RULE-MAKING ORDER
PERMANENT RULE ONLY

CR-103P (December 2017)
(Implements RCW 34.05.360)

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DATE: June 28, 2018
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WSR 18-14-042

Agency: Department of Revenue

Effective date of rule:

Permanent Rules

☒ 31 days after filing.

☐ Other (specify) _____ **(If less than 31 days after filing, a specific finding under RCW 34.05.380(3) is required and should be stated below)**

Any other findings required by other provisions of law as precondition to adoption or effectiveness of rule?

☐ Yes ☒ No If Yes, explain:

Purpose: The Department is amending WAC 458-20-196 to provide information on how to claim bad debt deductions, credits and refunds when reporting taxes on Washington excise tax returns. Examples are also provided.

Citation of rules affected by this order:

New:
Repealed:
Amended: WAC 458-20-196 Bad Debts
Suspended:

Statutory authority for adoption: RCW 82.32.300 and 82.01.060(2)

Other authority:

PERMANENT RULE (Including Expedited Rule Making)

Adopted under notice filed as WSR 18-10-106 on May 2, 2018 (date).

Describe any changes other than editing from proposed to adopted version: References added throughout WAC 458-20-196 to refer to refer to "recovery value" instead of market value, and "recovery" instead of repossession. This is for clarity, and does not represent a change in Department policy. Added "sales or use taxes payable to a seller" in section (2)(b) to the list of items that are not bad debts. This is from RCW 82.04.4284, on bad debts, and is also not a policy change.

If a preliminary cost-benefit analysis was prepared under RCW 34.05.328, a final cost-benefit analysis is available by contacting:

Name:
Address:
Phone:
Fax:
TTY:
Email:
Web site:
Other: This rule is not a significant legislative rule as defined by RCW 34.05.328.

Note: If any category is left blank, it will be calculated as zero.
No descriptive text.

Count by whole WAC sections only, from the WAC number through the history note.
A section may be counted in more than one category.

The number of sections adopted in order to comply with:

Federal statute:	New	0	Amended	0	Repealed	0
Federal rules or standards:	New	0	Amended	0	Repealed	0
Recently enacted state statutes:	New	0	Amended	0	Repealed	0

The number of sections adopted at the request of a nongovernmental entity:

	New	0	Amended	0	Repealed	0

The number of sections adopted on the agency's own initiative:

	New	0	Amended	1	Repealed	0

The number of sections adopted in order to clarify, streamline, or reform agency procedures:

	New	0	Amended	1	Repealed	0

The number of sections adopted using:

Negotiated rule making:	New	0	Amended	0	Repealed	0
Pilot rule making:	New	0	Amended	0	Repealed	0
Other alternative rule making:	New	0	Amended	1	Repealed	0

Date Adopted: June 28, 2018	**Signature:**
Name: Erin T. Lopez	
Title: Rules Coordinator1	

AMENDATORY SECTION (Amending WSR 10-21-012, filed 10/7/10, effective 11/7/10)

WAC 458-20-196 Bad debts. (1) **Introduction.** This ((~~section~~)) rule provides information about the tax treatment of bad debts ((~~under the business and occupation (B&O), public utility, retail sales, and use taxes.~~

~~(a) **Bad debt deduction for accrual basis taxpayers.** Bad debt credits, refunds, and deductions occur when income reported by a taxpayer is not received. Taxpayers who report using the cash method do not report income until it is received. For this reason, bad debts are most relevant to taxpayers reporting income on an accrual basis. However, some transactions must be reported on an accrual basis by all taxpayers, including installment sales and leases. These transactions are eligible for a bad debt credit, refund, or deduction as described in this section. For information on cash and accrual accounting methods, refer to WAC 458-20-197 (When tax liability arises) and WAC 458-20-199 (Accounting methods). Refer to WAC 458-20-198 (Installment sales, method of reporting) and WAC 458-20-199(3) for information about reporting installment sales.~~

~~(b) **Relationship between retailing B&O tax deduction and retail sales tax credit.** Generally, a retail sales tax credit for bad debts is reported as a deduction from the measure of sales tax on the excise tax return. The amount of this deduction, or the measure of a recovery of sales tax that must be reported, may differ from the amount reported as a deduction or recovery from the retailing B&O tax classification due to exempt sales (for example: Sales of motor vehicles and trailers for use in interstate or foreign commerce (RCW 82.08.0263); sales of manufacturing machinery and equipment (RCW 82.08.02565).)~~

