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PRODUCT & SERVICE GUIDE

Recouping Sales Tax on Bad Debts: Help Your Retail Clients Reduce the Pain of Bad Debts

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For accrual method clients chalking up bad debts, a claim for refund of transactional taxes previously remitted can be a worthwhile engagement. Sales taxes are the most common form of transactional taxes for retailing vendors, and since the majority of retailers remit sales taxes on a monthly basis, sales taxes are often remitted in full to a taxing authority long before a vendor sees a penny. When the bills related to these sales go unpaid and uncollectible, your vendor-client, and you, are presented with an opportunity.

Here are some considerations:

What debts are "bad" for purposes of the transactional tax itself? General accounting principles apply; when an underlying debt is deducted from taxable income for income tax purposes, the transactional taxes remitted on behalf of those transactions are typically available for refund or credit.

What is the proper format to claim the taxes back? The states vary a bit, but generally provide one or more of the following three methods:

1. A credit against taxes due.
2. A deduction from taxable sales in the period when a debt is declared uncollectible.
3. A refund claim submitted separately from regular monthly reporting forms.

Whether the process involves an adjustment (credit or deduction) or a refund, the challenges and opportunities for a requesting entity are similar.

Who can claim a credit, deduction or refund of transactional taxes paid on bad debt? In all cases, the vendor who paid and reported the taxes paid can advance a claim through any method available. In some states, firms who provide third-party financing for retailers or who purchase debt that becomes uncollectible may make a claim, but not in others. A key early determination in these situations is whether the party holding the bad debt has standing to make a claim.

What does it take to get this done? It shouldn't surprise you that states require extensive documentation and support whenever a claim or adjustment is made. However, the trail of a bad debt is usually easy to identify for a retailer. A business with their billing house in order should be in a good position to support a credit, deduction or refund claim.

In general, a company hoping to claim, and actually receive, a sales tax refund, or to support an adjustment for bad debts should record and be prepared to make available the folllowing:

- name of the purchaser;
- date of the sale;

- price of the property or services;
- amount of sales tax charged;
- amount of interest, finance and service charges;
- whether the property was retained by the vendor or seller or repossessed;
- the dates and amounts of any payments made on the debt;
- records of the portions of the debt which represents charges not subjected to the tax in the original transaction; and
- records of collection activities and the determination of uncollectibility.

What isn't available for a transactional tax adjustment or refund? Naturally, states limit the scope of claims for adjustments or refunds. This likely strikes you as a given, but only taxes actually remitted can be claimed back. Still, pay attention to carefully trace the path of the original collection and remittance to the state before you get too far. Also note the states universally exclude additional fees, interest or collection expenses from the scope of transactional tax refunds or adjustments.

If this short article has triggered interest in the possibility of a transactional tax refund or adjustment, rest assured, your work is just beginning … once you have verified the debt is bad and that the taxes were actually remitted, gain a comfort level with the processes and paths available in the state(s) at issue. Since solving complex tax issues is already your specialty, a refund or adjustment of transactional taxes remitted can provide a lucrative engagement for you and provide a little reduction in your client's bad debt pain.

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