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Cite as Det. No. 22-0036, Annual WTD Page (Year)

BEFORE THE ADMINISTRATIVE REVIEW AND HEARINGS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

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| 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. 22-0036 |
| |) | |
| ... |) | Registration No. . . . |
| |) | |

[1] WAC 458-20-254; WAC 458-20-196; RCW 82.32.070; RCW 82.08.037; 82.12.037; RETAIL SALES TAX – DEDUCTIONS – BAD DEBTS – RECORDKEEPING. When an automobile dealership claims a higher amount of bad debt deductions than it previously reported due to vehicle repossessions, it must provide suitable records that establish it correctly calculated the amount of the deduction, including subtracting the market value of repossessed vehicles from the value of its claimed bad debt deductions. Absent such records, the Department correctly denied the dealership’s additional deductions claimed for bad debts.

[2] WAC 458-20-254; WAC 458-20-196; RCW 82.32.070; RCW 82.04.4284; BUSINESS AND OCCUPATION TAX – DEDUCTIONS – BAD DEBTS. An automobile dealership has not provided suitable records that establish it is eligible for a deduction from its measure of business and occupation tax for bad debts associated with vehicles it repossessed when its records failed to exclude the value of the repossessed vehicles from its bad debt calculation.

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.

McCormick, T.R.O. – A used automobile dealership disputes the Department’s decision to not accept its amended tax returns for the January through July, September, and October, 2019, periods, which include a lesser retail sales tax and business and occupation (B&O) tax liability than that initially reported. Taxpayer asserts that its amended returns correct its gross income and bad debt deductions for the covered periods because it asserts it qualifies for additional bad debt deductions due to vehicle repossessions that it did not previously claim. Taxpayer has not provided

suitable records to support its amended returns and demonstrate that it qualifies for the additional deductions. We deny the petition.¹

ISSUES

1. Whether, under RCW 82.32.070 and WAC 458-20-254, a used automobile dealership has provided suitable records to establish that it . . . is eligible to claim a higher amount of deductions for bad debts than it previously reported due to vehicle repossessions, under RCW 82.08.037, RCW 82.12.037, and WAC 458-20-196.
2. Whether, under RCW 82.32.070 and WAC 458-20-254, a used automobile dealership has provided suitable records to establish that it is entitled to a deduction from its measure of B&O tax for bad debts associated with vehicles it subsequently repossessed, when it did not adjust its measure of B&O tax to exclude the value of the repossessed vehicles under RCW 82.04.4284 and WAC 458-20-196.

FINDINGS OF FACT

. . . (Taxpayer) is a . . . limited liability company that owns and operates a used vehicle dealership that primarily makes retail sales of used automobiles. Taxpayer is assigned to report its tax liability on a monthly basis.

Taxpayer submitted combined excise tax returns for each of the monthly periods included in the calendar year 2019. On each of the returns, Taxpayer reported its retail sales tax and retailing B&O tax liability.

On September 22, 2020, Taxpayer submitted amended combined excise tax returns for the January through July, September, and October 2019 tax periods, claiming its actual tax liability was lower than that previously reported. Taxpayer claimed a higher bad debt deduction than previously reported due to additional vehicles that Taxpayer repossessed, resulting in a lesser amount of retail sales tax and retailing B&O tax owing for each of the covered periods.

On October 15, 2020, the Department's Taxpayer Account Administration Division (TAA) requested that Taxpayer provide additional records to substantiate its amended tax returns. The additional records were due October 29, 2020.

When Taxpayer did not respond to TAA's initial request for additional records, TAA sent Taxpayer a second request for additional records on October 30, 2020, with a new due date of November 13, 2020.

On November 20, 2020, TAA confirmed that it received the additional records that Taxpayer provided for the February through July, September, and October 2019 periods, but that such records stated different amounts than those reported on Taxpayer's amended returns for those periods. As a result, TAA sent Taxpayer a web message that requested an electronic copy of an

¹ Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

Excel spreadsheet showing its calculations, as well as a breakdown of Taxpayer's retail and wholesale income, and Taxpayer's bad debt deductions. The due date for the additional records was December 2, 2020.