~~(c) **Relationship to federal income tax return.** Washington credits, refunds, and deductions for bad debts are based on federal standards for worthlessness under section 166 of the Internal Revenue Code. If a federal income tax return is not required to be filed (for example, where the taxpayer is an exempt entity for federal purposes), the taxpayer is eligible for a bad debt credit, refund, or deduction on the Washington tax return if the taxpayer would otherwise be eligible for the federal bad debt deduction.~~

~~(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, "bad debts" do not include:~~

~~(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;~~

~~(iii) Debts sold or assigned by the seller to third parties, where the third party is without recourse against the seller (see (c) of this subsection for additional information about this restriction); and~~

~~(iv) 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.~~

~~(c) **Assigned debt and installment sales.** Effective July 1, 2010, RCW 82.08.037 and 82.12.037 limit who can claim a credit or refund for retail sales or use tax. Only the original seller in the transaction that generated the bad debt, or a certified service provider (CSP) used by the seller, is entitled to claim a credit or refund on or after July 1, 2010. If the original seller in the transaction that generated the bad debt has sold or assigned the debt instrument to a third party with recourse, the original seller may claim a credit or refund only after the debt instrument is reassigned by the third party to the original seller. In the case where the seller uses a CSP to administer its sales tax responsibilities the CSP may claim, on behalf of the seller, the credit or refund allowed. See chapter 23, Laws of 2010, 1st sp. sess., (2ESSB 6143).~~

~~(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).~~

~~(c) **Extracting and manufacturing classifications.** Bad debt deductions are only allowed under the extracting or manufacturing classifications when the value of products is computed on the basis of gross proceeds of sales.~~

~~(4) **Public utility tax.** Under RCW 82.16.050(5), taxpayers may deduct from the measure of public utility 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. No deduction is allowed for collection or other expenses.~~

~~(5) **Application of payments - General rule.** The special rules for application of payments received in recovery of previously claimed bad debts described in subsections (2)(b) and (3)(b) of this section are not used for other payments. Payments received before a bad debt cred-~~

~~it, refund, or deduction is claimed should be applied first against interest and then ratably against other charges. Another commercially reasonable method may be used if approved by the department.~~

~~(6) **Private label credit cards.** If a business contracts with a financial company to provide a private label credit card program, and the financial company becomes the exclusive owner of the credit card accounts and solely bears the risk of all credit losses, the business that contracted with the financial company is not entitled to any bad debt deduction if a customer fails to pay his or her credit card invoice.~~

~~**Example.** Hot Shot Ski Equipment (Hot Shot) is a sporting equipment retailer. Hot Shot contracts with ABC Financial Institution (ABC) to issue a Hot Shot private label credit card. ABC has the authority to accept or reject an applicant's credit card application. After Hot Shot transmits the credit card sales records to ABC, ABC pays Hot Shot the proceeds of the sales including the retail sales tax minus any applicable service fees. Hot Shot remits the retail sales tax to the Department of Revenue. If a customer using the Hot Shot credit card fails to pay ABC the outstanding amount on the credit card invoice, ABC suffers the loss. Hot Shot is not entitled to a bad debt deduction or credit as it has no bad debt loss when a customer defaults on a debt to ABC.~~

~~(7) **Reserve method.** Ordinarily, taxpayers must report bad debt refunds, credits or deductions for specifically identified transactions. However, taxpayers who are allowed by the Internal Revenue Service to use a reserve method of reporting bad debts for federal income tax purposes, or who secure permission from the department to do so, may deduct a reasonable addition to a reserve for bad debts. What constitutes a reasonable addition to a reserve for bad debts must be determined in light of the facts and will vary between classes of business and with conditions of business prosperity. An addition to a reserve allowed as a deduction by the Internal Revenue Service for federal income tax purposes, in the absence of evidence to the contrary, will be presumed reasonable. When the reserve method is employed, an adjustment to the amount of loss deducted must be made annually to make the total loss claimed for the tax year coincide with the amount actually sustained.~~

~~(8) **Statute of limitations for claiming bad debts.** No credit, refund, or deduction, as applicable, may be claimed for debt that became eligible for a bad debt deduction for federal income tax purposes more than four years before the beginning of the calendar year in which the credit, refund, or deduction is claimed.~~

