Cite as Det. No. 01-075ER, 23 WTD 64 (2004)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Refund of	)	F I N A L E X E C U T I V E
	)	D E T E R M I N A T I O N
	)	
	)	No. 01-075ER[1]
	)	
. . .	)	Registration No. . . .
	)	
	)	Docket No. . . .
	)	

RULE 196; RCW 82.08.037: RETAIL SALES TAX – BAD DEBT CREDIT -- FINANCIAL BUSINESSES -- PRIVATE LABEL CREDIT CARD. A financing business that offered private label credit card services to a retail store's customers was not entitled to a retail sales tax credit for bad debts where it was not the person that previously paid the retail sales taxes to the state.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

NATURE OF ACTION:

A financing business petitions for executive level reconsideration of that part of Det. No. 01-075 in which we denied its request for a retail sales tax credit for bad debts under RCW 82.08.037.[2]

FACTS:

Okimoto, A.L.J. – . . . (Taxpayer) is a financing business with its administrative office located in [State A]. On December 31, 1996[3] Taxpayer filed a refund claim for unclaimed bad debt credits covering the period January 1, 1990 through November 30, 1996 in the amount of $ . . . . Taxpayer explained the basis for the credit in its original petition for refund as follows:

[1] The original determination, Det. No. 01-075, is published at 23 WTD 55 (2004).
[2] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.
[3] Taxpayer had previously filed waiver claims preserving its rights for a refund for the years 1990 and 1991.

Pre – . . . , 1994 Period.

> [Taxpayer] provides financing services for private-label credit card programs involving sellers in many industries. [Taxpayer] purchases consumer revolving charge accounts from sellers.
>
> The transactions, which give rise to the bad debt sales tax refund in this claim, begin with the sale of tangible personal property or taxable services by a seller to a purchaser on a credit basis. Immediately following this sale the seller pays the sales tax on the entire amount of the sale to the Washington Department of Revenue. The retailer subsequently assigns the account to [Taxpayer]. The purchase price [Taxpayer] pays for the account includes the amount of sales tax paid by the seller to the Department of Revenue, which is then collected by [Taxpayer] from the consumer.
>
> The retailer assigns the account to [Taxpayer] on a nonrecourse basis. [Taxpayer], therefore, has all of the rights, title and interest of the retailer in the account. When a consumer defaults, [Taxpayer] will not be able in most instances to recover the outstanding balance. At that time, the unrecovered portion of the debt becomes a worthless debt for federal income tax purposes.

Taxpayer stated it purchased [Store's] accounts receivables at full face value and received all rights regarding those accounts. In addition, Taxpayer received an account service fee of $ . . . for each active account during the service period. [Store] paid an account collection service fee because Taxpayer had purchased the receivables at full face value and not at a discount. The contract also required Taxpayer to allocate a portion of its service fee to fund a Loss Reserve Account in the name of [Store]. This account was set at the level of estimated bad debts. As accounts went bad, they were charged against the Loss Reserve Account. [Store] was also obligated to pay Taxpayer a Loss Supplement Fee of $ . . . for each settlement period. Any unused balance in the Loss Reserve Account at termination belonged to [Store].

Post - . . . , 1994 Period.

In 1994 [Store] decided that it wanted to get out of the credit card business. Consequently, on . . . 1994, Taxpayer changed the private label credit card program with [Store] so that Taxpayer and not [Store] became the principal. From that date forward, Taxpayer provided the credit card services directly to [Store] customers, and in Taxpayer's own name. The credit card application was made to, and accepted by Taxpayer. Taxpayer advanced the money and ran and operated the entire credit card program. [Store] was no longer involved in the lending activities.

Taxpayer relied on *Puget Sound National Bank v. Department of Revenue,* 123 Wn.2d 284, 868 P.2d 127 (1994), in support of its position that it is entitled to a bad debt credit for retail sales taxes paid and subsequently written-off as worthless on its federal income tax return.

