

## Seattle Rule 5-064

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(1) Introduction. This rule explains the Seattle business license tax as it applies to credit losses, bad debts, and recovery of previously reported losses. It also addresses bad debt deductions available to cellular telephone businesses.

(2) Bad debts defined. Bad debts mean income or revenue amounts written off the taxpayers books of record when it is decided that the income previously reported by a taxpayer will not be received.

(3) Business License Tax.

(a) Bad debt deductions. In computing the business license tax, taxpayers whose regular books of accounts are kept on an accrual basis may deduct the amount of business credit losses actually sustained, providing that such deduction will be allowed only with respect to activities upon which a tax has been previously paid and providing that the amount has not been otherwise deducted and that credits have not been previously issued (see 5.45.100(L)).

(b) Bad debt deductions must be taken by the taxpayer during the tax reporting period during which such bad debts were actually charged off on the taxpayers books of account and would be eligible for a bad debt deduction for federal income tax purposes. Such deduction must be adjusted to amounts attributable to:

(i) Expenses incurred in attempting to collect debt; and

(ii) The value of repossessed property taken in payment of the debt; and

(iii) Amounts due on property that remains in the possession of the seller until the full purchase price is paid.

(c) In cases where the amount of bad debts legitimately charged off in a particular reporting period exceeds the gross income for such period, the excess of the amount of the bad debts charged off during such period may be deducted from the gross income of the subsequent tax reporting period.

(d) A dishonored (bad) check which proves to be uncollectible is a bad debt, to the extent it was taken as payment for goods or services on which business tax was previously reported and paid.

(e) Extracting or manufacturing. Bad debt deductions under the extracting or manufacturing classifications will be allowed only when the value of products is computed on the basis of gross proceeds of sales.

(4) Determining credit losses specific charge off method. The amount of credit losses actually sustained must be determined in accordance with the specific charge-off method which is the amount actually charged off within the tax reporting period with respect to debts determined to be worthless.

(a) Worthlessness of a debt is usually evidenced when all the surrounding and attending circumstances indicate that legal action to enforce payment would result in an uncollectible judgment.

(b) A "charge-off" of a debt, either wholly or in part, must be evidenced by entry in the taxpayers books of account.

(c) When the taxpayer actually determines and charges off bad debts on a tax reporting period basis, the amount so charged off each period shall be considered prima facie as a proper deduction for such period.

(d) When bad debt losses are ascertained annually upon specific charge-off method, the deduction must be taken against the gross amount reported for the period in which the bad debts were actually charged off.

(e) Credits, refunds, and deductions for bad debts are based on federal standards for worthlessness under section 166 of the Internal Revenue Code. If federal income tax return is not required to be filed, the taxpayer is eligible for a bad debt credit, refund, or deduction on the Seattle business license tax return if the taxpayer would otherwise be eligible for the federal bad debt deduction.

(5) Recoveries. Amounts subsequently received on account of a bad debt or on account of a part of such debt previously charged off and allowed as a deduction for business license tax purposes, must be included in gross proceeds of sales (including value of products when measured by gross proceeds of sales) or gross income of the business reported for the taxable period in which received. This is true even though the recoveries during such period exceed the amount of the bad debt charge-off.

(6) Application of payments. Payments received before or after a bad debt credit, refund, or deduction is claimed should be applied first against interest and then against other amounts.

(7) Utility tax. Only bad debts written off for cellular phone revenue may be deducted as bad debts under the utility tax. There are no other provisions for bad debt deductions under the utility tax.

(8) Statute of limitations for claiming bad debts. No credit, refund, or deduction, as applicable, may be claimed for debt that became eligible for a bad debt deduction for federal income tax purposes more than four years before the beginning of the calendar year in which the credit, refund, or deduction is claimed.

(9) Examples. The following examples identify a number of facts and then state a conclusion. These examples should be used only as a general guide. The tax results of other situations must be determined after a review of all of the facts and circumstances.

In all cases, an eight percent combined state and local sales tax rate is assumed. Figures are rounded to the nearest dollar. Payments are applied first against interest and then ratably against the taxable price, sales tax, and other charges except when the special rules for subsequent recoveries on a bad debt apply (see subsections (2) and (3) of this section). It is assumed that the income from all retail sales described has been properly reported under the retailing B&O tax classification and that all interest or service fees described have been accrued and reported under the service and other activities B&O tax classification.

(a) Seller makes a retail sale of goods with a selling price of \$500. No payment is received by Seller at the time of sale. One and a half years later, no payment has been received by Seller, and the balance with interest is \$527. Seller is entitled to claim a bad debt deduction on the federal income tax return. Seller is entitled to claim a bad debt deduction of \$500 under the retailing tax classification, and a bad debt deduction of \$27 under the service and other activities B&O tax classification.

(b) The facts are the same as in (a) of this subsection, except that six months after the write off and deduction are claimed, a \$50 payment is received on the debt. Recoveries received on a retail sale after a write off and deduction have already been claimed must be applied first to the interest and then to the taxable price in order to determine the amount of tax that must be repaid. Therefore, Seller must report \$27 in interest income on the current excise tax return and \$23 under the retailing classification.

(c) Seller sells a car at retail for \$1000 and charges the buyer an additional \$50 for license and registration fees. Seller accepts trade-in property with a value of \$500 in which the buyer has \$300 of equity. Seller receives and passes on the \$50 for license and registration fees. Eight months later, Seller has not received any payment on

balance due. Seller is entitled to claim a bad debt deduction on the federal income tax return. The equity in the trade-in is equivalent to a payment received at the time of purchase, reducing the balance remaining on the initial sale to \$700, or \$1000 - \$300. Seller is entitled to claim a deduction of \$700 under the retailing tax classification, exclusive of any deduction for accrued interest.

DIRECTOR'S CERTIFICATION

I, Glen M. Lee, Finance Director of the City of Seattle, do hereby certify under penalty of perjury of law, that the within and foregoing is a true and correct copy as adopted by the City of Seattle, Department of Finance and Administrative Services.

DATED this \_\_\_\_ day of July 2016.

CITY OF SEATTLE,

a Washington municipality

By: \_\_\_\_\_

Glen M. Lee, Finance Director

Department of Finance and Administrative Services

Effective date: July 14, 2016

Jul 14, 2016