~~(9) **Examples.** The following examples identify a number of facts and then state a conclusion. These examples should be used only as a general guide. The tax results of other situations must be determined after a review of all of the facts and circumstances.~~

~~In all cases, an eight percent combined state and local sales tax rate is assumed. Figures are rounded to the nearest dollar. Payments are applied first against interest and then ratably against the taxable price, sales tax, and other charges except when the special rules for subsequent recoveries on a bad debt apply (see subsections (2) and (3) of this section). It is assumed that the income from all retail sales described has been properly reported under the retailing B&O tax classification and that all interest or service fees described have been accrued and reported under the service and other activities B&O tax classification.~~

~~(a) **Scenario 1.** Joe's Hardware makes a retail sale of goods with a selling price of $500 and pays $40 in sales tax to the department. No payment is received by Joe at the time of sale.~~

~~(i) Bad debt. One and a half years later, no payment has been received by Joe, and the balance with interest is $627. Joe is entitled to claim a bad debt deduction on his federal income tax return. He is also entitled to claim a bad debt sales tax credit or refund in the amount of $40, a B&O tax deduction of $500 under the retailing B&O tax classification, and a B&O tax deduction of $87 under the service and other activities B&O tax classification.~~

~~(ii) Recoveries. Six months after the credit and deduction are claimed, a $50 payment is received on the debt. Recoveries received on a retail sale after a credit and deduction have already been claimed must be applied first proportionally to the taxable price and sales tax thereon in order to determine the amount of tax that must be repaid. Therefore, Joe must report $4, or $50 x ($40/$540), of sales tax on the current excise tax return and $46, or $50 x ($500/$540) under the retailing B&O tax classification. Additional recoveries should be applied in the same manner until the original $40 credit for sales tax is reduced to zero.~~

~~(b) **Scenario 2.** Joe makes a retail sale of goods on credit for $500 and pays $40 in sales tax to the department. No payment is received at the time of sale. Over the following year, regular payments are received and the debt is reduced to $345, exclusive of any interest or service charges. The $345 represents sales tax due to Joe in the amount of $26, or $345 x ($40/$540), and $319 remaining of the original purchase price, or $345 x ($500/$540). Payments cease.~~

~~(i) Bad debt. Six months later the balance with interest and service fees is $413. Joe is entitled to claim a bad debt deduction on the federal income tax return. He is also entitled to claim a sales tax refund or credit on the current excise tax return of $26, a deduction under the retailing B&O tax classification of $319, and a deduction under the service and other activities B&O tax classification of $68.~~

~~(ii) Recoveries. Before Joe charges off the debt, he repossesses the goods. At that time, the goods have a fair market value of $250. No credit is allowed for repossessed property, so the value of the collateral must be applied against the outstanding balance. After the value of the collateral is applied, Joe has a remaining balance of $163, or $413 - $250. The allocation rules for recoveries do not apply because a bad debt credit or refund has not yet been taken. The value is applied first against the $68, or $413 - $345, of interest, so the $163 remaining is attributable entirely to taxable price and sales tax. Any costs Joe may incur related to locating, repossessing, storing, or selling the goods do not offset the value of the collateral because no credit is allowed for collection costs. Joe is entitled to a sales tax refund or credit in the amount of $12, or $163 x ($40/$540) and deduction of $151, or $163 x ($500/$540) under the retailing B&O tax classification.~~

~~(iii) Sales of repossessed goods. If Joe later sells the repossessed goods, he must pay B&O tax and collect retail sales tax as applicable. If the sales price of the repossessed goods is different from the fair market value previously reported and the statute of limitations applicable to the original transaction has not expired, Joe must report the difference between the selling price and the claimed fair market value as an additional bad debt credit or deduction or report it as an additional recovery, as appropriate.~~

~~(c) **Scenario 3.** Phil, of Phil's Fine Cars, sells a car at retail for $1000 and charges Alice, the buyer, an additional $50 for license and registration fees.~~

~~(i) Trade-in accepted. Phil accepts trade-in property with a value of $500 in which Alice has $300 of equity. (The value of trade-in property of like kind is excluded from the selling price for purposes of the retail sales tax. Refer to WAC 458-20-247 for further information.) Phil properly bills Alice for $40 of sales tax, for a total of $1090 owed to Phil by Alice. Phil pays the department the $40 in sales tax. No payment other than the trade-in is received by Phil at the time of sale.~~

