



Procedure for Retailers Claiming Credit for Sales Tax Previously Paid on Worthless Accounts Receivable

Purpose: This Policy Statement explains the procedure for retailers to claim a credit for sales tax paid on worthless accounts receivable.

Effective Date: Effective upon the issuance of this Policy Statement and applicable to all open periods.

Statutory and Regulatory Authority: Conn. Gen. Stat. §12-408(2), as amended by 2000 Conn. Pub. Acts 230, §5; Conn. Agencies Regs. §12-408-1.

Worthless Accounts Receivable: Under Conn. Agencies Regs. §12-408-1, a worthless accounts receivable is an account receivable that is determined to be worthless and is actually written off as uncollectible for federal income tax purposes.

Connecticut Sales and Use Taxes Reporting Requirements for Retailers: In general, the Department of Revenue Services (DRS) requires sellers of goods and taxable services to report all sales during the filing period in which the sales are made, not when the customer provides payment. This is the accrual basis method.

Although DRS requires most retailers to report sales on the accrual basis, DRS may allow retailers whose only sales are taxable services enumerated in Conn. Gen. Stat. §12-407(2)(i) and who report their sales on the cash basis of accounting for federal income tax purposes to report sales on the cash basis for Connecticut sales tax reporting purposes. Under the cash basis method of accounting, the retailer reports its sales during the filing period in which the customer provides payment regardless of when the services were rendered.

Who May File a Claim for Sales Tax Previously Paid on Worthless Accounts Receivable: DRS only accepts claims for credit filed by retailers that have determined a sale is worthless for federal income tax purposes and have remitted the tax for the sale to DRS. This does not include retailers reporting sales on the cash basis for Connecticut sales and use tax reporting purposes. In addition, DRS does not accept claims for credit from any persons to whom the retailer assigns or sells a debt or portion of a debt.

Credit for Worthless Accounts: Under Conn. Gen. Stat. §12-408(2), retailers may claim a credit for sales tax previously paid to DRS for accounts receivable that have been deemed worthless.

Retailers on the Accrual Basis Method of Accounting for Federal Income Tax Purposes: Retailers reporting sales made using the accrual basis method may claim a credit for sales tax paid to DRS on charge accounts or credit sales that are determined to be worthless and are actually written off as uncollectible on the retailer's federal income tax return.

Retailers on the Cash Basis Method of Accounting for Federal Income Tax Purposes: Retailers reporting sales made using the cash basis method for federal income tax purposes and the accrual basis method for purposes of reporting Connecticut sales and use taxes may claim a credit for sales tax paid on any sales recorded as accounts receivable on the retailer's books and determined by the retailer to be worthless. However, DRS does not usually consider an account receivable to be worthless, despite substantial and continuing efforts to collect the debt for at least six months following the sale, unless it is apparent from the facts the retailer presents that the account is uncollectible. For example, a retailer could show that a customer or client has declared bankruptcy or that legal action to collect the debt would not result in

payment of any part of the debt. Retailers using the cash basis method of accounting for reporting Connecticut sales and use taxes may not claim a credit under Conn. Gen. Stat. §12-408(2)(B).

A retailer using either the cash basis or accrual accounting methods for federal income tax purposes must report its sales on the accrual basis method for Connecticut sales tax reporting purposes to claim the credit against the tax due on its next **Form OS-114, Sales and Use Tax Return**. See *Procedures for Retailers to Claim a Credit* for further details.

Conn. Gen. Stat. §12-408(2)(B) imposes a three-year limitation period from the date the tax is paid to DRS for claiming credits for worthless accounts receivable. See *Guidelines for Retailers Claiming a Credit Under Conn. Gen. Stat. §12-408(2)* for circumstances under which the limitation may be extended.

Credit for Worthless Accounts Under the “Pay When Paid” Method for Materialmen: The provisions of Conn. Gen. Stat. §12-408(2) regarding worthless accounts receivable apply to transactions under the “pay when paid” method, with the three-year deadline based on the date the tax was payable by the materialman to DRS, as determined by the “pay when paid” method. See **Informational Publication 2001(13), “Pay When Paid” Method for Materialmen**.

The worthless accounts receivable provisions apply only to sales tax that has been remitted to DRS. Therefore, if an account receivable is determined to be worthless for federal income tax purposes within one year of the original transaction date, the materialman must remit any remaining tax due on the account by the one-year deadline, and then claim the credit under Conn. Gen. Stat. §12-408(2) on its next sales and use tax return.

