

Cite as Det No. 10-0201, 31 WTD 43 (2012)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of)	<u>D E T E R M I N A T I O N</u>
Assessment of)	
)	No. 10-0201
...)	
)	
)	Registration No. . . .
)	Document No. . . .
)	Audit No. . . .
)	Docket No. . . .
)	

- (1) RULE 196; RCW 82.08.037 – RETAIL SALES TAX – CREDIT OR REFUND FOR BAD DEBTS – REPOSSESSIONS. The amount of any credit or refund for sales and use taxes previously paid on “bad debts” must be adjusted to exclude amounts attributable to the value of repossessed property taken in payment of debt.
- (2) RULE 196; RCW 82.04.4284 – RETAILING B&O TAX – CREDIT OR REFUND FOR BAD DEBTS – REPOSSESSIONS. The “bad debts” may be deducted from the measure of tax for B&O tax purposes, but that “bad debt” deduction is not to include the value of repossessed property. If a deduction is taken for a bad debt and the debt is subsequently collected in whole or in part (including by repossession), the tax on the amount collected must be paid and reported on the return filed for the period in which the collection is made.

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.

Weaver, A.L.J. – Taxpayer, a used car dealer, petitions for correction of an assessment of retail sales tax and retailing business and occupation (B&O) tax based upon the Department of Revenue (Department) disallowing a portion of Taxpayer’s claimed bad debt deductions for the value of automobiles subsequently repossessed by Taxpayer. . . . Taxpayer’s petition is denied.¹

¹ Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410. Nonprecedential portions of this determination have been deleted.

ISSUES

1. Whether, under RCW 82.08.037, a car dealer is entitled to a sales tax credit for bad debts on automobiles that the car dealer repossessed.
2. Whether, under RCW 82.04.4284, a car dealer is entitled to deduct bad debts from the measure of its B&O tax on automobiles that the car dealer repossessed. . . .

FINDINGS OF FACT

Taxpayer, a used car dealer with lots in . . . Washington, is in the business of selling cars to people with either poor credit or no credit. As a result of selling to high-risk customers, the default rate on Taxpayer's customers' financing is higher than the rate applied to financing for customers of most other used car dealers.

In a typical transaction, a buyer will purchase a car with a combination of cash down and seller financing. However, many of Taxpayer's customers default on their loans. Whenever possible, Taxpayer repossesses the vehicle. In most cases, the repossessed vehicle is worth less than the car's outstanding loan balance. Because Taxpayer files its excise tax returns on the accrual basis, it was in the practice of deducting the defaulted portion of its customer's loans as bad debts.

The Department's Audit Division audited Taxpayer for the period January 1, 2005, through December June 30, 2008. After reviewing Taxpayer's books and records, the Audit Division determined that Taxpayer used its Month End reports to calculate and report bad debt deductions. The month-end report used by Taxpayer [listed these repossessed vehicles] and Taxpayer would deduct the entire "Balance Due" amount from that worksheet as its bad debt deduction. Audit verified that the Balance Due column included amounts for taxes, licenses, any fees, and/or interest accrued. The Audit Division determined that those amounts should be excluded from the deduction. Additionally, the Audit Division determined that Taxpayer failed to account for the selling price of repossessed vehicles, trade in allowances, or exempt sales such as Sales to Indians from the amount reported as bad debts.

On April 3, 2009, the Audit Division assessed \$. . . in retail sales tax, \$. . . in retailing B&O tax, \$. . . in motor vehicle tax, and \$. . . in interest, for a total of \$. . . Taxpayer appeals the assessment.

ANALYSIS

[1] Retail Sales Tax

In 2003, RCW 82.08.037 was amended to provide [expressly] that a credit or refund for sales taxes paid on bad debts do not include repossessed property. Specifically, RCW 82.08.037 provides:

(1) A seller is entitled to a credit or refund for sales taxes previously paid on bad debts, as that term is used in 26 U.S.C. Sec. 166, as amended or renumbered as of January 1, 2003.

(2) For purposes of this section, “bad debts” does not include:

- (a) Amounts due on property that remains in the possession of the seller until the full purchase price is paid;
- (b) Expenses incurred in attempting to collect debt; and
- (c) Repossessed property.

(3) If a credit or refund of sales tax is taken for a bad debt and the debt is subsequently collected in whole or in part, the tax on the amount collected must be paid and reported on the return filed for the period in which the collection is made.

(4) Payments on a previously claimed bad debt are applied first proportionally to the taxable price of the property or service and the sales or use tax thereon, and secondly to interest, service charges, and any other charges.

