ST 2394 - SALES TAX : REFUNDS FOR BAD DEBTS WRITTEN OFF

TAXATION RULING NO. ST 2394

SALES TAX : REFUNDS FOR BAD DEBTS WRITTEN OFF

F.O.I. EMBARGO: May be released

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REFERENCE NO:	SUBJECT REFS:	LEGISLAT. REFS:
I 1010639	REFUNDS BAD DEBTS	SALES TAX ASSESSMENT ACT NO 1 SUB-SECTION 26(2); SALES TAX ASSESSMENT ACTS Nos 2,3,5,6,7 SUB-SECTION 11(2); SALES TAX ASSESSMENT ACT NO 9 SUB-SECTION 4(1A)

PREAMBLE The provisions of sub-section 26(2), Sales Tax Assessment Act (No.1), sub-section 11(2), Sales Tax Assessment Acts (Nos. 2,3,5,6 and 7) and sub-section 4(1A) Sales Tax Assessment Act (No.9), allow for refunds of sales tax where a taxpayer has sold or leased goods upon the sale value of which that person has paid tax, and has subsequently written off as a bad debt all or part of the amount for which the goods were sold or leased.

2. This Ruling sets out the situations where taxpayers may claim refunds under these sections and the information that must be provided to the Taxation Office to support any claim.

3. The phrase 'written off as a bad debt' is not defined in the sales tax legislation. It is taken to mean a situation where the taxpayer:-

(a) has exhausted all reasonable means of recovering a debt,

(b) makes no further attempts to recover the debt,

(c) accepts in fact that the debt is irrecoverable and is therefore a bad debt, and

(d) in his books of account writes the debt off as a bad debt which he charges as an expense of the business.

4. In this Ruling the term "taxpayer" includes registered person where appropriate.

RULING 5. As specified in the above provisions, where a taxpayer has sold or leased goods upon the sale value of which he has paid tax, and has subsequently written off as a bad debt the whole or any part of the amount for which the goods were sold or leased, the Commissioner may -

(a) on proof to his satisfaction that the whole amount for which the goods were sold or leased is a bad debt -

refund to the taxpayer the amount of tax paid on the sale value of the goods; or

(b) on proof to his satisfaction that a part of the amount for which the goods are sold is a bad debt - refund to the taxpayer so much of the tax as bears to the total amount of tax the same proportion as the amount so proved to be a bad debt bears to the total amount for which the goods were sold.

6. A refund for the sales tax component included in a bad debt is subject, inter alia, to the conditions that the taxpayer concerned -

(a) has sold or leased goods;

(b) has paid tax upon a sale value of those goods, either on the sale or leasing of the goods or at some other point of time, e.g., on the entry for home consumption of imported goods (subsection 4(1), Sales Tax Assessment Act (No.5)); and

(c) has subsequently written off the whole or a part of the amount for which those goods were sold or leased as a bad debt.

7. For payment of a refund the debt must be in existence at the time of writing off. Accordingly, no refund will be allowable where the debt has been released (Point v FCT (1970) 119 CLR 453) or where the debt has been compromised or otherwise extinguished by the voluntary or acquiescent act of the creditor (G.E. Crane Sales Pty Ltd v FCT (1971) 126 CLR 177).

8. There are no limits in the law governing the period within which a taxpayer may apply for refunds, or within which the Taxation Office may allow refunds, where monies owing from sales of tax paid goods have been written off as bad debts.

9. Claims for refunds under the relevant Sales Tax Assessment Acts relating to bad debts written off, whether claimed by way of rebates on monthly returns or otherwise, are to be accompanied by a statement setting out the following particulars
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(a) name of debtor;

(b) amount of account;

(c) amount written off as bad debts for taxable goods only;

(d) months of returns in which the relevant taxable transactions were originally included, and amounts of tax paid on the sale value of the goods included in each return;

(e) action taken for recovery (including any action taken against a guarantor);

(f) reason debt was considered to be bad;

(g) date on which debt was written off as a bad debt; and

(h) an undertaking to pay tax on any amount subsequently recovered.

10. Sub-section 11(2), Sales Tax Assessment Act (No. 5), authorises a refund to any person, registered or unregistered, who has paid tax at the time of entry for home consumption of goods imported by that person and who has written off as a bad debt the whole or any part of the amount for which those goods, or part of those goods, were sold. Accordingly, the warrant number and date of the entry for home consumption will be sufficient in lieu of the reference to monthly returns in paragraph 9(d) above. A copy of the relevant Customs warrant should also accompany the claim.

11. The Taxation Office is not empowered to make refunds on account of bad debts unless it is proved to its satisfaction that the amount written off is a bad debt. Where there is a guarantor answerable for the debt, in the event of default by the principal debtor, the conditions for the making of a refund would not be met unless the guarantor also defaults in meeting the obligations under the guarantee. In instances where a debt is guaranteed, the documentation required by paragraph 9 above would also need to include details of the guarantee and action taken against the guarantor. Should a refund have been allowed in respect of a guaranteed debt which had been written off as a bad debt, tax would be repayable to the Taxation Office in respect of amounts subsequently recovered in relation to that debt, whether recovered from the principal debtor or the guarantor.

12. A creditor may take out insurance to cover bad debts rather than rely on guarantors. Where a debt becomes bad and is written off the creditor will have a claim against the insurance company. A payment by the insurance company in its capacity as insurer would not be the recovery of a bad debt but rather be in the nature of compensation under the terms of the policy. An amount recovered in this way would not create any liability to pay sales tax.