On December 3, 2020, when Taxpayer did not provide the additional records as requested, TAA denied Taxpayer's amended returns for the January through July, September, and October 2019 periods, due to a lack of substantiating documentation.

On February 22, 2021, Taxpayer petitioned for administrative review of TAA's denial of its amended returns. In its petition, Taxpayer asserts:

. . . I believe sales were inflated by the previous GM. The corrected total taxable amount is [\$. . .]. . . . Enclosed is a month-by-month breakdown of all sales and credits with total taxable amounts. These are the only sales documents for 2019 except for the months which have already been processed and funded [and] there were no discrepancies in these amounts. Taxes were paid for the months of January, March, November and December 2019. . . .

Petition at 1.

Taxpayer asserts that TAA incorrectly denied its amended returns. In support of its petition, Taxpayer submitted a monthly summary for each of the subject periods, which includes a total sales amount, total bad debt amount, and taxable amount. Taxpayer also submitted: (1) the original purchase order for each of the subject vehicles; (2) a monthly summary for each of the subject months, that states the amount of Taxpayer's total sales, claimed total bad debt, and total taxable amount (indicating Taxpayer's formula for calculating its total taxable amount as being: SALES – BAD DEBT = TAXABLE AMOUNT); (3) a worksheet for each of the subject vehicles, which includes the total sales price, amount paid by the purchaser towards the total sales price before Taxpayer's repossession of the vehicle, bad debt amount, and total taxable amount; and, (4) a repossession affidavit for each of the subject vehicles that states the date Taxpayer repossessed each vehicle. Taxpayer also provided copies of retail installment contracts for some of the subject vehicle sales, but did not provide such contracts for the majority of the subject sales.

In response to the additional records, TAA stated:

. . . Initial documentation received for the February through July, September, and October 2019 tax reporting periods on November 17, 2020, was a collection of used vehicle purchase orders oftentimes indicating the Taxpayer provides in-house financing for their vehicle sales. These documents indicate a retail sales tax rate of 9% spanning the listed periods and include handwritten notes stating a vehicle was repossessed. No substantive documents were provided for income from wholesale sales, interest income from providing financing, nor calculations detailing their bad debt deduction figures. Invoices are not numbered to indicate that all invoices issued were provided and no electronic ledgers or reports were provided.

Secondary documentation received on February 16, 2021, with the petition request included handwritten summary pages for each month, handwritten worksheets per vehicle, used vehicle purchase orders, and nonnotarized repossession affidavits for the months of February and April through October 2019. The summary pages state their total sales, their total bad debt and their taxable amount for the month indicating their formula as “Sales – Bad Debt = Taxable Amount”. . . .

Taxpayer is incorrectly calculating the value of their bad debt deductions for repossessions and resale of the recovered vehicles; *the market value, or resell value if higher, of the repossessed vehicles are not being subtracted from the value of the bad debt, nor are they being applied to any accrued interest and fees then proportionally being applied to the original selling values and retail sales tax.* Additionally, the documents provided to demonstrate repossessed vehicles are not substantive. The date of repossession compared to the dates of sale are consistently around 30 days apart, the documents are handwritten without notary,² and are occasionally in conflict with handwritten notes from other documents.

. . .

Division Response at 4-5 (emphasis added).

As part of this review, Taxpayer submitted an excel spreadsheet purportedly showing its calculation of taxable income. The information included in the spreadsheet is limited to the purchase price of the vehicle, the bad debt amount (equal to the amount of the outstanding balance owing on the vehicle at the time of repossession), and total taxable amount (calculated by subtracting the bad debt amount from the purchase price).