Guidelines for Retailers Claiming a Credit Under Conn. Gen. Stat. §12-408(2): The following are guidelines for retailers seeking a credit for sales tax paid on worthless accounts receivable.

- DRS does not allow an adjustment if more than three years have elapsed from the date the tax was remitted to DRS. However, the three-year limitation period for claiming a credit for worthless accounts receivable is extended if the credit relates to a period open under an audit waiver under Conn. Gen. Stat. §12-415(g).

- If DRS allows a credit to the retailer on uncollectible accounts receivable and the retailer later receives full or partial payment for these sales, the retailer must include the amount of the payment in the sales and use tax return covering the period in which the payment was made.
- All adjustments must relate to the tax rate in effect at the time of the original sale. For example, if there is a change in the tax rate between the date of the original sale and the date a claim is made, retailers must use the tax rate effective at the date of the original sale.

Procedures for Retailers to Claim a Credit: To claim a credit for worthless accounts receivable under Conn. Gen. Stat. §12-408(2), retailers must maintain adequate and complete records showing:

- The date of the original sale;
- The name and address of the purchaser;
- The amount which the purchaser contracted to pay;
- The amount on which the retailer paid the sales tax to this state;
- All payments or other credits applied to the account of the purchaser; **and**
- Evidence that the uncollectible portion on which sales tax was paid to this state has been actually written off as uncollectible for federal income tax purposes.

The procedure for filing a claim for credit is:

1. Enter the amount of the uncollectible sales as a deduction on either Line A “Other Adjustments – sales of goods,” Line B “Other Adjustments – leases and rentals,” or Line C “Other Adjustments – labor and services” of **Form OS-114**.
2. Identify the amount on Lines A, B, or C as “uncollectible sales previously reported.”
3. Add the amounts entered on Lines A, B, and C to the total deduction amount at the bottom of the return. Deductions cannot exceed gross receipts. If the deduction amount exceeds the gross receipts, the taxpayer should carry forward the excess to Line A, B, or C for the next return after the period the original deduction is reported.

Retailers on the Accrual Basis Method of Accounting for Federal Income Tax Purposes: Adjust the sales and use tax return for the first reporting period after filing the federal income tax return in which the uncollectible accounts receivable were claimed as a deduction.

Retailers on the Cash Basis Method of Accounting for Federal Income Tax Purposes: Adjust the sales and use tax return during the reporting period after which the retailer has determined that the accounts receivable are worthless. Cash basis filers must attach **Form AU-65, Worthless Debts Credit-Cash Basis**, to the sales and use tax return, providing the debtor's name and any business or family relationship to the retailer, the due date of the debt, efforts made to collect the debt, and the reason the debt was determined to be worthless.

Renegotiated Contracts for Reduced Amounts: Sales tax not collected as a result of renegotiated contracts is **not** considered a worthless debt. If a contract is renegotiated for an amount that is less than the original contract, you may request a refund for excess sales and use tax previously paid. See **Policy Statement 98(5), Sales and Use Tax Refund Policy**.

You must file an amended sales and use tax return with the refund request. In addition, you must submit a copy of the final bill and show the adjustment to the original contract.

Effect on Other Documents: This Policy Statement modifies and supersedes **Bulletin No. 26, Adjustment of Sales and Use Tax Returns for Tax Previously Paid on Uncollectible Accounts**. In addition, do not rely on any correspondence from DRS that is not in accord with this Policy Statement.

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Sales and Use
Worthless Accounts Receivable
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Effect of This Document: A Policy Statement is a document issued by DRS that explains in depth a current position, policy, or practice affecting the tax liability of taxpayers.

For Further Information: Please call DRS during business hours, 8:00 a.m. to 5:00 p.m., Monday through Friday:

- **1-800-382-9463** (toll-free within Connecticut), or
- **860-297-5962** (from anywhere)

TTY, TDD, and Text Telephone users only may transmit inquiries 24 hours a day by calling 860-297-4911.

Forms and Publications: Forms and publications are available all day, seven days a week:

- **Internet:** Preview and download forms and publications from the DRS Web site: **www.dr.state.ct.us**
- **DRS TAX-FAX:** Call **860-297-5698** from the handset attached to your fax machine and select from the menu.
- **Telephone:** Call **860-297-4753** (from anywhere), or **1-800-382-9463** (toll-free within Connecticut) and select **Option 2** from a touch-tone phone.