13. The tax content of amounts written off as bad debts should be calculated as follows:-

(a) Where a taxpayer wishes to claim an amount of tax as a bad debt but is unable to establish from his records the exact amount of tax to be written off, it will be acceptable to claim an amount of tax based on the following formula -

Amount Written Off / Invoiced Amount (tax inclusive) x Tax Invoiced

For example, a taxpayer invoiced goods to his customer totalling $1765 including $291 tax. The tax was made up of $23 for goods at the 10% rate, $82 at the 20% rate, $186 at the 30% rate and $214 of the invoice total represents exempt goods. The customer pays only $500 and the taxpayer writes the rest of the amount off as a bad debt, ie $1265. Application of the formula results in a refund of tax calculated as follows:-

1265/1765 x 291/1 = $208.56 = 71.67% of
(Tax refund) total tax

Amount written off also represents 71.67% of the invoice total.

(b) Losses on realisation of book debts, upon the sale of a business as a going concern -

Company A (a taxpayer) sold a branch of its business as a going concern to company B. Included in the assets so sold were book debts. Prior to the sale each debt to be taken over by company B was analysed and its expected realisable value determined. The amount by which the book value of each debt exceeded the expected realisable value was written off by company A as a bad debt. It is accepted to the extent that each debt is written off that the amount is a bad debt.

Refund under sub-section 26(2) is allowable to company A in respect of the tax content included in the amount that it has written off as a bad debt. The formula set out in example (a) may be used to determine the tax content where the tax inclusive price and amount of tax invoiced are known.

(c) Losses on account of goods sold by a taxpayer to a person who subsequently assigned his estate -

Goods were sold by a taxpayer to a person who subsequently assigned his estate. Proof of debt was lodged by the taxpayer for the price of the goods sold. The full amount of the debt was not recoverable. Dividends amounting to 13/ in the dollar were paid to the taxpayer the balance being written off as a bad debt.

Refund under sub-section 26(2) is allowable to the taxpayer of
87/100 of the tax paid on the sales of taxable goods.

14. Under the proviso to sub-section 26(2) where an amount has been written off as a bad debt and a refund has been made of the sales tax component of the bad debt, if the amount or any part of the amount is recovered, the proportionate amount of sales tax must be repaid to the Taxation Office. This amount must be paid within 21 days of the close of the month in which the amount was recovered. The tax content of an amount recovered can be calculated by using the following formula -

Amount Recovered / Amount written off x Tax refunded

For example, to use the figures in paragraph 13(a), if $500 of the debt was recovered the tax to be repaid to the Taxation Office would be calculated as follows:-

500/1265 x $208.56 = $82.43

15. It should be noted that a refund under sub-section 26(2), Sales Tax Assessment Act (No.1) or sub-section 11(2), Sales Tax Assessment Acts (Nos 2,3,6 and 7) may only be made to a

registered person who has sold goods, paid tax thereon, and subsequently written off the whole or part of the sale price as a bad debt. Similarly, a refund under sub-section 11(2), Sales Tax Assessment Act (No.5), may only be made to a taxpayer who has paid tax in respect of the entry for home consumption of imported goods, has sold the goods and has subsequently written off the whole or part of the sale price of those goods as a bad debt. Consequently, refunds under those sections may not be made to any person, whether registered or unregistered, taking over book debts which are subsequently found to be irrecoverable, because the person who writes off the debts is not the person who paid the tax in respect of the sale or importation of the goods.

16. The term 'registered person' in paragraphs (a) and (b) of sub-section 26(2), Sales Tax Assessment Act (No.1) (and sub-section 11(2), Sales Tax Assessment Acts (Nos, 2,3,6 and 7)) is used merely to designate the person to whom the refund is made, i.e., it identifies that person as the one who has sold goods, paid tax thereon, and written off the whole or part of the sale price as a bad debt. If, therefore, an amount is written off as a bad debt by a person who, while a registered person or a person required to be registered, sold goods and paid tax thereon, a refund may still be claimed by that person under sub-section 26(2) even if, at the time of writing off or claiming the refund, that person is no longer registered.

17. Sub-section 4(1A), Sales Tax Assessment Act (No.9) authorises the Commissioner, on proof to his satisfaction that the whole or any part of the amount for which goods were leased (otherwise than by hire-purchase agreement) has been written off as a bad debt, to reduce the sale value of goods to such amount as, in his opinion, having regard to the amount written off, is fair and reasonable. Under the proviso to sub-section 4(1A) if the registered person recovers, at any time subsequently, wholly or in part, the amount written off as a bad debt, the Commissioner is authorised to increase the sale value accordingly.

18 This authorisation relates only to leases of goods in respect of which the sale value is an amount to be assessed by the Taxation Office in accordance with the provisions of sub-section 4(1), Sales Tax Assessment Act (No.9), and does not apply to leases of goods under hire-purchase agreements, the sale value of which is, by virtue of sub-section 4(2) of that Act, the fair wholesale value of the goods at the time the lease is effected.

19. Some finance companies engage in the financing of sales of taxable goods made by persons registered for sales tax purposes by the factoring of debts. The position as to the claiming of bad debts in cases where the registered person legally assigns a debt and the retailer subsequently does not pay the assignee, i.e., the factor, is that the registered person is not entitled to claim the bad debt of the factor as a deduction in returns. Having legally assigned the debt, the registered person is not the person who writes off the debt as bad. It is the factor who does this. The situation is not altered even if, under the terms of the assignment, the factor may have recourse to the registered person in respect of bad debts because it still remains the bad debt of the factor.

COMMISSIONER OF TAXATION
10 March 1988