**Section 130.1960 Finance Companies and Other Lending Agencies – Installment Contracts – Bad Debts**

a) Lending Agencies – When Liable For Tax

Finance companies and other lending agencies are not relieved from liability for tax in cases in which they engage in the business of selling to users or consumers tangible personal property to which they hold or acquire title. Except as provided in subsection (b), when a lending agency transfers title to a repossessed car to a user, the lending agency is engaging in the business of selling tangible personal property at retail and incurs Retailers' Occupation Tax (ROT) liability on its receipts from those sales. It shall be registered as a retailer under the Retailers' Occupation Tax Act and shall file returns and otherwise comply with that Act.

b) Lending Agencies – When Not Liable For Tax

1) Finance companies and other lending agencies are engaged primarily in the business of financing or acquiring the promissory notes given by purchasers of automobiles, furniture, refrigerators or other items of tangible personal property.

2) To guarantee payment of these promissory notes, lending agencies sometimes take as security chattel mortgages upon the tangible personal property. When the purchaser of the automobile or other tangible personal property fails to meet its obligation, the lending agency repossesses the property and sells it to satisfy the obligation evidenced by the notes. In connection with these sales, the lending agency acts as agent for the owner of the repossessed property if the owner is known or disclosed to the purchaser and if the lending agency does not take title to the property; the lending agency, under these circumstances, is not liable for payment of any ROT with respect to the proceeds from these sales.

3) Even if the lending agency does title a repossessed motor vehicle in its name, if the original buyer, after the expiration of the redemption period provided for in the Retail Installment Sales Act [815 ILCS 405], is granted permission to redeem and to resume possession of the vehicle and to continue performance under the buyer's original installment contract without any change in the terms of the contract, and the lending agency re-endorses the repossession title to the original buyer, the transaction is not regarded as a sale and so is not taxable.

c) Installment Sales

1) When a retailer of tangible personal property sells an installment contract or "paper" to a third party, the difference between the selling price of the tangible personal property and the selling price of the installment contract or "paper" is a cost of doing business and is therefore not deductible in computing ROT liability. ROT is measured by the total selling price of the tangible personal property purchased from the retailer for use or consumption. Upon sale of the installment contract or "paper" to a third party, ROT becomes due based on the entire selling price to the purchaser of the tangible personal property, with credit allowed for any tax already remitted to the Department based on the receipts from the sale of the tangible personal property. As an illustration, a computer vendor enters into an installment sales contract with a business for a computer system. The selling price of the computer system is $120,000 and the contract requires monthly installment payments of $10,000 for one year. After the business makes the first payment, the computer vendor sells the installment contract to a bank for $90,000. Upon the sale of the installment contract to the bank, the computer vendor incurs ROT on $120,000 (the entire selling price to the original purchaser), with credit allowed for the tax that was remitted on the first $10,000 payment made by the business.

2) For purposes of this Section, "paper" means any instrument of indebtedness that was acquired by the retailer from the purchaser of the tangible personal property. Sales of "paper" to a third party includes the sale of accounts receivable as well as assignments or sales of the actual instruments of indebtedness themselves.

d) Bad Debts

1) Definitions. For purposes of this subsection (d):

A) "Bad debt" means any portion of a debt arising from a taxable sale at retail that is:

i) found to be worthless or uncollectible;

ii) has been charged off in the retailer's or lender's books and records; and

iii) has, except as provided in subsections (d)(2)(F) and (G), been claimed as a deduction pursuant to the Internal Revenue Code, U.S. Code: Title 26. For information on calculation of the bad debt deduction see subsection (d)(4).