In Det. No. 01-075, we allowed the retail sales tax bad debt credit for periods prior to . . . 1994, but not for later periods because of the different relationship. In disallowing the credit, we stated:

> As stated above, the Washington Supreme Court has interpreted RCW 82.08.037, as having three requirements before the bad debt credit will be allowed:
>
> > . . . (1) the seller must be a person, (2) making sales at retail, and (3) entitled to a refund for sales taxes previously paid on debts which are deductible as worthless for federal income tax purposes. *Puget Sound* at 287.
>
> In *Puget Sound*, even though Bank was not making sales at retail, it satisfied the second requirement because the orginal seller had assigned all of its rights and obligations regarding the receivables to Bank. As a result, Bank was held to satisfy the requirement of "making sales at retail" because it "stood in the shoes" of the original seller who satisfied that requirement. For periods after . . . , 1994, however, Taxpayer is neither making sales at retail in its own right, nor is it the assignee of all rights from the original seller, [Store]. Instead, during this period, Taxpayer is only loaning or extending credit directly to [Store]'s customers so that they can purchase goods and services from [Store]. Taxpayer acts only as a financing company and makes no retail sales.[4] Consequently, Taxpayer does not satisfy the second requirement of "making sales at retail" within the meaning of RCW 82.08.037 and is not entitled to the credit.

CONTENTIONS AND ARGUMENTS:

On reconsideration, Taxpayer makes the following arguments. First, Taxpayer states that for periods after . . . , 1994, Det. No. 01-075 is in error when it finds that Taxpayer is not making sales as a retailer, in its own right. Taxpayer points out that even though it does not make retail sales through its [Store] private label credit card program, it does make retail sales in Washington state through its retail equipment-leasing program. Taxpayer states that it is registered with the state of Washington and has reported retailing and retail sales tax on equipment rentals throughout the audit period. Consequently, Taxpayer argues that since it makes sales at retail in the state of Washington in its own right, it satisfies the second requirement under RCW 82.08.037.

Second, Taxpayer argues that to make a distinction between the pre-1994 private label credit card programs and the post-1994 private label credit card programs just because no assignment was made is inconsistent and arbitrary. Taxpayer states:

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[4] Taxpayer explained the differences between the [Store] Washington credit card program before and after . . . , 1994 as follows: "For the period January 1, 1990 through . . . , 1994, [Taxpayer] purchased accounts at face value from [Store]. [Store] assigned all its rights, title and interest in the accounts to [Taxpayer]. Starting . . . , 1994, the [Store] agreement was amended to provide that for Washington cardholders only, [Taxpayer] would extend credit directly to [Store] cardholders rather than purchase the accounts from [Store]." Taxpayer's Letter dated May 25, 2000.

> The restructuring of the arrangement whereby [Taxpayer] offers direct credit to cardholders should not change the result simply because there is no assignment. Under this reasoning, [Taxpayer] would be able to sell their direct credit program accounts and the buyer would then be entitled to the refund by virtue of the fact that they are assignees. [Taxpayer] is certainly bearing the risk of loss by extending credit which includes an amount necessary to satisfy the tax liability. It should, therefore reap the benefit by being able to obtain the refund. To do otherwise would be contrary to the rationale of *the Puget Sound, supra*, decision which stated that such distinctions are inconsistent and arbitrary.

Finally, Taxpayer states that:

> The court in *Puget Sound, supra*, emphasized the fact that not allowing the refund would entitle the State to a windfall simply because an assignment took place. The State would also enjoy a windfall in this situation in that it would have been prepared to offer the refund to [Taxpayer] as an assignee but not as a direct credit debtor. Additionally, [Store] will have no claim for bad debt refunds since they do not write-off the worthless accounts on its federal income tax return.

ISSUE:

Is a financing business that offers private label credit card services directly to a retail store's customers entitled to a retail sales tax credit for bad debts written off on its federal income tax return?

DISCUSSION:

Post - . . . , 1994 Period:

RCW 82.08.037 and WAC 458-20-196 (Rule 196) allow the bad debt credit and provide:

> A seller is entitled to a credit or refund for sales taxes previously paid on debts, which are deductible as worthless for federal income tax purposes.

The case upon which Taxpayer relies, *Puget Sound National Bank v. Department of Revenue*, 123 Wn.2d 284, 868 P.2d 127 (1994), is the most recent pronouncement in this area. In *Puget Sound*, car dealers had entered into installment contracts with retail car buyers to allow them to purchase cars over a period of time. At the time of purchase, the dealers charged retail sales tax to their customers on the full sales price of the automobile and remitted that amount to the State. Puget Sound National Bank (Bank) purchased these installment contracts at full face value on a non-recourse basis from the dealers who had sold the vehicles. In return, the dealers assigned to Bank all of the dealers' rights under the installment contract. After the assignment, many buyers defaulted on their contracts and Bank repossessed the automobiles and usually sold them at a loss. That loss was then written off as a worthless debt on Bank's federal income tax return.

The Department denied Bank's refund request for retail sales taxes previously paid on contracts written-off as bad debts, and Bank appealed to court.

