

**TENNESSEE DEPARTMENT OF REVENUE  
LETTER RULING #98-48**

**WARNING**

**Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This presentation of the ruling in a redacted form is informational only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Department policy.**

**SUBJECT**

The proper procedure for taking a sales and use tax credit for bad debts.

**SCOPE**

This letter ruling is an interpretation and application of the tax law as it relates to a specific set of existing facts furnished to the department by the taxpayer. The rulings herein are binding upon the Department and are applicable only to the individual taxpayer being addressed.

This letter ruling may be revoked or modified by the Commissioner at any time.

Such revocation or modification shall be effective retroactively unless the following conditions are met, in which case the revocation shall be prospective only:

- (A) The taxpayer must not have misstated or omitted material facts involved in the transaction;
- (B) Facts that develop later must not be materially different from the facts upon which the ruling was based;
- (C) The applicable law must not have been changed or amended;
- (D) The ruling must have been issued originally with respect to a prospective or proposed transaction; and
- (E) The taxpayer directly involved must have acted in good faith in relying upon the ruling; and a retroactive revocation of the ruling must inure to the taxpayer's detriment.

## **FACTS**

[THE TAXPAYER] sells [PRODUCTS] at wholesale and at retail. This ruling pertains only to retail sales on which the taxpayer has properly remitted sales tax to the State of Tennessee.

A small percentage of the taxpayer's retail customers pay with a check, and a small percentage of those checks are returned to the taxpayer by the bank due to insufficient funds in the customer's account. The taxpayer's policy is to try to collect on the bad checks. However, some are uncollectible. The uncollectible checks are written off as bad debts nine months after the bad check was received. For purposes of this ruling, it is assumed that the taxpayer is required to file federal income tax returns.

The taxpayer has not been deducting these bad debts on its monthly sales and use tax returns.

## **QUESTIONS**

1. Can the taxpayer still receive the bad debt credits which it failed to take in prior months?
2. What is the proper procedure for taking a credit for bad debts resulting from taxable sales?

## **RULINGS**

1. The taxpayer can file amended returns to correct the returns on which it failed to take the appropriate bad debt credits. Amended returns can be filed for periods that are within three years of December 31st of the current year. The taxpayer can only receive a credit. It cannot receive a refund with respect to bad debt credits.
2. The credit is allowed for tax paid on sales resulting in bad debts, provided the credit is taken on the sales and use tax return covering the month in which the debt was actually charged off for federal income tax purposes. The debt is actually charged off for federal income tax purposes at the time the taxpayer files the federal income tax return on which it claims the bad debt deduction.

If none of the items which resulted in the bad debts were subject to the \$1600 single article cap when originally sold, then the taxpayer should enter on Line K of Schedule A of the return the total amount of bad debts charged off during that month. This will reduce the taxable amount for that month and result in the appropriate credit.

If any of the items were subject to the \$1600 single article cap when originally sold, then an additional step is required. After entering the total amount of bad debts on Line K of Schedule A, the taxpayer must add back on Line 4 of Schedule B any amount in excess of \$1600 on which local tax was never paid.

### **ANALYSIS**

1. TENN. CODE ANN. §67-6-507(e) provides the remedy under which a dealer may obtain credit for taxes paid on uncollectible debts. That section provides in pertinent part:

(1) A dealer who has paid the tax imposed by this chapter on any sale as defined in § 67-6-102 may take credit in any return filed under the provisions of this chapter for the tax paid by the dealer on the unpaid balance due on accounts which during the period covered by the current return have been found to be worthless and are actually charged off for federal income tax purposes; provided, that if any accounts so charged off are thereafter in whole or in part paid to the dealer, the amounts so paid shall be included in the first return filed after such collection and the tax paid accordingly.

(2) For the purposes of subsection (e), "actually charged off for federal income tax purposes" includes, without limitation:

(A) The charging off of bad debts and uncollectible accounts for federal income tax purposes by any dealer required to file federal income tax returns; and

(B) In the instance of any dealer who is not required to file federal income tax returns (or files with the internal revenue service a return as a nonprofit tax-exempt organization), any municipal corporation or any agency, board or department thereof, any county, any instrumentality of local government, any electric membership corporation, any electric cooperative and similar nonprofit corporation, which charge off past due accounts or uncollectible bad debts against income or which, in lieu of charging off past due accounts and uncollectible bad debts on any federal income tax return, shall, by resolution of its governing board provide policies for charging off unpaid balances due on accounts as uncollectible, or declare from time to time as uncollectible such unpaid balance due on accounts.

TENN. CODE ANN. §67-6-507(e)(1) and (2).

Under this provision the credit for bad debts must be taken on the sales and use tax return which covers the period in which the debt was found to be worthless and was charged off for federal income tax purposes. The taxpayer failed to take the available credit during the months they were charged off. However, the Department will allow an amended return to be filed to correct mistakes made on a previously filed return. Thus, the taxpayer can amend the returns covering the periods in which bad debts were charged off. Amended returns are allowed for periods which are within three years of December 31st of the current year.

Amending the return will create a credit in the taxpayer's account. The taxpayer will then receive a credit memo from the Department which can be offset against sales and use taxes due on a subsequent return.

It should be noted that a refund is not available with respect to bad debt credits. *Estate of W.T. Grant Company v. Lewis*, 358 So.2d 76 (Fla. Dist. Ct. App. 1978), *aff'd*, 370 So.2d 764 (Fla. 1979) (construing a bad debt credit statute virtually identical to the Tennessee statute.) The refund provisions found in TENN. CODE ANN. §67-1-1802 are specifically directed to taxes "that are, on the date of payment, paid in error or paid against any statute, rule, regulation or clause of the constitution of this state or of the United States." The tax paid on a sale which ultimately results in a bad debt is due on the date of payment. *Causeway Lumber Company, Inc. v. Lewis*, 410 So.2d 511, 513 (Fla. Dist. Ct. App. 1981). It is not paid in error. *Id.* Consequently, the provisions of TENN. CODE ANN. §67-1-1802 do not apply.

2. The taxpayer's second question concerns the mechanics by which the taxpayer may take a credit for bad debts.

Of course, the credit is limited to the amount of tax previously paid on sales which result in bad debts. Additionally, as discussed above, the credit must be taken on the sales and use tax return covering the month in which the debt is actually charged off for federal income tax purposes.

The phrase "actually charged off for federal income tax purposes" is explained in TENN. CODE ANN. §67-6-507(e)(2). The statute distinguishes between those who are required to file federal income tax returns and those who are not. Internal Revenue Code §166(a) allows a deduction for any business debt which becomes worthless during the tax year in which the deduction is taken. If a dealer is required to file federal income tax returns, the debt is actually charged off for federal income tax purposes at the time the dealer files the federal income tax return on which it claims a bad debt deduction under I.R.C. §166(a). TENN. CODE ANN. §67-6-507(e)(2)(A). For example, if the dealer claims a bad debt deduction on a federal income tax return which it files on April 15th, the bad debt credit must be taken on the dealer's April sales and use tax return. In contrast, bad debts held by dealers who are not required to file federal income tax returns are actually charged off when the debt is charged off against income or declared

uncollectible as set out in TENN. CODE ANN. §67-6-507(e)(2)(B). The taxpayer in this ruling is required to file federal income tax returns and thus must claim the bad debt credit on the return covering the month in which the taxpayer claims the bad debt deduction on its federal income tax return.

If these conditions are met, the credit may be taken by following the procedure set out in Ruling #2 above.

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APPROVED: Ruth E. Johnson  
Commissioner

DATE: 12-8-98