B) "*Retailer" means a person who holds* itself *out as being engaged (or who habitually engages) in selling tangible personal property at retail with respect to such sales and includes a retailer's affiliates.*

C) "*Lender" means a person, or an affiliate, assignee, or transferee of that person, who owns or has owned a private-label credit card account or an interest in a private-label credit card receivable that the person purchased directly from a retailer who remitted the tax imposed under the Retailers' Occupation Tax Act; originated pursuant to that person's contract with the retailer who remitted the tax imposed under the Retailers' Occupation Tax Act; or acquired from a third party.*

D) "*Private-label Credit Card" means a charge card or credit card that carries, refers to, or is branded with the name or logo of a retailer and may only be used to make purchases from that retailer or that retailer's affiliates.*

E) "*Affiliate" means an entity affiliated under section 1504 of the Internal Revenue Code, or an entity that would be an affiliate under that section had the entity been a corporation.* [35 ILCS 120/6d]

2) Bad Debt Claimed by Retailers

A) In case a retailer repossesses any tangible personal property and subsequently resells that property to a purchaser for use or consumption, the retailer's gross receipts from that sale are subject to ROT. The retailer is entitled to a bad debt credit with respect to the original sale in which the default has occurred to the extent to which it has paid ROT on a portion of the price that the retailer does not collect, or that the retailer is not permitted to retain because of being required to make a repayment of that portion to a lending agency under a "with recourse" agreement.

B) Retailers of tangible personal property other than motor vehicles, watercraft, trailers and aircraft that must be registered with an agency of this State may obtain this bad debt credit by taking a deduction on the returns they file with the Department for the month in which the federal income tax return or amended federal income tax return on which the receivable is written off is filed, or by filing a claim for credit as provided in subsection (d)(2)(E).

C) Because retailers of motor vehicles, watercraft, trailers and aircraft do not pay ROT to the Department on retail sales of motor vehicles, watercraft, trailers and aircraft with monthly returns, but remit the tax to the Department on a transaction by transaction basis, they are unable to take a deduction on the returns that they file with the Department, but may file a claim for credit with the Department, as provided in subsections (d)(2)(E), (F), (G) and (d)(5)(B) on any transaction with respect to which they desire to receive the benefit of the repossession credit.

D) Retailers who incur bad debt on any tangible personal property that is not repossessed may also obtain bad debt credit as provided in subsections (d)(2)(A), (E), (F) and (G).

E) In the case of tax paid on an account receivable that becomes a bad debt, the tax paid becomes a tax paid in error, for which a claim for credit may be filed in accordance with Section 6 of the Retailers' Occupation Tax Act, on the date that the federal income tax return or amended return on which the receivable, including as provided in subsections (d)(2)(F) and (G), is written off is filed.

F) Ordinarily, a deduction for uncollectible debts is allowed only for a retailer who uses the gross sales (accrual) method of accounting to keep its books and records and to file its federal income tax and sales and use tax returns. However, in the limited situation in which a cash basis retailer has prepaid the tax, such retailer is allowed to claim a bad debt deduction if the debt:

i) has been found to be worthless or uncollectible; and

ii) would be eligible to be both charged off in the retailer's books and records and claimed as a deduction under the Internal Revenue Code if the retailer had kept accounts on an accrual basis.

G) Likewise, retailers who use the gross sales method for filing their sales tax returns, but who file their income tax returns on a cash basis are allowed to claim a bad debt deduction if the debt:

i) has been found to be worthless or uncollectible; and

ii) has been charged off in the retailer's books and records and would be eligible to be claimed as a deduction under the Internal Revenue Code on the income tax return filed by the retailer if its income tax return was not filed on the cash basis.

EXAMPLE: ABC Auto Inc. reports on the cash method of accounting and is in the business of making retail sales of automobiles. On occasion, ABC Auto Inc. will itself finance sales for some of its customers and pay the full amount of sales tax upfront so that its customers can obtain license plates. In 2020, ABC Auto Inc. financed a sale to a customer and paid the sales tax upfront. The customer never made a payment, and in 2021 the debt was found to be worthless. If ABC Auto Inc. reported on the accrual method, the debt would be eligible to be both charged off as a bad debt in the retailer's books and records and claimed as a deduction pursuant to the Internal Revenue Code. Therefore, ABC Auto Inc. can file a claim for the sales taxes it paid out-of-pocket to the Department. For purposes of filing a claim with the Department, the bad debt will be considered claimed as a deduction pursuant to the Internal Revenue Code on the 2021 income tax return filed byABC Auto Inc.

H) For information on claiming a deduction or refund for tax previously paid, see subsection (d)(5).