ANALYSIS

1. Taxpayer has not provided suitable records to establish that it is eligible to claim a higher bad debt deduction than that previously reported because it has not shown that it subtracted the market value of repossessed vehicles from the value of its claimed bad debt deductions.

Washington imposes a retail sales tax on retail sales in the State of Washington and persons making retail sales are subject to retailing B&O tax on gross income received from retail sales. RCW 82.04.250, RCW 82.08.020. The retail sales tax is measured by the selling price of the retail sale. RCW 82.08.020. “Retail sale” is defined in RCW 82.04.050. Relevant here, the term “retail sale” includes sales of tangible personal property. RCW 82.04.050(1)(a).

Here, Taxpayer makes retail sales of vehicles. Vehicles are tangible personal property. Thus, Taxpayer’s sales of vehicles are “retail sales” that are subject to retail sales tax, unless a specific exemption or exclusion applies. RCW 82.04.050(1)(a).

² The Department of Licensing Repossession Affidavit form includes the following instruction: “You don’t need your signature notarized if you sign in front of a WA vehicle licensing agent, who can certify your signature.”

RCW 82.08.037 provides a retail sales tax exemption for retail sales tax paid on bad debts (in the form of a credit or refund); however, repossessed property does not qualify for the exemption because it is not considered a bad debt. 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;
 - (c) Debts sold or assigned by the seller to third parties, where the third party is without recourse against the seller; and
 - (d) 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 (emphasis added).

WAC 458-20-196 is the Department’s rule that explains the application of the bad debt deduction. The relevant provisions of WAC 458-20-196 (2017)³ 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.

³ WAC 458-20-196 was amended effective July 29, 2018.

(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(2)(a) and (b) (emphasis added). Thus, in order to claim a bad debt deduction for a vehicle sale where the buyer has defaulted and the seller has repossessed the vehicle, the seller must establish that it reduced the amount of bad debt from the vehicle by the value of the repossessed property (because the value of the repossessed property is considered a payment on the debt). A seller is only entitled to claim a bad debt deduction equal to the difference of these two numbers.

Each taxpayer is required to maintain suitable records from which the Department may determine its tax liability, as well as verify that it correctly reported its tax liability to the Department. *See* RCW 82.32.070(1); WAC 458-20-254. Specifically, in pertinent part, WAC 458-20-254 states:

(3) Recordkeeping requirements—General.

(a) **Duty of taxpayer to keep records.** Every taxpayer liable for a tax or fee imposed by the laws of the state of Washington for which the department has primary or secondary administrative responsibility, e.g., Title 82 RCW, chapter 67.28 RCW (hotel/motel tax), chapter 70A.95 RCW (fee on tires), and chapter 84.33 RCW (forest excise tax), must keep complete and adequate records from which the department can determine the tax liability of the taxpayer.

It is the duty of each taxpayer to prepare and preserve all records in a systematic manner conforming to accepted accounting methods and procedures. Records are to be kept and preserved and must be presented upon request by the department or its authorized representatives. The records should demonstrate:

(i) The amounts of gross receipts and sales from all sources, however derived, including barter or exchange transactions, whether or not such receipts or sales are taxable. *These amounts must be supported by original source documents or records* including but not limited to all purchase invoices, sales invoices, contracts, and such other records as may be necessary to substantiate gross receipts and sales.

(ii) The amounts of all *deductions*, exemptions, or credits claimed through supporting records or documentation required by statute or administrative rule, or *other supporting records* or documentation necessary to substantiate the deduction, exemption, or credit.

(iii) The *payment of retail sales tax* or use tax on capital assets, supplies, articles manufactured for your own use, and other items used by the taxpayer as a consumer.

...

(b) Types of records. *The records kept, preserved, and presented must include the normal records maintained by an ordinary prudent business person.* These records may include general ledgers, sales journals, cash receipts journals, bank statements, check registers, and purchase journals, together with all bills, invoices, cash register tapes, and other records or documents of original entry supporting the books of account entries. The records must include all federal and state tax returns and reports and all schedules, work papers, instructions, and other data used in the preparation of the tax reports or returns.