~~(ii) Bad debt. Eight months later, Phil has not received any payment. Phil is entitled to claim a bad debt deduction on his federal income tax return. The equity in the trade-in is equivalent to a payment received at the time of purchase, reducing the balance remaining on the initial sale to $790, or $1090 - $300. Phil is entitled to claim a sales tax credit or refund of $29, or $790 x ($40/$1090) of sales tax, and a deduction of $725, or $790 x ($1000/$1090) under the retailing B&O tax classification, exclusive of any deduction for accrued interest.~~

~~(d) **Scenario 4.** Phil sells a car at retail for $1000, and charges Jake an additional $50 for license and registration fees. Phil properly bills Jake for $80 of sales tax and remits it to the department. No money is received from Jake at the time of sale.~~

~~(i) Bad debt. Eight months later Phil is entitled to claim a bad debt deduction on the federal income tax return. Phil claims an $80 sales tax credit, a $1000 retailing B&O tax deduction, and an additional amount under the service and other activities classification for accrued interest.~~

~~(ii) Recoveries. Six months after claiming a bad debt, Phil receives a $200 payment from Jake. Recoveries must be allocated first proportionally to the taxable price (the measure of the sales tax) and the sales tax thereon, and secondly to other charges. B&O tax consequences follow the same rules. Accordingly, Phil must report $15, or $200 x ($80/$1080) of sales tax and $185, or $200 x ($1000/$1080) of income under the retailing B&O tax classification. Additional recoveries should be applied in the same manner until the original $80 sales tax credit is reduced to zero.~~

~~(e) **Scenario 5.** Phil sells a car at retail for $1000, and charges Robin an additional $50 for license and registration fees.~~

~~(i) Trade-in accepted. Phil accepts trade-in property with a value of $500 in which Robin has $300 of equity. Phil properly bills Robin for $40 of sales tax for a total of $1090 owed to Phil by Robin. No payment other than the trade-in is received by Phil at the time of sale.~~

~~(ii) Bad debt. Eight months later, no payment has been received by Phil. Phil is entitled to claim a bad debt deduction on the federal income tax return. The equity in the trade-in is equivalent to a payment received at the time of purchase, reducing the balance remaining on the initial sale to $790, or $1090 - $300. Phil is entitled to claim a sales tax credit or refund of $29, or $790 x ($40/$1090) of sales tax, and a deduction of $725, or $790 x ($1000/$1090) under the retailing B&O tax classification, exclusive of any deduction for accrued interest.~~

~~(iii) Recoveries. Six months after that, Phil receives a $200 payment from Robin. Recoveries must be allocated first proportionally to the taxable price (the measure of the sales tax) and sales tax~~

~~thereon, and secondly to other charges. B&O tax consequences follow the same rules. Accordingly, Phil must report $15, or $200 x ($40/$540) in sales tax, and $185, or $200 x ($500/$540) under the retailing B&O tax classification. Additional recoveries should be applied in the same manner until the original $29 sales tax credit is reduced to zero.~~

~~(f) **Scenario 6.** The facts are the same as in Scenario 3 (c) of this subsection, except that immediately after the sale, Phil assigns the contract to a finance company without recourse, receiving face value for the contract. The finance company may not claim the retail sales tax credit or refund. The finance company may not claim any deductions for Phil's B&O tax liability. No bad debt deduction or credit is available to Phil, as the contract was sold without recourse.~~)) when income is reported by a taxpayer, but that income is ultimately not received by the taxpayer.

(a) **References to related rules.** The department has adopted other rules that readers may want to refer to:

(i) WAC 458-20-197 When tax liability arises;

(ii) WAC 458-20-198 Installment sales, method of reporting;

(iii) WAC 458-20-199 Accounting methods;

(iv) WAC 458-20-229 Refunds.

(b) **Examples.** The rule includes a number of examples that identify a set of facts and then state a conclusion. These examples are only a general guide. The tax results of other situations must be determined after a review of all facts and circumstances. For each of the examples, assume an 8% retail sales tax rate.