On reconsideration, Taxpayer contends that the retail sales made by its equipment rental operation should satisfy the second requirement under the holding of *Puget Sound*, i.e., the making of sales at retail. Taxpayer contends that the Court does not interpret the statute to require that the bad debts for which it claims the credit must arise from the same sales at retail which qualify the taxpayer for the bad debt credit. In other words, the taxpayer argues that making any retail sales in this state is merely a condition precedent to receiving the bad debt credit. We disagree. We believe that only the retailer that made the original retail sale of the product being financed and who previously paid retail sales tax on the original sale is entitled to the bad debt credit.[5] This interpretation is supported by the language in the last part of RCW 82.08.037 which limits the credit to the retailer that "is entitled to a credit or refund *for sales taxes previously paid on debts . . . .*" [Emphasis added.]

To better understand the legislature's intent in enacting the retail sales tax bad debt credit, we believe it helpful to examine the economic effect that a bad debt credit has on retail sellers and financing businesses.

In regard to sellers making retail sales, the retail sales tax is actually imposed on the purchaser. RCW 82.08.050 only imposes upon the seller the duty to collect the tax from the purchaser on behalf of the state and to remit 100% of all retail sales taxes collected. We further note that a seller making retail sales on an accrual basis is required to report and remit retail sales taxes on the full sales price of the product sold in the month the sale was made. WAC 458-20-199. This is true even though a seller may actually collect the proceeds of sale and retail sales tax at some later time. The ultimate effect of this reporting procedure is that the seller is required to advance to the customer the entire invoiced amount of retail sales tax with the expectation that it will later be able to collect it from the purchaser. When a retail sale becomes uncollectible and a bad debt occurs, however, the seller is never able to collect the full amount of retail sales tax that was previously advanced and remitted to the state. In such situations, the retail seller bears the entire economic loss of advancing 100% of the retail sales tax to the customer and being unable to collect reimbursement. We believe that it was this harsh result that the retail sales tax bad debt credit was designed to alleviate. In general, we believe bad debt credits and deductions[6] are intended to adjust a seller's tax liability to the amount of compensation actually received for its products or services and upon which it has previously paid taxes. *See generally*, WAC 458-20-196.

The economic impact of a bad debt deduction for financing businesses is significantly different from the economic impact on a retailer, specifically as it relates to the payment of B&O and retail sales taxes. Financing businesses, such as Taxpayer, pay B&O tax on their gross income

[5] In *Puget Sound*, the bank was the assignee of all rights and therefore stood in the shoes of the original seller.
[6] RCW 82.04.4284 allows a bad debt deduction from B&O taxes, whereas RCW 82.08.037 allows a bad debt credit for retail sales taxes.

measured by interest and financing charges, but not on the return of loan principal. Det. No. 99-121, 19 WTD 153 (2000). For periods after . . . , 1994, Taxpayer acted solely as a financing business. [Store] customers purchased products and charged the sales amount to Taxpayer's credit cards. Taxpayer paid the amounts charged for the products and retail sales taxes to [Store] and [Store] reported and remitted the appropriate retail sales taxes. In such cases, [Store] was fully compensated for the amount of retail sales taxes it advanced on behalf of its customers and for the sales price of the products sold. Furthermore, the entire amount charged on Taxpayer's credit card (including retail sales taxes) is principal, and Taxpayer pays no B&O taxes on the return of its principal. Instead, Taxpayer pays B&O tax only on its interest and service charges. WAC 458-20-146. This is only a small portion of the total payments received by Taxpayer from its credit card holders.

Furthermore, bad debts credits and deductions are generally only intended to return to a taxpayer B&O or retail sales taxes which that taxpayer had previously paid on worthless accounts. WAC 458-20-196.

For the above reasons, we believe RCW 82.08.037 requires that the person taking the bad debt retail sales tax credit must have been the person (or its assignee) who actually paid or remitted the retail sales taxes to the state. For periods after . . . , 1994, Taxpayer was not that person. Taxpayer had not previously paid sales taxes on the debts, which were later deducted as worthless for federal income tax purposes. The retail sales taxes were remitted and paid solely by [Store] and not Taxpayer. In addition, Taxpayer could not have received that status from [Store], because no assignment of rights was made. Accordingly, we find that Taxpayer fails to meet the second requirement of RCW 82.08.037 for periods after . . . , 1994.

DECISION AND DISPOSITION:

Taxpayer's petition for executive reconsideration of its refund request for retail sales taxes paid on bad debts is denied.

Dated this 22nd day of August, 2002.