3) Private-label Credit Cards – Bad Debt on and after July 31, 2015

A) On and after July 31, 2015, *with respect to the payment of taxes on purchases made through a private-label credit card, if consumer accounts or receivables are found to be worthless or uncollectible, the retailer may claim a deduction on a return in an amount equal to, or may obtain a refund of, the tax remitted by the retailer on the unpaid balance due if:*

i) *the accounts or receivables have been charged off as bad debt on the lender's books and records on or after January 1, 2016;*

ii) *the accounts or receivables have been claimed as a deduction pursuant to Section 166 of the Internal Revenue Code on the federal income tax return filed by the lender; and*

iii) *a deduction was not previously claimed and a refund was not previously allowed on that portion of the account receivable.*

B) The deduction or refund allowed under subsection (d)(3)(A):

i) *does not apply to credit sale transaction amounts resulting from purchases of titled property;*

ii) *includes only those credit sale transaction amounts that represent purchases from the retailer whose name or logo appears on the private-label credit card used to make those purchases;*

iii) *may only be taken by the taxpayer, or its successors, that filed the return and remitted tax on the original sale on which the deduction or refund claim is based; and*

iv) *includes all credit sale transaction amounts eligible under* subsection (d)(3)(B)(ii) *that are outstanding with respect to the specific private-label credit card account or receivable at the time the account or receivable is charged off, regardless of the date the credit sale transaction actually occurred.*

4) Bad Debt Calculation

A) If the amount of an account found to be worthless is comprised in part of nontaxable receipts, such as interest, insurance, and other charges exempt from sales or use tax, 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.

B) Accounts found to be worthless include receivables written off as uncollectible by a retailer or lender who uses the bad debt reserve method or allowance for doubtful account method of recognizing bad debt expenses pursuant to the Internal Revenue Code.

C) No deduction is allowed for expenses incurred in attempting to enforce collection of any account receivable, or repossession expenses.

D) No deduction is allowed for payments of late fees, and other penalty charges that occur when customers do not comply with the terms of the sales contract.

E) The fair market value of repossessed property is not factored into a bad debt calculation.

F) For purposes of computing the deduction or refund, payments on the accounts or receivables shall be prorated against the amounts outstanding on the accounts or receivables. For information on claiming a deduction or refund using an alternative method, see subsection (d)(4)(G).

i) For revolving credit loans involving private label credit cards, retailers may calculate the uncollectible taxable amount by applying the percentage of charges that went to taxable purchases to the outstanding balance on the account.

Example: ABC Retailer Inc. allows customers to finance purchases using a private label credit card. During the time the card was active, the customer had the following charges added to the customer's account:

|  |  |  |
| --- | --- | --- |
| **Charge** | **Amount** | **Percentage** |
| Taxable Merchandise: | $10,000 | 87.7% |
| IL State and local sales taxes: | $800 | 7.0% |
| Interest fees: | $500 | 4.4% |
| Late fees: | $100 | 0.9% |
| Total: | $11,400 |  |

The outstanding balance at the time of the charge off was $1,000. Applying the 87.7% merchandise proration percentage to the $1,000 charge off amount results in an uncollectible taxable amount of $877. (The merchandise proration percentage is calculated by dividing the charge item amount by the total charge amount).

ii) For installment loans, the formula for calculating the uncollectible taxable amount is the unpaid balance when the receivable is charged off divided by the total amount of the finance contract multiplied by the taxable amount financed.

Example: XYZ Auto Inc. sells an automobile for $20,000. The tax due on the sale at 6.25% is $1,250. The customer makes a $1,000 down payment and finances the remaining amount of the purchase price plus the sales taxes through XYZ Auto Inc. The applicable loan details are as follows:

|  |  |
| --- | --- |
| Total Amount Financed: | $20,250 |
| Taxable Amount Financed: | $19,000 |
| Total Interest Payments: | $10,000 |
| Total Finance Contract: | $30,250 |

The customer makes $5,000 in payments but then stops paying with the unpaid balance of the total finance contract being $25,250. ($30,250 - $5,000). XYZ Auto Inc. determines the loan is uncollectible. The uncollectible taxable amount is calculated as follows:

|  |  |  |
| --- | --- | --- |
| Uncollectible Taxable Amount | = | (unpaid balance when charged off / total amount of the finance contract) x taxable amount financed |
| Uncollectible Taxable Amount | = | $25,250/$30,250 x $19,000 |
| Uncollectible Taxable Amount | = | $15,860 |

G) The Department may allow an alternative method of substantiating the deduction or refund where the volume and character of the uncollectible accounts would warrant use of alternative computations and the Department finds that, subject to the provisions of this Section, the method used fairly and equitably

i) prorates the taxable and nontaxable elements of a bad debt; and

ii) computes the amount of sales tax imposed and remitted with respect to the taxable charges remaining unpaid on the bad debt.