(2) **Definitions.** The following definitions apply throughout this rule:

(a) "Bad debt" is an amount owed to the taxpayer as payment for the sale of goods, services, or digital products which is not actually received and is written off as a worthless debt on the taxpayer's books and records. For Washington excise tax reporting purposes, a bad debt is based on federal income tax standards of worthlessness under 26 U.S.C. Sec. 166, as amended or renumbered as of January 1, 2003. A bad debt may only be taken by the original seller of goods, services, or digital products.

(b) "Bad debts" do not include:

(i) Amounts due on property remaining in the seller's possession until the full purchase price is paid;

(ii) Expenses incurred in attempting to collect debt;

(iii) Sales or use taxes payable to a seller;

(iv) Debts sold or assigned by the seller to third parties, where the third party is without recourse against the seller (RCW 82.08.037 and 82.12.037. See subsection (6)(a) of this rule); and

(v) The value of repossessed property taken as payment of debt at the time the property is repossessed.

(3) **Reporting a bad debt.**

(a) Only amounts previously reported as gross income on the Washington excise tax return are eligible for reporting as bad debts to the state of Washington. The bad debts reported must meet the federal revenue code standards for worthlessness. However, if a taxpayer who is not required to file a federal return is otherwise eligible for a federal income tax bad debt deduction, credit, or refund, that taxpayer may claim a Washington bad debt deduction, credit, or refund on a previously paid Washington state tax. For taxpayers who file a consolidated federal return with controlled affiliates, the bad debt deduction, credit or refund is only available to the original seller or provider that incurred the loss from the worthless debt.

(b) Taxpayers who report using the cash method do not report income until it is received. For this reason, bad debts are most relevant to taxpayers reporting income on an accrual basis. However, some transactions must be reported on an accrual basis by all taxpayers, including installment sales and leases. These transactions are eligible for a bad debt deduction as described in this rule.

(c) Bad debts can be reported using one of the following methods:

(i) **Deductions:** Generally, a bad debt is reported as a deduction from the measure of the tax previously reported and paid on the excise tax return. The bad debts discussed in this rule are assumed to be reported as deductions unless otherwise stated.

(ii) **Credits:** A bad debt credit is most commonly taken when there is a change in the retail sales tax rate between the time of sale and the reporting of the bad debt. To claim the credit, a taxpayer must complete a Schedule B addendum to their excise tax return. This form is available on the department's web site at dor.wa.gov.

(iii) **Refunds:** A taxpayer may also claim a bad debt by requesting a refund directly from the department using the process as described in WAC 458-20-229.

(d) **Reserve method.** Ordinarily, taxpayers must report bad debt deductions, credits, or refunds for specifically identified transactions. However, taxpayers who are allowed by the Internal Revenue Service to use a reserve method of reporting bad debts for federal income tax purposes, or who secure permission from the department to do so, may deduct a reasonable addition to a reserve for bad debts. What constitutes a reasonable addition to a reserve for bad debts will vary by business type and economic factors. The department presumes reserve methods allowed by the Internal Revenue Service for federal income tax purposes are reasonable, absent contrary evidence. When the reserve method is used, the amount of loss deducted must be adjusted annually to make the total loss claimed for the tax year coincide with the amount of actual loss.

(e) **Statute of limitations for claiming bad debts.** No deduction, credit, or refund may be claimed for debt that became eligible for a bad debt deduction for federal income tax purposes more than four years before the beginning of the calendar year in which the credit, refund, or deduction is claimed.

(4) **Claiming bad debt deductions for various taxes paid.**

(a) **Business and occupation (B&O) tax.** Taxpayers may deduct from the measure of B&O tax, bad debts on which B&O tax was previously paid. RCW 82.04.4284.

(b) **Retail sales and use tax.** Taxpayers may take a bad debt deduction for retail sales and use taxes previously paid on bad debts. RCW 82.08.037 and 82.12.037.

Example 1. Joe's Hardware, which reports on an accrual basis, sells $500 worth of goods to a buyer. Joe's Hardware receives no payment from the buyer at the time of sale. Joe's Hardware reports and remits $40 (8% of $500) in retail sales tax to the department. Joe's Hardware also reports $500 of gross income under the retailing B&O tax classification, and reports service and other activities B&O tax on the interest and fees accruing on the outstanding balance.