WAC 458-20-254(3) (bold in original, italics ours).

Thus, a taxpayer claiming a bad debt deduction has the burden of showing that it qualifies for the deduction by maintaining and providing to the Department suitable records from which the Department may determine that it is eligible to claim the deduction.

Here, Taxpayer submitted amended returns for each of the subject tax periods, on which it claimed higher bad debt deductions equal to the outstanding balance of loans associated with each of the subject vehicles, with no reduction for the value of the vehicles that Taxpayer repossessed in payment of the associated loans. Taxpayer provided the following records in support its amended bad debt deductions: (1) the original purchase order for each of the subject vehicles; (2) a monthly summary for each of the subject months (indicating Taxpayer formula for calculating its total taxable amount as being: SALES – BAD DEBT = TAXABLE AMOUNT); (3) a worksheet for each of the subject vehicles; (4) a repossession affidavit for each of the subject vehicle, stating the date Taxpayer repossessed each vehicle; (5) in a few instances, Taxpayer also provided copies of retail installment contracts; and (6) an excel spreadsheet indicating the purchase price of each vehicle, the amount of the outstanding balance owing on each vehicle (the bad debt amount), and total taxable amount (calculated by subtracting the outstanding balance from the purchase price).

Taxpayer's records do not sufficiently establish the amount of Taxpayer's asserted tax liability and bad debt deductions that were included in its amended returns. We note that the repossession affidavits are not notarized and do not appear to have been signed in front of a Washington vehicle licensing agent. According to the records Taxpayer provided, Taxpayer calculated the amount of its bad debt deductions based upon the entire balance remaining due on each of the subject vehicle sales after it repossessed the associated vehicles, without excluding the value of those vehicles. However, in order to satisfy the statutory requirements and qualify for the intended deductions, Taxpayer's records must establish that the amount of its claimed bad debt deductions do not include the value of any repossessed property. RCW 82.08.037(2); WAC 458-20-196(2).

Thus, because Taxpayer's repossession affidavits are not properly notarized and Taxpayer incorrectly included the value of repossessed property in calculating its asserted bad debt deductions, Taxpayer has not provided suitable records to establish that it qualifies for the intended deductions under RCW 82.08.037(2) and WAC 458-20-196(2). We deny Taxpayer's petition as to this issue.

2. Taxpayer has not provided suitable records to establish it is eligible for a deduction from its measure of B&O tax for bad debts associated with vehicles it repossessed because Taxpayer's records fail to exclude the value of the repossessed vehicles from its bad debt calculation.

RCW 82.04.4284 provides a deduction from the measure of B&O tax for bad debts; however, just like the retail sales tax deduction in RCW 82.08.037, the value of repossessed property must be applied as a payment to reduce the amount of the bad debt. The statute states 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 (emphasis added).

With respect to the B&O tax treatment of repossessed property, WAC 458-20-196 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).

(Emphasis added.)

Here, Taxpayer deducted from the measure of its B&O tax on its amended returns the outstanding balance remaining on the vehicles at the time of repossession, with no reduction for the value of vehicles that Taxpayer subsequently repossessed. As with the calculation of its bad debt deduction for retail sales tax, Taxpayer failed to exclude the value of the associated repossessed property. RCW 82.04.4284. As explained above, Taxpayer's repossession affidavits are not properly notarized, and Taxpayer incorrectly included the value of repossessed property in calculating its asserted bad debt deductions; thus, Taxpayer has not provided suitable records to establish that it qualifies for a deduction from its measure of B&O tax for bad debts associated with vehicles it subsequently repossessed under RCW 82.08.037(2) and WAC 458-20-196(2). We deny Taxpayer's petition as to this issue.

DECISION AND DISPOSITION

Taxpayer's petition is denied.

Dated this 22nd day of February 2022.