RCW 82.08.037 (2003). It is undisputed that, during the audit period, Taxpayer claimed credit for retail sales tax paid on the outstanding balance of loans in default with no reduction for the value of automobiles that Taxpayer subsequently repossessed.

... The relevant provisions of WAC 458-20-196 read as follows:

(2) **Retail sales and use tax.**

(a) **General rule.** Under RCW 82.08.037 and 82.12.037, sellers are entitled to a credit or refund for sales and use taxes previously paid on “bad debts” under section 166 of the Internal Revenue Code, as amended or renumbered as of January 1, 2003. Taxpayers may claim the credit or refund for the tax reporting period in which the bad debt is written off as uncollectible in the taxpayer's books and records and would be eligible for a bad debt deduction for federal income tax purposes. However, the amount of any credit or refund must be adjusted to exclude amounts attributable to:

- (i) Amounts due on property that remains in the possession of the seller until the full purchase price is paid;

- (ii) Expenses incurred in attempting to collect debt; and
- (iii) The value of repossessed property taken in payment of debt.

(b) **Recoveries.** If a taxpayer takes a credit or refund for sales or use taxes paid on a bad debt and later collects some or all of the debt, the amount of sales or use tax recovered must be repaid in the tax-reporting period during which collection was made. The amount of tax that must be repaid is determined by applying the recovered amount first proportionally to the taxable price of the property or service and the sales or use tax thereon and secondly to any interest, service charges, and any other charges.

WAC 458-20-196 (Rule 196). . . . The Audit Division properly reduced Taxpayer's credit for sales taxes previously paid on bad debts by the value of the repossessed property.

[2] B&O Tax

In 2004, RCW 82.04.4284 was likewise amended to provide [expressly] that the amount of bad debt that could be deducted from the measure of B&O tax cannot include the value of repossessed property. The statute reads, as follows:

- (1) In computing tax there may be deducted from the measure of tax bad debts, as that term is used in 26 U.S.C. Sec. 166, as amended or renumbered as of January 1, 2003, on which tax was previously paid.
- (2) For purposes of this section, "bad debts" do not include:
 - (a) Amounts due on property that remains in the possession of the seller until the full purchase price is paid;
 - (b) Expenses incurred in attempting to collect debt;
 - (c) Sales or use taxes payable to a seller; and
 - (d) Repossessed property.
- (3) If a deduction is taken for a bad debt and the debt is subsequently collected in whole or in part, the tax on the amount collected must be paid and reported on the return filed for the period in which the collection is made.
- (4) Payments on a previously claimed bad debt must be applied under RCW 82.08.037(4) and 82.12.037, according to such rules as the department may prescribe.

RCW 82.04.4284 (2004). Again, there is no dispute that Taxpayer deducted from the measure of its B&O tax the outstanding balance of loans in default with no reduction for the value of automobiles that Taxpayer subsequently repossessed.

With respect to the B&O tax treatment of repossessed property, Rule 196 provides:

(3) **Business and occupation tax.**

(a) **General rule.** Under RCW 82.04.4284, taxpayers may deduct from the measure of B&O tax "bad debts" under section 166 of the Internal Revenue Code, as amended or renumbered as of January 1, 2003, on which tax was previously paid. Taxpayers may claim the deduction for the tax reporting period in which the bad debt is written off as uncollectible in the taxpayer's books and records and would be eligible for a bad debt deduction for federal income tax purposes. However, the amount of the deduction must be adjusted to exclude amounts attributable to:

- (i) Amounts due on property that remains in the possession of the seller until the full purchase price is paid;
- (ii) Sales or use taxes payable to a seller;
- (iii) Expenses incurred in attempting to collect debt; and
- (iv) The value of repossessed property taken in payment of debt.

(b) **Recoveries.** Recoveries received by a taxpayer after a bad debt is claimed are applied under the rules described in subsection (2)(b) of this section if the transaction involved is a retail sale. The amount attributable to "taxable price" is reported under the retailing B&O tax classification. If the recovery of debt is not related to a retail sale, recovered amount is applied proportionally against the components of the debt (e.g., interest and principal remaining on a wholesale sale).

Rule 196 The [express] requirement that repossessed property be excluded from the bad debt deduction from Taxpayer's B&O tax measure was effective before the audit period at issue herein. The Audit Division properly reduced Taxpayer's bad debt deduction by the value of the repossessed property. . . .

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 29th day of June 2010.