



## Retail Bad Debt

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### Overview

Consumers seek retail installment sales contracts to finance larger, more expensive purchases like vehicles, boats, appliances and furniture. Installment sales contracts allow consumers to pay off the purchase over time with reasonable monthly payments.<sup>1</sup> Unfortunately, circumstances occasionally arise, whereby customers, for one reason or another, lose the ability to pay off, or decide not to pay off, their purchases. In these cases, when dealing with a vehicle, the consumer's vehicle is returned to the finance company or vendor and sold at auction with the proceeds used toward the unpaid debt. The proceeds are to include any paid sales taxes.<sup>2</sup> Upon receiving the proceeds, a finance company applies the amount received toward the unpaid portion of the contract. Any remaining amount is considered a deficiency balance and is still owed by the consumer. If further collection efforts fail, the unpaid amount may be determined to be uncollectable and is charged off and considered a *bad debt*.<sup>3</sup>

For a consumer who makes a purchase on an installment sales contract, the financed amount usually includes sales taxes due for the full cost of the purchase, which are included in the payments spread out across the term of the contract. Because the consumer repays the contract in regular installments over months or years, the full sales tax amount is remitted to the state tax authority long before the contract is paid off. When the borrower fails to pay the total outstanding balance, it means the finance company has funded the entire amount of the sales tax, but only received repayment for a portion of it. Retail bad debt statutes are drafted to reflect the relationship between retailers and financial institutions to finance sales, as well as the process for remitting sales taxes.<sup>4</sup> Under retail bad statutes, the financial institution is entitled to a tax credit or deduction for the amount of the sales tax remitted but unpaid by the consumer on accounts considered uncollectable.

Financial institutions benefit from retail bad debt laws, not just because of the tax advantage that comes from the deductions or credits, but also because they lower the financial risk associated with accounts that may become uncollectable. These benefits are largely felt by consumers. Lower risks associated with providing financing will mean more competition and more credit availability. This will facilitate financial inclusion and increase availability of an essential

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<sup>1</sup> American Finance Services Association, *Retail Bad Debt*, at [https://afsaonline.org/afsa\\_resource/retail-bad-debt-tps/](https://afsaonline.org/afsa_resource/retail-bad-debt-tps/), (August 2020).

<sup>2</sup> *ID.*

<sup>3</sup> *ID.*

<sup>4</sup> *ID.*

financial capability, which helps consumers establish financial stability and manage their finances effectively.<sup>5</sup>

Retail businesses also benefit from retail bad debt laws.<sup>6</sup> Retail companies forward substantial amounts of sales tax owed monthly to their states, and the sales tax is conveyed to the state revenue department before customer payments are collected because of retail installment sales contracts.<sup>7</sup> Some businesses provide their own financing and, also, remit sales tax before money is recouped. Without retail bad debt laws, retail businesses could face more difficulty facilitating financing for their customers, because financial institutions would be forced to pay all the sales tax on consumer accounts that would never be fully paid,<sup>8</sup> and, when the returned item is resold, be liable for the full sales tax, again. This may be especially impactful for small retailers who could face serious financial difficulty if financing is limited without retail bad debt statutes.

Financial institutions, retail businesses, and consumers all benefit from retail bad debt laws, due to their proven role in cutting costs, lowering interest rates and allowing many more consumers to qualify for loans. AFSA advocates that it is essential for states to create, maintain and reinforce retail bad debt statutes.<sup>9</sup> These laws recognize today's crucial consumer, retail business and lender relationships and promotes fairness for all parties involved.

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<sup>5</sup> *ID.*

<sup>6</sup> RSM, *Navigating Sales Tax Bad Debt Is More Important Than Ever*, at <https://rsmus.com/insights/services/business-tax/navigating-sales-tax-bad-debt-is-more-important-than-ever.html>, (September 2021).

<sup>7</sup> *ID.*

<sup>8</sup> Southwest Public Policy Institute, *Why Retail Bad Debt Statutes are Vital for Businesses and Consumers Alike*, at <https://southwestpolicy.com/why-retail-bad-debt-statutes-are-vital-for-businesses-and-consumers-alike/>, (April 2023).

<sup>9</sup> American Finance Services Association, *Retail Bad Debt*, at [https://afsaonline.org/afsa\\_resource/retail-bad-debt-tps/](https://afsaonline.org/afsa_resource/retail-bad-debt-tps/), (August 2020).



**Nevada Chapter 372** was revised in November 2022. Currently effective, Section 910 permits a direct sales organization to the same deductions, allowances and collection credits to which an independent salesperson would be entitled if the sales tax collection agreement were not in effect. Section 532 defines a bad debt deduction as the deduction from the taxable sales of a retailer provided pursuant to [NRS 372.368](#) and [374.373](#) for the amount of the sales price which the retailer is unable to collect. Also revised was Section 534 that describes the procedures a retailer is required to complete before requesting a retail sales tax deduction. A retailer who claims a bad debt deduction is required to file a claim form with the state Revenue Department no later than 12 months after the last day of the month and to write off the bad debt in the retailer's business records to become eligible to claim a deduction for the bad debt.

**Ohio** Republican Governor Mike DeWine signed [HB 223](#) on December 22, 2022. This law became effective March 23, 2023. This law permits businesses to deduct sales tax collected for certain bad debts charged off as uncollectible by credit account lenders. This law defines and focuses on a "private label credit account" that carries, refers to, or is branded with the name of a vendor for the lender. Previous bill [SB 188](#) from the 2020 regular session died in the Senate Finance Committee in December 2021.

**Texas HB 3389** was left pending in the House Ways and Means Committee on May 1 before the legislature adjourned on May 29. The bill would allow a seller who is required to collect taxes on sales, rental and use of motor vehicles to file a claim with the comptroller to receive a refund of sales taxes paid on the seller's bad debt under certain circumstances. If the seller assigns the retail installment contract to a lender in a retail installment transaction, the lender could file a claim for a refund of sales taxes paid on the seller's bad debt. In April 2023, AFSA advocated for retail bad debt legislation in Texas.<sup>17</sup> AFSA's comment letter for HB 3389 emphasized that financed motor vehicle retail sales tax transactions that are repaid in full are critical in preventing an additional unfair and unwarranted tax burden on businesses.

## Conclusion

Allowing financial institutions to claim refunds for sales tax paid in advance for financed retail transactions that are not repaid in full, is critical in preventing an additional, unfair and unwarranted tax burden on businesses. Preventing this burden benefits consumers and businesses alike by decreasing the risk of providing credit and lowering the cost of credit for borrowers. Financial institutions rely on bad debt statutes to offset the risk of purchasing retail installment contracts from dealers and to mitigate losses associated with uncollectable accounts. Consumers also directly benefit from retail bad debt laws because the amount recovered by the financial institution is then credited to offset any loss. In states that don't allow bad debt refunds, non-recourse retailers are forced to sell their accounts at a discounted price and, in some cases, the lender may forgo the purchase altogether if the risk of doing so cannot be offset by the sales tax credit. AFSA will continue to monitor legislation in this area closely and to advocate for states to create, maintain and reinforce retail bad debt statutes.

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<sup>17</sup> American Finance Services Association, *Texas HB 3389 Re: Retail Bad Debt*, at [https://afsaonline.org/afsa\\_resource/texas-hb-3389-re-retail-bad-debt/](https://afsaonline.org/afsa_resource/texas-hb-3389-re-retail-bad-debt/), (April 2023).