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

CREDIT FOR CERTAIN BAD DEBTS

This bulletin is intended solely as advice to assist persons in determining and complying with their obligations under Maine tax law. It is written in a relatively informal style and is intended to address issues related to bad debts incurred by your business. Taxpayers are responsible for complying with all applicable tax statutes and rules. Although bulletins issued by Maine Revenue Services (MRS) do not have the same legal force and effect as rules, justifiable reliance upon this bulletin will be considered in mitigation of any penalties for any underpayment of tax due. This bulletin is current as of the last revision date shown at the end of the document.

The Sales and Use Tax Law is found in Part 3 of MRSA ("Maine Revised Statutes Annotated") Title 36. Both Title 36 and all MRS rules may be seen by clicking on "laws and rules" on the MRS website.

In most cases a retailer is required to report and remit sales tax on all taxable sales made during the reporting period, whether or not the retailer has received payment from the customer. If all or part of the amount owed by the customer is subsequently determined to be uncollectible and is properly charged off as worthless on the books of the retailer, the retailer may be entitled to a credit within 3 years of the charge off for the sales tax paid to the State with respect to the charged-off amount. (See 36 MRSA § 1811-A).

1. REQUIREMENTS FOR CREDIT

a. Credit Must be Claimed within Three Years of Charge-off. The amount must be claimed on a sales and use tax return filed within three years from the date the amount was actually charged off as worthless 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 as worthless on the books of the retailer.

b. No Credit for Amounts Not Actually Charged Off. The amount claimed as a credit must actually be charged off as worthless on the books of the retailer. Bad-debt credits will be disallowed unless there is evidence that the retailer has done so. No credit 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. A periodic accounting entry for bad debt allowances is not a charge off of a worthless account.

c. Credit is Allowable Only for Taxable Sales Previously Reported. The credit may be claimed only with respect to taxable sales that 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 credit must 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 below.

d. Information Must be Retained to Support Credit. Retailers claiming the credit must maintain adequate and complete records showing the following information:

- 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 (principal and interest).
- vi. Evidence that the uncollectible amount on which tax was paid to the State actually has been properly charged off as worthless on the retailer's books.

e. Tax is Due on Amounts Subsequently Collected. If a retailer subsequently collects any account (partially or in full) for which it has claimed a credit, any amount subsequently collected on that account by the retailer 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 in the retailer's books and records.

f. Taking Credit on Return. When taking a credit for an amount that a retailer has properly charged off as worthless on its books, the retailer must report the taxable amount charged off on the "Bad Debts" line of the Sales and Use tax return and provide a statement to MRS containing details about the credit. Here is an example of how to compute the credit:

Example:

Sale price of wide screen television		$ 900
Sale price of wall mounting rack		$ 100
Amount financed		$1000
Payments made	$388	
Principal	$227	
Interest	$161	

Bad-debt credit computation:	
Taxable amount financed:	$1000
Less: principal payments made:	$ 227
Unpaid balance of taxable amount properly charged off as worthless on the retailer's books:	$ 773

2. PARTIALLY TAXABLE ACCOUNTS

If the amount that the retailer charged off as worthless includes the price of property or services not subject to Maine sales tax as well as taxable amounts upon which tax was paid to the State, the credit 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 prorated against the taxable and nontaxable portions of the account. An example of how to compute the credit allowable for accounts that include trade-in allowances is discussed in Section 3 below.

Example:

Sale price of wide screen television (taxable)	$ 900
Sale price of wall mounting rack (taxable)	$ 100
Price of 3-yr extended warranty (non-taxable)	$ 250
Amount financed	$1250

Payments made	$388
Principal	$227
Interest	$161

Taxable amount: $1000 Non-taxable amount: $250
Taxable percentage: 80% Non-taxable percentage: 20%
Principal payments made toward taxable amount: $181.60 ($227 x 80%)

Bad-debt credit computation:	
Taxable amount financed:	$1000
Less: principal payments made:	$ 181.60
Unpaid balance of taxable amount properly charged off as worthless on the retailer's books:	$ 818.40

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 credit must reflect the rate that was in effect when the sale was made.

3. CREDIT FOR LOSSES ON REPOSSESSION

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

To compute the credit, as in the above example, the retailer must deduct the amount of all applicable payments and credits from the original sale price upon which tax was paid to MRS. "Applicable payments and credits" include any trade-in allowance, down payment, and subsequent payments applied to the principal. It does not include the amount of any payments applied to finance charges. In computing the credit when the retailer repossesses the property after the purchaser defaults, the retailer must also deduct the fair market value or actual subsequent sale price of the repossessed property (i.e., resale after repossession), offset by any direct material or labor costs that the retailer incurs to recondition the property for resale.

The following is an example of a transaction involving a sale with a trade-in, a subsequent default by the purchaser, and a repossession of the property (assume that the retailer properly charges off the account as worthless):

Sale price of property:	$10,000
Less: Trade-in allowance	$ 2,000
Taxable amount	$ 8,000
Less: Cash down	$ 1,000
Amount financed	$ 7,000

Payments made	$2,000
Principal	$1,500
Interest	$ 500

Bad-debt credit computation:

Taxable amount financed	$ 7,000
Less: Principal payments made:	($1,500)
Unpaid balance of principal:	$ 5,500
Direct material and labor costs to recondition property:	$ 300
Break-even price on subsequent sale:	$ 5,800
Less: Subsequent sale price of property after repossession:	($5,000)
Unpaid balance of taxable amount properly charged off as worthless on the retailer's books:	$ 800

If the retailer properly charges off the account as worthless on its books, claims a credit based on the fair market value of the repossessed property, and subsequently resells the property at a price greater than the declared fair market value (reduced by any direct material or labor costs the retailer incurred to recondition the property for resale), the retailer must include the amount by which the resale price exceeds the declared fair market value as a taxable sale in the return filed for the period in which the resale occurred. If the property is subsequently resold at a price less than the declared fair market value (reduced by any direct material or labor costs the retailer incurred to recondition the property for resale), the retailer may claim additional bad-debt credit in that amount in the return filed for the period in which the resale occurred.

b. Trade-in with Unpaid Loan Balance. When a motor vehicle, watercraft, farm tractor, self-propelled vehicle or loader used to harvest lumber, chain saw, special mobile equipment, livestock trailer, or camper trailer on which a loan 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 charge-off attributable to the unpaid balance on the trade-in will not be allowed as a credit.

Example:

Sale price of property:	$10,000
Less: Trade-in allowance	$ 2,000
Taxable amount	$ 8,000
Trade-in loan balance pay-off	$ 1,500
Amount financed	$ 9,500

Portion attributable to unpaid balance on trade in – 16% ($1500÷$9500)
Portion attributable to taxable amount – 84% ($8000÷$9500)

Payments made	$2,000
Principal	$1,500
Interest	$ 500

Bad-debt credit computation:

Taxable amount financed	$8,000
Principal payments made toward taxable amount (84% of $1500.00)	$ 1,260
Unpaid balance of taxable amount properly charged off as worthless on the retailer's books:	$ 6,740

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:

MAINE REVENUE SERVICES
SALES, FUEL & SPECIAL TAX DIVISION
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