A year and a half after the sale, Joe's Hardware has still not received any payment, and the balance with interest and fees is $627 ($500 selling price + $40 retail sales tax + $87 accrued interest and fees). Joe's Hardware meets the requirements to claim a federal income tax bad debt deduction. Therefore, it may claim a $40 bad debt retail sales tax deduction, and a $500 bad debt deduction from gross income under the retailing B&O tax classification. It may also take a bad debt deduction of $87 for the accrued interest and fees previously reported under the service and other activities B&O tax classification.

(5) **Post bad debt reporting: Payments, recoveries and repossessions.**

(a) **Application of payments.**

If a taxpayer takes a bad debt deduction for a previously paid tax, and later collects some or all of the debt, the amount of tax recovered must be reported and paid in the tax-reporting period in which the collection was made. The amount of tax reported and paid on the recovery for B&O tax, retail sales tax, and use tax purposes is determined by first applying the recovered amount proportionally to the taxable price of the property or service and the retail sales or use tax thereon. Secondly, the recovered amount is applied to any interest, service charges, and any other charges. RCW 82.08.037(4).

Example 2. Joe's Hardware in Example 1 above receives a $50 payment on the $500 purchase six months after claiming the bad debt deduction. Joe's Hardware must report and pay an additional $3.70 of retail sales tax on its current excise tax return ($50 payment × ($40 retail sales tax/$540 selling price + retail sales tax)).

In addition, it must report $46.30 as gross income under the retailing B&O tax classification ($50 payment × ($500 selling price/$540 selling price + retail sales tax)).

Additional recoveries are reported in this same manner until the original $40 retail sales tax bad debt deduction reduces to zero.

(b) **Repossessions:**

(i) The value of any property repossessed from a buyer for nonpayment must be subtracted from the value of the bad debt. In determining the amount of the bad debt deduction for B&O tax, retail sales tax, or use tax purposes, the repossessed value must first be applied to any accrued interest and fees. Any remaining value must be proportionally applied to the original selling value and retail sales tax.

(ii) For bad debt purposes, the value of repossessed property is its fair market value on the recovery date (recovery value). If postrecovery repairs and improvements that increase the value of the property are made after recovery and prior to resale, the cost of these repairs may be subtracted from the selling price to establish its recovery value.

(iii) Only post-recovery repairs and improvements that increase the value of the repossessed property qualify to reduce its selling price to establish its recovery value. Repairs and improvements that are routine maintenance do not qualify to reduce the selling price of the repossessed property to establish its recovery value. In general, repairs and improvements considered routine in nature have a useful life of less than one year. Repairs with a useful life of more than one year are typically considered an improvement that increases the value of the property for the purpose of establishing recovery value.

In addition to routine maintenance costs, a taxpayer may not offset the value of repossessed property with any costs related to locating, repossessing, storing, or reselling the property, including associated attorney fees.

(iv) If the sales price of the repossessed property is less than the recovery value previously reported, the taxpayer must report the difference between the selling price and the claimed recovery value as an additional bad debt deduction. Alternatively, if the property resells for more than the recovery value previously reported, the taxpayer must report it as an additional recovery. This is because the sales price establishes the correct value of the repossessed goods.

Example 3. Phil's Fine Cars (Phil) sells a car to Alice on credit for $1,000. Initially, Phil reports $1,000 in gross income under the retailing B&O tax classification, and reports and remits $80 in retail sales tax (8% of $1,000). When Alice makes no payments, Phil repossesses the car. The recovery value of the repossessed car at the time of repossession is $700. Also, assume $63 in accrued interest at the time of repossession, resulting in an outstanding balance of $1,143 ($1,000 selling price + $80 retail sales tax + $63 accrued interest). The $700 recovery value is first applied to the accrued interest, resulting in a selling price and retail sales tax balance of $1,080. The remaining recovery value of $637 ($700-$63 accrued interest) is applied to the balance of $1,080, resulting in an outstanding balance of $443 ($1,080-$637) eligible for a bad debt deduction. Phil can claim a bad debt deduction of $32.81 against the retail sales tax ($443 × ($80/$1,080)), and a $410.19 deduction against the measure of the retailing B&O tax ($443 × ($1,000/$1,080)).

Example 4. If Phil's Fine Cars later resells the car repossessed from Alice in Example 3 in this subsection, it must collect and remit retail sales tax, and pay retailing B&O tax on the sale to a new buyer. The payment of the retail sales tax and retailing B&O tax on the sale of the repossessed car does not affect Phil's tax liability regarding the reported bad debt deduction from the original transaction. Here, Phil resells the car for its $700 recovery value to a new buyer, Jim. Phil will collect and report $56 of retail sales tax on the sale ($700 × 8%), and report $700 in gross income under the retailing B&O tax classification.

