjustment on line 2c:	\$36.00

If the sales tax rate in effect at the time of the sale is different from the rate in effect at the time that the credit is claimed, the deduction must be adjusted to reflect the rate that was in effect when the sale was made.

3. DEDUCTION FOR LOSSES ON REPOSSESSION

a. Loss on Repossession. Repossession of property sold under a conditional sales contract does not necessarily create a basis for deduction. Tax is due on the original sale, and tax is also due on the eventual sale of the repossessed property.

The retailer may compute the net loss to be charged off by deducting the amount of all applicable payments and credits from the original sale price upon which tax was paid. "Applicable payments and credits" includes the trade-in allowance, if any; the amount of the down payment, if any; and the amount of any subsequent payments applied to the principal. It does not include the amount of any payments applied to finance charges. In computing the net loss, the retailer must deduct the fair market value or actual subsequent sale price of the repossessed property reduced by any direct material or labor costs incurred to recondition the property for resale.

The following is an example of a transaction in which a loss on repossession has occurred:

Original sale price of property:	\$10,000.00
Less: Down payment (cash, trade-in, or both):	(3,000.00)
Less: Payments (excluding finance charges):	<u>(1,500.00)</u>
Unpaid balance of principal:	\$ 5,500.00
Cost to recondition article:	<u>300.00</u>
Break-even price on subsequent sale:	\$ 5,800.00
Less: Subsequent sale price of property:	<u>(5,000.00)</u>
Loss on repossession (bad debt):	\$ 800.00

A retailer who has incurred a loss on repossession may either deduct the loss immediately based on the fair market value of the property or wait until the property is sold and deduct the loss based on the actual sale price of the property (provided that the property is resold within three years from the date of repossession). If the retailer elects to claim a deduction based on the fair market value of the repossessed property, and the property is subsequently resold at a price greater than the sum of the declared fair market value and the cost of reconditioning the property for resale, the additional amount must be included in the return filed for the period in which the resale occurred.

b. Trade-ins with Unpaid Balance. When a motor vehicle, watercraft, aircraft, farm tractor, self-propelled vehicle or loader used to harvest lumber, chain saw, special mobile equipment, livestock trailer or camper trailer on which a balance remains unpaid is traded in toward the sale price of another of the same kind of property, the full amount of the trade-in is deducted before the sales tax is computed. Therefore, a subsequent loss attributable to the unpaid balance due on the trade-in will not be allowed as a deduction.

4. ADDITIONAL INFORMATION.

The information in this bulletin addresses some of the more common questions regarding the Sales and Use Tax Law faced by your business. It is not intended to be all inclusive. Requests for information on specific situations should be in writing, should contain full information as to the transaction in question and should be directed to the:

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Issued: January 15, 1958

Last Amended: January 28, 1991

(Published under Appropriation 010-18F-0002-07)

ATTACHMENT #1
Excerpts taken from 36 M.R.S.A.

36 §1811-A. Credit for worthless accounts

The tax paid on sales represented by accounts charged off as worthless may be credited against the tax due on a subsequent report filed within 3 years of the charge-off, but, if any such accounts are thereafter collected by the retailer, a tax shall be paid upon the amounts so collected.

Relevant Rules:#305 - Retailers' Records