

SA-VIT COLLECTION AGENCY TIPS OF THE MONTH ARCHIVES



May 2009

Bad Debts and Income Taxes

This time of year the question comes up, "Why can't a healthcare practice deduct bad debts from their gross income for tax purposes?"

There are two ways of accounting on which income taxes are paid. One is called cash basis accounting and the other is accrual accounting.

Most healthcare practices and other service-based business are usually on the cash basis accounting system. This means that the practice pays taxes only on the cash received. Since the bad-debt cash was never received the income tax was not paid on that bad debt.

Other businesses, like manufacturing, use accrual accounting and declare their income when the products are shipped, so they pay income taxes on the amount charged not on the money received. If the company getting the goods does not pay the invoices, the business can write off the original charge as a bad debt and thus deduct the prepaid tax on that income.

In the medical field it would be a nightmare to use accrual accounting because of the insurance write downs, secondary insurance payments, courtesy write-offs and bad debt recovery.

With cash basis accounting healthcare facilities only pay income taxes on their net income.