H) In situations where the books and records of the retailer or lender support an allocation of the bad debt allowance among multiple states, an allocation of the bad debt is allowed between Illinois and the other state or states.

5) Bad Debt Procedural Requirements – Record Keeping – Limitations

A) Retailers of tangible personal property other than motor vehicles, watercraft, trailers, and aircraft that must be registered with an agency of this State may obtain this bad debt credit by taking a deduction on the returns they file with the Department for the month in which the federal income tax return or amended federal income tax return on which the receivable is written off is filed. Failure to take the deduction on the proper return will not in itself prevent the allowance of a deduction or refund provided an amended return for that month or claim for refund is filed with the Department within the statute of limitations as provided in subsections (d)(2)(A) and (B).

i) When a retailer who uses the bad debt reserve or allowance for doubtful account method of recognizing bad debt expenses takes a deduction on the federal income tax return prior to writing off the receivable in its books and records, the retailer may take a deduction on the return filed with the Department for the month in which the federal income tax return or amended federal income tax return covering the period in which the receivable is written off in its books and records is filed.

ii) If the bad debt deduction exceeds the amount of the taxable sales on the Form ST-1 return for the period in which the retailer's federal income tax return is filed or amended, the taxpayer is allowed to carry forward the unclaimed portion of the bad debt deduction and apply it to succeeding Form ST-1 returns until it has been deducted in its entirety.

iii) Any amount of a bad debt deduction taken that is subsequently collected by the retailer, in whole or part, shall be included in the first return filed after the collection, and the tax shall be paid with the return.

B) Because retailers of motor vehicles, watercraft, aircraft, and trailers do not pay Retailers' Occupation Tax to the Department on retail sales of motor vehicles, watercraft, trailers and aircraft with monthly returns, but remit the tax to the Department on a transaction-by-transaction basis, they are unable to take a deduction on the returns that they file with the Department but instead may file a claim for credit with the Department, as provided in Section 6 of the Retailers' Occupation Tax Act, using Form ST-557, available at https://tax.illinois.gov/.

C) *The retailer and lender shall maintain adequate books, records or other documentation supporting the charge off of the accounts or receivables for which a deduction was taken or a refund was claimed under Sections 6 or 6d of the Retailers' Occupation Tax Act,* including, but not limited to, a copy of that part of the federal return on which the deduction was claimed, including any supporting statements or schedules*.*

D) If a retailer or lender does not charge off an account receivable that is found to be worthless or uncollectible as a bad debt in its books and records and does not claim a deduction pursuant to the Internal Revenue Code on its federal income tax return or amended return, or, for cash basis retailers, the account receivable would not be eligible to be claimed as a deduction pursuant to the Internal Revenue Code on its federal income tax return or amended return if the retailer or lender filed a federal income tax return on an accrual basis, the tax paid on that bad debt or receivable will not be considered a tax paid in error. Thus, the retailer will not be able to file a deduction or claim for credit in accordance with Sections 6 or 6d of the Retailers' Occupation Tax Act.

E) *For purposes of the deduction or refund allowable under Section 6d of the Retailers' Occupation Tax Act, the limitations period for claiming the deduction or refund shall be the same as the limitations period set forth in Section 6 of the Retailers' Occupation Tax Act for filing a claim for credit, and shall commence on the date that the accounts or receivables have been claimed as a bad debt deduction pursuant to section 166 of the Internal Revenue Code on the federal income tax return filed by the lender, regardless of the date on which the sale of the tangible personal property actually occurred.* [35 ILCS 120/6d].

(Source: Amended at 48 Ill. Reg. 2856, effective February 8, 2024)