



Tax and Licensing Division  
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## Tax Compliance Guide

### Bad Debts

(12/2022)

THIS GUIDANCE IS A SUMMARY IN LAYMEN'S TERMS OF THE RELEVANT AURORA TAX LAW FOR THIS TOPIC, INDUSTRY, OR BUSINESS SEGMENT. IT IS PROVIDED FOR THE CONVENIENCE OF TAXPAYERS AND IS NOT BINDING UPON THE CITY. IT IS NOT INTENDED FOR LEGAL PURPOSES TO BE SUBSTITUTED FOR THE FULL TEXT OF THE AURORA MUNICIPAL CODE AND APPLICABLE RULES AND REGULATIONS. THIS GUIDE DOES NOT CONSTITUTE A CITY TAX POLICY.

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The Aurora Municipal Code provides that any tax collected by a licensed retailer constitutes a debt from the purchaser to the retailer until paid and shall be recoverable at law in the same manner as other debts. Taxable sales that are found to be worthless and are actually and properly charged off as bad debts for Federal income tax purposes, may be deducted from gross sales by the retailer who collected and remitted the tax. Provided, that the transactions were included in gross sales on the current or prior return, and to the extent that the statute of limitations has not expired.

In establishing worthlessness, the retailer has the burden of providing adequate evidence that the usual remedies available in collecting the debt have been exhausted. If the debt is subsequently collected, the purchase price and related tax must be reported on the next periodic City sales/use tax return.

No bad debt deduction is allowed in cases of repossession, or if there is a secured interest in the property.

#### Amount Subject to Deduction

**Taxable receipts** - If the amount of an account found to be worthless and charged off is comprised in part of nontaxable receipts such as tax, interest, insurance, repair, or installation labor and in part of taxable receipts upon which tax has been paid, a bad debt deduction may be claimed only with respect to the unpaid amount upon which tax has been paid. In determining that amount, all payments and credits to the account shall be applied ratably against the various elements comprising the amount the purchaser contracted to pay (pro rata method).

**Expenses of Collection** - No deduction is allowable for expenses incurred by the retailer in attempting to enforce collection of any account receivable, or for that portion of a debt recovered that is retained by or paid to a third party as compensation for services rendered in collecting the account.

**Worthless account subsequently collected** - If any account found worthless and charged off is thereafter collected by the retailer, in whole or in part, the taxable percentage of the amount so collected shall be included in the first return filed after such collection and tax shall be paid on such amount with the return. The same percentage of the account which the retailer claimed as an allowable bad debt deduction or refund shall be used to determine the taxable percentage of the recovery.

**Records** - In support of deductions or claims for refund for bad debts, retailers must maintain adequate and complete records showing:

- (1) Date of original sale.
- (2) Name and address of purchaser.
- (3) Amount purchaser contracted to pay.
- (4) Amount on which retailer paid tax.
- (5) The jurisdiction(s) where the taxes were allocated.
- (6) All payments or other credits applied to account of purchaser.
- (7) Evidence that the usual remedies available in collecting the debt have been exhausted. Collection attempts, such as phone calls, correspondence, and pursuit via litigation, must be adequately documented.
- (8) Evidence that the uncollectible portion of gross receipts on which tax was paid actually has been legally charged off as a bad debt for income tax purposes (whether or not the income tax return has yet been filed) or, if the retailer is not required to file income tax returns, charged off in accordance with generally accepted accounting principles.
- (9) The taxable percentage of the amount charged off as a bad debt properly allocable to the amount on which the retailer reported and paid tax.

#### Examples

1. Max's Sporting Goods sells uniforms to public and charitable high school sports teams. The schools provide their exemption certificate and are not charged sales tax. The sales are deducted on the return as Governmental/Charitable Sales. At the end of the year, one of the charitable schools had not paid for an order for \$150.00 after many attempts to collect. Max has determined the amount qualifies as a bad debt. Max will not be able to deduct the \$150.00 amount because taxes were never paid on the initial sale.

2. A business sells cell phones to customers under installment contracts. The cell phone is identified as collateral in the contract and may be recovered by the seller if the purchaser defaults on the payments. The business must remit city sales tax on the full purchase price in the month the contract was signed.

If the customer defaults on the payments, the business may not take a bad debt deduction on the sales tax return for the uncollectible amount of the installment sale due to having a security interest in the phone. In addition, the business is not entitled to a refund or credit of the tax remitted.

If the phone is returned and the business sells the same cell phone back to another customer, the sale to the customer is a new taxable transaction. The business must collect city sales tax on the full amount of the sale, and no adjustments are allowed for the prior events related to the default and or repossession on the first sale.

3. A used car dealership provides financing for all its non-cash sales. Under a financed sale the dealership holds a lien on the title to the car until the selling price is paid in full. The dealership has a security interest in all cars it finances and thus no bad debt deduction is allowed if the customer fails to make the required payments.
4. A customer of a home improvement center who has an open credit account files bankruptcy. The home improvement center may take a deduction for the amount of the bad debt representing taxable credit sales on which they had previously remitted sales tax to Aurora.

The business subsequently files a claim with the bankruptcy court. Four years later, the business recovers 50% of the amount due from the customer. The amount of the recovery which was previously deducted as a bad debt must now be reported as taxable bad debts collected.

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**Filing:** <http://aurorataxportal.gentaxcpc.net>

**Licensing:** <http://www.auroragov.org/bl>

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## Related Topics

Credit, Installment, and Secured Sales  
Leased and Rented Property

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## Citations

*Aurora Municipal Code*

§ 130-31. Definitions

§ 130-156. Taxable items

§ 130-160. Responsibility for payment

§ 130-161. Schedule of taxes

§ 130-163. Collection and refund of disputed tax

§ 130-166. Credit sales and leases

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## Contact Us

For additional assistance, please contact us:

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