Example 5. Phil's Fine Cars repossessed a car from Bob. Phil's estimate of the car's recovery value upon repossession for bad debt reporting purposes was $1,500. Phil reports a bad debt deduction based on this $1,500 value, the outstanding debt balance, and any payments Bob made. Later, Phil makes repairs and improvements to the car and resells it to Ron for $2,500. In order for Phil to know if he needs to adjust his prior bad debt reporting he must determine if his original estimate of $1,500 recovery value upon repossession was correct.

Phil made the following repair and maintenance expenditures after recovering the car from Bob, and before reselling it to Ron:

Post Repossession Expense:	Reduction of selling price?	
Replace engine:	$350	Yes, increases value
Replace windshield:	$70	Yes, increases value
Replace filter:	$20	No, maintenance
Replace wipers:	$45	No, maintenance
Change oil filter:	$50	No, maintenance
Repair transmission:	$200	Yes, increases value
Detailing/cleaning:	$75	No, maintenance
Replace tires:	$130	Yes, increases value
Total expenses that increased value of the car: $750		
Total expenses for maintenance: $190		

Phil has repair and improvement costs of $750 that qualify to reduce the selling price to determine the car's recovery value before any repairs and improvements. After reducing the $750 of qualifying expenses from the $2,500 resale price to Ron, the recovery value of the car at the time of repossession is $1,750. Because the $1,750 recovery value is greater than Phil's bad debt reporting estimate of $1,500, Phil must adjust his bad debt reporting for the bad debt relating to the repossession from Bob. Phil must reduce his bad debt deduction previously taken by the $250 in increased recovery value ($1,750-$1,500).

If Phil's qualifying repair expenses had been $1,750, then the recovery value of the car repossessed from Bob would only have been $750 ($2,500 resale price - $1,750 repairs). The lower actual recovery value increases the amount of bad debt, which allows for a larger bad debt deduction than had been originally reported by Phil.

(6) **Assigned debt and private label credit cards.**

(a) **Assigned debt.** RCW 82.08.037 and 82.12.037 limit who can claim a bad debt deduction for retail sales or use tax. Only the original seller in the transaction that generated the bad debt, or a certified service provider (CSP) as defined in RCW 82.32.020 used by the seller, is entitled to claim a bad debt deduction. If the original seller in the transaction that generated the bad debt has sold or assigned the debt instrument to a third party with recourse back to the seller, the original seller may claim a bad debt deduction only if the debt instrument is reassigned by the third party back to the original seller. Alternatively, if the original seller has sold or assigned the debt instrument to a third party without recourse back to the seller, the original seller may not claim a bad debt deduction. Where the seller uses a CSP to administer its retail sales tax, the CSP may claim, on behalf of the seller, the bad debt deduction allowed.

Example 6. Immediately after Phil's Fine Cars sells a car, it assigns the contract to Finance Company ABC without recourse back to Phil. Phil receives face value for the contract from Finance Company ABC. If the buyer fails to make payments, Finance Company ABC may not claim a bad debt deduction because it is not the original seller. Phil is also unable to claim a bad debt deduction because Finance Company ABC purchased the contract without recourse back to the seller.

(b) **Private label credit cards.** A seller is not eligible for a bad debt deduction, credit, or refund for customers failing to pay credit card invoices if the seller:

• Contracts with a third party, such as a financial institution, to provide a private label credit card program;

• The third party becomes the exclusive owner of the credit card accounts.

Example 7. Mountaintop Ski Equipment (Mountaintop) is a sporting equipment retailing chain store. Mountaintop contracts with ABC Financial Institution (ABC) to issue Mountaintop private label credit cards. ABC has the authority to accept or reject an applicant's credit card application. After Mountaintop transmits the credit card sales records to ABC, ABC pays Mountaintop the proceeds of the sales including the retail sales tax less any applicable service fees. Mountaintop reports and remits the retail sales tax to the department. If a customer using the Mountaintop credit card fails to pay ABC the outstanding amount on the credit card invoice, Mountaintop is not entitled to a bad debt deduction because it has no bad debt loss when a customer defaults on a debt to ABC.